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Will HIPC Matter? The Debt Game and Donor Behaviour in Africa

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Abstract

In this paper we focus on the question: will the HIPC debt reduction programme help in the transformation of the development assistance business and change the rules of the 'debt game' in Africa? We concentrate on the donor and official creditor side, by exploring how the growing debt of African countries, over the last two decades, has affected the provision of new resources by the donor community. Our results indicate that if debt levels are reduced sufficiently in high debt countries, donors can shift from the current pattern of non-selectivity and defensive lending to a low debt regime, a regime that has in the past allowed selectivity in lending in relation to levels of poverty and quality of policy.

Keywords: debt relief, foreign aid, low-income countries, international organizations

JEL classification: O11, O19, F34, F35

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1 Introduction

At the turn of the century, the international donor community has put a high priority on a one-time reduction of the official debt of more than 40 of the world's poorest countries. The initiative, known as HIPC (for highly indebted poor countries), has been supported, indeed pushed hard, by non-governmental groups, many working under the banner of the aptly named Jubilee 2000 initiative of church-led groups. The objective of Jubilee 2000 and other non-governmental groups as well as of the official bilateral and multilateral donors is to significantly reduce the burden of debt service by poor countries to the multilateral organizations and other official donors, allowing debt-laden countries to devote more of their own resources to health, education and other programmes to reduce poverty and improve people's well-being.

The debt reduction initiative is one part of a larger effort by the international donor community to redefine the external assistance strategy toward the poorest countries.[1] This stems from a recognition that despite billions of dollars of assistance over more than three decades, economic growth in these countries remains low and the reduction of income-defined poverty (there has been progress, although uneven across countries, in areas such as school enrolment and reductions in infant mortality) is painstakingly slow and in some countries entirely stalled. Civil society groups have played a central role in shaping the new strategy. The strategy is built on three axes: greater ownership of reform programmes by recipient country governments and, through increased participation of citizens and civil society groups in each country, by their societies; greatly improved coordination of donors—an elusive objective up to now—by governments that are truly 'in the driver's seat'; and a new round of reduction of the onerous debt overhang of the poorest countries, this time including multilateral debt, i.e. debt owed to the international financial institutions. Many civil society groups in the donor countries have also emphasized the need for an increase in the total volume of development assistance.

While the new approach seeks a historical break with past practices, it also relies on a courageous leap of faith. Why would practices that are well entrenched in the countries and in the IMF, the World Bank, the regional development banks, and among bilateral donors, change quickly? Why would internal problems of recipient countries, including lack of technical capacity and in some cases, governments that are not accountable to their citizens, disappear? Will the 'ownership' approach adequately distinguish between countries able to sustain the reforms necessary for growth, and those unable to do so? Will the creditors and donors become more selective in their transfers and in the debt reduction itself, concentrating adequately on the former group? In short, will the new approach resolve the fundamental constraints of the past? Finally, if the problems of the past are resolved, will the traditional donors increase net transfers sufficiently to finance the critical social, physical and institutional investments that would in turn crowd in the private resources ultimately needed?

A large literature has developed on the country factors that influence the development aid business and the effectiveness of aid. Two major findings emerge: an adequate policy and institutional environment in the recipient country is key to aid effectiveness;

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[1] The donor community has formally set the goal of reducing the number of people in the world living in extreme poverty by half between 1990 and 2015 (IMF, OECD, UN and World Bank Group, *2000: A Better World for All*, June 2000, www.paris21.org/betterworld).

but aid and debt relief have not been particularly targeted to countries with adequate policies and institutions.[2]

In this paper we concentrate on understanding the dynamics behind the second finding, i.e. behind the aid process from the donor and official creditor side. We do so by exploring how the growing debt of African countries over the last two decades has affected the process of granting new loans and grants to them by the donor community. We look at the past to understand a question about the future: Will the HIPC debt reduction programme help in the transformation of the development assistance business? Or will debt reduction simply invite another round of business-as-usual (in the form of new loans and new debt accumulation) of the kind that is implicated in the debt build-up in the first place?[3]

Why should we focus on the effect of debt build-up on donor behaviour? We argue that without this angle, the arguments of the proponents of debt reduction about the benefits of HIPC are incomplete and need to be extended. Proponents have focused on the speed and size of debt reduction. But there has been no analysis of past donor and creditor behaviour to provide guidance on a framework for new debt relief that will benefit the low-income countries. For one thing, official debt reduction via the HIPC programme will not necessarily provide additional resources to countries, i.e., it will not necessarily lead to higher transfers net of debt service payments. Additionality, either at the country or aggregate level, is likely to be endogenous and an outcome of the process: we can only expect more aid over time if aid is demonstrably more effective at reducing poverty. The traditional argument about the potential positive effect of debt reduction—that it would reduce uncertainty and fear of future high taxation, and thus might trigger a new higher level of investment—was made in the context of expected changes in the behaviour of private agents in the case of Latin America in the late 1980s (Sachs 1990; Krugman 1990). For Africa, however, and indeed for most of the poorest countries with high debt, most debt is official (owed to other governments or to multilateral institutions), not commercial. For most countries in most years, net transfers have been positive, i.e. there has been no 'debt tax' on recipients. Though reduction of public debt might affect the expectations of the private sector in Africa, the main channel by which debt reduction is likely to change the circumstances and development prospects in Africa is through its effect on the behaviour of the official donors, and then in turn on the behaviour of countries.

These considerations motivated us to investigate the possible sources of 'efficiency gains' that would be connected with HIPC. We use past creditor and donor behaviour as guides to what might happen going forward. Future gains related to debt reduction are the flip side of what is likely to have been inefficient behaviour induced by the debt crisis.

We begin with a description of what we call the 'debt game' in Africa over the last two decades, including the basic information on net transfers by creditors and donors and the accumulation of debt (section 2). We then set out the logic for our analysis of how the

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2 World Bank (1998).

3 Easterly (1999) develops a model to explain why countries with certain characteristics end up with high debt. His model has the strong implication that countries pursue bad policies to receive future debt reduction. The model does not examine the behavior of the creditors to these countries.

ongoing HIPC programme (HIPC II) for reduction of multilateral debt could alter the debt game. We outline its potential effects on *additionality*, i.e. an increase in total net transfers by donors to the HIPC countries; on country *ownership and efficiency* in the use of transfers by recipient countries to a particular country; and on donor *selectivity*, i.e. on donor willingness and ability to discriminate among recipient countries in where transfers are likely to be most effective in encouraging broad-based growth and poverty reduction. We justify a focus in particular on selectivity (Section 3). In Section 4, we turn to our empirical analysis of the selectivity of donor and creditor behaviour over the last two decades. We conclude by summarizing the implications of our results for the potential benefits of the HIPC debt reduction programme.

2 Development assistance and the debt game in Africa, the 1980s and 1990s

Over the last 25 years Sub-Saharan African countries have been major recipients of overseas development assistance. Gross transfers in the form of grants and loans from bilateral and multilateral donors have amounted to about US$ 350 billion (in nominal terms—the figure in dollars of the year 2000 would be much higher). In some countries in some years, gross transfers were as much as 60 per cent of GDP; in many countries transfers often exceeded the government's own revenue collection

In the same period, with a few exceptions, countries have had relatively low rates of per capita growth. The growth rate per capita for the region as a whole was negative in the 1980s (about –2 per cent per year) and about –1 per cent in the 1990s. Despite high levels of lending and grant programmes, average GDP per capita at constant prices is lower in 2000 than it was in 1960, and the number and proportion of poor people have increased; of its population of 600 million, 40 per cent in Sub-Saharan Africa today live on less than US$ 1 a day.[4]

Meanwhile, the high levels of development assistance in the form of loans and low growth have combined to produce a growing stock of debt—from about US$ 60 billion in 1980 to US$ 230 billion in the year 2000. Annual debt service paid also increased, but by much less, from an average of US$ 6 billion per annum in the early 1980s to about US$ 11 billion in the late 1990s. Indeed, donors and creditors, to help governments avoid arrears on their high debt service obligations, and to maintain the credibility and potential benefits of their favoured programmes, have resorted to a combination of debt rescheduling and fresh loans and grants which, in fact, represent fewer truly additional resources. The resulting process, if not a shell game,[5] is hardly one conducive to sustained development initiatives truly owned and managed by recipient governments. The basic features of the debt game as it evolved over the last two decades in Africa can be summarized as follows.[6]

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4 World Bank (2000a). An estimated 200 million have no access to health services.

5 This is the term used by Sachs *et al.* (1999).

6 From now on, data we use throughout is for a subset of African countries, the dataset is described in part 4 below.

2.1 Large and positive net transfers, with no 'debt tax'

Average net transfers as a proportion of GDP for Africa (in our sample) as a whole have been about 12 per cent, representing half of all government revenue and most of all public investment. Figures 1a, 1b and 1c show net official and private transfers, debt service and disbursements for two subperiods: 1977-87 and 1988-98, in nominal terms.

