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LIFTING THE LOAD OFF THEIR BACKS : LEGAL SOLUTIONS TO THE THIRD WORLD DEBT CRISIS

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I sit on a man's back, choking him and making him carry me, and yet assure myself and others that I am very, very sorry for him and wish to lighten his load by all possible means --- except by getting off his back.

Leo Tolstoy

INTRODUCTION

It seems obvious that if the precepts of the Declaration on the Right to Development were truly applied in the international context, there would be no debt crisis. That is, the duty of States "to promote a new international economic order based on sovereign equality, interdependence, mutual interest and cooperation among all States"[1] would preclude wealthy countries allowing a situation to persist in which the living standards of a large part of population in the Third World[2] actually regressed over an extended period of time, due to financial and not to any physical or environmental circumstances.

On the other hand, more sceptical observers have already hastened to point out that the official positions taken in relation to the goals of a New International Economic Order are ill-suited to being rendered as binding legal rules.[3] In this sense, the declaration merely demonstrates in the sphere of international trade and finance the dilemma faced by public international law more generally. It cannot ensure the definitive settlements of problems in international relations, but only offer means and mechanisms by which to resolve them, since unlike the application of domestic law to disputes between private parties, public international law is a system of norms which are largely unenforceable. Only political will ensures that they are respected.

This essay will briefly describe the Third World debt crisis and then consider some of the measures which have been proposed to alleviate the burden. All of these proposals will be discussed both in terms of the degree to which law can be used to justify or enhance them and in light of their practical consequences.

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1. Art. 3(3), U.N.G.A. Res. 41/128, 4 December 1986.
2. By Third world I mean the countries outside Europe and North America, with the exception of Japan, Australia and New Zealand. I acknowledge that, like all generalizations, this category poses certain problems: notably the growing wealth of the "newly industrializing countries" of East Asia, such as South Korea and Taiwan, which have significantly reduced their dependence on commodity exports in favour of manufactured goods; in addition, the unique size of the economies of the Asian giants, India and China.
3. See, for instance, Norbert Horn, "Normative problems of a New International Economic Order" *J. of World Trade L.* vol. 16 (1982), p. 338.

It is my view that while the law appropriately classifies the repayment of debts as an obligation, in the public sphere still more than between parties, repayment can only be one duty among many, which must also include justice and solidarity. While a number of legal justifications can be found for valuing one goal over others, it remains in the final analysis a moral or ethical choice which must be imposed by the use of political means.

II. CAUSES AND CONSEQUENCES OF THE DEBT CRISIS

1. The Historical Causes

Unusually among economic problems, the causes of the Third World debt crisis cause little controversy among scholars and analysts. The disagreement therefore arises over the appropriate solutions.

The "oil shocks" of the 1970s were the result of successful efforts by the Organization of Petroleum Exporting Countries (OPEC) to raise the world price of their chief commodity : it increased by fully 1,200 per cent between 1973 and 1979.[4] For all oil-importing countries, this sharp increase in the cost of the most important source of energy caused a significant increase in the outflow of funds required to pay for it, generally in convertible Western[5] currencies. For many oil exporters in the developing world, such as the Gulf states, the sudden deluge of hard currency was more than they could absorb and they invested much of their new-found wealth in Western financial institutions.

A large part of these so-called "petrodollars" were in turn recycled to oil-importing countries in the developing world through short - term loans at floating interest rates. These appeared to be a solution to two problems: they addressed oil's serious drain on their balance of payments, while creating new demand in the Third World for the exports of the Western nations, whose economies were entering a recession. For more populous exporting states such as Nigeria and Mexico, meanwhile, large oil reserves constituted impressive assets which they could use as security to borrow funds internationally for ambitious development projects.[6]

The second oil shock of 1979 was followed by a change in Western monetary policy in which interest rates, particularly in the United States, were raised sharply to bring an end to persistent price inflation and to raise the value of Western currencies. "By mid-1981 the debtor countries had suffered a triple blow : the rise

4. Joyce Kolko, *Restructuring the World Economy* (New York : Pantheon, 1988), p. 163.
5. In this paper, the term "Western" refers to the wealthy, industrialized nations of Europe and North America, as well as Japan, Australia and New Zealand. I have avoided the term "the North" in order to distinguish these countries from the former command economies of Central and Eastern Europe.
6. A very brief summary of this process is provided in Norbert Horn, "The Crisis of International Lending and Legal Aspects of Crisis Management " in Norbert Horn, ed. *Adaptation and Renegotiation of Contracts in International Trade and Finance* (London, 1985)/295 at 297-98. For a more critical perspective, see Susan George, *A Fate Worse Than Debt* (London,1988), chapters 1 and 2, "How much is $1 Trillion?" and "The Money Mongers."

in the oil price, the interest rate war [among Western nations], and the subsequent rise in the value of the dollar, in which both debt and oil were denominated."Rising interest rates also brought on recession in the richer nations, reducing demand for the commodities on which most developing nations'exports were heavily dependent. Even the price of oil began to fall by 1982 and in this context the result was a crisis in the ability of most Third World nations to pay the debts they had incurred during the 1970s.[7]

THE CURRENT CONSEQUENCES

Since then, the debt crisis has been notable for two charaacteristics: its long duration and the involvement of the international community. Most developing countries have been unable to improve their export earnings significantly, due to the increased volatility of commodity prices caused by the failure of existing international commodity agreements, declining demand due to technological innovation and a growing supply, as each developing country attempts to solve its own trade problems by increasing and diversifying primary exports.[8]

At the same time, the relative demands of foreign debt on the economies of developing countries has grown: high interest rates ensured the continuing decline of domestic currencies as the value of the borrowed dollars appreciated; they also ensured that the total value of the debt compounded rapidly into higher and higher sums. The lending of the 1970s had produced net capital in-flows from the Western nations to the developing world, but to the extent that the poorer nations met their debt obligations in the 1980s, they ensured a net capital outflow to the Western nations. For instance, Latin America paid U.S. $ 144 billion in debt service between 1982 and 1985 while receiving only $ 38 billion in aid and investment.[9]

The second characteristic of the debt crisis has been the heavy involvement by the creditors' governments and by the International Monetary Fund (IMF), as well as the World Bank. Scholars have pointed out that while the pre-World War I era did see the use of "gunboat diplomacy" by imperial powers to enforce debts owed to their citizens, the debt crisis of the 1930s saw a large number of countries default on their bondholders with relative impunity, particularly in Latin America. "What is different about the 1980s is a global official intervention, one shaped at least in part by an unprecedented exposure of a few major lending banks to country risk."[10]

THE ROLE OF INTERNATIONAL INSTITUTIONS

Mexico brought the debt crisis to international attention when its government announced in August 1982 that it was not able to meet payments on its estimated

7. Joyce Kolko, note 4, pp 41-48.
8. *Id.* at chapter 9, "New Developments in RawMaterials and Agriculture."
9. Susan George, note 6, at p. 63.
10. Peter H. Lindert, " Responses to the Debt Crisis: What Is Different about the 1980s?" in Barry Eichengreen and Peter H.Lindert, eds. *The International Debt Crisis in Historical Perspective* (Cambridge, Mass, 1989) p. 227 at p. 263.

