



# Odious Debt

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## Abstract

Public international law does not encompass external sovereign debt. In particular, the current status of ‘odious debt’, which may also be termed ‘illegitimate debt’, in international law epitomizes the weakness of international law with respect to external sovereign debt. Odious debt is subject to politics and ad hoc relations on the international stage. By and large, the law engages with external sovereign debt on the national level—e.g., via the national laws and the national courts of financial centers. In the event of a dispute regarding external sovereign debt, it is very rare that international law or international adjudication deal with external sovereign debt.

**Keywords** International loans · International arbitration · Government debt · External sovereign debt · National debt · Odious debt

## Introduction

The world economy has been suffering from the repercussions of the 2008 world financial crisis and the 2020–2022 Covid-19 pandemic. Government debts worldwide are increasing. Indeed, recently, more than one hundred governments have applied to the International Monetary Fund (IMF) for credit.<sup>1</sup> At present, the prospects for the world economy do not seem bright, as evidenced by the huge wealth

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<sup>1</sup> The IMF Press Briefing, 7 May 2020. Accessible at <https://www.imf.org/en/News/Articles/2020/05/07/tr050720-transcript-of-imf-press-briefing> (accessed on 26 June 2020).

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and revenue imbalances that exist both between and within countries and by the debt repayment difficulties of emerging markets.<sup>2</sup>

In this context, the notion of “odious debt” inevitably gains prominence. That’s because nations may object to the repayment of huge sums of external sovereign debt via the invoking of the concept of odious debt: they may argue that their governments unjustifiably incurred these debts due to selfish and corrupt aims and practices with no real benefit to their citizenry. Indeed, in the international community, one can see some emerging debates in that respect.<sup>3</sup> The concept of odious debt may soon constitute an important component of discussions in respect to external sovereign debt.

When previous governments abusively and illegitimately ran into external debt, the latter can be defined as odious debt. International law does not regulate odious

<sup>2</sup> The New York Times, *Poor countries face a debt crisis unlike anything we have seen*, 1 June 2020. Accessible at <https://www.nytimes.com/2020/06/01/business/coronavirus-poor-countries-debt.html>, (accessed on 31 August 2021). The Japan Times, *Managing the coming global debt crisis*, 18 May 2020. Accessible at <https://www.japantimes.co.jp/opinion/2020/05/18/commentary/world-commentary/managing-coming-global-debt-crisis/>, (accessed on 31 August 2021). Voice of America, *Spike in global debt during pandemic leaves some countries on shaky ground*, 27 May 2021. Accessible at <https://www.voanews.com/economy-business/spike-global-debt-during-pandemic-leaves-some-countries-shaky-ground>, (accessed on 31 August 2021). Financial Times, *Debt dilemma: how to avoid a crisis in emerging nations*, accessible at <https://www.ft.com/content/de43248e-e8eb-4381-9d2f-a539d1f1662c>, (accessed on 31 August 2021). Nurith Aizenman, NPR, *A debt crisis seems to have come out of nowhere*, 20 April 2018. Accessible at <https://www.npr.org/sections/goatsandsoda/2018/04/20/604169277/a-debt-crisis-seems-to-have-come-out-of-nowhere>, (accessed on 31 August 2021). Selwyn Parker, *Sea of debt*, World Finance, 17 February 2021. Accessible at <https://www.worldfinance.com/special-reports/sea-of-debt>, (accessed on 31 August 2021). Financial Times, *Ethiopia asks for debt relief as Covid takes toll*, accessible at <https://www.ft.com/content/4992e00e-557a-4c06-858b-e7e15bbf10ac>, (accessed on 31 August 2021). Ben Parker, *The debt crisis looming for poor countries*, The New Humanitarian, 8 October 2020. Accessible at <https://www.thenewhumanitarian.org/analysis/2020/10/08/pandemic-debt-crisis-looms>, (accessed on 31 August 2021). Bangkok Post, The Wall Street Journal, *Covid’s next economic crisis: developing-nation debt*, 28 July 2020. Accessible at <https://www.bangkokpost.com/business/1958507/covids-next-economic-crisis-developing-nation-debt> (Accessed on 31 August 2021). Financial Times, *UN chief warns of coming debt crisis for developing world*. Accessible at <https://www.ft.com/content/abcd97d3-fb65-47e5-973a-598514f1fd5a>, (accessed on 31 August 2021).

<sup>3</sup> Bloomberg, *Mitu Gulati and Ugo Panizza on Haiti’s odious post-colonial debt*, 26 August 2021. Accessible at <https://www.bloomberg.com/news/articles/2021-08-26/mitu-gulati-and-ugo-panizza-on-haiti-s-odious-post-colonial-debt>, (accessed on 31 August 2021). Financial Times, *Venezuela crisis raises talk of “odious debt” doctrine*, Accessible at <https://www.ft.com/content/fa6850cc-96c3-11e7-b83c-9588e51488a0>, (accessed on 31 August 2021). Financial Times, *The calls for sovereign debt relief are mounting*, accessible at: <https://www.ft.com/content/42a69de6-0b67-4c53-b9e4-e94ae4f7142b>, (accessed on 31 August 2021). Eric Toussaint, *Break the taboo on odious debts and their repudiation*, CADTM, 7 January 2019. Accessible at <https://www.cadtm.org/Break-the-Taboo-on-Odious-Debts-and-their-Repudiation>, (accessed on 31 August 2021). UNCTAD, *Debt warning lights flash for poorest countries, experts say*, 3 May 2018. Accessible at: <https://unctad.org/news/debt-warning-lights-flash-poorest-countries-experts-say>, (accessed on 31 August 2021). Carlotta Gall, *Why Tunisia’s promise of democracy struggles to bear fruit*, 28 July 2021. Accessible at <https://www.nytimes.com/2021/07/28/world/africa/tunisia-revolution-democracy.html>, (accessed on 31 August 2021). The Zimbabwe Mail, *Debt burden weighs heavily on Zimbabwe*, 27 February 2021. Accessible at: <https://www.thezimbabwemail.com/economic-analysis/debt-burden-weighs-heavily-on-zimbabwe/>, (accessed on 31 August 2021). Financial Times, *Why does Mozambique need to pay its non-odious debt?*, Accessible at: <https://www.ft.com/content/89228649-c22e-3ee9-9aad-1bbaef985773>. (Accessed on 31 August 2021).

