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Report of the independent expert on the effect of economic reform policies and foreign debt on the full enjoyment of all human rights, Bernards Mudho

Summary

In the present report to the Human Rights Council submitted pursuant to Commission on Human Rights resolution 2005/19 and Human Rights Council decision 1/102, the independent expert on the effect of economic reform policies and foreign debt on the full enjoyment of all human rights, Bernards Mudho, outlines the evolution of his mandate during the past years and summarizes its main results.

The first part of the report analyses recent debt relief initiatives and their impact on poverty reduction and the realization of all human rights. It concludes that current concepts of debt sustainability used by the Bretton Woods institutions do not sufficiently reflect Millennium Development Goals (MDGs) and human rights related objectives. Integrating local views, for example, through domestic peer review mechanisms could help in defining a more complete and balanced picture of debt sustainability. The report emphasizes that debt service savings resulting from the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDR) initiatives are probably too small to have a measurable impact on MDGs or human rights improvement in poor developing countries. There is continued need for more comprehensive solutions not only with regards to further debt relief, but also in the closely linked areas of fiscal/debt management and trade. All creditors should, in particular, define their own transparent criteria for the illegitimacy of certain categories of debt, and proceed to their cancellation.

The report underlines the shared responsibility of creditors and borrowers with regards to poor countries' current and future foreign debt burden. To that end, it urges that forward-looking debt sustainability analysis tools should guide both the creditors and borrowers in their decisions and in the choice of an adequate mix of concessional loans and grants. In this context, the primary responsibility of the borrowing countries, to ensure that credits are invested in a productive and human rights promoting way, is recognized.

In its second part, the report reviews possible human rights implications of standard reform policies promoted by the multilateral financial institutions. While recognizing the importance of broad macroeconomic stability for growth, development and realization of human rights, the report underlines the equally important need for county-specific solutions instead of one-size-fits-all stability thresholds and macroeconomic schemes. In examining the reform policy of privatization of State enterprises the report highlights its possible positive impact on the human rights situation, but cautions that careful consideration must be given to all the functions and purposes that a public enterprise serve, in particular with regards to accessibility to goods and services that result in the realization of pertinent human rights.

Concerning trade reform policies, the report calls for sound economic and social impact assessments, allowing for a careful design and scheduling of reform steps, including adequate transition periods, balanced exclusion of strategic products from liberalization, as well as human rights-inspired safeguard clauses. Trade liberalization should be combined with measures to improve the productive capacity of the poor country's economy and to strengthen its competitiveness on the global market. The report underscores the importance of governance

reform, as weak governance constitutes an important impediment to rapid development. This includes, but is not limited to, the necessity to define a reference framework for public sector reforms based on a definition of the appropriate role and size of government.

Finally, structural reforms in health and education sectors should always be guided by countries' international human rights obligations. For instance, user fees are, in general, an obstacle to the full enjoyment of human rights in these two sectors. Therefore, pertinent reform programmes should take into account both the obligations for a progressive abolition of service fees and avoidance of imposition of user fees or other charges.

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Introduction

1. The independent expert submits this annual analytical report to the Human Rights Council pursuant to the resolution 2000/82 of the Commission on Human Rights in which his mandate was established and he was requested 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 international financial institutions, other United Nations bodies and intergovernmental and non-governmental organizations with respect to structural adjustment policies and human rights.

2. In its resolutions 2004/18 and 2005/19, the Commission further 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 final draft of general guidelines at the sixty-second session of the Commission.

3. In the same latest resolution 2005/19, the Commission requested the independent expert to seek the views and suggestions of States, international organizations, United Nations agencies, funds and programmes, regional economic commissions, international and regional financial institutions and non-governmental organizations on the draft general guidelines and his proposal of possible elements for consideration and urged them to respond to the expert’s requests. In addition, the resolution requested the independent expert to explore further the interlinkages with trade and other issues, including HIV/AIDS, when examining the impact of structural adjustment and foreign debt.

4. As part of his mandate the independent expert undertook annual consultations with the World Bank and the International Monetary Fund (IMF). The latest meeting took place on 12 and 13 October 2006 in Washington. On those occasions, the independent expert had the opportunity to exchange views with interlocutors from various departments of both institutions. Discussions focused on (a) further incorporation of human rights concepts in the work of the institutions; (b) the implementation progress as well as the poverty reduction and human rights impacts of recent debt relief initiatives; and (c) possible elements of guidelines for human rights compatible with the design and implementation of economic reform and debt related operations. The independent expert wishes to thank both institutions for their cooperation and the open dialogue that characterized all meetings.

5. In compliance with resolution 2005/19 of the Commission on Human Rights the independent expert reported on 25 October 2006 to the Third Committee of the General Assembly at its sixty-first session. He was gratified by this opportunity that enabled

him to provide the General Assembly with an update on recent developments concerning the Multilateral Debt Relief Initiative (MDRI), in particular, with regards to the current debate on concept, implementation modalities and impact of this initiative on the realization of the Millennium Development Goals (MDGs) and all human rights.

6. In his 2006 annual report to the Commission on Human Rights (E/CN.4/2006/46), the independent expert highlighted some of the obstacles and challenges faced with respect to the elaboration of the guidelines requested by Commission resolutions 2004/18 and 2005/19. The independent expert, therefore, had recommended the extension of the time frame for the elaboration of the guidelines, in particular in order to relaunch the consultation process with all stakeholders. The independent expert would like to thank those countries and institutions that have already provided inputs to this work. At the same time, he wishes to reiterate his call on those Member States that have not yet done so to submit their views and suggestions as he has repeatedly solicited in that regard.

