ODIOUS DEBTS AND NATION-BUILDING: WHEN THE INCUBUS DEPARTS

Lee C. Buchheit and G. Mitu Gulati

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ODIOUS DEBTS AND NATION-BUILDING: WHEN THE INCUBUS DEPARTS

Lee C. Buchheit* and G. Mitu Gulati**

People tend to think that because we changed all the politics in four days, we can change the economy in four days. Well, we can’t. It will just have to take a little more time.¹

I. THE BEOWULF SYNDROME

We learn the pattern in the nursery. A village, a town, a shire languishes for generations under the oppression of a monster, a giant, a dragon, a wizard. Despair and helplessness blight the landscape until the sudden appearance of a deliverer. Jack kills the giant. Harry Potter vanquishes Lord Voldemort. Beowulf overpowers Grendel. Dorothy melts the Wicked Witch of the West. Once the source of the evil is removed, the dark enchantment lifts, the flowers blossom again, and the children laugh once more. All live happily ever after.

The appeal of these stories lies in their simplicity. The cause—the sole cause—of the people’s suffering can be traced back to a single point of origin. Extinguish the source of that evil and, in one stroke, felicity and fecundity return.

II. OUTSIDE THE NURSERY

History offers numerous examples of the operation of the Beowulf Syndrome outside of the nursery. When a society is victimized for a sufficiently long period of time by an oppressive or corrupt regime, the temptation to ascribe all of the ills of the society to that one source gradually becomes irresistible. The despot can become, in the minds of the people, the wellspring of the totality of their suffering. However improbable it may be as a matter of etiology to trace every social disorder back to a nasty government, there is something in human psychology that apparently yearns to do so.

The stage is then set for the appearance of that equally familiar phenomenon: revolutionary disillusionment. When the dictator is suddenly removed, particularly if the removal is at the hands of the long-suffering citizenry, folks just naturally assume that their lives will improve—dramatically, palpably, and promptly.

It rarely happens that way. Sometimes the revolution merely replaces one form of tyranny for another: Robespierre for the Bourbons, the Bolsheviks for the Tsars, the

* Partner, Cleary Gottlieb Steen & Hamilton LLP in New York. At various times, Cleary Gottlieb represented a number of the countries discussed in this Essay in their debt renegotiations. For comments, thanks to Daniel Bradlow, Anna Gelpen, Jurgen Kaiser, Kimberly Krawiec, and Charles Norchi.

** Professor, Duke Law School in Durham, North Carolina.

¹. ALFRED A. YUSON & RICARDO B. RAMOS, THE PUBLIC CONSCIENCE OF JAIME V. ONGPIN 141 (1988) (quoting an interview with Jaime V. Ongpin, Minister of Finance, Republic of the Philippines). The four days to which Minister Ongpin was referring were the period of the People Power revolution in the Philippines in 1986 that overthrew the dictatorship of Ferdinand Marcos.
Ayatollah for the Shah. Sometimes the new regime, even if well-intentioned, is incapable of delivering on the explicit and implicit promises that helped bring it to power. (A law of political gravity also operates in these situations. The higher the new leaders allow public expectations to rise, the more painful is the inevitable crash back to earth.) An example is the Cory Aquino administration that took office in the Philippines following the People Power revolution against Ferdinand Marcos in 1986. Mrs. Aquino was an honest (a refreshing change from Mr. Marcos), but relatively ineffectual leader. Sometimes chronic human frailties—egotism, incompetence, envy, greed, parochialism, and so forth—become visible in the officers of the new government, gradually staining the image of the successor regime. Those traits were probably always present, of course, but they may have been temporarily eclipsed by the meridian glare of the revolutionary moment. The bickering among the Founding Fathers following the American Revolution is a case in point.

Whatever the cause, the result is usually disillusionment, and occasionally profound disillusionment. This has been a nearly universal theme when nation-building is accomplished through a dramatic substitution of a corrupt or dictatorial regime.

