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**HIPC Debt Analysis & Strategy**
- First Comsec/OIF Joint Ministerial Meeting: 2
- Fiscal Sustainability of Debt: 4
- Diversifying Finance for Development: 5
- Capacity Building: More ‘Downstream’ Money Needed: 6
- Regional Workshop Combines CBP And DSF Methodology: 7
- CEMLA Begins Intensive Assistance to Haiti: 8
- HIPC Recent and Forthcoming Activities: 9
- Debt Relief Technical Questions: 16

**Foreign Private Capital Flows**
- Financial crisis hits Latin America hard: 11
- Zambia: FPC 58% Higher Than Estimates: 13
- FPC CBP Update: 15
First COMSEC/OIF Joint Meeting

Just before the IMF and World Bank Spring Meetings, the Commonwealth Secretariat and Organisation Internationale de la Francophonie (OIF) organized their first joint meeting of Ministers from low income and debt vulnerable countries. The HIPC CBP provided funding for HIPCs which are not Commonwealth/OIF members to attend, and HIPC CBP partners wrote and presented many technical background papers for the meeting, benefitting from DFID funding provided to the Government of Guyana. In this issue of Strategies for Financing Development, we focus on the outcomes of the meeting and the analysis presented to it, beginning with the Ministerial Communiqué and following with three articles on the Fiscal Sustainability of Debt, Diversifying Financing for Development, and Debt Strategy Capacity-Building Needs.

Statement of the Ministerial Forum
1. Ministers from Commonwealth and Organisation Internationale de la Francophonie (OIF) low income and debt vulnerable countries met on 23rd April in Washington D.C. Ministers or their representative from Benin, Burkina Faso, Cameroon, Central African Republic, Democratic Republic of Congo, The Gambia, Ghana, Guyana, Lesotho, Malawi, Mozambique, Niger, Nigeria, Senegal, Sierra Leone, Tanzania, Togo, Uganda and Zambia were present. Representatives from Ethiopia and Nicaragua also attended by special invitation. Ministers took stock of progress in implementing the HIPC and MDRI initiatives in the light of the ongoing global economic and financial crisis.

2. They noted the serious implications of the crisis for low income and debt vulnerable countries. The sharp contraction in world output and trade is increasing the financing gap such countries face while deteriorating financing conditions make access to external finance even more difficult. Without sharply increased concessional assistance and action to protect critical expenditures including on social safety nets, human development and key infrastructure projects, progress in growth, poverty reduction and attainment of the Millennium Development Goals (MDGs) will be seriously set back. In this context they welcomed commitments made by G20 nations at their London meeting, and the prompt action by IFIs to step up concessional and other financial support for developing countries. They stressed the need for rapid fulfillment of these commitments but noted that these commitments fall short of the needs of low income countries. They urged donors to provide further resources to support growth in their countries to reach the MDGs.

3. Ministers strongly welcomed a new proposal made after the G20 meeting to augment the resources provided to developing countries in the crisis through the provision of further debt relief for the duration of the crisis financed through the sale of IMF gold reserves.

4. They also discussed new instruments for protection against exogenous shocks; ways to diversify sources of concessional and non-concessional finance; good practice in fiscal sustainability; and the possibility of a “debt for climate” adaptation initiative.

5. Ministers reviewed progress in implementing the HIPC and MDRI initiatives, noting challenges that remain if countries are to benefit fully from these initiatives, including increasing participation by all creditors in the initiatives, tackling the problem of litigation by vulture funds, maintaining debt sustainability after completion points, tackling debt vulnerability in some countries not eligible under these initiatives, and making countries less vulnerable to future shocks and changes in financing conditions.

6. In discussions with representatives of the International Financial Institutions and the Multilateral Development Banks, Ministers:
   • Noted the changes to the IMF’s approach to structural conditions and urged further progress in reducing conditionality and welcomed the review of the IMF’s facilities and instruments for low income countries;
   • Welcomed the commitment of G20 countries to a review of the flexibility of the Debt Sustainability Framework, and look forward to a report on this by the Bank and Fund at their 2009 Annual meetings and emphasised the importance of ensuring that the views of borrowing members are fully integrated into any revised policy.
   • Welcomed the establishment of the legal facility in the African Development Bank;
   • Stressed the importance of a rapid replenishment of the Fund for Special Operations at the Inter American Development Bank.

Protection against shocks
7. Ministers recognised the damaging impact of exogenous economic shocks on growth and poverty reduction. They noted that the adverse long term impact of the current crisis had been increased by the multiple poverty traps which it has created. They underlined the importance of development assistance in lessening the impact of
shocks and to establish compensation methods and social safety nets for the population most affected by shocks.

8. They examined the existing systems and other possible methods for protecting low income countries against exogenous shocks and urged bilateral and multilateral donors to:
   • Accelerate the disbursement of additional resources in the framework of the existing mechanisms of compensatory financing in the wake of exogenous shocks, while insisting that the current ineffective forms of conditionality should be replaced by result based conditionality which would support faster disbursement and be more consistent with country ownership;
   • Promote counter cyclical measures through the terms of new loans or debt rescheduling to reduce instability through the automatic disbursement of resources which would function as insurance for the poorest in the event of a negative shock.

9. The crisis has shown that the current instruments for providing compensation for exogenous shocks are ineffective. Ministers called on the Multilateral Development Banks to seize the opportunity to revise the aid allocation criteria and be willing to support countries resilience to shocks before their impacts are felt. They therefore recommended that the aid allocation formulae put a greater emphasis on structural vulnerability rather than performance indicators which tend to be subjective.

Diversifying sources of finance
10. Ministers discussed options open to debt vulnerable countries in diversifying sources of finance while maintaining debt sustainability. They noted the need for a high degree of prudence in diversifying sources of finance, including building government systems and capacity to transparently and objectively assess options regardless of political, commercial or other pressures. The best option in most cases will be enhanced concessional flows and, in this context, Ministers urged donors to implement and go beyond their Gleneagles pledges to increase concessional aid. Such aid is needed more than ever in the light of the impact of the current economic crisis and funding needed to combat climate change. In particular Ministers called for:
   • An accelerated timetable for further replenishments of IDA and the AfDF resources.
   • Measures to offset MDRI induced reduction of concessional flows to some countries.
   • A more gradual approach to graduation by the MDBs, and the continued provision of anti-shock concessional finance to graduated countries where debt or other vulnerability is high, and in support of social safety nets and measures to combat climate change.
   • The IMF to review its policies on concessionality to link them more clearly to DSF results, and for the MDBs to review their non-concessional lending policies in parallel.
   • All donors, including the new “southern” donors, to untie their aid and channel more through sector and budget support. Ministers agreed to encourage all donors to exchange experience in order to improve each other’s practices.

Fiscal Sustainability
11. Ministers reviewed experience on the fiscal sustainability of differing levels of public debt. Ministers called for efforts:
   • By the international community to establish norms for what constitutes domestic and external debt, and how fiscal sustainability is to be defined.
   • By the IFIs to define in full collaboration with low income countries appropriate indicators and thresholds for domestic and total public debt sustainability, to be incorporated in the review of the DSF to be presented to the Annual meetings.
   • These norms and indicators should include appropriate treatment of guaranteed debt, contingencies and debts by sub-national authorities and agencies, all of which need to be managed responsibly.

Debt for climate adaptation initiative
12. Ministers committed themselves to compiling and publishing accurate and timely data on all types of public debt, and to strengthen capacity to analyse debt sustainability and formulate debt strategies as part of their budget process. Ministers called for increased donor resources to fund regional and national assistance to build capacity in these areas. They welcomed the work done by the Commonwealth legal clinic on developing a framework for fiscal responsibility, and urged governments to adopt the framework to their own country circumstances should they decide to adopt a fiscal responsibility law.

