

STRATEGIES FOR FINANCING DEVELOPMENT

The Newsletter of the HIPC CBP and the FPC CBP



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HIPC Debt Analysis & Strategy

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DEBT AND NEW FINANCING PROPOSALS TO THE AFRICA COMMISSION

In the second half of 2004, Debt Relief International was contracted by the Commission for Africa, created by the UK Government to promote Africa's accelerated development during the UK Presidency of the G8 in 2005, to write three studies, on debt relief and sustainability, improving the effectiveness of new aid flows, and protection of African economies against exogenous shocks. This article presents the main conclusions of these studies¹.

1. DEBT RELIEF AND SUSTAINABILITY

This report assesses how debt relief and debt sustainability can make a greater contribution to financing the Millennium Development Goals (MDGs). It analyses Africa's debt profile and sustainability as well as recent debt relief initiatives and finds that, in spite of recent progress, the sustainability of African countries' external debt remains highly precarious if not illusory. The report finds that in principle debt relief is among the most desirable types of external development finance, the way in which relief is currently being delivered is reducing its desirability, as well as diverting aid away from other low-income countries. As a result, mechanisms for debt relief need to be fundamentally reformed, and complemented by large new aid, private finance and trade access, to ensure balanced financing for the MDGs for all African and developing countries. The report recommends several actions:

- 100% cancellation of all debt service for all HIPC countries and other severely indebted low-income countries through to the year 2015;
- relief on all 'dangerous' debt owed to non-OECD bilateral and commercial creditors which are not participating in the HIPC Initiative, and which is a target for creditors to make fortunes through lawsuits;
- a 10-year service holiday for middle-income debt-distressed countries;
- higher budget support for less-indebted countries;
- ensuring additionality of the funding, by using available multilateral resources, especially IMF gold and SDRs;
- establishing a mechanism to ensure all African and developing countries are receiving balanced allocations of funds to reach the MDGs;
- formulating a more comprehensive and

suitable framework for assessing long-term debt sustainability in developing countries; and

- enhancing programmes to build technical capacity and political voice for Africans to lead analysis and policy design on their future debt sustainability.

2. EFFECTIVENESS OF AID

At an international level, donors/creditors and African governments have been making major efforts to improve both the quantity and quality of development finance. However, there are questions as to how effective these efforts are in raising both the quantity and quality of external assistance flows to African governments. Above all, in spite of recent initiatives on harmonisation of donor practices and the PRSP-based partnership, there is no systematic monitoring across all recipient countries, at the individual country level, of whether donors are living up to their pledges on aid quality and support for the PRSP framework, or behaving consistently across a range of African countries. Even more important, African countries are not systematically empowered to lead the monitoring of the improvement of aid quality themselves – donors still lead the process in most countries. Existing efforts to assess donor performance focus mainly on procedures or are too-donor-driven. As a result there is an urgent need for African governments to take the lead in using a methodology that reflects their needs. The HIPC CBP has been helping HIPC governments to assess the quality of aid they receive as part of the process of designing overall national debt and new financing strategies (for methodology and results see Newsletter 20). The report makes recommendations for donors as a whole, and for each major bilateral or multilateral donor or creditor to improve their policies and procedures, 17 steps for improving international aid quality and effectiveness, measures for African governments to define clear external financing policies and improve absorption procedures. Finally, it stresses the urgent need for African governments to take the lead in implementing a system of mutual partnership and accountability, so that donors and creditors adapt their assistance to Africa's priorities, both at the country level and the regional/international level, and suggests how, so that Africa can fund and attain the MDGs.

3. MILLENNIUM DEVELOPMENT GOALS

This report examines how to protect Africa against 'shocks' (events beyond the control of African governments) that could severely disrupt their progress towards the MDGs. It finds that shocks could reduce Africa's growth rates by 50% during the next 10 years. Effective protection against shocks would therefore be a highly worthwhile investment for international financing and policy. Yet African countries and the international financial system have devoted insufficient attention to shocks. The paper suggests five types of measures:

- a) Improving analysis to prevent shocks from occurring, by improving the methodology used in baseline economic projections and more successfully forecasting or allowing for real shocks;
- b) Taking measures to prevent individual types of shocks, including protecting against natural disasters, improving predictability of aid, diversifying sources of export earnings and growth, rationalising import use, promoting domestic savings and investment, increasing reserves to 6 months of imports, keeping debt levels low, maximising 'fiscal space' to fight shocks, and directly protecting the poor;
- c) Compensating for or offsetting individual shocks through risk management and insurance measures, and adjustments to debt burdens;
- d) Taking comprehensive measures against Africa's overall vulnerability to shocks, by introducing into PRSPs programmes comprehensive anti-shock plans and fiscal contingency reserves to allow countries to combat shocks while progressing to the MDGs, and adjusting PRGF programme targets to shocks;
- e) The report ends by recommending faster-disbursing, larger, lower-conditionality and grant-based contingency financing against shocks. As African HIPC governments have themselves suggested, there is no better use or higher priority for additional aid than immediate, low-cost contingency financing.

¹ *The Commission for Africa is conducting a wide consultative process to design its recommendations so it is not clear whether any of these recommendations will be adopted. The report of the Commission will be produced in March 2005.*

STEERING COMMITTEE AGREES FOURTH PHASE OF HIPC CBP



15th meeting of the HIPC CBP, Livingstone, November 2004

The 15th meeting of the HIPC CBP Steering Committee was hosted by the Government of Zambia and MEFMI in Livingstone, end-November. In addition to implementing partners and donors, it was also attended by HIPC policymakers from Ghana, Guyana, São Tomé and Príncipe and Zambia. The plenary sessions of the meetings discussed the following issues:

Review of Phase 3: ECORYS/NEI presented the review of phase 3 of the CBP (see separate box for main conclusions). It was agreed that the review would be published and distributed widely.

Plans for Phase 4: SC members agreed that there would be a fourth phase of the CBP, lasting at least 3 years. They agreed on a process for preparing phase 4 of the CBP through a consultative process involving HIPC debt managers, existing and potential additional donors, implementing partners and international organisation members of the HIPC CBP Consultative Group. This will begin in January and culminate in agreement on a final document by the Steering Committee in May 2005. Phase 4 will start on 1st July.

Ministerial Meetings: it was agreed that future ministerial meetings would be held jointly with the Commonwealth Secretariat and other international organisations so as to reduce demands on HIPC Ministers' time and donor funds.

Evaluation of Country Capacity-Building

Progress: the latest evaluation scores showed an increase to an average of 3 out of 5, with the highest increase in the HIPC CBP core area of debt strategy analysis. Two of the HIPC CBP's three logframe targets for country progress have been reached, and the third looks likely to be met by June. It was agreed that the evaluation methodology would be reviewed for use in phase 4.

Methodology: it was agreed that the CBP methodology needs to be updated to incorporate the new long-term debt sustainability analysis methodology of the BWIs as soon as this is

finalised. Partners also discussed recent advances in the CBP's new financing, macroeconomic forecasting and poverty reduction programming methodology.

Distance Learning: it was agreed that distance learning should be continued in phase 4, and the implementing partners will prepare a plan for extension.

Information Products: a new design and structure for a joint HIPC CBP website was agreed (see details on page 11), and substantial progress was made on planning publications.

Financial Issues: it was agreed that partners would find financial savings from budgets in order to fund the process of preparing the phase 4 document.

MAIN CONCLUSIONS OF HIPC CBP PHASE 3 REVIEW

The HIPC CBP phase 3 review was conducted by ECORYS-NEI through a fully participatory process in which all of the stakeholders in the CBP were consulted. As presented in Livingstone, the main findings of the review were that:

- HIPCs feel debt strategy formulation and implementation is the key issue in debt management and therefore the CBP is highly relevant to their needs;
- The CBP has played a major role in strengthening technical capacity and helping countries through the HIPC Initiative process, but less so in building sustainable institutions, putting debt management at the centre of macroeconomic policy discussions or raising awareness outside governments;
- The HIPC CBP is very largely demand-driven and the methodology is of high quality, but should continue to be updated for new developments;
- The distance learning programme is of high quality but has suffered from delays in student

work and measures are needed to prevent these in future;

- Almost 50% of countries receiving significant assistance from the CBP are preparing national debt strategies, though some still require some assistance from the CBP and other sources;
- Decentralisation of CBP execution to regional partner organisations (ROs) is being executed too fast and may not be economically feasible for all CBP services;
- ROs require further technical and financial support through a fourth phase, to ensure full decentralisation of the programme and to become sustainable centres of excellence;
- Progress in building up HIPCs' own capacity to conduct training varies across regions, and could be undermined by staff turnover;
- There is a need for independent reviews of the quality of outcomes in addition to the self-evaluations conducted by ROs and HIPCs.

