

# A fresh look at the Odious Debt Doctrine

Charles Abrahams

## INTRODUCTION

In recent years, the doctrine of Odious Debts has become a powerful tool in the hands debt activists. Joseph Hanlon in his paper entitled “*Defining illegitimate debts and linking its cancellation to economic justice*”<sup>1</sup> is of the view that \$500 billion’s worth of loans of 23 developing countries could be regarded as odious as they have mostly been contracted by dictators or odious regimes.<sup>2</sup> Of particular note are the debts of the former Apartheid regime which, for more than forty years, maintained a policy of racial segregation at a great cost to the lives of millions of black South Africans. Apartheid has universally been condemned as a crime against humanity. However, in 1993 South Africa’s Apartheid debts contracted with the international community stood at \$25 billion.

More recently, the events in Iraq have sharply brought into focus the sovereign debts contracted by the regime of Saddam Hussein. The Center for Strategic and International Studies<sup>3</sup>, in its study released in January 2003, calculated Iraq’s overall debt burden at a staggering \$ 383 billion.<sup>4</sup> This consists mostly of unsettled compensation claims of about \$ 172 billion against the Iraqi regime, arising out of its invasion of Kuwait in 1991, foreign debt of between \$ 62 – 130 billion and pending contracts amounting to about \$ 57.2 billion. These are but two instances, amongst others, where debt activists have made out compelling

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<sup>1</sup> Defining illegitimate debt and linking its cancellation to economic justice by Joseph Hanlon, Open University, June 2002

<sup>2</sup> Id., p.36

<sup>3</sup> A Wiser Peace: An Action Strategy for a Post-Conflict Iraq, Supplement I, Background Information on Iraq’s Financial Obligations , January 23, 2003 by the Center for Strategic and International Studies

<sup>4</sup> Id., p.1

arguments for debt cancellation based on the doctrine of Odious Debts because of the nature, manner and purpose for which they were contracted.

But despite these arguments, both debtor and creditor countries as well as the broader international financial community have given a cold shoulder to the applicability of the doctrine to debts contracted with questionable regimes whilst international law scholars have maintained a deafening silence as to its place in international law. The South African government for instance denied that the amount of R 49 411 million put forward by debt researchers as at the end of 1993 was the figure for the Apartheid debt and at most deemed the outstanding amount which it never disclosed to the public as so insignificant that it was not worth risking its credit rating for.

In the light hereof this paper revisits the traditional formulation of the odious debt doctrine to ascertain why states have not resorted to readily invoke the doctrine in appropriate instances and global financial institutions have given scant regard to it.

This paper starts off by considering the definition of the doctrine as formulated by Alexander Nahum Sack. It briefly outlines the constituent elements of Sack's definition and cites the Cuban debt controversy as a historical example of the odious debt doctrine. It goes on to consider the criticism of the doctrine and outline the problematic aspects of Sack's definition by showing how unsustainable its formulation is under international law. The paper considers and adopts the formulation put forward by the Mohammed Bedjaoui, former Special Rapporteur of the International Law Commission as a proper formulation of the doctrine in the context of contemporary international law.

## DEFINING ODIIOUS DEBTS

Alexander Nahum Sack, the first scholar to have formulated the doctrine, defined odious debts as follows:

When a *despotic regime* contracts a debt, not *for the needs or in the interest of the state*, but rather to strengthen itself, to suppress a popular insurrection, etc, this debt is odious for the people of the entire state. This debt does not bind the nation; it is debt of the regime, a *personal debt* contracted by the ruler, and consequently it falls with the demise of the regime. The reason why these “odious” debts cannot attach to the territory of the state is that they do not fulfil *one of the conditions* determining the *lawfulness* of State debts, namely that *State debts must be incurred, and the proceeds used, for the needs and in the interest of the state*.