debt. Actually, odious debt presents us with opportunities to understand the current state of international law. Thus, this article aims to demonstrate the capabilities and limits of international law through the question of odious debt. The article argues that the political dimension of external sovereign debt is so dominant that public international law stands no chance of changing the *status quo* in respect of odious debt.

The term “external sovereign debt”, as mentioned in this article, concerns money owed by a debtor state to foreign lenders. External sovereign debt may also be called external state debt, external public debt, external national debt, international sovereign debt, or borrowing by a nation. This article looks at the scenario in which the debtor is the state or state entities, or in which the debt is guaranteed by the state. The creditor may be another state, an international organization (e.g., the International Monetary Fund), a corporation (e.g., a commercial bank), a fund (e.g., a pension fund) or a businessperson.

In the case of non-governmental creditors, the latter shall be resident in a foreign state,<sup>4</sup> though it is possible that local people and local corporations buy the foreign debt of their own state. Money borrowed by a state from foreign persons (natural persons or legal persons) in foreign currency under foreign law—e.g., Brazil’s US<sup>5</sup> dollar-denominated New York law bonds, which are sold to US residents—is a typical external sovereign debt. In brief, this article looks at “external” financing and “external” investors.

External sovereign debt is the debt owed to non-residents and which is repayable in “*foreign currency*” (Avery 1990, p. 504). This is important to highlight because, at present, the world over, some public debt held by non-residents is issued locally and denominated in the *local currency* of the debtor state and subject to the debtor state’s local jurisdiction (Akyuz 2017, p. 3). There are many foreign holders of domestic securities. For instance, an international bank may buy the local currency public debt of a country. Although domestically issued local-currency debt as held by non-residents can be considered external sovereign debt, this paper does not deal with that particular type of debt. This paper’s focus is on *foreign currency debt* which is internationally issued (e.g., international sovereign bond) by the government and which is held by non-residents. This, incidentally, is the most common form of external sovereign debt.

There is a rationality of external sovereign debt: external sovereign debt is a method of satisfying the liquidity needs—viz., the financial needs—of sovereign nations. The primary financial centers—e.g., New York—and those centers’ national laws and national courts cater for the financial needs of countries worldwide.<sup>6</sup> “Sovereign debt holdings play a stabilizing role in the portfolios of pension funds, central

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<sup>4</sup> Residence is determined by the center of economic interest of the debtor and the creditor—not by their nationality.

<sup>5</sup> United States of America.

<sup>6</sup> “The United States of America and the United Kingdom are national legal jurisdictions of most foreign currency sovereign bonds.” Accessible at <https://www.ft.com/content/de43248e-e8eb-4381-9d2f-a539d1f1662c> (accessed on 31/08/2021).

banks, and investors around the world.” (Samples 2014, p. 51) However, interestingly, “the international monetary system still lacks the instruments to cope effectively with sovereign debt crises” (Walter 2014, para. 49) and this has implications for the doctrine of odious debt. This is, arguably, the consequence of the ideological power of external sovereign debt.

While there is a strong ideology that surrounds and enforces the concept and the instrument that is external sovereign debt, international law can also be said to be supported by a strong ideology. And the relationship between these two ideologies is intriguing as external sovereign debt has become a familiar commodity—it is for sale in international markets. External sovereign debt has become a crucial part of the global economy and of international relations and poses a challenge to international law.

In this respect, this paper begins with a discussion of the question of odious debt (section two) and then goes on to situate odious debt within the framework of external sovereign debt in the light of international law (sections three and four).

## Odious Debt

As a matter of principle, governments inherit the debts of prior governments (Gulati & Panizza 2018, p. 1). The perpetual debtor is the legal person of the state, while government is the temporary representative of the state. As long as the legal personality of the state continues, the debt of the state continues, too. The change of government does not make any difference to the external indebtedness of the state. This is the position of public international law. Yet, today, default on external sovereign debt as inherited from the former government has become a natural phenomenon of international relations. And, the crucial question is whether those debts defaulted on constitute odious debt. That’s because the idea of odious debt justifies non-repayment or cancellation or reduction of debts.

The notion of odious debt has been a topic of debate for a long time but positive international law does not deem the invocation of odious debt valid; the idea of odious debt has failed to take root in international law (Lowe 2015, p. 122). Arguably, that is because corrective or redistributive justice are not functions of international law. Whatever economic or moral arguments in favor of the cancellation of odious debts, the most public international law can do is tacitly seal an eventual agreement of the debtor state and its creditors on the cancellation of a particular debt. That is, the change of the external indebtedness of a country is regarded as an ad hoc matter.

A previous government might have run into debt that it cannot repay. Worse, a previous government might only have been a de facto government that had

overthrown a lawful—*de iure*—government.<sup>7</sup> Still, what counts under international law is the actual sovereign government.<sup>8</sup> A peaceable administration without notable mass resistance or contest demonstrates the existence of a *de facto* government<sup>9</sup> and a *de facto* government, at the end of the day, represents the state. The legal fiction of the continuity of the state tolerates a *de facto* government taking loans from abroad.

