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Aid Declines Despite Progress on Policy Reform in Recipient Countries

AID CONTINUED TO FALL IN 1998, JUST AS improvements in policy regimes were enabling countries to use aid more effectively. Several long-term trends are emerging:

- Net concessional flows remain depressed, and are now one-third below the 1990 level in real terms. Despite a few positive developments in 1998, the prospects for recovery remain poor.
- The downward trend in aid flows comes at a time when the conditions for aid to be effective appear to be improving. Several low-income countries are making important advances in policy reform, and recent studies have found evidence that aid is successful in reducing poverty in countries with sound economic management. Reallocating the current level of aid only to countries with good policies and large numbers of poor people could substantially increase the number of people who escape poverty. The fungibility of aid means that donors need to consider the adequacy of the overall expenditure program in determining whether aid is effective.
- Substantial progress was made over the past year in assisting the poorest developing countries to achieve sustainable debt levels through the Heavily Indebted Poor Countries (HIPC) Debt Initiative. But a large number of countries remain to be considered, including several that are experiencing, or just emerging from, civil conflicts. The HIPC Initiative can strengthen the effectiveness of aid by supporting countries with a solid track record of policy performance.

Trends in Aid

The decline in concessional finance. Net concessional assistance to developing countries totaled \$32.7 billion in 1998, slightly below the \$33.4 billion received in 1997 and \$12 billion below the 1990 level (table 4.1). Net disbursements of concessional assistance in 1998 to all developing countries totaled only about one-sixth of the amounts pledged (and just over half of the amounts disbursed) under rescue packages to Brazil, Indonesia, Korea, Russia, and Thailand. There have been some positive developments in development assistance over the past year, however. Donors approved the replenishment of IDA-12 (covering July 1999 through June 2002) with more than \$11 billion in new contributions, for a total of about \$20 billion if repayments to the International Development Association (IDA) from outstanding loans and contributions from the World Bank are included. And further progress was made under the HIPC Initiative.

The major changes in the regional allocation of concessional flows in 1998 were the increase to South Asia (owing in part to emergency support in the aftermath of the natural disasters in Bangladesh) and the sharp decline in concessional flows to the transition economies of Europe and Central Asia (table 4.2). Concessional flows remained low in 1998 as a share of developing countries' GNP. Every region has experienced a sharp fall in concessional flows relative to GNP since 1990, with the exception of Europe and Central Asia, where concessional flows rose in the early 1990s following the breakup of the Soviet Union.

Official development assistance. The 1997 data on net official development assistance (ODA) (including technical cooperation grants) from the

Table 4.1 Net official long-term flows to developing countries, 1990–98
(billions of U.S. dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 ^a
Official development finance	56.9	62.6	54.0	53.3	45.5	53.4	32.2	39.1	47.9
Concessional finance	44.8	51.0	44.0	41.5	45.8	44.7	40.1	33.4	32.7
Grants	29.2	35.3	30.5	28.3	32.4	32.3	28.9	25.7	23.0
Loans	15.6	15.7	13.5	13.2	13.3	12.3	11.2	7.7	9.7
Bilateral	9.6	9.3	7.0	6.7	5.6	5.1	2.9	0.2	2.8
Multilateral	6.0	6.4	6.5	6.5	7.8	7.2	8.2	7.4	6.9
Nonconcessional finance	12.1	11.6	10.0	11.8	-0.3	8.8	-7.9	5.7	15.2
Bilateral	2.9	3.9	4.5	3.4	-2.5	5.0	-12.7	-8.0	0.8
Multilateral	9.2	7.6	5.5	8.4	2.3	3.7	4.8	13.7	14.4
<i>Memo items</i>									
Use of IMF credit	0.1	3.2	1.2	1.7	1.6	16.8	1.0	14.7	21.0
Technical cooperation grants	14.3	15.9	18.0	18.6	17.3	20.6	19.4	17.0	16.1

Note: Although the Republic of Korea is a high-income country, it is included in the developing country aggregate since it is a borrower from the World Bank.

a. Preliminary.

Source: World Bank Debtor Reporting System.

Table 4.2 Regional allocation of concessional flows, 1990–98
(percent)

	Share of total aid				Aid as a share of GNP			
	1990	1996	1997	1998	1990	1996	1997	1998
East Asia and Pacific	16.7	13.5	14.7	15.6	0.8	0.3	0.3	0.3
Latin America and the Caribbean	10.0	10.2	9.0	9.8	0.4	0.2	0.2	0.2
Middle East and North Africa	19.2	12.0	11.7	10.7	1.8	0.7	0.6	0.5
South Asia	11.8	10.5	8.4	12.5	1.4	0.8	0.5	0.7
Sub-Saharan Africa	37.1	35.4	39.2	38.8	6.0	4.6	4.1	3.8
Europe and Central Asia	4.9	18.5	17.1	12.5	0.2	0.7	0.5	0.3
All developing countries	100.0	100.0	100.0	100.0	1.0	0.6	0.5	0.5

Source: World Bank Debtor Reporting System.

