IOB

RESULTS OF INTERNATIONAL DEBT RELIEF IN BOLIVIA

Eisa Abdelgalil and Willem Cornelissen (Seor B.V., Erasmus University Rotterdam)

Working Document | The Netherlands | January 2003

POLICY AND OPERATIONS EVALUATION DEPARTMENT

RESULTS OF INTERNATIONAL DEBT RELIEF IN BOLIVIA

CASE STUDY FOR THE IOB EVALUATION OF DUTCH DEBT RELIEF

EISA ABDELGALIL
&
WILLEM CORNELISSEN

(SEOR B.V., ERASMUS UNIVERSITY ROTTERDAM)

IOB Working Document │ January 2003

PREFACE

This report contains the findings of one of the eight country case studies that were undertaken in the context of an evaluation study of Dutch debt relief during the period 1990-1999, conducted by the Policy and Operations Evaluation Department (IOB) of the Netherlands' Ministry of Foreign Affairs. As the results of Dutch contributions to debt relief cannot be distinguished from the effects produced by contributions from other donors and creditors, the eight country studies analyse the results of the combined efforts of all actors.

Although the Bolivia case study was conceived as a desk study, it did benefit from a limited amount of field research as one of the authors managed to get some additional field research done during a trip he made to La Paz for an unrelated purpose in September 2001.

The research was carried out – in close consultation with the chief consultant for the evaluation, Dr. A.G. Dijkstra – by W.J. Cornelissen and Dr. E. Abdelgalil of SEOR BV, a subsidiary company of Erasmus University, affiliated to the Faculty of Economics, who are responsible for the contents of this report. It is published in the series of IOB 'Working Documents', comprising consultant studies of interest to a wider public.

Rob D. van den Berg
Director, Policy and Operations Evaluation Department

CONTENTS

TABLES

FIGURES

BOXES

ABBREVIATIONS

BCB	*Banco Central de Bolivia* (Central Bank of Bolivia)
BEMO	*Beoordelingsmemorandum* (Appraisal Memorandum)
BBS	Bolivianos (national currency of Bolivia)
CAF	*Corporación Andina de Fomento* (Investment Corporation of the Andes Pact)
CDF	Comprehensive Development Framework
c&f; cif	cost and freight; cost, insurance, freight
COMIBOL	*Corporación Minera de Bolivia* (Bolivian Mining Corporation)
DAC	Development Assistance Committee (of the OECD)
DGIS	*Directoraat-Generaal Internationale Samenwerking* (Directorate General for International Co-operation)
DIFEM	*Dirección de Financiamiento Externo y Monetización* (Office of External Financing and Monetization)
EDT	External Debt Total
ENDE	*Empresa Nacional de Electricidad* (National Electricity Company)
ENFE	*Empresa Nacional de Ferrocarriles* (National Railways Corporation)
ESAF	Enhanced Structural Adjustment Facility
FDI	Foreign Direct Investment
fob	free on board
FONPLATA	*Fondo de Desarrollo de la Cuenca del Río de la Plata* (Development Fund for the Rio Plata Basin)
GDP	Gross Domestic Product
GNP	Gross National Product
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Interamerican Development Bank
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
IMF	International Monetary Fund
IOB	*Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie* (Policy and Operations Evaluation Department)
JSA	Joint Staff Assessment
LDOD	Total Long-term Debt Outstanding and Disbursed, including IMF charges
MGS	Import of Goods and Services
NCM	*Nederlandsche Crediet Verzekering Maatschappij* (Netherlands Credit Insurance Society)
NEP	New Economic Policy
NGO	Non-Governmental Organization

NLG	Dutch Guilder
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Oil Exporting Countries
PRGF	Poverty Reduction and Growth Facility
PRS(P)	Poverty Reduction Strategy (Paper)
SAFCO	*Sistema de Administración y Control del Gasto Público* (System of administration and control on public expenditure)
TDS	Total Debt Service on long-term debt
TGN	*Tesoro General de la Nación* (National Treasury)
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USD	United States dollar
USAID	United States Agency for International Development
VIPFE	*Viceministerio de Inversión Pública y Financiamiento Externo* (Secretariat for Public Investment and External Financing)
WB	World Bank
XGS	Export of Goods and Services
YPFB	*Yacimientos Petrolíferos Fiscales Bolivianos* (Bolivian Oil Company)

EXCHANGE RATES

Year	per United States Dollar	
	Bolivianos (BBS/USD)	Dutch Guilder (NLG/USD)
1989	2.98	2.12
1990	3.40	1.89
1991	3.75	1.87
1992	4.095	1.7585
1993	4.475	1.8572
1994	4.695	1.8197
1995	4.935	1.6053
1996	5.185	1.6861
1997	5.365	1.9509
1998	5.645	1.9845
1999	5.990	2.0683
2000	6.047	2.3912

Sources: Central Bank of Bolivia, ABN-AMRO.

SUMMARY AND CONCLUSIONS

The situation at the start of the 1990s

The transition from military rule to democracy (1978-1982) was followed by a deep economic and monetary crisis (1982-1985). After years of imprudent macro-economic management, with severe external debt payment problems, exports collapsed, while extreme droughts and floods ravaged the rural areas and resulted in a major economic crisis with hyperinflation.

At the start of the stabilisation effort (mid-1980s), the Bolivian debt problem could be characterised as one of both liquidity and solvency. Liquidity in the short term (mainly vis-à-vis the commercial debt obligations) and solvency, because the recovery of the economy was hindered by a debt overhang. By the end of the 1980s, most arrears had been eliminated, while the composition of the debt portfolio showed increasing reliance on the multilateral creditors. The Bolivian Government contracted sizeable new loans in order to finance various structural reform programmes. Although the total debt outstanding was modest compared to neighbouring countries, it was high in relation to the economic performance of the economy.

Debt relief 1990-1999

Bolivia had been an 'early adjuster' with a good track record: it became eligible for almost every relief initiative. Since 1987, Bolivia cleared arrears with the commercial banks by pioneering with buybacks and swaps. By 1993, almost all commercial debts had been eliminated.

Agreements with the Paris Club creditor countries and successful negotiations with Brazil and Argentina and took out a substantial part of the bilateral obligations. The total (flow) reduction obtained in the bilateral debt has been estimated at USD 1,200 million in nominal terms over the period 1990-99. New bilateral loan agreements were signed with Japan, Germany and Belgium.

After a period in which bilateral donors assumed part of the debt service obligations to multilateral creditors on behalf of Bolivia, the Multilateral Debt Fund was established. Including the Heavily Indebted Poor Countries Initiative (HIPC) 1 and 2, the total reduction obtained in multilateral debt in nominal terms over the period 1990-99 was USD 226 million. Simultaneously, almost 90 per cent of all new loans were contracted from multilateral institutions.

Efficiency

It was Bolivia's policy to service both its external debt and to fund approximately fifty per cent of its public sector capital budget from fiscal revenues. To leave sufficient room for the latter spending priority, debt service obligations should not exceed a level of some USD 250-300 million per year. Debt restructuring enabled the government to spread out servicing over time.

The Total Debt Stock increased during the decade, but the public and publicly guaranteed component thereof decreased, mainly as a result of the HIPC-1 Initiative and the buyback and conversion of commercial debt. While in 1990, the public and publicly guaranteed debt represented 86.3 per cent of the total external debt; in 1999 this had decreased to 61.8 per cent.

In the course of time, the composition of the public debt changed. At present most external debt is to multilateral creditors (Interamerican Development Bank [IDB] and International Development Agency [IDA]). Both financing institutions showed little prudence in issuing new loans.

Debt relief contributed to the reduction of the fiscal deficit; to the restructuring of the debt portfolio to such an extent that the average grace periods increased and interest rates declined; and to the contracting of new loans, while servicing existing ones.

Debt rescheduling and forgiveness have been efficient instruments to expand imports.

The Net Present Value (NPV) of Bolivia's external public debt is reduced by 35 per cent as a result of the combined original and enhanced HIPC Initiatives, which came on top of a 17 per cent debt reduction already achieved under traditional debt relief mechanisms.

Effectiveness
Debt relief has been effective in improving all debt sustainability indicators. Although Bolivia contracted sizeable new (multilateral) loans, the country's debt profile can be considered as sustainable.

Debt relief may have contributed to reducing the fiscal deficit and financing the Pension restructuring. In addition, debt relief did contribute to investments in the social sector. These public investments in turn contributed to the improvement of the access of the poor to social facilities. However, poverty incidence remained severe.

Although both imports and private sector investments increased until 1998, foreign direct investments were either attracted by the privatisation / capitalisation process or by the opportunities for natural gas exploitation. Once these investments were made, the level of foreign investments declined again.

There are no indications that debt relief has triggered private sector investment, although the domestic private sector benefited from the increased outsourcing of public works to the private sector.

Relevance
Bolivia has been successful in attracting external financial support for its reform programmes. The International Financial Institutions (IFIs) and bilateral donors contributed both with concessional loans and grants as well as with debt relief. The structural adjustment programmes required new investments, for which new loans and grants were required. The contracting of new loans was triggered by the reduction of obligations on existing ones. Debt restructuring in the context of the Paris Club was relevant to the public sector’s multi-annual financial planning and programming process.

Various relief mechanisms imposed policy conditions on the Bolivian Government. Debt relief can be considered as a relevant instrument to enforce such policy adjustments. These adjustments contributed to a sustained, although slow economic growth. The impact of this growth on poverty reduction has only been modest.

The Netherlands' development co-operation with Latin America and the Caribbean region is diminishing. Nevertheless, in 1999 Bolivia was the fifth most important destination of Dutch development assistance, while to Bolivia the Netherlands was its fourth most important donor. Over time, the Netherlands has provided different kinds of programme aid (commodity aid, parallel funding of structural adjustment programmes, earmarked budget support). In the second part of the decade debt relief became the most important instrument.

The Dutch white paper *A World of Difference* (Ministry of Foreign Affairs 1991) stressed the importance of development assistance as a catalyst. From that perspective, debt relief has been relevant: the Netherlands was a frontrunner in several innovative forms of debt relief (buybacks of commercial debt and the multilateral debt fund) and triggered the support by other donors.

1 DEBT PROBLEM ANALYSIS: NATURE, CAUSES AND CONSEQUENCES

1.1 Economic trends

1.1.1 Economic trends up to 1985

Until 1952, the Bolivian economy was dominated by the mining industry, while a few landlords owned 98 per cent of the cultivable land. The majority of the population lived in semi-feudal circumstances. Economic, political (military) and religious powers were linked by family ties. The National Revolution of 1952 resulted in the improvement of labour rights, in free education, in the nationalisation of enterprises (mainly tin mines) and in the Agrarian Reform, whereby (some) land was expropriated and redistributed according to the principle 'the land to the one who works it'. The role of the public sector expanded swiftly: numerous state enterprises emerged and the public sector realised approximately 70 per cent of all investments. Private sector investments were discouraged by restrictive control mechanisms, in combination with a complex system of protection (tariffs, price control, direct marketing of consumer goods, export levies). The prevailing economic model was that of self-sufficiency and import substitution, using protectionist policies, preferring employment to productivity. The continuously changing governments (with almost 200 governments between Independence in 1821 and 1982) took populist measures subsidising inputs and basic needs. The policy of import substitution was a mainstream economic development model at the time, supported by the International Financial Institutions.

During the first part of the 1970s, the Bolivian economy showed capacity to grow: the discovery of gas deposits allowed the State to contract loans from private banks, while modest international development co-operation started to assume part of the financing requirements for social services. The lack of management capacity in the public enterprises, the rather hostile environment to the private sector, and military abuse eroded confidence in the economy. In 1982, dollar accounts had to be changed into national currency. International private banks became reluctant to deal with Bolivia; private enterprises closed. Military governments covered budget deficits by the creation of money, causing an uncontrollable hyperinflation. The collapse of the economy was postponed by the increasing international demand for coca derivatives. The profits of the coca industry maintained some military regimes in power, while the parallel financial market became a life belt for the (informal) economy.

The tumultuous transition from military rule to democracy (1978-1982) was followed by a severe economic and monetary crisis (1982-1985). After years of imprudent macro-economic management, with severe external debt payment problems, exports collapsed in 1985 due to the great tin market crash, while extreme droughts and severe floods ravaged the rural areas (1983-1987). A major economic crisis with extreme hyperinflation (up to 11,700 per cent) during 1984-85 provoked almost daily demonstrations by labour unions.

The initiation of a radical orthodox economic stabilisation programme in August 1985 implied a serious political risk to the fragile democracy. However, the majority of the population was convinced that only draconian measures could reverse the downward spiral of hyperinflation and unemployment. Bolivia never witnessed 'austerity riots', such as have occurred in other countries that experienced 'shock therapies' (van Lindert 1996:15). The 'Bolivian-made' 1985 economic reform package gained support from the World Bank and the IMF. Their support paved the way for further donor involvement. The international donor community did not only aim at the restructuring of the economy, but also at the consolidation of the democratic order.

1.1.2 The New Economic Policy

The 1984 government aimed at economic growth based on market forces. The adjustment programme (August 1985) introduced the so-called *Nueva Política Económica* NPE (new economic policy). After Chile, Bolivia was the second country in Latin America to undertake structural reform of its economy (an 'early adjuster'). Bolivia opted for a radical orthodox neo-liberal model, applying a 'shock therapy' (Vos, Lee and Mejía 1996:1). The first 'strike' was strictly stabilisation: a package of immediate measures to balance the public budget and to get the monetary system under control.

Although the adjustment programme has been a continuous process over the last 15 years, several periods with a different focus can be distinguished:[1]

- stabilisation and adjustment, initiated in 1985;
- structural adjustment, with an emphasis on the Social Strategy, started in 1991;
- second generation of reforms (1994) followed immediately by a third generation of reforms (1996), when decentralisation and people's participation were institutionalised;
- institutional reform and poverty reduction programmes (1998-) .

In this chapter the first period will be described. Policy and strategies post 1990 will be presented in chapter 4.

Stabilisation and adjustment, 1985-1990

The emphasis was placed on stabilisation, liberalisation and administrative reform programmes.

The *stabilisation* programme comprised:

- devaluation of the national currency with 93 per cent and the introduction of a new currency valued at 1: 1.000.000;
- unification of exchange rates; exchange rate determined by auctioning;
- severe restriction on the creation of money;
- restrictive fiscal policy with a drastic reduction of public expenditures, and increased revenue generation by new taxes;
- restrictive measures on credits provided by the Central Bank of Bolivia; elimination of subsidies on credits.

The *liberalisation* measures included:

- trade liberalisation by abolishing subsidies and price control mechanisms; the elimination of administrative and tax restrictions, and unifying import levies;
- liberalisation of the labour market, with an initial freeze on wage increases;
- liberalisation of the capital market, eliminating restrictions on transactions in foreign currency and on interest rates; introduction of a stock exchange and a strengthening of the private banking system.

The *administrative and institutional reforms* included:

- new employment policy, dismissing some 30,000 civil servants;
- social safety net, the *Fondo Social de Emergencia* FSE (Social Emergency Fund);
- reorganisation of the public administration and financial control system by the law *Sistema de Administración y Control del Gasto Público* SAFCO (System of administration and control on public expenditure).

[1] These periods coincide more or less with the government periods of Dr. Paz Estenssoro (1985-1989), Lic. Paz Zamora (1989-1993), Lic. Sánchez de Lozada (1993-1997) and General Hugo Banzer (1997-2001).

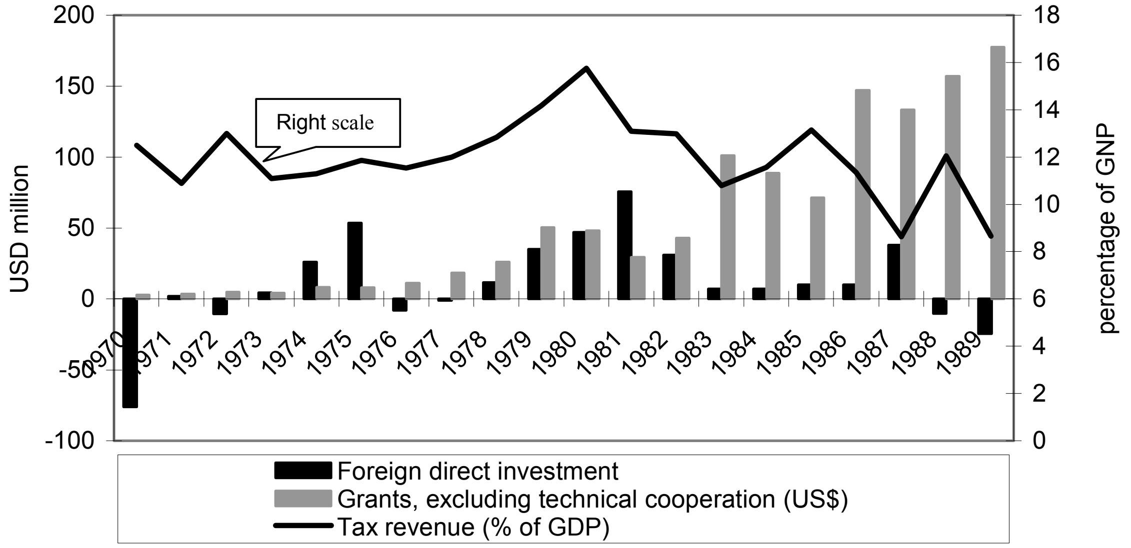
The *privatisation* policy was formulated, but not yet implemented, with exception of joint venture mechanisms in the mining sector.

By the end of the decade (1989) the results had been below expectation. Two external factors had a negative impact:

- the international tin prices continued to decline;
- a prolonged drought affected the agricultural sector and forced the country to import food.

While foreign investments and tax revenues slowed down as a result of the sluggish economic performance at the end of the decade, the external aid flow increased substantially after the start of the structural adjustment programme.

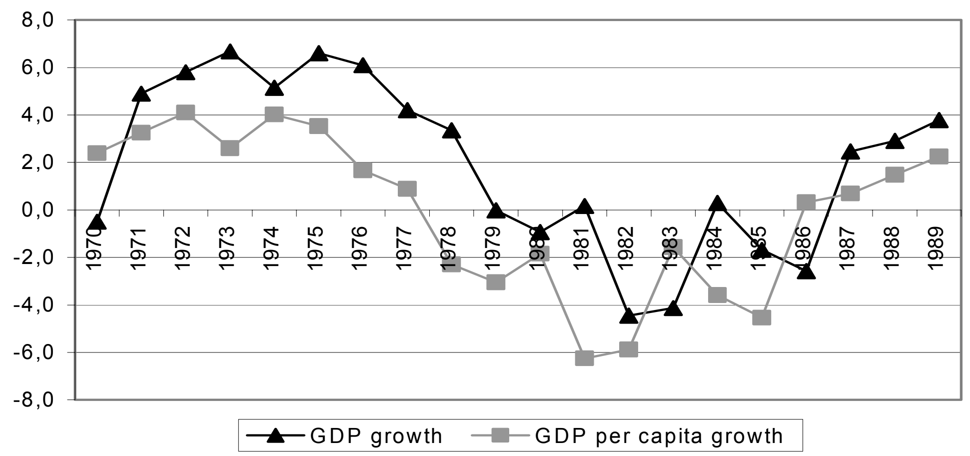
Figure 1–1 Foreign Direct Investment, grants and tax revenue, 1970-1989



Source: Based on World Bank, 2001.

After years of negative GDP growth, the growth rate became positive from 1986 onwards.

Figure 1–2 Annual growth of GDP and GDP(and per capita) (in per cent)



Source: World Bank, 2001.

1.2 Trends in poverty and social indicators

Poverty reduction was assumed to be a result of economic growth. While safety net facilities, temporary employment programmes and services mitigated the effect of structural adjustment on the 'new poor', the structural causes of poverty remained unaltered. Daily living conditions in the mining centres of the *Altiplano*, and in the rural areas had deteriorated during the 1980s (World Bank 1996:7-27). Poverty remained severe:

- 70 per cent of the Bolivian households lacked adequate access to basic services;
- the overall poverty rate increased from 60.1 to 62.6 per cent between 1986 and 1993;
- the proportion of the population living in extreme poverty (according to the Unsatisfied Basic Needs Index) remained unaltered (22.3 per cent in 1986 vs. 22.4 per cent in 1993);
- of the rural households, 72.7 per cent lived in extreme poverty conditions in 1993, as compared to 63.1 per cent in 1986.

Bolivia's position on the Human Development Index of the United Nations Development Programme (UNDP) remained low in 1990 (no. 113 on a list of 173) and its position had not improved. Among the Latin American countries only Honduras and Haiti occupied lower positions.

Table 1–1 Selected social indicators 1970-1990

Indicator/year	1970-80	1985	1990	
			Bolivia	Latin America
average annual population growth rate (%), periods 1976-88, 1988-92,		2.09	2.21	2.4
% EAP formally employed	36.1	46.0	27.0	na
Health				
infant mortality rate (per 1,000)	101		80	
under 5 mortality (per 1,000)	172	148	118	52
maternal mortality in hospitals (per 100,000)	373	201	247	180
life expectancy (years)	46.7	57.0	59.3	69
population with access to health facilities (%)	na	21	32	72
pop. with access to safe drinking water (%)	34	44	47	80.0
child malnutrition < 5 years (% age group)	37	na	na	10.0
Education				
adult illiteracy rate overall (> 15 years)	36.8	26.0	22.7	15.5
adult illiteracy rate female	48.6	35.0	29.9	17.2
primary enrolment rate overall (% PEE)	85.0	91.0	90.7	98
primary enrolment rate rural			74.0	88
primary enrolment rate female (% PEE)	76.0	85.0	86.7	94
secondary school enrolment overall		27.0	29.4	
Poverty Incidence based on Unsatisfied Basic Needs, % population (1993)			69.8	

Sources: CEDLA-ILDIS (1994), World Bank (1993 and 1996) and WDI CD-ROM (2001).
Note: The enrolment rates are influenced by high repetition rates, and the decline in enrolment reflects declining repetition rates. PEE = Population in school age (*Población en Edad Escolar)*.

1.3 The build-up of Bolivia's external debt

Until the mid 1990s, domestic debt was almost non-existent in Bolivia. All public debt was external debt.

A significant part of the public debt to private creditors was contracted during the military regimes of the 1970s and early 1980s. The public sector of Bolivia hardly had access to either the International Financial Institutions (with exception of some credit lines of the International Bank for Reconstruction and Development -IBRD) or bilateral sources.

Loans were used for investment in the mining and petroleum sector (Bolivian Fiscal Petroleum Deposits, YPFB), transport and communications.

Origin of official debt to private creditors

Most loans were contracted by state enterprises for purchases and imports on credit. Initially, these credits were obtained at relatively low interest rates, but with short grace and repayment periods. Later, variable market interest rates were applied.
Over fifty (50) per cent of all external financial resources obtained between 1975 and 1980 were supplied by Bank of America and Arlabank (for investments in the exploration and exploitation of oilfields), Banco de la Provincia de Buenos Aires and City Bank (both for infrastructure development programmes and the purchase of aircraft), and Luxembourg Company (foundries and mining projects). Contrary to public opinion in Bolivia, almost no loans were contracted for military purposes.

In 1984-85, the central government took over the debts of the main public enterprises, such as those of the National Electricity Company, the railways (ENFE), the national mining company (COMIBOL), the Banco Minero and the Banco Agrícola. Debt reduction efforts were initially hampered by the lack of a sound registration of the debt portfolio.

Origin of the bilateral debt

During the military regimes, most bilateral loans were contracted on non-concessional terms, mainly from neighbouring countries (Brazil and Argentina). Similar to the commercial debt, the vast majority of these loans were for economic infrastructure, telephone and transport systems. Main OECD-creditors were Japan, United States (USAID) and Belgium.

Origin of the multilateral debt

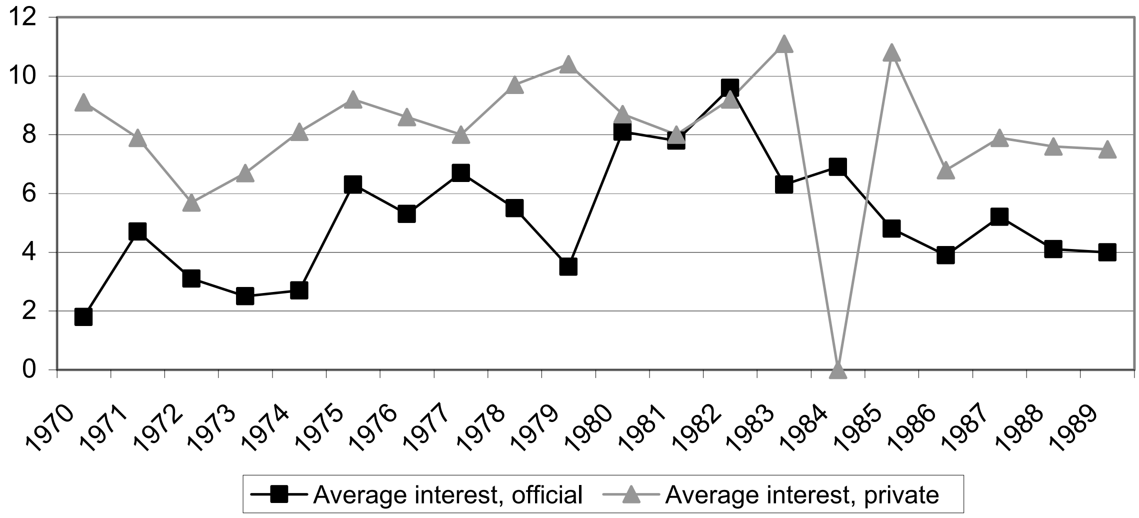
The International Financial Institutions, such as the Interamerican Development Bank (IDB), the World Bank (both International Development Association and IBRD), Corporación Andina de Fomento (CAF), FONPLATA and International Fund for Agricultural Development (IFAD) issued long-term credits for various projects and programmes. Prior to 1985, the majority of these loans were granted for investments in infrastructure (roads, bridges, integrated development projects). From 1985 onwards most credits were issued to finance reform programmes. The World Bank issued Sectoral Adjustment Loans, sometimes accompanied by sectoral programme and project loans by the IDB. After 1994 multilateral loans were contracted for public sector reform programmes, such as the decentralisation of the public administration and the restructuring of the pension system.

1.3.1 Interest rates and concessionality

During the early 1970s, interest rates were relatively low. Since Bolivia is a hydrocarbon producer, credits could be obtained at 6-8 per cent interest, with short repayment periods. When market interest rates started to rise, new private contracts were signed at 10 per cent and above. The military regimes during the late 1970s and first years of 1980s had an adverse influence on Bolivia's conditions for public borrowing. This was aggravated by unsound macroeconomic policies at the time, including ‘devaluation battles’ between Bolivia and Argentina and monetary financing of budget deficits.

By the mid 1980s, the concessional part of the loan portfolio represented less than 30 per cent of the public and publicly guaranteed debt and 24 per cent of the total debt (EDT). By the end of the decade of the 1980s, this had improved to 47 per cent of the public debt and almost 40 per cent of the total debt stock (1989). At the same time the average interest rate on new official debts had decreased to approximately four per cent and the average grace period on new loans had increased to 7.5 years.

