

# ODIOUS, NOT DEBT

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## I

### INTRODUCTION

#### REAL PROBLEMS AND ORPHAN DOCTRINES

The U.S. invasion of Iraq in 2003 revived public and academic debate about a wobbly old doctrine of international law: the Doctrine of Odious Debt.<sup>1</sup> As formulated in 1927, Odious Debt allows governments to disavow debts incurred by their predecessors without the consent of or benefit for the people, provided creditors knew of the taint. The doctrine has roots in nineteenth century jostles over colonial possessions. Few countries have invoked Odious Debt as grounds for repudiation;<sup>2</sup> none has succeeded.

To be sure, the problem of debt incurred by vile regimes to finance evil deeds precedes colonialism and has yet to be solved. But for the past eighty years, Odious Debt's rhetorical appeal has vastly outstripped its "legal vitality."<sup>3</sup> Bypassing the doctrine, countries and their creditors have addressed odiousness by proxy—using economic necessity, rather than fraud or political taint, as

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1. *E.g.*, Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L. J. 1201 (2007); Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82 (2006); Center for Int'l Sustainable Development Law, *Advancing the Odious Debt Doctrine* 13–21 (CISDL Working Paper No COM/RES/ESJ, Mar. 11, 2003), available at [http://www.odiousdebts.org/odiousdebts/publications/Advancing\\_the\\_Odious\\_Debt\\_Doctrine.pdf](http://www.odiousdebts.org/odiousdebts/publications/Advancing_the_Odious_Debt_Doctrine.pdf). [hereinafter *Advancing Odious Debt*]; Odious Debts, <http://www.odiousdebts.org> (last visited Jan. 20, 2007); Jubilee Iraq, <http://www.jubileeiraq.org> (last visited Jan. 20, 2007).

2. *See, e.g.*, Jackson v. People's Republic of China, 794 F.2d 1490, 1495 (11th Cir. 1986) (discussed in James V. Feinerman, *Odious Debt, Old and New: The Legal Intellectual History of an Idea*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007)). *But see* Jeff King, *The Doctrine of Odious Debt in International Law: A Restatement* (Jan. 21, 2007) (unpublished manuscript, on file with author) (including a broader range of incidents when states refused to assume responsibility for debt whose legitimacy had been questioned, without necessarily invoking the term or the doctrine of Odious Debt).

3. "Iraq's need for very substantial debt relief derives from . . . economic realities . . . Principles of public international law such as the odious debt doctrine, whatever their legal vitality, are not the reason why Iraq is seeking this debt relief." Felix Salmon, *Restructuring Debt is Top Priority*, EUROMONEY, Sept. 2004, at 76 (interview with Adil Abdul Mahdi, Minister of Finance in the interim government of Iraq).

grounds for debt relief. Some explanations for Odious Debt's disuse criticize its vague, complex, and politically fraught criteria for repudiation and its unworkable institutional arrangements;<sup>4</sup> this author has suggested that readily available alternatives achieve a similar financial outcome faster.<sup>5</sup> This article raises a different concern. It argues that the Doctrine of Odious Debt frames the problem of odious debt in a way that excludes a large number, perhaps the majority, of problematic obligations incurred in the second half of the twentieth century.

Advocacy and academic literature traditionally describe the odious debt problem as one of government contracts with private creditors. These turn odious when borrowing officials abuse the public trust by diverting the proceeds, abetted (and occasionally bribed) by their bankers.<sup>6</sup> Solving the problem thus defined requires both ridding the people of the debt and discouraging private creditors from financing evil going forward. But in the latest crop of cases, including Iraq, Liberia, and Nigeria, private creditors represent a small fraction of the old regime's debts. Most of the creditors are other governments and public institutions. In Iraq and Liberia, public (official) credits outnumbered private credits at least six to one before debt relief; in Nigeria official creditors held over seventy percent of all sovereign debt compared to six percent for foreign private creditors.<sup>7</sup> Many governments lent for the specific purpose of propping up odious but friendly regimes, not to make money off the coupons. Transfers took the form of loans rather than grants because loans were more palatable to donor country taxpayers. In such cases, the prospect of repudiation may not have dissuaded officials quite as readily as it might private bankers.

The predominance of private creditors in the Odious Debt literature is a relic of the early twentieth century, when governments financed themselves almost entirely from private sources. The predominance of official creditors in the odious debt problem poses a distinct challenge. The most practical proposals to deal with odious debts to private creditors—using domestic contracts, agency, and corporate law doctrines—do not help with official debt. These doctrines may have moral sway but have no legal force against public creditors.<sup>8</sup> On the other hand, the law of state succession and sovereign-debt practice fail to address the diversity of sovereign obligations, including official

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4. Buchheit et al., *supra* note 1, at 1203–04.

5. Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391, 410, 413 (2005).

6. Buchheit et al., *supra* note 1, at 1218.

7. From Joint BIS, IMF, OECD and World Bank External Debt Statistics for 2003Q4, Joint External Debt Hub, [http://devdata.worldbank.org/sdmx/jedh/jedh\\_dbase.html](http://devdata.worldbank.org/sdmx/jedh/jedh_dbase.html) (last visited Jan. 25, 2007) (click to view data from 2003Q1 to 2004Q4).

8. Government creditors generally do not sue other states in domestic courts. *See infra* note 61 and accompanying text. Domestic doctrines have analogues in the law of treaties. *See, e.g.*, Vienna Convention on the Law of Treaties 46–53, May 23, 1969, 1155 U.N.T.S. 331. Because official debt documentation conventions are murky and inconsistent, *see infra* notes 75–76 and accompanying text, the law of treaties is unlikely to offer satisfactory answers.

debt, in a coherent and principled fashion. The result is a set of binary outcomes (repudiation or full succession), a convoluted web of restructuring fora, and ad hoc restructuring rules that use financial necessity to mask political accommodation.

Meeting the challenge requires a better understanding of the difference between private and official debt. The two categories of debt share formal similarities (such as the promise to repay), but are far apart in substance. Unlike private debt, official debt is never extended at arm's length or for direct economic gain;<sup>9</sup> the usual goal is policy influence over the borrower. Governments often lend in dire economic circumstances where no arm's length money is available and repayment prospects are dim. Some officials may prefer to give outright grants, but settle for loans in the face of domestic political opposition; others prefer the loan form because it reinforces a long-term political relationship. Are these transfers really debt?

This article suggests that they are not. Implications from this proposition are central to any comprehensive treatment of the odious debt problem and go beyond odious debt. Concluding that some or all official debt is not debt raises new questions. If it is not debt, what is it? The most popular answer is "grant," but this answer ignores the complexity of form and motive in official transfers. Most official transfers in loan form look nothing like altruistic, discretionary gifts. And lurching to grants does not answer the question of why parties bothered to document the transaction as debt, even when in substance it lacked most traditional characteristics of arm's length lending. Outside the sovereign context, debt is one of many kinds of financial obligations that differ in priority of repayment, control rights, and other attributes. The sovereign world is not altogether different in practice. But in theory, all sovereign obligations are part of one great mass of senior unsecured debt, where all creditors are equal under law.<sup>10</sup>

This article uses the case of official debt as a starting point to explore the significance of debt form in sovereign finance. It focuses on the apparent disconnect between the form of official transfers and the substance of the economic and political relationship it represents to draw out some implications for debates about odious debt. Leading theories about sovereign debt and odious debt generally elide the question whether a particular payment obligation that purports to be debt is in fact debt, and what makes it so. This

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9. This does not rule out economic considerations altogether: official export promotion aims to boost economic growth and job creation in the creditor country; however, this is distinct from making money off the export finance transaction itself.

10. For criticisms of the lack of formal priorities in sovereign debt, see Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763 (2004); Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1119 (2004); Jeromin Zettelmeyer, *The Case for an Explicit Seniority Structure in Sovereign Debt* (Int'l Monetary Fund, Research Dep't, Working Paper, Sept. 29, 2003).

question is a staple preoccupation of corporate finance<sup>11</sup> and debtor–creditor law.<sup>12</sup> For example, U.S. domestic law doctrines of equitable subordination and recharacterization of claims in bankruptcy directly address the gap between the form and substance of an obligation and prescribe remedies. Both doctrines move claims back in the asset distribution line<sup>13</sup> based either on creditor misbehavior or on the economic essence of the transaction. This article looks to the moral impulse behind the two doctrines for insights on dealing with official debt generally and, in particular, with the problem of odious official debt.

Applied to odious debt, analysis grounded in the concepts of subordination and payment priorities modulates the “all-or-nothing” approach to state and government succession with respect to debts that prevails under public international law, including the doctrine of Odious Debt. It suggests a unified framework for addressing the challenges of political transition and financial restructuring, which are at the core of the odious debt dilemma. And it departs from both the economic theories of sovereign debt and the law of state succession by focusing on the actions and motives of creditors, which have received scant attention to date.

Even as it illuminates an important aspect of the odious debt problem, subordination-inspired analysis—like most private law analogies—does not yield obvious policy prescriptions. It could support radical alternatives, such as subordinating all official debt to all private debt within the existing institutional structure, or it could offer a template for case-by-case analysis of individual credits so as to subordinate the most odious of the lot. This article sketches out some of these possibilities but refrains from specific policy proposals. This is because any policy design based on the analytical framework suggested here would go far beyond the problem of odious debt and the scope of this symposium. The aim of this project is not to come up with a definitive policy solution, but rather to contribute to a more frank and principled discussion on the meaning and implications of “debt” in sovereign debt.

The next section of this article highlights aspects of the Odious Debt Doctrine that may help account for its sparse use. Part III explores the phenomenon of government-to-government debt against the background of theories about sovereign debt and foreign aid. Part IV introduces the doctrines

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11. See WILLIAM W. BRATTON, *CORPORATE FINANCE: CASES AND MATERIALS* 173–75 (5th ed. 2003) for an overview. The broader subject of inconsistency between legal form and economic substance in financial transactions is at the center of a large tax law literature and related writing on financial innovation. *E.g.*, Alvin C. Warren, Jr., *Financial Contract Innovation and Income Tax Policy*, 107 HARV. L. REV. 460 (1993); Michael S. Knoll, *Put-Call Parity and the Law*, 24 CARDOZO L. REV. 61 (2002).

12. *See, e.g.*, MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON & STEVE H. NICKLES, *BUSINESS REORGANIZATION IN BANKRUPTCY: CASES AND MATERIALS* 585–618 (3d ed. 2006) (discussing recharacterization and equitable subordination in corporate bankruptcy); David Gray Carlson, *The Logical Structure of Fraudulent Transfers and Equitable Subordination*, 45 WM. & MARY L. REV. 157 (2003) (resituating equitable subordination outside bankruptcy).

13. *See* John D. Penn, *Moving Someone Else to the End of the Line*, 15-8 AM. BANKR. INST. J. 36 (1996) (discussing the equitable powers of the bankruptcy court).

of equitable subordination and recharacterization. Part V examines the potential relevance of these doctrines to odious debt and sovereign debt. Part VI concludes.

## II

### PUBLIC REMEDIES, PRIVATE CREDITORS, AND THE PERILS OF DOCTRINE DESIGN

If odious debt is law, it is a doctrine of public-international law aspiring to the status of customary international law.<sup>14</sup> To qualify as custom, a legal norm traditionally must “harden” through general, consistent practice of states over time, which must be “accepted as law”—that is, experienced as binding and legal, rather than habitual, discretionary, or accidental.<sup>15</sup> The subjective element (*opinio juris*) often resides in state pronouncements—official statements, laws, or treaties. States can resist, or at least slow down, custom formation by publicly protesting a nascent norm, denying its legal status or its applicability to them.<sup>16</sup>

Odious Debt has had trouble with both practice and *opinio juris*. As others recount in detail in this volume and elsewhere, states have invoked elements of the doctrine in a small handful of reported legal incidents.<sup>17</sup> In each case, prominent jurists groused, a key party protested, the arbiter balked or split the baby, or debt relief was granted on other grounds.<sup>18</sup>

Odious Debt’s high point as a doctrine may have been the day in 1927 when it was put to paper by Russian émigré jurist Alexander Sack.<sup>19</sup> Sack pulled

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14. See, e.g., Christoph G. Paulus, *Odious Debts vs. Debt Trap: A Realistic Help?*, 31 BROOK. J. INT’L L. 83, 91 (2005) (noting that odious debt does not meet the criteria for custom).

15. See Statute of the International Court of Justice art. 38(1)(b), Oct. 24, 1945, 832 U.S.T.S. (The Court shall apply “international custom, as evidence of a general practice accepted as law). Custom formation and its two elements—practice and *opinio juris*—are the subject of a vast literature and many famous domestic and international cases. See, e.g., *The Paquete Habana*, 175 U.S. 677 (1900) (custom as “ancient usage among civilized nations, beginning centuries ago and ripening into a rule of international law” prohibits capture of fishing smacks as prize of war). *But see* Case Concerning Military and Paramilitary Activities in and against Nicaragua (*Nicaragua v. United States*) (Merits) 1986 ICJ 14, para. 186 (finding customary law against intervention and use of force: “The Court does not consider that, for a rule to be established as customary, the corresponding practice must be in absolutely rigorous conformity with the rule.”).

16. However, once a norm has hardened, objectors may have a hard time escaping its application. Jonathan Charney, *The Persistent Objector Rule and the Development of Customary International Law*, 56 BRIT. Y.B. INT’L L. 1 (1985).

