E6 | Debt relief

'Since 2000, the developing world has been a net exporter of capital to the advanced economies' – World Bank 2004.

'The largest international flow of fixed-income debt today takes the form of borrowing by the world's richest nations at (probably) negative real interest rates from countries with very large numbers of poor' – Larry Summers, Harvard University, 2004.

The global economy today appears to be approaching a 'tipping point' – a point at which the vast imbalances that characterize the international financial system may well tip over into recession, or even worse into a period of debt-deflation not unlike that faced by Japan in 1990. These imbalances, and in particular rich country debts, eclipse the debts of poor countries.

The instability caused by these huge debts and other imbalances is partly a result of the lack of G7 coordination and cooperation in the management of trade, exchange rate volatility, rising levels of debt and climate change. This failure is leading to global political tensions, a collapse of multilateralism, and growing calls for higher subsidies and protection from unfair competition. It is exacerbated by the decision of the US central bank and government to do nothing to arrest the decline in the value of the dollar, which has depreciated by 30% since 2002, increasing trade tensions and causing the Japanese central bank to borrow massively to manage the dollar/yen relationship (in effect Japanese central bankers are managing trading relationships). It is one of the factors, along with falling supplies and rising demand, that provoked oil producers to raise prices, further exacerbating existing imbalances.

Another major cause of global instability is the historically unprecedented foreign deficit built up by the US, the most indebted nation on earth. The net foreign indebtedness of the US is in excess of US$ 3 trillion, compared with US$ 176 billion owed by 42 heavily indebted poor countries. The US trade deficit – just one part of its net foreign indebtedness – soared to yet another record in 2004, reaching 5.3% of GDP, or US$ 617.7 billion – US$ 121.2 billion higher than in 2003. It was driven by an extraordinary rise in imports, which grew by 16.3% in 2004. Exports also grew at a healthy 12.3%.

The US deficit arises from a consumption boom largely financed by low-

25 Breaking the chains of debt: protestors at Sikh temple, Birmingham, UK.

income countries. As the World Bank notes (2004), 'financing the US current account deficit has been shouldered by official institutions in developing countries that have invested reserves accumulated through good trade performance, effective exchange-rate management, and the strengthening in capital flows. Inflows of foreign official assets to the US amounted to US$ 208 billion during 2003, compared with US$ 95 billion for 2002, *financing almost 40% of the US current account deficit*' (our italics).

Neoliberal economists assure us that in a deregulated world capital flows from where it is plentiful to where it is scarce – but the reverse is happening today. Capital is being sucked out of low-income countries with large numbers of poor people, and moved to high-income countries with large numbers of the very rich. The injustice of transfers from the poor to the rich through debt repayments, unfair terms of trade and excessive consumption of natural resources has been widely explored in development literature. However, insufficient attention has been paid to financial transfers that enable rich countries to live off poor countries.

The poor finance the rich

The structural changes central to globalization that have created this situation occurred in 1971, when President Nixon unilaterally broke up the dollar-gold standard, and introduced the Treasury bill standard instead. These changes mean that in the absence of gold as a reserve currency, low-income countries are required to hold as their reserves low-cost loans (Treasury bills) lent to the US. In other words, poor countries hold US Treasury bills in order to prove they have 'money in the bank', for example to pay for exports. They need to offer low-cost loans to the US Treasury to acquire these bills. The establishment of the Euro gives poor countries the alternative of making low-cost loans to the EU which are then held as reserves. This system, which allows the US and increasingly the EU to borrow cheaply, build up debts and live beyond their means, is an important cause of today's imbalances and instability.

Inflows of capital from developing countries to the US and UK help to lower interest rates and therefore borrowing costs for the people of these countries, and over the last few years have inflated the value of their currencies by about 20%. High-income countries are therefore able to purchase imports from the rest of the world 20% cheaper than they would otherwise have been able to. But despite benefiting immensely from the international financial system, OECD countries are not particularly generous with aid (see part E, chapter 5). So poor countries, while lacking funds to support millions of their own poor, are obliged to finance the overconsumption of rich countries.

