

**FHSMUN 31**  
**GENERAL ASSEMBLY SECOND COMMITTEE**

**EXTERNAL DEBT AND DEVELOPMENT**

*“Emphasizing debt sustainability is essential for underpinning growth, and underlining the importance of debt sustainability and effective debt management to the efforts to achieve national development goals, including the Millennium Development Goals...”*<sup>1</sup>

**Introduction**

External debt remains a fundamental obstacle to sustainable development for many countries, particularly those designated as developing countries. When countries confront mounting and unsustainable debt payments, governments, business groups, workers, non-governmental organizations (NGOs) and related civil society representatives must consider how to finance ongoing development projects while also negotiating the intricacies of fiscal solvency and international creditworthiness. Lenders must also confront the harsh realities of the impacts of their demands for debt payments, particularly when the debts are considered “odious,” meaning that they were first contracted by military dictatorships or other illegitimate governments that are no longer in power. Delegates to the General Assembly Second Committee must negotiate faithfully to devise a comprehensive framework for resolving the myriad complexities and obstacles embedded within the problems of external debt and development.

**Scale of the Problem**

External indebtedness is not a new phenomenon, nor are the economic, political, security, and social problems that are exacerbated by persistently high levels of indebtedness. The primary focus within the UN System and related international financial institutions (IFIs), including the International Monetary Fund (IMF) and the World Bank Group, is overwhelming on the problems that external indebtedness poses for developing countries, especially the Least Developed Countries (LDCs). “During 2008, the dollar value of total external debt of developing and transition economies ... increased by \$176 billion, surpassing \$3.6 trillion at the end of the year.”<sup>2</sup> Highly developed countries are not immune to the perils of rising indebtedness, however. One criterion for acceding to the European Monetary Union (EMU) has always been maintaining public debt below 60% of total national income, or Gross Domestic Product (GDP).<sup>3</sup> Furthermore, concerns about the US government’s ability to pay off its enormous and escalating debt of over \$10 trillion USD may influence potential creditor countries, including China, Japan, and European Union (EU) countries, to restrict their lending to the United States.<sup>4</sup>

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<sup>1</sup> United Nations General Assembly (UNGA), A/C.2/64/L.69 Draft resolution “External debt sustainability and development” December 7, 2009 p. 2.

<sup>2</sup> Ban Ki-moon, “Towards a durable solution to the debt problems of developing countries: Report of the Secretary-General” A/64/167 July 24, 2009 p. 3.

<sup>3</sup> *BBC News*, “Special Report: The EMU criteria” March 19, 1998.

<sup>4</sup> *BBC News*, “China reduces holdings in US debt” August 18, 2009.

Critically, the composition of debt is evolving quite rapidly. Private creditors own increasingly greater percentages of external debt throughout the developing world, “varying from 21 per cent in sub-Saharan Africa to 78 per cent in Latin America and the Caribbean.”<sup>5</sup> One reason why the composition of this external debt is so critical is that private creditors are generally much stricter with their repayment schedules than governments; private creditors can be persuaded to write down debt in specific circumstances that will be analyzed in greater detail below but the prevailing impression is that private creditors and investors resent debt forgiveness. Equally important is that during the contemporary economic recession or slowdown, Foreign Direct Investment (FDI), essentially private investment by transnational corporations (TNCs) and large investment firms, fell by 50% in 2008 with further cuts expected throughout 2009.<sup>6</sup>

### **Contracting debt**

Governments and businesses frequently contract debts in an attempt to jumpstart new development projects and initiatives. While these debts are contracted under presumably laudatory premises, it is clear that many debt repayment schedules are based more upon ideal circumstances rather than the harsh and volatile realities that many countries and businesses actually confront. Development priorities may shift as governments change, development projects may take longer than projected to produce significant economic benefits, and recessions, including the contemporary global economic slowdown, may disrupt development projects and also further delay debt repayment. In other situations, governments and businesses contract debts for military expenditures or questionable investments, often with little consideration for future repayment schedules.

