

For the FfD Working Group (by Eva Hanfstaengl)

Talking Points on Debt for Multistakeholder Dialogues at the United Nations in New York

The situation: Need for more debt relief

ActionAid/Oxfam and Eurodad recently examined European government approaches to aid, debt and trade¹. The findings were that far too little is being done by many governments. On debt relief, unfortunately; the HIPC Initiative has so far failed to reduce debt to sustainable levels in most countries where it is in place. Even those countries which have qualified for HIPC are paying \$2.8 billion a year to their creditors, money which could instead go on development spending.

Bilateral debt

Most creditor countries have agreed to cancel 100 per cent of the bilateral debts owed by the 42 countries in the Heavily Indebted Poor Countries (HIPC) initiative. In some cases; they have included other low-income countries in their debt relief lists; as well. However, some countries have been very slow in delivering their promises. *Italy*: promised an ambitious lift of up to €4 billion to HIPC countries and other low-income, but has delivered €2 billion so far; *Germany* HIPC debt relief has been provided to only 6 countries (out of a €6 billion figure; has delivered only €2 billion); *Slovakia* delivered debt relief to all HIPC countries; *Czech Republic, Hungary and Poland* cancelled some debt for some HIPC countries.

Additional debt relief

Debt relief should be additional to the aid previously announced. *France, The Netherlands and Belgium*, for example, have falsely inflated aid statistics because debt relief payments are included in them. These payments are largely for export credit debt and often more an export subsidy than a development transfer.

Multilateral debt

Ireland was the first EU member state to argue for multilateral debt cancellation, in 2002. Since then, other EU countries have either contributed to the HIPC Trust Fund or pushed their neighbours to do so (*UK and The Netherlands*; for example, are late with their contributions. *France* does not see the need for multilateral debt cancellation).

The most promising proposal for funding debt cancellation in a genuinely additional manner is to use IMF gold. This is currently an undervalued asset sitting in the IMF's vaults, worth around 40 billion Euros. Some EU members; such as the *UK, Germany and Italy* back the use of this gold. Others, like the *Netherlands* are not yet backing the gold revaluation proposal.

Panel No. 1 “Debt sustainability: what it implies for policy makers, private sector and civil society”

While there is clear recognition that for many developing countries their debt servicing obligations undermines development, insufficient action has been taken to take effective action to ensure that levels of debt are sustainable. The International Monetary Fund (IMF) has adopted an approach (IMF 2002) that defines a sustainable foreign debt situation as one in which the government could continue to service its obligations without an “unrealistically large” future correction to the balance of income and expenditure. The IMF strengthened its approach for assessing

¹ ActionAid/Oxfam and Eurodad: “EU Heroes and Villains”, 4 Feb. 2005

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public and external debt sustainability by adopting a new framework, which was further enhanced in 2003. This framework focuses on crisis prevention and potential vulnerabilities and is designed for countries with financial market access. IMF now performs debt-sustainability analysis more frequently based on deeper country-specific analysis (see Issues Paper, paras 11-15). Still, the Bretton Woods Institutions act as both creditors and centralised assessors of debt sustainability, which not only represents a clear case of conflict of interests but reduces the debt issue to one of mere technicalities.

This definition of “debt sustainability”, does not take into account fundamental factors, like excessive levels of poverty, low economic growth, high unemployment, HIV/AIDS and social insecurity. The official “Issues Paper” therefore rightly acknowledges that the “sustainability of foreign debt has been defined in both macroeconomic and social terms”. This second approach was developed by NGOs and “looks at the social and development imperatives of a government’s expenditure and its revenue-raising capacity, calculates the funds that could be made available for debt servicing, and compares that to actual obligations. The general thrust of this approach was endorsed by the Member States of the United Nations in the Monterrey Consensus, and the United States Government adopted legislation calling on the Bretton Woods institutions to limit external debt servicing by HIPC countries to 10% of revenues, except in the case of countries with public health crises, where the prescribed limit was set at 5% of revenues” (Issues Paper, para 11).

After the Monterrey Consensus, also the UNDP Human Development Report 2003, the New Partnership for Africa’s Development, the Irish Government and HIPC Finance Ministers have taken up the importance of a human development approach to debt sustainability. This approach recognises the very real human and development consequences of high levels of indebtedness, and prioritises human rights over debt repayments (see Eurodad response to Issues Paper).

