

FOOL'S GOLD

THE CASE FOR 100% MULTILATERAL DEBT CANCELLATION FOR THE POOREST COUNTRIES

More than seven years into the Heavily Indebted Poor Country initiative, a durable exit from the debt crisis remains elusive. Even against the IMF and World Bank's inadequate criteria, just seven countries have seen their debts reduced to sustainable levels, and 90% of low-income country debt remains on the books. Meanwhile, multilateral creditors are using the extra generosity of bilateral creditors to reduce their own contribution to HIPC debt relief. A new deal on debt relief is urgently needed, to address these shortcomings and deliver the additional resources necessary to accelerate progress towards the Millennium Development Goals. Gold is part of the solution, with the IMF sitting on reserves undervalued by at least \$30bn. Revaluing this gold, and mobilising new donor finance, offer a way out of the current crisis. At the 2004 Annual Meetings, the major shareholders have a literally golden opportunity to drop the debt.

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Introduction

More than five years on from the G7 Summit in Cologne, it is clear that the debt problem is far from being solved. While the Heavily Indebted Poor Countries (HIPC) initiative¹ has delivered more than \$29bn of debt cancellation and pledged to deliver \$24bn more, only 7 countries have actually seen their debts brought down to levels considered 'sustainable', even according to the narrow and inadequate criteria of the HIPC initiative². Even those countries that have qualified for debt relief are still paying \$2.8bn a year to their creditors, 15% of their revenues and in many cases more than they spend on education or health.

Non-governmental organisations (NGOs) in the UK and elsewhere have consistently argued that poor country debt will only truly be 'sustainable' if debt service payments do not compromise the ability of such countries to meet the internationally agreed Millennium Development Goals (MDGs.)³ While considerable uncertainty remains about the true costs of meeting the MDGs, most estimates suggest that the majority of low income countries will require total debt cancellation, plus significant increases in aid, if the MDGs are to be met. Set by this standard, the progress made to date through the HIPC initiative remains woefully inadequate. Moving forward, if poor countries are to be able to take on the new financing needed to meet the MDGs before 2015, they will also need further debt cancellation, and a move towards further grants, if they are to avoid another debt crisis.

Most of the larger bilateral creditors, including all of the G7 countries, have already agreed to cancel most if not all of the debts owed to them by the HIPCs, and in some cases other low-income countries as well. The bulk of the outstanding debt, therefore, is owed to multilateral creditors, most notably the IMF and World Bank.

In order to bring poor country debts down to something approaching sustainable levels, and to restore 'creditor equity', Actionaid UK, Oxfam International and CAFOD believe that:

¹ The HIPC initiative was started in 1996 and expanded at the Cologne Summit in 1999. Under the initiative, 42 countries are eligible to receive partial debt cancellation, of which 14 countries have so far received a debt write off and 13 more have qualified to do so. For more on the HIPC initiative, see http://www.jubileeresearch.org/hipc/what_is_hipc.htm

² 'HIPC Initiative: Status of Implementation' IDA, August 2004

³ See, for example 'Debt and the Millennium Development Goals' Working Paper by Cafod, Christian Aid and Eurodad, September 2003

- 100% multilateral debt cancellation must be provided to all low-income countries which need such relief in order to meet the MDGs, under a fair and transparent process.
- Debt relief should not be financed out of existing aid budgets, but from new donor contributions, and the sale or revaluation of IMF gold.
- Debt relief should not be confined to HIPCs, but should also be extended to other poor countries that need debt relief in order to meet the MDGs.
- There should be an end to harmful economic policy conditionality associated with debt relief. Debt relief should be provided to any country able to use such relief to meet the MDGs.
- Moving forward, we believe that in countries where human development needs are greatest, and where the feasible tax base is narrow, future aid flows should be in the form of grants rather than loans for the foreseeable future.
- In future, a fair, transparent and comprehensive international insolvency process should be created to allow creditor and debtor countries to resolve debt crises without compromising the ability of poor countries to meet the basic social needs of their people, and without forcing poor countries to repay what the insolvency process determines to be odious debts.

Debt and the low income countries

At the end of 2002, low-income countries owed the rich world a total of \$523bn, or roughly half their combined Gross National Income (GNI). Of this total, \$154bn, or a little under a third, was owed to multilateral creditors, including the World Bank and IMF. Low-income countries as a whole paid out \$39bn in debt service in 2002, or roughly \$100m per day. Of this, \$13.1bn was paid to multilateral creditors⁴. In contrast, low-income countries received \$27bn of aid in the same year.

HIPC relief and other forms of debt relief have so far relieved low-income countries of around \$46bn of their debts, of which HIPC debt relief accounts for about \$29bn⁵. However, this remains less than 10% of the total debts owed by all low-income countries to rich countries and institutions.

