

ASSESSING BOLIVIA'S DEBT RELIEF UNDER THE HEAVILY INDEBTED POOR COUNTRIES' INITIATIVE

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ABSTRACT

This paper examines whether Bolivia has made enough progress in debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, thus taking a sustainable debt path and graduating from debt renegotiations definitely. We find that reaching the completion point at the Enhanced HIPC initiative was a major milestone to provide significant debt relief, far bigger than the one obtained under previous traditional debt renegotiation mechanisms. However, given exogenous—external and domestic—shocks, declining aid trends and optimistic macro-assumptions used in the Enhanced HIPC debt renegotiations, the probability of having Bolivia reversing to unsustainable debt ratios is high. Henceforth, there are four possible reasons for Bolivia to consider adopting further debt proposals. Achieving the Millennium Development Goals would require extra resources; unexpected shocks would justify the creation of a HIPC contingency fund for graduated countries, Bolivia debt sustainability targets might be lower than the standard ones defined by the Enhanced HIPC; and donors aid might be turning to be more selective, concentrated on good performers like Bolivia.

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1. INTRODUCTION

In August 1982, Mexican banks in New York encountered difficulties in meeting their obligations to fully repay maturities in their interbank loans. This announcement set the stage for a major debt crisis in a middle-income country as important as Mexico, whose example disrupted the delicate web of international financial markets, and was rapidly followed by other debtors. Mexico was not the first one. Other low-income countries like Bolivia, had accumulated arrears since 1979, but their small size had left them unnoticed by the media.¹

The ensuing cut-off of the flow of net lending from external creditors to developing countries that followed the Mexican debt moratorium reflected a sharp reversal in the perceived ability of the public sector of these countries to service their debts in market terms. Successful debt renegotiations, however, allowed some middle-income countries most affected by debt to recover from their liquidity problems temporarily; but other middle and low-income countries were not that lucky and turned into severe solvency problems that ultimately led to the Heavily Indebted Poor Countries (HIPC) Initiative in the late nineties.

Two decades later, the international financial system still is in search of a lasting solution to the debt burden problem of poor developing countries. The general outlines of the problem are now well known, especially the resilient features of the debt ratios in low-income economies, and the domestic political constraints they face, which makes its solution an extremely complex challenge.

This article analyses the impact of the HIPC Initiatives and focuses on the particular case of Bolivia. It is important to notice that any comparative analysis must be taken with caution for countries had different initial stocks of debt—measured in present value—and that their distance with respect to the target ratio aimed by HIPC also did a major contribution to the various observed results.

¹ The debt literature actually uses the World Bank classification to distinguish between low-income and middle-income countries. Low-income countries have a per-capita Gross National Product (GNP) at or below US\$755 in 2000; middle-income countries have a per-capita GNP between US\$755 and US\$9,266. The wider range in the second group splits such group into lower middle income ones, with per-capita GNP below US\$2,955, and upper-middle income with a higher per-capita GNP.

2. HISTORICAL BACKGROUND

By any standard, in the last three decades, Bolivia's debt crisis has been as persistent, as remarkable. How did Bolivia become a heavily indebted country? Three important periods can be distinguished: 1975-1981, 1982-1987 and 1988-1995. The first one deals with the analysis of the extent of "odious" original debt-build up that characterized so many poor countries. The second one addresses the domestic and external shocks that led to hyperinflation and its solution. And finally, the third period deals with Bolivia's participation in traditional debt renegotiation schemes.

During the first period, Bolivia's debt problems emerged due to rapid debt accumulation and poor economic performance. Rapid debt accumulation has all the components of "odiousness" (debt that was not truly intended to benefit citizens of poor countries and was acquired by illegitimate governments). Examining Bolivia's historical chronology, it can be stated that political instability was extremely present. Banzer's first administration² prompted external credits that financed not always successful projects in the sectors of natural gas, crude petroleum, as well as generous subsidies to the private sector. Increased foreign borrowing was the formula used for postponing reforms. By the end of the Banzer era in 1978, the fiscal situation had already started to deteriorate, thus reflecting no attempts to raise taxes, multiple credit subsidies and severe overvaluation of the exchange rate. However, GDP growth still reached 3,4 percent of GDP such year. Nobody would have then suspected that it would take almost a decade before Bolivia's economy could have a similar rate of growth again.

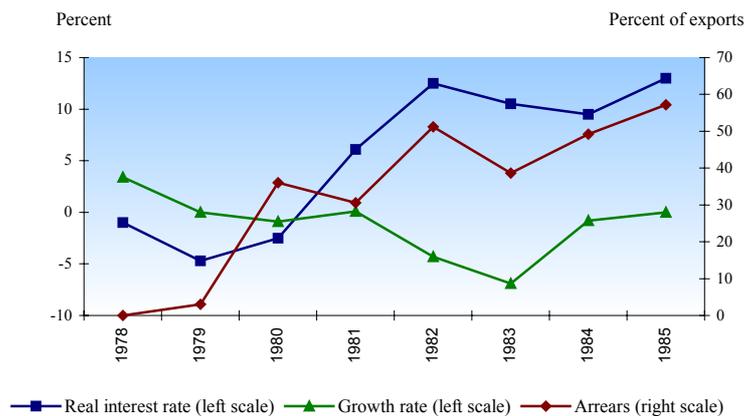
The Banzer regime ended in a coup in 1978, due to the suspicious of a massive fraud in a presidential election, which led to a long period of political instability. When General Garcia Meza became president, the acute underlying economic problems surfaced: severe capital flight led Bolivia to enter into arrears with foreign creditors as early as 1979 and reached their peak in 1980-1981, totalling US\$590 million, an amount equivalent to 10 percent of GDP. Commercial banks stopped all lending in 1980 and negotiated an emergency rescheduling agreement, which was

² While former President Banzer was responsible for the initial rapid rise of Bolivian debt during his first administration (1971-1978), paradoxically it was during his late administration (1999-2002) that Bolivia reached the completion point under the Enhanced HIPC Initiative.

defaulted soon (Morales and Sachs, 1989). To make matters worst, the international economic situation started to severely deteriorate.

In the early eighties, the second important period began. Bolivia suffered from three additional external shocks that led it to enter a prolonged recession: the strong 1981-1982 combined decline (above 20 percent) in its terms of trade due to the fall of world prices of its two main commodity exports (tin and natural gas); the combined rise in world real interest rates by more than 15 percentage points, and the cut-off in lending from the international capital markets, once Mexico's arrears led to the international debt crisis (Figure 2.1).

FIGURE 2.1
BOLIVIA: GROWTH, ARREARS AND INTEREST RATES, 1978-1985



Source: López Talavera (2002)

The extent of Bolivia's crisis was so deep that five governments stepped down in a very short period of time 1979-1982. None of them was in position to raise taxes or enforce economic austerity. By the time President Siles Zuazo came to power in 1982, real GDP was in a sharp downward decline and the price level had risen by 308 percent in the 12 months preceding Siles's accession to power (Morales and Sachs, 1989). Not surprisingly, Agénor (1999) estimates that while the actual primary surplus of Bolivia in 1982 was -6,5 percent, a sustainable one was 8,3

percent. It was clear by then that a substantial fiscal adjustment, not a minor one, was needed at this point to redress this situation.

President Siles was unable to make such adjustment and hyperinflation did not wait long. The fiscal deficit turned to double digits in 1982 and reached 30,6 percent in 1984. In the spring of 1984, the government suspended all debt service payments to the commercial banks and the annual inflation rate reached 1.282 percent, the exchange rate multiplied by 1.000 (from 24,5 pesos per dollar in 1980) and growth remained negative. But this was only the beginning.³ Short of alternatives, forced adjustment took place under hyperinflation.⁴ At its outset, August 1985, the price level had risen by 8.081 percent and the exchange rate to 1.182.300 pesos per dollar (Krugman and Obstfeld, 2000).

The new Bolivian Government of Paz Estenssoro introduced a dramatic Stabilization Plan in late-August 1985. The successful implementation of the stabilization plan, coupled with the new debt-renegotiation strategy, made room for an extraordinary operation: Bolivia's debt buy-back of March 1988 (Sachs, 1990). By that time, Bolivia's inflation rate had turned to a 10-15 percent annual average rate. The Stabilization Plan was a success. The critical element of the success of the Plan was President Paz Estenssoro's decision to face trade unions: they called for a general strike against the Plan, but the sense of national chaos and fatigue of accelerating inflation broke such strike (Morales and Sachs, 1989).

Bolivia's third important period in becoming a Heavily Indebted Poor Country consists of its participation in the so-called "traditional debt relief mechanisms", which include a buy-back operation in 1988 and its early participation in the Paris Club rounds.

Well before President Bush announced the Brady Plan in March 1989, the U.S. Government had already supported an explicit policy of debt reduction: Bolivia's buyback of its commercial debt in March 1988. The rationale for the buyback is simple: debtor banks/countries should take advantage of current low secondary market prices to retire some of their loans/debt. The discounts available on many countries can be significant

³ According to Cagan's classic definition of hyperinflation, it occurs when price increases exceed 50 percent per month. So, Bolivia's hyperinflation officially began in September 1984 and ended in October 1985.

⁴ There are several textbooks that explain hyperinflation in Bolivia: Sachs and Larrain (1993), Krugman and Obstfeld (2000).

and high nominal debts can be repurchased with a much lower amount, financed by a combination of official bilateral and/or multilateral grants, own resources and new borrowing.⁵ Even though the market value benefit of the buyback should not be overstated: a US\$400.000 nominal debt reduction represented a very small fraction (1,2 percent) of the US\$34 million buyback cost (Bulow and Rogoff, 1988). Sachs (1988), however, believes that the strategy was very successful due to additional reasons such as:

- It officially recognized that Bolivia had a non-payable debt.
- Bolivia did not pay interest on the debt to the commercial banks during the entire period of negotiations, which took almost two years.
- Bolivia obtained additional official external financing that it would not have been able to get otherwise.
- The buyback allowed to consolidate Bolivia's Stabilization Plan.

Despite its completion, the buyback only affected less than a quarter of Bolivia's total public debt: the commercial one. In parallel to this effort, Bolivia's arrears with official creditors had been accumulating and their rescheduling was mainly contributing to raise the stock of debt. This prompted the active participation of Bolivia at the Paris Club roundtables.

Before HIPC, Bolivia participated in six additional rounds of the Paris Club. As a first step toward debt reduction, Toronto terms in the Paris Club allowed Bolivia to reduce US\$76 millions for the first time and lengthen the maturity period between 15 and 20 years and the grace period up to 10 years. Then, ensuing Paris Club initiatives increased the percentage of concessionality (reduction of the stock of debt in present value): London terms (January 1992) -50 percent; and Naples terms (March and December 1995) -67 percent. Naples terms lengthened maturity to 23-33 years and the grace period to 6-20 years. The nominal amount of debt consolidated by Bolivia before the Original HIPC, and its subsequent impact on Paris Club terms, was equivalent to US\$2.379 million (for a present value of about US\$1.308 millions) (Daseking and Powell, 1999) (Table 2.1).

TABLE 2.1

⁵ There is considerable debate on whether buybacks at market prices are an efficient way for a debtor country to allocate its resources, including aid from abroad (See Bulow and Rogoff, 1988).

**BOLIVIA: OVERVIEW OF RESCHEDULING OF OFFICIAL BILATERAL DEBT AT THE
PARIS CLUB, 1976-1996**

Number of Rescheduling	Date of Agreement	Amount Consolidated ¹ (In millions of US dollars)	Consolidation Period (In months)	Terms	
				Grace (In years)	Maturity (In years)
I	6/25/86	449,0	12,0	6,0	9,5
II	11/14/88	226,0	15,0	8,2	9,3
III	3/15/90	276,0	24,0	Toronto terms	
IV	1/24/92	65,0	29,0	London terms	
V	3/24/95	482,0	36,0	Naples terms	
VI	12/14/95	881,0	Stock	Naples terms	
VII	NA	NA	NA	Lyon terms	
TOTAL		2.379,0			

Source: Brooks and others (1998).

