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Short Measures

Why UK Government proposals won't end the Third World Debt crisis

With thanks to Eurodad

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Introduction

This year's G8 promises further action on Third World debt following general agreement that the relief currently on offer is wholly inadequate. The UK Government argues in a new debt relief proposal it has tabled that the Heavily Indebted Poor Country (HIPC) Initiative has shown that debt relief can be extremely effective for reducing poverty, but that there is a *"wider context of a failure to meet the Millennium Development Goals (MDGs) caused by inadequate resources"*.

The UK says the advantages of debt relief over other forms of aid are:

- Predictability of debt relief over other sources of development financing;
- Country-ownership: debt relief allows governments to spend their resources according to their own priorities for poverty reduction;
- Low transaction costs compared with the bureaucratic process of making aid applications.

UK Proposal

The UK proposal represents a real step forward, but its claim that this amounts to "100% debt cancellation" is untrue. The UK does not propose complete cancellation of poor country debt stock. Instead, the proposal is for "up to" 100% relief of **debt service payments** between 2005 and 2015 for the debts owed by (currently) 23 eligible countries to the IMF, the World Bank's concessionary lending arm the International Development Association (IDA), and the African Development Bank (AfDB). While some debt stock would be reduced during this period since debt service includes both interest and principal payments, the long repayment periods of AfDB and IDA loans (30-40 years with 10 year grace periods) mean that about 70% of the debt will still remain outstanding in 2015[1], even for those qualifying for the maximum relief possible.

In other words, pending a concrete commitment beyond 2015, the UK Government proposal currently amounts to at best a 30% debt cancellation initiative for a strictly limited group of countries.

The UK Government has outlined guiding principles for multilateral debt cancellation:

1. Mobilising additional resources for financing the MDGs;
2. Equitable treatment between HIPCs and other low-income countries, as well as the importance of additionality of debt relief;
3. Maintaining International Financial Institution involvement in low-income countries;
4. Donor selectivity: debt relief should be directed towards those countries with appropriate policies and institutions in place;
5. Ensuring long term debt sustainability, including considering appropriate loan/grant mixes for low-income countries;
6. Frontloading resources where absorptive capacity can support poverty reduction.

The UK proposal includes the following:

1. That eligible countries would include:
   i. Countries past HIPC completion point;
   ii. "International Development Association (IDA) only" countries i.e. ones only receiving loans from the World Bank's concessionary lending arm, and which are also receiving a Poverty Reduction Support Credit (PRSC) as a proxy to show they have *"suitably robust public expenditure management systems to ensure savings are directed towards poverty reduction"*;
2. Use of some of the IMF's gold to finance its share of eligible countries' debt service;
3. Increased contributions from donors to finance the debt service of eligible countries to the World Bank and AfDB up to 2015;
4. That this debt service would be interrupted only due to *"serious fiduciary concerns"* like corruption.

[1] Paying for 100% Debt Cancellation: Proposals Explained, Sony Kapoor, Eurodad 21/01/05

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Eligible Countries
As of May 2005, **23 countries would be eligible** (see Table 1) for debt relief under the UK proposal. This could potentially be extended to a total of 65 countries if all HIPC countries reach completion point, and every IDA-only country qualifies for a PRSC. The current criteria in the UK proposal exclude countries like Nigeria, for example. Yet 75 million Nigerians live in poverty and Nigeria receives less in aid than any other country in Africa (just US$3 per person compared to the Sub-Saharan African average of US$21). Nigeria owes US$34 billion to creditors and the net resource flow to rich countries per year is over US$1 billion. So far, Nigeria has not benefited from any global debt relief initiative.

Table 1

Eligible Beneficiary Countries (May 2005)	
Benin	Niger
Bolivia	Rwanda
Burkina Faso	Senegal
Ethiopia	Tanzania
Ghana	Uganda
Guyana	Zambia
Honduras	Armenia*
Mali	Mongolia*
Madagascar	Nepal*
Mauritania	Sri Lanka*
Mozambique	Vietnam*
Nicaragua	

**IDA-only countries*

Financing Debt Relief
In line with WDM's position, the UK considers the *"IMF's gold reserves are an under-utilised resource that could be used to finance further debt relief by the IMF"*. The IMF has recently examined a range of technical approaches to using IMF gold to finance debt relief and concluded sale of part of its stock is feasible without negatively impacting gold producers. However, the US is currently cool on this idea following lobbying by its mining industry.

The UK says that any further debt relief using the World Bank IDA or African Development Bank's own resources will *"inevitably result in a dollar-for-dollar reduction in new disbursements to low-income countries"* and that this is not desirable. For this reason, the UK Government announced in September that it would pay its share of debt service from eligible countries to the World Bank and AfDB from 2005 until 2015. Based on the UK's voting rights at the World Bank and AfDB, this equals approximately 10% of eligible countries' relevant debt service. Canada and the Netherlands have now followed suit taking this figure to 16.5%, and the objective is to put the World Bank and the AfDB in a position to provide 100% debt service relief up to 2015, without using their own resources, by having all developed nations make similar commitments. The UK says it is willing to discuss extending its proposal to poor countries with debts to other multilateral development banks such as the Inter-American Development Bank. Canada has already extended its commitment to cover IMF debt service.

