Are States Entitled to Default on the Sovereign Debts Incurred by Governments in the Past?

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ABSTRACT. In this article I claim that states are in general morally responsible for repaying sovereign debts incurred by governments in the past. However, once we understand the reasons why they are morally responsible for repaying them, we should conclude that a portion of them are not binding. The steps of my argument are the following. In the first place, I reject the philosophical accounts that have been provided so far to explain why states should honour debts incurred by governments in the past. Second, I propose my own positive account, which relies on an analogy with private law. Third, I show that the strategy of relying on private law also leads to the conclusion that, under certain conditions, the general claim that debts ought to be honoured is not valid. When these conditions are satisfied, states are morally entitled to repudiate their debts.

KEYWORDS. Global justice, debt default, intergenerational justice, private law, international finance

I. INTRODUCTION

The debt crisis that started in 2007 in the US, and had an impact in Europe and the whole world, is essentially over. The markets are now, in general, stabilized. Bailouts made by the US governments have been recovered, most of the stock markets in the world are higher than they were at the time of the crisis, and the economy of the US is showing signs of recovery. A similar crisis might return, but at least this one seems to be gone.

However, there are many regions and countries in the world for which debts have been and continue to be a heavy burden. The debts I am referring to are *sovereign* debts; that is, national debts that states owe to the international community (typically private investors, other states,

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the IMF, and the World Bank). Possible examples are countries affected by the recent European debt crisis, such as Portugal, Ireland, Greece and Spain; and also many developing countries in Africa, South America and Asia. Some of these countries benefitted from the HIPC and MDRI initiative[1], which are programmes designed by the IMF and World Bank to alleviate heavily indebted poor countries from the burden of repaying their debts (in return for some economic reforms). But these programmes have only assisted a few countries – in general, the extremely poor ones. Many others continue to be burdened with sovereign debts, and they are not eligible to qualify for these programmes.

The effects of debts on these countries is in general pervasive. Paying them off shrinks their national budget, affects their trade policy, and generates currency instability. The African continent, for instance, owes hundreds of billions of dollars to the international community. If governments of debtor countries were not paying off that debt, they would have more freedom to invest in public goods, such as schools, roads and hospitals. Poverty could even be eradicated for entire generations with that amount. Also, since most of these debts are nominated in foreign currency, and in general the only way to obtain foreign currency is by having a trade surplus (i.e. by generating more exports than imports), debtor countries often end up having no viable alternative but to adopt a trade policy they do not necessarily want to adopt. If the burden of debt did not exist, debtor nations would have more autonomy to choose alternative trading schemes. Additionally, they could have more foreign currency available for themselves, which they could use to better preserve the value of their local currency, to increase imports, or to facilitate trips abroad for their citizens. Broadly speaking, it is possible that in the absence of debts, governments would still run the economy of their countries inefficiently or corruptly. However, for states whose governments are making an effort to use public funds for the benefit of their population, debts are clearly a *setback*.

Despite the fact that debts have a crucial impact in the economy of countries, little has been said about them in the global justice literature.

Debts should of course be honoured, and failure to honour them is a grave moral wrong. Thus, the debts of the poorest countries are a major difficulty for them, although at first glance they are not an injustice, given that they have borrowed under the promise of repayment. However, if we figure out the *reasons* why states should honour promises made by governments in the past, we should conclude that a huge amount of current and past debt should *not* be honoured and should *not* have been honoured in recent years. In other words, if we understand the general reasons why promises made by governments in the past are binding for current generations, we will also be able to understand why there are possible exceptions to these promises.

In this article I will show that many debtor countries are morally entitled to default on a large portion of their sovereign debts. I will do this by demonstrating that exceptions to the general claim that governments have the obligation to repay debts incurred by governments in the past should be made. I proceed as follows. First, I will show why currently existing philosophical accounts have not been able to justify inheritance of obligations across generations. Second, I will propose an alternative positive account to show *why* governments have the moral obligation to repay national debts incurred in the past. We can find a strong argument in support of this account by relying on an analogy with private law. In private law, lenders have priority over heirs to the funds they lent to their predecessors, so heirs should 'discount' that debt from the inherited package. Similarly, lenders have priority over loans made to governments in the past, so successor governments should bear the responsibility for these debts (by using a portion of the national treasury to repay them). Third, I will show that the strategy of relying on private law also reveals why there are *exceptions* to inheritance of debts. In private law, when an agent acts fraudulently in the name of the person he or she represents (the principal) by embezzling the borrowed funds, and lenders are aware of possible corrupt uses of the funds, the person in whose name the loan is incurred is not 'on the hook' for the debt. Thus, the heirs of that

person are fully entitled to the assets they inherit. Similarly, when governments acts corruptly and in the name of the state they represent by embezzling funds, and lenders are aware of possible corrupt uses of the funds, the state is not 'on the hook' for the debts. Thus, successor governments do not have the obligation to use funds from the national treasury to repay these debts. These debts are not binding on the state.

