



Citizen Public Debt Audit

Experiences and methods

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CITIZEN PUBLIC DEBT AUDIT: EXPERIENCES AND METHODS

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Introduction

Historically, the population has never been properly informed regarding the public debt that it pays for through government spending. In general, there is an understanding that if there are debts to be paid it is because there was previously an inflow of resources resulting from loan contracts and/or bond issues.

However, research done by specialists in a number of countries has shown that a large share of so-called public debt – whether internal or external – does not quite correspond to this criteria. Debts are generated without any goods, services, or public benefit provided in return. Worse, these debts rise as a consequence of excessive costs, abusive terms, and successive refinancing – among other strategies that lead to a continuous and self-generating accumulation of new debt. This, in turn, requires that funds be constantly allocated to pay for high levels of interest, commissions and costs – while the debt stock itself continues to rise.

This mechanism works as an interlaced set of bolts and gears that has prompted international financial organizations to impose financial adjustment plans and counter-reforms on debtor countries – with a focus on cutting back social rights and prioritizing public-debt payment. They also demand a range of measures favoring the financial sector, largely involving the conversion of private debt to public debt, which in turn leads to more cuts in social spending and a further rise in public debt.

It has thus become clear that public debt has not been used to finance collective needs. For several decades now, it has been a mechanism to transfer public resources to the private financial sector.



This is what we call the “Debt System” – this use of public debt in reverse with a view to diminishing resources rather than buttressing them.

This system works in a similar way the world over. It is based on the tremendous global power of the financial sector, which has established its control over each country’s legal, political, economic, and communications systems – setting in motion the different mechanisms necessary to the smooth functioning of the Debt System.

Ultimately, the cost of public debt is transferred directly to society, and especially to its poorest sectors. This occurs as much through the payment of high taxes on consumer necessities as through the absence or paucity of public services – health care, education, welfare, pensions – for those entitled to them. It also occurs through the privatization of public resources and the unbridled exploitation of natural resources, causing irreparable environmental, ecological, and social damage.

We should know what debts the population is paying for. The AUDIT is the tool that enables us to understand and document the Debt System.

In light of the influence of the financial sector over the majority of governments, one of our tasks is to carry out a citizen audit, gathering together the evidence and legal arguments required for the cancellation of illegal and illegitimate debts.

The goal of this book is to inspire social movements to undertake **citizen debt audits** everywhere – in order to empower society with an awareness of the financial facts and to strengthen social struggles for a different model based on Justice, Freedom, and Sister and Brotherhood.



Chapter 1 provides a brief overview of the worldwide process of financialization and its role in the explosion of public debt. The financial sector is the main protagonist and beneficiary of the Debt System and its conduct involves using a series of fraudulent strategies that have laid the groundwork for a plan for world domination. We look at the need to make headway toward the building of a different financial architecture based on principles of justice and equality.

Citizen audit initiatives have shown that most public debt has not been generated by actual inflows of resources, but rather by the use of a range of mechanisms, abusive terms, and measures pushed by international financial organizations. This gives rise to a continuous and self-generating accumulation of debt, a process described in **Chapter 2**.

In **Chapter 3**, we introduce basic concepts, examples of findings, and additional points that should be considered by a citizen audit. The goal is to document the functioning of the Debt System and offer clear proof of the mechanisms behind it.

Citizen debt audits and research in Ecuador, Brazil, and Argentina show it is possible to get at the truth and to secure concrete results through the use of the debt audit tool. Audits help to create breathing room for new initiatives, as we briefly describe in **Chapter 4**.

Chapter 5 offers methodological suggestions for carrying out a citizen debt audit. On the basis of past experience, we look step-by-step at proven techniques for unearthing the roots of indebtedness. The point here is to refute the claim that only specialists can manage an audit. In fact, all that is needed is dedication and a desire to get at the truth in defense of present and future generations.



We conclude the book with **Chapter 6**, which looks at legal arguments grounded in domestic and international law. They support the findings of the citizen audit around questions of irregularity, fraud, and abuses; and can determine whether a public debt is illegal and/or illegitimate. They enable us to declare the Debt System null and void and to impose exemplary sanctions against its domestic and foreign operatives.

The citizen debt audit is a tool that clears a path for a series of activities involving social mobilization, such as periodic tracking of changes to public debt and its impact on the economy, the environment, and the life of the people. Society cannot stand idly by as government budgets are squandered in order to fuel the Debt System – while human rights are simultaneously trampled. There is a critical need for powerful mass action leading to real change.

In 2006, the Europe Third World Centre (CETIM) and the Committee for the Abolition of the Third World Debt (CADTM), with the support of Auditoria cidadã da Dívida (Brazilian Citizen Debt Audit) published a manual on how to organize audits on Third World debts. This book has proven to be a valuable tool for social movements and some governments from all over the world (see www.cetim.ch).

The manual went quickly out of print and considering the Brazilian and Ecuadorean audit-based experiences that took place after its publication, the idea for this new updated book was born in Brasilia in October 2011 during the International Seminar on “Alternatives to Confront the Crisis” organized by the Brazilian Citizen Debt Audit and the CADTM, in which CETIM participated. These same organizations have financed the production of this book, as have la Red Latinoamericana sobre Deuda, Desarrollo y Derechos - Latindadd, public-sector organizations from the canton and city of Geneva



through the Fédération Genevoise de Coopération (Switzerland), FSPH, Norwegian Church Aid – NCA (Norway), Pain Pour le Prochain – PPP (Switzerland) –, Eusko Langileen Alkartasuna – ELA (Basque Country), Echange et Mission – EM (Switzerland), Oxfam Solidarité ASBL (Belgium), and the Observatori del Deute en la Globalització – ODG (Catalonia). We would like to extend sincere thanks to all these organizations.

It has been an honour to work on this volunteer project and to have an opportunity to present Citizen Audit initiatives – thanks to the assistance of a great many individuals and especially Myriam Ayala from the Ecuadoran audit. I would like to express my deepest gratitude for the participation and assistance of all these people from different parts of the world. Brazil: Eulália Alvarenga, Rodrigo Ávila, Daniel Bin, Marcelo Carcanholo, João Gabriel Lopes, Ary Minella, Modesto da Silveira; Argentina: Alejandro Olmos Gaona, María Elena Saludas, Jorge Marchini; Belgium: Cecile Lamarque, Virginie de Romanet, Eric Toussaint; Bolivia: Patricia Miranda; Colombia: William Gaviria, Daniel Munevar; Ecuador: Myriam Ayala, Hugo Arias, Piedad Mancero; Spain: Sergi Cutillas, Jérôme Duval, Itziar Gimenez, Saioa Igeregi, Mikel Noval, Janire Landaluze; France: Patrick Saurin; Greece: Spyros Marchetos; Ireland: Nessa Ní Chasaide; Norway: Gina Ekholt; Peru: Rómulo Torres, Giann Velásquez; Portugal: Rui Viana, Teresa Xavier; Switzerland: Julie Duchatel. Thanks to all of you for your important contributions, comments and suggestions.

We dedicate this book to all those who organize and mobilize in the struggle for a just and democratic society based on solidarity.

Maria Lucia Fattorelli





Chapter 1.

Global financialization, crisis and public debt



INTRODUCTION

Since the 1970s, the growing process of financialization has prompted a radical transformation of the relationship between the financial system and the productive apparatus. This has had a significant impact on all spheres of the capitalist economic system.¹

The forms of financing for all the economic players have changed – not just quantitatively but qualitatively as well. This is an upshot of the unscrupulous use of different financial tools purely for private interests, many of which have managed to ensconce themselves within government.

All these changes have brought about a variety of enduring crises – financial, social, and environmental, in the food system ² and in society's values – stemming from the continuous and untrammelled exploitation of resources. This has given rise to robust private monopolies led by large financial firms and multinational corporations, and has exacted a high social economic and social cost.

The aim of this chapter is to provide an overview of the relationship between global financialization and public debt. It is essential that citizen audits grasp the way in which public debts have been created in exchange for nothing and for the sole benefit of the financial sector. This is helpful for raising awareness of the need to fight for a new and more equitable international financial architecture.

1 GARZÓN ESPINOSA, A., “Qué es la financiarización?”, *Economía Crítica y Crítica de la Economía*, 5 [2009]. Available at: <<http://malaga.economiccritica.net/?p=434>>.

2 On the food crisis see: LAPAVITSAS, C. [Ed.], *Crisis in the Eurozone*, [NewYork: Verso, 2012].

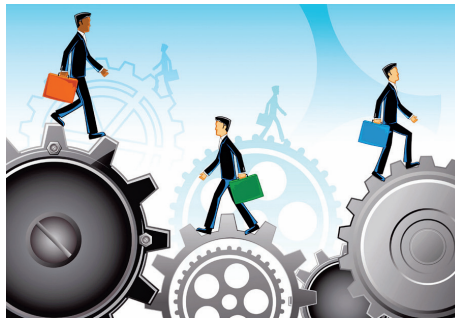


1.1 – GLOBAL FINANCIALIZATION AND THE DEBT SYSTEM

Global financialization is the outcome of the current phase of capitalism, which began in the 1970s – a mode of wealth accumulation based on the colossal power of the global financial sector.

This power has been entrenched through the excessive and unscrupulous use of financial instruments³ based largely on “debts” without the corresponding investment in resources, bond issues, currency,⁴ and un-backed securities, commonly known as toxic assets.

This mode of accumulation is closely intertwined with the use of public debt in reverse – through which funds are withdrawn rather than contributed – thanks to what can only be called a true “Debt System”, which



3 For an understanding of the financial markets, critical theories on money and finances as well as the crisis of capitalism, see:

- DOS SANTOS, P. L., and LAPAVITSAS, C., “Globalization and Contemporary Banking: On the Impact of New Technology”, *Contributions to Political Economy*, 27 [2008]: 31-56.
- DOS SANTOS, P. L., “On the Content of Banking in Contemporary Capitalism”, *Historical Materialism*, 17[2] [2009]: 180-213.
- ITOH, M., and LAPAVITSAS, C., *Political Economy of Money and Finance*, [London: Macmillan, 1999].
- LAPAVITSAS, C., “Financialized Capitalism: Instability and Financial Expropriation”, *Historical Materialism*, 17 [2] [2009]: 114-148.

4 Mainly in the issuance of dollars by the United States as of the end of parity with the gold standard in 1971.



has made a large-scale plan for world domination feasible. “Public” debt created for nothing in return is one of the main *mechanisms* that drives this plan and increasingly strengthens the hand of the financial sector.

The power of finance is embodied by, among others, private banks and their holding companies, international financial institutions (mainly the International Monetary Fund (IMF) and the World Bank), credit rating agencies, central banks and development banks. Their operations involve avowedly secret transactions – often in tax havens; a lack of transparency; protection under the regime of banking secrecy; the manipulation of accounting standards in line with their own private interests; and other privileges.

As has been shown, from the 1970s onward, private (or commercial), bilateral and multilateral banks provided a colossal volume of credit to countries in Latin America, Africa and Asia. One key feature of these loans, however, was that there was no actual handover of funds.

These loans took the form of tied loans. This meant that instead of transferring funds, lender countries provided financing at high rates for products and services from within their own borders. This financing went toward overpriced and unnecessary megaprojects, or infrastructure projects aimed at facilitating access to natural resources.

Another key feature of these loans was that they financed military and dictatorial regimes in a number of countries – once again without any actual transfer of funds. Instead, credit went toward weaponry and intelligence, in violation of the population’s sovereign interests. Such “credit” was odious from the start.



These loans led to a process of self-generating indebtedness. Debt servicing (payment of principal and interest) is financed with new loans at constantly increasing rates and at no benefit whatsoever to the borrowing countries.

The handiwork of global finance within the framework of the Debt System can be seen worldwide. History has shown that the costs for each successive wave of bank-induced crisis, and for the damage these crises cause, are borne by the public purse – through the various sorts of bank-rescue packages demanded by international financial organizations.

When a banking crisis erupts, the IMF demands financial stability arrangements along with taxation and budgetary adjustments that bring about structural, legal and economic change, especially with respect to the financial sector itself.

This is what occurred in Latin America and Africa in the 1980s, in Asia in the 1990s, and recently in Europe and the United States. In each instance, the result was the creation⁵ of “public” internal and external debt.

Financial power has grown even larger and more concentrated as a result of large-scale mergers that have created mega-corporations and financial groups with subsidiaries, tied, related, and offshore companies that enjoy the previously mentioned privileges and face numerous allegations of corruption.

Their conduct has been facilitated by advances in communication and other technologies, not to mention the absence of adequate

5 The mechanisms of public debt generation are analyzed in Chapter 2.



supervision and regulation. This has opened the way to un-backed⁶ banking products, especially derivatives.⁷ These products have an effect on different forms of exchange – tangible and intangible; present and future – and generate incalculable adverse consequences and risks, notably the creation of financial bubbles and the successive crises these engender.

1.2 – THE POWER OF THE GLOBAL BANKING SYSTEM

An important academic study undertaken in 2011 – *The network of global corporate control*⁸ – threw light on the striking level of concentration of the global economy's power and ownership within the hands of a few banking institutions.

The study looked at a sample including 43,000 of the world's largest companies and found more than one million ownership ties between them.

The study found that 40% of control in the world's 43,000 largest companies is concentrated in the hands of only 147 institutions

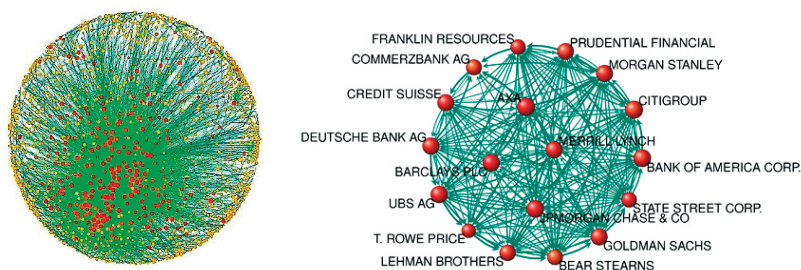
6 Financial reengineering plans created various financial products, such as swaps, factoring, leasing, forward sales, swaps on collateralized debt obligation (CDO), swaps on credit default swaps (CDS), mortgage securitization, commercial trusts, trust warranty etc.

7 Derivatives are derivative transactions, that is, financial transactions built on the basis of other financial transactions, allowing high levels of speculation on speculation and leverage. They are offered in secondary markets and open up the possibility of trading by speculators and arbitrageurs.

8 VITALI S., GLATTFELDER J. B., BATTISTON S., "The network of global corporate control", *PLoS ONE*, 6[10] [2011], e25995. Available at: <<http://arxiv.org/pdf/1107.5728v2.pdf>>



that, in turn, are themselves closely intertwined. Of these companies, 75% are financial institutions and ownership in the 147 institutions is held by just over 50 financial entities that exert control over the central core. The largest of these institutions are indicated in the following chart:



The study provides an overview of the banking sector's power worldwide, making it easier to understand its control of countries' economic resources and transactions – given that everything is channeled through this sector at some point. This concentration of power, control and ownership of global business in the hands of the banking sector has enabled it to intervene in strategic government policies and decisions – a state of affairs some academics have called “*financial hegemony*”.⁹

⁹ MINTZ, B., and SCHWARTZ, M., *The power structure of American business*, [Chicago: University of Chicago Press, 1985].



1.3 – HOW DID THE FINANCIAL SECTOR BECOME SO POWERFUL?

The Debt System is the mechanism that has enabled the financial sector to assert its economic ascendancy – whether through the implementation of structural adjustment programs or through direct involvement in a country’s economic, political, legal and media institutions.

Financial power over a country is primarily achieved by financing dictatorship or “democratic” elections – thereby securing control over government authorities and subordinating them to the interests of financial capital; and subsequently revamping the legal system in its favor.

We have seen this play out in **Latin America**. Economic power was essential in the financing of military regimes and in their decision to aggressively and non-transparently contract vast sums of debt from the international banking system in the 1970s. This process subordinated the entire region to the power of global finance and made balanced development impossible by preventing the implementation of measures aimed at ensuring social justice such as a fair tax system and land reform.

According to Harvey,¹⁰ in the **United States** the “Party of Wall Street” has dominated government policy over the last 40 years – extending its influence “beyond the state apparatus”. This helps to explain the massive bank-rescue package in place since 2007.

10 HARVEY, D., *O Enigma do Capital e as Crises do Capitalismo*. Translated by Joao Alexandre Peschanski, [Sao Paulo: Boitempo Editorial, 2012].



In **Europe**, the power of the banking system and its technocrats threatens democracy. When the former prime minister of Greece, George Papandreou, floated the idea of holding a referendum on the measures which the Troika was demanding "that Athens comply with, he was immediately forced to resign. An unelected technocrat from Goldman Sachs took over. In Italy, following Silvio Berlusconi's removal, his place was taken by Mario Monti, a figure with close ties to European finance.

A large number of **Asian** and **African** countries lack a system of regulations for political financing and most do not provide any sort of public subsidies for political parties.¹² This leaves the door wide open to private financing and conflicts of interest.

The citizen debt audit should be aware that public debt has been used as a key instrument in the prevailing model of capitalist accumulation.

11 Troika: term used to indicate the institutions that wield tremendous power over the financial decisions of the European countries affected by the crisis, such as the European Commission, International Monetary Fund, and the European Central Bank.

12 IDEA, *Funding of Political Parties and Election Campaigns*, Handbook series, [Sweden, 2003], 18.

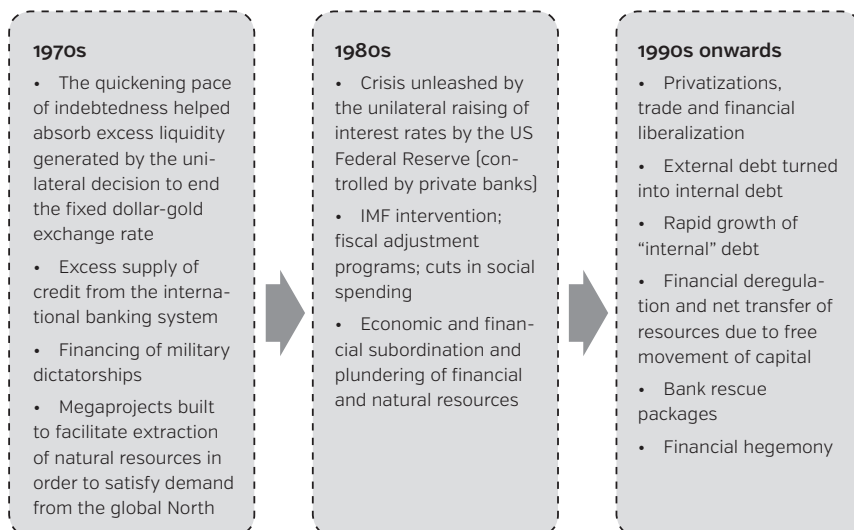


1.4 – PUBLIC DEBT AS A MECHANISM FOR ABSORBING CRISIS

Worldwide, the operation of the financial system has fomented fraud, bankruptcy and crisis. The public sector foots the bill with nothing in return, and this generates public debt.

Once created, these debts keep on growing. They become permanent due to their high cost and the abusive terms and restrictions demanded by international financial organizations.

The role of debt in **Latin America** is a perfect illustration of this. The process began as a way to absorb the excess-liquidity crisis of the 1970s and ended up fostering economic slavery, political interference, and the appropriation of natural resources and public assets through privatization. It has become a mechanism for domination that benefits private finance, as the following summary shows:





In **Africa**, the process was similar to what occurred in Latin America, but was even more brutal. Public indebtedness in the 1970s also absorbed the international banking system's excess liquidity; the World Bank and international private banking financed dictatorships and built infrastructure projects aimed at facilitating the plundering of natural resources – as well as unsuitable, useless and harmful megaprojects benefiting large multinational construction firms.

The unilateral increase in international annual interest rates (Prime and Libor) – from about 5 % to 20.5 % – sparked the crisis of the 1980s, which in turn cleared the way for the IMF's disastrous interference in the affairs of these continents.

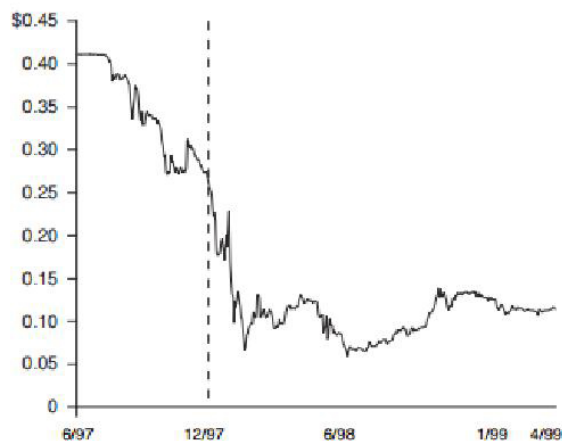
Asia also absorbed excess global liquidity to build megaprojects.¹³ The uncontrolled increase of public debt was brought to light during the major financial crisis prompted by speculator frenzy from 1997 onwards. The “Asian Tigers” and Japan, which had experienced accelerated growth since the beginning of the 1990s, endured successive crises brought on by speculation in Asian capital markets – with investment banks and institutions involved in the sale of financial assets playing a leading role.

This caused the collapse of national currencies (as can be seen in the chart on Indonesia). Public funds were used to save the private banks behind the crisis and countries were forced to unconditionally accept IMF involvement.

13 In the Philippines during the Fernando Marcos dictatorship, the construction of a nuclear power plant in 1976, which never entered into operations due to it being considered too dangerous for having been built close to an earthquake prone fault line and an inactive volcano, left the country with a 2.3 billion dollar debt. See <http://cadtm.org/Philippines-la-Cour-supreme-dompte>



FIGURE 6
Indonesia: rupiah against the dollar
(dollars per thousand rupiah)



Source: *Wall Street Journal*.

From the year 2000 onward, Asia experienced rapid economic growth that led to the issuance of debt instruments in some of the “Dragon” countries (South Korea, Hong Kong, Singapore and Taiwan), later followed by the “Southeast Asian Tigers” (Thailand, Malaysia, Indonesia, and the Philippines). Access to this market was provided through over-the-counter (OTC) derivative contracts and structured products¹⁴.

In **Europe**, the bank bailout was the mechanism for shifting the financial-sector crisis¹⁵ onto the shoulders of countries’ public

14 By Virginie de Romanet, of CADTM/Belgium

15 In relation to the current crisis in Europe, see LAPAVITSAS, C. [Ed.], *Crisis in the Eurozone*, op. cit.



accounts – increasing their public debt largely as a result of the “financial assistance” they were forced to dole out.

The following chart compares the largest amounts of financial assistance among European countries in 2010.¹⁶ The lion’s share went to bank bailouts, as can be plainly seen.

	Financial Crisis Assistance	Total amount of assistance	Assistance as a percentage of GDP
Ireland	361.2	362.9	235.76%
Greece	35.1	38.5	16.71%
UK	200.1	200.5	12.11%
Netherlands	53.6	56.8	9.61%
Spain	87.1	92.5	8.71%
Germany	164.5	184.5	7.38%
France	91.5	108.7	5.62%

Figures in millions of Euros (2010 data)

Source: IV Informe Anual sobre Ayudas Públicas en España (CNC)

Based on a confidential 17-page internal EU document, a February 11, 2009 article in the daily newspaper *The Telegraph* entitled “**European bank bailout could push EU into crisis**” revealed that EU officials were forecasting a crisis stemming from the bank bailout.

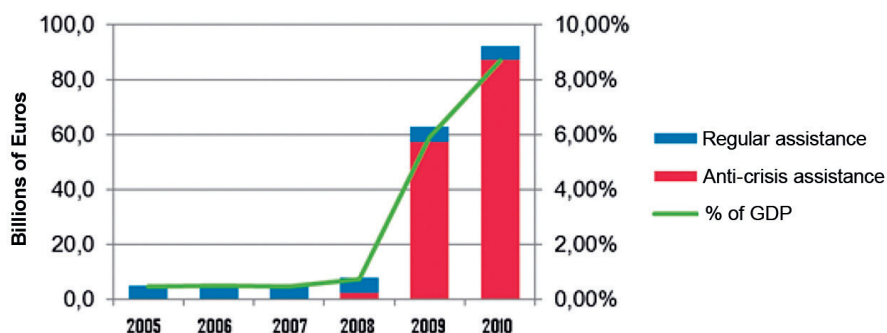
The crisis is having a profound effect on the region. In the case of **Spain**,¹⁷ for example, the following graph shows how “anti-crisis assistance” relied heavily on the public purse. People are losing their homes, jobs and public services, but banks have received incalculable assistance:

16 *Boletín ELA* – EuskalSindikatua, November 9, 2012.

17 By Sergi Cutillas and Itziar Gimenez, of the Citizen Debt Audit Platform, Spain.



EVOLUTION OF GOVERNMENT ASSISTANCE 2005-2010



Source: Comisión Nacional de la Competencia, Spain

In the **United States**, a Government Accountability Office audit¹⁸ revealed that between December 2007 and June 2010 the Federal Reserve secretly transferred 16 trillion dollars to banks and corporations in the form of loans at near-zero interest rates:

FINANCIAL INSTITUTION	AMOUNT (U.S. dollars)
Citigroup	2,513,000,000,000
Morgan Stanley	2,041,000,000,000
Merrill Lynch	1,949,000,000,000
Bank of America	1,344,000,000,000
Barclays PLC (UK)	868,000,000,000

¹⁸ <http://www.sanders.senate.gov/newsroom/news/?id=9e2a4ea8-6e73-4be2-a753-62060dcbb3c3>.



FINANCIAL INSTITUTION	AMOUNT (U.S. dollars)
Bear Sterns	853,000,000,000
Goldman Sachs	814,000,000,000
Royal Bank of Scotland (UK)	541,000,000,000
JP Morgan Chase	391,000,000,000
Deutsche Bank (Germany)	354,000,000,000
UBS (Switzerland)	287,000,000,000
Credit Suisse (Switzerland)	262,000,000,000
Lehman Brothers	183,000,000,000
Bank of Scotland (UK)	181,000,000,000
BNP Paribas (France)	175,000,000,000
Wells Fargo & Co.	159,000,000,000
Delia SA (Belgium)	159,000,000,000
Wachovia Corporation	142,000,000,000
Dresdner Bank AG (Germany)	135,000,000,000
Societe Generale SA (France)	124,000,000,000
Others	2,639,000,000,000
Total	16,114,000,000,000

These mind-boggling figures illustrate the privileges the financial sector enjoys even after unleashing such massive crises. It is interesting to note that the very same banks that received Fed largesse are the ones that figure prominently in the above-mentioned academic study on the global power of the banking sector.¹⁹

19 VITALI, S., GLATTFELDER, J. B., BATTISTON, S., op. cit.



One task of the citizen audit is to identify the use of public debt as a mechanism for absorbing crisis and fraud generated by the private financial sector.

1.5 – HOW THE POWER OF THE FINANCIAL SECTOR AND THE USE OF THE DEBT SYSTEM BECAME ENTRENCHED

Worldwide financialization was made possible by a series of factors that came to govern the global economy and that function as integral parts of the Debt System. These factors include:

- a) Creation of the U.S Federal Reserve (Fed)
- b) Financial deregulation and crisis
- c) End of fixed dollar-gold exchange rate
- d) International financial organizations
- e) Creation of the Euro and the role of the European Central Bank
- f) Credit rating agencies

a) Creation of the U.S Federal Reserve (Fed)

Sparked by a financial crisis in the United States, the banking panic of 1907 provided justification for the establishment of the Federal Reserve system, whose aims would be to manage **the country's monetary policy**; **supervise** and **regulate** banking institutions; maintain the stability of the financial system; and provide financial services to depository institutions, the U.S. government and foreign official institutions.



The law was passed in 1913 but one year earlier the House Committee on Banking and Currency of the U.S. Congress²⁰ had decried the concentration of banks and power in the hands of a small New York-based grouping within the system made up of J.P. Morgan and Co., First National Bank, and the National City Bank.

Concerning the supposed aims of the Fed, it's worthwhile to quote the opinion of academics such as Antony Sutton:²¹

"The Federal Reserve System is a legal private monopoly of the money supply, operated for the benefit of a few, under the guise of protecting and promoting the public interest."

Edward Griffin²² asks:

"What is the Federal Reserve System? The answer may surprise you. It is not federal and there are no reserves. Furthermore, the Federal Reserve Banks are not even banks [...] A banking cartel to protect its members from competition [...] the System is merely a cartel with a government façade."

Historically, the Fed has been focused on protecting and benefiting the private banking sector;²³ which runs the board of directors.

20 House Committee on Banking and Currency, headed by Arsene Pujo

21 SUTTON, A., *Wall Street and F.D.R.*, (New York: Arlington House Publishers, 1999), p. 94

22 GRIFFIN, G. E., *The Creature from Jekyll Island. A Second Look at the Federal Reserve*, (Westlake Village: American Media, 2010), 1, 3, and 21.

23 There are those who accuse the Fed of politically and economically manipulating the world since the beginning of the 20th century in collaboration with large multinationals and the U.S. government itself. Most such theories were popularized in a series of major documents contained in "Zeitgeist", by Peter Joseph,



This emerged clearly in past audits, where it was found that:

- the Fed, run by the same major banks that held foreign debt, advocated a unilateral hike in the international lending rates (*prime*) that governed borrowing in the 1970s, and which subsequently rose to an annual rate of 20.5% in 1981;
- the Fed was named custodian of the guarantees (held in U.S. Treasury bonds) demanded of the countries that signed on to the Brady Plan in the 1990s.

City University of New York Professor David Harvey refers to the way Fed power is deployed to defend private financial interests:²⁴

“The state-finance nexus has long functioned as the ‘central nervous system’ for capital accumulation. When the signals internal to its functioning go haywire, then crises obviously result. Much of what happens within the central banks and treasury departments of contemporary States is hidden from view and wrapped in mystery. Not for nothing did William Greider call his exhaustive 1989 investigation of how the Federal Reserve works Secrets of the Temple. [...]”

When the credit bubble bursts, which it inevitably must, then the whole economy plunges into a downward spiral of the sort

in “The Money is Debt” by Paul Grignon and in the two latest books edited by the well-known economist John Perkins: *Confessions of an Economic Hit Man*, [San Francisco: Berrett-Koehler Publishers, 2004] and *The Secret History of the American Empire* [New York: Penguin, 2007]]. Source: <http://www.efxto.com/diccionario/f/3716-fed-sistema-de-reserva-federal#ixzz2BqVKZ2Ok>

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24 HARVEY, D., *O enigma do Capital e as crises do capitalismo*, op.cit., 52, 98.

Translated from the Portuguese and then to English.



*that began in 2007. And it is at this point that capitalism has to create external power in order to save itself from its own internal contradictions. It needs to re-create the equivalent of the external feudal or non-capitalist gold reserve that it has historically fed upon. This it does by locating **the power of infinite money creation within a neo-feudal institution like the Federal Reserve.**"*

The citizen audit should keep in mind that the Boards of Directors of different central banks are made up of representatives from the private financial sector. Given that they have power over countries' public finances there is a potential conflict of interest.

b) Financial deregulation and crisis

The major financial crisis that began in the United States in 1929 affected the entire world economy.

U.S. senators²⁵ protested that the "country was subject to the control of financiers," given the existence of highly concentrated global financial supermarkets where depositor holdings were used for speculation and where corruption and financial shenanigans created a complex, opaque, and ungovernable system.

U.S. Senate hearings prompted the adoption of regulations, in particular the Glass-Steagall Act of 1933,²⁶ which – among other

²⁵ As, for example, in the Pecora investigation in 1932

²⁶ *Banking Act*. This law was the best known of such legislation and was applied,



measures – separated commercial banking from investment banking and barred bankers from sitting on the boards of industrial, commercial, and service companies.

For a few decades after this, there were indeed certain limits on speculation, and this enabled industrial firms to grow and industrialization to spread. Nonetheless, from the 1970s onward, a number of major changes led to financial deregulation. The end of the gold standard for the U.S. dollar was one step in this direction, as we shall see further on.

After 1983, IMF demands fostered deregulation through the slacking of capital controls and through financial and trade liberalization, thereby reducing obstacles to international banking operations and encouraging the use of tax havens.

The so-called Washington Consensus – which became the official program of the IMF in 1990, also promoted financial deregulation.

Under the guise of the “need to modernize”, the Glass-Steagall Act was repealed in 1999 and replaced by the Gramm–Leach–Bliley Act,²⁷ also known as the *Financial Services Modernization Act of 1999*. Among other features, the new law opened the way for:

with some variations, in European countries. See TOUSSAINT, E. “Bancos contra pueblos: los entresijos de una partida amañada”, December 31, 2012. Available at: <<http://cadtm.org/Bancos-contra-pueblos-los>>

²⁷ To consult the full text of the law see: *Gramm-Leach-Bliley Act*, Public Law 106-102, 106th Congress, Nov. 12, 1999. [113 STAT. 1338]. Available at: <<http://www.gpo.gov/fdsys/pkg/PLAW-106publ102/content-detail.html>>



- A rise in the number of mergers, incorporations, and multinational financial oligopolies;
- The emergence of new financial supermarkets following the removal of barriers between commercial and investment banks, insurers, brokerages²⁸ and other financial players;
- The quest for economies of scale and “too big to fail” status – to guarantee automatic government bailouts.

The corporate media hailed the advent of financial supermarkets, saying that the *new banks were “sounder”*. In fact, deregulation strengthened the speculative banking model and deepened financialization.

“Banking models”

In the traditional model of banking (“*originate and hold*”), banks assess and assume risk. In other words, they assess loan applications, decide to approve them or not, and then, once extended, keep these loans on their balance sheets until maturity.

As a consequence of deregulation, banks have put financing the real economy (households, businesses, and local government) on the backburner in order to focus on more lucrative speculative operations.

In order to speculate more, financiers have invented new techniques – especially securitization, which involves turning bank loans into financial securities.

28 By Patrick Saurin, of the Sud BPCE trade union, France.



So banks do not keep loans on their balance sheets. They sell them off as financial paper.

This is what is known as the new “originate-to-distribute” model of banking, also called “originate, repackage and sell”.

This offers banks a two-fold advantage. Not only do they reduce risk by retiring extended loans from their asset ledgers, they also receive additional funds with which to speculate.

A number of academics, including Joseph Stiglitz,²⁹ blame bank deregulation for the outrageous rise in speculative activity that led to the 2007 crisis.

John Bellamy Foster and Hannah Holleman³⁰ summarize this approach in their paper “The Financial Power Elite”:

“As financialization proceeded, more and more exotic forms of financial innovation (all kinds of futures, options, derivatives, swaps) arose, along with the growth of a whole shadow banking system, off the balance sheets of the banks. [...] The system had become increasingly complex, opaque, and unmanageable. A whole new era of financial conglomerates arose, along with the onset in 2007 of the Great Financial Crisis.”

The financial deregulation that began in the 1980s and accelerated in the 1990s opened the door to a range of questionable financial

²⁹ <http://abcnews.go.com/print?id=5835269>

³⁰ FOSTER, B. J., and HOLLEMAN, H., “La élite del poder financiero” *Monthly Review, Selections en castellano*, November, 12 [2011], Online edition. Available at: <http://www.cienciasocialcritica.com/2/9>.



products that produced fabulous profits. This was because they figured on the positive side of a bank's ledger and artificially inflated revenues – which in turn meant it could extend more loans, thereby “creating” money.

Auditing firms – private institutions that issue annual reports on the health of banks' financial statements – failed to blow the whistle on this maneuver that enabled banks to lend funds they did not even have.

These derivative markets operate like “pyramid schemes” with speculation and overleveraging offering ever-rising profits to those near the top of the scheme. A major link in the chain broke when the real estate loan portfolio could not be collected, bringing about the collapse of related derivatives.

It should be noted, though, that the real estate bubble was only a link in the chain and **not the cause** of the crisis. High-risk mortgages would not have created any problems for the financial system if the mortgages had not been tied into multiple layers of derivatives, which multiplied risk a hundred times over.

Broad awareness of the real estate bubble led many to conclude that ordinary people were to blame for the crisis. Yet the astronomical sums that went into the bank bailout surpass the total value of all the world's homes taken together!

Financial deregulation has played a major role in the creation of public debt. When banks started to collapse, the Fed and the European Central Bank (ECB) demanded that affected countries bail them out. This is a good illustration of the way in which the financial sector created the crisis – and of the influence it wields over governments.



The citizen audit should be absolutely clear about the causes of the crisis and identify which public debts were amassed in order to resolve problems in the private sector.

c) End of the fixed dollar-gold exchange rate

The commitment to a gold standard³¹ was made in 1944, while the Second World War still raged, at a conference in Bretton Woods, New Hampshire. The dollar was selected as international reference currency in order to “facilitate trade flows”, with the Fed holding the gold stock.

Following the dropping of atomic bombs on Hiroshima and Nagasaki in 1945, UN member countries established the Bretton Woods system.³²

In 1965, the Bank of France, followed by the Bank of England, began to exchange large portions of their dollar holdings for gold at the Federal Reserve. French President Charles de Gaulle called for another system “with a monetary basis that cannot be questioned and that does not bear the stamp of any one country in particular.”³³

Finally, on a Sunday in 1971 – August 15 to be precise – President Nixon unilaterally and on his own initiative announced that the Fed would not meet its obligation to exchange dollars for gold.

31 The parity that was established was one ounce of gold for each 35 dollars.

32 Idem, 16.

33 Idem, 14.



This broken commitment had a number of consequences and represented a major step toward global financial deregulation, given that by 1971 the hegemony of the U.S. dollar had already been entrenched.

