Legal change and debt crisis*

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I. Legal change is only exceptionally a question of original creation: it is mainly due to imitation, which may rely on prestige or on imposition. *Imposition* has been the ordinary way of expanding the Western legal tradition, that is of transplanting institutions and norms aiming at exporting capitalism and democracy worldwide. *Prestige* has been the usual occasion for the circulation of solutions concerning the way capitalism and democracy can be interpreted *within* the Western legal tradition.

This scenario seems to be a product of the Cold War, a time when the capitalist part of the world was engaged in a dramatic competition with the socialist part of it. The fall of communism has produced a much crueler confrontation between the two main ways of interpreting capitalism: stock market capitalism and welfare capitalism, the former dominated by finance and the latter based on social security. Legal change concerning the way of interpreting capitalism *within* the Western legal tradition is now less a question of *prestige*. It is linked to *imposition*, as the reaction to the current debt crisis clearly shows.

Of course, imposition does not mean direct use of violence, since legal change is obtained as an equivalent for public or private loans needed to prevent State bankruptcy. Nevertheless, *imposed* legal change is harmful to democracy as a foundation of the Western legal tradition, as well as capitalism.

II. Evidence of this harm is given by the arrangements under which the International Monetary Fund decided to provide its loan to Hungary, Portugal and Ireland, as well as by the arrangement concerning the financial support of Greece by the IMF together with the European Commission and the European Central Bank. These arrangements have to attest the will of the debtors to realize policies and reforms which are supposed to correct their balance of payment problems and to restore conditions for market confidence and economic growth. These policies and reforms

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are listed in the Memoranda of economic and financial policies contained in the Letters of intent of the Hungarian, Irish Portuguese and Greek government.

The Memoranda include measures aiming at a *decrease* of expenses, as well as measures concerning an *increase* of revenues. As for the decrease of expenses, they *all* comprehend commitments to cut or freeze wages in the public sector, to cut or freeze pensions, to save in social security non-contributory benefits, to streamline the Public sector, to reduce health, education and housing allowances.

On the revenue side, we find commitments to increase privatization and liberalization above all in transport, energy, communication and insurance.

Last but not least, among the structural reforms which are supposed to enhance competitiveness, great emphasis is given to those dedicated to the labor market. The aim is to increase freedom of contract by reducing employment protection and fostering flexibility, to limit the power of Unions by promoting firm-level agreements, and to stimulate cooperation between workers and employers promoting wage adjustments in line with productivity.

One can agree with those measures, or oppose them. However it cannot be denied that they determine an overcoming of the Keynesian compromise, which has allowed the development of a welfare system. It cannot be denied that they produce a transfer of wealth from the poor to the rich, the contrary of the transfer realized by the Keynesian compromise, that is a prevalence of stock market capitalism over welfare capitalism.

Of course, all this is *formally* decided by democratically elected parliaments. Nevertheless under conditions which recall the idea of State of exception analyzed by Giorgio Agamben from Carl Schmitts Ausnahmezustand, that is measures suspending democracy from a more substantial point of view.

III. What to do in order to produce legal change within the Western legal tradition without harming its foundations? What to do in order to reform capitalism *and* promote democracy as well?

Analogous questions are inspiring an interesting debate within the Law and Development Movement, that is among those scholars dealing with the relationship between legal change and economic development policies.

The starting point of this debate is that so far the role of private law has been overestimated, since the protection of property and the promotion of freedom of contract have not been able to produce a satisfactory market order. Also, the idea of development as mere economic growth and poverty alleviation should be overcome: development should be understood as *human* development, that is as freedom understood as a means of promoting people's capabilities, of enabling individuals to lead the life they choose to live.

This is to me the sense of welfare capitalism, as it is described in European post-war constitutionalism and fundamental rights theory: markets should be regulated to enhance individual emancipation as the main goal, and not just as a side effect of measures aiming at promoting a balanced economic order.

To that aim, a legal frame for sovereign debt restructuring is needed, giving debtors the opportunity to default through a structured process, able to enhance transparency and fairness as fundamental points of reference. This means, above all, that procedures have to be elaborated in order to differentiate among debts which have to be honored and debts which do not, as well as among classes of claimants, differentiating between those worthy of being protected, and those who are not.

IV. Regarding the legal frame for sovereign debt restructuring, some attempts have been made, though, frankly speaking, with no significant results, since the issue has been handled on an ad hoc basis. No overall solution could so far emerge, at least no satisfactory solution on the ground of predictability and equity.

A *statutory* approach was elaborated within the International Monetary Fund around the proposal of a Sovereign Debt Restructuring mechanism developed by Anne Krueger. The proposal has been criticized by the UN-Commission of Experts on Reforms of the International Monetary and Financial System chaired by Joseph Stiglitz. The Final Report considers the IMF as non-neutral mediator or arbitrator, since it is a creditor itself and since it is subject to disproportionate influence by creditor countries.

