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## **UICIFD Briefing No. 1: Debt Forgiveness** **By Yolanda Rivera**

UICIFD's Briefing Papers seek to inform the Center's readers in a concise manner about issues and problems relating to international finance and development. Our inaugural Briefing addresses debt relief. Part I below provides an overview of the developments that led to proposals to forgive the debt of poor developing countries and the actions taken by the International Monetary Fund and the World Bank to achieve such result. Part II provides an overview of some of the plan's criticisms as expressed by NGO's, scholars and members of the beneficiary countries. Part III contains the official communiqué of the agreement reached by the Finance Ministers during the June 2005 meeting in London.

### **I. Overview**

In 1996 the World Bank and the International Monetary Fund launched the Debt Initiative for Heavily Indebted Poor Countries (the [HIPC Initiative](#)). This Initiative was aimed at reducing the debt burden of some of the poorest countries. The excessive debts were regarded as an impediment to the countries' economic growth. Under this program, major international lenders agreed to provide debt relief to the most heavily indebted countries. Twenty-eight countries are currently receiving debt relief which will amount to \$56 billion dollars.<sup>1</sup>

International conferences and summits held in the 1990s led to the creation of the Millennium Development Goals. On September 18, 2000, member states of the United Nations adopted the Millennium Declaration,<sup>2</sup> which sets goals to improve human development as a means to achieve social and economic progress in all countries. Among these goals is reducing poverty in half by the year 2015. A list of targets and indicators are being used to monitor progress towards the implementation of the Millennium Declaration.<sup>3</sup> The goals seek to:

1. Eradicate extreme poverty and hunger.
2. Achieve universal primary education.
3. Promote gender equality and empower women.
4. Reduce child mortality.
5. Improve maternal health.

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<sup>1</sup>*Debt Relief at a Glance*, September 2005

<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040942%7emenuPK:34480%7epagePK:34370%7etheSitePK:4607,00.html>

<sup>2</sup>*General Assembly Resolution 55/2*, United Nations Millennium Declaration, September 2000.

<http://daccessdds.un.org/doc/UNDOC/GEN/N00/559/51/PDF/N0055951.pdf?OpenElement>

<sup>3</sup>*About the Goals*, Millennium Development Goals, The World Bank Group

<http://ddp-ext.worldbank.org/ext/GMIS/gdmis.do?siteId=2&menuId=LNAV01HOME1>

6. Combat HIV/AIDS, malaria, and other diseases.
7. Ensure environmental sustainability.
8. Develop a global partnership for development.

Progress towards achieving the millennium goals has been slow. Many nations, most of them African, have found it hard to implement measures to achieve the goals. For example, in order to accomplish the poverty reduction goal, African nations would have to double their annual growth rates to 7%.<sup>4</sup>

In an effort to accelerate global efforts to reduce poverty, the finance ministers of the G8, who convened in London in June 2005 to prepare for the Gleneagles Summit the following month, agreed to cancel \$40 to \$55 billion dollars of the debt owed to the World Bank, IMF and African Development Bank (AfDB). In theory, the money forgiven will be used to stimulate and improve the infrastructure, health, education, housing and a range of other initiatives, helping to release the world's poorest countries from poverty. The deal was confirmed by UK Prime Minister Tony Blair during the G-8 meeting in Gleneagles on July 2005.

Under the agreement, the \$40 billion dollar debt owed by eighteen countries would be immediately forgiven. These countries are: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda and Zambia. Nine other countries would become eligible for 100 percent debt relief for a 12- to 18-month period. Eleven other nations would receive similar debt cancellation of \$4 billion dollars, bringing the total amount of debt relief to \$55 billion dollars.

Both the International Monetary Fund (IMF) and the World Bank gave careful consideration to the G8 proposal before finally deciding to endorse it. During the 2005 Annual Meeting of the International Monetary Fund and the World Bank Group, the Finance Ministers of 184 countries endorsed the G-8's plan. In the Communiqué of the Development Committee, composed of the governors of the World Bank and the IMF, the groups reiterate that debt cancellation will allow HIPC to achieve the Millennium Development Goals.<sup>5</sup> World Bank President Paul Wolfowitz believes this will allow these developing countries to no longer worry about whether to spend their resources helping their people or repaying impossible debts.<sup>6</sup>

