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The Legacy of the Jubilee Debt Relief Movement: Agreements, Lessons, and Remaining Challenges

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This is a short essay that provides a brief contextual overview of several recent debt agreements as well as the remaining challenges ahead. It was prepared for the CGD event, "Whatever Happened to the Jubilee? A 10th Anniversary Assessment of the Debt Relief Movement."

Post-HIPC Challenges—Lend and Forgive (Yet Again)

Over the last 25 years, the international community has pursued a series of measures to address unsustainable debt burdens in low-income countries. Early actions focused on debt relief for official bilateral claims—initially by rescheduling—followed by increasing levels of debt stock reduction. During this period, the Paris Club repeatedly reduced or rescheduled the debts of a number of countries.[1] Between 1976 and 2002, low-income countries restructured their Paris Club debt nearly 250 times, with 12 countries restructuring eight or more times.

In 1996, IMF and World Bank shareholders agreed on the Heavily Indebted Poor Country (HIPC) Initiative. For the first time, loans from international financial institutions (IFIs) were included in broader debt stock reduction agreements. For their part, Paris Club creditors agreed to so-called "Lyon Terms," which provided debt stock reduction of up to 80 percent on eligible nonconcessional bilateral claims. Due to slow implementation and continued debt risks, the international donor community agreed to the Enhanced HIPC Initiative in 1999. This initiative sought to provide faster and even deeper debt relief for poor countries. Paris Club creditors agreed to the "Cologne Terms," canceling up to 90 percent of eligible nonconcessional bilateral obligations. Some G-7 creditors, including the United States, went as far as 100 percent debt reduction on both nonconcessional and concessional loan obligations. The overriding objective was to reduce HIPCs' external debt ratios to or below a specific target level (debt-to-exports ratio of 150 percent).

[1] The Paris Club is an informal group of official bilateral creditors that seeks coordinated, sustainable solutions to the payment difficulties of debtor countries. Member countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, Russia, Spain, Sweden, Switzerland, United Kingdom, and the United States.

Even as past debt was relieved, low-income countries' debt sustainability was eroded by even greater *new* official lending—primarily by IFIs. Between 1989 and 2003, new nominal lending to HIPCs was twice as large as the amount of nominal debt relief provided ($85 billion versus $38 billion). There were several reasons for providing new multilateral lending at the same time as HIPC debt relief, including (1) IFI institutional incentives; (2) defensive lending practices (i.e., rolling over preexisting claims to prevent default);[2] (3) a need to fill financing gaps created by sudden declines in commercial credit;[3] and (4) a poor credit culture within the borrowing countries themselves.

Birth of the Multilateral Debt Relief Initiative

In the early 2000s, several donor governments, think tanks, and civil society organizations began to realize that the HIPC Initiative did not provide a lasting solution to the problem of unsustainable debt in poor countries. In the first phase, G-7 countries—most prominently the United States—began pushing for the multilateral development banks to provide assistance to the poorest countries in the form of grants. The majority of bilateral donors had been doing this since the early- to mid-1980s.[4] Following highly contentious negotiations, the World Bank's and African Development Bank's concessional windows finally agreed to provide between 18 and 21 percent of their total assistance as grants. However, the broader issue of additional debt relief did not gain international prominence within senior policymaker ranks until 2003 and 2004. Immediately before the 2004 G-7 Summit in Sea Island, Georgia, the United States first made a proposal for 100 percent debt relief for qualifying HIPCs. It also argued that 100 percent of future MDB assistance should be provided as grant financing.[5] The United Kingdom also began floating informal proposals for forgiveness of HIPCs' debt service obligations through 2015.[6]

The U.S. and UK proposals received significant opposition from other G-7 countries—namely France, Germany, and Japan. Each country had distinct policy positions. However, all opposing countries argued that the majority of HIPCs had sustainable debt levels over the long term. In

