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Debt Sustainability: Oasis or Mirage?

UNCTAD Report on Economic Development in Africa

In the context of the Millennium Development Goals (MDGs), the international community has set itself a target of reducing poverty by half by the year 2015. Many observers have now come to the conclusion that, on present trends, there is very little likelihood that this objective can be achieved at any time close to that date in the poorer countries, including in Africa.

UNCTAD has argued that the current levels of GDP growth would have to be raised to seven or eight per cent per annum and sustained if poverty reduction targets were to be met. This would imply doubling the current amount of aid to the continent and maintaining it at that level at least for a decade if the continent was to break the vicious circle of low growth and poverty. Such an action, within the context of an appropriate mix of domestic policies

and supportive international measures, would generate sufficient investment and savings to reduce aid dependency in the longer term and place Africa on a sustainable growth path.

The continent's debt problems and its resource requirements are inextricably linked to the capacity of African countries to generate capital accumulation and growth. It was contended that the Heavily Indebted Poor Countries (HIPC) Initiative, and later its enhanced version, would ensure a permanent exit solution to Africa's debt problems. There now seems to be an emerging consensus, however, that many African countries continue to suffer from a debt overhang despite the HIPC Initiative and various actions in the context of the Paris Club. The fact that even those countries that have reached (or are about to reach) the so-called completion point will soon find themselves in an unsustainable debt situation gives credence to the arguments advanced by critics with respect to the

inappropriateness of the criteria applied in the debt sustainability analysis. And the fact that several more debt-distressed African countries are not eligible for HIPC debt relief reflects the lack of objectivity in the eligibility criteria.

Debt sustainability is basically a relative concept. The questions that beg for a response are: what level of debt is sustainable for countries in which the vast majority of the population lives on under \$1 a day per person? Have debt sustainability criteria been based on internationally recognized benchmarks such as those of the MDGs, or on objectively and theoretically verifiable criteria? What is the relationship between Africa's total external debt stocks and the actual amount of debt serviced? Is complete debt write-off a moral hazard or a "moral imperative"?

It was only in 1996 that the international financial community accepted the need for a comprehensive approach to the debt problems of the poorest low-income countries. The first major coordinated effort in this respect was the launch of the Heavily Indebted Poor Countries (HIPC) Initiative by the Bretton Woods Institutions (BWIs), the International Monetary Fund (IMF) and the World Bank. The Initiative was launched in response to concerns that many low-income countries would face unsustainable external public debt burdens even after receiving traditional debt relief. Against this background, the goal of the HIPC Initiative was to reduce the external public debt burden of all "eligible" heavily indebted poor countries (HIPCs) to sustainable levels in a reasonably short period of time. The Initiative was to make it possible for all HIPCs so designated to meet their "current and future external debt service obligations in full, without recourse to debt rescheduling or the accumulation of arrears, and without compromising growth"

An enhanced version of the HIPC Initiative was outlined in September 1999 after intensive pressures from non-governmental organizations (NGOs) and

civil society at large, academics and debtor Governments highlighting the inadequacies of the Initiative. These include the limited country coverage of the original Initiative and the fact that it provided too little debt relief and delivery was too slow. The main aim of the enhanced HIPC Initiative is to strengthen the link between debt relief and policies tailored to a country's circumstances to reduce poverty through the delivery of "deeper, broader and faster" debt relief. Thus, the major modifications contained in the enhanced framework are larger reductions to total debt stock, faster reductions in debt-service payments and a relaxation of the stringent qualification criteria contained in the original HIPC Initiative.

Despite these improvements to the original Initiative, the enhanced HIPC has had its share of criticisms: "... progress has been much slower than expected and the Initiative is suffering from problems of under funding, excessive conditionality, restrictions over eligibility, inadequate debt relief and cumbersome procedures" (United Nations, 2000, p. 2). The debt sustainability analysis (DSA) and the overly optimistic assumptions with respect to GDP and export growth rates have been particularly criticized.

How sustainable is African HIPCs' debt after debt relief?

Post-HIPC debt sustainability

The debt overhang literature does not provide conclusive answers or evidence as to what sustainable debt levels are. A recent IMF Working Paper supports the claim that, on the basis of current fiscal policies, debt levels will remain unsustainable in many African HIPCs even after they graduate from the HIPC Initiative. Another recent study by Kraay and Nehru (2003), corroborated by the IMF staff's empirical analysis (see IMF and World Bank, 2004b), finds strong evidence that institutions and policies, as well as external shocks, are important in determining the levels of debt at which countries experience distress. As discussed

in the previous chapter, the assessment of debt sustainability is, by its nature, a forward-looking concept and inherently probabilistic.

