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Economic Commission for Africa

ECONOMIC AND SOCIAL COUNCIL

Sixth Session of the Conference of African Ministers of Finance

Addis Ababa, Ethiopia
31 March - 2 April 1997

Distr.: Limited
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AN OVERVIEW OF AFRICA'S DEBT IN THE CONTEXT OF THE HIGHLY INDEBTED POOR COUNTRIES (HIPCs) INITIATIVE

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LIST OF ACRONYMS

AfDB	African Development Bank
CG	Consultative Group
CS-DRMS	Commonwealth Secretariat-Debt Recording and Management System
DMFAS	Debt Management and Financial Analysis System
DSM	Debt Strategy Module
ECA	Economic Commission for Africa
ECU	European Currency Unit
ESAF	Enhanced Structural Adjustment Fund of the IMF
ESAIDARM	Eastern and Southern Africa Institute on Debt and Reserves Management
HIPCs	Highly Indebted Poor Countries
G.7	Group of Seven Industrial Nations
IBRD	International Bank for Reconstruction and Development
ICORs	Incremental Capital Output Ratios
IDA	International Development Association
IFIs	International Financial Institutions
IMF	International Monetary Fund
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
NGOs	Non-Governmental Organizations
NPV	Net Present Value
OAU	Organization of African Unity
ODA	Official Development Assistance
SAF	Structural Adjustment Fund of IMF
SDR	Special Drawing Right
SPA	Special Programme of Assistance Africa
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations Children Fund

Introduction

1. Africa's enormous debt burden has had a profound damper impact on economic and social indicators, and on the options available to policy-makers, as they try to design and implement development strategies. In the past, calls for its alleviation were not as loud as those made in respect of the Latin American debt. Mexico's inability in 1982 to service its debt as contracted triggered a rapid cascade of similar moratoria by other debtor countries, and led to what came to be known as "the debt crisis". Within two years of Mexico's default, 30 countries, representing half of developing country debt, were failing to service their debt as scheduled. The crisis was first thought to be a liquidity problem, but turned out to be insolvency of sovereign states. It is important to note at the outset that the countries in the limelight were high profile, middle-income, Latin America borrowers, whose debt structure reflected a preponderance of private debt owed to commercial bank syndicates. In these countries, obligations to official creditors and to multilateral institutions were of relatively less significance. By contrast, on the African continent, apart from Nigeria, commercial debt was relatively small; the bulk of debt was owed to official bilateral creditors and to multilateral institutions. Africa's debt stock was also small compared to that of Latin America. Therefore, although indicators of debt burden were high, as was the risk of default, the debt did not threaten the stability of the international financial system like the Latin American debt.

2. Because of the above reasons, the international community's initiatives to address the debt crisis centred on the Latin American case and, although Africa was free to take advantage of all the new debt relief mechanisms associated with it, in practice, many were of limited applicability. At the same time, the Paris Club instruments, the principal source of debt relief to Africa on her bilateral debt, have proved to be less effective than the instruments used in Latin America. Moreover, Africa's debt to multilateral institutions was never subject to rescheduling due to their preferred creditor status. Thus, while the debt issue in Latin America is no longer a pressing matter to the international community (as long as there is no policy slippage of the kind that caused Mexico's 1995 crisis), it has risen to higher prominence in Africa.

3. The recognition that Africa's debt crisis persists, in-spite of the application of traditional debt relief mechanisms, has led the international community to revisit the subject, re-examine existing debt relief mechanisms and their efficacy; and, in light of this, to design and propose a new debt relief mechanism, the Highly Indebted Poor Countries (HIPCs) initiative. It is a mechanism to provide debt relief to all ESAF-eligible, IDA only countries which face a debt situation that is *definitely* or *possibly* unsustainable. A sustainable debt situation is defined as falling below 200 percent debt-to-exports ratio and 20 percent debt service-to-exports ratio, in present value terms, after full application of traditional relief mechanisms, in the context of a strong track record of performance, under Bank/Fund-supported adjustment programmes. The HIPCs initiative, which targets 41 of the most highly indebted poor countries, was designed by the staffs of the World Bank and IMF, in close consultation with the G.7 countries, and was approved by their respective Boards of Governors in October 1996 and their Executive Directors in November 1996. The African debt, in the context of this new initiative, is the focus of this paper.

4. Since much of the historical information on debt and past relief initiatives is well known, the paper focuses only on material that is relevant to understanding the issues that led to the initiative. Chapter I reviews the evolution of the debt crisis and gives an overview of the Africa debt profile; chapter II presents and synthesizes existing (traditional) debt relief mechanisms, and summarizes the significant factors and issues which tended to compromise or increase the impact of past initiatives; chapter III presents the essential features of the HIPCs initiative and its operational modalities; chapter IV appraises it in light of past experience (chapter II), concerns that were raised by various constituencies on earlier drafts, and other issues that are likely to arise during its implementation. Chapter V summarizes the major debt management issues in Africa, identifying priorities for a focused plan to prevent a re-occurrence of imprudent borrowing in the future.

CHAPTER I

Africa and the Evolution of the Debt Crisis in the Context of the HIPCs Initiative

5. Recent Trends. Over the past two decades, aggregate net resource flows to developing countries grew steadily. Overall, the share of private capital rose, while official flows became relatively less significant. This reflected shifts in global investment opportunities, financial constraints in the major donor countries, and steps in developing countries to actively attract private investment, in response to declining flows of official assistance. In addition, there was a shift away from debt-creating private flows (lending) to direct foreign investment (equity acquisition). Net private flows to developing countries increased from an average of $16.4 billion per annum between 1975-79 to over $164 billion in 1995 (Iqbal, Zubair. et. al). Most of the flows were to Asia and Latin America; in Asia they were largely in the form of direct foreign investment, and in Latin America, they were mainly in the form of lending and portfolio investment. But this trend was not true of Africa, especially of Sub-Saharan Africa, where bilateral official credit remained the major source of external funds, alongside disbursements of loans and credits from multilateral financial institutions. Net positive flows explain the increase in the debt stock of recipient countries.

6. Sub-Saharan Africa's share of net flows. Compared to other developing countries, and those in transition, flows to Sub-Saharan Africa, by each source, other than multilateral aid, have continued on a declining trend since the 1975-79 period: from 18 to only 9 percent in 1995 for official bilateral credit. By contrast, Latin America and Caribbean's share of official bilateral credit shot up from 15 to 53 percent, over the same period [Annex 1, Table 1]. Only the share of Africa's publicly guaranteed multilateral credit (largely World Bank and IMF) increased over the same period, from 16 to 22 percent [Annex 1, Table 2]. Africa's share of net private capital flows nose-dived, from 39.6 to a mere 8 percent between 1975-79 and 1995.

7. Sources of Debt Servicing Difficulties. The inter-related factors underlying debt servicing problems for Africa, and indeed all the HIPCs, are well known. The key ones are:

External factors

- Increases in international interest rates, exacerbated by disinflation in the major industrial countries in the 1980s;
- The global recession that began in 1980;
- Continued positive net transfers to Africa and rescheduling of interest on official and commercial credits;

- Recession-induced slump in the demand for non-oil commodities, the principal exports of African countries;

- Deterioration in the terms of trade and external account positions of most non-oil developing countries;

- Pressure-lending by commercial banks, with little regard to country risk considerations.

Internal factors

- Delayed and inadequate adjustment effort on the part of several commodity-exporting, oil-importing, developing countries;

- Underlying structural characteristics of the HIPCs' economies, which dampen supply response in the real sectors;

- Inadequate supply response in the export sector was compounded by the collapse of commodity prices;

- Poor investment project implementation environment, which, in many cases, results in public sector investment projects undertaken with borrowed foreign funds not achieving rates of returns indicated at appraisal;

- Fiscal imbalances due to poor tax effort and inability to curb public consumption;

- Pressure-lending by commercial banks, which shortened the maturity structure of debt, resulting in bunching of payments;

- High marginal cost of borrowing as debtors approached their credit-worthiness boundaries;

- Domestic price-cost distortions in the real, financial and exchange markets as authorities unsuccessfully interfered in the markets to arrest the situation, hurting competitiveness in the process, and supporting consumption at levels that could only be sustained by further foreign and domestic borrowing.

