THE CURIOUS CASE OF 'ODIOUS DEBTS' IN INTERNATIONAL LAW

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ABSTRACT

The epilogue to the twentieth century marked the formation of numerous nation states by the rupturing of fractured societies. This state of affairs has carried over into the twenty first century, well unto the present year. It poses the greatest problems to the 'continuity of obligations' of states and governments. Pertinent areas of discussion within the realm of Public International Law are State successions and Political transitions. It is generally believed that states and governments succeed to the debts of their predecessors. The odious debt doctrine is the most controversial of the exceptions to this general rule. Odious debts are the debts incurred by a particular regime that do not benefit the state. Debate over Iraq's possible repudiation of the debts incurred by the Saddam Hussein regime has renewed interest in the subject. The sheer odiousness of the debts is best understood through countries with a history of autocratic regimes such as Nicaragua and Congo where the odious debt to income per person ratios are as high as 563.3% and 274.9% respectively. While the existing state of affairs may not affect a majority of nations, the reality that funds continue to flow into nations with autocratic and oppressive regimes is only deplorable. This Paper examines the odious debt doctrine and its foundations in Treaties and Customary International law. Arguing that the doctrine has not crystallized into International custom, the paper makes a case for its recognition in International law and makes recommendations for an International regulatory mechanism. The Paper identifies doctrinal legal challenges to the viability of such mechanism and provides potential solutions.

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1. INTRODUCTION

"None of us clearly know to whom or to what we are indebted in this wise, until some marked stop in the whirling wheel of life brings the right perception with it."

- Charles Dickens, Little Dorrit

Considered by some to be a 'more seditious' text than Marx's Das Kapital, Charles Dickens's Little Dorrit remarkably portrayed the degrading reality of bankruptcy.[1] Set in Marshalsea's Victorian-era debtors' prisons, though the novel's tortuous fabric may have been sewn for nineteenth century middle class English households, its haunting truth continues to be relevant to numerous nations saddled with odious debts.

State successions and political transitions pose the greatest problems to 'continuity of obligations' of a state or a government. It is generally believed that states and governments succeed to the debts of their predecessors.[2] While the veracity of this statement is beyond the scope of this paper, it should however be observed that arguing otherwise would render sovereign lending impossible for want of certainty. The rule has a number of exceptions; and the most significant and complicated of those is the concept of 'odious debt'.[3] First proposed by Aristotle,[4] this rarely invoked doctrine has been debated since the introduction of its modern avatar in the writings of the Russian Jurist Alexander Nahun Sack.[5] Though the legal standing of the doctrine has been subject to severe criticism from numerous quarters, the doctrine's moral foundation has inspired support. Published in the 1920's, Alexander Sack's treatise, The Effects of State Transformations on their

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1 T Hunt, *Toxic Debts, Collapsing Banks And Endemic Fraud... Ring Any Bells?,* The Guardian (11/10/2008), available at http://www.theguardian.com/books/2008/oct/12/charlesdickens, last seen on 9/2/2015.

2 B. Lewis, *Restructuring The Odious Debt Exception*, 25 Boston University International Law Journal 297, 301 (2014).

3 A. Yianni & D. Tinkler, *Is There A Recognized Legal Doctrine Of Odious Debt?*, 32 North Carolina Journal of International Law and Commercial Regulation 749, 751 (2007).

4 Cheng T, *Renegotiating The Odious Debt Doctrine*, 70 Law and Contemporary Problems 7, 12 (2007). ; *Ukraine's Odious Debts*, Hudson Institute, available at http://www.hudson.org/research/10247-ukraine-s-odious-debts, last seen on 18/3/2015.

5 R. Howse, *The Concept Of Odious Debt In Public International Law*, UNCITRAL Discussion Papers, 2, United Nations Conference on Trade & Development (2007).

Public Debts and Other Financial Obligations, offers the first modern discourse on the subject of odious debts.[6] Essentially, odious debts are the debts that do not benefit the state, incurred by a particular regime and hence, should be unenforceable. While the doctrine remained dormant for the major part of the twenty-first century, there has been renewed interest in the subject beginning with the debate over Iraq's possible repudiation of the debts incurred by the Saddam Hussein regime.[7] The recent crisis in Ukraine has also sparked off the debate on the odious debt doctrine.[8]

Part I examines the definitions and the types of odious debts. Part II examines the concept's foundations in Treaties and Customary International law. Part III expounds on why the odious debt doctrine must be recognized in International law. Part IV puts forward suggestions to concretize the odious debts doctrine. Part V examines some of the challenges posed to the doctrine's viability and possible solutions.

2. DEFINING & CLASSIFYING ODIOUS DEBTS

2.1. Definition of Odious Debts

"*If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights against it, etc., this debt is odious for the population of all the State*."[9] The concept of odious debts, despite the lack of sizable state practice, has been a recurrent subject in academic literature. The world's pre-eminent authority on state debts and political transformations, Russian jurist Alexander Nahun Sack propounded the odious debt doctrine in 1927, synthesizing from historical instances of debt repudiation. Sack's definition proposed

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6 Ibid, at 2.

7 A. Allawi, *How To Save Iraq From Civil War*, The New York Times (27/12/2011), available at http://www.nytimes.com/2011/12/28/opinion/how-to-save-iraq-from-civil-war.html?pagewanted=all&_r=0, last seen on 12/2/2015; M. Medish, *Make Baghdad Pay*, The New York Times (4/11/2003), available at http://www.nytimes.com/2003/11/04/opinion/make-baghdad-pay.html, last seen on 12/2/2015.