Figure 1–3 Average interest rates (per cent)



Source: Based on World Bank, 2001.
Note: The 1984/1985 drop of the private interest rate is explained by hyperinflation. In that year hardly any private lending took place.

1.3.2 Composition of the debt portfolio

The private share in the total external debt was small, since in the 1960s and 1970s most major enterprises had been nationalised. In 1985, debts of state enterprises were subrogated and taken over by the Treasury.

In 1970, the official debt to private creditors was almost 43 per cent of the debt stock. This declined to less than 9 per cent in 1990. The bilateral debt fluctuated between 30 and 52 per cent, while the multilateral debt increased its share from only 5 per cent in 1970 to 43 per cent in 1990.

The total public debt stock of USD 480 million in 1970 increased by 355 per cent during the decade 1970-1980 and a further 46 per cent in the 1980s. The composition of the public and publicly guaranteed debt is shown in Table 1–2.

Table 1–2 Composition of Public and publicly guaranteed (PPG) debt 1970-1990 (in USD million and in percentages)

Debt	1970	1980	1985	1990
Total debt stock (EDT)	588	2702	4,804	4,275
Total PPG Debt	480	2,182	3,512	3,687
of which:				
Commercial (% of PPG)	205 (42.7%)	1,072 (49.1%)	1,424 (40.6)	325 (8.8)
Bilateral (% of PPG)	249 (51.9)	663 (30.4)	1,364 (38.8)	1,773 (48.1)
Multilateral (% of PPG)	26 (5.4)	447 (20.5)	724 (20.6)	1,589 (43.1)

Source: World Bank, 1996c and 2001.

1.4 Conditionality and compliance

Before 1984, the conditions imposed on external loans were exclusively of a technical and financial - administrative nature. Conditions were set on Bolivia's own financial contributions, while strict reporting systems were imposed. Since credits were provided for projects, financial and economic feasibility (cost-benefit analysis) was a key criterion. Little or no attention was paid to either the policy context or the sustainability of the investments. Conditions had to be fulfilled at several stages of the financing process: conditions for contracting, effectiveness and for disbursement. As far as the public sector is concerned, credits from the multilateral organisations and increasingly the bilateral creditors were directly related to the structural adjustment and reform programmes. The multilateral financiers carried out precise monitoring on progress and compliance with conditions. Donor co-ordination on policies, work methods etc. gradually improved. Conditions set by bilateral donors were harmonised. The Netherlands Office for Development Co-operation (later the Royal Netherlands Embassy) played an active and guiding role to improve co-ordination among bilateral donors.

Bolivia deals with a wide array of donors (in 1989: 28), most of them applying their specific –internally determined- conditions (tied aid, countervalue funds). Prior to 1990, co-ordination by the Bolivian Government of 'its' donor community was absent.

1.5 Debt relief before 1990

When in the late 1970s interest rates started to increase, servicing debts to private creditors (commercial debt) became a problem to many countries. The 'debt crisis' started in August 1982. In late 1983, Bolivia unilaterally declared itself unable to continue the servicing of its external debt to private creditors. Governments, international institutions and banks, formulated various plans to solve the problem (annex A). Various initiatives were taken during the decade 1980-1990.

A 'secondhand' market for debt titles had developed. The (reduced market value of the) debt could be exchanged for local currency to be used by, for instance, private foreign enterprises -for their payment obligations in local currency. Other buyers were Central Banks who could obtain currency of trading partners at a discount, used to pay for imports.

Prior to 1990, the main relief mechanisms had been:

- In 1986, the Paris Club dealt with Bolivia's case for the first time.
- In 1987, Bolivia was the first country to buy back part of its commercial debt making use of donor funds only. The largest share of the commercial debt was 'taken out of the market' by 1989 (buybacks and conversions).
- In 1988, the second Paris Club meeting comprised for the first time a forgiveness component (the so-called Toronto-terms).

- Direct (re)negotiation of bilateral loans (mostly non-concessional) with Paris Club and non-Paris Club members (Brazil, Argentina).
- In 1989, Bolivia made use of the Brady Initiative (aimed both at the stock and at the debt service to private banks for some twenty countries, backed by funds from the IMF, the World Bank and Japan) to convert a limited number of non concessional debts into concessional ones.

Prior to 1990 restructuring and rescheduling of multilateral obligations were 'out of the question' in order to protect the foundations of the Bretton Woods principles and the 'preferred creditor' status (the triple A).

Bolivia's policy on debt management
Up to 1984 Bolivia lacked a clear policy on how to deal with its debt situation. In practice, between 1979 and 1982 the country lacked the political stability (eleven governments) to define strategy or policy. In 1985 a special committee was appointed to manage and administer the external debt, while in 1986 a broad policy on external debt was formulated, of which the main principles were:

- in the short term, normalising the relations with the creditors;
- improving ties with potential donor countries for the reopening of international co-operation;
- to contract new long-term credit at concessional terms;
- to exchange loans on unfavourable conditions (duration or interest rates) for loans on concessional terms.

First priority was the elimination of the official debt to private creditors by making use of donor funds. The second priority was approaching the Paris Club for restructuring the commercial part of the bilateral debt and to negotiate forgiveness of the concessional (development) part of the bilateral credits. The third action was to approach the non Paris Club creditor countries (Argentina, Brazil).

Official debt to private creditors.
In 1979, Bolivia initiated renegotiations of a part of its debt to private creditors. The “Refinancing Agreement between the Republic of Bolivia and the Original Obligors and Bank of America National Trust and Savings Association” of April 1981 achieved a rescheduling of 90 per cent of Bolivia's debt to commercial banks.

After Bolivia had assumed the debts of the parastatal enterprises, its debt portfolio had to be restructured in 1985.

On the second hand market debt titles were negotiated at a discount. This discount was an indicator of the confidence of banks in recovering the credits, as well as their confidence in the country's economic performance. The following table presents some secondhand market prices, comparing 1987 with 1991:

Table 1–3 Secondary market prices of debt titles for selected countries (as percentage of nominal value)

Country	1987	1991
Bolivia	11	16
Argentina	13	33
Peru	6	11
Nicaragua	1	--
Mexico	36	58

Source: IMF, 1992.

In 1987, the discount amounted to 89 per cent, one of the highest at the time. The idea of buying back debt titles with donor funds came from the Netherlands. Using donor funds, buybacks could reduce the debt portfolio at no cost to the debtor country. The IMF was 'not amused' by the Dutch initiative through the NMB bank, since it was in the preparatory stages of setting up a multilateral fund for the same purpose. Repurchasing larger volumes could avoid speculation by commercial banks. The Dutch purchases were discontinued and the remaining funds deposited in the IMF Trust Fund[2], which took off in 1988. The advantage of the Dutch initiative had been that it had ‘sounded out’ the rather thin market (van Loon and Rühl, 1988).

In 1987-1988, USD 253 million was taken out of the market at 11 per cent of face value, while another USD 204 million were taken out through debt swap mechanisms and conversions into investment bonds (World Bank, 1991:28). In 1989, additional Swiss, Swedish, and Dutch contributions enabled further reduction of the commercial debt. By the end of that year the official debt to private creditors had been reduced by USD 1,079 million (nominal).

After 1989, the IDA Debt Reduction Facility replaced the IMF Trust Fund. With contributions from the World Bank, Sweden, Switzerland and the Netherlands, Bolivia achieved the removal of almost all debt to private creditors.

Bilateral debt

The Bolivian bilateral debt was not renegotiated until 1985. The exact amount of bilateral debt was not known at that time, also because the Central Bank of Bolivia had no adequate records of interest, amortisation, commissions, penalties, etc.

Prior to 1990, two negotiating meetings were held with the Paris Club (Paris Club I in July 1986 and Paris Club II in November 1988). Eligibility for consideration by the Paris Club was conditioned on an agreement with the IMF on the macro-economic policies to be pursued. The 1985 IMF endorsement of Bolivia's stabilisation and structural adjustment programme paved the way for a meeting with the Club. Separately from the Paris Club agreements, Bolivia renegotiated bilateral debt payments with the United States, Argentina, and Brazil. On top of the Paris Club arrangements, special agreements were made with Denmark and Switzerland.

[2] Depositors to the IMF Trust Fund were finally Sweden, Switzerland, Spain, Brazil and the Netherlands.

1.5.1 The Netherlands contributions prior to 1990

Bolivia's debt to the Netherlands had its origin in two loans granted in 1979 for the purchase of six F-27 Fokker aeroplanes for the Bolivian Air Force[3]. The balance recorded by the Paris Club at the cut-off date (31st of December 1985) was NLG 80,973,214 (Delgadillo, 1994:59). There were no Dutch concessional bilateral loans outstanding to Bolivia.

The Netherlands bilateral aid to Bolivia started in 1982-1983. Initially, its principal aim was to show support for the young democracy, while the continuation afterwards depended on the adjustments in the Bolivian macroeconomic policies. Bilateral aid to Bolivia was embedded in the so-called Andes programme. On top of the allocations from that budget category, Bolivia received balance of payments support from the corresponding budget category (from 1987 onwards).

The contributions by the Netherlands to alleviate the Bolivian debt situation (disbursements before 31-12-1989) were made in the context of the Paris 1 and 2 debt restructuring agreements; the repurchase of commercial debt titles through the NMB Bank (NLG 4.4 million in 1987) and deposits to the IMF Trust Fund for the same purpose (NLG 4.8 million, NLG 10 million and NLG 20 million over the years 1987-89).

1.6 Bailout

Bailout effects could have taken place in both the buyback of commercial debt and the bilateral relief. Bailout mechanisms can be perceived from various perspectives. i.e. as bailout by local or international taxpayers (see Jeanne and Zettelmeyer, 2001) or bailout of private banks by official donors. This section is limited to the latter perspective.

In the case of a debt buyback, the price on the second hand market for debt titles reflects the price commercial bank could have received anyway. In practice, only four or five banks were involved in trading Bolivian debt titles. The sounding out of the market carried out by the NMB bank indicated an extremely thin market. So most of the private creditors would have had to write off their claims. If there had not been a debt buyback under the principle ‘once and for all’, those creditors would not have traded, hence not have recovered anything. The ‘for all’ principle happened to be difficult. The Bolivian Central Bank invested time and effort to identify all commercial creditors. Some of those creditors did not even exist anymore. It is unknown which part would have been recovered by banks or would have been written off.

Through the buyback mechanism a small premium was paid in order to persuade the private banks to sell their claims. This premium on both occasions has been approximately 0.5 per cent. In consequence, the minimum bailout has been 0.5 per cent of USD 1,079 million face value, that is approximately USD 5.4 million.

The official bilateral bailout is harder to judge. Beyond doubt, some of the bilateral creditors would have had to write off their claims, as is most likely the case with the trading debt with Argentina[4] and Brazil.

---

[3] The interest rate was 7.5% per annum with an eight years repayment period and a grace of one year. Although the airplanes were used on civilian lines, they were equipped for military purposes. The Stichting Onderzoek Multinationale Ondernemingen (1991) accused the Fokker company of serious corruption in this sale.

[4] For example: the World Bank 2001 GDF tables still comprise ‘arrears’ pertaining to the debt interchange between Bolivia and Argentina. The Central Bank of Bolivia does not recognise these arrears.

1.7 Debt sustainability

The debt sustainability indicators reflect the developments during the first years of the 1980s. The TDS/XGS indicator was well above the threshold level of sustainability at the time (20-25 per cent) (World Bank, 1991).

Table 1–4 Selected debt sustainability indicators 1976-1989 (percentages)

Indicators	1976	1980	1985	1989
Total debt service/ exports of goods and services (TDS/XGS)	21.5	34.9	49.5	33.7
Public and publicly guaranteed debt service/ exports of goods and services (PPG TDS/XGS)	17.1	31.1	32.6	27.7
interest/ exports of goods and services (INT/XGS)	6.2	10.9	22.7	14.1
Total long term debt/ Gross National Product (LDOD/GNP)	55.6	81.7	141.5	81.5
Total debt service/GNP (TDS/GNP)	9.9	13.1	21.4	8.6
Public and Publicly guaranteed debt service /GNP (PPG TDS/GNP)	6.3	10.4	12.8	6.7
Interest/ GNP (INT/GNP)	2.3	7.9	5.8	2.8

Source: Based on World Bank 2001.

Improvement of the sustainability indicators was the combined result of:

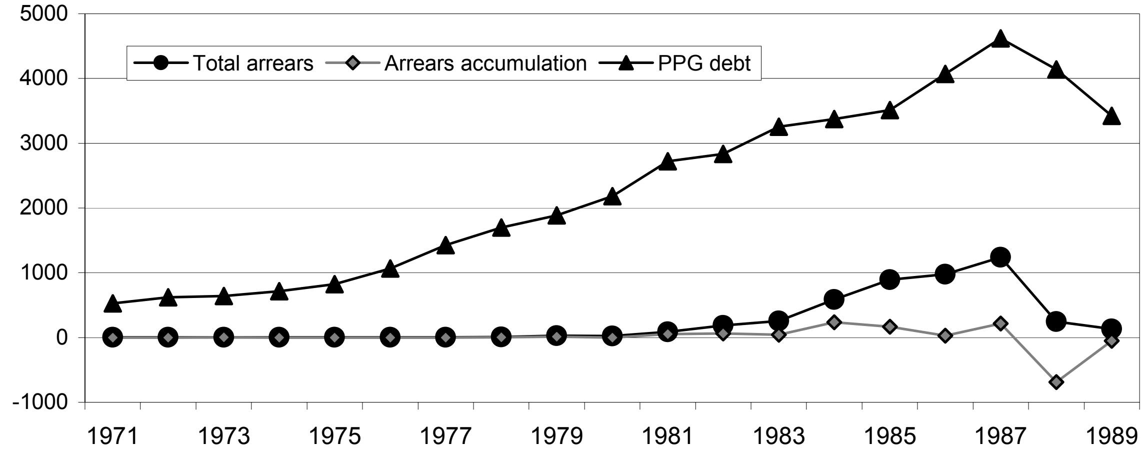
- relief efforts of the bilateral and commercial debt;
- improvements in the denominator: GNP and export earnings.

The debt service due over the period up to 1990 is not precisely known, but the sum of the debt service paid and the arrears have been taken as a proxy. Up to 1983 Bolivia has been a reliable payer of its external obligations, although registration was rather chaotic, mainly because various state-enterprises did not know how much they owed to creditors. When debt service paid reached USD 400 million per year (1978), Bolivia realised it could not sustain such a level of servicing. Arrears increased and the Central Bank authorities deliberately restricted debt service payments to a range of USD 200 and 300 million per year. This amount reflects Bolivia's 'willingness to pay' (interviews Ministry of Finance and Banco Central de Bolivia).

Although Bolivia never failed to service its multilateral debt, in 1985 it was decided that all multilateral service obligations would get first priority, if necessary at the expense of other creditors. While during the seventies multilateral debt service was only USD 2.8 million per year, by 1980 this had increased to USD 28.4 million, and by 1990 it had soared to USD 177.7 million per year.

As indicated by Figure 1–4, service on public and publicly guaranteed debt continued to increase, while the arrears increased as well after 1980. By the end of the decade debt service forgiveness, and stock-of-debt reduction contributed to a partial elimination of the arrears.

Figure 1–4 PPG Debt and arrears accumulation, 1970-1989 (USD million)



Source: Based on World Bank, 2001.

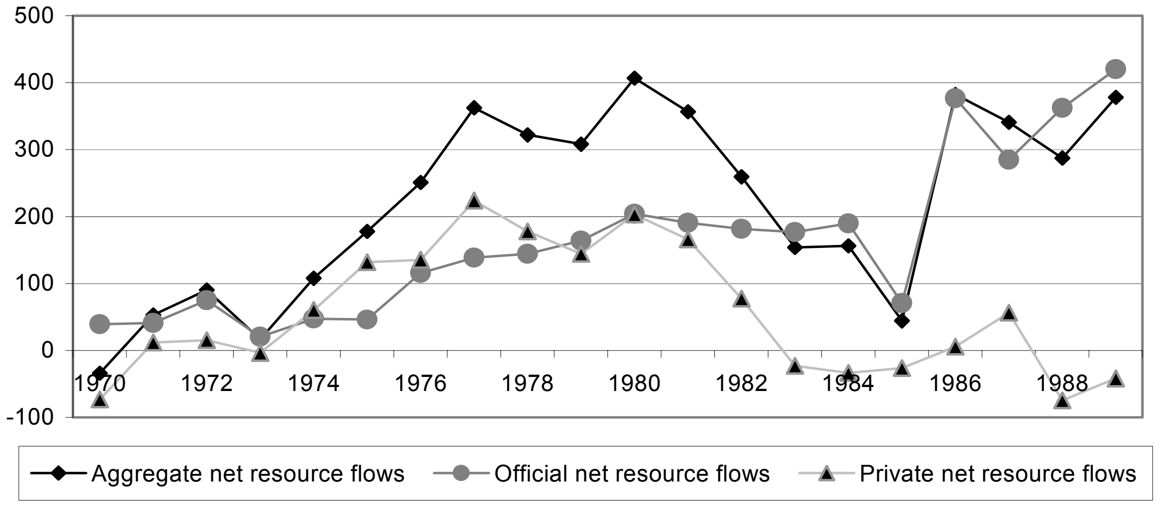
1.8 Net transfers on debt and aid flows

New investments may lead to economic growth. Apart from growth triggered by local investment, it is essential to count with a positive net financial flow. This can be achieved by:

- export earnings exceeding expenditures for imports (positive balance of trade);
- foreign private investments;
- other transfers of capital from abroad (i.e. remittances);
- international (official) grants or loans.

In Bolivia, the trade balance used to be negative, while foreign direct investments was modest during the 1970s and 1980s. The privatisation process (before 1990 only a few regional state enterprises) did not generate significant flows. Remittances by the approximately one million temporary migrant workers gradually become an important flow, which, however, is hardly recorded in the National Accounts. Narco-dollars are either circulating in the informal economy or kept in bank accounts in the U.S. (Chassudovsky, 1997). The registered inflow is largely consists of official international transfers (disbursements on loans and grants) and the outflow of debt service paid (see Figure 1–5).

Figure 1–5 Net resource flows (USD million)

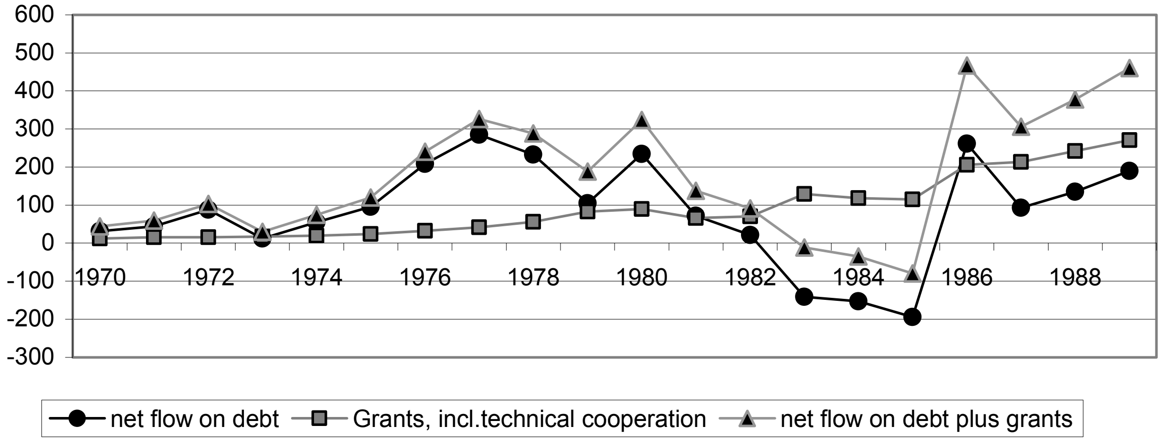


Source: World Bank, 2001.

The aggregate net resource flow has been positive since the 1970s, but shows a noticeable decline between 1980 and 1985. In later years it regains its former level, as a result of the stabilisation programme.

The net flow on debt and grants shows a comparable pattern (Figure 1–6)

Figure 1–6 Net flow on debt and grants (USD million)



Source: World Bank, 2001.

1.9 Nature and consequences of the debt problem in 1990

Debt has both liquidity and solvency aspects. Liquidity problems occur when the current or future debt service requires too much of the liquidity in circulation within the national economy. Solvency problems occur when the 'debt overhang' implies that the debt service cannot be paid without affecting economic growth.

At the start of the debt crisis in 1982, the problem was internationally considered to be one of *liquidity* and not of *solvency.* Initially, creditors, like the Paris Club looked for 'solutions' in terms of capitalisation of interest and the restructuring of servicing obligations in time. Others (International Financial Institutions) offered additional credits at softer conditions. But when economic growth in the debtor countries remained low, the structural inability to meet servicing requirements became evident.

By 1990, the Bolivian debt problem could be characterised as follows (World Bank, 1991):

- the debt problem had both liquidity and solvency characteristics; liquidity in the very short term (mainly vis-à-vis the commercial debt obligations). Solvency problems, because the recovery of the economy would proceed too slowly for regaining access to new credits on the international capital market;
- private sector investments were supposed to be stimulated by the elimination of the official debt to private creditors, hence the relaxation of the constraints on lending by commercial creditors to the private sector.

To the Bolivian Government one of the salient aspects of the debt situation was its inability to finance reform programmes with own (fiscal) resources. Implementation of structural adjustment programmes (public service reform, pension fund) required external funding.

Although Bolivia's policy was to diminish the existing external debt in stages, it never formulated its own yardsticks regarding levels of indebtedness. The criteria used were those applied internationally by the IMF and the World Bank. These institutions calculated the debt sustainability indicators. All projections made in the course of time turned out to be consistently far too optimistic. The optimism concerns mainly the denominators of the ratios: GDP growth and export earnings.

By 1990, as compared to the pre-1984 period, restructuring of the debt portfolio had taken place. An important feature was that debt service obligations had been spread out as a result of rescheduling or had been reduced (elimination of the debt to private creditors). The total stock of debt had increased. Part of that increase was due to the depreciation of the US dollar against other currencies (the IMF estimated 17 per cent over the period 1985-1990), but the bulk of the increase was due to new lending for the implementation of the structural adjustment and sectoral reform programmes.

The debt situation at the start of the 1990s was a debt stock of 81 per cent of GNP and a debt service of 34 per cent of exports. About 91 per cent of the debt was owed to bilateral and multilateral official creditors.

The World Bank's opinion was that "despite these improvements, Bolivia's debt burden remains high. Bolivia will continue to rely on concessional borrowing and has little prospect of becoming creditworthy for commercial bank lending"(World Bank 1991:29). Key problem was the slow growth of the economy. The GDP growth rate between 1985 and 1990 (2.7 per cent) had remained only slightly above the population growth (2.6 per cent).

Notwithstanding the relief in debt service obligations, the government was facing severe constraints in financing the necessary implementation of the (sectoral) reform programmes. Low levels of internal savings made domestic borrowing difficult. It should be noted that Bolivia implemented obediently almost all recommendations of by the IMF and World Bank.

At the start of the 1990s, the total debt outstanding and debt service obligations were high in relation to the small size of the economy. The debt situation had become less dramatic towards the end of the 1980s: the sustainability indicators had improved as a combined result of relief and some growth of the economy. The internal composition of the debt portfolio showed an increasing dependence on multilateral creditors. The growth of the economy remained slow as a result of low private investment and deteriorating terms of trade.

2 INPUTS: AMOUNTS AND MODALITIES OF DEBT RELIEF (1990-1999)

2.1 Overview of amounts and modalities of debt relief

Debt relief mechanisms are applied to the medium and long-term parts of the public and publicly guaranteed debt only. They may target either to the stock of debt or to the servicing requirements, or to both.

2.1.1 Official debt to private creditors

In 1987, the Netherlands financed the exploration of the use of donor funds for buying back debt titles on the secondary market. Simultaneously the IMF was in the process of creating a Trust Fund for the same purpose. Since not all creditors could be identified and the resources pledged by donors were insufficient for a 'once and for all' buyback, the IMF completed only a first round of purchases. It requested the World Bank to take over (1990) through its IDA Debt Reduction Facility.

It took until April 1992 to reach the (Santo Domingo-) agreement between the Government of Bolivia and four major private creditors (Bank of Montreal, Citibank, Morgan Guarantee Trust Company and Bank of Nova Scotia). These banks agreed on a discount of 83.5 per cent (the discount had decreased from 89 [1987] to 83.5 per cent as a result of the successful stabilisation programme). In order to avoid free riders and to guarantee equal treatment, the government requested a waiver from each of the contractual conditions signed with the remaining 40 financial companies with claims on the Government of Bolivia. These conditions were replaced by a single standard set of conditions.

Of all outstanding debt to commercial banks and private suppliers, 97.5 per cent could be repurchased. The Netherlands' contributed USD 3.6 million to the IDA Debt Reduction Facility (September 1992) out of a total of USD 32 million. During the period 1990-1993, almost all debt to private creditors could be removed either through buybacks, debt swaps or conversion of external into domestic debt (bonds exchange):

Later buybacks took place in 1997 (bonds from the US District of Colombia and the Polish Company KOPEX). The discount agreed was 67 per cent (Republic of Bolivia, 1998:15). In 1998, the Government of Bolivia issued new Treasury bonds for the nominal value of USD 11.8 million. By 1999, the official debt to external private creditors was USD 27 million, of which USD 16.7 million corresponded to 'old' debt (Banco Central de Bolivia, 2000:81).

Table: 2–1 Retirement of public debt to private creditors 1990-1993 (USD million)

	1990	1991	1992	1993	Discount (%)
Outstanding debt at start of period	265.8	209.3	199.6	179.8	
cash (buyback)				32.5	83.5
investment bonds	56.5	9.7	19.8		65-75
bonds exchange				32.9	0
debt for development swaps				59.7	40-80
purchase by Bolivian investors				7.2	70-75
total retired	56.5	9.7	19.8	177.2	
total outstanding end of period	209.3	199.6	179.8	2.6*	

Source: IMF, Article IV Consultation, Statistical Annex, 1994. p.66.
Note: Government challenges the legitimacy of some claims, while others showed up afterwards.
* :In 1993, the debt registration system was adjusted, which brought the official debt to private creditors to USD 44.3 million.

2.1.2 Bilateral debt

Paris Club creditors
At the *Paris Club III* meeting (March 1990), creditor countries could select from various options on the 'Toronto Menu' regarding the refinancing of pre-cutoff date debt that fell due between 1 January 1990 and 31 December 1991. This included the restructured debts of 1986 and 1988 (Paris I and II). The concessional (ODA) part was made payable over 25 years with 14 years of grace, while the non-ODA credits were made payable over 14 years with 8 years of grace, after cancellation of 33 per cent on principal and interests. The total sum restructured amounted to USD 276 million, the amount forgiven to USD 76.0 million.