8. Debt Profile. Of the total HIPCs debt stock, equivalent to $164 billion in present value terms in 1994, debt to private creditors amounted to only 17 percent, of which, 7 percent was short term and 10 percent long term. Debt to official creditors was estimated at about 64 percent, divided almost evenly between Paris Club members and non-members. The balance, about 19 percent, was owed to multilateral institutions, of which: 25 percent to IDA, 22 percent to IMF, 15 percent to IBRD, 13 percent to the African Development Bank (AfDB), and another 13 percent to European and Arab institutions. The balance, 12 percent, is owed

to smaller organizations (Claessens, Stijn et. al, 1996). This contrasts with the profile for **all** developing countries, including HIPCs, where 41 percent was owed to private creditors (largely due to the large commercial bank credits to Latin America), 35 percent to bilateral creditors and 24 percent to multilateral institutions.

9. Debt Service Burden. In-spite of the belief that the bulk of African debt, which, as noted, is owed to official creditors and multilateral organizations, contains a significant grant element, its burden is heavy. By standard debt burden indicators, the debt difficulties are immense, even compared to the Latin America debt at its peak. Applying a present value measure of future payment obligations and exports to 1992-94 World Bank debt data, the median debt-to-exports ratio for the 41 HIPCs was estimated at 340 percent (Claessens, Stijn. et. al, 1996). Twenty countries had ratios between 200 and 400 percent, five countries had ratios between 400 and 600 percent, eight were above 1000 percent, while only four had ratios below 200 percent. Preliminary data for 1995 for 34 HIPCs shows that 21 African countries had ratios of 200-400 percent, five had ratios of 400-600 percent and four had ratios between 600 and over 1000 percent (Boote, Anthony. et. al. 1997). By contrast, at the peak of the Latin American debt crisis, the comparable ratios for Mexico and Brazil were estimated at 400 and 450 percent respectively.

10. Status of payments. With the situation as described above, its little wonder that debt service due is often partially paid, and paid late. In 1994, for example, only Burkina Faso, Burundi and Ghana, among the HIPCs, met their debt service obligations fully. All other debt service paid on Africa's debt was below the contract amount and was not paid on time (Claessens, Stijn. et. al, 1996)]. Arrears to bilateral creditors have accumulated. However, only a relatively small number of African countries have large arrears to commercial creditors and to multilateral institutions.

11. Heavy burden of *concessional* aid, with *positive net flows*: a contradiction? The Africa debt, though relatively small by Latin American standards, is a heavy burden to carry, by all debt burden indicators (para. 9). Most of the debt is long term, not short term, and is concessional. Africa has also continued to benefit from positive net flow of resources, partly accounting for the rising debt stock, as opposed to Latin America during the crisis, when new money dried out and net capital outflow was devastating. The apparent contradiction between the concessionality of Africa's long-term debt and its heavy burden can be explained largely by the fact that most of the money was borrowed for investment and growth of the economies, but the economies have not grown at rates reflecting the levels of borrowing/investment. Additionally, as has been convincingly argued by one ardent proponent of the cancellation of Africa's debt, Percy Mistry (1996), the concessional/grant element of the debt is neutralized by the secular decline of the dollar, the currency earned by Africa's exports, relative to the SDR and ECU, the units of account in which most of the debt is denominated.

12. Africa within the HIPC. Of the 41 countries preliminarily identified as HIPCs, 33 are African; 14 of which, Angola, Benin, Burkina Faso, Central African Republic, Chad, Equatorial Guinea, Ghana, Guinea, Kenya, Mali, Mauritania, Senegal, Sierra Leone and Togo, are said to *may* already be in a sustainable debt situation. Nine countries, Cameroon, Congo, Cote d'Ivoire, Ethiopia, Madagascar, Niger, Rwanda, Tanzania and Uganda, are classified as "**possibly stressed**". Seven countries, Burundi, Guinea-Bissau, Mozambique, Sao Tome and Principe, Sudan, Zaire and Zambia are classified as being clearly in an "**unsustainable**" debt situation, while the status of Nigeria, Liberia and Somalia has yet to be determined. No northern Africa countries are in the group. Non-African HIPCs are: Bolivia, Myanmar, Vietnam, Republic of Yemen, Laos P.D.R. and Honduras. This classification, which was arrived at by setting threshold ratios, and using projections and policy simulation tools to determine eligibility, has raised controversy, as it appears to exclude some countries that might need assistance (see para. 39).

13. Behind the numbers, the fate of real people. Africa has the poorest socio-economic development indicators in the developing world. Sub-Saharan Africa has the shortest life expectancy at birth, the highest infant mortality rates, etc... Social programmes, particularly health and education, have suffered and child survival services have been adversely affected by inadequate budgetary allocations. The reduction in appropriations for these programmes under adjustments was largely to free resources for debt service. Authoritative social development reports by UNDP, and on children's welfare by UNICEF, have consistently pointed to the singular motive of debt repayment in the context of structural adjustment, as a major source of Africa's deteriorating social conditions. In different fora, including the UN, African Heads of State, Councils of Ministers and the Organization of African Unity have intensified their campaign, urging international creditors to genuinely ease the continent's debt problem, so that tackling the socio-economic development agenda can begin realistically in earnest. It is reassuring that the international community has taken a significant step in this direction in the form of the HIPCs initiative.

CHAPTER II

Traditional Debt Relief Mechanisms and Instruments

14. Dealing with pre-crisis debt service stress. Prior to the generalized debt crisis of the early 1980s, two broad categories of debt difficulties were recognized: servicing officially financed and/or insured credits; or servicing debt contracted with private parties. In both cases, debt problems were perceived as individual events, mainly as a temporary cash-flow problem of one or a few debtors, without significant repercussions for global financial stability. For countries dependent upon official flows, which included most of the poor countries, the Paris Club forum was well suited to resolving their problems, by restructuring official debt, including principal, interest and arrears, on a case-by-case basis. To bridge the debtors over what was perceived as merely a temporary liquidity shortage, the creditors expected, as a precondition, the debtor to have negotiated a stabilization programme supported by the International Monetary Fund (IMF), through a stand-by arrangement. The arrangement was to serve as a guarantee that appropriate policies in the debtor country would be implemented, so that the problem does not re-occur.

15. Commercial debt. Middle and lower middle income countries, apart from benefiting from official credits, also borrowed from the private market, mainly from commercial banks. If they encountered difficulties in servicing their debt, they would negotiate on an *ad hoc* basis with their creditor banks, who usually would also require that the debtor enter into an arrangement with the Fund and seek relief on the official portion of his debt through the Paris Club. The process was *ad hoc*, partly because the affected bank did not want to incur high costs of policing the follow-on actions between the debtor and other creditors, but also because the bank did not think that other banks were facing similar situations on a scale so massive as to threaten the very existence of the institution(s). Although the framework of the London Club of banks was evolving, debtors by and large negotiated with their creditors separately as the need arose.

16. Post 1982 Initiatives. Since the on-set of the debt crisis, the international financial community, including non-Paris Club bilateral and commercial creditors and multilateral institutions, introduced and implemented a wide range of instruments designed to alleviate the debt burden. These mechanisms and instruments were available to African as well as non-African countries, including the heavily indebted middle income ones, But it became abundantly clear then to the non-African countries, as it has become now to the Africans (indeed to all HIPCs), that these mechanisms could not resolve the debt crisis. Other innovative instruments had to be explored.

17. Initiatives were largely geared to commercial debt. The follow-up initiatives were largely geared towards resolution of the private commercial debt problem, which threatened to collapse the global financial system. Besides the obvious need to find a way to pay

creditors, an overriding objective of the new initiatives was to return the economies of debtor countries to growth as a pre-requisite for enhanced capacity to service debt in the future. The new strategy challenged the traditional relationship between debtors and creditors by forcing the creditors into a concerted approach and debtors into structural and policy adjustment programmes, all under the supervision of International Financial Institutions (IFIs), who, like official creditors and the commercial banks themselves, were to put up new money to finance or provide collateral for debt reduction transactions. The following programmes were proposed and made use of by various countries at different times.

