

MONTERREY CONSENSUS

EVALUATION AND RECOMMENDATIONS BASED ON THE SITUATION IN LATIN AMERICA

In practice, the application of the Monterrey Consensus still has important gaps to close, commitments to assume and transformations to make in line with the new roles of some international financial organizations and as the changes towards a just financial architecture move forward.

- The criteria for granting financing are still based on the countries' ability to pay rather than the need for concessionary financing and social and developmental needs.
- National strategies formulated by the countries themselves through analysis of debt sustainability do not have the necessary support to be considered a tool that generates co-responsibility and a more complementary relation regarding financing and its destination.
- Debt pardoned did not reach the 100% level and there were long approval and negotiation processes, accompanied by conditions placed that still have an economic and social cost. The impact is to occur gradually over the course of 40 years and debt relief alone does not reduce poverty.
- Financing of debt reduction was not executed with additional resources because the cost of relief for the HIPC countries is less access to concessionary resources.
- Official Development Aid (ODA) resources have been undermined by the provision of debt relief.
- The provision of aid is not sufficiently flexible to consider the achievement of the Millennium Development Goals (MDGs), and furthermore that of the countries' other social and development goals a success. The analysis consists of the sustainability of foreign debt alone and in evaluations based on subjective criteria or strictly financial parameters.

New foreign debt and mainly internal debt is being issued to finance the re-profiling operations but in commercial terms (private creditors). That is, in the cases of the Paris Club, bilateral debt is being "converted" directly into private debt, which in addition reduces the possibilities of reaching accords on debt for development swaps. On the other hand, although the new instruments are at fixed interest rates and in the case of internal debt in national currency, interest rates are quite high given that they are commercial interest rates, above 7% annually. This is leading to a worrying level of growth of internal public debt while it is not clear if it will be sustainable in the future.

Therefore and due to the modalities being followed, we

can say we are dealing with strictly financial operations to alleviate public finances and achieve investment grade but without explicit connection to the needed attention to the internal social debt.

- Information is lacking on the costs of intermediation that is, what the state paid to financial intermediaries who carried out the re-profiling operations.
- The World Bank (WB) and the International Monetary Fund (IMF) no longer have the same role or presence; some low and medium income countries have opted to propose their policies without the intervention of these organizations, pre-paying their debts to eliminate any commitments and declining to sign on to new programs. These changes should be taken into account for channeling resources and aid in benefit of developing countries.
- Innovative mechanisms have not been proposed to deal with the problem of debt; the initiatives are emerging from the developing countries themselves as alternatives to traditional cooperation.
- The attitude of official providers of cooperation to the reform of the international financial architecture has been passive and the asymmetries of the current model deepen inequalities and poverty even further.

RECOMMENDATIONS

- The problem of foreign debt has not been resolved for the entire region; measures are needed for restructuring the debt in a way that changes its composition and alleviates its burden.
- Support a change towards a new financial architecture and international financial mechanisms, giving priority to fair trade.
- Improve the quality of aid with concessionary resources without conditions and with an orientation towards meeting social and developmental goals.
- Create awareness in creditors and debtors for responsible financing that promotes development without negatively affecting the environment.

Priority should be given to substantially reducing the social debt.

States need to achieve transparency regarding the re-profiling operations so that civil society can verify both the economic-financial and social cost/benefit to the country.

- Promote and support the participation of civil society in the countries that receive resources so that social control and transparency exists, that citizens are adequately informed regarding the destination and use of the resources.

- That international cooperation succeeds in reaching a commitment of granting 0.7% of GDP for development, but in addition, that it be distributed in a just and equitable manner to the different regions and countries in the developing world.

- Part of the cooperation that international financial institutions (IFIs) provide should be technical assistance; they should be oriented towards promoting the strengthening of capacities of the countries to improve their debt management and design their own financing strategies.

COMMITMENTS ASSUMED

Among the most relevant points of the consensus signed in 2002 we find:

- Development, multilateral and regional banks should contribute to assuring an adequate volume of financial resources in poor countries that have assumed rational economic policies but do not have sufficient access to capital markets.

- The importance of the formulation of national strategies to supervise and manage external obligations, considering debt sustainability.

