

DEFUSE THE DEBT CRISIS

**LESSONS TO BE LEARNED
FROM DEBT RELIEF IN
THE PAST**

THE CASES OF GHANA AND MOZAMBIQUE

Koos de Bruijn, Kristina Rehbein



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COLOFON

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INTRODUCTION

This paper is an abstract of research conducted by Erlassjahr.de and Jubilee Netherlands, which aimed to investigate the success of past debt relief efforts in Africa. The research was based on the presumption that debt cancellation resulted in debt relief, but not necessarily in a situation of structural debt sustainability.

This research has focused on the case studies on debt relief conducted in Mozambique and Ghana. Both countries received debt relief as part of the HIPC (Heavily Indebted Countries Initiative) and MDRI (Multilateral Debt Relief Initiative) initiatives, however there are strong indications that the debt relief did not result in a situation of structural debt sustainability in these countries. According to the Debt Sustainability Framework (DSF), Ghana was at moderate risk of debt distress in 2008. Due to the financial crisis, circumstances will most likely not have improved since then. Mozambique is at low risk of debt distress according to the DSF, but analysis by Erlassjahr.de revealed a higher risk (more details of this analysis will follow in the chapter on Mozambique). What this shows is that both Ghana and Mozambique are at risk of ending up in an unsustainable debt situation again.

The following questions will be addressed in this report:

- What were the origins of the debt unsustainability prior to HIPC and MDRI?
- Did debt cancellation result in a situation of debt sustainability?
- Did the cancellation of debt bring the countries closer to reaching the Millennium Development Goals (MDG) or help to achieve poverty reduction/economic growth?
- Is the debt stock currently sustainable? If not, why?

Debt distress in poor countries is often caused by geopolitical circumstances, of which the cold war is the clearest example. Both the US and the Soviet Union were eager to convince countries to take their side, also by lending. The excessive availability of cheap money - mainly the result of oil revenues after the 1970s oil crisis - is also to blame. The inflated capital flows that resulted have been major contributors to the debt crises in poorer economies. We are now seeing this pattern repeated in European countries such as Greece and Portugal and parallels can be drawn with the subprime mortgages in the United States.

In the late 1970's to the early 1980's, debt problems were triggered by internal factors in creditor countries that resulted in increased interest rates. These highly increased interest rates meant that debtors were unable to afford the debt-servicing required of them.

In 1996, the IMF and World Bank launched the HIPC-initiative to reduce the debt of some Heavily Indebted Poor Countries. However promising at first, it soon became apparent that the HIPC initiative was not able to help reduce debts to a sustainable level. There were several reasons for this, including the sheer number of multilateral loans and lower than expected export prices.¹ In addition, the high sustainability thresholds defined in 1996 (see text box HIPC on next page) meant that only six countries received some limited benefits through the initiative until 1999.²

In the meantime, there was increasing pressure from civil society organisations and the general public to do something about the debt issue. In 1999, the debt issue became an important part of the G8 agenda at its summit in Cologne, Germany. Campaigners from the Jubilee movement petitioned the G8 leaders to cancel poor countries' debt. In 1999, the petition was already signed by 17 million people worldwide. By 2000, some 24 million people had signed the petition. Although the campaign asked for more drastic measures, it led to an extension of the initial HIPC initiative: the result was additional and more efficient relief under a more flexible framework, or Enhanced HIPC.³

The Jubilee movement continued its public campaign, and in 2005 the issue again reached the G8 agenda, thanks to the movement's Make Poverty History campaign, with 250,000 people demonstrating at the G8 summit in Gleneagles, Scotland. A new debt initiative was agreed upon at that G8 summit, promising a 100% cancellation of multilateral debts, which were the result of loans made prior to 2003/04.⁴ This initiative was later formalised in the MDRI.

HIPC

The HIPC is a joint approach by the IMF and World Bank, designed to reduce the debt of selected low-income countries.⁵ To qualify for debt relief under the HIPC initiative, countries must have debt that is higher than 150 % of exports or more than 250 % of revenues and they have to be eligible to borrow from the World Bank's International Development Agency, which provides interest-free loans and grants to the world's poorest countries.

After successfully implementing structural conditions that are specified within a separate loan agreement with the IMF, and after approval of national poverty reduction strategy papers (PRSP), all debts above these thresholds are cancelled.⁶ The PRSPs place the responsibility on the countries, while the content of the strategies is dictated by the IMF and World Bank. These strategies include structural adjustments and the liberalisation of the movement of capital streams.

MDRI

The Multilateral Debt Relief Initiative (MDRI) provides 100% relief on eligible debt from three multilateral institutions (the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF)) to a group of low-income countries with loans made prior to 2003/2004. The initiative is intended to help these countries advance toward the United Nations' Millennium Development Goals (MDGs), which are focused on halving poverty by 2015.⁷ Contrary to HIPC, MDRI did not require countries to comply with additional IMF policy conditions. In fact, the MDRI was automatically granted after the HIPC completion point, which was dependent on meeting certain policy conditions and implementing economic adjustment programmes. Moreover, in many cases, MDRI resulted in a far more sustainable debt stock by the time it was granted.

