

## To get rid of moral hazards in debt cancellations

Michel-Henry Bouchet<sup>i</sup>

Moral hazard is the perverse effect of a party that has an incentive to take unusual risks because it does not bear the full costs of that risk. This is exactly the case with the complacent promises of debt cancellation to developing countries, encouraging corruption and irresponsible borrowing. In Europe, at a time when some are calling for the cancellation of national debts to the ECB, one must question the complex relations between debtors and creditors.

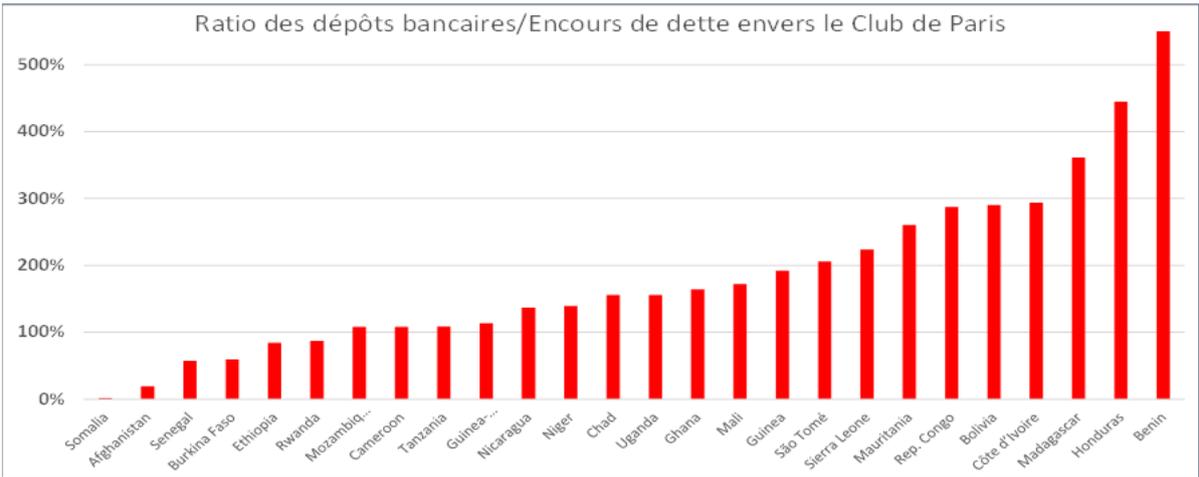
1. **The Debt Cancellation Ideology.** It is fashionable today to preach debt cancellation in the name of morality or the commercial or even political interest of creditors. The argument would be to promote social justice in the form of refusing loans at interest and forgiving debts to break the subordination of poor countries to rich countries. The purpose of this release is to "reset the counters".

In the Torah, Deuteronomy and Leviticus invite the cancellation of debts every 7 years and then during jubilees every 50 years, a continuation of the Assyrian-Babylonian tradition of remission of debts by the monarch between 2500 and 1500 BC<sup>ii</sup>. The Qur'an also calls on creditors to show understanding towards their debtors when they have difficulty honoring their commitments. Faced with the global pandemic threat, in April 2020, Pope Francis called *Urbi et Orbi* for international solidarity "by reducing or canceling the debt which weighs on the budgets of the poorest countries".<sup>iii</sup>