[2] Nancy Birdsall, Stijn Claessens, and Ishac Diwan, "Policy Selectivity Foregone: Debt and Donor Behavior in Africa," *World Bank Economic Review*, Volume 17(3), 2003, 409-435. Originally published as CGD Working Paper 17, October 2002.
[3] William Easterly, "How did the heavily indebted poor countries become heavily indebted? Reviewing 2 decades of debt relief," *World Development*, Volume 30(10), October 2002, 1677–1696.
[4] Notable exceptions include France and Japan.
[5] In the end, the G-7 only agreed to "consider measures that can further help the poorest countries address the sustainability of their debt."
[6] Also see Todd Moss, "Briefing: The G8's Multilateral Debt Relief Initiative and Poverty Reduction in Sub-Saharan Africa," *African Affairs* 105/419, 285–293.

contrast to the U.S. and UK, they contended that individual country cases could be handled through traditional Paris Club treatments or ad-hoc agreements. They also stringently objected to two central tenets of the U.S. approach: (1) reducing recipient countries' new MDB assistance by the amount of annual debt service forgiveness (i.e., "netting out") and (2) not providing additional funding to offset any forgone revenue caused by debt relief. The United States argued that earmarking donor funding for additional debt relief was unnecessary. Instead, donor countries would offset the netting out effect—and any impact on IFI financing capacity—by delivering continued general funding increases to the MDB concessional windows, such as the International Development Association (IDA) and the African Development Fund (AfDF). Partly recognizing that the issue would remain on the G-7 agenda, France, Germany, and Japan jointly issued their own debt relief proposal. Under their proposal, poor countries could receive interim debt service relief through 2015 if their external debt ratios breached certain thresholds. G-7 discussions remained deadlocked along these lines for months.

Ahead of the 2005 G-8 Gleneagles Summit, calls for 100 percent debt relief gained significant grassroots momentum. During this time, "Drop the Debt" marches, concerts, and sit-ins occurred throughout the globe. With similarities to the 2000 Jubilee Movement, a diverse group of celebrities, legislators, and civil society groups ensured that the issue of full debt cancellation remained on the front pages of leading newspapers. Behind the scenes, the U.S. and UK finance ministries began to iron out a compromise approach. In the end, the United Kingdom agreed to the "netting out" approach and 100 percent debt stock cancellation (versus forgiveness of debt payments for ten years) of HIPCs' obligations to the IMF, IDA, and AfDF. For its part, the United States agreed to long-term donor financing commitments to offset foregone MDB revenues due to debt relief. This compromise approach was unveiled publicly in June 2005 and later agreed by the G-8 at the Gleneagles Summit. IFI shareholders adopted the debt relief agreement—now named the Multilateral Debt Relief Initiative (MDRI)—the following year.

In 2005, World Bank and IMF shareholders also agreed to implement a new Debt Sustainability Framework (DSF) to help prevent the re-accumulation of unsustainable debt burdens in the future. In simple terms, the DSF classifies countries' debt risks based upon their (1) institutional and policy performance and (2) external indebtedness ratios. The underlying premise makes intuitive sense: poorly governed countries are more likely to become debt-distressed at a lower external indebtedness level and better-performing countries can handle higher debt levels. In operational terms, IDA and the AfDF utilize these classifications to determine whether a country should receive grants, loans, or a combination of the two. Taken together with the MDRI, donor countries effectively decided to wipe the slate clean and proceed afresh with a prudent lending framework going forward.

Expanding MDRI to Latin America—Fund for Special Operations

Following the MDRI agreement, some civil society groups and legislative representatives questioned why the African Development Bank (AfDB) was included, but not the Inter-American Bank (IDB). The IDB's exclusion meant that Latin American HIPCs (Bolivia, Guyana, Haiti, Honduras, and Nicaragua) received far less debt relief on a relative basis than their African peers.[7] However, this argument lacked the same level of international grassroots support—based in part on the Africa-centric lobby and financing fatigue following the large MDRI commitments. Nonetheless, the U.S. Treasury quietly began exploring potential debt relief options covering the IDB's concessional finance window—the Fund for Special Operations (FSO).

