Upheaval in the Back Yard

Illegitimate Debts and Human Rights

The case of Ecuador-Norway

Centro de Derechos Económicos y Sociales

November, 2002

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The case of Ecuador-Norway

Translated from spanish by Leslie Wirpsa

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PROLOGUE

When we hear that countries should honor the payment of their public foreign debts, we need to ask: Who contracted these debts and how were they used? And, why should we pay them if we derived no benefit from them?

The existing foreign public debt was contracted under financial conditions that are very favorable for the creditors and extremely onerous for the State of Ecuador, creating a vicious cycle within which, although we pay, we end up more and more indebted.

Many creditors, private and governmental, eager to obtain profits or benefits for their countries, easily extend credit to countries which are not very developed without taking into consideration their capacity to pay or their long term limitations; thus, delays in debt payments are renegotiated at high interest rates that significantly increase the original debt. These conditions turn the debt into a perverse instrument which favors the enrichment of a few at the cost of the impoverishment of many. This instrument privileges the voracious international financial system and corrupt political processes which have weakened the fragile structures of our democratic system.

During the Ethical Tribunal on the Foreign Debt, organized by CDES and the Inter-American Platform for Human Rights, Democracy and Development, which took place in November 2001 in Peru, Bolivia and Ecuador, we presented a case of Ecuadorian debt contracted with Norway for the purchase of four ships by a private company. CDES brought this case before the Commission for the Civil Control of Corruption (CCCC) whose mandate, according to Article 220 of the Political Constitution of the Republic of Ecuador, is to "promote the elimination of corruption and receive complaints regarding allegedly unlawful acts committed within the institutions of the State, in order to investigate them and request judgement and sanction."

The joint investigation between the Commission and CDES, revealed that this debt, initially private then transferred to the government of Ecuador, was extended in open violation of Norway's internal procedures, contravening the spirit and the law of international cooperation. Moreover, thanks to the conditionality imposed by the creditors and the international financial system, this debt has not only increased exorbitantly, but it is impossible to identify any direct benefits conferred to the population of the indebted country.

This debt contains all of the necessary elements to be declared an "illegitimate debt." This debt also constitutes a clear example of how foreign debt spurs massive violation of the economic, social, cultural and environmental rights of people, infringing the International Conventions and Agreements of the international system of Human Rights.

The government of Ecuador assumed responsibility for part of this debt within the framework of agreements with the Club of Paris. Over 15 years and after seven agreements, the debt rose from its initial amount of US$ 13.6 million to total US$ 50 million, even though Ecuador paid US$ 14 million. These agreements, far from reducing the debt, increased it instead.

If we add the fact that the whereabouts of the object of the loan (four ships) is unknown, as well as the use to which the ships have been put to date and who derived benefits from this use, we prove that the loan for the purchase of these ships has in no way benefited the people of Ecuador. Instead, it has caused remarkable damage, and thus fits clearly into the category of an illegitimate debt, given that today we owe US$ 50 million for an initial loan of US$13.5 million. How many similar illegitimate debts are strapped to the crutch of "honoring commitments" of sovereign foreign debt?

On these grounds, the Commission for the Civil Control of Corruption decided to "require the national authorities, through diplomatic channels, to demand that the Government of Norway cancel all of the obligations contracted with Ecuador under this component of the debt with the Club of Paris, considering it illegitimate."

This publication contains an overview of the socio-economic situation in Ecuador, an article analyzing perspectives regarding doctrine of illegitimate debt, and the Report from the Commission for the Civil Control of Corruption.

CDES believes it is necessary to take measures to achieve the complete cancellation or termination of this debt, beginning with a national and international advocacy campaign leading to the establishment of an international body for arbitration. We think that this case of illegitimate debt could establish a clear international precedent in the search for alternatives leading to the cancellation of the foreign debt and the extreme weight it puts on the budgets of states, using arguments from international law and human rights, and demonstrating that it is possible for citizens to audit the public debt and work toward its cancellation. In this way, we hope to promote upheaval in the back yard of the world of international finance.

Dr. Patricio Pazmiño Freire
General Coordinator
Centro de Derechos Económicos y Sociales (CDES)

ECUADOR IN FIGURES

ECUADOR IN FIGURES[1]

Susana Chu Yep[2]

The vulnerable state of Ecuador´s Economy

In 1999, Ecuador suffered an unprecedented economic and financial crisis that led to a 7 % drop in real GDP, a 200 percent devaluation of the *sucre* (national currency), a moratorium of the foreign debt and the intensification of poverty to include 70 % of the population. Official protection of corrupt bankers, the freezing of bank accounts and the conversion to the dollar, and finally a grassroots and indigenous uprising, led to the ousting of President Jamil Mahuad who was replaced by Vice President Gustavo Noboa.

The "assistance" from the International Monetary Fund (IMF) to the "new" government of Ecuador brought the imposition of new structural adjustment measures negotiated within the Tenth Letter of Intention. Additionally, the IMF became the guarantor before international creditors in the process of the refinancing of the private foreign debt, through a swap of Brady Bonds and Global Bonds valued at US$ 5 billion, contracted at interest rates at 12% and 10%, three times higher than the effective Libor rate in the international market. This renegotiation has not brought a lessening of the heavy burden of the debt on the National Budget, given that, according to the pro forma budget for 2002, the payment of the servicing of the public debt,[3] foreign and domestic, absorbs 34% of the national budget compared to 19% earmarked for fulfilling the obligation the state has regarding economic and social rights (education, health, creating employment and promoting production).

While the conversion to a dollar economy has brought a certain degree of economic stability in the aftermath of the 1999 crisis, it has not brought any substantial improvement to Ecuador's economy; instead, it has caused a severe weakening of the country's productive and social structure. Inflation declined from 91% in 2000 to 22.4% in 2001, with projections for 2002 set at 13%. Nevertheless, this is an excessively high inflation rate for a dollar economy, if we consider that inflation in the United States is annually 4%. As a result of this, among other reasons, the cost of production of goods for export and for internal consumption has risen, which has translated into a decline in the level of competitiveness of the productive apparatus which is extremely vulnerable to imports from neighboring countries that have suffered devaluations. This problem is further aggravated given that interest rates for loans[4] continue to be high for a dollar economy.

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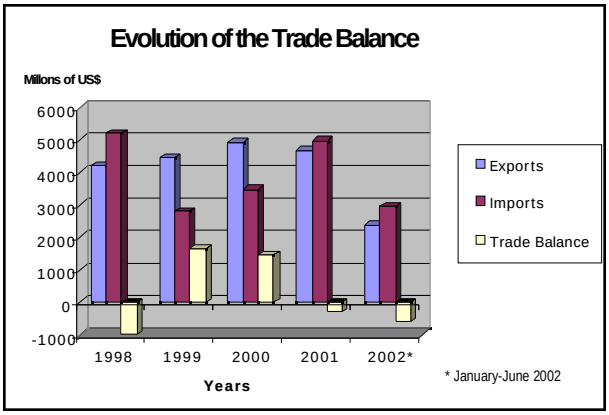
1 The first part of this article contains sections of the article "Ajuste, Deuda y Privatizaciones," written with the assistance of Jorge Acosta and Patricio Pazmiño of CDES.

2 Economist, M.A. in Environmental and Natural Resource Economy. Researcher in the Area of Globalization at the Centro de Derechos Económicos y Sociales, CDES, Ecuador.

3 The debt service estimate in the budget for 2002 is US$ 2.0 billion.

4 Bank interest rates for loans in dollars presently fluctuate between 15% and 20%.

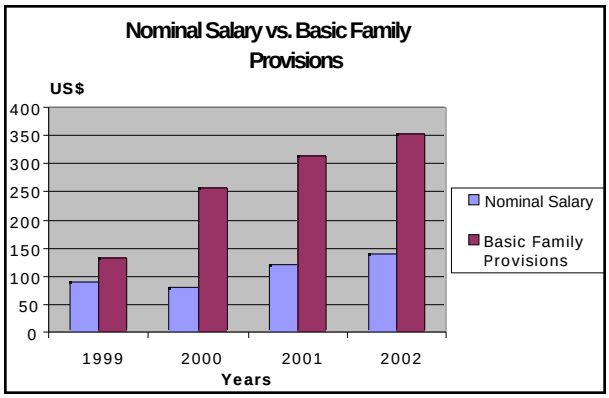
The result of this situation is a substantial growth in imports and a decline in exports, which has generated a trade deficit of US$ 600 million during the first semester, with expectations that the deficit will reach US$1.6 billion at the close of 2002. This sum is approximately 8% of calculated GNP for 2002.



Graph by CDES. Source: Monthly Bulletins from the Central Bank of Ecuador

Within this economic context, 40% of the Economically Active Population (EAP) is sub-employed, and almost a million Ecuadorians, or more than 8% of the population, has migrated, especially to Spain, Italy and the United States. [5]

Under -consumption is also a problem in families given that the average monthly salary in 2002, US$ 140, does not even cover half of the officially established basic family provisions, which in August 2001 cost US$ 330.



Graph by CDES. Source: Instituto Nacional de Estadísticas y Censos (INEC)

The unsustainable public debt

The history of the foreign debt in Ecuador began in the decade of the 1970s. Since then, the country has experienced a process of massive indebtedness, aggravated by the increase in international interest rates and by the resulting process of *sucretización*, which occurred in

[5] According to the Migration Directorate, 504,203 Ecuadorians left the country between 1999-2000. These migrants, paradoxically, generate the second most important source of income for the country, sending approximately US$ 1.4 billion in remittances in 2001, constituting a pillar of the dollar economy.

the mid 1980s.[6] These factors led to the adoption of structural adjustment measures imposed by multilateral organizations (IMF, WB, IDB, etc) to assure the servicing of the debt. These measures were progressively regressive in regards to social guarantees and protection. In other words, they have favored the liberalization of markets in Ecuador, excessive dependence on foreign capital (through exports or short term speculative capital investments), and vulnerability of markets in relation to external shocks. The result of this has been dramatically worsened living conditions for 12 million Ecuadorians.

In 2001, the public debt, domestic and foreign, reached US$ 14.3 billion, or per capita, approximately US$ 1,177, equal to 79.4% of the GDP. The debt service was US$ 1.7 billion, equal to 9.6% of GDP. Funds destined to education and health for a population of 10 million poor Ecuadorians, half of which are children, meanwhile, did not even represent 19% of the budget. New public debt contracted in 2001 totaled US$2.3 billion, equal to 12.9% of the GDP. Thus, in net terms, the debt did not decrease but rather increased US$ 581 million.

Policies of contracting new loans to service the old debt have contributed to the exorbitant growth of the public debt, domestic and foreign, and this has become a recurring trend in the management of the national budget. From 1986-2001 capital and interest payments for the foreign public debt totaled US$ 40.8 billion, while new disbursements reached US$ 30.5 billion, or a net transfer of funds of US$ 10.3 billion.

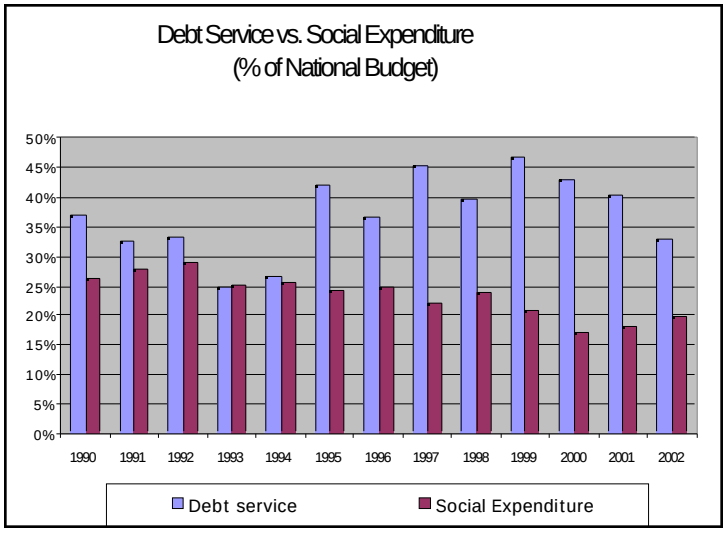
This figures are even more dramatic if we consider the parameters of sustainability established by the International Monetary Fund itself for Heavily Indebted Poor Countries (HIPC), according to which, for a country to have a sustainable economy, servicing of the foreign debt must not exceed 15 % of total exports, total foreign debt must not exceed 150% of total exports, and total foreign debt must not exceed 280% of total government income. Analyzing data for Ecuador in December 2001, it is obvious that Ecuador's foreign debt represents an unsustainable burden for the country's economy and its people.

