

**PREPARATIONS FOR THE FOURTH SESSION OF THE MINISTERIAL CONFERENCE**

Proposal for the Establishment of a Working Group for the Study of the  
Inter-Relationship between Trade and Debt

*Communication from Cuba, Dominican Republic, Honduras, India, Indonesia, Kenya, Malaysia,  
Pakistan, Sri Lanka, Tanzania, Uganda and Zimbabwe*

The following communication, dated 31 July 2001, has been received from the Permanent Mission of Pakistan.

**Rationale**

1. In many developing countries, particularly some low-income countries, the heavy debt burden reduces their ability to develop an adequate supply response.
2. The external debt situation of the developing countries has considerably deteriorated since the beginning of the 1990s. The debt overhang of the heavily indebted poor countries (HIPC) has not been resolutely lifted, as the expected debt relief from the HIPC initiative has been slow to come and many poor indebted countries are excluded from the list of beneficiary countries. Difficulties encountered by developing countries in serving their debt have increased with the recent decline in commodity prices which is affecting the export growth prospects of HIPC and other commodity-dependent countries, particularly the low-income countries.
3. The debt burden can work through several different channels to reduce supply capacity. First, a large debt overhang discourages private (foreign and domestic) investment which would help alleviate the financing constraint. Second, heavy debt servicing requirements can create foreign exchange liquidity because of the draft on foreign exchange reserves, and reduce the ability of governments to meet the basic requirements of public expenditure in terms of providing for adequate expenditure on education, health and public physical infrastructure. For some heavily indebted poor countries, the HIPC Initiative may provide strong relief that may remove the debt constraint on improving supply capacity. However, this is not the case for all low income developing countries.
4. Repeated reschedulings in the past have added to the amount of unpayable debt, as a result of the capitalization of interest arrears. The servicing of debt absorbs budgetary and foreign exchange resources, and in the absence of any benefits accruing from the investment of the original loan, will have a net negative effect on a government's ability to fund its social expenditure programme. At the same time, high levels of debt service weaken the supply capacities of debtors as resources are diverted away from productive investments.
5. Certain measures which could be taken in relevant international fora could include:

- There is an urgent need to expand the list of poor indebted countries eligible for debt relief needs to be extended to include all low income countries.
- The length of the debt relief process needs to be shortened – from 6 to 3 years.
- While sustainable levels of debt should be repaid, the definition of what is sustainable levels of debt should be relaxed, to ensure that the levels set are realistic.
- All ODA debts of poor heavily indebted and low income countries should be cancelled, official bilateral debts should be reduced by a minimum of 80 per cent.
- The cost of relief should be met from partial sales of IMF gold, a fresh allocation of Special Drawing Rights, and additional bilateral contributions to multilateral Trust Funds for debt relief.
- Beyond debt relief, poor countries will need new concessional resource transfers to achieve sustainable growth. Debt relief, therefore, should not be given at the expense of ODA.
- Effective debt management needs to be further strengthened in indebted countries.

### **Proposal**

6. To ensure that the developing countries, many of which are faced with acute debt problems, are able to benefit from trade liberalization. We would propose that a Working Group in the WTO should be established at the Fourth Ministerial Conference *inter alia*:

- (a) Study various implications of debt on the capacity of developing countries to take advantage of the trade liberalization and to suggest remedial measures and appropriate flexibilities to be developed to ensure that once a country is faced with a specific level of debt, it should not be required to implement particular agreements including maintenance of market access under GATT and GATS.
  - (b) The Working Group could also look into the establishment of a mechanism to “swap” debt for financing the development of the supply capacity: some ODA debts could be transformed into investments for productive industries of the indebted country, particularly in the sectors that have been liberalized by that country.
  - (c) Relationship between the debt burden of developing countries and flexibility for imposition or maintenance of export restrictions under GATT and GATS.
  - (d) Establish debt thresholds beyond which augmented Special and Differential treatment provisions would automatically become operative.
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