III. THE DEVIL AND ALL HIS WORKS

In the first flush of euphoria following the overthrow of an oppressive regime, the new administration will want to fumigate the premises. Old political appointees will be fired. Collaborators and sympathizers will have their heads shaved, figuratively and sometimes literally. Laws and decrees associated with the ancien régime may be revoked. In extreme cases, even the constitution may be rewritten. The behavior of the Coalition Provisional Authority in Iraq in 2003 is a splendid example of this cathartic impulse. ²

But there is one souvenir of the former regime that may not be so easy to expunge—the debt obligations incurred by the prior government in the name of the state. Public international law, with few exceptions, requires a new government to recognize the debts incurred by its predecessors, however dissimilar in political form or philosophy those predecessors may have been.³ So in this one area—debt contracts—the former despot will continue to keep a chokehold on the country long after the devil and his other works have been buried.

IV. THE MORAL CONTEXT

To most people, the notion that the citizens of a country lucky enough to have ousted a dictator should spend the rest of their lives paying off the debts incurred by that dictator in the name of the state is morally repugnant. This is a situation in which a strict requirement of the law (that governments automatically succeed to, and must

honor, the debt obligations of their predecessors) is incongruent with most people's sense of the morally right outcome.

At a superficial level, state responsibility for debts incurred by prior governments resembles the belief that a country carries a collective responsibility for the crimes or wars perpetrated by prior governments of that country. The Allied Powers represented at the Paris Peace Conference in 1919 certainly demonstrated their belief in this version of collective responsibility. It did not matter to them that the German Kaiser had fled and his government had fallen—the German people had to be made to pay. In our own day, the damage caused by Iraq's invasion of Kuwait in 1990 has resulted in more than $50 billion of reparation awards handed down by the United Nations Compensation Commission. Shortly after Saddam Hussein was deposed in 2003, the new Iraqi Government began to agitate for those awards to be reduced or nullified. The argument? The Iraqi people were co-victims of Saddam's tyranny. It would be morally reprehensible to saddle them with the obligation to compensate Saddam's other victims as well.\(^5\)

But the similarity to other types of state collective responsibility is only superficial. The significant difference between foreign debts incurred by a prior regime and damages or injury inflicted on foreigners by such a regime is that, in the debt example, the foreign creditors chose to lend their money while the regime was in power. The odious (to use a word) characteristics of a prior regime—the very characteristics that fuel a sense of moral outrage when citizens are asked to assume the debts of such a regime once it is displaced—were presumably visible to a lender when it elected to advance money. So, the argument goes, such a lender is in the position of a collaborator whose head, or at least whose wallet, is subject to righteous shaming by the incoming administration. In contrast, it is difficult to portray the victims of state-sponsored crimes or aggressive wars as somehow complicit in the behavior of the perpetrators of those acts.\(^6\)

V. THE ODIOUS DEBT DEBATE

The proximate cause of the current debate about whether public international law recognizes a "doctrine" of odious debt was the U.S. invasion of Iraq in 2003. Individuals at the extreme ends of the political spectrum (the Bush Administration neo-conservatives on one side and the non-governmental organizations championing third

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5. See Matthew Martin, Banks Reject Baghdad's $30bn Debt Plea, MIDDLE EAST ECON. DIG., Nov. 23, 2007, at 24 (quoting an Iraqi official as saying, "[t]he regime of Saddam Hussein is now gone and Kuwait is at peace with the people of Iraq . . . . Why does it continue to force Iraqis to pay for the crimes of the old regime?'').

6. Additionally, in purely economic terms, the external creditors are better risk bearers or cheaper cost avoiders than the suffering populace. See generally Omri Ben-Shahar & Motu Gulati, Partially Odious Debts, LAW & CONTEMP. PROBS., Autumn 2007, at 47 (arguing that creditors should bear odious debt liability to the extent that they could have taken measures to reduce the risk of forfeiture or to monitor the use of money).
world debt relief on the other) both argued that Iraq’s Saddam-era obligations fit a legal category of odious debts, a category, they claimed, that had a basis in customary international law. More recently, the debate has moved from the activist realm to the academic.

