CONTENTS

By
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FOREWORD

Photo: Norwegian Church Aid

As a result of the debate in the international ecumenical movement on the root causes of poverty and injustice, Norwegian Church Aid issued in 1989 the first booklet in Norway addressing the debt crisis of developing countries. Since then, seeking a solution to the debt crisis has been an integral part of Norwegian Church Aid's work for global economic justice.

During the last decade the debt crisis has been addressed by millions of people through the Jubilee 2000 campaign and the Jubilee South platform that together raised 25 million signatures. The success of the campaign is the global recognition of debt as a crucial element in all struggles against poverty and for justice.

The achievements are significant, but the reality is that the poorest countries still pay US$ 59 million every day to rich creditor countries in the North. The current debt-relief mechanisms, the most important one being the HIPC-initiative rooted in the World Bank and International Monetary Fund, are cancelling too little debt - too slowly. They have also been linked to questionable macroeconomic policy conditionalities.

The campaign focus for Jubilee 2000 was the cancellation of unpayable debt. Jubilee South criticised this focus and argued that major part of the debt should not be paid because it was illegitimate for historical and contemporary reasons. Classical examples include debts inherited by democratic governments from dictators and racist governments like the ones in Argentina and South-Africa.

Norwegian Church Aid as a church based organisation recognises that the question of the legitimacy of debt is valid and ethically necessary to address. We also know that the concept is easier said than implemented. We therefore asked Joseph Hanlon, at the Open University in UK, to conduct a study on the understanding of illegitimate debt in order to bring the debate further and eventually the political decisions closer.

The study indeed shows that the concept of illegitimate debt is relevant both in terms of national and international law and historical practices. It further documents that a major part of the present debt burden can be classified as illegitimate according to acceptable, national and international standards, and should therefore be cancelled.

Our hope is that this study will create constructive discussions on the concept of illegitimate debt. Along side this, dialogue with our partners and all other relevant stakeholders will form the foundation for the Norwegian Church Aid's future position on this issue. We also hope that the study will stimulate political action by key decision-makers on the realities of illegitimate debt.

The issue might seem technical and difficult. But the reality is quite simple: those responsible for the debt burden must take the responsibility to cancel it. So far the poor people, who had no influence in the process of taking the loans and who benefited - at the best - marginally from most of the loans, have carried the burden. It is time for the creditors in the North to take their responsibility. If not, democratic nations in the west are legitimising political oppressive regimes and irresponsible creditors. That can not continue.

Atle Sommerfeldt

SUMMARY AND KEYPOINTS

By Joseph Hanlon
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June 2002

Campaign groups in the South have been increasingly calling for the cancellation of "illegitimate debt", and in April 2002 even the International Monetary Fund recognised the issue. However, "illegitimate" has no formal meaning in law. In this paper, we look at national legislation and practice with respect to debt and insolvency and try to extend this thinking to international practice, in combination with the few existing international doctrines such as "odious debt".

We conclude that international lenders have made improper loans, which would not have been acceptable under domestic law, on the assumption that the international community would enforce repayment. We also conclude that lenders must be made liable for their bad lending, both on the grounds that the people of poor countries should not be forced to repay loans which the lenders should never have made, but also on grounds of "moral hazard" – that lenders will only learn to exercise the required caution and prudence if they are penalised for past negligence.

We consider loans to be illegitimate if they are against the law or would be against national law; are unfair, improper or objectionable; or infringe public policy. We propose that "illegitimate" loans should be divided into four categories. We separate the loans themselves and the purposes for which they were granted from the conditions attached to those loans. Thus we consider that the purpose of a loan can be legitimate but that the conditions, for example usurious interest rates, can be illegitimate. Second, we distinguish between loans and conditions which are "unacceptable" and those which are "inappropriate". We consider a loan or condition to be "unacceptable" if it is improper prima facie, that is, at first sight or obviously. In that case, we follow the British legislation on "extortionate" debt, and argue that it is up to the lender to prove that the loan or condition was not illegitimate. We consider a loan or condition to be "inappropriate" if it would be acceptable in some circumstances but not others. We would require the borrower to justify the claim of inappropriateness.

Examples of these categories are given. Odious loans to dictators and apartheid South Africa are examples of **unacceptable loans**. Usury and requirements to violate national law are **unacceptable conditions**. Loans to a poor country for consumption could be argued to be **inappropriate loans** on the grounds that it was imprudent to lend to a country which had no chance of repaying the loan. Conditions imposed by the IMF could be argued to be **inappropriate conditions** if they created an economic environment which made it impossible to repay the loan.

Complications are also considered, including the fungibility of money and the problem that most countries have borrowed repeatedly, using new loans to pay off old loans.

In this paper, we have distinguished "illegitimate debt" from "unpayable debt" and from counter claims. We note that in national insolvency procedures, there is normally a neutral court or other arbitrator who considers all three issues. We argue that such a procedure is necessary internationally, although as with national insolvency issues we expect this arbitrator to only be a court of last resort which sets standards which are then used in finding a negotiated settlement. Having excluded illegitimate debt for which the lender has no right to claim repayment, the arbitrator would then look at counter claims against the creditors. This would surely include the argument that flight capital in northern banks should be attached to pay debts and would include claims

SUMMARY AND KEYPOINTS

for reparations for harm done by odious lending. Only then would the arbitrator look at how much of the remaining debt the developing country could afford to pay.

Just as international campaigning has made the concepts of unpayable debt and an international insolvency procedure part of the discourse on international finance, it is now necessary to define and establish the third side of the triangle, and allow debtors to argue that some debt is illegitimate. This is necessary both to remove the burden of illegitimate debt from poor countries, but also to avoid moral hazard and impose discipline on international-lenders.

INTRODUCTION

"The time has come to invoke the Doctrine of Odious Debt. The debts of developing states which have arisen as a result of bad lending policies by the developed world should be declared odious and written off.»

The Most Rev Njongonkulu Ndungane, Archbishop of Cape Town, speaking in London 24 April 1997.

As the debt crisis grew in the 1980s, voices in the developing countries began to argue that at least some of the debt was illegitimate and should not be repaid. But it was not until the end of the century and the growth of the Jubilee movement that there were strong demands from activists and civil society in the South to cancel or repudiate "illegitimate debt".

Jubilee 2000 declared that "All illegitimate debt, in accordance with the Doctrine of Odious Debt, and debts resulting from failed development projects should be cancelled." [1] Jubilee South goes much further and argues that "debt steals resources from meeting people's most basic needs." It cites high interest rates which mean that new loans are only used to repay old loans, increasing indebtedness. Jubilee South goes on to argue that loans were given to support Apartheid and other dictatorships, that loans fuelled corruption, and that loans for dams and mining projects "resulted in intense environmental and social damage". It argues that the World Bank and International Monetary Fund use indebtedness to impose conditions "designed in the interest of the elites in the North and further impoverish the poor"; and for these reasons, we argue that the purported debt of the South to the North is illegitimate." [2]

The term "illegitimate debt" seems not to have been used in any law or court ruling until an Argentine Federal Judge in 2000 ruled that debt contracted during the period of the military dictatorship (1976-1983) was illegitimate. Patricia Adams, a specialist in "odious debt", noted that "The implications of this ruling extend beyond Argentina and send a clear message to the citizens of all the highly indebted countries that international creditors were responsible for ensuring that the money loaned was used for the interests and needs of the state."[3]

Then in March 2002 a paper was presented to an International Monetary Fund conference which recognised that a "rationale for debt relief is that some debts were illegitimate in the first place"[4] – probably the first time the term had been used by the international financial institutions.

In part 1 of this paper, we will attempt to define and characterise illegitimate debt. In part 2 we will grapple with the difficult concepts of usury, successor loans, fungibility, and capital flight. In part 3 we give a series of national examples of what might be considered illegitimate debt. And in part 4 we will propose a structure for illegitimate debt.

DEFINING ILLEGITIMATE DEBT

part 1

In all legal and social systems, there are certain debts which are not expected to be repaid – either because the debt itself is improper, or because of the hardship that would be caused by repaying the debts. Furthermore, it is always accepted that the lender takes a certain risk that the loan will not be repaid – it is up to the lender to determine if the borrower will be able to repay, and to charge an appropriately higher interest rate (the risk premium) on more doubtful loans. And it is accepted that the lender will not cheat the borrower.

One aspect of the campaign against "illegitimate debt" is the view in the South that lenders no longer shoulder a fair proportion of the liability and responsibility for the loan, and that the Bretton Woods Institutions are enforcing repayment independent of whether or not the loan should be repaid.

There is relatively little case law on international debts, but substantial law and tradition nationally. In what follows in this part, we largely draw on national law, and especially bankruptcy and insolvency, because that legislation defines most clearly what loans are invalid and what limits can be placed on creditors.

What is 'illegitimate'?

"Illegitimate debt" has no existing definition in law, and the term seems almost never to have been used in legislation or court judgements. Furthermore, the word "illegitimate" in law tends only to refer to children. Dictionary definitions of "illegitimate" include "not authorised by law; improper";[5] "not sanctioned by law; illegal"[6], "not legal or fair"[7], "against the law; illegal"[8] and "not legitimate; unlawful"[9]. This is only partly helpful, because the *Oxford Companion to Law* notes that "illegal" is "a very general term for what is contrary to law, with no precise meaning or consequence."[10] But it goes on to note that the term "illegal contract" is "sometimes extended to cover contracts which are objectionable and void as being contrary to public policy." Similarly, *Words and Phrases Legally Defined* points out that "illegal" actually means more than "unlawful" and also means that it "infringes some public policy". Thus a court can determine that "a contract is void or unenforceable for public policy reasons".[11] A loan or debt is a contract, so these definitions apply.

Thus we can conclude that an "illegitimate debt" is one which satisfies one of the following conditions:
1) is against the law or not sanctioned by law,
2) is unfair, improper or objectionable, or
3) infringes some public policy.

Debts which are "null" need not be repaid

Two specific terms have been defined, "extortionate credit bargains" and "odious debt", and a number of specific principals established about debts which cannot be enforced by a court, and which must be excluded in a bankruptcy proceeding.

Extortionate debt

Britain's Consumer Credit Act 1974 says that "a credit bargain is extortionate if it (a) requires the debtor … to make payments … which are grossly exorbitant, or (b) otherwise grossly contravenes ordinary principles of fair dealing."[12] This definition is extremely broad, and the courts have wide powers to cancel the debts or change the terms. Perhaps most remarkably, if a debtor alleges that a credit bargain is extortionate, the burden of proof lies on the creditor to prove that the bargain is *not* extortionate.[13] The court is expected to take into account the borrower's "age, experience, business capacity and state of health", the degree to which the borrower was under

part 1

DEFINING ILLEGITIMATE DEBT

ILLEGITIMATE DEBT

"financial pressure and the nature of that pressure", and "any other relevant consideration". British courts have, for example, ruled that a loan could be considered "extortionate" when the borrower had no choice in their financial circumstances but to accept the terms of the loan, and have also found that failing to assess the credit-worthiness of the potential debtor contravenes ordinary principles of fair dealing.[14] (This issue of usury and interest rates is discussed in Part 2).

Odious debt

The concept of "odious debts" has a long history, arising initially from the United States seizure of Cuba from Spain in 1898. Spain demanded that the US pay Cuba's debts and the US refused, on the grounds that the debt had been "imposed upon the people of Cuba without their consent and by force of arms." Furthermore, the US argued that, in such circumstances, "the creditors, from the beginning, took the chances of the investment. The very pledge of the national credit, while it demonstrates on the one hand the national character of the debt, on the other hand proclaims the notorious risk that attended the debt in its origin, and has attended it ever since".[15] In the century since, the US has never revised its view that Cuban debt was odious and not the liability of the new government.

The name and doctrine of odious debt was formalised 30 years later by Alexander Sack, a former minister in Tsarist Russia who became a law professor in Paris and an expert on the obligations of successor governments. He wrote: "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 to the population of all the state. This debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls with fall of this power."[16]

Sack continues: "The reason these 'odious' debts cannot be considered to encumber the territory of the state, is that … the debts of the state must be incurred and the funds from it employed for the needs and in the interests of the state. 'Odious' debts, incurred and used for ends which, to the knowledge of the creditors, are contrary to the interests of the nation, do not compromise the latter. … The creditors have committed a hostile act with regards to the people; they can't therefore expect that a nation freed from a despotic power assume the 'odious' debts which are the personal debts of that power."

Finally Sack goes on to suggest that "one could also include in this category of debts the loans incurred by members of the government or by

"The future is paying the price. Discarded Ethiopian tanks, outside Asmara, Eritrea, 1991"

Photo: Håkon Lislerud, Norwegian Church Aid.

persons or groups associated with the government to serve interests manifestly personal – interests that are unrelated to the interests of the state."

Sack makes four points which we will apply later:

i) a condition of legality of a loan is that it is "employed for the needs and in the interests of the state";
ii) odious debts fall with the regime and are not owed by successors;
iii) debts can be considered odious if they are used for personal rather than state purposes; and
iv) creditors commit a hostile act when they make an odious loan.

The concept of "odious debt" was further recognised by the British House of Commons International Development Committee in 1998 when it wrote that "the bulk of Rwanda's external debt was incurred by the genocidal regime which preceded the current administration. … Some argue that loans were used by the genocidal regime to purchase weapons and that the current administration and, ultimately, the people of Rwanda, should not have to repay these 'odious' debts. … We further recommend that the [UK] government urge all bilateral creditors, in particular France, to cancel the debt incurred by the previous regime."[17]

Other exclusions

Bankruptcy administrators or trustees are also allowed to look into the background of debts, and are expected to exclude as void debts which involve fraud, undue pressure or victimisation, or usury, or which arise out of an illegal act. In Britain and Australia, gambling debts cannot be enforced.[18]

There has been little in international law in this area, except for a landmark arbitration ruling in 1923 by US Supreme Court Chief Justice Taft. A Costa Rican dictator, Frederico Tinoco, was overthrown and the new government refused to repay loans made by the Royal Bank of Canada to the Tinoco government. Taft ruled: "The payments made by the bank were either in favour of Frederico Tinoco himself 'for expenses of representation of the Chief of State in his approaching trip abroad,' or to his brother as salary and expenses in respect of a diplomatic post to which that latter was appointed by Tinoco. The case of the Royal Bank depends … upon the good faith of the bank in the payment of money for the real use of the Costa Rican government under the Tinoco regime. It must make out its case of actual furnishing of money to the government for its legitimate use. It has not done so. The bank knew that this money was to be used by the retiring president, F Tinoco, for his personal support after he had taken refuge in a foreign country. It could not hold his own government for the money paid to him for this purpose. The position was essentially the same in respect to the payments made to Tinoco's brother. The Royal Bank of Canada cannot be deemed to have proved that the payments were made for legitimate governmental use. Its claim must fail."[19]

Patricia Adams and others[20] have noted the tendency in the second half of the 20th century to give more weight to the need to repay the creditor and less weight to lender negligence. This, however, helped promote loan pushing (see p.11) and undue risk taking. So there is a need to restore proper responsibility to the lenders.

Rights of the debtor

"In order to protect the individual from being thrown on to the streets with nothing to keep him alive, insolvency laws invariably exempt some assets from seizure. … Commonly the law may exempt pensions and salaries from seizure … Tools of the trade are usually exempt so that the bankrupt may continue to earn his living."[21] In the US, most states have a "homestead exemption" in which the family home cannot be seized (unless it is mortgaged). In Britain, "the court must leave the bankrupt with the amount of money necessary to meet the reasonable domestic needs of the bankrupt and his family."[22]

US bankruptcy codes go further than most other countries to protect corporate and municipal debtors. Chapter 11, which applies to companies, leaves the debtor in possession for 120 days and gives the debtor exclusive right to propose a settlement in that time. If the company can continue to operate without loss if it does not pay past debts, then the court will cancel those debts and allow the company to continue to operate. Chapter 9 applies to municipalities, and has strong protections of residents and workers of the municipality: "the court may not … interfere with (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property." Furthermore, any plan requires whatever approval would be normal under "nonbankruptcy law", including electoral approval. Kunibert Raffer and increasingly others have been advocating Chapter 9 as a model for an international insolvency process which could apply to poor countries. Raffer notes that under Chapter 9 "a municipality is not expected to stop providing basic social services essential to the health, safety and welfare of its inhabitants in order to pay its creditors."[23] Raffer also notes that employees and taxpayers have a right to be heard by the court and to object to the confirmation of the plan, and that the court has the right to permit any interested party to intervene.

A moral philosopher's view

A decade ago, a US moral philosopher James Child wrote what remains a unique article "The limits of creditors' rights: the case of Third World debt".[24] He stresses that he starts from "a thorough-going moral commitment to capitalism" and "that the lending of money for interest, as a species of capitalist transactions, is a morally permissible activity." Child first looks at borrowing by individuals, and notes that in US or English contract law, a lender has no right of repayment if the borrower does not have the capacity to borrow — for example, if the borrower is a minor, is insane or is a severe drug addict. The lender needs to show prudence and good faith and not lend to someone who lacks the competence to borrow.

Similarly, Child continues, consider an extreme case where a mother who lacks capacity (say because she is a drug addict) borrows money. "Suppose further that if she is forced to repay the loan, deprivation will be visited not only upon her but upon her minor children. Moreover assume [the lender] could have predicted this but, believing that the loan plus interest will ultimately be collectable, even while imposing severe deprivation, he perseveres in making the loan." Child concludes: "It is safe to say that in an Anglo-American legal system, repayment of such a loan could not be compelled at law or in equity. Further, it is certainly an immoral transaction."

Now suppose a government wants to borrow money for a development project, but that the government "is generally too inept, corrupt, disorganised, etc to bring off projects like this."

