

STRATEGIES FOR FINANCING DEVELOPMENT

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HIPC Debt Analysis & Strategy

A path to Long-Term Debt Sustainability?	2
Public Debt National Committees	4
The Experience of Institutional Missions in Latin America	5
The Role of Legislators in Tanzania's Debt Management	6
The Challenge of Maintaining Long-Term Debt Sustainability in WAIFEM HIPCs	7
HIPC Initiative and PRSP Progress: March 2004	8
HIPC CBP Activities from January to April 2004	10
Debt Relief Technical Questions	16

Foreign Private Capital Flows

Foreign Private Capital CBP Update	12
Sectoral Financing Patterns in Zambia	13
Foreign Private Capital: Frequently Asked Questions	15

A PATH TO LONG-TERM

On February 2, IMF and World Bank staff issued a paper that attempts to chart a path to long-term debt sustainability for low-income countries, looking beyond the HIPC Initiative. This article is a commentary on the paper while it proffers possible alternatives, based on the views expressed in the past by HIPC Ministers and officials.

The BWI paper is not designed to change the thresholds of the HIPC Initiative. Rather, it explores the possibility of maintaining debt sustainability, for countries that have already reached the completion point under the HIPC Initiative, and for low-income non-HIPCs.

SUSTAINABILITY INDICATORS

The paper highlights the advantages of using a variety of indicators such as PV, debt stock and debt service to measure debt burden, as well as of using different denominators (GDP, exports and budget revenue) as appropriate to country circumstances. However, it proposes that the primary focus of HIPCs should remain on PV, with debt service indicators playing only a secondary role in assessing liquidity problems.

SUSTAINABILITY THRESHOLDS

The paper begins by reviewing historically unsustainable external debt thresholds, based on two different IMF and World Bank studies that reach slightly different conclusions. Table 1 shows the sustainability thresholds identified by these studies, compared to those of earlier studies and those of the HIPC Initiative. The empirical evidence for debt-distressed countries finds slightly different thresholds from previous analysis, somewhat higher for PV/exports and somewhat lower for PV/revenue than those used under HIPC (higher for both than DRI work).

It then suggests that the level of sustainable debt varies dramatically due to 3 factors: policy performance, external shocks and debt

management. It disaggregates analysis to find that policy performance (as measured by the World Bank CPIA¹ scores) has a major influence on the level at which debt becomes unsustainable, with higher policy performance allowing a higher margin for borrowing without the debt being considered to be unsustainable. It therefore introduces the idea of varying thresholds for debt sustainability according to CPIA scores, as shown in Table 2 below, with good performers on policy and institutions being allowed significantly higher thresholds (i.e. being allowed to borrow more) than poor performers. For HIPCs, this raises several issues:

- How is the quality of policy to be measured? The paper suggests using the World Bank's CPIA index and other indices but does not provide sufficient details of how this would work in practice. It points out that in applying the indices, there is considerable need to exercise 'judgement' but it is not clear whether the World Bank, the countries themselves or a third party would make such judgements. These details would be left to future Board papers to provide more detailed guidelines.
- More importantly, it is not clear why good performers should be allowed to have a higher threshold, as this would raise moral hazards in encouraging irresponsible borrowing by countries which have just emerged from major debt overhang, and which remain highly vulnerable to external shocks. While there may be a case for a somewhat greater room for manoeuvre for good performers, a margin of 200% between poor and good performers seems excessive and may engender renewed inability to service debt.
- In practice, it is also not clear how these variations would apply. For example, what mechanism will there be for dealing with situations where policy and institutional performance deteriorates and yet a country has already acquired a large debt burden?
- HIPCs would favour a more narrowly

defined range of benchmarks centred on the historically based experience of thresholds that proved unsustainable for countries facing debt distress. Under such a system, the margin for additional borrowing would be greater than it seems, because high-performing countries would be able to contract even more debt within the thresholds due to their strong GDP, export and revenue growth.

- They would also favour more effort to take into account other factors such as additional types of debt, vulnerability to shocks, and ability to absorb funding for productive and anti-poverty expenditures without compromising macroeconomic stability.

DEBT COVERAGE

The paper marks a major step forward in acknowledging that low-income countries can have high levels of domestic debt and private sector external debt burdens, and therefore the importance of extending debt sustainability analysis to include analysis of domestic and private sector debt. However, it does not attempt to define sustainable thresholds for either of these types of debt, thereby automatically relegating them to a secondary status. The HIPC CBP has in the past analysed domestic debt sustainability and found that domestic debt PV/budget revenue ratios exceeding 88% have proven unsustainable. The CBP is currently undertaking a review of sustainable levels with a view to provide thresholds that could help to define sustainable total (external +domestic) public debt levels.

CALCULATING PV

The paper also proposes a more streamlined methodology to calculate PV, compared with that used under the HIPC Initiative. It highlights that HIPC methodology is too complex, as discount rates vary by currency. It proposes using a uniform discount rate based on the US dollar CIRR (instead of a currency-specific

Table 1: Sustainable debt thresholds

	Present Value/Exports	Present Value/Budget Revenue
HIPC Initiative	150	250
DRI	140	151
IMF*	180	189
World Bank*	190	201

* Mid-point of ranges

Table 2: Indicative policy-dependent thresholds

	Policy Assessment		
	Poor	Medium	Strong
PV/exports	100	200	300
PV/revenue	150	200	250

DEBT SUSTAINABILITY?

CIRR), which is similar to the former OECD methodology of using a 10% uniform discount rate for calculating grant elements, regardless of currency.

- In order to avoid the problem of currency-specific discount rates, the paper proposes that low-income countries should convert all of their debt data into US dollars, but using exchange rates which would incorporate information embedded in market-interest differentials for different currencies over the relevant time period (e.g. 10 years). This is likely to prove highly complex for low-income countries, which will not necessarily have access to future interest or exchange rate projections, or to explanations of the reasoning behind such differentials. If this system were to be adopted, it would be essential for the BWIs to issue detailed guidelines on how to implement this system in practice, and to guarantee to provide reliable projections and supporting analysis to low-income countries in order to make regular analysis feasible.
- The paper also indicates that the current HIPC methodology generates a high degree of volatility, because it changes all currency-specific rates every six months depending on global interest rate trends. Instead, it proposes changing the uniform discount rate only when the US dollar CIRR for a six-month period changes by 1% (100 basis points) compared to the level previously adopted. This would reduce the volatility of the discount rate somewhat, but would also potentially lead to more dramatic effects on sustainability. It would also require low-income countries to review trends in CIRRs every six months and therefore would not reduce their workload in assessing debt sustainability.

NEW LENDING

- The paper proposes to tailor new lending to the debt sustainability thresholds, and makes it clearer than in past Board papers that this would require an increase in concessionality from most lenders, for the most debt distressed countries. The increase in concessional lending by creditors is also welcomed by HIPCs. However, while the paper suggests that circumstances in which creditors wish to lend more than the amounts compatible with debt sustainability would be exceptional, this is already happening in

several countries if existing HIPC thresholds are used – notably Burkina Faso, Ethiopia and Rwanda. Given these countries' crucial needs to finance the MDGs, more flexibility in judging debt sustainability with higher thresholds will be essential.

- However, HIPCs would vastly prefer greater availability of grants, to supply the financing needed for the MDGs and maintain debt sustainability. While the paper does stress the need for more grants, it does not discuss the impact on debt sustainability if grants are not forthcoming; nor link the timing of these additional resources to the timing country MDG financing needs; nor mention how additional grants might be achieved, such as the UK's proposal for an International Financing Facility (IFF) or IDA 14. HIPCs look forward to much more specific analysis of grant funding needs at a national and international level, and to BWI support for all initiatives such as the IFF.
- The paper briefly mentions the need for improved *quality* of resources from donors and creditors, going beyond past BWI focus largely on the concessionality of funds. However, future papers could go into far more detail on this issue, and set monitorable benchmarks to improve financing quality for developing countries and their sources of financing.

EXOGENOUS SHOCKS

- The paper proposes a framework combining ex ante and ex post anti-shock measures. It bemoans the inadequacy of previous facilities such as the EU Stabex and the IMF CFF², but is somewhat vague about alternative and new proposals to combat shocks. The main proposals made relate only to a proportion of shocks (e.g. commodity prices and currency fluctuations) rather than all possible types of shocks (e.g. including aid shortfalls).
- More important, the paper is silent on measures to pre-empt relatively predictable shocks such as periods of drought. Instead these are to be addressed with by stress testing.
- HIPCs have proposed instead that the IMF incorporate predictable shocks into the baseline scenario of programmes, based on risk analysis, and that donors and creditors commit up-front contingency funding to offset these shocks automatically if they materialise, instead of

waiting to analyse the issue and mobilise the funds after the shock – by which time the negative impact will have undermined country prospects for poverty reduction.