8 Supra 4.

9 E. Mancina, *Sinners In The Hands Of An Angry God: Resurrecting The Odious Debt Doctrine In International Law*, 36 George Washington International Law Review 1239, 1246 (2004).

three criteria to determine odious debts. *First*, the debt should be incurred hostile to the debtor state's interests; *second*, the creditors should be aware of the fact that their debts had been used to oppress the population of the state; *third*, the debtor state's population must not have consented to the debt.[10] Mohammed Bedjaoui, the Special Rapporteur to the International Law Commission, formalised a definition of 'odious debts' that was to beinvoked from two different perspectives.[11] *First*, from the perspective of the Successor State, an odious debt is a debt contracted by the Predecessor State to attain objectives hostile to the major interests of the Successor state. *Second*, from the viewpoint of the International community, odious debts included all debts contracted for attaining ends contrary to contemporary international law, particularly the principles crystallized in the UN Charter.[12]

2.2. The Three Types of Odious Debt

There is considerable disagreement on the question of types of odious debts. Commonly, odious debts are classified into two categories: war debts, and hostile or subjugation debts.[13] War debts are those debts that have been contracted by governments to defeat an enemy that eventually overthrows the government.[14] Hostile debts are those that have been contracted to the detriment of its own people, for example to

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[10] C. Paulus, *The Evolution of the "Concept Of Odious Debts"*, 68 Heidelberg Journal of International Law 391, 404 (2008).

[11] Yearbook of the International Law Commission, Volume I, Sales E.78.V.1, 66, (1977) available at http://legal.un.org/ilc/publications/yearbooks/Ybkvolumes(e)/ILC_
1977_v1_e.pdf , last seen on 18/3/2015.

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

[13] J. King, *Odious Debt: The Terms Of The Debate*, 32 North Carolina Journal of International Law and Commercial Regulation 605, 629 (2007).

[14] V. Nehru & M. Thomas, *The Concept Of Odious Debt: Some Considerations*, 205, 206 in *Debt Relief and Beyond: Lessons Learned and Challenges Ahead* (Carlos A Primo Braga, 1st ed., 2009).

suppress secessionist movements, for conquests, etc.[15] This Paper also contends that war debts should not constitute a category of odious debts.[16] Scholars such as Sack and P K Menon have argued for an additional category of 'regime debts'.[17] The third category primarily consists of the debts of the developing world incurred against the interests of the population of a State, particularly debts incurred by undemocratic or dictatorial regimes.[18]

3. THE ODIOUS DEBT DOCTRINE IN INTERNATIONAL LAW

It must be appreciated that the odious debt doctrine has never been theorized as a legal norm; but only as an exception to the norm that debts continue upon succession, both of the state and the government.[19]

3.1. Conventions

The only international convention that deals with the subject of debt repayment with respect to 'state' succession is the Vienna Convention on Succession of States in Respect of State Property, Archives and Debts of 1983.[20] It must be noted that the final draft Convention did not contain any provisions defining odious debts. A number of critics have argued that the non-inclusion of Bedjaoui's definition of odious debts in the final draft should be construed as an express rejection of the doctrine's relevance.[21] Such criticism must be deemed to be unsubstantial because the International Law Commission, after having discussed the article defining odious debts, believed that there was no need to specifically provide for a definition article and that the rules for each type of succession would govern the odious debt doctrine.[22] The

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[15] Supra 2, at 301.

[16] Reasons have been dealt with below in Part II (C).

[17] P. Menon, *The Succession of States and the Problem of State Debts*, 6 Boston College Third World Law Journal 111, 117 (1986).

[18] Supra 3, at 761.

[19] A. Khalfan, J. King & B. Thomas, *Advancing The Odious Debt Doctrine*, 21, Centre for International Sustainable Development Law, (2003).

[20] M. Akehurst, *Akehurst's Modern Introduction to International Law*, 172 (Malanczuk P, 1st ed., 2002).

[21] Supra 4, at 24.

[22] Supra 11, at 79.

Convention, however, has remained a highly unsuccessful piece of drafting; and has not entered into force as yet.[23]

3.2. Customary International Law

Traditional Customary International Law under Article 38(1)(b) of the ICJ Charter contains two elements: state practice, and *opinio juris*. State practice, i.e. the actual general practice of the States, is the objective element of international custom; while *opinio juris* is the subjective element, i.e. it establishes whether States behave in a particular manner owing to some binding international law obligation or owing to other reasons such as formalities, convenience, etc. There is no disagreement as to the need for consistent and uniform state practice for an international custom to be established.[24] Despite criticism from some quarters, the traditional psychological requirement of *opinio juris* also continues to be relevant for the purpose of determining international custom. A number of historical instances are pivotal to the study of this doctrine, *particularly* the following.

3.2.1. The Franco-Prussian Peace Treaty (1807)

The Peace Treaties signed at Tilsit in 1807 brought the War of the Fourth Coalition fought between France on the one hand and Prussia and Russia, on the other hand, to an end.[25] Importantly, the Franco-Prussian Peace Treaty[26] excluded the debts that had been contracted during the war from the Successor state's obligations.[27] However, it must be noted that these war debts were not actually treated as a legal exception to the continuing obligations of the Successor state in the early 1800's. It is best evinced by the fact that numerous war treaties that had been entered into in Europe contained no provisions to exclude war debts till the 1860's.[28] Therefore, it cannot be said that these debts were excluded owing to any binding international law obligation.

