A NEW DEBT CRISIS?

Assessing the impact of the financial crisis on developing countries

JUBILEE DEBT CAMPAIGN

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Jubilee Debt Campaign is part of a global movement working for full cancellation of unjust and unpayable poor county debts by fair and transparent means. It is a UK coalition of around 90 national organisations and 100 local and regional groups, as well as thousands of individuals.

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Executive summary

This is a wake-up call to anyone who thinks the developing world debt crisis has been resolved

As the financial crisis leads us into a deep recession at home, what impact is the economic downturn having on the world's poor, and in particular what might be the consequences for developing country debt?

This report is intended as a wake-up call to anyone who thinks the developing world debt crisis has been resolved. In fact, it assesses fears of a new debt crisis, as serious as that Jubilee Debt Campaign was set up to combat, spreading to nearly 40 countries. **38 of the 43 countries that the World Bank calculates are most vulnerable to the economic crisis already required substantial debt cancellation *before* the current crisis, in order to meet the needs of their people.** As their situation considerably worsens, many more countries could join them.

This should not come as a surprise. Debt relief to date has not only cancelled too little debt for too few countries, but has made very little attempt to implement the sort of structural reform which would end the rule of global finance. In fact, the same reckless and irresponsible lending which created the developing world debt crisis in the 1980s, is also behind the current financial crisis that the whole world is now experiencing.

In particular:

- Zambia, which has already received debt cancellation once, could soon face a debt-to-export ratio of 300% – double that deemed sustainable by the World Bank and IMF – because of the slump in copper prices;
- The Philippines has $8 billion of short-term debt which will come to maturity in the next year. But the country is already suffering from a credit squeeze, which could make re-financing this debt impossible;
- Bangladesh, which depends heavily on exporting garments to Europe and North America, will suffer a major fall in demand which could lead to a debt-to-export ratio of almost 170% – again unsustainable even by the World Bank's own narrow criteria.

The IMF and World Bank, which are being called on to help solve the crisis through greater lending, have themselves often been central to the problem of debt, the increased dependence of Southern countries on export industries, and the liberalisation of finance which has increased countries' vulnerability to international financial flows. As such, it is impossible to see, without really radical reform, how these institutions can play a constructive role in bringing the crisis to a sustainable and just solution.

We believe the solution lies in far-reaching reforms of the global economy which would ensure more responsible, sustainable and just lending whilst also reducing the dependence of developing countries on international capital, namely:

- Wider, deeper debt cancellation, amounting to at least $400 billion – a fraction of the bail-outs and stimulus packages recently proposed in the West;
- Radical reform of the World Bank and International Monetary Fund including removal of economic policy conditions from lending and debt relief, allowing countries to make their own policy choices, and full democratisation;
- Internationally agreed responsible lending standards which would bind governments, multilateral institutions and private lenders;
- A Debt Tribunal to ensure a fair and open work-out process for debts at a global level;
- Efforts to assist developing countries in raising more domestic finance, for example by tackling illicit capital flight, so they are less dependent on the debt cycle in the long-term.

Introduction

Debt, often arising from irresponsible lending, has been part of the Global South's experience for decades. Could the fallout from the most recent bout of reckless lending in the North see these countries tipped into an even deeper debt crisis?

With traditional sources of finance drying up, export markets collapsing and a range of other economic impacts, the threat of a renewed debt crisis is very real. At this time there is an urgent need to increase financial flows to the poorest countries. However, there is a serious concern that this will be done through new lending, often on more expensive terms, therefore increasing unpayable debts in the longer term.

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Reckless finance

The current financial crisis bears a strong resemblance to the debt crisis that poor countries have been facing since the 1980s. Andrés Velasco, Chile's finance minister, stated that the credit crunch is *"a more modern and a much bigger version of what we have seen in emerging markets over the last couple of decades*[1]*."* In other words, a new form of debt crisis, but this time affecting the rich world.

The story is now a familiar one. Banks have been caught out selling more and more mortgages to people who could not afford to repay them. These debts were then repackaged and sold on, in ever-more complicated 'derivative' products, which investors themselves mostly did not understand. Instead of diffusing the risk, as the experts had claimed, this process widened the exposure of the markets to these 'toxic' debts. As the huge levels of these bad debts, and their vast reach, have been uncovered, the financial markets have gone into free-fall. What is left is a huge pile of debt, and a vast hole in the confidence of lenders. The so-called 'credit crunch' has arrived.

Meanwhile ordinary citizens of rich countries, including the UK, are now bearing the consequences of unregulated finance on a grand scale: housing prices collapsing, spiralling personal debts, massive cash injections into banks that have weakened our currencies and increased our public debts, and the onset of a deep recession.