Sustainabilty Indicators of the foreign debt	**Ecuador (dic 2001)**	**Maximum Limit (HIPC)**
Foreign debt service/Total Exports	35%	15%
Total foreign debt / Total Exports	248%	150%
Total foreign debt /Total government income	293%	280%

Source: Monthly Bulletins from the Central Bank of Ecuador

Prioritizing the payment of the debt service within the national budget negatively impacts the fulfillment of Economic and Social Rights. An average of 45% of the National Budget has gone to meeting debt obligations from 1992 - 2001; during the same period, an average of 22% of the budget, has gone to social spending, or less than half of the resources destined to payment of the debt.

[6] According to decree 075-83 dated 04-21-83, the State of Ecuador assumed responsibility for debts in dollars contracted with private foreign agents, allowing them to pay these loans in sucres, and the State absorbed the exchange rate differential (at a time when the sucre was devaluing at a rate of 100 percent).



Graph by CDES. Source: Monthly Bulletins from the Central Bank of Ecuador

In the 2002 pro forma budget, servicing of the public debt, foreign and domestic, will absorb US$1.85 billion of the National Budget, or 34% of all projected expenditures; budget allotments for education and health total US$ 575 million and US$ 297 million, respectively. However, between January and September this year, US$ 1.7 billion have gone to servicing the public debt (or 90 percent of the amount budgeted for that purpose), while funds earmarked for education and health during the same period reached US$ 258 million and US$ 133 million, respectively.

Category	**Budget 2002 US$ Millions (a)**	**Budget Executed January-September 2002 US$ Millions (b)**	**% executed until September 2002 (c = b/a)**
Service of Public Debt	1,854	1,671	90%
Education	575	258	45%
Health	297	133	45%
Agricultural Development	199	90	45%

Source: Monthly Bulletins from the Central Bank of Ecuador

Payment of the debt prevents the State from directing resources toward investments or reinvestments in infrastructure, expenditures which represent only 6.3% of the 2001 budget, compared to 50% for debt service; for 2002, meanwhile, the category of investments represents 6.2% of the budget, compared to a debt service equal to 34%. This clearly indicates the government's priorities when distributing scarce national resources: satisfying creditor demands takes priority over productive investment and the well being of the Ecuadorian people.

The main creditors of Ecuador's foreign debt are precisely the ones who require us to implement structural adjustment measures, with the aim of generating the necessary budget resources to pay the debt service: multilateral financial institutions (IMF, World Bank, IDB, CAF). These measures convert productive and social investment into the "adjustment

variable" when budget deficits occur, given that debt payment is obligatory, causing repeated violations of the Economic, Social and Cultural Rights (ESCR) of the people of Ecuador, especially their right to education[7], health[8] and development[9].

Creditor	**US$ Millions**	**% of the total public foreign debt**
Banks and private individuals	4,326	38.5%
International Financial Institutions	4,220	37.6%
Club of Paris	2,624	23.4%
Others	57	0.5%
Total	11,227	100%

Source: Monthly Bulletins from the Central Bank of Ecuador

The need to obtain resources for the payment of the debt leads to the application of policies whose objective is to increase budget income, by increasing oil production, privatizing public companies, or slashing subsidies to basic goods and services (electricity, water, gas, etc.)

Ecuador's oil policy is aimed at creating conditions for the massive influx of private capital for petroleum exploitation, significantly diminishing the role of the state oil company, Petroecuador. The construction of the Heavy Crude Pipeline (know by its acronym in Spanish, OCP), has opened the door to foreign capital under new oil exploitation contracts which are highly favorable for the foreign companies but harmful to national interests, not only in economic terms, but also in terms of social and cultural rights, given that the development of new oil fields brings severe harm to the indigenous communities living in the Amazon and the biodiversity which sustains them and the planet.

A country is not sustainable if it must direct more resources to paying its foreign debt that it directs toward satisfying the basic needs of its people: THE DEBT SHOULD SERVE THE COUNTRY INSTEAD OF THE COUNTRY SERVING THE DEBT.

[7] Constitution of Ecuador, Article 71: "The national budget shall allocate no less than thirty percent of the central government's total current revenues to education and the eradication of illiteracy."

[8] Constitution of Ecuador, Article 46: "Treasury allocations for public health shall increase yearly, in proportion to the percentage of increase in the central government budget's total current revenues. There shall be no budget cuts in this area."

[9] In April 2001, the United Nations Human Rights Commission resolved that "structural adjustment programs have serious implications for States' ability to comply with the Declaration of the Right to Development and to make national development policies that will seek to promote their citizens' rights". (Resolution E/CN.4/2001/L.33) In 1997, the Commission stated that "debtor-country populations' enjoyment of basic rights to food, housing, clothing, employment, education, health services and a healthful environment cannot be subordinated to the application of structural adjustment policies and debt-driven economic reforms."

ILLEGITIMATE DEBTS, DEBT RELIEF AND CITIZEN AUDITS

ILLEGITIMATE DEBTS, DEBT RELIEF AND CITIZEN AUDITS

Patricio Pazmiño Freire[1]

Introduction

This presentation is a reflection, from sources of doctrine and history, from an academic perspective, and from activism in human rights, on the extent to which we have advanced the conceptual discussion of initiatives for debt cancellation. But it also aims to transmit, with the force granted by an example, if it is possible to open new roads of hope, struggle and action to efficaciously confront the perverse system of extraction of resources from the nations of the South, a system which cloaks itself in illegal and illegitimate mechanisms.

In this summary presentation, we outline the first case of citizen auditing of a debt between a country from the South (Ecuador), a developed country (Norway) and the Club of Paris. In this vein, this study attempts to lay out proposals and arguments in favor of the cancellation of illegitimate debts, arguing for the possibility of independent international arbitration and mediation.

This attempt by society to confront imperialist financial and speculative powers, and their national partners, was inspired by the anonymous, solitary and pioneering struggle that the great Latin American, Alejandro Olmos, waged during 18 years. Olmos achieved the legal recognition of the illegality of the process of debt accumulation in Argentina.

In the aftermath of the international campaign waged by networks like Jubilee 2000 and other organizations and citizen groups like the Inter-American Platform for Human Rights, Democracy and Development, social movements, indigenous peoples, workers, human rights activists and sectors of the churches throughout the continent of Latin America, there has been a flourishing of multiple and diverse proposals contemplating the reduction of public sovereign debt, total cancellation of obligations, swaps for social investment and environmental protection, and proposals abrogating pardon.

Without a doubt, the problem of the debt, and mechanisms to confront it, have multiplied and occupy a more prescient place on the international agenda. This has increased public pressure on an issue that for years was ignored by financial institutions, governments, and even by people themselves. In this way, requests have accumulated for the establishment of an international insolvency procedure for countries whose debts are un-payable. Recently, the IMF and Jubilee Research, along with other organizations, have proposed initiatives of this kind.

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Although these debates and proposals have focused on the un-payable sovereign debt, we are examining other approaches regarding what are called illegitimate debts. One such approach, for example, was the Canadian Ecumenical Jubilee Initiative, which, in November of 2000 in Canada, demanded that creditors immediately and unconditionally cancel the illegitimate debt of all of the developing countries. The initiative abrogated for an end to the imposition of structural adjustment programs. Another interesting perspective regarding illegitimate debts is included in the request for an advisory opinion contained in the arguments made by the Latin American Parliament before the World Court in regards to the legality of the foreign debt. From an academic perspective, an interesting approach is that developed by Professor Joseph Hanlon who, eager to conceptually substantiate the term, has defined an illegitimate debt as:

> debt which the borrower cannot be required to repay because the original loan or conditions attached to that loan infringed the law or public policy, or because they were unfair, improper or otherwise objectionable. It does not include loans which were legitimate but which the borrower cannot now afford to repay, or which the borrower argues should be set off against other claims.[2]

Defined thus, illegitimate debt could include odious debts, loans secured through corruption, usurious loans, and certain debts incurred under inappropriate structural adjustment conditions. Consequently, in our opinion, Ecuador's debt with Norway and the Club of Paris, fits within this concept. The term itself has no uniform or agreed upon definition,[3] and has sometimes been equated with odious debt alone;[4] thus the definition established by Hanlon will serve as a useful and more expansive framework for this presentation. In the following text, we clarify aspects of illegitimate debt, referring to historical precedents, and present a brief summary of the case of Ecuador's debt with Norway.

I. The Doctrine of Illegitimate Debt and Debt Relief[5]

There are some primary justifications for nullifying illegitimate debt. We begin with moral arguments: citizens of impoverished countries should not be obligated to pay debts acquired by their governments, especially when the creditors knew, or should have known, that the debts were illegitimate. [6] For example, the creditors who lent money to Zaire's corrupt dictator, Mobutu Sese Seko, should bear the losses attributable to their decision to finance his self-enrichment, rather than expect the impoverished people of the now-Democratic Republic of Congo to continue to pay for his misdeeds. At the U.N. International Conference on Financing for Development held in March 2002, the countries assembled stressed "the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors."[7] Holding creditors responsible for illegitimate loans

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2 Hanlon, Joseph, "Defining Illegitimate Debt and Linking Its Cancellation to Economic Justice," Open University, Milton Keynes, England, June 2002, 44 (hereinafter "Illegitimate Debt").

3 *Id.* at 3.

4 Kremer, Michael and Seema Jayachandran, "Odious Debt," IMF paper, April 2002, 1.

5 This paper is based on an investigation conducted by Edward Grauman, a student from Harvard University's Law School who interned at CDES, Ecuador, during the Summer of 2002.

6 Hanlon, "Illegitimate Debt," p.1.

7 United Nations, Report of the International Conference on Financing for Development (A/CONF.198/11), Monterrey, Mexico, March 2002, 12.

would shift some of the burden toward them and away from citizens who often neither democratically approved nor benefited from debts. An important aspect of moral argumentation is the perspective from the Canadian Initiative for Ecumenical Jubilee which states:

> ...the biblical tradition, in Nehemias 5: 1-13, calls for debt cancellation and restitution when payment of the debt causes extreme suffering and threatens community coherence. Paying the debt in this context is illegitimate. The rule of law in a contract is not guaranteed if the relationship between those involved is too unequal. A contract cannot be morally obligatory when it damages the health or the life of one of the parties; therefore, terminating, canceling or rejecting a debt is a moral response when a situation is immoral or illegitimate.

The reasoning of this initiative takes the concept a step further, placing the issue of illegitimate debts not only in the moral sphere, but also within the framework of political economy and structural problems which stem from the international financial system, stating that the debt:

> Is not an aberration but a key mechanism of exploitation. If the system itself is illegitimate, the debt which is a fruit of this system is illegitimate, and the debate over it questions the system itself. Cancellation of the debt is a necessary but insufficient measure. What is needed is a systemic change, a challenging of the illegitimate system of domination and exploitation beyond partial cancellation, which serves to participate the system of domination.[8]

The Latin American Parliament, meanwhile, has developed a legal foundation characterizing four causes of illegitimate foreign debt:[9]

1. ***Origin of the debts,*** given that in many cases they were contracted through fraud and instrumental forgery in the contracts. These cases depend on the application of a respective nation's civil and criminal laws so that, once legal contract irregularities are proven, the contracts can be nullified. Processes of arbitrary conversion of private debts into public ones – measures which have been considered illegal and even criminal — are included here.

