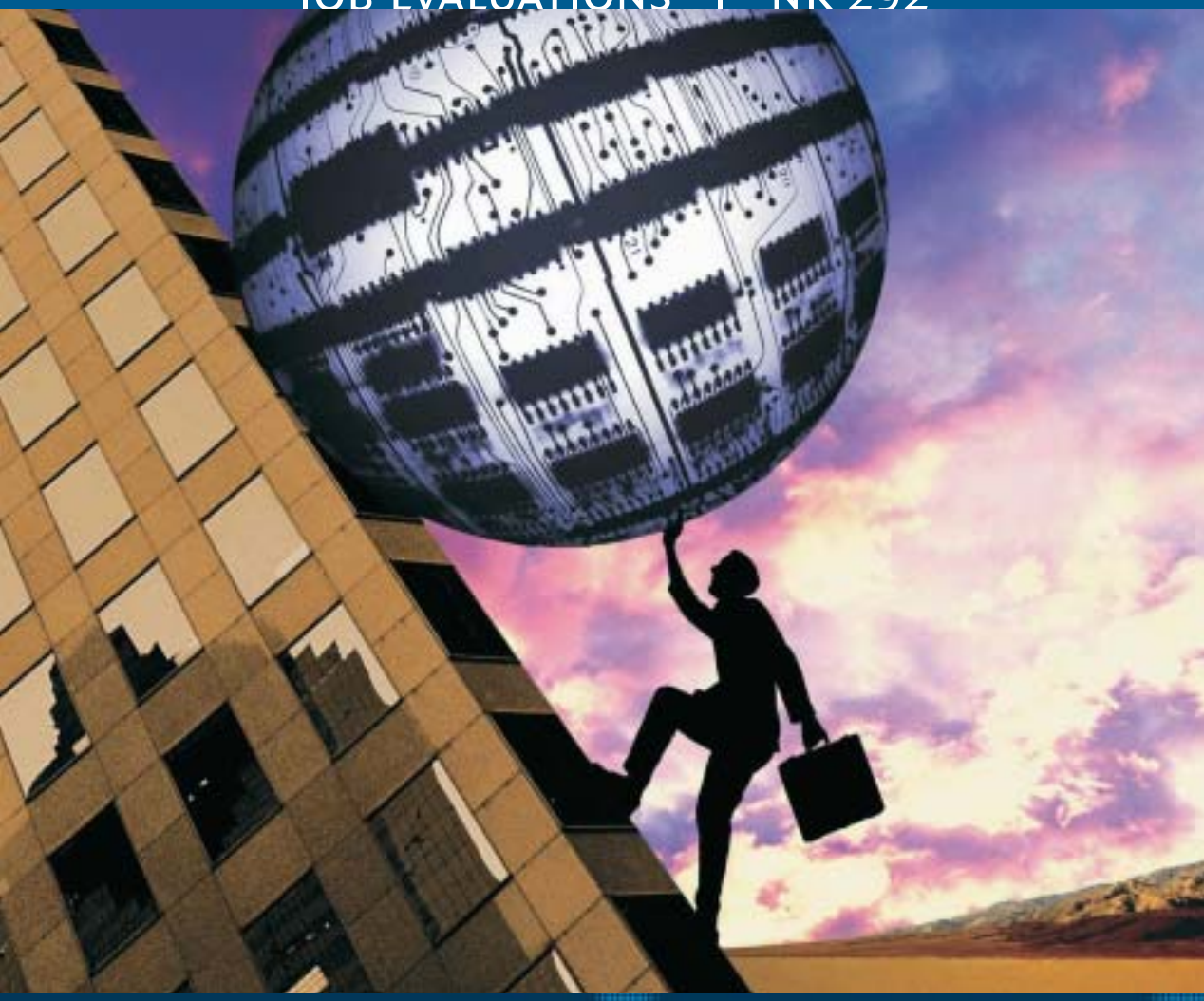

Results of International Debt relief

1990 - 1999

POLICY AND OPERATIONS EVALUATION DEPARTMENT | MAY 2003

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Results of International Debt Relief

1990-1999

with case studies of
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Peru, Tanzania, Uganda and Zambia

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Preface

In the last two decades few issues in the relationship between developed and developing countries have given rise to so much debate, controversy and even civil commotion as the international debt problem. It is therefore, perhaps, not surprising that since the outbreak of the debt crisis in 1982, few policy areas have absorbed more money and energy in order to cope with its consequences.

This was more than sufficient reason for the Policy and Operations Evaluation Department (IOB) to initiate an independent study into the ways in which the Netherlands – both as a donor and as a creditor – has contributed, financially as well as politically, to the alleviation of the debt problems of developing countries, and especially, what these efforts have produced in terms of results. Hence the Evaluation Study on Debt Relief, carried out under the supervision of IOB evaluator Dick van der Hoek.

A methodological problem that presents itself in this type of evaluation, is that inputs and outputs of debt relief activities cannot be usefully studied from the same perspective. While the Netherlands' *input* – in terms of financial resources and political initiatives can be reconstructed and evaluated on its own, this is not possible for the subsequent *results* of debt relief, as these cannot be clearly distinguished from the effects produced through comparable inputs from countless other bilateral and multilateral actors. Therefore the results of Dutch policy can only be studied in a meaningful way as part of the effects of the combined efforts of all actors. This is the reason why the findings of this evaluation have been set down in two separate volumes.

The present volume contains the synthesis of the research into the results of debt relief received by debtor countries during the period 1990-1999 from all creditors and donors. It is based on eight case studies of debtor countries, an extensive literature review and an econometric study: All these studies have been (co-)authored or co-ordinated by Dr. A. Geske Dijkstra, associate professor of economics at Erasmus University in Rotterdam, who also wrote this report. From an evaluation perspective this publication may be considered a *product evaluation*. In this sense it dovetails with the other volume of the final report on the Evaluation Study on Debt Relief, which contains the *retrospective process evaluation* of the design and implementation of Netherlands' debt relief policy.

More persons than can be mentioned here by name have provided, through their insights, experiences and comments indispensable contributions to the execution of this study. Although the Evaluation Department is grateful to each and everyone of them, this in no way dilutes the IOB's full and final responsibility for the contents of this report.

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

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Abbreviations and Acronyms

BWI	Bretton Woods Institutions
CONPES	Consejo Nacional de Planificación Económica y Social (National Council for Economic and Social Planning) - Nicaragua
DRF	Debt Reduction Facility (IDA)
DSA	Debt Sustainability Analysis
ECA	Export Credit Agency
ESAF	Enhanced Structural Adjustment Facility
FSS	Fondo Social Suplementario (Supplementary Social Fund) - Nicaragua
GDF	Global Development Finance (databank, World Bank)
GDP	Gross Domestic Product
GMM	General Methods of Moments
GNP	Gross National Product
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IDB	Inter-American Development Bank
IFI	International Financial Institution
IMF	International Monetary Fund
IOB	Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie (Policy and Operations Evaluation Department) - Netherlands
JSA	Joint Staff Assessment
LDOD	Long-term Debt Outstanding and Disbursed
MDF	Multilateral Debt Fund
MTEF	Medium-Term Expenditure Framework

NCM	Nederlandse Credietverzekering Maatschappij (Netherlands Credit Insurance Co.)
NNI	Net National Income
NPV	Net Present Value
NGO	Non Governmental Organisation
ODA	Official Development Assistance
ORET	Ontwikkelingsrelevante Exporttransacties (Development-relevant export transactions - Netherlands programme)
PAF	Poverty Action Fund
PER	Public Expenditure Review
PRBS	Poverty Reduction Budget Support (Tanzania)
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
SAF	Structural Adjustment Facility
SDR	Special Drawing Right
UNCTAD	United Nations Conference on Trade and Development
WDI	World Development Indicators (databank, World Bank)

Main findings and Issues

Introduction

From 1990 through 1999 almost 3.2 billion guilders from the Netherlands' budget for development assistance were spent on relief of the external debt of developing countries. A separate volume of the final report on this evaluation study reconstructs the design and execution of Dutch debt relief policy; this volume evaluates the results of that policy. As these cannot be usefully isolated from the results of debt relief financed or granted by other creditors and donors, the study focuses on the effects of debt relief in general. A separate chapter (no. 6) deals with Netherlands' debt relief.

The purpose of the evaluation is to investigate whether debt relief has been (i) efficient, (ii) effective and (iii) relevant. To examine systematically how the inputs relate to outputs, outputs to outcomes, and outcomes to impact a *logical framework* has been elaborated. The inputs comprise the resources spent on debt relief as well as the associated policy conditions. The most important impact variable is economic growth. The intervention theory behind this logical framework is, that *if* debt relief has a positive effect on economic growth, this may occur via three channels:

- Via a decrease of the size of the outstanding debt, the debt stock (output), which may lead to a reduction of the debt overhang, an increase in investment and renewed access of the debtor country to international private capital (outcomes);
- Via a reduction of recurring debt payments, the debt service (output); the release of resources may increase imports and create fiscal space for public investment in physical and social infrastructure (outcomes);
- The conditions which creditors and donors attach to debt relief may lead to policy improvements (output). Provided the correct conditions have been formulated, these may stimulate economic growth (impact) via, for instance, increased public investment and social spending (outcomes).

This can be pictured as follows:

Intervention theory debt relief

	Debt stock	Debt service	Conditionality
Input	Various debt relief modalities		Policy conditions
Output	Debt reduction	Increased resource flow	Policy reform
Outcome	• Inflow of private capital; and • Increased private investment	• Increased imports • Public deficit reduction, or increased public spending, leading to: • Increased public investment; and/or • Increased social spending	• Inflow of private capital, increased private investment • Increased public investment; and/or social spending
Impact	..... economic growth		

This evaluation is based on eight country studies, a literature study of the debt problem and the international response to it, and an econometric study. Of the eight country studies three involved field research: Mozambique, Nicaragua and Tanzania, the other five were desk studies: Bolivia, Jamaica, Peru, Uganda, and Zambia. Jamaica and Peru are middle-income countries. The remaining six are all *Heavily Indebted Poor Countries - HIPCs.*

Main findings

To answer the key research questions with respect to efficiency, effectiveness and relevance of international debt relief the study has produced the following main findings:

Efficiency of debt relief

The efficiency of debt relief was limited in all countries investigated by a number of factors:

1. Debt relief was often provided through rescheduling which postponed, but did not reduce, debt payments and therefore had little effect on the size of the debt stocks of debtor countries.

2. In six of the eight country studies debt relief had almost no effect on the actual flow of debt payments, because:
   - debt service obligations were forgiven which debtors would not have met anyway;
   - agreements on debt relief stipulated that remaining obligations, which had not been honoured so far, would henceforth be paid;
   - debtor countries took out new loans: in most of the countries studied the annual amount of new loans exceeded the amount of debt forgiveness.

3. Bilateral donor funds were used on a large scale to bail out multilateral creditors. Thanks to this bailout International Financial Institutions (IFIs) avoided a substantial part of the cost of their imprudent lending policies, which caused moral hazard.

4. The conditionality attached to debt relief generally included an IMF agreement. In many cases, however, implementation of the policy conditions was limited to reforms that the debtor countries intended to carry out anyway.

Effectiveness of debt relief

Debt relief was far from effective in most of the cases studied: only in a minority of the countries has it led to visible stock or flow effects. In none of the eight countries has the debt burden become sustainable.

5. In three of the eight countries positive stock effects have occurred, which enable them to meet their current obligations and has raised their creditworthiness. In one case there has also been a positive effect on private investment.

6. In the two countries where debt relief did reduce the actual flow of debt payments, this had a positive effect on the government's budget, either through a decrease of the fiscal deficit, or via an increase in public spending. On the other hand, two negative flow effects occurred:
   - Heavily indebted low-income countries appear to receive more aid than other countries. This development assistance to the six HIPCs examined consisted mainly of project aid which, although it helped maintain public investment,

could not be used for debt payments. In five of the six HIPCs the combination of substantial project aid with limited relief on the actual flow of debt payments led to a decrease of current expenditure, including that in the social sectors;

- Debt relief did not reduce the (regular) aid flow to the eight countries investigated in this evaluation, but it was financed partly at the expense of aid to other developing countries with lower debts.

7. In seven of the eight countries the debt burden has become less unsustainable, but in none of them this has restored solvency. Nor are the prospects for long-term debt sustainability favourable. Even if, thanks to the HIPC Initiative, the debt burden becomes sustainable in the short run, it will soon become unsustainable again as a result of the new loans that are likely to maintain sizeable trade deficits (see also main finding 9). In addition, domestic debt is rising rapidly in most countries.

Relevance of debt relief

As a consequence of limited flow and stock effects debt relief could only rarely contribute to economic growth. Especially for the poorest heavily indebted countries debt relief was therefore hardly relevant.

8. For many of the debtor countries the international community long diagnosed their debt problem incorrectly as a question of temporary illiquidity, whereas the actual problem was one of persistent insolvency. As a result, debtor countries received far less debt relief than they required, often in a less appropriate or inappropriate form (restructuring instead of forgiveness, debt service relief instead of stock relief), and new loans were extended too easily.

9. The volume of lending of the multilateral institutions has prolonged the unsustainability of the debt burden of many debtor countries. Apart from the moral hazard factor, this lending practice was encouraged by the interest that the IFIs have in concluding new (loan) agreements. That is because a new IMF agreement not only leads to the inflow of new multilateral loans, but also triggers bilateral programme aid, which may be used to repay earlier IMF and other IFI credits. The self-interest of the multilateral institutions restricted the possibilities for selectivity and the imposition of sanctions on countries with inadequate policies. This points to the fact that the roles of, on the one hand, gatekeeper for concessional resources and, on the other

hand, creditor and therefore stakeholder in the inflow of these same resources are not compatible.

10. The fact that far from all policy conditions were honoured by the debtor countries does not mean that those conditions that were implemented had unambiguously beneficial effects. Some even impacted negatively on economic growth.

Netherlands contributions to debt relief

11. The Netherlands has participated in all modalities of debt relief, and its contributions were substantial in comparison with those of other donors. Dutch practice also compared favourably to common international policy in that the Netherlands almost invariably decided to forgive aid debts outright, even when this had not been agreed in the Paris Club. Such forgiveness was in keeping with the nature of the debt problem – the insolvency of the debtor countries – and therefore, in principle, effective. With bilateral funding the Netherlands has played an important role in multilateral buyback operations of commercial debts, and has thus contributed to the clearance of arrears.

12. On the other hand, the Netherlands has also contributed substantially to the funding of multilateral lending, and was very active in relieving the debt originating from those same loans. This policy supported the long-held misconception of the international community, that debtor countries only suffered from temporary illiquidity problems and that new loans could help solve the debt problem. Dutch grants were thus converted into loans that increased the debt burden.
    Together with other bilateral donors the Netherlands contributed substantially to the concessional lending of the multilateral institutions, in three different ways: (i) by co-financing these soft loans through bilateral grants; (ii) by recognising the preferred creditor status of the multilateral institutions, which downgraded the value of its own bilateral claims; and (iii) by funding the repayment of IFI claims for poor indebted countries with programme aid and debt relief.

13. In almost all cases the Netherlands followed the IMF conditionality, thereby reinforcing the gatekeeper role of the Fund (and to a lesser extent of the World Bank) for macro-economic aid. This position also reflected the great importance that the

Netherlands attached to new programmes of those institutions, which contributed to the maintenance of the high volume of multilateral lending.

Issues

In addition to the findings in response to the research questions, the study highlights a number of issues that deserve special attention with a view to future policy making. The most important ones are:

Conditionality

In spite of the generally uninspiring experience with the efficiency and effectiveness of *ex-ante* conditionality, the policy conditions attached to the Enhanced HIPC Initiative are heavier and more comprehensive than ever before. Apart from well-founded doubt regarding the functionality of such extensive conditionality, this raises questions about the much-emphasised local ownership of the Initiative as well as the room for genuine participation.

Debt sustainability

One of the phenomena threatening the long-term sustainability of the debt burden for the HIPCs is the inflow of new loans from the multilateral institutions. This flow is stimulated by the preferred creditor status of the IFIs, coupled with the willingness of bilateral donors to (partially) bail them out, which promotes moral hazard at these institutions.

Conflict of interest and adverse selection

As long as the IFIs, particularly the IMF and the World Bank, combine the roles of gatekeeper and creditor, a conflict of interest remains, because – as creditors – these institutions have a stake in the inflow of concessional resources which they – as gatekeepers – control to a considerable extent. They exercise this control by concluding new agreements that serve as seals of approval for themselves and other aid providers. This conflict of interest entails the risk that countries do not receive aid primarily because of their good policies and governance, but because they have a high debt burden. This may result in adverse selection whereby countries with bad policies receive more aid than those with good policies.

1 Introduction

1.1 Introduction

This report evaluates the results of the Netherlands' debt relief policy during the 1990s and, in particular, its effects on the recipient countries. The purpose is to investigate whether funds spent on debt relief have been used effectively. In view of the fact that the results of Dutch debt relief cannot be considered independently of those achieved by other creditors and donors, this report evaluates the results of debt relief in general. Wherever possible and relevant, specific conclusions will be drawn with regard to debt relief granted by the Netherlands.

The report is based on a study of the literature on the debt problem and its international repercussions, on an econometric study, and on eight country studies: Bolivia, Jamaica, Nicaragua and Peru in Latin America, and Mozambique, Tanzania, Uganda and Zambia in Africa.[1] The literature study also concentrated on these two regions, namely, Latin America and the Caribbean, and Sub-Sahara Africa.[2] This choice was dictated on the one hand by the allocation of Netherlands' debt relief expenditure and, on the other hand, by the empirical fact that Asia has never suffered a major debt problem. The accompanying volume of this final evaluation report contains a study of how Dutch debt relief policy came into being and has been implemented. (IOB, 2002).

Numerous recent studies on the subject of debt relief agree that, during the past 20 years, those effects have not always been favourable. Although many heavily indebted poor countries have received sizeable debt relief, they still seem to need more. From this, two contradictory conclusions can be drawn. Some argue that the international community has done far too little in alleviating the debt burden of these poor countries. They have been given just sufficient relief to enable them to pay their primary creditors, but not enough to allow their economies to grow, let alone to reduce poverty (cf. Sachs 2002, Hanlon 2000). Others conclude that too much relief has already been given. For example, empirical studies show that the greatest relief has gone to countries with bad policies

1 The literature and econometric studies are collected in Dijkstra & Hermes (2003); for the country studies see Abdelgalil & Cornelissen (2003a, b and c), Danielson & Dijkstra (2003), Dijkstra & Evans (2003), Dijkstra & Koonings (2003) and Lindner (2003a and b).
2 In the rest of this report, for the sake of brevity, the regions will usually be referred to as 'Latin America' and 'Africa'.

(Easterly 2002) or without good governance (Neumayer 2002), and that it has not yet been used for poverty reduction (Allen & Weinhold 2000).

Most empirical studies into the effectiveness of debt relief show a number of shortcomings that the present study tries to avoid. First, they lump together of all forms of debt relief. They mostly make use of the World Bank's database, *Global Development Finance* (GDF), which provides data on debt relief and forgiveness of interest and repayment obligations - as does the present study. However, the effects of these various forms of debt relief can vary considerably, dependent on the creditor and the circumstances of the recipient. A reduction of principal or of debt service that so far has not been repaid, in no way increases the amount of resources in the debtor country. On the contrary, a precondition for an agreement on debt reduction is usually that the remaining debt will be serviced in the future; in the years following such a 'relief operation', therefore, actual debt service paid may be higher than before. It is thus incorrect to speak of the use or spending of funds released by debt relief in the same way as of foreign aid. Aid is not the same as debt relief. Whether or not debt relief recorded in the GDF databank frees resources needs to be examined case by case. Consequently, great care should be taken in drawing conclusions from econometric studies, while detailed country studies should be utilised to analyse the effects of debt relief.

Secondly, most recent studies have stressed one aspect of debt relief, i.e. its effect on the reduction of the debt service: the periodical payment of interest and amortisation. In the terminology used in this evaluation, this is known as the flow effect. The other possible effect of debt relief is the stock effect: debt relief can also reduce the size of outstanding debt. The debtor is then better able to make the payments due on the remaining debt. This leads to a reduction of the so-called 'debt overhang': a term indicating that the debt has become so large that the creditors no longer expect that it will be repaid in full. As debt overhang decreases, creditworthiness increases, and the debtor country will regain access to the (private) capital market. In addition, investments will increase. Private investors need no longer fear that the government's debt problems will cause macro-economic imbalances such as inflation or exchange rate instability, or higher taxation rates. This evaluation thus investigates both the flow and stock effects of debt relief.

Thirdly, recent empirical studies focus on the problems of presently heavily indebted poor countries, endeavouring to explain those problems from the policies and governance of

the debtor countries themselves.[3] It seems to be forgotten, however, that in some heavily indebted countries in the past, particularly in Latin America, debt relief has enabled debts to become sustainable. This may have been due to the fact that such countries were indebted primarily to *private* creditors. In general, too little attention is given to the supply side of the debt problem (the loan providers). The specific characteristics of official creditors may well have been instrumental in worsening the debt problem. While some studies (e.g. Easterly 2002) conclude that high levels of debt lead to adverse selection (i.e. countries with inadequate policies are given more aid and/or debt relief) and to moral hazard (i.e. greater debt relief will encourage countries to irresponsibly borrow more because they anticipate more forgiveness), the present study also analyses the moral hazard and (the causes of) adverse selection on the part of suppliers.

1.2 A methodology for the evaluation of debt relief

This evaluation aims to investigate whether debt relief has been (1) efficient, (2) effective) and (3) relevant. Insight into these three research questions is obtained by using the *logical framework* model in which the various levels of the assumed objective-means hierarchy are arranged vertically, and ways by which to check the degree to which objectives on successive levels have been achieved are ordered horizontally. The evaluation matrix presented in the Terms of Reference for this evaluation is shown in Figure-1. It is important to note that no attempt will be made to compare funds allocated to debt relief with those expended in any other way on developing countries. This restriction is unavoidable if the research is to be kept manageable.

A general principle is that as a phenomenon in the objective-means hierarchy becomes more distant from the original intervention (inputs), the more difficult it is to prove a causal linkage between them, as the effect of other factors on the results increases. On the other hand, causal linkages are facilitated because the logical evaluation matrix shown in Figure 1-1 is based on important theoretical insights into the way, in which debt relief may contribute to economic growth and, eventually, to poverty reduction. If debt relief is to promote economic growth, this can in principle occur in three ways:

1. Debt relief can lead to a reduction of the debt *stock* (output), and thus of the debt overhang, which stimulates private investment and enables the country to regain access to international private capital (outcomes);

3 Of course, making appropriate adjustment for external circumstances.

2. Debt relief can result in a fall in the debt *service* (output); funds released in this way may lead to additional imports and public investment in physical and social infrastructure (outcomes);

3. Conditions attached to debt relief may induce policy improvements (output); in turn, if the correct conditions have been set, this can lead via higher public investment and social expenditure (outcomes) to increased economic growth and poverty reduction (impact).

A combination of this theory[4] with the three research problems of efficiency, effectiveness and relevance leads to the following elaboration of the research questions.

In order to analyse *efficiency* inputs are compared with outputs. Inputs concern not only the magnitude of debt relief but also its various modalities. In addition, the conditions laid down for the recipient, whether or not through policy dialogue, are of importance. The outputs, i.e. the direct results of debt relief, are a reduction of the debt service (a decrease in the flow of outgoing payments) and of the debt stock (a decrease in the size of the outstanding debt). A third output considered here is the implementation of policy conditions that may be attached to debt relief. This required a broader political economic analysis, using existing literature, which not only looked at the extent to which conditions were implemented, but also at the degree of donor influence in relation to other factors determining actual policy.

The investigation into the effectiveness of debt relief is concerned with a comparison of (intermediary) outputs and outcomes. The latter include, first, an increased sustainability of a debt burden that had become unsustainable. In addition, the effect of a possible decrease of the debt *stock* on a reduction of the debt overhang and consequently on the increase of private investments, improved creditworthiness, and increased imports of private capital was examined. This is the stock effect of debt relief. The third outcome is the flow effect. If a reduction occurs in the flow of debt payments as a result of debt relief, this may have effects on the government budget and on the balance of payments. The case

4 This theory is based on the academic literature on the ways in which a heavy debt burden affects economic growth, i.e. via a liquidity effect (the flow effect of debt payments) and via a 'debt overhang' effect. These two channels have been discussed extensively in the literature and were also tested (Dijkstra and Hermes, 2003. paragraph 6.2, summarised in paragraph 5.2 of this report). The flow and stock effects of debt relief reflect these two channels. The conditionality effect is based on earlier research into the effects of programme aid (White, 1998; White and Dijkstra, 2003).

studies analysed whether positive effects are traceable in the form of lower budget deficits, higher expenditure and increased imports. Such variables actually occupy a place between outputs and outcomes and are thus called in this report 'intermediary flow effects'. The analysis then proceeds to look for any evidence of an increase in public investment and social expenditure. This can indicate both a positive flow effect of debt relief and a positive effect of policy preconditions. Finally, the effect of a possible increase in social expenditure on the improvement of social indicators is analysed, and also the effect of a possible increase in public investment on private investment (*crowding in*).

Research into the *relevance* of debt relief includes above all a comparison of realised outcomes with its principal objective, i.e. its impact. It is extremely difficult to establish the exact relationship between outcomes and impact (economic growth) because so many other factors may influence economic growth; conclusions here are thus drawn principally on the basis of the above mentioned theory. If the outcomes have occurred and the relationship between them and outputs is established, it follows from the theory that a positive influence on economic growth is possible. If the outcomes have not occurred or if no relationship with debt relief is found, it is inconceivable that debt relief has contributed to economic growth.

The second purpose of the relevance question is to determine whether debt relief was an adequate response to the debt problem. This means that, on the one hand, the evaluators examined whether debts had indeed become unsustainable (i.e. hampered economic growth, see below) and, on the other hand, that they analysed how creditors in general, and the Netherlands in particular, contributed to the creation of the debt problem.

In the empirical analysis of efficiency and effectiveness in the country studies, relevant quantitative data are presented, and trends are analysed by presenting graphs or by applying simple quantitative analysis. Where possible, the influence of other possible factors is taken into account. With this method – common in evaluation studies – it is not possible to establish a hard counterfactual (what would have happened without debt relief?). In other words, if the intended outputs and outcomes are observed, one cannot conclude with absolute certainty that they are the result of debt relief, let alone by how much. Conversely, if the outputs and outcomes are not observed, one cannot conclude that debt relief did not have any effect. In practice this disadvantage can be overcome. By thoroughly analysing other possibly intervening factors and by using other academic

studies on the topic and country, one can almost always draw conclusions on the causal relationship between debt relief and outputs and outcomes.

The case study method also has an important advantage. The approach taken in the country studies allows to examine in detail the efficiency, effectiveness and relevance of different modalities of debt relief (restructuring versus forgiveness, relief on flows versus relief on stocks), and of debt relief on different types of debt (private, multilateral and bilateral). In addition, the extent of implementation of the policy conditions can be examined.

Figure 1-1. Evaluation matrix Debt relief

OBJECTIVES-MEANS	INDICATORS	SOURCES	EVALUATION CRITERIA
INPUT debt relief expenditure and modalities; policy dialogue.	magnitude of expenditure, assessments and (voluntary) contributions; conditions.	parliamentary documents; 'macro-exercises', appraisal memoranda Global Development Finance; national statistics; WB/IMF country reports; policy documents and representatives of local governments and donors.	
degree to which realised outputs offset chosen inputs and their manner of employment			EFFICIENCY
OUTPUT reduction of debt and debt service; changes in policy and governance	total debt (nominal and net present value); interest payments and amortisation	Global Development Finance; World Development Indicators; IMF; national statistics; policy documents and representatives of local governments and donors.	
degree to which outputs contribute to desired outcomes			EFFECTIVENESS
OUTCOME reduction of debt burden; improvement of credit-worthiness; investments; increased imports and public expenditure.	debt / GNP; debt service / exports; international credit ratings; I / GNP; Ip / GNP; balance of payments; Government accounts.	Global Development Finance; World Development Indicators; IMF; national statistics; Credit rating agencies; commercial banks and Chambers of Commerce.	
degree to which outcomes lead to intended impact			RELEVANCE
IMPACT economic growth.	change of GNP.	World Development Indicators; national statistics.	
sustainable poverty reduction			

In the country studies, no econometrics or modelling is applied. An econometric analysis does not make sense given that only annual data are available and that the evaluation period only covers ten years. Although it is possible, in principle, to apply modelling and thus simulate a counterfactual, there are several reasons why this choice was not made. In general, modelling requires reliable data and stable relationships, both of which are scarce in developing countries. Constructing a model implies making assumptions on possible relationships. Given the many shocks (policy and other) that these economies experience – and which would affect the coefficients of these relationships – it would be necessary to include many structural breaks. Modelling outcomes would appear more scientific, while they probably just reflect the assumptions made. All in all, the benefits of modelling would probably not outweigh the efforts involved.

Although poverty reduction is the central objective of Netherlands' development assistance, the design of this evaluation study stressed economic growth as being the principal goal of debt relief rather than poverty reduction. There are three reasons for this. Firstly, prior to 1999 sustainable poverty reduction was not an explicit goal of Dutch or international debt relief. Although poverty reduction, as well as good government, did form part of the so-called 'macro-exercise' that had been applied in the Netherlands to the selection countries for debt relief since the mid-1990s, it hardly appeared as an objective of the commitment decisions laid down in the Appraisal Memoranda. It was not until 1999, with the HIPC initiative (see Annex 5) that debt relief became linked explicitly with policy change aimed at poverty reduction. Given the evaluation period considered here (1990-1999), this study is not able to investigate the effects of that policy change. It is possible, however, to consider whether any such policy change is in the process of being implemented, particularly in the three countries where fieldwork has been carried out. Secondly, a relationship between debt relief and poverty reduction is very difficult to ascertain, especially within a limited period. If debt relief freed resources and if it subsequently led to greater expenditure in the social sectors, this will hardly be noticeable, for example in a lower child mortality rate or an increased degree of literacy over a ten-year period. Thirdly, it is now generally accepted that economic growth is a necessary, though not sufficient, condition for sustainable poverty reduction. If debt relief proves to have a positive effect on economic growth, then it may be assumed that is has also furthered the objective of sustainable poverty reduction.

1.2.1 Design of the research

For the country case studies the complete logical framework has been used; the questions of efficiency, effectiveness and relevance are thus all considered. The effects of policy conditions are discussed most extensively for the three countries in which fieldwork has been conducted. The literature and econometric study addresses the research question of the relevance of debt relief. The literature study further examines how the debt problem originated and how the various groups of creditors responded to it, whereas the econometric study investigates the effect of a high level of debt on economic growth, and attempts to analyse the ways in which such a high debt can influence growth, giving special attention to the effect of the volatility of debt repayments.

For the country studies, a selection was made among the 51 countries that benefited from Dutch debt relief during the 1990s. Particular attention was given to the volume of relief given during that period. The four Latin American and four African nations that were selected received both in absolute (≥ NLG 100 mln) and in relative terms (≥ 20% of total Netherlands' aid to the country in question) a substantial amount of debt relief. The three countries for field studies were chosen on the basis of the intensity of their development relationship with the Netherlands in 2001 and on the consistency with which they had benefited from Dutch debt relief during the entire evaluation period, particularly during the latter years. It was also important that they had received that relief in the greatest possible number of modalities. This led to the choice of Mozambique, Nicaragua and Tanzania.

In this report frequent use is made of the World Bank's Global Development Finance (GDF) databank. For the African countries in particular, the GDF figures do not always square with data obtained locally or from IMF statistics. For some countries, e.g. Mozambique, the exact amount of the debt is (still) not known and can only be estimated. The GDF databank is the best available source for making international comparisons, but the unreliability of the figures requires that care be taken when drawing conclusions.

Representativeness

As indicated above, the results of this study are based primarily on the eight country case studies that have been undertaken, three of which involved field research. Two of the eight are middle-income countries (Jamaica and Peru), while the other six belong to the so-called Heavily Indebted Poor Countries (HIPCs). Four of these were among the first to complete the requirements of the World Bank / IMF HIPC Initiative. The eight case studies

are, of course, not representative of all the debtor countries in a statistical sense, but they do reflect a fairly broad variety of debt situations and external conditions. The study further makes extensive use of the existing literature on international debt problems. In addition, an econometric study was carried out, using data on 102 developing countries for the period 1970-1998. The combined results of these efforts, laid down in nine separate working documents, provide a solid basis for the evaluation's findings as presented in this report.

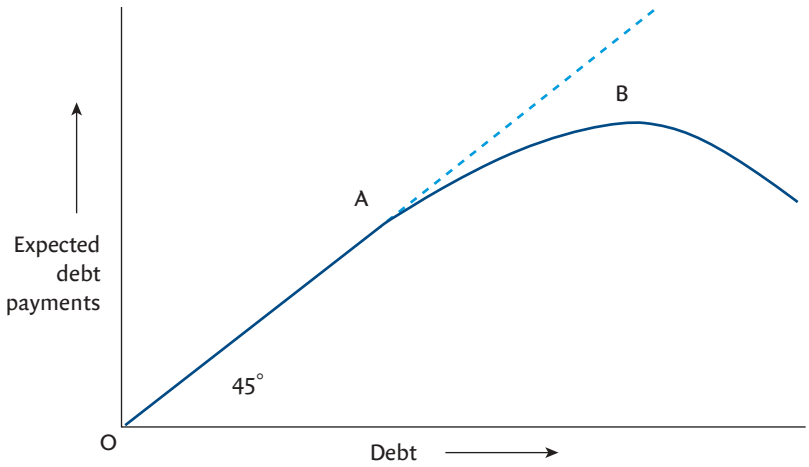
1.3 The concept of debt overhang

As has been mentioned earlier, debt overhang occurs when creditors anticipate that the debt will not be repaid in full (Krugman 1988). This means that expected debt payments will be lower than the value of the debt, i.e. the anticipated value is lower than the nominal present value. While initially the expected value of payments equals the nominal value of the debt (between O and A in Figure 1-2), if the debt further increases, the expected payments will be less than the nominal value (between A and B). If the debt grows even further, the expected value of repayments may even *decline*. The country then finds itself in the downward section of the Debt Laffer curve[5] (to the right of B in Figure 1-2). In such a situation, debt forgiveness is in the interests of both debtor and creditor. After forgiveness the debtor will be better able to pay remaining debt service on debts that are still outstanding, and thus the actual value of remaining debt will increase.

A situation of debt overhang has several negative consequences for the debtor country (Sachs 1989). In the first place, creditors will be less willing to provide further loans, even though profitable new projects may be available. Secondly, the debtor country will have no incentive to invest because any proceeds from new investments will go to the old creditors. When the concept of debt overhang was first formulated, it was stressed that private investors would be discouraged: they expect taxation on investments to increase because the country, i.e. government, needs to repay its debts. Nowadays, the debt overhang concept is interpreted more broadly (Deshpande 1997). Anticipated higher debt payments not only cause higher taxes, but can also lead to higher budget deficits, inflationary financing, exchange rate instability and, as a consequence thereof, to capital flight. Private investment is thus discouraged by the uncertainty regarding the general macroeconomic environment that accompanies a debt overhang situation. Moreover, govern-

5 Analogous to the Laffer curve in fiscal theory: when the tax rate reaches a certain level, tax revenue will no longer increase but decrease, due to declining efforts by (taxable) income-earners as well as to tax avoidance and evasion.

Figure 1-2. Debt overhang: the debt Laffer-curve



ment itself will find that proceeds from investments or from "good policies" accrue to its creditors. Debt overhang can thus even discourage good policy on the part of government.

It follows from the above that a high debt stock (e.g. in relation to GNP) *may* indicate the existence of debt overhang, although this is not necessarily so. How can it be ascertained in practice whether there is a case of debt overhang, i.e. a debt that creditors do not expect to be repaid in full? During the 1980s extensive trading in debt titles took place on the secondary market which had come into existence. Their expected value could then be derived from the price of debts on the secondary market, as calculated for example by Claessens (1990).[6] A secondary market for debts to official creditors does not exist, however, while that for private debts practically disappeared during the 1990s; no conclusions can therefore be drawn regarding the actual value of official claims.

An indicator of debt overhang, which can be used for official debt, is the relationship between arrears and total debt stock. When arrears are high and the country appears not to repay all debts, it is safe to assume that the expected value of the debt will increase (i.e. the debt overhang decreases) as those arrears decline.

6 Based on estimates of secondary market prices of debt claims, Claessens concluded that five countries were on the downward part of the debt-Laffer curve, including four of those discussed in this study: Bolivia, Nicaragua, Peru and Zambia.

It is also possible to examine actual debt payments (i.e. flows) and, in particular, the relationship between *actual* debt repayments and payments *due*. As O'Connell and Soludo (2001) have done, payments due can be calculated by summing actual debt service, restructuring and forgiveness of debt service, and the accumulated stock of arrears. If the ratio of actual versus due payments is considerably less than 100% the country probably finds itself in the downward section of the debt Laffer curve (to the right of point B). An increase in the ratio between actual debt service and debt service due could indicate increasing creditworthiness. If debt relief causes that ratio to approximate 100%, the debt overhang will be neutralised; it may then be expected that investment and good policy will no longer be discouraged and that the country will again become creditworthy. A significant obstacle to a new inflow of private capital is then removed. The relationship between debt relief and this indicator of debt overhang is rather ambiguous, however. Debt relief that decreases the *stock* of outstanding debt will reduce the debt overhang (because actual payments on the smaller debt will probably increase), but debt relief that reduces the debt service (the *flow*) through forgiveness or restructuring, will increase debt overhang because it reduces the ratio actual payment versus payments due. The debt relief modality that explicitly and most effectively reduces debt overhang is that of forgiveness of arrears.[7]

1.4 A sustainable debt

An important aspect of this study is to discover whether debt relief has made the debt and the debt burden more sustainable, i.e. has reduced that burden. In general, an unsustainable debt is defined as one on which future payments of interest and amortisation will be so high as to affect economic growth. In the past attempts have been made to establish empirically the magnitude of debt that is likely to cause repayment problems. For example, Cohen (1997) has determined that the ratios between debt and GNP, between debt and exports and between debt and tax revenue are good indicators of payment problems. Cohen subsequently examined the level at which these indicators would have the greatest negative impact on economic growth.

In practice, however, critical values for debt sustainability are usually measured by rule of thumb. In this report actual values are compared with criteria applicable under the HIPC initiative. In 1999 these were made more stringent as compared to those of the original initiative (HIPC 1). The HIPC criteria, in fact, are not dissimilar to those used by Cohen

7 This also applies if debt overhang is measured by the indicator described in the previous paragraph.

(Table 1-1). One difference is that Cohen's analysis is based on nominal value and HIPC on the 'net present value'.[8] In this report, actual values are compared principally with criteria used in the Enhanced HIPC initiative (HIPC 2). With regard to the debt/GNP ratio, actual values are mostly compared with the criterion applied within the European Union, namely, 60%. This should in fact be much lower for debts of low and middle-income countries, as Houben (2002) has argued, due to the much higher risk premium on interest rates that these countries are required to pay when their debt/GNP ratio is around 60%.

Table 1-1 Critical values for debt sustainability ratios, in percentages

	Cohen	HIPC-1	HIPC-2
Debt/GNP	50		
Debt/export	200	200-250	150
Debt/tax revenue	300	280	250

Proposals have recently been made regarding stricter sustainability criteria, namely, a debt that involves such low repayment obligations that the debtor country has sufficient resources to attain human development (Hanlon 2000, Sachs 2002). These authors calculate, in particular, how much in terms of resources is needed to achieve the so-called millennium goals[9] of poverty reduction and social development. As these calculations require far-reaching assumptions, this report confines itself to the commonly used current debt ratios, i.e. those between debt service and exports, and between debt stock and GNP.

8 The net present value (NPV) is the sum of all debt repayments and interest payments, discounted against the current market rate. If the actual interest is lower than the market rate (and/or the maturity is longer and/or there is a longer grace period), the NPV of a debt is lower than its nominal value. In view of the fact that many HIPC debts are concessional, i.e. they have a lower interest rate and/or longer maturity and/or grace periods, the NPV of those debts is lower than the nominal value.

9 The Millennium Development Goals, to be realised in 2015, include eight goals formulated by the international community, 18 targets and 48 indicators that were approved by the UN General Assembly in 2000. The most important goal (1) is that the number of people living in poverty (i.e. on less than USD 1 per day), should be halved between 1990 and 2015. The other goals are: (2) universal access to basic education, (3) the promotion of equality between men and women, (4) the reduction of child mortality and of(5) maternal mortality rates, (6) the combating of AIDS, malaria and other diseases, (7) ensuring a sustainable environment, and (8) the encouragement of a world-wide partnership for development, to be expressed, for example, in increasing development aid to 0.7% of GDP.

Absolute criteria for sustainability are not needed to answer the question of whether a debt has become more sustainable. The significant factor is whether the debt burden has been *lightened* as a consequence of debt relief. Absolute criteria, in particular at the start of the evaluation period, do matter when it comes to establishing the relevance of debt relief. Debt relief can only be the right intervention to achieve economic growth if, at that time, the debt was indeed unsustainable (i.e. could not be repaid without affecting economic growth).

In establishing the sustainability of a debt burden, a distinction can be made between indicators that measure whether countries suffer a temporary repayment problem (i.e. a lack of liquidity), and those that measure a more permanent payment problem (a lack of solvency). The distinction is, of course, relative: countries that are not solvent usually lack liquidity, while a temporary liquidity problem may become permanent if creditors loose confidence in the country's long-term growth prospects. The most important liquidity indicator is the debt service/export ratio. Cline (1995) argues that, in fact, it is only necessary to examine the ratio between interest payments and exports because repayment of principal simultaneously reduces liabilities. For the debt service/export ratio a limit of 25% is usually maintained, and for the interest/export ratio, this is 15%. It is also possible that these ratios are below the critical values, but that this is due to high payment arrears. Such arrears indicate long-term problems of liquidity, and probably also signify that the country is not solvent. As solvency deals with the question of whether, in the long term, the country will be able to repay the debt without compromising its growth prospects, the ratios debt/GNP and debt/exports are the most important indicators.

1.5 Structure of the report

Chapter 2 briefly considers the origins of the debt problem in general and the international responses to it. The causes of the debt problems of the eight countries are then discussed, including the question of whether their debts were unsustainable at the start of the evaluation period. The chapter then surveys debt relief received by the eight countries during the evaluation period: the 'inputs'.

Hereafter the report broadly follows the logical framework. Chapters 3, 4 and 5 discuss the efficiency, effectiveness and relevance of debt relief, reflecting the findings of the literature study and of the eight country studies. Chapter 5 also discusses the results of the econometric study.

Chapter 6 then lists some specific conclusions regarding the efficiency, effectiveness and relevance of Netherlands' debt relief. In Chapter 7, finally, lessons are drawn for the current discussion regarding debt relief and the HIPC initiative.

2 Origins of Debt and Debt Relief

2.1 Origins of the debt problem

The debt problem originated in the 1970s. After the 1973 oil price hike, in particular, developing countries started to borrow money on a large scale from banks in industrialised nations. The literature describes extensively how both demand and supply factors played a role in this situation. The oil-rich nations deposited their sudden wealth with western banks, causing surplus liquidity among them. The rich countries were then in recession, so that the banks had few possibilities of investing their petro-dollars at home. Developing countries, on the other hand, faced considerable balance-of-payments deficits due to higher oil prices and exerted a powerful demand for credit. Moreover, the predominant development paradigm at the time was that poor countries should invest in industry, particularly import-substitution industrialisation, and in infrastructure, and that governments must play a leading role in that respect. Consequently, money was borrowed chiefly by states (and state enterprises).

Later problems were caused particularly by the manner and conditions under which banks lent their money. Not only were international interest rates low at the time, but the banks also charged a risk premium that was far too low. In addition, they had high concentrations of loans in certain countries – a strategy prohibited when lending to private borrowers as it entails high risks for the bank's future. Finally, the banks charged variable interest rates – rational in a time of high inflation, but also increasing the risk of default as rates rose. In general, this collective irresponsible acting (market failure) on the part of banks can be attributed to the well-known herd behaviour shown by actors on financial markets: the costs of not going with the flow are far too high for individual banks or individual analysts within the banks who prefer to ignore the risks ('countries cannot go bankrupt'). In addition, a system of regulation and control over banks' international activities did not then exist and the banks assumed that governments would come to their aid if they should get into difficulties. After all, they had taken on the burden of recycling petro-dollars with the explicit support of their governments by channelling these surplus funds to countries that needed them (Dooley 1994).

These distortions (market failures) occurred not only on the supply side but also on the demand side (government failure). Partly due to the very low interest charged, govern-

ments of developing countries were tempted to borrow large amounts, even for projects that would not have been profitable under a normal interest rate. In Latin America, in particular, investment levels were very high between 1975 and 1982 (an average of 24% of GDP, higher than before 1975 and after 1982). Some countries, however, followed a policy that was clearly irresponsible, expressed in very large government deficits, for example.

This description of the origins of high debt levels applies especially to middle-income countries and in particular to Latin America. In Africa debt also started to grow during the 1970s, but that growth continued in the 1980s. Rather than commercial banks, the main sources of loans to Africa were official creditors, particularly the governments of industrialised nations. Here, too, distortions on the supply side played an important role. The recession of the 1970s and the emergence of foreign aid caused loans to be provided on a large scale to poor countries. On the one hand, these included export credit guarantees whereby the government of the exporting country guaranteed a commercial loan that an exporter extended to his buyer and, on the other hand, aid loans that, partially or wholly, were often spent in the creditor country. In both cases, the loan was not given on account of its anticipated yield, but due to a combination of need in the recipient country and the desire to promote exports.

Although the volume of World Bank loans in particular grew rapidly during the 1970s, the role played by multilateral institutions was then still limited. This changed during the 1980s when the debt crisis really erupted. The announcement by Mexico in 1982 that it was no longer able to repay its debts marked the actual start of the crisis. Even before that, however, various African countries had asked that their debts be restructured.

At the start of the 1980s the high debt burdens of many low and middle-income countries quickly became problematic due to a number of changes in the world economy. In 1979 the oil-producing countries again raised their prices, but this time the reaction by the wealthy countries was quite different. The USA and UK, in particular, were concerned principally about inflation and far less about the fall in demand. They introduced tight monetary policies, causing interest rates to shoot up. This led to a world-wide recession which, in turn, led to reduced demand for the export products of developing countries and to lower prices for those products. Debtor countries thus had to cope simultaneously with higher oil prices, higher interest rates, and lower prices for their exports. In Latin America, higher interest rates formed the most important reason for the rapid debt increase; in Africa, where official creditors usually charged a fixed interest, the main

cause were the deteriorating terms of trade. On both continents, the situation was further impaired by capital flight.

2.2 International reactions

The debt problem was called a crisis principally because many major western banks threatened to go bankrupt, and in a few cases actually did so. Initially, until about 1984, it was assumed that debtor countries were suffering temporary payment problems and that new loans would help them to recover. The IMF attempted to co-ordinate the banks in granting new loans; later, in 1985, the Baker Plan also aimed at mobilising new funds for debtor countries. Meanwhile, however, the banks had arrived at a different assessment of the situation. They no longer expected that they would get their money back, refused to provide debtor countries with new loans, and started to write-off the old loans. They, of course, still tried to recover as much money as possible from debtor countries, while making grateful use of the funds that official creditors (multilateral and bilateral) made available to those countries (Dooley 1994). For the average Latin American debtor country, however, the net effect was negative: they had surpluses on their balance of payments and repaid more than they received in the form of new loans and grants. The fact that multilateral institutions provided loans on a large scale led to commercial creditors being partly bailed out with official loans, but probably also made a greater outflow of debt repayments possible than would otherwise have been the case (Sachs 1989).

The response of official creditors to the payment problems of debtor countries was very different from that of the commercial banks. In general, they adhered much longer to the notion that debtor countries faced only temporary liquidity problems rather than insolvency. During the 1980s, export credit agencies (ECAs) such as the *Nederlandse Credietverzekering Maatschappij* (Netherlands Credit Insurance Company [NCM]) continued to insure commercial loans. Concessional aid loans were also continued. The net flow of bilateral loans to Africa remained positive during the 1980s. In addition, western donors started to provide grants to African countries at a growing rate. At the same time, western creditor governments, united in the Paris Club (see Annex 4), dealt with payment problems by means of rescheduling. This meant only a postponement of payment obligations while the interest was capitalised and the NPV of the loan remained unchanged (and its nominal value increased).

