LET'S LAUNCH AN ENQUIRY
INTO THE DEBT!

A Manual on How to Organise
Audits on Third World Debts

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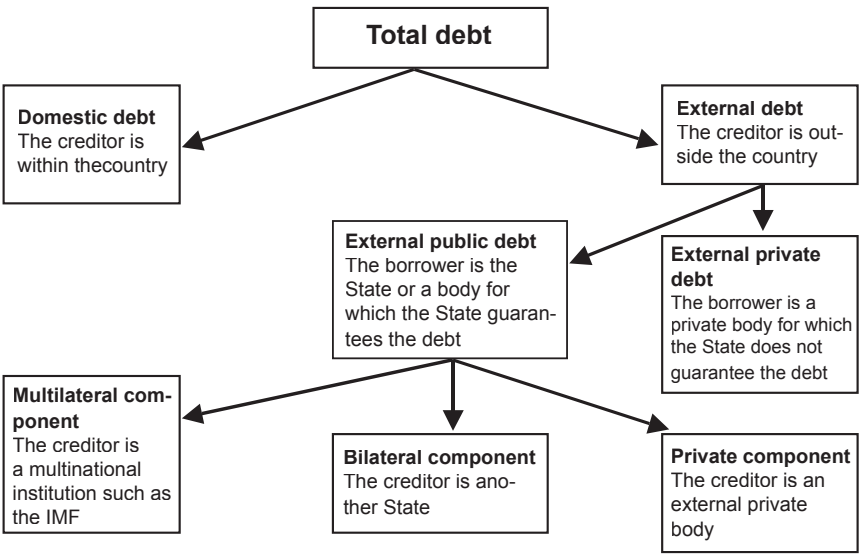
Chapter 1

Introduction

A debt is the commitment of a debtor towards a creditor. In principle the debtor is the one who has freely agreed to contract the debt and who benefits from it. But on the scale of the global system, debt is no longer a private affair because it now has a political dimension which concerns all people and all societies. The indebtedness of most countries of the South is becoming all the more unbearable because the repayments and interest payments demanded by the creditors are beyond their means and prevent all forms of development.

So it is essential to put the history of Third World debt into the context of *bad development,* of a capitalist system in crisis and of the unequal distribution of wealth (about one person in two in the world lives on less than two dollars a day… and these figures certainly underestimate the extent of poverty) and of a system of domination which is reproduced within each country.

Diagram of the composition of the debt of a country of the South [1]



[1] Diagram drawn from the book of D. Millet and E. Toussaint, *50 questions, 50 réponses sur la dette, le FMI et la Banque mondiale,* CADTM/Syllepse, 2002, p. 39.

Developing countries owe about one third of their external debt to creditor States and to the International Financial Institutions (IFIs) and about two thirds to private creditors – commercial banks, insurance companies, pension funds and other institutional investors on the financial markets. But this distribution varies greatly from country to country. In general, countries with strategic raw materials or those which have reached a certain stage of industrialisation have an external debt which is to a large extent held by private players (for example Brazil, Argentina, Chile, Malaysia, Turkey, and Slovakia). The poorer countries which are, or are deemed to be, without strategic mineral resources, have an external debt held to a very large extent by rich countries or multilateral institutions, which therefore have almost absolute control over the national governments. The IFIs hold more than 80% of the debt of Burkina Faso, Burundi, Rwanda, Chad, Gambia, Nepal and Haiti. Finally countries such as Cameroon, Congo, Gabon, Jordan, Nicaragua, and Sri Lanka have a debt which is mainly bilateral (held by other States), which is often linked to the still strong economic presence of the former colonial power or to contracts negotiated between major companies of the North and their export credit agencies [see chapter 3]. **[2]**

It should be noted that public concessional loans mostly concern official development aid, they are generally of longer term maturity (15 years or over) and are at below market rates (so-called subsidised or concessional rates). Private loans are most often short term (a few years, even a few months) and at market rates. Bank loans are most often variable depending on the changes in interest rates in New York and London (the planet's leading financial markets).

Moreover, many countries of the South finance themselves by issuing bonds which have different types of guarantee and amortization, different durations and often lucrative commissions as well. Market interest rates vary depending on what is called the "country risk", namely the estimated risk of the investment in a particular country. It can be defined as "the risk of materialization of a loss resulting from the economic and political context of a foreign State, in which a company carries out part of its activities".**[3]** The country risk is determined by private consultants based on partial analyses. In general, they assess the evolution of the repayment capacities of States, and do not consider the other essential functions which these States must assume.

[2] Idem, pp. 120-121.
[3] B. Marois, *Le risque pays,* PUF, Que sais-je ?, Paris, 1990.

There is also a market for these bonds, which can be exchanged among creditors. Some unscrupulous speculative funds, called "vulture funds" make juicy profits at the expense of the people.

Debt, a long running saga

The external "debt crisis" of the Third World has been talked about for over 20 years and the international community claims that it wants to provide a solution. Official initiatives have come and gone but the debt of the developing counties has continued to swell: from about $US 70 billion in 1970, it grew to $US 540 billion in 1980 and has today reached $US 2,800 billion, having increased 40 times in 35 years. It is now agreed that the debt crisis is structural, whereas it had been initially presented as a crisis of liquidity or insolvency. Of course, endogenous factors, such as the decisions taken by national leaders, corruption, etc., have played an important role in the development of this crisis. But it is above all exogenous factors, such as the increase in the oil price, deterioration in the terms of trade (with the failure of the New International Economic Order and the tremendous concentration of trans-national companies) and the increase in interest rates, among other things, which are responsible for triggering it.

Evolution of the external debt of developing countries

Year	Amount	Rate of multiplication from the reference year					
	(in bn $US)	1970	1980	1990	1995	2000	2005
1970	70						
1980	540	7.70					
1990	1340	19.14	2.48				
1995	1970	28.14	3.64	1.47			
2000	2280	32.58	4.22	1.70	1.57		
2005	2800	40.00	5.18	2.08	1.42	1.23	

Source: CETIM and CADTM.

Of course, compared to the external debt of the United States of America, the debt of the Third World may seem small in relation to the number of inhabitants. [4]

[4] The debt of the USA stands at $US 3,400 billion today for approximately 290 million inhabitants – happy country that can borrow in its own currency! – whereas that of the developing countries is about $US 2,800 billion for more than five billion inhabitants. Calculated by head of population the ratio is 21:1.

But taking account of the financial capacities of the countries concerned, it has an incommensurable weight. It serves as a pretext for bleeding their populations dry by reducing the social budgets, for exploiting their natural resources and for imposing on these economies measures favourable to the creditors, reducing their sovereignty to practically nothing.

Debt, a straitjacket

In the 1960's and 1970's, international loans were presented to the countries of the South as a fast track to development. It was claimed that they had everything needed for getting out of underdevelopment: abundant manpower, inexhaustible natural resources, etc. They only needed capital and new technologies to make these assets bear fruit, increase their production, and multiply their exports. A few years of effort and the they would catch up. Well-being would spread throughout the whole world.

New loans were contracted. Massive misappropriations, "white elephants" consisting of megalomaniac and unsuitable projects or prestige expenditures, arms purchases and the suppression of all forms of opposition, forced purchase of goods from the donor country, are some of the ways in which the funds borrowed were used, practically never serving the populations. When the debt crisis arose in the early 1980's, the International Monetary Fund (IMF) took control of the economies of these over-indebted countries in order to guarantee the resources necessary for the repayments. New loans then repaid the old ones or met the debt service and interest payments. Far from stimulating progress, the debt little by little emerged as a major obstacle to development, making the existence of hundreds of millions of the inhabitants of the planet intolerable and threatening the future of whole peoples.

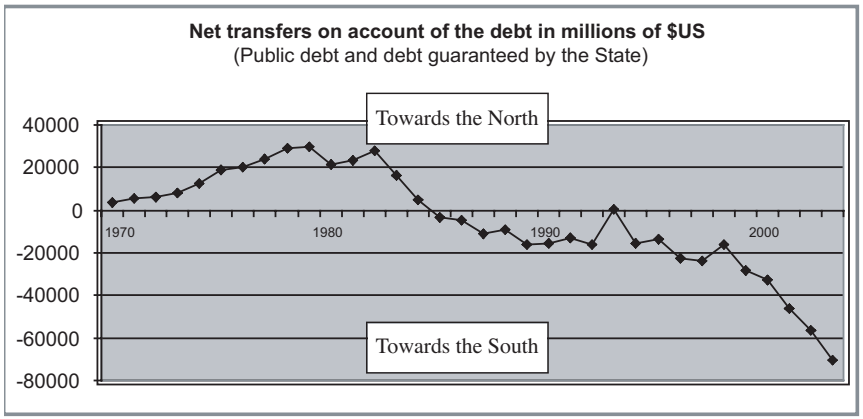
Under the pretext of increasing the capacity to repay, whole economies were "restructured" at the request of the IMF: health, education and housing budgets were drastically reduced, public services decimated, national currencies devalued or "dollarised", the control of capital movements abandoned, public enterprises privatised, local markets sacrificed. Whole economies were pushed towards an export oriented model in order to repay a debt which had become colossal, but during this time, the living conditions of the populations sharply deteriorated.

Debt, a real gold mine

The debt bill has continued to increase, but all is not lost for everyone. Taken together, interest payments and capital repayments represent a real goldmine. They have not stopped growing: from 1980 to 2005, the amounts paid by the

South in repayments of the initial capital borrowed amounted to more than $US 5,800 billion, [5] or the equivalent of 60 times the famous Marshall Plan, set up after WWII by the United States. The sums paid in debt service exceeded $US 450 billion in 2004, or 5.5 times the official amount of public development aid (79 billion).

All in all, since the middle of the 1990's, there has been a net reversal in the flow of resources linked to debt (interest payments, repayments, new loans, etc) from the South to the North contrary to general belief. Despite this, the debt is not decreasing. On the contrary, notwithstanding some temporary fluctuations, it is constantly increasing.



Source: UNCTAD statistics:
http://stats.unctad.org/Handbook/TableViewer/tableView.aspx?ReportId=140
Net transfers are the disbursements less the payments of the debt service.
The long term debt **disbursements** are the drawings on the debt commitments carried out during the year specified. In other words, the transfers of money in respect of loans made during the year.
The **payments of long term debt service** are the sum of the repayment of the principal and the payment of interest made during the year specified.

Debt, an instrument of blackmail and domination

For the banks and major transnational companies, as well as for the States which are defending their geo-strategic interests – by all means, including war if need be – the Third World debt crisis has come at the right time to strengthen their domination and take back control where they had somewhat lost it. Debt was a tool of colonisation and has become an instrument of re-colonisation.

[5] $US 4,900 billion on adding those operated by South Korea.

To maintain their position, the powerful countries have favoured two instruments which they control without the least hesitation, the World Bank and the IMF.

The story is well known. After having massively encouraged loans, these famous so-called "Bretton Woods" institutions used the debt crisis to assume a new role, that of collector of developing countries' money and regent of their economic and social policies. The course of the "structural adjustment programmes", in the framework of what is called the Washington Consensus, followed the same pattern almost everywhere, with as a result not only a general impoverishment of the populations and a ransacking of their economies, resources and biodiversity, but also considerable losses of sovereignty, through the opening of internal markets, privatisations, unbridled foreign investment and the tax free "repatriation" of profits.

All equal? All sovereign?

Apart from the money they were deprived, the peoples of every nation find themselves at the same stroke deprived of their popular sovereignty their real democratic power of decision and participation.

Of course, a majority of the leaders of the South and the dominant classes they represent, have not served their people's interest – that is the least that can be said; it can even be confidently suggested that they have, alongside their counterparts of the North, a heavy responsibility in the catastrophic use which was made of these funds – this brochure will give examples of this.

Afterwards, the steam roller of the IMF and the World Bank having carefully prepared the ground, launched the World Trade Organisation (WTO) offensive in 1995: this is an organisation fundamentally oriented towards a "globalisation" as desired by the big transnational companies, even if it has fortunately since met with several "set backs" as a result of popular mobilisations. More than any other mechanism, debt has enabled the forces of finance to consolidate their power and to impose economic and trade rules for their sole benefit.

Debt, an ink bottle

Periodically, the newspapers put forward figures on debt. The one thing they have in common is that they are always frightening: thus one learns that the debt

of such and such a country amounts to several times all the wealth that it is able to produce in a year, its Gross Domestic Product (GDP); that so many years of current exports would be needed to repay for it; etc. Nevertheless, these amounts do not explain what they cover. Certainly the press articles sometimes distinguish certain categories- external public debt, external private debt, bilateral debts, multilateral debts, etc. – and the particular authorities which are supposed to "take care" of them – London Club, Paris Club, when it is not the G8!

But there again, what do these figures hide, apart from the fact they are worth their weight in misfortunes, and how did we get here? Through the buy backs and sales of credits, the recovery of debts and their guarantees, defensive lending practices, the rescheduling and the partial but conditional deferments, the misappropriations and evasions, the bribes and the fictitious registrations, the funds which have never crossed the street but which changed name, it is really difficult to unravel the web.

Only some books, certain campaigns conducted at the price of considerable efforts, some parliamentary enquiries encountering many obstacles, some pugnacious lawyers and determined social movements have succeeded in lifting here and there a corner of the veil. But what have we learned? This university lecturer reveals to us, for example, that the external debt of the Democratic Republic of the Congo (ex-Zaire) is still today labouring under the burden of Mobutu's misappropriations, the Congo even "inherited" a debt on becoming independent in 1960 resulting from the loans imposed before independence by the former Belgian colonial power, in the name of "its" colony. An activist tells us in detail about the long struggle waged by the inhabitants of her region against the construction of a dam under the aegis of the World Bank and industrial trusts of the North, the forced displacement of populations, the land devastated, the vain resistance against a project which in the end never produced electricity. Another researcher details how loans served to arm the genocide in Rwanda, without any lending bank or any international financial institution lifting a little finger to put an end to these preparations. Social movements have investigated the genesis of another odious debt, that of apartheid in South Africa and called for redress. Research institutes and trade unions in Brazil have succeeded in unravelling the chain of loans, repayments and new-loans under other names, without which it is impossible to draw a complete picture of how the debt is constituted. And so on.

All we can say with certainty is that, on the whole, developing countries debt has been more than adequately repaid and that despite this, the slate has not been wiped clean. Quite the contrary. It remains however to give irrefutable proof of this, which implies full and exhaustive dossiers. Because, so the dictum goes, often the devil is in the detail!

Debt audits will enable things to be seen more clearly!

That is why we strongly advocate a generalised audit of the Third World debt, country by country. This little guide is intended to serve as a support tool for such efforts.

The first objective of an audit is to clarify the past, to untangle the web of debt, thread by thread, so as to reconstruct the sequence of events which has led to the present impasse. What has happened to the money of this loan, under what conditions was this loan contracted? How much interest has been paid, at what rate, how much of the principle has already been repaid? How has the debt swelled without the colour of the money being seen? What path has the capital followed? For what has it served? What share has been misappropriated and how?

But also: who has borrowed and in whose name? Who has loaned and what was his role? How did the State find itself committed, by what decision, taken on what account? How did private debts become "public"? Who embarked on phoney projects, who pushed for them, incited them, who profited from them? What crimes have been committed with this money? Why are civil, criminal and administrative liabilities not established?

The first objective is to be able to start a political process and a methodology enabling the external debt portfolio to be dissected, separated and reconstructed into what we will provisionally call "legitimate" and "illegitimate" components. Once the distinction is made, the "illegitimate" debt (odious debt – see chapter 4 – misappropriated funds and corruption of all types) will unquestionably be subject to cancellation in good and due form and in the strict meaning of the term [see box]. The "legitimate" debt, on the unlikely assumption that it has not yet been repaid, will for its part be subject to renegotiation under positive conditions, in the framework of a binding political approach. Because in the name of what, legally and morally, could the peoples of the developing world be held liable for all this debt and be obliged to continue paying?

The following questions would then arise: what remains in reality after all these additions and substractions, if the cancellations which should take place for good reasons are taken into account? Who are, in the final analysis, the real debtors and who are the real creditors, who owes whom?

And conversely, beyond the figures which appear in the account books, of what debts are the former colonisers, the former slave traders, the pillagers of the riches of the Third World, the polluters of all sorts, the heirs?

Taking the term "cancellation" at face value

Cancellation, n. Legal term. The act of cancelling, nullifying or invalidating, termination by one or both contracting parties. (Longman Modern English Dictionary)

This is indeed what is involved in respect of most constituent acts of the debt. It is a case of declaring them *nul and void,* whether it is because they cover odious crimes, because the contracts were signed following wilful misrepresentations or other deceptions, because there is forgery in the titles, promises not kept, undertakings not honoured, exorbitant or usurious interest, etc. In these cases, the money must be recovered, the sums wrongfully received in payment of interest or principle must be repaid, the culprits must be punished, and the victims of these abuses must be compensated according to the responsibilities established.

Only some amounts corresponding to real debts and valid credits, contracted in conditions respecting the interests of the populations involved may figure in the final accounting – if they have not been repaid and are not otherwise compensated by the previously mentioned acts. And these alone should be considered in any decision on *debt deferment.*

Presenting debt cancellation as an act of good will when we are talking about fraudulent credits is an intellectual hoax which can only have the purpose of covering misappropriations with a cloak of virtue.

Audits, a tool to mobilise and a bearer of hope

So audits essentially involve undertaking a meticulous examination of the past. But they are also, and perhaps especially, a means of mobilising citizens enabling them to gain a hold on the present, to avoid the fatality of future debt, and to prevent its indefinite perpetuation.

Audits which seeks to establish the truth about the debt is an elementary democratic right. The right to hold leaders to account. It is a powerful means for citizens to recover some power over the running of the State. It is also a tool for empowerment through which the mechanisms which govern international relations and the global economy can be understood.

Finally it provides the opportunity for setting up monitoring instruments at all levels: citizen, parliament, judiciary, government, international, so that new fraudulent debt processes do not start again unknown to the people.

Conducting collaborative and international audits, an opportunity to strengthen North-South solidarity and alliances

The G8, the IMF, the World Bank, the Paris and London Clubs are currently making a huge public fuss about "cancelling" some parts of the debts of the poorest and most indebted countries. Yet, for the moment, it is more of a public relations stunt: the amounts involved are very small and the whole thing is surrounded by numerous conditions. This could be taken as the first very modest victory for the innumerable campaigns conducted all over the world for the cancellation of the developing countries' debt.

