Third world debt: causes and solutions

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Title: Third World Debt: Africa

A detailed analysis of the third world debt problem in Africa, focusing on the problems, causes, and possible solutions to alleviating third world debt in Africa.

INTRODUCTION

Developing economies in Africa are facing a tough time. They are obliged to make principal repayments and interest on the external loans accumulated over the decades when they should have been spending their meagre resources on investing in health and education of their citizens, and development of infrastructure to fuel growth.

In 2000, Africa's external debt totalled US$ 334. 3 bn, equivalent to 58% of its GDP (Siddiqi, 2001). With debt and interest payments occupying a high per cent of GDP, it results in lower spending on development. The severity of debt problem can be judged by the fact that Sub-Saharan Africa receives US$ 10 bn in aid but has to make annual loan repayments of US$ 14 bn, resulting in net outflow of foreign currency before loans and investments [1] . In 2005, Nigeria paid US$ 12 bn to the Paris Club of creditors for partial debt cancellation [2] . Millions of Africans live on less than US$ 1 per day; US$ 12 bn would have gone a long way in improving their life style and developing the infrastructure required for future growth. The severity of debt problem in Africa is so much that the All-Africa Conference of Churches has called this debt " a new form of slavery, as vicious as the slave trade" [3] .

Rich countries and world financial institutions, mainly World Bank and International Monetary Fund (IMF), have started debt relief initiatives in the last decade. The High Indebted Poor Countries and Multilateral Debt Relief Initiative are steps in the right direction. These initiatives have resulted in debt reduction in many African countries and allowed their governments to spend more on social welfare. But still more is needed both in terms of relief under above initiatives and also through other initiatives like reducing trade barriers for poor countries.

This document studies the reasons behind third world debt in Africa and subsequent growth of it. It then looks at some of the prominent effects on the citizens of the affected economies. It also suggests some of the solutions that can be employed in reducing the external debt of the third world countries in Africa. Successful handling of debt will lead to better lives for millions in Africa.

THE REASONS BEHIND THE THIRD WORLD DEBT

- Debt transfer from colonizing states. The initial debt of third world countries arose from the unjust transfer of the debts of their colonizing countries. This was imposed on them when they acceded to international sovereignty. External debt of the newly independent countries amounted to US$ 59 billion in 1960 [4] . Not only the amount was high for economies just starting on development but the interest rate was set at 14 per cent. Such a high interest rate made it more difficult for governments of poor countries to make capital repayments.

- Odious debt. World financial institutions are to be blamed for lending money to countries with dictators and undemocratic governments, knowingly well enough that most of such lending will not be used for benefits of public. Joseph Stiglitz says that when the IMF and World Bank lent money to the Democratic Republic of Congo's ruler Mobutu, they should have known that most of the money would be used for personal enrichment of Mobutu (Stiglitz, 2002). Many times the reasons behind such lending are geopolitical to ensure alignment of the third world countries with the developed countries. Now citizens of the Democratic Republic of Congo are repaying loans that were never used for their benefit.
- Unregulated lending. During the high oil prices of 1970s, Arab nations deposited their excess cash with Western banks. Western banks then lent it to the third world countries without doing proper due diligence on the use of funds or the capability of the third world countries to repay in future.
- Mismanagement of projects. Projects, executed with foreign loans, were not managed properly resulting either in incomplete projects or projects with high over runs and time delays. Creditors didn't do a responsible job in monitoring of the projects.

INCREASE IN THIRD WORLD DEBT

Over decades, external debt of the third world countries has increased because of the following reasons:

- High interest rate. Not only the principal loan amount was high for economies just starting on development but the interest rate was set

at 14 per cent. This rate of interest is high and makes it even harder for developing countries to make loan repayments and simultaneously spend on development.

- Devaluation of third world currencies. External loans are to be repaid in the hard currencies of the developed countries. Over time, the currencies of third world countries have devalued significantly compared to currencies of developed countries due to high inflation and high deficits in poor countries. The decline in local currencies means that the third world countries have to work harder to repay external loans.

SOCIAL AND ECONOMICAL IMPACTS

- HIV/AIDS. Africa is suffering heavily from AIDS and is home to two-thirds of those living with the disease worldwide [5] . Only a few in Africa have access to the treatment and rest suffer in agony due to their governments' inability to make healthcare payments. This is because a significant part of their national income is spent on debt repayment. The rapid increase in AIDS will have a prolonged social and economic impact on the continent. As a result of governments' inability to stop spread of AIDS and proper treatment, future governments' will have to pay a much higher price for treatment. Also poor health will result in lower economic growth.
- Insufficient money for development. Given the priority of debt repayment over development projects, the governments of the third world countries are not left with enough resources to spend on much needed infrastructure development. These countries are very low on

social development and need financial assistance to implement welfare plans. Reduction in debt will free money that can be used for better health and education facilities.

Some of the benefits achieved in recent past because of reduction in debt are as follows:

- Reduction in debt has allowed Ugandan government to offer better educational facilities and it has more than doubled school enrolment in Uganda.
- Vaccinated half a million children against killer diseases in Mozambique
- Provided extra resources for treatment of HIV/AIDS patients in different countries in Africa [6] .

POSSIBLE SOLUTIONS

- More aid to the third world countries. The amount of development assistance to the third world countries has been falling not only in terms of real amounts adjust for inflation but also in terms of percentage of developed countries income (Stiglitz, 2002). If rich countries are keen on helping poor African countries achieve better living standards then they should increase the amount of aid.
- Aid as grant rather than as loan. In a G8 meeting in Genoa, President Bush proposed that up to 50% of aid to developing countries should be given as direct grant rather than as loans (Veseley, 2001). Grants would help the third world countries spend more on health and education without the burden of future loan repayments.