18. The Baker Plan developed in 1985, the initiative envisioned new lending by commercial banks of $7 billion annually during the three plan years, 1986-1988, basically to refinance interest. The international financial institutions would increase their net flows to $7 billion annually, effectively shifting risk to the public sector. Under the plan, debt write-offs were rejected, but major structural reforms in debtor countries were to be undertaken in exchange for the new money. This recipe was expected to grow the debtor countries out of debt. But concerted involuntary lending, the basis of the plan, which was partly fostered by the banks' collective self interest to protect their assets, but largely imposed by the International Financial Institutions, collapsed. The banks were uncomfortable about putting more of their money at risk. In response, the Baker Plan was modified in 1987 to introduce a market-based menu approach, which allowed banks to individually choose from various options, including new money facilities (as previously) and various exit instruments. The market-based transactions, designed to reduce debt and interest were: *buybacks* , where a country buys back its debt at a discount for cash, which cash would most likely come from a third party; *exchanges of claims,* which is an exchange of a debt instrument for another that carries less principal and/or interest; *debt-equity swaps,* where an investor exchanges a foreign loan for local currency to make domestic investment or to support some local worthy cause (such as debt-for-nature or debt for environment, etc). In order to work, the plan needed much more money than was available, and from diversified sources.

19. The Brady Initiative. Proposed in March 1989, the Brady Plan was the real breakthrough. It called for official support to countries to finance the restructuring of commercial bank debt, on the basis of a comprehensive menu of market-based transactions, to reduce debt and debt service. Debtor countries were to maintain strong, Bank/Fund-supported, growth-oriented adjustment programmes and provide incentives for the repatriation of flight capital. Under the approach, banks could choose among a range of options previously agreed between the borrower and a committee of the country's leading creditors. New money was put up by official sources, the Banks themselves and the Bretton Woods institutions, to finance the transactions. This approach facilitated nearly universal participation in debt packages, grouped in three broad instruments: *debt buy backs, exchange of old debt at a discount for new collateralized bonds, and exchange of old debt for new par value bonds with reduced interest rates.* Commercial banks were to provide debt reduction as well as new money to support the accelerated reduction of debt and debt service, while creditor governments were to continue to give relief through the Paris Club and maintain export credit cover for countries with sound adjustment programmes. The range of the instruments enabled the Banks to tackle the hitherto thorny issue of tax accounting and regulatory requirements in

their home countries. With these packages, strong adjustment policies, renewed investor confidence, good financial, economic and human infrastructure, and a responsive, relatively modern economic base, growth resumed in most economies faster than anticipated.

20. Brady Plan, a minor relief for Africa. The benefits to Africa of the Baker/Brady plan have been limited. Madagascar rescheduled $49 million in 1990. In 1991, under the plan, Nigeria restructured $5.8 billion, Niger $111 million, and Mozambique $124 million. This represented only 2.2 percent of Sub-Saharan Africa's total outstanding debt of $280.5 billion that year, and only 8 percent of total debt restructured between 1987 and June 1992. The pace picked up somewhat after, with five more countries utilizing the facility: Uganda in 1993 restructured $152 million; Zambia, Sao Tome and Principe, and Gabon restructured $200 million, $10 million and $187 million, respectively, in 1994; Sierra Leone restructured $233 million in 1995, while Ethiopia restructured $230 million in 1996. As of August 1996, Africa has accounted for only about 15.0 percent of total global debt restructured under the Brady Plan, (of which 3.9 percent is HIPCs' debt) and a mere 9.0 percent of Africa's outstanding debt of $306.2 billion as of end 1995. African non-HIPC countries that restructured under these terms are South Africa ($12.56 billion), Algeria ($4.7 billion) and Morocco ($3.2 billion).

21. The Paris Club and debt rescheduling terms. Over the past decade, bilateral official creditors have assisted African countries encountering debt service difficulties by applying a number of instruments: new financing through officially supported export credits; bilateral loans and grants, debt service restructuring, and bilateral ODA official development assistance in the form of debt forgiveness. Under the Paris Club, official creditors traditionally provided rescheduling for low income countries on standard, non-concessional terms, with relatively short grace and maturity periods (5 years and 10 years respectively), and at market-related interest rates. Basically the practice was to establish a cut-off date and reschedule maturities and interest and arrears falling due before that date; post cut-off debt and short-term debt were usually excluded. The precise terms were and still are determined on a case-by-case basis. This strategy, which effectively gave seniority to more recent claims, has been crucial to the continuation of new support, which has resulted in net positive flows to the African countries.

22. Burden-Sharing. Under the Club procedures, following agreed minutes of the meeting between the club members and the debtor countries, each debtor had to seek comparable relief on debt to non-Club bilateral creditors as well as on debt to commercial creditors (the *pari-passu* provision). Additionally, each debtor has to sign bilateral protocols with every member of the Club and other non-club creditors separately, a step which, in the past, proved circuitous and time consuming.

23. Relief not in sight, despite all effort. Although the treatment of debt for the low-income countries at the Club tended to be more comprehensive and provided for more cash relief than for other debtors, many of the African countries continued to have difficulties adhering to revised repayment schedules. The rescheduling of interest led to rapid debt

accumulation. Since most of the provisions of the Baker/Brady initiatives appeared to be geared to the resolution of commercial bank and private debt, they seemed to have little practical applicability to the African debt, except as indicated in paragraph 20 above. Furthermore, although IFIs increased their lending to Africa and bilaterals maintained net positive transfers, the debt burden remained intractable. Thus new relief terms were proposed.

24. Toronto and Houston terms (December 1988-June 91). The Paris Club took a decisive step, following the call by French President Mitterand at the Bank/IMF Berlin annual meetings, and the Toronto summit in 1988. The official bilateral creditors (under the Toronto terms) have since, been offering the HIPCs four options on eligible debt: partial write-offs, up to 33 percent in present value terms; longer maturities, up to 25 years; longer grace periods, up to 14 years; and, lower interest rates, depending on the circumstances of each country. The objective was to reduce the net present value of rescheduled amounts by up to one-third. In May 1989, outright forgiveness was introduced in the picture when France forgave 35 low-income African countries their public debt obligations to it under the Toronto terms 20 countries obtained rescheduling, consolidating obligations of some $6 billion. For middle-income and lower-middle-income countries, (under the Houston terms, since September 1990), the Club responded by lengthening the repayment periods up to 15 years, with a graduated payment option, and a grace period up to 8 years, on non-ODA debt. Consolidation of ODA credits was offered on terms of up to 20 years maturity with up to 10 years grace, depending on the country's circumstances. Several African HIPCs plus Egypt and Morocco took advantage of these terms.

25. London (Enhanced Toronto) Terms, (December 1991-December 1994). The above framework, eased the burden for some countries, but the problem remained. Creditors then agreed in 1991 to implement a new menu (under the enhanced Toronto terms) incorporating enhanced concession in rescheduling for the low income countries, most of which were African. The terms were: 50 percent reduction, in net present value terms, through either outright cancellation of 50 percent of the consolidated non-ODA claims or debt service reduction on the consolidated debt; graduated repayment schedule over up to 25 years, or a rescheduling on concessional interest rates/length of maturity combination to achieve the same result. Consolidation of qualifying ODA credits was offered at maturity periods of 30 years with 12 years grace or 25 years with 16 years grace, for the non-concessional option. These terms were taken advantage of by as many as 30 African HIPCs plus Algeria between January 1992 and December 1994.

