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# Introduction

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When I was asked in early summer of 2002 by officials of the Dutch Ministry of Foreign Affairs whether I was willing to organise an international workshop on how debt relief for heavily indebted poor countries (HIPCs) could be made more effective, my first thought was: "Gosh, why did they let this problem drag on for so many years? They should have resolved it long ago!"

In my opening remarks to the workshop in August 2002, I hinted at my spontaneous (but silenced) outcry in somewhat more diplomatic, but still provocative, terms, saying that I hoped the Forum on Debt and Development (FONDAD) would not be asked in three years time to organise yet another workshop on how the HIPC Initiative could be made more effective.

"The Initiative should just achieve what it is meant to do: get rid of the debt problem," I stressed.

During the coffee break, one of the Ugandan participants came to me and said with an ironic smile "You have been pretty tough with us."

"No," I answered, amused, "I wasn't blaming you so much, but rather the officials in the rich countries."

"Come on," she said, "we share part of the blame."

## Lessons from the 1980s Debt Saga

The first international workshop I organised on how to resolve the debt problem of developing countries dates back to March 1984.



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The meeting took place in Amsterdam and was held a year and a half after the international debt crisis erupted in August 1982 when Mexico could no longer repay its debts to the western commercial banks. At the time, discussions often included the issue of who was to blame for the emergence of the debt crisis: the poor countries, the western banks, or the rich countries?

The rich countries and the western banks tended to downplay or even dismiss their responsibility. Instead, they shifted (most of) the blame onto the developing countries, accusing them of having borrowed too much, adjusted too little, and pursued bad economic policies.

As chair of that March 1984 workshop in Amsterdam, I gave ample room to a Brazilian professor of economics, Maria da Conceiçao Tavares, who had a different analysis. She eloquently presented the view that the United States and Western Europe were, for a large part, to be held responsible for the emergence of the debt crisis in 1982.[1]

Basically, her argument boiled down to the thesis that the debt crisis had deep roots in how the international monetary and financial system had been operating since the establishment of the Bretton Woods system in 1944. The lack of will of the United States and Europe to reform the system and de-link it from the US dollar as the key currency, first led to an explosion of international interest rates at the end of the 1970s and then, as a consequence of the extension of roll-over credits by the banks to debtor countries at very high interest rates (to repay the banks), to the outbreak of the debt crisis in August 1982.

In Tavares' succinct and intriguing synthesis: "It all started with the foreign debt of the United States!"[2]

Obviously, some European officials disagreed with Tavares' analysis. And when she suggested that the Latin American debt could be easily resolved by establishing a special agency that would convert defaulting debts into long-term loans with a 7 percent rate of interest – as had been proposed by some Brazilian and American bankers – one of the participants, an official from the Dutch central

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1 See for an account of her view and that of other economists, including the late Robert Triffin, Jan Joost Teunissen, "The International Monetary Crunch: Crisis or Scandal?", In: *Alternatives*, Vol. XII, No. 3, pp. 359-395, July 1987.

2 See for an explanation of this uncommon statement, my article in *Alternatives* mentioned in footnote 1.

bank, said: "I have a problem with these designs for a global solution. The countries with high debt are very different. Brazil, for example, is a completely different case from that of South Korea. Moreover, these countries themselves are not interested in global solutions because they fear they might be cut off from access to commercial bank loans in the future. Indeed, Jan Joost is right that the ministries of finance and central banks of the industrial countries are not eager to bail out the banks. For such a bail-out, we would need the agreement of the industrial countries. In the present circumstances it is absolutely unthinkable that the US Congress would agree to such a solution."

What lessons can we learn from this debt debate of twenty years ago? Many, but I want to highlight only three of them.

The first lesson is that the creditor countries were consciously delaying debt reduction measures. In this way, they gave the banks sufficient time to build up reserves for the eventual debt reduction that would have to come. After seven years, a global solution was finally adopted which previously had been said to be "unthinkable". In 1989, Brady bonds (named after the US minister of finance Brady) were created to substantially reduce the debt burden of Latin American countries.

Second, the debtor countries were unable to get their acts together and negotiate a quicker and better solution. They talked a lot about forming a debtors' cartel, but it never got off the ground. In the meantime, the creditor countries had their own effective cartel, the Paris Club, and almost full control over the IMF and the World Bank as instruments to "guide" the economic policies of debtor developing countries.