The reviewers also noted some problems with the details of the implementation of the programme and recommended the following as improvements for phase 4:

- Clarifying further the roles of ROs, the Technical Office, HIPCs and donors in phase 4, especially in the context of decentralisation, based on mutual agreement on responsibilities and accountability;
- Focussing the role of the Technical Office on multi-regional products, and other activities demanded by ROs;
- Designing clearer indicators for decentralisation and flexibility in its speed, as well as clearer indicators for measuring ROs as 'centres of excellence';
- Attempting gradually to decentralise direct support for all HIPCs (including non-members of ROs) to ROs;
- Preparing the phase 4 document through a process of transparent consultation with all stakeholders;
- Tailoring the CBP interventions even further to the needs of individual regions and countries as they progress through and beyond the HIPC Initiative, as defined by national capacity-building plans resulting from institutional missions;
- Improving the content and 'joint' nature of the website and widening the distribution of newsletters and publications;
- Involving the CBP more closely in RO Fellows Programmes;
- Prioritising in-country capacity-building and institutional support missions and training of trainers, over regional training and other services;
- Promoting cost-savings and increasing cost-sharing by the HIPCs themselves.

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CONSEQUENCES OF DELAYING CAMEROON'S COMPLETION POINT¹



In October 2000, Cameroon was declared eligible to benefit from resources under the enhanced HIPC initiative. Within this framework, Cameroon was to benefit from external debt relief assessed at US\$1,260 million in NPV, and around US\$2,000 million in nominal value over a period of at least 20 years.

This HIPC assistance was to be given in two phases, with US\$305 million in nominal value during the interim period, situated between October 2000 and March 2003, and the remainder at the completion point. The amount of HIPC assistance was to be transferred to a special HIPC account, opened at the Central Bank, to be used to finance the poverty reduction programme.

For a number of reasons, namely insufficient execution of the programme agreed with the Bretton Woods institutions, Cameroon did not reach the completion point in March 2003. This situation has had many varied consequences for the country resulting from the reactions of its various creditors.

1. Multilateral creditors: the expected assistance from these creditors was US\$125 million in nominal value. During the interim period, US\$102 million was effectively provided. The World Bank and the African Development Bank suspended their HIPC assistance in April 2003 and September 2003 respectively; thus rendering the whole debt due payable after these two dates. The IMF continued to give assistance to Cameroon until December 2004 in support of the PRGF programme. Furthermore, Cameroon has continued to benefit from the assistance of the European Investment Bank, thanks to a reduction in debt servicing, and the OPEC Fund, through the rescheduling over a longer period of the service falling due of the two loans currently being disbursed, taking into account the fact that there were no longer any due dates on the older debts.

2. Paris Club creditors: these creditors extended the debt service consolidation period until 20 December 2004 (in total a consolidation period of 48 months), with a cancellation in NPV of between 90% and

100% of the debt. This operation meant that greater interim HIPC relief was obtained than had been planned.

3. Non-Paris Club creditors: reaching the completion point will allow Cameroon to enter into firm negotiations with a view to obtaining the expected relief, depending on the mechanisms agreed upon with each of these creditors.

4. Commercial creditors: commercial debt consisted entirely of arrears at the time of the HIPC decision point. The country received comparable treatment as per the Cologne terms for the buyback of this debt at 14.5% of its face value.

As table 1 shows, delaying the HIPC initiative completion point has meant that Cameroon has lost US\$285 million in nominal value up to the end of December 2004. However, the table also shows that the effects of the completion point delay differ depending on the category of creditor and the type of debt at stake. Effectively:

- Regarding multilateral creditors, the completion point delay entails massive gaps for the State treasury. Although losses will be recovered as from the new completion point, this assistance will come over a longer period than initially planned (after 2015);
- Finally, uncertainty remains over debts on which HIPC assistance had been calculated and which will reach maturity before the new completion point. Effectively, because of the amounts paid back since the decision point, the present value of some multilateral debts will be below the amount of expected assistance from these creditors according to the calculations made at the decision point.

As a result of the negotiations begun with the Bretton Woods institutions at the end of 2004, Cameroon could agree a staff-monitored programme covering the first half of 2005. The correct execution of this would allow the country to renegotiate a PRGF during the second half of 2005. In the best

Table 1 - Gap between promised and effectively disbursed debt relief (in millions of US\$)

Creditors	Interim period (Oct. 2000-March 2003)	2003 (actual)	2004 (actual)	2005 (forecast)
1 – Total assistance expected	335	149	205	209
o/w HIPC	305	49	83	77
non-HIPC	30	100	122	132
2 – Total assistance received	312	33	59	33
o/w HIPC	282	18	45	33
non-HIPC	30	15	14	...
3 – Gap to fill (3 = 2 – 1) (as a % of budgetary revenue)	- 23	- 116 (- 5,1%)	- 146 (- 6,6%)	- 176 (- 7,1 %)
3.1 HIPC total	- 23	- 30	- 38	- 43
3.2 Additional non-HIPC (incl. C2D)	...	- 85	- 108	- 132

Source: HIPC decision point document, CAA Cameroun

- Regarding Paris Club creditors, not being at the completion point is beneficial in terms of interim relief, as long as the country remains on-track with the Bretton Woods institutions;
- These gains are nevertheless insignificant when compared with the losses in non-HIPC relief mobilisation, mainly the non-entry into force of the *Contrat de désendettement et de développement* (C2D, Debt Relief and Development Agreement). Large sums of the debt due after the completion point (US\$193 million) were paid to France and will not be reimbursed;

possible case, the completion point will occur at the end of December 2005 at the earliest.

In that case the loss sustained by Cameroon would total US\$437 million for the period April 2003 – December 2005, of which US\$176 million would be for 2005 alone. This represents on average 6.3% of budgetary revenue, and will limit Cameroon's ability to carry out its poverty reduction programme.

¹ By Du Prince TCHAKOTE NOUMBISSI, Cameroon Sinking Fund (CAA Cameroun).

EXPERIENCES FROM THE FIRST LATIN AMERICAN TRAINING FOR TRAINERS WORKSHOP



The first Latin American Training for Trainers Workshop (TFT) in debt and new financing strategy took place in Mexico City from 11th to 21st October 2004. Participating nations included Bolivia, Honduras and Nicaragua, as well as non-HIPC observer countries such as Argentina and Guatemala.

The aim of this workshop was to develop the training skills of experts from the HIPC's in the region, through consolidating a team capable of training other local and regional government officials thus enabling them to act as facilitators, and to provide support at future events organised within the framework of the Capacity Building Programme (CBP).

Participants stemmed from finance ministries, central banks and other agencies involved in poverty reduction. Selection was based on their performance at previous events, determined by facilitators' post-workshop evaluations of participants, designed to assess the performance of each technical group participant during CBP events.

WORKSHOP METHODOLOGY

The event was structured around the TFT Guide, which outlines the technical tasks required to train participants. A generic national workshop manual was also used for reference purposes, based on the case study of Bolivia.

The workshop commenced with presentations on the aims and structure of the workshop as well as outlining the CBP methodology used for the analysis of debt sustainability and new financing. The next stage involved a series of tasks undertaken by each technical group. This included a series of role-plays, in which different participants assumed the role of facilitator for their group on a daily basis.

The practical training sessions were combined with presentations given by trainers, on the different tasks involved in workshop organisation, both prior

to and during the event, and included elements specific to the workshop opening sessions. In addition, there were practical demonstrations of good and bad presentations, the preparation and chairing of plenary sessions, as well as ways of analysing capacity building, combining optimum scenarios, organising groups in order to draft the final workshop report and presenting the results to the authorities. Similarly, both the facilitators and the participants led practical sessions on the use of Debt-Pro[®], designed to guarantee that future trainers forming part of the technical groups will have a working knowledge of this simulation tool.

Finally, another important aspect of the workshop included daily facilitators' meetings, during which participants took it in turn to represent their group.

WORKSHOP RESULTS

The workshop objectives were completed successfully, allowing for the exchange of experiences and best practices among participating countries. This success is clearly reflected in the event's evaluation, where 97% of participants stated that they had found the workshop useful.