The abandonment of the dollar-gold fixed rate cleared the way for the printing of vast sums of money and played a central role in the creation of excess international liquidity in the 1970s. This liquidity was transferred to private banks – which then extended loans to countries in Latin America, Africa and Asia and became the largest lenders to countries in the global South.

The citizen audit should take this analysis of the origin of public debt as its starting point.

d) International financial organizations – the IMF and World Bank

Created in 1944 at the same Bretton Woods gathering that established the hegemony of the U.S. dollar, the IMF and the World Bank have played a fundamental role in the Debt System. Their effects have been felt in all countries, with both developed and underdeveloped economies.

The IMF's mandate is set out in its Articles of Agreement. Its stated aim is to ensure the stability of the international financial system. In practice, its role has been one of leadership and oversight over the global financial and monetary order³⁴ – acting on behalf of

34 Comisión para la Auditoría Integral del Crédito Público [CAIC], Ecuador, "Informe



private banks and not of member countries. While the first article of its bylaws anticipates that it will contribute to high levels of employment, in practice the exact opposite occurs.

Despite this overall bias, these organizations do not always conduct themselves in the same manner.

- In **more “developed” economies** (including in some Latin America countries), the lion’s share of public debt is made up of bond issues placed by private banks. The IMF shows up at times of crisis with adjustment packages that ensure the transfer of funds to the private sector. The World Bank runs different national and regional projects³⁵ that tally with its interest to interfere in strategic economic policies.

- In **“underdeveloped” economies** (including HIPC³⁶ countries in Africa, Asia and Latin America), very little or no debt is issued as bonds. In these countries, most debt is owed to international financial organizations through loans tied to “development” programs that allow them to influence domestic economic policy and the implementation of structural adjustment programs. “Partnership Agreements” intensified the plunder of natural resources through massive low-cost exports. “Debt relief” measures announced for HIPC countries have only made it more likely that payments will continue to be shelled out for these debts – even though they are very

Final Resumen Ejecutivo”, 69, 126, 152, available at <http://www.auditoriadeuda.org.ec/>

35 TOUSSAINT, É., *Banco Mundial - El golpe de estado permanente*, [Caracas: Centro Internacional Miranda, 2006], 38.

36 HIPC. High Indebted Poor Country.



often odious and illegitimate, and that they have already been paid off many times over.

David Harvey makes the same point:³⁷

“On the one hand the international institutions and peddlers of credit continue to suck, leech-like, as much of the lifeblood as they can out of all the people of the world – no matter how impoverished – through so-called ‘structural adjustment’ programs and all manner of other stratagems (such as suddenly doubling fees on our credit cards). On the other the central bankers are flooding their economies and inflating the global body politic with excess liquidity in the hope that such emergency transfusions will cure a malady that calls for more radical diagnosis and interventions.”

Since the 1980s, the behavior of the IMF and World Bank in Africa has been characterized by the imposition of the adjustment programs, which have dictated the elimination of agricultural subsidies and social investment. Furthermore, by interfering in micro-economic policy-making they have brought about economic ruin. And even though Africa has swallowed these prescriptions, it is in no better position to pay its external debt – often contracted to finance dictatorship and war.

The IMF’s behavior in **European countries** affected by the crisis that began in 2007 resembles its approach to **Latin American countries** from 1982 onward. In both instances, we see:

- The imposition of strict financial adjustment packages that seek to reduce social spending (public health services, education, welfare benefits, public-sector job cuts, and so forth);

37 HARVEY, D., O enigma do Capital e as crises do capitalismo, op. cit., 8.



cuts in public investment; carrying out regressive reforms in the labor market, and tax, trade and pension systems; privatizations; increasing the cost of fuel and utilities such as electricity and phone services; and amending a range of laws.

- The defense of private interests through the conversion of private into public debts, State-funded bank capitalizations and bailouts – notwithstanding their role in creating the crisis in the first place.

Years of IMF intervention in the countries of the Global South caused what are now seen to be lost decades given the deepening of social injustice and the increase in financial flows out of the country and to the private sector. This interference opened the way to domination by the financial sector, with the attendant loss of sovereignty and freedom.

Over the past decade, the IMF's support for private banks has been illustrated in particular by its demand that **Collective Action Clauses (CACs)**³⁸ be written into sovereign debt bonds.

In Brazil, for example, a CAC has been included in bonds issues from 2003 onward. This has entailed a serious erosion of national sovereignty and interests. Worse, the measure was taken without the required approval of the country's Federal Senate.

CACs bring about fundamental changes in the way public debt is contracted. They give bondholders the power to decide how debt will be refinanced in the event of repayment difficulties. They can force countries to waive their sovereignty and immunity and introduce

38 FATTORELLI, M. L., "Más poder para la banca con la Cláusula CAC" in <http://www.auditoriacidada.org.br>.



amendments, alterations and changes to sovereign bonds without the involvement or consent of the issuing country – in violation of constitutional principles.

Such a clause can be found in the **European Stability Mechanism (ESM)**³⁹ that was recently created in Europe and replaces previous vehicles (the EFSM⁴⁰ and the EFSF⁴¹).

The ESM Treaty requires that a CAC clause be included for all sovereign bond issues and imposes abusive terms on countries – which have to waive national sovereignty in favor of undemocratic bodies such as the IMF, thereby perpetuating the control of private banks and financial elites.

The ESM Treaty provides for the creation of a Board in which all countries are represented in proportion to their economic strength. These administrators will operate independently of the European Parliament and national parliaments; they will have absolute power and enjoy privileges such as immunity from legal proceedings.

39 <http://madrid.tomalaplaza.net/2012/10/09/>

sobre-el-tratadeo-del-m-e-d-e-lo-que-nos-ocultan-desde-europa/

40 **European Financial Stability Mechanism (EFSM)**. Emergency financing program dependent on funds raised in financial markets and backed by the European Commission. Its aim is to preserve financial stability in Europe by providing financial assistance to European Union member States in economic crisis. The EFSM is rated AAA by Fitch, Moody's, and Standard & Poor's. http://es.wikipedia.org/wiki/Mecanismo_Europeo_de_Estabilidad_Financiera.

41 **European Financial Stability Facility (EFSF)**. Special legal instrument approved by the 27 member States of the European Union on May 9, 2010. Its main objective is to preserve financial stability in Europe by offering financial assistance to States in the euro zone facing economic crisis. The EFSF has its headquarters in Luxembourg. http://es.wikipedia.org/wiki/Fondo_Europeo_de_Estabilidad_Financiera.



ESM official papers and documents are inviolable; its resources and assets are exempt from restrictions, regulations and control measures; its operations are exempt from all direct taxes and import duties and free from any restriction; and the salaries and emoluments of ESM staff are exempt from national income tax.

The ESM Treaty grants powers to the IMF to advise countries on economic policy.

The citizen debt audit should identify the responsibilities of the IMF and World Bank and the consequences of their policy prescriptions.

e) Creation of the euro and the role of the ECB

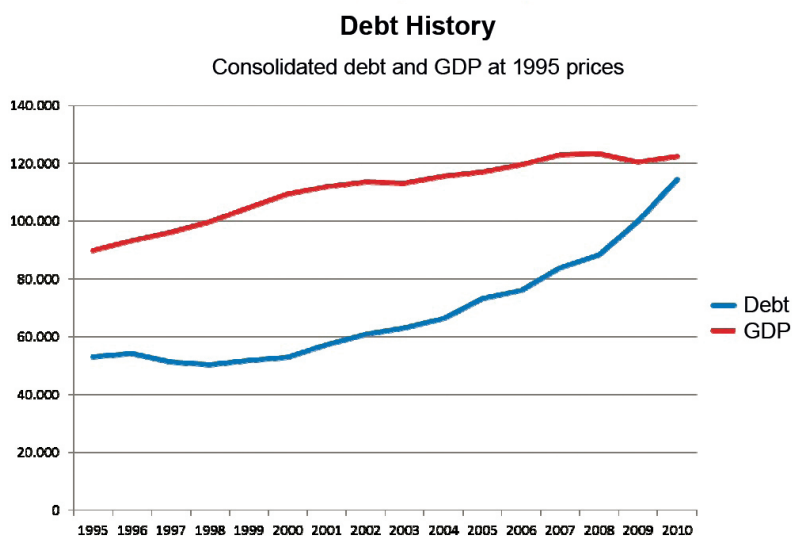
The monetary union of 17 European countries involved the creation of a common currency, the Euro, in 1999 – and the submission to a higher monetary authority, the European Central Bank (ECB). The ECB's main preoccupation has been to fight inflation, based on neo-liberal notions that work to the advantage of private finance.

Entry into the *Eurozone* had a major impact on the financial wherewithal of the countries that were involved, primarily as a result of the rapid pace of economic liberalization that affected internal financial flows – as if national borders no longer mattered. This liberalization was of direct assistance to private banks seeking to find outlets for excess toxic assets, and whose balance sheets were already inflated by the inclusion of large volumes of financial instruments.



This need generated large financial flows that took the form of loans to peripheral Eurozone countries. These flows were also driven by speculative transactions carried out by financial and commercial institutions that saw emerging European markets (Spain, Ireland, Portugal and Greece, for example) as places where their holdings could yield large returns.

It is clear that such transactions favored countries with more developed economies (Germany, Austria, the Netherlands, Belgium, Finland, France), and that the contracted loans were simultaneously turned into “public” debts in the recipient countries – as the following chart for Portugal shows:



Source: Elementos para um Retrato da Dívida em Portugal - Convenção de Lisboa - December 17, 2011 - Grupo Técnico da IAC - <http://www.auditoriacidada.info>



Economic disparities between countries grew. The problem would not have been so serious had the ECB been able to inject funds directly into the affected countries, applying terms in keeping with their ability to pay. But its bylaws prohibited it from doing so, and the industrial-financial establishment argued that such an approach would be inflationary. Needless to say, this did not prevent the ECB from lending one trillion Euros (€ 1,000,000,000,000) to private banks at near-zero interest rates over the course of the past year.

Bank bailout operations worsened budget deficits and deepened the already existing crisis.

Given the way it was designed, the European monetary union has exacerbated and not reduced disparities between member countries.

The institutions that run this system subject countries and their peoples to a flawed arrangement, which plunges them into a spiral of indebtedness and impoverishment.

The citizen audit should consider the way public debt was created by private banks extending toxic loans in order to stave off bankruptcy.

f) Risk rating agencies

The risk rating agencies are also an important part of the financial sector's power.

They emerged in the 20th century and were focused exclusively on assessing risk in shares issued by private-sector companies and



sold on U.S. stock markets – using accounting principles to quantify yield and sustainability.

The main agencies are also the oldest ones: Moody's (founded in 1900), Fitch (1913) and Standard and Poor's (1941).

Following the financial crisis of the 1980s, they began to measure country risk. Their approach was to see the United States as a country with "zero" risk and assign ratings to other nations based on an assessment of the risk of debt default.

The biggest problem with these agencies is conflict of interest.

- **Who pays them?**
- **What is their remuneration based upon?**

These agencies are clearly not independent, given that their biggest customers are also the same organizations that they subject to risk analysis. As such, there is good reason to question the importance given to their opinions.

There are a number of cases that illustrate how little credibility these agencies have. Just before they went bankrupt, companies such as Enron and WorldCom received top credit ratings – as did Lehman Brothers and a range of banks threatened with bankruptcy given the sheer volume of toxic assets on their balance sheets.

A number of recent judgments seek to hold these agencies responsible for the damage caused by their faulty assessments – to public finances in particular. In Australia, Standard & Poor's was ordered to pay 13 million Euros to 12 municipalities⁴² that lost money after

42 See the article on fraud from 09-11-2012: <http://agendaglobal.redtercermundo.org.uy/2012/11/09/la-nota-del-fraude>



investing in a fund that had received an “AAA” rating.⁴³ The U.S. government⁴⁴ filed a suit in which it accuses S&P of deliberately misleading investors because it was more concerned over its own profits than about its responsibility to provide trustworthy ratings.

Government authorities in Europe have also publicly challenged the power of rating agencies, accusing them of blackmail in response to the ratings that some countries have been given. Poorer ratings have led to an increase in the interest rates these countries have had to pay to refinance their debts, forcing them to sign crippling agreements with the Troika.

The agencies service a turbulent market and generally prefer to lose credibility in order to please their clients, on whom their survival depends. Occasionally they lose clients, as recently occurred in Los Angeles, California when the city government cancelled its contract with S&P following a downgrading of its bonds.

The citizen audit should keep in mind that the reports issued by non-independent agencies very often have no basis in fact. Their assessments should be reviewed on the basis of impartial criteria.

43 See news article in: <http://www.elperiodico.com/es/noticias/economia/australia-condena-standard-poor-por-crisis-del-2008-2242402>.

44 http://sol.sapo.pt/inicio/Internacional/Interior.aspx?content_id=67672.



1.6 – NEED FOR A NEW FINANCIAL ARCHITECTURE

It has been shown that the current financial system uses debt as a **mechanism** for the continuous misappropriation of public resources, in the process deepening injustice and social exclusion. It also generates successive crises and uses client confidentiality in the banking sector to draw a veil over illegal transactions, unscrupulous business dealings in tax havens, and fraud.⁴⁵ It allows for the creation of unbacked financial instruments – involving a series of illicit acts and the existence of a parallel or “shadow” banking sector.

In October 2012, the **IMF** released a preview of its *Global Financial Stability Report*.⁴⁶ While backing the dominant policy regime, the report **points out serious deficiencies in the international financial system**, such as:

- The role of the “shadow banking system” has not been dealt with and many operations have been shifted into the unregulated sector;
- Highly sophisticated financial products are evading regulation.

45 LIBOR scandal: In 2011, the Libor scandal brought to light two special characteristics of financialization: the illegal practices and the impunity enjoyed by their perpetrators. Between 2005 and 2009, the main banks responsible for setting the Libor [London Interbank Offered Rate] and Euribor [European Interbank Offered Rate] rates were involved in their manipulation, affecting numerous transactions involving large sums of money. Instead of coming clean concerning their deceit to the justice system, the banks negotiated penalties in order to put an end to the legal proceedings to which they should have been subject. This occurred in the case of UBS, which paid a fine of 1.40 billion Swiss francs [1.15 billion Euros] following an agreement with the United States, Britain and Switzerland due to its involvement in this scandal. By Patrick Saurin.

46 <http://www.imf.org/external/pubs/ft/gfsr/2012/02/index.htm>.



- Firms deemed “too big to fail” are actually becoming more concentrated and their advantageous position is being strengthened.

This state of affairs calls for a new financial architecture that repudiates fraud and runs on the basis of public needs and interests. This will only come as a result of mass mobilization. Given the problems of the existing financial system, it is essential that the citizen audit be part of the campaign for a new financial architecture.

a) Proposal for a New Regional Financial Architecture (NRFA) in Latin America

In light of the failures of the current financial system – both internationally (IMF, World Bank, and so on) and in the region (CAF, ALADI, FLAR) – a number of Latin American countries are developing proposals for a New Regional Financial Architecture (NRFA) and implementing monetary and financial reforms with this project in mind.

These proposals are the fruit of years of intense mobilizations around the need to find new ways to operate the financial sector. In 2007, an array of social organizations sent an open letter to the presidents of Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay and Venezuela entitled “For a Bank of the South at the service of the rights, needs, potential and democratic aspirations of the people”.

The protests were successful and the Founding Charter was signed in Buenos Aires in 2007. In part, the document said that a decision had been taken to “create a development bank that would be a legal entity within international public law, and that would be called Bank of the South. Its purpose will be to fund economic and



social development in the countries of the Union of South American Countries (UNASUR) that are members of the bank.”

As things stand now, the NRFA has three main pillars: the **Bank of the South** (development bank), the **Common Reserve Fund of the South** (funds for monetary and exchange-rate stability) and the **Single Regional Payments Compensation System** (trade organization).

The goal is to achieve greater economic and financial autonomy to promote sovereign sustainable development within a framework of regional integration.⁴⁷

The NRFA is moving forward and has thus far been ratified by parliament in five countries (Argentina, Bolivia, Ecuador, Uruguay and Venezuela), but it needs even broader supports.

Social movements should push for NRFA ratification in the remaining countries of the region, alongside involvement in Bank of the South operations and support for the Bank's larger goals:

- A break with the current international financial architecture (IMF and World Bank) and speculative capital;
- The building of a sovereign, democratic, and transparent regional financial system, aimed at ensuring a new inclusive and fair model of development serving human needs;

47 LEGEARD, N., “Nueva arquitectura financiera para el desarrollo en América Latina y Ecuador”, *Universitas - Revista de Ciencias Sociales y Humanas*, UPC, Ecuador, 14 [2011]: 43-71, Available at: <http://universitas.ups.edu.ec/documents/1781427/1792977/02Art14.pdf>



- Regional integration through the financing of projects with a priority focus on transportation and communications, food, energy and environmental sovereignty, development of information and communication technologies, education, and scientific and technical research.⁴⁸

b) Proposals for the creation of a public banking system in Europe

Europe has also seen proposals for altering the structure of global banking, such as:

- Creating public banks that would compete with the private banking sector;⁴⁹
- Socializing the entire banking system, to create genuine transparency in the sector.⁵⁰

The current crisis illustrates the need to replace a banking system based on competition, deregulation, and opaque functioning with new system based on solidarity, strict regulation of financial operations, and transparency.

Once we appreciate that currency, savings, credit, and the system they are based on are public assets – and that the security of the people's monetary holdings and the preservation of the integrity of

48 TOUSSAINT, E., *Banco del sur y Nueva crisis internacional*, [Barcelona: Editorial Viejo Topo, 2007].

49 By Patrick Saurin, of the Sud BPCE trade union, France. Further information available at <http://cadtm.org/Socialiser-le-systeme-bancair>

50 "Socialiser le système bancaire. Une urgente et impérieuse nécessité économique, sociale, politique et démocratique", Patrick Saurin, of the Sud BPCE trade union, France. Available at: <http://www.audit-citoyen.org/?p=3539>.



the system of payments are indispensable – the need for a public banking service becomes self-evident.

This means socialization of the banking system. Unlike nationalization, socialization involves democratic appointment of managers and decision-making by representatives of bank employees, customers, local government and representatives from national and regional banking authorities.

In such a system, the Central Bank could lend directly to the State and public-sector entities. One of the essential mandates of public banking would be to facilitate the transition from a capitalist and productivist economy to a socially oriented and ecological one.

The financial system should serve the population, and not the other way around.

CONCLUSION

In a global context of financialization and domination by banks, sovereignty and the rights of people are swept aside. There is a need to raise awareness about this state of affairs. With this in mind, the citizen audit should compile the relevant data and macroeconomic information about the public debt in order to pinpoint the mechanisms that lie behind it.

Public debt is not an isolated phenomenon. Rather, it is a fundamental mechanism of capitalist accumulation, which works as a system.

The financial sector has been the main driver and beneficiary of the Debt System. It is rooted in fraud and abuses that have caused



incalculable social, economic and environmental damage, with a direct impact on the life of ordinary citizens. This system is not in the interests of humankind. We urgently need to make progress toward building a new global financial architecture.

Only knowledge will set us free.



Chapter 2.

Public debt and mechanisms that generate it



INTRODUCTION

This chapter will seek to explain what is meant by public debt, its terminology, as well as some mechanisms that generate it.

These mechanisms begin to operate in scenarios marked by an oversupply of credit in terms that benefit only the banks, be they private, bilateral, or multilateral. Then they stimulate the self-generation of new debt and its massive growth, mainly as a result of onerous costs and measures imposed by international financial institutions and organizations, which leads to economic, financial, social, and environmental damage and losses.

All of these elements together represent a real Debt System that guarantees the perpetuation of the debts and financial domination by the previously alluded to institutions.

This unfair and illegitimate model subjugates almost all of the countries of the world and it is important that it be fully identified due to the incalculable damage it has inflicted on the population of the nations involved.

The tool that will enable this process to be transparent and documented is the debt audit.

2.1 – PUBLIC DEBT AND THE DEBT SYSTEM

Theoretically, the **public debt corresponds to financial obligations contracted by the State or public sector entities.**

It consists of a facultative instrument, the purpose of which is to obtain resources to finance government budgets or



public investment, with a specific legal and regulatory basis in each country.

For starters, public debt should not, in and of itself, be negative, since its purpose should only be to provide resources to improve government functioning, ensure the fulfillment of social rights, boost self-sustaining economic development, and guarantee investments with a high social impact.

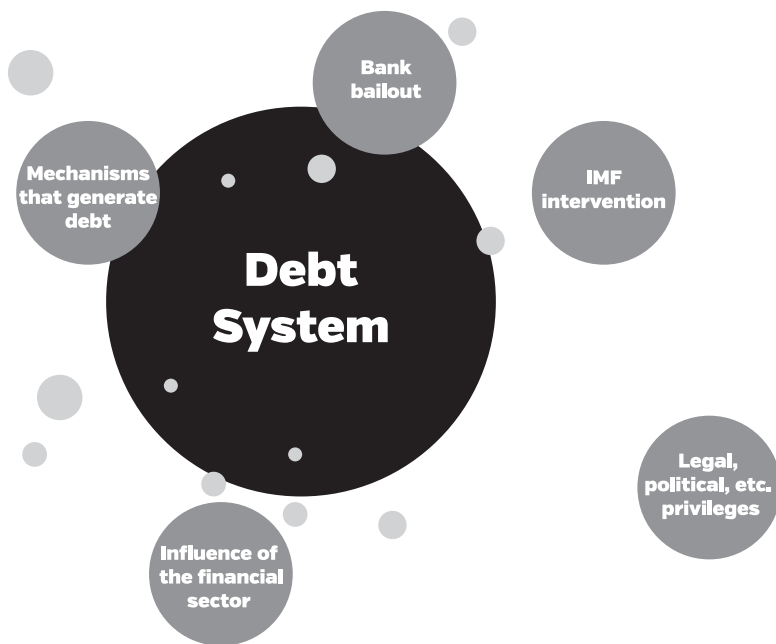
The use of this financial instrument should be strictly complementary. In other words, it should only correspond to the levels and amounts of the budgetary requirements that have not been financed by the government's own resources, such as tax collection (taxes, fees, duties) and other income from public sector assets, commercial,¹ and service sector activities.

Furthermore, the decision to accrue public debt should be stipulated in the corresponding constitutions of each country as a transparent process that is necessarily discussed with society, which, in the end analysis, will be paying such liabilities.

These criteria have not been applied in practice, due to the completely distorted use of the public debt. In other words, instead of representing an inflow of resources, public debt has become a mechanism for looting the recipient countries. We call this the “**Debt System**”.

Before delving into an explanation of the *modus operandi* of the Debt System, we will present some basic concepts.

¹ Depending on the country, this can correspond to revenue from oil, mining, agricultural and other natural resources.



2.2 – TERMINOLOGY

The citizen audit should distinguish between the different types of terminology used to describe public debt.

a) Public debt

Public debt involves liabilities assumed by the State, both on the national level or by local governments in provinces (States), municipalities (cities), cantons, etc., or public sector entities (Central Bank, State owned enterprises, etc.).



Public debt can be external or internal, direct or indirect, as will be described below.

On a formal level, public debt can be contractual (when formalized in a contract between the debtor and creditor) or take the form of securities (when securities or government bonds are issued).

In its physical dimension, traditionally contracts were signed and bonds were issued by physical means. In the past few decades, however, the process has become strictly electronic, which enables debt paper to be traded virtually, as a financial instrument, in any market in the world, in countless transactions per second.

b) Sovereign debt

Sovereign debt is the national public debt of each country – external or internal – originated through issuing sovereign bonds or through signing contracts or other such agreements, promissory notes, guarantees, bonds, or other fiduciary paper.

c) Internal or external debt

Depending on the location of the source of the resources and the currency used in the transaction, public debt can be:

- **Internal**
- **External**

In the case of contractual debt, the distinction is clear, but in case of debt securities (in bonds) there is a conflict between theory and practice:



INTERNAL DEBT

EXTERNAL DEBT

IN THEORY	The debt is contracted in national currency with domestic individuals and entities.	The debt is contracted in foreign currency (dollar, euro, yen, pound, etc.) with foreign individuals and entities.
IN PRACTICE	The creditors are not only national entities, since foreign banks directly purchase "internal" debt bonds. They can even assume the role of dealers, buying the bonds on the first round.	There are different cases in which external debt has been issued in national currency (Brazil, for example). In addition, entities resident in the country can purchase these foreign debt bonds.

Dealers are the banks that have the privilege of purchasing the "internal" debt bonds in the first round, after they have been issued by the government. Considering that foreign banks assume this role, then the "internal" debt becomes "external". In Brazil, every six months a group of 12 financial institutions assumes the role of *dealers*, with the significant presence of foreign banks:



TESOURO NACIONAL

INSTITUIÇÕES CREDENCIADAS A OPERAR COM A CODIP E COM O DEMAB	
DEALERS	
10/02/2012 a 31/07/2012	10/08/2012 a 31/01/2013
BCO BRADESCO S A	BCO BARCLAYS S A
BCO BTG PACTUAL S A	BCO BRADESCO S A
BCO CITIBANK S A	BCO BTG PACTUAL S A
BCO DO BRASIL S A/MERCADO	BCO DO BRASIL S A/MERCADO
BCO J P MORGAN S A	BCO SANTANDER (BRASIL) S A
BCO SANTANDER (BRASIL) S A	BCO VOTORANTIM S A
BCO VOTORANTIM S A	CAIXA ECONOMICA FEDERAL/MERCADO
CAIXA ECONOMICA FEDERAL/MERCADO	DEUTSCHE BANK S A - BCO ALEMAO
CM CAPITAL MARKETS CCTVM LTDA	HSBC BANK BRASIL S A - BANCO MULTIPLO
HSBC BANK BRASIL S A - BANCO MULTIPLO	ICAP DO BRASIL CTVM LTDA/BRAD
ITAU UNIBANCO S A	ITAU UNIBANCO S A
RENASCENCA DTVM LTDA/BRAD	RENASCENCA DTVM LTDA/BRAD

Referência Legal:

Decisão-Conjunta 18, de 10/02/2010, Ato Normativo Conjunto 26 de 08/02/2012 e Ato Normativo Conjunto 27 de 08/02/2012.



For contractual internal debt, special attention should be placed on debt owed to development banks, particularly to finance mega projects, with serious damage inflicted on the environment and the population. An example of this is the construction of such a project in Belo Monte, Brazil, which has displaced indigenous communities and inflicted untold damage all for the purpose of making it possible for a Canadian company² to mine large gold reserves, which will cause irreparable harm to the environment.

d) Direct or indirect debt

From the debtor's standpoint, public debt can be classified as direct or indirect:

- **Direct Debt:** corresponds to financial obligations contracted directly by the State or public sector entities with different types of creditors. It can be internal or external.
- **Indirect debt:** corresponds to commitments made by the State when the government provides some type of guarantee for loans or financial obligations contracted by third parties, public or private financial entities that hold the original debt.

e) Multilateral, bilateral or commercial debt

From the standpoint of the type of creditor, direct public external debt can be:

2 Belo Sun Mining Corp: <http://www.belosun.com/>.



- **Multilateral** - Creditors are the IMF, the World Bank, and other multilateral agencies.
- **Bilateral** - Creditors are governments or public banks of other countries.
- **Commercial** - Creditors are international private banks. Traditionally, this type of debt is formalized by contracts or agreements. This then gave rise to “sovereign bonds” such as in the Brady Plan, which was applied in close to 20 countries. Private banks are the most representative holders of sovereign debt bonds.

It has been shown that multilateral debt has been contracted in different countries in order to cancel commercial debt³ and even internal debt,⁴ demonstrating the interrelationship among the participants in the Debt System.

f) Gross debt and net debt

- **Gross debt** corresponds to all liabilities assumed by the State in the form of direct and indirect public debt, internal or external. It is on gross debt that interest, amortizations, and other costs are calculated.

3 In Ecuador, for example, it has been demonstrated that multilateral loans were contracted for the purchase of the guarantees required for the commercial debt renegotiation in the Brady Plan.

4 In Brazil, for example, several States are taking out multilateral loans from the World Bank for the payment of internal debt refinanced by the federal government.



– **Net debt** is a concept that is generally only used for statistical purposes. Net debt is what results from deducting the value of the financial assets corresponding to debt instruments from the gross debt.

The calculation is not precise, since different calculation methodologies are employed. In some cases, “net” debt can exclude the debts of provinces or municipalities to the central government; at other times, indirect debt can be eliminated from the figure. In some cases, contingent liabilities and floating debt can be included, with an imprecise content, especially for the central government and state and local governments.

The citizen audit should analyze the statistics provided by governments because the different methodologies used to calculate net debt are not clear and may be designed to distort the actual amount of the public debt and not make such data transparent, for the convenience of those who present such statistics.

Often this calculation does not even make logical sense, considering that it includes different debt instruments as assets (for example, the value of international reserves), but does not considered liabilities. It is important to note that the IMF recommends using gross debt for comparison purposes between different countries.⁵

The different calculation methodologies can lead to distortions in comparing the debt/GDP ratio between countries.⁶ With this in

5 <http://www.imf.org/external/np/pp/eng/2011/080511.pdf>.

6 The comparison of data between countries should also take into account the weight of the debt in each nation, considering the differences between interest rates in December 2012: Brazil (over 12%), United States (0.25 %), Japan (0.1%), Great Britain (0.5%), and the Euro zone (0.75%).



mind, the citizen audit should base its work on reports that contain raw data, that is, without any deduction or application, for only in this way will data for the entire universe of the amounts to be audited be available.

It is important that the citizen audit be familiar with the terminology involving public debt, maintaining the focus that everything is interrelated in the same Debt System.

2.3 – THE DEBT SYSTEM AND ITS REPERCUSSIONS

Experience in comprehensive and specific citizen audits that have already undertaken⁷ has enabled us to identify the existence of an integrated series of elements that make up a true Debt System.

The operation of this system begins with the generation of debt -most of the time without any correlation in terms of corresponding goods, services or benefits provided for the countries- through various **mechanisms**:

7 Public debt audit in Ecuador - CAIC (2007/2008); Citizen debt audit in Brazil [since 2001], investigation conducted in the Brazilian Parliament (2009/2010), as well as recent citizen audit experiences in European countries (2012).



Mechanisms that generate debts



1 ■ Excessive supply of credit

2 ■ Financing of dictators, elections, and wars

3 ■ Tied loans

4 ■ Successive swaps

5 ■ Macroeconomic measures

6 ■ Capitalization of costs

7 ■ Transformation of private debt

8 ■ Financing of mega-projects

9 ■ Bank bailouts

10 ■ Unfair tax system

11 ■ Speculative businesses



After being generated, the debt continues to multiply due to the effect of its high costs and related factors, such as fiscal adjustments,⁸ counter-reforms, changing laws, inflation control, modifications to accounting practices, etc., imposed by international financial institutions. The latter intervene when fiscal crises⁹ emerge, spurred precisely by the demand for a high volume of resources for the sustained payment of interest and financial costs.

The goal has been to ensure the availability of resources for debt payment.

The operation of this system guarantees the perpetuation of internal and external public debt, given that the debts grow rapidly due to the imposition of onerous conditions that continually require new obligations to be assumed in order to pay off previous liabilities. This involves repeated attempts to collect the debt, without any transparency in the process, resulting in the domination of financial and economic interests and the violation of national sovereignty.

The functioning of the Debt System is marked by the use of legal, financial, and economic privileges, due to the enormous influence of the financial sector in the political field and the media.

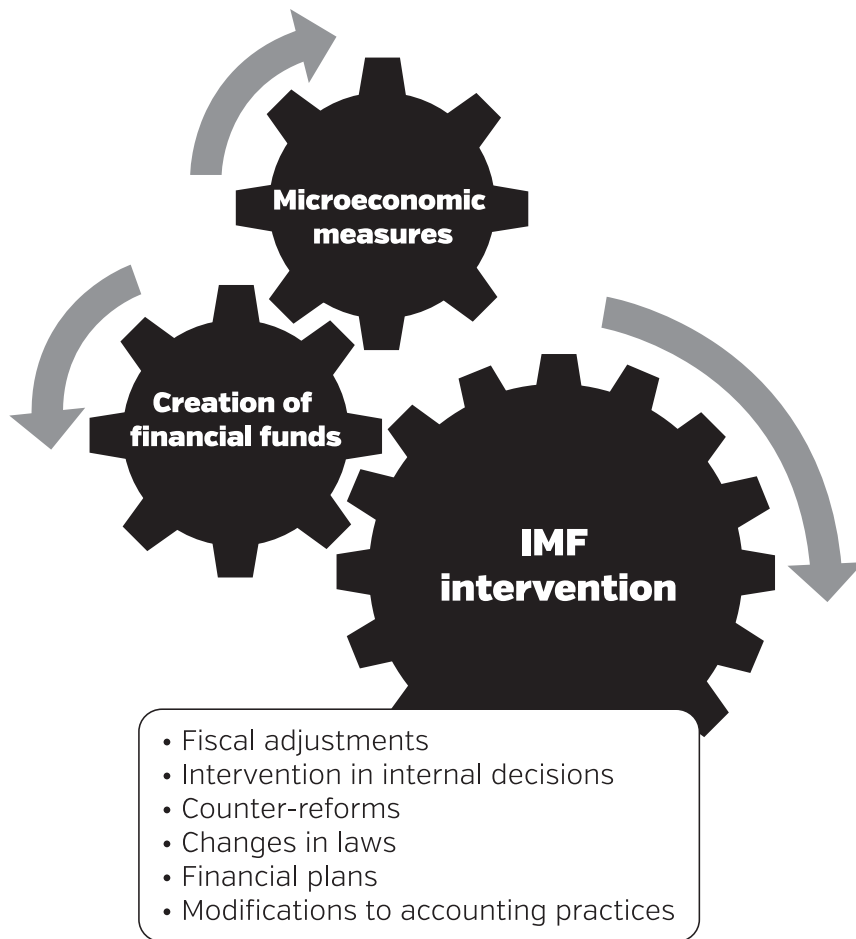
The technical tool that enables light to be shed on the Debt System and determine which public debts the population is paying for is the audit.

8 These fiscal adjustments involve a series of economic measures that affect government budgets, using public spending and taxes as control variables.

9 Deficiency noted in government budgets due to excess spending or insufficient fiscal revenue.



Related Elements of the Debt System





The upshot of the Debt System is, above all, the use of the instrument of public debt in reverse, that is, continuously withdrawing instead of providing resources. This results in *serious economic, social, gender, regional, ecological effects on nationalities and peoples*.¹⁰

This departure from the original objective has resulted in negative effects, for example, increased illiteracy, poverty, poor health, deficiencies in public health services and education. This is in addition to creating economies that are not self-sustaining, the financing of unnecessary projects, dictatorships, and systems of political domination, and the looting of countries' assets through exploiting their natural resources, handing over strategic State owned companies and sectors through privatizations,¹¹ PPP,¹² etc., representing, in short, a fraud against the people.

Considering these effects of public indebtedness, the citizen audit should comprehensively analyze **all aspects** surrounding the

10 Executive Decree no. 472/2007, of the President of the Republic of Ecuador.

11 Privatizations affect the public budget in several ways. The government loses revenue previously obtained by its State owned enterprises, and, following the sale of public assets, rents or contracts goods and services that it previously possessed. In the case of concessions, the State loses control over strategic areas of the economy, as well as revenue, generally for 25 to 50 years, as well as future stability in exchange for receiving an initial couple of million dollars. In most countries, privatizations were the result of non-transparent processes, with numerous allegations of fraud.

12 PPP - Public Private Partnerships - have helped transfer public resources to private interests, given that the conditions established in such "partnerships" impose a huge burden on the State that, in addition to paying for investments [generally through issuing public debt], still protects companies against almost all business risks.



generation of each of the public debts, to determine damages and losses, and thus question their legality and legitimacy.

The citizen audit will expose the “Debt System”.

2.4 – MECHANISMS THAT GENERATE PUBLIC DEBT

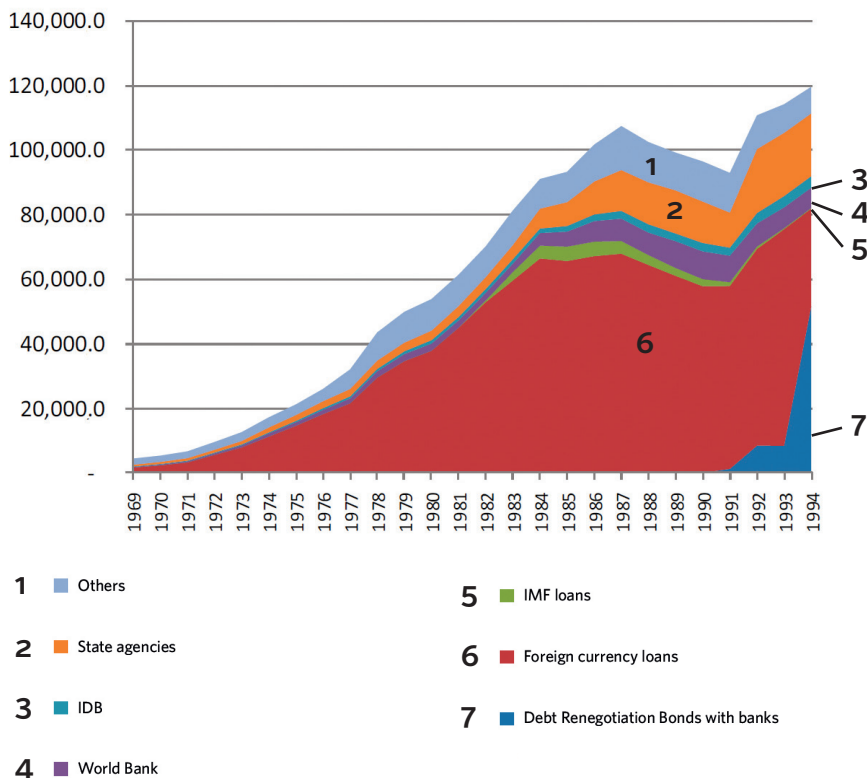
a) Excessive supply of credit and financing of mega projects

Excess international liquidity in the 1970s was channeled by international private banks to the Third World, through offering loans, mainly to finance military and dictatorial regimes and mega projects.