7. Having thus retraced the evolution of the mandate over the past years, the present report summarizes the main findings on recent debt relief initiatives, including underlying concepts of debt sustainability, as well as the impact of these initiatives on poverty reduction and on the realization of all human rights. In its second part, the report identifies some standard reform policies promoted by the multilateral institutions and frequently used within poverty reduction strategies. The report analyses possible impacts of these elements on the achievement of all human rights, in particular economic, social and cultural rights. The report concludes with recommendations on the above-mentioned issues that could be integrated into the general guidelines.

I. FOREIGN DEBT, DEBT RELIEF INITIATIVES AND HUMAN RIGHTS

A. Context

8. The World Bank statistics indicate that the overall debt stock of low-income countries currently stands at about US$ 426 billion. The annual debt service arising from this stock is estimated at US$ 32.6 billion. The debt stock figures are considerably higher for middle-income countries that have accumulated a debt stock of about US$ 2.3 trillion and annual debt service obligations of US$ 415 billion.[1]

B. Past debt relief operations

9. A lack of economic growth, falling commodity prices and economic shocks contributed during the 1970s and 1980s to an accelerated accumulation of foreign debt in many poor countries, to levels generally considered as “unsustainable”. Debt relief initiatives by “Paris Club” bilateral creditors started in the 1970s and gained speed during the 1980s and 1990s when bilateral debt stocks where subsequently cut by 33 per cent under the Toronto terms for low-income countries in 1988, 50 per cent under the London terms in 1991, 67 per cent under the Naples terms in December 1994 and finally by 90 per cent under the Cologne terms in November 1999. However, during the 1990s it became increasingly clear that bilateral debt reduction alone was insufficient to bring poor countries’ debt down to sustainable thresholds and consequently, a new relief initiative was called for, also involving multilateral lenders such as the World Bank, the IMF, and regional development banks.[2]

10. The Heavily Indebted Poor Country (HIPC) initiative was launched in 1996 with the objective to re-establish debt sustainability. The initiative was comprehensive, calling for voluntary debt relief by all creditors, whether multilateral, bilateral, or commercial. Under HIPC initiative, eligible countries receive interim debt relief as soon as they match certain policy performance criteria defined by the Bretton Woods institutions (BWI), namely; a three-year track record of sustained policy of structural reforms and macroeconomic stability ("Decision point"). Later on, irrevocable debt relief is granted, provided that the country has a Poverty Reduction Strategy Paper (PRSP) in place and policy performance has further stayed on track ("Completion point"). Currently 40 countries are eligible for HIPC initiative, of which 19 have reached the "Completion point". Ten more countries have reached the Decision point and 11 countries can still qualify for HIPC initiative, as an initial deadline for entry ("sunset clause") has been cancelled.[3]

11. In the context of the debates on MDGs, the Group of Eight (G-8) countries, as main shareholders of the multilateral development banks, proposed in summer 2005 that IMF, the International Development Association (IDA) of the World Bank and the African Development Fund (AfDF) of the African Development Bank fully cancel their debt claims on the world's most indebted poor countries. MDRI was explicitly created to provide HIPCs with additional support to achieve MDGs. Under MDRI, HIPC are eligible for complete and irrevocable debt relief as soon as they have reached - or will reach - HIPC completion point. Debt cancellation under MDRI will be in addition to debt relief already committed under HIPC initiative, but unlike HIPC initiative, MDRI does not envisage any parallel relief on bilateral or private debt, or on debt to multilateral institutions beyond IMF, IDA, and AfDF.

12. Although MDRI is an initiative common to three international financial institutions, implementation provisions differ in several points. For instance, Tajikistan and Cambodia as non-HIPC will benefit from IMF debt relief, as their per capita income is below US$ 380, but not from cancellation of IDA debts. Furthermore, only debt accumulated before an institutions-specific "cut-off-date" is cancelled.

13. While IMF is supposed to use its own resources to cover the debt relief, IDA and AfDF will be compensated. In March 2006, donors agreed to a financing package that calls for additional donor contributions over time to compensate IDA and AfDF "dollar-for-dollar" for the debt relief provided. The objective of this operation is to preserve the long-term financial capacity of IDA and AfDF.[4] [5]

C. Debt sustainability concepts

14. Past debt relief operations have been widely criticized for the use of inappropriate and undifferentiated analytical criteria - the debt to export ratio of 150 per cent - to judge the sustainability of a country's debt. In 2005 the Bretton Woods institutions improved their static debt sustainability concept by adding more country specific and "forward looking" elements, with the objective to early detecting and avoiding future situations of debt unsustainability. The new analysis involves (a) a forecast on how a country's outstanding debt is likely to evolve over time relative to its ability to pay, taking into account the quality of the country's policies and institutions related to debt; (b) an examination of how the outlook would change under plausible shocks, such as a rise in oil prices; and (c) an assessment whether the results may lead to an unsustainable situation.