DEBT MANAGEMENT

The paper acknowledges the efforts of the international community to assist countries in strengthening debt management, but does not mention the degree to which many low-income countries have recently strengthened their debt analysis capacity under the CBP, or the need for the Bretton Woods Institutions to take full account of countries' capacity and assess their analytical results. Many HIPCs are already setting up permanent debt analysis teams and to integrating the results of their analysis into the annual budget documentation.

CONCLUSION

Overall, HIPCs welcome the paper as containing a more open-minded view of debt sustainability than that in the HIPC Initiative. However, it is an odd combination of prescription and subjective judgement. It recommends setting clear but variable thresholds for debt sustainability based on one institution's method of judging country performance. Yet, it does not attempt to tailor thresholds to potential country vulnerability to shocks, absorptive capacity or debt management. Nor does it set objective thresholds for domestic or private sector external debt. HIPCs would like the proposals expanded to take shocks, absorptive capacity and debt management into account more objectively, and set thresholds for other types of debt, to help them chart a clearer path towards long-term debt sustainability and the MDGs.

¹ *CPIA: Country Policy and Institutional Assessment*

² *CFF: Compensatory Financing Facility*

NATIONAL PUBLIC DEBT COMMITTEES



Several countries in the CFA Franc Zone have undertaken to set up committees whose remit will be to ensure the sustainability of their public debt. A National Public Debt Committee (NPDC) has existed in Burkina Faso since 1996 and a National Debt Committee (NDC) was formed in Benin in 2003. This article provides some information on these committees, while preparatory work for similar committees are in progress in several other countries in the Zone.¹

I-OBJECTIVES

Three minimum objectives are required:

- to improve coordination between debt management and macro-economic policies;
- to build a shared vision of debt policy in order to avoid conflict between debt managers and macroeconomic policy managers;
- to durably maintain debt and public finance sustainability by focusing on long-term development objectives.

With this in mind, the terms of reference of the committees incorporate all the proposals made to the Government concerning debt ceilings and the drafting and implementation of the debt strategy (see Table 1).

II – INSTITUTIONAL ORGANISATION

A two-level institutional organisation is required so as to enable the committees to carry out their mission. The composition of the decision-making level is shown in Table 2.

The technical and operational level (Permanent Secretariat) is responsible for: (i) centralising and processing all financing-related information, (ii) technical preparation of dossiers, expressing considered opinions on State undertakings, the budget and activity reports of the committees, (iii) ensuring that opinions and dossiers are monitored and (iv) updating of all statutes and regulations.

III – OPERATIONAL ASPECTS

Currently the main activity of the Committees is providing opinions on new financing dossiers or on debt policy. Although these activities help to rationalise new financings, the committees need to place more emphasis on formulating and implementing a debt sustainability and public finance sustainability policy. Despite the significant reduction in the debt at the HIPC completion point, it will be several more years before the external debt of both

We recommend basing this analysis around the financial year, in two stages:

1. Start of financial year: establishing budget objectives and debt policy

At the start of each financial year the authorities will draft the macro-economic guidelines. Using the budgetary objectives as a basis, the Permanent Secretariat of the Committee will initiate an analysis in order to:

Table 2 : Composition of Committees

Composition of the NDC in Benin	Composition of the NPDC in Burkina Faso
<p>Chairman: the Minister of Finance; Permanent Secretary: Managing Director of the Beninese Sinking Fund</p> <p>Members:</p> <ul style="list-style-type: none"> • Economic Adviser to the President of the Republic; • Legal Adviser to the President of the Republic; • Legal Adviser to the Minister of Finance; • Director of Economic Affairs; • Director of the Budget; • Director of the Treasury and Public Accounts Department; • National Director of the BCEAO (Central Bank of West African States); • Technical Secretary of the National Committee monitoring the Poverty Reduction Strategy; • Two representatives of the Planning Ministry; • A representative of the Foreign Affairs Ministry. <p>Non-permanent or invited members:</p> <ul style="list-style-type: none"> • A representative of the Minister handling the dossier; • Any person or organisation that the NCD considers necessary. 	<p>Chairman: the Minister of Finance; Permanent Secretary: Public Debt Director</p> <p>Members:</p> <ul style="list-style-type: none"> • A representative of the President of the Republic; • A representative of the Prime Minister; • Director of the Treasury and Public Accounts Department; • Director of Cooperation; • Director of the Budget; • Director of Economy and Planning; • National Director of the BCEAO. <p>Non-permanent or invited members:</p> <ul style="list-style-type: none"> • Representatives of organisations seeking the opinion of the NPDC; • Representatives of bodies that the NPDC wishes to consult or inform.

countries becomes sustainable, and it remains highly vulnerable to exogenous shocks. Debt policy should analyse: (i) the scale of budget deficits and expenditure to reduce poverty, (ii) potential exogenous shocks, (iii) the conditions governing use and management of external resources, (iv) the impact of financed programmes and projects on development, (v) availability of non-debt-generating resources (grants, foreign investments), (vi) changes in the country's repayment capability and (vii) domestic debt policy.

- Set annual and multi-year budget objectives that meet the convergence criteria of the Franc Zone and the debt policy objectives;
- Assess future debt repayment capability;
- Determine the annual debt ceiling;
- Set the financing policy limits using qualitative and quantitative reference values.

Using this analysis as a basis, decisions governing debt policy orientation should be formalised by a directive from the Minister of Finance and incorporated in the Finance Law.

2. During the year: implementation of debt policy

Once the debt policy has been decided, meetings of the committees should ensure that every action taken complies with these guidelines. They will meet quarterly in regular sessions with, in case of emergency, extraordinary meetings or home-based consultations.

Table 1 : Terms of reference of the Committees

Remit of the NDC in Benin	Remit of the NPDC in Burkina Faso
<p>The NDC:</p> <ul style="list-style-type: none"> • drafts and follows the national debt policy; • spearheads analysis of public debt sustainability; • sets an annual debt ceiling for the State; • studies financing requests and offers; • studies domestic loan issue • expresses considered opinions on all dossiers; • formulates drafts recommendations designed to improve ensure better correlation the match between financings and projects. 	<p>The NPDC makes decisions on:</p> <ul style="list-style-type: none"> • debt legislation; • compliance with debt regulations; • all external or domestic debt projects; • all debt restructuring operations; • all requests for granting of endorsements; • all onlending; • annual analysis of public debt • all building of debt management capacity building.

¹ A fuller version of this article will be published shortly in the Pôle-Dette newsletter.

THE EXPERIENCE OF INSTITUTIONAL MISSIONS IN LATIN AMERICA

The present article refers to the *Institutional Missions for debt management evaluation in Bolivia, Nicaragua, Guyana and Honduras in 2003 and 2004.*

The Main Findings

Legal Framework

All the countries have a body of laws and regulations related to debt management. However, they are not exhaustive, and in some cases they are quite dispersed. In the first case, the regulations do not cover the new financing process, do not reach operating levels through procedures, suffer from legal voids and do not include the total amount of debt (both external and internal). In the second case, regulations from different Government levels and different types of debt are not incorporated into a single body of laws. One important problem is the absence of regulations which formally establish information flows and coordination relations in a detailed manner.

Contracting New Financing

There are clear limitations and controls on the matter of direct contracting of external financing by the State, where the absence of specific regulations on external financing is noteworthy. Furthermore, in some cases, several institutions are involved in obtaining a single loan, which results in a duplication of functions.

Debt Committee

All of the countries have an External Debt Committee, but they do not have one for global debt. Until the missions were created, the meetings of these committees were sporadic and in many cases, informal. The countries coincided on the need to formalise these committees and regulate their operations, clearly establishing institutional responsibilities and global debt coordination.

Transparency

There are no laws which make it obligatory to publish periodic information on debt, although the countries have begun to make efforts to improve the preparation of reports and the publication of information through printed bulletins and reports on the websites of the Central Banks and / or Finance Ministries.

Evaluation of the Public Debt

The countries sporadically carry out ex post

audits, focusing on debt operations and the fulfilment of procedures, when such procedures exist. No subsequent controls are carried out on debt management as regards actions and final results. There is a general lack of annual reports on debt policies, results obtained, and the evolution of debt.

Coordination of Debt Management with Macro-economic Policies and Poverty Reduction Strategies

In general, there is no real integration of the macro-economic and poverty reduction projections. Furthermore, certain coordination deficiencies exist between the units which make the macro projections and those which design the poverty reduction strategies (PRSs). Another common problem is the lack of quantification of the costs required to meet the goals of the PRSs, as well as the absence of well-defined links between policies, actions, resources and goals. Macro-economic projections are made by the economic policy departments in the different countries, but generally speaking, they are concentrated in one institution, and problems of coordination still exist. The countries have developed their own projection models based mainly on spreadsheets. Bolivia, Guyana and Nicaragua have evaluated their models, trying to make them compatible with the World Bank's RMSM-X tool. In addition, the countries plan to adapt the above-mentioned model to their own characteristics.

