Debt relief and economic recovery in Latin America: Lessons for HIPC$^1$

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Geske Dijkstra* and Niels Hermes**

*Public Administration
Erasmus University Rotterdam
P.O. Box 1738
3000 DR Rotterdam
The Netherlands
Dijkstra@fsw.eur.nl

**Faculty of Management and Organisation
University of Groningen
P.O. Box 800
9700 AV Groningen
The Netherlands
clm.hermes@bdk.rug.nl

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Abstract

The initiative for relieving the debt burden of the Highly Indebted Poor Countries (HIPCs) has raised attention to the possible effects of debt forgiveness on economic growth and development of these highly indebted countries. This paper draws some lessons from the Latin American experience with debt relief efforts in the late 1980s and 1990s. A flow effect of debt relief proved to be difficult to establish in the presence of large arrears. Secondly, the stock effect of debt reduction, i.e. the improved creditworthiness, proved to outweigh possible flow effects. The second part of the paper analyzes what these conclusions imply for the potential effects of the HIPC initiative, taking into account the aid dependency and the official nature of the main creditors of Sub-Saharan African countries.

1. Introduction

The initiative for relieving the debt burden of the Highly Indebted Poor Countries (HIPCs) has raised attention to the possible effects of debt forgiveness on economic growth and development of these highly indebted countries. While the HIPC initiative, first launched in 1996 but expanded in 1999, is novel in that it grants forgiveness on multilateral debt, it is by no means the first time that debt forgiveness has been applied. This paper aims to draw some lessons from earlier debt forgiveness experiences. In particular, it looks back at the Latin American debt crisis and the debt relief efforts of the late 1980s and early 1990s, in order to assess the impact of debt relief on economic recovery of the region. From the Latin American experience, some lessons can be drawn for possible effects of the current debt relief efforts.

In making these comparisons between Latin America and the current heavily indebted countries, mainly located in Sub-Saharan Africa, we have to account of course for the differences between the
nature of the debt problem in the two regions. Conclusions on the Latin American experience can only be applied by taking these differences into account. The two most important differences are:

1. The thrust of the debts of the Latin American and Caribbean (LAC) countries were commercial bank debts, while most HIPC and SSA debts are owed to official creditors, both multilateral (World Bank, other regional development banks and IMF), and bilateral creditors.

2. Most LAC countries are middle income countries with a more diversified economic structure, while HIPCs and SSA countries are usually dependent on a few primary commodities for their export income, AND are to a much larger extent dependent on foreign aid (i.e. grants and concessional loans).

We attempt to present the most important theoretical concepts and notions on the impact of debt forgiveness, and we review the empirical studies on Latin America. In addition, we present aggregate development and trends for Latin America and the Caribbean region (LAC), contrasting them with Sub-Saharan Africa (SSA) as a proxy for HIPC countries.

The Latin American experience with the debt crisis and the debt relief efforts is discussed in section 2. Section 3 assesses the impact of the debt relief efforts on commercial debts of the late 1980s and early 1990s on Latin America, by reviewing theoretical and empirical studies. Section 4 analyzes the nature of the SSA debt problem, while section 5 discusses the official debt relief proposals and efforts since 1988. Section 6 then analyzes the potential impact of the HIPC initiative by using the lessons from the Latin American experience. Section 7 concludes.

2. The Latin American experience with debt and debt relief
The origin of the Latin American debt problems is well-known. The oil price increase of 1973 led to large trade deficits in industrialized countries and in non-oil exporting developing countries. The oil-exporting countries had large surpluses, and they put a large part of this additional export income as deposits in commercial banks of industrialized countries. The banks then lent the money to oil-importing developing countries. The large supply of money and the optimistic expectations led to very low, and often negative real interest rates. At around 1979-1980, the international environment changed drastically. There was a second oil price increase, but this time the response of the industrialized countries, especially the US government, was different. US monetary policy became very tight out of fear for rising inflation. In combination with a large budget deficit this led to skyrocketing of US interest rates. That was quickly followed by rising interest rates worldwide. Since most of the loans were at floating interest rates, debt service of the borrower countries immediately increased. At the same time, the higher international interest rates also induced a worldwide recession, thus lowering the demand for and the price of developing countries’ export products. The burden of this unexpected, double shock, fell fully on the debtor countries.

Until 1982, the commercial banks had responded to payments difficulties of debtor countries with new lending, so the stock of debt increased rapidly (Figure 1). However, after the announcement by Mexico that it could no longer service its debts, the banks began to combine some new lending with rescheduling, thereby preserving the net present value of the debts but giving some liquidity relief. The new lending was in fact involuntary since it was only meant to allow countries to pay the debt service. Coordination among banks was necessary as for each individual bank it was better that others would provide the new lending: a new loan would simply mean that another creditor could be paid. In this sense, the new lending was involuntary or defensive lending. This ‘concerted lending’ was usually orchestrated by the IMF, and was accompanied by an agreement with the IMF (Bowe and Dean, 1997). Countries could get such as agreement provided that they carried out stabilization and adjustment policies, and that they kept paying interest rates on commercial loans.
The dominant belief in these early years (1982-1984) was that countries were not insolvent and that they only had a liquidity problem. But the banks’ perceptions already began to change. In fact, banks did not provide new money on a net basis, since they received more in interest and principal payments than the amounts they provided as new loans. To the extent that there was additional new money, it was given by official creditors (Dooley, 1994). In fact, official creditors partly financed the debt service to commercial creditors.

In view of the coordination problem between creditors, the US government proposed the Baker plan, named after the then Secretary of the Treasury James Baker. This plan involved increased lending to the 15 heavily indebted middle income countries by both official and commercial creditors. It was still based on the idea that debtor countries were temporarily illiquid, and that large packages of new money would be sufficient for these countries to grow out of the debt crisis. According to the Baker plan, both official and private creditors would provide $20 billion. Official money would be conditional on countries carrying out adjustment programmes under the coordination of the IMF.

In practice, the Baker plan raised resources but less than originally foreseen. From 1986 to 1988, almost $16 billion was coming from official sources and $13 billion from the banks (Bowe and Dean, 1997). However, as before, the new money from the banks did not mean that exposure rose to the same extent, because at the same time they reduced exposure by debt-equity conversions (Cline, 1995). From 1983 onwards, net transfers on debt were highly negative (Figure 2). For public and publicly guaranteed debt, the largest category, net transfers can be broken down by type of creditor. The overall negative transfers were mainly due to negative private transfers on debt, since official transfers remained positive during most of the 1980s (Figure 3). Net transfers from multilateral creditors, however, were also negative from 1987 onwards, except for 1990. In 1987, not all committed loans from the multilaterals was disbursed because there were problems with compliance of the policy conditions in Argentine, Brazil, and Mexico (Bowe and Dean, 1997). Although arrears accumulated in the 1980s, interest on commercial loans was almost always paid, as was debt service to
multilateral institutions. These transfers were made from export income and from positive official (and in the late 1980s: bilateral) transfers.