This was the origin of the excessive indebtedness of Latin American and African countries. Each year, the debt stock multiplied through non-transparent processes and secret operations conducted abroad. The most important component of the external debt, in terms of its origin, was with the international private banking system, with the so-called “Foreign Currency Loans”, as indicated in the following chart in the case of Brazil.



BRAZIL – EXTERNAL DEBT BY CREDITOR, 1970 TO 1994



Source: Central Bank Annual Reports available to the Parliamentary Investigation Commission on the Debt.

Part of these credits were earmarked for the construction of mega infrastructure projects, in electricity, telephony, transportation, steel, etc., in conditions that were so onerous that they subjected the region to a growing indebtedness. In the 1990s, the IMF recommended the privatization of all this public property to pay part of the debt that still continued to grow.



A similar process occurred in other continents, in countries under dictatorial regimes, such as in Egypt,¹³ Tunisia, and other nations.

The citizen audit should investigate the debt from its origins, especially because according to legal criteria, the debts contracted to finance military dictatorships should be declared odious, that is, null and void.

b) Bilateral tied loans

In general, bilateral loans are credits that are conditioned on the purchase of goods or services from the country that granted them. Some recent government actions proved the existence of illegalities and illegitimate measures and practices, such as, for example:

- Norway recognized the illegitimacy of the loans that had been granted to five countries (Ecuador, Egypt, Jamaica, Peru, and Sierra Leone), linked to the purchase of Norwegian ships. Oslo unilaterally canceled the remaining balances on these debts.¹⁴

- In Ecuador, the CAIC noted irregularities in loans granted by BNDES – the National Bank for Economic and Social

13 KABOUB, F., "Financial sovereignty", New Economic Perspectives, December 8, [2011]. Available at: <http://neweconomicperspectives.org/2011/12/financial-sovereignty.html>

14 ABILDSNES, K. ¿Por qué asumió Noruega su responsabilidad como país acreedor?– La Campaña de la Exportación Naviera. Oslo, SLUG/ForUM, March 2007. Available at: http://www.odg.cat/documents/formacio/SLUG_informe%20navieras.pdf



Development of Brazil – through the private construction firm Odebrecht.¹⁵

The citizen audit should make a detailed analysis of the projects financed with bilateral debts, particularly by development banks, related to mega projects in other countries in order to determine if such loans conform to legal criteria, if they are tied to vested interests or if their aim is to perpetuate the model whereby a country's natural resources are exploited and extracted and whose environmental damage leads to irreparable ecological destruction.

c) Sequence of public debt swaps

One of the mechanisms that the citizen audit should verify is the sequence of public debt swaps, rollovers, and renewals that generate new debts.

In general, these transactions do not involve the inflow of resources to the country, but rather the recycling of previous debts into securities that enabled the “creditors” to place them back in the financial market and obtain immediate returns. In addition to promoting an increase in obligations registered as “public” debt, even more onerous conditions, commissions, and expenses are required for each swap, such as charging for attorneys' fees.

Swaps have been used as a strategy for transforming illegitimate debt into instruments increasingly cloaked in formalities, as shown in some audits in Latin America. The simple promissory notes and shady contracts of the 1970s were transformed into debt under the

¹⁵ Final CAIC report, Ecuador – Executive Summary, 99, 100. Available at: <http://www.auditoriadeuda.org.ec/>



responsibility of the central banks in the 1980s, and then in the 1990s into Brady Bonds and they, in turn, into Global Bonds.

Swaps are an important mechanism in the Debt System, as they make it more difficult to determine the origin of such transactions. Each swap is like a high-cost bundling and, in several cases, involves prepayments of unmatured debts and moreover without any discount; on the contrary, they are overpriced.

c-1) Transformation of null or expired debt into Brady bonds

The Brady Plan represented one of the most scandalous swaps applied by international financial institutions in close to 20 countries – most of them simultaneously – in 1994.

The experiences of the official audit in Ecuador and the citizen audit in Brazil found that the Brady Plan did not represent any inflow whatsoever of resources for the countries involved, but rather the transformation of previous odious or prescribed debts, under flawed, illegal, and illegitimate conditions, into seven types of "sovereign" bonds, commonly known as Brady Bonds.¹⁶

This swap was an extremely onerous operation and did not consider the low value of the debts in the secondary market. Furthermore, it forced the recipient countries to create a monetary guarantee in the form of U.S. Treasury Bonds, which were to remain deposited with the Fed. It charged commissions, fees for legal studies,¹⁷ high

16 Brady Bonds is the popular name for such bonds. The different types of such bonds received the following names: Par Bond, Discount Bond, FLIRB, C Bond, Debt Conversion Bond, New Money Bond, EI Bond, Phase-in Bond.

17 The law firm Cleary, Gottlieb, Steen & Hamilton advised several countries in



yields, capitalization of interest in arrears and other penalties, and above all resulted in the existence of questionable practices such as anatocism¹⁸ and usury.

The operation was blatantly illegal, since it took on characteristics of a private transaction and one outside the traditional markets at that (in clearinghouses, especially in Luxembourg), given that it did not adhere to the rules¹⁹ of the U.S. Securities and Exchange Commission (SEC), the agency that is supposed to ensure the suitability of financial paper emissions.

With such negative characteristics, the Brady Bonds would have never traded freely in the financial markets.

This system of bond trading is carried out through trusts whose managers, treasurers, and agents are a small number of banks that have the option of “outright purchase” (as dealers). That is, they have the option to purchase the bonds in the first sale and then resell them, making an immediate profit in these shady and fraudulent restructurings.

the structuring of the Brady Plan, among them Mexico, Argentina, Chile, Uruguay, Ecuador, Brazil, and Bolivia (further details are available in the CAIC Executive Report at www.auditoriadeuda.org.ec). The firm recently advised Greece (http://www.cgsh.com/counsel_to_greece/) and other European countries.

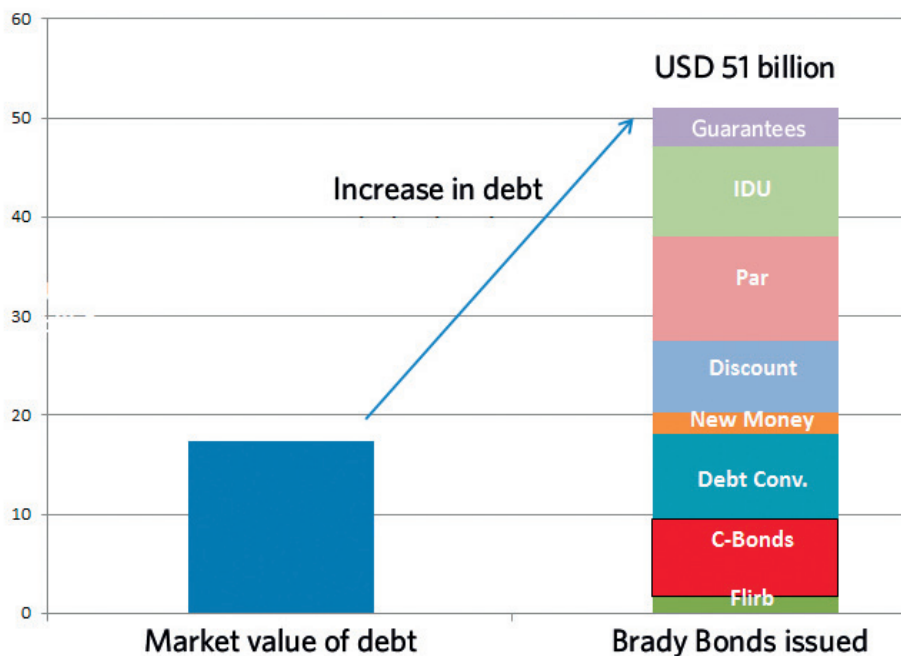
18 Anatocism: Compound interest is considered illegal, since it means the generation of new debt based on interest, and over time, the continued charging of interest on interest.

19 It was undertaken under exceptions to the U.S. Securities Act: Rule 144A and Regulations.



Despite the widespread propaganda offensive alleging that the Brady Plan has reduced the debt, the losses involved were, in fact, immense, as shown, for example, in the chart on Brazil.

BRAZIL - THE BRADY RENEGOTIATION RESULTED IN INCREASED DEBT [billions of USD]



BATISTA JR., Paulo Nogueira and RANGEL, Armênio de Souza [1994]. A renegociação da dívida externa brasileira e o Plano Brady: avaliação de alguns dos principais resultados. Programa Educativo Dívida Externa - PEDEX, *Caderno Dívida Externa*, n. 7, out. 1994, p. 15 and 18. CERQUEIRA, Ceres Aires. *Dívida externa brasileira - processo negocial 1983-1996*. Brasília: Banco Central do Brasil, 1996, p. 65, 122-124.



In Ecuador, the negotiations for the implementation of the Brady Plan began in 1992, following the waiving of time-barring external debts owed to international private banks through what is known as a Tolling Agreement under which Quito agreed to repayment²⁰.

In most of the countries, after the transformation was completed in 1994, the debt stock and the flow of payments increased and the economic situation worsened. Under these circumstances, the IMF demanded that the countries begin privatizing State owned enterprises, in order to pay part of the debt. Infamously, the Brady Bonds were used as currency for the purchase of strategic and lucrative enterprises subject to privatization.

Those who defend the interests of the financial market used to say that the Brady Plan represented the substitution of a new obligation for an old one and based on it, a new obligation emerged. It should be mentioned that the conversion of debt requires the presence of three criteria: the existence of a previous valid obligation; the creation of a new obligation with the extinction of the old obligation; and *animus novandi* (willingness to replace with something new). Novation does not apply in the absence of any of these requirements.²¹

In the case of the Brady Plan, there was no longer a valid previous transaction, since most of the external debt with international private banks had time-barred.

20 US legislation provides that debts become uncollectable after six years, but US bankers managed to persuade the Ecuadorian authorities to waive such a provision and, further, made them sign a backdated waiver.

21 For further information see: <http://www.webartigos.com/artigos/novacao-modalidade-indireta-de-quitacao-de-divida/89439/#ixzz21fYq5rvq>



c-2) *European Brady plan*²²

In Europe, the restructuring packages now in vogue are quite similar to those employed with the Brady Plan in Latin America.

In Greece, for example, in late 2011, a reduction in the amount of sovereign debt was announced. European authorities commissioned the Institute of International Finance (IIF) – a type of *ad hoc* cartel of the main creditor banks – to prepare a restructuring plan for the Greek debt.

In March 2012 this plan was put into effect and all major media repeated the official line that declared that the debt had been reduced by half.²³ According to the official estimates released at the end of October 2012, the Greek public debt – which represented 170% of the country's GDP on the eve of the March 2012 debt reduction – reached 175% of GDP in 2013 and then 174% in March 2014.²⁴ In other words, the reduction of debt with private banks was more than offset by a sharp increase in Greece's debt to the **Troika** (European Commission, European Central Bank, IMF). In addition, the conditions imposed by the Troika have sparked a 30 to 50% fall in the purchasing power of a large majority of the population. Unemployment and poverty have skyrocketed, along with the number of suicides.

Thus, the reproduction and application of the principles of Brady Plan in Europe is leading to the same disaster that occurred in the

22 By Eric Toussaint, president of CADTM.

23 The CADTM had, from the beginning, denounced the arguments advanced by the Troika and the Greek government. See <http://cadtm.org/Denunciamos-la-campana-de>. See <http://cadtm.org/Grecia-ya-ha-caido-en-el-impago-en>

24 Eurostat.



countries with emerging markets that joined the plan in Latin America, Eastern Europe, and the Philippines in the 1990s. The statements of some even neoliberal economists such as Kenneth Rogoff and Carmen Reinhart²⁵ should be emphasized in this regard. They wrote that *“in fact, in Argentina and Peru, three years after the Brady deal, the ratio of debt to GDP was higher than it had been in the year prior to the restructuring. By the year 2000, seven of the seventeen countries that had undertaken a Brady-type restructuring (Argentina, Brazil, Ecuador, Peru, the Philippines, Poland and Uruguay) had ratios of external debt to GDP that were higher than those they had experienced three years after the restructuring, and by the end of 2000, four of those countries (Argentina, Brazil, Ecuador and Peru) had debt ratios that were higher than those recorded before the deal.”*

c-3) *Unjustified swaps*

Due to their importance for the Debt System, swaps are made even though there is no justification for doing so, such as, for example, with the swap of Brady Bonds for Global Bonds in Ecuador.

The Brady Bonds should not have been swapped because, for the most part, they were prepaid bonds backed by collateral guarantees. At the same time, the false pretext of a payment default was used in 1999, which suspended the payment of interest and, at that time, the guarantees were not executed.

25 REINHART, C. and ROGOFF, K, *Cette fois c'est différent. Huit siècles de folie financière*, [Pearson, 2010] [Original edition Princeton University Press, 2009];
TOUSSAINT, É., “Un ‘plan Brady’ europeo: la austeridad permanente”, September 20, 2011. Available at: <http://cadtm.org/Un-plan-Brady-europeo-la>



CAIC investigations found that the government budgets had sufficient funds to meet their obligations.

This swap favored holders of Brady Bonds.

c -4) Swaps of external for “internal” debt and vice versa

Swaps have been used to transform one type of debt into another, usually due to more favorable conditions for the financial sector, for example:

- issuing internal debt to pay amortizations of external debt principal;
- issuing internal debt to pay external debt costs and interest.

The existence of reverse transactions has also been verified:

- Contracting loans or issuing external debt bonds to pay amortizations of the internal debt principal. It has been reported and verified that several Brazilian States are contracting loans from the World Bank to pay internal debt refinanced by the country’s federal government - a real aberration.

The citizen audit should take into account these criteria when analyzing statistics.

d) Capitalization of onerous and abusive loan conditions and costs

One of the mechanisms that most boosts public debt levels arises from the onerous and abusive conditions that make compliance with



debt obligations unsustainable. This forces new debt to be contracted solely for the purpose of paying interest and expenses, without any corresponding benefit.

New excessive costs will further and successively increase the debt burden, exponentially increasing the amount owed without new inflows of resources. For this reason, anatocism, or compound interest, is considered a negative aspect in any transaction, leading to such operations being declared illegal.

In addition, in some audits that have been undertaken, the payment of onerous fees to lawyers has been detected, attorneys who in certain cases are on both sides of the negotiating table.

e) Transformation of private into public debts

Due to the risks arising from unscrupulous activities of the financial system, transforming private into public debt has been a practice that affects almost all countries.

In Latin America, the impact of the unilateral increase in international Libor and prime interest rates²⁶ was one of the main causes of the 1982 crisis, since it brutally raised borrowing costs, affecting the public sector (State owned enterprises) and the private sector (banks and privately owned companies) that had business relations with international private banks.

26 By the Fed in the United States and the British Bankers Association, institutions that since their founding have been taken over by international private banks.



In these circumstances, from 1983 onward the IMF and the London Club²⁷ demanded that the central banks of the countries involved (Ecuador, Brazil, Argentina, etc.) sign successive “agreements” that meant the bundling of private and public debts in addition to including debt contracted in “promissory notes” of unidentified origin, which were suspected of being financial commitments to fund military dictatorships.

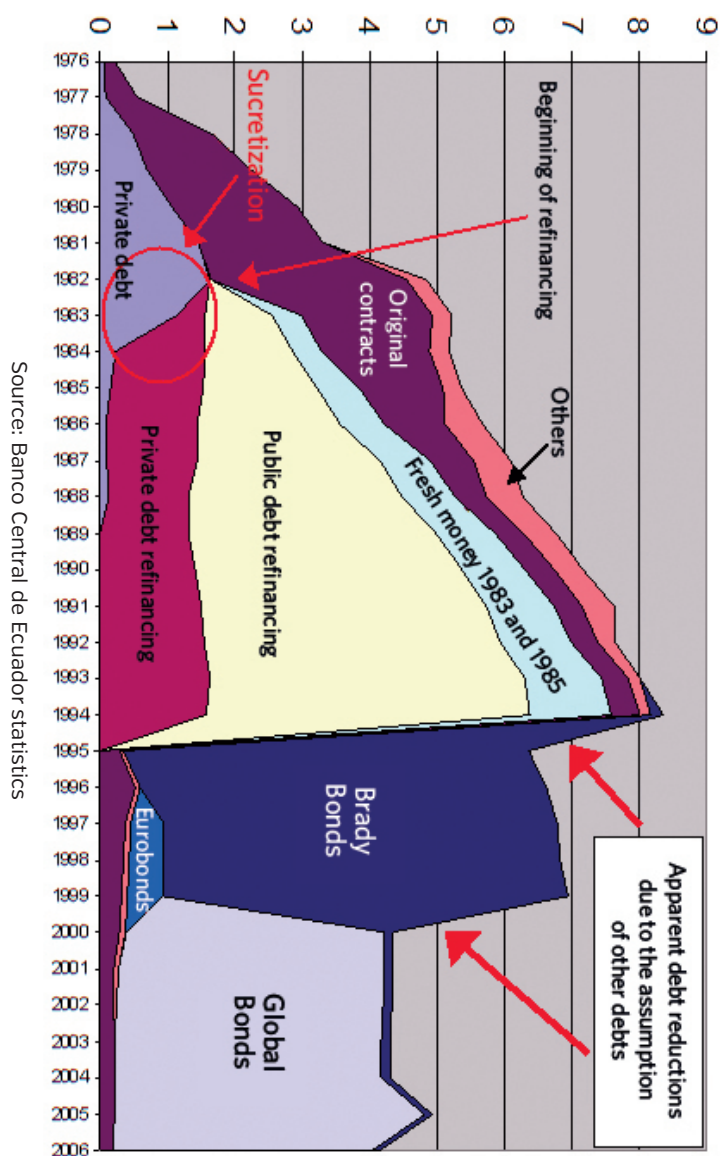
The bundling occurred in transactions conducted abroad and under the laws of New York State. Despite the extremely onerous conditions, such agreements did not translate into real inflows of resources for these countries, but rather a simple accounting modification. In other words, the new debtor (the Central Bank) did not receive the resources that were to be registered in their liabilities as “public” debt. Successive accounting maneuvers were instrumented to hide this situation.²⁸

This massive growth of the debt due to the absorption of private debt is reflected in the following chart for the case of Ecuador.

27 Dozens of international private banks were organized as a committee, known as the London Club, comprised of the major banks that represented them in negotiations with the different countries.

28 In Ecuador, for example, the London Club pressed for the adoption of a complementary mechanism that allowed bonds that only existed in crooked notary registries to be included in the assets side of the Banco Central's balance sheet.

ECUADOR - EXTERNAL DEBT WITH PRIVATE BANKS 1976 TO 2006 IN BILLIONS OF USD



Source: Banco Central de Ecuador statistics



In Europe, it has been clear that the entry of countries into the Eurozone has facilitated this mechanism for the transformation of private debt into public debt in several countries, for example:

- In Portugal, private debt posted massive growth when the euro entered into effect and then became public debt through the bank bailouts.
- In Greece, debt previously denominated in drachmas became debts in Euros, with interest rates set when the debt was in the national currency. This increased the weight of public and private debts, with the latter becoming public debt with the bailouts.

f) Speculative businesses

Due to the deregulation of the financial sector, debt securities or bonds may be sold in secondary markets, wherever they may operate, including in tax havens. The prices of these securities are linked to assessments and recommendations by rating agencies, institutions of questionable credibility, as we saw in Chapter 1.

The lower the rating of certain debt instruments, the higher will be the effective yield obtained by those who purchase them in the secondary market, as the interest to be paid on these securities is calculated on their nominal value. This makes them attractive for those speculating in sovereign bonds, but for the population this represents fraud.

In Greece, the manipulation of the risk premium by the rating agencies drove down the price of Greek bonds in the secondary market, generating immense profits for speculators, as detailed in the following chart. But this was entirely negative and abusive for



Greece, which continued to pay the interest on the nominal value of the bonds.

The table below shows what the 2011 announcement that the Greek ten-year rate was set at 14.86% translates into in practice. Let us take a concrete example of a bank that bought Greek debt in March 2010 for €500 million. Let us imagine that each bond is worth €1,000. The bank will thus receive every year a payment of €62.50 (i.e. 6.25% of €1000) for each bond of €1,000. In debt market jargon, one would say that a bond carries a €62.50 coupon. That was in 2011. Today, the ten-year bonds issued by Greece in March 2011 are considered high risk, for it is not at all sure that in 2020 Greece will be able to pay back the entirety of the capital borrowed. Thus, banks holding substantial amounts of Greek bond, such as BNP Paribas (which in July 2011 was holding €5 billion), Dexia (which was holding €3.5 billion), Commerzbank (€3 billion), Generali (€3 billion), Société Générale (€2.7 billion), Royal Bank of Scotland, Allianz and Greek banks are selling their bonds on the secondary market, for their balance sheets contain too many assets considered questionable, bad (junk bonds) or downright toxic. In an attempt to reassure shareholders (lest they dump their shares on the market), their clients who have deposited their savings with these banks (lest they withdraw those savings) and the European authorities, the banks have to divest themselves of a maximum of Greek bonds whereas they were buying them up voraciously in March 2010. At what price would the banks find buyers? It is here that the 14.86% rate plays a role. Speculative and vulture funds, which are ready to buy up Greek bonds issued in March 2010, want a return of 14.86%. If they are buying bonds that are bringing in €62.50, this amount must correspond to 14.86% of the purchase price or €420.50. In short, they will be ready to buy Greek bonds if the bond-holders are willing to settle for this price.



	Face value of the ten-year bond issued by Greece 11 March 2010	Market price	Interest rate	Interest	Effective yield
Example	€ 1,000.00	6.25%	€ 62.50	€ 20.50	14.86%

To summarize: the buyer will accept to pay €420,50 € for a €1,000 bond only if he can get a real interest rate of 14.86%. At this price, the bankers mentioned above are unlikely to be inclined to sell.

g) Bank bailouts

Among the most important of the mechanisms that have greatly boosted the public debt are transactions based on bank system bailouts or rescue packages.

This has been the case for decades in Latin America and Asia and recently in the United States and Europe, due to the growing power of the financial sector worldwide. For example:

- In the **United States**, since the beginning of the current financial crisis, in addition to the impressive decision of the Fed to provide USD 16 trillion²⁹ to banks and private corporations, the bank bailout was present in the partial nationalization of the largest banks at risk of going under, such as Citigroup and Bank of America. In addition, authorities authorized the creation of bad banks, institutions designed to absorb toxic assets in order to relieve the banks that were overburdened with unbacked derivatives.

29 USD 16.000.000.000.000,00, mentioned in Chapter 1.



– In **Brazil** during the Fernando Henrique Cardoso presidential administration, a scandalous bank bailout program was created in November 1995 and applied at the federal level. It was known as the *Stimulus Program to Restructure and Strengthen the National Financial System* (PROER). On a provincial (State) level, the Program for Reducing the Presence of the Provincial Public Sector in Banking Activity (PROES) was adopted, which meant the privatization of this sector.

The result was an enormous direct transfer of financial resources to the banks and the generation of debt for the national and regional public sector.

The estimated cost of PROER was USD 40 billion,³⁰ and the PROES price tag was USD 69 billion.³¹

The next step in the bailout was the privatization of State banks, and the transferring of their liabilities to the public debt of the respective States.

Strategic regional banks were handed over to the private national and international financial sector, as explained by Professor Ary Minella:

“In Brazil, two large national private banks and two foreign banks were the big winners with the privatization of

30 43.3 billion reales (R\$), converted into dollars at the prevailing exchange rate at the time of the transactions in 1999.

31 61.9 billion reales (R\$), converted into dollars at the prevailing exchange rate in 1998.



several banks. The winners were Bradesco (five banks),³² Itaú (four),³³ and foreign financial institutions ABN Amro (two)³⁴ and especially Spain's Santander.³⁵ In turn, in 2007, ABN Amro in Brazil came under the control of Santander after a consortium comprised of the Royal Bank of Scotland, Santander, and Fortis (Belgian-Dutch) purchased the Dutch bank."³⁶

Despite several charges involving fraud allegations, these processes were not properly investigated, even though they generated large amounts of public debt that to date have negatively affected the finances of the State governments.

– In **Europe**, several cases of bank bailouts occurred in different countries and are directly related to the growth of public debt in the region.

32 Banco do Estado da Bahia [Baneb] in 1999, Credireal de Minas Gerais, in 1997, and federalized State banks, such as Banco do Estado da Amazônia [BEA], in 2002, Banco do Estado do Maranhão [BEM] in 2004, and Banco do Estado do Ceará [BEC] in 2005.

33 Banco do Estado do Rio de Janeiro [Banerj] in 1997, Banco do Estado de Minas Gerais [Bemge] in 1998, Banco do Estado do Paraná [Banestado] in 2000, and, in the following year, Banco do Estado de Goiás [BEG], a financial institution that was federalized in 1999.

34 Acquired Banco do Estado de Pernambuco [Bandepe] in 1998 and Banco do Estado da Paraíba in 2001.

35 In 2000, it acquired Banespa, the largest of the privatized banks, which was under the control of the federal government. As of 1997, Banco Estatal Federal Meridional, which has previously been acquired by Banco Bozano-Simonsen, should be included as part of Santander.

36 MINELLA, C. A., "Maiores bancos privados no Brasil: um perfil econômico e sociopolítico", *Sociologias* [online]. 18 [2007]: 113-114. Available at: http://www.scielo.br/scielo.php?script=sci_arttext&pid=S1517-45222007000200006&lng=pt&nrm=iso



Some examples indicate that efforts at a citizen audit are already underway in several countries, especially in Ireland. A preliminary audit found that the State had given its backing, guaranteeing private bank assets, generating indirect debt, and affecting the sovereign debt risk rating. This, in turn, triggered an increase in interest rates, paving the way for more onerous obligations for the country.

Furthermore, the five largest banks – AIB, Bank of Ireland, Anglo Irish Bank, EBS, and Irish Nationwide – were totally or partially nationalized.

The public debt has also increased given the successive recapitalizations of banks,³⁷ used to inject resources into the banking system.

To put the banking system on a healthy footing, the *National Assets Management Agency* (NAMA) was created, which is, in reality, a *bad State bank*, whose assets are also guaranteed by the State, despite the possible participation of the private sector.

- **Greece** has been subjected to rigorous fiscal adjustment plans imposed by the Troika in return for successive assistance to capitalize the banks. This has boosted the public debt, despite the increased suffering of the population due to cuts in social spending and a massive drop in job numbers.

- In 2008 the **United Kingdom** adopted the Banking Special Provisions Act, which cleared the way for the nationalization of Northern Rock, one of the country's largest private banks. In 2010, the bank was divided into a *good bank* and a *bad bank*, in order for the latter to receive the toxic assets

37 <http://www.guardian.co.uk/business/2010/sep/30/ireland-banking-bailout-timeline>



that sparked the crisis. The “good” part of the bank was sold to Virgin Group at the end of 2011, while the “toxic” part remained under State control. The nationalization of RBS has been even more costly for the British Treasury.

- In 2009, **Germany** passed a law that permitted the nationalization of banks facing financial difficulties. The country that thought it was immune to the crisis had to rescue the Hypo Real Estate bank, after providing it with 102 billion Euros in assistance.

- In **Belgium**, in addition to the nationalization of the Fortis bank in 2008, the Dexia Bank followed suit in 2011. According to the Belgian government estimates, Dexia had close to 350 billion Euros in toxic assets.

- In **Spain**, 48.3 % of Bankia was nationalized in May 2012, amid rumors that it was on the verge of bankruptcy. The government contributed 22 billion Euros to the rescue package. The 15MpaRato citizen platform has taken Rodrigo Rato, CEO of Bankia between 2010 and 2012, to court, charging him with disloyal management, false accounting, fraud, and misappropriation of funds.

The “socialization of bank losses” has affected many countries, triggering high social and economic costs.

h) Mandatory debt through private banks

In the Eurozone, the State’s obligation to be funded only via private banks and other financial institutions greatly increases the cost of the debt, resulting in its growth.



i) Deceptive debt relief proposals that in reality generate greater indebtedness

Attempts to provide a solution to the debt crisis for poor countries are presented under the guise of debt relief proposals, such as the HIPC and MDRI initiatives,³⁸ which in most cases did not have the expected result. Furthermore, the trend in these countries has been to contract additional debt after the initial "relief" measures.

j) Unfair tax model

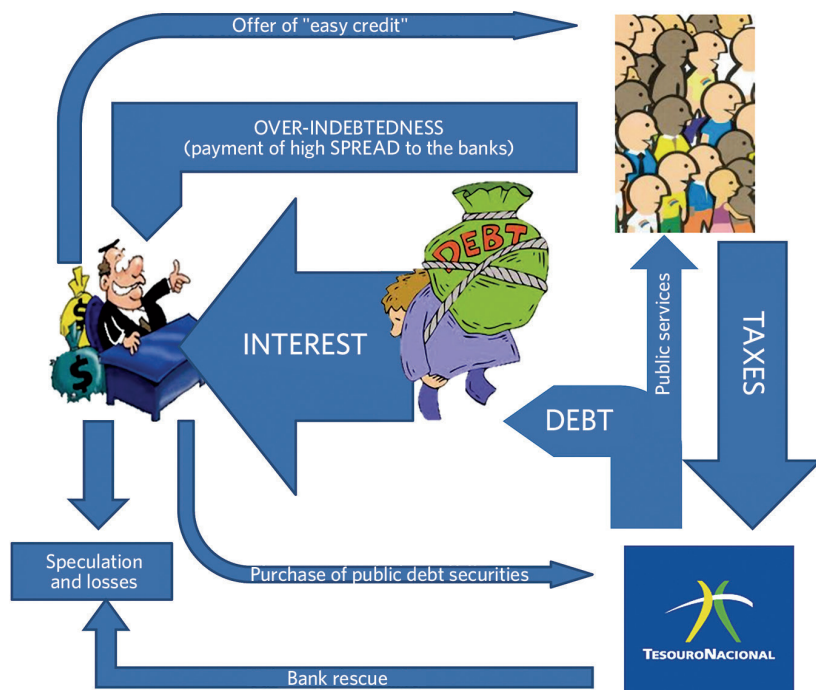
The most important source of resources for government budgets corresponds to the taxes paid by citizens, which theoretically should be applied to satisfy collective social needs.

The tax models are increasingly unfair and regressive.³⁹ This can be attributed not only to the continuous legal changes which increase taxes that affect consumption and workers' income, but also due to the exemptions and concessions that alleviate the tax burden of those with the highest incomes. In addition, facilities are in place that enable the economically and politically powerful to earmark their profits to subsidiary companies in tax havens where no taxes are paid.

The diagram below shows how flows of resources corresponding to taxes paid by the population do not fully return in the form of public services, but are primarily used to pay interest to the banks, which are the most significant holders of sovereign bonds worldwide

38 MDRI – *Multilateral Debt Relief Initiative*.

39 Regressive taxation means that the poorest strata of the population proportionally pay more taxes than the rich; that is, it is the opposite of progressive taxation.



and the most important beneficiary of the Debt System. While a small part of bank resources are earmarked for society in the form of credits, a much larger amount returns to the banks through the payment of high costs for these loans – spread and interest. The bank allocates resources to purchase new bonds, providing renewed life-blood to the system, and applies most of such funds to speculative activities. When the going gets rough for them, bank bailouts are not far behind.

The tax model has direct influence on the public debt. The tax breaks granted to the wealthy reduce the financial capacity of the government, whose current spending increases due to the unbridled growth of public debt, since it has financed its budget deficits by borrowing or issuing public debt.

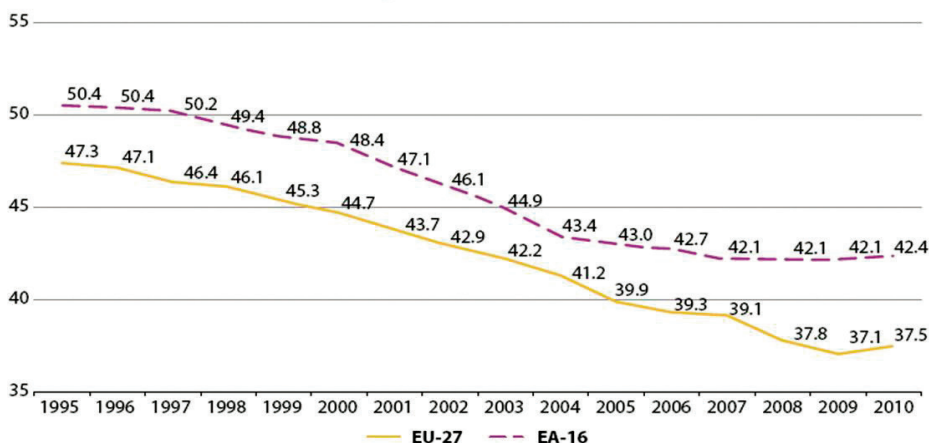


That has been the scenario in Latin America since the 1970s. The panorama deteriorated even further with the IMF impositions since 1983 and continues to worsen today.

In Europe the past few decades have seen a significant reduction in taxes on capital gains and large incomes. This has compromised public budgets and has affected the need for financing through contracting new debt, as illustrated in the following charts.

EVOLUTION OF TAXES⁴⁰ ON THE WEALTHY

Graph 4: Development of top personal income tax rate
1995-2010, in % (arithmetic averages)



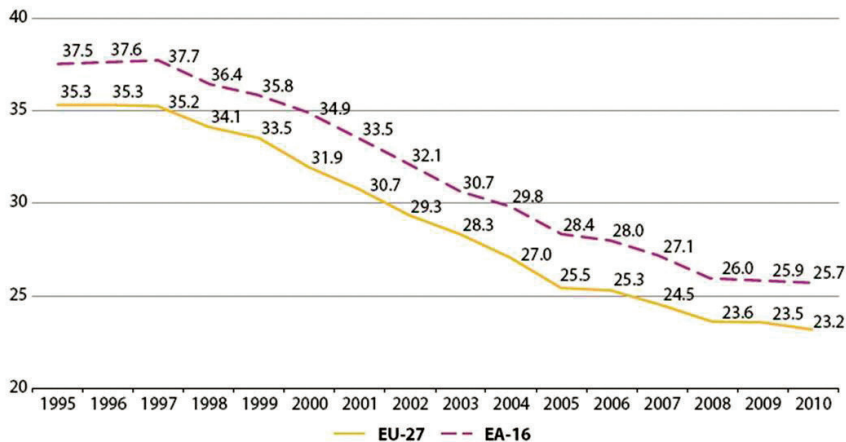
Source: EUROPEAN COMMISSION -TAXATION AND CUSTOMS UNION [2010]. *Taxation trends in the European Union. Main results*. Luxembourg: Publications Office of the European Union, p. 9. Available at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-EU-10-001/EN/KS-EU-10-001-EN.PDF

40 The effective rate has been lower than the rates indicated in the charts, which correspond to the legal rates.



EVOLUTION OF TAXES ON THE WEALTHIEST CORPORATIONS

Graph 5: Development of adjusted top statutory tax rate on corporate income
1995-2010, in % (arithmetic averages)



Source: EUROPEAN COMMISSION - TAXATION AND CUSTOMS UNION [2010]. Taxation trends in the European Union. Main results. Luxembourg: Publications Office of the European Union, p. 10. Available at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-EU-10-001/EN/KS-EU-10-001-EN.PDF

Due to the above mentioned considerations, the citizen audit must start from a diagnosis in which the real reasons why the country in question has become mired in debt are established, especially if it can be attributed to this fiscal panorama, in order to determine the influence of the tax model on the generation of public debt.

The population must have knowledge of the mechanisms that generate public debts as well as their effects and consequences.



2.5 – RELATED QUESTIONS CONCERNING THE DEBT SYSTEM

a) Measures imposed by international financial institutions

International financial institutions, mainly the IMF and the World Bank, have played a leading role in exacerbating the illegitimate public debt, exerting immense influence on the countries involved, as pointed out in Chapter 1.

Instead of putting public finances on a healthy footing, the measures imposed by these organizations and institutions worsen the economic situation, because they are aimed at withdrawing resources that were previously earmarked for social spending and investments in order to apply them to debt payment.

These measures have inflicted economic, financial, social, and environmental damage and losses since the 1980s in Latin America, Africa and Asia and, in recent years, in Europe as well. Such measures include:

- Fiscal adjustments that primarily are focused on reducing social spending in order for such resources to be channeled to bondholders;
 - Intervention in economic and administrative decisions;
 - Counter-reforms – labor, tax, fiscal and economic – and privatizations, whose effect is to diminish the funding sources of government budgets, creating deficits that are covered by the generation of new public debts;
 - Modifying specific laws such as the “Fiscal Responsibility Law”, which guarantees a priority being placed on interest payments on the debt, before any other social spending;
 - Imposition of financial plans that establish types of



restructurings, prepayments and especially the formation of trusts, by the same creditor institutions for their own benefit;

- Supposed measures prior to contracting debt, aimed at ensuring the sustainability of the external debt, but whose usefulness is questioned due to their criteria, parameters, and focus;
- Modifications in accounting standards. Through its manuals, the IMF imposes specific accounting standards that allow for mechanisms that increase the priority placed on debt payments and do not show the real situation of its flows and stocks.

