WHO Commission on Social Determinants of Health

Globalization, Debt and Poverty Reduction Strategies
The Globalization Knowledge Network (GKN) was formed in 2005 with the purpose of examining how contemporary globalization was influencing social determinants of health. It was one of nine Knowledge Networks providing evidence-informed guidance to the work of the World Health Organization’s Commission on Social Determinants of Health (2005-2008): like most of the Knowledge Networks, its operations were financed by an external funder (in this case, the International Affairs Directorate of Health Canada, Canada’s national ministry of health). The GKN conducted two face-to-face meetings to debate, discuss, outline and review its work, and produced thirteen background papers and a Final Report. These papers and the Final Report underwent extensive internal and external peer review to ensure that their findings and policy inferences accurately reflected available evidence and scholarship.

This GKN publication series was prepared under the general editorship of Ronald Labonté, with assistance from Vivien Runnels and copy-editing provided by Wayne Harding. All views expressed are exclusively those of the authors. A complete list of titles in the publication series appears on the inside back cover of this monograph.
Globalization, Debt and Poverty Reduction Strategies

WHO Commission on Social Determinants of Health

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<th>Description</th>
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<td>AfDF</td>
<td>African Development Fund</td>
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<tr>
<td>CGDEV</td>
<td>Center for Global Development</td>
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<tr>
<td>DRI</td>
<td>Debt Relief International</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GKN</td>
<td>Globalization Knowledge Network</td>
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<tr>
<td>HIPC(s)</td>
<td>Heavily Indebted Poor Country(ies)</td>
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<tr>
<td>HIV/AIDS</td>
<td>Human Immunodeficiency Virus (HIV) Acquired Immunodeficiency Syndrome (AIDS)</td>
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<tr>
<td>IDA</td>
<td>International Development Association</td>
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<td>IEG</td>
<td>Independent Evaluation Group (World Bank)</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>LDCs</td>
<td>Least Developed Countries</td>
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<td>LICs</td>
<td>Low Income Countries</td>
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<td>MDG</td>
<td>Millennium Development Goals</td>
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<td>MDRI</td>
<td>Multilateral Debt Relief Initiative</td>
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<td>MICs</td>
<td>Middle Income Countries</td>
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<td>MTEF</td>
<td>Medium Term Expenditure Frameworks</td>
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<td>NPV</td>
<td>Net Present Value</td>
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<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
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<tr>
<td>ODI</td>
<td>Overseas Development Institute</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<tr>
<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
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<tr>
<td>PRGF</td>
<td>Poverty Reduction and Growth Facility (of the IMF)</td>
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<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
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<tr>
<td>SDH</td>
<td>Social Determinants of Health</td>
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<tr>
<td>SDR</td>
<td>Special Drawing Rights</td>
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<tr>
<td>TB</td>
<td>Tuberculosis</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WHO</td>
<td>World Health Organization</td>
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This paper addresses cross-border debt financing as a key component of contemporary globalization. It sifts the evidence about the effects of both the debt burden and debt relief on the social determinants of health. Reviewing the state of the debt cancellation process for the Heavily Indebted Poor Countries (HIPC), the paper shows how it has been compromised by a lack of speed and the fact that whether or not debt relief is given is in the hands of the creditors. This paper suggests that debt relief can play a role in promoting economic growth and investment in the social determinants of health even in the poorest countries, but that as debt is only part of the web of poverty so debt cancellation must be coupled with broader reforms aimed at improving the external macroeconomic position of poor countries. The paper also argues that debt cancellation should be extended to all developing countries in the interest of global equity.

Given the likely need of poor countries to continue borrowing in the future – and indeed the fact that they are already taking on new debts – there is an urgent need to reframe the process of debt cancellation from one, which focuses on the detail of countries’ economic vulnerability to debt, to one which focuses on the idea of debt responsibility. A responsible approach to debt involves ideas such as public scrutiny of lending, the establishment of an international bankruptcy process, as well as ideas about how social needs should be put ahead of repayments of debt in the future.

The Poverty Reduction Strategy Paper (PRSP) process illustrates some similar possibilities and limitations to the current debt relief process. In this case, it is a commitment to more ownership undermined by continued donor conditionality; a poverty focus undermined by fiscal conservatism and in the health field by an unjustifiably narrow focus on a few targeted interventions; and a claim to be leveraging substantial new resources for the social determinants which do not materialize. The PRSP process is a start in the right direction, but not much more than that at the moment.
Key messages from this paper include:

- **Worldwide debate about debt has been a dynamic process, not only good in itself, but also leveraging more aid, new sources of development financing – such as International Monetary Fund (IMF) gold – and contributing to a reinvigoration of ideas about the importance of policy autonomy for the governments of developing countries.**

- **Debt causes problems for countries in the South, by restricting investment and creating economic instability, thus dampening economic growth and poverty reduction. While there is debate as to how far this effect occurs in the poorest countries (that face so many other constraints on growth), it is the conclusion of this paper that debt is an important part of the web of stagnation, and one that needs to be tackled if current positive growth trends for many countries are to continue.**

- **The most malign aspect of debt, in the popular view, is the way it reduces the ability of developing countries to finance the basic needs of their populations. This paper finds that the stock of debt in middle-income countries (MICs) and the level of debt service in low-income countries (LICs) both have negative effects on social expenditures, and particularly on non-wage expenditures within these budget lines, which are the first to be cut during debt-induced fiscal austerity.**

- **With the full implementation of the HIPC initiative and the Multilateral Debt Relief Initiative (MDRI), many low-income countries will eventually receive significant levels of debt cancellation. Yet debt relief for the HIPCs has not brought as many new resources for development as anticipated. This is partly because many countries were only servicing a limited proportion of their debt anyway. And, while debt cancellation has boosted what are classified as poverty-reducing expenditures, it appears from limited evidence that benefits have been highly focused in the field of education.**

- **Moreover, the paper notes some concerns with the current HIPC initiative which have relevance into the future, as countries will still be required to borrow on international markets to raise the capital they need for development. These include the inappropriateness of its indicators of debt sustainability, which have unnecessarily limited the extent of debt relief, and the fact that the Initiative is unable to deliver an exit from debt burdens for poor nations. Eleven of the 13 countries that have reached the completion point in the HIPC Initiative once more face an unsustainable debt burden, primarily due to new borrowing. Nor has the initiative been as comprehensive as once hoped. Commercial creditors and non-Paris Club government creditors are stalling on providing debt relief. Commercial creditors and so-called vulture funds are becoming increasingly litigious towards poor nations unable to repay their debts.**

- **Middle-income countries too are at risk from high debt burdens. Plans for an international bankruptcy process, where both creditors and debtors are judged fairly, need rejuvenating. More broadly, current debt relief initiatives need to be surrounded by an international financial architecture that reduces the many and differing economic vulnerabilities of poor nations.**

- **Debt sustainability indicators that focus more on the level of debt service to a government’s revenue, complemented by a battery of vulnerability indicators such as dependence on primary commodities or the size of the burden of HIV/AIDS, would be much more helpful in assessing the likelihood of new debt problems occurring in the future.**

- **This paper also calls for a more radical approach to debt cancellation – one which assesses the health and other human development needs of countries and provides a commensurate level of relief to meet them. It suggests that this approach should be applied to all developing countries, and cites research showing this would mean cancellation in the**
order of 31 to 43 per cent of the debt of the developing world, benefiting between 93 and 107 countries.

* Overall, there needs to be a shift from thinking about narrow debt sustainability targets to a more comprehensive vision of what some commentators are calling debt responsibility. This looks at the broader political and social circumstances of lending in addition to economic circumstance. There should be parliamentary and public scrutiny of loans in borrowing and lending countries, and an international bankruptcy process should be established which can balance the interests of creditors and debtors.

* The paper also addresses the PRSP process which sprang from the debt relief deal agreed by the G8 in Cologne in 1999. PRSPs have been beneficial in focusing governments and the international community on the need to deal with the impoverishing financial costs of health care. However, they have not performed the cross-sectoral linking function that the promise of comprehensive development plans suggested. As a result, their impact on helping international policy-makers to tackle the social determinants of health (SDH) has been limited.

* The paper also finds that the general macroeconomic strategies proposed by PRSPs have not differed markedly from previous adjustment programs recommended by the IMF and World Bank, suggesting that country ownership of the programs is limited. It investigates the controversy surrounding the limits on public spending proposed by the IMF. It finds that while there is less financial conservatism than in the past, the IMF still has some way to go in terms of helping countries debate different scenarios for public investment and the potential for increases in international aid. Adopting this strategy, rather than top-down recommendation, is the most important role that multilateral institutions can play in assisting countries in their economic development, and one which would chime with the principle of ownership at the heart of the PRSP idea.
This paper addresses one of the threads that link the different parts of the world economy – debt financing – and the debates about poverty reduction that substantial debt forgiveness has generated over the past decade.