17. See Buchheit et al., *supra* note 1, at 1212–13, 1216–17, 1221 nn.58 & 59, 1229, 1235 n.106 (discussing the cases of Mexico, England, the Philippines, Costa Rica, China, and Iran). No doubt more states have invoked the doctrine in private debt negotiations; however, the results had no reference to it, which would make such invocations dubious for custom formation purposes. *But see* King, *supra* note 2 (ascribing legal significance to less formal invocations of odiousness).

18. Tai-Heng Cheng, *Renegotiating the Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 7, 14–19 (Summer 2007); ERNST H. FEILCHENFELD, PUBLIC DEBTS AND STATE SUCCESSION 337–43 (1931); D. P. O’CONNELL, STATE SUCCESSION IN MUNICIPAL LAW AND INTERNATIONAL LAW, Vol. I, 458–61 (1967); A.N. SACK, RAZVERSTKA GOSUDARSTVENNYKH DOLGOV 19–22 (1923).

19. Alexander N. Sack, *Les Effets des Transformations des Etats sur Leurs Dettes Publiques et Autres Obligations Financieres* (Recueil Sirey 1927), in PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD’S ENVIRONMENTAL LEGACY 165 (Probe 1991),

together disparate grounds on which states had tried to walk away from deposed rulers' debts in the preceding decades and distilled them into three necessary elements: (1) despotic rule (also known as lack of consent on the part of the population), (2) lack of benefit for the people (a use-of-proceeds test), and (3) knowledge of the above on the part of the creditors.<sup>20</sup> Sack situated his doctrine in the law of state succession. The reasons likely reflected both the state of the world and the state of the law at the time. The practice and pronouncements on which Sack drew generally involved transfers of territory, in which "change in sovereignty" was undisputed. Early twentieth-century international jurisprudence sharply distinguished between state and government succession.<sup>21</sup> The former involved a break in territorial sovereignty and complex questions of allocating legal rights and duties among the predecessor and successor sovereigns. The latter came with an overwhelming presumption of continuity in obligations, which was then and is now among the "hardest" of custom.<sup>22</sup> Accepting the distinction and tying the young doctrine's fortunes to state succession made it more difficult to use outside the context of imperial disintegration. In cases involving no significant change of territory, debt-relief advocates are stuck arguing either that deposing a tyrant amounts to a change in sovereignty or that Odious Debt should be revised to discard the state succession component.<sup>23</sup> Both arguments are plausible; neither is user-friendly.

Two other features of the doctrine stem from the circumstances of its birth. First, as Buchheit, Gulati, and Thompson point out, Sack's search for public-international-law solutions reflects the fact that in 1927 private creditors had no private means of enforcing sovereign debts.<sup>24</sup> When the Odious Debt doctrine was born, states were absolutely immune from lawsuits in national courts. They repaid under political and military pressure from the creditors' governments. In

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excerpt available at <http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=subcontent&AreaID=3>. Sack's motives are not entirely clear. He was writing at a time when Russia's Bolshevik government was repudiating debts contracted by its Tzarist predecessors. As an émigré, Sack was not a natural Bolshevik sympathizer. See SACK, *supra* note 18, at 10 n.3 and Buchheit et al., *supra* note 1, at 1224. See Larry Catá Backer, *Odious Debt Wears Two Faces: Systemic Illegitimacy, Problems, and Opportunities in Traditional Odious Debt Conceptions in Globalized Economic Regimes*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007) for an in-depth analysis of the French text.

20. Practice against succession is somewhat more consistent with respect to the narrower category of "war debts," contracted to finance military operations against the successor regime. O'CONNELL, *supra* note 18, at 461–62.

21. *Id.* at 4–8.

22. *E.g.*, *Lehigh Valley R. Co. v. State of Russia*, 21 F.2d 396, 401 (2d Cir 1927); *Great Britain v. Costa Rica*, 1 RIAA 375 (1923) [hereinafter *Tinoco Arbitration*].

23. See, *e.g.*, *Advancing Odious Debt*, *supra* note 1. Sack may well have favored narrow application. See, *e.g.*, SACK, *supra* note 18, at 5–10, 19–22 (discussing precedent in favor of succession following regime change involving no change in territory, and apportionment following territorial change); Buchheit et al., *supra* note 1, at 1223.

24. Buchheit et al., *supra* note 1, at 1260. Criticizing a different aspect of Sack's theory, O'Connell notes that Sack's analytical framework "was rendered necessary by his adherence to the view that international law is a law between States only"; hence states could not acquire duties to (private) creditors under international law. O'CONNELL, *supra* note 18, at 374.

that world, the function of Odious Debt was to get diplomats and gunboats off debtors' backs. Today, sovereign immunity is restricted, states get sued all the time, and domestic-law doctrines offer direct financial and moral redress.<sup>25</sup>

The second relic of Sack's time is that the doctrinal edifice of Odious Debt is built around obligations owed by states to private creditors. One reason for this may have been the view that state succession specifically excluded obligations of "political" character.<sup>26</sup> The status of government-to-government lending would be difficult to determine in this context. As discussed in Part III below, many if not most such debts could qualify as political by some measure. If some or all financial obligations to other states were viewed as political, not economic, repudiating them would require no new doctrine. Aside from the difficulty of choosing sides between "political" and "economic" in this argument, state practice has increasingly favored assumption of official debt, followed by debt-relief negotiations based on financial necessity.<sup>27</sup>

Another reason for the focus on private creditors may have been even more pragmatic—they were the only ones on the scene. Governments borrowed almost entirely from private creditors well into the second half of the twentieth century.<sup>28</sup> Forty years after Sack's codification project, prominent commentators noted the existence of public creditors but dismissed them as statistically marginal.<sup>29</sup> Yet Cold War politics and development policy trends were already spawning large-scale official loan programs.

Official lending continued apace for the remainder of the century, even as its composition changed with economic, political, and intellectual developments.<sup>30</sup> The world of sovereign debt became increasingly bifurcated

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25. See, e.g., *Republic of Argentina v. Weltover*, 504 U.S. 607 (1992) (applying the commercial activity exception to the Foreign Sovereign Immunities Act).

26. O'CONNELL, *supra* note 18, at 11.

27. See LEX RIEFFEL, *RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY* 24–44 (2003). For example, Russia agreed to assume the debts of the USSR but rescheduled them under the auspices of the Paris Club of official bilateral creditors. Russia continued to service post-Soviet era debt. The distinction was clearly and transparently political; the solution was ad hoc and based on financial necessity. See, e.g., *Russia: Paris Club Press Release* April 29, 1996, available at <http://www.clubdeparis.org/sections/services/communiqués/russie/viewLanguage/en> (last visited May 7, 2007) (announcing "a comprehensive rescheduling of the debts owed to the Creditor Countries contracted or guaranteed on behalf of the Government of the Former Soviet Union for which the Government of the Russian Federation has agreed to be responsible").

28. For historical accounts of sovereign borrowing, see VINOD K. AGGARWAL, *DEBT GAMES: STRATEGIC INTERACTION IN INTERNATIONAL DEBT RESCHEDULING* (1996); Albert Fishlow, *The Debt Crisis in Historical Perspective*, in *THE POLITICS OF INTERNATIONAL DEBT* 37 (Miles Kahler ed., 1986); and Barry Eichengreen & Michael Bordo, *Crises Now and Then: What Lessons from the Last Era of Financial Globalization?* (Nov. 2001) (unpublished paper, available at <http://www.econ.berkeley.edu/~eichengr/research/goodhartfestschriftjan9.pdf>).

29. For example, O'Connell's still-classic treatise on succession, published in 1967, situates Odious Debt as part of the doctrine of acquired rights, which governs succession in private parties' claims against one another and the state. The author specifically raises the subject of official debt, but proceeds to limit the analysis to private debt, apparently because it is much more pervasive. O'CONNELL, *supra* note 18, at 369.

30. For statistics on official lending from 1960 through 2005 as reported by creditor states, see Organization for Economic Cooperation and Development, Development Cooperation Directorate—

between middle-income countries (such as Chile) that had some access to private financial markets, and poor countries (such as Uganda) that had none. A central problem for the first lot was extreme volatility; for the second, it was the poverty trap. With no market access, no tax base, no savings, and no infrastructure to attract investment,<sup>31</sup> the second group came to depend on transfers from a small group of official donors to finance basic needs. And although corrupt despots surfaced at every point on the income spectrum, the odious debt problem had more practical urgency in poor countries. Their debt, odious and otherwise, was overwhelmingly official. But the law of odious debt, such as it was, did not change.

The most recent doctrinal work, prompted in large part by the exit of Saddam Hussein, still essentially targets private creditors. Government debts receive an occasional courtesy mention, but their presence has no noticeable impact on the analysis. A focus on private creditors is perhaps the only point of intersection for two important but very different Iraq-inspired proposals: Jayachandran and Kremer's financial-sanctions regime, and Buchheit, Gulati, and Thompson's private-law remedies.<sup>32</sup> Jayachandran and Kremer seek above all to create ex ante incentives for creditors to stop financing despots. Their proposal would make all loans to sanctioned countries unenforceable. Buchheit, Gulati, and Thompson focus instead on permitting countries to breach loan contracts ex post, after loan proceeds are misappropriated. They look to domestic contract, agency, and corporate law doctrines for remedies.<sup>33</sup>

In both proposals official creditors are barely affected. The sanctions proposal adds little to the official debt status quo for two reasons. First, its focus on legal enforcement is irrelevant to government creditors because they do not sue. It is difficult to imagine a power that would refuse to sell arms on credit to a puppet regime for fear of enforcement problems under a successor. The point of the loan is precisely to prevent the successor's emergence.<sup>34</sup> Second, when states agree to impose sanctions restricting the rights of private creditors, it is quite likely that traditional sanctions directly applicable to governments (for

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Development Assistance Committee (DAC), Development Database on Aid from DAC, [www.oecd.org](http://www.oecd.org) (last visited Jan. 20, 2007). For purposes of this article, these are adequate as proxy for broader trends in official transfers. For debtor-reported statistics from 1970 through 2005, including lending by non-OECD states, see The World Bank, *Global Development Finance 2006*, Vol. II (2006). Individual categories, such as bilateral, multilateral, development lending, and export credits move over time; recipients also vary. For example, in the 1970s G-7 bilateral development aid begins shifting to grants, but export credits and multilateral aid continue in loan form. Economic and humanitarian crises trigger spikes in both loans and grants.

31. Jeffrey D. Sachs, John W. McArthur, Guido Schodt-Traub, Margaret Kruk, Chandrika Bahadur, Michael Faye & Gordon McCord, *Ending Africa's Poverty Trap*, 2004 BROOKINGS PAPERS ON ECON. ACTIVITY 117, 122 (2004).

32. Buchheit et al., *supra* note 1; Jayachandran & Kremer, *supra* note 1.

33. Adam Feibelman makes a parallel argument using a different set of domestic-law doctrines. See generally Adam Feibelman, *Equitable Subordination, Fraudulent Transfer, and Sovereign Debt*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007).

34. This example is stylized. Parts III.E and V, *infra*, discuss examples of official debt that mix commercial and political characteristics.



example, a ban on military sales) are already in place. On the other hand, the proposal to engage domestic-law doctrines does not apply to official creditors whose agreements are not enforced under domestic law.<sup>35</sup> Moral appeals about apparent authority and loan-by-loan veil-piercing fit poorly in the wholesale political horse-trading environment where sovereign debtors come to settle up with other governments.<sup>36</sup>

It is worthwhile at this stage to revisit the example of Iraq. Saddam Hussein foisted about \$120 billion in defaulted sovereign debt on his successors. Of this total, about \$100 billion was owed to other governments. Of that \$100 billion, a little under \$40 billion was the subject of an eighty percent debt reduction agreement negotiated with the personal involvement of Messrs. Bush, Putin, Chirac, and Schroeder in 2004.<sup>37</sup> Debt relief is being implemented in stages, conditional on economic reform programs, to be completed in 2010. Negotiations over \$60 billion claimed principally by governments in the Persian Gulf and Eastern Europe have produced minimal relief so far. In contrast, most of the roughly \$20 billion owed to private creditors was exchanged for new bonds in late 2004, resulting in about eighty percent relief for that category of debt on the spot *sans* new doctrines.<sup>38</sup>

The best of today's proposals to refashion Odious Debt go to some portion of the last \$20 billion. Of course, \$20 billion is nothing to sneeze at. But a conversation about the \$100 billion is long overdue.

In sum, the doctrine of Odious Debt has had a hard time taking hold for many reasons, some but not all of which were apparent when it was first formulated. Since 1927, the doctrine of Odious Debt and the problem of odious debt have drifted further apart. One area where the gap has been particularly palpable is the growth of official sovereign debt, which the doctrine essentially ignores. The following section will explore this category of debt in more detail.

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35. *But see* discussion of *Donegal International v. Zambia*, *infra* note 140, for an example of attempted enforcement of official debt by a private assignee.

36. *See* Miles Kahler, *Politics and International Debt: Explaining the Crisis*, in THE POLITICS OF INTERNATIONAL DEBT, *supra* note 28, at 16–22. For a more recent overview of official actors involved in sovereign-debt restructuring, see RIEFFEL, *supra* note 27 (Rieffel is a former Paris Club negotiator). For a lawyer's perspective, see Lee C. Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J. INT'L L. 333 (2005). States sometimes succeed in challenging the legitimacy of official debts; however, the resulting relief is couched in terms of economic necessity (as in the case of Vietnam, *infra* note 76).