The Report also firmly criticizes a *contractual* approach to sovereign debt restructuring. Solutions like the ones envisaged by collective action clauses are supposed not to provide effective means for solving conflicts among different classes of claimants.

As part of a political agenda overcoming the world-order established after World War II, an International Debt Restructuring Court should be created, if needed based on the experience made with a soft law solution – like the one suggested by Christoph Paulus – to facilitate a gradual creation of hard law solutions. In the words of the Un-Commission chaired by Stiglitz, this would be the only way to create the conditions for debtors to default within a legal frame based on international law principles: in particular the principle of human-based development, the principle of sustainability, the principle of equity in the treatment of debtors and their creditors and among creditors.

Of course, one could argue that there is no sufficient political support for the implementation of such an agenda. However, it should be noted that all stakeholders could benefit from it, since creditors as well as debtors need clear rules of the game. Both are moreover interested in the guarantee of a promising new start for the defaulted debtor.

V. What is more, lack of political support does not mean lack of legal basis, at least for affirming that there is no unconditioned State obligation to honor debts. In other words, decrease or repudiation of sovereign debts to defend fundamental human rights is possible under the current international law system.

According to the Statute of the International Court of Justice, the principle of pacta sunt servanda is a main source of international law, as well as the principle of equity (art. 38). We all know that a range of equitable considerations have led to the elaboration of the concept of odious debt, that is a debt which has *not* to be honored, since it has been contracted for objectives contrary to the general interests of the community, or for a purpose not in conformity with international law.

Odious debts are mainly discussed in connection with credits obtained by Third World non-democratic governments. However, the legal basis for the refusal to honor odious debts – although uncertain as for some aspects of the concept – could easily be extended to credits obtained by democratic governments.

Non-conformity with international law and contrariness to the general interests of the community affect all payments of debts which frustrate the achievement of objectives mentioned by sources like the Charter of the United Nations, the Universal Declaration of Human Rights, the International Covenant on Economic,

Social and Cultural Rights, and the International Covenant on Civil and Political Rights. The obligation of the State to honor debts cannot prevail over the protection of the human rights mentioned there, if this requires austerity programs incompatible with this goal, like the ones usually imposed by the arrangements related to IMF lending.

For debts contracted with public lenders this is clearly affirmed by the UN-Charter, stating that "in the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail" (art. 103). Reference to debts contracted with public and private lenders – although the latter are not related to international law obligations – is made by the International Covenant on Economic, Social and Cultural Rights, and by the one on Civil and Political rights, both stating that "in no case may a people be deprived of its own means of subsistence" (art. 1).

VI. Let us briefly go back to the Final Report of the UN-Commission of Experts on Reforms of the International Monetary and Financial System, simply to mention that it tries to link the proposal of a structured sovereign default process with the idea of a public debt audit.

Such an audit, as well as a structured default process, has to promote transparency and fairness in dealing with sovereign debt crisis, and is therefore the recommended way to reach a decrease or even a cancellation of the debt.

Even if public debt audits, as well as odious debts, are normally discussed in connection with the reduction or cancellation of Third World debts, there is no reason not to extend this practice to general sovereign debt restructuring. Audits enhance transparency and democratic control over public institutions, which are values recognized both by fundamental sources of international law, as well as by domestic constitutional law.

Public debt audit can be official or due to citizens' initiatives. In the first case they rely on a unilateral sovereign state act, which is supposed to be consistent with international law. In the second case they are based on a citizens' right to take part directly in the government of their country, as stated by the Universal Declaration of Human Rights (art. 21).

Such audits are performed by commissions researching documents, encouraging popular investigations and social pressure to get the information necessary to determine the real nature of the public debt. They are an opportunity to identify the political choices and social interests behind it, as well as the creditors and the conditions for the lending. An opportunity to determine the composition of the public debt, to clear up which part of it has been contracted for odious purposes: for example because it simply had to provide resources to be transferred into the private financial sector, or because it had to support military expenditures, while – as stated by the Italian Constitution – war is rejected as a means for settling international disputes.

VII. To sum up my brief considerations on legal change and debt crisis, the current way to prevent state bankruptcy overcomes the Keynesian compromise, and therefore determines an imposed circulation of stock market capitalism, producing a harm for democracy as a foundation of the Western legal tradition.

To reform capitalism without sacrificing democracy, a legal frame for a transparent and fair sovereign debt restructuring is needed. Procedures must be elaborated in order to assure citizens the opportunity to participate in identifying debts which have to be honored because they have been contracted for the general interests of the community, and debts which have not, because they do not fulfill this condition.

By doing this, capitalism will be reformed in a way that enables the enhancement of individual emancipation and therefore human rights as they are defined in international law, as well as in domestic constitutional law.

To put it in a few words, a state right to bankruptcy has to be affirmed, in order to make currency a resource comparable with commons, removed as such from mere and self-referential market logics.

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