Debt Relief for LDCs:

The new Trojan Horse of Neo-liberalism

Amitayu Sen Gupta

Introduction

Debt relief for poor countries has from its very inception been a highly contentious issue. While it is largely accepted that one of the biggest problems facing LDCs is loan servicing, writing off those loans as a solution for the problem has not had many takers in the developed countries. According to the "Jubilee Debt Campaign", the total external debt of low income countries is $523 billion, of which Africa alone accounts for $300 billion. Total debt services paid by these countries **every day** is $90 million, of which Africa pays $65 million. These resources could have been better used for meeting the social crisis in these countries. For example, in 2004, Zambia's debt repayment to the IMF alone was $25 million, more than the amount it spends on education and health. Similarly, Malawi spends much higher amounts for debt repayments than it spends on healthcare, even though Malawi has one of the highest cases of AIDS-affected population.[i]

It is to be noted that often the amount of debt repayment pending is a result of interest payments accrued over the years by these countries. For example, total 'loaned' amount for Nigeria was $17 billion. While it has already paid back $18 million till date, it still has an outstanding debt stock of $34 billion. According to a United Nations study, between 1970 and 2002, Africa as a whole had transferred $550 billion to pay back loans estimated at $540 billion. Yet, it continues to "owe" nearly $300 billion. Sub-Saharan Africa, for its part, had reimbursed $268 billion for loans estimated at $294 billion, but remains saddled with a debt of $210 billion.

This problem has mainly been aggravated because of faulty debt relief policies in the first place. The early treatment of the bilateral debt crisis was through debt rescheduling within the Paris Club, the forum for "creditor" governments. However, this "debt relief" mechanism contributed to worsening the crisis because it only postponed debt payments while adding to the debt burden, with penalties on the rescheduled portion. As a result,

the debt stock of most African countries continued to pile up, with a growing part in the form of accumulated arrears, which averaged 10% of exports in the 1980s and 27% in the 1990s, compared to 1.5% in the 1970s.[ii] It is in this context that debt write-off is sought for such poor countries, because it has been obvious by now that debt servicing has been having a heavy toll on these countries which are already burdened by abject poverty, famines, epidemics, malnutrition, etc.

Unfortunately, debt relief, as and where it has been implemented by developed countries, has not been in concurrence with these humanitarian considerations, despite all their moral high grounds claims. Instead, debt relief has been used by these countries as a bargaining tool to push forward their neo-liberal agendas or other political considerations, just as giving aids and loans were used in the first place. For example, total debt relief provided through the HIPC debt initiative (*Highly Indebted Poor Country debt initiative*, discussed in detail later) over 9 years was $30 billion, where as the Paris Club, **in a single day** in November 2004, cancelled $31 billion of loans for Iraq. Way back in February 1953, West Germany and its main creditors had reached an agreement in London, whereby:

a) West Germany's debt was reduced by half;
b) The balance was rescheduled on a long-term basis and at fixed interest rates;
c) The debt service was limited at 3.5% of annual export earnings; and
d) Debt service was levied only in case of a trade surplus. With that deal, debt service was down to about 2% of export revenues.

Three years later, West Germany had virtually repaid all of its debts.

However, no such 'soft' deal has ever been offered to the low income countries. A study of the ongoing debt relief programmes reveals a detailed picture. Most of the discussions that follow are in the context of Africa, because almost the entire continent is currently plagued by this problem.

Existing Debt Relief Mechanisms

The most comprehensive debt relief programme currently operating on a global scale is the HIPC debt initiative proposed in 1996 by the IMF–World Bank. It aimed to place debt relief within the overall framework of poverty reduction, in concurrence with the Fund-Bank programme of eradicating global poverty by 2015. The HIPC operates through the IDA (*International Development Agency*, a part of the World Bank that lends on concessional rates) and the IMF's Poverty Reduction and Growth Facility (PRGF,

previously known as the Enhanced Structural Adjustment Facility). The HIPC programme was reviewed in 1999 to make it "deeper, broader and faster". Under the new HIPC, a country's debt sustainability is to be first calculated by the Fund-Bank along with officials of the country claiming relief; eligibility being subject to certain preset conditions that must be fulfilled.

