A proposal for the Design of

HIPC DEBT RELIEF

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HIPC DEBT RELIEF

Debt cannot be treated as a commercial issue, but a human question – debt is the enslavement of citizens, before they are born, during their lifetimes, and even extends after their death.

Bishop Sengulane

Issue: To reassess the current approach to debt relief.

The debt relief issue is a Gordian Knot. It is self-evident that no one profits from wholesale impoverishment of countries with high indebtedness, depriving generations of adequate basic educational and health services. The political downside of debt relief is equally self-evident – significant numbers of taxpayers in sensitive domestic constituencies are forced to suffer bankruptcy without debt relief. Moral hazard is a legitimate concern. The consequences of debt relief for those on the cusp of high indebtedness should not be to encourage irresponsible decisions. The issue is complicated by the fact that some of the HIPC's have or have had undemocratic wastrel governments who, most would agree, don't 'deserve' debt relief. The knot is made more complex by the sourcing question – "where should the debt relief resources come from?" The issue devolves to the key questions of conditionality –What are the conditions? Who should impose them?

Background:

Debt relief for the Highly Indebted Poor Countries is not working. In 1997 and 1998 there was a net transfer of funds from Africa to the IMF. Servicing debt imposes an overwhelming burden on countries already short of resources. Between 1996 and 1999, the debt of 41 HIPC countries rose from $216 billion to $219 billion.[i] This problem is urgent and indicates that, despite the HIPC initiative, the reduction in debt stock has been insignificant. Debt service payments remain crippling, either through Naples terms or Paris Club. HIPC governments must spend large sums of money servicing creditor countries that are often giving them aid to support much-needed social services. Research conducted by Oxfam last year shows that nine of twelve countries studied will continue to spend far more on debt servicing (net of debt relief) than on health and primary education. [ii] In five of these countries (Zambia, Tanzania, Senegal, Mauritania, and Cameroon), debt repayments will exceed the combined health and primary education budget after debt relief.[iii]

At the end of 2000, the HIPC2 initiative brought the total figure of countries that have reached the 'Decision Point' (that is to the point at which debt relief is committed by participating creditors), to 22 out of a possible 41. There are some countries, for example, Uganda, Mozambique and Guyana, which have been successful under the initiative; debt relief had been deep enough to make a real impact. However, even after HIPC relief, some countries are still paying over one and a half times more in debt service than they are on health care. In countries such as Uganda, where the population suffers from one of the highest levels of HIV infection in the world, this is simply not tenable. It is clear that the HIPC2 initiative is in need of reform.

Poverty Reduction Strategy Papers

Under the HIPC initiative, countries were expected to gain World Bank and IMF approval of their "Poverty Reduction Strategy Paper"(PRSP) before eligibility was confirmed. Many countries found this challenging, and experienced tension resulting from the necessity for early debt relief and the burden of developing a good plan fit for approval. Under the new HIPC2, countries may begin to receive debt relief, provided they submit an Interim PRSP, which confirms the country's commitment to poverty reduction, and outlines a general plan of action. Unfortunately, even the Interim-PRSP' s are proving to be technical and time-consuming. What was intended as a light document, seems to have fallen into a slow bureaucratic process.

"Debt relief, though an important element of a broad strategy to tackle poverty, is not a panacea. It must proceed hand-in-hand with measures to address underlying weaknesses, most notably with those that improve governance and reduce military and other non-productive expenditures it is essential that we focus on the quality of conditionality rather than on the quantity. Sao Tome and Principe, a tiny island nation of 140,000 people, is required to carry out some 160 policy actions to obtain debt relief. This is absurd."[iv]

Moral Hazard

The HIPC process was subject to conditionality in order to prevent 'moral hazard'. "Excessive" cancellation of debt would lead to moral hazard, a high level of irresponsibility on the part of the borrowers who feel little obligation to repay their loans. Unless debt relief conditions are onerous, debtor countries may feel free to default; others would not have the incentive to borrow responsibly in the future.

Debt Review Body

Jubilee2000 recommends a review body that would be overseen by the UN or another independent organization. The organization could appoint an independent arbitrator to monitor the work for the DRB and appoint equal members from each side, including reps from civil society. The documents would be made public and decisions would be binding. The body would monitor funds and ensure that monies are being spent on poverty reduction priorities. Kofi Annan, UN Secretary General writes, " I would go a step further and propose that, in the future, we consider an entirely new approach to handling the debt problem. The main components of such an approach could include…establishing a debt arbitration process to balance the interests of creditors and sovereign debtors and introduce greater discipline into their relations. This approach is impractical, given the widespread opposition in influential quarters to subordinating any function of the IMF and World Bank to a United Nations creature.