One of the key workshop outputs was that each technical group provided detailed comments aimed at improving CBP methodology, based on each participant's experience as facilitator:

- The inclusion of certain tasks, particularly those related to the debt database, and macroeconomic and poverty data as part of workshop preparatory activities, thereby allowing more time to be spent on actual analysis during the workshop. Likewise, an initial presentation could be used to provide each participant with general information regarding database content, and macroeconomic and poverty reduction base projections.
- The creation of detailed glossaries covering standard terminology used by each technical group and in the manual tables.
- The incorporation of improvements to Debt-

Pro[®], including the combination of macro and poverty scenarios, as well as the incorporation of specific functions for domestic debt scenarios simulation.

- The creation of a methodology to determine cost-impact relations to support poverty reduction expenditure analysis.
- The provision of additional Debt-Pro[®] training prior to the workshop, to allow more time to design scenarios and to reduce the amount of time spent entering data.
- Standard national workshops could possibly include the presence of a member from each technical group at the daily facilitators' meeting.

In addition, the national delegations met to analyse and assess their debt management capacity. A set of valuable conclusions was reached regarding future steps to the progress made on debt analysis and new financing strategies. Importantly, these included actions to be taken by Bolivia in order to update and implement its debt and new financing strategy, whilst Honduras and Nicaragua laid the foundations for the organisation of national workshops scheduled for the first quarter of 2005. Such events will be of major importance for both countries, given that Honduras is on the verge of reaching its completion point, and Nicaragua is currently involved in defining a debt strategy based on its recently approved Public Loans Act.

HIPC delegations also highlighted the importance of consolidating their respective national teams in order to guarantee inter-institutional co-ordination to design and implement the strategy.

Observer countries expressed their satisfaction at the results obtained at the workshop, which, in their opinion, far exceeded initial expectations. The representative from Guatemala also highlighted the need to design a national strategy for his country and the practical feasibility of this methodology in this regard.

In sum, the event proved to be highly productive; participants gained valuable insight into the skills required by trainers and the workshop evaluation identified potential facilitators for future events in all areas. The event reinforced the training provided to trainers, the number of which has practically tripled in the last two years, rising from 11 to 30 experts who are now in a position to act as facilitators. In addition, a further 14 officials were identified as potential candidates to be trained as trainers in 2005.

ZAMBIA: CONSIDERATIONS FOR TOPPING UP OF RELIEF AT COMPLETION POINT

The enhanced HIPC Initiative framework allows for exceptional topping up of debt relief if the deterioration is due to exogenous factors that lead to a fundamental change in the country's economic circumstances. Additional debt relief may then be provided to bring the PV of debt-to-exports ratio down to 150% after the completion point. At the time of Zambia's decision point, its PV to export ratio at the end-December 2003 expected completion point was projected to be 161%.

The main factors which can lead to countries, including Zambia, having a higher than anticipated PV/exports at its actual completion are:

- Higher than anticipated new external borrowings resulting in a higher debt stock;
- Lower than expected exports because of commodity prices changes or environmental factors such as floods or droughts resulting in lower export volumes;
- Unanticipated variation in the parameters used for computing the present value of the debt (commercial interest reference rates (CIRRs) and exchange rates) between decision and completion points.

These factors are analysed below.

EXTERNAL INDEBTEDNESS

At the time of Zambia's decision point new disbursements were projected to total US\$1.6 billion between end-1999 and end-2003, resulting in US\$724 million increase in the PV of debt. These new borrowings were assumed to have an average grant element of 55%. However, Zambia received 35% less in disbursements (US\$547 million) than was anticipated and therefore its debt stock at completion point was lower than initially projected. Therefore the increase of new borrowing between the decision point and the completion point was fully anticipated and incorporated in the projections at decision point, and therefore will not be a factor in the increase of the PV of debt-to-exports ratio.

EVOLUTION OF EXPORTS

The guidelines of the HIPC Initiative stipulate that a three-year average (average of the reference



year plus the two preceding years) must be used in the computation of the PV of debt-to-exports ratio. For Zambia the three-year average for 2001-2003 was projected to be US\$1,4 billion in the decision point document. However, the actual outturn for exports is expected to be 19% lower, because the export projections made at the decision point assumed higher growth of both metal and non-metal exports than has occurred.

VARIABLES FOR THE COMPUTATION OF PRESENT VALUE OF DEBT

The variation of the *discount rates* used in the computation of the present value can have an important impact on the level of the PV of debt-to-exports ratio. An increase of the CIRRs (or decrease) will result in a lower (or higher) PV of a country's external debt.

The declining trend of CIRRs between decision and completion points has had a negative impact on the present value of Zambia's external debt. The discount rates of the five major currencies, accounting for 90% of the total portfolio, have declined resulting in an increase of the PV of the external debt of the country. The CIRR for the SDR declined from 5.6% at decision point to 4.2%, when this currency now represents 47.1% of the country's total external debt, compared with 35.4% in 1999. Similarly, the CIRRs for all the other major currencies of Zambia's borrowings have also declined, resulting in higher present value.

Industrial countries interest rates are beyond the control of the Zambian authorities. If the significant decline in interest rates reflects lower than expected inflation in the OECD countries,

anticipated future commodity export prices for Zambia will be lower, and the future capacity to service the debt to these countries will decline correspondingly. As such, a decline in nominal interest rates would increase the PV of debt-to-exports ratio.

The variation of the *exchange rates* has also had a negative impact on the present value of the external debt. The depreciation of the US dollar against the other major currencies, such as the SDR, euro and pound sterling has led to an increase of the overall present value (and the ratio PV of debt-to-exports) when the present value of the other currency denominated debt is translated into US dollars. The effect is significant given that more than 65% of Zambia's export receipts are in US dollars whereas 78% of Zambia's debt portfolio is denominated in currencies other than the US dollar implying a significant exchange rate risk for Zambia.

The variation of the exchange rate reduces the debt service capacity of the country since the export revenue remains constant in dollar terms, whereas debt service payments increase due to the appreciation of most currencies vis-à-vis the US dollar. In other words, Zambia must spend more dollars to service its non-dollar denominated debt.

The review of Zambia's external debt shows that the variations of discount and exchange rates and the evolution of exports are not under the control of the Zambian authorities but have negatively affected the economic circumstances to make Zambia potentially eligible for topping up of the Enhanced HIPC Initiative assistance.

THE ROLE OF RISK MANAGEMENT IN DEBT STRATEGY



INTRODUCTION

A major lesson of national debt crises has been the need for governments to manage risk in their debt portfolio, to achieve a permanent exit from rescheduling, and strong growth. This article explains how to use these techniques to protect a country from unanticipated changes in exchange rates, interest rates and commodity prices which worsen the debt burden.

CONCEPTUAL ISSUES

Risk is volatility of debt service costs relative to the budget. It results from the possibility that actual debt servicing costs exceed the expected value. Risk management refers to the careful monitoring and evaluation of the risks inherent in the government's debt structure, and the mitigation of these risks to the extent feasible by modifying the debt structure, taking into account the potential cost.

In the course of executing his functions, a debt manager typically faces the following risks, with varying intensity depending on the structure and composition of debt and the economic environment for debt management: market risk (composed in turn of interest rate risk; currency risk; and commodity price risk); rollover or refinancing risk; liquidity risk; credit risk; operational risk; and settlement risk.

For HIPCs, the most relevant risks are likely to be market, rollover and liquidity risks.

MARKET RISK INDICATORS

1. Exchange Risk

Exchange rate volatility became a problem for borrowing countries after the end of the Bretton Woods system in 1973 when major currencies began to fluctuate in value against each other. For all borrowing countries for which external debt data are available through the World Bank's Reporting System, as at end-2002, 38% of the debt stock consisted of non-dollar currencies, of which the euro is the most important. Consequently, debt service in dollar terms is highly sensitive to cross-currency exchange rates, as many HIPCs have discovered as their debt burdens denominated in dollars have risen sharply over the last two years.

2. Interest Rate Risks

Interest rates fluctuations, as evidenced by the

six-month LIBOR, have been wild. High interest rates of the late 1970s and early 1980s contributed substantially to the debt management problems of countries that had floating-value borrowings from commercial banks. However, this issue is much less important for HIPCs, which have little floating rate debt as most of their commercial debt has now been extinguished.

3. Commodity Price Risks

Fluctuations in commodity prices are currently among the biggest risks to many developing countries (including those in the WAIFEM region), which depend on primary commodity exports for most of their foreign exchange earnings, and depend on oil or food imports. The fluctuations in primary commodity prices have been a persistent source of instability for developing countries. However, there are also other vital risks, such as volatility of aid or private capital flows, and natural disasters, which need to be taken into account for a comprehensive analysis of macroeconomic risks.

