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## Why it pays to forgive poor nations' debts

By [David R. Francis](#)

If you forgot to celebrate Dec. 8 - the Global Day of Action Against Debt and Domination - you're not alone. Most people in rich nations pay little attention to forgiving poor nations' debts.

But last month's Asian tsunamis changed that. This past Friday, the United States, Britain, Japan, and the other well-to-do members of the Group of 7 announced a moratorium, perhaps brief, on the debts of the 12 nations hit by the tsunamis. At press time, a broader group, the so-called Paris Club of creditor nations, was due to suspend loan payments for three of the nations. And when the G-7 finance ministers meet in London next month, they'll take up debt forgiveness as well as the moratorium. British Chancellor of the Exchequer Gordon Brown is expected to push for some permanent debt relief.

Are rich nations growing soft-hearted? Or merely pragmatic?

Ever since 1996, when the World Bank, the International Monetary Fund (IMF), and their member nations agreed on a program to reduce the debts of the highly indebted poor countries, the economic case for forgiveness has become more widely accepted. Nations struggling at the bottom of the totem pole find it harder to pay for schools and healthcare while they're repaying huge loans. And the world is better off - and will have new consumer markets - if these countries develop.

The Bush administration saw this early on. The US Treasury now urges 100 percent multi-lateral cancellation of debts for some 30 of the poorest nations.

"President Bush is wrong on so many things, but he's right on this," says William Easterly, a former World Bank economist now at New York University.

Despite its merits, debt relief creates new problems that rich nations will

have to solve.

There's the "incentive problem." If nations can get current debts canceled, they may be tempted to take on more loans unwisely, assuming they too will be forgiven in the future.

For example: Last month, the US forgave \$4.1 billion owed it by Iraq from the Saddam Hussein era. "Now virtually every poor- to middle-income country can say, 'Can't I get the same relief as Iraq?' " says Mr. Easterly. Nonetheless, it's time to forgive all debts of the poorest countries, he adds. "So much time and energy has been wasted on gradual debt forgiveness. Let's just call a spade a spade" since most of the debts are really grants. Their nominal terms are for 40 years at low, low interest rates.

Another problem with debt relief is figuring out who will actually pay for it.

Much of the bilateral debt of the poorest countries has already been forgiven or paid back. Most of what remains is owed to the IMF (\$8 billion) or the World Bank (\$20 billion). Should they foot the bill, as the US has proposed?

The IMF could sell some of its \$400 billion in gold and the World Bank could use some \$10 billion of its reserves to cover the cost, points out JubileeUSA, a nongovernmental group pushing for debt relief.

But that would reduce the resources the two institutions have to make loans to other poor- and middle-income countries, notes Nancy Birdsall, head of the Center for Global Development. Such nations - Turkey, Brazil, and China, for example - would indirectly pay the cost of debt forgiveness, either through higher interest rates on their loans or less loan availability.

Mr. Brown, the British treasury official, says his country would cover 10 percent of the costs of debt cancellation, including the costs of multi-lateral institutions. But it's not clear that the US and other rich nations would join in. And if the IMF sells more gold, it will need approval of the US Congress.

Another complication lies in setting terms on loans. Allan Meltzer headed a 2000 commission on international financial institutions that urged the US to forgive the poorest countries' debts and make grants, not loans, to them in the future. But the Carnegie Mellon University economist sees a need for making sure such grants are used in ways that get results and reform poor policy.

Critics say such terms result in foreign domination, even the building of an empire, in the case of the US. Easterly argues that the rich nations "aren't smart enough" to devise a plot to manage poor countries through debt for the benefit of their multinational corporations.

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