Different studies have denounced the behavior of the international financial institutions.⁴¹

The citizen audit should make a detailed analysis of the documents that formalize commitments to international financial institutions, since they contain information on the impositions that compromise the countries' present and future economies.

b) Creation of Financial Funds

One of the bolts and gears in the Debt System is the creation of financial funds aimed at accumulating resources to resolve problems of the financial sector or for payment of debts.

41 TOUSSAINT, E. and MILLET, D., *60 preguntas/60 Respuestas sobre la deuda, el FMI y el Banco Mundial*, [Barcelona: Icaria-Intermon, 2009]; TOUSSAINT, E., *Banco Mundial: el golpe de estado permanente*, op. cit.



In several countries, different such funds were created, such as the Sovereign Fund, Financial and Monetary Stabilization Fund, Oil Fund, etc.

FROB:⁴²

In June 2009, the Spanish government created the Fund for Orderly Bank Restructuring (FROB), for which large sums of public resources were earmarked. Such funds were registered as public debt, but were delivered to the banking sector.

Its function is to inject public capital into banks with solvency problems, that is, it is the institution responsible for rescuing banks. Through December 2012, this institution had injected several million Euros into the banks and it has agreed to contribute an additional 1.90 million Euros. Furthermore, the FROB has contributed 1,700 million Euros to bad bank capital (Company for the Management of Assets Proceeding from the Restructuring of the Banking System, SAREB) and is expected to provide an additional 350 million Euros. The FROB, meanwhile, is financed by State backed bond issues.

Governments invest to save banks that are insolvent and facing bankruptcy without considering that the resources belong to the people, who continually must deal with the economic, social, and moral damages and losses that the banks never take responsibility for repairing.

42 By Sergi Cutillas and Itziar Gimenez, from the Citizen Debt Audit Platform, Spain



c) Macroeconomic Measures to Control Inflation

Certain macroeconomic measures announced as being important for controlling inflation have been employed, in reality, in order to conceal the transfer of public resources to the private financial sector, in the process generating “internal” public debt. For example:

- **Controlling the volume of currency in circulation**, through exchanging money for debt securities, has resulted in an increase in issuances of internal debt for such purposes. A number of inconsistencies in this policy have been verified, attributable to the absence of capital controls, which allow, for example, the inflow of any amount of currency that does not represent excess economic activity in the country. In this case, the applicable measure should be controlling currency inflows and not allowing such flows to go unchecked in order to subsequently issue debt to absorb the excess money. In Brazil, this was the cause of the explosion in domestic debt, since the issuance of large amounts of internal debt securities to control the excess currency paved the way for onerous obligations that accrue interest and costs that affect the entire State budget. In addition, the rigidity of controls on excess currency collides with the disproportionate supply of credit by the private banks to society.

- **Rising interest rates to curb consumption** has been questioned in different countries in which inflation was not caused by excessive consumption but rather, for example, by increasing the rates and prices charged for privatized public services. Thus, the increase in interest rates only serves to favor bondholders.



These operations are examples of the use of macroeconomic measures that have served to increase public indebtedness that – in most cases – can be attributed to the dictates of international financial institutions. Therefore, it is very important to promote the citizen audit of the respective central banks of each country.

2.6 - DEBT OF PUBLIC REGIONAL AND LOCAL GOVERNMENT DIVISIONS

The Debt System also plays out in the indebtedness of regional and local government divisions.

Different mechanisms generate these local debts:

- Loans for unnecessary or lavish mega projects, while there is a lack of resources for projects corresponding to a local public interest, such as hospitals, schools, etc.;
- The absorption of liabilities of public regional or local banks that are then subject to privatization;
- Signing on to toxic loans;
- Onerous conditions that require continually taking on more onerous debts for the payment of previous debts;
- Bonds or security issues by local governments;
- Taking out direct loans with international organizations;
- Illicit businesses and political privileges.

The ways in which the Debt System operates are different in each locality, and therefore it is important to organize local and regional citizen debt audit units in order to mobilize society over issues of concern to the population.



The following are some examples:

a) Refinancing of the Public Debt of the Brazilian Provinces⁴³

Brazil is organized as a federation comprised of 27 provinces (States) and 5,000 municipalities. Since 1997, the public debt of the provinces and different municipalities was subjected to refinancing based on the Letter of Intent sent by the federal government to the IMF.

In addition to the extremely onerous conditions imposed by the national government on this “refinancing”,⁴⁴ the latter was included in a package that demanded that the provinces apply a rigorous fiscal adjustment plan, privatization of public sector companies (energy, steel, mining companies, etc., including regional public banks), with the outrageous absorption of the liabilities of the State banks so that they could be privatized.

This package inflicted incalculable damage on the finances of the provincial governments, preventing the distribution of resources to meet social needs. This has occurred since the package was first adopted to the present day.

Absurdly, after years of compliance with the conditions established in the agreements signed with the federal government, the debts multiplied by 300% and several provinces and municipalities are taking on new loans with the World Bank for the payment of their debts to the federal government. Thus, it has been possible to

43 FATTORELLI, M. L., Auditoria Cidadã da Dívida dos Estados, [Brasília: Inove Gráfica e Editora, 2013].

44 BRAZIL, with Federal Law nº 9.496, September 11, 1997.



verify a strategy of transforming illegitimate internal debt into foreign debt with the World Bank, bundling illegalities and illegitimate practices.

b) Toxic loans granted to local public actors in France⁴⁵

In France, the banks, particularly Dexia, encouraged local governments, hospitals, and social housing agencies to sign on to so-called “toxic” loans.

The toxicity corresponds to the indexing of this type of loan to speculative indexes (for example, the evolution of the currency exchange rate).

At the end of 2011, the report⁴⁶ of the parliamentary commission of inquiry estimated the total amount involved in the structured credits signed onto by local public actors at 31 billion Euros, of which 18 billion Euros corresponded to risk or subprime loans.

This same commission estimated the additional cost at 730 million Euros per year, to which a further 252 million Euros must be added corresponding to default swaps.

This additional annual cost – of close to one billion Euros for local public actors – corresponds to a 13.5% increase in their financial expenditures and translates into the annual gross salary (including company social security and health system fee payments) paid by 40,000 jobs.

45 By Patrick Saurin, of the Sud BPCE trade union, France.

46 National Assembly, Report no. 4030, Investigating commission on financial risk products subscribed by local public entities, December 2011, 36-38.



This example clearly shows how the Debt System promotes financialization, as discussed in Chapter 1.

The citizen audit should verify the reproduction of the Debt System in regional and local units.

CONCLUSION

It has been shown that the public debt was not generated by the real inflow of resources, which should have been used for satisfying social needs, but rather has emerged as a result of the application of a number of mechanisms, flawed conditions, and measures imposed by international financial institutions that led to its continuous growth and perpetuation.

Identifying the mechanisms that have generated public debt will enable the citizen audit to document flaws, fraud, and illegalities that will be the basis for and argument in favor of the different actions related to the questioning of such debts.

The aim is to prevent nations and peoples from continuing to be subject to the Debt System, which has served to enrich a few, resulting in immeasurable social harm.

Exposing the Debt System to the light of day is a task for the public that bears the brunt of ongoing interest payments on a debt that does not stop growing.





Chapter 3.

Citizen Public Debt Audit



INTRODUCTION

In general, the **audit** is a technical tool applied to examine registries, financial statements, and operating cycles in order to determine their reasonableness and the appropriate presentation of figures, as well as to ensure the efficiency, effectiveness, and economy of their structures.

The monetary significance of public debt and its impact on government budgets justifies and demands the constant application of **audits** aimed at investigating the entire debt process to determine which liabilities the population is paying, if they present irregularities and/or fraud, and if they are legal and legitimate.

Considering that it is the population that, after all, is paying the public debt –due to the high tax burden, the inadequacy of public services to which they are entitled but do not receive, given that the budgetary resources are absorbed to pay debt obligations – the participation of citizens in the debt audit process is essential.

For this reason, the initiative to organize a **Citizens' Public Debt Audit** is of key importance in order to disclose the mechanisms that produce public debt. This is not only with the aim of democratizing knowledge and mobilizing society in the quest for transparency in relation to the debt process in each country, region or locality, but also to strengthen social participation in struggles for an economic model that is more equitable and respectful of human rights and the environment.

In this chapter, we will present the basic guidelines of the audit as a tool, and some points that should be considered by those who might have the opportunity to use it.



The citizen audit should verify the use of debt as a mechanism that enables the continuous transfer of public resources to the global financial sector.

3.1 – FUNCTION AND OBJECTIVES OF THE AUDIT

Worldwide, the audit plays an important social role, since with financial growth, investors, members of the boards of directors, regulatory agencies, etc. want to know the real situation of the balance sheet figures of a specific company and its operating systems, which are factors that will facilitate their analysis, control and decision making. Thus, the audits can take on the character of financial and/or operational audits.

For such purposes, private sector entities routinely hire private audit firms. The public sector has corresponding governmental agencies such as the Comptroller General, the Prosecutor's Office, the Court of Auditors, depending on the country.

In terms of the public debt, the audit is an indispensable tool for a transparent review of the figures being presented, the mechanisms and operations that generate such debts from their origin, who benefited from the corresponding resources, how they were applied, if they complied with the existing legal and administrative regulations, their social, environmental impact, etc.

While it is true that in most countries there are government regulatory and control agencies, prior to and following the transactions that give rise to public debt, it is obvious that the existence of an effective debt audit is a rare occurrence. In some cases, superficial



examinations are conducted, which are limited to a narrative of certain isolated points, simply noting some facts and developments in their reports.

The public debt audit should be a mandatory routine practice and performed comprehensively – based on an official instruction from the executive, judicial, or legislative branch or through a parliamentary bill or motion – with transparency and citizen participation.

This ideal practice is still far from being a current and historical reality, given that the right to access public documents and information concerning the debt is not respected. In most of the cases, transactions that result in public debt have been handled in secrecy and confidentiality by the financial authorities – the Central Bank and the Finance Ministry – together with delegated representatives from governments, banks, and international financial institutions. In general, parliament is simply informed superficially, when the decision is already a *fait accompli*. Society is not consulted, even though it is society that is paying the debt and suffering the consequences.

Given this panorama, people need to exercise their citizenship rights and participate in this process, organized by the **Citizens' Debt Audit**.

The citizen audit bases its work on access to data, public documents, and legal precepts, in addition to the information concerning the debt process from its beginning. Based on studies, verifications, and research, the citizen audit develops educational publications and participates in social mobilizations and related activities with the aim of disseminating and sharing the knowledge obtained so that the entire population can understand the Debt System that they are subjected to.



Consequently, a function of the citizen audit is to empower society with knowledge of the financial reality, identifying the role of debt in the domestic and international economy, the mechanisms that generate it and its benefits. The goal is to empower and train society so that it can conduct audits of the Debt System, and thus enable the identification of the debts generated illicitly and irregularly, in order for such liabilities to be repudiated in sovereign acts, as demonstrated by the experience of Ecuador.

The people, who are called upon to pay the public debts, have the right to know if it is their responsibility to do so.

3.2 - WHY CONDUCT A DEBT AUDIT?

The public debt audit will make it possible to respond to many doubts and questions that have been kept secret and that society needs to know, for example:

- 1 What is the origin of the public debt? Did the country receive the entire amount of the funds negotiated? Where was the money spent? Who are the beneficiaries of these loans? For what purpose?
- 2 What mechanisms and processes generated public debts?
- 3 Which private debts were transformed into public debt? What is the impact of these private debts in the State budget?



- 4 How much debt has been issued for the bank bailout?
- 5 What is the responsibility of the central banks in the debt process?
- 6 What is the responsibility of the risk rating agencies in devaluing sovereign debt, spurring an increase in its costs and enabling extreme speculation?
- 7 What is the responsibility of government authorities in allowing financial transactions with tax havens, which enable speculators to deposit the huge profits earned on transactions with debt instruments, in addition to spurring vulture operations that are based there?
- 8 What is the responsibility of government authorities regarding the acquisition of debt for unnecessary projects (such as sports stadiums) or white elephants, which are not utilized and do not benefit anyone?
- 9 What is the responsibility of the IMF and other financial institutions in coercing some governments to implement fiscal adjustment and counter-reform plans that undermine the interests of their peoples and benefit the financial sector?
- 10 What is the responsibility of the banks in:
 - offering excessive loans in the markets?
 - speculating on sovereign bonds, creating fiscal crises, and forcing IMF intervention?
 - playing with derivatives, credit default swaps, and other toxic assets?



11 What are the social, economic, gender, regional, ecological effects of the debt process and its impact on peoples?

12 How does the Debt System function in the different countries?

In many cases, there are limitations to conducting comprehensive debt audits, because this involves access to institutional archives that for decades have been considered confidential.

Therefore, citizen audit initiatives are important, not only for performing tasks that are of specific interest to the social movements, but also to promote legal changes that could facilitate the effective application of a comprehensive audit.

The experiences of the comprehensive audit conducted in Ecuador and the Citizen Audit in Brazil, as well as the methodology for their application, will be presented in detail in the next few chapters. Below is a brief presentation of our tool.

The Citizens' Public Debt Audit will be based on a detailed analysis of each of the operations that generate such liabilities, from their beginning.

3.3 - HOW TO CONDUCT AN AUDIT?

The first step in conducting the audit is the preliminary preparation, which begins with the organization of a team of individuals committed to this process and the obtaining of information.



For these tasks, it is important to create organizational structures or entities¹ specifically aimed at developing the Citizen Public Debt Audit. In the case of the Citizen Debt Audit in Brazil, a non-profit civil association was formally established.²

Their goal is to stimulate social participation in researching the debt process, and empowering society with knowledge of this financial reality, which has become economic slavery in all regions of the world.

These entities must be established with volunteers, students, retirees, workers in general, and contributing members belonging to other institutions of civil society – trade unions, associations, organizations, committees, etc. – that are involved in social struggles based on the concepts of equity and fairness in managing public resources. It is important to respect the criterion of the independence of the individuals who will participate in conducting the citizen debt audit. Therefore, it is recommended that the organization be independent without conflict of interests, especially in relation to the government being audited and the financial sector.

The audit tool should be used by society to identify how public debts were generated, and to thus provide the argumentation for their cancellation or repudiation based on proof of illegalities, fraud, and other transgressions.

The audit will be conducted through examining public debt instruments, such as contracts, legal authorizations, figures, accounting

1 The ideal variant would be to formalize a legally constituted entity that moreover has a legal representative, responsible for coordinating its technical and administrative functioning.

2 Auditoria Cidadã da Dívida, <http://www.auditoriacidada.org.br>



records, statistics, payment flows, application of resources, etc. – in addition to an analysis of the related macroeconomic information and the effects caused by the accumulation of debt.

The examination can be **comprehensive** or **specific**. It is **comprehensive** when the entire public debt of a country or region is focused on and all the related questions are considered from the very beginning, in order to determine the results and their effects. The **specific** examination focuses on relevant concrete situations.

The audit will be conducted in phases, which should encompass the process from the very beginning, based on methods that pinpoint the processes or operating cycles that generated the public debt, through the application of audit programs (as will be explained in Chapter 5).

The work involves the application of different **techniques**, such as inquiry, review, confirmation, research, testing, etc., and performing **substantive tests in terms of the audit itself** (verification of figures) and **compliance** (verification of standards).

One of the tasks that the citizen audit must prioritize is investigating the existence of real benefits in the generation of public debt.

In establishing the **scope** of the examination, it is recommended that the investigation start from the beginning of the debt cycle, given that, based on the experiences of debt audits already conducted, it was found that the clarification of the origin of the liabilities is essential for understanding and monitoring the entire process.

In considering the origin of the public debt cycle, there are different examples:



- In the case of Latin America and Asia, the current cycle began in the 1970s, and the debt itself continues to undergo a transformation through successive swaps that do not involve any inflow of resources;
- In Africa, the current cycle began with the IMF's entry into the region in the 1980s;
- In Europe, the origin of the current cycle would be the countries' entry into the Eurozone, which worsened with the financial deregulation and bank bailouts.

It is advisable to audit all the debt swaps that have been made, as it has been shown that they functioned as packaging that aggravates the debt panorama.

Obtaining findings are one of the central aspects of an audit, since they offer the documentary and oral evidence that will underpin and back its results.

For this reason, the findings should be sufficient and competent to serve as evidence of what we are seeking to demonstrate. For example:

- To reveal and document the **mechanisms that generate the public debt**, its operating cycles and those responsible, from the very beginning until such liabilities are paid and/or refinanced.
- To indicate the **reasons for the disparate growth of the debt**, which could have resulted from:
 - Refinancing in onerous conditions; recapitalization of interest, fees, and other costs; unnecessary pre-payments; establishment of collateral guarantees that are financed through other loans; debts arising due to bank rescue policies;



- The issuing of new debt, especially to pay interest on previous, largely unknown debts.
- To indicate the **weight of the debt for society**, demonstrating the relevance of debt-related expenditures in the public budgets, compared to budget spending on health, housing, education, etc.
- To show that the mechanisms of the **bank bailout** generate public debt.
- To uncover **speculation with sovereign bonds**, for the benefit of private sectors in secondary markets, including tax havens.
- To highlight the **use of debt during debt restructuring operations**, such as those that include privatization of state enterprises and public services. In some cases, the creditors convert government securities into shares of the businesses that they want to take control of.
- To expose the **juridical instrumentalization of the State** through legal regulations created to guarantee a priority on payment of the public debt.
- To demonstrate the **political instrumentalization of the State**, determining the relationship between privileges of the leading sectors in the Debt System and their important presence in the financing of election campaigns and/or support for dictatorial regimes.
- To pinpoint the **social, economic, ecological, and gender effects** engendered by the continuous and negative accrue-ment of public debt;
- To expose the **Debt System** and reveal its *modus operandi*, which has had a similar logic in Latin America, Asia, Africa and Europe;
- To clarify the objectives, effectiveness, and logic behind the **bilateral debts**, especially those relating to megaprojects;
- To demonstrate the handiwork of the **IMF**, which has exercised its intervention with the establishment of conditions



that serve to defend the interests of the private financial sector, while at the same time representing the loss of sovereignty of the countries involved and social sacrifices.

- To reveal the role of the *Troika* in the Eurozone and the **World Bank** in developing countries.

The findings may come from additional reports from specialized advisors or consultants or experts in specific fields such as the environment, human rights, and others necessary to determine the effects of debt accrument.

Considering that the comprehensive public debt audit represents an effective technical tool for exposing realities that the population of many countries is unaware of, the auditors should place a priority on attending to the details and diligence of their work, especially in the description of the findings and the presentation of the report. It is important to ensure the participation of some professional auditors in the citizen debt audit to assist in the verification of the necessary formalities, as well as in conducting the respective tests.

The **final audit report** should contain a description of the techniques and tests applied as well as a detailed account of the findings. The tests are very important, as they represent the essence of an audit, that is, the points that distinguish a common investigation from an audit. Therefore they must be included in the report, thoroughly, orderly and precisely, since in addition to representing the supporting documentation underpinning the findings of the audit, they can be the basis for subsequent legal and court proceedings.

Irresponsibility in the measures that led to the illegal or illegitimate indebtedness of a country, with dire consequences for society, should not go unpunished.



3.4 - ADDITIONAL FOCUSES

There are certain related phenomenon that should be simultaneously analyzed by the citizen audit, since they lead to or promote the growth of public debt.

These issues should not only be included in the reports, but also denounced and reported to the corresponding authorities so that they can charge those responsible for damages and losses and/or order the immediate suspension of the debt payments. For example:

a) **Measures imposed by international financial institutions:** Identifying such measures is crucial in accordance with what is explained in Chapter 5.

b) **Tax benefits:** The investigation of tax-rated legal measures can reveal their direct influence on the accrue-ment of public debt, as has already been mentioned in Chapter 2. The citizen audit should verify and disclose the tax privileges enjoyed by the banks and investors speculating with sovereign debt instruments.

c) **Priority on the payment of public debts:** An investigation should be made into the approval of legal measures, such as the Fiscal Responsibility Law in several countries, that establish ceilings on social investments, while no limits are placed on debt-related expenditures, or losses incurred by the Central Bank as a result of the application of the monetary policy that maintains the Debt System. Furthermore, these laws penalize the authorities who do not place a priority on debt payment, while at the same time condemning much of the population to misery while benefitting bondholders.



d) **Dependence of the monetary and economic system:** The international agreements that create mechanisms that limit countries to mere compliance with the interests of the financial market, such as the recent European Stability Mechanism (ESM), should be analyzed.

e) **Creation of financial funds** with public resources, which are used for the benefit of the Debt System, such as the FROB in Spain, the Sovereign Fund in Brazil, and other Financial Stability Funds in several countries.

f) **Inflation control:** Efforts should be made to verify the coherence and consistency of standards recommended by the international financial institutions for controlling inflation based on increasing interest rates and apparent control of the volume of money in circulation, once the central banks absorb excess currency to be exchanged for public debt securities, while no measures are established to control capital flows and others that would prevent the use of debt bonds.

g) **Activities undertaken by monetary institutions that contradict the principles of placing a priority on the public interest:** In several countries we have been able to identify the activities and measures taken by the Central Bank and Finance Ministry in operations that facilitated the plunder of resources through private banks, via the excessive supply of money by the issuer of currency, or privileged capitalization operations for private banks, or the invitation to representatives of the financial market to estimate the basic interest rates, or providing government securities to private banks at discounts, so they can be sold in the market at their nominal value, etc.



h) **The undertaking of speculative transactions that lead to financial crises and consequently public debt:** One of the situations that deserves to be investigated by the citizen audit is the accrument of public debt due to financialization, marked by the creation of different financial derivative products, speculation and leverage. For example,

- in April 2010, the Securities and Exchange Commission (SEC) filed a lawsuit in the Southern District Court of New York, against Goldman Sachs, accusing the firm of, since early 2007, designing and marketing an investment product (known as Abacus 2007-AC1) **linked to the junk mortgage loan or “subprime” market, which was doomed to failure**, and that would benefit the group itself and some of its investors. According to news accounts³ reported to date, this *hedge fund* earned some one billion dollars, which was the same amount lost by investors who were not alerted by Goldman Sachs, while the Royal Bank of Scotland posted a loss of 841 million dollars inherited from its acquisition of ABN Amro in 2007. Currently, the Royal Bank of Scotland is under British government control, which had to come to the rescue with a 45.5 billion pound rescue package. IKB was one of the buyers of Abacus and also incurred losses that were assumed by the German government.

The social movements that came together in “Occupy Wall Street” pleaded guilty to the Goldman Sachs executives in a makeshift people’s court.⁴

3 http://www.crisis-lehman.com/REVISTA/articulos/GestionNoticias_438_ESP.asp [Accessed August 11, 2012].

4 As can be seen in the 5 minute video available on line at: <http://www.youtube>.



The audit conducted into these situations should seek out documents and evidence of the damages and losses caused. The corresponding report can provide backing for social, political, and legal actions to strengthen the social movements that protest such unscrupulous acts and identify those responsible for them.

i) **Concealing information:** One of the factors that affected the public debt was the amount of money that was provided to the banking system, through secret operations, withholding information that could have prevented many financial problems.

This was the case with the Greek debt. Recent investigations have disclosed that Goldman Sachs was involved in manipulating data.⁵ The complicity of governments and banks through shady operations guaranteed more credit and, consequently, higher profits for the private players.

The investigations uncovered frauds at the time in which the Greek debt was refinanced. When undertaken through the issuance of government bonds denominated in foreign currency (dollars, Swiss francs, etc.), the result was a forex difference apparently in favor of Athens, but which turned into losses at the time of maturity, since the situation in the country resulted in the value of the foreign currency becoming more expensive.

In Greece, Goldman Sachs established these bonds with fictional exchange rates, which enabled Athens, at the beginning, to receive

com/watch?v=87A5jfUd5OU

5 See news article at <http://www.spiegel.de/international/europe/o,1518,676634,00.html> and Public Hearing at https://docs.google.com/document/d/1UFU_GjUZVi72ck5301Gasng8gQQqCWSekpmLDrhZOB8/edit?pli=1



02/08/2010

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Greek Debt Crisis

How Goldman Sachs Helped Greece to Mask its True Debt

By Beat Balzli



Greek Finance Minister George Papaconstantinou speaking at a conference in January. dpa

Goldman Sachs helped the Greek government to mask the true extent of its deficit with the help of a derivatives deal that legally circumvented the EU Maastricht deficit rules. At some point the so-called cross currency swaps will mature, and swell the country's already bloated deficit.

a loan at higher value than it would have obtained if the conversion had been made with the correct exchange rate. However, subsequently, the country was committed to making payments on interest and other charges calculated on the basis of this inflated value, which greatly benefited the creditor (in this case, Goldman Sachs). In the long term, when the bond was rescued, the creditor bank received other benefits, once Greece had reconverted the inflated value for the exchange rate on the bond.

The proof, due to an audit, of frauds in transactions with government bonds could reduce the impact of the crisis and strengthen the social struggles for the necessary change in the current financial system.



j) **Growth of the parallel market or “shadow market”:**

The existence of a parallel market, outside the few existing regulations and beyond the control of the financial authorities, shows the weakness of the current financial system, as well as the need to strengthen social mobilizations in favor of the proposals for a new financial architecture, as mentioned in Chapter 1.

It is believed that there are close to 60 trillion dollars⁶ in circulation in this parallel system, which includes the trading in debt securities, based on an estimate of the number of asset holders in this system,⁷ as shown above.

It is important that the citizen audit deal with this issue, given that the losses posted by the private banks, in these opaque markets, are transferred to the State through the various types of bank bailouts.

k) **Authorities’ behavior in relation to secret transactions and/or secret documents:** There are countless cases of secret and non-transparent operations in relation to the public debt on every continent. In Europe, for example, the decision to rescue the banks was made based on a secret, 17-page document cited in the account published by *The Telegraph*,⁸ as mentioned in Chapter 1. In Italy, the counter-reforms and a series of measures (fiscal adjustment plans, privatization, etc.)

6 <http://www.ft.com/cms/s/0/39c6a414-00b9-11e1-930b-00144feabdc0.html#axzz2UaXHPgm>

7 Obtained in: “Bank Run’s Modern Form”, *The Wall Street Journal*, December 5, 2011.

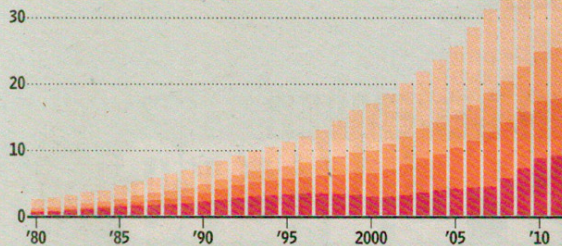
8 <http://www.telegraph.co.uk/finance/financialcrisis/4590512/European-banks-may-need-16.3-trillion-bail-out-EC-dcoument-warns.html>

Let There Be Light

The size of debt markets has risen sharply in recent decades to support shadow-banking activities, yet shortages of "safe" assets may still persist.

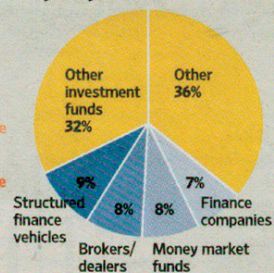
Outstanding U.S. bond market debt

\$40 trillion



Sources: Securities Industry and Financial Markets Association (bond market); Financial Stability Board

Share of shadow banking assets, by entity for 2010*



*Based on flow of funds data from US, UK, Germany, France, Italy, Spain, Netherlands, Japan, Korea, Australia and Canada

adopted in exchange for an operation involving the purchase of Italian debt bonds included a "secret letter"⁹ that the European Central Bank sent to the Italian government in August 2011. The verification of these measures can ensure transparency surrounding these developments that affect the economy and the life of the entire society.

1) **Transactions in Tax Havens:** In carrying out the work of the citizen audit, it was found that important public debt operations were undertaken in tax havens to avoid compliance with existing regulations in the different countries. One of the most egregious examples was the Brady Plan, a restructuring of public debt undertaken in Luxembourg, with different countries that agreed to this plan, as has been explained in Chapter 2. This operation represented grand

9 http://economico.sapo.pt/noticias/bce-envia-carta-secreta-a-berlusconi-e-gera-polemica-em-italia_124263.html



larceny on the part of the international banks against Ecuador, Argentina, Brazil, and other countries that were advised by the law firm of Cleary, Gottlieb, Steen & Hamilton, the same attorneys who recently have counseled Greece.

The citizen audit must fight for access to documentation related to operations concerning the public debt, since the utilization of tax havens has made it possible to hide who the creditors of the public debt are, or who benefits from the initial, intermediate and/or final negotiations. Furthermore, the existence of tax havens has enabled the central banks to send money orders to these places for the payment of interest on bonds generated in illegal and illegitimate operations.

According to Modesto da Silveira:¹⁰

“As long as there are tax havens, with their secrets articulated with individuals and companies, and even with interested nation States, it will be impossible to eliminate or reduce large scale global corruption. Clearly, if there is confidentiality, and especially, some secrecy in relation to third parties that might not be able to uncover what is shrouded, it is likely that what is involved are crimes against said third parties and even against humanity, enabling the enrichment of a few through some shady businesses. Often, some public debts are in this context. Large complex businesses, predatory loans, horribly unequal conditions are imposed, in the final instance, against the people, who are those who pay the public debt. In these great economic and political crimes –including those related to the public debt- the

10 Brazilian human rights lawyer. Since the period of the military dictatorship he has played an outstanding role in defending political prisoners. Text sent to the author as a contribution to this book.



powerful tax havens are the main beneficiaries. Their most faithful clients include drug dealers, arms traffickers, illegal gambling, prostitution, public debt scammers, and other major international criminals. Their representatives in Brazil alone can send, in each shipment to these tax havens, a minimum of one million dollars.”

According to the organization Tax Justice Network:¹¹

“Tax havens offer not only low or zero taxes, but something broader. What they do is to provide facilities for people or entities to get around the rules, laws and regulations of other jurisdictions, using secrecy as their prime tool. We therefore often prefer the term ‘secrecy jurisdiction’ instead of the more popular ‘tax haven’.

The corrupted international infrastructure allowing elites to escape tax and regulation is also widely used by criminals and terrorists. As a result, tax havens are heightening inequality and poverty, corroding democracy, distorting markets, undermining financial and other regulation and curbing economic growth, accelerating capital flight from poor countries, and promoting corruption and crime around the world.

The offshore system is a blind spot in international economics and in our understanding of the world. The issues are multi-faceted, and tax havens are steeped in secrecy and complexity – which helps explain why so few people have woken up to the scandal of offshore, and why civil society has been almost silent on international taxation for so long.

The fight against tax havens is one of the great challenges of our age.”

11 http://www.taxjustice.net/cms/front_content.php?idcat=2



The social movements must continue denouncing and fighting to change, modify, and/or eliminate the activities that feed the Debt System.

3.5 – THE RIGHT TO A PUBLIC DEBT AUDIT

Considering that the public debt has prevented an improvement in the peoples' level of development and has undermined compliance with the elementary principles of human rights, society must be aware that it has every right to know how it is generated.

In addition, there are other principles that complement this right, such as:

- **The Principle of Transparency and the Right to Access Information:** The principle of transparency is universal. Citizens have the right to access information on the transactions and data related to debt accrual. If the debt is public, the supporting documents should also be public. Taxpayers are, in the end analysis, those who are paying this debt, and it is their basic right to know to whom they are paying the debt and what the corresponding debt is.

When this right is not complied with, we face a serious limitation for the work involved in the audit. Negative responses are frequently given to requests for information, based on the argument that the documents would be protected by bank secrecy. This argument has no merit, since the credit operations that involve a public liability are subject to the **principles of the public administration, especially the principles of disclosure and public interest.**



- **The democratic principle of citizen participation:** The decision as to which sectors the public resources should be allocated to is a sovereign decision and, therefore, it is necessary that the population be able to participate and influence it. The audit is the tool that enables the population to have the information necessary for its participation.

- **The principle of motivation for undertaking public financial measures:** Any public sector measure or action should have a motivation and justification. The use of public resources must have a legal justification and be fully transparent, which can only be verified through conducting a debt audit. The illegitimate and illegal payments that the debt audit might identify should be immediately suspended and reimbursed.

The generating of public debts through different mechanisms has been the main form of submission for most countries, in some cases repeatedly undertaken under the same modality. This latter characteristic will allow for standardizing some of the citizen audit procedures for the different countries.

CONCLUSION

The tool that allows for documenting the activities of the Debt System and demonstrating the mechanisms that generate such liabilities is the AUDIT.

Considering the impressive impact that public indebtedness directly inflicts on the life of the peoples involved, since it absorbs



a significant part of government budgetary resources, it is essential that society be organized to undertake a **citizen debt audit**.

Historically, the public debt has been kept confidential and society is only called upon to pay it. It is time for citizens to know the truth and become involved in conducting the citizen audit of this process, which has caused the permanent secret looting of the public coffers and crises of all kinds.

The audit will let us know what we are paying as public debt.



Chapter 4.

Audit and public debt investigation experiences



INTRODUCTION

Various experiences in the **investigation** into and **audit** of the public debt in different parts of the world have revealed important facets and information on the debt process in different countries, showing remarkably similarities between them.

This chapter will present work guidelines and the results of recent **experiences in public debt audits and investigations**, such as:

- The official debt audit in Ecuador, through the Commission for the Comprehensive Public Credit Audit (CAIC),¹ the results of which achieved a 70% reduction of debt to international private banks;
- The Citizen Debt Audit in Brazil;
- The recent citizen audit initiative in Ireland;²
- The audit announced by Norway, from the standpoint of the creditor;
- The investigation conducted in the Brazilian parliament – the CPI,³ and
- The important Causa Olmos court case in Argentina, sparked by a judicial inquiry.

1 Commission for conducting the Ecuadorian debt audit, created by President Rafael Correa by Executive Decree 472/2007, July 9, 2007.

2 Report available at <http://www.debtireland.org/resources/publications/an-audit-of-irish-debt/>

3 Parliamentary Investigation Commission in the Chamber of Deputies - the Parliamentary Investigating Commission (CPI) into the Public Debt - August 2009 to May 2010.



The aim is to inspire and encourage the organization of citizen audit commissions to strengthen the hand of society, since it a proven tool, whose effects can provide significant benefits to peoples.

4.1 – MODALITIES OF PUBLIC DEBT AUDITS

From the standpoint of implementing the initiative, the public debt audit can be undertaken on the level of government – by official institutions of the executive, legislative, or judicial branch – or by civil society or civic organizations.

DEBT AUDIT MODALITIES [According to the branch of government or sector of society behind the initiative]	
GOVERNMENT	Comprehensive audit established and conducted at the initiative of governments or official public sector entities, designated with the authority to investigate the debt accrument. The most important example was the official audit promoted by the Ecuadorian government, based on the Executive Decree No. 472/2007, issued by President Rafael Correa.



PARLIAMENTARY	<p>Comprehensive audit established and conducted by members of parliament, in exercising their powers of overseeing the executive branch. The Brazilian Federal Constitution of 1988 provides for this type of audit through a joint commission comprised of senators and federal congressional deputies. To date, this audit has not been undertaken. A step in this direction was the recent parliamentary inquiry conducted by a commission of the Federal Chamber of Deputies - "Parliamentary Investigation Commission (CPI) into the Public Debt"- which functioned between August 2009 and May 2010.</p>
JUDICIARY	<p>The judiciary branch can decide to undertake a debt audit. The Causa Olmos, a court case launched at the initiative of journalist Alejandro Olmos in 1982, which charged that the Argentine debt was illegal, led to an investigation that was similar to an audit in several respects. That trial concluded in an important court ruling in June 2000, which declared the Argentine debt to be illegal, immoral, illegitimate, and fraudulent.</p>
CIVIL SOCIETY	<p>Comprehensive audit undertake by citizens and social organizations. It is a tool that enables society to understand how the Debt System subjects almost all countries to its whims and it is also a means of pressuring the governments to conduct an audit with citizen participation. The pioneer example is the Citizen Debt Audit in Brazil, which began in 2001. In addition to conducting studies and issuing publications based on official data and historical documents in constant coordination with other national and international social organizations, it played an important role in the Ecuadorian CAIC and Brazilian CPI.</p>



Even though it might be a government initiative, it is important to ensure citizen participation in order to democratize access to information and facilitate transparency.

Considering that it is society that is most affected by the public debt, the best variant would be that an audit be mandatory, comprehensive, be conducted with citizen participation, and be empowered to recommend administrative, civil, and criminal penalties. Thus, this would ensure that the government adopts an ethical commitment to its people, endorsing popular participation in the debt audit.

Based on the domination of the financial sector that is prevalent in most of the governments involved, as mentioned in Chapter 1, the citizen audit has an important role to play, due to its independence, in addressing the Debt System in its totality.

The public debt audit reveals the truth about the debt process.

4.2 - AUDIT AND INVESTIGATION EXPERIENCES

First of all, we should mention the historical precedent dating from the 1930s in Brazil, where a public debt audit was conducted that yielded significant results.

Brazilian President Getulio Vargas⁴ asked his finance minister to

4 REINALDO, G., " Auditoria e dívida externa: lições da Era Vargas", in FATTORELLI, M. L. [coord.], *Auditoria da dívida externa: questão de soberania*, [Brasília: Contraponto Editora Ltda, 2003].



conduct an audit of foreign loan contracts, given that such transactions would require large sums of money for interest payments.

Following investigations, this historical audit revealed that:

- Only 40% of the Brazilian external debt corresponded to contracts and documents;
- There was no regular accounting of the foreign debt, or control of the payments that had already been made.

The effect of these conclusions and audit results was the reduction of the debt balance and, consequently, a decrease in the amount of interest and costs to the tune of 50%. The audit took several years to complete and made it possible for national finances to enjoy a significant breather, which, in turn, allowed for the development of social projects and public services. It is important to note that this audit was conducted within the framework of a payment default.