37. *See* Paris Club, Iraq Debt Treatment, Nov. 21, 2004, <http://www.clubdeparis.org/sections/traitements/irak-20041121/viewLanguage/en> (last visited May 5, 2007) for a summary of restructuring terms. *See* White House Press Release, President Discusses Year-End Accomplishments, (Dec. 11, 2003), *available at* <http://www.whitehouse.gov/news/releases/2003/12/20031211-1.html>, on the high-level diplomacy.

38. International Monetary Fund, Iraq: Request for Stand-By Arrangement, IMF Country Report No. 06/15 at 69–70, (Jan. 2006), <http://www.imf.org/external/pubs/ft/scr/2006/cr0615.pdf> (last visited Jan. 21, 2007). Some writers suggest that Iraq obtained such deep debt relief “in the shadow of Odious Debt”—under threat of its invocation. *E.g.*, King, *supra* note 2; Jai Damle, Note, *The Odious Debt Doctrine After Iraq*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007). If true, this may say more about Odious Debt's political salience than about its legal status, which remains untested.

## III

## BETWEEN SOVEREIGN DEBT AND FOREIGN AID

## A. More Than Different Debtors

This section begins with an overview of economic theories of sovereign debt, which serve as a departure point for the discussion of official lending. Like the doctrine of Odious Debt, these theories key off the relationship between a government debtor and private creditors, who are motivated above all by economic gain. The literature contrasts the relationship involving a sovereign with one in which both the debtor and the creditor are private. The big difference between sovereign and private debt is the sovereign debtor's immunity from lawsuits (which has eroded since the 1950s)<sup>39</sup> and the more practically salient and persistent limits on private creditor control over debtor behavior and assets to secure repayment.<sup>40</sup> A related distinction stems from the fact that insolvent states have no recourse to a bankruptcy process that could give them meaningful financial relief and their creditors reasonable assurance of equitable treatment.<sup>41</sup>

Where enforcement is hard, repudiation should be easy. In response, economists have asked why governments bother to repay and why creditors risk lending to borrowers who could so easily walk away. Their composite response is that governments repay in part because creditors can interfere with countries' foreign commerce, pester them with lawsuits on the margins, refuse to make new loans, and tarnish borrower reputations.<sup>42</sup> These constraints help explain why most states repay their debts most of the time; however, because sanctions are weak and indirect, the risk remains that any given sovereign borrower might default for lack of willingness (including political capacity) to pay. Because governments cannot credibly forswear repudiation in advance, creditors may

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39. See, e.g., *Republic of Argentina v. Weltover*, 504 U.S. 607, 613 (1992) (discussing the emergence of restrictive immunity for foreign governments in U.S. courts since the Tate Letter in 1952).

40. Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L. REV. 977, 994–95 n.41 (2007) (discussing Citibank's unsuccessful attempt to impose policy conditionality on Peru).

41. The literature addressing the lack of sovereign bankruptcy is voluminous. For an overview of critiques and modern-day proposals, see Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001* (IMF, Working Paper No. 02/133, 2002), available at <http://www.imf.org/external/pubs/ft/wp/2002/wp02133.pdf>.

42. See, e.g., FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 31–47 (2007) (summarizing the literature); Jeremy Bulow & Kenneth Rogoff, *Sovereign Debt: Is to Forgive to Forget?*, 79 AM. ECON. REV. 43, 46–47 (1989) (discussing enforcement); Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUD. 289, 289–90 (1981) (discussing reputation and market access); see also NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS: RESPONDING TO FINANCIAL CRISES IN EMERGING ECONOMIES 305–06 (2004) (noting the importance of domestic constraints to the sovereign's decision to repudiate).

ration lending.<sup>43</sup> While they have market access, governments that expect to be shut off from credit may overborrow, overconsume, and overinvest in risky projects.<sup>44</sup> Without a bankruptcy system, the parties may have trouble coordinating debt restructuring, which in turn may lead to runs, panics, and deadweight losses on all sides.<sup>45</sup>

Although some elements of this theoretical framework apply to official lending, on the whole it is an awkward fit. The awkwardness has four essential dimensions. First, lending among governments is never at arm's length and is rarely motivated by economic gain.<sup>46</sup> Second, repudiation penalties are different. Since the emergence of large-scale official lending, governments have refrained as a rule from enforcing their loans in court. Arrears to official creditors appear to have limited impact on a country's reputation with private creditors.<sup>47</sup> Creditor governments threatened with default may refuse to lend,<sup>48</sup> insist on repayment, or agree to restructure—or better yet, they may simply lend the country its next coupon payment to avoid domestic implications of default for both governments.<sup>49</sup> Third, in a country without private market access, official creditors as a group may exercise significant long-term policy control. A government with market access does not depend on, and need not answer to, official creditors to the same extent. A private debtor emerges from domestic bankruptcy substantially rid of its creditors or owned by them. In contrast, official debt-relief initiatives perpetuate debtor-creditor entanglement

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43. Creditors worry about ex-post dilution, subordination, and default more with sovereign than with private debtors; as a result, they would lend less to sovereigns. *See generally* Bolton & Skeel, *supra* note 10; Carmen M. Reinhart, Kenneth S. Rogoff & Miguel A. Savastano, *Debt Intolerance*, 2003 BROOKINGS PAPERS ON ECON. ACTIVITY 1 (2003); Jeffrey Sachs, *Theoretical Issues in International Borrowing* (Nat'l Bureau of Econ. Research, Working Paper No. 1189, 1983), available at <http://papers.nber.org/papers/w1189.v5.pdf>; Patrick Bolton & Olivier Jeanne, *Sovereign Debt Structuring and Restructuring: The Role of Seniority* (2003) (unpublished manuscript, on file with author).

44. Bolton & Jeanne, *supra* note 43; *see also* Bolton & Skeel, *supra* note 10; Reinhart et al., *supra* note 43.

45. Sachs et al., *supra* note 31.

46. *See supra* note 9. As discussed in the next subsection, even repayment is secondary in many cases.

47. Nigeria was in arrears to its official bilateral creditors for years but maintained access to private credit markets. Lex Rieffel, *Nigeria's Paris Club Debt Problem*, Brookings Institution Policy Brief 144 (Aug. 2005), available at <http://www.brookings.edu/comm/policybriefs/pb144.pdf>. Ironically, a major reason for Nigeria's Paris Club arrears was the G7 countries' refusal to negotiate a debt restructuring with General Sani Abacha, as well as Nigeria's failure to comply with economic reform conditionality. *See infra* Part IV. Interest compounding accounts for Paris Club's dominant share in Nigeria's debt stock. Rieffel, *supra*.

48. *See, e.g.*, Foreign Assistance Act of 1961 § 620(q), 22 U.S.C. 2370(q) (2000) (denying foreign assistance to countries in arrears on U.S. government loans subject to Presidential waiver authority, as well as the so-called Brooke or Brooke-Alexander Amendment in annual foreign operations appropriations bills, which denies assistance to governments and does not permit waivers); Foreign Operations, Export Financing, and Related Programs Act 2006, Pub. L. No. 109-102, § 512, 119 Stat. 2172 (2006).

49. For an example of official bilateral loans made to repay multilateral loans, see Jeremy Bulow, Kenneth Rogoff, & Afonso S. Bevilacqua, *Official Creditor Seniority and Burden-Sharing in the Former Soviet Bloc*, 1992 BROOKINGS PAPERS ON ECON. ACTIVITY 195, 218-19.

for the poorest countries. Fourth and finally, creditor coordination is not a significant problem in official-debt restructuring. Official creditors are a small, tightly knit group; they have met regularly for decades and have developed a reasonably ritualized protocol for dealing with sovereign distress.<sup>50</sup>

Literature about official debt (as distinct from sovereign debt in general) is not so much about *debt* as it is about debt *relief*.<sup>51</sup> It addresses issues such as debt sustainability and the debt overhang (how much is too much and what happens when it happens),<sup>52</sup> as well as conditionality (how to make sure relief is not wasted).<sup>53</sup> There is a closely related literature on foreign assistance, which focuses on the effectiveness of government transfers in all forms, including debt.<sup>54</sup> But like the writings on sovereign debt to private creditors, the relief and assistance genre does not address the significance of debt form, or examine the extent to which official debt is really debt.

A series of papers by Bulow and Rogoff in the late 1980s and early 1990s is an important, albeit partial exception to the pattern.<sup>55</sup> Written near the end of the Latin American debt crisis and at the start of large-scale lending to the former Soviet Bloc, these papers focus on the relationship between private and official-sector lending, and between official bilateral and multilateral lending to

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50. RIEFFEL, *supra* note 27, at 56. Group dynamics may change with the rise of China, Venezuela, and other developing countries as creditors; however, the number of official creditors is limited by definition.

51. *E.g.*, NANCY BIRDSALL & JOHN WILLIAMSON WITH BRIAN DEESE, *DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE* (2002).

52. *See generally* Jeffrey D. Sachs, *The Debt Overhang of Developing Countries*, in DEBT, STABILIZATION AND DEVELOPMENT 80 (Guillermo Calvo, Ronald Findlay, Pentti Kouri & Jorge Braga de Macedo eds., 1989); Paul Krugman, *Financing vs. Forgiving a Debt Overhang*, 29 J. DEV. ECON. 253 (1988). These articles do not specifically target official debt but include among their progeny recent writing addressing the debt problems of countries whose debt is overwhelmingly official. *E.g.*, Jean Imbs & Roman Ranciere, *The Overhang Hangover* (World Bank Policy Research Working Paper 3673, Aug. 2005), available at <http://ideas.repec.org/p/wbk/wbrwps/3673.html>; Nicolas Depetris Chauvin & Aart Kray, *What Has 100 Billion Dollars Worth of Debt Relief Done for Low-Income Countries?* (World Bank Working Paper, Sept. 2005), available at <http://siteresources.worldbank.org/DEC/Resources/ChauvinKraayWhatHasDebtReliefAccomplishedSept2005.pdf>; *see also* William Easterly, *How Did Heavily Indebted Poor Countries Become Heavily Indebted?* *Reviewing Two Decades of Debt Relief*, 30 WORLD DEV. 1677 (2002).

53. *See infra* note 66 and accompanying text; Miles Kahler, *External Influence, Conditionality, and the Politics of Adjustment*, in STEPHAN HAGGARD & ROBERT R. KAUFMAN, *THE POLITICS OF ECONOMIC ADJUSTMENT* (1992); Jeffrey D. Sachs, *Conditionality, Debt Relief, and the Developing Country Debt Crisis*, in DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE 255 (Jeffrey D. Sachs ed., 1989).

54. *E.g.*, Alberto Alesina & David Dollar, *Who Gives Aid to Whom and Why?*, 5 J. ECON. GROWTH 33 (1999); Craig Burnside & David Dollar, *Aid, Policies, and Growth*, 90 AM. ECON. REV. 847 (2000); Dani Rodrik, *Why Is There Multilateral Lending?*, in PROCEEDINGS OF THE 1995 ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS (Michael Bruno & Boris Pleskovic eds., 1996).

55. Jeremy Bulow & Kenneth Rogoff, *The Buyback Boondoggle*, 1988 BROOKINGS PAPERS ON ECON. ACTIVITY 675; Jeremy Bulow & Kenneth Rogoff, *Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining Theoretic Framework*, 35 INT'L MONETARY FUND STAFF PAPERS 644 (1988); Bulow, Rogoff, & Bevilaqua, *supra* note 49. For an overview and update, see Jeremy Bulow, *First World Governments and Third World Debt*, 2002 BROOKINGS PAPERS ON ECON. ACTIVITY 229, 229–31.

middle-income countries. The authors suggest that official creditors as a group are functionally subordinate to private creditors, that official lending does not increase the borrowers' overall repayment capacity, and therefore that official loans are an inefficient form of aid.<sup>56</sup> This analysis goes both too far and not far enough. It reduces debt to the repayment obligation, reduces seniority to aggregate repayments over time, and limits the inquiry to cases in which private creditors are dominant.<sup>57</sup> But what is the function of debt when improved repayment capacity is not the goal, when repayment itself is inessential, and when private creditors are marginal or absent altogether? Extending the Bulow–Rogoff argument, one might answer that such debt is financial air, a figment of political imagination. This view fails to explain the persistence of official debt despite decades of official debt-relief initiatives.<sup>58</sup> Surely the debt form in official transfers must be useful to someone, especially if Bulow and Rogoff are right about its sorry track record of getting repaid.

The remainder of this section elaborates on the distinctive attributes of official debt discussed in the preceding paragraphs, to situate official debt more precisely at the intersection of sovereign debt and foreign aid.

## B. Loans to Friends

Large-scale official lending is a relatively new development. Sovereigns have occasionally borrowed from one another since the Middle Ages; however, such arrangements were the exception to the rule of borrowing from their own citizens, foreign bankers, and bondholders.<sup>59</sup> Among the exceptions were U.S. loans to its World War I allies. Many of these ultimately went unpaid after repeated reschedulings; in the interim, they exacerbated allied pressure for German reparations.<sup>60</sup> Another exception was export finance. Early in the twentieth century, several countries, including the United Kingdom, Germany, and the United States, established government and quasi-government agencies

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56. The argument is strongest in Bulow, Rogoff & Bevilaqua, *supra* note 49.