THE PARIS CLUB

The Paris Club provides financial services such as war funding, debt restructuring, debt relief, and debt cancellation to indebted countries and their creditors. It was founded in 1956, as a result of crisis talks held in Paris between Argentina and its official creditors. The Club is an informal group of financial officials from the 19 members of the OECD, representing some of the world's biggest economies, but has neither legal status nor rules of procedure. Creditor governments are invited to participate if they have relevant claims on the debtor in question. Unfortunately, political considerations have often influenced the outcome of negotiations - thus undermining the Club's basic rationale: that comparable cases should be comparably treated.

COUNTRY CASE 1: MOZAMBIQUE

When HIPC was introduced in 1996, Mozambique was one of the first countries to qualify for the programme. As can be seen in Figure 1 the debt situation in the country was not sustainable according to the HIPC debt-to-export threshold, and the debt stock was still growing. The debt burden in Mozambique was caused by a number of factors:⁸

- Lack of human capital and infrastructure.** Independence from Portugal and destabilization in the area by apartheid neighbours South Africa and Rhodesia from the 1970s till the 1990s.
- Foreign reserves.** Following Mozambique's independence, foreign reserves were used to finance the current account deficit. Subsequently, a sharp decline in exports meant that Mozambique ran out of the possibility to earn foreign exchange.
- Nature.** Various floods and droughts caused huge damage to the country's infrastructure, human capital, domestic agricultural supply, and food security.
- Geopolitics.** During the cold war (1978-1982), bilateral loans amounting to approximately US\$ 2 billion (based on market rates during this period) were given to Mozambique, (mainly) by the Eastern bloc and oil-exporting countries.

The total assistance from HIPC and MDRI amounted to US\$6.2 billion in total (in nominal terms). An amount of US\$ 4.3 billion was cancelled within the HIPC initiative and US\$ 1.9 billion with the MDRI initiative.⁹

As can be seen in the figure below, the largest part of Mozambique's bilateral debt was owed to Paris Club creditors, particularly to Russia, France and Italy.

Figure 1:
Debt sustainability thresholds:
Debt-to-exports¹⁰ and Debt to GNI¹¹

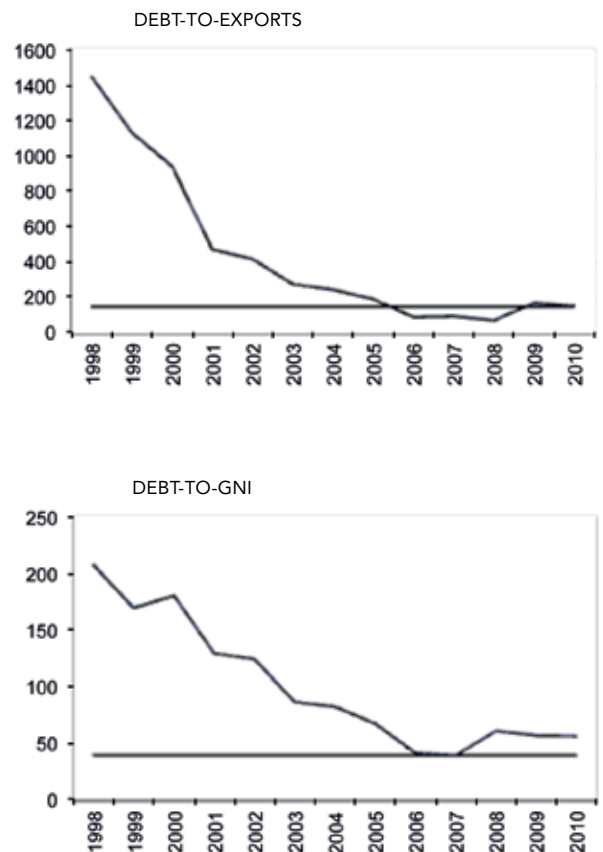
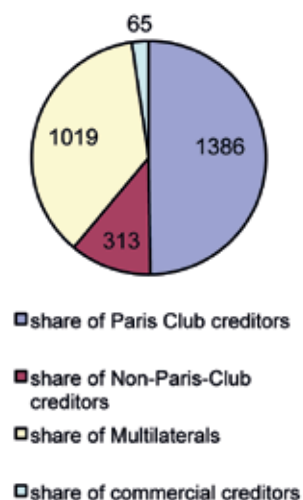


Figure 2:
Debt stock before debt relief in 2000



The debt relief significantly reduced Mozambique's debt burden. As illustrated in the following graph, the drop of debt service payments was mainly the result of MDRI relief. Those debts cancelled in 2001 under the HIPC Initiative mostly had not been served before completion point anyway. Thus, it can be concluded that debt relief within HIPC mostly functioned to clean creditor's books from unrecoverable loans.

