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## **Economic and Theological Approaches to Debt Cancellation**

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### **Abstract**

Differences in economic and theological approaches to debt cancellation result from differences in disciplinary assumptions in respect of purpose, method, and argument. We argue that they provide alternative commentaries upon the need for debt cancellation, but that it is not possible to demonstrate the superiority of one over the other, so practitioners in one are likely to continue to find it difficult to respond meaningfully to arguments from the other.

Keywords: debt cancellation, conditionality, theology

JEL classification: O19, F34, F35

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## 1 Introduction

In writing on the structure of scientific revolutions, Kuhn (1970) introduces the notion of a paradigm or a disciplinary matrix. While he uses these terms very loosely, so that their meaning (and value) remains vague, they have entered into common use as a way of locating social and cultural aspects of scientific research. Kuhn developed the notion of a paradigm to argue that scientific knowledge progresses by a process of punctuated evolution, in which periods of stability (or normal science) are interrupted by periods of revolution in which new paradigms develop and replace existing ones. We might compare this with the similarly fashionable idea of the meme, suggested by Dawkins (1976) as a carrier of social information. A disciplinary matrix would then be a set of memes capable of self-replication through the teaching and practice of a scientific discipline.

Kuhn argues that distinct paradigms are incommensurable, so that scientists will tend strongly to accept one and reject all others. In this regard Weinberg (1998) suggests that Kuhn was particularly heavily influenced by his work on Aristotelian physics, which as a system is very different from the Newtonian system. The two systems have very different purposes, very different modes of enquiries, apply different forms of reasoning and admit different forms of evidence. The unity and integrity of the Aristotelian system may disintegrate in the face of questioning motivated by a Newtonian understanding of physics, but it remains stable within its own domain.

### 1.1 The theological accommodation of commercial activity

The recollection of Aristotle at this point is wholly intentional. The campaign for debt cancellation was coordinated by an organization called Jubilee 2000. The initial call came largely from people within the churches, looking back to the Levitical code, in which the fiftieth and final year of a cycle was marked by the cancellation of all outstanding debts. Motivated by theological understandings of economic activity, they approach the problem of debt cancellation in a way that is entirely foreign to anyone steeped in the principles of neoclassical economics. In this theological tradition of thinking about economic activity, exchange is not only a social activity, but also possesses moral dimensions, often accompanied by the creation of mutual obligations. Such ways of thinking about exchange relations are of course prevalent in other disciplines. Sociologists such as Mauss (1954) argue that exchange in many cultures involves a sense of mutual obligation, so that conventional economic analysis is not necessarily the best way to analyse exchange relations.<sup>1</sup>

When we turn to Christian teaching on economic matters, we may note the argument of Viner (1977) that at least in the period since Christianity became the official

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<sup>1</sup> In the development of classical thought, Vivenza (1997) examines the evolution of the notion of benevolence in the Greek concept of *euergesia*, originally the 'beneficence' of the provision of corn to a city. Such a benefactor would be granted recognition for his service to the *polis* through the gratitude of the populace, as well as through payment. Aristotle extended the scope of this concept considerably, arguing that a man who is either rich or of high status should exercise *euergesia* through friendship with poorer or socially inferior friends. The calculation here was not simply utilitarian in nature. Beneficent action would be prompted by benevolent feeling for the other party, with a relationship of mutual dependence subsisting between the two parties. Roman authors such as Cicero similarly emphasized the nature of benevolence within the patron-client relation.

religion of the Roman empire, it has gradually accommodated itself to an increasingly wide range of commercial practices. For example, Augustine, on the authority of one (mistranslated) verse of Psalm 71, argued that the divine law forbade Christians from participating in trade that is, the practice of buying a good at one price and selling it at another. He also followed the prohibition on usury very precisely. Perlman (1997) suggests that Aquinas, relying upon Aristotelian reasoning, limited the prohibition, specifying three ways of charging effectively for the use of money.<sup>2</sup> Again, following Viner, we may note a further relaxation, with the prohibition of usury being abandoned in Catholic manuals of casuistics by the middle of the seventeenth century, with neither Jansenists nor Jesuits believing that it could be sustained.

In saying that the church has found it necessary to accommodate a range of business practices, we should also note that the church's teaching evolves, so that while there may be substantial adaptation of the teaching of earlier generations, there is also a considerable degree of continuity and appeal to earlier, particularly Scriptural, authority in all arguments. There may now be toleration of lending at interest, but the deepest currents in church doctrine tend to be Augustinian or Thomist in nature with, on occasion, more than a nodding recognition of Marx (or less frequently Smith). As a result, it is possible for a theologian to adopt the analysis of the role of money in society developed by, for example, Aristotle and Aquinas. To an economist trained in the methods of the neo-classical paradigm, such as Viner, such arguments are simply meaningless, depending as they do upon a distinction between natural wealth and created objects in the form of coinage.<sup>3</sup>

Thus we see between the forms of argument used within economics and theology something of the degree of incommensurability to which Kuhn pointed. A physical scientist such as Weinberg (1998) might be able to dismiss Kuhn's arguments as 'wormwood' because of their denial that science proceeds towards an objective truth. But economists perhaps do not have quite the same grounds to claim that the regularities that they observe are independent of their conceptions of social structures. Christian theologians tend to subordinate economic relations to both the social and the created order. They, therefore, question the implicit instrumentalist assumption of much economics that growth is necessarily associated with increased well-being.

