United Nations A/60/384

General Assembly

Distr.: General
27 September 2005

Original: English

Sixtieth session
Agenda item 71 (b)
Human rights questions: human rights questions, including alternative approaches for improving the effective enjoyment of human rights and fundamental freedoms

Effects of economic reform policies and foreign debt on the full enjoyment of human rights, particularly economic, social and cultural rights

Note by the Secretary-General*

The Secretary-General has the honour to transmit to the members of the General Assembly the report of the independent expert of the Commission on Human Rights on the effects of economic reform policies and foreign debt on the full enjoyment of human rights, Bernards A. N. Mudho, submitted in accordance with Commission resolution 2005/19 and Economic and Social Council decision 2005/260.

* The present report was submitted after the deadline provided for in the relevant General Assembly resolutions owing to the need to reflect the most up-to-date information available.

05-52563 (E) 201005

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Report of the independent expert of the Commission on Human Rights on the effects of economic reform policies and foreign debt on the full enjoyment of all human rights, Bernards A. N. Mudho

Summary

The present report, submitted pursuant to Commission on Human Rights resolution 2005/19 and Economic and Social Council decision 2005/260 reflects on current issues of particular relevance to the mandate of the independent expert on the effects of economic reform policies and foreign debt on the full enjoyment of all human rights.

For decades, heavily indebted developing countries have been spending significant amounts of their revenues to service external debts, at the cost of providing more basic services and protection that would enable their people to develop and attain their human rights. Despite these payments, the debt stock of developing, including middle-income, countries has quadrupled during the last two decades. The resulting alarming fact is that otherwise direly needed financial resources have been steadily drained from developing countries, and this trend has been on the increase since 1997. The report reviews briefly the historical background of developing countries' debt problems and the detrimental impact of sovereign default and structural adjustment on the ability of affected countries to promote and protect the human rights of their citizens.

Many initiatives have been launched and efforts made by the international community during the last decade in attempts to resolve, or at least temporarily relieve, the problem of developing countries' debt distress. The independent expert welcomes the proposal of the Group of Eight (G-8) leaders to provide full debt relief for countries completing the Heavily Indebted Poor Countries Initiatives. Although the operational details of the proposed relief are still being debated before the governing boards of the World Bank and the International Monetary Fund, which are scheduled to meet in September 2005, it is already clear that the proposal needs full support of other donor countries. There is also a need to explore other new and innovative financing mechanisms such as the proposed International Financing Facility put forward by the United Kingdom of Great Britain and Northern Ireland and other donors.

The report emphasizes the need for alternative approaches to estimating the debt sustainability of developing countries, on the basis of which decisions to grant debt relief or new loans are made. For experience has found that there is no straight or single answer to the question of what the sustainable level of debt should be for a country. The present macroeconomic approach to debt sustainability analysis has clearly proved inadequate, and consideration should be given to developing alternative approaches that take into account the disparate and urgent needs of developing countries to achieve the Millennium Development Goals and the corresponding obligations of the Governments concerned to protect the human rights of their people. The human rights framework also provides important guiding principles in increasing systemic coherence both within and among debtor countries and creditors.

The report concludes with the following recommendations: (a) full donor financing for the G-8 debt relief proposal; (b) increased support to developing countries to develop their own capacity to undertake debt sustainability assessments and decisions in a transparent and participatory manner; (c) a broader approach to debt sustainability taking account of the need of developing countries to achieve the Millennium Development Goals and to realize human rights; (d) a substantial increase of additional official development assistance and provision of more assistance in grant form; and (e) reform of the Paris Club and the establishment of a more formal mechanism to deal comprehensively with the debt distress of low-income countries, including a fair and transparent arbitration mechanism to resolve illegitimate and odious debts.

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I. Introduction

1. In its resolution 2005/19, the Commission on Human Rights requested the independent expert on the effects of economic reform policies and foreign debt on the full enjoyment of all human rights, particularly economic, social and cultural rights to report to the General Assembly at its sixtieth session on his mandate. The mandate of the independent expert has continued to evolve under the Commission, especially over the past several years. In resolution 2000/82 the Commission established the mandate of the independent expert, by merging two previously separate mandates that started in 1998, dealing respectively with the effects of structural adjustment policies and of foreign debt, into a single mandate. In the same resolution, the Commission requested the independent expert to pay particular attention to:

(a) The effects of the foreign debt and the policies adopted to face them on the full enjoyment of all human rights, in particular economic, social and cultural rights in developing countries;

(b) Measures taken by Governments, the private sector and international financial institutions to alleviate such effects in developing countries, especially the poorest and heavily indebted countries; and

(c) New developments, actions and initiatives being taken by the international financial institutions, other United Nations bodies and intergovernmental and non-governmental organizations (NGOs) with respect to structural adjustment policies and human rights.

2. In addition to the above, the Commission in resolution 2004/18 requested the independent expert to explore further, in his analytical annual report to the Commission, the interlinkages with trade and other issues, including HIV/AIDS, when examining the impact of structural adjustment and foreign debt and also to contribute, as appropriate, to the process entrusted with the follow-up to the International Conference on Financing for Development, with a view to bringing to its attention the issue of the effects of structural adjustment and foreign debt on the enjoyment of human rights, in particular economic, social and cultural rights.

3. In the same resolution, the Commission also requested the independent expert, in the discharge of his mandate, to draft general guidelines to be followed by States and by private and public, national and international financial institutions in the decision-making and execution of debt repayments and structural reform programmes, including those arising from foreign debt relief, to ensure that compliance with the commitments derived from foreign debt will not undermine the obligations for the realization of fundamental economic, social and cultural rights, as provided for in the international human rights instruments, and to present a preliminary draft on this matter to the Commission at its sixty-first session and a final draft at the sixty-second session.

