

Central America after Hurricane Mitch: Will the Donors Deliver?

Summary of action

During the week of December 7, the international community will hold two meetings of vital importance to the future of Central America. The Paris Club of creditor nations will hold their regular monthly meeting in Paris on December 9; on their agenda will be discussions on debt relief for Central America. The leaders of Nicaragua, Honduras, Guatemala and El Salvador will meet in Washington, DC with international donors on December 10-11, at an Emergency Consultative Group hosted by the Inter-American Development Bank.

Hurricane Mitch has set progress in the region back by at least a decade, with damage estimated at over \$4 billion. The affected countries will not be able to rebuild without a massive infusion of international aid. Just as important as levels of aid is the goal of the reconstruction effort. Participants at this week's meeting are confronted with two choices: restore the status quo of widespread poverty, social inequality, and environmental degradation, or create a new model of development that is socially and environmentally sustainable. Oxfam calls upon donors to meet the challenge by pledging long-term support, through debt cancellation and aid.

Oxfam calls upon meeting participants to lay the foundation for a comprehensive and coordinated approach. These meetings must produce concrete results, including:

- **An immediate moratorium on all bilateral and multilateral debt payments of Honduras and Nicaragua.**
- **Appointment of a Task Force of the World Bank, Inter-American Development Bank, International Monetary Fund and the Paris Club of creditors charged with developing options for debt cancellation and on implementation mechanisms. Report back to an extraordinary meeting of all creditors within three months.**
- **Commitment from regional governments to develop National Reconstruction Plans, and to establish concrete mechanisms for a broad spectrum of civil society to participate in their design and implementation.**
- **Commitment by donor governments and multilateral institutions to provide substantial aid for long-term reconstruction. To the extent possible, assistance should be provided in the form of grants rather than loans.**
- **Review the appropriateness of conditions attached to existing International Monetary Fund programs in light of the extraordinary circumstances faced by Honduras and Nicaragua.**

- **Commitment by donors and regional governments to ensure that reconstruction will promote social equity, poverty alleviation, and environmental sustainability.**

The Human Costs

Prior to Hurricane Mitch, the countries of Central America were already among the poorest nations in the Western Hemisphere. In 1997, 2.6 million Hondurans and 2.1 million Nicaraguans lived below the poverty line. This represented 50% and 47% of the countries' respective populations. In Guatemala, 53% of the population lives on less than \$1 per day.

Flooding, high winds and mudslides in Nicaragua, Honduras, El Salvador and Guatemala have resulted in an estimated 10,000 deaths and over two million have been left homeless.

Surveys by Oxfam International staff in the districts of Choluteca and Valle in Honduras reveal a dire situation. Displaced families are living in rudimentary shelter; food shortages prevail; town and village water systems have been destroyed. Not only have people lost loved ones and homes, but many have lost their only sources of livelihood as well. An estimated 80% of the region's agricultural production has been lost, including food crops as well as valuable export commodities.

Modesta Ordanne, an Oxfam project partner in Choluteca, said, *"...We have lost everything, the school, hospital, police station. The wells are filled with contaminated water and we need a pump to access the clean water that there is. Everything is dead, there's nothing green, it is like the vegetation has been burned."*

Outbreaks of cholera resulting from contamination of food and water have been reported in all four countries, with death tolls rising.

From Emergency Relief to Long-term Reconstruction

The international community – governments, international agencies, and non-governmental organizations from around the world – have collectively responded to the emergency.

Oxfam International members are responding to the humanitarian need through direct relief efforts on the ground and support of local community organisations. Over a million dollars has been allocated already and fund-raising efforts continue. Oxfam's provision of relief goods, staff and programmes will support public health interventions, shelter, and short and long-term food security.

Despite these efforts, demand for shelter, food and clean water continue to go unmet. These needs must be urgently addressed.

While the emergency response must continue, long-term rehabilitation and reconstruction must be the goal. This will require a coordinated approach that combines massive bilateral and multilateral assistance as well as action to ensure that the servicing of foreign debt does not divert resources away from vital social and economic needs.

The development prospects of these countries were poor even before Hurricane Mitch stripped them bare.

In spite of their losses, community-based organizations with which

Oxfam works are looking to the future with hope; from the tragedy they see the potential not merely to restore what was lost, but to lay the foundation for even stronger and more equitable societies.

