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KEY ANALYTICAL ISSUES FOR GOVERNMENT EXTERNAL FINANCING

Alison Johnson and Matthew Martin

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London EC1R 3AF, United Kingdom
Tel.: 44 (0)20 – 7278 0022 Fax: 44 (0)20 – 7278 8622 Email: publications@dri.org.uk

Foreword

To comply with additional findings on external aid, the 1st Edition of *Key Analytical Issues for Government External Financing*, published by Debt Relief International in 2003 is hereby modified:

- The full section 4.3 'Benchmarks for external assistance sustainability indicators' is replaced;

- Footnote 24 is amended;

- Annex 3 'OECD Donor/Creditor Agencies': note new information for the Netherlands ECA. New name and web address, amended details;

- Annex 4 'Bibliography': six additional references added.

The views expressed in the publications are those of the authors and not necessarily those of the HIPC CBP donors.

We welcome any comments on this publication or suggestions for other topics to be included.

Alison Johnson
Publications Editor

Yolande Eyoum
Publications Administrator

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Acronyms

ADB	Asian Development Bank
AECI	*Agencia Española de Cooperación Internacional* (Spanish International Co-operation Agency)
AfD	*Agence française de développement* (formerly called CFD: *Caisse française de développement*) (French Development Agency)
AfDB	African Development Bank
AfDF	African Development Fund
AFESD	Arab Fund for Economic and Social Development
BADEA	*Banque arabe pour le développement économique en Afrique* (Arab Bank for Economic Development in Africa)
BCEAO	*Banque centrale des États de l'Afrique de l'Ouest* (Central Bank of West African States)
BEAC	*Banque des États de l'Afrique Centrale* (Bank of Central African States)
BoP	Balance of Payments
BWI	Bretton Woods Institutions
CABEI	Central American Bank for Economic Integration
CAF	*Corporación Andina de Fomento* (Andean Development Corporation)
CCL	Contingent Credit Lines
CDB	Caribbean Development Bank
CEMLA	*Centro de Estudios Monetarios Latinoamericanos* (Centre for Latin American Monetary Studies)
CESCE	*Compañía Española de Seguros de Crédito a la Exportación* (Spain Export Credit Agency)
CFF	Compensatory Financing Facility
CIDA	Canadian International Development Agency
CIRR	Commercial Interest Reference Rates (OECD)
CMCF	CARICOM Multilateral Clearing Facility
COFACE	*Compagnie française d'assurance pour le commerce extérieur* (France Export Credit Agency)
CWB	Canadian Western Bank
DAC	Development Assistance Committee (OECD)
DANIDA	Danish International Development Agency
DBR	Domestic Budget Revenue
DFID	Department for International Development (United Kingdom)
DRI	Debt Relief International

EADB	East African Development Bank
ECGD	Export Credits Guarantee Department (United Kingdom)
ECOWAS	Economic Community of West African States
EDC	Export Development Canada (Canada Export Credit Agency)
EDF	European Development Fund
EFF	Extended Find Facility
EIB	European Investment Bank
EKF	*Eksport Kredit Fonden* (Denmark Export Credit Agency)
EKN	*Exportkreditnämden* (Sweden Export Credit Agency)
ERG	Export Risk Guarantee (Switzerland Export Credit Agency)
ESAF	Enhanced Structural Adjustment Facility
FDI	Foreign Direct Investment
FINNIDA	Department for International Development Cooperation (Finland)
FINNVERA	Finland Export Credit Agency
FONPLATA	*Fondo Financiero para el Desarrollo de la Cuenca del Plata* (Financial Fund for the Development of the River Plate Basin)
FSO	Fund for Special Operations (IADB)
GDP	Gross Domestic Product
GE	Grant Element
GIEK	*Garanti-Instituttet for Eksportkreditt* (Norway Export Credit Agency)
GTZ	*Deutsche Gesellschaft für Technische Zusammenarbeit* (German Agency for Technical Cooperation)
HIPC	Heavily Indebted Poor Country
HIPC I	Original HIPC Initiative
HIPC II	Enhanced HIPC Initiative
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
IsDB	Islamic Development Bank
JIBC	Japan Bank for International Co-operation
JICA	Japan International Cooperation Agency

KfW	*Kreditanstalt für Wiederaufbau* (German Development Bank)
LLDC	Least Developed Country
MEFMI	Macroeconomic and Financial Institute for Eastern and Southern Africa
MFA	Ministry of Foreign Affairs
MITI	Ministry of International Trade and Industry (Japan)
NDB	Nordic Development Bank
NDF	Nordic Development Fund
NGO	Non-governmental Organisation
NORAD	Norwegian Agency for International Development
NPV	Net Present Value
OCR	Ordinary Capital Resources
ODA	Official Development Assistance
ODF	Official Development Finance
OECD	Organisation for Economic Co-operation and Development
OeKB	*Oesterreichische Kontrollbank Aktiengesellschaft* (Austria Export Credit Agency)
ONDD	*Office national du Ducroire-Delcredere* (Belgium Export Credit Agency)
OOF	Other Official Flows
OGL	Open General Licence
OPEC	Organisation of Petroleum Exporting Countries
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PV	Present Value
SACE	*Instituto per i Servizi Assicurativi del Commercio Estero* (Italy Export Credit Agency)
SBA	Stand-by Arrangements
SDC	Swiss Agency for Development and Cooperation
SDR	Special Drawing Rights
Sida	Swedish International Development Cooperation Agency
SPL	Special Programme Loans
SRF	Supplemental Reserve Facility
TA	Technical Assistance
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund
USAID	United States Agency for International Development
VAT	Value Added Tax

WADB	West African Development Bank
WAIFEM	West African Institute for Financial and Economic Management
WFP	World Food Programme
XGS	Exports of Goods and Services

1. INTRODUCTION

For HIPCs and low-income developing countries, external assistance is primarily comprised of grants, concessional loans and export credits from official bilateral and multilateral sources. In contrast, the middle-income developing countries are not able to access these types of external finance. Instead they are reliant on non-concessional loans and credits from bilateral and multilateral agencies. In addition, the more creditworthy middle-income countries may also be able to borrow syndicated credits from commercial banks or issue bonds on the international capital markets. Table 1 summarises the main types of financial flows available to all sovereign borrowers as follows:

- Aid flows – comprised of grants and concessional loans which are the main sources of external finance for HIPCs and low-income countries.
- Non-concessional debt – comprised of export credits and other development finance (such as non-concessional loans from bilateral and multilateral agencies), syndicated loans and bonds issues which are available to more credit worthy borrowers
- Domestic debt – comprised of national debt instruments issued by governments, agencies and /or corporations. Domestic debt will not be considered in this paper.

This table also provides a comparison of the financial flows in terms of cost, conditionality, disbursements, utilisation, aims, predictability, risks and default which are discussed in detail in the paper *Financing Poverty Reduction in the Heavily Indebted Poor Countries: Beyond HIPC II*[1].

For HIPC governments to prepare their own national strategy for external assistance, they will need to go beyond these issues and analyse their experience of external assistance, how it has been delivered and the constraints to this delivery, as well as its impact on the macroeconomy and for poverty reduction spending. In addition, HIPC governments need to analyse future options for external assistance and design a national strategy enabling long-term sustainability of external assistance for poverty reduction.

This paper focuses on the key issues HIPC governments need to examine, when analysing their options for new external assistance and designing an external assistance strategy. The paper is divided into sections that look in turn at one set of key issues for designing an external assistance strategy, as follows:

- Classifying external assistance: defining external assistance, aid, concessionality and the different ways it can be classified by financial terms, source of funds, type of funds, and recipient,
- Accounting for external assistance in the budget, balance of payments and monetary sector accounts;
- Evolution of external assistance: the main components of a portfolio review of external assistance and the key indicators for monitoring external assistance flows;
- Analysing donor/creditor and government procedures and practices and the implications for external assistance;
- Policy aspects of external assistance and how to co-ordinate with the national poverty reduction and development strategy;

[1] See M. Martin (2000).

- Macroeconomic impact of external assistance on the balance of payments, budget, monetary sector, inflation, savings and investment and debt levels.

This paper draws extensively on Debt Relief International's experience in advising and training of 32 of the Heavily Indebted Poor Countries during the past six years, sometimes in collaboration with our regional partners: BCEAO/BEAC Pôle-Dette, Centro de Estudios Monetarios Latinoamericanos (CEMLA), Macroeconomic and Financial Management Institute for Eastern and Southern Africa (MEFMI), West African Institute for Financial and Economic Management (WAIFEM); and other international institutions, such as Commonwealth Secretariat, IMF, UNCTAD, UNDP and the World Bank. We are grateful to these institutions and especially to the governments of the 32 HIPCs with which DRI is working, of which policymakers and staff should take the real credit for the expertise we have gained. We would also like to thank Magdalene Ewuraesi Apenteng for her valuable contributions to the report.

TABLE 1: COMPARISON OF FINANCING FLOWS

	AID FLOWS		NON-CONCESSIONAL DEBT			
	Grants	**Concessional Loans**	**Export Credits / Other Development Finance**	**Syndicated Loans**	**Bonds**	**Domestic Debt**
Cost	no repayment or interest	concessional rates, grant element >35%	slight subsidy, overpricing, hidden costs	commercial rates, additional fees	commercial rates, additional fees	commercial rates
Conditionality	link to structural adjustment? donor fads?	link to structural adjustment? donor fads?	some - for cover	none, but higher spreads	none, but higher spreads	none, but risk premium
Disbursement	programme – fast project - slow	programme – fast project - slow	reasonable	fast	fast	fast
Utilisation	tying? counterpart fund requirements?	tying? counterpart fund requirements?	tying?	untied	untied	untied
Aim	development and budget finance	development and budget finance	trade finance	budget finance, credit worthiness	budget finance, credit worthiness	budget finance, financial market development
Predictability	reasonable	reasonable	low - depends on cover?	unstable	unstable	high until saturation
Risks	slight exchange risk	slight exchange risk, fixed interest, long maturity	high exchange rate, fixed interest, maturity bunching	high exchange rate (offset by risk management tools?) high interest risk, maturity bunching	high exchange rate (offset by risk management tools?), high interest risk, high maturity bunching	no exchange rate risk (unless indexed), fixed or variable interest? maturity bunching?
Default	none	Paris Club - bilateral	Paris Club - bilateral	London Club	Paris Club comparable?	?

2. CLASSIFYING EXTERNAL ASSISTANCE

This section examines the three main ways in which external finance can be classified: according to its financial terms, according to its source of funds, and according to the type of funds.

2.1 DEFINING EXTERNAL ASSISTANCE, AID AND CONCESSIONALITY

External assistance is comprised of aid or concessional finance, also known as ‘official development assistance (ODA)’, and market-related or non-concessional finance. The distinction between aid and market-related finance reflects the actual cost of funds to the recipient, which is characterised using the concept of concessionality. For HIPCs, aid flows account for the majority of external assistance for development purposes. However, many developing countries also use export credits and other types of non-concessional funding.

This section defines aid and the concept of concessionality which is used to distinguish between aid and non-concessional flows. For more details on the terms and definitions of external assistance, refer to the Glossary in Annex 1.

2.1.1 Aid

Aid (also known as ODA) is comprised of grants, which are transfers that do not have to be repaid, and loans, which qualify as ‘official development assistance (ODA)’ to developing countries. **Official development assistance** is grants or loans, which are:

- lent by the official public sector – that is by any government or government related body, or guaranteed by a creditor government body such as an export credit agency;
- intended to promote economic development and welfare. As a result, grants and loans for military purposes are excluded from ODA; and
- on concessional financial terms. For the Organisation of Economic Co-operation and Development (OECD), ODA concessionality is defined as loans having a grant element of at least 25%.

Loans, which are lent by the public sector but do not qualify as ODA because they are not primarily aimed at development or are not concessional, are known as **Other official flows (OOF)**. These include exports credits extended by donor governments or guaranteed by them. Military grants and loans are also classified as OOF.

2.1.2 Loan Concessionality

So how is the concessionality of a loan calculated? Loan concessionality is determined by the **grant element** (GE) calculation, which is defined as:

$$\text{GE}\,(\%) = \frac{(\text{nominal loan amount - present value}) \times 100}{\text{nominal loan amount}}$$

The calculation reflects the loan terms at the time of commitment, when the loan is agreed. The **present value** is the discounted stream of future debt service payments assuming the loan is fully disbursed on the date of contract. In other words, the calculation of future interest payments is on the total loan amount and does not take into account that disbursements can take place over a number of years. The present value calculation is set out in more detail in Annex 2.

Since a grant is not repaid nor is there any interest charge, the present value of future payments is nil and therefore a grant element of a 100%. For loans, however, it is a different story and the length of the grace and maturity periods and rate of interest will determine the present value of future debt service payments and hence the grant element. In general, loans with longer grace and maturity periods and lower interest rates have a smaller present value and therefore a larger grant element. For example, an IDA loan with grace and maturity of 10 years and 40 years respectively and a service charge of ¾% has a grant element of approximately 70%. This means that over the life of the loan, the borrower will only be repaying in present value terms about 30% of the nominal loan amount, the other 70% being equivalent to a grant. Loans with shorter grace and maturity periods and/or higher interest rates will have lower grant elements and therefore be less concessional or more costly to service.

The Development Assistance Committee (DAC) of the OECD defines concessional loans as having a grant element – calculated on the basis of a uniform 10% discount rate for all loans, of at least 25%. This is the current basis used for defining ODA. The difficulty with this definition is that at times of low interest rates, it is possible for a commercially priced loan in a low-interest rate currency to be concessional.

In 1996, the OECD changed the way in which it determined concessionality for export credits, but not for ODA. Instead of a flat 10%, the discount rate for calculating the grant element of an export credit is the market-related Commercial Interest Reference Rates (CIRR)[2]. Using CIRR discount rates, an export credit is considered to be concessional if it has a grant element of at least 35%.

However, for the 49 low income countries falling within the United Nation's classification of least developed countries (LLDCs), the concessionality threshold for export credits is a grant element of 50% or higher. This means that LLDCs should only be borrowing export credits which have a grant element of 50% or more. LLDCs is a sub-group of low income countries, established by the United Nations as falling below thresholds for income, economic diversification and social development[3]. Most, but not all, HIPC countries are LLDCs subgroups[4].

The International Monetary Fund has adopted the 35% grant element as the threshold for the concessionality of loans to be excluded from borrowing limits in Fund programmes[5]. It does not apply the 50% limit though many have suggested that it should. The IMF calculates the grant element based on the average CIRR rates for the preceding six months.

For HIPC Initiative purposes, the IMF and the World Bank use the OECD's currency-specific CIRRs as the discount rates for calculating the present value of debt[6].

2.1.3 Analysing Concessionality

The grant element of each loan can be used to evaluate concessionality. Table 2 below provides examples of some multilateral and bilateral creditor lending terms and analyses the concessionality of lending with alternative discount rates. This table illustrates the difference in loan concessionality of using a standard 10% or the currency specific CIRR rates as the discount

2 For the latest CIRR rates issued by the OECD, see www.oecd.org/news_and_events/new-numbers/cirr/cirrlist.htm.

3 For more details on LLDCs, see UNCTAD (2000) or website www.unctad.org/ldcs/LDCs/

4 The exceptions are Cameroon, Congo Republic, Côte d'Ivoire, Ghana, Honduras, Kenya, Nicaragua, Nigeria and Vietnam.

5 IMF (1995) and IMF (1996).

6 For more details on the HIPC Initiative and its implementation, see Martin and Johnson (2001).

rate. For example, Japanese ODA loans, with a grant element of 7.5%, are non-concessional when using the current CIRR rate because the loan interest rate of 1% is not very much less than the discount rate. This is not to say that Japanese loans are more expensive than those of other creditors. With a 10% discount rate, Japanese loans are highly concessional. So, in assessing concessionality it is important to know what discount rate is being used and to evaluate the grant element of an individual creditor relative to those available from other creditors.

In addition to individual loan concessionality, it is usual to compute the overall concessionality of the loan portfolio. If the portfolio is dominated by highly concessional borrowings then the overall concessionality will be high. However, if the country has borrowed relatively large amounts of exports credits or other non-concessional finance, then the overall concessionality will be much lower. The concessionality of the debt portfolio is sometime used as a benchmark against which to compare the concessionality of new borrowings. But the effectiveness of this depends on past borrowings.

TABLE 2: CONCESSIONALITY OF LENDING TERMS WITH DIFFERENT DISCOUNT RATES

Creditor	**Loan Terms**			**Currency-specific CIRR rate**	**Grant element (%)**	
	Maturity (yrs)	**Grace (yrs)**	**Interest rate (%)**		**with CIRR rate**	**10% discount rate**
Multilateral creditors						
IDA (IDA only countries)	40	10	0.75	SDR = 5.11	60.6	82.5
IMF (PRGF)	10	5.5	0.50	SDR = 5.11	27.2	46.9
AfDF	50	10	0.75	SDR = 5.11	66.4	85.8
IFAD	40	10	0.75	SDR = 5.11	60.6	82.5
BADEA	22	5	2.0 - 3.0	USD = 5.73	23.7 - 32.4	47.4 - 54.2
IADB	40	10	1.0 - 2.0	SDR = 5.11	41.2 - 54.5	69.3 - 78.0
OPEC Fund	20	5	2.0	USD = 5.73	30.8	52.3
Bilateral creditors						
Paris Club creditors						
Japan (LLDCs)	30	10	1.0	Yen = 1.45	7.5	73.8
(low-income)	30	10	1.8	Yen = 1.45	-5.9	67.2
(middle income)	25	7	2.2	Yen = 1.45	-10.2	57.9
Germany (IDA only countries)	40	10	0.75	Euro = 5.67	61.7	80.7
(other developing)	25	10	2.0	Euro = 5.67	38.7	62.8
France ODA	30	10	2	Euro = 5.67	32.3	59.3
USA ODA	40	10	2.0 - 3.0	USD = 5.73	34.0 - 46.5	60.7 - 69.3
Non-Paris Club creditors						
Kuwait Fund	20	5	4.0	SDR = 5.11	9.5	39.2
Saudi Fund	20	5	2.0	SDR = 5.11	26.6	52.3

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

While the conventional approach has to been to measure the concessionality of a country's debt portfolio, this ignores grants, which for many countries are a large proportion of external assistance. So to identify the overall concessionality of external assistance, grants as well as loans must be included in the calculation as follows:

$$\text{Grant element of external assistance} = \frac{\text{nominal grant amounts} + \text{nominal loan amounts} - \text{present value)}}{\text{nominal grant amounts} + \text{nominal loan amounts}} \text{x100}$$

This measure provides a much better indicator of the concessionality of external flows and can be used as a benchmark for assessing new borrowings.