⁴ Source: Global Development Finance 2004

⁵ Source: Jubilee Research

The case for further multilateral debt relief 1: The failure of HIPC

In 1999, when the HIPC was expanded⁶, the initiative pledged to provide HIPC countries with a 'permanent exit' from the burden of unsustainable debts. While HIPC has undoubtedly delivered some benefits for some countries, however, the most recent reports show that the initiative is falling far short of its promises.

Under the HIPC initiative, most countries are supposed to have their debts brought down to within 150% of their annual exports⁷. However, the latest Status of Implementation Report for the HIPC initiative, prepared by the IMF and World Bank, has shown that only 7 of the 14 countries that have fully passed through the initiative have actually seen their debts brought down to within these levels. In some cases, debt burdens remain way over the HIPC thresholds. Uganda, for example, has a debt amounting to more than 250% of exports, while Ethiopia's debt burden will remain at over 200% of its exports until at least 2010, despite HIPC's so-called Completion Point 'topping up'⁸.

Debt service payments remain high, because HIPC has not brought down debt stocks sufficiently. Last year, even the 27 countries that have either received a debt stock reduction, or have at least passed the first stage of the initiative (so-called 'Decision Point) still paid \$2.8bn to their rich country creditors. This amounted to 15% of their revenues and 2.5% of their annual GDP⁹. For some countries, the figures are even higher. Senegal, for example, spent almost 36% of its revenues in debt service last year, while Malawi paid more than 30%¹⁰. By contrast, legislative proposals put before the US Congress suggest that in countries with critical poverty needs, this figure should not exceed 5%.

The case for further multilateral debt relief 2: Debt and the MDGs

In the year 2000, the international community committed itself to halving world poverty by the year 2015 and to meeting a number of other poverty reduction targets – the Millennium Development Goals (MDGs.)

However, debt service payments from heavily indebted poor countries continue to undermine their ability to meet these internationally agreed targets. In 10 out of 14 African HIPC countries where data is available, debt service payments still take up a larger share of the budget than do health services. In Ghana, for example, 11% of government spending goes into repaying debts, while only 9%

⁶ The original HIPC initiative, started in 1996, had committed less generous terms to HIPC countries. In 1999, the initiative was expanded into its current form.

⁷ Some countries have qualified under the so-called 'fiscal window' under HIPC, which measures debt sustainability according to the ratio of debt to revenues.

⁸ HIPC Status of Implementation Report, August 2004, IDA/IMF

⁹ *ibid*

¹⁰ HIPC Status of Implementation Report, August 2004, IDA/IMF

is spent on health.¹¹ In Zambia, the Government spends more on servicing its debt than it does on education.

NGOs in the UK have held a consistent position over recent years that any calculation of debt sustainability should be linked to the poverty needs a country has, and in particular the financing gaps it is facing in reaching the Millennium Development Goals. This definition of debt sustainability has gained wide acceptance, in the UN, amongst African Governments, HIPC Finance Ministers and even creditor governments such as Ireland. Under this understanding of debt sustainability, it is clear that most if not all of the HIPC countries, plus other low-income countries, will require 100% debt cancellation, plus significant increases in aid.¹²

The case for further multilateral debt relief 3: Debt relief has been well used

Although the levels of debt relief provided to poor countries so far has fallen far short of needs, there is clear evidence that the money saved in debt service payments has been put to good effect in reducing poverty. Poverty reducing expenditures in African HIPC countries have increased on average 6% as a result of HIPC debt relief, and as much as 14% in some countries.

- In Benin, for example, 43% of HIPC debt relief went to Education in 2002, allowing the recruitment of teachers for empty posts in rural areas. 54% went to health, of which a fifth was used to recruit health staff for rural clinics, and the remainder was allocated to implementing HIV/AIDS and anti-malarial programmes, improving access to safe water and increasing immunisation.
- In Mali a monthly stipend of 25,000 CFA is provided to over 5000 community teachers using HIPC relief.
- In Niger a special programme that focuses on rural education, health, food security and water systems has been fully financed through HIPC. This has mainly been used so far in building classrooms and rural clinics.
- In Malawi, HIPC resources have been used among other things to train 3600 new teachers a year.
- In Burkina Faso, HIPC relief has been spent on education (39%), health (33%) and rural roads (28%)¹³.

¹¹ Also true for Cameroon (%GDP Debt 2.3 2002/3 Health 1.5), Ethiopia (%GDP Debt 1.3 2003, Health 1.1), Gambia (%GDP Debt 4.9%, Health 3.9% 2003), Guinea (%GDP Debt 2.7%, Health 0.8% 2002), Madagascar (Debt 1.1%, Health 0.9% 2002), Malawi (Debt 2.5%, Health 0.9% 2002), Mauritania (Debt 4.9%, Health 3.4% 2003), Senegal (3% Debt, 2.1% Health 2001), Uganda (1.6% Debt, 1.2% Health 2003), Zambia (Debt 3.9%, Health 2.0%, Education 2.8% 2001). Figures from Hinchcliffe, K and HIPC progress report 2003.