¹ Includes debt-service formally rescheduled as well as deferred maturities.

Having described the original build-up of the debt, along with the first attempts to alleviate Bolivia's debt burden, it can be stated that they were all insufficient to put Bolivia on a sustainable path. It is clear that not only Bolivia, but also other HIPC's, needed a new mechanism to alleviate their debt burdens.

3. BOLIVIA'S DEBT RELIEF UNDER THE ENHANCED HIPC INITIATIVE

In this section, first we examine Bolivia's performance under both HIPC Initiatives, second we assess the impact of debt relief on poverty reduction; and third, we examine prospects for a sustainable debt ratio.

Among 42 countries, Bolivia was the second HIPC country to qualify for the completion point under the Original Initiative in September 1998 and also the second country to reach the completion point under the Enhanced Initiative in June 2001. These achievements made it eligible for several benefits: eligibility for debt relief of about 50 percent of the net present value (NPV) of the existing external debt, access to concessional assistance and use of debt-service savings to finance poverty reduction programs.

The Enhanced HIPC Initiative aimed for debtor countries not only to get "broader, deeper and faster" debt relief, but also establish an explicit link between debt relief and a poverty reduction goal. To make sure these programs were selected properly and supported by wide national consensus, before the completion point, debtor countries were required to prepare a

Poverty Reduction Strategy Paper (PRSP) and to make substantial efforts in implementing it. The PRSP outlines the reorientation of the country's social expenditure trends and financing needs for the next decade. Bolivia's PRSP was completed in May 2001.

Almost six years later, since the decision point of the Original Initiative, this paper makes a preliminary assessment on whether HIPC mechanisms have succeeded in providing substantial debt reduction and in allowing for a significant increase in social expenditure in Bolivia. Such initial findings lead to two more fundamental questions: under the framework of HIPC, has Bolivia reached the point of no return for exiting the spectrum of an unsustainable debt burden in the medium term? Being part of the group of "good performers," what lessons from Bolivia are relevant for other HIPCs?

This section is structured in three parts. First, the magnitude of debt relief and budgetary savings (dividends) is calculated. Second, the contribution of those savings for Bolivia's poverty reduction programs is approached. Third, the prospects for medium-term debt sustainability, based on the realism of macroeconomic assumptions underlying Bolivia's debt scenarios are considered. In so-doing, we include both a sensitivity analysis that simulated changes to critical variables, like exports growth and GDP growth; and a vulnerability analysis that examines structural constraints, like exports concentration in a few products or the degree of concessionality in external resources. Not surprisingly, despite being significant in the short-term, Bolivia's achievements appear extremely fragile to adverse external and domestic developments in the future. Learning from such strengths and weaknesses, such discussion precedes one of the main topics to be considered in the next section: is HIPC-II well prepared to mitigate exogenous shocks in the medium term that could reverse substantial progress achieved so far in debt reduction, even for successful countries like Bolivia?

3.1. DEBT RELIEF AND BURDEN SHARING UNDER THE HIPC INITIATIVES

External debt relief under both HIPCs was projected to be substantial: under the Original HIPC, sustainable debt levels in NPV terms, defined on a case by case basis, were targeted within the range of 200-250 percent of exports (280 percent of fiscal revenue), and debt-service levels were targeted within the 20-25 percent of exports. Under the Enhanced HIPC, the first ratio was significantly lowered to 150 percent of exports and 250 percent of fiscal revenue. Debt-service was also lowered to 15-20 percent of exports. World Bank authorities were upbeat about their expectations on potential savings from the Enhanced HIPC: "Overall, with combined relief from traditional mechanisms and new bilateral commitments, the outstanding debt in these countries will be cut by about two-thirds and savings in debt-service will be cut by about one-third" (Van Trotsenburg, 2001). In this section, we concentrate on three aspects of relief: debt-stock reduction, debt-service relief, and finally, debt-service dividend. We will go through each one of them, questioning Bolivia's accomplishments under the HIPC Initiatives.

DEBT-REDUCTION. High expectations have been met by Bolivia's actual achievements. External debt reduction under the Original HIPC framework amounted to US\$448 million in NPV terms at end-1998; and the cumulative nominal debt-service relief was US\$760 million. In the context of the Paris Club meeting of October 1998, Japan granted additional relief of US\$371 million in NPV terms through a reduction in interest rates and a pledge to cover with grants a high share of its debt-service obligations. This brought Bolivia's end-1998 NPV debt-to-exports ratio down from 273,7 percent to 212,7 percent. Additional external debt reduction under the Enhanced HIPC amounted to US\$854 million in 2000-NPV terms, with a cumulative nominal debt-service relief of US\$1.302 million. Additional bilateral debt relief to HIPC assistance granted by some Paris Club creditors at the enhanced completion point for a total of US\$345,4 million was projected to bring Bolivia's NPV debt-to-exports ratio further down from 197 percent to 114 percent by end-2001.⁶ Burden sharing among creditors indicates a relatively higher role played by multilaterals in Bolivia's case than in the rest of HIPCs, or in the case of Latin American HIPCs considered as a group. Table 3.1 allows to estimate that multilaterals accounted for about two-thirds of the stock of Bolivia's debt reduction, a higher figure than the

⁶ Updated figures show that the debt-to-exports ratio only decreased to 131 percent in 2001 (IDA/IMF 2002b).

52 percent of all HIPC's as a group, the 61 percent of Guyana and Honduras, and much above the 34 percent of Nicaragua.

TABLE 3.1
ESTIMATED HIPC RELIEF COST FOR INDIVIDUAL HIPCS BY CREDITOR GROUP,
STATUS AS OF APRIL 2002¹

	Grand Total (26 countries)	Bolivia	Guyana	Honduras	Nicaragua
<i>(In millions of US dollars, in 2001 NPV terms)</i>					
Total	25.943	1.438	636	589	3.463
Bilateral	12.236	472	239	228	2.273
<i>Of which:</i>					
Paris Club	8.738	444	191	179	923
Non-Paris Club	2.888	21	27	47	1.307
Commercial	611	7	21	3	44
Multilateral	13.709	968	397	361	1.190
<i>Of which:</i>					
World Bank	6.502	213	74	104	201
IMF	2.112	93	81	32	86
AfDB/AfDF	1.807	0	0	0	0
IaDB	1.194	516	126	142	410
Others	2.094	146	117	83	493

Source: IDA/IMF (2002c)

¹ Data are expressed in 2001 NPV completion point terms, which might show minor differences with respect to other tables. For example, for Bolivia, HIPC relief under the original framework is US\$448 million in 1998 NPV terms, or US\$534 million in 2001 NPV terms; while enhanced HIPC relief is US\$854 million assessed at the decision point (2000 NPV terms) and US\$905 million in 2001 NPV terms. This lead to a total, at the decision point, of \$1.302 million in 1998 NPV terms and a total of US\$1.438 million in 2001 NPV terms in this table.

FIGURES 3.1-3.2
ENHANCED HIPC INITIATIVE DEBT REDUCTION FOR 24 DECISION POINT COUNTRIES,
STATUS AS OF DECEMBER 2001

Figure 3.1. The NPV Trend of the 24 Countries that Reached their Decision Point and Bolivia

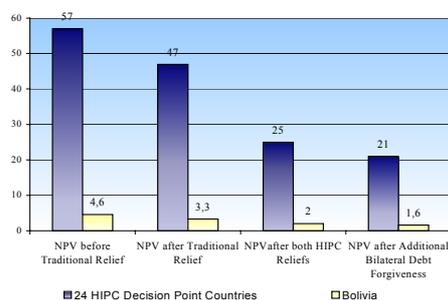
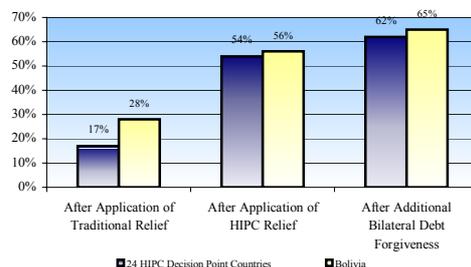


Figure 3.2. Cumulative Reduction of the NPV of the 24 Countries that Reached their Decision Point and Bolivia

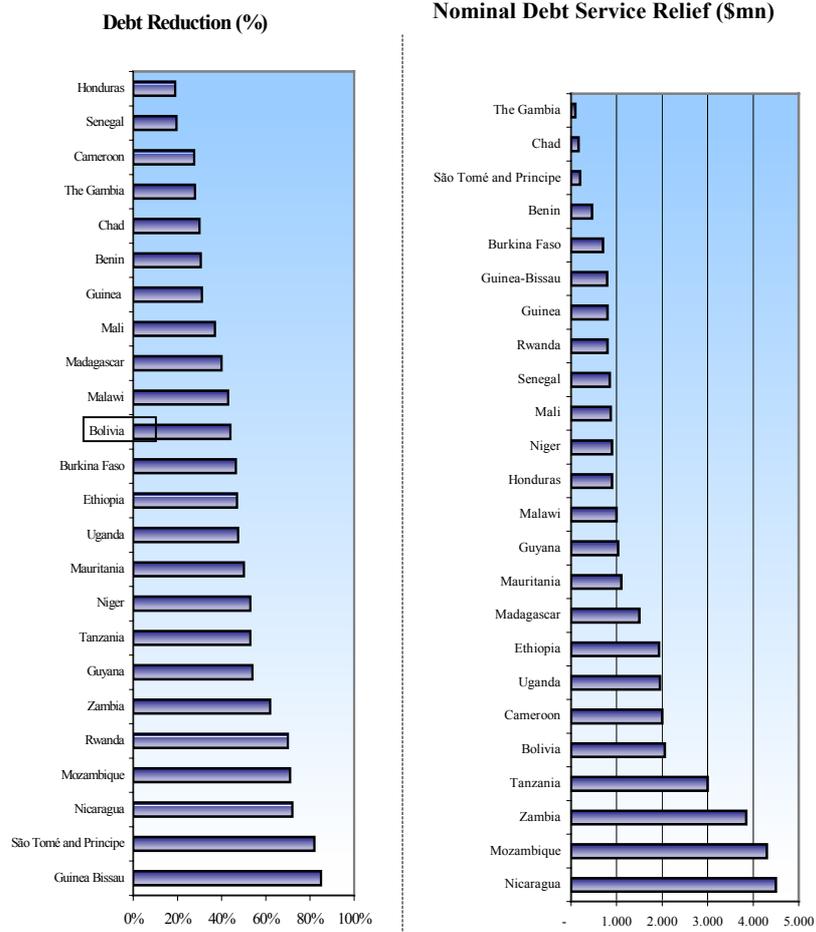


Sources: The World Bank (2002), IDA/IMF (2001a), Daseking and Powell (1999)

How does Bolivia compare to HIPC's overall debt reduction? Figure 3.1 shows a significant reduction in the stock of external debt under the Enhanced HIPC for 24 decision point countries, and Bolivia in particular, and compares them with debt reduction obtained after traditional mechanisms. In NPV terms, the total impact of both HIPC Initiatives on the stock of debt for Bolivia is quite close to its benchmark: a reduction of about 50 percent (including additional bilateral debt forgiveness), from US\$3,3 billion to US\$1,6 billion.⁷ This compares well with respect to the estimated impact of US\$1,3 billion obtained by Bolivia in prior traditional debt relief mechanisms, but is lower than the about two-thirds (63 percent) average debt reduction for all HIPC's combined.

⁷ Such amount is equivalent to US\$3,4 billion in nominal external debt.

FIGURE 3.3
ENHANCED HIPC INITIATIVE COMPARATIVE, STATUS AS OF JANUARY 2002



Source: The World Bank (2002)

Note: Debt reduction is measured by the common reduction factor. This refers to the percentage by which each creditor needs to reduce its debt stock at the decision point so as to enable the country to reach its debt sustainability target. The calculation is based in NPV information. For Bolivia, Burkina Faso, Guyana, Mali, Mozambique and Uganda assistance under the original and enhanced frameworks are combined.

