Conditioning Debt Relief on Adjustment:

Creating the Conditions for More Indebtedness

Over the past year there has been growing public recognition, even within official circles, that foreign-debt burdens, particularly those of the least-developed countries, are unsustainable and constitute severe constraints on those countries' future development. The dire situations in Honduras and Nicaragua after Hurricane Mitch serve to highlight the impossibility of those countries garnering sufficient resources to rebuild their devastated infrastructures while foreign-debt payments continue to absorb much of their governments' revenues and export earnings.

Various proposals have been developed for the cancellation of bilateral and multilateral debt. Most prominent among these proposals is the Heavily Indebted Poor Countries (HIPC) initiative.[(1)] The stated intention of this program, which is administered by the International Monetary Fund (IMF) and the World Bank, is to enable highly indebted poor countries to achieve sustainable debt levels within six years. After three years of implementation of structural adjustment programs (SAPs), countries reach a "decision point", at which time some debt rescheduling may be granted and the level of additional debt reduction needed is calculated. That reduction, however, is typically available only after another three years of adjustment. It could take even longer than six years for a country to receive any debt relief, as the "clock" stops if a country fails to fully adhere to the adjustment program and restarts only when the IMF has certified that it is in compliance once again. In fact, given the long time frame for debt cancellation, it appears that a central goal of the HIPC initiative is to keep countries locked into adjustment programs, with debt reduction now used -- as has been both access to finance and debt itself -- as leverage toward that end.

While the recognition that debt levels must be reduced is a step in the right direction, the requirement that countries continue to implement SAPs in order to qualify for and receive that relief greatly diminishes or even negates the benefits that might accrue from debt cancellation. Not only have adjustment programs devastated national economies across the South and caused misery for hundreds of millions of people, evidence shows that, in the large majority of countries implementing those policies at the insistence of the international financial institutions (IFIs), debt levels have increased.

In fact, a study carried out by two researchers affiliated with The Development GAP demonstrates that there is a positive linear relationship between the number of years that countries implement adjustment programs and increases in debt levels. Rather than leading countries out of situations of unpayable debt levels, the HIPC program and others conditioned on the implementation of SAPs would likely push participating countries further into a tragic circle of debt, adjustment, a weakened domestic economy, heightened vulnerability, and greater debt.

Methodology

The Development GAP study covers 71 economies of the South with a history of at least three years operating under World Bank-supported structural and sectoral adjustment programs during the period 1980-1995. Many of these countries have also implemented IMF adjustment programs. On average, the countries included in the study had implemented SAPs for 7.8 years. Some 42 African and Middle Eastern countries were included and comprised 59.2 percent of the sample. Eleven Asian countries, or 15.5 percent of the total, and 18 Latin American countries, comprising 25.4 percent of the cases, were also included in the study. A list of the countries included in the study, along with data related to SAPs and debt, is provided in the Annex.

The independent variable used in the study analysis was the number of years a country had been implementing a structural adjustment program. The dependent variable was the change in the ratio of debt to GNP. The total debt level used was the sum total of debt and the debt and interest cancelled during the period (so that official debt-reduction plans do not skew the results). Changes in the ratio of debt to GNP were derived by calculating percentage changes in the ratio from the first to last year of a country's SAP. In the cases in which the program was still ongoing, 1995 was used as the final year for calculation due to the unavailability of data on debt after that date. All figures are based on official World Bank information.[2]

Results

Of the countries included in the study, a full two-thirds saw their debt burdens increase during the adjustment period. Furthermore, as cited above and contrary to assertions by the IFIs that "sound economic policy" is the best road out of debt, statistical analysis of the data demonstrates a positive relationship between the number of years under adjustment and increases in debt levels. The longer these countries implemented the neoliberal programs, the worse their debt burdens typically became.

It is striking that none of the countries currently being considered for debt relief under the HIPC initiative has experienced a drop in the debt-to-GNP ratio under their respective adjustment programs. In some countries, the inverse relationship was especially strong. Guyana and Cote d'Ivoire, two countries that are scheduled to receive such debt relief, have experienced phenomenal increases in the debt/GNP ratio. In the former, the ratio grew by 147 percent after 13 years of adjustment, and, in the latter, 13 years of SAPs produced a 120-percent increase in debt to GNP. Of the 35 countries listed by the World Bank as HIPCs,[3] only three experienced decreases in debt-to-GNP levels under adjustment. All others experienced increases, ranging from an 11-percent rise in Mauritania to a 670-percent increase in Nigeria.

The average, or mean, increase in debt for all of the countries in the sample was 49.2 percent. The median, or most frequent, increase was 28.2 percent. The top 25 percent of the countries showed a 75-percent increase in foreign debt.

