Getting to Home Plate:
Why *Smarter* Debt Relief Matters for the Millennium Development Goals*

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This note links the relevance of debt relief to one of the great challenges of our time: achieving the Millennium Development Goals (MDGs). This is not a new point. Many have written, quite eloquently, on the importance of debt relief for the world's poorest countries as a way to reduce poverty, end hunger, and improve health and education prospects for the world's poorest people. In this note we emphasize the contribution that a more predictable, longer-term trajectory of debt relief could make for the poorest countries' potential to achieve the MDGs. The note builds on the argument for long-term "insurance" against unsustainable debt that is set out in the attached 2002 paper, "Beyond HIPC: Secure Sustainable Debt Relief for Poor Countries."

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In September 2000, the members of the United Nations agreed to set quantifiable targets for combating poverty, hunger, disease, illiteracy, environmental degradation and discrimination against women to be achieved by the year 2015. These targets, called the Millennium Development Goals (MDGs), represented a sort of global compact—between developed and developing countries—to increase the living standards of the poorest citizens in the world. The responsibilities of the two parties were clear: the developing world would commit to fundamental reforms that would help engender growth and opportunity for its citizenry; in return, the developed world would provide direct financial support to the poorest countries to help them realize the ambitious MDGs.

The Heavily Indebted Poor Countries (HIPC) program of debt relief is a critical component of this larger compact for development. But it is only one component, and in terms of expected financial transfers, it is relatively small. The report of the United Nations High-Level Panel on

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Financing for Development (commonly referred to as the "Zedillo Report") endorsed a rough estimate of an additional $50 billion per year over current aid transfers (now an estimated $58 billion) that the industrialized nations would have to provide if all poor countries were to achieve the MDGs. Of the resulting $500 billion or more (over 10 years) between now and 2015, the expected transfers under the HIPC program for countries that have reached decision point but are not "on track" to meet the MDGs, are on the order of $27 billion (Table 1).[2] Still, the HIPC program matters more than the figures suggest because without debt relief, HIPC countries face continued uncertainty regarding donors' commitments and their own ability to finance public programs while maintaining macroeconomic stability.

The fundamental objective of the envisioned debt relief provided under HIPC is to ensure that the debt burden of the poorest countries is sustainable over the long-term. Sustainable debt can then be managed without undue fiscal strain, contributing to macroeconomic stability that, in turn, encourages private sector investment and growth. A country's freedom from this undue fiscal strain is linked to its ability to fulfill its responsibility of meeting the MDGs and adhere to its end of the global compact.

However in the years since the inception of the Enhanced HIPC program, it has become painfully obvious that the HIPC debt relief system does not guarantee countries' debt will remain sustainable—at least not according to HIPC's definition of "sustainability."[3] And HIPC financing in any event was never meant to extend beyond the point at which countries' total amount of debt reduction is agreed ("decision point"), and paid—originally meant to be about three years after a country's eligibility is first approved ("completion point").[4] As World Bank economist Bhattacharya wrote in 2003: "The aim of the HIPC initiative is to reduce the debt burden to a reasonable level at exit, but it cannot ensure debt sustainability of HIPC graduates in the long-term."[5]

In 2002, the IMF was already reporting that as many as half of the countries receiving debt relief would be thrown back into an unsustainable debt situation by the following year.[6] In several cases exogenous shocks—extreme weather such as drought or unexpected declines in commodity prices—had reduced export income or led to unexpected borrowing. Take the case of Uganda, for example. Uganda was the first country to qualify for debt relief under the original HIPC scheme and was also the first to reach the Enhanced HIPC "completion point," when the total amount of debt reduction is finalized, in May 2000. But within two years by 2002, new projections showed Uganda's debt would rise to 254 percent of exports, well above the HIPC threshold of 150 percent, and more than double the originally projected level of 117 percent. The additional debt burden was not a result of economic mismanagement, but rather a drastic decline in world coffee prices due primarily to Vietnam's entrance into the world market.

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[2] For a description of the HIPC program, including decision point requirements, see Andrews et al. (2003) and Birdsall and Williamson (2002). For countries "on track" (using simple linear extrapolation) as of 2002, see UNDP (2002).
[3] HIPC debt of poor countries has been treated as unsustainable at a debt-to-export ratio above 150 percent. Cline (2003) and Kraay and Nehru (2003), among others, propose different definitions.
[4] The period between "decision" and "completion" points can now be shorter and may also be longer.
[5] Bhattacharya (2003).
[6] This included 2 countries (Bolivia and Uganda) that had reached completion point and approximately 8-10 countries (out of a total of 20) that had reached decision point as of April 2002. See IMF (2002).