According to Cline, the liquidity relief provided according to the Baker plan would have been sufficient to solve the debt crisis if circumstances had remained the same. But in practice, many circumstances changed (Cline, 1995). Cline points to seven factors, but they can be taken together in four groups:

First, external circumstances for the debtor countries changed. Some large debtor countries suffered from the fall in oil prices around 1985, leading to less capacity to pay (Mexico, Ecuador, Nigeria, and Venezuela); while some other debtors showed less willingness to pay, for example Brazil that announced a debt moratorium in 1987. Secondly, bank policies changed, partly as a result of those changing circumstances. Banks increasingly came to perceive debtor countries as insolvent, and they began to make provisions for bad loans. This led to a fall in the secondary market prices. The moratorium of Brazil reinforced the banks’ attempts to make provisions for bad loans. There was a growing trade in debt claims on the secondary market and increasing divergence of interests among banks. Thirdly, official policies increasingly pressed for debt forgiveness instead of liquidity relief. Politicians in the US were concerned about falling exports to the debtor countries, especially in Latin America, since these countries had to accomplish trade surpluses. In Europe, politicians were worried about the consequences of the high debt service for the fragile ‘new democracies’ in Latin America. The fourth factor was the academic work that began to stress the negative incentive effects on debtor countries of a debt overhang: A large debt stock implies high expected future debt payments. These expectations reduce incentives for good policies, and lower private investment and net private capital inflows since they act as a tax on future returns to investment and to capital.

All the above factors, but in particular the growing provisions of commercial banks and the lowering of the secondary market prices of the debt, freed the way for proposals that would imply market based debt reduction instead of providing new loans. In fact, by using the lower secondary market prices of
debt claims, several debtor countries had already reduced their debt stocks. The most important mechanisms included debt buybacks and debt equity swaps. In debt buybacks, countries buy back a certain portion of their commercial debt at a price that is related to the secondary market price, so is much lower than the face value of the debt. Debt equity swaps are a combination of a buyback and foreign direct investment in the debtor country: a foreign investor buys the debt claim at a reduced price in foreign currency, and then sells it to the country, receiving either local currency to be used for purchases of local physical assets, or directly receiving those assets.

In March 1989, the new Secretary of the US Treasury, Nicholas Brady, announced the Brady plan. This plan involved voluntary debt reduction by commercial banks, while the amount of forgiveness would be in proportion with the secondary market prices for the debt of a particular country. Official involvement consisted of providing money for debt buybacks and for the collateralization of exit bonds, usually US Treasury bonds (Bowe and Dean, 1997: 10). By June 1989, US$34 billion had been earmarked for buybacks and collateralization: 12 bln each from IMF and World Bank, and $10 bln from the Japanese Export Import Bank. For the first time, the IMF would also lend to countries with arrears to commercial banks, so that banks were expected to solve their own problems. IMF and World Bank involvement was conditional, however, on macroeconomic adjustment policies. The banks would be expected to give a substantial amount of debt reduction, but they were not forced to go as far down as the secondary market prices would suggest. It was also hoped that (some) banks would provide new lending. Negotiations were carried out on a country-by-country-basis. Participation of all banks in the reduction was ensured as the larger commercial creditors to a country no longer protected the ones with smaller claims, nor would the IMF require debtor countries to service debts to commercial banks (Bowe and Dean, 1997: 11).

Mexico was the first country for which negotiations were held. Banks could chose between exit or nonexit. ‘Exit’ involved the acceptance of a collateralized Brady bond with a price just above the secondary market price. Banks that would chose the ‘nonexit’ option were expected to ‘free ride’ on the higher secondary market prices that would be the result of the exit strategy of their colleagues. For
this reason, they were required to provide new financing as a fixed percentage of their outstanding claims (Bowe and Dean, 1997).

By 1994, Brady plan agreements had been concluded with eighteen countries (Cline, 1995). Most banks chose the exit option. Only 2% of original exposure was lent as new money by commercial banks. Aggregate figures for LAC show that during the 1980s, rescheduling dominated over debt forgiveness (Figure 5). However, there was already some forgiveness, in the form of buybacks and debt-equity swaps, before the Brady plan was implemented. In 1988, forgiveness amounted to almost 4% of the total debt stock. The amount of debt reduction reached a peak of about 5% of the total stock in 1990. After 1909, annual percentages of debt forgiveness were only at between 1 and 1.5% (Figure 5). These are aggregate figures. For individual countries the shares of debt forgiven were higher. According to Cline, the amount of forgiveness per Brady deal was about 30-35% of total commercial bank debt, but was higher for low-income countries. Since commercial debt was about half of the total debt, about one-sixth of these country’s total debt was forgiven (Cline, 1995).

3. The impact of debt forgiveness

In theory, the impact of debt relief on economic growth runs through the reverse of two negative effects of the debt burden that have been mentioned in the literature. These two effects include:

1. A liquidity effect: negative transfers on debt reduce resources for investment and for government social expenditure, and thereby hamper growth and development. For Latin America, this effect has been empirically established by Cohen and Weeks, for example (Cohen, 1993; Cohen, 1997; Weeks, 2000)

2. A debt overhang effect: a large debt stock implies high expected future debt payments. These expectations reduce incentives for good policies, and lower private investment and net private
capital inflows since they act as a tax on future returns to investment and to capital (Krugman, 1988; Sachs, 1989).

As a result, we can expect the following two effects of debt relief:

1. A flow effect. A reduced debt service flow will save resources for investment and for government expenditure, including public investment and social expenditure.
2. A stock effect, or reduced debt overhang effect: a reduced debt stock will remove or lower the disincentive effect of this stock on investment, directly or indirectly by better government policies or by reducing uncertainty on government policies, and will increase the debtor countries’ creditworthiness, so leading to more inflows of private capital.

There was some recovery in Latin America in the 1990s. Growth rates of GDP were higher in the 1990s than in the 1980s, achieving some 4%, on average, but are still volatile (Figure 7). The investment ratio was relatively low in the 1980s and increased between 1990 and 1997 (Figure 7). However, the increase has been far from spectacular. Nevertheless, neoclassical growth models do not need a Latin American ‘dummy’ anymore for the 1990s, as they needed for the 1980s (Fernandez-Arias and Montiel, 1997). The question now is to what extent this recovery can be related to debt forgiveness.