2. ***The creditor increases interest rates unilaterally and in unlimited fashion,*** a process initiated in 1980 by the Federal Reserve Bank and which served as the detonator of a chain reaction because it was applied to all foreign debts, legitimate and illegitimate.

3. ***The Brady Plan agreements,*** which forced governments of debtor countries to renegotiate debts with implicit and forced recognition of illegitimate debts, charging interest on interest due at the time the agreements were signed.

4. ***The co-opting of government negotiators,*** who resigned official posts shortly thereafter and immediately assumed managerial positions, precisely in the financial institutions which benefited from these agreements.

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8 Resolutions of the Forum for the Canadian Initiative for Economic Jubilee, Toronto, Canadá, November 2000.

9 See, Petition for an advisory opinion, INFORME Versión VII Parlamento Latinoamericano. November, 2001.

Another justification for rejecting illegitimate debt is violation of national sovereignty, given that foreign debt should be subject to domestic laws and the national interest, and that countries should not be forced to repay their debts. All countries are considered equal under international law, regardless of their size or power, and the decision to repay their debts is a matter of national prerogative which is recognized in the declaration on the Right to Development, passed by the United Nations.

This theory was developed in the 19th century by the Argentinean lawyer Carlos Calvo, and was put into practice by Argentinean Foreign Minister Luis María Drago in 1902. At the time, Great Britain, Germany, and Italy were attacking Venezuela for not repaying various debts. Worried that European countries would undertake similar measures in Argentina, Drago prepared a diplomatic note to be transmitted to the Argentinean ambassador in Washington. In it, he pronounced the Drago Doctrine, which held that "public debt cannot give rise to armed intervention, let alone the actual occupation of the soil of American nations by a European power."[10] Calvo's theory, upon which the Drago Doctrine rested, was applicable outside the context of armed aggression as well.

Another reason to forgive illegitimate debt is practical, and has to do with the principle of "moral hazard." This problem occurs when economic agents are insured against a risk and thus are encouraged to engage in riskier behavior. In the context of sovereign debt, the expectation of World Bank and IMF bailouts of economies in crisis leads creditors to make loans they might otherwise consider too risky.[11] They know they will recoup their investments whether the government can come up with the money or not. If debts deemed illegitimate were not subject to repayment and not included in bailouts, the moral hazard problem would be eliminated. Creditors would be forced to evaluate the true costs of their investments, including the possibility they may not be repaid, and would give fewer loans to corrupt governments or for excessively risky projects.

It is important to reiterate the distinction between illegitimate and un-payable debt. Un-payable debt is that which cannot be repaid "without impoverishing a country's people."[12] It may have been contracted legitimately or illegitimately, the important issue is that repayment itself would impose an economic hardship. For the poorest countries, virtually all of their debt is un-payable, which is why Jubilee 2000 originally focused on that issue.

Categories of Illegitimate Debt

The inquiry as to whether or not a debt is illegitimate must focus on the creditor. It is only in this way that moral hazard can be eliminated. Hanlon proposes two distinctions that should be made when evaluating creditor responsibility. First, he distinguishes between the "real purpose of the loan" and the "conditions attached to it."[13] Illegitimate conditions, such as usurious interest rates, can have as harmful an impact on a country as the underlying loan. Thus, debt should be deemed illegitimate if it is accompanied by illegitimate conditions, even if the underlying purpose is legitimate. Second, Hanlon distinguishes between "unacceptable" and "inappropriate" loans and conditions. Unacceptable loans or conditions are those that

[10] "Historia General de las Relaciones Exteriores de la República Argentina," 2 (on file with CDES).

[11] Kremer and Jayachandran, "Odious Debt," 4.

[12] Hanlon, "Illegitimate Debt," 10.

[13] *Id.* at 14.

are prima facie void because the original loan involved clear misconduct by the lender, violated the national law of the debtor, or was grossly unfair.[14] Inappropriate loans or conditions are those that "might be acceptable in other circumstances but...are not acceptable for the borrower in question. The lender failed to apply prudence and due diligence, and gave a loan [that] was inappropriate [under] the circumstances."[15] Using the British law of "extortionate debt" as a model, Hanlon suggests that when an unacceptable loan or condition is alleged, the burden of justifying the loan should be on the creditor, while in the case of inappropriate loans or conditions, the debtor should have to justify the claim of inappropriateness.[16]

Thus, there are four categories of creditor responsibility that give rise to illegitimate debt: unacceptable loans, unacceptable conditions, inappropriate loans, and inappropriate conditions.

Unacceptable loans

Unacceptable loans include odious debts, loans involving corruption, loans that are directly linked to capital flight, and loans for clearly ill advised or environmentally damaging projects.[17] Each of these cases involves some sort of lender misconduct or, at best, negligence.

The doctrine of odious debts holds that a population is not obligated to repay state debts that were not incurred in the public interest. The seminal definition was established by law professor Alexander Nahum Sack in 1927:

> 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 is, etc., 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.[18] (emphasis in original)

According to Sack, a new regime wishing to repudiate the odious debts of a previous regime would have to prove before an international tribunal both that the debts did not serve the public interest and that the creditors knew this would be the case. Upon such a showing, the creditors would have the opportunity to prove that debts did in fact serve the public interest—otherwise, the debt would not be collectable.[19]

It was in fact the United States that first employed the doctrine of odious debts, upon its capture of Cuba from Spain in 1898. In the subsequent peace negotiations, the U.S. argued

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[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* at 45.

[18] Sack, Alexander Nahum, "Les Effets des Transformations des États sur leurs Dettes Publiques et Autres Obligations Financières," Recueil Sirey, Paris, 1927, 157-58 (quoted and translated in Adams, Patricia, *Odious Debts*, Earthscan, London, 1991, 165).

[19] Adams, 166-67.

that it was not responsible for Cuba's debt, as it was "imposed upon the people of Cuba without their consent" and had not "been incurred for the benefit of the Cuban people."[20] In addition, argued the U.S., "the creditors, from the beginning, took the chances of the investment."[21] Despite Spain's objections, the U.S. never assumed the Cuban debt, leaving the creditors unable to collect fully on their claims.[22]

An important case combining corruption, capital flight, and odious debts was the *Great Britain v. Costa Rica* (1923) arbitration, presided over by Chief Justice Taft of the U.S. Supreme Court. The government of Costa Rica had repudiated a loan that had been given by the Royal Bank of Canada to the country's deposed dictator, Federico Tinoco, for his personal use. The bank sought to have the loan enforced, but Taft ruled:

> The case of the Royal Bank depends not on the mere form of the transaction but upon the good faith of the bank in the payment of money for the real use of the Costa Rican Government under the Tinoco regime. It must make out its case of actual furnishing of money to the government for ***its legitimate use.*** It has not done so. The bank knew that this money was to be used by the retiring President, F. Tinoco, for his personal support after he had taken refuge in a foreign country. It could not hold his own government for the money paid to him for this purpose.[23]

> Despite these precedents, the doctrine of odious debts is not often invoked by debtor states. This can be attributed to an international legal community that, over the past century, has become most sympathetic to the concerns of creditors in order to foster an environment more conducive to lending and international trade.[24] The issue of odious debt has in effect become dormant, as evidenced by the fact that the United Nations convention relating to sovereign debt does not even mention it.[25]

> It is also clear that creditors should have to bear the losses from financing poorly conceived or environmentally damaging projects. Creditors often take an active role in the design of such projects; moreover, developing countries are often dependent on the technical assistance provided by project lenders, particularly the World Bank.[26]

Another category of unacceptable loans is lending into "pyramid schemes," such as the Argentinean dollarization and Brazilian Plano Real of the 1990s.[27] In Argentina, foreign capital was attracted by guaranteeing peso-dollar convertibility, which required the government to

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[20] Moore, John, *Digest of International Law*, U.S. Government, Washington, 1906 (quoted in Kremer and Jayachandran, 5).

[21] *Id.*

[22] Adams, 164.

[23] Williams, Sir John Fischer and H. Lauterpacht, eds., *Annual Digest of Public International Law Cases: Years 1923 to 1924*, Longmans, Green and Co., London, 1933 (quoted in Adams, 168).

[24] Adams, 168.

[25] *See* United Nations, *Vienna Convention on Succession of States in Respect of State Property, Archives and Debts*, United Nations, New York, 1983 (cited in Kremer and Jayachandran, 6, fn. 5).

[26] Hanlon, "Illegitimate Debt," 12.

[27] *Id.* at 45.

borrow ever-increasing amounts of dollars to pay off investors.[28] A flood of cheap imports, combined with the high price of exports due to dollarization, decimated the country's domestic industries and ensured that the loans would not be repaid.[29]

In Brazil, the government created a new currency, opened up the economy, raised interest rates, and followed other IMF prescriptions. By raising interest rates, it was successful in attracting foreign capital, but also in crippling its domestic economy. Like Argentina, it needed to borrow more and more to pay off investors, and eventually the scheme collapsed.[30] In situations such as these, it should be clear to potential creditors that the risk of financial collapse is high. They should be made to bear any subsequent losses in order to discourage this type of lending.

Finally, successor loans to loans that were originally unacceptable are also themselves unacceptable under certain conditions. Hanlon gives the following definition of an "illegitimate successor loan":

i) If an institution replaces, rolls over or pays off an illegitimate debt with a new loan, then the new loan is an illegitimate successor loan.

ii) If a bond or new loan is issued for the sole or main purpose of paying off an illegitimate debt, then this is an illegitimate successor loan and the creditor has taken the risk.

iii) A government guarantee of an illegitimate successor loan does not make the loan any less illegitimate. Furthermore, it strengthens the illegitimacy if international financial pressure has forced the government to accept responsibility for a private debt.[31]

Unacceptable Conditions

Unacceptable conditions include usury, conditions that are illegal under the law of the debtor state, and conditions that violate public policy.

Usury is the lending of money at excessively high rates of interest, and is illegal in most countries.[32] Clearly, then, it should not be legitimate in an international context. Many developing countries accepted variable interest rate loans in the mid-1970s, when real interest rates (the interest rate relative to inflation) were negative. In the early 1980s, however, real interest rates shot up to over 12%. Thus, for example, Argentina's interest payments jumped from 12% to 43% of export earnings between 1980 and 1984.

Conditions that violate the laws of a debtor state are unacceptable. In Brazil, for example, the federal government was forced to mortgage the state oil company to the IMF in exchange for new loans. This was illegal under Brazilian law, as the company was not

[28] *Id.* at 28.

[29] *Id.* at 27.

[30] *Id.* at 38.

[31] *Id.* at 18.

[32] *Id.* at 15.

owned by the federal government, but rather by the individual states of Brazil.[33] Such lending undermines national sovereignty and should be considered illegitimate.

Conditions that violate public policy in the debtor state similarly undermine sovereignty and are unacceptable. IMF structural adjustment conditions requiring drastic cuts to health, education, and other social services do not serve the welfare of the population.[34] The people affected by these failed public policies should not be required to continue to pay for them. The international lenders that forced them to accept these programs should bear the loss.

Hanlon mentions two more types of unacceptable conditions. First, when unacceptable conditions are attached to a loan rescheduling, the underlying loan becomes unacceptable.[35] Creditors should not be able to use a rescheduling to sneak in conditions that would otherwise be unacceptable. Second, since a government guarantee of an illegitimate successor loan does not make the loan any less illegitimate, a condition requiring that a government guarantee or nationalize an illegitimate loan is unacceptable.[36]

Inappropriate Loans

The category of inappropriate loans is more controversial than that of unacceptable loans because for a claim of inappropriateness, it is proposed that the burden of proof be on the debtor. There may be cases in which these loans are in fact appropriate; more often than not, however, they should be treated as illegitimate. One example is consumption loans made to poor countries that cannot repay them without impoverishing their people. As Hanlon points out, "[b]orrowing for investment is obviously reasonable because the borrower hopes that the profits of the expanded enterprise will repay the loans. Borrowing for consumption means that to survive today, future consumption has to be reduced to repay the loan."[37] For this reason, a case can be made that this type of loan is extortionate. Loans for arms purchases, which account for a significant percentage of developing country debt, would also fall under this category.

