CONSEQUENCES OF DEBT RELIEF INITIATIVES IN THE 1990s

HEPP, Ralf *

Abstract

In this paper I investigate the effects of recent debt relief initiatives on resource flows to low-income developing countries. For countries that are part of the Heavily Indebted Poor Countries (HIPC) initiative, I find that good macroeconomic management does not influence the level of resource and foreign aid receipts. Furthermore, my estimates suggest HIPC countries receive higher net transfers than non-HIPC countries in the 1990s with the differences declining after 1996. Confirming findings in the earlier literature, my results suggest that aid flows have not changed significantly in response to debt relief.

Keywords: HIPC debt initiative, foreign aid, selectivity, additionality

JEL Codes: F34, F35, O19

1 Introduction

In the second half of the last decade, the call for debt relief or cancelation as well as poverty reduction in developing countries grew very loud. Apart from NGOs like Oxfam and Jubilee2000, prominent figures like the Pope, the Dalai Lama, and the Irish pop singer Bono were demanding a solution to the debt problems of poor countries. The Paris Club of Creditors and the international financial institutions – the IMF and the World Bank – responded to the public pressure by establishing the Heavily Indebted Poor Countries (HIPC) Debt Initiative in 1996, and the Enhanced HIPC Debt Initiative in 1999. Also, the United Nations General Assembly adopted the Millennium Development Goals in September 2000, calling for, among other things, a worldwide eradication of extreme poverty and hunger. The focus of my paper is on the effects of recent debt relief initiatives, such as the Heavily Indebted Poor Countries (HIPC) Debt Initiative of 1996, on resource flows to developing countries. My sample covers 66 low-income countries (most of them located in Sub-Saharan Africa) over the period 1989 to 2002.¹ Forty of these low-income countries are classified by the World Bank as Heavily Indebted Poor Countries [henceforth *HIPCs*].²

First, I investigate whether the HIPC initiative is selective in the sense of “rewarding” improved policies in HIPC countries with higher transfers. Instead of using a policy index, I use a novel approach to measure good policy. The HIPC initiative is explicitly designed to reward good macroeconomic performance by conditioning debt relief on the implementation of key reforms. I use this characteristic of the initiative, and classify country observations by the progress made in the initiative, i.e., whether and when a country qualifies for debt relief. Earlier literature suggests that foreign aid is more

* Address: Department of Economics, Fordham University, E-525 Dealy Hall, 441 E. Fordham Rd, Bronx, NY 10458. Email: hepp@fordham.edu.

Acknowledgments: The author would like to thank Joshua Aizenman, Carlos Dobkin, Kenneth M. Kletzer, and participants at the ZEI Research Breakfast, University of Bonn, Germany, and at the Brown Bag Seminar at the University of California, Santa Cruz, as well as my fellow classmates for helpful comments. Financial assistance from the Graduate Division of the University of California at Santa Cruz is gratefully acknowledged. All remaining errors are mine.

¹For a list of the countries, see table 1 in the appendix.

²I will call the remaining 26 countries *Non-HIPCs* or *non-HIPC countries*.

effective in promoting growth when allocated to countries with good policies, rather than according to strategic and political interests. Second, I ask whether HIPC and Non-HIPC countries are treated differently in terms of aid allocation in an environment of declining aid flows. In this context, I also compare the differences before and after 1996 – the year of the announcement of the HIPC initiative. This is an important policy question, because redistribution of resource flows towards HIPC countries can potentially distort incentives for (currently) ineligible countries. If the economic situation of the eligible countries improves dramatically without a significant effort in implementing key reforms, ineligible countries have an incentive to achieve HIPC status. Third, in following earlier literature, I investigate whether debt relief provides additional resources to low-income countries between 1989 and 2002. It has been argued that in the past, bilateral donors have often given aid in order to keep their debtors out of arrears, i.e. some of the aid money was used to pay back debt owed to multilateral and bilateral donors.³ One of the goals of the HIPC debt initiative is to break this “aid recycling”, and to provide additional resources to the eligible countries.⁴ If debt relief is additional, ineligible countries are in a moral hazard situation. Addressing these three issues in an empirical analysis, I find that, first, good macroeconomic management does not seem to matter in the HIPC initiative in terms of the level of resource transfers and foreign aid received by a country. Second, my estimates suggest that countries classified as *HIPCs* received higher (official and aggregate) net transfers than *non-HIPCs* in the early 1990s. These differences persist after 1996, however at a lower level. Looking at net official development assistance, differences between HIPC countries and non-HIPC countries persist throughout the 1990s and early 2000s with higher levels of aid going to HIPC countries. In this sense, resources have been allocated towards non-HIPC countries. Third, confirming findings in the earlier literature on additionality, debt relief initiatives in the 1990s did not affect aid inflows significantly for low-income countries, neither positively nor negatively. Hence, debt relief did not crowd out aid.

In section 2, I briefly review literature on the historical background of the debt crisis in low-income countries and the HIPC Debt Initiative. Section 3 describes the main issues, the methodology, and the data used in the paper. In section 4, I describe my regression results. Section 5 concludes.

2 Background

2.1 A Brief history of the low-income country debt crisis

The situation of low income countries in the last 35 years and until the mid 1990s can broadly be characterized as one with an increasing debt stock, increasing debt service, positive and increasing aggregate and official transfers, and increasing foreign aid (all in per capita terms).⁵ External borrowing increased significantly in the 1970s and 1980s, when creditor governments provided export credits to developing countries in order to increase their own exports. Low income countries – unlike the middle-income Latin American countries – had to rely on official loans, since their access to private capital

³ See, for example, Birdsall et al. (2002) about the politics of foreign aid in Sub-Saharan Africa.

⁴ “A key concept underlying the HIPC Initiative - that of *additionality* - is that debt relief should supplement, not replace, the flow of assistance in the form of grants and concessional loans to the poorest countries.”, quote from International Monetary Fund and World Bank (2002), page 9.

⁵ See figures 1, 2, 3, 5, and 7 in the Annex.

markets was very limited.⁶ During this period, export credit guarantees were considered part of the overall development strategy pursued by developed nations. The debt burden of low income countries steadily increased, and their overall financial situation deteriorated because of adverse terms of trade shocks, weaknesses in the management of debt, lack of adjustment to an evolving economic environment, as well as political factors such as wars and social unrest. The international financial community's reaction to the unfolding debt crisis in the 1980s differed for middle-income and low-income countries. The *Baker Plan* of the mid-1980s was mainly directed at middle-income Latin American countries and some African countries.^{7,8} The prevalent paradigm at the time was that the debt crisis was a problem of (temporary) *illiquidity*, and that countries could "grow out of debt", given temporary debt servicing relief. Under the *Baker Plan*, it was assumed that a rescheduling of debt without any adjustment in its net present value would bring about a solution.⁹ New lending would lead to increased investment, which would eventually lead to greater economic growth. Hence, the proposed solution was a flow rescheduling of debt, and provision of "new money" by commercial banks and creditor governments, conditional on the implementation of an IMF-approved structural adjustment program. The lack of IMF-approved adjustment programs and the Brazilian debt moratorium in 1987 made it clear that the *Baker Plan* was not adequate. In the meantime, commercial banks started setting aside loan-loss reserves, while the share of the debt owed to official creditors increased. With regard to low-income countries, the reaction of the international community to the debt crisis was to provide comprehensive non-concessional flow reschedulings through Paris Club creditors and several multilateral agencies. Commercial banks played only a minor role.

