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### **International Debt: Some Moral Mathematics**

**Sanjay Reddy** (Department of Economics, Barnard College, Columbia University)

The moral issues that arise in the assessment of international sovereign debt are complex. There are at least six underlying reasons for this complexity. First, sovereign debts may be contracted by persons ostensibly acting on behalf of the population of a country rather than by the members of that population acting directly. Second, the expenditure that these debts make possible may benefit different persons alive in the present or who will be alive in the future in different ways and to different extents. Third, members of the population on whose behalf a debt is contracted are typically of differing ages when the contract is entered into; they comprise both adults (whose endorsements of a government can play a role in directly legitimating contracts entered into on their behalf by that government) and children (whose endorsements cannot play this role); further, they vary in their expectations of subsequent life (and therefore in the share of the ultimate burden of repayment that they may be expected to bear). Fourth, those who will bear the ultimate burden of repayment of international debts may include persons who are as yet unborn. Fifth, a number of the relevant considerations (such as whose births and death occur and when they occur and what level of advantage is experienced at each moment in time by persons who are then alive) are potentially endogenous; they may depend on the extent of the debt contracted, on the manner in which the resources garnered through debt are expended, and on who is required to bear the ultimate burden of repayment and when. Sixth, the assessment of the moral status of international debt (and in particular of the strength of debt repayment obligations) must take note of the fact that debt contracts are entered into in the context of uncertainty concerning future circumstances and that the manner in which this uncertainty is ultimately resolved may owe a great deal to the actions of creditors and third parties. The paper outlines the problem and suggests some practically applicable principles of moral judgment.

### **Heritage of Judeo-Christian Tradition on Debt: Political, Not Ethical**

**Ton Veerkamp**

The first part of this paper reflects the Judeo-Christian tradition on debt problems. The attitude of the Thora, the first five books of the so-called Old Testament of the Bible, is not ethical but political. Since ancient Judean society was oriented by a “comprehensive doctrine,” there was no difference between ethics and politics. Policy in ancient Judea was designed to maintain an egalitarian society based on freedom from serfdom. In a second part the paper stated that in our situation of pluralism and tolerance ethics are not the adequate way to solve the problems of the indebted countries. Rather a political platform of common interests on both sides must be found. In the third part the biblical heritage and the political tasks of dealing with the indebted countries are linked together. Justice is responsible government, responsible in restoring the autonomy of indebted countries to stop the destabilization of the social structures in those countries: more equality, less poverty.

### **Responsibility and Sovereign Debt**

**Alexander Cappelen, Rune J. Hagen, and Bertil Tungodden** (Norwegian School of Economics and Business Administration)

Excessive indebtedness is a fundamental problem for many countries and in many excessively indebted countries parts of the sovereign debt is seen as illegitimate. Much recent normative theory, in particular liberal egalitarian ethics, has focused on the necessary conditions for responsibility and on what it means to

hold agents responsible, and we start out by applying this framework to the question of debt legitimacy. We then discuss problems associated with efforts to establish illegitimacy empirically, focusing on a specific type of plausibly illegitimate sovereign obligations, dictator's debt. Finally, we discuss various mechanisms that could be created to deal with illegitimate debt, emphasizing the need to take into account the likely impact on the behavior of both borrowers and lenders.

### **Sovereign Debt and Intergenerational Justice**

**Axel Gosseries** (Belgian National Fund for Scientific Research)

Several reasons are generally invoked to justify the debt cancellation of the poorest countries in the world. After reviewing such possible reasons, we shall isolate those with a markedly intergenerational dimension. Notably, there is an intergenerational sense in which any foreign debt, be it contracted by a legitimate government or not, is inevitably anti-democratic. This is so because the next generations were generally not asked whether such a debt should be contracted. We shall look at whether such a problem can constitute a proper justification for not having to pay back the debts contracted by our ancestors. And we shall check whether the constant renegotiation of such debts changes anything in this respect.

### **Ethics and International Debt: A View from Feminist Economics**

**Julie Nelson** (Global Development and Environment Institute, Tufts University)

Feminist scholars examine not only the gendered impacts of programs whose design has been influenced by disciplines such as economics, but also the gendered biases that permeate the models and methods of the disciplines themselves. This essay draws on aspects of feminist critiques of economics, philosophy, law, and finance to analyze the ways in which international debt has been framed. How are terms such as "agent," "contract," "ethics," "capital," "debt," and "development" understood within standard approaches? How can these terms be more appropriately and more usefully understood, if gender-related biases in these disciplines are overcome?

