

# Advance Unedited Version

Distr.: General  
15 May 2013

Original: English

## Human Rights Council

### Twenty-third session

Agenda item 3

**Promotion and protection of all human rights, civil,  
political, economic, social and cultural rights,  
including the right to development**

## **Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephias Lumina\***

### **An assessment of the human rights impact of international debt relief initiatives**

#### *Summary*

For close to two decades, the World Bank and International Monetary Fund have coordinated international efforts to address the debt crisis of low-income countries through two main mechanisms: the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI). The aim of these initiatives is to reduce the debt burdens of the beneficiary countries to levels deemed “sustainable” by the two institutions and to help fund poverty reducing expenditures and progress towards the Millennium Development Goals.

According to the World Bank and IMF, these debt relief efforts have “significantly reduced” the debt burdens of the participating low-income heavily indebted poor countries while enabling them to scale up “poverty-reducing” expenditures. To the extent that it can be shown that increased social spending in HIPC completion point countries is the result of debt relief, it can be argued that the initiatives have had a positive impact on poverty reduction. Nevertheless, it is difficult to establish a causal relationship between debt relief and increased poverty-reducing expenditure. Indeed, the empirical evidence on the social impacts of the two international debt relief schemes presents an inconclusive picture.

Not intended to be a permanent mechanism to relieve the external debt burdens of the recipient countries, the HIPC Initiative is now winding down and the future of international debt relief efforts remains uncertain. In this context, the present report

\* Late submission.

assesses what the initiatives have achieved in terms of poverty reduction, development and human rights. The report argues that the completion of the HIPC Initiative provides an opportunity to address the shortcomings of the existing debt relief mechanisms and to devise new strategies that fully address the underlying causes of the debt crisis including through human rights-based debt relief strategies.

The present report is submitted pursuant to Human Rights Council resolution 16/14.

## Contents

	<i>Paragraphs</i>	<i>Page</i>
I. Introduction .....	1–5	4
II. Understanding debt relief .....	6–13	4
A. What is “debt relief”? .....	6–9	4
B. How debt relief under the initiatives works .....	10–13	5
III. Impact of debt relief .....	14–32	6
A. Fiscal impacts .....	14–24	6
B. Poverty reduction and development.....	25–29	9
C. Human rights .....	30–32	10
IV. Limitations of current debt relief initiatives .....	33–52	11
A. Creditor dominance .....	34–35	11
B. A rigid definition of debt sustainability .....	36–41	11
C. Harmful conditionalities .....	42–45	12
D. Lack of additionality .....	46–47	14
E. Vulture fund litigation .....	48–50	14
F. Other shortcomings.....	51–52	15
V. International debt relief: what next?.....	53–68	15
A. Reinforcing the principle of shared responsibility .....	56–58	16
B. Establishing an impartial international debt workout mechanism .....	59–61	17
C. Prioritizing domestic resource mobilization .....	62–64	18
D. Reforming the international financial system .....	65–68	19
VI. Conclusions and recommendations .....	69–70	19

## I. Introduction

1. There are currently two main international debt relief initiatives aiming at reducing the external debt burdens of low-income countries: the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).<sup>1</sup>
2. The HIPC Initiative was launched in 1996 by IMF and World Bank with the aim of reducing the external debt burdens of the most heavily indebted poor countries to a level deemed “sustainable” by the two institutions. In 1999, it was comprehensively reviewed in order to provide more substantial debt relief and to strengthen the links between debt relief, poverty reduction and social policies.
3. In 2005, the Enhanced HIPC Initiative was supplemented by MDRI, which was designed to further reduce the debt of HIPCs and provide resources for the attainment of the Millennium Development Goals. Under the MDRI, the International Development Association (IDA), IMF, the African Development Fund (ADF) and the Inter-American Development Bank (IDB) provide 100 percent debt relief on eligible debts (that is, loans disbursed by IMF, ADF and IDB by end-December 2003 and those disbursed by IDA by end-December 2003 and still outstanding after HIPC Initiative debt relief).<sup>2</sup>
4. As of March 2013, 35 of the 39 countries that have been assessed eligible or potentially eligible under the HIPC Initiative had reached the completion point,<sup>3</sup> one country (Chad) was in the interim phase of the Initiative while three pre-decision point countries – Eritrea, Somalia and Sudan – had yet to start the process of qualifying for debt relief under the Initiative.<sup>4</sup>
5. According to the World Bank and IMF, the two international debt relief initiatives have helped significantly reduce the external debt burden of HIPCs and enabled these countries to scale up poverty-reducing expenditure. The present report assesses the impact of the initiatives on poverty reduction, development and human rights.

## II. Understanding debt relief

### A. What is “debt relief”?

6. The presentation of debt relief under the current international initiatives as a key source of funding for poverty reduction has, together with the largely unclear nature of debt relief, led to high expectations as regards the impact of debt relief.

---

<sup>1</sup> For an overview of debt relief efforts for low-income countries, see Boris Gamarra, Malvina Pollock and Carlos A. Primo Braga, “Debt Relief to Low-Income Countries: A Retrospective” in Carlos A. Primo Braga and Dorte Domeland (eds) *Debt Relief and Beyond: Lessons Learned and Challenges Ahead* (Washington, D.C., World Bank, 2009), pp. 11-33.

<sup>2</sup> In the case of IMF, non-HIPCs with per capita income below \$380 are also eligible.

<sup>3</sup> Afghanistan, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Comoros, Cote d’Ivoire, Democratic Republic of the Congo, Ethiopia, the Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Republic of Congo, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Togo, Uganda and Zambia.

<sup>4</sup> International Development Association (IDA) and International Monetary Fund (IMF), “Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Statistical Update,” 25 March 2013.

7. The term “debt relief” refers to any type of reorganisation of debt which lessens the total debt burden of the beneficiary. Under the HIPC Initiative, debt relief takes various forms including cancellation (or “forgiveness”), restructuring and rescheduling.

8. Cancellation occurs when the creditor and the debtor formally agree that an outstanding debt or part of it, no longer needs to be repaid. In other words, cancellation extinguishes all or part of the financial obligation of the debtor to the creditor. Restructuring is a process whereby the creditor and the debtor agree to alter the terms previously established for repayment of a debt. This may include forgiveness (extinction of the debt), or rescheduling which can be implemented either by revising the repayment schedule by lengthening the period or extending a new refinancing loan.<sup>5</sup> Rescheduling refers to a postponement of the payments due (including interest) for a specified period of time in order to reduce near-term debt service obligations, thereby providing “relief” to the debtor country.<sup>6</sup> Rescheduling may also include forgiving or extinguishing a part of the loan.

