Africa's re-indebtedness following the HIPC and MDRI Cancellations: Proposals for Better Debt Governance

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Achieving the MDGs will require a large increase in resources, and all forms of development financing have a role to play. Borrowing can be a good way for countries to raise finance for development priorities. When countries put the money borrowed to productive use, they benefit from faster economic growth and increased investment, delivering effective social services. But rapid or excessive borrowing contributes to unsustainable debt, which can burden an economy, especially where financial systems are relatively weak. Debt service also diverts money away from investment in health, education and infrastructure.

Experience over the last twenty years has shown just how damaging excessive debt burdens can be. A number of studies[1] have concluded that developing countries with high debt ratios have suffered lower growth rates, possibly as much as a percentage point of GDP per year. This is because of the debt overhang problem where private investors are deterred from making growth-enhancing investments out of concern that future profits will be taxed away to pay for debt service.

The achievements of the last few years on debt relief have been striking. HIPC and MDRI debt relief worth more than $110bn is expected to reduce the debt stocks of the 30 countries that have already passed Decision Point by almost 90%. This is freeing up money to support poverty reduction strategies and other development priorities. It has

[1] Poirson et al. (2002); Clements et al. (2003) ; Cordella et al. (2005).

also introduced significant headroom for new borrowing. But it is essential that countries use this borrowing space wisely, or the debt overhang problem could return.

HIPC and the MDRI have been agreed to cancel countries' debt burdens, and help set them on a path to meet the MDGs by 2015. Debt relief on this scale will not be repeated, and the international community is very unlikely to fund further rounds of debt relief on new loans. At the same time, countries want to end their aid dependency and gain access to capital markets over time. Appropriate concessional lending fills a market gap and helps to establish a track record of good debt management that is essential to creditworthiness. Excess or inappropriate borrowing puts that process into reverse.

Partnership lies at the heart of the Monterrey Consensus for achieving the MDGs. And partnership too is at the heart of making debt relief work. To avoid the risk of a new debt crisis emerging, both creditors and borrowing countries must share the responsibility to ensure than any new lending is appropriately concessional and used for productive purposes. Creditors should co-ordinate their actions, and be transparent in their lending activities, to ensure that debt relief and grants are not used to cross-subsidise less concessional finance from other sources (the free-riding problem).

We all need to work together to improve the policy and institutional environment so that countries can obtain the finance they need to meet essential development needs, but also avoid another debt crisis. Solid debt governance will be at the heart of this challenge. What is the right balance between new borrowing to help meet the MDGs and prudent debt management? What are the responsibilities of borrowers and lenders in getting the balance right? Should the international community provide loans or grants to countries that have benefited from debt relief? And how can we encourage emerging lenders to play their part? There are no easy answers to these questions and I look forward to hearing your views.

Potential additional questions for discussion

1. What is the scope for and role of non-concessional borrowing, including from the export credit agencies and emerging official lenders, and of private sector lending including issuing bonds?

2. What complementary policies are required by borrowers to make effective use of foreign finance?

3. Debt Management is primarily the responsibility of the borrowing country, but what are the responsibilities of lenders, including the Bank and the Fund?

4. What steps should be taken to ensure borrowing decisions are both fully accountable and legally sound, which will not only help ensure appropriate borrowing, but should help limit the potential for so called ‘vulture’ funds to take legal action against borrowing countries.