Foreign debt is addressed as a component of the Globalization Knowledge Network’s (GKN) review because it represents a significant cross-border financial flow affecting health and livelihoods in both low- and middle-income countries. It is also widely acknowledged that foreign debt and accompanying policy reforms have been used by developed nations to lever more globalization, in the form of trade and financial liberalization. Foreign debt has additionally highlighted another feature of globalization, namely that powerful political campaigning can lead to global change – as shown by the success of the Jubilee 2000 campaign to cancel unpayable debt. The issue of debt thus holds a mirror to more than one of the processes that characterize contemporary globalization.

This paper starts by describing the history and extent of the debt problem for the developing world, focusing especially on the HIPCs. It outlines debt relief initiatives and looks at their strengths and weaknesses by addressing a number of questions related to the sustainability and additionality of debt relief, and its ability to generate poverty reduction. What help or harm does the Poverty Reduction Strategy Paper process, created to ensure that debt relief is beneficial, bring to poor countries?

These questions in turn raise more fundamental ones. Is indebtedness a problem in itself or a reflection of a deeper developmental malaise within poorer countries? Is the political urgency attached to debt relief a result of the real urgency of the problem? Or is debt relief a crowd-pleasing panacea for action on more deep-rooted and intractable causes of poverty? I return to these broad issues in the conclusion.
2. History of the debt crisis and debt relief initiatives

The origins of the debt crisis that still lingers in the poorest developing countries can be placed in what some call the second wave of globalization – the post-war “golden years” from the 1950s until the mid-1970s (World Bank 2001). This history illustrates some of the dilemmas of international interdependence, for arguably the crisis has largely been driven by structural changes in the industrialized economies and, for the poorest countries, dependency on official financial resources from the developed world.

The fundamental causes of the crisis that unfolded in the 1970s are as follows. A combination of economic slowdown and inflation in the developed world and wars in Vietnam and the Middle East created a shortage psychology which the members of the Organization of Petroleum Exporting Countries (OPEC) took advantage of when they tripled the price of oil in 1973 (Mosley, Harrigan and Toy 1994). This led to a further slowdown in the rate of economic growth and rising inflation in developed nations and other oil-importing countries.

The petrodollars created by the rise in oil prices were deposited in Western banks, which then lent the money to developing countries at low interest rates. For the poorest countries, official lending from developed country governments (particularly their export credit agencies) as well as from multilateral institutions such as the IMF and World Bank also rose. A second oil price shock in 1979 was followed by dramatic increases in interest rates in the industrialized economies, as conservative governments came to power in the United States, West Germany and the United Kingdom on a platform of tackling inflation. Global recession then followed.

For developing countries this was a triple blow. Rising prices of oil necessitated ongoing borrowing from foreign lenders whose high interest rate policies worsened their burden of loan repayments. Meanwhile, less demand from the developed economies for their exports reduced the resources with which they could repay their debts. In 1982, when the Mexican government threatened to default on its debt repayments, the world financial system was thrown into crisis.
With several American commercial banks threatened with closure due to the threat of widespread default on loans, the US Treasury put pressure on the World Bank and International Monetary Fund to bail out developing countries with new loans that would ease what was perceived initially as a liquidity crisis.

The developing world was affected unevenly by what was quickly called the debt crisis. The more diversified and less exposed East Asian economies were able to withstand the worst effects. The economies of Latin America and sub-Saharan Africa were particularly badly hit. In Latin America commercial lending dominated the debt profile. In sub-Saharan Africa it was bilateral and multilateral lending. The debt crises in these regions thus took somewhat different paths. African economies were particularly vulnerable as they were also affected by a steep decline in the prices of their major exports, non-fuel primary commodities, due to the global recession (UNCTAD 2004). Poor economic governance, and sometimes outright corruption, on the part of both lenders and creditors also contributed to the accumulation of debts that could not be paid back.

Although also affected by deep economic crisis, the debt-distressed wealthier Latin American nations were given some relief through bailouts and rescheduling

### Table 1: Heavily indebted poor countries

The HIPC initiative currently identifies 40 countries, most of them in Sub-Saharan Africa, as potentially eligible to receive debt relief.

<table>
<thead>
<tr>
<th>Completion Point (22 countries)</th>
<th>Decision Point (8 countries)</th>
<th>Pre-Decision Point (10 countries)</th>
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<tbody>
<tr>
<td>Benin</td>
<td>Burundi</td>
<td>Central African Republic</td>
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<td>Bolivia</td>
<td>Chad</td>
<td>Comoros</td>
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<tr>
<td>Burkina Faso</td>
<td>Democratic Republic of Congo</td>
<td>Côte d’Ivoire</td>
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<td>Cameroon</td>
<td>Republic of Congo</td>
<td>Eritrea</td>
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<tr>
<td>Ethiopia</td>
<td>The Gambia</td>
<td>Kyrgyz Republic</td>
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<tr>
<td>Ghana</td>
<td>Guinea</td>
<td>Liberia</td>
</tr>
<tr>
<td>Guyana</td>
<td>Guinea-Bissau</td>
<td>Nepal</td>
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<tr>
<td>Honduras</td>
<td>Haiti</td>
<td>Somalia</td>
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<tr>
<td>Madagascar</td>
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<td>Sudan</td>
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<tr>
<td>Malawi</td>
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<td>Togo</td>
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<tr>
<td>Mali</td>
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<tr>
<td>Mauritania</td>
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<td>Mozambique</td>
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<tr>
<td>Nicaragua</td>
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<td>Niger</td>
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<tr>
<td>Rwanda</td>
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<tr>
<td>São Tomé Príncipe</td>
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<td>Senegal</td>
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<td>Sierra Leone</td>
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<td>Uganda</td>
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<td>Zambia</td>
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Debt cancellation on a small scale for these poorer countries was first initiated with the Paris Club’s Toronto terms of 1988, which started to reduce their official bilateral (or Paris Club) debt, but not debts to the multilateral institutions such as the World Bank and IMF (UNCTAD 2004). The terms of bilateral debt cancellation were gradually expanded, but overall indebtedness continued to climb. Finally, in 1996 creditors proposed a more comprehensive scheme under which multilateral debt could be cancelled. This was known as the Heavily Indebted Poor Countries initiative.

Countries qualified for the HIPC initiative if they were very poor (i.e. if they qualified for assistance from the World Bank’s International Development Association program) and if their debt burden crossed certain

**Figure 1: Heavily indebted poor countries**

Total external debt of the HIPCs (source: UNCTAD 2006).

**TOTAL EXTERNAL DEBT OF HIPCs, 1970–2004**

(Billions of dollars)

Source: UNCTAD secretariat calculations, based on World Bank, Global Development Finance Database.
Note: The decision point countries include data for the 27 HIPCs that reached the decision point by end 2004.
thresholds of debt sustainability. The most important of these were measurements of the ratios of the stock of public debt to a country’s exports and to the government’s revenues. Countries also had to have a six-year track record of compliance with an IMF structural adjustment program.

At first the HIPC initiative process moved slowly, but was accelerated by successful campaigning led by the Jubilee 2000 movement that called for the cancellation of the unpayable debt of the world’s poorest nations by the millennium year. This led to a reformulation of the terms of the Initiative at the G7 summit in Cologne in 1999. Qualification thresholds were adjusted downwards, interim debt relief was to be provided and the completion point at which countries received full debt relief was no longer at the end of the full six years of IMF reform but could be adjusted to the pace of a country’s economic reforms. Finally, debt cancellation was linked to debtor countries formulating Poverty Reduction Strategy Papers (PRSPs) which would show how they were going to use the proceeds from debt relief for the benefit of their populations. In 2005, again largely in response to public pressure, the debt relief initiative was expanded once more through the Multilateral Debt Relief initiative (MDRI) announced at the G7 Summit in Gleneagles, Scotland. Major creditors now allowed 100 per cent cancellation of the debts owed by HIPC nations to three multilateral institutions – the IMF, the African Development Fund (AfDF) and the International Development Association (IDA) – with the proviso that the latter two institutions receive compensatory funding from donors. (One hundred per cent cancellation was later agreed by the Inter-American Development Bank on different terms). Debtor countries will see future contributions from the IDA and AfDF reduced by the annual amount of debt service relief they gain from these institutions. However, countries can claw some of this money back if they achieve good policy performance. The cancellation of IMF debt will be paid for from sales of its gold reserves. (IDA/IMF 2006; UNCTAD 2004).
The following section reviews evidence for the effectiveness of the HIPC initiative. It looks at the following issues:

1. Has the HIPC initiative delivered debt sustainability?
2. Has the HIPC initiative reduced the debt overhang on poor countries?
3. Has debt relief delivered resources which benefit the social determinants of health?
4. Has debt relief been additional to existing levels of international aid?
5. Has the link with the PRSP process improved cross-sectoral working and facilitated increased resource flows to SDH sectors?