Niger is another good illustration. Between decision point in December 2000 and scheduled completion point (October 2003), Niger was hit by declining world uranium prices and a corresponding reduction in its volume of uranium exports, which derailed its ability to maintain sustainable debt-to-export ratios. For a country that relies on foreign aid for nearly 45 percent of its budget, when an expected aid package from the European Union failed to materialize, the country had no choice but to borrow more money from the multilaterals—adding to its debt burden. (Now a controversy over the amount of Niger's final debt reduction has delayed "completion.")[7]

There is a solution to the problem: a contingency financing facility that insures countries that are on a path of good policy against external shocks that are beyond their control. This proposal addresses not only the HIPC countries unique vulnerabilities, but also the tendency of the World Bank and IMF to choose optimism over reality when conducting HIPC debt sustainability analyses. Such a facility would provide additional relief whenever shocks that are clearly exogenous to the country result in a new erosion of debt sustainability. Such a facility would need to cover a substantial period into the future, at least a decade, in order to serve the role of reassuring investors that the public sector's debt burden is sustainable.[8] This might also have the positive effect of forcing World Bank and IMF officials to develop less optimistic (and frankly, unrealistic) projections for a country's economy.

In the context of the estimated $50 billion (above and beyond existing aid) needed annually to help countries reach the MDGs, the cost of such an insurance facility is small. Birdsall and Williamson (2002) estimated the cost of such a facility to be in the ballpark of $5 billion for the entire set of HIPC countries over a 10-year period. Insuring countries against exogenous shocks for 10 years would provide them with a necessary base to establish a sound macroeconomic order over the long-term. If implemented, the facility would expire for completion-point countries right around the year 2015—providing them with the foundation to work toward achieving the MDGs over the entire period.

To use a metaphor from the American game of baseball, insuring against unsustainable debt would allow countries that are heavily indebted to move from their seat in the dugout to a spot at home plate. It will not assure them a home run or even a base hit. But it will ensure their chance to take a swing.

Under the Millennium Compact, the burden on improving the situation of the world's poorest people rests on developed and developing countries alike. Developing countries must uphold their end of the bargain and pursue enlightened economic policies. Rich countries must provide additional external financing, above and beyond debt relief, if the poorest countries are to have a prayer of attaining the MDGs. Smarter debt relief can also be a catalyst for future financing. But private investors will require that a country's debt is predictable *and* sustainable if they are to confidently calculate the costs and benefits of investing in a country. Likewise, governments making allocations for social expenditures need to be given reasonable assurances that

[7] The same controversy has since delayed Ethiopia's scheduled February 2004 "completion." See Alan Beattie, "Debt Relief Initiative for Poor Countries Held Up," *Financial Times*, February 12, 2004.

[8] This facility was originally proposed and is explained in more detail in Birdsall and Williamson (2002).

exogenous shocks will not force them to divert precious resources away from reducing poverty to servicing their external debt.

Table 1: Transfers Provided by HIPC to Countries Not on Track to Achieve the MDGs[1]

	Completion Point (8)	**Decision Point (16)**
	Benin Bolivia Burkina Faso Mali Mauritania Mozambique Tanzania Uganda	Cameroon Chad Congo, Dem. Republic of Ethiopia The Gambia Ghana Guinea Guinea-Bissau Honduras Madagascar Malawi Niger Rwanda Sao Tome & Principe Sierra Leone Zambia
Debt Reduction (in NPV Terms) ***$US billions***	**8.33**	**18.41**
Total: 26.74		

[1] Authors' calculations on progress towards the MDGs were made based on estimations found in the 2002 Human Development Report, Table A1.3. This table rates all countries' progress to Millennium Development Goals 1, 2, 3, 4, and 7 – using a set of 7 indicators. Countries rated as "On track" or who have "Achieved" less than half of the 7 indicators were deemed not on track to meet the MDGs. The following countries are on track to achieve the MDGs and are, therefore, not included in our calculations: Guyana, Nicaragua, Senegal, Lao PDR, and Sudan. Also not include were those countries have yet to reach their decision points. They include: Burundi, Central African Republic, Comoros, Republic of Congo, Cote D'Ivoire, Liberia, Myanmar, Somalia, and Togo.

Source: UN Development Programme, Human Development Report 2002; World Bank and the International Monetary Fund, Heavily Indebted Poor Countries (HIPC) Initiative—Status of Implementation, September 2003.

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