



# **Commentary<sup>1</sup> on the draft World Bank paper “The concept of Odious Debts: some considerations”, published Sept. 7<sup>th</sup> 2007**

## **Summary**

*The draft paper is incomplete, selective and misleading in its treatment of existing literature. Its conclusions are therefore based on shaky foundations and reveal themselves to be biased and flawed. The paper requires substantial rewriting and a further round of rigorous peer review by experts in the field working from different vantage points.*

## **1. A document with a telling history**

After its decision to unilaterally cancel claims on five countries for assumed creditor co-responsibility, Norway requested the World Bank to commission a Bank paper on the applicability of the Odious Debt (OD) doctrine and made money available for the study. The Bank less than welcomed the task and for some time simply denied that any commissioning had taken place; when this was no longer possible the then head of the debt department Vikram Nehru indicated to NGOs that it was completely up to the Bank if it would ever do the paper. Despite this, the Legal Department assumed responsibility and employed a consultant. The resulting paper, which was largely a simple stock-taking exercise, was obviously not negative enough for the stated purposes of the institution. So the issue was seized by the Debt Department again and the paper was re-written.

Despite having been very cautiously produced by the Economic Policy and Debt Department with input from the Legal Department, it still carries a disclaimer as not representing official Bank views.

## **2. The essence of the paper**

The authors dismiss the idea that there could be anything like an applicable OD doctrine. The reasons being that (a) a broad range of proposals for defining OD has been brought forward, and these are occasionally contradictory; (b) none of the common sources of International law - treaties, state practice and international custom - has already produced a coherent OD doctrine in the proper sense of the word.

The authors doubt whether anything like a defensible doctrine has a chance to ever be developed. They therefore proceed to suggest that the "in principle laudable" intentions of OD proponents are best being served by other mechanisms, namely the WB's various attempts to (finally) combat corruption or by its debt reduction mechanisms based on the concept of debt sustainability. Consequently the third part of paper presents some largely uncontroversial proposals about overall fairness and transparency in the loan making process, remotely related to the OD doctrine's purpose of holding bad lenders to account.

Beyond this, the paper recommends the enhanced application of voluntary codes of conduct like

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<sup>1</sup> Thanks to Alex Wilks (EURODAD) for helpful comments.

the private sector's "Equator Principles".

### 3. Critique of the big picture...

This is not the first time that the WB tries to sell itself as the best solution to a global financial problem. However, it seldom happened with such a high degree of effrontery. Key elements of the paper's line of argument are:

Arbitrary references: The paper distinguishes in some irreproducible way between a "traditional concept and categories", as developed by A.N. Sack, for which then "war, subjugation, regime debts" are dealt with and an "expanded concept", for which then equally arbitrarily "criminal", "ineffective" "inefficient"<sup>2</sup> and "unfair" debts are being referred to. No explanation is given for either selection from a broad set of phenomenological descriptions. Worse still, no reference is made to the more generalized criteria established by Sack and subsequently by King, Khalfan and Thomson or the more recent concepts of *ius cogens* violations<sup>3</sup> and domestic debtor protection<sup>4</sup>. All of them are specifically intended to overcome the weakness of somewhat arbitrary and largely phenomenological definitions. Only by ignoring them the World Bank is able to paint the pitiful picture of messy array of contradictory definitions.

Anecdotal rejection: In dealing with Sack the authors refer to three descriptive categories of the Russian scholar, but, surprisingly not to the three "classic" generalized criteria, i.e. absence of benefit, absence of consent and creditor awareness, which more than the terms analysed in the WB paper, have influenced modern scholars' thinking. Consequently the critique of Sack's builds on occasional counter-evidence (like Austria/Czechoslovakia after WW I on p.9 and the RSA's decision to rather pay apartheid debt than repudiate it, p.15) but lags far behind the analytical sharpness, which has led NGOs and academic proponents of an OD doctrine to start thinking beyond Sack. Authors like Bedjaoui, Abrahams and Michalowski are only referred to as witnesses for the deficits in Sack's classical doctrine (p.8ff), doing a severe injustice to their nuanced arguments.