Still, a new and lawful incumbent government may wish for the deferral, reduction or cancellation of the debt incurred by the previous *de facto* government, arguing that the debt it inherited from the latter is illegitimate. The incumbent government may invoke the notion of “odious debt”; that is, debt which does not serve the needs of the nation but rather that of a narrow corrupt clique connected to the previous *de facto* government. The incumbent government may argue that the previous government took the loan for its selfish private interests rather than for the public interest.

The odious debt doctrine invokes the illegitimacy of the previous government’s debt. As a result, an incumbent government should not be obliged to pay the odious debt it has inherited from its predecessor and should have the right to challenge the accumulated debt if the previous government engaged in corrupt financial transactions. Yet, the idea of odious debt risks remaining merely a moral argument.

Indeed, there is still no treaty on odious debt and it is difficult to argue for a customary norm of odious debt in international law due to the lack of regular practice in respect of odious debt (Wendorf 2018, p. 2) (Goldmann 2016, p. 133). By and large, the invocation of odious debt as a ground for debt repudiation or cancellation has not been successful so far (Gelpern 2007, p. 81). On top of that, there exists no strong *opinio juris*—a sense of the existence of a rule of prohibition of odious debt—which could compensate the *quasi* lack of practice. As regards odious debt, one cannot note an international custom “accepted as law”.<sup>10</sup> Besides, in international adjudication, apart from one example mentioned below, no debt crisis and no debt default case has ever been resolved on the basis of the purported legal doctrine of odious debt (Buchheit & Gulati 2008, pp. 483–5). Therefore, some argue that odious debt is an overtly politicized concept rather than being a normative and technical one (Potow 2013, p. 30).

<sup>7</sup> *Tinoco Arbitration Case, Aguilar-Amory and Royal Bank of Canada claims, Great Britain v. Costa Rica*, 18 October 1923, vol.1, p.378: “The same principle is announced in Professor Borchard’s new work on *The Diplomatic Protection of Citizens Abroad: Considering the characteristics and attributes of the de facto government, a general government de facto having completely taken the place of the regularly constituted authorities in the state binds the nation....It succeeds to the debts of the regular government it has displaced and transmits its own obligations to succeeding titular governments.... The legality or constitutional legitimacy of a de facto government is without importance internationally so far as the matter of representing the state is concerned.* (Bluntschli, Sects. 44, 45, 120; Holtzendorff, II, Sect. 21; Pradier-Fodéré, Sect. 134, 139; Rivier, II, 131, 440; Rougier, 481; *France v. Chile, Franco Chilean Arbitration*, Lausanne, p. 220.).

<sup>8</sup> *Tinoco Arbitration Case, Aguilar-Amory and Royal Bank of Canada claims, Great Britain v. Costa Rica*, 18 October 1923, vol.1, p.380–381. Accessible at [https://legal.un.org/riaa/cases/vol\\_1/369-399.pdf](https://legal.un.org/riaa/cases/vol_1/369-399.pdf) (accessed on 14/05/2020).

<sup>9</sup> *Ibid.*, p.379.

<sup>10</sup> Article 38(1)(b), Statute of the International Court of Justice.

Indeed, in only one adjudicatory case did the doctrine of odious debt assume a legal effect. That was the 1923 *Tinoco* arbitration where the United Kingdom (UK) challenged Costa Rica in respect of the treatment of the UK citizens and corporations in that country. The incumbent Costa Rican government argued that it would not be liable for the debts incurred to the UK corporations by the previous illegal and corrupt Costa Rican government. Although the sole arbitrator, in his award, did not use the term “odious debt”, he held that the debts incurred for the personal interest of the previous Costa Rican government members would be invalid and that it would not bind the subsequent governments.<sup>11</sup> This, the arbitrator maintained, was because such debt was not incurred for “legitimate governmental use.”<sup>12</sup>

One may counter-argue that the *Tinoco* case does not sufficiently support the doctrine of odious debt due to the identity of the sole arbitrator, who was *William Howard Taft*, a former U.S. president and a former chief justice of the U.S. Supreme Court. Arguably, the arbitrator was not happy with the presence of the British government and companies in Latin America (Toussaint 2019, kindle locations 2851, 2891–2893) and he considered the notion of odious debt a suitable instrument with which to counter or diminish British presence in Costa Rica.

Apart from the *Tinoco* arbitration, there is still no any other case that has been decided by an international court or tribunal on the basis of the ‘odiousness’ of an external sovereign debt (Paulus 2014, para. 31). There is no such precedent (Wendorf 2018, p. 1) (Feibelman 2007, p. 764). “This concept has never been cited by any other international tribunal as a reason to repudiate a debt claim” (Weiss 2011, p. 11). Thus, the international adjudicatory use of the concept of odious debt is almost non-existent.

Actually, in current public international law of finance, it is very rare to launch formal international legal proceedings for external sovereign debt. Public international law litigation is conspicuously marginal. Therefore, odious debt does not stand much chance of gaining prominence through international adjudication. Odious debt cannot enter the realm of formal public international law through international adjudication. However, law works best where it formalizes peoples’ behaviour (Lowe 2015, p. 105). And, “only if rights can be litigated and enforced is the law made formally binding.” (Lupo-Pasini 2017, p. 266) (Trachtman 2008, pp. 208–271).

Be that as it may, outside the realm of international adjudication, there have been some rare events which smack of the application of the doctrine of odious debt. There have been a few repudiations or cancellations of external sovereign debt that seem to hint at or allude to the notion of odious debt. However, the role of public international law in these cases is not certain. Rather, they seem to have been sporadic political cases.

