
**Working Group on Trade, Debt
and Finance**

THE RELATIONSHIP BETWEEN TRADE AND DEBT

A REVIEW OF SELECTED LITERATURE

Note by the Secretariat

This document has been prepared under the Secretariat's own responsibility and without prejudice to the positions of Members and to their rights and obligations under the WTO

I. INTRODUCTION

1. This Note has been prepared in response to a request from the Working Group for a review of selected literature related to Item II of the Group's work programme.¹ It focuses on ways in which a Member's trade and its integration into the multilateral trading system can be affected by external debt, and how high indebtedness may in turn defeat efforts by Members to build strong export-led economies.

II. THE LINKAGES BETWEEN INTERNATIONAL TRADE AND DEBT

2. External debt is a major issue confronting developing countries and emerging market economies and it has an impact on their capacity to reap the benefits of their participation in the multilateral trading system. This is recognised by G8 leaders (2002), as well as the Bretton-Woods Institutions and the WTO, when emphasising complementary between initiatives to reduce indebtedness and to improve market access for poor countries.²

3. From an analytical perspective the link between trade and debt appears less straightforward than that between trade and finance, or at least less direct. Debt is only one of several instruments of external financing, along with foreign direct investment and portfolio equity investment. Economic theory suggests that reasonable levels of foreign borrowing are likely to enhance growth, particularly in countries at an early stage of development which have low savings rates and small stocks of capital, and that in these countries investment returns are likely to be higher than in more advanced economies. Clearly, it is important that borrowed funds should be used for productive investment that generates a return – and economic growth – that is sufficient to cover debt repayment. Even where that is the case, however, a number of factors may still constrain countries' ability to repay their debt or to attract foreign capital for development. Some of these factors are examined below.

¹ WT/WGTDF/M/1 and W/1.

² See in particular the last G8's Summit Chair's conclusions at <http://www.g8.utoronto.ca/g7/summit>.

A. MARKET ACCESS AND FOREIGN DEBT

4. One relevant factor from the WTO's point of view is that **overseas market access restrictions** can impede the ability of indebted countries to earn the foreign exchange they need to service their external debt, and to avoid resorting to further unsustainable borrowing.³ Before the Doha Ministerial Session, the WTO, IMF and World Bank examined market access restrictions faced by developing countries.⁴ Special attention was devoted to the situation of the LDCs and highly indebted countries. The studies revealed that, while most other developing countries had shared in the growth of world trade in the past thirty years, the poorest countries saw their share of world trade divided by four; the LDCs' share of world trade fell from 1.9 percent to 0.5 percent between 1970 and 2000.⁵ The studies pointed to the prevalence, in these countries' main trading partners, of market access barriers on their exports of agricultural and labour-intensive manufactured products (see section III.A for a more detailed description). The poorest countries comprise virtually all LDCs and highly-indebted countries eligible for relief under the IMF-World Bank Enhanced HIPC Initiative. Reversing the marginalization of these countries requires a broad-based strategy combining economic growth, stability, poverty reduction and debt relief – as outlined by the Poverty Reduction Strategy Paper (PRSP) process of the IMF and World Bank. Nonetheless, trade policy reform and improved market access for these countries' exports needs to be a central part of that strategy.

5. Other studies have concluded that **the gains that can be derived from eliminating trade barriers on these countries' exports far outweigh annual flows of ODA and debt relief**. One IMF study calls for a more coherent approach between trade and aid policies, whereby trade policies would create market access opportunities for developing countries, and concessional financing of development policies would enable them to build the capacity necessary to respond to these opportunities.⁶ Key components of such an approach include: more generous and predictable market access, especially for the poorest countries; actions by industrialised countries to reform their agricultural policies; and open, outward-looking trade policies in developing countries themselves.

B. TRADE LIBERALIZATION AND DEBT

6. While lack of access to markets can be a major reason why developing countries may not be able to exploit their comparative advantage, **lack of trade liberalization by these countries can also play an important role**. Inward-looking, restrictive trade policies raise the cost of imports, and hence exports, and tend to divert labour and capital from their most efficient uses, thereby leading to a sub-optimal mix of production, investment and consumption.⁷ The Monterrey International Conference on Financing for Development highlighted in its conclusions (the so-called "Monterrey Consensus") that "meaningful trade liberalization is an important element in the sustainable development strategy of a country".⁸

7. All general equilibrium simulations indicate that **the largest gains for a country from further liberalisation of trade – around two-thirds of the total – accrue from the removal of its own trade restrictions**. The removal of trade barriers by its trading partners are typically of secondary importance, although they account nonetheless for around one-third of total gains. The largest gains stem in each country or region from liberalising the most protected sectors.⁹ Trade regimes in poor areas, in particular Africa, which remain more restrictive than in other parts of the

³ An elaboration of this link is available in WT/GC/W/356/Add.1.