In the end, the U.S. Treasury developed a proposal entailing (1) 100 percent cancellation of HIPCs' FSO obligations, (2) constant gross assistance volumes going forward, and (3) 100 percent grant financing for Haiti. Moreover, the $4.5 billion debt relief proposal was designed to ensure that there would be no additional costs to the FSO's donor countries. To make this work, the IDB would utilize its hard loan window (Ordinary Capital) to provide a portion of new lending capital for HIPC borrowers. In turn, the FSO would provide a highly concessional loan to buy down the financing terms—thereby, making them consistent with IMF borrowing limits.[8] In addition, the FSO had significant outstanding claims on its middle-income countries, which formerly had access to concessional FSO loans. As a result, the FSO had a steady stream of expected loan payment revenue over the medium-term—which would allow it to continue providing highly concessional loans to its HIPC borrowers without new donor funding.

Several Latin American countries—most notably Brazil—objected to the U.S. proposal. Following the MDRI precedent, Brazil argued that (1) donor governments should provide additional resources to finance FSO debt relief and (2) the OC should not have lending exposure to HIPCs. Similar to MDRI, IDB negotiations dragged on for many months. In spring 2007, the United States, Brazil, and several other influential IDB shareholders finally reached an agreement that closely followed the original U.S. proposal.[9]

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[7] The IDB was the largest multilateral creditor for the Latin American HIPCs.

[8] The reformed FSO loans would have a maturity of 40 years, an interest rate of 0.25 percent, and a bullet payment in the final year of the loan. These terms would entail a grant element exceeding 90 percent.

[9] Under the final agreement, Bolivia received roughly $1 billion in debt relief; Guyana, $467 million; Honduras, $1.4 billion; and Nicaragua, $984 million. Since Haiti had not reached its HIPC Completion Point, it was not immediately eligible to receive 100 percent debt relief (roughly $525 million).

Nigeria Buy-Back Deal

Yet another landmark debt agreement was reached in 2005—the Nigeria debt buy-back, which wiped out $18 billion in external debt. Beginning in 1999, the Nigerian government began to aggressively pursue comprehensive debt relief from official creditors. Nigeria had accumulated an unsustainable debt burden primarily through accrued arrears, interest, penalties, and other export credit defaults accumulated by the successive military governments that ruled the country from 1984 to 1999. By 2005, Nigeria's external debt obligations totaled roughly $36 billion—equivalent to nearly 50 percent of gross national income. The majority of these obligations were owed to Paris Club creditors, such as the United Kingdom, France, Germany, and the United States.

Despite its high debt burden and pervasive poverty,[10] Nigeria remained ineligible for existing debt relief mechanisms.[11] Under the Enhanced HIPC Initiative, bilateral and multilateral debt relief is restricted only to those countries without access to market-based lending (so-called "IDA-only" countries).[12] In the case of Nigeria, it actually had long been shut out of market-based borrowing—including from the International Bank for Reconstruction and Development (IBRD). However, the World Bank maintained its "IDA-blend" classification despite its low per capita income levels and lack of creditworthiness.[13]

Following over a year of intensive negotiations, Nigeria reached a final debt buy-back agreement with the Paris Club in October 2005. Under the agreement, Nigeria (1) was reclassified as an IDA-only country, (2) paid off $6 billion in Paris Club loan arrears on a par basis, and (3) bought back its remaining $24 billion Paris Club obligations for 24 cents on the dollar. Nigeria utilized international reserve holdings, which had grown dramatically due to the oil boom, to finance the buy-back operation. Through this approach, Nigeria was able to leverage $12 billion in government resources to retire $30 billion in external debt.

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[10] Approximately 100 million Nigerians were living on less than a dollar a day – by far the most of any African country.

[11] See Todd Moss, "*Resolving Nigeria's Debt Through a Discounted Buyback*," CGD Note (2005), http://www.cgdev.org/content/publications/detail/3223.

[12] The World Bank defines IDA-only status based upon each respective country's income per capita level and creditworthiness. The creditworthiness classification is largely based upon whether the International Bank for Reconstruction and Development (IBRD) is willing to lend to the respective country.