In the following sections we will summarize the most important aspects of recent public debt audit and investigation experiences, mentioning the origin of each initiative, the organization of the work involved, its methodology, the key findings, and the results and effects achieved. This does not pretend to be an exhaustive review, but rather the presentation of some experiences that can provide inspiration and motivation for organizing other initiatives, whose main basis is the will to carry out such audits.

I. ECUADOR – EXPERIENCE OF THE OFFICIAL PUBLIC DEBT AUDIT

The Commission for the Comprehensive Public Credit Audit (CAIC) of Ecuador was established on the government's initiative,



authorized by Executive Order No. 4725⁵ of July 9, 2007, issued by President Rafael Correa.

The CAIC lasted from July 2007 to September 2008, when the commission presented its report to President Correa.

This recent experience managed to concretely provide relief to the country's economy, due to the 70% reduction in Ecuador's external debt with private banks, thereby making it possible to increase public social investments and to consolidate national and international citizen participation.

Given the importance of this experience, a summary of some of its main features follows.

a) Background to the CAIC

The background to the CAIC is to be found in the important role played by the Ecuadorian social movements, especially the Ecuador Jubilee Campaign⁶ and the National Debt Group, and their many-year history of conducting studies, holding events, and organizing mobilizations to protest the country's foreign debt.

The question of the audit became part of the agenda of these social movements from 2002 onward, when an important international conference was held in the city of Guayaquil, which brought together 80 representatives of movements from Africa, Asia, Latin America, Europe, and North America.

5 <http://www.auditoriacidada.org.br/wp-content/uploads/2012/08/DECRETO-472.pdf>

6 The same campaign that was previously called the Guayaquil Jubilee.



The aim of the conference was to discuss the proposal for debt arbitration and included an analysis of the types of arbitration (institutionalized or *ad hoc*), conditions, legal basis, and strategies for the implementation of fair and transparent negotiations.

After several days of intense work, the conference ended with the decision that **before any steps could be taken in relation to the debt, an audit should be conducted.**

The conference participants agreed that independent, fair, and transparent arbitration would not be viable without the prior application of a complete audit.

Another important precedent was the Special Commission of Inquiry into the Ecuadorian Foreign Debt (CEIDEX), established in 2006, whose report served as reference for the CAIC's work. The commission included Professor Hugo Arias, author of important academic studies.

Different national and international social movements contributed to the CEIDEX's work. The Brazil's Citizen Debt Audit participated in the conference inaugural session, presenting its proposal on audit methodology based on a document prepared by a commission of the Brazilian parliament in 1989.

AUDIT CHRONOGRAM

A – GENERAL ASPECTS

The following points will be verified and compared in this section:

I - Evolution of the monetary authorities' standards and regulations.

- II - Evolution of the debt.
- III - Financial inflows and outflows.
- IV - Main creditors.

RECLAME HOY

MIÉRCOLES

13 DE MARZO DEL 2002
SANTIAGO DE GUAYAQUIL
ECUADOR

FASCÍCULO COLECCIONABLE N° 14 DEL ATLAS MUNDIAL DE FÚTBOL 2002

EDITORIAL | BULUBULU Y MILAGRO PÁGINA 10

EDICIÓN FINAL | US\$ 0,40
3 SECCIONES | 34 PÁGINAS
AÑO 81 | N° 177

EL UNIVERSO

El Mayor Diario Nacional

Encuentro de Jubileo 2000 terminó ayer

Arbitraje justo para deuda

Con la propuesta de crear un tribunal independiente de la deuda externa de los países deudores, que se encargue de un arbitraje justo y transparente, concluyó ayer el Encuentro Internacional sobre deuda, que impulsó Jubileo 2000.

Las conclusiones se presentaron en la Fundación EL UNIVERSO, donde se desarrollaron foros y conferencias.

Alberto Acosta, consultor del Instituto Latinoamericano de Investigaciones Sociales (Ildis), comentó que entre las dos últimas décadas los países del Cono Sur o endeudados pagaron a sus acreedores 238.000 millones de dólares, frente a los 15.000 millones que se desembolsaron con el plan Marshall para reconstrucción de los grandes países tras la II Guerra Mundial.

Dijo que en un proceso de renegociación de deuda debe haber condiciones equitativas para deudores y acreedores.

Francisco Pascual, de Jubileo 2000 Filipinas, indicó que la deuda de los países pobres asciende a 2,3 trillones de dólares, valor que se ha incre-

OBJETIVOS

JAIME ATIENZA, delegado de España, resaltó que Ecuador ocupa el primer lugar de migración a su país. En esa nación ibérica viven cerca de 300.000 ecuatorianos.

LA MIGRACIÓN es una consecuencia real de los procesos de endeudamiento de los países pobres, dijo Atienza, quien trabaja brindando ayuda a los que llegan en busca de mejores oportunidades en España.

LUCÍA FATORELLI, de Brasil, dijo que los problemas sociales originados por el endeudamiento público aumentarán con la vigencia del Área de Libre Comercio de las Américas (Alca).

LA EXPOSITORA defiende el derecho de la comunidad a auditar el proceso de endeudamiento en su país.

ESTA ALTERNATIVA busca frenar la dependencia a la deuda en los países pobres como Brasil o Ecuador. Además, pretende que los gobiernos dejen la "política entreguista" que mantienen con el Fondo Monetario Internacional (FMI), con el afán de pagar acreencias.



Martín Herrera / EL UNIVERSO

■ Alberto Acosta, del Ildis, expuso sobre la situación de la deuda externa en el siglo XXI.

mentado significativamente en los últimos 50 años.

Mónica Espinoza, de Jubileo 2000 Guayaquil, señaló que la aspiración del movimiento es cambiar estas desigualdades con la propuesta de arbitraje.

Acosta agregó que los negociadores ecuatorianos han estado frente a los países acreedores del Club de París por siete ocasiones y en ninguna han logrado un resultado justo.

La explicación de los expo-

sitores fue que los acreedores se agrupan precisamente con el objetivo de cobrar y sugerir formas de conseguir recursos para ello.

En la cita también se sugirió que los gobiernos deudores se comprometan a defender los derechos humanos y a brindar apoyo a la inversión social, en reemplazo de las condicionales del Fondo Monetario Internacional (FMI), organismo que fue mencionado como el cobrador de deudas.



V - Main agents in Brazil.

VI - Main final beneficiaries.

B - AUDIT OF ACTS [compliance proofs]

In each of the contracts examined the following points will be addressed:

I - Approbatory procedures.

II - Flow of contract-related funds.

III - General conditions of the contract.

IV - Special conditions of the contract.

C - AUDIT OF "FACTS" [substantive proofs]

In relation to the factors that generate foreign debt, for each contract examined, the following points should be verified:

I - Allocation of the resources.

II - Origin of the resources.

D - METHODOLOGICAL ASPECTS

I - Period to be audited.

II - Items to be examined.

III - Organization to conduct the work/
sources of information.

IV - Banking secrecy.

V - Reports.

La CEIDEX, luego de sus importantes estudios, destacó en su informe la necesidad de profundizar las investigaciones sobre el proceso de endeudamiento y la realización de una auditoría de la deuda.



In its report, the CEIDEX, based on its important studies, emphasized the need for more extensive investigation into the debt accrue-ment and the application of a debt audit. Subsequently, other devel-opments reinforced the debt audit proposal, with explicit domestic and foreign popular participation, spurring its application.

Thus, the creation of the CAIC by President Rafael Correa repre-sented the culmination of many years of social struggle.

b) Characteristics of the CAIC

At least three important characteristics of the CAIC should be emphasized: its official nature, citizen participation, and its compre-hensive character.

The first characteristic of the CAIC is related to its **official nature**, because it was created as a result of an initiative presented by the country's president, through Executive Decree 472/2007, which established the legal basis of and political support for carrying out its work.

This decree established the objectives, powers, and composition of the commission, in addition to the timeframe for the CAIC'S func-tioning, its scope, etc. and authorized CAIC representatives to audit all processes related to the debt in all State institutions. Furthermore, the degree required all government departments and agencies to pro-vide the required information, and the refusal to do so would lead to the application of penalties stipulated in the Fiscal Transparency Law.

Another key characteristic of the CAIC was **citizen participa-tion**. The decree appointed members of Ecuadorian and international



social and academic organizations, who conducted all sorts of investigation and applied all types of tests together with the auditors contracted for such purposes.

In addition, the decree stipulated that the audit should be **comprehensive**, since it not only would involve raw statistics, but also other related issues. The decree defined the audit as follows:

“Art. 2 – The Comprehensive Audit is defined as oversight and monitoring measures aimed at examining and evaluating the accrument and/or renegotiation of the public debt, the origin and allocation of the corresponding financial resources, and the implementation of the programs and projects to be financed with internal and external debt, in order to determine its legitimacy, legality, transparency, quality, effectiveness, and efficiency, considering the legal and financial issues involved, and its economic, social, gender, regional, ecological impact and the effect on nationalities and peoples.”

The main function of the CAIC, according to the decree, was to *audit the process whereby agreements, contracts, and other contractual arrangements were signed for the acquisition of credits obtained by the public sector in Ecuador, from governments, institutions of the multilateral financial system, or from banks and the private sector, national or foreign, from 1976 to 2006.*

As can be appreciated, the challenge was daunting. Therefore, the political implications and the involvement of the social organizations was very important in the work of the CAIC, which was chaired by Minister Ricardo Patiño, as Finance Minister, who was then named Minister of Policy Coordination.



c) Organization of the CAIC's work

Faced with the challenge of complying with the President's decision to audit the last 30 years of Ecuadorian debt in just 14 months, the CAIC was organized in **specific subcommissions** in accordance with the following **structure**:

- **Multilateral** – Subcommission in charge of auditing the country's foreign debt to multilateral institutions such as the IMF, World Bank, and the Andean Development Corporation (CAF), among others;
- **Bilateral** – Subcommission proposed for purposes of analyzing the Ecuadorian government debt (or that of any government agency) with foreign governments or the development banks of other countries;
- **Commercial** – Subcommission dedicated to auditing the external debt with international private banks, in which the liabilities corresponding to the initial contracts, promissory notes, and agreements were transformed into sovereign bonds as of 1994;
- **Internal** – Subcommission in charge of auditing the Ecuadorian domestic debt.
- **Legal** – Subcommission responsible for studying the juridical aspects of the Ecuadorian public debt and the legal remedies available in international law on the question;
- **Social and Ecological** – Subcommission focused on the verification of the social and ecological impact of debt accrument.

The decree also anticipates the establishment of an *Executive Coordination*, responsible for the administrative and logistical functioning of the CAIC.



Above is the structural flow chart of the CAIC.

d) Methodology

Considering the importance of the Ecuadorian experience in inspiring other such initiatives, the following is the methodology that was used, according to the important documentation⁷ compiled by Ecuadorian economist Mancero Piedad, a member of the CAIC:

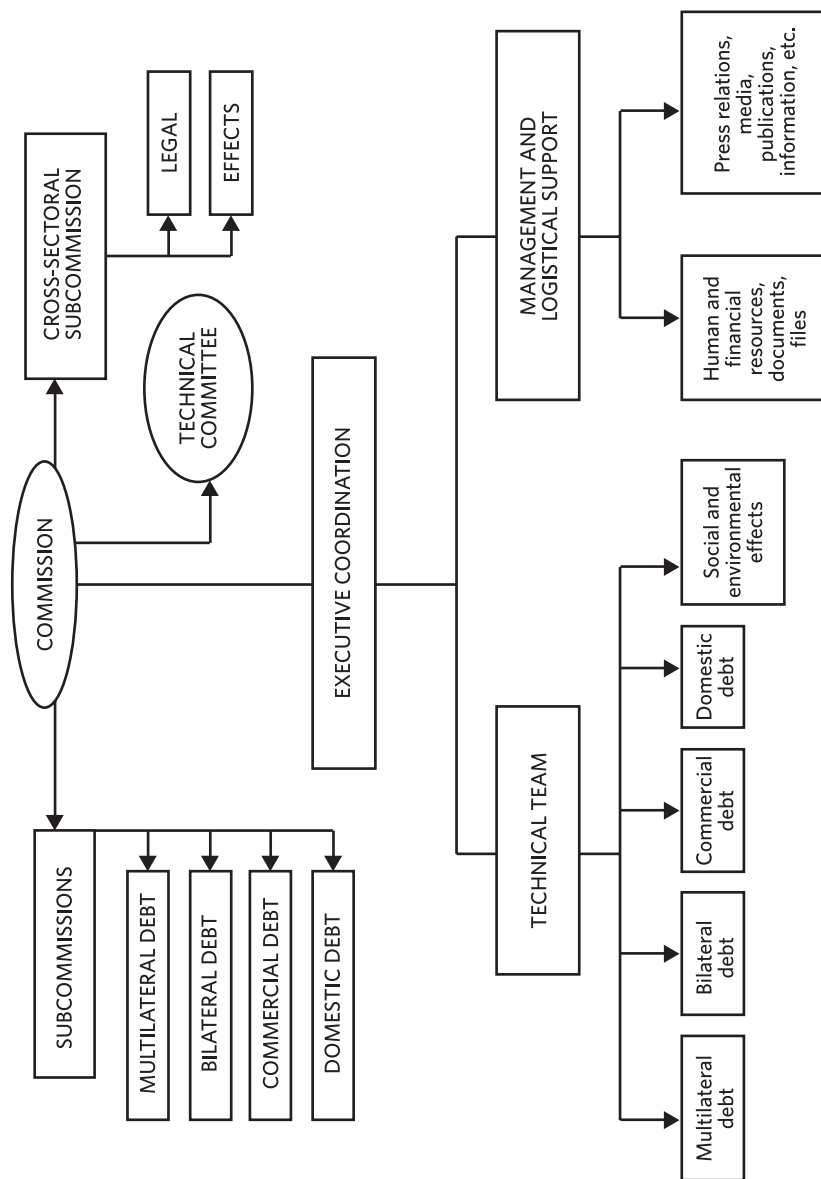
I. MASTER AUDIT PLAN

The master plan must be clearly defined in terms of the key reason for the audit, its general objectives, the scope established in the legal basis and its explicit attributions; components to be audited; processes and activities, the chronogram and the human, financial and material resources required.

- Key Purpose

As a message, it should be discernible to the entire public and in summary form it should state the political motivation and social aspirations the comprehensive audit seeks to satisfy. More specifically,

7 MANCERO, P. P., "El proceso de auditoría integral del Crédito Público", Ecuador, 2012. Available at <http://www.jubileo2000.ec/view-details/publicaciones/382-metodologia-de-la-deudaingles.html>



Prepared by Piedad Mancero



it should emphasize the opportunity to provide valid and conclusive responses to the serious problem of the debt, identify responsibilities, prevent mistakes, and recover the peoples' sovereignty.

- General objectives

- The verification of the existence [or lack thereof] of transparency, quality, effectiveness, efficiency, respect and protection of the environment, in the different stages of debt accrument, the contractual limitations or conditions, interventions, and impositions, both visible and hidden, that undermine the dignity and lives of the population and/or endanger the peaceful coexistence between peoples; equity in the agreements and contracts; and respect for the sovereignty of the country as sustaining factors for qualifying the debt as legitimate or not.
- The determination of legality or illegality [...]
- The furnishing of sufficient and conclusive evidence to the country's authorities and civil society in order to take corrective actions and to repair the damage caused by the debt.
- Establishing the responsibility and co-responsibility of internal and external actors [...].

- Basic lines of action

It is necessary to create a basic framework that would facilitate the work of those participating in the audit, through:

- The identification of sources of information, especially the institutions that have intervened in the debt accrument processes and their



specific responsibilities. Prior review of files, reports, research, and tests conducted [...].

- The training of technical teams in the basic concepts of the doctrines of illegitimacy, in the legal principles of national and international law in relation to debt accrue ment, in the right of countries and peoples to seek their development unobstructed by internal and external interference resulting from the debt accrue ment, especially debt that has been imposed, and the application of investigation procedures consistent with the objectives being pursued.
- Activities to be jointly carried out
- Determining the legal and institutional framework that was in effect during the period of the audit [...].
 - Availability of development aid programs and strategies formulated by international institutions and agencies, for implementation in regions and countries through the granting of credits and technical cooperation.
 - Collection, organization, and registration of information, previous studies, investigations, complaints and other indications of irregularities or damage detected.
 - Compiling a database of the all credits with their basic elements [data on the creditor, debtor, beneficiary or executor; allocation of loan resources, terms, interest rates, amounts contracted and disbursed, amortization, interest and commission fees paid, balance due].
- Personnel requirements



The planning of the work on the audit should establish the need for human resources and the individual professional profile of the audit investigators and personnel from other fields [...]. To ensure the comprehensive character of the audit, it is advisable to form multi-disciplinary teams, especially the cross-sectoral analysis group, which is the group that deals with the effects of the debt.

- Timeframes for implementation and calendar of activities. In the organization and planning of the work it is important to take into account the timeframe [...]. It is necessary to develop an overall chronogram and other specific schedules and deadlines for the predefined tranches of the debt and the cross-sectoral groups. Taking into account the expectations of the authorities and the public, which expects results, the chronogram should include progress reports, albeit partial, and texts suitable for distribution to the public. [...].

e) Findings

Each of the CAIC subcommissions submitted its reports in accordance with the investigations and audit tests that were undertaken, detailing their findings. The executive summary of the work of the commissions is available at www.auditoriadeuda.website.org.ec



It should be noted that in the report of the **Multilateral Subcommission** it was shown that the multilateral institutions themselves distorted the mission stated in their bylaws, since they promoted illegal debt programs with member countries by having aligned themselves with powerful private creditors. In most of the cases examined, the multilateral institutions granted credits earmarked for the payment of previous debts or guarantees related to them, in addition to unnecessary projects with high costs.

The report of the **Bilateral Subcommission** indicated that most of the projects fail to meet their objectives and the resources do not enter the country. They only generate benefits for contractors and lenders whose nationality is generally the same.

The **Domestic Debt Subcommission** documented the use of domestic debt to pay the service on the external debt, which indicates the interconnected functioning of the Debt System.

The following section highlights the results of the **Commercial Subcommission**,⁸ not only because of its very important effect in terms of achieving the cancellation of 70% of the debt in that tranche, but also because it involved debt contracted through government bonds, a similar situation to the sovereign debt of most countries today.

8 The commercial debt subcommission was coordinated by Professor Hugo Arias, with the participation of Maria Lucia Fattorelli, Miriam Ayala, and Rodrigo Ávila.



MAIN FINDINGS OF THE SUBCOMMISSION ON FOREIGN DEBT OWED TO INTERNATIONAL PRIVATE BANKS

- The Commission documented IMF interference in the country's internal affairs as well as its connection with the private banks and the Paris Club. Its behavior was characterized by an unacceptable coercion, in addition to the asymmetry between the parties involved.
- Violation of sovereignty and failure to comply with the country's legal dispositions.
- Violation of fundamental rights.
- Violation of international law.
- Abusive conditions reflected in successive unequal negotiations that did not consider the market value of the debt; unfair contract clauses; high interest rates; the existence of usury and compound interest [anatocism], collection of different commission fees and various other unjustified expenditures.
- Concentration of power in the international private banks in a small group comprised of Shearson Loeb Rhoades, Lloyds Bank, Citibank, and JP Morgan Chase, which acted as representative agents of the other banks.
- Responsibility of the financial sector in the aggressive borrowing in the 1970s (financing of dictators) and for the successive non-transparent "restructurings", generating losses due to the transfer of private debt to the Ecuadorian government; unjustified exchanges and prepayments; onerous costs and direct operations abroad without any resources flowing into the country.
- Application of mechanisms that simply "generated" debt, with no counterpart in goods or services for the country, not even inflows of resources. In other words, a true scam.
- Impressive similarities with developments in other countries of the region.
- Conversion of illegitimate debt into new debt; transformation of private debts (including bank debts) into public debt.
- Waiver of the statute of limitations or prescription of the external debt with the banks in 1992, through the unilateral measure known as a Tolling Agreement.
- Different irregularities in bond issues; for example, not registering the Brady, Global, and Eurobond securities with the Securities and Exchange Commission [SEC]. They were privately negotiated in tax havens such as Luxembourg.
- Fudging the accounting ledgers to cover up irregularities.
- Net transfer of resources abroad, while a pronounced growth in the foreign trade debt was verified.



These findings appear in the following detailed reports:

CAIC - Detailed Reports contained in the Final Report on the Ecuadorian External Commercial Debt	
No. 1/8	Origin of the Ecuadorian External Commercial Debt
No. 2/8	The Role of the International Monetary Fund
No. 3/8	Complementary mechanism
No. 4/8	“Refinancing” agreements since 1983
No. 5/8	Sucretization (debt swap between dollar and sucre)
No. 6/8	Tolling Agreement
No. 7/8	Brady Bonds
No. 8/8	Global Bonds

The main conclusion of the Commercial Debt Subcommission was that the accrument of Ecuadorian debt during the period between 1976 and 2006 **benefited the financial private sector and transnational corporations**, to the detriment of the interests of the Ecuadorian nation.

Official data underscored a net transfer of resources abroad, in favor of the private banks, while the debt balances never diminished. As a result, this process did not serve as a source of funding for the Ecuadorian government, but rather represented a continual outflow of the country’s financial resources:



Summary	Figures
Difference between registered financial inflows and outflows (net transfer of resources for international financial agents) in 30 years.	USD 7.13 billion
Increase in the debt in the same 30 year period	1976 - USD 115.7 million 2006 - USD 4.2 billion

Limitations

Despite being underpinned legally and having political support, the CAIC's task was quite difficult, not only due to the vast period of 30 years that it had to investigate, but also because of a number of limitations, including:

- negotiations based on separate and extremely extensive agreements, moreover couched in confusing language;
- impossibility of accessing foreign transactions and parties involved in foreign operations, especially given the debt write off by the international private banks and trusts;
- serious internal control deficiencies in official institutions and agencies responsible for managing the public debt ;
- disorganized and incomplete files;
- documents in foreign languages without official translation;
- insufficient responses by several financial and regulatory control institutions.



f) Audit procedures applied

The Commercial Debt Subcommittee initially used the **criterion of relevance**. Initial planning was based on an overall statistical analysis, underpinned by data published by the Banco Central de Ecuador and statistical studies released by the Foreign Debt Investigation Commission (CEIDEX).

The **statistical analysis** enabled the most relevant processes to be investigated to be pinpointed. Based on this identification, the next step was to locate the supporting documentation of the debt procurement of each period in order to proceed to the **documentary analysis**.

Confirmations were made and supplementary reports were requested from the financial institutions involved in the debt accrue-ment, especially the Central Bank, the Finance Ministry, the Attorney General's Office, the Comptroller General, and Congress.

To carry out the work, the **legal and operational responsibilities** of the different government bodies in relation to the handling of public debt **were verified**. An **accounting analysis** was made by examining the accounting ledgers and records of both the Finance Ministry and the Central Bank.

Considering the extended period being audited by the CAIC, **alternative sources** of information and historical registries existing in books, publications, and websites **were also used**.

The technique known as **statistical audit**, among others, was applied in the financial analysis. This involves a comparison of the figures for debt contracted and debt paid; of the figures for debt renegotiated in various transactions compared with the market



value of the debt; identification of the amounts paid through different commission fees as well as the agreed upon interest rates.

In the different relevant debt processes, the audit sought to **identify the respective participants**, whose **responsibility** should be determined in more thorough investigatory endeavors that correspond to the country's official institutions.

g) Result: a 70% reduction in Ecuador's external commercial debt in bonds

In October 2008, after receiving the CAIC's reports, President Correa told several media sources that serious indications of irregularities had been uncovered by the commission, and announced the suspension of payment of the interest coupon for the Global 2012 and 2030 bonds, which were to mature in November 2008. At the same time, Correa submitted the reports to a review by the government's legal institutions and also by international lawyers.

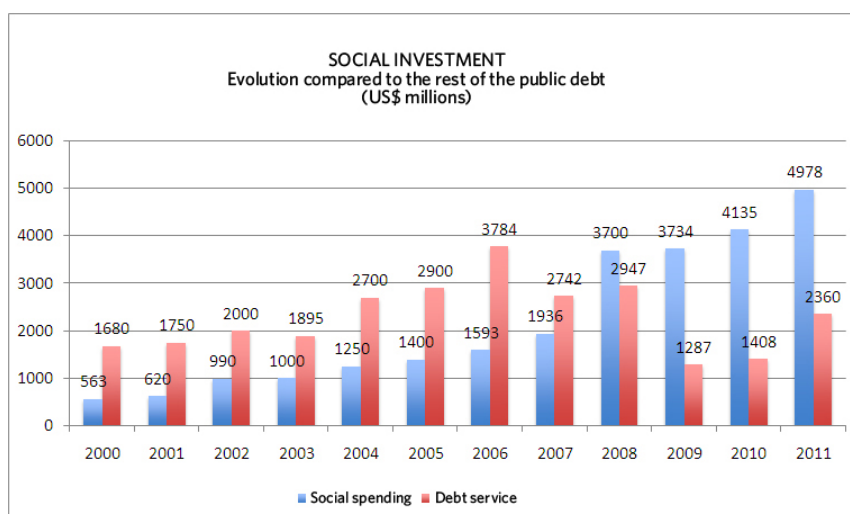
The amount of money that would have been allocated to the interest payments was immediately earmarked for spending on health and education, a decision that was highlighted even by the orthodox journal *The Economist*, which in its April 23, 2009 edition reported that “*Mr. Correa appears to be uncorrupt. The giant increase in public spending he has overseen (it rose by 71% last year) has resulted in new schools and hospitals.*”

In early 2009, in a sovereign act, President Correa made a proposal offering holders of Global Bonds 2012 and 2030 a rescue package at 30% of their nominal value. The maturity of these bonds was slated for 2012 and 2030, respectively, and the interest paid was 12% and 10%, thus far, in addition to other charges.



Close to 95% of the bondholders accepted the proposal and redeemed their bonds for the stipulated price and did not file any lawsuits against the country. The remaining 5% never appeared.

The early *buyback* of the 2012 and 2030 bonds for a maximum price of 30% of their nominal value meant the cancellation of 70% of that part of the country's debt, which represented an estimated USD 7.70 billion over 20 years (bond maturity dates). This savings made it possible to undertake important investments in the country, in particular, increasing resources for health, education, housing, among other investments, as shown in the chart below.



The Ecuadorian experience shows the importance of the audit tool, whose report, duly backed by tests, documentation, and sufficient and relevant argumentation, can serve to support sovereign acts at any time, as well as measures in other areas.



Another important result of the CAIC's efforts was the presentation of suggestions to the Ecuadorian Constituent Assembly, which at the time was in session. These proposals were included in the new Ecuadorian Constitution, approved by popular referendum in October 2008. The chapter on public credit contemplates monitoring bodies:

Article 289: "The State shall promote bodies enabling the citizenry to monitor and audit the public debt."

This Constitution establishes the preservation of Ecuadorian sovereignty and explicitly forbids compound interest (anatocism) and usury, in addition to prohibiting the socialization of private debts.

In addition, in showing that it is possible to address the problem of the debt as a sovereign power, the Ecuadorian experience encouraged other countries to announce their intention to audit their debts and influenced the creation of the Parliamentary Investigation Commission on the Public Debt in Brazil (CPI).

Ecuador's decision to conduct a comprehensive audit of its public debt signified a lesson in sovereignty for the world, demonstrating that it is possible to stand up to global financial power.



II. BRAZIL - CITIZEN PUBLIC DEBT AUDIT

The strengthening of civil society is a process that requires the continuous formation and growth of society in all areas of knowledge.

In economic terms, the prevalence of the mechanisms that regulate the country's finances is important, since it is the population that contributes to financing the State by paying heavy taxes, and often it does not receive the social services to which it is entitled in return.

The Brazilian experience of the citizen debt audit helped to popularize knowledge of the country's financial reality, involving different sectors of society in carrying out its work and in spreading its message.

a) Emergence of the Citizen Audit

The debt audit movement arose as a result of the Popular Plebiscite on the External Debt, held in Brazil in September 2000, involving hundreds of social movements and in which 6,030,329 citizens in 3,444 of the country's municipalities voted.

More than 95% of those casting ballots voted "No" to continuing the agreement with the IMF, "No" to continuing payments of the foreign debt **without conducting an audit** as contemplated by the Federal Constitution, and "No" to earmarking a large part of budgetary resources for speculators.

The organization of the plebiscite was the result of years of mobilization of civil society, which came to identify the public debt as responsible for the unacceptable social disparities and backwardness existing in Brazil.



Given the impressive result of the plebiscite and based on the constitutional stipulations, organizations and individuals came together to launch the movement known as the CITIZEN DEBT AUDIT. It was conceived as a social organization that investigates the accrue-ment of public debt and has denounced its incorrect use as a Debt System, that is, a policy involving the continuous diversion of public resources to the private financial sector, when it should be a source for funding public projects.

The Citizen Debt Audit of Brazil in the course of its activities has accumulated knowledge that has enabled it to work with others and transfer such information to other nations, especially the Ecuadorian CAIC, and to recent initiatives in different countries.

b) Organization of tasks

The Citizen Audit has operated based on the articulation with and support of different organized sectors of civil society –work-ers’ associations in general, trade unions, professional associations, church-based groups, groups working around women’s issues and against poverty, etc.- and individual volunteers, all of whom have, since the beginning of 2001, committed themselves to implementing a citizen audit, based on the following methodology.

c) Methodology

The Citizen Debt Audit initially was organized in local commis-sions, elaborating its work methodology⁹ after its creation:

9 Circular Letter no. 1/2001, dated 29/03/2001, addressed to local commissions of



1. In terms of the aims of the Citizen Audit:

1. *To determine the real status of the external and internal public debt.*

Investigate: amount, composition, profile, and costs; origins, objectives, conditions and circumstances of its accruelement; amortizations; where the resources are allocated, degree to which the public budget is committed to debt payment in order to demonstrate its social cost; its legitimacy; its legality; its historical evolution and future projection; what has actually been paid; who benefited and what relations of dependency were created; fee commissions paid; interest contracted compared to interest paid; distinguishing debt for investment and debt exclusively for paying interest; reckless management of the debt; and the relationship between the economic policy adopted and the evolution of debt accruelement.

2. *To broadly circulate the results of the Citizen Debt Audit.*

3. *To demand measures from the corresponding government institutions.*

4. *To pressure the National Congress to conduct an official audit, contemplated in the Federal Constitution.¹⁰*

2. In terms of strategy:

The Citizen Audit should involve the different sectors of society.

Teams should be established, with the participation of

the Citizen Debt Audit in different provinces.

10 Article 26 of the Transitional Dispositions Act.



different social sectors, in order to forge a common vision, both as regards diagnosis as well as proposed solutions.

3. In terms of the steps in carrying out the audit:

1st step: Development of an initial and preliminary overview that would enable the audit to be channeled in the right direction. Starting point: the current situation of the public debt (internal and external), going back to its origins and the circumstances of its accrument, also verifying where the resources obtained were earmarked. This work should be conducted by study groups created in the States, with representation by the different social sectors.

2nd step: Actual application of the audit. Creation of a coordinating commission responsible for the orientation and implementation of the audit; formation of teams that will conduct research, studies, and specific and/or localized audits, converging into a conclusive report. Trying to obtain the support of academics, economists, auditors, lawyers, with a composition that is representative of the different currents and entities.

3rd step: Definition of the proposals to address and provide solutions to the problem of the public debt based on a national, popular, and democratic outlook. These proposals should contain alternative lines of action for dealing with the question of the public debt, placing a priority on the collective interests of the population. Legitimacy should be sought for the report and the audit process by holding events to discuss the conclusions and the alternative proposals, with broad participation by the different sectors of organized society.



4th step: Circulation of the audit results, striving to mobilize society based on the conclusions and proposed alternatives, promoting broad public knowledge of the results and obtaining the most extensive possible support from society for all the proposals to resolve this issue. Preparation of articles, booklets, pamphlets, debates, campaigns, and other activities geared to the different social sectors. Emphasis should be placed on the relationship between public debt and the quality of life of the population, demonstrating the effect that the debt has on the definition of public policies, directly affecting the life of each individual in society. Finally, along with representatives from the different sectors of society, proposals should be formulated for orientations and solutions to the problem of the Brazilian public debt.

d) Relevant activities

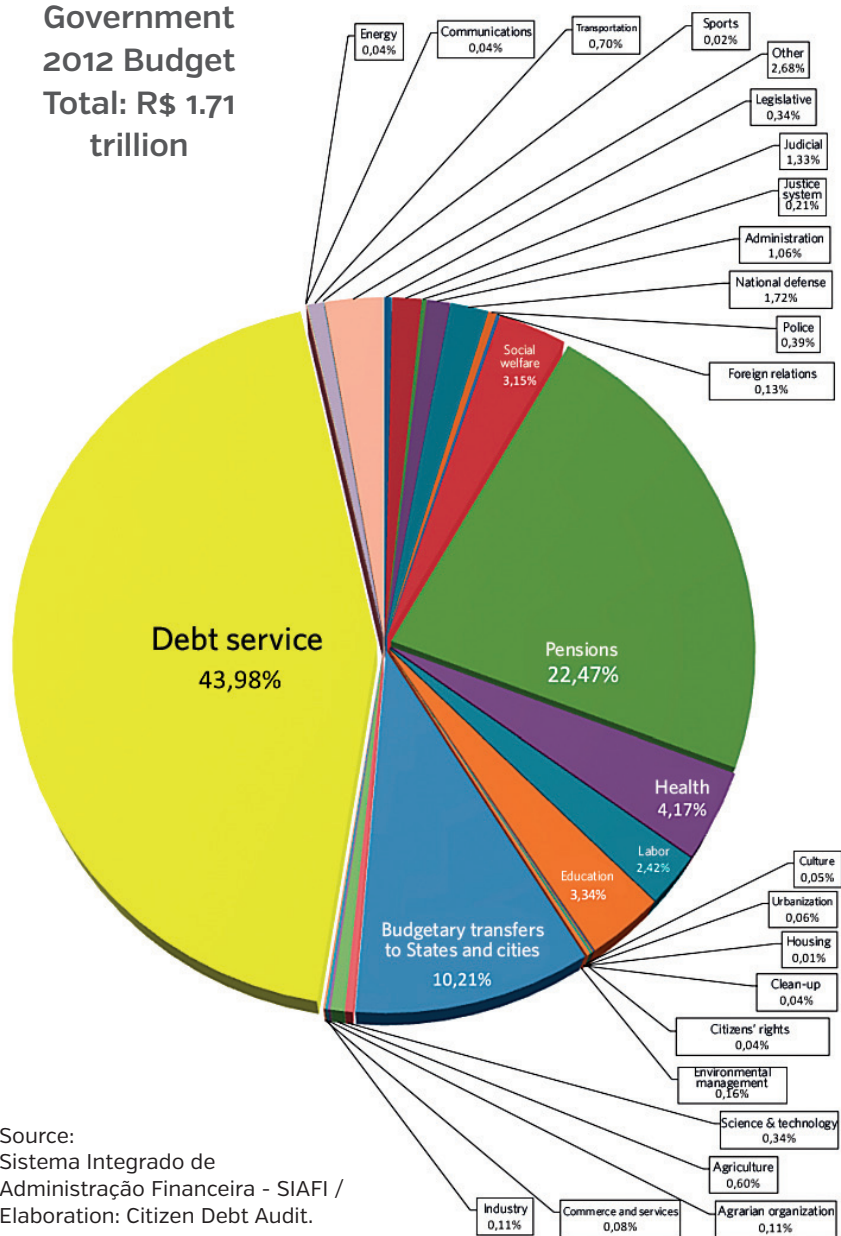
The activities of the Citizen Public Debt Audit will be undertaken based on documents and public and official data, for example:

i. Graphical representation of the Federal Public Budget: Each year the Citizen Audit will prepare a chart in order to popularize the public's understanding on where the country's governmental budgetary resources are allocated.

This chart will criticize how the debt is prioritized. In 2012, the debt absorbed almost 44% of budgetary resources, while health care received only 4.17%; education, 3.34%; social welfare, 3.15%, etc., with the same trends observed in previous years.

This clarifies the main reason for the Brazilian paradox. Brazil has the world's seventh largest economy, but the country is in 85th place in the United Nations' Human Development Index (HDI).

**Federal
Government
2012 Budget
Total: R\$ 1.71
trillion**



Source:
Sistema Integrado de
Administração Financeira - SIAFI /
Elaboration: Citizen Debt Audit.



ii. **Studies on the relationship between public debt and the violation of human and social rights.**

iii. **Studies on the relationship between public debt and counter-reforms**, especially on the level of pensions, taxes, labor rights, privatizations, etc.

iv. **Studies on the relationship between public debt and macroeconomic policies aimed at controlling inflation.**¹¹

v. **Studies on the early payment to the IMF;**¹² **early redemption** of external debt bonds with **overprice**, accumulation of international reserves through issuing debt.

vi. **Gender:** Study ¹³on the allocation of resources for policies to combat violence against women. Studies on the **priorities in the allocation of resources for public debt** and the reduction of resources earmarked for public sector workers.¹⁴

vii. **Recovery of historical documents**, for example, reports of parliamentary commissions and their circulation through the web page to facilitate broad public access.

viii. **Access to information** through the repeated request for documents related to authorizations for contracting debt by the different institutions involved, such as the National

11 <http://www.diplomatique.org.br/artigo.php?id=942>

12 <http://www.auditoriacidada.org.br/wp-content/uploads/2012/09/Contradição-Inexplicável-Maria-Lucia-Fattorelli.pdf>

13 <http://www.auditoriacidada.org.br/wp-content/uploads/2012/07/Divida-e-generous-texto.pdf>

14 <http://www.auditoriacidada.org.br/nao-ao-terrorismo-contra-os-servidores/>



Congress, Provincial Legislative Assemblies, the Banco Central, the Finance Ministry, Courts of Auditors, among others. Despite many limitations, some results have been obtained.

ix. **Identification of mechanisms that generate public debt**, for example, those discussed in the previous chapter.

x. **Production of materials for popular knowledge**: All the studies led to the preparation of educational publications.

xi. **Mobilization of society**: Growing articulation with civil society organizations to hold public events and conduct studies and investigations, issue publications, etc.

xii. **International presence and coordination**: Participation in the World Social Forum since it first met in 2001, and other activities that strengthen ties with international organizations that fight against the debt, especially the Latin American Network on Debt, Development, and Rights (LATINDADD) and the Commission for the Abolition of the Third World Debt (CADTM).

xiii. **Others** in <http://www.auditoriacidada.org.br>

e) Results obtained

First of all, it should be noted that the assessment of the results should not be restricted to the amount of debt that the audit helped annul, but rather the breadth of the impact of this citizen-based initiative.