Figure 1A
Annual net transfers to SSA by category of creditors (in nominal terms)

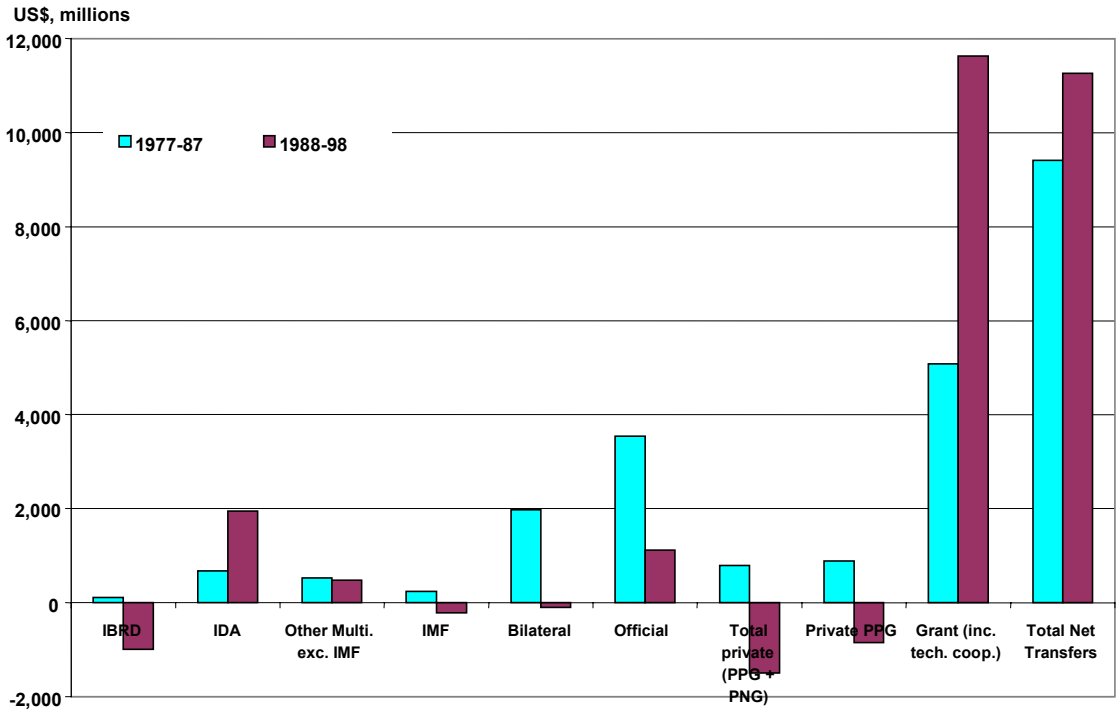


Figure 1B
Annual debt service of SSA by category of creditors

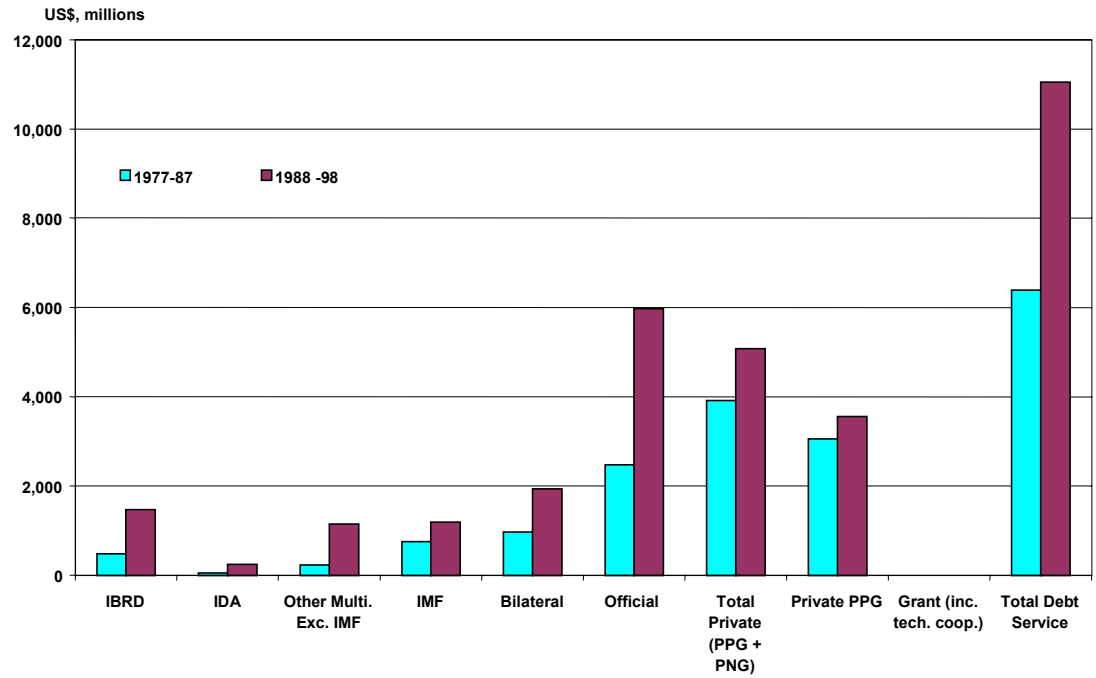
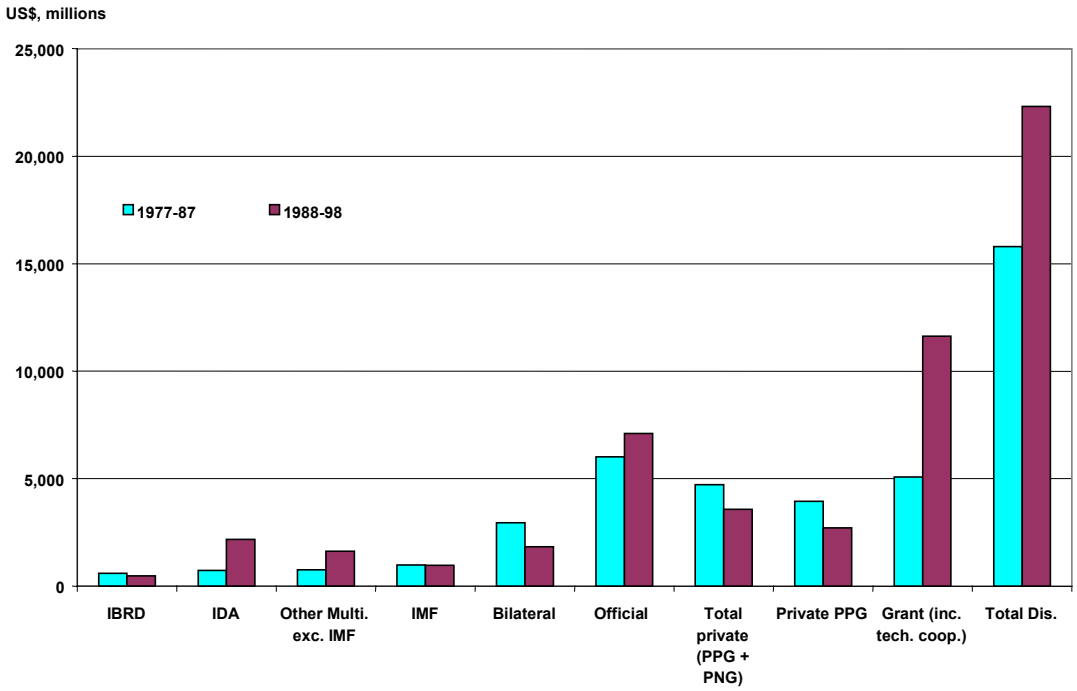


Figure 1C
Annual disbursements to SSA by category of creditors



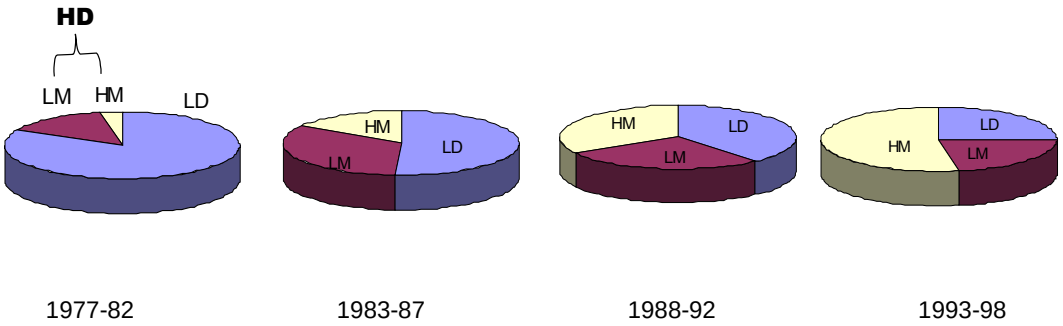
Debt service paid by the countries rose somewhat in the 1990s, from 4.5 to 5 per cent of GNP, compared to the 1980s as their total debt stock grew. But even in the 1990s debt service has always been less than half of net transfers—accumulating debt has in itself not reduced net transfers. As is clear from the figures, total net transfers did not change much (in nominal terms) in the 1990s compared to the 1980s because new disbursements were sufficient to maintain more or less steady total transfers net of debt service. In the aggregate in short, there has been no 'debt tax', i.e. the average country (in our sample, see below) have not been worse off in terms of net transfers as their debt stock rose over time.

But have countries with higher debts been treated worse that those with little debt? To provide a first cut answer, we have divided our sample into various subgroups of potential interest—we call these the low and high debt regimes, and the low and high multilateral debt regimes. Each cell (country/date) is considered low or high debt regime depending on whether its related debt to GNP ratio is below or above 62.8 per cent (the median of the sample). The high debt group has been further subdivided into a low and a high multilateral debt group, depending on whether the share of multilateral debt in total debt is below or above 41.2 per cent (again the median of the sample). Figure 2 illustrates the size of the sub-samples: over time, both the share of high debt cases grew, and so did the share of high multilateral debt cases within the high debt group.

We can now compare the average behaviour of net transfers and debt service over the different debt regimes (see Table 2). Somewhat surprisingly at first sight, while net transfers are about constant over time (as a share of GNP), they are larger in high debt and especially in the high multilateral debt regimes. Consistently, countries with high debt ratios *and* high debts due to multinational institutions have received larger net

transfers: 21 per cent of GNP in the 1980s, and 17.5 per cent in the 1990s. The low debt regimes have received much less (10.5 and 8 per cent of GNP). Interestingly, the low multilateral debt cases (a subdivision of the high debt regime) which received 15 per cent of GNP in the 1980s received only net transfers of 6 per cent of GNP in the 1990s. It is also interesting to note that debt service paid varied much less among the groups—between 3.5 and 6.5 per cent of GNP. We are thus left with a first mystery. Rather than a debt tax, there is some evidence of a *debt subsidy*: countries that found themselves with higher debts, and especially to international organizations, have actually received larger net transfers than other countries.