ROLLOVER OR REFINANCING RISK

Rollover risk refers to the likelihood of the debt manager not being able to obtain new financing as debt matures, or only at an unusually high cost. This risk is usually measured as the amount to be refinanced during a given period relative to the fiscal flows (budget) or as 'financing gap' to GDP or BoP if debt cannot be rolled over. Rollover risk is typically managed by:

- setting a limit on debt maturing in one year; and
- lengthening the maturities, and smoothening the issuance of new debt.

LIQUIDITY RISK

Liquidity risk results from assets having longer maturities, or being less liquid, than debt, and implies that assets are not liquid enough to service debt. Liquidity risk has been managed by:

- lengthening the maturity of debt;
- increasing liquid assets held in foreign currencies or other cash reserves; and
- holding a portfolio of liquid assets to cover a minimum of future financing needs.

RISK MANAGEMENT TECHNIQUES

From the preceding analysis, it may be noticed that much of risk management has

typically been conducted by means other than market instruments. Lenders pushed interest rate risks to borrowers by substituting variable for fixed-rate contracts. Exchange rate risk was covered in forward markets, but this only applied to short-term contracts. Fluctuations of some commodity prices were countered by relying on mechanisms designed to smooth price fluctuations. This included attempts to stabilise international commodity prices through commodity agreements, securing compensatory finance against the consequences of price changes, etc. Rollover risk has been addressed largely by setting a limit on debt maturing or lengthening maturities and smoothening the issuance of new debt. Similar techniques to those for rollover risk had been applied to deal with liquidity risk. However, those traditional risk management techniques highlighted above have not been successful. As a result, there were *ex-post* large adjustments to major price fluctuations, reflected in defaults and subsequent rescheduling of debt.

In recent years, the World Bank has developed a government Asset and Liability Management (ALM) model as an effective risk management tool. Under the framework, government's assets and liabilities are matched, with the objective of reducing overall risk for the government. Debt is unsustainable when future debt servicing costs (liabilities) exceed the governments' ability to raise taxes (assets). Risk analysis is vital to figure out the likelihood of not meeting debt payments on time.

CONCLUSION

Risk analysis should be an important tool available to a debt manager who seeks efficient management of the country's debt. It promotes prospects of timely payment of debt service obligations and early exit from debt rescheduling. In consideration of the importance of risk management to debt management, WAIFEM (as well as the other CBP regional partners) have organised with the World Bank regional workshops on 'Risk modelling for a sovereign liability portfolio', which have been well received by participants, who have called for country-specific training to deepen their knowledge and skills.

HIPC INITIATIVE AND PRSP PROGRESS: JANUARY 2005

Country	HIPC II Dates		PRSP Dates		HIPC Initiative
	Decision	Completion	Interim	Final	Creditor Participation
Angola	no current timetable		2005	...	NA
Benin	7/00	3/03	7/00	3/03	99%
Bolivia	2/00	6/01	2/00	6/01	95%
Burkina Faso	7/00	3/02	5/00	7/00	76%
Burundi	2Q2005	2Q2006	1/04	2Q2005	NA
Cameroon	10/00	4Q2005	10/00	7/03	98%
Central African Rep.	...	...	1/01	2Q2005	NA
Chad	5/01	3Q2005	7/00	7/03	93%
Comoros	2005	...	2005	...	NA
Congo, Dem. Rep. of	7/03	3Q2006	6/02	3Q2005	93%
Congo, Rep. of	2005	...	12/04	...	NA
Côte d'Ivoire	2005	...	3/02	...	NA
Ethiopia	11/01	4/04	3/01	9/02	92%
Gambia	12/00	1Q2006	12/00	7/02	81%
Ghana	2/02	7/04	8/00	4/03	90%
Guinea	12/00	1Q2006	12/00	7/02	85%
Guinea-Bissau	12/00	1Q2006	12/00	1Q2005	81%
Guyana	11/00	12/03	11/00	9/02	81%
Honduras	7/00	1Q2005	7/00	10/01	93%
Kenya	DSA Nov. 2003		8/00	2/04	NA
Lao PDR	no current timetable		4/01	12/04	NA
Liberia	no current timetable		no PRSP process		NA
Madagascar	12/00	10/04	12/00	11/03	91%
Malawi	12/00	4Q2005	12/00	8/02	97%
Mali	9/00	3/03	9/00	3/03	85%
Mauritania	2/00	6/02	NA	1/01	90%
Mozambique	4/00	9/01	4/00	9/01	88%
Myanmar	no current timetable		no PRSP process		NA
Nicaragua	12/00	1/04	12/00	9/01	87%
Niger	12/00	4/04	12/00	2/02	86%
Rwanda	12/00	1Q2005	12/00	8/02	95%
São Tomé & Príncipe	12/00	1Q2006	4/00	1Q2005	85%
Senegal	6/00	4/04	6/00	12/02	81%
Sierra Leone	3/02	1Q2006	9/01	1Q2005	84%
Somalia	no current timetable		no PRSP process		NA
Sudan	no current timetable		...	...	NA
Tanzania	4/00	11/01	3/00	12/00	90%
Togo	...	...	...	...	NA
Uganda	2/00	5/00	NA	5/00	96%
Vietnam	DSA 2002		4/01	6/02	NA
Yemen	6/00	...	2/01	8/02	NA
Zambia	12/00	2Q2005	7/00	5/02	97%

Sources:
HIPC Governments,
IMF & World Bank

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

Burundi is the latest country to become eligible for HIPC relief, following the BWIs Board approval of its Preliminary Document. One I-PRSP (Congo, Rep). and one Final PRSP (Lao) were approved in December.

Key Debt Relief and New Financing Issues	Key Macroeconomic and Poverty Reduction Issues
HIPC CBP DSA shows ratios under HIPC thresholds	Discussions for new SMP on-going
Most creditors provide relief, unsustainable due to new borrowing	New PRGF to be negotiated. PRSP progress report due soon
Debt unsustainable after new borrowing; heavy fiscal debt burden	PRSP progress report finalised. 2003 standby agreement being implemented, 4 th review completed. New PRGF expected for 2005
First to get additional relief at CP, large new borrowing allowed	PRGF review approved in April 2004. PRSP on-track: 5 th PRSC reviewed and adopted by Parliament in June 2004
Preliminary HIPC document presented to BWI boards in Jan 2005, decision point expected in May	1 st PRGF review completed
79% buyback from IDA on commercial debt, 2 lawsuits. Paris Club consolidation period extended to Dec. 2004	Off-track with IMF since 30 Aug 2004. SMP being negotiated
Political instability postpones HIPC timetable, multilateral arrears accumulating	Emergency post-conflict assistance programme approved by IMF in July 2004. Final PRSP delayed due to instability
10 non-Paris Club creditors not providing relief, delay to CP	New PRGF negotiated late October, to be submitted to IMF board in late January. PRSP review expected
High debt burden. HIPC timetable still uncertain	New SMP pending additional economic measures. I-PRSP validated by government to be revised
IMF grants US\$1.7m additional interim assistance (Jul.04)	PRGF on-track. Final PRSP due soon
Naples terms from PC	3-year PRGF granted in Dec. I-PRSP approved
DP delayed because of civil conflict. World Bank suspended disbursements	Off-track with IMF. PRSP delayed
CP topping up of \$707m approved	Good PRGF record, despite exogenous shocks
Interim IMF relief lapsed, 2 nd tranche Paris Club relief not implemented	PRGF off-track, SMP through to Dec. 04. Donors' budgetary support suspended
PC Cologne terms on stock. Participation of some Non-Paris Club and commercial creditors remains an issue	Multi-donor budget support programme set up. PRSP progress report finalised and IBWs staff assessment published June04
IMF, AfDB, PC interim relief suspended.	SMP still in negotiation. PRSP progress report assessed by BWIs
IMF and Paris Club have suspended relief	Currently negotiating a new PRGF
PC Cologne terms agreed; commercial lawsuit dropped	PRSP progress report completed. PRGF on-track
Interim relief expired; PC rescheduling arrears & service due. Debt sustainability expected at CP	PRSP review planned for 1Q2005
DSA shows ratios under HIPC thresholds. PC Houston Terms relief	1 st PRGF review completed. PRSP progress report due soon
DSA shows possible HIPC eligibility. DP could be reached quickly if government decides participation in HIPC Initiative	4 th PRGF review completed. Final PRSP approved by BWIs
Debt stock estimated \$3bn (600% of GDP), nearly all in arrears	Donor support for reconstruction. Arrears clearance sought
After CP, unsustainable on fiscal ratios	On-track with PRGF, programme extended through March 2005. 1 st PRSP progress report completed and 1 st PRSC endorsed by World Bank
IMF and AfDB interim relief exhausted. Paris Club Agreement expired Dec 2004	SMP agreed through June 2005
Difficulties with non-PC, commercial creditors	1 st PRSP progress report finalised and IBWs staff assessment published May 04. Drought and Côte d'Ivoire shocks
No relief from some non-Paris Club creditors (Algeria, Kuwait, FKDEA)	New PRGF approved in July, progress report on PRSP expected soon
Currently negotiating with non-Paris Club creditors. Lawsuits	PRGF being implemented. PRSP on-track
No WB lending since 1987. Probably unsustainable	No IMF programme since 1981-82
CP achieved in January 2004	2 nd PRSP progress report finalised. PRGF being implemented
CP topping up of \$142.5m approved. No agreement with non-Paris Club creditors. Taiwan won lawsuit	PRGF on-track. PRSP review due soon
Possible topping up required at CP	Joint staff assessment of PRSP progress report endorsed. PRGF on-track
Running out of ADF relief. CP delay	Negotiating for new PRGF. Final PRSP pending BWIs approval
CP reached. Cologne stock agreement signed with Paris Club	On-track with PRGF. PRSP progress report completed
Commercial lawsuits of US\$35m. Running out of ADF interim debt relief. CP expected Jan. 2006	PRGF on-track. Final PRSP now expected Jan. 2005
Accumulating large arrears to creditors. No work Bank lending since 1991	No current IMF programme due to lack of recognised government
Possible donor support group to clear multilateral arrears	I-PRSP near completion. SMP on-track
India has cancelled all ODA debt	2 nd PRGF review completed. New PRSP expected soon
No current prospect of debt relief	No resumption of engagement after June 2003 elections. Government validation of I-PRSP due soon
Ceiling on new borrowings, seeking more grants as debt is unsustainable.	PRGF third review completed May 2004. Growth in non coffee exports
Board report on HIPC eligibility due shortly	New PRGF to be negotiated. 1 st PRSP progress report approved by BWIs
Ratios under HIPC thresholds so Paris Club Naples stock treatment	PRGF on-track
Possible topping up required at CP	PRGF agreed in June 2004 and 1 st review approved

