Candidate briefing: Lending boom to developing countries threatens a new round of debt crises

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Summary

- **While important steps were taken to tackle the debt problems of some developing countries in the 2000s, the core drivers of unsustainable and unjust debts were not addressed.**
- **Now the debt situation across the global South looks sets to deteriorate further, with a lending boom threatening a new round of debt crises with severe potential impacts on inequality and poverty.**
- **Urgent action is needed now to help avert a new developing world debt crisis, including urgent progress on lending regulation, sovereign debt restructuring, and tax justice.**

1) Debt cancellation necessary but not enough

The international community has not seriously engaged with the problem of unjust developing country debt since the G8 summit in Gleneagles in 2005. Following global campaigning in the 2000s, $130 billion of debt was cancelled for 35 countries through the Heavily Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative. This saved billions of dollars in debt service for these countries every year, and has led to millions more people having access to healthcare and education. However, many developing countries were excluded from this scheme because they were considered ‘not poor enough’ or ‘not indebted enough’, including countries with past odious regimes and/or high levels of poverty like Jamaica, Kenya, El Salvador, Tunisia and the Philippines.

Furthermore, the international community failed to take effective action to tackle the underlying causes of unjust and unsustainable debt. The removal of regulations on lending from the 1970s has driven devastating debt crises affecting people on every continent: Latin America and Africa in the 1980s and 90s, East Asia in the late 1990s, Russian and Argentine defaults at the turn of the century, and the European debt crisis in the late 2000s. This has been compounded by the increased ability of companies and wealthy individuals to avoid and evade tax, which is causing huge losses to all countries through illicit financial flows, but particularly developing countries.

Large debt payment burdens have dramatic impacts on poverty and inequality. The ‘Third World debt crisis’ of the 1980s and 90s caused two or more ‘lost decades of development’. In sub-Saharan Africa, the number of people living in extreme poverty (on less than $1.25 a day) increased from 205 million in 1981 to 330 million by 1993.[1]

2) The new reckless lending boom to impoverished countries

Now the debt situation across the global South looks sets to deteriorate much further, with a new lending boom to developing countries taking place. External loans to low income countries increased by 75% between 2008 and 2012.[2] Loans to sub-Saharan African governments more than doubled over the same period of time. This increase in lending has been caused by several factors:

- More ‘aid’ money is being given as loans, both directly by governments, and through multilateral institutions such as the World Bank and African Development Bank
- More loans were made available to help countries cope with the impacts of the global financial crisis
- Low interest rates and quantitative easing in Europe, the UK and US, combined with the lack of regulations on capital movements, has meant the private sector has borrowed money in Western countries, and lent it on at higher interest rates to developing countries

Almost half (45%) of loans to low income countries are from the World Bank and IMF. Together, multilateral bodies are responsible for 60% of lending to low income countries, other governments 30% and the private sector 10%.[3] However, as a proportion of debt payments, loans from the private sector are higher, because they have higher interest rates. A representative of Agence Française de Développement told a meeting of European NGOs in June 2013 that there is currently such a glut of cheap loans that the agency is hard pressed to find projects to fund as they are effectively competing with Germany and the European Investment Bank to find viable projects.

3) Debt payments will rise significantly over the next decade

Jubilee Debt Campaign has recently published research[4] on the possible implications of the continuation of the current lending boom for 43 developing countries over the next decade in terms of their ability to service those debts and the knock-on impacts for the provision of basic public services and other critical state functions. The research, based on data from the IMF and World Bank finds that:

- One quarter of countries face significant increases in debt payments (more than 5 percentage points of government income) even if IMF estimates of high economic growth over the next decade are met.
- This number of countries facing significant increases in debt payments will rise to over 60% if IMF and World Bank estimates of one economic shock over the next decade are met, or there is lower, but still substantial, economic growth

If lending to these countries was sustainable, it would be expected that over time, debt payments as a proportion of government revenue would *fall*, as investments funded by debt generate revenue to repay the loan and interest. Where debt payments are instead rising significantly over the medium term, it suggests that lending is unsustainable. Overall, the research shows a general trend of rising debt payments as a percentage of government revenue across all three scenarios. The average relative debt payment burden increases by between 85% and 250%, depending on growth rates and frequency and extent of any economic shocks.

As many as two-thirds of countries which qualified for debt relief over the last decade could have debt payments the same or higher than before debt cancellation in the next ten years. The increase in debt payments could once again restrict spending on public services. For example, the research shows cuts of up-to 30% in education and health spending for countries such as Ethiopia, Ghana and Senegal in order for debt payments to be met.

4) Other debts are being hidden from public scrutiny
Debt owed by the private sector is not fully included in IMF analyses, despite the fact that it has been at the root of a number of recent debt crises, including the East Asian Financial Crisis and the European Debt Crisis. In addition, payment obligations created by Public-Private Partnerships (known as the Private Finance Initiative in the UK) are not monitored by the IMF and World Bank even though they have the same or greater fiscal impact as direct government borrowing.

5) Action is needed now to prevent new debt crises
Whilst debt relief has helped some countries, it has not dealt with the structural issues underlying a succession of debt crises across the world over the last three decades. There is a real risk that today's lending boom is sowing the seeds of a new debt crisis in the developing world, threatening to reverse recent gains in the fight against poverty and inequality. Urgent action is needed now to help avert a fresh round of crises. The UK government should:

a) **Commit that all UK bilateral aid will remain as grants, not loans, and shift aid money away from sources which give loans such as the World Bank, towards sources which give grants.**
b) **Require all lenders funded by the UK, including UK Export Finance, the World Bank and IMF, to sign up to responsible lending guidelines, including public scrutiny of loans before contracts are signed.**
c) **Support the creation of a fair, transparent and independent process for resolving sovereign debt crises, to show banks they won't be bailed out for reckless loans.**
d) **Support the creation of debt sustainability assessments which are conducted independently of creditors and debtors, take into account the meeting of basic needs and public services, and apply to all countries.**
e) **Introduce policies to support developing countries in increasing their tax revenues, including by preventing the loss of revenue through tax avoidance and evasion.**

What you can do

- Write to your International Development spokesperson asking her / him to support these recommendations

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[1].Calculated from World Bank World Development Indicators database.

[2] Calculated from World Bank World Development Indicators database.

[3] World Bank. World Development Indicators database.

[4] The full research paper (26 pages) is available at: http://jubileedebt.org.uk/wp-content/uploads/2014/10/Lending-boom-research_10.14.pdf