13. Ministers discussed options for using debt relief as a mechanism for combating the effects of climate change, including through the buy back and conversion of commercial, bilateral and multilateral debt. They encouraged further work in the context of the ongoing UNFCCC process on the options for using such a facility.
Most international analysis of low income countries’ (LICs) debt sustainability has focussed on external debt. However, there is now a pressing need to analyse domestic and total public debt sustainability in relation to the budget (also referred to as fiscal sustainability). This is particularly true because domestic debt for fiscal financing and monetary policy has been growing rapidly in many LICs in recent years. The IMF estimated that domestic debt accounts for 20% of LIC public debt in 2006, and DRI analysis indicates this is closer to 25% in 2007. In addition, during the international financial crisis, LICs are having to borrow more, externally or domestically, to cope with falling overseas inflows, or to support troubled domestic financial markets.

There is no international agreement on how to assess or increase the fiscal sustainability of debt. While wider measures, such as fiscal responsibility laws which control the budget deficit, can help to maintain inter-generational fiscal equity, this article presents an assessment based on the level of public debt (domestic and external) been accumulated to finance the deficit, and its service costs, in relation to GDP, government revenues and expenditures.

**Domestic and Total Public Debt Thresholds**

A number of ratios and thresholds are currently being used as follows:

- The European Union Stability and Growth Pact requires member states to have a ratio of national debt (domestic and foreign) to GDP of 60% or less to maintain fiscal discipline.
- Other regional organisations such as the Andean Community, West African Monetary Zone (WAMZ) and Union Economique et Monétaire Ouest Africaine (UEMOA) have established limits for total public debt to GDP in the range of 60-70%. The UEMOA has also set an informal guideline for total debt service/ budget revenue of 15%.
- The IMF describes the domestic debt burden as significant when the nominal domestic debt stock to GDP ratio is above 15%-20%. It has also indicated that an annual increase of 5-7% in the PV/GDP ratio of public external or total debt should act as a ‘caution flag’ that countries are more likely to suffer debt distress.
- Overall, the literature concludes that capacity to repay public debt should be assessed in relation to budget revenue, and that ratios related to GDP are much less precise.

The main features of LICs domestic and public debt sustainability are as follows:
- On average, LICs have a domestic debt burden of 12% of GDP, compared to an external burden of 52% of GDP (30% for post-HIPCs). Key factors affecting the burdens are the longevity of domestic debt markets, and progress through the HIPC Initiative.
- Fourteen countries (Bolivia, CAR, Djibouti, Ethiopia, The Gambia, Ghana, Guinea-Bissau, Guyana, Kenya, Mauritania, Nicaragua, Sierra Leone, Togo and Zambia) have domestic debt/GDP ratios in excess of the IMF’s 15% significant level. Sixteen countries have total public debt/GDP above 60%, and fourteen countries have service above 15% of revenue.

The financial crisis is exacerbating fiscal sustainability problems. Thirteen additional LICs may reach a high risk of unsustainable external debt due to the financial crisis. In many countries, the global financial crisis is leading to tighter domestic financing conditions or withdrawal of foreign investors, putting upward pressure on interest rates and domestic debt service costs. Coupled with currency depreciation, this has increased public debt service and reduced fiscal sustainability. The financial crisis has also prevented LICs from tapping international capital markets, pushing them to issue more expensive domestic bonds. Kenya’s domestic bond to finance infrastructure has an interest cost of 12.5% compared to Ghana’s 8.5% international bond.

Countries have widely varying experiences of domestic debt, from accumulating payment arrears to securitisation, low or high (and managed or market-determined) interest rates, and dramatic increases or falls in their domestic debt. However, these show conclusively that governments must have an active domestic debt management strategy as the market does not discipline government access without severe negative effects on fiscal and financial sector sustainability. Even the most positive strategies, which have managed to create long-term debt markets, are now under considerable pressure as the crisis leads investors to seek short-term instruments.

Key Issues for Analysing Domestic and Total Debt Sustainability

The paper concludes that there is an urgent need for:
- A common global definition of domestic and total public sector debt, including the widest possible domestic debt (bills, bonds and stocks as well as arrears to civil servants, suppliers and others and contingent liabilities) and public sector debt (owed by public enterprises and other national and sub-national agencies).
- Clear indicators and thresholds for fiscal sustainability, with nominal debt and service as numerators, and GDP and budget revenue as denominators, based on more detailed analytical work of recent country experiences of domestic and public debt crises. This work should be finalised during the current IMF review of country borrowing ceilings and limits, and incorporated in modifications to the LIC-DSF presented to the BWI Annual Meetings.
- LICs strengthening their own national and sub-national capacity to analyse trends and policy issues in domestic debt, contingent liabilities and sub-national debt, as a basis for designing and implementing a total public (including domestic) debt policy and strategy.
- Reinforced longer-term policy responses for dealing with country-specific contingent liabilities, which include contingency funds, insurance schemes or charging for loan guarantees; as well as forward-looking strategies for financing contingent liabilities which are likely to become actual liabilities based on assessments of probabilities.
- Greater transparency in publishing data on total public and domestic debt, contingent liabilities, and sub-national debt.

The CBP has already developed indicators and thresholds for fiscal sustainability of debt, as well as methodology and templates for forecasting domestic and sub-national debt developments (for more details see the CBP private website at www.hipc-cbp.org). It will be continuing this work during 2009, including through publications on debt sustainability in low-income countries and sub-national debt.

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1 This article is based on ‘Fiscal Sustainability of Debt’, prepared by DRI for the joint Commonwealth Secretariat – Organisation Internationale de la Francophonie (OIF) Ministerial Debt Sustainability Forum meeting on April 23 in Washington DC. The paper can be downloaded from http://www.thecommonwealth.org/files/190143/FileName/FISCALSUSTAINABILITY.pdf
In the context of the financial crisis, and their higher needs for financing to combat the shock, developing countries need to diversify their international financing sources for development, while being prudent to maintain debt sustainability. This paper examined three main sources of flows, to help countries assess prospects for diversification.

In terms of North-South concessional flows,

- though some OECD governments are struggling to live up to their earlier aid pledges during the recession, there will be a large increase in aid from most OECD governments during the next few years. There will also be more funding to combat climate change.
- Nevertheless Ministers need to work actively to ensure they identify donors which are increasing aid, and convince them to apply their best aid delivery practices, as well as keeping the pressure on OECD governments to deliver their pledges with clear timetables, and to provide even more anti-crisis funding.
- Multilateral development banks are dramatically accelerating their disbursements against the crisis, and making their disbursement rules much more flexible, providing a major opportunity for increasing funding. However, they are likely to run out of concessional funds within the next 18 months, so early replenishments of IDA, IDIF and AsDF, and the IADB FSO, will be essential to keep concessional funds flowing.
- With many donors reducing the number of countries they support, “fragile states” which do not have emergency or post-conflict needs are finding it increasingly difficult to diversify funding. They need to play a leading role in global discussions on aid allocation, and advocate redesign of donor allocation criteria to take more account of vulnerability to shocks and fragile states as well as performance, to counteract this trend.
- Many OECD countries and multilateral organisations are also putting more emphasis on funding infrastructure, agriculture/food and regional projects, enhancing prospects for diversifying sectoral funds.
- Countries also need to push donors at global and national level to make aid more effective in producing results, by establishing mutual accountability mechanisms to monitor progress on implementing the Accra Agenda for Action, and increasing progress on reducing conditionality and transforming technical assistance into genuine capacity-building.