2.2 TYPES OF EXTERNAL ASSISTANCE

There are four main ways of classifying external assistance as follows:

- financial terms, including concessionality, discussed in Section 2.1 above,
- source of funds from multilateral and bilateral donors/creditors, commercial creditors, private sector and non-governmental organisations (NGOs),
- type of finance, such as programme, project and technical assistance grants and loans, and
- recipients of external assistance, including government and its agencies, the private sector and NGOs.

This section discusses these classifications and provides details of the types of assistance.

2.2.1 Sources and Terms of Finance

The main sources of external assistance for most developing countries are official, that is multilateral and bilateral donors and creditors. Many multilateral institutions and bilateral governments have two financing windows: a concessional window for aid finance and a non-concessional window for export credits or market-related loans. Aid flows are also provided by non-governmental organisations (NGOs), charities and religious, scientific, educational and cultural organisations[7]. Many developing countries are also able to access non-concessional trade finance from private sources such as banks, or exporters, though in most cases a developed country government guarantees this finance. In addition, the most creditworthy developing countries can borrow directly from commercial banks or issue bonds on the international capital markets.

Table 3 provides an overview of the main external assistance flows to developing countries between 1970 and 2001. While net long-term debt flows rose significantly to all developing countries during the 1970s and 1980s, there was a significant decline in new debt during the 1990s and in 2001, developing countries actually repaid more long-term debt than they received in new borrowings. Grant flows too increased significantly in the 1980s but thereafter have stagnated. For severely indebted low income countries, net debt flows were negative, meaning countries repaid more than they borrowed, in 2000 and grant receipts declined during the 1990s.

The other significant change in the last decade has been the growth in private capital flows, especially to middle income countries[8] but also to some low-income countries. For severely

[7] See Chang et al (1999), chapters 10 and 11 for more details.

[8] See Bhinda et al (1999) for more details.

indebted low-income countries, private sector flows were less in 2000 than they had been a decade earlier. For all developing countries, there has been a decline in net private capital flows in 2001 following the downturn in the global economy.

TABLE 3: EXTERNAL ASSISTANCE TO DEVELOPING COUNTRIES, 1970 – 2001 (US$ BILLIONS)

	1970	1980	1990	2000	2001
All developing countries					
Net long-term debt flows	7.0	65.3	43.1	13.6	-19.5
Grants (excludes TA)	1.9	13.1	28.2	29.9	29.2
Net private flows (FDI + portfolio)	2.2	4.4	27.8	217.6	186.7
Total net flows	11.2	82.8	99.1	261.1	196.5
Low income countries					
Net long-term debt flows	2.4	13.6	15.9	0.9	na
Grants (excludes TA)	1.0	7.1	14.9	15.2	na
Net private flows (FDI + portfolio)	0.3	0.2	2.6	9.1	na
Total net flows	3.7	21.0	33.5	25.2	na
Middle income countries					
Net long-term debt flows	4.6	51.7	27.2	12.7	na
Grants (excludes TA)	0.9	6.0	13.2	14.7	na
Net private flows (FDI + portfolio)	1.9	4.2	24.2	208.4	na
Total net flows	7.5	61.9	64.7	236.0	na
Severely indebted low income countries					
Net long-term debt flows	1.7	9.5	9.2	-5.2	na
Grants (excludes TA)	0.5	3.4	8.2	7.3	na
Net private flows (FDI + portfolio)	0.1	0.0	2.3	0.8	na
Total net flows	2.3	12.8	19.7	2.9	na

Net long-term debt flows excluding IMF. TA = technical assistance, FDI = foreign direct investment.
Source: World Bank, Global Development Finance 2002

Multilateral donors/creditors

The main international institutions providing external assistance are:

- The European Union, which provides both grants and concessional loans to developing countries. The European Investment Bank (EIB) is its development bank, providing long-term loans to both public and private sectors. The European Development Fund (EDF) provides resources, mainly grants, to cover planned macro-economic support, programmes and projects. In addition, resources can be used for debt relief or to help with unforeseen shocks.
- The International Fund for Agricultural Development (IFAD), which provides concessional loans and grants in support of rural poverty reduction in developing countries.

- The International Monetary Fund (IMF), which provides concessional loans to low income countries through its Poverty Reduction and Growth Facility (PRGF)[9]. Non-concessional loans are provided through five main facilities: Stand-by Arrangements (SBA), Extended Find Facility (EFF), Supplemental Reserve Facility (SRF), Contingent Credit Lines (CCL) and Compensatory Financing Facility (CFF).
- The Islamic Development Bank, which provides long-term finance for development projects, mainly agriculture and infrastructure, in the least developed countries.
- The United Nations and its main agencies, such as the United Nations Development Programme (UNDP), United Nations Conference for Trade and Development (UNCTAD) and United Nations Children's Fund (UNICEF) and World Food Programme (WFP), which provide most of their assistance in the form of grants.
- The World Bank, which has three lending arms. The International Development Agency (IDA) provides highly concessional loans and some grants to low income countries, with per capita income in 2000 of less than $885. The International Bank for Reconstruction and Development (IBRD) provides non-concessional loans to middle income and creditworthy poorer countries[10]. The International Finance Corporation (IFC) provides loan and equity finance for private sector projects in developing countries.

9 Formerly Enhanced Structural Adjustment Facility (ESAF).

10 For details of issues relating to countries graduating from IDA to IBRD lending, see International Development Association (2001).

TABLE 4: LENDING TERMS OF MULTILATERAL CREDITORS

	Grace (years)	Maturity (years)	Interest rate (%)	Commitment (%)	Front-end fees (%)
IMF					
Stand-by Arrangements	3.25	5	variable	0	0
PRGF	5.5	10	0.5	0	0
IBRD[1]					
<$1,445 GNI[2] per capita	5 or 8	20	Libor + margin	0.85[3]	1.0
$1,446-$2,995 GNI per capita	4 or 5	17	Libor + margin	0.85[3]	1.0
>$2,996 GNI per capita	3 or 5	15	Libor + margin	0.85[3]	1.0
IDA					
IDA only countries	10	40	0.75[4]	0 - 0.5	0
Blend countries	10	35	0.75[4]	0 - 0.5	0
AfDB	9	12-20	variable	1%	-
AfDF	10	50	0.75[4]	0.5	
IADB					
FSO	10	40	1.0 - 2.0[5]	0.5	1.0
Non-concessional: single currency	?	12 - 25	variable by currency	0.75	1% over 4 years
IsDB	3 - 7	15 - 25	0[6]	0	0
IFAD					
Special loans	10	40	0.75	0	0
Intermediate terms	5	20	50% of reference rate[7]	0	0
Ordinary terms	3	15-18	reference rate	0	0
EIB	2 - 8	20	fixed market related rate[8]	0	0

[1] Fixed-Spread Loans Standard country terms for level repayment of principal
[2] GNI - gross national income
[3] 0.85% on undisbursed amounts for the first four years, 0.75% thereafter.
[4] Service charge instead of interest
[5] 1% during grace period, 2% thereafter
[6] Interest free, with service fee to cover related administrative expenses
[7] Reference rate is set annually.
[8] Subsidy applied to some loans

Sources : Creditor sources and documents

There are also regional development banks and institutions which specialise in providing external assistance to geographical regions. The main regional providers are:

- The African Development Bank, which provides external assistance through its concessional window the African Development Fund (AfDF) and non-concessional lending through the African Development Bank (AfDB).
- The Arab Bank for Economic Development in Africa (BADEA), which provides concessional loans for project financing and technical assistance grants.
- The Asian Development Bank (ADB), which provides both concessional (its OCR facility), non-concessional loans and exceptional assistance via its Special Programme Loans (SPL).

- The European Bank for Reconstruction and Development (EBRD), which provides market-related loans to governments and private enterprise in the countries of central and eastern Europe and the Commonwealth of Independent States.
- The Inter-American Development Bank, which provides both concessional finance, through its FSO window, and non-concessional loans (Ordinary Capital) to its member states.

In addition, there are sub-regional institutions providing external assistance including:

- Arab Fund for Economic and Social Development (AFESD);
- Caribbean Development Bank (CDB) and CARICOM Multilateral Clearing Facility (CMCF);
- Central Bank of West African States (BCEAO), West African Development Bank (WADB), ECOWAS Fund;
- East African Development Bank (EADB);
- Central American Bank for Economic Integration (CABEI), Andean Development Corporation (CAF) and Financial Fund for the Development of the River Plate Basin (FONPLATA);
- Nordic Development Bank (NDB) and Nordic Development Fund (NDF);
- Organisation of Petroleum Exporting Countries (OPEC).

Details of the main lending terms of international institutions and main regional development banks are set out in Table 4.

Bilateral donors/creditors

Bilateral donors and creditors are sovereign governments or their agencies, which provide external assistance. These donors/creditors include developed and developing country governments and agencies. The developed country governments, which are members of the Organisation for Economic Co-operation and Development (OECD), are sometimes referred to as OECD donors/creditors, with all others being called non-OECD donors/creditors. Another classification of a country's bilateral donors/creditors are those governments, which are participating creditors at its Paris Club[11], referred to as Paris Club donors/creditors, and those which are not, called non-Paris Club donors/creditors.

Most developed country governments provide grants and concessional loans directly via the ministry, department or agency responsible for implementing its aid and development policy, such as the UK's Department for International Development (DFID), the Swedish International Development Agency (Sida) and Germany's *Kreditanstalt fur Wiederaufbau* (KfW)[12]. A list of the principal developed country agencies is available in Annex 3.

Some bilateral donors/creditors have a stated policy or clear guidelines on the provision of grants and loans. For example, the Canadian, Danish, Irish, Dutch and British governments have publicly indicated that all bilateral ODA will be extended as grants. Table 5 below illustrates, for OCED countries, the percentage of bilateral donors/creditors ODA provided by grants in 2000

[11] The Paris Club participating creditor countries vary depending on which ones the debtor nation has borrowed from. See Vilanova and Martin (2001).

[12] For further details of the organisational structure of OECD bilateral creditors and donors, see Chang et all (1999), chapter 5.

and the average terms of ODA loans committed for donors/creditors, which do not provide all ODA in the form of grants. Seven OECD countries – Australia, Canada, Denmark, Ireland, Luxembourg, Netherlands and New Zealand – provided all their ODA in the form of grants in 2000[13]. On the other hand, Japan (50%), Spain (77%) and Italy (87%) had the lowest share of grant ODA. The average grant element of concessional loans was about 72%, with maturity of about 33 years, 11 years grace period and 1.4% interest rate. The countries with the highest grant element are Italy, Portugal and Belgium while those with the lowest are Norway, France and United States.

TABLE 5: CONCESSIONALITY AND AVERAGE TERMS OF OECD BILATERAL ODA*, 2000

Bilateral Donor	**Grants as % total ODA**	**ODA Loans – Average Terms**			
		Grant element (%)**	**Maturity (yrs)**	**Grace period (yrs)**	**Interest rate (%)**
Australia	100.0	-	-	-	-
Austria	89.3	61.3	23.6	8.7	1.9
Belgium	97.4	78.1	30.0	10.0	0.5
Canada	100.0	-	-	-	-
Denmark	100.0	-	-	-	-
Finland	95.1	na	na	na	na
France	94.2	54.0	22.1	6.9	2.2
Germany	94.0	65.2	35.5	7.5	2.0
Greece	99.3	na	na	na	na
Ireland	100.0	-	-	-	-
Italy	87.4	88.4	36.9	23.4	0.5
Japan	50.3	73.1	34.8	11.0	1.3
Luxembourg	100.0	-	-	-	-
Netherlands	100.0	-	-	-	-
New Zealand	100.0	-	-	-	-
Norway	97.7	33.0	7.8	4.1	2.3
Portugal	98.4	80.3	30.7	8.9	0.1
Spain	76.6	69.4	26.5	9.2	1.1
Sweden	98.4	69.9	15.0	9.8	0.1
Switzerland	97.7	na	na	na	na
United Kingdom	95.5	na	na	na	na
United States	99.2	56.2	24.3	4.6	2.0
All DAC	**83.6**	**71.9**	**33.7**	**10.8**	**1.4**

* excluding debt reorganisation
** calculated using 10% discount rate
na = not available
Source: OECD, Development Co-operation Report, 2002

While Table 5 illustrates the average terms of concessional loans actually made by OECD bilateral creditors in 1999, Table 6 below provides details of their stated interest rates for both concessional and export credit lending of OECD bilateral creditors

Bilateral export credit agencies

In addition to lending on ODA terms, most developed country governments have agencies, which provide non-concessional export credit finance directly to the borrower or which

[13] In 1999, Sweden and Switzerland also provided 100% grant aid.

guarantee export credit finance provided by exporters or banks and financial institutions[14]. The main OECD export credit agencies are listed in Table 6.

Loans provided directly by the export credit agency are straightforwardly bilateral credits. However, loans and credits provided by exporters, banks or financial institutions and guaranteed by an export credit agency only become bilateral credits if the debtor fails to service the loan and guarantee is invoked. When this happens the export credit agency effectively becomes the creditor, instead of the exporter or bank, and hence the debt is then classified as bilateral. The difficulty for recipient governments is that they do not always know whether an export credit has been guaranteed by an export credit agency, so it is not easy to classify it as official or private finance.

TABLE 6: OECD BILATERAL CREDITOR INTEREST RATES

	ODA		EXPORT CREDITS			
	Agency	*Rate(%)*	*Agency*	*Currency*	*CIRR**	
Austria	MFA	4	OeKB	Euro	5.22	(> 8.5 years)
Belgium	MFA	2	ONDD	Euro	5.22	(> 8.5 years)
Canada	CIDA	0.5-2	CWB/EDC	Dollar	5.77	(>8.5 year)
Denmark	DANIDA	2.5	EKF	Krone	5.50	(> 8.5 years)
Finland	FINNIDA	0.5-0.75	FINNVERA	Euro	5.22	(> 8.5 years)
France	AfD	2	COFACE/ Banque de France	Euro	5.22	(> 8.5 years)
Germany	KfW	0.75-2.0	Hermes	Euro	5.22	(> 8.5 years)
Italy	MFA	4	SACE	Euro	5.22	(> 8.5 years)
Japan	JIBC/JICA	1.-3	JIBC/MITI	Yen	1.59	(> 8.5 years)
Netherlands	MFA	2.5	Gerling NCM	Euro	5.22	(> 8.5 years)
Norway	NORAD	2.5	GIEK	Krone	7.04	
Spain	AECI	4.5	CESCE	Euro	5.22	(> 8.5 years)
Sweden	SIDA	**	EKN	Krona	5.80	
Switzerland	SDC	2.5	ERG	Franc	2.99	
UK	DFID	**	ECGD	Sterling Pound	5.52	(> 8.5 years)
USA	USAID	2.-3	Ex-Im Bank	Dollar	4.54	(>8.5 years)

* rates as of 12 November 2002, for period 15/11/2002-14/12/2002
** ODA delivered as grants
MFA = Ministry of Foreign Affairs
Source: OECD, DRI and country websites and documents.

[14] For more details of terms and conditions, see OECD 2001.

The OECD member government have established a set of guidelines covering export credit finance which is known as the *Arrangement on Guidelines for Officially Supported Export Credits*[15]. The guidelines set limits on the cash payments to be made at or before the starting point of the credit, repayment and interest terms and restrictions on the provision of tied aid. The key elements for officially supported credits are as follows:

- At least 15% of the contract is to be covered by cash payments. This means the export credit can be for a maximum of 85% of the contract value and this can vary depend on the goods being purchased. In some instances the credit will be limited to 100% of nationally provided goods (i.e. it is tied).
- The maximum repayment term is 5 years (or 8½ years with prior notification). This may be extended to 10 years for poorer developing countries.
- The minimum interest rates are the Commercial Interest Reference Rates (CIRRs) to which the lender may add a spread based on its assessment of credit worthiness, size of the loan and/ or its maturity. Commitment fees and other fees may also be levied by the export credit agency.
- Credits with concessionality of less than 35% (or 50% for LLDCs) cannot be tied. (See Section 5.2.2 for more discussion of tied finance.)

Many OECD bilateral donors/creditors also offer financing packages, which combine grants or concessional loans with non-concessional funds, such as export credits. These are known by various names such as *mixed credits,* joint financing, or parallel financing of which some proportion may be tied to the procurement of goods and services from the donor country.

Since many developing countries have established new borrowing criteria based on loans having a minimum grant elements of 35% or higher. However many creditors have ways of preparing financing packages which appear to meet the concessionality criteria but in practice do not. Box 1 below provides some examples of how this is done.

Box 1: Creditor Strategies Creditors to Get Round Concessionality Limits

Some creditors, in their eagerness to lend funds to developing countries, try and circumvent countries' new borrowing guidelines by a variety of methods, which can conceal the true costs of the loan amount and/or the project or programme the money is finance. The specific strategies used may be one or a combination of the following:

1. Inflating the contract price

The contract price of a project is inflated to include the true cost of servicing the loan, which is higher than the concessional terms appearing in the loan documentation. This is achieved by increasing the price of equipment, machinery and/or services to reflect difference between the true market-related interest cost of the funds and the concessional interest cost set out in the financial agreement. Since the rate of interest has a big impact in the determination of concessionality, a reduction in the loan interest rate alone can increase the concessionality sufficient to meet government's borrowing criteria.

This can also be done by securing agreement with the borrower that there will be no competitive bidding for the contracts and/or procurement of goods and services, instead these will be provided by the creditor or its agent or nominees.