Other loans that may be inappropriate include loans to support the public policy of the lending country (e.g. Cold War loans) that could not reasonably be repaid, loans to elected governments that later become dictatorial, and loans that are used indirectly to repay unacceptable or inappropriate loans.[38]

These are conditions that may be appropriate in certain cases but are inappropriate under the circumstances. Certain structural adjustment conditions fall into this category.[39] If international financial institutions apply a "one-size-fits-all" set of policy prescriptions, they may be much more successful in some cases than in others. When their prescriptions end up harming a country's population, the people should not have

[33] *Id.* at 39.

[34] *Id.* at 46.

[35] *Id.*

[36] *Id.*

[37] *Id.* at 7.

[38] Hanlon, "Illegitimate Debt," 46.

[39] *Id.*

to repay the accompanying loans. It is important that the connection between the condition and the harm is clear. In 1999, the IMF capped the amount of money Nicaragua could spend to rebuild after Hurricane Mitch. The country was limited to spending US$190 million, though it had access to much more.[40] This kind of conditionality is a clear affront to national sovereignty and, moreover, does nothing to help a country's people.

Strategies and action alternatives

We are convinced that more emphasis must be placed on illegitimate loans. Although the IMF has taken notice—a paper on odious debt was presented at its Conference on Macroeconomic Policies and Poverty Reduction in March 2002[41] — little concrete action has been taken to forgive illegitimate debt. We believe this issue must be confronted through legal, political, and public pressure strategies, on the national and international levels.

Legal Initiatives

Jurisprudence

In July 2000, Criminal and Federal Correctional Judge Dr. Jorge Ballesteros ruled that the debts incurred by the military dictatorship between 1976 and 1983 were illegitimate.[42] During that period, the country's debt increased from US$7.8 to US$46 billion, with little or no benefit to the people.[43] According to Judge Ballesteros, Argentina's foreign debt had been "increased since 1976 by means of a vulgar and offensive economic policy that brought the country to its knees...and that tended, among other things, to benefit and support private companies and businesses—national and foreign—to the detriment of state businesses."[44] The judge forwarded his recommendations to the Argentinean Congress for further consideration. Unfortunately, that body took no action due to pressure by foreign creditors and other international financial institutions. However, the ruling has provided the basis for a new case, which seeks to challenge the legitimacy of the refinancing of the original debt.[45]

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[40] *Id.* at 44.

[41] Kremer and Jayachandran.

[42] Olmos Gaona, Alejandro, "The Illegal Foreign Debt: The value and likelihood of a legal ruling," April 21, 2001, 4 (available at http://www.odiousdebts.org); *see also* case no. 14.467, entitled "Olmos, Alejandro S/dcia," file no. 7.723/98, in Federal Criminal and Correctional Court No. 2, July 13, 2000 (hereinafter "Argentine Debt Case") (available at http://www.e-libro.net/E-libro-viejo/gratis/ballesteros.pdf).

[43] Pettifor, Ann, Liana Cisneros and Alejandro Olmos Gaona, "It Takes Two to Tango: Creditor co-responsibility for Argentina's crisis—and the need for independent resolution," Jubilee Research, London, September 2001, 8 (available at http://www.jubileeplus.org/analysis/reports/it_takes_two_to_tango.pdf).

[44] Argentine Debt Case, "Conclusions."

[45] *Id.*

Petition of advisory opinion

Before the International Court of Justice *(ICJ),* requesting an advisory opinion on the doctrine of illegitimate debt.[46] While it would have no binding legal effect, a favorable opinion would provide a strong precedent for action in both domestic and international arenas.[47] Article 65 of the Statute of the ICJ gives the Court power to give advisory opinions on "any legal question at the request of whatever body may be authorized by or in accordance with the Charter of the United Nations to make such a request." Requests for advisory opinions may only be made by agencies of the United Nations (e.g., General Assembly, Security Council, IMF, IBRD/World Bank, World Health Organization, UNICEF, etc.)[48]

Before the Inter-American Court of Human Rights. Article 64 of the American Convention on Human Rights gives the Court the power to give advisory opinions. A member state of the Organization of American States, or certain divisions within the OAS (Pan-American Health Organization, Inter-American Indigenous Institute, etc.) can request advisory opinion. Member states may request an advisory opinion on any matter within the Court's jurisdiction, while OAS organs are limited to requesting opinions on matters within their competence.[49] The Inter-American Commission on Human Rights, for all practical purposes, is not limited in this manner.[50] A request under Article 64(1) must be grounded in a convention or treaty "concerning the protection of human rights in the American states." The Court has interpreted this requirement expansively, holding that the treaty not necessarily be one *between* American states, but only that it concern human rights *in* American states.[51] Thus, for example, the Court could interpret international human rights treaties that include non-American states as well. It may also be possible to request an opinion on a treaty that is not primarily aimed at promoting human rights, but which has such a component (e.g. a trade agreement).[52] A good option would be to use the text of an advisory opinion prepared by the Latin American Parliament.

Enforcement Strategies

International insolvency procedure

This initiative attempts to address the situation under which, just as domestic legal regimes need a bankruptcy procedure to help businesses and municipalities with un-payable debts get back on their feet, internationally, a similar procedure is needed for countries with severe financial problems. The IMF has proposed a sovereign debt restructuring mechanism (SDRM), which would "facilitate the orderly, predictable, and rapid restructuring of

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[46] *See* Jochnick, Chris, "Nuevos Caminos Legales para Enfrentar la Deuda: Una petición a la Corte Mundial," 95 (in Jochnick, Chris and Patricio Pazmiño Freire, eds., *Otras Caras de la Deuda: Propuestas para la acción*, Nueva Sociedad, Quito, 2001).

[47] *Id.* at 96.

[48] International Court of Justice website (http://www.icj-cij.org/icjwww/igeneralinformation/ibbook/Bbookframepage.htm).

[49] Davidson, Scott, *The Inter-American Human Rights System*, Dartmouth, Aldershot, England, 1997, 234.

[50] *Id.*

[51] *Id.* at 244.

[52] *Id.* at 248.

unsustainable sovereign debt, while protecting asset values and creditors' rights."[53] A country with an unsustainable debt burden would have the right to request a stay on creditor enforcement from the IMF. Subsequently, a debt restructuring plan could be approved by a binding vote of a majority of creditors. Under the SDRM, the IMF would still have to approve the restructuring plan, either explicitly or by conditioning future support on its approval.[54]

This proposal gives creditors too much power, is non-transparent, includes only Highly Indebted Poor Countries, and exempts World Bank and IMF loans from the restructuring process.[55] More importantly for this inquiry, the IMF proposal makes no mention of forgiveness of illegitimate debt. A counter-proposal by Jubilee Research does contain such a provision. The "Jubilee Framework" calls for an *ad hoc* mechanism that would establish an independent panel to judge cases of national insolvency.[56] Such a panel would be empowered to decide, among other things, the legitimacy of sovereign debts.[57] Because the IMF has recognized the importance of the issue of international insolvency, it is likely that some sort of mechanism will be developed. It would be an enormous breakthrough if such a mechanism were empowered to adjudicate the legitimacy of debt.

The issue of illegitimate debt is not entirely foreign to the IMF. A paper presented at a recent IMF conference proposes that an institution be established to designate particular regimes "odious." Under this proposal, the institution would rule on the legitimacy of *future* loans in order to limit potential biases for or against a particular regime. Such a ruling would protect the reputation of legitimate successor governments that refuse to repay odious debts, and could be supported by economic sanctions against those that do repay such debts. The goal of such an institution would be to eliminate the moral hazard associated with lending to odious governments.[58] The idea could be extended to encompass lending to legitimate governments for illegitimate purposes.[59]

Citizen Audits

During the Ethical Tribunal on the Foreign Debt, organized by CDES and the Inter-American Platform for Human Rights, Democracy and Development, which took place in November 2001 through public hearings in different cities in Peru, Bolivia and Ecuador, the case of illegitimate debt between Ecuador and Norway for the purchase of four ships by a private company was presented. CDES brought this case before the Commission for the Civil Control of Corruption. This Commission decided to demand that the Ecuadorian government require the government of Norway to terminate this debt, considering it illegitimate.

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53 Krueger, Anne O., *A New Approach to Sovereign Debt Restructuring*, International Monetary Fund, 2002, 4.

54 *Id.* at 24.

55 Statement of Jubilee 2000 conference, Guayaquil, Ecuador, March 2002 (available at http://www.jubileeresearch.org/jmi/jmi-news/guyaquil110302.htm).

56 Pettifor, Ann, "Chapter 9/11? Resolving international debt crises—the Jubilee Framework for international insolvency," Jubilee Research, London, February 2002, 11.

57 *Id.* at 14.

58 Kremer and Jayachandran, 29-30.

59 *Id.* at 4.

There have been other requests for public hearings on the foreign debt. Such was the case in Brazil, where protesters have called on the government to follow a provision in the constitution requiring it to audit its foreign debt.[60]

Social and environmental compensation.

There are three reasons to demand compensation from countries and financial institutions of the North.

First, many northern countries encouraged capital flight, thus contributing to the impoverishment of debtor countries. Governments opposed tighter regulations[61] while banks encouraged Third World elites to send their funds abroad. Second, international creditors are responsible for the environmental and social damage caused by some of their loans. Many World Bank project loans and IMF structural adjustment packages have had harmful effects on developing countries, and it makes sense to ask why those institutions should not have to compensate the people who have been harmed.[62]

Consequently, it is sensible and valid to argue that, in the strict political sense, the North is the debtor, because it has brought conquest and colonialism, the slave trade, and later the Cold War and environmentally-destructive resource extraction to the South.[63] Therefore, it is the North that should be repaying the debts of history.

II. The case of Ecuador – Norway, and public hearings

Often we are told that public sovereign debt obligations, like any contract obligation, should be met or else a country's risk will escalate, our credibility will be put into question, no one will issue us credit in the future, and therefore, we will not be able to grow and develop. These affirmations, relayed by government officials and spread by the media, should bring us to seriously reflect: If, consistently, throughout many years, we have fulfilled our debt payment obligations, why are we equally or more indebted? How long can this go on?

In the case of Ecuador, in the period from 1982 to 2000, "the country paid in capital and interest US$ 75.9 billion dollars and received in fresh loans US$ 65.7 million, implying a net negative transfer of US$ 10.2 billion, in spite of which, the debt increased US$ 6.9 billion, from US$ 6.3 billion to US$ 13.6 billion..."[64]

The servicing of the sovereign public debt absorbed more than a third of the General State Budget, and in the last three years, from 1999 to 2001, it absorbed 65.2%, 54% and 44.7 % respectively, or more than total investments directed toward education, health and roads together. Nevertheless, the growth of the debt shows no clear signs of waning; on the contrary, it increases, despite restructuring of payments. Poverty, exclusion, unemployment

[60] Hanlon, "Illegitimate Debt," 39.

[61] *Id.* at 47.

[62] *Id.* at 47-48.

[63] *Id.* at 48.

[64] Acosta Alberto. La Deuda Externa, un problema político global. En Deuda Externa: construyendo soluciones justas. CDES. 2001. Pag.70.

and migration, meanwhile, increase exponentially, affecting primarily the most vulnerable sectors of the population, systematically and massively violating economic, social, cultural and environmental rights.

The vicious circle: the more we pay, the more we owe.

