3

The Case for More

We argue in this chapter that there is indeed a compelling case for the donor community to do more than is currently envisaged to help the HIPCs. This case is based on two internationally agreed-on objectives, both of which we also regard as appropriate, and thus as constituting a sensible and hopefully uncontroversial basis on which to judge how much is enough.

The first is proclaimed as the official objective of the HIPC Initiative: "The principal objective of the Debt Initiative for the HIPCs is to bring the country's debt burden to sustainable levels . . . so as to ensure that adjustment and reform efforts are not put at risk by continued high debt and debt service burdens."[1] The second relates to what is really the underlying objective of the HIPC Initiative, which we identified in the preceding chapter: the promotion of poverty alleviation and human development. The international community has officially endorsed a set of Millennium Development Goals for the year 2015 that quantify its agreed-on aims in this regard. Initially proposed (as International Development Goals) by the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) in 1996, these goals were reshaped in an agreement with developing countries and endorsed by the UN Millennium Summit of Heads of State in September 2000.

Debt Sustainability

We first consider whether the enhanced HIPC Initiative reduces these countries' debts sufficiently to make them sustainable. The World Bank

1. See http://www.worldbank.org/hipc.

and IMF (2001a) presented a study to the World Bank-IMF Development Committee in April 2001 that was intended to establish whether the enhanced HIPC program had reduced the countries' debt burden enough to make their debt sustainable in the longer term. According to that study:

> A country can be said to achieve external debt sustainability if it can meet its current and future external debt service obligations in full, without recourse to debt reschedulings or the accumulation of arrears and without compromising growth. (World Bank and IMF 2001a, 4)

Rather than attempt any direct estimation of the point at which debt service obligations begin to jeopardize growth, the study drew on a historical analysis to argue that countries have usually serviced their debts on schedule as long as the ratio of the present value of debt to exports was less than 200 percent. This figure was in fact embodied in the original HIPC Initiative as the standard to which debts should be reduced. The enhanced HIPC Initiative reduced this figure to 150 percent, so as to give some headroom for debts to rise again without quickly throwing countries back into debt service difficulties. The study built projections intended to illuminate whether the HIPCs could expect to maintain the ratio of the NPV of their debt to exports below 150 percent to 200 percent during the next 20 years.

The World Bank and IMF (2001a, appendix table 3b) study offers projections for the debt-export ratio for each of the 22 HIPCs that had already reached decision point by the end of 2000 out to the year 2017. For 9 of the 22 countries, projected debt-export ratios are less than 150 percent throughout the period. For another 4, they edge over 150 percent only for a single year. At the other extreme, Bolivia remains in the 150-170 percent range throughout the period, and 6 countries remain over 150 percent for more than 5 years. All countries except Bolivia are projected to be trending down in the later part of the period.[2]

As was noted in the previous chapter, these projections have already attracted a lot of criticism. It is therefore important to assess how much credence should be placed in them. Projection exercises are inherently fragile, and so it is important to ask whether the assumptions are conservative ones, or whether there is a lot of scope for worse outcomes. And how sensitive are the conclusions to reasonable variations in the key assumptions?

The variables of central importance in judging the realism of these projections are the real growth rate of exports; the terms of trade; and the growth, composition (i.e., mix of grants and loans), and terms of new

2. Because Bolivia is one of the two middle-income HIPCs, it may be that it is capable of carrying a heavier debt load than most other countries covered by the initiative.

external financing.[3] The average real annual growth rate of exports is projected to accelerate from 4.6 percent in the 1990s to 8.6 percent in the present decade (this is the unweighted average for the 22 countries given in the study's table 5). An average annual terms-of-trade decline of 0.7 percent in the 1990s is projected to give way to an improvement of 0.5 percent. New borrowing is projected to decline from an annual average of 9.5 percent of GDP in the 1990s to only 5.5 percent in the current decade, presumably with the loss made good by an increase in grants. The grant element in new borrowing is projected to almost double, from 30 to 58 percent.

One can certainly hope that policy improvements will have the effect of accelerating the growth of exports and GDP, though the projected increases (especially that of GDP from 3.0 to 5.5 percent) are substantial. It is not unreasonable to hope that the severe decline in the terms of trade these countries experienced in recent years will be reversed. One indeed hopes that the donors will replace loans by grants and ease the terms on those loans that remain. But these cannot reasonably be described as central assumptions, let alone conservative ones. They are what one can hope will happen under favorable conditions, rather than what one can have confidence will materialize.[4]