15. The Bretton Woods institutions underline the opportunities offered by the new tool to both borrowers and creditors to better manage foreign debt. The institutions point out that the new system provides borrowing countries with the information needed to maintain debt at a sustainable level, to develop and strengthen debt management capacity and to reduce vulnerability to exogenous shocks. Creditors and donors, for their part, are given clear signals to consider additional grants or highly concessional loans if the tool shows a risk of debt distress.[6]

16. The new framework is undoubtedly a substantial improvement compared to the previous concept, but can still be criticized for various reasons: first, as several civil society groups rightly point out, the approach relies heavily on subjective World Bank analytical tools and projections that have often been overoptimistic in the past.[7] More importantly, the new framework still regards the ability to service debt as the core objective and main criteria for sustainability. As pointed out in his earlier reports, the independent expert rather advocates a definition of sustainability that also considers the country's ability to achieve its poverty reduction goals and human rights obligations. In this context, the level of debt payments a country can afford while still meeting MDGs should clearly be considered in the analysis.

17. In addition and complementary to the analysis provided by the World Bank/IMF debt sustainability framework, a foreign debt peer review mechanism could be set up in order to provide alternative views on a country's debt situation. This mechanism could provide a global view on debt available to all stakeholders and act as a forum for policy dialogue and crisis resolution. The participation of local human rights institutions could also contribute valuable inputs on the impact of external debt on human rights, and on financial requirements and conditions necessary to ensure that minimum human rights standards are protected in the country. This participatory approach would improve transparency and accountability of the external financing policy of concerned countries and creditors, and would thus be more coherent with core human rights principles. The creation of this mechanism would in most cases require capacity-building measures in order to be operational, in particular with regards to the capacity of the public sector and civil society to conduct own assessments on debt sustainability (see E/CN.4/2006/46).

D. Impact of debt relief operations on poverty and human rights

18. The following paragraphs outline some general remarks on the overall impacts of debt relief on the achievement of human rights while considering in particular MDG as a well defined and measurable subset of economic, social and cultural rights.

19. The projected full benefit of HIPC and MDRI, that is to say, the total amount of debt that will ultimately be cancelled, will be around US$ 100 billion. In the absence of these initiatives, this significant amount of resources would have been paid back to creditors over a period of about 40 years, which means that the annual savings on debt service by participating countries can be estimated at about US$ 2.25 billion on average over the same period. However, this magnitude of resources does not automatically and directly translate into poverty reduction or human rights related expenditure. Rather, debt relief operations do enhance the concerned governments' "fiscal space" which, in turn, adequate policy decisions provided, can be used - or partly used - for increased public spending in areas linked to human rights obligations.

Consequently, the impact of debt relief on human rights related expenditure depends not only on the amount of debt service savings but also on the existence of government policies orienting expenditure towards human rights objectives. The implementation of such policies must be seen as part of the obligation of all States parties to the International Covenant on Economic, Social and Cultural Rights (ICESCR) to take steps, to the maximum of their available resources, to progressively achieve the full realization of all economic, social and cultural rights. Furthermore, good governance, accountability and transparency have to be considered crucial to realize the benefits created by debt relief.

20. However, with cost estimates for MDGs achievement - let alone the achievement of all economic, social and cultural rights - ranging from an extra $30 billion per year to over $100 billion per annum[8] the impact of recent debt relief operations on the achievement of all human rights should not be overestimated, even with adequate policy in place in beneficiary countries.

21. In many HIPC, the increases in social spending exceed the amounts accruing from debt relief, often largely due to new government priorities in the framework of a national poverty reduction strategy and/or increased donor engagement in the social sector projects. Empirical data collected by the World Bank and IMF in the context of HIPC initiative implementation operations actually show that the developing countries' poverty reduction expenditures have increased following the debt cancellation. In those HIPCs that have reached completion point, social spending in the areas of health and education, which is usually closely linked to basic human rights obligations, has increased by 20 to 50 per cent.[9] Weighted against such increased government spending in the framework of PRSPs and substantial donor engagement in social sectors the debt relief savings are likely to be too small to have a measurable impact on MDGs achievement or human rights improvement.

E. Need for further debt relief

22. It should always be recalled that poor developing countries continue to face important debt burden. In total, low-income country debt is currently estimated at over US$ 400 billion, about four to five times the amount cancelled by HIPC and MDRI. There, therefore, is a need for further comprehensive solutions to the debt problems of poor countries, including further debt relief by other multilateral institutions and for permanent solutions to the problems of bilateral and commercial debts. Future international cooperation operations could take various forms and should consider innovative techniques such as different forms of debt swaps. As already outlined in earlier reports, additionality of resources is crucial in the context of all debt relief operations. In order to obtain a positive impact, debt relief operations ought to be in addition to existing aid and must not be offset by a reduction in traditional bilateral or multilateral aid programmes. Unhappily, based on Organization for Economic Cooperation and Development (OECD) statistics, there are real doubts that this important principle has always been respected in the past.[10]

23. In the light of the foregoing considerations, within future debt relief initiatives, a special status should be given to the debt owed by developing countries that are deemed illegitimate

because they result from irresponsible lending and borrowing. In this context, many non-governmental organizations (NGOs) have called for the creation of a fair and transparent arbitration process for this kind of debt and have proposed a neutral decision-making body that would be independent from immediate parties involved, and at which forum all stakeholders would have an equal right to be heard. Nevertheless, the independent expert is cognizant of the fact that such an independent arbitration system is bound to be confronted with major conceptual and operational problems, not least of which is the definition of clear criteria for the illegitimacy of debt acceptable to all creditors.

