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## *Resolving the Debt Crisis of Low-Income Countries*

THE IDEA OF BANKRUPTCY FOR insolvent sovereign borrowers has been around a long time, at least since Adam Smith's favorable mention of it in the *Wealth of Nations*.<sup>1</sup> Kenneth Rogoff and Jeromin Zettelmeyer have recently reviewed the history of the idea, as has Ann Pettifor.<sup>2</sup> The current international framework for workouts of distressed sovereign borrowers is woefully inadequate, lacking both the efficiency and the equity protections that characterize well-designed bankruptcy systems. This paper focuses on one part of the problem, namely, the plight of the world's most highly indebted poor countries, and illustrates the serious problems that have arisen because of the weakness of international institutional arrangements. I conclude with several recommendations for reform.

### **Motivations for Bankruptcy Laws**

Bankruptcy laws have two somewhat distinct motivations. The first is to overcome the collective action problems that arise when multiple cred-

I would like to thank Pierre Yared for superb research assistance.

1. "When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment [in a depreciated currency] . . . . When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor" (Smith 1776 [2000], Book V, Chapter III, pp. 1008–09).

2. Rogoff and Zettelmeyer (2002); Pettifor (2002).

itors confront an insolvent debtor.<sup>3</sup> In the absence of a bankruptcy law, a creditor “grab race” can undermine the value of the assets of an insolvent debtor. The bankruptcy law forestalls the grab race through devices such as an automatic stay on debt collection that is triggered by the filing of a bankruptcy petition. In bankruptcy reorganizations under Chapter 11 of the U.S. bankruptcy code, further protections against a grab race are implemented, such as debtor-in-possession financing and provisions for confirmation of a restructuring plan in the absence of unanimity among creditors; the latter weaken the power of an individual creditor to hold out for special treatment.

The second motivation of bankruptcy law is to offer a “fresh start” to an insolvent debtor. Whereas the motivation to avoid a grab race applies in principle to all kinds of insolvent debtors—businesses, individuals, and municipalities—the motivation for a fresh start applies only to individuals (Chapters 7, 12, and 13) and municipalities (Chapter 9) rather than to businesses.<sup>4</sup> The key instrumentality of the fresh start is the discharge of debt, which frees the debtor from future collection efforts while leaving the debtor with some exempt assets and with a future income stream. An insolvent debtor may seek the discharge of debt even when there is only one creditor, and thus no possibility of a creditor grab race.

The motivation for forestalling a creditor grab race is efficiency. The motivations for offering a fresh start, however, include both efficiency and equity. The creditors’ claims are superseded by the higher interest of protecting the autonomy of the individual vis-à-vis the creditors,<sup>5</sup> or analogously, of ensuring that a debt-strapped municipality maintains the sovereignty needed to provide public services to its residents. For example, under Chapter 9, a municipality’s assets cannot be liquidated to pay creditors, because that would undermine sovereignty. Moreover, “neither creditors nor the court may control the affairs of a municipality indirectly through the mechanism of proposing a plan of adjustment of the municipality’s debts that would in effect determine the municipality’s future tax

3. I have previously discussed these issues in many places, including, for example, Sachs (1984, 1995).

4. Under Chapter 11, businesses are allowed a fresh start only to the extent that creditor interests are thereby protected. Creditors can force the conversion of a Chapter 11 restructuring into a Chapter 7 liquidation by failing to confirm the reorganization plan.

5. For a similar reason, individuals may not voluntarily sell themselves into slavery. The autonomy of human beings takes precedence over any contractual obligations, even those voluntarily and knowingly made.

and spending decisions.”<sup>6</sup> Indeed, the powers of the court and of creditors are deeply circumscribed. “The debtor’s day-to-day activities are not subject to court approval and . . . the debtor may borrow money without court authority. . . . The court also cannot interfere with the operations of the debtor or with the debtor’s use of its property and revenues.”<sup>7</sup> Most important, neither under individual bankruptcy (Chapter 7 or Chapter 13) nor under municipal bankruptcy (Chapter 9) do creditors obtain the maximum discounted value of income and property potentially collectable from the debtor. Individuals and municipalities are allowed to keep important property out of the creditors’ reach, such as a homestead up to a certain value, as well as keep most or all future income.<sup>8</sup>

The idea of the fresh start can be framed variously in terms of ethics (preserving the autonomy of the individual or the sovereign), equity (preserving an acceptable standard of living for an insolvent debtor), or ex ante efficiency (bankruptcy mechanisms as a way to spread risks between a debtor and world financial markets when other risk-spreading mechanisms such as contingent contracts are incomplete). In any case, the debtor is not reduced to destitution and permanent servitude to creditors. The borrowing costs to a debtor rise in anticipation of the possibility of bankruptcy, but the downside risks of extreme adverse shocks are thereby limited.

### **International Sovereign Borrowers**

For hundreds of years, sovereign borrowers have experienced repayment crises, including defaults and restructuring of debts.<sup>9</sup> Despite the repeated experience of sovereign debt crises, and despite the important efficiency and equity issues they pose, no international system of sovereign bankruptcy has been devised. In the age of imperialism in the nineteenth and early twentieth centuries, creditors often resorted to force or

6. Bankruptcy Judges Division (2000, p. 51).

7. Bankruptcy Judges Division (2000, p. 48).

8. Thus, in an individual bankruptcy under Chapter 7, creditors are paid out of the property of the bankruptcy estate, and remaining debts are discharged. The individual’s future income stream is protected against any future collection efforts. Thus repayment of debts is limited to the amount available from the liquidation of nonexempt property and does not extend to the discounted value of the debtor’s future labor income.

9. Borchard and Wynne (1951); Sachs (1989); Sachs and Jorgensen (1989).

the threat of force to collect debts, including the removal of insolvent sovereigns from power. Since the Great Depression, however, sovereign debt crises have generally been worked out in negotiations between creditors and debtors, often with the heavy political engagement of major creditor powers or international institutions such as the International Monetary Fund (IMF), where creditors predominate. These negotiations have been characterized by a high degree of ad hocery and a low degree of systematization of international rules.

This ad hocery has come at a very high cost. Insolvent countries have often been locked into decades of instability and impoverishment. There is certainly no guarantee of a fresh start. The creditor grab race has often undermined economic stability in debtor countries, to the detriment of both creditors and debtors. Debtor nations complain bitterly about the loss of sovereignty to creditor-led institutions, especially the IMF and the World Bank. And ad hoc bailouts of private creditors by official lenders—for example, through IMF loans to debtor governments to maintain debt servicing to private lenders in the creditor countries—have been widely seen as creating moral hazard, encouraging future indiscriminate lending by creditors to weak borrowers on the basis of expected future bailouts.

The absence of a fresh start for sovereign debtors can have a particularly pernicious effect on economic and social development. In a country whose government is insolvent, but that has not been released from extremely onerous debt servicing, the provision of public goods is likely to be severely curtailed. Macroeconomic stability and even public order (in the case that services such as health, police, and fire services are limited) can easily be lost. Prolonged political uncertainty and instability may result, as the sovereign power has limited means to defend itself against internal insurgencies and external military threats.