$80 billion in foreign debt. Similarly, the case of Mexico set the pattern for future restructuring of Third World debt:the IMF contributed $1.3 billion and governments of creditor countries $2 billion in new loans to enable Mexico to meet its immediate obligations, but they insisted that private banks contribute another $5 billion. Debts were neither forgiven nor reduced, but "rolled over" or rescheduled so as to come due further in the future. In return, the Mexican government was obliged to impose an IMF-designed austerity program it had earlier resisted.[11]

Since then, the IMF has taken on a coordinating role in all major debt rescheduling. To indebted developing countries, it presents a plan designed to improve their balance of payments by treating the problem primarily as a domestic policy question, not as the systemic result of international trade. The chief characteristics of these plans, in addition to a heavy emphasis on reducing imports and increasing exports, are usually: " reduced government expenditures (particularly cuts in social service spending, food subsidies, and wages, since these are both more visible and more politically acceptable to many governments than cuts in defence budgets or civil service salaries), higher tax rates, domestic credit ceilings and higher interest rates, liberalization of exchange controls and devaluation, all of these to be applied relatively quickly in a 'shock' rather than a 'gradualist' manner.'[12]

In return for this "structural adjustment", the debtor nation is ensured considerable access to credit. As one scholar has discretely put it :

> Recognizing that maintaining the flow of adequate financing to the country in trouble is a necessary part of any adjustment effort and that the Fund can provide only a small portion of the necessary means, the Fund has begun since 1982 to clearly define in its recovery plan what amount of new credits from the banks it deems necessary for the success of the program and has begun to urge the banks by moral persuasion to enter into new commitments of the size proposed. This policy of the Fund is supported by important national banking authorities.[13]

In other words, in return for imposing macroeconomic measures ensuring creditworthiness, the IMF and creditor countries' central banks force private banks to roll over their loans to the debtor nation.

In practice, the successful negotiation of a structural adjustment program has become the precondition for most major sources of credit for developing countries. No write-off of private debts (as opposed to those owed to Western governments) has taken place, though the value of sovereign loans on the banks's balance sheets has been written down substantially and in some cases written off.

11. Susan George, note 6, at pp.40-44. The United States government proved particlarly anxious to cooperate since Mexican loans represented almost half of the capital of the nine largest American banks.
12. G.K.Helleiner, *The New Global Economy and the Developing Countries: Essays in International Economics and Development* (Aldershot, England, 1990), p. 53.
13. Norbert Horn, note. 6,at p.303.

The IMF itself professes not to be able to "take upon itself the role of dictating social and political objectives to sovereign governments",[14] suggesting that its economic policy prescriptions are neutral and objective. Nevertheless, the effect of structural adjustment has been to reduce redistributive efforts by governments and therfore to accentuate social inequality. A leading development economist concludes that as a result of these policies:

> A high proportion of the world's poor, notably those in sub-Saharan Africa and Latin America, at best spent the 1980s in a 'holding pattern.'In Africa, the progress of a whole post-independence generation was lost and the costs of cutbacks to child health, nutrition and education will be felt for more than another generation.

Meanwhile the problems of low commodity prices, high debt-service ratios, stagnant capital flows and shortages of foreign exchange have all persisted, in spite of the avowed goals of structural adjustment. In fact, per capita incomes declined throughout the 1980s in sub-Saharan Africa and Latin America, leading to the description of the period there as a "lost decade."[15]

III. LEGAL SOLUTIONS TO THE DEBT CRISIS

A Contract Law justifications for Repudiation

1. Rebus sic stantibus: Fundamental Change in Circumstances

Susan Gerorge asked the question close to a decade ago: "Given all the obstacles in their paths, why don't Third World countries simply refuse to pay -- tell the banks and the creditor governments where to get off, so to speak?" As she points out and as noted above (supra, section II.), sovereign debt default would not be a new phenomenon in international finance.[16] As we shall see, there are both legal and practical reasons not to repudiate, but it is worth examining the legal justification for a state's decision simply not to pay its debts.

One international lawyer offered the following useful summary of the broad legal problem posed by the debt crisis:

> If the foreign debt crisis problem of developing countries -- especially the middle- income countries of Latin America -- could be reduced to a contest of legal principles, expressed in Latin, it would pit the concept of *pacta sunt servanda* against the concept (or defense) of *rebuc sic stantibus.*
>
> *Pacta sunt servanda* -- one of the basic legal principles underlying our social and economic systems, means that contractual commitments must be honored.

14. Jacques de Larosiere, "Does the Fund Impose Austerity?" (Washington, D.C.: International Monetary Fund, 1984) as cited in G.K. Helleiner, note. 12, at p.155.
15. G.K. Helleiner, note 12, at pp.8,7.
16. Susan George, note 6, at. p. 67.

The concept of *rebus sic stantibus*, on the other hand signifies that this principle may not apply when circumstances have substantially changed.[17]

The question is therefore whether the changed circumstances constituted by the precipitous decline in the Third World's terms of trade and the steep rise in Western interest rates are sufficient to justify a unilateral derogation from the original terms of the loans, which are the contracts at issue.[18]

Norbert Horn believes they do not: " After all, no nation's contract law recognizes the inability to pay as a ground for relief from contractual liability." In his view, "mere insolvency" does not constitute *force majeure* (an unforeseeable and irresistible event) nor extraordinary hardship sufficient to provide relief on the grounds of impossibility or commercial impracticability. There has been no change in "the values of each party's promised performance as set out in the contract", which the doctrine of *rebus sic stantibus* sets out as a requirement.[19]

But on a different interpretation of the facts, at least one scholar has taken the contrary view. He points out that when real interest rates rise in the creditor country (or in a third country in whose currency the debt is denominated) so that the currency increases in value, the result is "higher payments on the part of the debtors to the advantage of the creditor." An adjustment of loan agreements would be justified "if the parties assumed their contractual obligations believing in the stability of the international monetary system [and] their payment obligations suddenly undergo significant increases as a result of the national policies of other countries."[20]

The difficulty with such an argument based on the intention of the parties concerning exchange rates is that it becomes weaker with every passing year, as the collapse of the 1971 Bretton Woods Agreement ensuring monetary stability recedes into the past. Since then and since the 1974 Second Amendment to the IMF's Articles of Agreement allowed a free system of national monetary policy, the unpredictability of foreign exchange rates has become increasingly obvious.[21]

If the crucial factual element arguing that a substantial change in circumstances has taken place is not the parties'expectations, then another author argues it must be "the undisputed fact that some of the key circumstances which made the original

