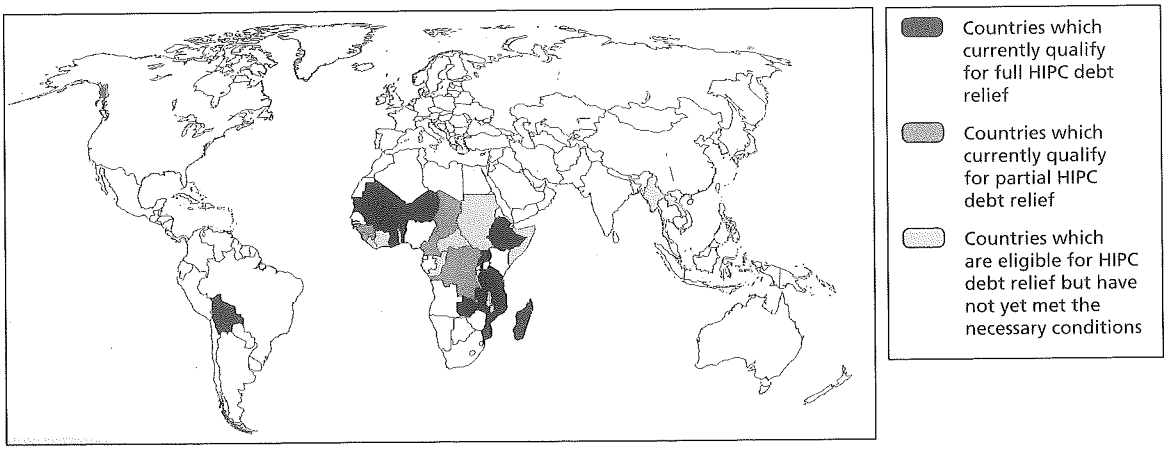
The impact of aid and debt relief (1)

THE EFFECTIVENESS OF AID

When aid is effective	When aid is ineffective
It provides humanitarian relief	Aid might allow countries to postpone improving economic management and mobilization of domestic resources
It provides external resources for investment and finances projects that could not be undertaken with commercial capital	Aid can replace domestic saving, direct foreign investment and commercial capital as the main sources of investment and technological development
Project assistance helps expand much-needed infrastructure	The provision of aid might promote dependency rather than self-reliance
Aid contributes to personnel training and builds technical expertise	Some countries have allowed food aid to depress agricultural prices, resulting in greater poverty in rural areas and a dependency on food imports; it has also increased the risk of famine in the future
Aid can support better economic and social policies	Aid is sometimes turned on and off in response to the political and strategic agenda of the donor country, making funds unpredictable, which can result in interruptions in development programmes
	The provision of aid might result in the transfer of inappropriate technologies or the funding of environmentally unsound projects
	Emergency aid does not solve the long-term economic development problems of a country
	Too much aid is tied to the purchase of goods and services from the donor country, which might not be the best or the most economical
	A lot of aid does not reach those who need it, that is, the poorest people in the poorest countries

POOR COUNTRIES' DEBT



Heavily indebted poor countries (HIPCs)

Sub-Saharan Africa (SSA) includes most of the 42 countries classified as heavily indebted and 25 of the 32 countries rated as severely indebted. In 1962, SSA owed $3 billion (£1.8 billion). Twenty years later this debt had reached $142 billion. Today it is about $235 billion. The most heavily indebted countries are Nigeria ($35 billion), Côte d'Ivoire ($19 billion) and Sudan $18 billion).

Many developing countries borrowed heavily in the 1970s and early 1980s, encouraged to do so by western lenders, including export credit agencies. They soon ran into problems:

- low growth in industrialized economies
- high interest rates between 1975 and 1985
- a rise in oil prices
- falling commodity prices.

EXTENSION

Visit **http://www.imf.org/external/np/exr/facts/hipc.htm** for a fact sheet on debt relief under the Heavily Indebted Poor Countries (HIPC) initiative.

