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What Iraq and Argentina Might Learn from Each Other

Anna Gelpern*

I. INTRODUCTION

Financial collapse usually triggers a flurry of market, academic, and policy innovation.¹ The Latin American debt crisis of the 1980s produced the Brady Bonds and led to the rise of today's emerging markets. In the late 1990s, crises in Pakistan, Ecuador, and Ukraine helped teach the markets how to restructure international sovereign bonds.² Crises in Mexico, Russia, Brazil, Turkey, and throughout East Asia raised doubts about the international system's ability to manage vast and rapid capital flows, and prompted a big-picture reassessment under the rubric "international financial architecture." This included most famously the sovereign bankruptcy proposals discussed elsewhere in this volume.

The sovereign debt workouts now underway in Iraq and Argentina continue this trend. Each country is trying to restructure more than \$100 billion in defaulted external debt this year—perhaps before this Essay goes to print.

* Visiting Fellow, Institute for International Economics, Washington, D.C. I am grateful to Robert Ahdieh, Bill Bratton, Anupam Chander, Caroline Gentile, G. Mitu Gulati, Brad Setser, and Edwin M. Truman for valuable comments, and to Carol Roehrenbeck, Renee Cullman and the staff at the Rutgers-Newark law library for help with the research. I thank Peter Kenen and Elise Carlson Lewis for the opportunity to present an early version of this essay at the IAF Annual Conference at the Council on Foreign Relations in October 2004. Although I have advised emerging markets companies holding Iraqi debt, the views expressed in this article are my own and without reference to the views of any client. Errors and omissions are all mine.

¹ See Lee C. Buchheit, *How to Negotiate Eurocurrency Loan Agreements* 16 (Euromoney 1995). For reform proposals in the wake of Mexico's "Tequila Crisis," see Barry Eichengreen and Richard Portes, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors* (Centre for Econ Poly Rsrch 1995); see also James Hurlock and Troy Alexander, *The Fire Next Time: The Dangers in the Next Debt Crisis*, 15 *Intl Fin L Rev* 14 (1996). For a comprehensive survey of the crises and lessons of the 1990s, see Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins: Responding to Financial Crises in Emerging Economies* ch 4 (Inst Intl Econ 2004).

² See Lee C. Buchheit, *How Ecuador Escaped the Brady Bond Trap*, 19 *Intl Fin L Rev* 17 (2000) and Lee C. Buchheit and G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 *UCLA L Rev* 59 (2000).

Each may fail, leaving the debts unresolved for years. A full study of the law emerging out of the two restructurings must await their completion, and will likely take volumes. This Essay focuses on several early data points that Iraq and Argentina offer for the law of sovereign debt, and suggests lessons that the two cases might hold for each other and for future restructurings.

The two cases are rarely mentioned together.³ Most think of Argentina as the quintessential case of financial globalization gone awry—a lapsed market reformer that sank under the weight of (depending on your perspective) misguided liberalization or its own financial *chutzpah*,⁴ and took with it Argentine depositors, Italian retirees, Japanese banks, and offshore investment funds. Iraq's debt has a distinctly “preglobalization” flavor. Most of its obligations date back to the 1970s and 1980s, before the recent wave of financial liberalization. Iraq's money troubles came to light after three wars, a quarter-century of dictatorship, and over a decade of financial isolation under international sanctions. In the words of Iraq's own advisers, its debt restructuring is a “quintessential geopolitical case, a classic outlier” framed by strategic more than financial concerns.⁵

Aside from the obvious intuition that no case of government debt is immune from politics and no multibillion dollar restructuring is devoid of finance, Argentina and Iraq appear to be on opposite ends of the finance-politics spectrum. Despite, or because of this distance between them, each of these two restructurings offers insights for policy and doctrinal problems normally associated with the other. I focus on two such problems: shielding sovereign debtors from lawsuits, now most acutely associated with Argentina,⁶ and restructuring debts inherited from bad regimes, such as those Iraq had incurred under Saddam Hussein.

The first half of this Essay surveys recent efforts to protect governments from private creditor lawsuits in national courts. The general shield already in place—a bundle of sovereign immunities that have inspired a rich literature⁷—has looked increasingly fragile in the wake of emerging sovereign bond crises, an impression reinforced by hundreds of lawsuits against Argentina. But the project of bolstering these protections, which culminated in the IMF's statutory

³ For one exception, see Felix Salmon, *Seeking Forgiveness of Saddam-era Debt*, 35 *Euromoney* 72, 76 (Sept 2004).

⁴ Michael Mussa, *Policy Analyses in International Economics* 67, *Argentina and the Fund: From Triumph to Tragedy* 41 (Inst Intl Econ 2002).

⁵ Lee C. Buchheit, Lecture on Restructuring Iraqi Debt, New York Law School (Mar 30, 2005).

⁶ *Argentina Delays Debt Swap, Awaits US Court Ruling*, Reuters (Mar 31, 2005).

⁷ See, for example, Lee C. Buchheit, *The Role of Official Sector in Sovereign Workouts*, 6 *Chi J Int'l L* 333 (2005).

sovereign bankruptcy proposal, kept running into political and technical constraints that looked insurmountable. In the case of Iraq, the United Nations dispensed with these constraints and granted broad new immunities for Iraqi assets, all but destroying the prospect of near-term recovery from litigation.

In the second half, I look at the Odious Debt Doctrine, which is experiencing a revival after regime change in Iraq.⁸ The doctrine is often cited for the proposition that the countries emerging from nasty dictatorships can repudiate their debts, because those debts came about without the consent of or benefit for their people. But since its invention and throughout the past century—rife with oppressive regimes, revolutions, reckless borrowings, and debt defaults—the doctrine has languished in near complete disuse save for an occasional NGO campaign or bout of parliamentary rhetoric. Just as Iraq is an unlikely source of lessons for sovereign bankruptcy in the age of financial globalization, Argentina's experience since 2001 helps explain why governments do not use the Odious Debt Doctrine to disavow the obligations of their predecessors.

The cases of Iraq and Argentina suggest that alternative tools to shield countries from creditor lawsuits and reduce sovereign debts have helped preempt the emergence of new law in the areas of sovereign bankruptcy and Odious Debt. The fact that public and private creditors seem to prefer the existing tools weighs heavily against the new norms.

Together, the two cases illustrate that sovereign borrowers in dire financial straits inhabit a relatively flexible legal universe, in which they may use a mix of public, private, legal, and political resources to keep their creditors at bay. The case of Iraq suggests the outer limits of this flexibility. UN Security Council Resolutions shielding Iraq from its creditors show that the Great Powers stand ready to give less fortunate governments extraordinary legal protections in extreme political circumstances. But only a month before the key UN measure, its principal backers rejected the IMF's effort to institutionalize much milder protections in a statutory sovereign bankruptcy regime. The resolutions reaffirm implicitly the official sector's resistance to establishing sovereign bankruptcy as a routine financial event or institutionalizing its own entanglement with private contracts. This policy preference for exceptionalism⁹ also comports with market

⁸ See <<http://www.odiousdebts.org>> (visited Apr 15, 2005); see also <<http://www.jubileeraq.org>> (visited Apr 15, 2005).

⁹ This goes beyond the preference for discretion. See Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, 4 J Intl Econ L 613 (2001).

preference, reflecting fears that a standing insolvency regime would diminish market discipline and encourage sovereign defaults.¹⁰

Examining the two cases side by side also reveals a doctrinal gap in the law of sovereign debt. The erosion of sovereign immunities since the 1950s exposed governments to a real risk of creditor lawsuits in national courts. The result was a boon for the development of private law in an area previously dominated by foreign ministries.¹¹ A growing number of countries adapted sophisticated debt contracts and restructuring techniques used by large corporations. As markets developed in their debt, countries handled their periodic money problems as a challenge of financial reorganization, not as international (political) incidents.¹² Public international law seemed to shift behind the scenes, supporting and lightly guiding the development of private sovereign debt markets.¹³

If Argentina succeeds in restructuring its bonds on anything close to the terms it has announced, it will validate the capacity of this private machinery to deliver debt reduction. But Iraq is a reminder that financial relief alone may not be enough—financial restructuring elides fundamental public questions of governance and responsibility that are the province of domestic corporate and constitutional law, but that have no easy international counterpart. These questions lie at the heart of the public international law doctrine of Odious Debt. While this doctrine is a flawed tool for debt relief in today's markets, it may be worth reinventing to confront economic damage from corrupt, inept, and illegitimate governments that persist in every age.