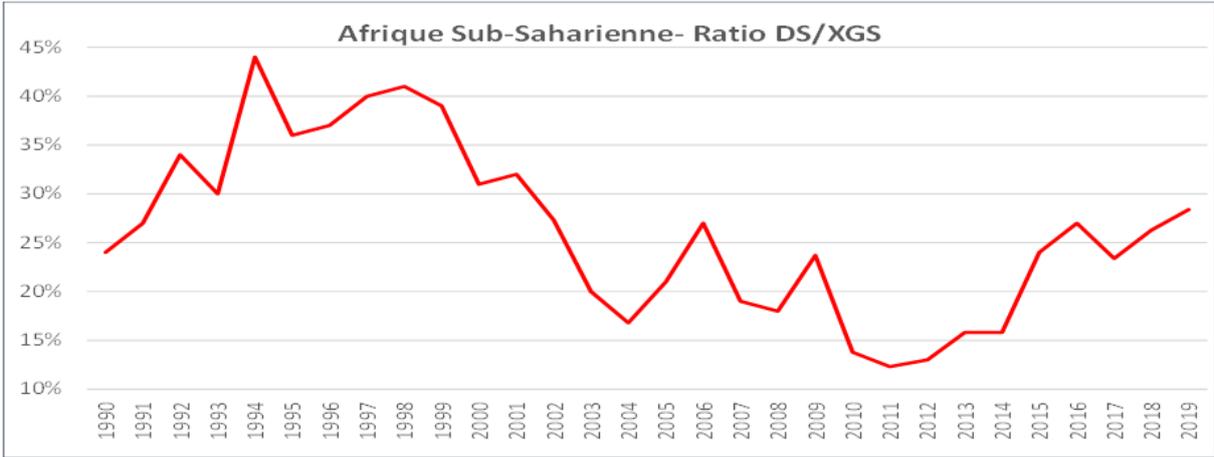
Today, at the forefront of the militant call for the cancellation of debts are a number of NGOs (Oxfam, Attac, CADTM...). The rants of the Committee for the Cancellation of Illegitimate Debt revile the IMF and the World Bank for using "external debt as an instrument of debtor subordination ... by violating international human rights covenants and by supporting dictatorships."<sup>iv</sup> The public debt would be an instrument of enslavement by a massive transfer of wealth from the peoples of the South to globalized capitalists and local ruling classes. Debt would become an instrument of political and economic domination through a new form of colonization: "The peoples of the South are bled dry"<sup>v</sup>. The operational conclusion of these libels is that the "odious debt" doctrine, formulated in 1927 by the Russian jurist Alexander Sack, invites states to default on account of "debts contracted by despotic governments, contrary to the interests of the population, and with the complicity of creditors".<sup>vi</sup>

2. **The perversity of debt cancellation.** Debt reduction programs for developing countries have appeared in a concerted manner, integrating public and private creditors, since the Brady initiative during the crisis of the 1980s and 1990s. The World Bank and the IMF played a key role with the Paris Club (developed countries) and the London Club (international banks). The objective was as much to finance the current account deficits of the debtor countries of Latin America, Africa and Asia, to stimulate growth, to stabilize the socio-political systems, and to maintain their trade flows, as to protect the balance sheets of under-capitalized banks. The impact on debt ratios was so short-lived that in 1996 the multilateral agencies launched the Debt Reduction Initiative for Heavily Indebted Poor Countries (HIPC), reinforced during the 2005 G28 in Gleneagles which decided to write off over US \$ 40 billion

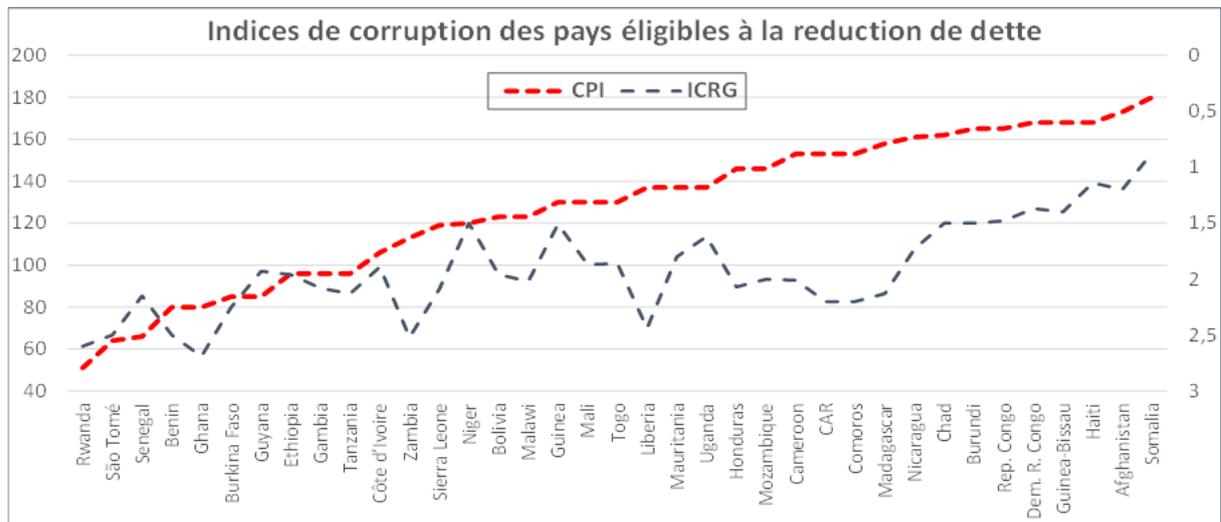
in debts from 18 developing countries. The governments of developed countries, meeting at the Paris Club, renegotiated nearly US \$ 600 billion in debts for 60 countries, combining the granting of time (rescheduling) and money (refinancing) with total cancellations, affecting their national budgets. However, developing countries have borrowed heavily from Eurobonds taking advantage of the fall in interest rates since 2009. What is more, debt reduction negotiations have often benefited unscrupulous investment banks combining all possible conflicts of interest, both traders and advisers. These costly and poorly targeted initiatives cannot offset the impact of poorly invested or recycled debt in tax havens. Debt and capital flight are intimately linked: Debt is too often "recycled" by corrupt elites, depriving the economy of sources of financing for development<sup>vii</sup>. The attached graph illustrates the relationship between private deposits in international banks and debt to Paris Club creditor governments: the vast majority could repay their debt by repatriating their exiled capital.<sup>viii</sup>