## 2 Debt contracts as moral obligations

A party entering into a debt contract agrees that repayments of principal (and interest) should follow a specified schedule. The word debt, derived from the Latin verb *debere* which we might translate either as 'to have to' or 'to be obliged to' suggests that these repayments are an obligation on the part of the borrower. It is consistent with this moral perspective on the nature of loan contracts that the name given to the lender, 'creditor', is derived from the verb *credere* meaning either 'to believe', or

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<sup>2</sup> Insurance against loss, payment for loss of opportunity to gain, compensation for consumption foregone.

<sup>3</sup> Aristotelian analysis does not seem to admit even the possibility of the creation of fiat money, and there is a theological current that is critical of fractional reserve banking purely, it seems because the money stock has debt, rather than tangible assets, as a counterpart.

perhaps more appropriately ‘to entrust.’ For these reasons, it is often argued that breaching the trust implicit in a loan contract should lead to the imposition of severe sanctions. In German law, for example, writing a cheque on an account that lacks the funds to meet it entitles the payee of the cheque to sue for sequestration of the drawer’s assets. Similarly, we tend to talk about a creditor who has chosen not to pursue a right to repayment as ‘forgiving’ the debt.

A term with slightly less moral force is more usually used in the context of the HIPC Initiative, which refers to ‘debt relief.’ This is used by authors such as Sachs *et al.* (1999), Easterly (1999) and Allen and Weinhold (2000). Yet members of the Jubilee 2000 Coalition have argued that even ‘relief’ has moral connotations inappropriate to the situation facing many countries. They find it condescending to suggest that rich countries should claim to be lifting a burden from the shoulders of poor ones that could not otherwise be shifted. Campaigners prefer the term ‘debt cancellation’, which we use throughout this paper to emphasize that the proposed action is simply the variation of terms of a contract.

## **2.1 Usury: the obligations of the lender**

The Christian tradition of opposition to the taking of interest on loans, relies, as noted above, both upon Scriptural injunctions such as Exodus 22: 25, Leviticus 25: 35-37 and Deuteronomy 23: 19-20, and also upon the Aristotelian argument that lending at interest involves the increase of money from money. Since money is artificial, and created by man, such an increase is against nature.

This Aristotelian objection is very easy to counter in terms of modern economic theory, relying as it does upon a confusion of the concepts of money and wealth. People choose to hold a part of their wealth in the form of money because in that way they are able to obtain liquidity services that other forms of wealth do not permit. Lending, therefore, constitutes a transfer of wealth or resources, not simply a transfer of money. Define one object of economic activity as being the creation of new resources, or more generally value, from existing resources.<sup>4</sup> For example, a country borrows money to fund a programme that will provide villages with secure supplies of clean water. The value created comes principally through the reduction in disease, which permits the generation of wealth through various channels as well as raising what might be called social capital.

We consider that this increase in resources resulting from the use of other resources can also be used to justify the payment of interest, and to make a distinction between a fair reward for willingness to supply the resources necessary to the completion of a project, and lending that is usurious. Note that the injunction against usury in Exodus appears in the context of Israel being identified as a chosen, holy, separate people, while in Leviticus it is associated with a reminder of the experience of slavery in Egypt. Reminders that the Israelites’ wealth is the result of God’s undeserved favour (and a sign of their being chosen by God as a people) appear frequently in the Law, as

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<sup>4</sup> In a separate paper, Mochrie (2001), I have examined this question at rather greater length in the context of a critical reading of Shakespeare’s *The Merchant of Venice*, considering in particular why Antonio, a trader, is considered virtuous, while Shylock, a necessary adjunct to his trade, is not.

a commentary on injunctions to use that wealth appropriately. Thus in the year of Jubilee, land was to be returned to families (Leviticus 25). The edges of fields were not be gleaned, so that the poor might take something for themselves (Deuteronomy 24). The security taken for a loan should not be excessive (Deuteronomy 24). And where an Israelite has had to enter into debt slavery, because of inability to pay off debts, this should be limited in time, and the slave treated well when he is released (Deuteronomy 15). Wealth was not to be used to oppress, but to liberate the oppressed, for otherwise it would be lost over time.

Perlman (1997), writing within a Jewish context, argues that these prescriptions were at the level of tort, designed to prevent the fraying of fellowship within society. Northcott (1996), applying them to a rather more modern context, relates them to the fragility of the land itself. Unless it was nurtured carefully, its fertility would soon be exhausted, and these rules were attempts to remind people of the need for restraint.

