

STRATEGIES FOR FINANCING DEVELOPMENT

The Newsletter of the HIPC CBP and the FPC CBP



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HIPC MINISTERS: FINANCIAL CRISIS

The 15th meeting of Finance Ministers of Heavily Indebted Poor Countries (HIPCs) was held in Washington on 10 October 2008. The meeting was co-sponsored by the HIPC Capacity-Building Programme, the Commonwealth Secretariat and the Organisation Internationale de la Francophonie.

The meeting was held under the joint chairmanship of H. E. Ali M. Lamine ZEINE, Minister of Finance and Economy of NIGER; and H.E. David CAREW, Minister of Finance and Economic Planning of SIERRA LEONE. HIPC Ministers made important recommendations to mitigate the impact of the global financial crisis on their economies, improve debt relief delivery, assure long-term debt sustainability, finance the Millennium Development Goals (MDGs), and continue to build their debt management capacity.

Global Financial Crisis

Ministers warned that the global financial crisis will have a negative impact on their economies, through many channels, including: falls in remittances and private capital flows; reduced access to and increased costs of bonds, and bank credit lines for trade; falls in stock exchanges; and reduced returns on reserves invested in OECD bonds. Lower OECD demand for commodities could also reduce their export earnings, though oil price falls would benefit oil importers.

In this context, Ministers undertook to be even more vigilant in maximising their own national tax receipts (including from foreign investors) and savings, in increasing the value added and earnings from their exports, and in using all resources mobilised to make maximum contributions to development. At the same time, they urged donors to fulfil their pledges of development financing and urged the Bretton Woods Institutions to

produce comprehensive analysis of the impact of the crisis on low-income economies.

Debt Relief and Debt Sustainability Multilateral Debt Relief Initiative

Ministers congratulated the international community on implementing the Multilateral Debt Relief Initiative (MDRI), and mobilising most of the financing needed for the relief, but

- Urged donors to begin negotiations immediately on a substantial replenishment of the FSO, as well as to provide higher aid levels for poverty reduction in Latin America, to that MDRI funding does not considerably reduce concessional flows in Latin America,
- Indicated that it would be desirable to extend the MDRI to cover the Asian Development Bank, Caribbean Development Bank and other sub-regional institutions.
- Urged the international community to redesign formulas for allocating concessional finance from the Multilateral Development Banks, to take more account of country financing needs for the MDGs.

HIPC Debt Relief

Ministers indicated once again that stronger efforts should be made to accelerate progress to decision and completion points for remaining HIPCs. As delays appear to be due to problems maintaining an IMF track record, they urged the international community to link HIPC progress to PRSPs rather than PRGFs. They also urged rapid movement from IMF EPCA to PRGF programmes for post-conflict countries.

Ministers also noted that there has been little progress on increasing creditor participation in HIPC, or reducing lawsuits by rogue creditors and third parties. Ministers welcomed the legal technical assistance provided by the Commonwealth Secretariat, the proposed support by the AfDB, and the reinforcement of the IDA Commercial Debt Reduction Facility, and urged that these initiatives should be fully coordinated.

Nevertheless, they urged the international community to go beyond such assistance by:

- Establishing a small fund to relieve debts owed between severely indebted and low-income countries, which cannot afford to provide debt relief to one another
- Intensifying efforts to convince non-Paris Club governments to participate
- Convincing a maximum number of creditors not to sell debts to third parties.
- Reinforcing laws in creditor countries to limit or prohibit such lawsuits.

Long-Term Debt Sustainability

Ministers reiterated that they are determined to maintain their debt sustainability by maximising the concessional nature of their new financing, and its effectiveness in promoting development. To this end, they also undertook to implement all the necessary legal and institutional reforms, and to adopt debt strategies through their national parliaments.

Ministers noted that country increases in risk of unsustainable debt had been due to export and climatic shocks, and to changes in World Bank evaluations of country policies and institutions, rather than any renewed irresponsible borrowing. They therefore urged the international community to help them to design comprehensive strategies and provide grant-based financing to protect them against shocks, as well as to switch to a system for evaluating country policies which is more transparent and country-led.

To help them maintain their debt sustainability, they urged that there should be a continuing increase in grants and concessional loans, especially for infrastructure and agriculture; and an improvement in the value-for money of aid. They also urged that the IMF should fix minimum grant elements at 35% except for countries with the most extreme risks of unsustainable debt; and that the Bretton Woods Institutions

MUST NOT JEOPARDISE MDGS

and independent institutions should continue to analyse domestic and private sector external debt, to set guidelines to avoid these types of debt provoking renewed debt crises.

Financing the Millennium Development Goals

Aid Quantity

Ministers expressed disappointment that some members of the international community are not delivering on their promises made in 2005 to increase aid flows, and urged all G8 and EU members to publish 3-year plans to reach their pledges by 2010, preferably before the Financing for Development meeting in Doha.

Ministers urged the international community to scale up innovative financing mechanisms by widening the International Financing Facility beyond the IFFm pilot, and increasing the number of countries utilising an airline ticket tax to fund development. However, they reiterated the need to ensure that such financing is entirely additional to normal funds from national budgets, and allows countries to provide more than 0.7% of their GNI in aid.

Aid Effectiveness

Ministers reiterated their determination to meet all the aid effectiveness targets assigned to them under the Paris Declaration. They welcomed the modest advances in terms of time-bound action commitments made at the Accra High-Level Forum, while regretting that there had not been more progress on aid untying, conditionality reduction, capacity-building and budget support.

Ministers undertook to play a full part in future international-level discussions on issues such as conditionality, assessing their own national systems, and mutual accountability, and urged that the UN Development Cooperation Forum should play a strong role.

At a national level, Ministers committed themselves to formulate and implement

aid policies to encourage maximum alignment by donors, and to holding donors and creditors accountable for compliance with these policies. They also emphasised that in order to ensure such mutual accountability they will require extensive building of their analytical and monitoring capacity at the national, regional and international levels.

Debt Strategy Capacity-Building

Ministers undertook to reinforce their efforts to adopt and implement debt strategies, building on the successful support already provided by the HIPC Debt Strategy and Analysis Capacity-Building Programme. They also undertook to implement the necessary legal and institutional reinforcements, and capacity-building plans, and to continue to provide large amounts of their own funds for such activities.

Ministers welcomed the continuing initiatives by the Bretton Woods Institutions on debt strategy issues through the Low Income Countries Debt Sustainability Framework (DSF), the initiative to help countries design Medium-Term Debt Strategies (MTDS), and the World Bank's Debt Management Performance Assessment tool (DeMPA). However, they urged the BWIs to work closely with the HIPC CBP partners, given their pre-existing experience in these areas, as well as guaranteeing a strong voice for low-income countries in the governance and direction of their initiatives.

Ministers decided to change the name of their network to the Low-Income Countries' Debt Sustainability Network, and to expand their membership to include all low-income countries with debt sustainability problems. They urged the Commonwealth Secretariat, OIF and HIPC CBP partners to hold discussions with a view to jointly organising and financing future meetings. ●

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to assess for themselves their debt and economic policies and design the necessary reforms (as also recommended in the Accra Agenda for Action), rather than having assessments done by external agencies. The key policies should be those which will maximize growth (and poverty reduction which itself enhances growth), rather than stabilization and liberalization.

In terms of lending and borrowing, we need to look beyond concessionality, to the quality and effectiveness of the money provided. We also need to avoid providing poor advice and technical assistance which urges countries to pursue expensive borrowing on international or domestic markets; help LICs to analyse and monitor much more closely the sustainability of domestic debt and how it can genuinely develop local savings and investment, as well as the sustainability of private sector debt and financial flows; and do much more to combat crooks from OECD countries offering fraudulent money, or organizing tax evasion and avoidance. Above all, we need to provide adequate concessional finance for countries to reach the MDGs without expensive borrowing.

What overall lessons have we learned?

Debt relief has produced a lot of benefit for low-income countries, but this could have been (and could still be) achieved less painfully and more effectively. It remains a priority to prevent recurrence of the crisis which provoked the relief in the first place, but if we do not achieve this, further relief will need to be: virtually immediate, low conditionality, offered automatically by creditors based on country debt ratios and risks (rather than negotiated); spent on broadly-defined development and poverty reduction, tracked by national stakeholders; genuinely involving all creditors; and surrounded by better measures to enhance long-term debt sustainability. Only if we learn these wider lessons can debt relief maximise its contribution to the attainment of the MDGs. ●

COMMONWEALTH MINISTERIAL DEBT SUSTAINABILITY FORUM

The Commonwealth Ministerial Debt Sustainability Forum (CMDSF) held its 14th meeting on 6 October 2008 in St Lucia, prior to the 2008 Commonwealth Finance Ministers Meeting. Cameroon, the Gambia, Guyana, Ghana, Malawi, Mozambique, Sierra Leone, United Republic of Tanzania, Uganda, and Zambia attended, as well as representatives from Kenya, Australia and the United Kingdom, and of DRI, MEFMI and WAIFEM. This meeting was chaired by Ashni Singh, Minister of Finance, Guyana.

