

# Do the Deal.

The G7 must act now to cancel poor country debts.

February 2005

The poorest countries in the world pay \$100 million dollars a day to their rich country creditors, more than they spend on health. Along with increasing aid and reforming trade, debt cancellation is an essential step towards ending poverty. As the G7 Finance Ministers convene in London for their first meeting of 2005 they must act to cancel debt as the first step towards making poverty history.

# Summary

Every month rich country leaders delay a deal on debt cancellation, the poor pay with their lives.

Last month, rich countries agreed to suspend the debt repayments of the countries devastated by the Tsunami for 12 months. Under the intense media spotlight, it was clear that rich countries could not continue to give aid with one hand only to take it back with the other hand through debt repayments. Through this step, they recognised that saving lives is more important than repaying debt.

Every week, poverty kills more people than the Tsunami. A child dies every three seconds through preventable diseases. Yet at the same time the poorest countries in the world routinely spend more on debt repayments than they do on health. In 2002 low-income countries paid out \$39 billion in debt repayments to rich country creditors - the equivalent of \$100 million every day. In that same year, despite the billions living in poverty, the millions out of school, and the thousands dying daily, they received only \$17bn billion in grant aid.

On Friday 4<sup>th</sup> February 2005 the Finance Ministers of the G7 will meet in London. These seven men have the power to make a decision which would end the crippling debt burden of the poorest countries. G7 leaders have made warm speeches about the importance of solving the debt problem. The time for talking is over. The world is watching - and the time to act is now.

Following massive campaigning by the Jubilee movement worldwide, rich countries agreed to some debt cancellation in Cologne in 1999. Sadly, more than five years on, it is clear that the debt problem is far from being solved. While the Heavily Indebted Poor Countries (HIPC) initiative<sup>1</sup> has delivered almost \$30bn of debt cancellation and pledged to deliver more than \$20bn more, only 7 countries have actually seen their debts brought down to levels considered 'sustainable', even according to the narrow and inadequate criteria of the HIPC initiative<sup>2</sup>. Even those countries that have qualified for debt relief are still paying \$2.8bn a year to their creditors, 15% of their revenues and in many cases more than they spend on education or health.

Debt relief works. The debt relief that has been delivered so far has had a massive positive impact on fighting poverty. Debt relief in Tanzania enabled the Government to make primary education free. This meant over 2 million children can now go to school. In Benin debt relief is paying for staff at rural clinics across the country, and in Mali the debt relief dividend has allowed the recruitment of 5000 community teachers.

When politicians want to act, they can. Rich countries can and do find the money. In one day in November 2004, rich countries agreed to cancel a total of \$31 billion of debt owed by Iraq. This is more than all the HIPC debt relief granted to all the poorest countries in the world in the last five years.

At the same time the IMF is also sitting on a huge pile of gold it neither needs nor uses. These 100 million ounces are worth over \$45 billion dollars, but are valued by the IMF at \$8 billion. Revaluing or selling this gold would immediately release vital resources to finance debt cancellation.

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<sup>1</sup> The HIPC initiative was started in 1996 and expanded at the Cologne Summit in 1999. Under the initiative, 42 countries are eligible to receive partial debt cancellation, of which 15 countries have so far received a debt write off and 12 more have qualified to do so. For more on the HIPC initiative, see [http://www.jubileeresearch.org/hipc/what\\_is\\_hipc.htm](http://www.jubileeresearch.org/hipc/what_is_hipc.htm)

<sup>2</sup> 'Jubilee Research and HIPC Initiative: Status of Implementation' IDA, August 2004

Debt campaigners worldwide have consistently argued that poor country debt will only truly be 'sustainable' if debt service payments do not compromise the ability of such countries to meet the internationally-agreed Millennium Development Goals (MDGs.)<sup>3</sup> Recently this position was fully endorsed by the report of the UN Millennium Project under Jeffrey Sachs.

What this will mean for the majority of low income countries is 100% debt cancellation, plus significant increases in aid, if the MDGs are to be met. Set by this standard, the progress made to date through the HIPC initiative remains woefully inadequate.

The UK Government announced last September that it will pay its share of the debts owed by 21 poor countries to the World Bank and African Development Bank until 2015, and will push for the revaluation or sale of IMF gold to fund IMF relief.

