

BRIEFING NOTE ONE
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Expanded Debt Cancellation: A Key Tool to Fight Global Poverty

Debt cancellation now has a ten-year record of success. We now know that debt relief — together with development assistance and trade policy — is one of several critical tools with which to fight global poverty. The debt cancellation provided to date means impoverished nations are saving \$2 billion a year in debt service payments. Debt relief works.

But the reality is that even after the debt cancellation provided to date, the world's most impoverished nations continue to send \$100 million each day to the United States government, other wealthy nations, the IMF, the World Bank, and other creditors.¹ It is time to extend the promise of debt cancellation to additional countries that require it to fight extreme poverty, provided these nations can demonstrate their ability to utilize released funds well.

THE UNFINISHED AGENDA ON POOR COUNTRY DEBT

While current commitments to debt cancellation are welcome, there is still a long way to go. Since 1996 and the launch of the Highly Indebted Poor Country Initiative (HIPC), the governments of the world's most impoverished 66 countries have paid more than \$230 billion to service their foreign debt, an amount exceeding the grants these countries have received from donor governments over the same period.² Even with the progress made on debt relief in the past 11 years, the forgotten truth is that the majority of the world's poorest nations are still mired in a debt crisis. While 23 nations have reached "completion point" in the HIPC Initiative, 44 more impoverished countries are either chronically delayed or ineligible.

A growing number of NGOs, governments and analysts have come to the conclusion that debt cancellation should be expanded. As independent expert Bernard Mudho explained earlier this year in a report commissioned for the United Nations: "There... is a need for further comprehensive solutions to the debt problems of poor countries, including further debt relief by other multilateral institutions and for permanent solutions to the problems of bilateral and commercial debts."³ In the July 2007 Report of the UN Secretary General to the General Assembly, Ban Ki Moon noted that "debt relief has been too slow," and should be expanded to additional low-income countries which were not part of HIPC and MDRI initiatives with the ultimate objective of reaching the Millennium Development Goals.⁴

DEBT CANCELLATION TO REACH THE MILLENNIUM DEVELOPMENT GOALS (MDGS)

Together with Official Development Assistance (ODA) and just trade policies, expanded debt cancellation forms a critical part of efforts to meet targets that the United States and nearly every other nation in the world set in 2000 to halve extreme poverty. Halfway to the target date of 2015, the world is still falling short of meeting the Millennium Development Goals. The World Bank and the United Nations have estimated that anywhere from \$40 billion to \$75 billion annually will be needed globally if we are to achieve the MDGs.⁵ Some of this can be achieved through additional aid, but expanded debt cancellation is critical as well.

Debt cancellation is not merely another "pot of money" for development, it makes our development assistance more effective. As Jeffrey Sachs and his team pointed out in the 2005 United Nations Millennium Project Investing in Development report, "Dozens of heavily indebted poor and middle-income countries are forced by creditor governments to spend large proportions of their limited tax receipts on debt service, undermining their ability to finance vital investments in human capital and infrastructure. In a pointless and debilitating churning of resources, the creditors provide development assistance with one hand and then withdraw it in debt servicing with the other."⁶

Civil society analysts have long complained that the HIPC Initiative eligibility criteria fail to take into account the critical

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¹"The World is Still Waiting," Oxfam International, Briefing Paper 103, May 2007, p. 4.

²"Enough is Enough: The debt repudiation option," Christian Aid, (citing data from the World Bank, Global Development Finance, 2006) January 2007, pp. 9 -10.

³Bernard Mudho, "Report of the independent expert on the effect of economic reform policies and foreign debt on the full enjoyment of all human rights," Report to the UN Human rights Council, Document #A/HRC/4/10, January 3, 2007.

⁴"Recent developments in external debt," UN General Assembly, Report of the Secretary General, Document A/62/151, July 26, 2007.

⁵Shantayanan Devarajan, et. al. "Goals for Development: History, Prospects and Costs," April 2002, p. 3.

⁶"Investing in Development: A Practical Plan to Achieve the Millennium Development Goals." UN Millennium Project. 2005, New York.