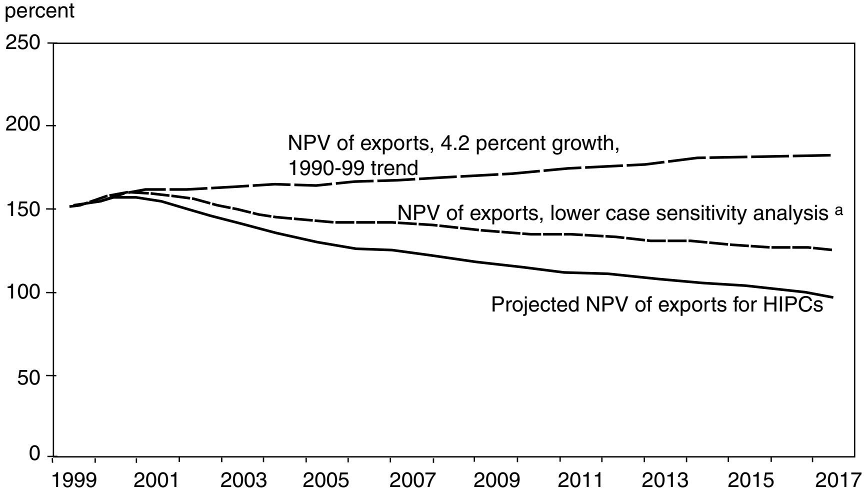
Are the projections sensitive to these outcomes being materially worse than assumed? Unfortunately, the answer appears to be yes. The World Bank-IMF paper tells us that ''during the Board discussions of the first 22 HIPCs to reach decision points, concerns were raised that small deviations from the . . . projections could jeopardize debt sustainability'' (2001b, 22).

This is illustrated by figure 3.1 (figure 3 of the World Bank-IMF paper), which shows the projected path of the average debt-export ratio declining monotonically from the year 2000 on. It also shows a ''lower case sensitivity analysis'' in which the ratio declines less rapidly, and a projection showing what would happen if exports grow at the same rate as in the 1990s. In the last case, the debt-export ratio rises monotonically (though it is still on average somewhat below 200 percent in 2017), almost as fast as it falls under their base case. One may infer that the HIPCs will need an acceleration of export growth of close to 2 percent a year to achieve declining debt-export ratio. Even if the average country achieves this, the

3. The assumption in all the HIPC exercises that savings on debt service are translated into increases in government spending implies that the gross new inflows of foreign resources remain unchanged (as is pointed out in a report of the US General Accounting Office; GAO 2000).

4. It is not clear that the IMF-World Bank team that drew up the debt sustainability paper would disagree. They write: ''Raising the average annual growth rate by 2-3 percentage points (as projected in the scenarios underlying the debt sustainability analyses) should be feasible by strengthening the economic reform agenda and forging greater social cohesion . . . that could be unlocked by the PRSP process.'' (World Bank and IMF, 2001b)

Figure 3.1 Ratio of NPV of debt-to-exports for HIPCs at the decision point, projections, and past export trends



a. Effect of 1 percent lower export growth, based on sensitivity analyses from decision-point documents.

Note: Excludes countries that qualified under the fiscal openness criteria.

Source: The Challenge of Maintaining Long-Term External Debt Sustainability, progress report by the World Bank and the IMF, 20 April 2001.

vulnerability of these countries to shocks makes it highly likely that some countries will fail to do so and will consequently run into renewed trouble.

The World Bank-IMF paper also reports a variety of downside scenarios concerning worse financing terms in half of the 22 HIPCs that had reached decision point. Although the effects of some of these scenarios in some countries were minimal, in others they were substantial. For example, if Benin received only half the level of grants that is assumed, then the ratio of the NPV of debt to exports would increase by 50 percent above the level projected.

It seems clear that the enhanced HIPC Initiative does not suffice to provide reasonable assurance that these countries will achieve debt sustainability as a result. Something more is needed. We will argue later that ensuring this objective requires a strategy specifically directed to ensuring sustainability even in the face of shocks.

The Millennium Development Goals

The Millennium Development Goals for 2015 are: to cut in half the proportion of people living in extreme poverty, of those who are hungry, and

Figure 3.2 "Group of Eight" by Dan Wasserman

of those who lack access of safe drinking water; to achieve universal primary education and gender equality in education; to accomplish a three-fourths decline in maternal mortality and a two-thirds decline in mortality among children under the age of 5 years; to halt and reverse the spread of HIV/AIDS and to provide special assistance to AIDS orphans; and to improve the lives of 100 million slum dwellers.

An earlier version of these goals differed slightly (e.g., by including universal access to reproductive health care and a reversal of the loss of environmental resources, and by excluding specific mention of AIDS orphans and slum dwellers). But a set of goals that includes halving poverty, achieving universal access to primary education, stemming the AIDS epidemic, and securing striking reductions in maternal and child mortality have been endorsed by the international community about as strongly as the international community has collectively ever endorsed anything.

As the cartoon (figure 3.2) suggests, setting goals is at best a meaningless act, and at worst hypocritical, without a willingness to follow through with measures that can be expected to achieve them. The unifying theme of the report of the UN High-Level Panel on Financing for Development (United Nations 2000, often referred to as the Zedillo Report[5]) is its attempt to elucidate what that would imply in terms of actions by both industrial and developing countries. The report described the types of actions by developing countries—in governance, macroeconomic discipline, public expenditure, financial-sector reform, and so on—that it believed were necessary if those countries were to generate the sort of equitable growth needed to achieve the goals. It emphasized that addressing their fundamentals along the lines identified was not merely a matter of political will but was going to demand a major focus on capacity building to strengthen many of their institutions.