Since 2000, Non-Governmental Organisations call on governments to adopt measures that will once and for all remove unsustainable levels of debt to all low and middle income developing countries. Debt sustainability should be measured, among others, against the needs of indebted countries to achieve the Millennium Development Goals.

- NGOs propose that assessments of debt sustainability **according to the human development approach** be carried out to determine exactly how much debt needs to be cancelled to free up resources for investment in essential services such as health and education and in important infrastructure such as rural roads;
- A minimum requirement is that debt sustainability analysis should take into account the impact of debt relief on progress towards the **achievement of the MDGs** (see Monterrey Consensus, para 49 ²). To achieve the MDGs, further substantial debt cancellation is needed for low income countries beyond the HIPC initiative and for middle income developing countries.
- Governments must ensure that funding of debt cancellation is **additional** to donor’s targets to achieve its commitment to provide 0.7% GNI;
- As mentioned in the Issues Paper, any reasonable assessment of a country’s level of debt distress must also take into account the burden of **domestic debt**.
- Lending decisions are essentially governed by the political interests of creditors, and debt is often an instrument of control over the economic policy space of debtor countries. The cancellation of debt therefore should be done free from economic policy **conditions**. Debt sustainability analyses should be carried out in the first instance by the loan contracting governments themselves.

² “Future reviews of debt sustainability should also bear in mind the impact of debt relief on progress towards the achievement of the development goals contained in the Millennium Declaration...Continued efforts are needed to reduce the debt burden of heavily indebted poor countries to sustainable levels” (UN 2002, para 49).

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- IMF signals of a poor policy performance has a high risk of giving some creditors the excuse to select and withdraw debt relief and aid completely from any poor country. The Issues paper rightly points out concerns regarding the robustness of the Country Policy and Institutional Assessment (CPIA) as the central guide to determine a country's capacity to carry debt over time. It has an ideological bias towards trade liberalisation and would work as a new form of externally-driven donor conditionality. IMF and World Bank remain the final arbiters of what constitutes good and bad macroeconomic policies.

Panel No. 2 “Debtor-creditor relations in good times and bad”

The 1990s witnessed the growing severity and frequency of debt crises for middle-income countries. These new and more rapid crises have largely arisen from the integration of the capital markets in emerging market economies and the introduction of IMF-recommended capital account liberalisations. The resulting huge inflows of volatile capital – leading to crises in Mexico, Asia, Russia and Argentina – have made it necessary for the IMF to organise increasingly expensive rescue packages. But even these “rescues” have led to criticism of the IMF for bailing out private lenders with public money at the expense of the longer-term development prospects of millions of people. In other cases such as former Yugoslavia or, more recently Iraq and Sri Lanka, the readiness of bilateral and multilateral creditors to grant substantial debt relief is guided by strong political interests – adding to the lack of transparency and inequality of the present international debt management procedures. While the debt crises in middle-income countries have led to increasing costs, debt-restructuring packages have become more complicated. There is now a greater diversity of creditors (including banks, bond holders, trade financiers) involved in restructuring exercises. Debt restructuring packages that require collective action and coordination between creditors and debtors have become even more difficult to reach. Even the IMF stated, “the present process for restructuring is more prolonged, more unpredictable and more damaging to the country and its creditors than would be desirable.” Moreover, the absence of a “predictable and equitable process makes it more difficult to attract long-term capital to the emerging market asset class” (Anne Krueger, 2002).

In the context of the above-mentioned Argentinean debt crisis in 2000-2001 and at the Financing for Development Conference 2002 the need for an international debt workout mechanism was discussed and the following paragraph was adopted by consensus:

“ To promote fair burden-sharing and minimize moral hazard, we would welcome consideration by all relevant stakeholders of an international debt workout mechanism, in the appropriate forums, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner. Adoption of such a mechanism should not preclude emergency financing in times of crises.” (Monterrey Consensus, para 60)

In 2001 the IMF put forward its proposals for a new Sovereign Debt Restructuring Mechanism (SDRM) in which some of the principles of domestic insolvency procedures were applied to sovereign countries. However, the SDRM had substantial flaws: It involved a cumbersome decision-making procedure that retained most of the inequities of existing processes. Primarily addressing public debt owed to private sector creditors the SDRM failed to deal with multilateral debt and bilateral creditors. More important the SDRM did not comply with basic demands regarding impartiality, transparency and a poverty perspective. IN April 2003 the IMF's SDRM initiative was blocked. Opposition mainly came from the US Treasury Department which did not want to see a legally binding framework, preferring the voluntary inclusion of so called ‘Collective Action Clauses’ (CAC) in bond contracts instead. Also emerging market countries were reluctant. Their main concern was that their borrowing conditions

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would be negatively affected by the simple existence of a debt workout mechanism that would bail-in private creditors stronger than before.

