

Beyond HIPC

Debt cancellation and the Millennium Development Goals

The G8 has taken a welcome first step by agreeing multilateral debt cancellation for some countries covered by the HIPC initiative; but rich countries need to go much further if all poor countries are to reach the Millennium Development Goals (MDGs). The ability of poor countries to fight poverty and reach the MDGs should be the basis of calculations to determine the necessary level of debt cancellation. This means that the G8 debt initiative should be extended to include all other poor countries that need to have their debts cancelled to meet the MDGs. Similarly, debts owed to other creditors not covered by the G8 initiative such as the Inter-American Development Bank (IDB) should be cancelled wherever this is necessary to fight poverty.

Summary

Millions of citizens around the world are uniting in 2005 as part of the *Global Call to Action against Poverty*, to call on their leaders to show visionary leadership in the fight against poverty. In response to their demands, governments have taken some significant steps forward on debt cancellation, but these measures still do not match the effort needed to lift countries beyond the rhetoric and the bureaucratic formalities of the Heavily Indebted Poor Countries (HIPC) initiative and into a world where ending poverty and hunger – and the pointless suffering associated with them – can become a reality.

The Millennium Development Goals (MDGs) present a set of benchmarks, endorsed by governments, which are meant to guide the work of the UN and the entire family of multilateral organisations. Too often, however, rich-country governments and the international financial institutions treat these goals with little more than ritualised respect, offering up customary homage at appropriate intervals, yet doing little to alter their engagement in poor countries so that these goals can become real and meaningful changes in poor people's lives.

The people whose voices are raised this year are asking governments to remember that targets such as 'reduce by half the proportion of people living on less than a dollar a day' or 'reduce by three quarters the maternal mortality ratio' are not merely worthy goals or convenient bureaucratic markers, requiring pious respect at suitable moments. They are about the lives of men and women struggling to survive in poverty, without the basic needs of shelter, food, health and education. Until the reality of these people's needs bursts the bubble of complacency surrounding donor initiatives such as the debt-sustainability framework, the vision of a world beyond the drab confines of HIPC will remain only a vision.

Oxfam believes that, to achieve this vision, governments and the international financial institutions need to move radically beyond the conceptual context in which debt relief is currently administered. The move towards 100 per cent cancellation of the multilateral debt of HIPC countries is a welcome step forward. However, debt cancellation urgently needs to be extended to all countries where this relief is needed in order to reach the Millennium Goals.¹ Debts owed to other multilateral creditors such as the Inter-American Development Bank should also be cancelled if countries require such a measure in order to reach those goals.

Recommendations

- 1 Broaden the current debt-relief initiative
 - Shareholders of the World Bank and International Monetary Fund (IMF) should immediately agree to implement the G8 debt-cancellation proposal and cancel 100 per cent of the debt of all countries within the HIPC initiative, without imposing further conditions or delay. World Bank and IMF shareholders should leave open the list of beneficiary countries, so that others in similar need of debt relief can be included.
 - The World Bank and IMF should conduct an MDG-based analysis of the debt sustainability of each poor country, and recommend debt cancellation accordingly.
 - Rich-country governments and the International Financial Institutions (IFIs) should agree to provide cancellation of all bilateral, multilateral, and commercial debts owed by all the poorest countries where cancellation is needed to reach the MDGs.
- 2 End the double counting
 - Debt relief should not be financed out of existing aid budgets, but from new contributions from donors.
- 3 Extend the debt-cancellation initiative to include debt owed to other multilateral creditors
 - Cancel debt owed to other multilateral creditors such as the Inter-American and Asian Development Banks, in cases where countries need this relief in order to reach the MDGs.
- 4 Free poor countries from the constraints of conditionality
 - Put an immediate end to harmful economic-policy conditionality associated with HIPC debt relief. The G8 pledge that countries must be able to decide, plan, and sequence their economic policies to fit with their own development strategies must become a reality.
 - Restrict the use of conditions to requirements for financial accountability and poverty-reduction goals, agreed through open and transparent decision-making processes in which civil society and parliaments play an active role.

Glossary

AfDF	African Development Fund
CPIA	Country Policy and Institutional Assessment
GCAP	Global Call to Action against Poverty
GDP	Gross Domestic Product
G7	Group of 7 rich countries (Canada, France, Germany, Italy, Japan, UK, USA)
G8	Group of 8: Russia plus the G7
HIPC	Heavily Indebted Poor Country
IDA	International Development Association: the World Bank's concessional lending arm
IDB	Inter-American Development Bank
IFIs	international financial institutions
IMF	International Monetary Fund
LICs	low income countries
MDGs	Millennium Development Goals
MICs	middle income countries
UN	United Nations

1 Debt, the HIPC initiative, and the MDGs

Origins of the debt crisis

Underlying the arguments about appropriate solutions to the problem of poor countries' external debt are two very different visions of culpability, justice, and sustainable development.

On the one hand, the IMF and World Bank have continued to push indebted countries through complex and painful regimes of fiscal austerity – and prescribe deeply unpopular policy reforms in controversial areas such as privatisation and liberalisation – inspired by the conviction that this medicine is necessary to establish a 'sound' economic-policy environment for the future and supposedly overcome the conditions which led to the accumulation of debt in the first place.

On the other hand, campaigners and activists from both poor and rich countries have consistently argued the complicity of creditors, including the World Bank and IMF themselves, in making many of the unwise lending decisions that led to the original accumulation of the debt. Campaigners have accused rich-country governments of using loans to support the regimes of corrupt dictators during the Cold War. And they have rejected the notion that the citizens of indebted poor countries should now have to pay for the mistakes and abuse of the past.²

The establishment of the HIPC initiative

The HIPC initiative aimed to reduce the excessive debt burdens faced by the world's poorest countries. The initiative included three distinct stages. Firstly, countries had to qualify for the initiative, by having debt levels which were defined as 'unsustainable' by the World Bank and IMF. Secondly, countries prepared an interim Poverty Reduction Strategy Paper (PRSP) and reached 'decision point', at which point they began to receive debt relief. In the third and final stage, countries had to prepare a full PRSP, based on consultations with civil society; they also had to comply with numerous trigger conditions, including implementation of an IMF programme. At the end of this stage, they reached 'completion point' and a portion of their debt was finally cancelled.

