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A CRITICAL REVIEW OF THE HIPC PROCESS

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Introduction

Debt relief has become a prominent issue in recent discussions about development, poverty and the relationship between developed and developing countries. The debt problems of the poorest countries have attracted the attention of development agencies that fear that the crisis may worsen poverty and economic decline in which the indebted nations are trapped. The inability to serve external debt by the severely indebted low-income poor countries is vividly reflected not only in massive build-up of arrears but most importantly by the number of frequency of rescheduling. Thus the debate on debt relief is no longer confined to economic and financial spheres; it is transcending every human domain-health, education, agriculture and industry.

Many development agencies and skeptics have expressed widespread doubts regarding the Heavily Indebted Poor Countries Initiative (HIPC) launched in 1996 and its successor the Enhanced Heavily Indebted Poor Countries Initiative (EHIPC) 's ability to achieve the promised objective of a "robust exit from the burden of unsustainable debts" for developing countries. Problems associated with the design and implementation of the initiative suggest that neither of the two HIPC versions has succeeded in providing adequate response to the Third World 's debt overhang. An analysis of key debt indicators shows that external debt and debt-servicing problems are most severe and persistent in the heavily indebted poor countries (HIPCs), the target group of the HIPC Initiative.

Throughout the process, creditors failed to put sufficient political will, resources and serious analysis into the debt reduction operations. Debt reduction targets were set and reset arbitrarily - writing off 30 percent, then 50 percent, and so on-rather than based on serious assessments of the needs of each country. Despite claims of success by creditors for their Heavily Indebted Poor Countries (HIPC) initiative for debt reduction, the IMF estimated that Africa's debt service payments would only go as low as 17.1 percent of export earnings in 2001 (down from 20.3 percent in 1999, before rising again to 18.4 percent in 2002. This is still a crippling economic burden, as African leaders as well as debt cancellation campaigners continue to stress. The overwhelming majority of the debt is owed to the World Bank and the IMF. But neither the international financial institutions nor the rich creditor countries gave any indication that they were willing to consider more than marginal adjustments in the HIPC program.

The process has been much slower than expected and the initiative is suffering from problems of under funding, excessive conditionality, and restrictions over eligibility, inadequate debt relief and cumbersome procedures.

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The Concept of HIPC

The HIPC initiative entails coordinated action by the international financial community, including multilateral institutions to reduce to 'sustainable' levels the external debt burden of heavily indebted poor countries that demonstrated sound economic and social policy reforms. Extreme poverty, poor social development indicators and human resources, poorly diversified economies, a high concentration of export earnings in a few primary commodities, and dependence on official aid as well as high debt overhang in general characterize the HIPCs.

Beneath the HIPC initiative, a country is considered cured of its debt crisis if it is current on its debt servicing, did not restructure its debt in the Paris Club during 1997-2001, is not a candidate for relief under the Heavily Indebted Poor Countries (HIPC) initiative, and was not under an IMF lending program during 1999-2001. Thus, sustainable debt levels under HIPC I meant a debt to export ratio of between 200 to 250%, and a debt service to exports ratio of between 20-25%. Sustainable debt should not exceed two and a half times the value of exports.

A Critical Appraisal of the Process

Sustainable debt definition

There has been disagreement in what constitutes 'sustainable debt' in the HIPC initiative. Sustainability' is subject to the determination of export performance and many debt campaigners fear overly optimistic calculations will reduce the amount of debt reduction and may mean that countries fall back into the debt trap.

It seems the International Financial Institutions are only in interested in Third World debt crisis when it reaches proportions that threaten the poor countries' ability to service their debt to Northern creditors. Thus sustainable debt to the Bretton Woods is when a country reaches a level where it can meet its current and future repayment obligations in full-meaning interest plus principal without compromising economic growth and need for further relief. Debt relief has not managed to ease domestic expenditure constraints and the curbing of investments.

The 22 African countries that have so far qualified to receive some relief are still required to pay almost $2 billion each year in debt repayments to wealthy creditor countries and institutions, mainly to the World Bank and IMF themselves. African countries' efforts to address urgent domestic priorities, from poverty reduction to the fight against HIV/AIDS, continue to be undermined by their persistent debt burden. Most African governments still spend up to three times more on debt repayments than on health care for their own people

Not only are some countries spending more on debt payments after they receive debt relief, but they are overshooting the World Bank and IMF's own definitions of debt sustainability. [2] Uganda, the first HIPC graduate, currently has debts of over 200% of the debt-to-exports ratio. This will be the third time Uganda has exceeded its debt sustainability after reaching Completion Points. Surprisingly, the World Bank and IMF have changed definitions of debt sustainability to include liquidity as the operative criterion.