In the least defensible situations, governments, international banks, and transnational corporations (TNCs) strive to use their influence and resources to cajole and/or even coerce national governments and businesses to contract loans for development, even when those loans only benefit very narrow segments of society. John Perkins, a self-proclaimed former “economic hit man”, argues that his work in Indonesia in the 1970s conformed exactly to this last pattern. “The World Bank, its affiliates, and the Suharto government appreciated MAIN’s willingness to provide reports necessary for securing huge loans that would benefit US corporations and the Indonesian rulers. They did not care that these loans would leave the country deeply indebted.”<sup>7</sup>

While it would seem that private debts would presumably be the responsibility of the corporations or other private entities that contracted the debt, private debt, in reality, often becomes public debt. Governments often provide guarantees and/or financial assistance to large corporations or culturally or historically critical entities, transforming formerly private debt into public debt. UN Secretary-General Ban Ki-moon recently noted that “with regard to the United Arab Emirates, while official statistics report no

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<sup>5</sup> Ban Ki-moon, A/64/167 July 24, 2009 p. 3.

<sup>6</sup> Ban Ki-moon, A/64/167 July 24, 2009 p. 4.

<sup>7</sup> John Perkins, *The Secret History of the American Empire: The Truth About Economic Hit Men, Jackals, and How to Change the World* Plume Books New York May 2008 p. 30.

private external debt, it issued \$100 billion of publicly guaranteed corporate debt between 2006 and 2008, making it one of the largest issues of external corporate debt in the emerging world.”<sup>8</sup> When governments guarantee private debt, these accumulated responsibilities may further erode public resources and the government’s creditworthiness in the eyes of donor governments, development banks, and other lenders while shielding corporate leaders from the consequences of contracting the original debt.

## **How Debt Impedes and Prevents Development**

When governments and businesses directly confront the impact of their impending debt payments, economists, financial officers, and policy-makers must undertake difficult fiscal decisions with profound consequences. Cash-strapped governments may have to reduce government spending on education, health care, environmental protection, and even infrastructure projects, although these budget cuts rarely adversely affect the military. Many of the loans received by governments come from the International Monetary Fund (IMF) and the World Bank Group and in the past have included strict repayment schedules and austerity measures, often called Structural Adjustment Programs (SAPs). Steve Gloyd analyzes the impact of SAPs on many developing countries, especially the 50 poorest countries known as the Least Developed Countries (LDCs), and concludes that “the overall social impact of SAPs has been devastating for the poor...Health services for the poor were particularly hard hit by the SAPs.”<sup>9</sup> Richard Kim further notes that “in 1995 ... the IMF forced Haiti to cut its rice tariff from 35 percent to 3 percent, leading to a massive increase in rice-dumping, the vast majority of which came from the United States.”<sup>10</sup> Public outcry about the detrimental impacts of SAPs prompted the IMF and World Bank Group to reform their lending procedures and policies over time but not before these SAPs led to devastating outcomes for tens of millions of very poor people around the world.

When external indebtedness reaches such a point that it impedes and ultimately prevents development, this indebtedness can eventually plunge economies into prolonged recession, topple governments, and create situations where development is virtually impossible. In Latin America, the 1980s is frequently referred to as “the lost decade” because economic development was often restricted by dictatorships, many run by military *juntas*, that implemented misguided policies and contracted enormous debts that had to be repaid. The first country that exposed the fragility of the worldwide debt financing system was Mexico when the Mexican government announced in August 1982 that it would suspend its debt payments. Nobel laureate Paul Krugman notes that “by 1986 Mexican real income per capita was 10 percent lower than it had been in 1981, and real wages, eroded by an average inflation rate of more than 70 percent over the preceding four years, were 30 percent below their pre-crisis level.”<sup>11</sup> Mexico garnered

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<sup>8</sup> Ban Ki-moon, A/64/167 July 24, 2009 p. 8.

<sup>9</sup> Steve Gloyd, “Sapping the Poor: The Impact of Structural Adjustment Programs” from Meredith Fort, Mary Anne Mercer, and Oscar Gish, eds., *Sickness and Wealth: The Corporate Assault on Global Health* South End Press Cambridge, Massachusetts 2004 p. 50.