At the aggregate level, there seems to be some impact of the debt relief, especially the relief granted in the years 1988-1990, on debt service payments (Figure 9). The debt service/exports ratio fell from 37% in 1988 to 24% in 1991, but slowly began to rise thereafter. This means that debt service payment for LAC continued at a relatively high level, but that is also due to new inflows of capital.

This already shows that it is difficult to make a distinction between the flow effect and the debt overhang effect of debt relief. If the reduction of the debt overhang is effective, there will not only be higher investment and growth, but also more inflows of foreign capital. As a result, the debt service
flows may not diminish after a debt relief agreement. New debt service will substitute for old debt service.

Figure 2 shows that the net transfers on debt are no longer consistently negative in the 1990s, and in fact reach large positive sums in 1993 and 1995. This must have been due to large new gross inflows, given that debt service payments were still relatively high (Figure 9), and that the stock of arrears fell precipitously after 1991 (Figure 5). The new inflows were of another nature, however. Between 1989 and 1990, commercial banks reduced their share in the debt to LAC countries dramatically, while the share of other private debts (portfolio investment, bonds) increased (Figure 11).

We now review the empirical studies that attempt to assess the impact of debt relief in Latin America. The discussion begins with an analysis of debt buybacks and then continues with the impact of Brady deals. We will show that the impact on creditworthiness is generally considered most important.

Debt buybacks and debt equity swaps were applied by several debtor countries already before the Brady proposal was launched. One problem of these buybacks was that it is difficult to establish comprehensive deals (Sachs, 1988). Heavily exposed banks are not eager to participate since they may face bankruptcy if they are forced to lower values of claims in their books. Secondly, the US government, protecting the interest of those banks, was not keen on these agreements either. According to Sachs, the servicing of commercial interest rates of debtor countries became the ‘litmus test’ of foreign policy relations (Sachs, 1988: 710). Only in one case the US government supported a comprehensive buyback, and that was the case of Bolivia in 1988. Several other countries also carried out buybacks but these were often more limited in terms of number of creditors and amount of debt involved.

Debt buybacks have been criticized as benefiting the creditors more than the debtor (Bulow and Rogoff, 1988). The price at which debtor countries buy is considered too high and especially if compared with alternative uses. Debtor countries have to pay the post-buyback average secondary
market price, while the value of the country’s remaining debt service falls by the marginal price, which is much lower. Usually, the secondary market price rises after the debt buyback: the value of the remaining claims rises since expected payments on these remaining claims increases due to the lower debt stock. In Bolivia, the average pre-buyback secondary market price was 6 cents to each dollar, and the post-buyback price was 11 cents. Bulow and Rogoff also argue that buybacks are too costly for sovereign debtors since they cannot use assets that would be seized by creditors in case of default.

Although Sachs admits that buybacks are usually costly to the debtor, he argues that these have to be compared with the costs of default. These costs may include the reduced access to trade credits and to borrowing for investment purposes, and bargaining costs. He considers the Bolivian buyback particularly beneficial, for two reasons. First, the country was not forced to pay the arrears in debt service of the years of before the buyback, and second, the buyback was financed by donors and was accompanied by large new credits from IMF and the World Bank (Sachs, 1988). While Bolivia had paid 6% of its GDP annually in debt service in 1982-1984, with the buyback it received 5% of GDP in new resources.

Most Brady deals also involved a combination of debt relief, debt conversion and new capital inflows. As already stated above, it is therefore difficult to separate empirically the flow effect of debt relief. One study that does examine the liquidity effect of debt relief and in fact compares it with the debt overhang effect has been carried out by Morisset (1991). He builds a macroeconomic model for Argentina consisting of eight behavioural relationships and 14 identities. The model fits quite well for the 1962-1986 period. Simulation results confirm a liquidity effect of the reduction of the debt stock on public investment. However, the incentive effect on private investment is larger. This is an indirect effect and it mainly comes about via a portfolio shift. There is more demand for domestic assets and this leads to increases in loanable funds and to a reduction of the interest rate. Other channels for indirect positive effects on private investment include the lower public borrowing leading to less crowding out, and a lower expected tax burden (Morisset, 1991).
For Mexico, the Brady deal also proved to have positive effect on private investment (Claessens et al., 1994). Surprisingly, the reduction in the size of the expected net transfer on debt was not the important factor, but the reduction in the variance of the expected net transfer. This reduced variance led to a lower interest differential between peso denominated Treasury bonds and dollar denominated Treasury bonds. This reduced interest differential is an indicator for the decrease in the exchange rate risk. There was also some reduction in the country risk, measured as the interest differential between Mexican dollar denominated Treasury bonds and US Treasury bonds, but this only explains 4 percentage points of the total fall in peso interest rates of 20 percentage points. In itself, the drop in domestic interest rates led to a saving in domestic debt servicing of 4% of GDP (Claessens et al., 1994: 6).

In sum, it was the reduced uncertainty on government policies, in particular exchange rate policies, that caused the lower interest rates and the rise in investment in Mexico. The impact of debt payments on exchange rate policy runs through possible domestic borrowing or monetization of the government deficit that may be induced by these payments. However, it has also been stressed that the reforms previously carried out by the Mexican government were a precondition for the success of the debt reduction (Claessens et al., 1994; Oks and Van Wijnbergen, 1995). These reforms included privatization of the banks and of many other state firms, and liberalization of foreign trade. While reforms plus debt reduction thus seem to have had positive effects on investment and economic growth, Oks and Van Wijnbergen (1995) cast some doubts on the sustainability of that growth. This was because higher growth was accompanied by a large current account deficit and by a fall in domestic private savings.

There is a general consensus in the literature that the Brady agreements played a role in the restoration of creditworthiness in Latin American countries. Perceptions in financial markets changed dramatically, leading to the return of flight capital and to new voluntary lending (Bowe and Dean, 1997; Cline, 1995). However, it is also recognized that new inflows were probably also due to the lower world interest rates in the 1990s or other exogenous factors (Bowe and Dean, 1997: 57).
Indicators for increased creditworthiness include the amount of capital inflows, but also the prices of debt claims on the secondary market (Acharya and Diwan, 1993; Boehmer and Megginson, 1990; Dooley, Fernandez-Arias, and Kletzer, 1994). According to Dooley et al., they are more sensitive than the flows itself, and they reflect expectations on governments’ capacity to service debts. The rising of secondary market prices means that debtor countries can have cheaper loans – the yields for these loans fall. Brady deals have led to a generalized increase in the secondary market prices of debt between 1989 and 1993 (Bowe and Dean, 1997). However, in this period world interest rates also fell and this may also have caused the lower prices.