¹² See 'The Human Development Approach to Debt Relief for the World's Poor' CAFOD, 1998, Northover, Joiner, Woodward, and 'The Unbreakable Link – Debt Relief and the Millennium Development Goals' Romilly Greenhill, Jubilee Research, February 2002

¹³ All these figures are taken from Hinchcliffe, K *Notes on the Impact of the HIPC Initiative on Education and Health Public Expenditures in African Countries*

Moreover, there is very little evidence that debt relief has been used indirectly to support government spending in other areas, such as the military. Research by Jubilee Research in August 2002, for example, found that while education and health spending had sharply increased as a result of debt relief, military expenditure had remained roughly constant.¹⁴

The case for further multilateral debt relief 4: Creditor equity

One of the fundamental principles underlying any debt relief agreement should be that of creditor equity – all creditors should take their fair share of the ‘haircut.’ This is to prevent some creditors from holding out and waiting for other creditors to take a larger debt reduction, thus freeing up money to be repaid to the non-participating creditors.

At present, debt relief for the HIPC countries violates the principle of creditor equity in several ways. Under the HIPC initiative itself, all countries are supposed to reduce debts by the same proportion in order to bring down HIPC debts to a level considered sustainable. However, some creditors are refusing to participate in this initiative. More importantly, some bilateral creditors, including all of the G7, have promised 100% or close to 100% debt cancellation for all HIPCs.

Multilateral creditors have in some cases responded by cutting their own contribution to debt relief, leaving the debtor country no better off as a result of the extra generosity of the bilaterals.

A commitment to provide 100% debt cancellation on the part of the multilateral creditors would ensure that creditor equity is restored and that HIPCs genuinely benefit from additional bilateral debt cancellation.

The case for further multilateral debt relief 5: Future financing

International estimates suggest that if poor countries are to meet the Millennium Development Goals, at least a further \$50bn will need to be provided in aid money each year. While some of this aid will be provided in the form of grants, it is likely that part of it will be provided in the form of concessional loans, thus adding to poor countries debt burdens. If insufficient debt relief is provided now, countries risk facing an unpalatable choice between refusing new money, undermining their ability to meet the MDGs, or facing another debt crisis in 2015.

The case for additionality

Most of the funding for the debt relief delivered to date has come directly from donor country aid budgets, rather than providing new money. Current US

¹⁴ See ‘Relief Works: African Proposals for Debt Cancellation, and Why Debt Relief Works’ Romilly Greenhill and Sasha Blackmore, Jubilee Research, August 2002.

proposals to provide 100% multilateral debt cancellation for the HIPC's even propose cutting aid flows to HIPC's by the same amount as the reduction in debt service payments, leaving the heavily indebted countries with no new money with which to build schools and hospitals. While the UK has agreed to fund its share of the debt service paid by low-income countries to the World Bank and African Development Bank, this money is also included in the UK's aid budget. In 2002, total debt relief, including relief provided to non-HIPC's, amounted to approximately 10% of all aid spending.

There are 3 reasons why any money used to fund debt relief should be additional to existing aid budgets:

- Debt campaigners have consistently called for further debt relief in order to free up resources to meet human development needs. If debt is funded by using aid money, then while some heavily indebted countries may benefit, poor countries as a whole will not receive any extra money to fund poverty reduction programmes.
- Using aid money to fund debt relief deprives other less indebted low-income countries of resources. This undermines equity between countries, and creates perverse incentives for countries to become more heavily indebted in order to receive a larger share of global aid flows. Some have even argued that it can lead to a reduction in aid effectiveness, on the grounds that money is allocated to countries which have proved less able to use that money in the past.
- One of the central messages of the Jubilee 2000 campaign was that creditors should take some responsibility for the debt crisis. Creditors have lent money irresponsibly to corrupt governments, or imposed conditions on their lending that in many cases have worsened rather than improved the economic situation of the countries they were supposed to be helping. Providing debt relief should amount to an acknowledgement by creditors that they need to take their share of the costs of past mistakes. If they use aid money to fund debt relief, it is other low-income countries who pay for these mistakes, not the creditors.

Sources of additional financing

Assuming that any debt relief agreement should result in new money flowing to all low-income countries, there are 2 main options for funding relief:

- **New contributions from taxpayers in rich countries.** As the UK has done, rich countries could provide direct contributions to cover the cost of multilateral debt service to low-income countries. However, these contributions should not be taken out of existing aid budgets, but must amount to genuinely new money.

Figures compiled by Oxfam show that, if all OECD donors were to follow the UK's lead and provide new funding to cover the cost of debt service paid by low-income countries by the World Bank and African Development Bank, only \$1.79bn more would be needed per year, or only \$2.1 per person, on average, in the rich countries. This amount would only cover the low-income countries that the UK has estimated to be eligible for the additional relief.