Uganda has conformed to rigid economic conditions imposed by the Bank and the Fund for ten years and urgently needs financial breathing space. One child in five dies before reaching age 5 in Uganda, yet the government spends $3 per person on health and $17 per person on debt repayments. The Ugandan government has anticipated HIPC relief in its current budget plan and had allocated some of the freed-up resources to primary education. Without the promised debt relief it is estimated that 1.7 million children may be sent home from school[3].

The amount of relief given is not sufficient to put a country on a sustainable path to debt reduction. Ethiopia, for example will have its total debt stock reduced by 47% at completion point, the benefits of this relief over the short run will be felt through reductions in debt service. Yet, even after HIPC assistance Ethiopia's debt service will remain high- more than $74 million per year for the next twenty years, and more than $100m from 2004/05 onwards, absorbing roughly 5% of government revenues.

HIPC is too economic to address social concerns

The initiative's focus on purely economic criteria in assessing a country's debt burden betrays an utter lack of concern for human development and for the capacity of poor countries to meet the needs of their own people. The socio-economic gains made as a result of enhanced debt relief are by no means universal and, where they exist, they are limited and precarious.

The HIPC countries, continue to face development challenges such as the spread of HIV/AIDS, low levels of literacy and poor nutrition, equipped with only scarce and highly vulnerable domestic resources.

Taking Burkina Faso for instance, although HIPC will bring down her existing external debt value to below the HIPC sustainability threshold of 150% of exports her total debt will

[2] Africaaction, A Critique of the HIPC, www.africaaction.org, June 2002.
[3] Halifax Initiative, Update and Action Alert. March 2002.

remain at between 180% and 190% of her exports until beyond 2015[4]. The country still has some of the worst human development indicators, with 45% living below the poverty line and life expectancy is 46.1years.

There is no correlation between debt relief and poverty reduction; the two derive from separate motivations. Debt relief is suppose to reflect the repayment capacity of poor countries while there is little evidence that poverty reduction as addressed in the Millennium Summit Declaration explicitly relates to debt relief.

Conditionalities

The HIPC initiative is further flawed because it is tied to controversial economic adjustment measures. In his speech to the International Monetary and Financial and Development Committees in Prague on September 24 and 25, 2000, Canadian Finance Minister Paul Martin develops a critique of the current HIPC process, including Poverty Reduction Strategy Papers (PRSPs), especially the overburdening of countries with a huge quantity of conditions to fulfill before receiving debt relief. Martin cites the problem of overburdening the HIPCs with "unrealistic conditionalities", and an excessive concern among creditors with the "quantity of conditionality rather than its quality." He says;

"*…. the requirement that developing countries undertake a comprehensive, inclusive and long term process at an unprecedented speed—a process that developed nations themselves have never had to undertake. The overburdening of countries with a huge quantity of conditions to fulfill before receiving debt relief; the delay in countries reaching not just the decision point, but the completion point—that is, the delay in countries receiving debt relief. Plus the unrealistic expectations by creditors in the development of PRSPs.."* [5].

The economic policy conditions attached to the HIPC process mirror the same prescriptions that have been imposed by the World Bank and IMF on African countries for the past two decades, with disastrous results. Tying debt relief to conditions determined by creditors undermines African priorities and initiatives and affords creditors an inordinate degree of control over the running of African countries.

The HIPC process itself is longer than the stipulated six years before the relief is given. Uganda had to take 11 years, 5 more than 6 and the social gap is met according to the donors' preference and not Ugandans' preference. The 'rule of the thumb threshold values' does not go hand in hand with the social reality in the severely indebted poor countries.

[4] Jubillee 2000 Research: Profile Burkina Faso Analysis.
[5] Analysis of the Statements of Canadian Finance Minister, Paul Martin, Prague, September 24&25,2000. www.ceji-iocj.org

For example, the annual debt service pf 20-25% of a country's annual exports does not in any reflect the human development indicators in Uganda. Thus many debt campaigners have argued that the process of debt relief should be seen through the lens of the relationship between the north and the south in a globalising world. There are losers and winners in the process.

The HIPC initiative's conditions are not different from those of Structural adjustment programmes. Between 1980 and 1987 half of the countries in Sub-Saharan Africa (22 out of 44) introduced adjustment programmes. The adjustment programmes were adopted under duress by African governments who were desperate to obtain financial assistance from Western governments, donor agencies and international financial institutions. As Mkandawire and Olukoshi (1995) noted the programmes were also implemented in the face of considerable local opposition that was in form of protests and demonstrations against hardships. All resistance was repressed with varying levels of brutality.