At the *Paris Club IV* (1992) creditor countries could choose from the 'Enhanced Toronto' menu of options. Option A consisted of cancellation of 50 per cent of the debt service, (and restructuring of the remaining 50 per cent over 23 years). A new option was the debt-for-nature swap or the conversion of debt into local currency bonds. Debt stock reductions were adopted by France, Germany, Great Britain and the Netherlands for a total of USD 21.6 million The rescheduled amount totalled USD 65 million. The minutes of the Paris Club IV refer explicitly to the Club's intention to come to a final solution within three years.

At *Paris Club V* (1995), Bolivia was eligible to treatment according to the Naples Terms. Payments due under Paris III were postponed for 5 years and became due from December 2001 onwards. Repayment of non-ODA credits would take place in 23 years with 6 years of grace, after a cancellation of 67 per cent. Repayment of ODA credits would take place over 40 years, with 6 years of grace. The total amount of debt (stock and service) forgiven was approximately USD 130 million; the amount of debt restructured was USD 482 million.

Application of the 'early review clause' enabled an 'exit agreement'. The *Paris Club VI* (December 1995) comprised repayment of non-ODA credits over 23 years with 6 years of grace, after cancellation of 67 per cent (starting 1 July 2002) and repayment of ODA credits over 40 years with 16 years of grace. The treatment period was brought forward to December 1995. Special options for debt swaps were introduced. The flow component was applied to previous restructured debts, with an additional 33 per cent reduction of the non-ODA debts. This arrangement was regarded as final, whereby Bolivia had reached sustainable levels of indebtedness, according to the World Bank calculations at the time (main indicator was the 250 per cent NPV debt/exports threshold). The total amount of debt consolidated was USD 881 million, of which USD 157.1 million were forgiven and USD 721.4 million rescheduled at lower interest rates (Republic of Bolivia, 1998). The exit agreement was estimated to have saved Bolivia USD 620 million in debt service during the period 1996-2004 (Martin, 1996:1), on average USD 68 million per year.

When Bolivia reached the Completion Point under the Heavily Indebted Poor Countries Initiative (HIPC-1) as the second country in the world (after Uganda), it became entitled to stock-of-debt reduction, in order to reach a debt sustainability level of 225 per cent of NPV debt stock/export. At *Paris Club VII* (October 1998) Bolivia was granted:

- application of the Lyon conditions: a 80 per cent reduction on the pre-cutoff debt stock;
- restructuring of the remaining (1995 debt) over 23 years, with a 6 year grace period (non-ODA credits), and on ODA credits 40 years with 8 year grace.

The total amount treated was USD 561 million. World Bank calculations indicated that this arrangement would lead to a NPV debt service to export ratio of 218 per cent.

A new Japanese loan of USD 300 million exerted influence on the debt stock reduction. This new loan converted previous credits into one single soft loan. The total stock reduction by Paris Club members –on top of the 1995 exit agreement- reached USD 112 million, but would have been USD 148 million without taking into account the effects of the Japanese loan.

In 2001, Bolivia reached the Completion Point under the HIPC-2 Initiative and became entitled to further debt reduction under the Cologne terms (90 per cent reduction). The *Paris Club VIII* (July 2001) agreement encompassed USD 1,350 due to the Paris Club creditors as of July 2001. The amounts treated were USD 685 million. Creditors were allowed to apply a 100 per cent reduction (the Netherlands opted for that).

Non-Paris Club bilateral debt reduction
In 1990, within the context of the Initiative for the Americas, the US government authorised a 90 per cent reduction of the debt owed to USAID as well as 80 per cent of a debt under Public Law Programme 480 (PL 480), totalling USD 373 million (Delgadillo, 1994). The PL 480 was a swap, and the 'freed' resources had to be used for the new Environmental Fund FONAMA. In 1991, Russia accepted a buyback of USD 9.2 million in claims at 11 per cent of face value.

2.1.3 Multilateral debt
Multilateral debt comprises both concessional (i.e. IDA), and less concessional loans (e.g. IBRD and CAF). In 1989, the first instrument developed for multilateral debt relief was the 'fifth dimension' programme of the World Bank (consisting of IDA reflows). In 1994, the Swedish development co-operation paved the way for bilateral donors to assist Bolivia in servicing its multilateral debt obligations. In 1995, the Dutch Minister for Development Co-operation decided to allocate NLG 40 million for multilateral debt relief to four countries, including Bolivia. In that year several countries (USA, Sweden, Switzerland, the Netherlands) started to assist Bolivia in servicing its multilateral debt. Initially only IBRD debt, later IDA and IDB debt as well.

Parallel to the direct servicing obligations assumed by bilateral donors on behalf of indebted countries, a World Bank task force (September 1995) recommended the creation of a Multilateral Debt Facility of USD 11 billion in order to cover both part of the stock-of-debt and part of the debt service of the multilateral debt of the 40 poorest countries. Eligible debts could be those owed to the IMF, World Bank and African Development Bank. Bolivia was expected to be among the first countries to benefit from that Facility. In that same year, the first steps were taken towards the Heavily Indebted Poor Countries Initiative (HIPC). At the same time (1996) the concept of Multilateral Debt Funds (MDF) emerged. The difference between the Facility and a Fund is that the first one would be managed by the World Bank on behalf of a number of countries, while the second would be 'owned' and managed by the governments of the respective recipient countries. The advantage of country-specific Funds would be that tailor-made policy conditions could be attached. On behalf of a number of bilateral donors, the Netherlands launched an appraisal mission in order to study the requirements, as well as the relation between the MDF and the HIPC. The mission recommended to consider the MDF within the framework of HIPC and confirmed that additional debt relief was necessary (Martin, 1996a).

When Bolivia reached the Decision Point under HIPC-1 (1997) the Netherlands decided to deposit NLG 27.5 million into the Multilateral Debt Fund. The other contributors were Denmark, Switzerland and Sweden. The MDF was placed in the context of the HIPC-1 Initiative and aimed at compliance with payment obligations to the IBRD, IDA, IMF and IDB. In 1998, the Netherlands made another contribution to the MDF of NLG 15 million.

The condition attached to the deposits was –apart from keeping on-track with the HIPC Initiative- special public sector attention to poverty alleviation.

The take-over of debt service by third parties is not reflected in the debt registration system. In consequence, multilateral debt service paid by third parties is counted in the statistics as 'service paid' and not as relief. Approximately USD 87 million were used for payments of multilateral debt service (mainly IBRD, CAF and IDB)
The amounts deposited in the Multilateral Debt Fund were as follows:

Table 2–2 Deposits bilateral donors into Multilateral Debt Fund, 1997-2000 (USD million)

Year	Deposits	Balance 31st December
1996	**n.a.**	
1997	**29.4**	
1998	**34.6**	
1999	**22.9**	
2000	**11.2**	**10.7**
Total used		**87.4**

Source: Banco Central de Bolivia, 2001.

2.1.4 The HIPC 1 and 2 Initiatives

According to the World Bank 1996 Debt Sustainability Analysis Bolivia was eligible for the HIPC Initiative. However opinions varied regarding the desirability of such assistance. The IMF argued (1996) that Bolivia's admittance to the HIPC Initiative could be interpreted as the wrong signal to private investors. Nevertheless, the IMF and World Bank supported Bolivia's request. In September 1997, Bolivia reached the Decision Point under the HIPC Initiative and in November it was granted debt relief of USD 448 million in NPV terms (or USD 760 million in nominal terms), of which USD 54 million as a direct contribution from the World Bank, USD 155 million from IDB and USD 29 million from the IMF.

The efforts would lead to a debt service/ exports ratio of 225 per cent in the short term and 140 per cent after 2011. During the Consultative Group meeting April 1997, Bolivia proposed a sustainability target at Completion Point of 200 per cent, while the bilateral donors (including the Netherlands) insisted on a ratio of 215 per cent of XGS. Donors pledged resources to the HIPC Trust Fund for the period up to the Completion Point; in the meantime use would be made of the Multilateral Debt Fund. The Interim period was shortened from three years to one, so Bolivia reached the Completion Point in September 1998.

Box 2–1 Multilateral Debt Fund and HIPC Trust Fund

The MDF and HIPC Trust Fund were complementary facilities. The MDF was created to assist in servicing debt obligations aimed at relieving immediate liquidity problems. The MDF did not contribute to stock-of-debt reduction. The HIPC Trust Fund has been created in order to reduce the stock-of-debt 'irrevocably' at the Completion Point (although later also during the Interim stage -between Decision and Completion point- the stock of debt could be reduced). So, the MDF aimed more at immediate liquidity problems, the HIPC Trust Fund aimed at the solvency problem.

The Enhanced HIPC (1999) amended the sustainability criterion to a NPV debt stock of 150 per cent of the exports. This allowed Bolivia to request reconsideration. Bolivia became the first country in Latin America to be declared eligible for debt relief under the Enhanced HIPC Initiative. It was expected that the Enhanced Initiative would amount to USD 854 million in NPV terms or approximately USD 1.2 billion in nominal terms. In January 2000, Bolivia reached its Decision Point under HIPC-2, while in May 2001, the Joint Staff Assessment of IMF and IDA confirmed that Bolivia had reached its Completion Point and concluded that "Bolivia can exit the debt rescheduling process" (IMF and IDA, 2001:5). In June 2001, the Boards of Directors of IMF and World Bank endorsed the Poverty Reduction Strategy Paper (PRSP) and the debt relief became irrevocable.

The eligibility targets of the HIPC Initiatives have been as follows:

Table 2–3 Eligibility targets under HIPC 1 and 2

Target	**Original Framework (HIPC-)**	**Enhanced Framework (HIPC-2)**
NPV-debt stock/export ratio (%)	range 200-250	150
if not then: debt service/export ratio (%)	range 20-25	range 15-20
if not then: *Open economies*		
NPV debt stock /revenue target (%)	280	250
constraints:		
- *openness*: export/GDP ratio (%)	40	30
- *revenue effort*: revenue/GDP (%)	20	15

One of the conditions for the HIPC-2 initiative was the elaboration of a full Poverty Reduction Strategy Paper. The elaboration was based on a participatory process, started in 1998, the so-called National Dialogue.

Box 2–2 Priorities of the Poverty Reduction Strategy 2001

- *Continued macroeconomic stability and sustained economic growth;*
- *Creating income and employment by*
  - *(a) promotion of rural development through irrigation infrastructure, local roads, rural electrification and definition of property rights;*
  - *(b) promotion of micro enterprise and small business*
  - *(c) microfinance facilities and technical assistance;*
  - *(d) intensive employment programme.*
- *Promoting human capacities by*
  - *(a) education with emphasis on primary education;*
  - *(b) health with emphasis on primary health care an elimination of endemic diseases*
  - *(c) basic sanitation in rural areas*
- *institutionalisation of participatory process and local democracy.*
- *introduction and expansion of social protection programmes (elderly, children, emergencies)*

Source: República de Bolivia, 2001.

The 2001 PRSP (see box 2–2) sets explicit targets for the medium and long term (1999-2015), including (a) a reduction in the incidence of poverty from 63 per cent to 41 per cent, and a reduction by half in the incidence of extreme poverty, from 36 per cent to 17 per cent, consistent with the International Development Goals (IDG); (b) an increase in life expectancy from 62 to 69 years (c) a reduction in infant mortality from 67 to 40 per 1,000 and of maternal mortality from 390 to 200 per 100,00 (both less than the IDG goals); and (d) significant increases in rates of school attendance and completion.

The combined effect of all efforts to reduce debt is presented in the following table[5].

Table 2–4 Debt rescheduling and forgiveness

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Total amount rescheduled	153	138	125	115	0	196	433	301	0	536	1,997
Debt stock rescheduled	9	8	0	0	0	10	0	0	0	532	550
Principal rescheduled	81	75	70	71	0	138	427	300	0	3	1,165
Official	69	64	62	70	0	137	420	300	0	3	1,125
Private	12	11	8	1	0	1	7	0	0	0	40
Interest rescheduled	63	54	54	40	0	46	4	0	0	0	261
Official	59	51	52	39	0	46	4	0	0	0	251
Private	4	2	2	1	0	1	1	0	0	0	11
Total amount forgiven	112	422	80	226	17	74	181	83	15	128	1,338
Debt forgiven	92	403	60	55	17	74	181	83	15	26	1,006
of which interest forgiven	60	9	6	1	0	8	0	12	0	0	96
Debt stock reduction	20	19	20	171	0	0	0	0	0	102	332
of which debt buyback	4	2	2	27	0	0	0	0	0	0	35

Source: World Bank, 2001.
Note: 1999 data rescheduled debt corrected; buyback data refer to donor financed amounts.

The NPV of Bolivia's external public debt was estimated to be reduced by 35 per cent as a result of the combined original and enhanced HIPC Initiatives, which is on top of the 17 per cent debt reduction that had already been achieved under traditional debt relief mechanisms (IMF Press release, 2001).

2.2 Netherlands contributions to debt relief

During the 1990s the Netherlands supported the Bolivian Government in reducing its commercial debt, bilateral and multilateral debt.

Commercial debt

In 1993, the Netherlands contributed NLG 5 million to the IDA Debt Reduction Facility for the buyback of debt titles.

Bilateral debt

All Bolivian debt to the Netherlands had originated in export guarantees. No concessional debt existed.

[5] Based on the World Bank Global Development Finance tables 2001. Data are not consistent with those published by the Banco Central de Bolivia.

At the Paris Club III the Netherlands initially opted for a 25 year repayment period with 14 years grace, without cancellation (option B). In the time lapsed between the Paris Club and the (compulsory) subsequent bilateral agreement, a Bolivian negotiation team convinced the Dutch to change from option B to option A (forgiveness of 33 per cent of the obligations on pre-cutoff debt, while the remainder was rescheduled at an interest rate of 9.1 per cent [as compared to a LIBOR of 8.45 per cent] for 14 years). So the Netherlands accepted a debt stock reduction, but at an interest rate for the remaining part, which was higher than agreed in the general Paris Club agreement. For the Netherlands this was the first time NCM guaranteed debts were reduced in a country outside Africa. One third of the restructured NLG 38.8 million would be forgiven, being NLG 12.9 million (USD 5.85 million). Of that amount 70 per cent (NLG 9 million) had to be reimbursed by the Ministry of Foreign Affairs to the Ministry of Finance (files Ministry of Foreign Affairs, Nov. 1990).

At the *Paris Club IV* the Netherlands opted for a debt stock reduction of NLG 9,7 million plus NLG 1,1 million adjustment of the Paris III agreement, a total NLG 10.8 million) (NCM, 1992 and Banco Central de Bolivia, 1994: table 5). At *Paris Club V*, the Netherlands agreed to a forgiveness of 67 per cent of the obligations due and a rescheduling of the 33 per cent remaining part at market interest rate (which implied about 1 per cent less interest, as compared to Paris III). The Netherlands' contribution was NLG 57 million in restructured credits and NLG 33.4 million in debt forgiveness (NCM, 1995). The Netherlands' contribution at *Paris Club VI* (a so-called exit agreement) was NLG 69.9 million in consolidated credits and NLG 34.9 in debt forgiveness[6]. At *Paris VII*, the Netherlands contribution was NLG 16.2 million. The remaining stock was calculated at NLG 30.5 million (Ministry of Foreign Affairs files, 1998). At *Paris VIII* all remaining pre-cutoff debts were forgiven, including the stocks (2001). A summary of the Paris Club agreements is provided in the following table:

Table 2–5 Summary of meetings Paris Club 1990-1999 (USD million)

	Paris III	Paris IV	Paris V	Paris VI	Paris VII	Paris VIII
Year	1990	1992	1995	1995	1998	2001
Total treated	276	65	482	881	561	1350
Total debt forgiveness (stock and service)	76	121	130	157	148	685
Dutch debt forgiveness	6.8	6.1	20.8	0.9	8.1	18.5*

Sources: Ministry of Foreign Affairs files, Banco Central de Bolivia data base, 2001, www.clubdeparis.org.
Note: * all remainder stock, approximately NLG 30.5 million.

Multilateral debt:
After an initial Dutch reluctance to support multilateral debt relief (Ministry of Finance 1995:22), the Minister for Development Co-operation decided in 1995 to allocate NLG 40 million for multilateral debt relief to four countries, including Bolivia.

Prior to that decision, the Bolivian authorities had requested Dutch support to multilateral debt servicing. The 1995 debt service to the IBRD was USD 34 million, of which USD 10 million interest. Since 95 per cent of the interest could be refinanced by new loans, USD 24.5 million was due. The Swedish Government offered an equivalent of approximately

[6] The amount refers to those applied at the previous Paris Club agreement. Due to the time lapsed and change in interest rate applied, the additional reduction was NLG 1.5 million.

USD 8 million, and the Dutch Government approved NLG 10 million (USD 6.2 million). In October 1995, the Netherlands offered NLG 17.3 million (or approximately USD 10.68 million) to contribute to the multilateral debt service, not only comprising IBRD service, but IDA (USD 2.06 million) and IDB service (USD 5.88 million) over 1995 as well. The total contributions by the Netherlands reached NLG 27.3 million in 1995. The condition for this support was that the equivalent of the resources 'saved' by the Bolivian Government would be used for investments in the social sector.

In 1996 a similar exercise was implemented. The IMF had calculated that multilateral debt service of USD 287 million was due (out of a total debt service of USD 363 (IMF, 1996). The debt service on multilateral debt had reached a level of 21.2 per cent of exports of goods and services (XGS), far above the World Bank recommended maximum of 10 per cent The Netherlands contributed NLG 15 million.

The Netherlands launched a mission to appraise the requirements for a Multilateral Debt Fund, as well as the relation between the MDF and the HIPC (Martin, 1996a). The moment Bolivia reached the Decision Point under HIPC-1 (1997) the Netherlands decided to deposit NLG 27.5 million into the Multilateral Debt Fund. Other contributors were Denmark, Switzerland and Sweden. In 1998, the Netherlands made a second contribution to the MDF of NLG 15 million. The condition attached to both deposits was that the public sector would pay special attention to poverty alleviation.

Table 2–6 Netherlands contributions to debt relief to Bolivia, 1990-1999

Year	Name of the activity	Type of debt	NLG	USD
1990	Debt relief poorest countries	bilateral (export credits)	12,900,000	7,087,900
1993	Repurchase commercial debt Bolivia 1993	commercial	5,000,000	2,692,200
1994	Paris Club IV	bilateral (export credits)	10,800,000	5,700,000
1995	Multilateral debt relief IDB, 1995, Bolivia	multilateral	9,445,000	5,883,600
1995	Multilateral debt relief IBRD and IDA 1995	multilateral	7,900,000	4,921,200
1995	Paris Club V	bilateral (export credits)	33,400,000	20,810,000
1995	Paris Club VI	bilateral (export credits)	1,700,000	1,059,200
1995	Debt relief Bolivia	multilateral	10,000,000	6,229,400
1996	Multilateral debt relief	multilateral	15,000,000	8,896,300
1996	Relief to Multilateral debt service IBRD, 1996	multilateral	12,500,000	7,413,600
1997	1997 Contribution to Multilateral Debt Fund, debt service Bolivia	Multilateral	27,500,000	14,096,000
1998	HIPC Trust Fund	Multilateral	10,000,000	5,039,000
1998	Paris Club debt consolidation (Paris Club VII, HIPC)	bilateral (export credits)	16,300,000	8,213,700
1999	Multilateral debt relief 1998 through MDF	Multilateral	15,000,000	7,252,300
Total	1990-1999		187,445,000	105,294,400

Source: Files Netherlands Ministry of Foreign Affairs.

2.3 Extent to which debt relief involved bailing out of private creditors by official creditors/donors

Commercial debt relief

The efforts to take out approximately USD 740 million by buybacks, swaps and conversions by using donor resources were to a certain extent a bailout of some American and Canadian private banks. The chance these banks had to recover their 'dubious debts' are reflected by the discount at the face value. For Bolivia, the discount amounted to approximately 89 per cent (1989). So, banks dealing in secondhand debt papers would not have received more than 10-11 per cent of the face value. During the first buybacks an incentive of approximately 0.5 per cent was paid. After the first purchases the discount decreased to 85 per cent. However, the market was thin. The 16.5 per cent of face value paid in the second round of buybacks comprised a 'goodwill premium' of some 1.5 per cent (The Wallstreet Journal 29th March, 1993). This is evidenced by the fact that several years later the discount rate had remained at the same level (repurchases 1998). More than by the ‘goodwill premium’ , those banks and creditors that not traded their claims got a free ride. It took several years to identify all of the approximately 40 private creditors. Most of them would never have recovered their claims. Private banks benefited in another manner as well: by keeping dubious debts on their books, profit figures were depressed, and this –in turn- allowed tax reduction in the country of registration. So when the dubious debt suddenly generated an income –even at a large discount- this implied a windfall profit.

It is difficult to speak of bailing out in a swap situation, although in these swaps (mostly for nature, but also for culture, such as in the Quipus debt swap) the Government of Bolivia paid a higher price than the market value. In a number of cases 33 per cent of face value was used as the indicative amount. As a rough estimate a ‘premium’ of 10 per cent on average can be assumed for the swaps.

During 1987-1990, the bailout can be estimated at USD 5.4 million (0.5 per cent of USD 1,079 million). The bailout in the 1992/93 buyback can be estimated at USD 2.78 million (1.5 per cent of USD 185.8 million) and in the swaps at USD 5.2 million (10 per cent of USD 52 million). This adds up to about USD 13.4 million.

Bilateral debt

A reference to ‘internal’ bailout in the context of bilateral debt can be found in the files of the Ministry of Foreign Affairs. With reference to the application of Toronto option A-terms, an internal memorandum (30 Oct. 1990) states: "…considering the weak position of the [Dutch] Treasury, writing off debts is highly undesirable. So [within the Paris Club] debt forgiveness should be restricted to the unrecoverable part of the debt outstanding". …"to reimburse the Ministry of Finance out of the aid budget for up to 50 per cent of the total debt forgiven…. would be reasonable". So the Dutch Ministry of Finance cashed in 50 per cent of the value of the debt forgiven which by itself was considered as unrecoverable. In 1998, the amount of debt forgiven in the context of the Paris Club (NLG 16.3 million) was even compensated entirely from the development budget to the Ministry of Finance.

Another form of bailout took place among donors: the credits dealt with in the Paris Club are of two kind: ODA loans and publicly guaranteed commercial loans. While some countries had forgiven the ODA loans in the course of time and focused on the commercial claims, other creditors had not forgiven their ODA loans (such as Spain, Denmark and Norway). Countries that did not forgive ODA loans at an early stage got paid for those debts in the context of all agreements between 1988 and 1998 (HIPC-1).

In 1998, a new Japanese ODA loan 'distorted' the Sustainability Assessment. Other Paris Club members benefited from the Japanese conversion of existing loans into a single new one. The Japanese conversion ‘saved’ the other Paris Club creditors USD 36 million as compared to a situation in which the new Japanese loan would have been issued one week later (Ministry of Foreign Affairs files, 1998).

2.4 Stated objectives and conditions attached to debt relief

Most official documents of the World Bank, IMF and bilateral donors refer to only few motives for debt relief:

- to obtain a sustainable debt profile;
- to support the macroeconomic policies of Government, in particular the (sectoral) structural adjustment programmes (including support to the institutional reform and decentralisation);
- to create financial ‘space’ for new borrowing in the context of structural adjustment (incl. the Pension system);
- to free resources on the budget to be used for public sector investment in the social sectors (health, education and drinking water supply) with the aim to reduce poverty, mainly in the rural areas.

Table 2–7 Motives and conditionality in main debt stock relief agreements

Area	Policy/target	Exit agreement 1995	HIPC-1	HIPC-2
Macro-economic	Stock of international reserves	yes	no	no
	Government deficit (% GDP)	yes	yes	Yes
	Government expenditure (% GDP)	no	no	no
Economic reforms	Tax reform	no	no	no
	Public sector reform	yes	yes	yes
	Composition of public expenditure	no	yes	yes
	Privatisation	no	no	no
	Liberalisation of good markets	no	no	no
	Liberalisation of foreign trade	no	no	no
	Liberalisation of labour market	no	no	no
	Financial liberalisation	no	no	no
	Other sector reform	yes	yes	yes
Political reforms	Elections	no	no	no
	Multiparty system	no	no	no
	Human rights observance	no	no	no
	Independent judiciary	no	no	no
	Free press	no	no	no
Governance	Transparency of budgeting	no	yes	yes
	Transparency of budget execution	no	yes	no
	Accountability	yes	yes	yes
	Anti-corruption measures	no	no	yes
	Establishment / respect for audit office	no	no	no
	Decentralisation	no	yes	yes
	Participation	no	yes	yes
Poverty reduction	Social expenditure	yes	yes	yes
	Social sector reform	yes	yes	yes
	Quality of social service delivery	no	no	yes
	PRSP	n.a.	n.a.	yes

In the later years, the HIPC Initiative put emphasis on maintaining economic stability, while strengthening the decentralisation and the 'municipalization' process, the increased attention to poverty reduction and the provision of social services. At the institutional level various reform programmes were pushed, such as the reform of the judicial system, the customs and excise, the reform of the budgetary system. The United States stressed the importance of the coca eradication programme and conditioned all its support on the so-called 'certification' of the reduction of the cultivated area under the coca crop.

As far as the Multilateral Debt Fund was concerned, particular conditions were 'negotiated' with the Government of Bolivia annually. It operated as if it were a countervalue fund. The Government presented lists of projects and programmes that could not be funded from available resources due to budget constraints. Donors and Government agreed upon the programmes that could now be implemented with the resources that became available thanks to the donors' payment of the multilateral debt service. Most of the activities were related to the social sectors, the 'municipalization' and the institutional reform programmes. The donors monitored the implementation of these public sector investments directly.

Based on that method, the Government of Bolivia decided that the resources that became available under the HIPC –2 (USD 80 –100 million per year) would be transferred to the municipalities according to a distribution key (in five categories) where the poorest municipalities would benefit the most.

2.4.1 Dutch motives, objectives, and conditions for debt relief

The Dutch motives and objectives for debt relief are comparable to the ones listed above:

The long-term objectives mentioned for *commericial* debt relief were:

- contributions to economic recovery;
- improvement of investment climate (creditworthiness and confidence);
- access to capital markets and short term trade credits;

The short-term motive was to eliminate the Bolivian official debt to private banks (IDA debt reduction facility 1992/93 [BEMO BO 92/903]).

For *bilateral* debt debt relief de the most frequently mentioned objectives were:

- sustainability of the debt profile;
- improvement of the cash flow as a result of reduction of debt service;
- reduction of the total debt outstanding.

In general, the Dutch policy[7] on *multilateral* debt relief implied that it should contribute to adjusting the debt service of a country to its capacity to pay. So, support to the multilateral debt service was thought to be more meaningful in the case of liquidity problems than in the case of solvency problems. The solvency should be improved by economic growth resulting from adequate structural adjustment. In line with that policy, objectives and motives mentioned were:

Objective: improvement of macroeconomic situation.

Motives:

- the seriousness of the debt service situation -1995, 1997;

[7] The Netherlands' policy on multilateral debt relief has been elaborated in the white paper on Debt Strategy by the Ministers for Finance and Development Cooperation, presented to Parliament. 1992-1993, 22800V, nr.54 and in the Note on Multilateral Debt, August 1995.