In the late 1980s - in an environment where the secondary market value of sovereign debt of many low- and middle-income countries was significantly below its face value – the paradigm shifted from one of a *liquidity* to a *debt overhang* problem. The concept of debt overhang is defined as the "presence of an existing 'inherited' debt sufficiently large that creditors do not expect with confidence to be fully repaid".¹⁰ The idea is that there is a *debt Laffer curve*, in the sense that the net present value of repayments is increased when debt relief is provided. Krugman (1988) and Sachs (1986) argued that highly indebted poor countries (HIPC) were on the "wrong side" of this curve. They suggested that in this situation, countries' incentives to invest domestically (and therefore to increase the available surplus used for debt repayment) are distorted, since the high stock of debt acts like a high marginal tax on domestic investment. This shift in paradigm led to the *Brady Plan* in 1989, which used market-oriented debt reduction schemes, such as debt buybacks and equity swaps, to solve the debt crisis.¹¹ Again, mainly Latin American countries were involved. Commercial banks used this opportunity to leave the market by making use of

⁶For a brief historical overview of the low income countries' debt crisis, see Daseking and Powell (1999).

⁷The plan was named after the then U.S. Secretary of the Treasury, James Baker.

⁸See Cline (1995).

⁹A (flow) rescheduling of debt means that interest and principal payments are postponed for some period in the hope that economic growth in the meantime will make it easier for the debtor to repay the debt.

¹⁰See Krugman (1988).

¹¹The plan was named after then US treasury secretary Nicolas Brady.

their previously accumulated loan-loss reserves. Around the same time, the notion of debt overhang gained prominence among policy makers in dealing with debt of low-income countries. An initiative by the Paris Club, that later becomes known as *Toronto Terms*, included an option that allowed debt rescheduling on a concessional basis, meaning that *below market* interest rates were charged on rescheduled debt. In the following years, the concessionality of debt reschedulings by the Paris Club of Creditors deepened. For example, the *Naples terms* agreed upon by the Paris Club in 1994 provided debt relief of up to 67 percent on bilateral debt.

2.2 HIPC Debt Initiative and Related Literature

There are several factors that distinguish the HIPC debt initiative from previous initiatives by the Paris Club.¹² One distinguishing factor is that for the first time multilateral debt owed to the IMF and the World Bank is eligible for debt relief. Second, the implementation of the initiative involves all actors – creditors, donors, and debtors, as well as NGOs, religious and social groups. Especially in the *Enhanced HIPC Initiative* in 1999, involvement and active participation of civic society plays an important role in the design of the required Poverty-Reduction Strategy Paper (PRSP).

The goal of the HIPC debt initiative is twofold. First, its purpose is to provide a permanent exit from debt renegotiations and rescheduling, and to lower the eligible country's debt stock to a sustainable level. This is to be achieved by removing the debt overhang through debt relief in order to promote economic growth. Second, a combination of debt relief and foreign aid should provide additional resources for increased social spending in infrastructure, primary education, health, and to reduce poverty in general. In this paper, I describe debt relief as *additional* if it leads to additional resources made available to the *individual* debtor receiving debt relief. The goal of additionality is explicitly incorporated in the *Enhanced HIPC Debt Initiative* in 1999.^{13,14}

Under the original 1996 HIPC initiative, debt sustainability is the key goal. Countries that are considered as potentially eligible generally have no access to private capital markets, and are only able to borrow from the International Development Association (IDA), the concessional lending arm of the World Bank. Once a country is classified as eligible for HIPC debt relief, it enters a two-stage process: First, an agreement is made with the World Bank and the IMF about key structural reforms. After a 3-year track record of good performance, the country reaches the *decision point*, where the Paris Club and other bilateral creditors provide debt relief of up to 80 percent on eligible debt, and the multilateral creditors provide funds through the structural adjustment program. After another 3-year track record of good performance, the *completion point* is reached. Deeper stock-of-debt relief is then provided. Since this process is described as “too little, too late” by the official review of the HIPC initiative in October 1998, the Enhanced HIPC

¹²The Paris Club initiatives are also called *traditional debt relief mechanisms*.

¹³“... the debt-servicing capacity of HIPCs depends not only on their ability to generate foreign exchange through exports, but also on how much foreign assistance is expected to be forthcoming in the future...”, quote from Claessens et al. (1997).

¹⁴“... the enhanced HIPC initiative will boost social spending ...”, quote from the World Bank website at <http://www.worldbank.org/hipc/progress-to-date/May99v3/may99v3.htm>.

Debt Initiative was created in 1999.¹⁵ The thresholds for eligibility are lower and the process simplified and accelerated.¹⁶ Debt relief is provided once *some* of the key reforms are implemented. A 3-year track record of good performance is no longer required. Also, poverty reduction is now explicitly included as a goal.¹⁷ Some argue that highly indebted countries engage in “aid recycling” – with the full awareness and support of their donor countries – meaning that a share of official aid flows is used to repay old debt. The underlying reason for this behavior is to keep the debtor countries out of arrears on multilateral debt, since that could potentially lead to a withdrawal of funds by the donor community as a whole. Under these circumstances, debt relief can provide a way out of this vicious circle, and eliminate aid recycling altogether. And if the aid budget is not adjusted for the foregone debt repayments, debt relief is additional. Hence, debt relief also provides an opportunity to correct distorted incentive structures by freeing up part of the aid budget of the donor country, which then can distribute those “extra funds” to countries with good institutional structures and sound policies.

Since I am interested in the link between debt relief and foreign aid, I turn first to the aid allocation literature, which investigates the motivation and determinants of aid allocation. Schraeder et al. (1998) find that different determinants of aid allocation are important for different donors. The authors suggest that U.S. foreign aid policy in the 1980s is mostly driven by strategic (Cold War) interests, mainly in the Middle East. However, they also find a positive relationship between aid to some African countries and US trade with these countries. For France, colonial ties play an important role. Sweden’s foreign aid allocation in the 1980s seems to be driven by ideological affinity of recipient countries as well as economic interests (again, there is a positive link between aid and trade). Alesina and Dollar (2000) investigate the same question with data from 1970 to 1994. The authors find that political and strategic considerations play at least as big a role in allocating foreign aid as economic need and “good policies” in recipient countries. In the Scandinavian countries, the humanitarian aspect of aid dominates. Again, France puts more weight on colonial ties, while foreign aid policy in the US is dominated by strategic interests in the Middle East, with Egypt and Israel being the main aid recipients. This kind of behavior by some of the major donor countries clearly distorts the incentives of developing countries, since the rewards for “good policies” are small or non-existent. Furthermore, democratization increases aid flows, while foreign direct investment (FDI) responds more to economic factors like trade liberalization and improved property rights. McGillivray (2003) questions the methodology of earlier literature on aid allocation and suggests that the importance of strategic considerations for aid allocation during the cold war period is overstated. He argues that aid allocation might have been driven by developmental criteria all along despite contrary results in earlier literature.¹⁸ Aid allocation and its effectiveness are interrelated. Recent literature emphasizes “good policy” as the most important factor for aid to be effective in the sense of being growth-enhancing. Burnside and Dollar (2000) is a widely cited and influential paper in this

¹⁵See International Monetary Fund and World Bank (1998).

¹⁶A country becomes classified as a HIPC once the net present value of the debt-to-export ratio exceeds 150% (previously 200-250% on a case-by-case basis) and the debt-to-revenue ratio exceeds 250% (previously 280%).