The IMF's recent recognition of the need for more-formal processes is without doubt a breakthrough in and of itself, as well as a major spur for new ideas in this area.<sup>10</sup> Any specific bankruptcy proposals launched in response to the IMF initiative should recognize the two intertwined motivations of bankruptcy: addressing the collective action problems and granting a fresh start. For the world's middle-income countries, with multiple classes of creditors including important private sector creditors

10. Krueger (2001).

(banks, bondholders, suppliers), the collective action problems probably loom largest and are the most complex.<sup>11</sup> For the low-income countries, the issue of a fresh start—suitably interpreted—is probably even more important. Dozens of low-income countries have been stuck for two decades or more in a persistent debt trap from which they are not recovering. For these countries, bankruptcy procedures will have to be considered in the much larger context of the overall foreign assistance strategy of the creditor-donor community.

This paper focuses mainly on the issue of insolvency among low-income countries. Because these countries' debts are owed mainly to official rather than private creditors, the focus naturally falls as well on the resolution of official debts, especially in the Paris Club and the claims held by the Bretton Woods institutions themselves.

### Poverty Traps and the Debt Overhang

One key hypothesis of this paper is that poor countries are vulnerable to a poverty trap, which can be caused or exacerbated by an excessive foreign debt burden. The basic idea of a poverty trap is that nonlinearities in saving, investment, and production can lead some low-income countries to remain stuck at low or even falling levels of GNP per capita, despite the forces of economic convergence that are also at play in the world economy, such as the potential for capital inflows into capital-scarce countries and the diffusion of technology from rich to poor countries. To illustrate the key ideas, I introduce a very simple model in which the net saving rate falls to zero when income drops below a minimum subsistence level.<sup>12</sup>

Suppose that individuals require a level of minimum real consumption  $m$  to meet basic needs of personal health and hygiene, food intake, and shelter. (Unless otherwise noted, all variables are in per capita terms.)

11. The key complexity, of course, is the reconciliation of national laws on creditor-debtor relations that govern outstanding loan agreements, with the global objective of avoiding the creditor grab race. It seems likely that the IMF Articles of Agreement will need amending so that international treaty law supersedes national law in the event of a sovereign bankruptcy.

12. A neoclassical version of the same model (based on intertemporal optimization in the presence of a minimum consumption constraint) is presented by Ben-David (1998), and the original model of this type was offered by Nelson (1956).

When income  $y$  is above  $m$ , the household saves a constant fraction  $\sigma$  of the excess  $y - m$ . When income is below  $m$ , household saving is zero, as the household consumes as much income as possible in order to come as close as possible to meeting basic needs. Thus

$$(1) \quad s = \begin{cases} 0 & \text{if } y < m \\ \sigma(y - m) & \text{if } y \geq m. \end{cases}$$

Income is equal to output  $q$  plus foreign aid  $f$  minus service  $d$  on foreign debt, so that

$$(2) \quad y = q + f - d.$$

Output is simply assumed to be linear in reproducible capital:

$$(3) \quad q = Ak.$$

Capital accumulation follows the standard accumulation equation:

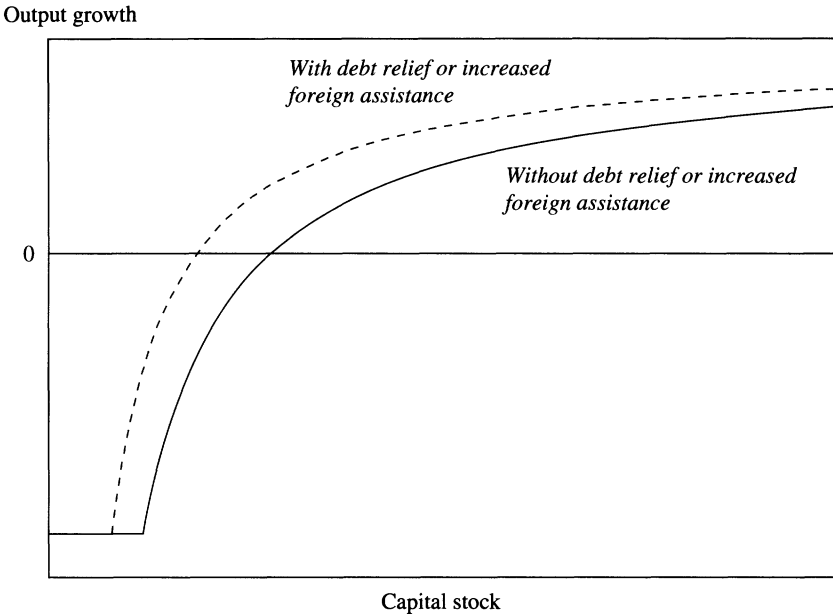
$$(4) \quad dk/dt = s - (n + \delta)k,$$

where  $n$  is the rate of population growth and  $\delta$  the rate of depreciation of reproducible capital. It is assumed, realistically, that  $f - d < m$ , that is, that foreign aid net of debt service does not fully cover basic needs. It is also assumed that  $A\sigma - \delta - n > 0$ , so that the economy maintains positive economic growth as long as  $y > m$ .

The economy grows or shrinks depending on the level of the capital stock  $k$ . A threshold between output growth and output decline occurs where the capital stock  $k^* = \sigma(m + d - f)/(A\sigma - \delta - n)$ . When  $k < (m + d - f)/A < k^*$ , saving equals zero,  $dk/dt = -(\delta + n)k$ , and the economy shrinks at the growth rate  $-(\delta + n)$ . When instead  $(m + d - f)/A < k < k^*$ ,  $dk/dt = \sigma(Ak + f - d - m) - (\delta + n)k < 0$ . Output and the capital stock decline to the point where saving equals zero and the economy once again shrinks at the rate  $-(\delta + n)$ . Finally, when  $k > k^*$ , the economy grows, and at a rising rate, which asymptotically approaches  $A\sigma - \delta - n$ .

The growth of output may be graphed against the level of the capital stock (figure 1), for given parameters and given levels of debt service and foreign assistance. For  $k > k^*$ , the economy grows; for  $k < k^*$ , the economy shrinks; and for  $k = k^*$ , output is stagnant. A rise in foreign aid or a cut in debt servicing of size  $\Delta$  shifts the growth curve upward by the amount  $\Delta\sigma/k$ , assuming that  $k > k^*$ , and  $k^*$  itself falls by the amount

**Figure 1. Effects of Debt Relief and Foreign Assistance on Output Growth**



Source: Author's model as described in text.

$dk^* = -\sigma\Delta/(A\sigma - \delta - n)$ . Thus an economy that was shrinking will begin to grow if  $k^*$  shifts below  $k$  as a result of debt cancellation or a rise in foreign aid.

The idea of a poverty trap runs counter to the more optimistic and typical view of convergence in the standard neoclassical growth model. Remember that the law of motion for the capital stock is  $dk/dt = s - (n + \delta)k$ . In the standard Solow model,  $s = \sigma q(k)$ , where the saving rate is constant and the Inada conditions are assumed to apply to the production function  $q(k)$ .<sup>13</sup> In this case  $dk/dt$  is necessarily positive when  $k$  is low. In the model presented here, the saving rate falls sharply (in fact, to zero) when  $k$  is very low, so that  $dk/dt$  turns negative for very low  $k$  (specifically, for  $k$  below  $k^*$ ).