- political opportunity (support to democratisation decentralisation -1996);
- continuity in the Dutch debt policy to Bolivia -1997;
- strengthening Bolivian capacity and structure for debt management –1997;
- successful implementation of adjustment programme and good track record - 1995,1997;
- achievement of Completion Point -1998.

Conditions:
- agreement with IMF -1996;
- co-ordination with other multilateral debt interventions –1996;
- no contract of new commercial and concessional loans (1997).

2.5 Additionality of debt relief

Additionality can be considered from the perspective of the recipient country and from the perspective of the donor.

From the perspective of the recipient country, additionality is that amount of financial support it receives and that it would not have received otherwise. This refers mainly to the amount of debt relief on top of the 'regular' flows of development assistance. Contributions by bilateral donors to commercial debt relief, as well as the contributions to the Multilateral Debt Fund (Denmark, Sweden, Switzerland) have been financed from the 'regular' aid budgets, so these have not been additional. Debt relief in the framework of the Paris Club, incl. the HIPC-1 and 2 can be considered as on top of regular aid flows, hence additional (interviews donors September 2001).

In the case of the Netherlands, there were basically three mechanisms for assuming the 'costs' of debt relief:

a. until 1997, the Ministry of Finance assumed the costs of relief on commercial (export) credits, guaranteed by the Dutch Government. There was no automatic write-down of those claims after X years.
b. the cost of relief could also be charged to the development budget: either the regional or country allocations (in the case of Bolivia, initially the Andes programme, later the indicative country allocation) or other budget allocations, including the so-called guarantee article.
c. the cost of debt relief could be covered by the allocation for macroeconomic support and/or world-wide programmes on top of the country allocation. To the recipient country, debt relief funded by the Macro-economic Support Programme of the aid budget can only be considered as additional in the case it would not have been allocated to other forms of programme aid to the same country. This is not the case for Bolivia, which received commodity aid and fertiliser aid in previous years from the same budget

Most donors claim that their contributions have been additional to their regular allocations to Bolivia. Since Bolivia passed the HIPC-2 Completion Point, one may assume that once all conditions have been fulfilled, Bolivia has a sustainable debt profile and will not require any further debt relief. If debt relief had been additional, then donor pledges to Bolivia would have returned to the level of allocations for ‘regular’ assistance programmes. However, at the 2001 Consultative Group meeting all donors pledged amounts similar or higher than the 2000 allocations (which included the debt relief).

Only part of the Dutch contributions to debt relief can be considered as additional, in the sense that it was financed from other sources than the budget for development assistance (see Table 2–8).

Table 2–8 Netherlands contributions to debt relief to Bolivia, 1990-1999 (NLG thousand)

			Aid budget		
Year	activity	amount	Budget Finance Ministry	Regional country programme	Macroeconomic support programme
1990	Debt relief poorest countries	12,900	3,900	9,030	
1993	Repurchase commercial debt Bolivia 1993	5,000			5,000
1994	Paris Club IV	10,800	10,800		
1995	Multilateral debt relief IDB, 1995, Bolivia	9,445			9,445
1995	Multilateral debt relief IBRD and IDA 1995 Bolivia	7,900			7,900
1995	Paris Club V	33,400	33,400		
1995	Paris Club VI	1,700	1,700		
1995	Debt relief Bolivia	10,000			10,000
1996	Multilateral debt relief	15,000		15,000	
1996	Relief to Multilateral debt service IBRD, 1996	12,500			12,500
1997	1997 Contribution to Multilateral Debt Fund, debt service Bolivia	27,500			27,500
1998	HIPC Trust Fund	10,000			10,000
1998	Paris Club debt consolidation (Paris Club VII, HIPC)	16,300			16,300
1999	Multilateral debt relief 1998 through Multilateral Debt Fund	15,000			15,000
Total	period evaluation 1990-1999	187,445	49,800	24,030	113,645

Source: Based on files Netherlands Ministry of Foreign Affairs.
Note: In 1990, the Netherlands' agreed to the Toronto A option to six countries, amongst them Bolivia. Seventy per cent was to be paid for by the Ministry of Foreign Affairs (NLG 9.03 million). This was paid out of budget for the Andes programme. So the difference of NLG 3.9 million can be considered as additional.

2.6 New loans and grants

During the period 1990-99 Bolivia contracted almost 90 per cent of its new loans from the International Financial Institutions. The percentage distribution (in value terms) of new loans contracted has been as follows:

Table 2–9 New loans 1990-1999

Creditor	Percentage of total value of new loans
Multilateral	89.8
of which IDA	30.3
IDB	29.3
CAF	16.2
Bilateral	8.4
of which Spain	3.4
Private creditors	1.8

Source: Based on data Banco Central de Bolivia, 2001.

The new loans had the following characteristics:

Table 2–10 Features of loans 1990-1999

USD millions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Loan commitments signed	549	448	420	156	501	677	291	174	468	314
of which: official creditors	542	434	413	156	501	671	281	168	453	301
Disbursements:										
Official creditors (incl. IMF)	331	316	445	369	437	519	497	665	492	428
Private creditors	7	15	0	0	0	6	9	6	15	13
All creditors:										
Interest (per cent)	4.2	4.9	3.1	3.2	3.4	3.8	1.8	4.8	1.7	1.7
Maturity (years)	29.1	29.1	25.2	25.2	28.2	28.7	31.7	20.1	35.1	34.5
Grace period (years)	7.9	7.9	6.5	7.4	7.3	7.7	8.7	5.7	9.6	9.1
Grant element (per cent	47.8	38.8	56.6	51.3	51.2	49.7	63.1	36.2	69.1	69.3

Source: World Bank, 2001.

Disbursements of grants over the period was as follows:

Table 2–11 Grants 1990-1999

Disbursed (USD million)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
multilateral grants	55	52	60	66	57	61	37	25	32	23
bilateral grants	184	220	275	206	216	209	166	273	200	183
of which: the Netherlands	21.1	30.4	18.0	29.9	24.6	43.1	33.2	47	38	36
Total grants disbursed	239	272	336	272	273	270	203	298	232	206
ODA	660	740	674	576	578	692	645	698	628	569
ODA as percentage GNP	14.5	14.7	12.8	10.7	10.5	11.2	8.9	9.1	7.5	7.2

Source: Republic of Bolivia, 1997, Banco Central de Bolivia, 2000.
ODA data from OECD website.

Part of the loans and all grants form part of the ODA flow to Bolivia. The ODA flow to Bolivia contains more elements and is therefore higher.

Sub-national borrowing

The decentralisation transferred not only resources, but also responsibilities from the central level to the municipalities. Some of the larger municipalities became increasingly involved in direct deals with donors (i.e. China) and financiers (mainly suppliers). Up to 2000 both local and international borrowing by municipalities was poorly regulated and barely controlled. Municipal debts are usually short-term obligations to suppliers. Departments (*Prefecturas*) had a debt stock/revenue ratio of 78.4 per cent in 1998 and a debt service/revenue ratio of 10.5 per cent (World Bank, 1999:56). Early in 2001, the central government took a number of administrative measures to control indebtedness by decentralised institutes, *prefecturas* and municipalities.

2.7 Assessment

Bolivia made use of all the opportunities open to it to either reduce its debt stock or its service obligations. It was the first Third World country to clear arrears with the commercial banks. Bolivia managed to wipe out the official debt to private creditors, so that in the early nineties commercial debts had become almost insignificant.

Since Bolivia was an 'early adjuster' and was able to keep a good track record, it became a country which benefited among the first from each new relief initiative. The agreements in the context of the Paris Club have been important, mainly to reschedule servicing obligations. Bolivian authorities considered rescheduling of high importance since it enabled them to match payment obligations with the (unofficial) government policy to service debt only within a certain range. Successful negotiations with Brazil and Argentina took out a substantial amount of bilateral debt obligations.

Various multilateral debt relief instruments were explored, amongst them the Multilateral Debt Fund. Bolivia managed to be recognised as a HIPC country (not withstanding the fact that its debt profile had been declared sustainable in 1995) and moved quickly through both the HIPC-1 and 2 process. Including HIPC 1 and 2, the total (flow) reduction obtained on the bilateral debt has been estimated at USD 1,200 million in nominal terms over the period 1990-99 (Banco Central de Bolivia, 2001), while the total stock reduction in nominal terms during the same decade was USD 226 million (Banco Central de Bolivia, 2001).

In the same period, almost 90 per cent of all new loans contracted were with the international financial institutions.

3 OUTPUTS OF DEBT RELIEF: EFFICIENCY ANALYSIS

3.1 The output of debt relief in terms of flow

Almost all debt relief mechanisms refer only to public and publicly guaranteed (PPG) debt. One of the intended outputs of debt relief is to 'free' liquidity that can be used for alternative purposes. Debt service relief (being either rescheduling or forgiveness on the principal or the interest) contributes to the liquidity available for public budget expenditures during a specific period. Debt stock reductions have a longer lasting effect on the debt service obligations.

The assessment of the efficiency of debt relief in flow terms is complex. This is particularly the case when different relief mechanisms are in force simultaneously. First of all, it is not always clear what the 'debt service due' was supposed to be. For example, in 1996 the interpretation of debt service due was subject to differences of opinion between Bolivia and the Paris Club creditors.

Methods of registration of data vary by source. Remarkable differences exist between data used by the IMF and by the Banco Central de Bolivia. For consistency reasons, the data of the World Bank (Global Development Finance) have been used for the analysis. The debt service due has been computed by adding to the debt service paid (TDS) the total amount of debt rescheduled; the debt service forgiven and the arrears on the debt service[8].

Table 3–1 Debt service (DS) due and paid (USD million)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total arrears	131	37	36	29	53	137	50	81	31	31	21
Debt Service											
Forgiven	785	152	412	66	56	17	82	181	95	14	26
Rescheduled	91	144	128	125	111	0	184	431	300	0	3
Due	1,255	645	843	458	513	474	644	1,056	845	426	439
Paid	248	275	220	224	272	286	291	304	317	347	257
DS due – DS paid	1,007	370	622	235	241	188	353	751	527	78	181

Source: Based on World Bank, 2001.

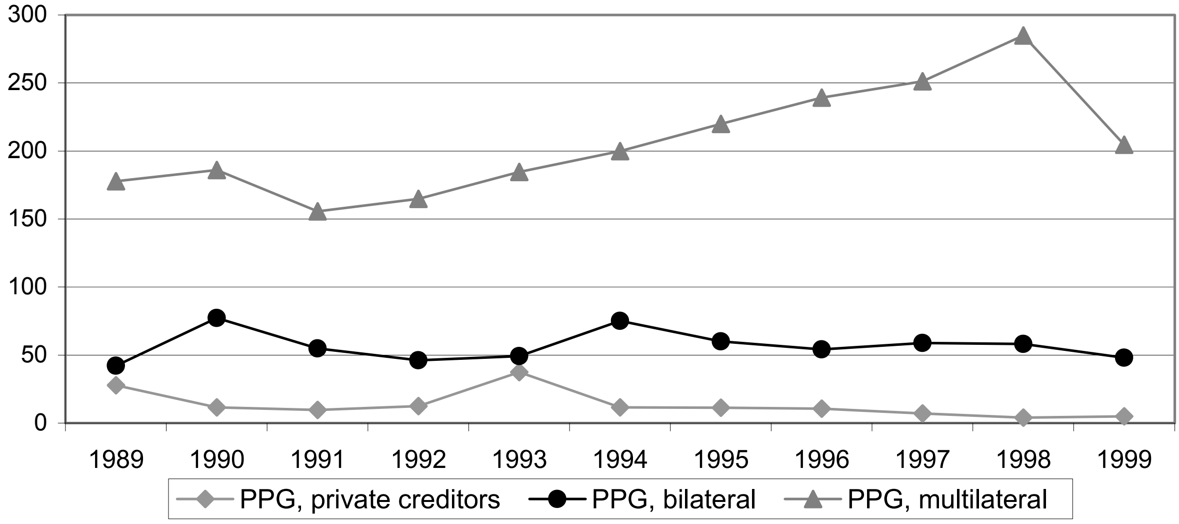
Bolivia always serviced its multilateral debt and never ran into serious arrears. After 1993, the commercial debt was almost eliminated. The Bolivian Ministry of Finance opted for a (non-official) strategy of rescheduling that would enable Bolivia to restrict its payment obligations to a 'range' of USD 250 to 350 million per year. The Paris Club restructuring mechanisms have been useful to achieve this 'spread' of servicing obligations.

As shown in the following Figure 3–1, most debt service paid is multilateral debt. The multilateral debt service is increasing. According to the Banco Central de Bolivia all arrears have been cleared since 1996, so since then the restructuring became useful for

[8] The methodological soundness depends on how rescheduling and forgiveness are being registered. Two methods can be distinguished: registration in the year of rescheduling or forgiveness (so the total sum of all future payments are registered in year X), or by registration of the effect in each of the future years (when debt service was supposed to be paid). The Global Development Finance tables used here, apply the first method.

current servicing obligations only. However, according to the World Bank data, arrears still exist (Table 3–2)[9].

Figure 3–1 PPG Debt service paid by type of credit (USD million)



Source: World Bank, 2001

Table 3–2 Arrears on LDOD (USD million)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Interest arrears	49.9	6.3	14.8	10.8	13.8	34.1	20.3	25.7	3.5	3.1	2.6
Principal arrears	81.5	30.8	21.5	18.1	39.3	102.7	30	55.5	27.7	28	18
Total arrears	131.4	37.1	36.3	28.9	53.1	136.8	50.3	81.2	31.2	31.1	20.6

Source: World Bank, 2001.

Debt relief is supposed to have a direct effect on the (de-) accumulation of arrears. In the case of Bolivia, however, this inverse relation is not crystal clear, as shown in Figure 3–2.

Table 3–3 Arrears and debt relief (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Accumulation of arrears	-94.3	-0.8	-7.4	24.2	83.7	-86.5	30.9	-50	-0.1	-10.5
Deft relief *	256	552	205	341	17	260	614	384	15	128

* Debt relief = rescheduling and forgiveness of interest and principal.

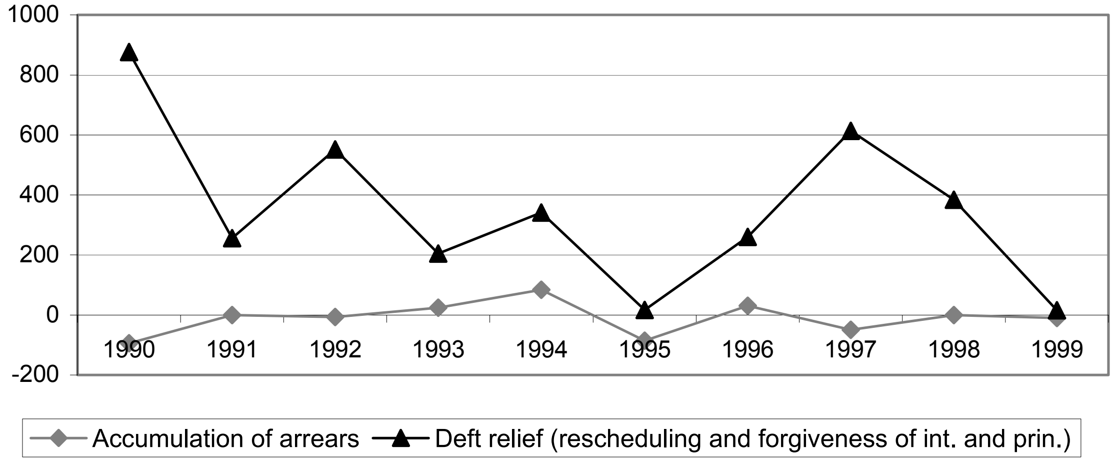
Source: World Bank, 2001.

Total debt relief is under-reported, since part of the donor contributions are included in the Debt Service paid data (i.e. direct payments by donors on behalf of Bolivia, as well as contributions to the Multilateral Debt Fund). This also applies to the Netherlands'

[9] The origin of the difference is the interpretation of the 'swap' of claims between Argentina and Bolivia.

contributions. In terms of annual liquidity, the contributions (1995, 1996,1997,1999) are recorded as 'debt service paid'.

Figure 3–2 Debt Relief and Arrears Accumulation (USD million)



Source: Based on World Bank, 2001. Note: Debt relief: year-1.

Figure 3–2 suggests that debt relief has hardly been used for clearance of arrears. Forgiveness and rescheduling of debt service due enabled the Ministry of Finance to comply with its current debt service obligations and helped relieve a real burden. Most likely, debt forgiveness and rescheduling relieved a debt that would otherwise have had to be paid.

3.2 The output of debt relief in terms of stock

Debt stock reduction and conversions took place as a result of the conversion of commercial debt, including buybacks, the Paris Club arrangements and the HIPC Initiative.

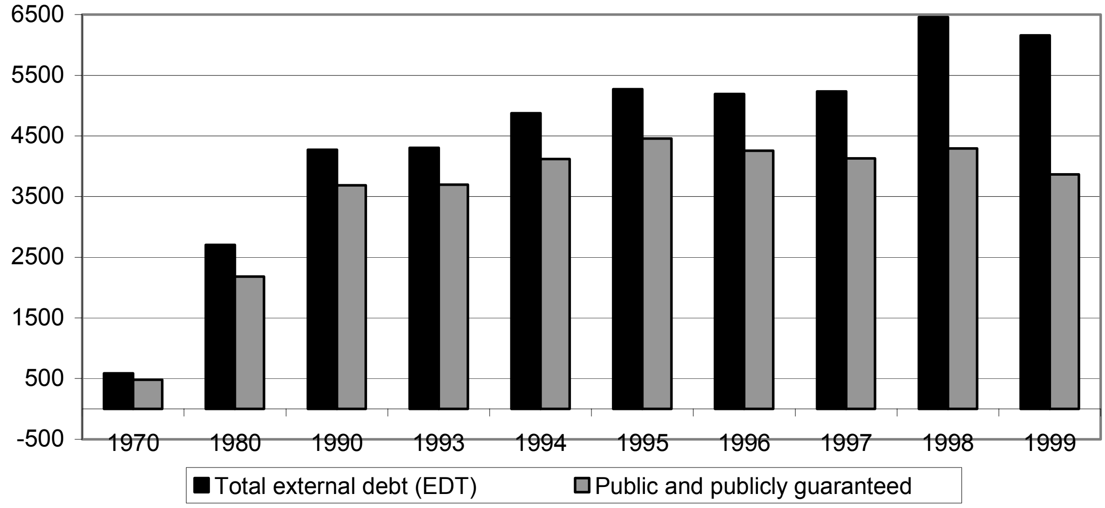
Table 3–4 Debt stock reduction (USD million)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt forgiveness or reduction	849	108	420	77	198	17	74	181	83	14	128
Debt stock reduction	169	20	19	20	171	0	0	0	0	0	102
Debt stock rescheduled	0	0	8	0	0	0	10	0	0	0	532
Debt buyback	16	4	2	2	27	0	0	0	0	0	0

Source: World Bank, 2001.

These reductions affected the composition of the total debt stock. Although the total debt stock continued to increase over the decade, the public and publicly guaranteed part of it reduced (see Figure 3–3).

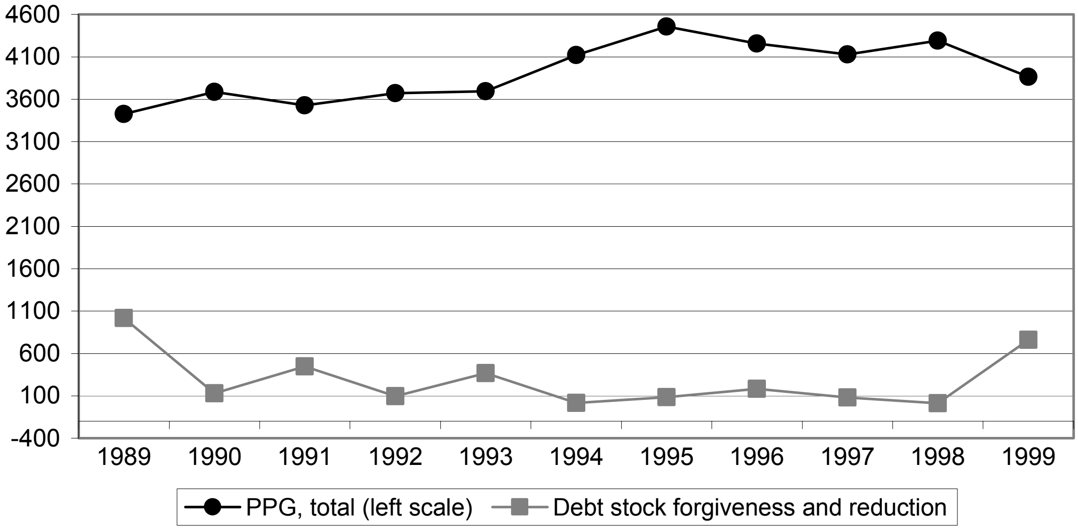
Figure 3–3 Total and public stock of debt (USD million)



Source: Based on World Bank, 2001.

Plotting the total PPG debt against the sum of debt stock forgiveness and reduction shows a clear inverse relation (Figure 3–4).

Figure 3–4 PPG total and debt stock forgiveness and reduction (USD million)



Source: Based on World Bank, 2001.

While the official debt to private creditors was almost eliminated after 1993, and the bilateral debt was reduced as well, the relative weight of the multilateral debt increased substantially, as shown in graph 3.5. Over the decade, the public and publicly guaranteed stock of debt decreased and came below the USD 4 billion line.

The debt forgiveness expressed as percentage of the total PPG debt stock indicates that on (arithmetic) average, the relief coincided to a 5.5 per cent decrease in stock per year.

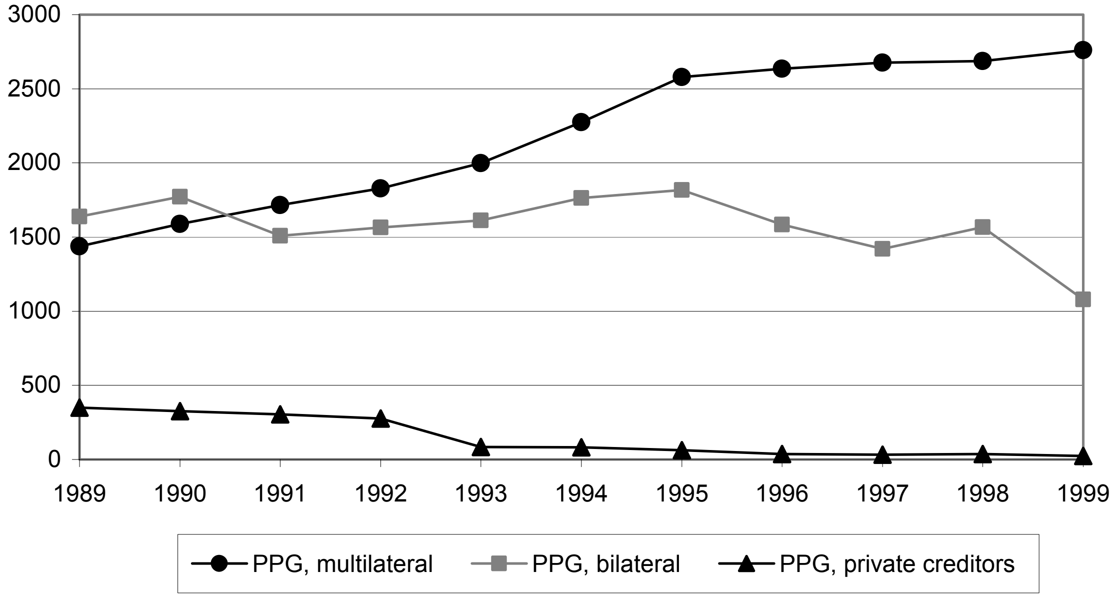
Table 3–5 Stock Effect of Debt Relief

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
PPG, total	3,687	3,530	3,669	3,695	4,122	4,458	4,256	4,129	4,292	3,864
Debt forgiveness	112.4	422.0	79.7	225.3	16.8	73.7	181.4	82.8	14.5	127.7
Forgiveness / PPG debt (per cent)	3.05	11.96	2.17	6.10	0.41	1.65	4.26	2.00	0.34	3.30

Source: Based on World Bank, 2001.

Apart from the decrease in stock, the composition of the debt stock changed as well as a result of the relief.

Figure 3–5 Composition stock of PPG Debt 1990 – 1999 by type



Source: World Bank, 2001.

Between the start of the HIPC Initiative and the end of the decade (31 Dec. 1999) the medium and long-term external public debt in NPV evolved as shown in Table 3–6. The total PPG debt decreased between 1996 and 1999 both in nominal and in NPV terms. The multilateral component increased in nominal, but not in NPV terms.

Table 3–6: Net Present Value of public debt stock end 1999 (USD million)

Creditor	1996		1999	
	nominal	NPV	nominal	NPV
International Monetary Fund	276	215	247	169
Multilateral	2,736	1,936	2,827	1,726
World Bank	913	402	1,106	480
Interamerican Development Bank	1,427	1,146	1,397	986
Corporación Andina de Fomento	278	289	209	219
Others	118	99	115	81
Bilateral	1,615	1,182	1,473	868
Japan			587	299
Germany			356	198
Spain			129	102
Others			401	275
Private creditors	11	11	27	27
Total	4,639	3,344	4,574	2,790

Sources: Banco Central de Bolivia, 2001; IMF and IDA, 1997: table 11.

The relative share of the multilateral debt increased. Also the internal composition of the multilateral debt changed, showing an increasing share of loans from IDA and a decreasing share of less concessional credits (CAF, IFAD). During the period 1990-1997 credits from multilateral sources increased by on average USD 250-300 million a year, with a slowdown after 1997. Table 3–7 presents the composition of the multilateral debt per year[10].

Table 3–7 Composition multilateral debt (USD million)

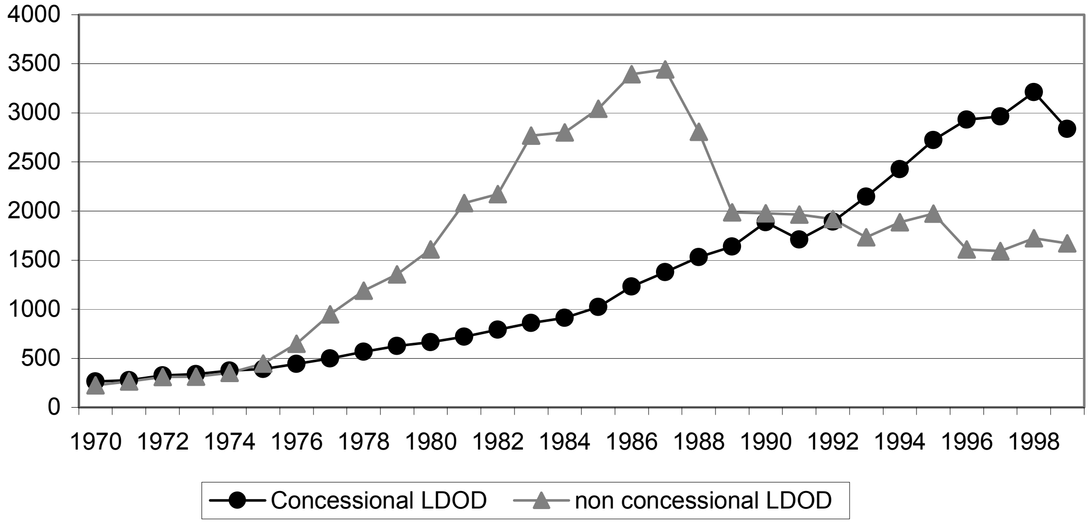
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
IDB	824	947	1,020	1,134	1,219	1,346	1,444	1,407	1381	1397	1394
IDA	325	393	443	482	542	652	767	790	930	1,045	1,097
IBRD	199	194	172	146	129	116	98	76	37	26	13
CAF	95	113	135	122	127	171	258	274	247	198	209
Other	82	58	70	74	87	95	112	113	114	112	115

Source: Based on Banco Central de Bolivia, 2000.