Internal and Total Debt Management

A high level of systematisation of external debt information and coordination has been achieved. There is a generally poor coordination of the total debt in all the countries, and their capacity for managing internal debt is smaller than in the case of external debt.

Functional Debt Management Organisation

Front office activities need formally established policies and instruments and greater coordination between the entities. In addition, new financing operations are not managed on the basis of a designed strategy. In some cases, external technical assistance is still required in order to perform debt analysis and renegotiation.

Middle office activities have improved considerably over the past few years, especially in areas related to debt strategy, but



Honduras national workshop, March 2004

deficiencies still exist, such as the absence or lack of implementation of new financing strategies, risk analysis and production of reports with policy implications.

Back office activities are those which have shown the greatest progress. However, the lack of qualified systems for recording and managing debt were mentioned in two countries.

Human Resources

The low salary level and reduced incentives for civil servants in the public credit area in Honduras and Guyana, has led to a large turnover of qualified personnel. This has resulted in very weak operative management and analysis. The countries with a lower turnover (Nicaragua and Bolivia) are those which have shown a greater capacity for debt management. However, the lack of comprehensive training programmes is an inherent feature in all the countries.

Conclusions

The lessons are useful for individual countries and on a regional level, because they make it possible to discover better practices and approaches. They also provide important resources for the development of CPB activities adapted to the characteristics and needs of each country. For this reason, *the institutional missions which followed, focussed on specific subjects in order to strengthen the capacity of the countries in certain crucial aspects which have an effective short-term impact on the improvement of debt management.* Among the main aspects, we can cite legal frameworks, information flow and coordination mechanisms, new financing policies, risk and portfolio analysis, evaluations and controls. Particularly in sectors with high personnel turnover, improved debt management capacity is a recurring activity, combined with permanent training.

THE ROLE OF LEGISLATORS IN TANZANIA'S DEBT MANAGEMENT

Legislators pay a crucial role in economic governance. When a critical mass of parliamentarians has good understanding of economic issues, checks and balances in public finance such as sovereign debt management are more effective. In many Heavily Indebted Poor Countries (HIPCs), legislators do not influence the framework for the conduct of debt management let alone its execution from the beginning (the procurement stage). This is especially important given the growth of multiparty politics in HIPCs, as well as the increasing demands from the grassroots due to high poverty levels and participatory policy formulation processes.

In terms of capacity-building, best practices in sovereign debt management can only be implemented effectively if all levels (executive, management & supervision, and operational) are addressed. The post-HIPC National Debt Strategy and New Financing Workshop for Tanzania in March 2002 under the HIPC CBP successfully trained 40 technical level officials, reinforcing the already high existing capacity for debt strategy formulation. However, it is important to sensitise other levels of government to support and sustain the operational capacity, through executive-level participation at seminars where critical issues are discussed.

To these ends, for the first time in the MEFMI region, the HIPC CBP in collaboration with the authorities of the United Republic of Tanzania conducted a one-day sensitisation seminar for legislators. Tanzania reached its completion point under the enhanced HIPC Initiative in November 2001. **The objective of the seminar was to sensitise members of parliament to debt issues, specifically the experience of Tanzania with debt relief, and to provide an opportunity to examine the national debt strategy Tanzania has adopted.**

KEY PREPARATION LESSONS

Ensuring success of a seminar that reaches beyond traditional clients involves engaging in early dialogue with the relevant officials. This was the case for Tanzania where the client institutions, Ministry of Finance and the Bank of Tanzania held discussions with the Parliament Office on content,

logistics and participation.

Participating parliamentarians were selected on the basis of committee structures of Parliament. A decision was taken based on considerations of cost effectiveness to invite only those members of Parliament who sit in key committees namely economic and finance, social and community and gender, rather than all parliamentarians.

In terms of topics, parliamentarians were able to suggest issues the public were most interested in or indeed puzzled about, and which could be clarified by debates in the presence of responsible officials. In the case of Tanzania these were above all the debts of privatised state enterprises, and the utilization of debt relief savings.

KEY ISSUES AND CONCLUSIONS

The key presentations were on the importance of debt management, Tanzania's experience with debt relief and the National Debt Strategy for Tanzania. These provided an opportunity for parliamentarians to comments; seek clarifications and make proposals for additional measures to improve debt management in Tanzania. The members of Parliament commended government for the strides made in improving sovereign debt management, but raised the following concerns:

- the role of Parliamentarians in designing and reviewing the national debt strategy ought to be clear and actively pursued;
- legislators need to carefully scrutinize bills before they are passed by the house in order to guard against areas that become problematic at a later stage;
- a wider section of society needs to be sensitised to the debt problem in Tanzania, the relief that government has benefited from, and the measures that have been put in place to ensure that there is proper

management of borrowed funds; and

- although the government of Tanzania has made remarkable improvements in the way it manages debt, a lot more can be done to ensure that there is complete transparency and accountability in the procurement and use of financial resources.

LESSONS FOR FUTURE SEMINARS FOR PARLIAMENTARIANS

Although the seminar held for Tanzania was a half-day event, there was keen interest in issues of sovereign debt among the members of parliament judging from the interventions and discussions. The members of parliament welcomed this opportunity to participate in debate on the issue and called on government to provide such a forum regularly and if possible, to all parliamentarians.

Among other lessons, it is vital to select topics of focus clearly and inform parliamentarians of these topics beforehand so as to avoid a situation whereby other areas encroach on the discussions and derail the objectives of the seminar.

Timing of the seminar is also crucial as this needs to dovetail with the calendar of other parliamentary events so as to ensure availability of key participants. This can best be achieved through close coordination with the Parliament Office.

Finally observing parliamentary protocol in the conduct of the seminar is important so as to create a conducive environment. A senior panel, fully conversant with government policies, needs to be nominated to respond at the end of the seminar to issues raised by parliamentarians to avoid sending conflicting messages to the nation.



Parliamentarians at the Tanzanian Sensitisation Seminar



THE CHALLENGE OF MAINTAINING LONG-TERM EXTERNAL DEBT SUSTAINABILITY IN WAIFEM HIPCs

I. INTRODUCTION

The yearning for economic growth and development has led a great many developing countries to borrow externally, especially due to low tax effort, meagre foreign exchange earnings and weak terms of trade. However, these factors and their poor debt management practices have resulted in excessive and unpayable debt overhang.

Following the failure of the traditional debt relief mechanisms to remove the overhang and foster growth, the HIPC Initiative came on stream in 1996 with an enhanced version in 1999, designed to offer a comprehensive treatment to the debt problem, which allows eligible debt distressed, low income countries to reach sustainable debt at its completion point.

Three of the four WAIFEM HIPCs — The Gambia, Ghana and Sierra Leone — are in their interim HIPC period as they have already reached the decision point under the initiative and are expected to reach the completion point by the end of 2004.

This article presents the challenges for these countries in their bid to maintain long-term debt sustainability beyond the completion point.

II. CONCEPTUAL FRAMEWORK

Definition

The IMF and World Bank (2001) have defined external debt sustainability as the capacity and willingness of a debtor country to 'meet its current and future external debt service obligations in full, without recourse to debt rescheduling or accumulation of arrears and without compromising growth'. This definition is based on debt payment capacity, modified by the institutions' recent concern for economic growth and poverty reduction.

Conditions Precedent

Two conditions must be met for debt sustainability:

- equilibrium in balance of payments (BoP) must be established without any kind of exceptional financing (e.g. debt forgiveness, accumulation of arrears, rescheduling etc.); and
- sustainable level of debt, that is, a level that the country will be able to service in future. This is measured by indicators of the debt

burden such as the ratios of debt service to exports (DS/X) or present value of debt to exports (PV/X) or budget revenue (PV/R).

The Threshold Levels

Under the HIPC Initiative, the primary indicators of sustainability are the PV debt-to-exports ratio ($PV/X < 150\%$), the PV debt-to-revenue ratio ($PV/R < 250\%$) and the debt service to exports ratio ($DS/X < 15-20\%$).

III. EXTERNAL DEBT PROFILES & SUSTAINABILITY INDICATORS

The Gambia

At US\$92 million or 38.1% of GDP in 1980, total external debt of The Gambia rose through US\$338 million or 101.6% in 1989 and US \$403 million or 109.9% in 1992 to US\$464 million or 101.6% of GDP in 1999, reflecting a compound growth rate of 8.9% over the two decades. At end-2002, total external debt stood at US\$504 million.