Figure 2
How has the pre-HIPC game worked? Four debt regimes



Legend: HD = high debt = debt/GNP > 0.6
HM = high multilateral debt = multilateral debt/total debt >0.4

2.2 No additionality since debt reduction: donors having apparently financed debt service reductions from a given total envelope of development assistance

Over the last two decades, there have been repeated rounds of debt rescheduling and reductions of debt service obligations by bilateral donors, as they have tried to deal with the recipients' lack of growth and consequent difficulty in meeting debt payments.[7] In the aggregate, it is clear that these reschedulings and reductions in debt service have not represented additional transfers for the recipient countries, since in fact the real value of total net transfers has declined.[8] Our data on net transfers actually include some information on debt and debt service reduction (the way these are included in ODA is unfortunately not entirely consistent across countries, see Renard and Cassimon 2001 for a description of how donors account for debt reduction). On average, countries have received on a yearly average basis less than 2 per cent of GNP in debt and debt service reduction over the 1990s (zero over the 1980s). Excluding this debt and debt service reduction from net transfers, 'net' net transfers have thus fallen even more. Moreover, net transfers have fallen despite a slight increase in official disbursements, as debt service owed to official creditors has risen. An increase in grants (from bilateral

7 The repeated rounds of debt reschedulings are described in Daseking and Powell (1999).

8 Given grants only, the real value increased slightly (Figure 1A)

donors—who were switching from loans to grants throughout the two decades) kept net transfers positive in absolute nominal terms, though not in real terms.[9]

2.3 Creditors' increasing presence has meant reduced space for 'ownership' of development programmes by recipients

Behind high and relatively steady net transfers over more than two decades lay large increases in gross transfers and debt service payments. Growing disbursements from donors and creditors meant their involvement in the development programmes of recipient countries was much larger (about one-third larger) in 1998 than at the beginning of the 1980s. Meanwhile the debt service burden also grew, increasing (in nominal terms) from US$ 6.3 billion to US$ 11.1 billion for this sample of Sub-Saharan countries (Figure 1).

The largest component of aid to Africa has been grants from bilateral donors. Grants have come primarily in the form of 'projects' as opposed to more fungible policy-based budget support, or debt relief. Grants mostly finance discrete projects and include a large dose of donor country technical assistance that is not fungible. What data there are on project vs. non-project aid indicate that there has been no measurable increase (if anything, a slight decline) between the 1980s and the 1990s in the share of donor assistance to non-project budget support, and that the share of debt relief increased only marginally (see appendix).

In the absence of budget support, it is the governments' domestic budgets that have to finance debt service. In 1998, gross donor disbursements (including grants) for projects were about US$ 13 billion, and for general budget support about US$ 3 billion.[10] Debt service paid from the budget was about US$ 9 billion. Thus, including debt repayments and excluding projects financed, governments on average in Africa had to finance a net negative transfer from their budget of US$ 6 billion. Governments thus ended up 'cash-poor,' but 'project rich'. Of course, if all the projects financed were, in fact, high priority for the governments, the bottom line is still a healthy positive net transfer, given the fungibility of money. The problem arises if the projects in fact reflected donor priorities more than government priorities—not only among investments but also between investment and operating costs of existing investment projects. In fact, most public investment in Sub-Saharan Africa has been externally financed.[11] A shift from investments to budget support would be more efficient assuming the marginal return to

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9 The mean of the dependent variable in the regression analysis, which is of course not weighted by population of the different countries and is not population-weighted within the countries, shows an annual decline in net transfers by about 0.14 percentage points of GNP per year for the average country. The decline accelerated in the second of the two periods, to 0.15 compared to 0.13 in the first period. The figures in the appendix give an idea of the variability of net transfers over time within countries. Sachs et al, 1999, discuss the difficulty for recipient countries of managing variability particularly if it is unpredictable. It is difficult to assess real variability from these data, however, since some of the variability may be associated with lumpiness in transfers at the beginning and end of each year, i.e. with less unpredictability than the figures imply.

10 World Bank (2000b).

11 Reflecting the dominance of the donors in public investment projects, public investment is higher than in other developing countries, given income. Public investment is also relatively high compared to the central government budget (one-third and more) and to GDP (5 to 10 per cent) (World Bank 2000a).

public investment is low (Devarajan 1996), as is likely to be the case in many countries in Africa, given low growth despite positive investment rates.[12]

2.4 Growing portion of total debt owed to the multilateral creditors

Meanwhile, a growing proportion of recipients' debt and debt payments became due to the multilaterals. Figure 2 illustrates how between 1977 and 1998, more and more countries in Africa shifted from a low debt to a high debt category (high debt classification being for countries in any years when their debt/GNP ratio exceeded 62.8 per cent); and from what we label a low multilateral debt regime to a high multilateral debt regime (when the share of multilateral debt out of total debt exceeded 41.2 per cent).[13]

High multilateral debt became the norm as net transfers of bilateral creditors had become negative by the second period, with bilateral donors switching to grants (Figure 1a). IMF net transfers also fell, and the World Bank switched from IBRD lending to the more concessional IDA transfers, with a lower future debt component.[14] Net transfers from private creditors became negative in the second period, from a marginally positive amount in the first period.

With the shift of bilaterals to grants, and the various debt forgiveness, rescheduling and reduction programmes of the bilaterals, the share of multilateral creditors in the total debt of recipient countries increased substantially. Between the early 1980s and the end of the 1990s, the stock of multilateral debt increased from about one-seventh of total debt (in 1980) to almost one-third in 1998. The share of the multilaterals in debt service grew even faster from one-tenth (1980) to one-third, as debt service on multilaterals' earlier round of concessional lending fell due.[15] Debt service to private creditors rose somewhat, but most of the total average annual increase from US$ 6 billion to US$ 11 billion for Sub-Saharan African countries was due to official creditors.

The result, of course, was that debt service payments of countries to multilaterals rose, so that higher disbursements by the multilaterals or bilaterals against new programmes and projects were needed to prevent a reduction in total net transfers to the recipient countries. This became increasingly difficult because in some countries the administrative capacity to absorb new money in new programmes and projects was limited. In addition, without a minimum commitment to policy reform and the ability of governments to sustain that commitment politically, the donors as a group, and in particular the multilaterals, faced the difficulty of designing and enforcing the policy conditions needed to justify new lending, particularly new programme lending. In addition, the growing multilateral debt made it more difficult for the bilaterals to switch

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12 In addition the system appears to be biased towards capital goods, with not enough finance going to labor costs—indeed, the labour share collapses after the 1980s in most African countries (Diwan 1999).

13 In both cases these are the medians for the relevant samples.

14 Some countries that had been receiving IBRD loans became eligible for IDA loans as their per capita income fell, and this affects our aggregate numbers that cover IDA and IBRD countries in Africa.

15 Total debt service paid was also increasing, of course, from about 7 to 15 per cent of the value of exports.

away from non-fungible projects to budget support, since they generally have preferred to provide budget support only under the umbrella of IMF and World Bank-led agreements with recipient governments on policy changes.

2.5 The overall result: a multilateral as well as a debt crisis

Over the two decades, differences emerged among countries in Africa in the relative size of their overall debt and in the share of their debt owed to the multilaterals. However, the fact is that over time more countries became 'high debt' countries and more became in particular 'high multilateral debt' (HM) countries. Table 2 includes several revealing facts about the HM countries as a group: (i) total net transfers as a per cent of GNP were *higher* for HM countries than for the others, especially in the 1990s; and (ii) for HM countries, though not for low debt countries, debt service payments actually *declined* in the 1990s, as they apparently benefited more than the others from the switch of bilateral donors to grants (and probably of IBRD to IDA lending, as some of them suffered negative per capita income growth and became IDA-eligible). Meanwhile the IMF and the World Bank were transferring a lower share of all net transfers to the Africa region (perhaps because of the absorption problem noted above), and were receiving an increasing share of all debt service payments.

The emerging picture then is one where the multilaterals appear to have been caught along with the poor countries in a debt trap, victims of their own and the donor community's eagerness to avoid recipient countries' falling behind in debt service to the multilaterals (with its larger costs including loss of access to trade credits and future lending). The donor community as a whole was trapped in a second sense as well, since it relies on the multilaterals to manage the policy dialogue backed by large programme transfers (with accompanying leverage on policy via loan conditions). On the other hand, we cannot be sure of such a conclusion from Table 2 alone. It is possible that the high transfers to the high debt and high multilateral debt countries were due to other reasons, in particular to their higher level of poverty (evident in Table 2) or, given their high poverty, to their relatively better policies compared to other recipient countries (possible but less evident in Table 2). Below we turn to regression analysis to sort out the relevance and weight of these factors.[16]

3 The HIPC programme and future donor behaviour

It was in this context—of rising debt stocks, despite repeated rounds of debt relief, and growing multilateral debt with diminishing donor discretion—that the proposal for debt reduction in the highly indebted poor countries (HIPCs) arose. [17] To motivate our analysis, here we comment on the potential effect of the proposed debt reduction via the HIPC programme on donors' and creditors' future behaviour in terms of three issues:

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16 Of course, other factors such as deteriorating terms of trade may also have played a role in the deteriorating debt situations of many low-income countries. Such factors alone nevertheless cannot explain the willingness of donors to continue to lend in light of worsening debt situations.

17 There are many extant descriptions of the HIPC programme. See www.WorldBank.org/hipc/about/about.html for a good analysis of the costs under different assumptions.

additionality, increased scope for efficiency and ownership by recipient governments, and selectivity.

3.1 Additionality

A first question about future donor behaviour is whether the HIPC programme will constitute *additional* funds for development needs, or whether its costs will crowd out new transfers by donors.[18] (In the aggregate debt rescheduling and debt service reductions in the past do not seem to have been associated with additional transfers, as we note above.)[19] A good portion of the reduction of multilateral debt under HIPC will be financed by bilateral donors, including through their contributions to multilateral trust funds which are set up to receive donations and then deploy them against the multilaterals' balance sheets. If these bilateral contributions come from the same political reservoir for development assistance as potential future donations to the multilaterals' concessional windows, then they may simply end up as another way in which bilaterals channel aid.

In short there is the risk of a tradeoff between debt reduction and new money. In bilateral donor budgets, real increases would be needed in the future to finance both new programmes and the annualized cost of the HIPC debt reduction.[20] In the absence of real increases in those budgets, aid disbursements could simply be replaced by debt write-offs of an equivalent value. (In fact, for bilateral donors, debt write-offs cost less than the nominal value of the debt forgiven to the extent there was some probability the debt would not be fully repaid anyway.)[21]

For the multilateral institutions, whatever portion of debt reduction they finance internally requires recourse to the use of capital or profits from ordinary lending.[22] That amount is divisive among the shareholders since use of capital or profits can raise the

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18 Whether donors provide additional assistance following HIPC debt reductions is particularly important because the size of the debt reduction programme itself is not that great in terms of recipient countries' needs. Martin (2000) notes that for all HIPC countries taken together, the annual savings on debt servicing from HIPC II levels of relief are equivalent to only about a tenth of total net resource flows to those countries. In referring to Martin, Killick (2000) makes the point that expectations of the effect of HIPC on countries' capacity to finance their own programmes of poverty reduction are thus probably exaggerated.