The initiative was pieced together in 1996, partly as an unwieldy compromise between the calls of campaigners for the 'cancellation of the unpayable debts of the poorest countries by the year 2000, under a fair and transparent process'³ and creditors' grudging recognition that more ambitious action was needed if they were to tackle the debt crisis that was spreading across the developing world and avoid countries defaulting on their debts on an unprecedented scale.

The HIPC initiative's achievements, and its shortcomings, all arise out of this peculiar compromise.⁴ It has succeeded in cancelling large amounts of unpayable debt owed by a group of poor countries;⁵ and it has substantially lowered the levels of debt service that these countries have paid out every year, enabling them instead to invest the resulting savings in the education and health of their citizens. However, at the same time, it has made poor countries even more vulnerable to the nightmarish cycle which begins with harmful policy reforms dictated from the World Bank and IMF. This is followed by: increased economic, social, and political vulnerability, external shocks and emergency corrective measures, by the country going 'off-track' from IMF and World Bank programmes, the consequent loss of bilateral aid, and finally the application of yet more harmful policy conditions for new lending.⁶

Bolivia: a vicious circle of debt and conditionality

Bolivia has been applying structural reforms for almost 20 years, under the supervision of the World Bank, the IMF, and the Inter-American Development Bank. Organisations in Bolivia argue that these have had severe negative consequences: 'a fragile economy, highly sensitive to external shocks; a productive sector brought to a standstill, with only a few isolated international raw material markets and scant links with other sectors of the Bolivian economy; a weak State, both in terms of its institutional nature and its fiscal balances, which, in turn, affects its capacity to respond to its internal problems; a predominantly poor population (64 percent) with high levels of unemployment and underemployment (11 percent and 60 percent of the economically-active population, respectively, in the urban area)'.

Has the HIPC initiative helped? Although Bolivia received \$628.8 million in debt relief in the first seven years of participation in the HIPC initiative, this figure is insignificant compared with the \$3490 million in new loans contracted between 1998 and 2004. Bolivian civil society organizations argue that the reason behind this is directly linked to the impact of the conditions being imposed on the country: 'although Bolivia receives debt relief, the reform factors associated with that process generate other problems in the economy that maintain or exacerbate the fiscal situation. As a result, the country is forced to keep resorting to new loans, reproducing a vicious circle of debt contraction, which can only be broken if the lending countries and international organisations stop setting the conditionalities for debt relief.'⁷

Source: Plataforma de Accion contra la Pobreza, Bolivia, 2005

The MDGs: a changed environment for international development policy

The debate about development policy has changed substantially since the launch of the HIPC initiative. However, on the subject of debt, the approach of creditor governments and the World Bank and IMF remains caught in a time-warp from the 1990s.

Since the launch of the initiative, governments have agreed to the Monterrey Consensus, setting out a new vision of a development partnership between rich and poor countries. They have completed a major cycle of UN conferences, establishing benchmarks and action plans in areas ranging from sustainable development to the rights of women. Donors have moved towards a renewed sense of the importance of 'country ownership' in development policy-making, and the World Bank and IMF themselves have sought to reform their approach to development lending. Finally, and perhaps most important of all, governments have agreed to structure the work of the UN system around efforts to implement the Millennium Declaration and achieve the eight Millennium Development Goals (MDGs).

In this sense, the cold economic logic behind the HIPC initiative is outdated. While the rest of the international system focuses on setting in place the conditions that will allow poor countries to scale up the delivery of basic services to reach the MDGs, the international financial institutions (IFIs) continue to tinker with the debt-to-export ratios in their definition of 'debt sustainability'. While other parts of the global policy-making community explore the costings and the policy environment that will enable these goals to become a reality,⁸ the IMF and World Bank debate how much more 'fiscal restraint' Malawi will be required to demonstrate before it is allowed to reach its completion point.⁹ In the bureaucratic gloom of a long-delayed 'sunset clause'¹⁰, the debate at the IFIs seems to have become detached from the principles which now guide policy making in the rest of the UN system.¹¹

Debt cancellation is a necessary but insufficient condition for achieving the MDGs. Oxfam, as part of the *Global Call to Action against Poverty*, is emphasising the need for a comprehensive set of actions by rich countries, including more and better aid, trade justice and debt cancellation. While substantial aid is clearly needed – and some progress has occurred in this area in 2005 – debt cancellation is another vital part of the equation. Indeed, the MDGs provide a common minimum international standard which helps to ensure that discussion of debt sustainability can and should be part of a forward-looking process, organised around the 2015 targets.

The UN Millennium Project, the most exhaustive and rigorous assessment to date of what will be required for countries to reach the MDGs, summarises the current situation in straightforward terms:

“The targets for debt relief are based on arbitrary indicators (debt-to-export ratios) rather than MDG-based needs. Many heavily indebted poor countries (HIPCs) retain excessive debt owed to official creditors (such as the Bretton Woods institutions¹²) even after relief. Many middle-income countries are in a similar situation and receive little or no debt relief”.¹³

The G8 debt deal

At their summit in July 2005, the G8 countries took an important step forward. They reached an agreement to cancel the debts of the 18 completion-point HIPCs¹⁴, and potentially also the debts of 20 other decision-point and pre-decision-point HIPCs¹⁵. Explicitly set in the context of the Monterrey Consensus and efforts to reach the MDGs,¹⁶ the new agreement could make a major contribution to decisions about debt cancellation, possibly with far-reaching implications for why, when, and how this relief is provided, and for which countries under which circumstances.

