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RESULTS OF INTERNATIONAL DEBT RELIEF IN UGANDA

Marianne Lindner (ETC Crystal)

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POLICY AND OPERATIONS EVALUATION DEPARTMENT

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CASE STUDY FOR THE IOB EVALUATION OF DUTCH DEBT RELIEF

MARIANNE LINDNER (ETC CRYSTAL)

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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.

The research was carried out – in close consultation with the chief consultant for the evaluation, Dr. A.G. Dijkstra – by Ms. M.E. Lindner of ETC Crystal, who is 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.

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ABBREVIATIONS

AfDB	African Development Bank
AfDF	African Development Fund
BoU	Bank of Uganda
CAS	Country Assistance Strategy
CG	Consultative Group
DGIS	Directoraat-Generaal Internationale Samenwerking (Directorate-General International Co-operation)
DSA	Debt Sustainability Analysis
DSR	Debt Service Ratio
ERP	Economic Recovery Program
ESAF	Enhanced Structural Adjustment Facility
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNP	Gross National Product
GoU	Government of Uganda
HIPC	Highly Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFIs	International Financial Institutions
IMF	International Monetary Fund
IOB	Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie (Policy and Operations evaluation Department)
MDF	Multilateral Debt Fund
NRM	National Resistance Movement
ODA	Official Development Assistance
PA	Programme Aid
PAF	Poverty Action Fund
PAPSCA	Programme for the Alleviation of Poverty and Social Costs of Adjustment
PC	Paris Club
PEAP	Poverty Eradication Action Plan
PNG	Private Non-Guaranteed
PPG	Public and Publicly-Guaranteed
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper

SAC	Structural Adjustment Credit
SAF	Structural Adjustment Facility
SPA	Special Programme of Assistance for Africa
Ug Sh	Ugandan Shilling
UPE	Universal Primary Education

EXECUTIVE SUMMARY

This country report assesses the effects of Dutch debt relief in Uganda in the period 1990-1999. It provides an answer to the following questions:

- To what extent were debt relief inputs in the form of financial and political interventions efficient in generating outputs including reductions of the debt stock and actual debt service as well as effects on internal and external accounts (increases in imports and government expenditure) and changes in government policy?
- To what extent were debt relief inputs and outputs effective in producing intended outcomes, such as increased debt sustainability, stock effects on higher investment and improved creditworthiness, and flow effects on improved social indicators?
- To what extent were debt relief inputs, outputs and outcomes relevant by impacting on economic growth and poverty reduction?

Before answering these questions, the report analyses the buildup of the debt problem during the 1970s and 1980s and the resulting debt situation at the start of the evaluation period in 1990, and gives an overview of debt relief inputs in the 1990s.

Analysis of the debt problem until 1990

While some increase in Uganda's debt took place in the 1970s, the rapid rise of the country's debt stock to problematic levels started in the early 1980s. Before the evaluation period total debt grew from USD 152 million in 1970 to USD 690 million. in 1980, and then increased sharply to USD 2.6 billion in 1990. Uganda's debt problem is rooted in economic and political developments during the 1970s and 1980s, which were characterised by major political instability and civil war, economic mismanagement, and adverse external shocks. After the economy had virtually collapsed at the end of the 1970s, an economic rehabilitation programme was put in place covering the period 1981-84 and backed by substantial aid from IMF and World Bank and other donors. This marked the start of the buildup of the debt problem. The programme led to a short-lived revival of the economy, but was abandoned in 1984-85, and the gains made in the early 1980s eroded. After Museveni took power in 1986 an economic reform programme was introduced in 1987; since that time foreign aid has been at very high levels; a large part of this aid included loans, leading to a rapid increase of the debt burden.

In 1990, at the start of the evaluation period, multilateral debt was the major element in the country's debt, with multilateral long-term debt (predominantly IDA debt) and IMF debt combined amounting to USD 1.6 billion or about 60 per cent of the debt stock. Bilateral debt amounted to USD 550 million. in 1990, or about 20 per cent of total debt, while commercial debt stood at USD 335 million, corresponding to about 15 per cent of total debt. The multilateral debt, which had been the major debt component since 1983, placed a particularly heavy burden on the economy, as debt service to IMF and World Bank had to be paid and no arrears could be built up. As a result, actual payments on multilateral debt were very high. In 1990 Uganda had built up considerable arrears on its bilateral and commercial debt payment obligations. The values of debt sustainability indicators suggest that Uganda faced a liquidity as well as a solvency problem in 1990, with a debt service ratio of 60 per cent, substantial arrears, a debt-to-GNP ratio at 60 per cent, and a debt-to-exports ratio at over 1000 per cent.

Development of the debt problem and debt relief inputs in the 1990s
Since reform started in 1987 two periods can be distinguished. During the first period 1987-1992 some important reform measures were implemented, but overall not many of the planned stabilisation and reform measures were carried out as the government did not show strong commitment to the programme and much slippage on conditionality occurred. After economic problems and related fall-out with donors in 1992, the second reform period 1992-1999 saw determined government commitment to reforms. This produced rapid achievement of economic stabilisation, while structural reforms were stepped up from 1993 onwards, although their implementation remained slower than planned. Social sector development and increased expenditure in this area were added to the reform menu later in the decade. With the launch of the Poverty Eradication Action Programme (PEAP) in 1997 poverty reduction became the overarching development objective of the country. Uganda adopted an external debt strategy in 1992, which was further updated and strengthened in 1995.

The reforms were backed with large amounts of foreign aid. A substantial amount of this involved loans, albeit largely on concessional terms. The bulk of these loans were provided by multilateral agencies, which including IMF loans amounted to an annual average of USD 250 million. Bilateral donors increasingly switched to grants, a process that had already started in the 1980s, but still some bilateral lending continued in the 1990s. Commercial lending in the 1990s was limited, and ceased in 1994. The continued (mainly multilateral) lending led to a further sharp increase in the country's debt in the 1990s. Since the start of the ERP in 1987, Uganda's debt stock tripled. In 1999 total debt stood at USD 4.1 billion. Of this total, USD 2.9 billion or almost three-quarters was owed to multilateral creditors, making their share even higher than at the start of the decade. Bilateral debt amounted to 23 per cent of the total in 1999, and commercial debt had declined to a mere 2 per cent of total debt.

Prior to 1990 Uganda received some relief on bilateral debt through the Paris Club framework. No relief on multilateral debt was provided. During the 1990s Uganda benefited from a broad range of debt relief arrangements. Relief of bilateral debt was provided through the Paris Club framework in 1992, 1995, 1998 (and 2000, outside the evaluation period) and included debt service and debt stock rescheduling and forgiveness, debt stock reduction and debt conversion schemes. Relief on multilateral debt was provided through a number of facilities. Through the Fifth Dimension facility between 1989 and 1994 bilateral donors provided debt relief on multilateral debt service obligations to the IBRD. The Multilateral Debt Fund (MDF) which operated during 1995-1998 involved the payment by bilateral donors of debt service obligations to multilateral institutions including the IMF, the World Bank/IDA and the African Development Bank. Towards the end of the decade Uganda was the first country to receive debt relief under the HIPC Initiative (both under the original and the enhanced HIPC framework, the latter of which fell strictly speaking outside the evaluation period) leading to reduction in the debt stock in NPV terms. Commercial debt relief was undertaken through a buyback operation in 1993 under the Debt Reduction Facility.

Conditionality attached to bilateral and multilateral debt relief consisted of the existence of an appropriate economic programme supported by the IMF as proof of the need for debt relief, and adherence to the prescribed policy measures and benchmarks. Governance issues became more important in the second half the 1990s, while towards the end of decade social development indicators were included.

While the major part of Uganda's external debt was multilateral, international relief operations initially focused on bilateral debt. Besides relief on IBRD debt in the first half of the 1990s, multilateral debt relief, including IDA, IMF and AfDB debt, became the main

focus of attention only from the mid 1990s onwards. Substantial debt relief operations aimed at stock reduction were only initiated at the end of the decade under HIPC. Hence, debt relief inputs in the 1990s were not sufficiently in line with the actual nature of the debt problem.

Outputs of debt relief: Efficiency
Despite debt relief, the stock of debt continued to rise rapidly throughout the 1990s. This was mainly due to new loans. The reduction of the debt stock as a result of debt relief was also very limited. The amounts of debt relief were small, before 1998 most relief was in the form of rescheduling, and until far in the 1990s relief arrangements left the multilateral debt burden largely untouched. The buyback operation did reduce the commercial debt stock, but this had been small to begin with. Only with HIPC, towards the end of the decade the amount of forgiveness increased, so a more substantial reduction in the debt stock came about.

PC debt relief and the buyback had limited effects on the actual debt service flow, as these debts were generally not serviced. PC debt relief was largely used to clear bilateral arrears and less to reduce the current debt service burden. Major problems were encountered with non-PC bilateral donors, who did not agree to provide debt relief on PC comparable terms, and were therefore not paid by Uganda, which led to increases of on against this type of debt. At the same time, PC debt relief seems by and large to have been additional to other PC bilateral aid inflows. Relief on multilateral debt did reduce the actual debt service burden, so that it freed resources. Multilateral debt relief was at least in part also additional. HIPC is expected to have a noticeable flow effect on debt service payments.

Aid including debt relief had a clear effect on the balance of payments, with imports sustained at a much higher level than would have been possible without it. An analysis of counterfactual imports also reveals that actual debt service was relatively insignificant in determining the level of imports, but that aid (including debt relief) was much more important as a determinant of import capacity. At the same time, aid including debt relief helped build up the foreign exchange reserves. With regard to the government accounts, aid including debt relief allowed higher public investment and social expenditure than would have been possible without it. Social expenditure as a proportion of GDP increased in the second half of the 1990s. Under the MDF extra resources freed through debt relief benefited the social sectors. Thereafter, under HIPC resources that were no longer needed for debt service payments were directed to the social sectors through the Poverty Action Fund (PAF), including budget support by donors.

During the first reform period, the effect of conditionality on government policy was limited. Considerable slippage on conditions occurred. During the second reform period the effect of economic conditionality on government policy was considerable. At the same time, government ownership of stabilisation and reform measures had been strong since 1992, although progress on structural reforms was slower than planned. There was much donor criticism on the lack of progress in the areas of governance (corruption) and political reforms and Uganda's increasingly heavy involvement in the war in DRC, but this did not lead donors to curb debt relief or other aid. Uganda became a showcase and pilot country for various schemes such as HIPC, and appears to have been given the benefit of the doubt by donors. The policy dialogue did help to draw attention to social issues in the reform agenda later in the decade.

Outcomes of debt relief: Effectiveness

Debt sustainability improved in the 1990s. The debt service ratio declined to the sustainability threshold of 20 per cent. However, the debt service due-to-export ratio was still high at over 60 per cent, indicating that Uganda still had large arrears. Solvency indicators also improved, but clearly remained unsustainable. The debt-to-GNP ratio improved (decreased) to a level of 60 per cent in 1999, which is still above the sustainability threshold of 50 per cent. The debt-to-exports ratio also improved, but, with 500 per cent, it stayed far above the threshold value of 200 per cent (or 150 per cent, according to HIPC 2). Improvements in these indicators were more the result of the increase in GNP and exports than of debt relief efforts. HIPC is expected to lead to greater debt sustainability through a reduction in the NPV of the debt stock. However, with HIPC 1 the sustainability benchmark was not achieved. Further relief under HIPC 2, which falls outside the evaluation period, is expected to bring down the debt-to-exports ratio to a sustainable level of 150 per cent. However, in view of Uganda's above-average vulnerability to adverse developments in the export sector, it remains to be seen how solid the debt sustainability status of the country will prove to be.

Private investment and also foreign direct investment (FDI) increased, but these were mainly the result of the more optimistic business climate, higher growth rates, credibility of government policies - aided by conditionality on aid including debt relief - and political stability. They were probably not related to debt relief reducing the debt overhang. Although the ratio of debt service paid to debt service due improved somewhat, it was still low. Apart from FDI and some returning capital flight as registered in the figures for private transfers, there were no private capital inflows to Uganda yet.

Many social indicators improved in comparison with the early 1980s, although some deteriorated. The improvements were mostly related to the continued peace in most parts of the country. Foreign aid including debt relief helped sustain public expenditure at a higher level than would have been the case otherwise, and this may have helped funding the policy of Universal Primary Education which substantially raised primary school enrolment rates in the later 1990s.

Impact of debt relief: Relevance

Uganda's macroeconomic performance during the 1990s was good, and Uganda became known as a successful reformer and a showcase. GDP growth averaged 6 per cent per year, inflation was under control, and the government deficit declined considerably, although it remained at a rather high level of 6 per cent of GDP (excluding grants). All sectors maintained positive growth. Aid including debt relief and the conditionality attached to it contributed positively to economic growth. As debt relief did not lead to substantial debt service and debt stock reductions until the end of the decade (although the burden of multilateral debt service payments was reduced through bilateral donors financing these payments), it was less important in improving debt sustainability than were the increases in exports and GNP. Nor was debt relief the major factor impacting on growth through increases in private investment. On the other hand, aid including debt relief did allow higher imports and public expenditure than would have been the case without it, which benefited growth. It also helped boost the country's foreign exchange reserves. The relative importance of aid decreased somewhat during the 1990s, confirming the positive impact of imports on growth, as exports and inflows of private capital increased. Although it is difficult to draw clear-cut conclusions about the effect of conditionality on growth, donor commitment and pressure through the policy dialogue, as compared to the conditionality attached to programme aid including debt relief, are likely to have played a positive role in raising the credibility of government policies, improving investment and creditworthiness, and fostering economic growth, although its effect should not be overstated.

The incidence of poverty declined considerably during the 1990s, from 56 per cent in 1990 to 35 per cent in 1999. Aid including debt relief was one of the factors contributing to poverty reduction, particularly in the second half of the decade, through its effect on economic growth and by helping to curb inflation earlier in the decade. However, progress in reducing poverty was accompanied by an increase in inequality, especially after 1997. The difference in poverty rates between rural and urban areas increased, and inequality between income groups increased. Despite improvements, levels of poverty remained high. At the end of the decade over one-third of the population still lived below the poverty line, and many social indicators remained at a very poor level.

Efficiency, Effectiveness and Relevance of Dutch debt relief

During the 1990s the Netherlands was the second biggest bilateral programme aid donor to Uganda. About four-fifth of Dutch programme aid between 1991 and 1997 was debt relief. During this period the Netherlands was the largest donor of debt relief to Uganda, providing 31 per cent of total relief. During the evaluation period, relief of the multilateral debt service burden was the major focus of the Dutch macroeconomic support programme. During the 1990s the Netherlands granted a total amount of NLG 148 million in 14 separate disbursements; all but one (a contribution to the buyback) were meant to service multilateral debt. Besides major financial support the Netherlands provided technical and political inputs through the policy dialogue.

The Netherlands was among the first donors to acknowledge the importance of the multilateral debt problem and argue for its alleviation and take concrete action accordingly, including the provision of major financial support. Multilateral debt relief always released resources for the government, and therefore had a flow effect on sustaining higher imports and higher government expenditure than would otherwise have been the case.

The contribution to the buyback did reduce the debt stock somewhat. However, It seems that this reduction did not have stock effects on creditworthiness or on private investment during the evaluation period. It may have played a role in improving the incentives for better government policies, as it removed uncertainty on future payments on these commercial debts.

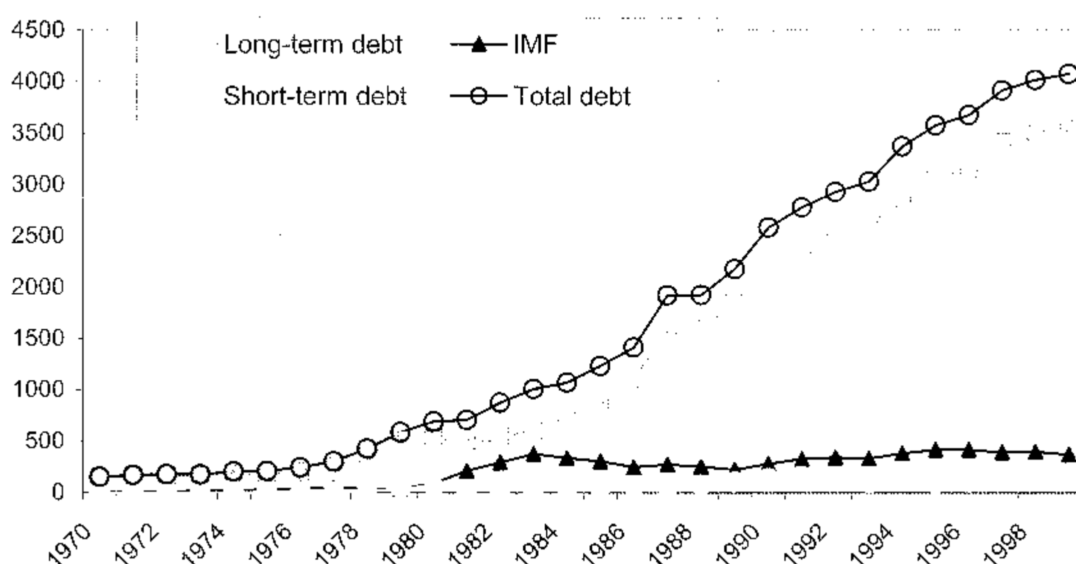
1 BACKGROUND: DEBT PROBLEM ANALYSIS 1970-1990

This chapter serves as an introduction to Uganda's debt problem. It provides an overview of its development since the early 1970s until 1990 (the start of the evaluation period), and addresses the nature, causes and consequences of the debt problem.

1.1 Background and causes of the debt problem

While some increase in Uganda's debt stock took place in the 1970s, the rapid increase in the debt stock to problematic levels started in the early 1980s. Total debt outstanding grew from USD 152 million in 1970 to USD 690 million in 1980, after which it rose to about USD 2.6 billion in 1990 (Figure 1–1).

Figure 1–1 Debt stock 1970-1999 (USD million)



Source: GDF 2001

Uganda's debt problem is rooted in economic and political developments in the 1970s and 1980s. These decades saw periods of major political instability and civil war, economic mismanagement, and adverse external shocks (World Bank 2000b; Ddumba et al. 1999). These factors together led to a severe decline and virtual collapse of the economy at the end of the 1970s, and dismal economic performance during part of the 1980s. Uganda received large amounts of foreign aid in the early 1980s, and in particular from 1986 onwards, to support and restore economic and social development, a considerable part of which consisted of loans (World Bank 2000a).

At independence in 1962 Uganda had one of the strongest economies in Sub-Saharan Africa (Ddumba et al. 1999). The 1960s, during which time the country was governed by the Obote I regime, were characterised by steady real GDP growth of about 5 per cent per year, high growth of domestic investment (8 per cent annually) and of private consumption (6 per cent), as well as high domestic savings rates (15 per cent) which were an important source of finance for domestic investment. All sectors showed positive growth rates. The balance of payments was healthy, and no serious inflationary pressures existed with annual inflation rates below 10 per cent. There was external and internal balance and internal financial stability, and fiscal discipline was good. The exchange rate was fixed but

the national currency was not overvalued. Exports were competitive. Agriculture produced enough for domestic consumption and a surplus for exports. Economic and social infrastructures were in good condition. The external debt was small and manageable.

The coming to power of Idi Amin in a coup d'état in 1971 heralded a major change in the economic situation (Dijkstra and Van Donge 2001). During the 1970s the economy faced internal and external shocks. Real GDP growth was persistently negative at –3 per cent for the period 1971-1979, with a virtual collapse towards the end of the 1970s. This was caused by several factors. The Ugandans of Asian origin, on whom the economy depended, were expelled from the country in the early 1970s, triggering a rapid economic decline. Political instability with brutalities committed by the regime against the population, insecurity and lawlessness affected most productive sectors of the economy. Investment rates fell rapidly, from 12 per cent of GDP in 1972 to 3 per cent in 1980. The agricultural sector reverted back to pre-colonial subsistence farming instead of commercial farming, and a substantial decline in the annual output levels of major export crops occurred. The economic and social infrastructure was destroyed or neglected. The current account position worsened due to several factors. The real value of exports declined from 19 per cent of GDP in 1970 to 2 per cent in 1980, which flowed from a decline in the production of export crops (with a narrowing of the export base to coffee only), and falling world coffee prices. Other factors were the oil price hikes and the world economic recession. The public deficit worsened, and as the government borrowed from the banking system inflation became rampant. Government expenditure as a proportion of GDP contracted, and many public funds were used for unproductive expenditures. The decade ended with a war against Tanzania, and the ousting of Amin in 1979.

Against this background, the Obote II regime that came to power in 1980 announced a package of policy measures covering the years 1981/82-1983/84 to reconstruct and rehabilitate the economy (Holmgren 1998). This IMF/World Bank-supported programme aimed at restoring internal and external balance in the economy. The conditionality attached to the external assistance provided under this programme included the usual stabilisation and reform measures applied under IMF and World Bank programmes, such as price decontrols, import liberalisation, increased interest rates, and exchange rate realignment. The programme led to a short-lived revival of the economy. The negative growth rates of the 1970s were turned into positive ones, and output increased by 17 per cent in the period 1980-1983. Coffee exports grew, but while modest revitalisation of other exports took place, the export base remained very dependent on coffee. Price decontrol and import liberalisation harmed domestic industries and encouraged imports (Ddumba et al. 1999). The resulting current account deficit was financed by foreign aid, including loans. From 1984 onwards the economy started to decline again, wiping out most of the gains of the early 1980s. Major factors behind this development included renewed internal political instability, civil war and insecurity; inadequate working capital after a devaluation and credit squeeze; widespread corruption; and the withdrawal of IMF funds. Amidst the turmoil Obote was ousted by the army in 1985, after which a guerrilla movement, the National Resistance Movement (NRM) led by Yoweri Museveni, took power in 1986.

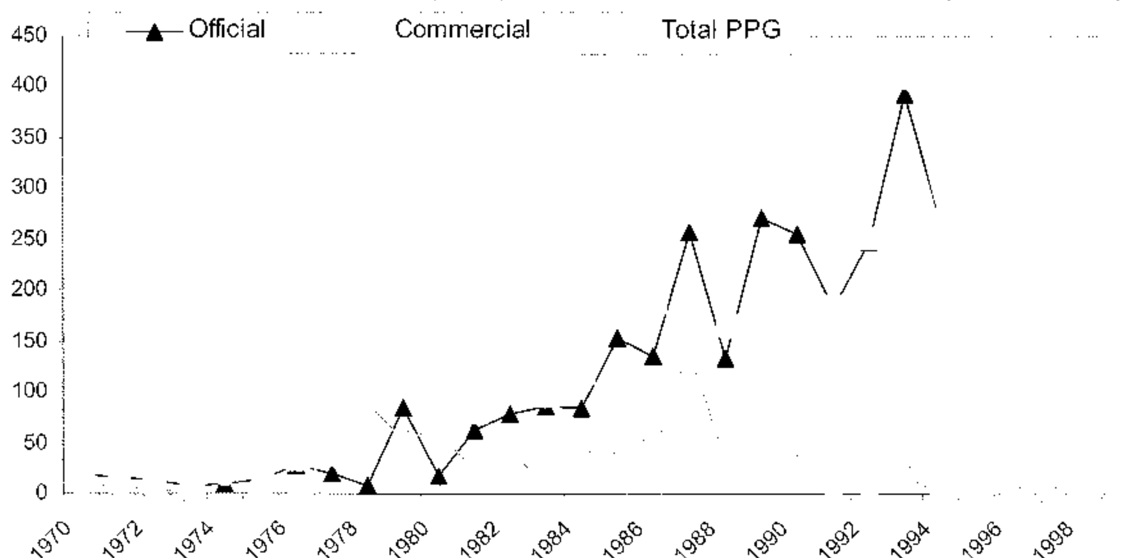
During the first year of Museveni's regime a control model to achieve economic stabilisation was followed. However, as the economic situation continued to decline, a major policy revision was undertaken, and a donor-supported Economic Reform Programme (ERP) was announced in 1987 (Holmgren 1998). The aims of the ERP were to bring about internal financial stability and lower inflation, external stability by increasing exports, and economic rehabilitation and growth. It was strongly supported by the IMF and World Bank, as well as with bilateral aid. The conditionality attached to these loans before 1990 involved the usual menu of measures required by the IFIs to stabilise and reform economies.

The reform programme can be roughly divided into two periods. During the first period, covering 1987-1992, not many of the planned stabilisation and reform measures were carried out, and much slippage on conditionality occurred. During the second period, from 1992 onwards, stabilisation measures were successfully applied, while structural reforms were stepped up, although they were still implemented at a rather slow pace; these reforms will be further discussed in Chapters 2 and 3.

During the first reform period 1987-1992 the Ugandan shilling was devalued several times, but it remained overvalued and foreign exchange controls continued (Ddumba et al. 1999, Holmgren 1998). Trade deficits were large. As public expenditure increased substantially while revenues increased only marginally, the budget deficit increased. This was partly financed by external funds. Real GDP growth rates were positive and inflation declined although it remained high. A few important reforms were carried through during this period (Kayizzi-Mugerwa 1999). Foreign exchange bureaux were legalised in 1990; eventually the foreign exchange market was entirely liberalised in 1993. Price controls for domestic products and export taxes for coffee were abolished, and coffee marketing was liberalised. By 1991 most properties were returned to their former Asian owners, who started to come back. This first reform period already saw some increase in ownership of the reform programme by government. However, its commitment to the programme was not yet very strong (Dijkstra and Van Donge 2001).