¹⁷For a more detailed overview on the design of the HIPC initiative, see Boote and Thugge (1997).

¹⁸See, for example, Maizels and Nissanke (1984), McKinlay (1978), McKinlay and Little (1979).

literature. Its authors find aid to be effective in promoting growth if a country's fiscal, monetary and trade policies are sound. Svensson (1999) finds that a higher degree of political freedom and civil liberties makes aid more effective in promoting growth. Collier and Dollar (2002) suggest that ten million people annually could be lifted out of poverty if aid would be allocated to poor, "good policy" countries, rather than to satisfy strategic, political and commercial interests. In a critique of the recent aid effectiveness literature, Easterly et al. (2004) point out that the significant positive link between aid (conditional on good policies) and growth disappears when the original data set of the Burnside and Dollar paper is extended. Furthermore, Easterly (2001) questions the strong link between good policies and higher growth rates. Controlling for other factors, he finds that growth rates in developing countries have stagnated in the 1980s and 1990s, even though a number of typical policy measures have improved. He speculates that the increased level of indebtedness in developing countries may have been a reason for such stagnation. If high indebtedness alone is an impediment to growth, as argued in the debt overhang literature, debt relief might then be a possible solution. As previously described, proponents of the debt overhang theory argue that the removal of the debt overhang corrects distorted incentives for domestic investment.¹⁹ Bird and Milne (2003) caution, however, that providing debt relief to highly indebted countries might simply redistribute resources to countries with a history of unsound macroeconomic policies. Hence, "bad policies" in the past would be rewarded ex-post by providing debt relief. The authors also question whether there is a debt overhang problem in low-income countries. They find that more highly indebted countries receive more official net transfers, not less. Hence, incentives might not be distorted for domestic investment. Easterly (1999) argues that debt relief initiatives in the past two decades have not helped the situation of HIPC countries. In some instances, these initiatives might even have promoted behavior worsening the debt situation of these countries.

Apart from the effects of debt relief on incentives, another concern is that debt relief might crowd out foreign aid receipts. For example, Cohen (2000) is concerned that aid flows will be cut as a result of the HIPC initiative. He argues that the nominal figures of debt relief overstate the true amount of additional resources available to poor countries. A "splitting up" of the accounting of debt relief is suggested: One part is the cleaning of the books of donor countries, i.e. a write-down of the debt that could not have been expected to be paid back. A second part will be accounting for the actual additional resources that become available through debt relief. Based on the Brady deals in the 1980s, Cohen attempts to estimate the market values of the debt of HIPC countries in order to answer the question how much debt was expected to be repaid. Hence, only debt relief that goes beyond the market value will provide additional resources to the HIPC countries. He finds that the market value of HIPC debt is far below its face value or net present value. Since HIPC debt relief is based on net present values, he warns against decreasing aid flows after the provision of debt relief. Furthermore, Sachs et al. (1999) lament the volatility of grants and new loans making planning for the developing countries harder.

¹⁹See Krugman (1988) and Sachs (1986).

3 Empirical Model and Data Sources

There has been little empirical research on the *direct* implications of the HIPC initiative on resource flows to the eligible countries. Powell (2003) investigates whether debt relief activities lead to a decrease in aid flows received by low-income countries. He states that debt relief and aid allocation decisions were kept largely separate in the past, and are usually dealt with by different ministries in the donor countries (this has changed in recent years, however). Where this is the case, we should expect that in donor countries debt relief will not have much influence on aid budgets (at least in the short-run). Looking at data for 60 “IDA-only” countries from 1996 to 2000, Powell finds that neither the level of official development assistance (ODA) nor official net transfers received is affected by debt relief provided by official and multilateral creditors.²⁰ Hence, there seems to be additionality (in the sense the term is used in this paper). In his empirical analysis, the factors that do play a role in determining aid flows to a country are population size, and whether an IMF program is in place. Birdsall et al. (2003) are mainly concerned about “selectivity”, meaning whether donors will be selective and provide more aid to countries with good macroeconomic management. The authors use a sample of 37 Sub-Saharan African countries over the period 1977 to 1998. The countries are categorized into three groups: low debt countries, high debt countries with low multilateral debt, and high debt countries with high multilateral debt. As a variable for policy performance, they use the World Bank’s Country Policy and Institutional Assessment (CPIA) data, and alternatively, the policy index created by Burnside and Dollar (2000), which is based on publicly available data.²¹ They find that policy seems to matter little in determining net transfers. Only if interacted with the country category, policy matters. High multilateral debt countries receive higher net transfers when their policies are bad.

3.1 Main Issues, Data and Methodology

In this paper, I assess the resource impact of debt relief on *HIPC* and *non-HIPC* countries before and after the implementation of the HIPC debt initiative in 1996. As mentioned previously, one of the goals of the HIPC debt initiative is to provide additional resources for social spending to the eligible countries. Again, the definition of additionality used in this paper is the following: There is full additionality if the net aid flow increases by the amount of debt relief granted. Whether there is additionality is an important policy question because poverty can only be reduced successfully if there are additional funds available. Since debt relief and foreign aid are imperfect substitutes, debt relief by itself, however, will not necessarily provide these additional resources. For example, suppose that – before debt relief is provided – part of the available aid budget is used to sustain the flow of debt service payments (i.e., “aid recycling” is present); in this situation, only a combination of debt relief and an aid budget that is not fully adjusted by the amount of debt relief leads to additional resources for the recipient countries. Another important and

²⁰ As previously mentioned these countries only receive loans from the International Development Association (the concessional lending arm of the World Bank) and usually have no access to private capital markets.

²¹ The CPIA data set is not publicly available. It contains twenty components that can be grouped into four subgroups: Macroeconomic policies, structural policies, public sector management, and social inclusion.

related issue is that of selectivity: Are HIPC countries with good macroeconomic policies “rewarded” by receiving more transfers than countries that qualify for the HIPC program, but are unsuccessful (or unwilling) in implementing reforms? Will aid donors be more selective in the sense of giving aid *conditional on good policy* rather than according to their strategic and/or political interests as they have done in the past?

In order to address these issues, I investigate donor behavior using data on *aggregate net transfers*, *official net transfers*, and *net official development assistance (net ODA)* for 66 low-income countries – of which 40 countries are HIPC countries – over the time period 1989 to 2002. All debt-related and GDP data come from the World Bank’s *Global Development Finance 2004* data set [World Bank (2004a)]. Population data are taken from the World Bank’s *World Development Indicators 2004* [World Bank (2004b)]. Data on net official development assistance (ODA) are taken from the OECD’s *International Development Statistics 2004* [OECD (2004)]. I also use data from *Annual Freedom in the World Country Ratings 1972 through 2003* by Freedom House [Freedom House (2004)]. My sample consists of 66 “IDA-only” countries.²² As previously mentioned, “IDA-only” generally means that a country has no access to private capital markets. I chose this restriction for two main reasons. First, the classification by the World Bank as “IDA-only” is a prerequisite for eligibility for the HIPC Debt Initiative. Second, since the HIPC initiative only deals with *official* bilateral and multilateral debt, choosing a set of countries with little if any private debt appears to be consistent with this criterion.

3.1.1 Descriptive Statistics

Figures 1 to 3 show some important features of the evolution of Debt and Official Development Assistance (ODA) per capita in HIPC and non-HIPC countries.

Figure 1: Debt stock per capita Figure 2: Debt service per capita

²²The International Development Association (IDA) provides interest-free loans and some grants to the world’s poorest countries.