Total debt service to exports ratio averaged 12.4% in the period, 1980 – 99 compared with the HIPC threshold of 15-20%. The PV of debt to export ratio was 141.0% in 2003, compared with 150% for external debt sustainability. PV/budget revenue was 208.8% in that year, as against the cut off margin of 250%. Thus based on the HIPC indicator approach, the debt situation seems sustainable but the performance of the macroeconomy does not support that verdict.

Ghana

At US\$1.4 billion or 33.0% of GDP in 1980, Ghana's external debt stock rose through US\$5.9 billion or 76.7% of GDP in 1999, climbing to US\$6.4 billion at end-2002.

Total debt service to export ratio averaged 25.4% in the period, 1980-99. The PV/export ratio is projected at 83.1% at expected completion point in 2004, compared with critical level of 150%. The PV/budget revenue at that point is estimated at 176.9%, a forecast well below the 250% critical level at its completion point, suggesting minimum sustainability problems.

Sierra Leone

At US\$435 million or 38% of GDP in 1980, Sierra Leone external debt stock rose through US\$1.1 billion or 79.4% in 1989, levelling off thereafter at

around US\$1.1 billion.

The PV/exports ratio is projected at 134.9% at expected completion point in 2004, compared with the critical margin of 150%. The PV/budget revenue is projected at 154.1%, below the 250% critical level at completion point.

IV. CHALLENGES

Although the indicators presented above look relatively optimistic, all of the WAIFEM HIPCs remain highly vulnerable to exogenous shocks as they are very dependent on individual commodities or sectors such as tourism for maintaining exports, growth and budget revenue.

Therefore none of the WAIFEM HIPCs can afford to relax in combating the main challenges facing the maintenance of long-term debt sustainability. They all need to:

- ensure that all creditors participate fully in HIPC debt relief;
- boost long-term growth of exports and hence repayment capacity;
- diversify their narrow export bases to overcome external shocks and the vagaries of commodity prices;
- prioritise long-term aid flows especially grant financing;
- place more stress on managing their burgeoning domestic debt, sub-national government debts and total domestic and external debt;
- accelerate economic growth to enhance budget revenue mobilization;
- enhance governance and macroeconomic reforms to ensure optimal utilization of debt relief savings and new financing;
- attract foreign direct investment and private capital flows;
- increase their analytical capacity in all of the above areas.

There is no primrose path to maintaining long-term debt sustainability. Debtor countries have to improve their macroeconomic policy to reduce debt creation and accumulation. There is a need to focus less on critical threshold indicators and much more on the enduring fundamentals of the real economy, namely, export performance, diversification of the budget revenue base, GDP growth and investment, if debt sustainability is not to remain a mirage.

HIPC INITIATIVE AND PRSP PROGRESS: MARCH 2004

Country	HIPC II Dates		PRSP Dates		HIPC Initiative
	Decision	Completion	Interim	Final	Creditor Participation
Angola	no current timetable		2004	...	NA
Benin	7/00	3/03	7/00	3/03	99%
Bolivia	2/00	6/01	2/00	6/01	95%
Burkina Faso	7/00	4/02	NA	7/00	88%
Burundi	1Q2005	...	1/04	1Q2005	NA
Cameroon	10/00	2Q2004	10/00	7/03	98%
Central African Rep.	...	...	1/01	4Q2004	NA
Chad	5/01	4Q2004	7/00	7/03	93%
Comoros	2004	...	4Q2004	...	NA
Congo, Dem. Rep. of	7/03	3Q2006	6/02	3Q2005	93%
Congo, Rep. of	2004	...	3Q2004	...	NA
Côte d'Ivoire	2004	...	3/02	...	NA
Ethiopia	11/01	4/04	3/01	9/02	92%
Gambia	12/00	4Q2005	12/00	7/02	81%
Ghana	2/02	2Q2004	8/00	4/03	89%
Guinea	12/00	3Q2005	12/00	7/02	85%
Guinea-Bissau	12/00	3Q2005	12/00	2004	81%
Guyana	11/00	12/03	11/00	9/02	81%
Honduras	7/00	1Q2005	7/00	10/01	93%
Kenya	DSA Nov. 2003		8/00	2/04	NA
Lao PDR	no current timetable		4/01	2Q2004	NA
Liberia	no current timetable		no PRSP process		NA
Madagascar	12/00	3Q2004	12/00	10/03	91%
Malawi	12/00	4Q2004	12/00	8/02	97%
Mali	9/00	3/03	9/00	3/03	94%
Mauritania	2/00	6/02	NA	1/01	80%
Mozambique	4/00	9/01	4/00	9/01	88%
Myanmar	no current timetable		no PRSP process		NA
Nicaragua	12/00	1/04	12/00	9/01	87%
Niger	12/00	4/04	12/00	2/02	85%
Rwanda	12/00	4Q2004	12/00	8/02	95%
São Tomé & Príncipe	12/00	4Q2005	4/00	2Q2004	85%
Senegal	6/00	4/04	6/00	12/02	81%
Sierra Leone	3/02	2Q2005	9/01	2Q2004	84%
Somalia	no current timetable		no PRSP process		NA
Sudan	no current timetable		2004	...	NA
Tanzania	4/00	11/01	3/00	12/00	90%
Togo	...	...	...	...	NA
Uganda	2/00	5/00	NA	5/00	96%
Vietnam	DSA 2002		4/01	6/02	NA
Yemen	6/00	...	2/01	8/02	NA
Zambia	12/00	1Q2005	7/00	5/02	97%

Sources:
HIPC Governments
IMF & World Bank

Dates for HIPC decision and completion points and PRSPs are those of final BWI Board approval.
Most governments have published PRSPs several months before BWI approval.

In the last quarter there has been more HIPC Initiative progress, with completion points for Ethiopia, Niger and Senegal. Both Ethiopia and Niger received topping up of relief, of US\$700m and US\$142m respectively, to offset changes raising from factors beyond their control since decision point, including changes in international exchange and interest rate. One full PRSP has also been approved.

Key Debt Relief and New Financing Issues	Key Macroeconomic and Poverty Reduction Issues
HIPC CBP DSA shows ratios under HIPC thresholds	Discussions for new SMP on-going
Most creditors provide relief, unsustainable due to new borrowing	On track with PRGF
Debt unsustainable after new borrowing; export shock; heavy fiscal debt burden	PRSP progress report finalised and reviewed; 2003 standby agreement being implemented and expected to be extended to Q4 2004.
First to get additional relief at CP, large new borrowing allowed	PRGF review approved in 2004. PRSP on-track.
Donor funds to clear multilateral arrears. PC Naples rescheduling Mar 2004	PRGF agreed and I-PRSP approved, both in January 2004
79% buyback from IDA on commercial debt, 2 lawsuits	PRGF extended to Dec 2004, PRSP progress report soon.
Coup postpones HIPC timetable, multilateral arrears accumulating	Re-engagement with BWI and donors under discussion
10 non-Paris Club creditors not providing relief, delay to CP	PRGF expired Jan 2004. Structural performance criterion outstanding
High debt burden, plans own DSA soon. HIPC timetable uncertain.	New SMP possible in 2004, followed by PRGF for 2005
DP agreed in July 2003, Cologne terms applied	On-track with PRGF of June 2002. Full PRSP expected in 2005.
Oil-guaranteed commercial loans, DP requires track record	New SMP to June 2004. PRSP being redrafted
DP delayed because of civil conflict	Civil conflict delays PRGF and full PRSP
CP topping up of \$707m of offset CIRR and exchange rate changes.	Good PRGF record, despite exogenous shocks
Interim IMF relief lapsed, 2nd tranche Paris Club relief not implemented	PRGF off-track. Donors' budgetary support suspended
Participation of some commercial creditors remains an issue.	Multi-donor budget support programme set up
IMF, AfDB, PC interim relief suspended.	SMP to start in 2Q2004, new PRGF in 2005. PRSP progress report due soon
IMF and Paris Club have suspended relief	Donor/ WAEMU supported Emergency Economic Management Plan approved.
CP achieved; PC Cologne terms agreed; commercial lawsuit dropped	PRSP progress report expected soon.
Interim relief expired; PC rescheduling arrears & service due. Debt sustainability expected at CP.	New PRGF and PRSP progress report agreed in Feb 2004
DSA shows ratios under HIPC thresholds. PC Houston Terms relief	New PRGF signed in Nov 2003 / Full PRSP 2004
Agreement reached with Russia. HIPC eligibility uncertain.	3rd PRGF review completed. Full PRSP to be soon finalised
Debt stock estimated \$3bn (600% of GDP), nearly all in arrears	Donor support for reconstruction. Arrears clearance sought
No relief from non-Paris Club creditors, except China and Kuwait	On track with PRGF. PRSP progress report due soon
IMF interim relief resumed and Paris Club agreement enforced Nov 2003	PRGF review/PRSP progress report approved Oct 2003, drought shock
Difficulties with non-PC, commercial creditors	PRGF/PRSP on track. Drought and Côte d'Ivoire shocks
No relief from some non-Paris Club creditors (Algeria, Kuwait, FKDEA)	New PRGF approved in July, progress report on PRSP expected soon.
Non-Paris Club problems/lawsuit keep debt unsustainable	On-track PRSP, new PRGF expected 2Q 2004
No WB lending since 1987. Probably unsustainable	No IMF programme since 1981-82
CP achieved in January 2004	2nd PRSP progress report finalised. PRGF being implemented
CP topping up of \$142.5m for unanticipated new borrowings, CIRR and exchange rate changes. Taiwan wins lawsuit	PRGF extended to June 2004. Negative impact of Côte d'Ivoire crisis
Will be unsustainable at CP. China, Libya, Saudi and Abu Dhabi no relief	PRSP progress report completed. Understandings reached on policies for 2004
Paris Club interim relief only Naples, non-PC problems, CP delay	Negotiations for new PRGF pending next IMF mission
CP reached. IDA relief extended to make up for reaching interim limit	On track with PRGF. PRSP progress report completed.
Morocco to cancel debt. Commercial lawsuits of US \$35m	PRGF on track, full PRSP now expected mid-2004
Accumulating large arrears to creditors	No current IMF programme due to lack of recognised government
Possible donor support group to clear multilateral arrears	Peace talks leads to start of I-PRSP preparation. SMP on track
Problems with non-Paris Club and commercial creditors	1st PRGF review approved Feb 2004. Low coffee export prices
No current prospect of debt relief	No resumption of engagement after June 2003 elections
Non Paris Club/commercial creditor lawsuits	PRGF second review approved Dec 2003. PRSP to be revised in 2004
Board report on HIPC eligibility due shortly	PRGF on track
Ratios under HIPC thresholds so Paris Club Naples stock treatment	PRGF on track
IMF interim relief expired end-2003. India has cancelled all ODA debt	Poor performance under SMP, signed June 2003. CP postponed