4. In accordance with these given mandates, the independent expert has highlighted in his successive annual reports, and pertinent country mission reports, the impact of unsustainable debt burden on the ability of poor countries to adopt policies and programmes for the enjoyment by their citizens of economic, social and cultural rights. He also sought to highlight recent developments and significant

initiatives such as the Heavily Indebted Poor Countries (HIPC) initiatives, both at the global and in specific-country contexts.

5. As requested by the Commission, he has also followed with interest and sought to contribute to the process entrusted to the follow-up to the International Conference on Financing for Development with a view to bringing to its attention the issues relating to his mandate. He participated in the multi-stakeholder dialogue on sovereign debt for sustained development, organized by the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat and the United Nations Conference on Trade and Development in Geneva from 20 to 23 June 2005. The independent expert wishes to thank, in particular, the Director of the Financing for Development Office for his cooperation in facilitating the fulfilment by the independent expert of his mandate in this regard.

6. The independent expert has also pursued constructive dialogues with the World Bank and the International Monetary Fund (IMF) and wishes to sincerely thank the two institutions for the open and frank exchange of views they always made possible during his annual consultations with them. He hopes such insightful exchanges will continue. The consultations have been particularly useful in examining some significant recent developments with regard to debt sustainability issues and structural adjustment policies. In his report to the Commission on Human Rights at its sixtieth session (E/CN.4/2004/47), he examined the current status of the HIPC initiatives and their contributions to the full enjoyment of human rights, while in his report to the sixty-first session (E/CN.4/2005/42), he highlighted the World Bank’s new approach to debt sustainability and new lending facility, which are premised upon country-specific approaches in developing appropriate external borrowing strategies. The new approach represents a significant shift within the World Bank’s operations from the old one-size-fits-all structural adjustment lending to more streamlined development policy lending instruments that emphasize the importance of country ownership.

7. As part of his mandate to study the impact of foreign debt and economic reform policies as well as experiences and initiatives of Governments, including those of the adversely affected countries, and the international community to overcome debt problems, the independent expert has undertaken country missions to Bolivia in 2002 (see E/CN.4/2003/10, sect. II), Uganda in June 2003 (see E/CN.4/2004/47/Add.1), Kyrgyzstan in June 2004 (see E/CN.4/2005/42/Add.1) and, most recently, to Mozambique in July 2005. The independent expert wishes to thank these Governments for their invitation and cooperation in realizing these missions, as well as the United Nations resident coordinators and the country teams, the representatives of the IMF and the World Bank and non-governmental organizations in these countries that provided valuable information and insights.

8. The independent expert is also grateful to the Government of the United Kingdom of Great Britain and Northern Ireland for favourably responding to his request for a briefing and discussion with Her Majesty’s Treasury and the Department for International Development on their initiatives for debt relief under the G-8 framework and the proposed International Financing Facility, which was held in London on 27 June 2005.

9. He welcomes this opportunity to report, for the first time, to the General Assembly, as he believes that the issue of economic reform policies and foreign debt and their impact on the full enjoyment of all human rights deserves comprehensive

discussion as the General Assembly holds its High-Level Plenary Meeting to review the progress of the implementation of the United Nations Millennium Declaration, particularly the Millennium Development Goals and other human rights-related commitments. The approach of the present report is to highlight the current situation of foreign debt and its impact on human rights from a historical perspective (sect. II) and to review new initiatives for debt relief, in particular the recent proposal under the G-8, and their implications (sect. III). In section IV, the independent expert highlights the importance and necessity of developing alternative approaches to the issue of debt sustainability based on human rights imperatives. The report concludes with a number of recommendations directed at both debtor States and creditor States and institutions.

II. The scope of debt problem and its impact on human rights

10. The Millennium Project report *Investing in Development*, issued in January 2005, painted a bleak picture of the highly indebted poor countries. These countries, according to World Bank statistics, saw their incomes rise only from US$ 298 per capita to US$ 337 between 1997 and 2002, while the volume of world trade almost doubled in the same period. Dozens of heavily indebted poor and middle-income countries are forced by creditor Governments to spend significant portions of their income to service their unpaid and unpayable debt, undermining their ability to invest in human capital and infrastructure. What is more cynical is that some creditors provide development assistance with one hand and then withdraw it in debt servicing with the other.[1]

11. The debt stock of developing, including middle-income, countries quadrupled during the last two decades, rising from US$ 500 billion in 1980 to US$ 1 trillion in 1985 and to around US$ 2 trillion in 2000. The 41 HIPC countries — among the poorest of the poor — saw their total indebtedness increase from US$ 60 billion in 1980 to US$ 105 billion in 1985 and to US$ 190 billion in 1990; in the absence of debt reduction, the figure would have reached nearly US$ 200 billion in 2000. The total external debt of low- and middle-income countries stood at US$ 2.6 trillion at the end of 2003, compared with US$ 1.3 trillion in 1990. For low-income countries, external debt stood at about US$ 424 billion, of which US$ 356 billion were non-commercial guaranteed debt. Almost a third of it, or US$ 107 billion, was owed to the World Bank.[2]

12. An alarming fact is that, despite all efforts for debt relief and calls for increased aid, financial resources have been steadily drained away from developing countries to developed countries. Since 1997, net outward transfer of financial resources from poor countries to rich countries has steadily increased, while net official flows to all developing countries remained negative. Developing countries' loan repayments to multilateral financial and development institutions have outpaced loan disbursement. The International Bank for Reconstruction and Development in particular has experienced net inflows since the early 1990s. This means that the multilateral financial institutions are no longer providing net financial resources to developing countries, but are currently net recipients of financial resources that are needed by these countries to achieve the Millennium Development Goals.[3]