3.2.1. The Annexation of the Republic of Texas by the United States (1844)

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[23] Supra 20, at 172.

[24] Ibid.

[25] J. Verzijl, W. Heere & J. Offerhaus, *International Law in Historical Perspective*, 331 (3rd ed., 1998).

[26] Ibid.

[27] H. Cahn, *The Responsibility of the Successor State for War Debts*, 44 American Journal of International Law 477, 481 (1950).

[28] Ibid.

The United States and the Republic of Texas entered into a treaty to effectuate the Union of the two states in 1844; and the same provided for the assumption of Texas's debts by the United States.[29] Certain circumstances prevented the US Senate from ratifying the treaty; and the union was effectuated through a joint resolution.[30] As the debts persisted, the United States agreed to transfer a sum of $10,000,000 in consideration of the revocation of all debts that accrued to the United States after the union with Texas.[31] Ultimately, the US Government on a *pro rata* basis settled the debts in 1855.[32] Though this scenario does not deal with the question of 'odious debts' as such, it can be argued that the United States founded its arguments, not in hard law principles, but on equitable principles of what would have been '*right*' and '*just*' in the particular situation.[33] Its contribution to the instant inquiry is the tendency of examining the moral and equitable aspects of debts, and not towards establishing instances of state practice and *opinio juris*.

3.2.2. Mexican Repudiation of Emperor Maximilian's Debts (1867)

Emperor Ferdinand Maximilian Joseph, the archduke of Austria and the Emperor of Mexico,[34] was known to have contracted debts at onerous rates in order to prevent uprisings against his suzerainty over Mexico.[35] Subsequent to his execution and the succession to the monarchy by the liberal Republican Government under President Benito Juarez, Mexico repudiated the loans contracted by him in 1867.[36]

3.2.3. Cession of Cuban Territory to the United States (1898)

The American repudiation of Cuban debts marks the first significant exposition of the odious debt doctrine. Before the Spanish-American War of 1898, the Spanish territory of Cuba contracted a number of loans with the Spanish Government under Spanish laws, secured by

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[29] M. Hoeflich, *Through a Glass Darkly: Reflections upon the History of the International Law of Public Debt in Connection with State Succession*, University of Illinois Law Review 39, 48 (1982).

[30] Ibid, at 49.

[31] Ibid, at 50.

[32] Ibid, at 50.

[33] Ibid, at 51.

[34] Encyclopedia Britannica, Britannica, available at http://www.britannica.com/EBchecked/topic/370459/Maximilian, last accessed on 18/3/2015.

[35] Ibid.

[36] E. Borchard & J. Hotchkiss, *State Insolvency and Foreign Bondholders,* 129 (1st ed., 1951).

Cuban revenues. Victory at the 1898 war gave the United States control over the Cuban territory.[37] When the question of continuity of Cuban debt obligations came up, the Americans argued that Cuba's debts had been imposed against the consent of its people, and aimed at suppressing the uprisings against the Spanish Government. [38] Consequently, the United States invoked the odious debt doctrine to avoid maintenance of the debts, and Spain assumed the Cuban debts instead. It has been argued that Spain's act validated and established an instance of odious debt repudiation. However, it must be noted that Spain accepted responsibility for Cuba's loans out of international pressure, and not out of any legal obligations.[39]

3.2.4. Annexation of the Boer Republics (1900)

Britain annexed the Republics of the Transvaal and the Orange Free State after emerging victorious at the Second Boer War of 1900. [40] Though the Supreme Court of the Transvaal in *Postmaster General v. Taute*[41] ruled that the debts of the South African Republic and the Orange Free State had devolved unto the Successor state i.e. Britain, the latter refused to maintain these debt obligations claiming that they were odious.[42] After denying all legal liability of Britain for these debts, Great Britain only made *ex gratia* payments for these debts.

3.2.5. Soviet repudiation of Tsarist Debts (1918)

While the Russian Revolution and the related events of 1918-19 have been widely studied, the fate of the debts of the Tsarist regime has been little explored. Though the Russian state's identity remained unchanged through the political transition, Soviet Russia unequivocally repudiated all the foreign debts incurred by the Tsarist regime on the ground of their odiousness. Despite its creditors' demands that Russia recognize

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[37] R. Zedalis, *Claims Against Iraqi Oil And Gas: Legal Considerations And Lessons Learned*, 28 (1st ed., 2010).

[38] Ibid.

[39] *Odious Debt: When dictators borrow, who repays the loan*, The Brookings Institution, available at http://www.brookings.edu/research/articles/2003/03/springdevelopment-kremer, last seen on 18/3/2015.

[40] F. Pretorius, *History Of The Boer Wars*, *BBC* (29/3/2011), available at http://www.bb c.co.uk/history/british/victorians/boer_wars_01.shtml, last seen on 12/2/2015.

[41] Postmaster General v. Taute, TSCR 582 (1905, Transvaal Supreme Court).