Although it is flawed by several significant weaknesses described below, the deal is welcome for a number of reasons. Among its most significant positive aspects is its inclusion of IMF debt as well as World Bank and African Development Fund debt. The deal also places heavy emphasis on the need to provide ‘additional funds’ and to ensure ‘that the financing capacity of the IFIs is not reduced’.¹⁷ It covers both debt stock and debt servicing, providing permanent relief for the countries concerned. And, because it represents recognition on the part of donors that 100 per cent debt cancellation will be needed for many countries if they are to reach the MDGs, it also constitutes a historic milestone on the road towards cancelling the debt of all countries that will need it.

Among the most significant weaknesses of the agreement, is the fact that it currently includes only a limited number of countries, and covers only some of the multilateral creditors to whom poor countries are indebted. Despite the emphasis on the need for additional funds, it does not set out in detail how these funds are to be guaranteed over and above future regular contributions to the International Development Association (IDA) - the World Bank’s concessional lending arm - and to the African Development Fund (AfDf). It fails to make good use of the IMF’s massive and undervalued gold reserves (worth around \$45 billion, but valued at only \$9 billion on the

organisation's books). It will oblige countries that have not yet reached completion point – or have not even entered the HIPC framework – to continue to implement burdensome policy conditions, imposed by the World Bank and the IMF.¹⁸ Finally, the deal further entrenches reliance on existing World Bank 'performance-based allocation systems' – including tools such as the controversial Country Policy and Institutional Assessment (CPIA) mechanism¹⁹ for the allocation of the resources released.

If fully financed, the deal should represent substantial additional resources for poor countries. The World Bank recently estimated the nominal cost of the G8 agreement to be \$38.8 billion for the 18 post-completion-point HIPCs (including IMF and AfDF debt).

Table 1: Estimated cost of the G8 debt deal

	Nominal cost of G8 proposal (\$ billions)			
	IDA	IMF	AfDF	Total cost
Post-completion-point HIPCs (18)	30.7	4.3	3.8	38.8
Africa (14)	26.3	3.4	3.8	33.5
Latin America (4)	4.4	0.9	5.3
Interim HIPCs (9)	7.3	1.7	2.1	11.1
Total post-decision-point HIPCs (27)	38.0	6.0	5.9	49.9
Pre-decision-point HIPCs (11)²⁰	5.7	3.2	0.4	9.3
All HIPCs (38)	43.7	9.2	6.3	59.2

Source: Presentation by Geoffrey Lamb, World Bank VP for Concessional Finance and Global Partnerships.²¹

Ensuring that debt cancellation is really 'new money'

Along with many other organisations campaigning on debt, Oxfam has consistently argued that money for debt cancellation must be 'additional': that is, it must be additional to aid that has already been allocated (including money in each country's existing aid budget and money that has already been provided to the IFIs as aid), and it must ultimately also mean additional resources for poor countries.

The G7 Finance Ministers' agreement in June 2005 stated that countries whose debt is cancelled would have their aid flows reduced by the same amount.²² Donors would pay an amount equivalent to the cancelled debt into the World Bank's IDA fund (and the AfDF), and this would be shared out across all IDA borrowers, depending on whether the World Bank considers them to be 'performing well' or not.²³

The G7 communiqué does commit members to making additional funds available immediately to cover the full costs during the IDA-14 and AfDF-10 period²⁴. It goes on to say that 'for the period after this, donors will commit to cover the full costs for the duration of the cancelled loans, by making contributions additional to regular replenishments of IDA and AfDF'.

The challenge is how to assess how funding can be considered 'additional' to the cycles of IDA negotiations which have not yet happened. If donors have not yet committed these funds for IDA, how can anyone tell whether money paid into IDA for debt cancellation is additional to regular donor contributions? The World Bank itself has proposed three possible mechanisms to assure this 'additionality':²⁵

1. Full up-front financing (present value of foregone reflows paid up-front, at an estimated cost of \$44bn, or \$24bn in present-value terms).
2. Firm financing commitment up-front to cover reflow losses over 10 years (FY2006–FY2016), with encashment over 10 years, on IDA encashment model (estimated cost: \$8.3bn, or \$6.6bn in present-value terms).
3. Minimum condition: establish a benchmark (such as donor contributions to IDA14).²⁶

While it may be neither necessary nor feasible for donors to finance now the entire cost of the debt cancellation up-front, we do believe that donors should provide the firmest possible commitment to poor countries, to ensure that additional financing will be guaranteed in the future. Ideally, this would take the form of a legally binding commitment to ensure that future debt cancellation funds supplement and do not replace ongoing IDA replenishments.

The G8 agreement therefore contains a number of weaknesses that need to be addressed. This paper will consider in more detail the urgent need to expand the number of countries to benefit from debt cancellation, and the need to extend the range of creditors that are included.