A Report of the United States General Accounting Office (GAO, 2004) highlights the overly optimistic growth assumptions of HIPC debt sustainability analysis. The report shows that, on the basis of the IMF's and the World Bank's projected growth rates, the average probability of achieving debt sustainability in 2020 was 83.9 per cent for the 27 HIPCs that had reached their enhanced decision point by the end of 2003. If based on historical growth rates, the average probability drops to 45.1 per cent. Limiting the comparison to the 23 African HIPCs that had reached their enhanced decision points by the end of 2003, the probability would be of 82.5 per cent if using the IMF's and the World Bank's growth rates, but only 41.0 per cent if using these countries' historical growth rates. Serious concerns have thus arisen as to the appropriateness of the basis on which the amount of debt relief is determined within the HIPC framework.

Alternative modalities for delivering sustainable debt

Payment caps on HIPC debt service

Limiting the debt service payments of HIPCs to 10 per cent (or 5 per cent for countries experiencing major public health emergencies) of internal revenues of Governments is a prominent reform proposal, especially in the United States. In May 2003, the United States Congress passed a bill requiring the Administration to seek agreement with other countries to put these limits on HIPC debt payments into effect.

The proponents of payment caps argue that the remaining high debt burden of HIPCs constitutes a challenge to the central objective of the HIPC Initiative "to provide a greater focus on poverty reduction by releasing resources for investment in health, education, and social needs." Furthermore, it is contended that a

cap on debt service payments would protect HIPCs against deteriorations in the world economy, as their debt payment obligations would be adjusted to the lower levels of government revenues. Without payment caps, HIPCs are likely to remain highly vulnerable to currency depreciations, as they would need to spend more of their revenues to purchase the foreign exchange necessary to service external debt. Thus, without a mechanism to automatically reduce countries' debt servicing obligations, HIPCs could find themselves in a situation where their debt burdens are once again unsustainable, even after full debt relief from the enhanced HIPC Initiative .

Critiques of payment caps maintain, however, that the differences between the outcomes for HIPCs can be attributed as much to differences in the level of government revenues as to any variation in their treatment by the HIPC framework. Thus, a cap on debt service based on government revenue will benefit most those HIPCs whose Governments have the smallest share of revenues (relative to GDP) from domestic sources. Such caps could, however, be defined with reference to historical values of government revenues, or in terms of GDP.

The human development approach to debt sustainability

This approach was originally suggested by Northover, Joyner and Woodward at the Catholic Agency for Overseas Development (CAFOD) in 1998. It argues that most of the world's poorest countries have unsustainable debt and that countries with a large proportion of their population living in absolute poverty have a more urgent need to spend their resources on poverty reduction than on debt service. It is for the same reason that other NGOs, such as OXFAM, Jubilee Research (formerly Jubilee 2000) and Debt Relief International, among others, have campaigned for a complete write-off of the debt of very poor low-income developing countries. Over the years, this campaign has won popular support in many developed countries.

MDG-based approach to debt relief

There is increasing recognition that a full debt write-off will make an important contribution to reaching the MDGs in the current group of HIPCs and other poor debt-distressed African countries. However, as has been argued in previous UNCTAD reports, even if all SSA's debt is written off, this would represent only half of the resource requirements for Africa's development in the next decade. Thus, a debt relief initiative that is premised on achieving the MDGs in all African HIPCs and other debt-distressed African countries, within the context of overall ODA flows to these countries, should be considered. The important benchmark for calculating the appropriate size of debt relief to be offered to this group of countries should be the level of resources that these countries need, taking into account the level of ODA flows, to attain the MDGs, without compromising growth.

Meeting the costs of a debt write-off

While some major donors have started to provide 100 per cent debt relief, there remains a considerable amount of bilateral debt that HIPCs and other equally poor and debt-distressed African countries will find difficult to service. This situation is underscored by the persistence of critical developmental problems in these countries that discourage higher domestic and foreign investment. However, the current constraints in financing the MDG-based approach are enormous and might require a more constructive discussion that looks into new global financing instruments.