19 Using our country and panel data, we estimated the effect of past debt service reductions on net transfers by the bilaterals (in loans and grants) and multilaterals. We found evidence of only weak additionality (less than one-to-one, and virtually none at all if the value of debt stock were discounted).

20 Such increases could come from the contracting of assistance to middle-income countries (e.g. Israel, the Balkans, as cold war motives and older historical links phase out) but there is no reason to count on this.

21 Moreover, contributions of bilaterals to trust funds can be divisive and create burden sharing difficulties, as different donors want to support different countries in different regions. For example, the French are likely to be concerned to target any contributions from them for multilateral debt reduction to the Francophone African countries.

22 This is the case for the World Bank, the Inter-American Development Bank and the Asian Development Bank. The African Development Bank does not have sufficient hard loan assets to resort to this device, and thus requires bilateral contributions to trust funds to cover reduction of its debt.

cost of borrowing to middle-income borrowers. For that reason, use of net profits for HIPC is likely to cut into the future allocations of those same profits to the concessional funds for new loans (in effect diverting resources from non-HIPC IDA-eligible countries).

Finally, the size of the enhanced HIPC II Initiative (though small in terms of recipient country needs)[23] increases the likelihood that debt reduction will substitute for new transfers. While the original HIPC Initiative, initiated in the fall of 1996, sought to bring down the ratios of debts to exports to 250 per cent, the expanded initiative seeks to bring them down further, to 150 per cent (in net present value terms).[24]

In short, there is no reason to expect the envelope of donor resources to increase because of debt relief; additionality in future transfers may have to come only for some countries, at the cost of others, through greater discrimination or selection *among* potential recipient countries by donors.

3.2 Efficiency and ownership

Even in the absence of additionality at the recipient country level, countries could benefit from the HIPC programme if it leads to allocation of a higher portion of total net transfers for budget support as opposed to specific projects, and if in the context of the HIPC programme, it becomes easier for countries to manage donor resources and thus 'own' their own programmes. (This is the philosophy behind the new requirement that recipient countries prepare their own 'poverty reduction strategy papers' to provide the basis for the HIPC debt relief and for subsequent new lending.)[25]

The problem is that in the past donors and creditors may have been reluctant to increase budget support because they lacked confidence in the capacity and accountability of recipient governments.[26] In this context, debt reduction has the disadvantage that it releases the creditworthiness constraint, allowing impatient (or badly managed or corrupt) governments to accumulate debt again (Easterly 1999)—unless donors exercise limits on new lending of a kind that they did not exercise in the past (see on this also the debt sustainability exercises for the HIPC programme). Thus whether debt reduction increases ownership and efficiency in use of future net transfers boils down to the question of donor and creditor behaviour: whether debt reduction, once accomplished, will make donors and creditors more able or willing to be selective in channelling

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23 See footnote 17.

24 The expanded initiative would reduce the debts of some 40 countries by an estimated US$ 27 billion (in net present value terms), of which half would be borne directly by multilateral organizations and the other half by official and private creditors. See Table 1 for a list of the possible eligible countries.

25 Whether this will occur in practice, given political and time constraints, is not yet clear.

26 It would be useful to test explicitly whether donors have switched over time to more budget or programme support. The problem is lack of adequate data to distinguish between 'project' and budget support. And even with good data, it would still be difficult to distinguish between project support that is fungible from the point of view of receiving governments and project support that is not. In any event, as we note, this benefit can only be realized if donors are able to enforce 'good' policies after debt reduction. So the benefits of efficiency are contingent on the question of whether debt reduction would allow for more selectivity.

resources to countries with governments that are reasonably accountable in terms of good policies and financial management.

3.3 The bottom line is thus selectivity

In short, we believe a sensible case can be made that the potential additionality and ownership effects of the HIPC programme of debt reduction rely heavily on whether the programme will enable donors to be more *selective* across countries in their future post-HIPC transfers. Country selectivity would imply that after debt reduction, donors and creditors would be better able to channel limited resources to those recipient countries more capable, in terms of their policy stance and their institutions, of using transfers well, and more likely to benefit from transfers because of their lower initial levels of income per capita and higher levels of poverty.[27]

Where governments are not able or willing to spend incoming resources to promote development and reduce poverty, donors need not abandon countries altogether. They can still maintain a policy dialogue if governments are receptive, and to improve the well-being of the poor in the short run they can finance small food, health, and education programmes administered by non-government groups, and can support strengthening institutions of civil society. Such assistance would best come in the form of much smaller amounts directed to non-government entities; and is unlikely to affect much if at all the trends and relations we analyse below.

4 Creditor and donor selectivity: an empirical analysis

We investigate the question of selectivity by assessing the extent to which in the past donors and creditors provided higher net transfers to countries with better policies, and adjusted their transfers with changes in recipient country policies; and by assessing whether for given a policy framework, countries with higher levels of poverty received higher net transfers. In doing so, we also look at the extent of defensive or forced lending (i.e., lending by creditors associated with debt stock or debt service due to them) and at how donors and creditors implicitly shared the transfer burden and relied (or not) on leverage and conditionality. In short, has there been selectivity by donors and creditors as a function of countries' changing policies and degree of poverty? Or has the mounting debt stock and the resulting debt 'crisis' locked donors into some form of defensive lending to high debt countries, depriving them of selectivity and sufficient leverage with respect to recipient country policies?

4.1 Data and estimation

To assess creditor and donor behaviour, we use information on debt indicators and net donor and creditor transfers for a sample of countries in Sub-Saharan Africa over the period 1977 to 1998. We want to assess donor behaviour to countries in the region independent of whether they eventually became HIPC-eligible or not, bearing in mind

[27] Collier and Dollar (1999) show that aggregate donor transfers could be more effective in increasing growth and reducing poverty were they channeled to countries with higher poverty rates.

that those that did become HIPC-eligible were those where donor transfers are likely to have at least appeared more defensive. We therefore use a sample that includes both HIPC and non-HIPC countries. This avoids any sample selection problem. We include in our analysis all Sub-Saharan countries for which we have the necessary data. Of the 46 countries in Africa included in the figures above we end up with a sample of 35 countries—countries including Ethiopia, Eritrea, Angola, Guinea, Somalia and Tanzania are excluded for lack of data on many individual years. Of the 46 countries, 32 are deemed to be eligible for HIPC; of those 32, 25 are included in our sample of 35 (Table 1).

Table 1
Sample countries (35)

HIPC		Non-HIPC
The Gambia	Guinea-Bissau	Botswana
Niger	Kenya	Comoros
Benin	Madagascar	Gabon
Burkina Faso	Malawi	Lesotho
Burundi	Mali	Mauritius
Cameroon	Mauritania	Nigeria
Central African Republic	Rwanda	Swaziland
Chad	Senegal	Seychelles
Congo	Sierra Leone	Zimbabwe
Congo, Dem. Rep	Sudan	
Côte d'Ivoire	Togo	
Ethiopia	Uganda	
Ghana	Zambia	

For our 35 countries, we have a total of 666 country/year observations, with 284 observations in the first period and 382 in the second.[28] All data on debt, net transfers and interest forgiven are from the World Bank's Global Development Finance statistics. This dataset, published annually by the World Bank, relies on creditors 'reports for the debt statistics and on donors' ODA and OECD reports for the grant information. Grants tend to include debt and debt service reduction, but the quality of this data is known to be poor (see further Renard and Cassimon 2001). Data on GNP per capita are from the IMF International Financial Statistics. We also use a measure of poverty from Collier and Dollar (1999).

Our analysis is based on the results of estimations of the following form:

(1) Net transfers $_{ij}$ = f (debt $_{ij}$, policy $_i$, policy $_i^2$, poverty $_i$, poverty $_i^2$, population size $_i$, debt reduction $_i$)

in which net transfers and debt variables are scaled to GNP; 'debt' refers to a measure

[28] We limit the impact of outliers by dropping observations for years when net transfers to a country as a share of GNP is more than 30 per cent.

Table 2
Means and standard deviations [a]

	All		Low debt		High debt		Low multilateral		High multilateral	
	Mean	St dev.	Mean	St dev.	Mean	St dev.	Mean	St dev.	Mean	St dev.
Period 1977-98										
Total net transfers/GNP	0.12	0.1	0.1	0.07	0.15	0.12	0.11	0.12	0.19	0.11
Total debt services/GNP	0.05	0.04	0.03	0.03	0.06	0.05	0.07	0.05	0.06	0.05
Total debt stock/GNP	0.73	0.56	0.33	0.16	1.13	0.55	1.15	0.48	1.11	0.61
Total debt services reduction/GNP	0.01	0.01	0	0.01	0.01	0.02	0.01	0.02	0.01	0.02
Total debt stock reduction/GNP	0	0.01	0	0	0	0.01	0	0.02	0	0.01
CPIA (policy index)	2.84	0.73	2.96	0.79	2.74	0.66	2.49	0.66	2.98	0.57
GDP per capita	748.18	1100.07	1014	1344.05	519.86	767.12	730.23	1051.04	318.44	118.78
Number of observations [b]	753		379		374		186		188	
Period 1977-87										
Total net transfers/GNP	0.13	0.10	0.10	0.07	0.17	0.14	0.16	0.14	0.22	0.14
Total debt services/GNP	0.04	0.04	0.03	0.03	0.07	0.05	0.07	0.05	0.06	0.04
Total debt stock/GNP	0.49	0.36	0.29	0.14	0.90	0.35	0.91	0.33	0.88	0.42
CPIA (policy index)	2.83	0.74	2.82	0.79	2.84	0.65	2.74	0.58	3.12	0.77
GDP per capita	644.73	831.33	753.75	980.24	459.78	427.95	526.50	482.07	277.41	70.02
Number of observations	371		253		118		88		30	
Period 1988-98										
Total net transfers/GNP	0.12	0.10	0.08	0.07	0.14	0.11	0.06	0.07	0.18	0.11
Total debt services/GNP	0.05	0.05	0.04	0.02	0.06	0.05	0.07	0.05	0.06	0.05
Total debt stock/GNP	0.96	0.62	0.41	0.16	1.23	0.59	1.36	0.49	1.15	0.63
Total debt services reduction/GNP	0.01	0.02	0.01	0.01	0.01	0.02	0.01	0.02	0.02	0.02
Total debt stock reduction/GNP	0.00	0.01	0.00	0.00	0.00	0.02	0.00	0.02	0.00	0.01
CPIA (policy index)	2.85	0.72	3.16	0.75	2.69	0.66	2.28	0.65	2.95	0.52
GDP per capita	829.96	1268.15	1406.6	1685.57	546.14	874.61	900.69	1334.18	326.23	124.57
Number of observations	382		126		256		98		158	

Note: [a] All reported variables are calculated as three-year moving averages.