II. IRAQ: BACKDOOR BANKRUPTCY?

On May 22, 2003, the UN Security Council passed a resolution establishing the framework for the occupation and reconstruction of Iraq. Among other things, Resolution 1483 immunized all of Iraq's oil and gas wealth from legal

¹⁰ Hal S. Scott, *Market Discipline for Financial Institutions and Sovereigns* 11–12 (unpublished draft manuscript), available online at <<http://www.law.harvard.edu/programs/pifs/pdfs/hscottmarketdiscipline.pdf>>; Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 Georgetown J Intl L (forthcoming 2005) (manuscript at 77–78, on file with author); <<http://www.emcreditors.org>> (visited Apr 15, 2005).

¹¹ See, for example, Buchheit, 6 Chi J Intl L at 339 (cited in note 7).

¹² See W. Michael Reisman, *International Incidents: Introduction to a New Genre in the Study of International Law*, 10 Yale J Intl L 1 (1984); see also W. Michael Reisman and Andrew R. Willard, eds, *International Incidents: The Law That Counts in World Politics* (Princeton 1988).

¹³ For example, the Paris Club of government-to-government creditors has no legal personality; agreements among members are documented in the form of nonbinding meeting minutes. Lex Reiffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery* 56–65, 91–95 (Brookings 2000); <<http://www.clubdeparis.org>> (visited Apr 15, 2005).

process until the end of 2007,¹⁴ and directed all UN member states to freeze the remaining Iraqi assets in their jurisdictions and transfer them to the Development Fund for Iraq, internationally supervised and also immune.¹⁵ To give the UN resolution the force of law in the United States,¹⁶ President Bush issued Executive Order 13,303 the same day, essentially tracking the Security Council's language—except that his order had no sunset date.¹⁷

One year and a day later, a joint US-UK draft of another resolution (marking Iraq's transition to interim self-government) went beyond blocking enforcement against Iraqi assets—it tried to stay legal proceedings against Iraq. In the draft, the Security Council:

Calls upon its member states to take appropriate steps within their respective legal systems to stay for a period of 12 months from 30 June 2004 all legal and other similar proceedings before their courts or other tribunals involving claims by or against the State of Iraq, its Government, or

¹⁴ The operative language reads as follows:

Noting the relevance of the establishment of an internationally recognized, representative government of Iraq and the desirability of prompt completion of the restructuring of Iraq's debt as referred to in paragraph 15 above, further *decides* that, until December 31, 2007, unless the Council decides otherwise, petroleum, petroleum products, and natural gas originating in Iraq shall be immune, until title passes to the initial purchaser from legal proceedings against them and not be subject to any form of attachment, garnishment, or execution, and that all States shall take any steps that may be necessary under their respective domestic legal systems to assure this protection, and that proceeds and obligations arising from sales thereof, as well as the Development Fund for Iraq, shall enjoy privileges and immunities equivalent to those enjoyed by the United Nations except that the above-mentioned privileges and immunities will not apply with respect to any legal proceeding in which recourse to such proceeds or obligations is necessary to satisfy liability for damages assessed in connection with an ecological accident, including an oil spill, that occurs after the date of adoption of this resolution.

Security Council Res No 1483, UN Doc S/RES/1483 § 22 (May 22, 2003). A subsequent resolution reaffirmed the basic commitment to immunize Iraqi assets, but carved out from it final judgments arising from obligations incurred after June 30, 2004 (presumed transfer of sovereignty). Security Council Res No 1546, UN Doc S/RES/1546 § 27 (June 8, 2004).

¹⁵ Security Council Res No 1483, UN Doc S/RES/1483 at § 23 (May 22, 2003) (cited in note 14).

¹⁶ UN resolutions are not self-executing under US law. See *Diggs v Richardson*, 555 F2d 848, 850–51 (DC Cir 1976).

¹⁷ The President, Exec Order 13,303—Protecting the Development Fund for Iraq and Certain Other Property in Which Iraq Has an Interest, 68 Fed Reg 31931 § 1 (May 28, 2003). In November 2004, he expanded the order to cover the assets of the Iraqi central bank. The President, Exec Order 13364—Modifying the Protection Granted to the Development Fund for Iraq and Certain Property in Which Iraq Has an Interest and Protecting the Central Bank of Iraq, 69 Fed Reg 70177 § 1 (Nov 29, 2004).

any of its agencies or instrumentalities, including its State-owned enterprises or similar bodies.¹⁸

This provision did not make the final text,¹⁹ perhaps because the drafters realized it would be both excessive and redundant: excessive for blocking access to the courts, and redundant since the practical utility of litigation was already near zero after Resolution 1483.

For those following the sovereign bankruptcy debate, the Iraqi solution had a *Presto!* feel to it. With nary a peep from the markets, the UN and its key member governments effectively immunized a bankrupt sovereign and implemented the most controversial early aspiration of the IMF's Sovereign Debt Restructuring Mechanism (SDRM), shelved just weeks before. Since oil production alone accounts for over 75 percent of the Iraqi economy,²⁰ the UN resolution and perhaps more importantly the US Executive Orders put Iraq's prime commercial assets outside creditor reach.

This move was radical against the background of sovereign debt workouts following Mexico's default in 1982. Although major financial powers do not like messy sovereign defaults—these often trigger costly humanitarian crises, economic decline, and financial contagion—they also do not normally go around immunizing other governments to keep private creditors (their own nationals) from bothering the debtors. Policymakers also jealously guard the preeminence of their markets and reasonably see respect for contracts as essential to market function.

The compromise that has addressed these concerns since the 1950s—a restrictive approach to sovereign immunity—allowed creditors to sue foreign governments in connection with commercial activities abroad (such as borrowing money), but did little to help them enforce judgments.²¹ A sovereign

¹⁸ Security Council Res Draft May 23, 2004, available online at <http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/24_05_04iraqdraftscr.pdf> (visited Apr 15, 2005). It is noteworthy that the draft would block not only claims against the Iraqi government, but also claims by it.

¹⁹ See Security Council Res No 1546, UN Doc S/RES/1546 (June 8, 2004) (cited in note 14).

²⁰ *Iraq—Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding* ¶ 8 (Sept 24, 2004), available online at <<http://www.imf.org/external/np/loi/2004/irq/01/index.htm>> (visited Apr 15, 2005).

²¹ Until the 1950s, sovereigns had enjoyed substantial immunity from litigation. In 1952, the US executive branch adopted a restrictive approach to sovereign immunity, which allowed governments to be sued in connection with commercial activities, including borrowing money abroad. See Letter from Jack B. Tate, Acting Legal Adviser, Department of State, to Acting Attorney General Philip B. Perlman (May 19, 1952), reprinted in 26 Dept St Bull 984, 984–85 (1952). It was later codified in the US Foreign Sovereign Immunities Act of 1976, the UK State Immunity Act of 1978, the Singapore State Immunity Act of 1979, the South African Foreign States Immunity Act of 1981, and the Canadian State Immunity Act of 1982, among others. See Philip Wood, 2 *Law and Practice of International Finance* §4.02(1), (3) (1990), also surveying case law

debtor's exposure was limited to the extent it had left nondiplomatic property lying around for creditors to seize. Since governments proved adept at keeping valuables away from their creditors, diplomatic and humanitarian fallout from litigation was contained, albeit not eliminated entirely.²² The large commercial banks that dominated sovereign lending in the 1970s and 1980s weighed the uncertain benefits of suing against the certain costs of disrupting long term relationships with sovereign clients, and refrained from going to court.

