

PROJECT SYNDICATE

THE WORLD'S OPINION PAGE

BUSINESS & FINANCE



ROBERT HOWSE

Robert Howse is a professor at New York University School of Law.



RUTI TEITEL

Ruti Teitel, a professor at New York Law School and a visiting professor at the London School of Economics, is the author of *Humanity's Law*.

APR 4, 2011

Debt, Dictatorship, and Democratization

NEW YORK – After Saddam Hussein's fall, the United States successfully pressed creditors to write off much of Iraq's external debt. Senior American officials, including Paul Wolfowitz, later President of the World Bank, argued that the Iraqi people should not be saddled with obligations that the dictator contracted in order to enrich himself and oppress his subjects. Citing a long-standing doctrine in international law, advocates of a write-off claimed that Iraq's debt was "odious." As a result, the creditors were no longer protected under global legal rules.

As political change again sweeps across the Middle East, the issue of odious debt is back. But all debt that was contracted by a previous oppressive regime cannot, for that reason alone, be classified as "odious." The question is this: how much of the money went to meritorious development projects, and how much went instead to prop up the regime and line its leaders' pockets?

In the case of Egypt, for example, Minister of Economic Cooperation Faiza Abu al-Naga suggested in January that Mubarak himself was directing the country's foreign-loan policy and "oversee[ing] the entire process." Even if true, there may be nothing legally wrong with such an arrangement. After all, lending and aid to Egypt by the US and other Western powers have long been entangled with geopolitics, and using the tools of finance to back a loyal ally in an unstable region is not odious or illegitimate *per se*.

But, to the extent that the funds contributed to internal repression, or to the personal enrichment of the regime's leaders, lenders may bear some responsibility, at least for relieving taxpayers of the burden of debt contracted against, or with indifference towards, their interests. This responsibility cannot be absolute or unlimited, however, and should be confined to situations where lenders were aware (or should have been aware) that the funds might be used for corrupt or oppressive ends.

The bulk of Egypt's estimated \$35-\$37 billion in external debt is owed to official (governmental) creditors and multilateral and regional development institutions. At the same time that the World Bank publicly described Egypt as one of the region's most corrupt countries, its own International Finance Corporation maintained Egypt as a leading customer.

Likewise, Tunisia's foreign borrowing increased significantly in recent years, even as perceived corruption, as measured by Transparency International, worsened significantly. In both countries, a narrow elite managed and manipulated the economy for their own benefit, but found it easy to win praise from the international financial institutions whenever they made gestures toward liberalization.

Debt relief will doubtless make it easier for new regimes to proceed with much-needed policies to create jobs, improve infrastructure, and develop human capital. But the case for debt cancellation is fundamentally about transitional justice. The risk of a hasty bargain with creditors for debt forgiveness is that it could preclude a process of accountability for the past.

Instead, an independent commission should be established to examine the previous regime's foreign-borrowing policy, its objectives and effects, and what lenders knew (or could reasonably be assumed to have known) about those objectives and effects.

Such a commission should be composed largely of nationals who have broad public credibility, perhaps with a minority delegation of foreign experts. Its mandate should be

not only to allocate responsibility for past decisions, but also to forge recommendations for transparent, accountable borrowing in the future. On the basis of such a commission's findings, the new government should engage in discussions with its official creditors, including the international financial institutions.

Critics of forgiving odious debt argue that it risks discouraging future lending to some developing countries, given the uncertainty of being repaid. But, where oppressive regimes are using foreign credit to postpone needed domestic political and economic reforms, that may be a good outcome.

At a minimum, creditors would have to examine more carefully those to whom they are lending, and where the money is really going. If creditors turn a blind eye to corruption and oppression, they should have to pay a price.

<http://www.project-syndicate.org/commentary/debt--dictatorship--and-democratization>

© 1995-2014 Project Syndicate