This pattern of reckless lending, followed by repayment difficulties that sparked a crisis and left ordinary people suffering, is very similar to the one that brought the developing world to its knees in the 1980s. But the contrast in policy responses is striking. While developing countries were left to suffer for decades, with only meagre relief and restructuring packages, often in return for onerous conditions, trillions of dollars has been pumped into the markets and bailing out banks in recent months.

History of the debt crisis

After the Second World War and the end of most colonial regimes, banks sought to lend money to governments in Africa, Asia and Latin America, seeing them as a safe investment. As the Cold War deepened, governments from both East and West blocs lent increasingly recklessly as they sought to gain political influence. The situation was dramatically intensified in the 1970s, when cheap money flooded the financial markets and banks lent it on to poor countries without regard for what it was being spent on and whether it could be repaid. The change in economic situation from the late 1970s, with rising interest rates, deflation and falling commodity prices, caught developing countries in a spiralling debt trap.

Since this time, despite many plans to reduce the debt burden, the crisis has continued to engulf countries in the Global South. Today developing countries' debt stocks stand at a staggering $2.9 trillion and every day the poorest countries pay the rich world almost $100 million in debt repayments[2].

As the Cold War deepened, governments from both East and West blocs lent increasingly recklessly as they sought to gain political influence

These debts are not just one-off transactions. Debts often accumulate huge amounts of interest very quickly, so countries repay them many times over, taking out more loans just to cover previous debts.

Every day the poorest countries pay the rich world almost $100 million in debt repayments

For example, in 2005 Nigeria had around $30 billion debts outstanding to the Paris Club group of rich country creditors. This is despite the original loans totalling only $8 billion[3] in the 1970s and early 1980s and Nigeria having already repaid an estimated $18 billion. The vast majority of the debt was therefore interest and charges incurred because the previous military regime did not fully meet its repayment obligations. A deal struck with the Paris Club meant that $18 billion was cancelled, but the now elected government of Nigeria still had to repay $12 billion[4].

Without access to further credit, Nigeria would not have been able to do this, underlining the way in which debt lies at the heart of the global financial system. When credit dries up as it has done now, the system breaks down.

Where does the responsibility lie?

The developing world debt crisis is an early manifestation of the same irresponsibility that is at the heart of today's financial implosion. Now, as then, it is the poorest who suffer the most. In this crisis, the developing world did not cause the problem. Developing country bankers were not those lending irresponsibly to mortgage holders who were unlikely to meet their repayment obligations. Their financial services industries were not the ones involved in the complex and ultimately flawed derivatives markets. Yet they are suffering the consequences. This demonstrates the lack of accountability and responsibility in the financial system, which extends to countries' debts and how they are handled.

It is now clear that banks' behaviour, and unsustainable lending practices, contributed to the financial crisis.

It is now clear that banks' behaviour, and unsustainable lending practices, contributed to the financial crisis. And there is widespread recognition of the need to bail out the economies and the people affected via stimulus packages, not just to save the banks. It is high time we rethink the contrasting way in which indebted countries have been treated, where there has been no similar recognition of the role of reckless and irresponsible lending in creating their debt burdens.

Irresponsible lending has included loans to oppressive regimes; for corrupt, useless or overpriced projects; or on unfair terms

As the financial system stands, countries' debts are entirely the responsibility of the borrowing state, while the lender does not share any part of the risk[5]. This implies a high degree of impunity for lenders and it has sometimes encouraged reckless behaviour because of the moral hazard that means they are almost always guaranteed to recover their debts.

Thus developing countries have lived with the consequences of reckless finance for many years. Irresponsible lending has included loans to oppressive regimes; for corrupt, useless or overpriced projects; or on unfair terms, creating huge illegitimate debt burdens that fall on the poorest people. Much of these debts are owed to national export credit agencies and international institutions that have provided public finance to get a project off the ground, but often without proper due diligence or even the application of basic standards. When the project goes wrong, it is the people of the developing country who have to pay – not the companies or the financiers.

The responses to the debt crisis have also ignored any sense of responsibility on the part of lenders. Efforts to tackle the indebtedness of borrower countries have ranged from individual lender and borrower negotiations; restructuring deals struck at the Paris Club of 19 wealthy nations; to the Heavily Indebted Poor Countries (HIPC) scheme and Multilateral Debt Relief Initiative (MDRI), which were attempts to deal more comprehensively with the debts of the poorest countries following massive public campaigning pressure. However all these approaches have been aimed at protecting creditors and the financial system, rather than tackling the joint responsibility of both lender and borrower, or fundamentally resolving the debt crisis for poor countries.