[13] See Todd Moss, Scott Standley, and Nancy Birdsall, "Double-Standards, Debt Treatment, and World Bank Country Classification: The Case of Nigeria," Center for Global Development, Working Paper Number 45.

Lessons Learned from Liberia

In July 2010, the Liberian government secured comprehensive debt relief under the Enhanced HIPC Initiative and MDRI. This achievement marked the completion of Liberia's reengagement process with the international financial community. In roughly two and a half years, the Liberian government cleared its arrears to the international financial institutions (IFIs), secured comprehensive debt relief from bilateral and multilateral creditors, and concluded a landmark commercial debt buyback deal. In total, these agreements canceled $4.5 billion worth of external debt obligations—or roughly $1,200 per Liberian.

Historically, low-income countries have taken nearly 5 years, on average, to complete the HIPC process.[14] In other words, Liberia successfully navigated the complicated, arcane multilateral processes twice as fast as the average HIPC-eligible country. Its successful reengagement demonstrates several broad lessons, which may be instructive for other low-income countries in the future.

(1) *Strong, unifying political leadership is critically important*. To secure debt relief and clear loan arrears (to a lesser extent), recipient governments are forced to implement significant economic, financial, and social reforms. Executing these reforms in an expeditious manner requires political unity and courage.

(2) *Governments need to develop and communicate a credible vision and plan both for financial reengagement and long-term development.* In the context of its Poverty Reduction Strategy, Liberia completed a broad-based consultative process, provided candid reporting on progress, and implemented proactive remedial plans for areas of lagging performance.

(3) *Governments often must be creative in mobilizing capacity—both internally and externally.* When the Sirleaf Administration assumed office in January 2006, Liberian government institutions were nearly nonexistent. Nonetheless, the Liberian government was able to mobilize near-term expatriate, diaspora, and domestic expertise while simultaneously attempting to build permanent capacity.

[14] IMF, *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation* (2009).

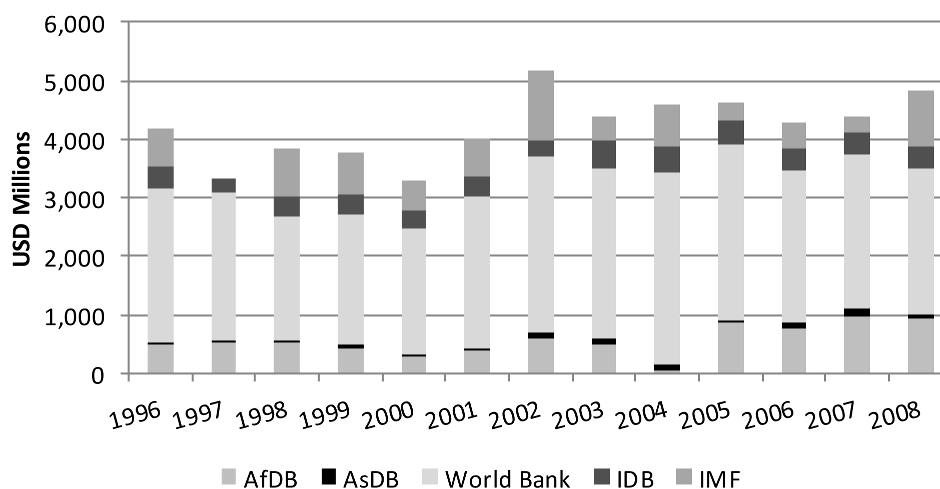
Remaining Challenges

Undoubtedly, the various agreements during the 2000s dramatically improved the long-term debt sustainability prospects in low-income countries. However, several important challenges remain, such as (1) potential reaccumulation of unsustainable debts; (2) odious debt; and (3) vulture funds.

***Reaccumulation of Unsustainable Debts*:** There remains a material risk that new lending may lead to the reaccumulation of unsustainable debt. There are a number of contributing factors in this area—such as: (1) significant new IMF and MDB lending; (2) DSF structural limitations and shortcomings; (3) emergence of nontraditional lenders over the last decade; (4) resurgence of lending activity by select bilateral donor governments; and (5) new commercial lending.