In that case, the government is clearly incompetent to borrow.[25] Suppose also that it is unable to repay the debt without imposing privation and suffering on its people. In that case, like the mother in the previous paragraph, it lacks the competence to act as a fiduciary (trustee) for its people. If the lender knew that the government lacked competence in these two ways, then the lender's "knowledge has vitiated any *prima facie* creditor's right," Child argues. And if the lender did not know, it surely should have, and its failure is "contributory negligence" and "surely [the lender's] right to require repayment is compromised."

Child also looks at coercion and at what might be seen as "odious debt", where a dictator who maintains his position by terror borrows money. Child sites the analogy of a kidnapper invading a house and holding the family hostage, and a banker is called in to negotiate a mortgage on the house and give the money to the kidnapper. In "a domestic court in any lawful society" the lender would not only fail to recover the loan and not be allowed to foreclose on the house, but would also "end up in jail for conspiracy to extort and defraud."

Special consideration is given to loans for consumption, which are now common. World Bank balance of payments support and lending for salaries are examples. Borrowing for investment is obviously reasonable because the borrower hopes that the profits of the expanded enterprise will repay the loans. Borrowing for consumption means that to survive today, future consumption has to be reduced to repay the loan. Child argues that a government lacks capacity if it borrows for consumption and can only repay by imposing privation on its citizens. Lenders who lend into this environment are acting in bad faith, and lose the right to collect the loan. The British term "extortionate debt" includes the same concept, because in deciding if a debt is extortionate, the court must take into account the degree to which the borrower was under financial pressure – in other words, if you lend money to a starving man, you cannot expect to collect on the loan.

Child concludes that although a borrower has a duty to repay debts, the creditor must show due diligence to know about the prospective borrower. In the end, "it is not the fault of the people in Third World countries governed by incompetent and corrupt politicians or kleptocratic dictators that the banks behaved in a negligent and heedless way."

Loan pushing

After each economic cycle, there are retrospective complaints of reckless lending and of "loan pushing" – banks and other lending agencies encouraging foreign governments to take loans they do not need and encouraging borrowers to live beyond their means. When they cannot repay, they are encouraged to take out new loans to repay the old ones. Frances White, the US Assistant Secretary of State for Latin America, commented that "in the carnival days from 1922 to 1929, when money was easy, many American bankers forsook the dignified, aloof attitude traditional of bankers and became, in reality, high pressure salesmen of money, carrying on a cut-throat competition against their fellow bankers, and once they obtained the business, endeavoured to urge larger loans on the borrowing countries."[26]

In 1973, quite early in the lending boom that led to the current debt crisis, the US Federal Reserve Governor Andrew Brimmer noted that "the main explanation" for the sharp rise in lending to less developed countries was the "failure in demand for loans from borrowers in developed countries to keep pace with the expansion of credit availability." This caused "the Eurocurrency banks (especially in

London) …to push loans to the developing countries with considerable vigour." Brimmer cited a form of loan pushing that involved a drastic softening of terms.[27] And in the mid-1970s, loans actually had a negative real interest rate (see p. 20) but a variable interest rate, so that once borrowers were trapped, the interest rates were increased substantially.

In a prescient book in 1973, economist Paul Einzig[28] looked at the boom in variable interest rate "roll-over credits". He argued that banks were having trouble using the rapidly increasing volumes of money they had available. Combined with the "spectacular increase in the number of banks", this led to "fierce competition between banks" and an "incentive for banks to acquire new clients at almost any cost." Banks "went out of their way to take the initiative to find eligible borrowers" and "many of them departed from well-established traditions of prudent banking" and lent to borrowers with lower credit ratings. This "spectacular expansion" in medium term lending, Einzig wrote, "recalls the lending boom of the late twenties, when in large or even medium-sized German towns it was almost impossible for visitors to find accommodation in first-class hotels because they were full of representatives of foreign banks anxious to persuade municipal authorities … to borrow through their respective banks." Municipalities and public utilities borrowed more than they needed. "The end of the story was general default."

"It is hoped that this history will not repeat itself in respect to the roll-over credit boom," Einzig noted in 1973, warning that "sooner or later, major defaults are likely to occur." As Brimmer and Einzig warned, borrowers could not pay and there was a debt crisis – only the power of the Bretton Woods Institutions and their link to international aid prevented governments from defaulting.

In the 1970s, it was the banks who were loan pushing, as they tried to recycle the "petrodollars". In the 1980s and 1990s, the international financial institutions were pushing new loans to repay old loans. And in the 1990s, it was the World Bank which was loan pushing, as success was measured only on the amount of money lent, and task managers found they were more likely to be promoted if they lent more money.

Loan pushing increases the argument for illegitimacy, because the lenders were increasingly reckless and encouraging inappropriate borrowing. It crosses the line from poor business judgement to negligence.

Attempts to characterise "illegitimate debt"

There have been three serious attempts to define "illegitimate debt".

Tegucigalpa Declaration

Latin American and Caribbean Jubilee 2000 in the Tegucigalpa Declaration[29] agreed on 27 January 1999 argued that foreign "debt is illegitimate because, in large measure, it was contracted by dictatorships, governments not elected by the people, as well as by governments which were formally democratic, but corrupt. Most of the money was not used to benefit the people who are now being required to pay it back.

"The debt is also illegitimate because it swelled as a result of interest rates and negotiating conditions imposed by creditor governments and banks, who persistently and outrageously denied debtor countries the right of association, while the creditor groups joined together in veritable creditor syndicates (Club of Paris, Management Committee), backed by the economic coercion of the International Monetary

Fund and the World Bank. Their strategy was clear: you negotiate on your own; we negotiate as a bloc.

"In addition, it is immoral to pay the debt, because in order to do so, the governments of our countries would have to allocate an extremely high percentage of public spending, which mainly affects the delivery of social programs and the wages of working men and women, generates unemployment and seriously hurts the economy."

Canadian Ecumenical Jubilee Initiative

The Canadian Ecumenical Jubilee Initiative, at a policy forum 15-16 November 2000 in Toronto,[30] proposed the following four-part definition of illegitimate debt:

Debts which are illegitimate to repay:
debts which cannot be serviced without causing harm to people and communities (e.g. when the state fails to meet the basic needs of people, causing a violation of their fundamental human rights)

Debt incurred by illegitimate debtors and creditors acting illegitimately:
i) odious debt or debt incurred not for the needs or interests of the state but to strengthen a despotic regime and repress the population that fights against it;
ii) loans which were stolen through corruption.

Debts incurred for illegitimate uses:
i) debts for projects which did not happen or did not benefit the people as they were intended;
ii) debt for projects that were destructive to the community or its environment;
iii) debt contracted for fraudulent purposes.

Debts incurred through illegitimate terms:
i) debt incurred with usurious interest rates;
ii) debts that became unpayable as a result of external factors over which debtors had no control (e.g. after Northern countries unilaterally raised interest rates, or following dramatic falls in commodity prices);
iii) private loans converted to public debt under duress, in order to bail out lenders.

AFRODAD

AFRODAD, the African Forum and Network on Debt and Development, based in Zimbabwe, issued a policy brief at the beginning of this year.[31] The brief says illegitimate debts "include the following:

i) debts that cannot be serviced without causing harm to people and communities. It is a violation of human rights to repay debt at the expense of meeting human development needs;
ii) debts incurred by illegitimate debtors and creditors acting illegitimately which includes odious debts and loans stolen through corruption;
iii) debts incurred from illegitimate uses such as projects that did not benefit the people as were intended;
iv) debt incurred through wrong policy advice or a result of external factors over which debtors have no control;
v) debt in which the money was actually stolen and banked in the North.

Later in the same paper, AFRODAD gives a slightly different list:

i) debts contracted by dictatorships or repressive regimes, and used to strengthen the hold of these regimes;
ii) debts contracted by corrupt governments, which were stolen by leaders and senior public officials;

part 1

DEFINING ILLEGITIMATE DEBT

iii) debts used for improperly designed projects and programs;
iv) debts that swelled because of high interest rates and other conditions imposed by creditor governments and banks;
v) debts which cannot be serviced without impoverishing a country's people.

Finally, AFRODAD mentions, cautiously, that "all debts owed by the South to the North can be considered illegitimate, as Jubilee South maintains that the countries of the South are in fact creditors of an historical, social and ecological debt which Northern countries refuse to recognize."

Some preliminary conclusions and proposals

In the last section of this part, we test the Tegucigalpa, Canadian and AFRODAD characterisations against the legal and moral definitions presented above, look at outstanding questions, and put forward our initial suggestions, to be refined in the rest of this paper. Our discussion is based on a division which is explicit in law but only implicit in Child, Tegucigalpa, AFRODAD and the Canadian initiative – that national law always distinguishes and treats differently the liability of the creditor for odious or extortionate loans and protection of a debtor who cannot pay. This distinction is important. The first question is about creditor liability and debts which are null or where the creditor has no right to claim repayment. The second question is about not imposing hardship on the debtor, and on ruling that all or part of loans granted in good faith need not be repaid. Both involve creditor risk and responsibility, but the fundamental basis for decision is very different. And in a bankruptcy or insolvency process, the court or the administrator is expected to first exclude those debts which should not be repaid, and then decide what proportion of the remaining debts can be repaid. In what follows, this distinction between "should not" and "cannot"[32] will be maintained, and we will concentrate on "should not".

"Members of the Jubilee South delegation in a demonstration during the World Social Forum in Porto Alegre, 2002."

Photo: Kjetil G. Abildsnes

Can't pay: debtor rights and inability to pay

Tegucigalpa, Canada and AFRODAD all say that debts are illegitimate if they cannot be serviced without impoverishing a country's people. This is obvious and we accept this point totally. This is confirmed in all national bankruptcy and insolvency laws, which require that people retain an income sufficient to maintain a reasonable standard of living as well as the tools of their trade and, often, a house.

This part of illegitimate debt was the original target of the Jubilee 2000 movement, which called for the cancellation of "unpayable debt", and it has been the subject of most discussion. We have dealt with this subject in extensive detail in another paper.[33] That paper uses a rights-based approach built on the Universal Declaration of Human Rights which in articles 25 and 26 states that "Everyone has the right to a standard of living adequate for the health and well being of himself and his family, including food, clothing, housing and medical care and necessary social services. Everyone has the right to education. Education shall be free, at least in the elementary and fundamental stages. Elementary education shall be compulsory." The targets adopted in 1996 by the OECD Development Assistance Committee[34] are often seen as appropriate to reaching these human rights goals. These include universal primary education by 2015, a reduction by two-thirds of infant and child mortality by 2015, and a reduction by one-half of the proportion of people living in "extreme poverty" by 2015.[35]

A rights-based approach requires that $600 billion of debt be cancelled, according to our study. The paper also looks at recent historic precedents of debt cancellation (Peru, Germany, Indonesia) which took into account how much money the countries needed to spend before paying debt service. Following these precedents would mean that at least $1 trillion in debt would be cancelled.

Shouldn't pay: creditor responsibility and culpability

In many ways, the issue of creditor liability and misconduct is much more contentious, and is at the heart of what is considered "illegitimate debt".

The Tegucigalpa declaration argues that "most of the money was not used to benefit the people who are now being required to pay it back." If lenders can be held responsible for this, then the original loan can be considered "illegitimate".

The Canadian definition talks of "illegitimate debtors". Child argues that the lender must assess the capacity and competence of the borrower, and cannot participate in criminal activities of the borrower. British law requires the court to consider the capacity of the borrower. Thus it seems clear that certain loans must be considered uncollectable because the borrower had no right or competence to enter into the loan contract. The Tegucigalpa, Canadian and AFRODAD characterisations of illegitimate debt all refer to dictators and corrupt borrowers; Canada and AFRODAD specifically cite odious debts. AFRODAD specifically cites "debt in which money was actually stolen and banked in the north", raising the issue of complicity with capital flight, which we deal with in more detail in the next section.

Both the Canadian and AFRODAD characterisations cite projects "that did not benefit the people as they were intended" to do. Canada cites environmentally damaging projects and AFRODAD cites improperly designed projects. Clearly the lender has some responsibility for project loans, and in most cases the lender is connected with the project design – directly in the case of World Bank loans – and therefore must accept responsibility for badly designed projects.

In this context, the United Nations Institute for Training and Research *Debt and Financial Management (Legal Aspects) Training Package*[36] has some useful views: “Developing countries rely on external expertise because they lack the technical know-how and assistance to plan infrastructure policies and to implement projects. Consequently, developing countries should not bear the burden of … bad planning and bad implementation performed by external sources. … comparative law studies indicate that modern civil and commercial law has broadened contractual obligations in complex business transactions beyond the strict delivery of goods … to include dissemination of professional information, exchange of motivated opinions, discovery of special risks, and instructions and consultations, especially if one party is less knowledgeable than the other and therefore must trust the other’s superior skills. Neglecting these accessory obligations may be considered a breach of contract … and should be all the more applicable if the lender is an official donor with the statutory obligation to finance and assist in the execution of development projects.”

AFRODAD also cites “debts incurred through wrong policy advice”, and this is clearly a key issue since much of World Bank and IMF lending in recent years has been policy-linked, and dependent on the acceptance of neo-liberal, free market and structural adjustment policies. These institutions have never been held liable for bad policy advice, but the economic collapse in Argentina has clearly put this on the agenda.

In terms of the conditions of the loans, the Tegucigalpa, Canadian and AFRODAD characterisations of illegitimate debt all refer to high interest rates, and there is no question that in national laws, usury voids a loan. We discuss this in more detail in Part 2.

All of the preceding issues seem arguably to lead to “illegitimate debts.” However all three groups put forward candidates for illegitimate debt which are less obvious, and need further discussion.

The Tegucigalpa Declaration complains of “negotiating conditions imposed by creditor governments and banks” under which creditors negotiated in blocs but debtors were required to negotiate individually. Since these negotiations are always over rescheduling of loans, they cannot be used to argue that the original loans were illegitimate. We can see three ways in which illegitimacy might enter, however. First, we have already shown that in all national laws demands for repayment are considered illegitimate if they force the debtor into poverty, so these rescheduled loans would need to be treated with all other debts when considering what is unpayable. Second, debt rescheduling that involves additional policy conditions might be considered unacceptable, as is the case now where HIPC debt cancellation requires the adoption of a Poverty Reduction Strategy Paper largely mandated by the Bretton Woods Institutions. The addition of new conditions not in the original loan agreement could make the loan illegitimate. Third is where a new loan must be taken out to pay off an old loan, which is discussed in more detail in Part 2. For the second and third areas, the issue of “coercion” raised by Child is important. British law says that “financial pressure” must be taken into account when a court decides if a person has agreed to an "extortionate" credit contract. Thus the creditor has less right to demand repayment if it has used the financial crisis of the debtor to impose unacceptable conditions or unacceptable new borrowing.

The Canadian Ecumenical Jubilee Initiative introduces two new causes of illegitimacy. One is "debts that became unpayable as the result of external factors over which the debtors had no control" such as unilaterally raised interest rates or dramatic falls in commodity prices. We discuss this more in Part 2 under usury, but note that this should be governed by a discussion of unpayability rather than by illegitimacy of the terms of the debt itself. The second issue is "private loans converted to public debt under duress, in order to bail out lenders". We have already mentioned this in connection with the Tegucigalpa Declaration, and in Part 2 we set out an argument as to when successor loans ought to be treated as illegitimate.

Finally AFRODAD mentions "Debts incurred [as] a result of external factors over which debtors had no control." We take this to mean in particular "apartheid-caused debt", which is built up of the loans the neighbours of the then apartheid-ruled South Africa took out in the 1980s to defend against the attacks and sanctions of the apartheid state. We noted above (see p. 7) that "illegitimate" can mean "illegal" and that in *Words and Phrases Legally Defined* "illegal" means more than "unlawful" and also means that it "infringes some public policy". In all of the nations that lent to South Africa's neighbours, apartheid was accepted as a crime against humanity and it was public policy to help the neighbouring states. They were forced to borrow because of the depredations of the apartheid state, and loans were granted out of solidarity. With the benefit of hindsight, it is clear that the loans could not be repaid and the money should have been grants. Asking people to pay such loans now goes against the original public policy goal of defending these countries against apartheid, so it can surely be argued that these debts are illegitimate, if only with the benefit of hindsight.

Setting off other debts

AFRODAD cites the Jubilee South view that "countries of the South are in fact creditors of an historical, social and ecological debt" and thus loans from the north are illegitimate. All insolvency and bankruptcy laws call for a procedure to set off money owed *to* the debtor against money owned *by* the debtor. Indeed, in the United States chapters 9 and 11 can be used by a company or municipality which is owed more than it owes to force a repayment standstill until it receives money owed which can then be used to pay debts. Clearly, it is reasonable for Jubilee South to ask that debts owed by the north be set off against debts owed *to* the north.

But asking for such an offset is very different from claiming that the loans granted by the north were illegitimate. Of course, it can be argued that if the north had paid its debts, the south would not have been forced to borrow. Nevertheless, we are moved to make the somewhat pedantic point the offsettable debts are not necessarily illegitimate.

While supporting the argument that debts must be offset, we reject the argument that this makes loans illegitimate, and we exclude this from our definition of illegitimacy.

part 1

DEFINING ILLEGITIMATE DEBT

Initial proposals

We argue that where a debtor cannot pay, it is "illegitimate" to demand repayment. This is clear in all national laws and was the subject of the Jubilee 2000 campaign to cancel "unpayable debt". Defining what levels of debt are "unpayable" is not the subject of this exercise. But whatever criteria are used, they must include human rights and the 2015 targets. We take this as already debated and agreed, and do not consider it further here.