2 Broadening the new debt initiative

If poor countries are to be set on a firm path towards the achievement of the Millennium Development Goals (MDGs), debt relief needs to be made available to many more countries across the developing world. A significant proportion will also need 100 per cent debt cancellation²⁷ (along with more and better aid, and trade reform) if they are to reach the goals. The report of the UN Millennium Project makes the following recommendations in this regard:

“‘Debt sustainability’ should be redefined as ‘the level of debt consistent with achieving the Millennium Development Goals’, arriving in 2015 without a new debt overhang. For many heavily indebted poor countries this will require 100 percent debt cancellation. For many heavily indebted middle income countries, this will require more debt relief than has been on offer. For some poor countries left off the HIPC list, such as Nigeria, meeting the Goals will require significant debt cancellation.”²⁸

There have been few official attempts to identify which countries will need full debt cancellation to reach the MDGs. Nonetheless, initial assessments by civil society organisations suggest that more than 60 low-income countries need immediate, 100 per cent debt cancellation simply to meet the Millennium Development Goals.²⁹

One of the first steps that the World Bank and IMF should take is to conduct a rigorous and systematic MDG-based analysis of the debt sustainability of every low-income country and all heavily indebted middle-income countries. Until the IFIs have clear information at their disposal about poor countries’ financing needs, it will remain practically impossible for them to make meaningful recommendations of any sort about ‘debt sustainability’, in the sense which the UN Millennium Project proposes for this term. On the basis of the MDG-based debt-sustainability analysis, the IFIs should recommend 100 per cent debt cancellation for every country which needs it, and also recommend partial debt relief wherever this will be required to reach the MDGs.

Many governments have already recognised that debt cancellation needs to go beyond the current list of HIPC countries. For example, in September 2004 the UK government announced that it would provide unilateral debt cancellation for all low-income countries which had sufficiently robust public-expenditure management systems to ensure

that the savings from the additional debt cancellation would finance progress towards attaining the MDGs.³⁰ Completion-point HIPCs 'as well as a number of other countries such as Vietnam and Armenia' were to benefit.³¹ The UK Chancellor of the Exchequer, Gordon Brown, has recently suggested that debt cancellation could be extended eventually to as many as 66 countries.³²

The Canadian government has also consistently emphasised the need to ensure that equity between HIPCs and non-HIPCs is a principle which underpins debt cancellation at the international level. The unilateral debt initiative that they announced in February 2005 involved extending debt cancellation to 19 countries, with a further 37 being considered 'potentially eligible for benefits'.³³ The Netherlands announced a similar initiative in April 2005.³⁴

Table 2: Canadian initiative: country eligibility³⁵

Immediately eligible		Potentially eligible	
HIPCs (15)	IDA-only LICs (4)	HIPCs (22)	IDA-only LICs (15)
Benin	Mongolia	Burundi	Angola
Burkina Faso	Nepal	Central African Rep.	Afghanistan
Bolivia	Sri Lanka	Chad	Bangladesh
Ethiopia	Vietnam	Cameroon	Bhutan
Ghana		Congo, Dem. Rep. of	Cambodia
Guyana		Congo, Republic of	Eritrea
Madagascar		Comoros	Haiti
Mali		Côte d'Ivoire	Kenya
Mauritania		Gambia, The	Kyrgyz Republic
Mozambique		Guinea	Lesotho
Nicaragua		Guinea-Bissau	Moldova, Rep. of
Niger		Honduras	Solomon Islands
Senegal		Lao, PDR	Tajikistan, Rep. of
Tanzania		Liberia	Timor Leste
Uganda		Malawi	Yemen, Rep. of
		Rwanda	
		Sao Tome & Principe	
		Sierra Leone	
		Somalia	
		Sudan	
		Togo	
		Zambia	

Prior to the Spring Meetings of the World Bank and the IMF in April 2005, France made a debt-relief proposal aimed at alleviating potential shocks, to provide temporary relief for countries in these circumstances. The French proposal was aimed at supporting 'post-

completion point HIPCs and other non-HIPC IDA only low-income countries'.³⁶

Countries such as Japan, the USA, and Germany have also placed particular emphasis on the need to reward those that have managed their economies well. As many heavily indebted countries not in the HIPC initiative have run their economies well, and diligently paid debt service for many years, it is arguably inconsistent not to provide debt relief for these countries too. It is important not to create a perverse incentive for governments to mismanage their countries' economies by providing debt cancellation to some countries but not to others with equivalent needs.³⁷

Creditors also recognised the importance of extending debt cancellation to countries outside the HIPC framework. They created an important historical precedent when they provided debt relief to Nigeria in mid-2005.

The World Bank's debt-sustainability framework highlights an important contradiction in donor governments' policies on debt to date.³⁸ This instrument identifies a large number of HIPC and non-HIPC countries as having a high risk of debt distress, and therefore recommends that these countries should receive all their aid in grant format. However, although the debt-distress risk of many non-HIPC countries is identified as being at least as severe as that of many of the HIPCs, governments have not yet taken the next logical step of cancelling the debt of the non-HIPC countries.³⁹

IMF Managing Director Rodrigo de Rato explicitly addressed the issue of uniformity of treatment for low-income countries in a statement issued on 3 August 2005, in which he also emphasised the objective of 'freeing up resources to help them reach the Millennium Development Goals'.⁴⁰ Legal considerations at the IMF may mean that debt cancellation will have to be extended to other non-HIPCs which are equally qualified to lay claim to being the IMF's 'poorest and most indebted members' and which have an equal need for debt cancellation if they are to reach the MDGs. An IMF paper prepared for the Spring Meetings explicitly notes that 'regarding country coverage, all low-income countries could potentially be made eligible'.⁴¹

The G8 themselves recognise the need for debt cancellation to extend eventually beyond the limited number of countries currently participating in the HIPC initiative. The Finance Ministers' Communiqué states that 'We are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens'.⁴² A number of countries could quite possibly soon meet the criteria for entering the

HIPC initiative: Georgia, Tajikistan, Kyrgyzstan, Moldova, Eritrea, and Haiti might be possible candidates, among others.

However, the HIPC process itself has been a long road to debt relief, and it is only now that this relief is being finalised in the form of irrevocable and complete debt cancellation. In most countries, the obstacles to reaching the completion point have been many. Not least have been the numerous policy conditions which the IFIs impose, often going far beyond the measures detailed in countries' own poverty-reduction strategies.