24. Such anticipated difficulties of reaching a generally agreed definition notwithstanding, the independent expert calls on all multilateral, bilateral and commercial creditors to address this problem on a voluntary basis and to regard it as a moral obligation to define appropriate transparent criteria for the illegitimacy of debt. Such debt should then be cancelled immediately and without preconditions. In this regard, the independent expert warmly welcomes and commends the example of Norway, that recently announced the cancellation of US$ 80 million in debt owed by five poor developing nations upon determining that the loans in question were not primarily granted to promote development but were instead the result of a campaign to bolster the country's troubled shipbuilding industry by selling 156 vessels and shipping equipment to poor countries.[11]

25. A recent evaluation of HIPC initiative's result shows that in most examined countries external debt sustainability indicators have deteriorated since 2003 and in several countries debt ratios once again exceed HIPC thresholds. Deteriorating debt management capacities are found to be one of the main factors leading to growing debt unsustainability. The study also shows that debt reduction alone is not a sufficient instrument to affect the multiple drivers of debt sustainability. Complementary measures in areas such as export diversification, fiscal management and debt management are crucial, as well as adequate terms of new loans.[12]

II. ECONOMIC REFORM POLICIES AND HUMAN RIGHTS

26. Since the late 1990s, the international financial institutions have replaced structural adjustment programmes by poverty reduction strategies based on country-owned PRSPs. According to IMF definition, PRSPs describe the macroeconomic, structural and social policies and programmes that a country will pursue over several years to promote broad-based growth and reduce poverty, as well as external financing needs and the associated sources of financing. PSRPs are prepared by Governments in low-income countries through a participatory process involving domestic stakeholders and external development partners.

27. Many observers argue that the PRSP approach has not diverged fundamentally from the earlier neoliberal principles of the Washington Consensus, except for slight variations in policy approaches.[13] In fact, core reform policies usually pursued in PRSPs still include many structural adjustment elements and can be classified in two types: (a) quantitative measures with the objective to stabilize a country's macroeconomic framework; and (b) structural measures that vary widely across programmes but usually include specific policies targeting economic and social sectors as well as questions of governance.

28. There are strong formal links between economic reform policy and debt relief as an economic reform track record is a precondition for HIPC and MDRI participation. As a consequence eligibility for debt relief might ultimately depend on the respect of conditionality that is not directly related to poverty reduction or debt sustainability, but to specific privatization requirements, for example.

29. The following paragraphs analyse some policy reform concepts commonly included in Poverty Reduction Strategies.

A. Macroeconomic stability

30. Following IMF definition, macroeconomic stability is characterized by current account and fiscal balances consistent with a low and declining debt level, low inflation and a rising per capita gross domestic product (GDP).[14] It is widely recognized that broad macroeconomic stability lays the basis for economic growth which, in turn, is an essential prerequisite for poverty reduction and the achievement of human rights. It can thus be argued that the objectives pursued by macroeconomic stabilization are coherent with article 6, paragraph 2, of ICESCR, pursuant to which signatories undertake to adopt policies and measures to achieve steady economic, social and cultural development and full and productive employment.

31. However, there is no general consensus among experts regarding the level of macroeconomic stability that leads to an optimal impact on growth and development, and there are, consequently, no generally recognized thresholds or benchmarks in this respect. The inflation target, one of the core elements of stabilization policy, can serve as an example as it is the controversy discussed between international financial institutions and civil society organizations.

32. Generally speaking, all stakeholders agree that high inflation can be harmful to the poor, by raising prices, eroding real wages and inhibiting growth. Inflation can thus have a negative impact on a wide range of economic, social and cultural rights, while policies that avoid high inflation rates can, a priori, be considered as being coherent with human rights obligations.

33. IMF maintains that the level of inflation ought to be kept “in the low single digits” in order to ensure macroeconomic stability. In this context, the Fund makes reference to studies providing evidence that higher inflation, even at fairly low levels of about 2 to 11 per cent, can robustly lead to lower growth.[15] This view is not shared by the United Nations Conference on Trade and Development (UNCTAD) and many civil society organizations, who argue that very low inflation may harm the poor if the policies implemented to achieve low inflation target restricting pro-poor government spending and induce recession.[16]

34. It may thus be concluded that policy advice in the area of macroeconomic stabilization should not be based on generalized benchmarks or thresholds, but on individual analysis of the interaction of stabilization measures with other pro-poor policies in the country specific context. This can involve difficult trade-offs, for example between the benefits of increasing public spending at the cost of experiencing higher inflation or choosing to keep public spending within low targets in order to ensure the growth effects of macroeconomic stability.

B. Privatization

35. Economic reform policy advice from the international financial institutions often includes the privatization of State business undertakings or measures facilitating such privatization. This advice was, in the past, often based on the general assumption that public enterprises and services are inefficient and should, therefore, be privatized in order to improve their performance. However, past privatization operations have shown mixed results. The envisaged productivity increase has not always been achieved and privatization costs have often been higher than expected. Moreover, on a macroeconomic level, it remains unclear if, and to what extent, privatization has contributed to economic growth and poverty reduction.

36. More importantly, the narrow focus on enterprise profitability has often ignored the fact that public enterprises can, and often do, serve important social objectives closely linked to human rights obligations, so that their utility cannot be measured solely by the efficiency or profitability of the enterprises themselves. For while the privatization of such public utilities may, in a narrow economic sense, increase their profitability, it may nevertheless destroy important external social benefits, thereby reducing efficiency in the broader sense. Negative impacts on the poverty and human rights situation that have been observed in such cases include a rise in the price of basic services such as water. In addition, privatization has very often been accompanied by increased unemployment and job insecurity. Unskilled workers and workers belonging to other vulnerable groups have often been the first to lose their jobs and privatization operations have thus contributed to increased inequality.[17]

37. Privatization decisions should consequently not only be based on broad and sensible economic considerations, but also on a sound analysis of their strategic economic and social functions. Hence, requisite detailed assessment should consider the advantages of different forms of ownership, including public, private and mixed forms, based on each country's unique set of social, economic, political and cultural circumstances. In the case of basic services, such analysis should always be guided by the objective to best ensure the provision of affordable quality services to all segments of the population.