57. For example, Bulow's recent overview stipulates that "IFI debt is rarely very large." Bulow, *supra* note 55, at 238. This assumption echoes O'Connell's, made several decades earlier in the context of state succession. *Supra* note 29. It does not hold for poor countries. For example, at this writing, debt to the International Financial Institutions (IFIs) was the largest single category of debt for Liberia. See *supra* note 7.

58. See RIEFFEL, *supra* note 27, at 56–94, 132–48, 178–87 for the history of official debt-relief initiatives. See also BIRDSALL & WILLIAMSON, *supra* note 51. The latest major initiative was agreed at the G8 Summit in Gleneagles, Scotland, in 2005. Chair's Summary, Gleneagles Summit (July 8, 2005), available at <http://www.g8.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1119518698846>; G8 Finance Ministers' Conclusion on Development, London, (June 10–11, 2005), available at [http://www.g8.utoronto.ca/finance/fm050611\\_dev.htm](http://www.g8.utoronto.ca/finance/fm050611_dev.htm). Most recently, official lending patterns have begun to shift: as G7 states and the multilaterals write off poor country debts, states like China are lending more. See, e.g., Todd Moss & Sarah Ross, *China's Export-Import Bank and Africa: New Lending, New Challenges*, Center for Global Development Brief (Nov. 6, 2006), <http://www.cgdev.org/content/publications/detail/11116/>.

59. M. H. Hoeflich, *Through a Glass Darkly: Reflections upon the History of International Law of Public Debt in Connection with State Succession*, 1982 U. ILL. L. REV. 1, 39–40 (1982).

60. Fishlow, *supra* note 28.

to promote national exports; these occasionally lent to importing governments.<sup>61</sup> The World War II Lend-Lease program financed shipments of supplies from the United States, primarily to the United Kingdom and the U.S.S.R.<sup>62</sup> Exceptions aside, governments in capital-exporting countries participated in sovereign lending indirectly, by channeling and protecting their citizens' financial adventures abroad.<sup>63</sup> Private creditors were often encouraged to lend to their governments' allies; lending to enemies was perilous. When sovereigns defaulted, bankers and bondholders appealed to their foreign ministries and occasionally persuaded their governments to intervene on their behalf legally, politically, and militarily.<sup>64</sup>

The end of World War II ushered in a new political and economic order, and along with it a new model of sovereign financing. Since the wave of bond defaults in the 1930s, private debt markets remained closed to all but the most creditworthy countries. On the other hand, the idea that governments may properly intervene to counter market fluctuations was in ascendance.<sup>65</sup> The World Bank was established to finance public reconstruction and development needs. Its charter barred the new bank from taking on private sector risk—it could lend only to governments or when backed by government guarantees.<sup>66</sup>

More important for odious debt purposes, as the Cold War and anti-colonial struggles escalated, the governments of the United States, the Soviet Union, and other countries that could afford it began financing friendly governments directly on a large scale. New programs went beyond targeted military and export credits to encompass all manner of political, humanitarian, and economic development goals. A comprehensive U.S. foreign-assistance program was a landmark initiative of the Kennedy Administration, launched with the enactment of the Foreign Assistance Act of 1961<sup>67</sup> and the founding of

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61. *E.g.*, Ex-Im Bank History, <http://www.exim.gov/news/reporter.html> (last visited Jan. 20, 2007).

62. Lend-Lease terms were deeply subsidized. Repayments were stretched over more than fifty years; interest accrued at two percent. The program was generally recognized as a matter of politics, not finance. *See, e.g.*, 637 PARL. DEB. H.L. (2002) 439, available at [http://www.publications.parliament.uk/pa/ld200102/ldhansrd/vo020708/text/20708-03.htm#20708-03\\_head0](http://www.publications.parliament.uk/pa/ld200102/ldhansrd/vo020708/text/20708-03.htm#20708-03_head0) (last visited Aug. 16, 2007).

63. *See* Louis A. Pérez, Jr. & Deborah M. Weissman, *Public Power and Private Purpose: Odious Debt and the Political Economy of Hegemony*, 32 N.C. J. INT'L L. & COM. REG. (forthcoming 2007), for a historical overview of government-sponsored private lending as political intervention in Latin America.

64. Tinoco Arbitration, *supra* note 22; FEILCHENFELD, *supra* note 18. In the past, creditor-country governments seized debtors' customs houses to secure repayment for their nationals. *See* Ernst H. Feilchenfeld, *Rights and Remedies of Holders of Foreign Bonds*, in 2 SYLVESTER E. QUINDRY, BONDS & BONDHOLDERS: RIGHTS & REMEDIES § 666 (1934) (discussing intervention remedies available for foreign default); Fishlow, *supra* note 28, at 62–69 (discussing intervention remedies taken after the Barings crisis of 1890).

65. *See generally* THE POLITICAL POWER OF ECONOMIC IDEAS: KEYNESIANISM ACROSS NATIONS (Peter Hall ed., 1989).

66. World Bank, Articles of Agreement of the International Bank for Reconstruction and Development, art. III, sec. 4, <http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf>.

67. 22 U.S.C. § 2384 (2000).

the U.S. Agency for International Development.<sup>68</sup> Much of the new money took the form of loans—a political accommodation with the perennially reluctant Congress. One participant in the debates of the day had this to say about the new lending:

I think we are fooling ourselves and the world if we think that these loans are really going to be repaid. Indeed . . . [such] loans . . . tend in the very nature of the case to become disguised grants. . . . We have had experience with that sort of thing before. Witness First World War loans. The whole thing simply became unworkable. . . . Still, if grants are politically impossible, loans are far better than nothing. The problems of repayment will have to be dealt with in the future.<sup>69</sup>

The passage above is seductively candid; it finds echoes in subsequent policy writing, debt-relief advocacy,<sup>70</sup> and the more recent debates about reconstruction funding for Iraq.<sup>71</sup> But to the extent it was meant or is taken to describe all official lending, or even all U.S. bilateral lending, it oversimplifies. Political expediency was an important reason, but not the only reason for choosing loans over grants. Some, but far from all loans were made without any expectation of repayment. And even when the expectation was attenuated or unreasonable, it seems premature to dub the transaction a grant when the donor's legislature only authorized the funds on condition that the recipient promise to repay.

Since 1961, the United States Congress has authorized scores of foreign loan initiatives to promote goals ranging from U.S. export growth, to East European democracy, to poverty reduction in Africa, to fighting disease in Asia, to propping up dictators in Latin America.<sup>72</sup> Other governments established their own lending programs. Half a dozen major multilateral institutions joined the

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68. For a history of USAID, see USAID, About USAID, [http://www.usaid.gov/about\\_usaid/](http://www.usaid.gov/about_usaid/) (last visited Jan. 20, 2007).

69. ALVIN H. HANSEN, ECONOMIC ISSUES OF THE 1960S 128 (1960).

70. *Do the Deal: The G7 Must Act Now to Cancel Poor Country Debts*, Joint NGO Briefing Paper of Actionaid International, CAFOD and Oxfam International, at 6 (Dec. 2005), available at [http://www.oxfam.org.uk/what\\_we\\_do/issues/debt\\_aid/downloads/g7\\_deal.pdf](http://www.oxfam.org.uk/what_we_do/issues/debt_aid/downloads/g7_deal.pdf); Treasury Secretary Paul H. O'Neill, Statement to the House Committee on Financial Services, May 22, 2001, available at <http://www.ustreas.gov/press/releases/po392.htm> ("Grants are also more transparent than loans that are not likely to be repaid. If it is a grant we should call it a grant and not a loan."); John B. Taylor, Grants and Sovereign Debt Restructuring: Two Key Elements of a Reform Agenda for the International Financial Institutions, Testimony before the Joint Economic Committee, Feb. 14, 2002, available at <http://www.ustreas.gov/press/releases/po1016.htm>. See generally Report of the International Financial Institution Advisory Commission (Mar. 2000), available at <http://www.house.gov/jec/imf/meltzer.pdf> [hereinafter Meltzer Report] for an influential example of debt-relief- and grant-financing advocacy from the right.

71. See, e.g., Jonathan Karl & Steve Turnham, *Bush Wins Few GOP Senators on Iraq Money*, Oct. 15, 2003, <http://www.cnn.com/2003/ALLPOLITICS/10/15/sprj.nilaw.bush.congress.iraq/index.html> (last visited Oct. 2, 2007). For a nuanced political economy analysis, see Eric Helleiner & Geoffrey Cameron, *Commentary: Another World Order? The Bush Administration and HIPC Debt Cancellation*, 11 NEW POL. ECON. 125, 129–31 (2006).

72. STEVEN RADELET, CHALLENGING FOREIGN AID 2 (2003) ("[T]he US Foreign Assistance Act of 1961 . . . specifies a remarkable 33 goals, 75 priority areas, and 247 directives."); see also United States Agency for International Development, U.S. Overseas Loans and Grants: Obligations and Loan Authorizations July 1, 1945–September 30, 2004 ("The Green Book"), at iii-vi, <http://quesdb.usaid.gov/gbk/index.html> (last visited Jan. 20, 2007).

World Bank in lending long-term for economic development.<sup>73</sup> These programs all have in common the recipients' promise to repay. Beyond the promise, program design has varied widely, including direct budget contributions, project finance, commodity and military sales on credit, insurance, and guarantees. Some loans have "market-based" interest rates (usually calculated to recoup the lender's costs);<sup>74</sup> others are deeply subsidized (concessional). Legal documentation includes complex commercial contracts governed by New York law, much like the ones sovereigns sign with New York banks,<sup>75</sup> patently political international agreements with no governing law or dispute-resolution provisions, and everything in between.<sup>76</sup> Some loan recipients are creditworthy (China), others in desperate straights (Nicaragua); however, actual expectations of repayment are difficult to discern from credit quality since they are deeply entangled with the loan's policy aims.<sup>77</sup>

Related to repayment expectations, the subject of loan enforcement is also murky. Governments rarely if ever sue one another over money. At one end of the spectrum, bilateral loan agreements in areas such as budget support and

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73. *E.g.*, Inter-American Development Bank, <http://www.iadb.org> (last visited May 7, 2007); African Development Bank, <http://www.afdb.org> (last visited May 7, 2007); Asian Development Bank, <http://www.adb.org> (last visited May 7, 2007); European Bank for Reconstruction and Development, <http://www.ebrd.org> (last visited May 7, 2007); European Investment Bank, <http://www.eib.europa.eu> (last visited May 7, 2007); Islamic Development Bank, <http://www.isdb.org> (last visited May 7, 2007).

74. Wealthy governments and multilaterals typically borrow at lower cost than the governments to which they lend. For a government with a low credit rating, borrowing from official sources, even at market-based rates, can bring substantial savings. Some sovereigns cannot access private markets at any price—for them, the decision to borrow from the official sector is not driven by price.

75. U.S. Ex-Im Bank Model Loan Agreement (on file with author) [hereinafter Ex-Im Model].

76. A well-publicized example of blatantly political foreign-assistance lending is the case of U.S. agricultural support for South Vietnam in the early 1970s. The agreements specifically allowed South Vietnam to monetize (sell) rice and tobacco shipments from the United States for "common defense" (to buy arms). *See, e.g.*, Agreement between the Government of the United States of America and the Government of the Republic of Viet-Nam for Sales of Agricultural Commodities, 22 U.S.T. 1459, Sec. II.A.2 (June 28, 1971). The arrangement was apparently designed to allay U.S. congressional concerns about the Vietnam War. Although Socialist Vietnam subsequently agreed to pay virtually all other debts of the former Republic of Vietnam as part of a 1993 Paris Club rescheduling, it refused to pay these military debts disguised as food aid. Marian Nash (Leich), *Contemporary Practice of the United States Relating to International Law*, 91 AM. J. INT'L. L. 697, 705–06 (1997). Compare this to the discussion of war debts, *supra* text accompanying note 20.

77. Neither the fact that each loan includes an obligation to repay in full, nor that it is subject to the creditor's domestic budget accounting rules to identify subsidy costs, is dispositive here. Full repayment obligations are frequently flouted or renegotiated. Budget accounting is another measure of the borrower's creditworthiness, which is quite distinct from its willingness to pay and which says nothing of the creditor's willingness to tolerate arrears. In the example of Vietnam cited earlier, the Legal Advisor to the U.S. Secretary of State issued an opinion to the effect that the disguised military loans were "uncollectible," to enable the Executive Branch to write them off under existing Congressional authority. Considering that Vietnam promised to repay the bulk of its other debts, the determination must have been based on the U.S. assessment of Vietnam's willingness to accept the obligations. *See* Nash, *supra* note 76. For an overview of relevant U.S. budget accounting rules and the Credit Reform Act of 1990, see James M. Bickley, *Federal Credit Reform: Implementation of the Changed Budgetary Treatment of Direct Loans and Loan Guarantees*, CRS Report RL 30346, Congressional Research Service (June 23, 2003), available at [http://digital.library.unt.edu/govdocs/crs/data/2003/upl-meta-crs-7706/RL30346\\_2003Jun23.pdf](http://digital.library.unt.edu/govdocs/crs/data/2003/upl-meta-crs-7706/RL30346_2003Jun23.pdf). Domestic budget accounting rules vary considerably among creditor governments.



military sales are secured by the bilateral political relationship.<sup>78</sup> Legal enforcement is inconceivable in most such cases; however, an old promise to repay can complicate political transition. The festering dispute between Iraq and its Gulf neighbors over their funding of its war with Iran illustrates the point.<sup>79</sup> The case against enforcement is harder to make for limited-purpose export finance transactions, especially considering their elaborate private-sector-style documentation. However, even in such quasi-commercial loans, relationships loom large.<sup>80</sup> Export finance commitments are regular “deliverables” at political summits. It is common knowledge that exporters’ governments look first to bilateral political channels to resolve disputes with the borrowing sovereign. It is significant that despite the U.S. Export-Import Bank’s long-standing practice of including U.S. governing law provisions in its sovereign contracts,<sup>81</sup> there are no reported cases of Ex-Im suing a sovereign in U.S. courts.<sup>82</sup>

Analyzing each subspecies of official lending in detail is beyond the scope of this article. However, several salient points emerge from the cursory survey in the preceding passages. First, to reiterate, none of the government loans are arm’s length in the traditional sense used to describe commercial transactions among independent economic actors. At some level all official loans, and especially bilateral ones, are extended in the name of the underlying political relationship and secured by it. Second, official transfers mix commercial and political attributes in very different ways; they range in formality, enforcement history, accounting treatment, use of proceeds, and actual expectation of repayment. Third, as discussed in detail below, virtually all official loans are premised on the expectation of policy performance by the debtor.