13. A variety of factors have contributed to the debt servicing difficulties of highly indebted countries. For most developing countries with insufficient levels of domestic savings, external finance in the form of concessional loans has been an important means of financing their development for decades. These loans are usually given at very favourable terms with interest rates of 1 per cent or less and maturities over 30 years. Despite these seemingly favourable terms, many developing countries have had difficulties in servicing their debts, owing to a variety of factors — both internal and external. The lending boom of the 1970s was much premised on the neo-classical export-led growth development strategy encouraged by the Bretton Woods institutions, bilateral donors and commercial institutions. The creditors advocated that such large inflows of capital and the rapid industrialization of developing countries would kick-start their economies and help them to take off on their own. Multilateral institutions disbursed loans to large infrastructure projects without much consideration for the social impact of such projects or loans. Bilateral lending was often driven by political agendas and other concerns. Furthermore, creditors in the 1960s and 1970s made little effort to coordinate among themselves, nor paid sufficient attention to the impact of overall debt accumulation on the country's ability to service its loans.[4]

14. Both debtors and creditors bear responsibilities for mismanagement of external finances. As with development and the realization of human rights, the primary responsibility for prudent debt management and responsible use of external resources rests with national Governments. However, Government officials in poor developing countries typically lacked capacity and found themselves in a weak position from which to negotiate terms with multilateral and bilateral lenders. Governments and leaders of some developing countries had borrowed excessively and irresponsibly, which encouraged corruption and abuse and eventually led to serious mismanagement of their economies. In other cases, Governments were badly advised by multilateral institutions or had ill-conceived projects and programmes that did not benefit the people but only contributed to further increasing the country's external debt burden.

15. Some factors were beyond the expectations of and control by borrowers and lenders. Exogenous factors such as the oil price shocks, high interest rates and recession in industrialized countries, as well as low commodity prices in the 1970s and 1980s were other factors contributing to the debt build-up of these countries. To maintain their balance of payments, countries increased foreign borrowing to compensate for declining terms of trade as commodity prices dropped sharply in the early 1980s. Some poor countries increasingly resorted to new borrowing simply to service debt, and conditionalities were set by international financial institutions, curbing public expenditures and imposing structural adjustment programmes to reduce the dependence on foreign loans. This triggered a vicious cycle: funds for new investment became scarcer, economic growth slowed and as the debt became more unsustainable, more borrowing was necessary to service debt and more expenditures were reduced. Poor management and weak governance mechanisms in recipient countries also played a part in the debt build-up, as well as civil wars and conflicts, natural disasters and the vagaries of weather. All of these meant that much of the foreign borrowing was squandered, bringing little long-term benefit in terms of capacity to produce and to earn foreign exchange reserves.

16. The debt spiral led to the rise of structural adjustment conditionalities. As more developing countries built up debt stocks and increasingly faced difficulties in

servicing their loans in the 1970s, the Bretton Woods institutions and lenders increasingly applied pressure on debtors to adopt structural adjustment programmes (SAPs) as a condition for obtaining debt rescheduling. These programmes were aimed at restoring macroeconomic stability, ensuring sound management of the Government budget, accelerating the implementation of market-oriented reforms and establishing efficient trade and exchange-rate policies. While these are important economic principles that countries need to pursue, SAPs, as a conditionality imposed for debt relief/rescheduling and other economic assistance, greatly reduced the space of developing countries to set in place policies and programmes appropriate to the national context.

17. SAPs met with wide criticism for having had a detrimental impact on the concerned countries' ability to develop and to promote human rights. In essence, implementing the SAPs meant that poor developing countries had to prioritize running a current account surplus and building foreign exchange reserves over Government expenditures, which had to be reduced, particularly in the social sectors. The aim of SAPs was to put in place structural economic reforms and sound macroeconomic management that would ensure the debtor's ability to repay the debt beyond the short term. These reforms, while essential for long-term economic growth and stability, were not without severe consequences, at least for the short term. Draconian economic policies prescribed by the international financial institutions (IFIs) have severely undermined the ability of developing countries to protect their people and to provide basic essential services. Subsidies to protect domestic agricultural producers and infant industries were also reduced, leaving them vulnerable to foreign competition. Privatization and liberalization, which were key pillars of SAPs, left many developing countries with massive unemployment and increases in food prices. The poorest and most vulnerable, among them women and children, bore the brunt of structural adjustment, which brought decline in real family incomes and reduction in health and social services or the introduction of user fees to access these services.[5]

18. Despite its failures, the basic tenets of SAPs still remain today. Facing criticism from developing countries and civil society about their doctrinaire, one-size-fits-all approach, IFIs do not use the term SAP nowadays but rather emphasize the country ownership of national development and macroeconomic policies through the Poverty Reduction Strategy Paper (PRSP) process. However, the principle of good macroeconomic management remains the same and for HIPC debt relief, countries would need to have their IMF programme on track as a criterion for reaching the completion point. For example, before Mozambique reached the completion point in 1999, one of the necessary conditions it had to meet was to liberalize its cashew nut trade. As a result, thousands of workers lost their jobs in cashew processing plants which had been one of the largest private sector employers in the country. Instead, Mozambique exported raw nuts to India, where, reportedly, child labour was used to shell the nuts. Moreover, the price of raw nuts collapsed as the factories closed, which cut the peasants' income almost by half.[6]

19. The promise of return to rapid economic growth remained elusive for many of the developing countries in the 1980s, which came to be called the "lost decade". Not only did these poor countries not grow as rapidly as had been hoped, but their level of external debt continued to rise. Some countries such as Brazil were able to maintain a high growth rate of around 7 per cent in the second half of the 1970s, which was, however, accompanied by a rapid increase in its current-account deficit,

from US$ 1.7 billion in 1973 to US$ 12.8 billion in 1980. As the international financial system was awash in petrodollars and was eagerly offering low-interest loans, Brazil kept on borrowing to finance its deficit, resulting in a significant increase in its external debt from US$ 6.4 billion in 1963 to nearly US$ 54 billion in 1980. The IMF austerity programme implemented in the first half of the 1980s enabled Brazil to meet interest payments on its debt, but at the price of economic decline and increasing inflation.[7]

20. Major defaults by Latin American countries in the 1980s prompted an increased role for private capital in resolving the debt crisis of middle-income countries. Under the Brady Plan introduced by the United States Treasury in 1989, creditors of Latin American countries were able to convert their existing debt claims into a menu of new claims. The basic idea was that IMF, the World Bank and others would lend money to troubled debtors for debt restructuring with which they could buy back their debt on the secondary market in the form of "Brady bonds". While the Brady Plan may have worked for creditors who were able to tailor their credit restructurings, for debtor countries it meant another round of indebtedness.