The empirical evidence on saving rates in poor countries supports the basic thrust of this simple model. Saving rates are generally very low in low-income countries and increase as incomes rise, presumably because

13. The Inada conditions are  $q'(k) \rightarrow \infty$  as  $k \rightarrow 0$ , and  $q'(k) \rightarrow 0$  as  $k \rightarrow \infty$ .



of the rising margin of income above subsistence. Norman Loayza, Klaus Schmidt-Hebbel, and Luis Servén calculate that “in developing countries, a doubling of income per capita is estimated, other things equal, to raise the long-run private saving rate by some ten percentage points of disposable income,”<sup>14</sup> a finding shared by many studies showing that saving rates do indeed rise with income (or fall in a crisis). Ibrahim Elbadawi and Francis Mwega find that African saving rates were not only low but falling in the 1980s and 1990s compared with the 1970s,<sup>15</sup> consistent with the idea that Africa’s economic stagnation in the past twenty years has been provoked, in part, by low saving rates associated with very low income per capita.<sup>16</sup>

Poverty traps can, of course, arise for other reasons as well. For very low  $k$ , the marginal productivity of capital may be very low rather than very high (as assumed in the Inada conditions), because a threshold level of  $k$  may be needed for capital to become productive. For this reason, too,  $dk/dt$  may turn negative when  $k$  is very small. For example, the profitable use of modern technology may depend on a minimum scale of the market, or a minimum level of public expenditure on public goods, or a minimum quality of infrastructure such as ports and electric power. When  $k$  is too low,  $q(k)$  and  $q'(k)$  will both be very low, and  $\sigma q(k) - (n + \delta)k$  becomes negative. Alternatively, a demographically induced poverty trap is possible if  $n$  becomes large as  $y$  becomes very small (that is, if the population growth rate varies inversely with income per capita) and  $dq(k)/dk$  does not become too large as  $k$  approaches zero. In that case, a very poor population has so many children that saving per capita is insufficient to maintain the capital-labor ratio.<sup>17</sup> Yet another alternative is that the returns to human capital accumulation are a rising function of the level of human

14. Loayza, Schmidt-Hebbel, and Servén (2000, p. 180).

15. Elbadawi and Mwega (1998).

16. According to their appendix table 1.1, the Sub-Saharan African countries had average gross domestic saving equal to 11.7 percent of GDP in the 1970s, falling to 6.7 percent in the 1980s, and 6.2 percent in the period 1990–95.

17. A plausible pattern is as follows. Very poor countries have very high infant and child mortality rates because of lack of coverage of modern health services. This in turn leads to high fertility rates, as households compensate for the high mortality rates by having more children. Higher fertility rates in turn lead to lower investment in human capital per child (the famous quality-quantity trade-off), which in turn leads to low or negative economic growth. This in turn prolongs the health crisis.

capital, so that poor and uneducated parents do not find it profitable to educate their children.<sup>18</sup>

At very low levels of income per capita, the most important investments for poverty alleviation and overall economic growth are likely to be public sector investments in basic human capital (primary health and education) and basic infrastructure (such as roads from rural villages to ports and major cities). The reason is that private investments are unlikely to be made in economies where basic literacy and health are not achieved. Ironically, despite the critical importance of public investment in health and education, public (and private) spending on health and education is usually treated in national income accounts as consumption rather than investment. Whatever the accounting, a properly articulated growth model would distinguish between public and private investment and would recognize the critical role of public investment in human capital and basic infrastructure. Since taxes are generally collected only on incomes in excess of the subsistence threshold  $m$  (for example, the rural poor are typically exempted from income and value-added taxes), tax collections would be equal to  $\tau(y - m)$ , where  $\tau$  is the tax rate applied to incomes above subsistence. The previous model would then operate essentially as before, but with capital accumulation in human capital and infrastructure being determined mainly by budgetary outlays, rather than by overall national saving. Debt relief or foreign aid would work through budgetary flows rather than overall national income flows.

What kinds of economies are likely to find themselves in a poverty trap? First—and for present purposes critical—poor countries with a heavy inherited debt burden are likely to be in the zone of negative growth. Second, and very important, economies with intrinsically low productivity  $A$  are especially vulnerable. Low-productivity economies include geographically isolated regions (such as landlocked states and countries with a small internal market, especially those that are remote from larger markets) and regions with adverse ecologies (such as tropical rainforests and regions with high rates of malaria transmission, fragile soils, or water stress). Third, economies with low initial levels of reproducible capital  $k$ , perhaps the result of previous war or natural disaster, are obviously vulnerable. Fourth, countries with very high fertility rates, for

18. Azariadis and Drazen (1990).

cultural reasons or in response to high infant and child mortality rates, are especially vulnerable as well.

Not all very poor countries fall into a poverty trap. Indeed, countervailing forces, the most important of which are inflows of technology and capital from the rich countries, can promote very high growth rates in poor settings. In particular, if a poor country has an adequate mix of favorable geography (good ports, proximity to major markets), physical ecology (fertile soils, plentiful rainfall, absence of tropical diseases), little inherited debt, large internal markets (to spur domestic and foreign investment aimed at the home market), and good governance (to promote private sector investment and provide essential public services), the prospects for rapid growth are likely to be high and the risk of a poverty trap is likely to be remote.

### **The Debt Overhang and the Poverty Trap in Low-Income Countries**

The rich creditor governments that “own and operate” the principal international financial institutions—such as the IMF, the World Bank, and the Paris Club—have failed to acknowledge the pervasive risks of poverty traps for very low income countries. During the late 1970s and early 1980s, several dozen developing countries, including a large number of very poor countries, fell into serious sovereign debt crises. And although debt service burdens were rising, inflation-adjusted foreign assistance per capita in the recipient countries was declining. The squeeze of rising debt burdens and falling aid levels threw a large number of poor countries into persistent stagnation or economic decline. For roughly twenty years the standard interpretation of this phenomenon was that the countries needed yet more “structural adjustment” rather than debt relief or increased foreign assistance.

As debt burdens became more and more untenable, and as sustained growth in dozens of low-income countries proved elusive, the official creditors wrote off increasingly large portions of the debts owed them. But throughout the process, creditors failed to put sufficient political will or serious analysis into the debt reduction operations. Debt reduction targets were set and reset arbitrarily—writing off 30 percent, then 50 percent, and so on—rather than based on serious assessments of the needs of each coun-

try. To examine the debt restructuring process more formally, table 1 lists those countries that required Paris Club restructurings during the period from 1975 to 1996. For these purposes I exclude the transition economies, because the debt and restructuring problems of Eastern Europe, the former Soviet Union, and other economies once closely linked to the Soviet Union pose special issues. I also exclude very small economies (those with populations less than 1 million in 1998) and countries that were not sovereign as of January 1, 1980. Fifty-nine developing countries in the included group rescheduled their debts in the Paris Club during this period; only thirty did not, of which eight were oil-exporting states.<sup>19</sup>

For all Paris Club reschedulers during 1975–96, the countries are classified according to the outcome of the debt restructuring operations. Since a debt crisis signifies a kind of macroeconomic pathology, a three-way medical analogy is used: countries are either cured, or in remission, or in chronic crisis. The criteria for this classification are as follows:

—A country is considered *cured* of its debt crisis if it is current on its debt servicing, did not restructure its debt in the Paris Club during 1997–2001, is not a candidate for relief under the Heavily Indebted Poor Countries (HIPC) initiative, and was not under an IMF lending program during 1998–2001.