Starting in 1988, official creditors also began to acknowledge that some of the loans would probably never be repaid, and they started to cancel them partially. This applied

only to debts entered into before a certain date, however (the cut-off date, usually three years prior to the initial agreement and later unchanged), and only to the debt service during a specific period. The percentage that was forgiven on this limited part of the debt service was gradually increased from 33 to 50 (1991), to 67 (1994), and to 80% in 1996. The remainder of the debt service was rescheduled on market terms. One condition for such an agreement with the Paris Club was that the country in question had entered into an agreement with the IMF. The agreement with the Club concerned debt service obligations falling due during the course of the IMF agreement.

Multilateral institutions such as IMF and World Bank strongly expanded their lending during the 1980s. In doing so, they fulfilled the role of 'lender of last resort'; by imposing policy conditions, they also tried to persuade other creditors to make funds available again. World Bank and IMF co-operated ever more closely in so-called structural adjustment programmes. Starting in 1986 the IMF also opened a concessional 'window' for the poorest countries: firstly, the Structural Adjustment Facility (SAF) and, from 1987 onwards, the Enhanced Structural Adjustment Facility (ESAF). The two institutions were preferred creditors. That is to say, debtors always had to meet their debt service to these creditors; otherwise, they would not be considered for new loans, or for debt restructuring by bilateral creditors united in the Paris Club, or for (part of the) aid provided by bilateral donors. During the 1990s this obligation proved to be an unsustainable burden for many poor debtor countries. It was not until 1996, however, and more extensively in 1999 with the Enhanced HIPC Initiative, that the international community came to acknowledge that debt relief was also needed on multilateral debts.

Although for commercial banks and for most Latin American countries the debt crisis was over by 1990, this was by no means the case for the majority of the poorest countries and for most countries in Sub-Sahara Africa. In Latin America the average debt/GNP ratio started to fall considerably after 1988, but in Africa it continued to rise until 1994. Even after that it remained at over 60%. Yet more evidence that the successive rescheduling agreements with the Paris Club did not solve the debt problems of poorest countries is that many of the latter 'relapsed'. Sachs (2002) shows that out of the 59 countries that entered into agreements with the Paris Club between 1975 and 1996, 39 were still in need of restructuring between 1996 and 1999 while 12 countries still made use of an IMF facility (i.e. suffered balance-of-payments problems). Only nine countries had been 'cured', i.e. were no longer in need of either.

Why were private creditors so much quicker than their official counterparts in realising that it was necessary to forgive debt? One reason is that private creditors and in particular the commercial banks are subject to regulations that force them to revalue and (partially) to write-off bad debts. Secondly, the market forces these creditors to seek alternative and more profitable investments. Such considerations do not apply to official bilateral creditors. During the 1980s and much of the 1990s they maintained the fiction that debtor countries would eventually repay most of their debts. They did not write-off and forgave only part of the debt service. Export credit agencies continued for a long time to provide poor debtor countries with guarantees. Meanwhile, however, the poorest countries had become quite unable to pay their debt service, even after rescheduling with the Paris Club. Bilateral donors thus increased their grants to such countries and multilateral institutions expanded their concessional lending.

This combination of debt restructuring, new loans and grants was beneficial to the various stakeholders in the wealthy countries (Daseking & Powell 1999). That is the third reason for the different approach adopted by official creditors. Since ECAs did not write-off bad debts, they could continue to lend, thus helping to promote exports from rich nations. The restructuring of debt service payments reduced pressure on Ministers of Development Co-operation to provide yet more aid in support of adjustment programmes. Moreover, most ministers preferred to provide new aid rather than to contribute, directly or indirectly, to the payment of the claims of their ECAs, as would probably have been the case if greater amounts of debt had been forgiven. This approach also benefited multilateral institutions, enabling them to continue to provide loans to debtor countries that were in fact no longer creditworthy. Such loans were only possible because multilateral institutions were preferred creditors and thus assured of recovering their funds.

However, the delay in acknowledging that large-scale relief was needed had a number of consequences for the allocation of aid and for its distribution among creditors. There proved to be a clear link between the size of the debt, particularly of multilateral debt, on the one hand, and the volume of aid (concessional loans and grants) on the other hand. Moreover, a process of adverse selection seems to have been initiated: countries with poor policies were given more aid (Birdsall *et al.* 2001). This is one of the indications for the fact that bilateral aid ministers ultimately settled the account of multilateral creditors (see Chapter 3).

2.3 Origins of debt problems in the eight case study countries

In five of the eight countries studied (Bolivia, Jamaica, Peru, Tanzania and Zambia) the high debt burden originated in the 1970s (see Figures 2-1 and 2-2). These countries adopted a strategy of import substitution-industrialisation, requiring loans for investment in industry and infrastructure. That strategy also entailed the relative neglect of the agricultural sector, causing deficits on the current account of the balance of payments. These deficits were aggravated after 1974 by high oil prices and in some cases also by falling prices for the most important export products. This was particularly the case in Zambia which was very dependent on copper, but also in Tanzania (sisal) and Jamaica (bauxite, sugar). Zambia turned to the IMF in 1976 and Jamaica in 1977; Tanzania also approached the IMF in 1979 but was unable to agree to its terms. The other five countries were still reasonably able to finance their deficits throughout the 1970s.

In Nicaragua and Uganda, debts only started to climb slightly towards the end of the 1970s. Dictators were in power in both countries (Anastasio Somoza and Idi Amin respectively) who showed no interest in development and thus did not go along with the modern vogue of large-scale investment. In Mozambique, which became independent in 1975, *recording*[10] of external debt started only in 1981.

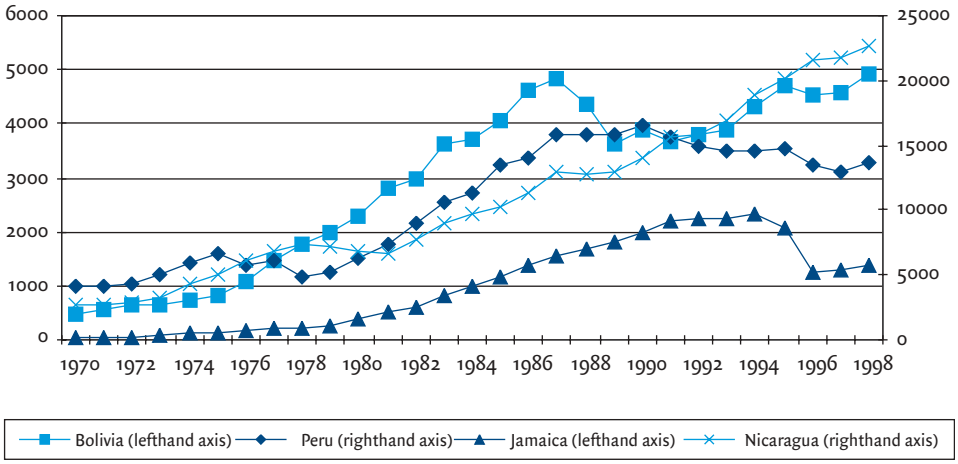
The growth of debts of these countries during the 1970s was made possible on the supply side by the same factors that played a role in general, namely, a plentiful supply of cheap loans from the western banking sector, and the desire of official bilateral creditors to promote their countries' exports. But these eight countries, including those in the western hemisphere, received relatively large amounts of government loans and fewer commercial credits. In 1980 the share of commercial banks in total debt was less than half in all four Latin American countries, which in that respect were comparable with Uganda and Zambia (see Table 2-1). In Tanzania, a 'donor darling' at the time, bilateral loans accounted for three-quarters of the total debt in 1980. Donors as it were, queued for the chance to support President Nyerere's policy of self-reliance, with the result that the country became very dependent on foreign aid.

All eight countries considered in this study saw their debts increase strongly during the 1980s. In those that were already highly indebted in 1980 and where commercial loans

10 According to an IMF study, Mozambique started to borrow at the end of the 1970s, particularly from East European countries (IMF 2001). Those loans are not recorded in the World Bank's data bank, however.

played a large part in that situation (i.e. Peru, Bolivia and Zambia), this was due at least in part to the sudden rise in interest rates. In all countries, the global recession and the consequent (further) deterioration of the terms of trade also played a role. In addition, a variety of factors on the demand side caused debts to increase even further.

Figure 2-1 Outstanding long-term debt (LDOD) of Bolivia, Jamaica, Nicaragua en Peru, 1970-1998, in USD millions (nominal)



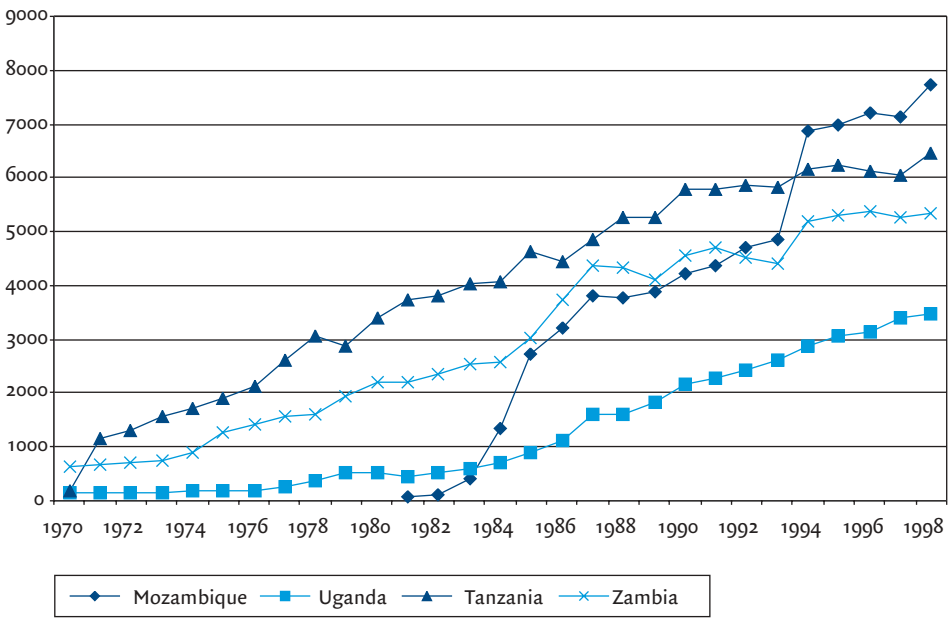
Source: World Bank, Global Development Finance, CD-ROM 2002

At that time Mozambique and Nicaragua introduced an import substitution-industrialisation policy along socialist lines which, similar to that of Tanzania introduced a decade earlier, was largely supported with donor loans. Mozambique was then anxious to finance its development with loans rather than grants, in order to retain its independence (Bossema 1995). In 1990 the share of bilateral loans in the total debts of the two countries was almost as large as that of Tanzania in 1980 (see Table 2-1). In Uganda, after the ousting of Amin, reconstruction was supported especially by multilateral institutions. The first adjustment programme started in 1984 but soon came to an end when a new civil war erupted. President Museveni, who came to power in 1986, signed an agreement with the IMF and the World Bank a year later. Although bilateral aid to Uganda also started to flow

at the end of the 1980s, multilateral institutions are responsible for the greater part of the country's debt (59% in 1990; see Table 2-1).[11]

Jamaica and Zambia underwent a series of adjustment programmes during the 1980s which were supported by bilateral and multilateral loans and thus increased the debt burden. The programmes were only partly implemented, however, and did not lead to economic recovery, due in part to the still unfavourable terms of trade. Zambia broke with the International Financial Institutions (IFIs) in 1987 over the policy to be followed; this lasted until 1991. The country was given no new loans, and suspended its payments to the IFIs. As a result, the debt situation stabilised. Tanzania did not enter into an agreement with the IMF over structural adjustment until 1986. This agreement made it possible to finance balance of payments and fiscal deficits more easily: economic growth started to increase, but so also did foreign debt.

Figure 2-2 Outstanding long-term debt of Mozambique, Tanzania, Uganda and Zambia, 1970-1998, in USD millions (nominal)



Source: World Bank, Global Development Finance, CD-ROM 2002

11 This was partly because much bilateral aid then consisted of grants and no longer of loans.

Bolivia had already started to conlcude restructuring agreements regarding debt service to private creditors in 1979, but high interest rates caused the debt to increase rapidly in the early 1980s. In 1983 the country announced that it was no longer able to pay its debts. Yet the net inflow of commercial and government funds remained positive in the first half of the 1980s, partly because bilateral creditors started to support the 'young democracy'.[12] Meanwhile, the budget deficit continued to grow, resulting in hyperinflation in 1985. A new government started to implement an orthodox adjustment policy and entered into an agreement with the IMF. Inflation then declined rapidly but the debt continued to increase and there was little evidence of economic growth during the 1980s.

Table 2-1 Share of the various categories of creditors in total public debt, 1980 and 1990, in percentages

	Bilateral		Multilateral		Private		Total	
	1980	1990	1980	1990	1980	1990	1980	1990
Bolivia	30	48	20	43	49	9	100	100
Jamaica	44	57	20	30	36	13	100	100
Nicaragua	26	70	25	11	48	19	100	100
Peru	42	32	8	16	50	52	100	100
Mozambique[1]	34	74	65	11	1	15	100	100
Tanzania	75	58	17	34	8	8	100	100
Uganda	40	26	15	59	45	15	100	100
Zambia	51	59	19	31	30	10	100	100

1 The 1980 column for Mozambique refers to 1981 when the size of recorded debt was still so small that little can be said about its distribution.

Source: World Bank: Global Development Finance, CD-ROM 2002

At the start of the 1980s Peru was forced to reduce its imports since neither commercial banks nor official creditors would make further loans available. In 1985 the long-standing military regime at last came to an end, and donors began to support Alan García's new government. The latter did not sign an agreement with the IMF but followed an heterodox stabilisation policy which, in practical terms, meant that macro-economic deficits and

12 Between 1979 and 1982 the transition took place from a military dictatorship to a democratically-elected government.

foreign debts increased. Arrears in debt servicing increased rapidly, and in 1987 Garcia announced a moratorium on debt payments.

As might be expected, the share of private debt in the total debt fell during the 1980s in all eight countries (Table 2-1). Peru was an exception, due particularly to arrears on private debt payments that had been mounting since 1984. Banks withdrew as much as possible from the affected countries. In Bolivia, the share of private debt declined in particular as a result of a co-ordinated buyback operation of private debt carried out in 1986.

In most countries the share of multilateral debt grew considerably in the 1980s due to successive structural adjustment programmes. In Peru, however, the increase was only slight because that country had no agreement with the IMF. In Nicaragua and Mozambique, where socialist governments were still in power, the multilateral share in total debt even decreased. The USA effectively exercised its veto power with regard to multilateral lending to these countries.

The Netherlands was a creditor in seven of the eight countries, having provided export credit guarantees to Bolivia, Peru, Tanzania, Zambia and Nicaragua (on a very small scale to the latter). To Peru this occurred almost exclusively in the 1970s, to the other countries

Table 2-2 Debt ratios in 1990 for the eight countries, in percentages

	Bolivia	Jamaica	Nicaragua	Peru	Mozambique	Tanzania	Uganda	Zambia
Debt[1]/BNP[2]	84	106	842	55	182	142	51	151
Debt/Export[3]	387	161	2058	317	1411	1065	879	334
Debt service/ Export	39	27	4	11	26	33	59	15
Interest payments/ Export	14	11	3	6	13	11	15	6
Arrears/Debt	1	7	50	87	22	21	14	49

1 Debt: Long-term debt outstanding and disbursed, LDOD).
2 GNP: Gross National Product.
3 Export: exports of goods and services.

Source: Calculated on the basis of World Bank data, Global Development Finance, CD-ROM.

also in the 1980s. In addition, Nicaragua, Peru, Tanzania and Zambia received aid loans, sometimes in the form of mixed credits. Jamaica and Mozambique also received many concessional loans: Jamaica since the end of the 1970s and Mozambique particularly in the 1980s. The Netherlands initially gave Uganda only emergency aid. When development relations with that country were formalised in 1991, Dutch aid already consisted exclusively of grants.

By 1990 the debt burden in all eight countries had become unsustainable when measured by conventional debt ratios (Table 2-2). Only Peru and Uganda were then under the 60% level that is usually considered as sustainable for the ratio between debt and national income. The other six countries were (far) above that limit, with Nicaragua at the peak with 842. In all eight countries, moreover, the debt/export ratio was higher than 150%, the threshold used in the enhanced HIPC initiative. Nicaragua was again in the lead with 2058%, but for Mozambique, Tanzania and Uganda the ratios were also high. All this signifies that, in 1990, not one of the eight countries was solvent. With a debt/export ratio of 161%, Jamaica only slightly exceeded the HIPC solvency norm of 150%.

The fact that all eight countries were also experiencing liquidity problems can be seen from the high values for the debt service to export ratios. Only in Nicaragua, Peru and Zambia was that ratio less than 25%, but that was due chiefly to high arrears (see final row of Table 2-2): actual payments were far less than payments due. This applied also to Mozambique and Tanzania, although to a lesser degree. In 1990 Jamaica was in the most favourable situation, also in terms of liquidity.

2.4 Inputs: Debt relief to the eight countries during the 1990s

Table 2-3 surveys the modalities of debt relief received by the various countries. Columns 2-8 show the years in which agreements were entered into with the Paris Club regarding bilateral debt. The middle-income countries Jamaica and Peru had access only to restructuring that was barely concessional, if at all (columns 2-3). Since 1988 an increasing percentage of debt forgiveness has been applied to eligible debt service (columns 4-7). Since the Naples terms, forgiveness of the outstanding debt itself (i.e. the stock) has been possible, while an agreement under Cologne conditions always includes a stock-of-debt treatment (columns 6-8). Columns 9 and 10 show bilateral relief on multilateral debt service. At the start of the evaluation period, some countries were in arrears with multilateral institutions. These were cleared with the aid of loans and grants from bilateral creditors and donors. In addition, many countries were given bilateral grants with which to settle

multilateral debts. This often took place through a special World Bank facility, known as the 5th dimension. Bolivia, Nicaragua, Uganda, Tanzania and Zambia, in particular, benefited from this. However, it was not possible to obtain sufficient data on this during the country studies and it is therefore not included in Table 2-3.[13] In some countries such relief on multilateral debt service was co-ordinated at the end of the decade through a Multilateral Debt Fund (MDF). This Fund was usually terminated when the country qualified for the HIPC initiative (see columns 11 and 12). The final column in Table 2-3 shows that in most countries private debts have been bought back. In all countries, such buybacks have been financed in full with capital received through the Debt Reduction Facility (DRF), also known as the 6th dimension of the World Bank, to which bilateral donors contributed.

Table 2-3 shows that Bolivia and Uganda soon reached the Completion Point of HIPC 1 but subsequently also became eligible for HIPC 2. Six of the eight case study countries are now Heavily Indebted Poor Countries (HIPCs). Four have already reached the Completion Point; the two others are in the interim period and thus receive interim debt relief from multilateral institutions.

Notes to table 2-3:

1 Classic terms are limited to restructuring which leaves the real (or net present value) of the debt unchanged.
2 Houston terms were introduced in 1990 for middle-income countries and comprised extension of maturities which reduced the NPV of the debt slightly.
3 MDF: Multilateral Debt Fund: fed by bilateral grants and used for the payment of multilateral debt service.
4 HIPC: Heavily Indebted Poor Country Initiative.

13 Usually it was only possible to trace the Dutch contribution. Figures regarding contributions by other donors were sometimes found during the field studies, but proved not to tally with regard to the Netherlands. The 5th dimension was applied until about 1996, i.e. before the World Bank became more transparent (internet).

Table 2-3 Summary of types of debt relief to the eight case study countries

(1) Countries	(2) Classic[1]	(3) Houston[2]	(4) Toronto (33%)	(5) London (50%)	(6) Naples (67%)	(7) Lyon (80%)	(8) Cologne (90%)	(9) Multilateral arrears	(10) MDF[3]	(11) HIPC 1[4]	(12) HIPC 2[4]	(13) Private
Bolivia	'86		'88-'90	'92	'95-96	'98 (stock)	'01		'96-'00'	97 Decision pt '98 Compl. pt	'00 Decision pt '01 Compl. pt	'86 Buyback '88 Brady '93 Buyback '97 Buyback
Jamaica	'84 '85 '87 '88 '90	'91 '93										
Nicaragua				'91	'95 '98			'91 (IDB, WB) '92 (IMF)			'00 Decision pt	'95 Buyback '96 Brady
Peru	'68 '69 '78 '83 '84 '91	'93 '96										
Mozambique	'84	'87 (ad hoc)	'90	'93	'96	'98 '99 (stock) '00	'01		'96-'98	'98 Decision pt	'00 Decision pt '01 Compl. pt	'91 Buyback
Tanzania	'86		'88 '90	'92	'97	'00	'01		'98-'00		'00 Decision pt '01 Compl. pt	'90-'93 Debt swap '99 Buyback
Uganda	'81 '82	'87 (ad hoc)	'89	'92	'95 (stock)	'98 (stock)	'00		'96-'98	'97 Decision pt '98 Compl. pt	'00 Decision pt '00 Compl. pt	'93 Buyback
Zambia			'90	'92	'96 '99			'91 IMF '91 WB			'00 Decision pt	'94 Buyback

Source: Country case studies

Table 2-4 shows the amounts of debt relief received by the eight countries during the 1990s, based on figures in the GDF databank (middle column). It should be remembered that not all debt relief is recorded in that databank (and therefore probably, neither are all debts): in 1997, for example, Mozambique signed an agreement with the former Soviet Union regarding a considerable debt reduction, but this is not to be found in these figures.[14] In general, reductions of debts to the Soviet Union are probably underestimated in GDF data (Daseking & Powell 1999). They do indicate the magnitude of debt relief, however.

Table 2-4 Debt relief received during 1990-99, and shares of the various modalities

	Share forgiven in %	Share rescheduled in %	Total debt relief in USD million (=100%)	Share flow relief, in %	Share stock relief in %
Bolivia	49	51	2823	89	11
Jamaica	43	57	1249	92	8
Nicaragua	77	23	9338	54	46
Peru	15	85	15432	91	9
Mozambique	54	46	5111	69	31
Tanzania	53	47	2629	100	0
Uganda	74	26	1202	79	21
Zambia	41	59	3738	88	12

Source: Global Development Finance.

Peru and Nicaragua both received much debt relief, while Jamaica and Uganda had much less. By far the greatest part of debt relief to Peru consisted of restructuring. Jamaica, which like Peru is a middle-income country, was forgiven a remarkably high proportion of its debt. In general, the share of debt forgiveness is low: only in Nicaragua and Uganda was it clearly more than half. In all eight countries most debt relief proved to be flow relief (rescheduling plus forgiveness on debt service due). A very small part of the total relief concerned debt stocks. Only in Nicaragua did this amount to 46%.

14 However, it is reflected in the IMF's balance-of-payments figures.

2.5 Conclusions

1. The causes of the debt problem may be found both on the demand and the supply side. Commercial banks did not properly estimate the risks involved and offered too low rates of interest because they had surplus liquidity. Their international activities were not subject to supervision and regulation. Creditor governments wanted to promote development in recipient countries, but also their own exports. Later, in the 1980s, the IMF and the World Bank acted more or less as lenders of last resort for debtor countries. In these cases the decisions to lend were not taken on the basis of an appraisal of expected yields and risks. Moreover, loan applicants frequently pursued an irresponsible policy expressed, for instance, in high budget deficits and over-valued exchange rates that hampered exports.

2. Private creditors were far quicker than official creditors to recognise that debtor countries suffered from more than a temporary problem of liquidity and that they were actually insolvent. This was due firstly to the fact that, unlike governments, banks are subject to regulations that force them to write off dubious debts. Export credit agencies continued until well into the 1980s to provide new credit guarantees to countries that could no longer meet their obligations. Secondly, western countries preferred to reschedule debts and provide new aid. The recognition that the debts would never be repaid gave rise to the difficult question out of which budget the write-off of dubious claims, including those of ECAs, would have to be financed.

3. In the eight countries investigated, the debt problem was primarily one of official debt. In 1980 private debt represented between 30 and 50% of the debt in six of the eight countries, but by the start of the 1990s this share had fallen to less than 20% in all but Peru. In 1990 all eight had an unsustainable debt if outstanding debt is compared with exports. Jamaica's debt was the most sustainable; in the other seven the debt/export ratio was far above the HIPC criterion of 150%.

4. During the 1990s the eight countries received a broad variety of debt relief modalities. A large part of that relief, however, consisted of the rescheduling of debt service due, which did not reduce the total volume of outstanding debt. For the majority, the share of debt forgiveness ranged between 41 and 54%. For Peru it was much lower (15%) and for Nicaragua and Uganda much higher (approximately 75%). By far the greater part of debt relief received consisted of relief on *flows* (including arrears), and far less of relief (forgiveness) on principal (*stocks*).

3 Efficiency of Debt Relief

3.1 Introduction

This chapter attempts to answer the question of whether debt relief was efficient, i.e. whether the funds made available for the purpose were efficiently used. To this effect, 'inputs' are compared with 'outputs'. Debt relief is efficient if the funds used have reduced the debt stock and/or have led to a considerable reduction in the flow of actual debt payments. Sections 2 and 3 of this chapter will thus discuss the effects of debt relief on the debt stock and debt payments respectively.

A third 'output' consists of policy changes that donors and creditors try to bring about by setting conditions. Until 1999 the only condition attached to debt relief in the multilateral framework (Paris Club, HIPC 1) was that the country in question must have an agreement with the IMF. The enhanced HIPC initiative also introduced conditions regarding the reduction of poverty. Countries were required to draw up a strategy for this purpose (laid down in a Poverty Reduction Strategy Paper, PRSP), with broad-based participation of stakeholders. That strategy then also had to be implemented, so that resources released by debt relief could be applied to poverty reduction. The requirement to draw up and to implement a PRSP was introduced only in the final year of the evaluation period (1999), so that there is as yet little insight into the degree of implementation. At the time of the fieldwork carried out for the Mozambique, Nicaragua and Tanzania country studies in 2001 and 2002, the initial effects of the requirements were becoming visible. These are discussed in Section 3.4 below. Conclusions are drawn in Section 3.5.

3.2 Reduction of the debt stock

Reduction of the debt stock can only be brought about by debt forgiveness. Restructuring leads merely to the deferment of payment; if the interest is then also capitalised, the nominal value of the debt will even increase.

Analyses of all debtor countries in Latin America and Sub-Sahara Africa show that the various debt relief initiatives have had little effect on reducing debt stock (Dijkstra & Hermes 2002). The implementation of market-based debt reduction on private debts, which culminated in 1988 in the Brady Plan, led to a peak in debt forgiveness in 1988-1990 when 4 to 5% of total debt in Latin America was cancelled each year. In Africa, where

private debt forms a smaller percentage of the debt stock, a peak occurred in 1989 but of less than 3%. On the other hand, Africa also reached 3% in 1996, 1997 and 1998 when the Paris Club's forgiveness percentage had already been raised to 67% (later 80%) of debt service; a few countries then profited from reduction of their outstanding debt stock and, in 1998 and 1999, some started to benefit from the HIPC initiative. In the other years the forgiveness percentages were much lower. These general figures are averages for the region as a whole, however; i.e. they include countries that needed little debt reduction.

According to Table 2-4, about half or more of the debt relief in most of the eight countries which are the focus of this evaluation, consisted of debt forgiveness, while forgiveness represented only 15% in Peru. Table 3-1 shows what this signified in relation to outstanding public debt in the preceding year.

Nicaragua, which received a great deal of debt relief, including fairly considerable forgiveness, shows the greatest debt reduction, both in annual average percentages and in percentage of total 1999 debt. In 1995 and 1996 large sums were forgiven by some bilateral creditors: the former DDR in 1995, the former Soviet Union and Mexico in 1996. In 1995 there was also a buyback of private debt. The contribution made by the Paris Club was small, partly because Nicaragua owed relatively little to Club members. Mozambique also received substantial debt relief, but the share of forgiveness was lower than in the case of Nicaragua (Table 2-4). The annual average percentage of public debt that has been forgiven is relatively high (6.1%, Table 3-1), but that was caused primarily by the high percentage in 1990. That figure may not be accurate.[15] As percentage of the 1999 debt, debt reduction in Mozambique was far less than that in Nicaragua.

In the remaining countries, average annual debt reductions were far smaller (between 1.3 and 3.6%). During the 1990s Bolivia received mostly bilateral debt forgiveness within the Paris Club framework. Multilateral forgiveness started in 1998 and was relatively small. In Zambia, the greatest debt reduction occurred in 1994 as the result of a buyback operation. Uganda's debt was reduced chiefly due to buyback in 1993 and to multilateral debt relief in 1998. In Tanzania the slight reduction was due largely to agreements with the Paris Club. Jamaica benefited from debt reduction only at the start of the 1990s, particularly in 1991. In Peru debt reduction has been slight, and that was mostly taken care of by the Brady operation in 1996, which was not financed by aid funds.

15 See Note 3, Table 3-1.

Table 3-1 Debt forgiveness[1] as percentage of total public debt in the preceding year, 1990-99 for the eight countries

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average	Total[2]
Bolivia	4.9	11.6	2.4	5.4	0.5	2.0	4.1	2.2	0.4	3.0	3.6	55
Jamaica	0.7	8.9	0.7	3.0	0.7	0.0	0.0	0.0	0.0	0.2	1.4	19
Nicaragua	0.0	5.2	0.1	0.0	0.2	23.5	46.8	5.8	0.9	1.5	8.4	122
Peru	0.0	0.0	0.5	0.0	0.0	0.0	10.5	0.0	0.6	0.9	1.3	12
Mozambique	30.4[3]	5.6	0.5	0.8	1.3	6.2	2.5	4.2	0.6	9.0	6.1	60
Tanzania	2.1	3.0	2.7	4.0	1.7	2.3	0.5	5.7	1.2	0.4	2.4	22
Uganda	2.8	0.0	0.6	6.4	0.3	1.4	0.0	0.0	18.1	0.0	3.0	30
Zambia	3.9	2.0	4.9	6.9	13.7	0.1	0.6	0.0	0.0	1.7	3.4	38

1 Defined as the sum of forgiveness on principal and interest due, debt reduction, and reduced by funds spent on buybacks.
2 The total of all debt forgiveness as percentage of the 1999 public debt.
3 The high percentage is due primarily to a debt reduction of USD 950 million in that year; however, this cannot be traced to any reduction of the debt stock. This inconsistency may be attributable to an inaccuracy, or may have originated because a debt had first been re-valued and then (partially) forgiven. The facts are not known.

Source: Calculated on the basis of World Bank, Global Development Finance CD-ROM, 2002.

Table 3-2 New loans to government[1] as percentage of public debt in the preceding year, 1990-99 for the eight countries

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average
Bolivia	8.7	7.7	11.1	8.7	10.0	10.4	8.0	8.8	7.6	6.8	8.8
Jamaica	7.6	10.7	8.5	6.0	3.1	6.8	6.2	10.2	13.4	4.8	7.7
Nicaragua	7.6	3.8	3.1	1.1	3.6	2.9	2.6	11.8	4.8	5.0	4.6
Peru	2.3	3.9	4.1	9.7	3.7	4.1	2.0	7.5	3.3	5.6	4.6
Mozambique	5.4	2.7	4.5	4.0	4.7	4.4	5.4	4.8	4.3	2.2	4.3
Tanzania	5.7	4.8	6.7	4.1	4.4	4.2	3.3	4.1	3.6	4.0	4.5
Uganda	15.8	8.7	11.1	16.8	10.3	8.0	7.4	9.3	5.1	5.0	9.8
Zambia	3.9	7.8	5.8	5.3	6.6	6.8	4.4	5.1	1.2	3.8	5.1

1 New foreign loans to government ('Disbursements' on 'Public and Publicly Guaranteed Debt', PPG).

Source: World Bank, Global Development Finance 2002, CD-ROM.

In relation to the high debts and the severe lack of solvency shown by seven of the eight countries in 1990 (Table 2-2), the average annual debt reduction in the 1990s was minimal. Debt reduction as percentage of the 1999 debt was also small, with the exception of Nicaragua. That was of course largely influenced by the new loans that the countries received as well as the size of repayments made. Table 3-2 shows that new loans were quite considerable: for almost all countries the average annual increment was greater than the average reduction. Only in Nicaragua and Mozambique was the situation reversed. The effect of these new loans on debt sustainability will be discussed in Chapter 4.

3.3 Reduction of the flow: debt service

An important argument in favour of debt relief is that it reduces payment obligations for debtor countries, so that they can then use the freed resources for development purposes. Liquidity problems also form an important reason for debt relief by the Netherlands (IOB 2002, section 4.4.2). The larger part of debt relief received by the eight countries during the evaluation period was indeed relief on flows (by means of rescheduling and forgiveness, see Table 2-4), so that a flow reduction can be expected.

In Chapter 1, however, it was already indicated briefly that by no means all debt relief leads to a reduction of debt service. It does not only depend on the modality of debt relief, but also on the type of creditor, and on circumstances. More in particular, six factors or circumstances can be distinguished which may prevent debt relief from leading to the actual release of resources:

1. Debt relief that reduces an outstanding debt (stock reduction), on which no interest or principal repayments were being made, does not lead to lower debt service, but frequently to an increase in *de facto* payments: debt relief agreements routinely require that the remaining, reduced, debt be serviced punctually.

2. Debt relief (rescheduling or forgiveness) on debt service that has so far not been paid will also not reduce the actual payment burden.

3. Although the rescheduling of payment obligations will reduce debt service in the short term, the shift towards the future means that payments in future years will be higher than they would have been without rescheduling.

4. Debt relief and aid given by one creditor may mean that another creditor can be paid, while that probably would not have happened in the absence of that relief and aid. This is known as 'bailing out'.

5. Debt relief may replace regular development aid, and in that case does not supply additional funds to the recipient country.

6. Finally, debt relief may lead to a new inflow of loans. On the one hand, debt relief thus has an indirect positive effect on the availability of funds (but that is a stock effect, see Chapter 4); on the other hand, it has a negative flow effect because the total debt service increases.

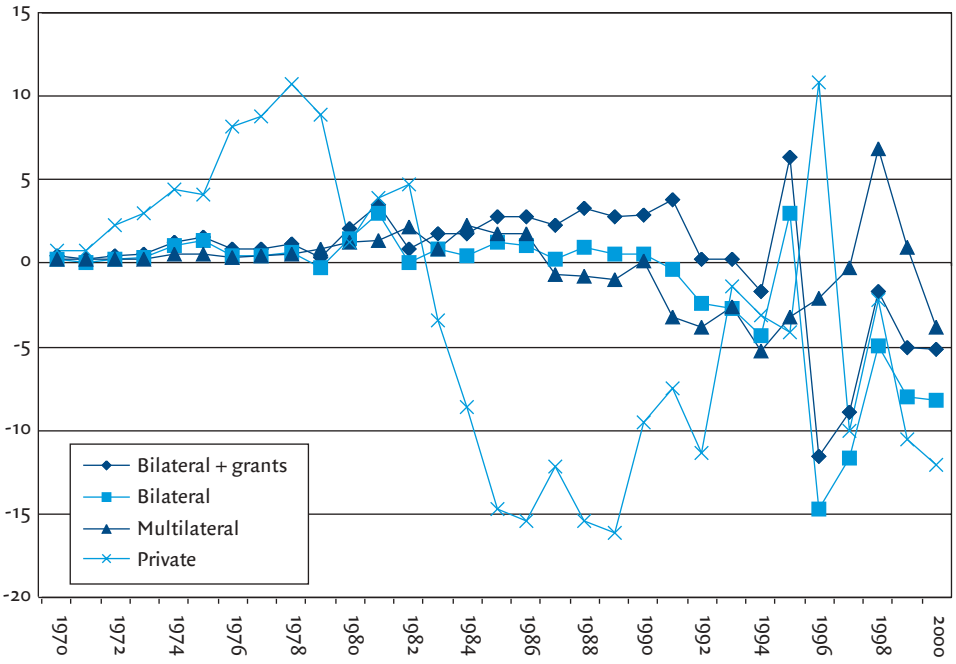
Any investigation into the occurrence of these factors requires a detailed analysis per debt relief modality and per debtor country. However, a few general conclusions, based on comparative research, can be drawn with regard to bailing-out and additionality.

3.3.1 Bailing out

The first question is that of whether debt relief, new aid and loans by a particular group of creditors will lead to payment of the debts of other creditors (bailing-out). Chapter 2 concluded that commercial creditors started to withdraw early from debtor countries and that they wrote off their dubious claims before official creditors did so. Nevertheless, in the 1980s commercial creditors were able to extract more from Latin American debtor countries than they provided in new loans (Figure 3-1). Between 1983 and 1994 the net flows to the region were negative, at the expense of the countries' incomes but also of official creditors. In the peak years of Latin America's debt crisis (1984-1992) private creditors were partly bailed out by their official counterparts.

The net flow of private creditors to Africa was also mostly negative after 1983 (Figure 3-2). After about 1990 that also applied to bilateral creditors. However, the total net inflow of funds to the region remained positive due to the fact that bilateral creditors (frequently also donors) started to transfer large sums in the form of grants that replaced the loans formerly given. The multilateral flow also remained positive, although far smaller than the bilateral flow. Moreover, debt service to multilateral creditors always had priority: they were preferred creditors. Through their higher priority, new loans provided by multilateral organisations caused the older debt titles of bilaterals to lose value; moreover, grants by bilateral donors made it possible for obligations to multilateral institutions to be paid.

Figure 3-1 Net transfers on debt by type of creditor[1] to Latin America and the Caribbean, 1970-2000, in USD billions



1 Net transfers on debt: New loans minus interest and principal repayments.

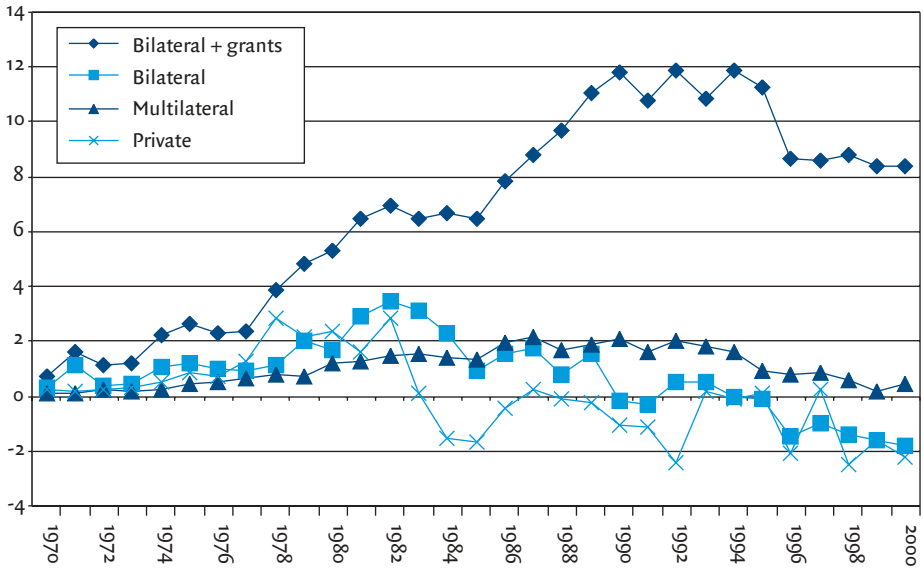
Source: Global Development Finance, 2001.

It can thus be concluded that, in a way, bilateral debt relief and grants made it possible for debt service to other groups of creditors (including export credit agencies) to be paid. Once again, it is a case of bailing out, but now of private and multilateral creditors and of ECAs by bilateral donors.[16]

In fact, therefore, bilateral donors in the Paris Club substantially contributed in three different ways to the granting of concessional loans by the multilateral institutions: firstly,

16 In view of the fact that export credit (guarantee) agencies usually belong to the government or operate on its behalf, as for example in the Netherlands under the *aegis* of the Ministry of Finance, it is not strictly speaking a case of one party bailing out another.

Figure 3-2 Net transfers on debt by type of creditor[1] to Sub-Sahara Africa, 1970-2000, in USD billions



1 Net transfers on debt: New loans minus interest and principal repayments.

Source: Global Development Finance, 2001.

by making these concessional loans possible;[17] secondly, because their own claims lost value and thus required more bilateral debt relief; and thirdly, by taking over debt service to multilateral institutions, whether partially or in full, through the 5th dimension, a multilateral debt fund or, more recently, through contributions to HIPC Trust Funds, such as the HIPC-PRGF Fund of IMF and the HIPC Trust Fund for the international development banks, managed by the World Bank. The existence of this third channel is confirmed by empirical research which shows that countries with high debt, and particularly those with high multilateral debts, receive more aid (Birdsall *et al.* 2001).

17 Through contributions to the (interest) subsidy account of the IMF's ESAF/PRGF, the 'Replenishment Fund"of the International Development Association (IDA) and to a similar fund of the Inter-American Development Bank (see IOB, 2002).

3.3.2 Additionality

Debt relief is additional if the regular aid flow is just as great as in the counterfactual case without debt relief. On the part of the relief *provider* it can be checked from which budget the debt relief is financed and whether the aid budget would have been greater in the absence of debt relief. It is impossible to do this for all providers collectively, however, because the hypothetical aid budgets in the absence of debt relief are unknown. Moreover, for an individual *recipient* of debt relief the only thing that matters is whether debt relief is coupled with reduced aid in a particular year, compared to the preceding year. A negative relation between aid and debt relief indicates that the relief has replaced the aid; on the other hand, a positive relation or the absence of any link may indicate additionality.

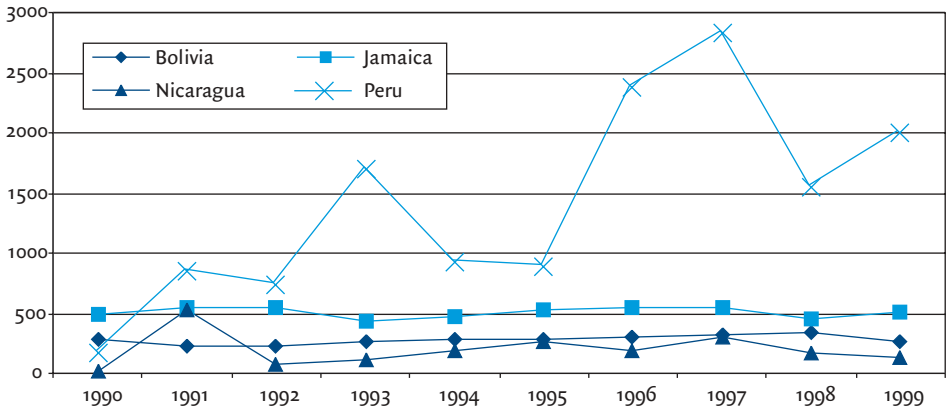
A recent study has econometrically examined the relationship between debt relief and aid for a large group of countries. The estimated equation controlled for other factors that can influence both aid and debt relief to a particular country (Birdsall *et al.* 2001).[18] No significant relationship could be found between aid and debt relief, indicating that there is no substitution between them. Given the problems with figures in the GDF database (apart from that mentioned earlier of concentration in one year of debt relief by the Paris Club, debt relief figures also includes e.g. debt reductions by private creditors who do not provide aid), and that definitions of debt relief and aid sometimes overlap,[19] it is difficult to draw conclusions regarding additionality at this aggregated level.

3.3.3 Flow reduction in the eight countries

Figures 3-3 and 3-4 show that in none of the eight countries did the nominal value of the debt service paid show a clear fall during the 1990s. Peru had a definite rise, while Zambia and to a lesser degree Tanzania, experienced heavy fluctuations. In Bolivia, Jamaica and Uganda the actual debt service paid remained fairly constant, while in Nicaragua (with the exception of the peak in 1991) and Mozambique the debt service at first rose slightly and then fell slightly. On the basis of the country studies, an analysis is now made of the extent to which the six factors that may prevent debt relief from leading to the freeing of resources (see 3.3) influenced developments in debt service in the eight countries.

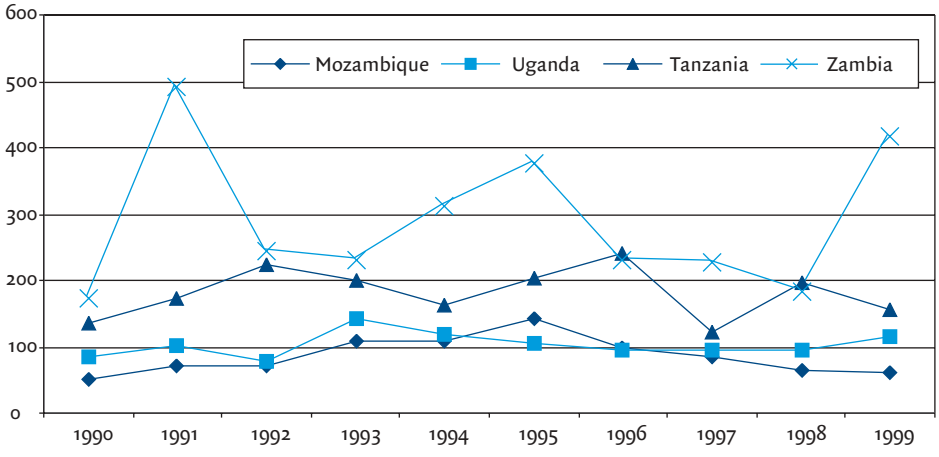
18 Debt relief is defined as relief on debt stock and debt service, and aid as the net flow of funds including grants.
19 The debt relief modality which always releases funds (bilateral take-over of obligations to multilaterals) is included in GDF under 'grants', i.e. aid. As will be shown below, this modality is the least additional.

Figure 3-3 Debt service paid on public debt: Bolivia, Jamaica, Nicaragua en Peru, 1990-99, in USD millions



Source: Global Development Finance

Figure 3-4 Debt service paid on public debt: Mozambique, Uganda, Tanzania en Zambia, 1990-99, in USD millions



Source: Global Development Finance.

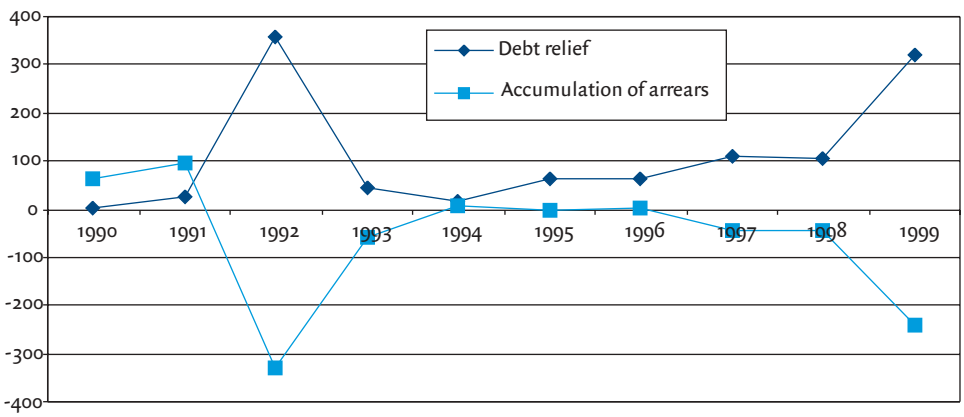
The most extreme case is that of Peru, where debt relief had no effect whatsoever on the flow of debt service payments. Debt relief only cleared away accumulated arrears: the complete net present value of arrears to IMF (in 1991), paid from aid by bilaterals, and arrears to private creditors against considerable discount under a Brady agreement in 1996-97. Debt service increased because Peru entered into many new debts.

In many other countries, too, the majority of debt relief was destined for arrears and for debts that would otherwise not have been paid. In Uganda, Tanzania, Zambia and Nicaragua arrears were already high in 1990 (see Chapter 2), and there was a strong negative correlation between debt relief and the accumulation of arrears.

Figure 3-5 illustrates this inverse relationship for Uganda: a large amount of debt relief coincided with, and thus was used for, a great reduction of arrears.

Debt relief provided by the Paris Club to Nicaragua, Mozambique, Uganda, Tanzania and Zambia during the first half of the decade included above all the restructuring and forgiving of arrears. Prior to the agreements, the creditors in question had not been paid. Around the mid-1990s, however, the arrears were smaller and the countries in question started to give priority to servicing their debts to the Paris Club members. From then on,

Figure 3-5 Uganda: Debt relief and the accumulation of arrears, 1990-99, in USD millions



Source: Lindner 2002, based on Global Development Finance data.

it can be said that debt relief by the Paris Club also reduced actual payments to some extent.

On the other hand, debt relief received from private creditors and from bilateral creditors who did not belong to the Paris Club (e.g. Russia) frequently increased actual debt service. These other forms of debt relief played an important part in Nicaragua's total, but also occurred in Zambia, Uganda, Mozambique and Tanzania. Paris Club agreements in the 1980s and at the start of the 1990s sometimes caused debt service later in that decade to increase. The sole form of debt relief that unequivocally freed resources for the governments of the four countries was that of bilateral take-over of multilateral debt obligations (because the latter were always paid). However, such modes of debt relief often replaced other forms of macro-economic support or programme aid, and thus did not always provide the recipient government with additional funds.