9. It should be noted that, as opposed to other sources of finance, debt relief resources do not constitute new money from external sources.<sup>7</sup> Their direct effect is to allow beneficiary countries to retain general budget resources that would otherwise have been spent on debt servicing. The resulting fiscal space can either be used to increase poverty reducing expenditures, to pay down debt (both domestic and foreign) or to lower taxes. In addition, for countries that had not been servicing their debt in full, the fiscal space resulting from debt relief is smaller than the stated volume of nominal debt relief. In short, “one dollar of debt relief does not necessarily translate into one additional dollar of expenditure on poverty.”<sup>8</sup>

## B. How debt relief under the initiatives works

10. In order to be eligible for debt relief under the HIPC Initiative, a country must meet specified conditions, commit to poverty reduction through policy changes and establish a track record of macroeconomic stability. As a first step, a country must: (a) be eligible to borrow from the IDA, which provides interest-free loans and grants to the world’s poorest countries, and from the IMF’s Poverty Reduction and Growth Trust, which provides loans to low-income countries at subsidized rates; (b) have a debt burden deemed

<sup>5</sup> See [www.oecd.org/glossary/0,2586,en\\_2649\\_33721\\_1965693\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/glossary/0,2586,en_2649_33721_1965693_1_1_1_1,00.html)

<sup>6</sup> For example, in 2010, five HIPC completion point countries - Afghanistan, the Democratic Republic of Congo, the Republic of Congo, Liberia and Togo - concluded stock of debt restructuring agreements with the Paris Club involving a total of \$13 billion of which \$8.9 billion was cancelled. Similarly, Guinea-Bissau concluded an agreement (on Cologne terms entailing a 90 percent net present value reduction) in July 2010 to restructure a total of \$171 million, including arrears of principal and interest as of 31 December 2009 and maturities falling due from 1 January 2010 to 31 December 2012. Under the terms of the agreement, \$54 million was cancelled while \$117 was rescheduled over the three year consolidation period. See World Bank, *Global Development Finance: External Debt of Developing Countries* (Washington, D.C., World Bank, 2012), p. 11.

<sup>7</sup> S. Arslanalp and P.B. Henry, “Helping the Poor to Help Themselves: Debt Relief or Aid?” Working Paper 10230 (Cambridge, MA, National Bureau of Economic Research, 2004), cited in M. Kaddar and E. Furrer, “Are current debt relief initiatives an option for scaling up health financing in beneficiary countries,” *Bulletin of the World Health Organization*, vol. 86, No. 11 (November 2008) p. 3.

<sup>8</sup> Kaddar and Furrer, “Are current debt relief initiatives an option for scaling up health financing in beneficiary countries,” pp. 1-9.

“unsustainable”<sup>9</sup> by the World Bank and IMF and which cannot be addressed through traditional debt relief mechanisms; (c) have established a track record of reform and “sound policies through IMF- and World Bank-supported adjustment program”; and (d) have adopted a Poverty Reduction Strategy Paper (PRSP)<sup>10</sup> through a broad-based participatory process in the country.<sup>11</sup>

11. Upon meeting or making sufficient progress in meeting these four conditions, the World Bank and IMF formally decide on the country’s eligibility for debt relief and creditors commit to reducing its debt to a “sustainable” level. At this initial stage, referred to as the “decision point,” creditors, multilateral and bilateral creditors, begin to provide interim relief on debt service falling due. However, this interim relief may be stopped if the country goes off track with its reforms.<sup>12</sup>

12. In order to reach the “completion point” and receive full and irrevocable reduction in debt under the HIPC Initiative, a country must (a) establish a further track record of “good performance” under IMF and World Bank programmes; (b) implement to the satisfaction of the IMF and World Bank key reforms “agreed” at decision point; and (c) adopt and implement its PRSP for at least one year.

13. It should be noted that the portion of debt that creditors are asked to forgive (the “common reduction factor”) is calculated to bring the country’s debt to the sustainability threshold of 150 per cent of present value of exports (or in some cases, 250 per cent of government revenue). Thus, debt relief under the initiatives does not necessarily entail extinguishing all of the debtor country’s debt.<sup>13</sup>

### III. Impact of debt relief

#### A. Fiscal impacts

14. The total cost of providing assistance to the 39 countries eligible or potentially eligible under the initiative is estimated at \$112.9 billion (\$76 billion under the HIPC Initiative and \$36.9 billion under the MDRI) in end-2011 net present value terms.<sup>14</sup>

15. According to the World Bank and IMF, debt relief under the initiatives has “substantially” reduced debt burdens in recipient countries and enabled these countries to increase their poverty reducing expenditure.<sup>15</sup> For the 36 post-decision point HIPCs, the

<sup>9</sup> The World Bank and IMF consider a low-income country’s debt unsustainable if either (a) its external debt exceeds the value of its exports by a ratio of 150 per cent, or (b) the ratio of its debt-to-government revenues is above 250 per cent.

<sup>10</sup> The PRSP links debt relief and poverty reduction: it consists of a report by the debtor country on the macroeconomic and social policies and programmes to be implemented under its strategy for growth and poverty reduction. It also describes the requirements for and sources of external funding. The PRSP is subject to approval by the World Bank and IMF.

<sup>11</sup> International Monetary Fund, Factsheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative, available from [www.imf.org/external/np/exr/facts/hipc.htm](http://www.imf.org/external/np/exr/facts/hipc.htm)

<sup>12</sup> This was the case, for example, with the Gambia, Guinea, Guinea-Bissau and Malawi.

<sup>13</sup> In 1998, IMF rejected calls for outright cancellation of the entire external debt of HIPCs as “unrealistic” and raising “false expectations” in view of the reduced net official development assistance (ODA) flows. See IMF, “HIPC Initiative: The IMF’s Response to Critics,” available from [www.imf.org/external/np/hipc/res.htm](http://www.imf.org/external/np/hipc/res.htm).

<sup>14</sup> IDA and IMF, “Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Statistical Update,” 25 March 2013, p. 4.

<sup>15</sup> *Ibid.*, p. 3.

average poverty debt service payment relative to GDP has dropped from 2.9 per cent of GDP in 2001 to 0.9 per cent of GDP in 2011.

16. It is, however, not easy to measure the direct fiscal impacts of debt relief.<sup>16</sup> A decision to cancel a given nominal amount of debt does not necessarily result in an immediate cash flow gain. These may arise over time. Further, although the reduction in debt service payments may have contributed to improved social indicators, it may not be the main avenue through which these reported improvements have occurred. Other factors have also contributed to the reduction in debt payments, including higher prices for commodity exports, robust economic growth and increased government revenue. The experience of the Plurinational State of Bolivia appears to support this view.

17. Bolivia first had some debt cancelled under the HIPC Initiative in 1998 and then again in 2001. According to a recent report by Jubilee Bolivia (Fundación Jubileo), this debt relief made little reduction in the total level of debt. The amount of debt increased between 1998 and 2005, with debt payments peaking in 2005 and only falling after further debt relief. The report indicates that there has been a noticeable reduction in poverty and inequality since 2007, along with improved social and economic outcomes. The proportion of the population living in extreme poverty fell to 26 per cent in 2009 and there has been an improvement in health and social outcomes. The country has also experienced robust economic growth, with GDP per capita rising from \$1000 in 2005 to \$2000 in 2010.

18. Debt savings from 2005 have been correlated with higher prices for the country's hydrocarbon and mineral resources. Although the Government's external debt has increased by \$700 million since 2007, it has continued falling as a percentage of GDP due to economic growth. In contrast to other HIPCs, Bolivia has had a trade surplus since debt relief, averaging 1.7 per cent of GDP since 2006 (compared to a deficit of 3.7 per cent from 1997 to 2005). All other post-completion point HIPCs have continued to record trade deficits

19. It is also important to note that some countries which had substantial arrears to multilateral institutions before entry into HIPC actually saw their debt service costs rise by joining HIPC. The reason for this is that one of the HIPC conditionalities was that all arrears to multilateral creditors be cleared before decision point. This was an enormous problem for a number of countries such as Burundi, the Democratic Republic of Congo, Guinea-Bissau and Sierra Leone. The arrears were refinanced by grants or bridging loans. In the case of the Democratic Republic of the Congo which had arrears of 80 per cent of total debt (or \$10.6 billion) before it joined HIPC in 2002, the payments amounted to 20 per cent of government revenue, on average, from 2002 until it completed HIPC in 2010.