Moreover many countries, for example Philippines, Bangladesh and Lesotho, have been left out of the HIPC process, despite having high levels of poverty and often paying more on debt service than on essential services. These countries are some of the most exposed to the economic crisis, and may now be even more vulnerable to debt crisis[6], while the international community refuses to take any responsibility for creating this situation.

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

Nor have debt relief schemes been binding on lenders, leaving loopholes wide open for those willing to exploit them. For example distressed debt funds, or 'vulture funds,' sue heavily indebted poor countries for repayment of defaulted debts in order to make money, paying no heed to any debt relief schemes that may have been agreed. These funds carry out a perfectly legal practice but one which robs poor countries of resources that could be used to tackle poverty.

At the same time conditions attached to aid, lending and debt relief have imposed liberalisation upon many developing countries, including opening up their financial sectors, which has made them more vulnerable to another aspect of irresponsible finance: the volatility of global financial flows, especially speculative capital.

Backdrop to the crisis: **a perfect storm**

Several years of high economic growth had helped to reduce the debt burden for many developing countries. This situation now looks likely to be reversed by the effects of the financial crisis. At the same time a combination of crises have been hurting the developing world for some time. This means that many developing and especially small and African countries are in a weak position to face yet another crisis.

Islamic Relief

Floods in Sylhet, Bangladesh, which has been left out of debt cancellation despite its poverty and vulnerability to disaster.

Food crisis

While some developing countries benefited from the recent commodity price boom, over the past year some of the poorest countries in the world have experienced a massive rise in the price of basic foods. This has threatened serious long-term impacts on hunger, malnutrition and poverty. In 2007 the Food & Agriculture Organisation (FAO) listed 37 countries facing food crisis. Riots and food protests swept across a vast swathe of these countries, including Haiti, the poorest country in the Western Hemisphere. Perversely the social unrest resulting from the food crisis in Haiti has meant delays in meeting conditions attached to desperately needed debt cancellation. While food prices are now starting to fall, the effects of this crisis are still being felt in many places.

Lenders, in particular the International Financial Institutions, have played a critical role in creating vulnerability in the countries impacted by the food crisis. For over two decades, poor countries have adopted a series of liberalisation policies as part of structural reform packages and conditions attached to loans from the IFIs and other lenders. These policies have often weakened domestic agricultural sectors and removed safety nets. Farmers found themselves competing with cheaper subsidised products from the richer world. In addition they were told to stop stockpiling grain and other essentials in order to stabilise prices. Developing countries have turned from being net food exporters to net food importers: a food trade surplus of S$1.9 billion in the 1970s was transformed into a US$17.6 billion deficit in 2000 and a US$9.3 billion deficit in 2004[7]. Meanwhile the World Bank estimates that the food crisis could push 100 million people into poverty.

Practical Action

Climate crisis

Changes in the climate are having a disproportionate effect on developing countries. For example, Kenya and Bangladesh (two poor, indebted countries that don't qualify for debt relief) are already experiencing the frontline effects of climate change, such as droughts on the one hand and flooding on the other. Developing countries need an estimated $50 billion every year to adapt to climate change, but very little of this finance has so far been forthcoming.

In terms of the 'polluter pays principle'[8], rich countries owe poor countries an enormous carbon debt – on the basis of the huge carbon emissions 'fair share', the rich world owes an estimated annual carbon debt of more than $1 trillion – nearly $870 billion of it coming from G8 countries. This is greatly magnified if historical emissions are taken into account.

Meanwhile developing countries repay some $400-500 billion in debt service every year. Many of these countries are not deemed eligible for debt cancellation, while their debt burdens are in fact contributing to climate change and wider environmental destruction including through deforestation, oil and gas extraction, mining, and intensification of agriculture. This is because countries have to prioritise these sorts of export-oriented activities in order to earn the foreign exchange needed to service debts.

First order consequences

In this already turbulent context, the financial crisis could potentially see the development gains of recent years erased, and instead trap millions more people in a lifetime of poverty.

Financial contagion

The extreme volatility affecting financial markets in the North has spilt over into developing countries' markets, especially larger ones whose financial sectors are quite well integrated into the global economy. There was a 25% fall in the Brazilian real against the dollar in 2008; the Philippine Central Bank announced that private investment inflows for the first seven months of 2008 were 60% less than what they were at this time in 2007; the Bombay stock exchange fell 7% on 10 October alone, culminating in its biggest one week drop in almost 18 years[9]. Where these countries are regional centres for other, often poorer countries, there may well be a knock-on effect regionally as well as at the national level.