In view of the close and growing cooperation between the CMDSF and the HIPC GBP Ministerial Network, the newsletter is presenting the main substantive conclusions of the meeting, which were that Ministers:

Resource Mobilisation

- reviewed other developments since their April meeting and noted the donor recommitment to aid increases at the Hokkaido Summit and through the EU. They reiterated the urgent need for delivery on these commitments.
- noted progress with the IMF ESF review, and repeated their call for greater flexibility in its design and application, especially in relation to expanded access and less onerous conditionality.
- reiterated the need for timely commencement and conclusion of negotiations for the replenishment of the Fund for Special Operations within the Inter-American Development Bank.

HIPC Issues

- remained concerned that there had been no change in the number of countries reaching HIPC completion and decision points, and hardly any progress on issues of non-Paris Club participation in the HIPC Initiative, or on creditor litigation; as well as that under the Debt Sustainability Framework (DSF), a significant number of post-Completion Point countries will continue to remain in a moderate or high risk of debt distress.
- agreed on several actions to be taken to enhance information exchange on debt relief negotiations under HIPC including the preparation of more detailed information for HIPCs on creditor participation,

best possible relief terms and litigation experiences to be presented at the April 2009 CMDSF to assist countries in their negotiations.

Role and Membership

- agreed that CMDSF discussions should continue to stress debt sustainability and the ability to utilise borrowing productively to achieve the MDGs, which will mean aligning debt sustainability analysis with MDG scenarios, delivering donor commitments on aid quantity and effectiveness, and maximum concessionality in other finance to achieve the MDGs without compromising debt sustainability.
- reviewed various options for extending CMDSF membership to other Commonwealth countries, taking into account the income level and debt sustainability of Commonwealth states. They agreed that the membership should consist of the 12 existing members of the CMDSF, as well as IDA-Only Countries with Unsustainable Debt (Lesotho, Solomon Islands, and Tonga). Other countries with unsustainable debt would be invited to participate if they express an interest in doing so.

Future Work Programme

- agreed on the following action papers to be discussed at the April 2009 meeting:
 1. debt strategy capacity building needs and how to fulfill them sustainably;
 2. enhanced actions and information exchange on creditor participation or litigation;
 3. diversifying concessional and non-concessional financing sources;
 4. how the international community can better assist in mitigating shocks, notably those from climate change, high oil and food prices, and the current global financial crisis; and
 5. best practices in ensuring fiscal sustainability of total (including domestic) public debt.
- identified two priority advocacy issues to take forward over the next six months:
 1. Ensuring that debt relief provides additional concessional resources to finance the MDGs, and does not come at the expense of new concessional flows, by
 - i. allocating concessional resources on the basis of MDG-related needs, as well as performance, in particular by

adjusting the PBA formulas of IDA and the Regional Development Banks;

- ii. starting and concluding negotiations urgently on a replenishment of the IADB FSO.
 - iii. holding donors to their promises to meet their 0.7% GNI commitment, by advocating that donors establish or stick to clear timetables.
2. Lobbying for increased creditor participation in debt relief, by:
 - i. changing laws in creditor countries to restrict prospects for litigation by creditors;
 - ii. G8 members launching top level diplomatic initiatives to convince non-Paris Club bilateral creditors to participate;
 - iii. donors providing assistance to clear HIPC to HIPC debt; and
 - iv. all Commonwealth creditors providing full relief and commit not to sell on their claims to other creditors.

Co-operation with Non-Commonwealth HIPCs

- agreed that there should be continuing collaboration with the Organisation Internationale de la Francophonie (OIF), and participation and contribution of Ministers from non-Commonwealth HIPCs in the substantive CMDSF meetings in Spring each year. They noted that both groups shared common concerns and therefore could share experiences and, by combining forces, strengthen advocacy in the international forums, by exploring the possibility of a joint meeting in Spring 2009.
- supported participation by special invitation of representatives of Commonwealth and other donors, international and regional institutions, civil society, parliamentarians and capacity building institutions. ●

As a result of the debt relief provided by HIPC and MDRI initiatives, as well as rapid economic growth in recent years, Honduras' external debt burden has fallen dramatically, from 62% of GDP in 2000 to only 17% in 2007. This new situation has been accompanied by progress on public debt management, including publication for the first time in 2008 by the Honduran government of a three-year "Public Debt Policy". This sets out the channels and conditions for government financing through the international and domestic markets, placing particular stress on moving towards alternative sources of capital market financing, while keeping debt sustainability as a fundamental goal.



In this context, the Honduran government asked CEMLA to help conduct a workshop to update the National Debt and New Financing Strategy, from 22 to 29 September, in the framework of the HIPC CBP. The participants were 29 technical officials from various public sector institutions, aiming to build the capacity of the national technical team and revise and update the National Debt Policy and Strategy.

DSA Scenarios

The sustainability analysis was based on two scenarios:

- **Baseline:** macroeconomically, this continues current policies (in accord with the IMF standby), which will produce GDP growth of 4.3-4.8%, and a consolidated public sector fiscal deficit of around 1% of GDP, while keeping anti-poverty expenditure at 7% of GDP. The external debt scenario includes only the relief signed by 31 December 2007, while that for domestic debt includes budget gap-filling as well as refinancing of expected maturities. New external financing includes disbursements on signed agreements, as well as loans being negotiated (notably through the ALBA and Petrocaribe initiatives with Venezuela), as well as an assumption that Honduras will lose access to concessional financing over the medium-term – with the average grant element falling from 35% to 11%, and a fall in grants.
- **Pessimistic:** the alternative scenario assumes a negative shock to the main macroeconomic variables, based on more

pessimistic global prospects (especially for the USA) as a result of the financial crisis, because approximately 80% of Honduras' exports go to the US.

Main Conclusions and Recommendations

1. Honduras' public external debt will stay sustainable and well below the LIC-DSF thresholds established by the BWIs for countries with "strong" policies. Total public debt stays low and stable and, in spite of a slight upward trend over the medium-to-long-term, its sustainability indicators stay well below those for external public debt, showing clear sustainability for total public debt.
2. In terms of risks, the maturity periods of external financing are almost entirely (95%) over 15 years, even over the medium-term. The interest rate structure of the portfolio is also low-risk, because more than 90% is fixed –interest and only 9.4% floating. No significant change is foreseen over time in maturity periods or interest structure.
3. The alternative scenario produces deterioration in the debt sustainability indicators, due to the high central government deficit and less favourable global macroeconomic context. Nevertheless, the indicators stay sustainable, largely due to recent debt relief, economic growth and prudent fiscal management.
4. In analysing new financing policy, Honduras identified that most donors are supporting

the government's priority sectors, but there is a need to increase budget and sector support, based on the government's own results-oriented framework for expenditures to increase ownership and alignment.

Capacity Assessment

Honduras' self-assessment of debt management capacity, using the methodology of phase 4 of the HIPC CBP, found that its average score was 3.84, among the HIPCs with the highest capacity. Nevertheless, the assessment underlines some future challenges:

- Improved coordination at political and technical levels.
- Execution of links between debt and financial management softwares
- Inter-institutional coordination to agree common criteria for classifying expenditures as "poverty-reducing".
- Strengthening national budget and public investment systems.
- Extending risk analysis to the whole economy, especially the non-central government public sector, to conduct a comprehensive portfolio risks analysis.
- Training new personnel in debt management and analysis.

Next Steps

Following the event, the report on the workshop and the proposal for Public Debt Policy Guidelines were sent to the relevant government authorities, so that the executive can approve the Public Debt Policy for 2009-2012. ●

MEFMI'S EXPERIENCE OF DSAs USING THE DSF



During the last two years, MEFMI has been working closely with the Bretton Woods Institutions, DRI and country authorities to increase country capacity to use the BWIs Low Income Country Debt Sustainability Framework (LIC-DSF) tools. This has included a regional workshop on the DSF for its member states, as well as intensive training in using the tools in national workshops. This article summarises the lessons learned, with a particular focus on two recent national workshops, in Tanzania and Uganda, as well as the way forward. It focuses on two issues – inputs and outputs.

1. Data Input

The main conclusion of work on inputs is that the DSF needs to be complemented by other tools which allow countries to forecast their financing strategies and macroeconomic prospects, and produce debt data projections, because the DSF tool does not construct forecasts. In turn this implies the need for excellent tools to conduct forecasting, and for comprehensive training at the national level. During both workshops, officials spent 5 days using HIPC CBP tools and national macroeconomic models to prepare forecasts, as well as downloading data from CS-DRMS and DMFAS debt recording systems, and validating these data, before inserting data into the DSF template. A comprehensive DSF training should, therefore, start with training on other tools which will produce realistic forecasts, before work on the DSF template begins.

