Solutions - External Debt Relief

Many of the world's poorest countries are saddled with high levels of **external debt** owed to other governments, institutions such as the IMF and foreign companies, banks and individuals. Funds that could be used to reduce poverty must instead be diverted to making interest repayments. This is known as debt servicing and does not itself achieve any reduction in the capital sum owed.

- The near $5tn of external debts owed by developing countries costs them more than $1.5bn a day in repayments – and much of that comes from the poorest countries.
- Most of the world's poorest countries have **limited access to international capital markets.**
- Without **conditional loans** from the IMF, World Bank and others, they would have to pay interest rates many times higher on private sector loans.
- Some developing countries have chosen to borrow from other emerging economies such as China or Brazil as a way of avoiding **conditional loans** from international institutions.
- Countries with **persistent trade deficits** end up accumulating large external debts, so too a government where spending greatly exceeds annual tax revenue leading to **high fiscal deficits**.
- A country defaulting on loans will find it harder and more expensive to attract future loans.

External debts can act as a **severe constraint on growth and development** – often times, the interest payments on existing public sector debt takes up a large percentage of a nation's export revenues or annual tax revenues.

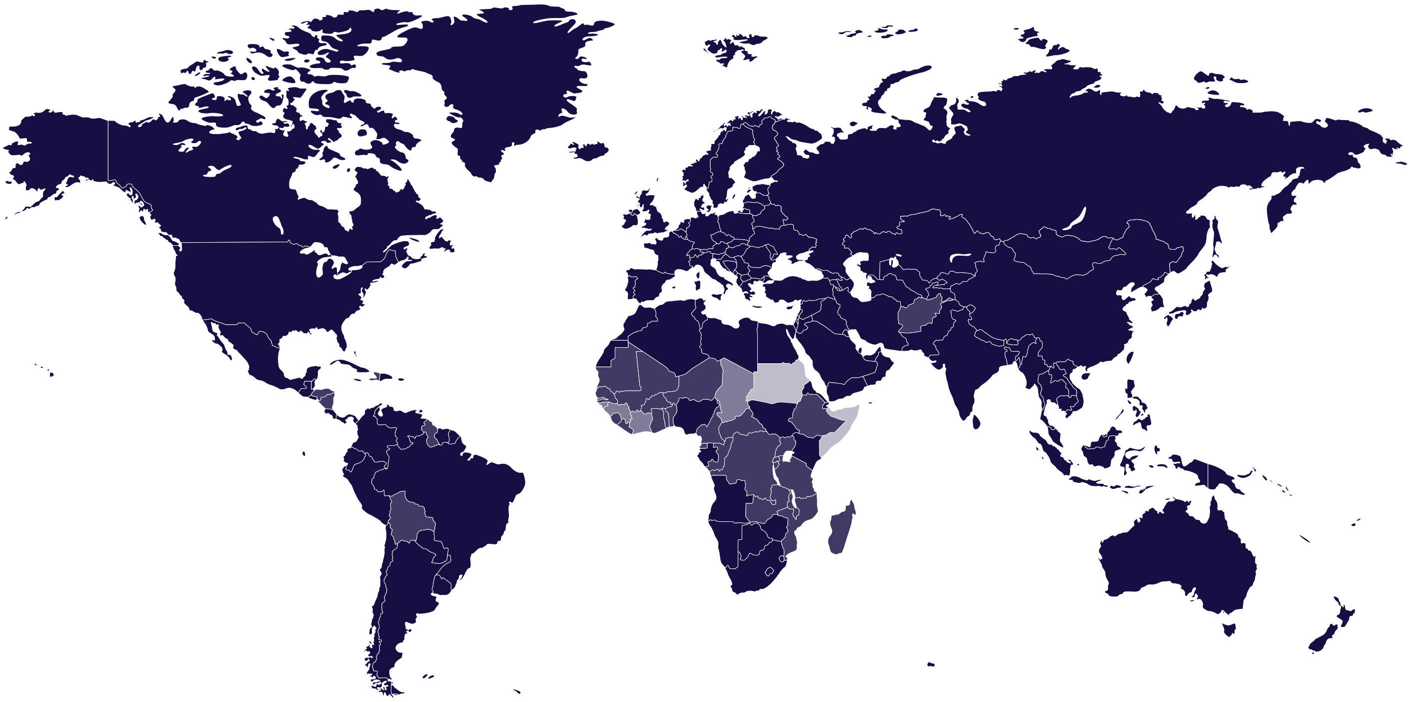
These debt repayments have an opportunity cost, they might be better used in supporting development policies such as investment in health and education to boost the human capital of the population.

To what extent should richer nations be prepared to write-off external debts of poor countries?

Relieving developing countries of part of their debt or cancelling it altogether is likely to carry substantial benefits for their development.

The Heavily Indebted Poor Countries (HIPC) Initiative

In the second half of the 1990s and early years of the new millennium, political pressure for debt cancellation grew. Organisations such as Jubilee 2000 and Make Poverty History lobbied the leaders of the developed world to offer such assistance.



The states recognised as the Heavily Indebted Poor Countries (HIPC).

- Countries qualifying for full HIPC relief.
- Countries qualifying for partial HIPC relief.
- Countries eligible for HIPC relief but not yet meeting the necessary conditions.

The HIPC Initiative was launched in 1996 and provides debt relief with the aim of either cancelling debt or reducing it to sustainable levels. To be considered for the initiative, countries must face an unsustainable debt burden which cannot be managed with traditional means. Assistance is conditional on the national governments of these countries meeting a range of economic management and performance targets. The HIPC initiative has become an important part of the strategy to achieve the Millennium Development Goals (and following Sustainable Development Goals).