But is it really a victory? If this is allowed to pass without at the same time establishing the truth about the debt crisis, this supposed generosity acts only as a smokescreen which hides responsibilities and could well backfire against both the peoples of the South and those of the North:

- against the peoples of the South, by accompanying these supposed gifts with new negative conditions and by opening the door to new debts, in the name of "growth";

- against those of the North, who in their own way suffer a logic comparable to that of structural adjustment. Moreover, the repayment of allegedly wronged and unscrupulous creditors, leads to these "indemnities" being shouldered by the tax payers of the North, burdening their countries' domestic debt by this amount. The leaders of the G8, with Great Britain at their head, are already insisting that any cancellation of the credits held by the IMF and The World Bank should not in any way reduce the financial capacities of these institutions. Who is going to the till after the peoples of the South?

The majority of individuals, businessmen, leaders, banks, institutions, governments, and industrial trusts who have been more or less involved in the process of accumulating the debt have certainly no desire to lay out the facts clearly.

The citizens of the South and the North on the contrary have every interest in having everything done in the greatest degree of transparency. The quality of their relations of solidarity, which must be based on a clear understanding of the realities experienced by each, and not on a hypocritical charity mixed with bad conscience, depends on it.

In short, the four vital strategic objectives of debt audits and the aims of this manual are to:

- *place cancellation within a discourse of transparency and justice:* in the case of genocide or crimes against humanity, the history of several countries shows that it has been necessary to have the truth established by the perpetrators of the abuses in a process of national reconciliation. So the establishment of the history of the debt could strengthen the claim for debt cancellation and enable those responsible for its illegitimate part to be prosecuted;

- *develop a broad movement of popular education and mobilisation* and deploy all the pedagogical potential of the debt in order to prevent its infernal spiral returning;

- *bring the peoples together* through common strands linking their particular histories; break with all "donor/recipient", "charity/poverty", "developed/undeveloped" attitudes, and place ourselves resolutely on the basis of solidarity and transparency, human rights and communities of social interest;

- *prevent debt cancellation operations* becoming an opportunity, in the North, for hateful and racial campaigns against "the assisted peoples of the South" and moreover, a new scrutiny by the latter on the control of their own history for the benefit of local oligarchies.

Debt audit are not a new idea, on the contrary! Setting up debt audits is promoted by numerous movements who have been working on debt for a long time. One of the most representative movements, the international Jubilee South movement, has for long been encouraging and supporting debt audit initiatives. At its second general meeting, held in Havana on 28 September, it declared:

"We will also continue to vigorously expose the involvement of South governments in perpetuating the debt problem, placing at great risk and even surrendering the resources of our peoples. We pledge to redouble our efforts to force changes in South government policies that should lead to the repudiation of debts claimed from our countries. We view the realization of debt audits as fundamental steps in that regard." [6]

6 Read the whole of the Final Declaration of the second Global Assembly of Jubilee South on http://www.jubileesouth.org

While debt repudiation is a unilateral act decided by a government and which shows a strong determination for protest and change, carrying out an audit prepares a confrontation and without a doubt constitutes one of the most effective instruments.

Illustration

Multiple failures of the international financial system

Debt audits can throw light on the numerous and costly failures of the international financial system. For example, on each dubious debt, bankers make provisions against loss. These are reserves which correspond to a certain percentage of the total debt in case the money is not recovered. But, as Susan George remarks, the loans granted to governments are generally tax deductible, without the debt of these countries being reduced. So this type of debt player is, thanks to this system, far from militating in favour of the cancellation or the reduction of debts.

Note that lenders can sell their credits at a reduced price on specialised markets (secondary markets), without the amount of these debts actually diminishing. On the contrary, this complicates the method of repayment and the conditions of repayment may even be tightened, without the indebted country having any voice in the matter. The management of credits is still more opaque and the number of interlocutors (traders and other brokers) is increasing, as are the opportunities for corruption and fraud. Concerning the debt of Congo-Brazzaville, François-Xavier Verschave wrote: "Many African leaders allow themselves to be tempted by easy money. But for that tempters, counsellors in misappropriation, are needed. The traders, brokers and other intermediaries are insistent. Their methods, so they affirm, are not necessarily illegal from the point of view of the dominant justice system – the western system. The West has, indeed, multiplied tax havens throughout the world, lawless "States", from where all sorts of frauds can be organised with impunity. But what is "legal" from Jersey, Monaco or the Cayman Islands is necessarily criminal for the countries who are the victims of these acts …" [7]

Companies buy debts on these markets at a discount (often more than 70% below their face value) and acquire shares of public companies in the indebted countries.

At the end of the day it is the tax payers in the North and the South who bear a part of these costs. [8]

The undertaking of audits will enable a little order to be installed and perhaps in the long term things to be changed at the heart of a very complicated financial system which is not very transparent, is unjust and which only profits a few.

7 François-Xavier Verschave in *L'envers de la dette. Criminalité politique et économique au Congo-Brazza et en Angola,* Dossiers Noirs n°16, Agone, Paris, 2001, pp. 77-78.

8 See Susan George, *L'effet boomerang. Choc en retour de la dette du tiers monde,* La Découverte, Essais, Paris, 1992, pp. 113-117.

Illustration
Some examples of scandalous debts

- The Inga dam in Congo-Zaïre

This dam enabled an unprecedented 1,900 km high tension line to be laid to Katanga, a province rich in iron ore with a view to extracting the mineral. The cost of the work was greatly underestimated, and suffered an increase of 125% (or a total of $US 163 million)! In addition, while none of the industrial projects associated with the construction of the dam materialised and the Inga power station was being used at half capacity, industrialists, backed by Belgian investors and bankers, decided in the late 1980's to launch themselves into the construction of Inga II, an even larger power station. But this was done without precautions and the real cost amounted to $US 100 million more than the estimates at the time (or a total of $US 450 million). Inga II experienced serious silting up problems, which considerably reduced its potential. In 2004, only 6 turbines out of 14 were in working order and power cuts are still very frequent in Kinshasa. In addition, no industrial project which had justified its construction has seen the light of day. Finally, while Inga actually produces electricity, this has in no way benefited the populations: the villages situated under the high tension line still have no current. [9]

- The Bataan nuclear power station in the Philippines

Its construction cost more than $US 2 billion and began more than 30 years ago. It is not yet producing electricity but it is still costing $US 155,000 a day in interest payments. Moreover the British contractor Westinghouse admitted having paid $US 17 million in commission to a friend of the former president of the Philippines Ferdinand Marcos. The reactor is situated on an active fault line which represents a major risk of nuclear contamination if the station became operational one day. [10] As for the repayment of the debt, it has been going on for a long time.

- The Yacyretá hydroelectric dam project [11]

Erected on the Argentina-Paraguay border with the support of the World Bank and the Inter-American Development Bank, this project began in 1973 and finished in 1994 (or more than a decade after the planned date). The real costs (at least $US billion) greatly exceeded the forecasts ($US 2 billion) which made the electricity generated at Yacyreta uneconomic. The debt contracted by the two Latin American States consequently grew heavier. Moreover, according the director of the General Verification Bureau of Paraguay, $US 1.87 billion of the expenses invested in this project "are not supported by the necessary legal and administrative documents". The artificial lake drowned 110,000 hectares of land, including natural ecosystems unique in the world,

9 E. Toussaint, *La finance contre les peuples. La bourse ou la vie,* CADTM/Syllepse/CETIM, 2004, pp. 194-195.
10 www.transparency.org, 2005 Report.
11 www.amisdelaterre.be/article.php3?id_article=108 et www.transparency.org, 2005 Report.

rich agricultural lands and densely populated urban zones. Moreover, the impact of the project on the communities is very great and 50,000 people were displaced. The rise in water level and the modifications of the surface water system has contaminated the water supply and exposed thousands of poor families to great risk of disease. No local consultation was held. The Binational Yacyreta Enterprise (EBY) consortium, today plans to increase the water level from 76 meters to 83 meters so that the dam can finally work at full capacity (for an additional $US 500 million).

Chapter 2

First stage: mobilising politically at all times and on all fronts

I. Who can take the initiative of a debt audit?

The initiative to launch a debt audit can be taken by different players. Who does it depends on the country's political context and institutions. Nevertheless it should be noted that citizen mobilisation is essential for such an initiative and probably it alone can ensure success in the end, as is shown by the examples of audits in Brazil and the Philippines today. This citizen approach must afterwards or simultaneously be relayed by the State authorities.

A debt audit can be conducted by different organs whose approaches may run in parallel and be complementary.

- *The legislative organ*. An example is the Peruvian Congress. After the restoration of the democratic state and the flight of the previous head of the Executive Alberto Fujimori, the Peruvian Congress decided to set up an investigative Commission on the country's external debt. [1] This Commission worked during the 2001-2002 legislative period, under the Chairmanship of the deputy Rafael Valencia Dongo. The Commission's mandate was to investigate the external public debt during the period 1990-2000. The investigative Commission detected the existence of serious signs of the illegal and fraudulent management of the external public debt burden by the Minister of the Economy under the Fujimori regime.

Another example is the Philippine Parliament today. Freedom from Debt Coalition conducted active lobbying for several years among Philippine Members of Parliament which bore fruit. The Philippine Parliament drew up a joint resolution in September 2004 on an audit of the Philippines' debt.

[1] Congress of the Republic, "Comisión Investigadora encargada de cumplir las conclusiones y recomendaciones a las que arribaron las cinco comisiones investigadoras del período legislativo 2001-2002. Area Delitos económicos y financieros. Area Deuda Externa, 01204", under the chairmanship of Ernesto Herrera Becerra, Peru, 25 July 2003. See also: "Informe de Decretos Secretos de urgencia, Denuncia constitucional 28", 26 September 2001.

A parliamentary commission has been created and has the task of opening the books in order to review and assess the policies, programmes and strategies of the country on the handling of debt. This resolution has been blocked in the Senate for several months for technical reasons.

- *The executive organ*. An audit may be undertaken when the executive organ has a progressive or nationalist orientation. In Brazil in the early 1930's, when the country was confronting a major economic crisis, the Brazilian President Getulio Vargas created the Commission for economic studies and State and municipal finances. Supported by a technical secretariat, this Commission was mandated to review all debt contracts and to shed light on all types of irregularity uncovered in the process of Brazil's indebtedness.

- *The judicial organ*. On the initiative of a complaint lodged in 1982 by an Argentine lawyer and journalist, Alejandro Olmos, a federal judge, J. Ballesteros, [2] engaged criminal proceedings against those responsible for the Argentine State's indebtedness under the dictatorship. During the judicial investigation, the federal judge, confronted by the argument of secrecy invoked by those responsible for the debts, ordered all the documents, minutes, financial accounts and statements, to be handed over. The Olmos verdict revealed the illicit character of the State's external debt and the responsibility of the creditors and of the debtors.

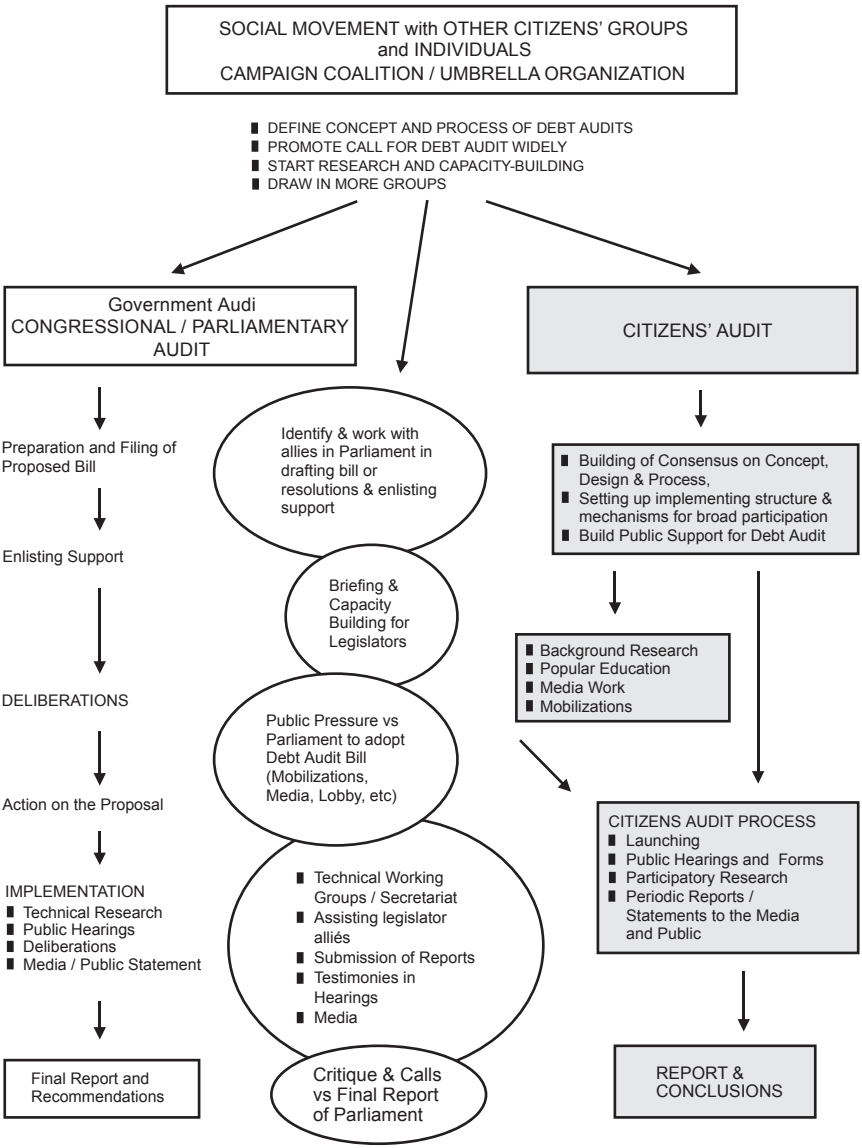
As we have already pointed out, these audits must be supported by a wide popular mobilisation. They may be accompanied or preceded by a citizen audit, encouraged by social or citizens' movements seeking justice, sometimes thanks to contacts within the State. The goal is then to force the State to do a proper auditing job.

[2] Case n°14 467, tried in the federal criminal court, 23 July 2000. The full text of the verdict is available, in Spanish, on the internet site: www.cadtm.org.

An example among other cases is that of the most recent audit undertaken in Brazil and conducted by the union of tax auditors Unafisco, in close collaboration with a coalition of social movements such as Jubilee South Brazil.

The case of the Philippines is the most accomplished in terms of political mobilisation and collaboration between the Parliament and social movements. It will be taken as an example in this manual. The diagram [next page] clearly summarizes the debt audit process in the Philippines, as it has taken place.
Several points stand out on reading this diagram:
- The Philippine organisation, Freedom from Debt Coalition, with the support of other social movements and in the framework of the Jubilee South campaign on illegitimate debts began this process. It should be emphasised that in the first instance, the campaign on the Philippines' debt aimed to make the Philippine deputies aware of and informed about the debt issue. Indeed, some deputies had only a superficial knowledge about the debt and the high stakes involved. The goal of this lobbying was to push the Philippines' Congress into conducting an official audit of the national debt.
- The independent Philippines citizen audit and the parliamentary audit (the left and right hand columns) are two complementary procedures. They started at the same time. Social movements intervened constantly and decisively at every stage, especially during the deliberations on the joint resolution in the Philippines Congress. Today the resolution is blocked in the Senate and Freedom from Debt Coalition is continuing its lobbying work among senators to get the resolution passed.
- Finally, the Philippines citizen audit has denounced the structures and procedures which perpetuate and aggravate the situation of indebtedness. Many areas must be considered when carrying out an audit, including non-financial and non-economic aspects such as the environment.

Debt audit process in the Philippines *



* Diagram by Lidy Nacpil, General Secretary of Jubilee South

We can already draw more *general conclusions* from these elements.

1. The importance of social movements

In the South in broad terms two types of situation can be encountered: either the existence of an established social movement and debt cancellation campaigns, or the existence of small working groups on debt. The demands for undertaking an audit will be judged differently depending on the case. The absence of a coalition of organisations which deals specifically with the debt issue may imply a slightly different approach.

Of course, the presence of a strong social movement and of democratic institutions and press freedom are prior conditions favourable for starting a debt audit. The capacity to conduct an audit depends on the ground conquered by the democratic and citizen movements. At the same time, the carrying out of an audit will certainly strengthen local social movements and help build democratic spaces. It will also provide an opportunity to monitor the freedom of the press and to test the "democratic" institutions.

That is why social movements, of all types, must be mobilised at all stages of the process.

2. Collaboration of political forces

It is important to establish publicly agreed working relationships with members of the opposition parties and progressive parties who are interested in a debt audit. The country's political forces must be constantly appealed to. Their weight and their experience may turn out to be invaluable and their collaboration is also necessary because many documents will only be accessible with official authorisation. The case of the Philippines illustrates this. In Brazil, Jubilee South Brazil, in close collaboration with Unafisco, constantly sought to establish links with the progressive political parties, and also with the trade unions and other political players.

It is also be important to try to contact and interview key individuals in the public and private arenas on the indebtedness processes.

3. *Making an effort to reach out to the media*

Research, popular education campaigns and political actions must be conducted simultaneously. The need to envisage and allow for a constant to and fro between the audit research work and popular mobilisations must be emphasised. The work of ensuring media coverage is also essential since it is part of the popular education process. It is also advisable to associate and coordinate the work of (independent) research centres and universities.

All sectors of society and all professions should participate in this process. It is essential that groups of people (corporations of different sizes) should be able to appropriate this theme and incorporate it among their demands. Debt affects all sectors of life and all populations. In addition, conducting an audit may require diverse professional skills to be mobilised. For example, in Brazil, the citizen debt audit group undertook research on the Brazilian debt, then organised study groups composed of intellectuals, university professors, civil servants, and citizens. It also prepared various teaching materials and public events [see inset on citizen audits in Uruguay].

4. *Financing*

The lack of finance to carry out an audit should not prevent it from being started, but will certainly slow the process. Unafisco economists undertook the citizen audit in Brazil, during their spare time. This work was based on information useful for their day to day work and research conducted by trainees employed by Unafisco.

