HIPC DEBT STRATEGY

The Newsletter of the HIPC Debt Strategy and Analysis Capacity Building Programme

Debt Relief International

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Issue 11, 1st Quarter 2002

HIPC MINISTERS WRITE TO HEADS OF BWIs REQUESTING ACTION TO OVERCOME KEY BARRIERS TO DEBT SUSTAINABILITY

At recent meetings in Maputo, Lilongwe and London, HIPC Ministers of Finance and senior officials discussed key barriers to long-term debt sustainability. They decided that they would make concrete suggestions to overcome these barriers and write to the heads of the Bretton Woods Institutions requesting support for these solutions. The following letter has been sent to Horst Köhler and James Wolfensohn, by Minister Jumbe of Malawi (the current Chair of the HIPC Network). It has been copied to Kofi Annan, UN Secretary-General; Romano Prodi, European Commission President; Mark Malloch Brown, UNDP Administrator; Rubens Ricupero, UNCTAD Secretary-General; and Donald McKinnon, Commonwealth Secretary General – and to Finance and Development Ministers of G7 and like-minded countries, and Executive Directors representing HIPCs. Minister Jumbe and Minister Ssendaula of Uganda (Chairman of the African Constituency) will be following up on the letter in discussions at the Spring Meetings, and our next edition will let you know the results.

DECLARATION

Non-Participation of Creditors

The Bretton Woods Institutions have made clear in several recent Board papers that non-participation of several creditors (principally non-Paris Club governments, smaller multilateral institutions and commercial creditors) in the Initiative is of growing concern. The lack of relief on such debt has meant that the present value sustainability thresholds established under the Initiative are not being attained by most countries, damaging their creditworthiness and growth prospects.

This issue is rapidly becoming critical as non-Paris Club governments, commercial creditors and 'vulture funds' that have bought debts from creditors are taking an increasing number of debtors to court and demanding payment at 100% of face value. The HIPC Ministerial Network is aware of 12 HIPCs who are currently fighting lawsuits. Immediate settlement of such debts has in the past cost countries upwards of US$50 million in one year: similar payments now will ruin poverty reduction plans.

We would propose that solutions to this problem contain 5 elements:
For those creditors that are refusing to participate in the Initiative, but are not threatening legal action, the international community must accelerate its efforts to convince them to participate.
It should convene a conference of HIPCs, international financial institutions and non-OECD and other bilateral and multilateral creditors, to agree innovative mechanisms for relief. This should include where appropriate creditor countries which are not members of the BWIs or the UN. Funding mechanisms could include the IDA buyback facility, HIPC Trust Fund resources, and donor grants to relieve debts owed-to countries that have themselves received concessional debt relief. The 12 HIPC creditor countries which are members of this network are prepared to come to such a meeting and to discuss positively all potential solutions to the problem.

In order to forestall the trend to legal actions the international community should envisage 4 measures:

a) An international initiative led by the IMF and World Bank to inform all member states (creditors and debtors) about the degree to which IMFC and Development Committee communiqués and Executive Board decisions are legally binding on BWI member states. If necessary, we would suggest that the BWIs pass rapidly through their Executive Boards decisions committing member states in a binding manner to providing HIPC-comparable terms, and to opposing in their legal jurisdictions any settlement that provides terms that are more favourable than HIPC. This issue could be treated in discussions on "standstill" procedures, with special procedures for HIPC-related comparability clauses and rapid action to help with immediately foreseeable lawsuits.
b) Initiatives by major international arbitration fora (such as ICSID and the International Chamber of Commerce) to ensure that their arbitration decisions find in favour of HIPC comparability.
c) Initiatives by major creditor governments to incorporate similar provisions in their laws and procedures in order to prevent creditors from launching lawsuits in their jurisdictions.
d) Legal technical assistance to HIPCs (as in IDA buybacks) in formulating legal instruments that can be passed into law rapidly and simply to prevent creditors from suing in HIPC jurisdictions.

Finally, we would like to stress that, contrary to appearances, some Paris Club creditors are not participating fully in the Initiative. The Paris Club has not finalised agreed minutes on interim relief for some small debtors, and bilateral agreements are coming through very slowly. Some G7 Paris Club creditors continue to exclude certain 'special' debts from relief, and some are providing 'cancellation' in ways that use the funds to pay for non-essential imports or NGO-led projects, and do not free

Dear Sirs,

I am writing as Chairman of the HIPC Finance Ministers' Network, which groups 33 HIPC Finance Ministers, to inform you and the members of the Executive Boards of IMF and the World Bank of the recent deliberations of HIPC Finance Ministers and senior officials on the Enhanced HIPC Initiative, and to request a reply before the Spring Meetings on a number of matters which are of urgent concern to HIPC governments for the future sustainability of the Initiative.

Meetings in Maputo, Lilongwe and London during November 2001-March 2002 brought together Ministers and senior officials of 33 HIPCs. They expressed strong support to the international community and in particular to the Bretton Woods Institutions, for the development and execution of the Enhanced HIPC Initiative and the renewed focus on Poverty Reduction as a cornerstone of development. They underlined their appreciation for the benefits these measures are providing to their countries in terms of reducing the debt burden and higher spending on poverty reduction. They also reiterated their full commitment to: designing and implementing poverty reduction strategies with full popular participation; mobilising external and domestic financing for poverty reduction in ways which ensure sustainable debt levels and financial market development; spending debt relief proceeds and other budget funds transparently and efficiently on poverty reduction; and establishing institutional structures and other prerequisites for national capacity-building in these areas.

However, they expressed strong concerns about four factors that risk undermining the credibility of the Initiative and the long-term sustainability of their debt. As you will see from the attached Declaration, in each of these areas, they have made suggestions for essential measures on which we would welcome your views and those of the Boards.

These factors are:

- *the non-participation of a significant number of creditors in the Initiative, which is becoming a critical issue as an increasing number of such creditors are demanding full settlement of debts;*
- *the failure of the Initiative and other mechanisms available at an international level to take sufficient account of the risks of shocks due to commodity prices and aid shortfalls which are already undermining the debt sustainability of a significant number of HIPCs;*
- *the slow progress in streamlining conditionality, introducing macroeconomic flexibility and Poverty and Social Impact Analysis, which is the main reason delaying completion points;*
- *the need to establish a wider set of measures to ensure sustainable financing for poverty reduction.*

We look forward to responses from the Bretton Woods Institutions as to the feasibility and potential timetable for these solutions, and any alternative suggestions you may have for resolving these problems, so as to improve the prospects for permanent debt sustainability for HIPCs.

funds for PRSP implementation. To us this represents a backtracking on commitments made at past G7 summits, and a worrying development for the sustainability of the Initiative. We urge the Spring Meetings and next G7 Summit to ensure that any such delays and obfuscations are eliminated rapidly.

External Shocks

External shocks have long been a principal cause of problems with the execution of economic reform programmes. Past response to such shocks has usually combined adjustment by the affected country and mobilisation (after some considerable delay) of additional aid. However, the recent falls in world commodity prices, the global recession and the effects of the 11 September tragedy, combined with the continuing effects of climatic shocks, and conflicts in HIPCs themselves or among their neighbours (in particular for landlocked and island nations), have made many HIPCs unsustainable once again. They have re-emphasised the importance of establishing mechanisms to pre-empt and overcome such shocks so that long-term debt sustainability can be maintained. In addition, the international community can no longer require a country to adjust to shocks: under a Poverty Reduction Strategy, such adjustment represents a cut in poverty reduction spending and an abandonment of Millennium Development Goals.

Our proposals in this area would be as follows:

- Comprehensive assessment of HIPCs' debt sustainability, to take into account all the sources of financing for attaining the Millennium Development Goals, and the combined burdens of external and domestic debt, to assure adequate funding for poverty reduction goals.
- More realistic long-term economic projections in such assessments, with baseline scenarios taking full account of past external shocks through volatility and probability analysis.
- Annual reassessments of sustainability between decision and completion points, and after completion points, in order to identify as fast as possible any renewed unsustainability of debt or reduction in anti-poverty spending, and to augment debt relief where necessary.
- Restoring a full safety margin to protect against future shocks. This would involve allowing the additional bilateral debt cancellations pledged by some creditor governments beyond Cologne Terms to be fully additional to HIPC relief, thereby bringing HIPCs' debt ratios down by an additional 25-30%. It would also imply presenting frankly in completion point documents the prospects for creditor participation, to assess the effects of non-participation on sustainability.
- Introducing rapid (and affordable) contingency financing mechanisms, through 'floating additional tranches' in IMF PRGF programmes which can be disbursed immediately in the event of shocks. These could be funded for individual HIPC PRGF programmes by upward adjustment of quota-based borrowing ceilings, and overall by the reallocation of developed country SDRs.
- Accelerating recommendations of the World Bank Task Force on Commodity Risk Management to provide countries and their poorer citizens with the means to protect themselves against shocks
- Reinforcing insurance mechanisms such as those of the Commonwealth Disaster Management Agency, to provide subsidised private sector insurance against some types of shocks.
- Ensuring that donors and multilateral institutions provide more predictable and stable aid flows, and avoid sudden suspensions due to individual conditions if PRSPs are generally moving forward.