HIPC CBP ACTIVITIES FROM JANUARY TO APRIL 2004

REGIONAL WORKSHOPS

BCEAO/BEAC Pôle-Dette Training for Trainers

From 8 to 19 March in Dakar, Pôle-Dette and DRI conducted their second joint regional Training for Trainers workshop. 47 participants from 10 countries were trained as expert trainers in CBP methodology, and participants were introduced to the 'second generation' methodology of debt strategy analysis in the Pole-Dette region as well as new techniques for new financing analysis. The participating countries also held extensive discussions on the design of National Debt Strategy Committees, building on the experiences of Benin and Burkina Faso (see article on page 4). The workshop recommended continuing improvements in methodology in the following areas:

- constant updates of the tools and documents to link CS-DRMS and DMFAS to Debt-Pro so as to produce data in the correct format for debt strategy analysis;
- more exchange of information on country experiences with external debt renegotiation;
- Urgent adaptation of the CBP methodology on domestic debt strategy analysis to the needs of the CFA Franc Zone, especially in the context of regional domestic debt markets;
- Systematic information-sharing on how other countries have induced donors and creditors to follow national policies and procedures in providing new financing;
- More development of user guides and graphics for the simple financial programming macroeconomic forecasting tools for debt strategy analysis developed by Pôle-Dette;
- Further development of simple forecasting tools for forecasting poverty reduction indicators and the impact of anti-poverty spending.

NATIONAL WORKSHOPS

Honduras

Honduras organised a second National Debt Strategy Workshop from 8 to 17 March, to update its debt strategy and its capacity-building plan. The workshop was especially useful in allowing a large number of new staff in the Public Debt Department to be trained (following recent staff rotation). In addition, Honduras had just agreed a new PRGF in February 2004, making a new debt strategy analysis timely for preparing a

completion point for 2005. The results showed that:

- the decision point macroeconomic projections were much more optimistic than the outcomes, which were closer to the realistic scenario designed in the 2001 workshop;
- Honduras' external debt will be sustainable at completion point and thereafter. But the debt burden may rise rapidly after 2010, due to its 'graduation' from concessional financing;
- based on trends in poverty indicators in the first three years of the PRSP, it is probable that Honduras will not reach its PRSP goals, nor the MDGs by 2015;
- therefore Honduras needs to concentrate its efforts on obtaining maximum debt relief under HIPC and concessional financing beyond its completion point;
- It is vital to continue capacity-building efforts for managing debt and new financing. Honduras needs a medium-term capacity-building programme with CBP support.

Sudan

From 29 March to 2 April, DRI organized a workshop in London, funded by DFID outside the CBP framework, to train 15 Sudanese government and SPLM officials in debt management and begin designing a national debt strategy. The workshop benefited from the participation of staff of DFID, the IMF and the World Bank, as well as discussions with debt managers from Bolivia, MEFMI, Uganda and Zambia on best practices that Sudan could adapt to its own needs. Sudan is currently emerging from protracted civil war and the workshop was seen as a contribution to preparing economic management for a period following signature of a forthcoming peace agreement.

The main conclusions of the workshop were that:

- Sudan's debt strategy options are complex. The fact that most of its debt is in arrears will mean that it receives minimal budgetary savings from the HIPC Initiative. It will require innovative solutions to huge multilateral debt arrears and its large commercial debt burden. It will also be vital for debt relief to be frontloaded and supplemented by large amounts of new finance, if it is to achieve a net fiscal gain and have more money available to spend on post-war recovery and reconstruction. It also needs to have highly responsible macroeconomic and new borrowing policy to avoid debt becoming rapidly unsustainable again.
- Both government and SPLM require large amounts of capacity building on debt analysis and strategy issues in the lead-up to the HIPC process, and to establish decentralised structures in Southern Sudan.

INSTITUTIONAL MISSIONS

The CBP is placing an increasing emphasis on institutional support and reform missions, to ensure that countries introduce institutional

changes that will ensure that the capacity created by the CBP is fully used and more sustainable.

Ethiopia

As part of a proposed intensive assistance programme, DRI conducted an institutional review mission to Addis Ababa from 15-23 March to review the current institutional arrangements for contracting, managing and analysing external and domestic debt and grants for funding economic development and poverty reduction in Ethiopia. The mission was scheduled to overlap with the mission of the Debt Consultant for a UNDP project Supporting Resource Mobilisation for Development, Aid Co-ordination and Management to ensure full co-ordination and collaboration between the two projects. The Government has placed priority on including debt and new financing strategy in the annual budget, commencing this year and to assist in this process, DRI will conduct a post-HIPC External Assistance Strategy workshop in the second quarter of 2004. In addition, the Government has committed to recruiting new staff, who will be responsible for analysis of debt and new financing issues, which means that the forthcoming training will be more sustainable over the long-term.

Guyana

This mission occurred from 26 January to 4 February, to assess the degree of implementation of the actions to improve debt management agreed by Guyanese officials and earlier CBP missions. It also coordinated the preparation of the next National Debt and New Financing Workshop.

The mission found that the National Debt Strategy Working Group had been revived formally, but that personnel shortages and turnover had blocked the implementation of various measures earlier suggested by the Government of Guyana. It was agreed that the top priority for assistance at the time of the National Workshop is in reforming the legal framework, documenting procedures and reinforcing the structure of the Debt Management Division.

Mauritania

The second part of the institutional mission to Mauritania took place from 8 to 17 February. It continued to identify measures to bring Mauritanian debt management closer to international standards, as well as to prepare the national post-HIPC debt strategy and new financing workshop scheduled for April 2004. This mission focussed on evaluating high-level debt management institutions and the legal framework, and the coordination of debt management with macroeconomic, fiscal and poverty reduction policies. It also discussed implementation of the recommendations of the December 2003 mission, which focussed on technical-level institutional and management changes.

The mission found an urgent necessity to

reinforce political commitment to debt management, and the structures that coordinate debt management among different agencies, and to enhance capacity to analyse development financing options to ensure longer-term debt sustainability and maximise the contribution of new financing to development and poverty reduction.

São Tomé and Príncipe

The institutional management mission to São Tomé was intended to provide support to the establishment of a new debt unit. It also began the preparations for the National Workshop to be organized and conducted by the Sao Tomean authorities in June.

