

Handout 4: Poverty Reduction not debt

What was agreed at the Gleneagles Summit?

‘No country genuinely committed to poverty reduction, good governance and economic reform will be denied the chance to achieve the Millennium Development Goals through lack of finance.’¹

Heavily Indebted Poor Countries Initiative (HIPC)

Pressure from campaigners in the 1990s produced the Heavily Indebted Poor Countries Initiative (HIPC). This is the name given to the official procedure through which countries can apply to the International Monetary Fund to have their debts reduced.

Poverty reduction was not possible when many low income countries were spending more on servicing debts than on their health or education services and were dependent on a range of donor-funded initiatives which rarely added up to a comprehensive service to meet the needs of their people. HIPC began in 1995 but changed in 1999, again under pressure from Drop the Debt campaigners, to introduce a new formula for calculating eligible countries and the relief offered. A total of \$52 billion was promised.

The Gleneagles Summit of 2005 added a lot more debt relief to that which was being provided through HIPC. The Summit promised to halve the debts of 18 indebted countries which have passed the economic and poverty conditions set by HIPC. The debts to be cancelled are owed to the World Bank loan fund for very poor countries (called the International Development Association (IDA)), the African Development Bank (AfdF) and the IMF. In the year following Gleneagles one more country qualified, bringing the total to 19.

Misleading promises

The G8 calculated that the debt cancellation promised was worth \$42.5 billion which would have been paid in future repayments by poor countries over the next 40 years². This figure includes all 38 countries which are in the process of qualifying - some of these have already qualified but some will possibly never make it. If an extra 8 countries, identified as poor and indebted, but not yet started on the process of qualification, are also included in the write-off, then the figure is \$56.5 billion. But these figures are misleading. The cost to rich countries in settling the debts of the poor is less than half of this figure, since aid flows from the World Bank will be reduced by about two-thirds to offset the costs of the debt cancellation.



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¹ G8 Africa Action Plan

² G8 research group : interim compliance report Feb 2006



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How does a country qualify for HIPC?

The country's debt has to be unsustainable. This is measured using the debt-export ratio. If the debts of the country stand at 150 per cent of export income, or the debt to government revenue ratio is over 250 per cent, then the debts will be reduced to these levels. Debt relief begins when the country reaches what's called "decision point". This is the moment when the country has cleared its debt arrears and has developed a programme of 'growth-friendly' economic reforms, and the IMF decides that it can have some debt cancellation.

Export earnings fluctuate with world prices and are therefore a poor predictor of debt sustainability. For example, Uganda in 2003/4 had debts of over 200 per cent of the debt to export ratio, despite having finished the HIPC process and so having received the maximum amount of debt relief. This was largely due to the falling price of coffee on the world market. The flawed mechanism adopted and insufficient debt relief led to the demand for greater debt cancellation.

The country must produce a poverty reduction strategy which plans for economic reform and shows how spending will be targeted on the poor.

As mentioned above, the point when the country starts getting relief is called "decision point". When the IMF is satisfied with the economic situation in the country - that is, when it judges that the country has maintained economic stability and carried out structural and social reforms for more than one year - the country reached "Completion Point". This means that the debts are reduced to the 'sustainable' level, and with this the country graduates from the HIPC programme.

Countries at decision point (April 2006):

Burundi, Chad, Democratic Republic of Congo, The Gambia, Guinea, Guinea Bissau, Malawi, Sao Tome & Principe, Sierra Leone.

Countries at completion point:

Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia

Countries who may qualify:

Central African Republic, Comoros, Cote d'Ivoire, Eritrea, Haiti, Kyrgyzstan Republic, Liberia, Nepal, Somalia, Sudan, Togo.

What has happened since the Gleneagles Summit?