[42] Supra 28, at 59.

the debts of the previous regime,[43] the Soviet Government stated that Revolutionary Governments had no duty to maintain the contractual obligations of the overthrown governments.[44] However, *opinio juris*, i.e. legal sanction to repudiate odious debts, cannot be inferred from the Soviet Government's acts. In fact, the Soviet delegation to the Genoa Conference (1922) declared that they were willing to denounce their extreme attitude and to settle their debts problem *in accordance with International law.*[45] Therefore, it can be concluded that the Soviet Statesmen repudiated the Tsarist debts knowing fully well that the same had not been permitted by International law.

3.2.6. The Treaty of Versailles (1919)

At the end of the Second World War, it was discovered that the German and Prussian Governments had contracted massive loans for ethnic Germans to purchase the Polish estates.[46] Consequently, Article 255 of the Treaty of Versailles waived these debts off the Polish Government to the extent that they were used in the colonization process.[47] Several authors including Jeff King and O' Connell argue that this is a direct application of the odious debt doctrine.[48]

3.2.7. Treaty of Saint Germain & Treaty of Trianon (1919)

After the First World War, the Treaty of Saint Germain was signed by German Austria and the Treaty of Trianon was signed by Hungary. Both these treaties excluded the Successor states of the Austro-Hungarian Empire from being burdened with the debts incurred by the Empire, post 1914.[49]

3.2.8. The Tinoco Arbitration (1923)

The Royal Bank of Canada had granted loans to the Costa Rica under the rule of its dictator Federico Tinoco. When his Government was

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[43] J. Foorman J & M. Jehle, *Effect Of State And Government Succession On Commercial Bank Loans To Foreign Sovereign Borrowers,* University of Illinois Law Review 9, 19 (1982).

[44] Ibid, at 20.

[45] Ibid.

[46] Supra 19, at 27.

[47] Peace Treaty of Versailles, Brigham Young University Resources, available at http://net.lib.byu.edu/~rdh7/wwi/versa/versa8.html, last seen on 20/3/2015.

[48] Supra 5, at 11.

[49] Supra 27, at 484.

overthrown in 1922, the Costa Rican Constitutional Congress enacted a legislation repudiating the obligations under those debts.[50] The dispute was arbitrated between Great Britain (representing the Royal Bank of Canada) and Costa Rica before a tribunal chaired by William Taft, former Chief Justice of the American Supreme Court. Judge Taft ruled that the public debt had neither been incurred validly not had been in public interest, and dismissed Great Britain's claim.[51]

The subsequent democratically elected Costa Rican government argued that the obligations contracted by the unrecognized government headed by Tinoco. However, the arbitral award clearly notes that Tinoco's government had the consent of the people towards its activities, and cited the report of the Successor government to that effect.[52] The Arbitrator awarded repudiation of debts in Costa Rica's favour only because the creditors had been aware that the funds had been for Tinoco's private purposes.[53] Furthermore, the doctrine of odious debts had not been invoked in the arbitration at all.[54] Hence, the Tinoco arbitration also cannot be used to defend the doctrine of odious debts as part of customary international law.

3.2.9. German Repudiation of Austrian debts (1938)

Upon annexation of Austria, Germany repudiated the former's debts owed to American and British citizens.[55] Germany founded its arguments on the basis that these debts were incurred to prevent the German annexation of Austria; and hence were odious debts that need not be serviced, assuming fully that its annexation was beneficial to Austrian citizens as such.[56] However, this has been considered to be a misapplication of the doctrine, as a substantial amount of the debts had been used to procure food,[57] and not to prevent German annexation of Austria. The doctrine having been invoked wrongly, this instance cannot be said to evince any *opinio juris* in favour of the odious debt doctrine.

3.2.10. Treaty of Peace with Italy (1947)

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[50] Great Britain v. Costa Rica, (1923) 1 RIAA 376 (William H. Taft Arbitral Tribunal).
[51] Ibid, at 399.
[52] Supra 50, at 379.
[53] Supra 9, at1248.
[54] Supra 9, at 1248.
[55] Supra 28, at 63.
[56] Supra 28, at 64.
[57] Supra 43, at 21.

After World War II, the Peace treaty entered into by the Successor states of Mussolini's Italy were excluded from being burdened with the debts that had been incurred for military purposes specifically.[58]

3.2.11. Franco-Italian Commission (1947)

The Franco-Italian Commission, constituted under the Treaty of Peace with Italy after the Second World War in 1947, declared that Ethiopia could not be forced to maintain debts that had been contracted by Italy for the subjugation of Ethiopia itself.[59] It must be noted that these funds were used against the consent of the Ethiopian people; and to their detriment.[60] While the attachment of *opinio juris* in this situation is highly ambiguous, even the Commission's observation does not distinguish between whether the loans had been applied for war purposes or for the subjugation of Ethiopia.[61]

Arguments have been made in favour of the odious debt doctrine constituting international custom, on the basis of the above instances. The *historic novelty* of the twentieth century is demonstrated by the numerous instances of state successions, especially after World War II and the Cold War.[62] This background must not be forgotten while analysing the legal standing of the odious debt doctrine. Surprisingly, the odious debt doctrine has not seen practical application in the last seventy years; despite attempts at and scholarly calls for its application. Without doubt, this phenomenon has been highly detrimental to the cause of establishing the odious debt doctrine as a binding principle of International law. It is important to examine if these instances actually led to the crystallisation of the doctrine as international custom.