COUNTRY CASE STUDY: LESOTHO

Total Debt: \$690 million

Government budget spent on debt service: 7%

Government budget spent on education: 7.2%

Population living with HIV/AIDS: 270,000 (15%)

Children not enrolled in primary school: 34.6%¹

Lesotho is a small land-locked Southern African country. 50 per cent of the people of Lesotho live below the poverty line. The incidence of poverty in Lesotho is worsened by the adverse weather conditions that have been hindering food production. The situation is further exacerbated by the HIV /AIDS pandemic.² Lesotho is not currently eligible for debt relief despite its poverty and health challenges.

As Charlayne Hunter-Gault described the village of Moyeni, Lesotho in a 2006 NPR story: "The government hospital in Moyeni itself is a victim of the poverty that, like AIDS, has Lesotho by the throat. Lab facilities are scarce and nurses are leaving every month, but they aren't being replaced. Dr. Mobashshar Hassan came here from Bangladesh hoping to make a difference. He says there are supposed to be five doctors at the hospital, but three left. The health professionals are leaving because of the low pay, which Hassan says is one-third what doctors earn in countries surrounding this landlocked Lesotho."³

Upon learning that many other African nations had qualified for debt cancellation in 2005, Lesotho's Finance Minister Timothy Thahane told Reuters that one of the reasons Lesotho was not classified as a HIPC country was that it had never defaulted on its debt. "It is important," he said, "that those who have paid their debts well, who run their mega-finances well, should be rewarded with debt forgiveness."⁴

Debt cancellation without harmful economic conditions attached could be used in Lesotho to provide adequate wages for the public doctors and nurses.

¹Statistics taken from:

"The Little Data Book on External Debt," The World Bank, 2007.

"Summary Education Profile: LESOTHO" The World Bank Statistics online. Available: <http://devdata.worldbank.org/edstats/SummaryEducationProfiles/CountryData/GetShowData.asp?sCtry=LSO,LESOTHO>

"UNAIDS 2006 Report: Children out of school: Measuring Exclusion from Primary Education" UNESCO. Available: http://www.uis.unesco.org/template/pdf/educgeneral/OOSC_EN_WEB_FINAL.pdf, p. 73.

²"The United Nations (UN) 2005 World Summit: Prospects for Lesotho." Economic Review, Central Bank of Lesotho, September 2005. Available: http://www.centralbank.org.ls/publications/09_05_Economic_Review.htm.

³Charlayne Hunter-Gault. "AIDS Transforms Life, Family Structure in Lesotho," NPR, Weekend Edition Sunday, August 6, 2006. Available: <http://www.npr.org/templates/story/story.php?storyId=5619332>.

⁴"Analysis of G8 Finance Ministers' Agreement on HIPC Debt Cancellation," United States Conference of Catholic Bishops, July 7, 2005. Available: <http://www.usccb.org/sdwp/international/g8hipc.shtml>.



factor: poverty. By focusing on the debt-to-export ratio as one of the primary eligibility determinants, the current debt relief initiative falls short. An alternative model would look at poverty levels or a country's per capita income and its ability to use released funds to fight poverty. By removing a country's debt burden as a determinant of eligibility, we could correct the problem inherent in previous debt relief efforts when countries with less debt (which, it might be argued, borrowed more responsibly) did not benefit, while highly indebted countries did.

Bernhard Gunter, of the Bangladesh Development Research Center, argues in a recent paper that there are 30 countries that are both poorer and more indebted (using a debt-poverty ratio) than the least poor and least indebted eligible HIPCs.⁷ Considering that the current debt levels of HIPC countries that have received debt relief under the Multilateral Debt Relief Initiative (MDRI) are far lower than the debt levels of non-HIPC low-income countries, Gunter questions whether the HIPC program provides equitable distribution of development resources. HIPC eligible countries may benefit from debt relief at the expense of the poorer, and now more indebted countries. Gunter proposes to do away with the HIPC debt-to-export ratio criterion described above, and to replace it with a focus on fiscal debt sustainability.