In Bolivia, debt service to the Paris Club members was paid throughout the 1990s: in other words, debt forgiveness given by that group of creditors reduced actual debt service. Jamaica was given only rescheduling, which caused debt payments later in the decade to increase. Nevertheless, Jamaica is the country where the flow effect of debt relief was probably the greatest: it allowed the country to spread payments throughout the decade.

All in all, the flow effect of debt relief was greatest in Jamaica, and also considerable in Bolivia. In the other countries the effect on actual payments was probably (far) below 50%, while in Peru it was zero. Most information was available for Nicaragua, where only 5% of total debt relief received in the 1990s proved to have led to an actual reduction of the debt service.

Additionality

All country studies concluded that debt relief was additional to aid, according to the definition given above from the viewpoint of the individual recipient: in general, no negative correlation existed between debt relief and aid. An exception must be made for one modality of debt relief, namely, bilateral relief on multilateral debt service, through the 5th dimension or an MDF. This frequently replaced other forms of macro-economic support (or programme aid): balance of payments or budget support, and was in those cases not additional for the recipient.

Even if the total debt relief received has been additional to aid for the eight countries under study, that does not imply that the donors involved made it available in addition to what they would have spent on aid loans and grants without debt relief. For the eight debtors, additionality may very well have been achieved by withdrawing the funds from destinations that they would otherwise have had, e.g. as aid flows towards less indebted countries. In a donor country such as the Netherlands, where the aid budget has a ceiling of a fixed percentage of national income (1.5% of NNI up to and including 1996) or national product (0.8% of GNP since 1997), that is by definition the case.[20]

The eight case study countries were selected chiefly on the basis of total debt relief received from the Netherlands and thus implicitly also on the severity of their debt problems. According to the concept of adverse selection as outlined in section 1.1, this makes it likely that they belong to the category of developing countries that attract extra flows of funds at the expense of other countries. If the latter enjoy better governance and policy, the shift has *possibly* reduced aid's effectiveness. It must be born in mind, however, that the effectiveness of debt relief is not directly comparable with that of aid in general: debt relief can also be effective if no funds are released in the recipient country, namely, by reducing the debt overhang. To establish whether or not this lack of additionality is negative, it is necessary to compare the effectiveness of debt relief with that of aid in countries with low levels of debt. This is not possible in the present evaluation.

The majority of donor countries such as the Netherlands finance most debt relief from their aid budgets. This relief, with a few exceptions, counts as Official Development Assistance (ODA). The GDF database, however, also includes debt relief by creditors who do not provide aid. This probably represents half of total debt relief: debt relief (write-offs, buybacks) by private creditors and by bilateral creditors such as the former Soviet Union or other former non-market economies that do not provide aid (or have stopped doing so). This form of debt relief is thus always additional.

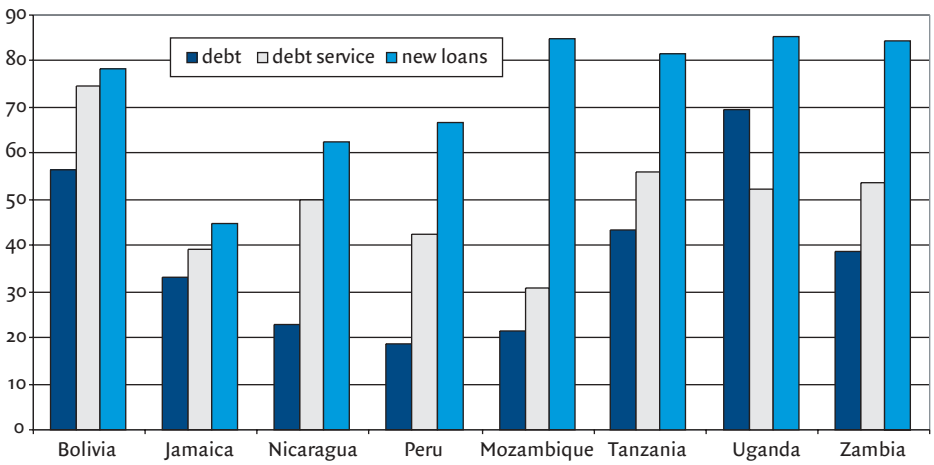
Bailing out

All eight country studies have shown that payments to multilateral institutions always take priority over payments to other groups of creditors. A few countries (Nicaragua, Peru and Zambia) got into arrears in the 1980s, but these had been cleared by the start of the 1990s (with the help of bilateral grants and bridging loans); since then, the most impor-

20 See IOB 2002, section 3.3.3.

tant multilateral creditors (i.e. IMF, World Bank and Inter-American Development Bank) have always been paid. This is shown by the fact that in almost all countries the share of multilateral *debt service* in total debt service was higher than the multilateral share of *debt* (Figure 3-6). This was notwithstanding the fact that in six of the eight countries (the exceptions being the middle-income countries Jamaica and Peru) most multilateral debt is concessional.[21] Only in Uganda, where the share of multilateral creditors in the total debt is also the highest (almost 70%) and where virtually 100% of the outstanding multilateral debt throughout the decade was concessional, the share of the multilaterals in the outstanding debt was greater than their share in the debt service, even though the latter still exceeded 50%. Multilateral debt service was also 50% or more in Bolivia, Nicaragua, Tanzania and Zambia, i.e. in five of the six HIPCs investigated. The HIPC initiative, under which multilateral institutions for the first time waived part of the debt service to themselves, is thus of great significance for this group of countries.

Figure 3-6 Share of multilateral creditors in the total public debt, debt service and in new loans to the government[1] of the eight countries, 1990-1999, in percentages



1 This concerns the share in 'Public and Publicly Guaranteed debt' (PPG): i.e. in 'Debt Outstanding and Disbursed' (DOD), 'Total Debt Service' (TDS), en 'Disbursements' (DIS) respectively.

Source: Global Development Finance, 2002.

21 This was not always the case at the start of the evaluation period, however. In Bolivia, Nicaragua and Zambia roughly two-thirds of outstanding multilateral debt was still non-concessional in 1990.

Figure 3-6 also shows that the share of multilateral creditors in new loans to all eight countries is very considerable. In the four African countries it amounted to over 80% and was not much less in Bolivia. Even in middle-income Peru, multilaterals were responsible for three-fifths of the increase in public debt during the 1990s. Only in Jamaica was the share of multilateral new loans less than 50%. As a rule, concessional multilateral loans have a grace period of ten years (in the case of IMF five years). It is thus to be expected that multilateral debt service will again become dominant in HIPCs during the present decade.

3.4 Implementation of policy conditions

3.4.1 Conditions for debt relief

During the 1980s an agreement with the IMF was a condition for new loans by commercial banks,[22] multilateral institutions and sometimes also bilateral creditors. At the time of the market-based reduction of private debts (the Brady Plan), contributions by official creditors (i.e. IMF and World Bank, but also Japan) were similarly tied to an IMF agreement regarding structural adjustment. Such an agreement was not necessary in deciding on the write-off on private debt (the debt reduction, or the discount on the nominal value of the debt). Commercial banks were interested not so much in an IMF agreement or its implementation, as in the inflow of official capital that accompanied it and enabled the country in question to repay at least part of the claims of private creditors (Dooley 1994).

An IMF agreement was a condition for debt relief agreements with the Paris Club on official bilateral debt. With a few exceptions and as was indicated above, such agreements were concerned with debt service only, i.e. with arrears on debt service incurred up to the date of the agreement, and with claims falling due during the term of the IMF agreement. Once the Paris Club signed an agreement, this was adhered to by its members, whether or not the debtor implemented the IMF agreement.

Bilateral contributions to a multilateral debt fund (MDF) were frequently linked to an IMF agreement and its successful implementation. In addition, it was important for such

22 Hardly occurring in practice (see Figure 3-1).

23 Recipient countries were able to use MDF contributions to repay their debts to multilateral institutions. In view of the fact that they would otherwise have had to pay from their own resources, this released monies that were known as 'countervalue funds', analogous to countervalue funds generated by import support. Bilateral donors who contributed to an MDF frequently demanded that these funds be earmarked for specific purposes.

bilateral debt relief that the country in question should make serious efforts to control corruption, that it had an independent legal system, and that it should hold free elections. In brief, bilaterals required good governance. Sometimes there was also a stipulation regarding better debt management by the government (Uganda) or on the use of 'countervalue funds'.[23]

The original HIPC initiative (see Annex 5) set only a few conditions. Countries had to be poor and highly indebted; apart from that they were required to implement twice a three-year adjustment programme in agreement with the IMF and the World Bank. After the first three-year period they could reach the so-called Decision Point. The degree of unsustainability of the debt would then be investigated and the amount of debt relief determined. After another three years of structural adjustment the Completion Point could be reached, after which the country would have complete access to all promised multilateral and bilateral debt relief.

The enhanced HIPC initiative not only brought more debt relief for more countries, but also changed the policy conditions. To reach the Decision Point countries had to draw up a Poverty Reduction Strategy Paper (PRSP) in which stakeholders had to participate. After the Decision Point they would have immediate access to debt relief by multilateral institutions (interim relief) which would have to be used for implementing the PRSP. The duration of the period between Decision Point and Completion Point would be flexible, because the latter would no longer be fixed in advance but would float: the country must at least implement a number of tangible reforms and start to implement a PRSP, to be certified by a Progress Report. On reaching the Completion Point the interim relief would be continued but would now be fixed for the next 15 to 20 years, and bilateral creditors would forgive the greater part of their debt stocks.

In short, HIPC 1 conditionality was restricted to evaluating (*ex post*) the track record of past performance, while HIPC 2 set again conditions in advance (*ex ante*). Moreover, HIPC 2 signified that demands were set on the use of debt relief. This had not occurred previously, except for a few countries with an MDF.

3.4.2 Implementation: earlier research

Creditors united in the Paris Club hoped to achieve various objectives with their demand that countries sign an agreement with the IMF regarding structural adjustment. Firstly, it was thought that it would lead to better policy-making, thus improving the balance of

payments position and the future repayment of debts. Secondly, it was expected that an IMF agreement would have a catalysing effect on the inflow of new loans and grants, thus enabling the country to solve its payment problems. Collier *et al.* (1997) have pointed out that these two functions, i.e. on the one hand, 'buying' good policy *(ex ante)* and on the other hand, the rewarding of good behaviour *(ex post)* are logically inconsistent.

Research has shown that IMF agreements do not cause an inflow of new private capital (Bird & Rowlands 2000). As a rule, an agreement regarding structural adjustment leads to programme aid by bilateral donors and, of course, also to programme aid by the multilaterals. The catalysing effect thus seems to apply only to official creditors and donors.

The implementation of the policy conditions was also uninspiring. Frequently, structural adjustment programmes were not carried out as agreed. In 24 of the 30 IMF Extended Fund Facilities (EFF) re-negotiations were necessary or the programme was discontinued (Haggard 1985). Out of 25 Enhanced Structural Adjustment Facility (ESAF) programmes examined, only five were completed according to plan, in 14 cases the period of implementation had to be extended, and two were discontinued (Killick 1995). A recent study has shown that only in the first year do IMF programmes lead to improvement of the current account on the balance of payments and of the amount of international reserves. Thereafter, they again deteriorate, while other indicators show no improvement at all. Most countries are soon in need of a new programme (Evrensel 2002). This is a sign not only of defective implementation, but also of 'moral hazard' on the part of the recipient country.

Research into World Bank programmes shows roughly the same results as regards implementation of policy conditions (Mosley *et al.* 1991, Killick *et al.* 1998). Adjustment measures that were actually carried out had mostly already been intended by the country in question; sometimes, measures were only 'cosmetically' implemented, or the government simultaneously took other measures that undid the intended effects.

In general, it seems that mostly domestic political factors determine which policy changes are implemented and which are not. Factors that the World Bank can influence, e.g. the number of preconditions, preparation and monitoring of the programme, have

24 Five of these eight countries overlap with those of the present evaluation. The earlier study covered Bangladesh, Cape Verde and Vietnam, while Jamaica, Bolivia and Peru form part of this evaluation.

little effect in comparison (Dollar & Svensson 1998). An earlier study of the implementation of IMF and World Bank programmes in eight countries[24] also concluded that domestic political factors in particular determine whether reforms will be implemented (White & Dijkstra 2003). If the recipient country is under heavy pressure to reach an agreement with IMF and World Bank, perhaps due to heavy indebtedness, then such an agreement will almost always come about. Similar pressure may sometimes cause reforms to be implemented that were not actually intended. Agreed measures will above all be implemented if: (1) donor and recipient have similar objectives, and (2) the political costs of implementation are not too high (Dijkstra 2002). Implementation is also encouraged if the aid that accompanies the agreement can be used to attain target figures, e.g. with regard to public deficits, or to compensate important political groupings that suffer loss as a result of the reforms.

Another reason why adjustment programmes are implemented so inadequately is that sanctions on non-compliance, e.g. the stopping of aid, are seldom effective (Killick *et al.* 1998). Donors have many varying objectives: they want to continue to help heavily indebted countries, and also those that are very poor and thus are in great need of aid. On the assumption that the prescribed reforms represent 'good policy', and that the country will become more indebted and poorer if the reforms are not implemented, this could lead to countries with poor policies receiving more aid: i.e. adverse selection. If a donor decides to discontinue aid, other donors often take its place. The lack of donor co-ordination reduces the effectiveness of possible sanctions. Moreover, aid is seldom halted in countries with high economic growth because that would detract from the credibility of donors (Mosley & Hudson 1996).

Finally, countries that are heavily indebted to international financial institutions will always be able to obtain from them another new programme and thus a new loan. This is not so much because the loan that accompanies an adjustment programme enables old loans to be repaid (it would not always be sufficient anyway, because the lending volume of the World Bank, for example, is far greater than the freely disposable loans for adjustment programmes), but because a new adjustment loan is accompanied by a seal of approval which leads to new programme aid from bilateral donors, and that aid is crucial for the payment of multilateral institutions (Dijkstra 2002:324). All this reduces for multilateral institutions the ability to be selective in their loan policies.

The conclusion that most studies draw from the defective implementation of policy conditions is that donors would do better to evaluate a country retrospectively rather than to set prior conditions (Collier *et al.* 1997, World Bank 1998). Another reason for some reticence in drawing up policy conditions is that there often are several viable alternative policies that may be followed, and that the policy prescribed by the donors has not always promoted the welfare of the country (Stiglitz 1998).

3.4.3 Implementation of IMF and World Bank Programmes in the eight countries

IMF and World Bank agreements reached during the 1990s with the eight countries on which this study is focused, specified targets for financial deficits and growth of the money supply. Furthermore, conditions were set regarding trade liberalisation, the privatisation of state industries (in particular public utilities and state banks), liberalisation of the financial sector, and reforms of the public sector. The latter concerned reducing its size and making it more efficient, but also decentralisation, and improvement of financial management and accountability. From the mid-1990s onwards, conditions were also introduced for social policies, e.g. that countries should set up a Social Fund (Peru, Jamaica), that they should reform their pension system (Bolivia), or that a certain percentage of government expenditure should be allocated to the social sectors (Zambia). In countries with a Multilateral Debt Fund, requirements regarding social policy often started with the MDF and concerned usage of the countervalue of debt relief.

The eight countries investigated in this study show none too favourable a picture as regards implementation of IMF and World Bank agreements. There are considerable variations, however. Since 1993 Bolivia, Mozambique and Uganda have always been on track with the IMF, while Tanzania has had a good track record since 1996. However, these countries have often been slow in implementing reforms required by the World Bank, and donors are far from satisfied with policies to achieve control of corruption, decentralisation, and increased transparency of public expenditure management.

Since 1991 Zambia has carried out numerous reforms at a fast pace, but it has been late in privatising state industries, particularly the state copper mines. This did not occur until 2000, which meant many years of major losses for the state and thus caused problems in reaching the IMF target for the public deficit. Zambia is always referred to as a country with poor policies (e.g. in World Bank 1998). On average, however, it was no slower in introducing reforms than Uganda for example, and was quicker in many respects after

1991. Nevertheless, and possibly because of this, the economy continued to stagnate. In Uganda, until 1992, high economic growth caused a blind eye to be turned to many policy shortcomings; thereafter, requirements regarding the speed of reforms were far lower than elsewhere (Dijkstra & Van Donge 2001).

Nicaragua implemented all IMF programmes during their first year only, and that was managed chiefly due to the inflow of programme aid in those years. Subsequently, the country invariably went off track, although not always officially.[25] Other reforms, too, were implemented far slower than required, and after 1996 relations with donors worsened because of issues related to good governance. Jamaica usually implemented IMF programmes according to the letter but not the spirit. In Peru in 1991, the new liberal government implemented all required stabilisation, privatisation and liberalisation measures because these were in complete agreement with it's own targets. Even the creation of a Social Fund in 1993 did not represent a problem since President Fujimori was able to utilise it as a political tool. When Peru was required to confront the drugs trade, however, IMF conditions were not implemented. Later, it appeared that high-ranking government officials were themselves involved in the trade.

Towards the end of the evaluation period, it became increasingly important, particularly for the six HIPCs in the group, that IMF requirements be satisfied because the countries were seriously in need of debt relief. Most of them therefore did at least that which was considered minimally necessary. Bolivia, Mozambique, Tanzania, Uganda and Zambia took care to meet the IMF targets, and all six drew up a PRSP. Although they needed the HIPC qualification and were thus dependent on donors, conversely, the latter were also dependent on the governments of the countries involved.

Mozambique, Tanzania and Uganda can be characterised as post-conditionality regimes (Harrison 2001) whereby donors are keen to be able to continue to give aid and thus to maintain the image of a country that performs well. This image is based on the relatively high economic growth in those countries: donors need such success stories. On the one hand, governments of the recipient countries are prepared to satisfy the wishes of the

25 In 1995 and 1999 the IMF was unable to provide a second tranche because targets had not been met; however, the IMF representative asked other donors to continue their programme aid.

donors; on the other hand, donors will be less severe if the developing country is lacking in some respects. In practice, this occurs primarily in matters related to good governance. In HIPCs yet another factor augments this mutual dependency, namely, pressure by the international community and particularly by international Non-Governmental Organisations (NGOs) to admit as many countries as possible to the HIPC initiative. This encourages donor inclination to ignore non-compliance with certain agreements or to back-pedal on certain demands. They admit countries to the HIPC initiative even though their poverty strategy may still be insufficiently elaborated,[26] and tend to tolerate corruption and other forms of bad governance.

3.4.4 Implementation of HIPC conditions in Mozambique, Tanzania and Nicaragua

As indicated above, introduction of the enhanced HIPC initiative (HIPC 2) also involved sharpening the preconditions set on debtor countries. In doing this, the international community aimed at achieving a number of objectives.

1. By requiring that a PRSP be drawn up and carried out, donors expected that the debtor would give greater priority to the reduction of poverty, causing it to decrease and enabling the country to achieve the millennium development goals.
2. The requirement of broad-based stakeholder participation in drawing-up a PRSP was intended to lead to more democratic decision making and greater transparency of government; moreover, it was thought that poverty reduction would become more effective if the poor themselves had a say in setting priorities.
3. In view of the fact that countries drew up their PRSP themselves, the country involved would 'own' the strategy rather than having to implement something conceived and imposed by the donors.
4. Finally, in the view of the Netherlands government (and that of various other bilateral donors) a PRSP would improve donor co-ordination and thus lead to more efficient aid programmes. Donors could contribute to the implementation of a PRSP with budget support, making it unnecessary to negotiate on separate projects. Reporting could then take place within the general budgetary framework.

26 When the condition that a PRSP be completed on a participatory basis proved too difficult for many countries, so that in 2000 a number threatened to fall by the wayside, the entry requirement to the Decision Point was toned down to formulating an Interim-PRSP that had the character of a draft strategy. This revision was successful in that by 31 December 2000, 22 HIPCs had qualified for the Decision Point. In Washington the phenomenon became known as the Millennium rush.

Based on the findings of earlier research and of further analysis of the design of the HIPC initiative, some scepticism regarding these expectations is inevitable. This scepticism, supported by the experiences of Mozambique, Tanzania and Nicaragua with the PRSP process, is inevitable. Those experiences with (i) PRSP and the reduction of poverty, (ii) participation and ownership, and (iii) monitoring and donor co-ordination, are described below.

PRSP and poverty reduction

Do PRSPs lead to greater priority to the fight against poverty and to its faster reduction? This question may be divided into three sub-questions:

1. Is the country's government *prepared* to give priority to combating poverty?
2. Is the PRSP as formulated a *good strategy* with which to reduce poverty?
3. Is the government *able* to implement the PRSP?

All three countries have drawn up a PRSP and for all three the strategy has first been approved as Interim-PRSP by the Boards of Directors of the IMF and the World Bank. Subsequently, the complete PRSP has also been approved. At first sight, the governments of Mozambique and Tanzania appear very motivated to reduce poverty in their countries. Local representatives of multilateral institutions recall that the countries had already developed a poverty strategy before this became obligatory within the HIPC framework, and that Tanzania had even organised a first round of participation. Other respondents point out, however, that during the 1990s it had already become clear that donors would attach increasing importance to poverty reduction and that the governments had played along with them. Moreover, a strategy is only a piece of paper and need not have much influence on the allocation of government expenditure. In Tanzania, donors were of the opinion that the fight against poverty was given priority at high government levels, but that this was not always the case at lower levels. In Mozambique high-ranking officials, e.g. in the Ministry of Health, proved to have their own priorities that were not directed towards improving rural health care. Donors in both countries had considerable misgivings about corruption in general, and particularly about the commitment of public officials and/or the lack of political will on the part of government to expose that corruption. This detracts somewhat from the apparent confidence that these governments will be effective in reducing poverty.

In Nicaragua it was clear that the Alemán government (1996-2002) gave no priority to the fight against poverty. Many doubts were voiced regarding use of the extensive aid that Nicaragua received after hurricane Mitch had ravaged the country in the autumn of 1998. It also became increasingly obvious that the government itself was involved in corruption. In 1999 and 2000 Nicaragua was given almost no more programme aid because donors were deeply disappointed at the lack of good governance. In the meantime, the government ensured that a PRSP was drawn up, and in December 2000 the country reached the HIPC Decision Point. International pressure for admission of as many countries as possible played a large part in this. The same group of technocrats that had drawn up the Interim-PRSP continued to elaborate a complete PRSP. In August 2001 the latter was approved by the IMF and the World Bank. Donor representatives in Nicaragua qualified this as being a seal of approval for a corrupt government which should never have been granted. On this occasion, however, the decisive factor was the pressure of forthcoming presidential elections and the fear that the Sandinista opposition candidate would win if the PRSP was not approved. On the whole, the governments of Tanzania and Mozambique seem to be rather more prepared to give high priority to poverty reduction than does that of Nicaragua.

As to the strategies' contents, misgivings regarding all three countries are very similar. They are voiced broadly by NGOs, local academics and by donors, but are also visible in official reports on PRSPs by the collective staffs of IMF and World Bank, i.e. the Joint Staff Assessments (JSAs). These show that PRSPs are generally well thought-out with regard to the improvement of social sectors such as education and health care, but are less clear regarding ways in which production can be increased. The lack of any strategy by which agricultural production can be raised is seen as a weak point in the Tanzanian plan, although it does include proposals for increased spending on expansion of the road network and water supply to rural areas, for example. In Mozambique and Nicaragua the gaps are even more serious. There is no strategy to promote economic growth. PRSP priorities are targeted almost exclusively toward the social sectors, and hardly at all towards strengthening the basis for economic growth and production. It is doubtful whether such a strategy can lead to a sustainable reduction of poverty.

An important question in the implementation of the PRSP is whether the planned expenditure will effectively benefit the poor groups for which it is intended. Nicaragua's PRSP contains ten projects and programmes that will be carried out with priority. These have been drawn up in close consultation with the multilaterals, World Bank and Inter-

American Development Bank, often in extension of existing projects for which monitoring and reporting systems have already been designed. Due to the great influence of the World Bank and IDB, implementation of these programmes is probably assured, but the question arises of whether it will not be at the expense of other public expenditure. The ultimate effect on poverty reduction is thus uncertain.

In Mozambique and Tanzania, PRSP priorities are formulated less in terms of isolated projects and more in the form of general targets. A vital factor is therefore whether or not budgeted expenditure in general reaches its targets. In Mozambique a Public Expenditure Review (PER), carried out as long ago as 1992, illustrated many shortcomings in this respect. A new PER has recently been published with conclusions that are just as disastrous. There is thus justifiable doubt regarding the government's ability to implement a poverty strategy.

For some years now, with donor support, Tanzania has been occupied with improving the budgetary process with the aid of Medium Term Expenditure Frameworks (MTEF) and PERs. An interesting element of the latter is that they are not one-off reviews but rather broad-based processes in which representatives of civil society and local academics are involved. Within the PER framework a number of so-called tracking studies have investigated whether outlays have indeed reached the destinations for which they were intended. The results are not always positive. A critical point in the Joint Staff Assessment on Tanzania's PRSP is that its priorities are insufficiently linked to existing budgetary processes such as MTEF and PER, and that there is too little insight into the costs involved with PRSP implementation. In Tanzania, too, implementation thus seems to be in need of considerable improvement.

Participation and ownership

Opinions within the three countries are divided as regards the degree of participation in drawing-up PRSPs. Representatives of governments and of multilaterals usually say that substantial consultation and participation has taken place, referring to the number of meetings organised and of participants who took part in them. NGOs, however, usually consider that there was little if any evidence of real participation. In Tanzania the principal complaint was that documents for the meeting were so late in reaching them that they had no time for real preparation, and that very little use was made of their input. The government listened primarily to the donors, particularly the multilaterals, and this

mostly determined the content of the PRSP. People involved on the local level had little if any chance to amend those contents.

In Nicaragua the donors' requirement for participation resulted in the establishment of the National Council for Economic and Social Planning (*Consejo Nacional para la Planificación Económica y Social* [CONPES]), in which NGOs, churches and political parties are represented. That was a considerable improvement at a time when the 1998 Pact between government and its opposition had gagged all dissent and pluriformity. CONPES immediately became involved in the development of the PRSP; nevertheless, NGOs in Nicaragua also consider that they have had practically no influence over the strategy, which was in fact laid down by the donors, notably multilateral institutions.

Similar complaints have been ventilated by the Mozambican NGOs, who also point out that it is not in their interest to be very critical of the PRSP: the aim of the strategy is to secure debt relief, and that is also the objective of NGOs. Strangely enough, Mozambique's poverty strategy *has* been discussed with the NGOs but not in Parliament – let alone that Parliament has approved the PRSP.

The great influence of donors on PRSPs, particularly the multilateral donors IMF and World Bank (and IDB in Nicaragua), is an ever-recurring theme. It is clear that access to debt relief through the HIPC initiative is the primary aim of PRSPs and of the subsequent Progress Reports. Comments on PRSPs made by multilateral staffs have a far greater effect than the government's own opinion or observations from the country's population. This detracts from the ownership concept. In Nicaragua the multilaterals also exercised decisive influence on the selection of the ten priority programmes and projects in the PRSP.

Monitoring and donor co-ordination

One objective of the condition to formulate a PRSP is to ensure that funds released by debt relief are devoted to reducing poverty.[27] In some sense, HIPC thus seems to be a 'debt for development swap' (Berthélemy 2001). Requirements are laid down regarding the use of countervalue funds of debt relief, that thus become a form of budget support. Earlier studies of balance-of-payments support and budget support are thus of relevance here. They show that budget support can have positive 'systemic effects' if donors concen-

27 Whether or not HIPC really leads to the release of funds will be discussed later.

trate on the improvement of budgetary and accountability processes in general (White & Dijkstra 2003). In addition, the drawing-up and implementation of a PRSP can have positive institutional effects. It will lead to better data compilation on poverty and to the development of relevant indicators with which to determine progress (Berthélemy 2001). However, if individual donors set their own requirements regarding the use of funds and on monitoring and reporting, HIPC in fact signifies a backward step when compared with the earlier freely-disposable programme aid. Donors are then occupied with micro-management. This is not effective, given that they have no influence on the use of the marginal aid dollar (money is fungible), neither is it efficient: donors and ministries have to devote much time and effort to the detailed tracking of certain expenditures, while it would be preferable to improve general budgetary and accountability procedures.

Tanzania has had some years of experience with donor demands regarding the use of countervalue funds of MDF debt relief. With the coming of HIPC, the MDF was converted into a fund for Poverty Reduction Budget Support (PRBS), and continues to operate in roughly the same manner. The benefit of MDF/PRBS is that donors work together and that monitoring is not oriented toward individual projects. It is questionable, however, whether monitoring as at present organised is effective and efficient.

Tanzania has a cash budget, which implies that monthly expenditure cannot exceed receipts. Any unexpected setback in income or unexpected expense will mean that not all budgeted expenditure can be met. Funds for mandatory outlays (e.g. the Public Prosecutor) and for salaries are always given priority, but 'other charges' (i.e. other than salaries) are often affected. The MDF/PRBS aims at protecting those other charges for the priority sectors. The latter are determined by the government and now include water, rural roads, education and health care. 'Other charges' then include maintenance, educational equipment and medicines. Quarterly reports are supplied to donors by the Ministry of Finance, but do not provide the information from which to judge whether other charges on behalf of priority sectors have been protected. This is because figures for other charges are aggregated according to groups of sectors: social sectors, economic sectors, etc., and only include expenditure by the central government. 'Social sectors' thus do not make it possible to evaluate health care and education separately; let alone basic health care versus other health care; in fact, very few conclusions can be reached because local governments play an important role in financing basic education and basic health care. Analysis of other charges in the social sectors (i.e. central government only) shows that this usually well exceeds the budgeted amount.

Another problem with this method of monitoring by donors is that the system itself may encourage strategic behaviour: seen from the viewpoint of the Ministry, it is easier to meet the target if the salary budget is set at a somewhat higher level and that for other charges rather lower. No evidence that this occurs has been found, but a ministerial official remarked that serious efforts to budget for other charges have never been made because experience has taught that the amount requested is never granted. Finally, even if it could be established that the funds for 'other charges' in priority sectors are allocated, there is no certainty that expenditure will ultimately reach the intended beneficiaries. This is a far more general problem, and Tanzania is making efforts to cope with it.

Notwithstanding the advanced donor co-ordination in MDF/PRBS, not all donors take part: some provide only project aid. So far, however, even the multilateral institutions do not cooperate. They maintain their own monitoring of HIPC savings through the PRSP. They monitor whether budgeted expenditure for certain items is in accord with PRSP priorities. In effect, there are thus two monitoring systems, which makes extra demands on the Tanzanian administration. It should be noted, however, that all donors concerned with debt relief and budgetary support cooperate in the PER process, as well as in the discussions and preparation of the PRSP and Progress Reports, so that positive institutional and systemic effects may be achieved.

Nicaragua has had a budget support fund since 1998, i.e. the Complementary Social Fund (*Fondo Social Suplementario* [FSS]): this was in fact a collection of projects initiated by World Bank, IDB and USAID.[28] In addition, bilateral donors Sweden and the Netherlands have each made a one-off, freely-expendable deposit in this Fund. Urged by the multilaterals, Nicaragua is now engaged with transforming the FSS into a monitoring system for the ten priority projects as defined in the PSRP. So far, the manner in which this is being done is not very promising from the viewpoint of improving donor co-ordination and efficiency. In contrast to the more global monitoring of the allocation of government expenditure favoured by multilateral institutions in Tanzania, in Nicaragua they seem to stress the micro-management of special projects and programmes.

28 In the case of USAID it involved countervalue funds for food aid, which thus resulted in double tying.

3.5 Conclusions

reduction of the debt stock

1. Debt relief efforts made by the international community have so far led to only a slight actual reduction of the debt stock. This is because the volume of debt relief has generally not been large in relation to outstanding debt, and also because a large part of received debt relief only restructured debt and did not cancel it. With the exception of Nicaragua and Mozambique, the annual accretion of new debt in the countries investigated was greater than annual debt relief.

reduction of the flow of debt payments

2. Notwithstanding the large share of rescheduling and forgiveness of flows in the total debt relief, debt relief had little effect on the flow of actual payments (debt service). In this respect, it was thus not efficient. Reduction of a debt stock on which nothing had so far been repaid, and restructuring and forgiveness of a debt service that had so far not been paid, in fact often caused actual payments, after such a debt relief agreement, to increase. In none of the eight countries did actual debt payments decrease in the 1990s, partly due to a strong growth in new loans.

3. In general, debt relief in the 1990s for the eight countries was additional to regular aid. On the one hand, it came partly from creditors that were not donors (e.g. private banks and former socialist countries); on the other hand, debt relief from donors/creditors was probably financed partly at the expense of aid to *other*, less-indebted countries. The take-over of multilateral obligations by bilaterals was usually also non-additional for recipient countries because it often replaced other forms of programme aid. At the same time, this modality of debt relief is the only one that unambiguously frees resources for the debtor country because debt service to multilateral institutions was always paid.

4. During the 1980s, private creditors were bailed out by official lenders. This also occurred in the 1990s, but bilateral donors then also bailed out multilateral creditors on a large scale. Bilateral donors were in a sense substantially contributing in three different ways to the financing of the concessional loans from the multilaterals: firstly, by making the loans possible through subsidies and periodical 'replenishments';

second, by agreeing with the preferential status of the loans, thus reducing the value of their own claims; and finally, by giving extra aid to the debtors concerned, including debt relief on (or the take-over of) multilateral claims. This was not efficient. Such bilateral financing and bailout enabled multilateral creditors to continue to provide imprudent loans for longer than would have been feasible if they had been saddled with the consequences of their own lending policy. Protection against part of those consequences by bilateral donors created *moral hazard* on the part of the institutions concerned. Of the new loans that governments of the six HIPCs took up in the 1990s, roughly 80% were granted by multilateral institutions (only Nicaragua had rather less, with approximately 60%).

implementation of conditions

5. In general, the prior setting of policy conditions for economic reform proved effective if the government concerned was itself already convinced of the correctness of the policies, which makes such conditionality not really necessary. To hold out the prospect of debt relief makes little difference. Conditions regarding good governance were seldom implemented. In that respect, too, debt relief has not been very efficient.

6. By entering into new adjustment agreements notwithstanding the deficient implementation of policy conditions, multilateral institutions have, as it were, given the debtor countries concerned their seal of approval. This led to new programme aid being provided by bilateral donors with which old debts to multilaterals could be repaid. The IMF and, to a lesser degree, the World Bank were simultaneously 'gatekeepers' for concessional funds and, as creditors, also stakeholders in those funds. This undesirable conflict of interest has helped to maintain the cycle of new loans, aid and debt relief.

7. The three field studies in Mozambique, Nicaragua and Tanzania have shown that in these countries:
   a. the requirement that the PRSP be endorsed by the IMF and World Bank Boards of Directors detracts from the degree of ownership of the strategy and restricts the chances of popular participation in drawing-up the strategy;

b. the content of those PRSPs is subject to considerable doubt, particularly as regards their ability to increase production and employment as a basis for the *sustainable* (i.e. permanent) reduction of poverty;
c. there is little agreement among donors regarding the monitoring of PRSP implementation and the criteria that should be applied; this is not efficient and places great demands on the resources of the recipient country. In the meantime, a more comprehensive monitoring of PRSP implementation is hindered by the (still) inadequate systems of budget control and accountability.

4 Effectiveness of Debt Relief

4.1 Introduction

In this chapter the effectiveness of debt relief is analysed by comparing outputs with outcomes. A primary aspect of effectiveness is the increase of debt sustainability. It is therefore investigated whether the debt burden has been reduced, i.e. whether the countries have acquired greater liquidity and have become more solvent during the evaluation period. Debt sustainability can be improved by reducing the debt stock or the debt service, but also by economic growth or export growth (the denominators of the debt burden indicators). These indicators are analysed for Latin America and Africa in general, and also for the eight case study countries individually. The analysis attempts to establish to what extent eventual improvements are due to debt relief and also examines two other aspects of effectiveness, namely whether debt relief has had a stock or a flow effect on economic growth (and poverty reduction). A stock effect occurs if a debt stock reduction leads to improved creditworthiness thus enabling the attraction of new foreign capital, and if domestic investments increase. There is evidence of a flow effect if additional funds that result from debt relief lead to increased imports and have positive effects on the government budget. Ultimately, social indicators may thus be improved.

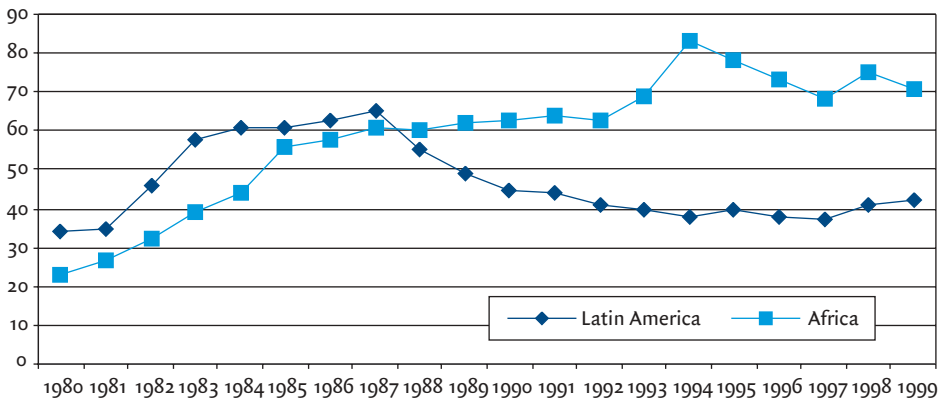
These three aspects of effectiveness are examined below for the regions of Latin America and Africa in general. Section 4.3 analyses whether debt burdens have become more sustainable in the eight countries, considering both solvency and liquidity. Section 4.4 examines possible stock effects, and section 4.5 the flow effects in the eight countries. The long-term sustainability of debts in the eight countries is discussed in 4.6, while the conclusions are given in the final section.

4.2 Effectiveness of debt relief in Latin America and Africa

Since 1988, the external debt burden has been sustainable for the average Latin American country (see Figure 4-1). The debt/GNP ratio reached its highest value in 1987 but then began to fall to about 45% in 1990; thereafter it remained fairly steady until the end of the decade. The implication is that most countries had again become solvent. Debt itself actually only fell between 1988 and 1990 and increased again thereafter. Debt reduction

was primarily due to amortisation paid by the countries themselves, but debt forgiveness also played a role in 1988-1990. The improved debt sustainability in the 1990s was chiefly due to increased GNP.

Figure 4-1 Debt/GNP ratio in Latin America and Africa, 1980-1999, in percentages

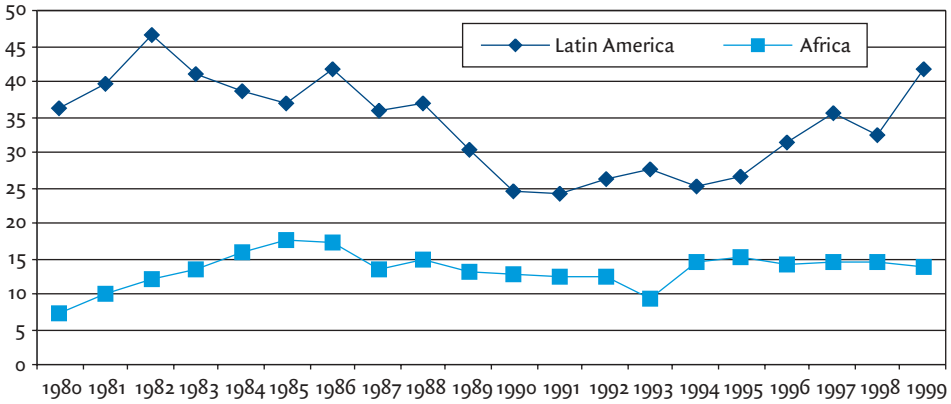


Source: World Bank, Global Development Finance 2001.

The debt service/export ratio in Latin America was above 35% between 1978 and 1988, falling to 24% in 1991 (Figure 4-2). In absolute terms debt service decreased between 1988 and 1991 (possibly due to the fall in nominal debt stock in the same period), but exports increased even more. In the second half of the 1990s, in particular, the debt service/export ratio again rose, as the result of two developments. Firstly, arrears fell rapidly after 1991, from roughly USD 50 billion in 1991 to about USD 10 billion in 1996; in the 1990s, as a result, Latin America paid almost all its debt obligations.[29] Secondly, Latin America regained access to private capital, which naturally also entailed an increase in payment obligations. Altogether, Latin American debt seems to be sustainable, but the liquidity position remains vulnerable. Export growth obviously lags behind general economic development, and the countries continue to depend heavily on the inflow of foreign capital.

29 These obligations included payments on claims that had been restructured during the 1980s.

Figure 4-2 Debt service/export ratio in Latin America and Africa, 1980-1999, in percentages



Source: World Bank, Global Development Finance 2001.

It is important here to consider the role that debt relief played in the increase of economic growth, i.e. in improving the debt's sustainability by increasing its denominator. Were there stock or flow effects? Literature on the Brady deals is fairly unanimous in concluding that these agreements improved the countries' creditworthiness and gave rise to a new inflow of private capital.[30] The nature of the inflow changed: in the first half of the 1990s, in particular, portfolio equity flows took the place of bank loans; later, however, net loans again increased. Foreign investments also grew during the 1990s.

In the countries where this has been investigated, there proved to be a positive effect on investment. A lower outstanding debt reduces volatility in debt repayments and thus the uncertainty regarding future payments. This proved more important than a reduction in the size of the debt service. Reduced uncertainty over possible balance-of-payments crises caused domestic interest rates to fall (Claessens *et al.* 1994). In Argentina too, the effect that debt relief had on interest rates and thereby on private investment, proved more significant than the direct flow effect of debt relief on public investment (Morisset 1991).

30 A 'push' factor also played a role in the new inflow, namely, lower interest rates in the USA.

In Latin America, flow effects of debt relief were barely visible. On the one hand arrears were considerable, so that restructuring and debt forgiveness only replaced accumulated arrears. On the other hand, the new inflow gave rise to higher debt service. In Latin America, therefore, the stock effects of debt relief, particularly on investment and creditworthiness, seem to have been more important than the flow effects.

In 1987, the debt/GNP ratio reached the 60% level in Africa, but even after that the debt burden continued to increase (Figure 4-1). On average, the African countries are still far from solvent. Debt itself continued to increase until 1995, as did the arrears which amounted to over USD 60 billion in 1995, 1996 and 1998 – higher than they have ever been in Latin America.

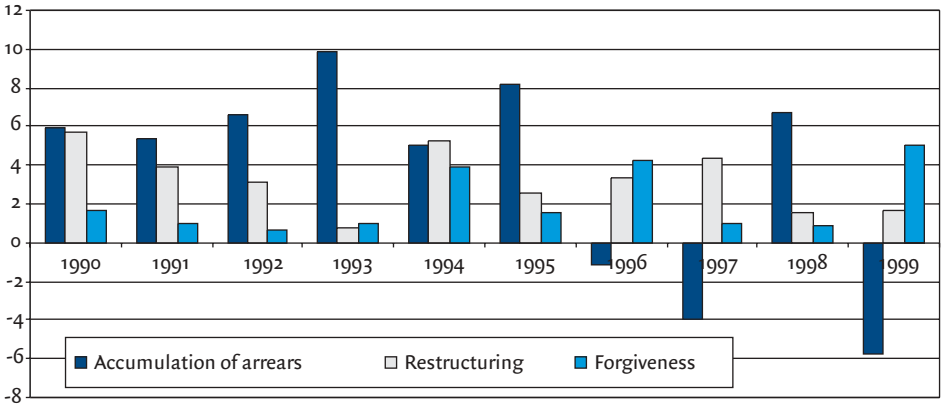
In Africa, debt service has never been very large, remaining in most years just under 15% of exports (Figure 4-2). In nominal terms it did increase slightly during the 1990s. Figure 4-3 shows that, up to and including 1995, the increase in arrears played a role in moderating actual debt service. In 1993, arrears increased by USD 10 billion! The restructuring of debt service was significant throughout the period, while debt forgiveness became more important in the second half of the 1990s.

With such massive arrears, debt relief can hardly have had a flow effect. Africa received enormous amounts in grants, however, so that the net flow of resources remained positive both in the 1980s and 1990s (Figure 3-2). As mentioned before, however, the larger portion of those grants was project-tied, and could thus not be used for the repayment of debts.

In view of the continuing high indebtedness and substantial arrears, stock effects in Africa are also unlikely. In practice, investment remains at the low level of around 16-17% of GDP, a few percentage points lower even than in the 1980s. Private capital flows towards Africa also remained negative in the 1990s. Since there are few effective stock exchanges in Africa and as many countries have not yet liberalised their capital accounts, possibilities for portfolio investment are limited. There is a great potential for returning flight capital, however. On average, Africans seem to keep a great deal of capital outside the region, namely, 40% of their total wealth.[31] Econometric estimates show that a reduction of the debt/GNP ratio could cause flight capital to return (Collier *et al.* 2001). Given

31 According to another study, the accumulated amount of flight capital over a 25-year period until 1996, for 30 African countries, averaged 180% of the annual GNP (Ndikumana & Boyce 2003:115).

Figure 4-3 Africa: Accumulation of arrears[1], restructuring and forgiveness of debt service[2] 1990-99, in USD billions



1 Net year-to-year accumulation, i.e. new arrears minus old arrears that have been paid or forgiven.
2 Only on debt service, i.e. excluding reductions in the debt stock.

Source: Calculated on the basis of World Bank: Global Development Finance 2002, CD-ROM.

the negative net private capital flow, this has apparently not yet taken place. The only capital flow towards Africa that is positive and which has also increased is that of foreign direct investment.

4.3 Debt sustainability in the eight countries

4.3.1 Solvency

Debt relief may have improved the solvency of a country if it led to a reduction of the debt stock or if it had indirect effects on the denominators of the solvency ratios, GNP and exports. In Section 3.2 above it was shown that debt stocks have hardly been reduced as a result of debt relief. Nevertheless, in most of the eight countries studied the debt/GNP ratio improved during the 1990s (Figure 4-4). Zambia is the exception, while Peru, Mozambique and Uganda showed only a slight fall. Nicaragua, Jamaica and Tanzania showed the greatest decrease. In Jamaica the debt/GNP ratio dropped to less than 60%, in Bolivia it fell to that level, and it was already less than 60% in Peru and Uganda. Nicaragua, Mozambique, Tanzania and Zambia, according to this indicator, are still far from being solvent.

The strong fall in Nicaragua was due particularly to the large reduction of outstanding debt (Table 3-1). Jamaica has received little debt relief, but has itself repaid many of its debts. Bolivia and Peru have also made considerable repayments, but on the other hand, they have taken on many new debts. The latter also applies to Uganda and Mozambique. In Zambia the increase in the debt/GNP ratio is due particularly to lagging economic growth. Nominal GNP in US dollars in 1999 was even 2% lower than in 1990.

Zambia is also the only country where the debt/export ratio rose during the 1990s (Figure 4-5): its exports fell substantially (by 30% between 1990 and 1999). Jamaica was already in the most favourable position as regards the debt/export ratio, and has further improved in the meantime. Its exports have risen considerably. Once again, Nicaragua shows the greatest improvement, influenced by both debt relief and export growth. In all countries except Jamaica (thus, surprisingly enough also in Peru) the debt/export ratio is still over 250%; in Mozambique debt is even tenfold the value of exports.

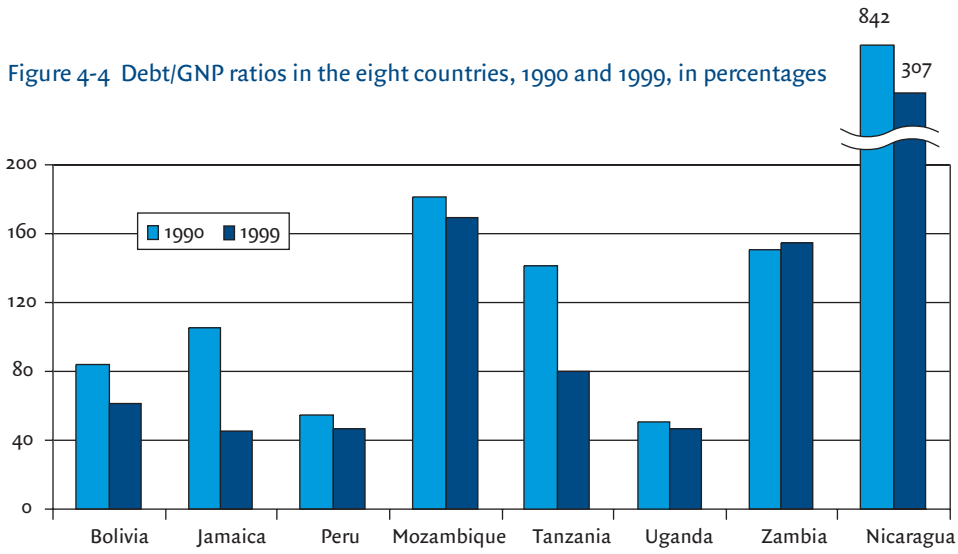
4.3.2 Liquidity

Liquidity indicators include the ratio between debt service and exports, that between interest payments and exports, and that between arrears and debt stock. Debt relief may have improved the liquidity position of debtor countries by reducing the flow of payments but also by reducing outstanding debt stock. Seeing that the latter was slight, and that only Bolivia and Jamaica experienced any flow reduction as a result of debt relief, much effect on the liquidity position is not to be expected.

