
Drowning in a Sea of Debt

by Augusto Lopez-Claros

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Benjamin Franklin once said that “in this world nothing is certain but death and taxes” and I have often wondered whether, if he were alive today, he might feel tempted to change it slightly, to “death and debts.” At least I felt this strongly a couple of weeks ago when, invited by BBC TV to comment on the results of the first round of the presidential elections in Argentina, I was forced to observe that all candidates had fairly specific proposals on what to do about the country’s multibillion dollar debts, which have been in default since December of 2001, when Argentina had its own financial earthquake, not unlike what we saw in Russia in August of 1998, only worse. For instance, then front-runner and former president Menem would not seek a partial reduction of the more than \$140 billion owed, just a lower rate of interest and large amounts of “fresh money” from the IMF and other multilateral financial institutions. But Mr Kirchner, who came in second and is now widely expected to win the second round on May 18th, would like both, a partial write-off *and* lower interest rates. He probably has been told about the Russian restructuring of Soviet debt in early 2000, because his proposal is very similar to what the Russian government got that year. Perhaps surprisingly (or maybe not?) none of the 5 candidates was advocating a repudiation of these debts. The politicians and the voters seem largely reconciled to the idea that although no one quite knows where exactly all the money went, these are debts of the State

and must be paid by Argentinean tax payers in years to come. Politicians may disagree, sometimes fiercely, about various aspects of economic policy but no one thinks that in the age of globalization and integrated financial markets populist slogans that call for debt repudiation are going to get them many votes.

One question that comes immediately to mind is whether there might be any set of circumstances under which a State might be justified in reneging on its debts without becoming a pariah in the international financial community. This is a non-trivial question because it is now universally accepted among international economists and development experts that a high debt burden can be a considerable drag on a country’s growth. And falling growth rates have been linked to higher infant mortality, higher incidence of poverty, political instability and many other economic and social ills. Indeed, for this reason, we have seen in the last 20 years a number of officially-sanctioned initiatives, led by the rich industrial countries, to provide debt relief to some of the poorer countries in the developing world, mainly in Sub-Saharan Africa.

It may surprise some readers to learn that one of the top experts in the world on the nature and legitimacy of state debts was Alexander Nahum Sack, a former minister of tsarist Russia who, in the 1920s, became a professor of law in Paris and wrote several works on the

subject. Sack's writings contributed to shape the legal framework which now is in place to deal with state debts and, I am quite sure, he would have been pleased with the position taken by Argentinean presidential candidates. He would have argued that since Argentina was a democracy during the period that the debts were accumulated, their service is an inescapable responsibility of the population even if many might feel that the loans were not always given the best possible uses. The regime may change and a new government take office, but the debt remains. Sack did allow, however, for an exception to this rule. He argued that when "despotic regimes" incurred debts not in the interests of the State but purely as a way of strengthening their control and to repress the population then the debt was not "an obligation for the nation" but was more in the nature of "a personal debt of the power that incurred it" and disappeared with the fall of the power. These debts he called "odious" ("*dettes odieuses*") and the strong implication was that lenders should think twice before lending to despots and criminals who were likely to use the funds for personal gain, military adventures, or any of a number of other nasty ends but not to promote the interests of the population.

The concept of "odious" debts never really caught on in practice. Awful tyrants have come and gone in many parts of the developing world, billions of dollars of loans and aid monies have been stashed away in secret bank accounts abroad by the likes of Mobutu, Marcos, Abacha and countless others, but the debts have largely remained. But Sack's ghost is very much alive today. Recently, two Harvard economists have proposed the creation of an international institution that would have the authority

to classify a regime as "odious." Lenders would then have been forewarned that, following regime change, debts accumulated during the tenure of the despot might become worthless. One reason the issue is very much alive stems from one key question which the international community will have to confront in coming months: what to do with Iraq's foreign debts which, by now, probably exceed \$100 billion. Saddam Hussein was responsible for the overwhelming majority of this debt, much of which went to finance senseless wars against Iran and Kuwait and the build up of a security apparatus that was equal parts repression and brutality. Before we know it, there will be IMF missions in Baghdad and a view will have to be taken as to what to do with these debts. Should debt payments to Iraq's creditors be built into the Iraqi budget and, if so, is this really fair? Might not one argue that at a time when the international community should be aiding Iraq to get back on its feet following three decades of misrule, the last thing one should do is saddle the population with debt payments for goods and services that largely went to finance its impoverishment?

Actually, the above questions raise more generally the issue of whether the time may not soon come to review some aspects of the legal framework underlying state's external debts. Already the international community has identified a set of 41 countries (mainly in Africa, the so-called HIPC countries, or "highly indebted poor countries") that are not going to be able to pay their debts any time soon under any set of reasonable circumstances. In a move without precedent in their nearly 60-year history, even the IMF and the World Bank agreed to

forgive their own debts to these countries.

What about Russia's own debts? Sack's would have argued that the nearly \$22 billion lent by the IMF to Russia during the period 1992-99 is fully payable. Much of it was wasted, for sure. The bulk of it should never have been given because, contrary to conventional wisdom, it was never accompanied by credible economic reforms. Corrupt "loans-for-shares" privatizations took place under a fully operational IMF program, but, the Russian government was a democratically elected one and it would be unfair to say that the monies did not benefit the population in some way. The monies were used to pay salaries and pensions, and also to give tax breaks to Gazprom and the oligarchs, who are also Russians after all.

What about Soviet debts? Here Sack might have paused a bit. The Soviet Union was not a democracy and it certainly had elements of repression, even in the 1980s when much of the debt was accumulated. The debt was thoroughly wasted; much of it was in the form of "tied" credits which required the Soviet Union—to take an example—to acquire shoddy goods from East Germany using the proceeds of the loan to pay the enterprises in Dresden or East Berlin. These loans are now being paid by the Russian government, using real dollars and euros, to the tune of \$4 billion per year, well into 2015 and beyond. It doesn't sound fair, does it?

But it would be difficult indeed to classify these debts as "odious." Stinking maybe, and certainly a huge drag on Russian growth. They may have financed capital flight and have had little beneficial impact on the Soviet economy, but they were not "odious" in the sense defined by Sack. (In an article published in *The Wall Street Journal* last year I proposed the creation of a fund, jointly run by Russia and her creditors, financed by Russia's debt payments on Soviet-era debt, to pay for a whole range of development projects within Russia, for the direct benefit of the population.)

As the international community comes to grips with the fact that there is a rapidly widening gap in levels of per capita income between the rich and the poor countries, with the latter literally drowning in oceans of debt—much of it accumulated at the behest of the lenders, sometimes with good intentions but often with terrible results—it may indeed be necessary to re-examine the whole question of State debts and the circumstances under which populations could conceivably refuse to pay them. Creating a mechanism to declare a regime "odious" seems like a good first step to protect the interests of future generations, in places like Iraq, Zaire, Indonesia, the Philippines, Haiti and the dozens of other countries run at various times by leaders with little political legitimacy and no thought for the welfare of the people.



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