Exclusion of Other eligible Countries

Many NGOs, development activists and academics have argued that the approach for debt relief should not be limited to HIPCs but should incorporate a broader spectrum of countries in need of special measures to overcome their official debt problems. In recognition of the unsustainable debt burden, not less than 13 out of 15 West Africa countries representing about 87per cent of ECOWAS members have come under the HIPC classification. It is interesting to observe that although Nigeria's debt stock is the largest in West Africa and the country is experiencing growing poverty, she has not been recognized as an HIPC eligible country. Debt relief has been more successful in protecting the interests of the creditors than the debtors. It is actually designed and controlled by creditors to extract the maximum possible in debt repayments.

According to the UN Secretary General's report of 2000 there are 18 least developed countries that are not included in the HIPC category, and some of them are considered severely or moderately indebted according to the World Bank classification. For instance, most of the debt-distressed African countries are classified, as moderately indebted middle-income countries such as Zimbabwe while Gabon and Nigeria are both severely indebted yet excluded from the HIPC initiative[6].

[6] UN A/55/422 General Assembly 26 September 2000

HIPC ignores the illegitimate debt

The HIPC Initiative obfuscates the illegitimacy of most of Africa's debt. As such, it fundamentally undermines the strong imperative for debt cancellation. It sanctions the continued exploitation of indebted countries by rich creditor nations and institutions. Many of the loans that are being re-paid were made during the Cold War to repressive regimes and corrupt leaders, who used the money to strengthen their rule or to line their own pockets. Many more loans were made without attention to the viability of planned projects or to the capacity of the recipient country to make repayments.

No foreign loan granted to South Africa during the apartheid years could have been legitimate because the apartheid state was itself illegitimate; and any attempt to claim ignorance of this fact would not be credible.

HIPC Policy Reforms are Debt and Poverty-Creating

Macro economic and structural reforms are being done with inadequate safety nets to cushion negative impact on the poor. In Tanzania, the ongoing process of structural adjustment, particularly privatization under the pretext of HIPC has adverse social impacts such as massive retrenchment and acceleration of poverty in general (i.e. through reducing access of the poor to the essential services offered by public utilities).

Out of 20 HIPCs that have already reached HIPC decision point, 4 countries (Mali, Niger, Sierra Leone and Zambia) will have annual debt service payments due in 2003-2005 which will actually be higher than their annual debt services paid in 1998-2000. 5 countries will be paying almost as much in debt service payments as before HIPC (Ethiopia, Guinea-Bissau, Honduras, Nicaragua, Uganda). In 6 countries, a modest $15 million in 2003-2005 will reduce annual debts serviced. The medium to longer term projections on debt servicing are also alarming - Senegal's debt service jumps by 61 per cent in 2004; Nicaragua's rises by 60 per cent in 2002; Mauritania's rises by 46 per cent in 2007; and Honduras faces an increase of 93 per cent in 2002. Over half of the HIPCs are spending more than 15% of their government revenue on debt servicing.[7]

Despite modest recovery in some countries, poverty has intensified, and human development indicators-life expectancy, infant mortality, and school enrolment have worsened. The export basket remains un-diversified. Since the start of the HIPC process the fragile industrial base has shrunk even further (de-industrialisation) in many countries. In Short, HIPCs worsened the crisis on a number of scores. The debt under HIPCs, strongly and negatively affects economic growth, threatens the sustainability of reforms, and prevents the development of a capable and functioning state due to the fiscal crisis that it engenders.

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[7] **A Joint Submission to the World Bank and IMF Review of HIPC and Debt Sustainability , www.cafod.org.uk**

In Tanzania since the introduction of SAPs and later HIPC, factories that were privatised have been working at lower capacity with fewer staff and a number have gone out of operation. A Case in point is the textile industry that was once a growth industry has collapsed. The initial perception of job creation from the privatisation exercise has not proven to be valid. Tanzania's debt also increased rapidly from US$2 257 million in 1980 to more than US$5bilion at the beginning of the 1990s.[8].

Although Tanzania is spending more on education than on debt service, its budgetary allocation for health is less than what it is paying back to creditors[9]. This has serious implications, particularly for a country where 40% of the population dies before the age of 35.In April 2001, several donors under the guidance of the Bretton Woods institutions asked Tanzania to prepare a Poverty Reduction Strategy Paper (PRSP). When James Wolfensohn of the World Bank and Horst Kohler of IMF visited Tanzania in February 2001 the message from civil society activists was loud and clear:

"*Cancel Africa's debts, without imposing conditions and support Africa's effort to combat HIV/AIDS'*[10]

Tanzania's foreign debt stands at about US$ 7billion. This compels government to spend a third of its monthly revenue in debt service, another third in civil servants payments, and the balance is thinly spread over public operations and social services. Privatisation has not really broadened the revenue base through increase in taxes. Privatisation has rather meant massive retrenchments and more suffering for the ordinary Tanzanian. A growing income gap, galloping inflation, sky-rocketing prices of basic commodities, illiteracy, diseases such as HIV/AIDS and malaria, and natural disasters contribute to Tanzania's poverty

Lack of Creditors' commitment.