One of the most important results in nearly 12 years of activities of the Citizen Audit of Brazil is the growing awareness in society on the subject. In this regard, the findings and conclusions of the citizen audit have served to strengthen the struggles for workers' rights and social demands.

In addition, the accumulation of knowledge has enabled collaborative efforts and the transfer of such knowledge to other countries, especially the Ecuadorian CAIC. This, in turn, prompted the creation of the Investigation Commission in the Brazilian Parliament (CPI) and opened doors for new initiatives in different countries. This continued expansion of social mobilizations allows for optimistic expectations for the creation of a sufficiently strong force for change in the current unjust model, in which public indebtedness plays a negative role.

RESULTS ACHIEVED BY THE CITIZEN DEBT AUDIT

- Growth of social mobilizations around the issue of the public debt.
- Use of the work of the Citizen Audit by social protest movements and vanguard sectors in academia.
- Participation in public hearings in the National Congress (on the debt and related issues such as fiscal reform, pensions, human rights, development, etc.), as well as regional legislatures (Minas Gerais, Rio de Janeiro, National Union of State Legislatures (UNALE), etc.), and municipal legislative chambers (Belo Horizonte). Participation in institutional working groups that are seeking out for proposals to resolve the public debt crisis faced by provinces and municipalities.
- Designation of the Citizen Debt Audit to function as a member of the CAIC in Ecuador (Commercial Debt Subcommission).
- Establishment of the Parliamentary Investigation Commission (CPI) into the Public Debt in the Federal Chamber of Deputies, proposed by Federal Deputy Ivan Valente (PSOL/SP) and based on documents and arguments produced by the Citizen Audit.



- Appointment to work in the technical consultancy section of the CPI in the Brazilian Parliament, whose activities resulted in the preparation and release of eight technical analyses, which were incorporated into the Alternative Report ("voted separately") by congressional deputies belonging to the CPI.
- Legal action undertaken by the Bar Association of Brazil (OAB-ADPF59/2004) before the Federal Supreme Court (STF). The OAB used the arguments and data from the Citizen Audit to file a suit demanding that the STF require the National Congress to convene a joint commission to conduct the debt audit anticipated in the 1988 Brazilian Federal Constitution.
- Joint work with the Prosecutor's Office to deepen the investigations launched by the Parliamentary Investigation Commission into the Debt.
- Installation of investigation commissions in the legislative assemblies of some States. In creating such commissions, arguments and data from the Citizen Audit were used. In Minas Gerais, for example, a Special Commission was created, approved by a vote of 52 of the 72 State deputies.
- Extension of the citizen audit experience to other countries in Latin America, Europe, and North Africa.

The public debt audit is a technical endeavor in which commitment is required in analyzing documents and courage is needed to reveal what is found.

III. BRAZIL - PARLIAMENTARY COMMISSION OF INQUIRY INTO THE PUBLIC DEBT (CPI)

The creation of the CPI in the Brazilian parliament was a conquest of the social movements. Although an audit as such has not been performed, the CPI represented a major opportunity for social mobilization and made it possible to access documents that for the first time were placed at the disposal of the Brazilian public. In addition, the CPI continues to have its effects, since its reports were delivered to the Attorney General's office in order to deepen the corresponding investigations.



The CPI was proposed by federal congressional deputy Ivan Valente (PSOL/SP), and the initiative received the backing of a third of the deputies. The required reading of the bill in the legislative plenary session occurred on December 8, 2008, following the momentum generated by a meeting of CAIC members with the president of the Chamber of Deputies of Brazil (congressional deputy Arlindo Chinaglia) during the International Seminar on Debt Audit in Latin America held in Brasilia in November 2008.

Nine months transpired before the political parties designated their respective members to the CPI and as a result, work did not begin until August 19, 2009. This was a clear indication that there was no political interest in this inquiry, because most of the parties receive financial contributions from banks for their election campaigns.

The pressure of the social movements, especially the Citizen Debt Audit, was key for the effective launching of the CPI's work.

Following its establishment, the members of the CPI did not organize a major commission of technical specialists, necessary to assist in the research, as was done in Ecuador, and restricted the working group to a small handful of individuals, which represented a strong limitation.

The Citizen Audit provided technical consultancy to the PCI, examining documents and reviewing and studying testimonies gathered by the commission. It furnished eight technical analyses, in addition to promoting constant coordination and contact with social organizations.

Different informational requirements proposed by the Citizen Audit were received and approved by the CPI, and directed to official



debt control bodies, mainly the Finance Ministry and the Central Bank.

After nine months of functioning, the official final report was approved, which included in its analysis various indications and evidence of illegalities committed and illegitimate behavior indicated in the technical analysis, testimonials from specialists, and allegations from civil society. The report acknowledged that, for example:

- The extremely high interest rates were the main factor that drove the rapid growth of the Brazilian public debt, characterized by the continued use of anatocism, a practice that had already been ruled illegal by the Federal Supreme Court (STF case 121).
- The “internal debt” (which pays the highest interest in the world) has increased rapidly in the past few years due to the issuance of public debt bonds that were used to finance the purchase of speculative dollars that entered the country through the private banks. These dollars were allocated to accumulate almost USD 400 billion in international reserves, mostly invested in U.S. government Treasury bonds, bearing interest at close to zero, to the detriment of the Brazilian Central Bank.
- The transformation of foreign debt into domestic debt through the early payment to the IMF¹⁵ in 2005 and the early

15 To pay the IMF, the government issued domestic debt bonds, which were acquired by banks (dealers), with much higher interest than what was paid to the IMF. Thus, the debt simply changed hands, with what was previously paid to the IMF then being owed to the banks.



calls on foreign debt bonds with overprice, which reached 70% in certain transactions.

- The Senate surrendered its authority in this regard, since it allowed debt bond issuances without specifying their characteristics.

- Information and documents requested were not furnished.

Despite the grave diagnosis, contradictorily, the Final Report did not acknowledge that irregularities had been followed in the debt accrue ment process. It did not recommend that the Public Prosecutor's Office conduct or undertake any actions aimed at furthering the investigations. However, pressure from civil society organizations that accompanied the work of the CPI led to only a third of the 24 members of the CPI voting in favor of this report, which was approved by a narrow margin of eight votes in favor and five against.

Congressional deputy Ivan Valente presented an alternative report, entitled "Separate Vote", which fully incorporated all the analyses submitted by the technical advisory team. The Alternative Report was signed by eight congressional deputies and recommended that an audit be conducted given the various indications of irregularities that had been reported, among them:

- Charging compound interest, known as anatocism, considered illegal by the Federal Supreme Court;

- The illegal, unilateral increase in floating interest charged by international private banks at the end of the 1970s, according to the Vienna Convention;



- The absence of key documents and contracts, especially those that would justify the origin of the debt accrument in the 1970s during the military dictatorship; the failure to reconcile figures in the most important external debt negotiations for decades; illegitimate, illegal, and unconstitutional clauses; not considering the market value of bonds and promissory notes in negotiations;

- Strong indications of illegality in transferring public and private sector debt to the Central Bank starting from 1983 as well as in the Brady Bonds swap in 1994;

- The illegality of the free flow of capital, according to the opinion issued by the Prosecutor's Office, which resulted in the exponential growth of domestic debt as of the adoption of the Real Plan;

- Early bailouts of Brazilian external debt bonds with the payment of a premium to the bondholders;

- Violations of human rights by the excessive use of budgetary resources for the payment of questionable amounts of "public" debt;

- Conflict of interest, as evidenced by meetings between the Central Bank and representatives of banks and other bondholders to define inflation forecasts, which determine interest rates.

The Separate Vote report (and its respective supporting documents) was presented to the Public Prosecutor's Office in order to deepen the investigations and adopt the appropriate legal actions.



In addition to preparing the technical analyses, the Citizen Audit published weekly bulletins¹⁶ to publicize what took place in each session of the CPI.

Despite the limitations and political pressures, the CPI was an important step forward and capped a decade of struggles, studies, investigations, and voluntary efforts, since its conclusions prove the need to conduct a debt audit.

The public debt declared illegal and illegitimate
should not be paid by the people.

IV - ARGENTINA - THE OLMOS CASE¹⁷

In October 1982, journalist Alejandro Olmos filed a complaint before the Second Federal Criminal and Correctional Court, then headed by Dr. Martin Anzoategui, to force an investigation into the country's entire debt accrue ment from 1976 onward and the responsibility of the Prime Minister of the Economy during the dictatorship, in addition to all the other officials involved until 1983. Although the trial court appointed 30 legally recognized experts, in the end, due to the resignation of almost all of them, who did not want to be involved in the investigation, only three remained, two tenured professors from the Faculty of Economic Sciences of the University of Buenos Aires and the other proposed by the National Academy of Economic Sciences, who joined

16 Documented at <http://www.auditoriacidada.org.br>

17 By Alejandro Olmos Gaona, Argentine legal scholar and historian, son of the author of La Causa Olmos.



three auditors from among the expert accountants of the National Justice system.

The legal case proceeded very slowly due to fears of the Judiciary and the situation in which, when requests were filed for the required reports from the Central Bank and the Finance Ministry in regard to explanations on the debt process and debt figures, the responses were never given immediately and the requests had to be filed over and over again.

In the court case, former economy minister José Alfredo Martínez de Hoz was indicted for defrauding the public administration, with a large number of officials presenting court declarations. A variety of evidence was gathered, official documents were incorporated, and the six experts prepared their conclusions on the accumulated material, which encompassed 28 major sections (12,000 pages), with more than 50 supplementary appendixes, and a voluminous amount of folders with different documentation on the debt.

The experts concluded that:

- a) The debt had no legal, administrative, or financial justification.
- b) The procedures used by the economic authorities were discretionary and reveal violations, irregularities, and behaviors and procedures that represent true illicit acts.
- c) State owned enterprises were forced into debt without having a need for financing.
- d) In many cases, State owned enterprises were required to take on credits with foreign banks to cancel debts with domestic banks.



e) Of the dollar loans contracted by State owned enterprises, the money went to the Central Bank, which gave them pesos in return, which later lost value.

f) There was embezzlement.

g) The international reserves were loans from international banks that never entered the country and were placed in the same banks at a lower exchange rate, with huge sums of money being lost in the process.

h) The fraudulent external debt of private companies was assumed by the government in 1982.

i) Central bank guarantees for public and private companies should have been cancelled by the institution, which never demanded such payment from the companies involved.

Coupled with this is the revelation that all transactions first passed through the law firm of Dr. Guillermo W. Klein, who was Secretary of Economic Planning.

Judge Jorge Ballesterro dismissed the case due to the statute of limitations on July 13, 2000, but pointed to the offenses and irregularities that had occurred and the clear responsibility of the International Monetary Fund in these transactions.

V - IRELAND - AN AUDIT OF THE IRISH DEBT¹⁸

The debt audit was a good point of departure to begin to build the Irish campaign against the illegitimate bank debt. This was spurred by the findings of the audit that explained the mechanisms to socialize bank debts, a question that the Irish people had not properly

18 By Nessa Ni Chasaide. Debt and Development Coalition, Ireland, <http://www.notourdebt.ir> and <http://www.debtireland.org>



understood. Public confusion grew due to the complexity and large number of financial arrangements between the Irish government, the Irish banks, the Central Bank of Ireland, and the Troika of international creditors. These credit arrangements have been assumed by the Irish government to date, to ensure that no local bank would go bankrupt.

The Irish people did not know who was paying the banks' debts or the national and European consequences of a default. This engendered tremendous fear and uncertainty, leading to a sense of paralysis and helplessness among the population. Moreover, this situation was intensified by the refusal of the Irish government to consult its own citizens (and often not even its own parliament) on key decisions in relation to the payment of the bank debt.

The groups that conducted the debt audit – *Action from Ireland (Afri)*, *Debt and Development Coalition Ireland*, and *Unite Trade Union* – developed the audit project as an independent investigation initiative, rather than a campaign. Thus, the audit could provide basic and objective financial information to the public. The audit findings were then interpreted by the commission groups. From our point of view, the key issues that the audit revealed included:

- The huge level of bank debt that was socialized, including debt originated by guarantees;
- That many bondholders were not resident in the country, were anonymous, and exercised an extraordinary and unjust power over the Irish people.

The debt audit, therefore, provided a highly credible result that enabled the commission groups to launch a national campaign. The result was the formation of the new coalition of activists against the



illegitimate Irish debt, *Debt Justice Action*, which is part of the *Anglo: Not Our Debt* campaign (Anglo refers to the most repudiated Irish bank) formed by members of the community, movements for global justice, those motivated by their religious faith, academics, and trade unionists.

The campaign has put aside activities in favor of an audit to center its efforts on a campaign directly focused on the Irish government, calling for the suspension of payments on the most odious bank and illegitimate Irish bank debts.

VI - NORWAY - THE FIRST DEBT AUDIT CONDUCTED BY A CREDITOR¹⁹

In the spring of 2013, the Norwegian government would conduct the first debt audit initiated by a creditor. This means an audit of the debts held by developing countries with Norway with the aim of assessing Oslo's co-responsibility in contracting these loans. The reasons for conducting the audit were purely normative. The Norwegian Ministry of Foreign Affairs (MFA) made it clear in its proposal that "*there are no reasons to believe that the Norwegian Export Credit Agency might have acted irresponsibly.*" In fact, the underlying intention is to shed light on the debate and promote more responsible credit practices.

The proposal also specified that "*as an integral part of this exercise, is the intention that the process should be conducted in such a manner that it can serve as a successful example of how a debt audit can be carried out. Hopefully this will serve as useful lessons to learn for interested*

¹⁹ By Gina Ekholt, director of the Norwegian Coalition for Debt Cancellation (SLUG), February 2013.



actors, both creditors and debtors. The purpose of the debt audit is not to cancel debt.”

An independent government consultancy firm conducted the audit of the Norwegian debt, but with monitoring by a commission of the country’s MFA. The audit seeks to provide feedback in relation to the Principles on Promoting Sovereign Lending and Borrowing, recently issued by the UN. The proposal states that a debt audit will review such principles and provide important information for their further development.

In order for a debt audit to establish an international precedent, the lines of action applied in the process must be generally accepted. For this reason, the Norwegian Coalition for Debt Cancellation (SLUG) supports the decision of the country’s government to base the audit on the previously mentioned UN principles. It is expected that the audit will identify the bad lending practices currently being applied and promote new responsible credit practices. SLUG expects that the audit will set a precedent and that other creditors will follow the Norwegian example. If this occurs, the initiative could become a turning point for international finances.

VII - RECENT EXPERIENCES IN EUROPE

In **Portugal**, the campaign for the citizen debt audit was launched in December 2011 during the Lisbon Convention, with the participation of members of the Citizen Audit of Brazil, the CADTM, and various local social movements and volunteers.²⁰ The movement has already produced a technical report²¹ with its findings.

20 <http://auditoriacidadada.info/>

21 http://auditoriacidadada.info/facebook/docs/relatorio_iac.pdf



In **France**, following the lead of several associations (ATTAC, CADTM) and unions (Solidaires, CGT, Sud BPCE, FSU), with the support of political parties (NAP, CPF, GP, European Green Party) a collective national movement was created with the aim of achieving a Citizen Audit of Public Debt (CAC).²² Other local collectives were created in all the regions of the country, and their number now reaches about 140. Their aim is not to turn their members into experts, but to enable the public to be in a condition to understand the essential issues with respect to the public debt and to react collectively, using the tools developed by the CAC such as, for example, the audit guidelines for a municipality or hospital.

In **Spain**, based on the social movements that emerged throughout 2011, the Citizen Debt Audit Platform²³ (PACD) arose, with the slogan “we don’t owe, we won’t pay”. This civil society movement has been established in more than 20 cities in Spain.

In **Belgium**, the campaign for a citizen audit has recently been launched.²⁴

CONCLUSION

Throughout the world, the constant crises of all kinds have sparked concern in society to understand the reasons why public resources do not allow for resolving even its elementary needs, while at the same time the public debt has grown immeasurably.

22 <http://www.audit-citoyen.org/>

23 <http://www.auditoriaciudadana.net/>

24 <http://www.onveutsavoir.be>



To get to the bottom of these reasons, Ecuador based its efforts on the experience of the Citizen Audit of Brazil, and raised the struggle to the State level, in which the government decided, through a Supreme Decree, to conduct a comprehensive audit with citizen participation, in order to examine 30 years of public debt. This important initiative not only achieved a 70% reduction in the debt owed to the international banks contracted through bonds, but enabled effective investments in social services in health, education, transportation, etc. as well as re-establishing the country's sovereignty and identity, an example for all.

These Latin American experiences show that the truth can be obtained and concrete results achieved. The limitations that arise along the way cannot be impediments to continue the social mobilizations, which should seek to build a global movement in favor of another, more equitable and just economic model, for all the peoples of the world.

The experiences of the debt audit should serve to inspire other initiatives and gain time for the social struggles against economic slavery imposed by the Debt System.



Chapter 5.

Methods for conducting a Citizen Public Debt Audit



INTRODUCTION

Based on the experiences and concepts covered in previous chapters, which underscore the urgent need to determine which debts the population is paying, social organizations can advance in the struggle against this system that is focused on the plundering of resources by conducting a **citizen debt audit**.

While the audit is a technical tool, it should be made clear that it can be applied by all types of individuals from different backgrounds. What is only required is the will and commitment to take on such a challenging task that will reveal the truth about the Debt System, in defense of current and future generations.

The aim of this chapter is to describe the methods for the preparation and application of debt audits by civil society. We will discuss the methods that were applied in different countries, with excellent results, such as with the reduction of Ecuador's debt to international banks, as explained in Chapter 4.

5.1 – ESSENTIAL REASONS FOR CONDUCTING THE AUDIT

As has been mentioned, the public debt audit is based on an analysis of the processes or operating cycles of the transactions that gave rise to such liabilities. The audit seeks to identify aspects of the form and substance of the debt, and other related factors, in order to determine whether the debt (see following page).

The preparation of an audit begins simultaneously with the formation of a working team or task force, the gathering of information, and defining the focus of the investigation to be undertaken.



Reflects the real amounts of the debt,
is duly justified and transparent

Is legal, legitimate,
and free of irregularities

Causes moral or economic
harm or loss; reflects fraud

a) Formation of the working team

To begin the citizen audit, a **team, commission**, or task force should be organized that will ensure fulfillment of all phases of the investigation, until the final report is issued.

The team may consist of individuals, from different backgrounds, requiring only their willingness and availability to conduct a thorough and objective examination of the transactions that have generated public debt and its social effects, through the implementing an audit with its corresponding procedures.

It is necessary to demolish the myth that only specialists can participate in a debt audit commission. The cooperation and collaboration of technical specialists to assist in the accounting and statistical analysis is advisable, but the participation of individuals with varied experiences is indispensable, and allows for broader investigations.



It is recommended that the work be permanently monitored, to ensure the quality and even-handedness of its analysis and investigations directed toward its goal.

b) Gathering of information and data

Regardless of whether it is an official or a citizen audit, it is only possible to conduct an audit on the basis of information and documents, which society has the right to access, in accordance with the principles mentioned in Chapter 3.

Thus, the first step is to verify (1) the documents and information that are available in physical or electronic files of the institutions or agencies responsible for managing the public debt (Finance Ministry and the Central Bank), libraries, institutional records and archives, books on economic history, news reports and articles, documentaries, and especially studies produced in the different social movements, and (2) the data, which requires a more exhaustive, thorough search, through filing formal requests for information from government departments and agencies,¹ directly by individuals or through parliamentary representatives.

For example, the Citizen Debt Audit of Brazil has sent letters to government departments and agencies requesting data, based on the right to access information, and in addition, by going through the legislature, both nationally and regionally.

¹ The information can be solicited directly from the Finance Ministry and the Central Bank. The data that has not been provided and that is essential could be requested through the monitoring and control units of the corresponding institutions, legislative commission, arbitration commissions, audit commissions, the judiciary, courts of auditors, etc.



The gathering of documents should include the **legal basis** and **basic statistical information** and **macroeconomic data** relevant to the issue of public debt, for the **period subject to the audit**. For example:

- Legal basis, specific regulation of public debt and constitutional provisions.
- Details of the formal authorizations that might have generated public debt (supreme decrees, legislative and administrative authorizations, etc.).
- Periodic statistics of an official nature or from an authorized body on debt stock and periodic flows (semi-annual, annual and/or monthly) of public debt principal and interest.
- Periodic budgets from the Finance Ministry, executed and projected.
- Periodic reports on the macroeconomic situation related to the generation of public debt.
- Government commitments to international financial institutions or agencies, or those of the region to which it belongs.
- Institutional reports from monitoring and control bodies (parliament, court of auditors, comptroller's office, etc.).
- Studies, comments, observations, value judgments formulated in the social movements, parliaments, newspaper articles, and/or by previous audit firms.
- Reports on the primary and secondary market for sovereign bonds, nominal rates, discounts values, premiums, yields, etc.
- Periodic balance sheets of the responsible governmental divisions and agencies such as the Central Bank, the Finance Ministry, or the Treasury, etc., or details of accounting records in which the public debt is registered.



Some recommendations should be observed in relation to documents that will be the basis for the audit analysis:

- The document should be of good quality, that is, it should be the definitive version (and not an intermediate draft), with the signatures of its authors or those assuming responsibility for it;
- In the copies of the documents, the files where they were found or the source from which they were obtained should be indicated;
- A certification and/or declaration should be requested from the responsible party to ensure that the copies obtained are a faithful reproduction of the original.

In the case of applying a specific audit, information should be compiled on the precise issue to be examined.

Because the transactions that generate public debt have, for decades, been managed in secrecy, obtaining documentation is a major challenge for the citizen audit.

In summary, the audit team will have to gather data on the legal and regulatory basis of the mechanisms that generate public debt, the operability of the cycles used in each mechanism, and the reasons for the growth in public debt, considering the macroeconomic and related effects, since such knowledge will provide a solid basis for carrying out the audit.

Once the data is obtained, the next task is to analyze it, in accordance with the objectives of the investigation.



c) Description of the audit's focus

At this stage of preparation, the citizen audit should define what the focus of the audit to be conducted should be, since this definition will guide the procedures to be adopted.

The focus can correspond to a comprehensive or a specific audit.

The **comprehensive audit** offers a broad review and is oriented to the analysis and evaluation of all the mechanisms, transactions, and processes (economic and political) that have led to debt accrument. This is in order to determine whether they reflect the real amounts, are duly justified and transparent, as well as if such debts were legal, legitimate, transparent, or devoid of irregularities. In addition, a comprehensive audit will determine whether, on the other side of the ledger, these public debts resulted in real advances or if, on the contrary, they triggered social, moral, economic, environmental, ecological or cultural damage or losses or undermined the country's sovereignty.

Thus, the comprehensive audit goes beyond verifying accounting records and statistics, since it considers the functioning of the Debt System in the context of the country's economic and political scenario in place from the time in which the debts were incurred. It also addresses legal aspects and the different effects of the debt process from its origin.

The **specific audit** offers a concrete examination focused on a particular aspect of public debt generated in the past or at present, such as:



a) A specific mechanism whereby multilateral debt, bilateral debt, debt to international banks, etc. was accrued.

b) A specific project financed with public debt, or item(s) of a specific balance sheet, a contract, or a relevant transaction.

c) Concurrent issues at the time the public debt is incurred in the present and in the future, such as banking system bail-outs, the signing of treaties, agreements signed by the government or official bodies with national and international institutions and agencies.

d) Issues related to specific **tasks focused on important social struggles and their respective mobilizations that are not organically linked to this technical tool**, and that should be permanently addressed by the citizen audit, such as:

- Periodic monitoring and follow-up to the behavior and evolution of the public debt and the demand for resources for the payment of interest, amortization, and costs, in comparison with other social expenditures.

- Development of macroeconomic research that would consider some measures adopted and their relation to the debt and their social effects, such as, for example, controlling inflation by using mechanisms that cause losses for Central Bank, which is transferred to the public budget and assumed by society.

- Undertaking studies on the country's Constitution, regulations, and legal basis, with the aim of identifying illegalities and debt priorities, and organizing social mobilizations to propose legal changes.

- Follow-up to legal actions, recommendations, and results of comprehensive or specific audits and investigations undertaken on the public debt.

- Review and analysis of criticisms of and scandals caused by the public debt.



- Preparation of reports, statistics, verification of balance sheets of government entities, economic analysis, identification of social, ecological, economic, financial, gender effects and impact on the populations involved.
- Circulation of the results of investigations and audit findings concerning the public debt: its origins, its evolution, the mechanisms implemented resulting in its growth, etc., in order to raise public awareness about the historical payment that society has been making and the reasons behind it.

Whatever the focus of the audit might be, the application of **four phases** is recommended, with the only difference between a comprehensive audit and a specific audit being the number of related issues that are addressed.

5.2 – PHASES OF THE DEBT AUDIT

Based on the Latin American experience, the suggested methodology for conducting a public debt audit consists of four **phases**:





a) First phase: review and preliminary analysis

Once the appropriate conditions have been ensured –working team or task force, documentation and definition of the approach to be followed - the first phase of the audit can begin. This first phase will be focused on a review and preliminary analysis of the documents that have been gathered.

The objective of this phase is to **define an initial overview of the debt process and its effects**. This will allow for visualizing the most important points, which will indicate the main issues that should be more thoroughly addressed in the following phases.

Some important points to be considered in the preliminary phase are:

1. Defining the debt accrument process and the types of existing multilateral, bilateral, commercial, and domestic debt;
2. Summarizing the major economic, historical, fiscal, banking, and tax developments that bear a relation to the country's fiscal situation, in chronological order;
3. Studying the country's political and social characteristics in order to determine their relationship to the problem of the public debt;
4. Identifying the legal basis on which the public debt was authorized as well as the government bodies responsible for its management and control;
5. Identifying the macroeconomic conditions that gave rise to the debt;
6. Identifying the statistical, budgetary, and accounting data that are available, in order to analyze the evolution of the stock of each type of debt and its flows (payments of interest, principal, commissions, and other costs);



7. Determining the main real amounts received and paid, for every debt incurred;
8. Comparing the annual budgets for health, housing, education, and other public expenditures to the amount of resources earmarked for debt payment;
9. Summarizing the evolution of the public debt, by periods corresponding to presidential administrations;
10. Analyzing the public debt according to financial indexes and their interpretation, considering the criterion of gross and not "net" debt;
11. Identifying the agreements signed, main clauses and conditions stipulated, in order to determine their legitimacy and legality;
12. Verifying where the funds were allocated (if they actually entered the country or only served as payment and/or prepayment of previous debts);
13. Identifying the main public debt transactions made abroad;
14. Determining which government bonds are traded on financial markets, as well as their value.

As a result of this work, both in a comprehensive as well as specific audit, the audit team or taskforce will issue a **preliminary report**. This report shall contain a clear and summarized account of the debt panorama, the mechanisms that have generated public debt, its operating cycles, the legal and regulatory basis, the analyses, comments and preliminary findings, as well as related points and macroeconomic factors.

It is important that the preliminary report indicate the most important points, which should receive special attention in the following phases of the work of the debt audit.



b) Second phase: planning

The information contained in the preliminary report will be the basis for the team to **plan the audit**.

In a citizen audit, **planning** involves the preparation of the plan or **audit program** that explicitly explains the main parameters motivating the investigation, how to conduct it, how thorough it should be, in what timeframe, under whose responsibility, with what procedures, etc.

The program can be developed by topic or type of mechanism, which will indicate a series of procedures to be followed during the work of the audit, and direct them in their implementation in order to obtain sufficient and quality evidence so as to achieve the previously established general and specific objectives.

The structure of an audit program will be the same for both a comprehensive and specific audit, and will contain:

PROGRAM FOR A CITIZEN AUDIT

Reasons for the Audit
Overall and specific objectives
Scope
Determination of the working groups or taskforces
Implementation schedule
Techniques to be applied
Types of tests to be performed (substantive and compliance)
Summary of evidence (findings)
Signatures of responsible parties



b.1) *Reasons for the audit*

The citizen debt audit will define the reason for the tests to be performed, depending on the points verified in the preliminary analysis, selected according to economic importance and/or social effects. For example:

- i. In Greece, the motive can be conducting a comprehensive audit of the Greek sovereign debt contracted through government bond issues;
- ii. In Africa, it can be a special investigation into the external debt to international financial institutions and agencies;
- iii. In Brazil, it could be a specific examination of the early redemption of sovereign bonds trading at a premium and advance payment of the external debt to the IMF;
- iv. In France, it could be the audit of the debt of a municipality;
- v. In Spain, the motive behind an audit could be a specific appraisal of the bailout program for the popular savings banks known as “*cajas de ahorro*”;
- vi. In different countries, it could be a comprehensive audit of the mechanism for transforming private debt into public debt, especially the bank bailout;
- vii. In Greece, Ireland, Portugal, and Cyprus, the debt with the *Troika*.



b.2) *Overall and specific objectives*

The overall objective is the broadest element that will serve as the final goal that must be reached by the team and is directly related to the motive behind the investigation.

In relation to the above-mentioned examples, the overall objectives are:

- i. To verify the legality of the Greek sovereign debt bond issues, the justification and use of the corresponding resources, the reasonableness of interest costs, lawyers' fees, rates, commissions, as well as the social effects resulting from the demand for the corresponding budgetary resources to debt payment;
- ii. To denounce the explicit and implicit conditions in each of the agreements and contracts signed by African countries with the IMF and World Bank and their economic and social effects;
- iii. To investigate the financial and legal details of the advance redemption of Brazilian sovereign bonds with over-price, and the prepayment of external debt to the IMF in order to determine the harmful financial and economic consequences resulting from such operations;
- iv. In France, to identify the toxic loans held by municipalities and calculate the extra cost involved;
- v. To identify the amounts of public resources that have been earmarked for the savings bank bailout (for the cajas de ahorro) as well as the origin of the embezzlement in these institutions;



vi. To identify the mechanisms through which private debts were transformed into public debts in other countries, especially via the bank bailout;

vii. To indicate the social consequences for the countries involved.

In addition, identifying some process related to other surrounding and related factors of great importance, because they represent acts and measures that influenced the growth of debt, can also be an overall objective, as mentioned in Chapter 3.

The **specific objectives** are determined based on each overall goal and are aimed at determining whether the processes or operating cycles of the mechanisms that have led to public debt being incurred were properly reflected. In addition, if they are legal, legitimate, transparent, and if they were free of irregularities, or if, on the contrary, they caused moral and economic damage and losses to the country, taking into consideration the pre-established legal, accounting, environmental, financial, and social aspects involved. For example:

- Irregular, illegal and non-transparent instrumentation;
- If the amount includes capitalization of interests (common and in arrears);
 - If the amount includes the absorption of debts that come from sectors with particular interests;
 - If the negotiation includes requirements of collateral guarantees or their liquidation without any formal authorization;
 - If the agreements or contracts involve illegitimate clauses or constitute a violation of rights or legal standards



or a renunciation of sovereignty, if they are written in other languages, and contain constraints and incoherencies;

- If the agreements and contracts imply the prepayment of obligations not yet due and/or issuing securities in more demanding conditions;
- If the settlement of the transaction implies charging excessive commissions and lawyers' fees;
- If the agreements and contracts include the unilateral increase in interest rates;
- If the acts reveal an external influence aimed at establishing beneficial conditions only for creditors;
- If the agreements and contracts stipulate that it must be a single agency that conducts the feasibility studies for the restructuring of the public debt, its implementation, collects its guarantees, ensures the settlement of a swap, and trades the bonds in the market;
- If the loans involve toxic products, derivatives, etc..

b.3) *Scope*

At this point, it is necessary to determine the scope of the audit, that is, what is the period being covered by the investigation. In general, the period is determined in accordance with some important developments that represent a reference framework.

In relation to the previous examples, the scope could be:

- i. x years, corresponding to the period of Greek sovereign debt bond issues from the time of Athens' entry into the Eurozone in 2001;



- ii. x years, the period in which the IMF was active in Africa, as of 1980;
- iii. x years, from the origin of the early debt payment operations with an overprice in Brazil in 2004;
- iv. x years, from the beginning of the toxic loans incurred by municipalities in France in 1995;
- v. x years from Spain's entry into the Eurozone, when a change in rules regulating the savings banks known as *cajas de ahorro* were promoted in order to facilitate their adaptation to the European banking system;
- vi. x years since the beginning of the banking bailouts in different nations, such as Ecuador (1983), Brazil (PROER-1997 and PROES-1998) United States (2007), European countries (2009).
- vii. x years, since the start of the *Troika's* functioning.

b.4) *Identification of the working groups or taskforces*

Planning must distribute the available personnel to develop the work of the audit, in accordance with the objectives established.

The working team can be organized into **subcommissions and specific groups** based on the issues and sub-issues to be investigated, for example:



PUBLIC DEBT AUDIT COMMISSION

SUBCOMMISSION	GROUPS
Commercial	Origin of the debt to international private banks
	Refinancing or swaps
	Bank bailouts
Social effects	Cutbacks in social spending
	Privatizations
	Neoliberal reforms: pensions, tax, labor, etc.
Multilateral	IMF
	World Bank
	Regional banks (IDB, Latin American Reserve Fund, others)
Bilateral	Paris Club
	Official development banks
	Countries A, B, C
Internal	Bond issue transactions
	Open Market operations
	Bank bailout
	Conversion of external into internal debt, etc.

b.5) *Activities chronogram*

The program should include an implementation chronogram, with deadlines for each stage of the work, depending on the test to be performed, as well as the date of completion of the activities for the audit and submission of the final report.



b.6) *Techniques to be applied*

The program should indicate the techniques used during the audit:

- Analysis
- Investigation
- Verification
- Inquiry
- Review
- Confirmation
- Inspection

Through the application of these techniques, findings or evidence will be sought that will support and underpin the preparation of the audit report.

b.7) *Compliance Testing*

Compliance testing involves all the procedures geared toward determining the formal aspects of the transactions that generated public debt, in order to verify whether or not the legal standards, rules and regulations in force at the time were adhered to:

- Were such transactions authorized in accordance with the legal, regulatory, and constitutional codes and stipulations?
 - Are the documents that formalize the authorization clear, precise, and codified in a public document by the competent authorities and/or duly appointed officials?
 - Were the transactions undertaken in compliance with the reports stipulated in the legal and regulatory codes?



- Are the documents that validate the authorization of debt accruelement objective, real, independent, viable, and do they refrain from undermining the interests of society?
- Were the transactions formalized with the signing of the corresponding contracts and agreements by the competent authorities and within the established timeframes?
- Are the documents that underpin the transactions free of irregularities, abusive terms, and waivers by the debtor or do they set conditions?
- Based on the analysis of the “Map of Participants”, it is possible to determine a party’s frequent participation?

b.8) *Substantive tests*

Substantive tests consist of tests involving transactions and balances, as well as analytical investigation techniques. The procedures will be aimed at determining substantial questions; that is, establishing whether the **amounts** represented as public debt and their costs are real, if they are reasonably presented, if they have defects or irregularities, are marked by fraud, abuse, change of circumstances, etc. Such tests should respond to the following concerns:

- Are the amounts of debt reported by the government real?
- Do the amounts of principal, interest, and commission fees reported by the government correspond to what was agreed upon in the documents and contracts on which the authorized transactions are based?
- Do the amounts of the public debt principal imply the capitalization of normal and back interest and other costs of previous transactions?
- In the resources obtained from public debt, are where



such funds are allocated and the financing of projects to benefit society duly documented?

- Does interest paid correspond to floating rates charged as imposed by the creditor?
- Do the expenditures paid represent more than the capital borrowed?
- Were the expenditures paid as commitment fees and commissions collected in advance or deducted from the gross proceeds of the transaction? Were they paid to companies linked to the creditors?
- Are there irregularities in the transactions?
- Do intermediate transactions have backup?
- Are the government accounting documents signed by those in charge of the securities' settlement? Is there backup documentation?

b.9) *Summary of the evidence - findings*

The program should indicate the need to summarize the evidence found during the execution of the audit through the application of the previously mentioned techniques and tests.

It is important to anticipate the possibility of some addition or change in the program based on the findings made during the Audit application phase.

Once these findings have been pinpointed, they must be analyzed by the technical staff, not only to identify what documents, files, and processes are to be investigated, but also the points that contradict the basic principles of internal control that should exist in any transaction.



b.10) Signatures of the responsible parties

Those responsible for the preparation of the audit program should assume the role of permanently monitoring and coordinating the work in each of the tasks, by providing assistance and support to the working group.