The advent of sovereign debt securitization in the 1990s seemed to threaten this balance. Bondholders replaced commercial banks as principal creditors to the sovereigns. Policymakers and some market participants worried that thousands of atomistic bondholders unconcerned with long term relationships would rush to the courthouse at the first sign of trouble.²³ This rush would be akin to a bank run, followed by a global scramble for scant sovereign assets that would exacerbate a crisis and block its resolution. To address this new fear, something like an automatic stay in bankruptcy was in order—a pause on private creditor enforcement that would allow for a collective deep breath before the work of orderly restructuring begins.²⁴

supporting the restrictive theory. See Scott, *Market Discipline for Financial Institutions and Sovereigns* (cited in note 10).

²² For a general discussion, see Jill E. Fisch and Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1075–88 (2004); Wood, 2 *Law and Practice of International Finance* at § 4.02(5); § 4.06(8), (9) (cited in note 21). In a sense, allowing lawsuits while limiting enforcement privatized the political pressure tactics that bondholders used after the defaults of the 1830s and the 1930s to convince recalcitrant sovereigns to pay up. See Rory MacMillan, *Towards a Sovereign Debt Work-out System*, 16 Nw J. Int'l L. & Bus. 57, 85 (1995). Instead of dodging diplomats from bondholders' home countries, borrowing authorities now paid lawyers to dodge liens on their external financial flows. Both are doable; neither is pleasant from the sovereign's perspective.

²³ See Hurlock and Alexander, 15 Int'l Fin. L. Rev. 14 (cited in note 1); Group of Ten, *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared under the Auspices of the Deputies* (1996), available online at <<http://www.bis.org/publ/gten03.htm>> (visited Apr 15, 2005); *Report of the Working Group on International Financial Crises* (1998), available online at <<http://www.imf.org/external/np/g22/index.htm#crises>> (visited Apr 15, 2005); Anne Krueger, *Speech at the American Enterprise Institute, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring* (Nov 26, 2001), available online at <<http://www.imf.org/external/np/speeches/2001/112601.htm>> (visited Apr 15, 2005).

²⁴ Group of Ten, *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared under the Auspices of the Deputies* at 21 (cited in note 23). Strictly speaking, neither the concept of a rush to the courthouse nor the automatic stay analogy was new by the mid-1990s. Sachs discussed the theoretical possibility of a rush to the courthouse more than a decade earlier, and shortly thereafter, the Second Circuit raised the possibility of a sovereign "automatic stay" modeled on Chapter 11 of the US Bankruptcy Code in its first *Allied Bank* opinion. Jeffrey Sachs, *Theoretical Issues in International Borrowing*, NBER Working Paper No. 1189 (Aug 1983); see also *Allied Bank Intl v Banco Credito Agricola de Cartago*, 733 F.2d 23 (2d Cir 1984), rev'd on rehearing, 757 F.2d 516 (2d Cir 1985). However, while commercial banks dominated the scene, experience and

A host of proposals followed, including amendment of the IMF Charter to sanction sovereign payment suspensions,²⁵ and modification of sovereign bond contracts to diminish the lure of litigation.²⁶ All these proposals failed partly because of fierce opposition from private creditors who complained that the changes would limit their already inadequate remedies.

But the crises kept getting bigger and nastier, and the search for a new compromise continued, spurred on by the specter of the world's largest sovereign bond default in Argentina. Early versions of the IMF's SDRM, unveiled just before Argentina defaulted in late 2001, had three basic elements: (1) protection from lawsuits—addressing the fear of a rush to the courthouse; (2) facilitating collective action among large numbers of creditors—addressing fear of holdouts; and (3) dispute resolution.²⁷ The sovereign bankruptcy proposal drew a new wave of criticism from the intended market and sovereign beneficiaries. Creditors worried generally about tilting the playing field in the borrowers' direction, and suspected the IMF of a power grab.²⁸ They forecasted reduced capital flows and higher borrowing costs for governments, who then joined in the protest. Many suspected the IMF would use SDRM to ease out of

expectations all clustered around one or two maverick litigants prompting other creditors to hold out, a fact pattern that never quite panned out since the cooperative majority was happy to pay the "maverick tax" to secure greater concessions from the debtor. See Kenneth Rogoff and Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001* at 7-9, IMF Working Paper No 02/133 (Aug 2002), available online at <<http://www.imf.org/external/pubs/ft/wp/2002/wp02133.pdf>> (visited Apr 15, 2005); William W. Bratton and G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 Vand L Rev 1, 59-60 (2004).

²⁵ Articles of Agreement of the International Monetary Fund, art VIII, § 2(b), available online at <<http://www.imf.org/external/pubs/ft/aa/aa08.htm#2>> (visited Mar 22, 2005). *Report of the Working Group on International Financial Crises* at 22 (cited in note 23), *Safeguarding Prosperity in a Global Financial System: The Future International Financial Architecture*, Council on Foreign Relations Task Force Report (1999), available online at <http://www.cfr.org/pub/pub3233/peter_g_peterson_carla_a_hills_morris_goldstein/safeguarding_prosperity_in_a_global_financial_system_the_future_international_financial_architecture.php> (visited Apr 15, 2005).

²⁶ Lee C. Buchheit, *The Sharing Clause as a Litigation Shield*, 9 Intl Fin L Rev 15 (Oct 1990); Anna Gelpern, *For Richer, For Poorer: Sovereign Debt Contracts in Crisis*, 1 J Intl Banking Reg 20, 25-29 (2000) (discussing sharing, trustees, barriers to acceleration, and enforcement); Fisch and Gentile, 53 Emory L J 1043 (cited in note 22); G-10 Working Group, *Report of the G-10 Working Group on Contractual Clauses*, 3-4 (Sept 26, 2002), available online at <<http://www.bis.org/publ/gten08.pdf>> (visited Apr 15, 2005) (concerning the role of a trustee).

²⁷ Krueger, *Speech at the American Enterprise Institute, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring* (cited in note 23) and IMF, *A New Approach to Sovereign Debt Restructuring: Preliminary Considerations* (Nov 30, 2001), available online at <<http://www.imf.org/external/NP/pdr/sdrm/2001/113001.pdf>> (visited Apr 15, 2005). See also IMF, *The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations* (Nov 27, 2002), available online at <<http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf>> (visited Apr 15, 2005).

²⁸ See Hagan, *Designing a Legal Framework to Restructure Sovereign Debt* at 75-78 (cited in note 10).

the bailout business.²⁹ For their part, rich countries worried privately that reopening the IMF charter would invite more reform than anyone had bargained for. In April 2003, the IMF Board officially shelved the proposal as politically unfeasible.³⁰

Of the three elements in the original SDRM proposal, the first—a stay on lawsuits—drew the most passionate advocates among the IMF shareholders and the most passionate detractors in the markets. IMF staff spent nearly a year going back and forth on whether and how to shield borrowers from legal action and/or enforcement against their assets. One rejected option would have blocked suits without requiring creditor consent to a stay.³¹ Another option would have reduced a creditor's recovery under a restructuring agreement by the amount of their lawsuit proceeds (the so-called hotchpot rule). A third option, favored by the Board, would allow a majority of private creditors to block enforcement by some or all private creditors for the sake of orderly restructuring and intercreditor fairness.

To the credit of private and public participants in the SDRM debate, the design of a litigation shield was debated openly and parsed carefully—perhaps too carefully—along with other aspects of the IMF's proposal to minimize intrusion into private contracts. It is ironic that only a month after the IMF dropped its own delicate compromise under market pressure, the UN took enforcement off the table for all creditors of Iraq without the intervening politeness of creditor consultations, much less a majority vote.