Answers to these questions have provoked fierce debate. Partly this is due to substantial data limitations which simply prevent clear answers from being given. Partly it is due to definitions. For example, what does “debt sustainability” mean? It is also due to some commentators taking an historical approach to analysis and focussing on the results of earlier forms of debt relief rather than the large cancellation effort made since the HIPC Initiative onwards. This underestimates the impact of debt relief, as many of the initiatives before HIPC initiative were more concerned with rescheduling debt payments rather than cancelling them.

Furthermore, evidence is sometimes skewed by those with a vested interest in seeing debt relief work – whether they be bilateral or multilateral creditors undertaking the cancellation or NGOs who want to see results from their campaign to cancel the debt. Likewise, there are political interests that are concerned with highlighting the failings of current debt relief initiatives, perhaps in order to claim more resources in the future. This review can only make readers more aware of potential bias in interpretation.

Assessment is complicated by the fact that the HIPC Initiative itself has so many policy goals – a critical weakness according to the review conducted by the Independent Evaluation Group (IEG) at the World
Bank. Not only does the HIPC Initiative seek a permanent exit from debt rescheduling; it is also charged with promoting growth by reducing the debt overhang, and releasing new resources for poverty reduction (IEG 2006). This concerns commentators who see debt as more of a symptom than a cause of underdevelopment and who argue that actions in a number of policy fields are needed to obtain the goals that the HIPC Initiative has set itself.

3.1 Has HIPC initiative delivered debt sustainability?

The HIPC initiative represented an important step forward. Creditors recognized that debt sustainability was an issue and that debtor needs could not be ignored (Martin 2004). However, the initiative has proceeded exceptionally slowly at a pace dictated by the creditors (Mandel 2006). “Too little, too late, for too few countries” has been a frequent criticism made by campaigners calling for deeper, faster and wider debt relief.

The choice of debt sustainability indicators was controversial from the launch of the initiative in 1996. Martin (2004:17) notes that:

“the amount of debt relief under HIPC was determined by eligibility thresholds which (according to public statements by Fund and Bank officials) were based on initial analysis… and then modified to suit political compromises amongst G7 creditors, balancing the need to include strategic G7 allies and their desire to keep costs down.”

The choice of a net-present-value (NPV) debt to exports followed standard practice from the Latin American debt crisis of the 1980s. At that time, substantial devaluations had helped these countries boost exports and pay off debt. Whether such an indicator is as useful for African countries is debateable. Devaluation cannot help them to the same extent, as they are heavily dependent on imports and foreign aid (UNCTAD 2004). Furthermore, the target of an NPV debt to exports ratio of 200 to 250 per cent was widely seen as too high in the first wave of the initiative – as was the fiscal criterion of NPV debt to revenue target of 280 per cent. Moreover the revenue target was constricted further by sub-targets which meant that it initially only brought Côte d’Ivoire into the Initiative – this at the behest of the French Government. Both indicators were revised somewhat when the initiative was enhanced in Cologne in 1999: the debt-to-exports target was lowered to a more realistic 150 per cent; and the NPV debt-to-revenue target was reduced a little to 250 per cent.

To what extent then has the initiative succeeded on its own terms? The World Bank Independent Evaluation Group’s evaluation of HIPC initiative (2006) notes that in the 13 post-completion-point countries the average NPV debt-to-export ratio has declined from 310 per cent to 142 per cent at the completion point, lower than the target set at Cologne. Similarly, the five countries that eventually qualified under the fiscal criterion have seen their debt service to revenue ratio decline by more than half between decision and completion point from 445 per cent to 181 per cent (2006:18), well below the target. Improvements in the two core indicators can also in part be attributed to increased exports and revenue mobilization by the HIPCs themselves (IEG 2006; UNCTAD 2006). However, the Trade and Development Report (2006) of the United Nations Conference on Trade and Development (UNCTAD) notes important improvements in the terms of loans being made to HIPCs. Average interest rates are lower, maturity rates longer and there is a higher proportion of grant element in new loan commitments. There has also been a shift away from short-term debt towards less volatile and cheaper multilateral and concessional financing.

Perhaps a more useful indicator of sustainability is one that is treated as a secondary criterion within the HIPC initiative. This is the debt service to exports ratio, which was originally set at a level of 15 to 20 per cent (Martin 2004). Overall, this ratio has been easing since the launch of the Initiative, with the debt service burden now down to around 11 per cent of export revenue.

The launch of the MDRI in 2005 will bring these levels down further, for those HIPCs with significant levels of debt owed to multilateral institutions that have reached the completion point. It is predicted that for these countries, implementation of MDRI will result in the cancellation of 80 to 90 per cent of their debts and will help lower their NPV of debt to exports to between 50 and 60 per cent, both significant achievements (DRI 2007).
However, there is a catch. For every dollar of debt relief awarded under the MDRI, post-completion point HIPCs will see a dollar reduction in their resource flows from both IDA and the African Development Fund (AfDF). At the same time, the multilateral institutions are compensated by donors for the debt reduction they give. This money then refinances the multilaterals that distribute it among both HIPCs and non-HIPCs on a performance-related basis. MDRI may or may not therefore provide additional resources to HIPCs.

Table 2 illustrates the point for IDA flows. Looking at the post-completion point countries you should be able to see that the performance-based re-allocation does make up for the resources lost after MDRI debt cancellation. Net flows from IDA to these HIPCs will fall from 6,951 to 6,605 million Special Drawing Rights (SDRs – the IMF’s unit of account, its value based on a basket of different currencies), that is by 346 million SDRs. Small positive transfers are predicted in the future for all other HIPCs groups but not enough to dent the total resource transfer loss to HIPCs. While maintaining resource flows to non-HIPCs is important, this should not be at the cost of the HIPCs.

3.1.1 Constraints about HIPC

3.1.1.1 Future prospects for debt sustainability

As Figure 1 illustrates, while the debt burden of the HIPCs declined in absolute terms from 1995 to 2002, it has been rising again since. Worryingly the World Bank’s Independent Evaluation Group (2006) notes that in 11 of 13 post-completion point countries, debt sustainability indicators are deteriorating, mainly on account of new borrowing. It is therefore questionable to what extent HIPC initiative delivers an exit from the debt problem. This issue is being compounded by the sudden availability of Chinese loans for African governments, leading the UK government to warn that further debt problems could be building (McGreal 2007).

3.1.1.2 Lack of burden sharing

While the HIPC initiative was meant to deliver comprehensive debt reduction, some commercial and bilateral creditors outside the main formal Paris Club grouping have not felt themselves bound by the Initiative (IEG 2006). Thirty-two non-Paris Club creditors are not partaking in the initiative which causes sustainability problems for some HIPCs, and allows these creditor countries to free-ride on the debt relief given by other creditors. HIPCs owe about $2 billion to commercial creditors, some of whom are increasingly litigious (IDA/IMF 2006). In 2007 the activities of so-called vulture funds – private investors who buy up poor country debts at a fraction of their book value and then press claims in the courts for the full legal value of the debt – have been in the media. Politicians from across the political spectrum have condemned the actions of the vulture funds, but there is little they can do, as the transactions of the vultures are perfectly legal.

3.1.1.3 Domestic debt

Many HIPCs are suffering from significant problems with domestic debt, a fact that is not taken into account when measuring sustainability which only deals with foreign debt. Yet, as UNCTAD (2004: 40) notes, there is a link between domestic and foreign debt ‘as economic agents borrow to fill the private savings investment gap, the fiscal gap and/or the foreign exchange gap’ created by external debt. Lack of access to international capital markets also forces a greater reliance on domestic financing. As a result, interest payments on domestic debt have been absorbing larger amounts of government resources and the HIPC initiative’s neglect of this burden leads to an underestimation of its impact on sustainability.