Resources for funding a complete write-off of Africa's multilateral debt could be raised through three possible channels: loan loss provisions, mobilization of donor resources for IFIs, or increased ODA flows.

Theoretically it is possible for the Bretton Woods institutions and other multilateral development banks to write off bad debts as their counterparts in the commercial

banking sector do against loan loss provisions, but they have insisted that a complete debt write-off would negatively impact on their preferred creditor status and increase the cost of their own borrowing on capital markets. This has drawn some scepticism from certain observers. It is contended that their "preferred creditor status" does not appear to be based on any legal codes, but solely on the premise that in the event of default or external debt servicing problems, sovereign borrowers make preferential allocation of foreign exchange to service the debts owed to these institutions without triggering remedial action on the part of the other creditors. According to Adam Lerrick (of the Carnegie Mellon University), total debt owed by the existing HIPCs amounts to only 5 per cent of IFIs' capital and 54 per cent of their provisions and reserves, and none of these institutions would find themselves in distress because of a 10 per cent fall in their equity capital. A total debt write-off for these countries will not, therefore, impair their ability to play an important role in the world economy.

It is important to recall, however, that the earlier discussions on disaggregating the additional total costs of the Initiative to various creditors suggest that creditors, in particular some multilateral ones, are unlikely to provide further debt relief unless they receive assistance from donor countries. Thus, a complete write-off would only be possible if the main shareholders of the Bretton Woods institutions provide the additional funding to cover the share of these institutions (about 30 per cent of total debt stocks) in total debt relief for African HIPCs.

The possibility of funding a complete debt write-off via aid resources should be explored, since aid levels are actually increasing, although slowly. After falling substantially in the second half of the 1990s, aid volumes rose in 2002. Net ODA flows, as estimated by the Development Assistance Committee (DAC) of the OECD, rose from \$52.3 billion in 2001 to \$58.3 billion in 2002. The ratio of ODA to donors' GNP, which

fell from 0.34 per cent in the early 1990s to 0.22 per cent in 2001, rose to 0.23 per cent in 2002. Although the aid effort and new commitments vary widely across donors, aid volumes as a whole are set to rise further when DAC members begin to deliver on their Monterrey commitments. If these commitments are realized, total ODA would increase by about \$18.5 billion over the 2002 level, from \$58 billion to \$77 billion, that is a 32 per cent rise in real terms, reaching 0.29 per cent of GNP in 2006.

While the increase in development assistance is encouraging, there are concerns that a large part of this increase may not finance the costs of meeting the MDGs. Of the roughly \$6 billion nominal increase in ODA by DAC donors in 2002 (an approximately \$4 billion increase in real terms), debt relief accounted for \$2.9 billion, technical cooperation for \$1.9 billion, and emergency and disaster relief and food aid for \$0.7 billion. In terms of recipient country distribution, the increase in bilateral ODA was concentrated in a small number of countries. Indeed, there is some concern that additional aid flows, as well as their distribution, could be significantly influenced by donors' strategic agendas. It is important, therefore, to ensure that such strategic concerns, irrespective of their immediate importance to donors, should not crowd out development aid to the poorest low-income countries.

In any case, given that the real costs of debt relief can be spread over the lifetime of the remaining loans, which for multilateral loans is around 30 to 40 years, the annual cost of 100 per cent debt relief, at least for those HIPC countries at the decision/completion point as at September 2003, remains relatively small in comparison to the resource requirements for meeting the MDGs.

It has often been argued that a 100 per cent debt write-off will send the wrong signals to debtor countries and others, set a bad precedent and thereby create a moral hazard for the IFIs. However, there is no greater moral hazard than the one entailed

in constant restructuring and partial debt forgiveness based on creditors' perspectives and interests, as is the case under terms agreed with the Paris Club. On the contrary, moral hazard will be limited by dealing decisively with the recurring debt crisis of poor African countries through a truly permanent exit from constant rescheduling that establishes a basis for long-term debt sustainability for debtors within an appropriate framework of national and international policy measures. A complete debt write-off, therefore, becomes a "moral imperative", as it will guarantee resources to help meet the MDGs in Africa and assure an exit from the debt crisis for the continent. UNCTAD has suggested that the international community consider applying key insolvency principles to international debt work-outs and writing off all unpayable debt in SSA determined on the basis of an independent assessment of debt sustainability

Conclusions

The analysis illustrates the weaknesses of the HIPC approach with respect to finding a permanent exit solution to the debt crisis of African HIPC countries, and highlights the fact that several other equally poor African countries have been left out of the process. On the question of the level of debt deemed to be sustainable for countries the majority of whose population lives on less than one or two dollars a day per person, the answer is self-evident: considering the seriousness with which the international community is addressing the attainment of the MDGs, these targets should be used as a major benchmark for debt sustainability. This in turn implies that virtually all of the outstanding debt would need to be written off, as the resources needed to attain these goals are substantial.