Figure 3:
Debt service payments in millions of US\$¹²

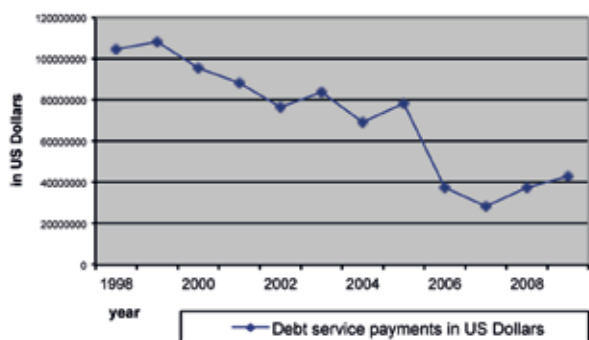


Figure 1 also shows that Mozambique's debt levels became sustainable after receiving MDRI relief in 2006, but only for a short time. As of 2009, the debt-to-GNI indicator reached critical levels again.

ECONOMIC DEVELOPMENT

After the debt cancellation there was economic growth. Foreign investors were attracted and resources for economic investments were freed up. While economic growth reduced during the financial crisis in 2009, annual growth rates have been holding steady at around 6 to 8 %.

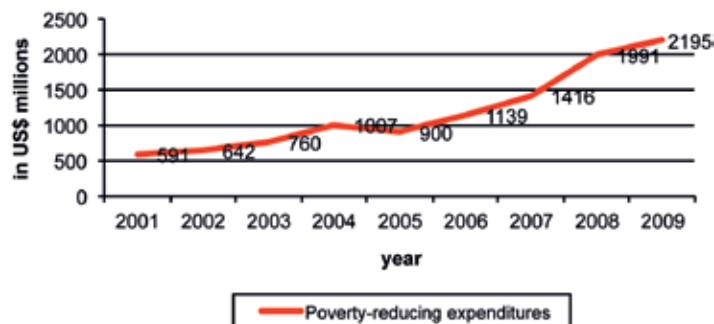
That said, Mozambique's economic growth has been dependent on a small number of mega-projects, such as the MOZAL aluminium smelter¹³ and "Pande"-oilfield.¹⁴ These projects make up more than 2/3 of the total export revenues. The IMF assumes that the share of mega-projects in the country's total export performance will remain high. To put into contrast, most of Mozambique's population is still employed in agriculture.¹⁵

Because the country's economic performance is highly influenced by external demand and the volatility of world market prices (for aluminium, for instance), the IMF has estimated that "a smaller proportion than usual of the export revenue could be considered 'available' to finance debt service".¹⁶

POVERTY REDUCTION

As can be seen in figure 4, debt relief made funds available for higher poverty spending. Mozambique's authorities consistently spent around 14-19% of GDP¹⁷ on poverty reduction. As well as the growth of national income poverty reducing expenditures have steadily increased since HIPC Completion Point, and especially after debt relief within MDRI.

Figure 4:
Poverty-reducing expenditures



Mozambique impressively doubled GNI per capita in only 10 years and absolute poverty has fallen rapidly. Remarkable successes have been booked in the areas of education and health. Primary school enrolment has increased sharply and infant mortality rates have been significantly reduced in the last ten years. However, more than half of the population still has to survive on less than US\$2 per day.

	1999 ¹⁸	2009 ¹⁹
GNI per capita	US\$230	US\$440
Poverty (% of population below national poverty line (US\$2 per day))	69%	55%
Life expectancy at birth in years	45 years	48 years
Infant mortality (per 1,000 live births)	134	96
Literacy (% of population)	57%	54%
Gross primary school enrolment in % of school-age population	71%	114%
Human Development Index	169	165

Table 1:
Human Development Indicators/
Economic Indicators 1999 and 2009

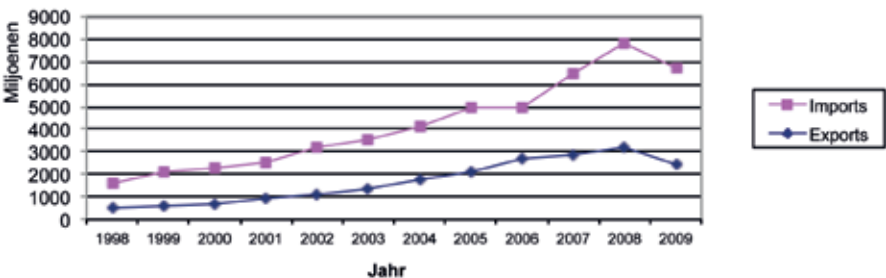
Although the overall percentage decreased, the absolute number of people living below the poverty line has increased from 10 million to 12 million due to a population growth of 3 million between 2003 and 2009.²⁰