<sup>10</sup> Richard Kim, “IMF to Haiti: Freeze Public Wages” *The Nation* January 15, 2010.

<sup>11</sup> Paul Krugman, *The Return of Depression Economics and the Crisis of 2008* W.W. Norton & Co. New York 2009 p. 34.

more attention from international bankers and financial analysts throughout much the mid-1980s but many other Latin American countries experienced significant erosions of real wages and consequent purchasing power as well as a decade of delayed development. In the 1990s, Latin American governments and businesses would strive to finance greater development through attracting more foreign investment as well as by contracting new loans from the IMF, World Bank Group, regional development banks, and private international banks. Robert Edgar notes, however, that “in 1997, before Hurricane Mitch, Nicaragua spent more than half its revenue on debt payments.”<sup>12</sup> While the opening years of the 1990s appeared promising, the façade of equitable and sustainable development would be ripped aside by the early years of the 2000s, especially in Argentina.

When governments face extremely high debt service payments, they frequently have to devote considerable resources, including foreign currency reserves, to meeting these debt service payments. Quite often, highly indebted countries experience a serious deterioration of their international credit rating and thus face very high interest rates; in March 1995, in light of the infamous *tequila* bond and debt crisis, “Mexico was paying investors an interest of 75 percent.”<sup>13</sup> Governments may also be tempted to print huge sums of money in an attempt to meet debt service payments; in critical cases such as Germany in 1923 and Argentina in 1989, massive printing of currency, at least due in part to escalating debt service payments, led to hyperinflation, with Argentina experiencing annual inflation rates of over 3,000 percent at the end of the 1980’s.<sup>14</sup>

In December 2001 and January 2002, Buenos Aires, Argentina may have been the least hospitable place for heads of state in the entire world; Argentina had 5 different presidents within a month’s time. Argentina’s political crisis stemmed from its external debt to the IMF, World Bank, and international development banks and its inability to maintain the inflexible 1:1 convertibility/exchange rate with the US dollar. Krugman notes that the results of the 2001-02 economic collapse as being “catastrophic”: “real GDP fell 11 percent in 2002, after falling 4 percent in 2001. Overall, the size of the Argentine economy declined 18 percent between 1998 and 2002, a Great Depression-scale contraction.”<sup>15</sup> Eventually, the Argentine political elite yielded to popular pressure and defaulted on its debt repayment schedule to the IMF.<sup>16</sup> The Argentine economy would finally recover and experience real and sustained growth, permitting Argentina to repay its IMF loans early, after the Argentine government convinced domestic and international bondholders to accept a significant debt swap and drawdown. President Néstor Kirchner then indicated that “his main aim in repaying debt is to avoid further IMF restraint on his policies.”<sup>17</sup> While enjoying greater autonomy from IMF and World Bank policies is indubitably beneficial to many politicians, antagonistic relations with the

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<sup>12</sup> Robert W. Edgar, “Jubilee 2000: Paying OUR Debts” *The Nation* April 5, 2000.

<sup>13</sup> Paul Krugman, *The Return of Depression Economics and the Crisis of 2008* 2009 p. 48.

<sup>14</sup> Paul Krugman, *The Return of Depression Economics and the Crisis of 2008* 2009 p. 41.

<sup>15</sup> Paul Krugman, *The Return of Depression Economics and the Crisis of 2008* 2009 p. 99.

<sup>16</sup> *BBC News*, “Argentine press attacks IMF over loans” November 15, 2002.

<sup>17</sup> *The Economist*, “Néstor Unbound” December 20, 2005.

IMF, World Bank Group, and international development banks may be problematic for Argentina going forward.

Latin American countries are by no means the only states to experience serious debt crises; African countries are currently experiencing considerable debt crises. In the late 1990s, many Asian countries, including Indonesia, and Russia experienced major debt crises. In fact, as different countries experienced debt crises and unprecedented currency volatility, these crises began spreading across the globe in a phenomenon known as “financial contagion.” During the contemporary economic crisis, “financial contagion” has reared its undesired head again, including in the recent debt crisis in Dubai as well as in countries such as Greece and Ireland in the European Union (EU). One recent prediction is that “if Greece were to default on its debts, investors would run from other European countries with low growth and big debts — pushing some of the weaker ones into a crisis of their own.”<sup>18</sup> Fears of “financial contagion” may be critical to convincing governments, bankers, and NGO’s to forge common solutions to their collective problems, particularly if creditors become more cognizant of the deleterious situation caused by the poverty trap.

