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Dept Relief for Developing Countries
as Development Assistance?

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Debt Relief for Developing Countries as Development Assistance?

Developing countries are chronically indebted – this is one constitutive criterion for defining a developing country. But also industrial countries are indebted so that further indicators are required in order to classify the international indebtedness as a specific attribute of developing countries. One such aspect is the endurability of the debt service, and the latter has for many countries run out of the rudder: the debt service – interest and repayment – cannot be financed. Debt service has to be paid in hard currency which would have to be earned by export earnings. Exports would, in addition, also have to finance the import needs of a country. But this is usually out of question in developing countries (DCs) so that the resulting gap in the balance of payments has to be financed by loans.

Debt Burden

The developing countries (DCs) have accumulated a total debt burden of some 2.83 trillion (German billions) USD (2005). The African states south of the Sahara carry a debt load of 200 billion USD which is roughly two-and-a-half-fold the export earnings of the entire continent. Mozambique would have to use its entire export earnings for twelve years in order to repay its debts. Therefore, (some) debt service can only be paid if fresh money is provided from abroad.

Regular interest payment is crucial since otherwise – according to local law – commercial creditors have to write off their receivables, in many countries to zero. This would be a burden to their commercial balance sheet as the depreciation of receivables results in a reduction of profits and is counterbalanced only to the extent of the respective profit tax rate – the rest is loss. No commercial creditor will voluntarily accept that. And also loans from states or international institutions such as the IMF or the World Bank have to be served properly in order to preserve some

credibility since otherwise it becomes very difficult to raise further loans internationally.

Appalling Consequences

The consequences are appalling. Indebted countries do not dispose of sufficient hard currency remaining for importing urgently needed goods such as medicine, food, or technology. And since the population is poor – which is a mayor cause of conflicts and violence – public funds resulting from tax payments are low so that the public services in health or education as well as the social and material infrastructure are insufficient. Consequently, also economic development is slow which results in low public funds. “Poor” means in a developing country something else than in an industrial country.

Debt Relief?

Calls for flat debt relief, hence, must differentiate as to which debts should be written off. Public creditors must not fear to a similar extent as private ones a deterioration of the optics of their balance sheet, but no finance minister is keen on loosing cash flow on which he had based his planning. In 1996 the International Monetary Fund (IMF) and the World Bank have launched the HIPC-initiative, a programme intended to relieve a group of 27 highly indebted poor countries (mainly in Africa) from most of their debt burden. Without going into details I claim that this concept has not produced much sustainable effect in practice. The benefiting countries are supposed to develop Poverty Reduction Strategy Papers (PRSP) (based on the participation of the civil society) – sort of debt-poverty-swap where a commitment to actions apt to potentially reduce poverty leads to debt relief. The issue at stake, though, is not to produce a plan but to actually implement efficient policies. However, economic development has not accelerated, public debts have not declined, and poverty has not been reduced. Worldwide, more than one billion people dispose of less than one dollar per day; only in Asia there is some improvement in this aspect.

Some critics say that debt relief is negatively affecting the credit rating of a country and the inflow of private investments. Admitted. But in many cases this is not really

relevant because that rating anyway is below creditworthiness. A better solution might be increasing export earnings but this is more easily said than done. After having been freed from its debts by the HIPC initiative, Uganda (as an example) has accumulated a fresh debt burden of twice its export earnings, and this is not a singular phenomenon. Why is a high level of debt normal for a developing country?

Structural Causes

Economists tend to identify a double structural problem. The DCs have to pay their imports by exporting, but the terms of trade develop unfavorably: they 'deteriorate' since the DCs' exports consist predominantly of (few) raw materials and agricultural products (which yield comparatively low world market prices), and imports are composed of more sophisticated consumer and industrial goods (which are comparatively expensive), in addition to often urgently needed basic nutrition. This tends to produce a gap in the balance of payments, to be financed by capital imports, and this means debts. This structural explanation is added to by the fact that the industrial countries are interested in low and declining prices for raw materials and agricultural goods they do not produce themselves.

So why then do the DCs not export more processed goods for which they can ask higher prices? This is the other structural problem. As a matter of fact, the typical DC does not have the industrial infrastructure to do so. Why? Lack of skilled workers, lack of know-how, and lack of finance is the usual answer.

Crucial Other Causes

I acknowledge that the scarcity of capital in DCs is partly due to the outflow of debt service payments. But a major cause for the lack of finance is a massive capital flight out of the developing countries. The UN Economic Commission for Africa (ECA) estimates that the deposits owned by Africans overseas amount to close to 30 percent of the GNP of the continent, and we find the corresponding syndrome in Asia and Latin America. A large amount of such money does not come from commercial earnings but from "diverted" public funds, exactly those which should be used for development purposes.

But there is more. A major cause for slow development in very many DCs is related to a large variety of internal factors. They include – to start with the most obvious ones – ethnical, religious and/or political conflicts which more often than not result in open wars, both internally and between countries, and in a disregard of human rights. I cannot list those conflicts here since this paper must not be that long. In any case, they absorb enormous amounts of money, and they impede development. Tanzania has not really reduced its military expenses after having benefited from the HIPC initiative, and it has not been able to develop an investment climate which would attract foreign (private) investments. Bureaucracy, corruption, open criminality, and lack of infrastructure are no favorable frame conditions. Transparency International estimates that one third of public debts relate to corruption – e.g. credit financed projects which favor certain groups but do not have any positive impact on development

Lack of Dedication and Commitment

Furtheron, also in very many peaceable countries we have to observe a considerable lack of dedication, commitment, and ownership on the side of the governments and the powerful classes for development initiatives. What is referred to as Good Governance is more often than not very little developed, and there is usually a large gap between the ruling groups and the poor population. What we call a middle class is barely well developed. Politicians in the field of development cooperation may tend to object, but reality points the other way. (I am actively engaged in development cooperation since thirty years, and my firm opinion is based on experience.)

This is why debt relief is not a sustainable solution as long as the underlying causes are not eliminated. As long as this is not the case, debt relief by one or some creditor countries is usually counterbalanced by debts raised in other countries, and the process starts from scratch. Debt relief will deflagrate unless this vicious circle of poverty can be broken through by a combined effort of improving the unfavorable external structural conditions on the world markets for the developing countries (admitted) plus – and this is the real crucial issue – by making very much better use of the existing internal resources. There is no need to look for new concepts.