In more detail the practical implications for MEFMI capacity-building programmes are:

1. **macroeconomic forecasts.** In several MEFMI member states (including Uganda and Tanzania), very few officials have expert knowledge of the tools used by their country to design macroeconomic forecasts. They are also more used to using the tools to prepare three- or five-year forecasts related to IMF financial programming or national development

strategies, than to designing 20-year multiple scenarios to test debt sustainability. This is not a sustainable situation and the countries have been urged to develop skills of staff in macroeconomic forecasting.

2. **debt databases.** In spite of intensive preparations focussed on data issues, the workshops have found continuing problems with debt database systems forecasting debt stock and service with accuracy. Improvements will require the regular maintenance and validation of databases, training in how to download debt data to the DSF, and construction of automatic links between CS-DRMS/DMFAS and the DSF. In cases where databases have not been fully updated for the effects of HIPC/MDRI debt relief, use of Debt Pro® is necessary to simulate such effects.
3. **financing strategies.** The CBP tools for designing new external and domestic borrowing strategies, and forecasting their impact on external and domestic debt data, have recently been updated (see newsletter 26) and were in both cases used effectively to design and simulate strategies. However, staff will continue to need training in the knowledge and skills to run these tools as well as the DSF template.

2. Outputs

The second main set of conclusions revolves around the DSF's usefulness in helping countries to design borrowing strategies. In both cases, DSF-based analysis revealed that, debts remained sustainable according to DSF thresholds over the long-term regardless of the borrowing scenario chosen, even with the most extreme foreseeable borrowing terms. On the other hand, different borrowing scenarios resulted in very heavy future debt service requirements, as well as dramatic changes in likely risks. This raises the question of whether a debt sustainability analysis is adequate for gauging the likely difficulties that countries may face with their public debt. Both workshops concluded that the DSF tool is good for establishing basic sustainability ratios, but additional analysis of fiscal and balance of payments implications is necessary before any decisions can be taken on financing strategies. It is also vital to assess the practicalities of accessing different types of financing, and tailoring such analysis to key issues currently facing the country, which is why both workshops spent much time

analysing the relative costs and benefits of issuing bonds on international or domestic capital markets (including prospects for international bond issuance given the current global financial crisis, and the capacity of the domestic financial and private sector to absorb domestic bonds).

Another key concern about the DSF is that its stress tests do not measure adequately the shocks and risks to which MEFMI LICs are exposed. In particular, the DSF stress tests are only applied once over 20 years, whereas MEFMI LICs have been subject to repeated shocks (each of which has medium-term impacts) over a 20-year period. A good example is droughts, which have reduced output and exports regularly in Southern African countries, and necessitated additional food imports, with medium-term effects lasting three years, and frequency varying between 2 and 5 years. For the DSF to be relevant to country decisionmaking, it will be essential to assume shocks which depict real country experiences. In the DSF there is a sheet that provides flexibility to incorporate country circumstances, and the TtT planned for April 2009 will focus on use of this sheet.

Future Plans

MEFMI member states remain committed to building capacity to design and implement national debt strategies, as has been shown by their cofinancing of recent national events up to 80% of total cost. As a result, MEFMI intends to accelerate its efforts at full transfer of the LIC-DSF to its member states. The next steps will be:

- Attachments in February 2009 to work with DRI in developing a manual for training trainers on the DSF.
- A regional DSF Training of Trainers Workshop to be held jointly with WAIFEM, the IMF/World Bank and DRI in Abuja in April 2009. In line with the lessons learned above, this workshop will begin with a week of intensive training of trainers in how to prepare forecasts using other tools, for input into the DSF; and will focus above all on financing issues and country-relevant macroeconomic scenarios. ●

20 YEARS OF DEBT RELIEF: WHAT HAVE WE ACHIEVED?

The World Bank organized a conference on 30-31 October in Washington, on Debt Relief and Beyond (see <http://www1.worldbank.org/economicpolicy/debtconf08/DebtConferencehome.asp>). Debt Relief International gave a presentation looking at what 20 years of debt relief have achieved, and lessons for the future. The presentation was of course based on the many inputs from HIPC Ministers and debt managers received over the course of 18 years of work by DRI on low-income country debt relief. It asked seven questions:

Is debt relief effective aid?

Debt relief has proven to be highly effective aid. In the format in which it has been recently delivered (as genuinely additional relief for country budgets, eg through the MDRI), it respects the Paris Declaration and Accra Agenda for Action principles more even than budget support, because it: disburses rapidly and predictably; is untied; is aligned with national development strategies; the resulting spending uses country systems; it has fewer (though still too many) transaction costs than negotiating new aid programmes and projects; and above all, as shown in a forthcoming study DRI has conducted with the African Development Bank, it achieves strong MDG results.

What conditions should be put on relief?

It has been agreed for many years by most international analysts that conditionality does not work. The view of HIPCs would be that the only conditions should be:

- Design and 1-year implementation of a strategy for growth and poverty reduction (broadly defined to go beyond the social sectors) – perhaps a preliminary strategy for initial relief, and a more final strategy for definitive stock cancellation;
- Commitment demonstrated by government to growth and macroeconomic stability eg single-digit inflation, demonstrated by a 6-month track record and agreement to a future growth and macroeconomic stability programme. This should involve rapid movement of countries from emergency assistance to normal programmes, so that they do not get “stuck” in a “post-conflict” classification, delaying relief for many years.
- Respect for basic international norms on human rights, gender, the environment and democratic government

- Beyond this, all detailed macroeconomic or structural targets, and especially micro-managing conditions should be avoided.

Should relief be spent on poverty reduction?

Yes, but (according to the AfDB study already mentioned), poverty reduction should be:

- Broadly defined – covering a wider range of MDGs (not just health and education, but water, social protection, the environment, food security, housing) and national development goals especially growth-promoting expenditures (such as power and transport infrastructure, agriculture, technology).
- With priorities defined by the country, not micro-managed by donors
- Focussing on improved public service delivery to citizens – not just on increasing the amount of spending
- Accompanied by increased and highly effective aid (such as budget support) – because by itself its scale is too small to make much impact on poverty reduction.

Should we invest more to track relief and its results?

Micro-managed tracking of the impact of debt relief should be avoided. Much more resources should be invested in tracking the channels and impact of wider expenditures – but not in reporting to donors and creditors (for which heavy obligations already exist). Instead donors should focus on supporting tracking and assessment of expenditures by domestic accountability structures – such as parliament, auditor-generals, civil society, by building their capacity to hold government accountable, which can have fundamental positive effects on the impact of debt relief and wider expenditures on MDG progress.

How can we enhance creditor participation?

Creditor participation has come a long way in the last 20 years – it is easy to forget that 20 years ago relief by multilateral creditors was regarded as impossible! However, the international community could do much more, especially extending debt relief to a much wider group of low- and middle-income countries where it could be a useful tool to help attain the MDGs. This could be creditor-led, to enhance developing country creditworthiness, and would be a highly efficient means of funding the MDGs.

In terms of the narrower challenge of creditor participation in the HIPC Initiative:

- Donors could fund the cancellation of debts owed among severely indebted LICs
- More systematic legal assistance could be provided to avoid or defend lawsuits
- All creditors could make commitments not to sell on debt – extending beyond the welcome Paris Club and EU commitments to other governments and commercial
- G8 heads of state could act bilaterally to convince governments, especially those over which they have leverage in current bilateral discussions (Algeria, Iraq, Libya)
- They could also reinforce laws in creditor countries to prevent lawsuits (this is feasible without any negative impact on commercial law, but political will is lacking)
- HIPCs and LICs can exchange information on best terms received, to push creditors to give such terms to all debtors.

Is debt relief the answer to sustainable debt?

Obviously not, but it is a vital step because it: reduces the fiscal burden, encouraging public investment; reduces the debt overhang, encouraging private investment and growth; widens access to private sector financing; and allows higher spending on growth and poverty reduction which reinforces longer-term debt sustainability. The international community should therefore be encouraging access to relief, by making it more automatic, provided for more countries, and before they reach crisis or default.

However, other measures are needed. Recent BWI analysis has found that continuing unsustainability risks for HIPCs post-relief are due largely to potential exogenous shocks (which are now materializing in the global economic downturn) and falls in policy quality, rather than “irresponsible borrowing”. This implies that, in addition to avoiding “irresponsible lending and borrowing”, we need to put more stress on overcoming countries’ structural economic weaknesses and improved economic and debt management.

In terms of protecting countries against shocks, countries need to design (and donors to fund) comprehensive anti-shock strategies and contingency funds, and the international community to provide much more substantial and rapid financing facilities to support these. To improve policy quality, countries need

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HIPC PROGRESS AND DEBT SUSTAINABILITY STATUS NOVEMBER 2008

This table has been revised to include HIPC's rankings according to the BWI's IRAI (formerly CPIA) indicator of policy performance and institutional strength and debt distress, incorporating the new DSF-based DSAs and used as the basis for countries' IDA.