The report also argued that these actions by developing countries should be regarded as a necessary but far from sufficient condition for achieving the goals. Complementary actions by industrial countries were going to be essential, in several dimensions. The industrial countries need to liberalize their imports of those goods that the developing countries are best placed to produce competitively. They need to maintain a liberal regime so far as capital exports are concerned, particularly with regard to foreign direct investment. And they need to provide a very substantially larger flow of aid than the current level of about $56 billion a year.

An attempt to quantify the additional flow of aid needed to complement country efforts to achieve the goals suggested an amount of about $50 billion a year, if all the poor countries were to qualify by virtue of their effort (see box 3.1). The subsequent deliberations of the Commission on Macroeconomics and Health, which quantified the need for additional health expenditure alone at $27 billion a year, suggests that the $50 billion estimate is probably conservative (WHO Commission 2001).

One of the studies on which the Zedillo Report drew in developing its estimate, Collier and Dollar (2000), concluded that even on present trends the overall target of halving world poverty may well be achieved because of the progress being made in Asia, where the bulk of the world's poor people still live. But it also concluded that the prospects in sub-Saharan Africa, where most of the HIPCs are located, were for only a modest decline in poverty, from 72 percent today to 64 percent in 2015, using a poverty line of $2 a day (on a purchasing power parity basis) in 1993 prices. It is widely accepted that the Millennium Development Goals should be interpreted as goals for at least the major regions, and preferably for individual countries, rather than just for the world as a whole. On that basis, Africa, and the HIPCs within it, are not on track to achieve the goals or even come close.

Excluding China and India, both of which are on track to achieve the Millennium Development Goals, the population of the low-income countries is about 1.3 billion. Almost half of these people live in HIPCs, which suggests that the cost of achieving the goals in the HIPCs might

5. One of the authors of the present study served as project director for that report.

Box 3.1 The annual cost of achieving the Millennium Development Goals

The Zedillo Report (United Nations 2001) included an annex that presented a back-of-the-envelope calculation of the cost of achieving the Millennium Development Goals. This basically consisted in assembling figures from other sources. For example, studies by the United Nations Conference on Trade and Development and the World Bank were used as the basis of the estimate that halving poverty would cost an extra $20 billion a year.

This estimate assumed that all the low-income countries themselves would adopt appropriate policies to make aid worthwhile. It was argued that halving poverty could also be expected to halve those in hunger, so no additional cost was added for that objective. The $9 billion figure for the cost of achieving universal primary education came from the United Nations Children's Fund. The HIV/AIDS figure came from the UN secretary-general. In several cases, the report failed to locate a reasonably convincing figure at all. The final annual figures presented (in billions of dollars) were as follows:

Halving poverty and hunger	20
Halving population without access to safe drinking water	0
Achieving universal primary education	9
Achieving gender equality in primary education	3
Achieving three-fourths decline in maternal mortality	No estimate
Achieving two-thirds decline in under-5 mortality	No estimate
Halting and reversing HIV/AIDS	7-10
Providing special assistance to AIDS orphans	No estimate
Improving lives of 100 million slum dwellers	4
Total (approximate)	**50**

It can be asked whether it is legitimate to sum these figures: For example, surely the least-cost way of halving poverty will involve improving education? That is indeed surely a source of overestimation. Conversely, several objectives were not quantified at all. New efforts since the Zedillo Report suggest the necessary amounts may be greater; the World Health Organization released a report in December 2001 that called for $27 billion a year for a Global Health Fund to combat HIV/AIDS, malaria, and tuberculosis. We use the $50 billion estimate as a conservative measure of the likely order of magnitude of the cost that will be involved if the world takes the goals seriously.

be half the global cost (the $50 billion of box 3.1). We therefore take $25 billion as our order-of-magnitude estimate of the annual cost of achieving the goals in the HIPCs.

That can be compared to the savings in debt service that have been generated by the enhanced HIPC Initiative: $1.2 billion a year as compared with the debt service that was being paid, and $2.4 billion a year as compared with the debt service that was falling due, for the first 24 HIPCs. Relief to these first 24 HIPCs represents 70 percent of total projected HIPC benefits;[6] if we scale this number up, the enhanced HIPC Initiative would

6. See "The Financial Impact of the HIPC Initiative," http://www.worldbank.org/hipc/Financial_Impact_-_December.pdf.

still save all 42 countries less than $4.2 billion a year. It can also be compared to the saving in debt service that would come from total cancellation of the debt, which would be about $8 billion a year (for the 42 countries). Finally, one should compare it to the net resource transfer into those countries as a result of new aid inflows minus debt service, which averaged $11.7 billion annually from 1995 to 1999.

In short, HIPC debt relief is far from sufficient to finance achievement of the Millennium Development Goals, and would still be far from sufficient even if it were to offer complete debt cancellation. Equally clearly, the HIPCs need all the resources that debt cancellation would bring them.

We conclude that—on both of the criteria that the international community has endorsed and that seem to be relevant in judging whether the HIPCs have now been given enough help—the answer is no. The next question is what should be done about it.