II. Inheritance of Responsibilities: Alternative Philosophical Accounts

Why should governments honour the debts incurred by governments in the past? In other words, what is the nature and basis of the legal and moral continuity of states across time? These questions are puzzling. Governments from the past are different from current governments, and citizens of past generations are not the same as citizens from current generations. Thus, it seems unfair at first glance to claim that current governments and generations should be held responsible for promises made by others in the past. This issue has been addressed by scholars and some (not many) answers have been proposed. I will discuss here three possible proposals, and will argue that they are unconvincing.

The Contractualist Approach

We can call the first possible solution to the puzzle described above 'contractualism'. According to this view, the reason why states have the moral obligation to honour debts contracted by governments in the past relies on two premises: (i) governments made promises of repayment in the name of contemporary and future generations when they borrowed; (ii) promises should not be broken. It follows from (i) and (ii) that debts ought to be repaid.

This argument is typically made by lawyers and economists, mostly in contexts in which a possible debt default is discussed, but similar

versions have also been defended by philosophers. Janna Thompson, for example, states that "[...] the moral practice we think we ought to adopt in relation to the promises of our predecessors is determined not by whether we actually make posterity-binding promises, but by what we think our successors ought to do were we to make them" (2002, 18). Thompson believes, in other words, that treaties signed in the past ought to be honoured, basically because they involve *promises*. The reason why these promises ought to be honoured, she maintains, is because we believe it is the right thing to do; and we believe it is the right thing to do because we think that our successors should honour our promises were we to make them.

As presented, however, the contractualist argument faces an obvious objection, namely that current generations could not have consented to debts incurred in the past, for the simple reason that they did not even exist at that time. Thus, they never really made any promise; and they consequently cannot be held responsible for such promises. It follows from the premises above that states should honour debts of the generations that lived under the government that made them (probably, if certain conditions are satisfied); but contractualists cannot justify inheritance of responsibilities from those premises alone.

Thompson's argument is likewise unpersuasive, but for different reasons. For Thompson, current generations ought to honour promises made by past generations because it would be hypocritical to believe that our successors ought to honour promises that we make, while we ourselves refuse to honour the commitments made by our predecessors (the implicit message that she seems to be endorsing is the following: "We have to pay off my debts, because we believe future generations ought to repay our debts").

The problem with this argument is that successor generations can have completely different beliefs about what the following generations have to do. Maybe they will think that future generations do not have any kind of obligation at all. If that happens, it would not be hypocritical for

them to refuse the debts they inherited. In such an instance, their message might be: "We do not think future generations should repay the debts they inherit from us, as we do not think that we should be held responsible for the debts that we inherited either". Thompson's argument fails because she relies on the premise that any given generation will believe that the following one will have the moral obligation to repay the debts, but she offers no argument for this; she simply states it.

Finally, the contractualist can try to make the case that current generations have an obligation to honour debts incurred in the past by appealing to the notion of consent in a more sophisticated way. According to this strategy, debt inheritance can be justified by following the well-known Rawlsian 'veil of ignorance' justificatory procedure (1999). How would the idea of the veil of ignorance apply to the case of debts? We can imagine that in such a hypothetical scenario representatives of parties would represent an entire generation, they would not know what generation they are representing, they would have to discuss how much to borrow, and what generation would bear the burden of these debts. The point that the contractualist would then make is that, behind such a veil of ignorance, as modelled, representatives of parties would agree on borrowing funds and bind a society across generations, as it would be more convenient overall for that society to borrow than not borrowing at all. So to the question of why generation G2 would have to honour the debts incurred by G1, the contractualist would answer that G2 agreed, behind the veil of ignorance, that an arrangement under which societies could borrow across generations is better for his or her society than an arrangement under which they could not borrow at all.

Buchanan (1987) discusses the merits of this possible strategy, but shows (convincingly, I think) that it would not work either, because it would be impossible to reach an agreement behind such a veil of ignorance. In fact, it would be too risky for each of the representatives to accept the burden of a debt for a random generation, given the fact that these representatives and the individuals they represent might themselves end up being

affected by such debts. If representatives of generations G1, G2 and G3 agreed that any given generation can borrow and bind the following one, they would also have to accept that their own generation could be the one that ends up being burdened with the debt incurred by the previous one. But it would be irrational for them to accept such a deal. It would be smarter for each of these generations to maintain the status quo (that is, to prefer a scenario under which neither party would be allowed to borrow), as in that scenario there would not be any risk of unwanted debts.