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78. See *supra* Part III.A.

79. Iraq maintains the advances were grants extended to support a war against the common enemy; Gulf states insist they were loans. See, e.g., Susanna Mitchell, *Jubilee Research Briefing on Debt in Iraq*, Jubilee Research, Apr. 14, 2003, <http://www.jubileeresearch.org/databank/Briefings/iraq170403.htm> (attributing about half of Iraq’s debt burden to the disputed transactions). At this writing, Gulf claims are yet to be restructured, lagging far behind Iraq’s other debts.

80. For a historical overview of foreign-policy influences in U.S. export finance, see Rita M. Rodriguez, *Exim’s Mission and Accomplishments: 1934-84*, in *THE EXPORT-IMPORT BANK AT FIFTY: THE INTERNATIONAL ENVIRONMENT AND THE INSTITUTION’S ROLE* 1, 6–10 (Rita M. Rodriguez ed., 1987). For a more recent perspective, see James A. Harmon, *A Chairman’s Perspective on the Future of Ex-Im Bank, in The Ex-Im Bank in the 21st Century: A New Approach?*, INST. FOR INT’L ECON. SPEC. REP. 14, at 35, 43 (Gary Clyde Hufbauer & Rita M. Rodriguez eds., Jan. 2001). For a comparison between U.S. and Japanese export finance politics, see Peter C. Evans & Kenneth A. Oye, *International Competition in Government Export Financing*, in INST. FOR INT’L ECON. SPEC. REP., *supra* at 113, 125. Middle-income countries such as China, Romania, or Venezuela may be more likely to regard government-to-government transactions as a source of revenue rather than, or in addition to, a source of influence.

81. Initially District of Columbia, changed to New York in the 1990s. Ex-Im Model, *supra* note 75, and Additional Terms and Conditions with Respect to Amounts Owed to Eximbank, in Agreement Between the Government of the United States of America and the Government of the Republic of Poland regarding the Reduction and Reorganization of Certain Debts (1991) (on file with author).

82. Ex-Im is more likely to sue private-sector borrowers. E.g., *Export-Import Bank of the United States v. Asia Pulp & Paper Co.*, 2005 U.S. Dist. LEXIS 8902 (S.D.N.Y. May 11, 2005).

### C. Commitment and Control

Private lenders to risky countries are in it for the money. They want to get out as soon as possible with as much money as possible.<sup>83</sup> In contrast, official lenders often want to stay in as long as possible, even as they seek to minimize the cost of engagement. For governments financing other governments, policy influence is a central objective, regardless of the form the transfer takes. The object of such influence may be entirely altruistic (hunger relief) or unsavory (suppressing political opposition). Conditionality is the mechanism by which the transferor obtains specific policy concessions from the transferee. Broadly defined, it includes eligibility criteria and conditions precedent, as well as promises of policy performance following loan disbursement. Some form of conditionality is common to all official lending (buying donor exports, fortifying insurgents, building schools for girls). It is also the subject of a large literature.<sup>84</sup>

Policy conditionality has been criticized as means for rich countries to control the poor.<sup>85</sup> But conditionality is also an intuitive response to the principal-agent problems in foreign assistance.<sup>86</sup> Voters in donor countries (principals) want influence over how their own and the recipient governments (agents) spend their tax money. Donor legislatures can exercise such influence, for example, by demanding environmental assessments in aid-funded projects or by banning talk of abortions in aid-funded clinics. Beneficiaries in recipient countries (the people, principal) may welcome externally imposed conditionality with respect to human rights, budget transparency, and civil-society involvement, especially to the extent it helps control incompetent or corrupt rulers (agent). But even where the beneficiaries might welcome them, conditions are usually written and enforced by lender constituencies.

The link between debt form and conditionality is not straightforward. Sovereign-debt theories often stipulate that conditionality is an attribute of debt form.<sup>87</sup> In this view, conditional loans are the opposite of unconditional gifts, or

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83. The phenomenon of relationship lending by private institutions—for example, arranging sovereign loans for the sake of future investment banking business or a local franchise—complicates, but does not negate this characterization. A private lender may take on more risk for a lower price than it might have in the absence of relationship considerations, but the transaction or set of transactions is still structured to make as much money as possible under the circumstances.

84. For early treatments, see Kahler, *supra* note 53, and Sachs, *supra* note 53.

85. For an influential NGO perspective, see Fifty Years is Enough, SAPS: The IMF, the World Bank, and Structural Adjustment (Mar. 2004), [http://www.50years.org/factsheets/SAPs-FactSheet\\_3.9.04.pdf](http://www.50years.org/factsheets/SAPs-FactSheet_3.9.04.pdf). For a critical scholarly analysis of the policy influence process, see NGAIRE WOODS, *THE GLOBALIZERS: THE IMF, THE WORLD BANK AND THEIR BORROWERS* 65–83 (2006).

86. Kahler, *supra* note 53; Bertin Martens, *Why Do Aid Agencies Exist?*, 23 DEV. POL'Y REV. 643 (2005); see also Merilee S. Grindle, *In Quest of the Political*, in GERALD M. MEIER & JOSEPH E. STIGLITZ, *FRONTIERS OF DEVELOPMENT ECONOMICS: THE FUTURE IN PERSPECTIVE* 364–67 (2001). Compare with discussions of agency problems of the people-rulers variety in sovereign debt in Buchheit et al., *supra* note 1, at 1237–45, and Robert K. Rasmussen, *Integrating a Theory of the State into Sovereign Debt Restructuring*, 53 EMORY L.J. 1159, 1177 (2004).

87. *E.g.*, Sachs, *supra* note 53. Sachs's own paper implicitly defeats the premise that loans are justified by conditionality. After demonstrating that IMF policy conditions are rarely enforced, he proposes an emphasis on “prior actions”—securing performance before money is disbursed. *Id.* This

grants. But it is possible to have enforceable conditionality without requiring repayment—development policy trends now favor grants that require policy performance before disbursement.<sup>88</sup> The loan form adds post-disbursement conditionality: donors pre-commit by advancing the loan proceeds, thereby acquiring the right and incentive to monitor future performance; recipients promise to repay and submit to donor monitoring of their policies.<sup>89</sup> From this perspective, policy conditions appear formally analogous to operational covenants in private-debt contracts.<sup>90</sup> But conditionality serves a distinct purpose in official lending. Whereas in private-debt contracts, covenants go above all to improving the prospects of repayment, in official lending, policy promises often are the principal rationale for the loan; the repayment promise is a vehicle to secure policy performance (which may also improve the prospects of repayment).<sup>91</sup>

For lending governments, the debt form has a domestic political function and a foreign-policy function.<sup>92</sup> The promise to repay tells domestic

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makes loans functionally indistinguishable from conditional grants, since the continuing repayment obligation adds little for policy performance.

88. *E.g.*, U.S. Millennium Challenge Corporation, Fact Sheet, [http://www.mcc.gov/selection/1006\\_Fact\\_Sheet\\_Selection\\_Process.pdf](http://www.mcc.gov/selection/1006_Fact_Sheet_Selection_Process.pdf); see RADELET, *supra* note 72; Bulow, *supra* note 56; Sachs et al., *supra* note 31; Taylor, *supra* note 70; Meltzer Report, *supra* note 70 (advocating conditional grants; “prior actions” are an established analogue in IFI lending).

89. The commitment embedded in a debt instrument need not be one-sided. If sovereign-debt theories are right about the weak nonpayment sanction, at least in some cases, the loan form may do more to bind the official donor than it would the sovereign recipient. For example, small, poor borrowers may be able to leverage the loan form at the margins to engage rich countries’ policy attention. As noted earlier, these countries depend on net transfers from a small group of donors. The same level of net transfers can result from new loans large enough to service the old ones plus meet the new needs, or full debt relief plus grants sufficient to meet the new needs. The form of the transfers does not change the basic fact that the borrower needs new money and can only get it from a handful of governments and organizations. When the transfers are in grant form, the grantor can walk away from the relationship at any point, for example, when money is tight and the poor country is strategically unimportant. With loans, a borrower might gain incremental leverage by threatening default. A recent U.K.-led initiative to “commit” donors to grant aid ten years forward through dedicated market borrowing illustrates the challenge. Gordon Brown, M.P., Chancellor of the Exchequer, International Development in 2005: The Challenge and the Opportunity, Speech at the National Gallery of Scotland (Jan. 6, 2005), available at [http://www.hm-treasury.gov.uk/newsroom\\_and\\_speeches/press/2005/press\\_03\\_05.cfm](http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2005/press_03_05.cfm). Here again, the debt form serves as a commitment device—binding donor governments by recasting them as borrowers. Donor governments presumably stand to lose more than aid recipients from defaulting on market borrowing, since unlike most aid recipients, they tap the markets routinely for essential financing needs.

90. BRATTON, *supra* note 9, at 209–32.

91. Kahler, *supra* note 53; see also Bruno, *supra* note 82, at 229–30 (“It is hard to envisage an institution such as the IMF or IBRD as being effective in promoting or supporting a country’s . . . reform agenda where it not also a creditor itself to the country in question . . . In particular, a mutual benefit exists to having an ongoing process of loan surveillance; this would account for the preponderance of loans, rather than grants.”).

92. The domestic function is common knowledge in the policy circles. The comments on Bulow, Rogoff & Bevilaqua, *supra* note 49, from participants in the Brookings Institution conference where they presented their paper, are revealing. See comments by Michael Bruno (“As to the issue of why the IFIs should extend loans, rather than simply grants, sufficient reasons exist—both economic and politico-economic, most of which are internal to the creditor countries.”) and Lewis Alexander (“Alexander added that it is politically easier for donor countries to provide assistance through loans, rather than through grants.”). Bulow, Rogoff & Bevilaqua, *supra* note 49, at 230, 233.

constituencies that their government is not giving away tax money and reduces the appearance of subsidy. It also suggests that the creditors have a way to monitor the use of loan proceeds over time and get the money back if anything goes awry. On the foreign-policy front, where the loan is an outgrowth of the political relationship, the principal value of a repayment obligation to the creditor may be neither legal nor financial, but instead may lie in its capacity to entrench the relationship.<sup>93</sup> At home and abroad, an official loan is a long-term commitment device.

In sum, the obligation to repay adds or reinforces a long-term, relational element in official transfers. Supporters and opponents of official lending are well aware of this. A former World Bank official observed that “loans established a desirable ongoing relationship between borrower and lender in a way that grants do not.”<sup>94</sup> This mirrors the views of NGO critics, minus the enthusiasm: “Debt is a political instrument, one that traps countries in the snare of conditions and never lets go.”<sup>95</sup>

#### D. No Fresh Start

The peculiar workings of policy conditionality appear starkly in the context of debt relief for the poorest countries. These are countries where people live on less than two dollars a day, which have no market access and depend on a small group of official creditors to make ends meet. The donors—members of the Paris Club of official creditors and the multilateral institutions they control (all long-time repeat players)—coordinate the provision of needs-based financial relief to restore countries to “sustainable” levels of external indebtedness. Debt relief is conditional on policy performance (usually in conjunction with an economic program agreed to by the International Monetary Fund (IMF)).<sup>96</sup> Thanks to serial debt rescheduling, a dollar lent in Cold War friendship in 1970 might be effectively recycled many times subject to new conditions *du jour*—privatization in the 1980s, financial liberalization in the 1990s, poverty relief in the 2000s. The result is a loss of policy autonomy, and

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93. The relationship may be unbalanced, but it is not entirely one-sided. Woods’ formulation is revealing:

Having extended loans to African countries throughout the 1960s and 1970s for a variety of geostrategic, postcolonial, economic, and domestic political reasons, the industrialized countries found themselves in relationships with aid-dependent states that could not repay even the most concessional loans. They turned to the IMF and World Bank for help and the institutions duly became more active in Africa.

Woods, *supra* note 87, at 146.

94. Bulow, Rogoff & Bevilacqua, *supra* note 81, at 233 (comments by Stanley Fischer). Fischer was Chief Economist at the World Bank shortly before making the comment; he later served as the First Deputy Managing Director of the IMF.

95. Soren Ambrose, *Assessing the G8 Debt Proposal & Its Implications*, Sept. 21, 2005, <http://www.50years.org/cms/updates/story/270> (last visited Oct. 2, 2007).

