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**Before the**

**COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE  
ONE HUNDRED TENTH CONGRESS  
SECOND SESSION**

*Building on International Debt Relief Initiatives*

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Good afternoon Chairman Biden, Ranking Member Lugar, Presiding Member Casey, and distinguished members of the committee. My name is Peter Blair Henry. I am the Konosuke Matsushita Professor of International Economics at the Stanford University Graduate School of Business, a Research Associate of the National Bureau of Economic Research, and a Non Resident Senior Fellow of the Brookings Institution. I have published a number of research articles on the topic of debt relief. Thank you for the opportunity to discuss the implications of this research for the Jubilee Act under consideration by this body (S 2166).

The bill under consideration essentially proposes to extend the reach of the G-8 Multilateral Debt Relief Initiative (MDRI). The proximate impetus for MDRI was the Gleneagles summit in July 2005, where the G-8 Heads of State called on the International Monetary Fund (IMF), the World Bank, and the African Development Bank to forgive the roughly 55 billion dollars owed to them by the world's poorest nations. MDRI itself is an extension and deepening of the Highly Indebted Poor Countries Initiative (HIPC), so I will use my previous analyses of HIPC as the basis of my comments about the implications of debt relief for the efficacy of S 2166.

Debt relief is not free. Like any other policy intervention it entails costs—political capital to garner support and financial capital to pay for the write-off. So the fundamental question is whether the potential benefits are greater. Over a decade ago, debt relief helped to restore investment and growth in a number of middle-income developing countries that arguably suffered from debt overhang. But debt relief is unlikely to help the world's poorest countries because they suffer not from debt overhang but from an absence of the economic institutions that provide the foundation for profitable investment and growth.

## **The HIPC Initiative Tries to Raise Growth And Reduce Poverty by Relieving Debt**

In 1996 the World Bank and the International Monetary Fund (IMF) launched the Heavily Indebted Poor Countries (HIPC) initiative in order to “provide a framework for all creditors, including multilateral creditors to provide debt relief to the world's poorest and most heavily indebted countries, and thereby reduce the constraint on economic growth and poverty reduction” (World Bank, 2004). The original HIPC initiative specified that in order to obtain debt relief a country must have: (1) a GNP per capita of \$695 or less and (2) a debt burden deemed to be "unsustainable" even after the full use of traditional debt-relief mechanisms under the Paris Club. Unsustainable means a ratio of the net present value (NPV) of debt to exports in excess of a country-specific threshold of 200 to 250 percent, or, for very open economies, a NPV of debt exceeding 280 percent of government revenue.<sup>1</sup> In 1996, 41 countries met these criteria (see the appendix for a list).

After qualifying for debt relief, the eligible countries needed to produce a track record of reform for three years in order to reach a “decision point.” At the decision point, the creditors arranged a debt relief package, given an adequate track record of reform. After no more than three additional years of proven policy implementation, countries reached their “completion point” and debt relief transpired.

### **The Enhanced HIPC Initiative**

Under the original framework, only six countries reached their completion points, and a consensus emerged that the process needed to move more quickly. Consequently, the G-7

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<sup>1</sup> See Rieffel (2003) for a detailed discussion of Paris Club logistics.

introduced the enhanced HIPC initiative at its Fall 1999 meeting in Cologne, Germany. The enhanced initiative reduced the ratios that qualified a country's debt burden as unsustainable to 150 percent for net-exports and 250 percent for government revenue. The second initiative also made it easier for countries to reach a decision point, allowed them to begin receiving debt relief as soon as they did so, and provided greater relief. Under the enhanced HIPC initiative, sixteen additional countries began receiving debt relief in 2000, and four more joined this group in January 2003.

### **The HIPC Initiatives Show No Signs of Increasing Growth Or Reducing Poverty.**

To assess the impact of the HIPC initiatives to date, consider first the countries that reached their decision points and began receiving debt relief in the year 2000. Panel A of Table 1 shows that from 1990-95 the GDP per capita of this subset of HIPCs grew at negative 0.5 percent per year. From 1996—the year in which HIPC was initiated—through 2000 their growth rate was 1.5 percent (the poverty indicators show a similar pattern). At a glance, the 2-percentage-point increase seems to suggest faster growth stemming from debt relief, but more careful consideration produces at least three pieces of evidence to the contrary.