Turning the spotlight on the creditor rather than the debtor is important for two reasons. First, although for many poorer countries this will make no difference because all of their debt is unpayable, for many middle income countries the cancellation of illegitimate debt may be larger than simply cancelling unpayable debt. But probably more important is to discipline lenders, who have come to assume that they will be repaid no matter how outrageous and improper a loan is. The IMF in its *World Economic Outlook 1998* noted that "Moral hazard exists when the provision of insurance against a risk encourages behaviour that makes the risk more likely to occur. In the case of IMF lending, the concern about moral hazard stems from perceptions that the availability of financial assistance may weaken policy disclipline, encourage international investors to take on greater risks in the belief that they will only partially suffer the consequences, or both." In other words, if lenders, including the IMF itself, can lend to the most corrupt and brutal dictator and be sure of getting their money back, that is moral hazard. This can only be prevented if lenders are penalised for past illegitimate loans. Prevention of a future debt crisis requires a change in debtor-creditor relations so that lenders can no longer make risk-free loans.

The IMF actually considered this issue for the first time when two Harvard economists presented a paper to an IMF conference in March 2002.[37] Michael Kremer and Seema Jayachandran stress the moral hazard argument, noting that "preventing illegitimate regimes from borrowing to enrich their leaders is a self-enforcing sanction, since banks would have little incentive to lend to an odious regime if the successor regimes could refuse to repay without hurting their reputation. … In fact, this sanction works precisely by eliminating the existing incentive of creditors to collude with dictators." They go on to cite the other "moral hazard argument [under which] the expectation of World Bank or IMF bailouts leads commercial banks and bondholders to make loans that governments could not reasonably repay on their own."

In terms of creditor liability and responsibility, we propose to make two distinctions — between the real purpose of the loan and the conditions attached to it, and between "unacceptable" and "inappropriate" loans and conditions. We will argue that a loan or condition is "unacceptable" if it is manifestly, or *prima facie*, null and should not be repaid because the original loans violated lending rules in national laws, involved obvious misconduct by the lender, or in the words of the British Consumer Credit Act "grossly contravenes ordinary principles of fair dealing". This would include odious debt and usurious interest rates.

We propose to use the word "inappropriate" for loans or conditions which might be acceptable in other circumstances but which are not acceptable for the borrower in question. The lender failed to apply prudence and due diligence, and gave a loan which was inappropriate for the circumstances. Policy lending clearly comes into this category.

Unacceptable loans and conditions would be less subject to debate, but claims of inappropriateness would surely be contested. We would argue that we should follow the procedures around "extortionate debt" in British law – that the debtor can claim a debt is extortionate and it is for the creditor to prove it is not. Similarly, we would allow the debtor to claim a debt or condition was unacceptable, and the onus would be on the lender to justify the loan. The debtor, however, would have to justify a claim of inappropriateness.

National bankruptcy laws always have a court, sitting as a neutral and independent body, to adjudicate claims as to how much should be paid and what debts should be excluded. The claims and justifications on an alleged extortionate debt are debated before a judge. It is frequently noted that no such body exists for international debt, and that the IMF cannot play this role because it is a creditor. In general, the Jubilee movement has been calling for some sort of independent arbitration system. Within our definitions, such a mechanism would be needed to decide on issues of acceptability and appropriateness. (As in insolvency proceedings, an arbitrator could also decide on levels of unpayability and on possible offsetting debts.)

In this context, then, we suggest four categories of debt, which would be illegitimate because of actions by the lender:

i) **Unacceptable loans**. This would include loans which were odious, were given to known corrupt officials, and were for obviously bad projects.
ii) **Unacceptable conditions**. This would include usurious interest rates and policy demands which violate national laws.
iii) **Inappropriate loans**. This would include consumption loans and loans given where grants would have been more correct.
iv) **Inappropriate conditions**. This would include policy lending linked to unsuitable policies.

part
2

MORE FRAUGHT ISSUES

In Part 1, we have tried to use national law and practice as well as widely acceptable moral arguments to show how some categories of debt can be considered “illegitimate”. In this part, we grapple with four difficult concepts where national law and moral philosophy provides less obvious guidance – usury, successor loans, fungibility, and capital flight.

Usury

Usury, or the lending of money at exorbitant interest rates, has been opposed for millennia. The word itself in English dates back at least to the early 14th century, and laws to control interest rates were passed as early as the 15th century in England and Scotland. Most countries consider loans at usurious interest rates to be illegal and thus illegitimate. But there are wide variations in rulings as to what interest rates are acceptable. In Britain and elsewhere, variable or floating interest rates have been ruled to be acceptable.[38] We look more closely at interest rates below, but we also look at two other issues which relate directly to international lending.

Interest rates

A central factor in the present loan crisis was the huge increase in real interest rates at the end of the 1970s. In the mid-1970s, international loans had a *negative* real interest rate – that is, interest rates were less than inflation and so a borrower actually had to repay less than they borrowed. But this is like a drug pusher offered free heroin in order to create addiction. The interest rates were variable, and they were pushed up to 12% in the early 1980s.[39]

Between 1980 and 1984, interest payments by the low and middle-income countries nearly doubled, and by 1984 there was a net transfer of $10 billion per year toward the north. The table below shows the impact of the interest rate increase. Argentina is one of the more extreme cases. All of its debt was at variable interest rates, and its interest payments jumped from $1.3 bn in 1980 to $3.3 bn in 1984 and $4.4 bn in1985. That was a jump from 12% of export earnings to 43% of export earnings. Is 43% of income a usurious interest rate?

Table 2.1
Impact of higher interest rates, $mn

US$ million	**Middle income countries**		**Low income countries**	
	1980	**1984**	**1980**	**1984**
New borrowing	84,645	67,155	20,613	24,049
less	27,817	45,507	4,324	7,325
Interest payments	37,393	37,831	5,493	9,949
Principal repayments				
Net transfer on debt	19,435	-16,183	10,796	6,775

Source: World Bank, World Debt Tables 1991-92.

Argentina's interest rates jumped from 6-8% in 1979 to as much as 22% in the mid-1980s. When a debt suffers such an interest rate, it doubles itself in less than four years. Alfredo Calcagno and Eric Calcagno calculated that if Argentina had been consistently paying an interest rate of 1-2% above the inflation in the USA, Argentina would have paid off its debt by 1988.[40]

Currency

International loans are denominated in hard currency, typically US dollars, British pounds or German marks. Most poor countries devalue, which makes the loans much more expensive in real terms. Consider Mozambique. Between 1986 and 1990, its debt in dollars increased from $3.3 bn to $4.7 bn, but its debt in meticais increased from Mt 132 bn to Mt 4465 bn. Officially most of the loans were concessional, and the dollar interest rate was only 2%. But the metical interest rate was 123%. This is a story repeated across the world. Indeed, just as rising interest rates were causing problems for borrowers, the international financial institutions pressed poor countries to devalue. The effect was debts escalating out of control.

In an insolvency proceeding, repayment of foreign currency debts can be claimed, however "it would appear to be a near universal rule that foreign currency debts owing by the insolvent … are converted into local currency on the relevant insolvency date. … The effect therefore is that if the local currency is depreciating, the [amount being claimed] is reduced. … This has been a serious problem in countries with runaway inflation."[41]

Since there is no "insolvency date" for a country, the choice of date would be more arbitrary. But this does suggest, at the very least, that it is illegitimate to continue to value debts in hard currency – to keep the debts in hard currency can be considered a form of usury.

Commodity prices and terms of trade

Countries pay their foreign debts from export earnings (and remittances). Since the debt crisis, most commodity prices have fallen and terms of trade have deteriorated badly. By the end of 2001, non-energy commodity prices averaged 44% of their 1980 value and 76% of their 1990 value. In other words, the value of the commodities that countries use to pay has been falling at nearly 4% per year for more than two decades[42]. This needs to be added to any interest rates.

Table 2.2
Imputed interest rates for exports of four agricultural commodities

	Price per tonne, $			Tonnes to pay $1 mn			Annual "interest"	
	1980	1990	2000	1980	1990	2000	1980-1990	1990-2000
Cocoa	2604	1267	906	384	789	1104	7.5%	3.4%
Coffee	3243	1182	913	308	846	1095	10.6%	2.6%
Sugar	632	277	180	1582	3610	5556	8.6%	4.4%
Cotton	2062	1819	1302	485	550	768	1.3%	3.4%

Source of average prices: World Bank.
Annual "interest" = %age increase in commodity volume to keep same payment levels.

What this means is that Ghana, whose main export is cocoa, which was officially paying an interest rate of only 3% in the 1980s, was actually paying over 10% because of the falling price of cocoa. Suddenly World Bank "concessional" interest rates do not look so good. Similarly Rwanda's debt was almost entirely from multilateral creditors and its official interest rate in the 1980s was only 1.5%, but in terms of coffee exports, it was paying 12%. (Ghana and Rwanda had little variable rate debt, so they were not affected by interest rate fluctuations.)

Successor loans and loan laundering

"The South Korean government reached agreement January 28 with a group of 13 leading international banks to extend the maturities on roughly $24 billion in short-term loans to local banks. Under the plan, announced in New York City, banks can exchange debt due in 1998 for loans maturing in one to three years. In a major victory for lenders, Seoul will guarantee the new loans. However, it was able to win acceptance of below-market interest rates for the new debt, which will be publicly traded. … The pact is especially important for Japanese banks, South Korea's largest creditors," wrote the *Japan Economic Institute Report* on 6 February 1998 in an article headlined "South Korean Debt Rollover Boon to Japanese Banks".[43]

United States "Secretary of the Treasury Robert Rubin had put pressure on both Seoul and international banks by not releasing any of the money the United States had promised to South Korea as part of the International Monetary Fund-led rescue package until the loan rescheduling talks were completed. This pressure may have been an important factor in forcing the group of international banks to accept much lower interest rates for the government-guaranteed debt than they were demanding when the negotiations began in early January. The Seoul-backed loans will bear a floating interest rate of either 2.25, 2.5 or 2.75 percentage points over the six-month London Interbank Offered Rate," *JEI Report* said, compared to the 4% over LIBOR that the banks had been demanding.

We have quoted this report at length because it illustrates a number of key points:

i) Bad loans on which Korean banks might have defaulted were replaced by new bonds which can be publicly traded and sold by the original Japanese, German and US banks. Thus the banks which made the original bad loans will not retain the bonds issued to replace those loans.
ii) A bad private debt is being replaced by a new government-guaranteed debt.
iii) The deal was made under heavy pressure from the IMF and the US Treasury.

It is hardly surprising that the banks considered the deal a "boon" – converting a bad debt into government guaranteed bonds at 2.5% over LIBOR is a good deal.

The Brady plan at the end of the 1980s started the trend to replace loans given to during the loan-pushing era of the 1970s with new bonds guaranteed by governments. Thus during the 1990s most developing country loans were refinanced in one way or another, with the original loans being paid off or replaced by new loans or bonds.

Who is responsible?

In this paper, we have argued strongly that lenders must be held liable for their negligence and misconduct. But international policy in the 1980s and 1990s was just the opposite – that lenders should be bailed out and not be held responsible. In part, this was due to a genuine fear in the early 1980s that banks had made so many bad and corrupt loans that the banking system would collapse if they were held liable. Thus, whereas loan-pushing in the 1920s led to default in the 1930s, loan-pushing in the 1970s simply led to new lending. Just as we talk of money laundering, perhaps we should also talk of “loan laundering”, whereby corrupt, negligent or foolish loans were washed and converted into new good loans.

But this presents a serious problem for any attempt to declare loans illegitimate and force the corrupt lenders to take the hit, because the thief has fled. Indeed, the whole method of using bonds to replace loans seemed intended to ensure that the new bondholders are not the original lenders of the illegitimate loans. Are these successor loans illegitimate? This issue seems not to arise in national laws.

We feel here that two cases must be treated differently. Where a loan is simply rolled over or the same institution simply grants another loan to pay back the first, as is done by the World Bank and IMF, or was done with Korean debt which was “exchanged” for new bonds, then it must be clear that any original illegitimacy carries forward. If the lender was guilty of misconduct in the first instance, then its responsibility continues.

But part of the purpose of making the Brady and Korea bonds publicly tradable is to prevent this taking place. There are two approaches to this. First, we should argue that such bonds were issued with the sole purpose of repaying an illegitimate debt, and that the buyers of such bonds should have known of the risk that they would be declared illegitimate and that they accepted the risk. In other words, the illegitimacy carries forward – even if the original loan has been formally paid off, its successor loan or bond is, in practice, the same illegitimate loan. And a bank that sell a bond for an illegitimate debt has the same responsibility as a dealer which knowingly sells a stolen car.

The second approach is the one being followed by organisations in South Africa in their campaign against Swiss banks. They argue that the Swiss banks profited from the odious loans, just as they had profited from other odious transactions during the Second World War, and that the banks must compensate the victims of those odious loans. Sack argued that odious loans were a “hostile act with regard to the people”, while Child characterised it as being an accessory to a crime. As with our argument above on “Setting off other debts”, the claim seems legitimate and reasonable, and should be raised in any discussion of offsets against payments owned – but we also should exclude this from any discussion of illegitimate debts which should be cancelled.

That leads us to the following definitions of what we will call an “illegitimate successor loan”:

i) If an institution replaces, rolls over or pays off an illegitimate debt with a new loan, then the new loan is an illegitimate successor loan.
ii) If a bond or new loan is issued for the sole or main purpose of paying off an illegitimate debt, then this is an illegitimate successor loan and the creditor has taken the risk.
iii) A government guarantee of an illegitimate successor loan does not make the loan any less illegitimate. Furthermore, it strengthens the illegitimacy if international financial pressure has forced the government to accept responsibility for a private debt.

Fungibility

Something is "fungible" if it is interchangeable or can be substituted.[44] Electricity and gas are fungible, and this is being used in Britain to create multiple suppliers. You pay a company that puts electricity or gas into the system, but you have no idea who supplied the electricity or gas you actually use, because in the pipe or wire it is all the same. In recent years the word has been used increasingly to apply to money, and in particular to aid or loan funds for poor countries. Aid or a loan can be supplied for a specific beneficial purpose – rural credit or an electricity supply line for poor people – but the aid or loan releases funds which the government would have used for the rural credit or the electricity line. Those funds can be used for another purpose – to buy arms or put in a foreign bank account.

The Sack discussion of odious debt does not consider fungibility. He wrote that odious debts are ones which are "incurred and used for ends which, to the knowledge of the creditors, are contrary to the interests of the nation". But when the apartheid state in South Africa became desperately short of foreign exchange because of sanctions in the 1980s, it perfected the technique of floating bond issues for seemingly acceptable projects such as expansions of the electricity grid. Many of these projects did not need foreign currency and could have been built using local currency, but the bond issues meant that South Africa obtained scare dollars despite sanctions. South African campaigners argue that these loans are illegitimate, even though they were not directly used for repression, because the lender surely knew that the loans were breaking sanctions and were releasing hard currency for sanctions busting, including arms imports.

We therefore argue that because of fungibility, all loans to odious regimes and dictators can be classed as odious, even if the ostensible purpose was permissible. As with the original Cuba debt that started the discussion, the debt was taken by the regime and not by the country.

As we move away from odious debts, however, the issue becomes more complicated. In Mozambique, people close to senior government ministers stole $400 million from the banking system. This hole was partly plugged by the government. Balance of payments support in the form of donor grants and IMF and World Bank loans were more than this amount. Just as electricity and gas are fungible, money is put into the state treasury by donors and lenders, and money comes out of the state treasury and into the banks, and money came out of the banks and into the pockets and foreign bank accounts of members of the elite. But it is a long and tenuous chain, and fungibility means there is no dollar which can be traced from the IMF to a foreign bank account. Although the linkage is obvious, we must conclude that the IMF and World Bank loans cannot be considered illegitimate on these grounds, unless we are prepared to declare all World Bank and IMF loans to Mozambique to be illegitimate. (Note that we might be prepared to do this, on the very different ground that it is illegitimate to give any loan – rather than a grant – to a country that is so poor that it manifestly cannot afford to repay the loan.)

Therefore, we are forced to conclude that fungibility means that either

i) all loans to a government are illegitimate, perhaps due to odiousness or incapacity, or
ii) to be illegitimate, an individual loan must be clearly linked to an illegitimate purpose or conduct.

Capital flight

Half of the money lent to the Argentine military dictatorship remained abroad, often with the knowledge of the lending banks because the money remained in the original account or was transferred to another account in the same city or country. Clearly these loans were not being used for the benefit of the country, and must be seen as illegitimate. The Costa Rica Tinoco decision, that a loan is illegitimate if a bank knowingly diverts the money to the account of an individual, applies here (see p. 9).

We are likely to see few cases as clearcut as Argentina which link capital flight to loans. In Nigeria and Indonesia loans provided money for the government to work with, and that allowed oil and other revenues to be siphoned off. Again we return to the setting off problem.

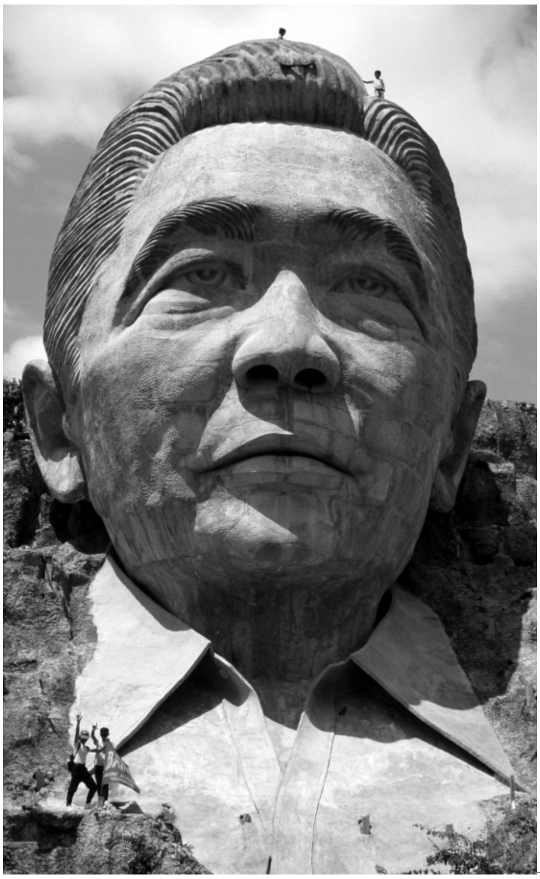


Photo: Anna Clopet,CORBIS

Sculpture of the deposed President of the Philippines, Ferdinand Marcos in Marcos Park, Pugo. Built in 1988.