DETERMINING A COUNTRY'S DEBT SUSTAINABILITY

- A Debt Sustainability Analysis will be prepared by the staff of the World Bank and the IMF, together with officials of the debtor country, to determine whether a country is facing an unsustainable debt situation after the full application of the traditional debt relief mechanisms.
- Under the new framework, sustainable debt-to-export levels are defined at a fixed ratio of 150% (on a net present value basis).
- For very open economies where the exclusive reliance on external indicators may not adequately reflect the fiscal burden of external debt: an NPV debt-to-export target below 150% can be recommended if the country concerned meets two criteria at the decision point: an export-to-GDP ratio of at least 30% and a minimum threshold of fiscal revenue in relation to GDP of 15%. For countries meeting these thresholds, the NPV debt-to-export target will be set at a level which achieves a 250% of the NPV debt-to-revenue ratio at the decision point. Côte d'Ivoire and Guyana qualified under this criterion, under the initial framework.

Source: IMF

All multilateral, bilateral and commercial creditors have agreed to comply with this programme (as per their individual commitments to the programme), providing assistance on the basis of broad and equitable burden sharing of their proportional share of a country's debt, after full application of traditional forms of debt relief (like the Naples term of the Paris Club). The HIPC Trust Fund has been set up for providing relief to the eligible countries.

THE HIPC TRUST FUND

- The HIPC Trust Fund provides debt relief to eligible HIPCs on debt owed to participating multilaterals.
- The HIPC Trust Fund can prepay or purchase a portion of the debt owed to a multilateral creditor and cancel such debt; or pay debt service as it comes due.
- The HIPC Trust Fund consists of contributions from participating multilateral creditors and bilateral donors.
- These contributions will help to ensure that all multilateral institutions are in position to meet their share of the cost.

Source: IMF

The Fund-Bank too has made respective commitments in this programme. The World Bank will operate through the IDA, which will 'forgive' a debt service payment as it

comes due. Infact, the IDA has committed to forgive a minimum of 50% of the annual debt service payments due to it, and will (to the extent possible) deliver its full share of debt relief to the country within 20 years after the decision point. The World Bank component of the HIPC Trust Fund will reimburse IDA, subject to the availability of resources, for the debt service relief provided by IDA.

The IMF has committed HIPC assistance at the 'decision point' to achieve the agreed reduction in the present value of its claims on eligible countries. Interim assistance can be made available between the 'decision point' and the 'completion point', with any remaining assistance provided at the 'completion point'. HIPC assistance will be provided through the special Poverty Reduction and Growth Facility (PRGF) grants to be paid into an escrow account and used to cover debt-service payments to the IMF.

As is quite apparent from the HIPC framework, the initiative is not a centralized programme for debt relief; instead it is dependent on the individual lending agencies. This means that a country that qualifies for HIPC still has to separately bargain with all the agencies it owes, and subsequently has to fulfil the different conditionalities imposed by these lending agencies.

The Multilateral Debt Relief Initiative or MDRI

An interesting development in this regard has been the role played by the G8 nations recently. In July 2005, the G8 proposed the immediate writing off of the debts of post-HIPC countries, most of which are in Africa, as part of a comprehensive package to help these countries achieve the Millennium Development Goals (MDGs) by 2015. Under this initiative, 100% of the debt owed by some of the poorest countries to the three major multilateral lending institutions, the African Development Fund (ADF), the International Development Association (IDA) and the International Monetary Fund (IMF), is to be cancelled. The deal is worth $40 billion for the 18 countries which had achieved their HIPC completion points by mid-2005, and as much as $55 billion as more countries qualify. This proposal is known as the Multilateral Debt Relief Initiative, or MDRI. Although the MDRI is a common initiative of the three multilateral institutions, the debt relief to be provided is the responsibility of each institution and so the details of its implementation vary. In December 2005, the IMF formally approved the details of how it will deliver its share of this debt relief and IDA has approved the modalities for debt relief from 1 July 2006. In May 2006, the ADF approved its delivery mechanism.

The different qualification criteria and other specifications for debt relief by the three bodies are discussed below.

IMF's Implementation of MDRI

Country eligibility and qualification for the IMF's MDRI debt relief are determined as follows:

- All HIPC and non-HIPC IMF members with per capita income of US$380 or less are potentially eligible for MDRI debt relief. The IMF has widened its criterion to include the poorest non-HIPCs in line with its principle of uniformity of treatment for all IMF member countries.
- To qualify for debt relief, HIPCs must reach their completion point and non-HIPCs must meet the income criterion.