Before the decline in world interest rates at around 1990, secondary market prices were determined by factors related to circumstances and policies of the debtor countries. Boehmer and Megginson (1990) empirically tested a model for the determinants of secondary market prices, in which they included several variables related to ability and willingness to pay. Within ability to pay, they distinguished between liquidity measures (ratio of net exports to debt service, and ratio of net imports to hard currency reserves), and solvability indicators (debt-to-GDP and debt-to-exports ratio). Willingness to pay was measured as the level of payments arrears. Other variables included were whether there were regulations on a debt conversion program. This model was tested before the implementation of the Brady deals. Solvency indicators proved to be significant in determining the secondary debt prices, while liquidity indicators were not. Existing regulations on debt conversion programs also proved to be significant, as was the existence of arrears. In sum, solvency and willingness were important determinants.

Another study established the importance of debt buybacks as signalling commitment or willingness to pay debt service (Acharya and Diwan, 1993). Countries with buyback or debt conversion programmes in place proved to have more inflows of new loans and could pay lower interest rates on those loans, and they had higher secondary market prices of their debts.
Dooley et al. examine the role of the decline in world interest rates in the fall in secondary market prices after the Brady deals (Dooley et al., 1994). They included the following variables in their model: the actual debt reduction (reduction in debt-to-GDP ratio and in debt-to-exports ratio), the international interest rate, the domestic interest rate, and the real exchange rate. The outcome was that both variables for the debt stock reduction were significant, but the world interest rate as well. In simulations with this model the impact of economic reform, proxied by the primary budget surplus, proved not to be a significant factor. The authors conclude that in the early 1990s, many countries were considered creditworthy again irrespective of whether they had carried out economic reforms. Like Oks and Van Wijnbergen (1994, see above), they question the sustainability of the recovery of the early 1990s. Once world interest rates increase again, secondary market prices will fall and the wave of private flows to Latin America will come to an end. The negative effect of the interest rate increase will be reinforced by its impact on the real exchange rate (depreciation) and domestic interest rates. Countries that have carried out reforms are in a better condition to face the reversal of capital inflows than other countries.

Hernández and Rudolph (1995) investigate the determinants of private capital flows directly, and they also examine external and internal factors. The external factor is again the US interest rate (Treasury Bill rate). In the group of domestic factors, they look at investment/GNP, saving/GNP, export growth, exchange rate instability, and the debt stock, measured as the ratio of the debt stock minus international reserves, and GNP. This means they have not examined the impact of debt stock reductions. They find a significant influence of almost all domestic factors: investment, saving, instability and debt stock. The US interest rate proved to be insignificant. They show that this surprising result can be partially, but not fully, explained by including a longer time frame (1986-1993) than other studies do, and to the inclusion of FDI, which constitutes the largest inflow in this period.

The main conclusions that can be drawn from this analysis are the following.
The flow effect of debt relief is difficult to establish for several reasons. First, countries were in arrears so it is not clear what they would have paid in the absence of debt relief. Second, debt relief increased creditworthiness and thus led to new inflows of foreign capital. As a result, the debt service flow need not diminish. Nevertheless, the reduction of uncertainty on future debt flows seems to have played an important role, especially in the case of Mexico. The large debt service due in this country created uncertainty for the private sector. It was not the size of the transfer that mattered, but the uncertainty on government policies to meet the transfer that mattered. In particular, monetization or domestic financing of budget deficits could bring about balance of payments crises. Given that arrears were very high by the end of the 1980s, we could add here that there was also uncertainty on the amount of debt service that would actually need to be paid. Debt relief thus reduced both uncertainties.

The most important effect of debt relief efforts, from individual buybacks via more concerted ones such as the Bolivian to the more comprehensive Brady deals, seems to have been the restoration of creditworthiness. In fact, one way of measuring this proved to be the secondary market price of debt claims, that went up enormously. These price increases reflect the higher expected payments on debt. Studies showed that prices were determined by ability and willingness to pay. It is somewhat surprising that the relatively low amounts of debt forgiveness had such a large impact on the secondary market prices of debt. One reason for this is clearly the improved external environment in the early 1990s. In particular, the lower world interest rates proved to be an important factor in the rise of secondary market prices.

The new inflows were of other types than the previous forms. With respect to debt creating flows, portfolio capital took the place of syndicated bank loans. This means that countries must at least have a developed financial market. Other important inflows included Foreign Direct Investment (FDI).

There is some conflicting evidence on the role of reforms on this improved creditworthiness. Adjustment short-term negative effects on especially public investment, but reforms important for investment and growth. Previous reforms do seem to have played a role in rising investment in Mexico
after the implementation of the Brady deal. Domestic reform-related factors like the investment and savings rate and the stability of the exchange rate, also proved to be important for the access to total private capital inflows, including FDI. However, whether or not countries had reformed seemed to have little influence on the inflows of portfolio capital in the early 1990s.

4. The debt problem in Sub-Saharan Africa

For several Sub-Saharan African countries the debt crisis started earlier than for LAC countries. When commodity prices began to fall in the mid 1970s, arrears began to increase and the first reschedulings were agreed upon (Figure 10). Although SSA countries had also incurred private commercial bank debts during the 1970s, the largest share of their debt was with official creditors, and in particular, bilateral creditors. The different composition of the debt stock implies that the reasons for incurring debt and the creditors’ reactions to payment problems were different for SSA. We discuss first the composition of the debt as it was built up during the 1970s, and then the creditors’ responses during the 1980s and 1990s.

The largest share of the debt stock of SSA countries was bilateral concessional debt (Figure 12). According to the DAC-OECD definition, loans are defined as concessional if the net present value of the sum of all discounted future debt payments is at least 25% lower than the nominal value of the debt; 10% is usually taken as discount rate. With concessional loans, the risk of creating unsustainable debts is lower, but later developments have shown that it is not absent. Since concessional loans are a form of aid, along with grants, the reasons for extending these loans are the same as for official development aid in general. These reasons include the combating of poverty in receiving countries, but also the favouring of domestic commercial and economic interests, as well as political-military-strategic reasons (Hoebink 1988; White 1995). In any case, the expectation of earning profits is NOT among the reasons, and the lending decision is not based on a rational evaluation of costs and benefits.
Non-concessional bilateral loans represented less than 10 percent of the debt stock until 1976 but this category became more important over the late 1970s and 1980s (Figure 12). These non-concessional loans were usually in the form of guarantees for export credits extended by domestic firms and their banks. Most industrialized countries had (and have) Export Credit Agencies (ECAs) for this purpose. The reasons for giving these guarantees include the promotion of exports, the creation or protection of domestic employment, and the maintenance of good diplomatic relations (Daseking and Powell, 1999). The promotion of exports was deemed particularly necessary in the 1970s, given the recession in the industrialized countries due to the high oil prices. The value of export credits increased rapidly during the 1970s, from US$ 2bn to US$ 18bn (Humphreys and Underwood, 1989: 46). They carried market interest rates, but the risks were not seen as very high given that commodity prices were at high levels during the 1970s. Governments saw export credit guarantees as a contingent liability, not as a cost to the budget (Daseking and Powell, 1999).