This debate about governmental succession to odious debts is complicated by the fact that one side (the activists who began the discussion) is talking mostly morality, and the other side (the academics, practicing lawyers, and policy makers), mostly legal and economic realities. The proponents of the idea that debts incurred by (now supplanted) odious regimes should be cancelled are responding to what they see as a moral imperative; something very akin to the presumption of the Beowulf Syndrome that when the source of the evil is vanquished, all of the baneful effects of that evil should automatically dissipate.

The creditors’ response to these ethical arguments is predictably legalistic. They point to the black letter of the loan agreements or bond indentures—documents that invariably contain representations about the legal, valid, binding, and enforceable nature of the contracts. They point to the strict public international law rules governing the inheritance of state debts incurred by prior regimes. They talk, also in quasi-religious tones, about the sanctity and inviolability of contracts.

Sovereign debtors have not usually gotten very far with purely ethical arguments. Even if the creditors may feel a twinge of conscience about having lent to a distasteful regime, they are unlikely to admit it publicly. Bilateral government lenders that eagerly finance sales of equipment, often military equipment, to client countries, argue that they cannot be too fastidious about the nature of the regimes governing those


8. See generally Symposium, Odious Debts and State Corruption, LAW & CONTEMP. PROBS., Summer 2007; Symposium, Odious Debt: Exploring the Outer Limits of Sovereign Debt Relief, 32 N.C.J. INT’L L. & COM. REG. 605 (2007). These symposia contain several articles forming part of this contemporary debate.


11. Cf. Joanna Chung & Stephen Fidler, Restructuring Under Fire: Why Iraqi Debt is No Longer a Write-Off, FIN. TIMES, July 17, 2006, at 15 (reporting on creditor unhappiness with the significant write-off that they had to accept with regard to the Iraqi debt).
countries. If they were, they would not sell much hardware. Finally, many of the debt instruments evidencing these credits are traded in the secondary market. A third-party purchaser of such an instrument is comfortably removed by the assignment chain from whatever ethical qualms may have, or should have, troubled the originator of the loan.

As a result, the proponents of the theory that odious debts should be carved out from the normal requirement of state/governmental succession to debt obligations have recently opted to engage their creditor counterparts in equally legalistic terms. The emotional propellant for their response may be moral outrage, but the language is now legal. The ingredients for this legal porridge, however, are astonishingly meager. They comprise mainly a debate between two colonial powers, Spain and the United States, about responsibility for the debts of Cuba in 1898, the writings of an obscure law professor of the early 20th century, and a single arbitral award of the same vintage.

VI. NATION-BUILDING AND ODIOUS DEBTS

Many countries that have ousted dictatorial regimes have hoped that their experiment in revolutionary nation-building would be accompanied by a cancellation of the debts incurred by those regimes. The Aquino administration in the Philippines, for example, was initially beset by calls for “selective repudiation” of corrupt loans incurred while Marcos was in power. Mrs. Aquino’s first minister of finance, Jaime V. Ongpin, even expressed the hope that once the country’s foreign creditors realized that the old crooks had been thrown out, the creditors would want to support the new government by offering, or at least accepting, debt relief. This may sound quixotic twenty-one years (and many sovereign debt workouts) later, but at the time many people believed that right would eventually make might, even in the area of sovereign debt.

12. A recent example of the willingness of governments to compromise their ethics so as to enable lucrative arms sales was the abandonment by the British government of a corruption probe into arms sales to Saudi Arabia by BAE Systems, Britain’s largest arms manufacturer. See James Boxell, Arms Export Buoy Sales Data, FIN. TIMES, June 11, 2007, at 2.


14. See 1 JOHN BASSETT MOORE, A DIGEST OF INTERNATIONAL LAW § 97, at 351-85 (1906); Buchheit et al., supra note 3, at 1214-16.