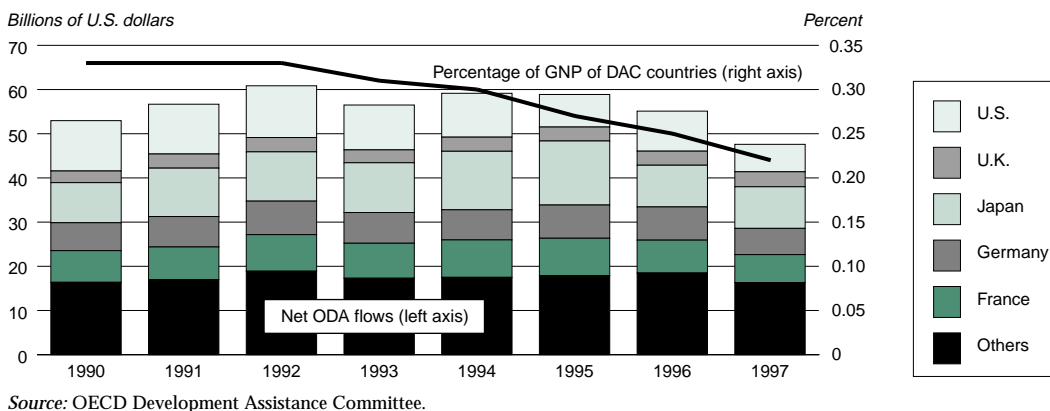
Organisation of Economic Co-operation and Development (OECD) confirm the continued decline in assistance to developing countries (the annex to this chapter explains the differences between the OECD and World Bank data on official finance). Net ODA fell by 6 percent in real terms, to its lowest level since 1981. Approximately half of the decline in net ODA flows in 1997 is attributable to the depreciation of the Development Assistance Committee (DAC) member countries' currencies in relation to the U.S. dollar. The ODA figures for 1997 also reflect the reclassification of a number of countries, most importantly Israel, from the DAC list of countries eligible to receive ODA. After adjusting for these factors, the decline in net ODA in 1997 in real terms was 2 percent.

The share of net ODA in the GNP of the DAC countries declined to 0.22 percent, compared to 0.35 percent in the mid-1980s. Only four coun-

tries—Denmark, the Netherlands, Norway, and Sweden—exceeded the United Nations target of 0.7 percent of GNP in 1997. Among DAC donors Japan recorded the highest net ODA in 1997 (\$9.4 billion, 0.22 percent of GNP), followed by the United States (\$6.2 billion, 0.09 percent of GNP), France (\$6.3 billion, 0.48 percent of GNP), and Germany (\$5.9 billion, 0.28 percent of GNP) (figure 4.1). The decline in ODA in recent years has been driven by the largest DAC donors—ODA flows from the G-7 countries have declined by \$5.2 billion (12 percent) since 1995, and represented only 0.19 percent of their combined GNP in 1997. By contrast, ODA from non-G-7 countries has remained stable in nominal terms and averaged 0.46 percent of their combined GNP in 1997. ODA rose in real terms in 1997 in 12 of the 14 countries in this group.

The DAC data on ODA do not include assistance provided to the transition economies of East-

Figure 4.1 ODA from donor countries is falling in relation to their GNP



ern Europe, referred to as official aid (OA) in the tables reported by the DAC. OA has averaged \$6 billion a year during the 1990s, compared to \$56 billion a year in ODA. Increased assistance to the transition economies has only partly offset the decline in ODA to other developing countries in recent years. From 1990 to 1997, ODA dropped by 19 percent in real terms, while the sum of ODA and OA fell by 11 percent. Also, OA itself has fallen from its peak of \$8.4 billion in 1995 to \$5.3 billion in 1997, in part reflecting the conclusion of the concessional restructuring arrangement for Poland.

The prospects for ODA. The outlook for a recovery of ODA flows remains poor. Preliminary data indicate that the decline in ODA budgets continued in 1998. Only three countries—Ireland, Sweden, and the United Kingdom—announced increases in aid budgets for 1998. Aid flows also should rise in the Netherlands, where the aid budget is set by political agreement at 0.8 percent of GNP. By contrast, in Japan, the largest donor, the initial FY98 budget (which covers the year beginning in April 1998) included a 10 percent cut in aid (although a portion of these funds were later restored in a supplemental budget to respond to the East Asia crisis). Against this backdrop net ODA for 1998 may have declined to below 0.20 percent of the combined GNP of DAC member countries. Recent negotiations do provide some hope for maintaining concessional flows from multilateral institutions in the near term: funds pledged by donors for IDA-12 will be adequate to

enable IDA to continue to support development at recent levels, and an agreement has been reached on the replenishment of resources for the African Development Bank.

The decline in ODA

The increasing scarcity of fiscal resources has been an important reason for the decline in net ODA during the 1990s. Most of the G-7 countries moved toward more restrained fiscal policies around 1993. From 1992–93 to 1996–97, average government outlays in G-7 countries fell by 1.2 percentage points of GDP and general government financial balances improved by 2.1 percentage points of GDP (a similar trend is seen in the fall in structural budget deficits). Greater budgetary discipline was motivated by the accumulation of debt from large deficits during the 1980s, concerns over the impact of high levels of expenditure and taxes on economic activity, and the agreement to reduce fiscal deficits as a condition of the European Monetary Union (EMU) (the Maastricht Treaty entered into force in late 1993).