3.1.1.4 Policy slippage

Debt relief has been delayed in several countries because they have gone off track with IMF programs. The IDA/IMF (2006) report on HIPCs argues that this is due to weak budget execution and the length of time it takes for countries to prepare PRSPs; as well as broader factors such as internal conflict and poor governance. However, Martin puts the blame squarely on the demands of the IMF arguing that it is “traditional conditionality rather than PRSP processes [that] are causing almost all the delay” (2004: 32), and noting that just four of 15 African HIPCs have been able to meet their conditions on schedule. Overly rigid inflation targets, a proliferation of poverty reduction performance benchmarks, and left-over conditions from past programs are some of the barriers put in the way of HIPCs.
Table 2: Estimated impact of MDRI on IDA-14 flows as of August 2006 (SDR millions)

<table>
<thead>
<tr>
<th>Countries</th>
<th>IDA allocation FY2006-08</th>
<th>MDRI relief FY 2007-08</th>
<th>IDA disbursements after deducting MDRI</th>
<th>PBA reallocation</th>
<th>IDA disbursements (excluding MDRI relief)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benin</td>
<td>169</td>
<td>18</td>
<td>151</td>
<td>4.2</td>
<td>155</td>
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<td>Bolivia</td>
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<td>89</td>
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<td>193</td>
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<tr>
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<td>0.4</td>
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</tr>
<tr>
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<tr>
<td>Mozambique</td>
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<td>344</td>
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<tr>
<td>Rwanda</td>
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<tr>
<td>Senegal</td>
<td>213</td>
<td>41</td>
<td>172</td>
<td>5.3</td>
<td>177</td>
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<td>89</td>
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<td>997</td>
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<tr>
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<td>691</td>
</tr>
<tr>
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<td>25</td>
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<tr>
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Post-decision point HIPC

<table>
<thead>
<tr>
<th>Countries</th>
<th>IDA allocation FY2006-08</th>
<th>MDRI relief FY 2007-08</th>
<th>IDA disbursements after deducting MDRI</th>
<th>PBA reallocation</th>
<th>IDA disbursements (excluding MDRI relief)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
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<td>1</td>
<td>174</td>
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<td>Chad</td>
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<td>8</td>
<td>60</td>
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<tr>
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<tr>
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<td>1,014</td>
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<tr>
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<td>14</td>
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<tr>
<td>Guinea-Bissau</td>
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</tr>
<tr>
<td>Haiti</td>
<td>106</td>
<td>-</td>
<td>106</td>
<td>2.6</td>
<td>109</td>
</tr>
<tr>
<td>São Tomé &amp; Principe</td>
<td>4</td>
<td>0</td>
<td>4</td>
<td>0.1</td>
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<tr>
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Pre-decision point HIPC

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<th>MDRI relief FY 2007-08</th>
<th>IDA disbursements after deducting MDRI</th>
<th>PBA reallocation</th>
<th>IDA disbursements (excluding MDRI relief)</th>
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<tr>
<td>Central African Republic</td>
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<td>-</td>
<td>9</td>
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<td>9</td>
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<td>-</td>
<td>5</td>
<td>0.1</td>
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<td>-</td>
<td>231</td>
<td>5.7</td>
<td>237</td>
</tr>
<tr>
<td>Lao, PDR</td>
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<td>-</td>
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<td>1.1</td>
<td>44</td>
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<tr>
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<td>-</td>
<td>69</td>
<td>1.7</td>
<td>71</td>
</tr>
<tr>
<td>Myanmar</td>
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<td>-</td>
<td>0</td>
<td>0.0</td>
<td>0</td>
</tr>
<tr>
<td>Somalia</td>
<td>0</td>
<td>-</td>
<td>0</td>
<td>0.0</td>
<td>0</td>
</tr>
<tr>
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<td>-</td>
<td>634</td>
<td>15.6</td>
<td>650</td>
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<tr>
<td>Togo</td>
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<td>-</td>
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<td>18</td>
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<tr>
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<td>1,009</td>
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<td>1,034</td>
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Potential HIPC

<table>
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<tr>
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<th>IDA allocation FY2006-08</th>
<th>MDRI relief FY 2007-08</th>
<th>IDA disbursements after deducting MDRI</th>
<th>PBA reallocation</th>
<th>IDA disbursements (excluding MDRI relief)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eritrea</td>
<td>76</td>
<td>-</td>
<td>76</td>
<td>1.9</td>
<td>78</td>
</tr>
<tr>
<td>Kyrgyz Rep.</td>
<td>81</td>
<td>-</td>
<td>81</td>
<td>2.0</td>
<td>83</td>
</tr>
<tr>
<td>Nepal</td>
<td>526</td>
<td>-</td>
<td>526</td>
<td>13.0</td>
<td>539</td>
</tr>
<tr>
<td>Total</td>
<td>683</td>
<td>0</td>
<td>683</td>
<td>17</td>
<td>700</td>
</tr>
<tr>
<td>Total</td>
<td>10,199</td>
<td>547</td>
<td>9,652</td>
<td>252</td>
<td>9,904</td>
</tr>
</tbody>
</table>

Source: World Bank

Source: Debt Relief International (2007)
3.1.1.5 Insufficiency of resources

The World Bank and IMF (IDA/IMF 2006) argue that debt service payments by the 29 decision-point countries have been reduced by about 2 per cent over the period 1999-2005, releasing new resources for poverty reduction. However, it is also clear that debt reduction is not releasing anywhere near enough the level of resources needed to meet the Millennium Development Goals (MDGs) (Thomas 2006). Estimates for meeting the goals for all developing countries are something close to $100 billion annually, yet cancellation of all the HIPCs’ debt would only provide $3.2 billion a year (Martin 2004). We return shortly to the issue of how any gains from debt relief have been spent.

3.1.1.6 Need to boost the number of countries receiving debt relief

Several commentators have proposed that the scope of the HIPC initiative should be widened to include more debt-distressed developing countries. The HIPC initiative only deals with countries receiving funds from the World Bank’s International Development Association concessional finance facility or the IMF’s Poverty Reduction and Growth Facility which are only made available to the poorest developing countries falling below a particular income level. UNCTAD (2004) argues that, given international agreement that poverty is about far more than lack of income, other indicators of vulnerability should be taken into account, including susceptibility to external shocks, natural disasters and the burden of HIV/AIDS.

Others have raised the issue of the debt sustainability of some key middle-income countries that is also not addressed by the HIPC initiative: Dervis and Birdsell (2006) and Arslanalp and Henry (2004) are also concerned about emerging market economies with higher incomes and high debts, but also with substantial numbers of people who still live in deep poverty including those in countries such as Indonesia, Pakistan, Colombia, Jamaica, Malaysia and Turkey. Meanwhile, Stephen Mandel (2006) has looked at developing countries as a group and has shown that between 1983 and 1989, and strongly between 1998 and 2003, there was a net flow of resources from the developing to the developed world, even when aid is taken into account. Looking at the three decades from 1970 to 2004, he notes that the flow of resources from North to South amounted to “a paltry $92 per person living in the South, i.e. less than $3 a year, just above a fifth of the average British child’s weekly pocket money” (Mandel 2006: 8).

3.1.2 Conclusions: from debt sustainability to debt responsibility

The HIPC initiative has been successful in cancelling substantial amounts of debt for the first time, but it has proceeded slowly, on the creditors’ terms (Mandel 2006). It is also now clear that debt reduction does not equal debt sustainability (UNCTAD 2006; IEG 2006). Given the ongoing need for low-income countries to generate capital for investment, there will inevitably be a reason for them to look for further international credit. Substantially enhanced efforts will therefore be needed over the long term to prevent a further build-up of debt. This cannot be done simply by focussing on the narrow economic sustainability indicators deployed under the HIPC initiative. Rather the international community needs to focus on promoting “debt responsibility” (Eurodad 2007: 17). So what kind of measures might be needed to achieve debt responsibility?

First, adjustment of some of the basic debt sustainability indicators used by the HIPC initiative would be important. The usefulness of the NPV debt to exports criterion has been questioned. Looking at debt service payments as a percentage of government revenue would be a more helpful way of measuring how far debt is constraining poverty reduction spending (Martin 2004). An NPV debt to GDP indicator would in turn be more helpful for analysing the problem of debt overhang (UNCTAD 2004). UNCTAD (2004) argues that creditors should also look at the total burden of foreign and domestic debt servicing when undertaking debt sustainability analyses.

Secondly, the International Financial Institutions have also been overly optimistic in the past about likely levels of economic growth in the HIPCs, which has led them to overestimate how sustainable debt levels will be. There are signs that this is changing (IEG 2006). However, given that these are countries vulnerable in a number of other dimensions, there have also been...
calls for a focus on price volatility, the extent of diversification of exports, the burden of HIV/AIDS, the frequency of natural disasters and other structural factors when assessments of debt sustainability are made (UNCTAD 2004; Martin 2004).

Thirdly, more transparency is needed in the loan contraction process. Government borrowers and lenders should be subject to parliamentary scrutiny. Public participation in important economic decisions would also be welcome (Eurodad 2007). Commercial creditors who refuse to provide debt relief when needed could be exposed. There is currently an urgent need to help countries facing lawsuits from commercial creditors. Martin (2004) suggests a legal assistance facility to help HIPCs in this position.