### **Catholic Church Activism on International Debt**

**Elizabeth A. Donnelly** (Ph.D. Candidate, Harvard University Department of Government)

In the late 1970s, church and anti-poverty groups began to organize on the issue of developing country external debt, concerned that the burden of repayment fell most heavily on the poor. Efforts in the 1980s principally focused on large, middle income countries, especially in Latin America, whose possible default threatened the stability of the international financial system. Limited debt reduction and rapidly expanding private sector investment in "emerging market" countries in the late 1980s largely defused the crisis in the eyes of creditor country policymakers and the international media. However, in the early 1990s a movement grew to press for debt relief for the poorest, most heavily indebted countries, which tend to owe the vast majority of their external debt to bilateral and multilateral creditors rather than commercial lenders.

By the late 1990s, an extraordinary global coalition of churches, anti-poverty groups, and other civil society organizations came together in the Jubilee 2000 campaign. Invoking a biblical norm from the Book of Leviticus, the campaign urged the international community to mark the millennium by recognizing a period of "jubilee" in which debts would be forgiven and the freed up resources used to alleviate poverty. The lead organizations in the campaign included Christian Aid (UK), OXFAM, EURODAD (the European Network on Debt and Development), and a Washington-based coalition of church and anti-poverty groups.

Nevertheless, the Catholic Church arguably played a unique role in the coalition. The world's largest and oldest transnational organization, it has for over forty years been the leading institutional voice

on the global stage articulating a sharp critique of the international economy for its failure to meet the needs of the world's poor. Its actors on the debt question have included individual Catholics, church personnel (especially missionaries), religious orders and their social action offices, relief agencies, academicians and universities, national episcopal conferences, the Vatican's justice and peace office, and the pope.

The paper will examine the Catholic Church's contribution to efforts advocating debt relief/cancellation from the late 1970s through 2000. It will briefly treat the ethical arguments advanced, and then the process by which various initiatives were taken. The paper will attempt to assess what types of impact the coalition and more specifically the Catholic Church has had, as well as what factors might account for that record. The paper will conclude with lessons the church's advocacy on debt might offer for efforts on other issues, with the understanding that the moral authority of the church's leadership has been seriously undermined by the sexual abuse crisis.

### **Latin America Debt Crises in the Light of Catholic Social Teaching: The Case of Argentina**

**Thomas J. Trebat** (Institute of Latin American Studies, Columbia University)

This paper, which is prepared by a former Wall Street economist and participant in Latin American debt markets, is a retrospective review of Catholic social teaching on international debt with special reference to the case of Argentina. The object is to comb through from a lay perspective the writings of various Church bodies to learn the moral and practical guidance provided by the hierarchy before, during, and after periods of severe debt-induced distress in Latin America. How was traditional Catholic social teaching interpreted in the case of the Latin debt? How did the Church reconcile in the case of democratically governed, middle-income, non-HIPC countries (e.g., Argentina 2002) its preferential option for the poor with the presupposition that debt legitimately contracted should be repaid? How clear and practical was the guidance provided to practitioners (creditors and debtors) and did the Church's teaching have an effect on the eventual outcome of negotiations? These are the questions the paper seeks to address. In order to do so, the paper briefly reviews the main documents of the Church dating back to the 1980s on international debt, including various Vatican encyclicals and statements, documents produced by national conferences of bishops in the United States and Argentina, and statements by the regional conference of bishops (Celam) for Latin America. It considers the Church's efforts to play a constructive role in the Latin American debt crises since the 1980s with a special emphasis on its words and actions as the latest Argentine crisis unfolded after 1999. The author finds that the Argentine debt crisis could have been interpreted by practitioners willing to do so in the light of a consistent moral framework articulated by various levels of the Church hierarchy over a period of two decades. The nuanced framework of the bishops generally avoided extreme judgments and shied away from recommending specific institutional solutions to the crisis. At the same time, the thinking of the bishops clearly traced the roots of the Argentine crisis to a decline in moral values among the powerful, including wealthy elites, governments, and the corporate sector resulting in suffering on the part of the poor which could have been lessened or avoided. Neither creditor groups nor debtor governments will find great comfort or support for their *ex ante* positions in the words of the bishops, but that was not the intention of those who took it upon themselves to interpret Catholic social teaching in the context of contemporary Argentina. A brief bibliography is included of the principal Church documents on international debt with a special reference to Latin America.

### **Lending to Tyrants: Who Should Bear the Cost?**

**Thomas Pogge** (Centre for Applied Philosophy and Public Ethics (ANU) and Columbia University)

Deeply entrenched in international common law is the international borrowing privilege. It entitles any person or group exercising effective power in some country to borrow in the name of its people. No

matter how undemocratically a ruler has come to power and no matter how oppressively he exercised it, the people are obliged to pay his accumulated debts. This practice is convenient to the banks and governments of the wealthy countries and very convenient to tyrants and generals. But it causes great harm to the people of developing countries—by encouraging coups, by strengthening tyrants, by obstructing anti-corruption efforts, and by weighing down poor economies with debt service obligation. The ongoing impositions of this practice, often accompanied by cynical pleas that the poor countries should practice good governance, is a large violation of human rights.