If the reconstruction program is to be equitable and sustainable, it must make rural development a priority. Reconstruction must not stop at the cities. In Nicaragua, for example, three quarters of the poor live in rural areas. For those that have been displaced by the storm, the goal must not be simply a return to unsafe, crowded, and marginal land only for them to be swept away by the next storm. For the many farmers at risk of losing their land as a result of loan defaults, debt forgiveness by local banks will be necessary. Efforts are needed to protect those small land-owning farmers from displacement and to open access to land and credit to those surviving on unsupportable lands. Environmental degradation, closely related to the poverty of the people, and a major contributing factor in the devastation, must be reversed.

Clearly, achieving sustainable development beyond merely restoring these countries to the pre-Mitch status quo will take far more resources than any of these countries can provide themselves.

The Government of Honduras has made preliminary estimates that recovery efforts may cost more than \$2 billion and take more than 20 years, just to reach the development levels existing prior to Hurricane Mitch.

The debt problem

Even before Hurricane Mitch, Honduras and Nicaragua were struggling under the weight of immense debt burdens (see appendix). Their position will be far worse now.

At the end of April 1998, Nicaragua had a debt of over \$6.1 billion, with the highest per capita debt in the world, at \$1,300 per person. Debt service payments of \$254 million in 1997 took over half of government revenue.

Debt service payments in Nicaragua were two and a half times recurrent expenditure in health and education combined. Yet, over half the population was living below the poverty line and two fifths of poor children were malnourished. Half of these people are unable to even meet their daily food needs.

A similar situation could be found in Honduras. Honduras had a debt stock of \$4.1 billion at the end of 1997. Debt servicing of \$410 million represents a third of government revenue. At the same time, 40% of children below 5 years are malnourished.

Guatemala and El Salvador, whose debts are not as high as Nicaragua or Honduras when compared to exports, also are under the strain of debt payments. According to the World Bank, El Salvador paid approximately \$314 million to service its debt in 1996. Thus, debt relief for these countries would also be an important component of the recovery package.

The Highly Indebted Poor Country Initiative is too little, too late for Central America

Both Nicaragua and Honduras are among the forty-one countries classified as Heavily Indebted Poor Countries (HIPC). The HIPC initiative is a World Bank/IMF framework, covering all categories of debt owed by poor country borrowers. It is intended to reduce debt to sustainable levels.

The HIPC framework was inadequate for Nicaragua and Honduras even before the hurricane. Under the best assumptions, neither Nicaragua nor Honduras would have received multilateral relief through HIPC until some time past the Millennium. Nicaragua was not due to receive debt relief until the end of 2002 and Honduras was not set to receive assistance until at least 2004, if it qualified at all.

One reason for delay is that countries have to comply with up to six years of IMF adjustment programmes before becoming eligible for HIPC relief. Nicaragua will have completed half of these programmes by the end of 1999. Honduras has yet to sign a new agreement with the IMF, which would allow it to enter the framework. Such programmes are unlikely to survive the economic shock of this catastrophe, and would need to be adapted to include human development concerns. Prior to Mitch, the IMF had argued that Honduras might not be eligible for debt relief because its export revenues were high enough to cover debt service. This point was disputed by Oxfam's partner organisations in the country and by the Honduran government. It is clearly irrelevant now.

Responses to the debt crisis by creditors has been insufficient

As soon as the storm hit, calls for emergency action to lift the debt servicing constraints of the region were coming from all corners of the world-- from citizen groups, religious leaders, regional government officials, and victims themselves. Creditors have responded in a variety of ways; some moved immediately to cancel all bilateral debt payments, others offered partial cancellation, some extended two to three year moratoriums on debt servicing (see appendix); others have been silent.

In addition to action on bilateral debt, some governments have called for action to deal with debts owed to multilateral institutions, including the World Bank, IMF, Inter-American Development Bank, and the Central American Bank for Economic Integration (CABEI). Several governments supported the creation of a multilateral debt trust fund into which donors deposit funds to help pay the debt service due to the multilaterals. The British contributed \$16 million to the fund, as has Norway. Sweden is also planning to approve a \$16 million contribution. According to the IMF, France has indicated a willingness to cover Honduran and Nicaraguan debt service to the IMF, amounting to roughly \$7 million in 1999. Denmark has agreed to contribute \$10 million to cover Nicaragua's debt service due to the IDB. Germany and Spain are also said to be considering contributions as well.

While these initiatives are a welcome starting point, they are no substitute for a coordinated and far-sighted approach that is based on a realistic assessment of the debtor countries' ability to pay.