Using tactics including extending qualifying periods for debt reduction, juggling statistics which determine debt sustainability, and by attempting to attach new conditions, many G-7 governments are trying to minimize the amount of money they put in the pot.

In most cases multilateral creditors have failed to provide sufficient relief and have thus violated 'the burden of sharing' approach to the HIPC initiative. For example Burkina's completion point document shows that when calculating the additional relief to be provided, the World Bank and IMF include d the additional bilateral conditions committed by creditors such as the UK, US, Germany and France, openly violating 'the burden of sharing' approach[11].

[8] Mwanza, 1991 SAPEM vol 4 No. 9. p18
[9] Melly.P. and Ette. M. (2001) Debt Relief in News Africa magazine, March 12, 2001.
[10] Melly.P. and Ette. M. (2001) Debt Relief in News Africa magazine, March 12, 2001.

[11] Halifax Initiative, Update and Action Alert. March 2002.

The Overall Picture

Despite all these efforts and their measures since 1996 the debt of all developing countries has climbed from $2.2 to $2,6 trillion, while their economic output has marginally fallen. The point is debt relief has not been adequately as expressed by the President of Guyana;

'Although alleviated by the HIPC and other related arrangements our debt burden remains a serious impediment to progress. There is an urgent need for deeper and wider relief .' (Bharrat Jagdeo, President of Guyana, 6th September 2000)

In reality debt service is being reduced by just over a third that is inadequate if one considers the recipient countries' socio-economic challenges. Take for instance the floods in Mozambique and the more than one million children orphaned by the HIV/AIDS scourge in Uganda. The HIPC initiative have been failing because it is designed by creditors and controlled by creditors, who determine who gets what when and how.

Paul Martin, the Canadian finance Minister could not hide his frustration at the slow pace of the HIPC during the Prague meeting. He called for a moratorium on debt payments to bilateral creditors for countries reaching decision point in the HIPC initiative. The HIPC initiative had very little benefit to the vast majority of people living in countries concerned, as they remained victims of falling commodity prices and carriers of unsustainable debt burdens.

Kofi Annan's 21st Century Action Plan speech sums the real need well;

'I would go a step further and propose that, in future, we consider an entirely new approach to handling the debt problem. The main components of such an approach could include immediate cancellation of the debts owed by countries that have suffered major conflicts or natural disasters; expanding the number of countries in the HIPC scheme by allowing them to qualify on the grounds of poverty alone…..'

Recommendations

1. The way in which debt relief is calculated for each country needs to be reviewed and alternatives adopted. The reliance on a debt-to-export ratio to calculate debt relief packages, based on World Bank and IMF projections, is flawed.
2. There is need for an independent panel of experts not unduly influenced by creditor interests to reassess the debt sustainability, eligibility for debt reduction, and the amount of debt reduction needed, conditionality and financing of developing countries.
3. 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
4. Reform of the international strategy regarding official debt of poor countries should address the problems of debt distressed low-income countries that are not currently eligible for special treatment accorded to the HIPCs.
5. Third World governments should be afforded the chance to determine their own approaches to poverty reduction, in consultation with civil society groups and other partners - not to have these prescribed to them by external powers.

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6. Needless to re-iterate, the idea of all countries caught in the debt trap forming a cartel to maximise the effectiveness of an international campaign of debt repudiation has been around for some time.

Conclusion

The analysis above shows that there are serious flaws in the HIPC initiative's approach to Third World debt crisis. Levels of debt repayment after HIPC initiative debt relief are far too high, undermining the necessary investment needed to accelerate poverty reduction. In the absence of radical reform, HIPC will join a long list of failed poverty reduction initiatives. Past and present initiatives at international debt relief are increasingly acknowledged to be inadequate and flawed. The creditors should not monopolise decision making on debt resolutions, there is need for the debtor countries to come up with their own initiatives.

The IMF and World Bank are off-track on meeting their performance benchmarks in the HIPC initiative. Any solution to the debt crisis must move beyond debt relief and conditionality, to consider debt within the wider context of equitable and sustainable development. It should address socio-economic and developmental relations between debtor and creditor countries. Needless to state again that if global efforts to reduce poverty and fight underdevelopment are to be successful, Third World's debt must be canceled outright.

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