It is contended that a write-off of the debt of the poorest countries may represent a "moral hazard" and discourage economic reforms by debtors, and that it may affect the status that the international financial institutions enjoy as "preferred creditors". These are legitimate questions and must be taken into consideration. At the same

time, however, it could be counter-argued that since the poor countries, particularly in Africa, would have to continue to rely on greatly increased levels of ODA to reduce poverty and attain the MDGs, there is little likelihood of their abandoning economic reform. Furthermore, as shown earlier, a write-off of the debt of poor African countries is unlikely to cause financial distress to the IFIs, as the amount involved is relatively small compared with their capital and could thus be absorbed through loan loss provisions, as is the practice in the commercial banking sector.

This article is an abridged version of the main report, which can be accessed at www.unctad.org

Odious Debt

Michael Kremer and Seema Jayachandran

The United States argued along these lines during the 1898 peace negotiations after the Spanish-American War, contending that neither the United States nor Cuba should be responsible for debt the colonial rulers had incurred without the consent of the Cubans and not for the Cubans' benefit. Spain never accepted the validity of this argument, but the United States implicitly prevailed, and Spain took responsibility for the Cuban debt under the Paris peace treaty. This episode inspired legal scholars to elaborate a legal doctrine of "odious debt." They argued that sovereign debt is odious and should not be transferable to a successor government if it (1) was incurred without the consent of the people and (2) did not benefit the people. Some scholars added the requirement that creditors be aware of these conditions in advance.

However, this doctrine has gained little momentum within the international law community, and countries are held responsible for repaying illegitimate debt under the international system's current norm. South Africa is a case in point. The apartheid regime in South Africa borrowed from private banks through the 1980s, while a large percentage of its

budget went to finance the military and the police to repress the African majority. The South African people now bear the debts of their repressors. While the Archbishop of Cape Town has campaigned for apartheid-era debt to "be declared odious and written off," and South Africa's Truth and Reconciliation Commission has voiced a similar opinion, the post-apartheid government has deferred to the current international norm and accepted responsibility for the debt. South Africa seems to fear that defaulting would hurt its chances of attracting foreign investment and wants to be seen as playing by the rules of capitalism. Indeed, when apartheid was being dismantled in 1993, Nelson Mandela, who would become president the following year, called for the world to normalize economic relations with South Africa; three days later, the finance minister announced at an investor conference in New York that South Africa would repay its sovereign debt.

Similarly, although Anastasio Somoza was reported to have looted \$100 million to \$500 million from Nicaragua by the time he was overthrown in 1979, and the Sandinista leader Daniel Ortega told the United Nations General Assembly that his government would repudiate Somoza's debt, the Sandinistas reconsidered when their allies in Cuba advised them that repudiating the debt would unwisely alienate them from western capitalist countries.

There are a number of other cases in which dictators have borrowed from abroad, expropriated the funds for personal use, and left the debts to the population they ruled. For example, under Mobutu Sese Seko, the former Zaire accumulated over \$12 billion in sovereign debt, while Mobutu diverted public funds to his personal accounts (his assets reached \$4 billion in the mid-1980s) and used them in his efforts to retain power (e.g., payments to cronies, military expenses). Similarly, when Ferdinand Marcos lost power in 1986, the Philippines owed \$28 billion to foreign creditors, and Marcos' personal wealth was estimated at \$10 billion.

Several countries have been granted debt relief under the Heavily Indebted Poor Countries (HIPC) initiative, which considers the level of debt and the income of the country as the criteria for debt relief, but not the circumstances under which the debt was incurred. Thus, countries that are not as impoverished but have a plausible claim that their debts are illegitimate are not on the current list of debt relief candidates. Indeed, South Africa, the Philippines, and Croatia do not qualify for debt relief under the HIPC Initiative.