Admitting error through policy change

Lending policies have changed in the past 30 years; banks, governments and international financial institutions would not now make some of the loans which they agreed in the 1970s and 1980s. In part this reflects a realisation that there is no point in making loans which will never be repaid. But in large measure it reflects the campaigns which have been carried out during the past three decades on environment, corruption, and other issues.

The World Bank, under constant pressure, has made policy changes. Happy to back Cold War objectives and secure in the view that governments would be liable for repayment no matter what happened to the money, the World Bank commissioned no internal studies on corruption between 1983 and the late 1990s.[45] Now, at least, the Bank pays lip service to its borrowers' good governance and anti-corruption programmes. Similarly the Bank was once one of the largest donors for new dam projects. But faced with corruption, massive cost overruns and unexpectedly low benefits, and bitter protests about environmental damage and inadequate resettlement, the World Bank sharply cut back its lending for dams. And the World Bank and IMF has eased off somewhat on the harsh neo-liberal policies that were imposed as conditions of loans granted in the early 1990s.

Similarly, the British government has cut back sharply on its lending for arms exports. And most governments which provided development funds in the form of loans in the early 1980s now give grants, at least to the poorest countries.

Lenders trumpet these changes as evidence that they do listen and are prepared to mend their ways. But these changes were needed precisely because previous lending policies were improper and imprudent. This is an admission of past error. And it is not acceptable to say that we should not be penalised for past mistakes because we have seen the error of our ways.

Where a lender has changed policy so that it would not now make an improper or imprudent loan that it made a decade or two ago, this is evidence that the original loan was illegitimate. Therefore we should take policy changes into account when assessing illegitimacy of older loans.

Some final thoughts

In this Part, we have been able to expand somewhat the conditions under which a debt can be illegitimate, but we have also faced some stumbling blocks.

In all legal systems, usurious debts are illegitimate. We conclude that it is important to consider more than the interest rate on the original hard currency loan, but rather to look at the real effective interest rate the country is paying by considering the cost in local currency, and by looking at the prices paid for a country's exports.

Similarly, we argued that in a wide range of circumstances, if a loan is illegitimate, then a successor loan or bonds taken out to pay off the first loan can also be considered illegitimate. Canada's definition of "private loans converted to public debt under duress, in order to bail out lenders" as illegitimate debt is confirmed, but we feel that we can go a bit further.

Finally, we argued that any loan given to an odious or dictatorial government must be considered illegitimate.

AFRODAD includes in its definition of illegitimate "Debt in which the money was actually stolen and banked in the North" and AFRODAD and Canada both talk of "loans which were stolen through corruption." But we recognise the problems of fungibility, which means that it will be difficult to identify debts which satisfy this criteria, and can be very hard to link illegitimate activity to particular debts. The definitions are thus acceptable, but probably cover few debts.

Thus we feel that, with a few exceptions already noted, the definitions put forward by Tegucigalpa, Canada and AFRODAD all form a reasonable basis for a definitive definition of illegitimate debt. However, we also find that the definitions as put forward may cover less debt than expected. That leads us more firmly to put on the table the issue of counterclaims and setting off debts owed by both sides.

Capital flight has been encouraged by the international banking system. Yet these are the same organisations which are demanding debt repayment. We consider it right and proper that debtor governments insist that this all-gotten wealth be identified and used to repay debts.

Similarly, where banks were able to use the muscle of the IMF to force poor countries to take on new successor bonds which could then be sold, it seems reasonable to argue that those banks' escape was illegitimate and that retrospectively they should take some further losses on those loans. Similarly, the original lenders of odious loans still owe compensation.

Because of the problems of identifying some debt as illegitimate, we argue that any campaign on illegitimate debt should also include a demand for payment of countervailing debts.

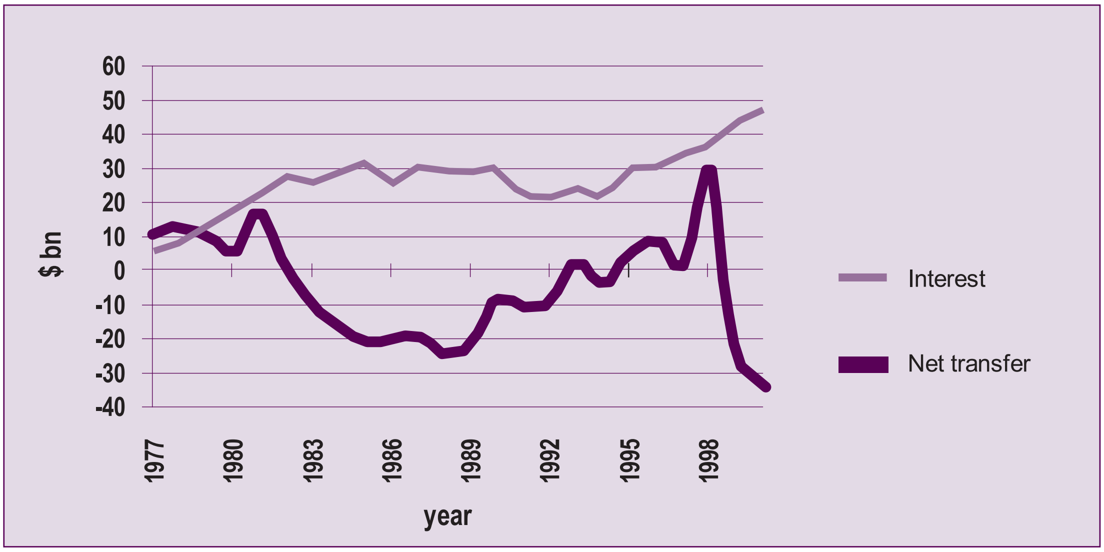
EXAMPLES

Latin America and the debt treadmill

Latin America's debt crisis is rooted in the loan pushing of the 1970s and the subsequent interest rate increase. Since 1982, Latin America has received no new long-term loan funding, and has paid $175 bn to its creditors – this is net, and means that debt service (interest payments and principal repayments) going out of Latin America have exceeded new loans coming in by $175 bn. This is shown in table 3.1 and chart 3.1 below. During nearly two decades, in only one year, 1988, was there a significant inflow of new money – and that money went out again the next year.

Yet the total debt has more than tripled, from $209 bn to $674 bn. During this same period, Latin America has made an incredible $574 bn in interest payments – but the debt continues to increase. (All figures in this section refer to long-term debt for Latin America and the Caribbean.)

Chart 3.1
Latin American interest payments and net transfer (negative transfer means money going north)



EXAMPLES

Table 3.1
Latin American long term debt, $ bn

Year	Total debt	Interest	Net transfer
1977	100	6	11
1978	127	8	13
1979	148	13	11
1980	187	18	6
1981	209	22	16
1982	237	27	2
1983	286	26	-10
1984	316	29	-16
1985	331	32	-21
1986	360	26	-20
1987	385	30	-19
1988	364	29	-25
1989	377	29	-22
1990	380	29	- 9
1991	387	23	- 11
1992	398	22	- 9
1993	426	24	3
1994	456	22	- 4
1995	497	30	5
1996	527	30	9
1997	557	34	2
1998	648	37	29
1999	673	43	-24
2000	674	47	-34
TOTAL			
1977-2000		**634**	**-119**
1982-2000		**567**	**-175**

Source: World Bank [46]

Notes:
1) This is for long term debt (LDOD in World Bank code), excluding IMF loans, for Latin America and the Carribean.
2) Interest is interest on long term debt (LINT) plus, for the period 1985-94, changes in interest arrears (treated as short-term debt) and capitalised interest.[47]

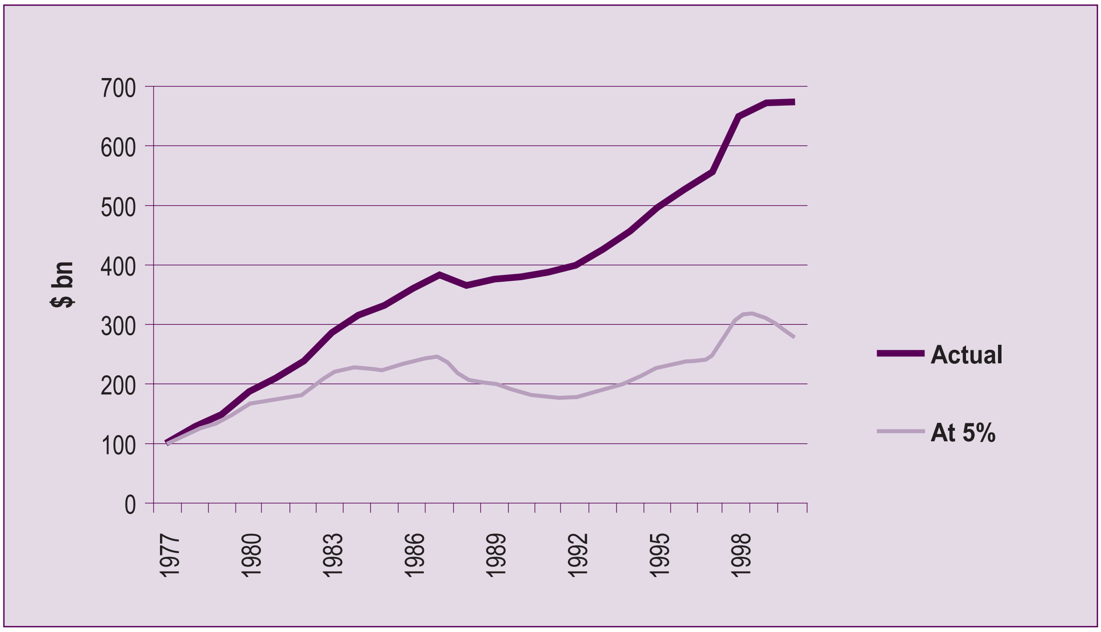
How does this happen? In the 1970s when banks were anxious to lend, they provided enough new money to repay old loans and have money left for development projects. In 1975, for example, Latin America made $7 bn in principal repayments and $5 bn in interest payments – $12 bn in total debt service. But it was given $18 bn in new loans – which covered all the payments to the banks and left them with $6 bn to spend. But interest rates began to rise, from 5% on average in 1970 to 10% in 1979 and 13% in 1982 (see table 3.2 below). At first, the banks continued to lend to cover the payments – in 1981 Latin America was lent an incredible $61 bn, of which $45 bn immediately went back to the banks as repayments, but it still left Latin America with $16 mn to spend. The crunch came in 1982, when the banks stopped lending. In 1981, the banks lent $54 bn and governments and the World Bank lent $7 bn. By 1985, the banks were lending only $10 bn, while governments and the World Bank lent $9 bn; by 1989 it was $5 bn and $9 bn. So from 1983, Latin America was paying more in debt service than it received in new loans, and this has continued to the present day.

But interest payments were vastly more than the amount which was actually being repaid to the creditors. Not only did Latin America stop repaying the principal, it could not even keep up with the new higher interest payments. So each year, the unpaid interest was added to the loan, and the next year interest was charged on the unpaid interest, and that too was added to the loan, and interest was charged on the interest on the interest – and so it went, as Latin America ran on its debt treadmill. In the last two decades, Latin America has, on average, received no new money. In 1982 it had $209 bn in debt, it paid its creditors $175 bn, but its debt has mounted to $674 bn.

This sounds exactly what happens with crooked moneylenders and loan sharks, when loans are repaid but keep getting bigger. Is this usury or extortionate? If so, then the debt is illegitimate. Chart 3.2 shows what would have happened if interest rates had remained at their 1970 levels, an average of 5%. Instead of paying $630 bn in interest during the past 22 years, Latin American countries would have paid just over one-third of that, $236 bn. This would have released $394 bn to make repayments on debt. It would have meant that present long term debt was $280 bn instead of $674 bn. What this data makes clear is that the on-going debt crisis is largely a result of increased interest rates on debt resulting from the loan pushing of the 1970s, in which countries were encouraged to borrow cheap loans they did not need – potentially making the debts doubly illegitimate.

The issue of successor debts also arises here, as many of the original loans of the 1970s have been refinanced many times, and more than two-thirds of the debt is, in practice, interest which has never been paid or was paid through new loans. What is clear is that *all* new borrowing after 1982 was, in effect, refinancing of old loans, and lenders must have been aware of this, and must therefore accept some liability if the original loans were illegitimate.

Chart 3.2
Comparing actual Latin American debt to what it would have been if interest rates were fixed at 5%



Source: table 3.1 assuming the net transfer on debt remains unchanged, but that the money saved due to lower interest rates is used to pay off some of the principal.

Argentina

As well as being in the headlines in early 2002, Argentina is an example of most of the issues related to illegitimate debt: odious debt, corrupt debt, successor loans, nationalisation of debt, and policy advice. Argentina is perhaps most important, however, since it is the only country in which a national court has ruled some of the foreign debt to be illegal and illegitimate. [48]

It is important to put Argentina in the Latin American context, and consider its debt history. As with other countries, Argentina took on new debt during the 1970s. But it has two special periods. As chart 3.3 shows, its debt grew during the military dictatorship until 1983, then remained almost constant until the introduction of dollarisation in 1991. Then debt increased substantially. What is apparent from chart 3.4 is that the banks lent to the military dictatorship and to the post-1994 dollarised economy, but not to the Alfonson government of the 1980s. During the 1982-92 period, there was a net outflow of money, and total debt levels increased only slowly. But from 1992 the private banks poured in money, only to pull out equally quickly when the crunch hit in 1998.

Chart 3.3
Argentina debt stock

Source: World Bank

Chart 3.4
Net debt transfer (= new loans – interest – repayments)

Source: World Bank

The debt of the dictators

In a coup on 24 March 1976, a military junta seized power in Argentina and was only overthrown on 10 December 1983, after its failure to win the Malvinas/Falklands war against Britain. In those seven years, the military junta and its allies in right wing militias killed between 20,000 and 30,000 people. At least 15,000 of those were "disappeared" – abducted, sent to one of 340 secret detention centres, tortured and killed. Nothing was ever heard of them again.[49]

In those seven years, foreign debt rose from $8 bn to $46 bn, most of it owed to banks. That debt constitutes about 20% of Argentina's total present debt of an estimated $211 bn. Even before the end of the dictatorship, Alejandro Olmos began an investigation of that debt. In 1982, he filed a criminal accusation against the former Minister of Economy and other officers of the regime, regarding the illegal origin of the Argentinean external debt. After 18 years of a complicated procedure, Federal Judge Dr. Jorge Ballesteros finally ruled on 13 July 2000 that the debt contracted during the 1976-83 dictatorship was illegal and illegitimate.

Olmos found that soon after the military took power, it began clandestine borrowing, particularly from US and British banks, in ways which violated Argentine law. Records for this period are largely missing, so later governments had to trust the foreign banks to tell them what was owed. One of the former presidents of the

Central Bank, Dr. Adolfo Diz, told Judge Ballesteros that the Central Bank kept no record of foreign debt, although he admitted that there was “a black notebook” with some records.[50] Later investigations by Olmos and others were able to partly piece together what happened, and at least 477 loans are involved.

State-owned companies were forced to take foreign loans and hand the money over to the central bank; the state oil company Yacimientos Petroliferos Fiscales, took $6 bn in loans during that period. Olmos wrote: “In the late 1970s, when Britain was supporting the Argentine military dictatorship (before it attacked the Falklands/Malvinas), British banks made multi-million dollar loans to Argentine parastatal companies – knowing that the money never went to Argentina but remained in accounts in London.” In 1982, over the opposition of the then Finance Minister, the Central Bank guaranteed the loans, effectively nationalising them. These debts were then rolled over and refinanced several times, most recently with new bonds issued in the early 1990s.

Mario Caffiero, an Argentinean MP, told a seminar in London that the World Bank calculated that half of the debt of the military regime was for capital flight.[51] Other experts estimate the flight capital of that period at $22-38 bn, much of it borrowed money that remained in the London and New York banks.[52]

Judge Ballesteros found that the increase in private and public foreign debt between 1976 and 1982 was “excessive, harmful and with absolutely no justification from an economic, financial or administrative point of view”. The debt was contracted under the regime, without parliamentary control as required by the national constitution.[53]

Ballesteros also looked at the Bretton Woods institutions. “The exact co-responsibility and eventual guilt of the international financial institutions (particularly the IMF and the World Bank) must be established, as well as that of the creditors, because during the whole period under examination (1976 to 1982) many technical missions sent by the IMF visited our country and analysed the performance of the Argentinean economy. … Additionally, technical missions from the World Bank came to our country with identical ends and to discuss the financial side of different projects. … The conclusion is that the creditor banks, the IMF and the World Bank acted with imprudence themselves, and that they awarded loans with an overruling urge to somehow place the funds generated by the apogee of oil industry”, Ballesteros states.[54]

Thus Federal Judge Dr. Jorge Ballesteros established many of the conditions for the illegitimacy of this debt. He has ruled that it was taken by the regime, not the country, which confirms that it is odious. And he has ruled that the IMF and World Bank acted imprudently. We also note the complicity of foreign banks in the misuse of the funds lent, and in support of capital flight.

The first post-military government nationalised more than $10 bn in private debt, freeing the banks of risk for their corrupt lending. Over the next decade, continued reschedulings pushed the debt up from $46 bn to $65 bn, but as we have shown, this is really just the same debt that Dr Ballesteros has ruled to be illegitimate.