But viewed from a different angle, immunizing Iraq's assets with a combination of international agreement and US Executive Order was not radical at all. After Iran agreed to release US hostages in 1981, Presidents Carter and Reagan issued executive orders terminating, among other things, all lawsuits and enforcement actions against Iranian property in the United States and transferring all claims to the international tribunal in the Hague. The US Supreme Court upheld the orders in *Dames & Moore v Regan*, 453 US 654 (1981), as consistent with the President's powers to conclude international agreements and with the economic emergency laws enacted by Congress. The advent of restrictive sovereign immunity codified in the FSIA did not diminish the President's power to settle US citizens' claims against foreign governments (as in

²⁹ Id.

³⁰ IMF, *Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda* (Apr 11, 2003), available online at <<http://www.imf.org/external/np/omd/2003/041103.htm>> (visited on Apr 15, 2005).

³¹ IMF staff were concerned that while creditors would be barred from enforcement, nothing would prevent the debtor from paying off its creditors selectively, fundamentally upsetting intercreditor equity. Hagan, *Designing a Legal Framework to Restructure Sovereign Debt* at 53 (cited in note 10).

the days of bondholder protective councils and gunboat diplomacy),³² and certainly did not give creditors unconditional access to courts, especially where an alternative forum was available.

The UN Security Council resolutions and US executive orders on Iraq arguably stopped short of the *Dames & Moore* scenario. The new measures mimicked the essential structure of the restrictive immunity compromise—creditors remain free to go to court and get judgments, they just cannot enforce them. It is even possible to argue that with these measures in place, Iraq and Argentina are not that different from the enforcement perspective: most of Iraq's foreign assets are immune, most of Argentina's have been privatized and cannot be seized to satisfy the government's debts.

The lessons of this incident for the law of sovereign debt are threefold. First, it is a reminder that the official sector has long had the tools to shield a sovereign borrower from its creditors, even without a statutory sovereign bankruptcy regime. In theory, the UN Security Council could use these tools whenever its members agreed on a worthy debtor. In the wake of Resolution 1483, all the design activity surrounding the recent automatic stay proposals looks strangely beside the point. It is significant that in the case of Iraq, policymakers chose the Security Council as the institutional vehicle for bankruptcy administration. Even more than the IMF, the UN is seen by market participants as biased in favor of sovereign debtors, ignorant of the complexities of modern finance, and insensitive to market concerns. But the Security Council is also the preeminent international institution for dealing with political crises of global significance. Its recent firefighting activities notwithstanding, the IMF's basic mandate is maintaining global financial stability.

Thus viewed against the background of Argentina's default and the demise of the SDRM, the second lesson of Iraq appears to be that the international community would step in to shield a government when its financial distress presents an extraordinary political threat, but not when it stems from periodic misfortune or mismanagement. Resolution 1483 and Executive Order 13,364 articulate the high standard for intervention under the UN Charter and US law—for the UN, it is a "threat to international peace and security"; for the US, an "unusual and extraordinary threat to the national security and foreign policy of the United States."³³

³² *Dames & Moore v Regan*, 453 US 654, 683–84 (1981).

³³ The relevant language is as follows: "*Determining* that the situation in Iraq, although improved, continues to constitute a threat to international peace and security . . ." Security Council Res No 1483, UN Doc S/RES/1483, preamble (May 22, 2003) (cited in note 14). "[T]o address the unusual and extraordinary threat to the national security and foreign policy of the United States posed by obstacles to the orderly reconstruction of Iraq . . . I find that the threat of attachment or other judicial process against the Central Bank of Iraq constitutes one of these obstacles." The

But even in extraordinary political circumstances, governments worry that endorsing a stay on enforcement would disrupt the markets. Iraq's debt structure mitigated this worry—of the roughly \$125 billion in external debt, more than two thirds was owed to other governments (many sitting on the Security Council and fielding coalition troops). Estimates of private debt were about \$15 billion. Most of this debt appeared to be in the hands of corporate creditors in Europe, Asia, and Latin America—exporters and construction companies that did not ordinarily trade in emerging markets debt, and did not have the institutional power base of banks and bondholders on issues of sovereign debt restructuring.³⁴ In contrast, almost all of Argentina's debt was in the form of actively traded bonds.

It might be tempting to read this incident as reaffirming the distinction between Argentina and Iraq. Argentina and the sovereign bankruptcy proposals it helped inspire argue for new rules to help resolve periodic, even routine financial distress. Iraq is a unique political event that holds no lessons for the bankruptcy project. But this distinction is exaggerated.

The ad hoc resolutions and orders shielding Iraq fall far short of an intricate bankruptcy regime. They do not aspire to balance debtor and creditor interests, to check debtor abuses, to empower the creditor collective, or even to create procedures for private creditor participation in Iraq's restructuring. But they do carve out a generous safe space for Iraq to rearrange its affairs, and even try to create incentives for new financing.³⁵ These measures require no new laws or treaties, and, if seen as principled and truly exceptional, may not undermine market discipline. Who needs a new regime?

This third lesson of Iraq may be its most significant: there already exist elements of an international bankruptcy regime for sovereigns, including the possibility of robust protection from creditor lawsuits. The threshold to invoke the most robust form of protection is high—diplomatic consensus that financial distress threatens international security. The existence of such a threat seems to

President, Exec Order 13364—Modifying the Protection Granted to the Development Fund for Iraq and Certain Property in Which Iraq Has an Interest and Protecting the Central Bank of Iraq, 69 Fed Reg 70177, preamble (Nov 29, 2004) (cited in note 17).

³⁴ See *Those Odious Debts: Reconstructing Iraq*, 369 *Economist* 13 (Oct 18, 2003); see also *A Load Off? Iraq's Debts*, 373 *Economist* 98 (Nov 27, 2004). Other potentially important creditor groups included reparations seekers and tort plaintiffs, such as US POWs that had been tortured in Iraq in the 1991 Persian Gulf War. Carol D. Leonnig, *Judge Bars POW Claims to Frozen Iraqi Assets*, *Wash Post* A16 (July 31, 2003).

³⁵ See for example, Security Council Res No 1546, UN Doc S/RES/1546 § 27 (June 8, 2004) (cited in note 14); see also The President, Exec Order 13364—Modifying the Protection Granted to the Development Fund for Iraq and Certain Property in Which Iraq Has an Interest and Protecting the Central Bank of Iraq, 69 Fed Reg 70177 § 1 (Nov 29, 2004) (cited in note 17) (exempting from immunity judgments arising from contracts entered into after June 30, 2004).

obviate the need for complex checks and balances inherent in a bankruptcy system. Crossing the threshold entails the usual, inevitably messy political process, no doubt favoring those debtor and creditor constituencies that already enjoy the support of the rich and powerful UN members. But maybe this is a more honest way to do it: more than any statutory bankruptcy proposal, the existing machinery reaffirms the political nature of the state and its membership in the messy, political community of states. At the very least, the Iraqi incident recasts the sovereign bankruptcy debate in a way worth exploring. It puts the politics of sovereign bankruptcy center stage, not as a sidebar to questions of technical design.

III. ARGENTINA: ODIIOUS DEBTS AND CUTOFF DATES

At this writing, over three quarters of Argentina's defaulted bond holders have agreed to reduce the government's debt by about 70 percent in present value terms using market discount rates. If last minute lawsuits do not derail the restructuring, these creditors will receive about thirty-five billion dollars in new bonds for sixty-two billion dollars in principal of the old debt in an offer announced in January and due to complete in April. If Argentina follows through on its promise to pay nothing to nonparticipating creditors (about twenty billion dollars in principal), the total debt relief would be even more impressive.

Argentina justified its offer in terms of its capacity to pay—it said it could not afford to pay more without jeopardizing the housing, jobs, education, and healthcare of Argentines.³⁶ Some of its creditors disagreed vigorously;³⁷ so far, they appear to have lost.

Iraq has adopted a broadly similar approach. It has presented its creditors with a theory of its payment capacity, and has argued for debt relief consistent with that theory.³⁸ Thanks to all out US diplomacy, Iraq has secured a reduction of 80 percent in principal and past due interest from the Paris Club of government lenders, and promised the Paris Club to seek comparable relief from the rest of its creditors.