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<sup>4</sup> *G-8 Gleneagles Summit and Development*, The World Bank, July 1, 2005.  
<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20567463~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>

<sup>5</sup> *Development Committee Communiqué*, September 25, 2005.  
[http://siteresources.worldbank.org/DEVCOMMIT/NewsAndEvents/20660181/Sept\\_2005\\_DC\\_Communique\\_E.pdf](http://siteresources.worldbank.org/DEVCOMMIT/NewsAndEvents/20660181/Sept_2005_DC_Communique_E.pdf)

<sup>6</sup> *Finance Ministers of 184 Countries Endorse G8 Debt Relief Plan*, The World Bank, September 25, 2005.  
<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/EXTOFFICEPRESIDENT/0,,contentMDK:20660227~menuPK:64260204~pagePK:51174171~piPK:64258873~theSitePK:1014541,00.html>

Policymakers, on the other hand, recognized that debt cancellation alone would not suffice to meet the needs of these developing countries. Along with debt cancellation, the Committee called for the timely implementation of the World Bank's Africa Action Plan, a plan aimed at building state capacity, improving governance, and promoting growth and sharing of benefits.<sup>7</sup>

In late December 2005, the IMF board approved 100 percent debt forgiveness totaling \$3.3 billion for all of the countries listed above except Mauritania, which was faulted for its poor economic management. Two other countries, Cambodia and Tajikistan, also qualified. The World Bank is expected to forgive the much larger debt owed by HIPC countries sometime in 2006.<sup>8</sup>

## II. World Reaction

While the London agreement seems to be a great step for these developing countries, some believe this is not the solution. The following section discusses the plan's drawbacks as expressed by leading NGO's, scholars and members of the beneficiary nations.

NGO's like Jubilee 2000, Africa Action and TICAD Civil Society believe the agreement is not complete enough because it lacks mechanisms to allow additional countries to receive similar benefits in the future. Neither the London agreement nor the subsequent G-8 Summit at Gleneagles discusses a possible increase of the number of nations who may benefit from the plan.<sup>9</sup>

Jubilee USA believes there are dozens of other countries which have been left out of the deal who are in immediate need of relief of 100% of their debt. According to Foreign Policy in Focus Organization, the present agreement only covers 10% of the debt of poor countries in need of relief.<sup>10</sup> Under the proposed plan, only those 18 countries who have already complied with HIPC conditions will benefit from the debt relief deal. One third of the low and middle income African Countries are excluded from debt relief.

Africa Action, the oldest organization in the U.S. working for political, economical and social justice in Africa, believes debt relief should be available to all African Countries. They believe an unconditional cancellation of all debts is needed to allow African Countries to invest in education, the eradication of poverty, and HIV/AIDS and other diseases affecting Africa.<sup>11</sup> However, under the proposed plan, nations would

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<sup>7</sup> *Development Committee Communiqué*, September 25, 2005.

<sup>8</sup> Andrew Balls, *Debt Relief for Poorest Countries*, *Fin. Times*, Dec. 22, 2005, at 2.

<sup>9</sup> *Civil Societies' Joint Statement on Gleneagles Summit*, July 13, 2005.

<http://ticad-csf.net/eng/joint-statement.htm>

<sup>10</sup> *The G-8 Debt Deal: First Step On A Long Journey*, Debayani Kar and Neil Watkins, *Foreign Policy in Focus Commentary*, June 21, 2005.

[http://www.jubileeusa.org/jubilee.cgi?path=/press\\_room&page=fpif062105.html](http://www.jubileeusa.org/jubilee.cgi?path=/press_room&page=fpif062105.html)

<sup>11</sup> *Africa Action Statement on 100% Debt Cancellation for Africa*, September 23, 2005.

<http://www.africaaction.org/newsroom/index.php?op=read&documentid=1411&type=15&issues=2>

first have to fulfill HIPC conditions before they are eligible to receive debt relief.<sup>12</sup> The HIPC program imposes harsh conditions which poor countries are not able to comply with, thus leaving them out of the reach of much needed relief.<sup>13</sup>

Furthermore, only a small fraction the money allocated to the debt forgiveness program, \$15 to 20 billion, will be dedicated to the economic development of these poor countries, whereas the rest will be used to cover debt write-offs and repayment postponement of loans.<sup>14</sup>

Uganda's President, Yoweri Museveni, has stated that canceling the debt is not the solution to poverty: "I am grateful that the G-8 cancelled our debt but this is just a relief but not the solution because if you cancel a poor man's debt without giving him a source of money, he will contract another debt."<sup>15</sup> "The strategy includes allowing poor countries have access to the markets of the rich countries with a provision of quota and tariff free. However free trade should be based on rules that introduce a level playing field while the developed countries should end their protectionism on cotton, sugar, beef and wheat among others." Uganda has a foreign debt of \$4.9 billion and spends about \$100 million servicing it.