So the standard contractualist view does not work, for the simple reason that it relies on the idea that the legitimacy of promises is based on the idea of consent, and no consent is given by current generations to promises made by past governments, and not even hypothetical consent exists.

The Libertarian Approach

Libertarians have offered a different solution to the puzzle. Their position, simply stated, is that these kinds of obligations do not even exist, because it is not possible to show consent of any kind. This is the view that, for example, the libertarian economist James Buchanan has adopted. What Buchanan states is that the only reason why current generations should honour debts from the past is a rational one: it is in general convenient for states to repay them, so that they are not excluded from financial markets in the future. This claim makes sense, given the fact that countries that default on their debts are normally unable to have access to more loans afterwards, or are 'punished' with high interest rates. Buchan states, however, that there is no moral reason why states should honour debts incurred by their governments in the past, precisely because they never consented to them. Buchanan thus becomes an unintentional critic of the contractualist approach mentioned above.

Nevertheless, the position that James Buchanan and other libertarians have adopted on whether current generations should honour promises of debt repayment in the past seems similarly unconvincing. The problem

with Buchanan's position is that if we are fully consistent with it, we should conclude that *all* debts incurred in the past can be repudiated, no matter what their origin and nature. This conclusion could also be extended to other domains. If responsibilities should never be inherited, and only prudential factors counted, we should conclude that states should be allowed to repudiate all kinds of commitments made in the past by governments, including trade and environmental agreements, conventions, etc., on the grounds that current generations have not consented to them. This view, however, would go against the moral intuitions of most of us. Typically, we believe that states *do* have legal and moral continuity across generations, and that at least some of the commitments made in the past by governments ought to be honoured by current generations. It will be clear, of course, that this objection against Buchanan does not fully refute him. The fact that his conclusion sounds unintuitive does not mean that it is incorrect. But the fact that his view leads to such an extreme position, and that such a position seems implausible, leads us to believe that perhaps we should look at a different way to understand the legal continuity of the state across generations.

The Consequentialist Approach

The third possible answer to the question of why current generations ought to respect promises made by previous generations can be called 'consequentialist', as it is based on the idea that the morality of an action is based on the outcomes that result from it.[2] This view, applied to the case of debts, can be interpreted as implying that states should honour the debts incurred in the past so that international financial stability and order is preserved. In fact, if countries were allowed to repudiate their debts, and this happened universally, it would be impossible for any financial order to exist at all. The idea that states should honour their debts for consequentialist reasons is also present in current international law (cf. Howse 2007, 7).

But this response faces a problem that is similar to the problem faced by Buchanan. The fact that it is convenient for a state to pay its debts, or for a lender to enforce their payment, does not obviously mean that the debt itself is morally binding. The consequentialist argument, in any case, would imply that it is better for the sake of the international order that states pay debts that are not theirs. But the argument does not prove that there is a general responsibility to honour debts incurred by past generations. An extension of the argument to the private law case would imply that individuals ought to honour the debts of their ancestors to preserve the legal stability of their society. But this is obviously not the case. There are different reasons why these debts should be honoured (which I will discuss later in the article), but the fact that the stability of the legal systems ought to be preserved is not necessarily among them.

III. The Desert-Based Account of Inheritance of Responsibilities

Given that existing accounts are misleading, we need to replace them with a better proposal. In his book *National Responsibility and Global Justice* (2007), David Miller has provided what I think is one of the most promising ways of responding to this question. His argument is also at the heart of current international law, and underlies common intuitions. I will explain this account, and see whether it can plausibly be applied to the case of states.

Miller believes that the puzzle of debt inheritance can be solved by making a correct interpretation of legal doctrine, and by carrying out an investigation into its underlying moral principles.

The reasons why states inherit responsibilities from governments of the past is analogous to the reason why individuals inherit responsibilities in domestic law, Miller says. According to Roman law, successors (the heirs) have the right to decide whether to accept or reject the inheritance of a deceased predecessor. If they do not accept it, they will not be able to benefit from the inheritance, and they will not have the obligation to pay

off the debts of the deceased person. But once they accept it, they will have the responsibility not only for paying debts and restoring the property of the deceased person, but also for other liabilities incurred by the person whose heir they are, including, for example, breaches of contract committed by the deceased. In other words, heirs can never be worse off as a result of debts incurred by their predecessors, and unless the debts of their predecessor exceeds his or her total assets, unless the heir *voluntarily* accepts to make him or herself responsible for the debts of his or her predecessor. So, if someone inherits €100,000 in assets from a deceased parent, and the deceased parent had debts worth €60,000, the heir has the right to inherit €40,000, and the creditor of the predecessor is entitled to the remaining €60,000. If the debts of the predecessor exceed €100,000, and the heir decides to accept the inheritance, he or she will end up inheriting a negative asset and will be responsible for restoring the debts of the deceased person. Thus, the burden of debts incurred in the past falls on the heir, and not on the creditor.

