Odious Debts: The Power of a Mythical Doctrine

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The doctrine of odious debts may be the most famous legal doctrine never to have existed. It aspires to be an exception to an actual doctrine: the rule of government succession. A doctrine of customary international law, the rule of government succession holds that a state's debts persist regardless of the identity of its governing officials or the form of its government. The question raised by the doctrine of odious debts is whether this rule should give way when a truly odious leader causes the state to borrow for a purpose contrary to the interests of the population.[1]

Talk of the need for such a doctrine dates at least to 1898, when, in the wake of the Spanish American war, the United States repudiated the external debt Cuba had incurred while under Spanish rule. As a historical matter, there are numerous other instances where states have refused to pay debts they viewed as improperly incurred, China and the Soviet Union being among the most prominent of these. As of this writing, Ukraine is refusing to pay a $3 billion debt incurred in 2013 by its then pro-Russia leader, Victor Yanukovych, under pressure and threats from Vladimir Putin's Russia.

Of course, there have been many cases where states *have* paid debts that might have been characterized as odious. Examples include debt imposed on Haiti by France to compensate French colonists for losses incurred in Haiti's successful fight for independence[2] and debt incurred by King Leopold to fund his horrific rule of the Congo.

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[1] Gulati, Mitu & Ugo Panizza, 2020. Alternative Solutions to the Odious Debts Problem", *Annals of the Fondazione Luigi Einaudi* 54(1): 153-168; King, Jeffrey. 2017. *The Doctrine of Odious Debt in International Law*, Cambridge: Cambridge University Press; Buchheit, Lee, Mitu Gulati & Robert B. Thompson. 2007. "The Dilemma of Odious Debts", Duke Law Journal 56(5): 1201-1262.

[2] Oosterlinck, Kim, Ugo Panizza, W. Mark C. Weidemaier & Mitu Gulati, 2022. "The Odious Haitian Independence Debt", Journal of Globalization and Development, https://www.degruyter.com/document/doi/10.1515/jgd-2021-0057/pdf

The positive argument for the doctrine is that, in an ideal world, where the doctrine would hold and where it would be easy to determine which regimes and which debts are odious, odious debts should not be observed. Rational investors would refuse to lend to the odious regime knowing that the debt would be repudiated later on. This would in turn starve the regime whose duration might be shortened because of its inability to borrow.

As a legal matter, however, we are unaware of any tribunal that has explicitly recognized the existence of a doctrine of odious debts. Yet. some scholars and commentators writing about the doctrine have questioned its underlying premises. Choi and Posner, for example, argue that a doctrine that denies enforcement to loans ex post will necessarily impose costs on the borrower state's population—including by reducing investments in infrastructure and other projects that benefit the public—and that proponents of a robust odious debts doctrine have not demonstrated that the doctrine's benefits will routinely exceed these costs.[3]

The Importance of Considering the (Non-)Doctrine

Why write about a fictitious legal doctrine, especially when we are not among those willing to assert its existence? The primary reason is that intuitions about "odiousness" seem to shape perceptions in sovereign debt markets. For example, investors seem capable of distinguishing odious from non-odious debt and occasionally appear willing to forgive non-payment when the borrower can plausibly assert that the debt falls into the former category. To this day, the People's Republic of China refuses to acknowledge debts incurred by the Kuomintang and its imperial predecessors, yet this does not seem to have affected its borrowing costs. Much of Iraq's borrowing under Saddam Hussein was infected with corruption or used to the detriment of the populace. These debts were restructured without being labeled "odious," but observers suggest that an awareness of the concept of odious

[3] Choi, Albert H. & Eric A. Posner. 2007. "A Critique of the Odious Debts Doctrine", *Law and Contemporary Problems* 70(3): 33-51.

debts mattered to restructuring negotiations. In some rare historical examples, debts which were labelled as odious traded at a discount when compared to non-tainted debts issued by the same country. Yet, these observations relate to a period when the purpose of the debts were clearly stated in the prospectus and investors had some idea about the way the proceeds of the debts would be used. This is no longer the case for most sovereign debt issues. These and other examples suggest that, while the concept of odious debt may not have crystallized into formal legal doctrine, the intuitions underlying that concept have power in the real world.

The Content of Such a Doctrine

If a legal doctrine of odious debt were to develop, what would it say? Over the decades, the doctrine has been described in varied ways, but the core concept is the same: it involves borrowing by a despotic leader (i.e., one who rules without popular consent) that provides no benefit to the population—for instance, because the despot uses the borrowed funds for personal benefit or because the funds are used to suppress dissent or terrorize civilians. Moreover, the doctrine applies only when lenders had reason to know that the loan would produce no benefit to the borrower state's population. Under these conditions, after the despot is removed, the doctrine permits the state to repudiate the debt.