Third, the creditor countries and the IMF and World Bank were successful in convincing (others might say: forcing) the debtor developing countries to "adjust" and liberalise their economies. Even though adjustment and liberalisation helped them to regain creditworthiness and investor confidence, it also led to what in Latin America is called the "lost decade" of low economic growth, high unemployment and social suffering.

Can similar lessons be drawn for the HIPC case? Before answering that question, I will say a few words about the slowness of action on the part of the policymakers of the rich countries (including the IMF and the World Bank) prior to launching the HIPC Initiative, mention the major criticisms of the Initiative, and summarise the main suggestions of what needs to be done to resolve the debt problem of low-income countries.

## The Long Way to the HIPC Initiative

The debt debate of the 1980s concentrated on the debt problem of, in World Bank and IMF parlance, severely-indebted *middle*-income countries (SIMICs). In the late 1980s and early 1990s, the debate shifted to the debt problem of severely-indebted *lower*-income countries, or SILICs, most of them being in Africa. At the same time, the discussion shifted from debt owed to *commercial* banks to debt owed to *official* creditors – donor governments and international financial institutions (IFIs). Official debt relief can be split into two segments: (i) debt owed to donor governments, i.e. *bilateral* debt; and (ii) debt owed to IFIs, i.e. *multilateral* debt.

Professor Gerald K. Helleiner of the University of Toronto was one of the first experts who warned at an early stage that African countries were running into serious problems with the servicing of official debt. In his introduction to the proceedings of a conference held in Nairobi in 1985,[3] Helleiner observed that, as a result of a collapse in commodity prices, high international interest rates and protectionism, many countries in Africa were facing debt servicing obligations that appeared "to exceed prospective servicing capacity".

Helleiner noted that while a whole range of debt relief measures were proposed at the Nairobi conference, the IMF paper was very cautious. Instead of emphasising the need for debt relief, the IMF paper just emphasised the need for "improved domestic-debt management systems".

In another book published by the IMF, *Analytical Issues in Debt*,[4] Joshua Greene of the IMF's research department discussed in a similar cautious vein a whole range of proposals for multilateral debt relief. Greene saw many obstacles in putting any of these proposals

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3 The conference was moderated by Helleiner and jointly sponsored by African central banks and the IMF. The proceedings were published by the IMF, Gerald K. Helleiner (ed.), *Africa and the International Monetary Fund*, IMF, Washington D.C., 1986.

4 Jacob A. Frenkel, Michael P. Dooley, and Peter Wickham (eds.), *Analytical Issues in Debt*, IMF, Washington D.C., 1989.

into practice, the main obstacle being that bilateral donors would have to provide the necessary funding. Such funding would be highly unlikely, said Greene, "given the present budgetary positions of the leading donors".

Helleiner's concern about the rising debt problems of poor African countries was shared by another Canadian economist, Roy Culpeper of the North-South Institute, who was advisor to the Canadian executive director at the World Bank from 1983 to 1986. In an April 1988 study, Culpeper observed: "Despite the growing 'menu of options' for debt relief offered to individual debtor countries and their respective creditors, in early 1988 one obvious option, *debt reduction* or *partial debt forgiveness*, was still conspicuous by its virtual absence. ... The best examples of the scope for debt reduction derive from the debt of low-income Africa. The debt of this region is insignificant in global terms."[5]

The lack of will of the IMF and the World Bank (and the rich countries controlling these institutions) to consider multilateral debt relief for poor countries in Africa prompted former high-level World Bank expert Percy Mistry to present compelling arguments in favour of official debt relief at meetings that FONDAD organised for European and Latin American development NGOs in the late 1980s.[6] Mistry undertook a number of studies that showed the urgent need for debt relief to low-income countries that would go much further than the terms offered in Paris Club deals. In his path-breaking study, *African Debt Revisited: Procrastination or Progress?*, (FONDAD, 1991),[7] Mistry stressed: "Debt relief ... is still being provided to Africa on a 'too little, too late' basis."

It was another study by Mistry, *Multilateral Debt: An Emerging Crisis?* (FONDAD, January 1994),[8] that contributed to putting increasing pressure on western policymakers to consider substantial

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5 See Roy Culpeper, *The Debt Matrix*, The North-South Institute, Ottawa, Canada, April 1988.

6 These meetings resulted in the establishment of the European network of NGOs engaged in debt campaigning EURODAD.

7 This study was the key document at a conference in Abidjan in July 1991 that was attended by African and Western parliamentarians and former World Bank president Robert McNamara among others, resulting in a 11-point action plan on debt relief for poor African countries.