Since both IDA and IDB (in part) provide soft loans, the overall concessionality of the debt portfolio improved over time. By the end of the decade, approximately 65 per cent of the medium and long-term public debt could be considered concessional.

[10] Some differences as compared to table 3.5.

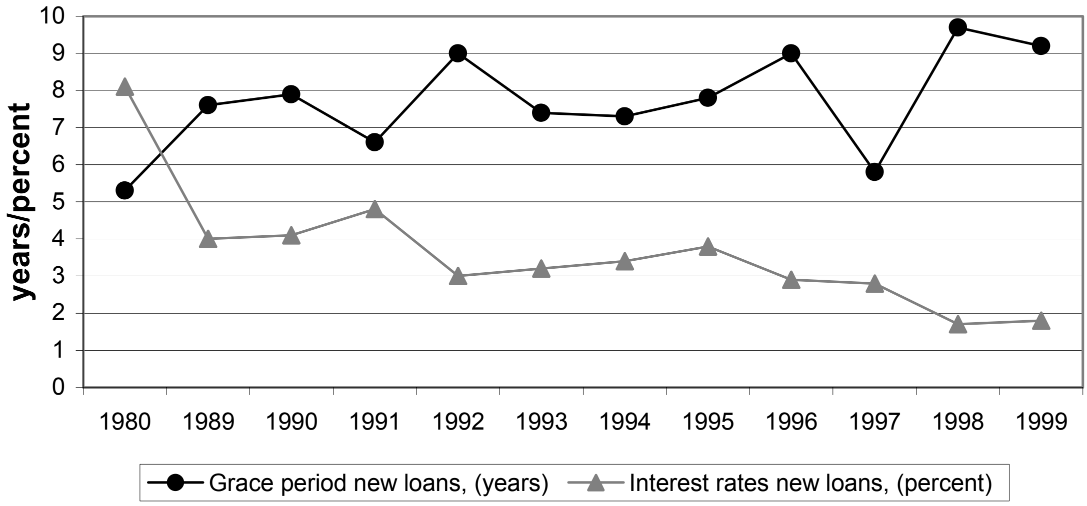
Figure 3–6 Concessionality



Source: World Bank, 2001.

The average grace period is influenced by both the new concessional loans with longer grace periods and the restructuring of existing loans, mainly through Paris Club agreements. The combined effect is that the average grace period of the total portfolio has increased. The World Bank data represent the conditions for new loans only, but the trends resulting from new loans on average grace periods and interest rates can be appreciated in Figure 3–7:

Figure 3–7 Average grace period and interest rates on new loans



Source: Based on World Bank, 2001.

The change in the composition of Bolivia's external debt is not uncommon to developing countries. Mistry (1994) indicated that as a result of the reduction in the commercial and official bilateral loans, the lack of access to private sector creditors, and the favourable lending conditions of the multilateral financiers, countries have little other options than to contract multilateral loans.

The contracting of new loans is also ‘pushed’[11] by the conditionalities of both relief and reform programmes. Additional resources are required for the funding of components of the reform programmes, such as public service reforms, safety nets and the pension fund system. As a result, the stock of debt may increase, but the corresponding debt service may decrease simultaneously.

3.3 Extent to which resources were freed

The extent to which resources became available to the government for alternative use can be derived in part from Table 3–1. In addition, bilateral donors took care of some multilateral debt service on behalf of Bolivia.

At the start of the decade, resources ‘freed’ were almost as important as the influx of grants (excluding technical assistance) and disbursements on new loans. In the second part of the decade, the relative importance of the debt relief mechanism diminished as compared to the inflow of new resources, as shown in table 3.8.

Table 3–8 External resources to the public sector (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt Service paid	-275	-220	-224	-272	-286	-291	-304	-317	-347	-257
Debt service forgiveness	152	412	66	56	17	82	181	95	14	26
Grants	239	271	325	272	273	209	202	298	232	206
New public loans	337	331	445	369	437	525	507	671	507	441
External resources to public sector	453	794	612	425	441	525	586	747	406	416

Source: Tables 3–1, 2–10, 2–11.

The increase in loans in the period 1995-1997 was the result of the start of the decentralisation programme, the educational reform programme and the start of the restructuring of the pension system.

3.4 Compliance with debt relief conditionality

Although Bolivia followed a deliberate step by step approach in reducing its external debt, it lacked a real ‘strategy’ on indebtedness. From 1993/94 onwards, government stressed the importance of external support in the context of its macroeconomic policy ('policy lending') as well as in support of specific sector policies. Bolivia introduced integrated long-term planning mechanisms and financial programming techniques (like the Comprehensive Development Framework and the Medium Term Expenditure Framework) at an early stage. Donor support, including debt relief, was supposed to match those frameworks.

Regarding specific conditionalities, the Multilateral Debt Fund operated with a system comparable to countervalue funds. Whenever donors made resources available for multilateral debt service, the local resources 'saved' should be used for projects and programmes that lacked the necessary financial means otherwise. Government co-ordinated with the donors the earmarking, while donors monitored progress on these

[11] The push factor is also implicit in the portfolio management of the International Financial Institutions. The IDB had ‘ allocated’ USD 540 million to Bolivia for a three year period (1994-1996), of which USD 440 million were concessional loans, while the World Bank has a continuous credit portfolio of USD 80-100 million a year.

projects. The Public Expenditure Review 1999, in which bilateral donors participated, concluded that these investments could be considered as additional.

The Bolivian Ministry of Finance recognises the fungibility of the contributions to debt relief, but is of the opinion that the direct involvement of donors through the MDF played a key role in directing public expenditure towards the social sectors[12].

A general condition for Paris Club agreements and HIPC is that the country should have an ongoing programme with the IMF. Since 1985, this has always been the case in Bolivia. At the start of the HIPC-1, government declared that the benefits reaped from the HIPC would be used directly for poverty reduction. This implied –for the first time- a direct explicit link between debt relief and poverty alleviation. Bolivia elaborated policy commitments accompanied by verifiable indicators in terms of improved quality and coverage of health services, education, rural development and other poverty alleviation activities (1997). Of the 19 indicators used, 17 were met in 1998, while 100 per cent was achieved in 1999 (República de Bolivia, 2001:25).

The elaboration of a Poverty Reduction Strategy Paper (PRSP) was a major condition under HIPC-2. Although the IMF-World Bank Joint Staff Assessment considered the PRSP a coherent policy, it observed the risks related to the government's limited implementation capacity. One of the risks identified was that the expected economic growth has to come from the capital-intensive hydrocarbon sector, which hardly generates employment. The economy is still considered to remain vulnerable to external shocks, while social unrest and disruptions of the economy may jeopardise the programme (IMF-IDA, 2001b: 11).

The bilateral donors also assessed the PRSP and considered the economic growth path unrealistic; the decentralisation process too slow and the employment generation not explicit enough. Serious doubts were expressed with respect to the institutional capacity to implement the PRSP (Ministry of Foreign Affairs files).

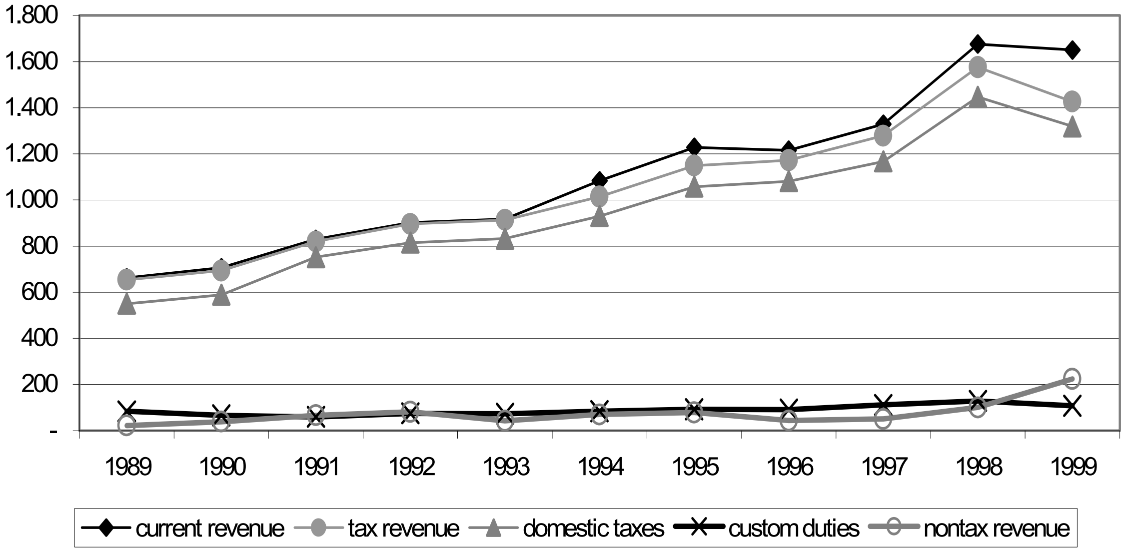
3.5 Effect of debt relief on the public accounts

All debt relief mechanisms refer to the public and publicly guaranteed debt only. The expected marginal effect of debt relief is that it increases the amount of resources available to the public (fiscal) accounts. This assumes that relief has not been used to either reduce or freeze fiscal revenues and/or that any fiscal deficits have been reduced. Only if and when the resources that might have become available as a result of debt relief were used to expand public sector expenditures (investments or recurrent), in particular in the social sector, a relation between debt relief and poverty reduction could be assumed.

A first condition is that fiscal revenues have not been frozen or reduced. In Bolivia, the revenues show an increasing trend over time. The decline at the end of the decade reflects the economic crisis, not a reduction as a result of changes in policy.

[12] Interview Budget Department, Ministry of Finance, September 2001.

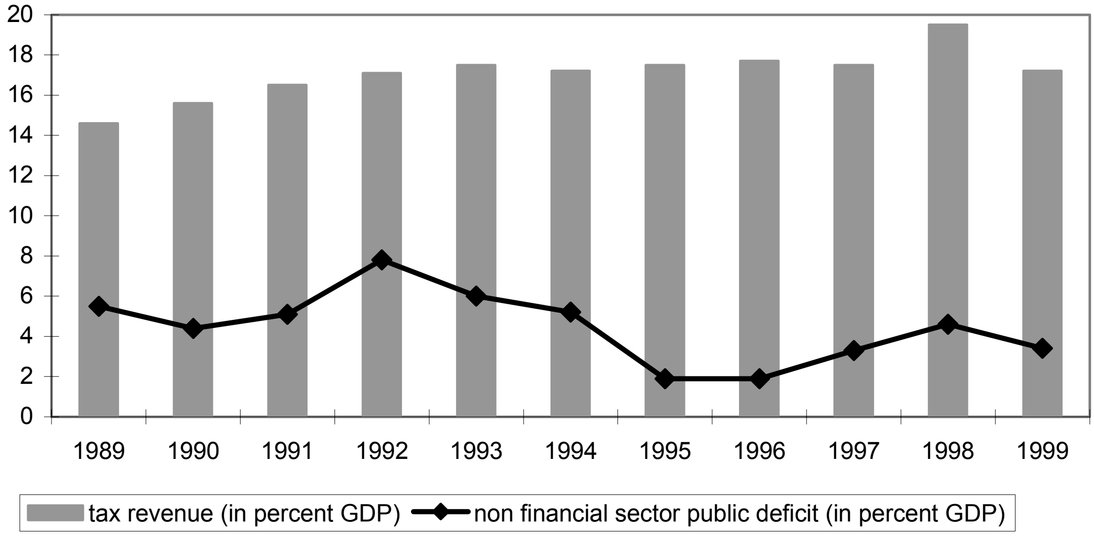
Figure 3–8 Revenues to Central Administration (USD million)



Sources: based on: IMF, 1994b: table 30 and 2001b: table 23.

While tax revenues oscillated between 15 and 17 per cent of GDP, the fiscal deficit decreased to less than 5 per cent.

Figure 3–9 Tax revenue and fiscal deficit (percentage of GDP)



Sources: based on: IMF, 1994b: table 30 and 2001b: tables 3 and 23.

After 1995, the restructuring of the Pension Funds influenced the public sector deficit. Excluding that restructuring the deficit would have been lower by 1-2 per cent of GDP (IMF, 2000). The IMF calculated the impact of HIPC (see table 3.10) to be 0.3 percentage point reduction in the fiscal deficit (IMF, 2001a:11). IMF stated that Bolivia's direct taxes couldn't be increased without affecting local demand (IMF, 2001a:11).

According to the IMF, debt relief has contributed to the reduction of the fiscal deficit, or at least made the restructuring of the Pension Funds possible without increasing the public sector deficit. So not all debt relief has been translated into an expansion of financial means for (social) investments.

The national budget

Bolivia enjoys strong support from the international financing community for the implementation of its public sector investment programme. Between 40 per cent (1997) and 60 per cent (1993) of the public sector investment programme (capital account) is funded externally. Between 20 and 25 per cent of the external financing consists of grants, the remainder is loans (República de Bolivia, 2001: table 2.1).

Table 3–9 presents Central government expenditure as percentage of GDP, as well as the poverty related components thereof (expressed as percentages of total capital budget).

Table 3–9 Central Government expenditure in percentage of GDP and poverty related expenditures as percentage of total

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total expenditure	21.0	22.1	23.1	24.5	24.1	21.9	22.0	24.3	24.6	25.1
Of which: Current expenditure	17.7	18.9	18.7	19.8	19.3.1	17.9	18.6	21.3	21.9	21.5
Interest	3.5	3.6	2.9	2.4	2.4	2.8	2.6	1.9	1.1	1.0
Capital expenditure	3.3	3.2	4.4	4.7	4.9	3.6	3.4	2.9	2.8	3.6
Social expenditure / total expenditure (%)	29.2	27.7	28.5	31.0	29.6	30.8	34.7	35.1	32.3	35.7
Poverty related expenditure / total expenditure (%)						32.9	35.5	35.6	34.7	36.5

Source: IMF, 1994b, 2000, 2001a.

In 1998 the sectoral distribution of the national budget was abandoned and replaced by a municipal distribution. The data on public expenditure by sector have become less clear, because the municipalities became responsible for the recurrent expenditures in the social sectors; as well as for small investments. So the expenditures for a particular sector are equal to the sum of all municipal expenditures in that sector plus the national, central expenditure (see Table 3–10).

Over the decade, the total Central Government expenditure remained more or less unaltered in terms of percentage of GDP, while expenditure in social sectors increased. Capital expenditures in education increased as a result of investments through the Social Investment Fund and the Educational Reform.

It is hard to claim any correlation with debt relief[13]. Since the capital budget is funded for approximately half by external funds, one would have expected a link (if any) between debt relief and the current expenditure.

[13] Donors stress the importance of performance indicators, just because 'single bullet' cause-effect mechanism can not be determined easily.

Table 3–10 Central Government Expenditures in the Social Sectors

	1992	1993	1994	1995	1996	1997	1998	1999
In percentage of GDP								
Total CG expenditure	23.1	24.5	24.1	21.9	22.0	24.3	24.6	25.1
Total expenditure in social sectors	6.9	7.7	7.5	7.5	8.5	9.3	9.3	9.5
Of which: Education	4.1	4.9	5.1	5.2	5.4	5.2		
Health	2.2	2.2	1.8	1.7	1.8	2.3		
Basic Sanitation	0.6	0.6	0.6	0.7	0.8	0.7		
In percentage of total social expenditure								
Education current expenditure	57.9	61.4	65.0	61.9	55.5	49.3		
Education capital expenditure	2.1	1.7	3.3	7.2	8.5	7.2		
Education total	59.9	63.2	68.3	69.1	64.0	56.5	55.0	58.3
Heath current expenditure	26.1	24.1	18.7	16.8	15.7	15.2		
Health capital expenditure	5.9	5.1	5.3	5.1	5.3	5.3		
Health Total	32.0	29.1	24.0	21.9	21.0	23.5	22.8	24.6
Basic sanitation total	8.1	7.7	7.7	8.9	9.5	7.9		

Source: Based on IMF, 1997b: table 7 and 2001b; World Bank, 1999.

Since the overall investment programme is co-ordinated by the Government of Bolivia with the international donor community, the outcome may be considered as the combined result of direct support and debt relief.

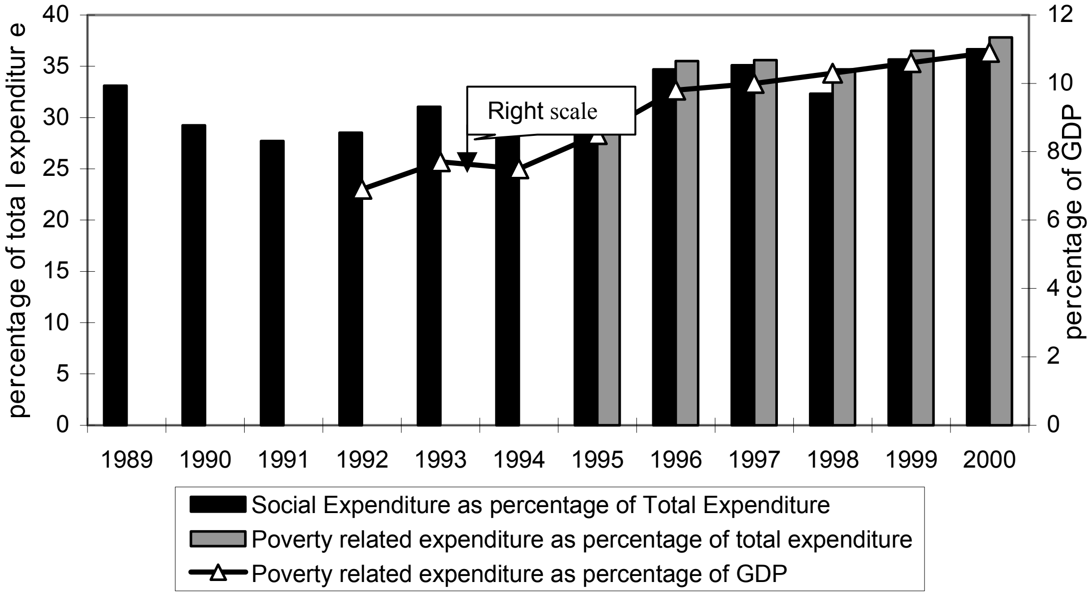
3.5.1 Debt Relief and Public Expenditures on Poverty Reduction

Although public expenditures in the social sectors increased, this is not necessarily the result of a deliberate policy. It is also the implicit effect of less public spending in the public and parastatal enterprises as a result of the privatisation and capitalisation process (Republic of Bolivia, 1997)

Figure 3–10 presents Bolivia's expenditures (both investment and recurrent) in the social sectors and on poverty reduction. Since 1995, Bolivia records systematically its 'poverty reduction expenditures' (data 1992-95 have been ex-post calculations, Republic of Bolivia, 2001). Poverty reduction expenditures are not equal to expenditures in the social sector, since they comprise also -for example- the provision of public utilities in marginal urban areas.

In the context of HIPC – 2, the Government of Bolivia agreed with the creditors that all 'revenues' -that means all resources freed- as a result of HIPC-2 would be transferred to the Municipalities for investments in –mainly- the social sectors. A distribution key has been developed, whereby the 'poorest' municipalities will receive –on a per capita base- five times as much as the wealthiest. Although the front-loading concentrates 81.2 per cent during the first 15 years, the period covered is 40 years.

Figure 3–10 Poverty related public expenditures



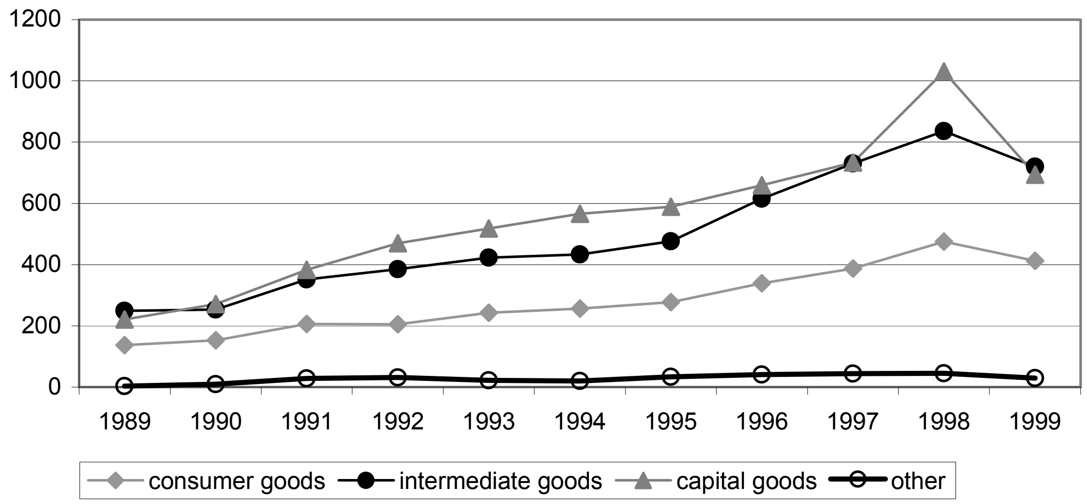
Sources: IMF 1994b: table 22; IMF 1997: table 7; IMF 2001b: table 10. Republic of Bolivia, 1997.

3.6 The effect of debt relief on the Balance of Payments

In general, it is assumed that debt relief makes resources available to the economy that can be used for productive investment. If that were the case, then imports should increase, in particular of intermediate and capital goods.

Figure 3–11 indicated that imports of intermediate and capital good indeed have increased. However, at first sight the link with debt relief is not straightforward. The sharpest increase in imports (1996-98) is mostly explained by the construction of the pipelines for hydrocarbon exports.

Figure 3–11 Imports by category (USD million)



Sources: IMF 1994b, IMF 1987b and IMF 2001b.

Use has been made of the data for the balance of payments as provided by the International Monetary Fund (1994b, 1996b, 2001). Comparison of the balance of payments data over time is risky. One of the components of the public budget management reform was the modernisation of the system of national accounts (1996). In addition, the system of registering debt and debt relief in both the fiscal account and the balance of payments has been modified in 1999.The balance of payments is presented in Table 3–11.

3.7 Assessment of efficiency

Since the early 1990s the subsequent governments of Bolivia pursued – unofficially – a policy of restricting the service of external debt to a range of USD 250 - 300 million per year. At that level, government would be able to finance simultaneously half of its capital budget. In practice, Bolivia always serviced its multilateral debt, while only a small amount of commercial debt was left. Debt relief enabled Bolivia to pay its current service obligations and made resources available for alternative use.

Bolivia was always among the first countries that benefited from various modalities of relief. Most debt forgiveness and rescheduling relieved a debt that would have had to be paid otherwise. The total PPG debt service continued to increase until HIPC relief became effective. It would have been more without debt relief.

The efficiency of debt relief in terms of stock is ex[ressed in an average decrease of 5.5 per cent in PPG debt per year, mainly as a result of the buyback and conversion of commercial debt, the Paris Club exit agreement and the HIPC-1.

At the start of the decade, the public external debt represented 86.3 per cent of the total external debt, at the end it had decreased to 61.8 per cent.

The Net Present Value of Bolivia's external public debt will be reduced by 35 per cent as a result of the combined original and enhanced HIPC Initiatives. That is on top of the 17 per cent debt reduction that was already achieved under traditional debt relief mechanisms (IMF Press release, 2001).

Debt relief changed the composition of the debt stock. The debt stock has now a large share of multilateral debt. While bilateral donors contributed to reduce the external debt, IDB and IDA showed little prudence in issuing new loans.

Debt relief has contributed to reduce the fiscal deficit, or at least made the restructuring of the Pension Funds possible without increasing the public sector deficit.

Table 3–11 Balance of payments

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Current account	**-196**	**-255**	**-395**	**-430**	**-218**	**-335**	**-333**	**-553**	**-667**	**-488**
Trade balance	-117	-192	-452	-496	-309	-334	-404	-684	-879	-704
Exports fob	845	776	638	710	970	1,042	1132	1167	1104	1051
Imports cif	-962	-969	-1,090	-1,206	-1,279	-1,376	-1536	-1851	-1983	-1755
of which: from capitalisation						-5	-201	-239		
Services	-12	-3					-14	36	34	26
Factor income (net)	-241	-242	-193	-205	-188	-221	-164	-196	-162	-196
of which: interest due							-154	-155	-144	-126
Official transfers	175	182	237	258	278	220	230	187	209	242
of which: HIPC assistance from grants									11	62
Other			13	13			20	104	132	144
Capital account	**164**	**158**	**264**	**300**	**208**	**257**	**674**	**656**	**792**	**515**
Capital transfers			0	0	0	11	40	25	10	0
Direct investment	35	50	86	122	58	138	426	876	955	1014
of which: capitalisation						5	200	570	638	506
Portfolio investment							0	-53	-75	-61
Public sector loans (due before relief)	101	78	152	90	125	79	248	205	104	113
. disbursements	335	300	384	319	360	379	397	371	320	280
. amortisation	-234	-222	-233	-229	-235	-301	-149	-166	-216	-167
. of which: amortisation due by public enterprises				0	0	0	0	-20	-59	-20
Private sector loans (net)				129	26	29	9	92	125	-30
Other	28	30	26				23	-83	-13	-284
Errors and omissions				-41			-73	-407	-314	-237
Overall Balance	-32	-97	-131	-130	-10	-78	341	103	125	27
Exceptional financing	131	187	162	269	134	202			3	16
Agreed debt relief				140	118	202				
Change in arrears				40	-6					
Exceptional Argentina				89	21					
HIPC assistance							0	0	3	16
Change net international reserves	-99	-90	-31	-139	-123	-123	-342	-103	-128	-42
Memorandum items										
Gross reserves (end of period)				495	658	737	1,138			
In months of next year's imports				4.7	5.7	5.6	7.8			
Unpaid debt service (public sector)			173	140	118	202	0	0	0	0
Stock of debt relief			0	0	0	130				
Interest relief						33				
Amortisation relief						97				
Total assistance HIPC									27	85

4 OUTCOMES OF DEBT RELIEF: EFFECTIVENESS

In Chapter 1, the economic trends were described up to the start of the 1990s. This Chapter deals with the trends during the decade.