This step is welcome, as it releases vital resources for these countries to spend on fighting poverty. The rest of the G7 should follow suit immediately. However, the proposal should also be expanded further to more than just 21 countries, and involve debt stock cancellation rather than just debt service relief. It should also use resources that are additional to existing bilateral ODA budgets. Lastly it should not be subject to countries having to implement risky and unproven policy conditions in order to access the relief.

The Finance Ministers of the G7 showed they could act in response to the Tsunami. They also showed they could act in November when they agreed to cancel 80% of Iraqi debt. Now they must act to end the crippling debt burden of the poorest countries.

## Recommendations

- **100% multilateral debt cancellation must be provided now** to all low-income countries which need such relief in order to meet the MDGs, under a fair and transparent process.
- Debt relief should not be financed out of existing aid budgets, but from new donor contributions, and the sale or revaluation of IMF gold.
- Debt relief should not be confined to HIPCs, but should also be extended to other poor countries that need debt relief in order to meet the MDGs.
- There should be an end to harmful economic policy conditionality associated with debt relief. Debt relief should be provided to any country able to use such relief to meet the MDGs.
- In countries where human development needs are greatest, and where the feasible tax base is narrow, future aid flows should be in the form of grants rather than loans for the foreseeable future.
- In future, a fair, transparent and comprehensive international insolvency process should be created to allow creditor and debtor countries to resolve debt crises without compromising the ability of poor countries to meet the basic social needs of their people, and without forcing poor countries to repay what the insolvency process determines to be odious debts.

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<sup>3</sup> See, for example 'Debt and the Millennium Development Goals' Working Paper by Cafod, Christian Aid and Eurodad, September 2003

## Do the Deal

### Debt and the low income countries

At the end of 2002, low-income countries owed the rich world a total of \$523bn, or roughly half their combined Gross National Income (GNI). Of this total, \$154bn, or a little under a third, was owed to multilateral creditors, including the World Bank and IMF. Low-income countries as a whole paid out \$39bn in debt service in 2002, or roughly \$100m per day. Of this, \$13.1bn was paid to multilateral creditors<sup>4</sup>. In contrast, low-income countries received \$17bn in grant aid in the same year.

HIPC relief and other forms of debt relief have so far relieved low-income countries of around \$48bn of their debts, of which HIPC debt relief accounts for about \$30bn<sup>5</sup>. However, this remains less than 10% of the total debts owed by all low-income countries to rich countries and institutions.

### *The case for further multilateral debt relief 1: The failure of HIPC*

In 1999, when the HIPC was expanded<sup>6</sup>, the initiative pledged to provide HIPC countries with a 'permanent exit' from the burden of unsustainable debts. While HIPC has undoubtedly delivered some benefits for some countries, however, the most recent reports show that the initiative is falling far short of its promises.

Under the HIPC initiative, most countries are supposed to have their debts brought down to within 150% of their annual exports<sup>7</sup>. However, the latest Status of Implementation Report for the HIPC initiative, prepared by the IMF and World Bank, has shown that only 7 of the 14 countries that had fully passed through the initiative<sup>8</sup> had seen their debts brought down to within these levels. In some cases, debt burdens remain way over the HIPC thresholds. Uganda, for example, has a debt amounting to more than 250% of exports, while Ethiopia's debt burden will remain at over 200% of its exports until at least 2010, despite HIPC's so-called Completion Point 'topping up'<sup>9</sup>.

Debt service payments remain high, because HIPC has not brought down debt stocks sufficiently. In 2003, even the 27 countries that have either received a debt stock reduction, or have at least passed the first stage of the initiative (so-called 'Decision Point) still paid \$2.8bn to their rich country creditors. This amounted to 15% of their revenues and 2.5% of their annual GDP<sup>10</sup>. For some countries, the figures are even higher. Senegal, for example, spent almost 36% of its revenues in debt service last year, while Malawi paid more than 30%<sup>11</sup>. By contrast, legislative proposals put before the US Congress suggest that in countries with critical poverty needs, this figure should not exceed 5%.

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<sup>4</sup> Source: Global Development Finance 2004

<sup>5</sup> Source: Jubilee Research

<sup>6</sup> The original HIPC initiative, started in 1996, had committed less generous terms to HIPC countries. In 1999, the initiative was expanded into its current form.