Countries	HIPC II Dates		PRSP Dates		HIPC Initiative	IRAI ranking of policies and institutions ¹	Latest risk of debt distress ²
	Decision	Completion	Interim	Final	Creditor Participation		
Afghanistan	7/07	end-2009	1/06	June 2008	87%	Weak	High
Angola	no longer eligible		2005	...	NA	Weak	Moderate
Benin	7/00	3/03	7/00	3/03	99%	Medium	Moderate
Bolivia	2/00	6/01	2/00	6/01	95%	Medium	Low
Burkina Faso	7/00	4/02	5/00	7/00	76%	Medium	High
Burundi	8/05	early 2009	1/04	9/06	84%	Weak	In debt distress
Cameroon	10/00	05/06	10/00	7/03	98%	Medium	Low
Central African Rep.	09/07	mid-2009	1/01	6/07	68%	Weak	In debt distress
Chad	5/01	end 2009	7/00	7/03	93%	Weak	High
Comoros	end 2009	...	05/06	Q1 2009	NA	Weak	In debt distress
Congo, Dem. Rep. of	7/03	2009	6/02	7/06	93%	Weak	In debt distress
Congo, Rep. of	03/06	2010	12/04	Apr-08	60%	Weak	High
Côte d'Ivoire	end 2008	...	3/02	Q4 2008	NA	Weak	In debt distress
Ethiopia	11/01	4/04	3/01	9/02	92%	Medium	Moderate
Gambia	12/00	Dec-07	12/00	7/02	81%	Weak	High
Ghana	2/02	7/04	8/00	4/03	90%	Strong	Moderate
Guinea	12/00	end 2008	12/00	3/07	85%	Weak	In debt distress
Guinea-Bissau	12/00	mid-2009	12/00	11/06	81%	Weak	In debt distress
Guyana	11/00	12/03	11/00	9/02	81%	Medium	Moderate
Haiti	10/06	mid-2009	11/06	delayed	96%	Weak	High
Honduras	7/00	4/05	7/00	10/01	93%	Strong	Low
Kenya	no longer eligible		8/00	2/04	NA	Medium	Low
Laos PDR	no current timetable		4/01	12/04	NA	Weak	High
Liberia	03/08	2010	1/07	03/08	NA	Weak	In debt distress
Madagascar	12/00	10/04	12/00	11/03	91%	Medium	Low
Malawi	12/00	09/06	12/00	8/02	97%	Medium	Moderate
Mali	9/00	3/03	9/00	3/03	85%	Medium	Low
Mauritania	2/00	6/02	NA	1/01	90%	Weak	Moderate
Mozambique	4/00	9/01	4/00	9/01	88%	Medium	Low
Myanmar	no current timetable		no PRSP process		NA	Weak	High
Nicaragua	12/00	1/04	12/00	9/01	87%	Strong	Moderate
Niger	12/00	4/04	12/00	2/02	86%	Medium	Moderate
Rwanda	12/00	4/05	12/00	8/02	95%	Medium	High
São Tomé & Príncipe	12/00	3/07	4/00	8/05	85%	Weak	High
Senegal	6/00	4/04	6/00	12/02	81%	Medium	Low
Sierra Leone	3/02	12/06	9/01	7/05	87%	Weak	Moderate
Somalia	no current timetable		no PRSP process		NA	Weak	High
Sudan	no current timetable		2007	NA	Weak	In debt distress
Tanzania	4/00	11/01	3/00	12/00	90%	Strong	Low
Togo	11/08	end 2010	03/08	Mid 2009	90%	Weak	In debt distress
Uganda	2/00	5/00	NA	5/00	96%	Strong	Low
Vietnam	no longer eligible		4/01	6/02	NA	Strong	Low
Yemen	6/00	...	2/01	8/02	NA	Medium	Moderate
Zambia	12/00	4/05	7/00	5/02	97%	Medium	Low
Potential HIPCs							
Eritrea	no current timetable		6/03	NA	Weak	na
Kyrgyz Republic	decided not to apply for HIPC		...	02/03	NA	Medium	High
Nepal	no current timetable			11/03	NA	Medium	High

Sources:
HIPC Governments,
IMF and World Bank

¹ World Bank IDA Resource Allocation Index (IRAI), formerly Country Policy and Institutional Assessment (CPIA), which is used to assess countries' institutional strength and policy performance (Strong ≥ 3.75 , medium 3.25-3.75, weak ≤ 3.25).

² This is based on latest DSA done jointly by BWI

³ Blend and gap countries are not eligible for IDA grants.

IDA-15 grant allocation for FY09	Key Debt Relief and New Financing Issues
100%	Progress on completion point triggers has been mixed
0% ³	Reclassified as a 'gap' country, no longer eligible for IDA grants
50%	Debt committee established and strategy approval due
0% ³	Sustainability vulnerable to gas price & production; significant growth of domestic debt
50%	Strategy approved. High PV/exports ratio due to lower than expected exports
100%	Strategy updated. IDA, ADB, Paris Club providing interim relief and promise of relief from EU
0%	Strategy drafted. Facing several lawsuits
100%	IMF interim relief. Arrears to IFAD and OPEC to be dealt with as part of HIPC
100%	Poor PRGF performance delays CP. SMP discussions started
100%	Resolution of political crisis. EPCA programme under discussion
100%	Progress on completion point triggers has been mixed
100%	Mixed progress on CP triggers. Lawsuits settled in favour of creditors
100%	DP awaiting new PRGF being concluded
50%	Government concluded DSA. Still to conclude with some non-Paris Club creditors
100%	High post-MDRI debt due to multilateral and non-Paris Club borrowings
0%	MTDS draft prepared. US\$750m 10-year bond at 8.5% issued on international markets
100%	Interim relief resumed end-2007 with new PRGF
100%	Only IDA & AfDB providing interim relief. Lobbying donor community to advance CP
50%	Government strategy drafted. High vulnerability of fiscal sustainability
100%	Political and hurricane shocks have delayed PRSP and donor conference
0% ³	Strong debt strategy. Guatemala & Mexico refuse to provide relief; agreements with Costa Rica & commercial banks pending; Argentinian Enterprise lawsuit
na	DSA shows ratios under HIPC thresholds. PC Houston terms relief
100%	Despite eligibility, government does not wish to participate in HIPC
100%	Strategy approved. Exceptional funding to clear arrears accounting for 96% of \$4.7bn debt
0%	Cancellation of Abu Dhabi and PRC debt to be finalised
50%	Debt and aid strategies approved. Kuwait relief to be negotiated
0%	Draft strategy. Difficulties with non-PC creditors
50%	Debt strategy approved. Unsustainable due to lack of relief from Arab creditors
0%	Debt strategy being finalised. Agreements with China, Kuwait and South Africa
100%	No WB lending since 1987
50%	Strong debt strategy & borrowing ceiling. Successful commercial debt buy back. Non-PC relief & lawsuits remain challenges
50%	No agreement with non-Paris Club creditors. Taiwan won lawsuit
100%	Debt strategy ceilings on new borrowings since 2006. Policy document being finalised
100%	Approved debt strategy. Sustainability vulnerable to delays in oil production
0%	DSA supporting budget since 2005. Benefited from non-PC creditors relief
50%	Strategy drafted. Lawsuits for US\$26 m settled
100%	Accumulating large arrears to creditors. No IMF arrangements since 1987
100%	IMF urged to minimise non-concessional borrowings. Need to clear arrears
0%	Debt strategy annually updated. Relief from Algeria, Angola, Iran and Zambia to be negotiated
100%	Qualifies with PV/revenue=309%, following arrears clearance
0%	Strategy and ceiling on new borrowings, some nonconcessional borrowing for infrastructure
0%	Debt ceiling for public debt/GDP of 50% by 2010
50%	Ratios under HIPC thresholds so Paris Club Naples stock treatment
0%	Donegal lawsuit has resulted in payment to be made
100%	Potentially qualify with PV/exports of 362%
100%	Debt ratios at end-2006 are below HIPC thresholds
50%	Potentially qualify with PV/exports of 201%. Authorities undecided about HIPC participation

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

Advocacy and Liaison

15th HIPC- CBP Ministerial Meeting 10th October

This took place in Washington with the co-sponsorship of the OIF and Commonwealth Secretariat, and focussed on the global financial crisis.

[See article on pages 2 and 3](#)

Commonwealth Ministerial Debt Sustainability Forum Meeting

As part of the wider preparation for these meetings, DRI and MEFMI made inputs at this meeting in St Lucia on 6 October.

[See article on page 4](#)

Cooperation with the Bretton Woods Institutions

All of the CBP implementing partners have been invited to be implementing partners, and members of the Technical Advisory Group, for the World Bank Debt Management Facility (DeMF), which was preliminarily launched at the World Bank Conference, Debt Relief and Beyond, in Washington on October 30-31, and launched formally at the FfD meetings in Doha in November. This will involve participating with the World Bank in joint assessment meetings on country debt management capacity, and providing technical advice (together with the Commonwealth Secretariat and UNCTAD debt management programmes) on the priorities and execution of these assessments and any resulting reform plans. Four low-income countries will also be included in the advisory group, one from each of the regions of the CBP. Precise funding and cooperation agreements will be finalised during the first quarter of 2009. Three of the CBP donors (Austria, Canada and Switzerland) are among the funding donors of the DeMF, allowing for close liaison between the World Bank's work through the DeMF and the continuing post-HIPC CBP programmes of the regional organisations.