⁴ See WTO 2001(a) and IMF and World Bank 2001(a). An update of the IMF and World Bank paper will be available shortly.

⁵ See in particular WT/COMTD/W/100 of 19 June 2002 – "Participation of the Developing Countries in the Global Trading System.

⁶ IMF 2002.

⁷ UNCTAD 2001 (b).

⁸ Paragraph 27 of the "Monterrey Consensus".

⁹ Hertel 2000; Department of Foreign Affairs and Trade, Australia 1999.

world are likely to be the among the biggest beneficiaries of further trade liberalisation, particularly multilateral liberalisation which combines the liberalisation of a country's own trade restrictions with the liberalisation of those of its main trading partners.¹⁰

8. At the world level, **estimates of the gains from further liberalisation of merchandise trade range from US\$250-550 billion, roughly one-third of which would accrue to developing countries.** This is well in excess of annual aid and debt relief flows, as noted above.¹¹ Model calculations show that in nominal (absolute) terms, industrial countries reap the largest gains from liberalization (notably as a result of the elimination of their own barriers to agricultural trade), but because developing countries' economies are on average more protected than those of industrial countries, they gain more from global trade liberalization as a percentage of their GDP.

9. Gains from trade typically stem from increased income for domestic consumers and industrial users of imported inputs. **Liberalising trade restrictions can therefore have a positive impact on external debt and debt servicing,** as it tends to boost domestic growth, productivity and exports. A recent study found that the level of openness to trade had positive effects on the debt structure of countries, by attracting foreign direct investment (a cheaper source of foreign capital than debt) and hence foreign exchange reserves, which in turn enabled countries to finance technology transfer and hence improve productivity, and to shift towards production with higher income-elasticity and better terms-of-trade.¹²

C. TRADE BALANCE, BALANCE-OF-PAYMENTS AND EXTERNAL DEBT

10. Recent economic literature identifies other (direct or less direct) links through which debt, fiscal policy, the balance-of-payments and trade are intertwined.

11. **The impact of declining terms of trade.** The problem of the structural decline in the terms-of-trade and its impact on commodity-dependent exporters, in particular their greater vulnerability to trade and current account imbalances and indebtedness, is recognized internationally.¹³ A paper by Birsall and Hamoudi (2002) provides evidence that declining export prices affect fiscal and external accounts negatively, contribute to reduced public consumption and investment, and force private companies, due to lack of export receipts, to reduce imports of productive inputs, thereby preventing the diversification of local production. UNCTAD (2001 (a)) suggests that declining terms-of-trade in sub-Saharan Africa have led in the past thirty years to a drying up of domestic investment resources. For each dollar of net capital inflow into the region from the rest of the world, more than half leaks out of the balance-of-payments through losses in the terms-of-trade, a quarter goes to debt servicing, and the rest is lost through other capital outflows.

12. **Deteriorating terms-of-trade and access to capital markets.** Poor market access prospects or deterioration of the terms-of-trade were cited as a factor undermining a country's ability to access international markets on attractive terms.¹⁴ In practice, countries with a low level of development and of integration in world trade lack credibility in international capital markets, thereby failing to attract private capital flows and becoming reliant on external public debt. UNCTAD (2001 (a)) suggests that at such a level of development, the low level of both domestic savings and investment (respectively

¹⁰ Sharer, 1999.

¹¹ IMF and World Bank 2001 (a).

¹² Lane, Milesi-Ferretti, 2000.

¹³ See paragraph 37 of the Monterrey Consensus: "multilateral assistance is needed to mitigate the consequences of depressed export revenues of countries that still depend heavily on commodity exports".

¹⁴ Document WT/GC/W/356/Add.1 says: "A country's trade balance [...] will affect the types and terms of external borrowing to which it has access, and thus the structure, maturity and servicing costs of its external debt. A country suffering from declines in its export prices or restrictions on market access will experience considerable difficulties in access to international financial markets".