Odious debts, contracted and utilised, for purposes which, *to the lender’s knowledge*, are contrary to the needs and the interest of the nation, are not binding on the nation – when it succeeds in overthrowing the governments that contracted them – *unless the debts is within the limits of real advantages that these debts might have afforded*. The lenders have committed a hostile act against the people, they cannot expect a nation which has freed itself of a despotic regime, to assume these odious debts, which are the personal debts of the ruler. Even if one despotic regime is overthrown by another, which is as despotic and which does not follow the will of the people, the odious debts contracted by the fallen regime remains personal debts and are not binding on the new regime.<sup>5</sup>  
(emphasis added)

Three necessary requirements must be fulfilled in order for the doctrine to be applicable. One, the debt is contracted by a dictator, two, it is contracted not for the needs or in the interest of the state and three, the creditors who advanced the loans are aware of the purpose for which

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<sup>5</sup> A.N. Sack, *Less effets de transformations des Etats sur leur dettes publiques et autres obligations financiers*, (Paris: Recueil Sirey, 1927), p. 127

the they are contracted. King, Khalfan and Thomas on their part identify the same three requirements, save for the different use of terminology. In their paper, “Advancing the Odious Debt Doctrine,” put the three necessary conditions as the debt has not received the general consent of the nation, the borrowed funds are contracted and spent in a manner that is contrary to the interest of the nation and the creditors lent in awareness of these facts.<sup>6</sup>

Implicit in the requirement that ‘the debt is contracted by a dictator’ is the absence of consent requirement. According to King, Khalfan and Thomas, Sack did not specify whether there should be a process for obtaining consent but are of the view that this matter is not of great concern as most contemporary cases in concern “dictator debts.”<sup>7</sup> As for the absence of benefit requirement, Sack referred to a debt contracted not for the needs or in the interest of the state but rather to strengthen itself or to suppress a popular insurrection. Lastly, as for the creditor awareness, Sack required that the creditors be subjectively aware of the odious purpose of the loan and conclude the deal under that awareness.<sup>8</sup>

### **A NEAT HISTORICAL EXAMPLE**

Based on the aforesaid definition, one of the most well know examples cited by activists and scholars as proof of state practice for the doctrine under international law is the United States’ repudiation at the Paris Peace Treaty in 1898 of the sovereign debts owed by Cuba to Spain.

Spain relinquished her sovereignty over Cuba to the United States after being defeated in the Spanish-American war that same year.<sup>9</sup> The problem of the Spanish debts, with its focus

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<sup>6</sup> Advancing the Odious Debt Doctrine, Working Paper for KAIROS: Canadian Ecumenical Jubilee Initiatives, p. 6 (February 2002)

<sup>7</sup> Id., at 7

<sup>8</sup> Id., at 8

<sup>9</sup> Hoeflich at 51-52

mainly around the so-called ‘Cuban debts,’ became the subject of a detailed and heated discussion at the peace conference.

The United States sought to include the following statement into the peace treaty: “Article I. Spain will relinquish all claim of sovereignty over and title to Cuba.”<sup>10</sup> The Spanish Commissioners were not prepared to accept an inclusion of such a bare statement into the peace treaty and demanded a fuller statement, which would include an acknowledgment by the United States of a transfer by Spain to the United States, of:

all charges and obligations of every kind in existence at the time of the ratification of this treaty of peace, which the Crown of Spain and her authorities in the island of Cuba may have contracted lawfully in the exercise of the sovereignty hereby relinquished and transferred, and which as such constitute an integral part thereof.<sup>11</sup>

This proposal was rejected by the American Commissioners and a controversy arose which, as referred to by Feilchenfeld: “... neither two hundred years’ development of usage, nor the various abstractions and theories of writers had created recognised rules of international law on the treatment of debts in case of cession, was shown even more clearly in the peace negotiations which followed the Spanish-American War of 1898.”<sup>12</sup>

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<sup>10</sup> I J Moore, *Digest of International Law* 351 (1906)

<sup>11</sup> *Id.*, at 352

<sup>12</sup> Feilchenfeld at 329-330

The arguments of the Spanish Commissioners favouring the allocation of debts were essentially based on precedent, and arguments based on revenue pledges and public debts forming part of the ceded sovereignty.<sup>13</sup> They argued that:

[I]t is perfectly self-evident that if, during the period intervening between the assumption of a sovereign by an obligation and the fulfilment of the same, he shall cease to be bound thereby through relinquishment or any other lawful conveyance, the outstanding obligation passes as an integral part of the sovereignty itself to him who succeeds him. It would be contrary to the most elementary notions of justice and inconsistent with the dictates of the universal conscience of mankind for a sovereign to lose all his rights over a territory and the inhabitants thereof, and despite this to continue to be bound by the obligations he had contracted exclusively for their regime and government.