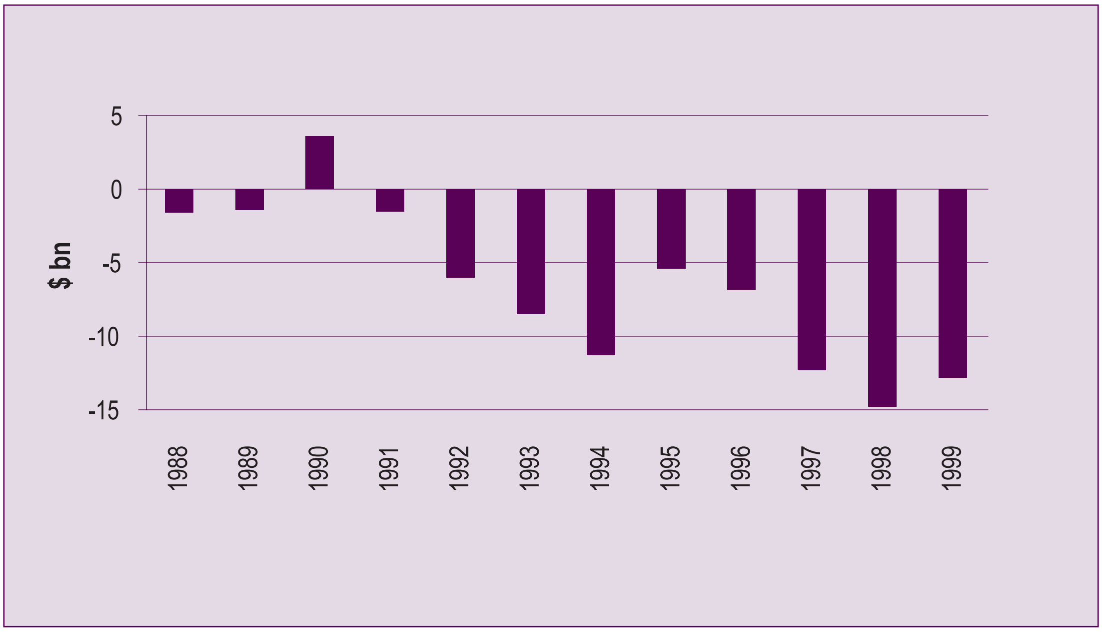
Dollarisation

In 1991, Domingo Cavallo, who had served under the military government and is partly blamed for the odious debt,[55] became Finance Minister. Under pressure from the International Monetary Fund, in 1991 Cavallo set the exchange rate of the Argentine Peso at one US dollar, and guaranteed convertibility of pesos to dollars. Money poured into Argentina; foreign debt began to shoot up, but inflation fell to 7.4% in 1993. Imports tripled in six years, and there was a massive trade deficit – which could only be covered by more borrowing.

Table 3.2
Argentina's Trade

$bn	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports	11	12	17	16	17	19	23	30	33	37	37	34
Imports	13	13	13	18	23	28	34	35	40	49	52	47
Trade balance	- 2	- 1	- 4	- 2	- 6	- 9	- 11	- 5	- 7	- 12	- 15	- 13

Chart 3.5
Argentina's trade balance



The convertibility of the peso also encouraged capital flight. Argentinean MP Mario Caffiero said that "wealthy individual Argentines, helped by foreign banks like HSBC and Lloyds, have been able over ten years, to export $130bn of wealth through the capital flight mechanisms that both foreign and local banks provided." Some of these foreign bank accounts were then used as collateral for domestic loans, which were increasingly denominated in dollars.[56]

IMF support in the early 1990s had been contingent on privatisation, convertibility of the peso and the free flow of capital, which was supposed to stimulate the economy. But tying the peso to the dollar made Argentina's exports prohibitively expensive, while the flood of cheap foreign imports destroyed the country's industrial base. Factories closed and unemployment spread.

In 1999 Argentina slipped into recession, and as chart 3.4 shows, the foreign private sector was already pulling its money out. In May 1999, IMF Managing Director Stanley Fischer, declared that "Argentina is to be commended for its continued prudent policies [and] sound macroeconomic management."[57] But the crisis worsened, with growing impoverishment and unemployment and a deepening recession. The IMF told the government that austerity was the only answer and it would have to reduce spending, which only made the crisis worse. By September 2001, foreign debt stood at $211 bn [58] but IMF spokesperson Tom Dawson said that "Argentina's recipe for reform is the right one, well deserving of strong international support."[59]

We have argued that the first $65 bn of Argentina's debt dates from the military regime and is manifestly odious and illegitimate. For the remaining $145 bn, however, the issue is less clear. The government was democratically elected and some people, particularly in the upper and middle classes, did gain – at least initially. But to what extent is the IMF liable for the failure of its imposed economic policy? Economist Paul Krugman in the *New York Times*[60] wrote "Argentina's economic policies had 'made in Washington' stamped all over them. … Wall Street cheered, and money poured in; for a while, free-market economics seemed vindicated, and its advocates weren't shy about claiming credit." But "when the economy went sour, the International Monetary Fund … was utterly unhelpful. IMF staffers have known for months, perhaps years, that the one-peso-one-dollar policy could not be sustained. … However, IMF officials – like medieval doctors who insisted on bleeding their patients, and repeated the procedure when the bleeding made them sicker – prescribed austerity and still more austerity, right to the end. …The people who encouraged Argentina in its disastrous policy course are now busily rewriting history, blaming the victims."

There are two ways in which the 1990s lending would have to be seen mainly as "unacceptable". First and foremost, the entire 1990s borrowing was a gigantic pyramid scheme.[61] Pyramid schemes such as chain letters involve a promise of a high return, such as double your money in six months. People put in money and the scheme operators use the money from the new investors to pay off the old ones. If the scheme expands rapidly enough, many of the early investors do reap large profits, which in turn gains publicity and encourages new investors. But eventually the promoters run out of suckers, money stops coming in, and the scheme collapses with most investors losing their money. In most countries, pyramid schemes are considered fraudulent and illegal. We first argue that peso-dollar convertibility was always dependent on borrowing enough dollars to pay those who demanded dollars in exchange for pesos – in other words, a classic pyramid scheme. Next, we argue that the IMF was promoting a pyramid scheme, even if it was doing so in good faith and believed that the debts could eventually be repaid; its guilt is underlined by Krugman's point that even when it realised its error, the IMF did nothing. Similarly, then, the banks that lent were guilty of lending money in a pyramid scheme. Here we also go back to James Child, whose reasoning can be used to argue that Argentina had no "capacity" to repay, and the banks lent knowing that fact. If I go into my bank and ask to borrow money to send to the top name on the chain letter, because I believe I will make 16 times as much when my name comes up, and thus be able to repay the loan, my bank manager will laugh me out of the bank – and if he was stupid enough to lend it to me, it would be his fault. Similarly, lending money to Argentina to participate in a pyramid scheme must be unacceptable.

The second area of unacceptability is capital flight. As the Costa Rica Tinoco ruling makes clear, if the lender knows that the money is being diverted for capital flight, then the loan is unacceptable and the debt cannot be collected. This was clearly the case with the loans to the state petroleum company during the military dictatorship, and as Argentineans increasingly opened accounts in foreign banks, it must also have been obvious in the late 1990s.

The reality, however, is more complex. Although much of the lending was to fund the pyramid schemes, a substantial part must also have been used for imports of real goods, which were then used by Argentineans. But the lender is expected to show prudence and make loans which can reasonably be expected to be repaid. At least by 1994, and surely by 1997, no prudent lender could have provided more money for the Argentina pyramid scheme – even if the IMF was backing it.

Therefore, we reach the following conclusions:

i) IMF lending was unacceptable, particularly because of the conditions imposed, which created the pyramid scheme.
ii) Any banks which lent knowing that the money would be used for capital flight, as some must have done, made unacceptable loans.
iii) Any loans after 1997 should be seen as inappropriate, because they were helping to fund a pyramid scheme and capital flight; a prudent lender should have seen that the loans could not be repaid. Chart 3.5 shows clearly the massive trade deficit which had arisen by 1997. We note in passing that the banks and other lenders should have a claim against the IMF, as the organiser of the pyramid scheme.
iv) There was no significant new lending, except by the IMF, until 1994. In the three year 1994-96, debt increased by $45 bn and there was a real flow of $27 bn into Argentina. The legitimacy of this debt would need to be analysed in more detail, with considerations of good faith by lenders backing a new economic project set against the huge trade deficit of 1994 which should have made clear to all lenders that this was a pyramid scheme.

Yacyreta dam

The Yacyreta hydroelectricity project on the border of Argentina and Paraguay includes an incredible 70 km earth dam[62] and is one of the biggest civil engineering works in the world. The project started in 1973 and has been particularly troubled; electricity generation only started in 2000 and the project is still not completed. The initial estimated cost of $1.6 bn was mainly provided by the World Bank

($510 mn) and the Inter-American Development Bank. But the cost has now escalated to an estimated $8-12 bn; as much as half of the cost escalation is due to corruption.[63] In 1990 the Argentine president Carlos Menem called the dam a "monument to corruption". Some money went into foreign bank accounts and some to the Argentine military. Some World Bank staff call Yacyreta "the dam that financed the Falklands war."[64]

The project has also been dogged by technical, social and environmental problems, which reduced the amount of electricity that could be generated. The dam will displace 300,000-500,000 people, and this was not adequately dealt with. A second World Bank loan was explicitly to "bring about tighter environmental protection and appropriate handling of social aspects in Yacyreta".[65] Local groups brought a complaint to the World Bank Inspection Panel, which in 1997 found violations of the World Bank's own social and environmental policies, and that resettlement and environmental mitigation costs had been under-estimated.[66]

So Argentina is entangled in debts dating back to the 1970s, an era of loan pushing, World Bank enthusiasm to provide backing to pro-United States dictators in Latin America, a general willingness to overlook corruption, dam mania, and a blindness to environmental and social issues. Taken together, there seems no question that the original loans must be seen as illegitimate, and that this illegitimacy is proven rather than reduced by later attempts by the World Bank to clean up its act.

South Africa

When Nelson Mandela walked out of prison in 1990, the international banks handed him a bill for $21 bn. In effect, the bankers told Mandela: "In 1985 we told the white government that we understood that they had financial problems and that it was expensive to keep you in jail and attack the neighbouring states. So we told P W Botha that he could defer payments on his debt. But now that you are out of jail, and we have majority rule, so it is time for you to pay the cost of keeping you in jail."

And Mandela was told by the international community to pay up, because if he didn't, there would be no foreign investment. So he did. In 1997, South Africa paid an incredible $6.5 billion in debt service – more than four times what the banks demanded of the apartheid state. Nevertheless, South Africa did not attract foreign investment.

Apartheid as a crime against humanity

Because of apartheid, South Africa was forced to leave the Commonwealth in 1961. In 1973 the United Nations began to describe apartheid as a crime against humanity and in 1977 the UN imposed a mandatory arms embargo on South Africa. In 1982 two lawyers from the First National Bank of Chicago wrote an article in the *University of Illinois Law Review*[67] in which they warned their employers and other banks of "the consequences of a change of sovereignty [in South Africa] for loan agreements. They noted that "if the debt of the predecessor is deemed to be 'odious', i.e. the debt proceeds are used against the interests of the populace, then the debt may not be chargeable to the successor." And they noted that the use of the money described in loan documents was often too general to ensure that the loan benefited the people, and thus to ensure repayment. The banks did not listen, however, and debt jumped from $16.9 bn in 1980 to $24.3 bn by the end of 1984.[68]

Protest was growing inside South Africa. On 20 July 1985 a state of emergency was proclaimed and on 1 September, South Africa defaulted and stopped paying its creditors. Negotiations with the banks continued over two years. Archbishop Desmond Tutu called on the banks not to reschedule the debts, and instead confiscate South African assets abroad.[69] In fact, the banks not only made a deal, but gave the apartheid state a very soft ride. In four years South Africa had to repay only $4.8 bn of capital – $1.2 bn per year. As Table 3.3 shows, the majority rule government has consistently had to pay more than double that. Despite the growing international sanctions campaign in the late 1980s, some banks actually began to lend to South Africa again.

With apartheid officially a crime against humanity, there is no question that the apartheid state satisfies Alexander Sack's description of "a despotic state [which] incurs a debt not for the needs or in the interests of the state, but to strengthen its despotic regime." And, in 1997 the South African Institute for Financial Policy Options[70] argued that "it is not necessary to prove that any one loan was used by the apartheid government for a purpose contrary to the wishes or interests of the majority of the population. The purpose of the apartheid state was to ensure and perpetuate the economic and social advancement of a racial minority at the expense of the majority. … Any loan incurred by the apartheid state perpetuated its hegemony, whether it was spent on roads or schools or the military or the expansion of a parastatal. Since government policy had the specific aim of disadvantaging the majority, it can therefore be argued that the first condition of the doctrine of odious debt applies – that the purpose of the loan was against the wishes of the majority."

Post-apartheid repayments

Majority rule finally began in 1994 when Nelson Mandela was elected president. Published debt data only starts from then, and is set out in table 3.3 but a Swiss and German study argued that some apartheid foreign debts are not listed in the official statistics.[71]

Table 3.3
South African debt after 1994, $ bn

	1994	1995	1996	1997	1998	1999	6 year totals
Total debt	21.7	25.4	26.1	25.2	24.7	24.2	
of which							
long term	13.0	14.8	14.3	13.9	13.3	10.4	
IMF	0.9	0.9	0.9	0.4	0.0	0.0	
short term	7.7	9.7	10.8	10.9	11.4	13.8	
Debt servic	2.9	3.4	4.2	6.5	4.4	4.8	26.2
of which							
principal repayments	2.0	2.1	2.8	5.1	2.9	3.4	18.3
Net transfer on long ter	0.9	0.6	-1.4	-1.0	-1.3	-1.5	-3.7
Foreign direct investment (FDI)	0.4	1.2	0.8	3.8	0.6	1.4	8.2
Profit remittances on FDI	3.0	2.6	2.4	2.0	2.2	2.3	14.5

Source: World Bank *Global Development Finance 2001*

EXAMPLES

Except for a symbolic IMF loan granted in 1993 and repaid in 1997 and 1998, all South African debt is with the private sector. Of long-term debt, 60% was government guaranteed in 1994, while by 1999, 88% was guaranteed, as the banks and bondholders who had lent to the private sector during apartheid were slowly paid off.

Two important points to be drawn from this table. First, except for a small amount of new lending ($1.5 bn) in the first two years of majority rule, there has been little change in the total volume of debt. This suggests that at least long-term debt is simply being rolled over. However, principal repayments exceed the amount of long term debt inherited from the apartheid era, which suggests that much of the original debt has been paid off and refinanced.

Therefore it seems likely that we are dealing almost entirely with successor debt. We will argue that this debt is not simply inappropriate, but is actually unacceptable. The loans themselves are unacceptable because they are obviously refinancing apartheid debt, which is odious debt.

But we also argue that the terms are unacceptable, and in two very different ways are extortionate debt in that the payments are "grossly exorbitant" and the terms were imposed incorrectly and unfairly.

First, we note the usury is necessarily defined in context. Over the objections of black South African leaders such as Bishop Tutu, in 1987 the international banks reached an agreement with the apartheid state to limit the amount South Africa would be required to pay. The majority rule government clearly should have diverted resources into redressing the heritage of apartheid. Thus any requirement that majority-ruled South Africa should pay *more* than apartheid South Africa must, *prima facie*, be grossly exorbitant. Thus the repayment requirements and the refinancing of the apartheid debt are unacceptable and illegitimate.

Second, we note that Nelson Mandela and the African National Congress came under heavy pressure not to renounce the apartheid debt. There was both carrot and stick. The stick was warnings that Mandela would be denounced as a leftist and ostracised if he repudiated the debt. The carrot was the promise of foreign investment if he paid off the old debt. This promise has not been kept. As table 3.3 shows clearly, foreign direct investment (FDI) had been tiny – only two-thirds of the profits repatriated by companies on investments they made in the apartheid state. And new lending has not kept up with repayments – over six years South Africa has paid out $3.7 bn more than it received. Thus promises have not been kept and policy advice was wrong. If South Africa had frozen profits on apartheid-era investments and simply repudiated the odious apartheid debt – or even if it had demanded a 10-year moratorium – it would have been $10 bn better off. Foreign aid during this period was only $1.1 bn, so even if aid had been cut off, South Africa would have profited by $8.9 bn. That is a huge amount of money – it would have allowed a 50% increase in the health budget, for example. Instead, the South African government decided not to spend enough on maintaining private hospitals, and finally in 2000 turned to the World Bank for a loan to revamp public hospitals – a loan it would not have needed it if had repudiated the odious debt.

Taken together, then, there is a very strong case that loans in the 1990s are illegitimate because they are successors to odious apartheid loans, because they require grossly exorbitant repayments, and because they were taken under pressure and based on false promises and wrong policy advice.

Compensation?

In a study of Swiss and German apartheid debt, Swiss economist Mascha Madoerin found that German capital was the most important financier of apartheid's public sector with 1993 claims against South Africa of DM7.4bn (then $4.6 bn). She estimated that gains made by their odious business amount to an estimated DM8.4bn (over $5 bn) for the period 1971 to 1993 (excluding trade). The Swiss financial centre was the second most important financier of Apartheid's public authorities.[72]

The Most Reverend Njongonkulu Ndungane, Archbishop of Cape Town, asked the general assembly of the Federation of Swiss Protestant Churches in Neuchâtel, Switzerland on 19 June 2001 for support in a campaign to press western governments and corporations to "acknowledge their culpability in the development and defence of what came to be called apartheid. It is in this way that western governments and corporations are liable for reparation. … I appeal to you to join me in challenging these world players, especially the banks and companies worldwide, that financed apartheid and its legacy of inequality."[73]

Archbishop Ndungane went on to say: "We seek compensation equivalent to the capital and interest paid in debt servicing by the previous regime from its rise to power in 1948 to December 1993. … We also call on apartheid's creditors to return the capital and interest incurred since December 1993.

"We call for compensation equivalent to the profits made by foreign companies and banks that continued to invest in South Africa after 1973, when the UN declared the apartheid regime a crime against humanity.