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17. Peider Konz, "The Third World Debt Crisis" *Hastings Intl. and Comparative L.R.* vol. 12 (1989).p.527 at p. 527.
18. Changed circumstances as grounds for terminating or withdrawing from the contract are not generally included in international loan agreements, according to Stephen A. Silard, "International Law and the Conditions for Order in International Finance : Lessons of the Debt crisis" *The International Lawyer* vol. 22 (1989),p. 963 at p. 968, fn. 20. However an explicit reference is probably not necessary, since the essence of the notion of rebus sic stantibus is that it refers to the parties' implicit assumptions and expectations.
19. Norbert Horn, "The Crisis of International Lending and Legal Aspects of Crisis Management" note 6, at pp.310-311.
20. Peter Sarcevic, "Two Approaches to the Debt problem: A) Adjustment of Loan Agreements (*De Lega Lata*);B) Strengthening of International Monetary Soft Law (De Lege Ferenda)", in Detlev Chr. Dicke, ed., *Foreign Debts in the Present and a New International Economic Order* (Fribourg, Switzerland, 1986)p.130 at pp. 140-41.
21. *Id.* at pp. 132-36, 138-39.

commitments so onerous were within the exclusive control, that is within the discretion, of the creditor countries."[22] Unfortunately, while this may apply to loans made by the creditor-country governments, for all other loans these policies are the actions of a stranger to the contract and they cannot alter the terms freely agreed to between the borrowing countries and private lenders.

2. Equitable Principles

The notion of *rebus sic stantibus* therefore provides at best a very partial solution so long as the question is posed in terms of standard contract law principles. However the ambit of contract has itself been considerably modified in recent years in the domestic law of Western nations.

In common law countries, the court may now often consider whether, "when the bargaining power of the contracting parties was quite unequal, it might be appropriate to apply notions of what could be considered fair and reasonable in deciding whether a contract should be upheld."[23] In civilian systems, increasingly, "in the interpretation and settlements of agreements, situative and interest considerations are included." As a result: "Especially the norms akin to morals (*bona fides; boni mores*) in national and international law prove themselves to be the gateways for social and political considerations."[24]

Thus it is possible to develop a line of argument based on an appeal to equitable principles which is conceptually separate from *rebus sic stantibus* but relies on many of the same factual elements. This was the approach taken by a Peruvian diplomat in 1986 at a symposium of the International Law Association's Committee on Legal Aspects of a New International Economic Order. Six months earlier, the government of President Alan Garcia had refused to negotiate directly with the IMF, attempting instead to deal directly with creditors, and had unilaterally fixed annual payments on its debt at 10 per cent of hard currency export earnings. With a total debt owing at the time of around $14 billion, or four times annual export earnings, the economic merits of the approach were clear.[25]

Presenting the legal case for Peru's policy, Ambassador Antonio Belaunde-Moreyra said:

> The radical course of action embarked upon by the Government of Peru is no simple desperate gesture; it rests on deep rational foundations to which we believe some attention should be paid. It is above all a call for equity...[26]

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22. Peider Konz, note. 7, at .p.528.
23. Wade Mansell, Legal Aspects of International Debt" *J.of L. and Society*, vol. 18 (1991).p.381 at 392.
24. Gunter Frankenkenberg and Rolf Knieper, "Legal Problems of the Overindebtedness of Developing Countries: The Current Relevance of the Doctrine of Odious Debts" *Intl. J.of the Sociology of L.*, vol.12 (1984), p. 415 at pp. 424-25.
25. Antonio Belaunde-Moreyra, "Dramatic Action or Muddling through Strategy in the Debt Problem" in Detlev Chr. Dicke, ed. *Foreign debts in the Present and a New International Economic Order* note 20.p.10 at pp.10-12.
26. *Id.* at p.14. See also Dr. W.-A.Benedek's comment "that equity, as a general priniciple of international law has a role to play with regard to the question of sharing the responsibility for the solution of this crisis, just because the causes are not on the side of developing countries alone": "Discussion" in Detlev Chr. Dicke, ed. note 20, at p. 115.

Equity, by his definition, was the principle that 'the supreme value of law is not its security but its justice.'[27] As a result, he said:

> ... Peru does not repudiate its debt; on the contrary, my country acknowledges it and affirms its will to pay, but on conditions that should not be equivalent to a submission to a sort of serfdom. The debt has to be restructured so that it may cease to be the insane and exorbitant load that it is now. Not doing this would be manifestly unjust.[28]

Thus Peru was able to provide a reasonable defence of its policy as a lawful course of action.

3. Practical Implications of Repudiation

However Peru's example, which fell well short of complete repudiation of its debt, was not followed by other countries. Moreover, it was abandoned after 1990 by Garcia's successor, Alberto Fujimori, who resumed negotiations with the IMF and imposed a severe austerity program. To what can we attribute its failure? Significantly, not to its legal consequences.

The possibilities had been menacingly described in 1983 by R.T. MacNamar, then United States Deputy Secretary of the Treasury:

> A repudiation takes place when a borrower unilaterally renounces responsibility for some or all of his debt obligations. Under such circumstances, the foreign assets of a country repudiated its debt would be attached by creditors throughout the world; its exports seized by creditors at each dock where they landed; its national airlines unable to operate; and its sources of desperately needed capital goods and spare parts virtually eliminated. In many countries, even food imports would be curtailed. Hardly a pleasant scenario.[29]

Yet none of this happened to Peru, which merely saw its credit cut off by international institutions such as the IMF, the World Bank and the Inter-American Development Bank.[30]

In fact, it was never very likely that these dire consequences would afflict Peru. It is true that creditors seem to dispose of an impressive legal arsenal: the doctrine of state immunity is not generally held to apply to international borrowing,[31] while loan agreements usually include express waivers of immunity and "elaborate acceleration and cross-default clauses, permitting creditors to accelerate their loans

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27. *Id.* at p. 18.
28. *Id.* at p. 20. Unfortunately, Belaunde's legal analysis is weak and uses the notions of equity and rebus sic stantibus interchangeably.
29. Copy of a speech to the International Forum, of the U.S. Chamber of Commerce, 12 October 1983, as cited in Susan George, note 6, at p. 67.
30. *Id.* at p. 216.
31. Norbert Horn, note 6,pp.304-305.

and pursue collection action upon event of default to any single creditor''.[32] But even the power to seize assets is not necessarily decisive. A former Special Assistant to the U.S. National Security Council suggested that a preventative exercise of the debtors' existing legal rights could include ''a series of maneuvers designed to prevent attachment of assets abroad, such as sale and leaseback of ships, sale of products at the point of origin rather than the destination. etc.''[33]

More importantly, it is perfectly clear to creditors that even if their enforcement action could withstand legal arguments concerning sovereign immunity, conduct which brings the weakened economies of debtor nations to a standstill merely further reduces the prospects for any significant repayment. The most basic characteristic of the economies of developing nations is that they receive less for their exports than they pay for their imports and are therefore constantly in need of convertible currency. Trade policies designed to reduce imports and increase exports are not enough to correct this imbalance and the shortfall can only be met through continued borrowing. That is, only new loans will ensure payments on the old loans unless there is a dramatic change in the borrower's balance of trade.