The buildup of long-term debt (official and commercial) started at the end of the 1970s. During this time IMF lending was still low or non-existing. The IMF and World Bank provided major support through a structural adjustment programme under Obote II in 1981-83 under two IMF standby arrangements totalling about SDR 270 million and an IDA credit of about USD 105 million These loans marked the start of the increase in Uganda's external debt to unsustainable levels. During the 1980s long-term lending was substantial and official long-term lending was considerably higher (annual average of USD 130 million) than commercial long-term lending (USD 50 million annual average) (Figure 1–2).

Figure 1–2 Long-term public (PPG) loans, official and commercial (USD million)



Source: GDF 2001.

The IMF provided substantial loans in the early 1980s amounting to an average of USD 100 million per year, and after Uganda's suspension in 1985-86 resumed lending – albeit

at a lower level – about USD 60 million per year. Multilateral lending increased virtually unabated during the 1980s, including the difficult period 1985-86. However, bilateral lending, after standing at a substantial level during the late 1970s and eraly 1980s, was relatively low in the period 1985-86, after which it increased. Multilateral lending has been substantially higher than bilateral during most if the 1980s, with an average volume of USD 90 million compared to USD 40 million of bilateral loans.

The proportion of concessional loans increased from under 20 per cent in 1981 to almost 60 per cent in 1990 (GDF 2001). Concessionality of multilateral loans was far higher than that of bilateral loans. However, the concessionality of bilateral loans increased much faster than that of multilateral loans, reaching about 70 per cent in 1990, versus almost 100 per cent concessionality of multilateral loans. Overall, most foreign aid received in the 1980s was in the form of loans as opposed to grants, although this proportion declined from about 70-80 per cent in the first half of the 1980s to 60 per cent in 1990. Although an increasing part of these loans were concessional, many loans were not. As a result, debt accumulated and debt service payments became a burden to economy.

Poverty has been very severe since the early 1970s (Ddumba et al. 1999, WDI 2001). While social indicators, especially those for education, were still relatively favourable in the 1960s, during the 1970s and 1980s they were poor. Life expectancy has always been very low. It stood at 51 years in the early 1970s (World Bank 2000b) and deteriorated in the 1980s to 48 years. Infant mortality was high, and worsened from 104 deaths per 1000 live births in the early 1970s to 116 during the 1980s. Net primary school enrolment was around 50 per cent in the 1970s and down to about 40-45 per cent in the first half of the 1980s, before it increased again after 1986.

Poverty reduction was not a major focus in Ugandan policy in the 1970s and 1980s. At the end of the 1980s PAPSCA[1] was put into place as a means of protecting poor segments of society against the effects of structural adjustment. This programme remained underfunded, and while it had some effect in terms of cushioning the poor, the impact on poverty reduction was limited (Opio 2000).

1.2 Buildup and composition of the country's debt

As indicated at the start of this chapter, total debt outstanding was modest in the 1970s, but started to grow rapidly at the end of the 1970s, and increased from USD 690 million in 1980 to about USD 2.6 billion in 1990 (GDF 2001) (Figure 1–1). Long-term debt constituted by far the largest component of total debt. It grew from about USD 150 million in 1970 to USD 540 million in 1980, after which it surged to USD 2.2 billion in 1990. IMF debt increased from a very low level in the early 1970s to USD 90 million in 1980, then to a peak of almost USD 400 million in 1983, after which it fell back to USD 280 million in 1990. Long-term debt as a percentage of total debt stood at 78 per cent in 1980, then fell to 60 per cent in 1983, and increased again to 84 per cent at the end of the 1980s. At the same time, the share of IMF debt increased rapidly in the early 1980s, from 13 per cent in 1980 to a peak of 38 per cent in 1983, after which it gradually fell back to 11 per cent in 1990. Short-term debt remained limited, averaging 4-5 per cent of total debt.

With regard to the composition of long-term debt, private non-guaranteed debt (PNG) has always been zero. Therefore, all long-term debt consisted of public and publicly guaranteed debt (PPG). As Figure 1–3 shows, official long-term debt has always been far higher than commercial long-term debt since 1980, and this was increasingly the case after 1986. Official debt mushroomed from just under USD 300 million in 1980 to 1.8 billion in 1990, while commercial debt increased from under USD 200 million in 1980-85 to

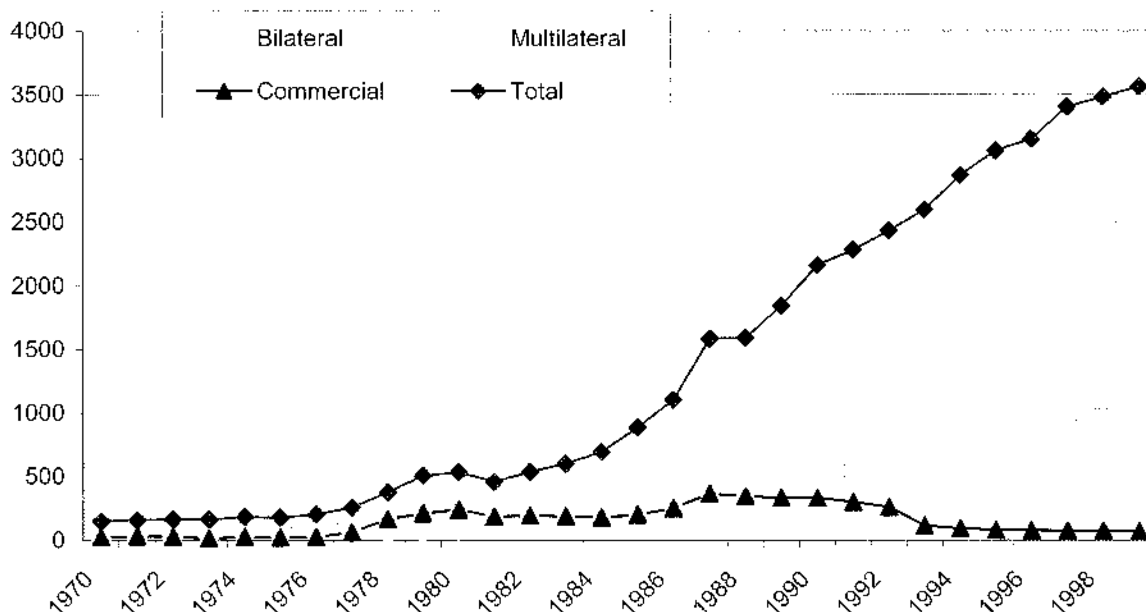
[1] PAPSCA = Program for the Alleviation of Poverty and Social Costs of Adjustment.

USD 335 million in 1990. Official debt as a proportion of total debt increased from 55 per cent in 1980 to 85 per cent in 1990. In tandem with this, the proportion of private debt declined from 45 per cent in 1980 to 15 per cent in 1990.

Bilateral debt increased from about USD 100 million in 1970 to USD 215 million in 1980, and showed a large increase after 1986 to about USD 550 million in 1990. Multilateral debt[2] increased from USD 19 million in 1970 to USD 80 million in 1980, after which a very rapid increase occurred – especially after 1986 - to USD 1.3 billion in 1990. As a proportion of total long-term debt, bilateral debt declined from 40 per cent in 1980 to about 25 in 1990. On the other hand, the proportion of multilateral debt increased sharply from 15 per cent in 1980 to 55 in the mid 1980s, and reached 60 per cent in 1990. Multilateral debt became the major element in Uganda's heavy debt burden. It has exceeded bilateral debt since 1983.

World Bank debt formed the largest component of multilateral debt. This concerned mainly IDA (soft window) debt, the proportion of which increased from just over 50 per cent of multilateral debt in 1983 to about 75 per cent in the early 1990s, corresponding to an absolute increase from USD 46 million in 1980 to USD 935 million in 1990. The proportion of IBRD (hard window) debt remained modest: at most 10 per cent of multilateral debt, and 5 per cent of total long-term debt. While negligible in the 1970s and absent in 1980-83, it increased to an annual average of USD 40 million in the period 1984-90. Other multilateral debt increased steadily since the early 1980s, from about USD 30 million in 1980 to USD 300 million in 1990. This corresponds to an increase from 6 per cent of total long-term debt in 1980 to about 15 per cent in 1990.

Figure 1–3 Long-term public debt 1970-1999, by type of creditor



Source: GDF 2001.

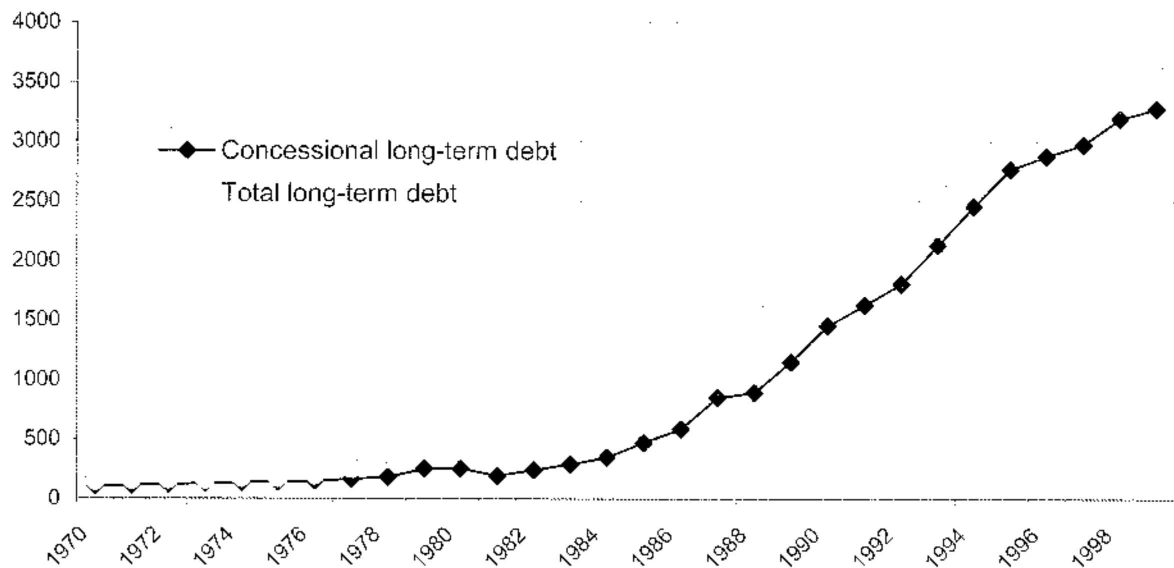
A further feature of Uganda's debt was the high level and proportion of concessional debt, as reflected in Figure 1–4. Concessional debt increased from just over USD 100 million in 1970 to USD 250 million in 1980, and then sharply to USD 1.5 billion in 1990, or from 28

[2] Multilateral debt according to the definition used here (and as applied in the GDF 2001 database) includes debt owed to IDA, IBRD and other multilateral creditors. It excludes IMF debt.

per cent of total debt in 1980 to over half (56 per cent) in 1990. This reflects the increasingly concessional terms on which Uganda contracted its loans since the early 1980s, increasingly from multilateral creditors.

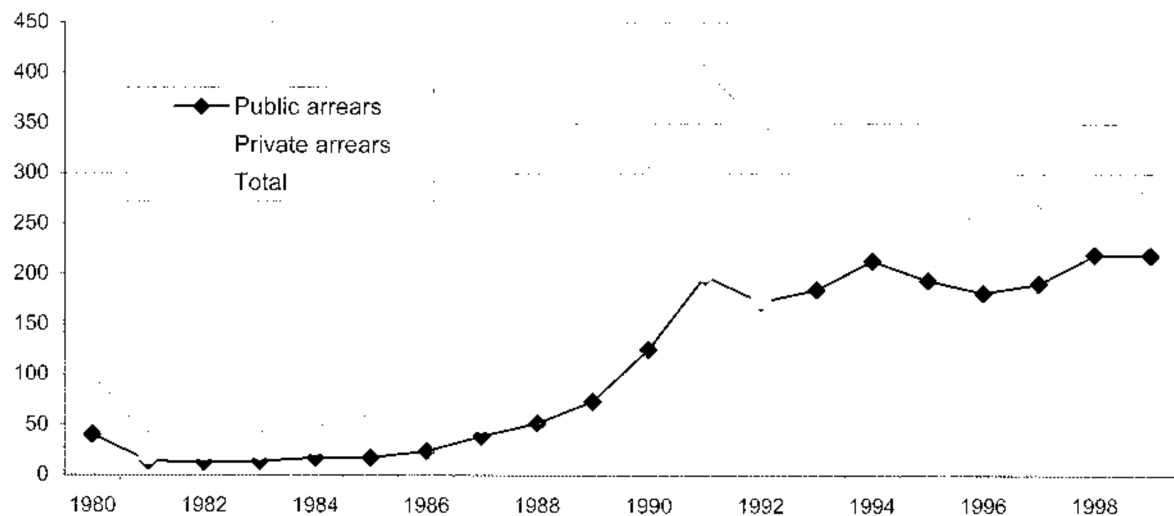
Average interest rates on new loans for all creditors fluctuated in the 1970s and 1980s within a range of 2-6 per cent, averaging about 3.6 per cent per year in the 1970s and 3.8 per cent per year in the 1980s. It started to decline at the end of the 1980s, and stood at 1 per cent in 1990. Interest rates on public debt stood at an annual average of 3 per cent, and declined in the latter part of the 1980s. Interest rates on private debt continued to be high during most of the 1980s with an annual average of about 7 per cent.

Figure 1–4 Concessional and total long-term debt (USD million)



Source: GDF 2001.

Figure 1–5 Arrears (USD million).

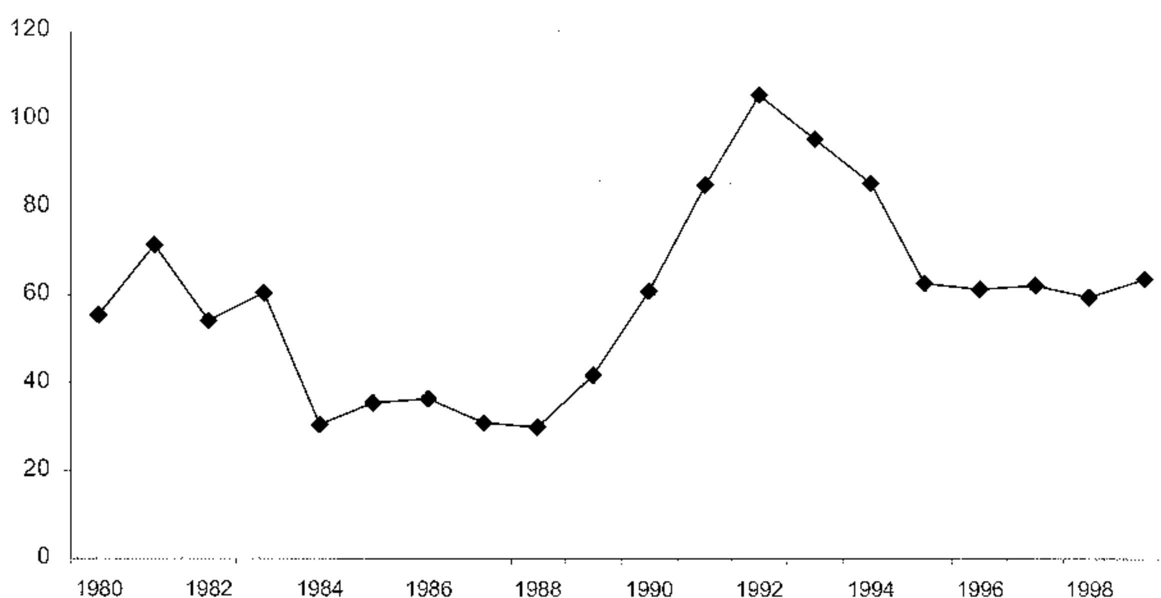


Source: GDF 2001.

As Figure 1–5 shows, arrears accumulation was low in the 1970s, became higher in the late 1970s and early 1980s (USD 100 million in 1980), followed by a decumulation in 1981 (to USD 34 million), and increased again substantially after 1986 to a high level of almost USD 300 million in 1990. In the 1980s about two-thirds of arrears were on commercial debt. As a proportion of long-term debt, arrears increased sharply at the end of the 1980s from between 6 and 8 per cent in 1981-86 to 14 per cent in 1990.

Some relief of the external debt took place in the 1980s through Paris Club reschedulings. However, this does not appear in the GDF statistics. The first two debt treatments took place in 1981 and 1982, covering USD 40 million and USD 19 million respectively under classic terms[3], followed by an operation on ad-hoc terms in 1987 covering USD 256 million. In 1989 a debt relief operation covering USD 90 million under the Toronto terms took place. Under these terms, with regard to non-ODA credits 33 per cent of claims were cancelled, while donors could choose from a menu of three options. These included a debt reduction option with 33 per cent of eligible claims cancelled and rescheduling of the remaining part with a 14 year repayment period and 8 years grace; a debt service reduction option whereby claims were treated at a reduced interest rate with a 14 year repayment period; and a commercial option, with claims restructured at the appropriate market rate at a longer period, namely 15 years including 14 year grace. ODA credits were rescheduled over 25 years period and 14 year grace (Paris Club 2001). The buildup of the external debt was not accompanied by a noteworthy domestic debt problem.

Figure 1–6 Debt-to-GNP ratio 1970-1999 (per cent)



Source: GDF 2001.

1.3 Nature and consequences of the debt problem

Longer-term debt sustainability can be measured by solvency indicators such as the debt-to-GNP ratio and the debt-to-exports ratio. Critical values have been established for these indicators, below which the debt can be considered sustainable (i.e. the debt can be serviced without affecting economic growth). These equal 50 per cent for the debt-to-GNP ratio and 200 per cent for the debt-to-exports ratio (Cohen, 1997). Figure 1–6 shows the

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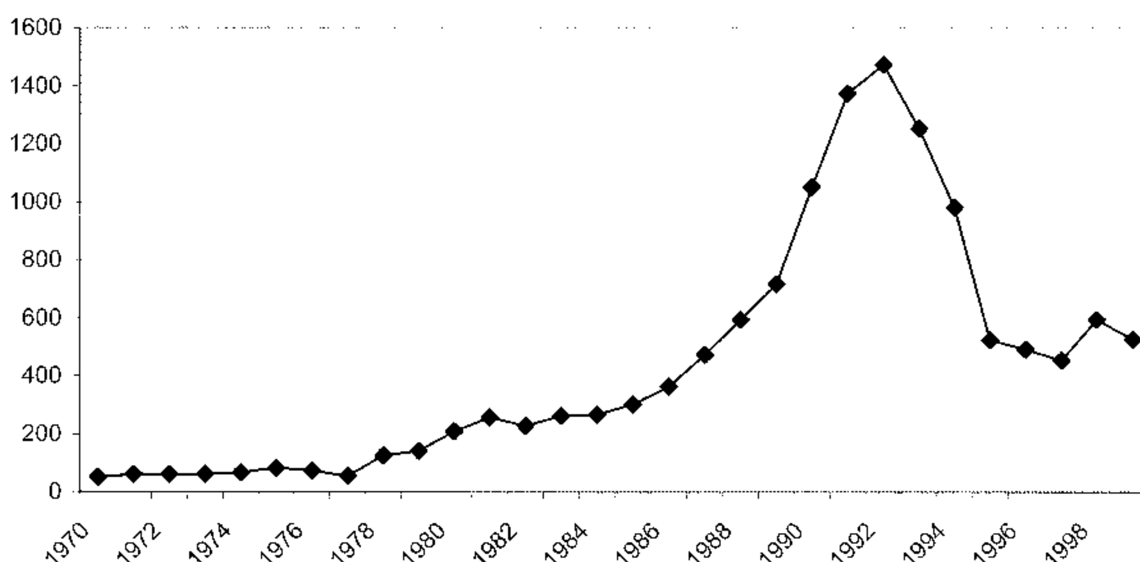
[3] Classic terms are the standard terms applied to a debtor country by the Paris Club.

trend in the debt-to-GNP ratio. This ratio was somewhat above the sustainability threshold of 50 per cent in the first half of the 1980s, but fell below that level in the period 1984-1988, which indicated improved sustainability. However, it started to increase rapidly towards the end of the 1980s, just after the start of the ERP, and stood at about 60 per cent in 1990. This indicates increasing *un*sustainability of the debt during that period. It should be noted that the debt-GNP ratio was relatively low in Uganda compared to other highly indebted countries. The debt-to-exports ratio exceeded the 200 per cent sustainability threshold already in 1980 and rose steeply, especially after 1987, reaching over 1000 per cent in 1990 (Figure 1–7). Hence, according to this indicator debt had become highly unsustainable.

Figure 1–7 Debt-to-exports ratio 1970-1999 (per cent)



Source: GDF 2001.

The values of debt sustainability indicators are the result of a combination of developments in the numerator and the denominator. The numerator – the debt stock – increased rapidly in the 1980s. Figure 1–8 gives insight in the denominator, showing the five-year rolling growth rates of GNP and exports (measured in current dollar prices). It shows that simultaneously with the increase of the debt stock, GNP growth was high in the second half of the 1980s, which contributed to the improvement in the debt to GNP ratio[4]. However, when GNP growth rates started to decline at the end of the 1980s and became negative in the early 1990s[5], this contributed to the rapid rise of the debt-to-GNP sustainability indicator as debt continued to soar. Export growth became negative in 1988 and reached its lowest point in 1992, which together with the increasing debt stock led to a rapid rise of the debt-to-exports ratio to highly unsustainable levels. In addition, throughout the 1980s the average interest rate on new loans exceeded the exports growth rate, which points to long-term unsustainability of the debt situation. However, GNP growth rates were far above the interest rate, which signalled longer-term debt sustainability from this perspective.

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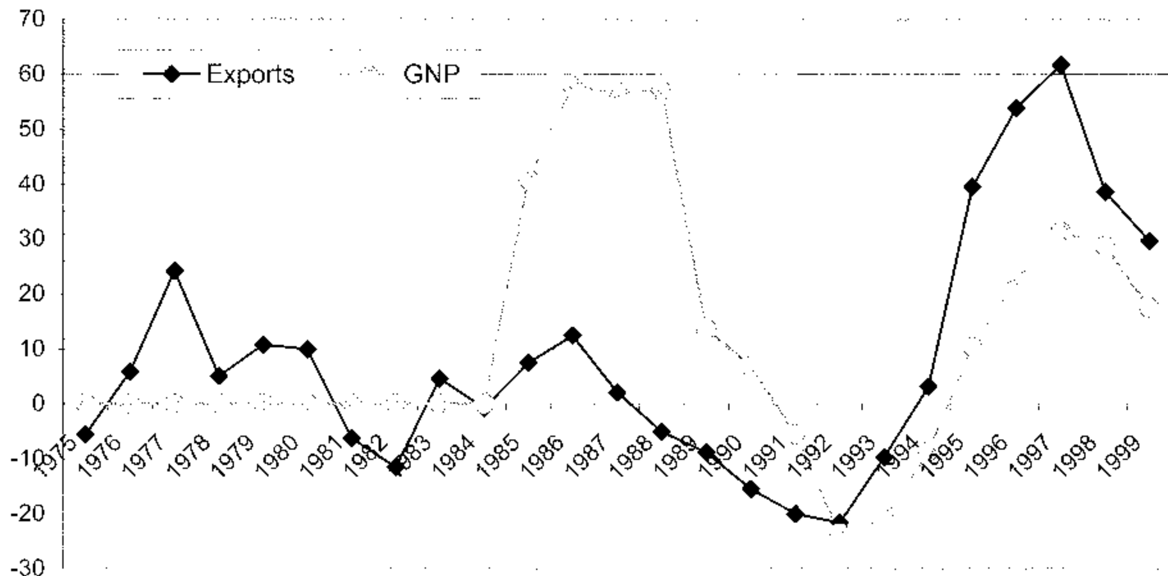
[4] Five-year rolling growth rates could only be derived from GDF data from 1985 onwards.

[5] The negative growth rates of GNP and exports at the end of the 1980s and early 1990s should be seen in the light of the devaluation of the Uganda shilling that took place at that time. Growth rates are based on GNP and export values in current dollar prices.