However, the data do not show a strict relationship between reductions in ODA and cuts in the budget in all of the G-7 countries. Net ODA fell as a share of GNP by approximately the same amounts in the United States, Japan, and Germany from 1992–93 to 1996–97, but the fiscal trends in the three countries differ substantially (table 4.3). In the United States, aid was cut both because of tighter fiscal policy and growing public skepticism about

Table 4.3 Fiscal balances, government expenditures, and ODA in G-7 countries, 1992–93 vs. 1996–97

(percent of GDP)

	Improvement in fiscal deficit ^a	Change in government outlays ^a	Change in net ODA ^b
United States	3.8	-2.1	-0.07
Japan	-3.8	2.9	-0.07
Germany	-0.1	-0.5	-0.07
France	1.3	0.0	-0.16
Italy	4.9	-3.7	-0.17
United Kingdom	4.1	-2.7	-0.04
Canada	7.2	-6.7	-0.13
Total	2.1	-1.2	-0.09

a. General government.

b. Share of GNP.

Sources: OECD *Economic Outlook* and World Bank.

aid's effectiveness. In Japan, increased expenditures tended to be devoted to measures that would stimulate the domestic economy rather than to foreign assistance. In Germany, the continued costs of absorbing the former German Democratic Republic may have contributed to crowding out aid. Reduced pressure to use aid for strategic purposes in light of the end of the Cold War, growing public skepticism over the effectiveness of aid, and the disruption from civil conflicts in several African countries also played an important role in the decline in aid.

Changes in the composition of ODA over the 1990s have accentuated the fall in ODA expenditures on development. The share in ODA of emergency assistance required by natural disasters and recovery from civil war increased from about 5 percent in 1990 to 9 percent in 1994, although it has since fallen back somewhat. Emergency assistance is certainly justified for humanitarian concerns. However, the increasing share of aid going to emergency assistance means that the amount of ODA devoted to promoting development has actually declined more rapidly during the 1990s than is shown by the data on total ODA.

Furthermore, expenditures devoted to administering bilateral aid programs in DAC countries (which are counted as ODA) increased from \$2 billion in 1990 to \$3 billion in 1996. The increase in administrative costs reflects a greater emphasis on social programs, which can be more labor-intensive than, for example, infrastructure. Higher administrative costs also may reflect greater resources devoted to the supervision of aid expenditures, especially by large donors such as Japan, France, and Germany, which account for most of the increase in administrative costs. The amounts devoted to administrative costs are not yet large relative to total ODA. Nevertheless, a rise of 45 percent in the dollar expenditures on administration over a period when the dollar deflator increased by only 20 percent should direct donors' attention to containing administrative costs.

Improvements in Aid

Looking over a long-term perspective, donors have achieved some improvements in aid that have contributed to its effectiveness, but are not reflected in the information on the dollar value of aid.

Improvements in the terms of aid. The decline in bilateral concessional flows (as reported in the World Bank data—see chapter annex) has been moderated by a switch from concessional loans to grants, thus increasing the actual transfer of resources for the given nominal dollar of aid and reducing the role of aid in adding to the debt burden. The share of grants in total assistance has increased from 47 percent in 1970 to 72 percent in the mid-1990s (table 4.4). Since most of the aid provided by the multilateral development banks is in the form of loans, the share of grants in bilateral programs has actually increased by more than the data shown in table 4.4. However, this improvement in the terms of aid has had only a modest im-

Table 4.4 Shares of grants in total concessional assistance, 1970–98

(percent)

	1970	1980	1990	1995	1996	1997	1998
All developing countries	46.8	53.7	65.2	72.3	72.1	76.9	70.3
Low-income countries	45.8	57.3	67.1	77.4	71.9	75.6	71.5
Middle-income countries	50.0	50.4	64.3	67.4	72.3	78.8	68.5

Source: World Bank Debtor Reporting System.

fact, and does not greatly affect the conclusions reached above on the decline in official assistance.

The reduction in tied aid. The value of bilateral aid has increased due to a sharp reduction in requirements that tie aid-financed expenditures to goods produced in particular donor countries. The share of bilateral aid that is fully or partly tied fell from about 50 percent in 1979 to about 20 percent in 1996 (figure 4.2). The motivation for tied aid is both to assist domestic producers and to reduce the net capital outflow generated by aid programs. However, the practice of tying aid directly to donor sales often reduces its value to the recipient. Morrissey and White (1994) found that the limits on competition implied by tying requirements increased prices by 15–20 percent over world market prices. Other studies have found that tying requirements increase the cost of aid-financed deliveries by 10 to 30 percent above deliveries not financed by aid (Jepma 1991). Even if recipients pay market prices for a particular piece of specialized equipment, the technology available in the donor country may not be the most appropriate for the project, either because it is more capital-intensive than desired, or because it is not the best technology for the specific use.

