



Are IMF and World Bank Economic Policy Conditions Undermining the Impact of Debt Cancellation?

SUMMARY

The international community, with the leadership of the United States government, has provided significant debt relief to a growing number of heavily indebted poor countries to help finance poverty reduction in these nations. As of this writing, 23 Heavily Indebted Poor Countries (HIPCs) — including 19 countries in Africa and 4 in Latin America — have reached “completion point” in the initiative, meaning that they have received 100% cancellation of eligible debt stock from the Paris Club, the IMF, and the World Bank. On average the relief provided to date has enabled a \$2 billion per year reduction in debt service payments from the recipient nations. These funds have been put to work in the fight against deadly poverty and to achieve the Millennium Development Goals.

But 12 years since the inception of the Heavily Indebted Poor Countries Initiative (HIPC) in 1996, the main debt relief program at the World Bank and IMF, the initiative suffers from serious flaws. Among them are the harmful economic policy requirements attached to both debt relief and lending from the IMF and World Bank. These harmful policy requirements (not to be confused with provisions to ensure transparency and accountability in the use of loans and debt relief monies) are undermining and sometimes even negating the benefits of debt cancellation. Some of the most egregious policies force countries applying for debt relief to adhere to strict IMF fiscal and monetary targets, privatize key industries, liberalize their markets, and remove subsidies for sensitive commodities like gasoline and cooking oil. These requirements often hurt the poorest and most vulnerable people and should be stopped immediately to enable debt relief to meet its life saving promise.

HOW DO COUNTRIES QUALIFY FOR HIPC? WHAT CONDITIONS MUST COUNTRIES MEET TO RECEIVE DEBT CANCELLATION?



To qualify for the Heavily Indebted Poor Countries Initiative of the World Bank and IMF, a country must be poor and highly indebted, having total debts worth more than 150% of exports or more than 250% of government revenue. There are currently 43 countries that meet these eligibility criteria.

To reach the first benchmark, called “decision point,” a country must implement an IMF economic program for three years, develop an interim Poverty Reduction Strategy Paper and clear any outstanding arrears. Upon reaching decision point, a country receives debt relief in the form of lower debt service payments. But no debts are actually cancelled at decision point, and debt service relief may be suspended at any time if a country goes “off-track” with its IMF program. Also at decision point, the IMF and World Bank determine a final group of 10 to 20 conditions, called “trigger conditions” that a country must meet in order to advance to “completion point,” at which time the country will receive irrevocable 100% cancellation of its eligible debt stock.

In addition to the trigger conditions, in order to reach completion point, HIPCs must develop an IMF/World Bank-approved Poverty Reduction Strategy Paper (PRSP) and be “on-track” with the conditionalities outlined in an IMF “Poverty Reduction and Growth Facility” (PRGF) loan. The approval of the IMF is critical: if the IMF declares a country “off track” in its PRGF program, it cannot reach completion point and its interim debt relief is suspended, meaning that the country’s level of debt service increases.¹

WHAT ARE THE CONDITIONS?

Conditions that HIPCs must meet on the path to “completion point” include a wide range of reforms regarding public expenditure management and governance and health and education targets, as well as so-called “structural reforms” which involve instructions on how to run various sectors of the economy or government, privatization of select industries or utilities, and trade and financial sector liberalization through removal of tariffs or deregulation.

Privatization has frequently been required in order for HIPCs to receive debt cancellation. Research by the Jubilee Debt Campaign (UK) found that in order to access debt cancellation under the HIPC Initiative:

- Zambia had to privatize its national bank in the face of parliamentary and public opposition. IMF policies also forced it to restrict public sector spending through a wage and hiring freeze, leaving it unable to employ 9,000 desperately needed teachers;
- Nicaragua had to privatize electricity. Electricity prices rose by 200%, pricing the poor out of the market. Blackouts became frequent;
- Sierra Leone has had to lay the groundwork for privatization of 24 state enterprises, including water, power, and telecommunications.²

While these sorts of conditions appear to have become less prevalent today, they remain serious concerns for some countries in the HIPC process. An analysis of IMF and World Bank documents conducted by Jubilee Debt Campaign (UK) in 2006 found that of the 29 countries that completed or were going through HIPC at the time of the study, 19 had to privatize state enterprises to obtain debt relief.³ All too often privatization is forced on a country without an adequate regulatory framework, with predictable results.