In three countries the debt service/export ratio has risen, i.e. worsened: Nicaragua, Peru and Zambia. These are the countries that were in arrears with the multilateral organisations in 1990. An important cause of their rising debt service is therefore that in 1991, they started to repay all their obligations to the multilaterals. Peru and Zambia are in an unenviable position: the debt service/exports ratio is over 40% in both countries, while the interest payment/exports ratio is at or above the critical value of 15%.[32] In Peru this is due above all to new loans, including those to the private sector; in Zambia the critical liquidity situation is caused mostly by lagging exports. In 1999 Uganda and Bolivia had already benefited from HIPC 1, but their debt service was still high when compared to exports (22 and 29% respectively). In 1999, however, these two countries had almost no payment arrears. This was also the case in Mozambique, where debt service was just under 20% of

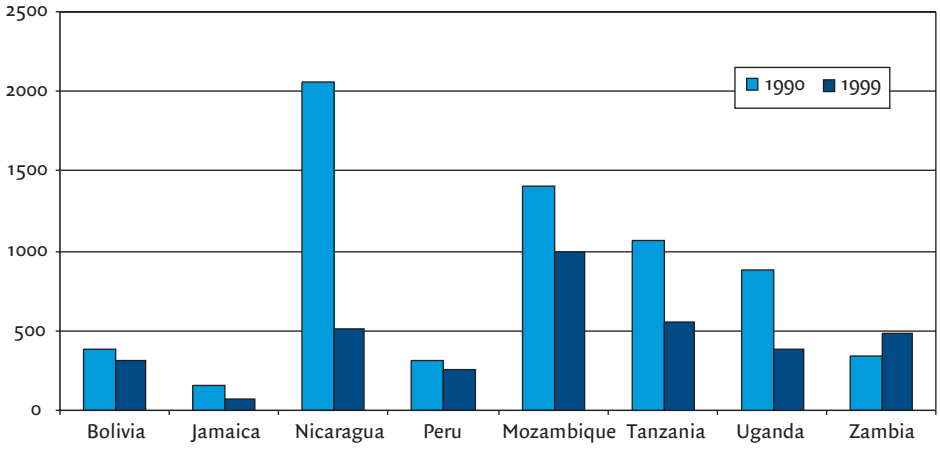
32 In Peru 18% and in Zambia 15%.

Figure 4-4 Debt/GNP ratios in the eight countries, 1990 and 1999, in percentages



Source: World Bank, Global Development Finance 2002.

Figure 4-5 Debt/export ratios in the eight countries, 1990 and 1999, in percentages



Source: World Bank, Global Development Finance 2002.

exports. Nicaragua and Tanzania pay only 16% of their exports on debt service, but they still have considerable arrears (see below).

4.4 Stock effect in the eight countries

The question now is whether the (slight) reduction of debt stocks as a result of debt relief has also reduced debt overhang in the eight countries, and thus had a positive effect on a new inflows of capital and on investments. As described in section 1.3, a reduction of debt overhang can be established by examining the stock of arrears with respect to total outstanding debt, and the ratio of debt service paid/debt service due. The first of these should fall, the other rise. If arrears are limited and if the country services the major part of its obligations, there may be stock effects on creditworthiness, i.e. the inflow of new private capital[33] and an increase of domestic investment.

An indicator of creditworthiness could be derived from scores awarded to countries by established credit rating agencies, such as Moody's and Standard & Poor. Most African countries and some in Latin America, however, are not listed by these institutions. Another agency, which evaluates many poor and middle-income countries, is Euromoney, whose credit ratings prove to be determined by four factors: the ratio between international reserves and imports, the balance on current account of the balance of payments, the growth of GDP, and inflation. Debt ratios do not seem to play a role in their assessments (Ul Haque *et al.* 1999). This indicator is thus of less significance for the present evaluation.

With regard to the inflow of capital, the net flows of new loans have been investigated, particularly those of private creditors, as well as net portfolio equity flows and foreign direct investment.[34] In addition, the analysis examined the question whether there is any relationship with debt relief. As regards the second aspect of the stock effect, i.e. the increase of domestic investment, the ratio between investment and GDP has been investigated.

33 The inflow of new *official* capital could, in principle, also be seen as an indicator of increased creditworthiness. The inflow of new multilateral loans, however, is only held up if there are arrears with multilateral institutions. Arrears with other creditors do not matter because the multilaterals are preferred creditors.

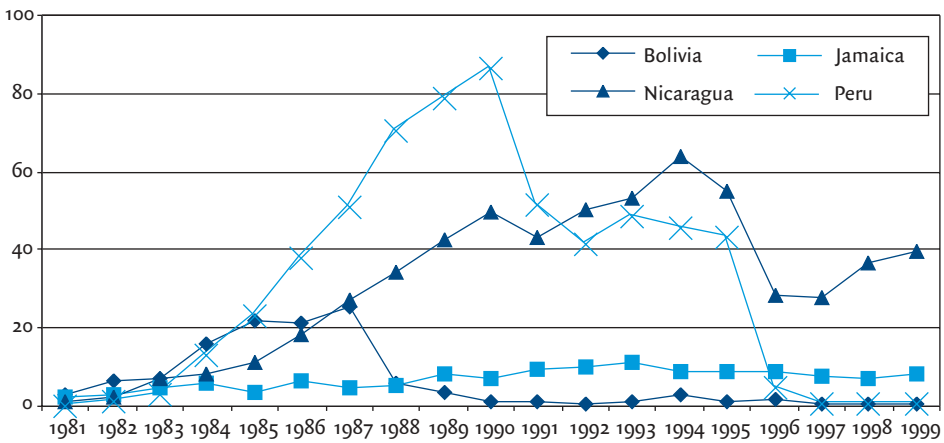
34 It may be expected that the net inflow of foreign direct investment will be less sensitive to the magnitude of foreign debt or to creditworthiness, because it does not involve loans that have to be repaid.

4.4.1 Reduction of the debt overhang

Bolivia had practically no arrears throughout the 1990s (Figure 4-6). In Jamaica and Uganda they represented only 10% of total debt and remained roughly at that level (a rise to 20% in 1992 for Uganda, but a fall thereafter). Peru, Nicaragua, Tanzania, Mozambique and Zambia show major arrears in 1990 (Figure 4-7).

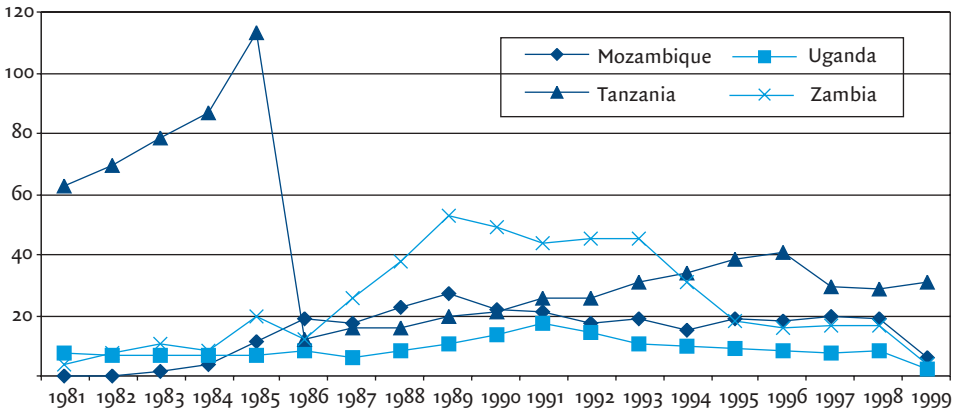
Peru reduced its arrears to zero in two stages during the 1990s: firstly, through a support group of bilateral donors who cleared arrears to multilateral institutions; secondly, through a self-financed Brady agreement. Zambia's and Nicaragua's arrears showed a fall, but they remained very high, especially Nicaragua's. Although that country received more debt forgiveness in comparison to others (see Table 3-1), this was apparently by no means sufficient to eliminate the debt overhang. Tanzania was not even given sufficient debt forgiveness to enable it to reduce its arrears, which rose during the 1990s.
In Mozambique arrears represented about 20% of total debt over the entire period.
Debt relief appears to have been particularly effective in getting rid of Peru's debt overhang. Arrears were reduced to some extent in Nicaragua and Zambia; other countries showed little effect, while in Tanzania the situation just worsened.

Figure 4-6 Arrears in percentages of long-term debt in Bolivia, Jamaica, Nicaragua and Peru, 1980-1999



Source: Calculated on the basis of World Bank, Global Development Finance 2002.

Figure 4-7 Arrears in percentages of long-term debt in Mozambique, Tanzania, Uganda and Zambia, 1980-1999



Source: Calculated on the basis of World Bank, Global Development Finance 2002.

Section 4.2 above concluded that the creditworthiness of the average Latin American country improved during the 1990s, as shown by Table 4-1. During the decade the ratio between debt service paid and due increased for Latin America, climbing to above 90% in 1997-99. In Africa the ratio even fell during the decade. In this respect, Bolivia and Peru were average Latin American countries, the ratio increasing to reach more than 90% at the end of the decade. Thanks also to debt relief received earlier, this enabled the two to become creditworthy. In Jamaica the ratio is rather lower, with about 70%. That the ratio is not higher here, is entirely due to still outstanding arrears, as the country received no debt relief or restructuring after 1995. Jamaica is therefore probably creditworthy.

In the other countries, the ratio of debt service paid to debt service due is much lower but fluctuates considerably from year to year. In 1999 it was over 70% for Uganda, due particularly to the reduction in arrears in that year. Debt service paid showed hardly any increase. In 1998 the ratio had been only 15%, principally due to substantial forgiveness of interest payments in that year. In 1995 paid debt service was exceptionally high in Zambia, partly reflected in a lowering of its arrears (Figure 4-7): this explains the 73% ratio in that year. In 1999 there was again evidence of increased debt service payment, combined with a reduction of arrears. Nicaragua, Mozambique and Tanzania mostly paid only about 10% of what they owed and there was no evidence of any rising trend during

Table 4-1 Debt service paid[1]/debt service due[2] in Latin America, Africa, and in the eight countries, 1989-1999, in percentages

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Latin-America	56	45	42	46	54	59	72	83	92	93	95
Africa	23	24	21	19	13	16	18	18	20	18	17
Bolivia	22	54	36	57	60	69	54	37	53	91	90
Jamaica	62	60	48	58	47	58	62	69	74	69	69
Nicaragua	0	0	9	2	3	3	4	7	16	10	7
Peru	4	4	8	11	24	11	11	36	79	82	97
Mozambique	7	5	6	6	10	9	8	8	6	6	12
Tanzania	13	11	11	11	9	8	8	10	6	11	9
Uganda	46	29	27	20	32	33	31	37	38	15	72
Zambia	8	6	20	12	13	16	73	19	20	17	45

1 Total debt service (TDS) paid on all debt.
2 Total of (1) debt service paid; (2) forgiveness of interest and principal obligations due; (3) restructuring of debt service, and (4) the arrears stock.

Source: Calculated on the basis of World Bank, Global Development Finance 2002.

the decade. A major part of debt obligations were restructured each year or were simply not paid. In all probability, therefore, these five countries are not creditworthy in the view of the private sector.

4.4.2 Creditworthiness

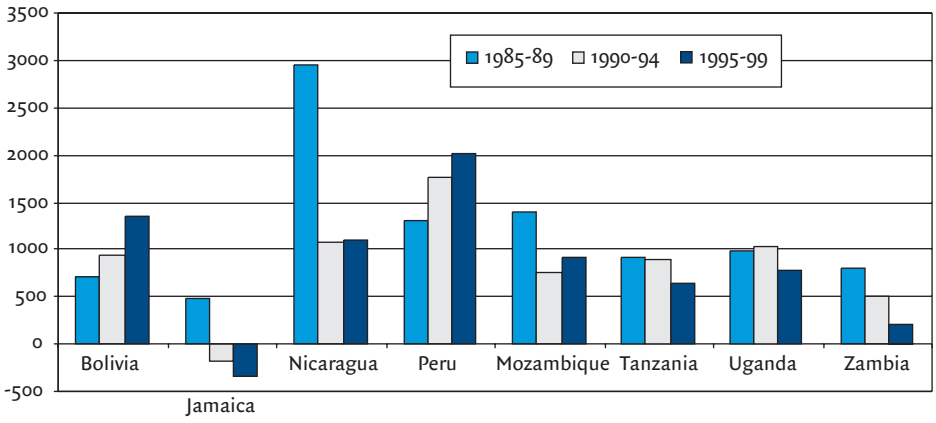
The primary indicator for the inflow of new foreign capital is the total of net loans. These have increased in Bolivia and Peru, and slightly in Mozambique if 1990-94 is compared with 1995-99 (see Figure 4-8). As shown in Chapter 3, however, the major part of new loans, especially to the government, came from multilateral institutions, (with the exception of Jamaica). In five of the eight countries, multilateral loans formed more than three-quarters of the total volume of (gross) new loans (disbursements) to the government (see Figure 3-6). As has been explained above (footnote 33), this says little about creditworthiness in general given that the multilaterals are preferred creditors. Net private loans to governments are negative everywhere, again with the exception of Jamaica, where total net loans have decreased primarily because of substantial amortisa-

tion on official loans. Since 1996, the earlier reschedulings of debt service had made considerable debt payments necessary.

It seems that most governments are creditworthy for multilateral institutions, but not for the private sector. In Tanzania, Uganda and Zambia, the net inflow of official capital has also decreased.

Bolivia and Peru show a large increase in loans to the private sector, thus confirming the creditworthiness of these countries. In Bolivia the flow increased from an average of USD -2 million in the first half of the 1990s to about USD 81 million in the second half. In Peru they rose from an annual average of USD 143 million to 535 million. In 1999 private debt represented a quarter of Peru's total long-term debt. The other countries showed only a slight increase (Jamaica, Nicaragua, Zambia, Mozambique, Uganda, in order of declining increase), or a small decrease (Tanzania).

Figure 4-8 Net flows on long-term debt1 to the eight countries, totals per period, in USD millions



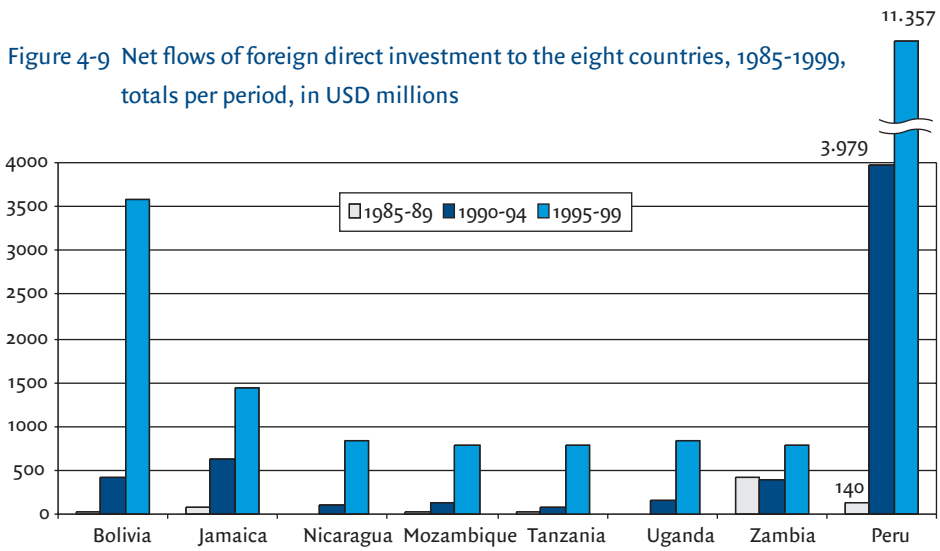
1 New long-term loans minus repayments (net flows on long-term debt).

Source: World Bank, Global Development Finance 2002

Another inflow that may indicate improved creditworthiness is that of portfolio investment (portfolio equity flows). Peru is the only country where this form of capital inflow occurs. Since 1993, when the capital account was liberalised, the net inflow has fluctuated between USD 0.3 and 2.7 billion per annum.

Foreign direct investment has increased in all eight countries (Figure 4-9). In 1985-1989 there was hardly any such inflow other than in Zambia. In 1990-94 inflows started to increase, and grew strongly during the second half of the decade, particularly in Bolivia where many foreign investments were linked to the privatisation process – or capitalisation as it was there known.[35] Other investors were attracted by the extraction of oil and gas. In the other seven the privatisation of state industries was also an important reason for increased foreign investment. As was more or less to be expected (see footnote 34) no country study has concluded that debt relief had any influence on this increase in foreign investment. Other factors were more important, e.g. macro-economic stability, liberalisation of the foreign exchange market, or higher economic growth. In Mozambique, however, where foreign investment increased spectacularly after 1999, agreements with the

Figure 4-9 Net flows of foreign direct investment to the eight countries, 1985-1999, totals per period, in USD millions



Source: World Bank, Global Development Finance 2002.

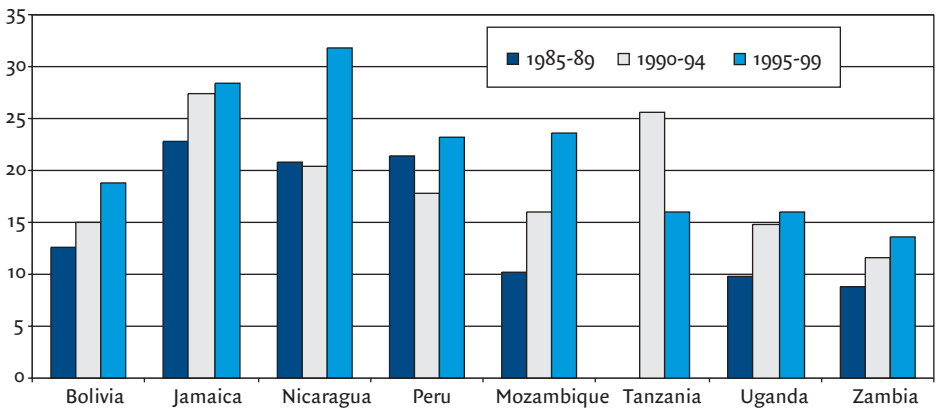
35 Foreign companies invested in former state industries that now belong to pension funds.

World Bank and IMF and compliance with those agreements were of influence. This was due particularly to the fact that a number of major foreign projects were financed partly (up to two-thirds) with official loans[36] or loans guaranteed by ECAs. Without those loans, and thus without the seal of approval from World Bank and IMF, those foreign investment projects would not have come about.

4.4.3 Investment

In all countries except Tanzania, investment as percentage of GDP increased in the 1990s (Figure 4-10). Again, however, the majority of country studies have concluded that debt relief was relatively unimportant. Only in Peru was the elimination of arrears to the multilaterals of significance. This removed Peru from the international black list and had a psychological effect on investors. From 1993 onwards, investments began to increase, mostly in the construction sector, so that they had positive short-term effects on growth and employment, but less effect in the long term. In the other countries, different factors were of more influence on the increase in investments, such as greater political and macro-economic stability, economic growth, and increased foreign aid which enabled the construction sector to develop. The latter was particularly significant for Nicaragua in

Figure 4-10 Investments[1] in percentages of GDP in the eight countries, 1985-1999[2], averages over three periods



1 Gross fixed capital formation.
2 No data available for Tanzania before 1990.

Source: World Bank, World Development Indicators CD-ROM 2001.

36 From, among others, the International Finance Corporation (IFC) of the World Bank Group.

1999, after hurricane Mitch had devastated the country in late 1998, but was also important in the other countries except Jamaica and Peru. In Mozambique debt relief did not influence investment, but the conscientious debt payments to the multilaterals and the Paris Club seemed to have a favourable effect as they enabled a flow of foreign aid from Paris Club members, which was considered essential for the stability and development of Mozambique.

In most countries, the level of investments is still not very high, with the exception of Jamaica and, more recently, Nicaragua. In Bolivia, Tanzania, Uganda and Zambia investments were very low.[37] The majority of country studies attribute these low investments to such factors as high domestic interest rates, lack of good physical infrastructure, e.g. roads, harbours or telecommunication systems, or to the high cost of utilities such as water, electricity and telecommunications. Moreover, some countries still suffer considerable political unrest, while serious corruption is also an obstacle to investment.
High levels of debt or debt overhang seem to play little if any role for private investors.

4.4.4 Summary of the stock effect

Table 4-2 combines the quantitative results of the various indicators of creditworthiness with the more qualitative analysis of the influence of debt relief (partly on the basis of the eight country studies). In Peru debt relief had a clear stock effect, running via an effect on the inflow of loans, of loans to the private sector, portfolio equity flows, and increased domestic investment. Bolivia and Jamaica also show a slight stock effect, but only through the inflow of loans in general (Bolivia) or an inflow of loans to the private sector (Jamaica). In the other countries debt relief had no stock effect. This seems clearly to be due to the continuing debt overhang in those countries, both in the form of considerable arrears on outstanding debt, and of a low ratio between debt service paid and debt service due (see 4.4.1).

4.5 Flow effect in the eight countries

Debt relief is similar to aid insofar as it leads to an increased flow of funds. Such an increase can have positive effects on the balance of payments through increased imports,

37 These figures, like so many others, must be approached with caution. In Nicaragua the under-valuing of GDP probably played a role in the large rise, while in Tanzania the changed system of national accounting can probably explain part of the reduction. Although investments were high in Jamaica, the growth of GDP was very low. One explanation given for this 'growth paradox' is that GDP is under-estimated and that figures for investments/GDP are therefore too high.

Table 4-2 Summary of ultimate stock effects in the eight countries[1]

	Net total inflow of loans		Loans to private sector		Foreign Direct Investment		Portfolio flows		Investment	
	Result	DR	Result	DR	Result	DR	Result	DR	Result	DR
Bolivia	+	no	++	yes	++	no	n.a.		+	no
yesmaica	-		+[2]	yes	+	no	n.a.		+	no
Nicaragua	o		o		+	no	n.a.		+	no
Peru	+	yes	++	yes	+	no	+	yes	+	yes
Mozambique	+	no	o		+	no	n.a.		+	no
Tanzania	-		o		+	no	n.a.		-	
Uganda	-		o		+	no	n.a.		+	no
Zambia	-		o		+	no	n.a.		+	no

1 The Results column shows whether the variable has increased (+) or decreased (-), has remained unchanged (o) or is not applicable (n.a.) because the inflow does not exist. The column DR shows whether or not debt relief has contributed to a positive result.
2 In Jamaica this concerns particularly *private loans to the government*, but loans to the private sector also increased somewhat.

Source: Text and country studies

and on the government budget. As regards the latter, two positive effects are conceivable, namely, a reduction of the deficit and an increase of expenditure. These immediate effects on the balance of payments and on the government budget are called here the intermediary flow effects and will be discussed in 4.5.1 below.

Greater public expenditure may give rise to two positive effects, i.e. increased public investment, and increased social expenditure. The former can encourage private investment through 'crowding in', while increased social expenditure may lead to improvement of the social indicators. Public expenditure and its composition may be influenced by a possible flow effect of debt relief and, in addition, by policy conditions attached to that relief. The possible effects on public investment are discussed in 4.5.2 below, and those on social expenditure in 4.5.3.

4.5.1 Intermediary flow effects on the balance of payments and on the government budget

Insofar as there is an effect on the release of funds for the *balance of payments*, there is no difference between debt relief and (other) foreign aid. Aid to Peru was minimal, and Jamaica received only limited quantities of aid during the first half of the 1990s. In the six low-income countries, aid had a greater effect than debt relief on the balance of payments, simply because the aid flow was far greater than the part of debt relief that freed resources. In Nicaragua, for example, such debt relief represented only 7% of total aid in the 1990s. In these countries, aid thus led to more extra imports than did debt relief.[38] In Tanzania, actual debt service during the 1990s was only 19% of foreign aid received in the same period. This shows that debt payments and debt relief were of relatively little importance for these countries as compared to aid.

Debt relief and aid can also release funds for the government budget, but only non-project-tied aid, i.e. programme aid or macro-economic support, is comparable in this respect with debt relief. The larger portion of aid, however, was in the form of project aid. For example, in 1998 Africa as a whole received USD 12 billion in foreign aid, but only USD 3 billion was in the form of programme aid. This contrasted with USD 9 billion paid in debt service (Birdsall *et al.* 2001). Thus, while highly-indebted countries were given more aid (frequently also those with ineffective policies), that aid was only partially appropriate for debt payments. From the point of view of government budgets, therefore, the net flow was negative. The incoming flow of aid ensured that public *investment* could often be guaranteed, but outgoing debt payments supplanted *current expenditure*. Another problem was that both aid and debt payments fluctuated strongly and thus complicated the management of public finances (Sachs *et al.* 1999).

Chapter 3 concluded that only in Bolivia and Jamaica did debt relief help to reduce the outflow of debt payments and also stabilised debt service. In five countries it had only a slight effect on debt service, and a zero effect in Peru. In Jamaica and Bolivia, in particular, debt relief may have had positive effects on the government budget. In the years that it received debt relief, Jamaica's public deficit of 6% of GDP in 1990 was gradually converted into a surplus of 4% in 1994, while public expenditure as percentage of GDP

38 Aid and debt relief naturally only lead to equal amounts of extra imports as long as all other flows on the balance of payments remain constant, e.g. exports, the net inflow of capital, direct investment, etc.

remained constant. Bolivia also reduced its public deficit in the first half of the decade, while expenditure gradually rose throughout the 1990s, as did current expenditure.

In Nicaragua and the four African countries, debt relief had little influence on the outflow of debt payments, but public deficits did decrease at the start of the 1990s. At the same time, public expenditure as % of GDP fell in many years, for example, in reaction to a temporary reduction in programme aid (e.g. due to donors' dissatisfaction with the quality of governance), or due to increased debt payments.

In the six low-income countries investigated, *public investment* was mostly financed with foreign aid. Current *expenditure* for those investments (salaries, school books, maintenance) was paid by the country. While project aid was largely independent of donor opinions about 'good governance' and was thus more continuous, current expenditure suffered from setbacks in programme aid or from extra debt payments. In pracyice, current expenditure decreased in all six countries except Bolivia during the 1990s, thus making apparent the negative effects of the combination of considerable project aid, little debt relief and little freely-disposable aid.

4.5.2 Public investment

As noted above, the volume of public investment in the six low-income countries depended above all on the amount of project aid received rather than on debt relief. In Jamaica, debt relief seems to have had no influence on public investment either: while total expenditure as percentage of GDP remained steady between 1990 and 1994, the share of capital expenditure fluctuated slightly but without showing any clear trend. If debt relief has no effect on public investment, there can also be no flow effect on private investment through 'crowding in'.

4.5.3 Social expenditure

This section investigates the possible flow effect of debt relief, aid, and policy conditions for debt relief on public expenditure in the social sectors, while possible consequences for the improvement of social indicators are also examined.

A first outcome is that during the 1990s many countries experienced a shift in the government's investment portfolio towards greater expenditure on the social sectors, e.g. for education and health care. This was due to three factors which to varying degrees played a role in the eight countries:

1. An autonomous trend: the privatisation of state industries, as a result of which government invested less in production capacity and thus had more funds available for social investment (particularly Bolivia and Peru);
2. Donor priorities: Donors gradually directed their attention more towards social projects and away from infrastructure or production; almost all countries have a Social Investment Fund that invests in social infrastructure and which receives many foreign loans; project aid and, in Peru, the new loans are almost always tied to increasing capital expenditure, i.e. investments;
3. Donor conditionality: In countries with a Multilateral Debt Fund and later with a collective fund for budgetary support, participating donors usually require that released funds be used to build-up the social infrastructure. Exceptions in this respect include Tanzania, where the MDF aims at protecting current expenditure in social sectors (see 3.4.4 above), and Uganda where the MDF and its follow-up the Poverty Action Fund (PAF) aim at increasing expenditure on the social sectors in general.

In five of the six HIPC countries (Bolivia is the exception), however, *current* expenditure on the social sectors decreased in the 1990s. In some countries even *total* public expenditure on the social sectors as percentage of GDP decreased during that decade. This applied, for example, to expenditure on health care in Mozambique, Uganda and Tanzania, and on education in Mozambique, Tanzania and Zambia (World Bank 2002b).[39] In Zambia this was caused particularly by falling total public expenditure: in percentages of the latter, spending on the social sectors increased – in agreement with the requirements of Zambia's donors. Project aid and policy conditionality thus influenced greater investment in the social sectors, but the shortage of freely expendable aid together with high debt payments (too little debt relief) meant that current expenditure on the social sectors could not grow at the same rate or even decreased.

Social indicators

The question now is whether and in how far these sometimes increasing investments and decreasing current expenditure have influenced social indicators. With respect to a couple of crucial health indicators, for example, infant mortality has fallen in all countries except Zambia. Life expectancy rose in all countries except those plagued by HIV-Aids:

39 This does not imply automatically that real spending has also fallen. Conversely, actual expenditure on social sectors can decrease even if expenditure rises as percentage of GDP. This is because wages and salaries represent the greater part of expenditure on the social sectors. If nominal wage costs rise more (less) than nominal GDP, actual expenditure on social sectors will increase less (more) than if calculated as percentage of GDP. This can cause considerable variations (see Botchwey *et al.* 1998).

Tanzania, Uganda and Zambia (Table 4-3). Infant mortality reacts more quickly than life expectancy to changes in access to, and the quality of, health care provisions, while the latter is partly the result of long-term developments. However, the reduction of infant mortality is not always due to improved health care. In Bolivia, and probably also in other countries, increased access to clean water is a vital factor. The Social Investment Fund, active in Bolivia since 1986, has invested a great deal in the water sector. Improved hygiene and counselling through educational services can also have had a favourable influence on decreasing infant mortality.

Table 4-3 Some health indicators for the eight countries, 1990 and 1997

	Infant mortality (per 1000)		Life expectancy	
	1990	1997	1990	1997
Bolivia	80	62	58	61
Jamaica	25	22	73	75
Nicaragua	51	37	64	68
Peru	54	36	66	69
Mozambique	150	135	43	45
Tanzania	115	99	50	48
Uganda	104	99	47	42
Zambia	107	113	49	43

Source: World Bank, World Development Indicators CD-ROM 2002.

The fall in infant mortality is particularly noticeable in Bolivia, Nicaragua and Peru. In Jamaica it had occurred much earlier. The rate is still very high in the four African countries, showing hardly any improvement. This may be due to decreasing (total) public expenditure on health care in three of the four. In 1989 Zambia introduced user fees for basic health care and basic education, which possibly had a negative effect on access to these services.

The reduction of current expenditure on education is reflected in a worsening of the pupil/teacher ratio in six of the eight countries (Table 4-4), signifying that the quality of education probably deteriorated. The greatest rise in the pupil/teacher ratio is to be seen in Uganda where, in 1997, the President proclaimed universal access to basic education

(apparently without the facilities being available); in Mozambique, Tanzania, Nicaragua, Bolivia and Zambia there is also evidence of deterioration in this indicator.

Table 4-4 Some education indicators for the eight countries, 1990 and 1998 (or 1999)

	Pupil/teacher ratio, primary school		Primary school enrolment (%)		Secondary school enrolment (%)		Illiteracy (%)	
	1990	1998[1]	1990	1998[1]	1990	1998[2]	1990	1999
Bolivia	25	26	95	106	37	40	22	15
Jamaica	37	31	101	98	65	90	18	14
Nicaragua	33	36	94	102	40	50	37	34
Peru	29	25	118	126	67	81	14	11
Mozambique	55	61	67	71	8	9	67	57
Tanzania	35	38	70	65	5	7	37	26
Uganda	29	60	71	154	13	16	44	34
Zambia	44	45	99	86	24	27	32	23

1 *For Bolivia and Nicaragua 1997.*
2 For Bolivia 1996; for Nicaragua and Tanzania 1997.

Source: World Bank, World Development Indicators CD-ROM 2002.

Primary school enrolment rates increased in six of the eight countries, and most in Uganda. New school buildings erected by the Social Investment Funds probably had an effect (though apparently not in Zambia), as did the new policy in Uganda. In Tanzania and Zambia, however, primary school enrolment actually fell. Together with Mozambique, these are the countries where actual government education budgets fell in the 1990s. In Tanzania it was not until 2000 that registration fees for basic education were abolished, influenced by extra funds made available under MDF/PRBS, and in 2001 also the tuition fees. Previously, the government had had no funds available for this purpose. Primary school enrolment will now possibly increase.

Secondary school enrolment rates increased in all countries, and illiteracy fell (Table 4-4), probably due to long-term trends rather than in response to policy in the 1990s. In the African countries, however, particularly in Tanzania and Mozambique, secondary school enrolment is still very low.

4.6 Long-term debt sustainability

4.6.1 Sustainability in relation to balance of payments and national income

According to Gillis *et al.* (1996:414) an external debt can be sustainable for the balance of payments in the long term, even in combination with a trade deficit, if the growth rate of exports is higher than the average interest to be paid on the debt. In the long term, the debt then tends towards:

$$\frac{D}{X} = \frac{a}{(g_X - i)} \qquad (1)$$

Where D = Debt, X = Exports, a = trade deficit as % of Exports, i.e. (M-X)/X, M = imports, g_X = growth rate of Exports, and i = average interest rate on debt.

A trade deficit in principle causes external debt to increase annually because it has to be financed with loans. Since many debtor countries are in a position to finance part of their trade deficit with ODA grants, this study investigates the 'adjusted trade deficit', calculated as follows: (M-X-Grants)/X. The expected value of the debt/export ratio (D/X) which comes about if all variables remain constant for a long time, can be calculated and compared to the critical value for a sustainable debt. According to the enhanced HIPC initiative, this critical value is currently 150%.[40] If the export growth is less than the interest rate on foreign debt, a trade *surplus* is needed to make the debt sustainable: {(M-X-Grants) < 0}.

Table 4-5 shows that in all eight countries except Zambia export growth[41] was higher than the average interest on new loans: column 3 shows a positive figure, which is largest for Nicaragua, Mozambique, Uganda and Tanzania. The adjusted trade deficit is positive in all countries, i.e. imports exceed exports plus grants, giving rise to a deficit (column 4). Although with the exception of Zambia, all countries can afford a trade deficit, in Nicaragua, Uganda and Tanzania that deficit is far too large to allow debt to be sustainable in the longer run (column 5). As a result, even if the debt were brought down to a sustainable level, e.g. through the HIPC initiative, it will in time inevitably again become

40 The threshold value of 150% is based on the NPV of the debt (see Annex 5). For countries with many concessional loans, a critical value of 150% for the NPV Debt/Exports would equal approximately 250% in nominal terms.
41 The export figures (GDF) used in columns 2, 3 and 4 include income transfers from abroad (remittances). This seems justified given that such remittances finance part of the deficit.

Table 4-5 Long-term sustainability of the debt/export ratio, in percentages

	Interest[1]	g_x [2]	g_x-i	Adjusted trade deficit[3]	Debt/export[4]
	(1)	(2)	(3)	(4)	(4/3)
Bolivia	3.3	5.6	2.4	28.5	1214
Jamaica	6.9	7.4	0.5	4.2	850
Nicaragua	3.5	12.9	9.4	88.0	936
Peru	6.0	7.0	1.1	38.5	3630
Mozambique	1.2	8.9	7.8	29.4	378
Tanzania	1.3	8.6	7.2	61.5	852
Uganda	1.1	9.8	8.7	84.3	971
Zambia	2.0	-3.9	-5.9	15.9	

1 Average over 1990-1999 of the average interest on new foreign loans, in percentages. Source: GDF 2002.
2 Average annual growth rate of exports of goods and services, 1990-1999, in percentages. Source: GDF 2002.
3 Average 1990-1999 of (imports less exports less grants)/exports, in percentages. Source: GDF 2002; on grants: WDI 2002
4 Calculated 'long-term' debt/export ratio in percentages, i.e. the D/X ratio that exists if all variables remain the same. Any deviations in dividing column (4) by column (3) are due to calculations with unrounded figures in columns (3) and (4); the results are multiplied by 100 in order to express the quotient in percentages. If columns 3 or 4 show a negative figure, the D/X ratio cannot meaningfully be calculated

unsustainable if the trade deficit does not fall.[42] At present the adjusted trade deficits can be as large as they are, because these countries receive many loans. For the HIPCs, those are chiefly loans from multilateral institutions.[43] For future sustainability it is important that a larger part of the trade deficit should be financed with grants and/or that the volume of external loans to these countries should decrease.

In Bolivia, Peru and Jamaica the margin between export growth and interest is very small. According to this analysis, long-term unsustainability is greatest in Peru which is not entitled to debt relief under the HIPC initiative. In practice, part of Peru's trade deficit (and also of Bolivia's) is financed with foreign direct investment over which interest need not be paid. Nevertheless, the trade deficits in Peru and Bolivia also appear to be too

42 ... or if the margin between export growth and interest rate does not become greater. The chance of this happening seems small, however, seeing that export growth in these countries was considerable during the 1990s; it is more likely that the margin will decrease, thus making it even more essential that the trade deficit should also decrease.
43 In the short term the trade deficit rises by definition as a result of loans from, for example, the World Bank. In the medium term, such loans could cause exports to increase. More recently, however, many loans have been intended for the social sectors, and have thus had at most a delayed and indirect effect on exports.

large. Zambia should really have a trade surplus if its debt is to be sustainable. Because it does not, it is impossible to calculate the long-term debt/export ratio.

The long-term sustainability of the debt/GDP ratio can be similarly examined. A debt can be sustainable for the economy in the long run, even in combination with a savings deficit, if the growth rate of GDP is higher than the average interest due. The debt then tends towards:

$$\frac{D}{Y} = \frac{(v - s) / Y}{g_Y - i} \qquad (2)$$

Where Y = GDP, v = I/Y, the investment ratio, s = S/Y, the savings ratio and g_y = growth rate of GDP.

The savings deficit (v - s, or (I - S)/Y) causes external debt to increase each year, assuming that it is financed by loans. Part of it, however, is financed with foreign grants. Therefore the savings deficit may be adjusted to read as follows: (I-S-Grants)/ Y. The value of the long-term debt/GDP ratio can then be calculated and compared with the critical value, usually set at 60%.[44]

In four of the eight countries the average growth of GDP in the 1990s was lower than the interest on new loans (Table 4-6). These countries should really have an adjusted savings *surplus*, but that is only the case in Zambia. In Mozambique the growth rate of GDP is far higher than the average interest, but that country has an adjusted savings surplus although it could afford a deficit. Mozambique's debt is thus sustainable in the long run if present trends in interest, investments, savings, aid and economic growth continue. It would in fact be better for long-term prospects if the country should invest more, i.e. would have a savings deficit.

The three countries where growth is higher than the interest rate all have too high a savings deficit for a sustainable debt; yet Uganda is close to the critical value. Growth has been too low in Bolivia, and in Tanzania the savings deficit is too large. Nicaragua, which should actually have a savings surplus, has the greatest savings deficit of all eight countries - a situation which clearly does not lead to a sustainable debt situation.

44 This 60% is probably too high for low and middle-income countries in view of the fact that they are financially far more vulnerable than developed countries. See Houben 2002.

Table 4-6 Long-term sustainability of the debt/GDP ratio, in percentages

	Interest[1]	g(GDP)[2]	g(GDP)-i	Adjusted savings deficit[3]	Debt/GDP[4]
	(1)	(2)	(3)	(4)	(4/3)
Bolivia	3.3	4.0	0.7	2.4	325
Jamaica	6.9	1.4	-5.4	5.2	
Nicaragua	3.5	2.8	-0.6	13.3	
Peru	6.0	3.1	-2.9	2.2	
Mozambique	1.2	5.5	4.3	-1.7	
Tanzania	1.3	3.1	1.8	8.1	455
Uganda	1.1	6.8	5.7	4.1	73
Zambia	2.0	0.2	-1.7	-6.7	

1 See Note 1, Table 4.5.
2 Average annual growth rate of GDP over 1990-1999 (based on figures in constant USD), in percentages. Source: World Development Indicators 2002.
3 Average over 1990-1999 of (fixed investments minus gross domestic savings minus grants)/GDP, all in nominal USD, in percentages. Source: Ibidem.
4 Calculated long-term debt/GDP ratio, in percentages. See also Note 4, Table 4.5.

The prospects for long-term debt sustainability are thus not favourable. All eight countries have too large a deficit on the trade balance, while in half of them economic growth has not been high enough to justify continual savings deficits. In that respect, only Mozambique, Tanzania, Uganda and Bolivia are on the right side of the divide; savings deficits in the latter two, however, are at present too high.

This signifies that, even if the eight countries should now have a sustainable debt, the burden will rapidly become unsustainable again if trade deficits remain as large as they are at present. Those sizeable deficits could rapidly lead to new unpayable debt. If all other factors remain equal, however, trade deficits (aid-adjusted) can only come about if sufficient loans are offered.

For the six HIPCs in particular, trade deficits could become smaller if the international community, i.e. the multilateral institutions, should restrict its lending. Chapter 3 pointed out that there is evidence of moral hazard among international financial institutions as they do not bear the cost if debtor countries are unable to repay their loans. The analy-

sis here shows that this moral hazard apparently has induced the IFIs to continue to lend, even when that was ill-advised from the viewpoint of long-term debt sustainability.[45]

It should be emphasised that this concerns not only the World Bank and IMF, but also the regional development banks, particularly the Inter-American Development Bank (IDB) which is active in Latin America. The IDB receives major contributions to the Special Operations Fund from bilateral donors, enabling it to provide concessional loans to the poorest developing countries in Latin America (so-called IDA-only countries), of which there are only four: Bolivia, Haiti, Honduras and Nicaragua. As a result, IDB has had to extend many loans to countries such as Bolivia and Nicaragua – loans that cannot be repaid without new aid from bilateral donors. In both these countries the new annual inflow from IDB is greater than that from the World Bank. In Nicaragua it amounts to roughly USD 100-140 million per annum, about one-fifth of annual exports. When asked about the chances that Nicaragua would ever repay those loans in view of the unstable growth of national income and exports, the IDB representative there replied: 'There should be growth.'

4.6.2 Sustainability in relation to the government

Similarly, the sustainability of public debt can be analysed by comparing the interest rate with the growth of tax revenue, and by examining whether the size of a country's budget deficit ensures that debt is sustainable in the long term. International data banks, however, do not include data on tax collection and government expenditure for all countries. In Bolivia, Nicaragua and Peru, the average annual growth of public revenue[46] was clearly more than the average interest due (tax revenues grew at 8.6%, 10.1% and 14.7% respectively), but in Jamaica it was a little less (6.6%). On the basis of IMF data presented in the country studies, public revenue in Tanzania increased by an average of 6.1% per year between 1991/92 and 1998/99; in Uganda government income increased by 9% between 1990 and 1999. These two countries are thus able to maintain public deficits. In Zambia total government income fell by 3.4% per annum during the 1990s.

A complicating factor in analysing debt sustainability for the government is that as a rule, governments do not only have foreign debts, but also domestic debts. In investigating

45 According to a recent study, there is also a strong relationship between new loans to African countries and private capital flight *from* those countries: it is estimated that, for every dollar received in loans, 80 cents leave the country again in the form of private capital (Ndikumana & Boyce 2003).
46 Calculated on the basis of nominal dollar figures from the WDI data base.

sustainability of the public debt, the magnitude of the domestic debt needs to be known and also its average interest rate, thus enabling a total average interest rate to be calculated. The country studies show that the domestic debt burden is increasing almost everywhere, mainly for the following reasons:

1. Governments began financing their deficits by issuing bonds, a possibility which had previously not existed. This had started early in Jamaica and Peru, occurred since the end of the 1980s in Tanzania, and since the 1990s in Bolivia and Nicaragua.
2. Many governments have had to take over domestic banks for whom bankruptcy threatened, usually again issuing bonds for the purpose. This was the major reason for the enormous increase in Jamaica's domestic debt around 1995. In the 1990s Zambia also had to take over a bankrupt bank, while Nicaragua took over four in 2000 and 2001. In the period 1999-2001 the governments of Uganda and Mozambique were also forced to save loss-making banks. In all countries, problems with domestic banks seem to have resulted from premature liberalisation and privatisation of the financial sector, i.e. before adequate systems of regulation and supervision had been designed and put into operation. The high domestic debts in all these countries were thus due at least partly to policy conditions laid down by multilateral institutions.
3. In Nicaragua the largest component of domestic debt was formed by special bonds that were issued to compensate the former owners of nationalised industries if those industries could not be returned to them.
4. In Bolivia and Peru, bonds were issued on a small scale in order to buy-out foreign creditors: foreign debt was thus transformed into domestic debt.

Jamaica's domestic debt increased from 30% of GDP in 1990 to 91% in 1999 when it even exceeded external debt. Jamaica's public sector debt was thus not sustainable, even if only its domestic part is considered. In Tanzania during the 1990s interest payments on domestic debt about equalled those on foreign debt. In such countries as Nicaragua, Mozambique, Uganda and Zambia payments on domestic debt increase rapidly, an important factor being that interest on domestic debt in these HIPCs was far higher than the average interest rate on foreign debt. External debts mostly have a low, concessional, interest, while domestic (market-based) interest rates are often high.

According to the rules of the HIPC initiative, Central Banks in HIPCs may not convert domestic debts into non-concessional foreign debts, although this could be more

favourable in view of the high domestic interest rates. This is all the more paradoxical in that a large part of 'domestic debt' is probably in foreign hands. Domestic banks (the most important bond-holders), for example, frequently belong to foreign conglomerates, or to people who have safely moved a large part of their capital abroad. In Nicaragua the holders of ownership compensations are often ex-Nicaraguans who have long enjoyed American nationality.

The rapid increase in domestic debt has various negative consequences:

1. High costs for government budgets. Just as foreign debt seems to be becoming sustainable through the HIPC initiative, many HIPCs have to spend increasing amounts on the payment of domestic creditors. This puts in doubt that the HIPC initiative actually releases funds for social expenditure and poverty reduction.

2. Public demand on the domestic capital market causes local interest rates to escalate and consequently reduces investment. This occurs both directly, with high interest rates putting off investors, and indirectly, because privatised domestic banks prefer to buy publicly-guaranteed debt titles to investing in riskier (private) production activities.

4.7 Conclusions

1. In Latin America the stock effect of debt relief proved more important than the flow effect in restoring positive economic growth in the 1990s. In Africa there was no stock effect during that decade, and hardly any flow effect.

debt sustainability in the eight countries

2. Although debt relief has led to only a slight reduction in outstanding debt, in seven of the eight countries examined debt did become more *sustainable* during the 1990s. Zambia formed the only exception. In all eight, however, the debt/GNP ratio is still above 40%, and it is even far higher in Nicaragua, Mozambique and Zambia. The debt/export ratio in all eight countries except Jamaica is above 150%; and in the six low-income countries it is far more.

3. As regards liquidity, all countries except Jamaica are in an unfavourable position. As a percentage of exports, debt service has increased in Nicaragua, Peru and Zambia. In the latter two the ratio is above 40%. Bolivia, too, spends a great deal of

its export income on debt repayments: 29% in 1999. Debt service amounted to about 20% in Mozambique and Uganda, and 16% in Tanzania and Nicaragua. The latter two countries, in particular, still have sizeable arrears, so their liquidity is very weak.

stock effects

4. In Bolivia and Peru debt relief has helped to eliminate the debt overhang. At the end of the 1990s these countries were free of arrears and able to meet all their obligations. Jamaica also pays most of its debt obligations, but it had hardly any debt overhang at the start of the evaluation period. Nicaragua, Mozambique and Tanzania pay only about 10% of the amounts they owe, and Uganda and Zambia slightly more. In these five countries, debt relief has not been able to eliminate debt overhang.