First, Panel B of Table 1 shows that the growth rate of the entire set of HIPCs from 1996 to 2000 was 2.4 percentage points higher than it was from 1990 to 1995. This means that the change in the growth rate of those HIPCs still waiting to receive debt relief (as of 2000) has been almost identical to those with debt burdens already reduced. Second, since the actual receipt of debt relief, as opposed to the qualifying process, did not begin until 2000, it is not clear that debt relief drove the increase in growth. Third, and related to the second point, since growth

increased before the implementation of debt relief, the reforms required as a precondition may be the principal cause of the increase in growth for both sets of HIPCs. These three points notwithstanding, many argue that more generous debt relief delivered with greater dispatch would yield better results.

### **The Gleneagles Declaration Promises Complete Debt Relief**

In contrast to the piecemeal approaches of the two previous initiatives, the Gleneagles declaration promises forgiveness of all the debt. For the HIPCs, the critical number is not so much the stock of debt being forgiven—55 billion dollars—but the reduction in debt service, which is somewhere between 1 and 2 billion dollars per year. To get a better sense of the economic significance of the numbers at stake, it is helpful to introduce the concept of the annual net resource transfer (NRT). The NRT of a country is simply its annual net inflow of capital: Gross capital inflows minus gross capital outflows. Because most capital flows to the HIPCs take the form of either grants (also referred to as aid) or new lending, we can write their NRT as follows:

$$\textit{Net Resource Transfer} = \textit{New Lending} + \textit{Grants} - \textit{Debt Servicing} \quad (1).$$

Table 2 highlights three central facts about the impact of the Gleneagles debt relief proposal on the net resource transfers to heavily indebted poor nations. First, the quantity of money at stake for the developed nations of the world is trivial. The \$2 billion of annual debt payments is equal to roughly 0.01 percent of the GDP of the OECD countries. Replacing the funds that would have been received by the multilateral development banks would cost about 1 cent for every 100 dollars of OECD GDP—not exactly a budget-busting expense.

Second, contrary to popular belief, debt service does not cause a net drain of resources from the group of 38 heavily indebted poor countries. Although capital outflows in the form of debt service amount to a nontrivial fraction of the GDP of the heavily indebted poor countries—roughly 3 percent between 2000 and 2005—their gross inflow of capital over the same period of time was much larger—roughly 15 percent of GDP. In other words, despite their debt servicing obligations, the heavily indebted poor countries receive more capital than they pay out to their creditors.

Third, for the past 30 years rich country governments have made no significant increase in the net quantity of resources that they transfer to the heavily indebted poor countries. Given this third fact, it follows from equation (1) that debt relief cannot have a major impact on the overall magnitude of net resource flows. Debt relief reduces debt servicing, but instead of the net resource transfer rising when this occurs, grants or new loans tend to fall. In other words, debt relief in the past has been given instead of, not in addition to, foreign aid. The sum of new lending and grants to the heavily indebted poor countries increased continually from 1970 to the mid-1990s. But starting with the onset of the HIPC initiative in 1996, aid flows (i.e., grants) as a fraction of GDP decreased. Prior to 1996, aid flows amounted to roughly 13.7 percent of GDP in the heavily indebted poor countries. Since 1996 that figure has dropped to between 9.9 and 11.1 percent. Together, the fall in aid flows and the postponed reduction in debt service has been associated with a decline in the HIPCs' net resource transfers (although they are still positive).

Since its impact on the NRT is minimal, debt relief cannot propel the HIPCs toward sustained growth and poverty reduction unless it produces benefits not captured by the numbers in Table 2. The likelihood of such a possibility is the topic of the next section.

## **Debt Relief Promotes Investment And Growth When Countries Have Debt Overhang.**

Debt relief promotes investment and growth when debt overhang inhibits a country's economic performance. "A country has a debt overhang problem when the expected present value of potential future resource transfers is less than its debt" (Krugman, 1988). In other words, a country suffers from debt overhang if it owes more money to its creditors than it is able to pay.