[15] For more details, see OECD 2001.

2. Capitalisation of interest in the contract price
This may happen with both parties agreeing to the capitalisation of interest or the creditor alone can do it. In practice, the contract price will be increased to reflect the market-related interest cost, while the loan is presented as interest free The financial agreement (setting out the loan terms) includes a repayment schedule which shows only principal payments due. There can be variations of this when the loan has different tranches with different interest rates. In this case, the interest cost of the more expensive tranche (or tranches) will be capitalised and the other tranches will be maintained with the lower interest rates thereby making the total loan appear to be concessional. Alternatively, concessionality can be calculated on each tranche independently and since the interest cost of the most expensive tranches has been capitalised, the concessionality of each tranche will fall within the stated guidelines.

3. Grace period
Since the grace period is also an important determinant of the concessionality of a financing package, some creditors offer to lengthen it. The loan terms with the longer grace period are set out in the financial contract. For projects there will also be a works contract, which defines the project implementation schedule, and it is usually independent of the financial contract. However in this case the financial contract and the works contract are linked and the commencement of principal payments are triggered (i.e. the end of the grace period) when the works contract has been completed. At he loan evaluation stage, the originally projected schedule for completion of the works contract coincides with the longer grace period, but in practice the works contract can be completed before this and hence trigger debt service payments to start before the end of the expected grace period. Therefore the creditor is able to meet the concessionality criteria at the evaluation stage, whereas in practice there will be a shorter grace period because of the 'faster' completion of the works contract.

4. Down payment
Creditors can get around the issue of higher loan amount and high interest payments by demanding an initial down payment which is higher than the normal 15% for suppliers' credits. In such cases, creditors will seek down payments for as much as 20% to 30%. Since the loan terms apply to the whole loan amount (including the down payment) but the borrower effectively receives an amount less than this, the creditor through this method is able to meet the concessionality criteria.

5. Fees and other payments
Creditors try to cut out commitment and other fees (such a front-end fees and legal fees) in a bid to increase the concessionality of the facility. The fees are not necessarily inflated but the creditor knows that to achieve the required concessionality, these fees have to be excluded from the loan terms, and instead the creditor will have included them in the contract sum or amount as part of the loan.

6. Interest moratorium
In some loan agreements, there is no interest during the grace period, or during the construction phase of the project. In such cases, interest during the grace period is actually not calculated or capitalised. However in these situations, the grace period is usually quite short. It is also important to check how interest is being calculated and charged after such a moratorium.

7. Insurance Premium
For most export credits, there is insurance cover against payment default by the borrower and the insurance premium is included as a part of the terms of the loan agreement or as part of the loan amount. Effectively, the premium is a type of fee and it should be included when calculating concessionality. To avoid this, creditors may insist that payments of insurance are outside the framework of the financial agreement. In view of the fact that the insurance cost reflects the risks associated with lending to the borrower, it can be very expensive for some developing countries and if it is included in the assessment of concessionality, the loans will fail to meet the authority's criteria.

As well as borrowing from OECD governments, many developing countries also borrow from other developing countries. In the past, non-OECD governments, such as the oil-producing states, have lent money to fund oil imports. In other cases, lending has been for specific projects such as tourism development, manufacturing plant and equipment and to fund imports of, for example, vehicles. Terms for many of main non-OECD creditors are listed in Table 2 above.

Commercial creditors

Creditworthy borrowers may have access to two type of market related finance:

- Commercial bank loans provide by one bank, or by a syndicate of banks (each one of which provides an agreed percentage of the total loan amount, thereby sharing the lending risk). The interest costs of these loans will be market related with the margin above the base rate (e.g. Libor) reflecting the borrower's perceived creditworthiness.
- Bonds are debt instruments issued by the borrower on international capital markets, usually with multiple holders including banks, financial institutions and other investment vehicles. Bonds are negotiable instruments and therefore their prices move up and down in response to market demand and sentiment. Bonds may be issued at a discount to face value thereby enabling investors to achieve potential capital gains in addition to interest income.

Table 7 provides information on some of the major commercial interest rates.

Indirect assistance

Indirect assistance is developed country government funding that is channelled through non-governmental organisations, academic institutions, religious groups, labour unions and other organisations outside the official donor agency.

Bilateral governments also provide money in the form of subscriptions payments, fees or grants to multilateral and regional institutions such as the United Nations, World Bank and African Development Bank.

2.2.2 Types of Finance

In addition to classifying external assistance by source and cost of funds, it is also important to look at the type of finance extended by donors and creditors in terms of its main purpose. External assistance, both grants and loans, can be to finance projects, such as construction of a new hospital, or programmes, such as budget or balance of payments support. It can also be in the form of technical assistance (also called technical co-operation) or food or emergency aid. Some types of finance lend themselves more to aid rather than non-concessional loans, or vice versa, but it is not always the case. For instance, food aid is usually thought of as being grants or highly concessional loans from multilateral or bilateral sources, but it is possible for government to borrow commercially to finance essential food imports.

While this section focuses on the main types of finance, it should be noted that they could also be used in combination, such as project loans and technical assistance grants.

Project aid and loans

Project assistance is funding for specific activities, such as capital projects for infrastructure developments. The project documentation will set out how the aid or loan monies are to be spent. Sometimes this funding includes money to pay for local and recurrent costs of the project. However, this is not always the case and so funding for these project elements may need to come from local sources.

Programme aid and loans

Programme assistance is funding made available to a recipient government for general development purposes. The main types of programme aid are set out below.

- *Budget support* is assistance provided directly to the government budget to meeting its financing gap. It can be general budget support which means the government can use it to finance general expenditures including wages and salaries, equipment and supplies, recurrent costs of hospitals or schools and so on. Sector budget support can be used to fund general government budgetary costs of wages and salaries, equipment and other running expenses relating to a specific sector, such as health or education. This type of assistance has been growing rapidly in recent years.

- *Balance of payment support* is assistance to finance the balance of payments gap, usually by providing funds to finance imports. The two main types of balance of payment support are (1) commodity import support for the purchase of specific commodities or list of commodities, often for intermediate goods, and (2) open general licence (OGL) whereby the donors/creditor provide foreign exchange which was sold by the government to the commercial banks and then to importers to make the necessary purchases. OGL operated primarily in fixed exchange rate regimes and so has been phased out as countries liberalise their exchange rates. Balance of payments support has been declining in recent years, with many donors/creditors moving to budget support.

- *Food aid* and *disaster or emergency relief* are specialised types of assistance. Food aid is often but not always associated with disasters and can be a form of balance of payments support. Disaster/emergency relief is short-term funding to meet immediate humanitarian needs arising from natural disasters, civil wars, etc.

- *Debt relief* consists of the cancellation and/or restructuring of loans under the formal auspices of the Paris Club, HIPC Initiative, or a creditor-by-creditor basis. It can be classified separately or as a form of balance of payment support, since debt service payments abroad are reduced, or as a form of budget support if it results in lower debt service payments by government. In some instances, debt restructuring may include an element of new funding but most debt forgiveness relates to the renunciation of claims due. Note that debt forgiveness does not give rise to new disbursements, so there is no effect on gross ODA disbursements. Instead the benefit accrues because repayments of principal originally reported as ODA are not made and this is reflected in net ODA figures. Forgiveness of military debt is recorded as other official finance (OOF).

TABLE 7: COMMERCIAL INTEREST RATES
End of year rates

	1995	1996	1997	1998	1999	2000	2001	2002
LIBOR (6 months)								
Euro 1/	5.12	4.18	4.45	3.22	3.51	4.83	3.25	2.80
US Dollar	5.50	5.60	5.84	5.06	6.13	6.20	1.98	1.38
UK Pound	6.43	6.75	7.68	5.95	6.29	5.86	4.13	3.99
Japanese Yen	0.52	0.51	0.76	0.54	0.23	0.53	0.09	0.07
Swiss Franc	1.81	1.88	1.62	1.56	1.94	3.37	1.84	0.63
Canadian Dollar	5.63	3.31	5.00	4.94	5.35	5.60	2.06	2.86
Australian Dollar	7.34	5.94	5.03	4.75	5.82	5.94	4.21	4.70
US Prime	8.65	8.25	8.50	7.75	8.50	9.50	4.84	4.25
SDR 2/	4.58	3.90	4.07	3.64	3.90	4.34	2.23	1.91

1/ Ecu prior to 1998. Last ECU rate for 1998 was 3.26
2/ Period average for 1995, 1996 et 1997

Sources
LIBOR: British Bankers Association (www.bba.org.uk)
US Prime: US Federal Reserve Bank (www.federalreserve.gov/releases)
SDR: International Monetary Fund (www.imf.org/external/fin.htm)

Technical assistance

Technical assistance (TA) is assistance relating to training and education activities, including human resources development. It also includes payments to foreign and national consultants, advisers, teachers, administrators and those working in similar jobs in the recipient country. One of the main ways of providing technical assistance is via the expert-counterpart mode which includes long-term expatriate resident advisers, short-term consultants, academic degree and other studies programmes overseas, study tours, international and in-country seminars. TA is often included as part of project agreement to provide supporting services such as equipment and software installations and training of national staff.

Training and education provided by technical assistance is not necessarily the same thing as capacity building. While the former has traditionally focused on the provision of specific management and technical training to fill immediate skills gaps, capacity building goes further and focuses on the institutional structures and strengthening of systems and procedures as well as skills development. In some countries, technical assistance has weakened local capacity as national experts are diverted or attacked away from their jobs to administer aid programmes and projects. It is estimated to account for up to 40% of aid in some African countries and is reckoned to be 'excessive' in 20 of them[16].

Hybrid assistance

These are the pure forms of external assistance instruments. There can, of course, be hybrids such as the sector wide approach[17] (SWAp), which can combine programme and project aid and/or technical assistance. Other examples can include technical assistance or debt relief running in tandem with programme and project aid.

The sector wide approach is a way by which governments and donors/creditors can support the development of a sector in an integrated fashion through a single sector policy and expenditure programme. It aims to integrate external assistance into the government's planning and management system, thereby reducing overlapping management, reporting and accounting donor/creditor processes and moving towards government procedures and processes. Sector support corresponds broadly to core government functions such as education, health, rural electrification, water and sanitation and so on[18].

NGOs and civil-society organisations assistance

NGOs and civil-society organisations aid is funds (independent of developed country governments) of church groups, labour unions, professional associations and other organisations, provided to developing country organisations and counterparts. Much of this aid is in the form of grants.

2.2.3 Recipients of External Assistance

External assistance can be classified by recipient, the main purpose of which is to track external assistance flows in the balance of payment and budget. The main recipient classifications are central government, parastatals and other government agencies, the private sector and NGOs.

Central government

The main borrower and recipient of donor/creditor aid in developing countries is the central government. While the procedures governing how grants and loans are contracted, recorded, monitored and managed varies from country to country, the Ministry of Finance plays a key role in the process and is responsible for tracking aid and debt flows in the budget. The role of line ministries depends on the degree and extent of decentralisation and internal government responsibilities and procedures. In some cases, they maybe able to contract grants and loans directly in which case this information may not be available to the Ministry of Finance, and there may therefore be off-budget external assistance flows.

Non-central government agencies

This classification includes the central bank, parastatals, local or state governments and agencies. In some countries, these entities are able to negotiate, contract and implement grant and loan agreements. Even when the central government does have fairly strong controls over external assistance flows, it may not always have comprehensive information on grant and loan flows to these entities.

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16 See Elbadawi and Gelb (2002), pages 9 and 10.

17 Sector funding can also be referred to as sector investment programmes (SIP), sector expenditure programmes (SEP) or just sector programmes (SP).

18 For more details on sector programmes, see Foster and Fozzard (2000).

Private sector

In terms of aid flows, the main recipients are national charities, religious, educational and scientific, institutions and trade unions, which receive grants or loans from abroad. On the other hand, private sector companies and organisations can borrow non-concessionally from overseas.

3. ACCOUNTING FOR EXTERNAL ASSISTANCE

Having defined the terms, sources, types and recipients of external financial flows, the next step is to focus on where and how external financial flows are recorded in the budget, balance of payments and monetary accounts.

3.1 BUDGET

In the budget tables, grant inflows are usually recorded as part of total budget revenue whereas disbursements of concessional and non-concessional loans are treated as a financing item.

Interest payments on debt are classified as recurrent expenditure. On the other hand, loan amortisation payments are a financing item. In some presentations only net flows (disbursements minus amortisations) may be presented, more especially for domestic financing. It is usual to specify separately the inflows for programme and project grants and concessional loans and sometimes the other types of aid flows, such as technical assistance and food aid. Bond issues are treated in the same way as loans.

3.2 BALANCE OF PAYMENTS

The balance of payments records flows on a recipient basis. Grant inflows from multilateral, bilateral private sources to the government sector are recorded in the current account and are a component of current and capital transfers, sometimes listed separately as official transfers. Capital transfers are related to payments linked to fixed assets, such as roads, hospitals, dams and so on. The data may be presented on a net basis, that is receipts from foreign governments less transfers made abroad. However, it is important to measure gross receipts for balance of payments purposes. Not all grant flows are received by the government sector and some may be recorded as private transfers. This can include aid flows to civil society, such as religious, scientific and cultural organisations. In most cases, these data are difficult to obtain. The aid flows recorded in the balance of payments may differ from those recorded in the budget as discussed in Box 2 below.

Loan and bond disbursements are capital and financial account items. Loan disbursements are recorded as part of other investment inflows of long-term capital, whereas bond disbursements are part of portfolio investment. It is usual to record separately official disbursements and those to the private sector. It may be necessary to seek further detail to obtain separate data for aid and non-concessional loan. Loan and bond repayments are also recorded in the capital and financial account and in some presentations, only data on net flows are available. Debt forgiveness is recorded as an exceptional financing item[19].

[19] See IMF (1993).

Box 2: Differences in External Assistance Data

1. National Sources: Budget and Balance of Payments

The balance of payments figures for external assistance inflows will be higher than those recorded in the budget because the balance of payments records all inflows/outflows of the economy, including those of the government and the private sector. So the government records of external assistance flows are a subset of the total flows which do not include:

- aid flows of non-governmental organisations (NGOs),
- off-budget disbursements by multilateral and bilateral donors/creditors directly to projects,
- external assistance flows to parastatals, local and state governments and other non-central government agencies,
- disbursements directly to non-government recipients (e.g. religious, scientific and cultural organisations) including technical assistance and emergency relief.

In addition, there may be differences arising due to the timing of actually recording disbursements and the exchange rate rates used for currency conversion. The budget is on a cash basis whereas the balance of payments is on an accrual basis which can also account for differences. Data on assistance in kind is usually difficult to obtain, however it is more likely to be included in the balance of payments than in the budget data.

The key differences are set out in Table 8 below.

2. National and International Sources

Data from national sources is usually from the balance of payments or the budget and includes external assistance flows, which pass through these two accounting systems. However, it can differ significantly from data available from international sources such as the Development Assistance Committee (DAC) of the OECD and the World Bank, which are based on donor/creditor reporting of external assistance flows. Information in UNDP's country-specific Development Co-operation Reports may also differ because differences in coverage.

The main differences arise because of the following:

- Some data, such as the DAC data, are solely for aid flows and exclude non-concessional loans and debt relief.
- Donor/creditor countries may not record debt relief as part of external assistance.
- Often donor/creditor data are presented on a net, rather than gross basis.
- Donor/creditor data may include off-budget disbursements made directly to projects.
- External assistance flows spent within the donor/creditor country or other developed countries on, for example, consultancy services will be accounted for by donors but not usually recorded in national data since these flows do not pass through the balance of payments or budget accounts.
- Expenditure on technical assistance frequently does not flow through the balance of payments or budget accounts and hence are not recorded by the recipient governments.
- External assistance disbursed as goods and services in kind may be valued differently by the donor/creditor and the recipient. The recipient may not even be aware of, or have weak reporting systems for, these types of disbursements.
- Timing differences in recording disbursements and exchange rates differences for currency conversion.

Table 8 sets out the main sources and recipients of external assistance flows and illustrates how inflows can be tracked in the budget and balance of payments.

TABLE 8: EXTERNAL ASSISTANCE – SOURCES AND RECIPIENTS

Source	Recipient		
	Central government	**Non-central government agencies**	**Private sector and NGOs**
Official multilateral and bilateral			
Grants	BoP: official current and capital transfers Budget: revenue source	BoP: official current and capital transfers Budget: off-budget	BoP: private current and capital transfers Budget: off-budget
Loans	BoP: capital and financial account Budget: financing items	BoP: capital and financial account Budget: off-budget	BoP: capital and financial account Budget: off-budget
Commercial creditors			
Loans	BoP: capital and financial account Budget: financing item	BoP: capital and financial account Budget: off-budget	BoP: capital and financial account Budget: off-budget
NGOs			
Grants	BoP: official current and capital transfers Budget: revenue source	BoP: official current and capital transfers Budget: off-budget	BoP: private current and capital transfers Budget: off-budget
Loans	BoP: capital and financial account Budget: revenue source	BoP: capital and financial account Budget: off-budget	BoP: capital and financial account Budget: off-budget

3.3 MONETARY SECTOR AND RESERVES

The impact of external financial flows on the monetary accounts and reserves depends on where and for how the funds are deposited before being spent. The most straightforward case is when the donor/creditor disburses foreign exchange to the government, which deposits these funds with the central bank, which in turn credits the government account with the equivalent in local currency. In this situation, the central bank's holding of net foreign assets will increase, resulting in an increase in government deposits with the central bank and then the reduction of net claims on government in central bank. So in fact there be offsetting entries and no impact on the money supply[20].

In some instances, donors/creditors maintain their own or project bank accounts at the central bank and disbursements are made directly into these accounts. These foreign exchange deposits will increase the central bank's net foreign assets and non-bank deposits, so this will result in higher money supply.

For non-government recipients of external assistance flows with commercial bank accounts, the impact will flow through to higher net foreign assets of the commercial banks and an equivalent increase in the money supply. If the commercial banks are not allowed to hold foreign exchange, then the commercial bank must sell the foreign exchange inflow to the central bank, thereby increasing the central bank's holdings of net foreign assets. So in this situation, external assistance inflows have a greater impact on money supply as they feed through by an increase in central bank net foreign assets and commercial bank deposits.