HIPC Consultation Meeting, London, 5 March 2002

Streamlining Conditionality

We wish to congratulate the Bretton Woods Institutions for their efforts to streamline conditionality under PRGFs and PRSCs, to define a new more flexible macroeconomic framework to maximise anti-poverty spending, and to develop poverty and social impact analysis (PSIA). However, progress in individual country negotiations has been slow, delaying an increasing number of countries in their progress through the HIPC Initiative. We therefore urge the BWIs to redouble efforts in three respects:

- Streamline conditionality more dramatically. The IMF should select 4-5 conditions that are essential to a pro-poor macro framework, and the World Bank a similar number of structural conditions that have a demonstrable direct positive impact on poverty reduction. Total combined PRGF/PRSC conditions should not exceed 10. Both institutions should verify closely that there is no 'conditionality fungibility' among their programmes, that other donors do not impose additional conditions, and that they avoid micro-conditions (such as precise percentages of spending on individual sectors or micro-institutional reforms). Compliance with conditions should be interpreted based on overall trends and efforts rather than individual performance criteria.
- Accelerate efforts to design more flexible growth-oriented macroeconomic frameworks. Encourage 'post-stabilisation' countries (defined in the recent Board paper SM/02/51 as those with inflation under 10% and cash budget deficits under 2% of GDP after grants) to think more closely about ways to increase growth and employment rather than further reducing inflation, about the supply-side (as well as demand-side) causes of inflation, and about defining sustainability of the budget deficit as including grants and debt relief. This will allow HIPCs to define alternative paths to poverty reduction, focussing more on growth and anti-poverty spending, and to maximise the mobilisation of concessional funding for poverty reduction spending.
- Dramatically accelerate PSIA in HIPCs. Analysis of the links between macroeconomic and structural policies and poverty reduction remains among the weakest areas of most PRSPs, and it is essential to equip countries with the tools to conduct their own PSIA rather than depending on outside assistance. These tools should have inputs from the BWIs and donors, but be administered and disseminated by independent capacity-building sources, to avoid conflict of interest for partners in the negotiation process of PRGF and PRSC frameworks.

Widening the Agenda for Financing Sustainable Development

HIPC relief is only a small part of the package needed for ensuring adequate financing to allow countries to meet the Millennium Development Goals. If we are to reach these ➤

goals through a joint effort, the following measures will be required by the international community:

- calculating the financing needs for each individual HIPC country to reach the MDGs and presenting such analysis in individual HIPC, PRSP, PRGF and PRSC documents;
- presenting aggregate needs systematically and comprehensively to BWI and UN meetings;
- limiting non-concessional lending where necessary to maintain long-term debt sustainability;
- a major increase in grant aid, to reach the UN targets of 0.7% of GNP as soon as possible;
- providing new finance in ways which support poverty reduction strategies, through
  - untying all aid from the exports of the supplying country
  - moving from project support to budget support
  - establishing common disbursement, procurement, accounting, auditing procedures
  - maximising value for money of aid and accelerating efforts to eliminate corruption
  - providing aid only for productive purposes rather than white elephants or arms
  - making longer-term commitments of aid flows.

Finally, we also recognise the need to reduce aid dependence by mobilising our national resources for poverty reduction. We ask the international community to assist us in these efforts by:

- strengthening HIPCs' efforts to increase budget revenue, while remaining realistic about the limited and gradual prospects for increases;
- encouraging non-debt private sector flows (especially FDI) to HIPC countries as a top priority in order to maximise growth and long-term debt sustainability;
- providing free market access for the least developed countries and HIPCs, as well as removing subsidies and other structural barriers which impede market access even in the absence of tariffs;
- placing even more emphasis in PRSPs on increasing value added of export products and moving from raw materials to finished products, to take advantage of trade liberalisation.
- procuring wherever possible goods financed by aid (notably food aid) from HIPCs themselves.

We believe that the above measures will be essential to the success of HIPC efforts to reduce debt to permanently sustainable levels, and PRSP efforts to meet the Millennium Development Goals.

CBP REGIONAL PARTNER INSTITUTIONS: WAIFEM

WAIFEM AND ITS MISSION

WAIFEM Mark I (1997–2000)

The West African Institute for Financial and Economic Management was established by the central banks of the five English speaking West African countries (The Gambia, Ghana, Liberia, Nigeria, and Sierra Leone) in June 1996. Its main objective was to strengthen capacity in macroeconomic and financial management through short term customized training courses for middle/senior level staff of Central Banks, Ministries of Finance and Planning, and other public sector agencies involved in macroeconomic policy formulation and implementation. Its mandate also included research, consultancy, networking and dissemination of best practices.

Training Activities

The Institute commenced training activities in April 1997. Until 2000, its core training programmes revolved around Macroeconomic Policy Analysis; Data Management and Techniques of Economic Analysis; Exchange Rate and Reserves Management; and Financial System Regulation and Supervision.

Particular emphasis was accorded to Debt Management in view of the barrier posed by a huge debt overhang to accelerating growth and development in Anglophone West Africa. The Institute offered regional courses on:

- External Debt Management, including data recording on the Commonwealth Secretariat's CS-DRMS and UNCTAD's DMFAS;
- Domestic Debt Management;
- Legal and Practical Aspects of Loan Negotiations and Agreements;
- Arbitration and Dispute Resolution in Financial Management;

WAIFEM's Expanded Mandate (2001-04)
During the first phase, WAIFEM built an international reputation as a centre of excellence, with the maintenance of a high standard in skills development, dedicated support from its owners, and high-level clientele from user institutions. This placed the Institute in a strong position to take bold steps to consolidate its achievements and reposition itself for the challenges of the new millennium. The Board of Governors authorised the Institute to execute a medium-term integrated capacity building programme for its members, spanning 2001–2004. The programme involves an expansion from organization of courses to a holistic and integrated approach to institutional, organizational and policy framework aspects of capacity building.

WAIFEM's Capacity-Building Objectives

WAIFEM's Capacity-Building Programme is financed by member Central Banks with support from the African Capacity Building Foundation (ACBF), Debt Relief international (DRI) (under the HIPC-CBP) and the Government of Sweden. Its cardinal objectives are to strengthen capacity to:

- manage public external and domestic government debt, including contingent liabilities;
- develop, regulate and supervise the financial sector, including managing international reserves; and
- formulate and implement macroeconomic policy.

The above objectives are pursued by three programme departments: Debt Management, Financial Sector Development, and Macroeconomic Management.

Debt Management Programme Outputs

The outputs expected from the Debt Management Department are:

- National capacity-building plans for debt management;
- Reinforced legal, institutional and organizational arrangements;
- Improved operational external and domestic debt management, including recording, disbursement/issuance procedures and servicing;
- Better results in renegotiating debt and negotiating new external/domestic borrowing;
- Independent capacity to conduct debt sustainability analysis and implement national external and domestic debt strategies; and,
- Greater awareness of debt management policy, among senior government officials, legislators, the media and other opinion-leaders.

Progress toward these objectives is monitored through a set of quantified and objective performance indicators.

Activities

To produce the outputs, the Debt Management Programme applies a range of complementary tools, including:

- Highly intensive and hands-on regional and national courses and workshops;
- Demand assessment, advisory and follow-up missions to member countries;
- Study tours and/or national retreats;
- Fellowship schemes to train debt managers to world-class levels of expertise;
- Regional workshops to disseminate best practices to legislators and practitioners in the mass media;
- Regional senior policy seminars for government policymakers;
- Research, publication and dissemination of best practices; and
- Online information services provided through the WAIFEM website.

WAIFEM'S TRACK RECORD

Between April 1997 and February 2002, the Institute offered 60 customized courses and advisory missions, which benefited 1,650 middle/executive officials. The share of participants from central banks has declined from three quarters to half, reflecting the

Institute's policy of broadening its capacity-building support to other public and private sector agencies. As a result, the share of finance ministries has been around 14%, and that of other public and private agencies including legislators and journalists has risen to 36%. Nigeria has provided 45% of participants, Ghana 24%, Sierra Leone 15%, The Gambia 12% and Liberia 3%. The remaining 1% is from non-member francophone or PALOP countries, reflecting the Institute's wish to exchange best practices with other regions.

The global outreach of the Institute has enabled it to access high calibre resource persons and the latest techniques in capacity building, resulting in high standards in programme design and delivery. It provides a highly cost-effective platform for international training institutes (those of the IMF, World Bank and UN) to access a regional audience. Finally, WAIFEM provides an opportunity for high-level dialogue among senior officials in West Africa, which augurs well for economic integration under the West African Monetary Zone (WAMZ) and the Economic Community of West African States (ECOWAS).

The DRI-WAIFEM meeting in Lagos

HIGHLIGHTS OF WAIFEM/DRI COLLABORATION

Past and Present Relationship

Under a Memorandum of Understanding (MOU) signed by the two parties in late 2000, the Institutions resolved to assist the four WAIFEM HIPCs - The Gambia, Ghana, Liberia, and Sierra Leone, (a) to gain debt relief under the HIPC facilities of the Bretton Woods Institutions, and (b) to devise and maintain a sustainable long-term debt strategy and portfolio. Both establishments are committed to enhancing capacity for debt sustainability analysis and strategy formulation and implementation in the sub-region, through cooperation based on a coordinated and complementary approach.

The two institutions have mapped out the following areas of cooperation:

i) Joint regional or country workshops on Debt Sustainability Analysis, Debt Strategy Design and Implementation, Capacity Building Planning, Debt Negotiations, Macroeconomic Forecasting for Debt Strategy, Links Between Debt Sustainability and Poverty Reduction, and Training for Trainers.
ii) Joint demand assessment and/or follow-up missions: These evaluate country capacity-building needs and provide follow-up assistance to facilitate progress in implementing debt strategies.
iii) Joint development of debt strategy and analysis training materials, to transfer DRI expertise to WAIFEM, refine regional and national training manuals, and develop and test training for trainers' manuals.
iv) Attachment-based training. As part of the transfer process, WAIFEM debt management staff and fellows would go on attachments to DRI offices and elsewhere as appropriate, to be trained as trainers in specific technical areas.

Collaborative efforts with DRI under the HIPC CBP commenced in December 1999, with joint demand assessment missions to WAIFEM's member states, which culminated in the articulation of the debt management programme under WAIFEM's CBP. This allowed the two organisations to design a joint work programme, under the HIPC-CBP, which began in 2000 with two joint workshops – an Anglophone Workshop on Debt Negotiations and Renegotiations (which was also attended by Ethiopia and Malawi); and a national Debt Strategy Analysis workshop in The Gambia. DRI also supplied resource-persons to WAIFEM regional workshops on External and Domestic Debt Management.