As a **result of the Planning Phase**, the audit team will have confirmed the guidelines of the test or examination to be applied. For example:

- What type of test or examination is to be performed, comprehensive or specific?
- What are the chosen objectives?
- What are the techniques and procedures to be used?
- What is the depth and scope of the examination?
- What type of report is to be issued?

c) Third phase: Performing the Audit

c.1) Team Organization: Establishing the Working Groups

According to the Audit Program, subcommissions and working groups will be established for the application of the audit for each overall objective chosen.

Considering that the work of the audit is a team effort, it is recommended that the subcommissions and working groups choose a general coordinating or monitoring committee.

Before starting the execution of the audit, it is important that all members of the subcommissions attend introductory conferences



on the issues raised in the previous phases of “Preliminary Review” and “Planning”, so they can resolve their doubts and concerns, unify criteria and, above all, determine the pointers and relevant questions that should be focused on in order to obtain evidence and documents.

A deadline schedule will be established for the execution of the audit in accordance with the group of people available to do the job and as defined in the program.

c.2) Application of the Compliance Tests and Substantive Tests

The application of the audit requires the application of compliance tests (verification of everything related to formalities, i.e., compliance with legal norms) and substantive tests (related to matters of substance or statistics) as defined in the audit program. This involves applying the anticipated techniques, such as inquiry, review, confirmation, investigation and research, testing, etc.

Through the application of these tests, the audit findings are to be obtained, consisting of the verbal and documentary evidence that will underpin the results in accordance with the established objectives.

The findings should comply with some essential requirements, such as:

- They should always be properly grounded in evidence and documents that are authenticated or certified;
- They should be grounded in elements of sufficient quality and competency that they reasonably allow for assuming the veracity of the points being analyzed;



- They should have their quality proven by analysis, confrontation, and verification through substantive and compliance testing;
- They should be described in working papers and reports, indicating the procedures applied in obtaining such findings, the source of information as well as a detailed analysis of the situation referred to in each of the relevant evidence and documents.

The findings may come from additional reports prepared by specialized consultants or experts in specific issues such as the environment, human rights, and other fields necessary to determine the effects of the debt accrurement process.

In the different analyzes made concerning the debt, sometimes a consideration of the juridical aspects is omitted, as if everything involving the debt were of no relation to the field of law, having a kind of immunity that prevents the issue from being brought to court. Therefore it is important to review the legal issues discussed in Chapter 6.

One of compliance tests suggested is the verification of adherence to the standards governing the implementation of each step of the operating cycle of the debt process. To do so, it is advisable that a **flowchart** be prepared corresponding to these cycles that helps to clarify the panorama of the institutions involved (and their responsible parties) and the pertinent generated documents, their location in files or other alternative sources. For example:

Operating Cycle for Debt Procurement – Flowchart

Process	Institution	Responsible party	Document generated	File
1. Authorization	Central government	President	Decree	Official registry
	Parliament	Chairman	Resolution	Legal standards library or institutional web page
	Attorney General's Office	Attorney General	Legal opinion	Institutional file
2. Formalization	Finance Ministry	Minister	Ministerial agreement, Sovereign bond issue document	Ministerial registry or institutional web page
	Foreign Affairs Ministry	Foreign Minister	Registry book	Letter of authenticity
3. Account ledgers	Finance Ministry	Undersecretary	Accounting book entry	MEF accounting
	Public Prosecutor's Office	Prosecutor	Judgment	National archives
4. Control	Court of Auditors	Ministers	Report	Library and institutional web page
	Comptroller's Office	Comptroller		
	Parliament	Chairman		
5. Accountability	Finance Ministry, Central bank, Court of auditors	Ministers	Report	Reports and institutional web pages



This procedure will allow the audit team to have a general overview of the operating cycles, and identify the documents that should be analyzed and the existing files (both for their authorization, application, accounting, etc.. of these types of operations as well as for the responsible areas), which will facilitate the verification of the original documents in case this is required.

It will also allow for visualizing items that contradict the basic principles of **internal control** that should exist in any transaction.

The **internal control system** is the totality of methods, measures, and procedures existing in a system with the aim of:

- 1 Protecting its resources against loss, fraud, and inefficiency;
- 2 Promoting the accuracy and reliability of the accounting and operating reports;
- 3 Supporting and measuring the achievement of the goals.

Thus, in a hypothetical case, the following can be noted as weaknesses of the transaction's internal control system:

- In the transaction's original cycle, if there is no report of an independent technical body that would justify the credit operation to society.
- That the analysis of the transaction by the Monetary Board in session, or by Public Prosecutor's Office, or by Parliament, is purely financial, superficial, generally conducted in a single session in a block vote with other issues.
- That the President of the Republic or the Finance Minister delegates to a single negotiation commission or department the preparation of the entire transaction, from making contact with



the creditor to agreeing on conditions, guarantees, settlement of expenditures, commissions, etc. That there is no monitoring and technical analysis of which option is the best in the market.

- There is submission to the rules of the market (for example, the *benchmark* theory), which means the supremacy of financial interests over collective interests, which should be prioritized by the corresponding government officials. An example would be issuing bonds with interest rates higher than the base rates approved by the Central Bank.

- That the Finance Ministry limits its activities to registering the operation and ordering, when due, the payment of the debt, based on the consideration that the negotiations are secret and that issuing debt to pay interest has been verified; that is, ignoring illegal aspects of the transaction.

- That the monitoring by the Comptroller's Office, the Court of Auditors. or Parliament is superficial, deficient, and only performed at the end of or subsequent to the transaction, or not even that.

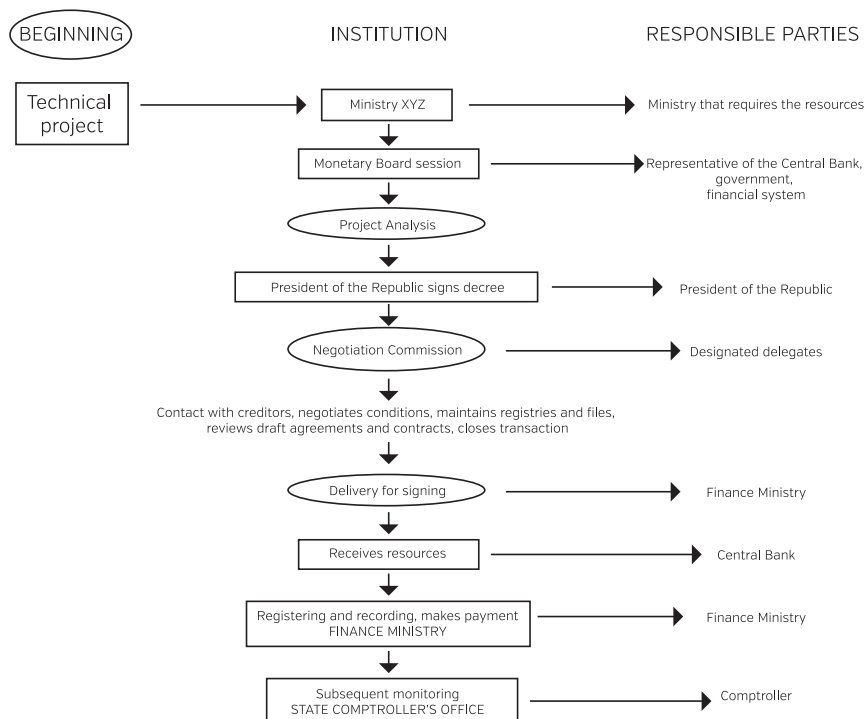
These points should be taken up in the report as relevant factors and could be represented in a flowchart that can be easily visualized (see next page.)

Many countries express their debt strategy in their Annual Debt Plans,² which should be an instrument for the verification of internal control as well as the quality and consistency of its content, supposed justifications, and compliance or lack thereof.

2 http://www3.tesouro.fazenda.gov.br/divida_publica/paf.asp



PUBLIC DEBT AUDIT DIRECT CREDIT CYCLE FLOWCHART



The existing internal control weaknesses may be **cause for additional activities of the citizen audit**. For example, the fight for the modification of laws and internal regulations as well as the demand for transparency simultaneously with undertaking public debt related operations.

After determining the operating cycle and verifying compliance with formal procedures –**norms** and standards at each step of the process- substantive issues must then be verified; that is, the **amounts**



of the transactions that generate public debt must be confirmed. This is one of the basic procedures of an audit, as it is necessary to determine whether the amounts reflected by governments as public debt are or are not real.

To facilitate verification of the testing, it is advisable to prepare a chronological or sequential **list of operations for each mechanism, such as contracting loans**, sovereign bond issues, absorption of indirect debt, issuances of guarantees, etc. for the period being audited. This is in order to obtain a database that would contain the universe of transactions to be audited.

It is recommended that, based on these documents, a **detailed analysis** be undertaken of each transaction, identifying all its characteristics, such as interest rates, creditors, allocation of the loan resources, etc.

This above-mentioned list will enable an **analysis to be made of the evolution of the transactions involved in the debt accrument process** as a chain, that is, how one transaction leads to the next through debt refinancing or replacement. Special attention should be placed on identifying the swaps that function as bundling of previous debt, and with this in mind, it is essential to **reconcile the figures**. If this criterion is not taken into account, it could distort the total amount of public debt transactions, hence its importance.

In addition, in this stage of detailed analysis, it is advisable to read in their entirety the documents that contain the authorization to conduct the transactions, since in several cases the existence of measures that are not explicitly mentioned in the contracts for public debt (either contractual or by issuing bonds), swaps, or renewals can be noted.



The audit team should keep in mind that in many countries these authorizations, which are codified through supreme decrees, enter into effect as of their publication in the official gazette. That is, the acts are valid when the authorization is legally formalized, and therefore it is suggested that the corresponding legislation in each State or region be reviewed.

At the same time, it is important to contemplate the possibility that the government might have issued guarantees to third parties unconditionally and unlimitedly and that they might not be registered or reflected in the balance sheets as public debt. Given that these guarantees are enforceable, they must be considered as public debt.

In the case of credits from multilateral financial institutions, it should be verified whether the amounts actually entered the country or were on *standby* as a mere guarantee for the peace of mind of private creditors, despite the charging of high commissions – commitment, administrative, etc. – and interest costs, lawyers' fees, etc.

After the transactions detailed in the chronological lists have been analyzed, the audit team will apply a **global test** to determine if the debt stocks reflected in government statistics and reports are similar or coincide.

This test should begin with the debt stock at the beginning of the period subject to the audit (origin), to which the month's transactions and the accumulated interest will be added. Subsequently, the monthly payments will be subtracted. This information could be taken from the already executed governmental budgets.



As a result, the actual balance will be obtained, which should coincide with the debt stock showed by the government. In that case, it will indicate:

- **Important differences** that represent significant indications of deficiencies in control that merit an in-depth investigation;
- A **reconciled balance**, which will serve as a basis for all the procedures to be applied.

These differences are evidence that should be mentioned in the final report of the audit.

In some countries this information, in accordance with the corresponding legal dispositions, is under the custody of the Finance Ministry and/or the Central Bank and takes the form of a Public Debt Book or Registry or Sovereign Bond Issue Book, or a chronological electronic registry of these credit transactions. If access were feasible, this source could be used instead of the “chronological or sequential list of transactions”, which would shorten the working time frame.

In the case of a specific audit, the same previous procedure would apply, but selecting only the steps applicable for the chosen objective.

c.3) *Map of participants*

Based on the chronological list referred to in the previous section, a detailed document should be prepared that identifies the participants in each of the transactions that have generated public debt. This is to determine the frequency of their participation and identify their legal status, company name, names of their shareholders, if they



are part of an international banking institution, type of transactions allowed, type of monitoring required, ties with the government, etc.

This report, which will be called the **Map of Participants**, will be prepared for each transaction that has generated public debt in the period being audited.

It has been shown, for example, that in Ecuador, the creditors of the initial debts were simple companies, mainly Shearson Loeb Rhodes. They were successively renewed for years under the “financial institutions” category, particularly Citibank, whose main shareholders were the same, namely, Loeb Rhodes, E.F. Hutton, Citibank, Lloyds Bank, Chase Manhattan Bank, and Morgan.

Subsequently, only one **agent** showed for the renewals, representing a committee of international banks. As a result, all interest payments, for example, had to be made directly to the agent in bank accounts located in **tax havens**.

This process frequently repeated itself, with **the same small group of international banks**, which acted on their own or represented several others, and was the “Management Committee”, which in the 1980s determined the conditions (IMF packages) for the refinancing of commercial debt.

Considering that these transactions should be completely transparent, the audit team should request additional information (such as the Management Contracts or the bylaws that created trusts), in which the international banks were authorized to act on behalf of the creditors, in order to determine the levels of responsibility of all the participants in the event of discrepancies, lawsuits, or disputes.



In the Latin American experience, procedures were undertaken to identify or confirm the institutions responsible for financial transactions registered as public debt, even though many of them have refused to provide any information in this regard. Such behavior gave rise to doubts concerning the transactions that are presented as public debt in some countries.

By the same token, in reading the contracts and agreements, the existence of trusts was determined, which had a priority in purchasing sovereign bonds issued in the first instance, to subsequently sell them in the secondary market. Thus, the trust obtained an economic advantage.

c.4) Responsible officials

To complement the above analysis, using the same source of information, it is advisable to register the names of the officials who were involved in each of the transactions in the period being audited.

After this, the appointments of each of the officials should be verified in the files, in order to determine whether or not they were acting legally, empowered to authorize such transactions.

From the Latin American experience, evidence was able to be obtained that the president of a “public debt restructuring commission” hired a single foreign company to undertake the studies, debt reprogramming, and handle the sovereign bond offer, even though, under domestic law, only the Finance Minister, can issue the call for bidding on contracts for such services. This clearly uncovered an illegality.



c.5) *Determination of legal liability*

Considering that the handling of public resources can become, in cases of liability, the subject of litigation, the audit reports should clearly indicate the responsible officials and determine the map of participants, in accordance with the above-mentioned criterion.

According to the legislation of several countries, the determination of administrative, civil, and criminal liabilities are functions of the control bodies, such as the Comptroller's Office and the Attorney General's Office. However, in almost all countries the determination of criminal liability corresponds to specific investigations by law enforcement authorities.

It is important to mention that the debt audit reports should provide itemized information not only on the documents that reveal legal responsibilities of individuals, institutions, or countries, but should also indicate in detail the acts or incidents that are grounds for investigation. These would include, for example, the use of public resources for personal purposes, misuse of debt, misappropriation of funds, illegitimate, illegal or unsustainable debt, damages and losses caused to public finances and society. Misappropriation of debt will be discussed in Chapter 6.

c.6) *Confirmation–Inquiry visit*

In many cases, the investigations are not sufficient to reach definitive conclusions, and therefore confirmation and inquiry visits are necessary.

In general, it is not easy to obtain this kind of access, but also not impossible. In December 2012, the Citizens' Debt Audit in Brazil



obtained a hearing with those responsible for the State public debt in Rio de Janeiro. These officials provided their testimonies and offered information related to documents that were being analyzed by members of Citizen Debt Audit Office in Rio de Janeiro.

Thus, the citizen audit should seek contact with officials in the departments responsible for debt procurement in entities such as the Central Bank, Finance Ministry, the Attorney General's Office, the Comptroller's Office, etc. in order to confirm and investigate the outstanding issues.

Visits considered to be necessary shall be made in accordance with a pre-established calendar, with the application of questionnaires prepared by the technical working group. These documents will contain questions that are directed toward confirming information initially obtained and to gather additional data.

The questionnaire should not be a sophisticated tool. On the contrary, it should be prepared technically, with objective questions about what is being investigated. In other words, it should be aimed at determining the mechanisms that give rise to public debt, the legislation that regulates such debt, the operating cycles applied, the main comments formulated by journalists, the control and monitoring agencies, and, above all, the financial accounts in which such liabilities are registered.

Questionnaires can be prepared for direct responses (yes/no) or the use of a **narrative system**, that is, those interviewed speak openly about a given issue, as if in a conference, but organized by chapters or sub-issues. Usually, such an investigation using the narrative system requires much more time, but can provide important information for the audit. An example of the narrative system could be:



CITIZEN PUBLIC DEBT AUDIT

NARRATIVE SYSTEM PUBLIC DEBT INQUIRY

For the period of:

Prepared by: Date:

Reviewed by: Date:

Official interviewed: Director of Public Credit

Institution: Ministry of Economy and Finance

Issues to be investigated		Minimum requirements for the responses
1.	Legal basis for contracting debt	Depending on the period subject to examination, debt procurement or bond issuances proceeded in accordance with the law ... or judicial examination of the issues of fact... if it had the prior approval of Congress... legal report of the Attorney General's Office...
2.	Operating cycle and documents generated in procuring loans or issuing bonds	Indication of documents related with each phase: <ul style="list-style-type: none">• Authorization• Technical report• Report from the Attorney General's Office• Registration in the Finance Ministry• Lawyer opinions• Audit results• Agreements, contracts, and other instruments.



Issues to be investigated		Minimum requirements for the responses
3.	Modality at maturity of interest	<ul style="list-style-type: none">• Amortization and interest payment tables.
4.	4. Documentation with regard to application of resources	List of documents in accordance with the applicable law.
5.	Documentation with regard to the renewal of the transaction	List of the same documents necessary in executing the previously mentioned contracts.
6.	Accounting system	Generally speaking, the body responsible for the accounting ledgers of the debt transactions is the Public Debt Department of the Finance Ministry. The accounting records can be reviewed for data on debt principal, interests, commission fees, and other costs.

After having applying the narrative system, comments should be made on the important issues, so for example:



COMMENTS

- The legal basis is confirmed;
- The statistics do indeed reflect the movements and balances;
 - It is confirmed that the use of the funds was mostly to pay and prepay previous debts;
 - For accounting purposes, the accounts 18191919 and 92393939 correspond to principal and interest; it has not been possible to find the ledger account for collateral securities;
 - Mechanisms or types of credits are confirmed;
 - Etc.

Following these confirmations, the technical team will now have concrete evidence of what it “perceived” concerning each operating cycle of the different debt transactions.

If it feels it to be advisable, the team should solicit in writing, through an explicit request to the officials interviewed, photocopies of the documents that it believes to be important.

The audit team should verify the information that it has gathered through confirmations, inquiries, etc. with documents that substantiate such information, and for which purposes it can attach the corresponding certified photocopies or originals. It should be noted that, in a footnote corresponding to these documents, the source and where they were obtained should be mentioned.

Other procedures may be adopted to determine, for example, the existence of public debt bonds in the financial markets as well as their value.



It is recommended that a priority be placed on inquiries into the existence of agreements or contracts that could establish the obligation to undertake transactions that affect the public debt through government “commitments”. These can include:

a) Signed documents in relation to the public debt during the period being audited, incurred by the government outside the country (through embassies, consulates). An example would be waiving the time-barring of debts (Tolling Agreement),³ open-ended guarantees for financial system transactions, etc.

b) Agreements or contracts signed by the government with financial institutions or bodies that are permanent in nature or that could affect the period being audited. It is necessary to identify these transactions with the country’s “commitments” or liabilities or obligations, for example, “Letters of Intent” with the International Monetary Fund, documents from the World Bank and the Central Bank, Brady Plan, Adam Project, the annual financial plan of each issuer, Central Bank, the European Investment Bank (EIB) Financial Plan, treaties with the European Stability Mechanism (ESM), etc.

With this analysis, the citizen audit team will be cognizant of the government’s main **commitments** on debt questions as well as be able to quantify their **impact** on the amount of public debt registered by the authorities.

3 *Final Report of the CAIC - Executive Summary*, 39-41, 54, 55, available at <http://www.auditoriadeuda.org.ec/>



d) Fourth phase: preparation of the audit report

Once the previous phases have been completed, the coordinating committee of the audit team shall prepare the Final Report.

It is important that the final report indicate whether all the procedures that were established in the Audit Program as overall and specific objectives were met, as well as if the corresponding tests were conducted. The findings should be correctly presented and substantiated with sufficient and compelling evidence. At the end, the report should contain a conclusion and recommendations, in accordance with what was verified.

In drafting the final report, special attention should be paid to a description of the findings, since they underpin the results of the audit. Thus, each finding should involve certain specifications such as condition, cause, criterion, and effect.

- Condition involves the overall description of the finding, for example:

No new credits had legal authorization in 2009.

- Cause: will detail what has led to this situation:

Public debt transactions that did not have legal authorization have been registered, pursuant to documents xxx, yyy, zzz, etc., obtained in file >>>> (specify location).

- Criterion: will indicate how the correct transaction should be:

It was found that law XXX, which stipulates that to procure credits there must be an explicit authorization of the Executive Branch, was not complied with.



- Effect: will indicate the result of the inquiry into the conditions of the finding:

The credit procurement transactions in the period under study are illegal, because they do not respond to the authorization levels anticipated in the applicable legislation.

In general, the report is divided into chapters that follow the order of the operating cycles of the mechanisms being audited and will be signed by the team responsible for its preparation.

In the case of the Ecuadorian public debt, for example, it was determined that the country's public debt was illegitimate and illegal and caused economic and moral losses and damage to society, according to the executive summary of the report, available at <http://www.auditoriadeuda.org.ec>

There are also reports prepared by the Citizen Audit of Brazil during the Parliamentary Commission (CPI) that are available at <http://www.auditoriacidada.org.br>

In addition, it is important that the Final Report of a citizen audit present a summary of the macro-economic analysis, as well as the effects of the debt on the budget, the economy, and social spending.

The recommendations should be objective and in accordance with what was proven by the audit. Such recommendations can include suspension and return of payments, punishing those responsible for the debt accrual, changing laws, policies, and procedures, etc.

It is also important to mention the limitations that were faced, such as lack of documentation necessary for the audit, which can illustrate the illegality of the public debt, given that the process should be transparent.



Once the report has been issued, the team should append the certified copies of the supporting documents, properly classified and identified.

In a citizen audit, the signature of the responsible party in the final report could correspond to the coordinator of the working group together with all the individuals who actually participated in the work.

5.3 – SPECIFIC TASKS FOCUSED ON SOCIAL STRUGGLES AND MOBILIZATIONS

Here we will mention some practical examples of specific tasks in relation to the important social struggles and the corresponding mobilizations that flow from the audit as a technical tool, and have been applied by the Citizen Debt Audit in Brazil.

a) Analysis of government budgets

Based on the consideration that payment on the debt service is codified in the Annual State Budget, analyzing it is of key importance.

One of the most important tasks of the citizen audit is to inform society of the burden represented by interest payments and amortizations and how the debt affects all other social spending.

In some investigations that have been already carried out, it has been noted that in various countries the information on the debt is not transparent.



One of the strategies used so that the real debt burden is not reflected is to separate out the part of the debt that is paid during the year through taking on new debt. This separation has been recommended by the IMF in the so-called fiscal responsibility laws that it demands be approved in each country.

This separation is an abuse of the budgetary principle of unity. It also involves placing a priority on the debt, whose interests, amortizations, and other costs were paid with the acquisition of new debt, while all other social expenditures are subject to budgetary constraints.

At the same time, errors were detected in the accounting ledgers in the expenditures column due to interest on the debt, separating out the monetary or foreign exchange restatement, as if it were equivalent to an amortization. This distortion also reflects a tremendous priority placed on the debt, since it conceals that the restatement of currency or exchange rate means guaranteed profits for the bondholders, while the other expenditures are not similarly adjusted.

In Brazil, the expenses incurred due to debts paid for with other debts are displayed separately in the national budget, and there is no transparency in relation to the amount of the monetary and foreign exchange restatement (which are part of the nominal interest paid), which is transferred to the amortization line item, increasing its corresponding amount. Nevertheless, it is an illusion, because the gross debt stock continues to grow. If such a large amount were being paid for amortizations, the debt would be declining and not rising. In point of fact, debt is being issued to pay interest.

Therefore, in its analysis of the government budget, the audit team should emphasize both “programmed” as well as “executed” debt payments.



b) Calculating net transfers

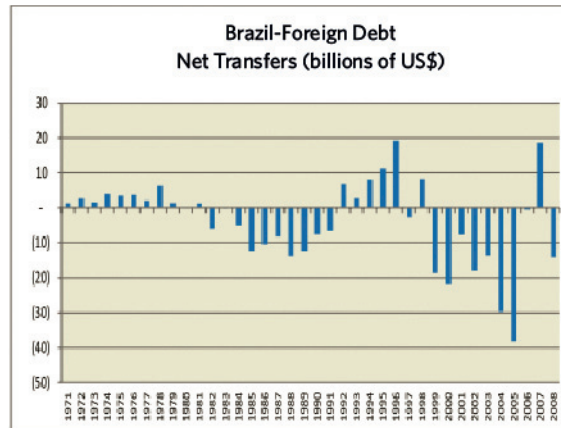
The purpose of calculating net transfers is to verify the importance of monetary outflows corresponding to public debt payments in order to clarify whether the debt functions as a source of resources for the country.

This calculation uses statistical data on public debt that is periodically issued by the Finance Ministry and/or the Central Bank, with the amounts duly confirmed. It also includes revenue registered for the procurement and/or issuance of public debt and their respective expenditures.

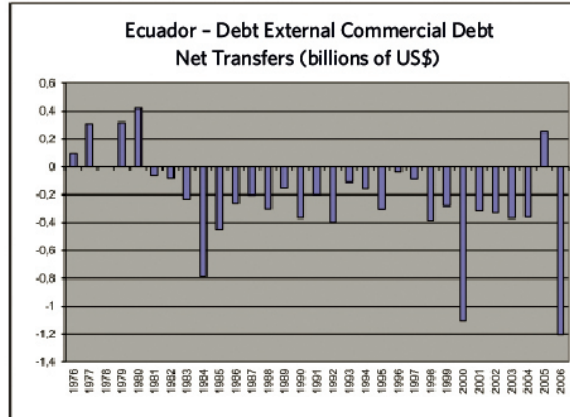
The graphical representation of the results will provide the audit team with the basic elements for visualizing whether the option of an audited debt represented an effective way of obtaining resources to stimulate the economy, or if it is functioning as a mechanism for the absorption of public resources.

Based on the experience in Latin America, it was determined that historically, the public debt has been a mechanism for looting the nations' resources:

- In Ecuador, official data clearly showed that in the 30 years examined by the CAIC (1976-2006), the external debt to international banks resulted in a net transfer of resources abroad to the tune of 7.13 billion dollars. Despite this impressive volume of payments, the debt stock continued to grow;
- In Brazil, net transfers calculated for the period studied during the parliamentary investigation (1971-2008) reached 144 billion dollars!



Source: Statistics of the Banco Central do Brasil – Nota Técnica Depec 2009/248.
Prepared by the Citizen Debt Audit - Brazil for the CPI da Dívida Pública.



Source: Statistics of the Banco Central Bank de Ecuador Prepared by the Citizen Debt Audit of Brazil for the CAIC.

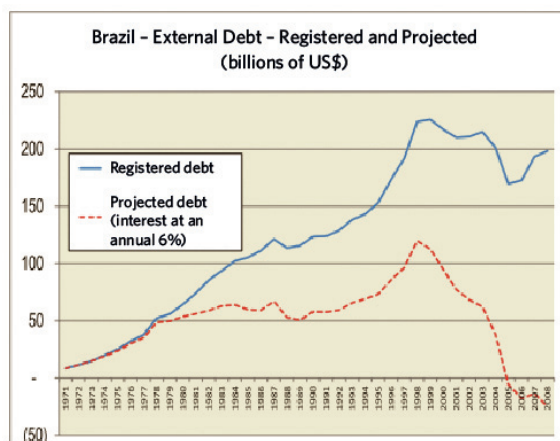


The graphs show that the Debt System does not contribute resources to the country but, on the contrary, that the debt is a mechanism for transferring public resources to the private financial sector.

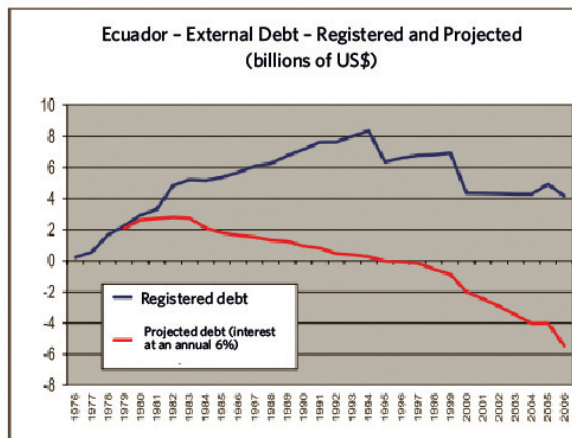
c) Study of the impact of the application of illegal or illegitimate interest rates on the evolution of the debt

This study identifies the impact of the use of illegal or illegitimate interest rates on public debt.

The Citizen Audit calculated the effect of a unilateral increase in international Libor and Prime interest rates on the evolution of the Ecuadoran and Brazilian external debts. It showed that if rates had been maintained at an annual 6%, based on the payments made (principal and interest) the debt would have been totally canceled years ago and the countries would have become creditors, as illustrated in the charts:



Source: Statistics of the Banco Central do Brasil – Nota Técnica Depec 2009/248.
Prepared by the Citizen Debt Audit - Brazil for the CPI da Dívida Pública.



Source [chart 2]: Statistics of the Banco Central Bank de Ecuador Prepared by the Citizen Debt Audit of Brazil for the CAIC.

This calculation can be used to compare the impact of different variables on the evolution of the debt, for example:

c.1) *Study of the impact of risk ratings*

Considering that the risk rating agencies and market players periodically rate the different countries' debt paper in order to "classify them according to risk", and taking into account that these ratings directly affect the level of the interest rates applied both in the secondary markets and for the new debt issues of these nations, an important task for the citizen audit team is to compare the historical risk ratings with the increase in interest rates required to refinance the "sovereign" debts.



c.2) The impact of the credit monopoly extended to the private banks in the Eurozone

In the past few years, the European Central Bank (ECB) has granted loans directly to private banks and the latter to countries, with differentiated interest rates:

- The ECB provides loans to banks with minimum interest rates of between 1% and 1.5% per year or less;
- The same banks provide loans to countries with interest rates that reached 7% per year.⁴

Based on these data, it is important to develop a projection of the behavior of the debt in the case of countries if they would have had the same interest rates applied by the ECB to banks offered to them as well.

c.3) Methodology to calculate the impact of variables on debt stock

It is possible to calculate the impact of the above-mentioned variables based on a comparison of the projected evolution of the debt that is actually registered with the expectation in which the variable to be compared is modified.

To do so, it is necessary to obtain for each year and each tranche of public debt the data on:

4 <http://noticias.terra.cl/mundo/europa/bonos-espanoles-llegan-al-7,93fb67022fef7310VgnVCM20000099cceboarCRD.html>; <http://www.elblogsalmon.com/economia/dinero-gratis-para-alemania-y-al-7-para-espana>; <http://cadtm.org/La-Deuda-llega-a-Europa-tras>



- a) Debt stock at the beginning of the year
- b) Loans obtained (it is necessary to verify the end result and whether the resources indeed entered the country)
- c) Accrued interest (item “A” + “B” multiplied by the interest rate of each debt tranche)
- d) Interest paid
- e) Amortizations (principal) paid
- f) Debt stock at year end

Based on these data, it is possible to track the evolution of the debt that was actually incurred. To verify whether the data are consistent, the debt stock obtained in “f” should correspond to “a” + “b” + “c” – “d” – “e”.

To track the other variant for the evolution of the debt to be visualized, simply replace variable “c” by the interest rate that should have been applied, for example:

- For the simulation calculated for the Ecuadorian and Brazilian debts, an interest rate of 6% per year was used, in effect at the time the loans were agreed to;
- To verify the impact of the risk speculated by the rating agencies, the normal interest rate would be used without the risk component;
- To simulate the impact caused by the banking monopoly in Europe, the interest rate applied by the ECB to banks of close to 1% per year would be factored in.

These examples can serve to reinforce the arguments of the social movements in struggles in favor of citizen’s rights and inspire the development of other practical studies and tasks that reveal the privileges and priorities of the Debt System.



CONCLUSION

Fulfilling the phases of a citizen audit converge in documenting the findings and verifying the existence of illegal and/or illegitimate debts, due to their origin in irregular and/or fraudulent processes.

The results of the citizen audit should result in a report and/or publications that should be widely circulated in order to achieve an increasingly stronger social mobilization.

These results should be furnished to the institutional control and regulatory agencies in order to determine administrative, civil, and criminal liabilities, in addition to providing additional arguments for the grass-root struggles for the cancellation and/or repudiation of these debts; for repairing the economic, social, and environmental damage caused, and for changing the legal structure that has been modified to privilege and prioritize the Debt System.

Thus, the citizen debt audit becomes a powerful tool for the authentic social movements that fight for truth, justice, and social equality.

The times of subjugation and enslavement of peoples end
when knowledge becomes a tool of social struggle.



Chapter 6.

Legal questions that must be addressed in the public debt audit



INTRODUCTION¹

The public debt audit can reveal different types of irregularities, abuses, and defects, which have resulted not only in incalculable economic and moral damage and losses, but also the creation of huge lingering social and ecological debt.

Legal support is needed to determine the illegality or illegitimacy of public debt and to provide grounds for its repudiation, abrogation, and/or partial or total annulment.

The aim of this chapter is to present the legal arguments that can assist the work of citizen audit, promoting social struggles to force government authorities to annul unlawful debts; determining the administrative, civil, and criminal liability of any participants in these processes that are harmful to the collective interests; and changing the legal and regulatory dispositions that enabled these frauds against society to be committed.

This contribution should obviously consider the national and international legal dispositions in the field of finances, but also criterion related to the debts' legitimacy.

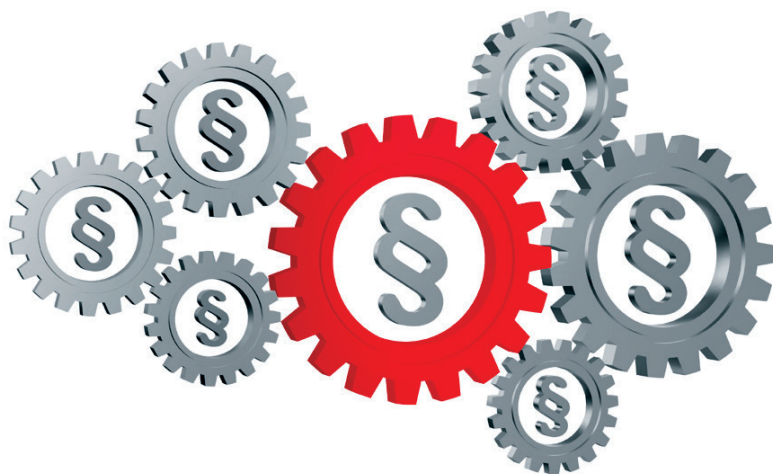
6.1 – BASIC PRINCIPLES

In order for a government to be required to pay a debt, the State must have explicitly and freely given its consent to its accrue-ment.

¹ Importance assistance was provided by Cécile Lamarque and Renaud Vivien [CADTM Belgium] and Alejandro Olmos Gaona [Argentina] in the preparation of this chapter.



From this consent a legal relationship is born, namely, the State's obligation to pay the debt. This obligation is grounded in the principle *pacta sunt servanda* (conventions and agreements must be respected); enshrined in Article 26 of the Vienna Convention on the Law of Treaties of 1969;² and by the principle of the continuity of the State, which implies that the State's debts are transmitted from one governmental administration to another.



However, these principles are not absolute and are only valid for **“debts incurred for the general interest of the collective.”**³ The key point is, therefore, **“the general interest of the collective.”**

In addition, the audit should verify whether the transactions are legally upheld by regulations established in the country's legislation as well as general principles of law, norms stipulated in international

2 http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf

3 RUZIÉ, D., *Droit International Public*, 17th edition, [Paris: Dalloz, 2004], 93.



public law and in the corresponding international covenants such as the International Convention on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights, among others.

The preparation of any audit needs to consider these concepts in order to analyze the legality and legitimacy of the public debt.

Under international law, the assessment of general interest and determining the legality or illegality of debt are within the faculties of the public authorities.⁴

Therefore, the participation of the population in the auditing of the public debt is absolutely legal and necessary in order to identify the mechanisms of the Debt System.

The different questions involving form, substance, and related factors should be analyzed in each transaction that generated public debt:

- If such transactions responded to the general interest of the collective,
 - If they were conducted in accordance with the established legal dispositions,
 - If irregularities, frauds, or transgressions occurred,
 - If they resulted in harmful consequences for economic, environmental, and especially human rights.

4 TOUSSAINT, É. and RUIZ DIAZ, H., "L'audit of dette: Un instrument dont les mouvements les sociaux devraient se saisir", [http://www.cadtm.org / L -audit -de -la- dette -un -instrument](http://www.cadtm.org/L-audit-de-la-dette-un-instrument)



When the audit findings in relation to each debt examined have been reached and the process by which the debt was incurred identified, we can say whether such debt or process is illegal and/or illegitimate, in keeping with the general principles of law, with legal arguments based on national and international law and norms and standards of customary law, such as:

- Principle of Legality, the result of the application of compliance tests to determine adherence to standards and regulations, as well as if the purpose of the contract was lawful or unlawful.
- Right to Sovereignty.
- Right to Development.
- Human Rights.
- Principle of Solidarity and Cooperation.
- Principle of Reasonableness, which implies that the laws that establish rights and duties and the regulatory decrees of the Executive branch of government must conform to the spirit of the Constitution of each country. They must not contradict the spirit of the Constitution, since such laws and regulatory decrees are the means that should lead to its being in full force and effect.
- *Rebus sic stantibus* clause, which involve contractual rules that can be modified when a substantial change has occurred in the circumstances prevailing at the time of the signing of the contract, leading to a serious imbalance in its benefits.