Further, the above analysis clearly demonstrates a lack of consistent and uniform state practice regarding odious debts.[63] As explained above, most acts of repudiation of the alleged odious debts were not accompanied by any legal obligation/sanction to do so. For example,

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[58] 61 US Stat. 1245, 76(5) (United States).

[59] Supra 3, at 759.

[60] Supra 3, at 760.

[61] Report of International Arbitral Awards, 13, 639, (1956), http://legal.un.org/riaa/vol_XIII.htm, last seen on 15/3/2015.

[62] E. Hobsbawm, *Some Reflections On The Break-Up Of Britain*, 105 New Left Review 3, (1977), available at http://newleftreview.org/I/105/eric-hobsbawm-some-reflections-on-the-break-up-of-britain, last seen on 18/3/2015.

[63] Supra 59.

later statements of the Revolutionary Soviet Government deemed their repudiation of the debts incurred by the Tsarist regime to not be in accordance with international law. Other instances like Spain's assumption of Cuban debts and Britain's repudiation of the Boer Republics' debts were also not out of a sense of legal obligation/sanction. While instances like Mexico's repudiation of Maximilian's debts indeed possessed *opinio juris*, such practice seems few and far between. Hence, it must be concluded that there is not sufficient and widespread *opinio juris* necessary for the odious debt doctrine to constitute customary international law. Therefore, this Paper concludes that there is no legally binding international custom that entitles Successor states to repudiate odious debts.

3.3. War Debts

The case of war debts is a *red herring* that must be subject to further scrutiny. It is submitted that the practice of the Conquering Sovereign repudiating the war debts of its Predecessor state is justified in International law.[64] Though jurists such as Sack and Menon have argued for recognizing three kinds of odious debts, this Paper contends that the inclusion of war debts will run contradictory to the other criteria defining odious debts. Professor O'Connell argues that there are no *intrinsic* reasons to include war debts within the umbrella of odious debts.[65] Repudiation of war debts is not founded on the doctrine of odiousness of debts; instead, on the rights of a Conquering Sovereign.[66] The practice of repudiation of war debts can be traced to Hugo Grotius who wrote, "*the conqueror may impose whatever terms, and exact whatever fines he pleases*".[67] It is important to note that the subsequent practice of repudiation of war debts developed even before the first instance of repudiation of debts based on the odious debt doctrine. Further, while repudiation of war debts had crystallized into international custom by the end of the Second World War,[68] the odious debt doctrine as such has rarely been invoked in the twentieth century.

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[64] Supra 27, at 487.

[65] Supra 19, at 18.

[66] West Rand Central Gold Mining Co Ltd v. The King, 2 KB 402 (1905, King's Bench Division).

[67] H. Grotius, *The Rights Of War And Peace* (A. Campbell, 1st ed., 1901).

[68] Supra 27, at 487.

4. WHY THE ODIOUS DEBTS DOCTRINE MUST BE RECOGNIZED IN INTERNATIONAL LAW?

The odious debt doctrine is of particular significance for the twenty-first century. The epilogue to the twentieth century marked the formation of numerous nation states by the rupturing of fractured societies.[69] The world has experienced a number of serious political transitions, particularly the democratization of numerous authoritarian regimes.[70] This change has not missed the attention of International lawyers and academics. It is interesting to observe[71] that the most recent edition of Professor Brierly's *locus classicus*, *The Law of Nations*, appreciates the need to reconsider the proposition that obligations ordinarily devolved unto the Successor states.[72] Professor Starke argues that debts incurred for purposes hostile to the Successor state need not be maintained.[73] Professor O'Connell argues that a Successor shall be legally obligated to repay debts only if it has been unjustly enriched by the Predecessor state's loans.[74] The probable advantages that would accrue, if the odious debt doctrine became a legally binding norm, would be immeasurable.

The following are a few potential examples of odious debts. Franjo Tudjman became the President of the then newly proclaimed Croatia in 1990, only to install autocratic governance with a pitiable civil rights record.[75] Western powers pressurized the International Monetary Fund to cut off all lending to Croatia in 1997. Despite this, private creditors lent more than $2 billion to Croatia, which are still being borne by the Croatian state.[76] It has been reported that the Nicaraguan dictator Anastasio Somoza had swindled about $150 million dollars from 1967 till his ouster in 1979.[77] Jean Claude Duvalier, Haiti's former dictator has

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[69] S. Kaplan, *Fixing Fragile States: A New Paradigm for Development*, 36 (1st ed., 2008).

[70] S. Huntington, *The Third Wave: Democratization In The Late Twentieth Century*, 48 (1st ed., 1993).

[71] This observation does not directly concern the odious debt doctrine. *Nevertheless*, it is important to understand the change in the attitudes of International law scholars.

[72] A. Clapham, *Brierly's Law Of Nations*, 165 (7th ed., 2012).

[73] J. Starke, *Introduction To International Law*, 334 (10th ed., 2014).

[74] Supra 28, at 46.

[75] D. Robertson, *Franjo Tudjman: Father Of Croatia*, BBC (11/12/1999), available at http://news.bbc.co.uk/2/hi/europe/294990.stm, last seen on 10/10/2014.

[76] T. Harford, *The Not-So-Sweet Smell Of Odious Debt*, *Financial Times* (9/3/2012), available at http://www.ft.com/intl/cms/s/2/a001772c-67f2-11e1-978e-00144feabdc0.htm, last seen on 10/10/2014.