Guyana is another one of the countries benefiting from the G-8's decision. Guyana's defense minister, Dr. Kwame Addo Kufuor, agrees with President Museveni's view that the cancellation of the debt is not enough to facilitate Africa's growth. "We plead with the G-8 to go a step further and consider the issue of agricultural subsidies, such as assistance to poor countries, to develop their local industry. I plead with our development partners to think about these things."<sup>16</sup>

The lack of funding for economic development is not the plan's lone deficiency. World Bank economist William Easterly, senior advisor in the Development Research Group, stated in his 2001 book, *The Elusive Quest for Growth*, that debt cancellation increases "moral hazard." He argues that cancellation does not help reduce HIPCs debt because national debts increase under the belief that the international community would eventually forgive their debts.<sup>17</sup> Instead of canceling the debts, debt forgiveness leads to "new borrowing to replace the old canceled debts."<sup>18</sup> Therefore countries will continue to have problems with high debt because "irresponsible governments" remain

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<sup>12</sup> *Debt is Not Done – The 2005 Debt Deal*, Africa Action, November 21, 2005.

[http://www.africaaction.org/campaign\\_new/page.php?op=read&documentid=1538&type=20&issues=2&campaigns=6](http://www.africaaction.org/campaign_new/page.php?op=read&documentid=1538&type=20&issues=2&campaigns=6)

<sup>13</sup> *Assessing the G8 Debt Proposal & Its Implications*, Soren Ambrose, September 21, 2005.

<http://www.50years.org/cms/updates/story/270>

<sup>14</sup> *The G-8 Debt Deal: First Step On A Long Journey*, Debayani Kar and Neil Watkins, Foreign Policy in Focus Commentary, June 21, 2005.

<sup>15</sup> *Debt Canceling is No Solution*, David Muwanga, AllAfrica.com English, June 17, 2005.

<sup>16</sup> *Ghana says debt cancellation for Africa "not enough"*, BBC International Reports (Africa), June 15, 2005.

<sup>17</sup> *A debt of morality*, Sina Kian, Cavalier Daily, U. Virginia: COLUMN, June 20, 2005.

<sup>18</sup> *The elusive quest for growth [electronic resource]: economists' adventures and misadventures in the tropics*, William Easterly, p. 127, Cambridge, Mass.: MIT Press (2001).

“irresponsible” once debt relief is granted.<sup>19</sup> In his view, instead of solving the economic troubles of HIPCs, debt forgiveness in the hands of irresponsible governments leads to a racking up of debts that are passed on to future generations.

However, others argue that pardoning the debt of HIPCs is a moral duty shared by society in general. In the article, *A Debt of Morality*, Sina Kian points out that the developing world has a moral duty to come to the aid of these countries. He argues that industrialized nations played a great part in the insurmountable debt developing nations entered into. Banks made loans for projects without completing a thorough examination of the nature of the projects. Increased interest rates in 1980s along with other factors led developing countries to accumulate unpayable debts. The author concludes, therefore, that industrialized nations are morally responsible for the debt of developing nations.<sup>20</sup>

Uganda’s President Yoweri Museveni believes rich nations have a moral duty to the aid of African nations. In an interview with the BBC he commented: "I should be more apologetic and say please help us but where I come from we believe that if you are better off than someone else you help them. It's as simple as that - it's a moral duty."<sup>21</sup>

### **III. G8 Finance Ministers’ Conclusions on Development, London, 10-11 June 2005**

1. We reaffirm the commitments we made at our meeting in February this year to help developing countries achieve the Millennium Development Goals by 2015, to make particular efforts in Africa, which on current rates of progress will not meet any of the Millennium Development Goals by 2015, and to set out for G8 Heads of Government and States the steps we believe can be taken to further implement the Monterrey Consensus on an open world trade system; increased aid effectiveness; absorptive capacity; increased levels of aid; and debt relief.