Policies to Curtail Odious Debt

We argue for establishing an independent institution, which could assess whether regimes are legitimate and could declare any sovereign debt subsequently incurred by illegitimate regimes odious and thus not the obligation of successor governments. This could restrict dictators' ability to loot, limit the debt burden of poor countries, reduce risk for banks, and hence lower interest rates for legitimate governments that borrow.

Currently, countries repay debt even if it is odious because if they failed to do so, their assets might be seized abroad and their reputations would be tarnished, making it more difficult for them to borrow again or attract foreign investment. However, if there were an institution that assessed whether regimes are odious and announced its findings, this could create a new equilibrium in which countries' reputations would not be hurt by refusal to repay illegitimate debts, just as individuals' credit ratings are not hurt by their refusal to pay debts that others fraudulently incur in their name. In this equilibrium, creditors would curtail loans to regimes that have been identified as odious, since they would know that successor governments would have little incentive to repay them. This argument draws upon a well-known result in game theory that repeated games have many possible equilibria, and simply making some information publicly known can

create a new—and, in this case, better—equilibrium.

While a public announcement that a regime is odious might curtail lending to such regimes, there is no guarantee that everyone would coordinate on this new equilibrium without some means of enforcement. Two enforcement mechanisms could ensure that lending to odious regimes is eliminated. First, laws in creditor countries could be changed to disallow seizure of a country's assets for non-repayment of odious debt. That is, odious debt contracts could be made legally unenforceable. Second, foreign aid to successor regimes could be made contingent on non-repayment of odious debt. In other words, donors could refuse to give aid to a country that, in effect, is handing the aid over to banks that have illegitimate claims. If the foreign aid were valuable enough, successor governments would have incentives to repudiate odious loans, so banks would refrain from originating such loans.

Advantages Over Traditional Trade Sanctions

As noted in the introduction, limiting an odious regime's ability to borrow can be considered a new form of economic sanction that has several attractive features relative to traditional trade sanctions. Like other sanctions that the international community uses to pressure governments without resorting to war, the threat of limits on borrowing could create incentives for regimes to reform. Governments might loot less to retain the ability to borrow. Would-be dictators might even be discouraged from seeking power if sovereign borrowing were not one of the spoils of office.

Limiting borrowing also avoids two key shortcomings of trade sanctions. First, third parties have incentives to evade most trade sanctions, while curtailing odious debt, in contrast, is a self-enforcing sanction. The difference arises because successor governments will have incentives to repudiate odious debt as long as there are a few creditors and investors

who are willing to continue lending to and investing in the country. If repudiation of odious debt is not a blight on a country's reputation, banks know that they will lose money if they disregard the sanction and issue odious debt. A private bank would thus think twice before lending to a regime if the world's leading powers, international organizations, and financial institutions had declared the regime odious and announced that they would consider successor governments justified in repudiating any new loans the odious regime incurs.

A second problem with trade sanctions is that they often inflict harm on the people they were intended to help. For example, if firms in the country are prevented from selling their products abroad, the loss of revenue might cause them to fire workers or decrease wages. In contrast, curtailing dictators' ability to borrow, loot, and saddle the people with large debts would hurt illegitimate regimes but help their populations. The burden of repaying the debts would almost certainly outweigh any short-run benefit the population would obtain from proceeds of the loan that trickled down to them. (If a regime loots only a small amount and most of the proceeds flow to the people, the regime probably should not be considered odious.)

More countries engage in foreign trade than in sovereign borrowing, so limits on borrowing could only be applied as a sanction in certain cases. Nonetheless, it could have a significant impact in these cases. For example, Franjo Tudjman of Croatia was arguably an odious ruler, having suppressed the media, instigated violence against political opponents, and looted public funds. In 1997, the International Monetary Fund (IMF) cut off aid that was earmarked for Croatia at the behest of the United States, Germany, and Britain, who were concerned about the "unsatisfactory state of democracy in Croatia." Despite this, commercial banks lent an additional \$2 billion to the Croatian government between the IMF decision and Tudjman's death in December 1999. If the proposed institution

existed, creditors might not have granted Tudjman the subsequent \$2 billion in loans, and the Croatian people would not bear the debt today. Such potential applications suggest that limits on borrowing should be part of the toolkit of policies available to the international community.

