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Conclusions

During the past several decades, a large number of the poorest countries in the world took on more debt than they were able to service except by obtaining ever more aid. A group of debt campaigners headed by Jubilee and with illustrious supporters like Bono and the pope led a campaign to cancel these debts, which they argued were unjust and were sabotaging the ability of those countries' governments to provide minimal social services to their citizens. The HIPC Initiative was the response of the G-7 and the international financial institutions (notably the IMF and World Bank) to that campaign. The first initiative was announced in 1996, and an enhanced version providing more, faster debt relief was agreed to in 1999.

The donor countries had good reasons to cancel some debt owed to them by the poorest countries, even without the political pressure of the Jubilee movement. In the poorest countries, including most of Africa, two decades of official lending, most of it at concessional rates, had failed to catalyze the increased growth and new economic activities needed to finance the existing debt and pull people out of poverty. In some of the HIPCs, donors were locked into defensive lending: endless rounds of rescheduling the debt and negotiating new grants and loans to help poor countries pay back old loans.

In this study, we have set out this background to what became the 1999 enhanced HIPC Initiative. Most HIPCs have had limited if any per capita growth during the past two decades. Poor growth (and the resulting unsustainable debt) were the outcome in some countries of incompetence, even thievery, and in others of unmanageable disease burdens, civil conflicts, lack of human capital and adequate infrastructure, and declines in the world prices of their limited export products. Much of the lending by Western governments was meant to address these constraints to growth. But even when well intentioned, it was often poorly channeled, reflecting Cold War politics rather than development objectives.

Among critics of the HIPC Initiative are some who think it is too big, too fast, and likely to "waste" more resources, and others convinced that, given the problems of the poorest countries, it is too small, too slow, and laden with the kind of IMF and World Bank "conditionalities" that they claim have not worked in the past.

Whether to Extend More Debt Relief

Against this background, we have argued that there are two compelling grounds for the international community to give more help to the HIPCs. More help is needed both to be reasonably sure that they will escape from debt unsustainability and also to give them a reasonable chance of achieving the Millennium Development Goals. But this positive answer does not necessarily imply that it makes sense to give more debt relief; we have argued that it is also necessary to ask whether debt relief (as opposed to bigger disbursements of new aid) is the right *way* to give additional help.

We have identified a number of factors that are relevant in making this choice. To begin with, the widespread concern that much of the debt is unjust, or odious, means that the cause of debt relief has gained significant political appeal, which gives hope that it can be a channel for bringing a net addition of real resources to the cause of development. This is important, because if there were no additionality then it would be other developing countries that would pay the bill for debt relief. We have traced the redistributive channels through which this can occur, including some that have not been acknowledged by all of the debt campaigners, such as the way in which a raid on the reserves of the multilateral development banks would increase their cost of borrowing, which would then get passed on to their other clients in the form of higher interest rates or lower new lending.

But we then noted that even if there were no additionality or redistributive effects at all—so that the volume of real resources going to these countries was totally unaffected—there are powerful reasons why debt relief might still be the right choice. In brief, the substitution of debt relief for aid disbursements can increase the efficiency of aid by increasing ownership of their development programs by poor countries, reducing transaction costs, increasing fungibility, eliminating tying, and reassuring the private sector that countries are going to be able to implement their plans. And debt relief can also free donors of the need for defensive lending, liberating them to put their new aid where they believe it can do the most good.

How to Extend the HIPC Initiative

The analysis leads us to conclude that it makes sense to extend the HIPC Initiative further, in three dimensions. First, we recommend deeper debt cancellation to eligible HIPCs where debt service still exceeds 2 percent of GNP. That will ensure that the burden on the countries' budgets remains manageable. It also means that no really poor country that makes a serious effort at getting its own citizens to pay taxes would have to use more than 10 percent of its tax revenue to pay debt service. The cost: $10 billion.

Second, we recommend expanding the HIPC Initiative to make eligible more low-income countries—including big ones like Indonesia, Nigeria, and Pakistan. It would be a mistake to concentrate what extra funds may be available for debt relief just on the existing HIPCs, because that would discriminate against the millions of comparably poor people in these other countries simply because they had better luck or better governments at some point in the past, or because they live in larger countries whose high absolute costs for debt relief the donors have been reluctant to face. The cost: $70 billion, including almost $50 billion for Indonesia.

Third, we recommend safeguarding countries (through a contingent facility at the IMF) for 10 years against being pushed back into unsustainable debt levels by circumstances beyond their control. Cost: unknown; we use $5 billion as illustrative because the current annual cost of the existing short-term contingency facility has been estimated at about $500 million.

Cost of the Extensions

The total cost of these extensions is thus between $30 and $80 billion. Most of the variation in this wide range depends on whether or not Indonesia is included, plus the unknown cost of the contingency facility.

A sizable portion of the costs should be financed by the mobilization of IMF gold, which could yield more than $20 billion. We propose that the IMF shareholders agree to mobilize gold to finance all the debts owed to the IMF, plus the cost of the contingency facility.

The remainder should be financed by an increase in donor contributions to foreign aid, partly through canceling bilateral debt, and partly by increased payments to the HIPC Trust Fund. We do not wish to see the MDBs emasculated by being forced to run down their reserves.

The case for making Indonesia eligible is strong: It has been pushed back into the ranks of low-income countries by the post-1997 crisis, it is highly indebted on every available measure, and there seem good reasons for believing that a lower debt burden would pay rapid dividends in revived growth and reduced poverty. Yet its inclusion is feasible only in the context of a major expansion of ODA (even if some of the bilateral debt has already been written down in accounting terms). Conversely, major expansion of debt relief in the absence of a corresponding increase in ODA (at minimum sustaining a steady outflow of new disbursements) would be pointless, because there would be too much robbing of Peter to pay Paul. In that sense, the debt campaign is and must be a campaign for more aid.

Toward a New Aid Architecture

But the case for more aid is unlikely to be successful without changes in the existing aid architecture—changes that would create greater incentives for donors to be accountable as well as for recipients to perform better. If one takes the optimistic view that the introduction of PRSPs is making a major difference in how aid is delivered—such as to make a reality of country ownership while strengthening the expectation that aid will be concentrated on those who will use it effectively—this has already started.

We have made a number of proposals—some no doubt controversial—for more transparency in the ODA accounts, for transferring the PRGF from the IMF to World Bank, for increased pressure on donors to channel aid selectively, and for expanding the scope of the aid that is provided under the umbrella of the PRSP to include bilateral aid (this would implement the common pool proposal). As always, aid is second best to trade: any campaign that aims to help poor countries needs to place their fair access to the markets of rich countries very high on its agenda.

By putting the issue of rich-country responsibility for helping the poor help themselves squarely back on the table, the debt campaigners have done an enormous service to the cause of development. Our analysis has linked debt relief to the even larger challenge of renewing and reforming the donors' aid architecture. With more and better aid and freer trade, there would indeed be real hope of reviving the drive for development and achieving the Millennium Development Goals.