4.1 Economic trends during the period 1990–1999

The second period of structural adjustment 1991–1995
At the start of the decade, the consolidation of the stabilisation efforts was the main policy effort, accompanied by the Social Strategy (1991), that started to focus on investment in human capital parallel to the 'modification of the economic productive structure'. Activities to modify the economic structure were:

- the capitalisation and privatisation of public enterprises (see Box 4–1);
- the reform of the financial system, including the strengthening of the Banco Central de Bolivia, the *Superintendencia de Entidades Financieras*, and insurance companies. Small credit lines aimed at micro and small enterprises were initiated;
- the modernisation of the state comprised the restructuring of the ministerial organisation and the decentralisation of administration by means of the *Ley de Participación Popular*.
-

Box 4–1 Privatisation and capitalisation
Privatisation of state enterprises is different from the Bolivian concept of 'capitalisation'. Privatisation implies that a state enterprise is either being sold to the private sector or made independent from the public sector otherwise (i.e. by handing it over to the workers). In the case companies are sold, the proceeds flow into the Treasury coffers. Capitalisation attracts private investments in public enterprises. In exchange, the private investor receives shares in the company. In the Bolivia model, the (maximum 50 per cent) state owned shares were handed over to the Pension Fund as component of its capitalisation process. The Pension Fund is entitled to trade these shares. Capitalisation does not generate revenues for the Treasury. In consequence, contrary to countries with a traditional privatisation programme, the Bolivian public sector lacked a financial resource influx from the 'privatisation' of the enterprises

The People's Participation Law (1994) was an instrument to decentralise the public sector while facilitating the co-ordination among indigenous communities, *campesino* (smallholder) communities, peripheral urban areas and public entities. Initially twenty per cent, later over thirty pe rcent of the national fiscal revenues were redistributed (on a per capita base) over the municipalities.

The Social Strategy comprised investments in primary health care and education (the Social Investment Fund –FIS; the Regional Development Fund - FDR and the educational reform programme). Special attention was paid to the most vulnerable social groups (identified as the population dependent on traditional agriculture, in particular women; the informal urban population; children; and the elderly).

The third period of reforms: 1994 to 1997/8
With the 1994 ESAF agreement, adjustment programmes went beyond the limits of finance and economics and dealt with processes of democratisation, legislation and administrative reform (IMF, 1994a). The implementation of the pension reform had

started; administrative decentralisation was fostered and good governance (civil service reform, administrative legislation) was pursued. The national budgeting system was overhauled by delegating substantial components of the national budget to the local governments.

Economic performance was stable with an average GDP growth rate of 4 per cent per year. Net reserves increased, while public sector deficits diminished. Capitalisation went slower than expected. Problems were experienced in the national oil company. The restructuring of the pension fund progressed slowly and required sizeable financial input, substantially more than initially expected.

The fourth period: since 1997

The World Bank poverty analysis (World Bank, 1996a) questioned the achievements of structural adjustment and stressed the importance of poverty reduction and institutional reforms.

The government of ex-general Hugo Banzer (1997-2001) launched a series of consultations with the private sector and civil society, the so-called ‘National Dialogue’. This Dialogue matched the instruments promoted by the IFI’s, such as the Comprehensive Development Framework and the Poverty Reduction Strategy. The National Dialogue was revitalised as the participatory system for the elaboration of the Poverty Reduction Strategy Paper (PRSP).

The institutional reforms comprised a judicial reform (Judicial Council, Supreme Court) and the reform of the public administration.

Economic situation at the end of the decade

External shocks and sluggish domestic demand resulted in the stagnation of the economy in 1999, when real GDP growth fell to 0.4 per cent. A sharp decline of the Brazilian *real* and falling commodity prices led to a decrease in exports. In 2000, the recovery remained below expectations and reached a level of 2.4 per cent growth of real GDP. The fiscal deficit widened to 3.7 per cent of GDP due to a tax revenue shortfall and emergency spending (social unrest). The external account deficit narrowed to 5.5 per cent of GDP as exports staged a recovery, led by natural gas and soybeans.

Thanks to privatisation and capitalisation, the public enterprises’ share in GDP diminished from 25 per cent in 1995 to 8 per cent in 1998 (World Bank, 1999: i). Foreign investment was characterised as ‘a boom’ in 1997/98 (FDI up to 10.2 per cent of GDP) (World Bank, 1999:iii) but dropped in 2000 (investments required in the capitalisation process and the construction of pipelines). Domestic revenue collection increased from 15.3 per cent in 1990 to 19 per cent in 1998. Inflation declined to 3.1 per cent, the lowest annual rate achieved over 30 years (2000).

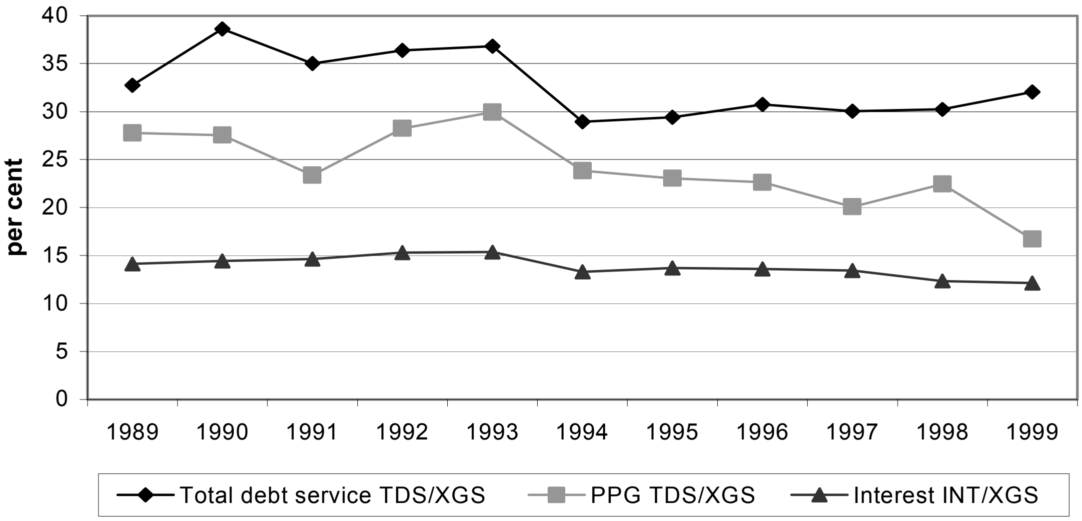
By the end of the decade the decreasing tin, zinc and silver prices hit the already fragile mining industry, while the agricultural sector faced price drops for the main export commodities. The introduction of non-tariff barriers by the European Union and US wiped out the export of Brazil nut, once the only promising export commodity from the tropical lowlands.

The government’s success in eradicating coca production and in controlling contraband hit the parallel economy. Deprived of their sources of income, poorer strata caused social unrest, with a negative impact on the economy in the order of 3.5 – 4.0 per cent of GDP (IMF, 2001b and 2001c:1).

The IMF considered the weakening of the private banks' performance (rise in non performing loans since 1999) a symptom of the economic slowdown. The public sector was lured into sizeable un-budgeted spending in order to stem social unrest, while donors applied pressure to make the first steps with the implementation of the PRSP (2000-01). Only a few months after the Ifs Board endorsement of the PRSP, the IMF concluded that the underlying assumptions (GDP growth, export growth, availability of external financing) had all been too optimistic (IMF, 2001c:4).

4.2 Debt sustainability
Sustainability of debt is defined arbitrarily. At the start of the decade, a debt service/export ratio of 25 per cent was considered sustainable. In 1997, the range for sustainability was supposed to be 20-25 per cent (HIPC-1 criterion) and in 1999 15-20 per cent (HIPC-2 criterion). Bolivia's public debt service to export ratio was well above 25 per cent until 1994, between 20 and 25 per cent until the HIPC-1 Completion Point and dropped to the 15-20 per cent range afterwards.

Figure 4–1 Debt service to export ratios



Source: Based on World Bank, 2001.

Until 1995/1996, the 80 per cent threshold for the debt stock/GNP ratio was considered sustainable (World Bank, 1991), but since then other criteria are used based on the NPV debt stock. After the exit agreement and according to the 1995 criteria, Bolivia's debt could be considered as sustainable (IMF, 1995). A change in the international yardsticks made Bolivia's eligible for first HIPC-1 and later, once more, for HIPC-2.

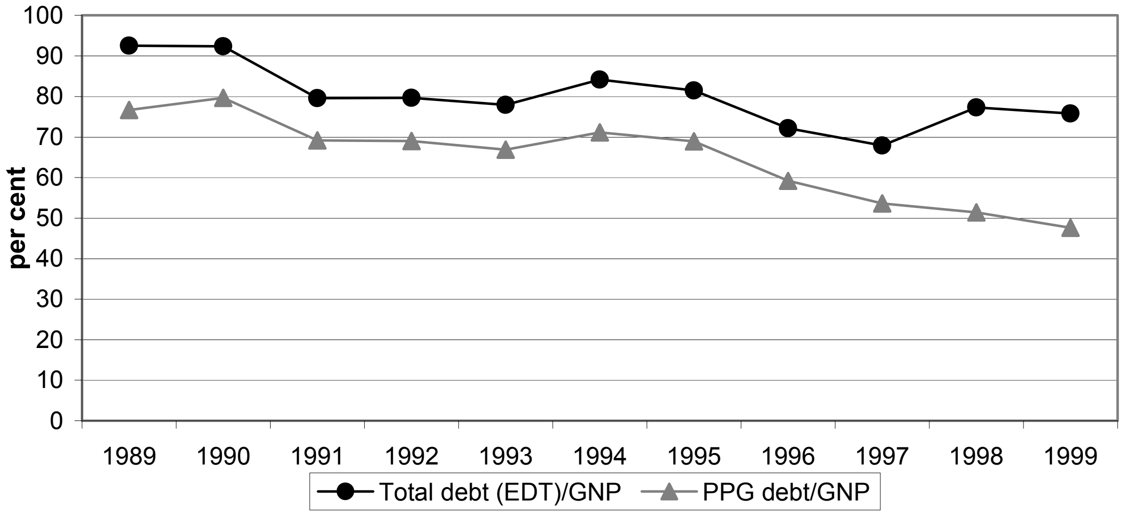
Making use of the NPV stock-of-debt data of the Banco Central de Bolivia for 1996 and 1999, the NPV of debt / export ratios were as follows:

	1996	**1999**
NPV stock of debt (USD million)	3,344	2,790
Exports (USD million)	1,344	1,542
NPV stock of debt/exports (%)	248	181
HIPC criterion (%)	200-250	150

In 1999, Bolivia's debt was not sustainable in terms of NPV stock of debt/exports according to the HIPC-2 criterion. The irrevocable debt relief leading to that sustainability level was made available in 2001.

For the decision making by the Paris Club (1995 exit agreement), the NPV debt stock/export ratio was set at 250-280 per cent. After the 'exit', the Banco Central de Bolivia calculated its NPV debt/exports ratio to be 270.2 per cent (IMF, 1997b: table 2). In order to reach a debt-export ratio of 225 per cent, the total relief under HIPC-1 required was USD 783 million (USD 1,137 million in nominal terms) over 40 years. With HIPC-2, the NPV debt-export ratio target was adjusted downwards to 150 per cent. In order to achieve that level, it was expected that the Enhanced Initiative would require USD 854 million in NPV terms (USD 1.2 billion in nominal terms) (IDA, 2000).

Figure 4–2 Debt stock / GNP ratio



Source: Based on World Bank 2001.

The denominators

While GDP growth was relatively constant over the decade, averaging 3.9 per cent, exports showed a rather volatile pattern. External factors were the decreasing tin, silver and zinc prices; the soybean prices and the climatic disturbances (El Niño). The internal factors were the instability of production and the transport disruptions caused by social unrest. All projections happened to be too optimistic, counting on oil and gas exports to Brazil and Argentina. The growth in exports over the last two decades is shown by Figure 4–3.

Figure 4–3 Exports: value (USD million) and annual change (per cent)

Source: Based on World Bank, 2001.

In the long run, debt service can be considered sustainable if:

$D/X = a/(g_E - i)$

where:
D = debt stock
X = Exports
a = trade gap (M-X)/X
g_E = growth rate of exports and
i = the average interest rate on debt (new disbursements).

Thereto the growth rate of exports can be compared to the average interest rate of new disbursements:

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	average
g_E	14.4	11.0	-3.9	-3.1	8.4	16.9	14.0	9.6	6.9	4.6	7.9
I	4.2	4.9	3	3.2	3.4	3.8	1.8	4.8	1.7	1.7	3.25

The growth rate of exports is based on a three year rolling average. This growth rate exceeds the average interest rate on the stock of debt. As indicated in chapter 2, the average interest rate on new loans has declined over the decade.

Debt service can be considered sustainable if compared to the growth rate of exports. In itself this is no guarantee for the future. In 2001 Bolivia has 'graduated' from a low-income to a middle-income status. After having reached the HIPC-2 Completion Point in 2001, Bolivia has lost its IDA-only eligibility status. Until 2004 Bolivia will receive a mix of IDA and IBRD loans. After 2004 it will be IBRD-eligible only. This will imply a higher average interest rate in the future. However, the margin between the growth rate in exports and the average interest rate seems to be enough to enable Bolivia to service its future debt.

In Bolivia, the trade gap 'a' is not constant, but widening gradually, as shown in the next Figure.

Figure 4–4 Trade gap (USD million)

Source: Based on World Bank, 2001.

The trade gap is not closed by aid flows:

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
X	998	943	792	907	1,201	1,264	1,344	1,580	1,546	1,540
M	1,354	1,408	1,567	1,649	1,554	1,809	1,968	2,357	2,490	2,347
A	0.4	0.5	1.0	0.8	0.3	0.4	0.5	0.5	0.6	0.5
AID	202	561	264	175	281	327	392	298	232	206
M-(X+A)	154	-96	511	567	72	218	232	479	712	601
a_{adj}	0.2	-0.1	0.6	0.6	0.1	0.2	0.2	0.3	0.5	0.4

Note: M, X and AID data from World Bank, 2001.

Similarly, the debt/GNP ratio (see graph 4.2) is sustainable in the long run if

$D/Y = (v-s)/(g_y-i)$

D = Debt stock
Y = GNP
v = the investment ratio I/Y
s= the savings ratio S/Y
g_y = growth rate of Y
i = average interest rate on debt

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	average
D/Y	92.4	85.5	79.7	78.0	84.2	81.5	72.2	67.9	77.3	75.8	
Y	4,627	4,748	5,315	5,524	5,793	6,468	7,191	7,706	8,355	8,122	
g_y	4.2	3.1	6.0	6.1	6.9	6.8	9.2	10.0	8.9	4.1	6.5
I	4.2	4.9	3	3.2	3.4	3.8	1.8	4.8	1.7	1.7	3.25
I	610	832	919	949	860	1,019	1,197	1,551	1,968	1,571	
S	554	539	423	416	529	709	851	900	918	765	
V	0.13	0.17	0.17	0.17	0.15	0.16	0.16	0.20	0.24	0.19	
S	0.12	0.11	0.08	0.07	0.09	0.11	0.12	0.12	0.11	0.09	
AID	202	561	264	175	281	327	392	298	232	206	
A/Y	0.04	0.11	0.05	0.03	0.05	0.05	0.05	0.04	0.03	0.02	
(v-s)/(gy-i)	1.91	0.03	-0.03	0.03	0.02	0.02	0.01	0.01	0.01	0.04	

Note: Gy is three years average.

Since the average interest rate is well below the growth rate of GNP, the debt stock can be considered sustainable, even if accompanied by a savings gap. AID hardly contributes to the savings.

Since the public sector is responsible for servicing almost all external debt, sustainability is directly related to the public sector's main source of income: taxes. So, to the public sector, debt is sustainable if:

$PPGD/T = \{(G-T)/T\}/ (r_t – i)$

where

PPGD = public and publicly guaranteed debt (Incl. IMF)
G = government expenditure
T = Tax income
r_t = growth rate of taxes

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	average
PPG Total	3,687	3,529	3,669	3695	4,122	4,588	4,256	4,129	4,292	3,684	
D/T	617.3	495.2	474	461.8	487	485.2	434.2	409.1	402.7	424.3	
T	692.5	820	894	932.6	1,002	1,086	1,195	1,279	1,604	1,451	
G	933.1	1099	1216	1310	1,449	1,469	1,619	1,907	2,104	2,100	
r_t	5.9	12.0	11.0	10.4	6.9	6.7	8.6	8.5	13.9	6.7	9.1
er	3.2	3.6	3.9	4.3	4.6	4.8	5.1	5.3	5.5	5.8	
G-T/T	0.35	0.34	0.36	0.41	0.45	0.35	0.35	0.49	0.31	0.45	
i	4.2	4.9	3	3.2	3.4	3.8	1.8	4.8	1.7	1.7	3.25
rt- i	1.7	7.1	8.0	7.2	3.5	2.9	6.8	3.7	12.2	5.0	
$\{(G-T)/T\}/ (r_t – i)$	0.207	0.048	0.005	-0.056	0.130	0.120	0.052	0.134	0.026	-0.090	

Note: r_t is three years average from 1992 onwards. 1990 and 1991 two years average.

Over the decade impressive progress has been made in tax revenue collection. After 1997, economic adverse circumstances affected the revenue collection. The average growth rate in tax revenue collection has been considerably higher than the average interest rate on new public and publicly guaranteed debt. Until 1998, domestic debt in Bolivia has been of no importance, but afterwards the public sector resumed borrowing on the domestic market for the financing of the Pension Fund.

The data presented above suggest a long term sustainability of both the debt stock and the debt service. However, there are some threats:

- Since all existing relief mechanisms have already been applied to Bolivia, further relief will depend on new mechanisms and modalities.
- Additional concessional loans from IDA and IDB replaced existing ones. This implied more “Washington domination” in policy formulation.
- Bolivia has 'graduated' from IDA to IBRD-eligibility. This implies that loans will become more expensive and (future) relief mechanisms less accessible.
- The restructuring of the Pension Fund will require substantial resources over the years to come. Government expanded its domestic borrowing since 1998.
- Although the central government has taken corrective administrative measures, the increasing indebtedness of municipalities to external suppliers is reason for concern, since eventually the government might be obliged to take over these debts.

4.3 Public sector investment in social sectors

Since the 1991 Social Strategy, the Bolivian government stressed the importance of improvements in the access to social facilities. Direct social assistance was considered either too expensive to sustain or counterproductive (school feeding programme, temporary employment programme). An exception is the Pension system that pretends to improve the conditions of the elderly people, but has not achieved that so far. Public protests by elderly have become part of the daily street life of La Paz.

Direct employment generation by the public sector did not match the liberal views of government. In consequence, public investment in the social sectors was restricted and channelled mainly through the Social Investment Fund (health, education, water supply and sanitation).

A more comprehensive effort was made in the educational sector through the Education Reform programme. As a result, public spending in education increased, while public spending in health showed stagnation. The allocations to the Ministry of Health and Social Insurance were cut drastically in the context of the decentralisation process, while these cuts have not been offset by the funds allocated by the municipalities to the health sector (República de Bolivia, 2001:91).

The government (República de Bolivia, 2001) and donors (World Bank, 1999) agree that public sector expenditures reflect increased attention to the social sectors. This is not only the result of a deliberate shift in government's priorities, but also the result of reduced public investment in public enterprises. While at the start of the decade the capital budget required almost 40 per cent of its funds for state enterprises, this decreased to approximately 12 per cent by the end of it.

4.4 Social Indicators

Over the decade, the successive governments of Bolivia paid attention to the improvement of social services, in particular to the poorer strata of society. Bolivia was the first Latin American country to have a Social Investment Fund, created to increase public sector efficiency and effectiveness in the provision of social services. Supported by substantial donor funding, large public investments were made in education, health and water supply. In consequence, the majority of indicators related to access to social facilities (i.e. school enrolment and infant mortality rates) improved considerably over the decade. The disparities in access patterns by gender also diminished. Differences between rural and urban areas, however, proved to be persistent.

The performance in the educational sector, apart from improvements in infrastructure, is also the result of the growing importance the population attaches to education. The quality of education is still below Latin American averages: only two-thirds of primary school students completes the sixth grade (World Bank, 1999).

Most changes in the health indicators can be attributed to improvements in potable water supply and sewerage. Thequality of health services,however, remained precarious. One of the reasons is that cost recovery systems are in place for few health services only (National Health Insurance Scheme).

While access to social services improved, the poverty incidence indicators did not show a similar pattern (República de Bolivia, 2001). The national poverty incidence (headcount index) comprises well over 60 per cent of the population, while almost a third of the population can be considered as extremely poor. (see also chapter 5).

Social indicators are presented in Table 4–1

Table 4–1 Social Indicators

Indicator	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Poverty Incidence (national)					62.1				63.2		62.7
Extreme poverty incidence (national)					32.1				37.9		36.5
School enrolment, primary (% net)	.	90.7	..	..	86.1	..	..	..	..	..	.102.1.
Gender equality in primary enrolment		0.916								0.93	
School enrolment, primary, female (% net)	..	86.7	..	..	..	..	..	..	..	94	..
School enrolment, primary, male (% net)	..	94.6	..	..	..	85.7	..	..	..	89	..
Share of population with fourth grade						63.6	63.8	63.8	64	64.1	64.6
Illiteracy rate, adult total (% of people ages 15 and above)	22.5	21.6	20.8	20	19.2	18.4	17.7	17	16.3	15.6	15
Gender equality in alphabetisation	0.799	0.805	0.812	0.818	0.824	0.834	0.835	0.842	0.847	0.852	0.857
Illiteracy rate, adult female (% of females ages 15 and above)	31	29.9	28.8	27.8	26.8	25.8	24.9	24	23.1	22.2	21.4
Illiteracy rate, adult male (% of males ages 15 and above)	13.6	12.9	12.3	11.7	11.2	10.7	10.1	9.7	9.2	8.7	8.3
School enrolment, secondary (% net)	..	29.4	..	..	46.5	..	..	..	..	52.3	..
School enrolment, secondary, female (% net)	..	27	..	..	..	..	..	..	..	46	..
School enrolment, secondary, male (% net)	..	31.7	..	..	..	..	..	..	..	57	..
Mortality rate, infant (per 1,000 live births)	..	80	..	75	..	..	67	..	62	..	58.8
Child Mortality rate, under-5 (per 1,000 live births)	..	120	..	116	..	112	92	..	85	..	83
Maternal mortality rate						390					374
Births attended by health staff (% of total)	43	..	..	..	..		55	..	..		59
Contraceptive prevalence (% of women ages 15-49)	30	..	..	..	..	46.9	..	..	..	48.7	..
HIV ratio											0.10

4.5 Private sector and debt relief

Over the decade, the net resource flow was positive and increasing. The private net resource flows have become three times the official net resource flows (see Table 4–4). Foreign direct investment (net), which is a private resource flow, has been increasing steadily during the 1990s, as is shown in Table 4–2.

Table 4–2 Aggregate net resource flows and net transfers (long-term) (USD million)

Flow	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Net resource flows	407	333	751	621	502	632	1,041	1,115	1,442	1,399	1,354
Net flow of long-term debt (ex. IMF)	312	104	137	264	203	221	321	249	414	210	132
Foreign direct investment (net)	47	27	52	93	124	130	393	474	731	957	1,016
Portfolio equity flows	0	0	0	0	0	0	0	0	0	0	0
Grants (excl. technical coop.)	48	202	561	264	175	281	327	392	298	232	206
Memo: technical coop. grants	41	108	156	174	190	190	217	195	199	185	192
official net resource flows	204	330			367	496	608	596	501	334	338
private net resource flows	203	3			135	136	434	519	941	1,065	1,017
Net Transfers	214	199	614	492	349	454	853	912	1,209	1,195	1,156
Interest on long-term debt	173	117			127	148	155	163	189	144	115
Profit remittances on FDI	19	17	18	20	26	30	33	40	43	60	83
Memo: official net transfers	161	230	622	441	258	366	474	447	352	197	228
private net transfers	53	-30	-7	51	91	88	379	464	857	998	927

The gross domestic investments in Bolivia expanded with some 35 per cent during the 1990s. Foreign direct investment increased as well and reached a level of 10 per cent of GDP in 1998 (IMF, 2001). Notwithstanding this growth, the IMF characterises private sector investment in Bolivia as modest (IMF, 2001b).

Table 4–3 Investment (per cent of GDP)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Gross domestic investment	12.1	13.3	13.9	15.7	16.6	14.4	15.2	16.2	19.6	23.2	18.8
Fixed capital formation	12.1	13.3	13.9	15.7	16.7	14.9	15.5	16.2	19.0	22.9	19.4
Public sector	8.1	9.0	9.3	10.8	9.0	8.5	8.0	8.2	7.2	7.0	7.1
Private sector	4.1	4.3	4.6	5.0	7.7	6.4	7.6	8.0	11.7	15.9	12.3
Change in inventories	…	…	…	…	-0.1	-0.5	-0.3	0.1	0.7	0.3	-0.6

Sources: IMF, 1994, 1998, 2000, and 2001.

It is hard to identify sound investment opportunities in Bolivia. Few of the opportunities identified by the Bolivian Export Foundation have been seized by the private sector. The general environment is not very conducive to investment in productive activities. Local investors show reluctance to invest in Bolivia and prefer investments abroad, for example in Florida.

Many circumstances play a role, such as the fact that the country is land-locked, the deteriorating terms of trade, political tensions, the small internal market, characterised by a lack of purchasing power and the lack of confidence in the socio-commercial system (red tape, corruption). The high interest rates of credit are due to risk (high default), small volume and complex networks linking the small commercial banks to particular private companies. Various banks went bankrupt during the decade. Local investors have a preference for low-yielding, but ‘secure’ investments like the construction sector.

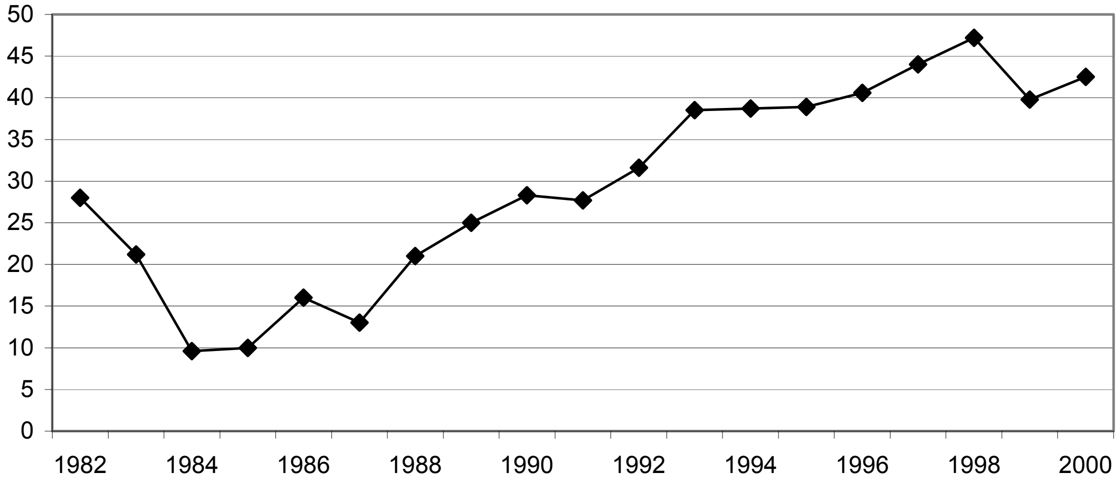
To a large extent, foreign investments were attracted by the capitalisation process, as well as to the building of infrastructure required for the gas exploitation. Between 1996 and 2000, 40 per cent of the total Foreign Direct Investment flows were directed to oil and gas exploitation[14]. The inflow of private investment has slowed down since 1999.