- **Using internal IMF and World Bank resources.** There are 2 main sources of internal World Bank and IMF resources that could be used to fund debt cancellation. Firstly, IBRD net income could be reallocated to debt relief. However, this would potentially increase interest rates for IBRD countries, meaning that middle-income countries are effectively paying for debt relief rather than wealthy OECD countries.

A better source of funding for debt relief for the IMF, and possibly also the World Bank and other multilateral creditors, would be to use IMF gold. The IMF is currently sitting on reserves of 100 million ounces of gold, and this reserve is significantly undervalued. As of August 2003, gold was valued on the IMF's books at \$8.1bn, but is probably actually worth around \$45bn at market prices. Thus, gold revaluation could potentially raise more than \$30bn to fund debt relief. Gold could be re-valued by undertaking a similar operation to that used to raise money for HIPC debt relief in 1999/2000. The IMF sold its undervalued gold to Mexico and Brazil at the market price, and put the proceeds in a special account. It then accepted back the gold from those two countries at the market price in lieu of their contributions to the IMF. The net effect of these two transactions was to leave the amount of gold held by the IMF unchanged, but to raise \$3.9bn to fund HIPC debt relief.¹⁵

Money could also be raised by selling a small amount of gold each year, at market prices. The proceeds of such sales could be used to cover the costs of cancelling the debt service to the IMF, or other creditors, as it comes due. Because only a small amount of gold would need to be sold each year, this should not have a very substantial impact on the world gold price.¹⁶

Ending economic policy conditionality

¹⁵ 'Can the World Bank and IMF Cancel 100% of HIPC Debt?' Sony Kapoor, Jubilee Research for Debt and Development Coalition Ireland, September 2003

¹⁶ 'The IMF, gold sales and multilateral debt cancellation' Sony Kapoor, Jubilee Research for Debt and Development Coalition Ireland, September 2004

At present, countries receiving debt relief under the HIPC initiative have to fulfil a number of conditions, often including privatisation of basic services, trade liberalisation and cutting government spending. Countries also have to remain 'on-track' with their IMF PRGF programmes for a period of time in order to be eligible for debt relief.

While debt relief benefits poor countries, however, conditions attached to debt relief can often harm rather than help these countries:

- In Tanzania, privatisation of the water system in the country's largest city, Dar es Salaam, was a key condition for debt relief. While the country was granted a waiver because the privatisation process took too long, donors eventually forced through the reform, which has led to increased prices, worsening service delivery and a project agreement in which 98% of the money is being spent on the richest 20% of the population.¹⁷
- In Zambia, IMF constraints over the budget ceiling has prevented the country from employing teachers, despite the fact that average class sizes are rising to 70, 9000 teachers are unemployed and a young generation needs an education - not least in the fight against HIV/AIDS.

Debt relief should be provided to more low-income countries

If debt relief is to be provided to all countries that need it to meet the Millennium Development Goals, any new debt relief deal must go far beyond the current, restricted and arbitrary, list of Heavily Indebted Poor Countries (HIPCs.) MDG based debt sustainability analyses should be undertaken for all low-income countries, and debt cancelled accordingly. Some countries may only require partial debt cancellation, while other, non-HIPCs, may also need to receive a 100% debt write off. The key point is that debt cancellation should be based on human development needs, not arbitrary lists and arbitrary economic ratios which take no account of poor people's needs.

Conclusion: The need for further multilateral debt cancellation,

In summary, ActionAid UK, Oxfam International and CAFOD are calling on rich country donors and creditors to come good on their promises and provide poor countries with a genuine exit from the burden of unpayable debts. This will require:

- 100% multilateral debt cancellation for all low-income countries which need such relief in order to meet the MDGs

¹⁷ 'Turning off the taps: Donor conditionality and water privatisation in Dar es Salaam, Tanzania' Actionaid UK, September 2004

- Debt relief should not be financed by cutting aid flows, but through new donor contributions (taken from general taxation rather than aid budgets) and the sale or revaluation of IMF gold.
- Debt relief should not be confined to HIPCs, but should also be extended to other poor countries that need debt relief in order to meet the MDGs.
- There should be an end to harmful economic policy conditionality associated with debt relief. Debt relief should be provided to any country able to use such relief to meet the MDGs.
- Moving forward, we believe that in countries where human development needs are greatest, and where the feasible tax base is narrow, future aid flows should be in the form of grants rather than loans for the foreseeable future.
- In future, a fair, transparent and comprehensive international insolvency process should be created to allow creditor and debtor countries to resolve debt crises without compromising the ability of poor countries to meet the basic social needs of their people, and without forcing poor countries to repay what the insolvency process determines to be odious debts.

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