HIPC DEBT STRATEGY

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

Debt Relief International

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HIPC INITIATIVE PROGRESS

As foreseen in issue 6 of our Newsletter, the HIPC Initiative made rapid progress in the last quarter of 2000, on the short-term issue of getting as many countries as possible to decision points and therefore to firm commitments of debt relief.

As shown in the table on page 6, 22 countries reached decision points by the end of 2000, in a last-minute rush which left all sides slightly exhausted. This marginally exceeded the G7 Cologne declaration, but was somewhat short of earlier promises that 24 would reach decisions by 2000. This shortfall partly reflected the last minute "slippage" of decision points for Chad and Ethiopia. Moving forward rapidly on these and as many remaining HIPC countries as possible should be a top priority for action by the international community in 2001.

Relief amounts and methods also made progress. Committed relief had by the end of the year reached $21 billion in present value terms, out of a total amount expected from HIPC of around US$36 billion. Promised PV reductions have averaged 40-50% of pre-HIPC debt (but with wide differences among countries). Almost all multilateral and OECD government creditors have agreed how they will provide debt relief, helped considerably by the US Congress coming through with some of the funding the Clinton Administration had pledged earlier in 1999. As explained in other articles in this edition (see Humps and Shocks – Two Key Issues for HIPC II; and Technical Questions), the IMF, World Bank and African Development Bank have included in their mechanisms wide scope for frontloading relief to accelerate poverty reduction – though countries will have to argue their case hard for treatment of the kind received by Zambia.

As also discussed below, there have been some important advances in the Paris Club's provision of bilateral relief. It has taken a step back in refusing to treat arrears incurred before decision points with the same reduction as other flows and, as we reported in our last bulletin, it continues to fall short of the Cologne declaration by not ensuring that all cancellation of ODA debt is additional to HIPC. But it has also moved forward in recognising that some countries cannot be sustainable unless their cut-off date is moved (as for Malawi) and/or their post-cut-off date service due after decision point is deferred until after the completion point (see Technical Questions). By taking dramatic exceptional measures like moving the cut-off date for some countries, they must be annoying others such as Uganda whose cut-off dates and post-cut-off service have not been touched.

Some non-Paris Club creditors have also moved to provide more relief – notably China, which has announced 100% cancellation; and some Arab and Central American governments. However, others remain reticent or short of funds.

In addition, earlier worries about delay in debt relief seem to be being borne out. There is already some evidence that conditionality is being applied very strictly after decision point, with Paris Club meetings and multilateral relief being delayed until international institutions and powerful OECD governments are happy with progress on economic reform, poverty reduction and an array of governance issues. Should this continue beyond mid-year, it could deprive countries of large amounts of expenditure. Furthermore, a few countries were required in their decision point documents to freeze HIPC relief in bank accounts until they resolve (often-exaggerated) worries about absorptive capacity.

All these factors mean that countries are getting somewhat different treatment under HIPC. Added to this, countries have dramatically different levels of debt compared to their existing poverty reduction spending, and the failure to include domestic debt and contingent liabilities in debt sustainability analysis is already meaning that some countries may have use HIPC savings to reduce domestic debt. This produces large variations in the amount of money HIPCs will have available to spend on poverty reduction. Future humps of debt service and "shocks" to their economies are likely to exacerbate these differences (see page 3).

Unless strong measures are taken now to complement debt relief with additional new aid flows, to protect against humps and shocks, and to avoid expensive borrowing for unproductive projects, all countries which wish to will certainly not reach the International Development Targets by 2015.

Many expect some of these issues to be treated in a paper due before the IMF Board in March, on measures to enhance long-term debt sustainability. This paper will also include an analysis of HIPC capacity in debt management. The IMF and World Bank Spring meetings will also be receiving papers reviewing HIPC and PRSPs. It will be essential that HIPCs react quickly to these papers. They will have two other fora at which to express themselves: a meeting organised by the British Government in February at which all parties will commit themselves to actions which accelerate progress to the 2015 targets (at which the Finance Ministers of Malawi, Benin and Honduras, current and past chairs of the HIPC Ministerial Forum, will represent HIPC Ministers); and the next meeting of the HIPC Ministerial Forum in London in June. We look forward to hearing their views.

HUMPS AND SHOCKS – TWO KEY ISSUES FOR HIPC II

Following the articles in our earlier newsletters, the UK Department for International Development (DFID) commissioned us to write two studies on major factors which could undermine long-term HIPC debt sustainability: "humps" – unsustainable levels of debt service; and "shocks" – unexpected events hitting HIPC economies.

Humps

HIPC II has been designed to provide "faster, deeper and broader debt relief" and creditors are encouraged to provide the maximum front-loading of debt service relief in the early years, thereby releasing more resources for spending on poverty reduction. However, there has been little formal analysis of countries' liquidity burden after the delivery of HIPC relief. In other words, are projected debt service payments after the delivery of HIPC assistance, including in the interim period between Decision and Completion Points, sustainable? Or do HIPCs have unsustainable debt service "humps" even after HIPC relief?

The usual interpretation of a debt service hump is an increase in debt service in any one year, or over a period of years. It can be defined in terms of the ratio of service to exports or budget revenue, or in terms of nominal amounts. However, this way of looking at humps does not take into account any idea of sustainability. Therefore, an alternative way to evaluate projected service is in terms of sustainability benchmarks. In line with our earlier comprehensive studies of what was the maximum sustainable burden for HIPCs (see issue 2), we define humps as when debt service to exports exceeds 13%, or debt service to budget revenue exceeds 12%.