The voluntary inclusion of CAC may be a small step forward to creditor coordination in new bond contracts. However, they do not offer an exit to any of the already existing contracts. Nor do they allow for civil society in debtor countries to be heard. The concerns of emerging market countries on the other hand clearly reflect the coercive power of the international financial markets. While the status quo gives centrality to the interest of creditors (including multilateral institutions), resolving a debt crises can only work when the basic human needs and rights of the poor are met. Also voluntary Codes of Conduct cannot provide a sufficient answer to this systemic problem of a one-sided bias, as they keep all control on procedures and results in the creditors' hands.

A Fair and Transparent Arbitration Procedure (FTAP)

Since the 1990s, Non-Governmental and church-related Organisations and some scientists such as the Austrian economist Kunibert Raffer have already argued in favour of a different neutral debt workout process which draws from the experience of insolvency procedures. They found support in Chapter 9 of the US Civil Code which regulates insolvency cases of municipalities taking into account their special situation as public bodies with responsibilities and duties towards their citizens. The aim is setting up of a fair and transparent arbitration procedure to address unsustainable debt burdens, based on a neutral decision making body, the right of all stakeholders to be heard, the protection of debtors basic needs, and the institution of an automatic stay of debt servicing. This demand for an "international insolvency law" later became known as the "Fair and Transparent Arbitration Process" (FTAP), an international procedure where neutral courts of arbitration are established to ensure fair and equal relationships between debtors and creditors.

A Fair and Transparent Arbitration Procedure (FTAP) would establish a comprehensive mechanism that would be open to all countries and that would address private as well as bilateral and multilateral debts. The FTAP proposal argues that a truly comprehensive debt restructuring process must be driven by an independent institution, such as an international arbitration panel. Longer-term, a permanent body should be institutionalised under the aegis of the United Nations to deal with successive debt, the UN being a more legitimate organisation to host and coordinate these efforts than the IMF.

The adoption of a predictable framework for debt arbitration that would replace the present ad-hoc, case by case, exclusive creditor-led approach to debt cancellation with a system that achieves fairer balance between the interests of creditor and debtor. One well developed proposal FTAP³/Chapter 9 framework applies principles of domestic bankruptcy law and provide for an independent third-party to make judgements on the claims of the creditors.

Recommendations for a debt crisis resolution framework, include the following conditions:

- An **independent authority** should make all decisions on the claims of the parties,
- The debtor country should be able to initiate a unilateral process where they obtain immediate **stand-still protection** – endorsed by the independent authority.
- The independent authority in charge of the process should be explicitly empowered to rule on whether debts are illegitimate or **odious**.

³ Kunibert Raffer in CIDSE / Caritas Internationalis, 'Sustainability and Justice: A comprehensive Debt Workout for Poor Countries with an International Fair and Transparent Arbitration Process (FTAP)', Sept. 2004

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- All foreign currency debts owed by the sovereign government should be on the table. This should **include all debts** owed to private lenders, to other sovereign governments (bilateral debt) and to international financial institutions (multilateral debt).
- The process should be transparent and provide for the right of **civil society to be heard** at all relevant stages of the process: public hearings, publicity of sessions and decisions.
- Any agreement between the debtor and the creditors should ensure that the debt burden of the sovereign is reduced to a level that ensures that the service on the remaining debt does not impair the ability of the indebted country to fulfil **basic human rights** of the population and meet the MDG's.⁴

Debt Working Group of the NGO Committee on Financing for Development. The UN NGO Committee on Financing for Development of the Conference of Non-Governmental Organisations (CONGO), represents more than 40 international NGO networks, many of them faith-based organisations representing several million people in the North and South⁵.

⁴ Aldo Caliarì, based on CIDSE / Caritas Internationalis, 'Sustainability and Justice: A comprehensive Debt Workout for Poor Countries with an International Fair and Transparent Arbitration Process (FTAP)', Sept. 2004

⁵ These notes are based on the Talking points of the NGO Committee on Financing for Development