—A country is considered *in remission* if it meets the conditions for “cured” except that it was under a lending program with the IMF during 1998–2001.

—A country is considered to be in a *chronic crisis* if it required a Paris Club restructuring during 1997–2001, or is a candidate for HIPC relief, or is in default on its Paris Club debts.

Note that all countries deemed eligible for further debt relief under the enhanced HIPC program are considered to be in a chronic crisis, since these countries are acknowledged to require further debt cancellation to bring their debts to sustainable levels.

Of the fifty-nine countries shown in table 1 that required a Paris Club restructuring of their debt during 1975–96, only eight have been cured:

19. The twenty-two non-oil-exporting states that did not reschedule are Bangladesh, Botswana, Burundi, China, Colombia, India, Lebanon, Lesotho, Malaysia, Mauritius, Myanmar, Nepal, Papua New Guinea, Paraguay, Singapore, South Africa, South Korea, Sri Lanka, Syria, Thailand, Tunisia, and Uruguay. The eight oil-exporting states that did not reschedule are Iran, Iraq, Kuwait, Libya, Oman, Saudi Arabia, the United Arab Emirates, and Venezuela. Despite having a population of less than 1 million in 1998, Equatorial Guinea is included in Paris Club reschedulings.

**Table 1. Dates of Restructurings and IMF Programs, and Economic Outcomes in Countries That Rescheduled Paris Club Debt\***  
Units as indicated

Country	Year of first Paris Club restructuring	Follow-up Paris Club restructurings	Years under IMF lending program	Recovery status	Average growth of GNP per capita <sup>b</sup> (percent a year)	
					1975-99	1990-99
Algeria	1994	1995	1994-98	Remission	-0.4	-0.5
Angola	1989	HIPC eligible <sup>c</sup>		Chronic crisis	-2.1	-2.8
Argentina	1985	1987, 1989, 1991, 1992	1983-2001	Remission	0.3	3.6
Benin	1989	1991, 1993, 1996, 2000	1989-2001	Chronic crisis	0.4	1.8
Bolivia	1986	HIPC eligible 1988, 1990, 1992, 1995(x2), 1998, 2001	1986-2001	Chronic crisis	-0.6	0.8
Brazil	1983	HIPC eligible 1987, 1988, 1992	1983-86, 1988-90, 1992-93, 1998-2001	Remission	0.8	1.5
Burkina Faso	1991	1993, 1996, 2000 HIPC eligible	1991-2001	Chronic crisis	1.0	1.4
Cambodia	1995		1994-97, 1999-2001	Remission	1.9	1.9
Cameroon	1989	1992, 1994, 1995, 1997, 2001	1988-90, 1992, 1994-2001	Chronic crisis	-0.6	-1.5
Central African Rep.	1981	HIPC eligible 1983, 1985, 1988, 1990, 1994, 1998	1981, 1983-90, 1994-95, 1998-2001	Chronic crisis	-1.6	-0.3
Chad	1989	HIPC eligible 1995, 1996, 2001	1987-1990, 1994-2001	Chronic crisis	0.0	-0.9
Chile	1985	HIPC eligible 1987	1983-90	Cured	4.1	5.6
Congo (Brazzaville)	1986	1990, 1994, 1996 HIPC eligible	1986-88, 1990-92, 1994-99	Chronic crisis	0.3	-3.3

Congo (Kinshasa)	1976	1977, 1979, 1981, 1983, 1985, 1986, 1987, 1989 HIPC eligible	1978-82, 1984-90	Chronic crisis	-4.7	-8.1
Costa Rica	1983	1985, 1989, 1991, 1993	1980-83, 1985-97	Cured	1.1	3.0
Côte d'Ivoire	1984	1985, 1986, 1987, 1989, 1991, 1994, 1998 HIPC eligible	1981-92, 1994-2001	Chronic crisis	-2.1	0.6
Dominican Rep.	1985	1991	1983-86, 1991-94	Cured	1.4	3.9
Ecuador	1983	1985, 1988, 1989, 1992, 1994, 2000	1983-92, 1994-95, 2000-01	Chronic crisis	0.3	0.0
Egypt	1987	1991	1991-98	Remission	2.9	2.4
El Salvador	1990	1989, 1992, 1994	1990-2000	Remission	-0.2	2.8
Equatorial Guinea	1985	1997, 2001	1993-96	Cured	8.4	16.3
Ethiopia	1992	HIPC eligible	1992-99, 2001	Chronic crisis	-0.3	2.4
Gabon	1987	1988, 1989, 1991, 1994, 1995, 2000	1987-2001	Chronic crisis	-1.7	0.6
Gambia	1986	HIPC eligible	1988-91, 1998-2001	Chronic crisis	-0.3	-0.6
Ghana	1996	2001	1983-92, 1995-2001	Chronic crisis	0.0	1.6
Guatemala	1993	HIPC eligible	1993-94	Cured	0.0	1.5
Guinea	1986	1989, 1992, 1995, 1997, 2001	1982-83, 1986-2000	Chronic crisis	1.4	1.5
Guinea-Bissau	1987	HIPC eligible	1995-98, 2000-01	Chronic crisis	0.3	-1.9
Haiti	1995	n.a.	1995-99	Remission	-1.8	-1.2
Honduras	1990	1992, 1996, 1999	1990-97, 1999-2001	Chronic crisis	0.1	0.3
Jamaica	1984	HIPC eligible 1985, 1987, 1988, 1990, 1991, 1993	1978-96	Cured	0.1	-0.6

(continued)

**Table 1. Dates of Restructurings and IMF Programs, and Economic Outcomes in Countries That Rescheduled Paris Club Debt\* (continued)**  
 Units as indicated

Country	Year of first post-1975 Paris Club restructuring	Follow-up Paris Club restructurings	Years under IMF lending program	Recovery status	Average growth of GNP per capita <sup>b</sup> (percent a year)	
					1975-99	1990-99
Jordan	1989	1992, 1994, 1997, 1999	1989-90, 1992-2001	Chronic crisis	0.4	1.1
Kenya	1994	2000	1988-94, 1996-2001	Chronic crisis	0.4	-0.3
Liberia	1980	1981, 1983, 1984	1979-85	Chronic crisis	n.a.	n.a.
Madagascar	1981	HIPC eligible 1982, 1984, 1985, 1986, 1988, 1990, 1997, 2000, 2001 HIPC eligible	1980-92, 1996-2001	Chronic crisis	-1.8	-1.2
Malawi	1982	1983, 1988, 2001	1979-86, 1988-99, 2001	Chronic crisis	-0.2	0.9
Mali	1988	HIPC eligible 1989, 1992, 1996, 2000	1982-2001	Chronic crisis	-0.7	1.1
Mauritania	1985	HIPC eligible 1986, 1987, 1989, 1993, 1995, 2000	1985-2001	Chronic crisis	-0.2	1.3
Mexico	1983	HIPC eligible 1986, 1989	1983-93, 1995-97, 1999-2000	Remission	0.8	1.0
Morocco	1983	1985, 1987, 1988, 1990, 1992	1980-93	Cured	1.4	0.4
Mozambique	1984	1987, 1990, 1993, 1996, 1997, 1999, 2000	1987-2001	Chronic crisis	1.3	3.8
Nicaragua	1991	HIPC eligible 1995, 1998 HIPC eligible	1991-2001	Chronic crisis	-3.8	0.4