In addition, the CBP partners have continued to participate in DeMPA missions, organise joint DSF regional workshops with the IMF and World Bank, and participate in Medium-Term Debt Strategy missions, as well as providing considerable technical input on the design and implementation of the DeMPA, DSF and MTDS tools – and ensuring that CBP methodologies provide the inputs necessary for successful country use of the BWI tools. They are also beginning joint work on preparing Training for Trainers workshops for combining the CBP and DSF methodologies (see future work below).

Governance

20th Steering Committee Looks Beyond Phase 4

The HIPC CBP's 20th Steering Committee Meeting took place in Dar es Salaam during 3-5 November, hosted by the Government of Tanzania and MEFMI. It focussed on two sets of issues: progress towards meeting the targets set by donors for phase 4, and prospects for sustainability of the HIPC CBP's achievements beyond phase 4.

On the first set of issues, the SCM agreed that the programme was largely on track to meet its phase 4 targets, indicating that the HIPC CBP will have achieved a massive increase in HIPC debt strategy and analysis capacity during its 11 years of existence. In addition, as attested by an independent monitor, regional organizations have developed capacity to lead the provision of capacity-building support, including pools of experts and trained staff, thereby achieving most of the CBP aims for decentralisation of programme execution. Nevertheless, there have been delays in implementation in some regions and countries, raising the question of whether ROs can absorb donor funds fast enough.

Beyond phase 4, the HIPC CBP donors made clear that they continue to be committed to support the building of country capacity on debt strategy and analysis, by providing substantial funding for independent country-led work. Demonstrating the success of the CBP in decentralising its leadership, this will in future be led by regional organisations, who will receive the funding from donors. HIPCs indicated strong commitment to debt strategy capacity-building and urged donors to continue to fund independent support for debt strategy via regional organisations. This will require three elements of sustainability:

- sustainable country capacity, for which the main challenges are staff turnover and post-MDRI debt sustainability;
- sustainable capacity by regional organisations to provide capacity-building support, and
- maintenance of a multi-regional network of independent providers of services to HIPCs and other LICs, with regional organisations leading this provision.

National Workshops

Burundi Bujumbura, 8-19 September



This was the second national workshop on debt and new financing strategy – the first having resulted in an approved strategy in 2006. As well as government agencies, civil society participated through the NGO

Inter-Africa, to maximise ownership of the strategy and prepare a national sensitisation campaign on debt issues for October 2008. The workshop designed strategies for debt reduction and for financing Burundi's future development without compromising debt sustainability. Based on continued very weak export performance, the workshop estimated that Burundi would need additional "topping up" at completion point of US\$89.9 million, with a common reduction factor of 37.2%. As a result of HIPC and MDRI debt relief, anti-poverty expenditure would rise from 3.6 to 17.7 times debt service expenditure in 2009. Burundi would also need to mobilise virtually exclusively grants to keep its debt sustainable thereafter, requiring it to diversify its development partners to increase grant flows, as well as to design strong mechanisms to protect it against exogenous shocks, given its very fragile export, GDP and revenue bases. The participants also prepared a plan for building debt and aid management capacity.

Honduras National Workshop 22-29 September [See article page 5](#)



Tanzania National Workshop 10-21 November [See also article page 6](#)



This workshop was part of the HIPC CBP's intensive assistance programme for Tanzania conducted at the request of the Tanzanian authorities. Tanzania being a post-MDRI country, the focus of the Government's aid and debt policy is on resource mobilization to finance infrastructural development and achieving effectiveness of development financing and ensuring effective domestic debt management. In addition, the Government aims to maintain long-term debt sustainability, in a post-MDRI context, by updating the national debt strategy document.

The workshop also provided comprehensive training to government officials in the analysis of debt strategy using CBP tools and the DSF, to ensure maintenance of a sustainable team capable of updating debt strategy analysis regularly, with minimal external technical assistance for the foreseeable future. During the workshop Tanzania used 6 local experts to lead in the various tasks. MEFMI provided 2 members of staff and one graduate fellow from Malawi, and DRI 1 expert to facilitate the workshop. The government of Tanzania co-financed a large proportion of the workshop cost.

Prior to the workshop there were intensive meetings in preparation by the country DSA

FORTHCOMING ACTIVITIES

team. The Tanzanian authorities indicated the need for the workshop to focus on the possibility of issuing sovereign bonds on either the international bond market or the domestic capital market, to finance infrastructure programmes. The results revealed that, though the country would remain sustainable in the long-run under all scenarios, there would be a heavy cost on the budget for issuing the bond on either market, as well as concern as to whether the domestic market could absorb a large bond.

Institutional/Follow-up Missions

Follow-Up Missions to Congo

14-22 September



Niger

22 September-1st October



Togo

20-29 October



The main objective of these missions was to strengthen the capacities of the national structures responsible for coordinating debt policy with macroeconomic policy. Each mission trained the national team members in basic debt management concepts, as well as the key stages of the design of coherent national macroeconomic forecasts and long-term national financing strategies.

Cameroon & Guinea DEMPA Assessment Missions



4-13 August and 29 September-7 October

These missions were conducted in the context of Pole-Dette's cooperation with the World Bank, in order to maximise coordination between the World Bank's assessments of country capacity and the national capacity-building plans designed by the country authorities and Pôle-Dette.

Rwanda 6-7 November



MEFMI conducted a mission to Rwanda to review progress towards the adoption of a national Debt Policy Document. It was agreed that MEFMI and DRI would jointly conduct a mission in mid-2009 to finalise the adoption of the debt policy through technical work and a sensitisation seminar for policymakers.

Methodology, Distance Learning and Attachments

Methodology

Work is beginning on the design of training for trainers manuals for the LIC-DSF, led by DRI in

cooperation with regional partners and the World Bank. DRI is also conducting studies on:

- the fiscal sustainability of debt (together with CEMLA);
- information-sharing on debt relief and new financing, and country debt strategy capacity-building needs (together with the CBP partners and the Commonwealth Secretariat); and
- diversifying financing sources for national development, with particular focus on non-OECD donors and market-based financing sources.

Distance Learning Programme

Most of the second Phase 4 intake of 40 students continues to be on track with their studies, with only a few being behind mainly because of heavy work commitments. The participating countries are Burundi, Cameroon, CAR, Cote d'Ivoire, Ethiopia, Ghana, Malawi, Nicaragua, Rwanda, Sierra Leone, Tanzania, Togo, Uganda and Zambia. The residential workshop to graduate the first Phase 4 intake of students in the Pôle Dette region is taking place in December 2008 in Senegal. The residential workshop for Lusophone countries will be in the first quarter 2008.

Attachments

Two Pôle Dette staff members have been on attachment to work on external debt strategy issues with DRI consultant Michel Vaugeois in Washington.

HIPC Website

New debt strategy analysis sections have been added to HIPC CBP website (www.hipc-cbp.org). On the public site there are new Debt Strategy Analysis (DSA) pages which provide information on the HIPC CBP approach to conducting debt strategy analysis, as well as links to the recent IMF and World Bank initiatives such as the Low-Income Country Debt Sustainability Framework (LIC-DSF) and Medium-term Debt Strategy (MTDS).

On the private members' only site, there is a new webpage which provides more detailed information on using the standardised DSF for conducting strategy analysis, including CBP prepared documents linking the HIPC CBP methodology with the DSF. As discussed in the MEFMI article on page 6, it remains essential to use the CBP domestic and external new financing templates, as well as Debt Pro[®], in order to prepare accurate inputs for the DSF.

Future Activities

During the next six months, the HIPC CBP will implement the following activities:

- **Regional Workshops:**
CEMLA DSF/DEMPA Regional Training for Trainers Workshop; MEFMI and WAIFEM Regional DeMPA Training for Trainers Workshops; MEFMI/WAIFEM Joint Regional Debt Strategy and DSF Training for Trainers workshop; PALOP Regional Workshop; Pôle Dette Debt Strategy and DSF Training for Trainers Workshop, Domestic Debt Regional Workshop, as well as meetings of the Regional Ad Hoc Committees on a Regulation on Public Cash Flow Management, and Generic Procedures Manuals;
- **National Workshops:**
Guinea; Guyana; Mozambique; Nicaragua (domestic debt); Sao Tomé e Príncipe; Sierra Leone.
- **Subnational Workshops:**
Bolivia
- **Institutional/Follow-up Missions:**
Benin; Burkina Faso; Cameroon; CAR; Chad; Comoros; Congo; Côte d'Ivoire; Guinea; Guinea Bissau; Guyana; Haiti; Honduras; Liberia; Malawi; Mali; Mozambique; Niger; Togo; and Zambia.
- **Sensitisation Seminars:**
Guinea; Guyana; Honduras; Malawi; Mozambique; Nicaragua; Rwanda.
- **Attachments:**
MEFMI and Pole Dette attachments to DRI to develop training manuals for the DSF TTT Workshop; Pôle-Dette Fellows attachments on new financing, domestic debt and external debt.
- **Distance Learning Programme:**
Lusophone Residential School, continuation of the work of the second wave of students, and revision of materials for post-phase 4.
- **Information products:**
Newsletters 37 and 38, 3 listserves on latest debt management developments, and publications on best Practices in Debt Management Institutions, and Fiscal Sustainability of Debt.