[20] The central bank net claims on government are not included in the money supply.

4. EVOLUTION OF EXTERNAL ASSISTANCE

In order to design a new external assistance strategy, it is important to understand the experiences to date, by conducting a portfolio review and analysing the key indicators which are discussed in this section.

4.1 PORTFOLIO REVIEW

As a portfolio review focuses on the evolution of a country's external assistance, it provides the background for determining future policy. For example, to analyse fully future aid and debt sustainability, it is essential to project accurately future new grants and loans and this can best be done effectively by knowing what has happened in the past.

The portfolio review can be based on the aid and debt cycle set out in Box 3.

Box 3: Aid and Debt Cycle

The key stages of the cycle are as follows:

Pledges – donors/creditors promise to provide an agreed sum of money to support the government's PRSP, development and expenditure plans. This most commonly happens at the country's Consultative Group or Round Table meetings. Pledges tend to be in broad terms but sometimes donors and creditors are prepared to be more specific, detailing the promised amounts for grants and loans and/or programme, project and technical assistance support.

Commitment – pledges are turned into commitments when grant and loan agreements are signed. The timing between pledges and commitments can vary a great deal, depending on the project or programme and any conditionalities which have to be fulfilled, such as being on-track with an IMF programme (see Section 5.1.1 for further discussion of conditionalities). Some donors and creditors are very good at making pledges but slow to convert these into actual grant and loan agreements. Commitments can also be made outside the framework of donor and creditor pledges as, for instance, when a borrower negotiates a commercial loan.

Disbursements – this is actual provision of cash or goods and services to the recipient. Frequently there are conditionalities, which need to be met prior to disbursement and procedures, which have to be followed to ensure timely receipt of resources (this is discussed further in Sections 5.2 and 5.3).

Committed undisbursed balance – this is difference between the grant or loan amount committed and the total amount actually disbursement as of a given date. So it is the amount of grant or loan resources available for future spending. It is also referred to as the pipeline amount.

For loans, debt servicing – the amortisation and interest terms for loan repayment will have been negotiated or agreed at the time of the loan commitment and set out in the loan agreement. The loan will be fully repaid when the final debt service payment is made.

The main components of a portfolio review are as follows:

- Pledges, commitments and disbursements: recent trends for grants and loans;
- Sources of new financing: recent trends and analysis of amounts committed, disbursed and the undisbursed pipeline by donor/creditor and type of finance;
- Terms and concessionality: analysis of concessionality for the overall portfolio and for loans, analysis of grant element, maturity and interest rate terms;

- Utilisation of external assistance: analysis of grants and loans by type of finance and sector;
- Debt stock: trends and composition by creditor categories, instrument types, currency and maturities;
- Debt service: assessment of actual vs. scheduled payments and arrears by creditor or creditor category;
- Debt restructuring: detailed analysis of terms of past restructuring by creditor;
- Net flows and net transfer: overall trends and analysis by donor/creditor (See the Glossary for explanations of these terms).

In addition to the above analysis, it is also important to consider the following issues, which can be picked up through a detailed analysis of external assistance stocks and flows.

Overall trends:

- Some donors/creditors are very happy to pledge large amounts of assistance at Consultative Group or Round Table meetings but are notoriously poor at turning these pledges into actual loan/grant commitments, let alone getting to the stage of disbursing funds. The relationship between pledges, commitments and disbursements will highlight donors/creditors, which fall into this group and hence should not be relied on to provide external assistance in future.
- Donors/creditors may curtail or withdraw support temporarily (or in some cases permanently) because of governance issues, perceived and actual corruption or if the country goes off-track with its IMF programme. On the other hand, countries may simply have failed to 'nurture' a donor/creditor and it has decided to rundown its assistance.
- There have been times when donors/creditors have decided that a country's recent economic performance means it can 'graduate' from programme to project aid as happened to Ghana in the mid-1990s.

Sources of funds:

- There can be significant changes in the donor/creditors providing external assistance. This can arise because of a shift in donor/creditor policy or cutbacks in their aid programmes.
- Heavy reliance on a few sources may limit possible sources of new financial flows. The government may not be sufficiently cultivating its donors/creditors and therefore new loans and grants may be more difficult to access.
- Not only does 'graduation' from programme to project assistance result in a significant change in the type of external assistance being provided, it can also lead to a dramatic slowdown in disbursements as project aid tends to be much more slowly disbursed.
- A large undisbursed pipeline of grants and loans indicates disbursement problems, which can arise due to cumbersome creditor procedures, lack of counterpart funds in the budget or delayed project implementation, which need to be analysed in more detail. See Section 5 for more details.

- On the other hand, it may be the case that the government is being too optimistic in projecting future disbursements. So the government's profiles for projecting future disbursements need to be based on actual experience and as realistic as possible.

Terms and concessionality:

- Looking at the overall portfolio concessionality – including grants – is important as well as considering the concessionality of the debt portfolio.
- Some donors/credits are very good at promising to provide grants. However, when it comes to committing funds, it turns out that these grants are only available if they come as part of a mixed credit, which is a financing package of part grant and part non-concessional or minimally concessional loan. It is important to know which donors/creditors provide mixed credits and at what cost in terms of the maturity and interest rate of the loan portion.
- In terms of costs, some donors are willing to negotiate loans terms whereas other adhere to their prescribed terms. So it is important to know which donors are prepared to negotiate and the bounds within they can do so. For export credits, it is also important to know your country's 'rating' with the main export creditor agencies.

Utilisation of funds:

- There are donor/creditor 'fads' in the type of aid being provided. In the 1990s, some donors/creditors were keen on the sector wide programmes or approaches. However, the fashion for swaps is not as strong as it was because of the difficulties involved in co-ordinating and implementing these programmes. Similarly, there was a vogue for supporting environment and gender projects a few years ago and this too is changing as the focus has shifted to poverty reduction. In addition, some donors/creditors also have preferred projects or sectors and will only, or mainly, provide support for them.
- Not all external assistance necessarily flows through the budget as some donors insist on disbursing directly to line ministry projects. Such off-budget support can account for the difference between budget and balance of payments figures for aid in flows. Donor support for NGOs, church and other non-government organisations can also account for higher balance of payment figures.
- Donors/creditors can provide substantial amounts of technical assistance which is being spent mainly on foreign experts and advisers and hence little of it flows to the recipient country.
- Disbursement delays can arise for a whole host of reasons (see Section 5 below) but the first step is to identify when and where shortfalls in external assistance raise. Box 4 discusses how best to do this.

Box 4: Monitoring Shortfalls in External Assistance

Shortfalls arise when actual disbursements are less than projected disbursements. This is particularly relevant for the government budget and balance of payments because shortfalls leading to financing difficulties (See section 7. for further discussion). To identify external assistance shortfalls in the balance of payments and budget, it is necessary to compare projected inflows with actual inflows.

The data on external assistance projections required for this is as follows:

- Balance of payments – projections for grant and loan disbursements, by programme and project assistance. Data on projections should be available by reviewing past national projections or those agreed with the IMF and published in Article IV and HIPC documents.
- Budget – projections for grant and loan disbursements, by programme and project assistance. Budget projections data should be available by reviewing past Budget Statements. It may also be available in the budget revenue tables of IMF Article IV and HIPC documents.

A good way to analyse this information is to prepare charts, which will highlight when shortfalls occurred.

One of the main reasons for shortfalls is over-optimistic projection of disbursements. On average, total aid disbursements in countries with IMF-supported programmes were some 20% less than what was projected. There are, however, notable differences for project and programme aid. Average project aid disbursements were found to be about 10% below predictions, with the median estimate of around 20%, and were independent of the status of the countries' IMF-programmes. However for programme aid, average disbursements for all countries were some 32% smaller than projections with a marked difference for countries which go off-track with the Fund. For countries with no interruptions to their IMF programmes, average programme aid disbursements were 25% less than projections, whereas for countries off-track with their Fund programmes, programme aid disbursements were more than 80% below the commitments levels[21].

4.2 EXTERNAL ASSISTANCE SUSTAINABILITY INDICATORS

As the debt indicators and thresholds for determining sustainability are discussed in detail elsewhere[22], this paper focuses only on the indicators and analysis of external assistance flows.

Analysing the impact of and dependency on external assistance can be done at three levels: (1) total external assistance, which is grants and concessional and non-concessional loans, (2) aid, which is grants and concessional loans, and (3) grants. In addition the sustainability indicators for external assistance and aid flows can be calculated on a gross or net basis. This means, therefore, that the numerators for calculating the indicators can be as follows:

(1) for external assistance: gross inflows, which is disbursements of grants and loans, or net inflows, which are gross grant and loan disbursements less loan amortisation payments.

(2) for aid flows: gross inflow, which is the sum of grant and concessional loan disbursements, or net flows, which is grant and concessional loan disbursements less principal repayment of concessional loans.

(3) for grants: the numerator is simply grant disbursements.

[21] See Bulir and Lane (2002) for more details.

[22] See Martin and Johnson (2001) for details of the debt indicators and benchmarks used for assessing debt sustainability under the HIPC Initiative, and Johnson (1999) for assessing the fiscal burden of debt.

The most common denominators for external assistance indicators are budget revenue, GDP, exports and population[23].

The main indicators for assessing external assistance and aid dependency are as follows:

- **Gross (net) external assistance disbursements/budget revenue**: this ratio is used to assess the fiscal impact of external assistance.
- **Gross (net) external assistance disbursements/GDP**: this measures external assistance flows relative to the scale of domestic activity. It is frequently used for inter-country comparisons.
- **Gross (net) external assistance/ exports**: this measures the impact of external assistance on the balance of payments.
- **Per capita gross (net) external assistance disbursement:** this measures external assistance inflows per head of population and is frequently used for inter-country comparisons.

In addition, there are other measures which can be used to analyse the fiscal sustainability of external assistance and aid flows in more detail as follows:

- **Gross (net) external assistance disbursements/government expenditure**: this measures the proportion of government expenditure financed by external assistance flows and is another fiscal indicator.
- **Project external assistance disbursements/ budget revenue**: this measures the relative importance of project external assistance.
- **Programme external assistance disbursements/ budget revenue**: this measures the relative importance of programme external assistance.
- **Project external assistance disbursements/government capital spending**: the measures the relationship between project inflows, which are usually for financing investment, as a proportion of government capital/investment.
- **Programme external assistance disbursements/government consumption (recurrent) spending**: this measures the relationship between programme external assistance and government's recurrent spending.

The other indicators used to analyse external assistance and aid include:

- **External assistance disbursements/reserves**: this measures the impact of external assistance flows on reserve holdings.
- **External assistance disbursements/ imports**: this indicates what proportion of imports being funded by external assistance.

The ratios looked at so far are all static ratios, that is they relate to one time period only and do not take account of whether the variables are increasing or decreasing. Dynamic ratios, on the other hand, look at the rate of change in the variables and the main ones for assessing aid are:

23 It is usual to use data for general government revenue, expenditure and assistance flows, which includes central government and agencies, local governments and public enterprises. However, there may be times when information is only available for central government and so it is important to ensure the numerator and denominator both relate to the same definition of government.

- **Change in external assistance disbursements/ change in revenue**: this indicates whether external assistance receipts are increasing more quickly or more slowly than revenue. A ratio greater than one indicates that external assistance dependence is growing as external assistance receipts are rising faster than domestically generated revenue. It is also useful to look at the ratio of change in external assistance disbursements to change in tax revenue as this will indicate whether external assistance is growing faster (ratio >1) or slower (ratio <1) than the government's revenue effort.

Dynamic ratios can be calculated with using any of the numerators and denominators referred to above.

4.3 BENCHMARKS FOR EXTERNAL ASSISTANCE SUSTAINABILITY INDICATORS

There are no internationally agreed indicators or benchmarks for monitoring the sustainability of external assistance and aid flows as there are for external debt. However, a number of empirical studies point to a threshold of 25% for the ratio of aid receipts/GDP as a critical level for measuring aid dependency[24]. The evidence suggests that there are diminishing returns to economic growth of increasing aid flows above this level because high aid flows can have a negative impact on the economy's competitiveness and export diversification and hence on growth (see Section 7.2 below). It can also lead to deterioration in the recipient country's institutional capacity to manage the aid effectively. However, there may be individual recipient country factors, which alter the effectiveness of higher aid flows for economic growth, and it is therefore an issue that should be judged on a country-specific basis.

5. ANALYSIS OF DONOR/CREDITOR AND GOVERNMENT PROCEDURES AND PRACTICES

While the portfolio review will provide a quantitative analysis of the trends in a country's external assistance and highlight issues for further analysis, it is also essential to do a qualitative analysis donor/creditor practices and procedures as these may be able to explain the numerical analysis. There are three main reasons why disbursements may fall short of expectations: conditionalities, donor/creditor procedures and practices, and government procedures and practices. This section focuses on donor/creditor and government procedures and practices, conditionalities are discussed in Section 6.

5.1 DONOR/CREDITOR PROCEDURES AND PRACTICES

One of the main hurdles developing countries have to overcome to receive external assistance are donor/creditor procedures and practices. These procedures and practices can affect grants and/or loans at any one, or all, of the commitment, disbursement, procurement and repayment stages. The impact is of these procedures is to delay the signing of grant and loan agreements or the disbursement and expenditure of funds. The types of procedures can vary with the type of aid flows. For example, the procedures relating to programme finance are significantly fewer than for project finance, and hence programme finance is usually faster disbursing.

One of the main reasons for delays between donor/creditor pledges and commitments is the procedures required to appraise and approve new projects and programmes. The appraisal procedures can involve missions to the country to assess proposed projects and programmes,

[24] This is the ratio above which negative returns to economic growth are experienced (Hansen and Tarp, and Hadjimichael). Other studies show negative returns with an aid/GDP ratio above 34% (Clemens and Radelet) or 40%-50% (Durbary, and Lensink and White), while others have found no evidence of diminishing returns at high aid/GDP ratios (Gomanee, Girma and Morrissey).

preparation of reports and budgets, discussions of the reports and then the administrative procedures with the donor/creditor government to get the funding formally approved.

5.1.1 Conditions Precedent

It is usual practice for the donor/creditor to insist upon certain conditions being fulfilled before disbursements of loan or grants funds can commence. This is sometimes referred to as the loan or grant becoming effective. The main conditions precedent include:

- *Legal opinion and issues* – this is usually a straightforward matter that simply requires a letter from the government's legal officers saying the agreement does not contravene any national laws. Depending on national practice, the government may be required to have the agreement approved by Cabinet or Parliament before it can be effective and this can take time. In some cases, the agreement may call for changes in national legislation or new laws to be drafted in which case there can be considerable delays in fulfilling the conditions precedent.

- *Administrative issues* – these can vary from the complicated and time-consuming, such as setting up and staffing of a new project management unit to relatively straightforward matters such as or provision by government of office space and accommodation for expatriate experts.

- *Financial issues* – these conditions can include opening a special account and arranging for signatories, which can be time consuming if it requires approval at Ministerial level. Some agreements also insist on the availability of foreign exchange and/or matching fund provisions in the budget (see below for more details). Cross-financing clauses, such as not being in arrears with the creditor, can also delay effectiveness. The borrower may also be required to provide security for a loan and /or bank guarantees, which too can take time to arrange.

- *Procedural/project issues* – this covers a range of issues relating to the necessity of having project agreements, contracts, bidding procedures etc all in place approved before the financing can be effective (see below for more details).

5.1.2 Disbursement Procedures

The main donor/creditor procedures and practices which cause disbursement delays are set out below.

Disbursement method

There are three main ways donors/creditors can disburse funds. The method, or combination of methods, each one uses can effect how quickly or slowly external assistance is received by the recipient as follows:

- *Direct cash payments to the recipient agency* – from the recipient's point of view, this is the most effective disbursement method as it provides cash upfront which can then be spent as required and is subject to the least controls by donors/creditors. This is the usual method for disbursing programme aid and commercial bank loans. Programme aid may be disbursed according to an agreed schedule, sometimes on the fulfilment of conditionalities. The approval process for release of programme aid tranches is usually less onerous than for other types of project aid. Commercial bank loans are usually disbursed in full on signature of the loan agreement. Direct disbursements are relatively easy to record and track.

- *Reimbursement claim* – this method requires the recipient to finance the expenditures and then seek reimbursement from the donor/creditor. For recipients, this is expensive as it means having to finance expenditures upfront and then prepare claims, with receipts and appropriate documentation, to receive the cash disbursement. However, some donors/creditors like it because it enables them to monitor and control expenditures. Donors/creditors have different procedures for preparing and submitting reimbursement claims, which can involve staff in considerable amounts of work as well as take a long time to prepare. Furthermore, donors/creditors or their agents can take a long time to scrutinise and process these claims, which further delays cash disbursement. This method is used mostly for project assistance but sometimes also for sector and macro programme assistance. The long delays of some reimbursement claims can make them more difficult to record and track.

- *Paying suppliers of goods/services directly* – using this method, no funds enter the recipient country. Instead the money is paid directly to external suppliers of the goods and services. This method is mainly used for the provision of technical assistance and consultancy services, although it can also be used to supply project equipment such as vehicles. Unless donors/creditors provide timely information on the value of goods and services disbursed, it is almost impossible for government to record and monitor these disbursements.

In the case of debt relief, most creditors simply cancel the debt service payments due or debt stock. So debt relief does not lead to new cash inflows instead it means that the money budgeted for servicing debt becomes available for other expenditures, primarily for poverty reduction. However, for the HIPC Initiative, the Japanese are unable to cancel debt and debt relief is provided by reimbursement, whereby HIPCs have to pay debt service on the due dates and the Japanese government will then refund the payment with a grant. This process can take up to 6 months.

Matching Funds[25]

To ensure government commitments to specific projects or sectoral programmes, donors/creditors often insist on government meeting some or all of the local cost requirements from its own resources. Therefore, there needs to be an allocation of budgetary funds for these matching funds. Line ministries, departments and agencies are required to identify all on-going and pipeline donor/creditor-supported projects and programmes indicating the government's required contribution for matching funds.