[b] The number of observations varies from the numbers in regressions, because in the latter the statistical programme drops any observation for which there are missing values on any variable.

such as total debt stock/GNP, or annual debt service/GNP; i refers to the recipient country, and j refers to the creditor or donor—the multilaterals (the IMF, World Bank distinguishing between IBRD and IDA (highly concessional) loans, and the African Development Bank), the bilateral creditors, grants primarily from bilateral donors, and private creditors. Net transfers are net of debt reduction. Our measure of debt reduction is principal forgiven and interest forgiven (available only in the 1990s). We use three-year moving averages of both the dependent and right-hand side variables. We estimate this equation for all donors and creditors combined, and separately for each. Thus we are able to look at the effects of 'own' debt stock owed to each creditor on total and 'own' transfers. We use ordinary least squares with and without fixed effects.

For our measure of the policy environment we use the World Bank's Country Policy and Institutional Assessment (CPIA), averaged over three years—the year for which we are measuring net transfers and the previous two years. This measure, set annually by World Bank country specialists, has 20 different components measuring macroeconomic, sectoral, social and public sector institutions and policies on a scale of 1 to 6. It is set on the basis of criteria that are standardized across countries, and is used to allocate scarce concessional (IDA) resources across countries from year to year. A separate World Bank unit makes a considerable effort to ensure consistency and comparability across countries and over time. Obviously the ratings have an element of judgement that may be affected by specialists' separate knowledge of a country's actual or likely overall prospects; this makes them potentially endogenous to, for example, growth, though probably less to net transfers and disbursements in a particular year. It is also possible that World Bank staff's assessments are influenced indirectly by their knowledge of or interests in the volume of lending itself, with some possibility that lending then influences the CPIA. To the extent this is true, the link between policy and lending will be overstated; and any result showing that policy is not a factor will thus be a strong result.

The CPIA has the advantage of including not only criteria related to public policy effort but criteria related to institutional capacity and thus may well be more closely related to capacity to absorb transfers effectively than traditional measures of policy effort such as trade liberalization, privatization, and so on.[29] Collier and Dollar (1999) show that transfers (to all recipient countries) are nonmonotonic with respect to the CPIA; they rise between low and moderate CPIAs and then decline as CPIAs improve further. We therefore allow for this nonlinearity.

Figure 3 shows the average CPIA across the 35 countries in our sample for the years 1977 through 1997.[30] On average, policies appear to have improved somewhat, with the variance across countries declining slightly. (Both changes may reflect a tendency for Bank country staff to have become slightly more optimistic over time in their assessments, and for Bank central staff to have converged with their ratings, perhaps as an outcome of constant negotiations with country staff.)

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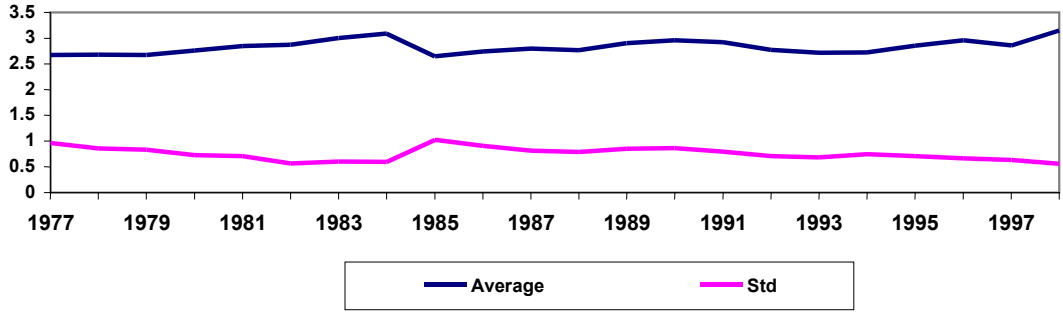
[29] In the absence of any good argument for alternative weighting of the components, we use the average. Collier and Dollar (1999) show that their results regarding aid allocation and poverty are not sensitive to reweighting the components.

[30] This calculation excludes Sudan and Seychelles because of missing data on the poverty headcount.

Figure 3
Mean and standard deviation of CPIA used in regression for SSA



For our measure of poverty, we use GDP per capita; for the 33 of our 35 countries for which data are available, the correlation of GDP per capita and the poverty headcount in the late 1990s (reliable data on poverty headcount are not available for earlier years) is –0.62. The GDP per capita measure has an additional benefit; donors may view recipient countries that are poorer on average as more needy of transfers than countries that have high levels of poverty but because of income concentration also have higher average GDP per capita. (This is among other things the logic used for deciding whether a country is eligible for the concessional window, IDA, of the World Bank.) Following Collier and Dollar, we also allow for the possibility that transfers by donors take into account the likelihood of diminishing returns to poverty reduction by including GDP per capita squared. We control for population size because of the tendency of small countries to receive higher transfers per capita, probably because of high fixed programme costs. Table 2 shows means and standard deviations for all the variables.

4.2 Results: selectivity or forced lending?

Selectivity across countries on the part of donors and creditors would be reflected in higher net transfers to countries with better 'policy' (a higher CPIA) or greater poverty (lower GDP per capita), independent of 'own' debt stock/debt service or total debt stock/debt service. Selectivity on policy is a necessary condition for any leverage on the part of donors or creditors, whether via traditional conditionality or via higher lending without formal conditionality to countries which have better policy and institutional environments. [31]

Estimating equation 1 (see Table 3) over the whole sample suggests that there is a strong positive relation between net transfers and debt stocks. Other experiments using an interactive dummy for high debt regimes indicated that the type of debt regime also affects the coefficients of the regressions. We therefore also estimated equation 1 separately for low and high debt countries, and for low and high multilateral debt

31 This form of selectivity would require showing that transfers contributed to better policy; there is not any good evidence that this has been the case. See, for example, Killick (1996) and the earlier Reviews of Adjustment Lending of the World Bank, and the report Adjustment in Africa (World Bank 1994).

countries. We also estimate the regressions for the entire period and the two separate periods defined above. (F-tests verify that these categories are structurally different in a statistical sense.) Table 3 shows the results from the regressions (without fixed effects; we will refer to the fixed effects results in the text where they differ).[32] We highlight three broad points here before going over the detailed results.

First, net transfers, controlling for per capita GDP, population, debt stocks, and debt service paid, have been higher for high debt and especially for high multilateral debt countries (see the size of the constant terms), consistent with the aggregate data presented above. In addition, net transfers are more dependent on policy variables in the low debt regimes: in the high debt regimes by contrast, a larger share of the net transfers is simply explained by a constant. It is as if the international community as whole became less selective in the high debt regimes.

Second, the results confirm the emergence of the multilateral debt crisis suggested above. In the regression over the whole sample, the policy variables (quality of policy and low levels of income per capita) have the appropriate positive effect on total net transfers (with the diminishing returns reported elsewhere). However, for the high multilateral debt group, the results indicate that net transfers were much less 'penalized' by high income per capita in the second period compared to the first[33] (the relevant coefficient is three times smaller in the second period). The loss of selectivity with respect to the quality of policy is even more pronounced. In the first period, better policy is clearly associated with higher transfers. In the second period, however, that is true only for the low multilateral debt countries. In the high multilateral debt countries, the policy variable has a negative (and statistically significant) effect on net transfers—as if the multilaterals were actually financing bad policies. For high multilateral debt countries, in short, policy selectivity collapses (since the CPIA is partially connected to the size of fiscal deficit, what is happening in parts is that deficits are getting financed by donor).

The selectivity effects, while varying greatly across regimes, are not just statistically significant but economically significant in most regimes, especially in the first period. In the aggregate regression, an increase in the CPIA by one standard deviation above the mean implies an increase in net transfers for the group from the mean of 12.2 per cent of GDP to 13.2 per cent.[34] A reduction of per capita GDP of one standard deviation reduces net transfers for the group to 6.9 per cent. The big difference across regimes in net transfers (e.g., in the second period 6 per cent for low multilateral debt countries versus 18 per cent for high multilateral debt countries [see Table 2]) are thus comparable in magnitude to difference in their policies or institutional capabilities within regimes.

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32 These results are available from the authors.

33 (with the effect changing the ratio of net transfers to GDP by as much as 5 to 10 percentage points, equivalent to a doubling of total net transfers)

34 But an increase in the CPIA by one standard deviation above actually implies a larger increase in net transfers for countries that had initially low CPIA because of the diminishing 'returns' to better policy captured by the quadratic term.

Table 3
Total net transfers/GDP regressions [a]

	All		Low debt		High debt		Low multilateral		High multilateral	
	Estimate	T stat	Estimate	T stat	Estimate	T stat	Estimate	T stat	Estimate	T stat
Period 1977-98										
Intercept	0.707	14.087	0.369	8.915	0.975	11.523	1.102	9.222	1.218	9.227
Total debt services/GNP	-0.683	-8.975	-1.296	-11.371	-0.420	-3.873	-0.876	-5.186	-0.189	-1.410
Total debt stock/GNP	0.078	13.269	0.140	7.391	0.054	6.497	0.026	1.838	0.076	7.712
Total debt services reduction/GNP	-0.078	-0.428	0.602	2.305	-0.311	-1.391	-0.353	-0.922	-0.138	-0.475
Total debt stock reduction/GNP	-0.220	-0.881	-2.658	-2.452	-0.150	-0.526	-0.207	-0.610	-0.223	-0.480
CPIA (policy index)	0.071	3.555	0.028	1.893	0.127	3.331	0.155	3.375	-0.081	-1.158
CPIA^2	-0.010	-2.855	-0.003	-1.122	-0.023	-3.166	-0.025	-2.790	0.010	0.852
GDP per capita	0.000	-12.189	0.000	-9.085	0.000	-8.838	0.000	-4.816	-0.001	-4.101
GDP per capita^2	0.000	7.398	0.000	5.866	0.000	6.456	0.000	2.793	0.000	2.723
Log of population	-0.043	-19.131	-0.020	-9.611	-0.060	-17.855	-0.069	-13.719	-0.050	-9.693
Number of observations	666		299		367		179		188	
R^2	0.592		0.649		0.638		0.666		0.648	
Period 1977-87										
Intercept	0.668	9.745	0.389	8.219	0.977	6.773	1.218	4.684	1.185	4.209
Total debt services/GNP	-1.214	-8.224	-1.304	-8.788	-1.290	-4.562	-1.163	-3.105	-0.985	-1.915
Total debt stock/GNP	0.157	10.767	0.145	5.533	0.100	3.918	0.079	2.231	0.091	2.351
Total debt services reduction/GNP	No debt service reduction									
Total debt stock reduction/GNP	No debt stock reduction									
CPIA (policy index)	0.075	2.732	0.052	3.128	0.264	3.340	0.216	1.684	0.355	2.960
CPIA^2	-0.012	-2.514	-0.007	-2.195	-0.044	-3.182	-0.034	-1.475	-0.061	-2.860
GDP per capita	0.000	-5.806	0.000	-7.074	0.000	-3.529	0.000	-3.415	-0.003	-1.664
GDP per capita^2	0.000	3.826	0.000	5.434	0.000	3.516	0.000	3.359	0.000	1.601
Log of population	-0.041	-12.508	-0.023	-9.766	-0.071	-11.825	-0.080	-8.310	-0.075	-6.324
Number of observations	284		173		111		81		30	
R^2	0.656		0.662		0.764		0.712		0.902	