We found that:

- on the basis of debt service/exports and debt service to revenue ratios, after HIPC II assistance, about four-fifths of the HIPCs have analysed humps, of varying degrees of severity;
- the main factors causing these humps are increased payments of IMF loans, higher servicing costs of post cut-off date debt to Paris and non-Paris Club creditors and principal repayments falling due on previously rescheduled non-ODA Paris Club debt;
- as to long-term sustainability, most HIPCs will have, after HIPC II relief, sustainable export ratios, but budget revenue ratios remaining unsustainably high for 10-20 years.

Analysing the sustainability of projected debt service and identifying future humps is crucial for all HIPCs and should lead to improved front-loading of relief, as happened for Zambia. Before HIPC assistance, Zambia faced a doubling of its debt service payments in 2001-05 because of higher service payments to the IMF. However, Zambia successfully negotiated additional front-loading of relief – with 75% of the IMF relief being provided in the period between decision and completion points. This brought its debt service ratios down sharply, but the budget revenue ratio remains unsustainable (averaging 23.7% in 2001-05), indicating that other creditors should have done more to remove this "hump".

Ultimately, of course, the key determinant of whether debt service is sustainable should be whether debt reduction and new flows are financing a path which will allow lower debt service to revenue ratios and higher poverty reduction expenditures, so that each HIPC can reach the International Development Targets. Each HIPC Board Paper should analyse whether this is the case. If this is to happen, all creditors will have to take action to front-load their debt relief, and to guarantee that countries' debt service ratios will not exceed critical levels:

- the Paris Club needs to widen its use of the practice of deferring debt service between decision and completion points, and preferably cancel all debt service from the decision point onwards;
- all multilateral creditors need to front-load their assistance;
- new aid flows need to grow and non-concessional flows to be even more strictly limited to avoid service on new debt taking the place of the cancelled debt.

In other words, all creditors and donors need to make sure that they fully share the burden of reaching the IDTs by 2015.

Shocks

Most HIPCs face regular shocks to their economies, which even made 4 of the first five HIPCs' debt unsustainable again between their HIPC I decision and completion points. HIPC II will not provide long-term debt sustainability unless it acts more forcefully against shocks.

The most crucial shocks are those which increase poverty. Ideally, every PRGF Board paper should contain a 20-year projection of the path to the IDTs and shocks that might derail this.

Many apparent shocks are predictable or the result of misdesign, misimplementation, or miscalculation of the effects, of policy changes. With more realistic policies and projections that consider these, most shocks would disappear. For the remaining

HUMPS AND SHOCKS – TWO KEY ISSUES FOR HIPC II cont.

genuine shocks, there should be no false distinction based on their source or duration: all shocks should be taken seriously to avoid compromising poverty reduction.

HIPCs are highly vulnerable to shocks due to aid dependence, export concentration, import dependence and low reserve coverage. The most common shocks have been to aid flows, exports, climate, imports and budget revenue: most HIPCs have suffered multiple shocks in the last 10 years.

There is also a strong likelihood of future shocks, for three reasons:

- projected export and especially GDP growth rates in Debt Sustainability Analysis (DSAs) are much higher than recent experience for many countries;
- the current sensitivity analysis in DSAs (especially compared to analysis by HIPCs themselves) is insufficiently pessimistic, does not examine comprehensively the effects of shocks, and pays too little attention to revenue and climate shocks;
- many key global trends are often omitted from DSAs, including the fallacy of composition, climate change, health pandemics and capital market shocks.

Overall, of 21 HIPCs examined, 7 will never become sustainable under HIPC II because of the way relief is provided; another 7 have sustainability predicated on unrealistic growth rates; and only 7 HIPCs are likely to remain sustainable for the next 15 years.

What can be done to prevent such shocks or to offset them if they occur?

1. **Remove All Of Those Which Are Not Really Shocks**, by improving the methodology of projections used in PRGF/HIPC programmes. Enhance baseline data availability and reliability, disaggregate projections more, and analyse historical trends and their causes. Adjust baseline forecasts downwards to include largely predictable events at national, regional or international levels, such as repeated climatic shocks, resource depletion, climate change, and HIV/AIDS. Refine analysis of recent country-specific shortfalls and what causes them. Take even more account of independent market analysis of country-specific factors and global market trends. Reduce over-optimism about the effects of policy changes, and tailor policies more to national circumstances. More deliberately target policies to reduce vulnerability. Provide HIPCs with more "voice" in forecasts, by accelerating capacity-building assistance to HIPCs themselves.

2. **Forecast Genuine Shocks**, by improving sensitivity analysis. Base projected shocks on probability, frequency distribution and scale of recent shocks, adjusting for secular long-term changes in HIPC circumstances or policies. Build baseline scenarios on the most probable combination, and downside scenarios on plausible negative combinations. Present considerably larger (though still historically realistic) potential shocks. Analyse the full primary and secondary impacts of shocks. Place far more emphasis on fiscal shocks, especially to revenue. Take more notice of aid shortfalls and climate shocks. For HIPC, analyse systematically which shocks would make debt "unsustainable" once more.

3. **Offset and Compensate Shocks, in three ways:**
   - make PRGF programme performance criteria and objectives adjustable to shocks, so as to avoid forcing countries to adjust to shocks and sacrificing poverty reduction;

   - provide highly concessional or grant automatic compensatory financing against shocks, by allocating a proportion of PRGF/PRSC financing to this purpose, and making the compensatory portion of the EU/ACP Cotonou Agreement arrangements far more flexible;

   - build contingency mechanisms into PRGF programmes, to ensure the effectiveness of contingency/compensatory financing, it would be set aside up front, for disbursement immediately rather than after the shock's negative effects on the economy, based on a realistic "low case" projection of plausible shocks. The compensatory financing discussed above, and the maximum possible debt relief and new financing, would be committed to keep debt sustainable in the event of the low case[1]. They could be put into a contingency account and disbursed immediately following any shocks, with semi-annual reviews.

This combination of measures would guarantee protection against all but the most extreme and genuinely unforeseeable shocks, removing the risk that any HIPC's debt might become unsustainable once more, and that the International Development Targets would be missed.