Since the commencement of WAIFEM's CBP in 2001, the Institute and DRI have jointly organized a busy work programme in 2001 and 2002:

- Demand Assessment Mission to Sierra Leone (16-19 January 2001);
- Follow-up Mission to The Gambia (14-25 May 2001);
- Follow-up Mission to Sierra Leone (23 July – 3 August 2001);
- Sierra Leone National Debt Strategy Analysis Workshop (6-16 August 2001);
- Follow-up Mission to Ghana (3-7 September 2001);
- Regional Workshop on Macroeconomic Management and Poverty Reduction, Accra, Ghana (23-27 July 2001); and
- Regional Workshop on Government Securities and Domestic Debt Management, Accra, Ghana (3-14 September 2001).

WAIFEM/DRI collaboration has benefited all the Anglophone HIPCs in West Africa. In particular, the Debt Strategy workshops and follow-up missions to The Gambia and Sierra Leone, and recently in Ghana, have seen these countries through to decision point under the HIPC Initiative. In 2001, a total of 142 senior/executive level officials from the five countries of WAIFEM attended these programmes. The Programme Officer, Debt Management, spent a week in October-November 2001 attached to DRI in London, for training in designing debt reduction and loan negotiation strategies. WAIFEM has also been attending the CBP Steering Committee, which has provided an additional forum for cementing its links with donors, international organisations and other regional partners. Finally, in January 2002, a team from DRI visited WAIFEM to discuss all aspects of CBP governance, management, content, information products, administrative and financial procedures, producing an extensive list of recommendations for improving mutual cooperation and coordination.

A Look Ahead

In 2002, WAIFEM and DRI plan to undertake follow-up missions to The Gambia, Ghana and Sierra Leone. These will build on the progress so far by helping the countries to obtain maximum relief under the HIPC Initiative, including assisting in building capacity for debt renegotiations with Paris Club and other creditors. The two institutions will also jointly organize regional workshops on 'External Assistance and Aid Management' and 'Domestic Debt Strategy', as well as an Executive Forum for Ministers and Governors of Central Banks, on External Debt Management and Capacity-Building. They are also at an advanced stage of discussions on cooperation in providing debt strategy support to the Government of Nigeria, which will be funded separately by the Nigerian Debt Management Office and the UK Department for International Development.

The ultimate aim of WAIFEM and DRI collaboration under the HIPC-CBP is, for DRI, as the Technical Partner under this programme, to transfer to WAIFEM, as the regional organisation, the knowledge and skills required to ensure its member countries have national ownership of the HIPC process, and maintain a sustainable debt portfolio while financing long-term development. To this end the two organisations are working in partnership with the CBP donors and other regional partners – BEAC/BCEAO Pôle-Dette, CEMLA and MEFMI – to design a programme for the CBP Phase 3 that will ensure such a transfer.

CAMEROON'S TOTAL DEBT SUSTAINABILITY[1]

By Bruno Iboklene, Caisse autonome d'Amortissement du Cameroun

In the 1980's, the debt crisis of developing countries was seen as an external debt crisis. But since then, given the deteriorating internal economic fabric of the countries, there has been a growing awareness that we can solve this crisis only by also reducing domestic debt.

Domestic debt consists of borrowings from residents, which the state or its agents enter into or guarantee. The Treasury bonds and obligations are the property of their holders, but also debts of the taxpayers. As a result, in contrast to external debt, domestic debt does not increase the resources of a country, but transfers buying power among its residents - though of course non-residents may also invest in government local currency debt instruments if permitted by national statutes.

However, in Cameroon's case, domestic debt is much wider than the traditional definition. Audits ordered by the Cameroon government have revealed many other categories of domestic debt: arrears for supplier credit, public works, construction, rents, compensation of people displaced by works or road construction, salaries and advances, debt to banks and insurance companies, cross-debts between the government and state enterprises, tax refunds, other remunerations, and debts of public enterprises which have been liquidated.

At end-September 2001, Cameroon's total domestic debt stock was CFAF1.2 trillion (US$1.7 billion), with the stock of arrears totalling CFAF246 billion (US$350 million) or 21% of the stock, as shown in Chart 1. A preliminary repayment plan combining various methods (securitisation, cash payments, offsets, rescheduling) has been established. However, the Cameroon government thought it prudent to carry out further research to analyse the feasibility of the payment plan, and to combine this with analysis of external debt relief based on the Enhanced HIPC Initiative in order to assess Cameroon's total debt sustainability.

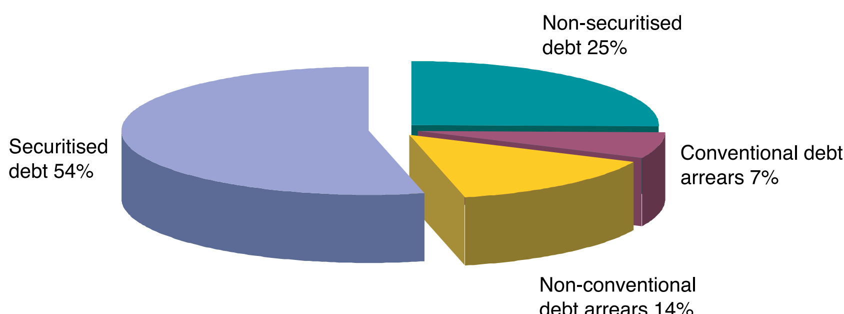
During the analysis, we also decided to simulate two other domestic debt-reduction scenarios: 1) debt conversion through the privatisation programme to reduce the burden of debt service compared to securitisation – which would have the additional advantage of widening the pool of potential investors; and 2) rescheduling over a period of 12 years the payments of securitised debt falling due between 2002 and 2005.

All of these domestic debt scenarios were combined with an external debt relief scenario which assumed that, in the context of the Enhanced HIPC Initiative, Cameroon benefits from all the relief programmed by the international financial community – though if commercial or government creditors refuse to provide relief, this may be unrealistic.
We combined these debt relief scenarios with a baseline macroeconomic scenario, using the hypotheses in the decision point document issued in May 2000 (adjusting for revisions to the DSA agreed with the IMF in September 2001). This included GDP growth of 5% to 2004 and 6% thereafter, export growth of 0.1% to 2004 and 5.5% thereafter, domestically generated budget revenues of 19.7% of GDP, and expenditure (excluding interest) at 15.7% of GDP. Complete projections were made for all items of the balance of payments and budget to ensure that financing gaps were filled. An alternative scenario was constructed with lower hypotheses on GDP and budget revenue growth as well as more gradual export recovery.

The framework for analysis was the following:

- the international community has not established thresholds to judge the sustainability of domestic debt. In the past, several theories have been suggested, based largely on simple equations that analyse of government finances and suggest tax increases if the debt appears unsustainable.[2] However, these approaches did not fulfil the needs of the Government of Cameroon, which wanted to look at the effects of restructuring domestic debt on the debt burden in terms of liquidity and overhang.
- So instead we relied on the analysis conducted by Debt Relief International,[3] which has found that countries whose domestic debt present value to revenue ratio is less than 88% have not accumulated arrears –an empirical indicator of sustainability. If we add this to the similar HIPC ratio for external debt (250 %), then total public debt (external and domestic) should stay below 338%. But DRI's additional work has indicated that the external ratio should be 151%, and that the total ratio should therefore not exceed 239%.
- For analysis of liquidity ratios, namely the ratio of domestic debt service (including principal payments and arrears clearance) to revenue, the empirical threshold established by DRI for domestic debt is 28%, and 40% for total debt.

Chart 1: Structure of Cameroon Domestic Debt Stock CFAF245.4 bn, end-September 2001



Analysis of Results for Sustainability Ratios

Combining debt relief and macro scenarios, we analysed the six outcomes. The baseline macroeconomic scenario combined with

[1] This article is a summary of research by officials of the Caisse autonome d'Amortissement under the supervision of the author, with assistance from Michel Vaugeois and Alison Johnson during a HIPC CBP mission in November 2001.
[2] Cf. Effective Domestic Debt Management in Developing Countries (Commonwealth Secretariat, 1999).
[3] The Fiscal Burden of Debt – Alison Johnson, July 2000.

each of the three debt relief scenarios produces total debt sustainability for Cameroon from the time of the HIPC completion point, currently scheduled for March 2004. The ratio of PV total debt/budget revenue falls sharply from 374% in 2003 to a 2004 level of 166.8% in scenario 1, 167.1% in scenario 2 and 168.1% in scenario 3. However, any delay to the completion point due to problems finalising the full PRSP, could delay full relief under HIPC and render the total debt unsustainable until the completion point is reached. This might force accumulation of additional domestic arrears and lead to long-term debt problems. Over the longer-term total debt sustainability improves in all three scenarios with ratios of 124% for scenarios 1 and 2 and 127% for scenario 3 by 2008.

The conclusions for total debt sustainability apply in general to domestic debt with the ratio of PV/DBR falling well below the 88% critical level in 2004 to 55% in scenario 1, 55.3% in scenario 2 and 56.3% in scenario 3, and to 16-19% by 2008. The analysis demonstrates clearly that the faster clearance of non-conventional debt arrears, as envisaged in scenario I, leads to a more sustainable situation. Conversely, the restructuring of current Treasury obligations in the third scenario increases the present value of domestic debt, demonstrating the burdensome nature of securitisation.

Analysis of Liquidity Ratios

When analysing the liquidity ratios, the conclusions are reversed for the three scenarios. In fact, scenario 3, with a longer period for clearing arrears and zero-coupon Treasury bonds, yields a much better liquidity ratio for domestic debt for the next few years, as shown in Chart 2, and hence total debt. Conversely, the acceleration of domestic debt repayments in scenario I, and the falling due salary debts in the 2002/2003 fiscal year, worsens domestic and total debt liquidity in the period 2002-06 as shown in Chart 2. By the end of this decade, the ratio of domestic debt service to budget revenue is projected to be around 4% which coupled with an external debt service ratio of 5.5%, yields a total debt service ratio under 10%.