Table continues

Table 3 (con't)
Total net transfers/GDP regressions [a]

	All		Low debt		High debt		Low multilateral		High multilateral	
	Estimate	T stat	Estimate	T stat	Estimate	T stat	Estimate	T stat	Estimate	T stat
Period 1988-98										
Intercept	0.618	8.558	0.305	3.916	0.852	8.493	0.586	4.764	1.403	8.898
Total debt services/GNP	-0.671	-7.030	-1.708	-8.859	-0.374	-3.226	-0.971	-6.032	-0.066	-0.508
Total debt stock/GNP	0.074	10.654	0.169	5.443	0.063	7.363	0.034	2.554	0.088	9.021
Total debt services reduction/GNP	0.188	0.983	0.762	2.760	0.036	0.165	0.316	1.111	-0.078	-0.293
Total debt stock reduction/GNP	-0.279	-1.121	-3.251	-2.788	-0.288	-1.079	-0.081	-0.304	-0.410	-0.968
CPIA (policy index)	0.058	2.110	-0.015	-0.467	0.066	1.452	0.226	4.122	-0.324	-3.913
CPIA^2	-0.005	-1.094	0.005	1.014	-0.009	-1.038	-0.043	-3.543	0.055	3.773
GDP per capita	0.000	-10.331	0.000	-5.552	0.000	-9.114	0.000	-4.610	-0.001	-5.633
GDP per capita^2	0.000	6.775	0.000	4.204	0.000	7.322	0.000	3.047	0.000	4.295
Log of population	-0.038	-12.154	-0.013	-3.105	-0.050	-12.731	0.044	-7.779	-0.040	-6.919
Number of observations	382		126		256		98		158	
R^2	0.608		0.716		0.641		0.646		0.688	

F-tests for structural significance [a]	Without country dummies			With country dummies		
	All	1977-87	1988-98	All	1977-87	1988-98
Low vs. high debt (F value)	6.399	11.547	1.506	4.582	0.379	0.632
Low vs high debt (prob. > F value)	0.012	0.001	0.221	0.033	0.539	0.427
Low multilateral vs. high multilateral debt (F value)	7.965	0.43	29.427	4.623	0.279	0.01
Low multilateral vs high multilateral debt (prob. > F value)	0.005	0.513	0.000	0.032	0.599	0.92

Note: [a] All reported variables are calculated as three-year moving averages.

The results also indicate that the loss of selectivity is connected with a sharp rise in defensive lending. In the first period, and in the second period for low debt and low multilateral debt countries, an increase in total debt service paid tends to be more than offset by a reduction in net transfers. There is no evidence of forced lending—quite the opposite, creditors tend to withdraw from countries with higher debt service. This near-neutrality, however, collapses in the second period for countries in the high multilateral debt regime where the coefficient drops to zero. In this case, any increase in debt service is being offset by an equivalent increase in disbursements, so that the net effect on transfers is zero. All debt service payments are being refinanced in countries in the high multilateral debt regime.[35]

Can we tell a more differentiated account by looking at the behaviour of the different donors? Table 4 summarizes results with respect to the policy (CPIA) variable, based on estimating equation 1 separately for each creditor and donor. (The results shown for total net transfers in the top row are thus identical to those shown in Table 3.) Focussing on the second period, the results for the entire sample (column 1) indicate that in general the donors (especially the IMF and IDA) were selective with respect to recipient country policy. However, in the high multilateral debt countries (column 5), the results indicate that with the possible exception of IDA (significance level of 10 per cent), none of the creditors or donors exercised policy selectivity. Transfers of the bilaterals through loans and grants to these high multilateral debt countries were *negatively* related to the policy index; i.e. within the high multilateral debt group bilateral, transfers were highest where policies were worst. This is consistent with the possibility that the bilateral donors were providing grant funds to the recipient countries with high multilateral debt to ensure they would not go into arrears to the multilaterals.

In the fixed effects regression, where we are controlling for country-specific factors, the effect of the policy variable is also positive in the entire sample, but smaller and statistically significant only in the first period. A positive effect (but not significant) in the first period for the high multilateral debt countries disappears in the second period—consistent with a conclusion of a collapse of selectivity in these countries. The only significant effect is for the low debt group in the second period. (In general our fixed effects results are less robust, though in the same direction. We believe this reflects the greater variation across countries than over time within countries. The CPIA and poverty variables, for example, vary more across countries than over time.)

Table 5 summarizes the results from the same set of regressions as those used to construct Table 4 in this case looking at the coefficients that capture the effect of *own* debt services on *own* net transfers for the creditors. We are here interested in the question of 'forced' lending by creditors, especially to countries that are in the high multilateral debt regime, given the evidence that policy selectivity is less likely in these countries. We use the term 'forced' lending rather than defensive lending because it allows for one or both of two possibilities: defensive lending in the traditional sense—that the creditor is anxious to retain some integrity of its own balance sheet; and lending

35 We also measure the impact of debt stocks on net transfers, given the size of debt service. The effect is positive: a country with a large debt stock relative to its debt service must have debt with a longer maturity and could be more 'creditworthy'. This effect becomes smaller over time in the high debt group and over debt regimes. However, this reduction is small relative to the (average) growth of debt stocks, so that the overall effect of debt stocks on net transfers seems relatively constant across the regressions.

Table 4
CPIA effects for 1977-98

	CPIA					CPIA square				
	All	Low debt	High debt	Low multi	High multi	All	Low debt	High debt	Low mult	High multi
Total NT	0.071	0.028	0.127	0.155	-0.081	-0.010	-0.003	-0.023	-0.025	0.010
	3.555	1.893	3.331	3.375	-1.158	-2.855	-1.122	-3.166	-2.790	0.852
Bilateral + grants NT	0.048	0.014	0.107	0.120	-0.094	-0.007	-0.001	-0.020	-0.019	0.010
	3.015	1.159	3.472	3.578	-1.547	-2.480	-0.699	-3.481	-2.845	0.920
IBRD NT	-0.003	0.001	-0.013	-0.019	-0.008	0.001	0.000	0.003	0.004	0.002
	-1.599	0.484	-3.651	-5.366	-1.281	1.821	-0.577	4.067	6.117	1.691
IDA NT	0.006	-0.001	0.007	0.014	0.009	0.000	0.001	0.000	-0.002	0.000
	2.060	-0.511	1.305	3.052	0.835	0.020	1.742	0.088	-2.192	-0.197
IMF NT	0.012	0.012	0.005	0.005	-0.001	-0.002	-0.002	0.000	0.000	0.001
	3.833	3.001	1.066	0.769	-0.106	-3.749	-3.079	-0.464	-0.360	0.602
CPIA effects for 1977-87										
Total NT	0.075	0.052	0.264	0.216	0.355	-0.012	-0.007	-0.044	-0.034	-0.061
	2.732	3.128	3.340	1.684	2.960	-2.514	-2.195	-3.182	-1.475	-2.860
Bilateral + grants NT	0.044	0.020	0.204	0.117	0.357	-0.006	-0.002	-0.034	-0.016	-0.066
	2.198	1.486	3.244	1.169	4.024	-1.809	-0.823	-3.098	-0.899	-4.192
IBRD NT	-0.002	0.000	-0.011	-0.026	-0.011	0.001	0.000	0.002	0.005	0.002
	-1.289	-0.354	-1.823	-3.122	-0.872	1.805	0.785	2.167	3.436	0.880
IDA NT	-0.004	0.002	-0.016	0.013	-0.027	0.001	0.000	0.004	-0.002	0.005
	-1.243	0.843	-1.809	1.228	-1.211	2.213	-0.157	2.303	-0.870	1.262
IMF NT	0.009	0.009	0.021	0.033	-0.028	-0.002	-0.001	-0.003	-0.006	0.008
	1.690	1.538	1.576	2.216	-0.756	-1.623	-1.210	-1.323	-2.101	1.213
CPIA effects for 1987-98										
Total NT	0.058	-0.015	0.066	0.226	-0.324	-0.005	0.005	-0.009	-0.043	0.055
	2.110	-0.467	1.452	4.122	-3.913	-1.094	1.014	-1.038	-3.543	3.773
Bilateral + grants NT	0.039	-0.016	0.070	0.193	-0.344	-0.004	0.004	-0.013	-0.038	0.055
	1.661	-0.633	1.758	4.834	-4.616	-1.081	0.896	-1.656	-4.314	4.172
IBRD NT	0.000	0.003	-0.007	-0.021	-0.011	0.000	0.000	0.001	0.005	0.002
	-0.007	0.834	-1.572	-3.185	-1.254	0.029	-0.815	1.632	3.573	1.544
IDA NT	0.013	0.001	0.006	0.018	0.022	-0.001	0.001	0.001	-0.003	-0.002
	3.080	0.200	0.901	2.272	1.726	-0.945	0.975	0.476	-1.635	-1.027
IMF NT	0.018	0.027	0.009	0.012	0.005	-0.003	-0.004	-0.001	-0.002	-0.001
	6.353	6.487	1.918	1.694	0.478	-6.284	-6.923	-1.409	-1.376	-0.287

Note: The second numbers are T statistics.