Figure 3: Net official development assistance per capita in US-Dollars

Table 2 compares the average values of the variables used in the regressions for HIPC and non-HIPC countries. The time period is split in 1996 when the original HIPC initiative is announced and implemented. The table provides a good comparison of the main characteristics of these two sets of countries. Per capita GDPs were similar for the first period, but increased much faster in non-HIPC countries in the late 1990s and early 2000s. See the Annex for more detailed information.

Table 2: Descriptive Statistics for the HIPC and non-HIPC countries

	HIPC			Non-HIPC		
	1989-1995	1996-2002	% change	1989-1995	1996-2002	% change
Population (in Millions)	516.0	608.0	17.8	223.0	255.0	14.3
GDP (in Mio. USD)	139,000	175,000	25.9	66,200	91,800	38.7
GDP per capita (USD)	269.4	287.8	6.8	296.9	360.0	21.3
GDP growth*	2.6	4.3		4.0	3.0	
Debt Stock*	139.0	107.0	-23.0	40.3	41.0	1.7
Debt Stock Reduction*	0.4	1.4	262.8	0.0	0.0	-46.6
Debt Service*	3.8	3.5	-9.6	1.7	2.0	19.7
Debt Service Reduction*	1.3	2.9	127.7	0.1	0.0	-62.2
OECD Debt Relief*	0.8	0.8	0.1	0.2	0.2	7.2
Aggregate Net Transfers*	9.5	7.3	-23.7	4.8	4.0	-16.6
Official Net Transfers*	8.9	6.1	-31.4	4.6	3.2	-32.0
Net ODA*	9.7	7.9	-18.4	4.5	2.3	-48.7

Notes: * = in percent of GDP; All values are averages of the variables for 1989-1995 and 1996-2002, respectively.

We see that debt stock and debt service have decreased significantly for the HIPCs, while both increased for non-HIPC countries. Furthermore, official development assistance for non-HIPCs dropped much more substantially (from about 4.5 percent of GDP to 2.3 percent vs. 9.7 to 7.9 percent for HIPC countries), suggesting that in relative terms foreign aid might have been shifted away from non-HIPCs. As we would expect, relief and reductions in debt are much higher for HIPC countries after 1996, but they are also much higher before the implementation of the HIPC initiative.²³

²³ All countries in the sample received some debt relief in the 1990s through the Paris Club.

Table 3: Descriptive Statistics for the HIPC countries Uganda and Ghana

	Uganda			Ghana		
	1989-1995	1996-2002	% change	1989-1995	1996-2002	% change
Population (in Millions)	18.6	22.6	21.5	16.1	18.6	15.5
GDP (in Mio. USD)	4,100	6,020	46.8	6,000	6,490	8.2
GDP per capita (USD)	220.4	266.4	20.8	372.7	348.9	-6.4
GDP growth*	4.3	0.2		4.1	0.8	
Debt Stock*	75.4	62.5	-17.1	76.6	106.6	39.2
Debt Stock Reduction*	0.7	0.8	12.7	0.0	0.0	
Debt Service*	3.7	1.9	-50.1	6.0	6.9	13.8
Debt Service Reduction*	0.4	1.4	216.8	0.7	0.4	-36.7
OECD Debt Relief*	0.4	0.7	65.7	0.6	0.2	-59.8
Aggregate Net Transfers*	12.8	11.4	-11.0	10.3	8.9	-13.2
Official Net Transfers*	12.5	9.1	-27.3	9.0	7.0	-22.7
Net ODA*	17.0	11.1	-34.4	11.1	9.6	-13.3

Notes: * = in percent of GDP; All values are averages of the variables for 1989-1995 and 1996-2002, respectively.

In table 3, we have the same measures for two HIPC countries, Uganda and Ghana. Uganda received all treatments and successfully completed both the original and enhanced HIPC debt initiative. Ghana, on the other hand, reached the *decision point* of the *enhanced HIPC initiative* only in February 2002, and received debt relief after that. Hence, those two countries are a good example for a comparison of a country with a very good record in implementing key structural reforms (Uganda) and a country with a mediocre record (Ghana). Whether the HIPC debt initiative framework is responsible for all (or at least most) of the differences between those two countries is an open question, and beyond the scope of this paper. Nonetheless, the emerging pattern is suggestive. While Ghana's per capita GDP dropped by about 6 percent, Uganda experienced an increase of about 21 percent. The significant drop in debt service for Uganda is reflected by the massive increase in debt service relief. We also see the debt stock increasing rapidly in Ghana, from 77 percent of GDP to almost 107 percent, while Uganda's situation improves significantly. The comparison of these two countries suggests that policy performance is rewarded under the HIPC initiative. I will test this more rigorously in section 4.

The dependent variables used in the following analysis are *aggregate net transfers*, *official net transfers*, and *net official development assistance (net ODA)*, respectively.

Net ODA is the first dependent variable considered. Funds being classified as ODA have to satisfy three criteria: First, they are provided by an official agency; second, the purpose of the assistance is economic development; and third, the assistance contains a grant element of at least twenty-five percent.²⁴ Debt relief, which – under OECD guidelines – is recorded as part of ODA is netted out for the purpose of my regressions (which gives us *net ODA*).

The second dependent variable used is *official net transfers*. These transfers consist of the sum of official net flows on long-term debt to official creditors, plus official grants minus

²⁴Using *net ODA* as a direct measure for *foreign aid* has been criticized by several authors, mainly because of the arbitrary calculation of the grant element of concessional loans. See, for example, Chang et al. (1998), and Renard and Cassimon (2001).

official interest payments on long-term loans. Highly indebted poor countries have received positive official net transfers in the past; therefore it is interesting to see whether and how debt relief influenced these transfers.

Finally, I use *aggregate net transfers* as a dependent variable. These transfers consist of net foreign direct investment, net portfolio equity flows, and official grants minus interest payments on long-term debt and FDI profits. All dependent variables, as well as debt stock, debt service, debt service and debt stock reduction, and OECD debt relief are measured as percentages of GDP.

3.1.2 Benchmark Regression

First, I investigate whether HIPC countries are treated differently compared to non-HIPC countries before and after 1996. As a benchmark, I start with a regression that includes only dummy variables:

$$y_{i,t} = \alpha + \delta_1 * hipc_i + \delta_2 * hipc96_{it} + \delta_3 * post96_t + \eta_t + \varepsilon_{it} \quad (1)$$

where $y_{i,t}$ stands for *official net transfers*, *aggregate net transfers* and *net official development assistance*, respectively, to nation i at time t ; the coefficient on *hipc* tells us what the difference in transfers per GDP is on average between HIPC and non-HIPC countries before 1996; the coefficient on *hipc96* is the change in transfers per GDP for HIPCs since the start of the HIPC initiative in 1996 relative to before 1996; hence, the sum of coefficients of *hipc* and *hipc96* represents the difference between HIPC and non-HIPC countries in transfers received for 1996 to 2002; the dummy variable *post96* helps distinguish the transfer levels between 1989-1995 and 1996-2002; η_t is a time-fixed effect and ε_{it} is an i.i.d. error term.