Bilateral debt continued to be the largest category over the 1980s and 1990s, but the share of bilateral concessional debt decreased while the share of non-concessional debt decreased. The reduction in the share of concessional loans is due to the fact that many bilateral donors switched from concessional loans to grants. Some aid loans were forgiven. However, while after 1982 commercial creditors by and large stopped new lending and began to reduce their exposure in developing countries, the reaction of bilateral creditors, united in the ‘Paris Club’, was different. From the late 1970s onwards, flow reschedulings were agreed upon. This implied that current payments due were postponed, but the interest on those payments was capitalized so that there was no reduction in the net present value (NPV) of the debt stock. Between 1976 and 1988, 81 of these nonconcessional reschedulings were concluded. They involved 27 of the countries that are now HIPC countries. These reschedulings increased the nominal value of the debt stock for these countries, involving in total $23 billion in delayed payments (Daseking and Powell, 1999: 5). The usual procedure was that debtor countries first had to have an agreement with the IMF in which they agreed to carry out specific adjustment policies.
In addition to these reschedulings, industrialized countries also continued their nonconcessional lending to the debtor countries through their export credit agencies (ECAs). New loans took priority over old claims. In sharp contrast with commercial creditors, all industrialized ECAs continued to report the full face value of the debts. They did not make provisions for bad loans (Daseking and Powell, 1999). As Daseking and Powell argue, this procedure seemed to be in the interest of the creditor governments. By allowing debt payments to be postponed, there was no additional pressure on aid ministers to finance the adjustment programmes in LDCs, which would have been more costly. On the other hand, aid ministers were not eager to increase aid flows if these would just be used to pay their ECAs. And if creditor governments would have decided on actually reducing debt stocks, this would probably have gone from the aid budgets. Debtor countries also seemed to benefit (in the short term), since they did not have to pay the ECAs, and had access to some additional aid money and to new loans – albeit nonconcessional ones.

The share of private debt in the total SSA debt stock increased at around 1979, mainly as a result of the higher interest rates. After 1982, this share diminished since private creditors gradually wrote-off their claims and moved out of the region. This can also be deduced from Figure 4: net transfers on public debt from private creditors became zero in 1983 and were mostly negative since 1984.

Reschedulings of bilateral and private debts, and later also bilateral debt forgiveness agreements, were always conditional upon the existence of an IMF agreement. An IMF agreement was usually also accompanied by loans from the World Bank and other multilateral development banks. The link between IMF agreements and bilateral rescheduling and forgiveness seems to have been an important reason why multilateral debt has increased, especially since the mid-1980s (Figure 12). Most SSA countries qualified for IDA loans, which meant that the loans were at concessional conditions. However, these loans still need to be serviced, and multilateral institutions, in particular, the World Bank and the IMF, are preferred creditors. In fact, defaulting on servicing of IMF and World Bank loans is prohibitively costly since countries risk their access to all official aid from OECD countries. At the same time, the presence of IMF and World Bank agreements and the need to service the debts
to these institutions, induced bilateral creditors/donors to contribute with new money – often in the form of grants. These mutual links can be deduced from the aggregate figures on the course of the debt crisis in SSA.

Figure 10 shows that the stock of arrears has continued to grow over the 1980s and 1990s in SSA and that arrears are still at a high level in 1998, while they have fallen rapidly in LAC since 1991. This shows that the debt crisis is far from over in SSA. The debt to GDP ratio was at around 60% in LAC during the years 1983-1987, but fell thereafter and was at below 40% in 1998 (Figure 7). In SSA, the total debt-to-GDP ratio has continued to increase until 1994 (Figure 8). It reached the 60% figure at around 1987 and has not fallen below that ratio until the latest year for which figures are available. However, the debt service (paid)-to-export ratio has always been a lot lower in SSA countries. This can be explained by the larger share of concessional debt (Figure 13), but also from the larger stock of arrears – especially if we take into account the much lower absolute stock of total debt in SSA. In addition, net transfers on debt have never become highly negative in SSA (Figure 2). And contrary to the Latin American case, total net resource flows (including grants) have always been positive (Figures 15 and 16).

For public debt, Figure 4 shows net transfers on debt from multilateral creditors were positive, but not very high. They were relatively stable between 1986 and 1993 and declined after that. Net transfers on bilateral debt have been on a downward trend since 1982. However, the net flow of resources from bilateral creditors/donors, including grants, has been very high.

Birdsall et al. (2001) have established that countries with high debts and especially with high multilateral debts, received a larger net resource flow. In addition, for these high debt countries, there proved to be a negative relationship between the quality of policies and the size of the net flow. While in the 1980s transfers to countries with less adequate policies were lower, in the 1990s countries with less adequate policies received more resources. Birdsall et al. conclude that donors are caught in a
‘debt trap’. They give more aid and more concessional loans to countries with worse policies, so maintaining the debt service problems of these countries.

This relationship is in apparent contradiction with the practice of IMF and other institutions and donors to set policy conditions for aid. The implication of this conditionality would be that countries receiving large amounts of aid have better policies. However, many studies already established that this conditionality ex ante is not very effective (Collier et al. 1997; Dijkstra, 1999; Dollar and Svensson, 1998; Killick et al., 1998). Since donors have many and sometimes conflicting objectives, one of these being to enhance repayment of past debts, sanctions are usually not applied. This opens up the possibility of the ‘adverse selection’ that Birdsall et al. (2001) empirically find.

5. **Official debt relief efforts**

By 1987, Paris club creditors began to change their view on the debt payments problems of the less developed countries. Most agreed that providing new loans and grants would not be sufficient, and that debt stock reduction would be necessary. However, in the beginning opinions still widely diverged. Some, most notably the US, did not want to give any forgiveness. As a compromise, what later became known as the ‘Toronto terms’ contained three options. The first and third implied a reduction by one-third in the NPV of the debt stock, either by interest rate reduction or by other means. The second implied a lengthening of the maturity without any reduction in NPV. Since the latter would imply a continuation of risky exposure, the three options were broadly considered comparable. In later G7 meetings, further debt relief was agreed upon. According to the London terms, debt relief on eligible debt mounted to 50%. This was agreed upon in 1991. The Naples terms (implemented from 1995 onwards) went as far as 67% and the Lyon terms (since December 1996) to 80%. Eligible debt is usually defined as pre cut-off date medium and long term debt (Boote and Thugge, 1997; Daseking and Powell, 1999).
Since multilateral debt had to be serviced with priority, these loans increasingly became part of the problem instead of being part of the solution. In spite of the concessionality of most World Bank loans, the debt service on these loans represented some 20-25% of total debt service of SSA countries in the early 1990s (Figure 14). While private creditors and bilateral creditors had already forgiven part of their debts, multilateral creditors had not granted any forgiveness. Several bilateral donors began to give debt relief to developing countries by taking over part of the multilateral debt service obligations of these countries. During the 1990s, the multilateral institutions came under increasing pressure to also grant debt relief.