In Figure 3.3, another perspective can be observed and it confirms that Bolivia obtained a rather average percentage of debt reduction among HIPCs. Countries like Nicaragua, Mozambique or Guinea-Bissau did much better by obtaining debt reduction above 70 percent. This finding deserves, however, an observation: as Bolivia did better than most of the rest of HIPCs under traditional mechanisms, its cumulative debt reduced from all renegotiation mechanisms considered, added up to 65 percent of its original debt, a value slightly above 62 percent for all HIPCs considered as of December 2001 (Figure 3.2). So, in less than two decades, Bolivia has phased out about two-thirds of its original external debt burden.

DEBT-SERVICE RELIEF. How these debt-stock reductions translated into annual debt-service relief and budgetary savings (also called debt dividends)? In principle, debt reduction was expected to imply a fall of about one-third in debt-service levels. As a percentage of exports, Bolivia's scheduled debt-service payments have fallen on target: from 24 percent in 1998-1999 (estimated before HIPC relief) to 17 percent in 2001-2003 (Table 3.2). This amount of debt relief, however, is below what HIPCs as a group, and the four Latin America HIPCs (including Bolivia), have actually obtained: a fall equivalent to about 50 percent.

TABLE 3.2
MEASURES OF DEBT-SERVICE SAVINGS FOR THE 24 COUNTRIES THAT
REACHED DECISION POINTS¹

	Bolivia	Latin America (4 Countries)	Total (24 Countries)
Debt-service Indicators			
(In percent)			
Debt-service relative to Exports			
Before HIPC Relief (1998-1999)	24%	16,2%	15,8%
After HIPC Relief (2001-2003)	17%	8,5%	8,2%
Debt-service relative to GDP			
Before HIPC Relief (1998-1999)	4,0%	5,1%	3,5%
After HIPC Relief (2001-2003)	3,3%	3,0%	2,0%
Debt-service relative to Revenue			
Before HIPC Relief (1998-1999) ²	16,5%	22,5%	22,3%
After HIPC Relief (2001-2003)	14,3%	12,4%	11,4%
Debt-service Levels			
(In billions of US dollars)			
Debt-service paid. 1998-1999	0,3	0,8	2,9
Debt-service due before HIPC relief. 2001-2003	0,4	1,1	3,8
Debt-service to be paid after HIPC relief. 2001-2003	0,3	0,6	2,0

Sources: The World Bank (2002) and IDA/IMF (2002c).

¹ Average annual data

² Based on countries for which data is available for 1998.

Table 3.3, depicts debt-service trends in absolute amounts. Results confirm that when compared to 1994-1998 levels for pre-HIPCs, Bolivia has a similar trend: Bolivia's scheduled service payments will fall by 32,8% (US\$136 millions) over the next five years (2001-2005) and 27,8% (US\$115 millions) over the next 15 years (2001-2015). On average, HIPC countries will have a much larger decline of 65,3% (US\$111 millions) over the next five years and 58,5% (US\$99.5 millions) over the next 15 years. Perhaps more important than the comparative analysis in this case, is that scheduled debt-service, as a percentage of debt revenue is expected to fall from a projected average above 20 percent before HIPC for 2001-2003 to below 15 percent after HIPC.

TABLE 3.3
DEBT INDICATORS FOR POST-DECISION-POINT HIPCs

	Bolivia ¹	Guyana	Honduras	Nicaragua	Average
Debt-service (US\$ millions/year)					
1994-1998	345,80 ³	116,00	512,10	258,00	170,20
2001-2005	238,36	41,20	224,90	141,30	99,40
2001-2015	357,13	51,10	343,3	140,80	102,80
Debt relief under HIPC (US\$ millions/year)					
2001-2005	136,00 ²	60,20	165,80	193,00	111,20
2001-2015	115,27 ²	48,20	78,00	194,20	99,50
Debt relief under HIPC/GDP (%)					
2001-2005	1,41	6,99	2,49	7,20	2,90
2001-2015	0,82	4,77	1,11	5,79	2,20
Debt dividend (US\$ millions/year)					
2001-2005	177,10	74,80	287,20	116,70	70,80
2001-2015	57,97	64,90	168,80	117,20	67,40
Dividend/gross flows of debt relief (%)					
2001-2005	130,22 ²	124,20	173,20	60,40	63,70
2001-2015	50,29 ²	134,70	216,60	60,40	67,80
Debt dividend/GDP					
2001-2005	1,8	8,7	4,5	4,3	2,0
2001-2015	0,4	6,2	2,3	3,4	1,4

Sources: Serieux (2001) and IDA/IMF (2001a)

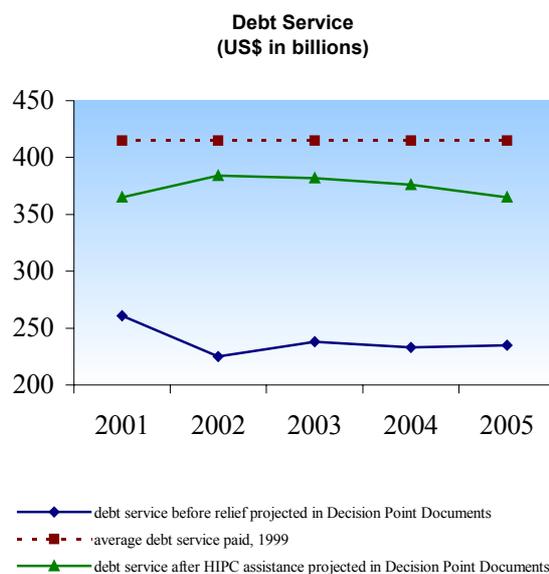
Note: Notice that the data for 1994-1998 corresponds to actual debt-service paid as average per year.

¹ Done with data at the completion point of the enhanced HIPC Initiative and does not include additional bilateral debt relief beyond HIPC.

² Debt-service relief does not include an additional amount obtained from bilaterals after attaining the enhanced completion point.

³ Data obtained from Central Bank of Bolivia.

FIGURE 3.4
ENHANCED HIPC DEBT RELIEF FOR BOLIVIA



Source: Central Bank of Bolivia (2002).

DEBT-SERVICE DIVIDEND. When a country has arrears, changes in the stock of debt and in ensuing future debt-service requirements (relief) do not necessarily translate into budgetary savings (dividends) for the debtor country. To estimate debt dividends, a simple assumption about scheduled debt-service is needed. This is to compare scheduled debt-service to its past annual average, for instance, for 1994-1998. Such an assumption is not unrealistic. In fact, before HIPC Initiatives, many poor debtors countries in arrears were paying approximately the same nominal amount in debt-service payments, which made appear their past debt-service levels flat over several past years (Serieux, 2001). Consequently, to estimate the debt dividend, it can be assumed that the average debt-service level of US\$345,8 millions for 1994-1998 will remain constant through the 2001-2015 period. This assumption is rather a conservative one, since scheduled (and effectively paid) debt-service levels for Bolivia kept increasing during 1994-1998.

The estimated budgetary savings (debt dividend) after debt relief are higher than actual debt-relief amounts for Bolivia during the initial period of 2001-2005. They are estimated by subtracting pre-HIPC annual debt-service obligations from average debt-service payments over the period 1994-1998. Debt relief is the differential between debt service pre- and post-HIPC. This result means that the average budgetary cut in annual debt-service repayments, US\$177 million for 2001-2005, will be higher than the average debt-service relief per year, US\$136 million, during the first five years of the Enhanced HIPC Initiative (and specially during the first three years) (Figure 3.4). Obviously, this is partly a result of the higher average debt service in 1994-1998 than the projected one, and partly an outcome of the heavily front-loaded nature of HIPC assistance in the case of Bolivia. However, it is not long-lasting: over 2001-2015, the average annual debt dividend, US\$57,97 millions, will decrease up to half the amount of debt relief, US\$115,27 millions (Table 3.3). Hence, even though Bolivia will get relatively a lower debt-service relief than the average amount obtained by all HIPCs considered as a group, its initial debt dividend/relief ratio will allow it to have relatively early and substantial budgetary savings, but only during the first years of the Enhanced Initiative.

Nevertheless, the importance of debt relief and debt dividend for Bolivia should not be overestimated. When compared to past aid flows, with an average of US\$91 million per-capita in 1994-1998, debt relief represents a modest fraction of those aid flows (Serieux, 2001). Assuming that Bolivia receives at least a similar average level of aid flows in the future, debt relief under HIPC would represent an average of 1.4 percent of GDP in 2001-2005 and 0,8 percent of GDP during 2001-2015 (Table 3.3). These would be equivalent to a modest 17 and 13 percent of total aid flows expected to be received by Bolivia. Furthermore, if budgetary savings are projected to be about half the amount of debt relief over the whole 2001-2015 period, then it is clear that the budgetary impact of HIPC becomes marginal over the medium term, and could easily be cancelled down by a 0,4 percent of GDP (about US\$36 millions in 2001 GDP terms) reduction in aid flows (on average) over the entire period.

In sum, in this section we analyzed the magnitude of debt-stock reduction, debt-service relief and budgetary savings (debt-service dividends) for Bolivia. To do so, we examined three important aspects. In what concerns debt reduction, it is significantly bigger than what Bolivia obtained thanks to

traditional debt relief, and brings the debt-to-exports ratio below the critical value of 150 percent, at least temporarily. Debt-service has also diminished below the critical threshold of 20 percent of exports and is projected to remain so, at least up to 2003. Finally, debt-service (budgetary) savings are significant, but only up to 2003 due to the front-loaded feature of the Initiative. So, in the short-term, Bolivia is having some breathing space in the actual payment of its debt service.

3.2 DEBT SAVINGS AND POVERTY REDUCTION

Poverty reduction is one of the major challenges of the HIPC Initiative and debt relief and savings were aimed to contribute to it. This section studies Bolivia's case. The PRSP set an ambitious medium-term agenda for allowing Bolivia to meet the Millennium Development Goals (IDA/IMF, 2001b). Its main 2000-2015 targets are:⁸

- a reduction in the incidence of poverty from 63 to 41 percent, and extreme poverty from 36 to 17 percent;
- an increase in life expectancy from 62 to 69 years;
- a reduction in infant mortality from 67 to 40 per 1.000 and of maternal mortality from 390 per 100.000 to 200; and
- significant increases in the rates of school attendance and completion.

The strategy itself, however, recognizes several limitations. Among these, perhaps the two most important ones are its high dependence on GDP growth and the weak link between policy inputs and final targets (IDA/IMF, 2001b).

GDP growth is recognized as the critical variable in attaining lower poverty targets. In fact, a sensitivity analysis in the PRSP indicates that if economic growth becomes lower than expected, poverty reduction would be slower. For instance, with an average GDP growth of 4 percent (instead of 5,3 percent), poverty would be reduced only to 50 percent by 2015 (instead of 41 percent).⁹

⁸ For a more general description of the Millennium Development Goals see www.developmentgoals.org

⁹ The outlook for debt sustainability in the medium term is in the next section (3.3).

Perhaps more important from the perspective of the intended impact of debt relief, it is the fact that the strategy recognizes that there is no close link between policy actions and final outcomes. As a result, there is no clear correlation, not only between public resources and final targets (i.e. those needed to generate the benchmark rate of poverty reduction), but also more specifically between savings from debt relief and their direct outcomes. "As is the case in many countries, the information base of Bolivia does not permit an explicit link between budgetary allocation, priority actions and possible impact on indicators...in some cases, the chosen indicator does not seem to match well with the priority action identified in the strategy...and the classification of expenditure does not cover all categories of pro-poor spending" (IDA/IMF, 2001b).

Given the modest medium-term budgetary impact of the debt dividend and possibly declining trend of official assistance flows for Bolivia, a financing gap might develop between required and available resources for financing the poverty reduction strategy, even after the debt dividend is accounted for.