The most prominent example—in terms of the amount of debt, the duration of the debt dispute and the countries involved—among those is this: in 1918, the Soviet

<sup>11</sup> *Tinoco* Arbitration Case, *Aguilar-Amory and Royal Bank of Canada claims, Great Britain v. Costa Rica*, 18 October 1923, vol.1, p.394. Accessible at [https://legal.un.org/riaa/cases/vol\\_1/369-399.pdf](https://legal.un.org/riaa/cases/vol_1/369-399.pdf) (accessed on 14/05/2020).

<sup>12</sup> *Ibid.*

Union successfully repudiated all government debt—purportedly odious debt—issued by the former Tsarist regime of Russia. That was a successful move in that for a long time after this repudiation, the Soviet Union did not acknowledge the debt and did not repay it. And, when, long after, Moscow agreed to redeem some sovereign bonds from the Tsarist era, it did so at a minimum rate: in 1986, the Soviet Union made an agreement with the United Kingdom (UK) to settle the Russian external debt.<sup>13</sup> The British holders of Russian government bonds were able to receive about ten percent of the value of bonds.<sup>14</sup>

And, the French holders of Tsarist Russian government bonds could receive only one percent (Toussaint 2019, kindle locations 4041–4042).<sup>15</sup> Due to the fact that a great majority of the holders of Tsarist Russian bonds were French citizens, Russia made a deal with France after the disintegration of the Soviet Union, in 1996, to be exact, to settle the debt issue.<sup>16</sup> The French state, at the time of the 1918 Soviet Russian repudiation of the debt, held a considerable amount of Russian Tsarist gold<sup>17</sup> and the French state seized this gold. Hence, the 1996 deal was made partially thanks to factoring in the liquidation of that Russian gold. Ultimately, Russia, through that deal, aimed to facilitate its access to international capital markets. Yet, as mentioned above, in total, Russia paid a small percentage of the debt represented by the Russian Tsarist sovereign bonds.<sup>18</sup> Indeed, today, the French bondholders still demand the outstanding due.<sup>19</sup> Russia responds that the French government did not compensate its citizens with the proceeds of the French-Russian deal.<sup>20</sup>

Arguably, repudiations and cancellations of sovereign debt are political matters, epitomized by the repudiation by the Soviet Russia. Public international law does not play a role in that respect. The Soviet Union was a political superpower with a vast market which Western creditors did not want to lose and wished to continue to lend to. Hence, the Soviet Russian disowning of the debts of the former Tsarist regime was by and large accepted by the international creditor community. The

<sup>13</sup> The Washington Post, Nancy L. Ross, *Defaulted Imperial Russian Bonds Draw Interest*, 25 July 1986. Accessible at <https://www.washingtonpost.com/archive/business/1986/07/25/defaulted-imperial-russian-bonds-draw-interest/42cb3170-650a-44a7-aa4c-5aa591cc4d52/> (accessed on 23 May 2020).

<sup>14</sup> Ibid.

<sup>15</sup> *French still waiting for multi-million imperial debt payout from Moscow*, Russia Beyond, 15 January 2018. Accessible at <https://www.rbth.com/lifestyle/327261-french-still-waiting-for-debts-payment> (accessed on 23 May 2020). RFI, (in French) *Emprunts Russes: 100 ans apres, les descendants esperent encore le remboursement*, 13/01/2018. Accessible at <http://www.rfi.fr/fr/economie/20180113-emprunts-russes-100-ans-apres-descendants-esperent-encore-remboursement> (accessed on 23 May 2020). Éric Toussaint. *The Debt System*, Haymarket Books. Kindle Edition, Chicago, 2019, (Kindle Locations 4041–4042).

<sup>16</sup> Chicago Tribune, Uli Schmetzer, *Russia to pay off old bonds*, 28 November 1996, Accessible at <https://www.chicagotribune.com/news/ct-xpm-1996-11-28-9611280180-story.html> (accessed on 23 May 2020).

<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

<sup>19</sup> *French still waiting for multi-million imperial debt payout from Moscow*, Russia Beyond, 15 January 2018. Accessible at <https://www.rbth.com/lifestyle/327261-french-still-waiting-for-debts-payment> (accessed on 23 May 2020).

<sup>20</sup> Ibid.

latter, despite the Soviet Russian debt repudiation, resumed the granting of loans to Soviet Russia (Toussaint 2019, kindle locations 3998–4000). This seems a highly politicized and ad hoc affair.

Due to this immense politicization and contingency, it is difficult to invoke the concept of “odious debt” as a general principle of law. Although some developing countries and some non-governmental organizations (NGOs) make the case for such a principle, that is still not enough to establish the concept of odious debt as a general principle of law, under Article 38 of the Statute of the International Court of Justice (ICJ). There seems no palpable evidence for the establishment of such a legal principle.

In fact, that is a reflection of the weakness of general international law in regard to external sovereign debt. That weakness inevitably leads to the discussion at a more theoretical level—the discussion of the distinction between the public and the private.

## The Public–Private Divide

The public–private distinction is variable and dynamic (Cutler 1997, p. 262). Any matter or issue can move into the public sphere if it is important enough to a large group of people (Goldmann 2018, p. 340). A public dimension involves politics. Any matter can be a matter for public law and politics if it concerns a sufficiently high number of people.<sup>21</sup>

While public law clearly has a political dimension, private law is an apolitical domain of economic exchange (Cutler 1997, p. 263). Private law envisions market as a neutral, technical and apolitical arena. This distinction is a way of envisaging politics and economics as separate realms. In this context, the governmental realm is separate from the economic and commercial realm.<sup>22</sup> The counter argument is that it is impossible to deny the political nature of private commercial transactions; there is no ‘pure’ private economic realm. That is especially true when a government incurs debts vis-à-vis a private creditor under a debt contract—that is, a sovereign bond.

