



Skeletons in the Cupboard Illegitimate Debt Claims of the G7





“Skeletons in the Cupboard: Illegitimate Debt Claims of the G7”

**Joint NGO Report
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Introduction**

Over recent years, the G8 has repeatedly stated that it is concerned about corruption and good governance in developing nations. In 2004, the G8 stated its commitment “to help cut away the burden of corruption on economic growth”. In 2005, G8 Heads of State promised “substantial extra resources” for those Sub-Saharan African nations “committed to good governance, democracy and transparency”. That year, it also committed to cancel up to US\$55bn worth of the debt owed by the set of countries classified as “Heavily Indebted Poor Countries” (HIPC). In 2006, G8 leaders emphasised “the serious danger posed by corruption in public administration” and committed to an anti-corruption Action Plan. These statements reflect an emerging official mood that development assistance cannot be effective unless the developing country government in question is committed to poverty reduction and sound financial management.

This approach captures only part of the story however. It fails to ask how and why countries became over-indebted in the first place and why the loans provided by rich countries failed to work.

This report highlights that a number of concrete cases of illegitimate debts - Canada, France, Germany, Japan, Italy, UK and USA – which are a result of irresponsible lending. In many cases, these governments lent money to regimes they knew to be corrupt or repressive in order to buy political allegiance, or they were loans designed to help rich country companies do business abroad and development was never their original purpose. In still other cases, loans were provided at exorbitant interest rates. Under the current system, these debts must always be repaid and there is no consideration of whether these loans were responsibly extended by creditors or the funds responsibly used by debtors.

Well-known examples of such dubious loans include over US\$12bn racked up by dictator Mobutu Sese

Seko of former Zaire who was considered an ally of the West during the Cold War despite barefaced corruption and human rights violations. Former Iraqi dictator Saddam Hussein borrowed significant sums from G7 governments despite similar concerns.

Some debts should not be paid. They should not be repaid because creditors bear a large part of the responsibility for having extended loans irresponsibly and negligently. Many civil society organisations believe that creditors need to be held to account for the bad decisions they have made and share responsibility for illegitimate debt.

There are precedents in international and national law. In 1923, Chief Justice Taft of the US Supreme Court ruled that the new Costa Rican Government was not liable for debts incurred by the former dictator Frederico Tinoco with the Royal Bank of Canada because at the time of the transaction the bank should have known that the loan was not for “legitimate use” of the government but was intended instead for the dictator’s personal support after he had taken refuge in a foreign country.

In national law, there are clear rules and protections in place for both debtors and creditors. It is the responsibility of the creditor to exercise “due diligence” when he/she extends a loan to an individual (for example a bank must ensure that the client has a sound business plan or sufficient income with which to repay the loan). In addition, there are guarantees against usurious (or unreasonable) interest rates and penalty charges. In July 2005 in the UK, a couple who feared losing their home after a loan of less than £6,000 (US\$11,000) spiralled to more than £380,000 (US\$700,000) had their debts cancelled by a judge who ruled that interest and penalty charges were “extortionate” and “unfair”. Finally, should anything go wrong, national bankruptcy procedures ensure an orderly work-out and avoid a run on the debtor’s assets.

This report focuses on dubious claims held on developing countries by each of the G7 nations – Canada,

France, Germany, Japan, Italy, UK and USA. Each case-study argues that these debts are illegitimate and should be investigated further urgently. It also shows that even when the odious lender is private, the complicity of the state may be at stake. In each case creditors bear a significant part of the responsibility for the mess. This report aims to challenge the argument that creditors should always be repaid and urges creditors to accept co-responsibility for loans which were irresponsibly and corruptly extended.

Our case-studies include examples of uneconomic projects being promoted, unnecessary goods or services being sold, blatant overcharging, the sale of military hardware or weapons to authoritarian regimes which were widely known to be corrupt or to abuse human rights, extortionate interest rates and huge negative social and environmental impacts.

Creditors can indeed accept shared responsibility for mistakes made in the past. In October 2006, Norway cancelled US\$80mn worth of debt owed by five developing countries (Ecuador, Egypt, Jamaica, Peru and Sierra Leone) acknowledging that it “shared responsibility” for these debts. Norway had exported ships to these countries that they didn’t really need and which were not suitable for their needs. Instead Norway’s motivation had been to support a domestic ship-building industry in crisis.

This case shows how it is possible to face past mistakes with truth and justice. The alternative is to carry on making the poor pay. Western politicians are currently focused on corruption and about ensuring that taxpayers’ money is well-spent and not wasted by corrupt elites. These are valid concerns. But our governments would have no credibility unless they apply these principles to the past and acknowledge their role in the spreading of corruption and their complicity. If our governments really want to weed-out corruption, they must also look at what went wrong in the past, put it right and make sure that it never happens again. Debts which are found to be corrupt, fraudulent and illegitimate must be cancelled and responsibility shared between the two parties. Otherwise, we risk repeated rounds of illegitimate and unsustainable lending and borrowing all over again.

This publication shows that it is not simply that impoverished countries cannot pay. Many of them should not pay.

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SKELETONS IN THE CUPBOARD

GERMANY'S ILLEGITIMATE DEBT CLAIMS

Warships for Indonesia, 1992 -2004

In 1993, a large section of the navy of the former German Democratic Republic (GDR) was sold to Indonesia. In total, 39 corvettes, minesweepers, troop supply ships and landing crafts were sold for 20 million Deutsche Marks (DM) (€10mn/US\$13mn), slightly above their scrap value. Due to the bad condition of the vessels the German Government felt it made perfect sense to also sell the modernisation of the vessels by German companies as well as the restoration of relevant navy infrastructure in Indonesia as part of the package. The restoration in Germany alone cost almost 475 million DM (€243mn/US\$316mn). The deal was insured for a total of 700 million DM (€358mn/US\$466mn) by Hermes, the German Export Credit Agency¹.

In 2001 and 2003, Hermes AG granted further cover in connection with the sale of the vessels. In reply to a parliamentary question from the Socialist Party Bench (PDS) the government stated that "the overhaul of eight corvettes' motors came with two export guarantees (Hermes-guarantees) of €24.2 million in total"².

In order to finalise the transaction, which was controversial both in Germany and in Indonesia, a private agreement was made between the German and Indonesian Defence Ministries. This stated that, "the buyer undertakes to use the objects of the agreement solely for coastal protection, the safeguarding of the sea route and to combat smuggling..."³.

This agreement was broken by the Indonesian side, especially by the government of General Suharto, who ruled Indonesia as dictator between 1968 and 1998 as well as by his successors Habibie, Wahid and Megawati Sukarnoputri. The vessels have been used in all internal armed conflicts.

Internal repression

In the summer of 1999, former East German Military [NVA] landing craft were used in the massacre in East Timor by Indonesian army supported militia⁴.

In January 2000, four former NVA vessels took part in the sea blockade of the Maluku Islands. Parts of the Indonesian army worked closely together with extremists and their blockade allowed hundreds of thousands of people to be driven from their villages⁵.

In March 2000 a landing craft brought soldiers from the Kostrad Infantry batallions 515 and the Elite Kopassus unit to the contested province of Papua and to the offshore island of Biak. The same vessel had already brought troops to the island in July 1998 who, on 6th July 1998, killed at least eight and injured 37 people in a bloody suppression of a demonstration by unarmed civilians⁶.

In May 2003 another vessel landed troops and tanks in the vicinity of the port of Lhokseumawe in the civil war ridden province of Aceh. In a raid, the troops killed ten villagers including a twelve year old boy⁷.

1 Frankfurter Rundschau dd. 14.12.94 and 16.12.94

2 Monitor dd. 19.6.2003. These Hermes covers were granted after the terms of payments for the already existing Indonesian debts to the bilateral creditors of the Paris Club was restructured. Normally any real or rumoured insolvency excludes the granting of a Hermes insurance. This leads us to believe that the interest in the lucrative order for the Mannheim Motorenwerke and MTU Friedrichshafen was so large that this regulation was ignored (Stuttgarter Zeitung dd. 17.4.03).

3 Monitor dd. 19.6.2003

4 The source in this and subsequent items: Delius, U.: Former NVA-vessels were used to quell an uprising in Indonesia in contravention of the terms of the agreement. Society for Endangered Peoples (GibV) 2003.

5 Jakarta Post, dd. 7.1.2000

6 Delius, GibV loc. cit. with reference to the Human Rights Organization of Papua Elsham. In a telephone question from the Society for Endangered Peoples, the Foreign Office merely replied by telephone and stated that this was a "sensitive situation" and that they were faced with a dilemma.

7 "Indonesian Forces execute 10 civilians in Aceh: witnesses"; dpa [German Press Agency] dd. 23.5.03

What does Indonesia owe on this dubious debt?

The servicing and restructuring of individual financing is not published in Germany. Therefore, the following account can only give a broad idea of the extent of the outstanding debt on this dubious transaction.

Original financing for the export of warships via the German Development Bank "Kreditanstalt für Wiederaufbau (KfW)	€ 280 mn
2000 and 2002 arms modernisation	€ 26.1 mn
Total	€ 306.1 mn

From 1993 until 1998 we assume this debt was serviced in accordance with the KfW's normal financing terms and conditions. In this period we can assume that less than one third of the outstanding debt was paid-off. In 1998, following the Asian financial crisis, Indonesia temporarily ceased payments on its bilateral foreign liabilities. In the same year - then again in 2000 and 2002 - Indonesia restructured its debts at the Paris Club. In 2005, following the devastating impact of the tsunami disaster, Indonesia was able to achieve a temporary stay of payment on its external debt which will come to an end in late 2007.

It can therefore be assumed that Germany is still owed at least €200 million of the original debt. This forms part of total known German claims on Indonesia of €551 million at end-2005.

Why are these debts illegitimate?

In accordance with the classic doctrine of "odious debts" three criteria must be met to make a creditor's claim illegitimate and therefore unenforceable: the loan did not benefit the population of the country, they did not approve the loan and the creditor must have been aware of both.⁸ While this doctrine based

on the work of A.N. Sack continues to be the cornerstone of any legitimacy/illegitimacy consideration regarding foreign debt, new developments in international law suggest a broader approach: the peremptory norms of international law (*ius cogens*)⁹. We conclude that the repayment claim on this loan is illegitimate because the export of these warships contributed to violations of fundamental human rights (*ius cogens* violations).

In whose interest?

The German government must have been concerned about the potential use of the equipment as it asked the government of Indonesia to sign an unusual clause in the deal saying that it would only use the vessels for civilian purposes. It was not reasonable for the German government to assume that the government run by General Suharto would purchase military equipment for civilian purposes and we argue that the exclusion clause was just a legal fig leaf to attempt to protect the German government when, as was predictable, the vessels were misused. From the point of view of the Indonesian population, which in 1998 liberated itself from three decades of repression and widespread human rights abuses under General Suharto, arms co-operation with Germany helped to prop-up the regime. As argued above the warships were used to kill, injure and displace a number of civilians on a series of occasions.

Did the people agree?