On institutional issues, the mission concentrated on: a) reviewing the responsibilities and duties of the staff involved in debt management; b) improving information flows between the new office and other government institutions; c) reviewing the efforts made to reinforce staffing in debt management; d) reviewing the formalization of the Debt Management Committee and its activities; and e) coordinating with the Debt Management Committee the preparatory activities to be undertaken for the National Workshop. It found that there had been considerable progress in the first four areas, and also submitted to Government its suggestions for a draft agreement between the Central Bank and the Ministry of Finance about division of responsibilities among them in debt management. It also provided detailed terms of reference for each staff position in the new unit and made recommendations for the future work programme of the Debt Management Committee.

FOLLOW-UP MISSIONS

Honduras

The Government of Honduras invited a CEMLA and DRI mission to visit Tegucigalpa from 14 to 21 February, to follow up earlier training. It organised an on-the-job workshop to train new staff in the HIPC Initiative, debt cancellation and Paris Club negotiations. The mission also reviewed the scenarios designed by Honduras in its last Debt Strategy Workshop, and revised these in preparation for the next National Workshop and Paris Club talks. Finally, it conducted a review of progress in implementing the recommendations of earlier institutional missions.

DEBT ADVISORS

Burundi

From 16 to 27 February 2004, DRI undertook the first mission of a project to build capacity in debt strategy in Burundi, which is financed by the UK Department for International Development (DFID) in the context of the HIPC CBP. The main objectives of the mission were to train Burundian officials in basic debt management and debt relief concepts; to review progress in institutional reforms recommended by earlier HIPC CBP

missions to the country, check the status of IT equipment and debt management systems in the Treasury Department, and examine capacity-building needs.

The mission found an urgent need to continue building capacity but also to reinforce coordination structures in order to ensure Burundi achieved the maximum benefit from its Paris Club negotiations. It noted with pleasure the regular functioning of the technical Debt Management Committee but also recommended the reestablishment of the political-level Debt Strategy Committee and the issuance of a procedural document that defines the work of each committee. It also highlighted the need for a Macro-Economic Coordination Committee with clear terms of reference to ensure that Burundi was well prepared for discussions with the BWIs, and a manual to formalise work procedures in the Treasury Department.

Ethiopia

Following the institutional mission described above, CIDA agreed to co-finance intensive assistance to Ethiopia especially in the design and implementation of a post-HIPC new financing policy during 2004.

Gambia

UK DFID also agreed to co-finance intensive assistance to the Gambia in reinforcing its debt management through a series of missions and a national workshop during 2004-05.

ATTACHMENTS

In view of the increasing emphasis on transfer of the programme to partner organisations and regional experts, there has been an accelerated programme of attachments for skills development:

- The newly appointed Programme Officer HIPC CBP at MEFMI, Alice Konga, was attached to DRI from 16 to 28 February. This enabled her to become fully familiar with all aspects of CBP management, to strengthen her skills in debt strategy design and implementation, and to redraft a workshop coordination guide.
- The Director of the Debt Management Programme at MEFMI, Anna Msutze, and two regional experts (Longino Tisasirana, Uganda and Jacob Mkandawire, Zambia) visited for two weeks in March, to enhance expertise in new financing strategy analysis methodology and analytical tools, and to prepare a regional new financing workshop in June.
- Two Pôle-Dette region Fellows, Alidou Adebé from Benin and Pierre Kamdem from Cameroon, visited for 2 weeks in April, in order to plan and work on their Fellowship papers which will deal respectively with 'Negotiating and Disbursing New Financing for Poverty Reduction' and 'Restructuring Commercial Debt'.
- The Website Coordinator from CEMLA, Jorge

Xicotencatl Cruz Bautista, spent a week in March in London to examine the CBP website closely and design a technical plan for its decentralisation during phase 3 of the CBP.

- A Bolivian official, Patricia Miranda, spent two weeks in CEMLA in January, to learn about all of the capacity-building training and information products of the CBP. The attachment included work on the fiscal sustainability of debt and an outline of issues for a future CBP study on decentralised debt strategy.

INFORMATION PRODUCTS

The CBP conducted a comprehensive update of its website, including new CS-DRMS®-Debt Pro© link documentation, and new technical reference documents on the latest debt renegotiation terms, new borrowing terms and CIRR discount rates, and launched a new monthly listserve for HIPC debt management officials on the latest developments in the CBP and its methodology, the HIPC Initiative and analysis of debt sustainability. For more details, see www.dri.org.uk.

HIPC CBP REVIEW

The review of the third phase of the HIPC CBP has begun with visits by the reviewers to Dublin and London in April. The company conducting the review will be NEI/Ecorys. They will be contacting HIPC debt managers and other key stakeholders to launch consultations during the next month and at the CBP meetings in Accra, and visiting all implementing partners and participating countries in June-July. The conclusions of the review are due to be presented in November at the 15th Steering Committee.

FUTURE ACTIVITIES

During the next quarter, the HIPC CBP plans include:

- a MEFMI Region Training for Trainers and New Financing Workshop in June;
- National Debt Strategy Workshops in Guyana, Mauritania, Niger and São Tomé and Príncipe;
- Institutional Management Missions to Angola, Burkina Faso, Mali, Niger and Nicaragua;
- Follow-Up Missions to Benin, Bolivia and Chad;
- Missions by Debt Advisors to Burundi, the Gambia, Guinea and Rwanda;
- Two further attachments by Pôle-Dette regional experts;
- The 2nd Inter-regional Debt Managers Seminar in Accra on 13-15 May;
- The 14th Steering Committee meeting of the HIPC CBP on 17-19 May;
- Newsletter 20, Publication 9 and a quarterly website update.

FOREIGN PRIVATE CAPITAL CBP UPDATE

In the first quarter of 2004, Malawi held its 2nd dissemination event, Uganda finished its 2nd analytical report, Tanzania finalised its database, and Bolivia and Kenya began preparatory work for launches. There were also important methodological and website advances, and ROs enhanced their participation.

COUNTRY PROGRESS

Bolivia has finalised comments on the FPC CBP Demand Assessment Report, and agreed to launch the project in the next quarter. In March, DFI trained a Bolivian consultant to run the preparatory work for the launch, and to manage the country project at a local level in consultation with DFI and CEMLA.

Malawi held a successful results dissemination conference in January, assisted by a DFI/MEFMI mission. Key policy findings were that Government should reduce budget deficits, inflation and interest rates for economic stability, and prioritise investments into productive sectors such as agriculture and manufacturing. Others were to improve infrastructure, enforce tax collection and rationalize duties to boost growth, while encouraging the private sector to utilise export initiatives. The team is finalising its analytical report to present recommendations to the Economic Management Committee of Cabinet in April, and will launch a second Phase II exercise in May.

Tanzania has finalised its data for the Mainland and Zanzibar, and is now drafting its analytical report, supported by a DFI/MEFMI mission that will also discuss next steps with officials and donors. The closing event is scheduled in quarter 2.

Trinidad and Tobago is receiving long distance technical support on designing an investor sample for the next survey. The team is due to submit its participation proposal and capacity self-evaluation, and to confirm dates for a postponed DFI/CEMLA follow-up mission in Q2 to review progress and plan next steps.

The **Uganda** working group has finalised its data (final results will be reported in the next issue. A DFI/MEFMI

mission in May will assist the launch of cycle 3 of the project, in sensitisation and training events run largely by nationals.

Zambia has prepared its FPC proposal and budget, and identified local donors that may be interested to co-finance the exercise. The team is planning to firm up these arrangements during the 2nd quarter, and to launch their Phase II in the 3rd quarter.

Both **Ghana** and **The Gambia** have finalised their proposals for phase II. They will be presented to local donors at top level early in quarter 2.

Kenya has launched the preparatory work for entry into the programme with DFI/MEFMI (including finalising survey and non-survey methodology and sample) pending finalisation of the Statistics Strategic Plan work programme in which FPC statistics are a top priority.

Lesotho and **Swaziland** are considering (with **Namibia**) a proposal for joint entry. **Mozambique** is commenting on DFI demand assessment mission recommendations.

COUNTRY CAPACITY SELF-EVALUATION

In January, CEMLA, MEFMI and WAIFEM launched the second round of self-evaluations, to help implementing partners assess progress towards CBP targets.

METHODOLOGY AND INFORMATION PRODUCTS

DFI has been working intensively on methodology in consultation with country teams and partners,

WHAT'S NEW ON THE WEBSITE?

A number of improvements were made to the FPC CBP website in March. The open pages include new information for Bolivia, calendar updates, and publications. Technical pages of the members' site* have been substantially updated with new: generic training materials on data quality; generic assets and liabilities survey forms; work programme for the next two quarters; and contacts for Bolivia.

* All officials of participating country teams are encouraged to sign up by:

Linking to <http://www.dfi.org.uk>

Selecting language to access the homepage.