21. However, for the poorest developing countries, particularly in sub-Saharan Africa, a more comprehensive solution needed to be found. For these countries this secondary market option was not feasible, as official development assistance (ODA) remained a major source of foreign exchange for these countries, constituting as much as 10 per cent of their national income. As the level of ODA to these poorest developing countries increased in the 1980s and the 1990s, they became increasingly dependent on aid money to pay debt service and were consequently left with fewer resources to spend on development and poverty reduction.

22. The HIPC Initiatives therefore emerged to ensure that debt relief would contribute to poverty reduction. By the mid-1990s, it had become evident that the combination of existing debt relief mechanisms, new official assistance, and policy packages aimed at reducing borrowing needs were still not enough to reduce debt to sustainable levels. At their joint annual meeting in October 1996, the IMF and the World Bank launched the HIPC Initiative, aimed at providing a comprehensive solution to the problems of poor country indebtedness. The goal of HIPC, as revised and enhanced in 1999, is to ensure deep, broad and fast debt relief with a strong link to poverty reduction. Currently, 38 countries are on the HIPC list, 32 of them in sub-Saharan Africa, which are potentially eligible to receive debt relief under the Initiative. Among them, 27 low-income countries owing about US$ 110 billion have qualified for potential debt relief of more than US$ 54 billion to be provided under the Initiative, representing a two-thirds reduction of their overall debt stock. The sunset clause has been extended for another two years for the additional 11 countries that are still at pre-decision point because of their unsatisfactory IMF programme implementation owing to civil unrest, cross-border conflict, governance challenges and substantial arrears problems.

23. Due recognition should be given to the progress achieved under the HIPC Initiative, particularly its recent emphasis on making an explicit link with poverty reduction goals. Notwithstanding the many difficulties faced by the countries participating in the programme, IMF and the World Bank report that debt relief under the Initiative has helped countries to increase poverty-reducing expenditures.[8] On the other hand, the analysis of the post-completion countries' performance revealed that for most of these countries, the net present value of debt-to-export

ratios has been significantly higher than the original estimates. While exogenous shocks may have contributed to these developments, this shows that the HIPC is not a panacea for solving the debt crisis.

24. HIPC is a limited instrument and not intended as a panacea. The HIPC Initiative is a debt-reduction programme and, as already noted above, was not intended as offering a comprehensive solution to long-term debt sustainability. Since the HIPC Initiative was first launched in 1996, the public expectations of the Initiative have grown to such an extent that many have come to believe that the Initiative will somehow provide an end to debt rescheduling and the poverty spiral. Indeed, many Government officials in debtor countries acknowledge that qualifying for HIPC assistance has become their main motivation in preparing their PRSPs, which is one of the basic prerequisites for HIPC assistance. It must be recognized that the HIPC Initiative should not be seen as an end in itself, but a means to achieve poverty reduction goals and to create an environment conducive to the realization of human rights. The HIPC Initiative is a limited instrument which essentially allows the debtor countries to make a fresh start in their overall development efforts, and it needs combined reinforcement from other developmental actions and measures by the affected countries and the international community at large.

25. Paris Club debt rescheduling has been too little. With regard to bilateral debt, debt relief took the form of payment rescheduling, sometimes on concessional terms, sometimes coupled with new loan packages. In recognition of the need to develop an elaborate mechanism to ensure that all of a country's bilateral creditors contributed equally, creditor Governments formed the Paris Club to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. Although the Paris Club has since 1983 reached agreements covering 80 debtor countries and a total debt worth US$ 485 billion, it has remained a strictly informal mechanism based entirely on the voluntary will of its member creditor countries. Consequently, the amount of debt relief provided under a Paris Club agreement has been too little to provide sustainable solutions to the payment difficulties of the poor debtor countries and repeated visits to the Club for additional relief became the norm for many of them. Moreover, the Paris Club has never evolved into a formal institution with mutually binding obligations on all the parties to ensure the debt sustainability of the heavily indebted countries and coordinated actions by creditors.

26. The impact of the Evian approach is still limited. Cognizant of these limitations and criticisms, the Paris Club has made an effort to increase transparency through Internet-based dissemination of information and activities.[9] Furthermore, it adopted new measures for debt relief, called the "Evian approach", in October 2003, following an agreement of G-8 finance ministers to reform the Club.[10] Targeting non-HIPC middle-income countries, the new approach bases itself upon the long-term debt sustainability analysis taking into account the historical evolution of debt and the economic potential of the concerned State. It seeks to provide comprehensive treatment of debt-crisis countries by debt reduction in three stages rather than a simple rephasing of the debt servicing schedule. The experience with the Evian approach has been limited, as Iraq is so far the only country to receive comprehensive treatment under the approach.