Persistently high levels of indebtedness may create the infamous poverty trap whereby very poor individuals or countries cannot escape poverty because they must consume all of their disposable resources to meet basic needs or provide legally required services. Quite often, in fact, these poor individuals and countries must borrow against tomorrow simply to meet the exigencies of today, all the way slipping deeper into long-term structural poverty. Providing sustained foreign aid, particularly in the form of Official Development Assistance (ODA) rather than through loans, may provide developing countries with the fiscal and policy space necessary to implement effective poverty reduction and development strategies. Jeffrey D. Sachs, Special Advisor to the Secretary-General on the Millennium Development Goals (MDGs) asserted in 2005 that “it is time for debts of the highly indebted poor countries to be cancelled outright as part of the financing package for the Millennium Goals-based poverty reduction strategies.”<sup>19</sup> Convincing donors, whether governments, private banks, or private investment firms, to cancel debts is a major component of the development strategies of many developing country governments as well as NGOs from around the world.

### **Preventing Moral Hazard**

The prevailing argument against writing down or forgiving debt is that it will encourage further profligate behavior by the borrowers. Economists refer to the encouragement of future misbehavior by insulating actors from their poor choices or decisions as moral hazard. Given the responsibility of many bankers in creating many of the current problems that countries, businesses, and workers are confronting today,

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<sup>18</sup> *New York Times*, “After Dubai” January 17, 2010.

<sup>19</sup> Jeffrey D. Sachs, *The End of Poverty: Economic Possibilities for Our Time* Penguin Press New York 2005 p. 281.

rhetorical flourishes about moral hazard may lose some of their impact.<sup>20</sup> The IMF and the World Bank actually addressed these dimensions a few years at a meeting of the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries. Regarding the 2005 G8 proposal to cancel the debts of Highly Indebted Poor Countries (HIPC) that had reached the completion point of the HIPC Initiative criteria, IMF and World Bank negotiators stated that “moral hazards and equity concerns associated with previous debt relief would be avoided since ‘gross assistance flows’ from IDA [International Development Agency] to eligible countries would be reduced by the volume of debt relief.”<sup>21</sup> Discouraging unsustainable borrowing in the future is important but it must not be used as a rationale to prevent the cancellation of external debts for developing countries.

### **Debt Forgiveness and Debt Relief**

Debt burdens that are unsustainable prevent countries and businesses from targeting their resources to productive enterprises. Governments and many non-governmental organizations (NGOs) have campaigned for years to achieve debt forgiveness and debt relief but persuading bankers and creditors to write down or outright forgive debt is often challenging. Responding to criticisms, the IMF and the World Bank launched the Heavily Indebted Poor Countries (HIPC) Initiative in 1996; according to Jeffrey Sachs, “the HIPC Initiative itself was a recognition that the structural adjustment era had failed to deliver its promises of economic development and growth to the world’s poorest nations.”<sup>22</sup> To qualify for the HIPC, developing countries already had to have sustained debt-to-export ratios of greater than 150% and focus on the implementation of Poverty Reduction Strategy Papers (PRSPs); once the countries qualify for assistance, the World Bank then monitors their progress until such a point where the country reaches a “decision point” where the World Bank then must assess whether the country is likely to reach a “completion point” whereby its remaining debt may be fully cancelled.<sup>23</sup> While the HIPC Initiative improved the situation for highly indebted poor countries such as Bolivia and Uganda, the poster children for the HIPC in the late 1990’s, it soon became clear that real debt relief would need to be even greater if these highly indebted poor countries were to achieve sustainable economic development and growth. Throughout the late 1990’s, increased calls for enhanced debt relief would eventually culminate in the Jubilee 2000 movement.