This is what positive law states, but there are also moral reasons why law is and should be set up this way, which underlie positive law. It is important to see what these moral reasons are, and to make them explicit, as these are the moral reasons that might also justify the legal continuity of states and, more specifically, the inheritance of state debts. One such moral reason is the following. In the dispute about who should bear the burden of the debt generated by the deceased person - the heir or the creditors of the deceased person – the balance of the argument is in favour of creditors, even if the creditors have died. This is because the moral case for inheritance is weak: heirs do not do anything to deserve the amount of money that the ancestor owes, while creditors used part of *their* wealth to benefit the now deceased person. There is no clear reason why the heirs should have priority over the creditor.

It should be clear at this point therefore that there is a strong moral principle that underlies positive law: the principle of desert. This principle takes into consideration the fact that heirs do not really deserve whatever

benefit they inherited from their ancestors, whereas the creditors do deserve (presumably) the money that they had lent in the past. It argues, thus, that the case of the person who inherits is in general weaker than the case of the person to whom funds were owed. This argument also extends to the heirs of the creditors. Since heirs are the rightful and legal owners of the property they have inherited from the creditors, and creditors are the rightful and legal owners of the money they had lent, it follows that heirs of creditors are entitled to recover the debt.

In sum, the reasons why heirs have the obligation to honour promises made by ancestors in the past are, basically, that the case of creditor is stronger than the case of the heirs, for the creditor lent money under the promise of restitution, while the heirs did not do anything to deserve the inherited wealth. The possible immediate reply here is that it would be unfair to burden heirs with debts they did not incur. However, under private law, no such burdens are incurred: the heirs always have the option to opt out of the inherited package of 'benefits'.

IV. States and Individuals

We can rely on the conclusions reached so far to explain why states are responsible for repaying debts incurred by governments in the past. The moral arguments that underlie the justification for debt inheritance can also be applied to the case of states.

How does this idea apply in more specific terms? In the previous section, I made the point (following Miller) that what justifies inheritance of responsibilities across generations in the individual case is the principle of desert: in balance, the case of the creditor is stronger than the case of the debtor, for the debtor did nothing to deserve the inherited wealth, while the lender had invested part of his or her wealth. In order for this idea to apply at the national level, it would make sense to claim that generations in G2 inherit assets from generations in G1, and that the benefits

or assets inherited by G2 exceed the value of the funds they have to repay.

In what sense can we describe generations as inheriting assets from previous generations? Generations do not always inherit cash (or funds in the National Central Bank), as sometimes happens between individuals of different generations; but it makes perfect sense to claim that they inherit natural territories, infrastructure (such as public buildings and bridges), cultural capital and so on. Although there is not an exact moment in time when inheritance is transferred from one generation to the other, each generation enjoys benefits that would not have existed had the previous generation not generated them.

That generation might also inherit debts attached to the said territory. Perhaps the IMF lent money in the past to the state in question; or perhaps private investors bought bonds from that state. Why do current generations have the obligation to repay these debts? As in the individual case, the reason is that, on balance, the claim of the creditor is stronger than the case of the population of the successor state. The lender had invested part of his or her wealth under the promise that the state was going to honour it, and the successor state did nothing to deserve the inherited wealth. So, as in the individual case, the case of the lender to recover the funds is stronger. The case of debt obligation, in other words, needs to be weighed against the rights of lenders to recover their funds.

We can apply this idea to a specific example. A public official contracts a debt with the IMF and then uses these funds to build up roads and hospitals. Since the new generations benefitted directly from these public hospitals and roads built in the past, and used part of their wealth to build them up, in a possible default dispute about who should bear the burden of the debt, the creditors seem to have a stronger case.

One might argue, however, that the analogy between states and individuals I am putting forward does not work, on the ground that there are two important disanalogies between the domestic case and the international case. I will call the first of these the 'negative asset' disanalogy and

the second the 'continuity of generations' disanalogy, and I will address each of them in turn.

The 'Negative Asset' Disanalogy

While individuals, according to Roman law, can refuse their inheritance, states cannot. If heirs can expect to inherit more in debts than the total asset, then they are allowed to refuse the whole inheritance. In fact, it would be fairly easy for individuals to refuse to inherit assets (they can do so simply by making it explicit to lawyers). States, however, do not have the option to refuse the assets they inherit. Thus, when the national debt they inherit is worth more than the accumulated assets of the country, states will end up forcefully inheriting a negative asset.