National workshops

Zambia. The CBP held a National Debt and New Financing Strategy workshop from 11-19 November 2004 in Livingstone. The workshop was organised at the request of the Government to assist officials to update the national DSA in preparation for Zambia's HIPC completion point negotiations.

The outcome of the debt sustainability analysis shows that Zambia needs maximum HIPC relief from all its creditors in order to achieve a PV/XGS ratio below the 150% threshold (for more details, see page 6). The key issues for follow-up are:

- negotiations of maximum relief from all creditors at completion point;
- adoption of policies aimed at restructuring of the domestic debt portfolio in order to lower debt service payments;
- seeking grants in preference to loans and maximum concessionality for new loans, preferably on IDA terms.

Regional workshops

CEMLA Training for Trainers. The first Latin American TFT in Debt Strategy and New Financing took place in Mexico City from 11th to 21st October 2004. (See article on page 5.)

Domestic Debt Sustainability Analysis

Francophone Workshop. This regional workshop, organised jointly by Pôle-Dette and DRI, took place from 6-16 December in Douala. There were 61 participants from 14 countries, including 8 Pôle-Dette member States: Benin, Burkina Faso, Cameroon, Chad, Congo, Côte d'Ivoire, Gabon, and Niger; and 6 non-RO countries: Burundi, Democratic Republic of Congo, Djibouti (observer), Guinea, Mauritania and Rwanda (observer).

The workshop was aimed at supplying Francophone HIPC domestic debt managers with mechanisms to analyse and design domestic debt strategies. It was composed of thematic presentations in plenary sessions and tasks conducted in technical group and multidisciplinary strategy teams. Cameroon's economic and financial data was used as a basis for seminar work. Participants made several recommendations aimed at improving domestic debt strategy and analysis methodology. As regards capacity building, all 14 countries expressed needs relating to: institutional debt management framework, domestic new financing policy, mechanisms (risks, econometric models) inherent in domestic debt management and macroeconomic policies.

Debt Advisors

Burundi. The mission to Bujumbura, from 4th to

8th October, aimed at (i) providing additional training on the use of Debt-Pro[®], (ii) analysing the impact of the latest Paris Club meeting, (iii) assisting officials to design an analytical report on debt for submission to policymakers and (iv) reviewing the implementation of the recommendations made in earlier missions. The mission identified measures to increase ownership of dissemination of the knowledge acquired from the HIPC CBP, by overcoming organisational limitations, revitalising the Debt Management Technical Committee, implementing previous mission recommendations, and accelerating the acquisition of new computing equipment that will allow staff to use and enhance their knowledge of Debt-Pro[®].

Gambia. This mission, conducted from 6th to 11th December, is the first institutional mission under the recently approved Intensive Assistance Programme being implemented jointly by the CBP and the Commonwealth Secretariat and financed by DFID. The main objectives of the project are (i) to enhance the institutional capacity for debt management in The Gambia, including domestic debt, the legal framework and (ii) to build an institutional and technical capacity for debt management in the country. The mission assisted the government to implement its restructuring plans for the Directorate of Loans and Debt Management, set up the work for the government to design and produce a procedures manual, and revitalised the Debt Strategy Technical Working Group.

Guinea. The Debt Management Advisory Project to Guinea resumed with two missions: a ComSec/DRI mission to continue training in CS-DRMS (from 15th to 26th November) and an institutional mission (from 29th November to 4th December).

Staff made a considerable effort regarding the update of the database to end-2003 and the mission managed to train them in data checking, validation and report production as well as validating approximately 85% of the database. Due to power problems, the 'debt restructuring' and 'euroconversion' modules of CS-DRMS will need to be covered in a future mission, as will the downloading of data from CS-DRMS into Debt-Pro[®] and helping update the database to end-2004.

The second mission aimed to review current institutional debt management and assess progress in designing the debt management procedures manual. In comparison to 2002, date of the last CBP institutional assessment, the organisational framework has improved considerably, there is a better debt recording

system and staff have gained a sufficient knowledge of the various basic concepts of debt management. However, it remains vital to reinforce institutional coordination and debt analysis capacities; these are the aims of forthcoming missions.

Mozambique. At the request of the authorities, DRI is providing an intensive assistance programme to enhance debt management capacity, to be financed by the Swedish International Development Agency. This programme will address Mozambique's capacity building needs in the institutional, legal, and technical areas. The first mission visited Maputo from 22nd November to 3rd December, and focussed on assisting Government officials to update their post-HIPC debt strategy, by incorporating the latest debt relief initiatives announced by the UK as well as their recent agreements with non-Paris Club members. The results of the strategy show that Mozambique needs to fully implement the HIPC debt relief from all creditors (including additional cancellations from Paris Club creditors) in order to reach sustainable levels. It shows that with full implementation, the country's indebtedness ratios are sustainable from 2003 until 2017, but without full implementation, Mozambique will only achieve sustainability by 2007. Furthermore, the country remains highly vulnerable to external shocks as well as the terms and composition of future new financing. The mission also reviewed with national authorities the overall content of the training programme as well as the calendar for the missions and workshops.

Rwanda. Following discussions between the Finance Minister and DRI during the BWI Annual Meetings, it was agreed to prioritise the update of Rwanda's debt sustainability analysis before the IMF mission scheduled in November to discuss the country's completion point. The HIPC CBP mission, conducted from 11th to 23rd October, assisted the DSA national team. The results of the exercise show that Rwanda has a strong case for a topping up of the Enhanced HIPC Initiative assistance at completion point. Using the methodology established by the Bretton Woods institutions, Rwanda should benefit from an additional relief estimated at USD230.9 million on a present value basis, early in 2005.

Institutional Management Assistance/Missions

Comoros. The mission to Moroni took place from 25th October to 4th November 2004. It aimed at (i) reviewing progress in implementing the institutional recommendations and the

design of the debt management procedures manual, (ii) assessing the update of the computerised debt database created in August 2003 and (iii) training officials in the use of Debt-Pro[®] to simulate a debt relief strategy. Adequate computerised debt recording started in August 2003 with the setting up of a database in Access. The mission recommended additional Access training for the Database Administrator. The Debt Department needs to perfect the database, especially by seeking more information from parastatal companies, classifying and identifying loans of which conventions are missing, and including postal debt due to France. The mission installed Debt-Pro[®] and gave a basic training to staff. It also recommended that the software should be installed at the Central Bank and Planning Commission.

