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Debt relief

Clean slate

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Should poor countries' debts all be written off?

EPA

A step out of debt?

WITH backers that include Bono and the pope, the campaign for poor-country debt relief has proved a powerful coalition. A decade ago, international institutions, such as the International Monetary Fund and the World Bank, denied that debts owed to them needed to be forgiven at all. Since 1996, however, a programme, inelegantly called the HIPC initiative, has tried to cut the debts of 38 heavily-indebted poor countries to "sustainable" levels. Now, ahead of the autumn meetings of the IMF and the Bank this weekend, America and Britain are touting rival plans to rub out the debts entirely.

America wants simply to write off the debts of HIPC countries. George Bush's Treasury officials point out that part of the money these countries borrow from international institutions goes straight back to Washington to service existing loans. Why not simply cancel the debt and switch to grants? Although the Treasury is not promising any new money, it says that eliminating debt would be a big step forward.

Britain, by contrast, is offering more cash and wants more countries to get help. On September 26th, Gordon Brown, the chancellor of the exchequer, said that the goal should be debt relief of up to 100% for all poor countries, not just those that are officially deemed to be heavily in debt. To "lead by example", he promised that Britain would pay its share (10%) of the debt service owed by poor countries to the World Bank and the African

Development Bank. He also called for the IMF's gold to be revalued to help pay the Fund's share of the debt write-off.

Debt activists are delighted. They hope that rivalry between rich countries will bring both debt write-offs and pledges of new money. Staff at international institutions are more sceptical, particularly about the American proposal, which they argue will drastically cut their resources. Debt forgiveness, they say, means that less money will flow back to the institutions to be lent to other poor countries later.

A better question, though, is whether total debt relief makes any sense. There is no doubt that the HIPCs include the world's most desperate countries. Virtually all are in Africa; many are ravaged by AIDS. In all, 27 countries have had some relief, and 14 have seen some debt eliminated. More than half of the total HIPC debt stock has been written off, saving the borrowers $900m a year in debt-service payments. Yet many HIPCs still have unsustainable debts. The current HIPC initiative will not solve their problems.

The political appeal of the American plan to wipe out debt and then move wholly to grants is plain. However, there is little evidence of the generosity necessary to make it work: the Bush administration has so far been unable fully to fund its own ambitious bilateral-aid plan, the Millennium Challenge Account.

That said, fears about the plan's effects on the financial health of the multilateral institutions are overblown. Bank staff point out that eliminating HIPC debt would reduce their soft-loan fund's capital base by 25% in present-value terms, and hence their future capacity to lend to the poorest countries. The hit would come after a decade, because the Bank's soft loans have a ten-year grace period. But this assumes that today's HIPC countries really will be in good enough shape to begin net repayments by then. It is more likely that they will not be able to resume repayments—in which case debt cancellation will make the Bank's finances no worse.

The problems with America's ideas lie elsewhere. Eliminating all the HIPCs' debts is both unfair and risky. The HIPCs do not include all the poorest countries, just the ones that are both poor and heavily indebted. Why should Uganda have all its debts cancelled but not Bangladesh, a poor country that has managed its debts more competently?

By broadening the prospect of relief to all poor countries, the British proposal eliminates that inequity. But it does not eliminate the risks associated with complete forgiveness, particularly that debt elimination might not foster prudent policies in the future.

One reason to worry is that newly debt-free countries could be tempted to rash new borrowing. Some private-sector lenders might be foolish enough to lend to a country with such a dismal credit history, but no current debt burden. Another possible cause for concern is the loss of “conditionality”. Once multilateral debt has been wiped out, the Bank and the IMF lose much of their leverage over poor countries' policies. That said, the evidence that “conditionality” leads to good policies is mixed at best, particularly when the World Bank and others are in effect renewing unrepayable loans perpetually.

The truth is that poor countries need more resources from the rich. If competition to sound most generous leads rich countries to put more money in the aid pot, then it is worth pursuing. But HIPC debt relief alone is no panacea.