[77] S. Hermann, *Nicaragua Timeline*, BBC News (9/9/2012), available at http://news.bbc.

allegedly looted more than $900 million of the funds forwarded to Haiti.[78] Saddam Hussein's regime in Iraq contracted loans amounting to more than $130 billion; most of these loans were used for military purposes and to suppress political opponents. Policy experts such Michael Hanlon had deemed these to be odious debts that needed to be repudiated.[79] The Nobel Laureate Joseph Stiglitz argues that requiring nations to maintain obligations under their odious debts would lead to a virtual destruction of those nations that have faced serious civil rights abuse and wars, such as Iraq.[80] Countries like Nicaragua and Congo have sky shattering odious debt to income ratios per person of 563.3% and 274.9% respectively.[81] The following summary[82] of odious debts incurred by a few nations from 1970 to 2004 should highlight the burden borne by these nations.

Country	**Total Odious Debt (In US $ Billion)**	**Total Public Debt still outstanding (In US $ Billion)**
Indonesia	223.5	72.9
Argentina	180.7	103.9
Nigeria	94.8	31.3
Philippines	70.6	35.6

co.uk/2/hi/americas/1225283.stm, last seen on 10/10/2014.

[78] R. Archibald, *Jean-Claude Duvalier Dies At 63,* The New York Times (4/10/2014), available at http://www.nytimes.com/2014/10/05/world/americas/jean-claude-duvalier-haitis-baby-doc-dies-at-63.html?_r=0, last seen on 10/10/2014.

[79] E. Pan, *Q&A: Iraq's Debt*, The New York Times (7/11/2003), available at http://www.nytimes.com/cfr/international/slot3_110703.html?pagewanted=all&position=, last seen on 10/10/2014.

[80] J. Stiglitz, Odious Rulers, Odious Debts, The Atlantic (1/11/2003), available at http://www.theatlantic.com/magazine/archive/2003/11/odious-rulers-odious-debts/302831/, last seen on 10/10/2014.

[81] *Odious Lending: Debt Relief As If Morals Mattered*, The New Economics Foundation, available at http://www.dette2000.org/data/File/Odiouslendingfinal.pdf, last seen on 18/3/2015.

[82] Ibid, at 17.

Pakistan	47.0	31.0
Peru	37.6	23.5
Sudan	17.5	11.7
South Africa	17.4	9.8
Democratic Republic of Congo	17.0	10.5
Nicaragua	10.7	4.1
Ghana	5.9	5.5
Malawi	3.3	2.8
Haiti	1.2	0.9

The doctrine, despite a century-long existence, has still failed to crystallize into international custom. The possible reasons could be that these states have hesitated to invoke the doctrine, fearing adverse effects in the capital markets. To substantiate, most nations with odious debts such as Iraq, Congo, Indonesia are developing, third world nations. Removal of access to credit will seriously stunt their development, only to let millions languish in ignorance and poverty.[83] The Paris Club created in 1956 is an informal group of creditors who meet often in Paris to provide debt treatment to nations seriously ridden with debts. Their schemes often involve debt restructuring or debt reduction.[84] However, debt relief provided under the Paris Club's auspices do not legally accept the odious debt doctrine, and the relief agreements do not provide for repudiation of odious debts. Though the mechanism has worked considerably, the ultimate need of the day is a full-fledged system. Professor Upendra Baxi argues for certain normative expectations of the Third World to become principles of International law through soft law instruments, such as General Assembly resolutions, etc.[85] He puts forward a case for recognizing the need for *global reparative*

[83] Supra 84.

[84] Who are we, Club de Paris.org, available at http://www.clubdeparis.org/sections/composition/membres-permanents-et, last seen on 18/3/2015.

[85] U. Baxi, *What May The 'Third World' Expect From International Law?*, 27 Third World

justice to address past wrongs. The odious debts doctrine would clearly fit under this category.[86] A fine example from history is the movement to force the UN Security Council to declare the odiousness of the debts incurred by the apartheid South African Government; and to prevent any Successor state from being obligated to repay the same.[87] One of the most practical solutions offered to the problem of odious debts is the *ex ante* model proposed by Jayachandran & Kraemer. This Paper accepts the effectiveness of the model; and it is dealt with below.

5. AN EX-ANTE MODEL TO SOLVE THE ODIOUS DEBTS PROBLEM

One of the solutions provided to tackle the problem of the odious debts is the *ex ante* model proposed by Jayachandran & Kraemer. The odious debt doctrine is envisaged as an exception that can be employed by the Successor state to repudiate the debts of its Predecessor. However, the later repudiation of debts can adversely affect the nation's access to funds. Founded in the economic analysis of the law, the *ex ante* model mandates that a regime be recognized by a pre-designated international institution as 'odious', thereby making it imperative on the part of the creditors to exercise *due diligence* before lending.[88] A mere declaration of 'odiousness' will not render all loans contracted odious. The other criteria of the loans being used against the state's interests, and without the consent of the population will still hold good. The pre-designation is only a matter of abundant precaution that acts as a notice to the creditors. Designating 'odiousness' will remove the impediments that creditors could possibly face; consequently, leading to an economically efficient *Coasean* situation. Coase theorem posits that high transaction costs distort efficient allocation of resources.[89] Transaction costs are the costs over and above the contractual consideration.[90] They include the costs of identifying the parties, bringing them together to bargain and

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Quarterly 9, 17 (2006).