How does this idea apply to a specific case? If someone inherits €10,000 from a deceased relative in debts and only €4,000 in assets, it is possible, legal and expected for that person to decline the 'whole package' and not to inherit anything at all, instead of inheriting a negative asset of €6,000. However, if a state inherits from a past government an external debt of 5 billion euros, and the total national assets of that country are estimated to be less than that, it looks like contemporary generations will forcefully end up paying more than they inherited.

If we carefully examine this objection, however, we should see that it does not entirely vitiate the analogy between states and individuals. As suggested above, the fact that individuals can decide not to accept the inheritance of their predecessors suggests that such heirs will never inherit a negative asset if they do not want to, as it is always an option for them to refuse the whole package (i.e. both the debts and the assets). Contrary to the objection's point of view, states are no different in this respect. There is also a sense in which states will never inherit a negative asset. Unlike individuals, states do not die, and they never declare bankruptcy. So even if they inherit a negative asset from past generations (say, an extremely inept government borrows much more money than the value

of the entire country), states can always decide through their governments to pay back the portion of the debt they decide is convenient, while still maintaining the country's operational capacities. Selling all kinds of essential public goods (such as courts, legislature and municipal buildings), natural resources and territories attached to the state so that debts can be repaid is not morally required. If the duty to pay off debts had moral priority over states' entitlements to natural resources and basic assets, and the worth of the public debt was higher than the total worth of the assets of the state, two consequences would follow. First, paying off such debts would lead to a scenario under which it would not be convenient to live under a state anymore. The right to the territory, natural resources and basic public assets are preconditions for a state to exist, and if a state does not exist there would not, of course, be a state debt in the first place. Second, the legitimate authority of states to coerce citizens into paying taxes rests on the fact that funds obtained through taxes will be used to enforce citizens' rights, or for citizens' benefits. If the state was required to bear the burden of an inherited debt, and the amount of debt was higher than the funds the state had collected through taxes, then the state would have no moral authority to force citizens to pay taxes anymore. Why would citizens consent to be members of a state that creates a burden for them, instead of a benefit? The only reason why they would accept it is that they would be forced to do so, but, in that case, they would pay their taxes out of fear of the consequences and not because there would be some sort of obligation to do so. This is the kind of dilemma that Greek citizens currently seem to be facing, with respect to their debt with foreign creditors. For them, accepting the burden of the debt they inherited is a matter of convenience. In the cost/benefit analysis, the majority believe that preserving the current currency, the euro, and abiding by international laws is far more convenient than not doing so. Almost no one believes, however, that Greece has some sort of moral duty to repay its debts.

Thus, contrary to what international law prescribes, there are limits to states' obligations to repay their debts. Such limits are determined by

the fact that states need some basic wealth in order to preserve themselves as states. The objection that the principle of desert cannot be applied to states as to individuals, because states are different from individuals (in the sense that states can never refuse an inherited debt), thus fails. Individuals are morally entitled to refuse the inherited wealth if the total assets are negative, as it would be unfair to make them responsible for a debt they have not contracted. Similarly, states are entitled to refuse inherited debts if the amount of money owed is higher than the total worth of the state.

The 'Continuity of Generations' Disanalogy

When talking about private inheritance, it is very clear who the relevant parties are. They are individuals with finite life spans. It is clear when the ancestor dies and the disposition of the inheritance, both assets and liabilities, must be determined. But with states and generations, this is not entirely clear. The state does not really 'pass away' (although a state today is probably different than the same state, say, 50 years ago), and it is not evident when exactly one generation ends and when the next generation starts. So, unlike inheritance at the domestic level, there is no clear discontinuity between those who incur the debt and those who might inherit it.

Two things can be said about this point. In the first place, the difference between both levels does not affect the main conclusions I am putting forward in this article. The idea that no one can be made worse off due to decisions made by someone in the past applies to both the domestic and the international levels. The fact that the boundaries between generations are blurred does not weaken this moral claim. The task of finding a clear division between generations seems then to be practical rather than ethical. This leads us to the second point. It might not be clear who the relevant agents for the international case are, but at least *it is* clear when a *government* ends, and when a new one starts. This is publicly available

information. So, for the sake of simplicity, we can say that when generation G1 borrows *through their own government*, and the government of G2 inherits that wealth, the creditor has priority over the funds over the government of G2. However, if the government in G1 borrows excessively (say, more than the total worth of the state), then the subsequent government is entitled to repudiate (a portion of) that debt. In light of this distinction, the analogy with the domestic case becomes clearer.