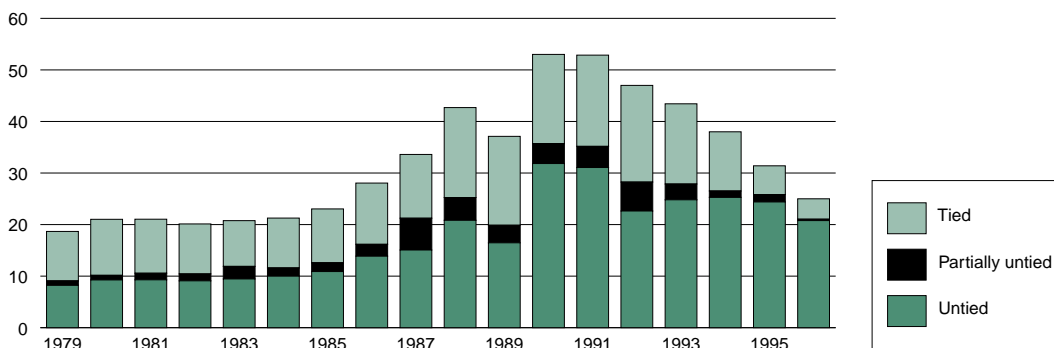
The sectoral reallocation of aid. The reallocation of aid toward sectors in which the government can be most effective may also have contributed to increasing its effectiveness. The share of ODA from DAC countries devoted to industry and other productive sectors fell from 14 percent during 1975–76 to 3 percent during 1994–95, while the share going

to sectors with a greater share of public goods (social services, administration, and infrastructure) rose from 31 percent during 1975–76 to 52 percent during 1994–95 (OECD 1998). The reallocation of aid away from industry and toward human and physical infrastructure reflects growing acceptance of the importance of government support for these sectors, and the relative failure of projects devoted to directly productive activities. However, there is some danger that the increasing provision of services by donors also may have increased the amount of aid subject to implicit tying requirements that do not show up in the statistics given above. The tendency to rely on donor country suppliers for consultants' services required in areas such as public administration may be greater than in projects involving goods purchases, which are more standardized, and in which information on the supplier is often less important in determining quality.

Increasing aid to countries with good policies. Some progress has been made over the 1990s in increasing the effectiveness of aid by allocating a greater share toward countries with good economic policies (see below). In a sample of low-income countries covering 1990–97, a rise in the share of total ODA commitments was positively and significantly related to an increase in performance ratings (as measured by the World Bank). However, the change in performance ratings explained less than 10 percent of the total change in aid allocation, so improvements in performance did not have a major impact on determining the level of aid commitments.

Figure 4.2 ODA flows to developing countries: tied aid has declined significantly

Billions of U.S. dollars



Note: Excludes technical cooperation and administrative costs.

Source: OECD Development Assistance Committee.

The allocation of aid by income. The allocation of aid may have shifted slightly away from the poorest developing countries since the mid-1980s. The DAC reports that ODA to the least developed countries fell from 28 percent of total ODA during 1985–86 to 22 percent during 1995–96. This decline reflects sharp drops in the share of the least developed countries in ODA from Japan and countries belonging to the European Union (in aggregate). The decline in the share of aid to the poorest recipients in part reflects the disruption of aid programs caused by civil conflicts in several of these countries during the 1990s. For example, net ODA to the Democratic Republic of the Congo, Somalia, and Sudan fell from just over \$1.8 billion during 1985–86 to \$530 million during 1995–96. As will be discussed below, aid to the poorest countries may not be effective in the absence of an appropriate policy environment.

Aid Effectiveness

The relationship between aid and growth

The decline in aid over the 1990s has been driven, in part, by growing skepticism in donor countries over the contribution of aid to growth. Many developing countries have become more aid-dependent since the 1970s. While official assistance has fallen steadily in the 1990s, assistance actually rose strongly during the 1980s; net concessional flows to all developing countries increased from \$25 billion in 1980 to \$45 billion in 1990. Tsikata (1998) finds that for a sample of 56 countries, the median ratio of aid to GNP increased from about 6 percent during 1976–80 to 11 percent during 1990–95, but per capita GNP growth in real terms fell from 1.3 percent per year to 0.4 percent per year, and the median share of domestic investment in GNP declined from 22 to 20 percent.

The 1990s have also witnessed a reconsideration of the contribution of aid to economic growth. Past theories emphasized the role of foreign aid in financing the gap between domestic savings and investment needed to attain a certain growth target. However, empirical studies consistently found a weak relationship between aid and investment and little impact of aid on growth (Snyder 1990; Reichel 1995; Levy 1988; and McGillivray and Ahmed 1994). In the 1980s there was renewed emphasis within development economics on the poli-

cies, institutions, and incentives that promote or constrain growth.

A study of 56 developing countries found little connection between aid and per capita growth (Burnside and Dollar 1997). However, among countries in this sample that had good economic management (as measured by inflation, the budget deficit, trade regime, effectiveness of the legal system, competence of the bureaucracy, and extent of corruption), the connection was much stronger: those receiving substantial amounts of aid achieved per capita growth rates of 3.7 percent, while countries that received little aid grew at only 2.2 percent. By contrast, the impact of aid was insignificant for countries with bad economic management. These results support the view that aid does matter, but only in countries that have a good policy and institutional environment. If the current aid budget were allocated among these 56 countries only on the basis of the quality of economic management, average per capita growth would have risen from 1.1 percent to 1.4 percent per year.