The Suharto government came to power in 1965 through a military coup. Until 1998 no democratic elections took place and the parliament was com-

8 Cf. erlassjahr.de: Manual Illegitimate debts; Düsseldorf 2003. The classical doctrine is not the only possible way to define illegitimacy. Other approaches start from an international law point of view (*Ius Cogens*), others start out from the transfer and application of standards of private contract law. For the first approach cf. Abrahams, Ch.: A fresh look at the doctrine of illegitimate debts in: Campaign Financial Centre Switzerland: Illegitimate debts. Indebtedness and human rights; Basel 2005; finally: Buchheit / Gulati / Thompson: The dilemma of odious debts, Duke Law School Legal Studies; research Paper No. 127; September 2006

9 Abrahams, Ch.: Ein neuer Blick auf die Doktrin der Illegitimen Schulden; in: Aktion Finanzplatz Schweiz: Illegitime Schulden. Verschuldung und Menschenrechte; Basel 2005



posed of military officers and supporters from each of only three permitted political parties (which regularly reappointed the dictator to office). Therefore there can be no question of a fundamental consent from the population in the form of a democratic process. But despite these undemocratic processes, technically General Suharto's regime was constitutional since he ruled based on a decree edited by the constitutional president Sukarno.

Did the creditors know?

The lender could not have been unaware of the nature of the regime under General Suharto given the dramatic human rights abuses during the coup of 1965 and during the occupation of East Timor in 1976. The undemocratic nature of the military regime was never called into question. It is precisely for these reasons that the German government insisted on the restricted use of the warships.

Even assuming that in 1992, the then-ruling federal government had grounds to assume that the Indonesian government would indeed use these vessels for civil purposes only, they should have intervened when in subsequent years official sources announced their use in contravention of the original agreement. In October 1995 the Commander-in-Chief of the Indonesian armed forces, General Feisal Tanjung, stated in an interview with the Asian Defence Journal: "with the construction of powerful Battalion Landing Team we intend to surmount any internal troubles. With the recent purchase of former East-German landing crafts the antiquated landing units will be replaced..."¹⁰

In 1991 there was opposition in the German parliament against co-operation on the planned project. The SPD committee member of the parliamentary defence committee, Dr. Elke Leonard commented: "the NVA vessels were to be delivered to Indonesia in 1991 and we strongly objected to this time-frame as the abuse of human rights in the region was flagrant. And we did not only protest from an ethical responsibility point of view but also on the basis of our fundamental legal principles"¹¹.

Finally there was no shortage of international warnings about this deal. The former colonial power of East Timor, Portugal, protested in February against the delivery of the German vessels¹². The World Bank was critical that development funds had been used for this large arms import programme with Germany¹³.

Conclusion: universally agreed norms of international law violated¹⁴

Two of the three classic legal criteria of an "odious" loan have obviously been met. Although the contract was signed by a government which was technically constitutional the legitimacy of the German claims for payment can be questioned because the contract has obviously not benefited Indonesia, and the creditor government was fully aware of the harmful use for which the Suharto Government intended the warships. The basis of the rejection is therefore the violation of the peremptory norms of international law. These internationally accepted (and undisputed) norms include the prohibition of wars of aggression, prohibition of genocide, slavery and torture and respect for fundamental human rights.

In this case there are clear indications of the creditor's aiding and abetting violations of fundamental human rights, particularly the right to life and liberty, the claim to legal protection and the prohibition of torture. On these grounds Germany must immediately open a public and impartial investigation into these claims.

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¹⁰ Quoted according to Delius: loc.cit.

¹¹ Monitor dd. 19.6.03

¹² FAZ dd. 23.2.93

¹³ Far Eastern Economic Review dd. 23.9.93

¹⁴ For a more extensive presentation of the ius cogens concept see: Queck, A.: Das Völkerrecht und die Frage der Legitimität von Schulden; erlassjahr.de Fachinfo Nr.9 Januar 2007; www.erlassjahr.de; Kadelbach, Stefan (I): Zwingendes Völkerrecht. – Berlin 1992; Hannikainen, Lauri (1988): Peremptory Norms (ius cogens) in international law: historical development, criteria and present status – Helsinki

Organisations in Indonesia:

- International NGO Forum on Indonesia's Development (INFID): www.infid.org
 - International Forum on Indonesian Development (INFID): www.infid.org
 - Indonesian Forum for the Environment (Walhi): <http://www.walhi.or.id/eng>
 - Indonesia Corruption Watch: <http://www.antikorupsi.org/eng/>
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SKELETONS IN THE CUPBOARD

ITALY'S ILLEGITIMATE DEBT CLAIMS

“Jaime Roldos Aguilera” project: BUY THREE WHEN YOU NEED TWO

In 1995, Italy's official development agency became involved in a controversial infrastructure project in Ecuador. This was the **“Jaime Roldos Aguilera” project** which aims to regulate the water of Rio Daule. Italy partially financed the construction of the Marcel Laniado Hydropower Plant, fed by the Daule Peripa dam.

Construction work on the Daule Peripa dam started in 1982. Worryingly, a broader hydraulic plan was drawn-up only in 1983, after construction of the 90 meter high dam had already started. The project, with a capacity of 6,000 million cubic meters of water, had begun without a proper assessment of potential environmental and social impacts. The “Jaime Roldos Aguilera” project had a direct impact on 15% of the territory of Ecuador. The social and environmental impact has been devastating.

The project has also had a major financial impact in terms of accumulation of external debt. Around 80% of the funds needed to finance the project were provided by external creditors¹. The construction of the Marcel Laniado Hydropower plant as well as the construction of the infrastructure for water transfer from the basin of Daule Peripa cost about US\$740 million, 45% of the total costs of the project². The economic unsustainability of the project was clear before its construction even started. As construction continued, the project saw an exponential growth of its economic costs.

Italy's role

In 1995, after the construction of the Daule Peripa dam was completed, its negative development impact was clear and the external debt burden of Ecuador already very high, the Italian Government decided to co-finance the project. The Italian government sold three turbines for the Marcel Laniado Hydropower Plant, for 92,998,004,000 Italian Liras (US\$50 million at

that time). The operation was made possible through a mechanism designed by the Italian development cooperation law called the “rotation fund”³. This fund was managed by an Italian Bank, Mediocredito SpA, in which the Italian government had a stake until 1999.

The three turbines were provided by the Italian company Ansaldo, accompanied by a guarantee for commercial risk by the Italian Export Credit Agency, SACE. With this operation, the Italian government contributed 20% of financing of the Marcel Laniado Hydropower plant⁴. However this commercial guarantee provided by SACE generated extra commercial debt for the country.

According to data gathered during a recent mission by a Senator of the Italian Parliament, Hon. Francesco Martone, the sale of three turbines was made without regard to a previous estimation of the power production capacity of the plant. Three turbines were sold to Ecuador, where only two were needed.

The Italian government should never have become involved in a project which was already significantly over-budget, was of questionable benefit to the population of Ecuador, and had contributed to significant debt accumulation in the country. The decision to sell an unnecessary extra turbine contributed to the accumulation of illegitimate debt. This warrants immediate and public investigation.

What does Ecuador owe on this dubious debt?

The details of individual financing agreements are not available to the public in Italy. Current figures of outstanding Italian credits – and export credits in particular – are

1 “Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Rodos Aguilera”, 2006, p. 30

2 As above, p. 32

3 The Italian cooperation law was approved on February 26th 1987, No. 49 “Nuova disciplina della cooperazione dell'Italia con i paesi in via di sviluppo”. Its review is currently under discussion by the Italian government.

4 “Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Rodos Aguilera”, 2006, p.40

kept secret by the Italian government and the Italian Export Credit Agency, SACE. Given that most of Ecuador's debt to Italy originated via commercial operations, it is difficult to give precise figures of the sums owed.

The original financing for the Marcel Laniado Hydropower Plant via Mediocredito SpA was for a total of: 92,998,004,000 Italian Liras (US\$50mn)⁵.

According to Ecuadorian CSOs, CDES and Acción Ecológica, the government of Ecuador has been regularly servicing its debt obligations toward external public creditors from 1982 to 2003⁶.

In 2002, Ecuador renegotiated its external debt with Paris Club creditors. According to an enquiry submitted by Senator Francesco Martone to the Italian Government in 2002, Italy renegotiated a total of US\$257.7 million among the main Italian creditors of SACE, Ansaldo and Mediocredito⁷.

According to official data provided by the Italian Embassy in Quito, the total amount of intergovernmental and commercial credits that Ecuador owed to Italy in 2004 was US\$340 million. Italy is Ecuador's biggest creditor at the Paris Club, accounting for 38% of the total bilateral external debt of the country.

Why are these debts illegitimate?

The repayment claim on a loan is illegitimate because:

- the loan did not benefit the population of the country,
- the people of the country did not consent to the loan, and;
- the creditor was aware of both⁸.

In whose interest?

The Daule Peripa hydropower plant had an enormous social, environmental and cultural impact on the people in the area. The dam created a reservoir that:

- flooded 30,000 hectare of land;
- displaced over 4,000 indigenous families, about

- 20,000 people in total;
- isolated over 100,000 people⁹.

Due to the state of absolute abandon in which they were left by the national government people living in the area around the Daule Peripa basin are now among the poorest in Ecuador, with 90% of people in poverty and lacking basic services¹⁰.

The flooding caused different sanitation problems. According to interviews conducted by Ecuadorian NGOs among the people living in the area of Santa Maria and Cabecera de Espana and reported in the research study "Sembrando Desiertos", environmental changes caused by the reservoir worsened diseases typical of the area, such as malaria, dengue and parasites.

The final estimates of the cost of the overall multipurpose project are US\$1,639 billion¹¹. If we add the major environmental, social and cultural costs of the project the cost-benefit calculation is negative in absolute terms (-US\$928 million)¹².

Therefore "Jaime Roldos Aguilera" project did not contribute to improving the living standards of Ecuadorian people.

4 "Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Roldos Aguilera", 2006, p.40

5 The credit was approved by the Government of Ecuador on June 26th 1996, with Resolution No. 192. Investigación Cuantitativa de la Deuda Externa Ecuatoriana 1979-2004, Marco Albuja Martínez, Fundación Lexis, Ecuador.

6 Sembrando Desiertos. Source as above, 2006, p. 17

7 Interrogazione del Senatore Francesco Martone al Ministro degli Affari Esteri e al Ministero dell'Economia, 2002, par 3

8 Cf. erlassjahr.de: Manual Illegitimate debts; Düsseldorf 2003. The classical doctrine is not the only possible way to define illegitimacy. Other approaches start from an international law point of view (Ius Cogens). Others start out from the transfer and application of standards of private contract law. For the first approach cf. Abrahams, Ch: A fresh look at the doctrine of illegitimate debts in: Campaign Financial Centre Switzerland: Illegitimate debts. Indebtedness and human rights; Basel 2005; finally: Buchheit / Gulati / Thompson: The dilemma of odious debts, Duke Law School Legal Studies; research Paper No. 127; September 2006

9 "Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Roldos Aguilera", 2006, p. 48.

10 As above, p. 48.

11 As above, p. 10.

12 As above, p. 10.



Did the people agree?

The Marcel Laniado Hydropower Plant was proposed and approved between 1992 and 1996, during the presidency of Sixto Duran Ballen while the country was going through a very tense political situation due to the external conflict with Peru¹³. Vice President Alberto Dahik Garzozzi was forced to resign, accused of misusing public money¹⁴.

President Ballen was linked to the same interest groups that successfully supported – with suspected use of corruption - the construction of the infrastructure necessary to bring water from the Daule Peripa reservoir to the Peninsula of Santa Elena¹⁵. In the same period, a new Law for Agricultural Development was approved¹⁶. This allowed CEDEGE to move indigenous communities without compensation and to cut away large areas of forest to allow construction to begin. Since construction of the Daule Peripa dam started, the building consortium kept the growing environmental, social and cultural costs hidden to the public. There has not been open and transparent consultation of local communities.

In this context, the Italian government decided to commit itself in the Marcel Laniado Hydropower Plant by negotiating the sale of three turbines with President Ballen, when apparently only two were needed.

