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**JUBILEE DEBT
CAMPAIGN**

A new way of dealing with debt

October 2008

So far the debt campaign has helped secure almost \$90 billion of debt cancellation through internationally agreed schemes. But these schemes have run out of steam and they have not finished the job. Far too much debt, for far too many countries, is not covered by the current schemes. What's more, they don't address the problem of illegitimate debts, which have arisen from reckless lending in the past. And we still have no way to deal with the roots of the debt crisis – a system that would prevent bad debts from being built up in the future. Poor countries urgently need a new way of dealing with debt. Here we set out what the problems with the current processes are, and what a new system – a 'Debt Tribunal' – might look like.

How does debt relief actually happen?

The attempts led by creditors to deal with the debt issue so far have largely been about defending the current international financial system, not about justice or protecting the rights of the people of indebted countries. A new system is needed to bring about a just solution to the debt crisis and rebalance power inequalities between rich and poor.

Traditionally, indebted countries can try to reduce their debt burdens in a number of ways. They can try to negotiate with individual lenders, or they can approach one of the informal creditors clubs – the London Club for *commercial debts* and the Paris Club for debts owed to rich countries (*bilateral debts*) to try to strike a deal. But these processes are ad hoc, opaque and creditor-controlled by their nature. They mainly postpone or at best partially reduce debts. In the case of the Paris Club – a group of 19 wealthy governments – countries must meet various International Monetary Fund economic conditions

to even be considered for a deal. Finally, these approaches don't address the huge *multilateral debts* that many poor countries owe to institutions such as the World Bank.

By the mid-1990s it became clear that these informal approaches were not doing enough to assist poor countries in debt crisis, even just in terms of making their debt burdens payable. The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996, and expanded in 1998, aiming to bring together the bilateral, multilateral and commercial creditors of some of the poorest countries, and to reduce their debts to a level deemed "sustainable". Since 2005, these same countries are eligible, on completion of the HIPC process, for further debt relief, through the Multilateral Debt Relief Initiative which was agreed by the G8 at Gleneagles. These schemes have so far delivered over \$88 billion of irrevocable debt cancellation to 25 countries. But we estimate that more than \$400 billion in unpayable debts must still be cancelled for all developing country governments to be able to meet their people's basic needs. Beyond this, remaining debts need to be audited so that those that arose from irresponsible lending can be cancelled on that basis.

Powerful players

The power dynamics of the debt cancellation process are completely unjust. The route to debt cancellation is governed by the same wealthy, powerful countries that made the loans and seek their repayment. So despite the fact that their often-reckless lending behaviour was responsible for much of the spiralling debts of poor countries, they are not accountable to anyone, and there is no penalty imposed on them for being careless lenders. The debtor countries remain the sole sufferers from the debts, and from



▲ Campaigners give the Paris Club of rich lenders a red card as it marks its 50th anniversary in 2006.

the hoops they have to jump through to get any debt cancellation. Citizens of indebted countries, those whose rights are infringed by impact of these debts, are completely absent from the process and their voice is not heard.

No obligation to cancel

For a just solution to the debt crisis, we need a way for countries to negotiate with *all* of their creditors. As it is not mandatory for creditors to join in the cancellation process, it is up to them, be they banks, international institutions or countries, to volunteer to cancel debts. This means that lenders can hold out and seek repayment, thus ‘free-riding’ over those creditors who have agreed to cancel debts, or even sell off the debts to so-called vulture funds. These creditors buy up bad debts and pursue them, sometimes taking the debtors to court, even though the debtor country qualifies for debt cancellation. Moreover the world of global finance has spawned a multitude of new creditors and lending instruments, like new kinds of bonds and derivatives, which make the picture ever-more complicated. It is these sorts of flaws in the system that mean reform is urgently needed.

On their terms

When it comes to debt relief, there is no negotiation. Whether at the Paris or London Clubs, or through HIPC, the rich lenders make the rules and decide who gets how much debt relief. Poor countries have to accept the following terms or not get any relief:

- **Arbitrary criteria, based on payability not genuine sustainability**, are used to decide who qualifies for debt relief, for example using a country’s debt-to-export ratios. Debts are only cancelled down to a level that the rich countries and banks think a country can afford to repay. This means

Kenya – poor and in debt, but doesn’t qualify for debt relief

Kenya is one of many countries left out in the cold. Kenya has debts of over \$6.5 billion but does not qualify for debt



cancellation through the Heavily Indebted Poor Countries (HIPC) Initiative because, according to criteria set by the World Bank, Kenya’s debt is ‘sustainable’. This is despite the fact that the Government of Kenya spends a third of its national income on servicing debts, \$538 million in 2005, thus wiping out most of the \$768 million in aid it received in the same year. Meanwhile around one third of Kenyans are malnourished and almost 60% live below the \$2 a day poverty line.

nowhere near enough debts are cancelled and some countries with huge debts are not included at all. This is regardless of other demands on a government’s finances, such as paying for essential services, tackling poverty, and protecting the human rights of its citizens.