These rather different analyses need not be in conflict. In the context of a largely agrarian society, the prohibition of usury can be understood in terms of the limited opportunities to increase social wealth through commercial activity. Monetization and market-oriented economic activity would have been at very low levels, with most people relying upon their own land to subsist. Wealth and well-being were associated particularly with access to land, and this identification of the people with the land appears in many places throughout the history of Israel.<sup>5</sup> We can understand this relation in terms of the covenant relation between God and Israel being expressed through the granting of possession of the land, with an inheritance being given to each family. Alternatively, we can understand it as a pragmatic response to the wealth of the community being held principally through land, and a set of rules to try to ensure stability.

Extending the theological commentary, we note that some commentators argue that Deuteronomy was written some time after Leviticus. Goringe (1994) uses this to explain the quite different treatments of Sabbath year regulations in Leviticus 25 and Deuteronomy 15. Whereas the earlier rules were expressed in terms of land pledged as the security for an obligation, the later ones seem to relate to people who did not possess land and whose main asset was their labour. There is also a distinction made between the redemption rules for land and those for buildings in a town. These suggest an awareness that in order to enjoy full human dignity, people need the degree of autonomy that comes from having a minimum level of wealth. Freedom entails command of sufficient resources to subsist and to be able to be accepted as a full member of the community, if not to live in luxury.

In these conditions of limited market based activity, suppose that a farmer's crop fails and that he approaches a neighbour to borrow grain to enable him to sow again, but that the neighbour, taking advantage of the desperate need of the first farmer, agrees on condition that he will receive a large proportion of the subsequent crop as a repayment. Such a loan is not being made so that a project is undertaken that will benefit society. Rather, it is essentially exploitation of someone facing temporary difficulties. This is the sort of behaviour that the Law condemns. Theologians who

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<sup>5</sup> For example, the daughters of Zelophedad in Numbers 35, Boaz in Ruth 4, Ahab and Naboth in 1 Kings 21, and the purchase of the field at Anathoth in Jeremiah 32.

have written on the need for debt cancellation identify elements of such exploitation of need in the lending relationships between rich and poor countries.

## **2.2 Theological perspectives on sovereign indebtedness**

This theological call for debt cancellation begins from the proposition that property rights are contingent, and dependent upon their being used appropriately in order to be legitimate. It also points to the use of language that treats debtors as being responsible for their own conditions as a source of difficulty. Most importantly, it tries to remind economists that beneath the formality of economic theory and analysis, there is great human suffering.

In a quite remarkable, rigorous questioning of the role of economic theory in public policy, Jenkins (2000) has argued that the concept of ‘the market’ has been idolized in that economists possess a blind faith in the beneficence of its working. Seeking to question the functioning of the market has become the equivalent of heresy, permitting the exclusion of all who do so from the debate on policy. This is a very strong claim. The objection is perhaps more that the language and values of economics are privileged in this debate, and that only those who are willing to adopt these can participate fully in it.

Jenkins alleges that this alleged idolatry can be seen in the elevation of the observation of the terms of debt contracts to a sacred duty. Peters (1996) notes that certain officials of the multilateral financial institutions argued that their articles of association prevented their remitting debts. It is curious that none of the critics has pointed to the extent to which those holding conservative political beliefs frequently argue that any deviation from the rule of law as it is currently constituted would have disastrous, if not truly apocalyptic, consequences.<sup>6</sup>

In part, that might be a result of the more robust theological critics, such as Duchrow (1994), Gorringer (1994), Selby (1997) and Northcott (1999), simply sidestepping debate and preferring to engage in self-described prophetic witness. Proclaiming that the blood of the poor cries out against the manifest injustices of the system that continues to enslave them, Duchrow and Gorringer construct a reading of the Old Testament that emphasizes the degree of solidarity of the writers with the poor and oppressed, arguing for the construction of very different kinds of economic relations, for which they are able to offer only preliminary sketches.

Selby questions the use of language surrounding indebtedness, arguing that we encourage both individuals and nations to ‘take credit’ and think the same way about our borrowing when we are in control of the situation, but prefer to talk about ‘falling into debt’, when borrowing becomes unmanageable. Selby argues that such language carries with it a presumption of negligence and culpability, allowing those of us who are more fortunate to exclude troubled debtors and require them to atone. In that context, Northcott (1999) is particularly interesting as he offers a counter-history of

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<sup>6</sup> Such arguments are used by Easterly (1999), Allen and Weinholt (2000) and Menzies (2000) as being the potentially undesirable result of overly rapid debt cancellation. These authors suggest the need for conditionality and commitment technology to ensure that debt cancellation is a unique event, capable of achieving the objective of restoring countries to sustainable growth.

the debt crisis that is grounded both in Biblical prophecy and in the witness of those suffering the oppression of living in poor, deeply indebted countries at the present time. This is a particularly interesting approach, and while it is not written with an academic audience in mind, it is compelling in its immediacy.