The citizen audit in Uruguay

In August 2005, Uruguayan organisations, including ATTAC Uruguay, Emmaüs International, the Federation of University Students (FEUU), the Trade Union Congress (PIT-CNT) and the Cooperative Confederation (CUDECOOP) set up a citizen's commission with the aim of auditing the national debt. The process is still only in its early stages but the organisations involved have already created different education and information commissions covering different areas (legal, economic, etc) in order to inform the population as much as possible. The key feature of this mobilisation is that the members of the commissions come from various professional backgrounds so as to cover the greatest number of social sectors. The aim is to take advantage of their capacity for mobilisation and also their particular expertise.

To find out more, contact: auditoriadeuda@adinet.com.uy
http://www.observatoriodeladeuda.org

II. And what about the role of the North?

The setting up of an audit campaign concerns both the countries of the South and the countries of the North. The need for auditing is as important for the North as for the South given the structure of the debt in general.

> *In France, for example, in the framework of the campaign conducted by the Debt and Development platform to question deputies as follow up to the "2005, no more excuses!" campaign, nearly 30,000 post cards were sent to French deputies. Members of Parliament (senators and deputies) of all political groups were met with, often in conjunction with the Friends of the Earth campaign on COFACE (the French export credit agency) and the Coordination SUD campaign on official development aid (ODA). The central demand of this campaign was the creation of a commission of enquiry to shed light on French credits vis-à-vis the countries of the South. NGOs demanded in particular that the cancellation of export credits debts no longer be reported as ODA.*

The lack of transparency about the exact nature of the debts cancelled by the French State, as well as the dubious practice of counting debt cancellation operations as ODA, has become an important issue in France, because debt cancellations represent a major part of the budget of French ODA.
Many Members of Parliament showed an interest and devised different means for improving transparency in debt cancellation operations. Two draft resolutions were tabled in the National Assembly in early 2005, covering the two central NGOs demands. However as these came from opposition parliamentary groups, neither of them materialised. The text of these proposals is nevertheless a useful contribution to the debate which has been started.
Given these results, French NGOs turned back to civil society to set up a citizen audit of French loans to three developing countries.

Another audit project to be set up in the North

Here is an example of a project realised by Christian Aid in the United Kingdom, which could be repeated in numerous European countries. It is the publication of a brochure of about 8,000 words entitled : *Auditing the UK's Loans.*

This manual aims to support debt campaign groups wanting to undertake audits of developed countries' illegitimate credits to developing countries. This document specifies that the majority of credits held by the United Kingdom are credits arising from export credits and shows how these credits can be audited, in particular through the use of the UK Freedom of Information Act legislation. It also lists the UK loans made to developing countries which could turn out to be illegitimate.

Electronic versions may be requested from the Global Advocacy and Policy Department of Christian Aid.

Contacts: Sara Bailey, SBailey@christian-aid.org
Adele Poskitt, APoskitt@christian-aid.org

Moreover, countries of the North are also very indebted, but essentially in the form of domestic debt. It could also be very useful to envisage an audit of the debts of the countries of the North. There can be no doubt that such an

investigation would constitute a good means of contesting governments' austerity plans or the draining of state resources through under bidding and tax hand-outs. But since the North's banks are also, and especially, on the side of the creditors, the validity of the debts and the way in which they were set up should be investigated. [see the end of chapter 3]

What North/South solidarity?

North/South solidarity could not be more fundamental. On the one hand it permits effective North/South collaboration, and all parties have an interest in this. The North has numerous documents essential for carrying out an audit and solidarity organisations in the North can provide assistance when requested by partners in the South who are launching audit processes.
On the other hand, this solidarity can be a support in the face of the repression which some authorities of the South may exercise, all the more so if these institutions are not really "democratic". This warning must be heard. It is important that organisations in the North are on stand-by to send out alerts and undertake media work in case where governments of the South attempt to thwart audit processes.
Launching an audit comes down to stirring up the murky past, and in the process risks uncovering various mafia like practices and cases of corruption and misappropriation of funds. Those who have profited from the debt and who are still in power may resort to any means to prevent light being shed…[3]

It is therefore essential to link all the mobilised groups in both the North and the South and establish connections between the different attempts to launch audits by making use of the various media such as internet sites, newspapers, meetings, etc.

Illustration

A citizen's audit of the Ecuador-Norway debt

In 2002, the Civil Corruption Control in Ecuador, in collaboration with the Norwegian campaign for the cancellation of Third World debt (SLUG) launched an audit on the sale of Norwegian ships to the government of Ecuador. The facts: in the late 1970's, the Norwegian government sold four ships to Ecuador in the context of a trade campaign to export Norwegian ships (the sector was in crisis at the time). It facilitated the

[3] See in this connection the numerous books and studies of François-Xavier Verschave including *L'envers de la dette. Criminalité politique et économique au Congo-Brazza et en Angola,* op.cit.

purchase of these ships through a “development assistance loan” given by the Norwegian export credit agency (GIEK).

Following an in-depth investigation and the carrying out of an audit, the Commission appealed to the Ecuadorian authorities to stop repaying this debt, considering it to be illegitimate because:

- the credit had not been granted to help Ecuador but for Norway to save its own industry;

- there was no assessment of the technical and financial viability of the project on the part of the Norwegian cooperation agency and GIEK;

- the ships had disappeared and no-one knew where they were, while the debt continued being paid;

- the growth of the Ecuador’s debt with Norway was due to the burdensome conditions which were imposed during the renegotiations of the debt.

This audit is a very rich document. It is available with full legal, historical, economic and technical references in English and Spanish on http://audit.oid-ido.org or www.cetim.ch. It is published by the Centro de Derechos Económicos y Sociales and it is entitled: “La Revuelta en el Patio Trasero Deudas Ilegítimas y Derechos Humanos. El Caso Ecuador-Noruega” or “Upheaval in the Back Yard, Illegitimate Debts and Human Rights. The case of Ecuador-Norway”.

2nd of October 2006: the Norwegian government announced this illegitimate debt to be cancelled unilaterally and unconditionally and recognized its co-responsibility! A victory in the struggle for the debt cancellation! See www.odin.dep.no/ud/english/news/news/032171-070886/dok-bn.html.

For further information, contact Dr. Patricio Pazmiño Freire, Colectivo de Abogados Defensores de Derechos (CADE), plpazmin3@hotmail.com, pchasociados@grucosch.com.

Let’s demand an audit of the international financial institutions!

(the World Bank, the IMF and regional development banks). A CADTM project.

These institutions constantly plead for “good governance”. Despite this rhetoric, they are far from applying it to themselves. Yet the International Financial Institutions (IFIs) are at the heart of the “debt system” and bear a heavy responsibility for the damage done. They must be subject to audits. The undertaking of an audit is also a means of transforming current structures and so constitutes a preventive treatment. Their documents are declassified after 10 years; it allows us to gain access to the discussions which are held within their precincts! The multiplication of national audits will produce much material which will enable an audit of the IFIs themselves to be envisaged.

For further information, contact: info@cadtm.org, www.cadtm.org

Chapter 3

Technical elements for conducting a debt audit

This chapter is divided into two parts: the first part describes a general methodology for understanding and unpacking a country's debt portfolio; the second part presents some elements for overcoming technical and political obstacles when starting out on a debt audit process.

For this purpose, the recent Brazilian citizen's audit, which is among the most accomplished and is relatively well documented, is frequently referred to.

It should be recalled that from 1964 Brazil was for more than 20 years under the iron rule of a ferocious dictatorship, and it was only in 1986 that a new Parliament was democratically elected. According to the Organisation for Economic Cooperation and Development (OECD), Brazil's external debt is the largest of all developing countries: it amounted to US$ 201.4 billion in December 2004. Its principal creditors are national and international commercial banks (43%). The IMF and other foreign investors hold the rest. [1]

[1] Figures quoted by A. Fontana, "Opening the Books: Brazil's experience with Debt Audits", Discussion paper, EURODAD, September 2005.

I. General methodology: unpack in order to reconstruct

The aim of this methodology is to reach a general understanding of the reasons for indebtedness by bringing out each particularity, each detail, point by point, then to draw up the fullest possible inventory before wholly or partially reconstructing the debt jigsaw.

Four stages can be identified:

- General analysis of the process of getting into debt
- Analysis of the contracts
- Examination of the real destination of the funds
- Analysis of current data

A. General elements for analysing the process of getting into debt

The first stage consists of drawing up an historical, economic, political and social analysis of the root causes of the national debt in order to understand its characteristics. These points may differ from one country to another; other categories may have to be added to the audit procedure, depending on the characteristics of the country in question. However it should be noted that the Third World countries have more or less followed a similar process of getting into debt, especially as far as the debts contracted after the so-called oil crisis of 1973 are concerned. The points listed below are therefore largely applicable to numerous Third World countries.

1. Studying the country's political and social characteristics

This study involves retracing how countries got into debt in the first place in order to reconstruct its political, economic and social context, as it appears from the account books.

But it is also important to have a broader view of the history of the relations of the country in question with the outside world and outline an overall view of all the other debts which might result from this context, such as the ecological debt, the historical debt due to slavery and to plundering of different sorts, etc.

As the organisers of the international meeting in Havana of 28 to 30 September 2005 entitled "Resistance and Alternatives to Debt Domination" rightly recalled:

"Wealthy governments, transnational companies and institutions such as the IMF, World Bank and WTO must accept responsibility for the plunder of the countries of the South, creating and perpetuating the debt crisis, and in particular for odious debt. Given the historical and on-going exploitation of the countries of the South, the unbalanced relations - from both the financial, and the economic and political point of view - between the exploited and the exploiter, and the ecological devastation imposed on the South by governments and commercial interests of the North, it is indisputable that the North owes the South." [2]

On the basis of his research, the economist Ernest Mandel estimated that between 1500 and 1750 the transfer of wealth from the colonies to Europe amounted to more than one billion English sovereigns, "that is, more than the total value of the capital invested in all European industrial enterprises around 1800".[3] As the Jubilee South movement pointed out, at its second world assembly in September 2005: "We, the people of the South are the creditors!"

Remark: the debt, in general, of an oil producing country is special because "petrol makes debts explode", as François-Xavier Verschave has often emphasised in his numerous studies. Social movements or organisations prepared to undertake an audit of these debts must be ready, more than elsewhere, to plunge into mafia like abysses and other murky zones.

2. Establish the evolution of interest rates

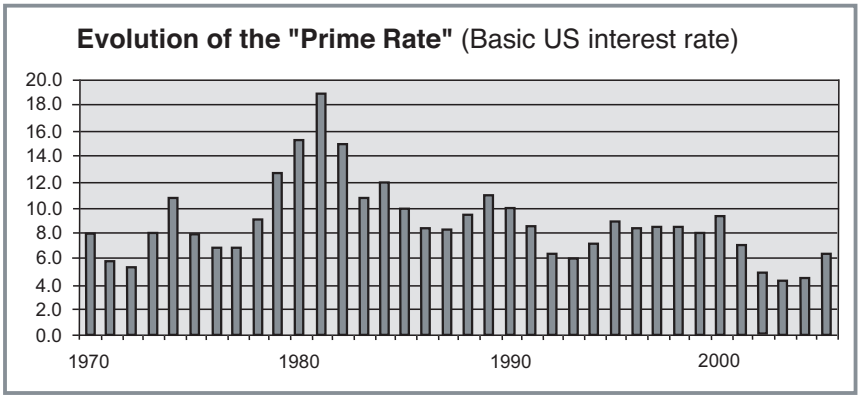
Many countries became indebted in the 1970's due to the excessive offer of capital, following the oil crisis and overproduction which shook the West in the early 1970's. Most debt contracts negotiated at that time contained a clause indexing the debt at a variable rate of interest. But this clause, which is not in itself illegal, [4] is in part the reason for the increase in developing countries' external debt, since the

2 Havana Declaration. Consult the full Havana Declaration at www.cadtm.org/article.php3?id_article=1677. This meeting was organized by, among others, the Jubilee South international coalition and the CADTM international network.

3 Cited in E. Toussaint, *La finance contre les peuples. La bourse ou la vie,* op. cit., p. 174.

4 However the point on the unilateral increase in rates of interest will be specified in chapter 4.

rates of interest rose considerably at the turn of the 1980's (whereas they had been relatively low a decade earlier and economists did not foresee a significant change). Retracing the evolution of interest rates is therefore pertinent in the audit context.



Source: Federal Reserve Bank. http://www.federalreserve.gov/RELEASES/h15/data/Annual/H15_PRIME_NA.txt. The majority of Third World country loans contracted in the 1970's had a clause foreseeing the indexing of the rates of interest according to the evolution of the US Prime Rate or the Libor (London Interbank rate). These two rates are the base rates of international loans

> *As a result of the evolution shown in the graph above, from 1978 to 2002, Brazil received US$ 527 billion in the form of loans and paid US$ 685 billion in interest and repayments, leading to a net transfer of resources from the country of US$ 158 billion. Meanwhile, its external debt multiplied almost by five rising from US$ 52.8 billion to US$ 230 billion.* [5]

In the framework of this research, it would also be useful to try and establish the evolution of macro-economic indicators, including economic growth (or stagnation), and total GDP and GDP per capita, and relate them to the external debt. This research would permit the impact of the debt on the economic and social situation of a country to be highlighted and would also enable key moments in

[5] It may be noted that in 2005, Brazil made a prepayment of all its debts to the IMF, the Paris Club and others.

the whole process of getting into debt to be detected. This would thereby enable specific periods to be better targeted or selected when carrying out a debt audit.

A chart of the evolution of exchange rate policy, particularly of the national currency in relation to the dollar should be drawn up. Devaluation generally increases the physical volume of goods which has to be exported to earn the same amount in US$.

3. Analysing private debt

When carrying out an audit, it might be useful to study the evolution of the national private debt, and to try and establish relationships with the evolution of the public debt. In fact, private debt, contracted by private players, has, in most cases, been negotiated in foreign currency. But these debts are often "nationalised" subsequently, that is to say the State takes over private debts on its own account without necessarily attempting to find out whether doing so was justified. This assessment enables those responsible for the indebtedness of a country to be identified. It also allows its different components to be tracked down so the debt can be better unpacked in order to reconstruct it.

> *Nationalisation of the private debt took place in **Brazil** in the 1980's. According to Unafisco calculations, external private debt today represents half the total external debt but is paid by public funds.*
> *The case of the **Argentine** debt is one of the most grotesque in this field. National elites enriched themselves, thanks to, among other things, the financial operations carried out around the debt, with private debt inflating external public debt. "John Reed, president of Citicorp, argues that three quarters of the Argentine debt was now deposited by some Argentines in banks involved in the debt process. (…) In a first approach, we note the growth in debt servicing and the transfer of private debt to the public sector. This private debt left the country, attracted by interest rates – or was 'hidden under the mattress', which is the same thing in terms of the financial effects – to be speculated on the currency markets abroad, especially in the USA. That is to say that the State indebted itself in US$ which it would transfer to the private sector, which deposited them in US banks, which re-lent this capital to the State, which sold it back at a low*

price to private investors, and so on. The consequences of this practice are the growth of private debt, and the increase of Argentine financial capital assets, or at least assets of Argentine nationality. From 1981, the State nationalised this debt".[6] *Argentine debt continued to spiral, partly due to capital flight and the increase in interest rates, until the point where the State could neither find US$ on the international market, nor supply indebted financiers with hard currency. The governments of the lending countries then demanded that control of the debt should be taken over by the State.*

Moreover, the Olmos trial [see chapter 2] had thrown light on the laissez-faire attitude of the government in authorising private companies to contract loans, without any technical study being undertaken prior to approval. This is how debts of several million US$, contracted by private institutions, were assumed by the Argentine government (while the living conditions of the Argentine people were becoming more and more difficult). The Olmos trial threw light on other forms of nationalisation of private debts, such as new government loans so that private enterprises could repay their own debts. [7] *Argentine justice revealed the existence of 477 irregular operations and sent its conclusions to the national Congress. However, a majority of votes could never be achieved to debate this theme in Parliament. The main defendant in this trial was the Minister of the Economy at the time, Alfredo Martinez de Hoz, but he was never convicted for his deeds.*

An audit should enable light to be thrown on these debt "transfers".

It should also be noted that in the North, many "private" credits are also nationalised, that is to say they are bought from the banks who held them without regard for their validity, and then carried out so-called and ostentatious debt reduction operations at the expense this time of tax payers of the North. [see illustration "The 'cancellation' of debts

6 R. Pajoni, « Faire payer la dette aux fauteurs de dette », in *Légitimité ou illégitimité de la dette du tiers monde,* cahier Archimède et Léonard, AITEC, special issue n°9, Winter 1992, p. 94. To learn more about the mechanism of Argentine indebtedness, read pages 94 to 97.

7 Document of the Jubilee South campaign "Auditoria Cidadã da Dívida. Justiça fiscal e social vs endividamento e lavagem de dinheiro", UNAFISCO SINDICAL, distributed at the Vth Social Forum of Porto Alegre, 2005.

by the North: is it such a disinterested gesture? A report which has a some surprises…"]

It would also be interesting to attempt to analyse, in a complementary manner and as far as possible, the Central Bank's monetary and exchange rate policy and accounts, as well as the evolution of basic expenses at the national, provincial and municipal levels. People can indeed pay a high price for an unsuitable monetary policy.

As already suggested, the successive metamorphoses undergone by this or that amount initially borrowed should be traced because often initial debts have been "reimbursed" at the cost of new loans and have therefore disappeared from the debt inventory at the time of the audit.

4.
Identifying the authors and seeking the concluding dates of contracts

The civil servants who have signed debt contracts should be carefully identified to ascertain whether at the time the contracts were approved they had the necessary powers and the legal attributions laid down in the relevant legislation.

> *In Brazil this stage revealed that the loan contracts signed by the dictatorial government had been signed without anyone being aware of it and without the approval of the federal Senate. The government had used numerous secret contracts which, in most cases, were not in the country's interests and the living conditions of its citizens. The international doctrine under construction classifies these debts as odious debts, subject to cancellation [see chapter 4].*

5.
Discovering whether part of the debt has not been reconverted into bonds

During the 1990's, new offers of financial capital produced a new increase in the external debts of Third World countries. In some countries, loan contracts were transformed into debt certificates or bonds, which could be sold to other investors. Debts were thereby split up, making the process of renegotiating and auditing them even more difficult [see below, the section on export credit agencies]. It may be noted that this offer of capital can also be considered as entering into the odious debt category [see chapter 4], because it only served to pay the interest on previous debts which themselves often entered into this same category.

Illustration
The privatisation of public debt: the African laboratory

While private debt was nationalised in some Third World countries, African countries experienced the reverse phenomenon: the privatisation of the public debt. This phenomenon should be looked out for when carrying out an audit.