15 percent and 18 percent in Sub-Saharan Africa) and continued mis-match between the two calls for external public financing for an extended period of time.¹⁵

13. **Countries having access to capital markets (in general middle-income developing countries) have become vulnerable to change in market sentiment and the increased costs of borrowing.** As seen in WT/WGTDF/W/4 on the relationship between trade and finance, large inflows of private capital have turned into outflows at times of changing market sentiment (such as during the Asian crisis), leading to major collateral damages on the financial system, trade, investment and employment. In a recent paper, Ajayi and Khan (2002) argue that such outflows, responsible for major drains on foreign exchange reserves, require governments to substitute for the private sector, and hence to borrow to match balance-of-payments gaps generated by private outflows. At the end of the crisis, government and private debt would have increased considerably, with negative spill-overs on international ratings and cost of debt.

14. **Trade, efficiency of the financial system and debt.** In this vein, it has been argued that the expansion of trade depends on efficient sources of financing, which in turn requires an efficient, sound and well-managed domestic banking system. An important issue in this respect is balancing the advantages that can accrue from liberalising trade in financial services with the need to ensure that liberalisation is properly timed, sequenced and prudentially managed so that it does not become a source of financial instability in its own right.¹⁶ Another issue is the need to modernize domestic banking systems and government budget financing in low-income countries, in order to avoid resorting to foreign financing (Beaugrand, Loko, Mlachila, 2002). It has been argued that the absence of efforts in some low-income countries to create liquid markets for long-term, fixed interest government debt and the unavailability of adequate instruments to hedge against exchange rate risk led also to risky external borrowing (Mello, Hussein, 2001).

15. **The "fiscal channel" is key to the link between trade and debt.** One aspect is the impact of trade liberalization on fiscal revenues, that some African countries regard as being negative. A study by Ebrill, Stotsky and Gropp (1999) indicates that well sequenced tariff reforms can be revenue-neutral (or in some successful cases, revenue-enhancing) if part of an overall fiscal reform, which would include, on the one hand, the offsetting of the negative effect on public finances of the lowering of average tariffs by the elimination of tariff peaks and of tariff exemptions, and on the other hand, and the introduction of internal taxes (such as the value-added tax). Another aspect is the fiscal impact of deteriorating terms of trade. The lowering of export prices (generally expressed in dollars) does not necessarily lead to reduced incomes of local producers, whose prices are expressed in local currency. However, it may affect public finances, for example in case of taxes levied on exports. On the other hand, the deterioration in the terms of trade may have a positive effect on public revenues if taxes drawn from the increase in import values outweigh fiscal effects of the reduction in export prices.

16. Nonetheless, some authors make the case that during the Asian crisis the loss in the terms of trade due to the devaluation and its related domestic income effects had a negative impact on government revenues (Hussain, Mlambo, Oshikoya, 2001). L.A. Winters (2000) further cautions that trade liberalization, when reducing government revenues, curtails expenditure on poverty and social policies, or forces governments to levy taxes on goods consumed by the poor. He advises governments to display care in liberalizing trade and suggests pro-poor expenditure that would offset the effects of liberalization.

¹⁵ Paragraph 39 of the "Monterrey Consensus" states that "for many countries in Africa, least-developed countries, small island developing States and landlocked developing countries, ODA is still the largest source of external financing and is critical to the achievement of the development goals and targets of the Millennium Declaration and other internationally agreed development targets".

¹⁶ WT/WGTDF/W/4, p. 2.

17. A third fiscal issue, is the fiscal impact of the cost of debt, which is addressed, for poor countries, in the context of the HIPC Initiative (section IV.B).

III. TRADE AND DEBT

A. WTO, MARKET ACCESS AND INDEBTEDNESS

18. **Initiatives to improve access of LDC's exports to industrial countries' markets are likely to result in significant benefits for these countries.** The integration of developing countries in world trade is core to the mandate of the WTO. The terms of its preamble and the 145 Special and Differentiated Treatment provisions contained in the various WTO Agreements are testimony to it.¹⁷ Still, soon after the end of the Uruguay Round, when it appeared that the least-developed countries continued to lose market shares, the then Director-General of the WTO, called, at the Group of Seven Summit in Lyon in 1996, for exports from the poorest countries to be granted across-the-board, bound, duty-free, and quota-free access to industrial country markets, a proposal subsequently endorsed by the Managing Director of the IMF and the President of the World Bank.¹⁸ Although multilateral negotiations were the best route for maximizing the economic effects of liberalization, the proposal was made on the grounds that gaining open access to industrial markets on a more permanent basis would significantly enhance trade incentives for Africa, and lead them to more active participation in future rounds.