Does aid help promote good policies? Indeed, much development aid, including the World Bank's assistance, has been devoted to encouraging policy reforms and strengthening institutions—but the record of success is mixed (World Bank 1998a). There are certainly cases in which aid has supported reform-minded governments (for example, the experience of donor support for the Ugandan government). But aid also has had the effect of delaying reform (Burnside and Dollar 1997; Mosley 1987; Killick 1991; Svensson 1997; Rodrik 1995; and Williamson 1994). The experience of Zambia illustrates the failure of aid to promote good policies and its ineffectiveness in a bad policy environment. The amount of aid received by Zambia increased from 0.2 percent of GDP in the early 1970s to 8 percent in the early 1990s, while policies deteriorated. Real GDP per capita was 8.5 percent of U.S. income in 1966, but only 3.8 percent in 1990.

Aid and private capital flows

One reason that aid promotes growth in a good policy environment may be that the availability of aid strengthens confidence in the sustainability of economic policies, thus improving the environment for private investment. Dollar and Easterly (1998) found that a rise of 1 percent of GDP in aid increases private investment an extra 1.9 percent of GDP in countries with good economic manage-

ment. However, in countries with poor management, a 1 percent of GDP increase in aid crowded out private investment by 0.5 percent of GDP. Collier and Dollar (1998) also found that aid increases private investment by reducing the perception of risk by private investors, but only in a good policy environment. The better the policy environment, the more effective aid was found to be in improving investors' risk perceptions, as measured by ratings published by the *Institutional Investor*. And ratings reflecting lower risk were associated with greater inflows of private capital, including FDI (see chapter 2 for a discussion of the impact of policies on private capital flows).

The fungibility issue

The ineffectiveness of aid in fostering growth at the macroeconomic level does not imply that the specific projects financed by aid were necessarily failures. Aid is fungible: donors may provide aid for projects that the government would finance in any event, and the increase in resources from aid could be devoted to something very far from the donor's intention, such as consumption spending, tax relief, or the payment of external debt. Even when aid is earmarked for a specific sector or activity, there is no guarantee that government spending for that purpose will increase by the full amount of the aid.

The fungibility of aid has long been recognized, but it has received more scrutiny in the context of the recent discussion of aid effectiveness. Most studies have found that aid was at least partly fungible. While Pack and Pack (1990) found no evidence of fungibility across sectoral expenditures in Indonesia during 1966–86, in a 1993 study of the Dominican Republic they found that aid aimed at development projects was shifted to deficit reduction, tax relief, and debt service. Looking at 14 developing countries during the last 20 years, Feyzioglu, Swaroop, and Zhu (1998) found that most aid is fungible, with evidence of fungibility particularly strong for agriculture, education, and energy loans.

In a sample of 18 countries in Sub-Saharan Africa from 1975–95, Devarajan and Swaroop (1998) found that every dollar of aid leads to an increase in government expenditure of 90 cents, allocated between current expenditures, investment, and debt service. The larger the number of donors in a country, the more likely that aid was fungible. A multiplicity of donors makes it more difficult for

any individual donor to monitor expenditures in the sector (particularly when donor expenditures are not adequately reflected in the government's budget), and thus ensure that the donor's priorities are reflected in overall expenditures.

A greater appreciation of the fungibility of aid could be reflected in donor programs by more explicitly using project assistance to change the allocation of government expenditures. In cases in which the donor has adequate information on the government's priorities (for example, owing to a long-term association with the recipient country), the donor could finance projects that the government would not choose to undertake on its own. Note, however, that aid has generally been found to be more effective when the government is committed to the program. Attempting to alter government priorities runs the risk of reducing effectiveness.

Another approach is for donors to provide funds to finance the budget based on satisfactory improvements in the overall allocation, execution, and management of public expenditures. However, the general financing of government expenditures, as opposed to discrete projects, has some pitfalls. While funds could be tied to improvements in the management of government expenditures, there may be less stringent oversight of the use of donor funds than there would be under a project approach. The time required to correct weaknesses in expenditure control and reporting could mean that initially it may be difficult to evaluate the extent of improvements in the allocation and effectiveness of government expenditures. General budgetary support should only be provided to countries in which the administration is efficient and honest, and where there is broad agreement between donors and the government on expenditure allocation.

Aid and Poverty

The studies cited above found that aid can be an important determinant of growth in a good policy environment, and that growth is essential for reducing poverty. But how effective is aid in reducing poverty? Collier and Dollar (1998) estimate that without aid there would be an additional 30 million poor people in developing countries each year (based on a poverty line of \$2 a day). However, they further estimate that increasing the allocation of aid to countries in which the

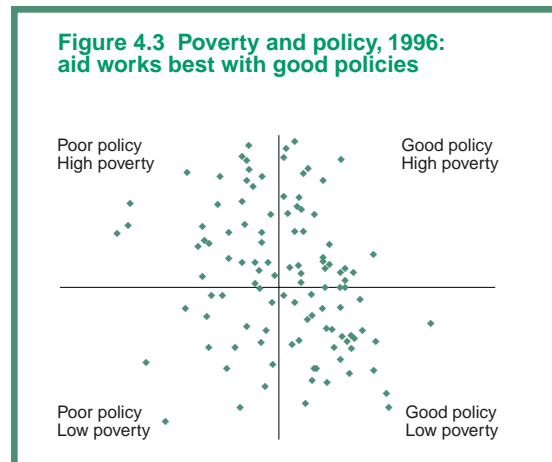
policy environment is strong and the income elasticity of poverty is high could substantially increase the number of people who escape poverty, perhaps by an additional 50 million people per year. This calculation equalizes the marginal cost (in terms of aid) of lifting someone above the poverty line in each country. To achieve such a large poverty reduction with the current allocation of aid, they estimate that the total volume of aid would need to increase by fourfold.