In the 1980's, financial institutions and western governments came to realise that numerous States could not pay back their debts in a conventional manner. So they proposed that the market and private players should take over the management of the sovereign debt of countries in difficulty, by drawing up the Baker and Brady plans (which involved private credits held by commercial banks), then the so called Houston treatment was agreed in 1991. The Houston treatment markets public debt certificates; and the last resort guarantee is the collective patrimony. The creditors therefore become private. Olivier Vallée wrote in a very exhaustive article on this issue, "the *titrisation* [French word. Transformation of public debt into private debt titles, ed.] of the debt substitutes business law for public law". [8] But this debt "management" considerably increases opportunities for misappropriation and corruption, as occurred in Nigeria. "Reticent about a real structural adjustment programme (…) Nigeria is the first African country to have set up a debt conversion programme. In parallel with this programme, the government launched a privatisation programme involving 110 of the 600 public enterprises.

The process of privatisation of debt was slow and not very transparent, but the marketing of the debt actually took place with promissory notes. In exchange for these bonds, the original creditors gave up their credits for the promise of being paid later and with a smaller remuneration. The purchasers for their part benefited by obtaining dollars from the Nigerian Central Bank. In this way a major traffic in hard currency grew, Nigerians and foreigners buying promissory notes in nairas (the local currency) on the secondary market, and presenting them to the Central Bank against dollars. This 'paper' market replaced the over-invoicing of imports which had encouraged high levels of capital flight in the golden years of rising oil prices as a means of exporting currency. (…). The privatisation of the debt, legitimised by the market, sanctioned the practices of financial and monetary *hybridisation* of the alliances between civilians and politicians, soldiers and wheeler dealers, on which the Nigerian style mafia is based. It also enabled the Abacha regime to decouple the management of the oil revenues from the debt bonds. During this period of privatisation, the Bretton Woods institutions had already lavished their traditional lessons of good management, encouraging Nigeria to transfer its risks of managing oil and debt to the market" [see illustration on the repatriation of misappropriated funds to Nigeria, chapter 4].

In Angola, the cycle of indebtedness is quite different although it also results from the privatisation of the debt. Since its independence, Angola has become heavily

[8] O. Vallée, « La dette publique est-elle privée ? Traités, traitement, traite : mode de la dette africaine », *Politique africaine,* n°73, 1999, pp. 50-67.

indebted in order to finance the civil war that undermined the country for 25 years. Actors involved in debt have progressively multiplied through the direct proposals by western banks of loans to public arms enterprises and not to the Ministry of Defence – some with a guarantee from their export credit agencies [see below] and others addressed to oil companies without even asking for a guarantee from the Angolan State. Swiss banks even offer loans pledged on oil, "barter and trade replacing the financial arrangements (…) the oil pledge [constitutes] an archaic form of privatisation of the public patrimony" notes O. Vallée.

In short, this mode of privatisating the debt must be exposed by an audit.

6. Retracing the evolution of the internal debt and the fiscal policy adopted

Domestic debt is contracted by the State, various public institutions or the national public bank, with a creditor within the country (or abroad, through major banks) and is often local currency denominated, even if in several countries this debt is indexed to hard currencies, including the dollar. It is therefore dependent on the fluctuations of the currencies to which it is indexed.

External and internal debt are closely linked: the fiscal policy adopted by a country influences the evolution of the internal debt, which in turn has repercussions on the external debt. Conversely, the burden of servicing the external debt and the constant need to collect funds are also responsible for the increase in domestic debt or for modifications in fiscal, foreign trade and other policies. The need to attract foreign capital can also push a government into issuing bonds in the national currency that are sold to national or foreign investors at generally high interest rates.

The increase in domestic public debt in most countries of the South these last 20 years should be noted. This growth is linked to the external public debt crisis, the repeated financial crises of the 1990's and the application of the shock treatments imposed by the World Bank and the IMF.

In addition, given that a large part of the banks of the countries of the South have been bought by major bank

groups of the North, the internal public debt is partly held by the same creditors as the external public debt. [9]

So it is interesting within the framework of an audit to ask what is the link between external and internal debt. In the countries of the South, this link is relatively close as is shown by the Brazilian example:

> *In Brazil, the currency stabilisation and inflation control policies had an important impact on society. The main measures were:*
> *- opening of ports, reduction of customs duties and liberalisation of imports;*
> *- artificial maintenance of the exchange rate, which discouraged exports and stimulated imports, at the expense of national industry;*
> *- substantial increase in internal interest rates: the attraction of foreign capital to finance imports and external accounts was not only undertaken by loans in US$, the government also became indebted in Brazilian currency, by paying the highest rates of interest in the world on domestic debt certificates bought by Brazilian and foreign investors. Domestic debt rose from R$ 59.7 billion (Brazilian currency) in 1994 to R$ 950 billion in 2005;*
> *- maintain of a primary surplus (budget surplus after payment of the debt service) by sacrificing investments and social expenditures.*
> *The consequence of these measures was to considerably increase the public debt, at the expense of national industry and the workers. Offering high rates of interest results in a real haemorrhage of public resources and is a disaster for the country's economy, particularly for the productive sector, but greatly favours financial capital. The banks which had invested in debt certificates thereby saw their profits multiply each year. Given the great vulnerability of Brazil's external policy, interest rates offered in Brazil reached excessive levels.*

9 To learn more, read the speech by CADTM at the international "Resistances and Alternatives to Debt Domination", meeting in Havana, on 28-30 September 2005, www.cadtm.org/article.php3?id_article=1674

Evolution of internal interest rates in Brazil

Year	Month	Rate (%)	Situation
1997	November	44,92	Asian Crisis
1998	November	42,70	Russian Crisis
1999	April	41,91	Brazilian Crisis
2001	September	19,05	September 11th and Argentine Crisis (Dec.)
2003	June	26,50	Manipulation of the Country-risk by international agencies
2004	December	17,75	Increase of the US interest rate

Source: Brazilian Central Bank.

An examination of the evolution of domestic debt and fiscal policy should also enable the relation between the external debt and the balance of payments to be analysed, so as to throw light on and quantify the extent of capital flight, the types and the impact of foreign direct investments, etc. To go further it would be necessary to take stock of the bilateral treaties and/or regional investment and trade agreements current or past, in order to analyse the impact of the economic opening of the country in question.

7. *Listing company privatisations*

Strategic and lucrative public enterprises were privatised in the 1990's in Third World countries. Some of them were sold, at very low prices, to foreign groups and became consumers of external raw materials and services, while the profits they made were repatriated to the investors' countries, increasing the need to obtain foreign currency and thereby increasing the external debt burden.

> *In Argentina for example, the strategic state enterprise YPF (Yacimientos Petrolíferos Fiscales), got heavily into debt in US$ in the period of military dictatorship but YPF did not in fact need this currency. It was obliged to transfer it to the Central Bank, which in this way maintained an unviable exchange-rate policy. Following a sudden devaluation all the negative balances of YPF were assumed by the Argentine State in the 1990's in order to improve the company's financial situation before it was privatised. Similarly 90% of Argentine banks and 40% of national industries were privatised.*

Undertaking an audit could enable light to be shed on the strategies followed by the privatisations.

It would be useful to have available for this purpose the national legislation on the privatisation of assets and public enterprises, legislation on external investments, legislation on foreign trade and that (possibly) on the referral to the jurisdiction of the World Bank's International Centre for Settlement of Investment Disputes (ICSID).

B. Analysis of contracts

This stage above all involves assembling all types of document concerning the external debt on the basis of the indications provided in the previous section which serve to develop the main features of the analysis. The documents found will then be analysed in detail according to a pre-established reference grid. It should be noted that the international financial institutions and the other major economic agents use standard loan contracts, which enables a relatively general method of analysing contracts to be outlined.

In the first place the entity and the civil servants who officially authorised the signature on the external debt contract must be identified. That will enable the place where the debt contracts are supposed to be filed to be localised.

> *In Brazil, the Senate is the entity responsible for final approval and some documents were made accessible through an official authorisation obtained thanks to the support of opposition senators… hence the interest once again in mobilising the "political class" during the campaign in favour of an audit. Finally, it should be realised that documentation on loans concluded during a military or dictatorial period will be difficult to find, the then executive government being in the habit of disregarding consultations with other organs. During the period of Brazilian military dictatorship, the level of indebtedness increased considerably, but almost no document or debt contract has been found.*

Here are the results of the analysis of the documents undertaken by the Brazilian citizen's audit group, which will give some useful indications.

- Archived documents. *Of 815 resolutions listed by the Senate, only 238 were found in the archives of the Senate, suggesting that the senators approved the loan contracts without really analysing them. The 815 resolutions were equivalent to loans amounting to US$ 219 billion. The 238 contracts only covered 20% of the total amount and covered debts up to 1987. Unafisco studied the 238 documents in detail and found that about US$ 124 billion referred to seven authorisations by the Senate to the government to issue certificates.*

Summary of contracts 1964 – 2001

	Number of authorisations by the Senate	% of the number of resolutions	Amount financed (US$)	% of total of debt contracts
Issue of certificates	7	0,86	124 billion	56,55
Contracts found	238	29,20	42,66 billion	19,46
Contracts not found	570	69,94	52,60 billion	23,99
TOTAL	815	100,00	219 billion	100,00

Source: Unafisco.

- The language of the documents. *The Unafisco researches indicate that most of the documents were not drawn up in Portuguese (the official language of Brazil) and were not accompanied by a translation.*

- The participation of the federal government in the debts. *It is surprising to note that the list does not contain a single contract issued in the name of União (the federal institution which corresponds to the central government in Brazil) during the period 1964-1987. It is important to take into account that it is the federal government that contributed most to increasing the Brazilian debt during these years of military dictatorship, while the Congress was really prevented from checking the debt contracts. The executive power was in the habit of negotiating with foreign banks without any restriction.*

- The debts with the IMF. *No IMF loan document (those which are usually the most damaging to the sovereignty of a country)*

was found in the archives. Once again, this absence reflects the powerlessness of the Congress during these years of military dictatorship.

- Identification of abusive terms and conditions in the contracts examined. *Among the results arising from the analyses of the debt contracts found in the Senate archives was a list produced by Unafisco of abusive [see chapter 4].*

Abusive clauses and conditions identified in debt contracts found in the Senate 1964-2001

Clause	% of the amount financed according to the contracts found in the Senate
Floating interest rates	91,78
All payments should be exonerated from Brazilian taxes	77,19
Payment of interest on the part of the loan which has not been disbursed	58,61
Establishment of an external forum to officially settle disputes (renunciation of national sovereignty)	49,24
Adoption by Brazil of an IMF/World Bank plan	38,15
The debtors obligations on the capital, the interest and other obligations contained in the debt contracts are considered to be direct and unconditional obligations	37,14
Brazil will impose no control on the capital flows out of the country	34,05
There must be creditor agreement over collateral concession on other debts incurred by the debtor	34,05
In case of non-fulfilment of one of the terms of the contract, all the remaining payments must be made immediately	34,05
All communications regarding the contract must be made in English	34,05
The debtor should supply all information on the process of privatisation (including the methodology used for the setting of prices for the sale of public enterprises) one week after the sale by auction	34,05
The funds obtained from the sale by auction should only be used for paying for the goods or services of the countries selected by the creditor	31,14
The debtor must pay the inspection and supervision taxes at 0.5-1% of the amount contracted	12,11

Source: Debt Contracts founded on Federal Senate / Unafisco.

The letter of intent and the country assistance strategy

During the contract analysis phase, it is useful to try and analyse as far as possible the letter of intent signed between a country and the IMF as well as the country assistance strategy (Country Assistance Strategy, CAS) with the World Bank.

If a country's indebtedness reaches critical levels, the IMF is the lender of last resort. The letter of intent is a document "addressed" by a debtor country to the IMF, summarising all the recommendations the IMF has made in order to grant exceptional financial assistance to cover the balance of payments deficit. In this letter, the debtor country undertakes to apply the recovery programme and the reforms advocated, in a first phase, by the IMF. If the letter of intent satisfies the IMF, the debtor country will be granted a confirmation agreement (standby) and a credit in special drawing rights (SDRs). This is a clever way of making the governments of the countries of the South shoulder the demands of the IMF.

In Brazil, the citizen audit group verified, thanks to this letter, the relationship between the demands made by the international financial institutions and the policies followed by the Lula government in order to be able to continue paying debt service. The demands of the IMF concerned the reform of the fiscal and pension policy and the acceleration of privatisation policies, including the few banks still public, etc.

The country assistance strategy (CAS) is a commitment signed by a country with the World Bank, which generally remains in force between three and five years, in the framework of poverty reduction programmes. This document, prepared by the World Bank, indicates the future actions of the Bank in the country in question and specifies the obligations of the government in the matter of fiscal policy and structural adjustment. This commitment must continue, even if the government changes as a result of elections (for further details on the CAS, see the site of the NGO, Bank Information Centre BIC, www.bicusa.org).

Moreover, it will be useful to try and analyse all the debt reduction or cancellation programmes subject to conditions.

C. Examination of the final use of funds

The analysis of the contracts found is in itself a relatively complex process. After this analysis there should be another sub-stage, which, when it can be carried out, will also allow us to ascertain whether a particular debt is legitimate. This means examining the final use of the funds granted by a creditor.

So it should be asked:

- what were the funds mean to finance?
- what was the final, real use of the funds?

This amounts to asking:

- what is asked in return for the loan?
- is what is asked in return for the loan something of "quality", whose interests does it serve? Did the loan really benefit the populations?
- which is the state body responsible for the monitoring and use of public funds and did it do its job correctly? (it is generally the State Auditor General who is responsible and who has the authority to review the accounts of an external credit).

1. What is asked in return for the loan?

From this examination, it can be seen that some projects have never seen the light of day.

> *For example, the Tanzanian Debt and Development Coalition estimates that Tanzania contracted more than US$ 575 million in debts from the World Bank for 26 agricultural projects that never came to anything.*
> *In Nigeria a government commission noted that 61 development projects for which foreign loans amounting to US$ 5 billion were contracted failed or never saw the light of day.* [10]

A methodology proposed by the jurist and lawyer, Laura Ramos, involves examining the final use of funds on two levels. The first level identifies the purposes which determine the decision of the creditors about granting a loan; these are the *primary debts*. The second level examines the financial means used by the creditors to achieve these ends (study of the facts, the paths, the structures, the systems, the mechanisms and the results actually obtained); these are the *emerging debts*.

> *"The objective of this dual approach is to expose the final, real use of the funds loaned – which are, among other things, oppression, war, corruption, harmful development projects, the nationalisation of 'losses' or fraud – are only the means by*

[10] See Joseph Hanlon, "Lenders, not borrowers, are responsible for 'illegitimate' loans", *Third World Quarterly,* vol. 27(2), 2006.

which leading world economic groups continue to achieve more general objectives that satisfy their exclusive interests. For example: (…) if the debt caused by corruption (emerging debt) meets the need to rely on local political structures subordinated to the interests of transnational enterprises in the periphery (primary debt); if this corruption debt (emerging debt) results from the race between enterprises - and/or the competition between the governments representing them – to win markets and land for the extraction of wealth (primary debt) (…); or if the debt caused by bankruptcies or by the harmful results of 'development projects' (emerging debt) is the consequence of the need to subsidise the industry of the North (primary debt).
The link between the ends and the means, between the motives and the tools, provides in addition the elements necessary to clearly establish who is responsible for the accumulated debts of the countries of the South, and to understand how this debt in its totality and as a phenomenon operates as an instrument of domination." [11]

2.
Is what is asked in return for the loan something of "quality"?

Laura Ramos presents numerous examples of primary and emerging debts in her book. Among other cases of emerging debt which can be mentioned is the use of the amount of a debt contracted by a public institution but in the final analysis benefiting the private sector. Only an audit can identify this misappropriation and so throw into question the payment of this part of the debt. "Often, external credits are legitimised by the argument that they will be used to give the country the necessary infrastructure for its development, such as for example the construction or restoration of roads, bridges, canals, runways, pipelines and even schools and health networks. The contracting of credits is also justified by the financing needed for preliminary studies for the said work, to systematise the information or archive the results obtained and even to modernise the means for achieving this. Is the aim of these expenditures to benefit the population that will have to pay the debt generated? Not always. The infrastructure designed or restored

[11] Laura Ramos examines in detail these levels and the consequent debt in her last book *Los crímenes de la deuda. Deuda ilegítima,* published in March 2006 by Editorial Icaria and l'Observatorio de la Deuda en la Globalización, p. 48.

and the studies carried out often have the real purpose of preparing the ground for the future stripping of the resources of the country in question. These are some of the costs the South must pay so that corporations 'have confidence and invest in' such and such a country. Thus it might be said that such investments serve to mitigate the problem of unemployment that is striking the countries of the South, but how can this argument be verified?" [12]

Here is an example of a project which was not in the interests of the well-being of the local population:

> ***Ecuador and the extraction of oil***
> *"An very telling example of this problem is that of the 26 years of operation of the oil company Texaco in Ecuador. Texaco was created in 1926 and was the first company to develop oil exploration and extraction activities in the Ecuadorian Amazon region. Between 1971 and 1981, the Ecuadorian government built all the infrastructure necessary for Texaco for its extraction and transport operations. During this same period, the external debt of the country multiplied by almost 22, climbing from US$ 260 million to 5,870 million. Part of this debt enabled the infrastructure mentioned and other related work to be financed. The trade in oil brought Ecuador about US$ 7,500 million for the extraction of a non-renewable resource which needs millions of years to create. As far as the field of employment is concerned, Texaco totally reneged on its obligations and sub-contracted a great number of auxiliary operations to other companies. Ecuadorian workers occupied high risk jobs and worked like semi-slaves (…) Texaco's incursions left an indelible mark in the history of the Ecuadorian people. The company, which had to flee the country in 1991, is responsible for the pollution and destruction of vast zones of forest in the Amazon region, for massacring and displacing indigenous people and for impoverishing the country's populations. According to the calculations of Acción Ecológica, Texaco owes, in terms of ecological debt, US$ 709 billion, or 51 times more than the Ecuadorian external debt (www.accionecologica.org)."* [13]

[12] L. Ramos, op. cit., p. 97.
[13] Idem, p. 98.

D. Export credit agencies [14]

Public export credit agencies guarantee companies selling abroad against the financial or political risks of exporting. Almost every rich country has one. They are extremely discreet and opaque. They give huge financial support (twice official development aid), mainly to big companies and the banks, that substitute for them, to manage over the long term the settlement of the debt contracted by the foreign buyer.