27. To date, no comprehensive mechanism exists to organize negotiations with private creditors, which poses a particular challenge for middle-income debtor countries. Although the London Club was formed in the 1980s and still functions as a forum for renegotiating loans made by commercial banks, most of the new sovereign borrowing on international financial markets has been in the form of bonds, and no mechanism exists to treat defaulted bond debt. As sovereigns increasingly turn from bank loans to bond issues, private creditors (investors) have become more numerous, anonymous and difficult to coordinate. Moreover, in the international financial system no strong legal framework currently exists which would provide for the predictable and orderly restructuring of sovereign debt.

28. The IMF sovereign debt restructuring mechanism (SDRM) proposal failed to gain support. In 2001, IMF made a proposal to design an SDRM based on private sector bankruptcy laws to provide a legal framework for an orderly restructuring of sovereign debt owed to private creditors.[11] However, it has so far failed to garner sufficient support among private and Paris Club creditors whose concerns included the moral hazard, the neutrality of IMF in the process and the increase in borrowing costs. In view of this situation, current attention is shifting to the broader use of collective action clauses in bond issues, as well as to developing a code of conduct as a voluntary framework for debt resolution between debtors and creditors.

III. New initiatives for debt relief and increased aid

29. The new G-8 debt relief proposal is a significant step forward. In July 2005, the Group of eight leaders met in Gleneagles, Scotland, and endorsed a proposal made by G-8 finance ministers to provide full debt relief for HIPC countries that had reached the completion point.[12] The deal covers 18 HIPC completion countries (Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Uganda, United Republic of Tanzania and Zambia) and provides for the cancellation of 100 per cent of their debt owned to IMF, the World Bank and the African Development Bank. The finance ministers' communiqué of 11 June 2005[13] stated that additional donor contributions would be allocated to all recipients of the International Development Association (IDA) and the African Development Fund (AfDF) based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the Millennium Development Goals and ensure that assistance is based on country performance. Furthermore, the G-8 finance ministers recognized that good governance, accountability and transparency are crucial to releasing the benefits of the debt cancellation, and made a commitment to ensure that this is reaffirmed in future bilateral and multilateral assistance to these countries.

30. But the proposal is currently under threat before the World Bank/IMF governing boards. The G-8 proposal is a significant step forward and represents an important political commitment towards solving the debt problems of some of the most indebted and poorest countries. While welcoming the G-8 proposal, some of these eligible countries voiced concern that such a commitment should have been made much earlier. Moreover, the communiqué does not provide sufficient details of how the debt cancellation would operate and how it would be ensured that it will be truly additional to future ODA. At the time of writing of this report, those details were still being worked out with the IFIs and will be presented at the September

2005 meeting of the IMF/World Bank governing boards. The G-8 proposal has already encountered opposition among some members of IMF which are concerned about the moral hazard and the financing of the debt relief through the use of IMF gold reserves.

31. Viewed more broadly, the deal may not look quite like the "historic breakthrough" claimed by United Kingdom Chancellor of the Exchequer Gordon Brown, or "the most comprehensive statement that finance ministers have ever made on the issues of debt, development, health and poverty". First of all, the deal covers only 18 countries that have reached the HIPC completion point, leaving many more low- and middle-income countries with difficulties servicing their debt. The focus on the HIPC completion point also means that only those countries that have successfully met the IMF conditionalities, including structural reforms, would be eligible, and not those countries that have difficulties in meeting such stringent conditions. Secondly, the proposal only covers debt owed to IMF, the World Bank and the African Development Bank and not other lenders such as other multilateral banks including the Asian Development Bank, the Inter-American Development Bank and the Caribbean Development Bank, or to private creditors. Thirdly, a clear picture is yet to emerge as to whether the deal will represent additional resources flowing to those countries concerned. The G-8 finance ministers' communiqué stated that, for IDA and AfDF debt, "100 per cent stock cancellation will be delivered by relieving post-completion point HIPCs that are on track with their programmes of repayment obligations and adjusting their gross assistance flows by the amount forgiven. Donors would provide additional contributions to IDA and AfDF, based on agreed burden shares, to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled." This in essence could be interpreted to mean that those eligible countries will no longer have to pay their debt owed to IDA and AfDF, but they will have less access to future lending or assistance by the same amount. On the other hand, donors will redistribute the funds across all IDA-only countries, not necessarily to those countries that have benefited from the debt cancellation, based on their policy performance. Lastly, the G-8 commitment covers only the next three years until the end of the IDA-14 and AfDF-10 period, i.e. until 30 June 2008 and 31 July 2007, respectively. Beyond that point, the communiqué only makes vague commitment to make additional contributions to regular replenishment of IDA and AfDF for the rest of the life of the loans.[14]

32. The proposal for the International Financing Facility: a new innovative financing mechanism or a virtual loan of future grant assistance? The above ambiguity regarding the additionality of resources is particularly perplexing when the G-8 communiqué generally reaffirmed the need for additional aid. The communiqué specifically announced the commitment of G-8 countries and other donors to double ODA to Africa to the level of US$ 25 billion a year by 2010. It also reaffirmed the assessment of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD/DAC) that the new commitments undertaken before and during the G-8 meeting will increase development assistance by around US$ 50 billion a year by 2010 as compared with 2004. It is also disappointing that the G-8 leaders did not make a concrete commitment with regard to the need for new innovative financing mechanisms such as the proposal by the United Kingdom to establish an International Finance Facility (IFF), which has been on the table for some time now. The Facility combines the long-term donor commitment with leverage funds from the international capital

markets. It enables the front-loading of the funding commitment of donor countries and brings forward the financing needed by developing countries to achieve the Millennium Development Goals. A pilot project using the IFF modality has been announced by the Global Alliance for Vaccines and Immunization to be undertaken with the cooperation and support of the Governments of the United Kingdom and France.[15] The G-8 communiqué in annex II acknowledged that a group of European countries would continue to consider the IFF mechanisms and that a working group would consider the mechanism, among others. While this is a positive step, some concerns and questions remain to be addressed before IFF can become widely accepted and fully operational. Some view IFF, although disbursed as grants to developing countries, as in fact a type of loan using future aid money as collateral. While there have been announcements of commitments to increase aid by 2015 as indicated above, there is no guarantee that the aid budget will actually increase to the predicted level. How the IFF mechanism will be governed and disbursement decisions made are other important issues yet to be addressed in detail.[16]