Regardless of disciplinary perspective — political science, economics, philosophy, law — observers who first encounter this description of odious debt doctrine tend to think it makes sense. Imagine that a dictator violently suppresses pro-democracy protests with guns financed by borrowing from capital markets. When the protesters finally storm the presidential palace and install a democratic leader, should they have to pay investors who enabled the despot's violent attempt to remain in power? Whether analyzed as a question of morality, ethics, or ex ante incentives, the question answers itself.[4]

[4] E.g., Jayachandran, Seema, & Michael Kremer, 2006. "Odious Debt", *American Economic Review*, 96(1): 82-92.

Indeed, we suspect this is why the concept of odious debt retains currency despite its dubious status as legal doctrine.

If the concept of odious debt were ever to crystalize into legal doctrine, many difficult questions would require answers. For starters, when does a political leader become sufficiently despotic to trigger the doctrine? Can a democratically-elected leader be (or become) despotic? What about monarchies recognized as members of the international community today? And why should the doctrine be limited to borrowing by despotic regimes? After all, non-despotic regimes can and do incur debts that do not benefit the populace, reflecting all sorts of governance failures, such as politicians' short-term incentives to maintain power.

As another example, when is money used for purposes adverse to the interests of the populace? There may be easy cases, as when a despotic ruler absconds with loan proceeds. But what about borrowing for military purposes, which can both provide benefits (e.g., national security) and inflict harm (e.g., by suppressing dissent)? In such cases, is it possible (or desirable) to apportion the borrowing into "odious" and "non-odious" components? And then, there is the question of lender responsibility. Should lenders be penalized for lending to despotic regimes? Such a rule might cause lenders to shy away from lending to poorly-governed countries, cutting off a desperately-needed source of funding. If such a rule is desirable, when does a lender have sufficient knowledge of the likely misuse of loan proceeds to trigger the doctrine?

Some of these questions relate to whether a hypothetical odious debt doctrine should be applicable after the debt was issued and after a democratic government replaces the despotic one, or whether the debt should be declared odious es-ante (i.e., priori to the debt's issuance). With the ex-ante approach, all debt issued after the declaration will not be upheld by future governments, and this action will not carry any legal or reputational consequences as long as debt issued before the declaration of odiousness is honored by the successor government.

Advocates of the ex-post approach include various NGOs supporting citizen debt audits, akin to the one utilized by President Rafael Correa to challenge Ecuador's debt legitimacy. While we hold reservations about the Ecuadorian debt audit's content, we understand the rationale behind those supporting ex-post odious declarations. Indeed, these are situations where it can be argued that the international community condoned despotic behavior and could not have been counted on to make an early designation to restrain the despot. Take for instance, South Africa's apartheid regime, which, despite imposing appalling policies on the majority of people, was accepted for many years as a member of the international community.

However, there are two problems in adopting an ex-post odious debt doctrine. The initial concern revolves around the uncertainty stemming from the potential declaration, which could adversely impact global credit access. This is especially the case if it were possible to apply this *ex-post* declaration to debt issued by non-despotic regimes. The second problem with the possibility of an *ex-post* declaration of odiousness is that under reasonable assumptions it would provide limited incentives for truth-telling and increase the likelihood of false positives. Legal tribunals may hesitate to embrace a doctrine of odious debts out of an understandable reluctance to answer difficult questions like these.

The case for an ex-ante odious debt doctrine is more compelling. In the worst-case scenario, it maintains the status quo (adhering to the principle of doing no harm). In the best case, it could ease credit access for non-odious governments while penalizing despotic ones.[5] It is noteworthy that advocates of the ex-post odious debt doctrine focus on shielding new democratic governments from their despotic predecessors' debts, while proponents of the ex-ante doctrine, typically economists and legal scholars, aim to limit despotic regimes' access to global capital markets. Alternatively, one can imagine institutional solutions. For example, various organizations and ratings agencies already provide assessments of how states fare on metrics like corruption, human rights, the rule of law, and

[5] Jayachandran & Kremer, *supra*.

commitment to environmental, social, and governance reforms. Perhaps a ratings system can be devised to rate borrower states or individual loans in terms of their "odiousness." Such a ratings system might inform legal tribunals in deciding whether to enforce a loan or, less formally, might create pressure on lenders to avoid making problematic loans in the first place.

We are skeptical that such institutions will evolve, much as we are skeptical that the doctrine of odious debts will ever receive formal legal recognition. But the overall objective is a worthy one: limiting access to credit for governments that do not seek to promote the welfare of their populations.