26. Naples (since January 1995) and Lyons Terms (since December 1996). Terms were revised in 1994 to increase the percentage reduction for eligible non-ODA debt to 67 percent in net present value terms. Creditors have a choice of three concessional options for achieving that percentage reduction: a debt reduction option, with repayment over 23 years, and 6 years grace; or, a debt service reduction under which the NPV contraction is achieved by concessional interest rates, with repayment over 33 years; or, a long maturities/commercial option, whereby no NPV reduction takes place, but repayment is over 40 years with 20 years grace. Pre cut-off ODA credits are rescheduled on interest rates at least as concessional as the

original interest rates over 40 years with 16 years grace (20 years, when combined with the long-term commercial rates option), for 50 percent NPV reduction. Generally, application of Naples terms has been slow. For the African HIPCs, stock-of-debt operation agreements under these terms has been reached with Benin, Burkina Faso, Cameroon, Chad, Guinea, Guinea-Bissau, Mali, Mauritania, Senegal, Togo and Uganda, which, together with the Gambia and Malawi. A non-HIPC African country that has consolidated debt under the terms is Algeria (July, 1995). The **Lyons** terms are those to be implemented in the framework of the HIPCs initiative, with up to 80 percent reduction in eligible consolidated debt in present value terms (paras 33 and 34).

27. Multilateral Creditors. Multilateral creditors have participated in the international effort to alleviate the debt burden in two ways: *technical,* in the form of design and supervision of adjustment programmes in debtor countries, and advisory services to facilitate the successful conduct of restructuring negotiations. Advisory and facilitation services have also been rendered in the process of raising additional concessional funds for developing countries through Consultative Groups (CGs) and the Special Programme of Assistance to Africa (SPA) meetings. Although these programmes were funded from bilateral sources, they were implemented either by IDA (the SPA) or under the general medium-term strategy agreed between the countries and the World Bank/IMF. IFI's participation has also been *financial,* in the form of collateral funds to accelerate market-based debt restructuring transactions, e.g. the IDA Debt Reduction Facility; accelerated concessional financing of the poor, debt-burdened countries, in the form of SAF and ESAF facilities of the IMF; and, IDA supplemental credits under the Fifth Dimension Facility.

28. Summary features of debt relief mechanisms for Africa. The traditional mechanisms for addressing the debt problems of African countries can be summarized as follows:

- Adoption of stabilization and economic reform programmes designed with technical support and implemented with financial resources, in the form of concessional loans, from the IMF and IDA;

- In support of the adjustment programmes, flow rescheduling agreements with Paris Club creditors on concessional terms, followed by stock-of-debt operation after three years of good performance under IMF-supported programmes and rescheduling agreements;

- Agreement by debtor country to seek at least comparable terms on debt owed to non-Paris Club bilateral and commercial creditors;

- Bilateral forgiveness of ODA debt by many creditors; and,

- New financing on concessional terms, determined on a case-by-case basis, depending on the severity of the problem and the particular debtor's resource position.

29. Major reasons behind success cases, and lessons for Africa. Although the Africa debt situation is not the same as that of Latin America (para. 8), the successful resolution of Latin America's debt crisis, in light of the ineffectiveness of the African efforts, demonstrated the importance of some factors and practices which Africa will be encouraged to pay attention to:

- **Good national policies** are likely to be the key to private capital-driven growth in Africa, following the next round of debt relief. Debt reduction is more effective when accompanied by good economic policies. When African governments choose an appropriate economic role, focusing on such activities as the management of policy reforms, provision of certain types of infrastructure and basic human services, they would be enabling private markets to do what they are best at: efficient provision of most goods and services. Poor economic

  management and a weak reform effort, if not avoided, could sabotage the impact of debt relief, to the detriment of Africa's recovery prospects.

- **Transparency of processes** and **policy direction** are very important factors. In the debt resolution process set in motion by the commercial banks, borrowers and the IFIs, at the Brady Plan stage, all the cards were put on the table, including new financing and its sources, the requisite policy adjustment programmes and the framework for subsequent transactions between parties. By pursuing an agreed and strong policy reform programme, by putting new money in the game plan and giving creditors real exit options, each creditor acting independently of other lenders, uncertainty was minimized, investor confidence was restored, and economic recovery followed.

- **Responsive financial and real sectors** speed up benefits. Financial infrastructures, including equities markets, were in place in Latin America to facilitate speeded-up reversal of capital flows, once uncertainty in the policy and investment environments was minimized. The real sectors, including exports, were relatively diversified and modernized and were served by relatively well-developed social and economic infrastructures. These factors enabled the economies to respond quickly to opportunities created by the lower burden of debt (para. 19).

30. Major reasons for poor outcomes in Africa; and a look ahead to a new solution. The favourable conditions above (para. 29) were not as established in the highly indebted poor African countries as in Latin America, due to:

- **Inadequate policies** on the part of some countries, particularly their inability to correct fiscal imbalances arising from poor tax effort and unsustainable public consumption; and, many unsuccessful public sector investment projects which contributed more to debt than to output and growth;

- **Inoptimal use of resources,** resulting in low output and undiversified exports, because of little application of modern technology; poor financial, economic and human infrastructure; devastating exogenous market shocks, sometimes compounded by adverse weather conditions and civil strife, which hampered normal economic activities in a number of African countries.

Largely for the reasons given above, the Africa debt problem defied all past attempts to resolve it. The international community therefore mobilized for concerted action on an agreed new debt reduction agenda. The question was as to how best to implement it, and this became the point of departure for the HIPCs initiative, which is presented in Chapter III and appraised in Chapter IV.

CHAPTER III

The Highly Indebted Poor Countries (HIPCs) Initiative

31. Key Features. Concerns over Africa's debt problems have been the subject of much debate and the impetus of the HIPCs initiative, since traditional debt alleviation mechanisms, without extraordinary financing have, in the past, not had their intended effect (paras 29 and 30). The initiative represents a commitment by the international financial community to reduce to sustainable levels the external debt burden of eligible African countries that successfully establish a strong policy track record. It encompasses **all** debt in order to target overall debt sustainability. It has the participation of all creditors, as it is based on broad and equitable burden-sharing. Its over-arching *objective* is to target *overall debt sustainablity*, focusing on the **total** debt, where sustainability is defined as debt-to-exports ratios lower than 200 percent and debt service-to-exports ratio lower than 20 percent, on a present value basis. Sustainable debt levels for each eligible country would be determined on **a case-by-case** basis, depending on a country's circumstances.

32. Entry Point. The initiative is open to all HIPCs, that is, all ESAF-eligible and IDA only countries that face an unsustainable debt situation defined as over 250 percent of debt-to-exports ratio and over 25 percent of debt service-to-exports ratio in present value terms, after full application of traditional relief mechanisms. The eligible countries would also have demonstrated an appropriate policy track record. Eligibility will be determined by the Executive Boards of IDA and IMF at the end of the first three years (*the first stage*) of Bank/Fund-supervised macroeconomic adjustment and social policy reform programmes. During this stage, Paris Club creditors will provide flow rescheduling under Naples terms (para. 26), up to 67 percent reduction of the net present value of eligible debt. Other bilateral and commercial creditors will act *pari passu*. Multilateral institutions and bilateral donors will continue to provide support in the context of on-going Bank/Fund-supported programmes.

33. Decision Point. Towards the end of the first stage, a point also known as *the decision point*, a debt sustainability analysis will be carried out jointly by the Bank/Fund and the concerned country's authorities, in consultation with other concerned creditors. Based on the analysis, three outcomes are envisaged:

(i) If strong policies and Paris Club stock-of-debt operation on Naples terms, up to 67 percent present value reduction of eligible debt, and comparable treatment by other bilateral and commercial creditors during a further three year period (*the second stage)*, are sufficient to put a country in a sustainable external debt situation at the end of that period (*the completion point),* the country would request such a stock-of-debt operation. It would then no longer be eligible for the exceptional assistance under the HIPCs initiative. It would exit or graduate from the rescheduling process.