C. Trade reform

38. Trade reforms are, in general, closely linked to multilateral, regional or bilateral trade negotiations or agreements. Their objectives include higher economic growth and increased welfare through cheaper imports combined with growth and diversification of non-traditional exports.

39. Trade reform is usually characterized by the rationalization of import regimes, in particular the elimination of import quotas and the reduction of import tariffs. These measures are supposed to:

(a) Allow local producers to access input and investment goods and services at higher quality and lower prices, as cheaper inputs improve the competitiveness of domestic producers;

(b) Increase pressure on domestic enterprises to produce more efficiently, as they are less protected from international competition - increased efficiency, in turn, will allow producers to sell their products not only on domestic markets, but also to increase exports;

(c) Enhance the welfare of consumers and reduces poverty, as a wider variety of goods and services will be available at lower prices.

40. Unfortunately, during the last two decades trade liberalization has often been implemented too hastily and without proper sequencing. It was sometimes more promoted by economic dogma than by an informed analysis of its probable economic and social impact.[18] Undifferentiated and abrupt liberalization across all sectors has in many cases triggered a sudden and massive influx of cheap import goods. Many local firms, especially small and medium-size enterprises, could not withstand this competition, thus triggering the shutdown of local production and a massive loss of employment. In addition, the sudden import increase created balance-of-payments problems, currency devaluations and ultimately higher consumer prices.

41. The expected increase in the competitiveness of local firms, in particular with regard to the export market, often did not materialize due to various reasons, including inadequate business environments and a multitude of supply side constraints such as poor infrastructure, high transaction costs of entering the international market, lack of technical experience and difficulties in obtaining export finance.[19] The importance of these supply side problems directly linked to the capacity to trade can be illustrated by the example of Sub-Saharan Africa, where poor infrastructure adds 15-20 per cent of transport costs to the price of exported products. These costs, more than three times the world average, are a far more important barrier to export than most tariffs.[20]

42. Trade reforms that do not take these effects into account are likely to lead to a situation where fundamental human rights, including the right to work are substantially eroded. In order to make trade reform measures compatible with poverty reduction and human rights objectives, trade policy should be based on sound economic and social impact assessments. These assessments should include a sector-by-sector and, if necessary, product-by-product analysis of potential liberalization impacts on domestic economic sectors, the balance of payment, employment and public finance. Based on such impact assessment, liberalization should be designed and sequenced with a view to maximizing its development and human rights benefits.

43. While competitive sectors can be amenable to immediate liberalization, others should be given adequate transition periods allowing local producers to adapt to the new context and to progressively improve their competitiveness. The impact assessment should also provide information on a certain range of strategic goods and services that should be permanently excluded from liberalization. Such exclusions should be allowed by international trade rules whenever market mechanisms are likely to inhibit the access of the population, or parts of it, to goods and services guaranteed by fundamental economic, social and political human rights.

44. The impact of trade reform on public finance can be substantial, as many developing poor countries rely on customs duties as a major source of government revenue. The likelihood and possible extent of a "fiscal gap", created through a loss of customs revenues should be carefully assessed. A fiscal gap can, in turn, have an adverse impact on the Government's ability to finance social spending, which would directly influence the ability to comply with human rights

obligations. In this context, the feasibility of simultaneous tax and trade reforms should be assessed in order to compensate negative revenue impacts and subsequent lower capacity to fulfil human rights obligations. If the trade reform has been carefully designed, fiscal gaps should however be transitional and ultimately compensated by increased trade flows, higher economic growth, reduction of tax evasion and higher customs administration efficiency following trade related reforms.

45. Trade liberalization agreements between poor countries and industrialized (or advanced developing countries) should ideally contain adequate aid packages designed to tackle the above-mentioned supply side constraints and help to strengthen the competitiveness of domestic sectors during the agreed liberalization transition periods. They should also include appropriate assistance packages such as safety nets and mechanisms for the vulnerable groups who would potentially be affected by reform-induced shocks.

46. Investment and trade decisions always take the respective business environment into consideration, in particular the legal and administrative framework set by government policy. While the creation of a stable and transparent environment conducive to investment and trade is the full responsibility of host Governments, the international community should support its implantation though development cooperation measures.

47. While not being part of economic reform policy in a strict sense, the importance of improved and stable access for poor countries to the markets of industrialized and advanced developing countries ought to be emphasized. This is especially the case of agricultural products, where many poor countries have comparative advantages. The problem of agricultural subsidies in the rich countries, undermining export opportunities of poor countries is, therefore, closely linked to this issue.

D. Governance

48. Governance can be defined as the institutional capacity of public organizations to provide the public services and other goods demanded by a country's citizens or their representatives in an efficient, transparent, impartial and accountable manner.[21]

49. The Commission on Human Rights had recognized in its resolution 2000/64 that "transparent, responsible, accountable and participatory government, responsive to the needs and aspirations of the people, is the foundation on which good governance rests, and that such a foundation is a sine qua non for the promotion of human rights".

50. Most economic reform programmes and PRSPs refer to a large number of governance aspects including accountability and anti-corruption measures; civil service and legal reforms; transparency within the budgetary process; strengthening of institutions and the enhancement of civil society's monitoring capacities.