Export credit agencies are public or semi-public institutions which grant guarantees for loans (support called "export risk guarantees"), or direct loans, to private companies of their own country in order to conclude business abroad, including in Third World countries that present a certain political and financial risk. In fact they operate like insurance companies: they cover the risks of non-payment of deliveries made to clients abroad and/or the loans linked to them. Originally, the risks covered were linked to the *political uncertainties* of the importing countries, risks over which neither the exporting company nor the client had any control. And the client then benefited from a State guarantee. Today the cover for *risks of non-payment* has widened to the mere inability of the client to pay and the guarantee of the importing State no longer has any political justification. These agencies are increasingly becoming institutions which transfer the risk from the company to public authorities.

14 To find out more, refer to The Corner House, "Underwriting Bribery. Export Credit Agencies and Corruption", *Briefing,* n°30, December 2003, www.thecornerhouse.org.uk, to the book of Laura Ramos, op.cit., chapter 3, to the article of W. Yerheyden « Les agences de crédit à l'exportation : un financement sans respect des droits écologiques, sociaux et économiques », 8 June 2003, available on the CADTM site, www.cadtm.org and see also the Déclaration de Berne (DB), www.ladb.ch. Special thanks to Jean-Claude Huot (DB) for this part.

These agencies fall into the framework of national export promotion. Export credit agencies are the most important source of public financing for private sector projects and they finance dams, mining projects and power stations among other things.

Contracts negotiated with export credit agencies today represent a quarter of the public debt of developing countries. In Africa this share is much greater and amounts to 71% of the external debt of Nigeria, 58% in Lesotho, 55% in Gabon, 42% in the Congo, 33% in the DRC and 31% in Cameroon. They are said to support twice as many oil, gas and mining projects as all the multinational development banks and the World Bank combined.

The actions of these agencies complicate the processes of indebtedness. A western company, having contracted an export guarantee – or the bank which takes over the credit on its own account – seeing that its services can no longer be paid, turns back to the export credit agency to be repaid. The agency becomes the holder of the debt title. The "private" debt becomes "public". In case of non-repayment, it is then the tax payer of the North who pays for the investment errors of the private sector. In turn, the agency could attempt to recover part of its money by selling the credit on specialised debt collection markets. The credit becomes private once again and the Third World country that has guaranteed the importer sees the terms of the debt contract change without being able to negotiate them, with very often stricter repayment conditions. If a sovereign counter-guarantee was included in the contract, the creditor can then turn against the State of the country of the company in difficulty and the debt then becomes a public debt.

Export credit agencies today control 10% of world exports and play a crucial role in the privatisation of public enterprises in the Third World, by providing insurance for western companies.

However reports, such as those published by The Corner House or the Déclaration de Berne, note the total lack of transparency of these agencies, although in general they are financed by public money. Indeed, it emerges that when contracts are negotiated, the institutions pay little attention to the viability and the seriousness of the project proposed. These reports also mention generalised corruption, by payment of commissions. The credits of these agencies in their current mode of operating, and the associated misappropriations lead to the growing external debt problem. A part of the debt audit should as far as possible examine in depth the contracts negotiated with these agencies, in order to determine to what extent they are illegitimate. Finally, it should be noted that most export credit agencies were not bound to take into account respect for human rights and the social and environmental impact of the projects they financed. Numerous scandals, such as the financing of the Three Gorges dam in China, of a big hydraulic project in Lesotho and the Yanada gas project in Burma, have thus surfaced. Thanks to the mobilisation of numerous NGOs, including those signatories to the Jakarta Declaration [see below], recommendations calling for stricter assessment of the environmental and social impact of the projects supported by these agencies have been accepted by the OECD. These recommendations are of course not legally binding, but the struggle continues…[15]

15 The big export credit agencies are COFACE in France, Ducroire in Belgium, Hermes in Germany, Export-Import Bank (EXIM Bank) in the United States, Export Credit Guarantee Department (ECGD) in Great Britain, etc. It is to be noted that COFACE was privatised in 1994 but that it can continue to draw on the State budget without limit if the amounts it must cover are greater than its resources. See *Bulletin du CADTM France,* May 2002, www.cadtm.org.

Corruption, export credit agencies in Pakistan

"In July 1998, the Canadian export credit agency indemnified the Canadian energy generation company BC Hydro, after the Pakistan government cancelled its contract for corruption reasons. That same year, development aid agencies such as the World Bank and other western governments put pressure on the Pakistan government to abandon its investigation into corruption concerning the construction of a power station in 1997 by a consortium including a British national company and which had been financed by the export credit agencies of France, Italy and Japan." [16]

Togo: a wretched government and corruption, encouraged by export credit agencies

"1st point: the financing of the Togo plastics industry (ITP) was undertaken in the form of a loan from Crédit Suisse. The project was so risky that the participating companies would not have committed themselves without the export credit insurance given by the Swiss government, through the intermediary of the agency for guarantees against export risks (GRE). ITP was already in the red from the moment the project started. Losses of several million US$ had accumulated and a senior official of the World Bank in Togo confirmed that the construction cost of the factory (US$ 10 million) was markedly greater than the real value of the factory, which was only US$ 3.7 million. No international call for tenders was launched. This operation involved the payment of hidden commissions to obtain the contract and the participation of GRE, thanks to the inflated price of the factory.

2nd point: Rolf Kohlgruber, owner of Ofenbaugesellschaft Berg & Co. GmbH (Cologne, Germany) and of Berg AG (Basel, Switzerland), convinced the Togolese government to guarantee a loan of US$ 5.8 million which he obtained from the Société de Banque Suisse to construct a corrugated iron factory in Togo. The Société de Banque Suisse granted the loan on condition the delivery of the factory was also insured by GRE. Without the guarantee of the Swiss and Togolese states this operation would very probably have failed. Since Togo had not launched any call

16 L. Ramos, op. cit. p. 91.

for tenders, it finally paid 5 million Swiss francs too much. An internal commission of enquiry presented a report declaring in these words that 'the profits made are such that they must be declared to be immoral and fraudulent'…" [17]

Since 1996, NGOs in various countries have launched an international campaign for the reform of export credit agencies, basing themselves particularly on the Jakarta Declaration.

For more information: http://www.eca-watch.org/

Illustration

"The cancellation" of debts by the North: is it such a disinterested gesture? A report which has some surprises…

A rather long article in the magazine La Vie économique (5-2001, p. 39 and s.) introduced by the sub-title "a gift on the occasion of the anniversary of the Confederation", was devoted a few years ago to drawing up a first review of the debt reduction programme adopted by the Swiss federal Assembly 10 years before in 1991. This programme which had followed an intense campaign conducted by the country's biggest mutual aid charities was voted on the occasion of the 700th anniversary of the Confederation. 700 million additional Swiss francs had then been allocated to international development aid, of which 500 to a debt reduction programme.

One hardly knows what to think on reading both the article and the original report on this subject by Seco (Secretariat of State for the Economy), even if a good part of the debt reductions which were awarded contributed to reducing the burden for the populations involved and to somewhat improving their situation. 450 million had been used for debt reduction in 2001. Only countries considered as "poor" were eligible. The magazine article specifies: "To be able to benefit from debt reduction, a country must demonstrate good policy performance and fulfil certain conditions. Good governance (respect for human rights, separation of judicial and political powers, press freedom, etc) are in particular part of these conditions, as well as efforts to improve its economic policy in order to accomplish social reforms and redefine its future strategy on indebtedness". Then the text outlines the "four instruments of the Swiss debt reduction programme":

1. *Cancellation of bilateral public debts.* The article specifies that "this measure especially concerns the repurchase of commercial debts covered by the guarantee against export risks (GRE)" after having previously noted that "the debt crisis does not so much concern a problem of short term liquidity as a problem of insolvency"

[17] Relatively old examples but which are not without interest and drawn from the document of B. Rich, K, Horta, A. Goldzimer, « Le rôle des agences de crédit à l'exportation en Afrique subsaharienne », Environmental Defense, http://www.environmentaldefense.org/documents/474_AfricaFrench.pdf.

(emphasis ours). For this purpose, "the Confederation had to take possession both of the credits covered by GRE and the exporters 'franchise' (exemption)(...). For re-purchasing the franchises, SECO offered the exporters an average price equivalent to 20% of the nominal value of the credits."

2. *Cancellation of non-guaranteed commercial debts.* It is to be noted in this respect that "this measure includes the payment of arrears with respect to banks and suppliers not having any State guarantee." (emphasis ours)

3. *Reduction of multilateral debts.* This measure is "intended for countries in which Switzerland already plays a very active role in development aid." "The aim of this action was to enable countries undertaking reforms (the SAPs, ed.) to maintain access to the advantageous credit lines of the multilateral institutions." (emphasis ours)

4. *Complementary measures.* These provide for "improving debt management (…) in particular to avoid future situations of insolvency." (emphasis ours)

Of the 455.5 million so distributed, 70.9 million are for the first type of measure, 84.9 for the second, 247.1 for the third and 52.6 for the fourth.

E. Analysis of current data

The group for the citizen audit in Brazil conducted, in parallel with the historic and contractual analysis, an analysis of the relation between the current data and the national debt. This stage is interesting but depends much on each country's characteristics. As an example we reproduce the parameters chosen by Unafisco, which give some avenues for refection.

> *The key results of the Unafisco research are:*
> *1. **Concerning the national budget:** there is a gulf between national expenditures on the social service sector and debt service. In 2004 social service expenditures were US$ 33 billion whereas debt service amounted to US$ 69.79 billion.*
> *2. **Concerning IMF agreements:** the Lula government accepted the agreements with the IMF, the conditions of which include, for example, maintaining a gross surplus in order to reserve funds for debt service and the reform of taxation and retirement systems.*
> *3. **Concerning the central Bank of Brazil and the tax legislation:** laws making the flow of capital outside the country more flexible have been passed in Brazil in recent years. Unafisco believes that this has a direct link to money laundering and has an impact on Brazil's level of indebtedness, given that the funds*

lent and badly used can leave the country without trace. Unafisco is particularly preoccupied about the process of streamlining taxes on "hot" money (speculative money invested in the capital markets).

*4. **Concerning the international financial indicators associated with levels of indebtedness:** Brazil has always been considered a country with a high "country risk" indicator [see chapter 1]. For this reason, it must pay higher rates of interest on its bonds despite the fact that Brazil is up to date and even in advance with its payments (in 2005 for example, Brazil paid a sum of US$ 5.1 billion of a debt contracted with the IMF in the framework of the Supplemental Finance Facility before it was due [18]).*

Beyond that, the audit should include an analysis of the relation between debt and social indicators, such as indicators of poverty and indigence, unemployment, under employment, informal employment, etc and the indicators on wealth distribution (incomes). For that it would be useful to consult the International Debt Observatory site (www.oid-ido.org) which lays down the methods of calculating these ratios.

II. How to overcome the obstacles ?

As already stated, the path of a debt audit is full of pitfalls and undertaking an audit is far from being an easy task. The obstacles can be both technical and political. Here are some indications and pieces of advice which may help overcome these obstacles.

A. Technical obstacles

Let us imagine that an audit is relatively well underway (general agreement of the civil society on the need to undertake an audit, mobilisation of organisations, of various social groups and movements, of members of political parties and parliament on the question, etc.). Also imagine that the strategy to follow (agenda and planning of tasks, organisation of working groups, identification of the types of document to look for, personnel resources, etc.) is clearly established.

18 One of the most expensive IMF credits, usually granted to middle income countries.

In this "ideal" situation, the problem of a lack of documentation can still arise, as well as the language used in the contracts, as is demonstrated by some results of the citizen audit in Brazil mentioned above. Moreover in working on the history of the debt, the scattering of documents in several countries (including those of the North) is important. This might discourage researchers and slow the start-up of the audit.

The existence of an active and rapid North/South support and solidarity network is essential to resolve these problems. The strength of this North/South network also depends on its capacity to undertake contractual research in various countries, partially reducing the problem of the scattering of documents. [19] In the North, organisations should *a priori* have easier access to official and governmental documents by using the freedom of information laws, especially in the framework of joint and media oriented campaigns on debt relief. It should also be noted that many organisations benefit from efficient and voluntary translation networks which may help translate contracts thought to be important in a relatively short lapse of time. Finally, ideally, commissions regrouping different, more or less activist, professional circles, with various skills should be set up which will provide several opportunities to gain access to documents and sources identified as important

It will also be useful to develop fruitful contacts with civil servants working in key posts.

B. Political obstacles

Political blockage preventing access to debt documents is relatively foreseeable. This obstacle is more difficult to overcome than the last one. In fact, politicians and other national players have no interest in the whole debt process being examined. That is why we emphasise the need to establish solid contacts with members of political parties

[19] See the work of EURODAD on this subject, www.eurodad.org.

including those in the opposition and the media from the beginning. The purpose of this effort is to bring political obstruction as far as possible into the public arena so as to increase pressure to open the archives.

Other types of obstacle of a political nature may be encountered throughout the audit process. Indeed, if a law promoting the undertaking of an audit is adopted, politicians may subsequently do everything they can to block its implementation.

> *In the Philippines, a joint resolution on the debt audit was adopted by the House of Representatives and is at the moment under examination in the Senate. However, senators have been trying to delay the adoption process for several months under technical pretexts. The Representatives and the social movements at the origin of this initiative could not prevent this blockage (due to unfavourable political conditions), but had strategically chosen the form of a joint resolution. According to Philippine law, this type of decision, which is not a law, enables the president to be prevented from vetoing such an initiative.*

Moreover, as the Philippines experience shows, the formulation and the choice of the vocabulary of the articles contained in the law (or other legislative instruments) and their aims are crucially important.

> *The Philippine joint resolution was drafted in such a way that it did not contain any article limiting the debt and which included "punitive" measures. The strength of this resolution, and this is what made the consensus among a wide majority of deputies, is that it does not aim to punish or judge this or that player, but to review the debt and economic situation of the country The only sanction envisaged in this text is aimed at the civil servants or other authorised agents who knowingly do not hand over documents to the official audit Commission foreseen by the resolution.*

Finally, it would be useful to try and force access to documents of the International Financial Institutions (IFIs). For example external researchers could be approached to undertake

an "enquiry" on the IFIs. Thanks to collaboration with organisations in the North and this solidarity network, it can also be planed to bring pressure on the national delegation of this or that government to an IFI to make the institution, in which they sit in, open its documents to organisations of the South that are undertaking an audit [see box on the audit of international financial institutions, chapter 2].

Illustration

General audit of the debt in Ecuador

"Ecuador has just launched an impressive initiative on debt audits. By government order, an official Commission for Research on the External debt was established which will study the debts contracted by Ecuador during the last thirty years in detail. The result of the audit will be communicated to the President. A prelate and an ex-Minister are members of the Commission.

Ecuador owes more than US$ 11 billion in external debt. Unfortunately this audit is only a small step. In the first place the deadlines fixed for the Commission are very short: only six months. The audit will therefore consider only a few cases, for example the over-financing of the Cuenca-Molleturo-Naranjal road (US$ 120 million, while the initial budget was 20 million, without counting damage to the ecosystem estimated at 130 million). Then, the Commission will only have a very small budget and will need the collaboration of different State agents in the ministries and national banks, which it is not certain of getting.

Finally the Commission has not been invested with powers of arbitration, it only has powers to investigate, inform and propose. The President alone will be authorised to take measures. Will he?

One of the members of the Commission is Hugo Arias, an activist in Jubilee 2000, who has precise evidence of corruption and concrete leads for the investigation. This is thanks to the activism and the watchdog role of the global anti-debt movement, of which Jubilee 2000 is part. Let us hope that this work will also enable the Commission to work on the multilateral debts contracted by Ecuador."

Extract from the *Bulletin du CADTM France,* n°23, May 2006.

Do not hesitate to go back and forth between chapter 3 and chapter 4 (legal elements)! Those wishing to go further are invited to complement the elements presented in this manual with others, particularly complete documents downloaded from: http://audit.oid-ido.org

Chapter 4

Legal aspects of the debt audit

This chapter presents the various legal aspects of the debt audit: in the first part, arguments about the right to carry out the debt audit are discussed; in the second part, the main legal points of reference when examining a debt contract to detect possible irregularities or other defects are described.

I. The right to an audit

As we have seen above, different players in public life can take the initiative to carry out a debt audit. Nevertheless in the end the government is the entity that can decide, following the results of any audit, not to pay a particular debt or to start legal proceedings. Pressure on and/or coordination with the public authorities is thus essential.

- The right to an audit as a duty of the public authorities: the right to act and decide legally

In the field of international law, important contributions to doctrines of odious and illegitimate debt (see among others the articles of Professors A. Sach and J. Hanlon) gave considerable support to the development of jurisprudence, at a time when specific international standards had not yet been developed. A public audit is the favoured instrument through which the competence of the public authorities is fully implemented in the field of national law. It enables governments to decide on the licit or illicit character of the external public debt. In the case of Brazil, the public debt audit has a constitutional status, a provision that depends entirely on state jurisdiction: the decision to repay the debt or not depends in the final instance on the public authority of the State concerned, exercising its domestic powers and after analysing the legality of the debt.

Similarly, when a government refuses to carry out an audit, citizens have the right to demand one by exercising their right to petition, the government's obligations, their

civil and political rights and the guarantees constitutionally established in each country. [1]

- The right to an audit as a citizen's right: the right to know and to demand compensation

The citizen audit places the problem of the right and the legitimacy of the debt at the heart of the debt issue. It includes the idea of compensation and allows an analysis of the past that delimits the responsibilities, whether those engaged internally or those of the creditors, and defines the odious part or the part tainted by another illicit character of the debt. The audit thereby provides social and financial protection for the citizens in addition to being a legal argument for cancelling the debt.