Further, countries have to meet the following criteria to be considered for IMF debt relief:

- Maintain a minimum 6-month track record of satisfactory macroeconomic performance under PRGF or Fund-supported arrangements,
- Have a minimum 6-month track record of satisfactory implementation of a poverty reduction strategy (PRS) or similar framework, and
- Demonstrate that the quality of the public expenditure management system (PEM) has not deteriorated since completion point or in recent years for non-HIPCs, using the main benchmarks of the HIPC Action and Assessment Plans reports.
- Countries must be current with their debt service payments to the IMF.

The IMF debt eligible for 100% debt cancellation is the disbursed outstanding debt as at end-2004. Repayments of eligible loans made between end-2004 and the date of qualification for MDRI relief are not eligible for relief and will not be reimbursed. Countries are expected to continue to service their IMF debt in full prior to qualification and such payments will not be reimbursed upon MDRI qualification.

IDA's Implementation of MDRI

Country eligibility and qualification criteria for IDA's MDRI debt relief are the same as those for the IMF, with the exception that only HIPCs are potentially eligible. The same conditionalities apply for post-completion HIPCs as of end-2005 to qualify for MDRI relief. In addition, countries must be current with their IDA debt service payments.

The IDA debt eligible for 100% debt cancellation is the disbursed outstanding debt as of end-2003. All disbursements after this date, whether on existing loans or new loans, are not eligible for debt cancellation. All debt service payments made between end-2003 and

the date a country qualifies for MDRI relief are not eligible for relief and will not be reimbursed. Countries which have yet to reach their HIPC completion points will receive IDA MDRI relief in the quarter following their completion point. So, for example, a country reaching its completion point in August 2006 will receive irrevocable MDRI relief from IDA in the fourth quarter of 2006.

ADF's implementation of MDRI

Country eligibility and qualification for ADF member states for MDRI debt relief are the same as for IDA. The same conditionalities apply for post-completion HIPCs as of end-2005 to qualify for MDRI relief. In addition, countries must be current with their ADF debt service payments.

The ADF debt eligible for 100% cancellation is the disbursed outstanding debt as of end-2004. All new credits and disbursements after this date are not eligible for debt relief and all debt service payments made after end-2004 and the date a country qualifies for MDRI relief are not eligible for relief and will not be reimbursed. Countries, which have yet to reach their HIPC completion points, will qualify for ADF MDRI relief three months after reaching completion point. However, this relief will not be delivered until 1 January of the following year to allow for new country disbursement allocations and the 'netting out' process described below.

This decision of the G8 countries has generated a lot of discussions ever since its announcement and has in fact given rise to many controversies as well, the most prominent being the eminent opposition to the proposal by the non-G8 members of IMF. Even though the IMF has finally ratified the programme, there are still numerous detractors of this programme, from both ends of the spectrum.

The developed countries' claims that the Gleneagles announcement is about '100% debt relief' can be seen to be totally false if one reads the fine prints. Firstly, only 18 to 30 countries qualify for debt relief under the new conditionalities. The most compelling cases (as the case of Nigeria) stand to be totally neglected under this proposal. Even for those countries that do qualify, the MDRI is applicable for debts owed to only 3 lending agencies. All debts owned to other lending agencies (which too form a substantial amount) are not covered. However, the conditionalities imposed are permanent changes that would infringe upon the abilities to service these other debts. For example, the five poorest Latin American countries have to pay $3.3 million in debt services to the Inter

American Bank which does not come under this agreement (Jubilee Debt Campaign). In fact, it was on these grounds that the non-G8 members of the IMF opposed the move, claiming that such a policy would render these lending agencies weak *vis-a-vis* the others that were not compelled to abide.

Campaigners for debt relief point out that these relief mechanisms come with a rider; further enforcement of neo-liberal policies, even after the SAP programmes in these countries had had a devastating impact. The G8 progress report on Africa[iii] (published after the Gleneagles summit in 2005) talks at length on the need of 'good governance', 'transparency' and 'prudent fiscal policies' as prerequisites for development in Africa. In fact, many of the G8 nations are actively involved in training and equipping military forces in conflict-striven areas and hence have a more direct role in shaping the governments in some of the countries.