Did the creditors know?

The scale of corruption, environmental degradation and local complaints surrounding the construction of the Marcel Laniado Hydropower Plant should have stopped the Italian government from getting involved. The Marcel Laniado Hydropower Plant was an extra part of an intervention that was financially unviable and generating very high economic and social costs for the population of Ecuador. The economic unsustainability of the project was clear even before its construction started. According to preliminary estimates the project was approved with a net negative projection of -US\$50 million¹⁷. This did not stop the InterAmerican Development Bank from financing it,

and it did not stop the World Bank from continuing to push for the project and from facilitating the involvement of other external creditors in its financing. According to an ex-post evaluation study realised by the Institute of Economics of the University of Guayaquil in 2001, the IDB decided to finance the project because it considered the project “a national priority” for Ecuador. The same study included a new evaluation of the economic sustainability of the project and a new - even more negative - evaluation of costs, this time for a net value of -US\$130 million¹⁸.

Conclusions

The government of Italy shares a major responsibility for having contributed to financing such an expensive and financially unsustainable project, at a time when:

- the environmental and social impacts of the Daule Peripa dam were already evident;
- massive violations of human rights were taking place among the indigenous communities of the Peninsula of Santa Elena;
- dubious negotiations led to the approval of the Marcel Laniado Hydropower Plant, without a clear sustainability plan and without a proper cost-benefit analysis.

The Italian government failed to meet the development needs of the Ecuadorian people and used pub-

13 The government of Ecuador authorised the Minister of Finance to negotiate the credit with Mediocredito on October 31st 1995, about 8 months after the peace declaration between Ecuador and Peru (“Declaración de Montevideo”) was signed. Troops from both sides withdrew on March 27th 1995. See: http://www.avizora.com/publicaciones/historia_de_paises/textos/0029_historia_ecuador.htm

14 On October 12th 1995, Vice-President Alberto Dahik Garzozzi left the country and requested for political asylum to Costa Rica after being sentenced to preventive imprisonment from the Supreme Court of Ecuador. See: http://www.avizora.com/publicaciones/historia_de_paises/textos/0029_historia_ecuador.htm

15 “Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Rodos Aguilera”, 2006, p. 28

16 As above, p. 28,29

17 As above, p. 35

18 “Sembrando Desiertos. La Deuda Social y Ecológica general por el endeudamiento externo en el Proyecto de Propósito Múltiple Jaime Rodos Aguilera”, 2006, p. 35

lic development money to serve the interest of an Italian company, Ansaldo to sell a extra turbine that generated an extra – and unnecessary – cost for the Government of Ecuador and for the people of the country.

These violations allow us to consider this debt as illegitimate. The commercial debt generated by the intervention of SACE in covering the risks of this transaction should never have been placed on the shoulders of Ecuadorian citizens.

The Italian government should make public the information concerning its outstanding claims on this project and on Ecuador more broadly. It should be the subject of immediate and impartial investigation and any debts found to fraudulent following this process.

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For more information and local organisations:

- CDES, Acción Ecológica: www.accionecologica.org
- Instituto de Estudios Ecológicos del Tercer Mundo: www.estudiosecologicas.org
- Jubileo 2000 Red Guayaquil: www.latindadd.org/Jublieo_2000.html





SKELETONS IN THE CUPBOARD

USA'S ILLEGITIMATE DEBT CLAIMS

Loans/Guarantees from the US Export-Import Bank for The Bataan Nuclear Power Plant Project, the Philippines

What Skeletons are in the USA's Cupboard?

The Bataan Nuclear Power Plant is a nuclear power station built by former Philippine dictator Ferdinand Marcos who ruled the Philippines between 1965 and 1986. The plant was constructed on a fault line in the province of Bataan in the Philippines. The Export-Import Bank (EXIM), the US government's export credit agency, provided loans and guarantees totaling US\$900 million for the project.

At the beginning of negotiations with the Filipino Government in 1974, Westinghouse, a US corporation, submitted a bid to the government of the Philippines to build two nuclear power plants for US\$500 million. Ultimately, the project cost more than US\$2.3 billion. Westinghouse was paid even though the plant never generated a single watt of electricity, as it was too dangerous to ever bring online. President Marcos reportedly received an US\$80 million kickback from Westinghouse on the plant that he authorized. The Filipino people continue to pay this debt and are projected to continue to do so until 2018, even though they have never received even a single watt of energy from the project. This paper argues that EXIM loans for the Bataan Nuclear Power Plant were odious and illegitimate in nature. They should be the subject of immediate public investigation.

What is the Bataan Nuclear Power Plant (BNPP)?

The BNPP was the largest power generation project undertaken in Filipino history. Begun during the energy crisis of 1970s, Filipino dictator Ferdinand Marcos commissioned the project as a way to generate energy for the Philippines. The project entailed the construction of two 600 megawatt nuclear reactors in Morong, Bataan province, about 100 miles north of Manila.

What was financed?

Westinghouse, a US company, won the bid to build two nuclear power plants in Bataan province of the Philippines in 1974 for US\$500 million. It won the contract with bribes and the help of a political crony close to dictator Ferdinand Marcos – Hernando Disini. Soon after the contract was awarded however, Westinghouse adjusted its price to nearly US\$1.2 billion. In 1979 the cost rose to US\$1.9 billion, and ultimately the cost of the project reached more than US\$2.3 billion.

In 1975, when the Philippine government formally requested support from the Export-Import Bank for the BNPP, nuclear power was becoming increasingly unpopular in the US and so the US nuclear industry was looking for overseas markets. By 1979, the crisis for the US nuclear industry became even greater with the incident at Three Mile Island. The US government helped Westinghouse to sell its plants in the Philippines with a series of loans and guarantees from the Export-Import Bank (EXIM), the US government's export credit agency.

EXIM authorized a project loan for the BNPP for US\$277.2 million in January 1976, its largest loan to date at the time. It also extended a US\$367.2 credit guarantee to the project so that it could more easily attract private investment. In 1979, when Westinghouse raised project costs, EXIM guaranteed two more loans totaling US\$308 million. In all, EXIM provided direct loans and guarantees for the BNPP totaling in excess of US\$900 million

What the Philippines owes on this dubious debt

At a total cost of US\$2.3 billion, the BNPP quickly became a significant drain on the Philippine economy due to the large debt payments that were made on the project annually.

By 1987, almost US\$1 billion had been paid on the loan – largely by the Marcos regime. From 1987-1989,

a further US\$460 million was repaid. During this period, payments on the project ranged from US\$300,000-\$357,000 each day. Payments continued at a similar rate until 1989, when the Filipino government undertook a securitization scheme in which some BNPP debts were nationalized and then converted into bonds and securities.

By 2002, debt service for the project was US\$43 million, of which US\$28 million went to the EXIM.

In 2007, the final payment of US\$16.7 million is due on the remaining unsecuritized portion of the BNPP loans.

In a country where 30% percent of the population lives in poverty, these funds could be used to fight poverty. Instead they are used to service a corrupt, odious and illegitimate debt for a project that never benefited a single Filipino citizen.

Why are these debts illegitimate?

According to the classic legal doctrine of “odious debts” three criteria must be met to make a creditor’s claim odious and therefore unrecoverable: the loan did not benefit the population of the country, the population did not give its consent to the government that took out the loan, and the creditor must have been aware of both. We argue that loans made by the US EXIM Bank for the BNPP meet the strict criteria for treatment as an odious debt.

In whose interest?

The BNPP project never benefited the people of the Philippines. From the very beginning of the project, serious questions were raised about the safety and viability of the project. The plant was built along a fault line in the Philippines and thus was at risk of being hit by earthquakes. It was also built near to Mt. Pinatubo, an active volcano. Operating the plant would have created serious health, safety, and environmental hazards for the communities surrounding the plant.

The design of the project was questionable from the start. In March 1979, the incident at Three Mile Island in Pennsylvania forced a global re-think of the safety and viability of nuclear power. Following the Three Mile Island disaster, the Marcos administration created a commission to inquire into the safety of the plant’s design, and this commission ultimately found that it was unsafe to operate.

US nuclear engineer Robert Pollard, who worked for the US Atomic Energy Commission, traveled to the Philippines in March 1981, where he proclaimed in a speech to the Manila Rotary Club, “The Bataan nuclear plan will not be safe: it will not be reliable; and it will not be inexpensive. At best, the Bataan reactor will be a very costly way to increase your energy dependence upon foreign countries (because uranium has to be imported). At worst, it may result in a catastrophe that could render an important part of your nation uninhabitable.” (Tanada, 5)

As public outcry grew about the risks associated with the plant, pressure mounted on the Marcos regime to make drastic changes to the plant or abandon it. The plan was completed in 1985. Shortly after Marcos fell in 1986, new President Cory Aquino made the decision to mothball the plant in 1987. The plant never generated a single watt of electricity and did not benefit the population of the Philippines.

Did the people agree?

President Ferdinand Marcos governed the country from 1965-1985. The BBC has reported that Marcos stole at least US \$10 billion from his country. Ferdinand Marcos stood ardently against communism and received strong support from most Western countries. In 1972 Marcos declared martial law and dissolved the parliament. He also shut down all media that was unsupportive of his regime.

Marcos was ultimately forced by the Filipino “people power” movement and replaced by Cory Aquino in 1986. It is clear that the people of the Philippines did not consent to be governed by the Marcos regime. Not only was Marcos unelected and unaccountable,



he was corrupt. Two US companies, GE and Westinghouse, were the leading bidders for the BNPP project. To help ensure that it got the contract, Westinghouse sought the help of a political crony and golfing partner of President Marcos – Herminio Disini. With Disini's help, Westinghouse got the contract.

Westinghouse has since admitted to paying US\$17.3 million in commissions to Disini. Moreover, according to estimate from lawyers, bankers, and government officials interviewed by the New York Times, Marcos received a total of US \$80 million in bribes and kick-backs for the BNPP project. (Mendoza 46-47)

Did the creditors know?

It is unquestionable that the US government knew about the undemocratic nature of the Marcos dictatorship. During the Carter Administration and its emphasis on human rights, questions were raised, but the Reagan administration was less critical. Dozens of US Congress members raised concerns in the early 1980s about the administrations' unconditional support for the Marcos regime despite major concerns about human rights violations. Despite this, the twenty-year period under Marcos rule was marked by extensive lending from international financial institutions.

Not only did the US government and the EXIM bank know about the nature of the Marcos regime, they were aware of the cost over-runs and made no effort to look into why the projected cost of the project increased so significantly from the initial US\$500 million estimate that Westinghouse made.

In 1975, EXIM's President and Chairman was William J. Casey, who would later become the Director of the CIA in the Reagan administration.

In June 1976, Casey approved the loans to the Philippines, making no effort to investigate why the project cost had gone up significantly from its initial estimates. Ironically, on the very same day he approved Philippine nuclear loans, he also granted a nuclear loan package to Spain for a plant which was

worth US \$687 million, almost one-half of the BNPP's price tag, but of a greater generating capacity.

Casey said, "if they (Westinghouse) charge too much, the Philippines has to pay for it...they have to protect themselves from being fleeced. We cannot do it for them." (Mendoza 69).

Conclusions

The case of EXIM financing for the BNPP in the Philippines is a case study of an odious and illegitimate debt claim made by the United States government. As G-8 leaders gather in 2007 to assess global economic development, Jubilee USA Network calls on the administration to conduct an audit of the BNPP project in the Philippines.