3.1.3 Regression including Main Determinants of Transfers/Foreign Aid

In a second approach, I estimate the following equation, including determinants used in the earlier literature:

$$y_{i,t} = \alpha + \beta * x_{it} + \delta_1 * hipc_i + \delta_2 * hipc96_{it} + \delta_3 * post96_t + \eta_t + \varepsilon_{it} \quad (2)$$

Again, the same dependent variables are used. x_{it} is a vector of the following variables: *debt stock*, *debt service*, logarithm of *GDP*, a country's *share of the total population* of the sample countries, *debt stock* and *debt service reduction*, an *OECD debt relief* variable, and a variable called *restrictions on freedom*, which is an index composed of the average of a *political rights* and a *civic liberties* indicator value.²⁵ When running the regression with *net ODA* as the left-hand side variable, I use the variable *OECD debt relief* as an alternative measure of debt relief.²⁶ As noted in previous literature, using this OECD measure for debt relief is not ideal.²⁷ It will only provide a *lower bound* for debt relief because of the different reporting approaches among creditors. Some countries report the amount of debt relief only when a payment should have fallen due (i.e. over the lifetime of the loan that was forgiven), others report the total amount of debt relief in the year when it was granted. Following Powell (2003), I control for the political environment in a

²⁵Both are measured on a scale from 1 to 7, where a higher value means "less free".

²⁶It is also taken from OECD (2004).

²⁷For a discussion, see Powell (2003).

country with the variable *restrictions on freedom*. This variable captures some institutional and political aspects in those countries.²⁸ The logarithm of GDP is included as a measure of poverty, since headcount data on poverty are not reliable in early years.²⁹ Previous studies have found that there is a small country bias, meaning that smaller countries tend to receive an over-proportional share of transfers. To control for this, I use the share of the total population of the sample.

3.1.4 Regressions distinguishing HIPC by Policy Performance

In my last set of regressions, I replace the dummy variable *hipc96* with a set of dummy variables that are proxies for a HIPC country's progress within the debt initiative. As previously described, the two HIPC initiatives are multi-stage processes, with each of them having a *decision* and a *completion point*. The dummy variables each signify a particular level of progress, describing which points have been reached. These variables can be seen as a measure of good policy, because progress in the HIPC initiative is equivalent with implementing key structural reforms under IMF and World Bank guidance. The use of these dummy variables therefore tells us whether "good policy" is rewarded with higher transfers within the HIPC initiative.

The following model is being estimated:

$$y_{i,t} = \alpha + \beta * x_{it} + \delta_1 * hipc_i + \delta_2 * hipc96_{it} + \delta_3 * post96_t + \sum_{n=1}^6 \gamma_n * hipc_stage_n_{it} + \eta_t + \varepsilon_{it} \quad (3)$$

The dummies for *hipc_stage_n* will tell us exactly how far a country has advanced at any point in time. The coefficient here is interpreted as the difference in transfers received by a country reaching a certain stage in this process and those of a HIPC country that has not advanced in the process.

4 Empirical Results

As mentioned earlier, my analysis focuses on the following questions: First, is there any differential treatment for HIPC countries in comparison to the other low-income countries in the sample before and after the announcement and implementation of the HIPC debt initiative in 1996? Second, is aid allocation more selective within the HIPC countries, i.e., does relatively more aid go to "good policy" countries? Third, is debt relief additional? In terms of coefficients, I focus on the coefficients of *hipc*, *hipc96* and the policy performance dummies *hipc_stage_n*.³⁰

4.1 Official Development Assistance (ODA)

Official development assistance comes closest to what is generally understood as foreign aid. In figure 3, in the Annex, we see that – in per capita terms – more and more ODA is flowing to HIPC countries, while in non-HIPC countries, the per capita amounts increase only slowly. It is interesting to see that in the mid-1990s there is a significant drop in

²⁸Using the World Bank's Country Policy and Institutional Assessment (CPIA) data would be preferable, but – as previously mentioned – this data set is not publicly available.

²⁹See Birdsall et al. (2002).

³⁰ The variation of the variables is weighted by population size in order to minimize the influence of small island nations on the regression results.

foreign aid to HIPC countries, temporarily narrowing the gap between the two sets of countries. However, the gap is increasing again for the second half of the 1990s. This is at least suggestive evidence that the HIPC debt relief initiative might be working in terms of providing additional (concessional) resources to the eligible countries.

The regression results for net ODA as the dependent variable are reported in table 4.

Table 4: Estimation Results. Dependent Variable: Official Development Assistance

	Ordinary Least Squares			Random Effects		Fixed Effects	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
hipc	0.069*** (0.011)	0.054*** (0.009)	0.055*** (0.009)	0.088*** (0.025)	0.090*** (0.026)		
hipc96	-0.007 (0.015)	-0.032*** (0.009)	-0.030*** (0.009)	-0.025 (0.019)	-0.027 (0.018)	0.004 (0.010)	-0.001 (0.010)
post96	-0.031 (0.022)	-0.011 (0.014)	-0.013 (0.013)			-0.016 (0.013)	-0.013 (0.013)
oDecPt		-0.012 (0.015)		-0.022 (0.021)		-0.036*** (0.012)	
oCmplPt		-0.005 (0.015)		-0.016 (0.023)		-0.043* (0.022)	
oCmplPt & enhDecPt		-0.015 (0.017)		-0.015 (0.024)		-0.054*** (0.020)	
oCmplPt & enhCmplPt		0.036** (0.017)		0.004 (0.026)		-0.019 (0.021)	
enhDecPt		0.02 (0.016)		0.004 (0.014)		0.016 (0.012)	
enhCmplPt		0.017 (0.018)		0.043 (0.041)		-0.009 (0.016)	
Debt Service		0.442*** (0.074)	0.425*** (0.077)	0.458*** (0.064)	0.461*** (0.063)	0.638*** (0.058)	0.634*** (0.060)
Debt Stock		-0.012 (0.008)	-0.012* (0.007)	0.003 (0.006)	0.003 (0.006)	-0.027** (0.013)	-0.029** (0.013)
OECD Debt Relief		0.694*** (0.212)	0.720*** (0.209)	0.044 (0.056)	0.036 (0.055)	0.047 (0.154)	0.016 (0.165)
log(GDP)		-0.068*** (0.005)	-0.069*** (0.006)	-0.070*** (0.009)	-0.071*** (0.009)	-0.082*** (0.025)	-0.089*** (0.025)
Share(population)		0.007*** (0.001)	0.007*** (0.001)	0.011*** (0.004)	0.011*** (0.004)	-0.059** (0.025)	-0.062** (0.025)
Restrictions on freedom		-0.010*** (0.003)	-0.010*** (0.003)	-0.005 (0.004)	-0.005 (0.004)	-0.002 (0.003)	-0.003 (0.003)
Observations	828	828	828	828	828	828	828
R-squared	0.18	0.57	0.56			0.83	0.82

Notes: * significant at 10%; ** significant at 5%; *** significant at 1%. Heteroskedasticity-robust standard errors in parentheses. A constant and year dummies are included in the regressions, but are not reported. The dependent variable is expressed in percent of GDP. Debt service, debt stock, debt service reduction, and debt stock reduction are expressed in percent of GDP. hipc is a dummy variable for HIPC countries. hipc96 is an interacted dummy that equals 1 if the country is a HIPC country and the data is from 1996 or later. Restrictions on freedom proxies the political rights and civil liberties in a country. A higher index number indicates that there are more restrictions on freedom. Definitions for "hipc status": oDecPt = reached decision point in original HIPC initiative; oCmplPt = reached completion point in original HIPC initiative; oCmplPt + enhDecPt = reached completion point in original and decision point in enhanced HIPC initiative; oCmplPt + enhCmplPt = reached completion point in original and enhanced HIPC initiative; enhDecPt = reached decision point only in enhanced HIPC initiative; enhCmplPt = reached completion point only in enhanced HIPC initiative