¹ See World Bank Debt website, www.worldbank.org/debt and Jubilee Debt Campaign (UK), “Cut the Strings: Why the UK government must take action now on the harmful conditions attached to debt cancellation,” London: October 2006.

² Ibid, p. 4

³ Jubilee Debt Campaign UK, op cit, p. 6.

COUNTRY CASE STUDY: THE HUMAN IMPACT OF ELECTRICITY PRIVATIZATION IN NICARAGUA

"I live in Managua, Nicaragua and I own a bakery which I started 15 years ago. The business has grown, thanks to a good market and lots of hard work. However, in the last 12 months, there have been electricity cuts, often up to 12 hours a day. We get no notice of the cuts and it's doing terrible damage to my business.

"As part of our access to loans and to much-needed debt relief, the World Bank insisted that the electricity supply be privatized. We had no choice but to agree. The privatization has been a disaster for me. As well as the cuts in supply, my bills have been going up. Before privatization things were not perfect but we didn't have all these blackouts and bills were much lower.

"Without electricity, I cannot make bread so it has been very difficult to survive the power cuts. In just one month I lost 26,000 cordobas and each month the losses continue. I have somehow managed to keep paying my workers and to keep supplying bread to the university, jail, and hospital. I am scared that I will be forced to lay off workers at a time when unemployment is so high.

"The World Bank didn't think about the impact of privatization on the poorest people or on small businessmen like me. We were promised lots of investment from big foreign companies, more electricity for Nicaraguans and cheaper and better service. But we have seen none of this. We just keep paying more. If I could speak directly to the World Bank I would ask them not to insist on privatization as a condition for lending us money we desperately need."

— As told to Christian Aid by Francisco Carvajal, owner of *Panaderia las Delicias* in the Barrio Jonathan Gonzalez, Managua, Nicaragua, September 2007.

Regardless of one's views on the efficacy of privatization, it should not be a requirement for debt cancellation. Countries should be left to make their own development choices in this sensitive area in collaboration with civil society and parliament.

The experience of Mali provides a recent example of how privatization has been and continues to be a condition of World Bank and IMF debt relief and loans. In Mali, 90% of the population lives on less than two dollars a day. Twenty percent of children will not live beyond age five and one in eight cannot read or write. Despite these challenges, Mali has a democratic government with a strong commitment to fighting poverty. And Mali's public financial management systems are among the best of all HIPC nations.

Mali should have been a candidate for expanded aid and expedited debt cancellation. Instead, donors forced Mali to undergo a lengthy process including the privatization of electricity and liberalization of the cotton sector to qualify for debt relief. Today, even though Mali has reached completion point in the HIPC initiative, the IMF and World Bank continue to insist on privatization and price liberalization in the cotton sector. For example the Bank requires Mali to adjust its producer price according to artificially low market prices for cotton farmers, even as cotton producers in the U.S. and Europe benefit from government subsidies. The result has been a 20% drop in the cotton price for 3 million Malian farmers.⁴

IMF REQUIREMENTS

The requirement that the countries seeking debt relief stay on track with a Poverty Reduction and Growth Facility (PRGF) loan from the IMF is of particular concern. PRGF loans include macroeconomic policy conditions such as maximum inflation targets and public spending limits, specific levels of currency reserves that must be attained, and caps on public wages. These conditions give the IMF the power to dictate spending levels in a number of sensitive sectors.

A growing number of analysts have criticized the IMF for being overly stringent by requiring impoverished countries to maintain low inflation, limit public spending, and accumulate high currency reserves.⁵ In fact, according to their 2005 PRGF programs, Burundi, Democratic Republic of Congo, Congo and Sierra Leone were all required to keep their budget deficits lower (as a percentage of GDP) than the US or UK.⁶ For countries like these, IMF policy requirements are a straightjacket that impedes the fight against global poverty, preventing desperately needed investments in the fight against AIDS, education, and clean water infrastructure.

In a September 2006 study for Jubilee Debt Campaign UK, analyst Angela Wood conducted a systematic analysis of the status of countries within the HIPC Initiative. According to her report, the most significant factor delaying governments from reaching comple-

⁴ Oxfam International, "Kicking the Habit: How the World Bank and the IMF are still addicted to attaching economic policy conditions to aid," Oxfam Briefing Paper 96, November 2006.

⁵ See, e.g., Independent Evaluation Office of the IMF, "The IMF and Aid to Sub-Saharan Africa," 2007; And Goldsborough, David, "Does the IMF Constrain Health Spending in Poor Countries? Evidence and an Agenda For Action," Center for Global Development, July 2007.