Table 5
Own effect table (NT/GNP)

	Debt service					Debt stock				
	All	Low debt	High debt	Low multi	High multi	All	Low debt	High debt	Low mult	High multi
1977-98										
IBRD	-1.281	-1.932	-1.209	-1.287	-1.140	0.106	0.251	0.079	0.106	0.053
	-37.533	-21.288	-31.490	-13.002	-37.257	17.000	18.678	10.532	6.265	6.983
IDA	-3.404	-2.897	-4.077	1.154	-6.571	0.077	0.106	0.081	0.063	0.090
	-6.146	-3.454	-5.500	1.062	-6.443	10.597	8.756	8.550	3.318	7.318
IMF	-0.187	-1.531	-0.116	-0.980	-0.080	0.027	-0.035	-0.009	0.116	-0.019
	-7.219	-20.080	-4.463	-11.556	-2.797	3.240	21.252	-0.954	7.294	-1.447
Bilateral + grant	-1.742	-3.115	-1.997	-2.482	-1.136	0.059	0.148	0.060	0.065	0.047
	-7.396	-6.468	-6.483	-5.855	-2.365	6.891	5.390	5.606	3.692	2.430
1977-87										
IBRD	-2.461	-2.772	-2.650	-3.240	-5.979	0.279	0.361	0.281	0.395	0.537
	-11.683	-9.782	-7.610	-7.337	-6.749	10.722	9.861	6.529	6.738	5.271
IDA	-3.937	-0.200	-5.688	-6.444	2.989	0.160	0.147	0.158	0.164	-0.088
	-3.736	-0.224	-1.956	-2.341	0.232	11.664	8.903	4.537	4.933	0.383
IMF	-1.285	-1.794	-0.810	-1.267	-0.834	0.262	0.412	0.114	0.172	0.053
	-13.339	-15.714	-5.946	-6.392	-3.011	14.348	18.756	4.378	4.686	0.458
Bilateral + grant	-2.463	-3.272	-2.473	-2.931	-1.968	0.176	0.199	0.183	0.190	0.248
	-7.499	-5.610	-5.299	-4.181	-2.606	9.868	6.420	5.650	5.122	2.987
1988-98										
IBRD	-1.163	-1.578	-1.142	-1.153	-1.040	0.062	0.168	0.048	0.046	0.031
	-42.913	-16.261	-39.666	-14.251	-70.646	10.522	9.905	7.370	2.668	7.782
IDA	-3.189	-1.977	-3.746	2.839	-5.778	0.074	0.084	0.075	0.135	0.080
	-4.977	-1.399	-4.659	2.427	-5.856	8.646	3.836	7.290	4.665	6.580
IMF	-0.080	-0.775	-0.061	-0.702	-0.047	-0.022	0.112	-0.022	0.014	-0.012
	-4.356	-11.529	-3.003	-14.843	-2.005	-2.916	5.578	-2.567	1.379	-0.964
Bilateral + grant	-1.482	-2.257	-1.425	-1.433	-1.010	0.028	0.032	0.032	0.039	0.045
	-5.085	-2.661	-3.770	-3.939	-1.626	2.958	0.640	2.860	2.491	2.131

Table 6
Poverty and population, 1977-98

	Poverty					Population				
	All	Low debt	High debt	Low multi	High multi	All	Low debt	High debt	Low mult	High multi
Poverty and population, 1977-98										
Total NT	-0.114	-0.062	-0.216	-0.147	-0.843	-0.043	-0.020	-0.060	-0.069	-0.050
	-12.189	-9.085	-8.838	-4.816	-4.101	-19.131	-9.611	-17.855	-13.719	-9.693
Bilateral + grants NT	-0.089	-0.050	-0.184	-0.123	-0.720	-0.033	-0.018	-0.044	-0.046	-0.037
	-11.979	-8.963	-9.348	-5.503	-4.031	-18.231	-10.689	-16.129	-12.466	-8.110
IBRD NT	-0.003	-0.003	0.000	-0.002	-0.059	-0.001	-0.001	-0.002	-0.001	-0.002
	-3.290	-3.686	0.035	-0.819	-3.131	-4.617	-2.760	-4.887	-2.735	-4.970
IDA NT	-0.020	-0.010	-0.039	-0.020	-0.093	-0.002	0.000	-0.004	-0.003	-0.003
	-15.377	-9.057	-11.980	-6.366	-3.126	-6.974	0.192	-8.741	-6.524	-3.730
IMF NT	0.000	-0.001	0.013	0.007	-0.028	0.000	0.000	-0.001	-0.001	-0.001
	0.025	-0.542	4.016	1.610	-0.950	-1.055	0.705	-1.363	-1.570	-1.525
Poverty and population, 1977-87										
Total NT	-0.100	-0.078	-0.401	-0.496	-2.776	-0.041	-0.023	-0.071	-0.080	-0.075
	-5.806	-7.074	-3.529	-3.415	-1.664	-12.508	-9.766	-11.825	-8.310	-6.324
Bilateral + grants NT	-0.096	-0.072	-0.237	-0.321	-2.907	-0.032	-0.021	-0.050	-0.052	-0.059
	-7.603	-7.979	-2.628	-2.836	-2.361	-13.214	-10.987	-10.568	-6.933	-6.730
IBRD NT	0.003	0.003	0.012	0.007	0.178	0.000	0.000	0.000	0.000	0.001
	2.633	3.580	1.388	0.727	1.035	-0.516	-0.710	-0.042	-0.776	0.581
IDA NT	-0.023	-0.014	-0.098	-0.072	-0.482	-0.002	-0.001	-0.004	-0.003	-0.008
	-12.188	-11.462	-7.621	-6.071	-1.535	-6.172	-2.998	-6.541	-4.086	-3.371
IMF NT	-0.003	-0.004	0.059	0.041	0.559	0.000	0.000	-0.002	-0.004	-0.002
	-0.922	-1.092	3.152	2.382	1.095	-0.480	0.518	-1.907	-3.481	-0.646
Poverty and population, 1988-98										
Total NT	-0.117	-0.056	-0.239	-0.118	-1.144	-0.038	-0.013	-0.050	-0.044	-0.040
	-10.331	-5.552	-9.114	-4.610	-5.633	-12.154	-3.105	-12.371	-7.779	-6.919
Bilateral + grants NT	-0.089	-0.047	-0.186	-0.090	-0.929	-0.031	-0.012	-0.039	-0.032	-0.030
	-9.279	-5.744	-8.101	-4.828	-5.087	-11.511	-3.763	-11.027	-7.732	-5.721
IBRD NT	-0.004	-0.002	-0.006	-0.003	-0.060	-0.001	0.000	-0.002	-0.002	-0.003
	-3.460	-1.926	-2.127	-1.062	-2.834	-4.215	-1.011	-5.173	-2.238	-5.347
IDA NT	-0.022	-0.012	-0.037	-0.019	-0.103	-0.002	0.000	-0.004	-0.003	-0.003
	-12.753	-6.477	-9.657	-5.175	-3.260	-5.004	0.350	-6.850	-4.333	-3.409
IMF NT	0.003	0.004	0.009	0.014	-0.025	0.000	0.001	0.000	0.002	0.000
	2.969	3.104	3.308	4.196	-0.949	0.202	1.266	0.110	2.161	-0.320

that is meant to sustain net transfers for 'development' reasons despite debt service due (independent of the balance sheet) including to avoid having one creditor be financed indirectly by other creditors.

We interpret the coefficients as follows. Coefficients below –1 indicate a creditor is withdrawing from a debtor, i.e., the effect of debt service due to it is to reduce net transfers more than proportionately. A coefficient of about –1 implies independence from the point of the view of the creditor between debt service due and net transfers; there is no effort to refinance the former by increasing disbursements. A coefficient close to 0 reflects the possibility of forced lending—creditors are ensuring repayment to themselves by maintaining new lending at a level sufficient to finance the service due them.

The results by creditor in Table 5 (the first column) indicate that private creditors and the IMF are closest to forced lending, particularly in the case of the IMF for the high multilateral debt countries, and particularly in the second period.[36] Controlling for other factors, transfers of IDA and the bilaterals are much more negatively related to debt service (suggesting withdrawal). These results on own debt service are consistent with the selectivity evidence above.

Our results are, thus, consistent with some ability of donors and creditors to be selective—but less so in the case of recipient countries already with high debt, and particularly with high multilateral debt. They are also consistent with forced lending, whether for traditional defensive reasons or not, particularly on the part of the IMF, and particularly in the second period when debt service due had risen as a per cent of GNP in the countries then classified as high debt and high multilateral debt countries.

It is also interesting to explore the ways in which different donors change their behaviour in targeting poorer countries. The results in Table 3 indicate donors across the board have generally provided larger net transfers to countries that are poorer, controlling for debt and policy variables. Results in the fixed effects estimation are similar for the sample as a whole, with the exception of the high multilateral debt countries, where the level of poverty is not statistically significant. Once again there is evidence that there is less selectivity in this group. Table 6 is analogous to Tables 4 and 5; it shows the coefficients on the poverty variable (GDP per capita), based on results of estimating equation 1 separately for each donor and creditor (without fixed effects). For all countries, most donors and creditors have the expected negative (and statistically significant) signs. The exceptions are the private sector for which net transfers are, not surprisingly, positively (negatively) related to GDP per capita (poverty) level, and the IMF, for which the coefficient is not statistically significant. The IMF effect is driven by positive (negative) relation to GDP per capita (poverty) in the high debt countries. These effects are stronger in the second period, when the IMF like the private sector, lends more in less poor countries—with the interesting exception

36 Regressions (not shown) of annual disbursements show similarly that IMF disbursements are closely linked to debt service due to the IMF, particularly in the second period, when the coefficients are near and above 1, and particularly in high debt and high multilateral debt countries. This is also the case in the fixed-effects estimations.

of the high multilateral debt countries where, as noted above, there is probably an element of forced lending.[37]