Effects of the Pessimistic Macroeconomic Scenario

The pessimistic macroeconomic scenario worsens all of the indicators, especially over the longer term. While it does not reach the point of making the debt unsustainable, it would be worrying if this scenario were to materialise.

Conclusions

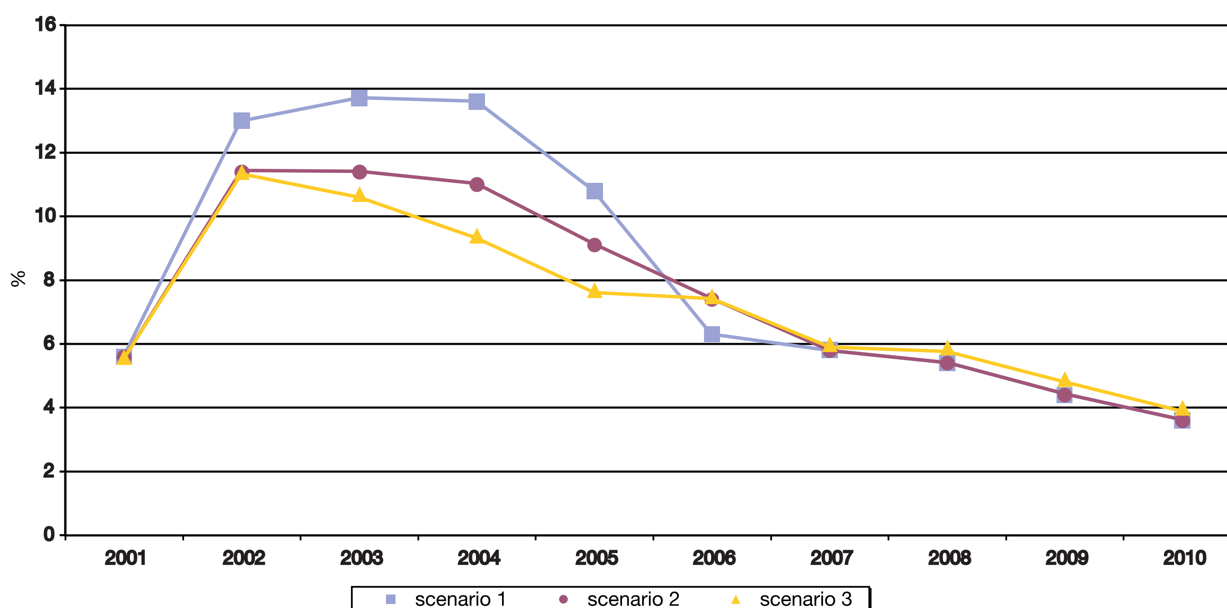
Though Cameroon's debt remains sustainable from 2004 in all the scenarios, this is highly dependent on the assumption that we receive full HIPC relief on external debt on schedule. Based on the experiences of other HIPCs, such relief might not occur on time, or some creditors might refuse to participate, rendering our debt unsustainable. Therefore it is in Cameroon's interest to reduce the domestic debt burden to the maximum.

Nevertheless, the different domestic debt reduction scenarios make very clear differences to the liquidity and overhang burdens. In the context of our poverty reduction strategy, we want to spend the maximum on anti-poverty programmes, and therefore it is the liquidity situation that is most important. In this context, it is obvious that securitisation is an expensive procedure, and the results suggest that it would be appropriate to restructure Cameroon's securitised debt in order to improve the liquidity situation and allow more poverty reduction spending from 2005.

It would also be extremely useful – if possible – to conduct more in depth research to determine precisely the sustainability thresholds of domestic debt in Cameroon. This would need to look back at the period(s) when Cameroon fell into arrears, to judge the different factors and levels of ratios which caused the arrears – but also forward at the spending needs for poverty reduction in order to ensure that we meet the Millennium Development Goals. In this context we might find that a truly sustainable liquidity ratio, allowing us to spend adequate amounts on poverty reduction, would be well below 20% of budget revenue.

Finally, we should note that the data for domestic debt remain estimates, pending finalisation of various inventories and audits. Cameroon must therefore continue to monitor its debt reduction strategy permanently (as it has been doing for the past 2 years), relying on its own national capacity to undertake this exercise rather than on external assistance.

Chart 2: Cameroon Projected Domestic Debt Service/Budget Revenue, 2001-10



HIPC INITIATIVE:

COUNTRY PROGRESS AND PRSP STATUS (MARCH 2002)

Country	HIPC II Dates		PRSP Dates*	
	Decision	Completion	Interim	Final
Angola	no current timetable		2002	...
Benin	7/00	2Q2002	7/00	2Q2002
Bolivia	2/00	6/01	2/00	6/01
Burkina Faso	7/00	2Q2002	NA	7/00
Burundi	2003	...	2002	...
Cameroon	10/00	2003	10/00	3Q2002
Central African Rep.	1S2003	...	1/01	3Q2002
Chad	5/01	2003	7/00	2Q2002
Comoros Islands	2002	...	mid-2002	...
Congo, Dem. Rep. of	1S2003	...	1Q2002	...
Congo, Rep. of	1S2003	...	2Q2002	...
Côte d'Ivoire	3S2002	...	1/02	3Q2002
Ethiopia	11/01	2003/2004	'3/01	3Q2002
Gambia	12/00	2003	12/00	2Q2002
Ghana	02/02	2004	8/00	2Q2002
Guinea	12/00	2003	12/00	2Q2002
Guinea Bissau	12/00	2003	12/00	4Q2002
Guyana	11/00	2002	11/00	2Q2002
Honduras	7/00	4Q2002	7/00	10/01
Kenya	DSA due in 2002		8/00	2Q2002
Lao PDR	DSA underway		4/01	4Q2002
Liberia	no current timetable		no PRSP process	
Madagascar	12/00	4Q2002	12/00	2Q2002
Malawi	12/00	4Q2002	12/00	3Q2002
Mali	9/00	2Q2002	9/00	2Q2002
Mauritania	2/00	2Q2002	NA	1/01
Mozambique	4/00	9/01	4/00	9/01
Myanmar	no current timetable		no PRSP process	
Nicaragua	12/00	2003	12/00	9/01
Niger	12/00	2003	12/00	2/02
Rwanda	12/00	4Q2002	12/00	2Q2002
São Tomé & Príncipe	12/00	2003	4/00	3Q2002
Senegal	6/00	2Q2002	6/00	2Q2002
Sierra Leone	3/02	2004	9/01	2003
Somalia	no current timetable		no PRSP process	
Sudan	no current timetable		no PRSP process	
Tanzania	4/00	11/01	3/00	12/00
Togo	2003	...	4Q2002	...
Uganda	2/00	5/00	NA	5/00
Vietnam	DSA due in 2002		4/01	2Q2002
Yemen	6/00	...	2/01	2Q2002
Zambia	12/00	4Q2003	7/00	2Q2002

Source: IMF & World Bank

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

In the first quarter of 2002, progress on HIPC and PRSPs has continued to be relatively slow. Only Ghana and Sierra Leone have reached their decision points, no country has reached its completion point, though Burkina Faso is about to. On the other hand, Kenya and Lao PDR have decided to explore the potential costs and benefits of HIPC relief by launching the process of a DSA this year. Niger's full PRSP is the only PRSP by a HIPC approved in this quarter. In the next quarter, 4 completion points, 1 interim PRSP and 14 full PRSPs are expected.

HIPC Initiative and PRSP Progress

Key Current Issues
preliminary DSA shows ratios under HIPC thresholds, staff-monitored programme
delays in preparing full PRSP; cotton exports shock may make unsustainable at CP
second country to reach completion point under HIPC II, after Uganda. Debt may be unsustainable
first country to be unsustainable at completion point due to cotton shock. Delay in PRSP implementation
IMF staff-monitored programme from July to Dec. 2001. Possible IMF PRGF Programme in 2002
delays in preparing full PRSP
political instability has driven PRGF off track; possible resumption of IMF financial support in 2002
Receiving interim debt relief but delays in PRSP. Cotton shock
IMF staff-monitored programme from July 2001 to June 2002 and then possible PRGF
3-year PRGF and preliminary HIPCD document being prepared
timing of possible PRGF arrangement and HIPC decision point will depend on improved performance
PRGF approved for 2002-2004; DP possible in Sept. 2002
reached decision point in November 2001; full PSRP for mid 2002
Delays in preparing full PRSP. Bilateral discussions on Paris Club interim debt relief ongoing
Decision point reached. Paris Club negotiation & PRSP expected in 2Q 2002
PRSP completed; PRGF problems
delays in completing review of PRGF; obtained Cologne terms with PC
PRSP finalised but PRGF problems delay approval by BWIs. No interim relief provided by PC; problems with commercial creditors
short delays in PRGF, extended to December 2002
likely to apply for debt relief, but preliminary DSA shows ratios under HIPC thresholds, rescheduled arrears at Paris Club
PRGF review completed; DSA underway for decision on HIPC
no current IMF programme
delay of HIPC process due to political turmoil
problems with comparable terms from non Paris Club creditors. Delays in PRSP & PRGF
delays in preparing full PRSP; cotton shock
. Receiving interim relief
third country to reach completion point; problems with non Paris Club comparability
no IMF programme since 1981-82, no WB lending since 1987. Probably unsustainable
IMF staff-monitored programme off track, negotiations on new PRGF in 2002; major CP delay
final PRSP approved by BWIs, but delay to CP; cotton shock
Will be unsustainable at Completion Point. Receiving interim Paris Club relief, but problems with non-Club comparability
Paris Club interim relief not yet provided, problems with comparable terms, staff-monitored programme recently agreed
delay in PRSP; receiving interim relief
DP reached, PRSP expected mid-2003
no current IMF programme
no current IMF arrangement
fourth country to reach completion point, major problems with comparable terms, coffee exports shock
IMF staff-monitored programme conducted from April to December 2001, may be extended to end 2002
continued difficulties with non Paris Club/commercial creditors; coffee exports shock makes debt unsustainable
preliminary DSA shows ratios under HIPC thresholds; PRGF review completed
ratios under HIPC thresholds so ineligible, Paris Club Naples stock, PRGF review completed
delays to finalising PRSP, no Paris Club interim relief yet, problems with non Paris Club creditors

PRIVATE SECTOR EXTERNAL DEBT

Until recently most developing governments have been focusing their efforts on reducing the burden and cost of external public and publicly guaranteed debt. However, recent experiences have highlighted the need to monitor and analyse private sector external debt. In the past, many believed that this was not an important issue for small low-income countries. Yet, even in countries with a small banking sector and little access to commercial debt or bond markets, large new foreign investment projects can often have a major debt-financing component. For example, in Mozambique 60% of the inflows relating to six such projects are debt creating. As a result, private sector borrowing has risen from an average US$36 million in 1990-98 to a projected US$420 million in 2002-06.