Due to the current global economic and political climate, the available resources from donors for budget support are declining, as are aid flows in general. Therefore, fewer funds might be available for poverty reduction in Mozambique. Meanwhile,

the IMF believes that additional fiscal space and larger contributions by the financial sector are needed in order to sustain economic growth there.²¹

Until progress has been made, Mozambique will have to rely much more on concessional- and non-concessional external loan financing. It will also have to deal with a constant resource drain, since the country's import costs consistently exceed its export revenues (see Figure 5):

Figure 5:²²
Import costs and export revenues



DEBT SUSTAINABILITY

Mozambique is currently categorised by the IMF and World Bank as being at low risk for debt distress. However, this assumption is not well-founded. For example, the IMF and World Bank assume that:²³

- Mozambique has successfully negotiated outstanding debt relief of Non-Paris-Club-creditors in 2010, which is not the case, unfortunately. Mozambique is still negotiating with countries like Angola, Bulgaria, India, Iraq, Libya and Poland. If cancelled, this would reduce Mozambique's debt burden by 20%.
- The projections of debt sustainability are based on the assumption of high economic growth and a high return on infrastructure investments and large scale projects. However, Mozambique relies on external financing for this. Thus, the country's development is mostly based on its ability to generate debt - as well as to service debt in the end.
- The IMF and the Worldbank have a more optimistic assumption on the return of mega-projects, that are mostly foreign-owned.

Taking into account that import costs might increase further in the future, that growth assumptions are highly uncertain and volatile, and that donor support will decrease, the debt situation might not remain sustainable. This will be especially the case when looking at urgently needed resources for increased spending on poverty reduction.

Given those results it becomes clear that although debt relief led to a significant improvement of Mozambique's debt situation (it helped to restore repayment ability, triggered economic growth and led to some poverty reduction), it did not abolish future risks of debt distress or unsustainable debt burdens.

COUNTRY CASE 2: GHANA

The debt situation in Ghana was very unsustainable by the end of the 1990's as it was in Mozambique (see Figure 6). However, in 1996, when HIPC was launched, Ghanaian debt was declared sustainable,²⁴ only to be declared unsustainable a little later in 1999, thanks to lowered access thresholds.²⁵ The debt burden had become unsustainable for the following reasons:

- **Excessive cheap money.** Between the late 1970's and the early 1990's, total debt rose by over 300% due to loans for projects and public investments that yielded limited export earnings and low returns.
- **Falling commodity prices.** Cocoa and gold are the country's main export products and also major sources of foreign exchange. Cocoa prices fell dramatically between 1980 and 1983²⁶ and gold and cocoa prices sharply declined in 1999.
- **High fiscal deficit.** The country's continuous high fiscal deficit was driven partly by unproductive public spending that was not efficient in supporting equitable development (for instance, during the run-up to elections in 1992,²⁷ 1996 and 2000²⁸) and by the collapse of the cedi (the unit of currency in Ghana) in 1999/2000.
- **Heavy dependency on external inflows.** As in many other countries, the implementation of the Structural Adjustment Programme in Ghana, demanded by multilateral institutions such as the IMF and World Bank, had many shortcomings, such as the inability to diversify the structure of the economy and the heavy dependence on external inflows.²⁹

Figure 6:
Debt sustainability thresholds
(debt-to-export and debt-to-GNI)

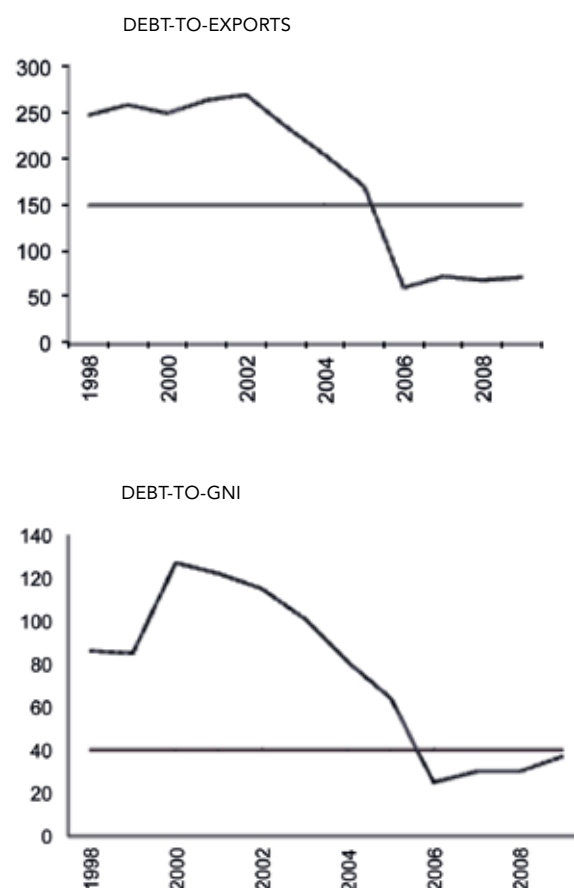
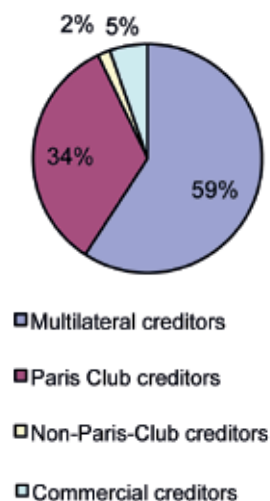