- Deepen debt alleviation; take measures of cancellation and others when it is considered necessary.

- The strengthened initiative for debt reduction of heavily indebted poor countries should be to completely finance the debt with additional resources; rapid and effective application is critically important.

- Donor countries should take measures so that resources they provide for debt relief do not undermine ODA resources earmarked for developing countries.

- Flexibility in provision of aid should take into account the degree to which debt relief has an influence in advancing achievement of MDGs, as well as being based on the analysis of debt sustainability.

- The WB and IMF will consider changes that fundamentally favor the sustainability of countries on formulating recommendations on rules and debt alleviation.

- Look for innovative mechanisms to confront the problems of debt of developing countries, including those with medium incomes and countries with economies in transition.

- Support the continuation of the process underway towards a reform of the international financial architecture. These proposals, assumed as commitments by the heads of state are of interest to civil society

because of the repercussions and the situation of indebtedness, poverty and inequality in the countries of Latin America.

The following is an analysis of this situation of the region regarding these points.

1. REDUCTION OF FOREIGN DEBT, IMPACT OF ALLEVIATION

Debt reduction was one of the principal ways foreseen to contribute to poverty reduction and economic sustainability.

Various and significant initiatives of debt relief were taken due to the debt crisis, but the results did not solve the problem of indebtedness because the countries still have not been able to emerge from debt dependency.

The initiatives of relief reduced the balance of foreign debt from levels above US\$5 billion in Honduras and Bolivia to less than US\$2 billion in 2007.

Nevertheless, the relief is gradual, and the effect, in terms of the resources that countries no longer pay, takes place over a 40-year period.

After nearly ten years of the implementation of the Heavily Indebted Poor Countries (HIPC) initiative, it was evident that debt relief alone could not resolve the issue of poverty and debt sustainability. In addition to the internal economic and social policies of each country, fresh resources of foreign aid on concessionary terms were still necessary.

This fact is reflected in debt performance during implementation of the debt relief measures. After HIPC, the countries once again took on more debt, reaching levels higher than those they had initially when being categorized as poor and highly indebted. Now, after G8's Multilateral Debt Relief Initiative (MDRI), the countries are managing and taking on new foreign debt in order to implement their development plans and poverty reduction strategies with the goal of reaching not only the MDGs but also their own social and developmental goals.

The characteristic of this new indebtedness is that new financing becomes more costly, implying higher repayment costs.

The basic element of the high level of debt burden is the negative relation between foreign debt and economic growth. The punctuality with which governments have tried to remain current with their debt servicing has the consequence that they are tardy in servicing the "social debt."

On the other hand, assistance through "debt relief" does not mean they can count on receiving available resources for social spending. They are resources a country stops paying but that in reality they did not have in the first place and if they had not been given the debt alleviation,

they possibly would have incurred in arrears.

In consequence, social spending did not increase very significantly; in the case of Bolivia, it rose from 10.2% of Gross Domestic Product (GDP) in 1998 to 13.3% of GDP in 2006. This performance can be associated with the results of debt relief by having allowed budgetary supports to reduce the deficit in the majority of cases. But it was also due to factors not related directly to debt such as the increase in income from hydrocarbons in Bolivia.

The poverty reduction strategies drawn up as part of programs with international financial institutions were not successfully implemented and monitored; they were even already out of date in some countries that opted for developing other instruments and documents to replace them.

According to CEPAL, some "post-HIPC" –countries like Bolivia- are among the furthest behind in reaching the MDGs, their growth was not sufficient to make progress that corresponds with the number of years passed from the time of the launch of this world commitment.

Debt alleviation has meant that only US\$37 million is earmarked annually for 298 municipalities in Honduras to finance anti-poverty projects; in a similar way in Bolivia each year around US\$ 35 million is transferred to 329 municipalities for use in education, health and productive infrastructure.

In several cases, these resources cover current expenses, such as payment of salaries to teachers and doctors that will not be sustainable in the future when the debt relief ends but that are necessary expenses to cover educational and health needs of the population.

Poverty and inequality have not been significantly reduced in the post-HIPC countries of the region. Even though the projections of CEPAL indicate that some countries will succeed in eliminating extreme poverty by half by 2015, other countries continue to lag behind and the achievement of the goal is conditioned on higher economic growth.