8 This study built on previous work done by Matthew Martin, one of the contributing authors to this volume.

debt relief for poor countries. But it would still take almost two years before the Development Committee of the IMF and the World Bank asked the staff of the Fund and the Bank (October 1995) to come up with proposals for dealing with the multilateral debt problem.

In April 1996, the staff presented "A Framework for Action to Resolve the Debt Problems of the Heavily Indebted Poor Countries". In June 1996, the framework was followed by a proposal to create a Multilateral Trust Fund for the financing of multilateral debt relief. And, finally, in September 1996, the IMF and the World Bank launched the HIPC Initiative.

The key objective of the Initiative was to provide a permanent exit from the repeated debt reschedulings of HIPCs in the Paris Club and bring their external debts to sustainable levels. Three years later, in 1999, when it became clear that the original framework was insufficient, the HIPC Initiative was enhanced. However, progress in implementation remained slow, instigating observers and policymakers in both HIPC and donor countries to review critically its effectiveness.

## Criticisms of the HIPC Initiative

The criticisms of the HIPC Initiative are manifold and can be summarised as follows.

First, since the Initiative has not resulted in long-term debt sustainability, private investors remain reluctant to invest in HIPC countries. In Chapter 2 of this book, Matthew Martin strongly advocates that debt sustainability would become an intrinsic goal of the Initiative, rather than something one hopes would happen after the debt relief is fully granted. Such a wishful policy "leaves the attainment of genuine debt sustainability to initiatives beyond and after HIPC," observes Martin.

Second, growth assumptions and projections of future debt levels have proved to be unrealistic. Uganda is a clear example. As Florence Kuteesa and Rosetti Nabbumba observe in Chapter 3 of this book, the debt-to-exports ratio of Uganda was in June 2003 fifty percent higher(!) than before Uganda obtained debt relief under the HIPC Initiative.

Third, the current requirement to spend all savings from debt service solely on social expenditures is seen by most of the debtor countries as highly inflexible.

Fourth, the implementation of the Initiative has been (extremely) slow, as the limited number of countries that have reached the decision point for actual implementation of debt relief indicates. As Martin Gilman and Wayne Mitchell of the IMF report in their contribution to this book (Chapter 5), of the 38 countries eligible for the Initiative, until now (December 2003) only 10 have reached the completion point and have thus received the debt relief committed by the international community. In Chapter 4, Mothae Maruping stresses that the HIPC process has been "slow and inadequate" in delivering urgently required debt relief to countries in Eastern and Southern Africa

Fifth, the eligibility criteria exclude countries that are as poor and hard hit by high debts as the selected group of HIPCs.

Sixth, the Initiative has done very little to protect countries against exogenous shocks such as the volatility in commodity prices, and thus failed to address the impact of these shocks on debt sustainability. Again, star HIPC country Uganda is a good example. As Florence Kuteesa and Rosetti Nabbumba report in Chapter 3, Uganda experienced a fall of 28 percent in export earnings during the three years it received debt relief, which undermined its debt sustainability.

Seventh, the Initiative has provided very little additional financing for development – if at all. As Matthew Martin shows, large amounts of aid are being diverted from bilateral budgets to fund relief by multilateral institutions. In Chapter 7, Geske Dijkstra adds another interesting and alarming element to the additionality debate: large amounts of aid are being used to repay loans due to western companies! In an evaluation study of the results of debt relief, Dijkstra reports that during the years 2000-2002, when implementation of the Enhanced HIPC Initiative began, the amounts of debt relief destined to repayment of Dutch export credits exploded. This led to what innocent observers might applaud as an all-time high of debt relief granted by the Netherlands in 2002. However, in practice it meant, as Dijkstra emphasises, "that much less money became available for regular aid".

Eighth, the Initiative is not linked to the funding of the Millennium Development Goals (MDGs). Matthew Martin argues that the key question here is whether debt relief is freeing funds for government spending on poverty reduction. His conclusion is that many HIPCs do not include achievement of the MDGs in their HIPC programmes, and that the current design of HIPC relief does not maximise its potential contribution to poverty reduction. In Chapter 6, Amar Bhattacharya, of the World Bank, argues that the goals of the HIPC Initiative and the MDGs can only be met if the rich countries give enough aid. "The HIPC Initiative will reduce the average debt servicing burden to less than 2 percent of GDP by 2005. But on average, HIPCs will need 10 percent of GDP or more in net transfers if they are to lay the foundations for sustained growth and accelerate progress towards the MDGs ... Before the launch of the [HIPC] Initiative, debt and debt service reduction was the first priority. Looking ahead, it will be additional financing in suitable terms and form that will be the key," stresses Bhattacharya.