Creditors, private or governmental, eager to obtain financial benefits for the development of their countries, agilely issue credits to countries with low levels of development, without considering their actual ability to pay or the long term limitations they face. In regards to renegotiating delays or parts of the debt we cannot pay, creditors impose financial conditions that later make the loans significantly more expensive; thus, in spite of systematic payment of the debt service, the capital amount is not diminished or it grows due to the capitalization of interests. This process is prone to sanctions under our legal system. These conditions are accepted docilely by our governments. Thus the debt becomes a perverse mechanism which favors the enrichment of the creditors and the impoverishment of our people; it also sustains a voracious international financial system which is structured to compulsively extract resources from economies of the South and to sustain corrupt political processes. This has been clearly denounced by the former Chief Director of the World Bank and Nobel Prize Winner in Economics, Joseph Stiglitz: "We see here a modus operandi. There are many losers in this system, but there is clearly a single group of winners: the Western banks and the US Treasury."[65]

On the other hand, part of the public sovereign debt has been absorbed by the State favoring both private and public companies. These companies should assume responsibility for loans granted to them, because these loans are illegitimate given that they only benefit the companies and not those who are paying for them – the Ecuadorian people.

A clear example of these processes of illegitimate debt is the case of loans contracted with Norway for the purchase of four ships in 1980.

This debt was initially contracted by the Ecuadorian Banana Fleet (FBE) for the purchase of four vessels from the Norwegian shipping industry for a value of US$ 52.5 million within the framework of the Shipping Exports Campaign promoted by the Norwegian government. The objective of this campaign was to support Norway's shipping industry (at the time, in crisis) by selling ships to developing countries under through "development assistance loans." Purchase of the ships was facilitated through credits authorized by the Norwegian Guarantee Institute for Exports Credits (GIEK).

Beginning in 1987 when the FBE entered into liquidation, the ships were purchased by Transnave, and the State of Ecuador assumed responsibility for the majority of the debt with GIEK, or US$ 26.2 million (US$ 15.5 million within the framework of negotiations with the Club of Paris, and US$ 12.7 million as a bilateral loan. This occurred even though the loan was considered "private commercial debt, " according to the Central Bank of Ecuador, and thus the companies should have met the obligations.

The State of Ecuador paid off the US$ 12.7 million loan with the government of Norway; meanwhile, the Club of Paris loan has increased from US$ 13.5 million to US$ 50 million, as a result of finance conditions established throughout the seven agreements with the Club, and

[65] Greg Palast. Interview with Joseph Stiglitz. The London Observer. En "Los Cuatro Pasos al Infierno del FMI". April, 2002.

even though US$ 14 million has been paid in interest and capital. In other words, the debt with the Club of Paris for these ships has increased in value 4.7 times (if we consider payments rendered and the balance pending with the Club of Paris).

This case does not only reveal the perverse logic of the re-negotiations of the debt which, far from reducing the burden of the initial credits, increases them; but it also reveals the ways in which industrialized countries issue credits to developing countries with their own interests in mind. If we add to this the fact that the location of the loan (the four ships) is unknown, as well as the use to which they have been put to date, it becomes obvious that the loan granted for the purchase of these ships has not benefited the people of Ecuador. Instead, it has caused unusual damage, and it represents a clear case of an illegitimate debt. [66] Canceling illegitimate debts is a way of fighting against impunity and corruption, and of protecting human rights.

The debt with Norway can be considered "illegitimate" from various perspectives: ethical, financial, legal and social. From the ethical stance, the loan was never intended as "development assistance for Ecuador," but rather as a life-saver for the Norwegian shipping industry. The Norwegian Parliament, officially and without euphemism, has described this process of indebtedness as "shameful." On the other hand, the urgency to issue the loan prompted the Norwegian Agency GIEK to relax its own mechanisms of control, granting credits to companies from a developing country without conducting a prior analysis of their actual payment capacity.

From the economic point of view, the increase of the debt is a result of an international financial system that imposes the conditions of negotiations, in this case under the agreements with the Club of Paris, backed by International Financial institutions like the International Monetary Fund (IMF) and the World Bank (WB). In many cases, these financial conditions to not take into consideration the economic circumstances or the payment capacity of receiving countries. They impose terms and interest rates inappropriate to the reality of the countries and the international situation, thus provoking moratoria on payment of the debt service, additional payments for interest in arrears and renegotiations which imply higher and higher interest rates.

From the legal perspective, the fact that the State of Ecuador has assumed responsibility for the majority of the commercial private debt of the Ecuadorian Banana Fleet (FBE) and Transnave, without any benefit or return received from the use of the ships, reflects a process of corruption at the governmental level which, in an unjustifiable manner, privileges the companies and constitutes an open violation of the rights of the people of Ecuador, given that resources have been re-channeled to pay the debt rather than being destined toward the domestic and international obligations to guarantee and protect the economic, social and cultural rights of the Ecuadorian people.

From a social standpoint, the purchase of the ships and the payment of the debt by the state has brought no benefits to the Ecuadorian people, who are the true debtor-payers of this debt, given that the returns from the operation of these ships went to two shipping companies that have been liquidated, but the State still continues to pay the debt.

With the funds the State of Ecuador has, to date, destined to these payments, US$ 26.7 million, plus the remaining balance, US$ 50 million, the living conditions of the people of

[66] England declared as illegitimate debt loans issued to an African dictator; given that the loans were destined to a purpose other than that established in the contract and because they were contracted with a government that was not democratically elected.

Ecuador could be improved, even marginally: this sum equals half of the national budget for health for a year, or the cost of creating hundreds of jobs in a year. (See annex, page 27)

This illegitimate debt has been over-paid, and therefore, we demand its cancellation and not a swap – and option under consideration by the governments of Ecuador and Norway, and promoted by some sectors of Ecuadorian society who are uninformed. Promoting a swap is to endorse impunity and corruption by foreign creditors and by national interest groups, exacerbating the impoverishment of the majority of the people of Ecuador.

Ecuadorian civil society, the press and public opinion are demanding not only that this debt be cancelled, but also that the government of Ecuador request indemnity for economic damages, basing this request on the fact that this debt was characterized by illegal irregularities from the start, when the Norwegian government granted the credit.

We believe this case can open the doors to establish certain new rules of the game regarding the issuing and renegotiation of foreign debt, rules that differ from traditional approaches. It is possible to demand transparency in these processes as well as widespread diffusion of information; the inclusion of independent third parties to that creditors are not acting as judge and benefactor; the adoption of notions of just reparations for the country; requiring internal audits to identify other cases of illegitimate debt and to prevent the continuation of impunity for those who have participated in and benefited from these processes, in both government and private spheres, and seeking appropriate legal sanctions.

An important lesson derived from this case is the powerful need for civil society to participate in the control and monitoring of public debt to keep the state from contracting illegitimate and corrupt loans which are harmful to the interests of the Ecuadorian population. We must also keep in mind other onerous debts that are equally illegitimate, and which are paid by all of the people of Ecuador: an example is the construction of the Cuenca-Molleturo-Naranjal highway, over the past 15 years, financed by a credit from the World Bank whose initial sum was US$ 15 million. Today, the loan totals US$ 250 million, and the road is still not finished.

Finally, the case presented above opens the doors to promoting a regional and global campaign demanding the cancellation of Norway's debt with all 24 countries receiving similar credits to purchase ships from Norwegian shipping companies.

ANNEX

ECONOMIC, SOCIAL AND CULTURAL RIGHTS AND DEBT RELIEF

1. According to the payment schedule established under the Seventh Agreement with the Club of Paris, Ecuador should pay, in the framework of its debt with Norway, beginning in the second semester of 2001, payments of US$ 1.2 million (average) every six months until 2018; in other words, US$ 2.4 million annually for 18 years.

2. According to the pro forma budget for 2002, this amount is approximately equal to:

   a. Annual allotments for National Services for the Eradication of malaria and vector control (US$ 2,607,437).

   b. 42 % of annual allotments for the Extended Program of Immunizations (US$ 5,663,153), which benefit 671,882 children under 5 years of age (according to the 2001 census, there are 1,599,720 children under 5 years old).

   c. Annual allotments for the National Council of Women CONAMU (US$ 1,925,345) and the Corporation for Afro-Ecuadorian Development CODAE (US$ 374,071) which benefit 6,120,000 women (2001 census) and 677,600 Afro-Ecuadorians (SIISE 2000).

   d. Annual allotments for the Program of Integral Attention to the Disabled (US$ 2,273,448 million).

   e. 42% of the annual allotments for the Program for the Eradication of Illiteracy (US$ 5,717,782), which benefit more than 450,000 Ecuadorians (the national illiteracy rate according to the 2001 census is 8.4% or approximately 1,100,000 Ecuadorians).

   f. 52% of the annual allotments for the Social Assistance Program for the most vulnerable population (US$ 4,553,727), which benefits 2,080,000 children and youth under 15 years old (according to the 2001 census, they represent 33% of the total population, or 4,000,000 youngsters).

   g. 50% of the annual salaries of all community educators nationally (US$ 4,857,600).

   h. Annual allotments for the education department of the Orellana Province (US$ 2,607,039), which has a school age population of 36,000 students).

3. Similarly, with this same amount annually, it would be possible to:

   a. Build 300 houses issuing housing bonds (US$ 8,000 /house).

   b. Benefit more than 13,000 women or female heads of households with solidarity bonds (US$ 180 /woman per year, keeping in mind that the solidarity bond is US$ 15 per month).

   c. Generate more than 1,100 direct jobs (US$ 2,100/ employee per year, considering 15 basic salaries at US$ 140 per month).

   d. Fund 16% of the annual allotments for implementing the Law of Free Maternity (according to the reform bill, the Law requires US$ 15,100,000) benefiting 720,000 women and children under 5 years old.

INVESTIGATIVE REPORT AND RESOLUTIONS FROM THE COMMISSION FOR THE CIVIL CONTROL OF CORRUPTION

ECUADOR'S FOREIGN DEBT WITH THE NORWEGIAN GOVERNMENT

Article 220. The Commision for the Civil Control of Corruption is a public law legal person, with headquarters in the city of Quito, with autonomy and economic, political and administrative inde - pendence. In representation of the citizenship it will promote the elimination of corruption practices; receive accusations on corrupt conduct involving Member State's officials and agencies; investigate them and request their prosecution and sanction. It will be able to promote its organization in both provinces and districts.

The law will determine its integration, administration and func - tions; institutions of the civil society that will make respective assignments and the duration of the period of its members who will have Supreme Court jurisdiction.

Article 221. When the Commission has finished investigations and found liability evidence, it will submit its conclusions to Public Ministry and the General State Comptrollership.

It will not interfere in the powers of the judicial function, but the judicial function will have to process its requests. It will be able to require Member State's official and organizations any infor - mation that would be deemed necessary to carry out its investi - gations. Any official who refuses to supply it will be sanctioned according to the law. Persons who collaborate to explain these facts will have legal protection.

Political Constitution of the Republic of Ecuador, 1998.

REPORT OF INVESTIGATION

ECUADOR'S FOREIGN DEBT WITH THE NORWEGIAN GOVERNMENT

I. INTRODUCTION

1.1 Motives

This report is a response to the claim presented by the Centro de Derechos Económicos y Sociales (CDES) before the Commission for the Civil Control of Corruption (CCCC), regarding the process to contract and renegotiate a small portion of the foreign debt of the Government of Ecuador with the Club of Paris.

1.2 Scope of the investigation

This report aims to establish and document the emblematic process of illegitimate debt which characterizes Ecuador's foreign debt. It explains how a loan originally negotiated between two private companies (Ecuadorian and Norwegian) in order to obtain four ships was converted into a debt between two nations (Ecuador and Norway). It demonstrates the cycle which leads to the increase rather than the reduction of debts, due to a simple dynamic of refinancing and perverse conditions.

The following investigation covers the period from April 1978 to March 2002, or a time span of 24 years.

1.3 Institutions involved

FLOTA BANANERA ECUATORIANA (FBE)
Ministry of Finance
Central Bank of Ecuador
TRANSNAVE
Norwegian Agency for Development Cooperation (NORAD)
Guarantee Institute for Export Credits (GIEK)

II. RESULTS OF INFORMATION COLLECTION, PROCESSING AND ANALYSIS

II. 1. DESCRIPTION OF THE EVENTS

II.1.1 The Norwegian Shipping Export Campaign

During the sessions of the Norwegian Parliament (Storting) on November 19, 1976, the Norwegian Government established a policy aimed at assisting the Norwegian shipping industry. At the time, the industry suffered from a lack of projects, and its workers risked losing their jobs.