4.6 Creditworthiness

Bolivia's creditworthiness was seriously affected in the early 1980's as a result of the economic crisis. After the stabilisation programme had shown some result, the credit-worthiness ranking started to improve. The upward trend was sustained until 1998, when Bolivia's economic performance weakened.

According to Moody's Investor Service (website October 2001, June Report) Bolivia's rating has remained constant and is classified B1 for foreign currency bonds and notes and B2 for foreign currency bank deposits. Moody's classifies Bolivia's situation as positive as far as its foreign debt position is concerned, but considers the foreign exchange earning capacity low and vulnerable. Future earning capacity will depend on gas exports. However, "future social progress will require substantial amounts of foreign savings over the medium term", while "serious domestic borrowing is to be expected" for the Pension System. Changes in the country’s creditworthiness over the last two decades are shown in Figure 4–5

Figure 4–5 Creditworthiness Euromoney scores



Source: Euromoney.

Bolivia’s disappointing score in the Transparency International’s Corruption Perceptions Index shows that corruption still limits confidence in both the public and private sector.

[14] Source: Moody's Investors Service, October 2001.

Table 4–4 Transparency International's Corruption Perceptions Index

Year	Total entries	Rank	Score
1988-1992	54	36	3.4
1996	54	36	3.4
1997	52	51	2.05
1998	85	69	2.8
1999	99	80	2.5
2000	90	71	2.7
2001	91	84	2.0

Source: Transparency International website.

4.7 Effectiveness of Netherlands contributions to debt relief

The effects of Netherlands' contributions to debt relief cannot be distinguished from those produced by other donors and creditors.

In the Paris Club agreements, the Netherlands always chose the most favourable option to Bolivia. The Dutch initiatives to repurchase commercial debt titles (1987) and the subsequent deposits in the IMF Trust Fund and IDA Debt Reduction Facility for the same purpose were innovative and effective. The Netherlands was the first country to deposit funds into the IMF Trust Fund, thereby setting an example for other donors. Similarly, the Netherlands played an important role in the creation and operation of the Multilateral Debt Fund and managed to get other donors interested in this modality. The Netherlands played a leading role in the HIPC Trust Fund in earmarking funds for Bolivia.

4.8 Assessment of effectiveness

Debt relief has been effective in improving all debt sustainability indicators. Although Bolivia contracted sizeable new (multilateral) loans, the country's debt profile can be considered as sustainable, also in the long run.
The margin between the growth rate in exports and the average interest rate is wide enough to assume that Bolivia will be in a position to service its debt in the future.

Since the average interest rate is well below the growth rate of GNP, the debt stock can be considered sustainable as well. However, it should be noted that the growth rate of GNP is stagnating since 1999.

Projections made in the context of the HIPC-2 Initiative (IMF-IDA, 2001) show a positive debt position in the medium term. However, these projections are based on rather optimistic assumptions regarding the growth of the economy and of export earnings.

The conditionalities attached to debt relief mechanisms, such as MDF and HIPC, contributed to the conclusion of an agreement between donors (creditors) and government on priorities in the public sector investment programme (or parts thereof). Donors stressed the importance of poverty reduction related investments. In terms of GDP, the poverty reduction related public investments increased over time. Debt relief had a positive flow effect, that contributed to sustained debt servicing performance on current obligations and on increased public investments in the social sectors. These investments improved access of the poor to social facilities. However, poverty incidence (in income) remained severe.

Debt relief has created room for the contracting of new, concessional loans, for public sector investments in social infrastructure and education. Additional loans also made it possible to start the restructuring of the Pension Fund system.

The capitalisation process attracted foreign private investment, while most domestic investment was restricted to the construction sector. Although forward linkages exist, neither the gas exploitation nor the construction sector creates lasting employment.

There are no strong indications that debt relief has triggered private sector investment, although the domestic private sector benefited from the increased outsourcing of public works.

5 IMPACT OF DEBT RELIEF: RELEVANCE

5.1 Economic growth

The impact of debt relief on economic growth cannot be distinguished from other macroeconomic support instruments. During the period 1990-1999, the magnitude in terms of annual resources that became available as a result of debt relief varied widely, but is estimated to average USD 80 million (1995-1999). The inflow of new grants has been considerably higher than that (see Table 3–8).

During the 1990s, the public sector investments in reforms, infrastructure and social services were financed externally for approximately 50 per cent (of which 75 per cent multilateral and bilateral loans and 25 per cent grants). Bolivia experienced a positive net flow of resources on its loan portfolio. New credits were all concessional and were used for the implementation of sectoral programmes and reforms (educational reform, public sector reform, pension fund).

Macroeconomic stability could be sustained. Until the early 1990s, Bolivia lacked a social political agenda. Poverty reduction was supposed to be the outcome of economic growth. In line with the change in the international paradigm, this changed during the decade. Bolivia's development process is closely monitored by the IFI's (i.e. IMF Article IV Consultations, IDA Credit Completion Studies, Public Expenditure Reviews) and by academic researchers. There is no consensus regarding the appreciation of the results of fifteen years of structural adjustment. The following achievements can be listed:

- Economic stability and fiscal discipline: inflation could be controlled to levels below five per cent; fiscal deficits became manageable (3-6 per cent).
- Increased capital inflow resulting from the introduction of commercial bank accounts in US dollars (over 80 per cent of all deposits) and Foreign Direct Investments as result of the capitalisation process.
- A modest economic growth -on average 3.9 per cent of GDP- could be registered.
- Official reserves increased to a level equivalent of seven to eight months of imports.
- The democracy could be consolidated and was strengthened.
- The role of the state was redefined, while the public administration (decentralisation and 'municipalisation') has been reorganised.

Disappointing developments have been:

- Foreign investments increased, but turned out to be directly related to the capitalisation process and investments in the hydrocarbon sector.
- Domestic savings are persistently low, as are domestic private investments.
- The effort to overcome the mass poverty showed only modest results.
- Social indicators improved, but -mainly in health- they continue to be below Latin American averages.
- Export earnings increased by 25 per cent during 1990-1999, but are still dominated by non-renewable primary commodities, vulnerable to price fluctuations. The value of exports remains extremely low: less than USD 150 per capita.
- Although the public sector slimmed down, it still accounts for over 50 per cent of total formal sector employment. Private sector employment creation is slow.

By the end of the decade, a recession slowed down growth. The increase of 0.4 per cent of GDP in 1999 was the lowest of the decade, followed by a 2.4 per cent in 2000. The continuously decreasing tin, zinc and silver prices hit the already fragile mining industry. The agricultural sector faced declining prices for the export commodities soybeans, cotton and coffee, while new non-tariff barriers by the European Union and US market ruined the opportunities for the Brazil nut production.

5.2 Poverty reduction

Apart from the debate whether economic growth alone is sufficient to reduce poverty, an average growth rate of 1.4 per cent in GDP per capita (0.9 per cent in real terms) over the decade was insufficient to overcome mass poverty.

Although access to social services improved (as expressed by a fall in the Unsatisfied Basic Need Index), income levels hardly changed, as expressed by the Headcount Index (República de Bolivia, 2001:21-23, 33). The Headcount index improved with an average of 1.2 per cent (and 0.2 per cent per annum in the rural areas) over a 15 year period.

Box 5–1 Poverty measurement

The Unsatisfied Basic Needs Index measures poverty as the share of households with unsatisfied basic needs and other basic necessities. It captures the degree of satisfaction of basic needs with regards to minimum standards for quality and access to housing, water supply and sanitation, energy, education, and health.

The Headcount Index measures the proportion of households with income levels below the consumption-based poverty line, which reflects the expenditure necessary to buy a 'minimum food basket' and other necessities

Although poverty levels are higher in rural than in urban areas, 52 per cent of the poor live in urban areas, a reflection of the rural-urban migration process.

In 1999, approximately 63 per cent of the population fall under the Bolivian poverty line, a figure comparable to the one at the start of the decade. The average monetary income of the poor was USD 290 per capita per year.

Using the internationally recognised 'poverty line' of USD 1 per day, 42 per cent (3.3 million persons) would be classified as extremely poor, while 70 per cent of the population (5.6 million persons) would fall below the USD 2 per day line (República de Bolivia, 2001:23).

There are significant regional disparities in economic growth (mainly concentrated in the more industrial Santa Cruz area), while some areas experienced a negative growth (northern Potosi). Growth is unequally distributed over the income quintiles. During the 1990s, 20 per cent of the poorest urban population accounted for only 4 per cent of the aggregate urban income, while the highest quintile accounted for 54 per cent. The urban Gini index[15] is as high as 0.71, while the rural Gini index is 0.5 per cent.

The unequal distribution of the benefits of growth has deepened the existing dichotomy in the Bolivian society between the mestizo minority and the indigenous (Aymara and Quechua) majority.

Most economic analyses, including the one presented in this report, are based on the underlying assumption of the existence of a single nation-state and a single national

[15] The Gini index is a measurement of inequality. The index uses a value of zero, when the population has the same income level ands of one (1) if income is fully concentrated in a few inhabitants.

economy. In Bolivia these assumptions are dubious. In fact, there are two distinct societies. While policies and strategies refer to the formal economy, over 70 per cent of the population generate income outside the formal economy. The 'other' economy is affected by, but not 'steered' by public sector policies. The international financing institutions have become aware of that (IMF, 2001c).

In 2001, the government's success in eradicating coca production and controlling contraband hit the parallel economy. Deprived of its sources of income, poorer strata caused social unrest, with a negative impact on the economy in the order of 3.5 – 4.0 per cent of GDP (IMF, 2001b and 2001c:1).
The eradication of coca cultivation is one of the policies pushed by the United States and used within the context of debt relief as well (i.e. in the Paris Club and USAID contributions).

5.3 Relevance of debt relief

Bolivia has been successful in attracting external financial support for its reform programmes. The IFIs and bilateral donors contributed with concessional loans, grants and debt relief. During the late 1980s, debt relief was relevant to solve the immediate and urgent liquidity problems and was relevant to the stabilisation programme. Since the structural adjustment programmes required new public investments, debt relief promoted access to new (multilateral) loans.

Since policy adjustments were attached as conditions to relief mechanisms and almost all of them were implemented, debt relief can be considered to have triggered changes in public policies. These changes did contribute to a sustained, but modest economic growth over the decade. The impact (hence relevance) of debt relief on poverty reduction has only been modest.

Along with privatisation / capitalisation, decentralisation has been the most important structural reform. The decentralisation process awarded a large degree of autonomy to local governments. However, this autonomy also led to sub-national borrowing and made the external debt problem more complex.

To the Netherlands' development assistance, the Latin America and Caribbean region is of decreasing importance (in 1999 it received 4 per cent of the ODA flow). Nevertheless in 1999, Bolivia was the fifth most important destination of Dutch development assistance, while to Bolivia the Netherlands was the fourth most important donor. The Netherlands has provided programme aid in various forms (initially commodity aid, later parallel funding of structural adjustment programmes, earmarked budget support to both safety net facilities and the educational reform programme and finally increasingly in the form of debt relief).

The Dutch white paper *A World of Difference* (Ministry of Foreign Affairs 1991) stressed the importance of using co-operation funds as a catalyst. From that perspective, debt relief has been relevant: The Dutch support to debt relief set an example and triggered the support of other donors. In addition, there has been a link between debt relief and the support to democracy in Bolivia. Not always were the economic results the most important outcome, but the consolidation and strengthening of democracy in Bolivia.

ANNEXES

ANNEX A DEBT RELIEF CONCEPTS

Concepts
The concepts regarding debt used in this report are those applied by the World Bank in its Global Development Finance report 2001.The following concepts are used with reference to "debt" in the present document:

a. (Long-term) *external (total) debt* (EDT) is defined as debt that has an original or extended maturity of more than one year and that is owed to nonresidents and repayable in foreign currency, goods, or services.
Long-term external debt has three components:
   a.1 *public debt,* which is an external obligation of a public debtor, including the national government, a political subdivision (or an agency of either), and autonomous public bodies,
   a.2 *publicly guaranteed debt*, which is an external obligation of a private debtor that is guaranteed for repayment by a public entity,
   a.3 *private non-guaranteed external debt*, which is an external obligation of a private debtor that is not guaranteed for repayment by a public entity.

b. *Public and publicly guaranteed debt* consist mainly of multilateral debt, bilateral debt and (part of) the commercial debt. *Multilateral debt* originates from loans and credits from the World Bank, regional development banks, and other multilateral and intergovernmental agencies (international financing institutions). *Bilateral debt* originates from loans from governments and their agencies (including central banks), loans from autonomous bodies, and direct loans from official export credit agencies. *Commercial debt or private debt* include bonds, loans from private banks and private financial institutions, as well as credits from manufacturers, exporters and bank credits covered by a guarantee of an export credit agency. A particular type of both bilateral and multilateral debt is the *concessional debt,* which originates from the receipt of aid from official lenders at concessional terms as defined by the Development Assistance Committee (DAC), that is, loans with (at least) an original grant element of 25% or more.

c. The total *contracted debt* is the sum of contracted loans which may or may not have actually been disbursed by the creditor; *disbursed debt* (or: long-term debt oustanding and disbursed - LDOD) are those loans which have actually been disbursed by the creditor, while *the total debt stock* is the sum owed by a country at any given moment, i.e. the loans which it has actually received and which have not yet been repaid (the net disbursements minus the repayment); the *net total debt* (or: net flows on debt) refers to the repayment of the principal only; the *gross total debt* owing at any given moment refers to the principal plus the servicing (interest, fines, commissions).

d. The (long term) *debt service* (LTDS) is the sum of principal repayments and interest (and commissions, fines) payments actually made over a prearranged period (usually a year). The *total debt service paid* (TDS) is debt service payments on total long-term debt (public and publicly guaranteed and private non guaranteed), as well as on use of IMF credit. *Total debt flows* include disbursements, principal repayments, net flows and transfers on debt, and interest payments. *Debt stock rescheduling* refers to the formal deferment of payment of the external debt service through the application of new maturities to the amounts placed. *Debt forgiven* is the amount of principal due or in arrears that was written off or forgiven. *Refinanced debt* is the conversion into a new loan of the debt due to mature or which has already matured. Debt stock reduction is the amount that has been netted out of the stock of debt using debt conversion schemes such as buybacks and equity swaps or the discounted value of long-term bonds that were issued in exchange for outstanding debt. The term *buyback* is used for operations that do not entail local currency on the part of the debtor country. In the event that any payment in local currency forms a part of the transaction, it is referred to as *debt conversion* or *debt swap*. The *grace period* is the period between the coming into force of the loan and the first amortization of the principal. The creditor may or may not request the payment of interest during the period of grace. The *maturity period* is the period of grace plus the period of amortization. *Maturities* are the obligations of the principal, interest and commission resulting from the loan agreement signed between the creditor and the debtor; the difference between the sum due for repayment and the sum actually paid represents the *default sum* (arrears).

The *domestic* public debt consists of the State's obligations to private organizations, bodies or individuals belonging to the private sector. Generally speaking, it is a debt in national currency in the form of (short-term) promissory notes (Treasury bills) and investment bonds

ANNEX B REFERENCES

Allen, T. and Weinhold D. Dropping the debt for the new millennium: is it such a good idea? In: *Journal of International Development*. London: John Wiley and Sons Ltd, 2000. Volume 12, 857-75.

Banco Central de Bolivia. *Estado de la Deuda Externa Pública al 31-12-1992.* La Paz: Division de la Deuda Externa, 1993.

Banco Central de Bolivia. *El perfil actual de la Deuda Externa*. La Paz: Banco Central de Bolivia, 1994.

Banco Central de Bolivia. *Boletín del Sector Externo* no. 24. La Paz: Asesoría de Política Económica, Diciembre 2000.

Banco Central de Bolivia. *Memoria 2000*. La Paz, 2001.

CEDLA. *The Current State of Bolivia's External Debt 1985-1995*. Bolivia: SNV, 1996.

Chossudovsky, M. Debt and the Illegal Drug Economy. The Case of Bolivia. In: *The globalisation of poverty. Impacts of IMF and World Bank Reforms*. London and Atlantic Highlands, NY.: Red Books, 1997. Chapter 11.

Collas-Monsod, S. *Markets, Government and Development*. Paper School of Economics, Philippines presented to Financierings Maatschappij voor Ontwikkelingslanden seminar. The Hague: FMO, 1995.

Cosio-Pascal, E. *Debt Sustainability and Social and Human Development. The net transfer approach and a comment on the so-called 'net present value' calculation for debt relief.* Geneva: UNCTAD, 1997. Working paper no. 128.

Demirgüc-Kunt, S and Huizinga, H. Official Credits to Developing Countries. Implicit Transfers to the Banks. In: *Journal of Money, Credit and Banking* 25(3), 1993. 431-444.

Delgadillo Cortes, J.. *El proceso de retiro de la deuda externa boliviana con referencia al caso de Holanda*. La Paz: Servicio Holandés de Cooperación al Desarrollo, 1994.

Devarajan, S. and Swaroop, V. *The Implications of Foreign Aid Fungibility for Development Assistance*. Policy Research Working Paper 2022. Washington: The World Bank, 1998.

Dijck, P. van. *Structural adjustment policies and the economic transformation of Bolivia: achievements ands challenges*. Paper presented to the seminar: Structural adjustment, poverty alleviation and external donors: the Bolivian Experience. Amsterdam: CEDLA, 1996.

Dijck, P. van. *The Bolivian Experiment. Structural Adjustment and Poverty Alleviation*. Amsterdam: CEDLA, 1999.

Hanlon. J. How much debt must be cancelled? In: *Journal of International Development*. London: John Wiley and Sons, 2000 Vol. 12, pp 877-901.

Informal Bilateral Cooperation Network on Poverty. *The Bolivian Poverty Reduction Strategy. Final Evaluation Report*. La Paz, 2001.

International Bank for Reconstruction and Development. *Bolivia. Policy Framework Paper, 1991-93*. Washington: The World Bank, 1991.

International Bank for Reconstruction and Development. *Bolivia. Policy Framework Paper, 1992-95*. Washington: The World Bank, 1992.

International Bank for Reconstruction and Development. *Bolivia. Policy Framework Paper, 1994-1997*. Washington: The World Bank, 1994.

International Bank for Reconstruction and Development. *Bolivia. Policy Framework Paper, 1997-1999*. Washington: The World Bank, 1997.

International Bank for Reconstruction and Development. *Bolivia Country Assistance Evaluation*. Washington: The World Bank, 2000.

International Development Association*. Implementation Completion Report. Bolivia Structural Adjustement program*. Washington: The World Bank, 1996.

International Development Association. *Comprehensive Development Framework. Bolivia: Implementing the Comprehensive Development Framework*. Washington: The World Bank, 1999.

International Development Association. *Bolivia: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative Decision Point. President Report and Recommendation*. Washington: The World Bank, 2000.

International Monetary Fund. *Bolivia. Policy Framework Paper for 1989-92*. Washington: IMF, 1989.

International Monetary Fund. *Bolivia - Enhanced Structural Adjustment Facility. Economic Policy Framework Paper for 1994-97*. Washington: IMF, 1994a.

International Monetary Fund. *Bolivia-Statistical Annex. Article IV Consultation 1994.* Washington: IMF, 1994b.

International Monetary Fund. *Bolivia. Memorandum on Debt Relief*. Paris: IMF, 1995.

International Monetary Fund. *Bolivia - Enhanced Structural Adjustment Facility. Economic Policy Framework Paper for 1996-98*. Washington: IMF, 1996a.

International Monetary Fund. *Bolivia – Midterm Review under the Second Annual Arrangement Under the Enhanced Structural Adjustment Facility.* Washington: IMF, 1996b.

International Monetary Fund. *Bolivia – Enhanced Structural Adjustment Facility. Economic Policy Framework Paper for 1997-99*. Washington: IMF, 1997a.

International Monetary Fund. *Bolivia. Final Document on the Initiative for Heavily Indebted Poor Countries (HIPC*). Washington: IMF, 1997b.

International Monetary Fund. *Bolivia. Staff Report for the 1998 Article IV Consultation. Request for Arrangements Under the Enhanced Structural Adjustment Facility and Policy Framework Paper for 1998-2001*. Washington: IMF, 1998.

International Monetary Fund. *Letter of Intent. Bolivia: Memorandum of Economic and Financial Policies*. La Paz. 1999.

International Monetary Fund. *Press release 007*. Washington: 2000a.

International Monetary Fund. *Debt Relief is designed to help poorest countries implement poverty reduction strategies*. www.imf.org/imfsurvey. 2000b.

International Monetary Fund. *Balance of Payments Statistical Yearbook. Part 1 Country Tables.* Washington: International Monetary Fund, 2000c.

International Monetary Fund. *IMF Article IV Consultation with Bolivia*. Washington: IMF. 2000d.

International Monetary Fund. *Staff Report for the 2001 IMF Article IV Consultation and Request for Third Annual Arrangement Under the Poverty Reduction and Growth Facility*. Washington: IMF. 2001a.

International Monetary Fund. *Staff Report for the 2001 IMF Article IV Consultation: Bolivia Statistical Annex.* Washington: IMF. 2001b.

International Monetary Fund. *The Impact of Debt Reduction under the HIPC Initiative on External Debt Service and Social Expenditures*. Washington: IMF, 2001c (www.imf.org).

International Monetary Fund. *Bolivia Enhanced Initiative for Heavily Indebted Poor Countries. Completion Point Document*. Washington: IMF, 2001d.

International Monetary Fund. *The Acting Chairman's Summing Up at the Conclusion of the Article IV Consultation with Bolivia*. La Paz, 2001e.

International Monetary Fund and International Development Association. *Final Document on the Initiative for Heavily Indebted Poor Countries (HIPC)*. Washington: The World Bank. 1997.

International Monetary Fund and International Development Association. *Modifications to the Heavily Indebted Poor Countries (HIPC) Initiative*. Washington: The World Bank. 1999.

International Monetary Fund and International Development Association. *Completion Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative.* La Paz, 2001.

International Monetary Fund and the International Development Association. *Bolivia. Poverty Reduction Strategy Paper. Joint Staff Assessment*. Washington: IDA/IMF, 2001.

Jeanne, O and Zettelmeyer, J. *International Bailouts, Moral Hazard and Conditionality*. Cesifo Working paper no. 563. Munich: Centre for Economic Studies and Ifo Institute for Economic Research, 2001.

Jenkins, R. Does trade liberalization lead to productivity increases? A study of Bolivian manufacturing. In: *Journal of International Development*. 1995. Vol. 7, no. 4, 577-597.

Lindert, P. van, *Urban Poverty in the 1990s. A view from Bolivia's Barrios.* Paper presented to seminar: Structural adjustment, poverty alleviation and external donors: the Bolivian Experience. Amsterdam: CEDLA, 1996.

Loon, F. D. van, and R.H.M. Rühl. Secundaire markt en schuldenprobleem. In: *Economische Statistische Berichten*. Rotterdam: NEI, 1988. No. 3681 (November), 1052-1055.

Martin, M. *Final report on Multilateral Debt Strategy Mission*. La Paz: 1996.

Martin, M. *Bolivia's Enhanced Debt Strategy (and Request for Multilateral debt relief)*. La Paz: 1996.

Ministry of Foreign Affairs. *A World of Difference. A new framework for development co-operation in the 1990s*. The Hague: Ministry of Foreign Affairs, 1991.

Minister van Financiën en Minister voor Ontwikkelingssamenwerking. *Rapport Schuldenstrategie.* The Hague: 1992. Tweede Kamer 1992-1993, 22800V, nr. 54.

Ministerie van Financiën. Directoraat Externe Financiële Betrekkingen. *Notitie Multilaterale Schulden*. The Hague: Ministerie van Financiën, 1995.

Minister van Financiën en Minister voor Ontwikkelingssamenwerking. *Brief van de Ministers van Financiën en voor Ontwikkelingssamenwerking. Multilaterale Schulden*. The Hague: Tweede Kamer der Staten Generaal. 1994-1995, n° 24 291, n° 1.

Mistry, P. S. *Multilateral Debt. An emerging crisis?* The Hague: Fondad, 1994.

De Nederlandsche Bank, *Briefing Notes on Debt Relief Paris Club*. Amsterdam: 29th March, 1990.

Nederlandsche Credietverzekering Maatschappij. *Verslag van de multilaterale besprekingen in de Club van Parijs op 24 januari 1992 over de consolidatie van externe schulden van Bolivia*. 1992.

Nederlandsche Credietverzekering Maatschappij. *Bilateral Consolidation Agreement on the reduction and reorganisation of the external debt service obligations of the Government of the Republic of Bolivia to the Netherlands' creditors*. 1999.

Niekerk, Nico van. La economía va cada vez mejor, pero qué con la gente? Deuda o beneficio social?. In: *Politicas sociales y ajuste estructural. Bolivia 1985-1993.* La Paz: 1994.

Paris Club. Communiqué tour d'horizon 16th June, 1997.

Powell, R. Debt Relief for Poor Countries. In: *Finance and Development*. Washington: IMF. 2000. December 2000, pp 42-45.

Republic of Bolivia. *Bolivia: Memorandum on Debt Relief. Paris Club V.* La Paz: 1995.

Republic of Bolivia. Public *Investment and External Finance. A retrospective overview and the prospect for the future*. Paris: OECD, 1997.

Republic of Bolivia. *Proposal for debt Relief. Paris Club VII*. La Paz: 1998.

República de Bolivia. *Bolivia. Interim Poverty Reduction Strategy Paper*. La Paz. 2000.

República de Bolivia. *Estrategia Boliviana para la Reducción de Pobreza*. La Paz: 2001.

Ross, D.C. and Harmsen, R.T. *Official Financing for Developing Countries*. Series World Economic and Financial Surveys. Washington: International Monetary Fund, 2001.

Ryckeghem, W. van, and Seligmann, J. *Bolivia: The problem of growth, savings and investment. A framework for analysis*. Paper presented to seminar: Structural adjustment, poverty alleviation and external donors: the Bolivian Experience. Amsterdam: CEDLA, 1996.

Social Policy Analysis Unit UDAPSO. *Indicadores Sociales*. La Paz: UDAPSO, 1993.

Stichting Onderzoek Multinationale Ondernemingen (SOMO).*Wat levert het op en wie levert in? Een onderzoek naar Nederlandse kunstmestleveranties aan Bolivia*, Amersfoort: Solidaridad en Vastenaktie Nederland,1991.

Study Centre for Labour and Agricultural Development, Latin American Institute for Social Research CEDLA-ILDIS. *Balance de Indicadores Sociales 1994. Informe Social Bolivia 1.* La Paz: CEDLA-ILDIS, 1994.