Figure 7:
Composition of creditors at time of
completion point (end-2003 data)

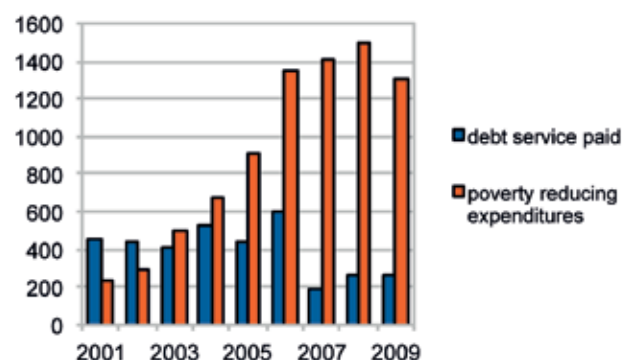


At the time of the HIPC-completion point in 2004, the debt stock amounted to 321% of government revenues.³⁰ Ghana received debt relief amounting to US\$3.5 billion (or US\$ 2.2 billion in Net Present Value (NPV) terms) under the HIPC initiative. Of this debt relief, bilateral (non-) Paris Club creditors provided US\$860 million (NPV)³¹ on a total of about US\$2 billion of total obligations. The largest bilateral creditors were Japan, UK, Germany, the Netherlands, France and Spain. The multilateral creditors provided US\$1102 million (NPV), while they accounted for almost twice the amount of bilateral debt owed by Ghana.

Ghana was therefore left with a high debt service burden to multilaterals after the HIPC initiative. This explains the country's increasing debt service even after completing the HIPC initiative (see Figure 8).

Debt service relief under the additional Multilateral Debt Relief Initiative (MDRI) brought another US\$1.9 billion³² in relief, leading to a sustainable level (see Figure 6). Together, the initiatives halved Ghana's debt burden.

Figure 8: Debt service paid compared to poverty reducing expenditures³³



	2004	2005	2006	2007	2008	2009	2010
domestic debt	1,830	1,927	3,133	3,821	4,315	4,273	5,618
external debt	6,448	6,348	2,177	3,586	4,035	5,008	6,111

Table 2: Evolution of public debt stock in US\$³⁵

ECONOMIC DEVELOPMENT

Ghana saved tens of millions of US dollars annually in the following years, since debt service obligations dropped significantly. In 2000, over 80% of domestic revenue went into debt servicing. This was lowered significantly to 27% in 2006,³⁴ which freed up a lot of additional resources to finance poverty reduction and invest in economic development.

After its completion point in 2004, Ghana's debt stock rose again. This was also caused by an increasing domestic debt stock, as can be seen in table 2 below. According to AFRODAD³⁶ domestic debt to revenues have nearly doubled between 2006 and 2009. In 2010, Ghana accumulated domestic payment arrears amounting to 9 % of GDP due to a lack of financing, consisting of expenditure arrears and central government liabilities for unpaid debts by state-owned enterprises.³⁷

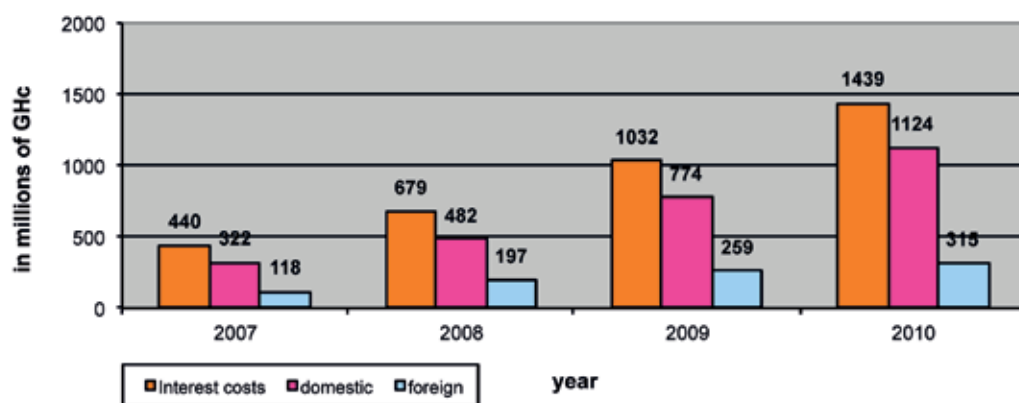
In spite of remarkable improvements in the country's tax administration and revenue-enhancing measures that substantially increased the collection of public revenues,³⁸ Ghana still faces high financing needs that are not sufficiently covered by external donor support and domestic revenues.