96. See, e.g., *Nigeria’s Debts: No Longer Unforgivable*, ECONOMIST, Mar. 17, 2005 (arguing for conditional relief), available at [http://www.cgdev.org/doc/Nigeria\\_economist.pdf](http://www.cgdev.org/doc/Nigeria_economist.pdf). In the final analysis, Nigeria’s Paris Club deal had unusually weak conditionality. Rieffel, *supra* note 47.

with it, domestic policy capacity.<sup>97</sup> Middle-income countries with market access may retain policy autonomy by playing creditor constituencies off one another, or may regain it by repaying official creditors under favorable market conditions.<sup>98</sup> Poor countries that depend on official creditors rarely have this option.<sup>99</sup>

Debt-relief advocates are conflicted over conditionality. Some like Sachs openly embrace G7 policy leverage and seek to influence program content;<sup>100</sup> others demand unconditional relief but cite the experience of conditional relief programs to argue that debt reduction has funded health and education spending.<sup>101</sup>

In addition to conditionality, two other features of the official debt-restructuring process are worth flagging. First, Paris Club terms rarely if ever emerge from a two-way bespoke negotiation between a debtor and its creditors. Instead, creditors periodically announce a coordinated debt-relief initiative; debtors present their case for eligibility and argue for relief based on a menu of standard scenarios. That Paris Club restructuring terms are named after the G7 summits where they were announced is telling: the debtors were marginal players in creditor designs on their behalf.<sup>102</sup> Borrowing governments also

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97. Cf. Stephen Knack, *Aid Dependence and the Quality of Governance: A Cross-Country Empirical Analysis* (World Bank, Policy Research Working Paper WPS2396, 2000), available at [http://wbln0018.worldbank.org/research/workpapers.nsf/0/30529397228d0a778525691c006768c7/\\$FILE/wps2396.pdf](http://wbln0018.worldbank.org/research/workpapers.nsf/0/30529397228d0a778525691c006768c7/$FILE/wps2396.pdf) (suggesting that countries that depend on conditional transfers lose governance capacity). Even the best-run government in a very poor country must devote inordinate resources to managing donor priorities rather than governing. INTERNATIONAL MONETARY FUND INDEPENDENT EVALUATION OFFICE, EVALUATION OF THE IMF'S ROLE IN POVERTY REDUCTION STRATEGY PAPERS AND THE POVERTY REDUCTION AND GROWTH FACILITY 23 (2004), <http://www.imf.org/External/NP/ieo/2004/prspgrf/eng/report.pdf> (describing tensions inherent in designing policy programs linked to the Heavily Indebted Poor Countries (HIPC) Initiative). On the other hand, as discussed earlier, conditionality is a way to secure accountability in foreign assistance.

98. See, e.g., Remarks by Deputy Managing Director, Murilo Portugal at a Debt Managers Conference, International Monetary Fund, Cairo, Egypt, Feb. 8, 2007, <http://www.imf.org/external/np/speeches/2007/020807.htm> (citing examples of governments that have prepaid their debt to the IMF under favorable capital markets conditions). For a recent study arguing that market access is consistent with policy autonomy, see Giselle Datz, *Global-National Interactions and Sovereign Debt Restructuring Outcomes*, in *DECIPHERING THE GLOBAL* 324, 336–37 (Saskia Sassen ed., 2007).

99. They may switch among official creditors; however, this merely substitutes one donor government's policy goals for another's. Most recently, many African states have secured deep debt relief from the G7 and multilateral institutions; they promptly proceeded to borrow from China. Geoff Lamb, *Aid, Africa and Fear of Another Borrowing Binge*, FIN. TIMES (London), Nov. 2, 2006 at 17. Although Lamb and others have described China's financing as unconditional, it is more accurate to say that China's conditions are different. See Lex Rieffel, *Why Bad Loans Are Good for Africa*, GLOBALIST, Feb. 13, 2007, <http://www.theglobalist.com/StoryId.aspx?StoryId=5970>, for a different perspective on the same phenomenon.

100. Jeffrey Sachs, *The G8 Must Fund the War Against Poverty*, FIN. TIMES (London), June 7, 2004, at 17.

101. *Do the Deal*, *supra* note 70. Truly unconditional debt relief, like unconditional aid, leaves spending decisions entirely up to the recipient government. It privileges recipient autonomy over donor policy priorities, even where autonomy yields marble fountains over school lunches.

102. RIEFFEL, *supra* note 27, at 67, 72 n.25; Int'l Monetary Fund, *From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries* (IMF Working Paper WP/99/142, Oct. 1999), available at <http://www.internationalmonetaryfund.com/external/pubs/ft/wp/1999/wp99142.pdf>. A recent Paris Club initiative named after the 2003 G7 Summit locale attempts to loosen

seemed to take the back seat to G7 powers and even civil-society groups in recent multilateral debt-cancellation initiatives. Here debt relief became a medium for negotiating the institutional architecture for aid delivery among donors and their constituents.<sup>103</sup> Aid recipients did not belong in these negotiations.

Second, Paris Club members require as a condition of restructuring that the debtor seek “comparable treatment” from all other creditors.<sup>104</sup> The goal of comparability is to avoid subsidizing the debtor’s concessions to other creditors. Although club members have no way to enforce the requirement against nonparticipating creditors (their agreement is with the debtor) and have interpreted it with some flexibility, the overall effect of comparability practice is to promote similar treatment across categories of sovereign debt, following the terms established in the first instance by the official creditors among themselves.<sup>105</sup>

In sum, successive layers of conditionality, creditor control over the restructuring process, and comparability come together in official debt relief to deepen and perpetuate, rather than sever, the underlying relationship. The next subsection begins to situate these and other attributes of official debt in the broader debates about what is debt.

## E. From Pole to Spectrum

The discussion so far suggests that official debt does not look much like arm’s length commercial debt. Governments do not lend to make money.

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the rigid formula-based approach of the traditional terms menu. The Paris Club, Evian Approach, <http://www.clubdeparis.org/sections/termes-de-traitement/approche-d-evian>. Compare Backer, *supra* note 19: “[F]orgiveness . . . provides a means for creditor states to retain power to control forgiveness, so that it remains an extraordinary act controlled wholly by creditor states.” Compare Norway’s unilateral debt-forgiveness initiative, *infra* note 130 and accompanying text.

103. See Helleiner & Cameron, *supra* note 71, at 131–36 (discussing differences between U.S. and U.K. strategies for funding multilateral debt relief). Some U.S. proposals would have the effect of shrinking multilateral development institutions, reflecting a preference for bilateral channels. See also Meltzer Report, *supra* note 70, and BIRDSALL & WILLIAMSON, *supra* note 51, for influential discussions of the relationship between aid and debt relief.

104. A typical clause in the Paris Club Agreed Minute reads as follows:

In order to secure comparable treatment of its debt due to all its external public or private creditors, [the country] commits itself to seek promptly from all its external creditors debt reorganization arrangements on terms comparable to those set forth in the present Agreed Minute, while trying to avoid discrimination among different categories of creditors.

Paris Club, Georgia Debt Treatment, July 21, 2004, <http://www.clubdeparis.org/sections/traitements/georgie-20040721>. See Paris Club, Rules and Principles—Comparability of Treatment, <http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B01WP06> (last visited Jan. 21, 2007). For criticism of the principle’s application to bonds, see Brian Caplen, *Sovereign Bonds: Logic Does Not Apply*, EUROMONEY, June 1999, at 17. Rieffel writes that before 1996, agreements distinguished between nonparticipating official and private creditors. RIEFFEL, *supra* note 27, at 75.

105. RIEFFEL, *supra* note 27, at 280–86. Note that in recent cases, comparability has run in one direction. Normally, the Paris Club restructures first and demands comparability in later deals with nonparticipating creditors. Ecuador’s private creditors went first and tried to extract “reverse comparability” from the Paris Club. The Club rejected the argument and proceeded to restructure under its conventional formulas. Jorge Gallardo, *Cracks in the New Financial Architecture*, EUROMONEY, Apr. 1, 2001, at 50.

Enforcement is indirect and the expectation of repayment may be attenuated. The lender's best repayment guarantee may reside in the survival and continued prosperity of the borrowing government and in the political relationship itself. Lending governments use conditionality as a vehicle to advance their substantive policy goals, to enhance accountability on the part of the recipient government, and to justify aid transfers to domestic audiences. Debt relief does not end, but perpetuates the debtor-creditor relationship and increases creditor control.

This set of attributes has no easy counterpart in private commerce.<sup>106</sup> For countries that depend on official sources of finance, wide-ranging policy conditionality resembles management control traditionally associated with equity-like instruments in corporate finance. That repayment is a function of recipients' economic and political fortunes similarly evokes equity. But creditor control in sovereign-debt restructuring also has parallels in recent domestic corporate-debt practice (for example, creditors taking operational control of an insolvent enterprise).<sup>107</sup> The difference with the poorest countries is that assets do not change hands, and control continues long after debt relief is granted, creating something akin to permanent receivership. Yet another analogy is to structured finance. In this view, the borrowing government sells limited policy cooperation; the lending government takes this "asset" along with the risk of regime change.<sup>108</sup>

In these domestic fields and others, "debt" marks one end of a spectrum (as in debt-grant, debt-equity, debt-sale), where the debt end is associated with the highest repayment priority. At the other end, each pairing emphasizes a different set of attributes. With grants, it may be charity and donor discretion, with equity, operational control, with sale, ownership and risk transfer. But a

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106. See *supra* note 81 (distinguishing "relationship lending" by private institutions (still profit-driven over the life of the relationship)). Domestic lending by governments holds few lessons for government-to-government lending in part because the lines of legal authority are clearly drawn in the domestic context, but are absent or confused in a world of formally equal sovereign states. See generally Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, J. INT'L ECON. L. 613 (2001).

107. Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673 (2003); Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921 (2001); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795 (2004); Lynn M. LoPucki, *A Team Production Theory of Bankruptcy Reorganization* (UCLA School of Law, Law & Econ. Research Paper Series, Paper No. 03-12, Apr. 23, 2003), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=397801](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=397801).

108. For a discussion of asset-backed financing structures and the distinction between debt and "true sale," see Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994). This analogy is attractive because it helps isolate the real value for which the public lender contracts. It could also end any presumption in favor of succession with respect to official debt. Cf. O'CONNELL, *supra* note 18 and accompanying text (on "political" obligations not subject to succession). A related analogy is the distinction between a true lease and secured financing. See U.C.C. § 1-203 (2004).

given set of facts can be a matter of more-or-less, not either-or—for example, more control, less repayment priority, hence more equity, less debt.<sup>109</sup>

The attributes of official debt discussed so far are present in all forms of official lending; however, the mix of official and commercial aspects is different across instruments.<sup>110</sup> Even if no category of official debt could meet the traditional definition of arm's length commercial debt, some categories may get closer than others. For example, an export credit extended to build a road, where conditionality is narrowly drawn, the borrower is creditworthy, and the transaction is documented under an apparently enforceable debt contract, looks more like arm's length commercial debt than does a shipment of rice monetized to finance ongoing military operations by a government fighting for its life, and more so than a budget-support package to an overindebted government conditioned on a broad range of economic and political reforms only vaguely related to repayment. It appears that official obligations, like private ones, fall along a continuum reflecting the substantive content of the transaction, including such factors as purpose, the creditors' repayment expectations, and the extent of creditors' operational control. The prevailing loan–grant- and succession–repudiation frameworks are much too binary to be useful—they obscure the substance of the underlying economic and political relationships. The following section addresses some consequences of this point.

#### IV

##### TAR, FEATHER, SUBORDINATE

If one were to describe an official loan in generic terms, it might be as a transfer of money in exchange for some degree of policy control over the borrower and the borrower's promise to repay, where the repayment expectation may be attenuated and the repayment prospects are tied to the borrowing government's fortunes, as well as to the quality of the political relationship between the debtor and the creditor. It is an animal unknown to international law, and unacknowledged in sovereign-debt practice.

As noted at the start of this article, international law governing succession is essentially black and white. Debt obligations are apportioned at face value or fail entirely.<sup>111</sup> Once it is established that the successor state owes the money, it

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109. See, e.g., Georgette C. Poindexter, *Dequity: The Blurring of Debt and Equity in Securitized Real Estate Financing*, 2 BERKELEY BUS. L.J. 233 (2005).

110. See *supra* notes 73–81 and accompanying text.

111. The distinction here is between apportionment (or repartition) of full face value among successor states and payment priority. It is further elaborated below. On apportionment, see O'CONNELL, *supra* note 18, at 454–56; SACK, *supra* note 18. Although state practice has varied, the presumption in favor of apportionment has been strongest where the debt has a connection to the territory changing hands (local or localized debts, incurred by the locality in its own name or by the ceding government for projects in the locality). See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 209(2). The Convention on the Succession of States in Respect of State Property, Archives and State Debts was opened for signature in 1983, but has not entered into force. It favors equitable apportionment of financial obligations, taking into account the apportionment of state property, but advocating a clean slate for post-colonial states. See Economic



may invoke Paris Club practice and request debt relief on financial grounds. In a sovereign workout, an obligation in the form of an “IOU” is presumptively senior, unsecured, unsubordinated indebtedness of the sovereign ranking *pari passu* with all other public and private debts.<sup>112</sup> Although IOUs to multilateral creditors are formally part of this category, they have enjoyed a blanket exemption from restructuring for most of their history.