So how does a country go about recording and monitoring private sector external debt and what are international best practices in this area? To help countries come to grips with these issues, DRI finalised a new publication Monitoring Private Sector External Debt: Main Issues and Challenges, already published in English and shortly available in French, Spanish and Portuguese.

The study starts by highlighting the need for monitoring private sector external debt because of its effects on investment, the banking and financial system and the balance of payments, and describing how lack of information on this debt can destabilise national economies, as happened in Southeast Asia in 1997. As a result of this and earlier crises, the international community has launched several important initiatives, such as the Special Data Dissemination Standard (SDDS), the General Data Dissemination System (GDDS), and the External Debt Statistics Guide, to improve the recording and reporting of private sector external debt. These need to be taken into account when embarking on private sector debt recording and monitoring.

Recording and monitoring private sector external debt can be much more complicated than for public and publicly guaranteed debt, particularly in countries with fully liberalised exchange controls, because governments may no longer have any legal mandate or institutional structures to facilitate the collection of such information. The publication discusses the institutional arrangements, legal mandates and data requirements for monitoring private sector external debt under fully liberalised, semi-controlled and fully controlled regimes and provides examples from Indonesia, Malawi, the Philippines and Uganda. It stresses that there is no 'one size fits all" recipe for institutions or legal mandates, and that these will need to vary for different countries.

Deciding the detailed methodology to use for data collection is another a crucial issue. Among the key questions which are asked are:

- are aggregate data sufficient or are loan-by-loan details required? The answer depends largely on the exchange control regime, the strength of a private sector 'culture of reporting' to government, the availability of staff time to gather more detailed data, and especially the role and importance of private sector external debt in the economy. Often countries will need to begin with aggregate data and move on to loan-by-loan data once private sector confidence that government will keep data confidential has been established. Accordingly, the study presents best practices for both aggregate and loan-by-loan data collection.
- Can data be gathered through the banking system or must the borrowers be contacted directly? This will depend largely on the type of debt the private sector is contracting, particularly whether disbursements and/or principal and interest payments pass through the banking system or whether they are largely offshore borrowings or inter-company transactions, and do not go through the domestic banking system. The study therefore looks at sources and channels of data collection including narrow surveys of companies' PSED, reporting by commercial banks and broader surveys of external assets and liabilities of all institutions.

The study discusses several other key issues which need to be considered in deciding methodology, using examples from The Gambia, Guyana, Indonesia, Malawi, Malaysia, Uganda, the Philippines, South Africa, Vietnam, Zambia and Zimbabwe.

Throughout, drawing on Development Finance International's extensive work in the field, the paper goes beyond theory to highlight in-country practical issues such as the types of coordination required among government and private sector institutions, staffing and resource levels, and the use of computerised debt management systems. Finally, it stresses that setting up procedures and methods for collecting data on private sector external debt is one thing, but getting good responses from the private sector is another. To achieve the latter, the private sector needs to be made fully aware of the objective of data collection– that it is for statistical and analytical purposes (and not, for example, for tax collection!). This requires in turn a programme of awareness creation for the private sector. It also means that data confidentiality has to be fully respected, and that government needs to report back the resulting analysis to the private sector to show them that the data can be useful for their own business decisions. Only by ensuring private sector trust and co-operation can government successfully monitor and analyse private sector external debt.

To obtain copies of this publication, please visit our website (www.dri.org.uk) or email us on publications@dri.org.uk.

CBP ACTIVIT

The CBP has continued to enhance HIPC debt management capacity in its transition phase (January-March 2002), beginning to implement donor recommendations for phase 3. Major steps forward in the CBP's advocacy role were achieved by the mobilisation of the HIPC Ministerial Network to put HIPC Minister's views to the IMF/World Bank Reviews of PRSPs and PRGFs; the World Bank Operations Evaluation Department evaluation of the HIPC Initiative (see next issue); the IMF/World Bank Board paper 'External Debt Management in Heavily Indebted Poor Countries'; and the Commonwealth Finance Ministers' Meeting on HIPC in February. Ministers have also decided to launch a direct dialogue with the heads of the Bretton Woods Institutions on measures needed to secure debt sustainability (see article on page 2).

To ensure continued design and implementation of national debt strategies into the future, donors have agreed that in phase 3, some countries will need intensive support to ensure sustainable debt management institutions. BEAC/BCEAO Pôle-Dette has proposed missions to five countries to learn lessons for intensive institutional assistance in the region. The mission framework is based on the BWI guidelines for effective debt management, recommendations of demand assessment missions, demands for institutional reinforcement by national policymakers and technicians at CBP workshops, the DRI system for evaluating HIPC capacity-building needs, and the conclusions of the Pôle-Dette Regional Seminar on Debt Management Institutions in May 2001.

Chad's Institutional Mission (21-30 January) was the first, the aim being to allow Chad to adapt best international practices in its debt management institutions, to immediate national priorities for debt management and wider institutional constraints in the country. The mission allowed Pôle-Dette and DRI to examine and discuss the measures to be considered to enhance debt management institutions; the ideal division of labour among main government agencies; institutional structures for implementing financial and debt policies and for coordinating them with macroeconomic management and poverty reduction; and a customised capacity-building training programme for all debt management staff. The mission also defined the immediate priorities for institutional reinforcement, a potential timetable for Chad to internalise and agree on measures and to implement them; and the costs of intensive institutional support from Pôle-Dette and its international partners.

The fifth mission of the ***Rwanda Capacity-Building Advisory Project*** took place from 21

January to 2 February. It continued to train officials in advanced areas of debt strategy, and conducted a comprehensive participatory review of the project's first year, which found that:

- striking progress has been achieved in building staff capacity for basic debt management, debt renegotiation, and debt strategy and DSA formulation;
- the project has brought institutional improvements, including new staff for the debt management unit in the Ministry of Finance, who have assumed the functions of debt recording, servicing and renegotiation, in cooperation with the Central Bank; and the documentation of all debt management procedures through an operational manual;
- Rwanda's decision-makers have begun to use this national capacity. They have strongly urged that the project be renewed for a further year, to consolidate and cement capacity building. The second year would focus on new financing policy, domestic debt analysis, legal issues in debt management, and assisting Rwanda to negotiate full interim relief and receive its full entitlement when its debt relief needs are reassessed at completion point;
- for year 2 to be successful, policymakers will need to use national capacity rather than external assistance; enhance coordination between debt management and other government units by reviving the debt management committee; approve and disseminate the debt operations procedures manual; and extend training to more officials within and beyond the Ministry of Finance and Central Bank. Policymakers have committed themselves to these steps and donors are considering funding a second year.

The ***Côte d'Ivoire National Debt Strategy Workshop***, from 4 to 14 February, attracted 33 participants from the Ministry of Economy and Finance, Ministry of Planning and Development, Central Bank and sectoral ministries. The team prepared a DSA that confirmed Côte d'Ivoire's eligibility for HIPC II, and a debt strategy report analysing the implications of eligibility, priority poverty reduction programmes for spending debt relief, and areas in which government capacity needs further reinforcement. The workshop highlighted the need to update the debt database to finalise the DSA; reach decision point as soon as possible; to train officials in debt renegotiation in order to mobilise the huge amount of debt relief needed to attain sustainability; and to finalise rapidly the I-PRSP.

As discussed in earlier newsletters domestic and total debt sustainability is vital to HIPCs, and this was the focus of the ***Follow-up Mission to Ethiopia*** on 4-13 March. 19 participants attended the training and prepared a Total Debt Sustainability Analysis Report. This stressed Ethiopia's high domestic debt liquidity burden, the resulting need to lengthen the its maturity profile to medium and long-term instruments, and the need to avoid financing the budget deficit through use of an inflationary central bank overdraft facility. It also found that Ethiopia's external debt would not be sustainable at its completion point without additional relief. The analysis also confirmed the need for a very prudent new financing policy, seeking grants first and borrowing only on IDA terms if possible. Finally, participants highlighted the need to widen debt strategy training to more national officials.

From 11 to 13 March, 43 senior officials from the 14 Zone Franc countries, assisted by regional and international organisations (Banque de France, BCEAO, BEAC, CEMAC, EU, IMF, UEMOA, and UNDP) participated in the ***Fiscal Sustainability of Debt Seminar*** in Yaoundé, Cameroon. The seminar was divided into 4 modules: i) Long-term fiscal and debt sustainability; ii) Fiscal policies for poverty reduction; iii) Growth-oriented policy mixes to maintain fiscal sustainability, and iv) Convergence criteria for debt sustainability and poverty reduction. Participants reached a consensus on reforms to current practice in the areas of coordination of financial policy, monitoring and analysis mechanisms for fiscal viability and debt viability, and capacity-building needs. The conclusions will be submitted to Zone Franc Ministers at their meetings in April 2002.