These maxims seem to be observed by all [cultured] nations that are unwilling to trample upon the eternal principles of justice, including those in which such cessions were made by force of arms and as a reward for victories through treaties relating to territorial cessions. Rare is the treaty in which, together with the territory ceded to the new sovereign, there is not conveyed a proportional part of the general obligations of the ceding state, which in the majority of cases have been in the form of a public debt.<sup>14</sup>

The American Commissioners in contrast, did not follow a strict legal doctrinal approach as the Spanish Commissioners, but adopted an approach based upon justice, equity and moral

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<sup>13</sup> *Id.*, at 334-336

<sup>14</sup> See Moore at 353

duty.<sup>15</sup> By adopting such an approach the American Commissioners could construct an acceptable rationale for repudiating ‘odious debts’ contracted for immoral purposes.<sup>16</sup> They advanced two arguments in support of thereof:

1. the loans have not been contracted for the benefit of Cuba, but, on the contrary, the proceeds had been spent in a way contrary to the interest of Cuba; and
2. the financial burdens connected with these loans had been imposed upon Cuba against her will and without her consent.<sup>17</sup>

The American Commissioners argued that ‘the Cuban debts were in no sense obligations properly chargeable to Cuba, because they were debts created by the Government of Spain, for its own purpose and through its own agents, in whose creation Cuba had no voice.’<sup>18</sup>

They further stated that:

If, as is sometimes asserted, the struggles for Cuban independence have been carried on and supported by a minority of the people of the island, to impose upon the inhabitants as a whole the cost of suppressing the insurrections would be to punish the many for the deeds of the few. If, on the other hand, those struggles have, as the American Commissioners maintain, represented the hopes and aspirations of the body of the Cuban people, to crush the inhabitants by a burden created by Spain in the effort to oppose their independence, would be even more unjust.”<sup>19</sup>

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<sup>15</sup> See Hoeflich at 54

<sup>16</sup> Id.

<sup>17</sup> See Feilchenfeld, at 337

<sup>18</sup> Id., at 340

<sup>19</sup> Id., at 341

With regard to the revenue pledge, the Commissioners pointed out that the creditors knew that the revenues were pledged for “the continuous effort to put down a people struggling for freedom from the Spanish rule,” and that “they took the obvious chances of their investment on so precarious a security.”<sup>20</sup>

### **CRITICISM OF THE DOCTRINE**

The Cuban Debts are a good example of state practice where all the elements of Sack’s definition are present. However, one critical element that has conspicuously been absent from this and other examples has been the element of *opinio juris*, the need for states to act out of legal obligation.

*Opinio juris* is the critical requirement that is needed, together with state practice, to give the doctrine the necessary status of a recognised rule under customary international law.

Generally speaking, *opinio juris* has often been referred to as the psychological element on the part of a state to act in the manner it does because it feels legally obliged to act in that manner. In this regard the International Court of Justice in the North Sea Continental Shelf Cases<sup>21</sup> stated:

Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e., the existence of a subjective element, is implicit in the very notion of the *opinio juris sive necessitatis*. The States concerned must therefore feel that they are conforming to what amounts to a legal

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<sup>20</sup> *Id.*

<sup>21</sup> 1969 ICJ Reports 3

obligation. The frequency, or even habitual character of the acts is not in itself enough. There are many international acts e.g. in the field of ceremonial and protocol, which are performed almost invariably, but which are motivated only by considerations of courtesy, convenience or tradition, and not by any sense of legal duty.<sup>22</sup>