"We believe, that in the interest of restorative justice, at least $78 billion are due to Southern Africa in reparation. This is the estimated total economic cost to the region due to destabilisation and destruction under apartheid."

Photo: David Turnley/CORBIS

Security Police Patrolling a Township in Gugulety, South Africa in 1986

Archbishop Ndungane continued: "Let me justify this appeal. Between 1985 and 1989 some of the world's major banks were presented with three unique opportunities to shorten the life of the apartheid regime. Firstly, a severe foreign exchange crisis threatened to bring the apartheid regime to its knees. Secondly, sanctions were starting to bite and, thirdly, the capital boycott by some foreign bankers was provingmore devastating and fast acting than anything Western governments were planning. Nonetheless, 14 major banks, from Germany, Switzerland, the UK, USA and France … negotiated three separate accords with the South African government. Thus enabling it to continue its massive abuse of human rights. It is worth noting that South Africa had such pariah status that none of the banks were prepared to deal directly with its principals. The problem was resolved by the parties agreeingthat Fritz Leutwiler, the former President of the Swiss National Bank, would act as mediator."

International campaigners as well as "my predecessor Archbishop Desmond Tutu and a wonderful Afrikaner called Dr Beyers Naude, who risked a great deal to go against his own people, joined forces. They asked the bankers to make a rescheduling of South Africa's debt conditional on the resignation of the apartheid regime and its replacement by an interim government responsive to the needs of all South Africa's people. Sadly, they were also ignored. The bank chairmen all agreed on the evils of apartheid but placed money ahead of morality and negotiated such lenient and sympathetic deals that even the South African government expressed 'pleasant surprise'."

Since many, perhaps most, of these debts have been repaid, it will be impractical now to repudiate odious debts which have already been paid off. But any campaign on illegitimate debt must also look to compensation, and return of money illegitimately collected.

Zaire/Congo

With US support, General Joseph Mobutu took power in the Congo in 1965, changing the country's name to Zaire and his name to Mobutu Sese Seko. As part of his loyality to the United States, he provided a home for the US-backed Unita forces in Angola in 1970s and 1980s.

Mobutu may have been on the West's side in the Cold War, but he was also one of the world's most corrupt dictators, and his government was widely described as a "kleptocracy".[74] In 1978 the IMF appointed its own man, Irwin Blumenthal, to a key post in the central bank of Zaire. He resigned in less than a year, writing a memo which said that "the corruptive system in Zaire with all its wicked manifestations" is so serious that there is "no (repeat no) prospect for Zaire's creditors to get their money back".[75] The secret memo itself was first published by Karin Lissakers, who later became US Executive Director of the IMF, arguably the most important person in the institution.

As Table 3.4 below shows, when Blumenthal wrote his report, Zaire's debt was $4.6 bn. When Mobutu was overthrown and died in 1998, the debt was $12.9 bn[76] and Mobutu had luxury estates in France and elsewhere and probably billions of dollars stashed abroad. For once, the private sector saw that they had no chance of getting their money back, and stopped lending from 1981. But shortly after the Blumenthal memo, the IMF granted Zaire the largest loan it had ever given an African country; over the next decade it gave Mobutu $700 mn, most of which has never been repaid. The World Bank was hardly involved in Zaire when Blumenthal wrote his memo, but in the next 15 years it lent $2 bn to Zaire – and was still giving new money to Mobutu as late as 1993. Western governments were the biggest lenders, and continued to pour in new money until 1990 – even though Zaire had virtually stopped repaying its debts in 1982.

In 1987 when Mobutu made his territory available for US covert action against neighbouring Angola, the US pushed through yet another IMF loan to Zaire – this time over the objections of some IMF officials.[77]

Table 3.4
Zaire's debt, $ bn

Total debt is composed of:					Memo:			
Total Debt	Bilateral	World	Bank	IMF	Long term private	Interest arrears	Debt service paid	Principal arrears
1977	3.4	0.8	0.1	0.3	1.8	0.0	0.1	na
1978	4.1	1.1	0.2	0.3	2.1	0.0	0.1	na
1979	4.6	1.4	0.2	0.3	2.2	0.0	0.2	na
1980	4.8	2.3	0.3	0.4	1.5	0.0	0.4	0.0
1981	4.9	2.4	0.4	0.4	1.4	0.0	0.2	na
1982	4.7	2.3	0.5	0.4	1.3	0.0	0.1	na
1983	5.3	3.0	0.5	0.6	1.0	0.1	0.1	na
1984	5.3	2.9	0.5	0.7	0.9	0.1	0.1	na
1985	6.2	3.5	0.6	0.8	0.9	0.1	0.1	na
1986	7.2	4.2	0.8	0.9	0.9	0.1	0.1	na
1987	8.8	5.1	1.2	1.0	0.9	0.1	0.1	na
1988	8.6	4.7	1.4	0.8	0.8	0.3	0.2	0.9
1989	9.2	5.5	1.6	0.6	0.9	0.1	0.2	0.7
1990	10.3	6.2	1.9	0.5	0.9	0.3	0.1	1.0
1991	10.8	6.2	2.2	0.5	0.9	0.7	0.1	1.8
1992	11.0	5.9	2.2	0.5	0.9	1.3	0.1	2.1
1993	11.3	5.7	2.2	0.5	0.8	1.8	0.0	2.4
1994	12.3	6.1	2.3	0.5	0.9	2.4	0.0	3.1
1995	13.1	6.3	2.4	0.5	0.9	2.8	0.0	4.6

Source: World Bank
Note: In World Bank accounting, unpaid interest is tabulated separately and then added to the debt, whereas principal arrears remain part of the main debt, so the last two columns are simply memo items and not to be added to the debt.

There is perhaps no clearer example of odious debt. Money was poured into Zaire when the lenders had already been told there was "no (repeat no) prospect" of being repaid, simply to back a Western ally in the Cold War. The money was stolen or used to oppress the people. Indeed, Western support for Mobutu over more than two decades is largely to blame for the current mess in the now renamed Democratic Republic of Congo (DRC). Not only is the debt odious and illegitimate, but a new government in the DRC surely has a claim against the lenders, including the IMF and World Bank, for the damage caused by Mobutu while they helped to keep him in power.

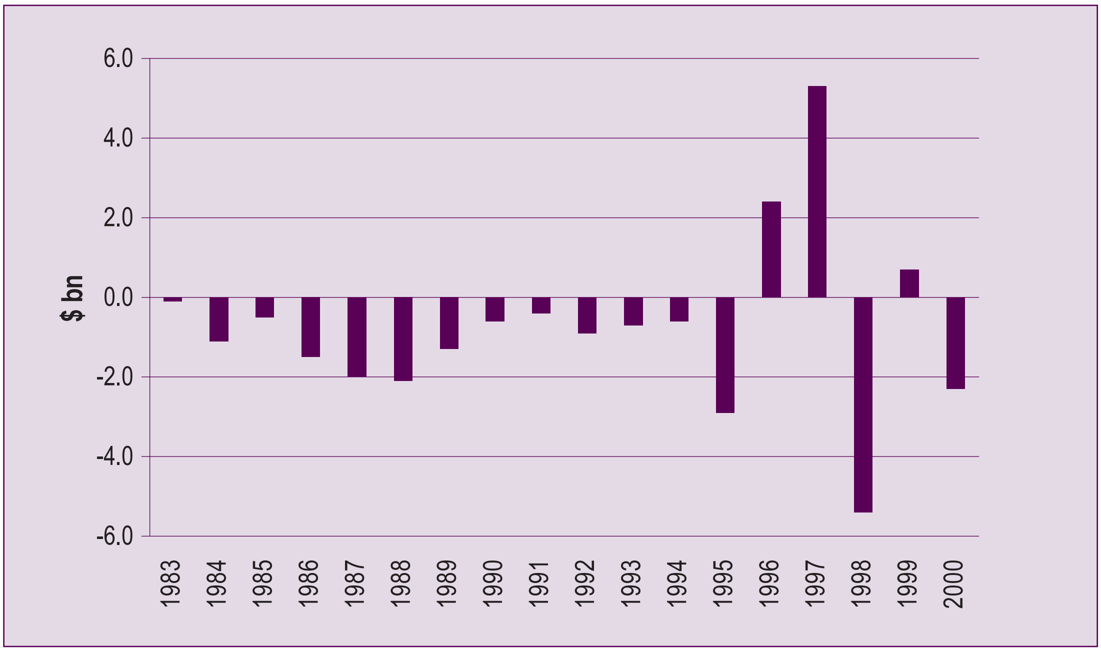
No other evidence is needed to declare all of the DRC debt illegitimate. But one other example can be given. The US export credit agency, Ex-Im Bank, helped to fund a useless $1 bn electricity transmission line. Mobutu is said to have pocketed a 7% commission,[78] and Ex-Im Bank was left with an unpaid debt.

Philippines

When the Philippine dictator Ferdinand Marcos was finally overthrown in 1986 and fled into exile with his wife Imelda, he had an estimated $5-13 bn stashed away in foreign banks.[79] In other words, up to one-third of the Philippines' foreign debts had passed into his very large pockets. Since then there has been an international campaign to recover some of the money, with court cases in the United States and Switzerland, but so far the only success has been the freezing of $590 mn in Switzerland. There is even a website (www.marcosbillions.com) which is devoted to the search. The churches are playing a leading role in trying to recover the money. In 1999 Roman Tiples, bishop in the Philippine Independent Church and general secretary of the National Council of Churches in the Philippines (NCCP), and Bishop Teodoro Bacani, of the Catholic Bishops' Conference, began playing a leading role in the campaign to have the Marcos assets returned to the Philippines.[80]

Chart 3.6
Net transfers on total Philippine debt $bn

Net transfer = new lending – interest – principal repayments
Negative values mean the Philippines gave money to the creditors



Most of Marcos borrowing was during the 1970s loan-pushing boom. Chart 3.6 shows that from 1983 there was a net outflow of money, which continued during subsequent presidencies of Corazon Aquino (1986-1992) and Fidel Ramos (1992-1998), except during the period just before the Asian financial crisis, which we discuss below.

During the Aquino period, there was a net outward transfer (payments to creditors) of $9 bn; nevertheless, debt grew from $28 bn to $33 bn due to high interest rates and rolling over of loans – no new money was involved and there was effectively no new borrowing. In March 1989 the Aquino government secured a new IMF loan of $1.3 bn – on the condition that nearly all of it, $1.1 bn, was to pay off old debts and that the debts of private corporations be nationalised and paid off by the government.[81]

President Fidel Ramos initiated his Philippines 2000 plan, based on liberalisation, encouraging exports and opening up the country to international trade. But the textiles, garments and other industries were immediately hit by cheap imports. The trade deficit reached $4 bn in 1996 and 1997 and the Philippines had to borrow massively to cover the gap. Then it was hit by the 1997 Asian financial crisis, and the money poured out again in 1998.

Devaluation also had an impact; in dollars the debt more than doubled from $24.3 bn in 1982 to $52 bn in 1999, but in Pesos it increased 10-fold from Pesos 207 bn to 2028 bn. The interest rate in pesos on this debt has been over 15%, and the debt is still growing faster than it can be repaid.

Corruption

The largest single debt of the Philippines is the Bataan nuclear power station. Completed in 1984 at a cost of $2.3 bn, it was never used because it was built on an earthquake fault at the foot of a volcano. "Filipinos have not benefited from a single watt of electricity," said the national treasurer, Leonor Briones. "It's a terrible burden which never fails to elicit feelings of rage, anger and frustration in me. We're talking of money that should have gone to basic services like schools and hospitals." The nuclear power station was financed by the US export credit agency Ex-Im Bank, Union Bank of Switzerland (which is accused of holding some of the Marcos billions), Bank of Tokyo and Mitsui & Co, all of whom are still being repaid. The Philippines still pays $170,000 per day for the power station and the debt will not be repaid until 2018.[82]

The nuclear power station was built by the US multinational Westinghouse, in spite of a much lower bid by General Electric which was favoured by a technical committee. Marcos overruled his own advisors, and Westinghouse later admitted that it paid a commission to a Marcos associate, which the *New York Times* estimated at $80 mn. Much of the construction was done by companies in which Marcos had an interest. Bribes were paid in Switzerland.[83]

The International Atomic Energy Authority noted that attempting to build a nuclear power station in an area of such high seismic activity was "unique in the atomic industry". We can all be grateful that the plant was never put into operation and never became an Asian Chernobyl. The mothballed Bataan nuclear plant sits on a 350-hectare land and the Metropolitan Manila Development Authority said in October 2001 that it would use part of the site for garbage disposal.[84]

«It's a terrible burden which never fails to elicit feelings of rage, anger and frustration in me. We're talking of money that should have gone to basic services like schools and hospitals.»

Leonor Briones, Philippines national treasurer

Is any Philippine debt legitimate?

Who could argue that the debt for the Bataan power station is legitimate – in national laws, such a loan could never be enforced. It is clearly illegitimate.

But in practice, all of Philippine debt, or at least the $40 bn before the Asian financial crisis, must be considered multiply illegitimate.

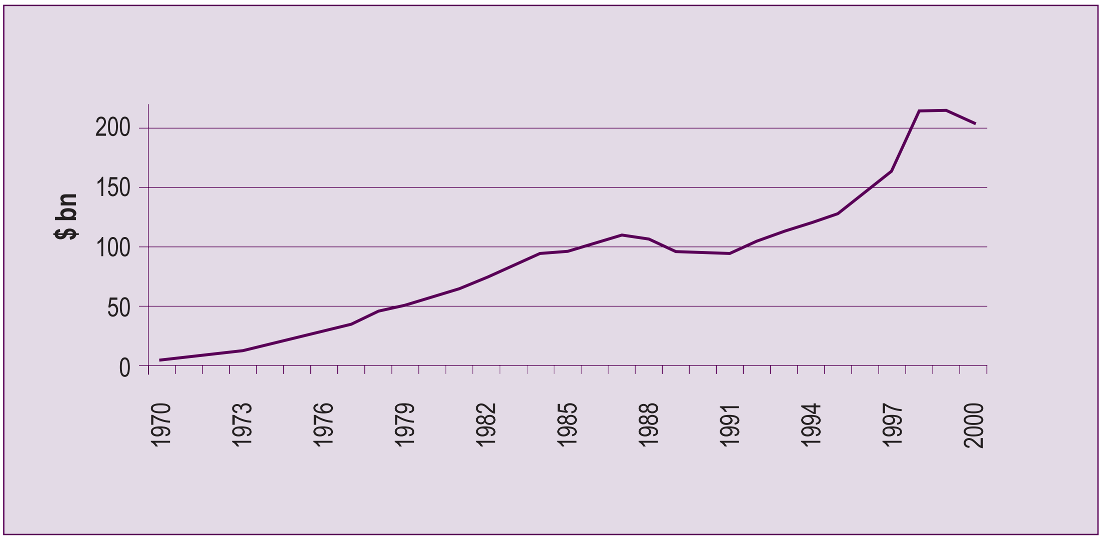
Marcos was a dictator and the debt was odious. Marcos was blatantly corrupt yet the banks lent to him. The IMF alone lent Marcos $1 bn and the World Bank lent him $4 bn. And a devaluation forced by IMF openness policies has imposed a defacto usurious interest rate.

Taken together, we think creditors would have difficulty defending any of the Philippine debt as legitimate.

Brazil

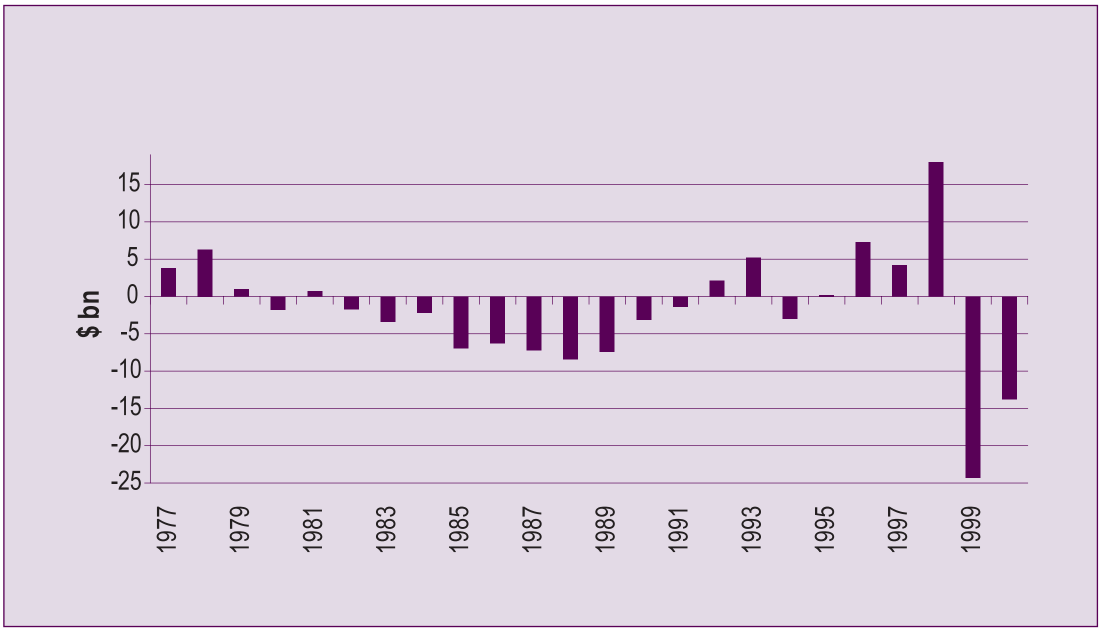
Brazil has the world's largest foreign debt, $245 bn, which is larger even than Argentina and Russia. Brazil followed the Argentine pattern shown earlier. During the loan pushing and military dictatorship era of the 1970s there was significant new borrowing and real transfers of money, This was followed in the 1980s with a net transfer of money from Brazil to its creditors – Brazil gave $48 bn to the rich north, yet its debts still increased by $40 bn. Then, as with Argentina, the late 1990s saw a doubling of debt.