The excerpts from the document itself bear out the facts:

"*Many G8 members have set aside commitments to supporting training and capacity building for peace support operations. Italy, with other G8 support, has formed the Center of Excellence for Stability Police Units in Vincenza (COESPU). Italy has also funded two training courses on conflict prevention, human rights and "peacekeeping" designed for 70 officers from 35 African countries organized by the United Nations System Staff College of Turin (UNSSC).*

Russia supports African peacekeeping by providing 220 observers, representatives and contingents for UN peacekeeping operations in the continent. Russia also provides assistance for training African personnel for conducting humanitarian, rescue and peacekeeping operations at the "Vistrel" Training Center. This is likely to expand".

Subsequently, G8 nations have been active in bringing about 'good governance' in their efforts to help development in Africa. To quote the Gleneagles report:

"*G8 members are increasingly supporting public sector reform and public finance development programmes that reflect the increase in African reform efforts. Governance reform is a focus of German bilateral cooperation in eleven African partner countries, for which Germany has provided €210 million. This includes assistance for democratic decentralisation and national democratic institutions, in support of which Germany has invited African Parliamentarians to two international conferences.*

Support to public financial management reform, typically jointly with other development partners, has been an essential complement to the UK's provision of budget support to many African countries, including Ghana, Ethiopia and Tanzania. French support to public sector reform and public finance development programmes has amounted to €52 million in 2003-05. Support to elections has amounted to €5 million over the same period".

It is this context that the debt relief commitments of the G8 nations must be read.

In simple terms, to be eligible for debt relief considerations, the countries need to have a track record of "successful implementation' of IMF/World Bank policies. Even after qualification, the countries have to separately negotiate with all lending agencies which may entail further criteria. It is to be noted that the HIPC initiative itself has other aspects along with debt relief, like HIPC Capacity Building Programme, which aim to help these countries develop their economies so that they are not once again caught in a debt trap in the future.

Moreover, the methodology for calculating the debt relief criteria too has drawn criticism. Debt ratios (debt-to-export ratios) have very little to do with a country's development needs or ability to service their debts. In fact, one of the glaring examples of the fallacy of this eligibility criterion was that Nigeria did not qualify even though it has one of the worst debt scenarios. The hue and cry raised on this issue has compelled developing countries to make special arrangements for Nigeria in a face-saving formula.

The formula for debt relief also talks of bringing down the debts to a 'sustainable level', where this 'sustainable level' is based on future export revenues. This means that this sustainability hinges on the prices of primary commodities, which form the bulk of Africa's exports. Any fall in prices would immediately render debt ratios of some countries unsustainable, which in turn could well entail further stringent conditionalities on these countries.

Finally, reaching the "completion point" is contingent upon implementing structural reforms and privatisation of public assets. The difficulty in fulfilling these reforms has often led countries to fall "off-track," having their programmes suspended by the IMF and the World Bank. This acts as an arm-twisting tactic under which these countries are compelled to implement such policies irrespective of the consequences. For example, Senegal was forced to privatize its peanut processing company Sonacos under what the Bank calls "completion point triggers," which are the conditions to be fulfilled by Senegal before reaching the point for debt relief. Even the chairman of the privatisation committee admitted that the World Bank had pressured them to reach a deal at any cost.

Such interventions by the Bank in domestic affairs as prerequisites for debt relief eligibility are numerous. In Mali, the World Bank forced the government to let the producers and management of the state-owned cotton processing company "freely" negotiate the producer price of cotton. After they had reached an agreement to fix the

price at CFA210 (Communaute Financiere Africaine francs), which was below the actual cost of production, the Bank said it was "too high" and that the price had to be renegotiated. It further imposed a price in the range of CFA60-175 for the next three years, to the dismay of producers, which has raised questions about the future of cotton production in the country.

It has in fact been argued that the very announcement of debt relief in the G8 Gleneagles summit in July 2005 was made keeping in view the Hong Kong round of negotiations of the WTO later in December, where developing countries including the African nations were expected to raise strong oppositions.