The ***Tanzania Post-HIPC Debt Strategy and New Financing Workshop***, conducted jointly with MEFMI from 11-21 March and attended by 40 participants and 2 observers from Uganda, showed that despite having reached its HIPC completion point, Tanzania would not achieve long-term debt sustainability unless it negotiates HIPC-comparable relief from all its non-Paris Club bilateral and commercial creditors. Without this relief, it will not be sustainable until 2007, and the situation will worsen if Tanzania borrows even small amounts non-concessionally. The workshop also made an important contribution to finalising a national domestic debt strategy, by quantifying the fiscal benefits of clearing payment arrears using grants and/or securitisation, and lengthening the maturity of the existing debt portfolio. For the first time in a CBP workshop, participants from governance ministries such as defence, police and prisons participated, designing and analysing key indicators and spending needs for poverty reduction. The workshop highlighted the excellent degree of capacity in Tanzania, with almost all resource-persons being Tanzanian officials – but also underlined the need for Tanzania's decision-makers to commit themselves politically to using national capacity rather than technical assistance, and to undertake institutional reforms (notably the immediate establishment of a permanent Debt Strategy task force) to ensure that debt strategy analysis can be conducted without external help.

The CBP has also continued to ***transfer responsibilities and knowledge to regional institutions and experts***. In January, a team from DRI visited WAIFEM to cement all aspects of cooperation (see page 4). In March, a regional expert from Senegal, Babakar Fall, spent two weeks at DRI enhancing tools for Francophone HIPCs to forecast macroeconomic policy and poverty reduction in the context of regional convergence. DRI has continued to work with MEFMI and Pôle-Dette regional experts to develop training for trainers' guides in advance of a Francophone Training for Trainers workshop in April, and has increased the average role of regional experts in CBP events to over 90%.

Special transport for HIPC OED meeting in Lilongwe

Finally, the CBP has continued to ***prepare for phase 3***, through a lengthy consultation process among the five executing partner institutions (CEMLA, DRI, MEFMI, Pôle-Dette and WAIFEM), the five existing donors and two potential new donors. Financial pledges have now been mobilised representing 82% of needs for the next phase, with the remainder looking likely to be covered by new donors within the next few months.

Future activities

The key events during April to June will include:

- the 6th and final mission of the first year of the Rwanda Project;
- 3 demand assessment missions to Comoros, Guyana and Mozambique;
- 2 debt strategy national workshops in Bolivia, and Senegal;
- 5 follow up missions in Ghana, Guinea, Guinea-Bissau, Mali and São Tomé & Príncipe, 2 institutional support missions in Benin and Mali, and a national debt strategy workshop preparation mission to Angola;
- 4 regional workshops: Training for Trainers with Pôle-Dette; DSA Tools with CEMLA; and Domestic Debt Sustainability, and External Assistance Strategy with WAIFEM;
- the 10th HIPC CBP Steering Committee Meeting in Yaoundé in the week of 20 May;
- attachment of various regional experts and institution staff members.

REVIEWING PRSPs:
THE VIEWS OF THE HIPCs

At the IMF/World Bank Conference on Poverty Reduction Strategies held in Washington in January 2002, Maxwell Mkwezalamba, Permanent Secretary Economic Affairs of the Ministry of Finance of Malawi, presented the views of Finance Ministers and coordinators of PRSPs from 32 HIPC countries on PRSPs. The summary of his presentation was as follows:

Poverty Reduction Strategies have made some important achievements in a relatively short period:

- a major increase in some nations' ownership and leadership of their own development strategies;
- much greater involvement of civil society in designing and implementing development strategies;
- an increased focus on poverty data collection, diagnostic analysis and monitoring
- reallocation of public expenditure to focus on poverty reduction priorities, and a widening of the definition of poverty reduction expenditure beyond the 'social sectors';
- major efforts to improve public sector management and transparency of public spending;
- a considerable increase in donor technical assistance efforts on poverty reduction;
- boosting analytical capacity in the BWIs and other multilateral and bilateral donor institutions on poverty reduction issues, with some feeding through to capacity in PRSP countries, and the most advanced donor institutions actually learning lessons from PRSP partner countries;
- increased alignment of donor funding behind national development priorities.

However, many challenges remain if PRSPs are to fulfil the expectations created among the people of developing countries for halving poverty by the year 2015. These go beyond guidelines and modalities of PRSPs themselves, as they need to be surrounded by other global initiatives. Our suggestions are:

1. Ownership and Participation

- Integrating PRSP participatory processes into normal national development planning procedures, notably with greater involvement of parliaments and decentralised governance structures.
- Accelerating changes in the attitudes of international financial institution and donor staff, to restrain and delay further their interventions and allow more space for national consensus, and to react to this consensus with greater changes in conditionalities and macroeconomic frameworks.
- Increasing the capacity of government and civil society to discuss the effects of macroeconomic, sectoral and structural policies on poverty reduction, and external openness to their views.
- Ensuring that PRSPs build more closely on existing poverty reduction strategies and MTEFs.

2. Content of Strategies

- Switching efforts away from data collection and diagnosis of causes of poverty, to assessing the impact of past policies and ex ante analysis of poverty reduction impact of all proposed policies.
- Providing governments and civil societies with technical tools and capacity-building programmes to analyse these issues for themselves, preferably through exchange of best practice among countries, instead of relying on the BWIs or donor-funded consultants.
- Making dramatic changes to existing macroeconomic, sectoral and structural policy frameworks where these are justified by such analysis.
- Increasing the focus in PRSPs on pro-poor growth, by increasing the scale of growth, verifying that it appears likely to halve poverty by 2015, and demonstrating how measures in programmes will produce targeted growth rates and redistribute the benefits of growth in favour of the poor.
- Deepening analysis of savings, investment, domestic resource mobilisation, employment and labour markets, social inclusion and equity.
- Continuing to expand the definition of anti-poverty spending beyond 'social sectors'.
- Dramatically accelerating the streamlining of structural and sectoral policy actions in PRSPs.
- Increasing the flexibility of macroeconomic frameworks to allow greater scope to absorb grant and concessional loan resources into poverty reduction spending, and to analyse alternative macroeconomic paths that allow different paths to stabilisation and growth.
- Dropping from BWI and donor programmes conditions which have not emerged as priorities from national consultative processes, and avoiding introducing new conditions in mid-programme.

3.Donor Assistance and Partnerships

- Moving from ill-coordinated donor-driven technical assistance interventions to coordinated country-led capacity-building programmes.
- Channelling more aid through the government budget, untying aid, avoiding 'unproductive' projects and maximising the concessionality of financing.
- Coordinating and reducing multiple donor initiatives and review processes.
- Avoiding conditionality 'fungibility' among donors and reversing recent conditionality proliferation by monitoring all donor conditions and empowering countries to refuse conditions that do not spring from the PRSP national consultations.

4. Implementation

- Protecting against shocks, streamlining conditionality and providing more macroeconomic flexibility in order to prevent avoidable delays and slippages in programme implementation.
- Clarifying guidelines for PRSP progress reports to focus on how to modify PRSP frameworks in order to ensure that lessons can be learned and poverty reduction goals attained.

5. Constraints

- Dramatically increasing capacity-building support to governments and civil societies.
- Establishing multiple procedures to protect against external 'shocks'.
- Reforming donor procedures in order to avoid aid shortfalls.
- Providing free trade access for least developed and PRSP countries to all developed countries, and bringing down structural trade barriers and removing agricultural subsidies.
- Promoting private sector capital flows to PRSP countries in ways that promote poverty reduction.
- Stressing intra-regional trade and financing initiatives and aid procurement from PRSP countries.
- Streamlining donor interventions and calendars behind government budget and planning timetables, and guaranteeing continued interim debt relief, in order to provide more time for finalising PRSPs where necessary.
- Acknowledging that, given our lack of success so far in reducing global poverty, PRSPs will probably require major adaptations in mid-course, and therefore making PRSPs more flexible.
- Maximising efforts to streamline procedures for accounting to donors on the use of their resources, by moving to budget support, capacity building and integrated budget accounting for all spending, including HIPC debt relief.

More details of the presentation can be found on the CBP website: ***www.dri.org.uk***

DFI INTERNATIONAL WORKSHOP: KEY ISSUES FOR PHASE 2

Development Finance International, its regional partners MEFMI and WAIFEM, and the Bank of Tanzania, hosted an International Workshop in Dar es Salaam on 18-22 March 2002. It was attended by 75 participants, representing 18 African, Caribbean and Latin American countries[1], and was facilitated by staff of DFI, the funding donors (DfID, Seco and Sida) and regional and international organisations[2].

The participants examine the findings of phase 1 and key issues for phase 2, and shared international and regional best practice in monitoring and analysing private capital flows. In keeping with their ownership of phase 1, country teams from central banks, statistics offices, investment promotion agencies and finance ministries, led the presentations and discussions.

The first two days discussed methodological lessons, and next steps including attaining all the IMF GDDS standards, and cooperation with neighbouring countries, OECD countries and international organisations. The next 2 days covered analytical lessons and ways forward, notably analysis of private capital's sustainability and its contribution to poverty reduction and sustainable development.

Country teams then defined their own priorities for next steps in detailed action plans, which will be presented to donors for funding as part of phase 2 of the programme. The workshop also provided a forum for discussion with countries and regional partners of a draft Phase 2 proposal, and interviews to support the review of phase 1.

1) METHODOLOGICAL LESSONS

Scope

- All participating countries are surveying all stocks and flows of foreign assets and liabilities necessary for balance of payments (BoP) and international investment position (IIP). Most also capture loan-by-loan private sector external debt (PSED)
- Phase 1 has shown the value of investor perceptions surveys in enhancing dialogue between public and private sector and improving response to FAL surveys. All countries will survey investor perceptions in phase 2.