After prolonged discussions, the initiative for the HIPC countries was finally launched in 1996. The HIPC initiative aimed to reduce the debt to a ‘sustainable’ level, meaning that countries would be able to service their future obligations in full, without resorting to arrears, reschedulings or debt relief, and without compromising economic growth. This level of ‘sustainable’ debt was originally defined as a NPV of debt of 200-250 per cent of exports (Andrews et al, 1999). The exact level for each country would be determined depending on ‘vulnerability factors’ such as concentration and variability of export earnings, the fiscal burden of external debt service, the debt/GDP ratio, the resource gap, the level of international reserves and the burden of private sector debt. Countries with very open economies (export/GDP ratio of more than 40%) and with fiscal revenues of more than 20% of GDP, would be eligible for HIPC with a debt/government revenues ratio of 280%.

Other conditions for eligibility for the initiative included that countries were poor, with per capita annual incomes below $925 (the limit for getting concessional loans from the World Bank), and that they had a track record of at least three years of compliance with IMF and World Bank adjustment programmes. At that moment, the decision point for HIPC assistance would be reached, and a detailed debt sustainability analysis would be carried out. If considered eligible, the amount of debt forgiveness would then in principle be determined. However, countries needed to be on track with the IMF and World Bank programmes for another three years before reaching the completion point. Between decision and completion point they would get some flow relief from Paris Club creditors (at Lyon
terms). At the completion point they would begin to receive debt relief from the multilateral institutions. In practice, some flexibility was applied with respect to the application of the second three-year period. For the seven countries that reached their decision points in 1997 and 1998, two reached their completion points in 1998 and three others were due to reach it in 1999 (Andrews et al., 1999).

Nevertheless, the HIPC initiative was still criticized for being too little. In 1999, the *enhanced* HIPC initiative was announced. The most important differences were (Andrews et al., 1999):

- The eligibility criteria, in terms of debt sustainability criteria and requirements for track records were amplified so that more countries would qualify. The criterion became a debt-to-export ratio of 150%, to be measured on the basis of a three-year average of the years preceding the decision point. Countries with an export-to-GDP ratio of more than 30% and a revenue-to-GDP ratio of at least 15%, would also qualify with a NPV of debt/revenues ratio of 250% In addition, this new HIPC initiative;
- The lower thresholds for sustainability would also imply that more debt relief would be granted;
- Multilateral debt relief would begin at decision point, and there would be a floating completion point;
- Countries had to write a Poverty Reduction Strategy Paper (PRSP) in order to qualify for the decision point. This PRSP had to be set up by the country itself and would have to be the result of a participatory process. The floating completion point would be conditional on some country-specific structural reforms, including measures related to poverty reduction and the monitoring of poverty.

In sum, with the enhanced HIPC initiative there would be more debt relief to more countries. However, donors and creditors also wanted to be sure that the moneys released from debt service would be used for combating poverty in the receiving countries. The requirement to write and implement a PRSP can be seen as an increase in conditionality for debt relief. Under the original HIPC
proposal, having a past track record in policy performance was the only requirement (conditionality ex post), with the enhanced proposal, conditionality ex ante has again been introduced.

By December 2000, 22 countries had reached the decision point under the enhanced HIPC initiative. Given the pressure for debt relief, the Boards of IMF and World Bank had accepted ‘Interim PRSPs’ from many of these countries. Interim PRSPs generally had not been composed in a sufficiently broad participatory manner, and sometimes data or detailed costing projections were also lacking.

When the HIPC initiative had already been approved, and under the ever greater pressure from Non-governmental organizations campaigning for debt relief, at their 1999 summit in Cologne the G7 agreed on 90% debt reduction: the Cologne terms. These Cologne terms would be applied to debt service flows of HIPC countries at their decision point. At completion point, these countries would get a 90% stock reduction. Several individual bilateral creditors enhanced Cologne terms to 100% for HIPC countries. In the context of the HIPC initiative, the Paris club debt relief efforts plus the debt relief granted by non-Paris-club bilateral creditors on comparable terms are called the “traditional debt relief mechanisms”.

6. Lessons for present-day debt relief efforts

In analyses on potential effects of the HIPC initiative, most attention has been given to the flow effects. The idea is that debt service be reduced and that this will free resources for public investment and for public expenditure on sectors that help to reduce poverty such as health, education, water supply and rural roads. From the Latin American experience, we know that the flow effect was difficult to establish, and that it was less important than other effects of debt reduction.

For HIPC countries, the possibility of a positive flow effect has already been questioned (Birdsall et al., 2001). First, as also shown above, net resource flows to HIPC countries and also to SSA countries
has never been negative. Although the debt/GDP and debt/export ratios have been very high, the ratio of actual debt service to GDP has been much lower and could to a large extent be financed from aid flows. Secondly and related to this, the additionality of HIPC assistance has been questioned. If HIPC debt relief is given from a fixed aid budget, there cannot be a flow effect. However, although aid budget of bilateral countries may be fixed, debt relief will probably imply a transfer from non-HIPC to HIPCs. Therefore, HIPC relief will probably be additional for individual HIPC countries.

From the study on Latin America, we concluded that the flow effect could not be established for other reasons, namely the possibility that debt service otherwise would not have been paid, and the improved creditworthiness so that new loans had to be serviced. Let us examine whether these arguments hold for HIPCs, or SSA countries today.

We saw above that arrears of SSA were still very high in SSA countries. This also holds in percent of total debt (Figure 6). Debt service on many debts had not been paid. This held in particular for private debts and for bilateral debts. Since countries can only get HIPC relief if they are up-to-date with servicing Paris Club creditors, this could imply that debts have to be serviced that were not serviced before. Although PC creditors are now granting a high percentage of debt reduction (90% since Cologne terms), this percentage only holds for eligible debt, and does not include post cut-off debt nor, in many cases, debts rescheduled in earlier PC agreements. This means that there is still a substantial part of debts to PC creditors that needs to be serviced – and that would perhaps not need to be serviced in the absence of HIPC agreements.