Incentives for Truthfulness

For such a limit on borrowing to improve upon the status quo, it is necessary to provide incentives for the institution assessing the legitimacy of debt to do so truthfully. An institution that cares about the welfare of the people of developing countries more than that of banks and other creditors might be tempted to declare legitimate debt odious so that the country will not have to repay it. However, if creditors anticipate being unable to collect on even legitimate loans, they will be wary of lending at all, and the debt market will shut down. This danger is one of the main reasons why the doctrine of odious debt has gained little support within the legal community.

To overcome this risk, the institution could be empowered only to rule on future loans to a government and not on existing debt. Then creditors would not face the uncertainty that loans they issue will be declared odious later. Moreover, the institution will be more likely to be truthful. Even if the institution is more concerned with the welfare of debtors than of creditors, it would have incentives to judge a regime honestly because honesty benefits the population. If the institution falsely calls a legitimate government odious, it deprives a country of profitable investments financed by loans. If it falsely calls an odious government legitimate, the government can borrow and loot the country.

Restricting an institution to rule on the legitimacy of loans before they are incurred also limits the potential for favoritism toward creditors. An institution that favors creditors and rules on existing debt might fail to declare some debts odious. However, if it rules only on future

loans, even a small degree of concern for truthfulness or for the welfare of people in borrowing countries should be sufficient to prevent an institution from calling an odious government legitimate. This is because before a loan is issued, the expected profits of a loan are very small for banks, as they have many alternative uses for their capital. In contrast, outstanding debt is a "zero-sum game" between creditors and debtors, so a biased institution can help whichever party it favors. Because false rulings about future debt hurt the population of borrowing countries and cannot substantially help creditors, an institution empowered only to block future lending is unlikely to make biased judgments in order to help debtors or creditors.

There remains a possibility that an institution that rules on future debt may be biased for or against certain governments. If the major powers regard a country as an important trade partner or strategic ally, the institution might fail to brand the government odious regardless of potential misdeeds. For instance, it is unlikely an institution would brand either China or Saudi Arabia as odious. Since such regimes with powerful friends can borrow presently, biased decisions in their favor would simply maintain the status quo. If instead the institution disfavors a government for foreign policy reasons, even though the government has the consent of the people or spends for their benefit, the institution might falsely term it odious, thus cutting it off from lending. For example, the United States might wish to block loans to Cuba under Fidel Castro, independent of whether the regime satisfies the definition of odiousness. If this happened, citizens of the country would be worse off than under the status quo. The institution could be designed under a "do no harm" principle. Requiring unanimity or a two-thirds vote to declare a regime odious could safeguard against the possibility that a country would falsely be branded odious due to the biases of a few members of the institution.

Inherited Debt

It also is important to consider how the new policy would affect an odious regime that inherits legitimate debt from the previous government. Even under the status quo, an odious regime likely would prefer not to repay its creditors and instead keep the repayment money for itself. It would be difficult to extract these resources from the regime; the best it may be possible to do is to prevent it from procuring more resources. To reduce the probability of the regime defaulting on its obligations, the international community might consider providing specific exemptions for the rollover of existing loans.

Who Should Assess Regimes?

A key question is which institution might judge odiousness. The United Nations Security Council already imposes sanctions against governments, so it is a natural candidate. The United States and the other permanent members (China, France, Russia, and the United Kingdom) might prefer this option since they would have veto power. Another option is a new international judicial body that hears cases brought against particular regimes and is composed of professional jurists representing several countries, similar to the International Court of Justice or the newly established International Criminal Court in the Hague.

Another approach is for major creditor countries to implement this system using solely domestic institutions. If the United States changed its laws to prevent seizure of a foreign government's assets when it repudiates odious debt, an American court ruled that a regime was odious, and the United States announced it would oppose IMF or World Bank aid packages to a successor regime that repaid illegitimate debt, then banks even outside the United States would likely be reluctant to lend to that regime, fearing that successor governments would not repay.

It might also be possible for civil society to begin putting pressure on banks not to lend to illegitimate governments. If a well-respected nongovernmental organization

identified odious regimes and promulgated a list of them, creditors might be reluctant to lend to governments on the list.

In short, the international community or even a few major countries, possibly in concert with nongovernmental agencies, could create a new norm under which a country is not responsible for odious debt, and creditors therefore do not issue odious debt in the first place.