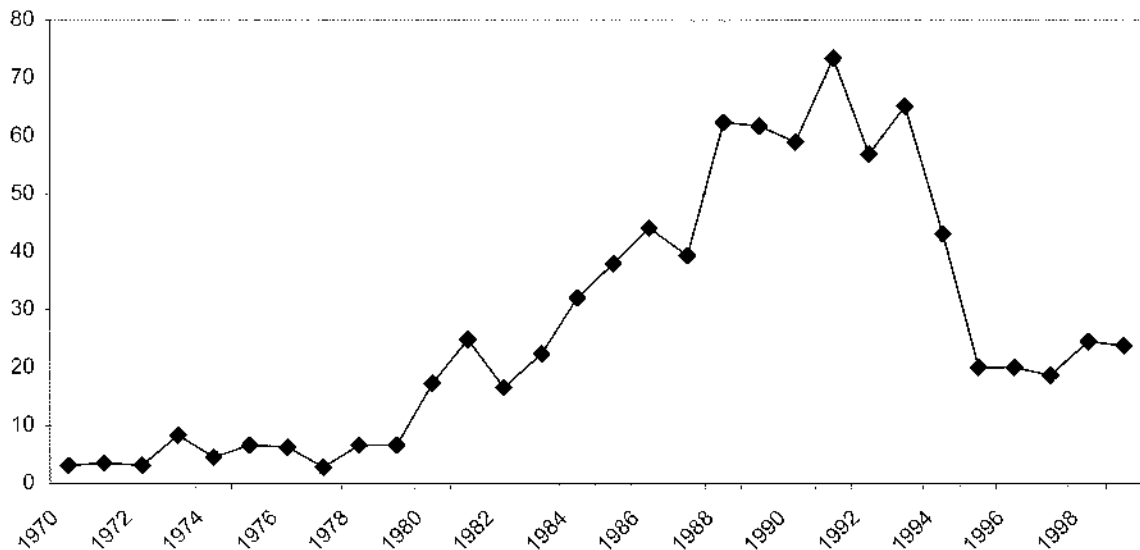
Figure 1–8 Growth rates of GNP and exports 1975-1999 (percent, based on figures in current USD)



Source: GDF 2001.

A measure of the extent to which a liquidity problem, i.e. a temporary payment problem, occurs, is the debt service-to-exports ratio (or debt service ratio). As Figure 1–9 shows, this ratio started to exceed its 20 per cent sustainability threshold in the early 1980s, and rose far above it during the 1980s to 60 per cent in 1990. This was due to a large and rapid increase in the debt service paid since the early 1980s from USD 57 million in 1980 to almost USD 200 million at the end of the decade (compared to an annual average of USD 16 million in the second half of the 1970s), combined with an unfavourable development in exports.

Figure 1–9 Debt service-to-exports ratio 1970-1999 (per cent)



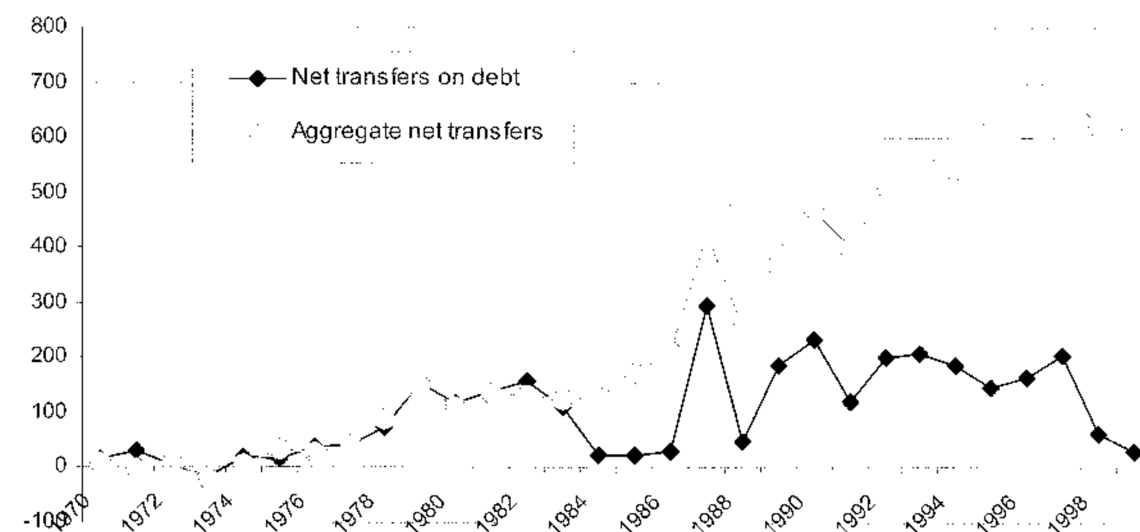
Source: GDF 2001

The level of arrears is another measure of liquidity problems. As was discussed in section 1.2, arrears rose sharply at the end of the 1980s and stood at a high level in 1990, signalling a clear liquidity problem (Figure 1–5).

In sum, the Ugandan debt problem at the end of the 1980s concerned a liquidity as well as a solvency problem according to most indicators examined here. This was due to the increase in debt stock and debt service paid, as well as unfavourable developments in exports and GNP.

Net transfers on debt[6] were positive since 1970 (Figure 1–10). After a gradual increase until 1983, net transfers on debt dropped to a low level (but remained positive) in the years 1984-86, when the IMF suspended assistance and bilateral donors kept aid at a low level. After that net transfers fluctuated at a higher level, averaging about USD 150 million per year. They stood at USD 233 million in 1990. This trend reflects the large amount of loans that Uganda received since the beginning of the 1980s. Aggregate net transfers[7] were at the same level as net transfers on debt until the early 1980s. They rose sharply since the mid 1980s, in conjunction with large increases in aid flows (loans and grants) especially under the reform programme. Aggregate net transfers were far above net transfers on debt since the mid 1980s and stood at about USD 470 million in 1990, or twice as high as the net transfers on debt.

Figure 1–10 Net transfers on debt and aggregate net transfers (USD million)



Source: GDF

It was concluded that the debt situation became unsustainable in the 1980s. The liquidity problem that emerged would be expected to dampen imports and economic growth. However, imports showed large increases, especially later in the 1980s. This was made possible by the large aid inflows, which also alleviated the scarcity of foreign exchange. While export growth rates were low (averaging –1.7 per cent annually in the 1980s when measured in current prices), as were reserve levels (around 1 month worth of imports), economic growth rates were positive during most of the 1980s.

6 Net transfers on debt = Loan disbursements - debt service payments.

7 Aggregate net transfers = loan disbursements + FDI + portfolio equity flows (zero in the case of Uganda) + official grants – (principal repayments + loan interest + FDI profits)

Net transfers on debt and aggregate net transfers were positive and rising (Figure 1–10), implying that an increasingly larger amount of funding was entering than leaving the country, sustaining imports and public expenditure. Foreign direct investment was virtually non-existent until 1993. Low rates of private investment and FDI during the 1980s were probably largely the result of political instability and insecurity rather than of the debt overhang.

1.4 Conclusions

In 1990, at the start of the evaluation period, Uganda's debt stood at USD 2.6 billion after a rapid increase since the early 1980s. Multilateral debt had become the major element in the country's debt since 1983. Multilateral debt excluding IMF debt amounted to USD 1.3 billion in 1990, corresponding to 58 per cent of long-term debt, and multilateral debt including debt owed to the IMF stood at USD 1.6 billion, or 60 per cent of the total debt stock. The multilateral debt placed a particularly high burden on the economy, as Uganda was required to service this debt and could not build up arrears against it, as a result of which actual debt service payments were very high. Uganda did accumulate considerable arrears on other types of debt. Debt sustainability indicators show that Uganda faced both a liquidity and a solvency problem in 1990.

2 INPUTS OF DEBT RELIEF IN THE 1990S

This chapter discusses the debt relief inputs covering the period 1990-1999. It describes the debt relief modalities applied, the amounts of funding involved, the conditionality attached, and the stated objectives of debt relief. First debt relief inputs for Uganda by all creditors are discussed, followed by specific Dutch debt relief inputs. At the start of this chapter, a brief overview of the main economic policies and donor support to Uganda in the 1990s will be provided.

2.1 Economic policy and donor support in the 1990s

As indicated in Chapter 1, the ERP was launched in 1987. During the first period of reform (1987-1992) not many of the planned stabilisation and reform measures were carried out, and much slippage on conditionality occurred. In 1991/1992 lack of expenditure controls led to a high budget deficit, giving rise to soaring inflation. A deterioration in the relationship with donors ensued, with the IMF suspending its assistance. The regime quickly reigned in the crisis, and from 1992 onwards it was more serious about stabilisation and reform measures, showing stronger commitment. Economic stabilisation was brought about quickly. The monetisation of the budget deficit came to an end in 1992, when a cash budget was introduced. As a result inflation declined rapidly to single-digit figures. Structural reforms were carried out more in earnest only from 1993, including privatisation, trade and financial sector reforms, public sector reform, and decentralisation. While these reforms were stepped up, they were still implemented at a slower pace than planned. More recently increases in expenditure for social sector development were added to the reform menu.

During the 1990s foreign aid (loans and grants excluding TA) amounted to an annual average of USD 635 million The value of the loan component varies from an annual average of USD 335 million in the first half of the decade to about USD 275 per year in the second half). The majority of new loans were extended by multilateral creditors, averaging about USD 200 million excluding IMF credits, and USD 250 per year including IMF credits. Bilateral donors had already switched to grant financing in the 1980s, although bilateral lending – even on non-concessional terms - continued in the 1990s. Bilateral lending amounted to an average of USD 30 million per year in the first half of the 1990s (it was even USD 189 million in 1993), but became much less towards the end of the decade (see Table 4–4 in Chapter 4). New commercial lending was limited in the 1990s, and ceased in 1994.

Table 2–1 gives an overview of IMF- and World Bank support programmes under the ERP. Since 1987 over USD 700 million was borrowed by Uganda from the IMF under these programmes, and almost USD 2 billion from the World Bank (IDA), giving rise to a major part of Uganda's debt problem as it manifested itself in the 1990s.

The continued lending led to a further sharp increase in the country's debt in the 1990s. Since the start of the ERP in 1987, Uganda's debt stock tripled. In 1999 total debt stood at USD 4.1 billion. Of this total, USD 2.9 billion or almost three-quarters was owed to multilateral creditors, making their share even higher than at the start of the decade. Bilateral debt amounted to 23 per cent of total debt in 1999, and commercial debt had declined to a mere 2 per cent of total debt.

Table 2–1 IMF and World Bank programmes since 1987

	IMF		World Bank (IDA)
1987/88-1988/89	SAF	1987/88-1988/89	Economic Recovery Credit 1
1989/90-92/93	ESAF I	1989/90-91/92	Economic Recovery Credit 2
		1990	Agricultural Sector Adjustment Credit
		1992-94	Structural Adjustment Credit (SAC) 1
1993-94	(ESAF I)*	1993	Financial Sector Adjustment Credit FSAC)
1994/95-1996/97	ESAF II	1994/95-1996/97	SAC 2
1997/98-1999/00	ESAF III (PRGF) **	1997/98-1999/00	SAC 3
		1998- 2001	Education Sector Adjustment Credit (ESAC)

* Original ESAF was for 3 years. In November 1992 the IMF approved an additional arrangement under ESAF, and in November 1993 it extended the commitment period for the additional arrangement to end June 1994.
** ESAF was renamed Poverty Reduction and Growth Facility as of November 1999.

2.2 Debt relief inputs: overview

Uganda received a wide spectrum of debt relief arrangements. Various modalities were used for the different types of debt involved. Relief on bilateral debt was given through debt service and stock of debt reschedulings and restructurings, debt service forgiveness, debt stock reduction, and debt conversion schemes in the framework of the Paris Club. Various schemes for relief on multilateral debt were applied. These included the Fifth Dimension facility, whereby bilateral donors paid debt service obligations to the IBRD; the Multilateral Development Fund (MDF), involving the payment by bilateral donors of debt service obligations to multilateral institutions including World Bank/IDA, IMF, and African Development Bank group (AfDB); and finally relief on debt service obligations under the Highly Indebted Poor Countries (HIPC) Initiative, including the Original HIPC framework (HIPC 1) and the Enhanced HIPC framework (HIPC 2), leading to a reduction in the debt stock in NPV terms. The latter arrangement took place in 2000 and was strictly speaking outside the evaluation period. Commercial debt relief was undertaken through a commercial debt buyback.

Total debt relief provided to Uganda is presented in Table 2–2. Major debt relief was provided in the years 1992/93, 1995, and 1998. Particularly in 1998 debt relief was very high. Forgiveness was modest compared to rescheduling during most of the decade. However, in 1998 major forgiveness was granted under the HIPC Initiative.

As indicated earlier, the structure of Uganda's debt stock is dominated by multilateral debt, the largest part of which concerns World Bank/IDA debt (Table 2–3). In 1990 two-thirds (64 per cent) of long-term and IMF debt was owed to multilateral creditors including the IMF, about one-quarter to bilateral donors (23 per cent) and 14 per cent to commercial creditors. At the end of the decade the distribution of debt among creditors had become even more pronounced, with three-quarters of debt owed to multilateral creditors including the IMF, still about one-quarter to bilateral donors, and a small amount (2 per cent) to commercial creditors. Hence, to ease the country's debt burden, debt relief on multilateral debt was most important. However, more concerted action to this effect was taken only from the mid-1990s onwards. With regard to bilateral debt, throughout the 1990s Paris Club debt amounted on average to about 40 per cent of total bilateral debt (fluctuating between 35 and 48 per cent), with the remainder (fluctuating between 52 and 65 per cent)

being owed to non-Paris Club bilateral creditors. Most of these did not agree to the granting of debt relief, which constituted one of the barriers to reducing the country's debt burden.

Table–2-2 Debt relief (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total forgiveness*	51	1	14	35	7	1	0	0	522	0
Interest	1	1	1	19	0	1	0	0	522	0
Principal	51	1	13	16	7	0	0	0	0	0
Total rescheduling	5	6	92	34	0	172	0	0	148	0
Interest	1	3	38	10	0	30	0	0	15	0
Principal	4	4	54	24	0	0	0	0	133	0
Debt stock rescheduling	0	0	0	0	0	142	0	0	0	0
Debt stock reduction	0	0	0	139	0	40	0	0	178	0
of which: debt buyback				17					85	
Total relief (excl. rescheduling)	51	1	14	174	7	41	0	0	700	0
Total relief (incl. rescheduling)	56	7	106	208	7	258	45	45	849	0
Memo item: MDF						45	45	45		

Source: GDF 2001.
Note: Paris Club relief is registered when it is committed; for this reason, annual amounts fluctuate widely.

Table 2–3 Structure of Uganda's long-term debt, including debt to IMF (per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Long-term debt (PPG)	88	87	88	89	88	88	88	90	90	92
Official Total	75	76	78	85	85	86	86	88	88	89
Bilateral	23	21	22	26	23	22	22	24	25	24
Multilateral	52	55	56	59	62	63	64	63	63	65
Private Total	14	12	9	4	3	2	2	2	2	2
IMF	12	13	12	11	12	12	12	10	10	9
Total multilateral (PPG + IMF)	64	67	69	70	74	75	76	74	73	74
Total long-term debt +IMF	100	100	100	100	100	100	100	100	100	100

Source: GDF 2001.

2.3. Uganda's external debt strategy

In the early 1990s the Government of Uganda's (GoU) External Debt Strategy 1992-1994 sought to eliminate arrears that had been built up over previous years, reduce the debt service ratio to a sustainable level, and improve the debt situation so as to restore a normal relationship with creditors and regain the required access to loans to finance the reform programme (GoU 1995; IOB 1997). This strategy involved:

- Obtaining maximum debt relief from the Paris Club (PC) on bilateral debt, through year by year rescheduling of pre-cutoff date eligible PC debt (pre-June 1981) at the most concessional terms possible, and maximum annual deferral of all post-cutoff date PC debt;
- write off or long-term rescheduling of all non-PC bilateral debt;

- debt buyback of (uninsured) commercial debt;
- donor support for debt relief, including extension of bilateral balance of payments support to cover multilateral debt service, especially to the IBRD and the AfDB group;
- limiting virtually all new borrowing to IDA-equivalent concessionality or better terms (exceptions were IMF ESAF loans and a USD 10 million annual limit on commercial lending in emergency cases).

The implementation of this strategy was only partially successful. Relief on bilateral debt was obtained, but was insufficient to have a substantial effect on the debt burden. Relief on non-PC debt proved problematic. A debt buyback of commercial debt was successfully concluded. Commercial lending had ceased in 1994. Relief on multilateral debt was not a major area of concern in the first half of the 1990s, and while some relief was provided, far too little was achieved in this area. Still some non-concessional lending took place by multilateral as well as bilateral creditors.

In 1995, in view of the continued high debt burden despite earlier debt relief, the debt strategy was updated. The resulting Enhanced External Debt Strategy comprised the following components (GoU 1995):

- Revised borrowing strategy: avoid all new (even concessional) borrowing until every effort has been made to secure grant financing. In case borrowing cannot be avoided it must only be done on highly concessional terms (IDA-equivalent concessionality or better terms). A USD 10 million ceiling for loans with a grant element below 78 per cent in emergency cases applied.
- Updated debt reduction strategy: Seek continued maximum debt relief from PC creditors and from non-PC creditors on PC-comparable terms; relief on multilateral debt through the MDF established in 1995; review of loan-financed projects, in order to rationalise the current loan portfolio, with a view to reducing the debt burden (starting with the AfDB portfolio).
- Sustainable budget strategy: Reduce budgetary dependence on donor resources, by increasing domestic revenue mobilisation by 13 per cent in real terms in the next years, and contain expenditure to a sustainable level while pursuing real increases in social spending. However, programme aid would remain important in the near future to fill the budgetary gap, pay external debt amortisation, reduce external arrears, and allow one-off special expenditures on financial sector restructuring, among other things.
- Reinforce external debt management structures: initiate major capacity building programmes (e.g. training in loan recording and analysis and debt strategy design and implementation), establish National Debt Strategy Committee which would undertake monthly meetings, and provide quarterly reports to donors to increase transparency.
- Reserve management strategy: the aim was to reach a level of foreign exchange reserves equivalent to six months worth of imports, in order to provide protection against risks of future sudden negative external shocks.

As to the implementation of this strategy, as was discussed in section 2.1. borrowing continued in the second half of the 1990s, even from bilateral donors although this became minimal in the last years of the decade. Multilateral lending, however, continued at a high level, amounting to an annual average of USD 250 million when lending by the IMF is included (see Table 4–4 in Chapter 4). Virtually all of this was at concessional terms. Debt relief under the Paris Club was stepped up, but still covered only a limited amount of the total debt stock. Problems continued to exist with debt relief by non-PC creditors. A portfolio review of AfDB loans was undertaken, but it is unclear to what extent

the loan portfolio was rationalised as a result. Some reduction in dependence on donor funds was achieved through an increase in domestic resource mobilisation, but as the domestic resource basis remained limited and could easily be raised, while on the other hand the volume of foreign aid continued to be substantial, dependence remained high. External debt management structures were established, and an improved reserve management strategy contributed to foreign exchange reserves amounting to about 5 months worth of imports at the end of the decade.

2.4. Debt relief initiatives

2.4.1 Paris Club debt relief

During the 1990s, four PC debt relief agreements were concluded (Paris Club 2001). Participating creditor countries in PC debt relief operations included the UK, France, Germany, Italy and Israel, and later in the decade – under the HIPC framework – USA, Japan, Norway and Spain. As Uganda had no bilateral debt outstanding to the Netherlands, the Netherlands was not part of the group of PC participating creditor countries. However, in view of its importance as a bilateral donor to Uganda and in supporting multilateral debt relief, it acted as an observer.

On 17 June 1992 Uganda reached an agreement with its PC creditors to treat an amount of USD 38 million under London terms. Under these terms the level of cancellation on eligible debt service flows was raised from the 33 per cent applied under the Toronto terms, to 50 per cent. Non-ODA credits were cancelled to a level of 50 per cent (after possible topping up of cancellation rates under earlier PC agreements), and the rest was rescheduled with a repayment period of 23 years, with 6 years of grace. Rescheduling of ODA credits involved repayment over 30 years with 12 years of grace. The agreement included the possibility to conduct debt swaps.

On 20 February 1995, Uganda was the first country to receive a stock-of-debt arrangement under Naples terms (Memo DNB 1995). This involved debt cancellation of two thirds (67 per cent) of the NPV of eligible pre-cutoff date non-ODA debt (IMF 1997, Paris Club 2001), and restructuring of the remaining amount. To implement the 67 per cent debt reduction, creditors could choose from two options: a debt reduction option and a debt service reduction option. The debt reduction option involved cancellation of 67 per cent of the claims treated, with the remainder rescheduled with a 23 year repayment period and a 6 year grace period. Topping up to 67 per cent the cancellation of debt that already received concessional treatment under the 1989 Toronto terms, was included. The arrangement did not include re-consolidation of debt covered under Uganda V (London terms), which still had to be repaid under the original terms. Under the debt service reduction option the claims treated were rescheduled at a reduced interest rate, with a 33 year repayment period. Rescheduling of ODA credits involved extension of the repayment period to 40 years, with 16 years grace. The arrangement included the possibility to conduct debt swaps covering 10 per cent of outstanding debt as per 30 June 1992 or USD 20 million, whichever would be highest. The total amount treated was USD 110 million, or the equivalent of one-third of Uganda's debt with PC creditors at the end of 1994, or 3 per cent of its total debt stock. This arrangement was intended to be an exit arrangement, after which it was expected that Uganda would not have to request further rescheduling from the Paris Club.

On 24 April 1998, the Paris Club agreed to grant Uganda a reduction of the stock of debt based on Lyon terms upon reaching the HIPC 1 Completion Point (see below). The amount of debt covered was USD 147 million. This involved an increase in the reduction

of the NPV of eligible non-ODA debt from 67 to 80 per cent. It included a topping up of the relief provided under the Naples arrangement to 80 per cent in NPV terms, and 80 per cent NPV reduction of all pre-cutoff date debt, including debt previously rescheduled on London terms in 1992 (hence a topping-up from 50 to 80 per cent of debt previously rescheduled under these terms). Again, creditors could chose from a menu of options, the most important again being a debt reduction and a debt service reduction option. The first concerned rescheduling of remaining credits, after cancellation of 80 per cent, with a 23 year repayment period and 6 years grace, and the second a rescheduling at reduced interest rate and 40 year repayment period including 8 years grace. ODA credits were rescheduled with a repayment period of 40 years and 16 years grace. In addition, creditors could engage on a bilateral and voluntary basis in debt swaps with a limit of 20 per cent of outstanding debt or USD 15-30 million, and without limit on ODA credits.

Finally, a PC debt relief operation covering USD 147 million of external debt was agreed on 12 September 2000 on Cologne terms under the Enhanced HIPC 2 framework. This arrangement included a reduction of 90 per cent or more of NPV of debt, while the remaining debt was rescheduled with a 23 year repayment period and 6 years grace. In practice, 100 per cent of pre-cutoff date debt was cancelled (DGIS Feb. 2000).

All PC agreements obliged Uganda to seek debt relief on comparable terms from other creditors, including non-PC bilaterals and commercial creditors, to ensure that no creditor would be repaid more than the others. The only exceptions were the multilateral institutions (IMF and World Bank) which were granted preferred creditor status.

PC agreements only applied to those credits granted before the cutoff date, which for Uganda was established at 30 June 1981, and could not be changed. Most of Uganda's debt was contracted after the cutoff date for debt relief (GoU 1995). Attempts by Uganda to alter the cutoff date to 30 June 1986, coinciding with the start of the current regime, have not been honoured.

2.4.2 Commercial debt buy-back: the Debt Reduction Facility (DRF)

In 1989 the World Bank created the Debt Reduction Facility (DRF) to reduce long-term commercial debt (IOB 1997, Martin 1995). The facility was funded by IDA, and in the case of Uganda co-financed by several bilateral donors including the Netherlands, Switzerland, and Germany, as well as the EU. The DRF was initially set up for 3 years, but was extended until 1995.

Under the DRF, in 1992-93 89 per cent of a total of USD 172 million of commercial debt principal of Uganda (i.e. USD 153 million) was extinguished at 12 per cent of its original face value. As a result of this operation the country's commercial debt was reduced from 14 per cent of long-term and IMF debt (or USD 335 million) to a low level (2 per cent or USD 72 million) at the end of the decade. Funding for this arrangement amounted to USD 22 million, including USD 10 million from the World Bank and the rest from bilateral donors including the Netherlands.

2.4.3 Fifth Dimension

Uganda also benefited from the Fifth Dimension facility of the Special Programme of Assistance to Africa (SPA) to countries which were IDA-only borrowers but still had IBRD debt outstanding, for the payment of Uganda's interest obligations to the IBRD. The facility was financed by the World Bank through IDA reflows and co-financed by bilateral donors. Between 1989 and 1994 Uganda received over USD 6 million of IDA Fifth Dimension

funds[8] (Martin 1995, IOB 1997). This covered an average of 80 per cent of interest payments, and was supplemented by other donors, notably the Netherlands, Sweden and Norway. In 1994/95 Norway paid the remaining principal, to eliminate future interest payments. This operation led to the entire servicing of the IBRD debt by 1994. Conditions for access to this facility were that adjustment measures were undertaken and that the debtor country be current on debt service payments to IBRD and IDA; both of these conditions were met by Uganda.

2.4.4 Multilateral Debt Fund (MDF)

Until the mid-1990s attention was mainly focused on the non-concessional part of multilateral debt. As debt service obligations on non-concessional debt fell sharply, the concessional component of multilateral debt was increasingly recognised as a problem. At the 1994 Consultative Group (CG) meeting it was decided to establish a multi-donor support group for addressing Uganda's multilateral debt problem, comprising the Netherlands, Sweden, Denmark and Austria (DGIS 1994). It was instrumental in contributing to the establishment in 1995 of the Ugandan Multilateral Debt Fund (MDF) to service all maturities to major multilateral creditors, i.e. IDA, IMF and AfDB group. A total of about USD 40-50 million per year was contributed by bilaterals in the period 1995/96 – 1997/98.