Niger	1983	1984, 1985, 1986, 1988(x2), 1990, 1994, 1996, 2001 HIPC eligible	1983-91, 1994-99, 2001	Chronic crisis	-2.2	-1.0
Nigeria	1986	1989, 1991, 2000	1987-92, 2000-01	Chronic crisis	-0.8	-0.5
Pakistan	1981	1999, 2001(x2)	1980-83, 1989-91, 1993-2001	Chronic crisis	2.9	1.3
Panama	1985	1990	1978-87, 1992-2001	Remission	0.7	2.4
Peru	1978	1983, 1984, 1991, 1993, 1996	1979-80, 1982-85, 1993-2001	Remission	-0.8	3.2
Philippines	1984	1987, 1989, 1991, 1994	1978-81, 1983-2000	Remission	0.1	0.9
Senegal	1981	1982, 1983, 1985, 1986, 1987, 1989, 1990, 1991, 1994, 1995, 1998, 2000	1979-92, 1994-2001	Chronic crisis	-0.3	0.6
Sierra Leone	1977	HIPC eligible 1980, 1984, 1986, 1992, 1994, 1996	1978-82, 1984-89, 1994-98	Chronic crisis	-2.5	-7.0
Somalia	1985	HIPC eligible 1987 HIPC eligible	1985-90	Chronic crisis	n.a.	n.a.
Sudan	1979	1982, 1983, 1984	1979-85	Chronic crisis	n.a.	n.a.
Tanzania	1986	HIPC eligible 1988, 1990, 1992, 1997, 2000, 2002	1980-82, 1986-94, 1996-2001	Chronic crisis	n.a.	-0.1
Togo	1979	HIPC eligible 1981, 1983, 1984, 1985, 1988, 1989, 1990, 1992, 1995 HIPC eligible	1979-98	Chronic crisis	-1.3	-0.5
Trinidad and Tobago	1989	1990	1989-91	Cured	0.4	2.0
Turkey	1978	1979, 1980	1978-85, 1994-96, 1999-2001	Remission	2.1	2.2

(continued)



**Table 1. Dates of Restructurings and IMF Programs, and Economic Outcomes in Countries That Rescheduled Paris Club Debt\* (continued)**  
Units as indicated

Country	Year of first post-1975 Paris Club restructuring	Follow-up Paris Club restructurings	Years under IMF lending program	Recovery status	Average growth of GNP per capita <sup>b</sup> (percent a year)	
					1975-99	1990-99
Uganda	1981	1982, 1987, 1989, 1992, 1995, 1998, 2000	1980-84, 1987-2001	Chronic crisis	2.5	4.0
Yemen	1996	HIPC eligible	1996-2001	Chronic crisis	n.a.	-0.4
Zambia	1983	1984, 1986, 1990, 1992, 1996, 1999	1978-87, 1995-2001	Chronic crisis	-2.4	-2.4
		HIPC eligible				

Sources: World Wide Web site of the Paris Club ([www.clubdeparis.org](http://www.clubdeparis.org)); Mumtaz Hussein, IMF, IMF, *Annual Report, various years*; IMF, *Debt Relief for Poverty Reduction: The Role of the Enhanced HIPC Initiative*, 2001; United Nations Development Programme (2002).

a. Includes all developing countries that rescheduled debt with the Paris Club on at least one occasion during 1975-96, but excludes the following: countries with 1998 population less than 1 million; former socialist economies in Eastern Europe, the former Soviet Union, and other economies that were closely tied with the Soviet Union; and countries that were not sovereign as of January 1, 1998.

b. In dollars at purchasing power parity.

c. Classified as a HIPC but expected to achieve debt sustainability after receiving debt relief under traditional mechanisms.

Chile, Costa Rica, the Dominican Republic, Equatorial Guinea, Guatemala, Jamaica, Morocco, and Trinidad and Tobago. Twelve more are in remission, and the remaining thirty-nine are in chronic crisis. Also notable is the sensitivity of countries' outcomes to their initial income: the low-income countries have generally failed to come out of their debt crises, requiring continued debt restructurings, including under the new HIPC terms, whereas most of the middle-income countries have been cured or at least gone into remission. Equatorial Guinea is the only least-developed country (according to the U.N. classification of those forty-nine countries with the lowest human development indicators) to achieve a "cure," and it did it in style: by discovering massive offshore oil reserves, which led to the fastest per capita growth rates in the world during the late 1990s. But apart from that anomalous outcome, all of the very poor countries fell into a persisting debt trap.

The countries in chronic debt crisis not only failed to reestablish a viable debt profile, but also failed to achieve sustained economic growth in the 1990s (table 2). The unweighted mean annual growth rate during 1990–99 of the countries in crisis was  $-0.2$  percent, and the median growth rate was only  $0.3$  percent; this compares with mean annual growth in the cured economies of  $4.0$  percent and median growth of  $2.5$  percent. Sixteen of the thirty-nine countries in chronic crisis experienced absolute declines in income, and only three experienced a per capita growth rate above  $2.0$  percent a year.

The unrealism of the current debt treatment of the poorest countries is also evidenced by endless and thankless rounds of debt renegotiation and IMF agreements. As table 1 shows, seventeen countries—all of which except Ecuador are in the low-income category—have experienced six or more Paris Club debt restructurings following the initial onset of crisis (dated as the first Paris Club round). And fourteen of these countries are now in line for yet another cancellation of debts in the enhanced HIPC process. Accompanying these endless rounds of debt restructurings have been nearly continuous IMF programs, going on for twenty years or more, despite the fact that under its Articles of Agreement (Article I, Section V) the IMF is supposed to make funding "temporarily available" for emergency relief, not continuously available for a country with unpayable debts.<sup>20</sup>

20. The continual Paris Club reschedulings and IMF programs go hand in hand, since an IMF agreement is generally a precondition for a Paris Club rescheduling. Thus, if an

**Table 2. Output Growth in Countries That Restructured Paris Club Debt, 1990–99**  
Units as indicated

<i>Recovery status</i>	<i>No. of countries</i>	<i>Average growth of GNP per capita<sup>a</sup> (percent a year)</i>	
		<i>Mean</i>	<i>Median</i>
In chronic crisis	39	-0.2	0.3
In remission	12	1.7	2.1
Cured	8	4.0	2.5
All countries	59	0.8	0.9

Source: table 1.

a. In dollars at purchasing power parity.