20. The World Bank and IMF further report that debt relief "has markedly improved the debt position of post-completion point countries, bringing their debt indicators down below those of other HIPCs or non-HIPCs" and, while recognising that many remain vulnerable to shocks, particularly those affecting exports as evidenced during the global economic crisis, the IMF advises these countries to "pursue cautious borrowing policies and strengthen their public debt management" if they are to reduce their debt vulnerabilities "decisively."<sup>17</sup>

21. Are the debt reductions under the initiatives enduring? The available evidence suggests that they may not be. According to a 2008 study of 16 post-HIPC completion point

<sup>16</sup> D. Cassimon and others, *Dynamic Fiscal Impact of the Debt Relief Initiatives on African Heavily Indebted Poor Countries (HIPCs)*, Document de Travail, DT/2013-01 (Dauphine Université Paris, January 2013), p. 6.

<sup>17</sup> IMF, *Factsheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, 2 April 2013, available from [www.imf.org/external/np/exr/facts/hipc.htm](http://www.imf.org/external/np/exr/facts/hipc.htm)

countries, on average, the net present value of external debt service relative to average exports for these countries, assuming the provision of relief in 2004 under the MDRI, was expected to increase from an initial ratio of 22 per cent in 2004 to 176 per cent in 2015, rising to a peak of 242 per cent in 2026.<sup>18</sup> In March 2009, IMF reported that the debt-to-GDP ratios of 28 low-income countries exceeded 60 percent<sup>19</sup> – twice the debt sustainability threshold set by IMF and the World Bank for countries with weak institutions. In 2011, the two institutions reported that “a third of low-income countries (were) either in debt distress or at high risk of debt distress” and that “a quarter of the post-completion point HIPC” were at “high risk of debt distress.”<sup>20</sup> A more recent IMF and World Bank assessment indicates that although none of the post-completion point HIPC is currently considered in debt distress, one fifth (7 countries) are at high risk of debt distress.

22. Moreover, the HIPC Initiative aims to bring the net present value of the debt/export ratio to below the 150 per cent threshold, but at least 13 HIPC had a higher ratio at completion point, with two (the Gambia and Uganda having ratios higher than at decision point).<sup>21</sup> Yet others have seen their debt indicators deteriorate after receiving debt relief. For example, Uganda’s ratio swelled to over 300 per cent within three years of its HIPC completion point. According to a June 2012 debt sustainability analysis, debt relief under the initiatives reduced Tanzania’s debt burden to 20.6 per cent of GDP at end-June 2007.<sup>22</sup> Nevertheless, by end-June 2011, the country’s external debt had risen to 34.7 per cent of GDP. It is notable that the assessment refers only to central government debt but acknowledges that “contingent risk from debt by other state-owned enterprises and pension funds could be sizable.” In the case of Haiti, the external debt burden has reduced but the country’s narrow export base poses a problem for debt sustainability.<sup>23</sup> In particular, Haiti remains at high risk of debt distress.

23. An issue of further concern is that substantial borrowing on the international capital markets has raised public debt to GDP levels of some HIPC to pre-relief points. The impact will depend on whether the new borrowing translates into productive investment and growth.

24. This suggests that debt relief under the two initiatives has generally not reduced the vulnerability of heavily indebted poor countries,<sup>24</sup> with many remaining profoundly dependent on foreign borrowing and investment. It is also evident that, with their particular focus on correcting imprudent debt management on the part of the indebted countries, the

<sup>18</sup> Jacinta Nwachukwu, “The Prospects for Foreign Debt Sustainability in Post-Completion Point Countries: Implications of the HIPC-MDRI Framework,” Working Paper No. 26 (Manchester, Brooks World Poverty Institute, University of Manchester, February 2008), p. 12.

<sup>19</sup> IMF, *The Implications of the Global Financial Crisis for Low-Income Countries*, March 2009, available from [www.imf.org/external/pubs/ft/books/2009/globalfin/globalfin.pdf](http://www.imf.org/external/pubs/ft/books/2009/globalfin/globalfin.pdf)

<sup>20</sup> IDA and IMF, “Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation and Proposals for the Future of the HIPC Initiative,” 8 November 2011.

<sup>21</sup> Benin (216 %), Burkina Faso (208.7%), Ethiopia (218.4%), the Gambia (242 %), Ghana (152%), Malawi (229.1%), Mauritania (256%), Niger (208.7%), Rwanda (326.5%), Senegal (154%), Sierra Leone (202.3%), Uganda (258%) and Zambia (174%).

<sup>22</sup> IDA and IMF, *United Republic of Tanzania: Joint Bank-Fund Debt Sustainability Analysis 2012 Update*, 15 June 2012, p. 2.

<sup>23</sup> IMF and IDA, *Haiti: Joint Bank-Fund Staff Debt Sustainability Analysis 2012*, 23 February 2012, pp. 1-2, 9.

<sup>24</sup> In 2009, UNCTAD raised concerns that there was potential for a new debt crisis to emerge in poor countries because of the global financial crisis. See UNCTAD, *Least Developed Countries Report 2009*, available from [www.unctad.org/Templates/webflyer.asp?docid=11721&intltemlID=2068&lang=1](http://www.unctad.org/Templates/webflyer.asp?docid=11721&intltemlID=2068&lang=1)

initiatives have ignored and failed to address the underlying causes of the debt problem such as unfair terms of trade, irresponsible lending and poor policy prescriptions by the international financial institutions.

## B. Poverty reduction and development

25. Recipient countries under the international debt relief mechanisms have to commit to allocate resources freed up by debt relief to key anti-poverty programmes which are outlined in their PRSPs. Due to the fungibility of public expenditures in most national budgets, however, it is not easy to track debt relief savings and therefore properly ascertain their impact on poverty reduction. Moreover, the empirical evidence on the impact of debt relief on social spending is inconclusive. While some studies have found a positive correlation between debt relief and increased social spending,<sup>25</sup> others have found that debt relief has had little or no effect on such spending in HIPC.<sup>26</sup>

26. According to IMF and the World Bank, however, for the 36 countries that have benefitted from debt relief, these expenditures have increased on average from 6.3 per cent of GDP in 2001 to 8.8 per cent of GDP in 2011.<sup>27</sup> Before the HIPC Initiative, eligible countries were, on average, spending “slightly more” on debt service than on health and education combined.<sup>28</sup> As a result of debt relief they have increased markedly their expenditures on health, education and other social services. On average, such spending is about five times the amount of debt-service payments.”

27. Nevertheless, it is also evident that conditionalities that have accompanied debt relief have exacted substantial social costs, including high unemployment and increasing poverty and inequality and have had an adverse effect on the realization of a number of

<sup>25</sup> See, e.g. J.D. Lewis, “What comes after debt relief? Some preliminary thoughts,” *GREAT Insights*, vol. 2, No. 1 (January 2013); Jesus Crespo Cuaresma and Gallina Andronova Vincelette, “Debt Relief and Education in Heavily Indebted Poor Countries,” in Carlos A. Primo Braga and Dorte Domeland (eds) *Debt Relief and Beyond: Lessons Learned and Challenges Ahead* (Washington, D.C., World Bank, 2009), pp. 35-48; E. Lora and M. Olivera, “Public debt and social expenditure: friends or foes?” Working Paper No. 563 (Washington DC, Inter-American Development Bank, 2006), available from <http://ssrn.com/abstract=905964>.