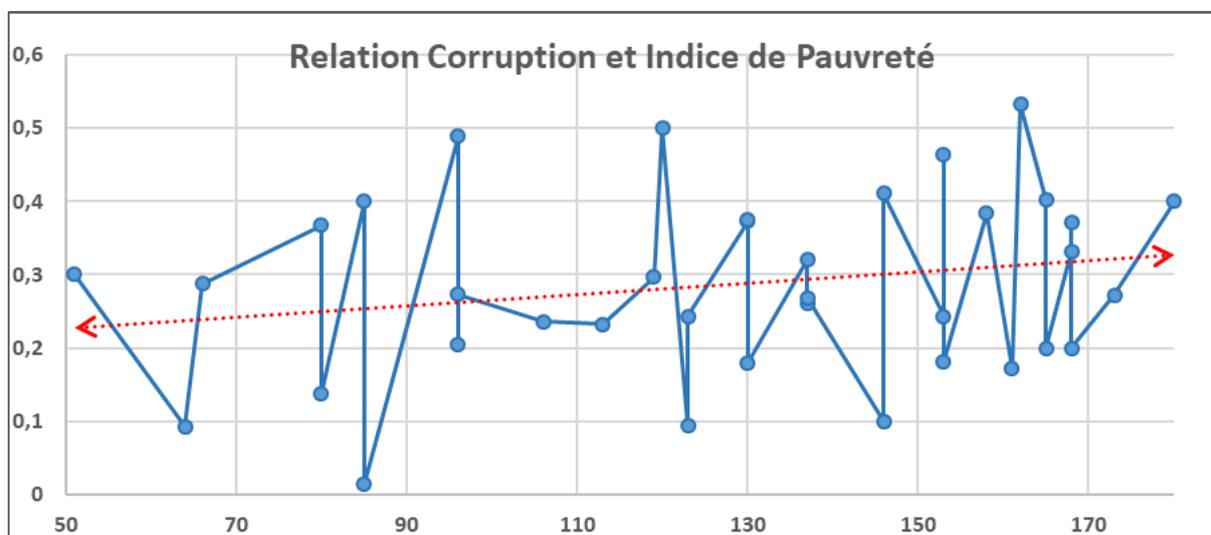
All in all, the mechanisms for canceling public, national and multilateral, and private (especially banking) debts, have had little lasting impact on the weight of indebtedness in budgets, balances of payments, and national wealth, and even less on the nature of public policies. The graph below illustrates the decline in debt service-to-export income ratios from 1997, and their rapid rise since 2011, despite very low interest rates. Their level in 2020 returned to that of 1990.