This briefing paper was written by Jubilee USA based on materials extensive research and writing by Sabyte Lacson and the Freedom from Debt Coalition – Philippines

Local organizations and more information:

- Freedom from Debt Coalition, Philippines: www.freedomfromdebtcoalition.org

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SKELETONS IN THE CUPBOARD

FRANCE'S ILLEGITIMATE DEBT CLAIMS

CORRUPT AND RIP OFF OIL DEALS TO CONGO-BRAZZAVILLE

Introduction

France's cupboard is full of skeletons. No matter how criminal or corrupt the governments were, France lent for many years to maintain its hold over many of its former colonies and to promote its civilian and military exports. Examples include former Zaire under Mobutu, Rwanda on the eve of the genocide, Côte d'Ivoire under Houphouët-Boigny and Togo under Eyadema. However oil deals between France and Congo-Brazzaville have been selected because of the very particular relationship between the two countries in recent years. This case study also allows going into a slightly more complex scheme, in which France, although not itself the lender, appears to be the complicit in a criminal financing system.

What Skeletons are in France's cupboard?

Since the 1980s, French banks and the petroleum company Elf – with the complicity of the French State – have been bankrolling oil extraction in the Republic of Congo. The mechanism of “prefinancing” which has been the preferred form of financing involves guaranteeing a loan to an oil-producing state in exchange for rights to future barrels of oil. But in Congo Brazzaville, this system has only served to guarantee the institutionalised pillage of oil resources in the country by Elf, the enrichment of a powerful national elite and its cronies and has supported the purchase of arms which were used in the massacre of thousands of people in 1998-99.

It is this mechanism which has been in use for over twenty years, more than one loan in particular, which gives cause of concern. In 1979 Denis Sassou Nguesso came to power by force and since then he has wasted Congo's oil resources. In 1985, the country saw its oil resources plummet with the sharp decline in oil prices and he was no longer able to service the debt¹. This was the start of France's “prefinancing” agreements with the country.

- In the mid-1980s, President Sassou Nguesso approached Elf in order to obtain an advance. Only 17% of oil revenues were demanded by the state, which did not even know how much oil was produced. According to Xavier Harel, a journalist, “it was a real windfall for Elf: the group was guaranteed to be repaid [...]. At the end of 1987, [...] Congo was the most indebted country in the world as a percentage of GDP. [...] From 1990, oil revenues had already been mortgaged up until 1994”².
- In order to meet its debt service obligations, Congo became even more indebted. “In June 1992 [...], I myself signed a loan agreement guaranteeing US\$50mn in oil with Jack Sigolet, Elf Finance Director” admitted Jen-Luc Malekat, Finance Minister at the time³.
- Faced with American competition from Oxy, which advanced US\$150mn in 1993, Elf granted another prefinancing deal of US\$180mn guaranteed against the promising Nkossa oil deposit⁴. Elf then convinced French banks to lend a further US\$150mn. It became a frenzied race to secure Congolese oil. Meanwhile, debt climbed from €200mn (US\$258mn) in 1992 to almost €600mn (US\$774mn) in 1996⁵.
- In 1997, Jack Sigolet and Elf's Head of Africa, André Tarallo proposed the sale of arms to President Sassou Nguesso's political opponent Pascal Lissouba for an amount of US\$61mn, via a Belgian arms dealer Jacques Monsieur. Elf would advance the funds for this. “In total, Lissouba's team would have paid around a billion francs [€150mn] from June to September 1997 for the purchase of arms.” When

1 François-Xavier Verschave, *L'Envers de la dette – criminalité économique et politique au Congo-Brazza et en Angola, Dossiers noirs d'Agir ici et Survie*, Ed. Agone, 2001, pp. 20-21

2 Xavier Harel, *Afrique, pillage à huis clos – Comment une poignée d'initiés siphonne le pétrole africain*, Ed. Fayard, 2006, pp. 53-54

3 Cité dans Xavier Harel, *Op. Cit.*, p. 57

4 *La Lettre du Continent*, 6 janvier 1994, cité in Verschave, *Op. Cit.*, p. 43

5 Xavier Harel, *Op. Cit.*, p. 59

in October 1997, Sassou Nguesso won the internal conflict, he declared “we can prove that oil money [...] bought combat helicopters and bombs [...]. The old power wasted 300bn CFA francs [€450mn] in future oil revenues”⁶.

- In 1998, Crédit Agricole advanced another oil prefinancing agreement to the coup-maker Denis Sassou Nguesso: he was given US\$60mn in return for 1.2mn tons of oil (around US\$7 a barrel)⁷.
- According to Xavier Harel, “between February 1999 and January 2004, the prefinancing agreements [from Paribas then BNP Paribas] to Congo’s national oil company (Société nationale des pétroles congolais - SNPC) reached US\$650mn”⁸.
- In 2004, BNP granted several prefinancing agreements to Congo’s national oil company or to its intermediaries, such as Trafigura⁹, which were selling oil at between 6 and 9 dollars below market price to companies controlled by Sassou Nguesso’s cronies. The profits generated from each transaction were huge. BNP even seemed to be one of the beneficiaries of certain cargoes of oil¹⁰.

What does Congo-Brazzaville owe on this dubious debt?

According to the IMF, Congo-Brazzaville’s total debt stood at US\$2.4bn in 1985 when the first defaults started to occur. Under Sassou Nguesso this climbed to US\$5bn by 1992. Under Lissouba, Congo’s debt burden stabilised before again spiralling after Sassou Nguesso once again seized power in 1997. At the end of 2005, it had reached US\$9.2bn: five times the country’s budget. Western governments and multilateral bodies are the country’s biggest creditors.

However it is very difficult to ascertain how much of this debt can be attributed to the oil prefinancing agreements. Even the IMF has not been able to obtain a clear budget from Congo. Activists who are trying to find out more about their country’s oil revenues such as Christian Mounzéou and Brice Mackosso of “Publish

What You Pay” have been subjected to continuous harassment by the Sassou Nguesso regime¹¹.

It is even more difficult to obtain an inventory of mortgaged loans, because they are not part of the common state budget and they have not been subject to any accounting and the repayment periods can be extremely short. In addition, the sale of Congolese credits on secondary markets makes it even more difficult to identify who actually holds the claims. This is how several vulture funds, including Kensington and FG Hemisphere, which bought the debts from other banks keen to get rid of dubious claims have been trying to obtain a full reimbursement of the debts for several years.

Why are these debts illegitimate?

We take the three criteria developed by Alexander Nahum Sack and argue that these debts can be defined as odious. According to Sack, a debt is odious and therefore unenforceable when: a/ it did not benefit the population; b/ the people did not consent to the loan; and c/ the creditor was aware of these facts.

In whose interest?

It was in response to an urgent liquidity crisis in the country that Congo Brazzaville resorted to these prefinancing agreements. Congo was not in a strong position vis-à-vis the oil companies who imposed unfair contracts on them. The future value of the country’s oil was systematically underestimated by BNP Paribas pre-

6 Cité in Verschave, *L’Envers de la dette*, p. 59

7 François-Xavier Verschave, *Noir silence – Qui arrêtera la Françafrique ?*, Ed. Les Arènes, 2000, p. 59

8 Xavier Harel, p. 145

9 Société de trading pétrolier au cœur de nombreux scandales, notamment « pétrole contre nourriture » (programme de l’ONU en Irak) et la pollution mortelle à Abidjan (Côte d’Ivoire) en août 2006

10 Xavier Harel, pp. 148-50

11 Récemment encore, en janvier 2007, ils ont été empêchés par le régime Sassou de décoller pour Nairobi (Kenya), où ils devaient se rendre pour participer au Forum social mondial



financing to SNPC (from US\$6 to US\$9 below market price in 2003-04), interest rates were exorbitant reaching 40% on a yearly basis in some cases of short-term loans, and the government was often ignorant about the quantities of oil being produced and of its quality. And this is not even to mention, as Elf former President Loïc Le Floch Prigent did, “phantom cargoes of fossil fuels which escaped all accountants’ books and were shared behind the scenes”¹². The World Bank remarked in 1990-1991, that “the financial efficiency of oil exploitation in Congo was among the lowest in the world”¹³. In Spring 1995, strangled by the massive debt burden and “the constraints of having to play the game according to Elf’s rules” (said then-Finance Minister Jean-Luc Malekat), Lissouba and his team sold-off part of the Congolese state’s share Elf-Congo (25%) to Elf for a price of 250mn francs (less than €40 mn) which was around four to six times lower than the market value¹⁴. In brief, oil-backed loans institutionalised the theft of Congolese oil for the benefit of Elf and at the expense of the Congolese people.

The pillage of oil resources – via oil backed loans – was not just something committed by foreign oil companies. Equally, a corrupt Congolese elite was using oil revenues to its own advantage.

In 1993, US\$150mn worth of loans obtained by the Congolese state were supposed to finance the construction of schools, support modernisation of the judicial system and support economic regeneration. None of these projects ever materialised. Renovation of the road which links Brazzaville to Pointe Noire was financed several times over but never actually happened. This has become a symbol.

Between 1999 and 2002, the IMF estimated that “the [Congolese] government has underestimated oil revenues by US\$ 248mn”¹⁵. A vulture fund, FG Hemisphere showed that between 2003 and 2005, the Congolese authorities had “forgotten” to put almost a billion dollars through their books¹⁶.

The theft of Congo’s resources, of which the oil backed loan deals were a part, has made a few people very

wealthy. TotalElf declared a record US\$12bn profit in 2005. By 1997, Denis Sassou Nguesso had accumulated a personal fortune estimated at €200mn, including a series of Paris hotels.

In recent years, the international press has captured Sassou in a series of luxury hotels in New York, Paris or London accompanied by his team of over 100 people. Meanwhile the majority of the Congolese population lives in abject poverty. Although GDP per capita is theoretically around US\$1000 per year, in 2003, 70% of Congolese were living on less than US\$1 per day. Just 10 years earlier, only 30% of the population were living on US\$1 per day or less. Life expectancy stands at around 50 years and infant mortality reaches almost 10%. The future does not look bright. Oil still continues to flow but it is already mortgaged.

Add to this the wars in the summer of 1997 and 1998-99 which were bloody. In 1997, as we saw, Elf became the intermediary and guarantor for the sale of arms to the government of Pascal Lissouba. In December 1998, on board vehicles recently delivered from France, Sassou Nguesso’s “cobra militias” systematically assassinated men, women, older people and children in the areas of Brazzaville which were considered “hostile”. According to French NGO Cimade, 25,000 people died. The International Federation of Christians for Action Against Torture (FIACAT) described it as “an act of genocide”. Along the Congo-Océan railway line, villages were systematically destroyed, women raped, and populations exterminated. 500,000 fled to the forest and many died of hunger¹⁷. It is in this context that Crédit Agricole, accordingly with the support of the French President, signed a pre-financing agreement with Congo for US\$60mn. At the beginning of 1999 Paribas signed a loan agreement

12 Description faite par l’ancien PDG d’Elf, Loïc Le Floch-Prigent, lors du procès Elf. In Nicolas Lambert, *Elf, la pompe Afrique – Lecture d’un procès*, Ed. Tribord, 2005, p. 82

13 Selon Martial Cozette, cité dans le rapport parlementaire, p. 228

14 Verschave, *L’Envers de la dette*, p. 46

15 Article IV sur le Congo, juin 2003

16 Xavier Harel, p. 152

17 Verschave, *Noir Silence*, pp. 15-33

with Sassou for US\$30mn more¹⁸. According to one socialist MP, “in Congo-Brazzaville, every bullet was paid for by Elf”¹⁹.