In other words, external government debt—though based upon a private bond contract—inevitably concerns the national public. And, the national public demands publicity in government transactions—the transparency of government activity is a central feature of public law. Government debt cannot be excluded from public scrutiny. The government cannot take and repay debts in a secretive way. That is, national public scrutiny restrains governments from taking loans in a private, covert and unaccountable manner. Government is to be held accountable for the loans it takes and this accountability can be envisaged under public law. However, that public law is national. And, national public law cannot altogether encompass a debt transaction which is “international”.

Granted, if an international private transaction has “effects” within the debtor state, then it creates a sufficient “nexus” with national jurisdiction and can become a matter for the national public law of the debtor state. On this view, external

<sup>21</sup> Ibid.

<sup>22</sup> Ibid., p.277.

sovereign debt has a sufficient nexus with the national jurisdiction of the debtor state. In particular, the intervention of the public law of the debtor state becomes all the more necessary, as there is no veritable public scrutiny of external sovereign debt at the international level; public international law does not check governments in taking and repaying loans. Public international law at present is inchoate and, ultimately, regards external sovereign debt as a matter for national sovereignty.

Yet, it is not only national public law which checks external sovereign debt. National private law plays a significant role, too. According to national private law, external sovereign debt is a matter only between the debtor government and the foreign private creditor—it is a private debt relationship. Private law is, purportedly, another realm, one that aims to do justice between the parties to the dispute without influencing outside relationships (Schmid 2002, pp. 415, 484). Private contracting does not interfere with or encourage systemic changes in resolving disputes. An ad hoc fairness and justice within the confines of the sovereign debt contract is to be pursued in the event of dispute settlement<sup>23</sup> and that dispute settlement should have no implications for systemic change.

Yet, the unavoidable public dimension of external sovereign debt creates difficulties for such a limited, or even simplistic, view of external sovereign debt. In peacetime, governments regularly issue bonds to pay for investment in public infrastructure, infrastructure being a typical example of a public interest. An economic slowdown may lead governments to issue bonds in international capital markets. A government may issue bonds during wartime, too—these would be called war bonds or defense bonds. These also represent the public interest.

Government debt has been the primary source for financing wars (Graeber 2011, p. 364). War bonds help pay for the war expenses of the legally recognized government or, even those considered ‘rebels’ or ‘insurgents’ by the government that happens to be in power. For instance, during the 1895 Cuban War of Independence against Spain, a renowned international banking house,<sup>24</sup> “which had been a long-time financier to Spain, refused to extend any further credit to Spain, and instead underwrote Cuban revolutionary bond issues.” (Rothbard 2011, p. 8) One cannot deny the political—i.e., public law—consequences of that action. In brief, a sovereign bond is a significant instrument for investment in the national economy and national defense, both of which are public law issues. Hence the necessity of public law in regulating sovereign debts, notwithstanding the conclusion of private debt contracts—e.g., sovereign bonds.

Granted, by applying national private law to the sovereign bond contract, the national courts—e.g., the courts of the financial center or the courts of the home state of private creditors—issue private law judgements.<sup>25</sup> National courts merely enforce the private debt contract upon which external sovereign debt is based. In that, national courts may

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<sup>23</sup> Ibid.

<sup>24</sup> The House of Rothschild.

<sup>25</sup> “The United States of America and the United Kingdom are legal jurisdictions of most foreign currency sovereign bonds.” Accessible at <https://www.ft.com/content/de43248e-e8eb-4381-9d2f-a539d1f1662c> (accessed on 31/08/2021).

be deemed mere agents of national private law. However, national courts do ultimately represent the public power of the state in which they are located and their intervention into external sovereign debt can be regarded as the intervention of national public law. This is not public international law—this is the “national” public law of the financial center or “national” public law of the home state of private creditors.

Arguably, in contracting, it is simply the economic relationship between the parties that is at issue as contract is, supposedly, concerned only with the economic interests of the debtor and the creditor (Perez, Jr & Weissman 2007, p. 736), while public law, in contrast, involves the general public interest. Yet, external sovereign debt threatens to destabilize that cozy and simplified dichotomy between public law and private law. The private debt contract—the sovereign bond contract where the state is the debtor—blurs the distinction between public law and private law. The “public” state borrows through a “private” contract.

Private law is, supposedly, indifferent to the political.<sup>26</sup> Private law assumes the superiority of economic liberalism based upon market forces.<sup>27</sup> It also, purportedly, ensures impartiality under market conditions.<sup>28</sup> External sovereign debt contracts are instruments of national private law and frame external sovereign debt in the framework of national private law. But, it is clear that sovereign debt is inevitably a political matter on the international plane. This presents a conundrum.

Hence the need for a larger look at the notion of external sovereign debt under public international law.

## Public International Law

Odious debt demonstrates the insufficiency of public international law with regard to external sovereign debt. Arguably, that is due to the dominance of the view of “contractual debt obligation”. This is the private law view. The so-called “international credit” is based upon the strict compliance with the contractual terms.<sup>29</sup> That is, external sovereign debt has been envisaged under national contractual terms under national law. Indeed, “the United States of America and the United Kingdom

<sup>26</sup> Ibid., p.735.

<sup>27</sup> Ibid., p.737.

<sup>28</sup> Ibid., p.736.