Debt overhang arises when a country accumulates too much debt, but it can also occur when a previously manageable stock of debt becomes intractable due to a change in a country's circumstances. When a country not suffering from debt overhang experiences a bad shock (e.g., a fall in its terms of trade) or bad policy (e.g., poor economic management), the expected present value of its future resource transfers will fall. For a given stock of debt at the time of the shock, if the fall in expected value is large enough, the country will find itself in a position of debt overhang. The country will also be unable to attract new creditors, because lending to it would, by definition of debt overhang, result in a stream of expected repayments whose present value is less than that of the loan.<sup>2</sup>

Importantly, a country suffering from debt overhang will also invest less than it would in the absence of an overhang and consequently may forego efficient (i.e., positive net present value) projects (Sachs, 1984). Underinvestment occurs because the stock of debt acts as an implicit tax. A country's government raises the resources it needs to service its debt by taxing firms and households. An increase in the government's debt increases the private sector's expected future tax burden. Because higher taxes divert the benefits of new investment from the

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<sup>2</sup> Existing creditors, on the other hand, have an incentive to continue lending in an effort to preserve the value of their initial loan (Krugman, 1988).

private sector to the existing debt holders, they also reduce the private sector's incentive to invest. In summary, a country suffering from debt overhang is unable to service its debt, obtain new loans, and invest as much as it should.

Krugman (1989) and Sachs (1989) point to a way out of this inefficient equilibrium. By extending the analogy between debt and taxes to a Laffer-Curve analysis, they show that both borrower and lenders can gain from debt relief. The logic runs as follows. At reasonable levels, the market value of the debt rises one-for-one with its face value. As the face value of the debt increases beyond a critical threshold, however, debt overhang ensues. The market value of the debt begins to fall—even as the face value continues to rise—and physical investment slumps along with the country's expected future growth rate. Consequently, if the creditors reduce the face value of the debt, the market value of the debt will rise. Debt relief also makes the borrower better off, because eliminating the debt overhang reduces the implicit tax on investment and reinstates the incentive for: (1) the country to undertake efficient investments and (2) for new lenders to extend credit.

But debt relief will not happen without coordination, because any individual creditor would prefer to maintain the full value of its claims while others write off some debt (Sachs, 1989). By forcing all creditors to accept some losses, a third-party-coordinated debt relief program has the potential to solve this problem and pave the way for profitable new lending, investment, and growth (Cline, 1995).

### **Debt Relief Helped Restore Investment And Growth in the Brady Countries**

The theory of debt overhang and efficient debt relief captures the experience of the middle-income developing countries hit by the debt crisis in the 1980s. During the international



commercial bank lending boom from 1970 to 1981, the net resource transfer to these countries was strictly positive. Starting in 1982, however, rising interest rates, a global recession, and poor economic policy choices substantially reduced the expected value of the banks' loan portfolios in the debtor countries. As their current and future economic prospects dimmed, debtors began defaulting, new lending to them ceased, and their net resource transfers turned negative for an extended period of time.

In March of 1989, US Treasury Secretary, Nicholas Brady, initiated a plan under which sixteen of the debtors reached debt-relief agreements with their private creditors. The commercial banks wrote off a fraction of the debt owed to them, and the countries agreed to implement major economic reforms.<sup>3</sup> In the twelve months preceding the signing of its debt-relief agreement, the average Brady country's stock market appreciated by 60 percent—a 42 billion dollar increase in shareholder value—while there was no significant increase in the stock market values of a control group of countries that did not sign Brady agreements (Arslanalp and Henry, 2005a).

Debtor-country stock prices rose, in part, because debt relief restored capital inflows. After roughly ten consecutive years of negative net resource flows, the NRT in all sixteen debtor countries turned positive immediately after the signing of their Brady Plan and remained so for the next several years. In order to appreciate the full significance of the change in net resource transfers, it is important to distinguish between two effects of debt relief. The direct effect is that debt relief reduces a country's debt servicing obligations. The indirect effect is that debt relief cleans the books and paves the way for new creditors to lend (Summers, 2000). The direct effect

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<sup>3</sup> See Cline (1995) for a detailed discussion of the restructuring terms.

is quantitatively less important than the indirect one. The Brady Plan led to the forgiveness of approximately 60 billion dollars of debt, but that number is small in comparison to the 210 billion dollars of cumulative net resource transfers the Brady Countries received in the five-year period following the official settlement with their creditors.<sup>4</sup>

The resurgence of capital inflows reflects the pithy Dornbusch maxim: “Unresolved debt problems, not debt *per se*, are an obstacle to investment. It is hard for a man to establish a relationship with a lender if the estranged wife keeps barging in claiming alimony” (Dornbusch, 1993, p.103). Indeed, the Brady Countries’ experienced an investment boom in the aftermath of debt relief. The average annual growth rate of their capital stocks rose by 1.9-percentage-points—from 1.6 percent per year in the five years prior to debt relief, to 3.5 in the subsequent five. The data on GDP per capita paint a consistent picture of economic recovery, rising from an average of 0 to 1.6 percent per year over the same time period.<sup>5</sup>