Short-cut conclusions: On p.13 the Bank admits that a series of odious debt cases are undeniable; however, the Bank considers as "highly doubtful", whether these instances have amounted to general practice. It does so without indicating, which number of cases, what degree of official involvement, what (other) type of treatments would have fulfilled the stated requirement of a "general practice". Here, as well as while very selectively quoting Michalowski (fn 21), the authors fail to distinguish between an already established OD doctrine and a state practice, which needs to be analyzed in order to establish, whether a doctrine could eventually develop out of such practice. Were the Bank's attitude in this case, common practice, international law would be dead in the water without any possibility to ever develop any further.

At times of high international liquidity voluntary codes are held in high regard. However, if the Bank identifies the need to prevent reckless lending and corruption, it is clear that voluntary codes will not go a particularly long way in deterring lenders (or borrowers), which have enough criminal energy to provide (or take out) repressive loans in the first place.

Superficial reading of legal history: Interpreting the fact the International Law Commission has declined to adopt a draft article as a rejection to apply the OD doctrine altogether, simply ignores

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<sup>2</sup> This term is quite unknown in either the academic or the civil society debate on OD.

<sup>3</sup> see for this school of thought: Sabine Michalowski's book: Unconstitutional regimes and the validity of a sovereign debt. A Legal perspective; 2007. However, Michalowski is only referred to in her critique of the classical OD doctrine, while the huge potential of an OD concept based on *Ius Cogens* norms is simply ignored.

<sup>4</sup> For this school of thought see: Buchheit/Gulati/Thomson: The dilemma of Odious debts; Duke Law Journal 56 (2007); this volume can also be found on the Bank's papers reference list, but its content is not taken into account.

the possibility that the status (not the content) of the doctrine could be based on other juridical instruments than codified law. This is particularly astonishing given the prevalence of informal and ad-hoc practice based on gentlemen's agreements rather than codified terms in international debt management – the most important example for this being the Paris Club.

Guided research: Parts I and II of the paper provide very superficial analysis of selected segments of the present OD debate. The all too obvious intent behind this is to pave the way for the white knight from H-Street, who then saves the “laudable intentions” of all too naive OD proponents by introducing them to the broad range of efforts which the Bank is already undertaking to improve debtor-creditor relations more generally.

This reference to the various instruments the World Bank has already been considering for a while is particularly annoying. These instruments have in common that as far as creditor behaviour is concerned they all build on the voluntary acceptance of standards and codes. They generally establish standards, which bind in those who are not the problem on the lending side, and with absolutely no instruments to enforce them on unwilling lenders. Instead, pressure on the borrowers, like in the Debt Sustainability Analysis, is presented as coercive action. Thus the “different approach” in addressing the concerns that motivate many of these (OD) proposals, follow the Bank's usual scheme of just pretending activity on an undeniable problem in international financial relations, in order to make sure nobody else will occupy the drivers seat of a relevant international debate.

Positively, the paper refers to dispute resolution mechanisms (p.34), particularly national courts and international arbitration – unfortunately without raising the question why those mechanisms have so far not led to any substantial elimination of questionable claims (which may have to do with the WB's role in existing dispute mechanisms after all).

#### 4. ...and of some details

- *"That countries must either pay their unsustainable debts or repudiate them is false dichotomy".* (p.4). Correct, it is not only a false dichotomy; moreover it is one, which nobody has suggested - but helps the bank smooth the argument towards suggesting that its Debt Sustainability Framework, which is all about quantity but in no way about quality of claims, could be helpful in some way. More recent debates on an O.D. concept have been exploring ways to establish illegitimacy as a far more flexible instrument.<sup>5</sup>
- At the very beginning of the paper the Bank rejects one of the three approaches, currently much discussed among NGOs and academics, namely the application of national debtor protection legislation. The Bank simply states that the question whether a national OD doctrine exists, needs not be addressed in the present paper.(p.6) It is even more explicit in this rejection in fn 18, completely ignoring the approach explicitly pursued by Buchheit/Gulati/Thomson (although that paper appears in the references), which explores (positively) the potential of law figures like "unclean hands" and "agency".<sup>6</sup>
- Authors consider creditor co-responsibility as generally hard to implement (p.19/20), by pointing to domestic court competence and to substantial information deficits on the part of the lender. However, the fact that a legal responsibility is difficult to establish, must as a matter of principle in no way prevent the definition of legal responsibilities and matters of fact. Had the Bank the ability to imagine debt renegotiation beyond those mechanisms,