Poor countries raise hard currency mainly through exports. While their exports of goods and commodities have failed to generate the resources needed for the holding of reserves and for development, they have discovered one export category that provides a major source of external development finance – but it may also be a cause of instability, for it is the export of people, especially young, educated, highly skilled people (see part B, chapter 3 for a discussion of the health worker brain drain). The money they sent home increased by a remarkable 20% during 2001–3, reaching an estimated US$ 93 billion – nearly twice as much as aid flows.

Against this economic background, the most indebted nations on earth, mostly in Africa, face daunting odds. Not only are they being drained of precious financial and human resources, but their economies are being ruined by a plague: AIDS. Per capita growth is falling by 0.5%-1.2% a year as a direct result: per capita gross domestic product in the hardest-hit countries could fall by a staggering 8% by 2010.

This is the global economic context in which world leaders gathered for the IMF and World Bank annual meetings in Washington in 2004. A furious row broke out over a report which argued that Fund restrictions on public spending in poor countries made it difficult for countries to hire more health workers and to buy medicines (Rowden 2004). It said thousands of health workers

Box E6.1 Zambia: inflation or death?

Zambia qualified in 2000 to become eligible to receive up to 50% reduction in its huge external debt of US$ 6.8 billion as a possible beneficiary of the Heavily Indebted Poor Country (HIPC) initiative. First it had to follow the IMF's loan conditions satisfactorily for three years, including a strict cap on the government's wage bill – no more than 8% of its gross domestic product (GDP).

However, the Zambian government – the country's biggest employer – faces a worsening brain drain of skilled professionals. It introduced a housing allowance system that made staying and working in Zambia more attractive. Other measures also increased the wages bill, raising public sector wages to 9% of GDP and exceeding the 8% agreed with the Fund. So Zambia was considered off track with its loan programme and was suspended from eligibility for debt relief. This means it will continue to pay close to US$ 300 million in annual debt service payments to foreign creditors in rich countries. If this issue is not resolved, even larger payments will be expected later.

The Fund says Zambia can get back on track by reducing the budget deficit to not more than 3% of GDP and the public sector wage bill to not more than 8%. It must also privatize its remaining public utilities and state-owned companies in the energy and telecommunications sectors. The monies realized from the sale of the utilities and companies must be used for increased debt servicing, not for investment or consumption.

The Zambian government is at a crossroads. If it pleases the Fund it is likely to provoke industrial unrest by workers opposed to privatization. If it seeks to maintain public ownership it will miss its chance of debt relief. Either way, it cannot raise the wage bill high enough to retain the teachers and health professionals needed to fight HIV/AIDS.

Why? Because the IMF fears inflation.

(*Source*: Bretton Woods Project 2004)

in Kenya were unemployed because Fund economic conditionality reduced government spending on resources needed to tackle AIDS. The Fund's spending constraints might also block poor countries from accepting outside help: Uganda nearly lost a US$ 52 million grant from the Global Fund to fight AIDS, TB and Malaria because it sought to stay within the strict budgetary constraints agreed with the Fund, necessary to be eligible for debt relief and new loans.

The response of Fund staff confirmed that those who dominate the international financial system put the creditor cart before the human rights horse. Their obsession with inflation can be explained simply. High rates of inflation hurt creditors by eroding the value of debts, while deflationary policies maintain or increase the value of debts. By making the interests of creditors and the achievement of 'macroeconomic stability with low inflation rates' the priority (stability that is most often a *consequence* of prosperity, not a cause) the Fund and its rich country shareholders, the G8 finance ministers, subordinate human rights to life and health to inflation targets set in the interests of creditors.

Rich country leaders under pressure

At the same meetings, world leaders were considering a proposal to cancel all the debts owed to the Fund and Bank by heavily indebted poor countries. So far only 14 of the 42 eligible countries have reached 'completion point' of the HIPC initiative since its launch in 1996. Another 28 countries will receive too little too late, the delays largely due to their failure to comply with the rising number of Fund conditions. Twenty seven countries receive debt relief in the form of reduced interest payments. Almost US$ 54 billion of such relief has been 'committed', so some have already benefited, but many still have debts that even the Bank and the Fund deem unsustainable. Hence the call from NGOs for 100% cancellation of these debts.