³⁶ *Discurso del Señor Presidente de la Nación Doctor Nestor Kirchner ante la Honorable Asamblea Legislativa* 10 (May 25, 2003) (Inaugural Address of President Kirchner, Buenos Aires), available online at <<http://www.argentina-canada.net/discurso.pdf>> (visited Apr 15, 2005), English translation available in *Argentina: Full Text of Kirchner's Inaugural Speech*, BBC Monitoring International Reports (May 26, 2003).

³⁷ Global Committee of Argentina Bondholders, available online at <<http://www.gcab.org>> (visited Apr 15, 2005).

³⁸ Interview with Adil Abdul Mahdi, Minister of Finance in the interim government of Iraq, *Restructuring Debt is Top Priority*, transcript available in Felix Salmon, *Seeking Forgiveness of Saddam-era Debt*, 35 *Euromoney* 72, 76 (Sept 2004).

Debt relief based on capacity to pay was not the only, and not necessarily the obvious approach for Iraq. Some Iraqi politicians, international NGOs, and their allies (notably including Paul Wolfowitz and Richard Perle) have argued passionately that Iraq must repudiate its debt as illegitimate because it was incurred under Saddam Hussein. The NGOs have also argued for an international tribunal where in order to get paid, creditors would have to prove that their funds benefited the Iraqi people.³⁹

Under this approach, based on the public international law doctrine of Odious Debt, the amount of debt and payment capacity are essentially irrelevant. Relief derives from the manner in which the debt was incurred. The debt is unenforceable and a government may repudiate it unilaterally if: (1) the people did not consent to the borrowing; (2) the proceeds did not benefit the people; and (3) the creditor knew (1) and (2) when lending.⁴⁰ These elements are central to the definitive restatement of the doctrine by Alexander Sack, an early twentieth century scholar:

If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights against it, . . . this debt is odious for the population of all the State. . . . This debt is not an obligation for the nation; it is a regime's debt, a *personal* debt of the power that has incurred it, consequently it falls with the fall of this power. . . . "Odious" debts, incurred and used for ends which, *to the knowledge of the creditors*, are contrary to the interests of the nation, do not compromise the latter—in the case that the nation succeeds in getting rid of the government which incurs them—except to the extent that real advantages were obtained from these debts. The creditors have committed a hostile act with regard to the people; they can't therefore expect that a nation freed from a despotic power assume the "odious" debts, which are personal debts of that power.⁴¹

Sack's treatise moved to institutionalize earlier invocations of the concept of illegitimate "imposed" or "hostile" debts, notably the US diplomatic position

³⁹ Preliminary Structural and Procedural Aspects of Iraq Tribunal, available online at <<http://www.jubileeiraq.org/tribunal.htm>> (visited Apr 17, 2005).

⁴⁰ See, for example, Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* 13–21, CISDL Working Paper No COM/RES/ESJ (Mar 11, 2003), available online at <<http://www.cisdsl.org/pdf/debtentire.pdf>> (visited Apr 15, 2005); Anupam Chander, *Odious Securitization*, 53 Emory L J 923 (2004) and Michael Kremer and Seema Jayachandran, *Odious Debt* 1 (Apr 2002) (unpublished manuscript), available online at <<http://www.imf.org/external/np/res/seminars/2002/poverty/mksj.pdf>> (visited Apr 15, 2005).

⁴¹ Alexander N. Sack, *Les Effets des Transformations des Etats sur leurs Dettes Publiques et Autres Obligations Financieres* (Recueil Sirey 1927), translated in Patricia Adams, *Odious Debts: Loose Lending, Corruption, and the Third World's Environmental Legacy* 165 (Probe 1991), excerpted online at <<http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=subcontent&AreaID=3>> (visited Apr 12, 2005).

on Spain's cession of Cuba after the Spanish-American War, as part of the law of state succession.⁴²

The law of government (as distinct from state) succession is settled—revolutions notwithstanding, “the nation remains with rights and obligations unimpaired.”⁴³ The law of state succession is more murky. The classic case of state succession involves the passage of territory between state powers. Revenues from the territory often specifically secure earlier borrowing by the ceding power, and even where there is no specific pledge, the loss of territory might affect the ceding state's debt payment capacity. To release the ceding state from its obligation to pay, the acquiring state (a new colonial ruler or a newly independent state) often must take the affirmative step of assuming the debt. The new state may resist the assumption, especially where debt proceeds paid for conquest and oppression, or less dramatically financed the general needs of the old empire unconnected with the territory in question.

The US-Spanish dispute concerned debts contracted by the Spanish Crown in its own name but secured by Cuban revenues. A large portion of the proceeds went to finance the suppression of uprisings in Cuba, San Domingo (now the Dominican Republic), and Mexico. After the Spanish-American War, Spain wanted the debt to follow the revenue pledge, and pressed for its assumption by the newly independent Cuban state. In response, the US advanced technical arguments to the effect that debts do not cede with territory and revenue pledges are not mortgages. The US also argued that the debts were illegitimate because the Cubans had not actually agreed to the borrowing, and the proceeds did not benefit Cuba. In 1931, a leading sovereign debt scholar of the day described the second set of arguments as not “strictly legal” but rather “in accordance with fairness and justice.” Spain specifically rejected the US position when it gave up demanding that Cuba assume the Spanish debt as part of “a compromise deviating from strict international law [in return for] certain compensations.”⁴⁴

Europe's military adventures of the nineteenth and early twentieth centuries produced several other treaties that specified the treatment of debts in cases of territorial conquest.⁴⁵ The conquering state often assumed some or all of

⁴² See Ernst H. Feilchenfeld, *Public Debts and State Succession* 337 (MacMillan 1931); see also John Basset Moore, *A Digest of International Law* § 97 at 359 (Govt Printing Office 1906).

⁴³ *Lehigh Valley R Co v State of Russia*, 21 F2d 396, 401 (2d Cir 1927); *Great Britain v Costa Rica*, (1923) 1 RIAA 375 (1923) (*Tinoco* arbitration).

⁴⁴ Feilchenfeld, *Public Debts and State Succession* at 337, 339, 343 (cited in note 42).

⁴⁵ P.K. Menon, *The Succession of States in Respect to Treaties, State Property, Archives, and Debts*, 6 *Studies in World Peace* 1, 162–63 (Edwin Mellon 1991); see also Feilchenfeld, *Public Debts and State Succession* at 104, 182, 393–95 (cited in note 42).

the debts associated with the acquired territory, but the specific arrangements varied widely. Some countries notably had refused to assume “war debts” where the proceeds were used to fight them. The British advanced this argument against the Netherlands South African Railway Company for supporting the Dutch in the Boer wars at the turn of the twentieth century. The outcome in this case reflects a common pattern: the state that prevailed in the military conflict also chose the debt arrangements. Even so, the British legal position was controversial: “This opinion of the British government was not supported by any precedent in the history of state succession and was not accepted by foreign powers.”⁴⁶

Decolonization since World War II did little to clarify the rules of state succession with respect to debts: arrangements were entirely case specific, and state practice was all over the map.⁴⁷ Sack’s Odious Debt principle, articulated on the eve of the war, seemed to lose ground in the state practice that followed.

The high bar for showing state succession may be one reason why the Odious Debt Doctrine has had trouble taking root in public international law.⁴⁸ The extent to which “regime change”—such as the Russian revolution, the end of military rule in Argentina, and the exits of Ferdinand Marcos and Saddam Hussein—amounts to state succession is an open question. These cases all involve a profound shift in the nature of the borrowing state without the transfer of territory. US case law and international precedent specifically addressing revolutions would make it difficult to establish state succession based on a new form of government or the deposing of a tyrant.⁴⁹ The practical burden also shifts in the case of regime change—unlike the Cuban-Spanish and British-Dutch scenarios, no treaty or other affirmative act of assumption is needed to transfer obligations to the new regime—since nominally, the debtor is the same.

⁴⁶ Id at 394–95.

⁴⁷ P.K. Menon, an advocate for the Odious Debt Doctrine, notes that

[t]he practice of the newly independent States after the establishment of the United Nations is singularly marked with inconsistency and contradiction. It is not dictated by any uniformly accepted legal principle. There are precedents both in favour of succession and against it, and even in cases of repudiation of debts after their acceptance . . .