Cohen also argues that given the large arrears, the actual amount of forgiveness in HIPC is much smaller than the NPV of forgiveness (Cohen, 2000). He computes a kind of market value of the debt of HIPCs, based on earlier regressions for highly indebted middle income countries in the 1980s where the market value proved to depend on the debt-to-export ratio, the ratio of arrears to total debt and the ratio of rescheduling to total debt. Secondary market prices were less than the full face value of the loan at a debt-to-export ratio of 200%. If there is a discount, the marginal price is usually below the
average price. When the average price is 32% of face value, which usually occurs at a debt-to-export ratio of more than 250%, the marginal price becomes zero (Cohen, 2000: 14). In that case, debt relief means no flow relief at all for the debtor country. However, these conclusions only hold for those debt claims that would perhaps not be serviced in the absence of debt relief. Most debtor countries always fully service the debts to IMF and World Bank, so we can say that relief on this debt service means a real flow.

So far, we established that there will be some flow effect since the HIPC-initiative implies debt relief on multilateral debt that would always be serviced, and that this relief will probably be additional from the point of view of individual HIPC countries. On the other hand, some debts that were not serviced before will probably have to be serviced now, so this reduced the flow effect.

We can also draw another parallel to the Latin American effectiveness of debt relief. Not the reduction of the exact size of the debt service flow proved to be important for enhancing private investment, but the reduction of uncertainty on future debt service payments. This may also hold for the current heavily indebted countries. Sachs et al. found that there was a large year-to-year variation in debt service due and in grants received (Sachs, Botchwey, Cuchra, and Sievers, 1999). They emphasize the negative impact of these uncertainties on fiscal management, but one could add here the consequences for other macroeconomic policies and therefore also for private investment. This uncertainty can be reduced by HIPC. Once HIPC countries reach the HIPC completion point, they know exactly the amount of debt relief they will receive over the next 15 or 20 years.

However, another reason why the flow effect was difficult to establish in the LAC case was that countries began to receive new inflows that also need to be serviced. In this area, it is difficult to make comparisons with the LAC experience because the main players are official creditors and not private creditors. The difficulty begins with the measurement of creditworthiness when most debts are with official creditors. We cannot use the secondary market price of the debt to assess the expected future
payments. Cohen (2001) made an attempt to estimate the secondary market price, but he did not take into account the different degree of priority with which different types of creditors are serviced.

There is, however, a measure that can be used to assess creditworthiness or the expected future payments on debt. This measure can distinguish between different types of creditors. It is based on the extensive practice of accumulating arrears. For SSA countries, we therefore propose the following measure for creditworthiness: debt service actually paid, divided by debt service due. We can assume that after the implementation of HIPC, but also after earlier concessional PC agreements, this ratio increases for bilateral creditors and probably also for commercial creditors. If creditworthiness improves, we can assume that the country will have more access to foreign capital. However, because the ratio of debt service paid to debt service due will vary according to creditor, and because the motivations of different creditors also vary, we have to assess separately for all types of creditors whether creditworthiness will improve and what the effects will be.

The HIPC initiative would be successful if it would lead to an increase of access of these countries to private capital. In general, we can assume that for most HIPC countries, expected payments on private loans will increase when they receive the debt relief. In the LAC case, new inflows consisted of portfolio capital and Foreign Direct Investment (FDI). There was also a large amount of returning flight capital. Of these three types, FDI and returning flight capital are the most feasible for SSA countries. Since most SSA countries only have incipient financial and capital markets, attracting large amounts of portfolio capital is not a feasible option in the short term. FDI is of course not debt creating, but improved creditworthiness can still play some role since it may become easier for foreign firms to access loans from abroad, both short term trade credits and investment credits. Furthermore, surveys of foreign investors have revealed that the risk of policy reversals, the risk of the exchange rate becoming inconvertible and civil wars are considered the most important factors hindering investment in Africa (Collier and Pattillo, 1999). On the basis of the LAC experience, we can assume that a debt stock reduction can help reducing uncertainty on future debt payments and on future exchange rate policies. But other factors are also important for foreign investment. Previous reforms,
in particular the achievement of fiscal and exchange rate stability, but also trade liberalization and privatization are necessary conditions. In SSA, about 20% of FDI inflows between 1988 and 1995 was related to privatization. This was just below the LAC figure, but much higher than for other developing regions (Bhinda et al., 1999: 58).

Many of these factors will also play a role in enhancing the return of flight capital. The SSA region has the lowest value of capital per worker as compared to other regions, but the highest share of private wealth held abroad, namely 40% (Collier et al., 2001). This means there is a large potential for returning capital flight. Econometric estimates show that at very high levels of the debt-to-GNP ratio there is a relationship with capital flight. For example, reducing the debt-to-GNP ratio from 297% to 60%, reduce the share of wealth held abroad by 33 percentage points. Collier et al. (2001) also estimated the potential effects of the original HIPC initiative on returning capital flight. This effect proved to be large for Guyana (proportion of wealth held abroad would reduce by 10.2 percentage points), since it had both a high debt and a high number for private capital per worker. In the African countries Burkina Faso and Uganda the effect would be more limited. The impact on returning capital flight is difficult to establish from balance of payments statistics, since this category is least well registered in balance of payment statistics. Country studies in Bhinda et al. found that capital flows were often hidden in ‘errors and omissions’ or in ‘private transfers’ (Bhinda et al., 1999).

Finally, we assess the impact of debt relief on new official loans and grants. Does HIPC relief lead to increased creditworthiness, and what will be the effects? For multilaterals, and in particular for the World Bank and the IMF, creditworthiness never mattered for the decision to grant a new concessional loan to SSA countries, since these debts have always been serviced. However, with HIPC, it is the first time that the multilateral institutions also grant debt relief from their own resources. Until then, they had fully benefited from the new loans and grants from other donors. Can we expect that the experience of now having to pay for less successful past lending will make these institutions more conscious of the lending risks and that they will take creditworthiness into account in future lending? This would be the case if the departments that make the lending decisions would suffer the
consequences from granting this debt relief, so would dispose of lower amounts of loanable funds after HIPC. Part of the HIPC relief on multilateral debt is financed by bilateral donors that have made pledges to the HIPC Trust Fund, to be used for the relief on multilateral debt service. But there is also a part that must be financed by the IMF, the World Bank and the other development banks themselves.

In the case of the World Bank and the other multilateral banks, HIPC relief is financed from the loanable funds in general, and from the money made available for concessional lending by bilateral donors (and that covers the interest differential). This means that HIPC reduced the money available for (concessional) new lending to other countries and to the HIPC countries themselves. In the case of the IMF, the own-financing of HIPC relief is done through ‘off-market gold sales’. This implies the symbolic selling and then repurchasing of part of the IMF’s gold reserves, thus increasing the price at which these gold reserves are valued in the books. This artificial gold selling can be considered to imply moral hazard for the IMF department that handled the concessional loans to the now HIPC countries, since they are not directly faced with the consequences of their unjustified lending (Felgenhauer, 2000). The off-market gold sales raise the asset value of the IMF, but they reduce the proportion of assets that is liquid, i.e. loanable. So like with the World Bank, there may be some effect on the amount of loanable funds.