In regard to South-South flows:

- the crisis is also reducing prospects for South-South flows as it hits Southern economies, but many Southern aid providers have reiterates their earlier commitments so there remain considerably prospects for diversifying away from North-South flows.
- However, it is vital to mobilize South-South aid on the basis of objective assessment of its qualities in supporting national development strategies, rather than strategic or other alliances.
- On the positive side, it has a strong focus on infrastructure and productive sectors, as well as regional projects, can easily fit within national debt sustainability policies, has virtually no conditionality, and is relatively predictable in delivering rapid, low-cost project. However, most Southern donors do not provide sector or budget support, channel aid via recipient budgets and procedures, or untie their aid.
- There is also much less public information available on the quantity, quality and policies/procedures of South-South flows. Many Southern providers also have variable terms and conditions, depending on recipient country circumstances and negotiating abilities.
- This makes it essential to exchange information and experiences with other developing countries which receive them, and consult the few existing written analyses, in order to benefit from each provider’s best practices.

Finally, on diversifying to less concessional financing:

- Most low-income countries are constrained in accessing non-concessional financing by the LIC-Debt Sustainability Framework, and related IMF and MDB policies. In this light, the G-20’s decision to ask the IMF and World Bank to review the LIC-DSF by the time of the Annual Meetings is very welcome, and DRI will be contributing extensively to that review.
- In particular, more flexibility is needed for countries with lower debt levels to borrow non-concessionally for projects which have a high rate of economic and social return (not just those which have a guaranteed stream of foreign exchange income to repay the loan), and to factor the growth impact of borrowing more clearly into DSF analysis.
- The IMF needs to set a clearer basis for deciding country borrowing thresholds and exemptions, which is more clearly linked to the DSF results, and make it more flexible to maximize growth-oriented finance.
- The MDBs need to review their “non-concessional borrowing policies” to allow more non-concessional borrowing exemptions, as well as modifying their own lending policies to fund more high-return projects with “blend” financing, which would be much less expensive.
- Near-commercial funding is likely to continue to be scarce. OECD countries are focusing their export credit cover on middle-income countries, to overcome crisis-related difficulties in mobilising trade finance. International banks and bond loans have temporarily dried up, though they will become an option again as the crisis recedes.
- Countries with limited experience of less-concessional funding will need intensive capacity-building and information-sharing support on laws, institutions and analytical/negotiating skills, to make their own detailed analyses of the advantages and risks of bond issuance, credit ratings and Public-Private Partnerships (PPP)/Private Financing Initiatives (PFI).

The key to diversifying finance while keeping debt sustainable will be to implement national borrowing ceilings strictly, and to design systems which can objectively assess and negotiate offers of finance, regardless of political, commercial or other pressures. Governments also need to have excellent anti-fraud and project value-for-money checking systems to avoid criminal or poor value financing. They need to prioritise projects and examine expected returns closely, discounting the optimism of project designers and financiers, to mobilise finance for only projects whose contributions to development justify the financing costs.

Many governments will need considerable initial capacity-building support to analyse complex new external financing options (as well as the relative merits of non-debt financing, domestic debt and private sector debt) as part of a national debt strategy. The CBP partners will continue to provide such support.
CAPACITY BUILDING: MORE ‘DOWNSTREAM’ MONEY NEEDED

Capacity building issues took centre stage during the Commonwealth Ministerial Debt Sustainability Forum meeting on 22 April. There were presentations by different departments of the Commonwealth Secretariat, and the World Bank, but the main assessment of country capacity-building needs was written and presented by the HIP-CBP partner organizations.1

The presentation on capacity building issues concluded that donor-funded assistance will achieve very little in any country without a strong commitment by the country’s government to improve its legal and institutional framework, and to use its national capacity rather than external technical assistance. To implement a long-term capacity-building programme, countries need to:

- Pass laws which give debt management staff a clear mandate to produce annual debt strategies as part of the budget process, and ensure strategies are formally approved by Cabinet/Parliament, disseminated to civil society and the international community, and consistently implemented.
- Update laws to ensure that they cover all aspects of debt strategy (including domestic debt, contingent liabilities, decentralized debt, and more sophisticated instruments such as Public-Private Partnership agreements).
- Design more comprehensive capacity-building plans which include measures to increase staff numbers and reduce staff turnover, such as more precise unit responsibilities, job descriptions, customized individual training programmes, and positively-oriented civil service strengthening programmes.
- Carefully select staff participating at training events, to fulfil the needs and career paths of each staff member.
- Make clear Government commitment to reducing dependency on external assistance, by refusing TA while implementing the capacity-building plan.

The analysis undertaken also used the responses from HIP-CBP countries’ self-assessments, to identify the technical areas on which to focus capacity building, and concluded that:

- in spite of major recent progress, the top need is to build capacity in “middle-office” analytical functions, notably on domestic debt and new external financing strategy.
- countries also need major capacity-building investments on macroeconomic forecasts, budget expenditure forecasting and risk management, all of which are essential aspects of debt strategy formulation and policy coordination.
- Commonwealth countries in particular need technical training in portfolio and risk analysis, domestic debt strategy and external new financing strategy.

The paper also describes the rapid progress made in recent years in HIP-CBP countries, from virtually no capacity on debt strategy issues to 3.5/5. Countries have also dramatically improved their legal and institutional frameworks, the availability of experts to train other staff, and the quality of their national capacity-building planning.

Ministers were also briefed with a description of the differences between the two most important capacity building assessment methodologies in debt management, the one developed by the HIP-CBP in 1998, and the one developed by the World Bank in 2007. The HIP-CBP follows a three step approach: 1. – self-assessment, 2. – evaluation of gaps and solutions, and 3. – design of capacity building plans, and incorporates the use of a results-based management (RBM) approach, requiring the self-assessment to be linked closely to RBM logical framework targets for each country, to monitor progress in country capacity development.

On the other hand, the capacity building assessment methodology developed by the World Bank uses various performance indicators that span the full range of government debt management functions and assesses the strengths and weaknesses in government debt management practices. It covers central government debt management functions comprehensively, as well as related activities such as issuance of guarantees, on-lending, and cash-flow forecasting and cash balance management. However, it is conducted by external missions, does not specify gaps in capacity or solutions to those gaps, or make recommendations on reforms or technical and institutional capacity building needs. Instead, based on the initial assessment, a further mission is needed to design a debt management reform plan, to be implemented by a technical assistance provider.

Based on this comparison, the paper also provided recommendations for countries and international organisations to improve practices used to assess capacity-building needs, such as:
- 1. making them comprehensive and fully objective, with clear scoring and evaluation systems.
- 2. ensuring they are conducted by the countries themselves, to maximize ownership, with quality control by regional and international organizations.
- 3. conducting them regularly (preferably annually) in order to track progress and provide donors with a means of assessing success.
- 4. combining them with the diagnosis of capacity gaps and potential solutions, and the construction of national capacity-building plans.

The paper also identifies country needs for capacity-building in relation to the BWI Initiatives on the LIC DSF and MTDS: these are on developing more accurate macro forecasts, improving domestic and private sector debt data, interpreting and understanding country-specific results, and using the results for designing policy recommendations.

Finally, the paper makes recommendations for donor financing of debt management support. There is a major need for additional “downstream” financing to support in-country capacity-building work, to complement the “upstream” assessment/diagnosis/capacity-building planning tools of the HIPCBP and the DeMPA. Many institutions already provide downstream debt management capacity-building support, but all need of further financing to accelerate debt strategy capacity-building, especially to maintain debt sustainability during a global financial crisis.

1 Based on ‘Debt Strategy Capacity Building Needs’, prepared by DRI for the Commonwealth Ministerial Debt Sustainability Forum meeting on April 22. The paper can be downloaded from http://www.thecommonwealth.org/files/190191/FileName/CAPACITYBUILDING.pdf
These activities were largely based on the CBP AND DSF METHODOLOGY REGIONAL WORKSHOP COMBINES CBP AND DSF METHODOLOGY

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The next stage was for participants to provide full training in how to combine CBP and LIC-DSF methodology; to ensure fuller ownership of the LIC-DSF tools; and to help countries to implement strategies in line with the Franc Zone framework for public debt policy.