Menon, *The Succession of States* at 184–85 (cited in note 45).

⁴⁸ The authors of *Advancing the Odious Debt Doctrine* argue that state succession is not a necessary element of the Odious Debt Doctrine, citing *Tinoco*. Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* at 13–21, (cited in note 40). This argument may work as advocacy for a new doctrine incorporating principles of fiduciary duty and standards of fraud in sovereign borrowing under international law, but they are at odds with all the writing and practice specifically addressing the Odious Debt Doctrine.

⁴⁹ See for example *Lehigh Valley R Co v State of Russia*, 21 F2d 396, 401 (2d Cir 1927); see also *Great Britain v Costa Rica*, (1923) 1 RIAA 375.

To get out of paying, the new regime must repudiate the debts booked in its name, and assert a fundamental change in its identity and/or the odious character of the debts as a defense for the repudiation. If the defense succeeds, the debt is extinguished, not transferred to another state obligor.

As it happens, no national or international tribunal has ever cited Odious Debt as grounds for invalidating a sovereign obligation. Each of the treaties and other examples of state practice cited even by the doctrine's most thorough and principled advocates appears fundamentally flawed—it lacks one or more of the doctrine's essential elements and/or is accompanied by a chorus of specific disavowals of the doctrine by indispensable parties.⁵⁰ But even if the examples were on point, the fact that Odious Debt's most fervent proponents to this day must cite an 1898 treaty and a 1923 arbitration as their best authorities suggests that the law-making project is in trouble.⁵¹

Odious Debt's apparent disuse and disarray after a century of Hitler, Stalin, Mobutu, Abacha, Somoza, Marcos and Idi Amin—not to mention the socialist revolutions, capitalist restorations, and the intervening wars of liberation from colonial rule—are more than mildly puzzling. Most recently, the overthrow of Saddam Hussein revived the hopes for resurrecting the Odious Debt Doctrine.⁵² But when given the opportunity to invoke it, the new Iraqi authorities demurred:

Iraq's need for very substantial debt relief derives from the economic realities facing a post-conflict country that has endured decades of financial corruption and mismanagement under the Saddam regime. Principles of public international law such as the odious debt doctrine, whatever their legal vitality, are not the reason why Iraq is seeking this relief.⁵³

Assuming for argument's sake that the decision not to invoke Odious Debt was Iraq's own, why would the country shun a doctrine that seems so hospitable

⁵⁰ See, for example, Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* at 21–30 (cited in note 40). The authors' suggestion that the US refusal to apportion to Cuba Spanish debt secured by Cuban revenues is a "perfect" fit for the doctrine is puzzling considering Spain's specific protest and the compensation it evidently got in return for keeping its debt.

For other examples of scholarly writing supporting the existence of an Odious Debt Doctrine, see Menon, *The Succession of States* at 161–66 (cited in note 45).

⁵¹ See Patricia Adams, *Odious Debts: Loose Lending, Corruption, and the Third World's Environmental Legacy* 162–170 (Probe 1991), excerpted online at <<http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=subcontent&AreaID=3>> (visited Apr 15, 2005) and Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* at 21–30 (cited in note 40).

⁵² For general discussion, see <<http://www.jubileeiraq.org>>; <<http://www.odiousdebts.org>>. The Jubilee site contains links to a vast array of editorial opinion, most of it supporting the Odious Debt Doctrine and its application to Iraq.

⁵³ Interview with Adil Abdul Mahdi, Minister of Finance in the interim government of Iraq, *Restructuring Debt is Top Priority*, transcript available in Felix Salmon, *Seeking Forgiveness of Saddam-era Debt*, 35 *Euromoney* at 76 (cited in note 38).

to its cause? The costs of invoking Odious Debt to the country are roughly the same as with any other sovereign debt repudiation: the cost of dodging enforcement (discussed in the first half of this essay) and damage to reputation.⁵⁴ Debt repudiation could tarnish the country's good name in the private credit markets and even among government lenders just when the new government needs them the most. Even if the new government convinces the creditors that it is fundamentally a different entity from the one that had borrowed the money, is therefore not breaking its own promises, and would not make repudiation a habit, they might fear the political risk of future succession or regime change. On the other hand, the benefits of invoking Odious Debt are debt relief combined with moral and political redress for the wrongs of a bad regime. How the doctrine is implemented matters as well: if creditors are allowed to challenge the odious designation before a special tribunal or a even a national court, a comprehensive debt settlement may take many years and validate some creditor claims.

Others have written about the costs of invoking Odious Debt and ways to mitigate them within the doctrine's framework.⁵⁵ I suggest that countries often are able to get the same debt reduction benefit at a lower cost by going outside the doctrine and framing their decision as a financial restructuring, a composition rather than as repudiation. Iraq is a particularly good example: the debt default happened while Saddam Hussein was under international sanctions. The new government has the choice of effectively defaulting again by publicly repudiating most of the old obligations, or negotiating deep debt reduction to "normalize" its relations with creditors.

Argentina's experience is instructive. It defaulted on its international bonds in the last days of 2001, when it went through four presidents and abandoned its currency peg to the dollar. In the next six months, its currency lost almost three-quarters of its value, its Central Bank reserves dropped by half, and its people took to the streets.⁵⁶ In the next three years, unpaid past-due interest on the

⁵⁴ See, for example, Bratton and Gulati, 57 Vand L Rev at 14–16 (cited in note 24), for a concise summary of the Reputation and Enforcement Theories of sovereign debt. There are additional costs of debt default, as distinct from repudiation after default; these are mostly concentrated in domestic economic dislocation, bank runs, and so on.

⁵⁵ Kremer and Jayachandran, *Odious Debt* at 6 (cited in note 40) and Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* at 36–39 (cited in note 40).

⁵⁶ *The Republic of Argentina, Prospectus Supplement Dated Jan 10, 2005 and Prospectus Dated Dec 27, 2004, filed pursuant to Rule 424(b)(5) under the US Securities Act of 1933*, Registration No 333-117111 at 42, 46–47, 107, available online at <<http://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm#108>> (visited Apr 16, 2005). The peso went from 1:1 USD to a low of 3.87:1 USD on June 26, 2002 – 74.2 percent. Id at 42, 107. Real GDP (adjusted for inflation) fell 6.7 percent in the first six months and 10.9 percent for the year 2002. Id at 42, 46–47.

defaulted debt grew to twenty billion dollars. The government's name was mud with international investors and with much of its own citizenry.

While deeply traumatic and occasionally violent, Argentina's political break in 2001 would hardly even qualify as regime change. The government borrowed most of the money under President Carlos Saul Menem of the same Justicialist (Peronist) party as interim President Eduardo Duhalde and current President Nestor Kirchner. Yet President Kirchner has repeatedly called the old debt "illegitimate" and blamed Argentina's creditors for financing bad policies that hurt its people.⁵⁷

Within months of the default, the Argentine authorities began issuing new debt even as they publicly committed not to repay the old.⁵⁸ The government framed the distinction between the old defaulted and new performing debt in terms of cutoff dates.⁵⁹ The cutoff date concept was popular in the early days of the modern sovereign workout practice. In government-to-government (Paris Club) and commercial bank (London Club) agreements of the 1980s, cutoff dates protected "new money," presumably advanced for the debtor's recovery on the model of postpetition financing in domestic bankruptcy.⁶⁰ Old (pre cutoff) debt was rescheduled or reduced; new (post cutoff) debt was spared.⁶¹

⁵⁷ Larry Rohter, *Argentina Pressed for Quick Action*, Intl Herald Trib 14 (May 20, 2003). In his inaugural address, Kirchner said "We cannot go back to paying our debts at the expense of hunger and exclusion of Argentines [applause] generating more poverty and increasing social conflicts The unfeasibility [sic] of this old model must be noticed by the creditors themselves who must understand that they can only collect if Argentina does well." *Argentina: Full Text of Kirchner's Inaugural Speech* (cited in note 36).