5. In Peru, Bolivia and Jamaica debt relief has influenced the increase of investment and/or the inflow of new capital for the public and/or the private sectors. In the other five countries debt relief had no stock effect on creditworthiness or investment. Although foreign investments increased in all eight countries and, with the exception of Tanzania, also domestic investment as percentage of GDP, this was not due to debt relief.

flow effect

6. In two countries (Bolivia and Jamaica) positive flow effects on the government budget occurred due to resources released by debt relief. Public investment in the low-income countries, however, depended mainly on the quantity of project aid, and not on debt relief. Policy conditions and considerable project aid have frequently enlarged the volume of *investment in the social sectors*. In five of the six HIPCs, however (Bolivia is the exception), *current expenditure* on the social sectors lagged behind, particularly because programme aid and debt relief together were not sufficient to finance the payment of debt obligations. Increasing social investments seem to have had an influence on enrolment in basic education (but not in Tanzania and Zambia). On the other hand, the decreasing availability of funds for current expenditure probably means that the quality of education has suffered.

long-term sustainability

7. Prospects for long-term debt sustainability are not favourable. Even if debts should become sustainable in relation to exports in the short term, thanks to the HIPC initiative, this situation will soon be reversed if trade deficits remain at their present high level. The moral hazard for multilateral institutions has given rise to too great a volume of loans. To ensure a sustainable debt level in the future, it is necessary that a larger portion of the trade deficits be financed from grants and/or that the volume of loans to these countries should decrease, particularly those from the multilateral institutions.

8. With respect to the sustainability of the debt for the *government*, an additional fact is that all countries are faced with a rapidly increasing domestic debt on which far higher interest must be paid. In the six HIPCs this can practically nullify any positive flow and stock effects of the HIPC initiative.

5 Relevance of Debt Relief

5.1 Introduction

This chapter examines the degree to which debt relief was relevant; in other words, whether it has contributed to economic growth. Developments in the GDP of the eight case study countries are discussed below, and factors that were of influence on trends in the growth rate are analysed. Unless otherwise indicated, the analysis is based on the various country reports, and also considers whether and to what degree debt relief has been of influence on economic growth through the flow and stock effects discussed in earlier chapters.

Debt relief can only be of relevance, of course, if the debt or debt repayments hinder economic growth. Section 5.3 looks at this relationship between debt and economic growth, particularly insofar as it influences the relevance of debt relief and of specific modalities. Section 5.4 discusses the results of econometric research, carried out as part of this evaluation study, into the relationship between debt and economic growth, giving special attention to the 1990s and to the effect of the volatility of debt payments. In section 5.5 the results of the country studies and of the econometric study are brought together and analysed. Conclusions are drawn in the final section.

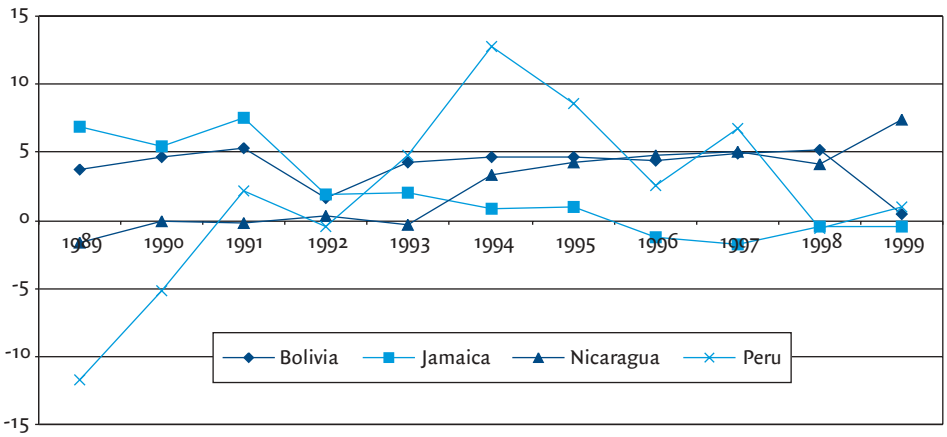
5.2 Debt relief and economic growth in the eight countries

The four Latin American countries in the group experienced very different growth trends during the 1990s (Figure 5-1). Jamaica was fairly prosperous at the beginning of the decade, but its economy stagnated completely from 1996 onwards. In Nicaragua the situation was reversed to some extent: the economy started to grow only in 1994 and this growth continued until the end of the evaluation period, with a peak in 1999 due to the aid received after hurricane Mitch. Bolivia showed the most stable growth pattern throughout the period, but that seemed to come to an end in 1999. Peru's growth was the most volatile, with high peaks in the middle of the decade and low or negative growth prior to 1993 and again after 1998.

Bolivia conquered hyperinflation as long ago as 1986. Since then the country had benefited each year from a major inflow of new multilateral loans and bilateral grants. Debt relief helped to release funds, but in quantitative terms, aid and loans had a much greater

influence on imports and government investments. Moreover, debt service is still high, partly due to the inflow of new loans. Debt relief had a minor flow effect and also a small stock effect.[47] Private investment is still low in Bolivia, as was average growth throughout the decade, i.e. 3.9%. The most important reasons for the decline in 1999 were the low prices for zinc, copper and tin and the hard line taken against coca growers, which caused loss of income as well as social unrest which, in turn, pulled the economy down. The years of economic growth have not led to the economy becoming less dependent on primary (and illegal) exports. Even after extensive privatisation (in Bolivia, capitalisation[48]) 50% of employment in the formal sector is in the hands of government.

Figure 5-1 GDP growth in Bolivia, Jamaica, Nicaragua and Peru, 1989-1999, in percentages



Source: World Bank, World Development Indicators CD-ROM, 2002.

Jamaica managed to bring inflation down in the first few years of the decade and also liberalised its economy, including the foreign exchange market and the financial sector. At first this was accompanied by economic growth, but it also led to a credit boom and to irresponsible lending behaviour on the part of domestic financial conglomerates (Kirkpatrick & Tennant 2002). In 1995 and 1996 a number of those conglomerates

47 At the end of the 1980s Bolivia managed largely to eliminate its arrears, partly through a donor-financed buy-back of private debt.

48 Under Bolivian 'capitalisation' a maximum of 50% of shares in state industries has been transferred to pension funds that are entitled to sell the shares to private investors.

threatened to go bankrupt due to inadequate regulation and supervision of the banking system. The government then intervened in the banks in order to protect small savers and to prevent capital flight. The public deficit rose substantially, causing interest rates to climb and the exchange rate to appreciate. Investments fell, as did exports, leading to negative economic growth after 1996.[49] Jamaica only enjoyed debt relief in the first half of the decade, which possibly had some positive influence on growth in that period. At any rate, the flow of debt payments decreased thanks to debt relief and the public deficit was turned around into a surplus. In addition, there was possibly some stock effect because the government gained access to private loans. External debt was reasonably sustainable at the start of the decade and has improved further, so that Jamaica is creditworthy in that respect. The domestic debt is now far greater than the external debt, however, and its burden is in itself unsustainable.

In 1991 *Nicaragua* had managed to overcome hyperinflation, but economic growth came much later. Arrears with multilateral institutions were eliminated with the aid of bilateral loans and grants; however, this did not lead immediately to a net inflow of funds from those organisations because bridging loans first had to be repaid. In the first years of the decade the political situation was still very unstable and investors adopted a 'wait and see' attitude. Around the mid-1990s investments and exports started to increase, as well as economic growth. The latter was based on the construction industry and on trade, and later also on exports from tax-free zones (*maquila*). Although Nicaragua shows the greatest debt reduction of all eight countries, only 5% of that actually freed resources for imports and government expenditure. This was due above all to the country's substantial arrears. These became smaller in the course of the decade, thanks to debt relief, but are still considerable. External debt is still staggeringly high and, in relation to GNP, still the largest of all eight countries. Debt relief thus had no stock effect on economic growth.

In *Peru* debt relief did not release resources at all because it was used entirely to eliminate arrears. This cleared the way for new loans from multilateral institutions (from 1991) and, after 1996, also for an inflow of private capital. The stock effect was greatest in Peru: debt relief restored the country's creditworthiness and had a positive influence on investments, including foreign investment. High growth after 1993 was caused by the adoption of a successful and orthodox stabilisation policy; which suppressed inflation and initiated

49 According to Kirkpatrick & Tennant (2002), the fall would have been much greater if the government had allowed the banks to go bankrupt. That would have undermined confidence in the financial sector and given rise to enormous capital flight.

the recovery. The political tide began to turn around the middle of the decade, and later also the economic situation. The Fujimori government was guilty of human rights abuses and of corruption, yet retained the support of the international community. In 1996 a tighter budgetary and monetary policy led to a record inflow of foreign capital. When the Asia crisis broke out in 1997, however, that capital flowed just as rapidly out of the country, with major negative consequences for the economy. Peru now pays all its debt obligations and is thus creditworthy, but uses a high 40% of its exports for the purpose. In the longer term Peru's debt burden is not sustainable, particularly because of its large trade deficit (see paragraph 4.6.1).

In Africa, Uganda and Mozambique were the success stories of Africa in the 1990s, each with a very high growth rate, particularly since 1992 (Figure 5-2). They were also donor darlings. The Tanzanian economy revived at the end of the 1980s but stagnated early in the 1990s. Since 1995, growth has been reasonably high and stable. In Zambia growth has fluctuated strongly from year to year, and the country with a stagnating economy throughout the 1990s, is clearly the worst off of the four African nations investigated.

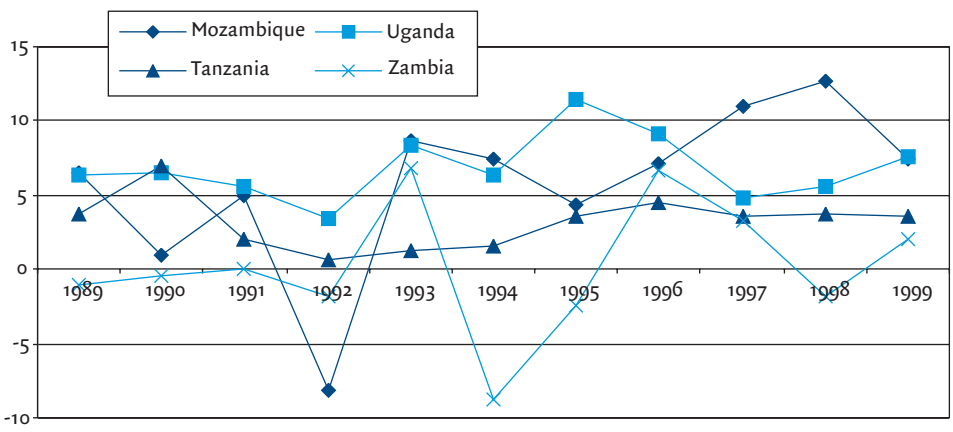
In *Mozambique* the destructive civil war did not come to an end until 1992. The economy has grown solidly since 1993, partly due to a catch-up effect after the earlier decline: the end of the war enabled the return of refugees, who immediately started to grow crops. The country has received an enormous amount of foreign aid that has had a positive effect on public investment and has also promoted construction and trading activities. Debt relief provided by the Paris Club had some influence on the government's debt payments in the second half of the decade because Mozambique then always repaid Club members. The country is in arrears to other creditors, however, and although the debt stock fell slightly during the decade, those arrears have hardly been reduced. Moreover, in relation to exports, Mozambique has the largest debt of all eight countries. Debt relief has thus had no stock effect on economic growth.

Since 1987, *Uganda* has shown a fairly stable and high economic growth (approximately 6% per annum), with a small slump in 1992 when it last had a serious difference of opinion with donors. Growth was initially due to stability after the end of the civil war and, in the 1990s, was based principally on the construction and manufacturing industries as well as on favourable terms of trade due to high coffee prices in the middle of the decade. Substantial aid also promoted growth, as did the liberalisation of the foreign exchange market and of domestic trade. The high growth rate increased the confidence of

investors, leading to the return of Asians with their capital, and to other foreign investment. In all this, debt relief played hardly any role, particularly because the major part of Uganda's debt is multilateral. This meant relatively little debt relief during the 1990s, while that provided by the Paris Club had almost no flow effect owing to the great arrears. The debt itself has grown, but its sustainability has also increased thanks to the growth of GNP and exports. During the last few years, however, growth and also exports have stagnated, due chiefly to falling coffee prices on the world market.

Tanzania's debt was built-up during the 1970s and 1980s when donors financed investments by state industries on a large scale with grants and with loans that were mostly non-concessional. When the development model supported by the donors proved ineffective, Tanzania was left with a massive debt and, at the start of the 1990s, also with towering arrears. Besides these, the small amount of debt relief Tanzania was given, pales into insignificance. Until the middle of the decade Tanzania received mostly restructuring of a limited part of its debt service through Paris Club agreements. This had almost no effect on the debt service paid. Only a small part of the debt was cancelled (more than in Jamaica and Peru but less than in all other countries), and arrears (as percentage of total outstanding debt) did not decrease throughout the decade. Debt has fallen in relation to GNP and exports, but that was due solely to the latter's growth. The fact that these indi-

Figure 5-2 GDP growth in Mozambique, Tanzania, Uganda en Zambia, 1989-1999, in percentages



Source: World Bank, World Development Indicators CD-ROM, 2002.

cators improved had no positive effect on investments or on the inflow of foreign private capital. On the contrary, investments fell. Against the background of sizeable new aid flows since 1986 when the country began to implement structural adjustment programmes, growth of the Tanzanian economy has been limited. During the 1990s growth was based on construction, mining and tourism, the two latter of which started to attract foreign investment. The important agricultural sector lagged behind, however.

Of all eight countries, *Zambia* has shown the most disappointing growth rate, averaging zero growth per annum during the 1990s, meaning that per capita growth was negative. In 1991, after a split with the IFIs in the second half of the 1980s, the country started to implement an adjustment programme which had IFI support. The sequence of the various measures was not always adequate, however. The financial sector and international financial flows were liberalised before inflation had been brought down and before adequate regulation and supervision of the banking system was introduced. Inflation remained high despite heavy cutbacks in the government budget, and this was partly due to capital flight. High inflation meant that tax revenue was disappointingly low; as a result, public deficits persisted, leading to continued inflation and high interest rates. Another problem was that the government withdrew hastily from the marketing of agricultural products. In Zambia that meant an end to the subsidised growing of corn, while infrastructure and credit were insufficient to allow private trading in agricultural products to develop. The public deficit was also enlarged by the slow privatisation of state industries, especially of the loss-making state copper mines. Economic growth was hampered even further by the continuously low copper price on the world market. Debt relief contributed little to reducing the deficit because it had hardly any effect on the flow of debt payments. On the contrary, those payments continued unrelentingly high throughout the decade, even increasing as percentage of exports. Although some debts were forgiven, debt stock and arrears both remained high. The stagnating economy and exports caused debt to increase in relation to GNP and exports.

These rough analyses have shown that debt relief probably had little effect on economic growth in all eight countries, with the possible exception of Peru which, however, still has very high debt service. In general, other factors than debt relief seem to have had a greater effect on positive and negative trends in growth rates. This manifestly slight relevance of debt relief is not surprising if the theory on which this evaluation is based (see 1.2 above) is taken into consideration. Chapters 3 and 4 have concluded that the

efficiency and effectiveness of debt relief were not great. A major contribution to economic growth was thus not to be expected.

The question now is: what caused debt relief to be of such little relevance? In 1990 all eight countries clearly faced a debt position that was unsustainable (Chapter 2); consequently, it might have been expected that debt relief would contribute favourably to solving the problem. The conclusions reached in Chapters 3 and 4 touched briefly on some likely explanations of that lack of efficiency and effectiveness, and these are briefly summarised below.

Chapter 3 drew several conclusions regarding the efficiency of debt relief. Firstly, it has led only to a slight reduction of outstanding debt stocks because the relief has been limited in comparison to outstanding debts; moreover, much debt relief has been given in the form of restructuring, which does not decrease the NPV of the debt. Secondly, and notwithstanding that most debt relief was given in the form of debt *service* reduction (not debt stock), it has had little effect on the flow of actual payments. In this respect also, debt relief was not efficient. Only in Bolivia and Jamaica did it have a more than slight effect on the flow of debt payments, chiefly because those countries had no stock of arrears at the start of the evaluation period. Moreover, actual debt payments did not decrease in any of the eight countries during the 1990s, partly due to the inflow of new loans. In the six HIPCs, the major part of the inflow originated with multilateral institutions, which were bailed out by bilateral donors, causing moral hazard. Thirdly, the conditions attached to debt relief were only partly fulfilled.

Chapter 4 has concluded that only in Peru and, to a lesser degree, in Bolivia and Jamaica did debt relief have any stock effects. At the end of the 1990s those countries were able to settle all claims; Peru in particular, but also the other two, gained access to new private capital during the evaluation period. In the other five countries debt relief has sometimes reduced the debt overhang to some extent, but has not removed it. The flow effects of debt relief were also slight, and sometimes even negative. In view of the conclusions reached in Chapter 3, positive flow effects could only be substantial in Bolivia and Jamaica. In the latter, debt relief probably helped to eliminate the public deficit (until 1995). In not a single country was there a positive flow effect on public investment, partly because the latter's volume (in the six low-income countries at least) was determined primarily by project aid. Current expenditure was frequently squeezed because the combination of freely-disposable aid and debt relief was not sufficient to settle debt obligations.

Bolivia did manage to keep public, and current, expenditure at an acceptable level, and thus showed a positive flow effect.

This summary shows a number of possible explanations for the modest relevance of debt relief:

1. the amount of relief has been too little;
2. it has not been given in appropriate modalities;
3. the context in which it has been given, e.g. its combination with new aid and new loans, or the policy conditions that have been attached to it, have reduced its relevance.

These three possible explanations need not be exclusive of one another. Before analysing them further, the relevance of debt relief in general will be examined first. The way in which high debt can have a negative influence on economic growth will be considered, and results of the econometric research will be presented.

5.3 Effects of high debt on economic growth

In principle, a country borrows in order to stimulate economic growth. Beyond a certain level, however, the debt can become too high and will then frustrate growth. According to the literature, a high debt level can prevent growth in two ways: through high debt payments or through a high debt stock. The first is known as the liquidity effect, the second as the debt overhang effect (see 1.3 above). In the first case, debt *payments* can have negative effects on the balance of payments and on public expenditure: as a result, the country can import less raw materials and machinery, and the government has less money available for physical and social infrastructure, for example. In the second case, the *high level of debt itself* discourages both investments and good policies because their yield will fall to the creditors rather than to the investors and the country's population.

If a country has a debt that compromises growth, debt relief may be relevant, i.e. may contribute to economic growth. It is thus important to establish whether the debt affects growth through the liquidity or through the debt overhang effect. In the first case, a reduction in the net flow of debt payments through restructuring or through the provision of new loans or grants, will be sufficient to guarantee economic growth once again. If it is a case of debt overhang, however, debt forgiveness will be needed: the debt itself will have

to be reduced and probably also the payment arrears, so that the expected value of debt payments can again increase proportionally with new loans.

Chapter 2 discussed how official creditors were long convinced that debtor countries principally suffered a liquidity problem. They tried to encourage those countries to pay their debts through a combination of relief on debt service (by restructuring and later also by partial forgiveness), grants, and new loans from multilateral organisations.

The question is whether the diagnosis that debtors had to cope with liquidity problems was correct. The design and adoption of the HIPC initiative and its later expansion (in 1999), implied recognition of the fact that the 42 poor and heavily-indebted countries that in principle were eligible for that initiative, had to cope with a problem of solvency rather than liquidity. It must then be asked whether that wrong diagnosis and, consequently, the wrong remedy, was partly responsible for the fact that economic growth was lower than would otherwise have been the case. Sachs (2002) has ascertained that the 39 countries that needed debt restructuring in the period 1975-1996 and again needed restructuring or debt relief via the HIPC initiative during 1997-2001, had an average annual growth of –0.2% during the 1990s. The nine countries that had been 'cured', i.e. needed no more debt relief or IMF agreement during 1997-2001, grew by an average of 4% per annum in the 1990s.

It is thus important to investigate whether high debt obstructs growth through the liquidity or the debt overhang effect. The expectation is that this was not the same in the 1990s as in the 1970s and 1980s. In the latter decade, Latin American countries had to increase their exports and reduce imports in order to release funds for debt service. That was not necessary in the 1990s because the then heavily indebted countries had access to new loans with which to finance their imports. Nevertheless, debt service probably made heavy demands on government budgets because new loans and grants were intended particularly for projects, and governments had to settle debt payments out of their own revenue, or from uncertain macro-economic support. Debt payments can thus certainly have had a negative effect on economic growth, primarily through their demands on the state budget.

It is quite possible, however, that there was also a debt overhang effect. Many highly-indebted countries do not pay all their obligations: some are restructured or forgiven, others are simply not paid. The classic debt overhang situation then probably occurs, in

which debt payments may increase in the future, even if the debt itself decreases or remains the same, owing to improved payment capability.

The research carried out by Sachs *et al.* (1999) discussed in Chapter 3 above, shows that one of the problems with which highly-indebted countries had to cope in the 1990s was that actual debt payments fluctuated strongly from year to year, and that this also held for foreign aid. As a result, the efficient management of public finances became more difficult. Various authors have pointed out that debt payments, and also new loans or grants with which to meet payment obligations, depend partly on negotiations between debtor and creditors, and that the outcome of such negotiations is uncertain for the debtor (Deshpande 1997, Sachs *et al.* 1999, UNCTAD 2000).

The country studies have shown that the degree and nature of that uncertainty regarding future debt payments varies per creditor. Multilateral creditors, at any rate the IMF, World Bank and IDB, are always paid. With regard to obligations to the Paris Club members, a multilateral agreement is signed about every three years, after which bilateral negotiations are held with each creditor separately. Other (non-Paris Club) bilateral creditors are mostly not paid until an agreement has been reached. Thereafter payments are made on the reduced debt. Commercial creditors are treated in broadly the same way as 'other' bilaterals: the debtor country starts to pay after an agreement regarding debt reduction has been signed, thus causing actual payments to increase. Such uncertainty regarding future payments thus occurs if the country has considerable arrears and is unsure about when and how much will have to be paid in the future. Creditors will grant less debt reduction and will demand higher payments as the economic situation of the debtor country improves.

The fact that uncertainty regarding future payments can have a negative influence on investment has been shown with regard to Mexico by Claessens *et al.* (1994). It was not so much the reduced volume of debt payments that caused investment to increase after the Brady agreement, but rather the reduced *fluctuations* in the level of debt payments. This seems to show that the negative effect of a debt overhang can become visible in the volatility of debt payments.

Empirical research into both the liquidity and the debt overhang problem uses the volume of debt as indicator of the latter, and the level of debt payments as indicator of the liquidity problem (Cohen 1993, Elbadawi *et al.* 1997, Serieux & Samy 2001). Cohen found

principally a liquidity effect; Elbadawi *et al.* both a debt overhang effect and a liquidity effect; and Serieux and Samy also found both, but mostly a negative effect on import capacity (i.e. a liquidity effect). Since debt overhang is concerned with expected payments (see 1.4 above), the magnitude of the debt is probably not a good indicator.[50] Moreover, none of these studies has investigated whether the 1990s differed from earlier periods (this was obviously not possible in earlier studies), neither have they examined the effect of volatile debt payments on economic growth or on investment.

5.4 Econometric research

The econometric research carried out for this evaluation study attempts to fill the gaps mentioned above. The 1990s have been investigated separately, and an analysis has been made of whether the volatility of debt payments in that period had a negative influence on economic growth. If that is the case, that could help to explain the results of the country studies. Debt relief may have been of little relevance because the modalities in which it was given did not reduce the volatility of debt payments.

The relationship between debt and economic growth has been examined on the basis of analysis of 102 low and middle-income countries for which data were available on GDP and growth-related variables, as well as on debt variables. The period examined was that from 1970 up to and including 1998, and the data used are averages taken over three periods: the 1970s, 1980s and 1990s.

5.4.1 Debt and growth: the entire period

First, a standard growth equation has been estimated, including a number of variables that, according to almost all studies, have influenced per capita growth. In particular (the logarithm of) GDP at the start of the period (the higher initial GDP, the lower the growth rate), investment as percentage of GDP, and secondary school enrolment. Other variables have then been added which have often proved significant in other studies, namely, measures of political instability, of financial development, and of distortions resulting from the over-valuation of exchange rates.[51] The first and third of these are expected to have a negative effect on growth; the second a positive effect.

50 Elbadawi et al. (1997) establish a debt overhang partly on the basis of debt variable squared at time t-1, which appears to have a negative effect on growth, while debt at time t has a positive effect. In this way a Laffer curve can be constructed. But debt (squared) at time t-1 is not a good indicator of debt overhang either, as the latter is concerned with expected payments.

51 These three variables may to some extent be seen as indicators of good governance and good policy, so that possible correlations between debt variables and economic growth have been controlled for them.

The next step is to add the following two debt-related variables to the equation: the debt/GDP ratio and the debt service/GDP ratio. Both variables are expected to have a negative effect on economic growth. In an estimate covering the entire period, both the debt/GDP variable and debt service/GDP had a significant negative effect on per capita growth, also when they were both included in the regression (Annex 6 Table 1). This could indicate that there is both a debt overhang and a liquidity effect of debt on economic growth. It makes no difference whether or not investment is included in the equation: debt and debt payments thus seem to exercise a negative effect on growth, both by reducing the *amount* of investments (columns 2, 4 and 6) and by reducing their *efficiency* (columns 1, 3 and 5).

In this test, however, the standard regression method of ordinary least squares (OLS) is applied, with fixed effects per country. The problem with this method is that it makes no allowance for the fact that the various explanatory (exogenous) variables can also be *endogenous*; that is to say, their variation is possibly the result of other variables or even of the change in growth. Moreover, these exogenous variables may be correlated with the error terms and with country-specific intercepts. To overcome these problems, the equation has also been estimated with the Generalised Method of Moments (GMM), a technique whereby the lagged differences of the exogenous variables are used as instruments.[52]

Table 2 in Annex 6 shows that debt still has an important negative effect on economic growth, but that the effect of debt payments on growth is no longer significant. This implies that the size of the debt is itself the most important obstacle to economic growth, and could indicate that debt overhang has a negative effect on growth.

5.4.2 Debt and growth: per decade

Next, the results were analysed for each period individually. The usual OLS-method was used because it was not possible to use the GMM[53] or to instrument the exogenous variables in any other way.[54] The results must therefore be interpreted with appropriate caution. Nevertheless, the hypothesis that during the 1990s, debt affected economic growth

52 For more information on this method, see Annex A2 in Dijkstra & Hermes 2003.
53 The data represent ten-year averages, thus there are only three observations (per country and per variable) and only one for the 1990s. The GMM requires a panel data set per period.
54 Instrumenting implies that the exogenous variables of the original equation are themselves estimated with the aid of a second equation; the results of the estimate of this second equation are then used in the original equation.

particularly through the (unexpected) volatility of debt payments, is sufficiently important to justify the presentation of the results of these primary estimates here. They should not be considered as a real test, however.

In the 1970s and 1980s, a high debt has a significant negative effect on economic growth, but this disappeared in the 1990s (Annex 6, Table 3). It makes no difference whether or not debt payments are included in the equation (the latter is not shown in the table). Debt payments, however, only have a significant negative effect in the 1990s, and not in the two preceding decades. If debt is not included in the equation, debt payments are significant in all three periods. This seems to indicate that the debt overhang effect was dominant in the 1970s and 1980s, and the liquidity effect in the 1990s.

5.4.3 Volatility of debt payments

The volatility of debt payments was subsequently analysed, measured as the coefficient of variation[55] of the debt payment/GDP ratio. Volatility appears to have been highest during the 1970s; in the 1980s it was also higher than in the 1990s (Table 5-1). Since these figures are 10-year averages, however, a high volatility of debt payments can, *ceteris paribus*, be the consequence of a rapid change in the debt itself. Generally speaking an annually-increasing debt will be accompanied by an annually-increasing debt service. Over a 10-year period this gives a high coefficient of variation, but this is no evidence of fluctuations or uncertainty. It is thus important to include the change in the debt situation in the

Table 5-1 Volatility of the debt payments/GDP ratio

	Total	1970-79	1980-89	1990-98	Total *	1970-79 *	1980-89*	1990-98
Maximum	3.16	3.16	2.39	1.19	1.23	1.23	1.03	1.19
Minimum	0.03	0.03	0.11	0.05	0.03	0.03	0.11	0.05
Median	0.35	0.38	0.38	0.26	0.34	0.38	0.37	0.26
Mean	0.42	0.55	0.41	0.34	0.39	0.46	0.39	0.34
Standard-deviation	0.34	0.48	0.28	0.22	0.23	0.26	0.19	0.22

* Excluding four extreme outliers for the 1970s and one for the 1980s.

55 The coefficient of variation is the standard deviation divided by the mean.

analysis. This was measured as the percentage change in the debt/GDP ratio over the 10-year period.

The following tables show the correlations between debt, debt payments, volatility in debt payments, and changes in the debt stock, both for the whole period and per decade. Over the period as a whole, a fairly strong correlation is seen between debt and debt payments (0.45) and also between change in the debt stock and the volatility of debt payments (0.50). Other correlations are far weaker (Table 5-2).

The correlation coefficient between debt and debt payments is highest during the 1970s (0.71), but somewhat lower in the 1980s and 1990s. This may be because debtors still paid practically all their obligations in the 1970s, but also because in the 1980s and 1990s a greater part of loans have become concessional. The volatility of debt payments appears to be linked strongly to an increase in the debt stock in the 1970s and 1980s (0.55 in both periods), but the correlation was zero in the 1990s. The volatility of debt payments in the 1990s (Table 5-1) can therefore not be attributed to a steady increase (or decrease) of debt in that period, but is due to fluctuations in the debt or in debt payments. These fluctuations may thus be due to uncertainty regarding debt payments.

There seems to be little correlation between the size of debt payments and their volatility; insofar as such a correlation does exist (particularly in the 1980s), it is negative: the higher the payments the less the volatility, and *vice versa*. The linkage between the size of debt and the volatility of payments, on the other hand, is interesting: in the 1970s and 1980s there was little correlation (in the 1970s it was even negative), but in the 1990s the correlation was reasonably strong (0.42). This seems to indicate that a high average debt in the latter period was coupled with considerable fluctuations in debt payments.

5.4.4 Volatility of debt payments and economic growth

The final step is to introduce the volatility of debt payments into the growth equation, in which the debt itself and debt payments are still included. To exclude volatility resulting from a steady increase or decrease of debt stock, however, the change in the debt itself is also included. It is expected that this change has a negative effect on economic growth. In the 1970s and 1980s the volatility of debt payments will probably not in itself have a significant negative effect on growth because volatility in those years proved strongly linked to the steady increase of the debt (see Tables 5-3 and 5-4). During the 1990s that volatility

Table 5-2 Correlation matrix of debt variables, entire period (1970-1998)

	Debt [1]	Change in debt [2]	Debt payments [3]	Volatility [4]
Debt	1.00	0.01	0.45	-0.02
Change in debt		1.00	-0.23	0.50
Debt payments			1.00	-0.19
Volatility				1.00

1 This is Debt/GDP.
2 This is the percentage change in the Debt/GDP ration over ten years.
3 Debt payments/GDP.
4 Coefficient of variation of (Debt payments/GDP) over ten years.

Table 5-3 Correlation matrix of debt variables, 1970s

	Debt	Change in debt	Debt payments	Volatility
Debt	1.00	-0.23	0.71	-0.21
Change in debt		1.00	-0.26	0.55
Debt payments			1.00	-0.18
Volatility				1.00

Table 5-4 Correlation matrix of debt variables, 1980s

	Debt	Change in debt	Debt payments	Volatility
Debt	1.00	0.33	0.43	0.05
Change in debt		1.00	-0.10	0.55
Debt payments			1.00	-0.36
Volatility				1.00

Table 5-5 Correlation matrix of debt variables, 1990s

	Debt	Change in debt	Debt payments	Volatility
Debt	1.00	-0.17	0.45	0.42
Change in debt		1.00	-0.37	0.00
Debt payments			1.00	-0.09
Volatility				1.00

can be expected to have a negative effect, apart from any negative effect caused by a change in the debt stock.

The results are shown in Table 4 of Annnex 6. GMM estimates have been made for the entire period, but for the three individual periods only the OLS-method has been applied. Debt remains significant throughout the entire period (1970-1998), as does the change in debt. Debt payments are only significant at the 10 percent level, while the volatility of debt payments is not significant at all for the period in the OLS estimate. The GMM for the whole period (column 2) shows that only the debt itself has a significant negative effect on growth. During the 1980s, among debt-related variables, debt itself and the changes in debt are significant, while in the 1970s only the debt is significant. In this first period the change in the debt stock did not have any significant effect on economic growth.

The picture changed completely in the 1990s. As proved to be the case above (5.4.2), the debt itself is no longer significant but debt payments are. At the same time, the changes in debt and the volatility of debt payments are both significant, showing the expected minus sign. This may indicate that uncertainty about expected debt payments plays a role, but definite conclusions cannot be drawn on the basis of this regression method. The results are almost identical if investments are not included in the growth equation (not shown here).

Altogether, the results can be seen as an indication that, during the 1990s, high debt had a negative effect on economic growth through high debt payments, but also through the volatility of those payments. There might have been a case of debt overhang, expressed not so much in a high debt/GDP ratio as in the form of uncertainty regarding future debt payments. This hypothesis deserves further research.

5.5 Analysis of the causes of the limited relevance of debt relief

This section analyses the three possible reasons put forward above for the slight relevance of debt relief: it was too little, it was given in the wrong modality, or was given in the wrong context, due either to the policy conditions attached to it or to its combination with aid. In 5.4.4 above it was concluded that, during the 1990s, economic growth was still hampered by debt, due particularly to the volume of debt payments and to their volatility. The first of these could indicate that debt relief was insufficient, the second that it was not given in the most appropriate form. After all, debt relief was chiefly oriented

towards lowering the debt service. As a result, the outstanding debt stock has been reduced only slightly and uncertainty regarding future payments has continued. Moreover, debt service remained high because creditors who were also donors preferred to give grants and new loans rather than debt relief. Creditors assumed that debtors, using these grants and loans and with the good policy that was set as a condition for that aid, would be able in future to pay a large part of their debt service. The third question is thus whether the context in which debt relief was given did in fact stimulate economic growth.

5.5.1 Volume

The country studies have made it clear that debt relief was too little to be effective in releasing funds for debt servicing, or to cause any substantial decrease in debt stock. That debt stock decreased most in Nicaragua, but that country still has the highest debt/GNP ratio of all eight countries. In the other seven, debt relief caused only a slight fall in debt stock. Arrears did decrease, except in Tanzania and Nicaragua, but most of the eight countries still show large arrears, and thus a debt overhang. Only in Peru and, to a somewhat lesser extent, in Jamaica and Bolivia, did the slight fall in the debt stock have any stock effects in the form of an inflow of private capital. In that respect, debt relief seems to have been sufficient in those countries.

Only in Jamaica and Bolivia did debt relief have a noticeable effect on the flow of debt payments, particularly (in the case of Jamaica exclusively) in the first half of the 1990s. Due to the large arrears in other countries, debt relief had little effect on the flow of actual debt payments. In Peru there was no flow effect at all because debt relief was used to clear arrears. The still high debt service/export ratio in all countries except Jamaica (at least if one ignores domestic debt service by the government) is another sign that debt relief has been insufficient.

5.5.2 Modalities

Based on the country studies and on experiences in Latin America at the end of the 1980s, it may be concluded that debt relief for insolvent countries is most effective if arrears are eliminated. As long as arrears continue, debt relief has hardly any flow effect. A reduction in debt *stock* will also have little effect as long as *the entire stock of arrears* is not eliminated. Although the clearance of arrears does not reduce the flow of payments (see Peru), it can have a major stock effect, at least if the whole stock of arrears is forgiven or converted.

The country will then again be creditworthy. New loans from private creditors will become accessible and will be repaid.

Debt relief by writing off debt stocks and arrears is applied mostly by private creditors and by official creditors who are not members of the Paris Club. These groups no longer had any confidence in the economies of highly indebted countries and therefore refused to provide new loans. Their only chance of recovering any of their former loans was to agree to major debt reductions.

The position taken by multilateral creditors and by bilateral creditors in the Paris Club was quite different. They wanted to continue to provide aid to highly indebted countries and, incorrectly, took the view that such aid would in time enable the debtors to pay-off their debts. With this in mind, some debt obligations were restructured and, later, also partly forgiven. Earlier payment arrears were generally included in these agreements, but these, too, were only restructured and later partly forgiven. Debt reductions were rarely granted. Restructuring generally increased the nominal value of the debt since the interest was capitalised. At the same time, poor and heavily indebted countries were given large amounts of new loans and grants.

The bilateral donors and creditors contributed in three different ways substantially to the new (chiefly multilateral) loans. This created moral hazard among multilateral preferred creditors, and, partly as a result, the volume of their loans was very large. The many loans provided by multilateral institutions to the HIPCs proved to be the cause of expected unsustainable debt in the longer term (see 4.6.1); in Africa, moreover, other authors found a direct linkage between new loans to governments and private capital flight.

The result of the combination of new loans and grants and limited debt relief on the flow of payments, was that debts remained large and that arrears continued to be substantial. Towards the end of the 1990s there were still major arrears on debts to bilateral creditors who did not belong to the Paris Club, and sometimes also on those to private creditors; in Nicaragua, however, there were also arrears to Club members. Many countries still have a debt overhang: expected payments could increase if the prospects of economic growth and of exports should improve. All this entails uncertainty for the debtor countries.

The analysis in section 5.4 has shown that, during the 1990s this uncertainty, together with the size of debt payments may have had a negative influence on economic growth.

The effect could come about through a lower level of investments and through a reduced efficiency. In other words, high debt payments and the fluctuations therein have forced governments to spend less money on development and/or have discouraged private investors; in addition, the effectiveness of funds that were invested was reduced. The latter *may* denote poor policy on the part of recipient countries. However, effectiveness may also be reduced by poor policy on the part of donors (e.g. lack of co-ordination) who, in many poor debtor countries, largely determine the government's investments.

This evaluation cannot answer the question of whether new loans and grants in themselves encouraged economic growth. It has been determined, however, that the combination of aid with limited debt relief was not very effective, for the following reasons:

1. In the 1990s, highly indebted countries received more development aid (concessional loans and grants), and countries with poor policies also proved to have received more aid; this indicates adverse selection which, insofar as it exists, will maintain ineffective policies.
2. Aid was largely given in the form of project aid, which usually kept up the level of investments but could not be used to pay off debts; current expenditure therefore came under pressure with possible negative consequences for the access to, and the quality of, social services.
3. New loans and grants meanwhile have increased deficits on the balance of payments and, insofar as new loans were concerned, caused debts to increase.

Only in Peru was there evidence that reduced debt overhang had any effect on private investment. In the other countries (except Tanzania) private investment increased, but not due to any reduction of the debt or to improved external creditworthiness. In most countries the debt/export ratio remained very high, thus any positive stock effect seems unlikely. Moreover, the size of the debt itself proved to have little influence on private investment. In the field studies on Tanzania and Nicaragua, private investors expressed their hope that extra debt relief would lead to lower taxation, or at any rate would prevent any tax increase. Domestic investment everywhere is still very modest, however, and was hampered by many other factors. It seems worth considering these factors more extensively because they are of significance to the wider context in which debt relief was provided during the 1990s.

Investments in Bolivia are low due to a lack of opportunities; in particular, the domestic market is small and prices for the most important export products are falling. Political tension and wide-spread corruption also play a role, as does the high domestic interest rate. Insofar as any investments are made they are in fairly safe construction projects. In Nicaragua, investments did increase during the second half of the 1990s, partly due to foreign aid, and also mostly in the construction industry. Here, too, lack of credit and the high domestic interest rate hamper investments: banks prefer to acquire state bonds rather than to lend to private firms. The high costs of electricity, transport and telecommunications are frequently listed as obstacles. State industries in this area were often profitable. They have now been privatised, but were sold too cheaply; in addition, they are still monopolies and prices of their services are still high.

In the African countries, lack of credit and high domestic interest rates are also said to obstruct private investment. In addition, the defective physical infrastructure is constantly blamed: electricity, transport and telecommunications. This is a particularly serious problem in Uganda, but is also common in the other countries. In Tanzania, entrepreneurs are concerned about the social infrastructure which has worsened seriously, with consequences for public health and for the productivity of the workforce. It is hoped that debt relief will be conducive to improving the physical and social infrastructure, and that these necessary improvements and debt payments would no longer be the cause of higher taxes. In all African countries, endemic corruption is a major obstacle to development.

All countries have enjoyed some degree of economic growth, due particularly to economic and political stability, and often to recovery after an earlier period of civil war and stagnation. Everywhere, however, growth stagnates again. Countries continue to depend on primary exports: whenever world market prices fall, growth again collapses. Moreover, domestic investments are at a low level everywhere. Political problems and corruption, high domestic rates of interest, and the lack of (or high prices of) physical infrastructure are the most important elements that impede investments. It is questionable whether the new loans and grants and the preconditions attached to aid and debt relief, have changed this situation in any way.

5.5.3 Context

The previous section mentioned the heavy emphasis bilateral donors and creditors put on new grants and loans for the debtor countries. In seven of the eight countries the annual increase of new loans exceeded the annual forgiveness (Chapter 3). In these circum-

stances debt relief could hardly be effective. The analysis of chapter 4 (4.6.1) shows that, if the aid-adjusted trade deficits continue, the debt burden will be permanently unsustainable, even if the concessionality of new loans and some export growth is taken into account. Especially in the six poorest countries the majority of new loans was extended by multilateral institutions.

Private creditors, and bilateral creditors who do not belong to the Paris Club, did not usually attach conditions to their debt relief. The Paris Club, however, insisted that a country must first enter into an agreement with IMF regarding structural adjustment. Chapter 3 concluded that most countries managed to meet IMF's macro-economic objectives, though sometimes only with the help of the foreign aid that accompanied the agreement. More structural measures were carried out primarily if the country had already planned to introduce them. If not, implementation was extremely slow if it occurred at all. It was thus not very efficient to attach policy conditions to debt relief.

During the last 20 years, however, developing countries in general have adopted policies that broadly tallied with World Bank and IMF requirements in their adjustment programmes. As a result, foreign exchange markets have been liberalised, state industries have been privatised, tariffs on foreign trade have been lowered, banks have been privatised and the financial sector liberalised.[56] The question is whether such policies have always promoted economic growth.

It was anticipated that such neo-liberal reforms would attract investments and thus stimulate economic growth. Although some of them have certainly had a positive effect,[57] the neo-liberal policy does not seem to have solved the problems private investors at present experience and which therefore interfere with growth. The most obvious example provided by the country studies is that the financial sector has often been privatised and liberalised prematurely. This occurred before the government budget had been straightened out and inflation had fallen, and also before an effective system of regulation and supervision of the banking sector had been developed.[58] In almost all countries involved in this evaluation, governments have found it necessary to intervene expensively when private banks were threatened with bankruptcy due to irresponsible lending behaviour or down-

56 This certainly applied in the eight countries studied in this evaluation, but also proved to be the case in the 18 programme countries of Swedish bilateral aid (see White & Dijkstra 2003).
57 For example, liberalisation of the foreign exchange market has almost always encouraged economic growth.
58 That this was the incorrect sequence was put forth in 1993, e.g. by McKinnon (1993). The same mistakes have unfortunately been often repeated since then.

right fraud. Partly because of this, many governments still have to cope with large deficits which keep interest rates high and make it easy for banks to earn a great deal of money on government bonds. Little credit then remains available for the private sector. In almost all countries, private investments are hampered by lack of credit and high interest rates. The neo-liberal policy may promote growth temporarily, but growth will stagnate if private investments are not forthcoming.[59]

In most countries investments are also hampered by the lack of good roads and public utilities, while the latter are also highly priced. Economies on the government budget over many years have often caused poor maintenance of the road network and the construction of too few new roads. On the instigation of IMF and the World Bank, most countries have privatised their public utilities, though usually only after considerable delay. It is questionable, however, whether this will produce better quality and lower prices. In many countries, public monopolies have been replaced by private ones. Moreover, privatisation often reduces access to these facilities for people and enterprises in remote locations and/or with few means to pay (increased) rates.

Another problem common to many countries is that of corruption, which donors are generally keen to tackle. They criticise government leaders, for example during meetings of Consultative Groups,[60] and try to persuade them to fight corruption and to punish those proven guilty. It might be asked, however, whether donors in some respects have not stimulated corruption.

In the first place, cuts in government budgets have often caused civil service salaries to be lowered substantially. Economies were often necessary, of course, but insufficient attention was given to the structurally negative consequences of the ways in which they were implemented.

Secondly, due to their dissatisfaction with the quality of the government administration, donors have often created parallel structures for their projects. Much foreign aid by-passes the government budget (60% or more is no exception), and almost all funds destined for project aid are deposited in accounts that are not managed by government institu-

59 High growth in Uganda during the 1990s, for example, was partly due to the liberalisation of domestic coffee marketing. Further growth in this sector requires investments, however, which are not coming about (see Dijkstra & Van Donge 2001).
60 Meetings of representatives of donors and of the recipient country, usually held once-yearly.

tions. The result is a lack of transparency which makes management of the funds difficult and facilitates their misuse.

Thirdly, at election time, donors are inclined to support the government in power, certainly in a country that appears to be doing well economically and where donors have established a good working relationship with that government. This occurs even when donors are simultaneously dissatisfied with corrupt practices of the incumbent administration. That support sometimes takes the form of approving new loans and grants just before the elections, thus enabling the government to win (extra) votes. It also happens, however, that criticism regarding serious corruption is expressed only in private in order not to discredit the incumbent government in the eyes of its own population (Mozambique), or that a PRSP is approved even if almost all donors consider it a seal of approval for a corrupt government' (Nicaragua).

5.6 Conclusions

1. In the eight countries under study, debt relief was of little relevance. Stock effects occurred only in Peru and to some extent in Bolivia and Jamaica; flow effects occurred in Bolivia and Jamaica, but were very slight or lacking in the other countries. As a result, debt relief had little if any positive effect on economic growth.

2. The underlying cause of the modest relevance of debt relief is that the international community made an incorrect diagnosis for many countries: they did not have a temporary liquidity problem, as had been thought, but one of solvency. As a result, too little debt relief was given, the most adequate modalities have not always been applied, and too much emphasis was placed on new loans and grants.

3. As regards modalities, too much debt relief was given in the form of restructuring rather than of forgiveness, and it was oriented too much towards reducing debt *service* (claims) rather than debt *stock*. The complete elimination of arrears proved the most effective form of debt relief because it produced stock effects, but that form was little used. However, countries that had little if any arrears (only Bolivia and Jamaica in this evaluation) did benefit from flow relief.

4. Highly indebted countries were given more aid, but that was largely in the form of project aid and thus did not relieve the debt service plight. To the extent that aid consisted of new loans, it only increased the debt stock. Partly due to the fact that

multilateral institutions did not themselves face the (full) costs of incautious lending policies (moral hazard), the volume of loans was too large and prolonged the unsustainability of the debt burden.

5. The context in which debt relief was given has contributed to its lack of relevance. Imposing policy conditions on debt relief was not efficient because countries only implemented what they had already intended to do. Other measures were only temporary or cosmetic, or were implemented after great delay. Moreover, some elements of the policy prescribed by IMF and World Bank (which most countries nevertheless began to carry out, although (only) along broad lines and frequently with delay), did not contribute to economic growth in the manner intended.

6. The econometric research has shown that high debt (in relation to GDP) has a negative effect on economic growth. This backs up the findings of the country studies, namely, that it is essential for debts to be reduced through forgiveness and fewer new loans.

6 Efficiency, Effectiveness and Relevance of Netherlands' Debt Relief

6.1 Introduction

This chapter analyses the results of financial contributions to debt relief made by the Netherlands, and examines their efficiency, effectiveness and relevance. In doing so, allowance must be made for the fact that, as distance from the input level in the logical framework increases, it becomes more difficult to distinguish results achieved with Dutch funds from those of other donors. Section 6.3 below on the efficiency of Netherlands' debt relief is thus the most extensive, and the subsequent sections on its effectiveness and relevance are shorter. The inputs of Dutch debt relief will be discussed with particular attention to activities in the eight countries under study.

This chapter is restricted in general to the debt relief amounting to 3.2 billion guilders that was financed from the Development Co-operation budget. Funds amounting to 0.4 billion guilders expended by the Ministry of Finance are not considered here.

6.2 Debt relief provided to the eight countries by the Netherlands

The greater part of Dutch debt relief in the 1990s has been oriented towards relieving bilateral aid debts, followed immediately by relief on multilateral debts. Smaller amounts were spent on debt relief on bilateral export credits and on relief for private debts. In the eight countries under study these proportions are approximately the same, although slightly more relief has been given on multilateral debts (Table 6-1).