Returning to the example of the Cuban debts, it is questionable whether the US commissioners acted out of a sense of legal obligation by adopted an approach based upon justice, equity and moral duty? Hoeflich makes the following point in his criticism of the US' position:

“leaving the theoretical justification aside, one sees here a clear instance of power politics. Implicit in the submission of both sides is the notion that ultimately the question of assumption of debt by a successor State rests, in part, on its political, economic, and military power, vis-à-vis the creditors involved and the whole community of nations.”<sup>23</sup> He asserts that the obligation to assume public debt became an obligation to do ‘right,’ but what was ‘right’ was to be determined by the successor State.<sup>24</sup> He is of the view that what one sees here is “that felicitous meeting of theory and practice resulting in what can only be described as a maximisation of national self-interest.”<sup>25</sup>

Today, the United States stands in virtually the same position it was more than hundred years ago, this time as an occupying force in Iraq. Should the US base any of its calls for cancellation of Iraq's debts on the odious debt doctrine, it would be interesting to ascertain

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<sup>22</sup> See North Sea Continental Shelf Cases at 44

<sup>23</sup> See Hoeflich, *supra note 47*, at 55-56

<sup>24</sup> *Id.*, at 55

<sup>25</sup> *Id.*, at 55

whether it does so because it feels legally obliged to do so, or whether, using Hoeflic's perspective, do we again see the maximisation of national self-interest?

### **PROBLEMATIC ASPECTS OF SACK'S DEFINITION**

Part of the reason for this anomaly is contained in the very manner in which Sack has formulated the doctrine. Sack's elements of debts contracted by a dictator and not for the needs or in the interest of the state are problematic elements under contemporary international law.

#### *Debts contracted by a dictator*

Under international law, debts contracted by a dictator stand on the same footing as debts contracted by a democratic government. The reason for this is because international law does not concern itself with governments, i.e. its internal structures and arrangements, but instead it concerns itself with states. Hence, international wrongful acts committed by governments do not give rise to government responsibility but instead give rise to State responsibility.

Whatever the internal structure of a state, for the purpose of international law, a state debt can be created by way of a direct commitment for a debt contracted by a state or an organ of a state or indirectly by way of a guarantee given by the state or an organ of the state.<sup>26</sup> In order to call a debt a state debt one must first determine which acts can be attributed to the state, that is the attribution to the state of the conduct of an individual, for the purpose of attaching legal consequences to that conduct at an international level.<sup>27</sup>

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<sup>26</sup>. De Vos, E, Remedies or Stumbling Blocks, The Public International Law Aspects of the International Debt Crisis, p.35 (Doctoral thesis Amsterdam/Nijmegen December 1992)

<sup>27</sup>. Id., at 35

As a general rule, acts attributed to a state at the international level are acts of persons or groups of persons who form part of its organization, the acts of its organs.<sup>28</sup> According to the International Law Commission, the following groups are considered to be organs of state:

- a) persons who have, under the internal legal order of the state, the character of organs of “public” institutions, though separate from the state, and who act in that capacity;
- b) persons who, under the internal legal order of the state, do not formally possess the character of organs of the state or of a public institution separate from the state, but perform public functions or act on behalf of the state; and
- c) persons who have the legal character of organs under the legal order of a state or of an international organization, and who have been placed at the disposal of another state provided that such persons are actually under the authority of the latter state and act in accordance with its instructions.<sup>29</sup>

In the context hereof, most dictatorial regimes have internal legal organs, albeit different from those of democratic states that possess character of organs of public institutions and fulfil public functions. Apartheid South Africa for example had a well- developed internal legal order ranging from a legislature, an executive, judicial institutions and various supporting and subordinate public organs constituting the organs of a state. It could be said that most of the 23 countries cited by Hanlon in his paper “*Defining illegitimate debts and linking its cancellation to economic justice*” would in one way or the other have some form of internal legal order wherein a person or groups of people would act and to which legal consequences could be attributed to those actions.