One reason why the optimal allocation of aid is not achieved is that donors tend to phase out aid from reforming countries as the growth rate takes off. Also, they tend to divert aid to where the poverty problem is acute, but possibly insoluble because of the weak policy environment. (Some of this aid may be used for other important objectives such as rebuilding postconflict societies or meeting humanitarian emergencies.)

Many developing countries have indeed improved their policy environment during the 1990s. According to the World Bank's ratings, average policy performance has improved significantly in both Sub-Saharan Africa and South Asia, and is now better than at any time in the previous quarter century (see chapter 2). Some 2 billion out of a total of 2.7 billion poor live in 32 countries that in the 1990s have adopted a good policy environment (for example, Ethiopia, India, Mali, and Uganda). Figure 4.3 classifies 113 developing countries on the basis of the quality of their policies in 1996 and their poverty incidence. Aid would be most effective to the 32 countries in the upper right quadrant, with good policies and poverty rates above 50 percent.

Progress Under the HIPC Initiative

The Heavily Indebted Poor Countries (HIPC) Debt Initiative aims to achieve a comprehensive solution to the unsustainable levels of debt owed by many of the poorest countries in the world. A critical element of the HIPC Initiative is to focus resources on countries with a solid track record of performance, which is a key element of improving aid effectiveness (a discussion of the goals and design of the initiative can be found in World Bank 1998b). In approving the HIPC Initiative at their September 1996 meetings, the Interim and Development Committees urged the World Bank and the IMF, working closely with donors and other creditors, to move swiftly to the imple-



mentation phase. Considerable progress has been made in this regard since then, and the first HIPCs have begun to receive debt relief. However, significant work remains to be done, as a large number of countries still have to be considered, including several experiencing, or just emerging from, armed conflict situations.

Country implementation through 1998

By the end of January 1999, 12 of the 40 countries classified as HIPCs had been reviewed for eligibility under the HIPC Initiative by the boards of the World Bank and the IMF.¹ Of these, debt relief packages have been agreed on for Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique, and Uganda, totaling more than \$3 billion in net present value terms and more than \$6 billion in nominal debt service relief over time (table 4.4). Ethiopia, Guinea-Bissau, and Mauritania were also judged, on a preliminary basis, to qualify for possible debt relief, pending decisions by the two Boards (the case of Guinea-Bissau will be reassessed after the end of the civil conflict). Debt relief for these three countries could total an additional \$1.2 billion in net present value terms, equivalent to about \$2.5 billion in nominal debt service relief. In Benin and Senegal traditional debt-relief mechanisms were found to be sufficient to enable them to achieve sustainable debt situations without requiring HIPC debt relief. Two of the early cases (Bolivia and Uganda) reached their completion points in 1998 and received debt relief under the HIPC Initiative totaling \$800 million in net present value terms (about \$1.4 billion in nominal debt service relief).

The unfinished agenda

During the first two years of the HIPC Initiative, 31 of the 40 countries classified as HIPCs were found to have met the entry requirement for consideration under the initiative.² Of these, 19 still remain to be reviewed for eligibility to benefit under the HIPC framework. Countries that could possibly reach their decision points in 1999 (in addition to Ethiopia, Guinea-Bissau, and Mauritania, discussed above) include Chad, Guinea, Mauritania, Nicaragua, Niger, Togo, Tanzania, Vietnam, the Republic of Yemen, and Zambia. Not all of these countries would be expected to require assistance under the initiative. World Bank and IMF staffs are also analyzing the situation of Honduras in light of the parameters of the initiative.

When the Interim and Development Committees endorsed the HIPC Initiative in 1996, they agreed that it would remain open for two years. During the 1998 annual meetings of the World Bank and the IMF, the original entry period for countries to begin adjustment programs was extended to the end of 2000. Of the nine HIPCs that could potentially become eligible under the extension of the entry period, nearly all have suffered recent armed conflicts, and many have arrears to the World Bank and the IMF. These countries present a special challenge, and their external debt overhang might need to be treated in the context of a broader approach to international assistance for postconflict situations, an approach that is still evolving.

Including the 12 cases already reviewed, and based on the assumption of satisfactory performance under IMF- and IDA-supported programs of adjustment and reform, a total of 26 countries (about two-thirds of all HIPCs) could reach their decision points by the end of 2000. Including the seven countries with debt relief packages already agreed, approximately half of the 31 countries that have already met the entry requirement could eventually be expected to qualify for HIPC assistance. For the countries that have not yet met the entry requirement, decision points would be reached in 2001 or later, and eligibility would be determined on the basis of debt sustainability analyses carried out at that time.