Villegas Q., C., and Loza, G.T. *Situación de la deuda externa de Bolivia 1985-1995.* La Paz: SNV-Bolivia and CEDLA, 1996.

Vos, R. Lee, H and Mejía, J.A. *Structural adjustment and poverty in Bolivia*. Paper presented to the seminar: Structural adjustment, poverty alleviation and external donors: the Bolivian Experience. Amsterdam: CEDLA, 1996.

World Bank. *Bolivia From Stabilization to Sustained growth*. Report No. 9763-BO. Washington: The World Bank, 1991.

World Bank. *Structural Reforms. Fiscal Impacts and Economic Growth*. Report no. 13067-BO. Washington: World Bank, 1994.

World Bank and IMF. *Multilateral Debt of the Heavily Indebted Poor Countries.* Washington: 1995.

World Bank. *Bolivia, Poverty, Equity and Income. Selected Policies for Expanding Earning Opportunities for the Poor*. Two Volumes. Report No. 15272-BO. Washington: World Bank. 1996a.

World Bank. *Implementation Completion Report. Bolivia Structural Adjustment Program (Credit 2298-BO).* Washington: IDA, 1996b.

World Bank. *World Debt tables. Global Development Finance.* Washington: World Bank, 1996c.

World Bank. *Bolivia Public Expenditure Review*. Report no. 19232-BO. Washington: The World Bank, 1999.

World Bank. *Global Development Finance. Building Coalitions for Effective Development Finance*. Washington: The World Bank 2001. CD ROM version.

Files Netherlands Ministry of Foreign Affairs and Royal Netherlands Embassy, La Paz.

ANNEX C: EVALUATION OF DEBT RELIEF 1990-1999, IOB

TERMS OF REFERENCE FOR COUNTRY CASE STUDIES

The evaluation of Dutch debt relief policy and expenditures aims to answer the following research questions:

- to what extent were the political and financial interventions (the inputs) **efficient** in terms of outputs such as debt and debt service reduction (DDSR) and increases in imports an government expenditure?
- to what extent were these inputs and outputs **effective** in producing desired outcomes such as improvement of debt sustainability, improvement of creditworthiness and investment?
- to what extent were these inputs, outputs and outcomes **relevant** by contributing to the longer-term impacts of economic growth and, ultimately, poverty reduction?

Country case studies
In the 8 country case studies, the evaluation questions of efficiency, effectiveness and relevance will all be addressed (see attached Table 1: evaluation matrix). In addition, an in-depth analysis is to be made of the nature of the country's debt problem and therefore of the relevance of debt relief as compared to, for example, new loans or grants.

Debt relief is defined as any action that leads to a reduction in the net present value of the debt. The basic assumption for this evaluation is that IF debt relief contributes to economic growth it does so via a reduction of the debt burden. Two effects are possible:

- The reduction of the net present value of the debt *stock* will increase creditworthiness of the country (according to the debt overhang hypothesis), and thereby lead to more private investment and inflows of private capital. This will enhance economic growth.
- The reduction of the debt *flows* (actual debt service) will lead to additional imports and government expenditure. Increased imports may include investment goods or intermediate goods leading to increased use of existing capital stock, and government spending may imply higher public investment and/or more social expenditure.

Since the effects of *Dutch* debt relief cannot be separated from those of debt relief by other actors, the object for the case studies consists of *all* debt relief received by the country, both from official and commercial sources. Where possible and relevant, special attention will be given to Dutch debt relief. The evaluation period covers 1990-1999, but the analysis of the debt problem has to start earlier, in the 1970s.

The country studies seek answers to five broad questions, each of which is to be dealt with in a separate chapter of the report, with chapters 2 to 5 corresponding to the different levels of the evaluation matrix (inputs, outputs, outcomes and impact), while chapter 1 will provide an introduction and background. In addition to the sources mentioned in the Evaluation matrix, the researcher carrying out the case study is expected to take into account the relevant academic literature on the country as well as pertinent previous evaluations. A minimum selection will be provided by the coordinator and her assistant, but the consultation of additional material at the researcher's own initiative will, of course, be welcomed.

1. Debt problem analysis: nature, causes and consequences.

Why had the debt burden become unsustainable by the beginning of the evaluation period, 1990, and what have been the consequences of this unsustainability? Answering these questions involves analytical descriptions of:

1. The build-up of the country's debt, going back to the 1970s, including major creditors, interest rates, degree of concessionality in real terms, that is including any adverse exchange rate effects (see Mistry, 1996: 25-6), etc.
2. Conditionality attached to loans granted before 1990, and degree of compliance (short overview).
3. Trends in GDP, exports, fiscal revenues; causes of slow growth rates: review of important factors such as developments in terms of trade, inflows of foreign aid, loans and FDI, political instability, natural and man-made disasters, adverse policies, etc.
4. Trends in poverty and social indicators before 1990.
5. Debt sustainability indicators: trends in debt/GDP, debt service *due*/exports versus debt service *paid*/exports.
6. Public and private shares of external debt, and changes over time; government take-over of private debt.
7. Extent to which the external debt situation was exacerbated by a domestic debt problem.
8. Net transfers on debt before 1990, and how these compared to aid flows (grants, new loans).
9. Debt relief, if any, provided before 1990 and its influence on debt sustainability indicators. Any bail out of private creditors by official creditors/donors (see Demirgüç-Kunt & Huizinga, 1993).
10. The nature of the debt problem in 1990, in particular, whether the country's inability to pay was caused by insufficient liquidity (short-term problem) or a lack of solvability (long-term problem). Any difference between this ex-post assessment result and the common perception of the debt problem at the time.
11. The consequences of the debt problem in 1990, in particular whether it affected growth rates:
    - through too high transfers on debt leading to lower imports and lower government expenditure;
    - and/or leading to lower growth rates through a heavy debt overhang (high debt stock, so high expected tax on private profits lowering private investment and inflows of private capital).

---

2. Inputs: amounts and modalities of debt relief in the period 1990-1999

What were the inputs into the debt relief process in terms funding, modalities and conditions? Answering this question requires the following data:

1. Overview of amounts and modalities of debt relief: by creditor, by type of debt, by framework for debt relief activities (Paris Club, Multilateral Debt Funds, 5th and 6th dimension, HIPC, etc.), extent of forgiveness, interest subsidy, buy-back, etc.
2. Stated objectives of debt relief.
3. Any conditions attached to the different modalities of debt relief, including assessment of *track records* (see attached Table 2 for possible contents of conditions and track records)
4. Special attention to Dutch modalities, motives, conditions, and objectives for debt relief.

5. The extent to which debt relief was *additional* to other inflows (loans or grants); in general, and for Dutch debt relief in particular; according to the HIPC initiative, debt relief should be additional (Andrews et al., 2000: 16) but practice may be different.
6. Amounts and modalities of new loans and grants 1990-99. Dutch loans and grants.

Assessment:
Was the combination of new funding and debt relief modalities consistent with the perceived and the actual nature of the debt problem (as described in 1.10)? Were these inputs suitable for the improvement of debt sustainability (see Cline, 1995: 29 and Hanlon, 2000)?

---

3. Outputs of debt relief: efficiency analysis

To determine how efficient the inputs were in producing the intended outputs the following data are to be collected and analyzed:

1. Debt service *due* during 1990-1999 as compared to debt service *actually paid* and accumulation versus payment of arrears.
2. The share of (total as well as Dutch) debt relief that effectively relieved the debt burden in that it led to a reduction of actually paid debt service (see Annex 1).
3. The effect of the different modalities of debt relief on actual payment of debt service on the reduced as well as on other debt. Since debt relief usually increases ability and/or willingness to pay other debts, other creditors may benefit. This may be an unintended side-effect and has been established for debt buy-backs (Bulow & Rogoff, 1988), or it may be an intended result: in the context of HIPC agreements, countries may be obliged to start or resume servicing debts that they ignored before.
4. Extent to which debt relief freed resources for the government, with special attention to Dutch debt relief. This follows from 2.6, 3.2 and 3.3. Compare to the amounts of new loans and grants received during the period 1990-1999 (see 2.7).
5. Extent to which debt relief benefited the creditor itself or other creditors (bailing out), with special attention to Dutch debt relief. This follows from 3.2-3.4. Specify whether official or private creditors benefited.
6. Effect of debt relief on the reduction of the nominal debt stock and the net present value (NPV) of debt.
7. Compliance with debt relief conditionality, changes in policies, changes in governance (see Table 2 and Annex 2).
8. To the extent that debt relief was additional and freed resources (3.4): trace its effects in the government accounts (on public investment and social expenditure, in particular) and in the balance of payments (increased imports, if possible broken down by destination: capital goods, intermediate inputs, consumer goods), according to the accounting framework outlined in Annex 3.

Assessment:
How efficient were the chosen modalities of debt relief in reducing the debt burden, in terms of both NPV of debt and actual debt service?

---

4. Outcomes of debt relief: Effectiveness

The effectiveness of debt relief is to be assessed by collecting / analyzing the following data:

1. Trends during the evaluation period 1990-1999 in the debt sustainability indicators: debt/GDP, debt service due/exports, NPV of debt/exports. We focus on trends as most relevant issue for this evaluation. However, the absolute values of these indicators will be compared to subjective sustainability criteria (limits) according to the IFIs (from HIPC documents) but also according to other sources, e.g. Hanlon (2000).
2. Extent to which change in sustainability can be attributed to debt relief. Both the numerators and the denominators of these indicators are not only the result of debt relief, but also of new loans and grants during the period and of the concessionality of those loans (see Annex 4). In addition, the trends in GDP and exports (the denominators) depend on many other factors: policies, political stability, weather conditions, international prices, etc. The possible causes for the developments in the debt sustainability indicators will be analyzed.
3. Improvement, if any, of social indicators (see Annex 5) as a result of debt relief leading to policy changes and changes in governance (as analyzed in 3.6) .
4. Improvement, if any, of social indicators as a result of debt relief freeing government resources for more public investment and social expenditure (3.7).
5. Increase, if any, in private investment as a result of debt relief freeing resources for more public investment: crowding in.
6. Increase, if any, in private investment as a result of debt relief lowering the debt stock, thereby reducing the debt overhang.
7. Improvement, if any, in the creditworthiness of the country leading to new private capital inflows, as a result of a reduction of the debt stock. This implies an analysis of creditworthiness according to ratings, and of figures on private capital inflows (distinguishing between loans, portfolio investment, FDI). It must be born in mind that other factors such as (expected) economic growth, credibility of government policies, and even conditionality attached to debt relief efforts may also have led to improvements in ratings and increases in flows. Debt relief may, on the other hand, have reduced creditworthiness by lowering expectations on future debt service by the country. According to a recent literature review and additional empirical evidence, policy-based lending and the attached conditionality have only limited effect on private flows (Bird & Rowlands, 2000).

***Field studies**:*
In the field studies, the trends in social indicators (4.3-4.4) and in private investment and private capital inflows (4.5-4.7) can be analyzed and explained more thoroughly by having interviews with government officials, NGOs, donors and representatives of the private sector.

Assessment:
How effective has debt relief been in increasing debt sustainability, stimulating private investment and improving social indicators, both via the attached conditionality and via the stock and flow effects of debt relief?

5. Impact of debt relief: Relevance

Assessment:
Based on the analysis under 1-4, the final impact of the different modalities of debt relief on economic growth and on poverty reduction is to be assessed.

1. Economic growth was already briefly analyzed in 4.1 and 4.2 as denominator for one of the debt sustainability indicators, but the analysis can now be broadened, taking into account the other outcomes under 4 (4.3-4.7).

2. For poverty, trends in the usual poverty indicators (P_0, per cent of population below poverty line), and P_1, the poverty gap (total shortfall of income of the persons below poverty line) will be collected (if available). For the analysis, it is important that poverty reduction may be achieved through economic growth, through an improvement of the income distribution or (in the longer run) through an improvement in social indicators.

References

Andrews, David, Boote, Anthony R., Rizavi, Syed S., & Singh, Sukhwinder. (2000). *Debt Relief for Low-Income Countries: The Enhanced HIPC Initiative* (Pamphlet Series No. 51). Washington DC: IMF.

Bird, Graham, & Rowlands, Dane. (2000). "The catalyzing role of policy-based lending by the IMF and the World Bank: Fact or Fiction?". *Journal of International Development, 12*(7), 951-973.

Bulow, Jeremy, & Rogoff, Kenneth. (1988). "The buyback boondoggle". *Brookings Papers on Economic Activity, Vol. 2*, 675-98.

Cline, William R. (1995). *International Debt Reexamined*. Washington: Institute for International Economics.

Demirgüç-Kunt, Asli, & Huizinga, Harry. (1993). "Official credits to developing countries: Implicit transfers to the banks". *Journal of Money, Credit and Banking, 25*(3), 431-444.

Easterly, William. (1999). *How did Highly Indebted Poor Countries become highly indebted? Reviewing two decades of debt relief* (Policy Research Working Paper 2225). Washington: The World Bank.

Fishlow, Albert. (1988). "External borrowing and debt management". In Rudiger Dornbusch & F. Leslie C.H. Helmers (Eds.), *The Open Economy: Tools for Policymakers in Developing Countries*. New York: Oxford University Press.

Gillis, Malcolm, Perkins, Dwight H., Roemer, Michael, & Snodgrass, Donald R. (1996). *Economics of Development*. (4th ed.). New York/London: Norton.

Hanlon, Joseph. (2000). "How much debt must be cancelled?". *Journal of International Development, 12*(6), 877-901.

Mistry, Percy. (1996). *Resolving Africa's multilateral debt problem*. The Hague: FONDAD.

White, Howard. (1998). *Aid and macroeconomic performance: Theory, empirical evidence and four country cases*. London: MacMillan.

White, Howard. (1999). *Dollars, dialogue and development*. Stockholm: Sida.

Table 1. Evaluation matrix Debt relief

OBJECTIVES-MEANS	INDICATORS	SOURCES	*EVALUATION*
INPUT **Debt relief expenditures and modalities;** Policy dialogue	Amounts spent, assigned and contributed; Conditions.	Documents for Dutch Parliament "Macro-exercitie", assessment memos for debt relief Global Development Finance; national statistics; WB/IMF country reports;	
Comparison outputs and inputs →			***EFFICIENCY***
OUTPUT Reduction debt and debt service; Increase imports and government expenditure Policy change and change in governance	Total debt (nominal and net present value); Interest payments and amortizations; Balance of payments; Government accounts.	Global Development Finance; World Development Indicators; IMF; national statistics; WB/IMF country reports	
Extent to which inputs via outputs contribute to outcomes →			***EFFECTIVENESS***
OUTCOME Reduction debt burden Improvement creditworthiness Investment	Debt/GDP; Debt service/Exports; International credit ratings; I/GDP; I_p/GDP.	Global Development Finance; World Development Indicators; IMF; national statistics; Moody's; Standard & Poor; WB/IMF country reports	
Extent to which inputs via outputs and outcomes contribute to impact →			***RELEVANCE***
IMPACT Economic growth	Change in GDP	World Development Indicators; national statistics.	

Sustainable poverty reduction

Table 2. Possible aspects of the track record possible policy conditions for debt relief

Area	**Policy/target**
Macro-economic	Stock of international reserves Government deficit (% GDP) Government expenditure (% GDP) Exchange rate policies (devaluation)
Economic reforms	Tax reforms Public sector reform/civil service reform Composition of expenditure (defense) Privatization of SOEs, public utility enterprises Liberalization of goods markets: prices, domestic trade Liberalization of foreign trade Liberalization of labour market Financial liberalization Other sectoral reforms
Political reforms	Elections Multiparty system Human rights observance Independent judiciary Free press
Governance	Transparency of budgeting Transparency of budget execution Accountability, to parliament, local councils, civil society Anti-corruption measures/sanctions Establishment of and respect for Audit Office Decentralization
Poverty reduction	Social expenditure Social sector reforms Quality of social service delivery PRSP

Annex 1

Effective debt relief

Effective debt relief (DR_e) is debt relief that reduces actual debt service (DS_a)

To be computed from:

$DS_a = DS_d - AA$ (1)

$DR_e = DR - PA$ (2)

Where:

DS = Debt Service
DR = Debt Relief
Subscript *a* = “actual”
Subscript *e* = “effective”
AA = Accumulation of Arrears
PA = Payment of Arrears
Subscript *d* = due

DR_e is still an approximation, since debt relief covering debt service due that would never be paid in the same year, is still included. This often the case with Dutch debt relief on Dutch aid loans. If known, it must be subtracted from the figure for DR_e.

Annex 2

The effectiveness of conditionality

To the extent that debt relief was accompanied by conditionality on future policies, or by conditions regarding past policies or policy outcomes ("track record") the extent of compliance with these conditions must be assessed (with respect to changes in policies and changes in governance, see Table 2). The track record has become important for Dutch debt relief decisions since 1996. The evaluation must therefore investigate whether and to what extent the conditions mentioned in the "macro exercitie" were fulfilled in the case of the involved country. A second issue is whether changes in country's policies or governance can be observed since 1996 that go in the direction of improving the "conditions" stipulated in the macro exercitie. Evidence for this can be looked for in HIPC documentation on the country, Policy Framework Papers, Implementation Completion Reports of SALs and SECALs of WB.

In field studies, information can also come from interviews. Interviews should also shed light on the issue of whether the fact that the Dutch have used this track record as basis for decision making on debt relief, has to any extent *influenced* governance and policies (see below).

In the context of the HIPC initiative, the track record has become important since 1998 and involves an assessment of whether conditions stipulated in earlier IFI programs have been complied with satisfactorily. This can be found in HIPC documents on the country, but an independent assessment by the evaluator is also necessary. For example, earlier evaluation research showed that countries were not always treated equally. As of 1999, the HIPC conditions include the setting up of a Poverty Reduction Strategy Paper (PRSP). For the desk studies it is too early to investigate whether the HIPC track record or the requirement of a PRSP have induced a change in the country's policies or governance. In the field studies, donor influence on policies and governance can be examined.

Donor influence (field studies only)

One thing is to establish that countries have complied (or not) with conditions set by the donor; another is to conclude on effective influence of donors. An earlier evaluation concluded that domestic political factors are most important in policy changes but there is also some room for donor influence, especially if we take other dimensions of the "policy dialogue" into account, i.e. other than the formal, directive conditions laid out by the IFIs and directly imposed on the recipient country's government (White, 1999).

This means, first, that we have to take on a broad political economy perspective in explaining why reforms have come about. Donors usually tend to overstate their roles. Second, it means that we have to consider the policy dialogue as a process with four dimensions as discovered in the previous evaluation: the degree of formality, the channel of influence (directly to government, indirectly through IFIs or indirectly through contact with other donors), whether conditionality is directive (policy monologue) or non-directive, and which instrument is used (White, 99: 53-54; see also a useful table of possible channels and degree of formality on p. 37).

Instruments can be debt relief, budget support, project aid or technical assistance. The earlier evaluation has shown that there may be some influence from donors, but that this is usually carried out through less formal means, non-directive approaches and often using other channels.

The study of donor influence consists of two parts: i) examining Dutch influence, and ii) examining the impact of the HIPC conditions, in particular, the requirement that countries elaborate a Poverty Reduction Strategy Paper (PRSP) and do so in a participatory manner. On the first, field studies can first investigate whether the Dutch Embassy has an infuence strategy that takes the different dimensions into account, and on which particular issues it focused. Second, by having interviews with government officials and with other donor representatives, the effectiveness of that influence strategy can be assessed. Since this may lead to subjective and not very exact statements, the approach will be to single out one or two issues (from the Dutch "track record") on which the Dutch had or have a strong opinion – different from the government's opinion – and examine what happened with this "conflict". For the second aim, the same interviews with donor representatives and government officials can be used to assess the progress in coming to a PRSP. On this topic, interviews with representatives of NGOs and private sector (civil society) will also be necessary. If possible, also for this part a particular issue on which opinions differ will be singled out and followed, in order to improve the judgement on the extent of influence.

Annex 3

The marginal effect of debt relief: the accounting framework

The approach proposed here is similar to the one described for the Sida Evaluation of Programme Aid (see White, 1999: 94-6). It focuses on the marginal impact of debt relief. This is different from the often used “gap approach” which is considered not very helpful (White, 1999: 89-93). It means that we analyze the influence of effective debt relief (free resources) on balance of payments, internal accounts and on government accounts (a subset of the internal accounts), on the basis of accounting identities.

For the external account, the identity is the following:

$M = AID + PCT + DR_e – DS + X + OKI + \Delta R + EO$ [16] (3)

If DR_e (see Annex 1) increases, one or more of the other items must change. The fact that DR_e is positive, implies that the absolute value of DS (debt service) has reduced (as established in 3.1). The impact of DR on other DS has been established in 3.2 and can be used here. Similarly, it has already been established whether DR was additional, i.e. did not lead to a reduction in aid (2.6). From all these, we can compute the net effective debt relief. It will now be examined whether this net DR_e leads to higher imports and/or reserves, which are the preferred responses for donors. This depends on the effects on OKI, ΔR, EO (often capital flight), X, and PCT. A reduction in X could be a negative effect of AID and net DR_e, for example due to Dutch disease effects. Decreases in PCT, OKI and EO (if capital flight) would also be negative responses to DR_e. Increases in PCT and OKI could be positive second round effects of DR_e.
A next step is to look at the composition of imports. Does the composition of imports change as a result of net DR_e? The preferred outcome would be that imports of capital goods and intermediate goods would increase more than imports of consumer goods. This would point to a higher propensity to invest as opposed to to consume.
For the internal account, the identity is the following:

$I = AID + DR_e – DS + OKI + \Delta R + EO + S$ [17] (4)

[16] M = Imports
PCT = Private Capital Transfers
DR_e = Effective debt relief
DS = Debt service
X = Exports
OKI = Other capital inflows
ΔR = Change in reserves
EO = Errors and Omissions

[17] I = Investment
S = Savings

The analysis for AID, DS, OKI, ΔR and EO is the same as above. The marginal effect of net DR_e on I depends on what happens to S, domestic savings.
If savings diminish as a result of the additional free resources (as claimed by Easterly, 1999, for example[18]), this would be a negative effect of debt relief. Ideally, DR_e would be accompanied not only by higher I but also by higher S.

The internal account can be broken down further, allowing for separate government income and expenditure. A change in domestic savings is the sum of changes in private saving and changes in government revenues. Investment can be broken down into government expenditure and private investment (see schemes in White 1999: 95).

According to the "fiscal response" literature (White, 1998), the marginal effect of aid (in this case, net effective debt relief) can be to reduce revenues. The analysis of government accounts must therefore begin by looking at what happens to government revenues. A second possible effect that must be examined is the effect on the deficit. If revenues and deficit remain unchanged, the whole effect of net DR_e is on increased expenditure, which is the intended effect of donors (resources should be freed for other – social – expenses). The third step is to look at the composition of expenditure. Does the freeing of government resources lead to increased priority for social expenditure or for public investment? The trends in the share of these sectors within total expenditure will be examined.

[18] Easterly (1999) does not distinguish between debt relief and effective debt relief, however; and his model that stresses "perverse incentive effects" also overlooks that the continued lending by HIPC countries is probably as much the result of (lending) supply factors than of demand factors such as a high discount rate.

Annex 4

Debt sustainability

In the long run, debt service can be sustainable if the following holds (Gillis et al., 1996: 414):

$D/X = a/(g_E - i)$ (5)

Where D = debt, X = exports, a = the trade gap $(M - X)/X$, M = imports, g_E = the growth rate of exports, and i = the average interest rate on debt.

This means that as long as the growth rate of exports is higher than the interest rate, a sustainable debt/exports ratio can be accompanied by a trade gap *a* (i.e. by increasing debt). A first issue to be examined is therefore whether the growth rate of exports is higher or lower than the average interest rate of the debt stocks over 1990-99 (as computed in 2.7). If it is lower, it can be argued that the country had a solvability problem and not a liquidity problem, and that new loans would not lead to a sustainable debt service.

The next component to analyze is the trend in the trade gap. This trade gap *a* is constant if the growth rate of imports is equal to the growth rate of exports, but this is not necessary for the analysis. In our study, the trade gap that leads to this increase in debt $a = (M - X)/X$ must be adjusted for the non-loans part of aid (i.e. grants, A) and for net effective debt relief (DR_e, see Annex 1), so we will look at what happens to

$$\frac{M - (X + A + DR_e)}{X}$$

If the growth rates of exports is lower than the interest rate, D/E is only sustainable if there is a surplus, so $M-(X+A+DR_e) < 0$.

Similarly, the debt/GDP ratio can be sustainable in the long run if (Gillis et al., 1996: 415):

$D/Y = (v - s)/(g_Y - i)$ (6)

Where $Y = GNP$, g_Y = the growth rate of Y, $v = I/Y$, the investment ratio, and $s = S/Y$, the savings ratio.
As long as g_Y is above the interest rate, a sustainable debt/income ratio can be accompanied by a continuing and constant savings gap ($v - s > 0$). This savings gap leading to increased debt must also be adjusted for grants (A) and for net effective debt relief (net DR_e) , so we look at:

$v - s - A/Y - DR_e/Y$

If g_Y is below the interest rate, there must be a savings surplus. The evaluation will examine the trends 1990-99 in g_Y as compared to i, and of v, s, A/Y and DR_e/Y

For the government, we can assess sustainability in relation to the tax capacity (Fishlow, 1988: 220-21). In the long run, the debt burden is sustainable if:

$D/T = \{(G - T)/T\} / (r_t - I)$ (7)

Where T = tax income, G = government expenditure, r_t = growth rate of taxes.

In this part of the analysis, the sustainabality of the debt burden for the government is not only determined by the external public debt, but also by the internal debt. This is a problem for Jamaica, for example. An average interest rate on total public debt will have to be computed. This average interest rate must then be compared with the growth rate of taxes. The latter will probably be related to the growth rate of GDP, but there can also be an independent effect due to, for example, tax reforms. If the interest rate is higher than the growth rate of taxes, the government must have a surplus (G-T) < 0 for debt service to be sustainable.

Annex 5

Social indicators

Social indicators to be analyzed could be taken from the OECD/DAC indicators for social development (Nos. 4-15 of the 21 Indicators for sustainable poverty reduction). These are:

Indicator	Measure	Source
Children under 5 with underweight	%	WDR (WDI)
Enrolment in primary education (%)	%	WDR (WDI)
Share of people with fourth grade	% of adults	HDR (WDI?)
Alphabetization	% of adults	HDR (WDI?)
Gender equality in primary enrolment,	F/m, in %	UNFPA or WISTAT
Gender equality in secondary enrolment	F/m, in %	UNFPA or WISTAT
Gender equality in alphabetization	F/m, in %	HDR
Infant mortality rate	%	HDR
Child mortality rate	%	WDR (WDI)
Maternal mortality rate	%	WDR (WDI)
Deliveries under expert supervision	% of total	UNFPA
Use of contraceptives	% of married women	HDR
HIV ratio	% of adults	UNAIDS

Ministry of Foreign Affairs | P.O. Box 20061 | 2500 EB The Hague | The Netherlands

Policy and Operations Evaluation Department

ISSN 15166-3000

ORDERCODE: OSDR0516/E

Ministerie van
Buitenlandse Zaken

O S D R 0 5 1 6 / E