Ghana also relies on additional borrowing to bridge the gap between government revenues and expenditures, since insufficient grants are available. This expensive additional borrowing only makes matters worse, because the interest costs and debt servicing use up resources that are actually not available and are desperately needed for poverty reduction and investments.

This is aggravated by the fact that ODA inflows stagnated in the last decade.³⁹ Furthermore, Ghana's debt structure appears to be moving towards much more costly borrowing.⁴⁰

The increasing government-expenditure is largely a result of higher interest costs, which skyrocketed in recent years, the result of inflated domestic borrowing (see Table 2)

Figure 9:
Interest costs
in Ghana



POVERTY REDUCTION

In spite of the problems, debt relief initiatives contributed positively to poverty reduction in Ghana. Due to consistent economic growth, foreign investment, debt relief and the sound management of poverty-related expenditures, the overall poverty rate has declined substantially from 52% in 1992 and 39,5% in 1998 to 28.5% in 2006, indicating that the MDG-target of 26% could be achieved well ahead of 2015

Although remarkable progress in poverty reduction has been made, this progress was not distributed evenly. High poverty levels persist in the northern regions of the country. Over 70% of people whose incomes are below the poverty line can be found in the three northern areas and some coastal zones. Economic growth is mainly driven by particular economic sectors in the south, such as cocoa, gold and oil.

Table 3:
Human Development Indicators⁴¹

	1998	2009
GNI per capita	US\$ 380	US\$ 1,190
Poverty headcount ratio at \$2 a day (PPP) (% of population)	63%	54%**
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	39%	28,5%**
Infant mortality (per 1,000 live births)	68*	47
Literacy, adult (% of people ages 15 and above)	58%*	67%
Literacy, youth (% of people ages 15- 24)	71%*	80%
Life expectancy at birth (years)	59	57
School enrolment, primary (% net)	60% (1999 data, no data available for 1998)	76%
Human Development Index	132 (1994 data) ⁴²	130

*2000 data, no data available for 1998

**2006 data, no data for available for 2009

In 2005, Jubilee Netherlands found that Ghana would require an average of US\$1.16 billion a year to sufficiently finance the MDG targets.⁴³ Ghana received US\$1.3 billion in 2008 and US\$1.6 billion in 2009⁴⁴ in official development assistance. Hence, ODA inflows should be sufficient to finance the MDGs in general. However, the reality is harsher. The actual National Development Agenda 2010-2013 has an estimated financing gap of more than US\$3 billion annually.⁴⁵ One option to fill this gap, mentioned by the National Development Planning Commission, is to further access the capital market and use domestic financing.⁴⁶ This would make poverty reduction dependent on or determined by (costly) loan financing instead of non-refundable grants.

Since Ghana is a food and fuel importer, a rise in food and fuel prices might pose a significant future risk to the debt situation, and to budgetary space for poverty expenditures. This is especially important when considering the chronic deficit in the external balance.

Future hopes lie in the oil exporting sector, which should bring in about US\$ 1 billion annually.⁴⁷ This sector is expected to have the potential to provide the needed additional fiscal resources to achieve the MDGs⁴⁸ and to lower the risk of debt distress.⁴⁹

If resources are used effectively, oil exports could help to achieve export diversification and reach the MDGs. It might also help to reduce the dependence on other commodity exports such as cocoa and gold and could be used to expand productive infrastructure and sectors, including agriculture.

However, the history of oil exploration in Africa has shown that the exploitation of resources often leads to deterioration in government quality, a widening of social gaps and economic imbalances. There's also the risk of so-called Dutch disease, where dependence on one export pushes up the exchange rate, and therefore holds back the development of other sectors and the economy at large.

DEBT SUSTAINABILITY

The Debt Sustainability Analysis of the IMF and World Bank indicates that Ghana is currently at a moderate risk of debt distress.⁵⁰ Ghana faces certain risks that heavily impact the evolution and sustainability of its debt situation:

- **Fiscal vulnerability:** A deterioration of the fiscal balance, lower government revenues or a shortfall in oil income (caused by lower oil prices, for instance) would mean that more external financing is required to finance expenditures and deficits. This would impact the debt situation negatively.
- **Lower growth:** According to the IMF, Ghana would have a high risk of debt distress⁵¹ if faced with lower GDP and export growth, coupled with higher borrowing. Its debt sustainability could deteriorate significantly if higher economic growth does not materialise.⁵² The World Economic Outlook of the IMF projects the growth rate to return to pre-HIPC completion point (2004) again by 2016.⁵³

Debt relief clearly helped to create the conditions for sustainable economic development and freed up resources that were desperately needed to fight poverty. However, it could not solve all the problems faced by a developing country such as Ghana. These issues include its narrow export base and its heavy reliance on external donor inflows, as well as a lack of domestic resources to finance basic human development, social needs and further economic development. The country's heavy dependence on external sources to finance its development has led to a large accumulation of debt that might create a debt overhang. Such overhangs are known to keep developing countries trapped in a circle of financial fragility. This is a major problem for developing countries, since costly debt servicing takes away resources for poverty reduction and the build-up of social services.