[1]Adding additional disbursements to PRGF programmes or providing more bilateral grants *expost* would be woefully insufficient because i) it would not provide up-front automatic financing; ii) it would not be sufficient on its own, and iii) it would be conditional on additional adjustment – and based on past experience some of these will adjust to shocks rather than compensating.

FRANCOPHONE WORKSHOP ON MACROECONOMIC FORECASTING (Yaoundé, 11-20 December 2000)

How many macroeconomists does it take to operate a video projector?

Improvements in forecasting macroeconomic policy and poverty reduction took a major step forward at the first Francophone Workshop on Macro-Economic Forecasting, co-organised by DRI and the BEAC/BCEAO Regional Debt Management Training Unit (Pôle Dette). Fifty-one high-level officials from nine countries (Benin, Burkina Faso, Cameroon, Gabon, Guinea, Guinea-Bissau, Mali, Senegal and Togo) and representatives of BCEAO, BEAC, CEMAC and UEMOA[1] participated in the workshop – those responsible for macroeconomic forecasting in the real, external, fiscal and financial/monetary sectors, and for the design of poverty reduction programmes.

The seminar was held in three stages. First, experts from Afristat, the Agence française de Développement, the Association of Coffee Producing Countries, the Bank of France, Debt Relief International, the European Commission, the IMF, INSEE[2] and the World Bank presented best international and regional practice in macroeconomic modelling, and in forecasting all the above sectors. Their presentations were complemented by presentations by countries and regional organisations on best regional practice.

Participants then divided into sectoral working groups, to discuss how to reinforce regional best practice. They produced 5-10 page reports. Among the key conclusions of the sectoral groups were:

Real Sector

- The priority is to build reliable (and regionally consistent) national accounts databases, including 1-2-3 surveys of the informal sector and full regional training on concepts.
- Forecasts need to take full account of instability, especially climatic factors such as drought, desertification and deforestation.
- Efforts should be focussed on forecasting agriculture and major mining/industrial projects.
- Base years and baskets for inflation projections need to be rapidly updated.
- Savings and investment should be forecast in more disaggregated econometric ways.

Poverty Reduction

- All countries need dramatically to reinforce their monitoring of poverty trends.
- Forecasting poverty reduction needs to be comprehensive, integrating three main perspectives: income poverty, poor living conditions, and inadequate ability to realise potential.
- Income poverty should be measured absolutely (by a food/non-food basket) and relatively (by the percentage of income of the bottom 20% and Gini coefficients), so forecasts must disaggregate by decile but also above and below poverty thresholds.
- The key indicators to be modelled should be results which can be tested against poverty: infant mortality, literacy, employment, road density, the % of government expenditure and aid going to poverty reduction, the satisfaction of the poor with basic services and the % of the population using clean water, decent housing, electricity, financial intermediation and their own land.
- These indicators should be related to government spending and aid flows to test their quality.
- The group designed a prototype model for further discussion at the second seminar.

Fiscal Sector

Priority areas for improving forecasting methodology are in:

- taxation of major (especially petroleum) companies, and VAT revenue;
- programme budgeting and medium-term expenditure frameworks based around the core of poverty reduction programmes, to move away from incremental expenditure forecasts; and
- better country-specific definition of the long-term sustainability of government finances (particularly integrating domestic debt into debt sustainability ratios).

External Sector

Better projections require:

- much greater disaggregation of all line items, especially exports, imports and services;
- assembling multiple sources of forecasts on international economic variables such as commodity prices, interest and exchange rates, and global/regional/national economic growth, focussing especially on independent market-based analysis;
- maximising use of international sources of information e.g. on aid flows, bank debt;
- surveys of providers and recipients of services, transfers and migrant remittances to avoid using simplistic correlation techniques for forecasts;
- to track developments in competitiveness using factor cost.

Monetary and Financial Sectors

- The two monetary sub-zones should move towards regional rather than national programming.
- The programming model needs to be much more sophisticated, integrating issues of bank stability, credit allocation and savings mobilisation.
- BCEAO should follow BEAC in drawing on private bank's own projections of money/credit.
- Micro-credit and informal financial systems need to be integrated into forecasts.

Institutions and Tools

- Better co-ordination of all forecasting units is crucial – both between and within sectors.
- Most forecasting units need more personnel, training and equipment.
- Countries in the region should establish networks to keep permanent contact on these issues.
- Countries need to build macroeconomic models tailored to their economies, which integrate sectoral growth and poverty reduction equations; and which allow different sectors to project their variables (e.g. fiscal, monetary), and accompany them with training and manuals.
- Past forecasts should be reviewed regularly to test accuracy and learn lessons for improvements.
- Forecasts should be updated at least quarterly and well in advance of Bretton Woods missions.
- Public explanation of data and forecasts by government and other (donor, private sector) agencies is essential to participation in poverty reduction and long-term development strategies.

Finally, participants regrouped into country teams and designed plans and timetables for building their national capacity in this area and for mobilising external technical and financial support. In the closing plenary there was an exciting discussion of the need to make sure that regional convergence criteria take full account of poverty reduction spending needs.

The Pôle Dette and DRI committed themselves to following up these recommendations with international partners, to a second seminar on these issues in July, and to a forum for Finance Ministers at the next Franc Zone meetings, at which the key issue will be how to ensure regional convergence reduces poverty.

[1]Franc Zone institutions – BCEAO; Central Bank of West African States; BEAC: Bank of Central African States; CEMAC: Economic and Monetary Community of Central African States; UEMOA: West African Economic and Monetary Union.

[2]French National Institute for Statistics and Economic Studies.