This is confirmed by Pascal Lissouba who was questioned on the matter by a parliamentarian. “Congo, so close to France [...] is in the process of being destroyed by bombs paid for by Elf [...]. As elected President of the Republic [...] I had the right to use a part of oil revenues to defend my country. Elf chose Sassou N’Guesso”²⁰.

Former Elf President, Loïc Le Floch-Prigent, concluded, “every month, while their oil is being sold, the Congolese see a part of their money going directly to Elf in order to pay for the arms”²¹.

Did the people agree?

Sassou Nguesso was brought and kept in power by force from 1979 to 1992. A national conference in 1992 accredited over 3000 deaths to him. Pascal Lissouba was elected to office in 1992, before being ousted in 1997 after a brutal war with Sassou Nguesso. Sassou Nguesso committed the worst atrocities in order to hold on to power. In 2002, the French courts declared that he could be described as a “dictator” who had committed “crimes against humanity”²². The country’s elections in 2002, which extended Sassou Nguesso’s regime, were a sham and changed nothing.

This means that the Congolese people did not consent to loans granted either before 1992 or from 1997 onwards. But financing agreements signed by Lissouba are also worth looking at in detail. It is not certain that his parliament or his people knew the details of the obscure financing agreements he was signing. This is confirmed by Elf financier Jack Sigolet. He stated that “the mechanism was developed in such a way that the official lending institution made everything as opaque as possible to the Africans”²³. If legally such discrepancies can be identified in contracts, their validity should clearly be questioned.

Did the creditors know?

There can be no doubt as to the knowledge of the Congolese context by Elf and French banks. Indeed, to a certain degree, Elf supported the return to power of Sassou who was judged more malleable than Lissouba. Knowing they were in the wrong, in 1991, Elf and Agip refused to comply with an audit on the management of oil resources. More recently in 2003, BNP lent US\$72mn to a small dummy corporation called Likouala SA based in the British Virgin Islands for the purchase of an old offshore oil deposit from TotalElf. However, Total was be involved in the management of Likouala SA, which may just be another invention in order to facilitate the disappearance of Congolese oil.

The mortgaged loans should not just be declared null and void. The culpability of Elf and French banks in the pillage of Congolese riches is such that criminal responsibility must be established. This could be based on the United Nations Convention Against Transnational Organised Crime which prohibits participation in an organised criminal group²⁴. Meanwhile, the American vulture fund Kensington is in proceedings against BNP, which it accuses of participating in the disappearance of Congolese revenue²⁵.

17 Verschave, *Noir Silence*, pp. 15-33

18 Verschave, *Noir Silence*, p. 59

19 Citée dans Verschave, *Noir Silence* p. 56

20 Assemblée nationale, Rapport d’information n°1859. pp. 271 et 282

21 Loïc Le Floch-Prigent, cité dans Xavier Harel, pp. 49-50

22 Denis Sassou Nguesso avait intenté en 2000 un procès pour offense à chef d’État contre l’auteur du livre *Noir Silence* (François-Xavier Verschave, président de l’association *Survie*), qui l’avait ainsi qualifié. En 2001, il a perdu en première instance, car le Tribunal avait estimé que le délit invoqué était contraire à la Convention européenne des Droits de l’Homme. En juillet 2002, la Cour d’Appel de Paris a donné raison à l’auteur sur le fond.

23 Cité dans Xavier Harel, p. 62

24 Verschave, *L’Envers de la dette*, p. 115

25 Xavier Harel, p. 145



Official complicity

In the context of oil financing to Congo, complicity in the mess goes far beyond these particular creditors. The highest echelons of the French State and part of the political class were also involved. Jacques Chirac blindly supported Sassou Nguesso going even so far as to free the Congolese Chief of Police one night in April 2004, who was being pursued in France for crimes against humanity.

More broadly, Elf (today part of Total) is not just an oil company. According to former president Loïc Le Floch-Prigent, “Elf was created to keep Algeria and the black kings under French control using oil”²⁶. It is at one and the same time, “an extension of the state”, France’s intelligence services in oil-producing countries and key to preserving French access to resources²⁷. The entire public sector was at its disposal. The French development agency (now the Agence française de développement – AFD) loaned €70mn (US\$91 mn) to Elf Congo in 1995²⁸. And the criminal policies of Elf – notably their support for Sassou – benefited French companies. From January 1999, while bodies were still being removed from the streets of Brazzaville, friendly contact was once again struck up between Congo and Bolloré, Rougier, Vivendi, Suez, PPR, among others. French political parties also benefited from this system which financed their electoral campaigns. “I knew about this and I tolerated this practice,” admitted Le Floch-Prigent. Millions of dollars would have been at stake every year.

In sum, Elf has been using and buying political support to impose its rule over Congo and conversely, the French government has been using Elf in order to keep a hold over Congo. In other words, in Africa, Elf and France are more often than not one and the same. When the responsibility of Elf is involved, so should that of the French government.

An audit is indispensable not only to shed light on the likely illegitimacy of most of those loans, but also to understand the exact responsibility of the French government. The Congolese drama shows that no mere

debt relief can ever compensate the human, social, ecological, historical and financial costs endured by the Congolese people. Odious lenders and those who stole the loans should face their legal responsibility in criminal law and be made to pay reparations to the Congolese. Eventually, this case demonstrates that any international agreement to prevent future odious lending should take in due consideration the key role played by unscrupulous banks and companies.

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Local and international organisations and more information:

- Survie: www.survie-france.org
- CADTM-France: www.cadtm.org
- Justice et Paix, Congo-Brazzaville
- Rencontre pour la paix et les droits de l’homme, Pointe Noire (Congo Brazzaville)
- Publish What You Pay: www.publishwhatyoupay.org
- Global Witness: www.globalwitness.org/

26 Cité in Nicolas Lambert, *Elf, la pompe Afrique*, p. 81

27 Xavier Harel, p. 51

28 Verschave, *Noir Silence*, p. 61



SKELETONS IN THE CUPBOARD

CANADA'S LOAN TO THE YACYRETÁ HYDROELECTRIC PROJECT: THE UNFINISHED ODIUS DAM

ARGENTINA-PARAGUAY BI-NATIONAL PROJECT 1973-

WHAT SKELETONS ARE IN CANADA'S CLOSET?

The Yacyretá dam on the Paraná River between Argentina and Paraguay – conceived in 1973 and begun in 1979 by the two countries' military dictatorships – is one of the world's longest running unfinished hydroelectric projects and a symbol of the inability of the state and its creditors to manage accounts and control corruption. Originally expected to cost US\$1.5 billion, the latest estimates for the unfinished dam that operates at only 60% capacity and counts thousands of impoverished dam evacuees as its victims, is now expected to cost US\$15 billion – 10 times the original estimate – if it is ever completed. Canada's Export Development Corporation lent Cdn\$86.4 (US\$72.9) million to Argentina in 1987 to purchase four hydroelectric turbines from Canadian General Electric, the hydroelectric subsidiary of the American multinational General Electric. The funds came out of a special Federal Cabinet-administered account called the "Canada Account" which is used to subsidize loans that are deemed to be for "national interest lending." Yacyretá has also received a total of US\$1.8 billion in loans from the World Bank and the Inter-American Development Bank, including on the heels of a public admission by former President Carlos Menem that Yacyretá dam was a "monument to corruption" and a "display of permanent waste."

WHAT IS THE YACYRETÁ PROJECT?

Born out of international cooperation between Paraguay and Argentina in 1973, the 3100MW Yacyretá project has been under construction since 1979 on the Upper Paraná River. Under the Yacyretá Treaty of 1973, the Entidad Binacional Yacyretá (EBY – the bi-national electric utility) was created to design,

build and operate the project. The dam structure itself is 45 miles wide, 42 meters high. So far, the reservoir has been raised only to 76-78 meters above sea level, still below its intended level of 83 meters because of neglected resettlement, environmental and management measures. The 250 km long reservoir will have a surface of 1650 km² – making it one of the largest hydroelectric reservoirs in Latin America – which will force as many as 75,000 people in both countries from their homes, including Mbya-Guarani indigenous people. The powerhouse has 20 turbines and generators with the capacity to generate close to 19,000 GWh of electricity a year, which will be principally used in Argentina. The dam is also supposed to control flooding, improve navigation, and provide irrigation.

The reality is dismal. The project has faced technical, financial, social and environmental problems. The floodgates were closed in 1994 before a detailed environmental and social mitigation plan was in place: fluvial islands and archipelagos with their endemic species, tropical forest and farmland in the mid-Paraná River have now been flooded, fish stocks harmed, and the seepage of the reservoir into the Iberá wetlands is threatening the region's rich biodiversity. The filling of the reservoir created stagnant, polluted water and contaminated groundwater supplies used for drinking. Now, schistosomiasis¹ has been detected in the reservoir. Meanwhile the 15,000 to 20,000 that have already been forced to evacuate their homes are living destitute lives without proper housing, jobs and sanitary conditions. Even the World Bank, which has carried out two investigations of the saga, admits, "the Yacyretá project has incurred important environmental and social liabilities that are causing increasing friction with affected populations."

Meanwhile, because of insufficient funds and the state's inability to solve the intractable social and environmental problems, the reservoir has never been filled to its full capacity and the dam is operating below its

¹ Yacyretá Hydroelectric Project, Report of the Review Panel, Inter-American Development Bank, Independent Investigative Mechanisms, September 15, 1997

installed capacity. Furthermore, three turbines had to be taken out of service in 1998 at a cost of US\$5 million when cracks appeared. Then, in May 1999, four turbines failed and the binational company, EBY, sued the manufacturers for damages. The project was originally justified on the assumption that electricity demand would grow by 8-10% per year. It grew only 2%, so when the first turbines came on stream in the mid 1990s, Argentina already had a surplus of generating capacity.

Yacyretá has come to represent the worst of corruption plagued state vanity projects with soaring cost overruns and allegations of bribery. As Glen Switkes, International Rivers Network's Latin America programme director said, "the principal beneficiaries from the project were the military dictatorships in Argentina and Paraguay who fuelled off billions of dollars from the project." For years, Yacyretá has been known as the dam that financed the Falklands War. IRN calls Yacyretá "a textbook study in corruption, inefficiency, poor planning, and lack of respect for human rights and the environment," and that it "may go down in history as one of the world's worst dam projects."

WHAT DO ARGENTINA AND PARAGUAY OWE ON THIS DUBIOUS DEBT?

Because clear and reliable accounting for the costs and expenditures are not available, it is impossible for citizens to get an accurate picture of the financial status of Yacyretá. However, it is known that, under the 1973 Yacyretá Treaty, EBY was created to implement the project, with the Argentine government assuming the role as the principal financial figure, responsible for securing and paying back loans. The Paraguayan government is responsible for re-paying Argentina for its share after the dam is finished. It will do so by selling its share of the power to Argentina at the prearranged price of US\$30MWh to Argentina, which is now a fraction of the real cost to Paraguay.² Estimates are that more than US\$13 billion has already been spent on the project, and the costs required to complete the project, including social and environmental mitigation measures, and additional required infrastructure could easily exceed

an additional US\$1 - 2 billion. According to Argentine government documents, US\$9 billion has been financed by the Argentine treasury, about US\$1.8 billion has come in loans from the World Bank and Inter-American Development Bank, and other financial institutions, including Canada's EDC, and the Japanese and U.S. Ex-Im Banks have contributed about US\$1 billion. Argentina has calculated that Paraguay owes it US\$11 billion for Yacyretá, with interest, and has offered to "pardon" US\$6 billion of this amount, in exchange for receiving additional energy from the dam.