Credit crunch

The lack of money available for lending at home is being replicated and magnified in developing countries. Typically in a global downturn, capital leaves perceived 'risky' markets, like poorer countries, for the relative safety of more established markets. In the current crisis, the part or full nationalisation of some banks in countries like the UK and USA has guaranteed their safety, whilst worsening this global trend.

Recent forecasts from international institutions and experts such as the Institute for International Finance suggest that private capital flows to developing countries could fall to around $165 billion in 2009. This is less than half the $466 billion of 2008 and down 82% on the peak year of 2007[10].

At the same time the cost of borrowing is rising in the developing world, as investors withdraw, risk premiums and interest rates go up. JP Morgan's EMBI index measures the difference between returns on emerging market debt instruments and US Treasury bonds, and is a key measure of risk aversion. According to this index, there was a huge increase in risk aversion in the second half of 2008, with the difference in returns (the 'spread') growing from around 300 points to nearly 900 points in the last quarter of 2008[11]. This means that it is much more expensive for developing countries to borrow money on the financial markets.

In some places, the sudden withdrawal of foreign capital has caused dramatic falls in exchange rates. Governments with large debt burdens, which are usually denominated in foreign currencies such as the dollar, may struggle to meet the repayment requirements, and even default on their debts. The South African rand, for example, lost 30% of its value against the dollar between September and November 2008.

Christian Aid / Caroline Waterman

KENYA: Solomon Alitsi and his family are tea and coffee farmers but find it increasingly difficult to make a living.

Economic knock-ons

Exports

As demand falls in recession-hit countries, export markets are shrinking. A leading indicator of world trade and economic activity is the Baltic Dry Index, which measures the cost of moving raw materials by sea and so provides an accurate barometer of the volume of global trade. This index fell by 94% between May and December 2008[12]. As a result of the fall in demand, commodity prices on which many developing countries depend are falling[13].

Remittances

Furthermore, with rising unemployment and rising living costs in Northern countries, migrant workers are more vulnerable and their remittances (money they send back home) will inevitably fall. According to latest figures from the World Bank, remittance flows to developing countries reached $305 billion in 2008[14] – almost three times global aid levels. But the growth in remittances is already slowing dramatically, and with this crisis unprecedented in its global scale, the future remains uncertain.

Aid

Official development assistance, or aid, remains an important source of finance, especially for the poorest countries. But there are fears that Western governments will use the recession at home to cut aid levels. Indeed there are already reported cuts in Ireland's and Italy's aid budgets. Even in those countries, like the UK, which have stated that they will protect existing aid commitments, falling currencies (like sterling), and contracting economies will mean that a percentage of GDP commitment will be worth less in real terms.

Growth

Recent months have seen economists scrambling to revise their growth estimates downwards, including in poorer regions. Indeed, it would appear that predictions of a 'decoupling' of the global economy, whereby the developing world would not be very much affected by a downturn in Europe and the US, have proved incorrect. The most recent IMF projections[15] are that developing economies will grow by a mere 3.3% in 2009, down from 6.3% in 2008. Sub-Saharan Africa will see growth of just 3.5%, having risen to 6.9% in 2007.

Will this bring about a new debt crisis?

Some will argue that talk of a debt crisis is misplaced as there are substantial differences between this financial crisis and the economic situation that led to the debt crisis of the 1980s. Indeed there are diverse elements to all financial crises – be they debt, currency, or banking related. But in reality these crises often contain elements of each, and one can lead to the other. In the current context, a banking crisis became a wider financial crisis, which has already precipitated recession in many industrialised countries, falling growth in the developing world, currency falls and balance of payments problems in some countries. It could well lead to a wider debt crisis, adding more hardship to those already in the most vulnerable position.

What are the factors that can lead to a debt crisis?

The economic and financial effects will make it harder for some countries – especially those most dependent on exporting to developed economies in deep recession – to service their debts. They will simply have less money in the bank to pay out.

Whether or not this leads to debt default depends on the extent to which they have borrowed short-term to repay longer-term debts, and the amount of debts that are due to be repaid in the next year. Developing countries' total short-term debts (those with a repayment date of one year or less) stood at $660 billion in 2006, with $43 billion of Sub-Saharan Africa's debts coming to maturity within a year[16]. If any of these countries find themselves unable to repay these debts, they will have to look for refinancing or restructuring, options which are extremely difficult in the credit desert that has emerged.

The US dollar plays a key role in the indebtedness of many developing countries. In the absence of an international managed exchange rate system (abandoned unilaterally by the US in the early 1970s) or an international reserve currency, the dollar acts as a vehicle for all global reserve holdings and many external debts.