As noted previously, IFI lending contributed to the accumulation (and reaccumulation) of unsustainable debt during the 2000s—both before and after the Enhanced HIPC Initiative. There are several warning signs suggesting that IFI management and shareholders may not have learned this lesson. For example, IFI lending to HIPCs has actually increased since the HIPC and MDRI agreements in 1999 and 2006 (see figure 1 below) despite the new DSF designed to prevent the reaccumulation of unsustainable debt. In part, this is the result of significant donor funding increases for the MDB concessional windows over the last ten years. For example, donors increased their contributions to IDA by 45 percent and 41 percent, respectively, during the IDA-14 and IDA-15 replenishments. In other words, the relative share of MDB funding provided as grants may have increased, but the overall assistance volume increased as well.

Figure 1—IFI Lending to HIPCs, 1996–2008



Source: OECD-DAC

Second, the existing DSF has a number of structural and methodological weaknesses. Most importantly, long-term debt risk assessments rely on systematically overly optimistic IMF growth projections. In a recent paper, I found that the IMF overprojects GDP growth by nearly 1 percent annually, on average, for HIPCs.[15] Given that these growth projections directly feed into IFI lending decisions, they could have an important impact over time—particularly in individual countries.

Third, several nontraditional donor countries have assumed greater importance in the international financial architecture over the last decade. By illustration, the Democratic Republic of Congo (DRC) finalized a $9 billion line of credit agreement with China while simultaneously seeking completion of the Enhanced HIPC Initiative.[16] In addition, Ghana recently reached agreement with two Chinese creditors for a $13 billion line of credit to finance infrastructure and agriculture projects over time.[17] While China has received the greatest attention and level of scrutiny, other leading actors include India, Arab countries, and other emerging economies. For the most part, these lenders do not report overall lending levels. As such, it is difficult to gauge the full impact of their increased lending activity. However, anecdotal reporting concerning several African countries suggests that the figures may be significant.

Fourth, many bilateral donor governments have restarted substantial lending programs to low-income countries, including HIPCs. For example, France increased lending to HIPCs by 300 percent between 2001 and 2008 (from $62 million to $250 million). In addition, Spain has provided over $700 million in new loans to HIPCs since 2000—mostly to Latin American countries. While bilateral lending by traditional donors is much smaller than IFI volumes overall, it still can have a material incremental impact on debt sustainability prospects.

Lastly, several low-income countries have reentered commercial debt markets following comprehensive debt relief. For example, Ghana issued a $750 million Eurobond with a ten-year maturity and interest rate of 8.75 percent only one year after receiving $3.9 billion in MDRI assistance.[18] Several east African countries—such as Kenya, Uganda, and Tanzania—plan to float Eurobond issuances as well. In certain circumstances, low-income countries' renewed

[15] See Ben Leo, "Will World Bank and IMF Lending Lead to HIPC IV? Debt Déjà-Vu All Over Again," Center for Global Development, Working Paper 193.
[16] The Congolese government subsequently agreed to renegotiate aspects of this infrastructure for minerals agreement with China.
[17] This includes a $3 billion agreement with the China Development Bank to finance Ghana's oil and gas infrastructure and agricultural development and a $9.87 billion agreement with the China Export-Import Bank for road, railway and dam projects.
[18] MDRI assistance figure is presented in nominal terms.

access to commercial financing can be viewed as a positive development. It demonstrates market confidence and diversifies countries' financing options. However, the hard loan terms make it essential that loan proceeds are utilized for highly productive investments over the near- and medium-term. If not, new commercial borrowing could have a significant, negative impact on countries' long-term debt sustainability prospects.