In contrast, domestic debtor–creditor law is used to dealing with a wide variety of financial instruments that are neither senior nor void. Such obligations retain repayment rights but are lower down in priority of distribution.<sup>113</sup> Against the background of priority, U.S. law has developed ways of managing claims whose form does not reflect their substance, as well as claims for which creditor misbehavior may warrant a loss of priority otherwise inherent in the instrument.

For example, when the form of a transaction does not reflect its substance, the bankruptcy doctrine of recharacterization allows courts to use equitable powers under section 105 of the U.S. Bankruptcy Code to treat debt as equity.<sup>114</sup> When creditor misbehavior is an issue, a court may demote a claim in distribution priority, including under section 510(c) of the Bankruptcy Code, to the extent necessary to remedy harm to other creditors and the estate.<sup>115</sup> Both doctrines are used to punish corporate insiders for entering into non-arm’s length transactions to the detriment of others.<sup>116</sup> Applying each of the two doctrines often leads to the same result—the offending claim is subordinated and goes unpaid. However, recharacterization and equitable subordination are

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Aspects of State Succession: Final Report, International Law Association Toronto Conference (2006) Aspects of the Law of State Succession. Sack took a more extreme position, accepting territory as proxy for assets available to repay state debts, with liabilities generally following the assets when territory changed hands. SACK, *supra* note 18, at 13–18. Compare a leading incident cited in support of the Odious Debt doctrine, involving the U.S. refusal to let Cuba assume Spanish debts secured by Cuban revenues. The United States claimed that linking debt so closely to territorial succession would make it tantamount to a mortgage, which it was not, and in any event, that proceeds from the obligations at issue were used to oppress the Cubans. See FEILCHENFELD, *supra* note 18 (describing debt negotiations following the Spanish-American War). See King, *supra* note 2, at 31–32, for an example of how the incident is used traditionally in the Odious Debt literature. Perez & Weissman, *supra* note 63, at 23, offer a more critical treatment.

112. See *supra* note 10.

113. E.g., 11 U.S.C. § 507 (2000); BRATTON, *supra* note 11; Carlson, *supra* note 12.

114. 11 U.S.C. § 105 (2000). For a recent analysis of the recharacterization doctrine, see David A. Skeel, Jr. & George Krause-Vilmar, *Recharacterization and the Nonhindrance of Creditors*, 7 EUR. BUS. ORG. L. REV. 259 (2006).

115. 11 U.S.C. § 510(c) (2000). Carlson offers the most elaborate treatment of equitable subordination outside bankruptcy; Feibelman applies the expanded analysis to sovereign debt owed to private creditors. See Carlson, *supra* note 12; Feibelman, *supra* note 33.

116. The inquiry is whether the transaction “carries the earmarks of an arm’s length bargain.” *Pepper v. Litton*, 308 U.S. 295, 306–07 (1939). See Keriann M. Atencio, *Recommending Turnaround Managers: Ensuring that a Good Deed Goes Unpunished*, 23-10 AM. BANKR. INST. J. 44 (Dec. 2004), for a discussion of factors courts consider in drawing the boundary for control or insider conduct for purposes of subordination.

analytically distinct;<sup>117</sup> each contains elements important to the odious debt debate.

Recharacterization is the more controversial of the two doctrines. Although a majority of courts have concluded that their equitable powers in bankruptcy permit recharacterization, some have not.<sup>118</sup> Those courts that have shown a willingness to recharacterize have created complex (eleven- and thirteen-part) tests to ground what appear to be one-off, fact-based determinations.<sup>119</sup> Factors include debt form, sources and expectation of repayment, the nature and extent of benefit for the debtor, creditor control over the borrowing firm, and others going to the arm's length quality of the transaction. But courts have emphasized that none of the tests is mechanical: their purpose is to guide detailed factual inquiry into whether the claimant acted as a "banker" or an "investor"<sup>120</sup> but avoid condemning entire categories of transactions that courts might consider unfair. Rather, courts purport to isolate instances in which the gap between legal form and economic substance is so wide that allowing form to prevail would be inequitable. Recharacterization does not require a bad act on the part of the creditor, though recharacterized claims are often an unsavory lot.<sup>121</sup>

In contrast, courts have generally held that equitable subordination requires a wrongdoing. It is a remedy, not a classification device, and may be invoked only in response to a creditor's inequitable conduct and under section 510(c). The subordination remedy must be proportional to the injury from such conduct; recharacterization simply treats debt as equity. Courts generally require the following three elements to subordinate in bankruptcy: (1) inequitable conduct by the creditor (2) leading to harm for other creditors or

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117. See *In re Submicron*, 432 F.3d 438 (3d Cir. 2006) (discussing the difference between the two doctrines); Bruce H. White & William L. Medford, *Debt-to-Equity Recharacterization: Is It More than Equitable Subordination's Evil Twin?*, 23-9 AM. BANKR. INST. J. 26 (Nov. 2004).

118. Concern is reordering Bankruptcy Code priorities based on general notions of equitable distribution, beyond the framework of sec. 510 remedies. See Klee & Mervis, *Recharacterization in Bankruptcy*, in BUSINESS REORGANIZATION AND BANKRUPTCY; see also *In re Autostyle Plastics, Inc.*, 269 F.3d 726 (6th Cir. 2001) (permitting recharacterization); *In re Pacific Express, Inc.*, 69 B.R. 112, 115 (B.A.P. 9th Cir. 1986) (recharacterization is beyond the scope of Bankruptcy Code Sec. 105).

119. *Roth Steel Tube Co. v. Comm'r of Internal Revenue*, 800 F.2d 625 (6th Cir. 1986); *In re Autostyle Plastics*, 269 F.3d 726, 749-50 (6th Cir. 2001); *In re Cold Harbor Associates L.P.*, 204 B.R. 904 (Bankr. E.D. Va. 1997); see also Klee & Mervis, *supra* note 118, at 589-90.

120. *In re Submicron*, *supra* note 117. See JoAnn J. Brighton, *Submicron Developments in Recharacterization: Certainty and Finality, or Further Confusion?*, 25-3 AM. BANKR. INST. J. 28 (Apr. 2006). Skeel and Krause-Vilmar suggest that many of the elements the courts use as grounds for recharacterization address the concern that *bona fide* creditors might be misled about the existence of a debt to the insider because it lacks the formal attributes of arm's length debt. Skeel & Krause-Vilmar, *supra* note 115, at 268-69, 276-79.

121. See, for example, *In re Hoffinger Industries, Inc.*, 327 B.R. 389 (E.D. Ark. 2005), in which a swimming-pool manufacturer created a series of sham financial entities and transactions to make the pool company judgment-proof in the face of a tort action. A seminal case for the early development of both recharacterization and equitable subordination involved a parent corporation (Standard Gas & Electric) making a series of loans and charges to a severely undercapitalized subsidiary (Deep Rock Oil), which, if honored, would have put the parent ahead of the preferred stockholders in Deep Rock's bankruptcy. *Taylor v. Standard Gas & Electric*, 306 U.S. 307 (1939).

the estate or unfair advantage for the creditor, and (3) the subordination remedy is not inconsistent with other provisions of the bankruptcy code.<sup>122</sup>

Like recharacterization, the equitable-subordination remedy is granted most often against insiders. When the claimant is not an insider, courts require additional evidence of inequitable conduct, such as fraud.<sup>123</sup> However, when inequitable or insider conduct causes no harm and brings no unfair advantage, there is no cause for the remedy. Courts have even sought to protect some instances of insider lending as necessary to the firm's survival.

The contrast with sovereign practice is illuminating. Both corporate and sovereign borrowers have diverse obligations that range along a continuum in repayment expectations, control rights, and other substantive features. In the corporate world, this diversity is recognized and reflected in payment priority. In the sovereign world, this diversity is formally denied and practically accommodated through a patchwork of ad hoc restructuring arrangements. In the case of corporate debt, courts have used equitable powers to ensure that the transaction's form and substance roughly coincide, and to penalize creditors for inequitable behavior. Sovereign-debt practice has no similar function.<sup>124</sup> Quintessential insider lending, such as bilateral official credits to prop up puppet regimes, is treated on par with arm's length financing.

The result is not without irony: herding diverse financial obligations on equal footing as "debt" into a needs-based financial restructuring precludes open discussion of the political character of some claims and shuts out consideration of creditor behavior.<sup>125</sup>

The next section examines the implications of these analogies from U.S. debtor-creditor law for the problem of odious debt.

## V

### SOVEREIGN UN-DEBT

The literature on sovereign debt rests in large part on reasoning by analogy to domestic bankruptcy.<sup>126</sup> Scholars writing in this area are well aware of the political character of the state, the impossibility of liquidation and valuation, and the gaps in legitimacy and authority that distinguish the sovereign context

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122. *In re Mobile Steel Co.*, 563 F.2d 692, 699–700 (5th Cir. 1977).

123. *In re Fabricators, Inc.*, 926 F.2d 1458, 1465 (5th Cir. 1991).

124. The sovereign context lacks two elements: a system of payment priorities, and a process whereby this system is engaged to join form and substance and to remedy inequitable conduct.

125. Debt negotiators realize and occasionally reflect the political character of the debt in restructuring agreements, as in the example of the Paris Club's treatment of U.S. military assistance to Vietnam. However, official accounts go to great lengths to obscure the political character of the outcome, reflecting domestic legal and political constraints in creditor countries. *See supra* note 76.

126. *See* Rogoff & Zettelmeyer, *supra* note 41, for an overview. *See* Jeffrey Sachs, *Do We Need an International Lender of Last Resort?*, Frank D. Graham Lecture at Princeton University (Apr. 20, 1995), available at <http://www.earthinstitute.columbia.edu/about/director/pubs/intllr.pdf>; Bulow, *supra* note 55; Bolton & Skeel, *supra* note 10; and Kunibert Raffer, *Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face*, 18 *World Development* 301 (1990), for prominent examples.

from its domestic counterparts.<sup>127</sup> Of immediate relevance here, subordination and recharacterization presuppose a single collective proceeding framed by statute, a far cry from the customary sequence of loosely coordinated restructuring arrangements between the sovereign debtor and the various creditor groups. In practice, sovereign-debt priority does not mean first dibs on liquidation proceeds, but first dibs on scarce fiscal resources. The focus is on cashflows, not liquidation value; the question is whether foreign bondholders get the next coupon payment in full while local banks forbear and teachers go unpaid.<sup>128</sup>

Even as such disclaimers have become routine, the domestic analogy remains inherently risky: adopting complex domestic-law doctrines may taint the analysis with more unstated assumptions about the parties' motives, incentives, politics, and the administrative-enforcement context of the debtor-creditor relationship.<sup>129</sup> At the other extreme, and at the risk of treating domestic doctrines as shallow shorthand for simple ideas, this article draws on recharacterization and equitable subordination (conflated at this level of generality) for two very basic insights. First, for an obligation to be treated as debt, it must have certain characteristics that give rise to the expectation of priority repayment. Second, when a relationship is documented as debt, but lacks some or all such characteristics, the obligation may not be honored according to its terms. It may lose repayment priority to other claims on the debtor, or may not be paid at all.

These two points have wide-ranging implications for odious debt and sovereign debt but do not lend themselves easily to policy prescriptions. First, it is not obvious that the same characteristics that give rise to priority for commercial debt should give rise to priority for official debt. Norway's recent debt cancellation initiative is instructive. In October 2006, the government announced that it would cancel unconditionally about \$80 million in debts owed to it by Ecuador, Egypt, Jamaica, Myanmar, Peru, Sierra Leone, and Sudan on the grounds that the debts were illegitimate. They were illegitimate because they did not serve the borrowers' development needs.<sup>130</sup> The debts were

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127. See, e.g., Tarullo, *supra* note 103; Rasmussen, *supra* note 88, at 1163; ROUBINI & SETSER, *supra* note 42 (including extensive discussions of problems and implications of the domestic analogy). Cf. Carlson's admonition against reasoning by metaphor (quoting Justice Cardozo) when analyzing equitable subordination. Carlson, *supra* note 12, at 160-61.

128. I have suggested elsewhere that for public entities that cannot be liquidated (including states and municipalities), insolvency is framed in cashflow terms. Different categories of debt may be paid in order from a state's primary budget surplus. Gelpern, *supra* note 10, at 1155. The legal challenges inherent in the concept of priority in sovereign debt are most apparent in the debates about the *pari passu* clause. See Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869 (2004), and William W. Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823 (2004), for different perspectives.

129. Pérez and Weissman make a related argument questioning the utility of private-law analogies in a public context that is sovereign debt. Pérez & Weissman, *supra* note 63, at 44.