Under the MDF, bilateral donors paid contributions for multilateral debt service in the form of annual upfront disbursements of untied balance of payments support into an account in the Bank of Uganda (BoU), out of which multilateral creditors were paid. This meant a departure from earlier practice whereby donors made direct payments to the multilateral creditors. Advantages of this new modality were that it facilitated improved co-ordination of the debt policy and facilitated the planning of debt management by the Ugandan authorities. As it was now known in advance how much funding would be available for debt servicing, interest arrears and double payments could be prevented (a practice which had often occurred as donors submitted their contributions for debt servicing at the last minute). In addition, the MDF offered an opportunity for the government to benefit from small amounts of interest on the fund which could be used to pay multilateral debt service.

With the MDF the responsibility for debt management was restored to the Ugandan authorities; the External Debt Management Office in the BoU managed the MDF. To ensure maximum transparency and co-ordination, the MDF arrangement was accompanied by quarterly reporting by the government and quarterly debt meetings between the government and the donors about the debt situation in particular and macroeconomic issues more broadly (GoU 1996). Donor contributions to the MDF were conditional on sound macroeconomic policies and strict application of the country's debt strategy, especially where it concerned avoidance of borrowing on non-concessional terms (Memo MFA 1998). The facility was discontinued with the start of HIPC, and was transformed into the Poverty Action Fund (PAF) (see below).

2.4.5 Highly Indebted Poor Countries Initiative (HIPC)

Uganda was the first country to receive assistance under the HIPC Initiative, including both HIPC 1 or Original framework, and HIPC 2 or Enhanced framework (GoU 1996; IMF 1997, 1998, 2000a and 2000b). It reached the Decision Point for HIPC 1 in April 1997, and the Completion Point in April 1998, at which moment assistance was effectively delivered. While in HIPC 1 countries usually have to undergo another three years of adjustment after the Decision Point before reaching the Completion Point, in the case of Uganda this period was shortened to one year as it had already undertaken eight years of

[8] The exact yearly and total amounts provided under the Fifth Dimension could not be established from the information available.

adjustment. Uganda then reached its HIPC 2 Decision Point in January 2000, and its Completion Point in May of that year. HIPC 2 debt relief was provided upon completion of the country's Poverty Reduction Strategy Paper (PRSP). Uganda was the first country to complete such a strategy paper.

Under HIPC 1 a total of USD 347 million NPV debt relief was provided, equalling nominal relief of USD 650 million (HIPC documents). Four-fifths (79 per cent) of this relief was provided on multilateral debt, amounting to USD 274 million NPV debt relief: relief on IDA debt amounted to USD 160 million NPV, on IMF debt USD 69 million, on AfDB debt USD 22 million, and USD 23 million on debt to other multilateral creditors. The remaining 21 per cent of debt relief under HIPC 1 was granted on bilateral debt as part of the 1998 PC agreement, amounting to USD 73 million Under HIPC 2 a total of USD 656 million NPV debt relief was granted, equalling nominal debt service relief of USD 1.3 billion. Relief on multilateral debt was USD 546 million NPV or 83 per cent of total HIPC 2 relief, and that on bilateral and commercial debt 19 per cent or USD 110 million in NPV terms. Multilateral debt relief involved the following: IDA USD 357 million (or USD 629 nominal), IMF USD 91 million (or USD 139 nominal), and other multilaterals USD 98 million HIPC 2 debt relief falls outside the evaluation period. In total, debt service relief provided under HIPC 1 and HIPC 2 combined amounted to about USD 2 billion nominal, i.e. relief from two-thirds to three-quarters of the total debt service.

With the start of HIPC, the MDF was discontinued and transformed into the Poverty Action Fund (PAF). As the IFIs now became engaged in relieving their own debt, bilaterals such as the Netherlands discontinued their debt relief. Through the PAF, funds freed as a result of reduced debt service payments under HIPC, including foreign aid from donors in the form of budget support, were allocated to the social sectors. The policy dialogue related to HIPC and PAF was broadened to include budget and social policy.

2.4.6 Stated objectives and conditionality

Clearly stated objectives of the various debt relief initiatives cannot be easily detected. Subsequent PC debt relief agreements were concluded with the aim of enabling the country to ease the debt burden and exit from the debt rescheduling process. The main objective of the MDF was to ease the debt burden of multilateral debt service falling due in the near future and in this way contribute to sustainable debt service ratios. HIPC aimed at eliminating unsustainable debt in the world's poorest most heavily indebted countries, whereas the Enhanced HIPC aimed at broader, deeper and faster debt relief. HIPC was designed to improve prospects for a permanent exit from unsustainable debt. It was also to assist Uganda in channelling resources for increased public spending and policy reforms in the social sectors.

During the 1990s conditionality attached to both multilateral and bilateral debt relief consisted of the existence of an appropriate programme supported by the IMF which demonstrated the need for debt relief as well as adherence to the prescribed policy measures and benchmarks, and to the agreed debt service payment schedule. Whereas conditionality was initially restricted to stabilisation and structural reform measures, governance issues became more important in the second half of the 1990s. Later in the decade social development benchmarks were included, although the latter served predominantly as guidelines rather than as strict targets to be achieved to.

2.5 Dutch debt relief to Uganda

During the 1970s Dutch aid to Uganda consisted only of emergency relief. Development assistance was increased from 1981 onwards, but the amounts were still small. All Dutch aid was given as grants. After a stagnation in the period 1984-86 and since the current

regime came to power in 1986 the bilateral development co-operation relationship between Uganda and the Netherlands has intensified, although it was not until 1991 that Uganda was granted special status in the official Dutch bilateral policy and aid to Uganda increased substantially. Dutch net ODA to Uganda amounted to USD 120 million in the period 1991-95, or an average of about USD 25 million per year. This compares with an average of USD 650 million per year in total ODA to Uganda during 1991-95, and an average yearly total ODA of over USD 700 million in the second half of the 1990s (IOB 1997, GDF 2001).

Dutch programme aid to Uganda in the period 1990/91-1997/98 amounted to USD 96 million, or 8 per cent of total programme aid to Uganda of about USD 1.3 billion (Ddumba et al. 1999). This made the Netherlands the second biggest bilateral programme aid donor after the UK. Of the Dutch programme aid during this period, 79 per cent was debt relief, and the rest (21 per cent) import support. Providing 31 per cent of the country's total debt relief, the Netherlands was the biggest donor of multilateral debt relief to Uganda.

During the evaluation period, relief of the multilateral debt service burden was a major focus of the Dutch macroeconomic support programme. The Netherlands was among the first donors to recognise the importance of the multilateral debt problem and argued for and took concrete steps to alleviate this burden. It provided substantial financial assistance, as well as technical inputs for the policy dialogue. The Netherlands played a lead role in the MDF (DGIS 1997) and granted debt relief of NLG 148 million in 14 separate disbursements, all but one of which were used to service multilateral payment obligations (DGIS/IOB 2001). The one exception concerned a contribution to the commercial debt buyback under the Debt Reduction Facility in 1992-93. As no bilateral debt was owed to the Netherlands by Uganda, the Netherlands did not participate in PC debt relief operations. Table 2–4 contains an overview of the Dutch debt relief operations.

In the framework of Uganda's external debt strategy 1992-1994, the Netherlands provided support to the Debt Reduction Facility, to debt service relief to IBRD through the Fifth Dimension Facility, and to debt service payments to the African Development Bank group. Participation in the commercial debt buyback through the DRF was a first priority as arrears had accumulated on commercial debt, while they had not on AfDB debt (DGIS 1992).

The 1992-93 commercial debt buyback was co-financed by the Netherlands. Of the total of USD 23 million provided for this operation, USD 10 million was financed by IDA, and the other USD 13 million by bilateral donors, including NLG 4.9 million (or USD 2.8 million) by the Netherlands.

Support amounting to NLG 10 million was provided by the Netherlands to the Fifth Dimension facility for relief on IBRD debt service in 1992 through co-financing with the World Bank, after funds for this purpose provided by Sweden and Norway were exhausted. Conditions set by the Netherlands for granting this support included good socio-economic policies, respect for human rights, and proven need for Dutch support.

Table 2–4 Dutch debt relief to Uganda (NLG million)

No.	Date	Amount	Type of debt	Type of relief	Objectives	Rationales	Account
1	1992	4.9	Commercial	Commercial debt buy-back through Debt Reduction Facility	Improve debt position	Quality of macroeconomic policies; Severity debt situation; External vulnerability/ balance of payments	Unknown
2	1992	10	Multilateral	Debt service reduction IBRD via 5th Dimension Facility	Improve debt position	Implementation reform programme; Severity debt situation; External vulnerability/ balance of payments	KBE 784
3	1993	16.7	Multilateral	Contribution to debt service to AfDB in 1993 and 1994	Relieve debt burden	Implementation reform programme; Burden on government budget; External vulnerability/ balance of payments	KBE 743
4	1993	5	Multilateral	Contribution to debt service payments to AfDB in 1993 and 1994	Relieve debt burden	Implementation reform programme; Burden government budget; External vulnerability/ balance of payments	KBE 784
5	1994	10	Multilateral	Contribution to debt service payments to AfDB	Relieve debt burden	Implementation reform programme; Burden government budget; External vulnerability/ balance of payments	KBE 784
6	1994	5	Multilateral	Contribution to debt service payments to AfDB	Relieve debt burden	Implementation reform programme; Burden government budget; External vulnerability/ balance of payments	KBE 784
7	1994	12.5	Multilateral	Debt service relief 1994-95 to IMF	Support economic reforms; Relieve debt burden	Implementation reform programme; Burden government budget; Severity debt situation	KBE 728
8	1995	10	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden	Implementation reform programme; Burden government budget; Severity debt situation	KBE 784
9	1995	20	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden	Implementation reform programme; Burden government budget; Severity debt situation	KBE 777
10	1996	15	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden	Implementation reform programme; Burden government budget; Severity debt situation	KBE 777
11	1996	10	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden	Implementation reform programme; External vulnerability/ balance of payments; Severity debt situation	KBE 777
12	1997	15	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden	Quality macroeconomic policy; Implementation reform programme; Participation in HIPC Initiative	KBE 777
13	1998	3.8	Multilateral	Contribution to HIPC Trust Fund	Relieve debt burden	Quality macroeconomic policy; Severity debt situation; Participation in HIPC Initiative	KBE 777
14	1998	10	Multilateral	Contribution to MDF	Support macroeconomic policy; Relieve debt burden; Support management capacity Min.of Finance and BoU	Quality macroeconomic policy; Severity debt situation; HIPC status	KBE 777

The Netherlands gave a substantial contribution, totalling NLG 36.7 million during 1993 and 1994 for debt service payments to the African Development Bank group, especially its hard loan window. This included two p.m. posts of NLG 5 million each. The other co-financier was Denmark. Conditions put forward by the Netherlands for this support were that Uganda would not contract any new non-concessional loans with the AfDB (DGIS 1994). A contribution of NLG 16.7 million was used to cover debt service payments due on 1 July 1993, one NLG 5 million p.m. post to cover payments due on 1 January 1994, NLG 10 million for those due on 1 July 1994, and NLG 5 million for those due on 1 January 1995.

In 1994 the Netherlands helped finance principal repayment obligations to the IMF under the Structural Adjustment Facility totalling NLG 12.5 million. This amount was initially NLG 10 million, but was increased when earlier plans to finance IBRD debt service were made unnecessary as that had already been provided for by other donors. Part of the NLG 12.5 million contribution was used to cover debt service payments in advance of the date due, with the advantage of reducing interest obligations to the IMF.

The Netherlands, as a key member of the multi-donor support group for multilateral debt servicing set up in 1994, was a major initiator of the establishment of the MDF in 1995 under Uganda's Enhanced External Debt Strategy (IOB 1997). The Netherlands played a leading role in the provision of technical inputs, and was also the main financier of the MDF with a total contribution of NLG 80 million between 1995 and 1998. These funds were used to finance debt service of the IMF, IDA and the AfDB group. The Netherlands set as a condition for its support to the MDF that a portfolio review of AfDB projects be undertaken, the outcome of which should be treated as binding by Uganda, leading to cancellation of all non-core and bad loans (DGIS 1995).

With the advent of HIPC the MDF was discontinued and transformed into the Poverty Action Fund or PAF. As the debt situation was considered to have become sustainable with HIPC, the Netherlands discontinued its debt relief support as per April 1998. The Netherlands supported the establishment of the PAF and continued its programme aid contributions to this fund in the form of budget support.

In 1998 the Netherlands contributed NLG 102 million (about USD 54 million) to the HIPC Trust Fund, with which it was one of the biggest donors of the fund. Out of this amount, NLG 3.8 million was allocated to the HIPC Trust Fund for Uganda[9].

Throughout the evaluation period the objectives of Dutch debt relief as stated in the official documentation were to improve the debt position or relieve the debt burden. In later years support to Uganda's macroeconomic policy was added. Especially under the MDF, the objective was to relieve the high multilateral debt service in order to free public resources for the socio-economic development of the country. The main rationales for Dutch debt relief were the severity of the debt burden, implementation of the reform programme or quality of the macroeconomic policies, the country's external vulnerability/balance of payments, and the burden on the government budget caused by the high debt. In 1997-98 participation in the HIPC Initiative was cited as a rationale as well (DGIS/IOB 2001).

Dutch debt relief was financed from the budget of the Minister for Development Co-operation (DGIS/IOB 2001). Virtually all relief was meant for relief on multilateral debt service obligations, which is classified as ODA. Half of the debt relief (NLG 74 million)

[9] Of the rest of the total of NLG 102 million, NLG 41.8 million was allocated to the AfDB, NLG 26.6 million to IFAD, NLG 20 million to the core component, and the remaining NLG 10 million to other country activities.

came from account KBE 777, which is an account for macro-economic support/debt relief. Decisions on the spending of funds under this account are taken on a worldwide basis. However, it cannot be assumed yet that all this money was additional to the amount of aid that Uganda would have received without this debt relief: as one of the target countries for Dutch aid, Uganda would most likely have received part of this money anyway. The same holds for funds under the accounts KBE 728 and 743 used for programme aid purposes, which together amounted to NLG 29 million Another NLG 40 million of debt relief came from account KBE 784. This appears to be an account for the Eastern-African region, and this debt relief may therefore be even less additional. The account from which funds for debt relief for the commercial debt buyback originated was not specified.

2.6. Conclusions

The major part of Uganda's external debt concerned multilateral debt. However, initially the focus of debt relief operations for Uganda was more on bilateral debt relief, although relief of IBRD debt was undertaken in the first half of the 1990s. Multilateral debt relief, especially the concessional part of it, became the main focus of attention only from the mid-1990s onwards. Substantial relief operations aimed at a reduction of the debt stock were only initiated towards the end of the decade, with HIPC. Hence, debt relief inputs in the 1990s were not sufficiently in line with the actual nature of the debt problem. Uganda received substantial amounts of new aid during the 1990s, easing the balance of payments and government accounts positions and enabling the country to service its debt. A substantial part of this new aid consisted of loans, especially from multilateral agencies but even some from bilateral donors, as a result of which the debt burden increased. The Netherlands appears to have been instrumental as one of the first donors to draw attention to the importance of the multilateral debt burden, and to promote action to alleviate this burden. On the other hand, it could be argued that some contradiction exists between the ending of debt relief from the Netherlands with the start HIPC in 1998, and the call for continued debt relief by the Ugandan government and the need to grant further debt relief under the framework of HIPC 2 in the year 2000.

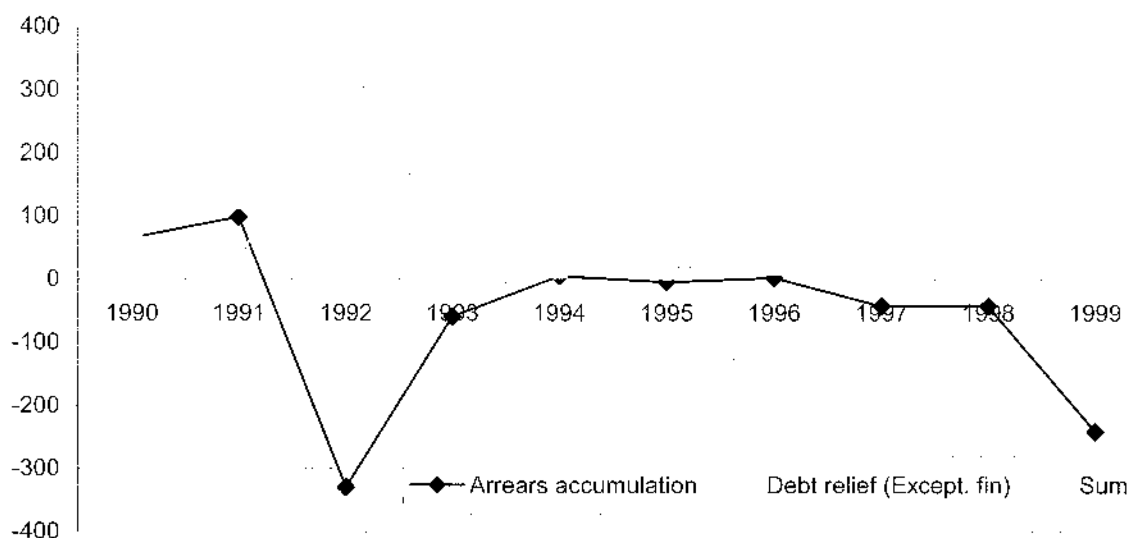
3 OUTPUTS OF DEBT RELIEF: EFFICIENCY

This chapter examines how efficient the chosen debt relief modalities have been in reducing the debt burden. The effect of debt relief on the reduction of the debt stock and on actual debt service flow are analysed. Further, the effects of debt relief on changes in government policies, and on the external and internal accounts (balance of payments and government accounts) are assessed.

3.1. Effect on the debt service flow

To determine the extent to which resources were freed as a result of debt relief (comprising debt forgiveness and rescheduling), it is necessary to analyse how much debt service is actually paid versus the amount that would have been spent in the absence of debt relief. As this varies according to the type of debt relief and type of creditor, it will be analysed for the different modalities of debt relief separately.

Figure 3–1 Arrears accumulation and debt relief (USD million)

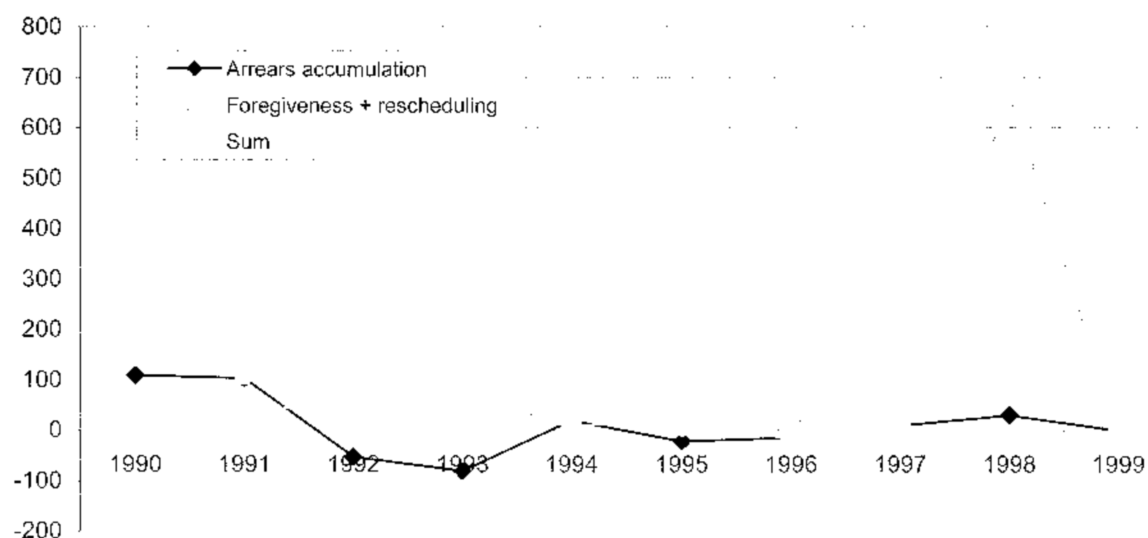


Source: Elaboration of Table 3–1 (IMF data).

Debt relief registered in the balance of payments (recorded as 'exceptional financing' in the IMF balance of payments accounts) includes PC debt relief and relief through conversion schemes, as well as HIPC assistance at the end of the 1990s. Figure 3–1 shows the inverse relationship between this debt relief and the accumulation of arrears. PC agreements, especially those in 1992 and 1998, coincided with large payments of arrears. Hence, this debt relief was to a large extent used more to clear past arrears than to reduce current debt service. We can assume that these accumulated arrears would not have been paid in the absence of debt relief, so that it did not lead to a reduction of actual debt service payments. On the other hand, the clearance of arrears through forgiveness, as was especially the case in 1998, led to a reduction of future debt service payments; where relief was given by rescheduling, future payments, of course, increased. From the mid-1990s onwards the sum of debt relief and arrears accumulation showed an upward trend. As debt relief was in virtually all years somewhat larger than arrears decumulation, this is expected to have led to some reduction of the actual debt service flow in those years.

A broadly similar pattern of inverse relationship between debt relief (debt forgiveness and rescheduling) and arrears accumulation emerges when GDF data are used (Figure 3–2.), with substantial payment of arrears in years with high debt relief. While declining in the early 1990s, the sum of debt relief and arrears accumulation fluctuated around zero after that, with an exception in 1998 when it became strongly positive as major debt relief under the HIPC framework coincided with some accumulation of arrears (on non-PC debt).

Figure 3–2 Arrears accumulation and debt relief (USD million)

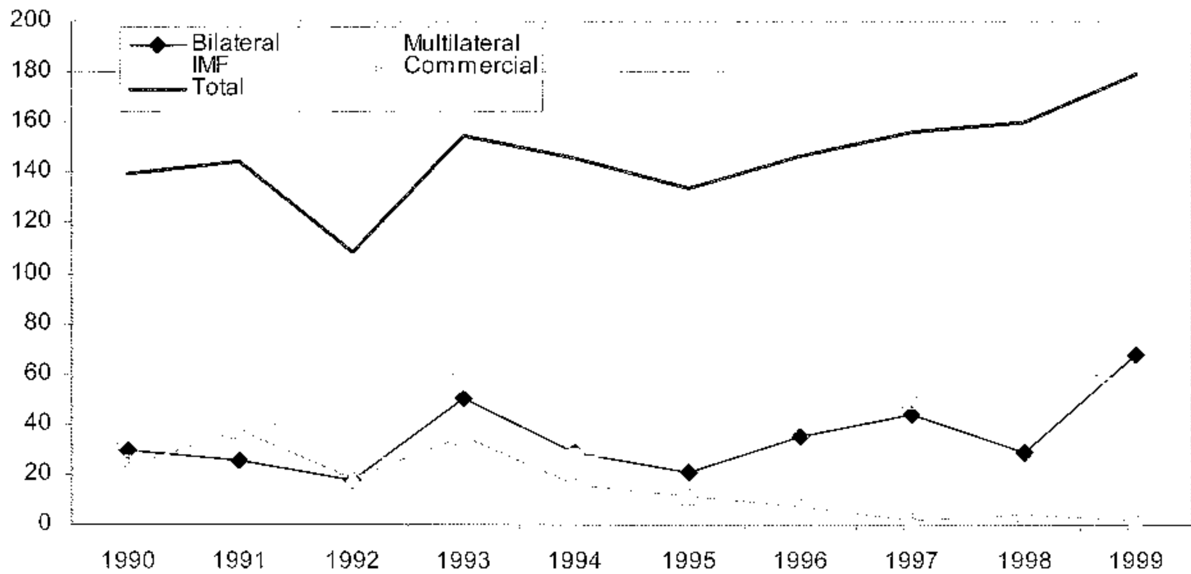


Source: GDF 2001.

Since the early 1990s Uganda successfully reduced its arrears on PC debt, commercial debt and smaller multilateral creditors, although they remained at a high level compared to the 1980s (see Figure 1–5 in Chapter 1). No arrears to major multilateral creditors (IMF, World Bank, AfDB) existed in the 1990s as Uganda serviced the debt owed to them. Arrears on PC debt were cleared as of 1994. The bulk of the remaining arrears (at least three-quarters) still outstanding at the end of the decade concerned those on non-PC debt, as well as on commercial debt (IMF 2001b).

Figure 3–3 shows debt service paid by type of creditor. Total debt service paid showed a dip in 1992, followed by an upsurge in 1993, after which it declined somewhat but in the latter half of the decade it rose steadily again. The low level in 1992 reflects a decline of bilateral and private debt service paid in conjunction with PC debt relief and the commercial debt buyback in that year. The peak in 1993 was caused by a simultaneous increase in debt service paid to bilateral and private creditors related to earlier debt relief agreements, combined with increasing multilateral debt service. From 1993 onwards debt service to private creditors continued to decline, while debt service to the IMF steadily increased. Multilateral debt service remained high with some fluctuations, and bilateral debt service surged again towards the end of the decade.