According to representatives of civil society organisations in Ghana, debt has become a source of political discussion there. While the main opposition party argues that the debt level is escalating, the government claims that the debt level is currently only at 39% of GDP, and therefore sustainable. Although that assumption is correct, that percentage has been rising recently, which indicates an uncertain future.

CONCLUSION

As this summary has shown, debt relief programmes have contributed to important improvements in the past. In fact, debt relief programmes actually halved the debt stock in Ghana. In Mozambique the drop was almost 90%.⁵⁴

In general, debt relief efforts under HIPC (1996), enhanced HIPC (1999) and MDRI (2005) have definitely helped to reduce the unsustainable debt burdens of countries that have been included in the initiatives. Recent research by Jubilee Debt Campaign found that for 17 investigated HIPC-countries, debt repayments as a percentage of government revenue fell from an average of 19% in 1998 to 9% in 2005 and 5% in 2009.

The results in Mozambique and Ghana have been impressive:

The **reduction of debt stocks** positively impacted the countries. So, for instance, it allowed for significant economic growth in Mozambique and freed up resources in Ghana that were desperately needed to fight poverty. In Mozambique, the debt-to-export indicator dropped from more than 1,400% in 1998 to around 150% after debt relief. In Ghana, it dropped from 258% in 1999 to 65% in 2010.

Debt relief saved both countries millions of US\$ dollars it otherwise would have needed to repay these debts. This can be seen in the debt service statistics. In Mozambique, this dropped from more than US\$1 billion in 1998 to around US\$400 million in 2009. In Ghana, it dropped from approximately US\$450 million in 2001, rising to US\$600 million in 2006 and then dropped to around US\$250 million in 2008.

The fact that the drop in debt services was so significant after MDRI, point to the fact that most debts cancelled in the HIPC-initiative were unserviced anyway before HIPC-completion point. Thus, it can be concluded that debt relief within HIPC mostly functioned to clean creditor's books from unrecoverable loans.

Poverty reducing expenditures in Mozambique quadrupled in the 8 years between 2001 and 2009. Poverty reduction expenditure is also increasing in Ghana. In fact, it almost doubled between 2007 and 2010.

Unfortunately, this doesn't mean that poverty has been reduced to the same extent. In Mozambique, the population living on less than US\$2 per day dropped from 69% to 55% between 1999 and 2009. In Ghana, this level dropped from 63% to 54% between 1998 and 2009. A good development, but disappointing if one takes into account that the economy (in GNI per capita) in both countries more than doubled, and in the case of Ghana, even tripled.

It's clear that Ghana and Mozambique cannot risk a new debt crisis. That could lead to a fall-back in poverty expenditures and an increase in actual poverty levels. That is why it is worrying that both countries show rising debt service expenditures and are again at (moderate) risk of debt distress.

Unfortunately, this shows that debt relief in itself does not guarantee sustainable economic development. It doesn't prevent a country from getting into a debt problems again.

There is a clear risk of history repeating itself, because of the following reasons:

- Dependency on a few single goods, such as aluminium in Mozambique and coffee and oil in Ghana.
- Ongoing negotiations about past debts (a weak point in HIPC/MDRI: it doesn't include all creditors and therefore is not comprehensive). While the authors of the initiatives (such as Paris Club members, World Bank, IMF and others) provide the debt relief they have defined for themselves, other creditors are less inclined to do the same. A good example of this are countries like China, that are not part of the existing structures, but are playing an increasingly important role in lending funds to these countries.
- Increasing domestic debt (as the doubling of debt in Ghana between 2006 and 2009 shows), and an increasing burden of interest payments in the public debt.
- Domestic resource mobilisation is falling behind, because of weak tax administrations and tax evasion by MNCs.
- Structural adjustments required by creditors (particularly from the IMF and World Bank) often resulted in policy reforms that took important instruments away from developing country governments to direct and control capital inflows and outflows. HIPC was deliberately defined as a one-off operation and was never intended as an ongoing mechanism. This is based on the implicit assumption that over-indebtedness was a temporary exceptional problem that could be overcome once and for all. In Ghana and Mozambique we have seen that this is unfortunately not the case.