A. Determining the legality or illegality of the external debt: a sovereign right and a duty of the public authorities

No government should have to pay an external debt that was legally determined to have been an illegitimate or illegal act under the pretext that there is an international obligation. According to the standards of public law, it is within the *competence* of the public authorities to determine whether a debt is licit or illicit. Indeed, as a State organ, the government has the right and duty to exercise its domestic powers to assess public debts, particularly by having recourse to public audits and by the corresponding fiscal investigations that could enable liabilities to be established and those responsible to be prosecuted. Moreover, citizens' movements, as direct victims of the debt, have the right to question the

[1] This prerogative could be applied to the States that are part of the inter-American system, by invoking the inter-American convention against corruption, which specifies in article III (Preventive measures): "For the purposes set forth in Article II of this Convention, the States Parties agree to consider the applicability of measures within their own institutional systems to create, maintain and strengthen:
Para. 6. Government revenue collection and control systems that deter corruption (…)
Para. 10. Deterrents to the bribery of domestic and foreign government officials, such as mechanisms to ensure that publicly held companies and other types of associations maintain books and records that, in reasonable detail, accurately reflect the acquisition and disposition of assets, and have sufficient internal accounting controls to enable their officers to detect corrupt acts.
Para. 11. Mechanisms to encourage participation by civil society and nongovernmental organizations in efforts to prevent corruption." See the website of the Organization of American States: www.oas.org.

validity of the alleged debts and to demand adequate compensation, on the basis of internationally recognized human rights, if the damage and losses provoked by the government's actions are proved. [2]

Illustration

The right to compensation, but not on any conditions…

In September 2005, the Swiss and Nigerian governments, under the auspices of the World Bank, signed an agreement to repatriate US$ 458 million stolen by the former leader of Nigeria, General Sani Abacha, and deposited in different Swiss banks (however 14 million in legal costs were deducted from this amount). The Swiss government authorised this transfer basing itself on the verdict of the Federal Tribunal and a first part of the money has been returned to Nigerian coffers. There is no doubt that this repatriation is an important precedent and is the result of 5 years of work led by Swiss and Nigerian citizen's campaigns.

However conditions for the repatriation of the loot were imposed, including a "supervision agreement" on the accomplishment of "good results". This mechanism guarantees the Swiss government and the World Bank key roles in ensuring that the repatriated funds are really used for the priorities established when the agreement (entitled Public Expenditure Management and Financial Accountability Review) was negotiated. Once again it is the western powers and the international financial institutions who identify these priorities and assess how far they have been fulfilled. In the way it has been set up, this supervision mechanism can only reinforce the already considerable power of the international financial institutions and western countries over the countries of the Third World. When a mechanism for supervising the repatriation of funds following a debt cancellation process is necessary, it should be defined and governed locally (that is to say in the debtor country and with the involvement of concerned local NGOs and social movements). The World Bank must not hold such a central (and costly) role for itself, since, moreover, it is very often both judge and party.

The peoples of the developing world can legitimately wonder, indeed be indignant, about the cost in time and money of setting up this supervision mechanism. At the end of the day, is it Nigerian, Swiss or World Bank money? Why are the priorities for

[2] Although it is only at the debates and analysis stage in the international legal field, violations of the Rome statute could eventually be considered and the jurisdiction of the International Criminal Court (ICC) asked for in the area of offences against humanity (part k) and the ICC's prosecutors office solicited for debt investigations and audits, to establish the criminal liability of governments, and potentially try to identify the non-State players as being responsible for the debt. On this subject see point E of part II of this chapter.

the use of the repatriated money not identified above all locally? [3] Finally, should the creditor banks and the Swiss Confederation who are surrendering the misappropriated money with so many conditions and precautions not have questioned the real use of the funds borrowed at the time General Abacha signed the first loan contracts?

The right to compensation is legitimate and should be a priority for the movements and organisations fighting for economic and social justice and the cancellation of debt. However this right should not be granted and applied under any conditions. It is the very function of a debt audit (undertaken in the creditor countries and in the debtor countries) to ensure that this does not occur, to shed light on illegitimate loans granted and/or misappropriated for personal ends and to promote the fair repatriation, that is to say serving the needs of the people, of the stolen or illegitimate funds deposited in western banks. Finally, a debt audit can considerably help a campaign to repatriate money by exposing the private banks involved with corrupt governments or former dictators as well as the volume of money deposited in foreign banks. Campaigns for carrying out an audit and for repatriating money are complementary.

B. Demanding and implementing an audit: a fundamental right

1. The right to take part in the public affairs of the State

The Universal Declaration of Human Rights of 1948 states that "Everyone has the right to take part in the government of his country, directly or through freely chosen representatives…" (article 21).

There is a similar provision formulated in the International Covenant on Civil and Political Rights of 1966, that strengthens this right by protecting political rights, particularly the right to take part directly in public affairs (article 25a). [4]

[3] For more information, see www.eurodad.org and African Network for Environmental and Economic Justice (ANEEJ), www.aneej.org.

[4] UN-CHR, *Promotion and consolidation of democracy.* This working document concerns the measures defined in the various international instruments on human rights aiming to promote and consolidate democracy, presented by Mr. Rodríguez Cuadros according to the mandate set out in the Sub-Commission's decision, 2000/116, E/CN.4/Sub.2/2001/32, 5 July 2001, § 20.

We have already said that the external debt, as an act of government, commits the resources of the State in the broadest sense: financial resources, human resources, natural resources, national budget, etc. Through the very act of borrowing the State not only commits itself but by extension the whole population. When a government acts as a State organ, the act is essentially public: its effects will be felt directly by the citizens. Consequently, in return, the citizens have the right to take part in "public affairs": every citizen has the right every time the State organ acts as the public authority, to demand that the government give account. Citizen supervision thus appears as an essential element derived from the right to participate in public affairs. [5]

By giving a right of oversight and supervision on the use of funds to the population, the citizen audit also enables a structure to be set-up which is capable of managing the return of dishonestly acquired property and to use it for the benefit of the population.

It will then be possible for a constitutional government anxious to improve the living conditions of its citizens to put an end to the serious violations of human rights provoked by the spiral of indebtedness and to decide on an audit and an investigation by the public prosecutor that will permit legal actions to determine responsibilities and justify the suspension of payments and the repudiation of the debt.

[5] UN-CHR, "Civil and political rights", written declaration of the International centre for human rights and democratic development (Rights and Democracy), E/CN.4/2003/NGO/79, 7 March 2003, point 3 b). See also, UN-CHR, "The right to development", written declaration presented by the American association of jurists, E/CN.4/1999/NGO/2, 29 January 1999.

2. The right to information: a human right

In respect to the right to information, the aforementioned 1966 Covenant provides as follows:

"Everyone has the right to freedom of expression; this right includes the right to research, to receive and spread information and ideas of any sort, without consideration of borders, in an oral, written and printed form" (article 19).

For its part, the UN Commission on Human Rights has recently emphasised that the exercise of democracy covers:

a) transparency in the management of public affairs and the administration in all sectors of society and the obligation to be accountable;

b) real participation of civil society. [6]

Access to information can be considered as a fundamental right as far as governmental acts are concerned and particularly when the government contracts public loans that commit the resources of the State. It is to be noted that, at the international legal level, this right has been recognised by almost all States who have ratified the 1966 Covenant on Civil and Political Rights – with the notable exception of the United States that, more than 30 years after having signed it, refuses to ratify it. [7]

The aim of this right is that citizens should have access to documentation or information that is in the hands of the public authorities. This right implies, as a corollary, that civil servants and state entities have the obligation to facilitate the implementation of this free exercise. The field of application of the provision of the 1996 Covenant is very wide. The aforementioned article can be interpreted

6 UN-CHR, "Promotion of a democratic and equitable international order", Resolution of the Commission on Human Rights, E/CN.4/RES/2003/63, 24 April 2004. See also, "Strengthening popular participation, equity, social justice and non discrimination as essential foundations of democracy", Resolution of the Commission on Human Rights, E/CN.4/RES/2003/35, 23 April 2003; UN- CHR, "Interdependence of democracy and human rights", Resolution of the Commission on Human Rights, E/CN.4/RES/2003/36, 23 April 2003.

7 On the inter-American scale, the application of the Convention on access to information can be called for.

as covering the right of every citizen to research, request and obtain information referring to laws, decrees, administrative acts, resolutions and regulations, budgets and balance sheets, memoranda, and reports, declarations of the property of civil servants and of State authorities and, in general, all types of document: written documents, photos and recordings in the possession of the public entity applied to and under its control. The exercise of the right to information covers the inspection and the reproduction of documents, the analysis of dossiers and documents, the selection of official documents and access to copies.

Everything concerning external debt also falls within the field of application of this provision: the secrecy of the negotiations with the future creditor or of the renegotiations of the external public debt, [8] cannot be invoked to prevent citizens' access to the information needed by them to discover how public resources are administered.

The exercise of this right is an integral part of democracy, that cannot be reduced solely to the internal aspects of the functioning of the State apparatus (periodic elections every three or four years, etc.). As the UN Commission on Human Rights has justly emphasised, democracy and the exercise of the related rights also covers transparency and the public administration's obligation to be accountable. [9]

Democracy and the democratic control of government acts undoubtedly implies the right for citizens to:

a) know what the government decides at the level of international relations in general and at the economic and financial level in particular;

8 This interpretation in no way implies denying the need for some level of confidentiality in the processes mentioned. Nevertheless, confidentiality cannot be assimilated with the regime of "State secrecy", the characteristics of which are radically different.

9 UN-CHR, "Promotion and consolidation of democracy", extended working document on the measures defined in the different international instruments on human rights in order to promote and consolidate democracy, presented by Mr. Rodríguez Cuadros, according to the mandate set out in the Sub-Commission's decision 2000/116, E/CN.4/Sub.2/2002/36, 10 June 2002, § 10-11.

b) actively participate in this process every time State property, public resources, natural resources and the well-being of the population (health, education and other budgets) may be "mortgaged" because of the public debts contracted in the name of the people.

So the interpretation of the content of the right to information includes without a doubt the right to demand an audit of the external debt. Hence the importance of the *right to information* as a fundamental human right. Indeed, without guaranteed access to documents such as loan contracts, agreements with international financial institutions, conditionalities, etc., the audit could not be undertaken. To summarize, it is true to say that the audit is the most appropriate instrument for guaranteeing the transparency and legality of government acts.

To ensure that the rights mentioned above are respected it will be crucial to generate a powerful citizen and social movement.

C. Scope of the debt audit

The field of application of the audit covers the analysis of *all the debts contracted by the public authorities with public or private institutions regardless of the nature of the regime*. But also *all the private debts contracted by private enterprises and that were subsequently transferred to the State,* transfers from which the branches of transnational firms have largely profited. From this point of view, the objective of the audit is to shed light on government actions and legal acts, [10] whether it is a dictatorial or constitutional regime.

In fact, three basic questions have to be answered: "how much is owed", "to whom is it owed" and "for what is it owed". And sometimes even: "is it really owed?". In this

10 See J. Atienza Azcona, "Luzes, cámara, ação… auditoria cidadã", M. L. Fatorelli Carneiro and R. Vieira de Avila, *Auditoria, Da dívida externa: questão de soberania,* Campaña Jubileu Sul, Contraponto, Rio de Janeiro, 2003, pp. 151-152.

context, the participation of trade unions, peasants, women's, young people's, indigenous and other movements is the condition *sine qua non* for the audit to be conducted transparently and objectively, thus preventing the creditors from becoming both judge and party. [11] In this respect, the audit will provide a favourable context for determining the public authorities' degree of responsibility in the process of external indebtedness, just as the responsibilities of the creditors, both private (banks) and public (IMF/World Bank). But especially so that those responsible, beyond determining whether the debt was illegal or odious, give an account of their acts. Therefore, the audit is not just a technical act: it is above all a deeply political instrument of democratic control. It is also an instrument turned towards the future that puts into place tools which allow citizens to take control of the debt process.

At the level of international economic and financial relations with respect to human rights, audits can play a key role. These rights are directly affected by the policies introduced by governments as a result of the policy "recommendations" of the IMF and the World Bank, that entail violating human rights, as the UN Commission on Human Rights has specifically emphasised. [12]

11 A. O. Krueger, *A New Approach to Sovereign Debt Restructuring,* IMF, April 2002; IMF, Legal and Policy Development and Review Department, *The Design of the Sovereign Debt Restructuring Mechanism - Further Considerations,* November 2002. See also, O. Ugarteche, A. Acosta, "A favor de un tribunal internacional de arbitraje de la deuda soberana (TIADS)", presented to the international seminar « Amérique Latine et Caraïbes : sortir de l'impasse de la dette et de l'ajustement », CADTM, Brussels, 23-25 May 2003; Hugo B. Ruiz Diaz, « La gestion des crises de la dette. Arbitrage sur la dette : une alternative viable et équitable ? », December 2003, Hugo B. Ruiz Diaz, « La création d'un tribunal d'arbitrage sur la dette : une solution alternative ? », July 2003. The texts may be consulted on the CADTM website: www.cadtm.org.

12 UN-CHR, "Effects of structural adjustment policies and foreign debt on the full enjoyment of all human rights, particularly economic, social and cultural rights", E/CN.4/RES/2001/27; "Effects of structural adjustment policies on the full enjoyment of human rights", Report of the independent expert, Fantu Cheru, presented in conformity with the decisions 1998/102 and 1997/103 of the Commission, E/CN.4/1999/50, 24 February 1999; UN-CHR, Joint report of the special Rapporteur R. Figueredo and the independent expert, Fantu Cheru, "Effects of structural adjustment policies on the enjoyment of human rights", E/CN.4/2000/51, 14 January 2000.

Case study

Paraguay's debt to private bankers: a case of odious debt

The act of debt repudiation: a licit act under international law

Paraguay's unilateral act in this case is interesting because, with the help of solid documentation and incontestable proofs, it was able to demonstrate not only the illegality of the debt but moreover the complicity of creditors. The non-recognition of the Paraguayan debt on the part of the government is a very recent event which has not gained much media attention.

In August 2005, the Paraguayan government refused to pay the debts contracted with private bankers under the dictatorship of Alfredo Stroessner. The Swiss court, where the creditors lodged a complaint, decided in favour of the bankers and sentenced the Paraguayan State to repay the debt in full.

The Paraguayan government was resolute: by Decree 6295, adopted on 26 August 2005, the Paraguayan State considered that the debts were illegal and that the State had no obligation to repay them. On the same day, the Paraguayan Minister of Foreign Affairs relayed the text of the presidential Decree decision to his Swiss counterpart.

A null and void act

Between 1986 and 1987, the Paraguayan consul in Geneva, Gustavo Gramont Berres, asked for a loan of US$ 85 million in the name of the government. Stroessner had taken power in 1954 and had installed a dictatorship that was overthrown in 1989. The loan asked for was granted by Overland Trust Bank, of Geneva, knowing full well that Gramont had no authority to ask for such a loan in the name of the State. Despite this, the Overland Trust Bank granted him the loan and the sum was used for his personal enrichment. Subsequently, Gramont was criminally prosecuted in Paraguay and finally sentenced to jail. He confessed to having received a commission of US$ 6 million from the Overland Trust Bank before the judge.

It is therefore clear that the funds obtained never arrived in Paraguay. But before its disappearance, the Overland Trust Bank sold the titles to the debt to nine banks who then asked for full repayment from the State. Confronted by the refusal of the government to pay a debt it considered fraudulent, the holders of the debt titles lodged a complaint against the Paraguayan State before the Swiss courts in 1995 for compliance with the contract. They judged that Paraguay should pay the debt of US$ 85 million plus interest that amounted to 185% of the principle.

The Paraguayan State made it known that the decision of the Swiss court was an infringement of the rights of the Paraguayan State and a violation of international law, that were sufficient reasons for bringing the case before the International Court of Justice (ICJ). This odious debt was denounced by the President of Paraguay in his

speech before the UN General Assembly in these terms: “This fraudulent act was undertaken by officials of a corrupt dictatorship, that in collusion with a group of international banks, tried to cheat us of resources which our country urgently needs” (extract from the speech of the Paraguayan President before the UN General Assembly, 3 October 2005). [13]

The Paraguayan position and international law

The debt contracted by the Consul in order to serve the dictatorship is quite obviously odious. It is a debt that is rendered null and void. The Overland Trust Bank and subsequently the purchasers of the titles to the debt could not ignore that it was a loan granted to an illegal regime and that the debts take out by this regime could not be invoked as an international obligation. Add to this mess the issue of corruption, as the Paraguayan Consul admitted at his trial. The private creditors have no legal right to demand its repayment.

In this respect, the Paraguayan State’s act of repudiation is founded in international law. The constitutional regime in place has no obligation to repay. The argument of the continuity of the State is substantially inadmissible because it is a void act that can in no case become the responsibility of the Paraguayan State.

The decision of the Swiss court can also be considered an internationally illicit act because it systematically ignored and set aside the proofs presented by Paraguay. In international law, the court acted as a State organ. For this reason, the international responsibility of the Swiss government is clearly engaged. This internationally illicit act opens the door to legal challenges and the possibility of recourse before the ICJ. Paraguayan social movements should ask the government in place to bring the case before this international jurisdiction. Similarly, given the bad faith of the creditors, their abusive conduct and their breach of the obligation of due diligence, they are duty-bound to provide compensation for this illegal act. Hence, the responsibility of the private banks can be established through civil and criminal proceedings before the competent Paraguayan courts.

At the political level, the act of the Paraguayan government shows that if a government wishes to invoke the fraudulent character of the external debt, it can do so, including by decree, that in international law is a unilateral act of the State, considered by the ICJ as the source of law.

13 It should be recalled that odious debt has recently been brought back onto the international scene by the United Nations Commission on Trade and Development, UNCTAD, *Economic Development in Africa, Debt Sustainability: Oasis or Mirage?,* Geneva, 2004. This report has two merits: first it updates the notion of odious debt and on the other hand, it highlights the responsibility of the creditors. Hence its pertinence for the present case.

II. Legal elements for examining a loan contract

After having exposed the legal arguments on which the right to an audit is based, this part aims to give some legal leads to help examine a loan contract more closely and detect possible "anomalies".

Before undertaking any legal examination of loan contracts, it is necessary to keep in mind the following general elements:

- the nature of the law applicable to the loan contract;
- the hierarchy and interpretation of international conventions (see the Vienna Convention on the law of treaties);
- the debate on the use of the terms illegality or illegitimacy of the debt.

1. The nature of the law applicable to loan contracts

What is the nature of the law applicable to loan contracts? This question often comes up when a particular loan contract is contested or judged. Is it a case of domestic law, international public law, international human rights, the right to development, business law, or even the law of the creditor States? Can applying these latter two at the same time be envisaged? And, concerning private creditors: is it international commercial law or the domestic law of the debtor States that applies?

The nature of loan contracts is very varied, as is the identity of the contracting parties. A few leads for identification may be useful in the context of an audit.

In the first place, it is necessary to check whether an arbitration procedure is foreseen in the loan contract. If this is the case, the nature of the applicable law can be determined more easily.