The burden of conditionality has been such that leaders of poor countries have responded with only wary enthusiasm to the recent G8 agreement. President Bharrat Jagdeo of Guyana 'cautiously welcomed' the new deal, but deferred final judgement until clarity on any associated conditions emerged. He noted that in the past his country had suffered from 'conditionalities imposed in many ways arbitrarily' by the IFIs.⁴³ Such caution is born out of years of harsh experience: years which any new entrants to the HIPC process have yet to begin. It is for this reason that, if entering HIPC is to be beneficial for the poorest citizens of newly eligible countries, the World Bank and IMF will need to re-model fundamentally the conditionality constraints which they impose on HIPCs.

Conditionality and debt: two issues that must be dealt with together

The World Bank has recently completed its review of conditionality, and has largely concluded that World Bank practice in this area is satisfactory. However, if governments are to provide meaningful debt cancellation to all poor countries that need it, a more far-reaching reform of World Bank conditionality is urgently required.

The World Bank and IMF still need to reduce dramatically the number of conditions which are imposed on poor countries, as well as the overall burden of conditionality. They need to ensure that there is genuine 'ownership' of policies at a national level, including ownership by the national government, parliament, and civil society. Although the World Bank and IMF must engage in the dialogue, they should enable a country's citizens to determine any given policy route – especially when controversial issues such as privatisation and liberalisation are at stake.

The World Bank's review suggests that decision makers in developing countries continue to perceive little difference between binding and non-binding conditions, instead experiencing both categories as contributing to the overall burden of conditionality. This calls for more than a change of communication strategy from the World Bank, as the Board seems to have concluded; rather, it is indicative of a recurrent underlying problem, requiring urgent and substantive action.

3 Deepening the debt initiative by including debt owed to other creditors

If the G8 are indeed to 'complete the process of debt relief for the Heavily Indebted Poor Countries' and 'provide significant support for countries' efforts to reach the goals of the Millennium Declaration', they will need to extend the debt cancellation on offer to include not only debts owed to the IMF, World Bank, and African Development Fund but also other creditors such as the Inter-American Development Bank (IDB).⁴⁴ As poor countries owe debt to as many as 19 multilateral creditors in total, and Ghana alone has debts to nine such institutions, only a debt-cancellation strategy which is truly comprehensive in scope will provide the lasting solution to unpayable debt that was originally foreseen by the architects of the HIPC initiative.⁴⁵

Although the G8 agreed in July 2005 to cover the cost of debt owed by the 18 completion-point HIPCs to the African Development Fund,⁴⁶ no such arrangement is made to cover debt owed to the Inter-American Development Bank by the four Latin American HIPCs in this group.⁴⁷ These four countries will still pay a total of almost \$1.4 billion in debt service to the IDB over the next five years.⁴⁸

President Bharrat Jagdeo of Guyana noted that his government 'would examine a bilateral approach to the US to see if they would consider expanding this initiative to cover the Inter American Development Bank'. He suggested that the USA had a special 'moral responsibility' to the Western hemisphere, and should therefore champion the cause of debt cancellation for Guyana, Nicaragua, Honduras, and Bolivia. Although HIPC has successfully reduced Guyana's total foreign debt from \$2.1 billion dollars in 1992 to half that amount now, and brought down the proportion of government revenue spent on repaying debt from 94 per cent at least 10 years ago to less than 20 per cent today, significant challenges still remain if the country is to reach the MDGs.⁴⁹

The debt the G8 forgot: the case of Nicaragua

Debts owed to the Inter-American Development Bank

The debt deal agreed by the G8 includes money owed to the World Bank, the IMF, and the African Development Fund. It does not cover debts owed to the Inter-American Development Bank (IDB). This exclusion affects four of the HIPC countries: Nicaragua, Honduras, Guyana, and Bolivia.

Nicaragua's debt to the IDB accounts for 25 per cent of all its external debt, which amounts to millions of dollars in repayments each year - money that could instead be spent on education and health care. Debts owed to the IDB, and other regional development banks, must be included in the G8 deal as a matter of urgency.

Crippling domestic debt

The Nicaraguan government has massive domestic debts, incurred by the issuing of bonds within the country. These debts were largely run up by the previous government, to finance the bailing out of a number of banks.

Repayment of this domestic debt dwarfs external debt repayments: the Nicaraguan government serviced external debt to the tune of \$76 million in 2004, compared with pay-outs of \$354 million on domestic debt. In all, debt repayments consumed 45.3 per cent of government revenue for the year.

Given this crippling burden of domestic debt, civil society in Nicaragua is calling for the government to legalise the internal debt, as it is now being challenged by some public institutions⁵⁰, and to reschedule the payments. However, recent discussion with representatives of the World Bank and IMF in Nicaragua confirmed that this option had not been investigated in any way. Instead the World Bank and the IMF endorsed the reallocation of HIPC debt-relief funds away from poverty-reducing initiatives to the repayment of internal debt. This meant that HIPC relief funds did not lead to any increase in government expenditure on poverty reduction between 2000 and 2004.

The inadequacy of the resources being spent on poverty reduction is having a serious impact on the country's progress towards the MDGs. Nicaragua is currently expected to miss several of the targets for the goals. In 2005, CEPAL estimated that the country would require almost \$100 million more in order to reach the education goals alone.

Source: Co-ordinadora Civil

The IDB is the biggest creditor of both Honduras and Nicaragua. The latter country currently owes the institution \$1.37 billion. According to 2004 figures, Nicaragua's debt to the IDB accounts for 25 per cent of the total external debt.⁵¹ The IMF and World Bank should now conduct a rigorous and systematic MDG-based debt-sustainability assessment for the country, taking into account debt owed to the IDB.