Institutions and legislation

- In almost all countries, reinforced institutions have been key to the success of surveys. As a result, all have plans to further enhance political commitment, and cement coordination with the private sector and strategic ministries in phase 2.
- Phase 1 has helped countries to strengthen or publicise Acts which ensure data confidentiality and enforce collection mandates – but have more ideas for phase 2.

Sample

- In phase 1, countries greatly improved their samples of enterprises with equity liabilities, drawing on multiple information sources. In phase 2, they will refine samples further, targeting companies with non-equity liabilities and foreign assets.
- They will also continue to coordinate with other surveys (e.g. enterprise surveys) to include filter questions, to help identify FAL enterprises.

Response rate

Survey response has been extremely high, averaging 71% of companies with FAL, and an estimated 82% of FAL, providing a reliable base for analysis. This reflected:

- Awareness creation for the private sector through workshops, advertisements, private sector associations, and press/media coverage. These tested the methodology, provided information on the mutual benefits of the exercise, and informed the private sector of the legal mandate for data collection.
- User-friendly methodology and proactive administration and follow-up of forms by trained HQ and regional office staff, using comprehensive enumerator manuals.
- Targeting at the appropriate level (CEO, Chief Accountant, or equivalent).
- Coordination with other surveys or national events, reducing respondent burdens.
- Integration of FAL and Investor Perception questions to boost response.
- Prioritisation of large companies and key sectors/regions.

The timely and comprehensive feedback of analysis to the private sector at the end of each national project has provided a foundation for continuing future response.

Data validation, up-rating and software

- To validate data, countries used inbuilt checks in forms, other sources including financial statements, published information, local knowledge and the media.
- The private sector continues to have problems reporting market value, dividend remittances and short-term (especially inter-company) debt. Phase 2 will need to provide more training for the private sector on these issues.
- To overcome under- or over-reporting, the programme has developed methods to up-rate data using sector analysis, other surveys/databases, or investor interviews.
- Countries have found DFI generic Access-based software for FAL and investor perceptions user-friendly, but suggested several improvements for phase 2.
- They intend to use CS-DRMS and DMFAS for recording PSED, but require more support and training from international and regional organisations, especially on how to handle inter-company loans and short-term debt

Meeting international codes and standards

All countries are complying with most GDDS standards, and exceeding some:

- Coverage: all capture all components of BoP (GDDS), and IIP (a recommended extension to GDDS). All collect (or plan to) PSED loan-by-loan (beyond GDDS).
- Periodicity: all have reached the GDDS standard of annual collection, but intend to move to semi-annual or quarterly (as recommended by GDDS – or beyond GDDS for PSED) in the medium term as resources permit.
- *Timeliness:* all had problems meeting GDDS guidelines (6 months after the reference period), reflecting the timing and length of the first census. They intend to meet the timeliness guidelines within the next 2-3 years.
- *Transparency/reporting:* countries are presenting data and analysis to all stakeholders, notably the private sector, based on priorities these identify for decision-making. Several have also moved from BPM4 to BPM5 in IMF reporting.

Comparing data with other countries and international institutions

- Most country data sets are now reliable enough to make worthwhile comparison with regional neighbours (especially source countries such as South Africa or

Kenya), and OECD countries (in national publications or from international organisations such as the BIS and OECD).
- Based on IMF and OECD experience, protecting data confidentiality will make it impossible to reconcile data with any disaggregation. However, it can prove useful to compare aggregate data (as LSE CREFSA has done).
- It will also be useful to compare national with regional and international trends. An important aspect of phase 2 of the DFI programme will be to provide countries with greater access to international information, in consultation with experts from OECD and other relevant organisations. This would also require comparing broad methodologies and associated common problems with OECD countries.

Sustainability

The following steps are essential for ensuring sustainable capacity transfer:
- Ongoing awareness creation among senior officials, private sector stakeholders and donors, via institutional coordination and targeted sensitisation events.
- High-quality analysis to enhance the quality of policymaking, and justify the importance of the exercise to users of the data and analysis.
- Timely and effective dissemination of analysis to government agencies, private sector and international/donor organisations to enhance their stake in the exercise.
- Incorporating the exercise into work programmes of institutions to avoid resource wastage and burden on respondents, and ensure effective division of labour.
- Taking more responsibility for training locally, decentralising to regional institutions over time, and reducing reliance on external sources.
- Allocating more local financing to reduce aid dependence and show commitment.

2) ANALYTICAL LESSONS AND POLICY IMPLICATIONS

Lessons on foreign assets and liabilities
- Private capital flows and stocks are much greater than previously thought in most countries. Because remittances of capital and dividends are very high, they offset high inflows, leaving net data close to previous estimates. The scale of the flows emphasises their impact on the BoP, the exchange rate and the wider economy.
- More than three quarters of the capital is provided by companies themselves, in foreign direct equity investment, or shareholder and intercompany borrowing.
- However, when shareholder and intercompany borrowing is added to borrowing from other sources, investors have high debt/equity ratios. These range from around a third for Tanzania, to over 50% for Guyana and Malawi. The largest companies (especially in extractive industries) fund their projects 80-90% by borrowing. Debt terms are highly variable, with intercompany borrowing cheap, but other loan interest rates averaging 9-10%. Countries need to conduct more analysis of the motivation for and terms of debt finance in phase 2.
- All countries have portfolio equity liabilities – though these remain small especially where stock exchanges do not exist, are closed to non-residents, or are small. However, countries are not capturing transactions by international portfolio equity funds or non-resident dealings in government debt, and others have plans to liberalise portfolio flows as well as private capital outflows – so there is much work needed to record these flows accurately in phase 2.
- While identifying a healthy diversification of source countries, countries are concerned that it is difficult to track the true source country of an investment – where the decision to invest was made – rather than the country of registration. As a result, much private capital that appears in the BoP as foreign investment, is actually money remitted out of the host country and reinvested from offshore locations. Similarly, many African companies are registered overseas. These complications make investment promotion targeting more difficult.
- Recipient regions and sectors were also much more diverse than expected, but the countries nevertheless identified some regions and sectors which were attracting very little investment, and were able to suggest policies to overcome this.
- Countries are currently pursuing the disaggregation of analysis in more detail, so as to check, for example, rates of return for different sectors or source countries, of allowing them further to refine BoP analysis and investment promotion policies.

Lessons on investor perceptions

Investor perception questions have generally produced very positive responses, with most countries (notably Tanzania and Uganda) finding investors highly disposed to increase future investment, and praising political and macroeconomic stability. However, they have also identified many policy lessons for:
- initiatives to increase regional and domestic political stability
- adaptations needed to macroeconomic and structural reform policies;
- measures to expand the size of the regional and domestic market and the purchasing power of the population;
- priorities in increasing access to local credit rather than external financing;
- accelerating the fight against HIV/AIDs and other pandemics;
- increasing vocational and literacy/numeracy training to provide skilled labour;
- combating urban crime and insecurity in regions of host countries;
- improving the quality and especially reducing the cost of infrastructure; and
- making the labour market more flexible while protecting worker rights.

These findings are already being fed into discussions about the business and investment environment in the countries, and will have a major impact on policy.

However, the surveys also draw attention to the necessity to avoid knee-jerk reactions to survey results, by 1) adjusting results to take account of the views of other stakeholders – such as domestic investors, trades unions and other civil society organisations; 2) comparing them with results from neighbouring countries to judge whether the

[1] *Botswana, Ethiopia, The Gambia, Ghana, Guyana, Jamaica, Kenya, Lesotho, Malawi, Mauritius, Nigeria, South Africa, Swaziland, Tanzania, Trinidad and Tobago, Uganda, Zambia, and Zimbabwe.*

[2] *BEAC/BCEAO Pôle-Dette, CEMLA, COMESA, MEFMI, the OECD Secretariat and WAIFEM attended the conference. The Ethical Investment Research and Information Service, IMF, UNCTAD and World Bank supplied background documents and the workshop also discussed an LSE-CREFSA project on reconciling data among 4 Southern African countries.*

results appear to be objective; 3) analysing them nationally and regionally in relation to more objective ways of measuring issues such as access to credit, inflation trends; and 4) comparing them with country rankings in other international surveys of the business environment or analyses conducted for credit rating purposes.

3) NEXT STEPS IN ANALYSIS

Countries also decided to expand the analytical agenda in two directions that are crucial for assessing the contribution of private foreign capital to development.

Comprehensive national development financing strategies

Countries intend to include in the next phase much more analysis of the sustainability and volatility of private capital. This will include rates of return and repayment periods for equity; maturity, interest, currency and guarantee risk, volatility and variance analysis, and various sustainability ratios. This will help define policies to attract the most sustainable and least volatile flows, to foresee and counteract switches in directions of flows, define guidelines to assist the private sector to mobilise capital on the best terms, and refine guarantee policies. To facilitate this analysis, countries will collect some additional micro data from investors through surveys, and receive more training in analytical techniques and access to international information. They will then combine this with public debt sustainability analysis, to design comprehensive national development financing strategies.

Contribution to sustainable development and poverty reduction

Current surveys focus on private sector concerns about government policy. Developed countries and international initiatives are increasingly tracking Corporate Social Responsibility (CSR) - the contribution of the private sector to national development, in the context of poverty reduction strategies and the Millennium Development Goals – but recipient countries have been less involved in such initiatives. They are therefore anxious to analyse these issues, which will imply adding to perception surveys a few questions that analyse technology and skills transfer, forward and backward linkages, ethical codes, environmental practices, and social policy. In phase 2, countries will advance this analysis on a pilot basis, being careful not to duplicate other national efforts to this information.

More detailed findings and plans for phase 2 will appear in final country reports and multi-country studies coordinated by DFI, posted on the website in the next 6 months.