In consequence, the search for and contracting of external loans continues latent even after the MDRI.

Regrettably, one of the main impacts of the debt pardons is the higher cost of new foreign loans and less accessibility to aid on concessionary terms.

2. POOR MEDIUM-INCOME COUNTRIES

According to WB data, there are currently around 94 medium-income countries in the world, of which 60 are developing countries.

There are considerations for medium income, those whose per-capita income is between US\$1,000 and US\$11,000. Honduras's per-capita income exceeds US\$ 2,000 and Bolivia's reaches US\$1,152.

Since averages tend to lead to generalized conclusions, it is also important to analyze the number of inhabitants that in fact belong to this sphere of "medium income," because, according to poverty indicators, at least 64% of the population in Honduras lives on less than US\$730 a year.

In Bolivia's case, a similar proportion (60%) lives on US\$1.6 a day, that is, less than \$US600 a year.

This classification of "medium-income country" used by the WB has an operational and analytical purpose. It is simply the result of taking the GDP and dividing it by the number of inhabitants of each country.

It's clear that this does not consider other factors that affect the level of development of a country and its inhabitants such as distribution of wealth, existence of pockets of poverty, vulnerability to external shocks, including natural disasters, etc.

The problem is that the gap between the rich and the poor does not stop growing and it is not only growing among people but among regions and for this reason there are zones that are more isolated than ever from the rest in terms of "development" and in terms of meeting the MDGs in a country; it is forecast that some regions or cities will reduce extreme poverty by half and others will not.

The isolated classification of "medium-income country" is many times used as negative criteria for access to commercial markets and international cooperation. The qualification as medium-income country justifies "graduation" from official development aid or non-repayable assistance.

If this "title" had been in place in 1998 when Hurricane Mitch hit, it is very likely that Honduras would not have been eligible for the benefits of debt alleviation.

The inequality in Latin America is a factor that still remains latent and that does not allow poverty indicators to improve. The countries furthest behind or at the lowest level of medium-income countries continue to be the poorest.

3. THE DEBT BURDEN

The Monterey accord depended mainly on the commitment to reduce the debt burden of countries denominated "poor and highly indebted."

Although debt service was reduced slightly at the beginning of the HIPC initiative, the impact was not significant, foreign debt began to increase again until it reached levels higher than those registered before the HIPC.

In the case of Bolivia, the lowest level reached was a foreign debt equivalent to 55% of GDP in fiscal year 1998 (at the start of the HIPC), and its highest level was in 2003, when it was equivalent to 64% of GDP (after HIPC). After

the MDRI it has reached 17% of GDP, the lowest level in the last 225 years.

Currently, Bolivia no longer pays US\$ 130 million for the HIPC initiative and added to the G8 initiative, it will stop paying around US\$ 210 million in the coming years.

Nevertheless, it is important to take into account that debt alleviation does not imply the transfer of fresh resources to developing countries; therefore, what it basically makes possible is to generate a lower deficit than it would have had if it had paid the debt.

In this sense, the greatest impact of debt pardons can be observed in debt servicing, since it is registered in terms of capital and interest that will no longer be paid each year.

Currently, foreign debt service in the budget is lower but with a tendency to increase once again, although not in greater proportion to the rise in the balance because new loans have a more expensive profile that represents higher financing costs.

This becomes even more serious if we consider that countries are also resorting to another type of debt: internal debt.

Internal debt also has a cost and in general, it is higher than that of foreign debt; creditors are from the private sector (companies and individuals) of the same developing countries.

If we add the internal debt to the foreign debt in the analysis, Bolivia's total debt was US\$ 5.9 billion in 2007, which represents 45% of GDP.

INTERNAL DEBT

This debt has an ever more evident weight in the countries, although it is not specifically considered by international financial institutions because jurisdictions outside the countries have difficulty gaining access to this information, which in most cases is only partially available or requires different databases and information among government entities needs to be conciliated.

Internal debt has increased in the last 10 years due mainly to the need to cover the fiscal deficit (gaps not covered by foreign debt relief) for specific financing needs, the most important of which are: the crisis of the financial sector, debt relief for producers and stabilization funds (Honduras); the transition of the pension system and monetary policy to control inflation levels (Bolivia); prepayment of debt to multilateral organizations (Argentina, Brazil, Mexico) and to the Paris Club and bondholders (Peru).