The distinction made already between usury and the hiring out of productive capital at reasonable cost may help to clarify the matter. The problems of HIPC countries are so severe, and the wealth of developed countries so great that insistence upon repayment at least risks being seen as usurious. For such reasons, there has been virtually global agreement that something like a HIPC Initiative is necessary.<sup>7</sup> Recall that the total indebtedness of all low- and middle-income countries is approximately 12 per cent of OECD income. OECD countries have the capacity to make transfers that are very large relative to the size of recipient economies. Economists have provided some very good arguments suggesting that this should occur. But they are also well aware of the need to regulate such flows in order to ensure that they are used for the purposes for which they are intended.

### **3 Debt cancellation as a component of development assistance**

We argue that it is sensible to treat debt cancellation as simply one element in a process of development assistance, adducing a number of reasons to suppose that it will be a very efficient use of resources. We consider that it is necessary to restrict the granting of assistance to those cases in which governments are able to use the resources released effectively, noting the possibility that premature release of resources may enable governments that are not committed to maintaining the process of reform necessary to foster economic growth to delay acting in the interests of their populations. In terms already introduced, we could argue that we wish to promote *euergetic* or beneficent relations between both rich and poor nations and between rulers and the populace of poor countries.

#### **3.1 The need for reform of development assistance**

Within economic analysis, the problem of severe indebtedness has frequently been analysed as one of debt overhang, as developed in the models of Krugman (1988) and Sachs (1989). In this approach, the costs of servicing debts contracted in the past are so high that potential lenders are unwilling to make further advances because of the risk of default. Sachs *et al.* (1999) has addressed the specific problems of the HIPC countries within this framework. We shall discuss at length below some of the limitations of this model as an analytical base in this context.

Considering the slightly more general problem of making the most effective use of development assistance, much debate has taken place on the problem asserted in the title of Collier (1997), 'The Failure of Conditionality'. At present, programme lending

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<sup>7</sup> It is perhaps important in this context to recognize that the HIPC Initiative was developed by the multilateral financial institutions in the mid-1990s prior to the launching of the global campaign for debt cancellation. The debate is not over the need for debt cancellation, but rather over its political modalities.



is generally based upon a complex web of conditions, particularly where lending is intended to facilitate economic adjustment. Killick (1995, 1997) argues that conditions tend to agglomerate over time so that they become increasingly invasive and pervasive, reducing the autonomy of debtor states.

Both the nature and the form of conditionality appear to be problematic. Kanbur (2000) identifies a number of routes in which extreme dependence upon external assistance conditional upon the adoption of particular policies leads to aid dependence, to the detriment of good governance. For example, debtor states tend to have to account to a quite remarkable number of external agencies, each of which is helping to fund projects or programmes. There is very little co-ordination among donors and creditors, so the debtor must deal with each one separately. Such arrangements impose a very heavy burden on the limited resources of poor states and represent an important distortion of their political economy.

Collier argues forcefully that all of this effort in making development assistance dependent upon conditions has failed. There is now a body of work suggesting that the effectiveness of aid in supporting development depends upon the quality of the policy environment within the debtor state, with aid tending to be used to achieve economic and social objectives effectively where the policy environment is good, as defined by the index of quality due to Collier and Dollar (1999). They find that the pattern of development assistance does not reflect the ability of countries to apply it effectively. This would not matter if high levels of aid, whether or not accompanied by the extensive conditionality currently used, tended to support policy improvement. However, there is no evidence of this happening. Indeed, as Collier and Gunning (1999) emphasize, while development assistance does tend to increase with the quality of the policy environment to some extent, across the range of environments that tend to be most supportive of development, it tends to taper out.<sup>8</sup>

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<sup>8</sup> A number of explanations for the divergences from the 'optimal aid distribution' of Collier and Dollar (1998, 2001). Rodrik (1999) argues that poor economic performance is often associated with social conflict. Expanding upon the model of Alesina and Drazen (1991), he attempts to explain delay in policy reform, which is proximately costly but ultimately beneficial. Donors might believe that in continuing to support governments whose policies are weak they prevent social conflict escalating. Certainly, many of the countries receiving the highest levels of development assistance tend to be recovering from civil war, a time in which Collier and Hoeffler (2000) found that there is a grave risk of social fragmentation.

On the other hand, Alesina and Dollar (2000) examines the pattern of development assistance from the point of the donors, and has found that the large donors—the UK, the USA, France and Japan—tend to use it to support their own strategic objectives. Thus the USA makes huge payments to countries in the Middle East, France and the UK support former colonies, and Japan supports countries that are allied with it in its international objectives, such as the campaign to rehabilitate its whaling industry. Among these countries, only the UK discriminates in favour of democracies (and even then quite weakly) and countries that have effective policies. Other donors, particularly the more generous donors seem to be rather more discriminating, ensuring that their aid flows to those countries where it is likely to be used effectively. Collier (1997) considers cause and effect in this matter: whether it is that more efficient use of development assistance makes it easier to establish the sort of coalition necessary to obtain the substantial increases that development economists wish to see; or that having a large development assistance budget leads to more effective oversight on the part of donor governments.