There are two broad estimates of the financing gap; one is developed by Andersen and Nina (2000), and the other by the PRSP. Andersen and Nina (2000) estimate an annual financing gap of US\$109 millions. It develops its estimates based on preliminary municipal development plans that accompanied the preparation of the country's PRSP.¹⁰ The costing of these plans projects an annual financing requirement of US\$636 million. Traditional budgetary resources (transfers and local income generated by municipalities) will only cover 47 percent of these costs. Debt relief is expected to cover an additional 25 percent. Taking into consideration an additional 11 percent of the costs to be financed from the windfall of gas exports, this leaves an additional 17 percent of the poverty reduction budget to be financed by other unidentified sources.

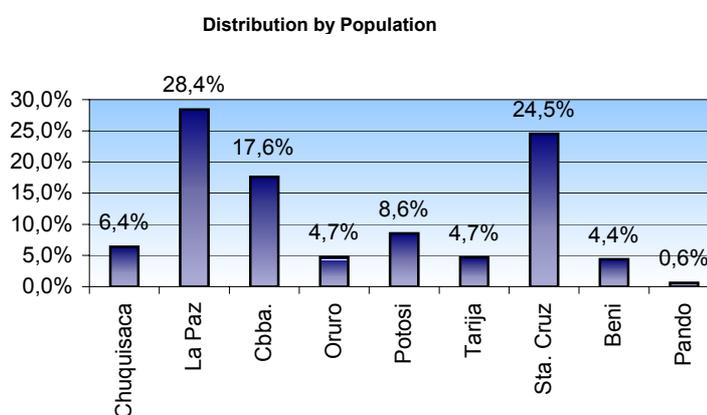
More comprehensive estimates contained in the PRSP indicate a revised annual financing gap slightly higher: US\$148 millions (a cumulative US\$889 over 2001-2006) (IDA/IMF 2001b). Perhaps recognizing realistically that filling such financial gap will be difficult, the PRSP proposes several measures: to reduce projected domestic budgetary funds in order to achieve the execution of available resources; to increase tax collections; to redirect existing spending toward poverty programs; to invite

¹⁰ A major decision for Bolivia was to implement its poverty programs in a decentralized way, i.e. through municipal governments.

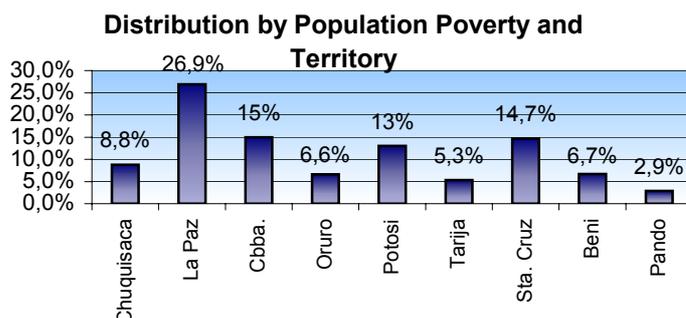
the private sector to participate in concessions, so as to generate some non-tax revenues; and to look for further concessionary external credits.

Another important problem to solve by the PRSP was to define the criteria for distributing resources by municipalities. Pre-HIPC Popular Participation Funds developed under the decentralization strategy of Bolivia distributed funds according to population size; but debt relief under the PRSP added poverty levels and territory extension as new criteria for distribution of resources by municipalities. The difference between the two approaches is illustrated in Figure 3.5, which shows a hypothetical percentage distribution among the nine departments of Bolivia under the two alternatives approaches. The proposed redistributions involve large differences for Santa Cruz, Cochabamba and Chuquisaca, and certainly raise the share obtained by the poorer departments under the PRSP mechanism.

FIGURE 3.5
BOLIVIA: THE PERCENTAGE DISTRIBUTION OF DEBT RELIEF UNDER DIFFERENT ASSUMPTIONS



Source: Censo Nacional (Nov. 2001)



Source: Censo Nacional (Nov. 2001)

Perhaps the biggest long lasting impact of the HIPC Initiatives on poverty reduction policies was their desired increase in social expenditure of poor countries (Table 3.5). For more than a decade, unsustainable debt levels have long frustrated the capacity of governments to make required increases in social investment. HIPC Initiatives have contributed to reverse such trend since the end of the nineties, as well as those of other social indicators. Broadly speaking, on average, HIPCs are expected to boost social expenditure, as a percentage of GDP, from 6 percent in 1999 to 10 percent in 2003. For their part, Latin American HIPCs, taken as a group, are projected to have a lower relative increase, from 11 percent to 13 percent; and so does Bolivia (Table 3.4).

TABLE 3.4
SOCIAL EXPENDITURE BY THE 26 HIPCS THAT REACHED DECISION POINTS

	1999	2000	2001	2002	2003	2004	2005
Social expenditure¹ (In millions of US dollars)							
Bolivia	882	921	918	956	1.086	...	...
Latin American HIPCs	1.800	1.971	2.152	2.191	2.466	1.519	1.637
Total HIPCs	5.330	5.930	6.898	7.637	8.178	7.902	7.326
Ratio of social expenditure to government revenue² (In percent)							
Bolivia	45	48	52	52	55	...	...
Latin American HIPCs	48	52	58	57	59	65	65
Total HIPCs	37	43	47	53	59	60	56
Ratio of social expenditure to GDP							
Bolivia	11	11	11	12	13	...	...
Latin American HIPCs	11	11	12	12	13	14	14
Total HIPCs	6	7	8	9	10	10	9

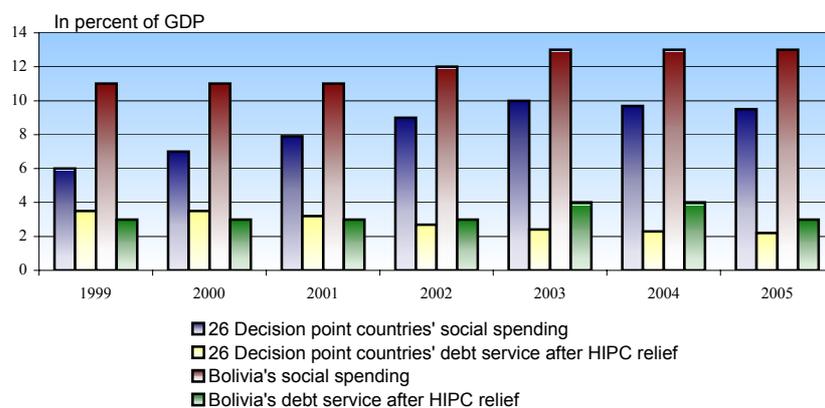
Source: IDA/IMF (2002c)

¹ Data is not available for all countries, particularly in 2004 and 2005. For this reason, social spending may appear to be declining in those years.

² Weighted averages account for unavailable data

Whereas most HIPC countries will finance their increase in social spending from debt-service relief (reflected in a lower debt-service), this will not be the case for Bolivia due to higher than anticipated debt-service arising from new borrowing in 2001.¹¹ In Figure 3.6 it can be observed that debt-service, as a percentage of GDP, will broadly remain constant in 1999-2002, but social spending will increase up to 2003 and then remain constant. This is in contrast to HIPC countries, considered as a group, whose gradually lower debt-service flows will make room to finance an increased social spending during the same period. Bolivia's projected ratios, rather conservative, indicate that the observed financial gap does not allow it to be more ambitious in setting increased social spending flows. Obviously, more aid will be needed.

FIGURE 3.6
SOCIAL SPENDING AND DEBT-SERVICE DUE AFTER HIPC RELIEF FOR
26 DECISION POINT COUNTRIES¹



Source: IDA/IMF (2002c)

¹ Weighted averages.

Note: For Bolivia, social spending includes: education, health, basic sanitation, and urban and rural development.

Debt-service is higher than anticipated at the decision point due to higher new borrowing than previously projected.

¹¹ To close the fiscal deficit in 2001, Bolivia had access to expensive financing from a regional bank, which explains the higher than projected debt-service levels at the decision point.

According to World Bank officials (Van Trotsenburg, 2001), two-thirds of increased HIPC social spending should go to education and health. Other priority areas include rural development, water supply, HIV-AIDS, road construction, and governance and institution building. In the case of Bolivia, as an average of GDP, non-university education spending will increase from 4,7 percent in 1999 to 5,3 percent in 2003; while health spending will increase from 3 percent to 3,5 percent in the same period. Then, the combined differential amount adds to 1,1 percent of GDP, roughly half the projected increase in social spending and below the two-thirds above mentioned target (Table 3.5).¹² Whereas there is nothing implicitly wrong with such redistribution, as this is decided on a country case-by-case basis, it also suggests that the impact of PRSP resources devoted to education and health outcomes could be lower than projected for all HIPCs.

TABLE 3.5
BOLIVIA: ESTIMATED POVERTY-RELATED EXPENDITURE AT THE COMPLETION POINT

	1995	1996	1997	1998	1999	Prel.	Projections		
						2000	2001	2002	2003
<i>(In millions of bolivianos)</i>									
Current expenditure	1.820	2.212	2.537	2.933	3.027	3.282	3.576	4.153	4.571
Health ¹	692	872	1.000	1.172	1.192	1.298	1.418	1.652	1.825
Education (excluding university level) ¹	1.128	1.340	1.537	1.752	1.828	1.975	2.149	2.491	2.735
<i>Of which:</i>									
primary education									
wages	...	906	974	1.050	1.187	...	...	...	...
Other social expenditure ²	...	...	...	9	7	9	9	10	11
Capital expenditure	1.119	1.474	1.628	1.892	2.125	2.458	2.767	3.256	3.572
Health	126	160	174	192	241	380	428	503	553
Education	179	325	405	353	446	521	687	831	911
Basic sanitation	222	430	423	454	577	568	437	492	540
Urban development	367	310	307	350	283	309	425	464	508
Rural development	225	249	319	543	578	680	790	966	1.060
<i>Of which: rural</i>									
roads	58	100	123	183	266	269	275	361	399

¹² Table 3.5 reflects that Bolivia's PRSP gives a high priority to rural development spending, whose increased spending is almost similar to the one of education; and a low priority to basic sanitation, whose decreased spending is also substantial.

Adjustment for revised HIPC projections ³	...	...	...	...	...	...	57	196	186
Total poverty-related expenditure	2.939	3.686	4.165	4.825	5.152	5.740	6.400	7.605	8.329
<i>(In percent of total expenditure)</i>	32,9	35,5	35,6	34,7	36,5	37,8	38,3	42,5	43,6
	<i>(In percent of GDP)</i>								
Current expenditure	5,6	5,9	6,1	6,2	6,2	6,3	6,3	6,7	6,7
Health ¹	2,1	2,3	2,4	2,5	2,5	2,5	2,5	2,7	2,7
Education (excluding university level) ¹	3,5	3,6	3,7	3,7	3,8	3,8	3,8	4,0	4,0
Of which: primary education wages	...	2,4	2,3	2,2	2,4	...	...	...	...
Other social expenditure ²	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Capital expenditure	3,5	3,9	3,9	4,0	4,4	4,7	4,9	5,2	5,2
Health	0,4	0,4	0,4	0,4	0,5	0,7	0,8	0,8	0,8
Education	0,6	0,9	1,0	0,8	0,9	1,0	1,2	1,3	1,3
Basic sanitation	0,7	1,1	1,0	1,0	1,2	1,1	0,8	0,8	0,8
Urban development	1,1	0,8	0,7	0,7	0,6	0,6	0,7	0,7	0,7
Rural development	0,7	0,7	0,8	1,2	1,2	1,3	1,4	1,6	1,6
Of which: rural roads	0,2	0,3	0,3	0,4	0,5	0,5	0,5	0,6	0,6
Adjustment for revised HIPC projections ³	...	...	...	...	...	...	0,1	0,3	0,3
Total poverty-related expenditure	9,1	9,8	10,0	10,3	10,6	10,9	11,2	12,2	12,2
Memorandum items:									
Baseline poverty-related expenditures ⁴	9,1	9,8	10,0	10,3	10,6	10,9	10,7	11,0	11,1
HIPC assistance	...	...	...	0,3	1,0	0,9	1,2	1,8	1,5
Of which: under the enhanced framework	...	...	...	...	...	...	0,5	1,2	1,1
Total social expenditure ⁵	8,5	9,6	9,9	9,6	10,4	10,6	10,5	11,1	11,2
Current	6,9	7,2	7,4	7,4	7,8	7,8	7,8	8,2	8,2
Capital	1,6	2,4	2,4	2,1	2,6	2,8	2,7	2,9	2,9
General government expenditure (millions of bolivianos)	8.925	10.383	11.686	13.905	14.117	15.174	16.697	17.907	19.094
Total social expenditure (In millions of bolivianos) ⁵	2.747	3.602	4.102	4.495	5.033	5.561	6.002	6.927	7.609

Source: IDA/IMF (2001a)

¹ Does not include spending on health and education by the ministries of defense.² Social spending by prefectures.³ Reflect revisions to projections of enhanced HIPC assistance since the publication of the PRSP. The upward revision is expected to result in a commensurate increase in poverty-related spending.⁴ Bank/Fund staff estimated series equal to the authorities' actual and projected poverty-related expenditure less enhanced HIPC assistance.⁵ Health and education expenditures, including universities, and basic sanitation expenditures.