First, although a moratorium does provide temporary relief to countries by suspending payments, this is not equivalent to cancellation. Unless the creditor agrees to absorb the interim payments, than a moratorium simply postpones payment without reducing the debt stock. Given the massive needs, a moratorium is a grossly insufficient response for long-term reconstruction.

Second, a long-term solution must be found to deal with the multilateral debt burden well beyond the current HIPC framework. Debts owed multilateral lenders -- totalling 60% of Honduras's debt and 27% of Nicaragua's -- must also be cancelled.

Finally, unilateral action by some creditors has the effect of letting other creditors – both bilateral and multilateral – shirk their responsibility.

What is needed is a coordinated approach that deals with all types of debt together and addresses the problem from the point of view of the ability of the debtor to pay rather than the willingness of each creditor to postpone or cancel payment. For all of its weaknesses, the HIPC framework does offer a critical benefit: it requires all creditors – both multilateral and bilateral lenders – to act together to reduce the debt to a mutually agreed upon level. It also requires all of the creditors to share the burden. These principles must be applied to debt relief for Nicaragua and Honduras.

The piecemeal nature of the existing proposals points to an urgent need for an extraordinary meeting of all of the creditors of the Central American countries to craft a solution that protects the

governments of the region from choosing between serving the needs of their people or servicing their foreign debt.

Donor Governments' Aid Commitments

In addition to debt relief proposals, donor governments have provided millions of dollars in emergency aid and pledges of assistance in the reconstruction process are also beginning to come in. (See appendix) The Emergency Consultative Group meeting will be the first opportunity for donors to come together to assess the needs and pledge funds. A follow up pledging meeting is being planned for April 1999 in Stockholm, Sweden. In an era of shrinking foreign aid, donor governments will be challenged to mobilize resources for the recovery. It is important for donors to work with governments to develop concrete national development plans that are consistent with the goals of social equity, poverty alleviation and environmental sustainability. Donor must also work with governments to ensure that these plans are developed and carried out with the full participation of a broad spectrum of civil society.

Actions by Multilateral Institutions

The World Bank has redirected \$200 million in existing project lending to the region for recovery needs. As described earlier, the Bank has also established a multilateral trust fund into which donors may contribute in order to help cover multilateral debt service obligations as they come due. The Bank, along with the Fund and the IDB, have agreed to undertake an assessment of the external debt situations of Honduras and Nicaragua. Action by the Bank's board of directors on debt forgiveness is not expected until January 1999.

The International Monetary Fund. After visiting the region in November, the IMF director Michel Camdessus pledged support for highly concessional loans for Nicaragua and Honduras, as well supporting action by bilateral creditors forgiving 80% of the debts owed by these countries (i.e. Lyons terms). However, Camdessus also urged the governments of the region not to be "obsessed by the debt", as it is only part of the problem.

There is considerable concern among non-governmental organizations in the region about how the IMF will respond to the crisis through its Enhanced Structural Adjustment Facility program and whether the macroeconomic conditions placed on the loans will be revised to reflect the new reality.

Under ESAF, countries agree to implement economic reforms in exchange for loans. Recent external and internal reviews of ESAF have observed that almost three-quarters of ESAF agreements are delayed or not completed, mainly due to policy disagreements between the government and the IMF. The reviews noted that for such programs to be implemented consistently, governments must own the programs, and must also be able to build consensus within and beyond official circles.

Before the crisis, the Nicaraguan government publicly released the ESAF “letter of intent” and had promoted a public discussion of ESAF. Even in the best of circumstances, such processes require time and flexibility on the part of the IMF to ensure that policies are appropriate for the country and allow for local input. And, as the ESAF reviews suggested, such programs should pay closer attention to the effects of policies on the poor and vulnerable, and to integrate their needs into the program from the outset. The reforms already undertaken have come at high social costs. Clearly, the circumstances of the countries of Central America, particularly Nicaragua and Honduras, demand significant levels of sensitivity.

Inter American Development Bank has a critical role to play. According to press reports, the IDB recently announced that it has approved \$103 million in disaster relief as part of a total \$230 million Central American loan package it plans to approve before the end of the year. In the longer term, it will be critical for the shareholders of the IDB -- including major donors such as United States as well as Brazil, Mexico, Chile and Argentina -- to provide sufficient levels of concessional lending to Central America. Even before the crisis, concessional resources available for lending were scarce and barely adequate to meet the financing needs of eligible countries. A solution to the resource gap is now all the more urgent.