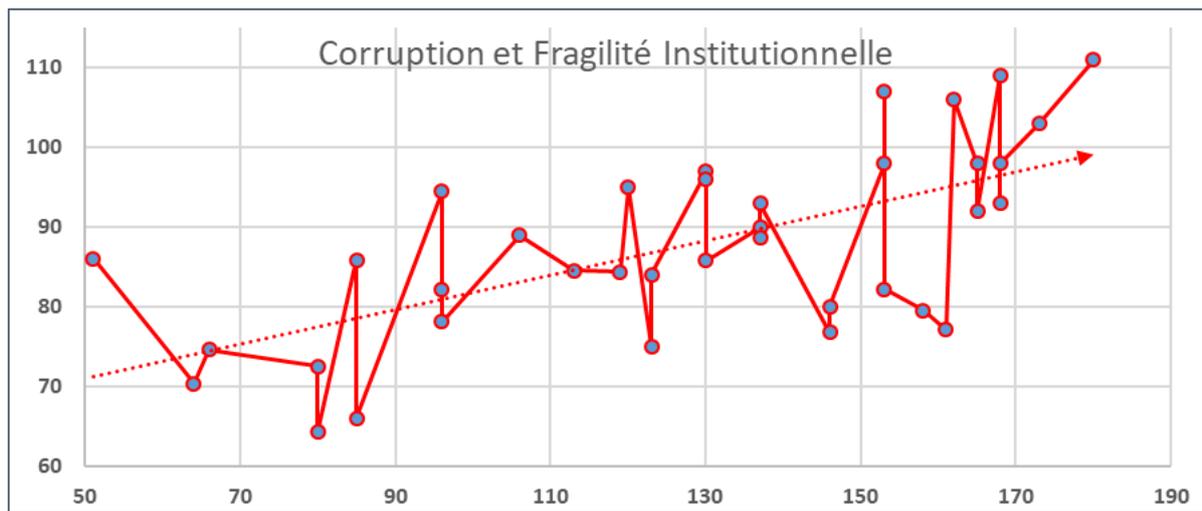
Debt cancellations neither distinguished beneficiaries according to their performance in governance and sustainable development policies, nor improved good governance trajectories despite the conditions of poverty reduction programs involving civil society! Corruption remains constant before, during and after debt cancellation. The populations have not benefited from the budget cuts. The 37 countries of the HIPC Initiative are among the most corrupt in the world in their vast majority, whatever the criterion of measurement.<sup>ix</sup>



Poverty is not inevitable, however. Sub-Saharan Africa, for example, shows examples of "relative success" in development and good governance: Mauritius, Sao Tome, Ethiopia, Rwanda, Ghana, Botswana, or Namibia, for that matter without any former French colony<sup>x</sup>. In 2020, the relationship between a dozen criteria of the UNDP Poverty Index in 2020 and corruption remains strong. This is particularly the case of countries whose growth depends on hydrocarbons and mineral wealth which combine corruption, poverty and inequalities, due to the triple concentration of power, economic, financial, and political: Cameroon, Gabon, Niger, Bolivia, Mali, Togo, Uganda, Mozambique, Angola, Zimbabwe, and the two Congo ...



The countries which have remained very poor despite the debt cancellations are therefore also the most corrupt and those which show a persistent institutional fragility, according to an index backed by some fifteen criteria.<sup>xi</sup>



Despite the perverse effects of debt cancellations, which in no way encourage the promotion of sustainable and inclusive development, demands have multiplied, such as a right inherent to low and stagnant GDP per capita. In the aftermath of the Arab Spring of 2011, voices were raised to demand the cancellation of the "odious and illegitimate" share of Tunisian and Egyptian debt. But in 2011 the debt weighed "only" 50% of Tunisian GDP and had been invested in good quality infrastructure, which differentiated Tunisia from its neighbors. The endemic corruption under Ben Ali had given rise to other evils, such as the taxation of local entrepreneurs and the embezzlement of public funds and customs receipts. In 2020, deficits have exploded and the debt represents more than 90% of GDP while the general state of infrastructure and institutions is in constant decline! Lebanon faced with a political system plagued by corruption, calls for debt relief, in the context of the migration crisis and repeated disasters in Beirut in mid-2020. The Ivory Coast benefited from a debt reduction of more than 90% in 2012 and additional relief in summer 2020 as part of the international initiative to fight the pandemic. Its level of sustainable development (as measured by the UNDP) remains 165 ° out of 189 countries, life expectancy remains at 57 years, and the country once again faces threats of civil war in the context of controversial presidential elections in November of 2020.