2. We reaffirm our view that in order to make progress on social and economic development, it is essential that developing countries put in place the policies for economic growth, sustainable development and poverty reduction: sound, accountable and transparent institutions and policies; macroeconomic stability; the increased fiscal transparency essential to tackle corruption, boost private sector development, and attract investment; a credible legal framework; and the elimination of impediments to private investment, both domestic and foreign.

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<sup>19</sup> Id.

<sup>20</sup> *A debt of morality*, Sina Kian, Cavalier Daily, U. Virginia: COLUMN, June 20, 2005.

<sup>21</sup> *G8 reaches deal for world's poor*, BBC News, June 11, 2005.

<http://news.bbc.co.uk/1/hi/business/4083676.stm>

3. We reaffirm our view of February that it is crucial that the international community improves the effectiveness of aid. In particular bilateral and multilateral donors need to: harmonise their operational procedures; align aid behind country-owned priorities for growth and poverty reduction; and provide for measurable results. Donors must also: focus their aid on poverty reduction; enhance efforts to untie aid, based on DAC principles; and deliver aid in a more predictable way. We welcome the progress made at the Paris OECD DAC High Level Forum in March, and call on the OECD DAC to set by September this year, ambitious and credible targets against all the indicators of progress agreed at the March meeting.

4. A successful outcome for the Doha Development Agenda, our highest common priority in trade policy for the year ahead, will bring real and substantial benefits to poor countries. The Hong Kong Ministerial in December will be a critical step towards a successful outcome of the DDA in 2006, which delivers substantial increases in market access for developing countries; establishes a timetable for the elimination of all trade-distorting export support in agriculture; and provides effective special and differential treatment for developing countries.

5. However, not all countries will benefit in the short term from reductions in trade barriers. Some countries lack the capacity to produce and deliver goods to international markets competitively; for others, the transitional costs of moving to more open markets may be substantial. We also recognise that poor countries face particular problems and need the flexibility to decide, plan and sequence reforms to their trade policies to fit with country-owned development programmes. We commit to provide support to enable developing countries to benefit from trade opportunities. We call on the IFIs to submit proposals for the Annual Meetings for additional assistance to countries to develop their capacity to trade and ease adjustment in their economies, based on a systematic analysis of transition costs, so they can take advantage of more open markets.

6. Tackling diseases that undermine growth and exacerbate poverty in developing countries will require not only strengthened health systems, but also improved treatment, including universal access for AIDS treatment by 2010 and development of vaccines, including for HIV and malaria. We have made progress this year in implementing the Global HIV Vaccine Enterprise agreed at Sea Island, and are committed both to taking this further; and to scaling up our support for vaccines and medicines research through the successful Public Private Partnerships model. We call for a report on progress by the end of the year. We recognise also that advance purchase commitments (APCs) are potentially a powerful mechanism to incentivise research, development and the production of vaccines for HIV, malaria and other diseases. We asked Minister Siniscalco to consult the relevant institutions, governments and industry, with the aim of developing concrete proposals by the end of this year.

7. The Enhanced HIPC Initiative has to date significantly reduced the debt of 27 countries, and we reaffirm our commitment to the full implementation and financing of the Initiative. Moreover, individual G8 countries have gone further, providing up to 100 per cent relief on bilateral debt. However, we recognise that more still needs to be done

and we have agreed the attached proposal. We call upon all shareholders to support these proposals which we will put to the Annual Meetings of the IMF, World Bank and African Development Bank.

8. We also recognised at Monterrey that a substantial increase in ODA and private capital flows will be required to assist developing countries to achieve the Millennium Development Goals. We acknowledge the efforts of all donors, especially those who have taken leading roles in providing and increasing ODA and committing to further increases.

9. Specifically we welcome: the progress the EU has made towards the 0.39 per cent ODA/GNI target agreed at Barcelona; the announcements by France and the UK of timetables to reach 0.7 per cent ODA/GNI by 2012 and 2013 respectively; and the recent EU agreement to reach 0.7 per cent ODA/GNI by 2015 with an interim target of 0.56 per cent ODA/GNI by 2010 - a doubling of EU ODA between 2004 and 2010. In line with the EU agreement, Germany (supported by innovative instruments) and Italy undertake to reach 0.51 per cent ODA/GNI in 2010 and 0.7 per cent ODA/GNI in 2015. We welcome the tripling of US ODA to Sub-Saharan Africa and the near doubling of US ODA to all developing countries since 2000. The US now accounts for roughly 25% of all ODA to Sub-Saharan Africa. In addition, we welcome the launch of the Millennium Challenge Account and the President's Emergency Plan for AIDS Relief. We welcome Japan's commitment to double its ODA to Africa over the next three years and Canada's budget plans to finance its commitment to double aid levels from 2001 to 2010, and to double aid to Africa by 2008. In addition, we welcome Russia's \$2.2 billion contribution to the HIPC Initiative.