While defaults and even payment moratoria by Third World debtors have occurred frequently, repudiation has not: the principal sources of liquidity, the IMF and the World Bank, are not surprisingly reluctant to extend further credit to countries which seriously dispute the legal justification for their existing obligations. Repudiation is only politically and economically feasible if a country also undertakes a policy of autarchy, as North Korea has done.[34]

B. The Doctrine of Odious Debts

Another legal reason which has been offered for Third world countries to refuse to pay their debts is the characterization of those debts as ''odious.'' Unlike the arguments considered above concerning equity, impracticability or impossibility, the doctrine of odious debts refers not to changed circumstances but to the subject and purpose of the contract itself.

The doctrine denies the liability of States for certain debts based simply on the original contract. The classic formulation is by Alexander Nahum Sack:

> When a despotic power incurs a debt which does not meet the needs or interests of the State, but aims at strengthening the despotic regime, suppressing a popular insurrection, etc., then this debt is to be regarded as an odious one for the people of the entire State.

32. Stephen Bainbridge. ''Comity and Sovereign Debt Litigation: A Bankruptcy Analogy'' (1986) 10 *Md. J. of Int'l. L. & Trade* vol. 10 (1986).p 1 at pp. 15-16.

33. Norman Bailey. '' Remarks'' *Proceedings of the Seventy-Ninth Annual Meeting of American Society of International Law.* 1985. p 130 at p.130.

34. North Korea repudiated its debt in the mid-1980s and yet continued to obtain credit from companies interested in trading with it: Id. at p.130. British merchant bankers Morgan Grenfell agreed in 1988 to accept repayment of only 30 per cent of North Korea's debt. rescheduled over four years at a fixed interest rate of eight per cent : Kunibert Raffer. '' Applying Chapter 9 Insolvency to International Debts: An Economically Effecient solution with a Human Face'' (1990) 18 *World Development* vol. 18 (1990) p. 301 at p 310. n. 4.

> This debt is not binding for the nation; it is a debt of the regime, a personal debt contracted by the ruler, consequently it goes down with the demise of the regime .
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> * * *
>
> Odious debts, contracted and utilized for purposes which, to the debtor's full knowledge, are contrary to the interests of the nation, are not binding -- in the case of their being successful in bringing down the regime which has contracted the debts -- unless within the limits of real advantages these debts might have afforded. The debtors have committed a hostile act against the people:they cannot count on a nation, which has freed itself of the despotic ruler, assuming "odious" debts because they are personal debts of the ruler.[35]

In addition to debts contracted in support of despotism, Sack also counted as unenforceable against the State "borrowing agreements made with purposes which are manifestly particular and personal to members of the government or to persons and groups tied to the government -- purposes which bear no relation to the interests of the State."[36]

Given the wildly varying quality of public administration in Third World countries, the appeal of this doctrine should be obvious. The period of significant lending in the 1970s offered great opportunities for corruption in many of these countries:bribes and pay-offs were often the determining factor in the construction and design of large-scale development projects, which later proved to be inefficient or even useless. The deterioration in the balance of payments was accentuated by capital flight, the movement of private funds from the Third World to the West, but this frequently represented deposits by government officials of the proceeds of their personal enrichment through corruption. A large amount of borrowing, estimated at up to 20 per cent. went to fund the purchase of arms which were most often used by governments to repress internal dissent.[37]

Patricia Adams, for one, believes that the doctrine of odious debts will allow the Third World to "repudiate its debts, not through appeals to charity but by recourse to due process of law."[38]

> Lenders who finance the arming or enrichment of despotic rulers and the suppression of popular insurrections... have no guarantees of protection from international law. Financing the colonization of the Amazon and its peoples by Brazil, or of Indonesia's outer islands, would also be odious...

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35. A.N. Sack, *Les effets des transformations des Etats sur leur dettes publiques et autres obligations financieres* (Paris, 1927) p. 127, as cited in translation in Frankenberg and Knieper, note. 24, at p.428 -29.
36. *Id.* author's translation.
37. See, generally, Patricia Adams, *Odious Debts: Loose Lending, Corruption and the Third World's Environmental Legacy* (Toronto, 1991) and Susan George, note 6, in Chapter 1 "How much is $1 Trillion?"
38. Patricia Adams, note. 37, at p. 194.

> Even those loans extended for purposes that are broadly governmental -- to an electric utility or for balance of payments' support-- are subject to challenge. When government officials treat state investments as vehicles for political favours, graft and capital flight, and are prepared to turn a blind eye to the technical and economic viability of such projects, foreign bank loans become grease in wheels that turn against state interests. Foreign bankers who fail to recognize or to act upon pricing irregularities, slipshod plans, and suspect contracts soon become parties to hostile acts against a populace.[39]

However her analysis passes over several of the complexities of the doctrine.

Firstly, it is only universally held to apply to cases of State succession. The general rule is that the rights and obligations of one state devolve upon the states which succeed its peoples or territories; as custodians of the assets burdened by debt, successor states herefore generally remain bound to pay the debts of their predecessors. The doctrine of odious debts carves out an exception for debts whose benefits never accrued to the territory and its people.[40] Thus its best-known use was by the United States following the Spanish-American War of 1898 in refusing to assume the debts contracted by the Spanish Crown as sovereign of Cuba, since Spain had resisted the Cuban independence movement by force of arms.[41]

The reason that the doctrine should be extended to cases of government succession as well, according to recent authors, is found in "the problem of distinguishing state from government successions in this century..." The leading example of such a case is the Soviet Union, which repudiated the debt of Czarist Russia in 1918 without making the legal basis for its decision clear. Two interpretations emerged: that the revolution was a sufficient change in the political and economic system to interrupt the continuity of legal obligations, or else that it simply created a basis in Soviet domestic law for disavowing debts which were held to be associated with exploitation.[42]

The odious debts doctrine therefore requires not just considerable political will on the part of the government which invokes it, but it also requires that the government be the representative of a discernibly new state or, at the very least, that it assert that a significant change in the political and economic system has taken place.

Even assuming this legal obstacle can be overcome, the doctrine can actually be a weaker defence for non-payment than *rebus sic stantibus* or equity, which rely simply on objective circumstances. For the renunciation of odious debts also requires what Sack termed the "subjective culpability of the creditors."[43]

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39. *Id.* at pp.169 -70.
40. James L.Foorman and Michael E.Jehle, " Effects of State and Government Succession on Commercial Bank Loans to Foreign Sovereign Borrowers" (1982) *U. of Illinois L. R.* (1982) p.9 at pp 11, 21-23.
41. *Id.* at pp. 22-23.
42. *Id.* at pp. 10, 19-21.
43. A.N.Sack, note 35, at p.163 as cited in Frankenberg and Knieper, note 24, at p. 430 (author's translation)

(1) The new government would have to prove and an international tribunal would have to ascertain the following:

(a) that the needs, which the former governments claimed in order to contract the debt in question, were odious and clearly in contradiction to the interests of the people of the entirety of the former State or a part thereof, and

(b) that the creditors, at the moment of paying out the loan, were aware of its odious purpose.[44]

The test for the debt's odious purpose which the creditors would need to have understood would be "the extent to which it is unbeneficial to the population of the territory it burdens."[45]

The very question of an investment's benefit is vastly more subjective than Patricia Adams acknowledges. The " technical and economic viability" of projects can rarely be determined absolutely, so that while large-scale hydroelectric power generation, for instance, has many disadvantages, it is rarely objectively useless. Similarly, " pricing irregularities, slipshod plans, and suspect contracts' may occur as part of larger project which still produces some benefits. Even the colonization of the Amazon in Brazil, which violates the land rights of indigenous peoples,may still be a generally very popular policy on the part of a democratically - elected government.