Ninth, HIPC conditionality impedes the attainment of the MDGs. Geske Dijkstra comes out strongest against conditionality. According to her, there are three arguments against setting conditions for debt relief: (i) HIPCs are forced to spend more on social projects from their tax income while in many cases debt relief does not free resources for such expenditures; (ii) it implies the "double tying" of aid since conditions are first set for the original loans, and then *new* conditions are posed to the relief on these same loans; (iii) the setting of conditions to aid in general has little effect because governments will not carry out policies that they do not believe in while the donors seldom impose real sanctions on lack of performance.

## What Needs to Be Done?

The answer to the question of what needs to be done to resolve the debt problem of poor countries depends on what one wishes to achieve. Protestors on the streets of Seattle, Genova or Cancún have urged for putting an end to IMF and World Bank "interference" in poor countries (or even the outright abolition of the Fund and the Bank) and for a total cancellation of debt. Others, in a more moderate tone, have advocated more effective debt relief and a redefinition of the roles of the IMF and the World Bank in developing countries.

In the following chapters, this book provides a wide range of suggestions of what needs to be done. They can be summarised under three broad categories: (i) speed; (ii) depth; and (iii) time-horizon.

The *speed* of providing debt relief is severely hampered by the conditions set for the implementation of debt relief. The main hindrance to quicker debt relief seems to be the traditional IMF macroeconomic conditionality. Therefore, many experts argue that such conditionality should either be minimal or even completely abandoned. The IMF, the World Bank and the rich countries, on the other hand, oppose this view and argue that conditionality is needed to guarantee future debt sustainability. In addition to the traditional conditions applied by the IMF, there is the more specific HIPC conditionality of reaching agreement on a Poverty Reduction Strategy Paper (PRSP). Here the story is the same: some observers suggest eliminating the PRSP as a condition for debt relief while others claim the need to stick to its adoption.

The *depth* or profoundness of debt relief granted under the HIPC scheme has fallen short of what would be needed to achieve debt sustainability, as Martin Gilman and Wayne Mitchell acknowledge in Chapter 5. This is awkward and in clear contrast with the stated objective of the Initiative. Therefore, many observers argue that additional debt relief is needed and that the problems of domestic debt and private debt should be addressed as well.

The *time-horizon* of debt relief in the context of the HIPC Initiative is too limited. Instead of just looking at the period in which countries enter and complete the debt reduction scheme, attention should be focused on the longer-term future of debt sustainability. It is suggested that bilateral donors should stop bailing-out the multilaterals (see Chapter 7) and that aid should be given in the form of grants rather than loans. It is also suggested that the IMF should completely withdraw from long-term lending to poor countries, implying that the poverty-reducing growth facility (PRGF) should be abolished altogether.

## The Future of HIPC Debt Relief

At the August 2002 workshop on HIPC Debt Relief organised by FONDAD, it was remarkable how many of the African participants hastened to blame themselves for the lack of progress in achieving debt sustainability and poverty reduction. It is encouraging that African officials take their own responsibility. Northern officials, on the other hand, tend to be less critical about their policies. So it was equally remarkable that a Dutch Treasury participant exclaimed at the end of the workshop: “We are putting so many conditions to HIPCs that we don’t even apply to ourselves!”

Just as happened during the debt crisis of the 1980s, the HIPC creditors remain reticent in providing substantial and prompt debt relief. The following chapters provide useful insights into why this happens. And just as happened before, the creditors remain successful in putting conditions to the delivery of debt relief. In this way, they make sure that the IMF and the World Bank continue to exercise influence over the economic policies of the poor nations. The poor debtor countries, on the other hand, are having even less power than the middle-income debtor countries had in the 1980s to influence creditor action (or lack of action) on the debt issue.

This book presents a thorough analysis of the successes and failures of the HIPC Initiative. Although the contributing authors have diverging views, they share the common objective of providing facts and arguments that aim to resolve the HIPC debt problem. The crucial question is, however, how quickly and thoroughly the problem will be solved.