One can almost say that, for a poor country, requiring an IMF program has been an absorbing state: once in the IMF's clutches, it has been almost impossible to escape. That is the main reason why the number of countries under IMF programs has continued to soar during the past thirty years (figure 2). In 1978 there were twenty-two countries in IMF lending programs. By 1996 that figure had reached seventy-five, and as of 2001 it was sixty-three. Dozens of these countries have experienced nearly a quarter century of continuous IMF lending.

Several authors have recently studied the remarkably long-term use of IMF resources, finding as one might suppose that the problem is especially serious among low-income countries.<sup>21</sup> The IMF's new Independent Evaluation Office has recently taken up the issue.<sup>22</sup>

### **Reforming the Debt Relief Process for Low-Income Countries**

Poor countries that fell into a debt crisis got neither sufficient help to restore economic growth, nor deep enough debt reduction to reestablish normal relationships with creditors. There has been neither an economic recovery nor a fresh start. When one looks closely at the modalities of debt rescheduling, it is not hard to understand why. The guiding principle of official debt relief in the past twenty years has been to do the minimum possible to prevent outright disaster, but never enough to solve the debt

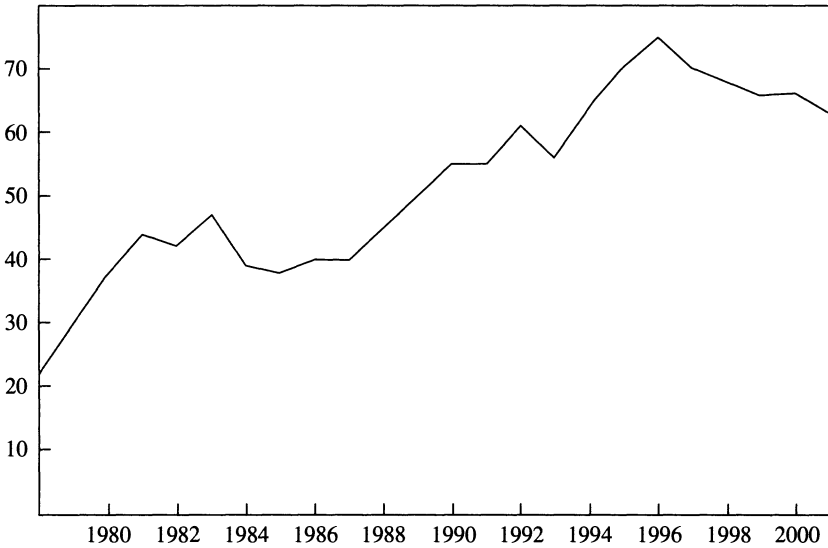
unpayable debt burden must constantly be renegotiated, the country is also obliged to remain within an IMF program (and the IMF is similarly obliged to continue lending to the country).

21. See, for example, Bird and others (1999).

22. Independent Evaluation Office (2002).

**Figure 2. Countries under IMF Lending Programs, 1978–2001**

No. of countries



Sources: Dates of programs provided by Mumtaz Hussein, IMF, and updated with data from IMF, *Annual Report*, various years.

crisis. In particular, the official creditors (in their capacity both as bilateral creditors in the Paris Club and as multilateral creditors through the IMF and the World Bank) have used arbitrary formulas rather than a serious analysis of country needs to decide on the level of relief. That remains the case today. Even now the so-called debt sustainability analysis of the enhanced HIPC initiative is built on the flimsiest of foundations.

The guiding principles of the Paris Club debt restructurings for low-income countries since 1975 are shown in box 1. Two things are striking about these principles. The first is that they have repeatedly been eased over time, both in the extent of relief and in the number of countries covered, as the terms of debt reduction have consistently proved inadequate to give a fresh start to the vast majority of these poor countries. The second is that the quantitative guidelines are across-the-board indicators, not based on an assessment of each country's characteristics and circumstances. For a decade after the outbreak of the developing-country debt crisis in the late 1970s, creditor countries denied the need for debt cancellation altogether. That changed for the first time in 1988, with the intro-

**Box 1. Paris Club Restructuring Terms for Low-Income Countries, 1975–2001**

**1975–88.** Paris Club debt is rescheduled but not cancelled or reduced in present value by reductions in interest.

**October 1988.** *Toronto terms* are introduced. For the first time, bilateral debts can be reduced in present value terms by as much as 33.3 percent. This can be accomplished through a debt reduction option or a debt service reduction option. Twenty countries benefit. Multilateral debts are not reduced.

**December 1991.** *London terms* raise the allowable debt reduction for low-income countries to 50 percent. Once again, debt reduction and debt service reduction options are offered. Twenty-three countries benefit, including many that had benefited from the Toronto terms. Multilateral debts are not reduced.

**December 1994.** *Naples terms* raise the allowable debt reduction for low-income countries to 67 percent and set the minimum debt reduction for “the poorest and most indebted countries” at 50 percent. In September 1999 the 67 percent threshold is applied to all heavily indebted poor countries. Thirty countries benefit. Multilateral debts are not reduced.

**December 1996.** *Lyon terms* (also known as the Heavily Indebted Poor Countries, or HIPC, Initiative) raise the allowable debt reduction for heavily indebted poor countries to 80 percent. For the first time, debts owed to the multilateral institutions (mainly the IMF, World Bank, and the regional development banks) may also be reduced. The concept of debt sustainability is

duction of debt reduction in Paris Club agreements equal to one-third of the outstanding debt. The one-third limit was arbitrary and was soon relaxed, then relaxed again, and then again, and then for a fourth time in the enhanced HIPC initiative.

The current definition of debt sustainability in the enhanced HIPC initiative is as arbitrary as the previous standards, if a bit more generous. A ratio of debt to exports of 150 percent or a ratio of debt to government revenue of 250 percent cannot truly be judged to be sustainable or unsustainable except in the context of each country’s needs, which themselves must be carefully spelled out. It is perfectly possible, and indeed is currently the case, for a country or region to have a “sustainable” debt (and significant debt servicing) under these formal definitions while millions of its people are dying of hunger or disease.

**Box 1. Paris Club Restructuring Terms for Low-Income Countries, 1975–2001 (continued)**

introduced. Debts are to be cancelled to bring countries' debts to between 200 and 250 percent of annual exports of goods and services, or, for countries with a high export-GNP ratio, to no more than 280 percent of annual government revenue.<sup>1</sup> Five countries benefit.

**November 1999.** *Cologne terms* (also known as the Enhanced HIPC Initiative) raise the allowed debt reduction to 90 percent or more "if necessary to achieve sustainability in the framework of the HIPC initiative." Debts of bilateral and multilateral official creditors are also to be reduced sufficiently to establish debt sustainability, as redefined by the initiative. Debt sustainability is now defined as debt no greater than 150 percent of annual exports, or, in countries with a high export-GNP ratio, no greater than 250 percent of net annual government revenue.<sup>2</sup> Forty-one countries are potentially eligible for the initiative, and fifteen countries have benefited to date.