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<sup>28</sup> . Id., at 35

<sup>29</sup> International Law Commission Yearbook, 1971, p.233

Thus, Sacks requirement of a debt to be contracted by a dictator or a dictatorial regime does not help us much as under international law, a debt contracted by such a despot or dictatorial regime attaches legal consequences and becomes an act of state.

*Not for the needs or interest of the state*

Just as international law does not concern itself with governments and the internal legal order of a state, so does it not concern itself with how a state applies the proceeds of a debt within its internal boundaries. This rationale is rooted in the positivist tradition of international law and the notion of state sovereignty of which non-interference lies at its very heart.

However, this traditional approach has given rise to serious violations of international law by various states, most notably those committed by Nazi Germany. The prohibition on intervention in the domestic affairs of states, enshrined in the Covenant of the League of Nations, was respected as a guiding principle but it ensured that states failed to intervene in Germany before 1939 despite awareness of the atrocities committed by the Nazis against their own nationals.<sup>30</sup> International law changed because of the enormity of the atrocities committed by the Nazis and as a result a new order was proclaimed by the Charter of the United Nations which recognised the promotion of human rights as a principal goal.<sup>31</sup>

Sack, in his definition referred to a debt contracted ‘not for the needs or in the interest of a state but rather to strengthen itself and to suppress a popular insurrection.’ International law is not concerned with the internal use of a loan even if it is used not in the interest of or to the benefit of the people of a state. Whilst most of the debt contracted by dictators or dictatorial regimes would generally not be in the interest of or to the benefit of its people, it cannot be

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<sup>30</sup> Dugard, J, *International Law, A South African Perspective*, p.199, Juta & Co., Ltd, 1994

<sup>31</sup> *Id.*, at 199

said that all such debts are therefore odious. King, Khalfan and Thomas are of the view that where a debt is contracted without consent in a manner that is contrary to the interest of a population but the proceeds are eventually spent on its interest, such a debt would not be an odious debt.<sup>32</sup> One hypothetical example they cite is an instance where Apartheid South Africa could well have contracted a debt to strengthen its apartheid regime but the proceeds were subsequently used to benefit most of the population.<sup>33</sup> A further anomalous instance they cite is where a debt is contracted for the benefit of a state and with its general consent, but subsequently spent in good faith on items that are in fact of no benefit to the population.<sup>34</sup> Precisely because of these uncertainties created by Sack's definition, it is understandable why the 'absence of benefit requirement' cannot be regarded as an acceptable criterion under international law.

However, a debt contracted to strengthen a despotic regime or to suppress a popular insurrection cannot be regarded as the same as a debt contracted not for the needs of or in the interest of the state. Whilst Sack might not have intended to make a distinction between the two, international law does concern itself with instances where debts are contracted for the purpose of suppressing popular insurrections or to strengthen despotic regimes. Implicit in the latter would be physical acts which a despot would have to perpetrate against its subordinates in order to suppress its subordinates or for the purpose of maintaining itself. However, Sack does not give us sufficient information about his own knowledge of which physical acts were outlawed by international law at the time of his formulation of the doctrine. What we do know is that at the time of his formulation, international law had already outlawed acts of slavery, piracy and acts of aggression.

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<sup>32</sup> Advancing the Odious Debt Doctrine, at 7

<sup>33</sup> *Id.*, at 7

<sup>34</sup> *Id.*, at 8

It is appropriate at this point to refer to the decision of the International Court of Justice in the *Barcelona Traction Case* wherein the Court made reference to the existence of a core group of norms, whose protection, it maintained, were of paramount importance to all states. The Court held that by their very nature they are of concern to all states and in view of the importance of the rights involved, all states can be held to have a legal interest in their protection; they are obligations erga omnes.<sup>35</sup> What the Court meant by these obligations erga omnes in which all states have an interest was the protection of a core group of norms generally referred to as jus cogens norms.