Structure of the workshop
The workshop alternated between plenary sessions and practical work in country teams:
- The first day of the workshop introduced the aims and objectives, the main stages in designing a public debt policy to be annexed to the annual budget, and the roles and responsibilities of the National Public Debt Committees.
- It also provided presentations on two key prerequisites for such a policy: how to build long-term macroeconomic forecasts, and how to calculate long-term financing needs. Thereafter the country teams spent three days building their macroeconomic forecasts and calculating their long-term financing needs based on government programmes and projects.
- The next stage was for participants to identify how to finance these needs. To this end, there were plenary presentations on the debt relief mechanisms of the HIPC and MDRI initiatives, as well as on how to calculate the impact of these initiatives using Debt Pro². These issues were still important for seven of the participating countries, because they were still pre-HIPC completion point. There were also presentations on how to design new financing strategies (both external and domestic). The teams then worked for a further two days on designing these strategies to finance their needs.
- These activities were largely based on the debt and new financing strategy methodology designed by the HIPC CBP, but also benefitted from new templates facilitating the calculation of financing needs. Each country team presented its recommendations to the others at the end of the first week and revised them taking account of peer comments.
- The second week began with presentations on the LIC-DSF framework developed by the BWIs – as well as the related templates, their practical functioning, the inputs needed and the outputs to analyse and the analytical basis for their design.
- The practical work in the first half of the second week revolved around inputting data into the LIC-DSF templates, and analysing their results. This work was assisted by the design of new reports in Debt Pro² which downloaded automatically the data needed for the LIC-DSF, and allowed the results of the first week to be input into the DSF templates.
- Once the DSF results had been calculated and checked, the countries then proceeded to draft their country policy documents to be annexed to the budget for 2010, and finally presented their conclusions back to the closing plenary session.

Participant evaluation of the workshop
The participants evaluated the workshop as follows:
- As regards the plenary sessions, 87% of participants found them very interesting, but 61% thought they were too short. In particular the participants would have liked to see longer presentations on the details of the work they were expected to do after each plenary session, in order to make the different steps in the methodology even clearer;
- On the technical tasks, 55% of participants found them difficult. In part this was because participants were relatively unfamiliar with the LIC-DSF and related methodology. The high degree of difficulty explains why 98% found the support of country-specific resource-people “essential”. However, this intensive recourse to resource-people was also due to the fact that there was no formal appropriate training manual – only 47% of the participants used the training and presentation documents provided to a considerable degree.
- 91% of participants thought the workshop objectives were clear and 64% that they were attained. However, 61% thought the workshop was too short, especially because the tasks in country teams were very complex and data-intensive, leaving them insufficient time for analysis and writing.

Conclusions and recommendations
Overall, the workshop generated many fascinating conclusions regarding debt relief and future financing strategies from different countries, notably the need for more flexibility in the LIC-DSF to ensure that countries are able to finance their development needs and the attainment of the MDGs without compromising debt sustainability. It also prepared countries for producing their own national public debt strategies during 2009. However, many will need more training and support at national level to replicate the workshop methodology, and Pôle-Dette and DRI will be working together to provide this support and improve methodology through to the end of the year and beyond.

Note: The full evaluation of the workshop is annexed to this report.
In December 2007, CEMLA conducted a demand assessment mission to evaluate Haiti’s debt management capacity and establish the government’s priorities for future assistance.

This mission concluded that Haiti had reasonable recording and servicing capacity, but needed urgently:
- a stronger legal and institutional framework for debt management;
- capacity-building on middle-office analysis of external debt and new financing;
- improvement of domestic debt management, and analysis of its sustainability and of the domestic financial market, to improve public bond issuance.

Other slightly less urgent priorities included:
- a strategy to mobilise new development financing; and
- enhancing capacity to conduct macroeconomic forecasts, and analyse portfolio and risks.

Based on this assessment, CIDA approved financing to Haiti for a programme which started in March 2009. A mission in May-June was designed to assist the Ministry of Economy and Finance to establish rapidly a Public Debt Management unit by:
- designing its institutional framework, functions, procedures and job descriptions, as well as a work and capacity-building programme for its staff;
- designing a strategy for issuing bonds, especially to recapitalise the Bank of the Republic of Haiti (BRH), as well as preparing the design of an overall debt strategy for Haiti.

1. Debt Management Unit
The mission agreed with the authorities that the new Unit would contain three teams: the Public Debt Operations Department (back office, to cover recording and servicing); the External Debt Analysis and Control Department (middle and front office for external debt); and the Domestic Debt Analysis and Control Department (middle and front office for domestic debt).

To fulfil the necessary functions:
- the Operations Dept needs a minimum of 5 staff;
- the External Debt Department 4 staff, including specialists in debt strategy and project finance tracking, in debt renegotiation, and in portfolio and risk analysis; and
- the Domestic Debt Department 4 staff, including specialists in domestic debt strategy and sustainability, financial sector analysis, and risk analysis.

The mission reached detailed agreement with the Haitian authorities on the functions of each department and staff post, as well as for the sharing of information and coordination with other units, and other activities to ensure efficient debt management.

2. Strategy for Issuing Treasury Bonds
Given that the Haitian government intends to begin issuing bonds to recapitalise the Bank of the Republic of Haiti, the mission also worked on designing a strategy for bond issuance, and training MEF officials in the tools needed to decide on the details of the bond. Its work focussed on analysis the following issues and making recommendations for optimal bond issuance:
- The theory of auctions of public bonds and optimal auctions
- Advantages, disadvantages and details of various types of bonds:
  - Paper and paperless securities
  - Bills and Bonds
  - Currency denomination
  - Maturities
  - Other details
- Advantages, disadvantages and details of public bond auctions:
  - Competitive and uncompetitive mechanisms, and mixtures of the two
  - Unit value
  - Sale based on price or interest rate
  - Auctions formats (Dutch or English auctions)
  - Authorised participants in the auctions
  - Minimum and maximum amounts
  - Controls to address participants’ failures to settle
  - Settlements
  - Procedures and timetables for issuance

- Systems needed (institutions, computerisation, etc.)
- Publicity and Commitments strategy
  - Commitments by government
  - Meetings with market participants
  - Information needs of participants in the auctions
- Secondary markets and financial sector development
  - Repurchase agreements at Central Bank (Repos)
  - Interbank sales
  - Custody and transfer (Central securities depositories, CSDs)
- Development of the financial system

3. Plan of Activities
The final task of the mission was to agree with government on the remaining activities planned for 2009 under the Project to Reinforce Debt Management Capacity, and their dates:
- Second mission to provide debt strategy capacity support and assist in finalising a debt management law (August)
- National Workshop on Debt and New Financing Strategy (23 November-4 December)

Other activities are due to be executed in 2010, but precise dates have not yet been agreed (preliminary dates are in brackets):
- Follow-up mission on domestic debt management (March, two weeks)
- Follow-up mission on new financing strategy (July, two weeks)
- National Workshop on Debt Strategy in the context of the LIC-DSF (September, two weeks)
- Follow-up mission to provide support in macroeconomic forecasting or portfolio and risk analysis.
Advocacy and Liaison

Commonwealth Secretariat/OIF Ministerial Meeting Washington, 22-23 April

HIPC CBP partners provided technical support for these meetings (see article pages 2 and 3), as well as holding discussions with the IMF and World Bank about their intended future support to debt strategies in developing countries, and the World Bank’s Debt Management Facility partnerships with the HIPC CBP member organizations.