It is hard to determine how exactly this ethical argument can be embodied in international courts. Perhaps a detailed scrutiny of the origin of each of the debts inherited from past governments, and an investigation into the basic assets that a state needs in order to continue to exist as a state, would be the first necessary step. Clearly, more research needs to be done in this regard. However, the ethical argument that I put forward here should lead us to the conclusion that current international law ought to be reformed in some direction, as currently *all* sovereign debts, regardless of their origin, are considered to be binding for nations.[3]

The arguments examined so far give us reasons to justify debt inheritance. Such reasons can be found by examining private law and its moral underpinnings. An interesting upshot of the strategy of relying on private law is that it is also useful to show why some debts should *not* be honoured by states. In fact, private law is also very clear about the cases in which debts are not binding.

I have mentioned already that states do not have the obligation to repay their debts whenever it exceeds the total worth of the state. But there is an even more radical conclusion we can reach from the comparison with the individual case. In some cases, the amount of money owed, even if it is smaller than the amount of money inherited, should *not* be taken out of the inherited package. In other words, individuals are entitled to the full amount of the inherited wealth. Similarly, we should conclude that a large portion of debts incurred in the past by states are not binding, and successor inheriting governments are entitled not to repay them. Conversely, in some cases, lenders are not entitled to recover from debtors

the amount of money owed. In the state case, international lenders are not entitled to recover from states to which they have lent. This conclusion can only be reached by showing that there has been some kind of fraud involved, and by showing how exactly fraud fits into the picture.

The reason why using this analogy necessarily leads to this radical conclusion is the following. In the case of national debt, individuals who borrow money (i.e. public officials) are different from individuals who inherit the debt (i.e. citizens of the state). Public officials bind the whole state because they are the legal and moral *agents* of that state, and they are thus authorized to borrow and to spend those funds in the name of the state, as long as they do it within certain limits.

So the proper analogy with the private law case is one in which there is an authorized agent, let us call him or her A, who borrows money from the bank in the name of B. Can we now apply the same moral principle that we have been applying so far, and say that the heir of B should repay the debt of B, after B dies? The answer is 'yes', but one important exception applies: if the agent, A, oversteps his or her authority and uses the borrowed funds for purposes that are *clearly* outside his or her mandate (for example, he or she buys a fancy car for a friend), and the lender knows or *should have* known that this was very likely going to happen, B (the agent in whose name the debt was incurred) is not responsible for repaying the debt. In private law, since the borrower defrauded the lender, the person in whose name the loan was taken out is not a party to the transaction. Thus, this debt cannot be passed on to future generations after B dies, because B was never bound by any debt in the first place. This is clearly what positive law stipulates in most of the legal systems across the world. Positive law, in this case, is not mistaken: it is the most plausible way of setting things up.

Someone might be sceptical about the fact that positive law can be used to justify the non-repayment of a debt. However, there are specific principles of positive law that can be used to justify such action. The most important principle is *agency law*. Agency law can be defined as a consen-

sual relationship created by contract or by law where one party, the principal, grants authority for another party, the agent, to act on behalf of and under the control of the principal to deal with a third party. An agency relationship is fiduciary in nature, and the actions and words of an agent exchanged with a third party bind the principal. Agency law also states that whenever the agent exceeds or oversteps his or her mandate as an agent, and acts for his or her own personal gain, the principal is no longer bound by the agent. This is especially true if the party who is dealing with the agent is aware, or should have been aware, of the fact that the agent was going to overstep his or her authority. So, for example, as Buchheit, Mulati y Thompson (2007) show, agency law in the US states that when a corporate office signs a guarantee for a debt for which the corporation is not receiving any benefit (that is, when the agent exceeds his or her mandate), the "[...] duty of diligence in ascertaining whether an agent is exceeding his authority devolves on those who deal with him, not on his principal" (2007, 1240). This means, in practical terms, that the loan is at the lender's risk. If there are clear and visible indications that the agent will misuse the money, the lender still lends, and the agent runs away with the funds, or uses it for purposes for which he or she was not authorized, the principal is *not* bound by the loan. This is because the lender had the duty of diligence to check whether the agent he or she was dealing with was exceeding his or her authority. The authors mention a real example to illustrate this idea. In a well-known case, in which the vice-president and treasurer of the Anaconda Corporation purported to act for Anaconda in guaranteeing the debt of another company, the court held that the third party, the recipient of the guaranty, could not rely on the asserted agency to bind Anaconda.[4] What shifts to the third party in the burden of verifying the agent's fidelity to his or her principal in a particular transaction is the presence of visibly suspicious circumstances or behaviour.

Using agency law to analyze state debts is not far-fetched. In fact, the idea that public officials are the 'agent' of the citizens (who could be considered the 'principal'), and the idea that public officials are authorized

to act within certain limits, have been present in political philosophy at least since early modern times. Hobbes, for instance, has claimed that citizens give the state the right to act on their behalf:

> As the Right of possession, is called Dominion; so the right of doing any Action, is called AUTHORITY [and sometimes warrant]. So that by Authority, is always understood a Right of doing any act: and *done by Authority*, done by Commission, or License from him whose right it is (1651/1996, 107).