The difficulty in arriving at an agreed defintion of general benefit is demonstrated by one of the occasions on which the odious debts doctrine was actually used. After Germany's annextion (or *Anschluss*) of Austria in 1938, the German government refused to assume the former Austrian federal government's debts on the grounds that the loans included terms designed to preserve Austria's political independence. Since the Nazi government held that, on the contaray, annextion was beneficial to Austria, it termed the loans odious, even though many of them had been used for humanitarian purposes such as food purchases.[46]

Two legal schloars have attempted to use the goals of international development law to set out criteria for the application of the doctrine of odious debts. Frankenberg and Knieper maintain:

> An obligation of all states (thus the developing countries as well) can be drawn from the projected aims of the U.N. and its organistions, to make every effort within their powers which are apt to (1) narrow the "gap in wealth" between the industrially-developed and the under-developed societies (Art.14); (2) secure the provision of foodstuffs and (3) develop and expand production structures which will put especially the L.D.C.'s [less developed countries] in a position to participate in international trade

44. *Id.* at p. 157, as cited in translation in Frankenberg and Knieper, note 24, at p. 430.

45. D.P. O' Connell, State Succession in Municipal and International Law (Cambridge, 1967) 460, as cited in Frankenberg and Knieper, note 24, at p. 430.

46. Foorman and Jehle note 40, at pp.21-22 The authors note that Germany's position is "generally regarded as incorrect."

(Art.58),(U.N.[G.A. ,International Development Strategy for the Second U.N. Decade, Res. 25/2626, 24 October]1970). While such efforts -- aside from any concrete results -- enjoy the protection of international law, one would have to deny this protection to projects and agreements which exacerbate North -South relations. Consequently, also *debts which are inimical to development have to be regarded as odious.*[47]

They would therefore replace the criterion of benefit to the territory and the people with the goals of more equal distribution of wealth, better provision of food and greater trade.

But few governments or lenders have avowed purposes which do not agree with such noble goals. The only specific examples these authors can give of obligations which would not meet their criteria are "luxury expenditures of ruling elites". "transfers of armament... insofar as they do not serve legitimate security intersts", and "projects without any identifiable utility."[48] The first category could only account for a relatively small part of third world debt; the second category is difficult to define, for every government believes it arms itself in view of "legitimate security interests"; finally the category of "identifiable utility" is merely a reformultion of the test of benefit to the territory and the people.

Even if a Third world country which renounced its debts could adequately demonstrate that they were odious by some agreed upon criteria, it would still then have to demonstrate that the creditors had real or imputed knowledge of that fact. Certainly, it would be reasonable to expect a high standard of prudence in any overseas lending by financial instituions, but it would be more difficult to judge to what extent they were entitled to presume good faith on the part of sovereign borrowers. To insist that they could not assume good faith would pose the danger of adopting a very patronizing attitude toward the Third world as a legal principle.

Even where some knowledge of illegal conduct can be shown, the evidentiary burden on Third world debtors would remain very heavy. For instance, many banks seem to have been very clearly aware of their role in capital flight, which was usually in violation of local currency regulations and which allowed the banks to accumulate as deposits large parts of the same money they were lending to the Third World.[49] Yet were they entitled to assume that the source of these funds was their depositors' corruption and that it was their own lending which provided the opportunity for this corruption? Even if the answer might be clearly affirmative when examining the pattern of Western lending as a whole, proof would be more difficult when disputing individual loans by individual banks.

This problem becomes even more acute to the extent that the banks have prepared for such arguments. It is, for instance, common in bank loan agreements for the borrowers to provide representations and warranties concerning the use of the proceeds.[50] The United States Agency for International Development's Project Loan Standard Provisions include "covenants that borrowers will carry out projects

47. Frankenberg and Knieper, note 24, at p. 433 (emphasis added).
48. *Id.*
49. Susan George, note 6, at pp. 19-21.
50. Foorman and Jehle, note 40, at p. 21.

with due diligence, use funds only for the particular project financed by the loan, maintain records according to generally accepted principles of accounting, and procure goods and services at a reasonable cost."[51] In face of such contractual commitments, the debtor country would have to demonstrate that it was not reasonable for the creditor to rely on them.

Significantly, the doctrine of odious debts was not relied upon even after recent government successions such as the 1979 Sandinista revolution in Nicaragua, which could have been argued to represent a change of regime by the degree of political and economic change and which succeeded a despotic dictatorship characterized by notorious corruption.[52] This suggests that like the arguments concerning equity and *rebus sic stantibus*, the doctrine of odious debts carries more academic than practical weight. Simply put, the needs of even new Third world regimes for credit may outweigh the political satisfaction of informing financial institutions that they provided the funds for activities now viewed as having constituted "a hostile act against the people."

On the other hand, a more limited application of this approach could still provide a reasonable means for a Third World country to reduce its debt load somewhat. Consider that Costa Rica reduced its interest in arrears owing by ten per cent, merely by verifying the amounts claimed by the banks on a loan by loan basis.[53] A debtor country could apply a similar approach to loan agreements, determining whether the lender ought reasonably to have been aware of the fact when they were improperly formed or their proceeds improperly applied. It hardly seems important whether this would be an application of the odious debts doctrine or merely of the requirement for banks to act in good faith and exercise due diligence, as set out in jurisprudence such as the Tinoco arbitration.[54] Nevertheless, it seems unlikely that even very thorough verification along these lines would reduce the total debt load by more than a small fraction.