Fourthly, the delays and creditor control over the HIPC initiative process has re-invigorated calls for a more balanced approach to debt cancellation. It would seem prudent to heed the call of UNCTAD (2006) and debt campaigners for reforms to the international financial architecture to ensure orderly bankruptcy procedures and independent arbitration and mediation between the claims of creditors and debtors.

Finally, we come to the underlying questions of how much indebted and poverty-stricken countries should be forced to pay in debt service. Which countries should be included in debt reduction opportunities and how much fiscal breathing space should they be given?

As mentioned earlier, it is clear that there are several middle-income countries with substantial numbers of poor people that suffer from a high-debt burden. Providing debt relief for middle-income countries has therefore had more policy attention in the last few years, and Paris Club members have agreed to provide relief to richer nations with unsustainable debt burdens, as long as they are committed to IMF programs (UNCTAD 2006). Dervis and Birdsall (2006) have suggested a separate debt initiative to provide debt relief for heavily indebted emerging market economies which they call a Stability and Social Investment Facility which would be housed either at the World Bank or IMF. Noting that debt burdens sometimes keep growth rates low in these countries, they argue that such a facility would help them out of the trap of never-ending fiscal austerity while reducing the debt overhang and avoiding a future debt crisis. It would also help middle-income countries protect social expenditures in the face of a high-debt burden.

Currently international liquidity is such that middle-income countries themselves seem to lack the desire for such a facility. The IMF’s power over middle-income countries has also been reduced because of the availability of other sources of loans. But this should not stop the international community from creating mechanisms that ensure debt responsibility, as outlined above. Furthermore, given the paltry transfers from North to South over the past 40 years, it could be argued that all developing countries should be considered for debt cancellation, in the name of promoting international equity.

Defining how much debt cancellation should be made available should not be limited to even the expanded range of debt sustainability indicators listed above. In the context of the HIPC initiative, some political purchase has in fact already been achieved with the idea of capping debt service payments to 10 per cent or 5 per cent of government’s domestic revenues. However, it should be noted that such a cap would benefit those HIPCs with the smallest share of revenues coming from internal sources (UNCTAD 2004), creating a perverse incentive not to raise domestic revenue efforts.

A number of commentators and reports have called for debt cancellation to be based on the resources needed for countries to meet the Millennium Development Goals. Even the G8, at its meeting in Kananaskis, Canada in 2002, said that “no country committed to poverty reduction, good governance and economic reform will be denied the chance to achieve the Millennium Goals through lack of finance” (quoted in Mandel 2006: 11). Nevertheless, complete debt cancellation alone will not allow some poor countries to reach internationally agreed targets, as they will still require even higher levels of aid. Some are alarmed at the prospect of such deep cancellation and suggest that it will create moral hazard, as countries are encouraged to become even more indebted in the future. On the other hand, UNCTAD notes “there is no greater moral hazard than the one entailed in constant restructuring and partial debt forgiveness based on creditors’ perspectives and interests…” (2004: 71).
A far more radical interpretation of the concept of debt sustainability is contained in proposals by Mandel (2006) which incorporates a feasible net revenue approach to debt forgiveness. Mandel starts by using the work of Peter Edward (2006) who argues that the international $1-a-day poverty line is an arbitrary cut-off point for defining absolute poverty. It is based on income and not on accepted ideas about human development. Edward points out that the attainment of good health is a key attribute of human development, and notes that there is a strong correlation between income and life expectancy (see Figure 3). As can be seen in Figure 3, there is a kink in the line beyond which there is little improvement in life expectancy even as wealth increases further. Edward argues that this kink falls at a life expectancy of 70 years and, based on different calculations, suggests that this outcome can generally be achieved in countries where average consumption levels are about $3 per day, equivalent to a GDP/per capita of around $5,000. This, he argues, would be a better, or more “moral”, figure for a poverty line.

In his paper Mandel suggests that we can use this “moral poverty line” to calculate the amount of debt relief that should be given to developing countries. He assumes first that governments should not be collecting revenue from anyone living under the poverty line; and secondly, that all people over the poverty line will only be taxed at a rate of 25 per cent. This will then give us a potential total for government revenue. He then moves on to calculate how much needs to be spent on providing essential services for the population in order to meet the MDGs and subtracts this from government revenue. Only after this has been done, Mandel argues, should a proportion of what remains be set aside for debt servicing. Based on a sample of 136 developing countries, Mandel argues that between 31 per cent and 43 per cent of all outstanding developing country debt – affecting 93 to 107 nations – needs to be cancelled if poverty is to be reduced and the Millennium Goals met.

3.2 Has the HIPC initiative reduced the debt overhang?

One of the most important motivating factors for providing debt relief has been the idea that low-income countries are suffering from economic problems created by debt overhang – a stock of debt that cannot be repaid. This unpayable debt acts as implicit tax on investment, which will tend to lead to lower rates of economic growth. Uncertainty about future economic prospects raises the cost of borrowing, which reduces both public and private investment. And it acts as a disincentive for governments to carry out economic reforms. Private investors also fear the currency instability, inflation and higher taxes that a large debt burden is likely to bring. Overhangs also tend to lead to high rates of short-term investment with lower productivity (Arslanalp 2004; UNCTAD 2006; Dijkstra and Hermes 2001; Were 2001).

The existence of the debt overhang and its growth-suppressing effects was first noticed in Latin America in the 1980s. However, others have questioned the applicability of the debt overhang hypothesis in relation to the HIPCs (Arslanalp and Henry 2004; Moss 2006; Chauvin and Kraay 2005; Bird and Milne 2003; Killick 2003). The sceptics’ arguments are threefold:

- First, there have been net resource transfers to the HIPCs since the mid-1990s – debt overhangs are usually associated with significant net outflows.
- Secondly, HIPCs are in the main borrowing from official creditors who have less reason to worry about the effects of debt overhang than commercial creditors (i.e. foreign and domestic private investment is deterred more than bilateral and multilateral aid).
- Thirdly, private sectors are not well established in these countries, so there is not much private investment to deter. In reality, HIPCs are afflicted by broader economic problems which are the real cause of lower economic growth rates.

3.2.1 What is the evidence?

Based on their own analysis and examination of the literature, Chauvin and Kraay (2005) argue that there is no historical evidence for a relationship between economic growth and debt overhang for the HIPCs, nor is there a great deal of evidence for positive effects of debt relief in generating economic growth. The IEG’s report on the implementation of the HIPC initiative suggests that evidence is not conclusive: one study cited suggests
that debt relief could contribute to a one percentage point increase in GDP per capita growth, while another study says that in countries with good policies, the ‘debt overhang affects growth negatively, but only at intermediate levels of debt, but not at high or low levels’ (IEG 2006: 72). UNCTAD (2006) suggests that debt relief has played its role in raising the growth rate in HIPCs from a negative one of -2 per cent in 1980 to 1995 to a positive one of +1.5 per cent from 1996 to 2004. They claim that, while it is too early to say that this is a result of the HIPC initiative, “the expectation and actual provision of debt relief is likely to have been a contributing factor.” Nevertheless, “elimination of a debt overhang is a necessary but certainly not sufficient condition” for achieving economic growth over the long term (UNCTAD 2006: 95).

An interesting study by Dijkstra and Hermes (2001) notes that it may not be the stock of debt that is the real problem in hindering growth; rather it is the instability of debt service payments. While there may be net financial flows to HIPCs, this often comes about as a result of defensive lending and granting by creditors trying to ensure that debt repayments are made (Machesi and Missale 2002). So there is tremendous uncertainty within time periods as to whether new financial resources will come in to meet the country’s need to service its debt. This uncertainty and the swings in debt service may prevent economic reforms and reduce incentives for private investors. Furthermore, the complex process of debt negotiation uses up valuable administrative time. Examining data from 104 less developed countries from 1970 to 1998, Dijkstra and Hermes suggest that the uncertainty of debt service payments has undermined economic growth in the past for HIPCs but not for the whole group of LDCs. This suggests that the HIPCs do face a different problem generated by their heavier indebtedness and that debt reduction could help solve the problems caused by debt service instability.

3.2.2 Conclusions: debt overhang

There are strong arguments against the applicability of the debt overhang hypothesis to HIPCs. Nevertheless, debt can be seen as part of a web of factors limiting

Figure 2: The relationship between income and life expectancy

![Figure 2: The relationship between income and life expectancy](source: Mandel 2006)
growth. Debt service instability may well be a factor which in itself constrains economic expansion. Further research is needed in this area.