19. In response to this call, several industrial and transition economies decided to grant LDCs similar treatment than that promoted by the Director-General (one the most significant being the "Everything but Arms Initiative" by the European Union), or improved preferences under their GSP system.¹⁹ ²⁰ These measures, no doubt, constitute progress relative to existing unilateral trade preferences for developing countries (GSP, GSTP), which had been criticized in part because of their lack of transparency, permanency, complexity of rules of origin (Sharer (2001)) which limited their benefits and use.

20. **A recent paper by the World Bank measured the incidence of the recent initiatives to improve market access for the poorest countries** that have been announced by the European Union, the United States, Japan and other countries on a sub-set of 37 Sub-Saharan African countries. It found that unrestricted access to the Quad's markets would produce substantial gains for the beneficiary countries, leading to a 14% increase in non-oil exports (in the order of US\$2.5 billion) and boosting real incomes by around 1 percent, with negligible trade diversion costs for the rest of the world. Most of the gains would come from preferential access to the Japanese and European agricultural markets (Ianchovichina, E., A. Mattoo and M. Olarreaga, 2001)

21. However, while increased preferences for LDCs are a step in the right direction, **all recent studies measuring the gains of a global, non-discriminatory reduction of trade barriers, in the context of a new multilateral round of negotiations, point to much larger gains for all countries**, including developing countries. These calculations are based on the current patterns of protection in industrialized and developing countries which have recently been outlined by the WTO (2001):

¹⁷ The Preamble of the Marrakesh Agreement states: "Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth of international trade commensurate with the needs of their economic development, ...".

¹⁸ This endorsement is for example to be found in the tripartite Declaration of the Heads of the three agencies on the occasion of the third WTO Ministerial Conference.

¹⁹ A review of such initiative is found in WTO (2001), Overview of Development in the International Trading Environment, Geneva".

²⁰ The Monterrey Consensus called on "developed countries that have not already do so to work towards the objective of duty-free and quota-free access for all least-developed countries, as envisaged in the Programme of Action for the Least Developed Countries adopted in Brussels".

- Developed countries, and Quad countries in particular, display much lower bound and applied average tariffs than developing countries, although tariff peaks exist in selected industries (food and footwear in the European Union and Japan; textiles and clothing, footwear, glass and electrical parts in the United States and Canada; while tariff escalation also exist for these countries, it is also a common feature many WTO Members, including developing countries, in relatively similar categories of products. Therefore, possibly contrary to common belief, there is ample scope for further liberalization in industrial products (details in WTO, 2001 (b), p.27-31).
- For developed countries, the average bound and applied rates for agricultural products is four to nine times higher than that on industrial products (depending on countries and on methodology used), and for developing countries the average is two to three times higher than that for industrial products (WTO, 2001 (b), op. cit. p.30; and IMF and World Bank, 2001 (a), p.18).

22. Subsequently, and keeping in mind that countries benefit most from liberalizing sectors for which they have higher trade barriers, **in nominal terms developed countries would gain more from the elimination of trade barriers, but in terms of GDP, developing countries' gains could be as much as two and half times as much as for the industrial countries** (Hertel (2000)). Developing countries would in principle gain more from the liberalization of the manufacturing sector, while developed countries benefit most from agricultural liberalization. However, looking at Hertel's calculation (which results are broadly similar to those published by the Government of Australia), developing countries would account for 46% of total trade liberalization across both agriculture and manufacturing, developed countries taking up the remaining 54%. Looking at more detailed calculations (Anderson, 2000), LDCs would gain most from agricultural liberalization in developed countries because of greater relative importance of agriculture in their economies, while higher income developing countries gain most from liberalization in industrial products because of the greater importance of manufacturing in their GDP and exports. In any calculation, income gains generated by total liberalization of trade barriers would by far outweigh total savings from the HIPC Initiative.