### **The HIPC’s Exhibit No Symptoms of Debt Overhang**

Debt relief helped the Brady Countries, because it removed an obstacle standing in the way of new lending, investment, and growth.<sup>6</sup> If all else were equal, one might plausibly argue that debt relief for the HIPC’s would achieve similar results. The problem is that all else is not equal. There are at least three reasons why debt overhang does not deter capital flows to the HIPC’s (and hence their investment and growth).

First, if debt overhang hinders capital flows to the HIPC’s, then just as the Brady

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<sup>4</sup> See Arslanalp and Henry (2005b) for the source of the 210 billion dollar figure.

<sup>5</sup> The increase in growth can’t be accounted for solely by the rise in the capital stock, so total factor productivity may also have increased due to the accompanying economic reforms (Henry, 2003).

<sup>6</sup> This is not to say that debt relief solved all of their problems. Starting with Mexico in 1994 and most recently in Argentina in 2001, a number of Brady countries have encountered severe economic crises since the Brady Plan.

Countries experienced negative net resource transfers during their bout with overhang, the HIPC's should now be experiencing negative NRTs. But this is not the case. And nor has it ever been. In contrast to the Brady countries, NRTs to the HIPC's have always been positive (Table 2). If debt relief works by restoring positive NRTs in scenarios where it has turned negative, then the means by which it will help a set of countries in the midst of an uninterrupted stream of positive NRTs since 1970 is not clear. One counterargument to this line of reasoning holds that even if the HIPC's do not suffer from debt overhang, debt relief would make their already positive NRTs even larger. After all, Equation (1) shows that holding the quantity of grants and new loans constant, reducing debt service will surely increase the country's net intake. The problem with this counterargument, as we discuss in greater detail below, is that it ignores budgetary reality: Historically, capital inflows such as grants do not remain constant when countries receive debt relief.

Second, the concept of debt overhang is incongruous with the very nature of lending to the HIPC's. Debt overhang and the potential for efficient debt relief that stems from its presence are predicated on the incentives and rationale that drive lending by profit-maximizing entities. In contrast, official lending, the primary source of HIPC debt, responds to a very different set of considerations. For example, the international commercial banks lent to the Brady Countries because they expected to make a profit for their shareholders by doing so. The HIPC's' principal creditors, multilateral lending institutions such as the International Development Assistance arm of the World Bank, have a broader mandate. At least part of their mission is to channel funds, through a combination of concessional loans and grants, to development projects that may yield large social gains in the long run, but are not immediately profitable (Taylor, 2004).

Since debt relief is designed to enhance efficiency in the market for private lending, it is unclear what effects it would have in a market with a significantly different incentive structure. More generally, a case can be made that the multilateral financial institutions should not lend to poor countries at all but give grants instead (Bulow, 2002; Bulow and Rogoff, 1988, 2005; Taylor, 2004). The history of aid does not inspire confidence in the ability of such transfer schemes to achieve their intended goal (Easterly, 2003). But past failures and current research contain important clues for the design of more effective (and realistic) future aid endeavors such as the Millennium Challenge Corporation (Besley and Burgess, 2003; Birdsall and Williamson, 2002; Brainard, Graham, Purvis, Radelet and Smith, 2003; Burnside and Dollar, 2000).

The third point relates closely to the second. The private sector investment channel, which plays a central role in models of debt overhang, is all but absent in the HIPCs. In models of debt overhang, the government's debt burden deters investment because it imposes an implicit tax on private sector investment. Therefore, in order for debt overhang to act as a deterrent to private investment, the country must have a private sector with viable investment projects to deter. One indication that a country's private sector has viable projects is that it attracts capital to fund those projects. Again, the Brady Countries and the HIPCs show stark differences on this score. As early as 1974, capital flows to the Brady Countries' private sector (private debt + foreign direct investment + portfolio equity) comprised nearly half of their total net resource flow, but the HIPCs private sector never attracted a significant amount of capital. Inflows to the private sector in the HIPCs have accounted for as little as 4 percent of inflows and have never exceeded 13 percent (Arslanalp and Henry, 2005b).

