4.9 The role of international debt[1]

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Syllabus Objectives

Foreign debt and its consequences

• Outline the meaning of foreign debt and explain why countries borrow from foreign creditors.

• Explain that in some cases countries have become heavily indebted, requiring rescheduling of the debt payments and/or conditional assistance from international organizations, including the IMF and the World Bank.

• Explain why the servicing of international debt causes balance of payments problems (flows of money in and out of a country) and has an opportunity cost in terms of foregone spending on development objectives.

• Explain that the burden of debt has led to pressure to cancel the debt of heavily indebted countries.

Indebtedness

Many developing countries have borrowed significant amounts of money from western banks. Often this money has been spent on failed infrastructure projects, arms or left the country due to corrupt officials (capital flight).

Conditional assistance from the IMF - Structural Adjustment Policies (SAP's)

Due to developing countries suffering a major debt crisis, the IMF set up strict guidelines (policies that needed to be adopted) before loaning money to developing countries. These included:

- Encouraging trade liberalisation
- Encouraging exports in primary commodities
- Devaluing the currency
- Encourages FDI
- Privatisation of nationalised industries
- Reducing government expenditure to balance budgets
- Removing subsidies and price controls
- Improving governance (legal system, reducing corruption)

Costs of SAP's

- Increased prices of essential goods (due to the removal of subsidies)
- Increasing unemployment (falling currency rates increases production costs)
- Fall in real wages levels

Should debts for developing countries by cancelled or reduced?

- Debt relief relates to debt servicing. Nigeria struggles to make interest payments, let alone pay back loans. For example they borrowed 17 billion, but now owe 34 billion.
- Servicing debt = opportunity cost.
- Debt servicing slows down economic growth and development

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- Malawi spends more money on debt servicing than it does on providing health care. Debt relief would allow Malawi to increase spending on health care and education.
- Odious debt (not servicing the needs of the people) is often symptomatic in developing countries. Should thus debt be cancelled as the IMF or World Bank could be argued as being equally at fault.

Problems of Debt

- Higher taxes (to service the debt)
- Environmental damage (to increase production)
- Increased unemployment
- Increased international (and internal political) conflict

Heavily Indebted Poor Countries Initiative (HIPC)

2005 IMF and World Bank launched multilateral debt relief initiative in order to accelerate progress towards the millennium development goals. 40 sub-saharan African countries are eligible.

A summary of the necessary conditions for HIPC qualification

To be considered the country must:	In order to receive full and irrevocable reduction in debt under the HIPC initiative a country must:
1. Eligible to borrow from the World Bank's development agency	1. Establish a further track record of good performance under programmes supported by loans from IMF and world bank
2. Face an unsustainable debt burden	2. Implement key reforms
3. Track record in establishing sound policies through IMF and World Bank support programs	3. Adopt and implement poverty reduction strategy paper
4. Have a poverty reduction strategy paper (developed in partnership)	
Once the above has been achieved a country may receive interim debt relief	**Once the above is satisfied then full debt relief could be granted**

28 of 40 potentially eligible countries are currently receiving full debt relief. These countries include Niger, Haiti, Burkina Faso, Benin, Afghanistan, Ethiopia, Cameroon …

IMF view of debt relief:

- Boosts social spending (health and education)
- Reduces debt servicing (interest payments)
- Improves debt management … countries become more cautious with their borrowing policies