This policy was called the "Shipping Export Campaign," and it consisted in the sale of ships to developing countries through "development assistance" credits. Twenty-three developing countries were included in this unfortunate combination of "assistance" and subsidies to the Norwegian shipping industry (countries such as Costa Rica, Mexico, Lebanon, Singapore, Venezuela, Peru, Ecuador, Jamaica).

In order to sell Norwegian products or services to developing countries, certain procedures needed to be followed to facilitate the "acquisition" of the ships. However, these requirements were not taken into account.

Through normal procedures, NORAD (the Norwegian Agency for Development Cooperation) **should have carried out an evaluation to assure that projects undertaken promoted development. GIEK, (**the Guarantee Institute for Export Credits), meanwhile, **should have conducted a risk assessment of the projects and of the purchasers' payment capacity.**

Nevertheless, under the Shipping Export Campaign, the responsibility for issuing loans fell under the jurisdiction of the Ministry of Commerce. Consequently, **the required evaluations were never carried out** because of the need for Norwegian shipping companies to improve their status to compete in the international market.

This fact confirms that the Norwegian government's priority was to accelerate the issuing of purchase agreements for Norwegian ships to support the industry, **without stopping to examine the payment capacity of the debtor nations.**

II.1.2. The loan issued to the Flota Bananera Ecuatoriana (FBE)

Flota Bananera Ecuatoriana was established in 1968 as a company of mixed capital with the majority of shares held by the Ecuadorian Government (99 per cent), until it was liquidated in 1987. Nevertheless, it is listed in the commercial registry as a joint stock company.

At the end of the decade of the 1970s, the FBE purchased four ships under contract with the Norwegian shipping company DRAMMAN SLIP AND VERKSTED, of Dramen, Norway. **FBE signed the bills of sale ratifying its legal status as a joint stock company.** The bill of sale for the purchase of the refrigerated ships Rio Esmeraldas and Rio Chone was signed on April 19, 1978, and the bill of sale for the purchase of the Rio Babahoyo and Paquisha ships was signed on January 30, 1979.

The characteristics of the four refrigerated ships are outlined in detail below:

Name of Ship	**Rio Esmeraldas**	**Rio Chone**	**Rio Babahoyo**	**Paquisha**
Metric tons of cargo	11.000	11.000	11.000	11.000
Disposition	Motor-ship	Motor-ship	Motor-ship	Motor-ship
Length	144,45 meters	144,45 meters	144,45 meters	459,20 feet
Extreme breadth	18,00 meters	18,00 meters	18,00 meters	59,20 feet
Gross tonnage	9.000 tons	6.987,78 tons	6.987,78 tons	6.987,78tons
Net tonnage	Tons	4.084,65 tons	4.084,65 tons	4.084,65tons
Year built	1980	1980	1980	1980

The total value of the commercial sale reached US$ 354.65 million Norwegian Crowns (NOK), approximately US$ 56.9 million at the time. Of that total, FBE paid US$ 29.1 million NOK (US$ 4.4 million) as a down payment and the balance was financed through the **EKPORTFINANS A/S y LANEINTITUTTER FUR SKIPBSBYGGERIENE** under the following conditions:

• RIO ESMERALDAS	Received August 29, 1979, and financed through a loan from EKSPORFINANS A/S FOR 84.150.000 Norwegian Crowns, for twelve years, at 5.7 percent annual interest beginning August 31, 1979, establishing primary mortgage over the vessel in favor of the mentioned entity, as security for payment.
• RIO CHONE	Received April 24, 1980 and financed through a loan from EKSPORFINANS A/S for 86.850.000 Norwegian Crowns, for twelve years, at 5.7 percent annual interest beginning April 25, 1980, establishing primary mortgage over the vessel in favor of the mentioned entity, as security for payment.
• RIO BABAHOYO	Received August 22, 1980 and financed through a loan from EKSPORFINANS A/S for 87.300.000 Norwegian Crowns, for twelve years, at 5.7 percent annual interest beginning August 22, 1980, establishing primary mortgage over the vessel in favor of the mentioned entity, as security for payment.
• PAQUISHA	Received March 23, 1981, and financed through the following loans:

	1. Credit from LANEINTITUTTER FUR SKIPBSBYGGERIENE, for 67.900.000 Norwegian Crowns, for seven years, at 8.25 annual interest beginning March 23, 1981, establishing primary mortgage over the vessel in favor of the mentioned entity, as security for payment. 2. Credit from EKSPORFINANS A/S for 19.400.000 Norwegian Crowns, for 13 years, at 8.25 percent annual interest, establishing secondary mortgage over the ship, in favor of the mentioned entity, as security for payment.

These loans are considered **commercial credit**, and the government of Ecuador guaranteed the purchase **standing surety for the Flota Bananera Ecuatoriana (FBE)** before the Norwegian Guarantee Institute for Export Credit (GIEK) and EKSPORFINANS A/S.

Name of Ship	**Total Value**		**Financed Value**		**Import Permit**
	Millions NOK	**Millions Dollars**	**Millions NOK**	**Millions Dollars**	
Río Esmeraldas	84,15	12,78	84,15	12,79	02-0-03414
Río Chone	96,50	14,66	86,85	13,19	02-0-12439
Río Babahoyo	97,00	14,73	87,30	13,26	02-0-30026
Paquisha	97,00	14,73	87,30	13,26	02-1-18442
Total	**374,65**	**56,90**	**345,6**	**52,50**	

From 1980-1983, the FBE made payments to the creditors in the amount of US$ 12 million, or 83.547.793 NOK, of which US$ 3.7 million corresponded to payment on capital (26.263.942 NOK) and US$ 8.3 million corresponded to interest payments (57.283.851 NOK).

The FBE's debts with EKSPORFINANS A/S and LANEINTITUTTER FUR SKIPBSBYGGERIENE were transferred to GIEK, and thus, delays on payments of installments between May 1, 1983 and May 31, 1984 were included within the first agreement with the Club of Paris (CPI), signed in July 1983; meanwhile, the payments falling due in the period between June 1, 1984 and December 31, 1987 were included within the second agreement with the Club of Paris.

Between 1984 and 1985, Flota Bananera Ecuatoriana made payments on the debt subscribed under the first and second agreements with the Club of Paris in the amount of US$ 8.53 million (55 million NOK): US$ 4.8 million (32.1 million NOK) under the first agreement with the Club of Paris, and US$ 3.5 million (22.9 million NOK) under the second agreement.

In sum, between 1980 and 1985, Flota Bananera Ecuatoriana paid a total of US$ 20.53 million of the original loan.

II.1.3 The process of liquidation of the Flota Bananera Ecuatoriana

In 1985, the Flota Bananera Ecuatoriana entered a process of liquidation, having ceased making payments to the Norwegian creditors since 1983.

The state company Transportes Navieros Ecuatorianos (Transnave) took over operations of the four ships beginning September 23, 1985, as requested by FBE. Subsequently on November 6 that same year, FBE and Transnave formalized and signed the Operation Agreement for the four ships, agreeing that the FBE would take responsibility for the financial results, whether they were positive or negative, and that the contract would be in effect from September 23 of that year until the ships were sold to Transnave. At that point, the companies would close accounts. The closing of the accounts totaled US$ 7.222.988,80, distributed as follows:

Category	**US$**
Debts to local creditors of the FBE	126.850,60
Debts to local creditors of the FBE	8.257,15
Debts to creditors outside of the FBE	1'764. 735,17
Payments made by Transnave to FBE	2'654. 899,15
Operational losses from the vessels in 1985	592.720,39
Net losses from the operation of the vessels in 1986	219.658,59
Insurance payments, port fees and supplies 1987	1'594. 356,00
Insurance payments, port fees and supplies 1988	261.511,77
Total	**7'222.988,82**

Subsequently, the General Extraordinary Board of Shareholders of the FBE, in a meeting on June 2, 1986, decided to proceed with the planned liquidation of the company and to continue with negotiations for the sale of the ships to Transnave.

In 1987, Transnave formally acquired the Río Chone, Río Esmeraldas, Río Babahoyo and Paquisha ships. The loans were transferred to Transnave and a new contract was signed between the Ecuadorian State, Transnave and GIEK to refinance FBE's debt with GIEK. Thus, the mortgage GIEK held over the ships is lifted.

However, **the bill of sale of the ships implied the transfer of the existing loans, even those between FBE and the creditors (Club of Paris and GIEK), to the government of Ecuador** and to Transnave. The debt with the Club of Paris reflects the amounts refinanced under the agreements with the Club of Paris. The debt with GIEK, meanwhile, reflects the loans that had not yet matured before the date of the sale of the ships, and thus, this amount was not included in either agreement with the Club of Paris.

The debts transferred to Transnave and to the government of Ecuador are summarized in the following table:

Creditor	Amount in NOK	Amount in US$
GIEK	174.6 million	26.5 million
CP I and II	89.6 million	13.6 million
Total	264.2 million	40.1 million

In September 1987, a delegation led by Carlos Perez, representative from the Ministry of Finance, and including the General Manager of Transnave, Admiral Ruben Landazuri, a delegate from the Central Bank, Patricio Salvador; and the Liquidator of FBE, Rodolfo Baquerizo Blum, went to Norway to sign an agreement for the cancellation by GIEK of the portion of the debt not included in any of the Club of Paris Agreements for a sum of 177.6 million NOK (approximately US$ 27 million), in capital and interest. This agreement included a commitment to lift the mortgages on the ships as soon as a new loan for US$ 17.5 million was issued by GIEK to the Ecuadorian government and to Transnave to finance the bill of sale of the vessels between FBE and Transnave.

In other words, GIEK cancelled the initial debt of US$ 26.5 million with FBE, but it issued another loan for US$ 17.5 million with the government of Ecuador government and with Transnave; thus the cancellation of the debt was actually only for US$ 9 million.

According to the Central Bank report No. SRSP-1279-87, the debt with Norway was distributed as follows:

a. Transnave and the Ecuadorian State assumed responsibility for the US$ 17.5 million debt with GIEK, which was not included within the agreements of the Club of Paris.

b. The government of Ecuador took over the debt between the Flota Bananera Ecuatoriana (FBE) and the Club of Paris for a total of US$ 13.6 million.

The sale of the 4 ships to Transnave was for US$ 12 million; however, given that FBE indebted Transnave for the sum of US$ 7.222.988,80, for the operation of the ships (1985-1987), a sum which was included as part of the payment for the four ships, Transnave only had to pay US$ 4.777.011,20.

The Minister of Finance, Eduardo Cabezas Molina, approved the loan agreement between the Ecuadorian government, Transnave and GIEK on March 11, 1988, under Resolution No. SCP-88-0012.

Under a presidential decree published in the Official Registry 3821 on March 25, 1988, León Febres Cordero, Constitutional President of the Republic of Ecuador, authorized the restructuring of the debt pending with GIEK for a total of US$ 17.5 million. With this objective in mind, Transnave and the Ecuadorian Government signed, on June 21, 1988, a Loan Agreement with GIEK for the amount of $17.5 million, of which US$ 12.722.988,80 (loan No. 231105000) was responsibility of the government of Ecuador. Transnave, meanwhile, was responsible only for US$ 4.777.011,20 (loan No. 23106000). In this way, the government of Ecuador became the guarantor for Transnave.

Once the loan with GIEK was approved for the financing of the sale of the four ships, a bill of sale was signed, dated July 18, 1988, between the Flota Bananera Ecuatoriana, under liquidation, and Transnave for the sum of US$ 12 million, according to a Public Deed issued by the 22nd Notary of the county of Quito.