Benefits from Post-Uruguay Round Liberalization, 2005

	Benefits from:		
	Agriculture	Manufacturing	Total (\$ billions)
Developing countries	44	90	134
Industrial countries	120	40	160
Total	164	130	294

Source: Hertel, Thomas (2000), "Potential gains from reducing trade barriers", Federal Reserve Bank of Saint-Louis Economic Review, July/August 2000.

B. DOMESTIC TRADE POLICIES MUST BE SUPPORTIVE OF TRADE INTEGRATION AND DEBT REDUCTION EFFORTS

23. **Outward-oriented trade policies at country level help to maximize the gains of an international open trading environment.** However, special attention should be paid to the proper phasing and sequencing of trade liberalization to prevent an unequal distribution of benefits. According to Reimer (2002), while total effects of liberalization are positive economy-wide, the distribution of additional income among household groups may be uneven due to the reallocation of resources and factors of production triggered by the process of liberalization. Bannister and Thugge (2001) conclude in their study that the larger the number of sectors liberalized, the more individual groups will perceive the benefits of such liberalization and the more the cost of liberalization will be spread among sectors, age and gender groups. Although trade liberalization raises the average standard of living in the medium-term, groups that have been favoured by protection will see their income decline temporarily, and the resulting restructuring of the economy may create economic dislocations in the short-term.

24. **Trade policies should be supported by policies aimed at raising domestic private savings and foreign direct investment.** Standard economic theory teaches that in the absence of full mobility of factors of production (such as land, labour and capital) countries will obtain these factors by exchanging goods intensive in the factors in which they are well endowed against goods intensive in scarce factors (countries well endowed in labour would exchange labour-intensive goods against capital intensive goods) (Hecksher;²¹ Ohlin). As seen above, obstacles to this process are the lack of market access and/or deteriorating terms of trade for labour-intensive goods exporters, are creating external imbalances preventing the acquisition of imported capital goods. Another condition is that trade policy be supported by policies aimed at mobilizing private and international savings, notably in the form of foreign direct investment.

25. **The importance of foreign direct investment in indebted countries is emphasized in the literature and policy conferences on development, such as in the conclusions of the recent conference on financing for development held in Monterrey.**²² The WTO Working Group on Trade and Investment has on numerous occasions emphasized the positive contribution of FDI for development, in particular its stability relative to other forms of financing, its positive spill-overs on the technical development of host countries, and its absence of financial cost (no capital or interest to pay back). A recent study by Lehmann, (2002), emphasizes that the positive impact of FDI on the balance of payments of developing countries and on capital formation, is not so much explained by the amount of the initial investment, but because of re-invested earnings (on average three-quarters of investment incomes are reinvested in the host country).

26. **The mobilization of private savings in LDCs is problematic in many ways,** because of poor macroeconomic management (inflation, crowding-out of private investment), unsound banking sectors and lack of perceived investment opportunities in the LDCs: Ajayi and Khan (2002) examined, from the point of view of investors, the risk of investing into the local economy by residents. They found that LDC nationals often prefer to invest their assets abroad where risks is

²¹ See in particular Hecksher, E. (1919), The Effect of Foreign Trade on the Distribution of Income, *Ekonomisk Tidskrift*, 497-512 (translated in chapter 13 of American Economic Association's Readings in the Theory on International Trade, Philadelphia: Blakiston, 1949, 272-300).

²² In paragraph 20 of the "Monterrey Consensus", it is said that "private international capital flows, particularly foreign direct investment, along with international financial stability, are vital complements to national and international development efforts. Foreign direct investment contributes toward financing sustained economic growth in the long term. [...] A central challenge, therefore, is to create the necessary domestic and international conditions to facilitate direct investment flows [...] to developing countries, particularly Africa and least developed countries[...]. Paragraph 21 emphasizes the need for countries to achieve a transparent, stable and predictable investment climate, while paragraph 22 calls on relevant international and regional institutions to increase their support for private investment in priority areas.

perceived as neglectible, whereas they perceive assets invested into the national economy as more risky because they are prone to nationalization, taxation or expropriation. Other factors such as inflation, large fiscal deficits, fraudulent trade invoicing, lack of domestic credits and unfavourable terms of trade are found to be the main factors discouraging the investment of private savings into domestic investment. Lack of private savings, inefficient financial intermediation and crowding out from fiscal deficits explain the unavailability or high cost of credit for small and medium size enterprises, according to the authors.