4.3 Results: has there been additionality?

One possibility is that countries with high debts have received large debt reductions (in the form of debt service relief or reduction of their stock of debt), which would explain why they are getting high net transfers since debt service reductions are generally counted in the net transfers data. This would hold if there were no countervailing movements in disbursements (i.e., all debt reduction was additional). But on the other hand, countries that receive large debt reductions may be receiving lower disbursements, especially if both disbursements and debt reductions come from an essentially flat overall donor budget. Our data cover the debt reduction period of the 1990s, where bilateral donors forgave US$ 30 billion of debt service and loans in our sample and offers a natural experiment for the extent to which debt reduction has been additional in the past. The problem, however, is that the data on debt and debt service reduction are poor—it is less well reported than the other flows, and the accounting methods used by the various donors differ. We add to the right-hand variables estimates of debt service and debt stock reductions. Since those are already counted in net transfers, we would expect a coefficient of one under full additionality, zero indicating no additionality at all. With the exception of the low debt case, the coefficients are close to zero but not significant. This is consistent with the likelihood that in high debt countries, donors have taken advantage of debt reduction to reduce disbursements (including probably reversing previous forced lending) by about a one to one ratio. In low debt countries, the effect is much smaller: for each dollar of debt service reduction, disbursements have fallen by only 30 cents. We hesitate to be conclusive on this issue because of the poor quality of the data. But our preliminary results seem to indicate that the debt reduction of the 1990s crowded out other forms of disbursements and did not constitute an 'additional' source of funds to the poor countries.[38]

4.4 Interpreting the results

Net transfers have remained positive over two decades in most countries of Sub-Saharan Africa, and have only fallen slightly in the 1990s compared to the 1980s. Official donors and creditors remained committed to development programmes in Sub-Saharan Africa throughout the entire period. With low growth in recipient countries, however,

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37 We also estimated equation 1 for the 31 countries for which we could use information on the poverty headcount ratio for 1995 (not shown). In that regression the poverty variable was not statistically significant. We conclude that the poverty result based on GDP per capita is not very robust; indeed it may simply reflect the fact that with declining GDP any stickiness in net transfers (associated with disbursements against multi-year projects for example) will lead to increased transfers as a ratio of GDP wherever GDP per capita is falling. Donor selectivity with respect to poverty levels requires additional study and better data.

38 We conducted several other experiments to test the robustness of the results. In particular, we tested if outliers drove the results by progressively dropping outliers from the sample and re-running the same regressions. The results are essentially the same. We also tried to run the regressions over shorter time periods, to test whether there has been some improvements inselectivity in recent years, as sometimes claimed. These results are however inconclusive: there is no evidence in our sample of recent improvements, with the possible exception of IDA noted in the text.

and continued net transfers, the stock of debt rose. The donors and creditors tried to minimize the problem by shifting to grants in the case of the bilateral donors, and to the more concessional IDA rather than IBRD lending in the case of the World Bank.

The data on net transfers are thus consistent with continued donor efforts to foster development in Africa. At the same time, they are also consistent with an element of 'forced' lending. Controlling for levels of GDP per capita and population, the donor community as a whole transferred more to high debt and particularly to high multilateral debt countries, independent of—or even perversely related to—the countries' policy stance or institutional capacity. Donors as a group seemed driven by the need to avoid recipient countries going into arrears to the multilaterals.

There were differences across donors. In the case of IDA, selectivity across countries improved in the 1990s compared to the 1980s.[39] However, bilateral grants and loans to countries with high multilateral debt (to the IMF, World Bank and the African Development Bank) appear to have become negatively selective, offsetting the positive selectivity of IDA. In the case of the IMF, disbursements to high multilateral debt countries in the second period were tied to debt service due to the IMF in a virtually one-to-one relationship.

The behaviour of the donor community is not hard to explain. As the multilateral debt stock and debt service burden grew, donors were anxious to help countries avoid arrears, particularly to the multilaterals because of their preferred creditor status. Arrears would be embarrassing given the high level of poverty in Africa; the environment of constant search for new funds, particularly in the second period with the greater emphasis on coordination under the Special Programme for Africa; and the new rounds of lobbying in donor country legislatures for new IDA replenishments. For the countries, arrears to the multilaterals would imply the loss of access to short-term trade credits and thus of export income (which in turn was generating resources for debt service) and loss of access to new grants and lending for new development programmes. In addition, a constant stream of donor decisions on many new discrete programmes and projects had its own self-fulfilling dynamic. It allowed a relatively optimistic view about the likelihood of the next in-country reform being right around the corner, and about the reasonableness of supporting official colleagues in each country that was struggling to institute change and build institutions while managing increasing debt service falling due.

Bilateral donors were able as a group to minimize their own responsibility for debt build-up by switching to grant programmes and by reducing somewhat gross transfers. Lacking clear signals from the multilaterals, their disbursement pattern across countries became less refined—in our regressions, better explained by a constant than by variables such as the quality of policy, or income per capita. The total net transfers of all donors and creditors did gradually decline under the increasing weight of high debt service, but not, ironically, to the high multilateral debt countries. For those countries, new loans and grants (whether with 'healthy' conditionality or not, whether with country ownership or not) were no longer (if they ever had been) vehicles for a dialogue about policy or institution building; they were no longer effective as carrots or sticks. By the end of the 1990s, the donor community had no real leverage on governance and

39 In the 1990s, IDA allocations became 'performance-based', i.e., tied specifically to the CPIA measure we use in our regressions.

economic and social policy in the high multilateral debt countries. The community was stuck in a dance of new rounds of transfers to finance debt service, avoid embarrassing arrears, and stave off growing risks of documented development failures.

5 Implications for the development benefits of more comprehensive debt reduction

Our results indicate that if the debt level is reduced enough in high multilateral debt countries, then donors can shift into a low debt regime in those countries—a regime that in the past has allowed selectivity. Debt service reduction under HIPC (and now HIPC II) thus appears to be a way 'out' for the donor community locked into a pattern of non-selectivity in the high multilateral debt countries, fulfilling what is a necessary condition for selectivity in the high multilateral debt countries.

Expectations are high that the HIPC programme of debt relief will free resources in high debt countries for spending on the poor. But the programme, though small in relation to the countries' needs, is large enough in terms of traditional levels of donor financing that it will eat into future donor allocations, and therefore may not be followed by adequate new transfers to reduce poverty in the future.[40] Our results show that even without additional donor resources, debt relief, by encouraging selectivity, would at least ensure more funds for countries with good policies and adequate institutions—and of course fewer for countries with bad policies and inadequate institutions.[41] And it can create a virtuous circle by crowding in private flows to good policy/low debt countries.

Our analysis also suggests another immediate benefit from the planned debt reduction, also without any increase in total donor resources. Debt reduction can help correct the apparent current imbalance between discrete project funding and budget support. Compared to the low-level chaos of multiple projects with multiple donor sponsors under multiple procurement rules, this can bring greater efficiency to the development assistance business by creating space for country ownership. However, donors can only realize this benefit in settings where governments are accountable—and thus it relies on prior selectivity.

In short, our results show the potential for debt reduction to alter donor and creditor behaviour, creating a better 'regime' for the development assistance business to be effective. Better donor behaviour would not only enhance development outcomes in some countries in the short run, it would also set the stage for more effective development assistance in the long run, as creditors would have reasonable recourse to the use of assistance as a carrot for improved policies and institutions. That might, in turn, make it politically possible to convince the public in donor countries that it makes sense to raise development assistance budgets.

However, though necessary, debt reduction is far from sufficient to ensure donor selectivity. Though it can allow a change in donor behaviour, it does not guarantee it.

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40 Sachs *et al.* (1999).

41 The latter group could end up with reduced net transfers simply because the debt reduction will make it easier for donors and creditors (and particularly the IMF) to reduce what our evidence suggests is now forced lending.

Our results also point to the risks of donors as well as recipient countries falling back into the debt game of the past. They suggest the need, particularly following what may become 'non-selective' debt relief itself (and in our framework, there is no real reason why debt reduction should be selective, since it does not automatically lead to higher transfers), for greatly increased emphasis on selectivity in future 'grants' making and lending. At the same time, understanding of past behaviour of creditors suggests that it would be difficult for creditors, without debt reduction, to make the necessary break with past practice—and thus difficult to ever increase their contribution through development assistance to the tremendous development challenges in Africa.

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Appendix

Project and non-project activity-related flows

A World Bank report says there are 100,000 foreign advisors in Africa, and that they consume US$ 4 billion of all international assistance—i.e. as much as a quarter of all net transfers.[42] This may have been more the case in the 1980s than in the last decade, as donors have attempted to increase support for 'programmes' (e.g. to finance a portion of the education budget), making their transfers much more akin to budget support. The relevant ODA (overseas development assistance) data are difficult to interpret, but we categorized extensive listings of donor-assisted activities into 'projects', non-projects' and 'debt relief' for the two periods shown below, in an attempt to glean any evidence of change in the degree to which recipient governments were receiving more flexible budget support. Recognizing that even 'project' money may be fungible, we note that there has been no discernible change in the proportion of non-projects, and that debt relief increased only marginally in the 1990s compared to the 1980s.

Appendix Table 1
Project and non-project activity

	1977-87	1988-98
Project, %	71.5	74.3
Non-Project, %	16.5	13.6
Creditors (debt relief), %	11.9	12.1
Total, %	100.0	100.0

Thus it appears that at least some external support comes in a form that is difficult to spend efficiently, and may generate lower economic returns than would alternative uses of the same amounts. In addition to efficiency losses there is the less measurable cost of limited flexibility, i.e. that governments are likely to have difficulty planning and sustaining even those public investments with high returns.[43] In short, from the point of view of recipient countries the multiplicity of donors financing separate projects (with separate administrative, auditing and other demands) makes management of total resources difficult and reduces local officials' capacity to plan and manage programmes and policy.

There has been considerable discussion of the question of ownership of reform programmes financed by donors—with the lack of ownership of reforms said to explain poor programme effectiveness and low growth.[44] It is possible that the problem of ownership is rooted, however, not only or solely in the lack of local agreement on policy reforms, but also in the greatly reduced scope for planning and management of public programmes and resources that the multiplicity of donors, and the weight of donor financing in overall investment, has represented. At least in principle the problem could be minimized with a shift of donor transfers to a more common pool,[45] and the

42 World Bank (2000a).

43 The situation may also foster a climate of corruption as monitoring is difficult

44 For example, Collier (2000).

45 On this point, see Kanbur *et al.* (1999).

deployment of that common pool in the form of much more fungible programme or budget support. Use of a common pool remains unlikely because donors have their own bureaucratic limits and because bilateral donors often need to respond to their own legislatures' priorities. Budget or programme support has been limited because donors have not always been convinced about the capacity of recipient governments to utilize general funds well, or they have feared abuse of general funds in settings where corruption is a problem.