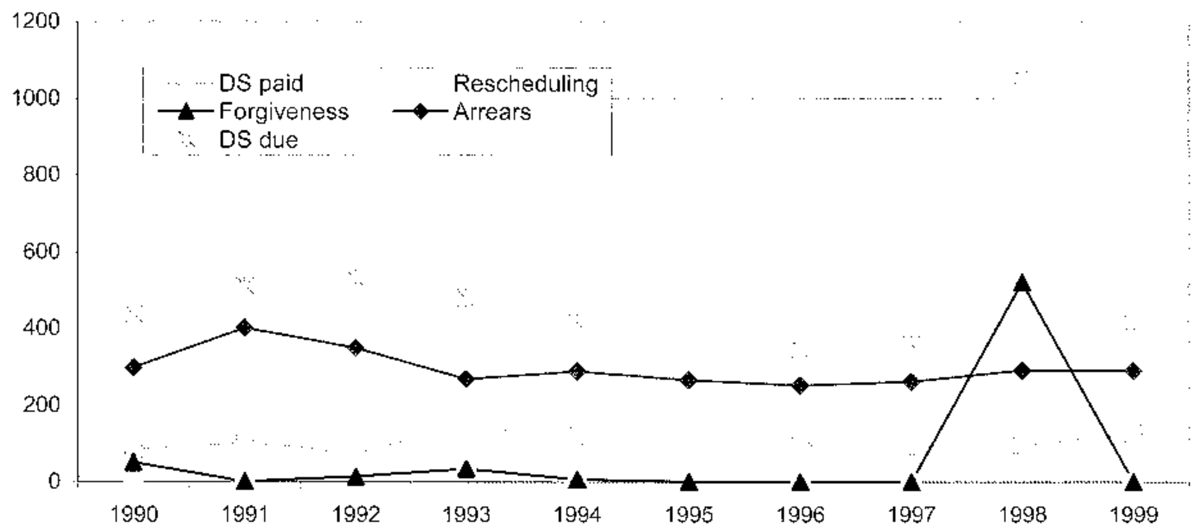
Figure 3–3 Debt service paid (long-term debt and IMF), by creditor (USD million)



Source: GDF 2001.

From GDF data presented in Figure 3–4 on debt service due and its composition, it appears that debt relief did not so much lead to a reduction in debt service paid but rather to a reduction in debt service due. However, GDF data do not take into account debt relief provided under the MDF and Fifth Dimension. If these were included, DS paid (from own resources) indeed went down over the decade.

Figure 3–4 Debt service due and composition (USD million)



Source: GDF.

PC debt relief was provided in 1992, 1995 and 1998. The consequences of these agreements on actual debt service paid depend on the terms of the agreements, and on whether the debt on which relief was given had indeed been serviced in earlier years or not . PC debt relief does not seem to have led to much easing of debt service paid. While arrears to PC

creditors were cleared in 1994, those to non-PC creditors accumulated because of their non-acceptance of debt relief on PC-comparable terms, and debt service to them was not paid (IMF 2000b). The 1992 PC debt relief covered only a limited portion of total PC debt, and therefore did not have much effect on the flow. The same is true for 1995 PC debt relief. The PC agreement towards the end of the decade under HIPC under improved terms (90-100 per cent reduction) is expected to lead to future alleviation of bilateral debt service payments. The fact that the share of bilateral debt in the total debt stock was only around 25 per cent, also contributed to a limited flow effect on the total debt service.

Throughout the 1990s multilateral long-term debt service[10] was the largest category of total debt service paid (Figure 3–3). This is consistent with the large share of multilateral debt in the total debt stock (see Figure 1–3 in Chapter 1). The heavy burden on Uganda of IMF debt service is clearly illustrated by the fact that the IMF share in total debt service paid was far higher (40 per cent in 1998) than the share of IMF debt in the total debt stock (10 per cent). IMF debt service increased rapidly from 1993 onwards, becoming the largest component of debt service paid by 1997. As a result, while that of multilateral debt service *ex*cluding IMF declined after 1995, the share of multilateral debt service *in*cluding IMF in total debt service paid showed a strong increase since 1993.

In general, relief on multilateral debt service reduces the debt service burden as this debt service is always paid. Arrangements where bilateral donors contributed to multilateral debt relief through the Fifth Dimension and the MDF had a direct flow effect, as indeed all multilateral debt was being serviced by Uganda. While it did not reduce the figures for multilateral debt service paid, it did relief its burden. Most programme aid during the second half of the 1990s had this effect, as a switch in the early 1990s took place from import support (which is largely tied and cannot be used for payment of debt service) to budget support and debt relief[11]. The advent of HIPC is expected to provide a further major boost to the relief of Uganda's multilateral (including IMF) debt service burden.

While the share of commercial debt was considerable in the early 1990s, it declined after 1992 to a low level following the debt buyback, as arrears were reduced at the same time[12]. This reflects the successful conclusion of the commercial debt buyback. However, as Uganda had not fulfilled its payment obligations on commercial debt but had instead built up arrears, the buyback operation did not reduce the actual debt service flow.

Uganda also owed a large debt to non-PC bilateral creditors[13], which at the end of the 1990s amounted to 10 per cent of total debt (long-term and IMF), and almost 60 per cent of bilateral debt. They accounted for the bulk of the arrears that remained on Uganda's books. With the exception of Tanzania, these creditors refused to engage in debt relief on terms comparable to those agreed with PC creditors. As a result, debt service to non-PC creditors was not paid and arrears built up. The IFIs accepted this situation as did the PC members, who continued to provide new loans and grants as well as with debt relief.

On the basis of balance of payments statistics it is possible to analyse how the debt service due was financed (Figure 3–5). It was, of course, partly financed by debt relief. Overall, accumulation of arrears did not play a role as a financing mechanism.

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[10] This concerns mainly the servicing of IDA debt, as well as that of the AfDB group and some other smaller multilateral creditors.

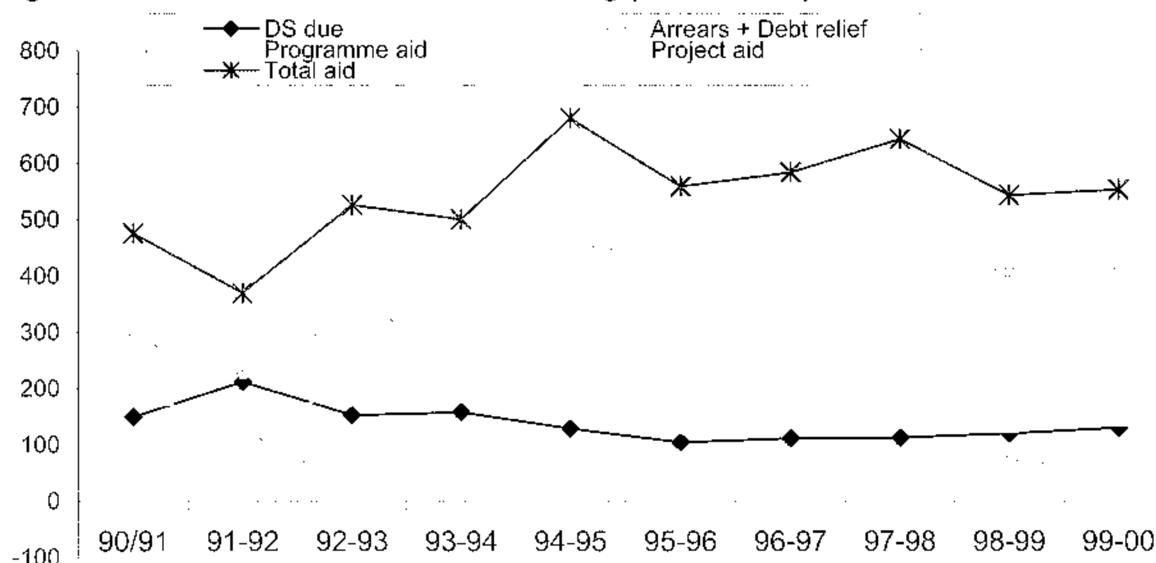
[11] Import support, a large part of which was tied support, was a crucial source of financing for Uganda from 1988 until 1994, but thereafter it became less important as most bilaterals, including the Netherlands, stopped providing it after 1993.

[12] Some commercial arrears remained, which amounted to 80% of the (strongly reduced) commercial debt stock and a quarter of total arrears in 1997.

[13] The most important non-PC bilateral creditors to which arrears were outstanding in 1997 included Libya, Yugoslavia and Tanzania.

Programme aid fluctuated at about the same level as debt service due, and played an important role in financing it.[14]

Figure 3–5 Debt service due and financing (USD million)



Source: IMF, Statistical Appendices, various years.

From 1995 onwards, programme aid in the form of grants became increasingly important compared to programme aid provided as loans (Table 3–1). When taking into account that most loans were extended by multilateral creditors, while grants originated from bilateral donors, it can be concluded that bilateral donors were important as a source of relief on debt service owed to multilateral institutions. Indeed, substantial transfers took place from bilateral to multilateral donors to finance debt service through the Fifth Dimension facility and the MDF. According to GDF data multilateral debt service (including IMF) amounted to an average of almost USD 100 million per year during the 1990s, and more than USD 110 million over the period 1995-1999. Annual programme aid loans remained far under this amount after 1995, averaging USD 49 million over the period 1995-1999.

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[14] While Uganda has been very richly endowed with grants, a large (and somewhat increasing proportion) of it has been project support and hence tied to specific activities, which could not be used for debt service payment.

Table 3–1 Balance of payments (USD million)

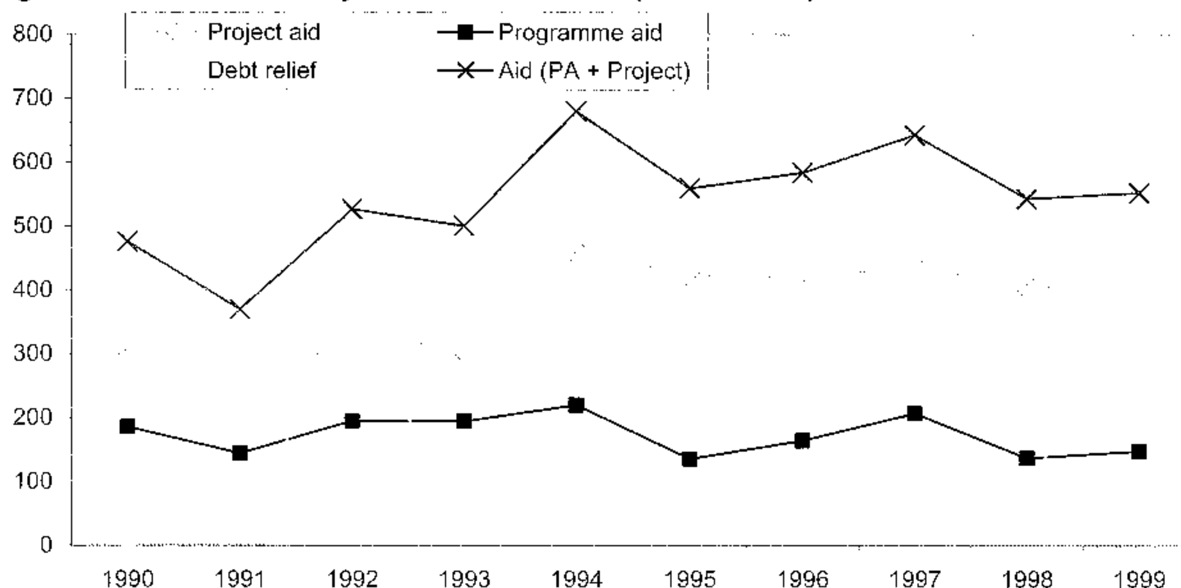
	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
X (goods)	176	172	157	254	595	590	671	458	549	439
Coffee	127	117	99	172	457	404	366	269	307	187
Other			58	82	139	186	305	190	242	252
M (goods)	-545	-451	-523	-672	-1086	-1218	-1246	-1411	-1376	-1513
Project related			-165	-153	-230	-211	-210	-218	-203	-202
Other imports			-357	-519	-856	-1007	-1037	-1193	-1173	-1311
Trade balance	-370	-279	-366	-418	-490	-628	-576	-953	-827	-1075
Net services	-102	-108	-90	-90	-226	-247	-251	-285	-280	-284
Net factor income	-58	-87	-49	-61	-58	-46	-17	-9	-14	-14
Net interest	-58	-87	-49	-43	-34	-33	-6	-2	5	-1
of which: interest due							-45	-45	-45	-48
Net dividend & distributed earnings							-10	-6	-19	-13
Unrequited transfers	342	342	385	532	633	811	790	1109	882	1073
Official	262	206	277	228	303	277	307	380	277	312
Import support	87	75	111	76	96	86	119	162	74	110
Project support	175	131	165	153	207	190	189	218	203	202
Private	81	136	108	304	330	535	482	729	605	761
of which: identified FDI							160	190	230	248
NGOs							86	90	95	100
Current account	-187	-132	-119	-37	-142	-110	-54	-137	-240	-300
Net capital flow	122	38	145	157	282	210	210	195	191	159
Disbursement	214	163	249	272	377	283	276	263	267	241
Project support	115	94	165	153	253	233	231	218	203	202
Balance of payment sup.	99	69	84	119	124	50	46	45	64	39
Amortisation due	-92	-125	-104	-115	-96	-72	-67	-68	-76	-82
Net private capital	-36	-28	-21	-16	-15	-41	-49	51	27	24
Capital account	86	10	124	140	267	170	161	246	218	208
Overall balance	**-101**	**-121**	**5**	**103**	**125**	**60**	**107**	**109**	**-22**	**-93**
Change official reserves*	37	-2	-33	-87	-146	-73	-129	-133	-40	15
Gross reserve change	-15	-24	-39	-107	-169	-92	-142	-129	2	29
IMF (net)	52	22	10	18	23	19	10	-5	-36	-14
Other	0	0	-4	3	1	0	3	0	-7	0
Change in arrears (net)**	65	98	-330	-59	5	-4	2	-43	-43	-241
Exceptional financing	1	28	357	43	15	18	20	67	104	319
Towards arrears reduction	1	28	332	26	0	9	0	62	59	229
Current maturities	0	0	26	17	15	9	20	5	0	34
HIPC assistance							0	0	45	57
Financing	103	125	-5	-104	-125	-60	-107	-109	21	92

* - = increase
*+ = increase.

The magnitude of increased flow of resources as a result of debt relief is also affected by the degree to which debt relief is additional to other aid. Although it is impossible to establish the counterfactual, that is to know what the aid flow would have been in the absence of debt relief, we can examine what happened to the aid flow when there was

debt relief or when debt relief increased. This is the additionality that matters for Uganda, the recipient country. IMF balance of payments statistics (Figure 3–6) show that debt relief was generally additional to other aid, although it might have gone somewhat at the expense of other aid towards the end of the 1990s. The overall trend was an increase in the provision of aid by donors in the first half of the decade, with a slight decline after 1995.

Figure 3–6 Additionality: debt relief and aid (USD million)

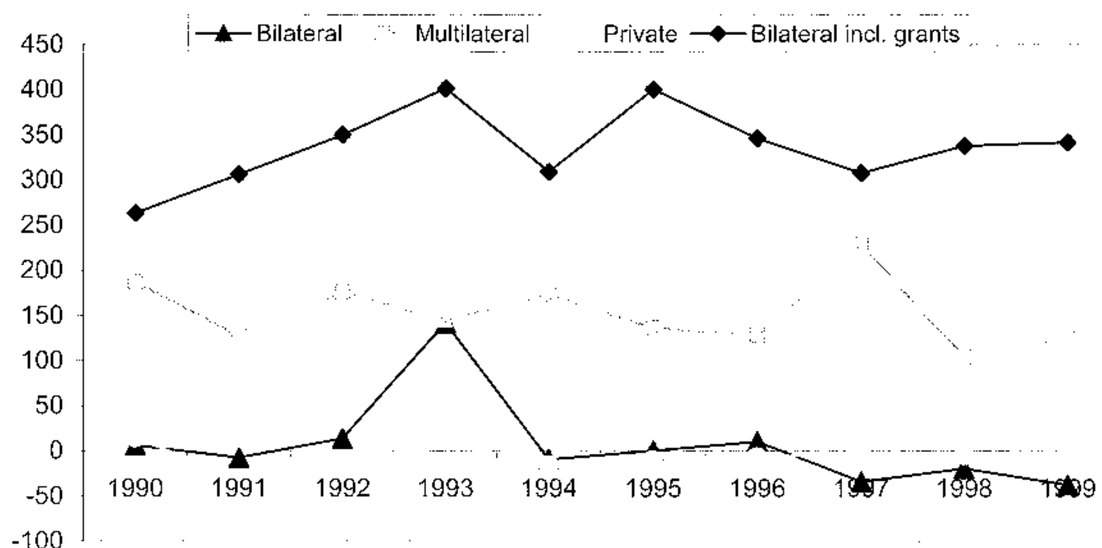


Source: IMF, Statistical Appendices, various years.

From the above analysis it can be concluded that so far PC debt relief seems to have had only a limited effect on the debt service flow. At the same time, this debt relief seems by and large to have been additional to other bilateral aid inflows (programme and project aid). Whereas relief on multilateral debt, notably on IDA debt, led to a reduction of the debt service burden, Not much flow effect resulted from the commercial debt buyback. HIPC is expected to have a noticeable flow effect on debt service payments in the future.

Figure 3–7 on net transfers on debt sheds light on the degree of bailing out that occurred. Private net transfers on debt were negative during the whole 1990s, implying that commercial creditors disbursed less on new loans than they received in debt service payments from Uganda. Commercial creditors were bailed out by official bilateral and multilateral creditors, which was particularly evident in 1992/93 when the commercial debt buyback operation, co-financed by the World Bank and bilateral donors, took place. Throughout the 1990s net transfers on debt by multilateral creditors were strongly positive. When grants (excluding TA) are included, net transfers by bilateral donors were far above those of other creditors, including the multilaterals, confirming the before-mentioned (partial) bailing out of multilateral creditors by bilateral donors.

Figure 3–7 Net transfers on long-term debt by creditor (USD million)



Source: IMF, Statistical Appendices, various years.

3.2. The reduction of the debt stock

In the 1990s Uganda's nominal debt stock continued to rise sharply from USD 2.6 billion in 1990 to USD 4.1 billion in 1999. With regard to PC agreements, their rescheduling component was generally more important than their forgiveness component, except in 1998 when considerable forgiveness was granted. Reschedulings do not lead to a reduction in the stock of debt, as the NPV of the debt stock is maintained and the nominal debt stock increases. Where forgiveness of arrears on past debt service obligations took place, this led to some stock reduction. The close inverse relationship between debt relief and arrears decumulation implies that PC debt relief contributed to some ex-post reduction in the debt stock, reducing expected future debt payments as interest charges on these arrears no longer increased. At the same time, the PC agreements of 1992 and 1995 involved only very limited debt stock reduction, as the amount of debt covered was only a small proportion of the total debt.

With HIPC more substantive debt stock reduction was granted. At the Original HIPC Completion Point in 1998, a reduction of eligible stock of debt (i.e. debt from before the cutoff date of 1 June 1981) was agreed with the Paris Club, involving 80 per cent reduction of eligible debt stocks leading to a reduction of the NPV of these stocks. In 2000 further agreement was reached with the PC for debt relief on Cologne terms (minimum 90 per cent, while many creditors choose a 100 per cent reduction of NPV). Uganda's nominal bilateral debt stock increased steadily throughout the 1990s from around USD 550 million in 1991 to a peak of USD 964 million in 1998, after which it showed a slight marginal decline for the first time in 1999 to USD 931 million This points at the lack of effect of earlier PC agreements on bilateral debt stock until HIPC in 1998. At the same time, arrears to non-PC creditors increased.

Substantial relief was provided on multilateral debt by bilateral donors though the Fifth Dimension and the MDF. Although this involved relief on debt service flows, it did reduce the debt stock because if it had not been paid, debt stocks would have increased with the amortiation and interest payments due. Nevertheless, multilateral long-term debt which consisted mostly of IDA debt and debt to the AfDB group, increased sharply from USD 1.3 billion in 1990 to USD 2.6 billion in 1999, mostly as a result of new loans.

Debt relief on commercial debt through a debt buyback in 1992/93 led to a significant debt stock reduction. Under this buyback around 90 per cent of commercial debt principal was extinguished at 12 per cent of its original face value. Commercial debt stock declined since 1992 from USD 260 million to USD 72 million in 2000, corresponding to a reduction from 15 to 2 per cent of total long-term debt. Most of this concerned arrears; no new commercial loans were contracted after 1993 (see also Table 4–4 in Chapter 4).

Multilateral debt relief under HIPC is limited to relief on debt service flows. However, as this relief is guaranteed for the next 20 years, the reduction in annual debt service was equivalent to a 20 per cent reduction in NPV of multilateral debt outstanding at that moment. This relief under original HIPC was followed by debt relief under the Enhanced HIPC Initiative in 2000 equalling a 37 per cent reduction of claims remaining after the original HIPC.

Debt relief under the original and enhanced HIPC frameworks combined amounted to a total of about USD 1 billion reduction in the NPV of Uganda's (multilateral and bilateral) debt, or USD 2 billion nominal. This included USD 822 million NPV on multilateral debt and USD 185 million NPV on bilateral debt.

Table 3–2 Reduction of the debt stock 1990-1999 (USD million and per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average	Total
Debt stock	2161	2283	2433	2599	2869	3062	3152	3405	3472	2980		
Reduction:												
in USD	51	1	14	156	7	41	0	0	615	0	89	886
in % of stock (t-1)	2.8	0.0	0.6	6.4	0.3	1.4	0.0	0.0	18.1	0.0	3.0	29.7[1]

Source: GDF, 2001.
[1] Total forgiveness in per cent of the debt stock of 1999.

Total debt forgiveness on stocks and on debt service amounted to USD 886 million in nominal terms over the 1990s, which is equivalent to 29.7 per cent of nominal long-term debt stock outstanding in 1999 (Table 3–2). Annual stock reductions averaged only 3 per cent. They vary between 0 and 6 per cent (the year of the buyback), with a high of 18 per cent in 1998 due to the implementation of HIPC 1. When MDF debt relief of USD 135 million over the 1990s is taken into account (not in GDF figures), forgiveness and stock reduction combined amounted to 34 per cent of the nominal 1999 long-term debt stock.

In conclusion, the largest reduction took place under HIPC at the end of the decade, and more followed with the enhanced HIPC initiative in 2000, so outside the evaluation period. Prior to the implementation of the HIPC initiative, there was very little debt stock reduction.

3.3 Effect of conditionality on government policies

The economic reform programme's objectives were to achieve internal financial stability and lower inflation, external stability driven by increasing exports, and economic rehabilitation and growth (World Bank 1995). To achieve these objectives, main stabilisation and macroeconomic reform measures under structural adjustment programmes of IMF and World Bank initially included devaluation and foreign exchange liberalisation, price decontrol, and liberalisation of cash crop marketing. From 1992 tight monetary and fiscal policies were applied, and a cash budget system was introduced.

From 1993 onwards the structural reform process was broadened and intensified (World Bank 1995, IMF 1998, Holmgren 1998). The civil service reform process aimed at downsizing and streamlining of the civil service was stepped up. Trade liberalisation involved reduction of tariffs and quantitative restrictions; by the end of the 1990s Uganda was one of the most open economies of Sub-Saharan Africa. Financial sector reforms comprised interest rate liberalisation, strengthening the regulatory powers of the central bank, and rationalising and rehabilitating the state commercial banks, including privatisation of Uganda's biggest bank. Restrictions on international capital transactions were removed by 1997. A privatisation programme aimed at reducing and abolishing subsidies to public enterprises, and selling and closing of a large part of these enterprises. The reforms also comprised issues related to governance, including measures to tackle corruption and to improve the transparency of the allocation of public expenditure. In addition, later in the decade, especially from 1998 onwards, donors increased pressure to democratise the political system.

In the second half of the 1990s a greater awareness developed of the need to incorporate poverty reduction programmes in the reform process. In 1997 GoU published its Poverty Eradication Action Plan (PEAP), with which poverty eradication became the government's overarching development objective (GoU 1997). The principal goal of the PEAP is to reduce the incidence of poverty (headcount index) to 10 per cent or less in 2017. It further includes objectives on achieving universal access to primary education (UPE), primary health care, and safe drinking water; guaranteeing political freedom and human rights; and establishing an effective disaster relief system particularly targeted at the poor. The PEAP rests on four pillars: creating a framework for economic growth and transformation; ensuring good governance and security; increasing the ability of the poor to raise their incomes; and increasing the quality of the life of the poor.

In conjunction with the PEAP, a Poverty Action Fund (PAF) was established, to ensure that funds would be allocated to poverty reduction activities specified in the PEAP. Initially, the PAF was created to ring-fence HIPC debt relief for basic services in 1998. After that, PAF attracted additional donor funding and became a mechanism for ensuring the reallocation of expenditures directly to poverty reduction activities, including primary education, primary health care, agricultural extension, feeder roads, water and sanitation, and law and order (World Bank 2000b). In 2000 a revised PEAP was prepared, the summary of which served as the country's Poverty Reduction Strategy Paper (PRSP) (GoU 2000). Uganda was the first country to finalise such a strategy and had it endorsed by the IFIs, which was a requirement to become eligible for HIPC 2 assistance.