During this quarter, regional partner organisations of the HIPC CBP also spent considerable time accompanying the World Bank on DeMPA missions (to Burundi 7-17 April, Côte d’Ivoire 15-24 June; Uganda March 29-April 10) and the IMF/World Bank on an MTDS mission to Kenya (27 March-8 April). DRI and regional partners also participated in MTDS training conducted by the BWIs in Vienna on 18-22 May.

Regional Workshops

Francophone Training for Trainers workshop Yaoundé, 4-15 May

National Workshops

Honduras – National Debt and New Financing Strategy Update Workshop Tegucigalpa, 3-10 June

A successful preparatory mission conducted by CEMLA in May meant that this workshop could be reduced to only 1 week. It was attended by 24 technical staff from the Finance Ministry, Central bank and Supreme Audit Tribunal. Its objective was to strengthen the capacity of the national technical team to update the National Public Debt Strategy and Public Debt Policy Guidelines, in line with the Organic Budget Law and the Technical Regulations for Public Debt. To this end it used CBP debt strategy methodology, as well as DSF/MTDS tools. The event was organised and mostly financed by the Government, with support from CEMLA, and was evaluated by participants as excellent both technically and administratively.

National Missions

Technical Support Missions for National Public Debt Committees Niger, 24 May to 3 June; and Senegal, 20-24 April

These missions aimed to help the NPDCs to design their work programmes and activities for 2009-10; ii) define the structure of the public debt strategy document to be annexed to the budget law; and iii) train the NPDC members on the techniques for debt strategy and sustainability analyses (including the LIC-DSF) needed to write the strategy.

Intensive Assistance Mission to Haiti 16 May-16 June

See article on page 8

Ethiopia Institutional Mission Addis Ababa, 1-5 June

Ethiopia’s debt management functions in the Ministry of Finance and Economic Development have recently been reinforced as a result of a Business Process Management (BPM) reorganisation, which widened MOFED’s mandate to include monitoring parastatal borrowing and Government guarantees and taking a more strategic role in domestic debt management and diversifying financing for development.

This mission, conducted by DRI, had two aims: • to review the changes to institutional arrangements, and in this context design an intensive assistance programme to build capacity for the new mandate, for financing by local donors. The mission found that Government strongly wished to lead the process of developing and approving its
own national debt strategy, with independent capacity-building support, by the time of the July 2010 budget, and designed a 3-year programme to provide such support.

- to provide initial training to reinforce capacity related to the new mandates. The mission conducted three half-day training sessions on: diversifying external resource mobilisation and practicalities of international bond markets and credit ratings; domestic debt and practicalities for developing domestic bond issues; and the BWI Medium-Term Debt Strategy (MTDS) framework and analytical tool. The training sessions were designed to provide the latest information on international best practices and relate these to the Ethiopian context.

### National Capacity Building Plan missions

<table>
<thead>
<tr>
<th>Country</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benin</td>
<td>Cotonou, 10-13 March</td>
</tr>
<tr>
<td>Mali</td>
<td>Bamako, 16-20 March</td>
</tr>
<tr>
<td>Niger</td>
<td>Niamey, 16-20 March</td>
</tr>
<tr>
<td>Gabon</td>
<td>Libreville, 6-10 April</td>
</tr>
<tr>
<td>Cameroun</td>
<td>Yaoundé, 13-17 April</td>
</tr>
<tr>
<td>Togo</td>
<td>Lomé, 20-24 April</td>
</tr>
<tr>
<td>CAR</td>
<td>Bangui, 27-30 April</td>
</tr>
<tr>
<td>Congo</td>
<td>Brazzaville, 8-12 June</td>
</tr>
</tbody>
</table>

These missions helped each country to identify its public debt management capacity-building needs, and to turn them into draft national capacity-building plans. These plans have since then been included in the document for phase 3 of Pôle-Dette, which was agreed by the Executive Committee of Pôle-Dette at its meeting in Moroni at the beginning of July.

### Distance Learning and Attachments

#### Lusophone Residential School

**Sao Tomé, 16-26 March**

The first residential school for Portuguese speaking students was held in Sao Tomé and Principe. Three students graduated successfully from the programme, which could be made available in future to the PALOP Economic and Financial Management Institute. Because Sao Tomé and Principe is a post-HIPC country and is yet to develop a local domestic debt market, students chose the new financing path. Students came from the Ministry of Finance, both Treasury and Planning, and the Central Bank. These students, who had already participated in previous regional and national activities, have shown the knowledge and skills to be resource people and to mentor future students, and are therefore expected to conduct future training in new financing methodology.

#### Pôle-Dette Attachments to DRI

**London, 15-26 June**

These attachments took place in the context of the Pôle-Dette Training of Trainers Programme. They involved two officials, one each from Chad and Guinea-Bissau, who are studying to be trainers in respectively new external financing and domestic debt strategy. They received two weeks of training during which they accelerated or finalised their distance learning work; and drafted a work programme, methodology and initial chapters of their technical papers for training of trainers. Both are expected to finish being trained as trainers by the end of 2009.

### Future Activities

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

- **Regional Workshops**
  - BCEAO/BEAC Pôle-Dette: Domestic Debt Strategies Workshop; Committee on Public Cash Flow Management Workshop; MTDS Workshop;
  - CEMLA: DSF Regional Workshop; Regional Seminar on Debt Strategy;
  - MEFMI: Regional Workshop on MTDS; Training for Trainers in Debt Strategy and the LIC-DSF;
  - PALOP Regional Workshop;
  - WAIFEM Training for Trainers on Debt Strategy and the LIC-DSF.

- **National Workshops**
  - Bolivia; Gambia; Guyana; Haiti; Mozambique; Nicaragua (domestic debt); Rwanda; Sierra Leone; Zambia;
  - Subnational Workshops
  - Benin; Cameroon; Chad; Comoros; Congo; Côte d’Ivoire; Guinea; Haiti; Liberia; Mali; Niger; RCA; Togo.

- **Institutional/Follow-up Missions**
  - Benin; Cameroon; Chad; Comoros; Congo; Côte d’Ivoire; Guinea; Haiti; Liberia; Mali; Niger; RCA; Togo.

- **DSA Review and Sensitisation Missions**
  - Burundi; Malawi; Zambia.

- **Attachments**
  - MEFMI Fellows Attachment to MEFMI Secretariat in Harare; WAIFEM Staff Attachment to DRI.

- **Distance Learning Programme**
  - English, Spanish and French speaking Residential Workshops for the second intake of students.

- **Information Products**
  - two newsletters, 4 listserves on latest debt management developments, and publications on Best Practices in Debt Management Institutions, Subnational Debt, post-HIPC Debt Sustainability and Macroeconomic Forecasting.

- **Governance and Liaison**
  - a meeting of the CBP-OIF-Commonwealth Secretariat Finance Ministers’ Network at the IMF and World Bank Annual Meetings, attendance at the UNCTAD Debt Management conference and the World Bank DMF Conference.

**HIPC Website**

DRI has recently prepared a new document ‘Instructions for Using HIPC CBP Domestic Debt Template’ which explains in more detail how the different functions of the template work, and how to conduct data entry. This document is now available on the website on the members’ only section, at [www.hipc-cbp.org](http://www.hipc-cbp.org)
Responding to country demand from Latin America and the Caribbean, CEMLA and DFI organised a “Regional Seminar on the Financial Crisis and External Private Capital Flows to Latin America”, in Mexico City during 11-13 March.

The event came at an ideal time for achieving its two aims:

- analysing the impact of the global financial crisis on the economies of Latin American and the Caribbean, as well as the governments’ policy responses to the crisis; and
- assessing the implications for flows of foreign private capital (FPC) and for future work in the region on monitoring and analysis of FPC to ensure that flows are more stable and the economies are less vulnerable to this crisis.