Unlike some other creditors, the IDB has participated in the HIPC process and has historically provided debt relief for all four countries as part of the initiative. As of December 2003, the institution had granted debt relief totalling \$313 million under both HIPC initiatives:

\$150 million to Bolivia, \$33 million to Guyana, \$44million to Honduras, and \$86 million to Nicaragua.⁵²

The G8 proposal, by establishing the MDGs as the benchmark for future debt relief, sets out an important challenge to other multilateral creditors. As the achievement of the goals becomes an increasingly significant dimension of development policy making across the institutional spectrum, other creditors such as the IDB will also need to ensure that MDG-based debt-sustainability assessments are driving their determinations of debt cancellation at the regional level.

Conclusion and policy recommendations

The debt initiative on the agenda at the Annual Meetings of the World Bank and the IMF in September 2005 is a good step forward. However, governments need to set out a bolder and more decisive vision that goes beyond the limited scope of the HIPC initiative. They need to take action now to set a greater number of poor countries on a clear path towards freedom from debt and the achievement of the Millennium Development Goals. This means broadening the current debt-cancellation initiative to include all countries that need further relief; deepening the initiative to cover other creditors; and ensuring that debt-relief funds are effectively used to combat poverty.

Recommendations

1 Broaden the current debt-relief initiative

- Shareholders of the World Bank and IMF should immediately agree to implement the G8 debt-cancellation proposal and cancel 100 per cent of the debt of all countries within the HIPC initiative, without imposing further conditions or delay. World Bank and IMF shareholders should leave open the list of beneficiary countries, so that others in similar need of debt relief can be included.
- The World Bank and IMF should conduct an MDG-based analysis of the debt sustainability of each poor country, and recommend debt cancellation accordingly.
- Rich-country governments and the IFIs should agree to provide cancellation of all bilateral, multilateral, and commercial debts owed by all the poorest countries where cancellation is needed to reach the MDGs.

2 End the double counting

- Debt relief should not be financed out of existing aid budgets, but from new contributions from donors.

3 Extend the debt-cancellation initiative to include debt owed to other multilateral creditors

- Cancel debt owed to other multilateral creditors such as the Inter-American and Asian Development Banks, in cases where countries need this relief in order to reach the MDGs.

4 Free poor countries from the constraints of conditionality

- Put an immediate end to harmful economic-policy conditionality associated with HIPC debt relief. The G8 declaration that countries must be able to decide, plan, and sequence their economic policies to fit with their own development strategies must become a reality.
- Restrict the use of conditions to requirements for financial accountability and poverty-reduction goals, agreed through open and transparent decision-making processes in which civil society and parliaments play an active role.

Notes

¹ The Millennium Development Goals were chosen precisely because governments decided that they represented an achievable level of ambition. However, poor countries' debts need to be cancelled so that they can achieve their human-development goals, in the broadest sense, and to enable national governments to respect the fundamental human rights of their citizens. The MDGs thus represent no more than an achievable minimum standard and a deadline to which governments have made a commitment.

² The origins of poor countries' debt are complex and they vary from one country to another. However, as an example, the debt of Honduras is considered to result from a number of factors: 'lack of a medium- or long-term national plan; lack of a policy on indebtedness as part of a national plan; inadequate selection of programs and projects; programs and projects that are badly adapted to the national context; high proportion of resources being absorbed by technical assistance and equipment from the donor country, with no resulting positive impact on economic growth or national development; frequent natural disasters which have destroyed a large part of the infrastructure built with loans, and reconstruction financed by further loans; low capacity for the execution of this work, and faults in its execution; contradictions between economic and social policies; a lack of complementarity and integral vision in investment; corruption' (FOSDEH 2005).

³ Pettifor, Jubilee 2000 Coalition UK., [Hhttp://www.jubilee2000uk.org/H](http://www.jubilee2000uk.org/H)

⁴ 'The goal of the Initiative was to restore the long-term debt sustainability of the beneficiaries. No more, no less. No more: it was not meant to become a new vehicle for economic development. No less, that is: nothing would be more disappointing but to close the Initiative with the feeling that everything should be started all over again, say in a decade or so' (Cohen et al., 2004).

⁵ Expected to amount to \$54.5 billion over time, in 2003 NPV terms. Source: World Bank website.

⁶ Fontana 2005.

⁷ Plataforma de Accion contra la Pobreza (PACP) 2005.

⁸ Report of the Commission on Africa, 2005; Report of the UN Secretary-General; Report of the UN Millennium Project.

⁹ Fontana 2005.

¹⁰ The 'sunset clause' extended the duration of the HIPC process to allow new countries to enter the initiative. It has now been extended on several occasions.

¹¹ 'Further Debt Relief for Low-Income Countries – Key Issues and Preliminary Considerations', by IMF Policy Department and Review Department, 10 March 2005. This paper provides significant insights into the

extent to which the IMF recognises the MDGs as a basis for further debt relief. Para. 1 notes that the IMFC provided a mandate for debt relief on this basis in their 2004 Annual Meetings communiqué, which calls for 'further debt relief' to meet the MDGs. Para. 9 of the paper suggests that debt relief could serve a number of objectives, including 'increasing available resources for achieving the MDGs', and notes these objectives 'are not mutually exclusive'. However, the first footnote to paragraph 11 reveals that HIPC debt relief and debt sustainability are still being considered in terms of the levels of debt at which countries experience debt-servicing problems – a far cry from any vision of debt sustainability oriented around human development and the MDGs. Perhaps the IMF's underlying fear is revealed in para. 31: 'securing additional resources to support the MDGs ... could be perceived as blurring the delineation between the IMF's responsibilities and those of a development institution'. If the IMF does not perceive its work – at least at some very basic level – as furthering human development, then something may be profoundly wrong with the institution's perception of the mission which the international community has entrusted to it.

¹² The Bretton Woods institutions means the World Bank and IMF, originally set up at a conference at Bretton Woods in the US.

¹³ Sachs 2005, page 197.

¹⁴ The final stage of the HIPC process, at which a portion of a country's debt is finally cancelled.