IV. Towards a human rights-based approach to sustainable debt management

33. There is a need for alternative approaches to debt sustainability, and increasing coherence. As set out at the beginning of this report, external financing provides an important means for developing countries to finance their development. If properly managed, external financing through concessional loans could contribute to development and further enjoyment of human rights. However, the problem arises when the debt becomes unsustainable and the country faces a risk of sovereign default. Countries will invariably try to avoid an unsustainable debt burden, since the costs of the economic turmoil that typically follows default are enormous. A sovereign default undermines domestic and foreign investor confidence in the Government and will result in a mass exodus of capital, which will plunge the country into deep economic recession and crisis, and ultimately affect the realization of human rights. This section addresses the imperatives of bringing human rights considerations to: (a) determining the sustainable level of debt in a country; and (b) addressing process-related issues in managing sovereign debts.

A. Measuring debt sustainability

34. A debt sustainability analysis to determine the level of "sustainable" external debt of a country is probably the most essential element in determining how much debt relief/restructuring is needed or how much a country can possibly borrow to meet its development needs without falling into repayment difficulties. While there are a variety of definitions of debt sustainability, a commonly used criterion of sustainability is whether a country can meet its current and future debt service obligations in full, without recourse to debt relief, rescheduling, or accumulation of arrears.[17] After the major defaults and financial crisis of the last two decades, this is increasingly taken to mean not only that a Government should be able to meet its external obligations on a timely basis in normal times, but that it should also be able to withstand the likely volatility in the international economy as well as the uncertainties in the domestic economy, including the effects of natural disasters.[18]

35. To date, the macroeconomic approach has been dominant in debt sustainability analysis. Economists have relied on macroeconomic analysis and indicators to deduce quantitative relations between foreign borrowing and overall economic performance. The ratio of debt is measured against key variables such as GDP, export earnings and fiscal revenues. The entry criteria for the HIPC Initiative was thus derived in 1996 as having a net present value (NPV) of debt-to-export ratio of more than 150 per cent or debt-to-revenue ratio of 250 per cent. There has been widespread criticism that these criteria are somewhat arbitrary and were heavily influenced by political considerations.[19] Furthermore, economists such as Jeffrey Sachs argued that the NPV debt-to-export ratio does not provide any real measure of sustainability because these criteria could point to when a country becomes insolvent, but do not take us far enough since sustainable is not simply the obverse of unsustainable.

36. An important criticism of the macroeconomic approach has been that it does not take into account the poverty and social dimensions. Despite its name, the HIPC Initiative's entry criteria are void of poverty indicators, thereby excluding the needs of some of the world's poorest countries or the debt of countries with a large population of poor people. In adopting the Monterrey Consensus in 2002, Member States at the International Conference on Financing for Development agreed that future reviews of debt sustainability should also bear in mind the impact of debt relief on progress towards the achievement of the Millennium Development Goals and that continued efforts are needed to reduce the debt burden of HIPCs to sustainable levels. This would require that considerations of debt servicing be based on the need to finance the Goals.

37. This discussion on alternative approaches to measuring debt sustainability is particularly relevant and essential in light of the request of the Commission on Human Rights to the independent expert (resolution 2004/18) to draft general guidelines to be followed by States and by private and public, national and international financial institutions in the decision-making and execution of debt repayments, to ensure that compliance with the commitments derived from foreign debt will not undermine the obligations for the realization of fundamental economic, social and cultural rights, as provided for in the international human rights instruments, and submit a final draft to the Commission at its sixty-second session.

38. There have been proposals to limit debt servicing in order to prioritize social spending. An interesting example is the draft legislation developed by a group of United States Senators and Congressmen in 2002 that would oblige the Government of the United States to modify the HIPC Initiative so as to limit debt servicing by HIPCs to 10 per cent of their current Government revenues, except for countries with a "public health crisis", for whom the ratio would be 5 per cent.[20] Although the 5- or 10-per cent criterion seems somewhat arbitrary, similar approaches could be considered to prioritize Government spending for the Millennium Development Goals and other areas essential for the realization of human rights over debt servicing.

39. However, the task is not so simple and not without conceptual and operational challenges. First, as mentioned above, there is no straight or single answer to the question of what a country's sustainable level of debt should be. Second, the human rights community is still far from having developed appropriate indicators and a methodology to measure the cost of realizing human rights in monetary terms, if this

is to be a factor in the debt repayment calculation. Third, even with complete debt write-off, the proposal does not provide sufficient resources or conditions for developing countries to meet the Millennium Development Goals, let alone the full realization of all human rights. A significant increase in ODA would be required in addition to debt relief, as well as further strengthening of the capacity of recipient countries to absorb and effectively use the assistance for the benefit of their people.

40. Still, the present debt sustainability formula needs to be revisited, as the G-8 debt relief proposal, if implemented as it currently stands, might have significant implications for the future access of the recipient countries to concessional loans under the current debt sustainability framework. Using the present formula for the HIPC thresholds, the full implementation of the G-8 debt relief proposal will produce ratios well below the threshold for the recipient countries, which would exclude them from receiving grants from the International Development Association in future. This poses a danger that such countries will enter into a new cycle of borrowing and debt accumulation if solutions are not found to guarantee their continued access to grant-based aid additional to the debt relief provided.