- Unjust enrichment, which is characterized by the use of public debt as a way to transfer large sums of resources to a specific sector, when public debts have been generated without any money flowing in.
- Prohibition of usury, known as the practice of excessive prices or unreasonable, illegal interest rates.
- Prohibition of compound interest, also known as anatocism.
- Defects in the expression of free will, for example, as illustrated by the asymmetry between the sides resulting from the imbalance between the parties to a contract, since, generally speaking, the international financial institutions intervene in order to defend the interests of the global private banking system. The result is that on one side there is an isolated country and on the other, a series of institutions (IMF, Paris Club, private banks, *Troika*), which indicates that the contracts and agreements do not emerge as an expression of free will, but rather due to uneven pressure being applied.
- Good faith, as expressed in the United Nations Covenant.
- Public interest.
- Co-responsibility of lenders, such as the private banks, international financial institutions, or others, due to their acts involving illegal and/or illegitimate transactions that generate public debts.
- Fairness, prohibiting abuse.



- Abuse of law, which is present in all the legal systems. In general, the main characteristics that define an abusive act involve activities that produce damage or losses, excessive harmful consequences to one party, evidence of the intention to inflict harm and obtain excessive benefits; or acts that contradict social and economic rights, or are incompatible with the adage of reasonableness in terms of social interests or conditions, among others.
- Force majeure.⁵
- State of need.⁶
- Doctrine of Odious Debt.
- Doctrine of illegitimate debt.
- Transgression of continuous offense.

5 It is worth mentioning the decree of January 28, 1918 adopted by the Soviet government through which the socialist republic declared that all foreign loans are unconditionally and without any exceptions annulled. To take this famous unilateral measure, the Soviet government substantiated its argument particularly on the basis of the concept of force majeure.

6 The concept of the state of need does not put the State in a material situation of facing an absolute impossibility of fulfilling its international commitments. But fulfilling such obligations could involve sacrifices for the population that go beyond what would be reasonable. In international law, one of the key elements of the State is its population [PELLET, A. et al., *Droit International Public*, 4th edition, (Paris: LGD), 1995], 400]. The State has obligations to its citizens and foreign nationals under its jurisdiction. The first of these obligations is to respect fundamental human rights, above its other obligations, among which are obligations with its creditors.



In addition, it is important to mention the right to not pay illegal and/or illegitimate debt. The 2000 report of the UN Conference on Trade and Development (UNCTAD), devoted to the doctrine of odious debt⁷ states that the obligation of a State to pay debts has never been recognized throughout history as an unconditional obligation. The author lists precedents for the non-payment of certain fraudulent debts and legal rules that limit the scope of the principle of *pacta sunt servanda*, based on general principles of international law such as good faith, fairness, abuse of law, etc.

Other legal arguments are still needed given the emergence of global financialization and its relation to the generation of public debt, including:

- Prohibiting market manipulation;
- Prohibiting abuse in the use of toxic financial products;
- Ending tax havens, etc.

Given the absence of a political commitment on the part of most governments, it will be up to the people to carry out a citizen audit. Based on this consideration, we must demand that the governments repudiate debts identified as illegal and/or illegitimate, and that those responsible, both citizens of the country as well as foreigners, be held accountable for their actions in a court of law. International public law⁸ and the internal legislation of the different countries provide many legal recourses and arguments to press for a sovereign unilateral act to repudiate debt payments.

7 HOWSE, R., "The concept of odious debt in public international law", *Discussion Papers* 185 [2007], UNCTAD, http://unctad.org/en/docs/osgdp20074_en.pdf

8 The sources of international public law are enunciated in article 38 of the Statute of the International Court of Justice. It encompasses treaties, customs, general principles of law, legal doctrine, and jurisprudence.



6.2 - HUMAN RIGHTS AS PRIORITY

To begin with, it is necessary to reaffirm that the Universal Declaration of 1948 represents the framework for the creation of international human rights law, which is a normative legal system of international dimensions, with the aim of protecting human rights.

The 1993 Vienna Declaration on Human Rights reinforces the conception of the 1948 text, when in its 5th paragraph it declares that:

“All human rights are universal, indivisible and inter-dependent and interrelated. The international community must treat human rights globally in a fair and equal manner, on the same footing, and with the same emphasis.”

The emergency social situation imposes the need to review the priority that has been placed on financial commitments to the detriment of the peoples' social rights.

The debt audit can identify illegalities and irregularities that will underpin the demand for rejecting the financial obligations and related impositions, as well as the austerity programs, in order to free up vital resources for the population and improve its standard of living.

Respect for and enforcement of human rights as they are universally recognized in the different international conventions and covenants⁹ take precedence over other commitments made by States,

9 Among these texts are the UN Charter (1945), the Universal Declaration of Human Rights (1948), the two 1966 covenants of 1966 on economic, social, and cultural rights and on political and civil rights, the Vienna Convention on the Law of



including debt payments and the implementation of austerity programs imposed particularly by the IMF, the World Bank, and the European Commission.

Article 103 of the UN Charter;¹⁰ which the United Nations member States must imperatively respect, states unambiguously 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.”

Among the obligations contained in the Charter, of particular importance are the stipulations of Articles 55 and 56:

“(The) raising of standards of living, full employment, and conditions of progress and development in the economic order and social [...] the universal respect for and observance of human rights and freedoms fundamental freedoms for all without distinction as to race, sex, language or religion. ”

The austerity plans implemented by the governments -both in the Global South as well as in the Global North- under pressure from their creditors, flagrantly violate the UN Charter and their different international juridical commitments. Therefore, the austerity measures and the debts incurred in the framework of the agreements with the IMF, the World Bank, and the European Commission, would have to be considered flawed and null and void. Indeed, with the Charter’s

Treaties (1969) and the Declaration on the Right to Development (1986).

10 <http://www.un.org/fr/documents/charter/>



dispositions having legislative value in public policy, everything that contradicts its stipulations should be considered as not applicable.¹¹

The UN reports regularly reiterate this imperative of protecting fundamental human rights. As an example and in a similar vein to its resolution of April 23, 1999, the UN Human Rights Council in its resolution of July 18, 2012, reaffirms the following:

“The exercise of the basic rights of the people of debtor countries to food, housing, clothing, employment, education, health services and a healthy environment cannot be subordinated to the implementation of structural adjustment policies, growth programs and economic reforms arising from the debt¹² (...) the economic programs arising from foreign debt relief and cancellation must not reproduce past structural adjustment policies that have not worked, such as dogmatic demands for privatization and reduced public services;”

In its resolution of July 18, 2012, the UN Human Rights Council also declared that:

“Every State has the primary responsibility to promote the economic, social and cultural development of its people and, to that end, has the right and responsibility to choose its means and goals of development and should not be subject to external specific prescriptions for economic policy.”

It is clear that the structural adjustment plans, re-labeled by the IMF and the World Bank in the late 1990s as “documents” or “strategic

11 WEYL, M. and R., *Sortir le droit international du placard*, Publicetim No 23, [Geneva: CETIM, 2008].

12 http://ap.ohchr.org/documents/dpage_e.aspx?si=A/HRC/RES/20/10



frameworks for growth and reduction of poverty”, violate the peoples’ right to decide their own fate, embodied in Article 1-2 of the UN Charter and in the two 1966 Covenants on human rights.

As Cephas Lumina, independent UN expert on the foreign debt, pointed out in 2009, in the Global South, in most cases the national parliaments are not consulted, and the final adoption of these documents is always conditioned by the final agreement with international financial institutions. In Europe as well, the *diktats* of the financial markets, the European Commission, and the IMF violate the peoples’ rights. In the case of Greece, for example, the austerity program was signed with the *Troika* and imposed in 2010, without even having been ratified by Parliament, as is stipulated by the Greek Constitution.¹³

The States are obligated to respect, protect, and promote human rights, Cephas Lumina explained. He added that the international agreements on the protection of human rights are required to be adhered to not only by States, but also by international financial institutions such as the World Bank and the IMF.

Relevant principles that orient the legal interpretation of social rights can be gleaned from international jurisprudence, among the most important of which are:

- a) The principle of adhering to the *minimum core obligation*. This requires the acceptance of at least two minimum essential levels of each right by the States-party. The essential minimum core demands obligations that satisfy the “existential minimum

13 KATROUGALOS, G. and PAVLIDIS, G., “La Constitution nationale face à une situation de détresse financière: leçons tirées de la crise grecque [2009-2011]”, *European Review of Public Law*, 23 [4/2011]: 1185-1208.



of each right”,¹⁴ whose source is the broadest possible principle of human dignity, which is the key principle of human rights.

b) The principle of progressive implementation, from which the principle of the prohibition of social retreat emerges. According to author José Joaquim Gomes Canotilho, “the principle of the prohibition of social retreat can be formulated as follows. The essential core of social rights already achieved and codified through legislative measures should be constitutionally guaranteed. Any measure that, without the creation of alternative or compensatory policies, will translate into a nullification, revocation, or the pure and simple outright destruction of this essential core should be considered unconstitutional. The limit to the legislator’s freedom in this regard is limited to the essential core that has already been achieved.”¹⁵

c) Principle of the reversal of the burden of proof. According to specialist Asborn Eide, “[a] State claiming that it is unable to carry out its obligations for reasons beyond its control therefore has the burden of proving that this is the case and that it has unsuccessfully sought to obtain international support to ensure the availability and accessibility of rights.”¹⁶

14 BILCHITZ, D., *Poverty and Fundamental Rights: The Justification and Enforcement of Socio-Economic Rights*, [Oxford/New York: Oxford University Press, 2007], 185.

15 GOMES CANOTILHO, J. J., *Direito Constitucional e Teoría da Constituição*, [Coimbra: Livraria Almedina, 1998].

16 EIDE, A., “Economic, Social and Cultural Rights as Human Rights”, in EIDE, A., KRAUSE, C. and ROSAS, A. [coord.], *Economic, Social and Cultural Rights: a textbook*, 2nd revised edition, [Dordrecht: Martinus Nijhoff Publishers, 2001], 27.



d) Principle of participation, transparency and accountability, which indicates that States must ensure mechanisms of participation, transparency and accountability in the preparation, implementation, and impact of public social policies. From this flows the importance of the democratic component in public social policy as well as in the public budget, as an effective tool to fight corruption.¹⁷

e) Duties of States in the field of social rights. The Committee on Economic, Social and Cultural Rights in its General Comment No. 12 emphasizes the obligations of the State in relation to these rights, namely, to respect, protect, and implement them.¹⁸

According to Flávia Piovesan⁶ it is necessary to define the sustainability of the debt in accordance with the “duties” of the States in relation to reducing poverty and promoting/protecting human rights.⁷ From the standpoint of human rights, the payment of the debt should be restricted to a ceiling that does not imply, under any circumstances, any violation of basic social rights such as the rights to food, health, education, and social security, among others.

The high budget outlay for debt payment is a serious affront to the State’s duty to implement the social rights enshrined in the international and constitutional normative system. Such payments represent a breach of the obligations assumed on an international level and in the constitutional law of the contemporary democracies, with regard to the implementation of social rights.

17 PIOVESAN, F., “*Impacto de la Deuda Pública en la Implementación de los Derechos Sociales*,” prepared for the Parliamentary Commission of Investigation into the Public Debt in the Brazilian parliament, 2009.

18 Idem.



Therefore, States that act this way violate this obligation, and in doing so engage in practices that are extremely unconstitutional and commit a breach of international law.

The citizen audit should consider all types of legal dispositions.

6.3 – NON APPLICABILITY OF THE STATUTE OF LIMITATIONS TO CRIMES AGAINST HUMANITY

Different international court rulings and norms and standards established by agencies that comprise the United Nations¹⁹ have determined the non-applicability of the statute of limitations for crimes against humanity. By the same token, in several courts decisions in Argentina, it was held that the crime of child abduction is imprescriptible as it is an offense that remains in effect and on hold until the definitive recovery of the minor's identity.²⁰

19 Joint United Nations report (U.N.E/CN.4/Sub 2/1997/20 Rev.1), UN Human Rights Committee [Concluding Observations of the Human Rights Committee: Argentina. 3/11/2000 CCPR/70/ARG] CIDH. Barrios Altos case, judgment of March 14, 2001, paragraph 41, United Nations General Assembly, Resolution 2391 [XXIII] of November 26, 1968; Art. 29 of the Statute of the International Criminal Court.

20 CN. Correccional Federal, Riveros Santiago Omar, 7/8/2003, NC Correccional Federal, Sala 2, Case No. 17.592, Gómez Francisco without remand 3/5/2001, and Argentine Supreme Court, S 1767, XXXVIII, "Simon Julio H and others without right to appeal, among others.



Even though crimes against humanity may appear to be different from offenses related to public debt, the effects caused by illegitimate debt lead to the same consequences. In addition, there are a number of singular characteristics that enable considerations to be advanced concerning the possible non-applicability of the statute of limitations to crimes arising from the undermining of human and social rights due to the allocation of resources to pay illegal and illegitimate debt. This is because this involves crimes that penal law doctrine defines as continuing offenses. The Argentine case is clear evidence of this, according to Alejandro Olmos Gaona. In other cases, such as the CAIC in Ecuador, and the CPI conducted by the Brazilian parliament, the same operational *modus vivendi* can be observed through which the debt accrual process occurred and progressed. This process began in Latin America in the 1970s, with serious consequences for the essential rights of society.

Olmos warned that the debt is a *continuing offense*. This juridical concept, which is frequently used in different criminal typologies, is generally not associated with offenses against the public administration, despite the suffering caused to the entire community.

Crimes associated with debt accrual are continuing offenses, since they meet the requirements demanded by the doctrine:

- Temporal and spatial connection. This characteristic is present, for example, in the debt incurred during the military dictatorships in Latin America and Africa, since these same liabilities underwent successive refinancing and permanent swaps, all of which continue to this day.
- Unity of purpose. Successive rollovers and swaps had the same purpose, namely, to defer payment of the bulk of the debt, applying interest conditions and other costs, increasingly



expensive, in addition to allowing international financial institutions to enter the fray, with their impositions, leading to permanent financial domination.

- Similarity in the form of execution. In the analysis of different debt instruments of Ecuador, Argentina and Brazil, for example, it became clear that there was a striking resemblance in terms of form (identical clauses, such as the waiver of sovereign rights) as well as substance (in most of the agreements with private banks the inflow of resources was not verified; in bilateral contracts, there was no fair or reasonable offsetting elements, but rather the imposition of clearly illegal demands; in multilateral agreements, resources remained on standby until used for payment to private banks).

- Similarity of the procedures performed. The implementation has followed the same pattern, using procedures that are always of the same nature, including the issuing of decrees, the repeated marginalization of the national Congress, the constant holding of secret negotiations without even informing parliament, etc.

- Identity of the holder of the legally protected interest. In all cases, debt refinancing affected the State, and therefore the population as a whole, which was to continue assuming the payment of obligations arising from criminal acts.

This characterization of the external debt as a continuing offense is not subject to a statute of limitation until its definitive culmination is concluded, according to Zaffaroni,²¹ who explains that “*the regula-*

21 ZAFFARONI, R. E., *Manual de Derecho Penal*, 4th Edition, (Buenos Aires: Ediar, 1985).



tory provisions of Article 63 (of the Criminal Code) will be applicable to continuing offenses; that is, the statute of limitations will begin to take effect when their last stage has concluded.”

6.4 – DISTORTIONS IN THE USE OF PUBLIC DEBT

The need to conduct a debt audit flows from the situation in which the amounts registered as “public” debt do not always reflect legal and legitimate debts.

Verifying the legality of a debt involves an analysis of various elements, such as the legal, economic, and financial terms used in contracts, agreements, bond issues, their effects, if the negotiated resources were indeed delivered, if where the funds were earmarked is justifiable and they were really allocated, as well as the conditions of each debt generated, viewed as a whole, from the very beginning of the process.

A debt may be legal and legitimate when the commitments are assumed by the State in accordance with legal norms and reasonable conditions, with a level playing field between creditor and debtor, when they benefit (subjectively and objectively) the collective interest, translating into a real counterpart in goods and services for society.

If it is corroborated that these terms are not met, those who are carrying out a debt audit can use the previously mentioned legal grounds to provide the government and the public with the arguments necessary to support an eventual annulment/repudiation of public debts.



In short, the distortions in the use of public debt can generate debts that are not payable and or which can be repudiated due to their illicit character, such as:

- **Illegitimate debts**, which correspond to commitments assumed by the public sector that can be in adherence with the legal stipulations, but, however, do not respond to the level playing field between the parties due to the absence of equal circumstances between debtor and creditor. Furthermore, they do not adhere to the criteria of being in the general interest of the community, and/or have no real counterpart in terms of goods and services provided to society;
- **Illegal debts** are debts that do not correspond to the criteria established in the norms present in the countries' legal systems or conventions, treaties and agreements;
- **Odious debts** correspond to the commitments made by authoritarian regimes, to the obvious detriment of the interests and rights of the population and without their knowledge of such agreements;
- **Unsustainable debts** are liabilities assumed by the government that overwhelm public finances and prevent compliance with human and social rights;
- **Null and void debts** are debts that present elements of illegality, illegitimacy, or are odious or unsustainable. Some examples are mentioned below.

6.5 – GROUNDS THAT GIVE RISE TO PUBLIC DEBTS BEING NULL AND VOID

As previously mentioned, different defects or irregularities can result in a debt being declared null and void. Some examples are:



a) Defect of consent

The Vienna Conventions of 1969 and 1986 indicate the different defects of consent that can lead to invalidating the loan contract, for example:

– **Incompetence of the contracting party:** ²²This defect of consent represented legal grounds for Paraguay's repudiation of a debt that amounted to US\$85 million in 2005. Indeed, the Paraguayan consul in Geneva, who had signed the corresponding papers on behalf of the Paraguayan government, had no legal authority to sign on to the loan with the privately owned Overland Trust Bank.²³

– **Corruption of the contracting party by direct or indirect means during the negotiations:**²⁴ Verified in contracts signed between Greece and Siemens, the transnational corporation was accused – both in German as well as Greek courts – of having paid commissions and other bribes to Greek political, military, and government officials to the tune of about 1 billion Euros.

22 Article 46 of the Vienna Convention on the Law of Treaties of 1946 and 1986

23 RUIZ DIAZ, H., "La deuda de Paraguay ante los banqueros privados; un caso de deuda odiosa", point 2 of "La auditoría ciudadana de la deuda: un instrumento de democratización de las relaciones económicas y de control democrático de los actos de gobierno", in <http://cadtm.org/L-audit-citoyen-de-la-dette-un>

24 Article 50 of the Vienna Convention on the Law of Treaties of 1968 and 1986.



– **Coercion²⁵ exerted on the contracting party through acts or threats:** Coercion was used by France in 1824 to impose a colossal payment²⁶ on Haiti as compensation in return for recognition of its independence. To that end, 13 French battleships equipped with 494 cannons surrounded the island of Haiti, and the slogan was clear that in case Port-au-Prince were to reject the payment demand, the ports were to be blockaded by force. Coercion also raises the question of a relationship of political forces very favorable to the creditor. In the framework of the audit, the people of Portugal, Ireland, Greece, etc. may invoke the existence of such coercion as an argument to pressure their governments to reject the austerity measures imposed by the *Troika*. Indeed, creditors took advantage of the crisis in Europe to impose austerity measures that flagrantly undermined economic and social rights and violated the sovereignty of the countries involved. In his report on the foreign debt, Cephas Lumina denounces the creditors' interference in defining development policies when he asserts that "The creditor States and the international financial institutions must not take advantage of an economic, financial or external debt-related crisis as an opportunity to push for structural reforms in debtor States, however useful such reforms might be perceived to be in the long term. Such reforms should be initiated, formulated and implemented by the debtor States themselves, if they deem appropriate, in pursuance of an independent process of national development."²⁷

25 Article 51 of the Vienna Convention on the Law of Treaties of 1969 and 1986. Article 52 of these international conventions also prohibits coercion of a State through the threat or use of force.

26 PERCHELLET, S., "*Haiti, entre colonisation, dette et domination*", <http://www.cadtm.org/Haiti-Entre-colonisation-dette-et>

27 See LUMINA, C., "Guiding principles on foreign debt and human rights. Report of the Independent Expert on the effects of foreign debt and other related international



– **Willful misconduct:**²⁸ If a State was induced to sign a loan through the fraudulent conduct of another State or an international organization that might have participated in the corresponding negotiations, we can pressure the State that requested the credit to invoke willful misconduct as grounds to invalidate its consent to be bound by the contract. Thus, the IMF and World Bank can be accused of having engaged in behavior that was willfully fraudulent, due to the vast difference between their discourses and the reality. Indeed, in Article 1 of its constitution, the IMF defines its aims as “to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.”²⁹ In practice, the IMF, in coordination with the World Bank, does exactly the opposite and violates its own constitution,³⁰ with serious social consequences.

b) The illegal or immoral nature of the contract:

This is a legal basis that is present in numerous national civil and

financial Obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights ", United Nations Commission on Human Rights, 20th Session, Agenda point 3, April 10, 2011, par. 80, p. 19 [A/HRC/20/23]. Available at: http://www.ohchr.org/Documents/HRBodies/HRCouncil/RegularSession/Session20/A-HRC-20-23_en.pdf

28 Article 49 of the Vienna Convention on the Law of Treaties of 1969 and 1986.

29 See the constitution of the International Monetary Fund at <http://www.imf.org/external/pubs/ft/aa/fre/aaor.htm>

30 TOUSSAINT, É., *Banco Mundial, el golpe de Estado permanente*, op. cit.



commercial laws. Among the illicit or immoral grounds that imply the illegality of the loan contract are:

- **Incurring debt to finance the purchase of military material**, which is a violation of the UN Charter;³¹

- **Tied aid**, which consists in State-to-State loans,³² often in the form of export credit, that is, loans in exchange for the purchase of goods produced by the “lender” country. This practice is even more illegitimate to the degree that these loans do not correspond to the real needs of the recipient country but rather to the interests of the “donor” nation. This is what led Norway in 2006 to unilaterally and unconditionally cancel the debts of five countries: Ecuador, Egypt, Jamaica, Peru and Sierra Leone.³³ In the case of Greece, which was in full crisis mode in 2010, under pressure from the French and German authorities who wanted to guarantee their countries’ arms exports, the PASOK government barely reduced its defense budget in order to continue purchasing military equipment from France and Germany, while at the same time it was determined to cut social spending. To the extent that Germany and France granted credits to Greece in May 2010, this clearly involved tied loans by these two European powers;

- **Financing conditioned on structural adjustment**. As explained by the special Rapporteur Mohammed Bedjaoui in his draft article on debt succession for the Vienna Convention

31 Ibid, en Article 26.

32 Generally speaking, these loans are also made through development banks or other official financial institutions.

33 ABILDSNES, K., “¿Por qué asumió Noruega su responsabilidad como país acreedor?...”, op.cit.



of 1983, “from the point of view of the international community, odious debt is understood as any debt incurred for uses that contradict contemporary international law, particularly the principles of international law incorporated in the UN Charter.³⁴” Thus, multilateral loans incurred in the framework of structural adjustment programs are odious debts, and therefore illegal, insofar as the adverse effect of these policies has been clearly demonstrated, especially by UN agencies. The conditions tied to these debts clearly violate the different conventions on the protection of human rights. The abandonment of States’ sovereignty is compounded by the clauses contained in most of the international loan contracts, which enable courts in the Global North to rule on such cases if disputes arise and anticipate the application of rules that favor creditors in the event of lawsuits between the parties involved.

In Ecuador, the Commission for the Comprehensive Public Credit Audit (CAIC) demonstrated that the policies imposed by the World Bank and other multilateral financial institutions through programs that they fund and the conditions that they place that are associated with these loans represent a denial of national sovereignty and a flagrant interference in the internal affairs of the country. Numerous bilateral loans similarly violated economic, social and cultural rights. In its recommendations, the CAIC proposed suspending debt payments

34 BEDJAOUI, M., “Neuvième rapport sur la succession dans les matières autres que les traités”, Rapporteur spécial, *Projet d’articles sur la succession en matière de dettes d’État*, Nation Unies, [A/CN.4/301 et Add.1, par. 129, p. 73]. [Extrait de l’Annuaire Annuaire de la Commission du droit international, 1st part, II (1977), 49-126]. Available at: http://untreaty.un.org/ilc/documentation/french/a_cn4_301.pdf



to several creditors as demanded by the multilateral financial institutions.³⁵

In Greece, a true legal coup d'État is underway. Through its conditions, the *Troika* not only breached international law, but also became complicit in the violation of Greek domestic law. Several legal dispositions (Law 3845/2010), which launched the austerity program, violated the Constitution, especially by eliminating the legal minimum wage. The abandonment of Greek national sovereignty is even more serious due to the clause in the agreement with the *Troika* that provides for the applicability of the common law and the jurisdiction of the Court of Justice of the European Union (CJEU) in cases of disputes. The State thus waives a fundamental prerogative of sovereignty, namely, the territorial jurisdiction of its national courts.

– **Public debt incurred to finance unprofitable projects, with harmful consequences for the population and the environment:** Among such projects, there are the “white elephants” such as the Inga Dam in the Democratic Republic of Congo (formerly Zaire), which contribute absolutely no benefit to the population. Even today, less than 10% of the Congolese population has access to electricity. The examples of projects that generate debt are also common in the Global North; for instance, the scandal surrounding the 2004 Olympic Games in Greece. While Greek authorities anticipated expenditures of 1.30 billion dollars, the price tag of the games actually topped 20.00 billion dollars.

35 CAIC report available at <http://www.auditoriadeuda.org.ec> and CADTM

“Los préstamos envenenados del Banco Mundial a Ecuador”, June 27, 2008.

Available at: “Alegación para conseguir su repudio”, 2008, <http://www.cadtm.org/Los-prestamos-envenenados-del>.



– **The private debt becomes public debt:** The financial crises that erupted during the 1990s in Southeast Asia, Ecuador, Argentina, Brazil, and Russia had their origin in the implementation of the measures advocated by the World Bank and the IMF. These international institutions particularly imposed the deregulation of the financial system and the prohibition of State control over movements of capital. As a result, foreign capital fled these countries when investors saw that their earnings prospects had dimmed, and this, in turn, led to a chain reaction of banks going under.

The debts of these private banks later became public debts, a policy driven by those responsible for the crises, namely the World Bank and the IMF. The global crisis that erupted in 2007 even further exacerbated public finances and increased public debt levels (mainly in the Global North) given the intervention by the governments in that part of the world to rescue the failed banks.

The reason for this public indebtedness in both the Global South and the Global North (linked to the socialization of financial sector debt) is, at the very least, immoral, since those directly responsible for the crisis are the international financial institutions and the private banks.

In Ecuador, the CAIC denounced the transfer of private debt to the State, which occurred between 1983 and 1984 under pressure from the IMF and World Bank while the country was facing a severe financial crisis. As a result of the evidence of how extremely harmful this operation was to the country, Ecuador's new constitution, adopted in September 2008, explicitly prohibits the socialization of private debt.³⁶

36 Article 290, paragraph 7: "The nationalization of private debts is prohibited."



– **Refunding payments made on previous illegal loans:**

According to the legal argument of continuing offense, an unlawful debt does not forfeit its illegal character, due to a renegotiation or restructuring. In this sense, the debt retains its defect of origin and the offense endures over time.

Therefore, all public debt whose purpose is to repay prior illegal debts is also unlawful.³⁷ The debt audit will shine the spotlight on the original illegal debt. For example, the argument of continuing offense was used by the CAIC in Ecuador to denounce many irregularities³⁸ (socialization of private debt and restructuring of prescribed debts with the Brady Plan) that led to the issuance of commercial debt bonds. Based on data from the audit, the Ecuadorian authorities refused to pay that commercial debt with international private banks (2012 and 2030 Global Bonds). In June 2009, after a confrontation with bankers who were holders of those Ecuadoran debt bonds, the holders of 95% of the bonds in question accepted the Ecuadorian government's buyback offer with a 70% reduction in their nominal value.

– **The payment of already settled debts:** A State's obligation to settle its debts is especially limited by general principles and categories of law, such as fairness, good faith, abuse of law, and even unjust enrichment. However, the debt of developing countries has already been repaid several times over. According

37 On the continuity of the offense, among other sources, there is an article by Alejandro Olmos Gaona entitled "La deuda argentina como un delito: un aspect no tratado por el derecho penal," available at <http://www.pctargentina.org/deuda-delito-2.htm>

38 These irregularities were noted in the report presented by the commercial debt subcommission of the CAIC. See <http://www.auditoriadeuda.org.ec>



to the data supplied by the World Bank, the governments of developing countries have already paid the equivalent of 98 times what they owed in 1970, although over the same period of time their debts increased 32 fold.³⁹ For developing countries this implies the right to repudiate their debts and demand restitution of what was wrongly charged by creditors, based on the argument of unjust enrichment.⁴⁰

– **Unjust enrichment means an abusive enrichment**, profits obtained by illegitimate means: It can also be applied to the loans granted to Greece or Ireland with interest rates of 5% or 6% by countries such as Germany, France, and Austria, which obtain credits at 2% in the markets. By the same token, the IMF asks for money from its member States, paying them very low interest, and lends to countries in difficulties at substantially higher rates. This also occurs with the European banks that borrow at very low interest from the ECB and lend to States at considerably higher rates.

39 This situation is particularly the result of an excessive and unilateral increase in interest rates by the United States in 1979, the implementation of usurious interest and even the capitalization of interest [compound interest or anatocism], which is prohibited or heavily regulated in different national judicial systems, such as those of Ecuador, France, Italy, and Germany.

40 This disposition is also contemplated and contained in several national civil codes. This is the case with Argentina in Article 784 and subsequent articles; Spain in Article 1895 and subsequent articles, and France in Article 1376 and subsequent articles.



c) Illicit use of borrowed funds:

The allocation of the borrowed funds is a determining criterion used to decide on the legal status of a debt. For such purposes, it is necessary to consider the nature of the government that has requested the loan, its conduct in relation to human rights, and the actual use of these funds. Debt in the following categories can be considered to be illegal:

- **Debt from colonization.** During the 1950s and 1960s, the World Bank granted loans to many colonial powers, such as Belgium, France, Portugal, and the United Kingdom, for projects that enabled them to maximize the exploitation of their colonies. These debts incurred by the colonial powers with the World Bank were quickly transferred, for the most part, to their former colonies, at the time of their independence in the 1960, without the latter's consent. These debts that originated in the colonization of the Third World are null and void under international law.

- **Loans granted to dictatorships.** The nature of a dictatorial regime under which the debt was incurred allows for reconsidering its payment, even though the representative of the government who signed the loan had the authority to do so in accordance with the country's prevailing legislation. Indeed, under international law, debts incurred under dictatorships are characterized as "odious debts"⁴¹, according to the doctrine of

41 OLMOS GAONA, A., *Una doctrina jurídica para solución política*, [Buenos Aires: Peña Lillo-Continente, 2005]. The author shows that Francesco Nitti was the precursor of the differentiation between State debts and regime debts. According to Olmos, "with an approach based on singular realism, Nitti doctrinally put forward criteria that have helped repudiate the Portuguese debt in 1834, the debt of the



the same name formulated by Alexander Sack in 1927, who wrote that “if a despotic regime incurs a debt, not for the needs and in the interest of the State, but to reinforce its tyranny, to repress the population that fights against it, etc., this debt is odious for the population of all the State (...) This debt is not an obligation to the nation: it is a regime’s debt, a personal debt of the power that has incurred it, and consequently it falls with the fall of this power.”⁴² Sack added that the creditors of these debts, when they lend with full awareness of the consequences “have committed a hostile act with regard to the people; they can’t therefore expect that a nation freed from a despotic power assume the ‘odious’ debts, which are personal debts of that power.”

The doctrine of odious debt can therefore justify the annulment of numerous loans such as those incurred by the dictatorships in Latin America between the 1960s and the 1980s; in Africa, in the emblematic case of Mobutu’s Zaire (1965-1997); by the former Soviet bloc regimes, such as Nicholas Ceausescu’s dictatorship in Romania, by the dictatorships in South Asia and the Far East (Ferdinand Marcos from 1972 to 1986 in the Philippines, Mohammed Suharto from 1965 to 1998 in Indonesia, the dictatorial regimes in South Korea between 1961 and 1981, Thailand between 1966 and 1988); by the Greek military junta of 1967-1974; by the dictatorships in North Africa, whose regimes fell at the beginning of 2011, such as Zine el-Abidine Ben Ali in Tunisia (1987-2011) and Hosni Mubarak in Egypt (1981-2011).

Southern States by the United States, and more importantly, the repudiation of the Cuban debt in 1898. In other words, the criteria to not accept the legality of debts incurred by usurper regimes, credits that were invariably used to sustain regimes.”

42 SACH, N. A., *Les effets des transformations des États sur leurs dettes publiques et autres obligations financières*, [Paris: Recueil Sirey, 1927].



– **Loans to so-called democratic regimes that violate *jus cogens*.** All debts contracted by governments that violate the mandatory standards of international law contained in *jus cogens* are equally null and void, without it being necessary to prove that the creditors intended to become accomplices of the abuses of that regime. This affirmation is confirmed by the Vienna Convention on the Law of Treaties of 1969, which in its Article 53, provides for the annulment of acts contrary to *jus cogens*. The following norms, among others, fall in this category: the prohibition of carrying out of wars of aggression, the prohibition against the use of torture, the prohibition against committing crimes against humanity, and the right of peoples to self-determination. Therefore, any loan made to a regime, even if democratically elected, that does not respect the fundamental principles of international law, is null and void. As examples, we can cite the apartheid regime in South Africa or the successive Israeli governments. In such cases, where the resources from the loan are earmarked is not essential for the characterization of the debt.

– **Loans diverted with the complicity of the creditors.** The doctrine of odious debt also fits within this category, as “loans incurred by members of the government or by persons or groups associated with the government to serve interests manifestly personal – interests that are unrelated to the interests of the State.” Indeed, “State debts have to be incurred and the funds that are derived must be used for the needs and in the interests of the State.” Of particular importance in this regard is the ruling handed down in 1923 in a dispute that pitted Great Britain against Costa Rica. In 1922 Costa Rica passed a law that annulled all the contracts signed by former dictator Federico Tinoco from 1917 to 1919 and refused to pay the debt it had procured from the Royal Bank of Canada. Therefore,



this is an instance when the doctrine was applied to a commercial debt. The dispute between Great Britain and Costa Rica was settled by the Chief Justice of the U.S. Supreme Court, William Howard Taft, who ruled the decision of the Costa Rican government to be valid, stating: “The case of the Royal Bank depends not on the mere form of the transaction but upon the good faith of the bank in the payment of money for the real use of the Costa Rican Government under the Tinoco regime. It must make out its case of actual furnishing of money to the government for its legitimate use. It has not done so.” Most recently, the CAIC in Ecuador revealed that some loans had been diverted from their goals of aiding “development”. Indeed, three credits from the Inter- American Development Bank, which were supposed to benefit the agricultural, financial, and transportation sectors, were partially used to purchase collateral guarantees demanded by the Brady Plan.

d) Abusive conditions in form and substance

The imposition of onerous interest rates, costs and expenditures (with private lawyers) can be questioned in accordance with the general principles of law. Furthermore, special attention must be paid to the Collective Action Clauses (CACs), included in sovereign debt instruments of different countries, imposed by the IMF, given that these clauses are an affront to the sovereignty of the countries involved and the norms of national and international law.⁴³

43 FATTORELLI, M.

L., “Más poder para la banca con la Cláusula CAC”, <http://www.auditoriacidada.org.br>



6.6 – THE LEGAL LIABILITY OF THE PARTICIPANTS IN ILLEGITIMATE AND ILLEGAL LOANS

Considering that the managing of public resources can, in some cases involving liability, result in lawsuits, as was noted in Chapter 5, the debt audit test should clearly provide a list of officials responsible for debt accrument and the map of participants in the process. For each of the transactions that generated public debt, the audit should contain a complete identification of and the frequency with which the participants were involved in the debt process.

The citizen audit should prepare reports and/or allegations directed to the regulatory control bodies or authorities (Comptroller General, Attorney General's Office, police, etc.), depending on the laws of each country, in order to determine administrative, civil, and criminal liabilities.

The authorities should be required to act in order to repair the damage caused by these processes that were so harmful to the collective interests and to prevent the continued use of the instrument of public indebtedness as a perverse Debt System.

CONCLUSION

There are sufficient legal arguments based on national and international law to underpin the findings of a citizen debt audit in regards to irregularities, fraud, defects, and improprieties revealed in questions of form and substance concerning the instruments used in the public debt accrument process, as well as in related factors that promote the continued generation of such debts. There are also legal arguments to determine these debts' illegality and/or illegitimacy.



The existence of these legal arguments will allow for declaring the Debt System null and void as well as for providing an exemplarily punishment for its internal and external operators. To allow this miserable system to keep functioning will cause irreparable and continued damage to society, which is experiencing all kinds of misery in addition to the economic, environmental and ecological devastation afflicting the country.

It is urgent and necessary to conduct citizen audits in all countries, with the aim of revealing the cogs and gears that generate public debts and strengthening the social struggle oriented toward obtaining knowledge of the financial reality, until the truth is obtained concerning the current economic model, based on a growing financialization that feeds on this fraudulent mechanism that absorbs resources, disguised as public debt. Raising awareness of this problem among the population of the planet is essential in order to achieve change aimed at promoting another model for society, based on justice, freedom, and brother and sisterhood.

Given the influence wielded by the financial powers in most governments, it will be a task of the people to carry out a citizen audit, which should bring together the evidence and legal arguments necessary for an annulment of the illegal and illegitimate debts.







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