The notion of 'consent' also works in similar ways in both agency law and political philosophy. In agency law, the principal consents to being represented by agent X or Y and, also, to conferring a certain list of rights to this agent. This list is almost always limited. A real estate agent can rent property in the name of the agent, but cannot do other things with it, such as organizing a party for their children when the agent is away on holiday. Similarly, in political philosophy, citizens 'consent' to being ruled by public official X or Y (at least ideally) and, importantly, they also 'consent' to conferring a certain list of rights to this official. This list is almost always limited. The boundaries of legitimacy of public officials are determined by obligations attached to their office. A public official may borrow for the purposes of protecting basic human rights of the population, but may not borrow for the purposes of violating these rights for private gain. Someone might argue here that the view that public officials are the agents or servants of people applies to some societies only (particularly liberal societies). Despotic regimes, after all, regard themselves as the *rulers* of their people, rather than their agent or their servants. However, as Buchheit, Gulati and Thompson (2007) have observed, agency law also applies in other (non-liberal) jurisdictions. *World Duty Free Co.* v. *Republic of Kenya* is a good illustration here.[5] In this case, a businessman bribed President Moi to obtain a contract with the Republic of Kenya. The businessman argued in his defence that this bribe was not paid to the agent of the state, because the President was one of the few "[...] remaining 'Big Men' of Africa, who,

under the one-party State Constitution was entitled to say, like Louis XIV, *he was the state*" (Buchheit, Gulati and Thompson, 1239, note 128). The defender's strategy, thus, appealed implicitly to the idea that the payment was not really a bribe, because the president was the state and, consequently, he was entitled to decide what to do with the money. The notion of 'bribe', as we can see, assumes that the agent is exceeding his or her entrusted power. But if we believe that there is no entrusted power, and that the ruler equals the state, the notion of 'bribing' becomes meaningless. Offering money in return for a contract, in that case, would simply be like offering money to an individual in return for a favour; there is no wrong implied in such agreements. The arbitral panel did not accept the plaintiff's argument and argued that President Moi was "[...] no more than an agent for the state, no matter what his self-conception might have been" (Buchheit, Gulati and Thompson, 1239, note 128). The idea underlying this statement was also, as in agency law, that a ruler is not the state and cannot use public funds as he or she pleases.

If the parallel between agency law and state borrowing makes sense, and we agree that citizens could be considered the principal and public officials the agents, we can conclude that there will be many circumstances under which the population of a state will not be bound by debts incurred by public officials. If a public official borrows 10 billion euros from the IMF in the name of the citizens for unauthorized purposes (e.g. channelling the said funds to the public official's private bank account), and it is clear, or should be clear, to the lenders that the official is borrowing for such purposes, then the citizens cannot and should not be held liable for the debt. It also follows from this that the debt in question, clearly, cannot be passed on to future generations, for *there is not even a state debt in the first place*. The state in this case is no longer a moral unit (i.e. the state cannot be considered holistically responsible for the debt) and, therefore, cannot pass on its debts to future generations. The moral principle of desert that we have been using so far no longer applies: in a possible dispute between lenders and

future generations, the case of the lender becomes weaker, because his or her loan was not innocent.

The point of this discussion is to show that if we rely on private law to explain *why* responsibilities are inherited across generations, we should be fully consistent with this idea and notice that private law also entails that there are *exceptions* to debt inheritance. In other words, by relying on private law we obtain two interesting results: first, we are able to justify the inheritance of debts in a plausible way; second, we are able to show why there are exceptions to the obligation to repay inherited debts – or similarly, why states can be said to be entitled to repudiate or default on some of their debts.

How would the account I am putting forward apply to a particular country? Take, for instance, the case of Argentina. During the dictatorship in the 1970s, the *de facto* government borrowed billions from the international community, and used a portion of these funds to favour local companies corruptly, or to oppress the population. During the 1990s, the government was democratically elected, but borrowed excessively, and for purposes that did not benefit the country at all. Some of these loans, for instance, were used to refinance debts inherited from the dictator governments, or to sustain a massive budget deficit. These facts are, of course, disputable (as facts tend to be), but let us assume that they are right. The question we should now ask is the following: did the new government (the one that came to power in 2003) have the moral obligation to repay *all* those debts? Following the account I am proposing, the answer is 'no'. The reasons are the following. First, the total amount of debt inherited by this new government largely exceeded the total 'worth of the state'. Had the government repaid the full amount owed, as the creditors wanted, the state would not have been able to preserve itself. In fact, the debt at that time was 191 billion dollars, which was approximately 160% of the GDP of the country. Clearly, the creditors did not want a full repayment of that debt in one single transaction. However, it was impossible for Argentina to even service the portion of the debt