51. Governance related reforms are generally very closely linked to human rights. Transparency in budgetary and other governmental processes is congruent with the right to information and the capacity of people to participate in the monitoring and assessment of polices

is an essential feature of the human rights approach, which also includes the right to take part in the processes and procedures for holding the duty-bearers accountable in case of policy failure. Appropriate institutional arrangements are needed for such participation to be possible.

52. In the same vein, it can be stated that corruption is unlikely to flourish where there is access to information, freedom of expression, participation and accountability - all key human rights features. Therefore, a human rights approach has the power to protect a poverty reduction strategy from being undermined by the corroding effects of corruption.[22]

53. There is a broad consensus that weak governance constitutes an important impediment to rapid development. Trade and investment decisions usually depend on the overall business environment, which is to a large extent defined by governance performance.

54. The role of good governance in the realization of benefits from debt relief operations has already been outlined in an earlier chapter. In general, it can be said that no debt relief measure or economic reform policy can contribute to a better realization of human rights, if it is not implemented within the enabling context of a good governance framework. Reforms targeting governance improvements must therefore be considered as a crucial part of State obligations under article 6 of ICESCR, which calls upon State parties to adopt policies and techniques to achieve steady economic, social and cultural development.

55. Public sector reform is an essential part of governance related improvement. It impacts directly on development through better delivery of basic public services affecting living standards, but as well through the creation of a climate conducive to private sector development and growth. In addition, public sector reform is supposed to create an enabling environment for good governance, accountability and transparency. Public sector reforms usually focus on four aspects:

(a) Administrative capacity-building intending to improve internal management and efficiency of a public structure;

(b) Policy capacity-strengthening aiming at building the capacity to develop rational and effective public policies;

(c) Institutional reform measures aimed at making the State more open and accountable;

(d) Civil service downsizing, usually motivated by a combination of fiscal discipline and a desire to move toward a more market-oriented economy.[23]

56. Past public sector reform programmes have often focused too much on downsizing, with dramatic negative consequences for the effectiveness of sector management. Future reform measures should target a more efficient public sector that delivers quality services in a transparent, accountable and responsive way. Downsizing decisions should be taken within a larger frame of reference that includes clear ideas on the appropriate role of the public service, an appropriate system for setting performance objectives and measuring progress against them, and a reformed pay structure conducive to attracting, retaining and motivating highly qualified staff.[24]

E. Sector reform policies regarding education and health

57. HIPC and MDR initiatives are intended to contribute to poverty reduction by freeing up resources for higher social spending. Additional resources made available through HIPC initiative were supposed to be allocated to priorities of the concerned countries' poverty reduction strategies.

58. While underlining the difficulties encountered in measuring the incremental changes in government spending attributable to HIPC initiative, a 2005 evaluation of this debt relief initiative shows that Governments have increased expenditure on education, but they are spending the same or less on health, agriculture and transportation. A similar evaluation undertaken in 2003 had already pointed out that HIPC initiative's emphasis had been on expenditure in the social services and mainly on education.

59. With regards to the education and health related MDGs the same evaluation concludes that 18 HIPC post-completion-point countries have made progress in reducing child mortality and modest progress in primary education. There has been no measurable change on infectious diseases and very little data is available concerning maternal health.[25]

60. Uganda is often cited as one of the biggest HIPC initiative successes, as all of its budget savings from debt relief were transferred to a "Poverty Action Fund", which then allocated these funds according to priorities identified in the national Poverty Eradication Action Plan. As an effect, gross primary school enrolment in Uganda has increased from 2.6 million to 7.3 million pupils between 1997 and 2002. In general poverty incidence fell from 56 per cent in 1992 to 35 per cent in 2000.[26]

61. However, in most cases, the positive impacts of HIPC initiative on social sectors are not directly attributable to the additional resources provided though debt service savings but to the "secondary effect" that countries were required, in order to be eligible for the initiative, to complete and implement a country-owned poverty reduction strategy. These strategies channelled resources beyond the actual HIPC savings to social sectors.

62. Reform policy outlined in poverty strategies usually includes education and health sector reforms as these areas are key in the context of poverty reduction. The international financial institutions core conditionality now often includes a "floor" on current expenditure on health and education. Despite the fact that economic reform programmes do not usually directly refer to economic, social and cultural human rights, their objectives are, at least partly, congruent with State obligations regarding the right to health and the right to education.

63. The right to health can be defined as a right to the enjoyment of a variety of facilities and conditions which are incumbent on the State to provide for its citizens. The basic legal documents, such as article 12 of ICESCR and its interpretation contained in the general comment No. 14 (2000) of the Committee on Economic Social and Cultural Rights on the right to the highest attainable standard of health, assert that all States have minimum core obligations, intended to ensure that people are provided with the minimum conditions under which they can live in dignity; enjoy the basic living conditions needed to support their health and be free from

avoidable mortality. Minimum core obligations cannot be relegated to progressive realization: all States regardless of their level of development are required to take immediate action to implement them. This entails, inter alia, enacting enabling legislations; regulations, designs and enforcement of policies; and mobilization of the necessary resources. In the same context, States must meet certain standards of availability, accessibility, acceptability and quality of health-care facilities.