Furthermore, the difference between the composition of capital flows to the Brady and

the HIPC's continues to widen. At the peak of the debt crisis (1985-89), grants plus public and publicly guaranteed debt accounted for 73 percent of the net resource transfer to the Brady countries, but by 1994, the private sector was the destination for the majority of their net resource flows (Arslanalp and Henry, 2005b). No such shift has taken place in the HIPC's. In fact, the opposite has occurred—official flows and flows to the public sector have become more, not less, important. The role of grants has increased to the point where they now constitute the majority of net resource flows to the HIPC's.

The resurgence and expansion of the private sector in the Brady Countries drove their post-debt-relief recovery in investment and growth, with foreign capital flows playing a significant financing role. Since the HIPC's' private sector has never attracted a comparable quantity or composition of foreign resources, it is hard to believe that even complete and immediate debt relief would generate capital inflows, investment, and growth of any consequential magnitude.

### **The HIPC's Principal Problem Is Weak Institutions**

Recent advances in law and finance help to explain why private capital does not flow to the HIPC's and would be unlikely to do so even in the event of complete and immediate debt forgiveness. In a series of papers, La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997, 1998, 2002) demonstrate that the degree to which a country's laws protect the rights of investors exerts a significant influence on its access to external finance. They measure investor protection by constructing a composite index of shareholder rights, creditor rights, efficiency of the judicial system, rule of law, and the accounting system.

The first row of Table 3 shows that the median Brady country ranks lower than the median G7 country on the Laporta et al. index of investor protection. The Brady countries' relatively low ranking may help explain why the quantity of capital flows they receive pales in comparison to the magnitude we would expect on the basis of the predictions of the neoclassical growth model (Lucas, 1990; Shleifer and Wolfenzon, 2002; Stulz, 2005). Although the median Brady country ranks low, the HIPCs do not even make the list. If private capital trickles to the Brady countries because they provide weak investor protection, then woe to the HIPCs whose capital markets and investor protection laws lack sufficient development to even merit a ranking.

More generally, poorly developed capital markets tend to be correlated with a weak economic infrastructure. The second row of Table 3 demonstrates this point by comparing the institutions of the HIPC and Brady countries using the index of economic infrastructure constructed by Hall and Jones (1999). The index ranks 130 countries and attempts to capture the extent to which a country's economic infrastructure provides "an environment that supports productive activities and encourages capital accumulation, skill acquisition, invention and technology transfer" (Hall and Jones, 1999). A ranking of 1 indicates the most development-friendly infrastructure, a ranking of 130 the most inimical. The median G7 country ranks 14<sup>th</sup> while the median Brady country 63<sup>rd</sup>; the median HIPC comes in a distant 102<sup>nd</sup>. The third row of Table 3 shows that a comparison of the Bradys' and the HIPCs' economic infrastructure using the Heritage House Index of Economic Freedom gives similar results.

In combination with the earlier data on net resource transfers, Table 3 demonstrates a point almost too obvious to state: Unlike the Brady countries during the 1980s, the HIPCs principal problem is not debt overhang but an absence of economic infrastructure—both hard

infrastructure like roads and schools, and soft infrastructure like markets and property rights. Without the crucial foundations for profitable economic activity, it strains the imagination to believe that even full and immediate debt forgiveness will precipitate the burst of foreign capital flows, investment, and growth that it did in the Brady countries.

Ironically, the political and financial resources devoted to securing debt relief for the HIPC countries might be more profitably employed towards a number of countries not being considered for such programs at all. These include a group of six highly indebted (but not as poor) developing countries—Indonesia, Pakistan, Colombia, Jamaica, Malaysia, and Turkey—whose economic infrastructures closely resemble those of the Brady countries (Column 4 of Table 3). Because the group of six have viable private sectors and reasonably well functioning capital markets, it is more plausible to expect the response of their economies to mirror the experience of the Brady Countries described earlier in the paper.

### **Debt Relief Will Not Help Build Infrastructure and May Have Unintended Effects**

The principle of policy targeting states that distortions arising from a market failure should be tackled with policy instruments that address the failure directly (Bhagwati, 1971; Dixit, 1994). Both debt overhang and inadequate economic infrastructure produce inefficient outcomes that result from market failure. However, the nature of the market failure, and therefore the appropriate policy intervention, differs in each case. Debt relief is an efficient policy response to debt overhang, because it forces each lender to internalize the negative impact of its intransigence on the borrower and other lenders.