In December 2005, following Gleneagles, the process of debt cancellation began with an announcement from the IMF that it would forgive US\$3.3 billion of debt to 19 countries.³ Financial Institutions, such as the IMF, need the G8 countries to contribute to the HIPC fund in order to settle the debts. Only two countries had contributed by February 2006. In September 2005 Canada increased its contribution to the World Bank's International Development Association Fund by 40 percent.⁴ The British Government had already pledged US\$476 million to HIPC⁵ and in

³ Announcement from IMF on 21st December

⁴ Statement for the development committee of the World Bank and IMF September 2005



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addition had agreed to the cancellation of all the debts owed directly to the UK by eligible HIPC countries.⁶ Britain has since worked with others on a debt relief package for Nigeria which was announced in October.⁷

On 28 March 2006, the World Bank announced that the Bank's Executive Board had approved the final plans for implementation of its side of the G8 Debt deal (officially called the Multilateral Debt Relief Initiative). 17 countries can expect to benefit from debt cancellation as of 1 July 2006 with a further 25 countries becoming eligible over the next five years. In total, the World Bank's debt cancellation is expected to amount to around US\$37bn over 40 years. This cancellation will be provided up-front with beneficiary countries receiving a letter from the Bank announcing that they no longer have to meet their IDA debt service payments on loans contracted before the cut-off date of the end of 2003.

Will the poor countries be better off?

The G8's promise was that all debts owed to the World Bank, African Development Fund (AfDF) and IMF should be cancelled for a select group of eighteen countries. Twenty more countries are likely to qualify for the same cancellation in the near future, and more may qualify at some point. The countries would stop making any payments on their debts as soon as the deal is implemented. On the surface, this looks like a big saving for the eighteen countries that qualify: nearly half (48%) of their debts are owed to the World Bank, IMF and AfDF, so the deal should reduce their total debts by nearly half. However, the real benefit will be much lower than this, as the World Bank will offset the cost of debt cancellation by reducing the aid that it currently gives to the eligible countries by about two-thirds. Jubilee Scotland calculates that the average gain to the countries that qualify for the G8 deal will be just over a quarter of the value of their total external debt. For some countries, this will make a big difference to their finances, but it is still about a tenth of what is needed overall.

Furthermore, the G8 are still looking to the indebted countries to carry out economic and political reforms in exchange for this debt relief. The donor countries argue that reform is necessary: the heavily indebted countries should take steps to ensure that they get their spending and tax raising under control and be prudent in their future borrowing in order to avoid further debts. Few would dispute the sense of this. But the indebted countries argue that if conditions are set for the indebted they should also be set to encourage responsible future **lending** by the rich countries. The loans being paid back by the poor today were not of the people's making and were rarely sanctioned by parliaments. The International Financial Institutions lent to heads of governments but the poor pay the price. Many Africans argue that reform should cut both ways. A new regime

⁵ Announcement: UK to provide wider and deeper debt relief to poor countries, January 2006

⁶ The claim that all of the debts owed directly to the UK have been cancelled depends on **not counting** "export credit debts", which are debt are owed to a branch of the Department of Trade and Industry. These are debts that arise when the Government compensates one of the UK companies for an export deal that has gone wrong, and then charges the expense to the government of that other country. In this way, risks taken by UK companies are transferred to the citizens of other countries. For more information contact Jubilee Scotland.

⁷ News release from Paris Club October 2005



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is needed for lending bodies where all loans must make a direct contribution to poverty reduction, be approved by parliament and be monitored by civil society.⁸

The current test for HIPC qualification covers the development of a poverty strategy and balancing the national income but is applied by a small group of technocrats. Citizens do have a say in the development of the poverty strategy but they have little influence over the economic restructuring embedded within the qualification process.

IMF Mission to Mali

Mali was the 7th country to complete HIPC. In January 2006 the IMF wrote off all the debts that Mali owed to it, a deal worth US\$108 million (a small proportion of Mali's overall debt). Mali qualified for debt relief by privatising and restructuring in the public sector, improving tax collection and modernising its administration and public expenditure management. Progress in poverty reduction included: more children in schools, although only half of all girls are able to attend, and improved health and living conditions. Infant mortality remains high at 23% of live births and four out of ten have no clean drinking water. The IMF assessed Mali's performance with a particular view to how far they had progressed in privatisating the state cotton company and in implementing banking sector reforms. They approved further spending of IMF debt relief resources towards the achievement of the Millennium Development Goals.⁹