C. Can a Sovereign Debtor Declare Bankruptcy?

Worried delegates to the 1985 Annual Meeting of the American Society of International Law held a session to discuss the question, "Is there an Emerging Legal Equivalent of Bankruptcy Protection for Nations?" With considerable relief and satisfaction, they concluded that in the United States at least, the answer was no.[55]

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51. Michael S. Sher, "Can Lawyers Save the Rain Forest? Enforcing the Second Generation of Debt-for-Nature Swaps" *Harvard Environmental L.R.* vol ,17 (1993), p. 151 at p. 194.
52. Susan George, note 6, at p. 18.
53. Kunibert Raffer , note 34, at p. 309.
54. United States Chief Justice Taft held in his arbitration of a dispute over cheques drawn by the Costa Rican dictator Tinoco on the Royal Bank of Canada that, while the bank was entitled to treat the actions of even a *de facto* government as binding on the state, it had not acted in good faith when it allowed payments to Tinoco and his brother personally: *Great Britain* v. *Costa Rica*, 2 Ann. Dig. 34 (1923) (Taft, Arb.).
55. "Comity, Act of State, and the International Debt Crisis : Is There an Emerging Legal Equivalent of Bankruptcy Protection for Nations?" *Proceedings of the Seventy-Ninth Annual Meeting*. p.126 (1985)

A particular case had provoked this discussion by the assembled jurists: *Allied Bank International* v. *Banco Credito Agricola deCartago*.[56] In 1981 the government of Costa Rica had ordered domestic banks to suspend all payments to foreign creditors temporarily; a syndicate led by the Allied Bank sued for payment of the debt in U.S. District Court New York and lost a motion for summary judgment in 1983. A few months later, 170 of the 171 creditor financial institutions agreed to a loan restructuring. The dissenting creditor, Fidelity Union Trust Bank, appealed the District Court's decision, but the Second Circuit upheld the trial decision in 1984. Supported by twelve of the largest U.S. banks, organized in the New York Clearing House Association, the appellant bank then successfully petitioned for a rehearing. After receiving a brief in the bank's support by the Executive Branch of the United States, the court reversed itself and held in 1985 that Costa Rica's debt moratorium was unenforceable.[57]

The Second Circuit had applied the doctrine of comity in its first decision, relying on the presumption that the law of a foreign nation is valid and owed deference by domestic courts unless it can be shown to run contrary to some fundamental domestic policy. In adopting this approach the court had been greatly influenced by the U.S.government's explicit support for the policies of the Costa Rican government. But it had also held that "Costa Rica's prohibition of payment of its external debts is analogous to the reorganization of a business pursuant to chapter 11 of our Bankruptcy Code." In this case, the sovereign used its legislative authority to defer payment and then renegotiated its obligations in good faith, protected "from the mad scramble of creditors for assets."[58]

Upon rehearing, the Second Circuit rejected both these lines of argument. Firstly, it held that comity could not extend to what it now viewed as an "attempted unilateral restructuring of private obligations" and which was therefore contrary to American law and policy.[59] In particular, it relied on the principle of contract law that inability and even impossibility do not provide a defense to the failure to repay a debt. The court now also completely disregarded its own earlier bankruptcy analogy, which the U.S. government's *amicus curiae* brief had rejected, on the grounds that there was no neutral tribunal arbitrating differences between the creditors and the debtor.[60]

This distinction was crucial for those who objected to the Second Circuit's initial decision. A New York lawyer explained to his colleagues:

> The concern created by the [1984] decision was that rather than foster restructuring negotiations by refusing to allow rogue banks to obtain judgment on their debts when other syndicate members are willing to

56. 566 F.Supp.1440 (S.D.N.Y.1983); the initial decision of the U.S. Court of Appeals, Second Circuit,23 April 1984, was published only in (1986) 10 Md.J.of Intl. L.&Trade 48; rev'd. on rehearing, 757 F.2d 516 (2d cir. 1985).

57. The background to these decisions is given in Stephen Bainbridge, note 32, at pp 29-35.

58. *Allied Bank International* V. *Banco Credito Agricola de Cartago*. U.S.Court of Appeals, Second Circuit, 23 April 1984, in (1986) 10 Md.J.of Intl. L.& Trade, p. 48 at p. 53.

59. 757 F.2d 516 (2d cir. 1985) at 519.

60. Stephen Bainbridge, note. 32, at p. 33.

accept the restructure [sic], the court gave a high card to debtor states by calling into question the hitherto assumed right of the creditors to sue.[61]

That is, in the absence of some court of sovereign bankruptcy, the banks prefer to hold all remedies available under their domestic law in reserve for possible use in persuading debtor countries to arrive at restructuring agreements, which will then have to receive the approval of all creditors.

Commentators sympathetic to the Third World have pointed out the anomalies created by this situation. Under U.S.insolvency law any "political subdivision or public agency or instrumentality of a state", from a hospital to a domesticity, may seek court protection from its creditors,[62] as may any private foreign debtor who is the subject of bankruptcy proceedings in another jurisdiction.[63] Yet foreign governments remain constantly vulnerable to proceedings to collect on outstanding debts, even as they are negotiating agreements with their creditors. Moreover, the *Allied Bank II* decision means that there is no legal means to force dissident creditors to adhere to these agreements, nor to prevent them from seeking independent remedies.

As a result, a number of authors have suggested that some form of international bankruptcy might be of use to the debtor countries of the Third World. Such a regime could offer protection from legal action by creditors in return for the impartial administration of disputes concerning the debts by an independent arbiter,[64] whose absence was so significant to the U.S. government in *Allied bank II*. However, it is reasonable to ask to what extent such an innovation would result in any concrete changes.

Obviously a number of banks, as well as the United States government, were sufficiently concerned about the suggestion that insolvency gives a sovereign debtor the legal right not to pay, that they intervened in the *Allied Bank* rehearing. But states had already asserted through their practice a right not to pay their debts under certain circumstances and had successfully continued trading afterwards (see, for example, the use of the doctrine of odious debts). The test of any proposed new regime, such as one analogous to bankruptcy, must be whether it will leave the debtors better off not just in law but by its application.

The litigtion by the Fidelity Union Trust Bank notwithstanding, few creditors use the courts to enforce sovereign debts. As discussed above, they refrain from litigation not just because of the difficulties in collecting, but also from a realistic calculation that only continued liquidity offers some possibility the funds will be repaid. Protection from legal action may not therefore be so important.

Even for creditors who owed debts so small that there might be enough attachable assets to satisfy a judgment , a political mechanism exists to persuade them to join the larger financial instituions in cooperating with the IMF's restructuring plans: the application of pressure by the central banks. Susan George

61. Michael Straus, "Remarks" note 55, p.127 at p.129.
62. Kunibert Raffer, note 34, p.302.
63. Stephen Bainbridge, note 32, at p.28.
64. See, for instance, Silard, note 18, at pp.972.-73.

recounts the means employed to arrive at a consensus on the 1982 Mexican debt rescheduling: "Those who resisted -- mostly smaller banks - - suddenly found punctilious Federal Reserve regulators making pointed inquiries about every aspect of their business, refusing mergers and the like."[65] One regional bank official later wrote:" cram down' is not an unduly harsh description of what in fact occurred,... the experience has been one that few would want to repeat."[66]

As for the need for a neutral tribunal to arbitrate between debtor and creditor, the IMF already plays a very similar role when it advises and mediates during the renegotation of loans between the debtor countries and their government creditors (the Paris Club) and private institutions. At the same time, the IMF both approves and monitors the national structural adjustment plans which have become the precondition for negotiations with other creditors, serving a similar function to an insolvent debtor's "plan of reorganization" in domestic law.[67]

This analogy is not without flaws: concerning the form, the IMF is itself a creditor, though for the most part it provides only short-term liquidity. Analyzed in terms of procedure, the IMF is hardly seen as neutral by many Third world countries, given its strict emphasis on market economics. However looking at the effects, it seems unlikely that any international arbitration panel could offer the same power of persuasion over creditors which the IMF enjoys by virtue of its own continued lending and the pressure it can exert via creditor country governments.[68] Third world debtors may have therefore already arrived at the most effective, if not the most equitable, means to stay collection proceedings and mediate disputes with private bankers in the form of the IMF.[69]

IV. "SOFT LAW " OPPORTUNITIES FOR REFORM

A. Total cancellation or Forgiveness

Any discussion of solutions to the Third World debt crisis must deal with the suggestion that it simply be forgiven in its entirety. This was the solution proposed in 1985 by Cuban president Fidel Castro, who had "come to the conclusion that the Latin American debt is unpayable and should be cancelled." As a justification he offered: "The amount wrenched away from our peoples in just the last few decades

65. Susan George, note 6, p. 43.

66. Gibbs, "A Regional Bank's Perspective: An Analysis of the Differences and Similarities in the U.S. Banking Community's Approach to and Participation in the Mexican Restructuring" Columbia J. of Transnt'l . L. vol. 23 (1984), p. 11 at pp. 23-28, as cited in Stephen, note. 32, p. 19.