Clicking on 'members' to open the members' sign-in box.

Completing the sign-in box fields, and clicking 'submit'.

Receiving email confirmation, which will include your username and password.

especially data quality and checking templates, sampling techniques, and manuals for Software and Data Management.

REGIONAL PARTNERS

Based on the Memoranda of Understanding signed in



Malawi Closing Dissemination Workshop, January 2004

December with DFI, MEFMI and WAIFEM have started to enhance staff capacities to accelerate their participation in the FPC CBP. MEFMI has nominated Mrs. Manneko Moyau, from Lesotho, to work on the Tanzania project.

A similar memorandum will be completed with CEMLA. In March, DFI and BCEAO held meetings to discuss BCEAO's potential role in the programme and a possible joint regional workshop in mid-year, to share experiences, and assess country capacity and demand for assistance in the CFA Franc Zone.

PERSONNEL

Hendrie Scheun has returned to Namibia, but will continue to perform Programme Manager functions for DFI and to act as a regional resource person for the FPC CBP.

FUTURE WORK PROGRAMME

During April to June 2004, the FPC CBP will:

Country Projects

- Finalise proposals and (subject to funding confirmation) demand assessment missions to the Gambia, Ghana and Zambia (DFI/MEFMI/WAIFEM).
- Conduct preparatory work and launch the project in Bolivia (DFI/CEMLA).
- Hold opening awareness and training events in Uganda, Malawi and Kenya and a closing dissemination event in Tanzania (DFI/MEFMI).
- Continue discussions with Lesotho, Mozambique, Namibia and Swaziland.

Information Products and Methodology

- Finalise investor sampling methodology and Software/Data Management Manuals.
- Finalise Publication 1 and revise draft Publication 2.

Evaluations, Advocacy and Governance

- Hold its second Steering Committee meeting in Accra on May 20, including analysis of the second round of country capacity evaluations.
- Finalise discussions and memoranda of understanding between DFI and CEMLA, and BCEAO.

SECTORAL FINANCING PATTERNS IN ZAMBIA

The Zambia article in Newsletter 17 showed very large stocks of FDI and private sector external debt in 2001, of 30% and 25% of GDP, respectively. Net flows were also large, with both categories at 4% of GDP. This article looks in more detail at sector financing issues. These include the choice of enterprises between equity and debt, and the resulting implications for costs and sustainability.

SECTOR FINANCING USING FOREIGN EQUITY AND DEBT

Analysing external financing structures in Zambia depends on which valuation method is used. The book value (BV) of a company or sector reflects historical prices, while the market value (MV) approximates current prices. As a number of surveyed companies had pre-1980 start-up dates, inflation and profitability have substantially raised their market values, to an average level of almost 3 times the book value.

Zambia is debt-financed if analysed based on book values, and equity-financed if based on market values. However, for the purposes of comparison with other countries in the developing world, as most countries still compile their data using BVs, we have to use BV. Zambia had an average debt-to-equity ratio of 247%, meaning for every US\$ 1 of equity there was US\$ 2.47 of private external debt. This compared relatively well, as the World Bank's Global Development Finance 2003 reports debt-equity ratios for Sub-Saharan Africa to be 303%, and 196% for all developing countries. It also compares

well with often-cited enterprise-financing rules - that a company should be financed with one-third equity, one-third short-term debt and one-third long-term debt, which would translate to a debt-equity ratio of 200%.

However, as BV bears little relation to reality, the rest of the analysis concentrates on MV. These results show an overall bias towards equity rather than debt financing, as indicated by an average debt-to-equity ratio of 85%. In other words, for every US\$1 of equity there was on average only US\$0.85 of external debt when measured using market value. Compared with the few countries which track market value, this also looks relatively sound.

However, even a low ratio can reflect very diverse sectoral financing patterns. This was the case in Zambia, where 2 sectors were predominantly debt financed – mining, and transportation; one sector (wholesale & retail) was financed with a balanced split between debt and equity; and the remaining sectors were mainly equity financed.

EXTERNAL FINANCING CONSIDERATIONS

The key reasons for the types of external finance chosen were specific to the kinds of business and their investment needs.

The sectors that relied on debt financing for investment were heavily capital-intensive. The majority of these enterprises had capital-intensive production methods, and procured machinery and equipment from industrialised or other nations, for which

formal advance debt financing is necessary, especially in start-up or recapitalisation phases of business.

In addition, enterprises in the trading sectors import most of the goods they sell in their day-to-day operations. For them, foreign loans from external parent companies provide the financing needed through 'trading accounts' to pay for foreign supplies. Until they become profitable, these enterprises usually also depend on large intra-company borrowing to finance their capital outlays through 'loan accounts', with the crucial benefit that these arrangements are very flexible – not demanding fixed-term repayments or interest rates. Once the subsidiaries become profitable in a sustainable manner, loan accounts are usually repaid or re-capitalised, allowing them to switch to equity financing as their business 'life-cycle' matures. Wholesale & retail sector companies started their businesses between 1930 and 1999, and company specific analysis confirms that younger companies have higher debt; the overall gradual expansion of the sector therefore explains its balanced split between debt and equity.

These factors were more important to companies than factors which often receive more attention, notably tax treatments such as stamp duties on equity, or being able to write-off interest payments as a business expenditure.

OVERALL (INCLUDING DOMESTIC) FINANCING

The data on total debt-to-equity financing, as opposed to the above external debt-to-equity financing analysis, show some important changes in Table 1.

A number of observations can be made on Table 1:

- a large number of sectors have higher total than external debt to equity ratios – manufacturing, electricity, construction, hotels, financial and other;
- however, this is primarily because domestic equity is very low in the other sectors: only the Electricity sector borrows more in absolute terms from domestic than foreign sources;
- in addition, none of the total ratios are

Table 1: Financing Structure by Sector, 2000-2001

Sectors	External Debt-to-Equity Ratios	Total Debt-to-Equity Ratios
Agriculture	40.8%	36.0%
Mining and Quarrying	202.7%	122.1%
Manufacturing	59.5%	69.0%
Electricity, Gas and Water	8.6%	25.6%
Construction	31.0%	54.8%
Wholesale & Retail	99.1%	86.3%
Hotel and Restaurants	47.3%	60.2%
Transportation	215.2%	168.5%
Financial	30.9%	56.4%
Other Sectors	79.8%	92.9%
Overall Average	85.2%	77.1%

SECTORAL FINANCING PATTERNS IN ZAMBIA (Cont.)

Table 2: Sector Profitability, 2000-2001

Sectors	Return on Book Value Equity	Return on Market Value Equity
Agriculture	103.9%	55.7%
Mining and Quarrying	(38.9%)	(23.3%)
Manufacturing	33.3%	11.9%
Electricity, Gas and Water	61.0%	5.7%
Construction	15.0%	14.3%
Wholesale & Retail	77.8%	15.1%
Hotel and Restaurants	(89.6%)	(43.5%)
Transportation	35.8%	13.6%
Financial	57.2%	13.1%
Other Sectors	(19.5%)	(7.3%)
Overall Total	10.8%	3.7%

CONCLUSIONS AND POLICY IMPLICATIONS

While the above results are based on Zambian sector financing patterns, many of the conclusions and implications are applicable to other participating FPC countries:

- capital-intensive sectors use sophisticated long-term borrowing methods, and depend on external debt. As a result, they incur below average financing costs;
- sectors of a trading nature use both equity and debt in a balanced way, but shift from debt to equity as their business life cycle matures;
- the remaining sectors depend mostly on equity, in large part because domestic debt is scarce and expensive, and foreign debt may be unavailable;
- however, equity financing is less flexible and more costly than external debt, especially related intra-company borrowing;

The policy implications of these findings are problematic. Orthodox suggestions are that governments should reduce their domestic financing needs through fiscal discipline in order to free up funding for the private sector and reduce overall interest rate levels. However, experience in other countries is that the domestic banking system is highly reluctant to lend to the private sector, and such behaviour will change only gradually. Governments therefore need to promote non-bank financial institutions such as venture capital funds, investment banks and leasing companies that can compete with existing sources of domestic financing and lower both equity and debt costs. They should also work more actively with bilateral and multilateral institutions to broaden the range of external debt financing options available to investors, and provide investors with more assistance in searching for finance of all kinds. This will enable enterprises to have better and cheaper financing options.

¹ For more details, see Foreign Assets and Liabilities and Investor Perceptions in Zambia, January 2004, available at www.boz.zm

above globally-comparable levels;

- only agriculture, commerce and transport have lower total ratios, but they dominate total investment;
- as a result, the average debt-equity ratio for Zambia was 77%, compared to the external debt-equity ratio of 85%;
- in fact, all companies borrow on average 4.6 times more externally than in Zambia. This partly reflects their access to sector-specific funds as discussed above, but is primarily due to barriers and high costs in accessing domestic credit.