However, it can be expected that there are strong pressures, from both inside and outside these institutions to expand loanable funds again. Pressures from outside will come from the shareholders. The donors will continue to highly value the loans to the poorest countries. This means they will want to assist countries with the highest need, rather than with the highest creditworthiness. Pressures from inside will come from the departments themselves. It has been shown that there are strong bureaucratic and institutional pressures to increase the amount of lending of these institutions. Institutions want to grow, and individuals can enhance their careers by lending higher amounts (Killick et al., 1998).

Birdsall et al. (2001) expect that after the debt stock reduction of the HIPC initiative, multilateral and bilateral donors no longer need to engage in involuntary lending or the involuntary giving of grants.
They can extend new loans or grants to countries with good policies. However, there are two reasons why this is unlikely to be the case. The first group of reasons has already been referred to above. Bilateral donors, as shareholders of the multilateral institutions and on their own, will continue to consider ‘need’ a very important criterion for development aid. Furthermore, the bureaucratic and institutional pressures within the international financial institutions themselves will also play their part in continuing loans to countries although policies may no not be fully appropriate.

The second reason is related to the way the HIPC initiative has been designed. With the enhanced HIPC initiative, conditionality ex ante has been re-introduced. In order to qualify for badly needed debt relief, countries must set up PRSPs. Twenty-two countries have done so before December 2000. Once they have done so, however, donors are likely to support these countries, even if a PRSP is only a piece of paper and does not say much about real government intentions and future policies. The very process of setting conditions for debt relief keeps the donor game going, because once this – formal – condition is fulfilled, the country will be considered a good performer and there is little that will stop donors from continuing aid disbursements. In sum, it is unlikely that donors and multilateral institutions will become more selective after HIPC. They will continue giving loans and grants, and the debt will be built up again. It depends very much on debtor countries’ growth rates and growth rates of exports whether there will be a need for a new HIPC within a few years.

There is one category of official creditors that must be dealt with separately, namely the export credit guarantees. From the moment onwards that countries wanted to qualify for HIPC, expected payments on these debts have improved. The question then becomes whether improved creditworthiness matters for the decision to guarantee new loans to the HIPC countries. There are probably few Paris Club countries that have stopped giving these guarantees in the years that bilateral debts were not always serviced. Only one case, that of the UK, has been documented where export credit guarantees were suspended in the 1980s because of non-payment (Bhinda et al., 1999: 91). In many OECD countries, the Export Credit Agencies (ECAs) themselves did not suffer the consequences of default, rescheduling or relief, since they were always compensated for from aid budgets (Daseking and
Powell, 1999). This is another instance of moral hazard. ECAs continued lending or guaranteeing lending because they did not incur the non-payment risks. If this was already the case, HIPC will not make any difference. In addition, there were and are strong pressures on these agencies from the private sector in the industrialized countries to continue these guarantees. In all countries where export credit guarantees were not suspended when debt service was not paid, the increased creditworthiness does not make any difference.

7. Conclusion

This paper analyzed the role of debt relief efforts in Latin America’s economic recovery of the 1990s, in order to draw lessons for the currently heavily indebted countries. In particular, it assessed the possible effects of the HIPC initiative.

In the context of HIPC, most attention has been given to the possible flow effect of debt relief: the relief will free resources that can be used for public investment and public expenditure on social sectors. However, the Latin American experience with debt relief shows that the flow effect is relatively less important. In the presence of large arrears it is difficult to establish what debts would have been serviced. In addition, debt relief leads to improved creditworthiness which means that more debts will be serviced and that new lending will take place. However, although the size of the flow effect was small and difficult to measure, the reduction of uncertainty on debt service due and on government policies required to meet debt service proved to have important positive effects. This could also be the case in HIPC countries.

The improved creditworthiness proved to be the most important effect of debt reductions in Latin America. The secondary market price of debt increased, and new private inflows came about. However, these new inflows were different from the earlier syndicated bank loans, namely FDI and portfolio flows. Although increases in portfolio flows are not very likely in most SSA countries given
weakly developed capital markets, increases in FDI are possible but will also depend on other factors than the debt stock reduction.

In the Latin American case, the commercial banks had stopped involuntary lending and little new voluntary lending came about. The paper shows that this withdrawal is unlikely for the official creditors that have lent the bulk of the current debt stock of SSA countries. Although HIPC probably increases creditworthiness, this is not an important criterion for official creditors. Recipient need is an important criterion, and for bilateral non-concessional creditors (export credit agencies) also the domestic economic and commercial interests. Within multilateral institutions, bureaucratic and institutional pressures play a role. Furthermore, both export credit agencies and to some extent the World Bank and the IMF as well, were subject to moral hazard. The former were compensated from bilateral aid budgets in the case of defaults, while the latter were preferred creditors which also meant that bilateral aid financed the debt service. For all these reasons, the multilateral institutions and ECAs will continue lending. The fact that the enhanced HIPC initiative has strengthened conditionality ex ante will further hamper selectivity in future, post-HIPC, donor behaviour. Once there is a PRSP donors will tend to support these countries since they seem to be good performers. All in all, the success of HIPC will depend crucially on the policies and exogenous circumstances in the HIPC countries themselves that may or may not lead to growth, export growth and development. But these in turn will have little relationship with conditions set for the HIPC initiative.
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Figure 1. Total debt stock, in billions of US$, by region

Figure 2. Net transfers on debt (NTD) for LAC and SSA, in millions of US$


Figure 3. LAC: NTR on public debt 1970-2000, in millions of US$

Figure 4. SSA: Net transfers on public debt 1970-2000, in millions of US$


Figure 5. LAC: Arrears (cumulative), rescheduling and forgiveness, in % of total LT debt, 1970-1997

Figure 6. SSA: Arrears (cumulative), rescheduling and forgiveness, in % of total LT debt, 1970-1997


Figure 7. LAC: investment, debt and growth

Source: World Bank, World Development Indicators 2000, CD-ROM.
Figure 8. SSA, investment, debt and growth

Source: World Bank, World Development Indicators 2000, CD-ROM.

Figure 9. Total debt service in % of exports

Figure 10. Arrears and rescheduling, LAC and SSA, in millions of US$


Figure 11. LAC: Composition of PPG debt, in %

Figure 12. SSA: Composition of PPG debt, in %


Figure 13. Share of concessional debt in total PPG debt, in %

Figure 14. Share of World Bank debt service in total debt service, in %


Figure 15. LAC: net resource flows, in millions of US$, 1980-1998

Figure 16. SSA: net resource flows, in millions of US$, 1980-1998