Conditionality related to debt relief was the same as the macroeconomic and structural reform conditions attached to programme aid of the IFIs. Donor contributions to the MDF were provided on the condition that the country would follow sound macroeconomic policies and strictly apply the external debt strategy. The policy dialogue focused on these issues accordingly. PC debt relief was granted on the condition that structural adjustment programmes were agreed with the IMF and World Bank, and that the country showed a good track record on key macroeconomic and reform indicators. In the run-up to HIPC, increased attention was paid to poverty reduction and the composition of government expenditure, especially the extent to which debt relief was used to increase expenditure for social development. With HIPC the policy dialogue widened from macroeconomic issues to social policy and poverty reduction and an increased focus on budget policy and public expenditures. HIPC conditionality also included observance of selected social development indicators, which for the first time were included in ESAF 3 in 1998. The Ugandan government took this one step further by insisting on the need to apply social conditionality more stringently than formulated under HIPC. Reasons for this self-imposed increase of conditionality were reportedly of a domestic political nature: explicit social

conditionality would be a countervailing power against internal pressure from other (non-social) sectors on the distribution of the extra resources that became available as a result of HIPC debt relief (DGIS 1996).

During the first years after the launch of the ERP (1987-1992) considerable slippage on conditions occurred, and government ownership of the programme was not very strong (Botchwey et al. 1998). When slippage on public expenditure coincided with a sharp fall of the coffee price in 1992 the budget deficit soared, and monetary financing of the deficit led to high inflation. The IFIs delayed their assistance and bilateral donors cut back aid. This crisis was swiftly resolved, and became a watershed in government commitment to stabilisation and reform. From 1992 onwards government ownership of stabilisation and reforms was strong (Dijkstra and van Donge 2001). Accordingly, compliance with the conditions was generally good, especially where it concerned the macroeconomic benchmarks. Uganda's performance was satisfactory and praised by donors, with average real GDP growth of about 6 per cent, containment of inflation to about 6 per cent annually, and a sharp reduction of the budget deficit excluding grants although it remained high at about 6 per cent of GDP (Table 3–3). Where macroeconomic indicators have not been on-track this was to a considerable extent due to external factors outside the government's direct control, such as a decline of the coffee price and drought. Towards the end of the decade signs emerged which may indicate some deterioration in economic performance.

Table 3–3 Selected macroeconomic indicators

	1991	1992	1993	1994	1995	1996	1997	1998	1999*
Real GDP growth (%)	2.6	8.4	5.4	10.6	7.8	4.5	5.4	7.8	5.0
Real GDP growth per capita (%)	0.5	4.4	3.1	8.2	6.0	1.8	2.6	4.4	1.5
Inflation (%)	42.4	30.0	6.5	6.1	7.5	7.8	5.8	-0.2	6.3
Fiscal deficit - excluding grants	-15.4	-12.1	-11.2	-8.9	-6.5	-6.9	-6.3	-6.4	-14
Fiscal deficit - including grants	-8.8	-3.4	-4.1	-3.2	-2.1	-2.0	-0.7	-1.3	-8.0
Government revenue (% GDP)	7.2	7.8	8.9	10.7	11.3	12.1	11.3	11.9	11.7
Government expenditure (% GDP)	23	20	20	18	18	18	17	18	26
Current acc. balance- excl. grants	-13.3	-12.6	-8.4	-8.3	-7.0	-6.3	-8.4	-9.1	-10.7
Current acc. balance- incl. grants	-5.2	-3.7	-1.6	-2.4	-2.0	-0.9	-2.2	-4.4	-5.3
Gross forex reserves (months imports)	1.5	1.9	3.1	3.4	3.6	4.5	4.8	4.9	4.3

*Preliminary.
Source: IMF Statistical Appendices, various years and IMF and IDA (2000a).

The track record on structural reforms was variable (IMF 2000b, IMF 2001). It was less favourable than that for macro-economic performance, and structural reforms progressed more slowly than planned (Ddumba et.al. 1999). Good progress was made in trade liberalisation and financial liberalisation, and initially in civil service reform. Problems were encountered particularly in the compliance with conditions related to increasing the capacity of domestic revenue generation through tax reforms, later stages of the civil service reform process, and privatisation. With regard to the composition of government expenditure, the level of defence expenditure was a contentious issue particularly in later years. With Uganda's increased involvement in the conflict in the Democratic Republic of Congo (DRC) and continued internal strife in the North of the country, donors were increasingly concerned that defence expenditure would be increased at the expense of the allocation of funds to the social sectors (DGIS 1998, World Bank 2000c). However, at least according to the official figures, defence expenditure appears to have remained within agreed limits.

With regard to political reforms, concern was expressed by donors about the development of the political system including democratisation, in particular about the absence of a veritable multiparty system and human rights abuses by the army in the Northern region (DGIS 2000a). On the other hand, the parliament started playing a more active role, and there was a free press. Conditions related to governance became more important especially in the second half of the 1990s, and increasingly became a matter of contention between government and donors. In particular, donors felt that the government was not doing enough to curb corruption (DGIS 1999, DGIS 2000a). Some progress was made in the area of decentralisation. However, capacity at the local level to design and implement programmes and undertake effective service delivery, including accounting for funds disbursed to local level authority, remained very weak.

Criticism by the donor community on the lack of progress in the areas of corruption and political reforms, and Uganda's involvement in the war in DRC, however, did not lead donors to curb debt relief or other aid to Uganda during the evaluation period. Contentious issues related to governance and political reforms were condoned in view of Uganda's generally good track record in the macroeconomic field and progress, albeit slow, in the structural reform process[15]. Uganda became a showcase and pilot country for various schemes such as HIPC, and appears to have been given the benefit of the doubt. The country continued to receive large donor pledges.

While not much attention was paid to poverty reduction policies in the first half of the 1990s, increased focus on social development in the framework of HIPC was pursued later in the decade. Various social sector reforms were set in motion, backed up by increased social expenditure as a percentage of total expenditure. In this regard, the establishment of PAF was an important development. Most notable was the UPE programme aimed at universal primary school enrolment. Among other major programmes were those that focused on the modernisation of the agricultural sector, and on the improvement of health care.

3.4 Effect on the balance of payments

Another important issue related to the outputs of debt relief is the extent to which it led to increased imports of goods and services, through which it may have contributed to higher economic growth.

As shown above, Paris Club debt relief had little effect on the freeing of resources. A considerable amount of this relief was used to settle accumulated arrears, as indicated by the fact that years in which substantial debt relief was received also showed high arrears decumulation (Figure 3–1). This is confirmed in Tables 3–4-a and b of the sources and uses of foreign exchange income, which were derived by re-arranging the balance of payments.

However, multilateral debt relief (Fifth Dimension, MDF) did have an effect on the flow of resources, and this effect cannot be separated from the effect of other programme aid such as budget support and balance of payment support. All involve freely spendable resources for government and external accounts. To the extent that aid is fungible, this holds for all aid. Hence the effects of debt relief and aid are now examined together.

[15] Some differences of opinion existed on issues related to political reforms, governance and defense expenditure between the bilateral donors and EU on the one hand, and the IFIs on the other hand, with the IFIs being inclined to withhold from criticism or portray the situation somewhat more favourably, while bilaterals were more critical (DGIS, 1998).

Table 3–4-a Sources and uses of forex (USD million)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of Goods	176	172	157	254	595	590	671	458	549	439
Aid	476	370	526	500	680	559	584	643	543	553
of which Programme aid	185	144	195	195	220	136	165	207	137	148
Private transfers	81	136	108	304	330	535	482	729	605	761
Arrears accumulation	65	98	-330	-59	5	-4	2	-43	-43	-241
Except.fin/Debt relief	1	28	357	43	15	18	20	67	104	319
Total	798	804	819	1041	1626	1697	1759	1855	1759	1830
Uses:										
Imports of Goods	-545	-451	-523	-672	-1086	-1218	-1246	-1411	-1376	-1513
Net Services	-102	-108	-90	-90	-226	-247	-251	-285	-280	-284
Net factor income	-58	-87	-49	-61	-58	-46	-17	-9	-14	-14
of which Net interest	-58	-87	-49	-43	-34	-33	-6	-2	5	-1
Amortisation	-92	-125	-104	-115	-96	-72	-67	-68	-76	-82
Net private capital	-36	-28	-21	-16	-15	-41	-49	51	27	24
Increase in reserves	37	-2	-33	-87	-146	-73	-129	-133	-40	15
of which IMF net	52	22	10	18	23	19	10	-5	-36	-14
Total	-796	-800	-819	-1041	-1626	-1697	-1759	-1855	-1759	-1856

Source: Elaboration of Table 3–1.

Table 3-4b. Sources and uses of forex (per cent)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods	22	21	19	24	37	35	38	25	31	24
Aid	60	46	64	48	42	33	33	35	31	30
of which Programme aid	23	18	24	19	14	8	9	11	8	8
Private transfers	10	17	13	29	20	31	27	39	34	42
Arrears accumulation	8	12	-40	-6	0	0	0	-2	-2	-13
Except.fin/Debt relief	0	4	44	4	1	1	1	4	6	17
Total	100	100	100	100	100	100	100	100	100	100
Uses:										
Imports of goods	68	56	64	65	67	72	71	76	78	82
Services (net)	13	13	11	9	14	15	14	15	16	15
Net factor income	7	11	6	6	4	3	1	0	1	1
of which Net interest	7	11	6	4	2	2	0	0	0	0
Amortisation	12	16	13	11	6	4	4	4	4	4
Net private capital	4	3	3	2	1	2	3	-3	-2	-1
Increase reserves	-5	0	4	8	9	4	7	7	2	-1
of which IMF net	-7	-3	-1	-2	-1	-1	-1	0	2	1
Total	100	100	100	100	100	100	100	100	100	100

Source: Elaboration of Table 3-4a.

In the 1970s and the years 1985-86, when Uganda received little aid, imports were roughly equal to exports. In contrast, in the years that substantial aid was received, including the periods 1981-84 and 1986-99, imports systematically exceeded exports. As is evident from Table 3–1, the trade balance and current account balance were negative every year. The current account deficit was financed by external inflows: official inflows were important throughout the 1990s, while more recently private capital inflows have also played a role.

The role of foreign aid in the external accounts can be seen in Tables 3–4-a and b. Throughout the 1990s aid was at a high level, and overall showed an upward trend, in particular when debt relief is taken into account (if debt relief is excluded, aid flows have levelled off somewhat since 1995). Aid was much larger than exports of goods until 1995; after 1995 this was not the case in all years, as exports increased considerably. As a percentage of total foreign exchange income, aid decreased from 60 per cent in 1990 to around 30 at the end of the decade. The share of programme aid decreased even more, from 23 in 1990 to a mere 8 per cent in 1999. This implies that while aid dependence was high, it decreased over time.

In the 1990s aid helped finance the high level of imports of goods and the services deficit, and at the same time contributed to the steady buildup of foreign exchange reserves from less than one month worth of imports in 1990 to almost five months at the end of the decade. As aid financed imports over and above a level that would have been allowed by export income, large aid inflows may have caused current account deficits (Ddumba et al.1999).

Table 3–5 Counterfactual imports as % of actual imports in 4 scenarios

	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98	98-99	99-00
Scenario 1	22	27	-6	30	41	57	56	56	60	57
Scenario 2	13	13	-6	28	36	53	52	53	56	57
Scenario 3	22	30	9	33	42	58	57	58	64	65
Scenario 4	13	19	-1	26	37	54	53	54	61	62

Scen. 1: No aid, no debt relief, debt service USD 50 million lower, no arrears decumulation.
Scen. 2: No aid, no debt relief, debt service as actual, no arrears decumulation.
Scen. 3: No aid, debt relief, debt service USD 50 million lower, no arrears decumulation.
Scen. 4: No aid, debt relief, debt service as actual
Note: Reduction of debt service paid is done by adding USD 50 million to arrears accumulation, while keeping debt service due at the same level (BOP figures give debt service due instead of debt service paid).

The positive impact of aid on imports is confirmed by means of an assessment of counterfactual imports, i.e. the level of imports that would have resulted in the absence of aid and debt relief. Table 3–5 gives the counterfactual imports expressed as percentage of the actual imports according to four different scenarios. Scenarios 1 and 2 assume that there is no aid and no debt relief, and there is no arrears decumulation. In scenario 1 debt service is reduced by 50 per cent (i.e. by USD 50 million, or half of the average annual debt service paid of USD 100 million, according to GDF data), reflected in an increase in arrears accumulation of USD 50 million, and arrears are increased with half the amount of actual debt relief. In scenario 2 the debt service is as actual. In scenario 3 and 4 there is no aid, but debt relief remains as actual. In scenario 3 debt service is reduced with USD 50 million, while in scenario 4 debt service paid and arrears accumulation remain as actual. Further, it is assumed in all scenarios that all other flows on the balance of payments remain the same. For detailed calculations of the four scenarios, see Annex C.

The analysis of the scenarios shows that, in all cases, in the absence of aid imports would be less than half of actual imports in the first half of the 1990s, and 50-65 per cent of actual imports from 1995 onwards, hence much lower than actual imports. Further, a scenario where debt service is reduced by 50 per cent produces only slightly higher imports compared to an otherwise similar scenario where debt service is not cut. Hence there is only a small difference between the effects on imports of keeping the debt service equal to the actual and a 50 per cent cut in debt service. This means that actual debt service is relatively unimportant in determining imports, and that aid (including debt relief) is much more important as a determinant of import capacity.

3.5 Effect on government accounts

Finally, the effect of debt relief on the government accounts, in particular public investment and social expenditure, will be analysed. Again, it was roughly only multilateral debt relief that freed resources, and its effect on government accounts will be the same as that of other programme aid. As figures for programme aid are not separately available, the effect of all aid on government accounts is examined.

Table 3–6 shows that government revenue as a proportion of GDP increased from 8 per cent in 1990 to 12 per cent in 1999, although it remained relatively low compared to other similar African countries. At the same time, since the early 1990s government expenditure as a proportion of GDP decreased somewhat and stabilised at about 18 per cent of GDP. The government deficit (excluding grants) has always been high, but declined substantially from 15 per cent of GDP in 1991 to 6 per cent later in de 1990s. The deficit including grants showed a similar trend, and was financed to a large extent by external loans. Prior to 1992 domestic financing was positive, as the government borrowed from the central bank to finance its deficit. Since the introduction of a cash budget in 1992 domestic financing was negative and no inflationary financing took place, which contributed to a lowering of inflation.

While expenditure was higher than it would have been without aid including debt relief, the extent to which this promotes growth also depends on the composition of expenditure.

The component of foreign financing in overall public financing was very high, indicating a high dependence. Grants were a major source of government income, and when foreign loans are added, aid funded over half of total expenditure in the first half of the decade. From 1995 the importance of foreign financing decreased (although still funding on average 30 per cent of expenditure) as government revenues went up. On the other hand, the grants part of foreign aid, which includes debt relief, also went up substantially. Before 1992 inflationary financing and hence inflation would have been much higher without aid. From 1992 onwards when curbing inflation became a policy priority, much higher levels of expenditure were made possible by aid than Uganda would have been able to sustain without it.

Table 3–6 Government accounts (Ug Sh billion, unless otherwise indicated)

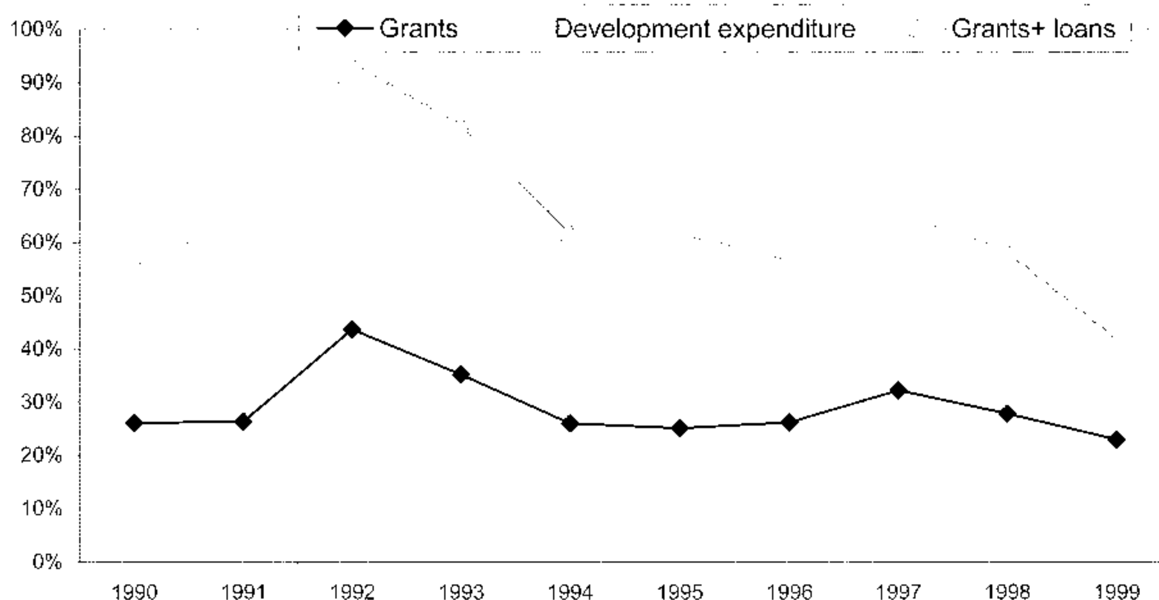
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total revenue and grants	207	339	595	651	761	877	1024	1199	1358	1526
Revenue	137	186	281	364	527	627	731	802	951	1010
Grants	70	153	314	288	234	249	293	398	407	516
Total expenditure	269	582	718	817	898	991	1117	1234	1463	2240
Recurrent expenditure	131	323	324	391	493	554	668	728	870	974
Wages/salaries	24	48	63	84	136	167	227	256	341	374
Interest	19	90	69	64	53	59	63	75	75	95
Other recurrent	86	185	191	243	304	328	378	398	454	505
Development expenditure	134	250	394	423	394	430	447	503	591	783
External	82	213	358	384	322	360	342	413	446	421
Domestic	10	37	36	40	72	70	105	90	145	263
Net lending and investment	5	9	1	3	11	7	2	3	2	392
Overall balance (Deficit)										
Including grants	-75	-242	-123	-165	-137	-114	-93	-34	-105	-715
Excluding grants	-145	-396	-437	-453	-371	-364	-386	-432	-512	-1230
Financing	75	242	123	165	137	114	93	36	102	732
External financing (net)	65			217	235	195	207	196	232	304
Domestic financing (net)	9			-52	-97	-81	-115	-161	-130	428
Percentage of financing:										
Foreign	87			131	171	171	223	544	227	42
Domestic	13			-32	-71	-71	-124	-474	-127	58
Banking system	5			-32	-70	-26	-60	-186	1	74
Non-bank	8			0	-1	-45	-63	-258	-128	-16
Percentage of GDP:										
Revenue	8	7	8	9	11	11	12	11	12	12
Expenditure	16	23	20	20	18	18	18	17	18	26
Deficit (incl grants)	-4	-9	-3	-4	-3	-2	-2	0	-1	-8
Deficit (excl grants)		-15	-12	-11	-8	-7	-6	-6	-6	-14
Percentage of total expenditure:										
Recurrent expenditure	49	56	45	48	55	56	60	59	59	43
Development expenditure	50	43	55	52	44	43	40	41	40	35
Memo: GDP	1669	2583	3602	4089	4925	5548	6041	7097	7991	8632

Source: IMF, Statistical Appendices, various years.

Development expenditure, which could be used as a proxy for public investment[16], was large (Table 3–6): around 50 per cent of total expenditure earlier in the decade, while since 1995 it came down to around 40 per cent; the bulk of it was externally financed. A close relationship existed between grants, the sum of grants and loans, and development expenditure each as a proportion of total government expenditure (Figure 3–8). It can be concluded that foreign aid played a major role in maintaining public investment. However, this may be more due to project aid than to programme aid.

[16] Development expenditure is not exactly the same as public investment, as development expenditure also includes the recurrent expenditures OF investment projects.

Figure 3–8 Aid and development expenditure, in per cent of total expenditure



Source: Elaboration of Table 3–6.

Without aid, government expenditure and public investment would have been at a much lower level. Programme aid including debt relief played a role, although its effect was smaller as programme aid amounts involved were smaller than project aid (Figure 3-5). Nevertheless, as was shown in Figure 3–5, PA was around the same volume (even somewhat larger) as the debt service paid, suggesting that PA filled this financing gap.

Table 3–7-a Government recurrent expenditure, in per cent of total recurrent expenditure

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Security		13	24	23	23	21	21	16	22	19
of which: Defence					20	18	18	15	21	18
Roads and works					2	2	2	2	3	3
Agriculture					2	1	1	1	1	1
Education		4	14	12	23	21	25	28	27	26
of which: Primary education					7	8	12	16	15	15
Health		1	5	5	9	10	7	6	7	7
Law and order					10	11	10	10	8	9
General public services		23	22	40						
Other social services		6	1	2						
Economic functions and soc.					4	2	2	1	1	2
Economic functions		18	6	6						
Public admin					24	26	25	28	24	26
Other					3	7	7	8	7	8
Other		35	27	13						
Total expenditure		100	100	100	100	100	100	100	100	100

Source: IMF Statistical Appendices, various years.

Social expenditure increased since 1995, relative to total recurrent expenditure and relative to GDP (Tables 3–7 and 3–8) (World Bank 2001). This was especially the case for primary education, which saw the launching of Universal Primary Education (UPE) in 1997. The share of recurrent expenditure for health declined from 1995 to 1997, but then partly recovered. Some mixed evidence exists for the trend in social expenditure in the first half of the 1990s: Tables 3–7-a and b, which only focus on recurrent expenditure, suggest that social expenditure increased during that time, but other sources which include recurrent and capital expenditure show a decrease in social expenditure during the first part of the decade (Ddumba et al. 1999).

The MDF probably had a positive effect on recurrent social expenditure. This development was reinforced as part of HIPC from 1998 onwards. The Poverty Action Fund (PAF) was set up to channel resources, that were no longer needed for debt service payments, to the social sectors, including budget support from bilateral donors such as the Netherlands. PAF expenditure as a proportion of total expenditure and GDP increased during the first years of its existence. Expenditure on programme priority areas (PPAs) increased from 1.6 per cent of GDP in 1997 to 2.3 in 1998 and an estimated 2.7 per cent in 1999. After 1998, the negative trend for relative health expenditure has been halted (Tables 3–7 and 3–8). It can be concluded that at least some substitution of social expenditure for debt service payments as a result of debt relief took place; donor contributions to the MDF and under HIPC freed resources for social expenditure.

Table 3–7-b Government recurrent expenditure, in per cent of GDP.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total recurrent expenditure		11.8	8.4	8.9	0.0	0.0	1.1	0.2	0.9	11.3
Security		1.6	2.0	2.1	2.3	2.1	2.3	1.7	2.5	2.2
of which: Defence					2.0	1.8	2.0	1.5	2.3	2.0
Roads and works					0.2	0.2	0.2	0.2	0.3	0.3
Agriculture					0.2	0.1	0.1	0.1	0.1	0.1
Education		0.5	1.2	1.1	2.3	2.1	2.8	2.9	3.0	3.0
of which: Prim. Educ					0.7	0.8	1.3	1.6	1.7	1.6
Health		0.2	5.1	4.8	8.8	0.3	7.2	6.5	6.7	6.7
Law and order					1.0	1.1	1.1	1.0	0.8	1.0
General public services		2.7	1.9	3.5						
Other social services		0.7	0.1	0.2						
Economic functions and soc					0.4	0.2	0.2	0.2	0.1	0.2
Economic functions		2.1	0.5	0.5						
Public admin					2.4	2.6	2.8	2.9	2.6	2.9
Other		4.1	2.3	1.1	0.3	0.7	0.8	0.8	0.8	0.9

Source: IMF Statistical Appendices, various years.

The share of defence expenditure was large. With civil strife continuing in the North of the country and Uganda's increasing involvement in the Democratic Republic of Congo conflict at the end of the 1990s, donors were concerned that this would lead to an increase in defence expenditure at the cost of social expenditure (DGIS 2000). After a substantial increase of defence expenditure to over 20 per cent of total expenditure in 1998, its share returned to the former level of 18 per cent. The target of a maximum defence expenditure of 2 per cent of GDP was maintained, at least according to official figures.

Table 3–8 Social expenditure 1997-2000

	1997	1998	1999	2000
as % of GDP:				
Total expenditure	17.5	18.6	20.6	
Domestic expenditure	10.9	12.2	14.2	
Social expenditure	5.1	6.1	7.1	
Education	3	3.5	3.8	
Health	0.8	0.9	0.9	
Agriculture	0.1	0.1	0.2	
Roads and works	0.6	0.8	1.2	
Water, land and environment	0.1	0.2	0.2	
Police and local defence units	0.6	0.6	0.6	
Governance and transparency	0	0.1	0.1	
Expenditure on PPAs	1.6	2.3	2.7	
as % of total expenditure:				
Domestic expenditure	62.5	65.8	69.1	
Social expenditure	29.5	32.7	34.2	
PPAs	9.3	12.6	13.1	
PAF expenditure as % of:				
Total expenditure	11.5	15.9	13.5	21.4
Nominal GDP at factor costs	2	2.9	3.5	4.9

Source: IMF and IDA (2000a) and IMF (2001).