By the time this paper went to press, neither EDC, nor the World Bank, had provided a breakdown of loans extended, repaid, and still outstanding.

WHY ARE THESE DEBTS ODIUS?

According to Alexander Sack, under international public law, debts could be considered odious if, to the lenders knowledge, they were not used in the interests of the state and without the consent of the people.

In whose interest?

The Yacyretá scheme was created, initiated, and financed under the oppressive cloak of military dictatorships where citizens had no mechanisms for expressing consent or dissent for the project. Clearly those who live in the path of the dam and its reservoir are worse off than they were before. The environmental costs have also been enormous: numerous investigations by the World Bank and the Inter-American Development Bank³ have documented these. The economic cost to the local community – mostly in Paraguay – has been devastating while the economic cost to the Argentinean and Paraguayan people and their economy, as a whole, outweighs the benefits.

² A priest running for President is making this re-negotiation a cornerstone of his campaign.

³ The IDB and the World Bank have held a total of three inspection panel investigations into this project in 1997, 2002, and 2003.



According to press reports, the World Bank's own audit report stated that "the Bank accepted repeated violations of major covenants and continued to associate totally with an unsatisfactory financial and operating performance." What is the price of this neglect? "The plant's output cost per kilowatt-hour at completion will be more than three times the competitive price for EBY's output....The ensuing economic and financial losses are huge." Apparently the Bank's own auditors estimate that "Yacyreta amounts to a loss of close to US\$8 billion in present value" and that engineering costs alone are four times what was originally anticipated and administrative costs are seven times the original estimates⁴.

The World Bank's own Performance Audit Report revealed that Yacyretá "was not a least-cost solution to expanded power supply and its relevance to the country's priorities was negligible"⁵. And, said the report, the Bank knew that trouble was afoot with the project because "on several occasions, the Bank had good cause for stopping the project before the major civil works were too advanced"⁶. The Bank and other financiers did not heed this evidence, but instead continued lending funds, sinking Argentinean and Paraguayan taxpayers in debt for a project that would create more costs than benefits.

Did the creditors know?

In 2000, an unprecedented judicial ruling from the Argentine courts (triggered in 1982 by a journalist who believed the military junta was borrowing and spending those funds corruptly and in contravention of Congressional rules) condemned the illegitimate origins of a substantial portion of external debt amassed during the military period from 1976 to 1983 – the period when Yacyretá was launched. Between 1976 and 1983, Argentina's debt rose from US\$7.5 billion to US\$43.5 billion, the judicial ruling found, yet those new loans were of no benefit to ordinary people in Argentina. Furthermore, the judges found, financiers, such as the IMF, were aware of the infractions.

In 1990, on the same day the Argentinean Economy Minister signed the documents for a new US\$250 million loan to Yacyretá, the former President Menem called Yacyretá "a monument to corruption." According to the New York Times, "Mr. Menem's remarks become known ... just before the signing and caused some dismay among officials of the bank and the Argentine delegation but did not lead the bank to rethink the loan"⁷.

Meanwhile, the World Bank's numerous investigations indicated to all financiers that the project was plagued with sky-high cost overruns and allegations of corruption. The Bank had to approve all the contracts with consultants and construction companies: with corruption so "suffocatingly ubiquitous,"⁸ neither the Bank – nor any of the creditors for that matter – can plead ignorance. An independent forensic audit of the project would reveal just what the Bank knew and the extent to which Bank officials were guilty of "willful blindness," "deliberate ignorance," or "conscious disregard"⁹ to the billions that have apparently been siphoned off from the project.

Under private (domestic) law rule of agency, agents (in this case the Argentinean government) owe a fiduciary

4 "World Bank Dam "Monument to Corruption," by Abid Aslam, IPS, Washington, in Albion Monitor, September 29, 1996 (www.monitor.net/monitor)

5 The United Kingdom parliament, Select Committee on International Development, Appendices to the Minutes of Evidence, Appendix 1, "Recent Cases of Corruption involving UK companies and UK-Backed International Financial Institutions." Prepared April 5, 2001
See also, <http://siteresources.worldbank.org/EXTINSPECTIONPANEL/Resources/>
<http://www.iadb.org/cont/poli/yacyreta/yacying.htm>
<http://www.iadb.org/cont/poli/investig/yacyreta03/notice27oct03.htm>

6 The United Kingdom parliament, Select Committee on International Development, Appendices to the Minutes of Evidence, Appendix 1, "Recent Cases of Corruption involving UK companies and UK-Backed International Financial Institutions." Prepared April 5, 2001

7 "Billions Flow to Dam [and billions Down Drain], New York Times, May 4, 1990

8 Gulati, G.Mitu and Buccheit, Lee C. and Thompson, Robert B. (2006), "The Dilemma of Odious Debts" Forthcoming, in Duke Law Journal. The authors were referring, not to Yacyretá, but to situations where governmental corruption is so suffocatingly ubiquitous that they believe "a U.S. court could legitimately shift onto the plaintiff the burden of showing that a particular a [sic] transaction was not tainted by corruption"

9 Mitu et al

duty to their principal (the Argentinean people). If the circumstances of a transaction raise reasonable doubts about whether the agent is faithfully representing the interests of the principal, a third party (in this case the lenders) has a duty to investigate. As legal scholars Mitu, Buchheit, and Thompson explain in general, it is fanciful that a principal “would ever have condoned the theft by government officials of money borrowed in their name and repayable out of their (or their posterity’s) taxes”¹⁰. Therefore, a “regime’s reputation for corruption may place upon the lender, as a matter of agency law, a higher burden to satisfy itself that the proceeds of the borrowing are benefiting the principal (the country) and not just the agent (the government officers signing the loan agreement.”¹¹. “There is indeed a price to be paid for dealing with a notoriously corrupt regime and that price, at the very least, is a higher standard of vigilance and investigation”¹².

EBY’s apparent corruption and inefficiency has been widely discussed. In addition to Argentina’s own former president Menem, the dam even became the subject of a U.S. congressional investigation into corruption in multilateral development bank projects by the US Senate Foreign Relations Committee. Chairman Richard Lugar expressed concern for Yacyretá’s skyrocketing debt, saying it would affect the project’s financial viability and is a burden on the Argentina and Paraguay governments. “Before work continues on this project and new programs are developed for the region, it is important that the international community learns how Yacyretá’s financial position deteriorated to this level,” he said¹³.

In Canada, EDC’s primary purpose is as a slush fund for the government of the day to finance the exports of politically favoured Canadian companies and constituencies. In the past 60 years, export credit agencies, such as EDC, have become notorious for financing export schemes regardless of their economic and environmental viability and without independent feasibility studies. As Gerald Rowe, Canadian General Electric’s assistant treasurer told a government review of EDC, “export financing drives large infrastructure projects,” and without EDC financing “you will not make the

short list and you will not win the order.” Conventional private sector credit for these kinds of projects, Mr. Rowe pointed out, is difficult to get because for-profit financial institutions “are oriented toward what is good for the shareholders, not for the interests of Canadian clients engaged in international business.” Without “our good friends at EDC, we certainly would not survive,” he added. The Canadian government’s primary purpose in using Canada Account resources to secure the Yacyretá contract for CGE was for domestic politics, not to secure the most cost effective, feasible investment for the citizens of Argentina and Paraguay.

Conclusion

The Yacyretá dam project meets all of the conditions for an odious debt under international public law, and under private (domestic) law as discussed, respectively, by legal scholars Alexander Sack, and Mitu, Buchheit, and Thompson. Many official bodies and representatives of civil society¹⁴ in the debtor and lender countries have called for an independent audit to determine where the money went, to recover stolen public assets, and to compensate the taxpayers of Argentina and Paraguay for losses suffered as a result of this odious debt.

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NGOs working on this campaign:

- International Rivers Network:
<http://www.irn.org/programs/yacyreta/>
- Sobrevivencia: <http://www.sobrevivencia.org.py/>

¹⁰ Gulati, G.Mitu and Buchheit, Lee C. and Thompson, Robert B. (2006), “The Dilemma of Odious Debts,” Forthcoming, in *Duke Law Journal*

¹¹ *Ibid.*

¹² *Ibid.*, pg 51

¹³ “U.S. Senate panel probes World Bank” by Carol Giacomo, Diplomatic Correspondent, Reuters, April 28, 2004

¹⁴ <http://www.irn.org/programs/yacyreta/>

<http://www.sobrevivencia.org.py/>



SKELETONS IN THE CUPBOARD

JAPAN'S ILLEGITIMATE DEBT CLAIMS

Illegitimate Debts during the Suharto Era

The Case of Asahan Aluminium Project

Introduction

Indonesia accumulated huge debts with Japan during the dictatorship of General Suharto between 1968 and 1998. At end-2003, Indonesia owed a total of ¥3,475.4 billion yen (US\$28.8bn/€22.1bn) which represents nearly 70% of the foreign bilateral public debt of Indonesia.

Many of these debts are of questionable origin in that they did not benefit local people and the Japanese Government was aware of the widespread corruption and repression in the country. In the case of the Asahan Aluminium Project, financed by Japan, the rationale behind the venture was to benefit Japanese interests, not Indonesian citizens. These dubious claims held by Japan need to be investigated immediately via a public and impartial process.

What Skeletons are in Japan's cupboard?

On July 7, 1975 the Governments of Indonesia and Japan reached agreement on the construction of two hydroelectric power plants and an aluminum refinery plant in North Sumatra, Indonesia. The deal was sealed during the visit of Indonesia's General Suharto to Tokyo. Just a few days before agreement was reached, the Miki Government in Japan had decided to finance 85% of the total cost as an "exceptional measure". General Suharto described the project as "an imperishable monument of friendship between Japan and Indonesia". The yen loan for this project provided by the OECF (Overseas Economic Cooperation Operations, Japan Bank of International Cooperation)¹.

Between 1977 and 1983, a total of ¥52.131 billion yen in loans was approved for the Asahan Hydroelectric and Aluminium Project, including engineering services and an average interest rate of between 3 and 3.5%².

The Asahan Aluminium Project

The two hydroelectric power plants, financed through the Japanese Overseas Development Aid scheme, produce 604,000 KWH of electricity from the Asahan River running from Toba Lake. This electricity is sent to the aluminum refinery in Kuala Tanung, 95 miles southeast of Medan. The purpose of this project was to ensure a supply of aluminum to Japanese companies: the entire production of aluminum ingot produced by the refinery was to be exported to Japan. The construction of the aluminum refinery was completed in 1982 and the opening ceremony was celebrated with General Suharto in attendance. The refinery was even adopted as the design on the Rp.1000 currency note in Indonesia.

The Japanese aluminum industry had lobbied hard for this project well before the official agreement was signed between the two countries. Five major aluminum companies: Sumitomo Chemical, Nippon Light Metal, Showa Denko, Mitsubishi Chemical Industries and Mitsui Aluminums formed a consortium and worked out a basic agreement with the Indonesian Government in January 1974, when Japanese Premier Tanaka visited Jakarta³. The Prime Minister's visit was greeted by strong anti-Japan demonstrations led by Indonesian students protesting the rush of Japanese investment and export of Indonesian commodities in close cooperation with the repressive Suharto Government.