When using ordinary least squares and random effects, I find that HIPC countries receive more assistance than non-HIPC countries (by approximately 5 and 9 percent of GDP, respectively) before 1996. When going beyond the benchmark regression, there is only a significant change in 1996 to 2002 when using OLS, suggesting that this difference drops by around 3 percent to a 2 percent difference between HIPCs and non-HIPCs. In the fixed effects approach, the coefficient of *hipc96* is not significant. Looking at the coefficients of the policy performance variables *hipc_state_n*, no clear picture emerges. If foreign aid is allocated selectively, we would expect positive coefficients for all of these policy dummies. Only the coefficients associated with the enhanced HIPC initiative are (mostly) positive, but almost none significantly so. This suggests that policy performance has at best no effect and at worst a negative impact on foreign aid flows to a HIPC country. The coefficient of *debt service* per GDP is positive and highly significant for all three estimation techniques, suggesting that countries with a higher debt service burden receive more foreign aid. Only in the fixed effects approach, does a high debt *stock* lead to significantly lower foreign aid. A higher GDP is consistently linked with lower foreign aid. Since $\log(GDP)$ is our proxy for poverty, we would expect that a poorer country receives more foreign aid. The coefficient of OECD debt relief is positive, but not robust. Hence, debt relief does not seem to crowd out aid flows. The population share variable is highly significant in all three specifications, but – unlike the other two approaches – the fixed effect model results in a negative coefficient. Hence, it is not clear whether there is a “small country bias”.

4.2 Official Net Transfers

After increasing for about two decades, per capita official net transfers to HIPC countries started declining throughout the 1990s (see figure 5).

Figure 5: Official net transfers per capita in US-Dollars.

Figure 6, in the Annex, suggests that after 1996 official net transfers per GDP dropped significantly for both HIPC and non-HIPC countries. The drop seems to have been more pronounced in HIPC countries, though. More recently, official net transfers as a share of

GDP have increased significantly more for HIPC countries. Table 5 reports the results for official net transfers.

Table 5: Estimation Results. Dependent Variable: Official Net Transfers

	Ordinary Least Squares			Random Effects		Fixed Effects	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
hipc	0.043*** (0.008)	0.037** (0.008)	0.039*** (0.008)	0.040** (0.016)	0.041** (0.017)		
hipc96	-0.011 (0.011)	-0.026** (0.008)	-0.022*** (0.008)	-0.007 (0.011)	-0.008 (0.010)	0.022** (0.010)	0.021** (0.010)
post96	-0.024 (0.016)	-0.006 (0.016)	-0.009 (0.016)	-0.055*** (0.015)	-0.046*** (0.015)	-0.049*** (0.014)	-0.052*** (0.014)
oDecPt		0.007 (0.014)		0.026 (0.022)		-0.01 (0.012)	
oCmplPt		0.001 (0.014)		0.002 (0.024)		-0.021 (0.019)	
oCmplPt & enhDecPt		-0.003 (0.026)		-0.001 (0.024)		-0.021 (0.015)	
oCmplPt & enhCmplPt		0.066 (0.048)		0.044 (0.027)		0.029 (0.036)	
enhDecPt		0.013 (0.013)		-0.028** (0.014)		0.009 (0.013)	
enhCmplPt		0.040** (0.012)		0.067 (0.043)		0.009 (0.014)	
Debt Service		-0.066 (0.051)	-0.089 (0.056)	-0.089 (0.060)	-0.079 (0.060)	0.08 (0.062)	0.072 (0.060)
Debt Stock		0.016* (0.007)	0.015** (0.006)	0.029*** (0.003)	0.029*** (0.003)	0.022* (0.012)	0.021* (0.012)
Debt Service Reduction		0.037 (0.021)	0.031 (0.021)	0.022 (0.043)	0.004 (0.042)	0.04 (0.030)	0.038 (0.030)
Debt Stock Reduction		0.149** (0.050)	0.169*** (0.042)	0.018 (0.039)	0.032 (0.039)	-0.003 (0.058)	0.005 (0.050)
log(GDP)		-0.045** (0.004)	-0.045*** (0.004)	-0.047*** (0.006)	-0.047*** (0.007)	-0.007 (0.022)	-0.008 (0.022)
Share(population)		0.004** (0.001)	0.004*** (0.001)	0.006* (0.003)	0.006* (0.004)	-0.086*** (0.022)	-0.082*** (0.022)
Restrictions on freedom		-0.014** (0.002)	-0.015*** (0.002)	-0.005* (0.003)	-0.005* (0.003)	-0.005** (0.003)	-0.006** (0.003)
Observations	828	828	828	828	828	828	828
R-squared	0.09	0.47	0.46			0.73	0.73

Notes: * significant at 10%; ** significant at 5%; *** significant at 1%. Heteroskedasticity-robust standard errors in parentheses. A constant and year dummies are included in the regressions, but are not reported. The dependent variable is expressed in percent of GDP. Debt service, debt stock, debt service reduction, and debt stock reduction are expressed in percent of GDP. hipc is a dummy variable for HIPC countries. hipc96 is an interacted dummy that equals 1 if the country is a HIPC country and the data is from 1996 or later. Restrictions on freedom proxies the political rights and civil liberties in a country. A higher index number indicates that there are more restrictions on freedom. For other variable definitions, see table 4.

As was the case for ODA, official net transfers before 1996 are significantly higher for HIPC countries than for non-HIPCs, regardless of estimation technique. The fixed effects approach suggests that HIPCs still received higher transfers than non-HIPC countries (about 2 percent of GDP). The coefficient of *post96* confirms what we see in figure 6, namely that the overall level of official net transfers dropped after 1995. The policy dummies are mostly positive, but none are robustly significant in the expected direction. This suggests again, that policy performance – even if evaluated directly and within the HIPC initiative – seems to matter little! Official net transfers respond positively and significantly to a higher debt stock per GDP. For each one percent increase in debt stock per GDP, a country receives between 1.5 and 3 percent more official net transfers. Neither debt service nor debt stock reduction has any robustly significant effect. This means that aid budgets did not respond to debt relief, hence there is additionality. The *restrictions on freedom* variable is significant and negative for all three techniques. A more democratic country receives between 0.5 percent (random effects and fixed effects) and 1.5 percent (OLS) more transfers per GDP. The share of population shows the same behavior as before: significant and positive for OLS and random effects, but significant and negative for fixed effects. Finally, relatively wealthier countries (higher GDP) receive fewer transfers, again consistent with our expectations.

4. 3 Aggregate Net Transfers

As suggested by figure 8, aggregate net transfers per GDP are higher in HIPC countries for the time period considered, but there is a significant drop for the period 1996-2002 for both HIPC and non-HIPC countries.

Comparing figures 6 and 8 suggests that the drop in aggregate net transfers is driven by the drop in official net transfers.³¹ In 1989-1995, aggregate net transfers are between 3.8 percent and 5.6 percent of GDP higher for HIPC countries than for non-HIPCs.

Figure 7: Aggregate net transfers per capita in US-Dollars.

³¹ When running a regression (not reported) with the difference between aggregate net transfers and official net transfers (i.e., non-official transfers) as the dependent variable, the coefficients on *hipc*, *hipc96* and *post96* are not significant.