27. **Trade liberalization and fiscal policies must also play their part in the mobilization of savings.** According to Go and Mitra (1998), trade liberalization may have, in the first instance, a negative effect on public revenues and public savings. However, as imports are also inputs in the production process, a tariff reduction has a favourable effect on output, private sector income, and hence private savings. But since just a fraction of the private sector finds its way to private savings, the increase in the latter does not completely offset the decline in public savings. Restoration in the savings-investment balance requires an increase in domestic savings, which can come either through an increase in the average tax rates or a reduction in government consumption. Depreciation of the real exchange rate also helps to restore the internal balance by boosting exports. Availability of external financing reduces the need for fiscal adjustment to make up for the shortfall in domestic savings arising out of tariff reduction.

IV. DEBT AND TRADE

A. DEBT AS A BURDEN TO THE ECONOMY

28. **One concern also expressed by a Member is that high levels of external indebtedness reduce the capacity of developing countries to take full advantage of improved export market access opportunities** because of insufficient new investment in productive capacity in their economies, particularly in their export sectors. The fact of being labelled as "indebted" deters new investors, while debt service obligations absorb available capital and foreign exchange to pay for imports.²³

29. **Some of these concerns are supported by empirical evidence found in the literature.** In a recent paper by Pattillo, Poirson and Ricci (2002), the authors try to answer to the question of why large levels of accumulated debt lead to lower growth and under which conditions. They test the "debt overhang" theory, referred to above, which shows that if there is some likelihood, in the future, that debt will be larger than the country's ability to repay, expected debt-service costs will discourage further domestic and foreign investment and thus harm growth. Potential investors will fear that the more a country produces, the more it will be "taxed" by creditors to service the external debt, and thus they will be less willing to incur costs today for the sake of increased output in the future. On this basis, the authors drew a "Laffer" curve for debt, which posit that large debt stocks tend to be associated with lower probabilities of debt repayment. It appears from calculations held on 100 countries that the overall contribution of debt to growth appears to become negative at 160-170% of exports and 35-40% of GDP, while emphasizing that reasonable levels of debt (much below those levels) have a positive impact on growth.

30. While this above paper emphasizes the "investment channel" as eroding growth and diversification of exports, **the "external debt trap" may also work its way through the external**

²³ The proposal in WT/GC/W/445 is: "In many developing countries, particularly low-income countries, the heavy debt burden reduces their ability to develop an adequate supply response...The debt burden can work through several different channels to reduce supply capacity. First, a large debt overhang discourages private (foreign and domestic) investment which would help alleviate the financing constraint. Second, heavy debt servicing requirements can create foreign exchange liquidity problems because of the draft on foreign exchange reserves,...At the same time, high levels of debt service weaken the supply capacities of debtors as resources are diverted away from productive investments".

sector, by maintaining a high level of vulnerability to balance-of-payments shocks. The mechanisms described by Beugrand, Loko and Mlachila (2002), associate high debt, responses to external shocks through currency depreciation or further borrowing, which in turn lead to an increase in the cost of existing debt expressed in local currency, with possible implication on the stability of local financial intermediaries.

31. **In extreme cases, countries may default on their external debt.** In such cases, the impact of default may vary widely according to countries. In cases where default is followed by a debt restructuring plan (such as the Brady Plan) coupled with the restoration of macroeconomic stability under the sponsorship of international agencies, default may not necessarily have long-term effects on a country's capacity to integrate in international trade and attract foreign direct investment as a substitute to bank loans (Brazil, Mexico, Bulgaria). Rose (2002) shows that the longer the debt renegotiation process lags and restoration of macroeconomic stability is delayed, the deeper the effect on the export capacity of the countries concerned will be (examples are essentially drawn from African experiences). Defaults not only cut off borrowing but also inflows of foreign direct investment, which are deterred by poor credit ratings.

32. **Measures to address supply-side constraints of developing countries are at the center of concerns of the international community.** In its section on international trade, the "Monterrey Consensus" (paragraph 36) clearly invites multilateral, bilateral financial and development institutions to "expand and coordinate their efforts, with increased resources, for gradually removing supply-side constraints (of developing countries)". Members of the Conference emphasized the need to, *inter alia*, improve trade infrastructures, diversify export capacity and support the technological content of exports; and strengthen infrastructural development and enhance overall productivity and competitiveness. To that end, the "Consensus" calls on relevant institutions, amongst which the WTO, to reinforce support for trade-related training, capacity and institution building, and trade supporting services.