But the HIPC countries market failure stems not from lender intransigence, but a classic public

goods problem in the following vein: Infrastructure investment in the HIPCs' could raise the rate of return to a range of private projects in these countries. For example, by allowing them to get their goods to market, building a road where none exists could encourage farmers to invest in technologies that increase crop yields. But no single farmer will want to build a road, because he will bear all of the costs while society reaps the benefits. In other words, left to their own devices, markets will not provide sufficient roads, or any other public good, so long as the private rate of return to doing so is less than the social return.

Rich-country governments address this type of market failure by collecting taxes to pay for public goods like roads, schools, and hospitals. Since the HIPCs' tax base is not large enough for this task, they require foreign resources to help fill their public goods deficit. The question, then, is whether debt relief for the HIPCs will increase their net intake of capital from abroad?

Ironically, past debt relief efforts have actually reduced net resource transfers to the HIPCs. The net resource transfer identity, equation (1), shows that debt relief increases a country's net resource transfer only if the reduction in debt service does not reduce other capital inflows. Historically, this has not been the case. Debt relief has been given instead of, not in addition to, foreign aid. Again, Table 2 displays the point. Aid flows to the HIPCs increased continually from 1970 to the mid-1990s. But starting with the onset of the HIPC initiative in 1996, aid flows as a fraction of GDP decreased significantly. Prior to 1996, aid flows amounted to roughly 16 percent of HIPC GDP. Since 1996 that figure has dropped to between 10 and 12 percent. Together, the fall in aid flows and the postponed reduction in debt service has caused a decline in the HIPCs' net resource transfers (although they are still positive).



## **Conclusion**

The main beneficiaries of the Gleneagles debt relief proposal would appear to be the rich countries who garner good political press at a trivial cost (Rogoff, 2005). Forgiving debt does not address the fundamental problem of inadequate economic institutions that impedes investment and growth in the world's poorest countries. And, to the extent that additional resources are part of the solution, the indirect approach of debt relief does little, if any, good. In the past debt relief has had a minimal impact on net resource flows, and there is nothing in the Gleneagles proposal to suggest that it will be much different. One of the central development issues of our day is whether the high-income countries of the world will stand ready to help with real money when the low-income countries demonstrate that they are ready to put the resources to good use. The danger is that the Gleneagles declaration may amount to a Pyrrhic victory: A symbolic win for advocates of debt relief that clears the conscience of the rich countries but leaves the real problems of the poor countries unaddressed.

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**Table 1. The HIPCS Receiving Debt Relief Are Not Growing Any Faster, or Reducing Poverty Any More Quickly Than the HIPCs Still Waiting to Receive Debt Relief.**

|  | 1990-95 | 1996-00 | 2001-03 |
|--|---------|---------|---------|
| <u>Panel A: HIPCs That Began Receiving Debt Relief in 2000</u> |         |         |         |
| Growth of GDP Per Capita                                       | -0.3    | 1.7     | 2.3     |
| Human Development Index  | 0.40    | 0.41    | 0.43    |
| <u>Panel B: All HIPCs</u>                                      |         |         |         |
| Growth of GDP Per Capita                                       | -0.5    | 1.9     | 2.0     |
| Human Development Index  | 0.41    | 0.42    | 0.43    |