This failure of conditionality in the form that it has developed in the last fifteen years appears to result from lenders and donors experiencing the Samaritan's dilemma.<sup>9</sup> Suppose that a donor wishes to attain an outcome in which the domestic government is uninterested. The classic example of this is the mixture of economic and political reform that the international community has allegedly been sponsoring in Kenya. It is well known that when international agencies sought to restrain what they considered to be President Moi's unsustainable economic policy in the mid 1990s, he responded by threatening to reverse political reforms. Following Collier (1997), we may well want to question just who was supposed to be benefiting from such reforms.

We might also note that in behaving in this way, Kenya is nothing if not strategically astute. On no less than five occasions, it has managed to secure funding for more or less the same package of agricultural reforms. Either these have not been implemented, or else, once implemented they have been reversed at the end of the programme and the monitoring period. The problem is that donors wish reforms to take place and so make access to funding conditional upon implementation. But reforms only become irreversible if the political class of the countries concerned wishes to sustain them.

There is of course a large literature in political economy about the design of social structures and institutions that sustain and promote continued reform and economic and social development. The papers in Collier and Patillo (2000) examine a number of mechanisms for making commitment to reform both credible and more permanent. They indicate the scale of the challenge involved in ensuring that institutional structures in poor countries are reformed so that they can fully benefit the people of the country. However, having noted the existence of this literature, I shall not comment further upon it here.

The counterpart of strategic behaviour by debtors is the willingness of creditors to accommodate payment indiscipline. Kanbur (2000) argues, based on his experience as the World Bank's representative in Ghana during the transition from military rule to democracy, that the institution's apparent strength in being the major creditor of these countries tends very quickly to be undermined.

As part of the transition, the outgoing regime agreed to a large increase in the salaries of civil servants, which was not part of the programme agreed with the World Bank. Kanbur therefore suspended the programme pending further negotiations. Immediately, he came under pressure to sign a waiver that would permit the restoration of the programme. Interestingly, this pressure came not only from the Ghanaian government and NGOs, but also from foreign-owned private companies, many of which would not be able to obtain further credit for their operations unless the World Bank programme was resumed. These were soon followed by the development assistance departments of a number of donor countries, of which one of the largest was the most vociferous for the interesting reason that the suspension occurred close to a financial yearend and funds committed but not spent would be lost permanently without resumption of the programme. Lastly, World Bank project lending (to specific sectors of the economy) was also suspended, so that pressure for resumption was also exerted from within the Bank's executive board.

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<sup>9</sup> For relevant applications, see Coate (1995).

The necessary waiver was soon agreed with the World Bank accepting the decision of the Ghanaian government. Note that even countries such as Ghana and Uganda, whose policy stance is generally considered to be appropriate, have to obtain waivers permitting deviation from the terms of agreed adjustment loans very frequently, though rarely are these to cover situations severe enough to merit suspension of the programme. Killick (1997) reports that waivers tend to be granted eventually in almost all cases. In other words, no matter the nature of the agreement between the World Bank and the debtor state, where the country is unable to meet the terms agreed, they will be varied to permit the discharge of funds. One result of this is that while only 65 per cent of projects remain on track during their lifetime, over 98 per cent of funding is released. However, Sachs *et al.* (1999) argue that it is inappropriate simply to look at totals in this way. As in the case of Ghana, delay in releasing funds can distort the economy severely. Planning in a situation where cash flow is uncertain becomes almost impossible. Where policy is weak and delays in making funds available are frequent, disruption can be very severe.

This commentary suggests that the ineffectiveness of the policy of the multilateral financial institutions *vis-à-vis* the HIPC is a result of their inability to enforce discipline on countries with poor policy. This problem is exacerbated, if Devarajan *et al.* (1999) are correct, by the extent of fungibility of aid in Africa. They suggest that with the exception of support for large infrastructure projects, such as road building, aid is almost entirely fungible, so that the inflow of funds is effectively reallocated across elements of the budget. This is important, for it means that governments use aid to increase their total resources, rather than reducing domestic taxation, as has been suggested by some earlier authors. But it also follows that governments will allocate their total expenditure according to their priorities. So project lending to a priority area for donors—such as education—may permit the financing of an increased defence budget. This suggests a further channel by which conditionality can be undermined: the simple relaxation of the government's budget constraint permits it greater freedom to allocate resources.

### **3.2 The use of development assistance**

In pure accounting terms, debt cancellation under the HIPC Initiative is really a form of development assistance. Creditors agree that they will maintain current levels of aid after the debt reduction agreed under the Initiative. So inflows to debtors should not change, while outflows are reduced, increasing the resources available to the country. It seems that this would be a very useful form because of the extent to which debtor indiscipline is associated with invasive and crude oversight of the debtors' economies, reducing their autonomy. Debt cancellation seems likely to be useful in the context of an increase in resource transfers, and debtor states would probably wish it to be offered. Important and valuable as it is, it should only be seen as one part of a much wider process.