3.6. Conclusions

Despite debt relief, the stock of debt continued to rise rapidly throughout the 1990s. This was mainly due to new loan inflows. Overall the reduction of the debt stock as a result of debt relief was very limited. The amounts of debt relief were small, before 1998 most debt relief was in the form of rescheduling, and until far in the 1990s relief agreements left the multilateral debt burden largely untouched. The commercial debt buyback did reduce the debt stock but the commercial debt stock itself was small. Only with HIPC towards the end of the decade the amount of forgiveness increased, so that a more substantial reduction of the debt stock came about.

PC debt relief and also the buyback had limited effects on the actual debt service flow, as most of these debts were not being serviced. Relief on multilateral debt did reduce the actual debt service burden. At the same time, PC debt relief seems by and large to have been additional to other PC bilateral aid inflows. Multilateral debt relief was at least partly also additional. HIPC is expected to have a noticeable flow effect on debt service payments.

Most Dutch debt relief was in the form of multilateral relief and therefore always released resources for the government. The Dutch also helped to finance the debt buyback, which had some effect on reducing the debt stock.

Aid including debt relief had a clear effect on the balance of payments, with imports sustained at a much higher level than would have been possible without aid. With regard to the government accounts, aid including debt relief allowed higher public investment and social expenditure than would have been possible without it. Increased focus in government policies on poverty reduction, advocated by donors through the policy dialogue, also played a role in increasing government expenditure for the social sectors.

4 OUTCOMES OF DEBT RELIEF: EFFECTIVENESS

This chapter assesses the effectiveness of debt relief, i.e. to what extent debt relief inputs and outputs have contributed to intended outcomes. First, it assesses the extent to which debt relief and the attached conditionality led to increased debt sustainability. Second, it examines whether the small reduction in the debt stock had stock effects on private investment and improved creditworthiness, and third whether the increased flow of resources as a result of debt relief and (mainly) aid, and the resulting increases in government expenditure (chapter 3) had flow effects on improved social indicators.

4.1. Debt sustainability

In the 1990s Uganda's debt sustainability indicators that measure liquidity, i.e. indicators of the country's debt payment problems in the short run, greatly improved (Table 4–.1).

Table 4–1 Debt sustainability indicators (USD million and per cent)

	1990	1991	1992	1993	1993	1995	1996	1997	1998	1999
DS due (l-t debt)	438	511	532	480	415	401	347	358	1058	417
DS paid (l-t debt)	84	102	76	142	120	104	95	96	96	126
DS due (l-t debt + IMF)	494	553	564	492	441	431	399	418	1122	470
DS paid (l-t debt + IMF)	140	144	108	154	146	134	147	156	160	179
Interest payments (l-t debt)	18	33	26	33	34	34	38	37	31	44
Interest payments (total debt)	36	46	34	38	38	38	43	43	37	50
Debt stock (l-t debt, LDOD)	2161	2283	2433	2599	2869	3062	3151	3404	3482	3564
Debt stock (total debt EDT)	2583	2777	2928	3029	3372	3572	3675	3913	4016	4077
Exports	246	202	199	242	344	683	747	863	676	776
Imports	753	732	672	746	913	1457	1668	1706	1922	1897
GNP	4227	3264	2771	3172	3936	5698	6004	6281	6769	6397
Investment (WDI)	547	504	455	491	587	945	972	1011	1017	1052
Savings (WDI)	25	23	12	36	173	425	278	502	379	311
Ratios (l-t debt +IMF), in %										
DS due/ Exports	201	273	284	203	128	63	53	48	166	61
DS paid/ Exports (DSR)	57	71	55	64	42	20	20	18	24	23
Interest payments/ Exports	15	23	17	16	11	6	6	5	5	6
DS paid/ DS due	28	26	19	31	33	31	37	37	14	38
DS due/ GNP	12	17	20	16	11	8	7	7	17	7
DS paid/ GNP	3	4	4	5	4	2	2	2	2	3
Interest payments/ GNP	1	1	1	1	1	1	1	1	1	1
Investment/ GNP	13	15	16	15	15	17	16	16	15	16
Savings/ GNP	1	1	0	1	4	7	5	8	6	5
Debt (LDOD)/ Exports	879	1130	1225	1074	834	449	422	394	515	459
Debt (EDT)/ Exports	1051	1374	1474	1252	980	523	492	453	594	525
NPV of debt/ Exports							243			240
Debt (LDOD)/GNP	51	70	88	82	73	54	52	54	51	56
Debt (EDT)/ GNP	61	85	106	95	86	63	61	62	59	64

Source: GDF 2001 and WDI 2001.

GDF data show that both the debt service paid-to-exports ratio (debt service ratio) and the debt service due-to-exports ratio improved. The debt service ratio stabilised at about 20 per cent in 1995, after it peaked at over 70 per cent in 1991 (see also Figure 1–10). According to HIPC benchmarks and the before-mentioned classification as developed by Cohen, which apply a sustainability threshold for the debt service ratio of 20 per cent, Uganda's debt became sustainable in the second half of the decade. When taking into account the debt relief provided under the MDF and Fifth Dimension, which is not included in GDF data, the burden of debt service payments was even lower. However, the debt service due-to-exports ratio is still at an unsustainable level.

The amount of debt service paid on long-term debt decreased, but the debt service paid on long-term and IMF debt combined did not. On the other hand, exports showed a substantial increase, and this was the major driving force behind the improvement of the debt service ratio, rather than a reduction in the actual debt service paid. After having reached record negative rates in the early 1990s, export growth since 1993 was very high. This was partly due to favourable terms of trade, especially in 1994-95 when world market prices for coffee were very high. The liberalisation of coffee marketing and other primary goods earlier in the 1990s also was an important factor in boosting production and exports in the agricultural sector. Foreign exchange liberalisation further aided the export sector. The volumes of major export crops increased, and those of non-coffee crops rose even faster than that of coffee. However, bad weather conditions in 1997-98 and a decline in the coffee price impacted negatively on agricultural production and exports. As non-coffee exports showed a substantial increase, the share of coffee in total exports declined from 73 per cent in 1990 to 56 per cent in 1998[17]. On the other hand, the large upsurge in exports since 1995 was at least partly due to an increase in registered exports. Uganda's debt sustainability is very vulnerable to export-related factors (see below under HIPC).

The drop in the debt service due-to-exports ratio was more pronounced than that of the debt service paid-to-exports ratio. The increase in the proportion of debt service due that was actually paid from 28 per cent in 1990 to 38 per cent in 1999 (Table 4–1) is a sign of improved debt sustainability, as is the decrease in the level of arrears from USD 400 million in 1991 to less than USD 300 million in 1999 (see also Figure 1–6).

Another indicator for determining to what extent a country faces debt payment problems in the short run is the interest paid to exports ratio. Table 4–1 shows that this ratio fell substantially in the second half of the 1990s, to an average of about 6 per cent (compared to over 15 per cent in the early 1990s). This is below the sustainability benchmark for this indicator of 15 per cent according to Cline. However, with no decrease in the amount of interest payments, which fluctuated around USD 40 million, the improvement in this indicator was largely driven by the increase in exports.

Debt sustainability indicators which measure solvency include the debt stock to GNP ratio and the debt stock-to-exports ratio which are presented in Figures 1–7 and 1–8 respectively. Both indicators peaked in 1992, at almost 100 per cent and over 1500 per cent respectively, after which they dropped substantially in the next few years and stabilised at a much lower level from 1995 onwards: at the end of the 1990s the debt to GNP ratio was about 60 per cent and the debt to exports ratio was about 500 per cent. As was the case for the debt service ratio, the big improvement in the debt-to-exports ratio was mainly driven by the increase in exports. The debt stock continued to increase in the 1990s, as the stock effect of debt relief was very limited and as debt relief was outweighed by new loans mostly from multilateral institutions, albeit on highly concessional terms. The

[17] When the NRM took power in 1986, the share of coffee in total exports had been 97%.

ratio of concessional debt to total debt increased from just over 50 per cent in 1990 to 80 per cent in 1999[18]. The end-of-decade value for the debt-to-exports ratio of about 500 per cent remained far above the sustainability threshold of 200 per cent for this indicator. Hence, when measured by this indicator, the debt situation of Uganda was not yet sustainable at the close of the decade. On the other hand, the debt-to-GNP ratio, after having peaked at over 100 per cent in 1992, dropped to around 60 per cent at the end of the 1990s. This is close to but still somewhat above the debt sustainability threshold of 50 per cent for this indicator. Again, this development was mainly driven by GNP growth, as the debt stock increased.

At the end of June 1997, the NPV debt-to-exports ratio before HIPC 1 assistance stood at 243 per cent. The debt sustainability target under HIPC 1 for Uganda for the NPV of debt-to-export ratio was set at 202 per cent (with a range of 192-212 per cent). After HIPC 1 assistance, the end June 1997 NPV debt-to-exports ratio stood at 196 per cent, hence slightly below the target that had been set at Decision Point. However, by the middle of 1999 the NPV of debt-to-export ratio had risen again to 240 per cent before HIPC 2 assistance, hence above the HIPC 1 debt sustainability benchmark of 202 per cent and far above the HIPC 2 new benchmark of 150 per cent, implying continued unsustainability of the debt situation. With the granting of assistance under HIPC 2 in 2000, the NPV debt-to-exports ratio was expected to be reduced to the level of the HIPC 2 sustainability benchmark of 150 per cent. With HIPC 2 debt relief effort Uganda's debt was expected to become sustainable and to allow for an exit from future debt relief operations. However, vulnerability analysis undertaken as part of debt sustainability analysis (DSA) in the framework of HIPC showed that Uganda is considerably more vulnerable than other countries in the region in terms of export concentration and export vulnerability, with its continued high dependence on the export of coffee. This was already born out by the fact that as a result of a drop in exports in 1998 the NPV of debt-to-exports ratio became considerably higher than foreseen (IMF 1998, World Bank 2000b).

The longer-term sustainability of external debt can also be assessed through a comparison between the interest rate on debt and the growth rates of GNP and exports (Table 4–2). Debt can be sustainable in the long run and be accompanied by a trade deficit if the growth rate of exports (measured here as five-year rolling averages, at current prices) is above the interest rate (here the average interest rate on new loans is used). In the period 1990-94 this was clearly not the case as growth rates of exports were negative, which implies that the debt burden was becoming more unsustainable. From 1995 onwards growth of exports was far higher than the interest rate, pointing at increasing long-term sustainability. New loans were provided at increasingly favourable terms especially since 1995, helping debt sustainability. Likewise, debt can be sustainable in the long run and accompanied by a savings deficit if GNP growth is higher than the interest rate. Again, this was not the case until 1995, when GNP growth rates were negative and considerably below interest rates (Figure 1–9). However, as of 1995 GNP growth became far higher than the interest rate, implying increased long-term sustainability according to this measure.

[18] Concessional bilateral debt as a proportion of total bilateral debt increased from 58% in 1990 to 85% in 1999. Likewise, the concessionality of multilateral debt (excl. IMF) increased from 89% in 1990 to 97% in 1999. Throughout the decade, the proportion of concessional debt has been greater for multilateral than for bilateral debt, although concessionality of bilateral debt has increased to such an extent that it approached that of multilateral debt.

Table 4–2 Long-term debt sustainability

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Average interest rate new loans	1.0	2.3	1.5	1.6	0.9	0.8	0.8	0.8	0.7	0.8
Growth of GNP*	6.8	-5.6	23.7	21.1	-8.8	10.5	22.5	31.4	28.7	17.6
Growth of GDP*	6.9	-5.4	23.1	20.9	-8.7	10.2	22.1	30.1	28.1	17.1
Growth of Exports*	-15.6	20.0	21.7	-9.8	3.1	39.5	53.9	61.7	38.6	29.7

*Growth rates are based on five-year rolling averages.
Source: Elaboration of data from GDF.

4.2 Stock effects on investment and creditworthiness

As was shown in chapter 3, before the HIPC initiative in 1998 Uganda experienced very little debt stock reduction. The highest reduction was registered in 1993 with the commercial debt buyback, amounting to 6 per cent of the end-1992 debt stock. Not much stock effects on private investment and on improved creditworthiness can therefore be expected over the evaluation period. In this section the trends in private investment and in some indicators for creditworthiness are presented, and the extent to which they may have been influenced by the debt stock reduction, is examined. This analysis may also throw light on the possible effects of debt stock reductions of 1998 and beyond with the (enhanced) HIPC initiative. Reduction in the expected future debt service payments may have beneficial effects on private investment, either directly as the tax on future profits is reduced, or indirectly by increasing the government's incentives to pursue good policies. Further, it may have beneficial effects on the country's creditworthiness for foreign investors and lenders.

Table 4–3 GDP by expenditure category (per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Resource balance:	-12	-14	-15	-14	-14	-16	-15	-20	-19	-24
X goods and non-factor services	5	6	8	9	13	13	14	10	12	11
M good and non-factor services	17	22	23	23	26	29	29	30	32	35
Consumption	100	108	104	101	103	107	106	112	109	108
Private	94	96	95	92	92	96	94	101	97	94
Public	6	12	9	9	11	11	12	11	12	14
Gross domestic investment	12	19	20	20	19	18	19	17	19	25
Private	6	9	9	10	12	12	13	11	13	14
Public	6	10	11	10	7	6	6	6	6	11
Gross domestic savings	0	-2	3	7	5	2	4	-3	0	1
Private	4	3	4	8	6	2	4	-3	0	4
Public	-4	-5	-1	0	-1	0	0	0	0	-3
Net factor service income		-3	-2	-2	-1	-1	0	0	0	0
Private transfers		5	4	8	7	10	8	10	8	9
Public transfers		8	9	6	6	5	5	5	3	4
Gross national savings		0	5	14	16	16	18	15	14	19
Private		5	6	14	12	12	13	9	10	17
Public		-6	-1	-1	4	4	4	5	5	3

Source: IMF, Statistical Appendices, various years.

The share of gross domestic investment in GDP remained steady during the 1990s, averaging almost 20 per cent according to IMF statistics after it stood at 12 per cent in 1990 (Table 4–3)[19]. This is a reflection of two trends. On the one hand, public investment as a percentage of GDP declined since 1994 to an average of 6 per cent, compared to about 10 per cent in the early 1990s. This is to a large extent in line with the privatisation programme which got off the ground from the mid 1990s onwards, involving the closing and selling of state-owned enterprises and utility companies. Private investment increased, from under 10 per cent in the early 1990s to 14 per cent in 1999. Private investment was at a substantially higher level than public investment since 1994.

As indicated in Chapter 3, without aid public investment would probably have been at a much lower level. In the early 1990s, it has been shown that most investment was in construction and not in machinery or equipment (World Bank, 1995b). It seems that donor grants and loans financed the rehabilitation of public infrastructure. But this probably had positive effects on private investment as well. Okurut concludes that some "crowding in" has taken place: foreign aid is estimated to have led to a 4.2 per cent rise in public investment, and this in turn is estimated to have provoked a 9.6 per cent increase in private investment between 1984 and 1994 (Okurut, 1997).

In the mid-1990s, the World Bank carried out a Private Investment Survey in Uganda (World Bank, 1995a). The most important bottleneck for private investment proved to be the poor quality and the high price of infrastructure, and in particular of electricity. On average, firms reported losing 90 days of work due to power cuts. Other problems included the high costs of finance, and taxes and the poor quality of tax administration. The high foreign debt was not specifically mentioned as a bottleneck for investment. However, lower (future) debt payments may release funds for the government with which it may improve infrastructure. Corruption also remained a widespread (and according to some even increasing) problem; it was a major reason for delays in the privatisation programme, which held back the level of private investment (World Bank 2000a).

Developments with regard to creditworthiness for private lenders and investors can be measured through various indicators, such as the ratio of debt service paid-to-debt service due, and the level of new financial inflows (including loans, portfolio investment, and foreign direct investment). As discussed earlier, the ratio of debt service paid to debt service due increased from under 30 per cent in the early 1990s to 38 per cent in 1999, but it is still at a very low level.

When looking at the inflow of new financial flows into Uganda (Table 4–4), it can be seen that the largest of these inflows consisted of multilateral loans, the bulk of which was concessional. Yet, there still remained some non-concessional loans. Most loans were multilateral credits, which averaged about USD 200 million per year (and USD 250 million per year when including IMF loans), but also included some bilateral loans, amounting to an annual average of almost USD 30 million in the period 1990-96, with the exception of 1993 when they even reached almost USD 200 million; after 1996 bilateral loans were in the range of USD 5-10 million annually. Bilaterals largely disbursed aid in the form of grants instead of loans. New foreign commercial loans to the public sector were at a low level, and no loans were given from this source since 1994; this was in line with the avoidance by Uganda of borrowing on commercial terms. While under Uganda's 1992 external debt strategy it was already agreed to limit borrowing to that on concessional terms, under the 1995 enhanced external debt strategy this was modified to an agreement to avoid all new loans - even those on concessional terms - unless every effort had been

[19] Investment was stable at about 16 per cent of GNP throughout the 1990s according to WDI figures (see Table 4–1).

made to obtain grant financing. If borrowing was unavoidable this would only be done on highly concessional terms. It was already concluded earlier that this policy was not sufficiently adhered to.

Table 4–4 New capital inflows (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
PPG - Total disbursements	293	188	253	410	269	231	226	293	175	175
PPG- Official	255	182	247	392	269	231	226	293	175	175
PPG- Bilateral	36	16	31	189	19	21	45	10	5	6
Bilateral concessional	23	15	27	150	19	20	45	9	3	5
Bilateral non-concessional	12	2	5	39	0	1	0	1	2	1
PPG- Multilateral	219	166	216	204	250	210	180	284	170	169
Multilateral concessional	215	162	200	180	247	200	167	264	168	166
Multilateral non-concessional	4	4	16	23	3	10	14	20	2	2
PPG- Private	38	5	6	18	0	0	0	0	0	0
PPG- Commercial banks	5	1	2	9	0	0	0	0	0	0
PPG- Bonds	0	0	0	0	0	0	0	0	0	0
PPG - Other private	34	4	4	9	0	0	0	0	0	0
PNG- Total	0	0	0	0	0	0	0	0	0	0
Disbursements (total l-t)	293	188	253	410	269	231	226	293	175	175
IMF	79	79	56	0	52	56	64	60	50	35
Disbursements (l-t + IMF)	372	267	308	410	321	287	290	353	225	210
Net resource flows on l-t debt *	227	119	202	301	183	161	169	235	109	92
Net transfers on l-t debt **	209	86	176	268	149	127	131	197	78	49
Foreign direct investment (FDI) (net)	0	1	3	55	88	121	121	175	210	222
Portfolio equity flows	0	0	0	0	0	0	0	0	0	0
Grants (excl. TA)	257	314	336	260	319	400	336	341	358	379
Aid (Disbursements + Grants)	629	581	644	670	640	687	625	694	582	589

* Net resource flows on debt = loan disbursements minus principal repayment.
** Net transfers on debt = loan disbursements minus debt service.
Source: GDF 2001.

Official loans to Uganda cannot be seen as a sign of creditworthiness as they are given for other reasons than expected profitability. In addition, all multilateral and bilateral loans extended after the cutoff date have to be paid with priority, so – as long as Uganda receives such large amounts of aid – these lenders need not be concerned about repayment. Private loans to public and private sectors are a sign of creditworthiness. As the former are kept in check by a conscious policy to avoid non-concessional borrowing, private flows to the private sector remain. In practice, private non-guaranteed loans, i.e. loans to the private sector, remained zero in the 1990s. In addition, despite liberalisation of the capital account in 1997, portfolio equity inflows remained nil.

On the other hand, foreign direct investment (FDI) grew at a very high rate, albeit from a very low level: from zero in 1990 to USD 222 million in 1999. This reflects increased credibility of government policies and increased confidence of investors in Uganda. It was

also at least partly related to the privatisation process. But creditworthiness is not very important for FDI, as these flows represent risk sharing equity that depend more on expected profits of the particular investment activity. Another positive development can be registered in the private unrequited transfers (Table 3–1) that increased rapidly during the 1990s. In the case of Uganda, this flow is at least partly related to FDI (Bhinda et al., 1999). These flows are often brought in by returning ethnic Indians, who had been expulsed by Idi Amin in the 1970s.

An important factor that appears to have impacted on private investment and also on FDI and on private unrequited transfers from abroad concerned the healthier macroeconomic environment since 1992 and the more positive business climate that came with it. High economic growth rates, lower inflation and lower public deficits, at least partly as a result of prudent government policies, as well as increased credibility of government policies and increased political stability since the end of the civil war in 1986, are likely to have boosted investor confidence in the country and to have been conducive to increased production and investment (World Bank 2000a). On the other hand, the same problems that hamper private investment (see above) also hinder foreign investment.

In the future, the reduction in the NPV of the debt stock as a result of the HIPC initiative may bring some further inflows of capital. Collier et al. estimated the effects of debt stock reductions on returning capital flight for several potential HIPC countries. This effect proved to be large for Guyana (proportion of wealth held abroad would reduce by 10.2 percentage points). In Uganda the effect would be more limited, but still positive (Collier et al. 2001).

4.3. Effect on social indicators

Chapter 3 concluded that aid including debt relief allowed government expenditure to be considerably higher than it would have been in the absence of aid. Also, foreign aid appears to have played a major role in maintaining public investment, but this was probably mainly due to project aid. As government expenditure would have been much lower without aid, it is likely that social expenditure benefited from increased aid flows including debt relief. Indeed, while total government expenditure declined slightly as a proportion of GDP since 1995, the share of social sector expenditure increased, especially for education (Table 3–8). Another important factor was the increased focus by government and donors on poverty reduction after 1995. Poverty reduction became the overarching goal of government development programmes in 1997, and under HIPC social development targets were incorporated in government development programmes. Donor funds channelled as debt relief through the MDF and later (from 1998 onwards) through the PAF as budget support were allocated to the social sectors.

Table 4–5 provides an overview of the trend in various social development indicators since the 1970s (World Bank, 2000b). Clearly, in the 1990s (1993-98), there was a substantial improvement in most social indicators compared to the period 1980-85. Net primary enrolment more than doubled from 41 to 93 per cent, exceeding the average for low-income countries. Immunisation coverage increased from under 20 to about 60 per cent, putting it at a par with the average for Sub-Saharan Africa, and access to safe water increased sharply in rural areas. Mortality rates for infants and under-fives declined; yet, they still remained above the averages for Sub-Saharan Africa, reflecting the previously very high level due to war and related poverty. Life expectancy at birth declined since the early 1980s. This was largely due to the AIDS pandemic, which ravaged the country since the mid-1980s. However, the ending of the civil war can be assumed to have been the most important explaining factor for the improvement of social indicators in the 1990s compared to a decade earlier.

Table 4–5 Social indicators 1970s-1990s

	1970-75	1980-85	1993-98	SSA	LICs
Public expenditure (% of GDP)					
Health	..	..	1,8	1,5	1,3
Education	2,7	3,5	2,6	4,1	3,1
Net primary enrolment ratio (% of age group)					
Male	..	44	..	..	89
Female	..	38	..	..	82
Total	..	41	93	..	86
Access to safe water (% of population)					
Rural	..	12	40	..	..
Urban	..	45	45	..	..
Total	..	16	41	..	..
Immunisation rate (% under 12 months)					
Measles	..	17	60	58	80
DPT	..	14	58	53	82
Child malnutrition (% under 5 years)	..	..	26	..	..
Life expectancy at birth (years)					
Male	50	48	42	49	62
Female	52	49	41	52	64
Total	51	48	42	50	63
Mortality					
Infant mortality rate	104	116	97	92	68
Under-five mortality rate	185	180	170	151	92
Maternal mortality rate	..	..	510	..	..

Source: World Bank (2000b), Statistical Annex.

Table 4–6 provides more detailed data on social indicators for the 1990s, indicating that many indicators improved although others deteriorated. It shows a very strong improvement since 1994 in primary enrolment. This is closely related to the Universal Primary Enrolment (UPE) policy which was initiated by the government in 1997, under which free education was provided to a maximum of four children per family. The policy succeeded in providing primary education to the whole country and reaching the poorest groups (IMF 2001). The number of children enrolled in primary school increased from 2.3 million in 1997 to over 6 million in 1999. However, the quality of education remained very low, and increasingly became a matter of concern. Illiteracy declined slowly throughout the 1990s, from 44 in 1990 to 35 per cent at the end of the decade. Access to safe water in rural areas increased.

However, a substantial fall in immunisation rates occurred. This may be related to declining recurrent expenditure for health between 1995 and 1998, as education was perhaps receiving resources that would otherwise have benefited the health sector (Tables 3–7 and 3–8). At the same time, an increase in budgeted public expenditure in itself is not a sufficient condition for improving social service delivery. Serious problems were encountered in the delivery of social services, especially at the lower levels of government, due to lack of capacity and corruption (IMF 2001).