This new policy could help legitimate debtors and their creditors. Creditors would benefit from knowing the rules of the game in advance. Currently, there is a movement to nullify some debt on the grounds of odiousness, but it is hard for creditors to anticipate which loans will be considered odious in the future. If odiousness were declared in advance, banks would avoid lending to odious regimes in the first place and no longer face the risk of large losses if a successful campaign nullifies their outstanding loans. Greater certainty would ensure that interest rates for legitimate borrowers would be lower. Most important, dictators would no longer be able to borrow, loot the proceeds—or use them to finance repression—and then saddle their citizens with the debts.

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Editorial: Debt relief or debt cancellation: should it be multilateral or unilateral?

Chandrakant Patel

At their meeting last month, the G-7 or G8 Finance Ministers, led by UK's Gordon Brown, revisited the issue of debt relief. In keeping with the hyperbole that accompany such meetings, Brown stated,

“It is the richest countries hearing the voices of the poorest”. This may well be the case, but debtors need to be forewarned that and alerted to the fact that the devil is in the details. The details are fuzzy: aside from the fact that the US is far from persuaded about the merits of 100 percent debt cancellation, considerable uncertainty surrounds the list of beneficiaries, conditions attached to programme and its funding. With respect to the latter, the suggestion to use proceeds from the sale of IMF's gold is unlikely to progress given the opposition of the US, which has a veto on such decisions. On the other hand, what is clear is that the debt cancellation covers only public debt; it is proposed to be linked to a liberalization agenda and will be on a case-by-case basis. Thus, the policy of ‘tight leash’ will continue to guide any relief programme, even taking into account the modest size of the relief likely to emerge.

Against a backdrop of continuing net transfer of resources from the South to the North (for the year 2004, these transfers have been estimated by the UN Report World Economic Situation and Prospects, 2005, to have reached US Dollars 312 Billion, compared to 268 Billion the previous year and 35 Billion in 1998). In this context, HIPC's contribution to restore financial viability and growth is at best marginal. Indeed, over the decade since the idea became operational in the multilateral financial institutions, the HIPC countries continue to slide backwards: their debt levels continue to be unsustainable and impossible to reconcile with the objectives of restarting sustained growth and reduce poverty levels. The initiative itself is highly dependent on donor leverage and on an elaborate bureaucracy that has been created to manage it.

The recent study by UNCTAD (reproduced in an abridged version in this Bulletin) and many others comes to the conclusion that HIPC in its present form and scope is largely another tool in the armory of creditors to continue to dominate the debt ridden countries. And yet, UNCTAD in its study proposes more

of the same: it argues for a massive transfer of resources to the South: **“the current levels of GDP growth would have to be raised to seven or eight percent per annum and sustained if poverty reduction targets were to be met. This would imply doubling the current amount of aid to the continent and maintaining it at that level at least for a decade if the continent was to break the vicious circle of low growth and poverty. Such an action, within the context of an appropriate mix of domestic policies and supportive international measures, would generate sufficient investment and savings to reduce aid dependency in the longer term and place Africa on a sustainable growth path.”**

Unfortunately, this recipe for greater aid dependency is precisely the reason why so many countries in the South have been brought to their present plight. In arguing for more of the same, UNCTAD and similar organizations are advocating further dependence, more creditor leverage and zero prospect of meeting the Millennium Goals. Until policy makers accept that there is no correlation whatsoever between more aid and more growth, or between aid and improved savings or better income distribution, (as asserted, contrary to all evidence, by the mainstream neo-liberal economists and international organizations), and in consequence jettison much of the advice emanating from the neo-liberal policy makers, chances of real economic transformation will remain a distant

prospect. Available evidence does suggest, on the other hand, that much of the aid is preempted by the well off and a major source of graft and capital flight.

In line with this type of thinking, they advocate (as in the Brookings Review article) for a special treatment of so-called odious debts. But their proposal is far from a cancellation of such debts or setting in place of institutions to organize such cancellation as has been argued by bodies such as Jubilee International. They propose, instead, that only future debts (on account of new borrowings) be the subject of treatment under the doctrine of odious debts. As will be obvious to all those who have followed this debate, a very large share of the present stock of private debts (as well as, to be sure, public debts) can be potentially classified as odious. But this is clearly not the concern of the authors: they appear to be seeking ways of ensuring that whatever creditors define as odious should be decreed to be so and subject to relief. This, of course, squares the HIPC circle: in the name of poverty alleviation, the donors have preempted the concept of odious debts and cast it in their own image.

Such debts warrant unilateral cancellation: otherwise, the charade of debt relief will continue to poison creditor-debtor relations.

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