67. Lee C. Buchheit, "Remarks" note 55,p.132

68. Thus Stephen Bainbridge is willing to argue for recognition of the IMF'S role as " equivalent to bankruptcy proceedings" in note 57, at pp.34-35.

69. Harvard economist Jeffrey Sachs has in fact called for the IMF to take on more of the role of an American bankruptcy court in order to eliminate "strategic bargaining and free-riding" by individual private banks engaged in separate negotations. He writes: "In cases of sovereign debt, the main function of the IMF should be to provide a forum to which all of a country's creditors are brought for a comprehensive, across the board settlement."
See: "Beyond Bretton Woods: A New Blueprint" *The Economist*, (1 October 1994) vol. 333, p 23 at p. 27.

through unequal terms of trade, high interest rates, protectionism, dumping, monetary manipulations and the flight of capital is much greater than the total amount of the debt." To prevent any destabilization of the international financial system, he added "that the industrialized creditor countries can and should make themselves responsible for the debts to their own banks."[70]

An important drawback of this proposal is that it would represent a wholesale assumption of the burden of Third world debt by taxpayers in Western countries while the creditors were reimbursed. Even if all Westerners can be said to have benefited from low prices for the commodities produced in the Third world, they certainly cannot be said to have benefited equally. Shifting the burden of Third World debt to Western tax systems as a whole would be a relatively inequitable solution to a problem which was largely created by Third World governments and Western bankers, particularly given that the tax burden has increasingly been shifted from corporations to individuals.

But the more telling criticism of total forgiveness of debts was made by Susan George in 1988:

> ... Unlike some of my colleagues, I do not believe that Third World debt, even African debt, should be purely and simply cancelled. For one thing, unconditional write-offs would reward the Mobutus and the Pinochets, the most repressive, profligate and corrupt regimes that borrowed the most for the worst reasons, while penalizing the more prudent countries and leaders who have been doing their best to reimburse. Worse still, a generalized wipe-out would give the West a perfect excuse to cut off aid.[71]

Within the Third world, then, the effect of a total cancellation would be completely undifferentiated, with no guarantee that those who have suffered the most from the debt crisis and its consequences would benefit proportionately.

To accept this criticism, however, is to acknowledge that even a solution to the debt crisis must begin from the premise that *prima facie* the repayment of debts is legitimately characterized as a legal obligation, even in the international context and even for the Third World. The issue is therefore to determine to what extent and on the basis of which criteria this obligation should be tempered, bearing in mind the historic and systemic disadvantages the Third World has suffered and given that the effects of fulfilling this obligation have been overwhelmingly negative for the debtors.

B. The Legal Basis for Reduction and Renegotiation

Decisions concerning debt restructuring and forgiveness offered by Western creditor governments, debt-for-equity and debt-for-nature swaps by private and public creditors, as well as the criteria of the IMF's structural adjustment programs

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70. Interview published in the Mexico City *Excelsior* (21 March 1985), as cited in Milan Bulajic, "Indebtedness of the Developing Countries and the New International Economic Order", in Detlev Chr. Dicke, note 20, p. 43, at pp. 60-61.

71. Susan George, note 6, p. 235.

already form part of the soft law of international cooperation and development. If, as civil law doctrine holds, contracts constitute the law as between the parties,[72] then surely these agreements are also a part of international law.[73]

More importantly, policies concerning Third World debt can ground themselves in the instruments of international law which have set out a right to development.[74] This right has been interpreted to include a duty of solidarity on the part of states and a duty to cooperate for global development, notably through preferential treatment of developing countries and an improvement of their terms of trade.[75] It is not my purpose to make a case for the enforceability of the right to development, but rather to recall that it provides a basis in law for the actions of states and international agencies which is at least as valid as the respect for the binding nature of contracts which has so marked the discussion of these debts up till now.

Similarly, two legal scholars have pointed out that the fact that hundreds of millions of people in developing countries are estimated to earn incomes too low to provide them with an adequate diet stands in contradiction to the International Covenant on Economic, Social and Cultural Rights, which declares the right to be free from hunger to be fundamental.[76] Since this basic norm is binding on all states parties to the Covenant, they conclude:

> ... Development agencies should regard the promotion of food security as an integral part of the development effort. They should support not only economic growth and direct measures to reduce chronic food insecurity but also involve themselves in efforts to prevent disruptions in the ability of the population to feed themselves, to educate their young and to maintain good health. These disruptions can have long-lasting effects on the development of human capital by attenuating health and cognitive skills.[77]

In this case, the IMF's structural adjustment programs should be changed not just on moral or ethical grounds, but to the extent required to meet this obligation of international law.

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72. Code Civil Francais, Art. 1134: "Les conventions legalement formees tiennent lieu de loi a ceux qui les ont faites." ("Valid contracts have the force of law as between the parties who entered into them.")
73. Note, however, that the IMF avoids entering into formal international legal agreements concerning restructuring, for fear of violating domestic constitutional requirements and relies instead on letters of intent: Wade Mansell, note 23, at p.388. Similarly, legal writers have expressed considerable concern about the enforcebility of the conditions imposed in debt-for-nature swaps. See: Michael S. Sher, note 51; Tamara J. Hrynik, "Debt-for-Nature swaps: Effective But not Enforceable" *Case Western Reserve J.of Int'l. L.* vol 22. (1990), p. 141.
74. Declaration on the Right to Development, U.N.G.A. Res. 41/ 128, 4 December 1986.
75. International Law Association, "Declaration on the Progressive Development of Principles of Public Inernational Law Relating to a New International Econmic Order (Seoul Declaration adopted at the 62nd ILA Conference, 1986)" in Paul de Waart et al. eds, *International Law and Development* (Dordrecht, 1988) 409.
76. Art. 11, U.N.G.A.Res. 2200/21, 16 December 1966.
77. G.J.H.van Hoof and B.G. Tahzib, "Supervision With Respect to the Right to Food and the Role of the World Bank" in Paul de Waart et al. eds. note 75, p.317, at p.331.