Table 6: Estimation Results. Dependent Variable: Aggregate Net Transfers

	Ordinary Least Squares			Random Effects		Fixed Effects	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
hipc	0.049*** (0.010)	0.038** (0.009)	0.044*** (0.010)	0.054*** (0.019)	0.056*** (0.020)		
hipc96	-0.013 (0.013)	-0.030** (0.011)	-0.023** (0.010)	-0.024 (0.015)	-0.019 (0.014)	-0.005 (0.014)	-0.005 (0.013)
post96	-0.015 (0.019)	0.005 (0.019)	0 (0.019)	-0.026 (0.020)	-0.009 (0.020)	-0.008 (0.018)	-0.008 (0.018)
oDecPt		-0.007 (0.021)		0 (0.029)		-0.02 (0.012)	
oCmplPt		0.018 (0.019)		-0.011 (0.032)		-0.006 (0.015)	
oCmplPt & enhDecPt		0.029 (0.027)		0.016 (0.032)		-0.008 (0.018)	
oCmplPt & enhCmplPt		0.101 (0.057)		0.074** (0.037)		0.054 (0.041)	
enhDecPt		0.030* (0.015)		0.014 (0.019)		0.019 (0.014)	
enhCmplPt		0.071** (0.016)		0.09 (0.058)		0.012 (0.018)	
Debt Service		-0.078 (0.081)	-0.126 (0.087)	-0.129 (0.080)	-0.137* (0.079)	0.024 (0.082)	0.008 (0.079)
Debt Stock		0.016* (0.008)	0.015* (0.008)	0.024*** (0.004)	0.024*** (0.004)	0.01 (0.018)	0.009 (0.018)
Debt Service Reduction		0.007 (0.025)	-0.002 (0.025)	-0.031 (0.057)	-0.033 (0.057)	0.015 (0.036)	0.011 (0.035)
Debt Stock Reduction		0.166** (0.050)	0.195*** (0.046)	0.054 (0.053)	0.062 (0.052)	-0.037 (0.060)	-0.021 (0.046)
log(GDP)		-0.049*** (0.005)	-0.050*** (0.005)	-0.049*** (0.008)	-0.049*** (0.008)	-0.014 (0.030)	-0.016 (0.029)
Share(population)		0.005** (0.001)	0.005*** (0.001)	0.007* (0.004)	0.007* (0.004)	-0.023 (0.025)	-0.014 (0.025)
Restrictions on freedom		-0.010** (0.003)	-0.012*** (0.003)	-0.011*** (0.004)	-0.012*** (0.004)	-0.007* (0.003)	-0.007** (0.003)
Observations	828	828	828	828	828	828	828
R-squared	0.07	0.37	0.35			0.63	0.63

Notes: * significant at 10%; ** significant at 5%; *** significant at 1%. Heteroskedasticity-robust standard errors in parentheses. A constant and year dummies are included in the regressions, but are not reported. The dependent variable is expressed in percent of GDP. Debt service, debt stock, debt service reduction, and debt stock reduction are expressed in percent of GDP. hipc is a dummy variable for HIPC countries. hipc96 is an interacted dummy that equals 1 if the country is a HIPC country and the data is from 1996 or later. Restrictions on freedom proxies the political rights and civil liberties in a country. A higher index number indicates that there are more restrictions on freedom. For other variable definitions, see table 4.

This difference decreases for the 1996-2002 period by between 2.3 percent and 3 percent of GDP under OLS. Using random effects, there is no significant change in the regression results. Even though the policy performance coefficients are mostly positive, only a few are significant for some specifications. Hence, overall, policy mattered little. Higher indebtedness leads again to bigger transfers. The coefficient on *log(GDP)* is consistently

negative and relatively robust, meaning that poorer countries receive more transfers. As with official net transfers, more democratic countries receive higher aggregate transfers.

5 Conclusion

The empirical analysis yields several important results. First, good policy performance in the HIPC initiative has little or no effect on either official and aggregate net transfers or official development assistance. This result is consistent with earlier literature showing that aid allocation is driven by strategic and political, rather than developmental interests. Second, the HIPC initiative has not brought about a dramatic change in transfer flows to HIPC and non-HIPC countries. In general, HIPC countries still receive higher aid flows than non-HIPCs, even though the gap has narrowed in some instances. Third, debt relief did not impact aid inflows to low-income countries. Hence, debt relief provides additional resources since donors did not cut aid flows by the amount of debt relief provided. Also, debt relief has not significantly decreased ODA nor official and aggregate net transfers. Taken together, these results have important policy implications. While aid flows declined significantly throughout the 1990s, my results indicate that donors' selectivity did not increase. That is, there is little evidence that aid allocation is driven by developmental rather than strategic and political interests. Furthermore, aid effectiveness can be increased by more selective behavior on the donors' side. Since debt relief in our sample did not lead to a crowding out of aid flows, deeper debt relief might not necessarily have detrimental effects on the aid level either. Additionally, removing the debt overhang completely corrects distorted incentives. Aid effectiveness can be increased significantly by providing more debt relief overall, and thereby "freeing up" foreign aid flows that were previously used for aid recycling. These aid flows can then be allocated to countries with better macroeconomic policies. The remaining results are largely consistent with earlier literature. Official development assistance is higher for countries that have a higher debt service burden, lower GDP, and are classified as Heavily Indebted Poor Countries. And countries with more political freedom and lower GDP receive higher aggregate net transfers. However, in contrast to earlier research, I find no small country bias in terms of aid and transfer inflows.

References

- Alesina, Alberto and Beatrice Weder, "Do Corrupt Governments Receive Less Foreign Aid?," *American Economic Review*, September 2002, 92 (4), 1126–1137.
- Alesina, Alberto and David Dollar, "Who Gives Foreign Aid to Whom and Why?," *Journal of Economic Growth*, March 2000, 5, 33–63.
- Amprou, Jacky, Patrick Guillaumont, and Sylviane Guillaumont Jeanneney, "Aid Selectivity According To Augmented Criteria," *The World Economy*, 2007, pp.733–763.
- Babu, Suresh and Prabuddha Sanyal, "Aid Effectiveness and Capacity Development," *IFPRI Discussion Paper 00838*, December 2008. International Food Policy Research Institute.
- Berthélemy, Jean-Claude, "Bilateral Donors' Interest vs. Recipients' Development Motives in Aid Allocation: Do All Donors Behave the Same?," *Review of Development Economics*, 2006, 10 (2), 179–194.
- Berthélemy, Jean-Claude and Ariane Tichit, "Bilateral Donors' Aid Allocation Decision - A Three-Dimensional Panel Analysis," *International Review of Economics and Finance*, 2004, 13 (3), 253–274.