Jubilee 2000 is probably the most famous economic movement of the last 20 years, if not longer. Celebrities such as Bono and Muhammad Ali joined Pope John Paul

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<sup>20</sup> John Ydstie, “Bankers Admit Mistakes in Financial Crisis” National Public Radio (NPR) January 13, 2010.

<sup>21</sup> IMF and World Bank, “Note on the G8 Debt Relief Proposal Assessment of Costs, Implementation Issues, and Financing Options” DC2005-0023 September 21, 2005 p. 2.

<sup>22</sup> Jeffrey D. Sachs, *The End of Poverty* 2005 p. 342.

<sup>23</sup> World Bank, “(HIPC) The Enhanced Heavily Indebted Poor Countries Initiative” September 28, 2009. Found at:

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20260411~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>

II and a host of academics, civil society representatives, NGOs, and a growing number of politicians in wealthy countries to call for immediate debt relief for the poorest countries of the world. The Jubilee 2000 movement aimed its most intense pressure at the annual meeting of the Group of 8 (G8) countries in Japan in July 2000.<sup>24</sup> Jeffrey Sachs served as one of the economic advisors to Jubilee 2000 and noted that “as in many circumstances, the successful campaign to drop the debt achieved perhaps two thirds of what is truly needed, but it was two thirds more than what was deemed possible before we began.”<sup>25</sup> The Jubilee movement has continued past its origins in the late 1990’s and continues to push for total debt relief for the world’s poorest countries.<sup>26</sup>

As wealthy countries and international financial institutions (IFIs) reform their lending practices, the actions of the Paris Club of the G8 and related countries will invariably come under further scrutiny.<sup>27</sup> The Paris Club first formally convened in 1956 when the government of Argentina agreed to meet with its creditors in Paris. Today, the Paris Club consists of 19 countries that coordinate debt relief issues for many developing countries through the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). The Paris Club member states also use the World Bank Debt Sustainability Framework (DSF) to mitigate against burdening developing countries with excessive and unsustainable debt loads. According to Paris Club guidelines, “all creditors, whether sovereign or private, also have an important role to play in this matter by adopting sustainable lending policies. Paris Club creditors consider that creditor coordination is key to ensure the protection of long-term debt sustainability in low-income countries.”<sup>28</sup> In 2006, Nigeria became the first African country to pay off its outstanding external debt after it negotiated down some of the debt that had been accrued under the dictatorial regime of Sani Abacha as well as other military dictatorships. “Nigeria agreed to pay the Paris Club \$12.4bn (£8.2bn) in exchange for the remainder of its \$30bn official debts being written off.”<sup>29</sup> According to World Bank statistics, nominal debt service relief provided to 29 HIPC countries that reached their decision points has totaled \$62 billion and HIPC assistance has permitted highly indebted developing countries to reduce their debt service payments and simultaneously increase their poverty reduction expenditures to nearly \$15 billion in 2005, 5 times the amount spent on debt service payments.<sup>30</sup> As other developing countries strive to pay off their outstanding external debts, it is clear that cooperation

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<sup>24</sup> *BBC News*, “G8 urged to honour debt promise” July 19, 2000.

<sup>25</sup> Jeffrey D. Sachs, *The End of Poverty* New York 2005 p. 343.

<sup>26</sup> Jubilee USA. <http://www.jubileeusa.org/>

<sup>27</sup> Paris Club member-states: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Russia, Spain, Sweden, Switzerland, the United Kingdom, and the US.

<sup>28</sup> Paris Club, “Debt sustainability challenges for low-income countries” 2010.

Found at: <http://www.clubdeparis.org/sections/themes-strategiques/2009-defis-soutenabilite>

<sup>29</sup> *BBC News*, “Nigeria settles its Paris Club debt” April 21, 2006.

<sup>30</sup> World Bank, “The Enhanced HIPC Initiative – Overview”.

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:21254881~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043~isCURL:Y,00.html>

with the Paris Club will be essential to successful resolution of these potentially crippling debts.