1. Participants and Structure

The seminar was successful in attracting a high level of participation, including many Directors from Central Banks and Investment Promotion Agencies, totalling 28 participants from 15 countries: Bahamas, Bolivia, Brazil, Chile, Colombia, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Paraguay, Peru and Venezuela. In line with indications that donors would expand the next phase of a CEMLA-led programme to cover middle- and low-income countries, the participating countries had very diverse levels of economic development and capacity to monitor and analyse FPC. The participants evaluated the event as having been very well organised in terms of technical inputs and discussions, as well as administrative arrangements.

The resource-people for the seminar included very high-level Directors from international and regional organisations, and benefited especially from the presence of the Executive Secretary of the UNECLAC, Alicia Bárcena, who made two key presentations.

The seminar was structured around 8 sets of themes:

3. Impact of the Crisis on Flows of FPC to the Region.
5. G-20 London Summit Decisions and Implications for the Region.
6. Implications of the Crisis for Best Practices in Monitoring and Analyzing FPC.

2. Impact of the Crisis and Policy Responses

Theme 1, and initial sessions for themes 2-5, were led by presentations from international and regional organisations including the IDB, IMF, World Bank, and UNECLAC, as well as CEMLA and DFI. In addition, beginning with theme 2, each participating country also made a presentation on the details of the impact and policy responses in its own national context, allowing representatives of countries to exchange experiences and learn best practices. These provided a huge amount of fascinating information on the impact of the crisis and national and global policy responses, and produced the following main conclusions:

- The crisis has already hit the region hard, and its impact will worsen. In the first quarter of 2009, some were still suggesting that the region would be much less hard hit by the crisis than other regions such as Eastern Europe, because its economies had diversified and economic policy had improved dramatically in the last decade. However, the seminar provided conclusive evidence from authoritative global and regional sources that the impact would be very severe.
for many regional countries. There were a multiplicity of different transmission channels, from huge cuts in remittances and exports to the US in Mexico, to falls in tourism revenue in Central America and the Caribbean, to falls in commodity prices in South America. Different speakers emphasised the impact on different aspects of the economy, with the IMF showing the major potential impact on financial, fiscal and monetary aggregates; the World Bank the impact on the real economy and trade; and UNECLAC on the social sectors, employment, poverty and vulnerable groups, and women. Whichever perspective was taken, the messages were fairly bleak.

• Private flows, including foreign capital and remittances, are already falling. International organisations and participating countries provided data which showed conclusively that all types of private flows to the region – including FDI, bank loans, portfolio flows, trade earnings, remittances, and tourism earnings – were falling fast or even (in regard to financial flows) turning negative. They also traced the impact of these falls on the economy – including exacerbating slumps in industrial and export-oriented production, shortages of local bank credit for investment and working capital, much tighter conditions in government and private sector debt markets, and stock market and exchange rate falls.

• The region is taking strong policy measures but badly needs external support. Many countries in the region were in a strong position to resist economic and financial crises, having accumulated high levels of reserves, reached highly sustainable fiscal and debt positions, and reduced inflation to single digits (in spite of food and petroleum price increases). This gave the general impression that the region could counteract the crisis without recourse to external resources. Indeed, the initial policy response in many countries was to rely on their own reserves and an easing of fiscal and monetary policy, to provide some degree of counter-cyclical economic stimulus (varying between 0.6% and 5.7%). Some also imported policies to protect strategic sectors, and employment levels. A smaller number of countries, which began with weaker economic positions, had to cut expenditures with pro-cyclical results. However, in most cases, the severity of the crisis forced countries to turn to external support, especially to ensure that they can boost reserves, honour their public and private sector financial obligations, and reinforce social safety nets and spending.

• The international financial architecture must be reformed to provide sufficient resources. The participants’ reaction to the G-20 decisions was that they were positive, but insufficient. The international and regional organisations have highly insufficient resources to play the roles allocated to them in the global financial system – whether anti-shock financing in the case of the IMF, or private sector and social sector responses by the MDBs. The increase in their resources promised by the G-20 is welcome, but much larger increases are needed in SDRs, IMF quotas, and MDB lending capacities. At the same time, conditionalities on funds (especially those intended to respond to exogenous shocks) should be drastically reduced, procedures for disbursing funds should be accelerated, and (especially for low-income and debt-distressed countries) the cost of funds should be reduced to avoid renewed levels of unsustainable debt. In short, counter-cyclical funding against crises needs to be virtually automatic, in line with the original Articles of Agreement and mandates of the institutions.

• For successful reform, the region needs to coordinate positions and speak with a unified voice. Low-income and smaller countries from the region are not sufficiently represented in global discussions including the G-20. Therefore it is vital that Latin America and the Caribbean establish structures for regular meetings among Heads of State, Finance and Planning Ministries, and Central Banks, to agree unified positions among member states (as African countries have done recently). This will allow them to express their regional voice effectively via their representatives in the G-20, as well as other international fora, such as the BWIs and the UN. CEMLA and UNECLAC could help to provide technical support to such processes.

In the final sessions of the seminar, countries evaluated their own needs for building capacity in these areas, using the self-evaluation methodology designed by the FPC CBP. Their final presentations of this evaluation underlined their major needs for capacity-building support from a regional institution, to improve FPC monitoring, analysis and policy responses and foresee or confront future crises with appropriate policy responses. Though there were important variations in their needs, with some countries needing comprehensive support and others only reinforcement in particular areas, all countries (regardless of income level or sub-region) had important needs for support.

In the concluding sessions, participant representatives therefore strongly underlined the need for CEMLA and DFI to continue and reinforce their joint FPC monitoring and analysis programme, including widening its coverage to more countries, in order to better protect countries against future financial crises.
This article presents key findings from Zambia’s recently completed census for 2006-2007. A total of 321 enterprises were surveyed, and a response rate of 84% (268 enterprises) was registered. The survey took place during a global FDI boom which peaked in 2007. Based on feedback from investors at the dissemination seminar for the census results, flows for 2008 have been depressed by the global economic crisis, especially as a result of declining copper prices.

Foreign Private Capital

The table below shows that FDI was the major type of FPC in 2006-07, but the largest flow transactions were in reinvested earnings and loans from related and unrelated sources, rather than new equity investment. Portfolio equity and debt securities remained insignificant.

FDI

FDI rose by 25% in 2007, and represented 90% of stock and 70% of flows in 2007. FDI inflows during 2007 were largely composed of reinvested earnings (59%), which rose to almost the same stock level as foreign equity investment, showing a high degree of confidence in the economy among existing investors. Loans from related companies also rose by 26%, mostly due to long-term loans, which were preferred to loans from unrelated companies, because they have flexible terms and conditions including low or 0 interest rate, and sometimes undefined repayment dates.

As Chart 1 shows, FDI stock was concentrated in mining, although manufacturing increased its share over the period. In addition, mining received the most FDI during 2007, accounting for 59% of the value of transactions. The increasing activities of multinational corporations in the mining sector were a response to rich mineral resources, a better investment climate, higher metal prices in the international market, and competition among consuming countries for metals. Activities in other sectors remained low at below 10 percent of stocks and flows. This is a major source of concern to Government, which is seeking to diversify its economy into other sectors.

FDI remained concentrated in regions with mineral resources (the Copperbelt and North Western Provinces) and good infrastructure/commercial centres (Lusaka Province). This is also of concern to government, which is trying to assist poorer regions to attract more investment.