1. Technically, the debt-export limit applied to countries with export-GNP ratios below 40 percent. The alternative measure could apply for countries with an export-GNP ratio above 40 percent, as long as government revenue was above 20 percent of GNP.

2. The thresholds for the government revenue alternative were eased slightly as well. The government revenue-based measure could apply for countries with an export-GNP ratio above 30 percent and with a government revenue-GNP ratio above 150 percent.

For twenty-five years the creditor nations and the IMF in effect defined debt sustainability as the amount of debt servicing that could be maintained in practice while still achieving a modicum of macroeconomic stability. If the country was maintaining a roughly balanced budget, with low inflation, the debt was considered manageable, even if economic growth was negligible or negative, and even if debt reschedulings had to be repeated every couple of years. And with creditors determining what was or was not sustainable, the flagrantly excessive demands on the impoverished debtor nations could not be challenged in the corridors of power. Only in the past couple of years has the inadequacy of this approach become widely recognized.

Looking forward, debt reduction for the HIPCs should not be based on arbitrary criteria such as a 150 percent debt-exports ratio, but rather on a

systematic assessment of each country's needs for debt reduction and increased foreign assistance, measured against explicit development objectives. The right starting point for assessing needs should be the internationally accepted targets for economic development that are (ostensibly) the guiding framework for the global development partnership between rich and poor countries. The targets are enshrined in the Millennium Development Goals (MDGs), a set of eight major goals and eighteen intermediate targets endorsed by all U.N. members at the Millennium Summit in New York in September 2000 and recently reconfirmed by the U.N. membership in the Monterrey Consensus of the International Conference on Financing for Development in Monterrey, Mexico, in March 2002. The MDGs are quantified goals for poverty alleviation, reduction of hunger, reduction of disease burden, and other targets, mostly for the year 2015.<sup>23</sup>

In principle, if the MDGs are taken as the baseline, and if there is a working economic model of growth and poverty for each country, it is possible to calculate a level of net resource transfers ( $f - d$  in terms of the model above) needed to achieve a given level of output per capita in the target year 2015. Suppose, for example, that there is a target level of output per capita  $q^T$  that should be achieved by 2015 in order to reduce extreme poverty by half (the first of the MDGs). That implies a target capital stock  $k^T$  equal to  $q^T/A$  that should be achieved by that year. Assuming for simplicity a constant level of  $f - d$  during the period 2002 to 2015, it is a simple exercise to take the differential equation for the capital stock,  $dk/dt = \sigma(Ak + f - d - m) - (\delta + n)k < 0$ , and to calculate the level of  $f - d$  needed to reach  $k^T$  in 2015.<sup>24</sup>

In practice, what is needed is nothing short of a country-specific "business plan" for scaling up essential public services (health, education, basic infrastructure) as part of an overall strategy for meeting the MDGs. In addition, each government—in conjunction with civil society—should articulate an overall development strategy that includes economic reforms and improved governance and accountability. The country-level business plan would provide an assessment of the financial gaps that must be

23. The goals are listed at [www.undp.org/mdg/Millennium%20Development%20Goals.pdf](http://www.undp.org/mdg/Millennium%20Development%20Goals.pdf).

24. Simply solving the first-order linear differential equation shows that  $k(2015) = \exp(13\beta)k(2002) - [1 - \exp(13\beta)](\sigma/\beta)(f - d - m)$ , where  $\beta = A\sigma - \delta - n$ . From here it is straightforward to solve for  $f - d$ .

bridged by development assistance and debt cancellation so that the country can scale up essential services. The Commission on Macroeconomics and Health of the World Health Organization (WHO) recently completed such an exercise for the health sector. For low-income countries in Sub-Saharan Africa, for example, it was found that spending on health care services needs to increase from 3.9 percent of GNP in 2002 to 13.2 percent of GNP in 2015, in order to extend the coverage of essential health services to roughly two-thirds of the population.<sup>25</sup> The commission assumed that these countries could muster an increase of 2.0 percentage points of GNP for health out of their own domestic revenues, leaving a gap of nearly 8 percent of GNP to be provided by donors (a sum estimated to equal \$26 billion a year as of 2015).<sup>26</sup>

Annual debt service owed by a HIPC rarely exceeds 5 percent of its GNP. Thus, even if all of the HIPCs' debts were cancelled, the savings would not be enough to fund the increased outlays needed just for health, much less the sums also needed for expanded education and basic infrastructure, such as water and sanitation, and feeder roads to villages. For the twenty-four countries that had reached the "decision point" of the HIPC process by the end of 2000,<sup>27</sup> the average level of debt servicing was scheduled to decline from 4 percent of GNP in 1998 to 3 percent during 1999–2000, and 2 percent during 2001–05.<sup>28</sup> Thus, even if all remaining debt servicing were cancelled, for a saving of 2 percent of GNP, the HIPCs would still likely need large increases in foreign assistance.

The idea of linking debt reduction to a detailed assessment of the financial requirements for meeting the debtors' essential needs may seem obvious, even trivial, but it is radically different from what the creditor-donor nations have done during the past quarter century. Debts owed by low-income countries have been collected, or partially cancelled, without any serious assessment of actual country needs anchored in specific development targets. And as we have seen, the results have been quite miserable. The vast majority of the HIPCs have suffered chronically from low or

25. WHO (2002, table A2.9, p. 171).

26. As shown in WHO (2002, pp. 172–73).

27. The decision point marks the beginning of interim relief under the HIPC initiative. Following successful implementation of a poverty reduction program for a few more years (up to three), the completion point is reached, under which the negotiated cancellation of the debt is completed.

28. IMF (2001, table 2, p. 8).



negative economic growth rates, and many have experienced a serious deterioration of social conditions. Almost all of the countries listed as in chronic crisis in table 1 are far off track from meeting many if not most of the MDGs by 2015.<sup>29</sup>

Table 3 highlights just how poorly the economies in chronic crisis are doing in terms of two central MDGs, those relating to child mortality and hunger, according to the most recent assessment made by the United Nations Development Programme (UNDP).<sup>30</sup> (The table singles out these two MDGs because they are the goals for which current data are most complete.) The child mortality goal is to reduce the child mortality rate by two-thirds by 2015 from its 1990 level. As table 3 shows, only five of the thirty-nine countries in chronic crisis are in a position to achieve that goal. Meanwhile, nine of the twelve economies in remission are on track or have already achieved the target, and among the eight cured economies only Jamaica is not on track. Regarding hunger, the goal is to halve the proportion of malnourished people on a country-by-country basis by 2015 from the 1990 level. Only nineteen of the thirty-seven crisis economies for which data are available are deemed to be on track for this goal or have achieved it. Of the ten countries in remission for which data are available, seven are on the desired trajectory. Among the cured economies, the corresponding figure is four out of seven. The crisis countries are clearly struggling, whereas the in-remission and cured economies are in vastly better shape.