B. DEBT RELIEF, POVERTY REDUCTION AND TRADE

33. After a succession of debt crises in middle-income and poor countries in the 1980's and 1990's, international creditors **launched several debt restructuring and relief initiatives or mechanisms**, under the auspices of the Paris Club (for bilateral ODA debt), the London Club for private debt, or international financial institutions for multilateral debt (the HIPC Initiative).

34. **The HIPC (Highly Indebted Poor Countries) Initiative** represents a framework designed by the IMF and the World Bank, along with other multilateral creditors, to provide special assistance for heavily indebted poor countries that pursue IMF and World Bank-supported programs to reduce the external debt burden to more sustainable levels and strengthen the links between debt relief and poverty reduction policies (see IMF and World Bank (2002). A first version of the HIPC Initiative was introduced in 1996, and an Enhanced Initiative, aimed at providing deeper and faster relief to a large number of countries, has been introduced in 1999. To be considered for the HIPC Initiative, a country must meet a set of criteria: facing an unsustainable level of debt, after application of existing "traditional" debt relief mechanisms (Paris Club for example), having a good record in implementing IMF and World Bank supported programs, and adopting Poverty Reduction Strategies (PRSP), through a broad-based participatory process involving civil society in the beneficiary country.²⁴

²⁴ The process takes place in two stages. First, countries must reach the Decision Point, the point at which the Executive Boards of the IMF and World Bank will determine the overall amount of debt relief available to which the countries in question are entitled; and thus, upon completion by countries of the additional conditions that the IMF and World Bank may request at the Decision Point, countries would be qualified for the Completion Point, point at which relief would be delivered (between the Decision and Completion Points, which may take between 6 months and three years, countries may receive "interim relief", that is a portion of the final amount of debt relief for which they qualified).

Thanks to PRSP, debt relief is fully integrated in a broad strategy to combat poverty that also involves integration through trade and trade liberalization.

35. **The Enhanced HIPC Initiative results in significant reductions in debt stocks and service.** According to a recent report by the World Bank (2002), the stock of external debt of the first 26 eligible countries will fall from US\$62 billion to US\$27 billion before and after relief in net present value terms, that is, from 60% to 24% of GDP (or 10 percentage points lower than the average of developing countries); debt service will decline immediately from 1/3 to half depending on countries.

36. **Some authors pointed to the positive impact of debt relief on development.** While savings from HIPC relief must be allocated to social and poverty reduction-related spending (health, education), the high standards required by the IMF and World Bank in the areas of macroeconomic management, good governance, public spending planning and poverty reduction, are likely to promote growth and improve the private investors' perception of the country risk in the eligible countries (Botchwey, 2000).

ANNEX 1

Grouping of HIPC's Under the Enhanced HIPC Initiative: Status as of July 2002

HEAVILY INDEBTED POOR COUNTRIES					
Angola*	Congo, Dem. Rep.*	Honduras	Mozambique	Somalia*	
Benin	Congo, Rep. of*	Kenya	Myanmar*	Sudan*	
Bolivia	Côte d'Ivoire	Lao P.D.R.	Nicaragua	Tanzania	
Burkina Faso	Ethiopia	Liberia*	Niger	Togo	
Burundi *	The Gambia	Madagascar	Rwanda*	Uganda	
Cameroon	Ghana	Malawi	Sao Tome and Principe	Vietnam	
Central African Republic*	Guinea	Mali	Senegal	Yemen	
Chad	Guinea-Bissau*	Mauritania	Sierra Leone*	Zambia	
Comoros	Guyana				
HIPC RELIEF APPROVED AT DECISION POINT (26)			DECISION POINT NOT YET REACHED (12)		POTENTIALLY SUSTAINABLE CASES (4)
Benin	Guinea-Bissau	Niger	Burundi	Lao P.D.R.	Angola
Bolivia 1/	Guyana	Rwanda	Central African Rep	Liberia	Kenya
Burkina Faso 1/	Honduras	Sao Tome and Principe	Comoros	Myanmar	Vietnam
Cameroon	Madagascar	Senegal	Congo, Dem. Rep.	Somalia	Yemen
Chad	Malawi	Sierra Leone	Congo, Rep. of	Sudan	
Ethiopia	Mali	Tanzania 1/	Côte d'Ivoire	Togo	
The Gambia	Mauritania 1/	Uganda 1/			
Ghana	Mozambique 1/	Zambia			
Guinea	Nicaragua				

* Conflict-affected countries.