Tragic Circles of Debt and Adjustment

There are a number of reasons for the rise in debt levels. In some countries, the trade liberalization required under adjustment programs leads to a flood of imports and, consequently, higher trade and current-account deficits. Those deficits need to be compensated for by higher foreign investment, foreign assistance or foreign borrowing. In many countries, such as Brazil, the maintenance of high real interest rates, as often mandated by the IFIs, in order to appease nervous foreign investors, is increasing the cost of domestic debt, thus adding to the government's budget deficit, raising the specter of further devaluation, and, consequently, creating greater difficulty in servicing the foreign debt

One of the central objectives of structural adjustment programs is to reorient economic activity away from production for domestic consumption and toward production for export. In making this shift, nations become exceeding vulnerable to the vagaries of the global economy. Countries export more and more as commodity prices continue to fall. Governments deregulate economic activity, "flexibilize" labor markets and raise interest rates in increasingly desperate efforts to attract and maintain fickle foreign investment. The recent crises in Mexico, East Asia, Russia and Brazil demonstrate the hazards of countries betting their future well-being on the erratic global financial market. Indeed, those countries receiving IMF-orchestrated "bailouts" could very likely constitute the next group of debt-crisis countries, as the adjustment conditions attached to these packages include the requirement that governments guarantee payments to private international banks, thus making private debt a public obligation.

High foreign-debt levels are both a result and a symptom of the extreme risk that governments take in tying their economies too closely to the global market. The causes of that debt are flawed economic policies that fail to develop domestic productive capacities or raise local income levels so as to reduce the need for external financing. For this reason alone, the requirement that governments adhere to the structural adjustment programs designed by the international financial institutions is pure folly. Instead, governments should be encouraged to develop national economic plans designed democratically to expand the domestic financial resource base, incomes and markets and, consequently, reduce their extreme dependence on foreign debt. Otherwise, we can expect the tragic circle of debt and adjustment to continue into the foreseeable future -- debt-relief programs not withstanding.

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[1] For more information on the HIPC initiative, see articles by Eurodad, including "The HIPC Initiative in a Nutshell," (November 1997) and "The HIPC Initiative Reviewed: Baker, Brady, HIPC...What's Next?" (September 1998). Available at http://nt.oneworld.nl/eurodad/ (return to text)

[2] The number of years under adjustment for each country was obtained from the World Bank Public Information Office. The figures used to calculate the debt to GNP ratio were taken directly from the World Bank's database.

[3] World Bank, "Debt Relief for Low-Income Countries: The HIPC Initiative." September 1998, p. 24.

Annex: Countries included in the Study

Africa and Middle East	Years under SAP	% Increase in Debt/GNP
Algeria	5	72.05
Benin	6	17.74
Burkina Faso	4	65.98
Burundi	9	155.96
Cameroon	6	156.96
Central African Rep.	7	110.76
Chad	6	81.43
Comoros	4	30.30
Congo	7	75.59
Cote d'Ivoire	13	119.53
Egypt	3	-22.89
Equatorial Guinea	4	23.10
Ethiopia	3	28.25
Gabon	7	62.58
The Gambia	5	-25.88
Ghana	12	148.31

Guinea	8	10.92
Guinea-Bissau	10	64.57
Jordan	5	-29.72
Kenya	15	120.50
Madagascar	9	87.87
Malawi	4	142.92
Mali	7	29.06
Mauritania	9	10.55
Mauritius	8	-15.91
Morocco	10	-28.19
Mozambique	7	30.92
Niger	9	63.92
Nigeria	11	669.66
Rwanda	4	106.65
Sao Tome and Principe	8	287.91
Senegal	14	56.66
Sierra Leone	3	-9.77
Somalia	6	37.75
Sudan	7	-25.54
Tanzania	14	361.07
Togo	12	14.43
Tunisia	8	-22.69
Uganda	13	33.19
Zambia	11	61.19
Zimbabwe	11	121.14

Asia	**Years under SAP**	**% Increase in Debt/GNP**
Bangladesh	15	75.76
China	3	15.94
India	3	-16.32

Indonesia	5	-9.32
Lao PDR	5	-33.23
Nepal	6	57.68
Pakistan	4	30.61
Papua New Guinea	5	-35.86
Philippines	14	7.57
Sri Lanka	5	-12.38
Thailand	3	6.72

Latin America & Caribbean	**Years under SAP**	**% Increase in Debt/GNP**
Argentina	9	-11.85
Bolivia	15	51.43
Brazil	9	-8.99
Chile	3	-19.99
Colombia	10	-33.56
Costa Rica	12	-56.61
Dominica	4	-19.22
Ecuador	9	13.80
El Salvador	4	-20.69
Guatemala	3	-13.86
Guyana	13	147.32
Honduras	6	38.97
Jamaica	14	75.13
Mexico	11	30.83
Nicaragua*	13	726.07
Panama	11	8.87
Peru	3	8.42
Trinidad and Tobago	3	-5.10
Uruguay	9	-55.72
Venezuela	5	-3.71

*Nicaragua was excluded from the analysis because of the unorthodox nature of its debt and because adjustment was implemented sporadically during the period (and at times without support from the international financial institutions), making it difficult to identify beginning and end years for the program.

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