<sup>7</sup> Some countries have qualified under the so-called 'fiscal window' under HIPC, which measures debt sustainability according to the ratio of debt to revenues.

<sup>8</sup> It was 14 countries at the time the report was published. It is now 15, including Madagascar.

<sup>9</sup> HIPC Status of Implementation Report, August 2004, IDA/IMF

<sup>10</sup> *ibid*

<sup>11</sup> HIPC Status of Implementation Report, August 2004, IDA/IMF

## *The case for further multilateral debt relief 2: Debt and the MDGs*

In the year 2000, the international community committed itself to halving world poverty by the year 2015 and to meeting a number of other poverty reduction targets – the Millennium Development Goals (MDGs.)

However, debt service payments from heavily indebted poor countries continue to undermine their ability to meet these internationally agreed targets. In 10 out of 14 African HIPC countries where data is available, debt service payments still take up a larger share of the budget than do health services. In Ghana, for example, 11% of government spending goes into repaying debts, while only 9% is spent on health.<sup>12</sup> In Zambia, the Government spends more on servicing its debt than it does on education.

NGOs in the UK have held a consistent position over recent years that any calculation of debt sustainability should be linked to the poverty needs a country has, and in particular the financing gaps it is facing in reaching the Millennium Development Goals. This definition of debt sustainability has gained wide acceptance, in the UN, amongst African Governments, HIPC Finance Ministers and even creditor governments such as Ireland. Under this understanding of debt sustainability, it is clear that most if not all of the HIPC countries, plus other low-income countries, will require 100% debt cancellation, plus significant increases in aid.<sup>13</sup>

## *The case for further multilateral debt relief 3: Debt relief has been well used*

Although the levels of debt relief provided to poor countries so far has fallen far short of needs, there is clear evidence that the money saved in debt service payments has been put to good effect in reducing poverty. Poverty reducing expenditures in African HIPC countries have increased on average 6% as a result of HIPC debt relief, and as much as 14% in some countries.

- In Benin, for example, 43% of HIPC debt relief went to Education in 2002, allowing the recruitment of teachers for empty posts in rural areas. 54% went to health, of which a fifth was used to recruit health staff for rural clinics, and the remainder was allocated to implementing HIV/AIDS and anti-malarial programmes, improving access to safe water and increasing immunisation.
- In Mali a monthly stipend of 25,000 CFA is provided to over 5000 community teachers using HIPC relief.
- In Niger a special programme that focuses on rural education, health, food security and water systems has been fully financed through HIPC. This has mainly been used so far in building classrooms and rural clinics.
- In Malawi, HIPC resources have been used among other things to train 3600 new teachers a year.

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<sup>12</sup> Also true for Cameroon (%GDP Debt 2.3 2002/3 Health 1.5), Ethiopia (%GDP Debt 1.3 2003, Health 1.1), Gambia (%GDP Debt 4.9%, Health 3.9% 2003), Guinea (%GDP Debt 2.7%, Health 0.8% 2002), Madagascar (Debt 1.1%, Health 0.9% 2002), Malawi (Debt 2.5%, Health 0.9% 2002), Mauritania (Debt 4.9%, Health 3.4% 2003), Senegal (3% Debt, 2.1% Health 2001), Uganda (1.6% Debt, 1.2% Health 2003), Zambia (Debt 3.9%, Health 2.0%, Education 2.8% 2001). Figures from Hinchcliffe, K and HIPC progress report 2003.

<sup>13</sup> See 'The Human Development Approach to Debt Relief for the World's Poor' CAFOD, 1998, Northover, Joiner, Woodward, and 'The Unbreakable Link – Debt Relief and the Millennium Development Goals' Romilly Greenhill, Jubilee Research, February 2002

- In Burkina Faso, HIPC relief has been spent on education (39%), health (33%) and rural roads (28%)<sup>14</sup>.

