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Aid and Debt Cancellation

If we take the view that peace, good governance and pro-poor growth policies can go a long way towards reducing poverty, then the resources required for poverty reduction are less of a problem than might be implied from a continuation of present trends. If, added to that, the global trade regime was to become pro-poor and systemic improvements to the global system were to reduce the vulnerability of the poor through less exposure to financial crises (see the next Section), then the outlook would seem to improve even further. It can also be argued that as governance improves, poverty is reduced and political stability develops, there will be enhanced private financial flows to such countries, filling the resource gaps in the context of combating poverty. Based on hopes such as these, African leaders expect that the NEPAD initiative will lead to an additional inflow of $64 billion per year into the continent. As against this, however, we need to bear in mind that:

- Special measures are required to meet the significant costs of peace-building and post-conflict reconstruction in some war-torn poor countries such as Sierra Leone;
- The gains from dismantling barriers to the exports of developing countries are still a distant prospect and may not necessarily flow to countries where the need is greatest;
- Some countries suffer from near desperate poverty that leaves little room for resource mobilisation with the best political will;
- There is a possibility that private resources will not be forthcoming to finance investments in:
  - health and education
  - basic infrastructure that is capital intensive and has long gestation lags such as roads and railways
  - countries that do not enjoy good ratings in international markets
  - small and island states that suffer from particular vulnerabilities, and cost disadvantages.

10.1 Official Development Assistance

The global community will, therefore, have to play a significant role through provision of ODA – with enhanced emphasis on grant-in-aid – if poverty levels are to be reduced.

How much additional finance is required? There are no accurate estimates, partly because the canvas is so large. If, however, we take the achievement of the Millennium

Development Goals as as our initial frame of analysis, including action in regard to deep poverty, child mortality, HIV/AIDS, access to clean water, education and gender-related targets, calculations by the UN and others suggest that a flow of $40–70 billion is required in addition to the current $56 billion a year in ODA. That is a doubling of aid, amounting to about 0.5 per cent of GNP of the industrialised countries, less than the 0.7 per cent target agreed at the UN General assembly in 1970.

What prospects are there that the global community will mobilise such additional resources? Aid declined by more than 10 per cent in real terms between 1990 and 2000 – at a time when the developed world enjoyed the longest boom of the post-second world war era – and it currently constitutes only about 0.22 per cent of the combined GNP of donor countries. In 2001, the British Chancellor of the Exchequer, Gordon Brown, called for an increase in ODA from $50 to $100 billion per year by 2007. While initially this appeal seemed to fall on deaf years, the announcements by the Bush Administration at the UN Monterrey Conference in March 2002 that it proposes to increase aid by $5 billion a year by 2006, and the announcement by EU Heads of State and Government of a new target of 0.39 per cent of GNP, representing an additional $7 billion a year, to be achieved by 2006, represent hopeful developments. The UK Government has already pledged that it will increase its total aid to 0.4 per cent of its national income by 2006.

Despite these positive developments, in the absence of fresh efforts by the donor community, the gap between what is required and what is likely to materialise still remains large.

10.2 Other Sources of Aid

Are there other avenues of aid that one might look to to make up the shortfall? Recently, George Soros (2002) made the interesting proposal that the global community should agree on and allocate additional special drawing rights (SDRs) accruing to richer countries to finance the costs of public goods such as health, education, bridging the digital divide and judicial reform. Under his proposal, the government-sponsored poverty reduction programmes would be excluded and be left to be financed by the IFIs. He suggests that his proposal should cover the 21.43 billion allocation of SDRs already authorised by the IMF in 1997, and currently waiting ratification by the US Congress; if this was agreed, nearly $18 billion, equivalent to the rich country allocation, could be made immediately available for international assistance. This could be followed by fresh special allocations of SDRs for the purpose of financing public goods. Given that the ratio of SDRs to global trade has been declining – and the holding of international reserves by developing countries in the currencies of major industrial countries such as the US dollar, the Euro and the Yen represent a real resource transfer unless offset by grant aid – there is considerable merit in taking this proposal seriously. Under current global conditions, when deflationary pressures are threatening global recovery, the fear of inflation need not deter such action; and it has the additional merit that it does not have any budgetary implications for the industrial countries, and that it avoids the 'free-rider' problem.