DFI – RESULTS FROM UGANDA & GUYANA

Monitoring and Analysing Private Capital Flows to Developing Countries progressed rapidly in this quarter, notably at an international workshop in March in Tanzania (see previous article). Of the 8 countries involved in the current programme:

- ***Uganda*** has achieved 70% response, covering 85% of foreign liabilities. At a closing conference in February, findings were well received by the private sector and donor community. They included high and increasing FDI, concentrated in the central region and in manufacturing, and sourced from Bermuda, the UK and South Africa. Total private sector debt was large (one third of liabilities), and short-term debt had large and volatile transactions. Uganda is formalising a Private Capital Unit in the Central Bank, and preparing to include investor perceptions in a Phase 2 survey.
- ***Guyana*** received 55% responses, due to disruptions surrounding elections and to lower on-site follow-up. The closing workshop, held in March, presented findings of increasing inflows of FDI, which are largely debt-financed, come from Canada, the USA, Korea and the Caribbean, and go into mining, telecommunications, timber and electricity. Most investors are planning to expand over the medium-term. They value investment incentives, efficient services, liberalised remittances and labour productivity, but are deterred by domestic politics, infrastructure costs, exchange rate depreciation, the corporate tax burden and crime. Guyana is planning to improve its methodology and achieve a higher response rate in Phase II.
- ***Tanzania's*** results were reported in Issue 10. It is now reviewing institutional, technical and sustainability issue in preparation for Phase II, in which it plans to focus on more detailed analysis, including sectoral analysis of mining and fishing, and analysis of corporate social responsibility.
- ***Malawi***: a follow-up mission in February assisted the national task force to finalise response collection, to test and adapt the DFI generic Access software, and to enter, process and analyse data. The team has attained 68% response (over 85% of foreign liabilities), and the closing workshop is set for early April.
- ***The Gambia***: a follow-up mission in February helped to achieve a response rate over 80%, to adapt the generic software, and to enter, process and analyse data. The national task force is currently preparing for a closing conference in late April.
- ***Ghana*** is working hard to improve a low response rate of 30%, and editing and checking returned forms. Progress has been hindered by institutional changes and staff rotation, and a DFI-WAIFEM follow-up mission in the second quarter will aim to overcome these problems and finalise the survey.
- ***Zambia***: after delays due to national elections, IMF missions and budget preparations, the team will launch the survey in mid-April.
- ***Trinidad & Tobago***: DFI is currently conducting a mission to finalise the budget, financing and timetable for a survey to be launched in the second quarter.

Methodology and Information Products

New methodological tools include an Access™ software for foreign assets and liabilities and investor perceptions, developed by DFI, Tanzanian and other regional experts, and a methodology for data validation and up-rating.

On information products, a study on Private Sector External Debt: Main Issues and Challenges for Monitoring was published in March, and all major DFI background and training materials have been posted on the DRI website (www.dri.org.uk).

Liaison with Co-operating Partners

DFI is continuing to liaise with regional partner organizations. MEFMI and WAIFEM participated in missions and workshops for their member countries during this quarter. BEAC/BCEAO Pôle-Dette, CEMLA, COMESA, MEFMI and WAIFEM attended the International workshop, and agreed in principle on cooperation mechanisms during Phase II.

DFI has continued to maintain close working relations with other international organisations which are expert in the area of analysing international private capital, notably the BIS, IMF, OECD and World Bank, which all supplied materials for the International Workshop (see previous article).

Projected Work Programme

During April-June, DFI will enter a transition phase, during which The Gambia, Malawi and possibly Ghana will finalise their censuses, Zambia and Trinidad & Tobago will launch phase 1, and Guyana, Tanzania and Uganda will launch phase 2. This period will also see the production of more publications, further work on website resources, and the conclusion of an independent review of the programme, leading to the finalisation of a programme document and funding arrangements for phase 2.

TECHNICAL QUESTIONS

How concessional is a loan?

Table 1 sets out the lending terms and concessionality of loans of the main multilateral and bilateral creditors. Concessionality, as measured by the grant element, can be calculated using a uniform 10% discount rate (by the OECD in defining official development assistance) or the most recent six-month average of CIRR rates (by the IMF in calculating present value for the HIPC Initiative). With a 10% discount rate all creditors shown exceed a 35% grant element. However, using CIRR rates changes the picture considerably. Even IMF loans are no longer concessional, and Japanese loans are very non-concessional with a maximum 7.5% grant element.

In calculating the grant element, the discount rate is supposed to represent the cost of borrowing for the debtor country or the cost of funding for the creditor. The CIRRs come near the cost of funding for creditors which have to source their funds from commercial markets – but this is not true for most multilateral lenders to HIPCs. Nor do CIRRs represent a true alternative borrowing cost for HIPCs, as they are the cost of borrowing export credits – to which most HIPCs do not have access. The 10% OECD fixed rate is even further from HIPC borrowing costs. For most HIPCs, the average weighted cost of borrowing in recent years is around 1.3%. Discount rates can also take into account two other factors – variability of market interest rates and different borrowing costs in different currencies – but virtually no HIPCs borrow at variable rates or with much variation of rates by currency.
So how should HIPCs think about concessionality? If they simply want to compare loan terms, it makes sense to use a uniform fixed discount rate across currencies. This could be the average cot of borrowing for HIPCs – 1.3% – to calculate a grant element that is more appropriate for policy definition. This would imply that much current borrowing would be seen as having no grant element.

It is important to be very clear about the discount rate used when a country says it is using the 'grant element' to establish its new borrowing limits, and about which creditors this will include or exclude. If a country says it will only borrow loans with a grant element of 35%, this would include almost every lender with a 10% discount rate, but exclude a large number (including the IMF) with recent CIRRs.

TABLE 1: CONCESSIONALITY OF LENDING TERMS WITH DIFFERENT DISCOUNT RATES

Currency		Loan Terms			Currency-specific CIRR	Grant element (%)	
		Maturity (yrs)	Grace (yrs)	Interest rate (%)		with CIRR	10% discount rate
Multilateral creditors							
AfDF		50	10	0.75	SDR = 5.11	66.4	85.8
BADEA		22	5	2.0 - 3.0	USD = 5.73	23.7 - 32.4	47.4 - 54.2
IADB		40	10	1.0 - 2.0	SDR = 5.11	41.2 - 54.5	69.3 - 78.0
IDA (IDA only countries)		40	10	0.75	SDR = 5.11	60.6	82.5
IFAD		40	10	0.75	SDR = 5.11	60.6	82.5
IMF (PRGF)		10	5.5	0.50	SDR = 5.11	27.2	46.9
OPEC Fund		20	5	2.0	USD = 5.73	30.8	52.3
Bilateral							
Paris Club creditors							
France	ODA	25	10	2.0	Euro = 5.67	38.7	62.8
Germany (IDA only countries)		40	10	0.75	Euro = 5.67	61.7	80.7
Japan (LLDCs)		30	10	1.0	Yen = 1.45	7.5	73.8
USA	ODA	40	10	2.0 - 3.0	USD = 5.73	34.0 - 46.5	60.7 - 69.3
Non-Paris Club creditors							
Kuwait Fund		20	5	4.0	SDR = 5.11	9.5	39.2
Saudi Fund		20	5	2.0	SDR = 5.11	26.6	52.3

Projections are on equal payments basis, except for IDA, AfDB, IFAD which assume IDA repayment profile
CIRRs are averages rates for July-December 2001 Sources: creditor websites and documents

When do HIPCs actually receive debt relief?

Under the HIPC Initiative, the amount of debt relief a country is to receive is initially determined at its decision point. Thereafter it receives interim debt relief between decision and completion point, with the major part of the relief coming at or after the completion point. However, this is not the way relief is presented in HIPC documents.

First, the decision point documents are based on a calculation, known as 'unconditional delivery of HIPC relief', which simulates that relief is 'advanced' to the decision point, showing the full impact of relief at the decision point. Countries can replicate this calculation for themselves by using the 'advance to decision point' option in the Preferences/Tools menu of Debt Pro©. Table 2 shows the impact in PV terms of doing this in the interim period for a sample of HIPC countries.

Secondly, even after the interim period, the full impact of HIPC relief is not felt. This is because a large number of creditors (including most of the multilaterals) do not provide stock relief at the completion point, but instead reduce annual debt service through cancellation or lower interest rates. In reality this reduces the PV of debt gradually year by year, over up to 33 years, rather than cutting it sharply at the completion point. Yet, when computing the PV of debt stock 'after HIPC', completion point documents assume that the full impact of relief comes at the completion point.

TABLE 2: DELIVERY OF HIPC DEBT RELIEF

Country	Present value of debt (US$ million)					Decision Point	Expected Completion Point
	1999	2000	2001	2002	2003		
Ethiopia*							
after HIPC			3263.7	2873.3	1757.7	Oct 2001	June 2003
full impact in July 2001			1427.5	1557.3	1757.7		
Ghana							
after HIPC		3818.6	3944.8	3908.0	4107.3	Feb 2001	Jan 2004
full impact in 2001		1706.5	1874.8	1976.5	2154.3		
Guinea Bissau							
after HIPC	487.0	403.0	424.0	456.0	110.0	Dec 2000	Oct 2003
full impact in 1999	71.0	77.0	95.0	105.0	110.0		
Nicaragua							
after HIPC	5268.6	4651.1	4308.9	1320.4	1395.5	Dec 2000	Dec 2002
full impact in 1999	1255.8	1339.0	1351.6	1320.4	1395.5		
Rwanda							
after HIPC	634.2	663.3	666.1	284.3	317.3	Dec 2001	Dec 2002
full impact in 1999	181.8	221.6	248.7	284.3	317.3		
Tanzania*							
after HIPC		2594.7	2661.7	2355.9	2616.6	Mar 2000	Nov 2001
full impact in 1999/2000		1876.9	2042.1	2355.9	2616.6		

* financial years e.g. to June 1999 Source: IMF Decision Point documents

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