Moreover, there is very little evidence that debt relief has been used indirectly to support government spending in other areas, such as the military. Research by Jubilee Research in August 2002, for example, found that while education and health spending had sharply increased as a result of debt relief, military expenditure had remained roughly constant.<sup>15</sup>

#### *The case for further multilateral debt relief 4: Creditor equity*

One of the fundamental principles underlying any debt relief agreement should be that of creditor equity – all creditors should take their fair share of the ‘haircut.’ This is to prevent some creditors from holding out and waiting for other creditors to take a larger debt reduction, thus freeing up money to be repaid to the non-participating creditors.

At present, debt relief for the HIPC countries violates the principle of creditor equity in several ways. Under the HIPC initiative itself, all countries are supposed to reduce debts by the same proportion in order to bring down HIPC debts to a level considered sustainable. However, some creditors are refusing to participate in this initiative. More importantly, some bilateral creditors, including all of the G7, have promised 100% or close to 100% debt cancellation for all HIPCs. **Multilateral creditors have in some cases responded by cutting their own contribution to debt relief, leaving the debtor country no better off as a result of the extra generosity of the bilaterals.**

A commitment to provide 100% debt cancellation on the part of the multilateral creditors would ensure that creditor equity is restored and that HIPCs genuinely benefit from additional bilateral debt cancellation.

#### *The case for further multilateral debt relief 5: Future financing*

International estimates suggest that if poor countries are to meet the Millennium Development Goals, an additional \$48bn in aid will be needed next year, over and above current commitments, rising to \$50bn a year by 2010. While some of this aid will be provided in the form of grants, it is likely that part of it will be provided in the form of concessional loans, thus adding to poor countries debt burdens. If insufficient debt relief is provided now, countries risk facing an unpalatable choice between refusing new money, undermining their ability to meet the MDGs, or facing another debt crisis in 2015.

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<sup>14</sup> All these figures are taken from Hinchcliffe, K *Notes on the Impact of the HIPC Initiative on Education and Health Public Expenditures in African Countries*

<sup>15</sup> See ‘Relief Works: African Proposals for Debt Cancellation, and Why Debt Relief Works’ Romilly Greenhill and Sasha Blackmore, Jubilee Research, August 2002.

## The case for additionality

Most of the funding for the debt relief delivered to date has come directly from donor country aid budgets, rather than providing new money. Current US proposals to provide 100% multilateral debt cancellation for the HIPC countries even propose cutting aid flows to HIPC countries by the same amount as the reduction in debt service payments, leaving the heavily indebted countries with no new money with which to build schools and hospitals. While the UK has agreed to fund its share of the debt service paid by low-income countries to the World Bank and African Development Bank, this money is also included in the UK's aid budget. In 2002, total debt relief, including relief provided to non-HIPC countries, amounted to approximately 10% of all aid spending.

There are 3 reasons why any money used to fund debt relief should be additional to existing aid budgets:

- 1 Debt campaigners have consistently called for further debt relief in order to free up resources to meet human development needs. If debt is funded by using aid money, then while some heavily indebted countries may benefit, poor countries as a whole will not receive any extra money to fund poverty reduction programmes.
- 2 Using aid money to fund debt relief deprives other less indebted low-income countries of resources. This undermines equity between countries, and creates perverse incentives for countries to become more heavily indebted in order to receive a larger share of global aid flows.
- 3 One of the central messages of the Jubilee 2000 campaign was that creditors should take some responsibility for the debt crisis. Creditors have lent money irresponsibly to corrupt governments, or imposed conditions on their lending that in many cases have worsened rather than improved the economic situation of the countries they were supposed to be helping. Providing debt relief should amount to an acknowledgement by creditors that they need to take their share of the costs of past mistakes. If they use aid money to fund debt relief, it is other low-income countries who pay for these mistakes, not the creditors.

## Sources of additional financing

Assuming that any debt relief agreement should result in new money flowing to all low-income countries, there are 2 main options for funding relief:

- **New contributions from taxpayers in rich countries.** As the UK has done, rich countries could provide direct contributions to cover the cost of multilateral debt service to low-income countries. However, these contributions should not be taken out of existing aid budgets, but must amount to genuinely new money.

If all OECD donors were to follow the UK's lead and provide new funding to cover the cost of debt service paid by 21 low-income countries by the World Bank and African Development Bank, only \$1.79bn more would be needed per year, or only \$2.1 per person, on average, in the rich countries. This amount would only cover the low-income countries that the UK has estimated to be eligible for the additional relief.