In April 2009, the G-20 countries requested changes or revisions to the IMF/World Bank Debt Sustainability Framework (DSF), particularly calling for a more flexible overall framework that would more accurately differentiate between debts contracted for short-term fiscal deficits versus longer-term development initiatives. Secretary-General Ban Ki-moon concludes that “a more flexible Debt Sustainability Framework which allows for higher debt thresholds when external borrowing is used to finance high-return investment projects would be desirable as it would recognize that not every increase in debt leads to a reduction in government wealth.”<sup>31</sup> Assessing the potential development impact of any loan must be a critical component of any borrowing strategy as well as a serious consideration for loan approvals.

### **Debt Management**

While debt relief and forgiveness are vital elements of addressing the problems of external indebtedness and sustainable development, governments and businesses that are indebted must also establish and implement effective debt management policies. Fiscal decisions must be orchestrated in such a fashion that governments and businesses reach debt sustainability thresholds while continuing to fund critical development programs. As governments emerge from previously unsustainable debt burdens, they “are frequently faced with new and conflicting proposals from the market, and other bilateral creditors, in new financing options, while, in many cases, lacking a coherent framework to fully assess the related costs and risks. Poor financial choices, including the terms on which new debt is contracted, could contribute to the re-emergence of debt vulnerabilities in these countries, putting sustainability at risk.”<sup>32</sup> Ensuring that debt loads are managed properly and that economic and human development is not stalled or prevented by poorly managed fiscal decisions must be priorities for all governments.

### **UN System Actions**

The UN System’s ability to redress the problems associated with external debt will only be maximized if all relevant UN agencies and bodies coordinate their policies to the fullest extent possible. Within the UN System, the Financing for Development (FtD) Office, the General Assembly (UNGA), and the Economic and Social Council (ECOSOC) are the leading bodies tasked with addressing the topic of external debt and development. The UN System, in collaboration with the Bretton Woods institutions of the IMF, World Bank, and the World Trade Organization (WTO), formerly the General Agreement on Tariffs and Trade (GATT), has also organized a series of high-level conferences related to the topic of external debt and development, including the Doha Review Conference (November 29 – December 2, 2008) that served as a follow-up to the International Conference on Financing for Development in Monterrey, Mexico in March 2002.

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<sup>31</sup> Ban Ki-moon, A/64/167 July 24, 2009 p. 14.

<sup>32</sup> World Bank, “Debt Management Stakeholder’s Conference” Oslo, Norway March 5-6, 2008.

## **Conclusion**

External debt continues to pose serious problems for development initiatives around the world. Governments and businesses must convince their respective creditors that creating a mutually acceptable debt sustainability framework with the potential for debt cancellation and/or forgiveness will be absolutely essential to any comprehensive solution to the debt dilemma. Debt forgiveness is clearly most essential for the Least Developed Countries (LDC's) of the world but may become increasingly important for middle-income developing countries and even highly developed countries that are heavily indebted. In light of the recent earthquake that devastated Port-au-Prince, Haiti, the Paris Club and World Bank announced that they were cancelling Haiti's external debts and called for all donor nations to cancel Haiti's total outstanding external debt of nearly 2 billion USD.<sup>33</sup> Ultimately, though, governments and their related development partners must consider more effective ways to achieve sustainable development without contracting such imposing debt burdens.

### **Guiding Questions:**

What is the current fiscal situation for your country? How much external debt does your country currently owe, and has that amount increased during the current global economic recession/slowdown?

Do countries have both legal and moral obligations to repay any outstanding external debt? If the original debt was contracted by a military dictatorship, particularly one that committed serious human rights violations against its own population, do succeeding governments have to repay all of the debt accrued by that dictatorship?

How might international financial institutions (IFIs) and commercial banks amend or reform their lending practices to mitigate against unsustainable debt burdens for developing countries?

How effective have recent changes to the IMF/World Bank Debt Sustainability Framework (DSF) been in establishing more sustainable debt thresholds for developing countries? Are the current Enhanced Highly Indebted Poor Countries (HIPC) Initiative criteria truly reflective of the needs and situations of highly indebted developing countries, especially the world's Least Developed Countries (LDCs)?

### **Resolutions:**

UN General Assembly (A/RES/64/191)

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<sup>33</sup> Alan Cowell, "Rich Nations Call for Haiti Debt Relief" *The New York Times* January 19, 2010.