As seen in this section, Bolivia is making slow progress in raising its social

expenditure, and thus making mild efforts to meet the MDGs. In the future, however, more aid is required to finance a likely fiscal gap, given presently scarce fiscal resources, a limited debt dividend and declining trends of official assistance.

3.3 THE OUTLOOK FOR DEBT SUSTAINABILITY IN THE MEDIUM TERM

The Enhanced HIPC Initiative defines a sustainable debt level as a ratio of debt-to-exports of 150% or less (or alternatively, a debt to fiscal revenue ratio of 250% or less). Based on 15-20 year forecasts of exports and GDP growth, countries are not only expected to stay below the sustainability threshold, but to experience decreasing ratios in the future. If original forecasts materialized, an average annual rate of GDP growth of 5,4 percent and an average annual rate of exports growth above 7,9 percent, the average debt-to-export ratio of HIPC countries that reached the decision point by the end of 2000 will be 95% in 2015 (IDA/IMF 2001c). This section takes a look at Bolivia's prospects for medium-term debt-sustainability, based on IMF and World Bank's projections.

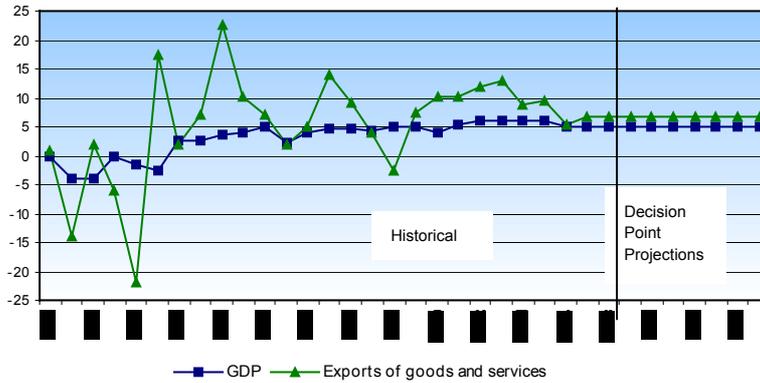
Bolivia's originally projected scenario was different: assuming an average annual rate of GDP growth of 5,3 percent and an average annual rate of exports growth of 7,9 percent, its average debt-to-export ratio was projected to fall to 150% in 2005, but then rather gradually *increase* to 159% in 2015 (IDA/IMF, 2001a).¹³ So, at the enhanced decision point, even assuming rather high GDP and exports trends, Bolivia recognized it was not going to be able to maintain sustainable debt ratios.

Were these macroeconomic assumptions too optimistic for Bolivia? When we compare these values to their historical patterns in the last two decades, the answer is positive. GDP growth averaged -0,9% in the eighties and 4,2% in the nineties, well below its assumed value for the HIPC Initiative. Exports growth averaged -1,6% in the eighties and 7,9% in the nineties. Only, the latter number is similar to what is assumed by the HIPC medium-term scenario (Figure 3.7). Perhaps more important than having these estimates much above their historical averages is that it is highly unrealistic to assume Bolivia could sustain such rates over 15 years. Indeed, both variables show high variability during the past two

¹³ Only after taking into account additional debt reduction, after it reached its enhanced completion point, Bolivia lowered its debt-to export ratio to 142 in 2002 and it was expected to continue decreasing to 137 by 2010 (See IDA/IMF 2002b).

decades, which in part reflect domestic and external shocks, as well as structural features of its economy. Before turning to discuss these problems in the sensitivity and vulnerability analysis that was part of HIPC documents, we examine how most recent updates of critical macro variables already show a high dispersion from their original values; not only for Bolivia but for HIPCs in general.

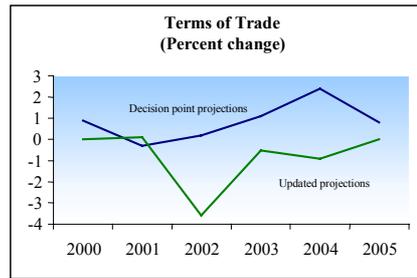
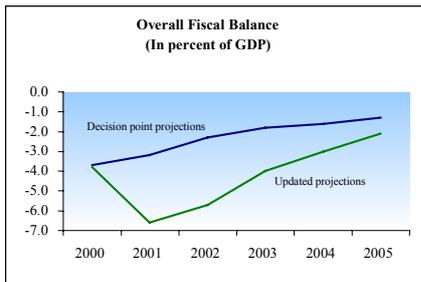
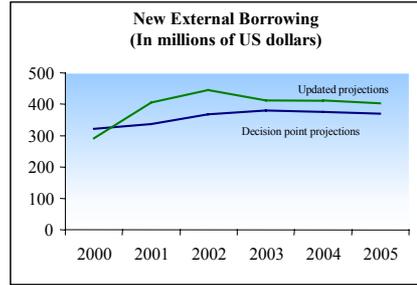
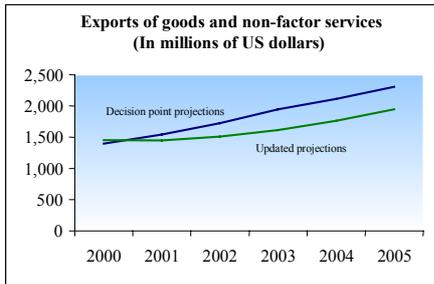
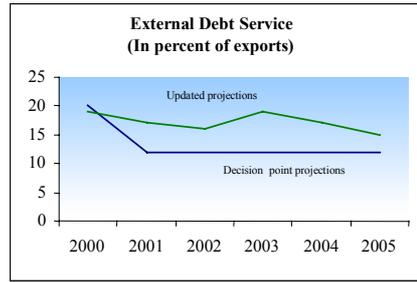
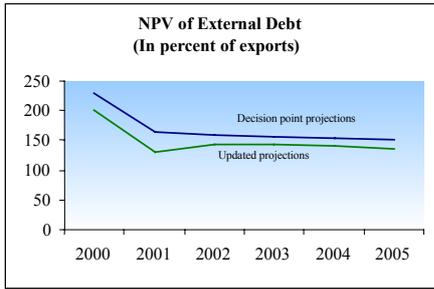
FIGURE 3.7
BOLIVIA: HISTORICAL AND PROJECTED ANNUAL GROWTH RATES, 1982-2015



Sources: IDA/IMF (2002b) and own estimates based on data from the Central Bank of Bolivia (for 1982-1999)

Box 3.1 reflects the updated forecasts that the IMF and the World Bank have made of their own critical variables for HIPCs, including Bolivia (IDA/IMF 2002b). They confirm not only the optimistic tone that dominated such HIPC projections but interesting additional results can be deduced.

**BOX 3.1
BOLIVIA: EXTERNAL DEBT SUSTAINABILITY OUTLOOK**



Source: IDA/IMF (2002b)

- *GDP growth.* The updated scenario surprisingly preserves very high rates of growth for all HIPCs as a group, except for the most recent period 2000-2002, where rates are below their original forecast! For its part, Bolivia's GDP growth was flat in 2000 and 2001, and is projected to be below 3 percent in 2002. Updated forecasts up to 2010 have already cut Bolivia's growth to an average 4,3 percent. Such a lower rate of growth in the case of Bolivia will have not only an impact on its debt sustainability, but also on its progress on poverty reduction as explained above.
- *Exports growth.* The updated scenario for all HIPCs also turns more optimistic after 2004, with several double digits rates until end-decade! These rates, however, do not fully offset the lower levels than expected exports that the HIPCs as a group have observed in 2000-2002. As a result, in nominal terms, exports are adjusted downward under the updated scenario for all HIPCs. In the case of Bolivia, forecasts are more conservative than in the original scenario, perhaps as a result of the negative growth reached by exports in 2001. As a result, in absolute numbers, total exports projections have also been revised downward when compared to those of the decision point.
- *Terms of trade.* Contrary to the most recent declining trends, terms of trade for all HIPCs are projected to have a slight improvement from 2003 onwards. The index of Bolivia's terms of trade, however, remains neutral after 2002, a relatively minor expected deterioration over the positive rates projected for 2002-2005 in the decision point.
- *Debt-to-exports ratio.* Lower exports mean a higher than originally projected debt-to-export ratio, and this is precisely what this updated ratio features for all HIPCs as a group. Despite this adjustment, this ratio is expected to be cut by more than half between 2001 and 2010. In contrast to this, the more dynamic export performance expected from Bolivia, leads to its projected ratio to fall and remain inside a rather narrow 130-140 percent range in 2004-2010.
- *Debt service-to-exports ratio.* No major changes are expected in the updated forecast for HIPCs debt-service as a group, except for a minor increase. In the case of Bolivia, though, previous decision point forecasts have been updated favorably by reducing projected

debt-service ratios by about one third in average throughout all decade. This is a direct result of the additional relief obtained after the completion point of the enhanced HIPC Initiative.

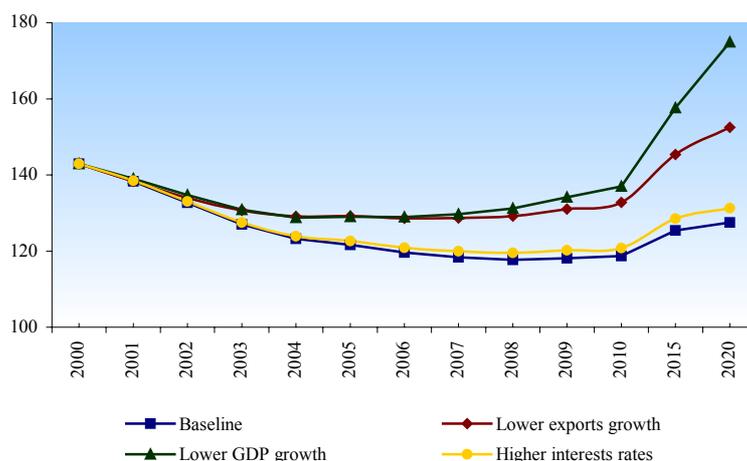
- *Net external resource flows.* Lower exports will also mean a higher external financing gap for HIPC's, and a need for higher resource inflows, which would logically result in higher external debt. This is true for Bolivia. Updated forecasts indicating lower amount of exports than projected at the decision point now will require higher amounts of net resource flows and external borrowing, hopefully in concessional terms. Such an increased dependence on additional borrowing makes Bolivia heavily dependent on the flows of external aid, both from multilaterals and bilaterals. For their part, bilateral flows were on a declining trend through most of the 1990s.

Above, we argued that Bolivia's external debt sustainability outlook has improved in the short term due to the front-loaded relief obtained during and after the HIPC enhanced decision point, but there is considerable uncertainty about the long lasting effects of such relief. Both, the stock of debt and debt-service trends have gone well below HIPC thresholds, falling much farther than in the case of the rest of HIPC's. Too much optimism in the macroeconomic projections of critical variables has been demonstrated by a recent update. Growth rates, terms of trade, and export growth, have all been officially revised downward. In consistency with such a gloomy scenario in the medium term, and as a result of predictable attempts to reverse the economic slowdown, projected fiscal deficits resource flows and borrowing are now higher than originally projected. Unless deficits are offset by spending cuts and new tax increases, pressure for new aid (and debt) should materialize and this would complicate prospects for preserving debt sustainability ratios in sound levels.