HIPC INITIATIVE

COUNTRY PROGRESS AND PRSP STATUS (Jan 2001)

Source: DRI & IMF documents

Country	HIPC Initiative Progress					
Countries which had already reached decision/completion points under HIPC I						
	HIPC I		HIPC II		Issues	PRSP Status/Timetable
	Decision	Completion	Decision	Completion		
Benin	7/97	ineligible	7/00	2001-2	finalised interim multilateral relief after administrative delay, need more programme aid	preparing full PRSP for February-March 2001
Bolivia	7/97	7/98	1/00	2001	completion point delayed until March-April 2001, no interim debt service relief between DP and CP	full PRSP finalised in February 2001
Burkina Faso	9/97	6/00	6/00	2001-2	implementation of CP triggers under way, new PRGF signed in December 2000	full PRSP being implemented, published in May 2000
Cote d'Ivoire	3/98	9/00	2001	2002-3	political instability and track record problems delaying HIPC II Decision Point	preparing I-PRSP for 2Q2001
Guyana	12/97	6/99	11/00	2001-2	HIPC I DP and therefore HIPC II CP delayed considerably, programme now back on track	preparing full PRSP for April-May 2001
Mali	9/98	9/00	9/00	2001-2	HIPC I DP and therefore HIPC II CP delayed considerably, programme now back on track	preparing full PRSP for June 2001
Mozambique	6/98	6/99	4/00	2001-2	IMF mission scheduled for late February will assess whether conditions for CP have been met	preparing full PRSP for March 2001
Senegal	7/97	ineligible	6/00	2001-2	interim relief delayed, three-year PRGF agreement to be discussed shortly at IMF Board	preparing full PRSP for November 2001
Uganda	4/97	4/98	2/00	4/00	PC stock relief delayed 6 months, not all post cut-off debt treated, difficulties to obtain comparable terms with some non-OECD creditors	implementing full PRSP, published in March 2000

Countries which have reached or are expecting to reach decision points under HIPC II

Country	Preliminary HIPC Documents	HIPC II		Issues	PRSP Status/Timetable
		Decision	Completion		
Angola	no current timetable			preliminary DSA shows ratios under HIPC thresholds, IMF mission to define future steps in 1Q 2001	preparing I-PRSP for 2Q2001
Burundi	2001	2001-2	2002-3	negotiations for an emergency post-conflict credit with IMF	preparing I-PRSP for 3Q/4Q 2001
Cameroon	6/00	10/00	2001-2	need to implement recent Paris Club agreements and long list of triggers for CP	preparing full PRSP for 4Q2001
Central African Rep.	2001	2001-2	2002-3	programme agreed in early January, building track record for DP	preparing full PRSP for 3Q2001
Chad	7/00	2001	2001-2	track record was judged insufficient and decsion point was delayed to 2001	preparing full PRSP for May-June 2001
Congo Dem. Rep. of	no current timetable			need to negotiate post-conflict assistance with IMF	no PRSP process
Congo Rep. of	2001	2001	2002-3	discussions on post-conflict emergency assistance completed and proposal for PRGF being considered by the IMF	preparing I-PRSP for 3Q/4Q 2001
Equatorial Guinea	no current timetable			GDP rise means graduation from HIPC list	no PRSP process so far
Ethiopia	1998	2001	2002-3	building track record under new PRGF agreement with the IMF for a possible DP in 2001	preparing I-PRSP for DP by 1Q2001
Gambia	11/00	12/00	2001-2	DP reached on schedule, relief increased by excluding re-exports	preparing full PRSP for 4Q2001
Ghana	no current timetable			new government considering options for debt relief including HIPC	preparing full PRSP for April 2001
Guinea	12/99	12/00	2001-2	review of implementation of PRGF due in April allowing Paris Club negotiations in May 2001	preparing full PRSP for 4Q2001
Guinea Bissau		12/00	2001-2	Paris Club deferred post-cut-off debt service, initiating bilateral discussions shortly	preparing full PRSP for 4Q2001
Honduras	12/99	7/00	2001-2	awaiting IADB decisions on financing modality to finalise implementation of DP agreements	preparing full PRSP for March 2001
Kenya	no current timetable			preliminary DSA shows ratios under HIPC thresholdsrescheduled arrears at PC	preparing full PRSP for May 2001
Lao PDR	no current timetable			government analysing debt relief and new financing options including HIPC	preparing I-PRSP for 1Q2001
Liberia	no current timetable			no current IMF programme	no PRSP process
Madagascar	2001-2	12/00	2002-3	DP accelerated into 2000, Paris Club expected for March 2001	preparing full PRSP for 4Q2001
Malawi	8/00	12/00	2001-2	Paris Club moved cut-off date, strating bilateral agreements	preparing full PRSP for 4Q2001
Mauritania	1/99	1/00	2001-2	implementing long list of triggers for the floating CP, including reducing poverty by 1/3	implementing full PRSP, published in December 2000
Myanmar	no current timetable			no IMF programme since 1981-82, no WB lending since 1987	no PRSP process
Nicaragua	10/99	12/00	2001-2	implementing triggers agreed at the DP including implementation of Debt Management Regulations	preparing full PRSP for March 2001
Niger	4Q/00	12/00	2002-3	Paris Club deferred post-cut-off debts, need programme aid to clear domestic arrears	preparing full PRSP for 4Q2001
Nigeria	no current timetable			dropped from HIPC list but now IDA only, Paris Club provided Houston terms	no PRSP process
Rwanda	1/99	12/00	2001-2	preparing documentation with IFIs to implement DP agreements and reduce debt service immediately	preparing full PRSP for 3Q2001
São Tomé & Príncipe	2000	12/00	2002-3	DP accelerated into 2000, preparing for PC negotiations in first half of 2001	preparing full PRSP for 4Q2001
Sierra Leone	2001	2001	2002-3	3-year PRGF to be considered in early 2001 together with I-PRSP	preparing I-PRSP for 1Q2001
Somalia	no current timetable			no current IMF programme	no PRSP process
Sudan	no current timetable			no current IMF programme	no PRSP process
Tanzania	9/99	4/00	2001-2	implementing floating CP conditions for HIPC, problems with non OECD creditors comparable relief	implementing full PRSP, published in November 2000
Togo	2001-2	2001-2	2002-3	no IMF programme since 1998, expecting results of IMF mission in late 2000	preparing I-PRSP for 2Q2001
Vietnam	no current timetable			preliminary DSA shows ratios under HIPC thresholds	preparing I-PRSP for 1Q2001
Yemen	no current timetable			preliminary DSA shows ratios under HIPC thresholds	no information on PRSP process
Zambia	8/00	12/00	2001-2	extra front loading of relief by IMF, full PRSP advancing gradually	preparing full PRSP for 2Q2001