<sup>29</sup> Leo Pasvolosky, TWO PHASES OF THE CONFERENCE OF THE INTERPARLIAMENTARY UNION AT COPENHAGEN, Source: Advocate of Peace through Justice, Vol. 85, No. 11, November 1923, p.386: “There was a tense moment at the last session of the XXIst Interparliamentary Conference when Representative Theodore EK Burton, of Ohio announced to the representatives of 22 European Parliaments the attitude of the United States toward the question of reparations and of the interallied debts. ....Mr. Burton, in his speech, laid down the principle that the interallied debts are voluntary **contractual obligations**, entered into among friends, without any reference to reparations, which are, in the very nature of things, penalties imposed by the victor upon the vanquished foe. He stated that the United States expects the European debts due to her to be paid. She is willing to make every concession necessary in arranging for the payments, but is utterly **opposed to** any idea of **cancellation**, which would undermine **the very foundation of international credit.**” (*emphases added*).

are national jurisdictions of most foreign currency sovereign bonds.”<sup>30</sup> Yet, the anomaly is that although in national contractual laws, there is a “legal” possibility of cancellation of obligations, there exists no such “legal” possibility of cancellation for external sovereign debt. In formal terms, external sovereign debt is conceived in such a way that the obligation of payment by the state is regarded as sacrosanct.

Importantly, there is no special international court or tribunal for dealing with cancellation of external sovereign debt. In other words, there exists no specific international court or tribunal which would supervise and harmonize sovereign debt restructurings. If such a court did exist, it would internationalize sovereign debt contracting, formalize debt restructuring and overrule holdouts—e.g., those private creditors and creditor governments who do not consent to restructuring proposal of the debtor government. Such an international court would minimize the national contractual dimension—bilateral and private dimension—of sovereign debt relationship. An international debt court would bring a multilateral public law dimension to external sovereign debt. Such court might form consistent and formal public international jurisprudence.

The current regime of external sovereign debt is similar to the nineteenth century era of global financial landscape where private actors, private information gathering, private relationships (and lobbying) with governments, national contractual laws (rather than public international law) and the law of the financial centres/the law of home state of private creditors (rather than a multilateral organization or an international court) together constituted the international debt regime. The nineteenth century was marked by a fragmented picture of the recovery of external sovereign debt. Public international law did not rule the day. Interestingly, today there is a similar situation. At present, public international law in respect of external sovereign debt is weak.

Interestingly, today, there exists only one difference with the nineteenth century. In the nineteenth century, sovereign default was regarded as a serious violation of international law (Kamlani 2014, p. 24). Repudiation of debts was sort of a taboo.<sup>31</sup> Yet, according to the present understanding of external sovereign debt, sovereign default is a “regular phenomenon” to be settled within the confines of a network consisting of creditors and the debtor government. Today, sovereign default has all but become a usual property of international debt.<sup>32</sup> This is aligned with the politicized

<sup>30</sup> Accessible at <https://www.ft.com/content/de43248e-e8eb-4381-9d2f-a539d1f1662c> (accessed on 31/08/2021).

<sup>31</sup> Leo Pasvolksy, American-British War Debt Negotiations, Source: World Affairs, Vol. 96, No. 4, December 1933, p.213: Complete obliteration of the obligations by cancellation, although on balance it would be the best solution from the economic viewpoint, appears to be equally impractical in view of the state of public feeling in this country (USA). Repudiation is regarded everywhere as a perilous course, fraught with destructive possibilities for the whole credit structure of the world. No debtor government desires to embark upon it, unless forced to do so by inflamed public opinion in its own country. Revision, on the other hand, is eagerly sought by all our debtors. In seeking revision, both debtor and creditor will naturally bargain to secure favorable terms.

<sup>32</sup> There were 250 government defaults on external debt from 1800 to 2006. Carmen Reinhart & Kenneth Rogoff, *This Time is Different, Eight Centuries of Financial Folly*, Princeton University Press, Princeton, New Jersey, 2011.

understanding of international debt. A sovereign debtor is now deemed to have the “political” right to default. There is a permissive attitude towards sovereign default. Sovereign default is deemed a routine political phenomenon which does not necessarily trigger a violation of international law (Kamlani 2014, p. 24).

This has to do with the understanding of national sovereignty. Governments freely choose other governments and private creditors with which they wish to have debt relations (White & Abass 2010, p. 547) and under international law, “restrictions upon the independence of states cannot be presumed.”<sup>33</sup> One shall not expect from public international law to restrain governments from taking loans, issuing sovereign bonds and defaulting. Yet, this seems an exaggeration of national sovereignty—the bedrock of international law.

Indeed, external sovereign debt challenges the most cherished principle of public international law and the United Nations (UN) Charter, which is national sovereignty/the right to self-determination.<sup>34</sup> Public international law is based upon the principle of equal sovereignty of nations as per the UN Charter,<sup>35</sup> and national sovereignty is a large concept that may yet encompass many more issues. When it comes to external sovereign debt, national sovereignty implicates unlimited sovereign capacity and the discretion to borrow and repay debt (Borchard et al. 1932, p. 140). A sovereign state cannot go bankrupt. Therefore, national governments need not an international compulsory and statutory sovereign debt mechanism. Governments do not wish to lose their sovereignty through such international mechanism (Gelpern & Gulati 2006, p. 1659).

The lethargy of the UN—the ultimate international organization which can bring a multilateral legal dimension to external sovereign debt—in respect of external sovereign debt may be due to the belief in external sovereign debt’s self-regulating capacity. Indeed, it is interesting to note that notwithstanding the existence of many external sovereign debt defaults and crises, the trust in the soundness of external sovereign debt has still not been undermined. That is a reflection of the political consensus in respect of external sovereign debt. In international markets, there is a strong belief in the sustainability of external sovereign debt that the sovereign will, somehow, find a way to repay its debts!<sup>36</sup> Indeed, those sovereign states that defaulted in the past may still return to the international capital markets and sell new debt.