(ii) If analysis indicates that a country's overall debt burden will not be sustainable by the completion point, it will be deemed eligible for and may request support under the HIPCs initiative. During the second stage, the Paris Club, along with other bilateral and commercial creditors, will, on a case-by-case basis, provide flow rescheduling on better-than Naples terms, with a net present value reduction on eligible debt of up to 80 percent (**Lyons terms**). The country would be required to further establish in the second stage, a track record of good performance under on-going Bank/Fund-supported programmes. The initiative also says that "the multilaterals may choose to provide assistance to help ease the burden of debt during the second stage for countries with continued strong performance and that such assistance will count towards the completion point action." Such exceptional assistance could be provided, in addition to the flow rescheduling under enhanced terms (Naples to Lyons) agreed with bilateral creditors.

(iii) If the analysis indicates a borderline case, the country may, at its option, defer the request for a stock-of-debt operation and, instead, request further flow rescheduling under Naples terms. Such a country would be assured of additional action at the completion point, if that were necessary to achieve debt sustainability.

34. Completion Point. At the end of the second stage, *the completion point,* where only cases (ii) and (iii) would be eligible for further assistance [because it was decided at the decision point that a case (i) country exit from the rescheduling process, and was not eligible for the HIPC initiative], actual *ex post* debt ratios will be compared to the targets for debt sustainability **on a case-by-case basis**. Creditors would deliver the exceptional debt relief promised at the decision point, so as to bring the actual ratios to agreed sustainability targets. Paris Club would provide deeper stock-of-debt reduction of up to 80 percent in present value terms on eligible debt; other non-Club bilateral and commercial creditors provide comparable treatment on debt owed to them; and, multilateral institutions, drawing on the IDA-administered HIPC Trust Fund and the IMF's special ESAF escrow account, take such additional action as might be needed to reduce the country's debt to a sustainable level and facilitate its exit from the rescheduling processes.

35. Treatment of exogenous factors. At the completion point, if the actual ratios were higher than the target ranges, primarily due to exogenous factors, debt relief would be increased to achieve debt sustainability. On the other hand, if actual ratios were lower than the target ranges for the same reasons, debt relief *could* be reduced below what was committed at the decision point. In any event the debt relief provided at the completion point will be unconditional, thereby effectively removing that eligible portion of debt from the country's books.

36. Flexibility in application of criteria. The case-by-case approach allows flexibility in the application of the initiative's principles. For example, sustainable debt levels for each country will be determined *within* the target ranges indicated above in the light of country-specific *vulnerability factors*, such as export concentration/variability and the fiscal indicators of the burden of debt service. Also, the required performance period for eligible countries to

demonstrate a solid record of reform and sound policies could be shortened. For countries who already have programmes underway, credit could be given towards the decision stage (the first stage), and for those that have already sustained strong records of performance, credit could be received towards the completion point, effectively reducing the six-year work out period.

37. Summary. A step-by-step summary of the Initiative, including its implementation guidelines, in chart form, is attached as annex 2. On a final note, it should be said that on balance, the commitment by **all** groups of creditors to return highly indebted poor African countries to a sustainable debt situation is commendable. But one must not forget that the HIPCs initiative is a product of proposals, counter proposals and negotiations between the several constituencies that have an interest in the debt situation of developing countries, including, of course, the debtors and creditors. Others are Non-Governmental Organizations (NGOs) and several voluntary agencies, academic and research institutions and the several UN organizations. Thus the terms of the initiative put forward in October 1996 are the result of a compromise of the various options in the proposals put forward. As such the initiative as a final product could not possibly satisfy everyone or answer every question. The next chapter recalls the original concerns with the draft initiative, points to how the IMF and World Bank attempted to address them, as reflected in the final HIPCs initiative, identifies outstanding issues and suggests additional steps that could be taken to ensure its success.

CHAPTER IV

Appraisal of the HIPCs Initiative

38. Overall Approach. The initiative shows a new and heightened sense of commitment to deal with the intractable debt problems of Africa, compared to previous efforts. It takes a comprehensive, integrated, and coordinated approach to debt reduction, covering all groups of creditors and all categories of debt: bilateral, multilateral, and commercial. But the role of the World Bank and the IMF in the process, acting as "honest broker" to many constituencies with potentially conflicting objectives, cannot have been an easy one; add to that their own interest as creditors, you have an awkward situation. The position of the Bank and the Fund in the process did raise the **issue of conflict of interest and possible lack of objectivity**. In some significant way, this concern underlies the lingering dissatisfaction with some aspects of the final version of the initiative, with some parties wondering whether, if the initiative was steered by an independent commission, the process would not have been smoother and the results more balanced with respect to the interests of debtors and creditors (Mistry, Percy, 1996). The concerns that keep coming up are focused on the following six areas:

- The seemingly restrictive country eligibility at the **entry** and **decision** points;
- The macroeconomic and financial programme targets, conditionality and performance criteria;
- The treatment of market and non-market exogenous factors in policy performance evaluation;
- The failure to main-stream the government budget constraint and domestic debt in the policy simulation, debt sustainability studies;
- The length of the work-out, a long six years;
- The commitment to, adequacy and timing of the financing for the initiative.

In response to the still-outstanding concerns, the Bank and the Fund do remind all parties of the difficulties in getting the final HIPCs agreement, and that the agreement is the best that could have been brokered. In fairness to them, despite outstanding issues, it is an improvement over the initial proposals as a result of their response to earlier comments and criticisms. As a compromise programme, they point out, the HIPCs initiative could not possibly satisfy every party's concerns. The rest of this chapter details the issues in the six above areas, pointing to how they were addressed in the final version of the initiative, flags continuing concerns, and suggests possible ways to address them, so as to increase the chances of success of the initiative.

39. Eligibility for participation in the HIPCs initiative process and the role of the Bank and Fund in determining it. The **issue** here is the basis of **country classification,** and whether or not a **potential conflict of interest** on the part of the Bank and the Fund, driven by the possible objective of minimizing costs to themselves, may not have been a factor in what appears to be restrictive country eligibility. It has been argued that eligibility seems to be restricted in terms of the countries potentially left out of the target set of 41 (para. 12) and the assignment of the targeted 41 countries to one of three debt sustainability categories, i.e "sustainable", "possibly stressed", and, "unsustainable". This categorisation was criticized in many quarters (e.g. UNCTAD and African Finance Ministers) as "artificial", arguing that all the 41 countries basically faced the same reality of a debt burden in excess of their debt service capacity. Moreover there are other potential beneficiaries hat have been excluded from this set by the methodology and threshold criteria employed. Emphasizing that Bank/Fund policy simulation models are based on overly optimistic projections, which also tend to have a wide margin of error, UNCTAD suggested that the debt sustainability ratio bands be lowered to below the current ratios of 200 to 250 percent of debt-to-exports and 20 to 25 percent of debt service-to-exports. Such a step would have made it possible for more African countries to be eligible to enter the HIPCs process. The **response** in the initiative was that the country classification was preliminary, and in principle, all the 41 countries in the three categories were targeted, but the determination would be made on a case-by-case-basis. This has not quite allayed the original fears, as eligibility ratios have not changed, and in addition, the fate of those potential stress cases, which are not in the eligible set of 41 countries, is not addressed. Ineligibility for the set of 41 countries at the classification stage may have precluded some legitimately deserving countries from getting on board later.

Macroeconomic issues

40. Performance criteria and eligibility studies. Worries persist that tough **performance criteria** under IMF/IDA- supported adjustment programmes could result in help for too few countries, too late. From past experience, the most important single risk to the initiative is the attainment of programme targets and their associated conditionalities; that risk increases with the length of the actual work-out period, as is suggested by lessons from the history of policy adjustment in Africa. In the past, governments have failed to meet the conditionalities of adjustment and reform programmes for several reasons: technical deficiencies, political, managerial and administrative capacity constraints. Wide-spread *ex post* criticism of failed Bank/Fund-supported adjustment programmes in Africa has focused on programme targets, which are said to have been *ex ante* "unrealistic", a label that even many of the governments participating in the programmes subscribe to. Several of them say they had no choice because they needed the money, but this way of looking at the issue should change. Strong discomfort with aspects of any programme needs to be addressed in the negotiating process assertively. By not doing so up-front, governments risk the "surprise" of "finding unrealistic" targets in the programme during implementation, which may simply be features that were not properly negotiated. In some cases, this has tended to be a major source of non-compliance, slippage and even termination of programmes.