In 2005, the World Bank and IMF conducted an examination of "debt sustainability" in countries that, because of very low

⁷Bernard Gunter. "MDG-Consistent Debt Sustainability: How to Ease the Tension between Achieving the MDGs and Maintaining Debt Sustainability," January 30, 2007.

per capita incomes or other special circumstances, are eligible to receive only IDA funds from the World Bank. When this exercise was conducted in 2005, it showed that 42 countries were at sufficiently high risk of debt distress to be eligible for grant financing. The list included 29 HIPC countries plus 18 other countries. This meant that there were 18 non-HIPC countries rated as having a risk of debt distress equal to, or greater than, the HIPC countries. Like the HIPCs, they would get grants going forward, but unlike the HIPCs they would get no debt relief. Because of the ten-year grace period on the repayment of IDA credits, the non-HIPCs would begin receiving the financial benefit of grants (rather than loans) only after ten years. In the meantime they would carry the full burden of existing debts and be unable to free up resources badly needed to move them towards achieving the Millennium Development Goal of cutting extreme poverty in half by 2015.⁸

CURRENT POLICY INITIATIVES FOR EXPANDED DEBT CANCELLATION

The UK MDRI

British Prime Minister Gordon Brown explained in January 2006 that “in Britain’s view, all 67 of the poorest countries should secure debt relief. By paying our share of their debt service, we will unilaterally lead debt cancellation for up to another 30 countries, and I will urge others to follow.”⁹ The United Kingdom is currently delivering debt service relief under the “United Kingdom Multilateral Debt Relief Initiative.” Under this program, the UK government goes beyond countries eligible for HIPC and pays its share (10%) of debt service payments owed to the concessional lending arms of the World Bank (IDA) and African Development Bank (AfDF) by low-income, IDA-only countries with suitably strong public expenditure management systems. Eight non-HIPCs currently qualify for UK MDRI: Armenia, Cape Verde, Georgia, Moldova, Mongolia, Nepal, Sri Lanka, and Vietnam.⁹

U.S. Congress: The Jubilee Act for Responsible Lending & Expanded Debt Cancellation

The Jubilee Act builds on the UK initiative, using the same group of impoverished nations — those eligible for “IDA-only” assistance from the World Bank — as the pool of potentially eligible countries. The Act would make 24 additional low-income nations not currently eligible for the HIPC/MDRI initiatives potentially eligible for debt cancellation from the United States and the international financial institutions, provided they meet human rights, public financial management, and budget transparency criteria and demonstrate their ability to use the money well. To benefit, countries would also have to engage interested parties, including a broad cross-section of civil society groups, in the spending allocation process and produce an annual report on this spending, making it publicly available and easily accessible. Countries would be excluded from receiving the debt cancellation under the Jubilee Act if they:

- have an excessive level of military expenditures;
- have repeatedly provided support for acts of international terrorism;
- fail to cooperate on international narcotics control matters; or
- engage in a consistent pattern of gross human rights violations.

Based on provisions in the act, we estimate that initially 9 nations would become eligible under the terms of this legislation — Georgia, Cape Verde, Samoa, Vietnam, Kenya, Mongolia, Lesotho, Moldova, and Vanuatu. Up to 15 additional nations could benefit if they meet requirements around human rights, public financial management, and budget transparency.

The Jubilee Act for Responsible Lending & Expanded Debt Cancellation has been introduced in the U.S. House (H.R. 2634) and U.S. Senate (S. 2166) and will be considered in 2008.

⁸“Debt Sustainability and Financing Terms in IDA14: Further Considerations on Issues and Options,” International Development Association, November 2004, pp. 26-29.

⁹Gordon Brown. “Our final goal must be to offer a global new deal,” *The Guardian*, January 11, 2006.

¹⁰Correspondence from Christa Rottensteiner, Debt and IMF Team Leader at the UK Department for International Development, September 2007.

RESOURCES

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Bernhard Gunter, Jesmin Rahman, and Quentin Wodon, “Robbing Peter to Pay Paul? Understanding Who Pays for Debt Relief,” *World Development* (Vol. 36, No. 1), January 2008.