The mission found that the Technical Debt Management Committee is working well. But the creation of the decision-making National Public Debt Committee is still pending. A second draft of the debt management procedures manual was elaborated during the mission, it will be finalised and adopted once the government completes additional institutional reforms.

In its capacity as member of the Franc Zone, the government of Comoros received a formal approval from both BCEAO and BEAC to its request to become a full member of Pôle-Dette.

Attachments

From Pôle-Dette region. Amadou Tchambou (from Niger's Education Ministry), Pôle-Dette Fellow studying 'Poverty reduction strategy and sustainable human development', was attached at DRI from 1st to 8th November. His attachment focussed around two main issues: (i) the review of the methodology for HIPC CBP poverty reduction analysis, and (ii) a fellowship research project.

The review of the methodology (i) compared the education indicators used during workshops with those of the Education for All Initiative and/or the MDGs to define a minimum of relevant indicators, (ii) identified the major constraints relating to the execution of the education budgets, and (iii) built unit cost templates for expenditure projections.

Mr. Tchambou's research project entitled 'Designing and implementing an anti-poverty expenditure strategy: the case of education' aims at clarifying the relation between poverty reduction policies and education expenditure. During his attachment he finalised an outline and work programme.

HIPC CBP Steering Committee Meeting

The 15th meeting of the HIPC CBP Steering

Committee, hosted by MEFMI, took place in Livingstone (Zambia) from 22nd to 24th November. The outcomes of the CBP Review were presented to donors, ROs and HIPC representatives during the meeting. (See page 3.)

Information products

Distance Learning. Three new fellows students from the MEFMI region joined the programme in December. Other regions' students are progressing well and the annual DL workshop should take place in June 2005.

Publication. Printed copies of Publication no. 9, 'Modelling Poverty Reduction' will be available end-March 2005.

Website developments. The current website has proved to be a useful tool for disseminating information to HIPC officials. Work is underway to develop a new jointly-owned HIPC CBP website outside of the DRI domain, to be launched in May 2004. The new restructured site (<http://www.hipc-cbp.org>) will contain additional materials, including more information on CBP events, advocacy work and country progress, as well as the latest versions of methodologies and training materials available to HIPC debt managers on a closed section of the site.

Information on the DFI Group and Foreign Private Capital programme will move to

separate websites:

- Development Finance Group: <http://www.development-finance.org>
- FPC CBP: <http://www.fpc-cbp.org>

To join our listserve and to receive advance notification of the launch of the websites, please contact DRI at mail@dri.org.uk

Future activities

The following activities are planned for 1Q2005:

- Attachment from Pôle-Dette region to DRI;
- Debt advisors/Intensive assistance: missions to Burundi, Gambia, Guinea, Mozambique and Rwanda;
- Follow-up missions to Burkina Faso;
- Institutional management missions to Cameroon, Comoros, Ghana, Guinea-Bissau, Guyana, Honduras and Nicaragua;
- National workshops: Kenya and Sierra Leone preparatory missions; Angola, Chad, Ethiopia, Nicaragua and Rwanda workshops;
- Regional workshops: WAIFEM Domestic Debt;
- Liaison: meetings with the OECD on new financing;
- Information products: update of the publication on countries capacity building needs, progress on new website design;
- 11th HIPC ministerial meeting (with the Commonwealth Secretariat and UN Financing for Development Office).



FPC CBP LAUNCHES IN CEMLA REGION

In the fourth quarter of 2004, the FPC CBP held a CEMLA regional seminar. *Bolivia, Ghana, The Gambia, Malawi, Tanzania and Uganda made progress with their projects, and technical materials and information products were enhanced.*

REGIONAL EVENTS

The FPC CBP held a major regional event with CEMLA in October. It was well attended, and produced a high level of demand for further FPC CBP support in the zone (see box).

COUNTRY PROGRESS

Meanwhile countries continued to progress with their own programmes:

- **Bolivia:** following revisions to its methodology, training of technical staff and awareness creation, the team will launch its next survey in January. DFI and CEMLA have arranged a follow-up mission for first quarter 2005.
- DFID West Africa has indicated that it will fund **The Gambia** to participate in phase 2, with the first cycle to begin in the first quarter of 2005.
- **Ghana** submitted a revised proposal for phase 2 to a wide group of donors, for a decision in January.
- **Kenya's** Statistics Strategic Plan is awaiting closure in Parliament, and release of donor funds. FPC CBP activities will commence thereafter.
- **Malawi** prepared to launch its third survey in the first quarter, when Government disburses funds.
- **Tanzania** has finalised its draft analytical reports for the second surveys for Zanzibar and the mainland. The dissemination event is scheduled for the first quarter, and the team is approaching local donors for funds for the third survey.
- **Trinidad and Tobago** continued to conduct quarterly surveys, and posted its metadata on the IMF GDDS website. DFI and CEMLA will support with an advanced training mission in the first quarter.

- A DFI/MEFMI mission assisted **Uganda** to validate data, write its report and hold a dissemination workshop in December. Uganda has incorporated FPC CBP data into the BoP, is establishing a time series for policy analysis, and is using investor perception findings to review promotion policies. It is mobilising local donor funding to launch the third survey in March.
- **Zambia** is currently circulating a proposal to donors, and plans to launch its second survey in the first half of 2005.

OTHER ACTIVITIES

Among other activities, the FPC CBP:

- Produced new **technical resources** on calculating profitability and updating data.
- Incorporated partner comments and uploaded onto the website the **National Taskforce Manual**.
- Produced a new version of the **software** with complex new functions, tested a revised **Software Users' Manual** during training for DFI staff.
- Updated the open pages and uploaded the enhanced technical resources on to the closed pages of the **website**.

FORTHCOMING WORK PROGRAMME

During January to March, the FPC CBP will:

- follow up with donors and country representatives on next steps in the BCEAO/BEAC and CEMLA regions, and continue support for Kenya and Zambia's technical preparations for country projects;
- conduct a demand assessment mission to Paraguay;
- launch third cycles in Malawi and Uganda, and first cycles in Ghana and The Gambia;
- conduct follow-up missions to Bolivia and Trinidad and Tobago, and a closing mission to Tanzania;
- finalise a publication synthesising country findings, and draft publications on methodology and institutional issues in building capacity for FPC analysis;
- continue to enhance technical materials including the National Taskforce Manual;
- disseminate and test the new software version with country teams;
- create a dedicated FPC CBP website, consistent with changes for the HIPC CBP.

CEMLA REGIONAL SEMINAR

This CEMLA-DFI event produced high demand for intensive support by the FPC CBP to the CEMLA Region. Eleven Hispanophone, and three Anglophone countries attended, representing central banks, investment promotion agencies and statistics offices. Countries shared experiences, heard about future developments in international codes and standards, and outlined their priority capacity building needs.

Countries concluded that:

- While in high compliance with the latest international codes and standards, some need to introduce more challenging BoP concepts (such as market value of equity). Most also need to broaden methodology to cover sustainability of FPC, investor perception and motivation, and corporate social responsibility (CSR);
- Most have legal and institutional frameworks in place. Staff rotation is a common problem in most countries as is the need to enhance information flow among institutions. Private sector responses to surveys are problematic in many countries, though countries participating in the FPC CBP have overcome this by sensitisation;
- Most countries want to reinforce all types of analysis (including data on source countries, recipient sectors and regions, investor perceptions, sustainability of capital, and CSR), by strengthening inter-institutional coordination to take advantage of different areas of expertise, and accessing FPC CBP best practices on new techniques;
- Some countries conduct parts of a development financing strategy but need to present a more holistic picture, taking into account all domestic, foreign, public and private financing. Strong political commitment to do this exists, but countries outside the FPC CBP do not have systematic capacity self-evaluations or plans.

Nine of the 14 countries requested country-specific support from the FPC CBP, while others would strongly value continued regional exchange of information on best practices. CEMLA and DFI are presently defining how best to meet the large scale of needs identified, and will pursue discussions with donors in the next quarter.

The FPC CBP has just implemented the third joint country capacity evaluation (CCE). During this period Uganda became the first FPC country to reach band A.

The results of the CCEs are summarised in Table 1. Ranks ranged from 1 (very poor) to 5 (international standards). As in the HIPC CBP, evaluation bands are C (2.4 and below), B (2.5 to 3.4) and A (3.5 and above). The averages were calculated from seven country ratings at 'start' – defined as the time of the first demand assessment mission and in May 2004, and eight (including Bolivia) in November 2004.