B. Need for systemic coherence in managing sovereign debt

41. International cooperation and development assistance for the realization of economic, social and cultural rights is an obligation for all States, as enshrined in Articles 55 and 56 of the Charter of the United Nations, coupled with well-established principles of international law, and with the provisions of the International Covenant on Economic, Social and Cultural Rights.[21] Sharing the responsibility between the debtors and creditors for preventing and resolving unsustainable debt situations is also a centrepiece of the Monterrey Consensus. In today's globalizing world, debt distress of developing countries is a serious concern for the global economy and financial markets as a whole. Moreover, it poses a serious limitation on the ability of those countries to allocate sufficient resources for the realization of the human rights of their people. In the event of sovereign default, the cost of economic turmoil and post-default treatment on human rights would be enormous.

42. Human rights principles such as indivisibility, non-discrimination, equality, participation and accountability could be the underpinning of improved policy coherence and international support for indebted developing countries. A human rights approach to international cooperation with regard to debt compels all countries and institutions to contribute to the creation of a favourable international environment, in particular through the transparency and democratization of decision-making in the bodies and institutions concerned with trade, finance, monetary policy, intellectual property and development assistance, and through greater international cooperation in the areas of assistance, financing and investment.

43. As with development, States have the primary responsibility for the realization of the human rights of their people. Creating favourable national conditions through appropriate economic policies and sound management of external debt is an essential part of the duty of the State. This requires not only improved debt management capacity of Government officials and institutions, but also their increased awareness and appreciation of relationships between the overall fiscal

budget, expenditures related to the realization of human rights, including poverty reduction and social expenditures, and the required payments to service external debt. Good economic policies and management are essential, but not sufficient, if the debt relief is to contribute towards greater realization of human rights in a country. Increased transparency and open dialogue between Government departments, the legislature and the public would also be necessary before the Government commits itself to new large borrowings. The full implications of loans, such as those for large infrastructure projects, should be studied and debated in an open policy dialogue. Greater transparency and timely disclosure of information by the Government are essential for this.

44. Far greater attention should be paid to the need for the building capacity of developing countries to conduct their own assessments, manage external financing and make decisions in consultation with the public in the ways most appropriate to their national context. While in recent years the international financial institutions have been advocating increased country ownership of their programmes through adoption of the PRSP approach, assessments and analyses of debt sustainability are still being carried out by the Bank and the Fund staff. In making borrowing decisions, it is essential that the capacity of national debt management offices and civil society groups to conduct independent analyses be strengthened to ensure genuine country ownership. In particular, independent human rights institutions and ombudspersons could, and should, be empowered to examine the impact of the foreign debt burden on human rights and to monitor in order to ensure that the debt relief will make a positive contribution to the realization of human rights. Since the PRSP process is one of the key conditionalities of the current Bank and Fund programmes, integration of human rights into PRSPs is an essential step in this regard.

45. Creditors need to exercise "due diligence" in extending loans to developing countries. It should be recognized that a decision regarding external financing involves not only borrowers, but also creditors. Creditors, too, therefore have their share of responsibility in whether to extend a loan. Creditors need to exercise "due diligence" in making such decisions, to avoid unsustainable debt accumulation. In view of the large role played by the private sector, including individual investors, greater transparency and open communication between the Government and creditors are essential to ensure investor confidence and avoid panic selling of Government bonds issued by developing countries.

46. More formal international mechanisms beyond the Paris Club would be necessary in order to monitor the debt situations of developing countries and their impact on the development and human rights potentials of those countries. The purpose of such mechanisms would be to collect and disseminate real-time debt information about developing countries to all types of creditors, as well as borrowers, and to serve as a forum for policy dialogue and crisis resolution. While the development of general guidelines such as those entrusted to the independent expert may serve useful purposes, they will most likely remain voluntary in nature and cannot be a substitute for a more formal mechanism to ensure the long-term debt sustainability of developing countries.

47. The current international debate on debt relief, including the G-8 proposal, is very much creditor-led and avoids some issues of serious concern expressed by debtor countries such as the question of illegitimate debt. Consideration of the debt

relief issue should be guided not only by how much relief a country needs or how much relief the international community can afford, but also by how a country became indebted in the first place. Many NGOs have called for the creation of a fair and transparent arbitration process (FTAP) for illegitimate and odious debt owed by developing countries resulting from irresponsible lending and borrowing. Such a process would involve a neutral decision-making body that is independent from both parties involved and all stakeholders would have the right to be heard. Civil society proposals for FTAP include rights-based criteria and approaches, including impartiality of the process and the assessment, primacy of human rights over debt repayment by guaranteeing the protection of the basic minimum standards for the citizens, participation of all stakeholders in the procedures, and ensuring monitoring and accountability of actors for the implementation of FTAP outcomes.

48. Lastly, the official creditors and donors should renew their commitment to ensuring the additionality of resources and to providing more grant-based assistance than new loans. Many low-income countries have struggled to maintain their external debt at sustainable levels while also trying to meet development objectives under the Millennium Development Goals. It has become increasingly evident that financing the Goals will require a substantial increase in resource flows to developing countries; one conservative estimate puts the need at US$ 100 billion a year for the Goals to be achieved. While the International Conference on Financing for Development has resulted in pledges of some US$ 16 billion for additional aid by 2006, this is still far short of a doubling of aid.[22] These resources need to be provided under appropriate terms in order not to jeopardize debt sustainability in many low-income countries, particularly HIPCs. Essentially, this would imply, inter alia, that more assistance should be provided in grant form, more efforts should be made by both recipients and donors to increase the effectiveness of aid, and concessional lending should be streamlined to ensure long-term debt sustainability.