[86] Ibid, at 18.

[87] Supra 5, at 14.

[88] M. Kremer & S. Jayachandran, *Odious Debt*, 96 The American Economic Review 82, 91 (2014).

[89] R. Cooter & T. Ulen, *Law And Economics*, 92 (1st ed., 1988).

[90] David M. Driesen & Shubha Ghosh, *The Functions of Transaction Costs: Rethinking Transaction Costs Minimization in a World of Friction*, 47 Arizona Law Review 61, 84 (2005).

enforcing the subsequent agreement.[91] Here, the envisaged pre-designation will lead to Creditors being able to identify creditworthy nations (or governments) to lend to. In turn, this incentivizes governments to take active measures to prevent their regimes from being designated as 'odious', and therefore allow access to credit to many economically weak countries. Consequently, the transaction costs for the creditor i.e. to identify creditworthy states and to enforce the debt contract will become less expensive. Similarly, for countries that have been incentivized to not have 'odious' regimes, the transaction costs of borrowing will become less expensive.

An automatic minimization of odious debts[92] will occur with creditors being made 'better off' with prior knowledge.[93] A number of ancillary advantages may accrue such as the deterrence of potential odious borrowing by dictators[94] and the reduction in interest rates for legitimate borrowing.[95] It must be remembered that even quasi-democratic governments can contract odious debts; consequently, not having designated 'odious' does not indicate the legitimacy of the debts. Their legitimacy can still be dealt with *post facto* by the institution. It must be noted that the *ex ante* model is not entirely free from shortcomings. A number of important questions must be answered. Some of these questions are - what standards that should be used to determine odiousness, who should determine odiousness, whether humanitarian loans ought to be blocked, etc. Comprehensive answers to these questions will be equivalent to designing an International framework to deal with the problem of odious debts, which is beyond the scope of this Paper. Nonetheless, attempts may be made at answering these questions preliminarily. The *ex ante* model necessarily requires an authorized[96] International body that has to wrestle with three important questions: whether a regime is legitimate or odious; regardless of the regime's legitimacy, whether the loans advanced have been utilized for odious purposes; the extent to which the debts can be repudiated.

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[91] James E. Krier & W. David Montgomery, *Resource Allocation, Information Cost, and the Form of Government Intervention*, 13 Natural Resources Journal 89, 91 (1973).

[92] S. Bonilla, *Odious Debt*, 105 (1st ed., 2011).

[93] Supra 88, at 91.

[94] Supra 92, at 105.

[95] Supra 88, at 91.

[96] 'Authorised' to distinguish it from the likes of the Paris Club, the London Club and the HIPC, which are managed by private creditors themselves. See Supra 85, at 22.

This Paper sets forth the following principles to solve the problem of odious debts. It must be noted that these principles are not comprehensive, and are mere guidelines that can be adopted while designing a suitable framework to implement the *ex ante* model.

i. The institution's determination is essentially quasi-judicial, and hence its objective independence is mandatory. Due importance must be attached to the principle of *nemo iudex in causa sua* i.e. no man should be a judge in his own cause.

ii. The institution must be free from the influence of the creditors as well as the debtor states. The task could be entrusted to a permanent International judicial or arbitral institution, and should be designed to not succumb to commercial and political exigencies. Ad hoc mechanisms such as the Paris Club have been heavily laden with the influence of the creditor states.

iii. It must be noted that neither the World Bank nor the IMF can provide for this procedure, solely because of their impartial decision making process.[97] It could possibly function under the auspices of the UN General Assembly.

iv. The Institution should work on the basis of principles agreed at the time of its inception, so as to avoid arbitrariness in individual cases.

v. Either the creditors or the debtors may initiate the procedure.

vi. The procedure must be fair, and premised on the principle that all parties must be heard.

vii. The institution should develop debt inventories mandatorily that distinguish between legitimate and odious debts. Debt servicing should be carried through a third party escrow account.

viii. Provisions must be made for appealing the decisions of the institution.

[97] R. Rajan, *The Future of the IMF and the World Bank*, 98 American Economic Review 110, 111 (2008).

It cannot however be the situation that odious debt working out mechanisms continue to function without a basis in International law. Though not immediately essential, an international treaty could be formulated to establish this mechanism in International law, with consequent rights and obligations.

6. CHALLENGES TO THE ODIOUS DEBTS DOCTRINE: POSSIBLE SOLUTIONS

6.1. State Succession vs. Government Succession

The debate that could actually cripple the application of the odious debt doctrine is the distinction drawn between succession of states and succession of governments. It has been argued by critics that the odious debt doctrine would apply only in case of state successions and to not mere successions of governments.[98] The Iran-United States Claims Tribunal has also espoused the same in its judgments.[99] Instances in history also hint at the verity of such a distinction. The Revolutionary Government in France after the 1789 French Revolution had assumed all the debts incurred by the monarchy.[100]The distinction was a key under pinning of the legal view of the nineteenth and the twentieth centuries. It has been argued by authors such as Professor Detlev Vagts that the principle of distinction could be traced back to Grotius.[101] It is expedient to make certain observations here. *First*, there are two general theories that prevail with respect to state successions – Universal Succession and Clean Slate Theories. Universal succession theory mandates that the Successor state succeed to all the obligations of the Predecessor state;[102] while the Clean slate theory puts forward that obligations shall not be carried on to the Successor state.[103] The former is a product of the Continental lawyers, while the latter evolved from Anglo-American practice in the nineteenth and twentieth centuries.[104]

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98 Supra 19, at 47.