### 3. Combining debt relief and good governance? Four avenues are promising:

a) First, enhancing governance-related debt cancellation programs. Debt relief counterparts must be linked to good governance, the uncompromising fight against corruption, and the reorientation of debt payment flows towards programs for social and sustainable development purposes. This is the spirit of the debt conversion transactions implemented in the 1990s with UNICEF, USAID, or WWF for countries such as Senegal, Morocco, Bolivia, Vietnam, Poland, Mexico, Chile, Costa Rica, Zambia, or Brazil. Debts were reduced and converted into local currency in favor of NGOs for social development projects, often under the supervision of the World Bank or the Bank for International Settlements.

b) The IMF, the World Bank and the Paris Club must refuse that a public creditor such as China maintains opacity both on debt data and on relief measures, while representing more than 25% of loans to African countries, often in transactions pledged on natural resources (Angola, Kenya, Zambia, Tanzania, Mozambique, Ghana, Cameroon, and Ethiopia).

c) Then, a solution to stimulate growth and sustainable development when the country demonstrates a real commitment to good governance, is to link the interest rate and the repayment profile to the economic performance of the country or to its export earnings, in the spirit of Islamic finance which combines the destinies of creditors and debtors.

d) Finally, public creditors should accept the gradual and conditional conversion of debts into very long-term zero-interest loans that can be converted into grants at regular intervals when corruption indicators point unequivocally towards a lasting improvement.

In conclusion, the debt remains first and foremost a contract between the two parties, and the concept of “odious debt” is only an alibi to exonerate debtors from their social responsibilities, and for creditor countries to conceal complacency and geopolitical as well as commercial interests under a false solidarity.

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<sup>i</sup> Michel-Henry Bouchet, ancien Senior Economist à la Banque Mondiale et président d'Owen Stanley Financial, est Professeur de Finance Emérite à SKEMA.

<sup>ii</sup> <http://cadtm.org/La-remise-des-dettes-au-pays-de>

<sup>iii</sup> <http://www.finance-muslim.com/2010/12/enseignement-dettes>

<sup>iv</sup> Voir par exemple : Éric Toussaint, « Le système dette. Histoire des dettes souveraines et de leur répudiation », Les Liens qui libèrent, 2017. <https://laviedesidees.fr/La-dette-odieuse.html> et surtout Graeber, David : « La Dette : 5000 ans d'Histoire », Les Liens qui Libèrent, 2013. <https://journals.openedition.org/regulation/11412>

<sup>v</sup> <https://www.cadtm.org/L-ABC-du-Fonds-monetaire-international-FMI>

<sup>vi</sup> Voir Charte politique du CADTM <https://www.cadtm.org/Charte-politique-du-CADTM-International-18147>

<sup>vii</sup> <https://www.imf.org/en/Publications/Books/Issues/2016/12/30/External-Debt-and-Capital-Flight-in-Sub-Saharan-Africa-3564>

<https://www.imf.org/external/pubs/nft/2000/extdebt/>

[https://www.researchgate.net/publication/222782179\\_The\\_revolving\\_door\\_External\\_debt\\_and\\_capital\\_flight\\_A\\_Philippine\\_case\\_study](https://www.researchgate.net/publication/222782179_The_revolving_door_External_debt_and_capital_flight_A_Philippine_case_study)

<sup>viii</sup> Données de la Banque des Règlements Internationaux, table A6 et du Club de Paris.

<https://clubdeparis.org/fr/communications/page/encours-du-club-paris>

<sup>ix</sup> Corruption Perception Index of Transparency International (left axis) et ICRG Corruption Index of PRS (right)

<sup>x</sup> The Economic Consequences of Legal Origins, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, Journal of Economic Literature, Vol. 46, No. 2 (Jun., 2008), pp. 285-332

<sup>xi</sup> <https://fragilestatesindex.org/excel/>