In some cases, internal debt has surpassed the level of foreign debt and servicing payments are higher because this debt has higher interest rates and shorter terms.

Internal debt is paid with a country's own resources; therefore at the time of determining its sustainability

using indicators that consider only capacity to pay, it should also be taken into account that available resources should cover payment of external and internal debt.

In this sense, the assertion of debt "sustainability" that countries have achieved is not completely accurate. On the one hand, it is not taking into consideration all the debt and on the other it is insufficient because it does not measure the capacity to cover the social debt with the population.

4. CHARACTERISTICS OF DEVELOPMENT AID

The debt of developing countries is above all with multilateral creditors; after debt relief programs, bilateral financing was reduced considerably.

Official Development Aid (ODA) is received in the Latin American region mainly through multilateral entities that, according to the Monterrey consensus, should complement other sources of financing for development as an instrument of support for education, health, development of public infrastructure, agriculture, rural development and a higher level of food security.

However, ODA has consisted mostly of debt relief for those countries that opted to enter the HIPC initiative, but it has not resulted in additional flows of cooperation resources. On the contrary, a negative transfer of resources is occurring, with countries in the south transferring more than they receive.

In Bolivia, aid on concessionary terms was reduced by 1.5% of GDP after HIPC and by 3.2% after MDRI. This means that Bolivia received less aid on concessionary terms after the HIPC and even less after the MDRI, in terms of percentage of GDP; therefore, there were no additional resources after the programs of debt alleviation.

This situation creates greater pressures on the fiscal sector to handle spending for poverty reduction, in turn generating internal debt.

In general, the increase of ODA resources in Latin America has been lower in comparison with other regions. In the 2002-2006 period, there was a 76% increase of these resources for developing countries, equivalent to US\$38.2 billion. Of this considerable amount, almost 50% was earmarked for Africa, 31% for Asia and 4% for Latin America.

Of this 4%, equivalent to US\$1.88 billion, US\$ 440 million went to 3 of the 4 countries classified earlier as HIPC (Nicaragua, Honduras and Guyana) and US\$420 million went to Haiti. In the same period, countries like Bolivia—also HIPC— as well as Peru, Ecuador and Brazil, received less ODA resources.

This transfer of a smaller amount of resources does not respond to the situation of poverty and inequality in the less developed countries of the region.

Projections on the effective achievements of the MDGs

in Latin America should be analyzed carefully. Progress of some countries in their poverty indicators shows that Brazil, Chile, Ecuador, Mexico and Peru have better possibilities of reaching and surpassing the first goal of the MDGs.

Argentina and Venezuela made important progress as of 2006 and have a better outlook for reaching the goals. Brazil is also in a similar situation and represents an important percentage of the region's population. On the other hand, countries like Bolivia, Honduras, Nicaragua and Paraguay present percentages of progress lower than 50%, and still have to cover important ground considering that 68% of the time has passed for reaching the goal .

These countries require sustained GDP growth above 4% annually to reach the first goal of the MDGs.

Besides regional growth, redistribution of income is important to reduce the high levels of still latent inequality.

In this sense, aid for the poorest countries of the region continues to be important and, with the assignment of fewer resources, official cooperation is not responding to these needs.

The quality of aid is also questionable, because after debt relief programs, external financing is more expensive and its level has been reduced, the placement of conditions for obtaining new loans continues and as a consequence new costly debt representing a greater burden in debt payments is generated.

The aid still does not finance the countries' national development plans and creditors still dictate some priorities in the assignment of resources, conditions that cannot always be applied in a generalized way in all countries.

5. DEBT SUSTAINABILITY

The WB and IMF's new framework of debt sustainability provides a prospective analysis of debt and the policies projected for the future. Nevertheless, it only considers foreign debt and the parameters and criteria of evaluation have a certain subjectivity for measuring the countries' performance, which can cause lower quality resources to be granted.