Why were Japanese companies and the Japanese Government so keen to back the project? One reason was the dependency of the Japanese aluminum industry on foreign countries for bauxite as a raw material. Indonesia supplied one fifth of Japanese bauxite imports. A second reason was that the production of

¹ Now implemented as Overseas Economic Cooperation Operations by JBIC (Japan Bank of International Cooperation)

² Data from JBIC Web-site <http://www.jbic.go.jp/english/oec/project/index.php>

³ Initially the consortium, formed in 1972, included two US companies, but they decided not to participate when it was decided to include the hydroelectric power plant since they felt the plant was not profitable.

aluminum is energy intensive: the electricity consumed constitutes nearly 40% of the production cost of aluminum ingot. After the oil crisis in 1975, Japanese electric power companies charged ¥8 yen (€0.05/US\$0.06)/KWH for industrial use in Japan. But in the Indonesian project it got electricity at a cost of only 1.5 yen/KWH. The cheap supply of electricity strengthened the international competitiveness of Japanese aluminum companies and was a significant factor in Japan's decision to provide loans and investment to the Indonesian project.

Costs related to the project also increased far more than was expected. When the price of aluminum fell just after the completion of the refinery and Indonesian Asahan Aluminum failed to achieve the expected income, the OECF had to make several additional investments taking their total capital in Japan Asahan Aluminum to ¥49,992.5 million yen.

The aluminum industry causes pollution. When processing alumina, manufactured from bauxite to create aluminum, cryolite is added and this process causes the generation of fluoric gas — a gas that is virulently toxic to human bodies and plants. In the 1970s, when environmental pollution became a huge issue in Japan, the aluminum refinery in Kuala Tanjung served to conveniently divert negative public criticism away from them since the problem was now somewhere else. Kuala Tanjung also provided the benefit of cheap electricity to the Japanese aluminum industry.

Why are these debts illegitimate?

The repayment claim on this loan is illegitimate because:

- the loan did not benefit the population of the country,
- the people of the country did not consent to the loan, and;
- the creditor was aware of both.
- In whose interest?

This project was designed to benefit Japanese aluminum companies that needed a staple supply of aluminum

ingot at cheap prices. The yen loan can be said to have been provided - not to Indonesia - but to Japanese companies. When they called this a "national project", it meant in the national interest of Japan, or more precisely, in the interest of Japanese aluminum-related companies. The master agreement shows this clearly.

What's in the contract?

1. The refinery facility and power plant were supposed to transfer to Indonesian ownership after 30 years of use. Currently the year of transfer is fixed for 2013.
2. 80 percent of the electricity produced by the Asahan hydroelectric power plant is to be supplied to the refinery and at-cost prices.
3. The company, PT Indonesia Asahan Aluminum, is free to decide the price of ingots and where to export them. No more than one third of production could ever be supplied to the domestic market. Products are exported free of any export duty.

Did the people agree?

Promoters of the venture stated that one of the largest benefits would be employment creation. Kuala Tanjung was a small fishing community with only 300 families before the construction of the refinery. Nearly 100 families living on the construction site were relocated. The construction work required a labour force of 20,000 to 30,000 and the operation of the refinery required a labour force of 2,000. This was supplied through the notorious Trans-Migration Program of the Suharto government which caused tremendous ethnic conflict. This meant that neither local people in Kuala Tanjung, nor those who were forcibly removed from their ancestral land to live in unfamiliar areas, benefited from this employment.

The demonstrations on the occasion of the visit of Japanese Prime Minister Tanaka Kakuei to Jakarta in



January 1974 ended with the death of eight participants and the arrest of 800 more, were clear indications of the anger against Japanese investment in the country. Many believed that this cooperation served to prop-up the oppressive Suharto Government.

Did the creditors know?

Both sides conspired in the corruption. "World Bank Memoranda On Corruption In Indonesia" leaked in 1997 states: "In aggregate we estimate that at least 20-30 per cent of Government of Indonesia development budget funds are diverted through informal payments to Government of Indonesia (GOI) staff and politicians". Moreover, it states, "numerous reports of diversion of 50-80 per cent of funds budgeted for project land acquisition and resettlement assistance, either by production of falsified documents showing higher amounts than actually paid or by use of "middlemen" to acquire land at a low price for resale to GOI at inflated values. Local governments agree undertake much of the land acquisition for central agency projects, only because of the potential for diversion." Therefore, as the leaked World Bank document confirms, creditors were aware of the nature and scale of corruption prevalent in General Suharto's Indonesia at that time.

The Asahan Aluminum Project is no exception to this. A clear demonstration of this is the appointment of former officers of Japan Bank of International Cooperation to the position of president of Japan Asahan Aluminum. The company was subsequently exempted from interest payment and was allowed grace periods in matters of repayment. Furthermore, additional lending to the company was arranged under very generous conditions.

Rise of Yen causes one-sided burdens

When the finance for Asahan aluminum project was provided in 1977, the exchange rate was US \$1=¥268.32. But after 1986, the Yen rose sharply and in the year 1988, when the repayment started, the exchange rate was US\$1=¥128.2. Since the

Indonesian rupee was linked to the US dollar, the burden of debt for Indonesia almost doubled. Not only in this project, but on all yen loans provided before the mid-80s. However because the yen loan for this project was such a large amount, the difficulty in this case was far worse. The fluctuation of the exchange rate of the US dollar and Japanese yen is beyond the control of borrowing countries, but the burden caused by this change in the yen rate is borne solely by the borrowing country. And this has become a serious obstacle as the Indonesian Government attempts to fight its way out of a crippling debt problem.

Conclusion

This debt is highly questionable on economic, social and environmental grounds. The Japanese government also cannot claim it was not aware of the nature of the Suharto regime and yet went ahead and supported this project for the benefit of its own exporters. The government of Japan should open an immediate public and independent enquiry into this failure and act on its recommendations.

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Local organisations:

- International NGO Forum on Indonesia's Development (INFID): www.infid.org
- International Forum on Indonesian Development (INFID): www.infid.org
- Indonesian Forum for the Environment (Walhi): <http://www.walhi.or.id/eng>
- Indonesia Corruption Watch: <http://www.antikorupsi.org/eng/>



SKELETONS IN THE CUPBOARD

UK'S ILLEGITIMATE DEBT CLAIMS

Illegitimate Debts: The UK and the Ewaso Ngiro Hydropower Scheme, Kenya

Introduction

Debt cancellation has been high on the agenda of the UK government – and the UK public – in recent years. But whilst some very poor countries have had debts cancelled after complying with the harsh conditions set for them, most are still struggling under debts. For many of these debts, creditors are arguably to blame; these debts are a result of reckless or irresponsible lending in the past. It is clearly unjust to demand that poor countries ‘repay’ debts that arose from loans knowingly given: to corrupt or oppressive regimes; for poor or overpriced projects that mainly benefited rich country businesses; or on unfair terms. This means that we need to look back at where debts came from and how they were built up, before we can properly assess whether they are legitimate. We focus on a debt of Kenya to the UK, arguing that concerns around how it was contracted mean that it – and other outstanding loans – should be subject to a proper investigation or audit to determine their legitimacy.

What Skeletons are in the UK's cupboard?

The UK is currently owed at least £3 billion (US\$5.8bn/€4.5bn) from low and lower-middle-income countries. These are countries where the average income is less than one tenth that of the UK. Some of these debts clearly warrant further investigation: for instance, a large proportion – more than £700 million (US\$1.3bn/€1bn) – is owed by Indonesia to the UK on loans made during the dictatorship of General Suharto. The UK was underwriting significant amounts of arms sales to Indonesia during this period, a time when the Indonesian army frequently unleashed appalling violence against the Indonesian people. It needs to be asked whether the Indonesian people are today repaying the UK for funding the provision of the weapons used against them (see also German case-study).

It is also important to ask whether lenders have been complicit in corruption in the past. The recent decision of the UK Serious Fraud Office to drop an investigation into corruption around a huge British Aerospace (Bae) contract to supply Saudi Arabia with arms seems to suggest that the UK government is quite happy to overlook bribery and corrupt practices as long as it is providing business for British companies. This kind of complacency may be good for the bottom line of British companies, but it can be devastating for the people of poor countries.

Guaranteeing loans or contracts to corrupt regimes – or corrupt individuals within a regime – is likely to leave the people of the ‘debtor’ country shouldering a debt long after those responsible for contracting it are gone from power, whilst projects originally funded by loans made in such circumstances are far less likely to have been of significant honestly evaluated.

Even if the borrowing regimes were not corrupt or oppressive, the deals that they were given may well have been far more to the lenders’ advantage than to the borrowers’. Loan pushing – to increase business for rich country companies, to encourage dependence – was all too common. As Professor Joseph Stiglitz argues in his latest book, *Making Globalisation Work*, “lenders encourage indebtedness because it is profitable. Developing countries are sometimes even pressured to overborrow”. He cites the example of Vietnam as a country encouraged to borrow from a wide range of creditors far beyond its means. And often the terms of loans – for instance, requiring repayment in hard currency even in the face of massive currency devaluations – have made them simply impossible for countries to afford (see Japan case study).

The UK government has acknowledged that the rich world funded corrupt and despotic regimes in the past. As long ago as 1998, the UK parliament’s International Development Committee noted that “the unsustainable debt burden of heavily indebted poor countries exists to some extent as a result of irresponsible lending policies pursued by bilateral and multilateral creditors”. And in February 2006, for instance, the

UK Secretary of State for International Development stated that in the past, “aid was used to buy support in the Cold War, rather than to fight poverty. All too often it rewarded dictators and the corrupt. Mobutu’s Zaire received enormous aid flows during this period.” A huge amount of this aid was given in the form of loans that have since become debt obligations of successor governments. The UK government now says it is opposed to corruption, and that it wants to support the rights and development of impoverished countries. For this to be credible and consistent, the UK government must not only put its current house in order, it must also look at the portfolio of debts it is still owed by developing countries. Any debts outstanding from irresponsible or politically-motivated financing in the past are the fault of the lender, not the borrower, and must be cancelled.

We now look particularly at the case of the **Ewaso Ngiro dam in Kenya** and argue that the UK acted irresponsibly with respect to this project and it cannot now ask the people of Kenya to pay for the mistakes it made.

Why are these debts illegitimate?

Ewaso Ngiro – what happened?

In 1990, the UK government, through the Export Credit Guarantee Department (ECGD), insured a commercial bank loan to the Kenyan government. The loan was to help finance a contract for a UK company, Knight Piesold, to carry out consultancy in relation to the Ewaso Ngiro Hydropower Scheme. Knight Piesold offers consultancy and engineering services in Mining, Environment, Hydropower, Water Resources, Roads and Construction Services.

It is seriously questionable whether the Knight Piesold contract was good value or was even sustainable for Kenya. The contract awarded for consultancy services worth £38.1 million (US\$74.8mn/€57.5mn): an amount the World Bank said was “five times what such services would normally cost”. At least £15.3 (US\$30mn/€23.1mn) was paid up front by the

Kenyan government to Knight Piesold. It is not quite clear why such an apparently over-priced contract would have been awarded. Perhaps the UK’s willingness to provide financing played a part.

“Commercial credits are the means by which rich countries manage to exploit the insolvency of developing countries so as to maintain a high level of export of their own goods and to have developing countries pay for these products several times over.”

Catholic Economic Justice Network, Kenya

Did the creditors know?

There were certainly grounds to be wary of supporting this kind of project: four years earlier the UK had insured a similar contract, for the same company to carry out work on another Kenyan hydropower scheme, the Turkwell Gorge dam and power station. The major construction contract in that project was awarded, in suspicious circumstances, to a Swiss company charging far more than was judged “economically feasible” by assessors. Meanwhile, the European Commission representative described the Turkwell project as “extremely disadvantageous”, and serious questions were raised about its environmental impact. The station eventually produces far less power than envisaged, after costing far more than promised. There are serious allegations of corruption in relation to the awarding of the construction contract and management of the project: so serious that donors imposed an aid embargo on Kenya.