Today, HIPC defines three minimum requirements for participation in the program. First, a country must show its debt is unsustainable; however, the targets for determining sustainability decreased to a debt-to-export ratio of 150% and a debt-to-government-revenues ratio of 250%. Second, the country must be sufficiently poor to qualify for loans from the World Bank's International Development Association or the IMF's Poverty Reduction and Growth Facility which provide long-term, interest-free loans to the world's poorest nations. Lastly, the country must establish a track record of reforms to help prevent future debt crises.

One of the goals is to ensure that impoverished nations re-channel the government funds freed from debt repayment into poverty-reduction programs. To that end, each country's program is modelled around a Poverty Reduction Strategy Paper (PRSP). PRSPs describe the macroeconomic, structural, and social programs that a country will follow to promote economic growth and reduce poverty. A broad range of government, NGO, and civil-society groups must participate in the development of the PRSP to ensure the plan has local support.

As of January 2012, the HIPC Initiative had identified 39 countries (33 of which are in Sub-Saharan Africa) as being potentially eligible to receive debt relief. The 36 countries that have so far received full or partial debt relief are:

- Afghanistan
- Benin
- Bolivia
- Burkina Faso
- Burundi
- Cameroon
- Central African Republic
- Chad
- Republic of the Congo
- Democratic Republic of the Congo
- Comoros
- Ivory Coast
- Ethiopia
- Gambia
- Ghana
- Guinea
- Guinea-Bissau
- Guyana
- Haiti
- Honduras
- Liberia
- Madagascar
- Mali
- Mauritania

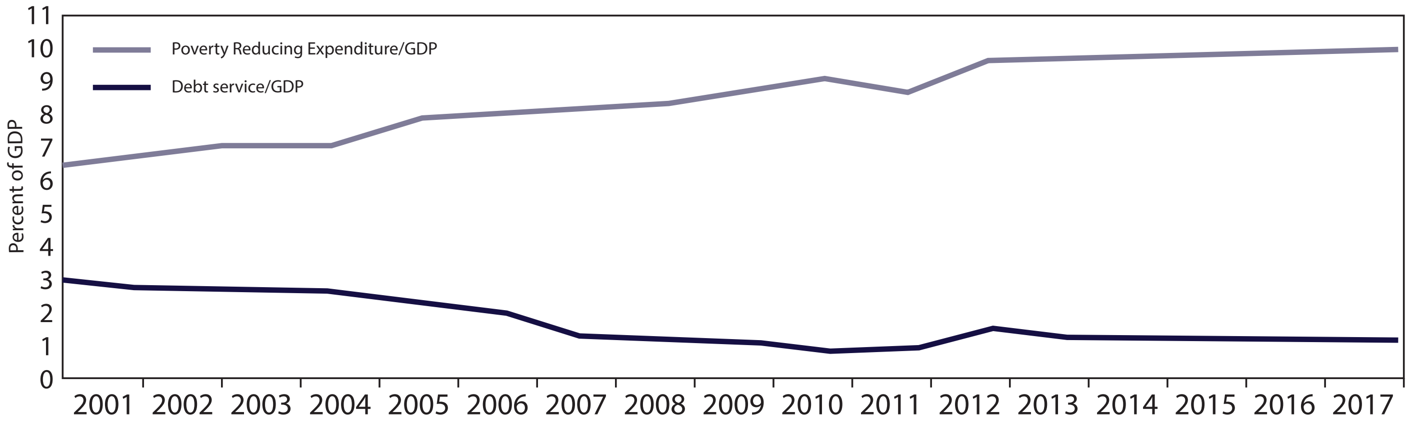
36 countries have completed the program and had their external debt cancelled in full, after Chad passed the Completion Point in 2015.

An additional three countries (Eritrea, Somalia and Sudan) are being considered for entry into the program.

Under the terms of the HIPC initiative and a further scheme known as the Multinational Debt Relief Initiative (MDRI) the debt stocks of 35 countries have been reduced by over 80%.

Evidence of the effect of the HIPC initiative is shown below. The HIPC initiative is shown to have reduced debt servicing to around 1% of GDP for those nations receiving relief. This has in turn released funds to be spent on reducing poverty. The **Ivory Coast** is an example of a country that has benefited from HIPC – it has been granted external debt relief of $7.7bn. As a result the stock of Ivorian public debt decreased from 69% of GDP in 2011 to 40% of GDP in 2012.

Average debt service and poverty reducing expenditures in countries receiving HIPC initiative relief



Source: World Bank

Brazil writes off debt of African nations

In May 2013, the Brazilian government announced that it plans to cancel or restructure almost $900m in debt owed by African countries. The move is designed mainly to expand Brazil's economic ties with Africa and fast forward the growth of trade and investment between emerging countries and regions. In the aftermath of this move, Brazil's future aid assistance is likely to target infrastructure, agriculture and social programmes. Among the 12 countries set to benefit are Tanzania, which owes Brazil $237m, along with oil-producing Republic of Congo and copper-rich Zambia.

Source: Adapted from newspaper reports, May 2013

Debt Relief for the Comoros

The International Monetary Fund (IMF) has agreed to US$176 million in debt relief for the Comoros, representing a 59 percent reduction of its future external debt service over a period of 40 years. The requirements met by Comoros included the maintenance of macroeconomic stability, reforms on telecommunications and energy, a national measles vaccination campaign for children to achieve 90 percent coverage nation-wide, and improvements in debt management.

Sources:

International Monetary Fund, December 2012

World Bank on Debt Relief for the world's poorest countries:

https://www.youtube.com/watch?v=EJYZCTXU4Dg

Partly taken from: http://www.tutor2u.net/economics/reference/external-debt-relief

Partly taken from: https://en.wikipedia.org/wiki/Heavily_indebted_poor_countries