Accepting this logic, in papers such as Kanbur (2000), Meltzer *et al.* (2000), and Sachs *et al.* (1999), economists have proposed debt cancellation programmes going some way beyond current proposals. However, it would be too simple to claim that there is a consensus among economists on the process of debt cancellation. Easterly (1999) is the pained response of one of the World Bank's most thoughtful economists to the extension of funding of the original HIPC Initiative in June 1999. He argues

that debtor states continuing to fund government programmes through borrowing demonstrate a very high rate of inter-temporal substitution. Such governments would be likely to borrow excessively to fund current consumption, and fail to pay sufficient attention to the costs of adjusting future consumption when debt repayments fall due. Slackening such a government's inter-temporal budget constraint through debt cancellation would lead to further borrowing, and further demands for debt cancellation. This argument emphasizes the similarities between debt cancellation and other forms of development assistance. Where it is made available in unreformed environments, it will not be used effectively.

Collier and Dollar (2000) refine their measure of the optimal distribution of aid. They argue that by altering the distribution (increasing efficiency by reducing the marginal cost of poverty reduction) and then increasing the flow of aid (until the marginal cost of poverty reduction is restored to the present level), significant increases in the pace of poverty reduction could be achieved. Relating this work to the International Development Goals, specifically the objective of reducing the number of people living in absolute poverty<sup>10</sup> it would be possible to come close to achieving the IDGs by the target date of 2015 even in Sub-Saharan Africa. In contrast, under the current aid distribution, there would be very little progress in this region. The scale of their proposals can be seen in that whereas full cancellation of debt would offer the equivalent of doubling the present flow of aid for about three years, they argue that aid flows should be doubled more or less for the whole of the period until 2015.<sup>11</sup>

A rather different approach to this question is to be found in Bloom and Sachs (1998). This examines the natural disadvantages that Africa suffers and concludes that geographical factors are particularly important. Bloom and Sachs consider the greater than usual population dispersion in Africa, the extent and nature of malarial infection and the low productivity of agriculture to be key factors, and argue that the first of these is partly a response to the others. They therefore advocate not only an increase in the flow of aid, but also in its composition, to enable it better to address the needs of countries in the region.

This is an area in which further research is necessary. If aid is generally fungible, and conditionality is ineffective in constraining the behaviour of governments, then donors and creditors have to be disciplined in allocating support through channels so that it might be used effectively. This may seem obvious, but it has some challenging implications. It would mean, for example, not providing the greatest assistance where there is apparently the greatest need because of the limited absorption capacity of countries in need of stabilization. It may also require, as suggested by Meltzer *et al.* (2000), reforms of the multilateral financial institutions to reduce and regularize their responsibilities, and so to increase their credibility as agents of change.

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<sup>10</sup> Absolute poverty is defined as having an income of less than one US dollar per day, valued in 1985 terms.

<sup>11</sup> Collier and Dollar carry out an interesting exercise for Uganda, arguing for an immediate doubling of aid, and further significant increases in support over the next few years so that aid flows would peak about 2008, but thereafter decline quite rapidly to zero in about 2013 as the country graduates from its current state of poverty.

### 3.3 The strange public silence of economists

We believe that economists have played a surprisingly small role in the public debate on debt cancellation. We offer three reasons. Firstly, as a profession, we are unable to say many things that are sufficiently simple. Second, there are other problems in economics that are more tempting, and third, partly a result of the second, we have developed ways of thinking about sovereign debt problems that may not take sufficient account of the precise circumstances of the HIPCs.

Turning to the first of these criticisms, the lack of simple things to say, this is not just a matter of living in a world of soundbites, in which only an idea that can be expressed in thirty seconds is admissible into public discourse. Following Krugman (1995), it is more a result of a distinction between ‘the professors’ and the ‘policy entrepreneurs.’ The professors, Krugman suggests, are most interested in discourse amongst themselves, caring very little for what people outside of the economics profession might think of them. No matter the circumstance, they will follow the rules of their internal debate, eschewing anything that might be judged to be vulgar populism. The policy entrepreneurs, on the other hand, are quite happy to peddle simple solutions to complex problems that permit them to collect large fees for books, interviews and articles. Unlike the professors, they are not constrained by the rules of academic enquiry.

Of course, this is not a new criticism. Plato, in a number of his dialogues, has Socrates demolish the pretensions of Sophist philosophers, whom he characterizes by their love of show and of tuition fees, rather than true seeking after virtue. But let us concede an unwillingness amongst academic economists to commit themselves to clear positions in public debate. The driver, I suspect, is less the desire to maintain some sort of intellectual purity than the constraints of our present research environment in which academic advancement is only possible through well founded (if not well funded) research activity.