- Bird, Graham and Alistair Milne, "Debt Relief for Low-Income Countries: Is it Effective and Efficient?," *The World Economy*, 2003, 26, 43–59.
- Birdsall, Nancy, Stijn Claessens, and Ishac Diwan, "Will HIPC Matter? The Debt Game and Donor Behavior in Africa," *WIDER Discussion Paper*, May 2002, (50).
- Birdsall, Nancy, Stijn Claessens, and Ishac Diwan, "Policy Selectivity Forgone: Debt and Donor Behavior in Africa," *Center of Global Development Working Paper 17*, 2003.
- Boote, Anthony R and Kamau Thugge, "Debt Relief for Low-Income Countries and the HIPC Initiative," *IMF Working Paper 97/24*, 1997.
- Burnside, Craig and David Dollar, "Aid, Policies and Growth," *American Economic Review*, 2000, 90 (4), 847–868.
- Chang, Charles C., Eduardo Fernandez-Arias, and Luis Servén, "Measuring Aid Flows: A New Approach," 1998. Online at <http://www.worldbank.org/research/growth/abschang.htm>.
- Chauvin, Nicolas Depetris and Aart Kraay, "What Has 100 Billion Dollars Worth of Debt Relief Done for Low-Income Countries?," *World Bank Working Paper Series 4000*, September 2005.
- Chauvin, Nicolas Depetris and Aart Kraay, "Who Gets Debt Relief?," *Journal of the European Economic Association*, 04-05 2007, 5 (2-3), 333–342.
- Claessens, Stijn, Danny Cassimon, and Bjorn Van Campenhout, "Empirical Evidence on the New International Aid Architecture," *IMF Working Paper 07/277*, 2007.
- Claessens, Stijn, Enrica Detragiache, Ravi Kanbur, and Peter Wickham, "Analytical Aspects of the Debt Problems of Heavily Indebted Poor Countries", in Iqbal, Z. and R. Kanbur (eds.), *External Finance For Low-Income Countries*, Washington, D.C.: International Monetary Fund, 1997.
- Cline, William R., *International Debt Reexamined*, Washington, D.C.: Institute for International Economics, 1995.
- Cohen, Daniel, "The HIPC Initiative: True and False Promises," *OECD Development Centre Technical Paper 166*, September 2000.
- Collier, Paul and David Dollar, "Aid Allocation and Poverty Reduction," *European Economic Review*, 2002, 46, 1475–1500.
- Daseking, Christina and Robert Powell, "From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries," *IMF Working Paper 99/102*, 1999.
- Dollar, David and Victoria Levin, "The Increasing Selectivity of Foreign Aid, 1984-2002," *World Bank Working Paper Series 3299*, 2004.
- Easterly, William, "How Did Highly Indebted Poor Countries Become Highly Indebted? - Reviewing Two Decades of Debt Relief," *World Bank Policy Research Paper*, 1999, (2225).
- Easterly, William, "The Lost Decades: Explaining Developing Countries' Stagnation in Spite of Policy Reform 1980-1998," *Journal of Economic Growth*, 2001, 6 (2), 135–157.
- Easterly, William, "Are Aid Agencies Improving?," *Economic Policy*, October 2007, pp.633–678.
- Easterly, William, Ross Levine, and David Roodman, "New Data, New Doubts: A Comment on Burnside and Dollar's "Aid, Policies, and Growth"," *American Economic Review*, June 2004, 94 (3).
- Freedom House, "Freedom in the World Annual Country Ratings 1972 through 2003." Available online at <http://www.freedomhouse.org/ratings/index.htm>.
- Gautam, Madhur, *Debt Relief for the Poorest. An OED Review of the HIPC Initiative*, 1818 H Street, NW Washington, DC 20433: The World Bank, 2003.
- International Monetary Fund and World Bank, "The Initiative for Heavily Indebted Poor Countries: Review and Outlook," September 1998, 98 (15). Development Committee.

- International Monetary Fund and World Bank, "HIPC Initiative: Status and Implementation," 2002.
- Krugman, Paul R., "Financing vs. Forgiving A Debt Overhang," *Journal of Development Economics*, 1988, 29, 253–268.
- Maizels, Alfred and Machiko K. Nissanke, "Motivations for Aid to Developing Countries," *World Development*, 1984, 12 (9), 879–900.
- Marchesi, Silvia and Alessandro Missale, "What Does Motivate Lending And Aid To The HIPC's?," *Development Studies Working Paper 189*, October 2004. Centro Studi Luca D'Agliano.
- McGillivray, Mark, "Aid Effectiveness and Selectivity: Integrating Multiple Objectives into Aid Allocations," *WIDER Discussion Paper*, 2003, 2003 (71). United Nations University.
- McKinlay, Robert D., "The German Aid Relationship: A Test of the Recipient Need and Donor Interest Models of the Distribution of German Bilateral Aid, 1961-70," *European Journal of Political Research*, 1978, 6, 235–257.
- McKinlay, Robert D., and R. Little, "The US Aid Relationship: A Test of the Recipient Need and Donor Interest Models," *Political Studies*, 1979, 27 (2), 236–250.
- Ndikumana, Léonce, "Additionality of debt relief and debt forgiveness, and implications for future volumes of official assistance," *International Review of Economic and Finance*, 2004, 13, 325–340.
- Nunnenkamp, Peter and Rainer Thiele, "Targeting Aid to the Needy and Deserving: Nothing But Promises?," *The World Economy*, 2006, 29 (9), 1177–1201.
- OECD, "International Development Statistics 2004," 2004. CD-Rom.
- Powell, Robert, "Debt Relief, Additionality, and Aid Allocation in Low-Income Countries," *International Monetary Fund Working Paper*, 2003, 03 (175).
- Radelet, Steven, "A Primer On Foreign Aid," *Working Paper Number 92*, July 2006. Center For Global Development, Washington DC.
- Renard, Robrecht and Danny Cassimon, "On the Pitfalls of Measuring Aid," *WIDER Discussion Paper*, 2001, 2001 (69). Helsinki: UNU/WIDER.
- Roodman, David, "An Index of Donor Performance," *Working Paper Number 67*, November 2006. Center for Global Development, Washington DC.
- Sachs, Jeffrey D., *Debt, Stabilization, and Development: Essays in Memory of Carlos Diaz-Alejandro*, Basil Blackwell,
- Sachs, Jeffrey D., Kwesi Botchway, Maciej Chackra, and Sara Sievers, "Implementing Debt Relief for the HIPC's," 1999. Center for International Development, Harvard University.
- Schraeder, Peter J., Bruce Taylor, and Steven W. Hook, "Clarifying the Foreign Aid Puzzle: A Comparison of American, Japanese, French, and Swedish Aid Flows," *World Politics*, February 1998, 50 (2), 294–323.
- Svensson, Jacob, "Aid, Growth, and Democracy," *Economics and Politics*, 1999, 11 (3), 275–297.
- World Bank, "Global Development Finance 2004," 2004. online version.
- World Bank, "World Development Indicators 2004," 2004. online version.
- World Bank, *Debt Relief for the Poorest. An Evaluation Update of the HIPC Initiative*, 1818 H Street, NW Washington, DC 20433: The World Bank, 2006.

Annex

Table 1: Sample Countries

HIPC		Non-HIPC	
Angola	Madagascar	Afghanistan	Solomon Islands
Benin	Malawi	Albania	Sri Lanka
Burkina Faso	Mali	Armenia	Tajikistan
Burundi	Mauritania	Bangladesh	Timor-Leste
Cameroon	Mozambique	Bhutan	Tonga
Central African Republic	Myanmar	Cambodia	Vanuatu
Chad	Nicaragua	Cape Verde	
Congo	Niger	Comoros	
Congo, Dem Rep.	Rwanda	Djibouti	
Côte d'Ivoire	São Tomé and Príncipe	Eritrea	
Ethiopia	Senegal	Georgia	
The Gambia	Sierra Leone	Haiti	
Ghana	Somalia	Kiribati	
Guinea	Sudan	Kyrgyz Republic	
Guinea-Bissau	Tanzania	Lesotho	
Guyana	Togo	Maldives	
Honduras	Uganda	Moldova	
Kenya	Vietnam	Mongolia	
Lao PDR	Yemen, Rep. of	Nepal	
Liberia	Zambia	Samoa	

Figure 4: Net official development assistance as a percentage of GDP

Figure 6: Official net transfers as a share of GDP

Figure 8: Aggregate net transfers as a share of GDP.