ANGLOPHONE & FRANCOPHONE NEGOTIATIONS REGIONAL WORKSHOPS

The CBP has continued to reinforce HIPCs debt negotiation skills by organising two more regional negotiation workshops in the last semester.

1st Anglophone negotiations workshop

The ***1st Anglophone Negotiations Regional Workshop***, jointly organised with WAIFEM, was held over 6 working days in Banjul, The Gambia, from 6 to 11 November 2000 and hosted 32 participants. Negotiation teams from five countries attended it. Ethiopia, The Gambia and Ghana have all had debt strategy national workshops before and hence were able to move a step forward in further refining their creditor by creditor debt negotiation strategy. Though Malawi's national workshop is scheduled only for the first half of 2001, the team prepared a negotiation report in preparation for their decision point at HIPC and their recent Paris Club negotiations. Although not formally a HIPC, Nigeria attended with financial support from WAIFEM. Observers from Liberia and Sierra Leone (WAIFEM member countries) also attended and prepared summary reports on their negotiation prospects. Observers from Tanzania, Uganda and MEFMI attended to exchange information on their negotiations experience.

The ***2nd Francophone Negotiations Regional Workshop*** was held over 6 working days in Dakar, Senegal, from 13 to 18 November 2000 and was jointly organised with the BEAC/BCEAO Regional Debt Management Training Unit (Pôle Dette). It hosted 30 participants from negotiation teams from Benin, Cameroon, Chad, Mauritania and Niger. All countries had debt strategy national workshops beforehand and hence were able to benefit fully from the whole simulation exercises, by using their own database, and moved another step forward in refining their creditor by creditor debt negotiation strategy. Observers from Burkina Faso, Central African Republic, Congo Republic, Guinea, Rwanda and Togo also attended the workshop, allowing exchange of information on some interesting experiences in negotiations with different creditors.

Both workshops aimed at deepening the knowledge of participants about negotiation of existing debt and new borrowing by discussing and simulating the negotiations in detail, by type of creditor and, in some cases, creditor by creditor.

The participants were trained in the concepts and terms available from different creditors and then simulated negotiations with their creditors using their own live data and documentation. Debt Pro was used to calculate appropriateness of the terms offered by different creditors, in particular to ensure that the terms suggested by the creditors were providing sufficient present value reduction from debt and allowed them to reach overall sustainability.

The first two days focused on training the participants on Paris Club negotiations. Before the multilateral negotiations, they prepared their own memoranda and debt relief request. This was followed by simulation of the negotiations for each team. The workshops proceeded to bilateral Paris Club negotiations in which debtor countries had lengthy and tough negotiations with their bilateral Paris Club creditors. Based on the lessons learned during the simulations, participants designed an agenda for preparing future bilateral negotiations. The next item was negotiating comparable terms with the non-Paris Club creditors which proved a difficult experience for the participating teams, in particular those held with Arab and Asian creditors.

National teams then calculated the burden sharing requirements of different creditors in the context of the HIPC Initiative and simulated negotiations for front-loading of the relief provided by multilateral creditors. They then evaluated different types of debt conversion proposals. The final working session was on new borrowing, describing institutional structures, procedures and calculations necessary to ensure that new loans match the required grant element. On the final day, all teams presented their future debt negotiations strategies with all types of creditors at a plenary session, receiving comments and questions from their colleagues from other countries and resource persons. All countries prepared a document summarising the results of their negotiations and the agenda for future negotiations.

In closing presentations on overall lessons learned, representatives of Cameroon and Nigeria made the following points:

- the workshop was well timed for Cameroon, Chad, Ethiopia, Gambia, Malawi and Niger which were all at the time preparing for possible decision points at the HIPC Initiative and the Paris Club and bilateral negotiations that will follow in 2001;
- Benin and Mauritania learned valuable lessons for the implementation of detailed relief agreements with bilateral and multilateral creditors, and will be much better prepared for their negotiations at Completion Points in 2001-2;
- the Nigeria team tested their negotiation skills in preparation for their Paris Club negotiations in December 2000; and analysed their prospects for becoming a HIPC;
- Ghana analysed the costs and benefits of becoming a HIPC should its new government decide on this option in 2001.

The key common lessons from the workshop are the need to:

- prepare in detail and well in advance for all negotiations if the country is to receive the maximum possible debt relief;
- have a well-balanced negotiating team including decision-makers and technicians;
- lobby bilateral and multilateral creditors in advance of formal negotiations;
- keep all creditors well informed of reasons for arrears and results of negotiations;
- be realistic about poor prospects for Paris Club comparable terms from non Club members;
- be proactive in establishing debt conversion policies, guidelines and monitoring systems;
- prioritise interim relief from multilateral creditors as the best source for immediate funding of poverty reduction;
- go beyond grant element calculations and analyse the quality of new financing;
- strengthen co-ordination among government agencies and build capacity on specific negotiations.

In view of the success of these workshops, as shown by countries improved performance in their Paris Club negotiations, DRI will be holding two more workshops of this type in the first semester of 2001.