### **Reforming the Treatment of Heavily Indebted Poor Countries**

In the very simple model I have used for illustrative purposes, economic growth depends on net resource transfers ( $f - d$ ), whether or not those transfers come in the form of new grants or loans (both signified by an increase in  $f$ ) or in the form of debt cancellation (reduced  $d$ ). To the extent that debts are cancelled, the needed increase in development assistance  $f$  is lessened. If debts are not cancelled, the same endpoint could in principle be reached by scaling up the level of official development assistance to cover the extra debt service as well. In practice this is unlikely to

29. UNDP (2002).

30. UNDP (2002).

**Table 3. Progress toward Development Goals in Countries That Had Rescheduled Paris Club Debt as of 2002**

<i>Country</i>	<i>Malnourishment</i>	<i>Under-five mortality rate</i>	<i>No. of goals either "on track" or "achieved"</i>
<i>In chronic crisis</i>			
Angola	On track	Slipping back	1 / 2
Benin	On track	Far behind	1 / 2
Bolivia	Lagging	On track	1 / 2
Burkina Faso	On track	Far behind	1 / 2
Cameroon	On track	Slipping back	1 / 2
Central African Rep.	Far behind	Far behind	0 / 2
Chad	On track	Far behind	1 / 2
Congo (Brazzaville)	Far behind	Far behind	0 / 2
Congo (Kinshasa)	Slipping back	Far behind	0 / 2
Côte d'Ivoire	On track	Slipping back	1 / 2
Ecuador	On track	On track	2 / 2
Ethiopia	n.a.	Far behind	0 / 1
Gabon	On track	Far behind	1 / 2
Gambia	On track	Far behind	1 / 2
Ghana	Achieved	Lagging	1 / 2
Guinea	On track	On track	2 / 2
Guinea-Bissau	n.a.	Far behind	0 / 1
Honduras	Far behind	On track	1 / 2
Jordan	On track	Lagging	1 / 2
Kenya	Far behind	Slipping back	0 / 2
Liberia	Slipping back	Far behind	0 / 2
Madagascar	Slipping back	Far behind	0 / 2
Malawi	On track	Lagging	1 / 2
Mali	Far behind	Far behind	0 / 2
Mauritania	On track	Far behind	1 / 2
Mozambique	On track	Far behind	1 / 2
Nicaragua	Far behind	On track	1 / 2
Niger	Far behind	Far behind	0 / 2
Nigeria	Achieved	Far behind	1 / 2
Pakistan	On track	Far behind	1 / 2
Senegal	Far behind	Far behind	0 / 2
Sierra Leone	Lagging	Far behind	0 / 2
Somalia	Slipping back	Far behind	0 / 2
Sudan	On track	Far behind	1 / 2
Tanzania	Slipping back	Far behind	0 / 2
Togo	On track	Far behind	1 / 2
Uganda	Far behind	Lagging	0 / 2
Yemen	Far behind	Far behind	0 / 2
Zambia	Far behind	Slipping back	0 / 2
Subtotal			24 / 76

*(continued)*

**Table 3. Progress toward Development Goals in Countries That Rescheduled Paris Club Debt as of 2002 (continued)**

<i>Country</i>	<i>Malnourishment</i>	<i>Under-five mortality rate</i>	<i>No. of goals either "on track" or "achieved"</i>
<i>In remission</i>			
Algeria	On track	Slipping back	1 / 2
Argentina	n.a.	On track	1 / 1
Brazil	On track	On track	2 / 2
Cambodia	On track	Slipping back	1 / 2
Egypt	On track	On track	2 / 2
El Salvador	Far behind	On track	1 / 2
Haiti	Lagging	Far behind	0 / 2
Mexico	On track	On track	2 / 2
Panama	On track	On track	2 / 2
Peru	Achieved	On track	2 / 2
Philippines	Far behind	On track	1 / 2
Turkey	n.a.	On track	1 / 1
Subtotal			16 / 22
<i>Cured</i>			
Chile	Achieved	On track	2 / 2
Costa Rica	On track	On track	2 / 2
Dominican Rep.	Far behind	On track	1 / 2
Equatorial Guinea	n.a.	On track	1 / 1
Guatemala	Slipping back	On track	2 / 2
Jamaica	On track	Far behind	1 / 2
Morocco	On track	On track	2 / 2
Trinidad and Tobago	Far behind	On track	1 / 2
Subtotal			11 / 15
<b>Total</b>			<b>51 / 113</b>

Source: United Nations Development Programme (2002).

be the case. The overhang of unpayable debt, and still more, the buildup of new debt if aid comes in the form of loans rather than grants, would convince potential private sector investors that the country remains trapped. Creditors themselves might promise their help now only to insist on increased debt service payments in the future if the country starts to recover. These are among the classic arguments for why a fresh start rather than a simple postponement of debt is needed in the case of an insolvent individual or municipality.

What kind of institutional changes are required to reorient the international system in the recommended direction? I suggest the following:

—The creditors should understand that, in a sovereign insolvency, whether under Chapter 9 in the United States or an international sovereign insolvency, the systemic goal is not the simple maximization of debt repayments to the creditors. Repayments to creditors must be placed in the context of additional objectives: a fresh start for an insolvent sovereign, preservation of its public functions, and achievement of broad development objectives. For low-income countries, the basic standard for debt collection should be to restructure debts in order to provide a macroeconomic framework within which the countries can achieve the MDGs.

—Each HIPC should be encouraged—indeed, required, in order to obtain comprehensive debt cancellation—to prepare medium-term plans for scaling up its investments in health, education, and basic infrastructure during the period from now until 2015. The targets should be set in order to meet the MDGs. These plans should be designed in conjunction with civil society, as part of the ongoing poverty reduction strategy process.

—The key U.N. agencies, including the UNDP, the WHO, and UNICEF, and the Bretton Woods institutions should support the countries in this costing exercise, but they should also carry out independent estimates of the countries' financing needs and incorporate those estimates into their own key country strategy documents.

—An independent review panel, with representatives appointed by both creditor and debtor countries but not representing either, should review the evidence from the countries and from the international agencies and make recommendations on the scale of debt cancellation and increased foreign assistance that should be granted to each country. For most HIPCs, the objective evidence will support a complete cancellation of debts, plus an increase in foreign assistance, all on a conditional basis to ensure that the increased net resource flow in fact supports the desired development objectives. The review panel could be convened under IMF auspices, but the recommendations should not be subject to a vote by the IMF's creditor-dominated executive board. In principle, such recommendations should be binding. In practice, it is almost certain that the rich countries will concur with such a system only if such a review panel operates on an advisory basis.

—The United Nations and the Bretton Woods institutions should provide published yearly updates on the progress of each country toward each of the MDGs. These assessments would help not only in monitoring

the low-income countries, but in monitoring the creditor-donor countries as well.

To the extent that the new system is merely advisory to the creditors, these recommendations may seem unnecessarily modest and might not resolve many of the political economy barriers that have blocked a more realistic approach to debt cancellation for the poorest countries. But they might just do the trick. A transparent process would shine important public light on the shortcomings of the creditor-dominated approach of the past quarter century. The objective evidence would underscore that the poorest countries are utterly impoverished and face multiple challenges of education, hunger, water and sanitation, and basic health that cannot be met without vastly larger flows of resources from the creditor countries. With the world just now recommitted to the MDGs after the Monterrey conference, an organized and intensive spotlight on the shortfall of practice relative to aspiration might help the international community come much closer to meeting its avowed aims.

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