Veseley suggested that the issue of giving grants is subject to local politics at the developed countries. During recessions and higher unemployment, the governments of the developed countries would be reluctant to offer grants.

- Debt forgiveness. After decades of paying a high percentage of their GDP and exports to meet external loan repayments and yet no where near to either finishing off those loans or bringing them to such low levels where most of the GDP is used for development, the third world countries need debt forgiveness otherwise they simply cannot grow. In some countries the debt service is more than a quarter of exports and in some countries it is as high as half of exports (Stiglitz, 2002).

The rich countries, under the ownership of World Bank and International Monetary Fund, launched Heavily Indebted Poor Countries (HIPC) debt relief initiative in 1996 with the aim of ensuring that no poor country faces a debt burden it cannot manage. The rich countries will cancel the debt of poor countries who meet stringent economic conditions set out by the creditors and monitored by World Bank and IMF.

In the 2005 G8 summit, rich countries agreed to cancel the debt of 14 African nations. Zambia is one of the countries to be short listed for debt cancellation. In 2003, Zambia spent twice as much on loan repayments as on healthcare. In January 2006, Zambia’s debt was reduced from US$ 7. 1 bn to US$ 500 million [7] . The partial debt cancellation under HIPC has allowed the government to offer free healthcare to its citizens.

The Jubilee movement in 1990s played a major role in focusing attention on debt relief. It put international pressure on IMF and rich nations and as a result, by the end of 2000, 24 countries passed the IMF threshold requirements for debt cancellations (Stiglitz, 2002). In 2005, the world financial bodies also launched the Multilateral Debt Relief Initiative (MDRI) which allows for full relief on debts by the IMF, the International Development Association of the World Bank, and the African Development Fund [8] . Though MDRI offers 100 per cent debt relief it does not offer any parallel debt relief by governments or multilateral institutions beyond the above three. IMF announced in December 2005 that it will grant 100 percent debt relief to 19 countries, most of them from Africa, under the MDRI amounting to about US$3. 3billion [9] . This was matched by World Bank in July 2006.

Though HIPC and MDRI initiatives are light at the end of tunnel and raise hopes of debt cancellation, yet they are far from the full action required to take care of debt problem. The poor countries are required to meet stringent economic conditions before they can be offered partial debt cancellation. Not all of the developing countries in Africa are in a state to meet tough fiscal conditions because of poor state of their economies. Putting more fiscal measures in place would deprive their citizens of even bare minimum standards. As of result of tough conditions, only about a quarter of African nations have qualified for HIPC and MDRI. Even after debt cancellation for 14 countries, African countries still owe over US$ 200 bn to rich countries and they would still have to pay US$ 14 bn every year in debt repayments to rich

countries [10] . The deal would result in annual saving of about US$ 1 bn, which is not enough considering that US$ 14 bn is still payable every year.

Also the deal proposed under HIPC doesn't cancel 100% of debts of any country. The debt cancellation will be 79% for Uganda and 48% for Mozambique [11] . Partial debt cancellation is better than nothing but the governments would still have to make debt repayments when they could have used the money for development.

- Rich countries to open trade to poor countries. Agriculture is the most important occupation in the third world countries and it is the biggest employer in Africa (Veseley, 2001). Most of the developed countries give subsidies to their farmers. These subsidies result in not only lower agricultural exports to the developed countries but also to other countries. The poorest countries account for less than 1% of the world's food exports (Veseley, 2001). Doha round of trade talks is focused on removing the agricultural subsidies in US and Europe. The World Bank estimates that if subsidies and trade issues are resolved in the Doha round, then it would generate extra gains in real income of about US$ 20 bn by 2015 to developing countries (Siddiqi, 2006). Mr James Wolfensohn, ex-President of World Bank said that the most important step for development of poor countries is for rich countries to open their markets fully to exports from the developing countries (Veseley, 2001). Stiglitz notes that so unfair has the trade agenda been that Sub-Saharan African countries were actually made worse off as a result of the last round of trade negotiations (Stiglitz, 2002). A reduction in agricultural subsidies would increase exports from African

countries and allow them better chances of not only GDP growth but also in meeting IMF criteria for HIPC and MDRI debt relief.

CONCLUSION

The third world countries in Africa are heavily burdened with debt and significant part of their foreign exchange earnings and new loans are used for repayment of principal and interest on previous loans. The third world countries are paying for legacy issues and are not left with money for the development work on health, education and generation of employment that is needed urgently. The government of developing and crippled economies in Africa are spending their hard earned money on meeting debt repayments when ideally they should have been spent on provision of health issues like HIV/AIDS, education and generating employment opportunities.

Rich countries and world financial bodies have taken initiatives under HIPC and MDRI schemes to reduce the debt burden of the third world countries. In 2005, 14 African nations were short listed for debt cancellation. 19 countries qualified for debt cancellation under the MDRI scheme. Countries are already seeing benefits of lower debt repayments in terms of better health and education facilities. But still a lot more needs to be done. HIPC offers only partial relief. Also some of the economic conditions imposed under HIPC will make it difficult for the African governments’ to offer free services to their citizens.

The rich countries should offer more aid as grant rather than as loan. Also they need to reduce subsidies and open up their economies to poor

countries. This would not only help reduce the debt of the third world countries but also increase their GDPs.

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