Many developing countries have built up large dollar reserves, in part as an attempt to protect themselves against volatility. In effect these reserves operate as large loans to the US, supporting its boom in the early part of this decade. But these may now be eaten in to by countries desperate to stave off the effects of the downturn. Debt burdens are also denominated in dollars and if local currencies are forced to devalue, or come under attack, these will inevitably become harder to repay.

The response to the financial crisis is being driven by new lending; there is a real concern that this will contribute to even more unpayable debts in the future

If and how debt disasters occur in developing countries also depends on what is done now. However, the response to the impact of the financial crisis on developing countries is being driven by new lending. For example in February, Douglas Alexander, Secretary of State for International Development, listed increasing World Bank lending threefold and giving a much bigger role to the Bank's private sector arm, the International Finance Corporation (IFC), as key aspects of the UK's attempts to help poor countries cope[17].

There is a real concern that this new lending will contribute to even more unpayable debts in the future. Moreover, given the Bank's involvement in projects with dubious social and environmental records a whole new round of illegitimate debts may be created[18].

What does all this mean for poor people?

Where exports, investment and growth are expected to fall, fewer jobs, lower incomes and more poverty will result. Where developing countries find themselves in debt distress, they will have less finance available to meet their people's basic needs, and their citizens will suffer. The International Labour Organisation estimates that 51 million people will be unemployed by the end of 2009.

As many as 53 million more people will be trapped into poverty this year as a result of the global economic slowdown

According to new World Bank analysis, as many as 53 million more people will be trapped into poverty this year as a result of the global economic slowdown. The Bank also predicts that between 200,000 and 400,000 more infants could die each year between now and 2015 if the crisis persists[19]. While effects like rising unemployment and home repossessions will obviously cause suffering in the North, these stark statistics highlight the severity of the consequences in developing countries, which lack the social protection measures that exist in wealthier parts of the world.

We can also assess how economic crises affect poor people by looking at the consequences for human development of past crises. Mexico and Indonesia experienced two of the deepest economic crises of the last decade[20].

Mexico experienced a crisis in 1994-5 triggered by a sudden devaluation of the peso in December 1994. In the wake of a growing deficit and the bursting of an asset bubble, the Government was forced to depreciate the currency. This increased the cost of Mexico's (dollar-denominated) debts, and it had to turn to the US, Canada and the International Financial Institutions for assistance.

Indonesia, meanwhile, grew at a fast rate during this period, but was then one of the countries in the eye of the storm of the 1997-1998 financial crisis, when speculation on the Thai baht led to economic collapse which spread throughout the region. Unregulated finance, overdependence on Japanese loans which were then called in, and a large short-term debt, all contributed to Indonesia's crisis, which saw the currency fall, banking closures, high inflation, and rioting on the streets.

Researchers have found that these crises had a strongly negative effect on household incomes. Wages fell, and many workers moved into the informal sector, thereby making themselves more vulnerable to future shocks and increasing inequality. Social spending fell significantly, particularly on health services. Mexico saw increased mortality rates among the vulnerable, and in Indonesia school enrolments fell. The impact of economic crisis is clear, in that even countries previously experiencing high growth and falling poverty are vulnerable, and many millions of people may be pushed back into poverty.

Furthermore, the consequences of crises may be long term, even generational. This is especially relevant when looking at the debt element: debts may be increased now to pay for 'crisis management' such as the increased World Bank and IMF lending being proposed, which could cause a lack of finance for social spending in the future.

Christian Aid / Mike Goldwater / Getty Images

NORTH EAST KENYA: women walk for two hours carrying water for their goat herd.

Which countries might be most vulnerable?

There is a real danger that 38 countries – and quite possibly many others – may face a debt crisis in the near future

The World Bank has produced a matrix of developing countries most vulnerable to the current economic crisis[21]. Almost 40% of developing countries are highly exposed to the poverty effects of the crisis, facing both falling growth rates and high poverty levels. Out of the 43 most vulnerable countries, Jubilee Debt Campaign estimates that 38 needed at least some debt cancellation to meet their people's basic needs, *before* the crisis[22]. There is a real danger that those 38 countries – and quite possibly many others – may face a debt crisis in the near future.

We would argue that those developing countries which are most at risk are also those that followed a certain set of economic policies – for example having opened financial markets making them vulnerable to contagion; or being highly dependent on exports, especially of commodities whose prices are falling rapidly; or on private foreign investment; or short-term, expensive credit.