¹⁵ G8 Finance Ministers, June 2005. Footnote 1 states: 'The following 18 countries would be eligible immediately: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia. As the remaining unsustainable HIPCs reach Completion Point they will also become eligible.' Bullet-point 5 states: 'We are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens'.

¹⁶ G8 Finance Ministers, June 2005. Paragraph 1 and text on 'G8 proposals for HIPC debt cancellation': 'Donors agree to complete the process of debt relief for the Heavily Indebted Poor Countries by providing additional development resources which will provide significant support for countries' efforts to reach the goals of the Millennium Declaration (MDGs)...'

¹⁷ G8 Finance Ministers, June 2005.

¹⁸ And some Board members are pushing for the deal to include even more. The Belgian Executive Director at the IMF has led a small group of non-G8 shareholders, who are usually among the more progressive countries, to push for further conditionality to be applied to countries before they benefit from any debt relief. He has also suggested 'phasing in' the deal, rather than providing immediate and irrevocable debt cancellation (as the G8 proposed). This is regardless of the fact that all the HIPC countries currently proposed as beneficiaries have already implemented years of unpopular policy reforms imposed through Bank and IMF conditions, in order to reach the 'lasting end to unsustainable debt' originally promised by the HIPC initiative;

and it also fails to recognise the likelihood that many of these countries will continue to implement further conditions under on-going World Bank and IMF programmes.

¹⁹ This mechanism has been criticised for providing arbitrary weightings of the policies that countries choose to follow, and for incorporating value-dependent judgements about the development path which countries should pursue. By excluding qualitative judgements, it arguably also fails to identify situations where a historical perspective is necessary, such as when a country emerging from conflict needs to be given a fresh start.

²⁰ Burundi has subsequently reached decision point.

²¹ Bank and IMF staff estimates. Costs assume end-2004 cut-off date for IDA, AfDF, and IMF. AfDF relief has been estimated by Bank staff and is being reconciled with AfDF staff estimates. IMF data refer to debt outstanding and disbursed.

²² G8 Finance Ministers, June 2005. '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.' A footnote goes on to say that 'additional donor contributions would be provided on the basis of IDA-13 and normalised AfDF-10 burden shares'.

²³ G8 Finance Ministers, June 2005. The Communiqué states that 'additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems'.

²⁴ IDA-14 and AfDF-10 are the names of the replenishment cycles of the concessional lending arm of the World Bank (the International Development Association) and the African Development Fund respectively.

²⁵ Lamb, July 2005.

²⁶ The Bank even goes so far as to suggest a new principle of 'proportionality', i.e. that 'IDA would lower debt service obligations by eligible countries to the extent that donor financing has been secured, on a pro-rata basis'. In other words, if donors failed to contribute as much money as was needed to provide the debt cancellation that they had promised, the Bank would simply provide countries with less debt relief (Lamb, July 2005).

²⁷ The IMF recognises as much in a recent paper which notes that 'to provide resources to address protracted balance of payments problems stemming from efforts to achieve the MDGs, the most debt relief that could be financed – even 100 percent – might be appropriate' (IMF, March 2005).

²⁸ Sachs 2005, pages 207–8.

²⁹ Jubilee Debt Campaign, ActionAid UK, and Christian Aid, 2005. See especially chapter 2, based on an analysis of debt sustainability by Romilly Greenhill, ActionAid UK. This analysis gives some sense of the scale of the challenge, identifying 62 countries from the following groups as requiring

100 per cent debt cancellation in order to reach the MDGs: 38 HIPC; three other countries deemed by creditors to be sustainable after traditional debt-relief measures; 21 non-HIPC low-income countries. Three other countries are believed to need partial debt cancellation of up to 90 per cent. Other severely indebted countries may also need debt cancellation in order to reach the MDGs.

Calculations are based on following assumptions. Financing needed: based on Millennium Project estimates of \$40–\$50 per capita in 2006, rising to \$70–\$100 by 2015, the report takes a mid-range estimate of \$45 and \$85, and assumes that the requirements (rise) gradually between 2006 and 2015. Population: World Bank estimates. Economic growth: 7 per cent (in line with MDG requirement). Financing modalities: 50 per cent grants, 50 per cent loans, with 0 per cent interest on current debt stock and new loans.

³⁰ Low income countries are defined as IDA-only. The list of countries with a Poverty Reduction Support Credit programme is apparently serving as a proxy for countries with 'sufficiently robust public expenditure management systems to ensure that the savings from the additional debt relief will finance progress towards attaining the MDGs'.

³¹ DFID press release, 26 September 2004.

³² 'Together and for years we have fought for debt relief – and this year we are finally delivering 100 per cent relief to the poorest countries in the world: a \$55 billion write off of multilateral debt, \$40 billion immediately – debts to the 38 poorest countries that would, under our proposals, be written off; debts to another 28 countries that it is Britain's intention to write off and for which we will continue to seek world wide support' (Brown, 29 June 2005).

³³ The Canadian announcement states that debt relief 'will be immediately open to all 15 countries that have already completed the HIPC Initiative, and those 4 low-income IDA-only non-HIPCs with a World Bank Poverty Reduction Support Credit (PRSC) program. An active PRSC demonstrates the ability of absorbing direct budget support within a robust public expenditure management system ... Going forward, a further 37 countries (22 HIPCs and 15 IDA-only non-HIPCs) may eventually become eligible for the initiative. For the HIPCs, access to additional debt relief will automatically coincide with completion of the HIPC initiative. All other IDA-only non-HIPCs will be granted access to debt relief under the new initiative when they can demonstrate they have sufficiently robust public expenditure management systems, through the adoption of a PRSC program' (Canadian Ministry of Finance, 2 February 2005).