The impact of aid and debt relief (2)

WHAT HAS BEEN DONE TO DEAL WITH THE PROBLEM?

Since 1988, the Paris Club of government creditors has approved a series of debt relief initiatives.

- The World Bank has lent more through its concessional lending arm.
- The International Development Agency has given loans for up to 50 years without interest but with a 3–4% service charge.
- Lending has risen from $424 million in 1980 to $2.9 billion, plus a further $928 million through the African Development Bank.
- The IMF has also introduced a soft loan facility conditional on wide-ranging socio-economic reforms.

Structural adjustment programmes (SAPs)

SAPs were designed to cut government expenditure, reduce the amount of state intervention in the economy, and promote liberalization and international trade. SAPs were explicit about the need for international trade.

SAPs consist of four main elements:

1. Greater use of a country's resource base
2. Policy reforms to increase economic efficiency
3. Generation of foreign income through diversification of the economy and increased trade
4. Reducing the active role of the state

These were sometimes divided into two main groups:

- **stabilization measures**: short-term steps to limit any further deterioration of the economy (e.g. wage freezes; reduced subsidies on food, health and education)
- **adjustment measures**: longer-term policies to boost economic competitiveness (e.g. tax reductions, export promotion, downsizing of the civil service, privatization, economic liberalization).

THE ACHIEVEMENTS OF LEDCS

People in the West tend to forget about the achievements of the developing world. For example:

- average real incomes in the poor world have more than doubled in the past 40 years despite population growth
- under-5 death rates have been cut by 50% or more in every region over the past 40 years
- average life expectancy has risen by more than one-third in every region since 1950
- the percentage of people with access to safe water supply has risen from about 10% to 60% in rural areas of the developing world since 1975.

EXTENSION

Visit **http://imf.org/external/np/exr/facts/mozam/mozam.htm** for facts on Mozambique and debt service.

THE HEAVILY INDEBTED POOR COUNTRIES INITIATIVE

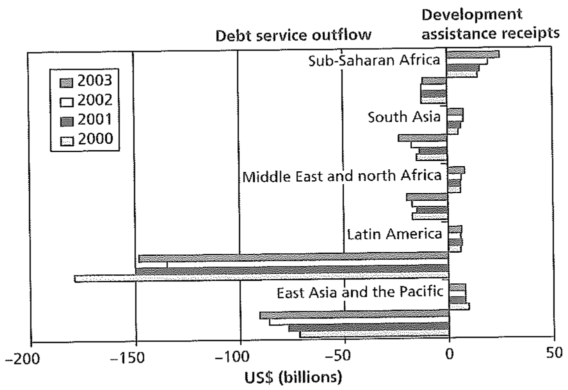
The HIPC initiative, launched in 1996 by the IMF and the World Bank and endorsed by 180 governments, has two main objectives:

- to relieve certain low-income countries of their unsustainable debt to donors
- to promote reform and sound policies for growth, human development and poverty reduction.

Debt relief occurs in two steps:

- At the decision point, the country gets debt service relief after demonstrating adherence to an IMF programme and progress in developing a national poverty strategy.
- At the completion point, the country gets debt stock relief upon approval by the World Bank and the IMF.

"Debt service" is the cash required over a given period for the repayment of interest and principal on a debt – monthly mortgage payments are a good example. "Stock relief" is the cancelling of specific debts; this will achieve a reduction in debt service over the life of a loan.



Debt service and development assistance, 2000–3 **Source:** *World Bank*

Of the 42 countries participating in the initiative, 34 are in sub-Saharan Africa. None had a PPP above $1500 in 2001, and all rank low on the HDI.

Expanding market access is essential to help countries diversify and expand trade. Trade policies in rich countries remain highly discriminatory against developing country exports.

MEDCs should set targets to:

- increase official development assistance
- remove tariffs and quotas on agricultural products, textiles and clothing exported by developing countries
- finance debt reduction for HIPCs having reached their completion points to ensure sustainability.