2nd Francophone negotiations workshop

CBP ACTIVITIES FROM OCTOBER 2000 TO JUNE 2001

The CBP has continued to enhance HIPC debt management capacity between October and January, organising missions, regional and national training events.

- ***Demand Assessment Missions*** to Rwanda and Sierra Leone. The mission to Rwanda, 30 October to 5 November, resulted from an urgent request for capacity-building training and assistance by the Minister of Finance and Economic Planning. It helped the Rwandan authorities to identify areas to strengthen and suggested a preliminary work programme: Rwanda has now requested intensive support through a capacity-building advisor supervised by the CBP. The mission to Sierra Leone, from 15 to 21 January, was conducted jointly with WAIFEM. The mission prepared a detailed aide-mémoire describing areas where debt management capacity needs reinforcing and a preliminary capacity building programme to be implemented jointly by DRI and WAIFEM in transferring the CBP to Anglophone West Africa.

- The ***São Tomé & Príncipe Debt Strategy Workshop***, from 18 to 31 October, attracted 34 participants from the Planning, Finance and Co-operation Ministry, Central Bank and agencies in charge of Poverty Reduction. The national team prepared a full DSA that confirmed that STP was extremely eligible for the HIPC Initiative and produced a debt strategy report analysing the implications of eligibility, priority poverty reduction areas to allocate debt relief resources, and identified institutional areas that need further reinforcing of capacity. The workshop was well timed allowing the government to be prepared for HIPC negotiations. Key issues identified for follow-up were: i) need to negotiate maximum front-loading to finance poverty reduction spending; ii) final liquidity ratios have to be negotiated taking into account high vulnerability to external shocks; and iii) the need to allow flexibility in fiscal targets to allow more resources to be spend on poverty reduction.

- The ***Zambia Debt Strategy Workshop***, jointly organised with MEFMI, was held from 23 to 30 October in Lusaka and attended by 30 participants from key government agencies who produced a DSA and were trained in debt sustainability analysis. They produced a Debt Strategy Report that was discussed with high level policy-makers at the closing day. The workshop was well timed allowing the government to be prepared for HIPC negotiations and to raise fundamental issues that where later incorporated in the HIPC Decision Point discussions. Key issues identified for follow-up were: i) need to negotiate maximum front-loading to reduce large debt servicing humps in 2001-5 arising from repayments to the IMF; ii) although the debt service to exports ratio is decreasing with HIPC relief the debt service to revenue ratio will remain around 20% reinforcing the case for further front-loading; and iii) Paris Club post cut-off date debt will need to be treated to provide burden sharing.

- ***Anglophone and Francophone Regional Negotiations Workshops*** organised with WAIFEM, MEFMI and the BEAC/BCEAO Regional Debt Management Training Unit (Pôle Dette), from 6 to 18 November (see pages 8-9).

- The ***Francophone Macro Forecasting Regional Workshop*** was jointly organised with the Pôle Dette from 11 to 20 December in Yaoundé, Cameroon (see page 5).

- A ***Follow-up Mission for Togo***, from 22 to 31 November, to enhanced debt management capacity in the Treasury, following the transfer of debt management responsibility to the Finance Ministry. A group of 12 officials were trained by two DRI regional experts in debt database management, sustainability analysis, and in the use of a simulation tool.

- ***Follow-up Missions for Cameroon, Malawi, Niger and Guinea-Bissau***, from 22 to 27 January in Paris, helped national teams to finalise preparation and assist during negotiations with Paris Club creditors, as a follow-up to their recent HIPC decision points. Some of the issues arising from these negotiations are presented in the Technical Questions article (see page 12)

- DRI has continued to provide comprehensive capacity building training in debt strategy through ***capacity building advisors*** in Honduras, Nicaragua and Guyana.

- DRI has also organised the ***7th HIPC CBP Steering Committee Meeting*** in Vienna in December 2000, at which donors approved the CBP work programme for December 2000 to June 2001 (see page 11).

- Progress continued in ***the transfer of the CBP to regional institutions***. The CBP has been implementing transfer to MEFMI through the Zambia National Workshop and by preparing a number of events for 2001. The transfer to the BEAC/BCEAO Pôle Dette in Francophone Africa has continued at an accelerated pace with 2 regional joint events. The agreement with WAIFEM on the transfer process to Anglophone West Africa was signed at the 7th Steering Committee Meeting and execution will start in 2001. Finally, the agreement for the CEMLA transfer programme for Latin America was signed in January and implementation will start in the second quarter of 2001.

A busy first semester of 2001 for the CBP will include:

- ***4 Demand Assessment Missions*** to Liberia, Yemen, Vietnam and Laos;
- ***5 National Workshops*** in Senegal and Congo Brazzaville with the BEAC/BCEAO Pôle Dette, Angola and Malawi with MEFMI and Rwanda;
- ***6 Follow up Missions*** to Burkina Faso, Chad and Guinea (with the BEAC/BCEAO Pôle Dette), The Gambia (with WAIFEM), Bolivia and Guyana (with CEMLA) and Ethiopia;
- ***2 Debt Negotiations Regional Workshops***: for Lusophone Africa in Lisbon and for Anglophone Africa with MEFMI;
- ***1 Macro Forecasting Regional Workshop*** for Latin America with CEMLA;
- ***1 Training for Trainers Workshop*** for the MEFMI region;
- The ***4th HIPC Ministerial Meeting*** on 5 June in London;
- The ***8th HIPC CBP Steering Committee Meeting*** on 6 June in London.

A well-deserved coffee break in beautiful São Tomé

SEVENTH STEERING COMMITTEE MEETING

Our seventh Steering Committee meeting took place on 30 November 2000 in Vienna, hosted by the Austrian Ministry of Foreign Affairs. It was attended by the CBP donors, international organisations, HIPC representatives of Benin, Malawi and São Tomé & Príncipe, and the 4 regional partners of DRI.