THE COSTS OF EQUITY AND DEBT BY SECTOR

Table 2 shows the sectoral profitability of private enterprises in Zambia for 2000-2001, based on Net Operating Profit (NOP) after tax, adjusted to reflect the foreign equity investment shareholding in the sector. Column 1 shows the return on equity investment at Book Value, while column 2 shows the return on Market Value equity. The results show that Zambian businesses were profitable in 2001, using either measure. The return on book value investment was 10.8%, while that on market value was 3.7%. Global Development Finance 2003 reports annual average rates of return on book value of FDI for 25 countries of 7.1% for the 1993-2000 period. The average for Sub-Saharan Africa was 13%, comparable to Zambia's return on book value.

However, there was a sharp contrast in the performance of different sectors. The most profitable sectors (in order) were Agriculture, Wholesale & Retail, Construction, Transportation, Finance and Manufacturing. Loss-making sectors were Hotels, Mining, and Other (mostly Real Estate). Of the 2 debt-financed sectors, Transportation had good profits, but Mining experienced a tough year.

If the return is treated as the annual 'cost' of the equity investment, then this cost can be compared with the cost of debt finance. Costs on debt finance were considerably lower than the book value rate of return for all sectors, and even lower than the market value equity rate of return for some. However, there were wide sector variations, which can be classified into 4 groups:

- sectors with mixed (intracompany and unrelated lender) external debt financing and relatively high interest rates, such as Hotels (8.8%) and Agriculture (8.1%);
- sectors with mixed external debt financing and relatively low interest rates, such as Manufacturing (3.9%), Mining (3.5%), and Wholesale & Retail (1.0%);
- sectors with unrelated lender external debt financing and relatively high interest rates, such as Other (7.0%) and Transportation (6.6%);
- sectors with unrelated lender external debt financing and relatively low interest rates, such as Electricity (3.6%) and Finance (1.7%).

FOREIGN PRIVATE CAPITAL: FREQUENTLY ASKED QUESTIONS

HOW DO COUNTRIES BUILD REGISTERS AND SAMPLES?

Almost all countries worldwide use surveys or censuses as one key method to collect FPC data. One fundamental challenge is building a reliable register or sample for the survey, to save on time and resources and ensure quality outputs.

1) WHEN TO COMPILE THE REGISTER?

This needs to happen before each survey. Best statistical practice recommends:

- a census or benchmark survey when establishing a new time series, and every 5 years thereafter. A census should cover the entire population of FAL enterprises – which is usually very large. A benchmark survey must cover a large sub-group of enterprises that is comprehensive enough to supply reliable benchmark data;
- sample surveys between each census. Sample surveys cover a smaller sub-set of enterprises, which are nevertheless representative of national FAL characteristics.

So countries compile a register before each census or benchmark survey, update it constantly thereafter, and choose samples from it for sample surveys

2) WHAT SOURCES TO CONSULT?

This depends on the desired data coverage. FPC CBP methodology distinguishes four categories of FAL data (equity liabilities, non-equity liabilities, equity assets, and non-equity assets). International best practice is to use multiple sources for each category. However, countries need to make value judgements about the reliability of each source and, if necessary, conduct a filter exploratory survey to test this.

There are usually many sources for **foreign equity liabilities**, although of varying quality. Previous surveys (or exchange control and debt registers for countries) are a good starting point. Investment promotion agencies provide lists of companies with investment

approved, but often do not know whether they have actually invested, use BoP definitions of residency, or cover all projects. Statistical offices have information from household, enterprise and sectoral surveys, but these may not be recent or identify FAL. Central banks yield bank names from bank supervision departments. Company registrars require companies to register and submit annual records, but these are often out of date or poorly organised due to lack of resources. Company websites may show FAL in financial statements (but usually only for a few large companies). Stock exchanges and brokers provide information on listed companies and share trades. Other reliable sources include privatisation bodies, line ministries, sector-specific regulators, export processing zones, export sector bodies, and private sector associations. One potential key source is the tax authorities – the VAT list contains virtually every active enterprise – but it is vital to make clear to the tax authorities that they will receive no data in return, to guarantee the confidentiality of survey data. Counterpart BoP compilers in other countries may also be prepared to exchange lists of investors, but not any data for confidentiality reasons.

Additional sources for **foreign non-equity liabilities** include foreign and domestic stock exchanges/brokers, financial market departments of central banks, line ministries, and previous debt surveys.

Identifying foreign assets is one of the most challenging tasks. Sources for equity include investment promotion agencies and BOP compilers in key partner countries, the ministry of commerce and industry, embassies abroad, trade directories and associations, and the media. Additional sources for non-equity assets are pension and life assurance bodies, and customs data.

In all countries and for all types of FPC, key sources are the financial and other media, telephone directories and conversations with the private sector. There is no substitute for local

knowledge and keeping your ear to the ground.

3) UPDATING THE REGISTER

Once a preliminary list has been compiled from these sources, countries need to remove duplication and non-existent enterprises. The whole process can be complex and lengthy (2-3 months). Even good registers have flaws, so the FPC CBP encourages countries to update them during implementation. It is also vital to realise that registers are not static – they need to be revised for new information while implementing each survey, based on information gathered in the field. Often initial sources prove very unreliable, requiring countries with larger investor populations to conduct two benchmark surveys before feeling confident about their registers and being able to start selecting smaller samples.

4) PRINCIPLES FOR DEFINING A SAMPLE?

Once a reliable census or benchmark survey is conducted, countries need to define samples for sample surveys. They do this using quantitative and qualitative filters.

Quantitative filters involve setting thresholds that companies must exceed to be included. These can be based on one or more of:

- **FAL stocks or flows.** This is recommended, but is available only after initial censuses or benchmark surveys, or from accurate exchange control records;
- **Investment approved** by investment promotion agencies). Though this can misestimate FAL (see above), it is often the basis for a threshold;
- **Projected or actual turnover.** This can come from company registrar offices and will indicate size, although not residency status of transactions;
- **VAT.** This requires judging the level of VAT payment that implies that a company has international transactions, but again does not distinguish residency.

Most countries do not mind using filters that do not distinguish residency for

DEBT RELIEF TECHNICAL QUESTIONS

ARE NEW DISBURSEMENTS AND BORROWINGS CONTRACTED BETWEEN HIPC DECISION AND COMPLETION POINTS ELIGIBLE FOR DEBT RELIEF?

The short answer to this question is no. The amount of HIPC relief each creditor is to provide, on a burden-sharing basis, is determined on the basis of the PV of debt at the decision point, which is based on the database used to do the decision point DSA. So interim relief, which is delivered by the percentage reduction in annual debt service payments, from for example IDA and the IMF, is applicable only to the debt service due on the debt stock used for the decision point DSA. This means there is no debt relief on any

disbursements after the country's decision point. In order to monitor the delivery of this type of debt relief accurately, a country has to record all post-decision point disbursements of existing loans and new loans separately from the debt stock as of its HIPC decision point database.

When simulating debt relief scenarios after a country has reached its decision point, it is essential to have separate debt category codes for loans, which comprised the debt as of the decision point and new disbursements and debt contracted after the decision point. So for example, it is necessary to have one debt category for all IDA debt as of the decision point database and a second debt category code for all IDA

disbursements after the decision point in order to simulate IDA debt relief accurately.

WHAT MECHANISM IS JAPAN NOW USING TO PROVIDE INTERIM DEBT RELIEF?

Initially under HIPC, Japan was not able to provide debt cancellations and so countries had to pay the debt service in full and Japan would then provide an equivalent amount in grant funds to offset the service payments. However, in 2003, Japan changed the way in which it delivers interim debt relief to HIPCs and it is now able to cancel debt. This policy change means countries can now negotiate for debt service cancellation in the interim period.

cont from page 15

FOREIGN PRIVATE CAPITAL: FREQUENTLY ASKED QUESTIONS

initial benchmark surveys, because a) they want to survey and contrast the transactions and opinions of both residents and non-residents, and b) they want to track the foreign assets of residents. However, following initial surveys they prefer to use FAL to set the threshold, supplementing it by adding any new large companies.

Qualitative filters are used to ensure that a survey is capturing data that are representative of various characteristics of the FAL, or of the economy. These can be used either to ensure that the survey is balanced (e.g. across sectors or regions), or to allow more selective detailed analysis of particular sub-groups (e.g. source countries or types of FAL).

Precise thresholds and numbers of companies will depend on the frequency of data collection, the length of questionnaires, and capacity constraints. More frequent, deeper or wider data will require a smaller sample, unless capacity can be enhanced.