41. The Debt Sustainability Study and performance criteria: a make or-break step. Given the critical importance of the Debt Sustainability Study, which leads to lasting decisions at the decision point, the African debt constituency needs to do their homework well in advance. It may be necessary to hire consultants to supplement in-house technical expertise, in order to play a decisive role in this study and subsequent decisions. Because if it was determined after the study, at the decision stage, that a country would be able to attain debt sustainability at the completion point, the country would effectively drop out of the running for the new initiative, i.e. it could not be considered for the exceptional funding either in the second stage or at the completion point. It is therefore important to be assured that the approach adopted in the policy simulations is more of the "availabilities/best available forecast" approach, than of the "requirements/best policies" approach, which in the past tended to be the basis for the optimistic (read unrealistic) targets, stiff conditionalities and performance criteria.

42. Exogenous factors and vulnerability issues. Concern was voiced early in the HIPCs initiative design stages about the real possibility that realization of macroeconomic targets, set at the beginning of each programme period, and particularly in the first stage, could be exaggerated or subverted by unforeseen developments in the global economy, such as a rapid deterioration in the terms of trade, or in the domestic environment, e. g. catastrophic weather conditions. In **response** to this concern, the initiative indicates that in each country assessment, greater recognition would be placed on such vulnerability factors in debt sustainability analysis and the conclusions to be arrived at, at the decision point. Among the factors that will help determine the actual level of debt relief to be provided are: the degree of export diversity; the sensitivity to export shortfalls; and the *extent of the fiscal burden*. In other words, the initiative will deliver debt relief based on the actual and not projected debt-to-exports ratio and debt service-to-export ratios (para 35). This went a long way towards addressing the original concerns, but the treatment of the fiscal constraint remains an issue.

43. Treatment of the fiscal burden of debt service. This aspect of the initiative has almost universally attracted criticism in the African and academic constituencies of the debt debate. It has been powerfully argued that the role of the fiscal burden of debt was not adequately addressed in the initiative, sighting such evidence as the fact that countries which experienced debt management problems in the 1980s had *one thing in common*: an **inability to control fiscal deficits**. The **response** of the initiative was to indicate that, in the case-by-case assessment of vulnerability factors in debt sustainability, due attention would be given to the fiscal burden of debt (para. 36). But treating the budget constraint simply as a vulnerability factor is not good enough analytically, as it denies the inherent interdependence of the four structural blocks of the macrosystem, i.e. the balance of payments account, monetary accounts, fiscal accounts and the national income and product account. The relegation of the fiscal constraint to a position inferior to the foreign exchange constraint in the policy models, introduced a bias in the eligibility threshold, and is clearly a weak link in the tools developed for decisions. It should have been included in the threshold formula, along with foreign exchange reserve criteria.

44. The length of the work-out, six years, is too long. There was concern that the proposed six-year , two-stage, policy adjustment period was too long, imposed unnecessary hardship on countries, since many of them were likely to carry the bulk of their unsustainable debt through those years, because post cut-off debt is not affected by operations until the completion point. A point was also made that the length of the adjustment period exposed them unnecessarily to the risk of programme failure. In **response**, the time frame for implementation of the initiative has been made flexible; performance periods will be set on a case-by-case basis, with countries receiving credit towards the decision-point stage for programmes already underway; and the second stage of three years might be shortened for the countries that have already sustained records of strong performance (para. 36). This was responsive to cases like Uganda, Burkina Faso, etc., who recently concluded flow rescheduling and debt reduction operations under Naples terms (para. 26), who have on-going Fund-supported programmes and are expected to make a head-start in the HIPCs process.

Financing Issues

45. Commitment. One key lesson from the resolution of the Latin American debt is that the clarity of financing provisions in any new initiative are critical to its success (para 19). Concern has been expressed about the commitment of key players to some of the funding aspects of the proposed initiative, particularly the role of the Bretton Woods institutions. The main **issues** are: the level of funding commensurate with the stated objectives and the uncertainty of the timing of release of funds by prospective creditors. To this concern, the Bank and Fund have **responded** by indicating that the situation of each country will be reviewed separately, and as long as eligible countries are pursuing strong economic adjustment policies, the process does not end until a sustainable debt position is reached, either at the completion point or before (paras 34, 35). While this is reassuring, additional steps below may be considered to firm-up the financing arrangements.

46. Clarify *ambiguous* provisions. The language in the initiative says: "the multilaterals may choose to provide assistance to help ease the burden of debt during the second stage for countries with continued strong performance and that such assistance will count towards the completion point action." (para. 33). What factors will determine such action by the multilaterals are not clear. In terms of IMF support, a mix of grants and enhanced, longer maturities ESAF loans is indicated. Factors determining the mix are not known, nor are the lending terms. Furthermore, there is uncertainty regarding the funding of the HIPC Trust Fund, which will be administered by IDA. It is expected to be funded with contributions from participating multilateral creditors and bilateral donors. The strength of the commitment by the bilaterals, particularly the G.7 countries to this trust fund idea will be crucial to its success and the amount of debt relief that can be provided to individual countries. Unwavering support for this plan by bilateral creditors needs to be assured. In this connection, assurances should be given to debtor countries that, as a minimum, the disbursement of funds by multilaterals during the second stage would not be at their own option, but would be guided by the logic of "the bottom line", which is attainment of a sustainable debt situation.

47. Paris Club processes and procedures. Consistent with current practice, debt eligible for flow rescheduling and stock-of-debt reduction operations is pre cut-off debt. In some countries, post cut-off debt, which is not eligible for restructuring during the work-out, is large and would not be affected until the completion point. Thus such countries would have to carry a large stock of debt throughout the work-out period. This is a feature that needs to be revised in order that the burden does not jeopardize on-going reform efforts during the implementation stage of the initiative. It would be preferable in such cases for the cut-off date to be brought as close to the time of negotiations as possible to net most of the debt for restructuring operations.

48. Comparable treatment of debt. Countries receiving assistance under the initiative would be required to seek treatment of debt owed to other bilateral and commercial creditors on terms at least comparable to those agreed with the Paris Club. From past experience, negotiations on debt owed to non-Paris Club bilateral and commercial creditors have been beset by problems of validation and valuation of the debts. In some cases, this step could not be concluded before the next meeting of the Club to consider a follow-on request for debt relief. Furthermore, in the past, following Paris Club debt rescheduling meetings, translating the Agreed Minutes into actual bilateral debt agreements with each creditor has often involved costly and protracted negotiations in different capitals of the world. How to assure that this will not continue to be the case, and therefore become an impediment to the implementation of the initiative, needs to be addressed.

49. Postscript. The issues raised and comments made above underscore the importance of applying the HIPCs initiative in a flexible manner, with regard to both the performance criteria for the ESAF and IDA adjustment programmes, and the time frame for implementation. **Maintaining the right perspective** will be fundamental to the success of the initiative. Where countries meet the performance criteria of the adjustment and reform programmes, they should be given the maximum debt relief to prevent slippage into unsustainable positions. The application of the debt service and debt-to-export ratios, should be sensitive to the requirements of long-term stable debt sustainability. For example, the provision that at the completion, debt relief could be reduced from what was committed at the decision point, if the actual ratios were lower than the target ranges should be applied with caution. It is important not to let spurious accuracy in numbers mask the ultimate objective of the exercise. An environment should be created whereby any decision errors would more likely benefit than hurt the debtor country. Here, the issue of transparency in the decision-making process will be paramount in ensuring that recommendations for debt relief reflect the actual needs of the debtor countries. The active involvement of governments in the analysis and decisions will be critical. Candour and a "bottom line" approach by all parties should be displayed early in the process, but critically at the decision point. Otherwise the initiative

could look good on paper but not benefit as many African countries as are genuinely burdened by debt, and deserve assistance. Assuming that the initiative is implemented in such a way that it will achieve its objective, a final concern would be how to make sure Africa does not find herself in the same situation again in the future. This, of course, is a matter for debt management, where the key issues and priorities for an action plan are identified and discussed in chapter V which follows.