Table 4–6 Social indicators 1990-1999

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1997/98	1998/99*	1999/00*
Primary education									
Net enrolment rate					55	56	85	94	77
Completion rate					30	35	40	45	
Gender ratio					45	46	47	48	
Access to clean water (rural) (%)					36	38	42	45	50
Immunisation rates (%):									
Children:									
BCG					98	96	88	69	
DPT3					79	74	61	46	
Polio3					78	78	62	47	
Measles					79	82	64	49	
Pregnant women (TT)					76	72	48	38	
IMR	104		97			98	99		88
U5MR	165						162		162
Life expectancy at birth (yrs)	47		46			44	42		42
Illiteracy (%):									
Male	31	30	29	28	27	26	25	24	23
Female	57	55	54	53	51	50	47	46	45
Total	44	43	42	40	39	38	36	35	34

Source: IMF (2001) and WDI 2001.

Overall, the first signs are that the government's recent increased focus on social sector performance, and the extra resources made available for this purpose, start to show some results. In particular, access to education has improved with UPE. It is likely that at least to some extent this positive development can be attributed to increased external aid including debt relief and the conditionality attached to it.

4.4 Conclusions

Debt sustainability improved during the 1990s. The debt service-to-exports ratio fluctuates around a sustainable level (of 20 per cent), but the high ratio of debt service due-to-exports indicates that this improved liquidity is based on continued non-payment of arrears. Solvency indicators also improved, but they are still well above the sustainability threshold. The role of debt relief in this achievement was limited, and the increases in exports and GNP were more important driving forces behind the sustainability improvement. With the country's vulnerability to exports it can therefore be questioned how solid the debt sustainability status of Uganda will prove to be.

Private investment and also foreign direct investment (FDI) increased, but these were mainly the result of the more optimistic business climate, higher growth rates, credibility of government policies - aided by conditionality on aid including debt relief - and political stability. They were probably not related to debt relief leading to a reduced debt overhang. Although the ratio of debt service paid-to-debt service due improved somewhat, it was still low. Apart from FDI and some returning capital flight as registered in the figures for private transfers, there were no private capital inflows to Uganda yet.

Many social indicators improved in comparison with the early 1980s, although some deteriorated. The improvements were mostly related to the continued peace in most parts of the country. Foreign aid including debt relief helped sustain public expenditure at a higher level than would have been the case otherwise, and this may have helped funding the policy of Universal Primary Education which substantially raised primary school enrolment rates in the later 1990s.

It seems that the Dutch contribution to the commercial debt buyback did not have stock effects on creditworthiness or on private investment yet during the evaluation period. It may have played a role in improving the incentives for better government policies, as it removed uncertainty about future payments on these commercial debts. The Dutch contributions to multilateral debt relief probably had a flow effect on increased public expenditure and more priority for the social sectors.

5 IMPACT OF DEBT RELIEF: RELEVANCE

Based on the analysis of the previous chapters, this final chapter assesses to what extent the inputs, outputs and outcomes of debt relief and the conditionality attached to it have impacted on economic growth and on poverty reduction.

5.1 Impact on economic growth

Uganda's macroeconomic performance during the 1990s was generally good, especially after 1992 (IMF 2000b, Holmgren 1998). Average annual real GDP growth was over 6 per cent. As population growth continued to be high, per capita GDP growth stood at an annual average of just below 4 per cent. All sectors maintained positive growth, with manufacturing and construction showing particularly high growth rates (Table 5–1). Agriculture remained the most important sector, but its share in GDP declined from just over 50 per cent in 1991 to about 40 per cent towards the end of the 1990s. Export growth (measured in current prices) was high at an average of 25 per cent per year since 1992. Inflation came down rapidly to about 6 per cent, and the budget deficit (excluding grants) decreased considerably from 15 per cent in the early 1990 to 6 per cent at the end of the decade (Table 3–2).

Table 5–1 Real GDP growth by sector (per cent)

	1992	1993	1994	1995	1996	1997	1998
Agriculture	9	2	6	4	1	2	7
Industry	9	13	20	17	11	12	9
Manufacturing	7	15	17	20	13	14	12
Construction	11	11	24	13	7	7	7
Services	7	10	20	9	6	7	7

Source: IMF, Statistical Appendices, several years.

Several internal and external factors have contributed to this performance. Major factors include prudent and consistent government policies combining stabilisation and reform measures, improved terms of trade in a number of years especially due to the rise of the world market price for coffee, and continued political stability after the civil war came to an end in 1986. Foreign aid as a major source of financing for the government also played an important role in fostering growth. To what extent did debt relief contribute it?

Before 1992 the so-called "rehabilitation" effect, involving the restoration of law and order, was, together with aid, the major factor responsible for stimulating economic growth. After 1992 government commitment to economic stabilisation and structural reforms combined with donor resources were major factors. During this latter period, debt relief became more important. The conditionality attached to aid and (in particular, multilateral) debt relief and the related policy dialogue contributed to the establishment of the basis for further economic growth.

Some of the earlier reforms such as the liberalisation of the foreign exchange market were undertaken to a considerable extent by the government on its own account (Botchwey et al. 1998), although programme aid played a part as well through facilitating these reforms. Later reforms, including fiscal reforms, privatisation, trade and financial sector reforms, and the civil service reform, were clearly influenced by conditionality attached to programme aid and debt relief. However, these reforms were often carried out with

substantial delays, and the donor community was not always satisfied with them. Nevertheless, donors appear to have been convinced of the sufficiency of the degree of ownership of the reform programme by the government (World Bank 2000a), and were less demanding and more willing to accept delays or non-implementation of reforms. The country's high growth rates also facilitated this rather lenient attitude of donors (Ddumba et al. 1999). On the other hand, the need felt by donors, especially the IFIs, to guard Uganda as a showcase which should not fail, probably also played a role.

Economic growth in the 1990s was accompanied and underpinned by increased investment. Gross domestic investment increased after the end of the civil war in 1986 from under 10 per cent of GDP to an annual average of about 19 per cent during most of the 1990s. Domestic savings as a percentage of GDP remained at a low level. Gross national savings showed a substantial increase, and stood with 16 per cent in the second half of the 1990s at a far higher level than domestic savings (which ranged between –3 and 4 per cent during that period). This points to a high dependence on foreign inflows, in particular aid but also FDI and the increased inflow of remittances and returning capital of Asians, which was an important factor stimulating investment. Consumption as a percentage of GDP also increased somewhat, from 100 per cent of GDP to 109 per cent in 1998; hence it appears that growth was also sustained by consumption, although to a lesser extent than by investment (GDF 2001).

Debt relief can only have played a limited role in these increases in investment and consumption. As shown above, the flow effect of debt relief was limited, as Paris Club debt relief hardly reduced the actual debt service burden and bilateral debt constituted only a small share of Uganda's debt anyway. Relief on multilateral debt through 5th dimension, the MDF and later HIPC did free resources. This result was part of the flow effect of aid in general, and to some extent this debt relief substituted for other forms of programme aid. Hence, as far as the flow effect of debt relief is concerned, the impact of aid on growth was far more important than that of debt relief during the 1990s.

Through aid, imports were sustained at a higher level than would have been possible without foreign aid including debt relief, which was an important factor in promoting growth. Aid also helped boost the foreign exchange reserves from less than one month worth of imports in 1990 to almost five months later in the decade. The relative importance of aid decreased somewhat over time, confirming the positive impact of imports on economic growth, as exports and inflows of private capital (including remittances and returning capital from Asians, and FDI) increased. At the same time domestic revenue mobilisation improved, although its basis remained weak and could not easily be raised.

Before 1992, when the government was not yet committed to stabilisation, programme aid contributed to curbing inflation rate (Ddumba et al. 1999), as it reduced the need for inflationary financing of the budget deficit. When, after 1992, the government became committed to stabilisation and inflationary financing of the deficit was stopped, aid helped maintain public expenditure at a higher level than would otherwise have been possible. The reduction of inflation witnessed in the 1990s contributed to an improved business climate, which in turn was beneficial to investment and growth.

Chapter 3 also shows that debt relief hardly reduced Uganda's debt stock during the 1990s. This is also related to the fact that multilateral debts were the largest component of Uganda's debt, and multilateral debt relief only became substantial with the implementation of HIPC in 1998. Annual stock reductions as a result of debt relief before 1998 were between zero and 3 per cent, with an exceptional 6 per cent in 1993 when the commercial debt buyback was undertaken. These reductions do not seem to have had stock effects on private investment or on creditworthiness, however.

Social expenditure increased especially after the mid-1990s. This was at least partly made possible by foreign aid and debt relief and the conditions attached to it. Its impact on economic growth is expected to be positive, but can only be determined in the longer run.

The debt burden as measured by liquidity and solvency indicators became more sustainable throughout the 1990s. However, while sustainability was more or less achieved as measured by liquidity indicators, solvency indicators (debt-to-GNP and debt-to-exports ratios) before HIPC 2 continued to point at an unsustainable debt burden, jeopardising long-term economic expansion. Further, the improved debt sustainability was to a larger extent the result of growth of GNP and exports than of a reduction of the debt burden through debt relief. While debt relief as part of programme aid played some role in the above-mentioned positive effects, overall its effects remained limited, especially as it did not succeed in bringing about a noteworthy debt stock reduction. This development was increasingly acknowledged after 1995, and with HIPC and its focus on the huge multilateral debt burden an important step forward was taken. However, in view of the vulnerability of Uganda's economy, especially in the export sector, it remains to be seen whether the debt will indeed prove to be sustainable after HIPC debt relief, or whether continued debt relief will be needed.

5.2 Impact on poverty reduction

Uganda experienced a substantial reduction in the incidence of poverty during the 1990s.[20] On a national basis, the head count poverty level fell from 56 per cent in 1992 to 44 in 1996, and further to 35 per cent in 2000 (Table 5–2). However, it was accompanied by an increase in inequality, especially after 1997.

Table 5–2 Poverty and inequality.

	1992	1996	2000
Poverty incidence (%)*			
National	56	44	35
Urban	28	17	10
Rural	60	49	39
Cash crop farmers	60	44	
Food crop farmers	64	62	
Northern region	71	59	
Eastern region	59	54	
Western	53	42	
Central	46	28	
Gini coefficient			
National	36	35	38
Urban	40	35	40
Rural	33	31	32

* Measured as per cent of population living below the poverty line. The poverty line in Uganda is calculated at UgSh. 16442 (about USD 14) per adult equivalent per month in 1992 UgSh.
Source: Government of Uganda (2001) and IMF and IDA (2000a).

[20] These data on trends in poverty and inequality in Uganda originate from annual survey research carried out by Simon Appleton of Oxford University, the results of which have been published in government documents (GoU, 2001) and in publications of the IFIs.

With about 96 per cent of the poor living in rural areas in 2000, poverty in Uganda was predominantly a rural phenomenon. Most of the poor are involved in agriculture. Poverty is most prevalent among food crop farmers (as opposed to cash crop farmers), the majority of whom are women. Great disparities existed in the incidence of poverty between rural and urban areas and between regions. This reflects, among other things, differences in security (worst in the north and west), geographic dispersion of agricultural production (cash crops being predominant in the centre of the country and food crops in the north), access to markets (worst in the north), and type of economic activity. In the year 2000, in rural areas 39 per cent of the population lived below the poverty line, compared to only 10 per cent in urban areas (IMF 2001).

Poverty declined in both rural and urban areas. However, the reduction was proportionally greater in urban than in rural areas (Table 5–2) (GoU 2001, IMF 2000a). Hence, the difference in poverty rates widened (World Bank 2001, Botchwey et al. 1998): in 1992 the incidence of rural poverty was twice as high as the incidence of poverty in urban areas, but by 2000 it was four times higher. The North and the East had the greatest concentrations of poor people. Poverty fell by one third in the Eastern and Western regions, and also substantially declined in the Central region. However, poverty in the North increased by an estimated 8 per cent between 1997 and 2000, leaving an estimated two thirds of the population there below the poverty line (GoU, 2001, World Bank 2001). This was partly due to drought and insecurity. Inequality between income groups increased. Measured over the whole population, mean real consumption grew by 22 per cent between 1997 and 2000. However, the consumption level of the richest 10 per cent of the population rose by 20 per cent, compared to only 8 per cent for the poorest decile. The increase in consumption was higher in urban than in rural areas. Increased inequality was also reflected in the Gini coefficient, which increased slightly from 36 in 1992 to 38 in 2000.

Several factors contributed for the reduction in poverty. Strong economic growth was a primary factor. In particular, strong growth in the cash crop sector was important (Table 5–3). Improvements in the conditions of smallholder cash crop farmers, especially those in coffee, accounted for more than half of poverty reduction between 1992 and 1997. This reflects the big impact of liberalisation of the marketing of coffee and other agricultural export products, as a result of which farmers received a much larger share and benefited from the emergence of a dynamic group of private traders which boosted production and incomes. Another factor impacting on poverty especially among cash croppers was the high price of coffee on the world market. Poverty among the largest group of poor in Uganda, subsistence food crop farmers, declined only marginally from 64 per cent in 1992 to 62 in 1997. Economic growth in the agricultural sector lagged behind that of the economy as a whole in most years, and that of the food crop agricultural sector even more. Curbing of inflation was beneficial to the poor, as they suffer most from sharp price increases. The return of peace in most parts of the country after many years of political turmoil and civil strife was an important beneficial factor for poverty reduction.

Table 5–3 Real GDP growth, agricultural sector (per cent)

	1992	1993	1994	1995	1996	1997	1998
Total	8.4	5.4	10.6	7.8	4.5	5.4	7.8
Agriculture	9.3	1.8	5.9	4.3	1.1	1.9	8.1
Cash crops	0.3	10.5	8.0	22.6	13.9	-2.8	14.3
Food crops	12.3	0.9	7.7	1.3	-2.0	1.6	9.6

Source: IMF and IDA (2000a).

The reduction in poverty coincided with an improvement of a number of social indicators (although some others, notably related to health, deteriorated), and occurred at a time when more emphasis was placed on social sector development in government policies, in particular after 1995. Aid including debt relief allowed government expenditure to be maintained at a much higher level than would have been the case in the absence of aid. This also benefited the social sectors. Since 1995 social sector expenditure as a percentage of GDP increased while government expenditure as a percentage of GDP decreased slightly, testifying to the priority in resource allocation given to the social sectors. This coincided with the increased attention paid to poverty reduction in government policies. Resources freed as a result of debt relief initiatives were directed at the social sectors and related priority areas of intervention. While this was already started at the time of the MDF, it became more pronounced under HIPC with the establishment of the PAF and the incorporation of social benchmarks in adjustment programmes. However, as HIPC implementation started only in earnest towards the end of the decade, it did not have much impact on the reduction of poverty levels during the 1990s. Its impact is expected to become more visible in the first years of the 21st century.

Conditionality in the form of social benchmarks was attached to programme aid and debt relief only in the late 1990s. It therefore had hardly, if any, influence on the poverty reduction that occurred during the 1990s. An earlier government programme, PAPSCA which operated between 1989 and 1994 to protect the poor from the negative effects of structural adjustment, had little impact on poverty (Opio, 2000).

5.3 Conclusions

Aid including debt relief and the conditionality attached to it contributed positively to economic growth. Debt relief did not lead to a reduction in the debt stock and debt service paid until late in the decade, and was only of limited importance in improving debt sustainability compared to the growth of exports and GNP. On the other hand, aid including debt relief allowed higher imports and public expenditure than would have been possible without it, which benefited growth. Although it is difficult to draw strong conclusions with regard to conditionality, donor commitment and policy dialogue on conditions attached to foreign aid are likely to have played a positive role in raising the credibility of government policies, increasing domestic and foreign investment, and fostering higher growth.

Aid including debt relief was one of the factors contributing to poverty reduction, in particular in the second half of the 1990s, through its effect on economic growth and by freeing resources for social sector development. Nevertheless, despite progress in reducing poverty, levels of poverty remained high. At the end of the decade over one-third of the population still lived below the poverty line, many social indicators remained at a dismal level, while inequality had increased.

Not much can be said on the particular relevance of Dutch debt relief. However, the Netherlands have played an active role in drawing attention to Uganda's multilateral debt burden and also in relieving the actual burden. As this relief freed resources, it has enhanced the positive flow effects of aid on economic growth and may contribute to the improvement of social indicators and poverty reduction in the future.

ANNEXES

ANNEX A: REFERENCES

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ANNEX B: 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 co-ordinator 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).

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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)?

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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 analysed:

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 / analysing 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 analysed.
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 analysed 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 analysed 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?

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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 analysed 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.

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Table 1. Evaluation matrix Debt relief

OBJECTIVES-MEANS	INDICATORS	SOURCES	*EVALUATION CRITERIA*
INPUT Debt relief expenditures and modalities; Policy dialogue.	Amounts spent, assigned and contributed; Conditions.	Documents for Dutch Parliament "Macro-exercise", 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 amortisation; 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 (defence) Privatisation of SOEs, public utility enterprises Liberalisation of goods markets: prices, domestic trade Liberalisation of foreign trade Liberalisation of labour market Financial liberalisation 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 Decentralisation
Poverty reduction	Social expenditure Social sector reforms Quality of social service delivery PRSP

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.

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 exercise" 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 exercise. 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 influence 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 analyse 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:

$$M = AID + PCT + DR_e - DS + X + OKI + \Delta R + EO \quad (3)$$

[21]

If DRe (see Annex 1) increases, one or more of the other items must change. The fact that DRe 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 DRe 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 DRe, for example due to Dutch disease effects. Decreases in PCT, OKI and EO (if capital flight) would also be negative responses to DRe. Increases in PCT and OKI could be positive second round effects of DRe.

A next step is to look at the composition of imports. Does the composition of imports change as a result of net DRe? 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 consume.

For the internal account, the identity is the following:

$$I = AID + DRe - DS + OKI + \Delta R + EO + S \quad (4)$$

[22]

The analysis for AID, DS, OKI, ΔR and EO is the same as above. The marginal effect of net DRe on I depends on what happens to S, domestic savings.

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[21] 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

[22] I = Investment
S = Savings

If savings diminish as a result of the additional free resources (as claimed by Easterly, 1999, for example23), this would be a negative effect of debt relief. Ideally, DRe 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 DRe 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.

[23] 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.

Debt sustainability

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

$$D/X = a/(gE - i) \qquad (5)$$

Where D = debt, X = exports, a = the trade gap (M – X)/ X, M = imports, gE = 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 analyse 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 (DRe, 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+DRe) < 0.

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

$$D/Y = (v - s)/(gY - i) \qquad (6)$$

Where Y = GNP, gY = the growth rate of Y, v = I/Y, the investment ratio, and s = S/Y, the savings ratio.
As long as gY 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 DRe) , so we look at:

v – s – A/Y – DRe/Y

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

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

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

In this part of the analysis, the sustainability 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 analysed 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?)
Alphabetisation	% 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 alphabetisation	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

ANNEX C: COUNTERFACTUAL IMPORTS OF GOODS AS % OF ACTUAL IMPORTS IN FOUR SCENARIOS

SCENARIO 1:	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of Goods	175,5	172,1	157	254	595	590	671	458	549	439
Aid	0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Private transfers	80,5	135,9	107,9	303,7	329,9	534,5	482,1	729,2	605	760,5
Arrears accumulation	115,7	162,4	0,0	12	62,9	54,55	61,8	40,5	59,1	0
Except.fin/Debt relief	0	0	0,0	0	0	0	0	0	0	0
Total	**371,7**	**470**	**264,9**	**570**	**988**	**1179**	**1215**	**1228**	**1213**	**1199**
Uses:										
Imports of Goods	**-120**	**-121**	**31,4**	**-200**	**-448**	**-700**	**-702**	**-785**	**-831**	**-857**
Services (net)	-102,1	-108	-90	-90	-226	-247	-251	-285	-280	-284
Net factor income	-58,2	-87	-49	-61	-58	-46	-17	-9	-14	-14
Amortisation	-92,2	-125	-104,1	-115	-95,6	-72,3	-66,9	-68	-75,5	-82,2
Net private capital	-35,8	-27,6	-20,8	-16,3	-15	-40,5	-48,7	50,9	27,1	23,7
Increase in reserves	37	-1,8	-32,8	-86,9	-145,8	-73,2	-129	-133	-39,9	14,7
Total	**-372**	**-470**	**-265**	**-570**	**-988**	**-1179**	**-1215**	**-1228**	**-1213**	**-1199**
% Import Scen1/ Actual	**22**	**27**	**-6**	**30**	**41**	**57**	**56**	**56**	**60**	**57**

SCENARIO 2:	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods	175,5	172,1	157	253,8	595,3	590,3	670,8	458,4	549,1	438,8
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	80,5	135,9	107,9	303,7	329,9	534,5	482,1	729,2	605	760,5
Arrears accumulation	65	98,2	0	0	5,2	0	1,8	0	0	0
Except.fin/Debt relief	0	0	0	0	0	0	0	0	0	0
Total	**321**	**406**	**265**	**558**	**930,4**	**1125**	**1155**	**1188**	**1154**	**1199**
Uses:										
Imports of Goods	-69,7	-56	31,4	-188	-390	-646	-642	-744	-772	-857
Services (net)	-102,1	-108	-89,7	-89,8	-226	-247,3	-251	-284,5	-280	-284,2
Net factor income	-58,2	-87	-48,9	-61,1	-58,1	-45,8	-16,5	-8,6	-14,1	-14,1
Amortisation	-92,2	-125,4	-104,1	-115	-95,6	-72,3	-66,9	-68	-75,5	-82,2
Net private capital	-35,8	-27,6	-20,8	-16,3	-15	-40,5	-48,7	50,9	27,1	23,7
Increase in reserves	37	-1,8	-32,8	-86,9	-145,8	-73,2	-129,2	-133,3	-39,9	14,7
Total	**-321**	**-406**	**-265**	**-558**	**-930**	**-1125**	**-1155**	**-1188**	**-1154**	**-1199**
% imports scen 2/ actual	**13**	**13**	**-6**	**28**	**36**	**53**	**52**	**53**	**56**	**57**

SCENARIO 3	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods	175,5	172,1	157	253,8	595,3	590,3	670,8	458,4	549,1	438,8
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	80,5	135,9	107,9	303,7	329,9	534,5	482,1	729,2	605	760,5
Arrears accumulation	115	148,2	-279,7	-9,3	55,2	45,6	51,8	6,9	6,9	-191,4
Except.fin/Debt relief	1,3	28,4	357,4	42,6	15,4	17,9	20	67,2	104,4	319
Total	**372,3**	**485**	**343**	**591**	**995,8**	**1188**	**1225**	**1262**	**1265**	**1327**
Uses:										
Imports of Goods	-121	-135	-46	-221	-455	-709	-712	-818	-883	-985
Services (net)	-102,1	-108	-89,7	-89,8	-226	-247,3	-251	-284,5	-280	-284,2
Net factor income	-58,2	-87	-48,9	-61,1	-58,1	-45,8	-16,5	-8,6	-14,1	-14,1
Amortisation	-92,2	-125,4	-104,1	-115	-95,6	-72,3	-66,9	-68	-75,5	-82,2
Net private capital	-35,8	-27,6	-20,8	-16,3	-15	-40,5	-48,7	50,9	27,1	23,7
Increase in reserves	37	-1,8	-32,8	-86,9	-145,8	-73,2	-129,2	-133,3	-39,9	14,7
Total	**-372**	**-485**	**-343**	**-591**	**-996**	**-1188**	**-1225**	**-1262**	**-1265**	**-1327**
% import scen 3/ actual	**22**	**30**	**9**	**33**	**42**	**58**	**57**	**58**	**64**	**65**

SCENARIO 4:	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods	175,5	172,1	157	253,8	595,3	590,3	670,8	458,4	549,1	438,8
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	80,5	135,9	107,9	303,7	329,9	534,5	482,1	729,2	605	760,5
Arrears accumulation	65	98,2	-330	-59,3	5,2	-4,4	1,8	-43,1	-43,1	-241,4
Except.fin/Debt relief	1,3	28,4	357,4	42,6	15,4	17,9	20	67,2	104,4	319
Total	**322,3**	**435**	**293**	**541**	**946**	**1138**	**1175**	**1212**	**1215**	**1277**
Uses:										
Imports of Goods	-71	-85	3,7	-171	-405	-659	-662	-768	-833	-935
Services (net)	-102,1	-108	-89,7	-89,8	-226	-247,3	-251	-285	-280	-284,2
Net factor income	-58,2	-87	-48,9	-61,1	-58,1	-45,8	-16,5	-8,6	-14,1	-14,1
Amortisation	-92,2	-125	-104	-115	-95,6	-72,3	-66,9	-68	-75,5	-82,2
Net private capital	-35,8	-27,6	-20,8	-16,3	-15	-40,5	-48,7	50,9	27,1	23,7
Increase in reserves	37	-1,8	-32,8	-86,9	-145,8	-73,2	-129	-133	-39,9	14,7
Total	**-322**	**-435**	**-293**	**-541**	**-946**	**-1138**	**-1175**	**-1212**	**-1215**	**-1277**
% import scen 4/ actual	**13**	**19**	**-1**	**26**	**37**	**54**	**53**	**54**	**61**	**62**

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