As stated earlier, at the time of Sack's formulation outlawing acts slavery, piracy and aggression would have already been part of this core group of norms, with genocide and torture included at a later stage. Some authors have suggested that even outlawed acts such as summary execution, arbitrary detention, cruel, inhumane or degrading treatment and racial segregation as an official policy should be included into this category of norms but this debate is beyond the scope of this paper.

Consequently, we can say that at least respect of the debts contracted by a dictator or dictator regime for the purpose to strengthen itself or to suppress a popular insurrection, Sack's formulation was consistent with international law principals then as it is now. However, this part of his formulation is not sufficient to provide us with continued reliance on his formulation and hence for that reason we need to look at a new formulation of the doctrine.

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<sup>35</sup> See *Barcelona Traction Company Case*, *supra* note 255, at 32

## FORMULATION BY THE INTERNATIONAL LAW COMMISSION

In 1977, Mohammed Bedjaoui, former Special Rapporteur of the International Law Commission on State Succession put forward the notion that the term ‘odious debts’ designated a genus, with ‘war debts,’ ‘subjugated debts’ or ‘imposed debts’ and conceivably other types of debts constituting the species within that genus.<sup>36</sup> What Bedjaoui then did was to clarify odious debts from the standpoint of the successor state but as well as from the standpoint of the international community. From the standpoint of the Successor State, Bedjaoui held that an odious debt can be taken to mean a State debt contracted by the predecessor State to serve purposes contrary to the major interest of either the successor State of the territory that it is transferred to. However, from the standpoint of the international community Bedjaoui held that an odious debt could be taken to mean any debt contracted for purposes that are not in conformity with contemporary international law and in particular the principles of international law as embodied in the Charter of the United Nations.<sup>37</sup> This paper accepts this latter approach as a proper formulation of the odious debt doctrine as opposed to the approach formulated by Sack. Bedjaoui’s formulation consists of principal elements:

1. A debt is contracted by a state
2. It is contracted for purposes that are not in conformity with contemporary international law, in particular the principles of international law as embodied in the Charter of the United Nations

Where Sack refers to a debt contracted by a dictator or dictatorial regime, Bedjaoui merely refers to a debt contracted by a state. Where Sack refers to a debt contracted not for the needs or in the interest of the state, Bedjaoui refers to such a debt contracted for purposes that are

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<sup>36</sup> Bedjaoui M, 9<sup>th</sup> Report on the Succession of States in Respect of Matter other than Treaties, 1977 YILC, Vol. 2 (Part I), at 68 and 70

<sup>37</sup> *Id.*, at 68 and 70

not in conformity with contemporary international law, and in particular the principles of international law as embodied in the Charter of the United Nations.

### **THE WAY FORWARD**

The ILC formulation put forward by Bedjaoui provides the opportunity for looking at odious debts doctrine in a completely new way. This approach places both democratic and undemocratic regimes on the same footing by no longer confining the contraction of debts to despots or despotic regimes but includes debts contracted by all states, which by implication includes debts contracted by democratic government. The overriding element that will determine whether such debts are odious or not is whether it is contracted for purposes that are not in conformity with contemporary international law, in particular the principles of international law as embodied in the Charter of the United Nations.

It is perfectly conceivable that a democratic state could contract a loan for purposes of violating international law or the principles of the Charter of the United Nations. One hypothetical example would be where the United States advances loans to dissident groups in and outside of Cuba with the intent to destabilize and overthrow the government of that country. Since such an act is clearly in violation of international law loans advanced in support thereof would equally be in violation of international law. The same argument goes for the war debts contracted by the United States government for the purpose of invading the sovereign territory of Iraq in clear violation of international law. In this regard the debts of the former Iraqi regime would stand on the same footing as any debts which the United States government might expect as reparations from a future Iraqi government. In both instances such debts are clear violations of international law.

It is conceivable that this approach might very well find resonance with both debtor and creditor countries because of their obligations to the principles as enshrined in the Charter of the United Nations. It also has the ability to send out a strong message to the international financial community about financing loans that might breach international law. It may very well be this approach which could bring renewed interest by mainstream international law scholars to consider the odious debt doctrine from this perspective.

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