Countries Affected by Conflict

Under the HIPC2 initiative, all 9 conflict-affected countries are excluded from accessing debt relief, but urgently require resources for recovery and development. For example, Chad, Guinea Bissau and Rwanda, are facing severe governance issues or undergoing civil conflict, which is complicating efforts to offer assistance.

Financing and Private Investment

In addressing this issue, creditors must either write off the debt owed to them by HIPC governments, or find an alternative. Writing off debt may be politically painful for some countries – in that it entails an increase in the country's budgetary deficit. The political 'pain', however, may be inevitable. For instance, in some countries such as Zambia, which now faces increased payments after qualifying for HIPC, it is clear that debt relief often amounts to no more than cancelling debt that could not be paid anyway. If this debt is not collectable, and hence an "accounting exercise" to write off, some feel it should be forgiven in its entirety as quickly as possible.

Some advocate selling 10 million ounces of the IMF's gold reserves, investing the proceeds, then use the interest to finance debt relief. US Congress rejects this proposal, claiming this will make the ESAF less accountable to donor governments. They feel that the price of gold on world markets will consequently decrease, hurting not only U.S. profits, but gold-exporting developing countries.

Others stress that funding debt relief should depend on ensuring that HIPC countries carry out programs that will attract private lending to and investment in them.

Poverty Action Fund

Oxfam International suggested that the success of the HIPC initiative depends on developing and maintaining a sound framework to govern the transfer of forgiven debt payments towards effective poverty reduction and health and educational programs in recipient countries. They recommend the establishment of a Poverty Action Fund (PAF), which would be transparently managed and audited, and channel debt relief resources to finance human development goals.

Oxfam proposes that all countries enter HIPC2 immediately if they meet one condition: *commitment to placing debt relief finance into a transparently managed Poverty Fund, as part of the Interim Poverty Reduction Strategy Paper, which directs expenditure towards poverty reducing areas such as education, health, rural roads, employment generation* *programmes etc.* This approach presumes the availability of significant funds available for debt repayment.

Mandate of Proposed Agency:

The HIPC Debt Relief Agency would explore viable and practical ways to accelerate the effectiveness and progress of the IMF's HIPC initiative. To insist that every dollar is paid back by donor countries is unrealistic; to expect donor countries to relieve 100% of debt load is also unrealistic. Instead of the straitjacket of a universal template, the agency would seek to find an optimal strategy, case-by-case, country-by-country, that determines an appropriate balance between the nature of conditionality and the degree of forgiveness.

The Agency would take as a departure point, the IMF's current approach to debt relief, the conditions upon which relief is committed, and the Poverty Reduction Strategy Papers. It would then be mandated to develop more efficient alternatives with fewer hurdles granting debt reduction and/or ongoing concession assistance. A key element to any new approach is to focus on the quality, rather than the quantity, of the programs conditions, with special attention focused on peculiarities of the individual HIPC. A monitoring group for future loans could be organized to ensure these loans are made in a transparent way. Various approaches will be explored and the Project will develop options for the Agency mandates to devise strategies that will accelerate Debt Relief.

It is important to find the right balance between conditionality that guarantees country "ownership" of poverty strategies while requiring HIPC countries to make lasting and tangible economic reforms. Paul Martin stresses that, "we must remember that we are asking developing countries to complete a comprehensive, inclusive and long-term process that developed nations themselves have never had to undertake…we are looking for significant changes in developing nations over a relatively short time frame in an increasingly complex an dynamic reality, with binding capacity constraints, requiring progress in a matter of years." Theoretically, forgiving debt would release more funds for education, health, and poverty reduction. The proposed Agency would determine how to ensure the money made available by debt relief is well spent.

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[i] Jubilee2000. "Twenty-two countries due to gain some debt relief in 2000, but cancellation must go deeper." Pp.1, 21 Dec.2000. from http://www.jubilee2000uk.org/reports/dropped1200.html

[ii] Awaiting info via e-mail from Carolyn Culey (Oxfam UK)
[iii] Oxfam. "21st Century Debt Relief", pp.1 January 01 . from http://www.oxfam.org.uk/policy/papers/debt.html

[iv] Martin, Paul. "Statement Prepared for the Development Committee." Sept.00. from http://www.fin.gc.ca/newse00/00-074e.html