The excellent news emerging from the 9th Steering Committee Meeting of the FPC CBP, is that the Swiss government is prepared to extend its funding for the monitoring and analysis of Foreign Private Capital, as conducted under the FPC CBP. However, in future this funding will be mobilised and run via regional organisations, owned and led by their member states, who will subcontract DFI to help with technical support. This extension of Swiss support reflects the assessment that the programme is even more relevant at a time of global financial crisis when such flows are likely to be even more volatile (see article on pages 2 and 3), and could also result in the extension of FPC CBP-type support to a wider range of middle-income countries with which the Swiss government has partnerships. It is hoped that a wider range of donors will also realise the valuable support the FPC CBP work has been providing, and provide funding for the same aim.

In the meantime, the 3rd phase of the FPC CBP has continued as follows:

Country progress

Countries have progressed as follows:

- Benin held its Opening Awareness and Training Workshop (OAT) in October and is planning a Follow Up Mission (FUM) in Q1 2009
- Congo and Gabon are preparing their first OAT Workshops for Q1 2009
- Bolivia (Cycle 3) is designing terms of reference for a follow up mission to review time series early in 2009
- Botswana (Cycle 1) is finalizing methodology to launch in Q1 2009
- Burkina Faso's response rate has reached 60% and a FUM is planned for Q1 2009
- Cameroon has completed its survey and will receive a FUM in Q1 2009
- CAR, Chad, Cote d'Ivoire, Equatorial Guinea and Guinea-Bissau will launch the programme with their first Demand Assessment Missions in Q1 2009
- The Gambia (Cycle 3) held a combined Closing Dissemination Workshop (CDW)

for Cycle 2 and OAT for Cycle 3 in Q4

- Ghana (Cycle 2) is making strong progress with a small sample survey, and is planning a larger survey to begin in Q1
- Malawi (Cycle 3) has finalised its results and is preparing to launch the next cycle in Q1 2009
- Mali (Cycle 1) achieved a 70% response rate and is processing data with a plan to hold a FUM in Q1 2009
- Nicaragua (Cycle 2) hosted a follow up mission to review data and analysis, and prepare for the proposed next cycle
- Niger is preparing for its OAT in Q1 2009
- Senegal has reached a 75% response rate and is scheduling a FUM in January 09
- Tanzania (Cycle 4) hosted a follow up mission on the Mainland and in Zanzibar to review data, analysis, analytical report and institutional arrangements
- Togo received a Demand Assessment mission in December
- Uganda (Cycle 7) is finalizing its current survey, and preparing towards disseminating results
- Zambia (Cycle 2) has attained response of over 80% and is finalising editing, data entry and checking ready for dissemination of preliminary results in Q1 2009.

Methodology and liaison

- The FPC CBP prepared enhanced methodology in FPC sustainability analysis (see article on pages 14 and 15)
- MEFMI hosted a regional workshop at Ngurdoto, Tanzania, on 3-14 November, covering diverse aspects of monitoring and analysis, attended by 8 member states
- Parts of the NTF Manual and the Software User Manual are being translated into Portuguese for the benefit of Guinea Bissau which will launch the programme in Q1
- The FPC CBP is continuing to track developments with new methodology and codes and standards of the IMF, OECD, and UNCTAD, and discuss with these organisations and participating countries the implications for their implementation.

Software

- The FPC CBP finalized and disseminated Version 2 of the generic software. See the article on page 13 for further information
- MEFMI is making progress with its

regional system (PCMS), which remains on track for delivery in Q1 2009

Information products

- **Newsletter 36** is now posted on the public website and available for download (visit www.fpc-cbp.org and link to "Newsletter"). In this issue, the FPC reports on the developments and implications of BPM6, optimistic investors in Malawi focusing FDI on manufacturing, and on Tanzania's mining sector leading FDI. For subscription enquiries, contact dfi@dri.org.uk
- **Briefing #21** will be sent out in Q1 2009.
- **Website:** the 9th Steering Committee report is available for download. Log onto the members' website at www.fpc-cbp.org.uk and link to 'Steering Committee'.

Governance

MEFMI with the Bank of Tanzania hosted the 9th Steering Committee Meeting in Dar es Salaam on 6th November. All implementing partners were represented, as well as country representatives from Cameroon, Mali, Nicaragua, and Tanzania, who presented valuable lessons and experiences. Seco and MEFMI co-chaired the sessions. The proceedings covered regional and country progress; methodology, software, and information products; governance and liaison; financing; and agreement on a work programme to the end of Phase 3. The main action points agreed were:

- The need to submit future **quarterly reports** in February and May, continuing in particular reports from participating countries on their progress and local financing;
- Acceleration of **methodology** development, and preparation of an **analytical publication** in which all participating countries will be included
- **An overall review** by Seco of all three phases of the CBP
- The circulation of **proposals for continued support** in response to the impact of the financial crisis on low and middle income countries ●

FPC CBP COMPLETES TRANSFER OF GENERIC SOFTWARE

Meeting its objectives for phase 3, the FPC CBP completed the transfer of its generic software to countries with the dissemination of Version 2 in September 2008. Henceforth, FPC support will be limited to minor enhancements, based on country demand.

The generic software is developed in MS Access®, to ensure that it can be adapted to country needs very easily, using existing programming skills in the countries. It is freely available to all countries, and is especially useful to those that do not have (or are still developing) a suitable national system.

The software is made up of three modules: Administration, Input and Output. The **administration module** allows the user to create new surveys or edit existing surveys. It is fully flexible, should a country need to revise its questionnaire, or use the software for an entirely new or different questionnaire. The **input module** permits data storage, checking, the creation of summary reports about each return, viewing and clearing problems, and exporting a list of respondents to Excel. The **output module** is designed to check and reconcile the data, and produce reports for analysis.

The software is accompanied by two **manuals**:

- **User Manual**: this is the basis of training and transfer to software users, containing all the instructions necessary to use the software for entering and analysing data.
- **Technical Manual for Designers**: this contains a description of the programming techniques used to create the software, and an explanation of how those techniques have been implemented to create the current version. An unlocked software for designers is also freely available, containing the programming code needed to effect any further developments using the Technical Manual.

The system is intended to store aggregate data relating to IIP/BOP, investor perception, and corporate social responsibility. It therefore complements rather than duplicating the loan-by-loan debt recording systems of the Commonwealth Secretariat (CS-DRMS) and UNCTAD (DMFAS).

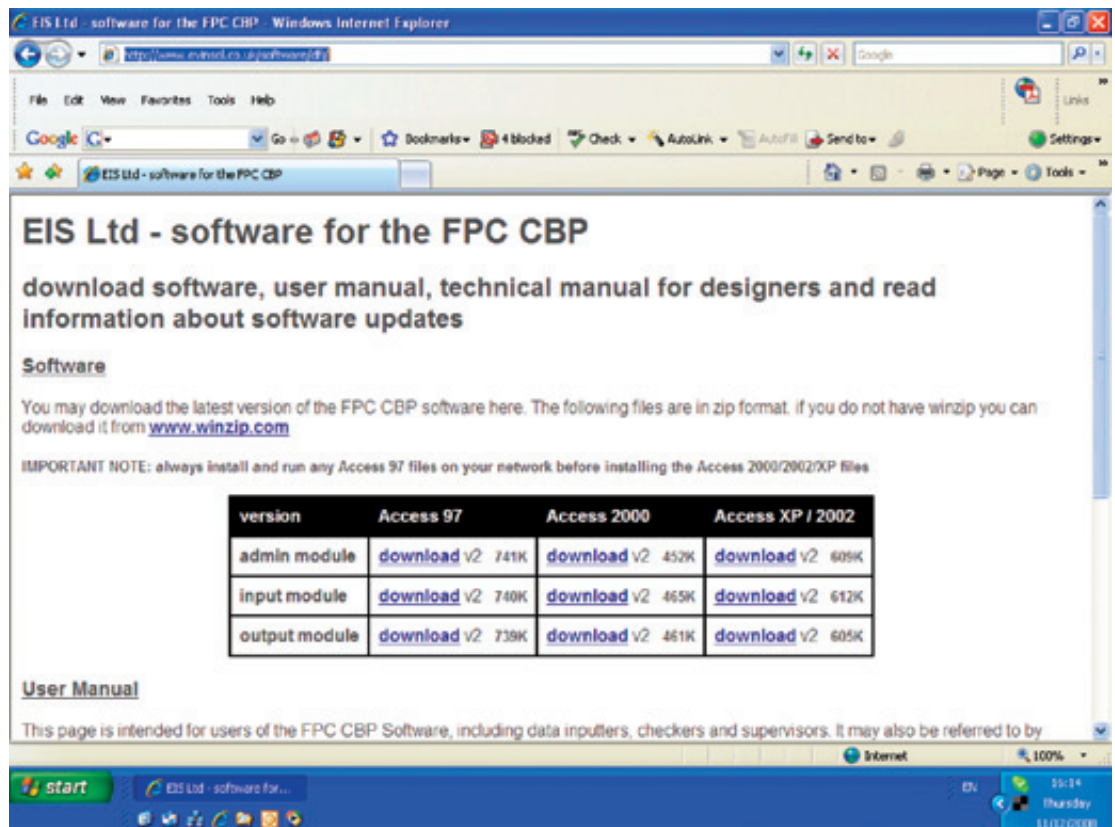
The system is designed and maintained by Eveleigh Information Solutions (UK), in consultation with Programme Implementing Partners and participating countries. All the above items are available via the EIS website (<http://www.evinsol.co.uk/software/dfi>), as described in the table below.