64. While increased public expenditure in the health sector is often part of economic reform packages, the scope of services provided is, in general, only partially coherent with minimum core obligations under international human rights law. PRSP health expenditure usually targets an expanded access to primary (essential preventive) health care while free curative health care is restricted to a few specific diseases. In general, user fees are advocated for curative health care, sometimes complemented by social or private insurance schemes.[27]

65. Regarding the right to education, comprehensive provisions relating thereto are stipulated in article 13 of ICESCR and in general comment No. 13 (1999) of the Committee on Economic, Social and Cultural Rights on the right to education. State parties have immediate obligations in relation to the right to education, such as the guarantee that the right will be exercised without discrimination of any kind and the obligation, at least, to take steps towards the full realization of the right. States also have obligations to respect, protect and fulfil each of the "essential features" (availability, accessibility, acceptability, adaptability) of the right to education. The question of economic accessibility to education is subject to differentiation: whereas primary education shall be available "free to all", States parties are only required to progressively introduce free secondary and higher education. According to article 14 of the Covenant, countries which, at the time of becoming a party, are not able to ensure compulsory and free primary education have to adopt, within two years, a detailed plan on how this objective can be attained.

66. In this regard, it should be noted that free education can have an important impact on the general perception, within the population, of economic, social and cultural rights. Government programmes such as the Universal Primary Education Programme in Uganda can trigger a systemic change in the mindset of the poor families, who saw the education of their children not simply as a privilege but as something to which their children are entitled. As the independent expert has previously noted, this new perception has a positive impact on enrolment (E/CN.4/2004/47, para. 18).

67. Economic reform polices adopted under PRSPs are often only partially compatible with human rights requirements. A common objective of PRSPs is to provide universal primary education. In many countries education reform includes abolishing or reducing school fees and providing exemption to targeted groups, as well as free school books for all or targeted groups. As far as secondary and tertiary education is concerned most strategies consider that they have to be covered at least partially by user fees.[28]

68. In order to ensure coherence with human rights obligations, free primary education has to be part of all PRSPs. Corresponding sector policy should be based on a comprehensive plan of action, as foreseen under article 14 of ICESCR. Strategies for higher education should be guided

by the obligation to make secondary and tertiary education accessible by every appropriate means, in particular by the progressive introduction of free education. This obligation should at least be described as a strategic objective of all PRSPs.

69. The facilitation of access to health and education through the abolition of user fees can be considered in both sectors as a key factor allowing the full enjoyment of the respective rights. Empirical findings confirm that the demand for education and health services is highly elastic and that user fees can often constitute an important impediment to access.[29] States should therefore reduce the financial burden of health care and education, especially on the poor. Measures could include the introduction of other mechanisms instead of user fees (e.g. national insurance or general taxation) or by keeping user fees and introducing non-discretionary, equitable and non-stigmatizing interventions for the poor (e.g. exemption schemes, direct cash subsidies and vouchers).[30]

III. CONCLUSIONS AND RECOMMENDATIONS

70. **Over the period covered by this report, the Bretton Woods institutions have meanwhile changed their concept of debt sustainability from a static indicator (debt to export ratio), essentially used for debt relief purposes, to a forward-looking analytical tool designed to avoid the accumulation of unsustainable debt. However, the key objective of the framework still remains the financial ability to service debt rather than the ability to achieve wider development objectives. The creation of country-owned and participatory peer review mechanisms could, and should, provide alternative and complementary views on debt sustainability by focusing on the achievement of the Millennium Development Goals (MDGs) and mainstreaming human rights as key thresholds for debt sustainability.**

71. **Creditors and borrowing countries have a shared responsibility for the current debt situation of poor developing countries. Therefore, forward-looking sustainability analysis tools should guide both parties in their decisions and in the choice of an adequate mix of concessional loans and grants. In this regard, the primary responsibility of borrowing countries to ensure that availed credits are invested in a productive and human rights promoting way cannot be over-emphasized; for a productive use of credits usually creates the capacity to service the corresponding debt.**

72. **The aggregate amount of debt to be ultimately cancelled through the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDR) initiatives (US$ 100 billion) is modest compared to the overall magnitude of the debt burden of poor developing countries (US$ 426 billion) and middle-income countries (US$ 2.3 trillion). When weighted against the overall poverty and MDGs related expenditures, including donor-funded development projects, debt service savings through HIPC and MDR initiatives are probably too small to have a measurable impact on MDGs achievement or desired human rights improvement. Under the circumstances, there remains the need for comprehensive solutions to the debt problems of poor countries, including further debt relief by other multilateral institutions, and for permanent solutions to the problems of bilateral and commercial debts. Innovative relief mechanisms such as different forms of debt swaps merit careful consideration. Accordingly, future relief operations should,**

among other measures, include an agreed definition of illegitimate debt and pay particular attention to such debt. The independent expert calls upon all multilateral, bilateral and commercial creditors to assume a moral obligation to define own transparent criteria for the illegitimacy of debt and to proceed to the cancellation of such debt.