### **Applying the Odious Debts Doctrine While Preserving Legitimate Lending**

**Michael Kremer** (Department of Economics, Harvard University), **Seema Jayachandran** (Department of Economics, UCLA), and **Jonathan Shafter** (Boston Provident)

Many analysts argue that trade sanctions are ineffective because they generate incentives for evasion. Others object to them as hurting the population of the target country as much as its leaders. We argue that loan sanctions unlike trade sanctions may be self-enforcing, and that they help the population by protecting it from being saddled with “odious debt” run up by dictators to finance looting or repression. In particular, governments could impose sanctions by instituting legal changes that prevent seizure of a country’s assets for non-repayment of debt if the debt was incurred after the sanction was imposed. This would reduce creditors’ incentive to extend loans to sanctioned regimes. However, decisions on whether assets can be seized to enforce debt repayment would be subject to bias if they were made *ex post* and the deciding body asymmetrically valued the welfare of debtor countries and their creditors. Restricting such decisions to cover only future lending would help avoid this time-consistency problem. We also discuss several other issues related to implementation, including which international bodies might make the decisions about whom to sanction and what the role of domestic courts might be.

### **Risks of Lending and Liability of Lenders**

**Kunibert Raffer** (Department of Economics, University of Vienna)

Risk and liability change the terms initially stipulated, overruling the otherwise binding nature of contracts. Risk encourages careful assessment of debtors’ ability to service debts. Errors and negligence in assessment, even external shocks, make creditors suffer losses. Disregarding one’s duty of care or professional standards, tortious or illegal behavior makes actors liable to compensate damage, a necessary systemic element of the framework markets need to function well. Both mechanisms were not allowed to work properly in sovereign lending.

This paper analyzes why risk and liability are necessary mechanisms of well-functioning markets, discussing how risk can be handled. In the US inappropriate regulatory norms hindered providing against risk. The absence of liability, a market imperfection, has produced debts no decent legal system would recognize, aggravating the sovereign debt problem, giving rise to concepts such as criminal, odious and illegal debts. Discriminating sovereign debtors and disobeying the Rule of Law distorted markets, caused grave damages to debtors, but also losses to creditors that the mechanisms risk and liability would have avoided. Finally, proposals are briefly presented how to repair these shortcomings in order to avoid the disasters of the past.

### **Unblocking the Path to Broader Debt Cancellation Using Trust Funds**

**Sony Kapoor** (Christian Aid UK, Jubilee USA Network)

One of the most contentious issues in the debate on debt cancellation is how to ensure that the resources released are used for development purposes. Within this, corruption and illegitimate undemocratic governments are seen to be the big obstacles that limit the scope and scale of debt cancellation on offer. This paper examines the possibility of using peer managed trust funds as a vehicle to separate the financing

of a broader debt cancellation from the actual delivery of funds. For countries with no governance issues, funds would be delivered immediately and for those with problems all or part of the funds could be held in trust thus offering a positive incentive for improvement. Thus a political agreement on financing debt cancellation can be reached for a much larger group of countries than has been possible to date. Additionally, such peer managed mechanisms have greater legitimacy in the developing world help improve the north-south power imbalances that exist.

## The “New” Problem of Sovereign Debt

**Christian Barry** (Editor, *Ethics & International Affairs*) and **Robert Hockett** (Cornell University School of Law)

Recent years have seen a renewal of attention paid to the ethics of sovereign debt and its relief. Conscientious observers rightly are concerning themselves with the propriety of requiring nations to discharge their debt obligations fully when, e.g., (a) circumstances surrounding the original transactions grounding those obligations might not have reflected a just distribution of bargaining power between contracting parties; (b) those who originally undertook the obligations might have done so without appropriate consent from those—often the most vulnerable members of society—that stand to be the most adversely affected by strict performance of the obligations in future; or (c) intervening circumstances or events since the undertaking of the original obligations might in some other way have rendered strict performance now ethically ill-advised.

Conscientious observers equally rightly concern themselves with the propriety of not requiring strict performance of sovereign debt obligations when such circumstances as those just adduced do not obtain. For such slacking in such case conscripts and subordinates lenders illegitimately to borrowers, and can both undermine the sanctity of contract or promise and diminish the future availability of credit to those who need it the most.

All of these just concerns share in common a single prototypic scenario—that in which the creditor nation or party is generally well to do and operating from a position of strength, and in which the debtor nation and/or certain of its citizens are less well to do and potentially therefore situated in positions of weakness. It will be salutary, then, and enriching of our considerations given the ethics of global credit and debt arrangements, to notice that by far the largest sovereign debtor nation on the world stage today is the United States. For that fact would seem to be of at least provisionally considerable ethical salience.