Source countries were mostly those which had major investors in mining: Australia (22%), Canada (11%), India (10%) and Switzerland (10%). On the other hand, the United Kingdom and South Africa (8% each) invested most in financial institutions and manufacturing respectively.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Investment</td>
<td>6,024.70</td>
<td>1,323.90</td>
<td>255.30</td>
<td>7,603.90</td>
</tr>
<tr>
<td>Equity</td>
<td>2,552.70</td>
<td>131.6</td>
<td>70.10</td>
<td>2,754.40</td>
</tr>
<tr>
<td>Reinvested Earnings</td>
<td>1,602.60</td>
<td>776.4</td>
<td>317.70</td>
<td>2,696.70</td>
</tr>
<tr>
<td>Loans Long-term</td>
<td>1,023.4</td>
<td>320.5</td>
<td>-77.3</td>
<td>1,266.6</td>
</tr>
<tr>
<td>Loans Short-term</td>
<td>236.6</td>
<td>26.7</td>
<td>1.6</td>
<td>264.8</td>
</tr>
<tr>
<td>Supplier Credit</td>
<td>609.4</td>
<td>68.9</td>
<td>-56.90</td>
<td>621.4</td>
</tr>
<tr>
<td>Portfolio Investment</td>
<td>53.1</td>
<td>43.7</td>
<td>1.80</td>
<td>96.6</td>
</tr>
<tr>
<td>Equity</td>
<td>53.1</td>
<td>3.6</td>
<td>0.10</td>
<td>56.8</td>
</tr>
<tr>
<td>Debt Securities</td>
<td>0</td>
<td>40.1</td>
<td>1.70</td>
<td>41.8</td>
</tr>
<tr>
<td>Other Investment</td>
<td>224.7</td>
<td>427.8</td>
<td>19.90</td>
<td>672.4</td>
</tr>
<tr>
<td>Loans Long-term</td>
<td>203.4</td>
<td>426.7</td>
<td>19.90</td>
<td>650</td>
</tr>
<tr>
<td>Loans Short-term</td>
<td>7.9</td>
<td>0.4</td>
<td>-1.40</td>
<td>6.9</td>
</tr>
<tr>
<td>Supplier Credit</td>
<td>13.4</td>
<td>0.7</td>
<td>1.40</td>
<td>15.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>6,302.50</td>
<td>1,795.40</td>
<td>277.00</td>
<td>8,374.90</td>
</tr>
</tbody>
</table>

Source: Bank of Zambia database
The average rate of return on equity was high at 21.5%. Though Chart 2 shows strong sector variations, there are highly profitable opportunities in most sectors.

The strongest performers included Construction, Transport & Communication, Finance, Wholesale and Retail Trade, Hotels and Mining. Manufacturing and Real Estate reported losses, but only due to development costs of new projects whose returns were yet to be realized.

Portfolio investment remained relatively very low accounting for only about 1% of FPC stock. Movement of portfolio investment was dominated by debt securities which accounted for over 90 percent in 2007, mainly due to higher returns on government securities. Nevertheless, since the census, the Lusaka Stock Exchange has been affected by the global financial and economic crisis: its All Share Index declined by 29.2% during 2008 in considerable part due to the withdrawal of these foreign investors. The increase in its market capitalisation by 13.9% was mainly due to the initial public offering of Zanaco and Celtel shares.

Debt Private Sector External Debt (PSED), which includes that from non-affiliates and affiliates (the latter being also a component of FDI), grew by 42% between 2006 and 2007 and accounted for 34% of FPC stock at the end of 2007, indicating a growing need for its monitoring. Debt from unrelated sources remained mostly long-term between 2006 and 2007, and was significantly lower than debt from affiliated companies. Debt was contracted mostly by Mining investors (62%), and the main creditor countries (80%) were Switzerland, Canada, the United Kingdom, and China.

Foreign Assets Foreign assets were mostly in the form of lending which increased from USD 138.9 million in 2006 to USD 329.5 million in 2007, mostly in the form of loans and advances (89%). Financial institutions accounted for 89% of the lending, mostly destined for the United Kingdom.

Investor Perceptions and CSR The main factors behind initial investment decisions included natural resource endowments and the stable domestic political environment. Subsequent investment decisions were however most positively influenced by domestic macroeconomic conditions, regional market size, and financial stability. However, negative influences on investment were interest rate levels, corruption and bureaucracy, and the cost and supply of electricity, calling for immediate government action to address the challenges. Looking forward, most investors expected to diversify by sector and forecasted increased profitability and turnover. In terms of corporate responsibility, investor’s financial contributions rose by 680% between 2006 and 2007. CSR was largely dominated by the mining sector with the main target areas being the environment, health and safety.

Policy implications The survey results show that FPC data in Zambia, before the current survey, were highly under-estimated. Pre-survey data was mostly sourced from administrative records from Zambia Development Agency, which is by its nature not designed for BOP purposes. In 2007, for example, pre-survey estimate for FDI was reported as USD 835.9 million, which was US $ 488.0 million lower than US $1,323.9 million obtained from the survey, a variance of about 58%. In the absence of FPC comprehensive survey, data would continue to be underestimated. It is therefore crucial for Zambia to continue to improve monitoring of FPC.

The survey also provided valuable lessons for policies. To attract investment and increase the developmental impact of FPC there is need:

- Continue with the ongoing efforts to improve country’s business environment, investment opportunities and government commitment towards private sector led growth, in particular fighting against corruption and reducing bureaucracy
- Provide sector and regional specific incentives to the disadvantage sectors/regions to facilitate diversification.
- Improve infrastructure and utilities through investments in energy, roads/railway and telecommunications.

However, the survey also covered a period before the onset of the global financial crisis, which has had a huge negative impact on FPC flows to Zambia. Several of the negative impacts of the crisis could have been foreseen had the survey results been available earlier, notably the fall in mining investment as minerals prices collapsed, the withdrawal of related and unrelated loans, and the negative impact on the Lusaka Stock Exchange.

For Zambia to use the results of future surveys to maximize the benefits of FPC as a source of development finance, and mitigate its possible destabilizing effects on the economy, the FPC team will need to a) conduct much more rapid sample surveys on a quarterly or semiannual basis; and b) enhance the forward-looking nature of survey questions and analysis, and make sustainability forecasts of flows to assess possible different scenarios. The Zambian government, which funded virtually all the costs of the current survey, intends to pursue this work urgently.
Over the last quarter, CEMLA hosted a Regional seminar in Mexico focusing on the impact of the financial crisis in the region, the FPC CBP progressed in all regions, with 6 Franc Zone countries, 4 MEFMI countries, and 1 WAIFEM country completing their enterprise surveys. Partners have been putting the final touches to their post-phase 3 funding proposals. The FPC CBP also started a synthesis analysis of country results to be published during Q3. Seco have extended the current phase of the programme to September.

CEMLA regional seminar

CEMLA hosted a seminar for its member states at its HQ in Mexico City during March. It addressed the causes and effects of, and policy responses to, the current global financial and economic crisis, and demand for the forthcoming new phase of the programme in the region. It was well attended by countries, regional and international experts. Main findings are summarized in the article on pages 11-12.

