CAFOD Just one world

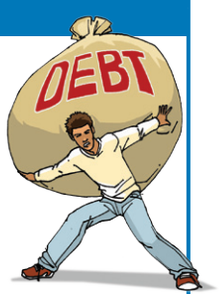
factsheet

Debt

What is debt?

Most of us have to borrow a large amount of money at some time in our lives. Buying a house usually involves taking on debt in the form of a mortgage. For many people, their first debt is their student loan. The sum borrowed is called the principal. On top of the principal you have to pay interest – the fee charged by the lender to the borrower for the use of the lender's money.

How do countries get into debt?



All countries have to borrow money from time to time. Just as house buyers borrow money which they pay back over many years, poorer countries use loans to finance basic infrastructure like dams and road systems.

Developing countries and debt

In the 1970s, rich oil-producing countries put their massive profits into banks to earn interest. To pay this interest, the banks made loans to developing countries. Interest rates were low, and these loans were thought to be affordable. It hardly mattered what the loans were used for because the borrowing governments guaranteed the debt. This is called 'sovereign debt'.

The causes of the crisis

Between 1979 and 1982, interest rates more than doubled worldwide, dramatically raising the cost of loans. The US dollar appreciated in value against other currencies. Loans were made in US dollars, and therefore became much more expensive, as loans were also paid back in US dollars.

At the same time, a worldwide recession reduced demand for developing countries' key exports, like coffee, cocoa and copper – and prices for these exports fell dramatically. Developing countries were earning much less income, but having to pay much more for their loans.

TRY THIS Go to the UN Millennium Goals website and find out what Goal 8 says about debt. Do you think the debt target has been achieved?

Impact of debt

Having become much more expensive, the debts became unmanageable. Countries took out more loans to pay off their original debts. These new loans mostly came from the World Bank, but were conditional – they came with strings attached. Borrowing governments had to show that they were committed to paying off their loans, by cutting public spending on things like education and health. The money saved would then be paid towards the debt. But poorly educated and unhealthy populations would never be able to pay off the debt. Debt was keeping poor countries poor.

FACT

In 2008 the total debt owed abroad by all developing countries was **$3.7 trillion,** with some $600 billion paid back to developed countries and their institutions in that year alone.

The money lenders

Multilateral lending: When international organisations, such as the World Bank and the International Monetary Fund (IMF), and regional development banks like the African Development Bank give loans to countries.
Bilateral lending: When one government lends money directly to another government.
Commercial lending: When banks and private companies give loans to countries.

Debt cancellation

In the early 1980s, the World Bank launched a series of initiatives to help alleviate the poverty and debt caused by huge loans. At first, these were just new loans, with lower rates of interest and longer repayment periods. When these did not work, they launched the Heavily Indebted Poor Countries initiative (HIPC). This was a promise to cancel debt, on the condition that indebted countries made a number of economic and social reforms. Following criticism that HIPC did not cancel enough debt in enough countries, the Multilateral Debt Initiative was launched in 2005, which sped up 100 per cent debt cancellation.

However, the vast majority of poor countries have not had their debt cancelled, and are still heavily indebted. Many countries are not able to satisfy the conditions for debt cancellation.

It's estimated that although around $100 billion in debt has been cancelled, another $400 billion of debt cancellation is necessary if 100 countries are to meet their people's basic needs
(Jubilee Debt Campaign).

TRY THIS What would you do if you owed someone money and were finding it hard to repay?

What difference do you think being in debt has made to developing countries? Do you think they would be different today if they hadn't been in debt?

Making a difference

Debt cancellation makes a real difference to developing countries. According to the World Bank, countries that benefited from HIPC increased their social spending by an average of 45 per cent between 1999 and 2003. Budgets for healthcare and schools increased dramatically:

- Zambia – people in poor rural areas no longer have to pay for healthcare.
- Uganda and Tanzania – primary school fees abolished, resulting in huge increases in attendance.
- Malawi – teacher training programme established with thousands of new teachers trained every year.

Charity Musamba, former Coordinator of Jubilee Debt Zambia, speaking at a rally in 2007 to remind G8 leaders to keep their promises.

What CAFOD thinks

Advances being made by countries that have had their debts cancelled shows that debt cancellation helps countries to escape poverty.

Great progress has been made, but the debt issue is still not resolved. Poor countries still need to borrow money to develop. Debts are mounting again. Financial crises often hit poor countries disproportionately more than developed countries, for example by lowering demand for their exports or reducing earnings from tourism, making it difficult for them to keep up loan repayments. Conditions, like cutting public spending, may still be attached to new loans.

CAFOD is a member of the Jubilee Debt Campaign, which believes rich countries need to cancel the remaining unpayable debts of all the world's poor countries. New loans should be fair and not force policies onto developing countries.

FACT

For every $1 developing countries receive from developed countries in aid, $5 is returned in debt repayments (Jubilee Debt Campaign)

TRY THIS Debate the statement, "Developing countries shouldn't have their debt cancelled – once you take out a loan you have to pay it back."
Some countries are refusing to pay back some debts. Why do you think this is?

Haiti: debt and disaster

In January 2010, a massive earthquake struck Haiti, one of the poorest countries in the world. The country was devastated. Over 200,000 people died and many more were injured.

Haiti was part of the HIPC programme (see above) but still owed many millions in debt. It was clear that the little money Haiti had was needed for rebuilding. After campaigning by CAFOD and other organisations, international financial institutions, like the World Bank and the IMF, agreed to cancel Haiti's remaining debt. Over $700 million that would have flowed out of the country could now be used for the recovery. After Haiti's earthquake, the Post-Catastrophe Debt Relief Trust Fund was set up. Following a major disaster, this fund can be used by poor countries to reduce, or in some cases, cancel, their debt payments.

FACT

Developing countries spend $1.5 billion every day on debt repayments. $34 million of this is paid by the very poorest countries. (Jubilee Debt Campaign, 2010)

Useful websites

jubileedebtcampaign.org.uk
Jubilee Debt Campaign

un.org/millenniumgoals
UN Millennium Development Goals

worldbank.org
World Bank - source of financial and technical assistance to developing countries

All facts correct May 2011

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