One of the chief difficulties with matching funds is poor forecasting of the local project costs and hence inadequate budgeting of funds by the government. In the first instance this can delay the commencement of the project if it involves waiting for the next year's budget to get the necessary allocation of matching funds. This can happen if the beneficiary ministries or agencies are unable to plan for matching funds needs at the budget formulation stage. If the provision of matching funds provided for in the budget is insufficient because of adverse exchange rates movements or higher domestic costs, then project and disbursement delays can occur.

Another key problem is that even if government has budgeted matching funds are often not available because of government overspending in other areas, or more usually due to shortfalls on domestic revenues or external or domestic financing.

[25] Matching funds are sometimes also referred to as counterpart funds. For the purpose of this paper, 'matching funds' is used to describe government contributions to project budgets, whereas the expression counterpart funds (or counter value) applies to the local currency equivalent of the foreign exchange disbursements.

If, for whatever reason, matching funds are not available, it can result in project implementation and disbursement delays. It can, in some instances, also lead to the government being in breach of project conditions which in turn leads to donor/creditor suspension of disbursements.

The problem of matching funds is frequently one of the key reasons for aid shortfalls. It most commonly occurs with infrastructure and construction projects or sector programmes, not those relating to poverty reduction. The best way to overcome these problems is for donors/creditors to provide programme budget support.

Budget or off-budget

Donors/creditors may have procedures about which institution and agencies they are willing to disburse to. For instance, some donors/creditors agree to disburse all their assistance through the Ministry of Finance which means the assistance goes through and is accounted for in the budget process. Others, however, will insist on disbursing directly to line ministries or projects, which may or may not inform the Ministry of Finance about the funding and hence this aid will bypass the budget process. Programme aid is usually disbursed directly to the Ministry of Finance, whereas project and sectoral aid and technical assistance can be disbursed directly to line ministries or projects, depending on donor/creditor preferences. From the government's standpoint, it is important to insist that all aid disbursements for government projects and programmes are accounted for in the budget and one way to do this is to try and ensure all disbursements are via the Ministry of Finance.

Donors/creditors may also support non-government programmes and projects run by NGOs, charities, religious and other organisations. In order to monitor this type of external assistance, the government needs to establish donor and recipient reporting systems.

Bank accounts

Some donors/creditors are unwilling to disburse project or sectoral funds to the government's bank accounts, in order to avoid the possibility of the funds being used to fund general government expenditure or for other projects. Hence the donor/creditor may insist on a separate bank account being set up into which funds will be disbursed. Often they will not allow it to be in the central bank or in the government's name, and will insist on it being in a commercial bank in the donor's name. In some instances, donors/creditors even insist the bank account is offshore, preferably in the donor/creditor country. This requirement can delay disbursements as it takes time to open the account and agree on signatories. There have also been cases where debt relief funds have had to be allocated to special accounts. In some cases, donors and creditors will agree to disburse to line ministries directly rather than via the government's main accounts.

Currency conversion

When the foreign currency disbursement is received it is usually converted into the local currency equivalent, which is known as counterpart funds or the counter value. In a liberalised exchange rate regime, the exchange rated used to convert the foreign exchange into its local currency equivalent is usually at or near the market rate. However, if in a fixed exchange regime, there is a significant difference between the official exchange rate and parallel market rate, then donors/creditors may request information about the rate at which conversions are being done. This arises particularly for commodity import support, whereby the recipient enterprises are required to pay the government in local currency for foreign exchange at the official exchange rate, although they have purchased the imports using foreign exchange purchased at the parallel market rate.

Pre-shipment inspection

This donor/creditor procedure, which applies to aid-funded imports, requires that goods with a value in excess of a set limit are inspected by a donor/creditor appointed agent. These inspections can be time consuming and cause delays in project or sectoral programme implementation. In some countries destination shipment inspections have been introduced but these too can be time consuming, especially if there is not sufficient well-trained staff to carry out the inspections. Direct budget support and debt relief, which do not directly result in import expenditures, are unaffected by these procedures; however balance of payment support and project aid can be delayed because of them.

Project management requirements

For projects and sector programmes, donors/creditors may require that special units are set up to oversee implementation. These units need staff with expertise to manage complicated donor and government implementation processes and there are frequently difficulties in finding the right people. The time taken to employ good staff and set up a well functioning unit can cause delays. If donors/creditors insist that expatriate staff are employed, this too can add to delays as it may involve advertisements, interviews and relocation. Special units may also require training of national officials which too can add to delays.

Managing external assistance projects and programmes can be very time consuming for national officials as it can involve receiving missions, negotiating agreements, co-ordinating requirements and documentation, preparing reports and accounting requirements. One survey found that managing the aid system can absorb half the time of key officials[26].

Auditing

Donors/creditors can insist on programmes and projects being audited regularly and by external auditors. This can cause delays if the auditors are unhappy with the financial procedures or discover financial discrepancies. The audit process can take up a lot of staff time.

5.1.3 Procurement Procedures

The main donor/creditor procurement procedures which effect the disbursement and utilisation of external assistance are discussed below.

Tying Aid

Tied aid is defined as official grants, loans or credits where procurement of the goods and services is limited to those of the donor/creditor country, or to a group of countries, which does not include most developing countries. In other words, there is no, or limited, competition for supplying the goods and services. Tied aid is primarily an issue for bilateral assistance as most multilateral donors/creditors, such as the World Bank, African Development Bank and other regional development banks, insist on internationally competitive procurement[27].

In the most restrictive cases, the donor/creditor will insist that all, or a proportion, of the funds are spent in the donor/creditor country even if the goods and services can be purchased more cheaply elsewhere, with lower transport costs. This raises the question of value for money and it has been estimated that tying aid can reduce the value of the assistance by anything up to 75% compared with procurement in the recipient country and up to 25%-40% compared with cheaper external sources[28]. Tying to expatriate staff or experts from the donor/creditor country is also

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[26] Elbadawi and Gelb (2002), page 9.

[27] See IDA and IBRD (1999).

[28] See Martin (2000) and World Bank (1998).

highly prevalent in technical assistance projects, where expatriate salaries and benefits can push up the cost by a factor of 10. As a result tying has been heavily criticised by recipients and those donors/creditors which care about the quality of assistance. On the other hand, some donors/creditors have insisted on continuing tying, arguing that it is essential to export promotion and therefore to business sector and political support for their aid programme.

While some donors/creditors are no longer tying goods and services per se, they are effectively doing so as they insist on the goods must be shipped and/or insured by their own country's companies. This is known as 'indirect tying'. Another type of indirect tying may occur when access to information on a donor/creditor's support is so difficult that only companies from the donor/creditor country can easily find out about it, or when donor/creditor trade representatives in the country give their companies unofficial advance notice of forthcoming projects, allowing them unfair advantage in procurement. Another example may be handing of procurement to 'agents' which have close links with exporters in the donor/creditor country.

In 2001 the DAC published new proposals for untying aid to the least developed countries as of 1 January 2002 in the following areas: balance of payment and structural adjustment support, debt forgiveness, sector and multi-sector programme assistance, investment project aid, import and commodity support, commercial services contracts, and ODA to non-governmental organisations for procurement related activities. To monitor implementation of these recommendations, the DAC has set as a reference point 0.60 for the ratio of untied bilateral ODA to total ODA calculated on the basis of a 5-year average.

Table 9 sets out proportion of tied to untied bilateral ODA as reported by donors/creditors in 2000 (the latest year for which data is available). The countries with 60% or more untied aid are Australia, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Portugal, Sweden, Switzerland and the United Kingdom. Those who still provide more than 60% of their aid on a tied or partially basis are Belgium, Canada, Greece and Italy. However, this data refer only to official development grants and loans and exclude export credits, other official finance and technical assistance, which are often the prime vehicles for tying procurement spending.

TABLE 9: TIED AND UNTIED BILATERAL ODA*, 2000

Bilateral Donor	Untied ODA (%)	Partially-tied ODA (%)	Tied ODA (%)
Australia	77.4		22.6
Austria	59.2		40.8
Belgium	39.0	49.1	11.9
Canada	24.9		75.1
Denmark	80.5		19.5
Finland	89.5		10.5
France	68.0	25.5	6.6
Germany	93.2		6.8
Greece	23.5		76.5
Ireland	na	na	na
Italy	38.2		61.8
Japan	86.4	0.5	13.1
Luxembourg	96.7		3.3
Netherlands	95.3	0.6	4.1
Norway	97.7		2.3
New Zealand	na	na	na
Portugal	96.6		3.4
Spain	47.2	0.1	52.7
Sweden	85.4	10.9	3.7
Switzerland	93.6		6.4
United Kingdom	91.5		8.5
United States	na	na	na
All DAC	80.8	3.0	16.2

* excluding technical co-operation funds
na = no data reported
Source: OECD, Development Co-operation Report, 2002

Bidding and contracting procedures

For large projects, donors/creditors often require that there be a competitive bidding process for the award of large contracts, especially for construction and supply of equipment. If the bidding process is international then the process can take several months as there need to be advertisements in the international press and time allowed for bids to be prepared, submitted and then evaluated before the contract can be awarded. Once the contract has been awarded and signed there can then be delay in the selection of contractors and consultants to do the work.

Timing of disbursements

The timing of disbursements can be affected by the donor/creditor financial year. Approvals and release of funds at the beginning of the donor/creditor year may be slower whereas they can be expedited towards the end of the financial year as donors/creditors want to close their annual accounts.

5.2 GOVERNMENT PROCEDURES AND PRACTICES

It is not only donors/creditors which are responsible for project and disbursement delays. Government too can cause delays.

Failure to meet conditionalities

If the government fails to fulfil donor/creditor conditionalities, this will almost certainly lead to the suspension of disbursements. In the extreme, being off-track with its IMF programme will lead not only to suspension of further IMF disbursements but many disbursements by other donors as well. However, failure to meet sectoral or project benchmarks can also result in donors/creditors withholding disbursements until the benchmarks are achieved.

As noted in Section 5.2.2, insufficient matching funds are a common reason for disbursement delays. This tends to happen more towards the end of the government's financial year when actual expenditures may outstrip budgeted expenditures.

Government may also fail to inform donors/creditors when conditionalities have been fulfilled and thereby delay disbursements. This can arise if there are not clearly defined responsibilities and information flows for external assistance monitoring within government. It also requires that there is frequent dialogue between the responsible government and donor/creditor officials.

Failure to pay debt service

Failure to pay debt service can result in donors/creditors refusing to disbursement funds until payments are resumed and, in some instance, arrears have been cleared. If falling into payment arrears results in breaching conditionalities, this can seriously effect future disbursements. This is especially the case if a country is declared in arrears to the IMF and World Bank as this usually results in other donors/creditors suspending disbursement of some external assistance. Some creditors have formal deadlines whereby service payments are not classified as being in arrears until so many days after the due date – for the World Bank this is 60 days, but others are less generous. It is also possible to negotiate delays in service payments with some creditors.

Bidding and contracting procedures

Government procedures for preparing and evaluating bids and awarding contracts may be cumbersome and time consuming, particularly if they result in large amounts of paperwork having to be approved by numerous government departments or agencies. In some cases, there may not be sufficient well-qualified staff to deal with these matters which too can lead to delays. Training of existing staff or appointing new staff also takes time.

Customs procedures and tax exemptions

Donors/creditors frequently point to delays in customs clearance of equipment and supplies as being a reason for delays in project implementation and hence disbursements. There are numerous factors which enter into this, such as not enough well trained customs officials, cumbersome paper work, manual systems and corruption, and changes to these should speed up the process. In addition, most donors and creditors insist in tax and duty exemptions being granted for goods and services imported using their funds. This can involve time-consuming paper work by officials and in some cases may even require special approvals at senior government levels which can be time-consuming to acquire. From government's point of view it also means lost revenue which is not counted towards its matching funds contributions.

Banking procedures

Donors and creditors complain about delays because of cumbersome central bank and/or commercial bank procedures. In particular, there can be delays in confirming the deposit of export and other trade credit funds and the subsequent opening of letters of credit for import purchases. Banking procedures are often too time consuming, bureaucratic and paper-generating. While there is a need to ensure financial probity and transparency, it is also important that the banking system is able to deal with such instruments efficiently. Similarly the banking system needs to be able to handle foreign exchange conversions quickly and efficiently.

Project management
Government procedures for managing external assistance may be too cumbersome and bureaucratic. There may be good reasons such as preventing over/under-invoicing and transfer pricing whenever possible. However, this can give rise to too much paper work moving across too many desks, in which case donors/creditors may insist on setting up separate project management units to overcome the resulting delays.

Reporting and auditing
Government's own procedures for reporting and auditing projects and programmes may be cumbersome and time consuming and lead to delays. Collecting information and the required paper work to conduct proper audits may take time, which may be especially the case if officials have to travel to rural and remote areas to obtain and verify information. The time taken to prepare reports and get them approved for release can also be long.

Shortage of staff
Government may not have enough well trained staff to ensure good project management. This can arise at both the Ministry of Finance level as well as at the line ministry and agency level and there may be an urgent need for training. Or there may be a need to fill vacant posts. Furthermore, staff may not have access to the required information, such as international prices, or computing facilities. The use of technical assistance experts and consultants to fill skills vacancies can also cause difficulties because of the time taken to recruit them and when they leave if officials have not been trained to take over.

Institutional issues
Government bureaucracy can cause delays, especially if it involves a labyrinth of paper trails between various agencies or even within a single Ministry. The more complex the bureaucracy, the more likely it is that papers will be lost, approvals will not be obtained and disbursements will be delayed. Having good institutional structures for co-ordinating and dealing with donors and creditors is crucial to improving disbursement performance.

6. POLICY ASPECTS OF EXTERNAL ASSISTANCE

Another key aspect of analysing external assistance is the degree to which it dovetails with government policy, or on the other hand whether the suppliers of such assistance are insisting on changes in government policy. There are several main elements to this analysis:

- Does the level of concessionality of the funding match government policy?
- Does the type of assistance offered fit with government priorities?
- Do the channels through which the assistance passes assist government management?
- Are the purposes for which the funds are supposed to be used in line with government policy, in terms of their sectoral and project composition?
- Is the assistance provided with the maximum flexibility to support budget spending?
- Is the assistance predictable over a medium-term period in line with government budget forecasting procedures?

- Are the policy conditionalities attached to the funding fully in line with government policy (preferably even inspired by it) or are they conflicting or additional? and
- Does the supplier of the assistance play an active role in supporting government in its policy dialogue with the international community?

6.1 CONCESSIONALITY

Issues surrounding the definition of concessionality and IMF programme ceilings have already been discussed in section 2.1 above. However, some governments have gone beyond IMF ceilings and defined their own policies, giving preference to grants wherever possible or to loans which have a grant element at least as high as that of the IDA loans. Others have small ceilings allowed for non-concessional loans or wish to continue to allow some parastatals, the private sector or revenue-generating projects to borrow on non-concessional terms with government guarantee. Government therefore needs to examine each funding proposal for its compliance with these terms

6.2 TYPES OF ASSISTANCE

Basic definitions of types of assistance and some of their advantages and disadvantages have already been discussed in 2.2.2 above. Typically, recipient governments will have defined for themselves many ideas about which types of assistance are preferable. Among the most common of these are:

- That budget support or balance of payments support which is not earmarked to any particular sector is the most preferable because it provides maximum flexibility for assistance to be used to fund government spending priorities and is faster-disbursing than project support, though it has the disadvantage of often being suspended rapidly in line with IMF programmes.
- That sector wide programmes can also be advantageous because they represent support by donors for key government spending priorities in sectors, but are less advantageous than budget support because they include earmarking to a particular sector or sub-sector (or in the worst cases are more of a collection of sector projects which are therefore all earmarked).
- That debt relief is generally high-quality funding because it operates like budget support by freeing up funding previously allocated to debt service for other budget priorities. However, this can sometimes be undermined by tying of debt relief savings to specific expenditures as part of the HIPC Initiative process, or by procedures such as Japanese reimbursement of debt service with grants (which cannot necessarily be spent on poverty reduction priorities) or French and Italian insistence on spending some debt relief on additional project run by NGOs (which may not be part of key government priorities for poverty reduction).
- That project-specific aid is generally more cumbersome and slow-disbursing than programme aid (though it generally has the advantage of generally continuing to disburse if IMF and World Bank programmes are temporarily suspended), but can be improved by at least ensuring that it is fully integrated into government sector programmes and spent on the highest priority projects in those programmes, rather than on donor priorities.
- That technical assistance is generally negative except insofar as it builds national capacity to replace it at the earliest possible opportunity through explicit transfer plans. This is often held to be particularly true of TA which is provided for accounting/auditing, as this should be a national priority and responsibility rather than handled by donors.

- That aid in kind (food aid, drugs, educational materials, turnkey projects) is usually the worst form of aid as it is almost impossible to verify its quality or value for money beforehand and it can undermine national production of the same goods or ownership of materials.

These rules are by no means agreed by all recipient governments and there are usually many exceptions and complications to them at a national level. But government needs to define its priorities for types of assistance and then analyse each provider of assistance comprehensively.

6.3 CHANNELS OF ASSISTANCE

As described in 2.2.2 and 2.2.3, providers of assistance can channel their assistance through many different routes and to different recipients. The key issue for central government here is generally the degree to which it is able to have a comprehensive overview of assistance – which means the percentage of the assistance which is channelled through or monitored as part of the government budgeting process. To the degree that providers disburse via line Ministries, other agencies such as parastatals or local governments, NGOs or the private sector (and/or there is failure of information flows between those agencies and the Finance Ministry), the government will be in a much worse position to analyse the effectiveness of its external assistance and influence its composition. Therefore the channels of assistance are usually seen as a key aspect of government aid policy.