This set of criteria resonates with the sorts of policy prescriptions which many developing countries have been following since the 1980s debt crisis, as part of structural reform packages put together by the IMF and World Bank, and other Western donors. One of the lessons that must be learnt from this crisis is that the 'Washington Consensus', as these set of policies have come to be known, has failed. Countries should be allowed to respond to economic issues, whether brought about by the crisis or more long-term concerns, in the way most appropriate to their local needs, and not by following a formula set by officials in remote institutions.

A recent UN paper noted the consensus that exists among macroeconomists that open economies are more exposed to the effects of volatility in international capital markets[23]. In particular, financial liberalisation can now be seen as a specific failure of the reform agenda of donors and international institutions in recent decades. The public spending and interventionist policies of IMF members including the USA, UK and others in Europe, shows that the era of 'unfettered finance' is over.

One of the lessons that must be learnt from this crisis is that the 'Washington Consensus' has failed

At the same time, the IMF has been continuing to impose the same policy mix on poorer countries that are not in a position to bail out their own economies. In November 2008 the IMF agreed a loan package for the Seychelles, which is in the midst of a debt crisis, connected in part to internal factors but brought to a head by the food and fuel price shocks, the financial crisis, and the global economic downturn. The reforms include liberalising the exchange regime, removing all exchange restrictions and floating the rupee.

The Central African Republic (CAR), a fragile war-torn state, entered the HIPC debt relief initiative in September 2007 and may complete it by mid-2009. In order to do so, and get some of its debts cancelled, the IMF told CAR that it must *"refrain from providing resources to recapitalise the troubled commercial bank"* - advice that runs counter to the actions of countries like the UK over its HBOS, Lloyds TSB, and RBS bail-outs, for example.

Country case studies

Zambia

Zambia's large debts and high poverty levels led to its acceptance into the Heavily Indebted Poor Countries Initiative (HIPC) in December 2000. Zambia completed HIPC in 2005 receiving a total of $6.6 billion debt cancellation through this initiative and the Multilateral Debt Relief Initiative that followed. The savings Zambia is making from debt relief are going towards eliminating school fees and user fees in rural health care centres, funding agricultural projects and infrastructure development. Yet Zambia is still an extremely poor country where 64% of the population live on less than $1 a day. Zambia currently has debts of approximately $2.1 billion and is also listed as a country at high exposure to the global economic crisis in the World Bank's assessment of vulnerability.

Copper mining generates three-quarters of Zambia's foreign exchange earnings[24]. Copper is a vital asset and one that should have benefited the country greatly, especially when the price of copper was, until very recently, at unprecedented levels: in 2006 it was hovering at around five times the average 2002 price[25].

However, both government mismanagement and then a privatisation deal that favoured foreign companies, have reduced the benefits Zambia has received. Nevertheless, in early

Christian Aid / David Rose

ZAMBIA: Kabanana township

2008 Zambia unilaterally instituted a modest mining tax increase to rectify the unbalanced rates that had followed the privatisation deal in the late 1990s.

Now however, the price of copper has slumped to a third of what it was in just six months. Not only does this have a direct impact on Zambia's export earnings; it has also shifted the negotiating positions of Zambia, and other resource-rich African governments, with respect to mining companies.

There is also a wider impact on investment in the economy. In December the World Bank's private sector arm, the International Finance Corporation (IFC), reported that the proposed $1.5 billion Kafue Lower Gorge Dam in Zambia had been put on hold, as many investors are shying away from major commitments in light of the financial crisis[26]. The drop in copper prices meant financiers were not confident they could recoup their investment. The project is now going ahead, but ordinary consumers in Zambia are having to pay instead, with electricity bills rising to cover the costs.

The World Bank uses the ratio of a country's export earnings to debt as an indicator of its debt sustainability. This is considered by many to be an arbitrary and inadequate criteria for debt cancellation, but here it can provide a useful approximation of what is actually payable. With Zambia's export levels now plummeting there is a real danger its debts will become unsustainable once more, even by this measure. A rough calculation[27] would now put Zambia's debt-to-export ratio at around 300%. This is more than double the 150% threshold considered sustainable by the World Bank.

Philippines

The Philippines' external debt stands at $60.3 billion and it paid $13.6 billion in debt service in 2006. international institutions like the World Bank have had a major role in the Philippines since its external debt crisis began in the early 1980s, but as a middle-income country it does not qualify for debt cancellation under the internationally agreed schemes.