CHAPTER V

Debt Management Issues

50. Conceptual issue. The debt problem partly arose and persisted in Africa due to imprudent borrowing policies which resulted from poor debt management. Africa's ability to properly manage her debt will be crucial to the success of the HIPCs initiative and to prevention of a re-occurrence of an unsustainable debt situation thereafter. The basic reasoning for borrowing by a sovereign country, which should be kept in mind by debt and macroeconomics policy managers, is consumption smoothing over time. Out of its own resources, the residents of a country have a choice between domestic consumption and domestic or foreign investment. Since most of the African countries are at a relatively low stage of development, the level of consumption is low, and, therefore, each unit of consumption foregone for investment purposes would be extremely costly, were domestic resources the sole source of investment funds.

51. Forward-looking borrowing. External borrowing allows a country to invest more now with less of a sacrifice of current consumption. Therefore, the cost of external borrowing is a sharing, by Africans, of future returns from the foreign-financed investment with the foreign lenders. It is clear that Investment must be efficiently productive and debt management must be *forward looking*; borrowing strategy and the management of debt must be in the context of an overall, forward-looking, macroeconomics management strategy. It should not be premised on *ad hoc* responses to needs as they arise, or purely to borrowing opportunities as they are availed from time to time by lenders, whatever their identity, and no matter the source of funds, except, of course, if they are purely grant.

52. The challenge: analysis and planning. In Africa, the challenges of debt management are:

- To develop the capacity for macroeconomics policy analysis; the grasp by practitioners of the analytic relationship between the four key macroaccounts, viz. the balance of payments (and **external debt** and reserves) accounts, the monetary accounts, fiscal accounts (and **domestic debt**), and the national income and product accounts;

- The availability in the national debt offices of appropriate tools (computer and software) for debt accounting and forecasting, and their grasp by staff;

- The capacity to prepare and make available in a timely manner key macroeconomics and financial data necessary to evaluate a borrowing plan, which necessarily must be prepared in a comprehensive macroeconomics framework;

- The *integration of systems,* which is a critical task since preparation of the debt and macroeconomics data identified above cuts across more than one agency of government;

- A grasp of the available computer-based modelling tools for policy simulation, so as to adapt them, if necessary, to capture specific peculiarities of a country, in order to answer in the best way possible the several "what if..." questions necessary to arrive at ***an optimal macroeconomics and financial programme with its supporting debt strategy and borrowing plan.***

53. Progress has been made. Considerable progress has taken place in Africa towards strengthening debt management, but advances have been more in the area of technology, and are uneven across countries. Technical assistance, provided by UNCTAD, the Commonwealth Secretariat and World Bank, in debt management, has helped tremendously. A number of countries, such as Egypt, which applies UNCTAD's DMFAS (Debt Management and Financial Analysis System) and the World Banks DSM (Debt Strategy Module) now are up to the task of managing their debt data base and providing the necessary policy decision support. Their capability has reached a point that has enabled them provide technical assistance to other countries (Lebanon). Other countries are also applying the UNCTAD system and the Commonwealth Secretariat's Debt Recording and Management System (CS-DRMS). But there is plenty more to be done to integrate the computerized debt systems within the local operating institutional environment, including manpower and the training of personnel, product quality assurance, consistency and reliability of data, the capacity to maintain and adapt the systems and ability to provide meaningful inputs to policy makers. Because institutional aspects have not advanced at the same rate as technology, the benefits of computerization have not been realized to their full potential.

54. Home-grown initiatives. African initiatives to increase skills in debt management, sponsored by a number of Central Banks and Finance Ministries, have a potential contribution to make. One such initiative, the Eastern and Southern Africa Initiative in Debt and Reserves Management (ESAIDARM), which provides training and advisory services to member governments, has recently expanded the scope of work to appropriately include the whole spectrum of macroeconomics management. Its name, recently changed to Macro Economic and Financial Management Institute (MEFMI) of Eastern and Southern Africa, to reflect its broadened mandate.

55. The paradigm of an integrated approach: management of debt needs special attention in Africa, to orient it towards the paradigm of systemic analysis in a forward-looking macroeconomics and borrowing framework, taking account of possible rapid changes (risks) in the international economic and financial environment. Heavy borrowing, undertaken outside the framework of a properly analyzed macroeconomics, sector and institutional capacity framework, and which was not accompanied by productive investments, has been a root cause of the debt problems for African countries as well as their creditors. Many public sector investment projects financed with borrowed foreign funds did not achieve rates of

returns expected at appraisal, thus contributing more to debt than to output. Had the borrowed funds financed high returns investments and growth in income significantly exceeded interest rates, the problem might not have arisen. Additionally, had those funds underwritten necessary structural changes, African countries could have survived the downturn in international economic conditions in the 1970s, like Korea did, pursuing that strategy while its debt increased nine-fold. Optimal use of borrowed funds will remain the challenge of economic and debt policy managers.

56. Regional centres and technical assistance. Towards meeting the above challenge, key inputs are needed: equipment, software, personnel training, systems adaptation and integration. These are tasks that render themselves to technical assistance, which, fortunately has been forthcoming (para. 53). Attempts to build up macroeconomics and debt management capacity at regional levels (such as MEFMI) are a positive development. Such regional institutions, in the context of economic integration, could be the most efficient tool for sharing with other countries the skills now located at a few local centres of excellence (Egypt; para. 54). Such technical assistance would have the advantage of delivering a product that has already been tested and adopted in an African institutional setting, and is likely to be less costly than assistance delivered from overseas. In this vein, use of the training capabilities and advisory services of MEFMI, beyond Eastern and Southern Africa, should be explored. *A strong debt management capacity will be necessary to prevent a re-occurrence of opportunity -driven borrowing, and promote the best use of borrowed resources during, and, especially after, the HIPCs initiative.*

Table 3
Net Flows of Publicly Guaranteed Debt of Developing Countries
Official Multilateral Creditors, 1975-95

(In millions of U.S. Dollars)

	1975-79	1880-84	1985-80	1990	1991	1992	1993	1994	1995
Sub-Saharan Africa	808.6	1,739.2	2,687.4	3,231.0	3,114.0	3,320.0	3,106.0	2,995.0	2,773.0
South Asia	820.0	1,768.0	2,877.2	3,433.0	3,993.0	3,356.0	2,851.0	3,028.0	2,231.0
East Asia and Pacific Latin	1,004.8	2,158.0	1,951.6	2,262.0	2,677.0	1,861.0	2,855.0	1,943.0	2,653.0
America and Caribbean	1,210.8	2,861.4	3,225.0	4,234.0	1,598.0	980.0	2,391.0	425.0	2,327.0
Middle East and North Africa	777.8	712.2	975.0	975.0	1,208.0	1,110.0	1,218.0	1,041.0	1,226.0
Europe and Central Asia	474.2	1,113.6	1,235.4	890.0	2,245.0	1,662.0	1,845.0	1,504.0	1,453.0
All Developing Countries	5,096.0	10,351.9	12,951.3	15,025.0	14,835.0	12,288.0	14,264.0	10,086.0	12,553.0
Severely indebted low-income	861.4	1,764.4	2,442.0	2,999.0	2,680.0	2,641.0	2,371.0	2,853.0	2,290.0

Source: Igbal, Zubair Evolution of External Capital Flows to Developing Countries: A Retrospective Appraisal (mimeo), IMF Institute, Washington D. C. 1996.