There are contracts in which it is stated that international public law is the governing jurisdiction (but this is rather rare).

If an agreement is signed between a State and a multinational bank or a private banking group, this is an

international contract subject to the rules of international contracts. The settlement of disputes takes place at the level of the International Centre for the Settlement of Investment Disputes (ICSID), an arbitral court created by the Convention on the Settlement of Investments Disputes between States and Nationals of other States of 1965 (the so-called ICSID Convention). This court is a member of the World Bank Group, its headquarters is that of the World Bank and the Chairman of the World Bank is Chairman of the Board of Directors of ICSID by right (article 5) [see our reservations below on the subject of ICSID].

If it is contract concluded between two public entities and involving a major long-term investment on the territory of the contracting State, the contract may be considered to be subject to *international development law.*

If an agreement is signed between two States or between a State and an international economic and financial institution, it is an *international agreement* governed exclusively by treaty law. In this case, recourse to ordinary courts, international arbitration courts or any other international institution is possible. **14**

Finally, a contract may specify legal order governing exceptionally the rights and duties of the contracting parties.

In the case of loans between private banks and Third World States, international public law and international development law are almost impossible to apply. **15**

In fact, the definition of applicable law is not simply a problem of technical legal definition, but a political problem.

14 Vienna Convention on the law of treaties of 1969 and Vienna Convention on the law of treaties between States and international organisations or between international organisations of 21 March 1986. See the article by Hugo Ruiz Diaz on this subject, http://www.attac.org/fra/toil/doc/cadtm42.htm#_ftn1.

15 This paragraph is inspired by the article entitled « La nature des droits applicables aux contrats de prêts » from the analysis of G. Feuer and H. Cassan, in *Légitimité ou illégitimité de la dette du tiers monde,* cahier Archimède et Léonard, AITEC, special issue n°9, winter 1992, pp. 23-27.

2. Placing the contract in the hierarchy of standards

When the cancellation of certain Third World debts is demanded, western countries often brandish the *Pacta sunt servanda* principle, according to which the parties are tied by the treaty to which they committed themselves until all their obligations are exhausted. Creditors have therefore taken up this principle as the golden rule of international commercial relations.

But to claim this principle is to ignore the fact that there is a hierarchy of legal standards. In principle, respect for and the application of human rights, such as they are universally recognized in international conventions, are superior to the rights guaranteed in a financial contract. When a loan contract is signed, the government can give priority to carrying out its obligations to respect human rights by excluding clauses from the contract without its international responsibility being called into question. This problem is illustrated in the fight for respect of economic social and cultural rights embedded in the International Covenant on Economic, Social and Cultural Rights (ICESCR), adopted in 1966 and to date ratified by 152 States. [16]

Moreover, principles of national and international law already allow for the questioning of contractual obligations if particular circumstances apply (apart from cases of *force majeure,* state of necessity, etc). We can invoke the *Rebus Sic Stantibus* principle that is an implicit clause in contracts, in virtue of which any convention is supposed to have been understood "things remaining as they are" and that to stay valid, the condition is that things remain in this state. Any substantial alteration can give rise to amendments to these provisions. A unilateral change of the original conditions of the debt contract (such as an increase in the interest rate, see below) can be added to this principle. This would enable the revision of the original contracts to be envisaged.

[16] The principles of this covenant are not yet being effectively applied. CETIM and other NGOs have been militating for years within the UN for a protocol to the ICESCR to be adopted. This protocol would be the international instrument for channelling complaints and effective monitoring of the application of ICESCR. See the CETIM didactic brochure published on this subject: "The case for a protocol to the ICESCR". To obtain it apply to CETIM or down load it from www.cetim.ch.

The purpose of an audit is to detect these circumstances in order to justify the cancellation of the debt, making use of these legal principles.

3. *Illegitimacy or illegality of the debt?* [17]

Here the question is to know whether a loan contract can be attacked on grounds of illegality or illegitimacy, or both.

Legality is the character of an act or a deed that is in compliance with the law, that is all the legal rules applicable in a given country at a given time. We speak of *legitimacy* when the character of an act satisfies a standard or a normative principle indicating what it must be or must do. Legitimacy calls on values (that are often subjective, which complicates the problem).

It is not possible to speak of the illegality of the debt from a global point of view because, even in the case of numerous presumptions of illegality, each debt must be examined and judged individually. A debt is illegal if there is a violation of the law, as in the case of an odious debt [see below]. On the other hand, it is possible to speak of the illegitimacy of the debt because this term deals with the aim of the debt and of its impact; its formation is a product of the evolution and the functioning of the international economic system and of capitalism. A debt is also illegitimate if there is a perverse use of the law, or non-law (tax havens, zones of legal void, etc).

So the terms of legitimacy and legality are two distinct but related notions. In short, and in general, the two notions are intertwined and it is necessary to consider the question of the angle of attack on the loan contract on both levels. The debt of the Third World countries must be judged in terms of illegality and illegitimacy. Nevertheless the term of legitimacy is more inclusive, this notion refuses the charity approach and places the debt in the perspective of justice and law. [18]

[17] See the cahier Archimède et Léonard, op.cit., pp. 7-19.
[18] Idem, p. 91.

> *For example, an increase in interest rates is not illegal in itself, but the unilateral decision to suddenly increase these rates is. Hence it is the unilateral change of circumstances, as happened in the 1970's, that may be condemned; this decision initially came from the United States. Yet it is responsible for the unprecedented increase of most Third World countries' external debts, with the effects that are known.*

A. What aspects of the formation of the loan contract might be legally questioned?

1. *What was the character of the contracting parties at the time the contract was concluded?*

The audit must examine and reflect on the political and historical nature of the regime and the ability of the creditor to take this information into account when deciding to grant the loan. If an illegitimate government contracts a debt, the succeeding government can perfectly well refuse to honour the commitment because of the illegitimacy of its predecessor. It is difficult for the creditor to ignore the legitimacy or otherwise of the government with which he is conducting business.

2. *Can procedural irregularities be detected?*

The question that must be asked in this respect is: have the contracting parties violated the standards that govern internal procedures for contracting a loan? If irregularities are found this may nullify the engagement. An audit should shed light on these irregularities.

To answer this question it is therefore necessary to try as far as possible to take stock of the following elements:

- Given that a debt contracted by a State is equivalent to a tax that citizens will have to pay at a later date, the principle according to which a tax that has not been legitimately decided cannot be forced on citizens ("no taxation without representation") should prevail. The farm of government responsible for contracting loans and defining policies in

the matter of public debt in republican systems falls on the legislative power. For that, it is necessary to analyse in the first place: what are the constitutional standards or domestic laws that authorise and regulate public debts? What State organ, both at the domestic and at the external level, has the constitutional authority to contract loans?

- In reality, whether because of the technical complexity of financial operations or because it is impossible to negotiate in the context of a deliberative body (such as the national Parliament), in general standards or laws on public debt management are delegated to the administration, that is to the executive power. Are there such standards or laws?

- Are there general standards or a finance administration law that lay down the delegation of authorities in specific cases? For example, in Argentina, the financial administration law allows the executive power to "restructure the public debt if that implies reducing amounts, timing and/or rates of interest" This authorisation, that at first sight seems proper since the executive is authorised to lower the level of indebtedness, is in fact a real trap.

Illustration

The financial catch of debt swaps or how debts can snowball

Faced with the accumulation of debts falling due at the same time, the repayment of which was therefore becoming impossible (due to debtor countries' lack of liquidity or insolvency), creditor circles proposed operating debt swaps. To try and gain time in these operations (which often amounts to lengthening the fuse of a debt bomb about to explode), it is normal practise to extend the deadlines for repayment, in exchange for an increase in the rates of interest applied to the newly set capitalization compared to the rates previously agreed.

But the crucial question is whether these swaps increase or reduce the debt. Is it advisable or not to carry out these swaps?

It is possible to make an assessment of these operations from a technical point of view. The transfer of funds that the debts in their old form would have implied must be compared to that engendered by the new debts. This assessment is known as the calculation of the net present value (NPV). This calculation is made for each of the

debts (namely the outflow of money that the old contract would have implied and that which would result from the new debt, then subtracting the new from the old and comparing the results obtained). If the NPV is positive, that means the swap has increased the debt. If the NPV is negative that means that the debt has decreased. If the NPV is close to zero, the swap has neither increased nor decreased the debt. To hide the enormous increase in the debt resulting from these financial operations, the "trick" is to manipulate the rate of deduction with which the calculations are made.

For example, in June 2001, the Argentine government, confronted with debts falling due, decided to undertake a financial operation of such a magnitude that it was called the "mega-swap" ("megacanje" in Spanish). More than US$ 30 billion of debts were swapped with an annual average rate of interest of up to 5% and an average maturity of 7 years. The new debts had a nominal value (capitalization) of US$ 32 billion, and an average annual rate of interest of 15% and a lengthening of the maturity of about two years. As a result of the brutal increase in the rate of interest of the new debts issued, the outflow of payments climbed to US$ 55 billion, whereas in the beginning the swap involved an amount of US$ 30 billion. The Argentine government and the IMF announced that the debt swap had been a success because the NPV, according to them, was practically neutral. Where was the catch? To hide the phenomenal increase in the debt, the revalued rate of interest was used to calculate the NPV, that is to say a rate of interest of 15% was used for this calculation instead of the old rate of 5% on the pretext that this was the new risk rate of the Argentine State. Financial nonsense approved by the IMF.

- The executive power uses the annual fiscal budget law to obtain authorisations to increase the debt. Generally these authorisations are granted for global amounts, without specifying the rate of interest, the type of currency, the conditions and use of the loan, etc. How were the public debt operations included in the annual fiscal budget law? Did the legislative power demand a prior study to analyse the sustainability of the debt or a financing plan?

- How is the gross and net public debt recorded or booked in the national public accounts? What State department or office deals with the national public accounts, State property, the debt, the investment accounts? Are there any analyses of State property, of solvency, of liquidity, etc? State approval for private operations is another form of increasing

public debt. Does the fiscal budget reflect the guarantees of the State to banks and/or private companies?

- When a government issues debt certificates and/or contracts loans on the international markets, the renunciation of the sovereign immunity of the State and/or the delegation of jurisdiction to foreign courts is generally demanded. What State organ is granted the power to authorize the renunciation of such immunity and/or the delegation of jurisdiction to foreign courts?

3. *Can lacks of consent be detected?*

If one or several lacks of consent are noted in a contract this leads to it being considered null and void. For example a typical lack of consent is that of threat: in the context of bilateral relations, a loan contract concluded in a relationship of manifest inequality between the creditor (dominant position) and the debtor, can be considered to be invalid because the debtor must not be subject to external pressure (violence, blackmail, etc.). The borrowing State must be able to exercise its full sovereignty.

Examples of lack of consent are to be found in the faults listed in the Vienna Convention that governs international treaty law. This instrument contains six articles on the forms of lack of consent, of which *the violation of internal law* regarding the competence to conclude treaties (article 46); this has, moreover been dealt with previously in the section on the capacity of the contracting parties); the specific *restriction* of the authority to express the consent of a State (article 47); *error* (article 48); *fraud* (article 49) – fraud qualifies a situation of deception: when the manoeuvres practiced by one of the parties are such that it is obvious that, without these manoeuvres, the other party would not have consented; *the corruption* of a representative of a State (article 51) and *the threat or the use of force* (article 52).

The Vienna Convention does not seem to apply to all debt problems. However, it appears to be useful for jurists engaged in an audit to be aware of these articles.

4. Is it an odious debt?

Alexander Sack is the legal scholar who developed the odious debt doctrine: "If a despotic power contracts a debt, not according to the needs and the interests of the State, but to strengthen its despotic regime and to suppress the population fighting it, this debt is odious for the entire population of the State: it is a regime debt, a personal debt of the power that contracted it; consequently it falls with the fall of this power".[19]

The international financial institutions, in clear violation of international law and their own statutes, have knowingly supported regimes that have planned and ordered crimes against humanity. The World Bank has unfailingly supported the strategic allies of the United States, such as the Mobutu dictatorship in Zaire, the Brazilian and Argentine dictatorships, Pinochet in Chile, Suharto in Indonesia, Marcos in the Philippines, etc.[20] To this should be added the fact that the IMF, the World Bank and private creditors could not ignore that they were dealing with illegal, illegitimate and usurping regimes, whose very foundations were the absolute negation of all legality. Neither could they ignore that they were dealing with governments that had planned and carried out the most serious crimes against humanity. Following international practice and the terms of the Olmos verdict [see chapter 2 and below], we can say that, if the IFIs and the private finance companies provided funds (in the form of loans) to a dictatorship (usurping government) that moreover planned and carried out crimes against humanity, these international institutions can *under no circumstances* claim that:

19 A. Sack, *Les effets des transformations des Etats sur leurs dettes publiques et autres obligations financières,* Recueil Sirey, Paris, 1927.

20 See F. Chauvreau and D. Millet, *Dette odieuse,* cartoon strip, CADTM/Syllepse, 2006.

a. such an act is an act of State legally valid under international law;

b. subsequent constitutional governments should be bound under international law to pay back the debts of the dictatorship in question.

These are debts that are null and void or substantially invalid. It is up to the creditor to prove that the debts were contracted in the interests of the State and its population, legally and by a legal and legitimate government. International law specifies that all government acts, including legal acts by which a usurping government has contracted public debts, are ineluctably null and void. The subsequent constitutional government is not bound to pay the external debt, even if the act concluded is an act of State under international law. On the other hand, the obligation to repay this debt falls on those who under the usurping regime were responsible for such acts. Consequently the creditors have no legal title to claim, even if the loans had been granted as the result of signed international agreements or contracts.

To maintain under these conditions that there is an international obligation to repay the external debt in full, under the pretext of the principle of the continuity of the State, is in clear contradiction with the obligation to protect human rights. It can be noted that such a pretension, that has its source in western doctrine, is an attempt to dissociate the international protection of human rights from international economic relations. This is in reality a call for the impunity of those responsible for massive violations of human rights.

International law considers that every government must take account of the nature of the regime that contracted the debt as well as the use that was made of the borrowed funds. This is exercising its rights and its authority to make a meticulous analysis of the state of public finances.

Illustration

Some useful precedents to bear in mind…

There are some historical precedents for the refusal to pay debt on the basis of political criteria, before the concept of odious debt was forged. When the United States occupied Cuba in 1889, Spain, the island's former colonial power, asked the United States to repay the Cuban debt to Spain. The United States refused because it considered that the debt had been "imposed on the Cuban people without its consent and by force of arms". The United States considered that the lenders had run risks and had lost. So the Cuban debt was not repaid. When Great Britain annexed the Boer Republic (South Africa) in 1890, it refused to pay the loans contracted for the needs of the war by the former republic. The Treaty of Versailles of 1919 exempted Poland from paying the debts contracted by the Prussians (the Germans) for colonizing Poland.

In 1919, when the Costa Rican dictator was overthrown, the new government refused to repay the loans contracted by the former government with the Royal Bank of Canada. In 1923, Judge Taft, Chief Justice of the United States Supreme Court, was appointed independent arbiter by the two countries in dispute. He declared that "the Royal Bank's case does not simply depend on the form of the transaction, but on the good faith of the bank when granting the loan for the real use of the Costa Rican government under the Tinoco regime (ed: the deposed dictator). The Bank must prove that the money was lent to the government for legitimate purposes. It has not done so." [21]

Recently, the United States argued and exercised great pressure to have the Iraqi debt contracted by Saddam Hussein cancelled. And successfully! Switzerland, France, Russia and other countries complied. But while the odious debt argument was advanced to begin with, it was quickly withdrawn for fear of contagion, and the cancellation of 80% of the Iraqi debt was obtained [22] within the Paris Club, an informal body bringing together 19 creditor countries.

21 See, among others, Eric Toussaint, *La finance contre les peuples. La bourse ou la vie¸* Editions CADTM/Syllepse/CETIM, 2004, pp. 512-520, and the article of Joseph Hanlon, "Lenders, not borrowers, are responsible for 'illegitimate' loans", *Third World Quarterly,* op. cit., pp. 211-226.

22 See D. Millet, « La dette de l'Irak n'a jamais existé », *Le Monde,* 23 November 2004.

5.
Can other sources of illegality and illegitimacy be detected?

There are other general principles of international law that are useful to know when carrying out a debt audit and that can nullify an abusive contract: [23]

- *usury:* if the creditor lends at an interest rate greater than the maximum legal rate;

- *enrichment without (good) reason:* non-enrichment at the expense of another is a general legal principle. This is recognized both in Roman law and in common law (as in the United States). This principle is important because it enables the entity that is the victim of impoverishment to obtain compensation from the person who enriched himself at his expense. [24] Corruption can be introduced in this framework.

- *excessive cost:* the indebted State may refuse to pay a service if for unforeseeable reasons the cost of this service increases excessively;

- *injury:* when one of the parties profits from the weak or unstable situation of the other to obtain an important economic advantage;

- *abuse of right:* when one of the parties, in exercising a right, behaves disloyally or abusively, is badly intentioned or contravenes the spirit of this right.

In addition, a loan can be considered illegitimate if the contract contains abusive clauses [as was already shown in chapter 3, when examining abusive clauses revealed by the Brazilian citizen audit]. It is the audit's role to uncover these clauses and to expose them.

23 To know more about this, see Laura Ramos's book, op.cit.

24 This principle is also recognized in the Algiers Declaration of 1976, as an instrument for claiming compensation. The recognition is interesting as it occurred in the context of a meeting of "Third World" activists and not of States, in order to specify the content of peoples rights. This declaration emanates from the International league for the rights and liberation of peoples created the same year on the initiative of the Italian Lelio Basso. Moreover the Declaration recognizes this principle especially in cases of infringement of development rights, that is to say, when some State's development is built at the expense of the non-development of other States. In this way the Algiers Declaration includes investments of foreign origin.