Chart 3.7
Brazilian long term and IMF debt $bn



Source: World Bank

Chart 3.8
Brazil: net transfer on long term debt $ bn



Source: World Bank
Net transfer = new lending – interest – principal repayments

The military dictatorship

A US-backed military coup deposed the elected government in 1964 and continued, sometimes with extreme repression, until José Sarney became president in 1985. New borrowing continued up until the end of the military period, but unlike Argentina, there seems to have been little effort within Brazil to compile details of just what the $100 bn went to. Some went abroad in capital flight. A lot of the money was simply used for imports, particularly luxury goods for the growing elite (Brazil has one of the greatest gaps between rich and poor in the world). For the six years 1977-82, imports exceeded exports by $70 bn, which is enough to account for most of the debt. In addition, there was substantial borrowing for big projects including dams and opening up the Amazon basin. In 1981 the World Bank lent Brazil $445 mn for the Northwest Brazil Integrated Development Programme (PoloNoreste). In 1987 World Bank president Barber Conable said that PoloNoreste was a "sobering example of an environmentally sound project gone wrong" and in 1992 the Bank launched a new project, known as Planafloro, to rectify these problems.[85]

The Sarney years

The end of the military period corresponded with the global financial crisis and huge rise in interest rates. Interest on new loans exceeded 15% in 1981 and stayed over 10% through 1985. Interest payments on long-term debt, which had been $3 bn in 1978, topped $6 bn in 1980 and $8 bn in 1982 and 1983. In his book on Brazilian debt, Marcos Arruda argues that these "unfair, extortionate and impoverishing rates of interest" constitute usury.[86] Between 1980 and 1983, GNP fell by 15%.

The new Sarney government cut back on imports and brought foreign trade into balance. In 1986 it declared a foreign debt moratorium, and limited total foreign payments to 2.5% of GDP, about $5-6 bn per year. The policy brought impressive results – in two years GNP jumped 35%.[87] But the creditors were not pleased. Foreign investors began withdrawing capital and Sarney came under heavy pressure from the US and the IMF. By the end of 1986 he had agreed to take new loans in order to keep up repayments on the old ones. In 1988 Sarney accepted $5.2 bn in loans, all but $600 mn of which was to repay old loans.[88]

FHC and bankruptcy

Fernando Henrique Cardoso, known as FHC, became finance minister in 1993 and president in 1995. He introduced the Plano Real, with a new currency and a successful anti-inflation policy. The mid-1990s was a period of great international capital volatility, and the FHC government decided to follow the advice of the IMF and open the country's economy completely, in the hope that footloose capital would migrate to Brazil. All controls over financial flows and markets were removed. Imports jumped from $55bn in 1994 to $78bn the next year and kept growing to $99bn in 1998; exports increased only slowly, and the trade deficit was $34 bn in 1998. Widespread privatisation attracted substantial foreign money, but the gap was mostly filled by massive borrowing. During FHC's first five years as president, debt jumped from $151 bn to $245 bn, despite their being zero net transfers on debt. Two-thirds of the increase in debt was simply new borrowing to make the $60 bn in interest payments during that five-year period. As elsewhere in Latin America, 1999 was a crisis year, and Brazil gave an incredible $24 bn (net) to its creditors. But that only stopped the debt from increasing; it led to no reduction.

This was a pyramid scheme just like Argentina, and was inherently unstable. To keep attracting foreign capital, interest rates were pushed up, reaching 46.4% in November 1997, crippling domestic businesses. By mid-1998 Brazil was effectively bankrupt and the bubble burst. In September and October 1998, almost $30bn left Brazil.[89] In January the Real was devalued; states began to default on the debts to the federal government. Again the IMF stepped in, with promises of more funding but with unusually harsh conditions –privatisation of energy and banks to raise at least $28bn, high domestic interest rates, and the operating revenues of two state enterprises pledged to debt servicing. The government also agreed to effectively mortgage the national oil company Petrobras to the IMF, under an agreement that if the loans were not repaid, Petrobras would be given to foreign creditors. This last action was illegal, because the federal government does not own Petrobras, which is actually owned by the individual states of Brazil.[90]

So, as with the military government era, a policy of borrowing to cover unlimited imports could not continue indefinitely. And protests began to grow about the debt. One demand is that the government should actually follow an article in the 1988 constitution, which requires an audit of foreign debt, to identify what part of the debt is illegitimate. In September 2000, six million voters took part in a "people's plebiscite" (out of a national electorate totalling 109 million); more than 90% said that Brazil should not pay its foreign debt without the audit required by the constitution.

Mozambique

Mozambique presents a difficult example. At first glance the debt is clearly unpayable, but does not seem illegitimate. However, we will argue that it was largely inappropriate.

Cold war battlefield

The Cold War was fought remotely in southern Africa. In the 1970s the West, through NATO, backed Portugal in its fight to prevent independence in Mozambique and Angola, while Britain did nothing to oppose continued white rule in Rhodesia (now Zimbabwe) and South Africa. South Africa was allowed to occupy Namibia, and a brutal pro-Western dictator was kept in power in Malawi. In the 1980s, as the East-West conflict intensified, southern Africa became a Cold War battlefield, as the then Soviet Union backed left-leaning governments in countries that had just won independence and the US backed apartheid South Africa as a bastion against communism. South Africa waged war against its neighbours.[91] With the end of the Cold War and the fall of the Berlin Wall, all the southern African wars came to a quick end. US-backed forces lost in all five free and fair elections in the early 1990s.[92]

In Mozambique South Africa attacked directly and created and backed a guerrilla force, Renamo. During a decade of war, 1 million people died and 5 million – one third of the population – were forced to flee their homes. Damage was estimated at more than $20 bn.[93] Mozambique still has not fully recovered. The international community was nervous about opposing the US in what was clearly a Cold War battle, but European countries – especially the Nordic states and Italy – were anxious to do as much as possible. They could not stop the war, so they poured aid into Mozambique to bind up its wounds. By the end of the war, Mozambique had $4.7 bn in long term debt, of which $3.8 bn was bilateral (government to government) and $700 mn was from the World Bank and African Development Bank.

These loans were the opposite of odious, in that they were clearly in the interests of the population, and helped them to survive the depredations of the apartheid state. Nevertheless, we argue that they are illegitimate. Mozambique could never hope to repay those

Table 3.5
Mozambique long-term public and publicly guaranteed debt $bn

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Total debt	2.5	3.0	3.7	3.7	3.9	4.2	4.3	4.7	4.8	5.2	5.2	5.3	5.2	6.0	4.6	
Net transfer	0.3	0.3	0.3	0.1	0.2	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	**2.2**

Source: World Bank
Notes:
i) Data only starts in 1985, when Mozambique joined the World Bank.
ii) Data for private and non-guaranteed debt is incomplete and varying, so only public and public guaranteed debt is shown.
iii) Mozambique received its first debt reduction in 1998/99.

loans; these were just the opposite of investment loans, in that they were being granted to patch up damage to infrastructure, to import food, and, yes, to import arms. To give this support as loans was for the lending institutions to show a lack of prudence. It may seem ungenerous, but the money should have been a grant and not a loan. Lending money to a starving woman to buy food when she has no capacity to repay does not create a legitimate debt. We also noted in part 1 that illegitimate can also mean "contrary to public policy". These loans were to support the struggle against apartheid; it cannot have been public policy that such support creates a circumstance in which the country would have to be further impoverished in order to repay. Thus the loans, although not unacceptable, were clearly inappropriate. The debt of Mozambique and others of South Africa's neighbours has come to be defined as "apartheid-caused debt"[94], and there are calls for it to be cancelled because to repay that debt is to ask the victims to pay for the damage caused by apartheid. Thus we consider the debt to be illegitimate.

Conditionality

In 1994 the World Bank agreed a series of new loans to Mozambique, but the 1995 *Country Assistance Strategy* for Mozambique contained seven of what it called "necessary conditions".[95] A total of $665 million in World Bank loans would only be granted if these conditions were met. One condition was that Mozambique effectively close the cashew nut processing industry, throwing 10,000 people (mostly women) out of work. The Bank's argument was that trade liberalisation would have long term benefit, and that since Indian peasant families were prepared to process the cashew nuts at home for less than Mozambican factory workers were paid, the raw nuts should be sent to India and the factories should close. The Bank argued that the long term gain to Mozambican peasants through higher prices would be greater than the losses due to the factory closures but this did not happen.[96] The government was publicly opposed. In late 1997 Prime Minister Pascoal Mocumbi said that the World Bank "imposes its conditions. But sometimes we have to accept things which are not in our interest, because there is no other way out."[97]

We have already pointed to the definition of extortionate debt, which includes the situation when, under extreme financial pressure, a borrower accepts unfair conditions. Throwing 10,000 people out of work is clearly such a condition, and the Prime Minister has already argued that it is not in Mozambique's interest. This is an unacceptable loan condition, and therefore the entire $665 mn World Bank loan package is illegitimate.

Two other points need to be made. First, the World Bank and IMF have maintained the condition on cashew nuts, which means all subsequent loans are tainted by the improper condition. The second point is that in late 1999 the IMF proposed to apply the same policy to sugar, forcing the closure of the sugar industry. But the Washington-based international financial institutions recognised the error of their cashew policy and withdrew the sugar proposal, which can be taken as evidence that the cashew condition was onerous, making linked loans illegitimate.

Other examples

Here we consider several specific areas of what might be considered illegitimate lending.

Dictators

More than $500 bn, 20% of all developing country debt, can be attributed to dictators in 23 different countries. Most were backed by the United States and the West, although Mengistu Haile Mariam was backed by the Soviet Union and Siad Barre gained support from both East and West at different times. In the terms set out by Alexander Sack (see part 1) these are all, arguably, odious debts which are personal debts of those dictators their regimes and which, in Sack's words, "fall with the fall of this power".

Failed projects and dams

Tanzania owes the World Bank more than $575 mn for 26 failed agricultural projects, according to the Tanzania Coalition on Debt and Development. It cites the World Bank's own Operations and Evaluations Department, which in 1998 admitted that the Bank had failed to involve Tanzanians in appraising projects before they went ahead, and that "pilot projects went to the Board as proven undertakings; early warnings of failings by World Bank technical staff and co-financers were ignored; and pricing issues were neglected."

Table 3.6
Debts which can be attributed to dictators, $bn

Indonesia	Suharto	126
Brazil	military	100
Argentina	military	65
Philippines	Marcos	40
Syria	Assad	22
South Africa	apartheid	22
Pakistan	military	19
Sudan	Nimeiry/al-Mahdi	17
Thailand	military	14
Nigeria	Buhari/Abacha	14
Chile	Pinochet	13
Zaire/Congo	Mobutu	13
Algeria	military	5
Iran	Shah	5
Kenya	Moi	4
Ethiopia	Mengistu	4
Bolivia	military	3
Somalia	Siad Barre	2
Paraguay	Stroessner	2
Malawi	Banda	2
El Salvador	military	1
Liberia	Doe	1
Haiti	Duvalier	1

Source: Updated from Joseph Hanlon, "Dictators and debt" [98]

Indeed, the World Bank's own evaluation of project performance in the 1990s showed that in the poorest countries, and in South Asia and Africa, between 60% and 70% of projects failed, according to data obtained by the US Congress's Meltzer Commission in 2000.

Dams have proved to be one of the largest groups of failed projects. The use of hydro-electric resources is widely recommended as a renewable energy source that causes less environmental damage. There is, however, no free lunch, and large dams have proved to create a whole range of other problems. The California-based International Rivers Network (IRN) has been one of the most effective campaigners against large dams. It estimates that the Bank has provided almost $75 billion for 538 large dams in 92 countries.[99] World Bank lending for dams peaked in the late 1970s and early 1980s at more than $2 billion a year, declining significantly from the mid-1990s – in part because of protests by IRN and others, and because the Bank recognised that many of its dams were partial or total failures and had financial, social and environmental costs far in excess of expectations. IRN argues that the World Bank has been the largest single source of funds for large dam construction worldwide, and that it "played a key strategic role globally in spreading the technology, lending legitimacy to emerging dam projects, training future engineers and government agencies, and leading financing arrangements."[100] Thus "the World Bank owes a debt to the many millions of people whose lives it has destroyed through the financing and construction of large dams." Dams remain a highly contentious subject, and communities and pressure groups in the south do not always accept IRN's blanket objection to large dams. However, even the Bank accepts that some of its dams were unsuccessful, so lending for at least some dams must be considered illegitimate.

The list of failed projects seems endless and the reasons always seem the same – overwhelming pressure to lend, corruption, bad planning, and failure to listen to local experts. For many countries, the issue is the one raised by the United Nations Institute for Training and Research (see p.16), that developing countries lack technical know-how and are dependent on institutions such as the World Bank. These countries "should not bear the burden of bad planning and bad implementation performed by external sources"; responsibility and liability rest with the lender, not the borrower.

There is often a link between failed projects and support for dictators. In Nigeria, at least 61 development projects financed by more than $5 bn in foreign loans have either failed or never opened, according to a government commission.[101]

In Indonesia, the dictator Suharto moved millions of Javanese people to populate other islands. Many of the militia members who fought against East Timor independence were migrants sent there as part of the "transmigration" programme. Despite complaints about the human rights and environmental problems, the programme was funded, in part, by nearly $1 bn in World Bank loans.[102] Many of the migrants were put on marginal land where they could not survive, so the World Bank had to put in more money to try to support them.[103]

In the late 1970s, the World Bank teamed up with a brutal dictatorship in Guatemala known to be waging a war of annihilation against Mayan communities. The village of Rio Negro stood in the way of the Bank's plans to construct the Chixoy Dam. After villages refused to relocate from their ancestral lands in 1982, paramilitary forces massacred people. The massacre survivors have gone to the World Bank to demand compensation.

The arms trade

Most arms deals are backed by export credits or export loan guarantees on favourable conditions. During 1976-90, one third of French Export Credits were for weapons. Arms represent about 20% of the British Export Credit Guarantee Department's total export credits.[104] The London Sunday Observer and Campaign Against Arms Trade (CAAT) reveals that in 1999 African nations received $75 mn in arms in deals with British firms. That figure rose to $180 mn in 2000 and is expected to reach $300 mn in 2003.[105] There was a scandal in Britain in 2001 when the government approved the sale, on credit, of a $40 mn air traffic control system to Tanzania, one of the poorest countries in the World. The International Civil Aviation Organisation, World Bank and IMF all opposed the purchase, saying a civil system costing less than half as much would do a better job. "Tanzania has taken out an expensive loan from Barclays [Bank] to pay for the system; the World Bank and International Monetary Fund refused to lend money to purchase a system they regard as a white elephant," reported the *Guardian.*[106] The increase in arms sales on credit to developing countries is particularly worrying.

In the 1980s arms purchases accounted for 15-20% of all debt.[107] Much of the debt of Mozambique, Ethiopia, Cuba and Afghanistan to Russia is for arms imported from the former Soviet Union. But much larger debts are owed to western arms suppliers, particularly the US, France and Britain. Russia in 2000 gave China $1.2 bn in arms to pay off a debt.[108] The US forgave $7.1 bn in military debt in return for Egypt's support of the US in the Gulf War in 1991.

As well as the obvious point about arms provoking war and domestic instability, arms sales have always been surrounded by a cloud of corruption and kickbacks leading many countries to buy weapons they do not need. Loans for weapons are not productive loans; no investment is being made and the loans will not generate an income to pay themselves off as one hope with investments in production. Arms loans are consumption loans, and we asked in 1.4 about the wisdom and prudence of making consumption loans to very poor countries.

Conditionality

All loans by the IMF and World Bank are given on the condition that countries have agreed programmes with those bodies. In a narrow, technical sense, these are only conditions on IMF and World Bank loans, but for poorer countries, other aid, debt renegotiations and relief, and new lending are normally dependent on the country having IMF and World Bank programmes. Some countries have more than 100 conditions attached to their loans. The package of conditions has been given a variety of names, including "structural adjustment" and "neo-liberalism", but always follows the same pattern of smaller government involving spending cuts and privatisation as well as open markets and an end to protection of domestic industry. This package has widened the gap between rich and poor and has not yet done much to reduce poverty. The *Wall Street Journal* said the IMF is "impoverishing people in [a] way that is morally indefensible and politically unsustainable."[109]

We cite just two cases to show how important and inappropriate these conditions can be. In 1999, after Hurricane Mitch, the IMF put a cap on how much Nicaragua could spend on reconstruction. Although much more was on offer, Nicaragua was only allowed to spend $190 mn on rebuilding. And in Rwanda, the highly influential Danish study accused the Bretton Woods institutions of actually helping to create the conditions for genocide with their structural adjustment programme which "added to the already heavy burdens of Rwanda's poor".[110] The IMF and World Bank "overlooked … potentially explosive consequences when designing and imposing economic conditions."[111]

The debate about World Bank and IMF conditionality will continue to rage. It does, however, seem obvious that borrowing governments at least have a potential claim that the conditions imposed on IMF and World Bank loans were unacceptable, and that the governments were forced to accept these conditions only because of extreme financial stress.

part
4

A DEFINITION WITH SOME EXAMPLES

Part 3 has shown clearly that creditors were making international loans which would never have been acceptable under national laws, precisely because they felt that no one would ever bring them to account for improper lending, and that repayment would be enforced no matter how gross the misconduct by the lenders. So far, this has indeed been the case.

Lacking any definition in law, we have tried to define "illegitimate debt" in terms of national law and practice, and in terms of the few phrases such as odious debt, extortionate debt, and usury which have entered the legal language. We underline the need for a fair and independent adjudication process to consider claims of illegitimacy, and we distinguish the issue of illegitimacy from the issue of unpayability and from counter claims against the creditors

Defining illegitimate debt

"Illegitimate debt" is debt which the borrower cannot be required to repay because the original loan or conditions attached to that loan infringed the law or public policy, or because they were unfair, improper or otherwise objectionable. It does not include loans which were legitimate but which the borrower cannot now afford to repay, or which the borrower argues should be set off against other claims. We distinguish between the liability of creditors for illegitimate loans, and protection of debtors who took legitimate loans which are now unpayable. Illegitimate debts are ones which should not be paid, unpayable debts are ones which cannot be paid.