15. ALEXANDER N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIERES (1927). Sack argued that successor governments might be allowed to avoid the odious debts of the governments that preceded them. See generally id. For an analysis and critique of Sack’s work see Ludington & Gulati, supra note 7.


17. Matthew Crabb, Marcos ‘Downfall Shakes All Asia, EUROMONEY, July 1986, at 52, 56 ("Filipino politicians have worried foreign creditors with their talk of selective repudiation of fraudulently transacted loans . . .").

18. YUSON & RAMOS, supra note 1, at 140-41.
Argentina in the 1980s experienced something similar. After the ruling military junta was replaced by a populist government under President Raúl Alfonsín in 1983, the new government initially announced that creditors would not be paid until the legitimacy of their debts to “the generals” had been determined. A June 1984 letter of intent submitted to the IMF stated that the debt “had been contracted by the means of arbitrary and authoritarian policies in which the creditors had actively participated and which did not bring benefits to the Argentinean people.” 19

Following the removal of Saddam Hussein in Iraq in 2003, the Iraqi National Assembly passed a resolution supporting the recommendation of its Economic and Finance Committee that Iraq should assert the doctrine of odious debts in connection with Saddam’s debts. The recommendation (which bears the fingerprints of an NGO drafter) stated:

The previous regime accumulated a heavy burden of foreign debts to states which financed the tyrant’s wars against his people first, and then against our neighbors. The foreign loans helped him build a huge military apparatus and manufacture weapons of mass destruction, including chemical weapons that he used against the Iraqi people in Halabja. The loans supported his system of oppression and paid for his palaces and prisons during the war against Iran when Iraq’s oil revenue was extremely low . . .

There is a strong basis in international legal principle and precedent to define these debts as being “odious” and thus not legally enforceable. This legal doctrine of odious debt was formulated in the 1920s by Alexander Sack, a former Russian Minister working as a legal professor in the Sorbonne University in Paris. He published the most extensive and important works on the treatment of state debts in the event of regime change. 20

In any event, neither Cory Aquino’s Philippines, Alfonsín’s Argentina nor Iraq’s post-Saddam Interim Government pressed a legal argument for debt cancellation based on the allegedly odious character of the debts left by the prior regime. The reasons in all three cases were pragmatic. The Philippines was at the time (1986) in the middle of a conventional debt restructuring/new money exercise with its commercial bank creditors. Five years later, the country would significantly reduce its stock of commercial bank debt, and stretch out the repayment of the balance, pursuant to the so-called Brady Initiative. 21 The Government concluded that a policy of selective repudiation of certain loans was likely to derail its efforts to obtain debt relief through more conventional channels. 22


21. The Brady Initiative, sometimes referred to as the Brady Plan, was a strategy implemented by the U.S. government in the late 1980s that stressed debt-forgiveness for developing countries. See Pérez & Weissman, supra note 16, at 727-30.

22. When asked in 1986 whether he believed the Government had “dispelled all the worries about debt
The Argentine experience was very similar. Here is President Alfonsin’s explanation in 1987, several years after taking office:

We maintained that we should not pay that which we regarded to be the illegitimate part of the debt because it had originated from irregular credits . . . but in the concrete exercise of power, things did not turn out this way and only in a very small, in fact irrelevant, number of cases could we effectively prove that we were dealing with this type of loan. It was therefore actually impossible to carry on with a policy of distinguishing between legitimate and illegitimate loans.23

For its part, the Interim Government of Iraq in 2004 enjoyed strong support from some of its allies for a massive write-off of the country’s $140 billion Saddam-era debt stock.24 But the justification for such a high level of debt cancellation was eventually articulated in gritty economic and geopolitical terms, not legal (odious debt) terms. Iraq’s Minister of Finance at that time, Adil Abdul Mahdi, was bluntly asked in an interview whether “any of Iraq’s sovereign debt [is] odious debt that can or should be repudiated entirely?” Minister Mahdi answered the question in this way:

Iraq’s need for very substantial debt relief derives from the economic realities facing a post-conflict country that has endured decades of financial corruption and mismanagement under the Saddam regime. Principles of public international law such as the odious debt doctrine, whatever their legal vitality, are not the reason why Iraq is seeking this relief.25

His successor as Iraq’s minister of finance, Ali A. Allawi, published an article the following year in which he summarized, in openly sympathetic terms, the moral argument for a repudiation of Saddam’s debts:

Widely different views have been expressed about the appropriate treatment of Iraq’s Saddam-era debts. Some have argued that all of this debt, in view of its provenance, should be classified as odious and cancelled outright. Lend to a despot, they say, and you should expect repayment only from the despot. If a country manages to free itself from the incubus of an odious regime, the citizenry should not be forced to carry the burden of that regime’s immoral extravagances for generations to come.26

By the time Minister Allawi published his article in 2005, however, Iraq had struck a deal with its large bilateral creditors that called for an 80% cancellation of Saddam-era debts.27 The principal argument Iraq used to support its request for debt cancellation on such a vast scale was political, based on the need to restore stability in Iraq, and not on moral grounds or on the legal doctrine of odious debts.28

repudiation,” the Philippine Minister of Finance Ongpin answered, “The president has publicly stated that we will honor all our legitimate obligations and that we will seek to obtain more liberal terms from all our creditors.” Crabbe, supra note 17, at 57.
23. Michalowski, supra note 19, at 18.
25. Felix Salmon, Restructuring Debt is Top Priority, Euromoney, Sept. 2004, at 72, 76.
27. See supra note 24 and accompanying text.
A similar scenario played out after the demise of the apartheid regime in South Africa. Outrage at foreign financial support for that regime was never translated into retributory action against the lenders once the regime fell. Why? The familiar story: a debt repudiation, however justifiable in moral terms, would have impaired the new government’s ability to attract the foreign capital needed for economic reconstruction.29

VII. CONCLUSION

What lesson should be drawn from these experiences—that the incandescent idealism of a “rebuilt” nation seeking relief from the debts incurred by its former oppressors will inevitably crumble in the face of the conservatism and venality of the country’s creditors? We think not. The moral case, the ethical case, the religious case (if you are so inclined) for debt relief in these circumstances is too powerful to be wholly ignored.

Moreover, the avalanche of research and writing about the odious debt question over the last four years has provided everyone involved with these issues (debtor, creditors, NGOs, economists, politicians, and lawyers) with a much better understanding of the historical precedents and theories supporting these arguments.30

The important question is how, not whether, countries that have shed themselves of corrupt or despotic regimes can ensure that the debts incurred by the former regime will not permanently blight the economic prospects of the rebuilt country. The Beowulf Syndrome leads naturally to an expectation that the debts will be eliminated in one sweep of a terrible swift sword as soon as the dictator departs. It rarely happens that way.

Many heavily indebted sovereigns over the last quarter century have achieved a significant degree of debt relief from both their official sector and commercial creditors. The conventional process for obtaining that relief, however, is admittedly tedious and attenuated. No one will ever be able to determine how much of the relief granted to these countries was attributable to the creditors’ own sense of culpability for having lent money, or at least lent so much money, in the first place. But this was surely an element in the deals cut for certain countries such as Iraq in 2004.

The public discussion about odious debts and its correlative principle of “responsible lending” has therefore had a dollars and cents effect on recent sovereign debt workouts, and will undoubtedly continue to do so in future cases. The only problem is that this effect cannot be quantified with precision nor—Beowulf notwithstanding—does it manifest itself immediately once the source of the evil is gone. As Minister Ongpin said in the quotation that opens this Essay, “It will just have to take a little more time.”31


30. See, e.g., Buchheit et al., supra note 3; Ludington & Gulati, supra note 7; Pérez & Weissman, supra note 16.

31. YUSON & RAMOS, supra note 1, at 141.