African Network on Debt and Development (AFRODAD) • Center of Concern • CIDSE • European Network on Debt and Development (Eurodad) • Halifax Initiative Coalitions (Canada) • Jubilee Debt Campaign (UK) • Jubilee USA Network • Jubilee South • Latin American Network on Debt and Development (LATINDADD) • Marianists International • Maryknoll Sisters of St. Dominic • Maryknoll Fathers and Brothers • Norwegian Church Aid • Plate-forme Dette & Développement, France

February 29, 2008

The Honorable Ban Ki-Moon
Secretary General
United Nations
New York, NY

Dear Secretary General:

At the end of this year, governments of the world will meet in Doha, Qatar to evaluate progress in implementing the Monterrey Consensus. One of the critical elements of this consensus is the issue of external debt and its role in financing for development.

<u>We the undersigned, networks and organizations that have long campaigned on and monitored the impacts of unjust and unsustainable debt, are writing on the occasion of the review of the Monterrey Consensus, to bring to your attention what we see as the critical policy issues around external debt today.</u> We offer these inputs in light of the agreed text of the Monterrey Consensus, as well as in response to new opportunities and challenges that have emerged in the five years since Monterrey.

While debt financing can be a critical tool for mobilizing resources for public and private investment and economic development, we remain concerned about the crushing burden that this debt continues to represent for many developing nations. Developing country debt today stands at US$2.85 trillion, up from US$2.24 trillion in 2000 and US$1.3 trillion in 1990. Developing countries paid out more than US$540 billion in debt service in 2005. Indeed, low income countries continue to pay out $100 million *each day* to creditors, diverting large sums of scarce government revenue to external debt service and away from investments needed for social and infrastructure investment.

As the Monterrey Consensus points out, "External debt relief can play a key role in liberating resources that can then be directed towards activities consistent with attaining sustainable growth and development." Development economists have long pointed to the strengths of debt cancellation as a preferred tool to reduce poverty. Debt relief initiatives to date, while laudable, have however fallen far short of the call of the Monterrey Consensus and the Millennium Declaration to "comprehensively address debt problems of developing countries." We offer the following recommendations in the spirit of helping to live up to this vision of a comprehensive solution that has so far been lacking.

<u>End harmful conditionality</u>

Debt cancellation continues to be subordinated to onerous forms of conditionality as countries must implement hundreds of conditions as part of the International Monetary Fund (IMF)/World Bank Heavily Indebted Poor Country (HIPC) Initiative. While mutual accountability and transparency should critical elements of any debt cancellation agreement, current conditionality goes well beyond these basic fiduciary standards into micro-management of the economies of impoverished countries. In a number of countries, recent studies have pointed in particular to the impacts of requirements from the IMF for tight monetary policies that have eliminated or vastly reduced the amount of money freed up by debt relief for spending on social services.[1]

Expanded debt cancellation

The Monterrey Consensus urges that "Future reviews of debt sustainability should also bear in mind the impact of debt relief on progress towards the achievement of development goals contained in the Millennium Declaration." The Doha Conference provides an opportunity to call for a new greater debt cancellation for many more countries to help them to achieve human development goals.

The liberation of resources to meet the Millennium Development Goals remains a challenge, with dozens of countries still falling far short of what is needed to achieve the UN's avowed goals of eliminating hunger and poverty. With the international community at risk of failing to meet these commitments, expanded debt cancellation to more countries, together with increased development assistance, can and should be part of a successful policy mix.

Debt sustainability

We are also concerned that even in countries that have received debt cancellation, new borrowing threatens to return countries to debt crisis. This trend threatens to undo efforts over the past several years to reduce and cancel debts.

To date, official efforts to address this problem have focused mainly on the IMF/World Bank's Debt Sustainability Framework (DSF). But this instrument has been ineffective in addressing the problem of debt re-accumulation. While the Monterrey Consensus calls for debtors and creditors "to share the responsibility for preventing and resolving unsustainable debt situations", the DSF sanctions *only the debtor* for breaches in the debt ceilings, even though new borrowing is in many instances the result of insufficient access to grants.

The DSF's flawed methodology emphasizes:

1) Reliance on debt distress as defined by the pure inability of countries to repay (rather than incapacity to meet the MDGs or other human development targets);
2) Debt indicators such as debt-to-exports and debt-to-GDP, which as indicators have failed to capture the real needs for debt relief of countries; and
3) A one-size-fits-all Country Policy and Institutional Assessment by the World Bank, which does not allow the policy space for borrowing countries to implement country-owned development strategies.

We underline the need for approaches that comprehensively address both the endogenous and exogenous shocks under which the post-HIPC countries now find themselves. We are also concerned with the situation in several middle-income countries, where external debt levels have apparently improved, but at the expense of generating new domestic debt. This creates its own set of risks and vulnerabilities.