130. Cancellation of Debts Resulting from Norwegian Ship Export Campaign, Royal Norwegian Ministry of Foreign Affairs Press Release No. 118/06 and Fact Sheet/Report (Oct. 2, 2006), <http://www.regjeringen.no/nb/dep/ud/Pressesenter/pressemeldinger/2006/Cancellation-of-debts->

incurred as part of Norway's export credit program to support its shipbuilding industry in the late 1970s. This initiative is consistent with past episodes of sovereign-debt forgiveness inasmuch as it is unilateral and discretionary on Norway's part. But it also breaks with precedent in three ways. First, relief is ostensibly unconditional. Second, related, it goes to "pariah states" such as Myanmar and Sudan, alongside states generally in good standing with the international community. The idea is to shift the focus from debtor to creditor responsibility. However, Myanmar and Sudan do not get relief from Norway until they become eligible for multilateral debt relief.<sup>131</sup> Third, Norway's initiative challenges the established rationale for export credit: the mandate of export-credit agencies is to support national exports and "level the international playing field" for creditor-country exporters. They are not aid agencies; development benefits to the borrowing state are incidental to their domestic mission.<sup>132</sup>

Judged by commercial-debt standards, a market-based export credit extended entirely in the creditor's self-interest might merit repayment ahead of a development loan extended for the benefit of the recipient. Norway's move implies instead that commercial-looking official loans should be repaid only when they serve the needs of the recipient *and* produce good economic outcomes, which would make export credits look like some combination of aid and equity. Traditional export lending would lose its claim to priority repayment.<sup>133</sup>

While applying different priority criteria to official and private debt is reasonable in view of their different functions, it poses an administrative challenge for restructuring a debt stock that includes both. One way to resolve the problem is to pick one scale over the other—subordinate all official debt to

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resulting-from-the-Norwegian-Ship-Export-Campaign-1976-80.html?id=272158 (last visited Oct. 2, 2007). The Development Minister first mooted the initiative in May. International Development Minister Eric Solheim's Statement to the Storting (May 16, 2006), <http://www.regjeringen.no/en/dep/ud/About-the-Ministry/Minister-of-International-Development-Er/Speeches-and-articles/2006/International-Development-Minister-Erik-Solheims-statement-to-the-Storting-16-may-2006.html?id=420850> (last visited Oct. 2, 2007). For NGO reactions, see Norway Makes Groundbreaking Decision to Cancel Illegitimate Debt, EURODAD (Oct. 3, 2006), <http://www.eurodad.org/whatsnew/articles.aspx?id=302> (last visited Oct. 2, 2007).

131. See Report, *supra* note 130. Here Norway is (understandably) on both sides of the fence: making Myanmar and Sudan technically eligible bolsters the image of unconditional relief; linking the write-off to multilateral action imports economic and human rights conditionality.

132. See, e.g., Rita M. Rodriguez, *Ex-Im Bank: Overview, Challenges, and Policy Options*, in Hufbauer & Rodriguez, *supra* note 80, at 5, 6, 21. A recent OECD agreement on Unproductive Expenditures is an exception that proves the rule: major export-credit agencies agreed to refrain from financing "unproductive expenditures" in Heavily Indebted Poor Countries (HIPC) that may benefit from official debt relief under the HIPC initiative. "Unproductive activities" are those that do not contribute to social or economic development and are not consistent with the borrower's poverty-reduction strategy. OECD, Official Export Credit Support to Heavily Indebted Poor Countries (HIPC) Statement of Principles, [http://www.oecd.org/document/27/0,2340,en\\_2649\\_34179\\_2675739\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/27/0,2340,en_2649_34179_2675739_1_1_1_1,00.html) (last visited May 7, 2007). The implication of the principles is that financing unproductive expenditures is permissible in non-HIPCs.

133. Another reading of Norway's initiative would be as an admission of bad faith, complicity in fraud or corruption, where the remedy is to void the transaction. Cf. Buchheit et al., *supra* note 1.

all private debt, or vice versa.<sup>134</sup> Either scenario would eliminate Paris Club comparability (a political problem), but would be much simpler than reconciling two priority scales.

As an alternative to blanket subordination, it is possible to engage in detailed loan-by-loan analysis of official and private debt, using something like the three-, eleven- and thirteen-part tests fashioned by U.S. courts in equitable subordination and recharacterization decisions. This might ultimately reveal a category of sovereign “un-debt”—financial relationships that include a promise to repay, in which the repayment expectation may be attenuated by factors such as:

1. The purpose of the loan
2. The extent to which loan proceeds actually benefited the debtor
3. The expectation of repayment, as evidenced by
  - a. A formal promise to repay
  - b. An enforceable agreement
  - c. A history of enforcement
  - d. Sources of repayment
  - e. The borrower’s creditworthiness at the time of the loan
4. The extent of operational control by the creditor, as evidenced by the breadth and depth of policy conditionality.

Such criteria may apply differently to private and official lending. For example, any commercial purpose and use of proceeds short of misappropriation might confer priority on private credits. The same might not be enough for official credits, especially those laden with policy conditions. The latter could be held to a higher standard of benefit to the debtor, on the Norwegian or similar model, subordinating loans for “unproductive” expenditures that are neither corrupt nor oppressive.<sup>135</sup> Private creditors may get extra scrutiny in other areas, such as lending to borrowers that patently lack repayment capacity.<sup>136</sup> Among official lenders, multilateral institutions may come ahead of bilateral ones using the illustrative criteria above because the former are generally barred from lending for political or security operations, and at least ostensibly reap no benefit from the loans.<sup>137</sup> Drawing again from

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134. Bulow et al. argue that official debt is *de facto* subordinate in any event. *Supra* note 49. The traditional arguments for the IFIs’ preferred creditor status and the priority of certain government claims in domestic bankruptcy point in the opposite direction.

135. See *supra* note 132 for a discussion of the recent OECD initiative on unproductive expenditures.

136. The existing literature on odious debt, including recent symposia, e.g., Symposium, Odious Debts and State Corruption, 70 LAW & CONTEMP. PROBS. (Summer 2007); 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007); 33 N.C. J. INT’L L. & COM. REG. (forthcoming 2007), has gone a long way to elaborate the conditions under which private debt should be unenforceable or subordinated.

137. Rodrik, *supra* note 54 (arguing that multilateral agencies are less “political” in their lending). Compare Alesina & Dollar, *supra* note 54 (on bilateral creditors). *But see* Martens, *supra* note 86 (noting that aid agencies broker compromises among donor priorities and that pressing a donor to depart substantially from its priorities may prompt it to withdraw).

equitable-subordination decisions, multilaterals may also benefit from their status as lenders of last resort—a position that underlies the preferred creditor status they have been accorded in practice.<sup>138</sup> Bilateral military loans to support puppet regimes would be prime candidates for subordination. Even at the far extreme of this framework, the subordination remedy would not deny the existence of an obligation to repay; it would demote it to reflect economic and moral factors.<sup>139</sup>

Such a detailed approach presents at least two problems. First, regardless of the criteria, it is inadministrable in the existing institutional context. It would rely on an adjudication apparatus that does not exist, and for which there is no appetite in the international community. Moreover, even if it were mechanically viable, case-by-case adjudication would be immensely time-consuming and would fail to deliver relief in a meaningful timeframe.

Second, the already cumbersome analysis must get messier still to address the growing number of assignment and securitization transactions that put official debt in the hands of private creditors. For example, a relatively straightforward 2007 case in the United Kingdom involved Zambia's Cold War debt to Romania. In the late 1970s, Zambia bought agricultural machinery on credit from Romania. Twenty years later, Zambia was an early candidate for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative, which would wipe out most of its official debt. Instead of writing off the debt, Romania sold it to a private investor, who succeeded in reviving it as private debt under murky circumstances. Under the court's ruling, Zambia could lose a substantial portion of its annual debt relief.<sup>140</sup> The original bilateral instrument was unenforceable in court under the U.K. State Immunity Act, and in other respects might look like the ideal "un-debt." Whether its status changed with assignment and subsequent renegotiation requires another layer of analysis.

An approach based in radical separation between private and official debt could simplify matters. One way to accomplish separation would be to limit the scope for assignment of official debt to private creditors. For example, multilateral or domestic measures in major financial jurisdictions could make official bilateral debt unenforceable in court if assigned to a private entity without recourse to the official creditor.<sup>141</sup>

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138. Rutsel Silvestre J. Martha, *Preferred Creditor Status under International Law: The Case of the International Monetary Fund*, 39 INT'L & COMP. L.Q. 801 (1990).

139. It would also provide a more coherent legal and economic basis for a determination that debt is "uncollectible," as in the case of Vietnam. *See supra* note 77. Ironically, the borrower's sovereign character may help subordinated lenders: without liquidation and barring repudiation, even the most junior may eventually claim some part of the debtor's primary surplus. In contrast, equity holders usually get nothing at liquidation.

140. *Donegal Int'l Limited v. Republic of Zambia* [2007] EWHC197 (Comm).

141. The *Donegal* court suggested that, notwithstanding the assignment, Zambia might have benefited from sovereign immunity; however, Zambia waived it for the benefit of the private creditor when it renegotiated the debt. A strict no-assignment rule would pose a problem for states that sell or securitize bilateral debt (an established if relatively infrequent practice) and, without proper carve-outs, could curb debt-for-nature exchanges and similar transactions. A full discussion of the merits of official

Implementation challenges aside, the concept of sovereign “un-debt,” loosely drawn from U.S. debtor–creditor law, is a useful analytical and rhetorical tool. It shares a moral impulse with this body of law, demoting obligations when the debt form is used to mislead (disguised grants), or to entrench privileged creditor control with no corresponding benefit to the debtor (propping up dictators).<sup>142</sup> “Un-debt” offers a way to think beyond the traditional constraints of sovereign-debt form without simply discarding it as if it never happened (along with donor country legislation authorizing it). This analytical lens is important because even when the obligation ultimately goes unpaid, the debt form may frame a decades-long financial, economic, and political relationship. Calling loans grants after the fact, or grounding relief in financial need alone, precludes consideration of this relationship.

## VI

### CONCLUSION

#### FROM ODIIOUS DEBT TO SOVEREIGN “UN-DEBT”

The Cold War and its various reverberations in the second half of the twentieth century helped bring about a surge in official lending. Although government-to-government loans are not without precedent, they had been relatively rare until then. As the new loans grew in scale and scope, their goals came to encompass military and political support, economic development, export promotion, and all manner of other strategic and humanitarian objectives—in short, everything governments do abroad.<sup>143</sup> The loan form helped secure domestic political support for foreign transfers, but also to entrench policy influence and bolster long-term relationships among states. Over time, other justifications for the loan form accreted, including the salutary role of credit in promoting repayment discipline among wayward countries.

Official lending was particularly important for poor countries and suspect regimes that had limited sources of external financing or that made a living by trading in political loyalties. It is therefore unsurprising that official loans dominated the debt stocks recently bequeathed by twentieth century despots to their successors. Inasmuch as the overarching goal of an Odious Debt Doctrine is to free the people from paying for the sins of their rulers, it cannot avoid dealing with official debt.

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debt assignment is beyond the scope of this article; however, two points bear mention. First, a non-assignment rule is unlikely to affect the price or availability of official credit when it is extended for non-economic reasons. Second, assignment of official debt to private-market participants arguably runs counter to the assumptions underlying the institutional structure of coordinated official debt restructuring: the Paris Club mechanism might work differently if a hedge fund held Italy’s economic interest in Argentina’s debt, along with a claim against Argentina that might be litigated in court.

142. *Compare* Skeel & Krause-Vilmar, *supra* note 114, at 268–76 (discussing Truth and Nonhindrance).

143. Alesina & Dollar, *supra* note 46 (arguing that colonial past- and political alliances are the major determinants of foreign aid).



The easiest way to deal with official loans would be to call them grants and simply disregard the repayment promise, either at the time of state succession or at the time of financial distress. This is roughly the position that united international debt-relief advocates in the NGO community and Bush administration officials.<sup>144</sup> Private creditors made a similar argument when they complained about being forced into comparability with “political” loans, though they did not go so far as to advocate repudiation. They wanted to dissociate their obligations from those held by official creditors, but made no affirmative case for how official credits should be treated.<sup>145</sup>

The diversity of instruments in corporate finance, and especially the bankruptcy debates about recharacterization and equitable subordination, suggest that there is room for a much more nuanced analysis of sovereign obligations—including obligations to other governments and public institutions—to help ground a more sound and fair policy approach. These debates may point to a useful analytic device, but fall far short of determining a policy proposal. Unpacking the debt form and using the result as a basis for demoting a claim on a state’s fiscal resources would reflect better the increasingly complex financial and political reality of sovereign finance. Like some of the recent writing on odious debt (but unlike most theories of sovereign debt), it also examines creditor motivations and behavior.

The analysis could support a range of prescriptions to deal with odious debt. Key policy design questions include timing: would the framework be available at all times, only in times of financial distress, or only in cases of state succession? The framework could be entirely self-judging and self-administered (announced by the borrower as grounds for preferential repayment—or by the lender, such as Norway, as grounds for unilateral forgiveness), applied by a third party (a national court, a standing international institution or a special tribunal), or advisory (applied in the context of existing restructuring mechanisms). It could support loan-by-loan analysis or subordinate entire categories of claims. As with all proposals concerning sovereign debt, the problem of enforcement looms large. Above all, the utility of this approach may be limited when the starting presumption is that private and official lending to poor countries are inextricably linked in an oppressive political system, following arguments by Pérez and Weissman and Backer.<sup>146</sup>

The task of comprehensive policy design goes far beyond the problem of odious debt and is beyond the scope of this symposium contribution. The goal of this article has been to identify an important gap in policy and theoretical approaches to sovereign debt using the example of odious official lending. The central implication of the analysis is the need for the law and policy to recognize the existing complexity of sovereign obligations, including official debt, and to

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144. *Supra* note 68 and accompanying text.

145. *See, e.g.*, Rieffel, *supra* note 47, at 281–86.

146. *Supra* notes 63 & 19.

examine the significance of debt form in sovereign finance. The world of corporate debt has long dealt with these questions. It is high time the world of sovereign debt began.