In the six countries where bilateral claims on aid loans were outstanding, the Netherlands regularly if not always forgave debt service. In Peru, Nicaragua and Jamaica, in particular, this involved large amounts. These were aid loans from the 1980s and, in the case of Jamaica, also from the 1970s. Almost always, debt was forgiven in years when the debtor country had a multilateral agreement with the Paris Club. Exceptions include forgiveness of Nicaragua's debt service in 1997 when that country did not have an agreement, either

Table 6-1. Netherlands' debt relief[1] to the eight countries, 1990-99, in NLG million

	Bilateral Export Credit	Bilateral Aid Credit	Multilateral	Commercial	Total
Bolivia	25		107	5	137
Jamaica		116		5	121
Nicaragua		122	125	10	257
Peru		156	50		206
Mozambique		91	92	4	187
Tanzania	150	14	70		234
Uganda			143	5	148
Zambia		88	40	9	137
Total	175	588	628	38	1428
Memo item:					
Grand Total	266	1621	1181	107	3175

1 Insofar as financed from the Development Co-operation budget, i.e. not from the 400+ million guilders paid from the budget of the Ministry of Finance.

Source: IOB Data base, Debt Relief.

with the IMF or the Paris Club, and Peru after 1996. The latter was mainly motivated by the wish to maintain a positive Dutch net ODA flow towards Peru.

The Netherlands almost always went farther than had been agreed in the Paris Club by forgiving debt service on aid loans rather than rescheduling it. In the eight countries, it occurred only once (Jamaica in 1990) that the Netherlands restructured debt service on an aid loan. The Paris Club sometimes recommended that claims on aid loans be converted into projects through a debt swap. For example, many bilateral creditors concluded agreements with Peru in 1996, under which Peru had to deposit the countervalue of the claim in local currency in the Social Investment Fund FONCODES. The Netherlands and the United Kingdom preferred to cancel their claims outright.

The Netherlands has also regularly forgiven outstanding principals of aid loans. This occurred on a large scale between 1990 and 1993 in Mozambique, for instance, after the country had acquired the status of Least Developed Country. The Netherlands thus com-

plied with UNCTAD Resolution S-IX from 1978, and did not restrict itself to loans that pre-dated the cutoff date (1984) as agreed in the Paris Club. On the basis of that same Resolution, all aid loans to Tanzania had earlier been forgiven. That Tanzania was still granted some forgiveness on aid loans in the 1990s (Table 6-1) was due to the fact that a few mixed credits were still outstanding.

The other four counties that received debt relief on aid loans sometimes were also forgiven the principal sum, but not in all cases. After 1996, Zambia was given no more debt relief on debt service on aid loans, although it entered into agreements with the IMF and Paris Club in that year. It is not clear whether there was no more bilateral debt or whether the Netherlands made its own, different assessment of the situation in that country.

In all the countries studied, except Jamaica, the Netherlands has been active in granting relief on multilateral debts. The largest sums involved were for Uganda, Nicaragua and Bolivia. The Netherlands also participated in Support Groups for the clearance of arrears to multilateral institutions (Nicaragua, Peru and Zambia, all in 1991). The Netherlands was usually one of several bilateral donors who took part, and the sums involved were not excessively high or low. In the case of Peru, however, the amount was high in comparison to Dutch contributions Support Groups for other countries. Peru's arrears totalled USD 1.3 billion, of which the Netherlands paid off NLG 40 million (approximately USD 20 million), compared to NLG 17 million for Nicaragua and NLG 10 million for Zambia.

Debt relief on regular multilateral debt service (5th dimension) started in most countries in 1994 or 1995; the Netherlands was frequently one of the first bilateral donors to comprehend the magnitude of the multilateral debt burden and to help to relieve it. In all five countries that were given relief through the 5th dimension (Bolivia, Nicaragua, Mozambique, Tanzania and Uganda), the Netherlands was a participant. Where Multilateral Debt Funds were established (Bolivia, Mozambique, Tanzania and Uganda) the Netherlands made one of the largest contributions, or even the largest (Tanzania and Uganda).

The amount of NLG 10 million given to Peru in 1998 in multilateral debt relief was exceptional. Not only was Peru no longer in need of debt relief, but the relief involved explicit agreements regarding the use of countervalue funds – although such an agreement had earlier been rejected by the Netherlands as 'double tying' of aid. The countervalue funds were to be used for the fight against drugs and for alternative development programmes

that would help in that fight. The contribution came about after an appeal by the USA as presiding country in the meeting of the Consultative Group of donors.[61] At that time, Amnesty International and others had already reported that the national drugs control agency was guilty of serious human rights violations. Six months earlier, the Dutch Ministry of Foreign Affairs proved to be aware of the 'far from optimal human rights situation' and of the 'lack of legal security' that existed in Peru.[62]

The Netherlands also used the aid budget to cancel part of the export credit debts of Bolivia and Tanzania in 1990. In both countries this concerned a contribution to the partial forgiveness of debt service financed by the Ministry of Finance., intended to stimulate more forgiveness on export credits (IOB, 2002). Between 1991 and 1996, all write-downs on these debts (i.e. on the debt service) resulting from agreements within the Paris Club were financed by the Ministry of Finance. In 1997 for Tanzania and in 1998 for Bolivia, however, that debt relief was again financed from the Development Co-operation budget. The 1997 amount was so large for Tanzania (NLG 121 million) that it was not given any balance of payments support by the Netherlands in that year (in preceding years this had amounted to about NLG 25 million).

Finally, the Netherlands usually participated in the buyback of private debts through IDA's Debt Reduction Facility (IDA-DRF), and for Jamaica in a debt swap on private debt ('debt for children' with UNICEF). The only buyback in which the Netherlands did not take part (apart from the Brady agreement with Peru and the 1997 buyback of Bolivia in which no donors were involved) was that of Tanzania in 1999. The reason given was that Dutch banks had no outstanding debts in Tanzania, but that argument cuts little ice since that had also no longer been the case in Bolivia in 1993. In Bolivia, the Netherlands had taken the initiative for the first buyback in 1987 and, in doing so, had won over other donors to the idea.[63] The Netherlands was usually one of the three or four bilateral donors that took part in buybacks, with the largest contribution mostly coming from the World Bank through IDA-DRF. Notwithstanding the relatively small amounts in relation to total Dutch debt relief, the Netherlands ranked second after Switzerland in buybacks through IDA-DRF (IOB 2002).

61 Abdelgalil & Cornelissen (2002c: 29). The source is the report of the Meeting of the Consultative Group, p.3, which is very complimentary regarding the policy carried out in Peru and the successes of the drugs control agency.
62 Memorandum No. 05-98, dated 5 February 1998, from the Directie Westelijk Halfrond (Directorate Western Hemisphere).
63 Dutch banks were involved in this first buyback.

6.3 Efficiency

The question is whether Dutch debt relief reduced the flow of debt payments and/or the stock of outstanding debt. In view of the fact that the situation varies for different sorts of debt relief, these will be discussed separately.

The forgiveness of *debt service on aid loans* has not always led to the release of funds. At the start of the 1990s, Nicaragua, Peru, Tanzania and Zambia had major arrears and, until the middle of the decade at any rate, debt relief did not bring any reduction in the flow of payments. This was probably also the case in Mozambique: although that country paid off the Paris Club in the early 1990s, it is questionable whether it would have done so if debt relief had not been available. In the second half of the decade, debt relief did have a flow effect in Nicaragua, Peru, Tanzania and Mozambique (Zambia then no longer received relief). Peru really no longer needed debt relief in the second half of the decade because it repaid all its obligations. Since 1997 the country has not requested any more debt relief. In Jamaica this type of debt relief did cause some reduction in the actual flow of payments because the Paris Club debts were always paid in full.

The forgiveness of *principal* as applied in Mozambique, Nicaragua, Zambia and Peru (particularly arrears) and Tanzania had by definition no immediate effect on the flow of payments. All forgiveness of debt service, of arrears and of outstanding capital sums did reduce the debt stock. The Netherlands applied a modality (forgiveness) that was more in keeping with the insolvency suffered by the majority of debtor countries than the restructuring that was mostly agreed in the Paris Club.

Contributions to Support Groups for the elimination of *arrears* in Nicaragua, Peru and Zambia with the multilateral institutions, had no effect on the flow of payments, but did reduce debt stocks.

The other multilateral debt relief concerned *debt service to multilateral institutions.* In view of the fact that these were always paid with priority, such debt relief had a direct effect on the availability of funds in the debtor country. In most cases, monies released through Dutch debt relief were freely disposable. An exception was the multilateral debt relief given to Peru in 1998 which was earmarked for the fight against drugs. MDFs sometimes also set requirements regarding the allocation of funds that were thus released. In Bolivia, for example, there had to be a noticeable effect on government expenditure in the social sectors, and in Tanzania on 'other' (i.e. non-salary) expenditure in priority sectors.

In Mozambique the MDF consisted only of an account with the Central Bank and in Uganda no conditions were set on the expenditure of released funds either.

The forgiveness of *bilateral export credits* to Bolivia and Tanzania was in accordance with agreements in the Paris Club, so they concerned only debt service. They probably had an effect on the flow of debt payments, but not in Tanzania in 1990. Since this involved forgiveness, the stock of outstanding debt was reduced.

The Netherlands contributed to the *buyback of private debts* through the IDA-DRF; this had no flow effect, but did affect the stock of outstanding debt. In most cases, by far the greater part of commercial debts could be bought back (Table 6-2). The percentage was somewhat lower in Mozambique; however, soon after the buyback operation, agreements were reached with banks in Brazil, so that also for this country the greater part of commercial debt was eliminated. The price paid by donors was only a small percentage of the nominal value of the debts (Table 6-2), made possible because private banks had already largely written off the debts. In Bolivia the price was highest at 17% of nominal value, but

Table 6-2 Buybacks of private debt in the eight countries in the 1990s, to which the Netherlands contributed[1] (in millions)

		Buyback (nominal value of the debt)	Share of total private debt	Price	Total costs	WB contribution	Netherlands contribution[2]	
		USD	%	%	USD	USD	USD	NLG
Bolivia	1993	194	98	17	32	n.b.	2.8	5
Nicaragua	1995	1377	81	8	110	40[3]	6.2	10
Mozambique	1991	203	64	10	20	n.b.	2.1	4
Uganda	1993	153	89	12	23	10	2.6	4.9
Zambia	1994	200[4]	80	11	25	12	2.8	5.1[5]

1 Amounts in USD or guilders (NLG) and in percentages where indicated; n.a. = not available.
2 Calculated on the basis of NLG/USD exchange rates from the ABN-AMRO website.
3 Including a contribution of USD 40 million from the IDB in the form of a loan.
4 In total USD 570 million private debt, including some very old arrears, could be eliminated.
5 The Netherlands had initially promised NLG 9 million, but when the costs proved lower the remaining US$ 3.9 million were transferred to a non-earmarked World Bank account.

Source: Country studies.

that was the second buyback financed with donor funds. The first, in 1987, was at a price of 11%. The higher price in the second buyback operation reflects Bolivia's improved creditworthiness in 1993. In Nicaragua in particular, buybacks enabled a considerable part of total debt and of arrears to be taken out of the market, but in other countries too, arrears were substantially reduced.

6.3.1 Additionality

If debt relief substitutes for other forms of aid it does not provide extra resources for the recipient country. The degree of additionality of debt relief is thus important, at least for the question of whether it releases any funds. Non-additional debt relief can still help to reduce outstanding debt stock. From the point of view of the Dutch development co-operation budget, none of the debt relief expenditures discussed here were additional because they were all financed from that budget. Debt relief has thus reduced the availability of funds for other forms and destinations of foreign aid.

From the viewpoint of the eight countries in question, Dutch debt relief may have been additional. Whether or not that was the case is difficult to establish. Insofar as it is known from which programme the debt relief was financed (in earlier years that was not always the case), most of it came from that for macro-economic support which was a 'world-wide' programme. It may be that the country in question would in any case have received something from that budget, e.g. balance of payments support. The middle-income countries Jamaica and Peru probably would not have received macro-economic support, if they had not been heavily indebted to the Netherlands. To them, therefore, Dutch debt relief was probably largely additional. Due to their lower incomes, the other countries presumably did have a claim to macro-economic support, but in all probability they were given more due to their high debt burden. In these countries, therefore, some additionality of debt relief from the Netherlands seems likely.

On the other hand, a portion of debt relief was certainly not additional to regular aid in the eight countries. In some, debt relief came partly from the country programme budget or a regional budget.[64] In Tanzania, bilateral debt relief on mixed credits came from the country budget; in Bolivia, Peru, Uganda and Zambia, it came partly from regional budgets.

64 In the latter case, it is still possible that debt relief for a particular country was additional, namely, if an extra payment from the regional programme budget was at the expense of what would otherwise have been received by other countries in the region.

Relief on debt service to multilateral institutions was probably also not always additional as it often replaced Dutch balance of payments support or budget support. In Nicaragua, for example, debt relief on multilateral debt service was not given every year, and was alternated with bilateral balance of payments support or budget support. Roughly the same pattern occurred in Tanzania, where even the (major) debt relief given on bilateral export credit debt in 1997 replaced balance of payments support in that year.

As most debt relief to the eight countries did not reduce the volume of (other) Dutch aid to the same countries, it can be assumed that the Netherlands[65] in general gave more aid to countries with large debts (and as far as middle-income countries are concerned, to countries with large debts to the Netherlands), than to countries with low debts. This implies that debt relief led to a smaller aid budget for low-debt countries.

6.3.2 Bailout and moral hazard

Debt relief also does not yield extra funds for the recipient country if it is used to bail out other creditors to whom the benefits then fall. But even if those benefits do not accrue wholly or partially to other creditors, the bailout or take-over of obligations to other creditors can lead to moral hazard. The original lenders then do not themselves have to bear the cost involved in their own misjudged lending decisions, and can more easily be tempted to extend new loans even if repayment is not assured.

The question of whether debt relief leads to bailouts of other creditors has been asked particularly with regard to private creditors, and far less if at all with regard to official (multilateral or bilateral) creditors. For all three groups there was evidence of bailing out, but it gave rise to varying degrees of moral hazard.

Buybacks of *private debt* did imply the bailout of private creditors who, however, had by then already written off the greater part of their claims. In the five cases involved in this evaluation, the degree of bailout varied from eight to 17 percent (see Table 6-2). In general the price involved in a buyback is slightly higher than the market value of the debts at the time, because allowance is made for a price hike after the buyback as the value of remaining debt claims increases. This mechanism therefore slightly increased the cost for

65 As did many other bilateral donors, see section 3.3.

the donors.[66] The buybacks of private debt through the DRF described here, however, involved almost the entire stocks of private debt. The official creditors thus gained greatest advantage from the increased value of remaining debt titles. Moreover, private creditors had long discontinued the provision of new loans to the countries concerned. Moral hazard was thus negligible. Insofar as the buyback did lead to new private loans as in the case of Bolivia, they have since all been repaid.

The help given by the Netherlands and other donors towards the elimination of arrears and the payment of debt service to *multilateral creditors*, was, by definition, a question of bailing out. Given the agreement within the international community that multilateral institutions were preferred creditors, however, the take-over of debt service did reduce the debtor country's burden of payments. They did not increase the income of multilateral institutions in that the debt service would in any case probably have been paid in full. In taking over arrears, the case is slightly different because these would have continued if bilateral help had not been forthcoming, and the institutions might ultimately have been forced to write off part of them. Even then, however, the major shareholders of the multilaterals, i.e. bilateral donors, would ultimately have had to bear the cost of that write-off.

Once its arrears have been taken over, the debtor country again has access to new loans from multilateral institutions. This naturally increases its flow of funds, but it is questionable whether the resultant flow of new loans is always desirable. This may also be asked regarding the take-over of multilateral debt service. As has been discussed in Chapter 3 above, there is a case of moral hazard among multilaterals, which continue to provide loans even when countries are unable to repay them or if no profitable destinations are available. This helps to maintain the cycle of aid, new loans and debt relief, and contributes to the still unsustainable debt burden (see Chapter 4). Moreover, as was pointed out in Chapter 3, loans by multilateral institutions are in fact paid for in three ways by bilateral donors.

In comparison to other donors, the Netherlands has contributed liberally to enabling multilateral institutions to make concessional loans, and is more active than most other

66 There has been much discussion in academic literature, particularly regarding the first donor-financed buyback. Bulow and Rogoff (1988) argued that this buyback mainly favoured private creditors, and that donors could have used their aid moneys more effectively. Sachs (1988) considered the net effect for Bolivia to have been positive, primarily because donors had financed the action and also gave more aid, and because access to private export credit was restored. From this evaluation it seems that Bolivia, after both buybacks in which all private arrears were eliminated, regained access to long-term private loans. Ultimately, the positive effect was probably greater than could have been anticipated immediately after the first buyback.

bilateral donors in taking-over debt service to those institutions. This policy has contributed quite considerably to the moral hazard involved and to maintaining or increasing the lending volume of multilaterals.

If the restructuring or forgiveness of *export credit debts* is paid out of the Development Co-operation's budget, this is in principle a question of bailout. It is an established fact that ECAs in wealthy countries long continued to provide credit and guarantees to countries that had long been unable to repay their debts. Exporters shifted the risks of doing business with such countries onto the state (Ministry of Finance). Since that Ministry is responsible for the Nederlandse Credietverzekering Maatschappij (Netherlands Credit Insurance Co. [NCM]) and can thus influence its policy, no moral hazard is involved as long as the same ministry also carries the cost of debt forgiveness. Although since 1997 these costs are charged to the development assistance budget, the Ministry of Finance is immediately responsible for the expense if a debtor defaults, whereas the debt is often not written off until years later (after an agreement has been reached in the Paris Club). In view of this often considerable time lag no moral hazard is involved.[67]

Forgiveness of *bilateral concessional debts* does not involve bailout because Development Co-operation itself has to bear the costs of its earlier decisions. Since 1992, the Netherlands has given no more aid in the form of loans but only as grants. There are still a few programmes, however, which enable commercial loans to be made by mixing them with grants, for example, that of Ontwikkelingsrelevante Export Transacties (Development-Relevant Export Transactions [ORET]). In carrying out the country studies for this report, it was found that some countries receive debt relief from the Netherlands, but at the same time entered into new loans with this country. Tanzania called on the ORET programme, for example, on various occasions in the 1990s.[68] The combination of debt relief and ORET occurred quite regularly.[69] There is no question here of moral hazard because aid funds are involved in both cases, but it does detract from the coherence of Dutch development co-operation policy.

67 This long time lag between the immediate expense and the ultimate write-off only prevents moral hazard as long as budgets are based on a cash system. In the (forthcoming) accrual system the Ministry of Finance maintains a claim that will either be settled by the debtor country or by Development Co-operation.

68 In 1998 a new ORET transaction was almost blocked because the Tanzanian government has to take on the loan portion which is non-concessional. This conflicted with the HIPC initiative rules on debt management. The solution, found in consultation with the Netherlands, was that Tanzania in effect did not formally borrow but paid the amount due "in cash" in two instalments (over two years).

69 IOB 2002, Table 5.3 in section 5.7.

6.3.3 Efficiency of conditionality

In general, for debt relief given within the framework of the Paris Club, the Netherlands sets the same conditions as the Club itself, namely, an agreement with IMF. The appraisal procedure for decision making on bilateral forgiveness, multilateral debt relief and buy-backs has been expanded and formalised gradually during the 1990s.[70] The country studies have also shown that, in the first half of the decade in particular, much debt relief was granted without an explicit rationale laid down in an Appraisal Memorandum. In the second half of the decade the so-called 'macro-exercise' was applied in almost all cases: i.e. an evaluation was made of the need for debt relief, and of the quality of the policy and governance of the debtor country.

The country studies show a number of cases in which the macro-exercise was not applied consistently. In 1997 Nicaragua was forgiven bilateral debt service after being evaluated according to the macro-exercise. In the same year, that country was given no multilateral debt relief although it had received it in 1995 and 1996 and again in 1998. The lack of an IMF agreement was apparently more important to the take-over of multilateral debt service, while for bilateral debt relief it was noted that 'an IMF agreement is imminent'. Thus policy continuity was a consideration for bilateral but not for multilateral debt relief. In September 1999, The Hague decided to make a new contribution to multilateral debt relief, but did so without consulting with the Embassy in Nicaragua. At the time donors in that country were then very dissatisfied with the quality of governance. In an attempt to bring pressure to bear on government, no other bilateral donor provided programme aid in that year. The debt relief provided by the Netherlands thus detracted from the effectiveness of that collective pressure.

After 1996, Peru was still given bilateral debt relief although the country's debt situation made it unnecessary, there was no IMF agreement (needed), and Peru had not asked for it. Moreover, Peruvian governance and the human rights situation in the country left much to be desired. Jamaica, on the other hand, asked for debt relief in 1998 but was refused on the grounds that the country had no agreement with the IMF. In Zambia too, Dutch debt relief was not given in 1996, 1997 and 1998, although the country was in great need of it. Zambia did have an agreement with IMF but, like many other bilateral donors, the Netherlands was probably dissatisfied with the quality of Zambia's governance. It is questionable, however, whether this decision was consistent with those taken regarding other countries.

70 IOB 2002, p.35 ff.

6.4 Effectiveness

In five of the six low-income countries studied in this evaluation, the combination of too little debt relief, much project aid and high debt payments caused budgetary problems for central governments, particularly as regards current expenditure. Since Dutch debt relief released fairly considerable funds (owing to the large share of relief on multilateral debt service), the Netherlands probably helped to prevent an even worse situation regarding current expenditure on the social sectors. This applied particularly in Bolivia, Nicaragua, Mozambique, Tanzania and Uganda. It was less the case in Zambia where debt relief was discontinued in the second half of the 1990s.

Debt relief on aid loans by the Netherlands was given fairly often in the form of forgiveness of debt service (instead of restructuring) and also of principal, and thus helped to reduce debt overhang.

Dutch contributions to the buyback of private debts via IDA-DRF were effective. Since almost all private creditors had already written off the greater part of the claims and almost all creditors took part, this form of debt relief entailed little if any moral hazard. Private arrears and outstanding debts were almost completely eliminated and, in Bolivia for example, this paved the way for new private loans. That this did not occur in all countries was due to other factors, e.g. some countries were still in arrears to other creditors.

At the end of the 1990s, external debt in seven of the eight countries was still unsustainable. Debt relief actions by the international community were inadequate; moreover, debts increased during the decade with yet more loans. With the exception of Peru, the larger part of these new loans came from the multilateral institutions. The Netherlands played a fairly considerable role in making this possible, particularly among low-income countries. This was done both directly, through contributions to the ESAF interest subsidy account and to IDA's Replenishments (and, in the case of IDB, to the Special Operations Fund), and by taking over debt service to those institutions so that the latter were not confronted with the weak payment capability of these still insolvent countries. The contributions by the Netherlands are given in the form of grants, then converted into loans by the institutions. This conversion proved expensive for the donor, and does not seem to have been in the best interests of debtor countries.

71 Represented by the Paris Club and by the managements of IMF and World Bank.

6.5 Relevance

Debt relief has generally had little impact on economic growth. It has not been sufficient, and moreover has often been provided in inappropriate modalities. The international community[71] based its policy on the assumption that debtor countries only had liquidity problems, while the majority were in reality insolvent. In addition, the context in which debt relief was given was not always effective, while some of the policy conditions attached to it actually had a negative effect.

Dutch debt relief policy (that is to say, the policy of the Minister for Development Co-operation) more frequently took the view that debtor countries lacked solvency. Understandably, the Dutch contributions were not of sufficient weight to generate any noticeably positive effects in debtor countries.

Moreover, Netherlands' policy (including that of Development Co-operation) in this respect was not always consistent: while solvency seemed to be emphasised with regard to bilateral and also private debts, relief of multilateral debts mostly assumed a liquidity problem. Based on that assumption, new loans by multilateral institutions were applauded and facilitated, and obligations by debtor countries to those institutions were subsequently taken over.

As regards conditionality for Dutch debt relief, the Netherlands has always followed IFI conditionality in the context of the Paris Club, and mostly followed it in its own development co-operation policy.

6.6 Conclusions

1. The eight country case studies confirm that, during the 1990s, the Netherlands provided fairly considerable funds towards relieving the debts of poor countries. The Netherlands participated in all modalities of debt relief and its contributions were considerable in comparison with those of other donors. Dutch Development Co-operation frequently exceeded agreements in the Paris Club by forgiving debt service obligations on aid loans rather than restructuring them. Sometimes this concerned not only the debt service that was to be consolidated under the Club's agreements, but also outstanding capital sums.

2. Relief on debt service was effective in Jamaica and Bolivia because those countries had no (more) arrears at the start of the evaluation period. Taking part in the Support

Group for Peru was also effective because it helped that country to become creditworthy. That the Netherlands more often forgave rather than restructured in the five HIPC countries with massive arrears was in keeping with the fact that these countries were insolvent. However, the Dutch debt relief was obviously not sufficient to eliminate all arrears in those countries. Similarly, the buyback of private debts helped to reduce debt overhang, but in most countries that was not enough to make them creditworthy.

3. In the six low-income countries the Netherlands gave fairly substantial debt relief on multilateral debt obligations, and thus released quite considerable resources. On the other hand, this practice did not contribute to the solution of the debt problem. The policy with regard to multilateral debt was based on the idea that countries suffered a liquidity problem and not a solvency problem. On the basis of that assumption, the Netherlands helped considerably in enabling the multilateral institutions to extend new concessional loans, and subsequently also took over the payment obligations of debtor countries to those institutions. This was not efficient because Dutch grants were converted into loans which then had to be repaid in two ways: Dutch bilateral claims lost in value because multilateral institutions were preferred creditors, and the Netherlands frequently took over the debt service to those institutions. It was also ineffective because it caused moral hazard among the multilateral institutions (which did not have to bear the consequences of their own inadequate lending policy) and led to a greater volume of loans than was desirable in view of the continued insolvency of the recipient countries.

4. In setting conditions for debt relief, the Netherlands generally complied with Paris Club rules. In giving relief on multilateral, private and bilateral export credit debts the IMF was followed invariably, as it was almost always when giving relief on bilateral aid loans. This indicates the central role that the Netherlands assigned to the IMF and, to a lesser degree, to the World Bank as gatekeeper for macro-economic aid, and also the great significance that was attached to the new programmes of those institutions. One of the outcomes of those programmes, however, was that the high volume of lending continued.

5. For the eight countries examined, debt relief by the Netherlands was partly additional to regular aid. This implies that the additional part of the debt relief was given at the expense of aid to other developing countries, probably those with lower debt levels.

7 Lessons for the HIPC process

7.1 Introduction

In the light of the findings of this evaluation, this chapter analyses the possible results of the HIPC initiative, i.e. debt relief action programme for heavily-indebted poor countries.

The main purpose of this analysis is to explore whether the enhanced HIPC initiative, implemented by the international community since 1999,[72] is likely to lead to a sustainable debt burden in the future, and to economic growth and a reduction of poverty in the countries concerned. Is debt relief within the HIPC initiative sufficient, is it given in the most appropriate way and with adequate conditions?

Unless otherwise mentioned (through references to literature that is generally available), the analysis is based on the case studies of the six HIPCs that have been investigated in the framework of this evaluation. On some aspects, only information gathered during the field studies of Mozambique, Tanzania and Nicaragua could be used. The group of six countries constitutes, of course, a limited sample, but it does include the four countries that first reached the HIPC Completion Point (Uganda, Bolivia, Tanzania and Mozambique). In addition, Uganda and Mozambique (and recently also Tanzania) are frequently held up by IFIs as examples to other countries.

7.2 Amount of debt relief

The HIPC initiative leads to debt relief to such an extent that the Net Present Value (NPV) of external debt is brought down to 150% of exports. For this purpose, the average value of exports over the three years preceding the Decision Point is used. In principle, all creditors cooperate in this exercise. Contributions by the various groups of creditors to the total debt reduction are proportional, i.e. all groups reduce the NPV of their debt by the same percentage. The Paris Club does this by reducing the still outstanding debt stock by 90% (on debt prior to the cutoff date); multilateral institutions do so by forgiving annually a certain, fixed percentage of the debt service on debt outstanding at the Decision Point, over a 15-20 year period. Other bilateral creditors (who do not belong to the Paris Club) and commercial creditors are encouraged to reduce the NPV of debts by the same percentage.

72 See Annex 3 for a brief description and the background of the enhanced HIPC initiative.

The amount of debt relief under the enhanced HIPC initiative is greater than has ever previously been given. The NPV of debts is reduced by an average of two-thirds, signifying a substantial reduction. This also implicitly recognises that, in the past, debt relief has been insufficient. Another positive factor is that debts to *all* creditors are involved in the agreement; in other words, including those to IFIs. In this way, the international community acknowledges that the multilateral debt burden forms part of the problem.

It is still uncertain, however, whether this will make the debt burden sustainable. After reaching the Completion Point, will the HIPCs be able to meet their obligations without compromising their economic growth?

A first problem is that some bilateral and private creditors (still) do not participate in the HIPC initiative. Mozambique and Tanzania, for example, have reached the Completion Point, but 10-12% of their debt is to non-participating creditors (IMF & IDA 2002). During the field studies it became clear that this caused considerable uncertainty among their Central Bank representatives. At present, they are not making payments on those debts. If agreements were reached with these creditors in accordance with the HIPC initiative, debt payments would rise but, in principle, would remain within the margins of sustainability. If the creditors concerned refuse to agree with the proportional contribution to debt relief and demand payment in full, however, the debt burden will rise to a far higher level.

An issue related to the design of the initiative is that in the debt sustainability analyses that are made before the Decision Point, sustainability is measured as the ratio between public and publicly guaranteed debt and exports of goods and services. It is questionable whether these exports are always a relevant measure of government's capacity to pay its debts. They include, for example, remittances made by workers abroad to their families at home, and exports from enclaves such as the new Mozambican aluminium smelter Mozal (claimed to be the world's best investment project in 2000). Governments are usually not able to levy taxation on private transfers, and Mozal does not pay import, export or income taxes. The sustainability of public debt is thus depicted rather too favourably.

A more practical problem is that the debt sustainability analyses were based on optimistic predictions regarding the growth of exports and GDP. Although these predictions have no influence on the amount of debt relief (which depends on debt in the Decision Point year and on exports during the preceding three years), they are significant for the

future sustainability of debt. Export growth for the 26 HIPCs that reached the Decision Point in September 2002 was predicted to average 7.5% per annum, although the average over the past 30 years had been only 4.7%. Predictions by IMF and World Bank staff have generally been based on too optimistic assumptions regarding macro-economic developments (IMF & IDA 2002:28).[73]

The export revenues of most HIPCs depend largely on a limited number of primary products. As a result, incomes can fluctuate strongly. Most analyses regarding debt sustainability were made in 2000 (on the basis of data up to and including 1999), i.e. just prior to a world-wide fall in the prices of many raw materials. Most of the 24 countries that had reached their Decision Point by January 2002 proved to have had export revenues in 2000 and 2001 that were lower than anticipated. As a result, their expected debt/export ratio at the end of 2001 has deteriorated when compared with earlier predictions (Geithner & Nankani 2002). In principle, the initiative allows for re-calculating the amount of debt relief needed at the Completion Point, so that a country may receive extra debt relief. That occurred in Burkina Faso, for example, when the Completion Point was reached in April 2002 (IMF & IDA 2002). Once countries have passed their Completion Point, however, the amount of debt relief is fixed.

A deterioration in the debt/export ratio can also be caused by an extra increase in the debt. In Bolivia and Uganda the ratio proved to have worsened after the Completion Point had been reached. In Uganda this was principally due to the fall in coffee prices, but Bolivia proved to have taken on new non-concessional foreign loans in order to cover its budget deficit (Geithner & Nankani 2002:17-18).

In general, the debt sustainability analyses carried out for the HIPC initiative show that debt is likely to increase strongly in the coming two decades. However, since it is assumed that exports will grow rapidly and that new debts will be concessional, the indicators for sustainability improve in the prognoses. These predictions are at odds with the analyses of longer-term debt sustainability, presented in 4.6 above, which show that if trade deficits continue unchanged, countries will remain so dependent on new loans that they will quickly have an unsustainable debt burden once again. This also applies to

73 It is, of course, possible that elimination of the debt overhang will lead to extra growth. In view of the analyses in 5.5 above of obstacles to private investment, and also that in 3.4.4 and further on in this chapter (new loans and little attention for the stimulation of economic growth), however, optimism in this regard seems misplaced.

countries that have mostly received concessional loans. Moreover, the domestic debt situation is worsening rapidly in many countries. This is often non-concessional debt and thus causes a far higher debt service than predicted.

It is also not always evident that the debt service actually decreases in the short term in those countries that have reached the Decision Point of the HIPC initiative. Calculations in the HIPC analyses compare debt service due before and after that initiative. Prior to HIPC, however, many countries paid only a small part of what they should have paid; actual debt payments consequently sometimes rise because one of the HIPC conditions is that obligations remaining after debt relief must be met punctually in future. Since hurricane Mitch (1998), for example, Nicaragua has paid no debt service to Paris Club members. The payments have been deferred and do not form part of the forgiveness of 90% of the debt stock anticipated when the Completion Point is reached. Forgiveness of that debt stock thus does not cause any decrease in actual debt payments. Nicaragua's multilateral debt service will probably also increase in the next few years. Outstanding debt to multilateral development banks has increased strongly since 1991. Its 10-year grace period means that debt service will increase each year after 2001. Multilateral debt relief is a fixed percentage of that debt service and thus also increases each year. However, the portion that has to be paid by the country itself inevitably also grows each year. Zambia was faced with a similar increase in 2001, soon after reaching the Decision Point. Actual debt service rose strongly due to a large IMF loan in 1996, which had to be repaid starting in 2001.

Another short-term problem is that many countries still have to overcome major obstacles before they can reach their Completion Point. Although the floating Completion Point was intended to give good performers earlier access to full debt relief, the practice proved otherwise. Of the 20 countries now in the Interim period, 10 are off track from their IMF programme or have not managed to implement particular reforms (IMF & IDA 2002). In some countries, attainment of the Completion Point is also delayed because they have not been able to draw up a complete PRSP. In such cases, multilateral institutions sometimes refuse to provide interim debt relief, so that the countries in question as yet benefit little from the HIPC initiative.

Finally, in both the short and the long term, it is still unclear to what extent the promised debt relief will be additional to regular development aid (see below).

7.3 Modality

As regards the modality of debt relief, the HIPC initiative signifies a break with the past. No longer is only debt *service* partially forgiven but now also debt *stock*. Although multilateral creditors do not give debt relief immediately but spread it over 15 to 20 years, the amount of debt reduction is fixed on reaching the Completion Point. Uncertainty on the part of debtors regarding future payments will thus be lessened. This substantial reduction of the debt(stock) itself and the accompanying reduction of uncertainty is, in view of the findings of this evaluation, of great significance and is expected to stimulate economic growth. This is on the condition, of course, that the debt burden does not increase at the same time (see below). Moreover, as we have seen above, uncertainty still exists regarding part of the debt owed to private creditors and to official bilateral creditors who do not belong to the Paris Club.

Theoretically, the HIPC initiative should put a halt to two other negative consequences of the manner in which debt relief was given during the 1990s. Firstly, the costs of debt relief is divided in a different way among the various categories of creditors. Now that multilateral institutions for the first time pay part of debt relief, moral hazard among these institutions will decrease. Secondly, implementation of the HIPC initiative should put an end to adverse selection: if debts are sustainable, donors will no longer be forced to provide more aid to heavily-indebted countries and will be able to avoid giving it to countries with poor policies. Donors will be able to be more selective in the allocation of concessional loans and grants.

Further consideration of the financing of debt relief on multilateral debt, however, makes it evident that bilateral contributions are still essential. As regards the World Bank, the HIPC initiative is paid from the HIPC Trust Fund to which the Bank has committed USD 2.15 billion out of IBRD profits. So far, bilateral donors have pledged more than USD 2.5 billion to the Trust Fund, but that money is used to finance debt relief by other multilateral development banks. Total costs for the World Bank are expected to amount to USD 8.1 billion. The remainder (8.1 *minus* 2.15, i.e. USD 5.95 billion) will have to be met from bilateral contributions in the framework of the 14th IDA Replenishment, planned for 2005 (IMF & IDA 2002:13). The greater part of anticipated costs will thus have to be paid by bilateral donors. If that money is not forthcoming, debt relief will be at the expense of new World Bank loans to the poorest countries.[74]

74 If the funds do become available, it will probably be at the expense of bilateral grants (see the remarks on additionality below).

The costs of the HIPC initiative for the IMF are estimated at USD 2.7 billion (SDR 2.2 billion), a large part of which will have to be met from the IMF's own resources. At first, IMF planned to sell part of its gold reserves for the purpose, but this was objected to by the major gold-producing countries. The plan was then changed to 'off-market' gold sales, meaning that a quantity of gold is be sold symbolically and then bought back in the framework of a transaction with a member state. This 'paper' sale and repurchase of gold enables its book-value to be upgraded. The investment income on the proceeds of this upgrading, to the amount of SDR 1.8 billion, is then used for the HIPC initiative. IMF has also contributed SDR 0.4 billion from other sources. The disadvantage of using the book-keeping profit of symbolic gold sales is that a slightly larger part of IMF's capital becomes illiquid (Felgenhauer 2000:245), thus reducing the basis for future loans. To restore this lending capacity, the IMF would have to appeal to its shareholders.

For the multilateral development banks, and to a far lesser degree also for the IMF, bilateral donors finance part of the relief given on multilateral debts. There is thus still a risk of moral hazard. It is already clear that multilateral institutions continue to provide new loans to countries that have reached their Decision Point. Although these loans have a grace period of 10 years (World Bank and other development banks) or five years (IMF), they will eventually increase debt service. If problems should re-appear regarding debt sustainability and debtor countries are again unable to pay off their debts, it is likely that the multilateral institutions will again be preferred creditors and that bilateral donors once again will have to step in with relief on multilateral debt service.

If some countries in future years again face an unsustainable debt burden, it is unlikely that donors will become more selective in allocating their aid. Multilateral institutions will continue to give more loans to countries that are already highly indebted to them, and bilateral donors will continue to provide them with grants that will be used to service multilateral debt. There is thus a likelihood that adverse selection will continue.

Another problem connected to the bilateral payment of multilateral debt relief is the possible lack of *additionality* of that debt relief in relation to regular aid. This is usually discussed in connection with the lending volume of multilateral institutions: bilateral donors have to share in the costs of multilateral debt relief because otherwise the concessional lending capacity of the multilaterals would be affected. Given that the magnitude of total foreign aid has long shown a falling trend, however, to keep that lending volume at its present level would mean that bilateral aid would decrease. Aid recipients would

then be faced with a greater share of loans as against grants in the total aid volume, and that would certainly not be in their interest.[75]

The great significance of the elimination of the high debt burden for the future economic growth of debtor countries, throws a different light on discussions about a possible lack of additionality. Even if debt relief does not release additional funds, it has a positive effect on economic growth by reducing or, better, eliminating the debt overhang –provided that the amount of relief is sufficient and the volume of new loans remains limited. Seen in this light, the lack of additionality by multilateral institutions can only be considered an advantage since it increases the possibility that new loans will be held in check. The lack of additionality should cause concern, however, if it involves a possible reduction of concessional funds for *other* poor countries with low debt levels.

7.4 Context

Before the HIPC initiative, the most important condition for debt relief was that there should be an agreement with IMF regarding structural adjustment. Chapter 3 above described (3.4.1) that conditions for the enhanced HIPC initiative also contain the formulation of a strategy for reducing poverty (PRSP) with civil society participation. In addition, debt relief given in the interim period (between the Decision and Completion Points of the HIPC initiative) must be used to implement the PRSP. To reach the Completion Point, each country must also execute a number of more conventional reforms and must be on track with an IMF agreement. The conditions for debt relief are thus more comprehensive than in the 1990s and also far more elaborate than those of the original HIPC initiative under which only past adjustment measures were evaluated. In view of the fact that, in roughly the same period, broad consensus was reached in academic circles (Killick *et al.* 1998, Collier *et al.* 1997) and in policy-making circles[76] that it was useless to draw up conditions *ex ante* and better to apply selectivity (*ex post*), this is a possibly unintended but nevertheless almost absurd development.

Earlier research, discussed in 3.4.2. above, and the country studies carried out for this evaluation, have shown that the prior setting of policy conditions does not work. Governments will implement policy primarily if they had already intended to do so.

75 This might perhaps be (partially) compensated because they would also receive grants from IDA. In the 13th IDA Replenishment in July 2002 it was agreed that up to 40% of IDA transfers might be in the form of grants (IMF & IDA 2002).

76 See the 'Assessing Aid' report of the World Bank (1998), which enjoyed great support in the Netherlands.

Consequently, governments that do not consider poverty to be an important problem, will draw up a PRSP because they would otherwise not receive debt relief, but will not be too active in its implementation. The three field studies have shown that this was particularly the case in Nicaragua, but in Mozambique also there were discrepancies between actual policy and the PRSP (see 3.4.4).

In addition, earlier research demonstrated that setting conditions has little effect because actual sanctions are seldom imposed. They are not applied because of the conflicting interests of individual donors, or have little effect because donors do not act collectively. The HIPC initiative guarantees greater donor co-ordination, but it still seems difficult to impose sanctions that are effective. Partly owing to pressure brought to bear by international NGOs such as Jubilee 2000 and Eurodad, it is in the interest of the international community that many countries should be admitted to the HIPC initiative. In December 2000 in particular, this led to the approval of PRSPs that did not really deserve it, or to the admission of countries that could only stay on track with IMF with the aid of numerous artificial waivers. Later, in Nicaragua for example, the full PRSP was approved due to the political interests of one or two donors, although the donor community as a whole considered the government in power to be corrupt and not interested in the reduction of poverty (see 3.4.4).

Conditions for access to the HIPC initiative state that the PSRP must be drawn up with broad-based participation. The intention is to ensure a large degree of ownership; in other words, that the people consider the strategy to be 'theirs'. As described in 3.4.4 above, however, the principal reason why countries draw up such a strategy is that they hope to receive debt relief once it has been approved by IMF and World Bank. The result is a paradox similar to that arising from earlier combinations of conditions: countries *must* adopt specific legislation (on privatisation, for example) in parliament, and simultaneously *must* have a democratic system (Dijkstra 2002). Ownership and participation can only be of limited significance if the strategy requires IFI approval. The three field studies have shown that governments *have* organised meetings and, perhaps for the first time, have listened to representatives of NGOs and of the poor themselves. The dominance of multilateral institutions, however, limits the influence that such meetings might have had and also the degree of ownership. The fact that local NGOs were aware only too well of the need for debt relief made them reluctant to bring forward their own position on poverty reduction.

Another finding of this evaluation is that conditions so far attached to debt relief, i.e. the measures that belong to structural adjustment programmes, have not always stimulated economic growth. Conditions for qualification for the HIPC initiative include not only drawing-up a PRSP, but also conventional requirements regarding macro-economic stability and structural reforms. As regards the latter, earlier comments still apply. It is questionable, for example, whether the 'cost what it may' privatisation of public utilities has always been beneficial to the development of the country. The same applies to the (premature) liberalisation of the financial sector.

As regards the content of PSRPs, it was noticeable in the three field studies that all Joint Staff Assessments (JSAs) of PRSPs by the World Bank and IMF observed that although the strategies gave sufficient attention to the social sectors, they did not indicate adequately how economic growth could be encouraged or what its 'sources' would be. Notwithstanding these criticisms, the strategies were approved and now form the basis for the 'spending' of debt relief, or at any rate the interim relief provided by multilateral institutions. The question is whether these strategies will lead to *sustainable* (permanent) poverty reduction seeing that this requires economic growth. If the strategies do not lead to economic growth although they form the basis for government policy and for future aid allocations by donors, they will be of no benefit to growth and development in the debtor countries.

In fact, it is very difficult for HIPCs to elaborate a strategy for economic growth and to make it operational with concrete measures. Although each country should naturally have its own growth strategy, Chapter 5 showed that the eight countries investigated have a couple of factors in common that impede private investments. These are a lack and/or high cost of physical infrastructure (including roads, harbours, water and electricity supplies and telecommunication) and lack of finance. Government measures that could tackle these two problems either conflict with the neo-liberal policy advocated by multilateral institutions (e.g. subsidised credit or state development banks) or they go at the expense of investments in the social sectors – while HIPCs undoubtedly assume that social sectors now have higher priority in the eyes of the donor community. In both cases, the elaboration of such a growth strategy most likely provokes the rejection of the PRSP. The first problem is most probably greater and more basic than the second. The neo-liberal policy whereby liberalisation of markets is expected to encourage economic growth, by definition leaves little scope for growth-stimulating measures. The three field studies also showed that representatives of multilateral institutions were little interested in advice on

ways in which a country could implement such a growth strategy. Their attention was devoted almost entirely to advising on projects in the social sectors. With regard to economic growth, advice was limited to further privatisation and liberalisation.

Another reason for restraint in setting conditions on the use of resources that debt relief is assumed to release, is that these sometimes do not exist. Debt relief by the Paris Club is in the form of forgiveness on debt stock, which does not always lead to a reduction in actual payments. The specific profile of multilateral debt service (see above) also implies that actual debt payments to multilateral institutions do not always decrease.

Finally, donors sometimes grasp at PRSPs as a means for greater donor co-ordination in the allocation and monitoring of aid, although there was little evidence of this as yet in the three field studies. The situation is not the same in all countries, but many donors seem to insist on the monitoring of specific expenditure, or of particular indicators that are not functional and which can provoke negative strategic behaviour. Positive systemic effects are possible, but on the condition that donors concentrate on encouraging debate on the PRSP itself, on stimulating the compilation of data on poverty, on the development of indicators with which to measure progress, and on the improvement of general budgeting procedures, budget implementation and accountability (Berthélemy 2002, White & Dijkstra 2003).

There is a widespread idea, particularly advocated by NGOs, that debt relief should be given in exchange for policy that gives priority to poverty reduction. This makes the HIPC initiative look like a debt conversion, in particular a debt for development swap. The three objections voiced earlier by the Netherlands against such debt conversions (IOB 2002:111) are still largely valid, namely:

- Debt conversion is in effect double tying of aid and implies interference in investment decisions made by the recipient country. To this can be added that preconditions are not always effective, and that the implementation of those measures does not always have positive effects on economic growth. If the PRSP places too narrow an emphasis on expenditure for the social sectors and neglects growth, the effect on sustainable poverty reduction will be negative.

- Debt conversion may cause higher government expenditure and thus (dependent on the financing method used) possibly lead to higher inflation. In the present context

this applies particularly to countries where debt service in the short term has been reduced little if at all (see above). It can also occur in countries that so far have expended little on the social sectors (Berthélemy 2002). The HIPC initiative forces such countries to spend more on social projects from their tax income, possibly at the risk of a greater deficit or at the cost of expenditure that would have had more effect on economic growth.

- Debt conversion is not very efficient in that it leads to greater complexity in the administration of funds. This is certainly the case under the HIPC initiative when donors continue to apply different monitoring systems.

Moreover, as long as debt relief remains tied to policy conditions, it is unlikely that donors will apply greater selectivity. Because countries are highly indebted, the cycle of debt relief, aid and new loans will continue. Debt relief is in itself so necessary and inevitable that even countries where corruption is rife, those with poor policies, and those where genuine participation does not exist, have received it or will eventually do so. Highly indebted countries will also continue to receive more aid than others.
Such adverse selection will only be reduced if debt relief is no longer tied to conditions. Donors could then start to be really selective in the allocation of new foreign aid.[77]

7.5 Conclusions

1. The HIPC initiative signifies a substantial increase in debt relief compared to the amount previously given. It is far from certain, however, whether debts of the HIPCs will be sustainable in the longer term. Most countries have export incomes that are vulnerable; also, they frequently take on new loans that increase their debt burden. Even in the short term, they do not always experience any reduction of their actual debt service.

2. The debt relief that is given at the Completion Point of the HIPC initiative implies a reduction of the debt *stock* and thus reduces uncertainty regarding future payments. However, the large bilateral contributions to multilateral debt relief, and the expectation of multilateral institutions that they will again be bailed out in future, means

77 Although aid continues to face the dilemma that countries with bad policies and/or governance are frequently very poor and desperately in need of aid, it could be decided to give no more aid to governments but possibly to NGOs in these countries. There is no longer any reason to continue to give loans and grants to government.

that moral hazard continues among those institutions, as does the risk of too great a lending volume and adverse selection in the allocation of loans and grants.