creditors were demanding, as the country was not generating enough foreign currency (Michalowski 2007, 27). Given that a person or a state should not honour a debt if the total assets they posses are less valuable than the amount of debt they have inherited (as I showed earlier in the article), it follows that Argentina did not have the moral obligation to repay the amount of money creditors were demanding.[6] Second, most of the debts incurred by the dictatorship during the 1970s fell into the category of 'odious debts' – that is, into the category of debts that were fraudulently incurred in the name of the state by a corrupt/illegitimate government. The exact amount of money that can be classified as odious is unclear, and an investigation into the details is beyond the scope of this article. However, according to my account, the government of 2003 did not have the moral obligation to repay debts and interest rates associated with odious debts either. Of course, a prudential argument can be made here: repudiating a debt might bring about negative consequences for the future (loss of reputation, exclusion from financial markets, etc.). But the validity of the ethical argument I am posing here is independent from prudential considerations. How and when this ethical argument should be posed in practice, is a topic that will not be discussed here. However, I can briefly state that it is good for states to know *when* their debts are not binding, so that they can *choose* to repudiate them should they find it convenient, and so that we can know how the international lending system should be reformed.

The case of Argentina is not an isolated one. In the recent history of loans, huge amounts have been contracted by governments for corrupt purposes for which they were not authorized, such as enriching themselves, oppressing the population, benefitting friends and allies, or nationalizing private debt. Moreover, lenders knew or should have known about the corrupt or illegitimate purposes of these loans, so the loans were not made in good faith. These loans, thus, failed to satisfy the requirements that need to exist for a debt to be passed on to the people and, therefore, to future generations.

There are many examples of these kinds of loans in the recent history of borrowing. Currently, the legitimacy of most of the debts of African and Latin American countries is under dispute, precisely because of the fact that many of the governments of these countries used funds for purposes that exceeded their legitimate authority. It is hard to establish the exact amount of money involved, but some estimation can be made. Boyce and Ndikumana have recently shown in their book *Africa's Odious Debts* that the amount of money that public officials of the recent history of Africa have in their bank accounts is equivalent to the money that they have received in loans, which is around 700 billion dollars. Needless to say, this does not imply that every single borrowed dollar has been robbed. However, the authors demonstrate that it is very likely that almost all of it was originated from international lending, since there are not many alternative sources from which these officials could have obtained the foreign currency. The situation is not very different in Latin American countries, where dictators and corrupt governments have been borrowing (especially in the 1970s) for personal embezzlement, benefitting friends and allies and to oppress the population. If we apply the legal framework that I have described in the previous section, we should conclude that none of the debts incurred by these kinds of governments should be honoured. We should also observe that if current governments are entitled to repudiate these debts, they are also entitled to repudiate the interest rates associated with them. The amount of money that governments are entitled to repudiate is, in the end, higher than people might be inclined to believe.

V. Conclusion

To sum up, and in disagreement with Buchanan and other radical sceptics, not all debts incurred in the past can and should be repudiated. Some promises made in the past ought to be honoured, for the same reason that debts of deceased people ought to be honoured. However,

when we make explicit the legal and moral reasons why these promises ought to be honoured, we should also conclude that there are *exceptions* to this obligation. A large portion of these debts is not binding on current generations. We can now make two seemingly inconsistent claims compatible. We can conclude that current generations are entitled to repudiate massive amounts of debts, without having to commit to the radical conclusion that promises made in the past are *never* binding for current generations.[7]

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NOTES

1. For more information on these programmes see Cristian Dimitriu, "Debt Relief," *Encyclopedia of Global Justice* (Dordercht: Springer, 2011), 228-229.

2. The idea that the morality of an action should be assessed by seeing the outcome it leads to is typical of utilitarianism. See, for example, Mill (1861/1998).

3. For a good description of how international law considers all states responsible for repaying their debts, regardless of the circumstances under which the loans were originated, see Janna Thompson (2002, 4).

4. Gen. Overseas Films, Ltd. v. Robin Int'l, Inc., 542 F. Supp. 684, 690 (S.D.N.Y. 1982) ("Because the circumstances surrounding the transaction were such as to put Haggiag on notice of the need to inquire further into Kraft's power and good faith, Anaconda cannot be bound.")

5. See World Duty Free Co. v. Republic of Kenya (ICSID Case No. Arb/00/7, 4 Oct. 2006).

6. It is not clear how much exactly Argentina had to repay. Here my aim is just to show that Argentina had strong moral arguments to defend partial repudiation.

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