There can be no doubt but that significant adjustments of a poor country's debt burden are feasible given the political will. For instance, when Indonesia's debts were rescheduled in 1969 they were simultaneously written down by fully 57 per cent under a "composition plan" which covered both private and public creditors, though government loans predominated. The German banker who drafted the plan cited the "special characteristics" of Indonesia's problems which demanded a permanent solution : the debts had been contracted by the fallen pro-Soviet government of Sukarno; they mostly took the form of credits which had to be reimbursed out of the state's central budget; the country was unable to repay the debts without generous foreign aid. As one commentator has pointed out: "What made Indonesia a special case in 1969 is nowadays the rule."[78] A similar example was provided more recently by Poland, which saw its $35 billion in debt to the 17 Western government creditors of the Paris club reduced by 50 per cent, in recognition of its new democratically-elected government and the market reforms it had introduced, while its debt to the United States government was actually reduced by 70 per cent.[79]

The debts in the examples above were predominantly or exclusively owed to governments, but debt-for-equity and debt-for-nature swaps have demonstrated that sovereign debts to private creditors can also be reduced, given that the creditors have in any case already written down or written off their value for accounting purposes. In a swap or debt exchange, a party in the West buys debt owed by a Third World Sovereign and which the original creditor is now disposing of on the secondary market at a discount. The purchaser then allows the Third World debtor to settle the debt for less than its face value but more than the purchase price, in local currency.[80] In debt-for-equity swaps the proceeds are used to buy productive capacity; in debt-for nature swaps they are generally used to preserve natural environments.

For the most part, debt forgiveness has been available to countries as a reward for agreement with western policies while the IMF has made credit available in return for respecting its economic orthodoxy. But there is no reason a *priori* why the measures rewarded could not be different ones, such as those to improve health and education or to protect the environment.

This proposition is not quite as naive as it appears: for instance, the government of the Netherlands purchased $33 million worth of Costa Rica's private debt on the secondary market in 1989, in return for the establishment of a fund to finance reforestation; the same year the U.S. Agency for International Development was empowered to provide grants to non-governmental organizations to make their own debt-for-nature swaps.[81] Since 1990 statutes to reduce debts owed to the government in return for the establishment of national environmental funds by Third

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78. Kunibert Raffer, note 34. at p.304.
79. Michael S.Sher, note 51, at p.185.
80. I have relied on the description offered by Priya Alagiri, "Give us Sovereignty or Give Us Debt: Debtor countries's Perspective on Debt-for-Nature Swaps" 41 *American U.L.R.* vol. 41 (1992), p. 485 at pp. 489-92.
81. Michael S. Sher note 51, at pp.170-173.

World debtors, though the pre-conditions include the implementation of IMF structural adjustment programs.[82] Similarly, the debt forgiveness Poland received in 1991 was supplemented by funds from other Paris Club creditors for initatives to reduce domestic pollution and conserve nature.[83]

Nor is the IMF obliged to retain its traditional narrow view of the proper goals of adjustment. Questioning the Fund's traditional refusal to consider the effects of spending by Third World governments on domestic income distribution, one writer has asked: "Fund mission provide policy advice on the balance-of-payments price stabilization, and growth aspects of its programmes; on what principle can it decline to do so for the distribution results?"[84] That the analytical capability exists was demonstrated by an internal document prepared in 1985 for the IMF's Executive Board. Its anonymous author suggested:

> If the Fund were to attempt to specify the specific functional expenditures with a view to improving internal income distributions, the following might be considered:
>
> a. Focusing educational outlays on basic skills and vocational training;
>
> b. Focusing health outlays on the provision of basic health services and away from the doctor - hospital environment;
>
> c. Limiting defense expenditure;
>
> d. Limiting grandiose public works and "prestige" projects;
>
> e. Advocating much stricter budgetary controls by the Ministry of Finance over spending ministries.[85]
>
> Obviously a large number of traditionally more critical economists would also be happy to provide suggestions.[86]

V. CONCLUSION

As I stated in my introduction, I do not blieve that law offers the means to settle problems of international relations so much as it can articulate the means to be used once the political will to solve them exists.

The common use of the term "crisis" to describe the debts owed by Third World nations speaks to the problem: the poorest nations owe sums of money to creditors in the wealthiest countries which are beyond their means to repay. Their continuing effort and the adjustment programs imposed by international instiutions such as the IMF to accomplish it have resulted in a demonstrably lower standard

82. *Id.* at pp 174-85. As of 1992, agreements had been reached with Jamaica, Bolivia and Chile.
83. *Id.* at pp. 185-88.
84. Tony Killick, *The Quest for Economic Stabilization* (New York: St. Martin's Press, 1984) 246, as cited in Susan George, note 6, p.54.
85. IMF, Fiscal Affairs Department, "Fund-supported programs, fiscal policy and the distribution of income", SM/85/113 (25 April 1985) 7, as cited in Susan George, note 6, at p. 54. The document was apparently marked " Not for public use".
86. See, for example, G.K. Helleiner, note 12, at Chapter 8, "Stabilization, Adjustment and Poverty."

of living for the populations in those nations.

Arguments justifying repudiation of the debts based on contract law principles lead to debatable results. A debtor nation which invoked the obvious substantial change in circumstances (*rebus sic stantibus*) would have to show that this was not within the parties' expectaions, in spite of the clearly volatile nature of interational trade and commerce, or else that the change was within the exclusive control of the creditors. It is more honest simply to appeal to equitable principles, namely, that it is no longer fair or reasonable for the contracts to be upheld.

The doctrine of odius debts, which holds there is no obligation to repay debts whose benefits never accrued to the territory and its people has also been suggested as grounds for repudiation. But it is only universally held to apply to cases of state succession and at the very least requires a significant change in the political and economic system. More importantly, it sets out the difficult requirement of proving both the debt's objectively odious purpose and the creditors's subjective knowledge that its purpose was of no benefit to the population of the territory burdened with the debt.

Suggestions for unilateral repudiation have rarely been followed because they fail to address the debtors' practical dilemma: their continuing need for credit, due to their existing disadvantages within the world economy. To permit debt restructuring, some authors have suggested a form of international bankruptcy which would offer protection from legal action by creditors in return for the administration of disputes concerning the debts by an independent arbiter.

However the IMF already plays a very similar role when it mediates between debtor nations and their private and public creditors for a renegotiation of loans, even as it approves and monitors the national structural adjustment plans which have become the precondition for negotiations. While the IMF hardly appears impartial from the point of view of the debtor nations, the cooperation of wealthy nations' central banks already allow it to impose a consensus on almost all private creditors.

Clearly, some combination of debt restructuring and foreign aid will remain necessary for many nations of the Third World. A restructuring which amounted to total forgiveness would give the same benefits to corrupt governments as to those which were efficient or honest; this demonstrates there is no good reason simply to dispense with the legal obligation to repay the debts. But in tempering this obligation, debt restructuring and foreign aid need not be based on the current obsession with regular payment of debts and market economics: it could just as easily aim to reduce income inequalities, based on the existing right to development under international law.