To determine how fragile is the debt outlook to shocks requires a formal analysis. Figure 3.8 reflects the sensitivity analysis developed at the completion point for Bolivia by IDA/IMF (2001a). In a base scenario with preliminary data for 2000 and 2001, three modifications are introduced to variables of central importance for judging the sensitivity Bolivia's NPV debt-to-exports ratio: a 1 percent lower GDP growth from 2001 onwards; a 1 percent lower nominal export growth in 2002-2003; and a 1 percent rise in the LIBOR international interest rate, which increases the marginal cost of borrowing and reduces the concessional component of lending.

FIGURE 3.8

BOLIVIA: RATIO OF NPV OF DEBT-TO-EXPORTS AT THE COMPLETION POINT, PROJECTIONS AND ALTERNATIVE SCENARIOS, 2000-2020



Source: IDA/IMF (2011a)

Results up to year 2020 reflect the degree of sensitivity of the debt-to-exports ratio to these “shocks.” By far, its highest sensitivity appears with respect to lower GDP growth, which brings the debt-to-export ratio above critical value of 150 before 2015 and to 175 by 2020. In order of importance, the next one is lower export growth, which also brings the debt ratio above 150, but only by 2020. Finally, the shock in the international interest rate has a rather marginal effect, as the debt-to-exports ratio increases, but remains inside the narrow 120-130 range during most of the period. The high degree of existing concessionality in Bolivia’s debt clearly minimizes the impact that this shock has on debt ratios.

There are also structural risks in attempting to preserve HIPC-like Bolivia below the sustainability threshold. They refer to the implicit assumptions that lie behind its vulnerability to external or domestic shocks. Three of them are particularly relevant: (i) the degree of exports concentration; (ii) the degree (and relative size) of present and future concessional lending; and (iii) the institutional shortcomings to implement poverty reduction programs effectively.

Little known in HIPC's broad forecasts is that behind the original assumption that exports growth would be near 8 percent in the present decade, a major reason for this improvement is that the terms of trade are expected to improve by 0,5 percent a year, instead of deteriorating at 0,7 percent a year as they have in the past decade (Birdsall and Williamson, 2002). It has already been pointed out that these forecasts are too optimistic for Bolivia. Certainly, some recovery in the terms of trade is not impossible; but for countries, which have their export structure centered in a few products, like Bolivia, such expectation cannot be generalized and may only be temporary.

In fact, HIPC's appear to be among those with the highest degrees of export concentration: 60 percent in three products. Bolivia's three main export products, in particular, add to 47 percent of total exports; a high value, but still below the average 60 percent for HIPC's. It is only a matter of having negative rates of growth in the prices of one of these products to have a substantial impact on the country's terms of trade. For example, in the case of Bolivia in 2002, a significant deterioration of -22 percent in the price of natural gas, its main export product, would contribute to a marked fall in the terms of trade of about -4 percent (IDA/IMF 2002b).

Another structural condition that makes Bolivia's forecast fragile is the assumption about the perceived flows increase and deepening of the degree of concessionality that lies behind future external credits (Table 3.6). For all HIPC's as a group, while new borrowing will decrease from a simple average of 9,3 percent of GDP in the nineties to 5,5 percent of GDP in 2000-2010, external grants are expected to remain constant at 5,5 percent of GDP. In addition to this, the grant component in new borrowing to HIPC's is projected to almost double from 30,7 percent to 57,8 percent. Nevertheless, Bolivia's new borrowing and grants are both expected to decrease as a percentage to GDP, from 5,9 percent to 3,2 and from 3,2 to 1,1 respectively. And the grant component in new borrowing is projected to slightly increase from 22,2 percent in the nineties to 26,3 percent in 2000-2010. Clearly, Bolivia is more likely, than all HIPC's considered as a group, not to receive the significant amounts of new borrowing and grants that obtained during the nineties.

TABLE 3.6
LATIN AMERICAN HIPCs THAT HAVE REACHED A DECISION POINT
FLows OF OFFICIAL EXTERNAL RESOURCES

	New Borrowing ¹		Grants ^{1 2}		Debt-service ¹ Paid/Due		Net Flows ^{1 3}		Grant Element in Borrowing	
	1990- 1999	2000- 2010	1990- 1999	2000- 2010	1990- 1999	2000- 2010	1990- 1999	2000- 2010	Existing debt at end- 1999	New borrow- ing 2000- 2010
	<i>(In millions of US dollars)</i>									
Bolivia	375,9	352,8	208,3	125,9	127,6	295,9	456,6	182,8		
Guyana	91,4	71,1	11,5	18,3	99,5	48,9	3,3	40,6		
Honduras	306,3	442,7	183,9	173,7	394,2	239,6	95,9	376,9		
Nicaragua	251,5	262,7	273,9	234,9	190,7	60,5	334,6	437,0		
Total⁶	3.832,0	4.851,2	3.708,4	4.054,1	3.219,4	2.163,9	4.321,1	6.741,5		
	<i>(In percent of GDP)</i>									
Bolivia	5,9	3,0	3,2	1,1	1,9	2,4	7,2	1,7	22,2 ⁴	26,3
Guyana	19,3	8,4	2,0	2,1	19,1	5,4	2,2	5,0	23,3 ⁴	51,2
Honduras	8,3	4,3	4,7	2,2	10,2	2,8	2,9	3,7	23,1	50,7
Nicaragua	13,4	8,6	14,8	7,7	10,2	2,0	18,0	14,3	16,0	48,6
Simple⁶	9,3	5,5	8,7	5,4	5,6	2,2	12,4	8,6	30,7⁵	57,8
Average⁶										

Source: Abrego and Ross (2001)

¹ Annual averages.

² Official transfers.

³ Defined as new loans plus grants minus debt-service paid.

⁴ 1998.

⁵ Excludes Mali.

⁶ For all HIPCs that have reached a decision point.

Note: Includes concessional and nonconcessional grants for 1998-1999.

The third structural feature of Bolivia's economy that we believe is relevant for poverty reduction is the adequacy (or inadequacy) of the institutional framework for implementing desired social investment effectively. Some authors have demonstrated that weak institutional frameworks tend to increase developing countries' chances of becoming highly indebted. In addition to this, governments of developing countries are less stable and at the same time less capable of taking on a wide range of functions than are the governments of the more developed, as their administrations tend to be more corrupt and less efficient. Bolivia's political instability is a secular phenomenon, but corruption is another endemic problem. In a 1996 survey of 54 countries developed by Economic Freedom, Bolivia had the dubious honor to be ranked as the 19th most corrupt country in the world (Pfefferman, 1997). This result suggests that HIPCs like Bolivia are simply questionable performers and achieving the desired PRSP outcomes they want will probably require them a much deeper and longer effort than initially assumed.

In short, despite the significant, but temporary relief provided by the Enhanced HIPC, we believe that the outlook for debt sustainability of Bolivia in the medium term is very uncertain. Macro forecasts that were used to estimate the amounts of debt relief are overly optimistic for Bolivia's previous historical patterns and have already been revised downward. Sensitivity analysis indicates that high rates of GDP and exports growth are, in this order, critical for future debt sustainability ratios. So, if recovery does not take place in the near term, chances for reversing to unsustainable debt ratios and pressure for additional aid are high. Structural factors of its economy, like the heavy dependence of its export structure on a few products, high dependence on external aid, and little control of corruption, makes this economy's performance even more vulnerable. To further complicate matters, when compared to the rest of HIPCs, Bolivia is more likely to receive less significant amounts of concessional financing than it obtained during the nineties.

4. IS THERE A NEED FOR A HIPC III FOR BOLIVIA?

In 1999, when the IMF and the World Bank announced the Enhanced HIPC Initiative, they did not exactly receive the praise they expected. Many institutions and organizations were not fully satisfied with the changes to the original HIPC initiative, which they called insufficient. Do these criticisms justify another round of debt renegotiations, even for countries that already reached the completion point like Bolivia? In this section, we argue for the need of a HIPC III for Bolivia.

This section is structured in the following way: First, we briefly examine the different criticisms made to the Enhanced Initiative. Second, we argue why more aid is needed in order to achieve not only debt sustainability, but to meet the Millennium Development Goals. Specific considerations about the new type of aid required are mentioned. Third, we make a set of very concrete proposals for strengthening debt sustainability beyond HIPC debt relief that could be applicable, even to post-completion countries such as Bolivia.

4.1 CRITIQUES OF THE ENHANCED HIPC INITIATIVE

According to Birdsall and Williamson (2002), the main criticisms to HIPC could be grouped into two broad categories; each one representing an extreme point of view. This section will summarize the two categories,

analysing their similarities as well as their differences.

The first category is based on the “foreign aid down the rathole’s argument.

This argument states that debt relief, as well as other forms of aid, have been too great and too easy to get for HIPCs. Debtor countries have not always behaved correctly and they have not always known how to use aid properly. Also, the degree of corruption in these countries is known to be high, and this constraint plays an important role when it comes to aid distribution. Furthermore, even in cases where there is adequate control of corruption, debt relief only serves to alleviate immediate problems the country is facing, but without changing their bad economic policies. Proponents of this approach believe a possible mechanism to prevent this problem would be to include a higher level of selectivity in the countries eligible for aid, underscoring high standards on their performance in economic management and governance. My impression is that even though most of the blame for wrong debt goes to debtors, part of the blame can also be given to the official donors and creditors, who provided too many loans and grants for political, commercial or bureaucratic motives. In any case, lenders definitively need to be more disciplined and selective in providing aid.

The opposite category is the “poverty trap.” This argument suggests that aid has been too small and that strict requirements to receive aid are inappropriate. One cannot forget that most of the HIPCs are troubled countries, relying mostly on primary commodities, whose prices are declining and unstable. The debt relief given until now has not been large enough to allow them to escape from poverty and be put on a growth path. Government corruption and incompetence are factors that have not helped, but they are rather the result of poverty and underdevelopment. In a similar way, this argument puts all the blame on the creditors and donors, but relieves all responsibility from debtors, which would also be a mistake.

These two types of criticisms, even though they widely differ, have three common reasons for past failures of assistance programs:

- High vulnerability of HIPCs to unpredictable shocks. This factor is most important in the short run. Commodity prices are unstable and declining, which leads to deteriorations in the terms of trade. Other unpredictable shocks include environmental disasters as well as civil conflicts.
- Failures of governance and leadership. This is a so-called structural

factor. It encourages aid "going down the rathole" instead of to benefiting the ones who mainly need these resources. Failure of leadership appears mostly in societies with civil conflicts.

- Bad lender/borrower behavior. Donors and creditors do not always make the right decisions even when well intentioned. Lenders, for example, often push for loans that satisfy certain lending targets, even when the debtor's programs are not credible and the projects concerned are of dubious value.

4.2 THE CASE FOR INCREASED RESOURCES AND CONSIDERATIONS FOR AN IMPROVED PROGRAM

Internationally there are two main objectives of the HIPC Initiative. The first is known as the official one, which is to bring a country's debt burden to sustainable levels. And the second is an underlying objective associated to it, which is to promote poverty alleviation and human development. In this section, these two objectives are described, and some rationale is introduced so as to explain why, in order to achieve them, more aid is required.

4.2.1 DEBT SUSTAINABILITY

According to the IMF and the World Bank the definition of debt sustainability is as follows: "A country can be said to achieve external debt sustainability if it can meet its current and future external debt service obligations in full, without recourse to debt rescheduling or the accumulation of arrears, and without compromising growth" (IDA/IMF 2001c). Historical ratios were used to justify the 150 to 200 NPV debt-to-export ratio that was agreed as a HIPC threshold. The expectation is that policy improvements will have the effect of accelerating the growth of exports and GDP and that donors will sustain significant flows of aid, in the form of grants rather than of loans, macro forecasts of debt sustainability trend down in the next 20 years. However, as described in the last section concerning Bolivia, in reality these forecasts are proving to be particularly sensitive to exogenous shocks and other disturbances, and additional aid might be needed, especially if the international recession continues, contagion from Argentina hits more severely the Bolivian economy or domestic political unrest develops, just to provide a few examples of possible shocks.