Annex 1

Page 2

Table 3
Net Flows of Publicly Guaranteed Debt of Developing Countries
Official Multilateral Creditors, 1975-95

(In millions of U.S. Dollars)

	1975-79	1880-84	1985-80	1990	1991	1992	1993	1994	1995
Sub-Saharan Africa	2,249	4,252	4,673	4,737	4,260	4,757	4,158	3,719	4,450
South Asia	2,005	2,571	4,370	4,587	5,351	3,908	3,217	3,843	3,625
East Asia and Pacific	2,175	4,658	3,905	6,103	6,298	6,349	8,011	5,019	7,254
Latin America and Caribbean	2,381	5,280	5,385	6,730	3,302	1,316	2,423	-1,318	12,320
	2,982	4,328	4,266	1,240	2,712	3,239	2,741	1,900	2,065
Middle East and North Africa	1,132	2,389	1,129	5,126	6,067	3,522	3,094	2,890	1,703
Europe and Central Asia	12,926	23,478	23,727	28,523	27,990	23,090	23,644	16,144	31,417
All Developing Countries	2,375	4,666	5,213	4,738	3,644	4,302	3,246	3,675	3,285
Severely indebted low-income									

Source: Igbal, Zubair Evolution of External Capital Flows to Developing Countries: A Retrospective Appraisal (mimeo), IMF Institute, Washington D. C. 1996.

Summary of the HIPC Debt Initiative

First stage

- Paris Club provides flow rescheduling as per current Naples terms (up to 67 percent reduction, on a net present value basis).
- Other bilateral and commercial creditors provide at least comparable treatment.
- Multilateral institutions continue to provide adjustment support in the framework of Bank/IMF-supported adjustment program.
- Country establishes first three-year track record of good performance.

Decision Point

- Either Paris Club stock-of-debt operation under Naples terms (up to 67 percent NPV reduction of eligible debt) and comparable treatment by other bilateral and commercial creditors is adequate for the country to reach sustainability by the completion point -- country not eligible for HIPC Debt Initiative.

- Or Paris Club stock-of-debt operation (on Naples terms) not sufficient for the country's overall debt to become sustainable by the completion point-- country requests additional support under the HIPC Debt Initiative, and Executive Boards determine eligibility.

- Or for borderline cases, where there is doubt about whether sustainability would be achieved by the completion point under a Naples terms stock-of-debt operation, the country would receive a further flow rescheduling under Naples terms.
  If the outcome at the completion point is better than or as projected, the country would receive a stock-of-debt operation on Naples terms from Paris Club creditors and comparable treatment from other bilateral and commercial creditors.
  If the outcome at the completion point is worse than projected, the country could receive additional support under the HIPC Debt Initiative.

Second stage

- Paris Club provides more concessional flow rescheduling as needed on a case-by-case basis.
- Other bilateral and commercial creditors provide at least comparable treatment.
- Debt Workout meeting to agree on a financing plan and identify additional assistance needed for the country to achieve debt sustainability at the completion point.
- Donors and multilateral institutions provide enhanced support.
- Country establishes a second track record of good performance under Bank/IMF- supported programs.

Completion Point

- Paris Club provides deeper stock-of-debt reduction as needed on a case-by-case basis.
- Other bilateral and commercial creditors provide at least comparable treatment.
- Multilateral institutions take such additional measures, as may be needed, for the country to reach a sustainable level of debt, each choosing from a menu of options, and ensuring broad and equitable participation

IMPLEMENTATION GUIDE: MAIN STEPS
(Some countries may proceed at a faster pace)

Action	Output	Timing
1. Preparation for Debt Sustainability Analysis (DSA)	Agreement on latest debt stock and debt-service data: · Debt data reconciliation, and, where necessary, reexamination of export data (by government, World Bank and IMF staff) Agreement on exports classification (exports of goods and services) consistent withthe IMF Balance of Payments manual.	9 months before Decision Point
2. Preliminary Debt Sustainability Analysis	Joint IMF/World Bank mission to agree on DSA and medium-term macroeconomic framework. Preliminary DSA paper jointly prepared by the government, World Bank and IMF. The DSA would reflect informal. Consultations with principal creditors. Based on the DSA, World Bank/IMF staff to make joint preliminary recommendations on: · eligibility under the Initiative · possible targets and the Initiative, within the range of 200 to 250 percent for the debt-to-exports ratio (on a present value basis), and 20 to 25 percent for the ratio of debt service-to-exports; · required action by multilateral creditors (based on assumptions of action by bilateral and commercial creditors); and · projected donor support for the country's development program. After endorsement by World Bank/IMF Boards, the preliminary DSA paper will be shared with principal creditors, including Paris Club, non-Paris Club bilateral and other multilateral creditors, and bilateral donors.	8 months before Decision Point
3. Consultations with creditors and donors	Understanding with Paris Club creditors to provide debt reduction of up to 80 percent on eligible debt so as to achieve exit from unsustainable debt. Indications of support by bilateral and multilateral creditors for debt workout.	5 months before Decision Point

Action	Output	Timing
4. Debt Sustainability Analysis	Completion of tripartite DSA paper. Agreement with government on key macroeconomic, structural and social performance critdteria under the HIPC Debt Initiative, to be monitored by the IMF (macroeconomic and structural) and the World Bank (structural and social).	3 months before Decision Point
5. Circulation of HIPC Initiative Board documents to World Bank/IMF Boards	Joint World Bank/IMF HIPC Initiative Board document, consisting of: · govrnment request for support under the Initiative; · tripartite DSA paper; · World Bank/IMF staff recommendations World Bank HIPC Board docudmrnt identifying interim measures of support, as well as structural and social performance criteria.	
6. Endorsement of the HIPC Initiative Board documents	IMF/World Bank approval in principle (subject to actions of other creditors) of: · country eligijbility; · target range for debt-exports ratio and debt-service ratio (on a present value basis) to be reached at the completion point and beyond; · proposed action by multilateral institutions to achieve these targets; and · key structural and social policy performance criteria. World Bank Board approval of the World Bank HIPC Board document, including: · use of IDA grants and/or supplemental allocations, where applicable; · structural and social performance criteria under the HIPC Debt Initiative; and · the World Bank's commitment inthe framework of the Initiative.	

7. Communication of decisions of World Bank/IMF Boards	Joint Letter by World Bank President and IMF Managing Director to creditors and donors.	Decision Point
8. Paris Club Meeting	Agreement on: · flow reschedulings during the interim period with debt reduction of up to 80 percent on eligible debt; · goodwill clause to consider stock-of-debt operation with debt reduction of up to 80 percent on eligible debt at the completion point, so as to achieve an exit from unsustainable debt; and · standard clause requiring at least comparable treatment of other bilateral and commercial creditors.	Shortly after Decision Point.

Action	Output	Timing
9. Debt Workout Meeting	Debt workout meeting attended by country authorities, World Bank, IMF, other multilateral creditors, and possibly Paris Club representatives and non-Paris Club creditors. Confirmation of participation of each multilateral creditor. Indication of support from other creditors.	Shortly after Decision Point
10. Updated Debt Sustainability Analysis	DSA update, based on actural outcomes during the interim period	3 months prior to Completion Point

11. Delivery of multilateral debt relief through instruments, including the HIPC Trust Fund	Completion point review by World Bank/IMF Boards of revised HIPC Initiative Board documents, and confirmation of country compliance with conditionality. If outcome within targeted range-action envisaged by multilateral institutions delivered through agreed instruments (including the HIPC Trust Fund); Joint letter from World Bank President and IMF Managing Director informing creditors and donors and requesting agreed action. If outcome outside targeted range-World Bank/IMF Boards decide on action by multilateral institutions to reflect actual outcome; Joint letter from IMF Managing Director and World Bank President to creditors and donors informing them of situationand (if necessary) requesting additional action by creditors. Agreement on additional action by multilateral institutions and other creditors.	Completion Point
12. Paris Club Meeting	Approval of stock-of-debt operation of up to 80 percent on eligible debt, so as to achieve an exit from unsustainable debt.	Shortly after Completion Point
13. Participation by other Creditors	Implementation of action by non-Paris Club offical bilateral and commercial creditors to provide relief on terms comparable tothose of Paris Club. Implementation of action committed by other multilateral creditors at Decision Point, or as adjusted above to reflect actual outcomes.	Shortly after Completion Point

Source:World Bank - IMF. The HIPCs Initiative Task Force Washington DC. 1996

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