⁶ Jubilee Debt Campaign (UK), op cit, p. 9.

tion point is the PRGF. Specifically, she noted that it was either a failure to comply with PRGF programs or to reach agreement with the IMF on a new PRGF program that lengthened the time countries remained in the HIPC process.⁷

For example, the Democratic Republic of Congo has several times been declared “off track” with its IMF PRGF program. In 2006, the IMF declared that the Congolese government failed to comply with budget targets due to, among other things, “increases in wages granted last fall to ease social tensions.”⁸ In the DRC’s latest Article IV consultation, IMF staff labeled the DRC “underperforming” on its HIPC trigger condition regarding macroeconomic stability, stating that “fiscal discipline is at risk following the promulgation in July of an expansionary budget for 2007.”⁹ The budget in question increased appropriations by 3.5 percent of GDP — including an increase of 1.5 percent of GDP for wages. According to the IMF, this “execution of budgeted spending would lead to a new round of currency depreciation and inflation.”¹⁰ In a country facing desperate poverty and in the throes of conflict, IMF demands for austerity budgeting as a condition of debt relief seem inappropriate.

In the case of Zambia, a study by the International Poverty Centre of the UN Development Program found that conditionalities imposed by the IMF as part of HIPC have meant less fiscal space and reduced investment in the fight against poverty after interim debt relief rather than more. According to the authors, Professor John Weeks and economist Terry McKinley, even with the expanded debt cancellation agreed to by the G-8 in 2005, “Regrettably, the net fiscal gain from debt relief has been marginal because of the external policy conditionalities linked to the relief and the associated ODA.”¹¹

As Weeks and McKinley explain, “If debt relief fails to increase space for poverty reduction expenditures, it has failed, in fact, in its fundamental purpose. A close inspection of the official IMF projection of revenue and expenditure in the five years immediately following Zambia’s attainment in 2000 of decision point yields a startling conclusion: as a ratio to GDP, HIPC debt relief will slightly reduce the amount of expenditure available for poverty reduction programmes, and the G-8 cancellation will increase it only marginally.”¹² The authors go on to detail how the limited fiscal space opened by expanded G-8 cancellation will be woefully insufficient to meet the MDGs.

In the case of Nicaragua, the IMF required the country to use the majority of its debt relief proceeds to bolster its foreign currency reserves and pay down its domestic debt. As a result, Nicaragua had been able to free up only a few million dollars of its debt cancellation monies for social investment as of late 2006.¹³

All these country case studies indicate that specific economic policy conditions required by the IMF/World Bank are undermining the promise of debt cancellation.

DEBT RELIEF IS ONLY ONE WAY THESE CONDITIONS ARE IMPOSED

The conditions described above are not an issue for the debt relief process alone. Nearly all IMF and World Bank borrowers — but especially low and middle-income borrowers — face similar requirements. Even after countries reach completion point, they will likely continue to face these types of conditions as they take out new loans or make new policy agreements with the IMF or World Bank.

**IT IS UP TO DEVELOPING COUNTRIES
THEMSELVES
AND THEIR GOVERNMENTS
TO TAKE THE LEAD
ON DEVELOPMENT.
THEY NEED TO DECIDE, PLAN,
AND SEQUENCE THEIR ECONOMIC POLICIES
TO FIT WITH THEIR OWN DEVELOPMENT STRATEGIES,
FOR WHICH THEY SHOULD BE ACCOUNTABLE
TO ALL THEIR PEOPLE.**

**G-8 SUMMIT COMMUNIQUE
GLENEAGLES, SCOTLAND
JULY 8, 2005**

⁷ Jubilee Debt Campaign (UK), “Tightening the chains or cutting the strings? The status of HIPC conditionality in 2006,” September 2006.

⁸ IMF “Democratic Republic of the Congo: Staff-Monitored Program,” July 2006, <http://www.imf.org/external/pubs/ft/scr/2006/cr06259.pdf>.

⁹ IMF “Democratic Republic of the Congo: 2007 Article IV Consultation, Sept. 2007. <http://www.imf.org/external/pubs/ft/scr/2007/cr07327.pdf>

¹⁰ Ibid. p. 8

¹¹ John Weeks and Terry McKinley, “Does Debt Relief Increase Fiscal Space in Zambia? The MDG Implications,” UNDP International Poverty Centre, Country Study no. 5, September 2006.