The debate in Washington became heated. The election was imminent, so Bush's ministers were instructed to get a result on debt cancellation to satisfy US voters concerned at the plight of the indebted nations, but without requesting additional funds from Congress. The official solution was straightforward: the Bank could use its International Development Association resources to write off old debts and as new resources. UK finance minister Gordon Brown proposed an alternative: creditors should use aid to write off all multilateral debts (Bluestein 2004). Both options propose that the cost of writing off debt should in effect be borne by developing countries, which would forgo future aid from bilateral sources or the Bank's soft lending arm. Jubilee Research had proposed a third way (Kapoor 2003): the sale of Fund gold to fund 100% debt cancellation. G8 finance ministers meeting in 2005 told the Fund to examine the proposal and report to a future meeting.

Crumbs from the creditors' table

HIPC debt has now risen to more than US$ 200 billion in nominal terms. Relief has been committed (but not fully delivered) to the 27 countries that have met the Fund's conditions, a two thirds reduction of their overall debt stock – savings that the Bank says have contributed to a 'substantial increase in poverty-reducing expenditures' (IMF 2004).

The HIPC initiative has now reached a dead end, largely because creditors are baulking at the 'cost' of writing off further debts. However this is far less than the Bank and Fund assert, as most of the loans were concessionary with low interest rates, grace periods and long repayment terms. So the HIPCs owe only about US$ 176 billion to governments and multilateral institutions, and the rest to private, commercial creditors. US$ 80 billion of these loans are owed to governments or bilateral creditors, and US$ 45 billion is owed to 27 multilateral agencies of which the Bank and Fund hold the dominant share.

The countries owe the Fund about US$ 7 billion of debt (in net present value terms), of which the Fund has promised or already cancelled just US$ 2 billion. The Bank is owed US$ 13 billion but has only found half the US$ 6.4 billion (in net present value terms) needed for its minimal HIPC debt cancellation effort. Of the sums made available, more than half have come through donor contributions to the Bank, i.e. from aid budgets funded by taxpayers in OECD countries. Yet the Bank and Fund hold a 'wealth of resources on their own balance sheets – about $500 billion in effective capital and $40 billion in provisions for loan losses and reserves' (Kapoor 2003). They could easily marshal internal resources for total debt cancellation, as it represents just 5% of their effective capital and 65% of provisions for losses and reserves. The Fund could sell 20 million ounces of its gold over a period of 3–4 years and raise US$ 5 billion, while the Bank could transfer up to US$ 10 billion from its 'retained earnings', which stand at US$ 27 billion – profits made from lending to developing countries. It could also transfer excessive provisions out of its loan loss provisions, currently standing at US$ 4 billion, more than 1.5 times its impaired loans (provisions made for just such an emergency as this debt crisis).

In other words, these two institutions are rich with the resources needed to help countries like Kenya, Uganda and Ethiopia deal with their health crises. All that is needed is the political will. Jubilee 2000 showed this is strong in civil society. However, just as world leaders are failing to cooperate and coordinate the global economy, so they seem unable to cooperate to solve a problem that is relatively easy to finance. It seems civil society will have to rise up again, and once more remind world leaders of the will of their peoples.

References

Bluestein P (2004). Debt relief plan eludes IMF group. *Washington Post*, 3 October.

Bretton Woods Project (2004). *Bretton Woods Update: Life under the IMF's magnifying glass. No. 39, March–April.* London, Bretton Woods Project.

IMF (2004). *Heavily Indebted Poor Countries Initiative – state of implementation*. Washington, IMF (http://www.imf.org, accessed 16 February 2005).

Kapoor S (2003). *Can the World Bank and IMF cancel 100% of HIPC debt?* Jubilee Research for the Debt and Development Coalition, Ireland (http://www.jubileeresearch.org/analysis/reports/jubilee_canceldebt.pdf, accessed 16 February 2005).

Rowden R (2004). *Blocking progress: how the fight against HIV/AIDS is being undermined by the World Bank and International Monetary Fund. A policy briefing*. Washington DC, ActionAid International US (http://www.actionaidusa.org/publications, accessed 16 February 2005).

Summers L (2004). *The Business Times*, 9 March.

World Bank (2004). *Global development finance 2004: harnessing cyclical gains for development*. Washington DC, World Bank.