A creditor government does not readily resort to international adjudication for the repayment of the external sovereign debt. Rather, a creditor government that holds another government’s securities (e.g., bonds) prefers stable and peaceful relations with the debtor government, in particular if currencies can be affected by

<sup>33</sup> *Lotus* judgment, Permanent Court of International Justice, no.9, 1927, Serie A, no.10 at p.18.

<sup>34</sup> Article 2(1), United Nations Charter. Accessible at <https://www.un.org/en/sections/un-charter/chapter-i/index.html> (accessed on 18/02/2021).

<sup>35</sup> Article 2(1), United Nations Charter.

<sup>36</sup> Federico Lupo-Pasini, *The Logic of Financial Nationalism, The Challenges of Cooperation and the Role of International Law*, Cambridge University Press, Cambridge, UK, 2017, p.13: “For instance, banks invested heavily in sovereign debt of OECD countries due to the perceived lower risk associated with sovereign debt.” p.38: “Sovereign debt has usually been considered a no-risk or low-risk financial instrument, because of the allegedly unlimited repayment capacity of states.”

unstable relations, conflicts and wars among governments (Polanyi 2001, p. 14). By and large, intergovernmental negotiations and diplomacy are the preferred tools for settling intergovernmental debt disputes. This is politics rather than public international law as such.

Likewise, only very rarely and exceptionally do external sovereign debt cases become the subject of international investment arbitration.<sup>37</sup> Creditors of sovereign debt do not seem to pay any attention to the existence of bilateral investment treaties, which constitute a significant part of public international law (Waibel 2011, p. 256). “Modern sovereign debt is governed by the municipal law (domestic law) of a foreign financial center, not by international law.”<sup>38</sup> Sovereign debt instruments (e.g., bonds) provide for national jurisdiction and national courts.

Public international law is comprised of two parts: the first component includes treaties, customary law and general principles of law. Article 38 of the Statute of the International Court of Justice (ICJ) posits them as the primary instruments of the ICJ to settle disputes.<sup>39</sup> The second component is that which exists neither in treaties nor in customary law nor in general principles of law. The first component is the strong dimension of public international law. It is formal and regular and is amenable to formal international adjudication. Yet, the second component is flexible—that is informal international law. Arguably, the global ideology of external sovereign debt envisages a flexible, informal and politicized treatment of external sovereign debt in the framework of the second component.

This flexibility is all the more striking as one of the contributing factors to the outbreak of the Second World War was sovereign debt crises (Goldmann 2012, p. 154). External sovereign debt has always been a matter for international peace and security.<sup>40</sup> The latter is specifically protected under formal public international law after the Second World War.<sup>41</sup> Moreover, as aforementioned, external sovereign debt is closely related with the right to self-determination of nations (Lothian 1994, p. 444)—one of the fundamental principles of public international law. Financial sovereignty is implicit within self-determination. The UN Charter, the International Covenant on Civil and Political Rights,<sup>42</sup> and the International Covenant on the Social, Economic and Cultural Rights<sup>43</sup> all refer to the right to self-determination. The latter two covenants, in particular, emphasize

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<sup>37</sup> For a handful of international adjudication cases and, in particular, international investment arbitration cases, which have been already examined in the academic literature, *See*, in general, Michael Waibel, *Sovereign Defaults Before International Courts and Tribunals*, Cambridge/New York, Cambridge University Press, 2011, Chapter 8 and Chapter 10.

<sup>38</sup> *Ibid.*, p.257.

<sup>39</sup> Accessible at <https://www.icj-cij.org/en/statute> (accessed on 26 June 2020).

<sup>40</sup> *Ibid.*, p.155.

<sup>41</sup> United Nations Charter, Article 1(1).

<sup>42</sup> Article 1.

<sup>43</sup> *Ibid.*

the economic dimension of the right to self-determination.<sup>44</sup> Yet, none of those instruments refers to external sovereign debt. The reason for the silence of treaties in respect of external sovereign debt may be that sovereign debt crises are regarded as political events (Macmillan 1995, p. 78). In fact, telling what counts as legal from what counts as political or moral argument has been a feature of doctrinal innovation (Lothian 1994, p. 468). Yet, the legal doctrine has still not engaged in such innovation.

Granted, loan agreements between the World Bank and governments are governed by formal international law (Mettela 1986, p. 228) (Hahn 1992, p. 56) (Sommers et al. 1956, p. 477)—a formal debt treaty is concluded between them. Likewise, public international law is applicable to debt agreements between the International Monetary Fund (IMF) and the borrowing state (Hahn 1992, p. 56). Both the World Bank and the IMF are subjects of public international law—both are official international organizations. They have a public international law relationship with debtor states. Yet, neither the IMF nor the World Bank would sue debtor states before courts. Debt repayment crises are settled through a flexible diplomacy behind closed doors.

Loans extended by both the World Bank and the IMF to governments are under the heavy influence of de facto international politics. Both institutions are highly politicized entities. True, they both admittedly claim that they give out loans “with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.” (Pinelli 2013, para. 6)<sup>45</sup> Yet, in effect, they are open to political influence from their biggest shareholder member states, such as the United States of America (U.S.) (Harvey 2005, p. 189).