<sup>26</sup> See, e.g. S.E. Dessy and D. Vencatachellum, “Debt relief and social service expenditure: the African experience, 1989-2003,” *African Development Review*, vol. 19, No. 1 (2007), pp. 200-216; N.D. Chauvin and A. Kraay, “What Has 100 Billion Dollars Worth of Debt Relief Done for Low- Income Countries?” *International Finance* (Econ-WPA) (2005) 0510001; Ralf Hepp, Health Expenditures Under the HIPC Debt Initiative, August 2005; Arslanalp and Henry, “Helping the Poor to Help Themselves”; W. Easterly, “How Did Heavily Indebted Poor Countries Become Heavily Indebted? Reviewing Two Decades of Debt Relief” *World Development*, vol. 30, No. 1 (2002) pp. 1677-96.

<sup>27</sup> See <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,print:Y>

<sup>28</sup> However, independent studies indicate a considerably higher level of spending on debt servicing relative to expenditure on basic social services such as education and healthcare for many HIPCs. For example, between 1992 and 1997, the portion of the national budget devoted to basic social services and debt service for some HIPCs was: Cameroon – 4 per cent on social services and 36 per cent on debt service; Cote d’Ivoire – 11.4 per cent on social services and 35 per cent on debt service; Tanzania – 15 per cent on social services and 46 per cent on debt service; and Zambia – 6.7 per cent on social services and 40 per cent on debt service. See D. Millet and E. Toussaint, “Figures relating to the debt for 2009” (Brussels, CADTM, 2009). See also Christian Barry, Barry Herman and Lydia Tomitova, *Dealing Fairly with Developing Country Debt* (2007), p. 2; Jubilee Debt Campaign, “Debt and Public Services,” Briefing (2007); Alcino Ferreira, Camara Neto and Matias Vernengo, “Lula’s Social Policies: New Wine in Old Bottles?”, Working paper, Department of Economics, University of Utah (2006-2007), p. 11; Lucie Stephens, *Debt relief as if justice mattered* (2008) p. 11.

basic human rights. For example, Zambia completed the HIPC Initiative in 2005 receiving a total of \$6.6 billion in debt relief through HIPC and the MDRI. Although the country has used the savings from debt relief to eliminate school fees and user fees in rural health centres and to fund infrastructure projects, it remains poor with approximately 64 per cent of the population living on less than \$1 a day. The country generates three-quarters of its foreign exchange earnings from copper mining. However, a privatization deal that favoured foreign companies has reduced the benefits that the country has received from this vital sector.

28. The impact of debt relief on development and on progress towards the MDGs is even less certain. In 2011, the World Bank and IMF, while reporting that HIPCs had increased their poverty-reducing expenditure, noted that these countries “have made uneven, and in some cases, limited progress towards achieving the MDGs.” Only a quarter of completion point HIPCs were on track to achieving Goal 1 (to eradicate extreme poverty and hunger), with progress toward Goal 5 (to improve maternal health less certain. Moreover, only a few HIPCs were on track to attain Goal 8 (to build a global partnership for development).

29. Similarly, a recent World Health Organization and UNICEF report covering 68 countries where more than 95 per cent of all maternal and child deaths occur notes the limited progress towards the MDGs.<sup>29</sup> The report indicates that 49 of the countries surveyed were off track for achieving Goal 4 (to reduce child mortality) and 5 (to improve maternal health). It is worth noting that 33 of the countries surveyed are HIPCs, including 27 post-completion point HIPCs.

## C. Human rights

30. According to some studies, a key benefit of savings from debt relief has been an expansion in public education and access to health care. In several countries, debt relief savings allowed governments to abolish user fees (initially introduced as a condition of IMF and World Bank adjustment lending in the 1980s and 1990s). According to World Bank estimates, in 2011, health expenditures in the 32 post-completion HIPCs rose from 5.2 per cent of GDP in the period 1995 to 2000 to 6.6 per cent in the period 2006-2009. In the field of public education, user fees have been reduced, with primary school enrolment increasing, from 59 per cent of children in the early to mid-1990s to 83 per cent in 2010, in the 19 HIPC-completion point countries for which data are available.<sup>30</sup>

31. In Mauritania and the Plurinational State of Bolivia attended births increased from 40 per cent to 60 and 70 per cent presumably after funds from debt relief were directed to the health sector. In Benin, the Plurinational State of Bolivia, Sao Tome and Principe and the United Republic of Tanzania, debt relief savings were used to fund schemes to educate mothers about nutrition and family planning. Similarly, Benin and Niger used savings from debt relief to increase access to water.

32. To the extent that it can be established that such increase in public expenditure is attributable to increased fiscal space provided by debt relief, it can be argued that debt relief has contributed to enhancing the conditions for the realisation of human rights such as the rights to health, education, water and sanitation. Nevertheless, as the example of the

<sup>29</sup> World Health Organization and United Nations Children’s Fund, *Countdown to 2015 decade report (2000-2010): Taking stock of maternal, newborn and child survival* (New York and Geneva, WHO and UNICEF, 2010), p. 1.

<sup>30</sup> See IDA and IMF, “HIPC Initiative and MDRI Initiative: Status of implementation and proposals for the future of the HIPC Initiative,” 8 November 2011.

Plurinational State of Bolivia (see paras. 17-18 above), causality is difficult to establish. The problem is compounded by the fact that many recipient countries do not have specific systems to manage and track spending from debt relief savings.

## IV. Limitations of current debt relief initiatives

33. The existing debt relief schemes have a number of shortcomings which, according to one commentator, appear to indicate that they have “not been quite as successful as claimed by the IMF and World Bank.”<sup>31</sup>

### A. Creditor dominance

34. A major criticism of the initiatives is that they are entirely creditor-driven and that impoverished countries overburdened with debt have no choice but to accept the onerous conditions imposed by creditors even where these are clearly not in their national interest. With respect to debt sustainability assessments conducted by the World Bank and IMF, for example, it has been asserted that given that these institutions are “the single most important creditors – in quantitative or qualitative terms or both – to most ... debtor countries ... the recovery value of these institution’s claims depends directly or indirectly on their own assessment.”<sup>32</sup>

35. In the Independent Expert’s opinion, creditor dominance of the existing debt relief mechanisms is inconsistent with the principle of shared responsibility of creditors and debtors for preventing and resolving unsustainable debt situations.

### B. A rigid definition of debt sustainability

36. One of the most contested elements of current international debt relief initiatives is the notion of “debt sustainability,” which has been defined narrowly by creditors according to the ability of debtor countries to repay their debts in terms of their export earnings.

37. In the context of debt relief, sustainability assessments are conducted by the World Bank and IMF using the Joint Debt Sustainability Framework for Low-Income Countries which the two institutions introduced in April 2005 “to help guide the borrowing decisions of low-income countries, provide guidance for creditors’ lending and grant allocation decisions to ensure that resources are provided to LICs on terms that are consistent with both progress towards their development goals and long-term debt sustainability and improve World Bank and IMF assessments and policy advice.”<sup>33</sup>

38. The assessments involve making projections of intended borrowings and economic variables over a 20-year period and then using ratios comparing debt stock, present value or service with gross domestic product, exports or budget revenue to assess payment capacity. This approach simply assesses whether, given certain analyses of economic growth, external trade dynamics and availability of external financial resources, a debtor country is able to service its debt. Thus, the criteria for assessing debt sustainability focus almost

<sup>31</sup> Sarajuddin Isar, “Was the Highly Indebted Poor Countries Initiative (HIPC) a Success?” *Journal of Sustainable Development*, vol. 9, No. 1 (2012), pp. 107-122.

<sup>32</sup> See Jurgen Kaiser, “Commentary on IMF/World Bank: Revisiting the Debt Sustainability Framework for Low-Income Countries,” erlassjahr.de Working Paper (Updated version), 9 February 2012, p. 1.