6.4 SPENDING PRIORITIES AND FLEXIBILITY

Another key method to use to assess whether donors are complying with government priorities is to look at the degree to which their funding (in terms of both commitments and disbursements) is in line with government spending priorities, and allows government maximum flexibility in executing the PRSP based on national rather than donor priorities. This can be assessed in five main ways:

- The willingness of each donor to fund the sectors or sub-sectors which are seen as the top priorities for poverty reduction, rather than funding those which are less high priority and, within those sectors and sub-sectors, to fund the projects which government ranks as top priority.
- The degree to which each donor allows government to design sector programmes and projects itself, and classifies and organises its assistance plans around these, rather than intervening to insist on the inclusion or prioritisation of its own projects, or to influence the classification of expenditure in order to fit with its own systems.
- The willingness of each donor to provide funding on an unearmarked basis, as budget support for the overall national development strategy, rather than tying it to specific sectors or projects. One argument which donors often use for earmarking funds and against more flexible support is that of fungibility. Box 5 explains this argument but shows that it has been largely discredited.
- The willingness of each donor to contribute money in a coordinated way through jointly monitored budget support or coordinated swaps, in order to minimise procedural burdens on government.
- The degree to which donors are flexible in coming forward rapidly to fund balance of payments or budget financing gaps with programme aid, and in changing their priorities for sectors or projects based on changes in national priorities as reflected through participatory poverty reduction strategy design. There are two types of such gaps –those

which can be identified in advance and presented to Consultative Group or Round Table meetings, and those which might arise as a results of unexpected developments during the course of the year (external shocks or changes in government policy). So each donor should be assessed to see whether they regard budget support or key sectors or capacity-building or other government priorities as their priorities for support to the country, and for their ability to mobilise money quickly to support those priorities. They should also be assessed for the degree to which they can set aside contingency reserves of assistance to allocate to a country which is affected by external shocks, and for the speed with which that money is then delivered.

Box 5: What is Fungibility?

Fungibility is the idea that aid pays not for the items against which it is accounted but for the marginal expenditure it makes possible.

Consider the simple example of a government with $100 million to spend. There are two projects to choose between: rehabilitating rural health clinics or buying a new fleet of tanks. Both cost $100 million. After much deliberation the government decides to rehabilitate the health clinics. But before it does so a donor comes along and offering $100 million for some worthy project. The government cannot ask the donor to buy the tanks and so it says to the donor 'our rural health clinics are in desperate need to rehabilitation, but we cannot afford to do it'. So the donor pays for the health clinics. The government can now use its won money to buy the tanks after all.

There is no corruption or misuse of funds here. The donor funds are indeed being spent on the health clinics as intended and accounted for against this expenditure. But, as the donor is paying for something the government would have done anyway, the government's own money is freed up for something else, in this case tanks. This is fungibility.

Government spending with and without aid:

No aid	Health clinics
Aid	Health clinics and tanks

Comparing government expenditure with and without aid, it can clearly be seen how the aid has in effect paid for the tanks even though it is accounted against the health clinics.

However, there is strong evidence to suggest that trying to achieve recipient accountability by having narrowly focused projects and donor driven accounting processes does not really work. Instead recipient accountability is better promoted by broadly based programme assistance in the context of a transparent and nationally supported reform agenda.

<u>Sources</u>: H. White (1999), page 24 and Elbadawi and Gelb (2002), page 7.

6.5 PREDICTABILITY

Another key aspect of policy compliance with recipient priorities is the degree to which assistance flows are predictable, thereby facilitating government planning processes. Providers of assistance can help in five ways here:

- Pledges of funds in principle are all very well, but providers need to live up to these pledges by turning them into firm commitments as soon as possible.

- Changes of government in donor countries can have dramatic impacts on aid priorities, putting at risk programmes and projects at the local level. Some countries are particularly notorious for adopting new 'fads' on a regular basis. Predictability and consistency of policy in all of the other aspects discussed in this section is vital for recipient planning.
- Some donors have moved to systems of multiyear programming for their aid, allowing recipient governments better to plan ahead in medium-term budget frameworks.
- Many donors are trying to advance their own decision-making timetables in order to be sure that they can communicate commitments and indicative disbursement timetables to recipient governments in time for them to be factored into budget planning.
- Others are trying to make funds available for disbursement early in the financial year to avoid bunching of expenditures later in the year.

6.6 POLICY CONDITIONALITY

Conditionalities are a set of measures specified by a donor or creditor, which government needs to implement within an agreed time period. They act as benchmarks for the continuation of external assistance flows, which will be suspended if the conditionalities are not fulfilled. In one sense, they can be viewed as 'bribes' to ensure donor agendas and preferences are actively pursued by the government. More benignly, conditionalities can be thought of as encouragement to implement policy measures more quickly, to support the direction of a policy change already designed by government or to counter possible diversion of funds and reduce the opportunity for corruption.

How conditionalities are viewed can often depend on the environment in which they are negotiated and the extent of dialogue between the government and donors/creditors. Conditionalities negotiated in a consultative manner are more likely to lead to the more benign view. This is particularly the case when donors/creditors make long-term commitments supporting the implementation of government policy. If, however, donors/creditors try to dictate policy through coercive financial leverage, then the more extreme view is likely to prevail.

Conditionalities can be at three levels:

1) *Macroeconomic or structural reform conditions*[29]. The most common macro conditionalities are those negotiated for IMF and World Bank programmes. The conditionalities usually relate to the main economic aggregates, such as the inflation rate or the growth of money supply and/or structural and policy reforms, such as timetables for financial sector liberalisation and privatisation of parastatals, which are within the remit of the key government ministries such as the Ministry of Finance and Central Bank. The conditionalities will specify the target to be achieved, the time frame for doing so and any intermediate benchmarks. In practice, many other donors and creditors tie some of their support (e.g. expenditure of programme aid) to a country remaining on track with its IMF and World Bank programmes. Being off-track with the IMF usually results in other donors/creditors suspending disbursement of some of their external assistance. This 'cross-conditionality' can often be a very worrying development as it can lead to a domino effect on disbursements from many different donors, and the resulting instability or shortage of aid funds can be very destabilising to the economy (see section 7 below). Some donors/creditors may also set their own additional conditionalities or conditions which are inconsistent with those of the BWIs – this is known as 'conflicting conditionality' and can cause major problems for government.

[29] For more analysis of macro conditionalities, see notably Killick (1998).

In the 1980s and 1990s there was a dramatic proliferation of macro conditionalities, notably in programmes with the IMF and in World Bank adjustment loans. It is now commonly agreed (even by the Bretton Woods Institutions) that long lists of policy changes, many of which were drafted in Washington before consulting the borrowing country, had very low effectiveness in achieving policy change, largely because in most borrowing countries only a few officials were committed to their implementation, and even they thought the conditions had unrealistic speed or sequencing[30].

As a result, more recently, there have been three trends which are designed to increase country 'ownership' of macroeconomic and structural reform conditionalities, all of which are implemented for low-income countries through the new framework of country-designed Poverty Reduction Strategy Papers (PRSPs), Poverty Reduction and Growth Facility (PRGF) loans by the IMF, and Poverty Reduction Support Credit (PRSC) loans by the World Bank. In this context, it is absolutely crucial for governments to analyse, for each source of funds, the degree to which they are genuinely supporting the government's own participatorily-designed poverty reduction strategy, rather than getting too involved in trying to design that strategy on behalf of government, or insisting on additional or contradictory conditions.

The main ways of undertaking this assessment are to look at:

- 'Streamlining of conditionality'. The Bretton Woods Institutions and other donors/creditors have been encouraged to cut back the numbers of conditions and to limit them to those which are critical to achievement of their programme objectives. There has been considerable progress in this area but many countries are still complaining that there are too many detailed (micro) conditions such as staffing of particular units or establishment of Trust Funds for small sub-areas of anti-poverty spending. It is therefore vital to assess whether the conditions in programmes are genuinely vital and likely to have a critical impact on the success of the programmes, or whether they are too micro and likely to delay compliance while having less immediate impact on poverty reduction. Similarly, while there has been a considerable reduction in the numbers of structural reform conditions in IMF programmes, it appears that the combined numbers of conditions in IMF and World Bank programmes have not been reducing as fast. Insofar as continuance of a programme by one institution generally depends on compliance with the programme of the other, HIPC Finance Ministers have suggested that we may instead be seeing 'conditionality fungibility', where one donor or creditor takes over the conditions previously used by the other[31]. Similarly, one important delaying factor in disbursing funds can be failure to synchronise and coordinate donor negotiations of conditions (or their evaluations of compliance), leading to a lowest common denominator where each donor waits for negotiations or evaluations to be concluded by another. So it is important to analyse conditionalities across the range of donors and creditors, and the degree to which they are synchronising and coordinating successfully in support of the PRSP.
- Flexibility in the design and interpretation of conditionality:
  - many have suggested that creditors and donors need to be more flexible in the design of conditionality, by giving the governments of recipient countries the chance to design for themselves a menu of options for achieving the desired policy changes, in terms of timing and sequencing of reforms and scale of macroeconomic adjustment . There is little evidence of such menus so far (especially that they are being designed

[30] See notably the IMF-funded External Evaluation of the ESAF, IMF EBAP/98/8, 22 January 1998.

[31] See the Maputo, London and Washington Declarations of HIPC Finance Ministers (HIPC CBP 2001 and 2002).

by the borrowing countries themselves), but the commitment to progress in this area is welcome and countries should assess for themselves the degree to which they are being offered choices in discussions on conditionalities.

- There has also been a particular focus on the need for more flexibility in allowing an increase in government spending on anti-poverty measures (where this can be financed sustainably), and a reconsideration of the balance between attacking inflation and accelerating growth. This case has been particularly argued for 'post-stabilisation' countries – those which have achieved a high degree of macroeconomic stability, as represented by inflation in single digits for 3 years, and a relatively low budget deficit – and some degree of flexibility has been introduced in a few of the PRGF programmes for such countries[32]. It is vital to analyse the degree to which flexibility is desirable in your own country (i.e. have you reached a 'post-stabilisation phase'), and the degree to which it is being offered in discussions on conditionality.
- Another area which is being advanced (though relatively slowly) is that of introducing into all PRSPs and PRGFs a large element of poverty and social impact analysis for all conditions, on the basis of which conditions could be removed or changed depending on their expected impact on poverty reduction. Some progress has been made in developing and using tools for such analysis in the BWIs and by some donors, and in helping some countries to begin to conduct such analysis, but there is a very long way to go in transferring such skills to countries to conduct such analysis independently for themselves. It is essential to look at the PRSP and PRGF and PRSC and judge the degree to which each proposed policy measure will impact directly and positively on poverty reduction, and to design transitional measures to offset any negative impacts[33].
- In addition, there is a greater focus on introducing flexibility into macroeconomic conditions to provide some degree of automatic protection against 'external shocks' (e.g. drought, commodity price falls, or aid shortfalls) which can disrupt the execution of conditionalities. This is provided by the use of automatic 'adjusters', most of which allow government to increase its deficit and borrow more domestically in the event of a shock. But of course, as discussed in more detail in section 7 below, borrowing more domestically can cause major problems for the monetary and financial sector aggregates – so many regard this flexibility as less than perfect, and prefer to cut expenditures, increase domestic revenue efforts, or ask donors for more aid.
- Finally, it is important to analyse the degree to which compliance with conditionalities is interpreted flexibly by the supplier of the funds. Most suppliers of funds have a clear system for monitoring compliance. Usually some conditions are known as 'prior actions' or 'effectiveness conditions', which must be implemented before any of the funds will be disbursed. These have often been particularly problematic for countries and efforts can be focussed on reducing these. Thereafter donors and creditors tend to monitor compliance on a quarterly, semi-annual or annual basis and, if countries are complying successfully with conditions, they will disburse another 'tranche' of funding. The IMF and World Bank and other donors often have the ability to grant 'waivers' of certain conditions to countries if they feel that overall progress with the PRSP is good, so that the next tranche can be disbursed. Yet often, discussions of compliance can get bogged down on one or two conditions which may not be critical to the poverty reduction strategy. One way

[32] See notably Adams and Bevan (2001).

[33] See PSIA papers on Fund and Bank websites.

round this has been the introduction of 'floating tranches', which do not have a specific timetable for disbursement but will be disbursed when conditions are met. The aim of these was to allow countries to take their time in implementing conditions at their own speed, and to avoid the need for waivers. However, countries need to judge whether these allow them to design and implement policies more coherently and in line with their PRSP, or whether the delay in disbursing floating tranches is having a pernicious effect on the PRSP.

2) *Sectoral level.* These conditionalities relate to policy and institutional changes at the level of sector line ministries or departments, such as health and education, and assume the macro level conditionalities are being met. They include targets and the time frame for their achievement. Examples of conditionalities for health and education sector programmes can include targets for the numbers of infants vaccinated, enrolment at primary school or spending allocations so money has to be spent on specific purposes. The conditionalities can also be institutional such as setting up of regional health authorities or the setting up of a new government agency.

3) *Project level.* These conditionalities are more micro level and relate to project implementation and management. They include three main types of conditions:

   - Legal – these require changes to existing legislation and regulations. Examples are the introduction of new banking legislation or the setting up of a new regulatory agency to supervisor and monitor insurance companies. Legal conditionalities are usually the most time consuming to achieve because it takes time to enact or change laws and regulations.
   - Procedural and disbursement conditions – these have already been discussed in Section 5.1.
   - Institutional – these conditionalities require the establishment of or changes to government agencies or departments, such as setting up a new unit or merging two government departments or agencies. Institutional conditionalities can also take a long time to implement, especially if there are staff implications such as employing foreign technical assistance, hiring new staff or making or redeploying or making existing staff redundant.

While the macro conditionalities apply to the economy as a whole and are negotiated with the IMF and World Bank, the sectoral and project level conditionalities can vary across sectors and between donors/creditors. Some donors/creditors are quite rigid in their conditionalities are there may not be much scope for negotiation. Other donors/creditors are more flexible and willing to negotiate, particularly if they agree with the overall direction of government policy and there is the opportunity to have a dialogue with the government on policy issues. Other issues such the government's track record of implementing programmes and projects; its ability to spend donor/creditor funds efficiently and effectively; and the level of corruption, or perceived corruption will also influence conditionalities.

It is also important to note that the level of the conditionalities does not necessarily match the type of external assistance. So sector programme assistance can have macro conditionalities, project assistance can have sector or even macro conditions, macro funding can have sector or project conditions. These mixtures of conditions are among the most undesirable and it is important to examine where they exist and how they can be eliminated.

6.7 POLICY DIALOGUE

Beyond conditionality, it is important to assess how active a donor is in the policy dialogue between the recipient country and the international community. Some donors undertake very little analysis beyond their own priority projects or sectors, and have virtually no representation in the country which can analyse macroeconomic issues. Others have economists who participate in the policy dialogue at a local level, but nevertheless tend to tie most of their disbursements to those of the Bretton Woods Institutions. The most preferable donors are those which have sufficient commitment to partnership with the recipient country, analytical capacity and engagement in the policy dialogue that they are able to disburse all their funds based on independent decisions and discussion with the recipient country, allowing it to avoid major disruptions to the economy if discussions with the Bretton Woods Institutions go temporarily off track, and are also able to discuss actively with the BWIs at a local and international level in order to increase their flexibility as discussed in 6.6 above.

6.8 EVALUATING DONORS

Based on analysing donor compliance with these types of rules and where necessary weighting the different rules for their importance, it then becomes relatively simple to identify an order of preference for donors which are the most supportive of the PRSP process, and to track the improvements in their compliance with government policies and their efforts to streamline their procedures. More details of such an evaluation system, which will be disseminated through capacity-building training in 34 countries over the next two years, can be found in the new financing training manuals sections of the DRI website, or is available on request from DRI.

7. MACRO IMPACT OF EXTERNAL ASSISTANCE

As discussed in Section 4.2 above, the main indicators of the sustainability of external assistance focus on its fiscal impact. However, it is also important to analyse the wider impact of changes in external assistance flows on the budget and in terms of its effects on the balance of payments, debt, monetary sector and inflation.

7.1 BUDGET IMPACT

In addition to the analysis of the key indicators, it is also important to assess the impact of changes in external assistance on government expenditure, revenue and the budget financing requirements. The key issues to consider are as follows:

- *On expenditure*: shortfalls in external assistance inflows can lead to supplementary budget requests in order to maintain necessary expenditures on goods and services. Alternatively, a shortfall in external assistance may lead to the government cutting expenditures, either on an across-the-board basis for discretionary recurrent expenditures or by reducing capital and/or development expenditures. Or do shortfalls result in cutbacks in 'soft' expenditures such as poverty reduction? Statutory expenditures, such as interest payments on debt and pensions, obviously have to be maintained. Higher than expected external assistance receipts may not result in increases in either current or capital spending, but instead lowers the government's financing requirements (see below). More broadly, does the availability of external assistance effect government spending allocations through 'fungibility'? See Box 5 above.
- *On domestic financing requirement*: in general there is an inverse relationship between inflows of budgetary external assistance, especially programme assistance, and domestic budgetary financing. So if external assistance receipts are higher than expected the

government does not need to issue or rollover as much domestic debt. However, if there is a shortfall in external assistance receipts, then it may have to issue more debt instruments or borrow from the central bank in order to finance its expenditure programme.

- *On revenue measures*: shortfalls in external assistance receipts can also be met by the introduction of higher taxes (e.g. customs duties or VAT) or a reduction in subsidies (e.g. petroleum prices rise to world market prices). Alternatively the government can introduce new taxes on, for example, luxury goods, or possibly raise additional revenue by expansion of its privatisation programme. Higher than expected external assistance receipts can, in principle, be used to lower taxes but this may not be a realistic option if the government is expected to raise its revenue efforts as part of an adjustment programme with the BWI. Conversely, there is some evidence that the availability of external assistance is associated with reduced tax efforts by countries[34]. However for countries with IMF programmes which place strong emphasis on increasing revenue mobilisation, this is unlikely.

- *On non-concessional borrowing*: shortfalls in external assistance can be offset by higher non-concessional borrowings, within the limits set on such new borrowings under an adjustment programme. But such borrowings are likely to provide much compensation given the low level of such ceilings, and they will also result in significantly higher debt service payments. Higher than expected external inflows may enable the government to reduce its recourse to new non-concessional loan finance, but the two are usually used for different purposes (e.g. concessional loans for poverty reduction and non-concessional loans for trade finance), so this may not be possible.