Country progress

Countries have progressed as follows:
- Benin (Cycle 1) has attained a 72% response rate and is finalising its data collection with a view to hold a Closing and Dissemination Workshop at the end of August
- Bolivia (Cycle 3) is preparing for an event in July, to disseminate the results of its latest survey
- Burkina Faso (Cycle 2) has finalized its data processing, obtained a 64% response rate and is working towards hosting a Follow Up Mission in Q3
- Cameroon (Cycle 2) completed its data processing and reached a 66% response rate. A FUM in scheduled for Q3
- CAR (Cycle 1) hosted an Opening Awareness and Training workshop at the end of May and is expected to launch the survey in July
- Chad (Cycle 1) received an Opening Awareness and Training workshop in June and is expecting to launch the survey in mid-July
- Congo (Cycle 1) held an Opening Awareness and Training workshop early in June and is expected to launch the survey early September
- Cote d’Ivoire (Cycle 1) has extended data collection by a month and will host a FUM in July
- Equatorial Guinea (Cycle 1) received a Demand Assessment Mission in June and aims at launching its survey in Q3
- Guinea-Bissau (Cycle 1) hosted a Demand Assessment Mission in May and is preparing an OAT for July
- The Gambia (Cycle 3) hosted a Follow Up Mission in Q2, which assisted in finalising data for 2007-8. It expects to disseminate data and analysis in Q3
- Ghana (Cycle 2) finalized its sample survey and published its results and analysis in June in a Bank of Ghana Briefing Paper. It expects to commence a census later in the year
- Malawi (Cycle 4) held a training workshop during Q2 to launch its 4th Cycle. The team is presently in the field
- Mali (Cycle 1) has a current response rate of 70% and is scheduling a Closing and Dissemination Workshop in September
- Nicaragua (Cycle 2) is continuing to implement surveys in coordination with its National Accounts exercise
- Niger (Cycle 1) is in the process of finalising its data collection and is working towards holding a Follow Up Mission at the end of July. A Software training workshop was also held in June to ensure software users’ proficiency
- Senegal obtained a 75% response rate and held a Follow Up Mission in March. It is now finalising its analytical report with a view to disseminate the results in Q3
- Tanzania (Cycle 5) finalised its analytical report for Cycle 4, and has just launched Cycle 5
- Togo (Cycle 1) finalized its data collection in April and obtained a 65% response rate. A Follow Up Mission was held in June and a Closing and Dissemination Workshop is planned for the end of August
- Uganda (Cycle 8) hosted a results dissemination event in Q2 and launched its 8th Cycle following a training workshop
- Zambia (Cycle 2) disseminated data and analysis for 2007 during Q2 – see article on pages 13-14, and is planning towards Cycle 3

Methodology and Software

- BCEAO-Siége Training Department and DFI trained representatives from Benin, Cote d’Ivoire, Senegal and Togo in how to use the FPC CBP generic software. The event took place at BCEAO Siege in Dakar, during 20-24 April
- The User Manual for the FPC CBP generic software is now available in Spanish and Portuguese to cater for the Hispanophone and Lusophone Franc Zone participant countries
- The MEFMI PCMS is being installed and tested in the region
- DFI is continuing to develop new methodology through to the end of Q3

Information products

- Newsletter 38 can now be downloaded from the FPC CBP website (www.fpc-cbp.org). In this issue, the FPC CBP updates on its activities and focuses on the impact of the financial crisis in participating countries in terms of capital flows
- DFI is preparing a synthesis analysis of country findings, expected to be published during Q3, which will focus on the implications for the effects of the global financial crisis

Governance

- Seco has extended the current Phase 3 to the end of September 2009
- Seco will commence its review of Phase 3 during Q3
- BCEAO, BEAC and CEMLA are submitting their proposals to donors for the next phase, and other regions are reviewing options for next steps.
A sovereign credit rating reflects the credit rating agency's opinions on the future ability and willingness of the sovereign government to service its commercial financial obligations in full and on time. A sovereign rating is a forward-looking estimate of default probability. It is required to issue sovereign bonds in certain markets (for example in US bond and Eurobond markets). The process of sovereign credit rating begins when the issuer signs a contract with one of the credit rating agencies, the three major ones being Fitch, Moody's and Standard & Poor’s.

Ratings Methodology
Although each rating agency has its own methodology, they all effectively assess the same categories, which are graded, using scales such as one (being the highest grade) to six (the lowest grade). The key categories analysed are summarised in table 1.

Sovereign Credit Ratings
Once each analytical category has been graded, the country receives a final grade which can range from AAA (the highest grade) to C (the lowest grade). The common gradings are as follows:

<table>
<thead>
<tr>
<th>Investment grade</th>
<th>Speculative Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>A</td>
</tr>
<tr>
<td>BB</td>
<td>BBB</td>
</tr>
</tbody>
</table>

Default:
- R = under regulatory supervision due to financial conditions
- SD = selective default when borrower fails to make due to specific issue
- D = default when borrower fail to pay and is unlikely to be able to pay on all obligations
- NR = not rated

A rating agency can also differential within a grade by adding a '+' or '-' after the rating, for example B+ or BB-.

Table 1

<table>
<thead>
<tr>
<th>Political risks</th>
<th>Income and economic structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stability and impartiality of political institutions</td>
<td>Prosperity, diversity and degree to which economy is market oriented</td>
</tr>
<tr>
<td>(separation of branches, particularly, the judicial)</td>
<td>Income disparities</td>
</tr>
<tr>
<td>Popular participation in political process</td>
<td>Effectiveness of financial sector in intermediating funds, availability of credit</td>
</tr>
<tr>
<td>Orderliness of leadership succession</td>
<td>Competitiveness and profitability of non-financial sector</td>
</tr>
<tr>
<td>Public security</td>
<td>Efficiency of public sector</td>
</tr>
<tr>
<td>Geopolitical risk</td>
<td>Protectionism and other nonmarket influences</td>
</tr>
</tbody>
</table>

Economic growth and prospects
- Size and composition of savings and investments
- Rate and pattern of economic growth

External liquidity
- Impact of fiscal and monetary policies
- Structure of the current account
- Composition of capital flows
- Reserve adequacy

Fiscal flexibility
- General government revenue, expenditure and surplus/deficit trends
- Revenue raising flexibility and efficiency
- Expenditure effectiveness and pressure
- Timeliness, coverage, and transparency of reporting
- Pension obligations (contingent liabilities)

Monetary flexibility
- Price behaviour in economic cycles (inflation)
- Money and credit expansion
- Compatibility of exchange rate regime with monetary policy
- Institutional factors such independence of central bank
- Range and efficiency of monetary tools

General government debt burden
- General government gross and net (of assets) debt as percent of GDP
- Share of government devoted to interest
- Currency composition and maturity profile
- Depth and breadth of local capital market

External debt burden
- Gross and net external debt including deposits and structured debt
- Maturity profile, currency composition, and sensitivity to interest change
- Access to concessional lending
- Debt service burden

Table 2

<table>
<thead>
<tr>
<th>Credit ratings of African countries (foreign currency issues), May 2009</th>
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<tr>
<td>Country</td>
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<td>Benin</td>
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<td>Cameroon</td>
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<td>Rwanda</td>
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<td>Senegal</td>
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<td>South Africa</td>
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Issues for consideration
The credit rating agencies are always keen to offer their services to countries, as they earn fees from doing a credit rating assessment. In addition, the rating agencies will try to sell the benefits of a rating, such as an enhancing international exposure, conferring financial gravitas, promoting foreign interest in the economy and encouraging foreign capital inflows to the private sector.

However prior to going for a credit rating, it is useful to consider the following issues:
- It is preferable to go for a rating when the rating is expected to be investment grade, because a sub-investment or speculative grade rating can increase bond issue costs considerably.
- Credit ratings are very sticky upwards (ie a country can get stuck in a sub-investment grade for a long time even if its performance improves), but slippery downwards (ie ratings can be rapidly downgraded, which has in the past provoked a capital crisis in several countries).
- In effect having no credit rating can be preferable to having a poor rating.
- If a country has any doubt as to whether it will achieve an investment grade rating, it is best advised to apply for a “shadow rating” which can be kept private and not published if it is disappointing. Alternatively, the country can decline a rating if it is unacceptable.
- Credit ratings have been criticised for not promoting any significant increase in capital flows to the private sector, and for not identifying problems in some countries before they default.

A credit rating should be sought by a sovereign government if it is planning to issue an international bond, or for a local currency bond if it wants to attract foreign investors to the domestic capital market. However, the cost (as measured by the spread) of issuing a bond is highly correlated to the credit rating that the country receives. Therefore, the credit rating level and the timing of its release is very important to the success of the bond operation.