3. This evaluation has concluded that debt relief often does not release funds but that it nevertheless, particularly in the case of elimination of arrears, can be beneficial to economic growth by reducing debt overhang. Some concern regarding a possible reduction of loans and grants to *other* low-income countries with low levels of debt, is certainly not misplaced. However, it is a positive factor if lack of additionality causes multilateral institutions to make fewer new loans to highly-indebted countries because it reduces the chance that the latter will in future suffer unsustainable debt levels. With a stagnating world-wide aid budget, extra payments by bilateral donors to multilateral institutions – intended to guarantee the 'additionality' of their concessional funds – signify merely that grants are converted into loans, possibly causing the debt problem to persist.

4. A serious problem of the HIPC initiative is that preconditions are set on debt relief. This is not efficient because past experience has taught that countries will do only what they had already planned to do. In addition, ownership and participation can only be limited because a PRSP's prime objective is to ensure debt relief, and plans are thus discussed principally with IFI representatives. As long as countries are heavily indebted to the multilateral institutions, the latter will continue to provide loans *for that reason alone*, and bilateral donors *for that reason alone* (i.e. because of the high debt itself, and because of the need for those countries to repay the institutions), will continue to give large amounts of aid. Sanctions on the non-compliance with conditions (e.g. drawing-up a good PRSP) will thus not be effective, as has already been proven. The *implementation* of a PRSP, i.e. the policy prescribed particularly by the IFIs, can be at the expense of regular and useful public expenditure, particularly if debt relief does not make additional resources available. Even apart from that, it is not certain that implementation of a PRSP will promote economic growth and help to reduce poverty.

ANNEXES

Annex 1 Policy and Operations Evaluation Department

The Policy and Operations Evaluation Department, in Dutch the Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie (IOB), is responsible for conducting evaluations of Netherlands foreign policy. Although part of the Ministry of Foreign Affairs, it operates as an independent unit.
At its establishment in 1977, the department's mandate was restricted to the evaluation of aid programmes. Following the reassessment of Netherlands foreign policy in 1995, IOB's mandate was broadened to include other fields of foreign policy. From 1977 to the mid-1980s, IOB's research was essentially limited to individual project evaluations, the status of which was then confidential. Since the mid-1980s, emphasis has shifted to comprehensive thematic studies, focusing on policies and modalities of implementation and covering sectors, themes or programmes.

External experts always participate in the various phases of the research, under the responsibility of IOB. Where relevant, institutions or individual experts in recipient countries are invited to take part in the fieldwork. In most cases reference groups consisting of independent experts and Ministry staff are appointed for the evaluations, to advise on the methodology, approach or subjects under review, and to comment on draft reports.

The final reports, based on various field and desk studies, are published under the responsibility of IOB. The Minister concerned submits IOB's reports accompanied by his/her policy reactions, to Parliament, where they are discussed by the Permanent Committee on Foreign Affairs.

Most of IOB's evaluation studies still concern development co-operation activities, as these absorb the largest volume of resources, but research in other fields is gradually increasing.
In addition to its own evaluations, IOB also participates in multi-donor evaluations.

Annex 2 Terms of Reference Evaluation study Debt Relief

- Final Text 18 January 2001 -

1. Rationale

An Evaluation of Dutch Debt Relief has been included in the working programme of the Policy & Operations Evaluation Department of the Ministry of Foreign Affairs for the year 2000. The decision to carry out such a study was based on three considerations, namely: (i) the size and persistence of the international debt problem; (ii) the volume of Dutch Development Assistance funds that have been invested in relieving the debt problem; and (iii) the fact that an external evaluation of debt relief had not previously been undertaken.

2. Background

Netherlands policy in the field of debt relief should be seen against the background of the international debt problem and the manner in which this has evolved.

2.1 Debt crisis

Although the outbreak of the international debt crisis is usually said to have occurred in 1982, the roots of the problem that led to it go much deeper. Various authors refer to the impact of the first oil crisis (1973), as a result of which the price of crude oil quadrupled and tens of billions of petro-dollars flowed from OPEC countries towards western banks. In their effort to recycle this gigantic cash flow banks started to issue loans on an unprecedented scale, to developing countries among others. The fact that little or no restraint was exercised is illustrated, for example, by the fact that at the end of 1982 the six largest American banks each had loans outstanding in just four Latin American countries (Argentina, Mexico, Brazil and Venezuela) to an amount that equalled or even doubled that of their own capital. On the debtor side, such transactions frequently showed a similar lack of prudence: many of these easily-acquired loans were used for consumer expenditure rather than for productive investments that would have generated the means with which to pay off the future debt burden. As long as interest rates remained low, however, and income obtained from raw materials exports by developing countries was high, the rising debt burden remained sustainable.

This changed with the second oil crisis in 1979, which caused oil prices to triple. The industrialised countries (led by the United States under the Reagan Administration which took office in 1980), in their effort to curb inflation, started to exercise a strict monetary policy which forced up interest rates and slowed down growth. The consequences for indebted developing countries were disastrous. The usually variable interest rate on their bank debts quickly changed from being negative in real terms to strongly positive, while the prices and volume of their raw material exports fell as a result of reduced demand from industrialised countries. This pincer movement of mounting obligations and falling income left the vulnerable debtor countries without a shadow of a chance. When, in August 1982, Mexico announced that it could no longer meet its debt service obligations, the debt crisis became a fact.

One of the most visible consequences of the outbreak of the crisis was the almost immediate collapse of the market for loans to developing countries. Internationally, this was seen as an extremely dangerous development because, when the crisis started, it was still assumed that payment difficulties experienced by debtors were mainly caused by liquidity problems that could be eased by a combination of restructuring current obligations and granting new (official and private) bridging loans. In this way, debtor countries were expected to gain the necessary time in which to put their internal affairs in order and augment their export capacity which should enable them to 'grow out of their debts'. This orthodox approach to the debt crisis was also prompted by the widespread belief that the biggest creditors (American and, to a lesser extent, European banks) had such high claims outstanding in the largest debtor countries (principally in Latin America) that any large-scale debt cancellation would threaten their own stability and, with it, that of the international financial system. In 1985, implementation of this restricted 'approach' to the debt crisis became known as the *Baker Plan* (after the then US Treasury Secretary).

Towards the end of the 1980s, however, it could no longer be maintained that the approach under the Baker Plan offered any hope of a structural solution. More was needed, in the shape of actual *relief* of the debt burden through (partial) debt forgiveness. This had become feasible because, in the meantime, the banks involved had had time to strengthen their capital base and, simultaneously, to reduce their exposure by selling debt titles on the secondary market that had come into existence. The new approach, again led by the US Treasury, the IMF and the World Bank, was launched in 1989 as the *Brady Plan* by Baker's successor. The essence of this plan was that participating creditors, in exchange for partial debt cancellation, should be given guarantees regarding repay-

ment of their residual claims. In this way, the plan explicitly acknowledged that the debt crisis was a problem of solvency rather than of liquidity. Similarly to its predecessor, implementation of the Brady Plan was coupled with drastic structural reforms. At the start of the 1990s, when the previously massive outflow of capital began to return to the larger Latin American countries, many thought that the debt crisis was over.

This was certainly not the case in Africa where the majority of outstanding claims were not held by private banks but rather by developed country governments. These were thus so-called official debts, originating under concessional aid loans (ODA) on the one hand, and export credits provided or guaranteed by governments, on the other. The forum for negotiations on this debt category had traditionally been the Paris Club. Similarly to the Baker Plan for commercial debts, the Club had long maintained that payment problems experienced by debtor countries could be solved through rescheduling (amounting mainly to longer maturities).

The fact that no permanent solution could be expected from such a limited approach was recognised only slowly. Between 1988 and 1996 this led to a series of debt relief conditions that gradually became more concessional and were applied by creditor countries united in the Paris Club in their negotiations with debtor countries. In all cases, relaxation of conditions (usually consisting of a menu of options: interest reduction, write-down of the stock of debt, or long-term rescheduling) required stimulus by the G7 summit meetings. That is why the successive packets of conditions are named after G7 meeting places: *Toronto terms*, *London terms*, *Naples terms*, *Lyon terms*. Under these successive 'menus' the reduction in net present value of eligible debt increased from 33 via 50 and 67 to 80 percent.

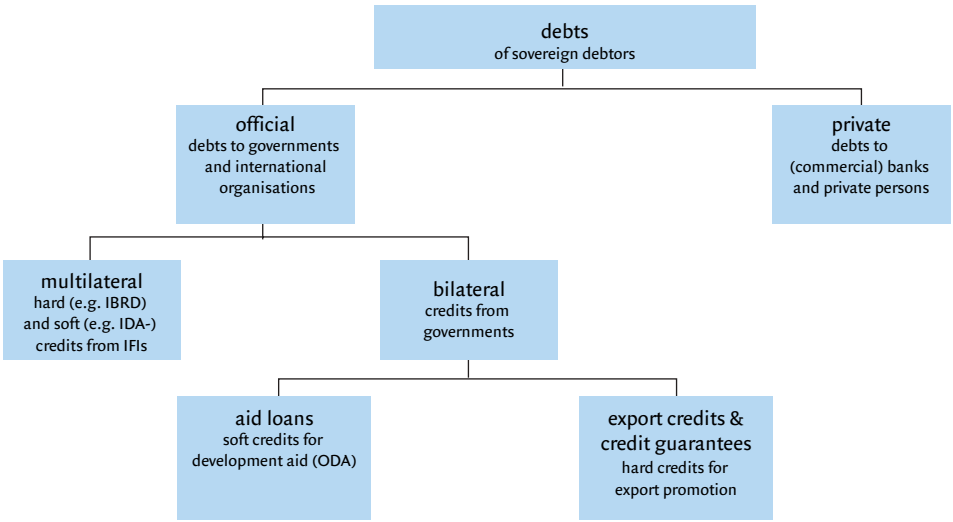
In the course of time, non-governmental organisations (NGOs) came to exercise increasing influence on international debt policy. In this respect the *Jubilee 2000* campaign attracted most attention and probably achieved the greatest effect. In particular, Jubilee's mass rallies around G7 meetings in the second half of the 1990s generated enormous publicity, stimulating participating heads of states and governments to make ever-greater concessions to debtor countries. This culminated in the so-called *Cologne terms* (1999) which offered the prospect of debt relief to a maximum of 90 percent, i.e. almost complete cancellation.

While the aid policies of bilateral donors increasingly replaced new loans with grants and relieved or cancelled old debts, the multilateral development banks and IMF continued to lend great sums of money, particularly within the framework of stabilisation and structural adjustment programmes. In this way, the debt burden of the Third World changed in composition. Towards the mid-1990s the share of International Financial Institutions (IFIs) had risen to a quarter of the total, and the 'multilateral debt problem' became a prominent item on the international agenda. Similar to other creditor categories, the IFIs strongly resisted the idea that they should write down their claims, referring in particular to their traditional status of *preferred creditor*. Nevertheless, in 1995, the World Bank and IMF organisations were ordered by their shareholders to draw up realistic proposals for relief of the multilateral debt burden. In 1996 this resulted in the *Heavily Indebted Poor Country (HIPC) Initiative*.

The HIPC initiative recognised that a number of debtor countries would never be able to reduce their debt burden to a manageable level without (partial) forgiveness. Under strict conditions, including a sustained structural adjustment policy, a maximum of 41 eligible countries could be offered the prospect, on an individual basis, of a definitive solution to their debt problem. All involved creditors (private, bilateral and multilateral) would have to cooperate proportionally, if necessary by reducing their outstanding claims. For the IFIs, traditionally proud of the fact that their claims were always repaid in full, this was an unprecedented change of course. It was not surprising, therefore, that their demands on participating debtors were great. According to some critics, their conditions were so strict and the ultimate debt relief so slight, that little remained of the real value of the initiative.

Pressure was consequently brought to bear from many sides for the liberalisation of both conditions and facilities. In 1999 this eventually led to a far-reaching adjustment of the original set-up, i.e. to the so-called *Enhanced HIPC Initiative*. Here, too, the G7 had to give the green light. The most important changes were the lowering of threshold values (for debt indicators) above which countries could be considered for HIPC aid, more flexible performance criteria for the adjustment policies to be implemented by HIPC countries, and the explicit linking of debt relief to poverty reduction, to be laid down in so-called *Poverty Reduction Strategy Papers (PRSPs)*. As a result, it was expected that the total costs of implementing the initiative will more than double, i.e. from USD 12.5 to USD 27.4 billion, to be divided about equally between bilateral and multilateral creditors.

Figure 1 Types of debt



Even from this brief description it is clear that there are many kinds of debt, to be classified in various ways. This is clarified in the Figure 1, concerned exclusively with so-called *sovereign* debt, i.e. debt incurred by governments of independent states. The debts of private debtors (individuals, companies, commercial banks, etc.) are left out of consideration, here and in the further study.

2.2 Netherlands policy

Although the Netherlands has long practised debt relief, it was only in the 1990s that it developed a debt relief policy that was recognisable as such. Previously, the Dutch government had responded to international appeals, e.g. when the UN called for the cancellation of *aid* debts to Least Developed Countries, and had supported the analyses and remedies of the Bretton Woods Institutions, but it had rarely developed an initiative of its own.

This situation changed with the publication in 1990 of the White Paper *A World of Difference*, in which international debt problems were given prominence and placed within a broader framework, together with concessional aid flows and trade policy measures. The Policy Programme 1990-93, intended to implement the White Paper, listed a number

of ideas for coping with the debt problem. These included the 'catalysing' use of development funds for partial debt relief, combined with increasing the quality of residual claims; the forgiveness of *all* official debts to LDCs and other low-income countries; various forms of debt swaps; the mobilisation of loan-loss provisions of private banks, and the combating of capital flight.
Furthermore, in 1990 the Second Chamber of Parliament received the first so-called *Debt Memorandum* which has since appeared annually. In that memorandum, the Minister for Development Co-operation explains the debt relief measures taken in the previous year.

Since 1991 the significance given to the new debt policy has been reflected by the name of the programme (previously: Balance of Payments Support), out of which the majority of debt relief activities are financed; the programme was re-named *Balance of Payments Support and Debts (cat.1-d)*. Since 1997 there has even been a separate programme called *Debt Relief (cat.VII-b)*. This intensification of policy gave rise to a rapid, though irregular, increase in expenditure on debt relief from less than NLG 200 million in 1990 to over NLG 500 million in 1999 (see below).
With the one exception described below, debt relief has always been completely financed from the development assistance budget and, in that sense, has never been additional to regular aid. Since the Re-evaluation of Foreign Policy and the definition of the aid ceiling given therein, debt relief has to satisfy the DAC definition of net ODA. The cancellation of principals of aid loans does not meet that definition; consequently, this form of debt relief has not been used since 1997.

Within the Netherlands, the catalysing input of debt relief funds from the development co-operation budget was first put into practice in 1990 in relieving export credit debts on the basis of consolidation agreements within the Paris Club framework. By financing debt relief partly from development funds, namely, for a percentage that corresponded to the real value of comparable debts of the country concerned on the secondary market, the Minister for Development Co-operation found his colleague in the Ministry of Finance willing to write off more debt than would otherwise have been the case. In addition to partial compensation out of the aid budget, the willingness to grant substantial relief reflected the acceptance of the practical impossibility of collecting the nominal value of the loans in question, a factor with which commercial banks had become familiar in the Latin American debt crisis. In accepting the loss of value, the creditor hoped that the quality of the remaining (not cancelled) part of his claim would improve.

The catalysing effect of such a concept, if applied by only one creditor, is, of course, almost negligible. Therefore, the Netherlands tried to 'export' the model, under which all parties involved (financier, creditor and debtor) had something to gain, so that its international application would have a noticeable effect on the debt situation of the poorest countries in particular. The so-called *Kok-Pronk Plan* was consequently submitted to various fora, including the Paris Club and the Interim and Development Committees of IMF and World Bank respectively, but with little success. The total cancellation of all bilateral official debt (i.e. both aid loans and export credits) to low-income countries, to be financed only partly from development budgets, was too radical for the other participants and the initiative failed to get off the ground.
In the Netherlands, the leverage of a limited input of aid funds in the hope of 'releasing' a far greater volume of debt relief, was not applied again after 1990. Under the Re-evaluation in 1995, on the other hand, it was decided that all future debt relief on guaranteed export credits, within the framework of Paris Club agreements, would be charged for the full nominal amount to the development co-operation budget. This came into force on 1 January 1997.

Dutch procedures for the granting of debt relief have evolved gradually during the evaluation period. When, in 1993, the Auditor-General's Office investigated decision-making procedures for the various forms of programme aid (including debt relief) and criticised their *ad hoc* character as being unsystematic and inconsistent, the Minister for Development Co-operation drew up the *Manual on Programme Aid* to provide the missing appraisal framework. After a major ministerial reorganisation in the wake of the Re-evaluation, decision-making procedures were further streamlined by the introduction, starting in 1996, of the annual so-called *Macro-exercise*, involving the simultaneous appraising of all proposals for programme aid for the year in question against the policy track records of the countries concerned. This working method, which is constantly being polished and improved, stimulates both the underpinning and transparency of decision making on debt relief and other forms of programme aid.

In international decision making on debt relief initiatives it was significant that each breakthrough required G7 approval (see above). For outsiders like the Netherlands, this domination was all the more difficult to accept because G7 members themselves often cried off when it came to converting statements of intent into financial contributions. In 1997, for example, it turned out that none of the important bilateral donors of the HIPC

Trust Fund (including the Netherlands, the Nordic countries and Switzerland) belonged to the G7.

Prior to 1990 the emphasis was on forgiveness of bilateral concessional debt; during the 1990s, however, relief on other claim categories, e.g. multilateral and export credits, became increasingly important. In this way, the share of debt relief on bilateral debts fell gradually from 80 percent in 1992 to less than 50 percent in 1996 (see Figure 3).
In parallel, the share of relief on multilateral loans increased in Dutch expenditure, notwithstanding the fact that the course laid down by the Bretton Woods Institutions was followed less automatically than had formerly been the case. The attitude of the Netherlands became more critical, particularly in the mid-1990s during the 'fight' to get multilateral debt recognised as a real problem and included in international agenda. Although the Dutch government continued to support the preferred creditor status of IFIs, it also repeatedly and forcefully urged that IFIs should put some real effort and creativity into searching for additional sources of finance (e.g. the sale of IMF gold reserves) with which to lighten multilateral debts.
As a consequence, the Netherlands became an enthusiastic supporter of the HIPC Initiative and, from the start, its largest financial contributor through the HIPC Trust Fund. At the same time, the country actively advocated expansion of the facilities and range of the HIPC framework, ultimately resulting in the *Enhanced HIPC Initiative*.
The linking of that initiative to the formulation of *Poverty Reduction Strategy Papers* was warmly welcomed.

The *Enhanced Structural Adjustment Fund* (ESAF) also long benefited from Dutch support, as proven by the substantial bilateral contributions of NLG 135 million for the period 1987-97, and NLG 125 million for 1995-2004. Later, the Dutch attitude became more critical, particularly when internal (1997) and external (1998) evaluations made it clear that both the realisation of macro-economic targets and the social effects and local ownership of programmes supported with ESAF funds, left much to be desired.

Of more recent date are a number of intentions and developments that are likely to influence future application of the debt relief instrument. For example, the present world-wide character of the Dutch Debt Relief Programme will be restricted to the 21 countries on which structural bilateral aid has been concentrated since 1999, and to six so-called countries in transition in Eastern Europe. Furthermore, the Minister has announced that budgets for debt relief and non-sectoral programme aid, with the exception of mac

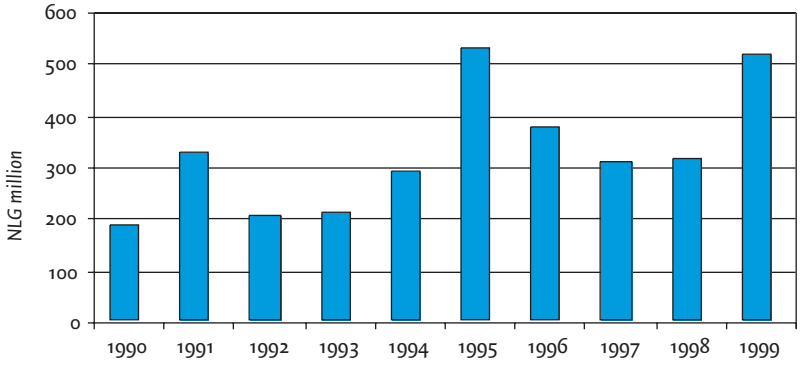
ro-economic emergency aid and multilateral trust fund contributions e.g. for HIPC and PRSPs, will be combined and ultimately integrated into country allocations.

2.3 Expenditure on debt relief

Between 1990 and 1999 the amount involved in debt relief rose from NLG 182 to NLG 514 million per annum, although that increase has not been uniform. On the contrary, as Figure 2 shows, total expenditure has fluctuated strongly from year to year. Since these changes cannot be explained by corresponding changes in the debt problem, an explanation of the phenomenon has to be sought elsewhere.

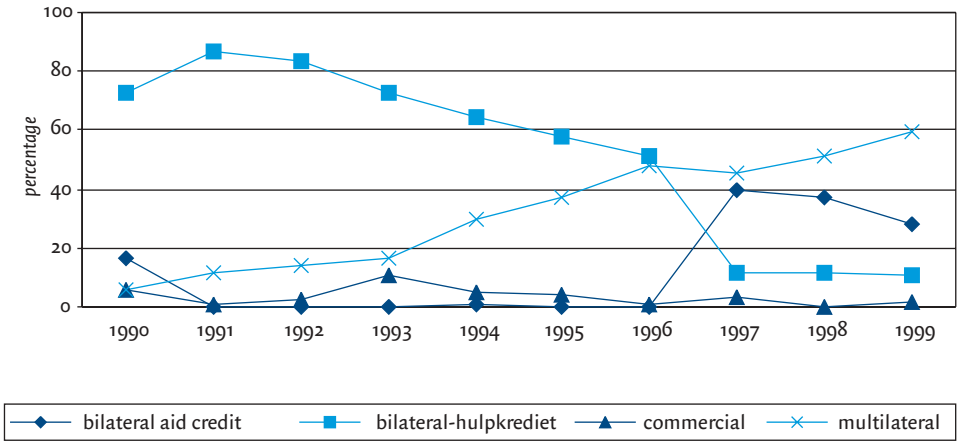
Over the period in question, expenditure amounted to over NLG 3.2 billion.

Figure 2 Development of Dutch expenditure on debt relief in the period 1990-1999.



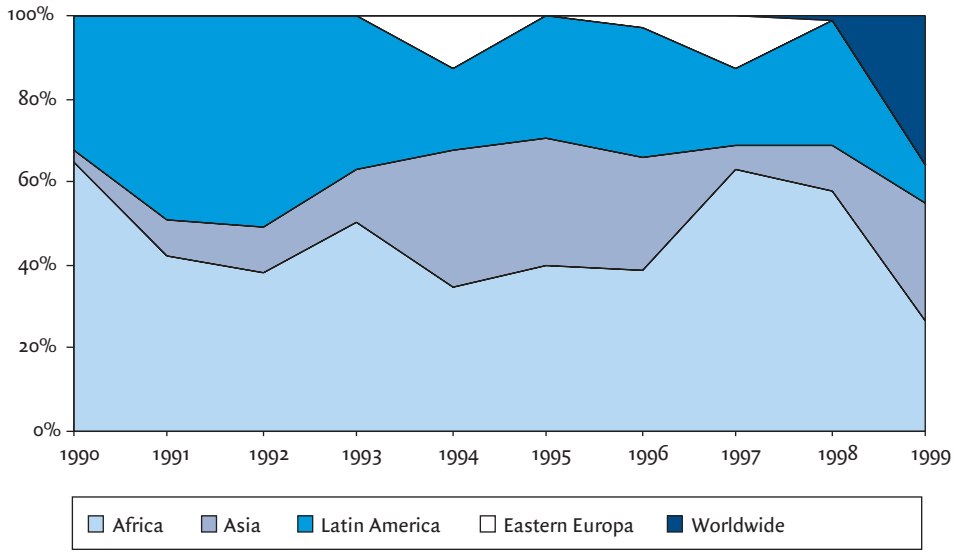
Within these totals, shifts occurred among the various types of debt (see the diagram in Figure 1). Figure 3 shows the development in percentage shares of the various types, in illustration of the description given in paragraph 2.2.

Figure 3 Evolution of the shares (in percentages) of the various types of debt (bilateral export loans; bilateral aid credits; multilateral en commercial) in total expenditure on debt relief during the period 1990-1999.



The distribution of expenditure on debt relief over the various regions is illustrated below.

Figure 4 Evolution of the regional Distribution of total expenditure on Debt relief in the period 1990-1999.



The debt relief expenditure recorded as 'world-wide' represents Dutch contributions to the World Bank's HIPC Trust Fund. Compared to the relative insignificance of the debt problem, expenditure of NLG 636 million in Asia seems remarkably high. This can be attributed principally to one consolidation loan amounting to NLG 133 million to Indonesia under a recent Paris Club agreement, and to the fairly high amount for India, namely, NLG 227 million. Although the latter was labelled as debt relief, it actually amounted to freely-expendable balance-of-payments support in view of the fact that India had never had an unsustainable debt problem, had never requested debt reduction, and had always promptly met its debt service obligations. Apart from these two cases, Dutch debt relief expenditure and debt problems in Asia were of limited scale.

The data used in this section are derived from the data base for debt relief activities, constructed as part of the preparatory research for this evaluation. Based on the annual Debt Memoranda to the Second Chamber, mentioned under section 2.2, it has been attempted to trace all therein mentioned 'activities' during the last 10 years in the records and archives of the Ministry. If a regular activity file was not available, the decision to commit and the subsequent disbursements have been reconstructed from other material. This has been successful to 99.6 percent, although for many debt relief activities, particularly in the early part of the 1990s, the available material was sketchy or incomplete. The data base includes core details for each traced 'activity' (insofar as available), needed for a description and analysis of the implementation of debt relief policy. The structure of data base is presented in Annex 2-A.

During the period 1990-1999, 51 countries received some form of debt relief from the Netherlands. The total expenditure of over NLG 3.2 billion was spread broadly though not equally, with amounts varying from NLG 500,000 for Benin to NLG 277 million for Nicaragua. Annex 2-B provides an overview of expenditures on all 51 countries, specified according to the kind of debt for which relief was given.

3. Purpose of the evaluation and research questions

The purpose and the research questions arise on the one hand from the rationale for the study, given in section 1 above, and on the other hand from the Evaluation Department's mandate.

3.1 Purpose

The purpose of the evaluation is to verify whether funds intended for debt relief have been expended appropriately and efficiently. In addition to the traditional accountability function, the investigation fulfils a formative purpose: dependent on the findings and the conclusions that will be drawn from them, the evaluation may provide lessons that will enable debt relief policy and/or its implementation to be improved.

3.2 Research questions

To realise the research objective, three main questions need to be answered: (i) how goal-oriented were Dutch debt relief policy and the consequent debt relief activities; (ii) how effective, and (iii) how efficient. In addition, the research will try to identify the factors that could explain the findings, both in the positive and the negative sense.

To relate the research questions with the research object it is illuminating to use a schematic representation of the latter. This makes use of the *logical framework approach*, showing vertically the various levels of the assumed objective-means hierarchy, and horizontally the manner in which it can be verified to what extent objectives on successive levels have been achieved.
Unfortunately, such a framework is not available ready-made in the field of debt relief; it thus has to be (re-)constructed for the purpose of this evaluation. An effort in this direction is made in the first three columns of Figure 5. The fourth column shows how the research questions relate to the various objective levels.

Two comments must be made with regard to this schematic presentation. Firstly, it is obviously a stylised representation of reality. The logical framework does not provide a blueprint for implementation of an evaluation, but it is a useful tool with which to order the researchers' thoughts about the different aspects of the evaluation object and their inter-relationships. Secondly, it will be clear that, as a phenomenon in the objective-means hierarchy is further removed from the original intervention (the input level), it becomes less easy to demonstrate a causal relationship between intervention and phenomenon. The effect of the original impulse becomes smaller and the influence of other, external, factors becomes greater.

The logframe is based on the following theory regarding efficiency, effectiveness, and relevance of debt relief. Debt relief can make the debt sustainable and thus contribute to economic growth in two ways:

1. By relieving debt service (interest and amortisation). This will release resources that may be used for extra import and extra government expenditure. In turn, such imports and government expenditure can increase economic growth via more private investment, better utilisation of the available production capacity, increased social spending, and higher public investment.
2. By reducing the debt stock. According to the *debt overhang theory*, this will increase the country's creditworthiness and give rise to more investments and a greater inflow of private capital. In turn, these also lead to higher economic growth.

The research questions can now be elaborated as follows.

3.2.1 Relevance

Relevance is concerned primarily with the question to what extent Netherlands policy forms a sensible and *adequate reaction to the debt problem*. Important in this respect is not only the policy followed with regard to the *relief* of existing debts, but also the role that the Netherlands had played in the *creation* of such debts.
The policy to be analysed includes the positions taken by the Netherlands in multilateral fora in which collective debt measures were discussed and decided upon.

Similar to other activities financed from the aid budget, debt relief is intended to serve the ultimate objective of development co-operation: sustainable poverty reduction.
There are three reasons, however, why in this evaluation emphasis is placed on economic growth rather than on poverty reduction as the ultimate goal of debt relief. Firstly, until 1999, reduction of poverty did not play a distinct role among the objectives of Dutch debt relief. It is true that poverty reduction, like good government, formed part of the annual 'macro-exercises' instituted in the mid-1990s to select countries eligible for debt relief, but it played little if any part as objective in commitment decision-making as laid down in Appraisal Memoranda. Secondly, a relationship between debt relief and poverty reduction is difficult to establish, especially within a limited period. Considering that only in 1999, with HIPC-2, did debt relief become firmly linked to policy reform oriented towards poverty reduction, it is possible in this evaluation to investigate whether such a policy change is in progress, but not what its effects will be on social indicators or on the prevention of poverty. Thirdly, it is now generally accepted that economic growth, although not sufficient in itself, is a necessary condition for a reduction of poverty. If the evaluation shows that debt relief has a positive effect on economic growth, it may be assumed that this is also a step towards the objective of sustainable poverty reduction.

3.2.2 Effectiveness

Debt relief is granted with the intention of achieving certain, more or less specified, effects, the most obvious being to *improve the sustainability* of a *debt burden* that has become unsustainable. The debt burden becomes more sustainable as the ratio between debt service and exports decreases, as also the ratio between the total debt stock and GNP. Reduction of the debt stock also implies that, through a reduction of the so-called debt overhang, investment will be stimulated and international creditworthiness (and thus private capital inflow), improved.
The question of the effectiveness of debt relief is thus addressed in particular towards the ratio *between output* and *outcome* in the logical framework.

Figure 5 Evaluation matrix Debt relief

OBJECTIVES-MEANS	INDICATORS	SOURCES	EVALUATION CRITERIA
INPUT Debt relief expenditures and modalities; Policy dialogue	Amounts spent, assessed and contributed; Conditions.	Parliamentary documents and policy papers; 'Macro-exercises', Appraisal Memoranda for debt relief; Global Development Finance; national statistics; WB/IMF country reports; Local government and donors' policy papers and representatives.	
Comparison between outputs and inputs			EFFICIENCY
OUTPUT Reduction of debt and debt service; Policy change and change in governance.	Total debt (nominal and net present value); Interest payments and amortisation;	Global Development Finance; World Development Indicators; IMF; national statistics; Local government and donors' policy papers and representatives.	
Degree to which outputs contribute to outcomes			EFFECTIVENESS
OUTCOME Reduction of debt burden; Improvement creditworthiness; Investment; Increase of imports and government expenditure.	Debt/GDP; Debt service/Exports; International credit ratings; I/GDP; Ip/GDP; Balance of payments; Government accounts.	Global Development Finance; World Development Indicators; IMF; national statistics; Moody's; Standard & Poor; Commercial banks and Chambers of Commerce.	
Degree to which outcomes lead to intended impact			RELEVANCE
IMPACT Economic growth.	Change in GNP.	World Development Indicators; national statistics.	
Sustainable poverty reduction			

3.2.3 Efficiency

To gain some idea of the efficiency of debt relief, it is necessary to consider not only the volume of expenditure but also the chosen forms and modalities. Conditionality is also important, whether or not imposed via policy dialogue with the recipient, as well as the procedures for preparation, commitment, and implementation of debt relief activities.

All this has to be compared with achieved results, in particular reduction of the debt service, the debt stock, as well as changes in public expenditure and the current account of the balance-of-payments. In addition, it is necessary to check whether policy reforms that may have been laid down as conditions, have in fact been implemented.
In this way, the efficiency question attempts to determine the relationship between delivered *input* and produced *output*.

4. Demarcation and research methods

Apart from the nature of the object of the evaluation, its demarcation and the choice of research methods are dependent on a number of practicalities and limitations in terms of available time, finance and personnel.

4.1 Demarcation

Various factors play a role in the definition of the evaluation period, e.g. the relevance of the research period for present policy and for future decision making, trends and changes in the policy implemented and, last but not least, retrievability of the necessary data.
Based on these considerations, it appears appropriate to take as point of departure an evaluation period of 10 calendar years, i.e. from 1990 up to and including 1999.
During this period, the Minister for Development Co-operation reported more than 300 decisions on debt relief to parliament, in ten annual Debt Memoranda. The amount involved in write-offs, buybacks and contributions to multilateral actions was about NLG 3.2 billion. Together with debt relief policy and initiatives, this amount forms the object of this evaluation. In investigating the effects of debt relief, consideration is also given to debt relief provided by other donors in that the effects of Dutch efforts are indistinguishable from theirs.
Insofar as Dutch funds made available to IDA and ESAF have been used in the framework of World Bank and IMF debt policies, these will also be considered.

4.2 Research methods

To investigate the relevance of Dutch debt relief policy and debt relief expenditure, it is necessary to examine the origins and development of the debt problem and international reaction to it. This will be done through literature research, concentrating on Africa and Latin America in particular. As was noted earlier, the debt problems of Asian countries in receipt of Dutch "debt relief" were relatively small.

Netherlands policy, both with regard to own debt relief efforts and in international fora, will be reconstructed with the use of official publications, file research and interviews with involved actors, both within and outside the Ministry of Foreign Affairs. The latter category includes personnel of other Ministries, Executive Directors to World Bank and IMF, international organisations, non-governmental organisations, other bilateral donors and individual experts.
The Implementation of debt relief policy will also be analysed, not only with regard to relevance but also to effectiveness: as regards country choices and the criteria applied in this respect, and then on the level of individual activities, using the data base constructed during the preparatory research and the conclusions of the planned country studies. Special attention will be paid to such questions as the selection of countries, the choice of forms and modalities of debt relief, the definition of targets, the consistency between modalities and targets, etc.

The *outcomes* or the effects of debt relief are obviously felt within individual debtor countries, and will be studied empirically. The question of effectiveness focuses on two effects: on the one hand the freeing of funds for imports and government expenditure through reduction of the debt service; on the other hand, the increase in the inflow of private capital as a result of improved creditworthiness. These effects will be investigated econometrically and through case studies of individual countries.

The case studies involve both desk and field research. In view of the large number of countries that have received debt relief, the application of these more intensive research methods naturally requires that choices be made.

4.2.1. Model studies

With regard to the effects on creditworthiness, use can be made of a model developed by Lensink and White with which to explain the private capital inflow to developing countries (Lensink & White 1998). This model shows that the influence of variables that

measure creditworthiness as such is not significant, but it is possible to investigate whether a *change* in creditworthiness is of influence. Normally, countries receiving debt relief should show a declining debt stock. Under the proposed approach, an important factor is whether *reduction* of the debt stock leads to an increase in capital inflow. In addition, the degree of debt relief and the inflow of official capital can be included in the model to be tested. Data for this research can be derived from the World Bank's Global Development Finance statistics.

An econometric model can also be used to measure the effects of debt relief on the freeing of resources for imports and for certain types of government expenditure (e.g. social expenditure, government investments). One problem in this respect is that international statistics on debt relief provide no insight into the degree to which 'debt relief' leads to a reduction in the *actual* debt service. This can be overcome by using national balance-of-payments statistics which, for the majority of countries, are available on the IMF website. In addition to debt relief, these statistics usually contain data on the accumulation or payment of arrears. This enables the real debt service as well as the part of the debt relief that has led to a reduction of the actual debt service to be calculated. It is then possible to investigate the linkage between this reduction and, for example, the increase of social expenditure or of public investments (see Allen & Weinhold 2000), or even the linkage with economic growth by using the model devised by Weeks (Weeks 2000).

The model studies will use data from all 51 countries in receipt of Dutch debt relief, or from as many as possible (that is, for which the necessary data can be retrieved).

4.2.2 Desk studies

For some of these 51 countries the effects of debt relief will be further investigated by means of desk studies. An analysis of the specific debt situation of the country concerned will form the point of departure for an evaluation of Dutch policy and activities. Consideration will be given to the effects of the different modalities of debt relief on the total debt stock, the net present value of the debt burden, and the debt service. Changes in the indicators *debt service/exports* and *debt/GDP* can be explained by the specific composition of the debt (type of creditor, interest rates), its increase (deficit on balance-of-payments), and the growth of exports or of GDP respectively. All these factors will be analysed. Furthermore, an *accounting framework* (White 1999) will be used to illustrate the consequences of debt relief, new money flows and possible policy changes for the balance-of-payments and the government budget. The results for investments and private

capital flows will also be examined, together with the ultimate impact of *outcomes* on economic growth and eventual poverty reduction.

In view of the time, research capacity and finance involved in such studies, they can only be carried out for a limited number of countries. If this consideration is combined with the desirability of concentrating the case studies on African and Latin American countries, where Dutch debt relief provided during the evaluation period has been substantial, both in absolute (>= NLG 100 million) and relative terms (>=20 percent of total Dutch aid to the country in question), a selection of the following eight countries results (see also Annex 2-B):

Africa	Latin America
Mozambique	*Bolivia*
Tanzania	*Jamaica*
Uganda	*Nicaragua*
Zambia	*Peru*

4.2.3 Field studies

For a yet smaller group of countries, the results of desk studies can be further augmented by means of field research. This will make it possible to use a larger arsenal of methods and materials, e.g. interviews with local actors, and national statistics. More than desk studies, field studies enable researchers to consider such questions as donor influence on policy change through policy dialogue, the effects of debt relief on (domestic) investments and, ultimately, the effects of these and of national policy formation/change on economic growth, i.e. the impact level of the logical framework discussed under 3.2. Possible direct effects on poverty reduction, for example of policy change or of an increase in social expenditure, can also be analysed.

The limitation on the number of desk studies again applies, though even more strongly, to field studies. In other words, within the framework of this policy evaluation, there is scope for field research in at most two or three debtor countries.

Since field research in countries that do not belong to the 21 new Dutch co-operation countries is less relevant for the future, Jamaica and Peru are excluded from the group of

eight listed above. Moreover, it is not practical to start field research in countries where debt relief activities have not recently occurred, in that it is then more difficult to find relevant local and donor actors. This consideration caused the elimination of Zambia and (again) Jamaica, neither of which have received debt relief since 1996. While commercial debt relief forms only a very small part of total expenditure, both bilateral and multilateral (official) debt relief during the evaluation period have been vital elements of Dutch policy. No bilateral debt relief has been granted to Uganda because there were no outstanding bilateral loans. Uganda is thus less attractive as a subject for field research. In Latin America preference was ultimately given to Nicaragua rather than Bolivia because the former has received not only far more (NLG 277 million against 142 million) but also more consistent debt relief, namely in 10 of the 10 years within the evaluation period as against 6 out of ten. Finally, since Dutch expenditure on debt relief in Africa was more than one-and-a-half times as much as in Latin America (see Figure 4) and as the debt problem in Africa has proven unmistakably more serious and persistent (and is expected to remain so in future), it is self-evident that, in addition to one Latin American country, two African countries should be selected for field research. Field studies will consequently be implemented in

Nicaragua
Mozambique
Tanzania

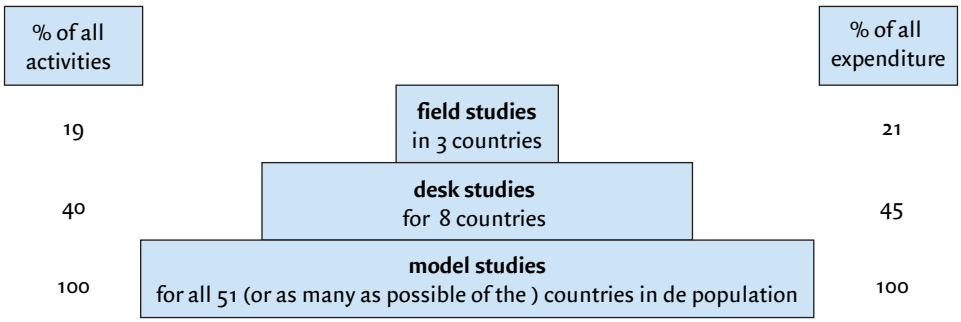
4.3 Representativeness

Any research that is dependent wholly or partly on case studies encounters problems regarding the external validity of its findings. That is here also the case. As we have seen above, countries for desk and field studies have been selected principally on the basis of the availability of recent research data. Thus, they are by definition *not* representative of the 51 countries that received debt relief in the evaluation period.

In evaluating effects, three research approaches are used that can be seen as three levels of depth versus representativeness. These are shown in Figure 6.
The lower levels encompass the higher, as it were, both as regards methods used and evaluation objects studied.

It will be clear that intensity of the research increases 'from the bottom upwards', but that the representativeness of results for the total population of over 300 Dutch debt relief activities decreases. Within the financial and logistic limitations that apply to any evaluation study, this is inevitable. At the same time, it is an additional reason for combining various research methods within one study. If, as is to be expected, the findings of different research levels confirm one another, they strengthen the construct as a whole and thus boost its validity for the entire research population.

Figure 5 Research methods and representativeness.



As the selection of a fully representative sample of countries for desk and field studies was obviously impossible, consideration was given, in the selection process described in Section 4, to the anticipated concentration and wealth of research data. For example, the three countries chosen for field research received about one-fifth of all Dutch debt relief, both in terms of numbers of activities and of expenditure. For the eight desk study-countries together, these shares were 40 and 45 percent respectively.
In addition to considerable Dutch debt relief, the eight desk study-countries also received substantial contributions from other sources for the same purpose, thus increasing the 'density' of the researched interventions (the Dutch share in their total debt relief was between 1 and 12 percent). In this way, the selected countries are eminently suitable for research into the effect of debt relief methods in their entirety.

5. Organisation and planning

Responsibility for the design and implementation of the evaluation study rests with the Policy & Operations Evaluation Department (IOB).

The Terms of Reference have been drawn up by D.C. van der Hoek (IOB) and Dr A.G. Dijkstra (Erasmus University, Rotterdam). The file research to trace debt relief activities for these ToR were carried out by research assistant J. Splinter in the archives of the Ministry of Foreign Affairs and in those of the Netherlands Investment Bank for Developing Countries (NIO).

5.1 Sub-studies and reporting

Within the evaluation study, separate working documents will be produced on the following sub-studies:

- the debt problem, its origins, development and consequences (literature and model studies);
- debt relief in Mozambique, Nicaragua and Tanzania (3 field studies);
- debt relief in Uganda, Zambia, Bolivia, Jamaica and Peru (5 desk studies);
- Dutch debt relief, policy and implementation (desk study + field studies).

The complete evaluation will be concluded with a final report that will contain a synthesis of the ten working documents.

5.2. Implementation and supervision

A chief consultant will be appointed for the general co-ordination of the various parts of the study. Together with the responsible IOB evaluator, he/she will plan the individual components, select researchers to be recruited for the work, and integrate sub-research results into the final report.

The literature and model studies will be guided and partly executed by the chief consultant, in co-operation with a second economist and assisted by a research assistant. The duration will be about two months.

Furthermore, the chief consultant will personally lead all three field research missions and will provide technical co-ordination to the desk studies. The field studies will be carried out by two experts and will take approximately one month per country (two weeks' mission, and three weeks' preparation and reporting).

Implementation of the five desk studies will be completely contracted-out to one or more consultants, and will also involve approximately one month per country. Separate Terms of Reference will be drawn up for the desk and field studies.

The reconstruction and analysis of Dutch debt relief policy and its implementation will be drafted by IOB on the basis of archive material, the data base of debt relief activities, and the results of the eight country studies.

Although extra capacity and expertise will clearly be needed, all efforts will be made to keep the number of individuals involved to a minimum in the interests of an homogeneous approach and implementation of the various sub-studies. Cohesion in research approaches will be encouraged by organising short briefing and debriefing workshops for the experts involved in the sub-studies.

A reference group will be set up to advise and comment on the research. This will be made up of external experts and of Ministry staff, and will be chaired by the Director of IOB.

Literature

Allen, Tim & Diana Weinhold (2000): 'Dropping the debt for the new millennium: Is it such a good idea?', *Journal of International Development*, 12(6), 857-75.
Lensink, Robert & Howard White (1998): 'Does the revival of international private capital flows mean the end of aid? An analysis of developing countries' access to private capital', *World Development*, 26(7), 1221-34.
Weeks, John (2000): 'Latin America and the "High Performing Asian Economies": Growth and Debt', *Journal of International Development*, 12(5), 625-54.
White, Howard (1999): *Dollars, Dialogue and Development* (Stockholm, SIDA).

Annex 2-A

Database Debt Relief (DR)

	ACTIVITY	
activity number:		**activity name:**
type of debt:	bilateral aid debt / bilateral export credit / multilateral / commercial	**budget category number:**
kbe / sub-article:		**programme:**
	RECIPIENT	
country:		**region:**
debt status:	SILIC / SIMIC / MILIC / MIMIC /LILIC / LIMIC	**HIPC:** yes / no
income category:	LIC / LMIC / /UMIC / HIC	**LLDC:** yes / no
DAC-list:	DAC-1 / DAC-2	**comments:**
	FUNDING	
amount:	disbursement / assessment (x NLG 1.000)	**date of commitment:**
oda:	(x NLG 1.000)	**state guarantee:** yes / no
non-oda:	(x NLG 1.000)	**(budget) year:**
	APPRAISAL	
rationales (3x):	liquidity problem / solvency problem / reward for good policy / Dutch policy consideration / emergency aid	
objectives:	improvement of macro-economic situation / policy support / other (sectoral) development objectives	
	IMPLEMENTATION	
DR type:	debt service / arrears / principal	**DR framework:** bilateral / MDF / Support Group / Fifth Dimension / IDA-DRF/ Paris Club
DR modality:	forgiveness / take-over / buyback / swap / (fund)contribution / interest subsidy / rescheduling	
Executing agency:	e.g. NIO / World Bank	**comments:**

Annex 2-B

Table 1 Debt Relief Expenditure per Type of Debt per Country 1990-1999 (NLG)

country	total	bilateral		commercial	multilateral
		export credit	aid credit		
Nicaragua	277,015,000		141,747,000	10,000,000	125,268,000
Tanzania	240,417,000	156,060,000	14,357,000		70,000,000
Peru	231,356,000		181,356,000		50,000,000
India	226,951,000		226,951,000		
World-wide	189,500,000				189,500,000
Mozambique	165,267,000		91,467,000	4,000,000	69,800,000
Uganda	147,910,000			4,900,000	143,010,000
Bolivia	141,545,000	29,200,000		5,000,000	107,345,000
Zambia	137,098,000		88,098,000	9,000,000	40,000,000
Indonesië	133,479,000	133,479,000			
Jamaica	121,466,000		121,466,000		
Jemen	99,278,000		18,771,000	10,000,000	70,507,000
Burkina Faso	82,244,500		17,244,500		65,000,000
Ivory coast	80,553,000	65,138,000	5,415,000	10,000,000	
Egypt	76,176,000		76,176,000		
Kenya	61,781,000		61,781,000		
Angola	59,733,000		59,733,000		
Honduras	57,342,000	3,300,000	33,092,000		20,950,000
Pakistan	54,542,000		54,542,000		
Zimbabwe	53,314,000		53,314,000		
Bangladesh	53,311,000		53,311,000		
Bosnia	51,532,000				51,532,000
Rwanda	50,943,000	3,420,000	7,500,000		40,023,000
Vietnam	48,096,000		48,096,000		
Tunesia	46,853,000		46,853,000		
Costa Rica	41,523,000		31,523,000	10,000,000	
Cameroon	38,894,000	3,990,000	34,904,000		
Malawi	36,453,000				36,453,000
Mali	33,024,000	3,024,000			30,000,000

Table 1 Debt Relief Expenditure per Type of Debt per Country 1990-1999 (NLG)

country	total	bilateral		commercial	multilateral
		export credit	aid credit		
Ghana	26,523,000		16,523,000		10,000,000
Macedonia	19,600,000				19,600,000
Surinam	18,350,000			7,735,000	10,615,000
Senegal	18,044,000	7,700,000	7,137,000	3,207,000	
Bulgaria	15,000,000			15,000,000	
Ecuador	12,045,000		12,045,000		
Niger	11,840,000				11,840,000
Guyana	11,470,000	6,900,000	4,570,000		
Sri Lanka	10,529,000		10,529,000		
Ethiopia	10,000,000			10,000,000	
Burundi	9,000,000		9,000,000		
Guinee Bissau	6,672,000				6,672,000
Bhutan	6,245,000				6,245,000
Nigeria	5,124,000		5,124,000		
Madagascar	3,508,000			3,508,000	
Haïti	3,500,000				3,500,000
Mexico	3,378,000		3,378,000		
Chili	3,343,000		3,343,000		
Philippines	2,000,000		2,000,000		
Georgia	1,775,000				1,775,000
Togo	1,300,000	1,300,000			
Cambodia	1,250,000				1,250,000
Benin	519,000		519,000		
Total	3,238,611,500	413,511,000	1,541,865,500	102,350,000	1,180,885,000

Annex 3 Organisation of the study

The investigation into the results of debt relief was carried out broadly in accordance with the Terms of Reference (Annex 2). This annex reports on the working methods used and the progress of the research, sources consulted, the persons who were involved in implementing the research, and the composition and role of the Reference Group.