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<sup>5</sup> Ben-Shahar,O. and M. Gulati: Partially Odious Debts? A framework for an optimal liability regime; Journal of Law and Contemporary Problems 2007.

<sup>6</sup> Not to mention the recent official US govt response to improve borrowing terms for some (house-owning) victims of the sub-prime mortgage crisis – a telling evidence of the evolution of domestic law to overthrow the supposed inviolability of contracts.

which it has designed itself, it might eventually understand that e.g. an arbitration court would be able to deal with matters, which have been defined with less than 100% clarity. Relevant questions like “has due diligence been exerted by the lender? And if not, what does this mean for the validity of his claims?” are obviously not in the orbit of the WB.

- The paper goes some way to reject the Kremer/Jayachandran approach of declaring regimes odious *ex ante*. NGOs have rejected this approach immediately after its publication, and except for scattered sympathizers in the IMF and the US government, nobody has ever supported the proposal. (p. 14ff).
- The authors try to cultivate the old myth that exerting discipline on creditors by questioning the enforceability of their claims will run the risk of “disrupting international financial flows to developing countries altogether”. Fifteen years ago, these doomsday fantasies were standard fare for the Bank while rejecting the idea of debt relief altogether. Never have they materialized anywhere to any discernible extent; and enforcing haircuts on creditors through Paris Club and HIPC arrangements is being fostered by the Bank itself with the explicit aim of restoring creditworthiness of the debtors. Also have involuntary restructurings like Argentina’s, which has come with a strong rhetoric of creditors’ co-responsibility led to anything like a credit crunch. No explanation is given by the authors, why an orderly process of assessing and sanctioning creditor co-responsibility should lead to a drying up of financial flows to debtor countries this time.

## 5. What to do with such a paper?

Among two common options the Bank usually applies when it is confronted with an unwelcome issue like this one – either dismiss the issue as irrelevant altogether or try to spearhead the debate and make sure it is channelled towards the Bank’s own interests – Vikram Nehru et al. have clearly chosen the former. Suggesting World Bank *ex ante* anti-corruption efforts and *ex post* sustainability-based cancellations as a remedy to the structural problem of counter-productive and reckless lending is so ridiculous that it can not even be considered as a serious effort towards the second option. This contrasts with the Bank’s actions in the mid-1990s when the need of debt relief for the poorest countries was no longer deniable, and the Bank in an admirable move managed to strengthen its own position by foregoing its own claims, and more so even without much of a financial loss.

That is a pity for all those who had hoped that given both, the traditional OD concept’s weaknesses, and the vibrant academic and civil society debate about new approaches, strong positions from stakeholders with different perspectives and interests could further sharpen the analysis and move the concept closer towards applicability. This is the more disappointing as a part of the Bank’s approach alleges to be based on exactly that: take up the noble and urgent intention of enhancing the scope of responsible lending. However, trying to score a point by channelling the water of such a debate all too easily onto the mill wheels of already existing World Bank approaches, mechanisms and facilities, is an all too obvious attempt.

Conclusions (p.35) seem to indicate that the Bank has simply nothing to say any more about the issue. Given the many omissions and misperceptions in the paper, one could indeed give up hope. However, recalling the Bank’s long journey from “Multilateral debts must be paid under any circumstances” in the early 90ies to large scale HIPC/MDRI relief after the Jubilee2000 campaign, one could hope that the “Knowledge Bank” may again start to listen and learn.

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