By May 2004, countries had already made considerable progress in building their capacity, from an average score of 1.85 to 2.89. Over the last 6 months, several countries have devoted their time to mobilising funding to continue in the programme, and have not made significant progress (The Gambia, Ghana, Kenya and Zambia). As a result, reflecting progress in Bolivia, Malawi, Tanzania, Trinidad & Tobago and Uganda, the overall average increased by only 0.08 to 2.97. However, these countries have generally made excellent progress. Uganda has moved from band B to band

A, Malawi is expected to reach band A very soon, and Bolivia is expected to improve its band B score over the next few months, due to the hard work of the country teams. Trinidad & Tobago has a high band B score and is expected to move to band A during the programme.

Most progress was made in the following areas:

- advanced analysis: Malawi and Uganda increased their analytical capacity as evidenced by their stronger FPC country reports;
- compliance with international codes and standards: all five countries moved to BPM5 and GDDS standards;
- design of a development financing strategy: due to better integration of the FPC CBP results into overall planning of economic and poverty reduction policies.

Conversely, the least progress occurred in:

- human resources: advances elsewhere were offset by staff turnover in Bolivia;
- non-survey methods: despite urging by DFI and ROs, countries still see this area as a low priority, as non-survey methods are of limited use for data and analysis.

As a result of this progress, capacity to conduct surveys reached the A band, and capacity in 'recording and compilation', 'compliance with codes and standards' and 'basic analysis' are all extremely close to A band. As more countries launch country-specific work under the programme in 2005, scores are expected to rise faster in the next semester.

Table 1: FPC CBP Country Capacity Evaluations

Evaluation Area	Rank			Progress
	Start	May 04	Nov 04	
I. Legal & institutional framework	2.2	3.0	3.0	0.06
II. Human resources	2.2	3.2	3.2	0.00
III. Management, supervision & work environment	2.1	3.2	3.0	0.10
IV. Conduct of surveys	1.8	3.4	3.5	0.10
V. Non-survey reporting methods	1.5	2.2	2.2	0.00
VI. Recording and compilation	1.8	3.3	3.4	0.08
VII. Compliance with international codes	2.0	3.3	3.4	0.14
VIII. Basic FPC analysis	1.6	3.2	3.3	0.10
IX. Advanced FPC & CSR analysis	1.3	2.4	2.5	0.14
X. Design of development financing strategy	2.0	2.4	2.5	0.14
XI. Political priority & leadership	1.6	2.4	2.5	0.08
XII. Transparency, evaluation & control	2.2	2.8	2.9	0.02
Overall Average	1.85	2.89	2.97	0.08

Source: FPC CBP country teams, DFI and ROs

In the FPC CBP, national task forces (NTF) survey not only data on balance of payments stocks and transactions, but also the perceptions of private investors in their countries. The programme is often asked why and how this is done: this article explains.

A survey of investor perceptions has many intrinsic advantages:

- It enhances development of both economic policy and investment promotion policy, by informing government of the factors affecting investment decisions, and how these are changing over time. This gives government a much better basis for analysing the sustainability of the investment and foreign private capital.
- As a result, it mobilises more direct interest for investors (especially their chief executives) than a survey of balance of payments data, and therefore when conducted jointly with the BoP survey (which also avoids sending two surveys to investors), has pushed up the response rates to BoP surveys by around 30%, in turn making results more reliable.
- The fact that government is leading the survey encourages the private sector to see government as being interested in their concerns, and so promotes dialogue, confidence and trust between government and private sector.

In many countries, the FPC CBP is the only regular survey of investor opinions. Some have other surveys, but there is no risk of overlap because:

- The FPC CBP survey covers both resident and non-resident investors, in order to make sure that government policy fulfils the needs of both groups, whereas many of the other surveys cover only non-residents. Such needs can be very different – for example, foreign investors tend to have greater access to foreign finance and are therefore less concerned about domestic financing than local investors.
- The FPC CBP survey covers actual investors in a country, asking them about the factors motivating their initial decision to invest, their current perceptions of the same factors, and their future investment intentions. It therefore provides results which are more reliable because they are based on actual experience, and indicates to government the measures it can take to increase investment rapidly – rather than

(as some other surveys do) focussing on international corporations which have no intention of investing and may be relying on hearsay for their opinions.

- The investor register and sample of the FPC CBP survey are both very comprehensive – an average of 450 investors is sampled in each country (ranging between 200 and 900), whereas most other surveys cover only the largest companies or a small sample of companies (maximum 100).
- The FPC CBP survey asks about a very wide range of factors: 72 grouped into 5 areas (economic and financial policy; political stability and governance; efficiency and cost of services; labour; environmental and health). Such a level of detail supports more focussed policy making and national advocacy efforts – for example, disaggregating 12 different types of infrastructure to see where problems lie.
- The FPC CBP survey is conducted through direct interviews of senior executives and decision makers, and not by mail. Up to 4 physical follow-ups are made to improve data response, and quality is validated through inbuilt logical checks within the questionnaire and local NTF knowledge. Very few other surveys have this standard of technical rigor.
- The FPC CBP surveys focuses above all on macroeconomic aspects of policy rather than individual regulations, whereas many others focus on the microeconomic aspects of the regulatory and practical barriers to setting up investments.
- The FPC CBP survey asks questions about aspects of government policy in a neutral way, thereby providing both positive and negative feedback on policy, and encouraging any positive trends. Many other surveys focus only on problems, difficulties, constraints and barriers, thereby exaggerating negative perceptions of countries. A few even have what appears to be an ideologically-motivated anti-government attitude based on the views of their designers or the mandates of their institutions for policy reform, which could bias government policy more severely and result in very incorrect policy decisions.
- The structure of the FPC CBP questionnaire allows countries to analyse the motivations of different groups of investors, by source country, sector and domestic region. This supports efforts to target promotion of international

investment, and to promote sectoral diversification and regional development.

- A task force of government institutions conducts the FPC CBP survey. It thereby encourages coordination between the central bank and statistics agency (which are more interested in economic statistics) and the investment promotion agency (which is more interested in investor perceptions), and avoids multiple surveys of the private sector. Limiting foreign support to training, institutional reinforcement and quality checking, makes sure that sustainable capacity in government is created. Leadership of surveys – and especially of analysis and policy recommendations – by government agencies increases government ownership and therefore the policy impact of the survey results. Many other surveys are conducted either by foreign consultants on behalf of donor organisations or directly from overseas, using national institutions more as suppliers of investor contact details and post-boxes for responses, and creating no sustainable national capacity, coordination or ownership.
- Because they are conducted and partly financed by national institutions, FPC CBP surveys usually have a much lower cost than other in-country surveys, and therefore can be executed more frequently (every 1-2 years) rather than being dependent on donor financing and therefore less frequent (often once a decade).

Many countries have created fora to promote public-private sector dialogue, but these often contain only a few investors, raising a risk that they will be dominated by the views of business associations or special interest groups, and not reflect a representative sample of private investor views. Governments therefore frequently use FPC CBP results in such fora to promote a dialogue representing 80-90% of investors.

Nevertheless, some other surveys are a useful complement to FPC CBP surveys – as their questions, aims, samples, end-users and intended policy results are different. For example:

- A global multi-country survey which compares perceptions of transnational corporations can (especially if compared with FPC CBP survey results) help identify the misperceptions and negative biases of less well-informed investors.

- A survey of factors pushing investment out of the exporting economy (such as economic openness, lower real interest rates, adverse macroeconomic environments, fiscal incentives to invest overseas, failing international communication costs, high levels of competition in home country markets, the growth of long-term institutional investors, rising costs in home country financial markets, and positive national savings-investment gaps) can be useful in complementing the FPC CBP survey identification of factors which pull investment into the receiving economy, especially by identifying the timing and magnitude of global capital flows to developing countries; or
- A survey that focuses on the process of starting up a company in micro detail can be very useful to identifying step-by-step barriers to investment.

The main international programmes that conduct perception surveys are UNCTAD, UNIDO, The World Bank and the World Economic Forum (see box).

It is interesting to compare FPC CBP results with those of other surveys, and also with the econometric literature on factors influencing capital flows. As Table 1 shows, the results of global surveys differ considerably from the factors tested in the literature (partly because some of the factors the surveys identify are not amenable to econometric quantification in the literature) For example, higher real interest rates appear from surveys to be a negative factor for investment, because they mean higher cost of local financing. Other factors such as credit ratings and debt prices are not at all significant in investment decisions, due to small local and bond markets.