4.2.2 THE MILLENNIUM DEVELOPMENT GOALS

The commitment of HIPCs to meet the United Nations Millennium Development Goals (MDGs) for 2015 brings additional fiscal challenges to those of merely reaching debt sustainability. Halve the number of people in extreme poverty and hunger, achieve universal primary education, eliminate gender disparity in primary and secondary education, reduce by two-thirds child mortality and improve by three-quarters maternal health, halve the cases of HIV and Malaria, ensure environmental sustainability and develop a global partnership for development are all very ambitious goals endorsed in the PRSPs that require a significant amount of fiscal resources by both donors and lenders.

Birdsall and Williamson (2002), however, indicate that setting and adopting such goals by most developed countries is a meaningless act, and at worst hypocritical, without a proper increase of corresponding resources to finance the programs required to meet them. They provide a back-of-the-envelope calculation done by a UN High Level Commission of the cost of achieving them worldwide of about US\$50 billion, which is considered conservative, but indicative of the likely high order of magnitude of the new resources that are involved.

In any case, fiscal discipline required by countries graduating or applying to enhanced decision points already represents a tight leash for increasing social spending beyond sustainable levels. Hence, my view is that countries face an apparent trade-off: or they comply with fiscal discipline and keep expenditure low, which would limit their potential for meeting the MDGs on time; or they spent beyond reasonable levels attempting to reach MDGs, but risking severe macroeconomic problems that could only reverse temporary progress achieved initially under the HIPC initiatives. This only leaves hopes, again, that increased investment mostly financed with significant grants from donors and multilaterals, is perhaps the only option to meet high expectations raised by the Millennium Goals. It needs to be pointed out, however, that declining contributions of official assistance is not the only issue to consider, which would provide a strong argument for the need of a HIPC III. In addition, countries need to make sure that scarce resources are distributed properly and used efficiently.

4.3 DEBT SUSTAINABILITY BEYOND HIPC DEBT RELIEF

The HIPC Initiatives have two main objectives: to bring country's debt burden to sustainable levels and support country efforts in reaching the Millennium Development Goals by 2015. Both of these goals place the country facing a difficult trade-off that can only be solved through faster growth, sound institutional debt management and no exogenous shocks in the medium term. However, more aid is required to raise the levels of social spending and this could perhaps be the most important reason for a possible HIPC III Initiative.

The novelty of the HIPC Initiatives is that it deals with the debt problem in a comprehensive way focusing first on achieving overall debt sustainability. Relief, in short, is based on the country's ability to pay within a total context of economic growth and poverty reduction. It therefore enables to exit from the debt rescheduling process, at least temporarily. It also represents a commitment by the international community, including all creditors, to act together in a coordinated and concerted fashion to reduce debt and maintain significant aid flows. The HIPC Initiative process encourages countries to tackle the whole range of factors currently limiting their growth performance, including poor infrastructure, the lack of effective policy making institutions and poor governance, but those issues will take time to be resolved, and as the economy is subject to shocks and to a severe budget constraint, there is no guarantee that such a sustainability path will be maintained in the medium-term.

In theory, what is offered from the Enhanced Initiative is believed sufficient for ensuring that HIPCs, as a group and as individual countries, are able to maintain sustainable debt ratios and to increase social spending, so as to reach MDGs (although as a subordinated goal). It is also implicitly assumed that the country will successfully overcome future crises thanks to sound economic management, little effects from shocks, and new and large concessional financing.

As we described in the past section, however, reality is proving much different as macro scenarios look too optimistic and shocks are hitting hard even the most successful HIPCs. The global economic slowdown is endangering the ability of HIPCs to break free from high debt and low growth. Collapsing commodity prices are threatening debt sustainability of graduated star HIPCs, like Bolivia. If external shocks continue, additional extra relief might be needed, which provides another strong argument for a HIPC III. The HIPC Initiative itself recognizes its need in "exceptional cases where exogenous factors have caused fundamental changes in a

country's economic circumstances." Birdsall and Williamson (2002) have estimated an additional extra relief amount of US\$1 billion needed from multilaterals and bilaterals, just to offset shocks. At first sight, however, countries reaching the enhanced completion point like Bolivia should not have preferential access to such funds, as these would rather prioritize still-to-qualify for completion point countries. But the extent of the shocks is so deep that prospects for preserving debt sustainability in the medium term should not exclude it.

Therefore, it looks like by providing substantial debt reduction and ensuring lower debt-service burdens well into the future, the Enhanced HIPC Initiative represents a dramatic turn in these countries' debt related fortunes and an initial step toward permanent exit from over-indebtedness. However, it does not chart a complete path to debt redemption, and guarantees little beyond these countries' completion point (Serieux, 2001). Future programs, like a hypothetical HIPC III, would have to be justified on the ground that is summarized below.

4.3.1 THE CASE FOR DEEPER RELIEF

Perhaps the most repeated criticism on the HIPC Initiatives is on its focus on the NPV debt-to-export ratio as the primary measure to measure how much debt relief is needed for a country debt to be sustainable in the medium-term. Criticisms address either the level of sustainability that might be lower (100-150 percent in the case of Oxfam) or the indicator itself, suggesting alternative indicators, like the debt-to-revenue or a totally different one like the UNDP Human Development Index (Eurodad), which is subject to measurement errors. Imperfect as it could be, the debt-to-export ratio appears reasonably justified on empirical grounds with two caveats, it does not consider a differential treatment per country and does not take into account exogenous shocks. Below, it is proposed that both features should be part of an improved HIPC III framework.

Another related criticism, but perhaps more relevant generally for fiscally-troubled HIPCs, is the twin-focus on debt service-to-export ratios. At present, by targeting debt stock reduction in NPV terms, HIPC mainly focuses on debt relief and, only indirectly, on debt dividend. This is the reason why several bilaterals, including the US Congress, have recently proposed to help HIPCs to "cap" their debt-service payments actually paid at 2 percent of GDP. Such proposal seems to me reasonable to achieve

as a minimum. As enhanced decision points collect, in average, about 20 percent of GDP in tax revenue, the proposed "ceiling" in debt service should represent in average about a tenth of HIPC's tax revenues. In the case of Bolivia, tax revenue was close to 18-19 percent of GDP in 2001.¹⁴

Table 4.1 gives Birdsall and Williamson's (2002) estimates of the amount of additional debt reduction that would be needed in each of 11 HIPC's that have already passed the decision point to limit debt service on publicly guaranteed debt to 2 percent of GDP (debt-service is below such ceiling in the other HIPC's that already qualified). The first two columns show the projected debt stock and debt-service at the completion point. The next two columns show GDP and the percentage of GDP spent on debt-service.

Then there is a column that shows the debt-service goal (2 percent of GDP), followed by one that calculates the corresponding debt-stock goal, assuming the same ratio of service-to-stock at the completion point. The following column shows the needed reduction in debt stock. According to the calculation, the cost would be US\$5,5 billion for the 11 remaining HIPC's.

TABLE 4.1
ADDITIONAL REDUCTION NEEDED FOR POST-DECISION POINT HIPC'S THAT ARE
ABOVE THE 2 PERCENT THRESHOLD
(In billions of Us dollars)

Country	NPV of debt	Debt service	GDP	Ratio of debt service-to-GDP (In percent)	Service goal	Stock goal	Stock reduction needed	IMF share ¹
Bolivia	1.649	260	8.660	3,0	173	1.098	551	33
Gambia	202	15	476	3,2	10	128	74	2
Guinea	1.254	78	2.239	3,5	45	720	534	21
Guyana	552	48	678	7,1	14	156	396	39
Honduras	2.912	204	6.649	2,5	133	1.898	1.014	48
Malawi	767	45	1.565	2,9	31	533	234	8
Mali	994	64	2.813	2,3	56	874	120	8
Mauritania	612	108	2.400		48	272	340	16
				4,5				
Nicaragua	1.320	116	2.231	5,2	45	508	812	21
Senegal	2.149	174	5.553	3,1	111	1.372	777	62
Zambia	2.231	151	4.059	3,7	81	1.199	1.032	213
Total							5.883	471

¹⁴ Birdsall and Williamson (2002) note that the 20 percent figure is slightly less than in the United States and Japan, much less in Europe, and somewhat above the average—but well below the peak—for developing countries.

Source: Birdsall and Williamson (2002).

¹ Hypothetical cost to the IMF based on current share of outstanding debt.

Note: Figures for Bolivia and Malawi include additional pledged bilateral assistance. All figures are post-HIPC assistance.

In the case of Bolivia, the cost for bringing debt-service from 3 percent to 2 percent of GDP would be US\$551 million. Such a lower figure would correspond to a debt-stock in NPV terms of US\$1.098 millions and an annual debt-service goal of US\$173 millions, which represents an additional effort equivalent to reduce present debt-stock and debt-service levels by roughly one-third.

Eurodad proposes a variation of the preceding approach, by requiring post-decision HIPC countries to pay what it calculates each country can afford to pay. The method of calculation follows the next procedure: Total resources consist of tax revenue plus grants, whereas minimum social spending consists of social expenditure that varies between US\$40 and US\$95 per head, plus domestic debt service. The difference between the two is the remaining resources available for inessential expenditures, and servicing foreign debt is about one-third of such sum.

Table 4.2 reflects Eurodad's numbers for HIPC countries. In the majority of cases, actual debt service exceeds the affordable level, but in 5 out of 21 cases affordable debt service exceeds actual debt service, so that these countries do not appear to need further relief. Surprisingly enough, Bolivia would belong to such a small group, so that according to Eurodad criteria, it would not require additional debt relief. However, it could be considered that the estimate of Eurodad is wrong for it limits the size of the state to the amount of current spending.¹⁵

Therefore, under a hypothetical HIPC III, among alternative criteria proposed for requesting additional debt relief, the one made by Birdsall and Williamson's seems preferred. This is so for the simple reason that, in practical terms, HIPC countries have always considered explicitly or implicitly to cap their paid debt service to a certain amount. In the particular case of Bolivia, this proposal would imply obtaining an additional reduction in debt service of about one-third its present level.

¹⁵ Grants were high since Bolivia's debt-service was significantly reduced in 2000-2002 due to front-loaded aid in the Enhanced HIPC and additional bilateral debt relief. It is however projected to increase above US\$300 million in 2003 (19 percent of US\$1.614 million in exports).

TABLE 4.2
Cost of Eurodad Proposal for Limiting Debt Service

Country	Total resources	Essential Spending	Remaining resources	Affordable debt service	Actual debt service	Additional resources needed		NPV of debt stock	Needed debt reduction
						Debt service reduction	Grant increase		
<i>(In millions of US dollars)</i>									
Benin	543	419	124	37	46	8	0	685	123
Bolivia	2,300	1,224	1,076	325	260	0	0	1,645	0
Burkina Faso	614	644	0	0	30	30*	30*	233	233
Cameroon	1,961	1,427	534	160	226	66	0	5,341	1,549
Gambia	96	191	0	0	16	16	95*	191	499
Guinea	521	438	83	25	78	53	0	1,870	130
Guinea-Bissau	90	122	0	0	6	6	31*	293	1,870
Guyana	348	280	68	20	48	27	0	282	161
Honduras	1,353	496	858	257	134	0	0	2,740	0
Madagascar	854	722	132	40	64	25	0	2,129	809
Malawi	558	750	0	0	59	59	193*	839	839
Mali	661	534	127	38	64	26	0	906	376
Mauritania	436	218	217	65	80	1	0	945	170
Mozambique	1,145	930	215	65	48	0	0	761	0
Nicaragua	938	546	392	118	108	0	0	2,274	0
Niger	325	578	0	0	28	28	253*	568	568
Rwanda	374	352	22	7	16	9	0	244	142
Senegal	1,168	620	548	164	159	0	0	2,007	0
Tanzania	1,626	1,816	0	0	142	142	190*	2,587	2,587
Uganda	1,251	1,253	0	0	48	48	3*	745	745
Zambia	895	738	157	47	136	89	0	1,575	1,024
Total						647	795		11,825

Sources: Eurodad (2001) and IDA/IMF (2001a).