Another suggestion that is made from time to time is that a part of the gold reserves of the IMF should be sold and the profit used to enhance aid flows to the poorest countries.

In this context, it is also important to recognise the contribution being made by private voluntary flows and NGOs to financing development, which amounts to some $6–7 billion a year (or about 8 per cent of ODA, of which about $4 billion is from government sources) and the potential for further increases. Contributions from NGOs such as Oxfam have the merit of reaching the poor at ground level: thus, the value of each dollar spent in terms of poverty reduction is high compared to official assistance. On the other hand, it needs to be said that NGOs, that are self-selected, can be driven by motives other than support for poverty reduction and deepening of democracy; the predominance of northern NGOs, in which local people do not have ownership, is also a matter of some concern in several countries where neither the Government nor the public have the capacity to monitor their activities, and the accountability and transparency of the operations of some NGOs are in question.

10.3 Aid Effectiveness and the Allocation of Aid

Poverty is real and the global community should help reduce it. But some people ask: is aid effective in reducing poverty?

Disappointment with aid performance arises partly because of donor country behaviour, and partly because of poor governance and utilisation in receiving countries.

It can be contended that donors have several motives for giving, which are not always consistent with the allocation of aid so that it has the greatest impact on poverty. The motives include historical links, solidification of regional ties (for example in the case of Japan) and the pursuit of strategic interests (for example voting in the UN, arms sales). Thus, some of the disaffection with the impact of aid on poverty reduction does not reflect the intrinsic ineffectiveness of aid, but rather the large share of aid that is not allocated on the basis of the quality of policies or projects and the number of poor people. Aid going to low-income countries has in fact fallen from 61 per cent of total aid in the early 1980s to 56 per cent in the late 1990s.

To achieve greater impact, one could argue that aid should be redirected towards countries with high levels of poverty and good governance – as the World Bank is trying to do. This, however, carries significant implications in terms of the regional distribution of aid: the World Bank, for example, found that a doubling of aid that is distributed according to what it calls the 'quality of policies' and the level of poverty implies that South Asia's share would increase from 11 to 45 per cent; that of sub-Saharan Africa would remain unchanged; and that of the other parts of the world – which include Latin America and Central Asia – would decline sharply from about one-third to 4 per cent.

The import of a focus on poverty into the allocation of aid would thus have significant geopolitical implications. Clearly, the global community will have to debate these issues in terms of how best it can support democracies in achieving poverty reduction.

For aid to become more effective, it is also necessary to untie aid – tied aid constituted some two-fifths of bilateral flows in 2000; and was higher at 50 per cent in respect of the least developed countries, as food aid and technical assistance tend to be more tied than other forms of aid.

A particular area for attention is the lack of donor co-ordination that reduces the effectiveness of aid. As James Wolfensohn, President of the World Bank, noted:

> ... too many rich countries are using their aid programmes to satisfy domestic interests, tying aid to national procurement, or are 'planting flags' on isolated projects in the developing world, only to see their foreign assistance used less effectively because of lack of coordination.[38]

The lack of aid co-ordination imposes multiple standards and reporting requirements, prevents the formation and pursuit of coherent sectoral plans and wastes precious administrative resources of the developing countries. There is thus a case for harmonisation of procedures, adoption of sector-wide approaches, greater donor specialisation, more capacity building and greater donor flexibility in some donor requirements. The preparation of good practice papers that the Development Assistance Committee (DAC) of the OECD is promoting is a step in the right direction. Some non-OECD countries are associated with this work, but it is important that the process is as inclusive as possible. It is also encouraging that aid co-ordination has received attention at the Spring 2002 DAC meeting. It needs to be borne in mind, however, that one should not devalue a degree of pluralism in the donor community – so that mistaken policies on the part of heavyweight donors do not subsume all, destroying space for bilateral dialogue at the international level.