<sup>33</sup> World Bank and IMF, *Revisiting the Debt Sustainability Framework for Low-Income Countries*, 11 January 2012, p. 1.

exclusively on the ability of debtor countries to repay their debts; they do not take into account a country's ability or human rights obligation to provide basic services (such as safe water, sanitation, healthcare, education and housing).

39. In 2009, the Framework was reviewed to address concerns that it had “unduly constrained the ability of [low-income countries] to finance their development goals”.<sup>34</sup> The aim of the review was to afford countries greater space to borrow more to cope with the challenges of the global economic downturn. Thus, the framework was “flexibilized” to enable countries to take on more debt without being deemed in debt “distress”. The revised Framework excludes certain State liabilities (i.e., debts of State-owned enterprises) and includes migrant remittances as contributions to countries' capacities to their external debt. In 2012, the Framework was further reviewed “to assess whether it [remained] adequate in the light of changing circumstances” in low-income countries.<sup>35</sup>

40. The assumptions underlying IMF and World Bank debt sustainability assessments have been questioned. For example, in 2007, the IMF's Independent Evaluation Office reported that “there is evidence that investment is consistently overestimated in IMF-supported programmes.”<sup>36</sup>

41. It is clear that the IMF and World Bank's definition of debt sustainability is not only very narrow but does little to advance the poverty reduction goals of debt relief, let alone sustainable development. In the Independent Expert's view, debt sustainability analyses should take into account the need to safeguard government spending required to meet basic human development needs and to establish the conditions for the realization of human rights, particularly economic, social and cultural rights. Put differently, debt sustainability analyses should include an evaluation of the level of debt that a country can carry without compromising its capacity to fulfil its human rights obligations and to pursue its own development agenda.

### C. Harmful conditionalities

42. In addition to the eligibility criteria for debt relief under the HIPC Initiative, indebted countries have to satisfy a plethora of other policy conditions similar to those imposed through structural adjustment programmes.<sup>37</sup> These include privatization of public utilities (sometimes called “public sector reform”)<sup>38</sup>, deregulation, removal of subsidies (including those that benefit the poor), cuts in public spending, introduction of user fees for

<sup>34</sup> See IMF and World Bank, “A review of some aspects of the low-income country Debt Sustainability Framework”, 5 August 2009.

<sup>35</sup> IMF and World Bank, “Revisiting the Debt Sustainability Framework for low-income countries”, 12 January 2012.

<sup>36</sup> IMF, Independent Evaluation Office, *Fiscal Adjustment in IMF-Supported Programmes* (Washington, DC, IMF, 2003), p. 4. See also John Weeks and Terry McKinley, *Does Debt Relief Increase Fiscal Space in Zambia?* (2006) p. 6; J.J. Teunissen and A. Akkerman, (eds) *HIPC Debt Relief: Myths and Reality* (FONDAD, 2004).

<sup>37</sup> The World Bank and IMF claim that the conditions attached to debt relief aim to encourage improved policies and institutions that allow more efficient use of debt relief savings. See World Bank, “Debt Relief and Development,” available from <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,print>; and IMF, *Factsheet: IMF Conditionality*, April 2013, available from [www.imf.org/external/np/exr/facts/conditio.htm](http://www.imf.org/external/np/exr/facts/conditio.htm).

<sup>38</sup> Conditions classified by the World Bank as “public sector reform” are often conditions enabling the legal and policy environment for privatization. See EURODAD, *Untying the knots: how the World Bank is failing to deliver real change on conditionality* (November 2007), available from [www.eurodad.org](http://www.eurodad.org).

public services such as health and education, increases in taxes such as valued-added tax, labour reforms, the promotion of exports and foreign investment, and trade liberalization.<sup>39</sup>

43. The adverse impact of these policies on the ability of governments to provide basic social services is well-documented.<sup>40</sup> While conditionalities can be beneficial,<sup>41</sup> the overwhelming view is that they are ineffective<sup>42</sup> and harmful: they have destroyed livelihoods, increased poverty and inequality and left many poor countries trapped in externally prescribed or approved policy frameworks that not only make it difficult for them to comply with their human rights obligations but also undermine their development and result in further impoverishment of their populations – a result that is inconsistent with debt relief objectives. The experiences of two post-completion point HIPC (Malawi and the United Republic of Tanzania) are instructive.

44. In Malawi, the liberalization of the agricultural sector through the reduction of subsidies for small-scale farmers, the removal of prices controls and the restructuring/privatization of the national agricultural marketing agency resulted in price increases, the increased hoarding of grain and lack of affordable food for the poor, thereby undermining food security for the majority of the population.<sup>43</sup> In the United Republic of Tanzania, the privatization of water supplies in Dar es Salaam resulted in severely reduced access to water for the poorest, both through cuts in services and through increased user fees.<sup>44</sup>

<sup>39</sup> A study of HIPC decision point documents for 26 countries found that all mentioned a previous privatization programme and an ongoing or future privatization process. A total of 15 specifically mentioned planned privatization of public utilities or basic services such as energy, water, transport and transport; 23 referred to past efforts to liberalize trade and 11 indicated a continuing trade liberalization process. See Hardstaff, *Treacherous conditions: how IMF and World Bank policies tied to debt are undermining development* (London, World Development Movement, May 2008), p. 7.

<sup>40</sup> See, e.g., E/1990/5/Add.48, paras. 3 and 35; CEDAW/C/CMR/1; CRC/C/65/Add.18, para. 382; CRC/C/3/Add.62, paras. 121, 134 and 457; CRC/C/KEN/2, para. 30; E/C.12/KEN/1, paras. 6 and 90; CRC/C/70/Add.18, para. 67; E/C.12/BOL/2, paras. 2 and 372; CRC/C/65/Add.2, paras. 35, 36 and 124; E/1990/5/Add.40, paras. 6, 36 and 170; CEDAW/C/HON/6, para. 350; CRC/C/65/Add.28, para. 53; E/C.12/IND/5, para. 4; CRC/C/70/Add.17, paras. 128 and 144; CRC/C/65/Add. 30, paras. 36 and 37; CEDAW/C/BRA/1-5; E/CN.4/2001/53; E/CN.4/2006/44; E/CN.4/2002/59; and E/CN.4/2001/52. See also United Nations Conference on Trade and Development (UNCTAD), *Least Developed Countries Report 2002: Escaping the Poverty Trap* (Geneva, UNCTAD, 2002); UNCTAD, *Economic Development in Africa – From Adjustment to Poverty Reduction: What's New?* (Geneva, UNCTAD, 2002); and Peter Hardstaff, *Treacherous conditions*, p. 5; Jeffrey D Sachs, *The End of Poverty: Economic Possibilities for Our Time* (New York, 2005), pp. 81-82, 280-281 and 342; Peter Hardstaff, *Treacherous conditions*; Eric Toussaint, *Your Money or Your Life! The Tyranny of Global Finance* (Pluto Press, 1999) pp. 155-165.

<sup>41</sup> For example, trade liberalization may lead to more competition and lower commodity prices.

<sup>42</sup> In a 2007 assessment of IMF conditionality, the IMF Independent Evaluation Office concluded that conditionalities neither instigated sustainable policy changes nor assisted countries in meeting the poverty reduction goals agreed with IMF. See IMF, Independent Evaluation Office, “An IEO Evaluation of structural conditionality in IMF-supported programmes,” 27 November 2007.

<sup>43</sup> K. Owusu and F. Ng'ambi, *Structural damage: the causes and consequences of Malawi's food crisis* (London, World Development Movement, 2002), available from [www.wdm.org.uk/campaign/resource.htm#reports](http://www.wdm.org.uk/campaign/resource.htm#reports).