Source: World Bank, World Development Indicators

**Table 2. New Lending, Grants, and Debt Service for the Heavily Indebted Poor Countries.**

|                               | 1970-79        |             |             | 1980-89        |             |             | 1990-95        |             |             |
|-------------------------------|----------------|-------------|-------------|----------------|-------------|-------------|----------------|-------------|-------------|
|                               | Billions<br>of | %<br>of     | % of        | Billions<br>of | % of        | % of        | Billions<br>of | % of        | % of        |
|                               | Dollars        | HIPC<br>GDP | OECD<br>GDP | Dollars        | HIPC<br>GDP | OECD<br>GDP | Dollars        | HIPC<br>GDP | OECD<br>GDP |
| <b>Net Resource Transfers</b> | <b>4.5</b>     | <b>7.7</b>  | <b>0.10</b> | <b>13.2</b>    | <b>12.2</b> | <b>0.13</b> | <b>18.9</b>    | <b>15.9</b> | <b>0.10</b> |
| New Lending                   | 2.1            | 3.6         | 0.05        | 6.1            | 5.6         | 0.06        | 6.0            | 5.0         | 0.03        |
| Grants                        | 2.9            | 5.0         | 0.07        | 9.1            | 8.4         | 0.09        | 16.3           | 13.7        | 0.08        |
| Debt Service                  | 0.5            | 0.9         | 0.01        | 2.0            | 1.9         | 0.02        | 3.4            | 2.9         | 0.02        |
|                               | 1996-99        |             |             | 2000-03        |             |             |                |             |             |
|                               | Billions<br>of | %<br>of     | % of        | Billions<br>of | % of        | % of        |                |             |             |
|                               | Dollars        | HIPC<br>GDP | OECD<br>GDP | Dollars        | HIPC<br>GDP | OECD<br>GDP |                |             |             |
| <b>Net Resource Transfers</b> | <b>13.9</b>    | <b>10.4</b> | <b>0.06</b> | <b>17.7</b>    | <b>12.2</b> | <b>0.07</b> |                |             |             |
| New Lending                   | 4.8            | 3.6         | 0.02        | 4.5            | 3.1         | 0.02        |                |             |             |
| Grants                        | 13.2           | 9.9         | 0.06        | 16.0           | 11.1        | 0.06        |                |             |             |
| Debt Service                  | 4.0            | 3.0         | 0.02        | 2.8            | 2.0         | 0.01        |                |             |             |

Source: The data on net resource transfers, new lending, and debt service are obtained from World Bank's Global Development Finance Data Base. The data on grants come from the World Bank's World Development Indicators Data Base.

Table 3. The HIPCs Have Much Weaker Economic Infrastructure Than the Brady Countries

|   | G-7 | Brady Countries | HIPCs | “Group of 6” |
|---|-----|-----------------|-------|--------------|
| Laporta et al. Score                          | 7.5 | 4.9             | N/A   | 4.6          |
| Hall and Jones (1999) Rank                    | 14  | 63              | 102   | 61           |
| Heritage House Index of Economic Freedom Rank | 14  | 59              | 110   | 58           |

The first row lists the median La Porta, Lopez-de-Silanes, Shleifer and Vishny (LLSV) score of social infrastructure for the G7 countries, Brady countries, HIPCs, and the group of six countries. The countries in the group of six are Indonesia, Pakistan, Colombia, Jamaica, Malaysia, and Turkey. The second row lists the median Hall and Jones (1999) rank for each country group. The third row lists the median Heritage House Index of Economic Freedom rank.

## **Appendix A, The Highly Indebted Poor Countries Eligible for Debt Relief at Various Stages**

The original 41 HIPC countries are: Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Congo, Cote d'Ivoire, Democratic Republic of the Congo, Equatorial Guinea, Ethiopia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Kenya, Lao PDR, Liberia, Madagascar, Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Nigeria, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, Yemen, and Zambia.

After a revised debt sustainability analysis, three countries were added (Comoros, the Gambia, and Malawi), while six countries were taken out of the group (Angola, Equatorial Guinea, Kenya, Nigeria, Vietnam, and Yemen). Currently, the HIPC group consists of 38 countries.

The six countries that reached their completion points under the original HIPC Initiative are: Bolivia, Burkina Faso, Guyana, Mali, Mozambique, and Uganda.

The sixteen additional countries that reached their decision points under the Enhanced HIPC Initiative, and began receiving debt relief in 2000 are: Benin, Cameroon, Gambia, Guinea, Guinea-Bissau, Honduras, Madagascar, Malawi, Mauritania, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Tanzania, and Zambia.

The five additional countries that had reached their decision points under the enhanced HIPC Initiative (as of June 2005) are: Chad and Ethiopia in 2001, Ghana and Sierra Leone in 2002, and Democratic Republic of Congo in 2003.

The eighteen countries that have reached their completion points under the enhanced HIPC Initiative (as of June 2005) are: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

The nine countries expected to reach their completion points in the next one to three years: Cameroon, Chad, Democratic Republic of Congo, The Gambia, Guinea, Guinea-Bissau, Malawi, São Tomé and Príncipe, and Sierra Leone.

## **Appendix B, The Brady Countries**

Argentina, Bolivia, Brazil, Bulgaria, Costa Rica, Dominican Republic, Ecuador, Jordan, Mexico, Nigeria, Panama, Peru, Philippines, Poland, Uruguay, and Venezuela.