* Needed increase in grants to supplement elimination of debt service.

4.3.2 EXTENDING NEW ELIGIBILITY CRITERIA

In the above section, we indicated how country selectivity could overcome defensive lending, thus awarding HIPC status to countries that have a good macroeconomic performance and social policies. In aggregate terms, by supporting HIPC countries that just have eligible debt ratios, but a questionable performance, diverts aid from non-HIPC developing countries that would deserve it to HIPC poor performers. This is also the risk of following Eurodad's proposal for including more countries in the HIPC Initiative. Somehow, the line should be drawn to avoid that countries most prone to waste external resources, even if they already reached HIPC status, but backtracked in their reforms, are excluded from receiving additional funds.

4.3.3 SETTING INCREASED MINIMUM CONCESSIONALITY LEVELS

Another lesson we indicated in Section II from Bolivia's debt history is that past borrowing, even at concessional terms, was too expensive. Today,

while some HIPCs (such as Bolivia and Cote d'Ivoire) could possibly borrow at fairly modest concessional terms, others clearly may find even borrowing on average IDA terms (approximately 70% concessional) more expensive than they can bear over the long term. It would seem logic to support countries engineering their unilaterally determined concessional levels by some ad-hoc combination of bilateral grants and multilateral lending (Serieux, 2001).

In the case of Bolivia, its concessional ratio is among the lowest for HIPCs and the gap with respect to HIPC as a group is projected to increase in the present decade. Such ratio is projected to be 26,3 percent of new borrowing, well below the average 57,8 percent for all HIPCs that have reached a decision point. This is a wider differential than the one existing at end-1999: 22,2 percent versus 30,7 percent for all HIPCs. Therefore, a proposal that Bolivia should consider carefully in its debt management strategy is how to increase the degree of concessionality in its future lending, and this concerns not only Bolivia itself, but also other HIPCs in a similar situation. Serieux (2001) goes to propose that it would be necessary to ensure that regional bank loans, which would be clearly too expensive for some countries, have an appropriate bilateral grant counterpart.

4.3.4 PROVISIONING EMERGENCY ASSISTANCE FOR SHOCKS

Another repeated criticism of the HIPC Initiative has been that its optimistic assumptions do not make contingencies against possible unexpected shocks. This is particularly important for countries like Bolivia, whose export structure is concentrated in a few products and their economy is not only highly volatile to terms of trade shocks, but to natural disasters. In principle, HIPC mechanisms make no provision for offsetting structural factors that will play a critical role in preserving sustainable debt ratios in the medium-term.

Birdsall and Williamson (2002) propose to grant additional relief in the case of exogenous shocks that would affect debt sustainability, supported by the formal definition of a mechanism for identifying when a country has suffered an exogenous shock and for quantifying its balance of payment effects, as well as by the Fund that would finance additional relief.

According to the same authors, the way exogenous shocks are identified should be explicitly related to the existing medium-term projections on the

key exogenous variables that affect poor countries at the time HIPC debt relief is agreed to: (i) terms of trade; (ii) market growth (exports volume); and (iii) natural disasters. Quantification of their impact on the balance of payments would be based on the regular analytical exercise that seems to be done frequently by multilaterals. Resources placed under the (Contingency) Fund would act like insurance against shocks, to preserve growth and social spending levels agreed under the PRSPs.¹⁶ Their broad estimate of the size of such a Contingent Facility for 2001-10 is about US\$5.3 billion for all first 24 HIPCs considered. Among them, Bolivia's needs would represent a slightly above than average amount of US\$221 million: US\$252 million or about 4,8 percent of all resources initially estimated for such fund. It has already been mentioned that such a feature is clearly needed for a HIPC III.

4.3.5 BETTER AND MORE TRANSPARENT ARRANGEMENTS FOR SOCIAL SPENDING

Perhaps the more challenging commitment of the HIPC Initiative is to guarantee a successful road for development. As mentioned in past sections, debt relief barely represents a very low amount of the aid needed for raising social spending in the medium term. Therefore, financing the PRSP will require a combination of domestic and external additional resources, especially on concessional terms. This is better said than accomplished.

In the past section, we suggested to make sure that countries are not put into a position where they risk their fiscal health in the pursuit of higher rates of social investment: the minimum 7 percent of GDP pursued by HIPC authorities. IDA/IMF (2002a) suggests this would require medium-term projections by the following procedure. First, matching the estimates of the needs arising from the cost of financing poverty reduction programs with the availability of domestic and external resources (including debt relief) and exploring ways to fill the gap gradually through several years. Second, given the limited resources available, PRSP financing would require transparency (full access through the web of the information referred to HIPC programs) and accountability (efficient allocation of resources to poor areas), supported by adequate regular monitoring, so as to prove that resources are well used and that specific outputs are being

¹⁶ Such proposal could also be considered as a variation of the contingency facility of the IMF, but on concessional terms and expanded to several creditors, which could actually contribute to the fund.

obtained. These are critical conditions and HIPC countries seem poorly equipped to deal with them: in 2002, the World Bank and IMF found that:

not one of the 24 HIPCs reaching decision points deserve little or no upgrading in their capacity to track spending related to debt relief transactions; nine out of twenty-four require some upgrading; and a big majority, fifteen out of twenty-four including Bolivia, require substantial upgrading in their public expenditure management systems to track poverty spending on a regular basis with full transparency.

In spite of its limitations, we believe that the PRSP process is a step in the right direction for preventing odious debt, for addressing major social needs, and for placing the poverty agenda among the top country priorities.

If the debt overhang still affects countries in the near future, the PRSP will at least contribute to protect social investment from eventual cuts.

4.4 IS THERE A NEED FOR A HIPC III?

Given the already difficult external environment, the high uncertainty surrounding macro scenarios and the potential for severe exogenous shocks—domestic or external—affecting HIPCs in the medium term, the answer is affirmative. Below are further reasons why we believe this is needed, even for good performer countries like Bolivia, as well as a few modifications that should be taken into account to improve it.

First of all, reaching the twin goals of achieving debt sustainability and meeting the Millennium Development Goals will require more resources, domestic and external, than originally estimated under the Enhanced HIPC. So, HIPC III should mobilize resources aimed at a more ambitious objective than the one aimed by the Original and Enhanced HIPC initiatives.

Second, just preserving debt sustainability in graduated HIPCs through future exogenous shocks, be them domestic or external, will require a Contingency Fund. For the time being, prospects for maintaining recently graduated HIPCs below switching sustainable ratios are uncertain, but we believe that it would be too presumptuous to assume that all graduated HIPCs will suffer no serious shocks in the next two decades. Birdsall and Williamson (2002) provide interesting insights on how to operationalize such a proposal. Resources under the Fund would protect priority social spending and contribute to preserve growth.

Third, having reviewed the rationale for alternative targets to assess debt sustainability, we found no better choice than to preserve empirically based HIPC debt- and debt service-to-exports ratios, but with two small, but important modifications that would actually lower the required debt sustainable ratios. The first one is suggested by Hjertholm (1999) and consists in adopting country-specific sustainability targets, perhaps hidden under pre-defined ranges that would make room for adjustments to the structural features that individual HIPCs economies have. In practical terms, for instance, this would imply to estimate debt relief required for reaching a NPV debt-to-export ratio of 130-150 percent (instead of the actual 150 percent ratio); leaving individual HIPC countries (and donors) to jointly decide on the country-specific target that would better fit its needs. Alternatively, the second modification is proposed by Birdsall and Williamson (2002). It consists in adopting the complementary criteria of capping NPV debt-to-GDP in consistency with a debt service-to-GDP ratio of 2 percent effectively paid. Obviously, it places emphasis on capping the budgetary cost of debt service. Any of those sustainability targets adopted could be reached gradually.

Fourth, and finally, HIPC III should be more selective. Contrary to the aim of the Enhanced HIPC II to extend its support to a significant higher number of countries, HIPC III should prevent odious debt and moral hazard among creditors, which would clearly reduce its actual number of members. So, we would propose switching to offensive lending, so as to have donors become more selective in awarding aid to HIPCs that effectively reform their institutional framework and achieve tangible results in making progress for attaining the Millennium Development Goals. Awards should be the degree of concessionality given to the HIPC III country. Of course, selectivity would depend on a timely and transparent monitoring of the PRSP expenditure financed with debt relief.

5. SUMMARY AND POSSIBLE EXTENSIONS

In this paper, we address two central questions: Has a successful HIPC country like Bolivia graduated from debt renegotiations and turned into a sustainable path definitely? And, taking into account multiple criticisms made against the Enhanced HIPC Initiative, can an HIPC III be needed for Bolivia.

The answer to the first question is mixed. Thanks to the Enhanced HIPC, Bolivia has remarkably achieved sustainable debt ratios and is projected to keep them in the near term. However, given exogenous shocks, declining external aid and too optimistic macro assumptions used in its debt projections, the probability of having Bolivia reversing to unsustainable debt ratios in the medium term is high. So, whereas we demonstrate that HIPC debt relief was a step in the right direction, when compared to Bolivia's achievements under previous traditional mechanisms, we also underscore the excess of optimism underlying macro projections of Bolivia's debt in the next two decades and their high vulnerability to exogenous shocks and structural factors: The Enhanced HIPC and its associated bilateral debt renegotiations have lowered debt and debt-service ratios below the target ratios of 150 and 20-25 percent of exports, but the extent to which this is sustainable in the medium term is uncertain and will clearly depend on future GDP and exports growth. After the Enhanced completion point, Bolivia's growth and export rates have been revised downward, its terms of trade have continued to fall; and its main macro balances—fiscal and external current account—have not improved significantly, in part due to external shocks, the country's recession and the political instability originated from the 2002 Presidential Elections. Despite these bad news, we underscore that HIPC conditionality has not only supported Bolivian sound macroeconomic management in a difficult situation, but increased expenditure for social programs, both critical policy elements of a development agenda. The achievement of the Millennium Development Goals, however, is perhaps a too ambitious challenge and requires further financing. Therefore, it could be considered that prospects about the sustainability of Bolivia's debt sustainable ratios in the medium term are promising, but obviously uncertain and subject to considerable caution.

The difficulties encountered to preserve debt sustainable ratios in the medium term by countries like Bolivia justifies the rationale for a HIPC III. We have four reasons to argue such initiative is needed: Achieving the MDGs will require extra resources not considered under the Enhanced HIPC; likely exogenous shocks in a difficult external environment will prompt the need for a non-existing HIPC Contingency Fund to preserve graduated HIPC from falling back into unsustainable levels of debt, while preserving their increased levels of social spending; different shocks and structural features of the HIPC economies will underscore the need for additional debt relief estimated under country-specific sustainability targets

(grouped perhaps under a sustainable range or capped by a below 2 percent of GDP debt-service rule), instead of the single target of the Enhanced HIPC of 150 percent debt-to-export ratio. Finally, given increased selectivity in declining global trends of concessional assistance by donors justifies a change to offensive lending in a HIPC III. Hence, whereas HIPC-II attempted to expand significantly the number of eligible countries, perhaps too much; HIPC III should rather reduce them to those good performers, which control corruption and set the right institutional framework to make real progress in their social programs.

After more than two decades dealing with the debt crisis of poor developing countries, no debt renegotiation mechanism can yet be considered as the magical solution. The traditional Paris Club and commercial debt renegotiations are obviously insufficient. The Original HIPC Initiative is only six years old, and the Enhanced is less than three years old. In response to a changing nature of the debt, with a raising official—bilateral and multilateral—debt and multiple criticisms, changes have been made to the HIPC framework. NGO's officials and academic work will obviously continue playing a positive role in assessing the experience of several countries under the present Initiative and molding solution to its future shortcomings.

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