Conclusion

The levels of devastation could consign these countries to years of poverty and misery, with massive reversals in human development. An unprecedented disaster deserves unprecedented support not just in the months ahead but in the years ahead. The Emergency Consultative Group and Paris Club meetings present the international community with an opportunity to marshal the political will to deliver a package that matches the significant human needs.

Appendix

Summary of Action on Bilateral Debt

Government	Summary of response
Australia	No action to cancel a \$AUD 5.8 million loan it made to Nicaragua for sugar cane harvesting equipment (in spite of pressure from citizens groups)
Brazil	Announced on November 21 a write off of the debts of \$190 million owed by El Salvador and \$118 million by Nicaragua.
Cuba	Cancelled \$50 million in debts owed to it by Nicaragua.
Canada	Announced a moratorium on repayment of debt service and principal on \$29.5 million in official debt owed by Honduras. (Nicaragua has no outstanding debt owed to Canada.)
Denmark	Contribution of \$10 million to multilateral Trust Fund to cover Nicaragua's debt service to the IDB.
France	Announced on November 15 cancellation of its outstanding concessional debts owed by the four Central American countries hardest hit, amounting to US\$133 million. The French government also called for a two to three year moratorium on bilateral debt payments. According to the IMF, France has indicated a willingness to cover Honduran and Nicaraguan debt service to the IMF, amounting to roughly \$7 million in 1999.
Germany	Moratorium on debt repayments by the countries of the region. Greatest affect on Nicaragua which owes Germany \$496 million, and Honduras, which owes \$125 million. Germany has also voiced support for a special meeting of Paris Club creditors and aid that it is ready to cancel all or part of the debt of Honduras and Nicaragua as part of a multinational creditor effort.
Great Britain	\$16 million contribution to multilateral trust fund, call for a moratorium on all official bilateral debt and shortened time-frame for completing debt relief.
The Netherlands	Cancelled \$1.2 million of debt service due from Honduras in 1998. The Dutch has also provided \$10 million worth of debt relief for Nicaragua.
Norway	\$16 million contribution to the multilateral trust fund.
Russia	The Nicaraguan government is planning to send a delegation to Russia next week to seek a four-year extension of service on its debt, which costs the Nicaraguans \$17 million per year.
Spain	Announced a moratorium through the year 2001 on debt payments on from Honduras, Nicaragua, El Salvador and Guatemala, at a cost of \$60 million.
Sweden	Set to approve a \$16 million contribution to the multilateral trust fund.
United States	Announced on November 18 th that it will grant a two year moratorium on U.S. debt payments from Nicaragua and Honduras, worth \$56 million, and called on other donors to do the same.

Appendix

Summary of Actions by Various Bilateral Aid Agencies

Government	Summary of response
Australia	\$AUD 1 million in relief with a focus on medial supplies, health care and water sanitation (as of 12/1/98)
Germany	Pledged a total of \$32.1 million in aid to the region (as 11/10/98)
Great Britain	Provided 1.2 million pounds for relief plus 800,000 pounds through the European Union.
New Zealand	NZ\$150,000 grant to United Nations Office for the Coordination of Humanitarian Affairs response.
Spain.	Pledged \$130 million in grants and concessional loans to the countries in the region. Will also be coordinating European Union response on debt relief and reconstruction
Sweden	Plans to provide \$100-200 million in aid.
United States	Pledged over \$291 million for relief operations and the Clinton Administration is poised to request from Congress \$250 million in emergency supplemental appropriations to cover additional needs. Canada has given \$9.15 million in emergency aid and announced on November 20 that it would provide over \$100 million over the next four years for the region's recovery (as of 11/23/98)