73. **Conditionality links between debt relief and economic reform policies should be revised and streamlined. Conditionality for debt relief should be limited to the macroeconomic and structural framework directly relevant for the core objectives of debt relief, i.e. the re-establishment of a comprehensively defined debt sustainability criteria and contribution to the achievement of MDGs.**

74. **While it is widely recognized that broad macroeconomic stability lays the basis for economic growth, there is not yet any consensus on an optimal level of stability and on whether the extent of stability promoted by Bretton Woods institutions (e.g. in the case of IMF inflation thresholds) can even damage growth. Economic reform programmes should not be based on one-size-fits-all macroeconomic solutions and should instead take the situation of the individual country into account.**

75. **Privatization of State enterprises can often improve the quantity and quality of available goods and services, and lower their prices. In the case of goods and services subject to economic, social and cultural rights (e.g. access to drinking water) the privatization can lead to better availability. However, privatization decisions should not only be based on narrow and purely economic considerations, but also on a sound analysis of all the functions that publicly-owned enterprises serve, in particular with regards to accessibility to goods and services that result in the realization of pertinent human rights. Such detailed assessment should consider, inter alia, the advantages of different forms of ownership, including public, private and mixed forms, based on each country's set of social, economic, political and cultural circumstances. In the case of basic services, such analysis should be guided by the objective to best ensure the provision of affordable quality services to all segments of the population. In any event, decisions regarding ownership structure should be made locally, and foreign loans and aid/assistance should not be tied to any preconditions in this regard.**

76. **Trade reform can be a powerful tool for improving availability and access to goods and services that are essential to the realization of basic human rights. In order to fulfil this function, trade liberalization must be based on sound economic and social impact assessments, allowing for a careful design and scheduling of reform steps. Adequate transition periods with temporary or permanent exclusion of strategic products or subsectors from liberalization should be defined with a view to maximizing human rights and development benefits. Human rights-inspired safeguard clauses in trade agreements should also be considered. Trade liberalization in poor developing countries should not be conducted without putting in place adequate safety nets for the most vulnerable population. It should always be combined with measures to improve the productive capacity of such country's economy and to strengthen its competitiveness on the global market. This requires not only an adequate policy by the concerned countries but also improved donor aid in all trade related areas.**

77. **One of the aspects of economic policy reform most linked to the human rights agenda is the development of good governance. Efforts should not merely focus on public sector downsizing but also on a more efficient public sector that delivers quality services. The reference framework for public sector reform should include a matrix on the appropriate role and size of Government, an appropriate system for setting performance objectives and measuring progress against them, and a reformed pay structure conducive to attracting, retaining and motivating highly qualified staff.**

78. **Structural reforms that impact human rights, especially in such sectors as health and education, should always be guided by the international human rights obligations the countries concerned have undertaken to fulfil. So far, however, current studies indicate that most economic reform programmes are only partially coherent with those obligations. Health reform targets increased public spending in primary, essentially preventive health care, while education reform focused on primary education. Yet, user fees have, in general, been an obstacle to the full enjoyment of human rights in these two sectors and reform programmes should, therefore, take into account both the obligations for a progressive abolition of fees and avoidance of user fees or other charges.**

Notes

[1] The World Bank, Data and Statistics Website: www.worldbank.org/data.

[2] See Moss, Todd, "Will Debt Relief make a Difference?"; Center for Global Development, Washington DC, May 2006, p. 6.

[3] The World Bank, Website on Debt Relief: Home > News > Issue Briefs > Debt Relief.

[4] The World Bank, Multilateral Debt Relief Initiative Fact Sheet, Washington DC, July 2006.

[5] See also the independent expert's report to the General Assembly (A/61/464), paras. 11-22.

[6] The Debt Sustainability Framework for Low-Income Countries, IMF website: http://www.imf.org/external/pubs/ft/dsa/lic.htm.

[7] The Bretton Woods project website: "New debt sustainability framework: too little, too subjective"; http://www.brettonwoodsproject.org/art.shtml?x=51225.

[8] Jan Vandemoortele and Rathin Roy: "Making Sense of MDG Costing", New York, UNDP, August 2004.

[9] Coopération internationale pour le Développement et la Solidarité (CIDSE), "More than a numbers game? Ensuring that the Millennium Development Goals Address Structural Justice", April 2005, p. 21, available online at http://www.trocaire.org/news/publication.php?id=44.

[10] See the report of the Secretary-General on "Recent developments in external debt" (A/61/152), July 2006.

[11] Inter Press Service News Agency: "Norway Breaks Silence on Illegitimate Debt" (http://ipsnews.net/news.asp?idnews=34979).

[12] Independent Evaluation Group/World Bank, "Debt relief for the Poorest. An evaluation Update of the HIPC Initiative", Washington, 2006, available online at http://www.worldbank.org/ieg/hipc/docs/hipc_update_evaluation.pdf.

[13] CIDSE (note 9 above), p. 39.

[14] IMF/World Bank: "Macroeconomic Policy and Poverty Reduction", Washington, 2001.

[15] IMF: "A response to ActionAid and other Organizations", http://www.imf.org/external/np/vc/2004/093004.htm.

[16] UNCTAD: "From Adjustment to Poverty Reduction: What is new?", Geneva 2002, p. 22.

[17] Structural Adjustment Participatory Review International Network (SAPRIN): "The policy roots of economic crisis and poverty", Washington, April 2002.

[18] CIDSE (note 9 above), p. 31.

[19] SAPRIN (note 17 above).

[20] UNDP Human Development Report 2005, New York, 2005.

[21] The World Bank: "Can Africa claim the 21st century?", Washington, 2000.

[22] OHCHR: "Principles and Guidelines for a Human Rights Approach to Poverty Reduction Strategies", Geneva, 2006.

[23] Schacter, Mark, "Public Sector Reform in developing countries", Ottawa, December 2000, p. 5.

[24] Ibid., p. 10.

[25] Independent Evaluation Group (2006).

[26] Jan Joost Teunissen and Age Akkerman, *HIPC Debt Relief - Myths and Reality*, The Hague: Forum on Debt and Development (FONDAD), February 2004.

[27] UNCTAD (note 16 above), p. 43.

[28] Ibid., p. 42.

[29] Ibid., p. 43.

[30] OHCHR (note 22 above), p. 37.