Pressure to deal with its debt levels, including from the World Bank and the IMF, has led the Philippines Government to seek foreign exchange earnings through its mining industries. Unfortunately many of the mining projects undertaken have caused social and environmental damage, and the incentives provided to attract the investment have meant that financial returns have not been high. Just one example is the open pit mine at Rapu Rapu in the south east of the Philippines, where cyanide spills and tailings have killed large numbers of fish on which the local population survive[28]. Now the lack of credit globally and the sharply reduced commodity prices have caused extractives projects to be scrapped or delayed, eroded profits and worsened their outlook.

More widely, as a middle income country the Philippines is much more dependent on private finance than some of the poorest countries. The country is therefore more vulnerable to the current crisis, and it is also rated as highly exposed to the crisis by the World Bank, meaning its households are more at risk of poverty and hardship in the months and years ahead.

To give an idea of the scale of the shift in the last year, the Philippines balance of payment yielded a deficit of $394 million in the third quarter of 2008, a reversal of the US$3.5 billion surplus registered in the third quarter of 2007[29]. Around three-fifths of its external debt is commercial, and over $8 billion is short-term, coming up for repayment in the next year[30]. Meanwhile, according to research by the New Economics Foundation before the crisis (in 2007), the Philippines requires 63% debt cancellation simply in order for the government to meet the basic needs of its citizens.

Christian Aid/Jon Challicom

PHILIPPINES: Farmers in Mindano

Bangladesh

Despite extreme poverty, climate-related disasters and high levels of debt, Bangladesh does not meet the criteria for debt cancellation under the international Heavily Indebted Poor Countries scheme. There is now a real danger that the impact of the economic downturn will lead Bangladesh into greater economic problems and debt crisis.

If aid levels decline, as many predict, this would also have a significant effect on Bangladesh, which is highly dependent on official development assistance. Aid levels were $1.6 billion in 2007[32]. And Bangladeshi remittances may be hit by economic decline in the Middle East, which have been exposed to the financial crisis.

As the global economy continues to decline, Bangladesh may well struggle under the weight of an unpayable debt burden

Bangladesh's economy is largely shielded from the financial market turbulence; its banks have not been engaged in so-called 'toxic' derivatives trading and most of its capital inflows come from aid and official lending. However, Bangladesh's economy relies heavily on garment exports and this is where the main risk lies. The ready-made garment industry accounts for over three quarters of export earnings and depends almost entirely on US and EU markets[31]. There is growing concern that a deep and prolonged recession in the US and EU may reduce consumer spending significantly, thus undermining the demand for Bangladeshi exports.

This would have an even greater effect on the economy: Bangladesh received $6.6 billion in remittances in 2007, some 9.5% of GDP[33].

Bangladesh's external debt stood at US $20.5 billion in 2006 and it paid $685 million in debt service in that year alone[34]. Almost all of Bangladesh's debts - $18.9 billion – are public and publicly guaranteed (i.e. from multilateral institutions, countries, and export credit agencies) as it is too poor to access commercial credit. Bangladesh also has $476 million in short-term debts to the IMF and $1.2 billion in other short term debts. These will come to maturity within a year and could therefore cause problems for Bangladesh if it struggles to meet the repayment terms.

Bangladesh is listed by the World Bank in their recent analysis of vulnerable countries as one of the countries highly exposed to the global economic crisis[35]. This is because of the high levels of existing poverty (49.6% of the population live on less than $1 a day[36]) and the expected low rates of real per capita growth. Its economy has little ability to raise additional finance without risking instability or increased unsustainable debts. As the global economy continues to decline, Bangladesh may well struggle under the weight of an unpayable debt burden.

If garment export earnings were to slump by a third, using the same debt-to-export measure of debt sustainability as for Zambia (page 15 above), a rough calculation would put Bangladesh's debt-to-export ratio at 166%[37]: above the 150% debt-to-export threshold of debt sustainability and particularly telling for a country with such a relatively high level of exports. On the basis of the New Economic Foundation's research in 2007, Bangladesh required 100% debt cancellation in order to meet the basic needs of its people.

What must be done?

The debt crisis that started decades ago for the Global South has still not been resolved. Now the global financial crisis, coming as it does at the same time as food insecurity and climate change, is hugely exacerbating the suffering of people in developing countries. The threat of a renewed debt crisis in many of these countries is looming large. Action must be taken now to help alleviate the pain being caused, and to create a new shared responsibility in the financial system.

Cancel more debts

Broader, wider debt cancellation is urgently needed to release funds in developing countries, which can be used to stimulate the economy and provide social protection to the most vulnerable, as is being done in the North. Eligibility for debt cancellation should be based on a measure of debt sustainability connected to human development, which would mean much greater debt cancellation for many more countries. Jubilee Debt Campaign estimates that at least $400 billion should be cancelled for around 100 countries if they are to be able to pay for essential services for their people without having to tax those below the poverty line[38], while debt portfolios need to be audited so that illegitimate debts – those arising from irresponsible loans – can be written off.