<sup>44</sup> Jubilee Debt Campaign, *Debt and Women*, Briefing Note (2007). See also Romilly Greenhil and Irene Wekiya, “Turning off the taps: Donor conditionality and water privatization in Dar es Salaam, United Republic of Tanzania” (ActionAid International, September 2004). The project included loans of \$61.5 million from the World Bank, \$48 million from the African Development Bank and \$34 million from the European Investment Bank the repayment of which is due to begin later this year although

45. The World Bank and IMF often emphasize that PRSPs, which are a condition of HIPC Initiative eligibility, are nationally “owned”. However, it is misleading to speak of country ownership of poverty reduction strategies in circumstances where these are subject to approval by the executive boards of the two institutions. There is also evidence that in a number of countries, there has been a lack of effective participation in the development of PRSPs as well as insufficient consideration of alternative policies.<sup>45</sup>

## D. Lack of additionality

46. An important factor in assessing the impact of debt relief is the issue of “additionality”- that debt relief should supplement, rather than replace or be funded from, existing ODA budgets. Although creditor countries pledged that they would not compromise debt relief by reducing ODA to poor countries, it appears that debt relief has been provided instead of, not in addition, to ODA. It is notable that the Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee’s definition of ODA includes relief on debt owed to the OECD countries. Thus, it is possible that some creditors have reported their debt relief commitments as ODA.

47. Yet another indication that debt relief is not additional is that the resulting debt service reductions are largely offset by an equivalent reduction in future concessional borrowing. For example, under the MDRI, the IDA and ADF implement debt relief by deducting the debt service payments forgiven each year from the recipient country’s annual IDA allocation of disbursements.

## E. Vulture fund litigation

48. The participation of creditors in the two international debt relief initiatives is entirely voluntary. This has created opportunities for some commercial creditors to refuse to participate and then attempt, through litigation, seizure of assets or political pressure, to recover the full face value of their debt together with interest, penalties and legal costs.<sup>46</sup> These creditors – termed “vulture funds” or “distressed debt funds” – purchase defaulted sovereign debt on the secondary market at significant discounts, hold out for other creditors to cancel their debts and then aggressively pursue repayments which are considerably in excess of the amount that they paid for the debt obligation.<sup>47</sup>

49. According to the World Bank and IMF, the number of vulture fund lawsuits against HIPCs “has been declining in recent years but flattened over the past few years.”<sup>48</sup>

---

\$6.6 million has already been paid in interest and charges relating to the World Bank loan. See Jubilee Debt Campaign, “Tanzanian activists call for non-payment of World Bank water debt,” 23 April 2013, available from [www.jubileedebt.campaign.org.uk/?1id=8265&tmpl=jdcmainprint](http://www.jubileedebt.campaign.org.uk/?1id=8265&tmpl=jdcmainprint).

<sup>45</sup> See, e.g., T. Bierschenk, E. Thioleron and N. Bako-Arifari, “Benin,” R. Jenkins and M. Tsoka, “Malawi”, I. Dante, J. Gaultier, M. Marouani and M. Raffinot, “Mali”, H. Falck, K. Landfald and P. Rebelo, “Mozambique”, and A. Evans and E. Ngalwea, “Tanzania”, *Development Policy Review*, vol. 21, No. 2 (2003).

<sup>46</sup> Vulture fund litigation has thrived in circumstances where the international community has done little to tackle them legally.

<sup>47</sup> For a discussion of the impact of vulture funds on human rights, see United Nations, Human Rights Council, Report of the independent expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephaz Lumina, 29 April 2010, A/HRC/14/21.

<sup>48</sup> See IMF, Factsheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative, 2 April 2013, available from [www.imf.org/external/np/exr/facts/hipc.htm](http://www.imf.org/external/np/exr/facts/hipc.htm).

However, it is difficult to ascertain the actual number due to secretive nature of vulture fund operations. At least 19 impoverished countries (Angola, Bolivia, Cameroon, Congo Republic, Cote d'Ivoire, Democratic Republic of Congo, Ethiopia, Guyana, Honduras, Liberia, Madagascar, Mozambique, Nicaragua, Niger, Sao Tome and Principe, Sierra Leone, Tanzania, Uganda and Zambia) have been subject to or threatened with vulture fund lawsuits since the HIPC Initiative was launched in 1996.

50. Vulture fund lawsuits erode the gains from debt relief by preventing heavily indebted poor countries from using resources freed up by debt relief for their development and poverty reduction programmes, thereby jeopardizing the fulfilment of these countries' human rights obligations. It has been estimated that, on average, the potential cost of lawsuits represents 18 percent of annual health and education spending, 59 percent of debt service and 5 percent of budget revenue. In 2008, the World Bank and IMF estimated that the potential impact of court awards varied from less than 0.5 per cent of the debtor country's GDP to 49 per cent in the case of Liberia.

## F. Other shortcomings

51. There are two other notable shortcomings of the initiatives. First, the eligibility criteria under the HIPC Initiative are too restrictive and exclude many highly indebted countries that have high levels of poverty and often pay more on debt service than on basic services.<sup>49</sup> Among these are the Bangladesh, Djibouti, Grenada, Jamaica, Kiribati, Lesotho, Maldives, Myanmar, the Philippines, Tonga and Zimbabwe. For example, in 2009, the external debt of the Philippines was estimated at \$60.3 billion and it paid \$13.6 billion in debt service in 2006.<sup>50</sup> Nevertheless, as a middle-income country, it does not qualify for debt relief under the current schemes. In 2011, Jamaica, which remains one of the most highly indebted countries in the world, had a total external debt of \$14.4 billion (or 330 per cent of exports) and its interest payments as a percentage of GDP (approximately 10 per cent) were higher than for any other country.<sup>51</sup> Between 2008 and 2012, debt servicing took up close to 50 per cent of total budgeted expenditures while spending on education and health combined was only been around 20 per cent.<sup>52</sup>

52. Second, the initiatives' overwhelming focus on imprudent debt management on the part of borrowers and do not appear to have addressed the underlying causes of the debt crisis. Thus, their impact may be limited.

## V. International debt relief: what next?

53. The HIPC Initiative was not intended to be a permanent mechanism to reduce the external debts of low income countries. It was therefore closed to new entrants in 2006

<sup>49</sup> The IMF's response to this criticism is that the eligibility criteria "reflect a broad-based consensus of member governments that the poorest countries should have the highest priority in concessional debt relief." See IMF, "HIPC Initiative: The IMF's Response to Critics," September 1998, available from [www.imf.org/external/np/hipc/res.htm](http://www.imf.org/external/np/hipc/res.htm)

<sup>50</sup> In 2011, the total external debt was \$76 billion. See World Bank, *International Debt Statistics 2013* (Washington DC, World Bank, 2013), p. 23.

<sup>51</sup> See Jake Johnson and Juan A. Montecino, *Update on the Jamaican Economy* (Washington DC, Center for Economic and Policy Research, May 2012), p. 10. See also World Bank, *International Debt Statistics 2013*, p. 22.