***Cost to DAC donors of doing the same as the UK Government<sup>16</sup>***

	<b>Annual cost to donor to 2015, US\$ millions</b>	<b>Annual cost per capita to 2015, US\$</b>
<b>Australia</b>	<b>25.92</b>	<b>1.3</b>
<b>Austria</b>	<b>13.94</b>	<b>1.7</b>
<b>Belgium</b>	<b>27.71</b>	<b>2.7</b>
<b>Canada</b>	<b>67.04</b>	<b>2.1</b>
<b>Denmark</b>	<b>28.25</b>	<b>5.2</b>
<b>Finland</b>	<b>10.73</b>	<b>2.1</b>
<b>France</b>	<b>107.26</b>	<b>1.8</b>
<b>Germany</b>	<b>184.13</b>	<b>2.2</b>
<b>Greece</b>	<b>2.15</b>	<b>0.2</b>
<b>Ireland</b>	<b>3.22</b>	<b>0.8</b>
<b>Italy</b>	<b>67.93</b>	<b>1.2</b>
<b>Japan</b>	<b>286.03</b>	<b>2.2</b>
<b>Luxembourg</b>	<b>1.79</b>	<b>4.0</b>
<b>Netherlands</b>	<b>46.48</b>	<b>2.9</b>
<b>New Zealand</b>	<b>2.15</b>	<b>0.5</b>
<b>Norway</b>	<b>27.17</b>	<b>6.0</b>
<b>Portugal</b>	<b>0.54</b>	<b>0.1</b>
<b>Spain</b>	<b>32.18</b>	<b>0.8</b>
<b>Sweden</b>	<b>46.84</b>	<b>5.2</b>
<b>Switzerland</b>	<b>43.44</b>	<b>5.9</b>
<b>UK</b>	<b>181.27</b>	<b>3.1</b>
<b>US</b>	<b>359.68</b>	<b>1.2</b>
<b>ALL DAC</b>	<b>1787.673</b>	<b>2.1</b>

<sup>16</sup> Estimates based on share of IDA for each of the DAC donors and the reported cost to the UK of £100 million.

- **Using internal IMF and World Bank resources.** There are 2 main sources of internal World Bank and IMF resources that could be used to fund debt cancellation. Firstly, IBRD net income could be reallocated to debt relief. However, this would potentially increase interest rates for IBRD countries, meaning that middle-income countries are effectively paying for debt relief rather than wealthy OECD countries.

A better source of funding for debt relief for the IMF, and possibly also the World Bank and other multilateral creditors, would be to use IMF gold. The IMF is currently sitting on reserves of 100 million ounces of gold, and this reserve is significantly undervalued. As of August 2003, gold was valued on the IMF's books at \$8.1bn, but is probably actually worth around \$45bn at market prices. Thus, gold revaluation could potentially raise more than \$30bn to fund debt relief. Gold could be re-valued by undertaking a similar operation to that used to raise money for HIPC debt relief in 1999/2000. The IMF sold its undervalued gold to Mexico and Brazil at the market price, and put the proceeds in a special account. It then accepted back the gold from those two countries at the market price in lieu of their contributions to the IMF. The net effect of these two transactions was to leave the amount of gold held by the IMF unchanged, but to raise \$3.9bn to fund HIPC debt relief.<sup>17</sup>

Money could also be raised by selling a small amount of gold each year, at market prices. The proceeds of such sales could be used to cover the costs of cancelling the debt service to the IMF, or other creditors, as it comes due. Because only a small amount of gold would need to be sold each year, this should not have a very substantial impact on the world gold price.<sup>18</sup>

## Ending economic policy conditionality

At present, countries receiving debt relief under the HIPC initiative have to fulfil a number of conditions, often including privatisation of basic services, trade liberalisation and cutting government spending. Countries also have to remain 'on-track' with their IMF PRGF programmes for a period of time in order to be eligible for debt relief. The UK proposal to give relief on multilateral debts for countries outside of the HIPC process also requires them to have in place World Bank Poverty Reduction Support Credit (PRSC) loans, which involve multiple policy conditions.