10. As we prepare for decisions at the G8 Summit in Gleneagles we continue our work programme on: the IFF and its pilot, the IFF for Immunisation; some of the revenue proposals from the Landau Report, including a pilot project, supported and led by France and Germany, for a contribution on air travel tickets to support specific development projects and to refinance the IFF; the Millennium Challenge Account; the Enhanced Private Sector Assistance with the African Development Bank; and other financing measures; so that decisions can be made on how to deliver and bring forward the financing urgently needed to achieve the Millennium Development Goals.

11. Nigeria is key to the prosperity of the whole continent of Africa. We welcomed Nigeria's progress in economic reform as assessed in the IMF's intensified surveillance framework, noted its move to IDA-only status, and encouraged them to continue to reform. We are prepared to provide a fair and sustainable solution to Nigeria's debt problems in 2005, within the Paris Club.

#### G8 Proposals for HIPC debt cancellation

Donors agree to complete the process of debt relief for the Heavily Indebted Poor Countries by providing additional development resources which will provide significant support for countries' efforts to reach the goals of the Millennium Declaration (MDGs), while ensuring that the financing capacity of the IFIs is not reduced. This will lead to 100

per cent debt cancellation of outstanding obligations of HIPCs to the IMF, World Bank and African Development Bank. Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the MDGs and ensure that assistance is based on country performance. We ask the World Bank and IMF to report to us on improvements on transparency on all sides and on the drive against corruption so as to ensure that all resources are used for poverty reduction. We believe that good governance, accountability and transparency are crucial to releasing the benefits of the debt cancellation. We commit to ensure this is reaffirmed in future bilateral and multilateral assistance to these countries.

Key elements:

Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems.

100 per cent IDA, AfDF and IMF debt stock relief for Completion Point HIPCs.[1]

For IDA and AfDF debt, 100 per cent stock cancellation will be delivered by relieving post-Completion Point HIPCs that are on track with their programmes of repayment obligations and adjusting their gross assistance flows by the amount forgiven. Donors would provide additional contributions to IDA and AfDF, based on agreed burden shares, to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled.[2]

Additional funds will be made available immediately to cover the full costs during the IDA-14 and AfDF-10 period. For the period after this, donors will commit to cover the full costs for the duration of the cancelled loans, by making contributions additional to regular replenishments of IDA and AfDF.

The costs of fully covering IMF debt stock relief, without undermining the Fund's financing capacity, should be met by the use of existing IMF resources. In situations where other existing and projected debt relief obligations cannot be met from the use of existing IMF resources (e.g. Somalia, Liberia, and Sudan), donors commit to provide the extra resources necessary. We will invite voluntary contributions, including from the oil-producing states, to a new trust fund to support poor countries facing commodity price and other exogenous shocks.

Globally and on this basis we are committed to meeting the full costs to the IMF, World Bank and African Development Bank. We will provide on a fair burden share basis resources to cover difficult-to-forecast costs, in excess of existing resources, to the IMF, IDA and AfDF over the next three years. Subject to further analysis by the institutions we will provide up to \$350-500 million for this purpose. We are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens. We will also seek equivalent contributions from other

donors to ensure all costs are covered and we will not jeopardize the ability of these institutions to meet their obligations. Utilize appropriate grant financing as agreed to ensure that countries do not immediately re-accumulate unsustainable external debts, and are eased into new borrowing.

We call upon all shareholders to support these proposals which would be put to the Annual Meetings of the IMF, World Bank and African Development Bank by September.

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Endnotes

1. The following 18 countries would be eligible immediately: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia. As the remaining unsustainable HIPC's reach Completion Point they will also become eligible.
2. Additional donor contributions would be provided on the basis of IDA-13 and normalised AfDF-10 burden shares.