POLICY RECOMMENDATIONS

As has been argued in this paper, HIPC and MDRI were one-off solutions. Countries like Ghana and Mozambique, that have received debt relief, are currently again at some risk of debt distress. More systematic measures will be needed to achieve a structural and long term solution.

PROMOTE RESOURCE MOBILISATION

Instead of relying on lending, countries should be empowered to make use of their own resources. This can be achieved by tackling capital flight and tax avoidance.

INSTALL A DEBT COURT

Nobel Prize laureate Joseph Stiglitz, who advised the UN in 2009 about the consequences of the financial crisis, said:

"In those countries where the crisis is seriously threatening debt sustainability, consideration could be given to debt moratoria and, where appropriate, partial debt cancellation within the framework of a permanent international debt regime (...) This entails the creation of an International Debt Restructuring Court, similar to national bankruptcy courts (...)"⁵⁵

This proposal is not new. Adam Smith argued for orderly state insolvency in his famous book *The Wealth of Nations* of 1776:

"When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor."

Therefore, civil society organisations have been fighting for what Stiglitz calls an "International Debt Restructuring Court" with their *Defuse the Debt Crisis* campaign, which aims to set up a fair and independent Debt Court.

When a country faces debt distress, which Ghana

and Mozambique are at risk of, this court could assess both the sustainability and legitimacy of the debt stock. It would use a mechanism that is already used by corporate businesses and individuals around the world, i.e. national insolvency laws. These fairly and efficiently divide the assets of an insolvent debtor between creditors, while ensuring that the debtor is left with enough resources for survival and dignity, and forbidding creditors from having access to the debtor's basic resources.

Nowadays, sovereign debtors rely on the willingness of their creditors to solve debt crises. In the cases of Ghana and Mozambique, the IMF and World Bank - both big creditors of these countries - decided if, and how much, debt was cancelled. The same goes for the Paris Club.

Creditors use this power to defend their own interests. For example, in the case of Mozambique, the debts cancelled in the HIPC-initiative were debts that were not expected to be repaid anyhow. Moreover, this situation allows for a continuation of irresponsible lending and collecting of illegitimate debt claims. When one looks at the Structural Adjustment Programs in Ghana and Mozambique, one can see that debt and debt relief are often used as a tool to enforce specific policies onto borrowing countries.

Introducing an international insolvency regime would be an important step toward an international financial system that is more predictable, fair and conducive to development. It would:

- 1) Give priority to a government's obligations to meet the essential needs of its citizens.
- 2) Discipline imprudence on behalf of both lenders and borrowers (thus leading to more responsible lending).
- 3) Elevate debt restructuring decisions to a neutral and legitimate forum. And thus:
- 4) Let irresponsible creditors pay for their irresponsible lending behaviour.

PROMOTE RESPONSIBLE BORROWING AND LENDING

As we have seen in this summary, the Debt Sustainability Framework (DSF) is not a flawless mechanism. According to the DSF, Mozambique is not at risk of debt distress, while erlassjahr.de found it clearly is.

The World Bank/IMF's Debt Sustainability Framework was launched in 2005 to assess low-income countries' risks of debt distress, and based on this risk assessment determine whether its finance should come in the form of grants or loans. The DSF provides the basis of allocation for the IDA (the World Bank's concessional lending arm) and is now accepted practice across the Bank, such as in the new Climate Investment Funds, and increasingly by other groups of lenders such as the OECD Export Credit Group. However, the DSF marks no fundamental shift from an understanding of debt sustainability merely in terms of what a country can afford to repay, rather than the required human-needs based approach.

Also, the reality is that there are not enough grants to go around, which means that countries may be forced into non-concessional borrowing even when they are aware of the risks. Moreover, the World Bank's policy on non-concessional borrowing states that countries which do take on what it considers as excessive levels of new unconcessional debt may be punished by having their IDA allocations reduced or the terms of IDA loans hardened. No punishments on lenders for lending "imprudently" are foreseen.⁵⁶

A lasting solution requires both good debt management by borrowing countries and responsible behaviour by lenders. See Afrodad's borrowing charter that presents principles and guidelines for good borrowing⁵⁷ (including debt management) and Eurodad's responsible finance charter⁵⁸ doing the same for creditors.

END THE „ODA-BILITY“ OF DEBT CANCELLATION

Most donors are at present "cheating their way" towards the agreed United Nations aid target of 0.7% ODA/GNI by including cancellations of defaulted commercial debt in their ODA figures. This blatantly misleads the public, who is led to believe that rich country aid is spent on the poor in developing nations. The Organisation for Economic Cooperation and Development (OECD), a group of rich countries that defines rules on Official Development Assistance (ODA) expenditure reporting, actually allows creditor countries to report debt cancellation related to commercial export credits as aid. This practice must end, or at least the relevance to development of the credits should be examined.

NOTES

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