Appendix

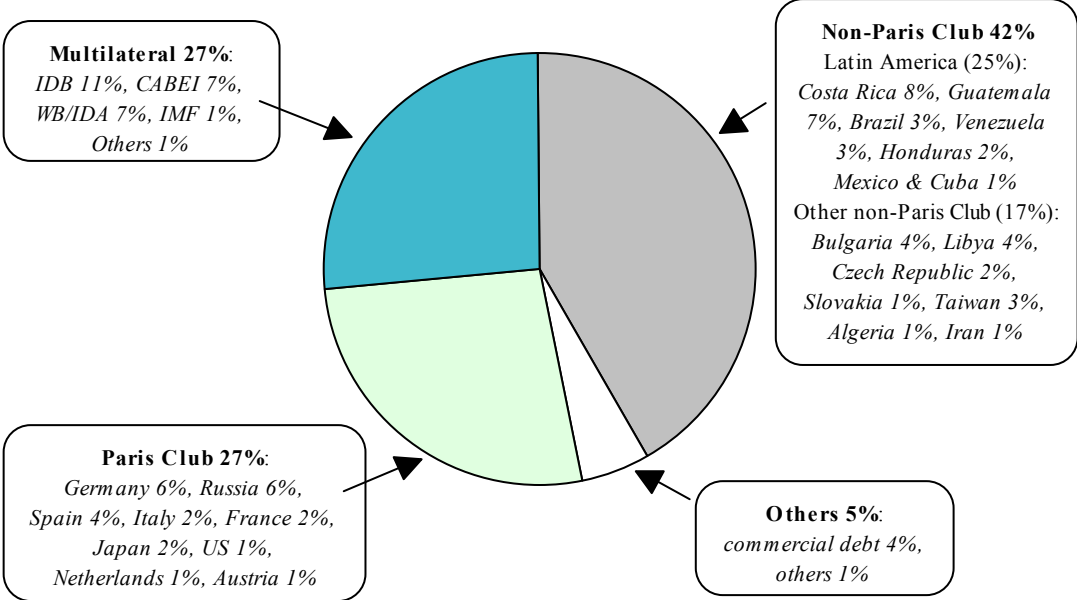
Debt and Poverty Fact sheet

Table 1

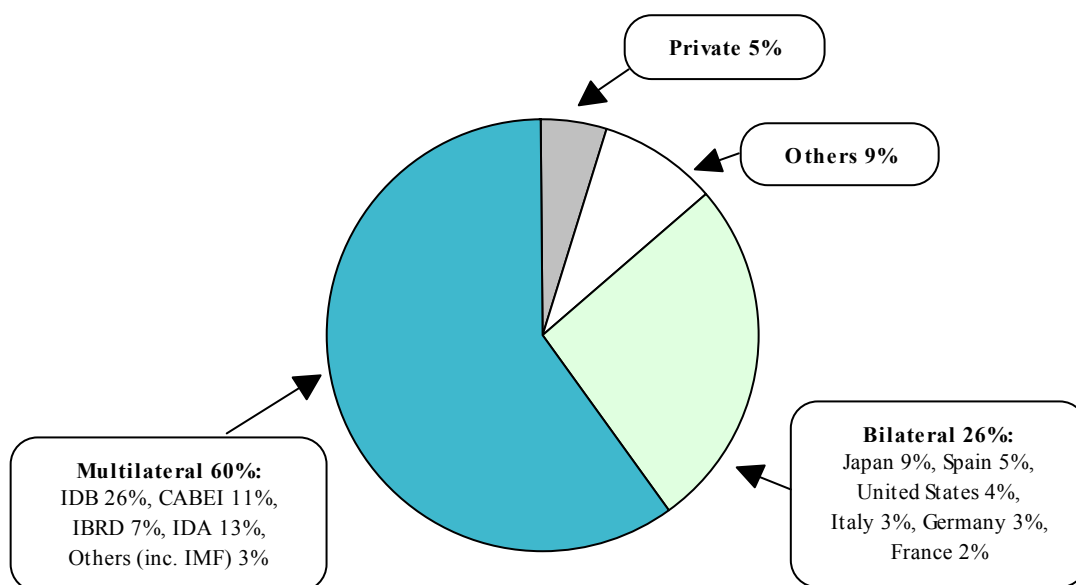
1997	Nicaragua	Honduras
Debt stock	\$6.1 billion	\$4.1 billion
Actual debt service/revenue	52%	30%
Actual debt service/exports	39%	27%
Debt service/health and education spending	250%, two and a half times the amount	140%, almost one and a half times the amount
Population	4.3 million	5.6 million
Population in poverty (before Hurricane Mitch)	2.1 million (50%)	2.6 million (47%)
Population homeless (est.)	500,000	2 million

Appendix

**Nicaragua: April 1998 debt stock
Total US\$ 6.1 billion**



Honduras: 1997 external debt stock
Total US\$ 4.1 billion



Oxfam International is a network of eleven aid agencies that work in 120 countries throughout the developing world: Oxfam America, Oxfam in Belgium, Oxfam Canada, Community Aid Abroad (Australia), Oxfam Hong Kong, Intermon (Spain), Netherlands Organization for International Development Cooperation (NOVIB), Oxfam New Zealand, Oxfam Quebec and Oxfam United Kingdom and Ireland. Please call or write to any of the agencies for further information.

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