99 *The United States of America v. The Islamic Republic of Iran*, [1996] CTR 175 (Iran-United States Claims Tribunal).

100 Supra 28, at 62.

101 D. Vagts, *State Succession: The Codifiers' View*, 33 Virginia Journal of International Law 275, 282 (1993).

102 Supra 28, at 44.

103 Supra 28, at 60.

104 Supra 28, at 44 & 60.

While the Universal theory has been traced back to the writings of Grotius, Pufendorf and Gentili, it must be remembered that each of these scholars focused his writings on the passing of duties from a Predecessor to a Successor sovereign.[105] This Paper contends that not only that Universal theory of State Succession (vis-à-vis Succession of governments) cannot be attributed to Grotius, the distinction between the two kinds of succession is also a later creation; consequently, the distinction should not be allowed to prevent the application of the odious debt doctrine. Numerous scholarly opinions also rank in favour of this conclusion. For instance, one of the world's foremost scholars on State Succession, Daniel O' Connell observes that the distinction between the two kinds of succession "*wears thin to the point of disappearance*".[106] Further, Professor Oscar Schechter argues that the distinction is no longer sound in law, and hence should change with the needs of the world.[107] His prognosis has only been confirmed by the recent surge in the number of nations facing serious internal political transitions. Professor Starke also argues that fundamental or revolutionary changes in the government should free the Successor government from maintaining the Predecessor government's obligations.[108] Some scholars such as Professor Cheng have completely redefined state succession to mean all changes in fundamental structures of governance that cause international demands regarding commercial obligations.[109] Redefining state succession or evaluating recent postulations is outside the scope of this Paper; nonetheless, the change in scholarly attitude to meet contemporary challenges is of crucial importance. Hence, an arbitrary distinction should not be allowed to prevent the application of the odious debt doctrine to solve the most pressing problem of undemocratic and unconstitutional regimes heaping debts upon a nation's future generations. It must however not be understood that a mere change in Government shall not entitle the Successor government to repudiate the obligations of its Predecessor. This Paper submits that such a change must be so fundamental to the

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105 M. Craven, *The Problem Of State Succession and the Identity of States under International Law,* 9 European Journal of International Law 142, 147 (1998).

106 O. Schachter, *State Succession: The Once and Future Law*,33 Virginia Journal of International Law 253, 254 (1993).

107 Ibid, at 255.

108 Supra 73, at 338.

109 G. Bowman, *Seeing the Forest and the Trees: Reconceptualizing State and Government Succession*, 51 New York Law School Law Review 582 (2006).

political and economic structure of the State.[110] It is implicit that the institution designated for implementing the *ex ante* model shall also hold this understanding of Succession.

6.2. Determining the odiousness of a Debt:

The *ex ante* model does not judge the legitimacy of a debt neither at the time of lending nor at the time of designation of an *odious* regime. The model only creates a presumption of odiousness in dictatorial regimes, which can be discharged before the institution. Similarly, a presumption of legitimacy of debts can be raised in cases of states with democratic regimes, which can also be discharged before the institution. The latter is particularly relevant because of the widespread use of bribes and corrupt practices with respect to the funds obtained for government projects, etc.[111] The legitimacy or odiousness of the debts depends on two factors: consent of the state's population, and benefits to the population. It is recommended that the institution adopt an adversarial procedure to determine absence of consent of the population. A presumption that consent to the debts exists must be made if they were contracted by democratic regimes, and a contrary presumption must be made if they were contracted by dictatorial regimes. In the former situation, the burden of proof will be transferred to the debtor state; in the latter situation, the burden of proof will be transferred to the creditors. Logically sound, this scheme has to be deemed to accord protection to good faith creditors, as these creditors should have had notice of 'odiousness' at the time of lending. Once the presence or absence of consent has been established, determining absence of benefit should be carried out on a case-by-case basis. Some *possible* factors could be: arms & ammunitions purchase to suppress internal minority uprisings; undesirable investment infrastructure projects; unjust enrichment of the regime's key official and their families, etc. Reiterating, these factors are not exhaustive and are merely indicative of absence of benefit.

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110 Supra 73, at 338.

111 Mike Stefanovic, 'Stepping up Prosecution of Transnational Bribery Cases' (*World Bank*, 2011), available at http://live.worldbank.org/stepping-prosecution-transnational-bribery-cases, last seen on 10/10/2014.

7. CONCLUSION

The question of whether the odious debt doctrine is a binding principle in International law must be answered in the negative, as has been demonstrated. It is however imperative to deter odious lending; otherwise *status quo* shall prevail. While the existing state of affairs may not affect a majority of nations, the reality that funds continue to flow into nations with autocratic and oppressive regimes is only deplorable. Notwithstanding the shortcomings of the doctrine today, the doctrine has not been given adequate opportunities for the world to realize its full potential. This Paper has put forward solutions to come to grips with the difficulties that the odious debt doctrine has created. The proposed *ex ante* model is appreciably the most effective mechanism to deal with the problem at hand.