Our second reason for supposing that economists have had little to contribute is rather more speculative. Work on debt cancellation first became important in the 1980s when a number of Latin American countries threatened to default upon debt payments. Compared with HIPCs, these countries have large economies, considerable debt management abilities and extensive assets. Consequently, they were able to contract debts large enough for their default to have a considerable impact upon the global economy. The threat of default led to large-scale debt management plans sponsored by US Treasury Secretaries Baker and Brady. Note, however, that the purpose of these plans was to permit debtors once again to have access to global financial markets and to raise new borrowing.

In contrast, the comparatively small economies of the HIPCs tend to lack functioning capital markets and investment institutions, and, even if they are very severely indebted according to a debt-to-GDP ratio, are small debtors in absolute terms. Many of them have not been able to raise funds through capital markets for many years, and their borrowing is now dominated by bilateral and multilateral official debts. Their default would not have the same global repercussions as that of large middle-income debtors.

When we searched the *Econlit* database for articles containing the terms ‘debt’ and ‘Latin America’ in either the title, the abstract, or in keywords, we found 723 articles since 1983, the year after the Latin American debt crisis began. A similar search for the terms ‘debt’ and ‘Africa’ yields 300. Dividing the period 1983-2001 into three year segments, the peak period for publication on Latin America was 1989-91, with 199 publications. In contrast the peak period for Africa was as late as 1995-97, with 82 publications. In no period did the rate of publication on Africa exceed that of Latin America, suggesting that the problems of the highly indebted poor countries, which have emerged over the last twenty years, have never attracted as great a concentration of effort on the part of economists as did those of Latin America.

Our last concern is that the standard economic model of debt overhang does not capture the nature of the problem in HIPCs. Krugman (1988) and Sachs (1989) devised this model in the context of the Latin American debt problem. It therefore assumes the institutional structure typical of middle income countries with access to global financial markets to raise funds. The debtor experiences an unfavourable state of the world, so that projects already begun do not generate the expected cash flow. Potential investors, therefore, expect the country to have difficulties in servicing debt repayments as they fall due. They, therefore, anticipate a default in which all of the country’s debts will be affected. Consequently, new projects are unlikely to attract external financing since potential creditors will expect to receive only a dividend rather than full repayment. Upon reaching an agreement with existing creditors to write down the outstanding debt and refinance existing debts, new projects will again appear to be viable and so external funding will resume. Cancellation in association with new lending increases the surplus of the creditor, ensuring benefits both to creditor and debtor. Such a process allows countries to obtain many of the benefits of bankruptcy proceedings in commercial law, but through a process more akin to a voluntary composition with creditors.

An analogy with commercial bankruptcy might be quite useful. In UK law, there are two very different types of court-directed processes for the recovery of debts, receivership and liquidation.<sup>12</sup> Receivership offers a company protection from creditors while it reorganizes its business and its financing, although as noted below, it is initiated by creditors (unlike a Chapter 11 filing) for their benefit. It enables a company that has a viable business, but which is currently illiquid, to return to profitability. Liquidation takes a number of different forms, but the main use is to wind up the assets of a company that is no longer able to trade profitably. It is, therefore, appropriate where the firm would not be able to meet its commitments to creditors in the future, were it allowed to continue trading, even after a financial restructuring. In many cases where a receiver is appointed by a creditor, the court will later need to confirm him as a liquidator, acting on behalf of all creditors in final winding up of the company’s affairs.

In this context, Schaffer (1998), studying the role of reorganization and winding up procedures in the context of transition in Eastern Europe, uses operating profit as a criterion of enterprise viability, suggesting the following policy rule for dealing with formerly state owned enterprises. Those making net profits are plainly viable; those making operating profits but net losses after financing costs are potentially viable, but

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<sup>12</sup> In the USA, the approximate equivalents would be Chapter 11 and Chapter 7 bankruptcy.

need assistance through reorganization; and those making operating losses are simply unviable and should be shut down. Another way of examining this problem would be to ask whether enterprises add value through their use of inputs.

Viability has to be determined over a period of time, rather than at a point in time. A company can continue trading while insolvent, although in the UK, it is a criminal offence for its directors to permit this, since they know that there is at least a risk that they will not be able to repay their creditors. While an insolvent company will have negative net assets and so would be unable to meet all of its obligations in full either now or at any point in the future, it will continue to have assets which it can use to try to trade out of its present difficulties. For example, a company that has lost a major source of revenue because of unfair competition by a competitor may seek to continue trading, even though its only hope of a return to viability is in the successful outcome of a court case seeking damages from the competitor.

In the case of the HIPC, their exclusion from primary capital markets and their consequent dependence upon external financing in the form of grants and concessional loans, as documented in World Bank (2000), together with the well-known arguments about the failure of conditionality, presented by Killick (1997), Collier (1997) and Mosley, Harrigan and Toye (1995), suggest that this is not a simple matter of a debt overhang. Rather, there is a problem more akin to insolvency.