- One of the biggest problems with the current systems of debt relief is that they come with many **‘strings’ attached**. Applying policy conditions to debt relief – telling governments how to manage their economy for example – is undemocratic, interfering, and often causes harm to the poorest people. Imposing such conditions also means it takes years for a country to complete the HIPC debt cancellation process. Some countries, such as Kyrgyz Republic, have been so concerned with the conditions involved that they have turned down debt cancellation, but this obviously leaves them with no solution to their high debt levels.
- There is no international platform for poor countries to bring evidence of **illegitimate debts**, for example arising from loans made to oppressive and corrupt regimes; to fund badly designed, useless projects; or on unfair terms such as extremely high interest rates. Billions of dollars of poor country debts are unjust, and there are growing calls for these debts to be audited and, where appropriate, written off. None of the current debt relief approaches recognise any concept of odious or illegitimate debt. This means creditors

Haiti – qualifies for debt relief but still hasn't received it

Haiti is the poorest country in the Western Hemisphere. Nearly 80% of the population live on less than \$2 a day and many people do not have access to basic services. Its external debt stands at \$1.2 billion, much of which is illegitimate debt run up by the corrupt and oppressive Duvalier family, who ruled Haiti from 1957 to 1986, and who either used the money to prop up their regime or simply stole it.



Haiti finally qualified for HIPC debt relief in 2005, and is now paying reduced debt service. However it still has to meet a range of policy conditions before it completes HIPC and has any of its debt stocks cancelled – this won't happen until 2009 at the earliest. This is at a time when soaring food prices and natural disasters such as hurricanes and flooding are causing misery for millions of ordinary Haitians and threatening to plunge the country into political and economic meltdown.

do not have to face up to their responsibility in creating the debts in the first place, and their lending practices cannot be challenged or changed in future.

The problems outlined here underline the reality that debt and debt cancellation are used as tools of power by the rich to control poorer countries, rather than giving them the freedom to take their own path out of poverty. Until now, the attempts made by creditors to address debt problems in poor countries have been more about shoring up that power, and maintaining the global financial system as it stands, rather than truly addressing the injustices of that system and the power imbalances it upholds. If we are to do the latter, we need a new way of assessing and cancelling debts which is open, equal and fair.

What do we need?

A new international debt work-out process, which could be along the lines of a *Debt Tribunal*, is urgently

Indonesia – huge unjust debts but no way to get them cancelled

Under the notorious Suharto regime, Indonesia acquired over \$150 billion in debt, for which its citizens today are still paying, a decade after Suharto left office. This is despite the fact that Indonesian civilians had no say in whether or not Suharto should take these loans, and experienced virtually no benefit from the funds (since much of the loans were diverted into politicians' pockets). Moreover, many of them were oppressed by the regime using weapons bought with some of these foreign loans, and this oppression was known about at the time. Cancelling these debts is a matter of justice, but current debt relief schemes make no provision for cancelling unjust debts.



needed. It is crucial to have a process that addresses the current limitations and power imbalances, making sure creditors share responsibility for the debts they helped to create so that their lending behaviour is altered going forward. Civil society and citizens' voices must be taken into account. All this would help to achieve the goal of cancellation of all unpayable and unjust debt, and create a fairer system of global finance.

Over the years, a number of models have been developed for a debt tribunal, panel or process. Austrian economist Professor Kunibert Raffer's proposal for a *Fair and Transparent Arbitration Process* (FTAP) has been widely supported since its development in the early 1990s. In the UK this same model, which is based on part of the US bankruptcy code, has been put forward as the *Jubilee Framework*.

More recently Latin American economists Acosta and Ugarteche proposed an *International Tribunal for Sovereign Debt* in 2003. Even the IMF has got in on the act, putting forward a Sovereign Debt Restructuring Mechanism in 2003, although this was widely criticised for being far too concerned with the interests of creditors.

Aside from the IMF initiative, these proposals share many of the same features, and would include the following elements:



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▲ Lots of help is available for the US banking system (left) and for individual borrowers (right) in dealing with debt problems. But for the Global South, the same rules do not apply.

- An impartial and independent panel would arbitrate the dispute.
- The debtor country's need for financial resources to fulfil the basic needs of its population would provide an overriding principle.
- Equal treatment would be given to debtors and creditors, public and private.
- The process would be transparent and would involve civil society and the citizens of indebted countries.
- The panel would also have the authority to determine which debts are legitimate and which are illegitimate.

A *Debt Tribunal* could, for example, be set up at the United Nations, through one of its agencies. It would not prevent countries from taking unilateral action to deal with their debts, but it would give them an international forum to present their case and to resolve their debts with all their creditors.

Why now?

The current schemes for dealing with debt have shown their limitations. For more debt cancellation to be forthcoming, on fairer terms, we need a new system. The coming weeks present a timely opportunity for the Government to *pick up the pace* in dealing with debt. In March 2002, the United Nations held a conference in Monterrey, Mexico to consider how to provide enough finance for global development. The resulting *Monterrey Consensus* made some strong

commitments to “address the challenges of financing for development” including measures to tackle the debt crisis. A review of this UN conference will be held in Doha, Qatar at the end of November 2008 and sadly it will find that there is still much to do. This is an opportunity to call for a commitment to a new way of dealing with debt – an international *Debt Tribunal*. The need for a new mechanism is already on the Doha agenda and Jubilee Debt Campaign is urging the UK to support it, so that it gets the international agreement it needs to turn it into a reality.

Take action

► **THIS AUTUMN** we are calling for the UK government to support a new *sovereign debt resolution mechanism* at the UN Finance for Development conference in Doha. Please send the email action on our website or download the template letter, and promote this action to your friends and family. It is vital that a new process is put in place if there is to be a lasting solution to the debt crisis:

www.jubileedebtcampaign.org.uk/doha

► **IN 2009** we will be pressuring the UK to follow-up on the outcomes of the conference. Check out the Act Now pages on our website for the latest ways you can support our campaigns: www.jubileedebtcampaign.org.uk/act



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Jubilee Debt Campaign works for 100% cancellation of unjust and unpayable poor country debts. We are a UK coalition of around 90 national organisations and nearly 100 local and regional groups, as well as thousands of individuals nationwide.

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