1/ Completion-point countries.

Sources: World Bank (July 2002), Financial Impact of the HIPC Initiative, First 26 Country Cases, HIPC documents and IMF and World Bank staff estimates.

ANNEX 2

(Status as of July 2002)

(in millions of US dollars)1/

(in millions of US dollars)								
	Reduction in NPV Terms			Nominal Debt Service Relief				
	Original HIPC Initiative	Enhanced HIPC Initiative	Total	Original HIPC Initiative	Enhanced HIPC Initiative	Total	Date of Approval	
Countries that have reached their Completion Points (6)								
TOTAL	2,740	4,788	7,528	5,510	7,830	13,340		
Bolivia	448	854	1,302	760	1,300	2,060	Jun-01	
Burkina Faso	229	324	553	400	530	930	May-02	
Mauritania	-	622	622	-	1,100	1,100	Jun-02	
Mozambique	1,716	306	2,022	3,700	600	4,300	Sep-01	
Tanzania	-	2,026	2,026	-	3,000	3,000	Nov-01	
Uganda	347	656	1,003	650	1,300	1,950	May-00	
TOTAL	377	16,851	17,228	660	26,720	27,380		
Benin	-	265	265	-	460	460	Jul-00	
Cameroon	-	1,260	1,260	-	2,000	2,000	Oct-00	
Chad	-	170	170	-	260	260	May-01	
Ethiopia	-	1,275	1,275	-	1,930	1,930	Nov-01	
The Gambia	-	67	67	-	90	90	Dec-00	
Ghana	-	2,186	2,186	-	3,700	3,700	Feb-02	
Guinea	-	545	545	-	800	800	Dec-00	
Guinea-Bissau	-	416	416	-	790	790	Dec-00	
Guyana	256	329	585	440	590	1,030	Nov-00	
Honduras	-	556	556	-	900	900	Jul-00	
Madagascar	-	814	814	-	1,500	1,500	Dec-00	
Malawi	-	643	643	-	1,000	1,000	Dec-00	
Mali	121	401	522	220	650	870	Sep-00	
Nicaragua	-	3,267	3,267	-	4,500	4,500	Dec-00	
Niger	-	521	521	-	900	900	Dec-00	
Rwanda	-	452	452	-	800	800	Dec-00	
Sao Tome and Principe	-	97	97	-	200	200	Dec-00	
Senegal	-	488	488	-	850	850	Jun-00	
Sierra Leone	-	600	600	-	950	950	Mar-02	
Zambia	-	2,499	2,499	-	3,850	3,850	Dec-00	
Countries still to be considered (12)								
Côte d'Ivoire	345	-	345	800	-	800	Mar-98	2/
Burundi	-	-	-	-	-	-		
Central African Republic	-	-	-	-	-	-		
Comoros	-	-	-	-	-	-		
Congo, Dem. Rep. of	-	5,773	5,773	-	9,800	9,800	Jun-02	3/
Congo, Rep. of	-	-	-	-	-	-		

	Reduction in NPV Terms			Nominal Debt Service Relief				Date of Approval
	Original HIPC Initiative	Enhanced HIPC Initiative	Total	Original HIPC Initiative	Enhanced HIPC Initiative	Total		
Lao PDR	-	-	-	-	-	-	-	
Liberia	-	-	-	-	-	-	-	
Myanmar	-	-	-	-	-	-	-	
Somalia	-	-	-	-	-	-	-	
Sudan	-	-	-	-	-	-	-	
Togo	-	-	-	-	-	-	-	
<u>Memorandum item:</u>								
Debt relief committed 4/	3,462	21,639	25,101	6,970	34,550	41,520		

1/ In net present value (NPV) terms of the decision point year.

2/ Approved debt relief under original framework.

3/ Preliminary document issued.

4/ By mid-Feb 2002, incl. Côte d'Ivoire.

Source: World Bank (July 2002), Financial Impact of the HIPC Initiative, First 26 Country Cases

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