Moreover, the lead company in the Ewaso Ngiro project, the Kenya Power Company, had also been accused of corruption. It and the other partner in the project, the Ewaso Ngiro South Development Authority, have both since been criticised by the Kenyan Auditor-General for Corporations for failing to keep adequate accounts and to prepare proper budgets. And the then Kenyan Energy Minister, Nicholas



Biwott, was being accused of corruption and was a prime suspect in the murder of Foreign Minister Robert Ouko, who had been killed while investigating high-level government corruption in Kenya. There were also questions raised over the environmental impact and sustainability of the project. Otsieno Namwaya, reported in *The East African* in September 1999 that, “Western donors froze funding to the Kenyan energy sector in the 1980s in protest over the construction of the Turkwell Gorge hydroelectric power plant in the Rift Valley, which was not only completed years behind ahead of scheduled time, but was destined to be uneconomical.”

Despite all this, the UK government – through its export credit agency, the Export Credit Guarantee Department – decided to insure the participation of Knight Piesold in the Ewaso Ngiro Hydropower Scheme. In the end Kenya was unable to keep up payments. The UK government has paid out over £8 million (US\$15.7mn/€12mn) to compensate the company for any losses on its contract. By 2002 the UK had recovered £5.74 million (US\$11.2mn/€8.6mn) of this from the Kenyan government, and was still seeking a further £2.38 million (US\$4.6mn/€3.6mn).

In whose interest?

The Ewaso Ngiro dam is functioning but concerns have been raised over its negative environmental and social impacts. Local Maasai populations expressed concern over the loss of land. Additionally, they claim that compensation does not adequately address or reflect the current communal ownership of land. Few consultations were ever held with the Maasai population over the construction of the Ewaso Ngiro Hydropower Scheme. Concern has also been raised over negative environmental impacts, including on local flamingo breeding and nesting grounds and the diversion of water away from the Masaura Swamp, a key river resource in Tanzania’s Serengeti National Park. Some perennial rivers have turned ephemeral, threatening the survival of the pastoralists and their livestock that occupy the lower parts of the river basin.

Did the people agree?

Moreover, this debt, like the vast majority of Kenya’s debt, was originally incurred during the corrupt and oppressive regime of Daniel arap Moi. The year before he came to power, Kenya’s external debt stood at just US\$1.7 billion; by the end of his regime in 2002, it amounted to over US\$6 billion. This massive financial support to the Moi regime helped him to consolidate his position and remain in power for 24 years. Some have commented that during this time he and his circle treated Kenya as their personal source of income in the way that they freely and openly embezzled money. The international financial institutions and official government lenders were pumping money into a regime whose corruption was well known around the world. Through their financing, creditors were complicit in supporting this regime.

There are serious questions over whether the UK acted responsibly in guaranteeing this contract back in 1990. In particular:

- Why did the UK government insure a contract for services offered at a price that the World Bank considered to be so hugely inflated? Why did it think this affordable for Kenya?
- Why did the UK agree to guarantee involvement in this project at a time when another very similar project was causing such a scandal over corruption that donors – though not the UK – were refusing aid to Kenya? What assurances did they have that this project was not similarly compromised?
- Were the UK authorities at the time in fact motivated more by the wish to subsidise a British company doing business abroad than by concern for whether the project was sustainable for Kenya and would benefit Kenyans?

There are still concerns about corruption in Kenya – so much so that the UK government is at present not providing general funding to the Kenyan government, but only in the form of direct support for health, edu-

cation or other development projects. In 1990, the undemocratic government of Daniel arap Moi was even more clearly involved in embezzlement, corruption and fraud. If the UK government does not consider it responsible to fund the Kenyan government now, why was it acceptable to fund the previous regime, or to fund the overpriced activities of consultants doing business with that regime? Is either of these activities something that Kenya should be paying for now? According to Wahu Kaara of Kenya Debt Relief Network, “NGOs maintain that irresponsible lending to previous governments in Kenya is the main cause of the debt burden, and that donors should be held accountable for this by being obliged to write off the debts.”

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Local organisations and more information:

- Kenya Debt Relief Network (KENDREN): Mbaruk Road / Mucai Drive; PO Box 76406 Nairobi; kendren@econewsafrika.org
- Catholic Economic Justice Network, Kenya (CEJN):

49 Gitanga Road, PO Box 21191, 00505 Nairobi; +254 20 3878008

- The Corner House, UK:
www.thecornerhouse.org.uk
- See also: Dr. S. Hawley, *Turning a Blind Eye – corruption and the ECGD*, Cornerhouse, 2003





SKELETONS IN THE CUPBOARD

Conclusion and Recommendations

The problems highlighted within our case studies cast serious doubt over the legitimacy of creditors' claims. They show very clearly that debt and corruption are not one-sided affairs. Our country examples all warrant further investigation via public audit processes in order to establish the facts in each case and cancel debts found to be odious or illegitimate.

If G8 Heads of State are really serious about the fight against corruption, they must put their own houses in order first. It is simply not acceptable for creditor governments to preach good governance and transparency to developing nations while at the same time they are receiving payments from them for loans which their countries extended corruptly to governments or individuals they knew would not use the funds judiciously.

The fact that the Norwegian Government has recently cancelled US\$80mn in illegitimate debt owed by five countries acknowledging "shared responsibility" for development failures shows what can be done. In this context, this report makes the following recommendations:

- The G7 should open official and impartial audit processes into the cases highlighted within this report. The process and the enquiry's recommendations should be public, involve debtor nations fully and lead to the cancellation of debts found to be odious or illegitimate.
- The G7 should exercise international leadership by supporting public audit processes of other claims they hold on developing countries. These audits are urgently needed to establish the true character of the debt and ensure that all dubious debts are cancelled fairly and equally across debtor nations. These processes should involve citizens and parliaments – in creditor and debtor nations - fully.
- The culture of creditor impunity which encourages irresponsible behaviour (moral hazard) needs to be stopped. It is not acceptable for the sovereign debtor to assume all the risk in a loan contract.

There are two parties to any transaction and principles of creditor co-responsibility and risk-sharing need to be written into future sovereign loan agreements. These are logical steps in the fight against corruption.

- Looking ahead, the G7 should support the development of a mechanism which would provide fair and independent assessments of the legitimacy of debts. Decisions would be provided by a neutral decision-making body which would decide which debts are to be declared null and void, and which need to be repaid.
- The G7 and all creditor nations need to urgently reform the way their domestic export credit agencies do business. The purpose of such agencies is to subsidise and aggressively promote rich country exports abroad. Instead, they have contributed to illegitimate debt problems. Much greater transparency and accountability is needed and the insurance premiums paid by exporters should cover losses in case of project failure. Developing country governments should not be made to pay.
- The G7 countries that have not yet ratified UN Convention against Corruption must do so immediately. Canada, Germany, Italy and Japan must ratify the convention without delay if they are to be taken seriously in the fight against corruption.

Following recent rounds of debt cancellation under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), creditors have (rightly) highlighted their concern that countries will embark on new rounds of unsustainable and irresponsible borrowing. In 2006, Gordon Brown, UK Chancellor said, "we do not want a fresh round of unsustainable debt". "[This requires] codes, standards, transparency and accountability in new lending".

The aims of this report has been to show that there are two parties to any transaction and it is the joint responsibility of both debtor and creditor government to ensure that loan agreements reflect the development aspirations of the population of the debtor country.

Should the international community be of the opinion today that it would have been better not to support Mobuto Sese Seko or Saddam Hussein with large-scale credits, it ought not only to sanction the cancellation of these claims on the grounds of illegitimacy but it should not miss the opportunity to work for more transparency, accountability and co-responsibility going forward. If not, we risk repeating the mistakes of the past.

Gail Hurley
Eurodad



SKELETONS IN THE CUPBOARD

Joint NGO Report

February 2007

About the organisations involved in the report:



Eurodad pushes for development finance policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development. Eurodad aims to coordinate the work of non-governmental organisations working on these issues, and collaborates actively with civil society in the North and South to attain these goals.

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www.eurodad.org



The Campagna per la Riforma della Banca Mondiale (CRBM) started its activities in 1996, with the support of 41 Italian development NGOs, environmental, human rights and grass root associations. The CRBM works for a democratic and radical reform of the international finance institutions, which remain among the main responsibilities for the unjust globalization process we are living. A special attention is given to the impacts of public investments from the North to the South of the world regarding the environment, the development and the social and human rights, in solidarity with the local communities which directly suffer from these impacts.

Contact: Campagna per la riforma della Banca mondiale c/o ManiFese
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E-mail: info@crbm.org
Website: www.crbm.org

Dette & Développement

Plate-forme d'information et d'action sur la dette des pays du Sud

Plate-forme Dette & Développement was created in March 2001 as a result of the year 2000 French campaign to cancel the debt that brought together more than twenty French unions and associations. Together with mobilising organisations working on debt issues worldwide, Plate-forme Debt & Développement seeks to enhance knowledge about these issues in France and to advocate that the necessary measures be taken for a large, sustainable and just solution to the debt problem, in the past, present and future. Looking beyond massive debt cancellation, the organisation seeks to ensure that freed resources from debt relief are beneficial to the people, particularly the poor; the organisation requests transparency on the processes that led to the debt crisis and promotes the establishment of an international debt law.

Contact: www.dette2000.org



erlassjahr.de is the German Jubilee debt relief network. It presently has some 850 institutional members, mostly from a faith-based background. Erlaßjahr2000 was founded in 1997. Its major aim is the replacement of existing unfair debt negotiation mechanisms by a Fair and transparent Arbitration Process (FTAP), which provides indebted countries with a basis for defending their own rights in rule of law setting.

Information: erlassjahr.de e.V. - Entwicklung braucht Entschuldung
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Carl-Mosterts-Platz 1
40477 Düsseldorf
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Jubilee Debt Campaign is part of an international movement demanding an end to the injustice of poor country debt. It is a UK coalition of about 200 national organisations and local groups, supported by thousands of individuals, working to help end the scandal of extreme poverty and the use of debt as a tool of Northern control over the South.

Contact: Jubilee Debt Campaign
The Grayston Centre
28 Charles Square
London N1 6HT
Tel. 020 7324 4722
Fax 020 7324 4723
www.jubileedebtcampaign.org.uk
Registered charity No: 1055675



Jubilee USA Network is an alliance of more than 80 religious denominations, faith communities, labor, environmental, and community groups working to build the political will for cancellation of unjust debts and an end to harmful economic policies. Founded in 1997, Jubilee USA is the US arm of the global Jubilee debt cancellation campaign.

Contact: Jubilee USA Network
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Pacific-Asia Resource Center (PARC) is Japanese NGO which was set up in 1973 with the aim to realize a society where people of "the North" and "the South" can live equally and in harmony and has been involved in the following activities: research & advocacy, education, production of audio-visual materials for education, publication and information dissemination, and international cooperation. As advocacy, PARC has been working on the issue of debt and Japanese ODA and international cooperation activities includes "the project to support the fishing communities affected by ethnic conflict and Tsunami" and "the project to support coffee producers cooperatives in East Timor."

Contact: Pacific Asia Resource Center
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through international financial institutions like the World Bank and the Asian Development Bank and through bilateral agencies like the Canadian International Development Agency and the Export Development Corporation. These national and international agencies have financed the world's worst environmental, social and economic disasters in the name of aid and trade.

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