The UK proposes that a trust fund mechanism, similar to the HIPC Trust Fund, would distribute the money to IDA and the AfDB. Donors would make payments on an annual basis until 2015. Alternatively, donors could pay for their share by increasing their contributions during the replenishment rounds of IDA and the African Development Fund, providing this money was truly additional. Beyond 2015, it is proposed that there would be a review on a country-by-country basis to see if further relief is needed to ensure that countries are left with a sustainable debt burden. The UK would consider increasing the proportion of grants relative to loans from the multilateral development banks to reduce future debt build up.

Conditionality
Bitter criticisms have been raised in the past over the structural adjustment conditions imposed on countries by the IMF and World Bank in exchange for partial debt reduction. Failure to comply has resulted in the suspension of large amounts of desperately needed debt relief. The UK Government now says that it will suspend debt relief only when there are "*serious fiduciary concerns such as corruption or diversion of resources*

for illegal purposes or military conflict"; and acknowledges that *"attempts to buy reform from unwilling governments have been a failure";* and that *"country-driven strategies can be very effective in ensuring pro-poor outcomes"*.

Paradoxically however, the UK proposal is limited to HIPC post-completion point countries and IDA-only countries receiving World Bank Poverty Reduction Support Credit loans. By definition, this limits eligibility to those that have already implemented extensive economic adjustment conditions such as privatisation and liberalisation, or are in the process of doing so. It also excludes dozens of pre-completion point countries that have been struggling with HIPC Initiative conditions for years. This appears to contradict the principles of country-ownership which the UK Government claims to support, and has the unwelcome effect of turning the World Bank into a "gatekeeper" of conditionality.

Conclusions

The UK rightly recognises that current debt relief efforts are woefully inadequate, in particular if poor countries are to have any hope of attaining the MDGs by 2015. However, whilst its proposals are an advance on the existing situation, they do not go nearly far enough. The UK Government has consistently labelled its proposals as "100% debt cancellation for the poorest countries". This is extremely misleading. The proposals actually amount to debt service relief between 2005 and 2015. After 10 years even eligible poor countries will be left with about 70% of their debts remaining. If the Government is willing to make a binding 30 year commitment on spending for its proposed International Finance Facility (IFF) there is no reason it cannot do so for its debt relief proposal. Instead, while there is a vague promise to look again at debt burdens in 2015, what is on the table now is nothing more than a 30% multilateral debt cancellation initiative for less than half the 53 countries that Jubilee 2000 identified as needing full cancellation.

It is important to remember that the MDGs only seek to reduce by half the proportion of people living on less than a dollar a day, so even if achieved, much will remain to be done after 2015. Yet according to the UK Treasury's own figures, the estimated annual debt service to the AfDB and IDA of countries currently eligible for the initiative is set to rise significantly between 2005 and 2015 (see Table 2). So even without new borrowing, poor countries involved in the initiative will suffer a massive spike in loan repayments after 2015, so the international debt crisis would remain far from being solved. This problem would be avoided by an outright cancellation of the debt stock as proposed by the US (or a cast-iron guarantee to meet the full service costs as they fall due) but with new resources and extended to all poor countries for which debt repayments are limiting their ability to finance the MDGs. This would also prevent the arbitrary exclusion of countries like Nigeria, and avoid the risk of rich country governments failing to renew their commitments on debt in 2015. Future aid should also be provided in the form of grants not loans to help prevent debt building up again.

Although the UK Government has taken the welcome step of committing to abandon the imposition of free-market economic policies on poor countries in return for UK bilateral aid, its debt relief proposal is currently based on the continuing imposition of conditions by the World Bank and IMF. The leash on many poor countries would remain very short under the UK proposal because relief on debt service payments would be made on an annual basis, rather than getting full cancellation upfront. As a result if a country stopped implementing the economic conditions required to receive a PRSC, it would also risk losing debt relief. The international financial institutions should stop imposing macroeconomic conditions on poor countries as a condition for receiving grants, loans and debt relief. The democratically elected representatives of a country should be the final arbiters of economic policy, and should be respected by the international community.

Table 2

Estimated Annual Debt Service to IDA and AfDF Currently eligible countries *(US$ millions)*					
Year	**2005**	**2006**	**2007**	**2010**	**2015**
Post completion point HIPCs	353	381	412	558	825
Currently eligible non-HIPCs	144	164	177	232	291
Total	**497**	**544**	**589**	**791**	**1116**

(Source: UK Treasury)