The Question of Private Debt Accumulation

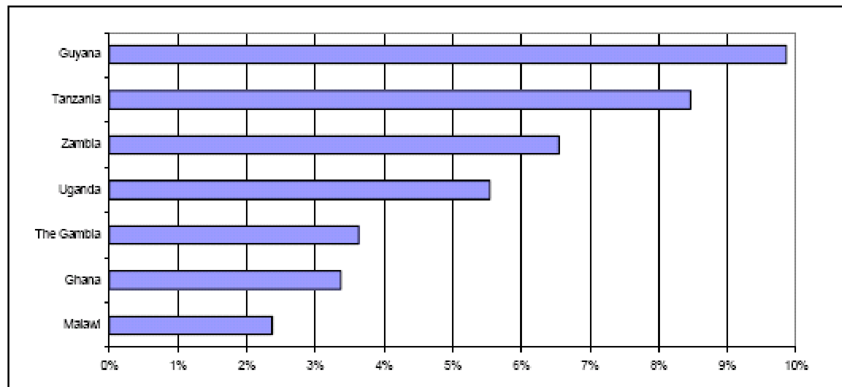
While discussing the economic vulnerability of these low income countries and the potential damages of neo-liberal policies that accompany debt-relief, it is also necessary to have a better understanding of the role of private investments in these countries. It is a common perception that these low income countries, most notably those in sub-Saharan Africa, are aid dependent, as there is very little private capital inflow into these capital-scarce countries. A poor surveying technique by both international agencies and the respective countries was responsible for such an outlook. However, better surveillance has now brought forward the true picture regarding capital flows in these countries.

It is seen that the scale of gross private capital inflows and accumulated stocks in relation to GDP in some of these countries are significantly high contrary to popular belief.[iv] Outflows accounted for 59% of total inflows. This is very high for such low income countries and can give rise to a crisis if adequate proper controls are not in place, as it happened in Ghana in 2000 when its outflows were almost double the inflows.

The composition of these foreign capital inflows shows that while foreign direct investment (which by definition here involves only equity investment) comprises about 32% of the total and foreign portfolio investment (new equity or reinvested earnings on existing equity) is less than 2% of the total, long-term intra-company loans comprise a much higher component of total inflows at 41%. In addition, debt/credit from unrelated companies is also substantial at 25%. Thus, the new capital inflows coming into these African countries are clearly debt-creating. Further, FDI, which is assumed to be the most desirable flow of private capital, demands and achieves a return of 14.8% on average

(exceeding 20% in Gambia and Malawi). Of this amount, around 75% is repatriated as remittances.

Private Foreign Capital Inflows (%GDP in the period surveyed)



Source: Canadian Development Report, 2004.

Further, for many countries, the debt-equity ratio is found to be around 1.5 per cent and the leverage ratio is around 60%. This is relatively high and is comparable to the East Asian and Pacific countries. Such high debt/equity ratios lead to a rapidly growing private sector debt burden. They represent 15% of total national external debt, while for countries like Ghana and Mozambique they are closer to 30%. With the reduction in public sector debt under the HIPC initiative, the rapid accumulation of private sector debt (almost 66% of new inflows) is set to become the key element of national debt burdens; a factor that the HIPC finance Ministers have been trying to highlight.[v] However, such concerns are brushed aside by developed countries, as highlighted by the recent declaration of the G8 nations:[vi]

"Recognising that private resources dwarf public flows and can have a considerable positive impact on development, we are taking steps to help African countries to mobilize the full range of development finance, as agreed in the Monterrey consensus".

CONCLUSIONS

The debt burdens of the low income countries are a major handicap for these nations in their fight against poverty and underdevelopment. However, developed countries are exploiting their present helplessness to further their own interests under the garb of charity. Debt relief mechanisms are just another method adopted in this regard. While debt relief is an absolute necessity for these nations, the present process would only add to the woes of these already burdened low income countries. When these poor countries

had originally taken such loans, the neo-liberal policies that were enforced on them have themselves rendered them incapable of paying off these debts. Today, the developed countries are taking advantage of this fall-out to further strengthen their grip on these poor countries. Given the effect of the policies in the past, it is but obvious that the new set of neo-liberalism would further weaken these economies. This burden could, in the long run, far exceed the debt burden they are presently reeling under.

---

[i] One in every five Malawians are HIV-infected.

ii See Jubilee Debt Campaign: http://www.jubileedebtcampaign.org.uk/

iii Progress Report by the G8 Africa Personal Representatives on Implementation of The Africa Action Plan, G8 Gleneagles 2005.

iv See Private Capital Flows to Low Income Countries: Perception and Reality, Chapter 2 of the Canadian Development Report 2004, Development Finance International.

v See the HIPC Ministerial Forum (2003) Declaration of the 8th HIPC ministerial meeting, Kigali.

vi Update on Africa, G8 summit 2006, St Petersburg, Russia.