



# When debt isn't so bad

By Michel Camdessus  
and Jean-Michel Severino

**P**ARIS Since the end of the 1980s, a vast movement championed by many countries and organizations has arisen in favor of canceling developing countries' debts. After several waves of bilateral cancellations, international institutions went to the forefront. The Highly Indebted Poor Countries Initiative has already made it possible to reduce two-thirds of the net present value of the foreign debt of 28 poor countries.

Last year, the international community went even further, canceling 100 percent of the debts of these same countries as owed to the World Bank, the International Monetary Fund and the African Development Bank.

Such moves are to be welcomed, but to see all debt as bad is to go overboard. A crusade of good intentions is threatening loans to the developing world.

This movement rallies together, under the same banner, extreme globalization opponents and neoconservatives, notably American. Some of them suggest turning the World Bank into a kind of foundation that does nothing more than distribute grants. They support their argument by pointing to the fact that the emerging countries now have broader access to financial markets.

But we should be very careful before doing away with loans completely. Loans now represent less than 15 percent of international aid, an amount that has continually decreased over the last 20 years. The question is whether it would be useful and productive to reduce even further the use of this instrument. The answer is no.

Economic history shows that borrowing is an essential element in the process of healthy development. Doing away with it would be tantamount to condemning the poorest countries to stagnation and dependence. Over-indebtedness must be avoided, but healthy projects must be given the opportunity to survive thanks to credit.

International financial institutions, which must continue to be reformed, can perform this function. Their loan instruments, used in conjunction with grants, provide advantages that cannot be obtained from using grants alone.

It would be erroneous to believe

that foreign grants would be enough to meet the major financial needs of the poorest countries. Well-adjusted loans will always have an important function here.

A commitment by a recognized lender is also a sign of trust that makes it easier to mobilize other external sources. Labeling some countries as incapable of taking on loans, reducing them to the status of an "assisted country," serves only to make market integration more difficult for them.

Even for emerging countries that already have some access to private capital, keeping international public loans is important. This is reflected in the fact that many high-growth countries continue to use bilateral and multilateral loans for investment projects; public capital is used for the riskiest and least profitable part of the investment, thus acting as a lever on private funds.

**A**id agencies should learn from past crises and develop instruments to avoid future ones; lending is a crucial part of this. Providing loans in local currency is one way to protect poor countries from currency risks and absorption, through debt servicing, of the rare hard currency they are able to obtain.

Public loans must also be adapted to deal with the risk of insolvency. Mechanisms must be developed that will help dealing with shocks over exchange rates, prices of raw material or natural catastrophes. Reimbursement timetables could automatically adapt to the fluctuating capacities of borrowers over the life of the loan.

The contribution to development of such loans could well be much higher than that of simple grants.

Aid agencies have a major role in providing financial products adapted to developing countries. If these instruments prove their efficiency, the markets will adopt them eventually.

The diversity of aid instruments must be preserved. At the spring meetings of the International Monetary Fund and the World Bank, to be held in Washington this weekend, let us hope that this message is heard.

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*Michel Camdessus is a former director general of the International Monetary Fund. Jean-Michel Severino is director general of France's international development agency.*