<sup>52</sup> *Ibid.*, p. 11.

when the sunset clause<sup>53</sup> took effect and the list of potentially eligible HIPC countries was ring-fenced.<sup>54</sup> According to the World Bank and IMF, the HIPC Initiative has largely achieved its objectives.<sup>55</sup> The Initiative is also winding down but its future remains unclear. The Executive Boards of the World Bank and IMF have “expressed little support for making the HIPC Initiative a permanent facility or for closing it down.” In the view of the World Bank and IMF staff, the former option would neither be “consistent with the original intent of the Initiative nor justified by the current debt sustainability outlook in LICs” and “it would also be beset with moral hazard.”<sup>56</sup> Thus, they have proposed adding new income and eligibility criteria (as at end-2010) and further “ring-fencing” potentially eligible countries as this “would eliminate considerable moral hazard and underscore the extent to which the HIPC Initiative has been successfully implemented”.<sup>57</sup>

54. The winding down of the HIPC Initiative should not signal the end of international efforts to comprehensively address the debt problems of impoverished developing countries. Rather, it should be seen as an opportunity to assess the successes and failures of the existing debt relief schemes and, based on such assessment, to undertake a fundamental restructuring of the global economy.

55. The Independent Expert further considers that debt relief alone is insufficient to put beneficiary countries on a path to sustainable development. He therefore supports the calls made by, inter alia, Jubilee Debt Campaign for fundamental reform of the global economy to ensure more responsible, sustainable and fair lending whilst also reducing the dependence of developing countries on international capital. Such radical reforms are necessary in view of the fact that the World Bank and IMF, which play a central role in the implementation of existing debt relief mechanisms, have themselves often been central to the problem of debt, increased dependency of developing countries on commodity exports and liberalization of finance which have increased these countries’ vulnerability to international financial flows, cannot conceivably play a leading role in resolving the debt crisis in a equitable and sustainable manner. In this regard, there are number of actions that the international community should consider. These are discussed below.

## A. Reinforcing the principle of shared responsibility

56. Responses to the debt crisis of developing countries have ignored any sense of responsibility on the part of the creditors for its development.<sup>58</sup> Thus, creditors have often cast the crisis as a problem of poor debt management on the part of these countries.<sup>59</sup> This is reflected in the design of the current international debt relief mechanisms which focus exclusively on debt management and ignore the role of the lenders. Yet the history of the

<sup>53</sup> The deadline by which countries had to establish a sufficient track record to join the initiative.

<sup>54</sup> IDA and IMF, “HIPC Initiative,” (2011), p. 24.

<sup>55</sup> Ibid, p. 7.

<sup>56</sup> Ibid, p. 27.

<sup>57</sup> Ibid, p. 29.

<sup>58</sup> A notable exception is Norway. In October 2006 the Government of Norway unilaterally and unconditionally cancelled the official debts of around \$80 million incurred by five developing countries under its Ship Export Campaign, which it acknowledged as a “development policy failure”. See Government of Norway, Ministry of Foreign Affairs, press release No. 118/06, 2 October 2006. See also A/HRC/21/Add.1, paras. 19-25.

<sup>59</sup> See Jubilee Australia, “Alternatives to debtors prison: Developing a framework for international insolvency,” ACFID Research in Development Series Report No. 4, October 2011, pp. 9-10; Sarah Edwards, *A New Debt Crisis? Assessing the impact of the financial crisis on developing countries* (London, Jubilee Debt Campaign, March 2009), p. 8.

debt crisis indicates that it is partly attributable to irresponsible creditors (countries, banks and bondholders) who made poor investment and financing decisions, as well as the complicity of the international financial institutions through bad policy prescriptions.<sup>60</sup> Irresponsible lending has included loans to oppressive regimes; for corrupt, useless or overpriced projects; or on unfair terms, resulting in large burdens of odious or illegitimate debt which are disproportionately borne by the poorest people in the indebted countries.<sup>61</sup>

57. Clearly, there is a need to reaffirm the principle of shared responsibility. As underlined in the Monterrey Consensus, “debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations.” This entails, firstly, accepting that lenders and borrowers have a mutual obligation to ensure that their lending or borrowing behaviour does not contribute to or culminate in unsustainable debt situations. Thus, for example, lenders must not extend loans without conducting due diligence or, in the case of development loans, must not lend for projects that have no developmental benefit for the population of the borrower State. For their part, borrowers must not contract loans that they are not in a position to repay, or they must not conclude loan agreements in circumvention of the applicable national legal and institutional frameworks. Secondly, it requires that lenders and borrowers accept responsibility for their role in the creation of debt crises and take appropriate remedial action. For the lender, this might entail the unconditional cancellation of loans extended by them in a profligate manner, while for the borrower this might require the establishment of a transparent and accountable system for the management of public debt.

58. As part of its re-commitment to the principle of shared responsibility, the international community should work together to develop a framework for responsible financing that not only incorporates the principles of fairness, mutual accountability and transparency, but also enhances the capacity of States to achieve their development goals and fulfil their human rights obligations. In this regard, the Independent Expert urges all States to fully adhere to the United Nations Guiding Principles on Foreign Debt and Human Rights adopted by the Human Rights Council in June 2012<sup>62</sup> and to support the adoption of the UNCTAD Draft Principles on Promoting Responsible Sovereign Lending and Borrowing.

## **B. Establishing an impartial international debt workout mechanism**

59. Over the years, numerous proposals for the establishment of an international sovereign debt workout mechanism have been made. Some of these proposals have drawn inspiration from the United States bankruptcy regime which provides protection for insolvent government authorities such as states and municipalities to keep them functional while enabling them to avoid sacrificing any of their basic public service provision functions in order to pay off debts.<sup>63</sup>

<sup>60</sup> See, e.g., Edwards, *A New Debt Crisis?*, pp. 7-8. Jubilee Debt Campaign argues that existing responses to the debt crisis “have ignored any sense of responsibility on the part of lenders and have been aimed at protecting creditors and the financial system.”

<sup>61</sup> For a discussion of odious and illegitimate debt, see A/64/289, paras. 8-22.

<sup>62</sup> See A/HRC/20/23, Annex.

<sup>63</sup> See, e.g., Kunibert Raffer, “Internationalizing United States municipal insolvency: a fair, equitable and efficient way to overcome a debt overhang,” *Chicago Journal of International Law*, vol. 6, No. 1 (2005), p. 363; C.G. Paulus and S.T. Kargman, “Reforming the process of sovereign debt restructuring: a proposal for a sovereign debt tribunal,” paper presented at the workshop on debt, finance and emerging issues in international financial integration, Financing for Development Office, Department of Economic and Social Affairs of the United Nations Secretariat, 8 and 9 April 2008.

60. The Independent Expert fully supports the establishment of a permanent, independent international sovereign debt workout mechanism under the auspices of a neutral, non-lending institution with sufficient global legitimacy – the United Nations. In his estimation, such a mechanism – based on the principles of equity, transparency, inclusion and participation – can help resolve sovereign debt payment difficulties and disputes fairly and efficiently. As opposed to existing debt workout mechanisms, such body should prioritise States’ obligations to meet the basic needs of their populations in line with their international human rights obligations and national development agendas.<sup>64</sup> By focusing on basic needs, the mechanism can serve to ensure that debt does not pose a structural obstacle to development. An independent debt workout mechanism would also discipline imprudence on the part of both lenders and borrowers.<sup>65</sup>

61. It should be recognised, however, that an international debt workout mechanism alone would not address the problem of indebtedness and impoverishment of poor countries and inequity in the global economy. Nevertheless, it bring accountability to the global financial system and limit the ability of international financial institutions to continue to force poor countries to implement policies which are not necessarily in line with their national development priorities.<sup>66</sup> More importantly, such a mechanism would address a critical gap in the international financial system.

### C. Prioritizing domestic resource mobilization

62. Many poor countries are chronically dependent on external finance (including loans and investment). A key reason for this is the continued loss of finance through illicit flows.<sup>67</sup> It is estimated that in 2010 developing countries lost between \$783 billion and \$1,138 billion in illicit financial flows (mainly through tax evasion, capital flight and corruption).<sup>68</sup> The slow rate of repatriation of stolen wealth has compounded the problem.