What, if anything, does the United States’ overwhelming capacity to attract scarce global credit to itself say about the justice of the distribution of global financial opportunity? What do the uses to which the United States puts that credit—e.g., the uses of unsanctioned military actions and occupations, or of conspicuous domestic consumption by citizens no longer taxed as they once were—say about the same? And what, finally, does the domestic American distribution of credit and consumption opportunity, as well as of the risk of having to perform ever more dangerous military service in order to earn an income, acquire an education or receive health-care assistance, say about the justice of our global credit arrangements?

We seek in this paper to draw a preliminary bead upon some answers to these and cognate questions. In the first part we discuss a number of seemingly telling statistics about global borrowing and spending patterns, and hazard some educated guesses as to the effects of U.S. debt upon global credit availability and pricing. In the second part we sketch the outlines of an approach to assessing those effects ethically, in view of further statistics bearing upon where and to what purposes America’s borrowed funds go and who it is who determines their direction. The third part then hazards a preliminary sketch of what just global credit arrangements would look like, and how they might be had. Then we conclude.

Our work here, we emphasize again, is provisional in nature. The aim is to open a line of inquiry that we think critical to the ethics-of-debt question and yet thus far, for entirely understandable reasons (recall that the United States was not a net debtor nation, post-1993, until recently, though it was during the Nixon and Reagan years too), not treated.

## **The Transformation of the International Financial System (1971–2005): The Injustice of the Poor Financing the Rich**

**Ann Pettifor** (New Economics Foundation)

“Since 2000, the developing world has been a net exporter of capital to the advanced economies.”  
*World Bank, “Global Development Finance: Harnessing Cyclical Gains for Development,” 2004, p. 7.*

“The largest international flow of fixed-income debt today takes the form of borrowing by the world’s richest nations at (probably) negative real interest rates from countries with very large numbers of poor”.  
*Larry Summers of Harvard University in Business Times, 9 March 2004*

“[E]xternal imbalances have never been larger in the postwar period. Any or all of these numbers might well revert to the mean, with associated implications for global economic growth. . . . Such an unwinding might be gradual, and possibly benign, but it could also be rapid and disruptive. In large part, what happens will be determined by real-financial interactions that we should not pretend to fully understand. . . . Everyone needs to commit to some unpleasant compromises now, in order to avoid even more unpleasant alternatives in the future.  
*Bank for International Settlements Annual Report, 27 June, 2005*

The restructuring of the international financial system in 1971, brought about by the US’s unilateral dismantling of the 1944 Bretton Woods Agreement, led to one of the biggest sovereign defaults in history: the US’s refusal to honour its foreign obligations in gold. If the US had followed the creditor-oriented rules to which European governments had adhered, it would have sacrificed its world position. Gold would have flowed out, and Americans would have had to sell their international investments to pay for, amongst other things, the war in Vietnam (Hudson, 2003).

Instead the US abandoned the key-currency standard, based on the dollar’s convertibility into gold, and introduced a new standard: the dollar-debt standard. Instead of being able to use their dollar earnings/revenues to buy US gold, foreign governments were, and are, effectively obliged to buy US governments debt (Treasury Bills) at low real interest rates (and to a lesser extent US corporate bonds and stocks). The emergence of the Euro as an international currency has provided foreign governments with an alternative; instead of using reserves to lend at low interest rates to the US’s Federal Reserve, central banks now have the choice of lending at low interest rates to the European Central Bank.

The international financial architecture put in place by the Nixon administration and its allies, and then liberalised by the Thatcher/Reagan administrations, helped transform the US and the UK from major exporters of capital, into major importers of capital. Today, contrary to economic orthodoxy, capital flows from where it is scarce (low income countries with large numbers of poor people) to where it is plentiful (high income countries with large numbers of rich people).

At the same time the system places no obligation on these major debtors to structurally adjust their economies and restore balance. On the contrary, the flow of capital to the US and UK has helped create the largest current account deficits in history; led to extended consumption booms; and lowered exchange and interest rates. Lower exchange rates allow the UK and US to import goods from poor countries at prices much lower than they would otherwise have to pay.

This injustice at the heart of the international financial system is seldom explored when commentators deplore the major imbalances in the global economy: the massive build-up of foreign reserves by e.g. China and Japan; and the massive US and UK foreign deficits. However if we are to tackle the systemic injustices of the global economic order, and avert the threat of a severe international financial crisis we must start with a transformation of the international financial architecture itself.

In my contribution I will draw on the work of the new economics foundation (real world economic outlook, Palgrave 2003); and also on the work of a group of Keynesians (Tily and Chick) to explore ideas for a new, more just and ethical international financial order.