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[1] On Zambia and Nicaragua, see John Weeks and Terry McKinley, "Does Debt Relief Increase Fiscal Space in Zambia? The MDG Implications," UNDP International Poverty Centre, Country Study no. 5, September 2006; and Acevedo, Adolfo "Nicaragua: The "Millennium Development Goals" (MDGs) and the IMF program," p. 9-11, 2006. Available: http://www.choike.org/documentos/ifis_odm_fmi_nicaragua.pdf

We are also concerned that the DSF does not leave space for participation by the borrowing country and its people in the preparation of their own debt sustainability analyses, strategies and goals. This flies in the face of the Monterrey Consensus commitment to "broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting."

Vulture funds

Vulture funds, by compromising the benefits arising from debt relief, present a specific challenge. We urge member countries to take concrete steps to change their laws so as to do away with the phenomena of vulture funds and give judicial and financial assistance to countries in case they are taken to court by vulture funds. We also urge the UN to actively co-operate with other agencies to develop and strengthen the necessary binding codes of conduct that could prevent vulture funds from buying debt from indebted countries.

A responsible financing framework for lenders and borrowers

It is clear that we must tackle the problem of debt re-accumulation and overindebtedness in a forward-looking way that looks comprehensively at the process of borrowing and lending – both in terms of *quantity* and *quality*. The international community has increasingly issued calls for more "responsible lending" in the past several years, including at G-8 summits, in the G-20, at the Organization for Economic Co-operation and Development (OECD), and in the United Nations General Assembly.

Again, the official response to this challenge -- the DSF -- is devoid of any effort to address the quality of new lending. This is necessary to avoid the re-accumulation of odious and illegitimate debt.

It is time for a bold, new approach. Responsible lending will only be achieved via the adoption of a binding legal framework that fairly allocates the burden of irresponsible borrowing on both creditors and debtors. It would take account of both the origin and impact of the debts, and give equal treatment to both debtors and creditors. Only a framework like this will change the incentives, and thereby the behavior, of lenders. Such a framework could assume the form of an impartial and transparent process for resolving debt crises and disputes. It would also be more in line with the Monterrey Consensus' call for "a set of clear principles for the management and resolution of financial crises that provides for fair burden-sharing between public and private creditors and between debtors, creditors and investors."

As a step towards this goal, we encourage careful consideration of the Charter on Responsible Financing, developed by Eurodad, which outlines the essential components of a responsible loan.

Responsibility in the borrowing side of the process should also be emphasized through, inter alia, civil society participation in the process of contracting and monitoring use of new loans.

Cancelling Odious and Illegitimate debts

A significant development after the Monterrey Consensus has been the growing legal and political interest in the concepts of odious and illegitimate debts. The justification for the cancellation of Iraq's debt focused on the odiousness of the previous Iraqi government. Though ultimately the decision to provide cancellation was not made on the basis of the arguments of odiousness, the ensuing debate surely raised the profile of the issues.

More recently, Norway became the first Northern government to unilaterally cancel specific debt claims on the grounds that the credit in question was an example of "failed development policy," a key element of conceptions of illegitimacy of debt. Across the developing world, civil society has been implementing citizens' debt audits to examine the nature of debts, and in 2007, Ecuador became the first government to convene an official debt audit commission, with a mission of determining the legitimacy or illegitimacy of historical lending to Ecuador.

The debate on odious debts has further been developed with the publication of papers on the topic by UNCTAD and the World Bank. As new developments in external debt are considered, the recognition of odious and illegitimate debt must surely be noted and affirmed in Doha, and the principle of their cancellation considered. The legitimacy of creditor countries and the Bretton Woods Institutions in addressing responsible lending is at stake.

Addressing the linkages between Debt and trade

The Monterrey Consensus was unique in setting the stage for a holistic consideration of all sources for financing development. This call is of particular relevance for debt, an area that has suffered by being targeted with measures taken in isolation from other economic dynamics that tend to affect it. An example of this is the HIPC initiative, whose debt relief gains are quickly eroded by commodity price dynamics that the initiative failed to address, although they were well-known at the time of its design and implementation.

Some issues that deserve consideration in the relation between debt and trade are the following: the relation between the export structure of borrowing countries and the collective debt profile; the need to target the fiscal revenue in export and investment activities; export-oriented structures and their impact on systems with growing domestic debt; the impact on debt of the privatization of natural resources revenue; the generation of liabilities by foreign investment; and debt service as a constraint in the export-profit-investment virtuous nexus.

To conclude, the Financing for Development Review process, culminating in Doha in late 2008, offers an important opportunity to update the international community's collective understanding of external debt and to address newly emergent issues that have come into greater prominence since the Monterrey Conference. We are optimistic that this UN process, under your leadership, can bring significant attention to the debt issue, and move towards some new agreements which will bring about a cancellation of existing debt and prevent the adoption of new onerous loans that will burden generations to come.

We look forward to your response and to engaging with you in this critical year-long process.

Sincerely,

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