3.3 Has debt relief delivered resources which benefit the social determinants of health?

The social determinants of health are obviously wide-ranging, encompassing housing conditions, water and sanitation, education and economic growth, as well as availability and quality of health care. Most of the papers examined here look at whether debt relief has freed up money for poverty reduction expenditures. These are generally taken to mean “basic health, primary education, agriculture, infrastructure, housing, basic sanitation and HIV/AIDS programmes” (IEG 2006). These categories obviously coincide to some extent with the social determinants of health as understood by the Commission. However, in reality, most studies of expenditures focus on health and education spending and we review these studies below. Readers should bear in mind that little work has been done on the relationship of debt burden to important social determinants of health like investment in public infrastructure programs for water, electricity, telecommunications, roads, etc. However, there are strong indications that these investments have been declining in poor countries (see Roy, Heuty and Letouze 2006 for further elaboration).

3.3.1 Effects of the debt burden on SDH resources

Before examining whether debt relief has increased resources for SDH, it is interesting to address the question of whether the debt burden itself affects government spending on social services. The widely taken assumption is that it does, but strangely this assumption has not been analyzed in great detail in the literature. Governments could for example take the option of protecting social expenditures.

Three recent studies (Mahdavi 2004; Lora and Olivera 2006; Thomas 2006) which test sizeable cross-national samples suggest debt does affect social expenditures but in complex ways. Mahdavi looks at shifts in the composition of government spending in response to the external debt burden. Examining 47 developing countries using data collected from 1972 and 2001, and controlling for several other relevant factors that may affect the composition of government spending, he finds evidence of a significant impact of the burden of public debt. Invariably, “the burden of debt… changed the composition of spending in favour of interest payments and displaced the share of non-wage goods and services category in most cases” (2004: 1151). Where the debt burden was particularly heavy (namely in the Middle East and North Africa and sub-Saharan Africa), the effects on spending shares were particularly pronounced. Wages of public employees tended not to be adversely affected by the debt burden, suggesting that politically sensitive expenditures are protected. Meanwhile, physical capital stock is left to decline. The result holds with observations made many times over the past 20 years when examining the impact of economic recession in developing countries.

Lora and Olivera (2006) process data on social expenditures and external and domestic debt for 58 developing countries for the period 1985 to 2003. To avoid results being influenced unduly by outliers, the sample is restricted to countries or years where the debt is not larger than 150 per cent of GDP. They find that higher debt ratios do reduce social expenditures – and that it is the level of the stock of debt rather than debt service payments which affect those expenditures. Worldwide, both education and health expenditures are hit by increases in debt, but the impact is larger on health. The authors suggest that the level of debt reduces the appetite for further indebtedness. Countries respond to a large debt burden by reducing total expenditures and increasing total revenues. “[I]n this process, social expenditures are hit disproportionately hard” (Lora and Olivera 2006: 11). The authors note the weaker political voice of users of government health and education services as an explanation for this, which is compounded by the extent of private provision of these services in many indebted countries. They also argue that, within budget lines, non-wage expenditures are easier to postpone.

Looking at debt and social (i.e. health and education) expenditure data for 110 countries from 1985 to 2003/04, Thomas (2006) suggests that, for middle-income countries, higher levels of debt have a significant negative effective on social expenditures. Meanwhile, for low-income countries, it is the level of debt service that affects their expenditures, sug-
gesting that these are “sensitive to the change in the flow of resources rather than the stock of wealth or debt” (2006: 10).

Overall the studies cited above suggest that debt burdens make a significant impact on social expenditures, though there is some debate about the mechanism (stock of debt or debt service). We can also suggest that within social expenditure budget lines it is spending on non-wage goods and services that is particularly strongly compromised. The conclusion that can be drawn is that debt relief should lift social expenditures somewhat.

3.3.2 Effects of debt relief on social expenditures

The World Bank’s Independent Evaluation Group (IEG 2006) estimates that poverty reducing expenditures in 28 decision point countries have gone up from 6.4 per cent to 8.1 per cent of GDP from 1999 to 2004, and are now four times as great as debt service payments. According to the IEG most of the rise is accounted for by education, while spending is the same or less on health, agriculture, and transportation (IEG 2006). It should be noted however that this assessment is based on data from just five countries.

UNCTAD (2006) shows similarly positive results for the relationships between government revenue and debt service and poverty reducing expenditures in 29 countries at or beyond the decision point (see figure 4). As well, based on his analysis of the impact of debt service payments on social expenditures discussed above, Thomas (2006) predicts that the projected decline in debt service ratio of 1 per cent of GDP in low-income countries is likely to lead to an increase in social expenditures between 2004 and 2007 of about 0.35 per cent of output.

Chauvin and Kraay (2005) are more cautious. In only one of the two historical periods they examine is debt relief associated with increases in health and education spending and the rise was driven by sharp increases in two countries, Yemen and Mozambique. Given that the extent of debt relief before the HIPC initiative was not great (and was more focussed on rescheduling), this might explain this result. However, the authors also note that there is little evidence of sharp upward trends in health and education as a share of total government spending after the implementation of the HIPC initiative. This, they argue, shows that supposed emphasis on these poverty reducing budget lines under the HIPC initiative/PRSP is not being borne out by spending allocations. They do not examine whether total per capita expenditures have increased in health and education in HICPs.

3.3.3 Conclusions

We can conclude from the above discussions that either a stock of debt burden or higher debt service payments has a suppressing effect on social expenditures; and that the available evidence suggests that debt relief can help to raise social expenditures. However, there are two cau-veats here. Other factors (such as increased aid) may be responsible for the observed rise in poverty reducing expenditures. As well, the studies are not conclusive on a positive impact of debt relief. At any rate, the benefits for health expenditure and for non-education expenditures affecting the social determinants of health appear, from the limited data available, to be not so large. This is likely a function of the fact that the new funds made available by debt relief are themselves not large.

Somewhat ironically, another complaint made often in the literature is that HIPC initiative debt relief has favoured health and education budgets to the exclusion of other poverty-reducing or growth-generating economic activities (IEG 2006; UNCTAD 2004). Killick puts the dilemma eloquently:

“Inadequate access to education and health is certainly a powerful influence on poverty. But poverty has many other causes as well, notably the effects of past economic stagnation or decline, inadequate access of the poor to various forms of capital, large and growing inequalities, high demographic dependency rates, gender biases, and various forms of disempowerment and of state failure” (Killick 2004: 9).

This has led to calls for a rebalancing of the uses of debt relief, although it is unclear how much policy impact these demands are having. UNCTAD (2006) has noted that, while debt service relief reduces the foreign exchange constraint, it does not necessarily ease the budgetary burden “as the amount previously scheduled for debt service payments will instead be
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3.4 Has debt relief been additional to existing levels of international aid?

The benefits of debt relief will only be apparent if they are truly additional to revenue already raised domestically and from foreign sources. While we cannot answer the question of additionality in relation to domestic resources due to lack of studies in this field, there has been a degree of speculation about debt relief’s additionality to aid. In part this is provoked by rather pessimistic assessments. This pessimism has some basis in the historical record. Both Bird and Milne (2003) and Arslanalp and Henry (2004) suggest that past debt relief has not been additional to aid. Arslanalp and Henry note that when the HIPC initiative started, aid flows as percentage of GDP decreased from 13.7 per cent of

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transferred into a special account that is drawn upon to finance social expenditures under the country’s PRSP” (2006: 97), thus, again placing pressure on competing (non-social) expenditures. These concerns are important to take into consideration from the point of view of SDH.

One further message that may be important is that Thomas’ (2006) study suggests that low-income countries protect social expenditures from budgetary consolidation better than middle-income countries, where “social expenditures are cut considerably when the budget balance is needed to strengthen” (2006: 10). While the focus of many is on social expenditures in low-income countries, social expenditures in middle-income countries should receive greater policy attention in times of economic crisis.

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Figure 3: Decision point HIPC: debt service and poverty reducing expenditures as a percentage of government revenue 1998-2008

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GDP to between 9.9 per cent and 11.1 per cent, and that this was reflected in a decline in the net transfer of resources towards HIPCs. These figures tally with our earlier assertion that lending and granting to the HIPCs has been largely defensive in nature. In other words, it has been designed to help poorer countries repay their debts. This is how Bird and Milne come to note that “higher levels of outstanding debt are associated with higher, not lower, levels of net resource transfers from official sources” (2003: 54).

However, there is some debate about the extent to which more debt relief will necessarily mean less aid. Thomas (2006) suggests that the decline in aid in the mid-1990s was more a function of the focus on fiscal deficit reduction in the developed world at that time, and that aid has been expanding ever since. More recent assessments of the additionality question have been more upbeat. IEG (2006) notes that net annual transfers to HIPCs have increased substantially over the period of the implementation of the initiative from $7.3 billion in 2000 to $15.8 billion in 2004. They argue that $4 billion of this increase is attributable to debt relief, and that the 11 per cent annual increase of non-debt relief transfers over the same period suggests donors “have not… cut back on non-debt-relief transfers, and that debt relief was additional in the aggregate” (2006: 11).