EIS Website Page	Features
Homepage	From this page users and designers may: <ul style="list-style-type: none"> • Download software v2.0 • Link to the User Manual page • Link to the Technical Manual page • Link to Information about Updates pages
User Manual	Users may download the entire manual in one zip file, or individual chapters as required
Technical Manual for Designers	Designers may: <ul style="list-style-type: none"> • Download the entire manual in one zip file, or individual chapters as required • Download the development database
Information About Updates	This page tracks the changes made in various versions

A few countries have developed their own systems, to align more closely with national or institutional programming priorities, using systems such as Oracle®. The most advanced countries have redesigned national systems, building on useful functions contained in the generic software. The table below summarises current country status.

System	Countries
CBP Generic users	Benin, Botswana, Burkina Faso, Cameroon, Central African Republic, Chad, Congo, Cote d'Ivoire, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea Bissau, Malawi, Mali, Niger, Senegal, Togo, Trinidad and Tobago, Zambia
National systems	Bolivia, Nicaragua, Tanzania, Uganda

In addition, one of the FPC CBP implementing partners, MEFMI, has decided to develop its own regional software, known as the PCMS, which is intended to be completed by March 2009, for the benefit of all countries in the MEFMI region. ●



ANALYSING SUSTAINABILITY OF

The FPC CBP has helped participating countries to analyse their balance of payments (BOP) and international investment position (IIP), and the composition of their foreign private capital by type of financing, supplier institution, beneficiary sector and region, and source country. It has also helped countries to look at the factors which influence FPC trends, including investor intentions and perceptions, and policy measures taken by the recipient countries. As a result, it has made a major contribution to helping countries formulate policies which will encourage more sustainable capital flows.

However, the FPC CBP was established because developing countries were subject to dramatic volatility of unsustainable foreign private capital, causing major negative effects on their national development. Especially given the current global financial crisis, it is essential that the CBP helps countries to analyse whether FPC is sustainable. This article provides guidelines for how to conduct such analysis, as well as some preliminary results.

1) Definition and Information Needed

Sustainability analysis is a more detailed examination of investors' recent, current and potential future behaviour. It is based on underlying analysis of FPC composition and the factors which influence these trends, and therefore focusses on those areas where basic analysis indicates that FPC is likely to be less sustainable. It can be undertaken in 4 ways:

- **Rates of return and profit**, defined as: grace and maturity periods, interest rates and present value of loans; profit and dividend levels (and repatriations) and implicit rate of return from FDI; and dividend and price gains on portfolio investment;
- **Volatility of flows**, measured by: the volatility of historical time series; investors' declared future intentions; and the execution rate of investments.
- **Net flows and transfers**, defined as: inflows of capital minus outflows of capital (flows) and interest/dividends (transfers),
- **Vulnerability of the economy**, assessing various key ratios which compare FPC to major economic aggregates of the recipient country

All of these aspects can be disaggregated by type of finance or supplier institution, beneficiary sector or region, and source country. It is also vital to analyse the factors which influence the sustainability of FPC, again in disaggregated classifications.

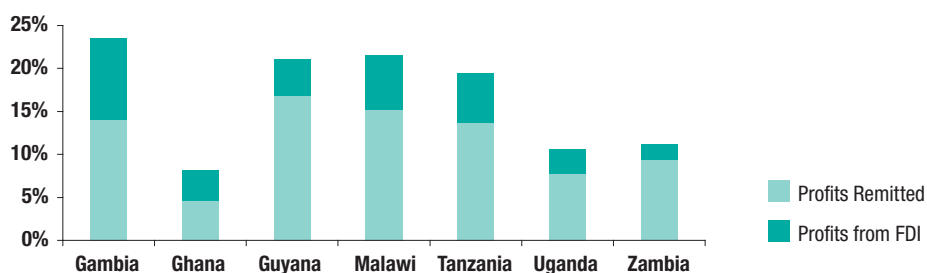
Most of the information needed can come from the FPC CBP questionnaires. However, to ensure it is available, questionnaires need to look at investor intentions, and factors influencing current and future investment. For comprehensive analysis of PSED sustainability it will be important to have responses on a loan-by-loan basis. Data quality also becomes even more fundamental – without valid data on reinvested earnings, dividends, and interest payments (all of which are often completed unreliably by enterprises) sustainability analysis is unlikely to produce reliable results.

In addition to data, countries need two further inputs: training in how to analyse volatility, including through econometric techniques such as standard deviations; and international analysis on the causes and scale of volatility, especially international market conditions.

2) Rates of Return

As shown in Figure 1, according to FPC CBP analysis, FPC in low-income countries has typically demanded very high rates of return, averaging 15% a year but more than 20% in the Gambia and Malawi. Of these profits, 72% are not reinvested. As a result, more than 10% of invested capital is repatriated each year. However, these returns vary dramatically with national or international economic developments, sectoral trends, or policies of individual enterprises. During periods of international, national, sectoral or enterprise crisis, they can exceed 100% of capital in one year.

Figure 1: FDI profitability (%)



Rates of return also vary by recipient country and sector. Construction routinely achieves returns of 50%, agriculture and finance 20%, and manufacturing 15%. Surprisingly, commerce, accommodation and tourism seem to be less profitable (at only around 5%). However, country authorities have major doubts about low returns for two reasons: a) enterprises in these sectors are noted for under-reporting profits to avoid taxes; and b) these sectors are most used for money-laundering purposes, implying that some investors are not concerned with profit-making and are dragging down sectoral averages.

In terms of debt financing, multinational enterprises with access to international markets have managed to borrow at low interest rates – around 2-3% above international commercial rates for the borrowing currency. However, international rates have been extremely volatile, cutting costs to 4-5% in 2001-02, but raising them to 8-9% in 2007. During the global financial crisis, LIBOR which forms the basis for most corporate borrowing has fluctuated wildly. The crisis has also cut MNE credit lines and increased spreads expect for the most creditworthy enterprises. In part this has been linked to the fall in commodity prices which has reduced access to export prefinancing loans.

Profit and dividend returns on equity FDI are generally much higher than those on debt, with annual rates of return in most sectors (and therefore also their present value) exceeding even the combined principal and interest payments (and therefore PV) of debts. The FPC CBP has not yet been able to collect comprehensive data on returns on portfolio investments, but fund managers demand annual rates of return well above 10%.

3) Volatility

Another means of assessing FPC sustainability would be to project forward possible ranges

FOREIGN PRIVATE CAPITAL

of volatility. The FPC programme has not yet generated sufficient data time series to judge volatility using formal econometric tests such as standard deviations – and in any case this might not tell us much about future prospects given that historical trends may bear little relation to future prospects. Some have suggested that comparing investment approvals and actual flows could help (for example providing early warning of falls in flows by examining trends in approvals), but these can provide only a very rough proxy.

The FPC CBP also gathers data on investor intentions – to increase, maintain or cut flows. However, to provide more useful information, questionnaires should in future ask what percentage of increase or reduction they intend in the coming year or 3-year period.

4) Net Flows and Transfers

The FPC CBP has already produced results in terms of net flows and transfers. These can be looked at in several ways – overall on total FPC (whether from non-residents or residents), disaggregated into inward FPC from non-residents (ie foreign liabilities), or outward FPC from residents (ie foreign assets), and disaggregated by type of flow.

Overall, the picture is shown in Figure 2, where high levels of capital outflows (averaging 59% of inflows) and enhanced volatility of FPC during crisis periods make all flows much less stable and more volatile. Figure 2 also shows two snapshots of extreme volatility where problems with gold price hedging and bunching of debt maturities by Ashanti Goldfields in Ghana, and a decision by Anglo-American to withdraw its equity investment in Zambia, destabilized each economy.

By type of flow, Figure 3 shows that equity FDI can frequently fail to provide net inflows because high repatriation/dividends require high new inflows to offset them. However,

non-equity FDI (especially-intra-company loans) and loans from unrelated sources can also dry up rapidly in global, national, sectoral or enterprise crisis. As a result, in difficult years both debt (Ghana) and equity (Zambia) have caused net outflows.