V. Conclusions and recommendations

49. **Based on the foregoing, the independent expert submits the following conclusions and recommendations for the consideration of the General Assembly:**

(a) **The independent expert welcomes the G-8 communiqué on the debt cancellation of a number of HIPCs. Although at the time of writing this report, a clear picture has yet to emerge from the World Bank and the IMF as to how the G-8 commitment can be translated into reality over the medium term, it is already clear that ensuring full donor financing for debt relief is crucial to the success of the initiative. Furthermore, consideration should be given to expanding the number of eligible countries as well as creditor institutions;**

(b) **Debtor countries, with international support, need to build their capacity to conduct their own assessments, manage external financing and make decisions in consultation with the public in ways most appropriate to their national context. Open, participatory and transparent processes should be established within the country to assess the needs and implications of new borrowings in the context of national priorities. Government officials and institutions should increase their awareness of their obligations as duty bearers to provide human rights to their citizens, including through integrating human**

rights into PRSPs. Independent human rights institutions and ombudsman could be empowered to examine the impact of the foreign debt burden on human rights and to monitor that impact to ensure that debt relief will make positive contribution to the realization of human rights;

(c) **Resolving the debt crisis of developing countries should be recognized as the common responsibility of both debtor and creditor countries and institutions. The international community should recognize the need to take a broad view of debt sustainability beyond the macroeconomic approach, premised on the fiscal need of developing countries for the realization of the Millennium Development Goals and human rights;**

(d) **The international community needs to ensure the additionality of resources and the reversal of outward resource flows from developing countries, inter alia through appropriate reforms and the establishment of a more equitable international trading system. This would require a substantial increase in additional official development assistance, more assistance provided in grant form and opening up developed countries' markets to exports from developing countries. Further efforts should be made to increase the effectiveness of aid through country ownership, rights-based approaches and a people-centred focus, as well as partnerships based on mutual commitment;**

(e) **A more formal and comprehensive mechanism should be established to deal exhaustively with the debt distress of low-income countries, including through further reform of the Paris Club. Serious consideration should also be given to the proposals for establishing fair and transparent arbitration mechanisms to deal with developing countries' debt, in particular illegitimate and odious debts.**

Notes

[1] United Nations Millennium Project, Investing in Development: A Practical Plan to Achieve the Millennium Development Goals, 2005, pp. 14 and 35.

[2] World Bank, 2005 World Development Indicators, table 4.16.

[3] See the report of the Secretary-General on the international financial system and development (A/60/163), sect. I.

[4] See United Nations, World Economic and Social Survey 2005, chap. V.

[5] For a more comprehensive review of the negative impact of structural adjustment policies and programmes, see the report of the previous independent expert on the effects of structural adjustment policies on the full enjoyment of human rights, Fantu Cheru (E/CN.4/1999/50).

[6] Letter from members of Congress to United States Treasury Secretary Paul O'Neil regarding the IMF/World Bank intervention in the Mozambique cashew nut industry, 26 April 2001. Available at http://www.cepr.net/pressreleases/cashew_letter.htm.

[7] "Brazil: Growth with Debt, 1974-80", based on the Country Studies Series by the Federal Research Division of the United States Library of Congress (http://www.country-data.com/cgi-bin/query/r-1735.html).

[8] International Monetary Fund and International Development Association, "Heavily Indebted Poor Countries (HIPC) Initiative — Status of implementation", 20 August 2004, p. 12.

[9] See http://www.clubdeparis.org.

[10] Paris Club, "Evian Approach" (http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B06WP14).

[11] IMF, "Proposals for a Sovereign Debt Restructuring Mechanism (SDRM): A Factsheet", January 2003 (http://www.imf.org/external/np/exr/facts/sdrm.htm).

[12] The Gleneagles Communiqué is available at http://www.fco.gov.uk/Files/kfile/PostG8_Gleneagles_Communique,0.pdf.

[13] "G8 Finance Ministers' Conclusions on Development", London, 10-11 June 2005 (http://www.hm-treasury.gov.uk/otherhmtsites/g7/news/conclusions_on_development_110605.cfm).

[14] For more detailed criticism of and concerns about the G-8 proposal as it currently stands, see, for example, European Network on Debt and Development (EURODAD) NGO Briefing, "Devilish Details: Implications of the G7 Debt Deal", 14 June 2005 (http://www.eurodad.org/uploadstore/cms/docs/Overview_G7_debt_deal.pdf).

[15] More information on IFF is available at http://www.hm-treasury.gov.uk/documents/international_issues/int_gnd_intfinance.cfm.

[16] Andrew Rogerson, "The International Financing Facility: Issues and Options", Overseas Development Institute, Opinions, No. 15, April 2004 (http://www.odi.org.uk/publications/opinions/15_the_IFF_April04.html).

[17] Bernhard G. Gunter, "Achieving long-term debt sustainability in all Heavily Indebted Poor Countries (HIPCs)", discussion paper prepared for the Intergovernmental Group of 24 (G-24) XVI Technical Group Meeting (Port of Spain, 13-14 February 2003), available at www.g24.org/guntetgm.pdf.

[18] Barry Herman, "Dealing Deftly with Sovereign Debt Difficulties", Initiative for Policy Dialogue Working Paper Series, 30 August 2004, p. 15 (unpublished).

[19] It was reported that the NPV debt-to-revenue ratio was set under pressure from France at a level just low enough to include Côte d'Ivoire in the HIPC list. See Gunter, op. cit., footnote 19.

[20] Debt Relief Enhancement Act of 2002, introduced both in the House of Representatives and the Senate of the United States Congress (H.R.4524 and S.2210, respectively). Elements of the proposal were later integrated into section 1625 (Modification of the Enhanced HIPC Initiative) of Title V (International Financial Institutions) of H.R.1298 (United States Leadership Against HIV/AIDS, Tuberculosis, and Malaria Act of 2003) and was signed into law by the President of the United States in 2003. Quoted in Herman, op. cit., pp. 20-21.

[21] See general comments No. 3 (1990), para. 14, and No. 2 (1990).

[22] United Nations Development Programme, *Human Development Report 2003*, p. 11.