Martin (2004) is similarly positive, arguing that additional resources – for example. IMF gold sales – have been brought into play through the advent of the HIPC initiative. Even Bird and Milne (2003: 58) argue that the “powerful symbolism of debt relief may create a political commitment in developed countries to increase resource transfers to low-income countries.” Thus, they suggest that debt relief is a dynamic process which is producing positive effects in the current context. What they do not discuss explicitly is the fact that the historic relationship between the award of debt relief and lower aid levels may have been broken due to the campaigning efforts of Jubilee 2000 movements in many countries.

Nevertheless there are still a number of questions over whether additionality will last and how far HIPCs are skewing aid distributions amongst all developing countries.

First, UNCTAD (2006) suggests that, although Official Development Assistance (ODA) has risen to unprecedented levels in 2005 – at $106.5 billion it is 31.4 per cent higher than 2004 – this was primarily the result of substantial debt awards to Nigeria and Iraq. ODA is therefore likely to fall. Whether this will affect the HIPCs is unclear. Furthermore, aid to HIPCs has not been additional when assessed over the whole lifetime of the initiative – i.e. from 1996, rather than from 1999/2000. As well, the recent level of ODA (minus debt relief) only equated to “a return to the level prevailing before the launch of the HIPC initiative” (2006: 97).

Secondly, while in aggregate aid can be seen as additional, it is clearly not extra where it has been used to refinance the multilateral development institutions. Martin calculates that over $3.5 billion of Organisation for Economic Cooperation and Development (OECD) aid has been promised to the HIPC Trust Fund or used directly to cancel multilateral debt owed by HIPCs. There have been further contributions to the value of $1.5 billion to the IMF’s HIPC Trust; and the Inter American Development Bank has also received funds (Martin 2004). This trend was also reflected in the Multilateral Debt Relief initiative in 2005, which is facilitating 100 per cent cancellation of multilateral debt. Here again, two of the three participating institutions – the World Bank’s IDA, and the African Development Fund – are to be reimbursed for any cancellation they make.

Thirdly, it is also unclear whether aid to non-HIPCs is rising at the same rate as aid to HIPCs. Killick (2004) has observed a redistribution of resources away from non-HIPCs since the launch of the initiative and concludes that there is “a real sense in which the poor countries outside the HIPC scheme are subsidising those who live in HIPC countries” (2004: 7). Killick suggests that this redistribution is rewarding those who, because of bad policies, became and remained indebted in the first place. Whether one agrees with Killick’s argument here, the distribution of aid between HIPCs and very poor non-HIPCs clearly has to be monitored, and the gain of one group of countries at the expense of the other is not compatible with the values of global health equity that underpin the WHO Commission’s work.
The issue of less-indebted poor countries is addressed by MDRI, but it does appear to come at some cost to net resource transfers to HIPCs.

3.4.1 Debt relief or aid?

Parallel to the debates on additionality, commentators have been examining an important underlying issue: is debt relief or aid better at delivering what poor countries need? Martin (2004) argues that debt relief is a better political mobilizer in developed countries than calls for more aid because:

- It is more stable, predictable and countercyclical than aid.
- Tied into the PRSP framework, it increases developing country ownership.
- It has lower transaction costs.
- It stimulates private capital flows, aid flows, savings and investment, whereas there is little evidence for similar dynamic effects of other flows.
- It has encouraged anti-poverty spending.
- By generating improved fiscal management, it has also stimulated better coordinated and longer-term aid to poor countries.

Bird and Milne (2003) throw doubt on some of these assertions, arguing that a restoration of sovereignty and policy autonomy would require much larger scale debt relief than has been contemplated. They also suggest (and Martin acknowledges this) that program aid might be faster disbursing, as debt relief only becomes available to countries over an extended period (i.e. the time over which they would have repaid the debt), and also because there are very often delays in disbursement of debt relief. Furthermore, as Martin points out, 100 per cent cancellation of debt relief would “exceed aid flows in only ten HIPCs and averages only 10 percent of exports. So potential gains from each percentage increase in aid and especially trade are much greater than those from additional debt relief” (Martin 2004: 37; Ranis and Stewart 2001).

3.5 Has the link with the PRSP process improved cross-sectoral working and facilitated increased resource flows to SDH sectors?

The Poverty Reduction Strategy Paper process was launched as a component of the Enhanced HIPC initiative at Cologne in 1999. It was intended to focus heavily-indebted countries on using funds from debt cancellation in a pro-poor manner, but quickly became an aid instrument used by a far broader range of low-income countries. The five central tenets of the PRSP process are as follows:

1. They are to be country-driven, involving broad-based participation.
2. They are comprehensive development plans, that recognise that poverty is a multi-dimensional phenomenon.
3. They are supposed to be results-oriented.
4. They are meant to stimulate more partnership between a range of development actors and promote better donor coordination.
5. They are based on a long-term perspective.

This section of the paper takes up two issues related to the PRSP: the way in which PRSP promotes anti-poverty action within the health sector and advances cross-sectoral working; and how far the new resources promised by HIPC and the PRSP process...
are being incorporated into the health sector, and the extent to which this is constrained by tight fiscal policies promoted by the International Monetary Fund.

3.5.1 Anti-poverty plans and cross-sectoral working

Driscoll and Evans (2005) note an upsurge in poverty diagnostic work and policy interest in the wake of PRSPs in developing countries, and similarly in the health sector where there has been a renewal of interest in health sector policies which focus on poverty reduction (WHO 2004). This has been marked by a specific interest in the effects of different forms of health care financing on poverty rates, analysis of how pro-poor government spending is, and in attempts to delineate bundles of health interventions which are most pro-poor.

With respect to health financing, there has been much work on the poverty-impact of user charges (Meesen et al. 2003), and an increasing acknowledgement from donors and governments that health plans must move away from charging fees at the point of use. There has been interesting thinking about the use of equity funds and output-based payment (Meesen et al. 2006) to support poor people’s attempts to access health services, and some low-income countries (such as Ghana) are rolling out national health insurance programs (Sulzbach et al. 2005). Arguably, this new consensus and stimulation of discussion about alternatives to user charges has been one of the most important outcomes of the PRSP process in the health sector.

The second focus of anti-poverty work in health sector plans has been on the perceived pro-rich distribution of government spending. Benefit incidence studies have demonstrated that in many low-income countries, higher percentages of government health spending are captured by richer groups. While this may be the case, others have observed that public spending can still be progressively redistributive, if the poor’s share of that spending is higher than their share of market income (UNCTAD 2002; Kida and Mackintosh 2005). In fact, Chu and others (2004) find that all 30 available studies in Africa show that government spending is redistributive. This is an important finding because the supposed anti-poor bias in government spending is used to drive calls for greater focussing of government spending on primary care services for the poor, while leaving better off groups to seek treatment from the private sector. For example, Uganda’s 2004 Poverty Eradication Action Plan stated that:

“...Government should focus its interventions on preventive care and on making sure that the poor, who would not otherwise be able to pay for good private care, have effective access to the public health system” (Government of Uganda 2004: 163).

However, others have raised concerns about the idea that separate systems for the poor and the rich will result in more equity (Rowson and Verheul 2004; Mackintosh and Tibandebage 2002). Indeed it is more likely that the government health service will become a poor service for poor people, as the political voice and money of better-off groups becomes detached from the public system (Sen 1999).

As the excerpt from the Ugandan government’s Poverty Eradication Action Plan suggests, much of the focus of the health element of PRSPs has been on which health interventions would be most pro-poor. WHO (2004) describes how countries are focusing on improvements in maternal and reproductive health and immunization, which probably continues the past emphasis on a primary health care approach. Since 2000 there have been massive incentives for poor countries to invest in vertical programs for HIV, TB and malaria (as well as immunization) as a result of increased funding opportunities, and these diseases have increasingly been mentioned in the PRSPs. While it may be the case that the poor do suffer disproportionately from these diseases, it is unclear why other conditions – including non-communicable diseases which also affect the poor – are sidelined in the health component of PRSPs.