5) Macroeconomic Vulnerability

The overall vulnerability of the economy is best measured by ratios such as:

- private sector debt/commercial bank foreign exchange reserves
- national debt (public + private)/total foreign exchange reserves
- national (public + private) debt service/exports or reserves
- short-term or trade credit ratios compared to reserves

However, given the high returns and volatility on equity, it is also prudent to think about non-debt ratios such as stocks of private sector foreign assets/liabilities; and private sector foreign liabilities/reserves or private sector flows/exports or reserves. It is also vital to test ratios excluding large offshore projects whose earnings do not pass through the national banking system, and to disaggregate ratios by sector, source country and even enterprise, in order to identify possible micro-economic sources of vulnerability.

6) Explaining and Projecting Sustainability

Assessing what is likely to happen to FPC in future requires analysis of the factors influencing sustainability, using the investor perceptions data from the FPC surveys; as well as analysis of trends in international and regional markets (including sectoral and individual enterprise developments) and their impact on the national economy. For example, the current financial crisis has increased the cost of, and reduced access to loans (and to FDI to the extent that it is financed by borrowing), reduced suppliers credits (in line with commodity price falls), reduced

OECD portfolio investments in developing country equity and T-bill markets, and cut the returns on developing country assets held in OECD countries.

It also requires medium-to-long term forecasting of FPC trends using different scenarios. An example of this would be to set the baseline scenario as being based on recent FDI growth levels but assuming high returns so that flows turn negative fairly soon; an optimistic scenario whereby an economic boom keeps flows positive for a longer period; and a pessimistic scenario whereby shocks (standard deviations in flows, higher rates of return, or cuts in trade lines and FDI) hit the economy. Similarly, it requires formal risk analysis based on variations in interest rates, exchange rates or commodity prices, time series analysis of volatility and analysis of portfolio flows, and non-traditional flows and contingent liabilities such as public-private partnerships, hedging and pension liabilities, as well as analysis of the relative costs and risks of local compared to external financing.

7) Policy Implications

The high rates of return on FPC show their potential for major negative effects on the economy in times of crisis, and therefore the close attention governments must pay to analyzing FPC sustainability, in order to take rapid policy measures to stabilize flows, or to adapt to changes in market conditions. They also underline the need to design and implement a national strategy for mobilizing development financing (going beyond public sector financing). Finally, they underline the need for greater timeliness in data collection (through quarterly sample surveys) and more forward-looking questions in surveys, to provide an early warning of potential FPC volatility. ●

Figure 2: FPC inflows/outflows (% of GDP)

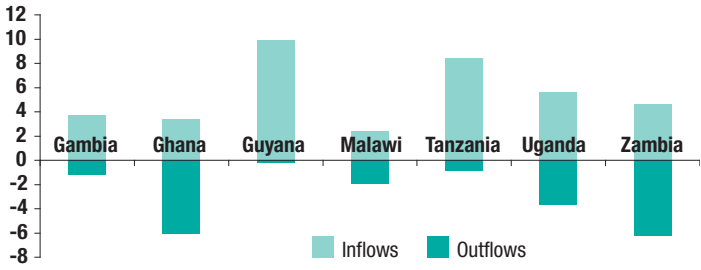
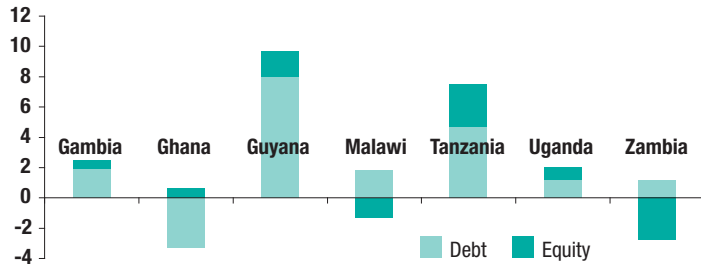


Figure 3: Net debt and equity flows (% of GDP)



DEBT RELIEF TECHNICAL QUESTIONS

What Are The Main Features Of The New BWI's Debt Sustainability Framework (DSF) Template?

The Bretton Woods institutions (BWIs) have recently updated their Debt Sustainability Framework (DSF) templates for low income countries, merging the separate analysis of external and fiscal sustainability into one new more user-friendly template. This new template retains the key elements of the original DSF templates whereby the analysis is based on 20-year macroeconomic projections, in US dollars and using a common 5% discount rate to compute present value. The alternative scenarios and standardised stress tests remain unchanged. However, the new template also provides two customised scenarios to facilitate analysis of country-specific macroeconomic or commodity price assumptions. The new template is available on www.imf.org/external/pubs/ft/dsa/lic.aspx and www.worldbank.org/Home > Topics > Economic Policy and ... > Debt Sustainability > Debt Sustainability Framework for Low-Income Countries.

The new Excel template consists of the following worksheets:

- *Language* sheet to allow the user to run the template in English, French, Portuguese or Spanish.
- *Navigator* sheet, to direct the user directly to the input sheets for entering assumptions

and the output sheets for analysing external and fiscal debt sustainability,

- *Instructions* sheet to provide a brief synopsis of how to use the template
- Two input sheets, *Data_input* and *Inp-Outp_debt*. The *Data_input* sheet is for recording historical data and 20-year projections of external public and private debt and domestic debt and the main macroeconomic aggregates of the balance of payments, budget and real economy. The historical data and projections cells are colour coded so data entry is only required in yellow cells. The *Inp-Outp_debt* sheet projects debt service of the existing debt stock and disbursements of new public sector external loans. The new template enables the user to enter detailed debt service and new disbursement projections for country specific key creditors (two each of multilateral, Paris Club bilateral, non-Paris club bilateral and commercial). The user can also now select to do all data entry and analysis in terms of millions, rather than billions.

- Four output sheets, a *Table baseline* and *Stress test* sheet for external and fiscal sustainability analysis. The two *Table Baseline* sheets set out the baseline projections of the main debt ratios and the key underlying macro variables

(balance of payments for external debt analysis and budget for fiscal analysis). The *Stress test* sheets summarises the key ratio results of stress tests and standard alternative scenarios.

- Output charts, *Panel Chart*, summarising the external and fiscal debt ratios in chart format, and the underlying data for the charts, *Chart Data*. The charts illustrate the DSA results of the baseline, alternative scenarios assuming historical averages, and the most extreme stress test.
- Series of worksheets that transform the input data into the output data, which can be accessed via the *Navigator*.
- *Customised Scenario* sheets for external and fiscal debt sustainability analysis, accessed via the *Navigator*. For external debt, this enables the user to enter country-specific assumptions for export or import commodity price shocks, changes in private or official transfers, FDI, real GDP growth or inflation. There are separate instructions, at the top of the sheet, on how to use it.

The new template is a large 6.7MB workbook and requires a computer with 504 MB memory to work properly. It also requires an Excel Macro security setting of medium to run the worksheet Macros.

How can the HIPC CBP DSA methodology be used to prepare the debt inputs for DSF?

As the DSF template is a framework for transforming macro and debt inputs into outputs for sustainability analysis, all macro and debt projection inputs need to be produced outside the template. On the macro side, this means that 20-year macro projections have to be prepared using the national macro economic model or financial programming framework. On the debt and new financing side, the data inputs required are:

- For public sector external debt in *Inp-Outp_debt*:
 1. Debt service projections of the current external public debt, in millions or billions of US dollars, for all years until current outstanding loans are fully repaid. Depending on the HIPC status, debt service projections for the baseline scenario need to take into account HIPC and MDDI relief – for completion point countries this is full HIPC and MDRI relief,

for interim HIPC countries, only interim relief, and for pre-decision point countries only traditional relief. As the DSF template cannot simulate debt relief, all such assumptions must be implemented outside the template. The required debt service projections can best be produced using Debt-Pro[®] or a country's debt recording system (CS-DRMS or DMFAS). The next release of CS-DRMS and DMFAS softwares will include facilities to produce DSF inputs in the appropriate format.

2. 20-year disbursements of new external public sector borrowings for key creditors and creditor category, in millions or billions of dollars. As the DSF cannot generate new disbursement forecasts, the HIPC CBP External Assistance Template has been revised to prepare disbursement projections for entry to DSF using Copy/Paste from Excel. The template is available on the Technical

Resources pages of the members' section of www.hipc-cbp.org.

- For private sector external debt, the DSF requires projections of stock, interest and amortisation payments, which must be produced outside DSF. There is no facility for recording any private sector debt arrears, if they exist.
- For domestic debt, DSF requires that the user enter projections of domestic debt stock, interest and amortisation payments for short-term and medium to long-term debt, in millions or billions of US dollars. As these data projections cannot be generated within DSF, the HIPC CBP Domestic Debt template has been updated to prepare disbursement projections for entry to DSF using Copy/Paste from Excel. The updated template is available on the Technical Resources pages of the members' only section of www.hipc-cbp.org.