10.4 Debt Forgiveness

The external debt of developing countries has increased by 40 times in the 30 years between 1970 and 2000, and debt service has grown even more rapidly. The debt service of low-income countries,where most of the poor of the world live, currently exceeds fresh inflows, and net transfers in 2000 are a negative $29 billion.[39] There is recognition that the debt burden of some of the poorest countries is unsustainable. The HIPC Initiative, launched in 1996 and enhanced in 1999, seeks to address the burden of official debt of the poorest countries that amounts to some $150 billion in 1999 nominal terms. Some of this debt – possibly as much as half – was contracted by authoritarian or dictatorial regimes in which the people of the countries had little voice; and some of the official debt involved tied credits involving adverse procurement conditions. It is right, therefore, that the international community has been addressing the issue of debt relief for these countries. The London and Paris clubs of creditors have also been dealing with the rescheduling of private and bilateral official debt and have been taking several initiatives. The HIPC Initiative, while bringing some relief, particularly by reducing the overhang of debt, is not adding to the cash flow of the indebted countries in a significant way:

- By June 2002, 26 countries had benefited from the HIPC Initiative. However, while the debt relief granted will amount to about $25 billion in net present value terms, the actual reduction in debt service is small – estimated at about $ 1 billion.
- As recognised by the Kananaskis G8 Summit in June 2002, the HIPC Initiative is not delivering the relief it has promised:
  - not all creditors have agreed to reduce their HIPC debts;
  - the expected financing needs of the Initiative have not been fully met;
  - as a result of weaker growth and export commodity prices, the debtor countries are in a far worse position than initially projected, with the result that they risk not being able to reach the Completion Point – i.e. the point when creditors are satisfied that the country concerned has taken the necessary actions to make its debt sustainable if a part of its debt is cancelled.

It can be argued that in so far as debt relief under the HIPC Initiative is financed from a stagnant or declining ODA budget in the donor countries, it does not add to total development assistance – it merely diverts resources from the moderately indebted to the severely indebted countries: this may be justified if the overall impact of such diversion is greater poverty reduction, even though it will have implications in terms of inter-country distribution.

The linking of the grant of relief under the HIPC Initiative to comprehensive poverty reduction strategies, agreed with the IMF and the World Bank, reinforces the poverty focus of aid. However, the implementation of the agreed strategies requires a degree of macroeconomic stability which many poor countries find difficult to achieve because of exogenous shocks such as an uncertain external environment, vulnerability to natural disasters and exposure to poverty-induced conflict. That poor country commodity producers face a particularly uncertain external environment has been well stated by Kenneth Rogoff, Director of Research, IMF:

> Many African countries rely heavily on exports of a small number of primary commodities (for example, cotton, coffee, cocoa, soyabean, metals and, in some cases, oil). All are subject to extraordinary price volatility in world markets. Add to that the extreme unpredictability of international aid flows, and one can see that macroeconomic stabilisation would be difficult to achieve under any circumstances.
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> *The Economist*, 3 August 2002

These difficulties are real as we well know from the experience of Uganda: when countries are confronted with rigid time frames and performance criteria against such uncertainties, domestic economic management does become complex and risks the loss of ownership by the countries concerned. Relief also takes a long time in coming, as donors wish to be assured that a country is truly set on reform and a sustainable path. These considerations have led many to argue that the terms of relief under the HIPC Initiative should be made more generous and flexible, and that relief be more rapidly triggered.

As Birdsall and Williamson (2002) argue, there is a case for deeper debt cancellation, bringing more countries under its net, and making greater efforts to ensuring that these countries are not pushed back into unsustainability for a decade at least.

That the HIPC Initiative is a regular item of discussion at the G7/G8 summits, and that there is now regular interaction between the G7/G8 and the leaders of Africa are welcome developments.