7.2 BALANCE OF PAYMENTS IMPACT

For the balance of payments, one of the main consideration is whether external assistance flows are sufficient to close a financing gap. To do this it is necessary to analyse the following:

- *Grant disbursements and current account balance (before official transfers)*: in nominal terms or as a percentage of GDP, to assess whether grant inflows are sufficient to balance the current account,

- *Concessional and non-concessional loans and debt forgiveness with the balance of payments financing gap:* in nominal terms or as percentage of GDP, to assess whether these flows are sufficient or not to fill the gap.

However shortfalls or excessive external assistance receipts can have other consequences for the balance of payments as follows:

- *On imports*: shortfalls/surplus external assistance receipts can lead to lower/higher than anticipated imports as a large proportion of aid inflows, both programme and project, are usually designated for import purchases. In the case of programme aid, this can be directly for import or commodity support or food/emergency imports. Much of project aid is also directed at the purchase of imported machinery, equipment and goods. Non-concessional loans can also be used to import goods and services.

- *On export competitiveness*: on the one hand, external assistance can be positive by financing the investment necessary for increasing the country's export competitiveness and trade. As result shortfalls can have a dampening effect of export competitiveness and growth.

[34] McGillivray, M. and Morrissey O., pages 423.

On the other hand, excessive external assistance can worsen competitiveness through the Dutch disease effect, whereby significant inflows of foreign exchange result in an appreciation of the domestic currency and a loss of competitiveness. A study of the determination of non-traditional exports of developing countries shows that more aid, in excess of 5% of GDP, hinders rather than helps export expansion[35]. So it is important to analyse what has happened to the terms of trade during times of large external assistance inflows.

- *On the exchange rate*: as noted above, excessive foreign assistance inflows can lead to an appreciation of the domestic currency. Dutch disease effects have been noted in Zambia (copper boom), Nigeria (oil boom) and Ghana (foreign aid). However, there is also evidence, from many countries, that external assistance is frequently responsible for a real exchange rate depreciation, mainly through support for exchange rate liberalisation[36]. Similarly, shortfalls in foreign assistance compared to anticipated inflows have frequently led to severe shortages of foreign exchange in liberalised foreign exchange markets, causing rapid devaluation of the domestic currency as the people try to purchase a scarce commodity.
- *On reserves*: increasing/decreasing external assistance receipts can result in higher/lower levels of international reserve holdings if the government deposits the foreign currency inflows with the central bank for some time before they are eventually spend on imports of goods and services. If the external assistance inflows are spent primarily on domestic goods and services then international reserve holdings will be boosted.

Over the longer-term, it is also important to assess the impact on foreign direct investment as lack of external assistance and its expenditure on infrastructure development can discourage new future investment.

7.3 MONETARY IMPACT

If the government deposits external assistance receipts with the central bank or commercial bank (prior to spending on imports or domestic goods and services), then this will lead to higher levels of net foreign assets, all other things being equal. This could increase the money supply and be inflationary. However, other factors do not usually stay the same, and the foreign currency is nearly always used to purchase imports or make debt service payments. So the net effect of such deposits is usually quite small.

The main potential monetary impact is from commercial bank loans and bond issues, which are usually disbursed in relatively large amounts over a short time period or in one tranche, whereas aid disbursements tend to be smaller and spread out over a longer period of time and hence have less impact. If such deposits do lead to an increase in the liquidity of the banking system and higher money supply, the government can sterilise the impact of such inflows, by issuing more domestic debt instruments to mop up this excess liquidity. However this is assuming there is a sufficiently well developed financial market which will agree to purchase and hold government debt.

7.4 IMPACT ON INFLATION

It is difficult to determine a priori the impact of external assistance on inflation because of the potential offsetting effects. Therefore it has to be analysed on a country-by-country basis.

[35] See Elbadawi and Gelb (2002), page 14.

[36] For further details see Hjertholm P., Laursen J. and White H. (2000).

External assistance and aid can contribute to inflation in the recipient country if it results in higher prices of aid-provided goods, especially imported goods, which have been 'over-priced' by suppliers in developed economies. On the other hand, if external assistance results in increasing the aggregate supply of commodities or eases supply bottlenecks in the economy, then it can have a deflationary effect. Furthermore, if it increases the productivity of the traded-goods sector – by for example lowering transport costs – then it can lead to lower prices and improved international competitiveness.

Shortages in external assistance can also fuel inflation through its effect on the exchange rate. If a shortage in foreign exchange results in the depreciation of the domestic currency, this will lead to higher prices for imported commodities and hence add to inflationary pressures.

7.5 IMPACT ON SAVINGS AND INVESTMENT

As national savings are low in most HIPC countries, external assistance is seen as complementary and provides the resources for investment and economic growth. On this basis, more external assistance should lead to higher investment and therefore higher growth. However, the recent evidence suggests that higher external assistance leads to higher consumption rather than higher investment. This implies that external assistance is a substitute to domestic savings, than complementary[37]. The evidence of recent African studies is that aid dependency accounts for a large portion of the shortfalls in domestic savings and as result growth rates have been retarded.

Some of the issues to consider when assessing the relationship between external assistance, savings and investment are as follows:

- The evidence above suggests there is a direct relationship between the change in external assistance and national consumption expenditure. This can be verified by comparing the growth (or decline) in external assistance with the growth (or decline) in consumption expenditure. It is also useful to analyse the relationship between external assistance and investment.
- The evidence also suggests an inverse relationship between external assistance and national savings, which can be reviewed by comparing the rate of change of these two variables.
- A shift in donor/creditor assistance towards programme aid, such a budget or balance if payment support, would be expected to result in higher consumption expenditure – government recurrent expenditure or imports. Conversely a shift away from programme assistance could result in lower consumption expenditure. However, this shift would not necessarily result in more immediate investment spending. The difficulty here is that there can be lags in investment spending so a shift towards to more support for capital projects would take time to feed through into investment spending.

7.6 IMPACT ON DEBT

External assistance includes loans as well as grants and so it can be debt-creating and therefore have long-term implications for both the fiscal and foreign exchange gaps. More debt means higher debt servicing costs in future and additional demand for foreign exchange and government revenues to finance these payments. In theory, long-term debt sustainability requires an expanding economy, export sector and tax base.

[37] See Elbadawi and Gelb (2002).

Shortfalls aid flows can result in additional non-concessional external borrowings by government if they have to contract more expensive export credits to finance imports. This, of course, will also raise the fiscal burden debt. As noted in Section 7.1 above, aid shortfalls can lead to higher domestic debt if the government is unable to borrow more quickly disbursing funds externally.

8. CONCLUSION

To ensure long-term debt sustainability, developing countries need to design and implement national debt strategies. Not only should these strategies focus on the maximum possible debt relief a country can expect to receive from international fora and initiatives, but they also need map out the best possible types of external assistance for maintaining long-term debt sustainability and delivering sufficient resources for financing poverty reduction programmes. This paper highlights the key analytical issues to be considered when designing such a strategy. In particular, it points out the need to look beyond the basic issues of concessionality of funding and take into account the how donor/creditor and government procedures can affect the actual delivery of funding. It also discusses the macroeconomic impact of external assistance and the policy issues for co-ordinating external assistance with the national poverty reduction and development plans.

For some aspects of external assistance there may be benchmarks, criteria and procedures and practices, which can assist government in designing its own strategy. But most importantly it is the country's own experience which counts and its desire to establish and implement its own policies and programmes rather than rely on donor/creditor prescriptions. Designing and implementing a national external assistance strategy will enable developing countries to set their new financing agendas to achieve long-term debt sustainability and poverty reduction.

Annex 1: Glossary

Aid: Defined as grants and loans, which qualify as 'official development assistance (ODA)' to developing countries or 'official assistance (OA)' to Central and Eastern European countries and newly independent states of the former Soviet Union and the more advanced developing countries. Technical co-operation is included in aid.

Arrears: Unpaid amounts of principal and/or interest payments.

Bearer bonds or stock: There is no register of who owns the stock, instead it is the physical possession of the bond or stock certificate, which constitutes primary evidence of ownership.

Bilateral donors/creditors: Sovereign governments which lend or transfer funds.

Bond: Debt instruments which promises to pay interest in one form or another. Bonds may be issued at a discount to face value providing investors with a possible capital gain, in addition to interest income. Bonds are usually negotiable instruments and therefore have a market price. **Zero-coupon bond** is a bond on which no interest is paid and it is sold at a discount to face value and the price appreciation yields the return.

Burden-sharing: The principle underlying debt relief is provided by creditors, achieved through various options, including debt service reduction, rescheduling or refinancing of debt service at lower interest rates and longer maturities, and the buying back of loans. Each creditor provides the necessary debt relief according to the share of the total debt.

Buy-back: The repurchase by a debtor government of all or a portion of its external debt at a discount from face value. The World Bank's IDA Debt Reduction Facility (funded by the IBRD and bilateral donors) has financed commercial debt buy-backs for low-income countries. Some creditor governments have also sponsored buy-backs of officially guaranteed export credits from export credit agencies or the un-guaranteed portion of such credits from exporters and banks for conversion through bilateral debt reduction programmes.

Commercial debt: Credits owed to commercial banks and other financial institutions.

Commitment: Amount of funds the lender agrees to lend when the loan agreement is signed.

Concessional loans: Credits requiring repayment, which cost considerable less than a loan on market terms. Loans having a grant element of 35% or more are defined as concessional, although for ODA loans the OECD uses 25% grant element as the threshold for concessionality.

Commercial interest reference rates (CIRRs): Currency-specific reference rates used by the OECD for officially supported export credits of the OECD countries. Used as the discount rate to calculate the present value of the expected future stream of debt service payments.

Counterpart funds: (also referred to as counter value) is the amount of local currency raised by the sale of external assistance foreign exchange inflows. For example, with budget support the government's account is credited with the local currency equivalent of the foreign exchange disbursement. This expression is also used to apply to government contributions to project budgets. However, to avoid ambiguity, government contributions to local project expenditures are called matching funds.

Debt conversion (debt swap): A debt swap involves the voluntary exchange, by a creditor with its debtor, of debt for cash, another asset, or a new obligation with different repayment terms. The economic rationale for debt conversion is based on the willingness of the creditor to accept less than face value for debt and of the debtor to make payment at a higher value, but usually at less than 100% of face value of the original debt.

Debt relief scenarios/simulations: The restructuring of the existing debt portfolio to evaluate the sustainability of debt and in particular to see whether a country is eligible for relief under the HIPC Initiative.

Debt sustainability analysis (DSA): An analysis under which a country's debt data is treated with simulations of various debt scenarios to assess future sustainability. Two types of simulations are performed to calculate debt sustainability: **debt relief simulations** and **new disbursement/ gap-filling simulations.**

Disbursement: The release of funds or provisions of goods and services by the donor/creditor to the recipient.

Export credits: Loans extended to finance trade, usually on market-related terms They are usually classified as short-term (under 2 years), medium-term (2-5 years) and long-term (over 5 years). Export credits can take the form of **suppliers credits** extended by the exporter and **buyer credits** where the exporters bank or other financial institution lends to the buyer. Government export credit agencies may provide 'pure cover' i.e. insurance or guarantees or direct lending.

Face value: The original amount of loans owed under a loan or other credit agreement, prior to debt rescheduling or reduction. Also referred to **nominal value of debt**.

Financing gaps ('gap-filling'): A lack of sufficient resources either in the balance of payments or budget. These 'gaps' can be filled by grants, concessional loans or commercial borrowing. Gap-filling assumptions have a crucial impact on **debt sustainability** and therefore relief under HIPC, and are assessed along with debt relief and new disbursement/borrowing scenarios.

Grace period: The period before first repayment of the loan when only interest is paid.

Grant: The transfer of cash, goods or services for which no repayment is required.

Grant element: Measures the concessionality of a loan and the percentage by which the present value of the expected stream of debt service payments differs from the nominal loan amount. It is calculated by:

$$\text{GE}\,(\%) = \frac{(\text{nominal loan amount - present value}) \times 100}{\text{nominal loan amount}}$$

HIPC I: Original Heavily Indebted Poor Countries Initiative, established in 1996, by the international community to help heavily indebted poor countries, with good policy performance, to escape from unsustainable debt burdens by providing comprehensive debt relief.

HIPC II: Enhanced Heavily Indebted Poor Countries Initiative, established in 1999 following a review of HIPC I, with lower qualifying criteria. HIPC II is designed to speed up the delivery process of debt relief, as well as creating a direct link to poverty reduction.

HIPC eligibility criteria: To be eligible for debt relief under the Enhanced HIPC Initiative a country must be **IDA-only** and PRGF-eligible, and it must have established a track record of performance under adjustment programmes with the IMF and the World Bank, including approval of an Interim Poverty Reduction Strategy Paper (I-PRSP). It must also not be expected to achieve sustainable external debt after the full use of traditional debt relief mechanisms (Paris Club Naples Terms).

A country is eligible for HIPC, if after receiving Naples Terms treatment (67% stock reduction) by the Paris Club:
- its present value of debt to exports ratio (PV/XGS) exceeds 150%, or
- its present value of debt to budget revenue ratio (PV/DBR) exceeds 250%.

In addition, the present value to budget revenue ratio also requires the fulfilment of 2 further thresholds:
- export to GDP ratio (XGS/GDP) of 30% or more, and
- budget revenue to GDP ratio (DBR/GDP) of 15% or more.

IDA-only: Classification of countries on the basis of per capita income (less than $885 in2000) thereby making then eligible for highly concessional loans from the World Bank's International Development Association.

Late interest: The interest accrued on principal and interest in arrears.

London Club creditors: Under London procedures for restructuring commercial bank debt, a Bank Advisory Committee representing the major creditors is set up, usually chaired by the largest creditor. The committee reaches an agreement in principle with the debtor country, which must then be approved and subsequently signed by the participating creditors.

Maturity period: The sum of the grace and the repayment periods.

Net flows: This indicates whether the country is receiving more in new resources than its repayment of debt. For the portfolio as whole, it is the sum of disbursements of grants and loans less principal repayments of loans. It can also be used to analyse flows of individual donors/creditors or type of finance. Negative net flows means a country is reducing its debt burden as it is repaying more debt than it is receiving in new external assistance. Positive net flows means inflows are greater than debt repayments. For debt alone, negative net flows the debt burden is declining whereas positive net flows means the debt stock is accumulating.

Net present value (NPV) of debt: see also **Present value** below. The NPV of debt is the sum of all future debt service obligations (interest and principal) on outstanding debt, discounted by the **commercial interest reference rate**.

Net transfer: This measures the overall net flows of external assistance. It is the difference between the sum of grant and loan disbursements and total debt service costs (principal and interest payments. Positive net transfers means there is more new money flowing into the country than is being paid in debt service. Negative net transfers means the country is paying more to service its debt than is being received in new external assistance.

New disbursement scenarios/simulations: In parallel with the running of **debt relief scenarios** to test a country's **debt sustainability**, it is also crucial to review the impact of all future financial inflows, including, disbursements of pipeline debt and new borrowings. The aim of these simulations is to calculate accurate projections of future debt service. As well as new disbursements and borrowings, it is important to look at how balance of payments or budget support help to fill **financing gaps**.

Nominal value of debt: The original amount of loans owed under a loan or other credit agreement, prior to debt rescheduling or reduction (Also referred to as **Face value)**.

Non-concessional debt (export credits and other market-related debt): This is defined as loans and credits that have short maturities and market interest rates. Debt contracted on non-concessional terms is often known as *non-official development assistance* (non-ODA) *debt.*

Non-ODA debt: see **non-concessional debt**.

Non-Paris Club creditors: Debt owed to bilateral creditors that are not members of the Paris Club.

Official development assistance (ODA): ODA is grants or loans which are:

- undertaken by the official sector – that is by government, parastatals or government guaranteed,
- intended to promote economic development and welfare (so grants and loans for military purposes are excluded from ODA), and
- on concessional financial terms. For the OECD, ODA concessionality is defined as having a grant element of at least 25%.

Official aid (**OA**) is the same as ODA but for the more advanced developing countries.

Official development finance (ODF): The sum of bilateral ODA, concessional and non-concessional borrowings from multilateral institutions and other official flows (OOF) for development purposes.

Other official flows (OOF): Credits which do not qualify as ODA or OA because they are not primarily aimed at development or are not concessional. It includes exports credits extended by donor governments or guaranteed by them.

Paris Club creditors: The Paris Club is an ad hoc group of official bilateral creditors that meets periodically to negotiate rescheduling terms agreements with debtor countries. The French Treasury serves as a secretariat for the Paris Club.

Passive debt: Loans in arrears for which creditors do not actively demand payment.

Pipeline debt: Loans/grants already agreed but not yet disbursed.

Present value (PV) of debt: This is the stream of future debt service payments, discounted for the time value of money. The idea behind PV calculation is that money paid today is more burdensome than money paid in the future because of opportunity cost and inflation (e.g. a debt service payment of US$100 today will in real terms cost less if paid next year). A key ratio used by the Bretton Woods Institutions to evaluate debt sustainability, involves relating the present value of debt to exports or budget revenue (see HIPC eligibility criteria above). The rationale for using present value instead of nominal value is that the present value takes into account the terms and concessionality of the loan portfolio and therefore reflects accurately the costs of servicing the debt.

Repayment (or amortisation) period: Time during which the amount borrowed is repaid.

Syndicated loans and **bonds:** Market instruments only available to borrowers which are considered credit worthy by international capital markets. A syndicated loan is a commercial borrowing from a group of banks whereas a bond issue is subscribed to by a wider variety of banking, financial and private sector lenders.

Annex 2: Present Value Calculation

The present value of the debt is the stream of future debt service payments, discounted for the time value of money. The idea underlying the present value calculation is that money paid today is more burdensome than money paid in the future because of its opportunity cost and inflation. This means that a debt service payment of $100 today will in 'real' terms cost less next year.