Poverty reduction strategies aim to be comprehensive and promote cross-sectoral working. However, as WHO notes “the results are surprisingly disappointing” (2004: 11), with few PRSPs linking up the strategies of different ministries. From an SDH point of view, there is great unfulfilled potential in PRSPs for much more of this cross-sectoral analysis.
3.5.2 Macro-economic stability, fiscal policy and health spending

The situation regarding whether health expenditure is increasing under the dispensation of the HIPC initiative and PRSPs is rather confusing. The results pointed to in our discussion of debt relief above suggest that education is benefiting over other sectors in the allocation of new funds. WHO’s own analysis of trends in health budget allocations in PRSPs also suggests that “health is not gaining significantly in priority as a sector” (2004: 14). There has also been worldwide debate about the ability of poor countries to pay their health staff, suggesting health budgets are far too low (WHO 2006). And a number of reports have noted the importance of raising health expenditures considerably in low-income countries in order to meet the Millennium Development Goals. Nevertheless, there has certainly been a recent sharp increase in funding for health from external sources in some low-income countries, particularly emanating from the new, disease-focused, global funds for HIV, TB, malaria and immunization (Lewis 2005). How far this is being captured in analysis of health spending is open to doubt.

The flux in expenditure has raised a number of issues regarding government health budgets in developing countries. Three sometimes competing considerations have come to dominate budget setting:

- The need to rationalize often chaotic budgeting processes
- The need to keep budget deficits low in order not to cause macro-economic instability
- The need to expand health (and other) spending to meet the Millennium Development Goals.

We deal with each of these issues in turn.

There is no doubt that the budgeting processes in many countries have needed rationalizing. Chaos has partly been driven by administrative and governance problems, but also partly by the inherent instability in debt financing and aid systems that we noted earlier, which make budgeting incredibly difficult in poor countries. In order to link budgets with the policies contained in the PRSPs and to avoid the short-termist approach to stabilization that had in the past dominated government budgeting, Medium Term Expenditure Frameworks (MTEFs) have been proposed as a way of linking policies, resources and outcomes in an orderly manner (ODI 2005). A briefing paper of the Overseas Development Institute (ODI) notes that evidence suggests that the usefulness of the link between PRSPs and MTEFs comes from how they provide a disciplined framework for focussing strategically on a set of pro-poor policies and how these will be financed. A drawback is that the focus on a narrowly defined set of pro-poor interventions will leave other interventions which are not perceived to be poverty-reducing as non-priorities (ODI 2005).

The second and third points about budget setting relate directly to the perceived trade-off between macro-economic stability and countries’ ability to meet health needs and the Millennium Development Goals. This paper starts from the perspective that public investment is an important contributor to poverty reduction and that, as economists Rathin Roy and John Weeks put it, “the economic function of government is not merely to maintain a stable macro environment; its primary responsibility to its citizens is to foster the general welfare” (Roy and Weeks 2004: 5). Here governments and international agencies (and particularly the IMF) stand accused of financial conservatism and emphasizing macro-economic stability too much over increasing the welfare of populations. First, attention has been focussed on the way that the total resource envelope is set in negotiations between ministries of finance and the IMF which tends to prioritize limiting inflation and fiscal deficits – i.e. macroeconomic stability – rather than addressing poverty or health needs. A recent paper from the Center for Global Development (CGDEV) think-tank suggests that criticism of the IMF is not unfounded, concluding that ‘IMF-supported fiscal programs have often been too conservative or risk-averse. In particular, the IMF has not done enough to explore more expansionary, but still feasible, options for higher public spending’ (CGDEV 2007: 6). However, the study notes that the IMF does not necessarily pursue a one-size-fits-all approach to public spending, as it allows quite a range of different spending and deficit levels in different countries.
Pessimism about availability of resources also extends to foreign aid. Critics have also pointed to the IMF’s tendency not to be accommodating enough about the ability of countries to absorb higher levels of aid. This assessment is verified by the IMF’s own Independent Evaluation Office (2007) which stated that IMF programs have “neither set ambitious aid targets nor identified additional aid opportunities”. Rather, in countries which the Fund perceives as “off-track” in macro-economic terms, aid has been used instead to increase reserves and retire domestic debt (IEO 2007: 2). In general the Fund is much more pessimistic about the future of aid flows to Africa than the aid commitments made to African countries by international donors would suggest. Whether this is based on a perception that African countries will find it difficult to absorb extra aid or on pessimism about whether donors will actually disburse the aid is hard to say (CGDEV 2007).

A particularly controversial area in several countries has been the setting of wage bill ceilings as mechanism to control public expenditure. While there may be urgent short-term reasons to do this if the public budget is under great threat, wage bill ceilings that remain in the long term undermine efforts to recruit and retain health workers needed to address the chronic health workforce shortages in most low-income countries (CGDEV 2007).

Overall the CGDEV study concludes that the IMF has not helped countries explore different scenarios for public spending as much as it could have. It also suggests that the limited degree of participation in negotiations around IMF programs weakens political support and ensures a lack of integration between sectoral policies and macro-economic ones. This conclusion echoes that of another study in four African countries which noted health ministries find it difficult to influence the budget setting process (Wemos 2006). More generally tight fiscal policy can help to drive expenditures, especially donor ones. “off-budget” (i.e. outside the particular government ministry), as they strive to spend money outside the limits set by the IMF/ministry of finance programs (Rowson and Verheul 2004).

3.5.3 Conclusions: PRSPs

From an SDH point of view, the Poverty Reduction Strategy process has been something of a missed opportunity. PRSPs hold great promise for more cross-sectoral working, yet ministries are not seizing the opportunity. Nor are international agencies providing them with adequate support to do so. Health budgets, especially “unfashionable” components, do not appear to be rising, and IMF policies do not necessarily help governments and donors to be more ambitious in increasing public spending to levels required to meet the MDGs and other health needs.

Recommendations for changes to the PRSP process to benefit SDH might include:

- More international focus on building up inter-sectoral action in the health field, perhaps through the department of Equity, Poverty and Social Determinants of Health and/or the department of Health Policy, Development and Services at WHO
- More support from donors and national governments for funding cross-sectoral work
- more support to health ministries attempting to engage with finance ministries and the IMF on the size of the health budget Here again WHO can play a key role in engaging with its sister multilateral institutions.
- Ensuring that there is much broader discussion at country level about the setting of macro-economic policy and about the nature of poverty reduction strategies Parliaments and civil society can play a key role in this process.
- Recognizing that fiscal policy that is too tight harms the important role that public expenditure can play in reducing poverty and improving health. The IMF should generate different scenarios for fiscal policy which can be debated by country stakeholders. It should also help countries to assess how they could best utilise higher levels of aid. Wage-bill ceilings should in general be abandoned, and the IMF should work with governments and other stakeholders on employment plans which aim to achieve the necessary scaling up of health human resources).
This paper has suggested that there is much that is positive that has been achieved by the HIPC initiative/MDRI debt cancellation for the poorest countries. It is a process that has released modest new resources to address development concerns, leveraged more aid and new sources of development financing (such as IMF gold reserve sales) and contributed to a reinvigoration of debate on the importance of policy autonomy for the governments of developing countries.

However, the rhetoric surrounding debt cancellation may have led some to believe that this was a quick fix to the problem of developing world poverty. It never could be. Debt is only one part of the web of interlinking domestic and international constraints on poverty reduction. With respect to those international constraints, trade and aid reforms (discussed in other GKN papers) must be as much a part of the solution to developing-world poverty as debt cancellation.

A fairly modest amount of resources have been released by the HIPC initiative/MDRI process to address the social determinants of health and the ambitious agenda launched by the UN Millennium Summit in 2000. For the poorest countries, substantial further resources will be needed to meet the international targets. Debt relief should also be offered to a broader range of developing countries in the interests of global equity, and the financing of social needs should be prioritized above debt repayments.

However, there are political barriers to such ambition. Even the current debt cancellation processes have been slow and speed of implementation and extent is determined by creditors. This must change. The idea of debt responsibility does not just mean prioritizing social needs above creditor needs. It implies establishing institutions that make lenders and borrowers behave responsibly. The time has come for an international bankruptcy process to mediate in a fair way between the interests of creditors and debtors, taking into account the social needs of populations. This type of international systemic reform should be complemented by national-level scrutiny of lending and borrowing by parliaments and civil society. This is important.
because, although debt cancellation has written off much of the older debt of the poorest countries, these nations will need to borrow again in order to meet their ambitious development goals. But the international community must avoid that debt becoming unsustainable once more.

The PRSP process also shows the same balance between positive change and foundering in the status quo that we observed for the process of debt relief. While there has been emphasis on poor country ownership of policies, much conditionality remains, and the fiscal conservatism of the international financial institutions constrains poor countries from making the public investments they need to reduce poverty. Putting developing countries back in the driver’s seat must centrally involve changes in political processes, allowing more stakeholders to the table to debate policies, and ensuring that financial concerns do not unduly limit ambitious social policy. Ministries of health, as well as the World Health Organization, can play a critical role in these development processes, but they must gear themselves to enter the debates as knowledgeable and respected participants.
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