Funding

The total cost of assistance under the HIPC Initiative is now estimated at about \$9.7 billion in 1996 present value terms, using a 6 percent dis-

count rate.³ This represents an increase from earlier estimates, attributable mainly to higher estimates of the potential cost of assistance for countries in postconflict situations and the use of a lower discount rate, in line with the fall in international interest rates.

HIPC costs are apportioned on the basis of proportional burden-sharing between multilateral and bilateral creditor groups. On this basis, multilateral and bilateral creditors are each, as a group, expected to bear about half of the estimated \$8.2 billion total cost. Bilateral assistance, which is in addition to that provided through traditional debt relief mechanisms, is provided by Paris Club creditors through stock-of-debt reductions on Lyon terms (up to 80 percent reduction of eligible debt in present value terms), while other bilateral creditors are expected to offer comparable terms on their claims. In individual country cases, bilateral creditors have provided additional debt relief (such as ODA cancellation), when the application of Lyon terms has not been sufficient to cover their full share of the required assistance.

The costs to be met by individual multilateral creditors also will be allocated in proportion to each creditor's outstanding claims. The World Bank intends to meet all the costs of its participation in the HIPC Initiative from its own resources, and for this purpose has transferred \$850 million from International Bank for Reconstruction and Development (IBRD) net income to the HIPC Trust Fund, the Bank's principal vehicle to deliver the debt relief. The IMF has provided for \$520 million so far to finance its share of the debt relief through the ESAF-HIPC Trust Fund. Multilateral creditors that, having exhausted their own means of delivering debt relief, still fall short of their share, can seek the support of interested bilateral donors, whose complementary contributions may be channeled through the World Bank's HIPC Trust Fund. By the end of January 1999, the HIPC Trust had received about \$450 million in bilateral contributions or pledges from 19 countries for this purpose. Based on current projections of the ultimate cost of the HIPC Initiative, additional donor contributions will be needed to ensure that all multilateral institutions are in a position to meet the costs of HIPC assistance.

1999 HIPC review

The boards of the World Bank and the IMF have called for a comprehensive review of the HIPC Ini-

Table 4.5 Country implementation of the HIPC Initiative, end–1998
(millions of U.S. dollars)

Country	Decision point	Completion point	Debt sustainability target ^a	Estimated debt relief ^b	Estimated nominal debt service relief ^c
<i>Debt relief agreed</i>					
Uganda	Apr. 1997	Apr. 1998	202	347	650
Bolivia	Sept. 1997	Sept. 1998	225	448	760
Burkina Faso	Sept. 1997	Apr. 2000	205	115	200
Guyana	Dec. 1997	Spring 1999	107	253	500
Côte d'Ivoire	Mar. 1998	Mar. 2001	141	345	800
Mozambique	Apr. 1998	mid-1999	200	1,442	2,900
Mali	Sept. 1998	Dec. 1999	200	128	250
Total				3,078	6,060
<i>Debt relief considered^d</i>					
Guinea-Bissau			200	300	600
Ethiopia	Spring 1999	Spring 2002	200	636	1,300
Mauritania	Spring 1999	Spring 2002	200	271	550
<i>Sustainable cases</i>					
Benin	July 1997	n.a.	n.a.	n.a.	n.a.
Senegal	Apr. 1998	n.a.	n.a.	n.a.	n.a.

n.a. Not applicable.

a. Net present value of debt in percent of exports of goods and nonfactor services at the completion point.

b. Net present value of debt relief at the completion point.

c. Nominal debt service relief refers to the cumulative amount of relief over time. It exceeds debt relief in net present value terms, which discounts the nominal debt service relief back to the completion point.

d. The case for Guinea-Bissau will need to be reassessed after the civil disturbances end.

Sources: World Bank and IMF staff estimates.

tiative, including updated cost estimates. In order to benefit from the ideas and perspectives of the many governments, organizations, and individuals dedicated to the complex challenge of development and poverty reduction, this review will build on the ongoing dialogue with NGOs and other segments of civil society and involve a wide-ranging consultative process, including a call for inputs through the Bank's HIPC website, as well as more formal consultations in regional forums.⁴ Views will be sought on all aspects of the initiative and its framework, including technical issues (debt sustainability, policy links, and timing), and special emphasis on the relationship between debt relief, social policies, and poverty reduction.

Annex: OECD and World Bank Data on Aid and Other Official Flows

Defining aid

The international forum for defining aid is the OECD Development Assistance Committee (DAC). There are two categories of aid provided by DAC

donors—official development assistance (ODA) and official aid (OA). The DAC List of Aid Recipients is divided into Part I and Part II recipients. Only countries on Part I receive ODA; those on Part II (which includes several countries in Eastern and Central Europe and Israel) receive OA. Only ODA may be counted by DAC donors as part of their “aid effort.”

ODA and OA are defined in the same way. Both consist of loans or grants to developing countries and territories by donor governments and their agencies that are developmental in intent and designed to promote economic welfare. ODA and OA loans are provided on concessional financial terms, with at least a 25 percent grant element (calculated as the net present value of the future payment stream discounted at 10 percent).