63. As the global financial crisis has demonstrated, such dependence can make these countries vulnerable to sudden changes in the availability and affordability of funds and give rise to high debt and foreign financial obligations.<sup>69</sup> In turn, this can impact government’s abilities to meet basic social expenditures as well as the sustainability of their debts.

64. While the Independent Expert recognizes the benefits of truly productive foreign investment, he considers that developing countries should make more efforts to utilize the resources that they already have in order to reduce their vulnerabilities. This requires mobilizing domestic resources through improved tax revenue collection (including revisiting tax incentives for foreigner investors); ensuring that local capital is invested within the country; monitoring and regulating financial transfers to prevent speculation, asset stripping, illicit capital flight and tax avoidance; encouraging genuinely productive long-term investment; increasing transparency concerning revenues from multinational

<sup>64</sup> See UN Guiding Principles on Foreign Debt and Human Rights, paras. 84 and 85.

<sup>65</sup> Jubilee Australia, *Alternatives to debtors prison*, p. 27.

<sup>66</sup> Jubilee Australia, *Alternatives to debtors prison*, p. 29.

<sup>67</sup> According to Eurodad, these outflows have been facilitated by financial liberalization by developing countries under the advice or coercion of the international financial institutions. See EURODAD, “Debt in the downturn: New loans and new rules proposed to help impoverished countries through critical times. Is this the right response?” 30 September 2009, pp. 13-14.

<sup>68</sup> Dev Kar and Sarah Freitas, *Illicit Financial Flows from Developing Countries: 2001-2010* (Washington, D.C., Global Financial Integrity, 2012). See also A/HRC/22/42.

<sup>69</sup> Tim Jones, *The state of debt: putting an end to 30 years of crisis* (London, Jubilee Debt Campaign, May 2012), p. 42.

corporations exploiting national resources; and enhancing international cooperation to ensure the return of stolen assets.

## D. Reforming the international financial system

65. In order to reduce vulnerability of poor countries to exogenous shocks and limit the incidence of debt crises, it is imperative that the global financial system is fundamentally restructured. Such reform should aim at the establishment of a more inclusive and equitable system in which decision-making is shared beyond a few States. In the Independent Expert's view, no equitable and durable solution to the debt problem can be provided by non-inclusive forums, in which only a handful of States participate. It is therefore important that all States participate in efforts to reform the international financial architecture. In this regard, it is worth recalling that in paragraph 9 of the Monterrey Consensus, the international community declared its commitment to "promoting national and global economic systems based on the principles of justice, equity, democracy, participation, transparency, accountability and inclusion." As the only inclusive institution with sufficient global legitimacy, the United Nations is best placed to lead efforts to reform the international financial system.

66. Reforms of the international financial architecture should also include redefining the role of the international financial institutions, notably the World Bank and IMF, which are the most important creditors, to ensure that their policies and programmes place human rights and the people at the core. There is also a need for these institutions to abandon their practice of attaching intrusive policy conditions (based on a "one-size-fits-all" model of development which has largely proved disastrous for many poor countries so that countries should be allowed to freely make their own development policy choices.<sup>70</sup>

67. Concern over the perceived negative developmental impact of policies of international financial institutions has increasingly led to some States considering the creating of alternative international financial institutions such as the Bank of the South and the BRICS bank. The Independent Expert fully supports these efforts but urges the States concerned to ensure that the new institutions prioritize the achievement of sustainable human development.

68. Finally, in order to ensure that indebted poor countries are able to maximize benefits from debt relief, and to ensure debt sustainability as well as sustainable development outcomes, States must undertake efforts to enhance the coherence and consistency of, inter alia, trade, aid, debt, financial and monetary policies (see A/65/260, paras. 49-53).<sup>71</sup>

## VI. Conclusions and recommendations

**69. Although reducing the debt burdens of heavily indebted poor countries (on paper), the existing international debt relief initiatives have failed to address the underlying causes of unsustainable debt in low-income countries, including unfair global trade terms, narrow production and export bases, vulnerability to exogenous**

<sup>70</sup> See United Nations Guiding Principles on Foreign Debt and Human Rights, paras. 73-83.

<sup>71</sup> The need for policy coherence among the trade, financial and monetary policies is widely recognized. See, e.g., The Sao Paulo Consensus adopted at the eleventh session of the United Nations Conference on Trade and Development, TD/412, part II, para. 17; *Report of the International Conference on Financing for Development, Monterrey, Mexico*, 18-22 March 2002 (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex, para. 52; 2005 World Summit Outcome, resolution 60/1.

shocks (including drops in international finance) and irresponsible lending. Instead, the initiatives have focused on reducing debts to a level deemed “sustainable” by creditors, implying that the problem lies with imprudent debt management and poor governance on the part of the countries receiving debt relief. The dominant role of creditors in the initiatives is inconsistent with the principle of shared responsibility, while the conditionalities associated with them have undermined the sovereignty of debtor countries and, in some cases, the poverty-reduction goals of debt relief.

70. It is unlikely that in their current form, the international debt relief mechanisms can provide a lasting and just solution to the debt crisis. This underscores the urgent need for a rethink of existing mechanisms and to devise strategies that not only place human rights and the basic needs of people at the core, but also respect the sovereignty of indebted countries. The completion of the HIPC Initiative offers an opportunity for the international community to consider solutions that can help deliver an equitable and durable solution to the debt crisis, as well as assist in the establishment of truly equitable international economic order. In this regard, the Independent Expert makes the following recommendations.

(a) States should uphold their commitment to share responsibility for preventing and resolving unsustainable debt situations.

(b) States should commit to internationally agreed standards on responsible lending and borrowing which are binding on States and financial institutions (international and domestic) alike. In this regard, they should implement the Guiding Principles on Foreign Debt and Human Rights and support the adoption of the UNCTAD Draft Principles on Promoting Responsible Sovereign Lending and Borrowing.

(c) States should intensify cooperative efforts to establish an independent international sovereign debt workout mechanism that can resolve debt repayment difficulties effectively and fairly. Such mechanism should operate under the auspices of an inclusive institution with sufficient global legitimacy – the United Nations.

(d) Efforts should be made to reduce developing countries’ dependence on international capital by enhancing their capacity to mobilize domestic resources through increased public revenue collection, ensuring a fair and mutually beneficial return on natural resource exploitation by foreign investors, tackling illicit financial flows and stepping up efforts to return stolen assets to the countries of origin.

(e) States should adopt wide ranging legislative frameworks in line with the UN Guiding Principles on Foreign Debt and Human Rights to curtail the predatory vulture fund activities within their jurisdictions

(f) Member States should undertake fundamental reforms of the World Bank, IMF and other international financial institutions to ensure that they respect the commonly accepted norms of good governance (including transparency, accountability, ownership and participation) as well as international standards on human rights, the environment and labour.

(g) The World Bank and IMF should undertake a comprehensive review of their Joint Debt sustainability Framework for Low-Income Countries to ensure that debt sustainability assessments paid sufficient attention to preserving adequate resources for the achievement of development and the creation of the conditions for the realization of all human rights, particularly economic, social and cultural rights. In particular, sustainability assessments should balance government revenues against a country’s needs to finance its nationally designed and owned development strategies and to fulfil its human rights obligations.

(h) In line with the UN Guiding Principles on foreign debt and human rights, international financial institutions and other lenders should stop economic policy conditions to loans and debt relief.

(i) States should urgently take measures to ensure coherence among finance, monetary, trade and development policies.

---