In the first session, the IMF and World Bank presented **a HIPC Progress Report**. The year 2000 would commit relief of US$21 billion to 22 countries. Nevertheless, it remained difficult mobilising new aid for poverty reduction, especially for post-conflict countries; and assuring delivery of relief by non-Paris Club governments and smaller multilaterals. The BWIs would produce papers on poverty-related spending and long-term debt sustainability shortly; and analysis of PRSP-HIPC results at the Annual Meetings. They would step up analysis of domestic debt in PRGF papers; and might modify relief to take account of debt service "humps", but "shocks" to HIPC economies would be dealt with only by higher ex post disbursements.

Malawi presented the conclusions of the HIPC Ministerial Meeting in Prague (see issue 6 of this newsletter), particularly: the need to front-load relief for poverty reduction, to analyse domestic debt, and to be pragmatic on conditionality to accelerate completion points. São Tomé & Príncipe urged the BWIs to channel all relief to rapid poverty reduction spending. Benin urged multilateral institutions to provide relief faster, an international initiative to increase new aid to HIPCs, and more flexible conditionality to enhance national ownership. Other participants urged the BWIs to maximise action against humps and shocks, to include domestic debt and contingent liabilities in HIPC analysis; to strengthen measures against non-concessional finance and in favour of additional aid; to accelerate efforts to include non-Paris Club governments; and to analyse the sustainability of a wider range of potential HIPCs.

In the second session, DRI presented a **HIPC CBP Progress Report** on work in June-November 2000 and projected work in December 2000-June 2001 (see article on page 10 for latest update). Other participants suggested that DRI should place more emphasis on intensive follow-up missions to build country capacity in specific areas; enhance liaison with international organisations, especially to transmit its lessons on best practices for reinforcing debt management; increase the amount of information available on its website; begin as soon as possible its independent review; and provide comprehensive evaluations of HIPC progress to future Steering Committee Meetings.

As priorities for DRI work in 2001 they suggested: a focus on institutional issues; closer tailoring of assistance to countries' different levels of capacity; continued political-level meetings to ensure a high political profile for debt management; a focus on the management of new external flows; and an acceleration of information-sharing among HIPCs on best practices, especially via the website.

The third session discussed **progress and prospects in transferring the execution of the CBP to regional organisations**. Each regional organisation presented its impression of progress. The BEAC/BCEAO Pôle Dette stressed the need to tailor interventions to the different capacity levels of its member states. CEMLA informed the Committee that it was about to sign a memorandum of understanding with DRI. MEFMI informed the Committee of an acceleration of joint activity in 2000. WAIFEM also reported a rapid acceleration and the signing of a Memorandum of Understanding with DRI at the meeting. In subsequent discussion, participants discussed the need to enhance networking among DRI and its regional partners, and not to forget the needs of countries that were not covered by regional partners (notably the Lusophone countries).

Session 4 concentrated **on capacity-building efforts by other organisations.** The IMF cited an External Debt Statistics Guide, a working paper on Institutional Elements for External Debt Management, and the production of the Debt Management Guidelines. In subsequent discussion, other participants indicated that the Guidelines were of limited utility to HIPCs and urged closer examination of HIPC debt management needs. The Commonwealth Secretariat described its workshop on Financing HIPC Development and Ministerial Meeting in Malta, as well as progress on CS-DRMS 2000+, which would be released in June 2001. The World Bank discussed its involvement in the Statistics Guide and Debt Guidelines and in capacity-building on poverty reduction. In subsequent discussion participants agreed that there were many successful models of debt management institutions, all dependent on sufficient resources for personnel, training and equipment, and donors were urged once again to support capacity-building rather than technical assistance, especially for the smallest and weakest HIPCs.

For the detailed minutes of the Steering Committee proceedings, please contact us at dri@dri.org.uk.

DFI LAUNCHES CAPACITY BUILDING PROGRAMME

Development Finance International (DFI, DRI's sister organisation formerly known as External Finance for Africa) is launching a new programme in the first quarter of 2001. The Monitoring Private Capital Flows to Developing Countries Programme (Capacity-Building for Codes, Standards and Analysis) is funded by the UK Department for International Development (DFID). It will be an important practical step to promote global financial stability by helping the poorest governments to monitor and analyse capital flows to the private sector in their countries. The Programme will generate data essential for national, regional and international analysis to inform policy response and investment promotion, and in turn increase and stabilise flows for sustainable economic growth and poverty reduction. Many countries have already asked DFI for assistance in this area. Since 1996, we have helped 16 African and Caribbean countries with monitoring and analysis, including 5 pilot surveys, 3 censuses of flows and 3 research projects.

The Programme will expand the census to 8 countries in 2001, selected according to need and demand, and thereafter expand to a wider group of countries while at the same time decentralising implementation to regional partner institutions. DFI will host an international workshop for 20 countries in 2001, to refine methodology and share analytical lessons. If you have any questions, please contact Nils Bhinda (Programme Manager) or Matthew Martin (Director).

TECHNICAL QUESTIONS

1. What debt relief can HIPCs receive from multilateral creditors?

The table below shows the latest information on multilateral debt relief for HIPCs. Most of the largest multilateral creditors (IMF, World Bank Group and African Development Bank Group) provide interim relief by reducing debt service payments between Decision and Completion Points. However, the amount of such relief depends on each country's success in negotiation. For example, IDA will provide minimum 50% relief on interim debt service, but it can go as high as 100% interim relief as long as over the three years this is less than 1/3 of IDA's total relief in PV terms. However, creditors often prefer to provide relief in equal annual proportions rather than front-loading. For example, if to provide its total PV relief, IDA has to reduce debt service by 80% per annum over 20 years, it might propose this rather than 100% in the interim period and 70% in the remaining years.