⁵⁸ For a detailed account of Argentina's debt management immediately before and after the default, see *The Republic of Argentina, Prospectus Supplement Dated Jan 10, 2005* and *Prospectus Dated Dec 27, 2004, filed pursuant to Rule 424(b)(5) under the US Securities Act of 1933*, Registration No 333-117111 at 165-74 (cited in note 56). Anna Gelpern and Brad Setser, *Domestic Debt and the Doomed Quest for Equal Treatment*, Georgetown J Intl L (forthcoming 2005) (on file with author). Most of the new securities went to cover the capital deficit in domestic financial institutions and to buy back the scrip issued by Argentine provinces in the dying days of the dollar peg. The government said the new securities were "senior" and exempt from restructuring. International investors believed it and promptly started scrambling for the few new bonds that were allowed to trade. Foreign investors believed rationally—and correctly so far—that the Argentine government would not default on the debt held primarily in its financial system, risking another bank run and broader economic shock that might follow.

⁵⁹ See, for example, Guillermo Nielson, Secretary of Finance, *Argentina's Restructuring Guidelines*, Remarks to Argentine creditors in Dubai (Sept 22, 2003), available online at <http://www.argentinedebtinfo.gov.ar/documentos/discurso_gn_dubai_con_diap_english.pdf> (visited Apr 15, 2005).

⁶⁰ See, for example, 11 USC § 507 (2000). See Paris Club, *Cutoff date*, available online at <<http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B01WP05>> (visited Apr 15, 2005). Lee C. Buchheit, *Whatever Became of Old New Money?*, 9 Intl Fin L Rev 11, 11-12 (1990). Buchheit suggests that most new money advanced in the 1980s was a thinly disguised way

Started as an incentive to keep lending, cutoff dates also can naturally mark a political breaking point—for Iraq, the Paris Club cutoff date is May 22, 2003, the date of UN Security Council Resolution 1483; for many countries of Eastern Europe the dates roughly track their departure from state socialism.⁶² Even though as a matter of contract practice, cutoff dates have been losing favor in sovereign workouts,⁶³ Argentina's revival of cutoff date rhetoric to draw a bright line between the bad debts of the old regime and the good debts of the new made eminent political sense.

In the same inaugural address where he pledged not to repay the old debts "at the expense of hunger and exclusion", President Kirchner declared a new political and economic era. He promised to redress both the human rights abuses of the military rule (1976–1983) and the corrupt, unfair economic policies of the 1990s, which had "condemn[ed] millions of Argentines to social exclusion, national fragmentation and the huge and endless foreign debt." Rhetorically, debt relief went hand in hand with purges of the military and of the judiciary.⁶⁴

Declaring the old debts illegitimate constrained the government on the one hand, and strengthened its negotiating position on the other. The strategy was a constraint because having condemned the debt, the President now had to explain to the voters why he was offering to pay anything at all to the creditors. It strengthened Argentina's hand in the workout because foreign creditors believed this domestic constraint to be substantially binding, and therefore believed that Argentina would stay in default for a long time rather than improve its aggressive restructuring offer. For the restructuring to succeed both

of financing interest payments on old rescheduled debt. In turn, new money made the already unsustainable debt stocks more so.

⁶¹ See id; see also <<http://www.clubdeparis.org>>.

⁶² Id.

⁶³ In London Club, their credibility suffered as debtors kept coming back for new new money, and old new money had to be restructured. The Paris Club's problem was the precise opposite of the London Club: because it refused to move its cutoff dates when the debtors came back for more relief, it had had to keep cutting the same old debts over and over again as the new debts ballooned. Recently most private sovereign debt has been restructured in bond exchanges, which tend to use other techniques to distinguish between old and new debt.

⁶⁴ *Argentina: Full Text of Kirchner's Inaugural Speech* (cited in note 36); Larry Rohter, *Letter from South America: Now the Dirtiest of Wars Won't Be Forgotten*, NY Times A4 (June 18, 2003); Hector Tobar, *Argentina's New President Cleans House*, LA Times 3 (June 5, 2003); *The Empty-Handed Social Democrat*, The Economist (May 31, 2003). In November 2004, Argentina's Congress debated legislation designating the debt incurred during the last military dictatorship (1976–83) odious and subject to repudiation. This debt amounts to about thirty-eight billion dollars, nominally a little less than half of the principal amount now in default, although much of it was likely reduced or rescheduled during the 1990s. See *Argentine Congress to debate Odious debt bill* (Nov 13, 2004), available online at <http://www.jubileeiraq.org/blog/2004_11.html> (visited Apr 15, 2005).

financially and politically, the majority of bondholders had to see the terms as acceptable, and at the same time the voters had to see them as punitive. The results so far—76 percent participation in the exchange—suggest that the gamble paid off for the most part. On the other hand, the harsh terms and even harsher rhetoric kept an unprecedented amount of debt (over twenty billion dollars) out of the exchange, potentially threatening the outcome.

Argentina's example suggests that governments still enjoy considerable discretion in selecting the debts they pay and those they seek to restructure. While Argentina's finances are clearly strained, it is not chronically impoverished like the countries of sub Saharan Africa. If this middle income country could reduce the old debt by over 50 percent in a matter of months, then surely a poorer middle income country like Iraq could aspire to do as well or better without invoking the wobbly doctrine of Odious Debt.

The conventional approach may look even more attractive next to the prospect of a special tribunal proposed by the NGOs to sort through Iraq's debts. That tribunal would follow the model established after the settlement of the Iran hostage crisis. The Iran-US Claims Tribunal in the Hague took decades to sift through each claim against Iran. Against this background, the three year period between Argentina's default and its exchange offer announcement looks positively brisk. In the case of Iraq, the tribunal might not even yield more relief than the conventional approach because it might unearth billions of dollars in "nonodious" claims.

If Argentina succeeds, it will show in graphic terms that most countries considering Odious Debt have ready alternatives for securing deep debt relief without proving state succession, illegitimacy, or specific knowledge by the creditors, and without costly and time-consuming claim-by-claim adjudication. The country's bargaining position in restructuring negotiations seems to strengthen after it has suffered the initial domestic and external damage from default—creditors' expectations of full repayment diminish as the government has to justify resumption of any payment to its citizens. Against this background, domestic proclamations of illegitimacy couched in the language of cutoff dates may not be as good as international recognition of illegitimacy, but may be worth the cost savings of going the conventional route.

IV. A DOCTRINAL GAP

The previous section suggests why governments seeking quick debt relief and market access might bypass the Odious Debt Doctrine. But it also leaves important questions unanswered and points to gaps in the law governing state and government succession with respect to debts. An inquiry limited to financial restructuring fails to address those aspirations of the Odious Debt Doctrine that go beyond debt relief. The doctrine's other, perhaps more important goals—to

discourage lending to thieves and tyrants, and to promote justice and healing after their overthrow—have no part in the conventional approach. First, it is worth examining alternative approaches to canceling dictators' debts based on their illegitimacy, rather than the country's capacity to pay. Such an alternative would help countries that could not get debt relief based on their incapacity to pay. These countries are also the most likely to have market access and worry about losing it with debt repudiation. Second, this section asks whether there is a way to improve on the current Odious Debt Doctrine in providing *ex ante* incentives against lending to tyrants.

The emphasis on state (as distinct from government) succession in Sack's restatement of the Odious Debt Doctrine, while historically grounded in the concept of hostile debts, is somewhat artificial. The doctrine's three elements—lack of consent, lack of benefit, and creditor awareness—could be found even where the borrowing state is unchanged. After all, sanctions against unauthorized activities by corporate and other agents, to which “odious” borrowing is occasionally compared, do not require substitution of the principal entity.⁶⁵ A government that repudiates the debts of a bad regime may argue that these had been contracted without proper authority and were otherwise fraudulent as a defense before a national court or an international tribunal.