Debt relief is critical to enhance governments' fiscal space to boost the real economy and maintain social spending, rather than using scarce financial resources to fulfil creditors' demands. Development economists and donor countries have long recognised the strengths of debt cancellation as a form of financing for poverty reduction which is predictable, flexible and non-cyclical, and has low transaction costs.

Meanwhile it is important that donors continue making progress towards giving 0.7% of national income as aid. New debt cancellation must be counted separately from donors' aid commitments. Both increasing aid volumes and substantial debt cancellation are required to enable developing countries to cope with this crisis.

Radical reform at the international institutions

It is vital that governments are held to account by their citizens, parliaments and civil societies, to ensure funds released through debt cancellation are used for the agreed purposes. Onerous and undemocratic economic policy conditions must not be attached by lenders or international institutions. In particular those calling for greater liberalisation are acutely misplaced in the current climate.

Moreover, the financial crisis underlines the fact that International Financial Institutions have failed to do their job. Major new roles for these institutions are now being discussed, but in their current form they are not fit for purpose. There must a transformation at the World Bank and IMF, to ensure that they are properly democratised, and made fully transparent and accountable, and respect international standards on human rights, the environment and labour.

If such radical change is not forthcoming, new institutions should be considered that are fair, representative and attuned to local needs. Regional models such as the embryonic Bank of the South should also be considered.

Responsible finance – no more reckless lending

Financial flows to developing countries urgently need to be increased, but must not contribute to future unsustainable, unjust debt burdens. As well as debt cancellation, additional grant-based finance should be provided to the poorest countries. Any new lending must take into account the essential components of a responsible loan, as set out in *Eurodad's Charter on Responsible Financing*[39], which include ensuring that terms and conditions are fair, that the loan contraction process is transparent, that human rights and environments of recipient nations are respected and repayment difficulties or disputes are resolved fairly and efficiently. Many of the provisions in the charter are drawn from international treaties and conventions to which lender and borrower nations are signatories.

A Debt Tribunal

The financial crisis and the possible increase in debt problems we may see in the months ahead, brings into sharp focus the need for an internatonal forum – akin to a tribunal - to deal with sovereign debt work-outs. The current debt relief initiatives are inflexible, entirely creditor-controlled, and wholly inadequate to meet the challenge of the continuing debt crisis, particularly when many more countries are at risk. There needs instead to be an open, impartial and transparent debt tribunal which could resolve debt crises and disputes. The creation of such a mechanism was strongly supported by 77 developing countries at the UN Financing for Development conference in December 2008.

Such a process would take account of both the origin and the impact of the debts, and would give equal treatment to both debtors and creditors, acknowledging the co-responsibility that creditors share for the creation of these debts and giving scope to assess debts on the basis of illegitimacy as well as sustainability.

This debt work-out process would also place the same moral and legal obligations on companies as it does on governments, thus tackling the current lack of participation by commercial creditors, and at the extreme end, the actions of so-called 'vulture funds' who buy up debts at a steep discount and pursue the debtor country for the full amount, often through the courts. This aggressive approach is typical of the rogue behaviour that has been exposed in the financial markets in recent months, where pursuit of profit has been put before values, such as human development and freedom from poverty, which the market must be made to serve.

No more business as usual

The current crisis is a moment for real change. We must look towards different solutions for countries to tackle poverty in the longer-term.

The financial system is based on vast amounts of capital flowing across the world, large sums of it in debt service, tax evasion and avoidance, other forms of illicit capital flight, and speculation. These flows are at best not contributing to efforts to tackle poverty, and at worst are actually damaging countries' ability to raise sufficient funds domestically to finance their own development. Moreover they make countries dependent on a vicious cycle of loans to pay off loans, contributing to a never-ending debt burden.

In the immediate term emergency funding must be provided, as much as possible in grants, rather than loans. Looking to the future, efforts must be concentrated on a fair and comprehensive way of dealing with debts; providing grant based finance to meet poverty reduction targets; and plugging the gaps that allow tax avoidance and illicit capital flight, for example by tackling tax havens.These sorts of measures will help states to build their capacity to raise taxes, reap the benefits of foreign investment, and choose their own paths to development, without the debt addiction that has characterised the last thirty years or more of relations between Global North and South.

The current crisis is a moment for real change

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There is a real danger that 38 countries – and quite possibly many others – may face a debt crisis in the near future

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