Involved in this transaction were, Rodolfo Baquerizo Blum, in his role as liquidator and legal representative for FBE, the seller; Vice Admiral Ruben Landazuri Zambrano, in his role as General Manager and legal representative of Transnave, the purchaser; the company EKSPORFINANS A/S, located in the city of Oslo, Norway, represented by **Mr. Enrique Ponce de León Román, delegate of Dr. Enrique Ponce de León y Carbo**; and the company LANEINTITUTTER FUR SKIPBSBYGGERIENE, also located in the city of Oslo, Norway, and represented by the same Mr. Enrique Ponce de León, delegate of Dr. Enrique Ponce de León y Carbo.

The bill of sale signed between FBE and Transnave was previously backed by a favorable report from the Attorney General of Ecuador, through official document No.26098, dated March 11, 1988, by the Auditor General of Ecuador, through official document No. 016175, dated March 23 of that same year, and through a certificate from the Finance Manager of Transnave, dated March 29, 1988.

Both loans were paid in their totality, as well as US$ 5.372.410 for interests and commissions paid by the government of Ecuador.

Nevertheless, it is important to clarify that the government of Ecuador assumed responsibility for a debt of US$ 12.722.988,80 as a shareholder of Transnave, as well as the debts with the Club of Paris.

II.1.4 Renegotiation of the debt with the Club of Paris

28 July 83 — The Minister of Finance and Public Credit, **Pedro Pinto Rubianes,** representing the Ecuadorian government, signs the first agreement with the Club of Paris (CPI) to refinance the private debt backed by Ecuador; the debts of the FBE with GIEK and EKSPORFINANS A/S, which matured between June 1 1983 and May 31, 1984, are included among the debts to be refinanced under the conditions of the CPI.

6 March 84 — A bilateral agreement is signed (BAI) between the government of Ecuador, represented by the Minister of Finance and Public Credit, Pedro Pinto Rubianes, and the Norwegian government for the refinancing of US$ 7.3 million (51.561.698,94 NOK) of which US$ 4.6 million correspond to capital (32.157.688 NOK) and US$ 2.7 million correspond to interests (19.404.010,94 NOK).

24 April 85 — The second agreement with the Club of Paris (CPII) is signed, under which the debt obligations of FBE with GIEK and EKSPORFINANS A/S, which matured between June 1, 1984 and December 31, 1987, are refinanced. On May 31, 1986, the second bilateral agreement (BA2) is signed between the Ecuadorian government and the Norwegian government for the refinancing of US$ 23 million.

Matured obligations	Capital (NOK)	Interest (NOK	Total (NOK)
1984	16.078.844	8.934.281	25.103.125
1985	32.157.688	16.261.984	48.419.672
1986	32.157.688	14.132.477	46.290.165
1987	32.157.688	12.002.971	44.160.659
Total	**112.551.908**	**51.331.713**	**163.883.621**

It is important to emphasize that in both bilateral agreements, the payments which fell due were paid in Norwegian crowns, and that the Ecuadorian government appears as the guarantor of the credits contracted by the FBE. The debtor owed the debt, and was responsible for canceling the payments falling due and for depositing the corresponding values in the Ecuadorian Central Bank. Additionally, we can observe that if indeed the bilateral agreement (BA 2) was signed in 1986, it included maturities from 1987, thus is can be assumed that it was a form of insurance for GIEK that the government of Ecuador would take responsibility for the debts of Transnave in advance.

The Central Bank issued Report No. SRSP – 1279 – 87 regarding the transfer of the ships to Transnave, stipulating the following:

"..., the Ecuadorian Banana Float proceeded to deposit in the Central Bank the counter-value in *sucres* of NOK 32.1 million (US$ 4.8 million) for payments falling due that were included in the first agreement with the Club of Paris, and NOK 22.9 million (US$ 3.5 million) for obligations refinanced under the second memo of the Club of Paris. The amounts that the FBE should have deposited in relation to the debt included in the Club of Paris I and II totaled NOK 144.7 million (US$ 22.0 million) of which the FBE deposited NOK 55.0 million (US$ 8.3 million). The government of Ecuador had to absorb the difference, that is, NOK 89.6 million (US$ 13.6 million). The reason for this is that in the bilateral agreements of March 16, 1984 and May 31, 1986, signed with the Norwegian government, it was not clearly stipulated that, if the Ecuadorian debtor did not deposit in local currency *sucres*, the obligation of the State would terminate, and any process thereafter should take place with the original debtor.

The same Central Bank report also stipulates that "Flota Bananera Ecuatoriana was established as a mixed capital company, and in its commercial registry it is described as a joint stock company; furthermore, the loan contracts signed for the purchase of the ships ratify the legal status of the Ecuadorian debtor as a joint stock company. Thus, in respect to payment of its contract obligations, the entity should service them with its own resources, and in consequence, they should not be assumed by the government of Ecuador."

And, it concludes:

1. Although the Ecuadorian government would not be forced to pay the part of the Club of Paris agreements which do not have a counter-value deposit in *sucres* made by FBE, the Ecuadorian government would honour the payment of the full amount of the debt with the purpose of having all the ships become part of Transnave´s flote and the corresponding mortgage would not be executed.

2. GIEK of Norway would sign a bilateral agreement for US$ 17.5 million with the government of Ecuador (for the remaining balance of US$ 26.5 million) with Transnave as the debtor. The balance of US$ 9 million would be eliminated from the registry of the GIEK.

In 1987, the government of Ecuador took responsibility for FBE's debt with the Club of Paris for US$ 13.6 million.

Owing to delays in the payments falling due, subscribed in the Club of Paris agreements 1 and 2, on January 20, 1988, the Ecuadorian government signed the third agreement with the Club of Paris (CPIII). Under these conditions, a restructuring of part of the debt with the GIEK began, the portion corresponding to the interest generated by the delay in payment of the obligations contemplated in the bilateral agreements 1 and 2 (BA1 and BA2), with the amounts agreed upon in US dollars, for a value of approximately US$ 20 million.

Once again, due to delays in payments falling due, the fourth agreement with the Club of Paris was signed on October 24, 1989, and a Bilateral Agreement with the Government of Norway (BA4) was signed on November 1, 1990, under which the **interest generated** for the obligations due under the bilateral agreements 1, 2 and 3 (BA1, BA2 and BA3) is refinanced, with the issuance of a loan for the sum of US$ 13 million.

Thus, as of that date, the total debt of the Ecuadorian government within the framework of the agreements with the Club of Paris was:

Agreement CP	**NOK**	**US$**
CP I (BAI 1)	8.774.550	1.399.670
CP II (BA2)	58.848.560	9.378.230
CP III (BA3)		21.039.840
CP IV (BA4)		13.043.500
Total		**44.861.240**

Source: Report SRSP-426-90. Central Bank of Ecuador.

In other words, an original debt of US$ 13.6 million in 1983 turns into a debt of **US$ 44.8 million** in 1990, due to the financial conditions of the agreements and the delay in payments by the government.

On January 20, 1992, the fifth agreement with the Club of Paris is signed (CPV), and a Bilateral Agreement (BA5) with the government of Norway is signed on July 31, 1992. A portion of the obligations of the BA2 is refinanced, for a value of 43.365.848,60 NOK (US$ 6 million), as well as the interest generated under the BA3 and BA4 for a value of US$ 3.662.481,05. For this purpose, loan No. 24134000 is signed with GIEK for the sum of **US$ 10 million**.

On June 27, 1994, the sixth agreement with the Club of Paris (CPVI) is signed, and on March 27, 1995, the sixth Bilateral Agreement (BA6) with the government of Norway follows, under which the balances of the debts contemplated under bilateral

agreements 2 and 3 (BA2 and BA3) are refinanced. For this purpose, **loan No. 24156000 for US$ 11 million** is issued; interest rates and balances under agreements BA4 and BA5 are also restructured.

In 1996, the seventh agreement with the Club of Paris (CPVII) is signed, as well as bilateral agreement seven (BA7) with the Norwegian government, under which the balances and debts contemplated in bilateral agreements 3 and 4 (BA3 and BA4) and the unpaid interest from bilateral agreements 5 and 6 (BA5 and BA6) are refinanced. For this purpose, **the loan CPVIINOR for the sum of US$ 25 million** is issued.

According to information from the Ministry of the Economy and Finance, as of October 31, 2001, the total debt of Ecuador with the Club of Paris was:

Debtor	Agreement	Amount owed (US$)
State of Ecuador	CP V (BA5)	9.627.127,75
	CP VI (BA6)	11.749.667,71
	CP VII (BA7)	29.703.492,96
Total		**51.080.288,42**

In spite of having paid **US$ 14 million** in payments fallen due, interest in arrears and commissions to the Club of Paris,[1] according to information from the Foreign Debt Renegotiation Commission, as of March 31, 2001, Ecuador's foreign debt with the Club of Paris totaled **US$ 49.6 million.** In other words, considering the total of what has been paid and the remaining balance, the final total is **US$ 63.6 million,** the initial debt has risen 470 %, or five times the initial value. Moreover, this is a debt for which the government of Ecuador and hence, its citizens, should never have been responsible.

II.1.5 Situation today of the ships and of Transnave

Once the ships were transferred to Transnave, their names were changed from the names previously identified on the bill of sale:

Previous name	Actual name
Río Esmeraldas	Isla Fernandina
Río Chone	Isla Genovesa
Río Babahoyo	Isla Pinta
Paquisha	Isla Isabella

[1] According to documents and memorandums from the files of the Central Bank of Ecuador, between 1985-2000.

Transnave used the four ships until it entered into a process of restriction in 1996, at which time they were sold. In any case, the way in which the ships were used and the destination of the benefits generated in the period from 1987 to 1996 is unknown. Also unknown is the value for which they were sold and their final destination.

II.1.6 Actual status of the Ecuadorian debt with Norway

The loans issued in 1998, for a value of US$ 17.5 million, between the Ecuadorian Government, Transnave and GIEK, were fully paid.

In January 2001, an Ecuadorian delegation visited Norway and met with the Norwegian Foreign Minister. Participating in this delegation were the economist Alonso Pérez, head of the Foreign Debt Renegotiation Commission, Ambassador Diego Stacey (Sweden), the economist Carlos Carrera, an official from the Foreign Debt Division of the Central Bank, the economist Alejandro Real, also from this division, and Dr. Gustavo Palacios, Advisor to the Minister of Social Welfare, and the economists Fabiola Calero and Cecilia Amores from the Ministry of Finance.

The Ecuadorian delegation suggested a debt swap between Ecuador and Norway. The representatives also suggested that the organization Norwegian People's Aid, with which they had met, participated in the process.

An attempt to renegotiate the debt with Norway (as part of the seventh agreement with the Club of Paris in September 2000) and to confirm a debt swap was made March 20, 2001, when Tom Tjomsland, a representative from the Norwegian Foreign Ministry, came to Ecuador. This attempt was frustrated as a result of the refusal of the Ecuadorian Congress to raise the Value Added Tax (VAT) to 14 %, a condition imposed as part of the Agreement with the International Monetary Fund (IMF).

On July 20, 2001, the Norwegian Foreign Minister told the press that it was possible to extend the Norwegian Strategy for Debt Relief[2] of cancellation and swaps to include some highly indebted middle income countries with high levels of poverty (Ecuador is part of this category of countries). This Norwegian Strategy is based on the limits determined by the Club of Paris, which stipulates highly indebted lower income countries as those qualifying for cancellation. Thus, in the case of Ecuador, only a swap would be considered, not cancellation.

In 2001, the Norwegian Minister of Development, Hilde F. Jonson, described the "Shipping Export Campaign" as "shameful" for Norway. Evaluations carried out by the Norwegian Parliament (St. Meld. nr25) concluded that this category of combinations of "assistance" and subsidies for Norwegian industries were harmful. Additionally, the Minister of International Development at the time, Ms. Anne Kristin Sydnes, recently said on the radio that she "never supported it."