¹² Ibid. p. 10.

¹³ Acevedo, Adolfo “Nicaragua: The “Millennium Development Goals” (MDGs) and the IMF program,” p. 9-11, 2006. Available: http://www.choike.org/documentos/ifis_odm_fmi_nicaragua.pdf.

There are various forms of conditionality at the World Bank and IMF beyond the specific conditions mandated for debt cancellation. These include:

- Direct loan conditions or “benchmarks.” These are requirements that World Bank and IMF borrowers must meet as part of their loan agreement;
- Country Policy and Institutional Assessment (CPIA). The World Bank’s CPIA process is an ex ante assessment that World Bank staff perform on each borrower in the International Development Assistance (IDA) program to determine the level of financial assistance that the Bank will provide to the country. Measures that countries are judged by include openness to trade and foreign direct investment, conduciveness of macroeconomic management to private investment, sustainability of fiscal policy (to avoid high inflation and unsustainable current account deficits), and sustainability of debt policy; and
- Relatively new instruments for imposing conditionality include the Policy Support Instrument at the IMF and the Performance Assessment Frameworks contained in World Bank Poverty Reduction Support Credits.¹⁴

CONCLUSION AND RECOMMENDATIONS

In 2005 G-8 leaders met in Gleneagles, Scotland, and seemed to agree that developing countries should have more policy space and autonomy to make economic choices for themselves. In the words of their official communiqué: “It is up to developing countries themselves and their governments to take the lead on development. They need to decide, plan, and sequence their economic policies to fit with their own development strategies, for which they should be accountable to all their people.”¹⁵

A growing number of governments and intergovernmental bodies, including the United Kingdom, the European Commission, and Norway, are raising concerns about the harmful impacts of economic policy conditionality, joining civil society groups from across the globe that have raised similar concerns for more than two decades.¹⁶

**MANY AFRICANS FEEL
[THAT CREDITORS] ARE NOW
USING DEBT AS A LEVER
TO DICTATE POLICY TO THE COUNTRY.** “ “
OUR COMMON INTEREST
2005 REPORT OF THE COMMISSION FOR AFRICA

Given the growing international consensus on the need for greater policy space for impoverished nations and documented harmful impacts of specific economic policy conditions, Jubilee USA recommends that specific economic policy conditions should be removed from debt relief and new lending from the IMF and World Bank. Prohibited conditions should include those that require nations to adhere to strict IMF fiscal and monetary targets, privatize key industries, liberalize their markets, and remove subsidies for sensitive commodities. These harmful requirements should be stopped immediately to ensure debt relief meets its life saving promise.

It is important to differentiate between the harmful economic policy conditions described above and necessary provisions to ensure transparency and accountability in the use of funds released by debt relief. It is essential to distinguish between harmful conditionality and legitimate requirements for transparency on the part of both the international financial institutions that are making the loans and the governments who receive debt cancellation. As we work to abolish harmful economic policy conditions attached to lending and debt cancellation, we must also strive to ensure that lending is conducted transparently and fairly and that money released by debt cancellation is used to alleviate poverty. Only then will debt cancellation meet its promise.

¹⁴For other recent studies on recent trends in conditionality in IMF and World Bank lending, see Bull, Benedicte, et al. al., “The World Bank’s and the IMF’s use of Conditionality to Encourage Privatization and Liberalization: Current Issues and Practices,” Centre for Development and the Environment, University of Oslo (commissioned by the Norwegian Ministry of Foreign Affairs), November 2006. See also EURODAD, “Untying the knots: How the World Bank is failing to deliver real change on conditionality,” November 2007.

¹⁵G-8 Communiqué, July 8, 2005.

¹⁶The UK government adopted a policy against requiring privatization and trade liberalization as a condition of its aid in 2005. The Norwegian government has a similar policy based on its 2005 Soria Moria declaration. See. e.g., Benedicte Bull et al, op cit.

ADDITIONAL RESOURCES

EURODAD, “Untying the knots: How the World Bank is failing to deliver real change on conditionality,” November 2007.

Jubilee Debt Campaign (UK), “Cut the Strings: Why the UK government must take action now on the harmful conditions attached to debt cancellation,” London: October 2006.

Oxfam International, “Kicking the Habit: How the World Bank and the IMF are still addicted to attaching economic policy conditions to aid,” Oxfam Briefing Paper 96, November 2006.