The general formula for calculating the present value of a payment stream is:

$$PV = \frac{C^1}{(1+r)} + \frac{C^2}{(1+r)^2} + \frac{C^3}{(1+r)^3} + K + \frac{C^n}{(1+r)^n}$$

Where PV = present value of the stream of future payments
C^n = debt service payments in time period n
r = discount rate

An example: if the debt service payments of a loan are $10,000 per annum for three years, the nominal value of these payments at the end of the three years is $30,000, whereas the present value of the payment stream, assuming a discount rate of 10%, is:

$$PV = \frac{10{,}000}{(1+0.1)} + \frac{10{,}000}{(1+0.1)^2} + \frac{10{,}000}{(1+0.1)^3} = 24{,}869$$

In principle, the *discount rate* used should represent the alternative cost of borrowing in financial markets (though few HIPCs can actually borrow in the markets).

Higher interest rates mean larger discount rates, which will result in a lower present value calculation. On the other hand, falling interest rates and lower discount rates lead to higher present value calculations. This has the counter-intuitive and unhelpful result that a rise in interest rates (which you would assume would make debt more costly to service) reduces the amount of debt relief, because it reduced the PV of the debt.

Annex 3: OECD Donor / Creditor Agencies

Country / Organisation	Web address	Details
AUSTRALIA Australian Agency for International Development (AusAID)	www.ausaid.gov.au	AusAID is responsible for the management of the official Australian government overseas aid programme. We are an administratively autonomous agency within the Foreign Affairs and Trade Portfolio. AusAID reports directly to the Minister for Foreign Affairs on all aspects of aid policy and operations.
AUSTRALIA Export Finance and Insurance Corporation (EFIC)	www.efic.gov.au	EFIC is a self-funding corporation wholly owned by the Commonwealth Government. It provides competitive finance and insurance services to Australian exporters and Australian companies investing in new projects overseas.
AUSTRIA Austrian Development Cooperation	www.bmaa.gv.at/eza/index.html.en	The Austrian Development Cooperation is part of Austria's foreign policy and the development policy of the European Union, which is aimed at securing global peace in concert with other industrial and development countries
AUSTRIA (OeKB)	www.oekb.co.at/english/index.shtml	OeKB as Austria's Export Credit Agency acts as the agent of the Republic of Austria. OeKB offers the business community customised instruments in the area of risk management for a variety of exports. Guarantees against political and commercial risks as well as guarantees by aval on bills of exchange enable access to the Bank's export financing scheme, offering the best possible interest rates for the refinancing of exports and foreign investments.

Country / Organisation	Web address	Details
BELGIUM Ministry of Foreign Affairs	www.diplobel.fgov.be/default_en.htm	The Directorate-General for International Cooperation includes the Belgian Policy Plan for Development Co-operation.
BELGIUM Office national du Ducroire-Delcredere (ONDD)	www.delcredere.be/Ducroire/WebSite.nsf/AllWeb/index_en.htm	ONDD's purpose is to promote international economic relations, essentially by covering risks related to exports, imports and investments abroad. ONDD is also authorised to cover foreign exchange risks, insure transit operations, participate in export financing and carry out on behalf of the government any technical, financial or representation mission entrusted to it. The insurance primarily covers non-OECD markets.
CANADA Canada International Development Agency (CIDA)	www.acdi-cida.gc.ca/INDEX-E.HTM	CIDA supports sustainable development activities in order to reduce poverty and to contribute to a more secure, equitable and prosperous world
CANADA Export Development Canada	www.edc.ca/index_e.htm	EDC provides Canadian exporters with financing, insurance and bonding services as well as foreign market expertise.
DENMARK Ministry of Foreign Affairs	www.um.dk/english/dp/index.asp	The Danish Agency for Development Assistance (DANIDA) is responsible for development cooperation. Countries that have a co-operation programme with Denmark are especially assisted within the framework of long-term programmes, and of national strategies. Increasing assistances go to sectoral programmes, which support the initiatives of the country in the sectors of health or teaching, for example. The goal of this policy is to transfer the assistance granted to projects given to sectors that imply local efforts and thus are integrated better into the national planning of these countries.

Country / Organisation	Web address	Details
DENMARK Export Kredit Fonden (EKF)	www.ekf.dk/default.asp?lang=en	Eksport Kredit Fonden insures the risk of financing export to difficult markets. EKF is backed by the Danish State but operates according to commercial terms and conditions
EUROPEAN COMMISSION Development Directorate-General	www.europa.eu.int/comm/development/index_en.htm	Includes News, the EU Development Policy, Publications, Operational Sectors and Activities, a link to the Development Directorate-General, and more...
FINLAND Department for International Development Cooperation	http://global.finland.fi/index.php?kieli=3	The government Decision-in-Principle of September 1996 is the main point of reference for Finnish Development co-operation. It upholds the main objectives of an earlier strategy approved in 1993. These objectives together with Finland's EU commitments and support for the international development goals and strategies of OECD/DAC Shaping the 21st Century: The Contribution of Development Co-operation form the basic policy framework.
FINLAND Finnvera	www.finnvera.fi/index.cfm?lang=3&to=-107	Finnvera plc is a specialised financing company offering financing services to promote the domestic operations of Finnish businesses, and to further exports and internationalisation of enterprises. Finnvera is owned by the Finnish state.
FINLAND FIDE	www.fide.fi/index.htm	FIDE Ltd, a subsidiary of Finnvera plc, is a state-owned limited liability. The Company has been accorded the Export Credit Agency status based on international agreements. FIDE Ltd offers companies and financial institutions an internationally competitive possibility to utilise OECD-term export credits by administrating the interest equalisation system and by developing the Finnish export finance system.

Country / Organisation	Web address	Details
FRANCE Ministry of Foreign Affairs	www.france.diplomatie.fr/cooperation/dgcid/index.html	Within the Directorate-General of International Cooperation and Development, the priorities of technical cooperation and development aid are as follows: contributing to satisfying basic social needs; aiding economic development and environmental protection environment by supporting sustainable development and the fight against poverty; promoting social and educational; guaranteeing the rule of law and civil liberties; involving researchers and civil society in joint discussions on development.
FRANCE Agence française de Développement Group (AfD Group)	www.afd.fr	The AfD Group comprises the following entities: the AfD, Proparco, the CEFEB, as well as 14 subsidiaries (banking, financial, real estate) operating in the overseas departments, territories and entities. The AfD is a key component of the system of French official development assistance (ODA).
FRANCE Compagnie d'assurance française pour le commerce extérieur (COFACE)	www.coface.com	The Coface Group provides insurance products and services for companies, with the aim of facilitating trade throughout the world. The Group's two core businesses are credit insurance (domestic and export) and credit management services (credit information, trade receivables ratings, management and recovery).

Country / Organisation	**Web address**	**Details**
GERMANY Federal Ministry for Economic Co-operation and Development (BMZ)	www.bmz.de/en/index.htm	The Federal Ministry for Economic Cooperation and Development is responsible for planning and implementing the German government's development policy. Its mission relates mainly to the following areas: contributing to the design of the global framework; developing bilateral and multilateral support strategies, and supporting our partner countries' development programmes and projects; supporting development cooperation programmes of nongovernmental organizations; aid evaluation and monitoring of the use of funds.
GERMANY German Agency for Technical Cooperation (GTZ)	www.gtz.de/english	The German Agency for Technical Cooperation is a government-owned corporation for international cooperation with worldwide operations. GTZ has been operating as a service company in international development cooperation since 1975. The primary goal of GTZ's work is to improve the living and working conditions of people in the partner countries and sustain the natural basis for life.
GERMANY German Development Bank (KfW)	www.kfw.de/EN/Entwicklungszusammenarbeit/Inhalt.jsp	Under the Financial Cooperation between the Federal Republic of Germany and developing countries, KfW, on behalf of the German government, finances investments and project-related consultancy services to expand social, economic and industrial infrastructure and to protect the environment and natural resources. KfW appraises the eligibility of projects for financing according to development-policy criteria, assists the partner countries in implementing them, and evaluates their success after they are completed.

Country / Organisation	Web address	Details
GERMANY HERMES Kreditversicherungs-AG	www.hermes-kredit.com/aga/eng/index.html	The management of the official export guarantee scheme is delegated to a consortium consisting of HERMES Kreditversicherungs-AG and PwC Deutsche Revision AG. These companies have been appointed and authorised to make and receive all declarations pertaining to export guarantees on behalf of the Federal Government. HERMES acts as the leading partner in this consortium.
GREECE Ministry of Foreign Affairs	www.mfa.gr	The International Cooperation Department (Hellenic Aid) of the MFA is responsible for the Hellenic Republic Development Cooperation programme. International humanitarian and development cooperation aims at bridging the gap between developed and developing countries by means of enhancing the development efforts of developing countries.
GREECE Export Credit Insurance Organisation (ECIO)	www.oaep.gr/english_init.htm	The Export Credit Insurance Organisation (ECIO) is an autonomous legal entity in private law, it is a non-profit organization that is supervised by the Ministry of National Economy. ECIO insures, against commercial and political risks of non-payment, the export credits granted by Greek exporters to foreign buyers abroad who buy Greek products, services, or even projects. ECIO also insures, against political risks, the investments undertaken abroad by Greek entrepreneurs.
IRELAND Department of Foreign Affairs	www.irlgov.ie/iveagh	The Development Co-operation Division is responsible for the administration of the Irish overseas aid programme and for the conduct of Irish development policy.

Country / Organisation	Web address	Details
ITALY Ministry of Foreign Affairs	www.esteri.it/eng/foreignpol/coop/index.htm	The MFA is responsible for the Italian Development Cooperation programme.
ITALY Sezione Speciale per l'Assicurazione del Credito all'Esportazione (SACE)	www.isace.it/portale/home.asp?l=eng	SACE is the Italian Institute for foreign trade insurances. It is an economic public entity having its own legal status and operational and financial autonomy. SACE is authorised to insure and re-insure political, economic and commercial risks inherent to the international transactions of Italian companies.
JAPAN Ministry of Foreign Affairs	www.mofa.go.jp/policy/oda	MOFA is responsible for Japan's Official Development Assistance programmes.
JAPAN Japan International Cooperation Agency	www.jica.go.jp/english	JICA is responsible for the technical cooperation aspect of Japan's ODA programmes. Technical cooperation is aimed at the transfer of technology and knowledge that can serve the socio-economic development of the developing countries. JICA carries out a variety of programmes to support the nation building of developing countries through such technical cooperation.
JAPAN Nippon Export and Investment Insurance (NEXI)	http://nexi.go.jp/e/index.html	NEXI, as a specialized Export Credit Agency, reduces risks with Japanese ‘export’, ‘foreign investment’ and ‘overseas finance’ and secures the overseas business of Japanese companies.

Country / Organisation	Web address	Details
JAPAN Japan Bank for International Cooperation	www.jbic.go.jp/english/index.php	The purpose of JBIC is to contribute to the sound development of Japan and the international economy and community through undertaking lending and other financial operations: for the promotion of Japanese exports, imports or Japanese economic activities overseas; for the stability of international financial order; and for economic and social development or economic stability in developing areas; in accordance with the principle that it shall not compete with commercial financial institutions.
LUXEMBOURG Lux Development	www.lux-development.lu	Lux-Development is the development cooperation agent for almost all the bilateral projects financed by the government of Luxembourg, and for Luxembourg's emergency relief work.
LUXEMBOURG Office du Ducroire	www.ducroire.lu	The *Office du Ducroire* is a publicly-owned establishment enjoying the legal personality. It is placed under the authority of the Ministry for Finances. The secretariat of the *Office du Ducroire* is attached to the Chamber of Commerce. The *Office du Ducroire* aim at supporting international economic and financial relations in the interest of Luxembourg, mainly by the acceptance of risks in the field of exports, the imports and international investments.
NETHERLANDS Ministry of Foreign Affairs	www.minbuza.nl/english	The MFA is responsible for the Dutch Development Cooperation programme.

Country / Organisation	Web address	Details
NETHERLANDS Atradius	www.atradius.com	Late 2001, former Gerling Credit Insurance Group and international credit insurer NCM merged. This combination, which was known as GERLING NCM for a short period of time, has been renamed into Atradius on 1st January 2004. On behalf of the Dutch Ministry of Economic Affairs, and for emerging markets where no cover is possible under the regular export credit insurance, Atradius can help Dutch companies – specifically those who export capital goods and construction.
NEW ZEALAND New Zealand Agency for International Development (NZAID)	www.nzaid.govt.nz	NZAID, a semi-autonomous agency of the Ministry of Foreign Affairs & Trade, replaces the New Zealand Development Assistance (NZODA). It supports economic and social development in developing countries, especially in the South Pacific and Asia regions
NORWAY Ministry of Foreign Affairs	www.mfa.no/ud/engelsk	The MFA is responsible for the Norwegian International Development programme
NORWAY Norwegian Agency for Development Cooperation (NORAD)	htpp://norad.no/default.asp?V_DOC_ID=244	NORAD's purpose is to assist developing countries in their efforts to achieve lasting improvements in political, economic and social conditions for the entire population within the limits imposed by the natural environment and the natural resource base.
NORWAY Norwegian Guarantee Institute for Export Credits (GIEK)	www.giek.no/default.asp?Language=E	GIEK is the central governmental agency responsible for furnishing guarantees and insurance of export credits. The primary function of the Institute is to promote export of Norwegian goods and services and Norwegian investment abroad.

Country / Organisation	Web address	Details
PORTUGAL Portuguese Institute for Development Assistance (IPAD)	www.ipad.mne.gov.pt/inicio.htm	IPAD results from the recent merge of the Portuguese Cooperation Institute (ICP) with the Portuguese Development Support Agency (APAD) and exerts its activities under the supervision of the Foreign Affairs Minister. This merge aims at providing a unique structure to formulate cooperation policy and its financing, so far respectively attributed to ICP and APAD. IPAD is the central instrument in development cooperation policy. Its main purpose is to improve Portuguese assistance and ensure its reinforcement within cooperation policy and the fulfilment of international commitments assumed by the Portuguese State.
PORTUGAL Companhia de Seguro de Créditos (COSEC)	www.cosec.pt/english/Default.htm	COSEC are entrusted with management of the Portuguese State Guarantee with regard to the cover of credit and bond risks and of Portuguese investment overseas, where there are hazards of political, monetary or natural causes. COSEC provide the Government with technical support relating to export credit and overseas investment insurance, both at the domestic level and in the sphere of works carried out by the relevant international agencies.
SPAIN Spanish Agency for International Cooperation (AECI)	www.aeci.es	The Spanish Agency for International Cooperation is appointed to the MFA through the State Secretariat for International Cooperation & Latin America (SECIPI). It is the technical body responsible for the design, execution and management of co-operation projects and programmes, directly with its own resources, or through collaboration (conventions and agreements) with other national and international agencies and NGOs.

Country / Organisation	**Web address**	**Details**
SPAIN Spanish Company for Export Credit Guarantee (CESCE)	www.ipyme.org/temas/financia/cesce.htm	CESCE is a joint public/private sector company in charge of providing default insurance to Spanish companies selling products an/or services to foreign Governments and/or companies.
SPAIN Instituto de Crédito Official (ICO)	www.ico.es/public/en/portada/index.html	ICO is a corporate state-owned entity under the Ministry of Economy and it has the legal status of a credit institution and is defined as the State's Financial Agency. ICO provides medium and long term financing to Spanish Government and private enterprises operating domestically or internationally.
SWEDEN Swedish International Development Cooperation Agency (Sida)	www.sida.se/Sida/jsp/Crosslink.jsp?d=160	Sida is the Swedish government agency dealing with bilateral international development cooperation and the major part of the cooperation with Central an Eastern Europe. Sida's task is to create conditions conducive to change and to socially, economically and environmentally sustainable development.
SWEDEN Swedish Export Credits Guarantee Board (EKN)	www.ekn.se	EKN is a governmental agency that, in return for a premium, provides companies, banks and other financial institutions with state-backed guarantees against losses incurred in export transactions and foreign investment.

Country / Organisation	**Web address**	**Details**
SWITZERLAND State Secretary for Economic Affairs (SECO) Swiss Agency for Development and Cooperation (SDC)	www.seco-admin.ch/e_index.html www.deza.admin.ch	The State Secretary for Economic Affairs (SECO) shares responsibility for the formulation of Swiss policy on cooperation with developing countries with the Swiss Agency for Development and Cooperation (SDC), a division of the Federal Department of Foreign Affairs. Together, these two bodies determine what path Switzerland's multilateral policy is to follow, mainly in the form of contributions made to the development countries, channelled through such international organisations as the World Bank, the regional development banks, and the specialised agencies of the United Nations. As far as bilateral aid is concerned, SECO and SDC each has its own area of responsibility.
SWITZERLAND Swiss Export Risk Guarantee (ERG)	www.swiss-erg.com/e/index.htm	ERG, a legally dependent self-supporting fund of the Swiss Federal Government, is the instrument of export promotion and support of small and medium sized enterprises.
UNITED KINGDOM Department for International Development (DFID)	www.dfid.gov.uk	DFID is the British government department responsible for promoting development and the reduction of poverty. The government elected in May 1997 increased its commitment to development by strengthening the department (formerly the Overseas Development Administration) and increasing its budget.
UNITED KINGDOM Export Credits Guarantee Department (ECGD)	www.ecgd.gov.uk	The Export Credits Guarantee Department is the UK's official export credit agency. It is a separate Government Department reporting to the Secretary of State for Trade and Industry.

Country / Organisation	**Web address**	**Details**
UNITED STATES US Agency for International Development (USAID)	www.usaid.gov	USAID is an independent federal government agency that receives overall foreign policy guidance from the Secretary of State. The agency works in six principal areas crucial to achieving both sustainable development and advancing U.S. foreign policy objectives: 1. Economic growth and agricultural development; 2. Population, health and nutrition; 3. Environment; 4. Democracy and governance; 5. Education and training; 6. Humanitarian assistance.
UNITED STATES Export-Import Bank of the United States (Ex-Im Bank)	www.exim.gov	Ex-Im Bank, a government held corporation, provides guarantees of working capital loans for U.S. exporters, guarantees the repayment of loans or makes loans to foreign purchasers of U.S. goods and services and provides credit insurance against non-payment by foreign buyers for political or commercial risk.

Source: OECD and government websites, 2002-2004

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