Illegitimate loans should be divided into four categories. We first separate the loans themselves (and the purposes for which they were granted) from the conditions attached to those loans. The purpose of a loan can be legitimate but the conditions attached to the loan can be illegitimate. Second, we distinguish between loans and conditions which are "unacceptable" and those which are "inappropriate". This leads to the following definitions:

A loan or condition is "unacceptable" if it is improper *prima facie*, that is, at first sight or obviously. In that case, following the British legislation on "extortionate" debt,
it is up to the lender to prove that the loan or condition was legitimate.

A loan or condition is "inappropriate" if it would have been acceptable in some other circumstances but not in the actual circumstances in which it was made.
The borrower must justify the claim of inappropriateness.

An illegitimate condition makes the entire loan illegitimate, even if the purpose or use of the loan is acceptable and proper. If social, environmental or other policy changes mean that a loan given in the past would not now be granted, this can be taken as evidence of illegitimacy.

We now give examples of the four categories of illegitimate debt.

Unacceptable loans

- Odious debts, such as those of the apartheid state in South Africa, and loans to dictators such as the Mobutu in Zaire, Duvalier in Haiti, Suharto in Indonesia, and the military in Argentina, which were clearly not in the interests of the people of those countries. They are loans taken by the regime and not the state.

- Loans which involve corruption, such as those for the Yacyreta dam. This would also involve arms loans involving kickbacks.

A DEFINITION WITH SOME EXAMPLES

- Loans directly linked to capital flight as happened in Argentina and Brazil in the 1990s, and loans whose proceeds were never sent to the borrowing country which happened in Argentina under the military.

- Loans for manifestly bad projects, such as the Bataan nuclear power station in the Philippines, and for environmentally damaging projects, especially ones such as dam projects and Indonesian "transmigration" which would not be funded now.

- Lending into pyramid schemes as were created in the late 1990s in Argentina and Brazil. Any loan made to Argentina after 1997 was manifestly imprudent.

- Successor loans, which are explicitly renewals, exchanges or rollovers of unacceptable loans, are also unacceptable.

- Private loans taken over by the state, nationalised or guaranteed and where the lender should have accepted the liability of a bad loan to a private enterprise.

Unacceptable conditions

- Usury, including the very high interest rates of the 1980s imposed on floating rate loans. In assessing usury, interest rates can be calculated in local currency or in the prices of the main export commodities. Comparison can also be used, so the requirement that majority-ruled South Africa pay higher effective interest rates than the apartheid government is necessarily usurious.

- Conditions which are illegal under national law, such as mortgaging Petrobras. This would include the requirement for repayment in violation of national law, such as the requirement for repayment of Brazilian debt before the audit required by the constitution.

- Conditions that violate public policy, such as cuts in health or education spending or the imposition of poverty wages on civil servants – especially where later statements by the international financial institutions admitted that such conditions were incorrect or unduly harsh.

- Conditions, especially related to policy lending, which prove to be harmful, such as deregulation and dollarisation in Argentina and Brazil – even if they are accepted by elected government.
- If new conditions imposed as part of a rescheduling are unacceptable, then it makes the underlying loan unacceptable.

- Requiring the government to nationalise or guarantee unacceptable or inappropriate loans made to the private sector.

Inappropriate loans

- Consumption loans made to poor countries, which have no chance of repaying without imposing unacceptable privation on their people. This includes loans which should have been grants, and as a result of policy changes in the 1990s, often now are grants.

- Loans to support lending-country public policy, such as assisting states like Mozambique under attack by apartheid, but which were imprudent because they had little chance of being repaid and which would be contrary to that public policy if repayment were demanded.

- Arms loans, particularly where they are in excess of needs, as for the Tanzania military air traffic control system.

- Loans to formally elected governments which had become dictatorial and were no longer using the funds in the interest of the people, such as Robert Mugabe in Zimbabwe or Alberto Fujimori in Peru.

- Loans which were used indirectly to repay or refinance unacceptable or inappropriate loans – nationalised inappropriate loans.

Inappropriate conditions

- Conditions imposed which make repayment of loans more difficult. This would include structural adjustment conditions requiring openness to trade or capital flows, which resulted in an outflow of money, which would otherwise have been available to repay loans.

- Harmful conditions, such as the closure of cashew processing factories in Mozambique.

- Restrictions which are inappropriate to the circumstances, such as limits on post-disaster reconstruction.

Other claims

In any insolvency process, the neutral arbitrator is expected to take into account money owed to the insolvent debtor. Indeed, a debtor can sometimes use insolvency procedures such as Section 11 of the US bankruptcy code to seek protection from creditors until such debts can be collected.

This is very different from claims that debts are illegitimate. But just as such claims are considered in a national insolvency process, so they must be part of an international debt resolution process. In particular, any campaign on illegitimate debts must also highlight the existence of counter claims, and demand that these be included. We cite three examples.

Capital flight

"Bringing back even a fraction of the $130 billion or so in Latin flight capital would take care of the region's debt servicing problems for years to come," wrote Karin Lissakers in 1986, and she actually suggested using the flight capital to pay the debts. She was a former US State Department official who later became the US Executive Director of the IMF, so she writes with some authority. And she quotes a representative of a major New York bank who explains that "there is no debate in [my] bank about the dual role of lending money to a country and accommodating flight capital."[112]

When banks come to demand repayment of loans, they do not come with "clean hands. Rich countries with the main banking centres have opposed tighter regulation for years, as they encouraged flight capital to go north to balance aid and investment flows. Only growing concern about illegal drug profits and funding for terrorists suddenly made them implement the rules that honest southern governments had been demanding for years. Foreign banks are accomplices in crime. Although many banks no longer have a significant part of the original illegitimate debt, having long since refinanced it or converted it to bonds and sold it off, one-third of Latin American debt is still with commercial banks.[113] Their complicity in theft means that they should be forced to negotiate the use of flight capital to repay debts.

A decade ago in her book *Odious Debts*, Patricia Adams made the point that "the Third World should repudiate its debts, not through appeal to charity but by recourse to due process of law. Declaring debts odious will compel the lenders – in order to recover some of the billions they've lost – to seek redress by pursuing and, where possible, seizing the booty of the unrepresentative Third World elites which borrowed so recklessly in the name of their people. In so doing the lenders will be discouraging future elites from similar behaviour."[114]

Compensation for loan damage

Creditors who made odious loans "have committed a hostile act with regards to the people," noted Alexander Sack. Thus when banks and international financial institutions lent to Mobutu or the apartheid government, they were not simply making bad loans, but also helping to oppress the people of those countries. The loans may have been repaid or refinanced, but it may seem reasonable to claim compensation for the damage done by the hostile act. South African Archbishop Ndungane has argued that banks which renegotiated loans with the apartheid state over the objections of the majority, and which thereby delayed majority rule, committed a hostile act and should be required to pay compensation. Similar, the government of the Congo should be able to claim compensation for the damage done to the country by the massive lending by the World Bank, IMF and western governments which helped to keep Mobutu in power and created the problems seen today.

Similarly, claims for social and environmental damage are being made against the World Bank for dam projects it funded. In some instances, the World Bank has offered new loans to correct the damage done by previous loans, but it seems unfair to increase the debt of poor people to correct the mistakes made by well-paid technicians in Washington.

Many of the examples we have cited are of loans which were given years ago and which would not now be repeated. But the debt crisis dates back to lending in the 1970s, and countries are being asked to repay loans which have their roots in that era. So if loans dating back that far, or their successors, must still be repaid, then the liability for damage caused by those loans can and should still be claimed.

We also raise the question of the liability of the IMF and World Bank for bad and incompetent policy advice, often backed by heavy and sometimes unacceptable pressure. Dollarisation and creation of a grand pyramid scheme in Argentina was a manifestly foolish and unworkable policy from the first, and it is arguable that the IMF should be required to compensate Argentina for the harm done.

Counter-debts and other forms of compensation

There is a growing movement to argue that the rich north has a debt to the south, historically for the slave trade and colonialism, and more recently for the damage done by Cold War proxy wars and environmental degredations. It is not the place of this paper to discuss the validity of these claims. However, based on national law and practice, it does seem reasonable that in assessing repayment of debts, counter-claims should also be considered.

There are at least two areas where this has been dealt with. In recent years there has been compensation to victims of the Nazis in World War II, and Germany gave a substantial amount of money and goods to the new state of Israel in partial compensation for the murder of 6 million Jews. Writing about Latin American debt, Marcus Arruda argues that similar compensation is owed "for the genocide of 100 million Amerindians and Negroes during the centuries of slavery", and that this compensation could be used to cancel the debt.[115]

Finally, a US court in Hawaii, where Ferdinand Marcos had fled, awarded 10,000 Philippine citizens $2 bn for human rights violations they suffered, and ordered that the money be paid out of the Marcos' estate.[116]

It is important not to confuse calls for economic justice with definitions of illegitimacy. In this paper we are trying to set out a clear definition of illegitimacy which is in keeping with national law and practice and with commonly accepted judgements of morality and debt. But any campaign for economic justice must go beyond simply the cancellations of illegitimate debt, and must take into account countervailing claims.

Final comment: why illegitimacy is important

The concept of "illegitimate debt" is important because it puts the liability for bad and imprudent lending back where it belongs, with the lender. The issue of moral hazard is important here, because creditors made illegitimate loans to developing countries which they would never have made locally under national law in their home countries because they assumed that the IMF and World Bank would enforce repayment, no matter how odious or dubious the loan. If lenders are not disciplined now, then they will know that they can make totally outrageous loans with total impunity. If discipline is to be reintroduced to the international capital markets, then moral hazard must be avoided and lenders must be penalised for past bad lending.

Campaigning on illegitimacy is also important as a contribution to ending blaming the victims. The concept of illegitimacy makes clear that much of the debt crisis can be blamed on corrupt and imprudent actions by the creditors rather than corruption and incompetence by the borrowers.

But the most important reason to campaign on illegitimacy is that it can have a real and practical impact on poor country debt. Over a four-year period, Jubilee 2000 took the arcane concept of poor country debt and turned it into a sexy political issue. Jubilee 2000 put the concept of **unpayability** on the international agenda, and forced the G7, the IMF and the World Bank to take action to cancel some debt (albeit not a lot). Next the Jubilee movement world-wide took up the issue of a neutral debt resolution process, **arbitration or insolvency**. This too, has now been taken up even by the IMF. Anne Krueger, IMF First Deputy Managing Director, in a series of speeches in late 2001 and early 2002 called for a formal Sovereign Debt Restructuring Mechanism (SDRM) analogous to domestic insolvency regimes like the US bankruptcy court.[117] She went on to argue that "The mere presence of a predictable formal framework should then encourage debtors and creditors to get together and reach agreement of their own accord. As in well-designed domestic bankruptcy regimes, most restructuring would likely take place 'in the shadow of the law' rather than through formal activation of the mechanism."[118] Finally, she alluded to the moral hazard issue when she commented that such a scheme would also help prevent crises by "reinforcing the fact that the official sector is not waiting on the sidelines to bail out imprudent creditors, [which] should help prevent crises by limiting overlending and overborrowing when times are good."[119]

There are many problems with Krueger's proposal. She suggests simply that a country would "come to the Fund and request a temporary standstill on the repayment of its debts, during which time it would negotiate a rescheduling or restructuring with its creditors."[120] Clearly this leaves too much power with the creditors. And the IMF's attempts to give itself a special role are clearly unacceptable, when it is one of the creditors.[121] In her most recent version of the proposals[122], she even suggests that a debt settlement would be subject to "adopting policies that were being supported by the IMF", when some debtors will in fact be blaming IMF policies for their debt problems. Instead, there needs to be a neutral party or arbitrator, as exists in national bankruptcy laws.

Nevertheless, the *Financial Times*[123] called Krueger's proposal "a bombshell" and "one of the most radical changes to international finance in a generation." Two things are important. First, the idea comes from international campaigners and was put on the agenda by international pressure – it proves the importance of putting pressure on governments and international financial institutions. Second, it means that there is now a high likelihood that some mechanism of negotiation or arbitration will be created. Such a mechanism will create a space where, for the first time, debtors can argue that certain debts are illegitimate, and that what Anne Krueger calls "imprudent creditors" should not be bailed out.

Now an invited paper[124] by the IMF has raised the issue of **illegitimate debt**, showing that this too, is being put on the agenda through international pressure.

An African finance minister once told me that they had not pushed for debt cancellation until they became convinced that the campaign was strong enough to actually win. Then that country argued publicly that its debt was unpayable. We face the same issue with illegitimacy – poor country governments won't use the argument unless they feel it has some chance of success.
Our goal as campaigners is to push the concept of **illegitimate debt** and lender liability higher up on the public agenda, just as we have already done with unpayability and insolvency, and to make it totally acceptable for a country to claim that some of its debt is illegitimate.

Economic justice means reversing the current transfer of wealth from poor to rich, and giving poor people and poor countries more control over their economic destinies. The debt trap has become an important means both to extract wealth from the poor and to impose policies on poor countries which increasingly seem not to be in their interest. Thus ending the debt trap is one important step toward economic justice.

Joseph Hanlon

RECOMMENDATIONS FOR FURTHER WORK

On the basis of this report, and through close dialogue with our partners and other relevant stakeholders, Norwegian Church Aid will formulate a position on illegitimate debt. We believe that implementation of this concept demands a global dialogue to articulate a more specific definition of illegitimate debt. To stimulate this process, **Norwegian Church Aid asks the following world actors to give a response to the outlined recommendations:**

A. The Norwegian Government

1. to recognise the concept of illegitimate debt.
2. to use its membership in the UN, the World Bank and the IMF to actively work for international recognition of illegitimate debt.
3. to find a meaningful definition of the concept, together with civil society actors and other relevant stakeholders.
4. to assess the possible illegitimacy of all debt owed to Norway. Priority should be given to bilateral loans granted through the ship export campaign.
5. to consider full commitment to the unconditional cancellation of all illegitimate debt, through releasing a new version of the Norwegian Debt Plan.
6. to use its membership in the UN to advocate the creation of a UN based international independent arbitration mechanism on debt.

B. Bilateral and Private Creditors

1. to unilaterally and jointly, in the Paris Club and the London Club, recognise their own responsibility for improper lending (such as lending money to apartheid South Africa) and actively engage in dialogue with debtor governments and other relevant stakeholders on this issue.
2. to give public access to all relevant information regarding public loans.
3. to actively co-operate with the UN in creating an international independent arbitration mechanism and consider how power can be transferred from the Paris Club and the London Club to this body.

C. Debtor Governments

1. to recognise the concept of illegitimate debt and engage in dialogue with national civil society and international creditors to find a meaningful definition.
2. to allow civil society's access to information regarding public loans.
3. to form alliances with other debtor governments, to demand cancellation of all illegitimate debt, when the concept has been defined.
4. to consider repudiation of repayment of potential illegitimate debt until an international independent arbitration mechanism has made a ruling otherwise.
5. to initiate the work of identifying potential counter claims.

D. The International Monetary Fund, The World Bank and other International Financial Institutions:

1. to recognise the concept of illegitimate debt and participate in dialogue with creditor and debtor governments, as well as civil society actors, regarding this issue.
2. to implement internal reforms regarding increased transparency and democratisation.
3. to assess the possible illegitimacy of multilateral debt. Priority should be given to assessments of, firstly, odious debts - loans given to 'despotic regimes'. Secondly, the extent of which new loans has been given to refinance old illegitimate debt, and thirdly, the possible ille-

Proposed Action Plan

1. Initiate: To create awareness about illegitimate debt. Publish and distribute this paper, stimulate dialogue and invite partners and other relevant stakeholders to respond to our recommendations for further work (2000-2002)

2. Define: In dialogue with our partners find a meaningful definition of illegitimate debt. (2002- 2003)

3. Mobilise: Create international support amongst politicians and academics, governments and civil society actors for the concept, and definition of illegitimate debt (2003-2004).

4. Campaign: To organise a mass grass roots campaign for the cancellation of illegitimate debt (2004-2005, if need be…).

RECOMMENDATIONS FOR FURTHER WORK

gitimacy of macro economic policy conditions, building on existing evaluations.

4. to support the creation of a UN based international independent arbitration mechanism on debt.
5. to implement unconditional cancellation of all illegitimate debt, once the concept is defined.

E. The United Nations:

1. to consider facilitating a dialogue between all relevant stakeholders in order to find a meaningful definition of the concept of illegitimate debt.
2. to create an international independent arbitration mechanism to deal with the issue of illegitimate debt and ensure international support. This mechanism should be given the following mandate:
   a) to rule debt illegitimate and enforce cancellation of such debt, in accordance with an internationally recognised definition of the concept,
   b) to consider claims for compensation by the debtor, and
   c) to consider a country's ability to serve the remaining debt burden without violating its human rights obligations.

F. The International Church

1. to consider ways of promoting the concept of illegitimate debt and contribute to a clear definition through engaging in dialogue with governments, international institutions and civil society actors.
2. to document the negative social and economic effects of the debt burden and the conditions attached to new loans and debt relief.

3. to mobilise social movements and build alliances in order to organise advocacy campaigns for unconditional cancellation of illegitimate debt, once the concept is internationally defined.

7. Academia

§ to encourage more research on the relevance of the concept of illegitimate debt in relation to historical and current economic and social realities.

§ to contribute to the international process of recognising and finding a meaningful definition of the concept of illegitimate debt.

§ to play an active role in bringing the international community closer to concrete political decisions on this issue.

§ to find ways of establishing the intellectual framework for an international independent arbitration mechanism on debt.

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