Odious Debt: The international community continues to face challenges in dealing with debt obligations incurred by odious regimes. These challenges include both attempting to reduce illegitimate regimes' access to financing (i.e., financial sanctions) and how successor regimes should deal with these financial obligations. For example, an illegitimate regime could sign a contract with a foreign entity that grants rights to national resources in exchange for an immediate payment or loan. In turn, the regime utilizes these proceeds to finance repression or officials siphon off the money for personal benefit.[19] Legitimate successor regimes often need to levy taxes to fulfill debt contracts incurred in this manner for fear of legal retribution and loss of reputation with investors. And in the case of natural resource contracts, citizens continue to suffer from the sweetheart contracts that deprive the government of deserved revenues.

A Center for Global Development (CGD) working group has examined these issues in detail over the last year. While many debt campaigners have advocated ex-post mechanism for canceling odious debt, the CGD working group focused on ex-ante measures that could help to prevent the accumulation of odious debt in the future. The working group is proposing a new financial diplomacy instrument: a declaration that successor governments to a (named) illegitimate regime would not be bound by contracts signed by the regime after the declaration becomes effective.[20] This tool would deter foreigners from signing such contracts in the first place given their knowledge that successor regimes would have incentives to renounce these illegitimate contracts in the future.

Vulture Funds: As poor countries' external debt situation has improved due to the HIPC Initiative and MDRI, an increasing number of so-called vulture funds have emerged to purchase their outstanding distressed commercial debt. Vulture funds then pursue legal action against these countries to recover the full face value of the original loan plus interest and penalties accrued over the years. These groups often attempt to seize country assets overseas to secure payment of court awards. According to the IMF and World Bank, new lawsuits were initiated in

[19] Apartheid-era South Africa often is presented as the archetypal case of this type of mortgaging of the future. The apartheid regime borrowed internationally, spent a large share of its budget on military and police repression of the Black majority, and left the new democratic regime that took power in 1994 with roughly $23 billion in debt. The new regime explicitly stated that it would not repudiate apartheid-era debt because of the consequences for its reputation among foreign investors and lenders.

[20] See http://www.cgdev.org/section/topics/debt/odious_debt for additional details.

the last year against the DRC, Sierra Leone, Sudan and Zambia—bringing the total value of outstanding legal claims against HIPCs to $1.2 billion.[21] However, the actual figure is likely to be much higher since debtor countries are often unaware that legal proceedings have been initiated against them.

The World Bank and the AfDB have launched several programs designed to support poor countries' efforts both to retire distressed commercial debt and defend themselves in court proceedings. In 1989, the World Bank established the IDA Debt Reduction Facility (DRF) to buy back debts owed to external, commercial creditors through grant funding to eligible governments. To date, the DRF has supported over 20 buy-back operations in 21 low-income countries. These operations have removed roughly $4.5 billion of commercial debt principal and more than $3.5 billion of associated interest arrears and penalties. By lowering the supply of distressed commercial debt, the DRF reduces the ability of vulture funds to "free-ride" on comprehensive debt relief for the world's poorest countries. In 2009, the AfDB created the African Legal Support Facility (ALSF) to enhance African countries' access to sound technical legal advice when dealing with debt recovery lawsuits. While this facility is ramping up operationally, it potentially could help to address legal capacity issues in some low-income countries.

G-8 members and the Paris Club have issued a number of statements denouncing vulture fund activity. In April 2010, the UK Parliament enacted legislation preventing creditors—including vulture funds—from utilizing national courts to pursue debt repayment claims beyond a level assessed as sustainable by the World Bank. While World Bank, AfDB, and UK actions help to discourage some activity, vulture funds remain a threat to many low-income country governments—especially HIPCs.

Conclusion

The debt relief movements during the 2000s had a significant, positive impact on long-term debt sustainability prospects. The successive debt agreements, including frameworks for new lending going forward, represent monumental leaps of progress. By illustration, debt was a high-profile development challenge during much of the 1980s and 1990s. In contrast, today it longer is a front burner issue. Despite this, a few important challenges remain, such as the potential reaccumulation of unsustainable debt and vulture fund activity. With additional focus

[21] World Bank and IMF (2008), *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation*, September 2009.

and policy action, the broader stakeholder community may be able to permanently cross off debt as a development challenge.