³⁴ Netherlands Ministry of Foreign Affairs, 2005.

³⁵ As at 2 February 2005. Note that Honduras, Rwanda, and Zambia have since reached HIPC Completion Point.

³⁶ IMF, 10 March 2005, page 21.

³⁷ The Lesotho Finance Minister reportedly told Reuters that one reason why his country had not been classified as a HIPC was because it had never defaulted on its debt. 'It is important', he said, 'that those who have paid their

debts well, who run their mega-finances well, should be rewarded with debt forgiveness' (Flood 2005).

³⁸ As noted above, Oxfam considers the current debt-sustainability framework to be inadequate insofar as it fails to define 'debt sustainability' with reference to human-development needs, and in particular the MDGs.

³⁹ The 47 countries eligible for grant financing include 29 HIPC's, plus 18 non-HIPC's 'rated as having a risk of debt distress that is equal to or greater than the HIPC countries' (ibid.).

⁴⁰ IMF, 3 August 2005.

⁴¹ IMF, March 2005, para 19.

⁴² G8 Finance Ministers, June 2005. Text on 'G8 proposals for HIPC debt cancellation', bullet point 5.

⁴³ Caribbean Net News, 13 June 2005.

⁴⁴ G8 Finance Ministers, June 2005. Text on 'G8 proposals for HIPC debt cancellation', first paragraph.

⁴⁵ EURODAD, 14 June 2005, page 5.

⁴⁶ Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

⁴⁷ Bolivia, Guyana, Honduras, and Nicaragua.

⁴⁸ Kar and Watkins, June 2005.

⁴⁹ Caribbean Net News, 13 June 2005.

⁵⁰ Recently, the Controller-General of Nicaragua issued a Communiqué which states that the debt is illegal.

⁵¹ Central Bank of Nicaragua, March 2005.

⁵² Source: IDB web story 'A helping hand'.

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This paper was written by Jonathan Hepburn. Oxfam acknowledges the assistance of Max Lawson, Carlos Galian, Violeta Delgado, Adolfo José Acevedo Vogl, Arabella Fraser, Bernice Romero, Caroline Bastable, Asier Malax, Marta Arias Robles, Marianne Lindner, Emily Alpert, Mohga Kamal Smith, Shalimar Vitan, and Caroline Pearce in its production. It is part of a series of papers written to inform public debate on development and humanitarian policy issues.

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Oxfam International Advocacy Offices:

Washington: 1112 16th St., NW, Ste. 600, Washington, DC 20036, USA

Tel: +1.202.496.1170. E-mail: advocacy@oxfaminternational.org

Brussels: 22 rue de Commerce, 1000 Brussels, Belgium

Tel: +322.502.0391. E-mail: luis.morago@oxfaminternational.org

Geneva: 15 rue des Savoises, 1205 Geneva, Switzerland

Tel: +41.22.321.2371. E-mail: celine.charveriat@oxfaminternational.org

New York: 355 Lexington Avenue, 3rd Floor, New York, NY 10017, USA

Tel: +1.212.687.2091. E-mail: nicola.reindorp@oxfaminternational.org

Tokyo: Oxfam Japan, Maruko-Bldg. 2F, 1-20-6, Higashi-Ueno, Taito-ku, Tokyo 110-0015, Japan

Tel/Fax: +81.3.3834.1556. E-mail: advocacy@oxfaminternational.org

<p>Oxfam America 26 West St. Boston, MA 02111-1206, USA Tel: +1.617.482.1211 E-mail: info@oxfamamerica.org www.oxfamamerica.org</p>	<p>Oxfam Hong Kong 17/fl., China United Centre 28 Marble Road, North Point, Hong Kong Tel: +852.2520.2525 E-mail: info@oxfam.org.hk www.oxfam.org.hk</p>
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<p>Oxfam Solidarité (Belgium) Rue des Quatre Vents 60 1080 Brussels, Belgium Tel: +32.2.501.6700 E-mail: oxfamsol@oxfamsol.be www.oxfamsol.be</p>	<p>Oxfam Ireland <u>Dublin Office</u>, 9 Burgh Quay, Dublin 2 Ireland, Tel: +353.1.672.7662 <u>Belfast Office</u>, 115 North St, Belfast BT1 1ND, UK, Tel: +44.28.9023.0220 E-mail: communications@oxfam.ie www.oxfamireland.org</p>
<p>Oxfam Canada 250 City Centre Ave, Suite 400 Ottawa, Ontario, K1R 6K7, Canada Tel: +1.613.237.5236 E-mail: info@oxfam.ca www.oxfam.ca</p>	<p>Novib Oxfam Netherlands Mauritskade 9, Postbus 30919 2500 GX, The Hague, The Netherlands Tel: +31.70.342.1621 E-mail: info@novib.nl www.novib.nl</p>
<p>Oxfam Germany Greifswalder Str. 33a 10405 Berlin, Germany Tel: +49.30.428.50621 E-mail: info@oxfam.de www.oxfam.de</p>	<p>Oxfam New Zealand PO Box 68357, Auckland 1032 New Zealand Tel: +64.9.355.6500 (Toll-free 0800 400 666) E-mail: oxfam@oxfam.org.nz www.oxfam.org.nz</p>
<p>Oxfam Great Britain Oxfam House, John Smith Drive Cowley, Oxford, OX4 2JY, UK Tel: +44.(0)1865.473727 E-mail: enquiries@oxfam.org.uk www.oxfam.org.uk</p>	<p>Oxfam Québec 2330 rue Notre Dame Ouest, bureau 200 Montréal, Québec, H3J 2Y2, Canada Tel: +1.514.937.1614 E-mail: info@oxfam.qc.ca www.oxfam.qc.ca</p>

Published by Oxfam International September 2005

Published by Oxfam GB for Oxfam International under ISBN 978-1-84814-238-1