The FPC CBP survey confirms these findings for the FPC CBP countries. However, when compared with the results for the same group of countries in the WEF survey, it finds some differences: for example, currency devaluation, smuggling, diseases such as HIV/AIDS and malaria, and drought, emerge as important factors from the FPC CBP surveys, whereas labour issues (apart from staff turnover as a result of health issues) do not feature at all prominently (in contrast to WEF). Disaggregating infrastructure issues in the FPC CBP surveys also highlights problems with electricity and telecommunications, but positive results for banking services and Internet provision. Similarly, disaggregating macroeconomic stability reveals that worries centre on inflation and devaluation, whereas financial sector and business environment stability are positive factors. Executed more frequently (every 1-2 years) rather than being dependent on donor financing and therefore less frequent (often once a decade).

Table 1 also shows how the WEF survey emphasises the negative factors preventing investment. This negative impression of countries becomes more pronounced when they 'rank' them compared to others, and contrasts with emphasis in the UNCTAD survey on positive factors such as market size and profitability – both of which also emerge from the FPC CBP surveys as crucial determinants of why investors invest in FPC CBP countries in spite of the negative factors – and of why they intend to increase their future investments.

The final set of questions asked in the FPC CBP survey concerns the information sources investors use in taking their decisions. Its key finding is that companies which invest pay little attention to international publications, relying instead on the views of existing investors, or their own analysis of local conditions. This contrasts sharply with non-investors, who are largely informed by international sources. Given that some of the most widely read international sources are highly negative, it is not surprising

Table 1: Factors Causing Capital Flows

Global Results		FPC CBP Country Results	
Literature	UNCTAD GIPA	FPC CBP	WEF EOS
Economic opening (+)	Market size (+)	Finance cost/access(-)	Finance (-)
Higher real interest rates (+)	Profitability (+)	Inflation (-)	Infrastructure (-)
Improving macro stability (+)	Trade policy (+)	Corruption (-)	Inflation (-)
Fiscal investment incentives (+)	Corruption (-)	Devaluation (-)	Corruption (-)
Credit ratings (+)	Political/economic outlook (+)	Bureaucracy/regulation (-)	Tax rates (-)
Secondary prices of debt (+)	Tax regime (+)	Smuggling (-)	Bureaucracy (-)
Productivity gains (+)	Regulations/laws (+)	Electricity cost/access (-)	Work ethic (-)
Negative savings-investment gap (+)	Investment incentives (+)	Diseases (-)	Tax rules (-)
	Natural resources (+)	Tax burden (-)	Labour skills (-)
	Labour access (+)	Market size/expansion (+)	Crime (-)
	Infrastructure (+)	Drought (-)	Forex regulations (-)
	Business costs (+)	Telecommunications cost (-)	Policy instability (-)
	Financing (+)	Crime (-)	Labour laws (-)
		Financial sector stability (+)	Political instability (-)

UNCTAD: Global Investment Prospects Assessment (GIPA)

www.unctad.org/Templates/Page.asp?intItemID=3341&lang=1

UNIDO: Country Foreign Investor Surveys

www.unido.org/file_storage/download/?file_id=19589

World Bank: Investment Climate Assessments

www.ifc.org/ifcext/economics.nsf/Content/IC-InvestmentClimateAssessments

Administrative Barriers to Investment Surveys, Doing Business Indicators

<http://rru.worldbank.org/DoingBusiness/>

World Business Environment Surveys

<http://info.worldbank.org/governance/wbes/index1.html>

World Economic Forum (WEF): Executive Opinion Surveys (EOS)

www.weforum.org/site/homepublic.nsf/Content/Global+Competitiveness+Programme%5CGlobal+Competitiveness+Report

that low-income countries, especially in Sub-Saharan Africa, receive a lower share of global capital flows than would be expected given their natural resource and market size endowments, low labour costs and high rates of profitability. It is up to FPC CBP country governments and the international community to make more effort to communicate the positive perceptions of existing investors to other potential investors, if the FPC CBP countries are to increase their access to foreign private capital.

DEBT RELIEF TECHNICAL QUESTIONS

IMPLEMENTING UK INITIATIVE ON IDA AND ADF DEBT RELIEF FOR POST-HIPC COUNTRIES

The UK Government is proposing to pay 10% of HIPC's debt service payments to IDA and ADF on the disbursed outstanding debt as of 1 January 2005. This debt service relief will be on payments due, after HIPC relief including topping up, as of 1 January 2005 (i.e. on disbursed outstanding debt as of 1 January 2005) and it will be provided initially for ten years to end-2014. Thereafter it will be reviewed and possibly renewed as appropriate.

The list of eligible countries includes post-HIPC countries (Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Mali,

Mozambique, Nicaragua, Niger, Senegal, Tanzania and Uganda) plus some countries including Armenia and Vietnam, with sufficiently robust public expenditure management systems to ensure that the additional relief aids progress towards the MDGs.

Implications for DSA Implementation in Debt-Pro®

Loans comprising IDA and ADF disbursed outstanding debt, as of 1 January 2005, will need to be categorised separately as eligible debt for this initiative. Effective % debt service reduction for IDA and ADF for 2005-

2014 will need to be calculated for Debt-Pro® reorganisation assumptions.

Table 1 shows how to calculate the annual percentage debt service reduction for ADF and IDA.

Participation by other G7 Countries

The UK's 0% debt service reduction is based roughly on its share in the last IDA / ADF replenishment rounds as shown in Table 2.

If other G7 and the Nordic countries follow the UK's lead, then the final column of Table 2 can be used as an estimate of the relief each will provide. The relevant percentages of participating creditor countries are aggregated and entered in the formulas in Table 1 to obtain the effective percentage reduction for Debt-Pro® reorganisation assumptions.

To date, Canada, Italy and Norway have made positive responses to the UK proposal and simulations could be tested on the basis that these creditor countries will participate starting in 2005. More optimistically, a scenario could assume that other EU and Nordic countries will join starting in 2006.

Possible Additional IMF Relief

There has also been discussion internationally about the provision of additional relief on IMF debt service, funded through the revaluation or sales of IMF gold holdings. It is possible that agreement on this could be reached in 2005 and if so then there will be 100% debt service relief on IMF payments falling due from 2006-2014.

Table 1

	ADF example with 80% reduction	IDA example with X% reduction IDA
Pre-HIPC debt service	100	TDS
minus HIPC debt relief	-80	- TDS*X%
Post-HIPC debt service	=20	=TDS*(100%-X%)
minus UK relief @ 10%	-2	- 10%*TDS*(100%-X%)
Post-UK debt service	=18	=90% TDS*(100%-X%)
Effectively % relief including UK initiative	(100%-18%)=82%	(100%-(90%*(100%-X%)))

Table 2

Country	Share in IDA-13 replenishment	Share in ADF-IX replenishment	Possible % additional relief
Canada	3.75	5.74	4.75
France	6.00	9.35	7.50
Germany	10.30	10.65	10.00
Italy	3.80	5.48	4.50
Japan	16.00	11.24	14.00
UK	10.14	7.01	10.00
US	20.12	15.07	17.50
Total G7	70.11	64.65	68.25
Denmark	1.58	3.83	2.75
Norway	1.52	4.51	3.00
Sweden	2.62	5.10	3.75
Nordic countries	5.72	13.44	9.50

WHAT ARE THE HIPC INTERIM RELIEF LIMITS OF MAJOR MULTILATERAL CREDITORS?

Interim HIPC relief from the World Bank is 50% or more of annual debt service payments (to a maximum of 100% in exceptional cases) up to a limit of 1/3 of the total PV relief to be provided by the Bank. However in special cases, for example if there are significant delays to a country reaching its completion point because its PRSP is taking longer than expected to be finalised and/or implemented and the country is on-track with its Fund programme, then the Bank may agree to a higher limit of up to 50% of total PV of debt relief. However, if a country is off-track with its Fund programme

or there is civil conflict, war etc, the World Bank will suspend interim relief. To date only The Gambia has reached the 1/3 limit on World Bank relief and this has not been increased.

ADF is providing interim relief at 80% of annual debt service payments up to a limit of 40% of the total PV of relief. A number of countries have reached the 40% limit and to date the ADF has not extended its limit and so HIPCs are being asked to service their ADF loans in full until they reach completion point. However, the ADF is reviewing its

current policy with a view to extending the limit on ADF interim relief in some cases. As for the IMF it provides up to 100% annual debt service reduction, not exceeding 60% of the total PV relief (75% in exceptional cases) or 20% of total PV relief in any one year (25% in exceptional cases). To date there has not been a need to reconsider these limits. In practice, the IMF approves interim relief on annual basis as long as a country is on-track with its macroeconomic programme. If it is off-track then the annual tranche of relief is not approved and the country is expected to pay service due.