More appropriate models, reflecting our understanding of the failure of conditionality, might build upon the idea of soft budget constraints.<sup>13</sup> Among HIPC, strong payments discipline is associated with low dependence upon external funding, and the virtual elimination of soft funding through the use of debt arrears and debt reschedulings. In Mochrie (2000), I have used such data to argue that there is debtor control of lending relationships, with HIPC, able to influence the terms of borrowing considerably, rather than having to accept the terms offered by public institutions. While further work is necessary to substantiate the robustness of this conclusion, it is certainly consistent with Easterly's hypothesis that HIPC, have often been treated rather leniently.

Pushed to its limits, the analogy with corporate insolvency could have a rather uncomfortable conclusion. Suppose that all of the debts of a state were to be discharged, and the state were to be so riven by social conflict that it would most likely once again become deeply indebted or else collapse. Such a state could reasonably be described as being unviable. Pushing the analogy to its very limit, we might wonder if such states should be wound up, with their assets being acquired for other purposes. For many reasons, we seem to be unwilling to contemplate this possibility. However, the logical conclusion of following it through would be for some other country or group of countries to acquire the territory of the bankrupt state, perhaps rather as the Reich was dismembered by the victorious powers in 1945, seeking to restore civil government where it has collapsed. Perhaps some of the conflicts that we observe in Africa at the present time can be explained at least in part as piecemeal, private attempts to undertake such projects.

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<sup>13</sup> See Dewatripont *et al.* (2000) for a survey of the use of soft budget constraints in the economics of transition literature.

## 4 Conclusion

We have sought to explain some of the differences between theological and economic understandings of deep indebtedness, and also to explore some of the reasons for the debate being inconclusive. We believe that the disciplines proceed from very different assumptions, use very different forms of argument and apply very different standards of evidence. Economists seeking to resolve this problem attempt to assess the extent to which the policies of multilateral financial institutions provide the sorts of incentives that foster growth and poverty reduction. Theologians tend to object to this instrumentalist approach, arguing that other objectives such as justice or dignity are of greater importance, and are not necessarily congruent with increased wealth. The language of economic analysis makes an implicit claim for its priority, arguing that we may dispose of ethical or social considerations, and arguing for the sufficiency of measures of wealth.

Good—or preferred—outcomes will be those in which poverty is reduced. This reveals an understanding of justice that is essentially restorative and private, since reduction in poverty might be considered to involve giving (back) to people lacking rights or property that they need to enter into full humanity. Poverty is then absolute, being deprivation of the material or the rights necessary to live a certain kind of life, or to achieve a threshold utility. So a central theme within this kind of work is the derivation of poverty lines, such as the well known dollar per day at 1985 purchasing power or a calorific entitlement based approach.

The opposite would be an understanding of justice that is both distributive and public. This entails locating the individual within a society. Poverty is then a state of relative, rather than absolute, deprivation of entitlements. It occurs where individuals are unable to take on acceptable roles within the society that they find themselves, so that they suffer alienation. Forrester (1997) argues powerfully for such a construction, claiming that apparently absolute measures of poverty tend to be culturally specific. Forrester also argues that a reduction in poverty is good not only because it enables people to overcome exclusion and alienation from the rest of society, but also because we should prefer the type of society that seeks to reduce poverty. It is difficult to contain such arguments within neoclassical economics which proceeds on a basis of methodologically individualist utilitarianism, examining individual, egotistical decisionmaking whose object is to maximize personal well-being.

Even if it is not methodologically innocent to proceed on the assumption that poverty reduction and growth are legitimate objectives of macroeconomic policy, it may still be reasonable. Statistical measures of inequality for many countries are quite stable over time, although sudden changes tend to be increases, rather than reductions, in inequality. Given increasing evidence that for poor countries the adoption of economic reforms entrenching market-oriented outcomes through institutional change are likely to have only limited (but generally positive) effects upon levels of inequality, and will tend to restore economic growth, then we might expect these to attract widespread support.

Recent developments within the economics literature have, therefore, suggested a very clear direction for future policy, associated with a considerable increase in the extent of resource transfer from rich to poor countries and substantial changes in the nature of the relations between states. Debt cancellation has been identified as one of



the most effective forms of transfers, so long as it is limited to states whose policy environment enables it to be applied effectively. Its value stems from the particularly detailed codes of behaviour to which debtors are required (at least to appear) to conform. These debilitate governments, making it more difficult for them to implement reform successfully. They also distort the political process, so that the executive is scrutinized for its ability to extract funds from creditors, rather than for more substantive achievements.

We do not wish to be critical of the theological tradition, which is much older than that of economics, and which still provides perhaps the most effective vehicle for the representation of the concerns of ordinary citizens of HIPCs to the multilateral financial organizations. But we do come back to the problem of commensurability. Economists consider this to be a period of ‘normal science’, in which they are gradually working out responses to a series of policy questions. The theological seeking of justice does not challenge the positive arguments of economics, but their application to a normative purpose, the defence of social arrangements that benefit those of us who live in wealthy countries. Economists believe that in the long run market-oriented systems will eradicate absolute poverty. Theologians seem to share Keynes’ attitude to that distant horizon.

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