It must be established whether there are clauses that can be challenged:

> *"the capitalisation of interest, a dispute settlement clause that allows disputes to be brought before the courts of a country whose regulations favour the creditors, etc.; or that lay down obligations that are excessive in relation to the payment capacity of the country. It must also be asked whether the cost/benefit ratio is arbitrary, absurd or disproportionate since the considerations are obviously imbalanced or since one of the obligations is excessively burdensome in relation to another. Through this analysis grid, it is possible to determine whether illegitimate debts have been paid. Finally, it must be asked whether there have been fundamental changes in circumstances since the agreement was initially signed (and not intentionally provoked by the debtor). These changes include an excessive rise in interest rates or a major devaluation of the local currency, up to and including natural catastrophes that might have an incidence on hard currency export earnings."* [25]

Conditions that infringe the public good of an indebted State or that undermine national sovereignty must also be considered unacceptable. Conditions arising from IMF structural adjustment plans, that require drastic cuts in the health, education and other social service budgets of course do not contribute to the well being of the population. Joseph Hanlon mentions two categories of condition that are also unacceptable: on the one hand, the creditors must not use a renegotiation of the debt to add conditions that, in other circumstances, would be unacceptable; on the other hand, the public guarantee of an illegitimate debt does not make the debt any less illegitimate. The condition requiring the government to guarantee or nationalise an illegitimate debt is also unacceptable.

B. Examining the creditor's conduct

The term "odious debt" has been explained above. The following elements however do not only concern odious debt.

Defining the (criminal and civil) liabilities in the process of debt accumulation is essential in the context of a claim

25 Laura Ramos, op.cit., p. 36.

for debt cancellation. The debt audit will enable light to be shed on these liabilities.

A loan contract may be considered to be illegitimate if the creditor is, in any way, responsible for crimes, serious offences, violations of human rights and the standards and principles of international law and/or of the debtor country's law.

The creditor is assumed to be aware of the nature of the debtor State's regime and to take an interest in the use of the funds lent, their rate of return, etc.

The creditor's responsibility is not however clearly defined in international financial relations, or in international law. But it is in national law.

> *In France, for example, a banker can be sentenced to pay damages if he finances an illicit or unsubstantial activity, or an enterprise in dire straits, if the credit turned out to be ruinous (the loan payments of the company turned out to be incompatible with its resources) and finally if the credit is inopportune (the return on the investment was doubtful). The banker has the duty to advise and not to grant excessive financing.*

The aim of these laws is to correct an unequal balance of power and particularly to protect the financial market because a badly granted credit can have a considerable and dangerous impact on the whole financial system and the functioning of bank credit. [26] These limitations are far from being the rule in international business law but in the context of an audit they enlighten us on the need to bring pressure for co-responsibility in the matter of debt to be recognized internationally.

Before any advance of international law in this area, it is useful in the findings of an audit to define all the responsibilities in order to prepare a solid and consistent dossier to submit to a court to have it cancel the debt.

1. The failure to examine the capacity of the future debtor meticulously

26 For more details, see the article of Bernard Legendre, « Responsabilité bancaire : une jurisprudence française à transposer dans l'ordre international ? », in *La dette au delà du contrat,* Edouard Dommen (dir.), Observatoire de la finance, supplement n°2, pp. 97-99. Also see the summary of Jean Stoufflet in the cahier Archimède et Léonard, op. cit., pp. 88-91.

Case studies

An innovative jurisprudence: the case of Cameroon vs. the German company Klöckner

This is an affair that was dealt with by the International Centre for the Settlement of Investment Disputes (ICSID), an institution created within the World Bank and about which we have serious reservations. Indeed, since it is presided by the Chairman of the World Bank, it is both judge and party. Given that the World Bank is a creditor institution, that it has already demonstrated an obvious lack of objectivity and impartiality and that it is in our view illegitimate (like the IMF), it is almost inevitable that the verdicts of ICSID, apart from its opaque functioning, often rule in favour of big transnational companies (for example in the cases of Metalclad vs Mexico and that of Waste Management vs Mexico the partiality of ICSID was evident). In addition, ICSID standards do not include those on human rights and the environment. This settlements institution is, by definition, not ideal for such judgements. Nevertheless, the exception proves the rule, and ICSID's verdict is very interesting in the case in point because of the arguments developed by the court.

"In 1971 a big German company, Klöckner, proposed to the Cameroon government (...) the installation of a 'turn key' fertilizer factory on the basis of a very positive feasibility and profitability study, carried out by Klöckner. Klöckner undertook to supply the factory, to ensure its financing and manage the business for a certain time. Cameroon had to guarantee the credits. The completed factory even broke-even. In addition, the material used did not stand up to Cameroon's climatic conditions. The factory only produced a small percentage of its capacity and was finally closed after several years of output much lower than that announced by the studies: another 'development ruin' was born.

The contracts foresaw an unconditional obligation to pay backed-up by the issuance of promissory notes. Confronted by this situation, the arbiters were asked to decide if there was an obligation to pay on Cameroon's part. (…) The arbiters refused to rule on bad faith, the corruption, the possible fraudulent intent (…). On the contrary, they based their decision on certain classic general notions of civil and commercial law. By applying these principles, the arbiters reached the decision that Cameroon was not obliged to repay this debt: a considerable component of the Cameroon external debt was thus written off".

The grounds of the verdict were in summary:

- Klöckner had undertaken to deliver a "turn key" factory ready to operate, but that was never the case;

- Klöckner did not deal with its partner with the necessary frankness in their relations, it hid vital elements of information at critical moments of the project;

- Klöckner failed in its obligations.

The partial non-fulfilment breaks the balance of relations between the partners that, on the basis of civil law, frees Cameroon from its obligations.

Unfortunately the verdict was quashed in 1985 by an ad hoc committee, in conformity with the provisions of article 52 of the ICSID convention. The reasons for quashing were that the Court gave few indications on the limits of the obligation to "reveal everything to its partner". Moreover, according to this committee, the non-fulfilment plea implied the suspension of the obligation and not its cancellation. This case was the subject of a new judgement the quashing of which was refused in 1990.

Information and citations drawn from R. Knieper, « La responsabilité comme principe actif : un exemple de jurisprudence », in *Légitimité ou illégitimité de la dette du tiers monde,* cahier Archimède et Léonard, AITEC, special issue n°9, Winter 1992, pp. 81-89.

The Olmos verdict, Argentina

The federal judge J. Ballesteros carried out an audit which ended in judicial action on the Argentine debt accumulated under the military dictatorship. This verdict clearly demonstrated the concurrent liability of the creditors such as the IMF and the Inter-American Development Bank (IDB) in the Argentine State's over indebtedness, because their only motivation was to dispose at any price of the worldwide excess of petrodollars. [27] The verdict also recognized the liability of private lenders and the Northern banks, but also that of the debtors.

For more information on this verdict, see chapter 2.

2. *A reckless risk*

Another lead to explore is the *moral hazard (or moral vagary)*. Creditor economic agents are prompted and encouraged to invest in high-risk shares, because they have taken out risk insurance that will cover their probable losses. Creditors know they will be repaid, it does not matter by whom, and they could not care less about the quality or the seriousness of the project [also see the section on export credit agencies, chapter 3]. As far as the external public debt is concerned, the creditors are sure that the World Bank or

27 See pp. 122-124 of the verdict.

the IMF will always be there, in the last resort, to straighten out a State's perilous financial situation. There have been any number of abuses in this matter and the IMF has even condemned the practice, because, on its own arguments, it can only weaken investment "discipline". [28]

Moral hazard must be considered as directly involving the responsibility of the creditor and the debts contracted despite this risk must be considered as illegitimate, therefore not to be repaid. Creditors should be obliged to assess the real costs of their investments, and include the fact that they may not be repaid. This "discipline" should thus encourage fewer and fewer investors to invest in dubious projects or lend money to corrupt governments. [29]

C. Examining the debtor's responsibility

The creditor may be accused of having abused the confidence of the debtor or of having deceived him. However it is also important to examine the debtor's degree of responsibility in the debt. For that, in the first place, the status of the persons who signed for or negotiated the debt contract must be identified and information obtained on them.

Secondly, it is essential to investigate whether any of the following offences has been committed, because some faults and offences can only be accredited to the debtor:

- *fraud:* such as claiming the existence of imaginary debts or pretending to pay a debt that has already been paid;
- *corruption:* when a public official accepts a commission or a bribe during the negotiation of a loan or the allocation of the funds of the loan;
- *falsifying documents;*
- *embezzlement of public funds:* when the money coming from loans received by the State is allocated for a purpose which is not that for which the debt was contracted;

28 IMF, *World Economic Outlook* 1998, Washington DC, 1998.

29 See among others the work of Joseph Hanlon, "Defining Illegitimate Debt and Linking its Cancellation to Economic Justice", Open University, Milton Keynes, June 2002.

- *extortion:* when conditions are imposed under threat of having the debt renegotiated;

- etc.

Public officials commit the offence of not accomplishing their duties when they take or execute resolutions or orders contrary to the constitution or local laws or when they do not execute the laws the carrying-out of which is incumbent on them. Moreover, "they commit the offence of fraudulent administration if, by abusing their functions, they commit or order any arbitrary act to the detriment of the public administration or individuals, or when by deceitful acts or signing of contracts they undermine the administration for their own (or more distant) advantage. Governments of the South commit offences of treason to their country if they subject its destiny to foreign interests. In general, all these common offences are punished as crimes by the domestic legislation of the countries in which they take place and create a duty to compensate the victims for the damage caused." [30]

Finally, "the second aspect to analyse is the context of circumstances in which the process of contracting a loan or restructuring the payment took place. If the payer of the debt was not in a state to give free and informed consent, we can consider that the loan is illegitimate and that consequently, it cannot be claimed. Seeking to discover if the population who must pay the external debt consented to the international financial operations that generated the debt leads us, in the first place, to analyse the nature of the governments who contracted the debts and, then in the case of democracies, to examine to what extent their behaviour is democratic." [31]

30 Laura Ramos, op.cit., p. 43.
31 Laura Ramos, op.cit., p. 28.

D. Can notions of private law inspire the examination of a loan contract?

The paradox is as follows: US or European domestic law for example, protects the debtor from the abuses of indebtedness, by imposing credit limitation clauses, non accumulation clauses according to the salary earned, credit ceilings, etc.; yet this does not exist in international law. So on the one hand, there are precisely framed domestic legal orders, and on the other hand a rather vague international legal order.

However, the general principles of international law include the general principles of law "recognized by civilized nations" and those included in the standards of civil law of European countries that have international scope. Lawyers can contribute to making this possibility become reality and advance the international legal order.

> *The* French civil code, *for example, specifies that an engagement without cause or having an illicit cause is null and void. If it is proved that a loan has been misappropriated, it can be deduced that the engagement is without cause and the debtor need not repay it. The French civil code also condemns all contracts where lack of consent has been established, such as the use of violence, but also fraud. A loan that infringes the national banking regulations is null and void (if the credit operation was undertaken, or is supposed to have been undertaken, in France).*

When carrying out an audit it is therefore useful to discover what are the national Central Bank legislation and charter look like, as well as banking and financial system legislation, the standards and regulations on deposits, loans and bank reserves, State guarantees for deposits and exchange insurance, the legislation and standards on capital movements, the deposits of national and foreign residents (flight of capital) and the legislation on off-shore companies.

British law also establishes a certain a degree of legal protection for the debtor. The British Consumer Credit Act *of 1974 (section 138) states that the negotiation of a loan is excessive if it requires the debtor to make payments that are grossly excessive, or if this negotiation grossly contravenes the common principles of fair negotiation.*

So British courts have the power to cancel debts or change the terms of the loan contract. The court can seek to establish whether the creditor and debtor were really on an equal footing when the contract was negotiated, if any pressure was brought to bear, etc. Moreover, according to this law, the burden of proof is on the creditor who must prove that the negotiation did not amount to extortion. [32]

Chapter 9 of the US legislative code: an example to internationalize?

Chapter 9 of the US legislative code concerns the bankruptcy of public bodies and contains interesting provisions that might justify the cancellation of certain developing country debts, if the lawyers involved in an audit can adapt them to international reality. Chapter 9 provides that municipalities can "call for protection against their creditors" when they prove to be insolvent. This automatically entails the stopping of debt repayments.

This act allows the municipality to protect living standards and maintain basic social services essential for maintaining health, security and well being of its citizens. This chapter establishes the principle of protecting the debtor and respecting his *sovereignty*. It also provides for the intervention of a neutral arbiter whose mandate is to find a fair compromise.

Professor Kunibert Raffer and others have been working for some years on the possibility and the interest of transferring this federal law to the international level, as an answer to the debt crisis, with the creation of a fair and transparent international arbitration council.

For further details refer to the work of Kunibert Raffer, professor of economics at the University of Vienna. Also see the research of Jubilee Framework and the New Economics Foundation: http://www.jubileeresearch.org/analysis/reports/jubilee_framework_fr.pdf

32 For further information, consult the work of Joseph Hanlon, "Lenders, not borrowers, are responsible for 'illegitimate' loans", *Third World Quarterly,* op.cit., pp. 211-226.

E. Conditions and perspectives of recourse to criminal justice

The criminal prosecution authorities have incisive means of investigation that may be useful in establishing the effective use of the amounts made available to the debtor State. However, these authorities may only have the case referred to them under certain conditions and the results of their investigations are never guaranteed.

At present, there is no supranational jurisdiction competent to investigate crimes and offences that might have been committed in the context of a loan to a particular State. Therefore, a case can only be submitted to the national legal authorities. They will intervene according to the rules specific to each State and within the limits of the international agreements that this State has concluded with other States. This means that the following explanations are necessarily confined to generalities, leaving aside the particularities of each national legislation.

1. The conditions

Criminal law can only act if it is suspected that an offence has been committed in the use of the borrowed funds. This suspicion must be based on precise facts and the authority that pursues the criminal action must be competent to prosecute the perpetrator or perpetrators of the offence.

In international matters, competence generally depends on the place where the offence was committed, on the nationality of the perpetrator or on that of the victim. Each national law has different rules in this regard.

If it is suspected that funds loaned to the debtor State have been misappropriated by means that are criminal in that State, the authorities of the debtor State will generally be competent to act.

The authorities of a State where the misappropriated funds have been deposited can also be competent, if that State considers money laundering to be an offence, that is notably the case in all the major financial centres in Europe and North America.

2. The measures

An authority competent to conduct a criminal investigation generally has effective means of constraint. It can conduct interrogations by making anyone able to supply useful information appear before it, eventually using the police. It can carry out searches and seize any document that could serve as proof. In financial matters, it can in particular oblige banking establishments to provide it with information and documents and it can order the seizure of accounts suspected of receiving funds of criminal origin. It is important to point out that even in States where there is banking secrecy, this secrecy cannot be subjugated to criminal investigations.

3. International cooperation

If the judge or the national prosecutor in charge of the investigation needs to perform acts outside his national territory, since he cannot carry them out himself he will be obliged to ask for the assistance of the judge in the State where the evidence being sought is to be found.

This assistance must be asked for by a written request addressed to the competent authority of the State applied to. The request should indicate the facts that justify the opening of the criminal action and specify what evidence is to be collected. It should be noted that a "fishing expedition" or blanket requests are generally not admissible.

Whether the authorities of the State requested will agree to execute the request and transmit the evidence asked for depends on the conditions foreseen by the international treaties applicable in that State and secondly on its domestic legislation.

The reasons invoked most often for refusing to execute a request for international cooperation are the following:

- the facts described do not constitute an offence in the State applied to;
- there is no guarantee of reciprocity on the part of the applicant State;

- the right to a fair trial is not guaranteed in the applicant State;

- the evidence asked for is not foreseen by the legislation applicable in the State applied to.

It is important to realize that, even in cases where the legal conditions for mutual assistance are met, many States show unwillingness to execute foreign requests. And there is no "legal" means of obliging a foreign State to pursue a request.

4. Recovering the misappropriated assets

The debtor State whose borrowed money was illicitly misappropriated has an obvious interest in recovering it. If these sums were deposited abroad, it is theoretically possible to recover them.

For this purpose, the mutual assistance of the State where the funds have been found may be called on according to the conditions and the modalities mentioned above. In this case, the application should specify that the provisional seizure of the assets found is requested. Afterwards the State applied to will be invited to return the funds to the applicant State.

In some States, the State that is victim of the misappropriation can intervene directly, by the civil or criminal route, to obtain the return of the funds misappropriated at its expense. In this case it is strongly recommended to take counsel from a local lawyer.

Annex

Putting an end to the World Bank's impunity!

In his latest book *La Banque mondiale : le coup d'Etat permanent,* Eric Toussaint lays out concrete ways of bringing the World Bank to justice. The World Bank does not benefit from immunity either as an institution or as a legal entity. It might therefore be prosecuted under certain conditions. It must be brought before a national legal authority in a country where it has a representation or in which it has issued or guaranteed securities.

The World Bank should be subject to legal proceedings because its policies have deliberately harmed hundreds of millions of people in the world. Its financial support for gigantic projects such as big dams, extractive industries, thermal power stations, etc., the bad effects of which on the population outweigh the good, can be mentioned. In particular, The World Bank has supported, from time to time or over the long term, dictatorial regimes responsible for crimes against humanity, whether in Latin America, South Africa or South East Asia, or helped to destabilize democratic forces, as was the case in Indonesia, Brazil or Chile. The World Bank has also granted loans to former colonial powers to help them exploit the natural resources of their colonies. After the wave of independence, these loans were transferred to the recently liberated countries, although they had been contracted by the former colonial home countries. Finally the World Bank may be attacked for its structural adjustment loans since the 1980's and their catastrophic consequences for the lives of millions of people throughout the world and on the structure of national economic, administrative and social systems.

According to Eric Toussaint, organisations representing the interests of people affected by the World Bank loans and/or by the support given by the Bank to dictatorial regimes could bring class actions in their national courts. Holders of securities could also envisage such actions, accusing the Bank of having badly used the money lent to it.

What is important is that the Bank gives an account of its deeds at once! The policies and actions of the World Bank must be punished by judicial decisions. Under the pressure of social movements they will be.

For more information, see chapter 23 of Eric Toussaint's book, *La Banque mondiale : le coup d'Etat permanent. L'agenda caché du Consensus de Washington,* CADTM/ Syllepse/CETIM, 2006.

CALL
for the Building of an International Network on the Debt Audit

This manual is meant to be a tool for popular education, helping to encourage social movements, members of parliament and civil movements to take up the question of the debt in their respective countries. We hope that the indications furnished here can be useful towards this end and that this manual will also help to build an international network on the audit of the debt.

From this perspective, a non-exhaustive bibliography, as well as a list of pertinent websites, has been put in an appendix. We provide a list of useful contacts for specific or particular information, or even for technical assistance.

In order to share all the necessary information (experiences, thoughts, propositions, etc.) and to centralize, the International Debt Observatory offers a web page:

http://audit.oid-ido.org
contact : info@oid-ido.org

Let us use all these resources to build an international network on the audit of the Third World debt!

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