This framework has a system of risk evaluation that defines the quantity and quality of the aid. The evaluation of the countries' national policies, with the motto that those with better policies have a capacity to manage a higher level of debt, donations are granted to countries with higher levels of risk and costly credits are given to those with less risk.

This criteria of debt sustainability considers only foreign debt and does not take into account that the countries have been generating a higher level of internal debt, which on one hand replaces foreign debt and on the other in some cases resulted from the application of

privatization policies contained in programs with the WB and the IMF.

In our understanding, debt sustainability should be looked at globally, considering external and internal debt. Several countries of the region have carried out this type of exercise with methodologies that allow them to make an exhaustive analysis of the debt, also incorporating the projection of macroeconomic, fiscal and anti-poverty policies. They also take into consideration possible scenarios in accordance with each particular situation.

We think that each country should carry out its own debt sustainability analysis and that technicians of international financial institutions should not be the ones to carry out the studies and approve them for their later application in each country.

Support from cooperating countries should consist of promoting the strengthening of capacities of national teams that periodically draw up their own documents on sustainability and letting each country to define its limits or parameters of indebtedness.

These studies have a relation with responsible indebtedness on the part of countries seeking external financing and also on the part of creditors because they will be financing development plans accompanied by a long-term financial program that shows scenarios of sustainability.

6. SITUATION OF MEDIUM-INCOME COUNTRIES

The large, medium-income countries of the region have also had a reduction of their foreign debt through early payments of their debts with international financial institutions.

In the same way as the least fortunate countries of the region, they seek a higher level of integration and mechanisms of alternative financing, such as the conformation of Banco del Sur.

These initiatives arose in response to faults in the system, the placing of conditions and the inequitable relationship that exists in the international organizations where the power of participation and decision of developing countries is minor.

The most advanced countries of the region also present increases in public debt, high levels of poverty in demographic terms and high levels of inequality.

Latin America needs assistance not only through debt relief but also through cooperation and effective aid to drive forward sustainable development with just external conditions that permit growth and elimination of poverty and inequality.

In recent years, Peru has witnessed the execution of a series of operations of re-profiling of the foreign debt, consisting basically of pre-payments of Paris Club debt

and operations of purchase and re-purchase of bonds. These four operations, carried out from 2005 to 2007, were financed by issuing internal and external bonds. That is, like in many other countries, external debt was swapped for internal debt.

In the last three years, the stock of public foreign debt in Peru fell from US\$ 22.28 billion to US\$ 20.08 billion, while internal debt rose from US\$ 5.85 billion to US\$ 9.29 billion. And it is expected that this tendency will continue in the coming years. explained mainly by the increase in the stock of public treasury bonds.

Nevertheless, these operations have not only “re-profiled” the country’s foreign and internal debt, but also according to calculations drawn up by Red Jubileo Peru in the document Operaciones de Reperfilamiento de la Deuda Externa Pública en el Perú y la Deuda Social, these have been costly for Peru.

According to the document, the four operations have cost the country US\$ 658,7 million . The analysis makes a comparison between debt service projected before and after each operation, taking into account the interest rates and periods of repayment agreed. Bringing up to date these future flows produces a negative Current Net Asset Value (-658,7 million), that is, the re-profiling is not profitable for the country.

7. INTERNATIONAL FAIR TRADE

Among the measures that should accompany debt alleviation is the implementation of rules for fairer trade to help developing countries.

The measures of protection and subsidy adopted by the most developed countries– which distort prices and the international market- convert “free” trade agreements into one more way these countries benefit from the asymmetries of international

Although the international accords make an increase in exports of products of some developing countries possible, the increase in imports is of a greater magnitude, generating a deficit in the balance of payments that rises all the time. Although the flow of goods increases on both sides, development is not for everyone, especially for the poorest countries,

One of the clearest cases is that of Honduras, whose exports under the Central American Free Trade Agreement (CAFTA) rose 25% in the last two years but imports increased by 50%. Nearly 50% of Honduras’ imports come from the United States.

In this case, the deficit generated in the balance of payments is compensated with remittances. Nevertheless, these remittances fell because of the deportation of Honduran citizens from the United States.

In this regard, it is important to strengthen investment in domestic production of developing countries and counteract this economic dependency. But it is also crucial that fairer trade relations be negotiated with accords that truly promote development.

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