While debt relief benefits poor countries, however, conditions attached to debt relief can often harm rather than help these countries:

- In Tanzania, privatisation of the water system in the country's largest city, Dar es Salaam, was a key condition for debt relief. While the country was granted a waiver because the privatisation process took too long, donors eventually forced through the reform, which has led to increased prices, worsening service delivery and a project agreement in which 98% of the money is being spent on the richest 20% of the population.<sup>19</sup>

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<sup>17</sup> 'Can the World Bank and IMF Cancel 100% of HIPC Debt?' Sony Kapoor, Jubilee Research for Debt and Development Coalition Ireland, September 2003

<sup>18</sup> 'The IMF, gold sales and multilateral debt cancellation' Sony Kapoor, Jubilee Research for Debt and Development Coalition Ireland, September 2004

<sup>19</sup> 'Turning off the taps: Donor conditionality and water privatisation in Dar es Salaam, Tanzania' Actionaid UK, September 2004

- In Zambia, IMF constraints over the budget ceiling has prevented the country from employing teachers, despite the fact that average class sizes are rising to 70, 9000 teachers are unemployed and a young generation needs an education - not least in the fight against HIV/AIDS.

## Debt relief should be provided to more low-income countries

If debt relief is to be provided to all countries that need it to meet the Millennium Development Goals, any new debt relief deal must go far beyond the current, restricted and arbitrary, list of Heavily Indebted Poor Countries (HIPCs.) MDG based debt sustainability analyses should be undertaken for all low-income countries, and debt cancelled accordingly. Some countries may only require partial debt cancellation, while other, non-HIPCs, may also need to receive a 100% debt write off. The key point is that debt cancellation should be based on human development needs, not arbitrary lists and arbitrary economic ratios which take no account of poor people's needs.

The UK Government has proposed that debt service relief on the payments of multilateral debt should be expanded to cover more countries, rather than just the HIPC list. However, only countries that have either reached HIPC Completion Point, or have a World Bank Poverty Reduction Support Credit (PRSC) loan in place will be eligible, meaning that only 21 countries will receive debt service relief. Yet the Millennium Project taskforce has suggested a further 14 countries that could absorb additional assistance to meet the MDGs<sup>20</sup>.

ActionAid UK, Oxfam International and Cafod believe that debt relief should be made available to any country which needs additional resources to meet the MDGs, and which can clearly demonstrate that the money saved will be used for poverty reduction purposes.

**Conclusion: The need for further multilateral debt cancellation,**

In summary, ActionAid UK, Oxfam International and CAFOD are calling on rich country donors and creditors to come good on their promises and provide poor countries with a genuine exit from the burden of unpayable debts. This will require:

- 100% multilateral debt cancellation for all low-income countries which need such relief in order to meet the MDGs
- Debt relief should not be financed by cutting aid flows, but through new donor contributions (taken from general taxation rather than aid budgets) and the sale or revaluation of IMF gold.
- Debt relief should not be confined to HIPCs, but should also be extended to other poor countries that need debt relief in order to meet the MDGs.

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<sup>20</sup> The Millennium Project suggest that potential candidates for MDG fast-tracking could include those which are part of the African Peer Review Mechanism; are Millennium Challenge Corporation Qualifiers, have a PRSP or included in the World Bank Absorptive Capacity Study. As well as the HIPCs and PRSC countries, the Millennium Project suggest a further 15 low-income countries meet at least one of these criteria: Angola, Bangladesh, Bhutan, Cambodia, Kenya, Kyrgyzstan, Lao PDR, Lesotho, Moldova, Nigeria, Pakistan, Tajikistan, East Timor, and Yemen.

- There should be an end to harmful economic policy conditionality associated with debt relief. Debt relief should be provided to any country able to use such relief to meet the MDGs.
- Moving forward, we believe that in countries where human development needs are greatest, and where the feasible tax base is narrow, future aid flows should be in the form of grants rather than loans for the foreseeable future.
- In future, a fair, transparent and comprehensive international insolvency process should be created to allow creditor and debtor countries to resolve debt crises without compromising the ability of poor countries to meet the basic social needs of their people, and without forcing poor countries to repay what the insolvency process determines to be odious debts.

Cafod, ActionAid UK and Oxfam International are all members of the Jubilee Debt Campaign and the Make Poverty History Campaign in the UK