Because this debt is considered "shameful" for Norway, representatives from the Norwegian Ministry of Foreign Relations have said that it should be canceled, and that an agreement of pre-established swaps could be reached.[3]

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[2] The plan in English can be found at http://odin.dep.no/ud/engelsk/publ/handlingsplaner/032005-990526/index-dok000-b-n-a.html

[3] Meeting with SLUG, September 5, 2001.

Presently, there is pressure from the Norwegian civil society, through the Norwegian Campaign for Debt Cancellation (SLUG), demanding that the government of Norway immediately cancel 100% of all of the debts originating in the Shipping Export Campaign, including Ecuador's, considering that this debt is ILLEGITIMATE because the creditor (Norway) acted illegitimately, and the objectives of this loan were NOT to improve the well being of Ecuadorian society.

II.2. ANALYSIS AND EVALUATION

1. The objective of the Campaign of Shipping Exports promoted by the Norwegian government at the end of the decade of the 1970s was to promote the Norwegian shipping industry through the sale of ships to developing countries, and at no time was it considered a loan for "development assistance," but rather a **"commercial loan."** This loan has become a paradigm revealing how our countries are indebted within an economic system that only benefits the so-called developed countries.

   This loan violates the spirit and the meaning of international assistance and cooperation recognized under the International Covenant for Economic, Social and Cultural Rights (ICESCR), ratified by the General Assembly of the United Nations on December 16, 1966, Articles 1.2 and 11.1, because "international economic cooperation" should be "based on the principal of mutual benefit" and should prevent denying "a people...its own means of subsistence" without "prejudice to any obligations arising out of international economic co-operation."

2. In statements to the Norwegian press, the Norwegian Development Minister, Hilde F. Jonson, described the Shipping Export Campaign as "shameful" for Norway. Similarly, the evaluation carried out by the Norwegian Parliament (St. Meld. Nr.25) of this campaign concluded that "this type of combination of assistance and subsidies to the Norwegian shipping industry have been harmful."

3. Flota Bananera Ecuatoriana (FBE) purchased four refrigerated ships from the Norwegian shipping company DRAMMEN SLIP AND VERKSTED, of Dramen, Norway, between 1979-1980, for the sum of US$ 56.9 million. These ships were registered with the names: Río Chone, Río Babahoyo, Río Esmeraldas and Paquisha.

   For the purchase of these four ships, FBE made an initial down payment of US$ 4.4 million, and the balance, (US$ 52.5 million), was financed by the Norwegian firms EKSPORTFINANS A/S and LANEINTITUTTER FUR SKIPBSBYGGERIENE.

   The debts with the FBE and the firms EKSPORFINANS A/S and LANEINTITUTTER FUR SKIPBSBYGGERIENE **were transferred to GIEK, involving the Norwegian government** as creditor for these loans and permitting their inclusion within the framework of the agreements with the **Club of Paris.**

4. FBE paid US$ 52.5 million for the initial loan, US$ 20.53 million of it between 1980-1985. Of this sum, US$ 8.53 million were paid within the bilateral agreements with Norway, under the framework of the Club of Paris.

5. In 1985, when FBE entered into liquidation, it left a debt of US$ 40.1 million which, after negotiations with GIEK, became US$ 31.1 million, due to the cancellation of a portion of that debt, US$ 9 million, by GIEK.

6. The debt left by FBE was distributed as follows: US$ 13.6 million with the Norwegian government within the framework of the Club of Paris, and US$ 17.5 million with GIEK (this debt was not considered within the bilateral agreements of the Club of Paris because it still had not matured).

7. Of the debt with the GIEK, Transnave paid US$ 4.8 million and the balance was taken by the government of Ecuador (US$ 12.7 million). However, the debt with the Club of Paris was full responsibility of the government of Ecuador, as guarantor of the Flota Bananera Ecuatoriana (FBE), under the agreements with the Club of Paris. Thus, the government of Ecuador became responsible for a total debt of US$ 26.1 million, which meant an increase of its foreign public debt.

8. Nevertheless, according to the Central Bank of Ecuador, **payment to the Club of Paris ought to have been made by the private debtor,** FBE, as purchaser of the ships and which was established as a mixed capital company but it is listed in the Commercial Registry as a joint stock company. Moreover, it carried out the loan contracts which it signed to purchase the ships as a joint stock company; therefore, **debt payment obligations should have been met with resources of the company, and not with resources of the government of Ecuador.**

9. In the agreements with the Club of Paris, not only matured quotas were refinanced, but advances as well, **assuring the creditor (GIEK-Norwegian government) that the government of Ecuador would cover the debts if FBE did not.**

10. The original debt of US$ 13.6 million for which the government of Ecuador assumed responsibility increased considerably throughout the seven agreements with the Club of Paris, **due to delays in payment, interest rate conditions and penalties subscribed in the agreements,** reaching US$ 49.6 million in March 2002, not including amounts which the renegotiations implied in regards to capital, refinancing interest in arrears, which totaled US$ 14 million. (penalties averaged 14 % annually).

11. This case is emblematic of a public foreign debt with the Club of Paris, which begins with an initial amount of US$ 13.6 million, for which Flota Bananera Ecuatoriana pays US$ 20.5 million, the Ecuadorian government US$ 26.7 million, and Transnave US$ 4.7 million, in other words, a total of US$ 51.9 million, and **to date, US$ 49.6 million is still owed to the Club of Paris.**

12. This means that the debt with the Club of Paris cost the government of Ecuador US$ 63.6 million (between the US$ 14 million already paid and the US$ 49.6 million balance). Put bluntly, the debt increased 467 %, or five times its original sum.

13. **In the 15 years since the government of Ecuador became responsible for the FBE's debt with the Club of Paris, this debt has remained unpaid, even though the government has already paid an amount equaling the capital. On the contrary, the debt has increased. When will the remaining debt of US$ 49.6 million be paid?**

14. With the roughly US$ 1 million a year the Ecuadorian government has paid the Club of Paris, Ecuador could have provided 5,500 families with solidarity bonds annually (distributing approximately US$ 180 to each), or directly created 470 jobs (with salaries of US$ 2,100 per worker per year).

15. Keeping in mind all that has been paid and the remaining balance, the loan for the purchase of the ships totals US$ 101.5 million, from an initial debt of US$ 52.5 million, or a 100% increase, based mainly on interest payments, interest in arrears, refinanced interests and commissions.

Concept	**FBE US$ millions**	**Government of Ecuador US$ millions**	**TRANSNAVE US$ millions**	**Total US$ millions**
Amount paid	20.5	26.7	4.7	51.9
Balance pending		49.6		49.6
Total	**20.5**	**76.3**	**4.7**	**101.5**

16. Of this total amount, the government of Ecuador has assumed responsibility to date of approximately US$ 76.3 million of this loan, distributed as follows:

Creditor	**Amount in US$ millions**
GIEK	12.7
Club of Paris (paid)	14.0
Club of Paris (pending)	49.6
Total	**76.3**

III. LEGAL CONCEPT

III.1 The purchase of the four ships by the Flota Bananera Ecuatoriana from the Norwegian shipping company DRAMMEN SLIP AND VERKSTED took place between 1979 and 1980.

III.2 Flota Bananera Ecuatoriana is a mixed capital company with the government of Ecuador holding 99 percent of the capital shares. However, in the Commercial Registry, it is listed as or joint stock company. The company was liquidated in 1987.

III.3 The Flota Bananera Ecuatoriana paid US$ 29.1 million for the down payment for purchase of these refrigerated ships: the balance was financed through commercial loans issued by EKSPORTFINANS A/S and LANEINTITUTTER FUR SKIPBSBYGGERIENE A/S. The government of Ecuador served as guarantor for these commercial loans.

The debts owed by the Flota Bananera Ecuatoriana to the companies EKSPORTFINANS A/S and LANEINTITUTTER FUR SKIPBSBYGGERIENE A/S were transferred to GIEK (Guarantee Institute for Export Credits). Therefore, the payments due in May 1983 and May 1984 were included within the first Agreement with the Club of Paris signed in July 1983; and the payments falling due between June 1984 and December 1987, were included in the second Agreement with the Club of Paris.

III.4 On September 23, 1985, Transnave, upon request from the Flota Bananera Ecuatoriana, took on the operation and administration of the four ships; this agreement was formalized November 6, 1985, and it was made clear that regardless of whether or not the results of the administration by Transnave were positive or negative, the Flota Bananera Ecuatoriana would assume responsibility for the results of the operations until the sale of the ships to Transnave was final. During the years that the ships were administered by Transnave to the moment of settling accounts, the account balance for the operations totaled a US$ 7'222.988,80 in Transnave's favor.

III.5 In 1987, Transnave formally acquired the four refrigerated ships. This purchase involved the transfer of the loans and the signing of a new contract between the government of Ecuador, Transnave and GIEK in order to refinance the debt. This transaction also involved the transfer of the existing debts between FBE and the creditors (Club of Paris) to the government of Ecuador.

III.6 In September 1987, a delegation from the government of Ecuador and the liquidator of FBE appealed to Norway with the objective of the requesting cancellation of the debt, but this proposal was not included within any of the agreements with the Club of Paris.

III.7 Through Executive Decree published in the Official Registry 3821 on March 25, 1988, the Constitutional President of Ecuador, León Febres Cordero Rivadeneyra, authorized the restructuring of the balance of the debt with GIEK. To this effect, a loan agreement was signed July 21, 1988 under which the government of Ecuador assumed responsibility for a US$ 12´722.988,80 of the debt, and Transnave US$ 4´777.011,20. The government of Ecuador once again served as guarantor for Transnave.

III.8 On July 18, 1988, a contract for the sale of the ships was signed between the Flota Bananera Ecuatoriana, in liquidation, and Transnave. This contract was backed by a certification of funds from the Financial Manager of Transnave and by favorable concepts from the Attorney General and the Comptroller General of Ecuador.

III.9 As part of all of these previously mentioned agreements under which the government of Ecuador served as guarantor, interest was capitalized and new loans generated.

III.10 The different Political Constitutions of Ecuador stipulate that public officials are responsible for the correct management and administration of government business negotiations, and that they are personally accountable for their actions and omissions.

III.11 According to Article 2438 of the Civil Code regarding "statute of limitations". The "statute of limitation extinguishing the acts and right of others requires only a certain lapse, during which these actions have not been extinguished. This time is counted from the time the obligation has been rendered enforceable." And Article 2439, "This time period is generally five years for executive acts and ten for ordinary ones..."

III.12 The criminal statute of limitations for the exercise of acts, before 1998 Political Constitution of the State of Ecuador took effect, was 10 years for crimes punishable with prison sentences, and the criminal statute of limitations for prosecution was five years. This time is counted from the date that the infringement was committed. This is the general rule.

III.13 In accordance with the Law of Civil Service and Public Administration, the statute of limitations for administrative actions is 60 days.

IV. CONCLUSION

The events described in this investigation which motivated this accumulation of debt by Ecuador occurred 15 and 24 years ago; thus, if public officials who participated in this process are indeed responsible, the statute of limitations has expired.

This process of debt accumulation has become a paradigm of the ways in which our nations become indebted within an economic system which only benefits the developed countries.

This loan violates the spirit and the meaning of international assistance and cooperation recognized under the International Covenant for Economic, Social and Cultural Rights (ICESCR), ratified by the General Assembly of the United Nations on December 16, 1966, Articles 1.2 and 11.1, because "international economic cooperation" should be "based on the principal of mutual benefit" and should prevent denying "a people...its own means of subsistence" without "prejudice to any obligations arising out of international economic co-operation."

V. RECOMMENDATIONS

Demand that officials of the government of Ecuador, through diplomatic channels, require the Government of Norway to cancel all obligations acquired by Ecuador as part of this component of the debt with the Club of Paris, considering it an illegitimate debt.

This report was approved by the Plenary of the Commission for the Civil Control of Corruption, in sessions held Wednesday, October 16, 2002. I certify this:

Econ. Pedro Votruba S.
Executive Director
Secretary of the Plenary of the Commission for the Civil Control of Corruption