Similarly, it is vital to make sure that after the Completion Point, other relief continues to be "front-loaded" so that poverty reduction spending can be kick-started, but this is not always the initial position which will be offered by many creditors.

Therefore, if a HIPC does not negotiate strongly, it will get less rapid relief. The first basis for such negotiation should be the debt service burden. The BWI Boards have stated that the debt service to exports ratio should preferably be below 15% and fall over time. As we have argued elsewhere (see issue 2 or article on humps), the historically-demonstrated levels of sustainability are 13% debt service to exports and 12% debt service to budget revenue. So, HIPC should try to negotiate sufficient front-loading to bring debt service ratios at least down to these levels and keep them falling gradually. The second basis for negotiation should be funding needs for poverty reduction. If a HIPC can demonstrate that it has funding needs and absorptive capacity for additional poverty reduction spending, it should argue for frontloading on this basis.

2. What is the Paris Club doing about post-cut-off date debt?

In our last issue, we foresaw that the Paris Club would have to be more flexible on post-cut-off date debt or HIPCs would never reach sustainable debt levels. Since then, the Paris Club has taken two important steps forward in January 2001:

- In negotiations with Malawi, the Club agreed to move its cut-off date from 1 January 1982 to 1 January 1997. This partly reflected some special circumstances, which may limit other HIPCs' access to this treatment. In particular, Malawi last went to the Club in 1988. It has a track-record of servicing its debt on time. There was virtually no pre-cut-off date debt eligible for Cologne Terms if the date was not moved. All the debt affected was ODA debt as Malawi has not been borrowing on export credit terms; and the 1997 date allowed some creditors to exclude very recent loans. However, other HIPCs which can potentially benefit from Malawi's experience include at least the Gambia and Ghana.
- In negotiations with Guinea-Bissau and Niger, the Club agreed to defer service on post-cut-off date debt that was falling due between the Decision and Completion Points, with a grace period of 3 years and maturity of 10 years. This reflected the very high liquidity burden of their debt if this measure was not taken. This is not a new practice but it is encouraging that it is now being applied at HIPC Decision Points.

3. If countries are "unsustainable" at the Completion Point, can they get more relief?

Several HIPCs look unlikely to be sustainable at the time of their completion points. For example, Niger and Malawi will have PV/export ratios above the 150% threshold even after HIPC assistance (until 2013 and 2014 respectively). Hence, HIPC II as currently designed will not provide sufficient relief to enable these two countries to achieve sustainability. Many more countries are likely to suffer interim "shocks" to their economies which would raise their ratios to unsustainable levels (see pages 3-4).

Fortunately, HIPC II allows for a comprehensive reassessment of a country's debt situation at Completion Point. If, on the basis of long-term projections, the PV/exports ratio remains above 150%, the IMF/World Bank Boards "could consider a topping up" of debt relief. However, there are two key unanswered questions:

- what criteria will be used to determine the size of the "topping up of relief"? In particular, how "long-term" will the projected unsustainability have to be?
- which creditors will provide this topping up of relief?

There is an urgent need to resolve these questions rapidly if HIPCs really are to achieve long-term debt sustainability.

HIPC DEBT RELIEF OF MULTILATERAL CREDITORS

Creditor	Between Decision and Completion Points	After Completion Point
African Development Fund/Bank (ADF/AfDB)	Debt service relief: ceiling of 80% annual service and max 40% of total PV relief	Debt service relief: max 80% of annual service due, until remaining 60% PV relief is delivered within 15 years
Arab Bank for Economic Development in Africa (BADEA)	Concessional rescheduling of arrears	Reschedule 100% stock at interest rate needed to produce PV reduction
CARICOM Multilateral Clearing Facility (CMCF)	Reschedule 100% stock at lower interest rate and extended maturity needed to produce PV reduction	Reschedule 100% stock at lower interest rate and extended maturity needed to produce PV reduction
Carribean Development Bank (CDB)	Debt service relief to 2002*	Debt service relief*
Central Bank of West African States (BCEAO)	Case-by-case basis	Rescheduling 100% stock at 0% interest rate and 15 years
European Investment Bank (EIB)	Forgive 100% annual debt service	Prepayment of loans to produce PV reduction
European Union (EU) / European Investment Bank (EIB)	Forgive 100% debt service	Grants to provide full or partial cancellation to produce PV reduction
Islamic Development Bank (IsDB)	Reschedule arrears and service on case-by-case basis	Reschedule stock at interest rate needed to produce PV reduction
Inter-American Development Bank (IDB)	Depends on timing of donor resources	Debt service relief: 50% of annual service due on FSO loans to 2008. After 2008, selective cancellation of principal for loans outstanding before 2000
International Fund for Agricultural Development (IFAD)	Clearance of arrears only	Forgive 100% debt service, until PV reduction provided
International Monetary Fund (IMF)	Up to 100% of annual debt service; not to exceed 60% of total PV relief or 20% in any one year	Remaining 40% of PV relief
Nordic Development Bank (NDB) / Nordic Investment Bank (NIB)	No relief	Forgive 100% debt service, until PV reduction provided
Organisation of the Petroleum Exporting Countries (OPEC)	Case-by-case basis	Reschedule 100% stock at interest rate and/or maturity needed to produce PV reduction
West African Development Bank (BOAD)	Debt stock reduction or payment of service not to exceed 20% per annum	Debt stock reduction or payment of service needed to produce PV reduction
World Bank		
IDA	Debt service relief: 50% or more of annual service due Front-loading = max 1/3 of total PV relief	Debt service relief: 50% or more of annual service due. To be delivered within 20 years of DP
IBRD*	IDA grant = IBRD share of relief in period Front-loading = max 1/3 of total PV relief	IDA credit to prepay debt = remaining PV relief

* Original HIPC Initiative

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