Debt Relief Debates

The Joint Ministerial Development Committee of the World Bank and International Monetary Fund met on September 21st 2005 to decide how the debt proposals would be implemented.¹⁰ They debated whether debt relief should be given immediately or only when resources from G8 countries became available. In the end it was decided that the IMF debts would be cancelled in January 2006 and the World Bank debts cancelled in July 2006. There might have been further delays but campaigners stepped up pressure to ensure that the cancellation took place as quickly as possible. The other countries, not on the original list, would only qualify for debt cancellation once they met the existing HIPC criteria.

Why did countries become so indebted?

Debt mounted to unsustainable levels for a number of reasons. Heavy borrowing took place in 1970s and 1980s, when newly independent states were under pressure to meet the expectations of their voters. Mineral and agricultural prices were good and the rise in interest rates, when oil prices soared in the 1980s was not foreseen. Poor countries were encouraged to continue borrowing, there were no democratic controls on the process and lenders continued lending throughout the 1980s and 1990s in the mistaken belief that 'structurally adjusted' indebted economies could grow their way out of poverty by increasing their income through foreign earnings. Income growth, however, eluded most of the African continent.

⁸ Financing Poverty Reduction not Indebtedness – African Communique on Loan Negotiations AFRODAD – SADC Parliamentary Forum, February 2006

⁹ From IMF press releases and reports, January and April, 2006.

¹⁰ World Bank Development Committee meeting, September 25th 2005



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Debts in Malawi

Malawi has accumulated external debts amounting to \$2.7 billion. There is nothing to show for all this borrowing in terms of the economy, export capability or poverty reduction. Most of the borrowing took place between 1973-82 and was caused by balance of payments deficits during the oil crises. Falls in export prices in the late 1970s and 1980s also increased the demand for foreign borrowing. Malawi suffered a heavy interest burden when interest rates rose in the Western world. Between 1976 and 1981 the interest on Malawi debt rose (by 373%) from only 1.9% in 1976 to more than 9% in 1981. Domestic economic policies in Malawi contributed to its worsening. There was a fifty four-fold increase in debts but less than a ten-fold growth in output.

Monitoring debt relief

A number of key areas must be monitored. Each of the G8 countries must pay into the HIPC fund. Monitoring can help to ensure that each of the rich countries gives enough money to fund what they agreed at Gleneagles. HIPC conditions for future taxation and spending constraints could involve job losses, charges for services and privatisations of the public sector, which are all highly contentious. In the past, pressure to complete the HIPC process has often overridden the will of local people and undermined their efforts towards the establishment of more accountable and transparent government. We can work with civil groups in Africa to expose these issues and keep up the pressure for reform.

In the long run the only way to ensure that debt forgiveness funds reach those who need it most is to work towards a new relationship between debtors and the international community that places debt cancellation in a framework that lives up to the G8 Plan for Africa. This plan committed rich countries to 'consolidating democracy', 'enhancing partnership' and producing 'measured results'. A new partnership is needed which commits the international institutions to responsible future lending with the full involvement of the peoples of Africa in decisions about what debts they wish to stack up for their children to repay.



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Activity 1

"Conditionality" is the term used to describe the conditions that a country has to agree to in order to receive, loans, aid or debt relief. In the past, conditions have been set by the IMF and World Bank that have made poverty worse - for example, the IFIs insisted on economic reforms such as privatisation or restructuring of certain sectors which have gone utterly disastrously wrong (eg in Zambia).

Should any conditions be attached to giving aid or allowing debt relief?

If so, what conditions would you place on allowing debt relief?

Activity 2

Debt relief and aid are intended to relieve poverty and target the poorest people. If a country has its debts cancelled how should the spending of this money be monitored?

Which groups in society should be responsible for monitoring the use of debt relief money?

Whose responsibility is it to ensure that debt relief money benefits the poorest?

Useful websites:

www.jubileescotland.org.uk

www.eurodad.org

www.worldbank.org/hipc