In the 1923 *Tinoco* arbitration concerning Costa Rica's debts, the sole arbitrator (former President and US Chief Justice William H. Taft) based his ruling essentially on the common law notion of fraud. Taft went to great lengths to establish that the ascent to power and demise of military strongman Frederico Tinoco did not qualify as state succession. Taft then devoted much of his opinion reaffirming the rule of government succession in the debts of their predecessors. He nevertheless ratified Costa Rica's unilateral repudiation of Tinoco's debt to the Royal Bank of Canada (represented by Great Britain in the arbitration) on the grounds that the entire loan transaction reeked of fraud. The Bank had accepted what it knew to be phony currency as collateral for what it knew to be personal loans to Tinoco and his brother on the eve of their escape from Costa Rica. Even though the Bank knew full well that the loan was personal, it booked it as a state loan and tried to enforce it as such.⁶⁶

The case is unusual in the line of examples usually cited in support of Odious Debt in that Taft examines the underlying transaction (rather than regime legitimacy) in great detail. Taft can dispense with the requirement of state succession because he focuses on the transaction to the exclusion of the regime.

⁶⁵ See Center for International Sustainable Development Law, *Advancing the Odious Debt Doctrine* at 36–39 (cited in note 40); Kremer and Jayachandran, *Odious Debt* at 1–2 (cited in note 40).

⁶⁶ In another part of his opinion (concerning an oil concession), Taft points out that Tinoco's own government could have walked away from the obligations at issue.

His opinion (which preceded widespread adoption of sovereign immunity and sovereign debt litigation in national courts) points to the potential for the wider use of more established domestic-law counterparts to Odious Debt and for establishing standards of good faith in sovereign lending under international law.⁶⁷

Tinoco also illustrates the challenge of invoking notions of fraud and unauthorized borrowing from the perspective of debt relief advocacy. As with the claims tribunal discussed in the last section, it would be impossible to deliver large-scale relief quickly where an arbiter or a national court had to evaluate the use of proceeds for every loan contract. An approach based on *Tinoco* may work for countries with only a few bad loans, or those for whom speedy resolution of the fraudulent debts is not essential—for example, wealthy countries that can borrow despite these debts or poor countries without any prospect of market access even after the debts are resolved.

The Odious Debt Doctrine as formulated by Sack is at its weakest in creating effective ex ante incentives against lending to bad regimes. With all its force directed at ex post repudiation and without a clear track record of practice, the Odious Debt Doctrine in its current state offers no meaningful guidance to shape decisions on lending to the emerging markets. Investors who lent to Iraq relying on the now famous pictures of US Defense Secretary Rumsfeld with Saddam Hussein would have been sorely disappointed. On the other hand, those that stayed away from Indonesia under Suharto and Mexico under the PRI might have made the wrong call too. Investors considering Venezuelan debt today would be truly confused. One response might be to hire democracy and civil society consultants to do the infinite investigations and issue “odiousness opinions”; an easier one would be to shut down lending or raise the cost of funds for all but the richest industrial countries.⁶⁸

An economic model of odious debt recently proposed by Michael Kremer and Seema Jayachandran seeks to address the problem of ex ante lending incentives. Kremer and Jayachandran suggest that there are two ways in which creditors can determine in advance whether a regime is odious—by engaging in “an infinite sequence of costly investigations” or by relying on the judgment of an independent institution.⁶⁹ In their model, the institution is more likely to

⁶⁷ Establishing such a standard could add to the still modest arsenal of tools to battle official corruption and kleptocracy. See Peter Reuter and Edwin M. Truman, *Chasing Dirty Money: The Fight against Money Laundering* 148–56 (Inst Int'l Econ 2004).

⁶⁸ It might be possible to avoid branding a regime if a creditor is prepared to monitor the use of loan proceeds to establish actual benefit to the population. That too might be costly, but more importantly, it would embed foreign private creditors deeply in domestic policymaking for all or most emerging markets, even those that do not turn out to be odious.

⁶⁹ Kremer and Jayachandran, *Odious Debt* at 13, 15–16, 20 (cited in note 40).

render unbiased judgments if its mandate is limited to declaring future lending as odious, in effect putting creditors on notice before they advance the funds, rather than ratifying repudiation.⁷⁰

The authors recast Sack's doctrine as a sanctions regime. They would empower an international institution to designate odious regimes in a process similar to the well-established one now used to impose trade sanctions. National courts would then refuse to enforce debt contracts with odious governments (signed after their designation), while national and international aid agencies would refuse to finance countries repaying odious debts. Although the aid penalty seems excessive and impractical (no aid agency would punish a good government merely for repaying the debts of a despot), the institutional design challenge is no greater than in the case of trade sanctions, and the overall framework is sensible and innovative.

Turning Odious Debt into a form of sanctions would remove some reputational damage to a country from repudiating odious debt, would shield the country from lawsuits, and would enable meaningful risk assessment by creditors. Most importantly, it may discourage lending to oppressive governments and free their people from responsibility for the debts.⁷¹

V. CONCLUSION

I have used the examples of Iraq and Argentina to make two arguments. First, I suggest that the existing toolkit for sovereign debt restructuring is even more versatile than is generally supposed. The recent UN Security Council Resolutions on Iraq show that the international community has extraordinary capacity to shield sovereign debtors from lawsuits even without a statutory sovereign bankruptcy regime, though it uses the most extreme measures only rarely. If last minute lawsuits do not derail Argentina's restructuring, its ability to secure deep reduction of the debts contracted under the Menem government will show how much a sovereign debtor can achieve with straightforward financial restructuring tools without resorting to complex and untested public law doctrines such as Odious Debt.

⁷⁰ Id at 20–26. Allowing the institution to ratify repudiation would encourage it to act on its biases. One that is prodebtor might call legitimate regimes odious just to obtain debt relief; a procreditor institution might let bad regimes slide to maximize repayment. Political and geographic biases would produce similar results. On the other hand, an institution favoring debtors would hesitate to call a good regime odious at the lending stage for fear of slowing capital flows to its constituents; one that favors creditors might be less reluctant to call an odious regime before the investors have advanced the funds and exposed themselves to the risk of repudiation.

⁷¹ Kremer and Jayachandran also show that financial sanctions on their Odious Debt model would work better than the widely used trade sanctions: unlike trade sanctions, financial sanctions hurt the rulers more than they hurt the people, and are less prone to abuse by third parties.

Second, Iraq and Argentina highlight the obvious point that is often ignored by debt relief advocates and technocrats alike—it is impossible to separate politics and finance in sovereign workouts; both are central and neither is a sideshow. While the IMF was busy designing a complex sovereign restructuring mechanism, the UN Security Council simply shielded an important country from its creditors. Political imperatives preempted the emergence of a legal regime. On the other hand, even if most see Iraq as a case of power politics, its decision to follow the conventional model of financial restructuring puts it in the line of cases resolved based on the debtor's payment capacity, with all the methodological and procedural baggage it implies. In a sense, financial pragmatism prevailed over succession politics. But Argentina's decision to call its defaulted debt illegitimate created a set of political constraints that profoundly affected its restructuring outcome.

A separate but related point is that financial relief alone is often insufficient in the case of emerging market sovereign debt. Countries have debt problems when they suffer external shocks through no fault of their own, when their governments mismanage the national economy, and when their governments borrow in the name of the people only to oppress them and steal from them. Private financial restructuring techniques can rearrange a country's liabilities, but are ill-suited to fight mismanagement, oppression and looting. The public international law doctrine of Odious Debt has languished because it is an inefficient tool for securing quick debt relief; it also fails to provide ex ante incentives against lending to tyrants. Instead of turning to Odious Debt, many countries emerging from oppressive regimes have sought deep debt relief using a combination of conventional financial technique and radical political rhetoric. But this approach does little to prevent lending to bad rulers, and is an indirect way of redressing it ex post. Reframing the Odious Debt Doctrine as an ex ante sanctions system along the lines proposed by Kremer and Jayachandran is a promising step that seeks to combine financial and political tools sensibly to fight bad regimes and do right by the people they have oppressed.