Measuring aid

Aid flows to developing countries can be measured in two ways. When *aid performance by DAC donors* is measured, ODA comprises bilateral disbursements of concessional financing to developing countries plus the provision by bilateral donors of

concessional financing to multilateral institutions (for example, IDA). When *resource receipts by developing countries* are measured, ODA (and, where relevant, OA) comprises disbursements of concessional financing from bilateral agencies and multilateral sources. The two measures will not be the same because the concessional funding received from donor sources by multilateral institutions does not match those institutions' disbursements to developing countries in any given year.

Official development finance

The concept of *official development finance* (ODF) differs from that of *aid* and measures all receipts from official creditors. It includes (a) ODA and OA from bilateral agencies, (b) grants and concessional and nonconcessional development lending by multilateral agencies, and (c) other official bilateral flows that are considered to be developmental in intent but for which the grant element is too low to qualify as ODA or OA.

Differences in the OECD and World Bank measure of official flows

There are differences in the coverage and presentation of data on official flows published by the World Bank in *Global Development Finance* and by the OECD in *DAC Development Report*. The major differences are data sources, geographic coverage, other official flows, technical cooperation grants, and debt forgiveness. In addition, when the volume of official flows is expressed in real terms, the OECD and the World Bank use different methodology to derive the relevant deflators.

Data sources. The World Bank compiles its information on loans from official sources on the basis of data provided by debtor countries through the World Bank Debtor Reporting System (DRS). The DRS does not require any reporting of grants. The OECD compiles data on official development finance (loans and grants) on the basis of information provided by donors to the Development Assistance Committee (DAC) and through the Creditor Reporting System (CRS). In principle, debtor and creditor records for official loans should accord but there can be timing differences in the recording of disbursements, debt service payments, and of payments arrears or future debt service payments that are rescheduled or forgiven.

Geographic coverage. The World Bank presents data for all countries that are defined as low-

and middle-income countries (countries with a per capita income in 1998 of \$9,655 or less) excluding countries with a population of less than 30,000. The OECD list of aid recipients (Part I and Part II) is broader and includes a number of countries and territories defined by the World Bank as high-income—for example, Israel, and New Caledonia.

Other official flows. Both the OECD and the World Bank measure official development finance as defined above, but the World Bank DRS captures some other official flows in addition to those measured by the OECD DAC. The most important of these are intra-developing country lending and transactions for military purposes (to the extent that these are reported to the DRS by developing countries). The World Bank also uses the term *concessional flows*, as distinct from ODA and OA, to mean grants and all loans (those that are directly developmental in intent as well as those that are trade-related) with at least a 25 percent grant element (using a discount rate of 10 percent).

Technical cooperation grants. Technical cooperation grants are for the provision of services. These are included in the OECD measure of overall grants. The World Bank does not include technical cooperation grants in its measure of resource flows on the grounds that (a) these grants frequently do not represent a cross-border transaction, and (b) because, in general, they do not get recorded in national income or flow of fund accounts. In 1997 technical cooperation grants amounted to 30 percent of net ODA and OA flows combined (OECD *DAC Development Report 1998*).

Debt forgiveness. The OECD records the flow of funds associated with debt forgiveness. When part or all of a loan is forgiven, the OECD DAC records as an inflow a grant equivalent to the amount forgiven and an offsetting outflow (debt service payment) against the relevant loan(s). The World Bank DRS recognizes debt forgiveness only as a change in stock and no flow transactions are recorded. When the World Bank measures total official flows it uses the OECD grant data, including the inflows associated with debt forgiveness for which the DRS loan data has no offsetting outflow. This results in an overstatement in the World Bank measure of total official flows. In 1997 this overstatement is approximately \$3.5 billion for all developing countries combined.

Presenting aid flows in real terms

To present aid flows in real terms the OECD uses currency-specific deflators to measure the aid performance of DAC members and a GNP-weighted aggregate of all DAC donors to measure resource receipts by developing countries. The World Bank uses an import unit price deflator for developing countries.

Notes

1. The 40 HIPCs are Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of the Congo, Republic of Congo, Côte d'Ivoire, Equatorial Guinea, Ethiopia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Kenya, Lao People's Democratic Republic, Liberia, Madagascar, Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, Republic of Yemen, and Zambia. This list excludes Nigeria, which is not an IDA-only country. The latter is a prerequisite under the Initiative. Any other country that meets the criteria would also be eligible for consideration.

2. To meet the initial entry requirement, HIPCs need to begin adjustment programs supported by the World Bank and the IMF through Enhanced Structural Adjustment Facility (ESAF) arrangements, ongoing Policy Framework Papers, and IDA adjustment operations.

3. This estimate excludes Liberia, Somalia, and Sudan because of insufficient data.

4. The boards of the World Bank and the International Monetary Fund have decided to make the final decision point and completion point documents available to the public, after consultation with the countries concerned. These documents are available on HIPC websites established by the two institutions (<http://www.worldbank.org/html/extdr/hipc.htm> and <http://www.imf.org/external/np/hipc/hipc.htm>).

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