Both institutions may have to bring their attitude in line with international political developments. For instance, both the World Bank and the IMF stopped the flow of loans to Croatia in 1997 until the Croatian government turned over ten indicted war crimes suspects to be tried in the International Criminal Tribunal for the Former Yugoslavia in The Hague (Pinelli 2013, para. 6). A sovereign debt issue was linked to the cooperation of a government with an international criminal tribunal that was established through the UN Security Council at the behest of the great powers—e.g., the U.S. This is international politics tied to external sovereign debt.

International financial politics—rather than public international law as such—involving the debtor government, the creditor government, official international organizations, commercial banks and private creditors reigns in respect of external sovereign debt. There has always been a close relationship between global finance and foreign policy (Dombrowski 1998, p. 13) and external sovereign debt is an important component of that relationship. International financial politics can

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<sup>44</sup> Article 1(2) of both Covenants reads: All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence.

<sup>45</sup> Art.III, Sect. 5(b), Articles of Agreement of the International Bank for Reconstruction and Development. Cesare Pinelli, *Conditionality*, Oxford Public International Law, Max Planck Encyclopedia of Public International Law, 2013, para.6.

be defined as a network system. Today, private investors (private bondholders) and various funds (e.g., hedge funds)<sup>46</sup> all constitute a network and are part of the international financial configuration.

There is a contradiction between hierarchy and network. The modern public international law, which reflects the post-1945 world system, (Ferguson 2017, p. XXV) is a hierarchical construct based upon sovereign states. That is, states are considered as the pre-eminent legal and legitimate source of authority, with the UN Security Council possessing another form of authority (hierarchy) over states.<sup>47</sup> This framework is operational as long as states are capable of fulfilling their obligations vis-à-vis their own populations and the UN. This is three-level-hierarchy comprising the UN Security Council, states and their peoples. However, external sovereign debt may undermine the capability of states to fulfil their obligations in this hierarchy.

While economy and finance have become global, the political structure of the world is still based upon the nation-state.<sup>48</sup> States are the foremost subjects of international law and they create international organizations. International organizations aim at bringing an apolitical and technical dimension to global problems (Klabbers 2016, p. 254). In particular, until the late 1960s, states (Ferguson 2017, p. 394) and international organizations—e.g., the United Nations (UN), the International Monetary Fund (IMF), and the World Bank—controlled the world system, with the ability to shut down or co-opt networks.<sup>49</sup> Yet, today, with regard to international debt, informal private creditor networks seem to possess a certain assertiveness. And, public international law does not respond to that.

Arguably, an informal network decreases the transactions costs for selling and buying international debt. A network brings efficiency and speed to transactions, because a network is about people trusting each other. “Credit is a function of trust, which in turn is higher within a cluster of similar people”.<sup>50</sup> “A credit system, by its nature, is a distributive network.” (Ferguson 2018, 5:45–6:00) Yet, the question is whether a networked world has order? (Ferguson 2017, p. 395) Put differently, is there an international legal order of external sovereign debt? This paper’s answer to that question is in the negative. Rather, there exists a set of highly politicized, informal and de facto relationships, understandings and assumptions with national laws and national courts of prominent financial centres as the backstop. The weakness of formal public international law in respect of external sovereign debt is obvious. And, the doctrine of odious debt takes its fair share from that weakness.

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<sup>46</sup> Hedge fund is “a largely unregulated speculative fund which offers substantial returns for high-risk investments.” Accessible at <https://www.thefreedictionary.com/hedge+fund> (accessed on 31 August 2021).

<sup>47</sup> Article 25, United Nations Charter: The Members of the United Nations agree to accept and carry out the decisions of the Security Council in accordance with the present Charter.

<sup>48</sup> *Ibid.*, p.397.

<sup>49</sup> *Ibid.*, p.XXV (preface).

<sup>50</sup> *Ibid.*, p.31–32.

## Conclusion

There is a tacit international agreement on the *status quo* in respect of external sovereign debt. Stakeholders of external sovereign debt do not intend to change the *status quo*. This *status quo* is a challenge to international law yet international law is too weak to propose answers to the current conundrums surrounding external sovereign debt.

The dichotomy of “public” and “private” is not in itself capable of dealing with the repercussions of external sovereign debt. It is not possible to force external sovereign debt into a public or private box. Rather, the real problem lies with the lethargy of national governments. National governments abstain from recognizing external sovereign debt as a matter for public international law as such. Public international law comes to the fore only in a sporadic manner.

Public international law does not encompass external sovereign debt. Despite the latter being a prominent feature of international relations, public international law is inchoate. In particular, the current status of ‘odious debt’, which may also be termed ‘illegitimate debt’, in international law epitomizes the weakness of international law with respect to external sovereign debt. Odious debt is subject to politics and ad hoc relations on the international stage.

By and large, the law engages with external sovereign debt on the national level—e.g., via the national laws and the national courts of financial centers. In the event of a dispute regarding external sovereign debt, it is very rare for international law or international adjudication to deal with external sovereign debt. Indeed, the parameters of the odiousness of external sovereign debt have still not been established by public international law and there is little indication that they will be established in the near future.

The international legal passiveness in respect of external sovereign debt and odious debt is all the more conspicuous when it comes to international legal scholarship. Works of publicists are subsidiary sources of international law, in that they help find rules of international law.<sup>51</sup> In that respect, in particular, textbooks on international law play a prominent role. However, no international law textbook contains a section or chapter dealing with the issues of external sovereign debt or odious debt. It seems that academia has still to make up its mind as to how to deal with external sovereign debt and odious debt through international law. Nevertheless, under current conditions, international legal scholarship seems the only safe place in which a new initiative with regard to those issues may emerge.

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<sup>51</sup> Article 38(1)(d), Statute of the International Court of Justice.

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