Execution of the country studies

Early in 2001, the researchers for the execution of the various country studies were recruited. The methodology for the country studies is detailed in the 'Terms of Reference for the Country Studies'. These ToR were discussed with the consultants who would implement the country studies as well as the literature and econometric studies, in a one-day workshop at Erasmus University, on 22 April 2001. The principal objective of that workshop was to take away any lack of clarity regarding methods and data sources to be used, but the discussion also caused a few changes to be made to the ToR.

Subsequently, the general ToR and the ToR for the country studies were discussed in a meeting of the Reference Group on 8 May 2001, which also gave rise to a number of alterations to the ToR for the country studies. These studies have subsquently all been carried out by, or in close consultation with, the chief consultant. Any new specific questions that arose regarding implementation were dealt with in the shape of decisions regarding working methods, use of data, etc., that were then communicated to all involved in the country studies.

Desk studies of Bolivia, Jamaica, Peru, Uganda and Zambia were carried out in the course of 2001 and the spring of 2002. The studies of Mozambique, Nicaragua and Tanzania all included a two-week fieldwork programme in the respective countries. To ensure unity in the methodology used, all three fieldwork studies were carried out by the chief consultant together with another evaluator chosen for his expertise on the country in question. The fieldwork in Tanzania was done in June 2001, in Mozambique in November 2001, and in Nicaragua in March 2002. In all three countries, the Netherlands embassy provided excellent assistance, so that an intensive programme of interviews and discussions could be carried out. Efforts were made to involve a local consultant in the field studies; this only proved impossible in the case of Mozambique.

When the initial results of the majority of country studies became available, a second one-day workshop was held on 10 April 2002, attended by all those who had carried out the studies. The principal question discussed was: what conclusions could be drawn on the basis of the methods used and the results obtained. The chief consultant had submitted a methodological paper ('Methodological Annex') and also an initial and partial draft of the final report ('Some Results'), which were discussed at the meeting. The Methodological Annex was then sent to the Reference Group, a few members of which submitted written comments.

Draft versions of the country studies were first extensively commented upon by the chief consultant (insofar as she was not the author) and by the IOB evaluator. In some cases this led to substantial changes being made to the text. The studies were then submitted to the Reference Group for comments, which were incorporated into the final versions by the implementers of the country studies.

Execution of the Literature and Econometric Studies

The ToR for the entire evaluation gave few details on the econometric study, as was remarked upon by the Reference Group in its meeting on 8 May 2001. It was therefore agreed that the study would be further elaborated upon and submitted for comment to the Reference Group at a later date. The chief consultant and the other researcher engaged to carry out the literature study and the econometric study worked during 2001 on the literature survey and on drawing-up a data set that would enable the relationship between debt and economic growth to be investigated. The initial results of the literature study were presented to a Conference of the Latin American Studies Association held in Washington in September 2001, while the initial results of the research into relations between debt and economic growth were presented to a conference of UNU-WIDER on debt relief, held in Helsinki in August 2001.

Based on the initial results and on comments received during these conferences, the authors worked on a plan for the econometric study. This was sent to the Reference Group in October 2001, together with the two papers. Some Group members submitted written comments, on the basis of which a few adjustments to the plan were made. The literature and econometric studies were then finalised in the first half of 2002.

Data Sources for the Country Studies

Various written and statistical sources were used for the country studies; moreover, during the fieldwork, interviews with key figures formed an important source of information.

The following written and statistical sources were used:

- Two World Bank databases, i.e. *Global Development Finance* and *World Development Indicators*. Both data banks were available in the CD-ROM version at the Erasmus University, and data on the countries in question were sent to all responsible for the studies if they had no personal access to the data banks.
- Available academic literature on the countries concerned. Relevant literature was identified through literature data bases such as Econlit, IPSA and Socio, particularly on the general economic, political and social development, and on the debt situation. Whenever necessary, other universities were asked for publications through the inter-university lending system.
- IMF and World Bank documents were available through their websites. In particular, use was made of IMF's Statistical Annexes, World Bank reports such as 'Recent Economic Developments', and HIPC documents such as 'Decision Point' and 'Completion Point' documents.
- Documents in the archives of the Ministry of Foreign Affairs. Such papers were used in particular for information regarding the amount, background, objective and motivation of debt relief by the Netherlands to the eight countries in question. They also provided inside information on policy dialogues between donors and debtor countries (e.g. reports of the Consultative Group of Donors), and access to IMF and World Bank reports insofar as these were not available on the websites (in particular, reports that pre-dated the opening of those websites).
- A short-term subscription was taken to *Euromoney* magazine, which provided access to data on creditworthiness (annual ranks and scores) of all eight countries involved in the evaluation between 1982 and 2000.[78]
- In the three field studies, finally, use was made of national documents and statistics, particularly those originating from Central Banks, but also from ministries and national statistical offices.

78 In the logical framework as included in the ToR mention is made of rankings by Moody's and Standard & Poor, but these proved not to evaluate the creditworthiness of the eight case study countries.

During the three field studies, interviews were held with:

- Representatives of government, in particular of the Central Bank, Ministries of Finance, Education, Health Care, and any other ministry or official institution of significance to the anti-poverty policy;
- Representatives of various donors, including the IMF;
- Representatives of the private sector;
- Representatives of non-governmental organisations;
- Independent scientists or consultants.

Sources used for the Literature and Econometric Studies

Use was naturally made of scientific literature but also of statistical information provided by the two World Bank data bases. The econometric study was based on a dataset developed by Easterly & Yu ('Global Development Network Growth Database'). This was at the time available through website http://www.worldbank.org/html/prdmg/grthweb/gdndata/html. With regard to debt-related variables, these data were supplemented by figures from *Global Development Finance*.

Researchers

The desk studies on Bolivia, Jamaica and Peru were carried out by Dr E. Abdelgalil and Mr W. Cornelissen of the Economic Research Foundation Rotterdam (SEOR). The desk studies on Uganda and Zambia were carried out by Ms M. Lindner of ETC Crystal. The three field studies were implemented by the chief consultant, Dr A.G. Dijkstra, together with Dr A. Danielson of the University of Lund for Tanzania; Dr T. Evans of ETS Consulting and Fachhochschule für Technik und Wirtschaft Berlin, for Nicaragua; and Dr K. Koonings of the University of Utrecht for Mozambique. Dr Godwin Mjema of the University of Dar es Salaam took part in the fieldwork in Tanzania; Mr A. Grigsby, Director of Nitlapán, the institute for research and socio-economic development attached to the University of Central America in Managua, took part in the field study in Nicaragua.

The literature and econometric studies were carried out by the chief consultant together with Dr C.L.M. Hermes of the University of Groningen. Prof. Dr B.W. Lensink of that university provided advice and co-operation when necessary.

Mr D. Looije and Ms K. van der Wiel, student assistants from Erasmus University, helped in the country studies and in the literature and econometric studies, particularly in seeking literature and other information and in processing the data.

Reference Group

For the purpose of this evaluation a Reference Group was set up, consisting of external experts and 'internal' stakeholderse (that is, involved in their official capacity). The external experts were Prof. Dr C.A.M.F. Claessens of the University of Amsterdam, Prof. Dr J.W. Gunning of the Free University Amsterdam, and Prof. Dr B.W. Lensink of the University of Groningen. The internal stakeholders were Mr W. Raab, Director Foreign Financial Relations of the Ministry of Finance, and Messrs M. Brouwer and J.H.F. Smeets, Head and staff member respectively of the Macro-Economic Analyses and Policies Division of the United Nations and International Financial Institutions Department (DVF/AS) of the Ministry of Foreign Affairs.

The Reference Group met on two occasions: once at the start of the study in order to discuss the Terms of Reference (including those for the country studies, see above), and once at the end to discuss the draft of this final report on the results of debt relief. Written comments were also received on the draft report, in particular from one expert who could not attend the meeting, and from those stakeholders who wished to clarify their position. In between the two meetings, Reference Group members were regularly informed by e-mail regarding progress. The plan of the econometric study and the Methodological Annex (country studies) were submitted to the Reference Group in this way, as were all draft sub-reports, and expert members almost always responded with written comments. Only on one occasion was a reaction received on a sub-report from those involved in their official capacity, namely, from the Ministry of Finance on the draft Literature and Econometric Studies. Insofar as feasible, all comments made by members of the Reference Group have been processed in the final text, and in nearly every case a reaction in writing was submitted by the authors of the report.

Annex 4 Paris Club (PC)

The Paris Club (PC) is an informal group of official creditors whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor nations. It was set up in 1956 and has since reached 348 agreements with 77 different countries (almost all of which have thus, over time, needed a rescheduling agreement more than once). Since 1983, the total amount of debt covered in these agreements has been USD 392 billion.

Principles

As guidelines for its activities, the Club applies five principles that are subscribed to by all participating creditors and debtors:

- *case-to-case approach*: all cases are approached on an individual basis;
- *consensus*: unanimity is required in all decision making;
- *conditionality*: only countries that implement reforms in order to solve their payment problems will be considered for debt treatment;
- *solidarity*: all participating creditors must agree to apply the conditions that are agreed within the PC framework;
- *non-discrimination*: the debtor may not offer to non-PC creditors repayment conditions that would be more favourable (for them) than those unanimously agreed within the Club.

Membership and working methods

At present, there are 19 permanent members (18 OECD countries + Russia); in addition, 13 other countries have participated in negotiations with individual debtors on an *ad hoc* basis. The chair and the secretariat are both provided by the French Ministry of Finance. Meetings are held in Paris (10 or 11 times per year) and are devoted to negotiations with debtors, exchange of information among Club members on the external debt situation of individual countries, and methodological issues related to debt and debt relief mechanisms.

Although Paris Club has no legal basis or status, it has certain rules and practices that determine its work and working methods, in addition to the principles mentioned above.

For example, negotiations are only held on medium and long-term public and publicly-guaranteed debt. Such public debts can arise both from export credits and from concessional loans provided within the development co-operation framework (ODA debts). Short-term debts are excluded because their restructuring would disrupt debtors' participation in international trade.

A pivotal concept in the Club's debt regulations is the *cutoff date*. This is established when a debtor country approaches PC for the first time, and is not changed thereafter, even if a new agreements should prove necessary. Credits granted after the cutoff date are not considered for rescheduling. Strict adherence to this date is intended to restore access to (new) credit for the debtor.

The outcomes of debt negotiations are recorded in *Agreed Minutes*, which in themselves are not legally binding but in which delegates undertake to implement agreed restructuring conditions *via* bilateral agreements to be entered into with the debtor.

Conditions

In practice, the principle of conditionality entails that negotiations can only be initiated after the condition has been met that the debtor country concerned has started to implement an IMF-approved and supported programme of reform. Financial IMF support can be provided under a regular *Stand-by Arrangement* (SBA), the *Extended Fund Facility* (EFF) for middle-income countries, or the *ESAF/PRGF* for low-income countries.

During the first 30 years of its existence, the Paris Club applied only non-concessional forms of restructuring. In other words, arrears and debt service payments falling due during the agreed consolidation period (usually varying from one to three years) were consolidated at market-based interest rates, with repayment being spread over a longer period. This, of course, relieved the burden on the debtor for the short term, but did not change the present value (NPV) of the total debt (see Annex 5). This form of restructuring was thus well suited to the relief of (temporary) liquidity problems. Such consolidation conditions are known as *classic terms*.

During the 1980s, however, it became clear that this was no longer sufficient for the poorest and most heavily indebted developing countries. This awareness led to international discussion on the feasibility and desirability of concessional restructuring which, through reduction of the NPV, would result in genuine debt *relief*. At that time, the concept of for-

giving public debt was unheard-of, and time and effort were needed to get the idea accepted. Once that was the case, the start was modest.

Menu approach

In 1988 the *Toronto terms* were introduced which, since the major creditors were unable to agree on the method of debt relief to be used, included a *menu* of three options for non-ODA debts: two concessional options, resulting in forgiveness of up to 33% of the debt service to be consolidated, either through direct reduction of the claims treated (option A), or through rescheduling of the claims treated at a reduced interest rate (option C); and one 'commercial' option whereby the claims treated were restructured over a longer period at appropriate market interest rates (option B). ODA debts were rescheduled over a longer period at an interest rate that was at least as concessional as that of the original credits, so that the NPV of these 'aid debts' fell automatically.

The Toronto menu was the first of a series of 'menus' that became ever more concessional. Similar to the Toronto terms, they were all called after the town where the G-7 summit took place which had provided the impulse for the new menu. In this way, the Toronto terms were replaced in 1991 by the *London terms* (or *Enhanced Toronto terms*) under which the maximum percentage of forgiveness rose from one-third to one-half of the debt service treated. In turn, the London menu was replaced in 1995 by the *Naples terms*, under which the maximum forgiveness rose to two-thirds.

The improvement (know as the *Lyon terms*) introduced in the following year, 1996, was connected to the launch of the Heavily Indebted Poor Countries (HIPC) initiative, and resulted partly from negotiations on the 'burden sharing' among bilateral and multilateral creditors for the comprehensive treatment of the overall debt burden of eligible countries envisaged under the initiative. Enhancement of the HIPC initiative into HIPC-2 in 1999 was accompanied by further improvement of the conditions for bilateral debt relief. These took shape in the *Cologne terms*.

The forgiveness percentages in the successive 'menus' applied only to the debt *service* that fell due during the consolidation period (the so-called *flow relief* or *Debt Service Reduction*) and that resulted from credits granted before the cutoff date. Starting with the London terms, it became possible in principle for debt *stock* (dating from before the cutoff date) to be forgiven (called *stock relief* or *Debt Reduction*[79]). However, this stock relief was only applied to a few countries after the introduction of the Naples terms. Within the frame-

work of the enhanced HIPC initiative it was agreed that 90% of the outstanding debt stock (from before the cutoff date) would be forgiven when the Completion Point was reached (under Cologne terms). The following table shows the successive terms with their percentages of forgiveness and their application.

Paris Club:
Concessional Consolidation terms for Low-income countries, and their application

terms	date	maximum forgiveness	numbers	
			consolidations	countries
Toronto	Oct 1988	33%	27	20
London	Dec 1991	50%	24	23
Naples	Jan 1995	67%	45	32
Lyon	Dec 1996	80%	8	5
Cologne	Nov 1999	90%	20	16

Source: www.clubdeparis.org

79 The debtor must then have followed an IMF adjustment programme for three years, and have serviced Paris Club debt punctually throughout that period.

Annex 5 Heavily Indebted Poor Country – (HIPC) Initiative

The HIPC initiative is an action programme, launched by the World Bank and the IMF, intended to offer permanent solutions to the external debt problems of those poor countries that implement sound policies. The initiative was developed in response to an appeal by the G7 summit in Halifax, Canada, in 1995 and was approved by shareholders in the Bretton Woods Institutions (BWI) at their annual meetings in September 1996. The target group included all heavily-indebted countries that were eligible for ESAF and IDA financing[80] and which implemented or accepted an adjustment programme supported by the IMF and the World Bank – 41 in total.[81]

Net Present Value of Debt

The nominal value of the external debt stock is not a good measure of a country's debt burden if a significant part of the external debt is contracted on concessional terms; for example, with an interest rate below the prevailing market rate. The net present value (NPV) of debt is a measure that takes into account the degree of concessionality. This NPV is defined as the sum of all future debt-service obligations (interest + principal) on existing debt, discounted at the market interest rate. Whenever the interest rate on a loan is lower than the market rate, the resulting NPV of debt is smaller than its nominal value, with the difference reflecting the grant element. For the HIPCs as a group, the NPV of external debt at the end of 1994 - based on the World Bank's World Debt Tables - was approximately USD 190 billion, compared with a nominal external debt stock of 241 billion.

80 So-called *IDA-only countries*: Developing countries that have access to the World Bank Group's 's soft loan window (IDA): per capita GNP in 1995 < USD 765.

81 At the start of the initiative 41 countries were classified as HIPCs:: 32 *Severely Indebted Low-Income Countries (SILICs)*, 7 *Low-Income Countries* (*LICs*) that had received concessional rescheduling from the Paris Club, and 2 *Low-Middle Income Countries* (*LMICs*) that had recently become *IDA-only* (IDA/SecM95-161).

HIPC-1

The Initiative comprised two phases, each of three years (in principle), during which the debtor was expected to execute a vigorous adjustment and reform programme. During the first phase the country would be supported, financially and otherwise, by Bretton Woods Institutions and, simultaneously, would receive up to 67% relief on debt service due from bilateral and commercial creditors, on Naples terms (see Annex 4), so-called *flow relief*. The first three -year phase could be considered as a probation period in which the country in question could show that it wanted to adopt and execute a serious reform policy. After thus having built up a track record of sound macro-economic policy, the country in question could reach the Decision Point, where its eligibility for aid under the HIPC Initiative would be determined. This required an analysis of the sustainability of the debt burden, projected over the following three-year period (the second phase) until Completion Point would reached. The Debt Sustainability Analysis (DSA), to be carried out at the Decision Point, would determine whether: (i) the Net present Value (see box) of the total external debt as a percentage of exports would be less than a target level (to be established per country) of between 200 and 250%; (ii) the external debt service would fall to less than 20-25% of exports; and (iii) for open economies (whose relatively abundant exports might prevent them from ever crossing the first two thresholds) the NPV of ratio debt/public income would fall or remain under the 280% level.

A country that, according to these projections, would not succeed after three years in reducing its debt burden to sustainable proportions, could be considered for the second phase of three years, during which the debtor was again expected to adhere to a tight reform policy. That policy would be supported by the international financial community. For example, bilateral creditors would forgive up to 80% of the debt service due in this period (flow relief under Lyons terms). At the end of the second phase the Completion Point would be reached at which all involved creditors – bilateral, commercial and multilateral – would reduce the NPV of their still outstanding claims to a level sustainable for the country. Paris Club members would apply their forgiveness percentage up to a maximum of 80 also to the debtor's outstanding debt stock in a so-called *stock-of-debt* operation.

In order to finance the relief of debts to multilateral development banks, two Trust Funds have been set up: (i) the IDA-managed HIPC Trust Fund, to be replenished with the World Bank own funds (chiefly retained earnings on non-concessional loans) and contributions by bilateral donors; (II) the ESAF-HIPC Trust, from which the IMF contribution to multila-

teral debt relief on reaching the Completion Point would be financed. This Fund would also be fed by donors but, in addition, would be complemented with the investment proceeds of the sales of a small portion of IMF's gold stock.

Although the HIPC approach, similar to earlier initiatives developed within the Paris Club framework, assumed a case-by-case approach (and thus shunned generic measures), it also introduced two innovations: firstly, *all* types of debt were involved in the problem analysis, and debt relief measures of *all* categories of creditors were co-ordinated; secondly, the inevitability of giving relief on the multilateral debt burden, on a NPV basis, was acknowledged.

At the time of its launch, the costs of the Initiative were estimated at USD 5.6 billion. This increased rapidly, to 7.4 billion in mid-1997, and then to 12.5 billion in 1999. Even more important than total costs, however, was their division between bilateral and multilateral creditors, which provoked lengthy and sometimes hot-tempered discussions.

As a result of the rather restrictive terms, particularly the strict admission requirements and the long qualification periods, actual debt relief effects of the Initiative in the short term were not spectacular. Although eligibility criteria were handled with some flexibility, only four countries reached the Completion Point under HIPC 1: Uganda and Bolivia in 1998; and Guyana and Mozambique in 1999.

HIPC-2

Almost from the start, critics considered the terms of the Initiative too restrictive and its facilities too restricted respectively. This was voiced particularly by international NGOs and their umbrella organisations (e.g. Jubilee 2000), which succeeded in mobilising public opinion in industrialised countries, thus bringing great pressure to bear on the IFIs and on governments of the countries concerned. This led to an extended consultation process during which Bretton Woods Institutions compiled criticisms and alternatives from around the world which, in 1999, were processed into fairly radical suggestions for improvement. After the G7 summit in Cologne in 1999, at which NGOs again demonstrated vociferously, World Bank and IMF shareholders, at their respective annual meetings, agreed with the *Enhanced HIPC Initiative* (HIPC 2). This revised version aimed at making debt relief offered under HIPC 1 deeper, faster and broader.

- *Deeper*, by lowering the thresholds for debt sustainability: the debt/export ratio of 200-250% to 150% and, for very open economies, the debt/public revenue ratio from 280% to 250%. Moreover, the sustainability analysis on reaching the Decision Point would no longer be based on a projection of exports and government income for the *coming* three years, but on an average of actual data for the *preceding* three years.
- *Faster*, by deciding that multilateral creditors, like the bilaterals, would now provide *interim* debt relief between the Decision and Completion Points. Speed would also be encouraged in future by allowing the Completion Point to float. In this way, its attainment would depend on the specific outcomes of reforms rather than on the length of a track record.
- *Broader*, by allowing more debtor countries to be considered for the Initiative's facilities. This would result automatically from the reduction of access thresholds.

All these improvements naturally cost money, and the estimate for the total cost of the Initiative accordingly rose from USD 12.5 billion to 27.4 billion, again to be shared more or less equally between bilateral and multilateral creditors.

To ensure that public resources, released thanks to the HIPC Initiative, are used to reduce poverty, the improved version of the Initiative requires debtor countries to elaborate a poverty reduction strategy. In addition, they are obliged to draw up such a strategy after an extensive process of domestic consultation and participation. Initially, the Poverty Reduction Strategy Paper (PRSP) had to be finalised before the Decision Point could be reached. When that demand proved too burdensome and too many candidate countries threatened to miss the boat, the condition was relaxed in 2000 to the formulation of an *Interim* PRSP, and demands with regard to citizen participation were toned down. These requirements proved to be easier to satisfy; as a result, 22 countries succeeded in passing their Decision Point before 31 December 2000 – a date that had gained symbolic significance, thanks to the Jubilee 2000 activities. Under the improved set-up of HIPC 2, those countries could from then on benefit from interim (debt service) relief from both bilateral and multilateral creditors.

In March 2002, the number of countries had increased to 26, four of which have in the meantime also reached their Completion Points: Uganda, Bolivia, Mozambique and Tanzania. The first three of these had already reached the Completion Point under HIPC 1 but, under the enhanced terms of the improved Initiative, became eligible for more far-reaching debt relief, up to the lowered sustainability levels. The World Bank and the IMF

anticipated that for the 26 countries that had passed their Decision Points, making allowance for extra debt relief outside the HIPC Initiative already promised by various bilateral donors, the total outstanding debt in NPV terms could be reduced by almost two-thirds, from USD 62 billion to 22 billion.

Annex 6 Tables with section 5.4: Econometric research

Table 1 External debt and economic growth, 1970-1998, using OLS[1]

	(1)	(2)	(3)	(4)	(5)	(6)
LGDP	-0.0781***	-0.0630***	-0.0825***	-0.0683***	-0.0642***	-0.0535***
	(-12.47)	(-9.49)	(-13.56)	(-10.58)	(-9.57)	(-7.68)
INVGDP	0.0011**		0.0012***		0.0009***	
	(4.13)		(4.38)		(3.59)	
SEC	0.0003**	0.0003*	0.0002*	0.0002	0.0004**	0.0004**
	(2.19)	(1.75)	(1.81)	(1.16)	(2.59)	(2.09)
DUM80	-0.0044	-0.0110***	-0.0048	-0.0121***	-0.0177***	-0.0206***
	(-1.19)	(-2.73)	(-1.32)	(-2.93)	(-5.78)	(-6.45)
DUM90	0.0070*	0.0027	0.0076*	0.0032	-0.0087**	-0.0092**
	(1.67)	(0.60)	(1.87)	(0.72)	(-2.20)	(-2.13)
DEB	-0.0003***	-0.0002***	-0.0003***	-0.0003***		
	(-5.89)	(-3.33)	(-6.61)	(-4.05)		
TDS	-0.1852**	-0.2674***			-0.3446***	-0.3678***
	(-2.61)	(-3.47)			(-4.75)	(-5.09)
GCRI	-0.0139***	-0.0210***	-0.0144***	-0.0224***	-0.0188***	-0.0236***
	(-2.85)	(-4.16)	(-2.99)	(-4.33)	(-3.49)	(-4.47)
CRE	0.0006***	0.0005***	0.0006***	0.0005***	0.0006***	0.0006***
	(4.65)	(3.99)	(4.09)	(3.09)	(4.61)	(4.03)
BMP	0.0107	0.0059	0.0304*	0.0335*	-0.0681***	-0.0515***
(x 10^{-4})	(0.61)	(0.30)	(1.87)	(1.80)	(-4.60)	(-3.38)
Adj. R^2	0.752	0.698	0.745	0.680	0.752	0.668
N	189	192	189	192	189	192
F-stat.	73.1	66.0	79.7	70.4	73.1	67.3

1 Explanation:
LGDP: logarithm of GDP at the beginning of the period;
INVGDP: total investment to GDP;
SEC: initial gross secondary school enrolment;
DUM80, DUM90: dummy variables for the 1980 and the 1990;
DEB: total external debt to GDP ratio;
TDS: total debt service payments to GDP;
GCRI: proxy for the number of government crises;
CRE: initial private credit from commercial banks to GDP ratio;
BMP: black market premium.

Data sources: Data on BMP, GCRI, INVGDP, CRE and SEC have been taken from Easterly and Yu (1999). Data on GRO en LGDP are given in Easterly and Yu (1999), but are originally taken from Penn World Table no. 5.6. All data on debt are obtained from World Bank, GDF data-bank, CD-ROM (2001). Unless otherwise mentioned, all variables have been averaged over the periods 1970-79, 1980-89 en 1990-98.

The equation was estimated using the ordinary least squares (OLS) methodology, with fixed effects.
The dependent variable is GDP per capita growth (GRO). Adj. R2 is the adjusted R2. N is the total number of observations. White heteroskedastic adjusted t-values are given between parentheses. F is de F-statistic. *) denotes significance at the 10 per cent level; **) denotes significance at the 5 per cent level; ***) denotes significance at the 1 per cent level.

Table 2 External debt and economic growth, 1970-1998, using GMM[1]

	(1)	(2)	(3)	(4)	(5)	(6)
Constant	0.122**	0.144***	0.117	0.119***	0.080	0.133**
	(2.08)	(2.85)	**(2.30)	(2.99)	(0.84)	(2.44)
LGDP	-0.0185**	-0.0194**	-0.0160*	-0.0154**	-0.0109	-0.0160**
	(-2.13)	(-2.59)	(-1.74)	(-2.32)	(-1.20)	(-2.33)
INVGDP	0.0006		0,0002		0.0003	
	(0.58)		(0,32)		(0.24)	
SEC	0.0002	0.0005*	0,0003*	0.0004**	0.0002	0.0006*
	(0.52)	(1.69)	(1.76)	(2.14)	(0.33)	(1.79)
DUM80	-0.0090	-0.0118	-0.0141	-0.0184	-0.0189	-0.0181**
	(-0.78)	(-1.04)	(-1.06)	(-1.30)	(-1.42)	(-2.04)
DUM90	-0.0124*	-0.010	-0.0132*	-0.0145*	-0.0185	-0.011
	(-1.67)	(-1.39)	(-1.78)	(-1.75)	(-1.53)	(-1.10)
DEB	-0.0002**	-0.0001**	-0.0001***	-0.0001***		
	(-2.37)	(-2.11)	(-3.08)	(-3.73)		
TDS	0.121	-0.165			-0.176	-0.501
	(0.39)	(-0.65)			(-0.31)	(-1.32)
GCRI	0.039	-0.014	-0.0011	-0.029	0.017	-0.069
	(0.56)	(-0,20)	(-0.019)	(-0.45)	(0.09)	(-0.62)
CRE	0.0008**	0.0009***	0.0008***	0.0009***	0.0007	0.0009***
	(2.07)	(3.33)	(3.32)	(4.04)	(1.04)	(3.42)
BMP	-0.00003**	-0.00003**	-0.00003**	-0.00003**	-0.00003	-0.00004**
	(-1.99)	(-2.64)	(-2.06)	(-2.45)	(-0.85)	(-2.17)
M1	-3.481	-4.144	-3.010	-3.961	-3.674	-4.201
	p=0.000	p=0.000	p=0.000	p=0.000	p=0.000	p=0.000
Sargan	7.769	7.390	8.541	6.873	14.363	10.478
	p=0.456	p=0.389	p=0.387	p=0.333	p=0.232	p=0.106

1 See notes Table 1 for abbreviations.

The dependent variable is GDP per capita growth (GRO). *) denotes significance at the 10 per cent level; **) denotes significance at the 5 per cent level; ***) denotes significance at the 1 per cent level.
M1 and Sargan are test statistics

Table 3 External debt and economic growth, 1970s, 1980s and 1990s

	(1)	(2)	(3)	(4)	(5)	(6)
	1970s		1980s		1990s	
Constant	0.1259**	0.0753	0.0895**	0.1058***	-0.0597*	-0.0480
	(2.15)	(1.41)	(2.43)	(2.66)	(-1.90)	(-1.33)
LGDP	-0.0191**	-0.0074	-0.0155***	-0.0154**	0.0068	0.0075
	(-2.07)	(-0.94)	(-2.81)	(-2.50)	(1.43)	(1.45)
INVGDP	0.0022***		0.0012***		0.0009**	
	(4.28)		(3.04)		(2.53)	
SEC	0.0005**	0.0004	0.0004**	0.0005**	0.0002	0.0002
	(2.25)	(1.39)	(2.15)	(2.54)	(1.11)	(1.19)
DEB	-0.0008***	-0.0005*	-0.0003**	-0.0003***	0.00003	0.00002
	(-3.03)	(-1.69)	(-5.43)	(-5.40)	(0.33)	(0.22)
TDS	-0.0500	-0.0512	0.0653	0.1123	-0.2736**	-0.2852**
	(-0.32)	(-0.25)	(0.65)	(1.08)	(-2.45)	(-2.45)
GCRI	0.0083	0.0021	-0.0101	-0.0192	-0.0050	-0.0105
	(0.98)	(0.26)	(-0.63)	(-1.24)	(-0.60)	(-1.26)
CRE	0.0005	0.0008*	0.0003	0.0003	0.0003	0.0004
	(1.03)	(1.65)	(1.29)	(1.56)	(1.14)	(1.31)
BMP	-0.0002*	-0.0002*	0.000001	0.000002	0.000004	0.00003
	(-1.95)	(-1.82)	(0.63)	(0.62)	(0.10)	(0.84)
Adj. R^2	0.384	0.183	0.392	0.291	0.357	0.235
N	57	59	72	72	60	61
F-stat.	5.4	2.9	6.7	5.2	5.1	3.6

1 See notes Table 1 for abbreviations.

Table 4 Volatility of debt service payments and economic growth (including investment)

	(1) 1970-1998 OLS (with FE)	(2) 1970-1998 GMM	(3) 1970s OLS	(4) 1980s OLS	(5) 1990s OLS
Constant		0.103	0.1242**	0.0882**	-0.0421
		(1.40)	(2.23)	(2.34)	(-1.38)
LGDP	-0.0770***	-0.0177*	-0.0199**	-0.0146**	0.0073*
	(-12.55)	(-1.81)	(-2.20)	(-2.55)	(1.71)
INVGDP	0.0012***	0.0003	0.0022***	0.0013***	0.0006***
	(4.12)	(0.61)	(4.36)	(3.28)	(3.40)
SEC	0.0003**	0.0002	0.0005**	0.0004**	0.0003*
	(2.11)	(0.66)	(2.12)	(1.40)	(1.82)
DUM80	-0.0051	-0.009			
	(-1.33)	(-0.83)			
DUM90	0.0054	-0.0077			
	(1.21)	(-0.61)			
DEB	-0.0003***	-0.0002***	-0.0008***	-0.0003**	0.00009
	(-5.78)	(-2.72)	(-3.17)	(-5.23)	(1.37)
TDS	-0.1263*	0.1971	-0.0408	0.0435	-0.4816***
	(-1.70)	(0.48)	(-0.25)	(0.43)	(-5.30)
VOLTDS	0.0091	0.028	0.0042	-0.0092	-0.0669***
	(1.39)	(0.43)	(0.25)	(-0.54)	(-3.98)
CHDEBT	-0.0017**	0.0009	-0.0019	-0.0032**	-0.0162***
	(-2.04)	(0.52)	(-1.36)	(-2.21)	(-2.82)
GCRI	-0.0141**	0.0319	0.0050	-0.0119	-0.0104*
	(-2.90)	(0.32)	(0.62)	(-0.76)	(-1.76)
CRE	0.0006***	0.0009**	0.0004	0.0002	0.0005***
	(4.65)	(2.36)	(0.82)	(1.02)	(3.79)
BMP	0.000003	-0.00003	-0.0002	0.000006*	0.00009***
	(1.25)	(-1.47)	(-1.63)	(1.91)	(3.29)
Adj. R^2	0.754		0.356	0.495	0.585
N	186		56	71	59
F-stat.	59.7		4.0	5.9	9.2
M1		-3.809			
		p=0.000			
Sargan		6.967			
		p=0.729			

1 See notes Tables 1 and 2.
VOLTDS is the coefficient of variation of the debt service payments to GDP ratio;
CHDEBT is the change of the external debt to GDP ratio;
OLS is Ordinary Least Squares methodology;
FE is fixed effects.

Annex 7 References

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Annex 8 Glossary[82]

Adverse selection
Selection of aid recipients that results in countries with bad policies receiving more aid and/or *debt relief* than countries with good policies.

Bailout
Take-over of a debt title whose recovery is uncertain, at face value or a portion thereof by a third party. This transaction "bails out" the creditor, in that it releases him from a questionable claim. See also *moral hazard*.

Baker plan (1985)
Initiative to help countries with high debts to private banks to 'grow out of their debt' by a combination of strong economic reform policies and the provision of new loans from their private creditors and the IFIs. Results were disappointing because the private banks were not sufficiently prepared to provide new funds.

Brady Plan (1989)
Initiative to restructure debt of highly indebted countries (HICs) to commercial banks, which – unlike its predecessor, the *Baker plan* – emphasised debt reduction. This was achieved through a combination of buybacks at a discount – with resources from the IMF, the World Bank and Japan – on the secondary market and the issuance of so-called 'Brady bonds' in exchange for banks' claims.

Cologne terms
Menu of debt relief options agreed in the *Paris Club* in 1999 for the treatment of official bilateral debt, resulting in a reduction of pre-*cutoff date* debt of up to 90 per cent (or more) in *NPV* terms.

Commitment
Firm obligation, expressed in writing and backed by the necessary funds, to provide specified assistance to a recipient country or multilateral organisation.

82 *Italics* in the descriptions refer to other entries this glossary.

Completion point
Point at which the bulk of debt relief under the *HIPC Initiative* is fixed and guaranteed, without any further policy conditions for the debtor country concerned.

Concessionality
Measure of the 'softness' of a credit reflecting the benefit to the borrower compared to a loan at market conditions.

Conditionality
Conditions regarding (generally) the recipient's social and economic policies and governance which a donor or creditor attaches to aid or *debt relief*.

Consolidation
Conversion of payment arrears into a new loan at the same or modified terms.

Cutoff date
Date established when a debtor country first comes to the *Paris Club*. Only debts resulting from loans and contracts signed before this crucial date are eligible for possible rescheduling. Hence the establishment of the cutoff date is often the object of intense political negotiations.

Debt burden
The strain put by a debt on the bearing capacity of an economy, usually expressed as the ratio of the *debt stock* to exports or GNP.

Debt forgiveness
Reduction of the NPV of the sum of all future payment obligations (interest and principal) on a debt.

Debt overhang
Insolvency problem of such magnitude, that creditors no longer expect to be repaid in full. Under a debt overhang expected debt payments will no longer increase at the same pace as the debt stock, but will ultimately even decline as the debt continues to grow. In a debt overhang situation (partial) debt forgiveness is in the interest of both the debtor and the creditor. This is because a reduction of the *debt burden* improves the ability of the debtor to repay the remaining claims, which raises their value.

Debt Reduction Facility - DRF (or 6th dimension)
Instrument of the International Development Association to help heavily indebted low-income countries with adequate macro-economic policies reduce their private debt, through buyback operations at high discounts.

Debt relief
Reduction of the *debt stock* or of *debt service* payments. The first always implies *debt forgiveness*, the latter may involve forgiveness, but not necessarily. The debt service can also be reduced by spreading the same repayment obligations over a longer period, which leaves the stock of debt unchanged, but reduces the size of the debt service payments.

Debt service
Interest payments and principal repayments.

Debt service/export ratio
Debt service expressed as a percentage of a country's exports for that year.

Debt stock
Nominal value of the total debt at a given moment.

Debt sustainability
An (external) debt is sustainable if the debtor country is able to fully meet his current and future *debt service* obligations without recourse to *debt forgiveness*, debt rescheduling or accumulation of arrears, and without unduly compromising its growth. According to the criteria of the Enhanced *HIPC-Initiative* this is the case if the *NPV* of debt-to-export ratio does not exceed 150 per cent.

Debt Sustainability Analysis
Study jointly undertaken by staff of the IMF and the World Bank and the heavily indebted country concerned, of the sustainability of the external *debt burden* to determine the country's eligibility for assistance under the *HIPC Initiative*.

Debt swap
Conversion of external debt – usually at a substantial discount – into equity or counter-value funds in local currency to be invested in a specific project or policy.

Decision point

Point at which the debtor country concerned completes its first (three year) track record of good performance under adjustment programmes supported by the IMF and the World Bank, and when, based on a *debt sustainability analysis*, the country's eligibility for assistance under the *HIPC Initiative* is determined.

Export credit insurance

Protects the insured party (normally the exporter), in exchange for a premium, against the risk of non-payment by the buyer. The coverage may embrace both commercial risk (default) and political risk (non-payment due to action by the buyer's host government).

Fifth Dimension

World Bank facility, financed from IDA-reflows and bilateral donor contributions, which was used to provide additional fast-disbursing IDA adjustment loans to well performing heavily indebted low-income countries. The extra loans were intended to compensate the recipients for up to 95% of the interest payment obligations on past IBRD loans. The result was that still outstanding IBRD credits were softened to the equivalent of IDA credit terms. The Fifth Dimension was one of the windows/modalities under the Special Programme of Assistance for Africa (SPA).

Flow effect

Effect of *debt relief* on public investment and social spending via a reduction of the *debt service*.

Grant

Transfer made in cash, goods or services for which no repayment is required.

Grant element

The difference between the face value of a loan and the sum of all future debt service obligations (interest and principal) discounted at an interest rate of 10 per cent (the DAC reference rate) and expressed as a percentage of the face value. The grant element results from the financial terms of a *commitment*: interest rate, maturity and grace period. Thus, the grant element is nil for a loan carrying an interest rate of 10 per cent; it is 100 per cent for a *grant*.

HIPCs

Group of (originally) 41 heavily indebted poor countries: 34 in Africa, 3 in Asia en 4 in Latin America, which constituted the target of the *HIPC Initiative*.

HIPC Initiative

Joint World Bank-IMF framework to reduce the total external *debt burden* of the poorest and most heavily indebted developing countries with the support of the entire international financial community to sustainable proportions in exchange for strong and sustained policy performance. An essential feature of the Initiative is that it links strict *conditionality* to equally firm guarantees for *debt relief*.

HIPC Trust Fund

This Fund, established by the World Bank, provides *debt relief* to eligible HIPCs on debt owed to participating multilateral institutions. The resources of the Fund are contributed by both multilateral creditors and bilateral donors.

Infant mortality

Number of infant deaths within the first year of life, per 1,000 live births per year.

Least Developed Countries - LDCs

Category of developing countries originally established by the United Nations in 1971. Currently 49 countries are designated as LDCs which means they combine a low national income with weak human assets and high economic vulnerability.

Liquidity

Ability to meet short-term payment obligations with currently available resources. A widely used indicator for liquidity of debtor countries is the ratio of *debt service* to exports. Another possible indicator is the ratio of payment arrears to total *debt stock*.

London or Enhanced Toronto terms

Menu of *debt relief* options agreed in the *Paris Club* in 1991 for the treatment of official bilateral debt, resulting in a reduction of pre-*cutoff date* debt of up to 50 per cent of eligible debt service in *NPV* terms.

Lyon terms

Menu of *debt relief* options agreed in the *Paris Club* in 1996 for the treatment of official bilateral debt, resulting in a reduction of pre-*cutoff date* debt of up to 80 per cent of eligible debt service in *NPV* terms and allowing for a similar percentage of debt stock reduction.

Mixed credit

Credit in which bilateral aid (grant or concessional loan) is blended with a commercial export credit so as to provide softer terms for the total package.

Moral hazard

Hidden behaviour: the risk that the existence of an explicit or implicit contract affects the behaviour of one of the parties. This is observed in the insurance industry where coverage against a loss may increase the risk-taking behaviour of the insured.
In this study the concept indicates the development or encouragement of irresponsible behaviour on the part of both borrowers and lenders, which may occur if they are protected (*bailed out*) from the unfavourable consequences of their borrowing or lending policies by a third party.

Multilateral Debt Fund - MDF

Fund established to alleviate the multilateral *debt burden* of a debtor country, fed by *grants* from bilateral donors and managed by the recipient country itself, so that it not only contributed to *debt relief* but also to the institutional development of the recipient's debt management capacity.

Naples terms

Menu of *debt relief* options agreed in the *Paris Club* in 1995 for the treatment of official bilateral debt, resulting in a reduction of pre-*cutoff date* debt of up to 67 per cent of eligible debt service in *NPV* terms and allowing for a similar percentage of debt stock reduction.

Net Present Value (NPV)

The sum of all future *debt service* obligations (interest and principal) on existing debt, discounted at the market interest rate. Whenever the interest rate on a loan is lower than the market interest rate, the resulting *NPV* of debt is smaller than its face value, with the difference reflecting the *grant element*.

ODA (Official Development Assistance)

Grants or loans to countries and territories on Part I of the DAC List of Aid Recipients which are (i) undertaken by the official sector, (ii) at concessional financial terms (if a loan, having a *grant element* of at least 25 per cent) (iii) with promotion of economic development and welfare as the main objective.

Official creditor

Public sector creditor, either multilateral (for instance, International Financial Institutions – IFIs) or bilateral (governments and their agencies).

Paris Club

Informal group of official bilateral creditors who negotiate collectively about concessional or non-concessional rescheduling of debts due to them with debtor nations that have a current programme with the IMF supported by a conditional arrangement.

Policy dialogue

Formal and informal consultations between donors/creditors on the one hand and aid recipients/debtors on the other about the latter's past, current and future social and economic policies and governance. Often results in *conditionality*.

Preferred creditor

Creditor who will receive repayment ahead of other creditors and whose claims are not subject to reductions imposed on or negotiated with other creditors.

Rescheduling

Change of the payment obligations on an outstanding debt is such a way that *debt service* obligations are reduced, which may or may not involve *debt forgiveness*.

Solvency

Ability to meet all future payment obligations as they come due. Widely used indicators for solvency of debtor countries are the ratios of the *debt stock* to exports and debt stock to gross national product.

Stock effect
Effect of *debt relief* on private investment and the inflow of private capital via a reduction of the total outstanding debt.

Structural adjustment
Policy aimed at strengthening the supply side of an economy in order to stimulate growth of production and export (especially as a result of increased efficiency).

Structural Adjustment Loan - SAL
(World Bank) loan in support of *structural adjustment*.

Support group
Group of (usually bilateral) donors providing additional aid in a co-ordinated operation to help a developing country clear persistent arrears to International Financial Institutions in order to remove an important obstacle to the release of new loans from those institutions.

Terms of trade
Ratio of the weighted averages of export prices to import prices. A country's terms of trade deteriorate if the price level of its imports rises faster than that of its exports.

Toronto terms
Menu of *debt relief* options agreed in the *Paris Club* in 1988 for the treatment of official bilateral debt, resulting in a reduction of pre-*cutoff date* debt of up to 33 per cent of eligible debt service in *NPV* terms.

Volatility
Unpredictability. In this study applied to the size of debt payments by governments of debtor countries.

Evaluatie-studies uitgebracht door de inspectie ontwikkelingssamenwerking en beleidsevaluatie (IOB) 1991-2003

253 1991 **Sectorprogramma Plattelandsontwikkeling.** *Een programma-evaluatie met projectonderzoek in Indonesië, Soedan, Rwanda, Tanzania en Nicaragua*

254 1992 **Milieu en Ontwikkelingssamenwerking.** *Een evaluatie van de effecten van het milieubeleid, met nadruk op veldonderzoek in Burkina Faso, Indonesië en Kenya*

255 1992 **Sector Aid and Structural Adjustment; The Case of Sugar in Tanzania**

256 1992 **La Riziculture Paysanne à l'Office du Niger, Mali, 1979-1991.** *Evaluation de l'appui néerlandais*

257 1993 **Het Flood Action Plan, Bangladesh.** *Een onderzoek naar aanleiding van het debat over waterbeheersing in Bangladesh*

258 1993 **Evaluatie en Monitoring.** *De Rol van Projectevaluatie en monitoring in de Bilaterale hulp *)*

259 1993 **Samenwerkingsverbanden in het Hoger Onderwijs.** *Een evaluatie van samenwerkingsverbanden in Botswana, Lesotho, Swaziland en Tanzania*

260 1994 **Evaluatie van de Nederlandse Hulp aan India, Mali en Tanzania.** *Samenvattend rapport*

261 1994 **India.** *Evaluation of the Netherlands development programme with India, 1980-1992*

262 1994 **Mali.** *Evaluatie van de Nederlandse hulp aan Mali, 1975-1992*

263 1994 **Tanzania.** *Evaluation of the Netherlands development programme with Tanzania, 1970-1992*

264 1994 **Humanitarian Aid to Somalia**

265 1995 **Fertiliser Aid.** *Evaluation of Netherlands fertiliser aid 1975-1993 with special reference to Bangladesh, Mali and Zambia.*

266 1996 **Netherlands Aid Reviewed.** *An analysis of Operations Review Unit Reports, 1983-1994*

267 1997 **Vrouwen in Burkina Faso en de Nederlandse Ontwikkelingssamenwerking 1985-1995**

267 1997 **Les Femmes du Burkina Faso et la Coopération Néerlandaise 1985-1995**

268 1998 **Vrouwen in Kenia en de Nederlandse Ontwikkelingssamenwerking 1985-1995**

268 1998 **Women in Kenya and the Netherlands Development Cooperation 1985-1995.** *isbn 90-5328-152-3*

269 1998 **Bangladesh.** *Evaluation of the Netherlands Development Programme with Bangladesh, 1972-1996 (Volume 1- Summary Report)*

269 1998 **Bangladesh.** *Evaluation of the Netherlands Development Programme with Bangladesh, 1972-1996 (Volume 2 - Main Report)*

270 1998 **Bangladesh.** *Evaluation of Netherlands-Funded NGO's, 1972-1996 (Volume 3 - Sub-Report)*

271 1998 **Vrouwen en Ontwikkeling.** *Beleid en uitvoering in de Nederlandse Ontwikkelingssamenwerking 1985-1996. isbn 90-5328-168-1*

272 1998 **SNV - Bénin, 1985-1995** *(franstalig)*

272 1998 **SNV - Benin, 1985-1995** *(Hoofdbevindingen en samenvatting) *)*

273 1998 **SNV - Nepal, 1985 - 1995** *(engelstalig). isbn 90-5328-164-9*

273 1998 **SNV - Nepal, 1985 - 1995** *(Hoofdbevindingen en samenvatting)*

274 1998 **Evaluation of SNV in Benin, Nepal and Bolivia** *(Summary evaluation report)*

275 1998 **Egypt.** *Evaluation of the Netherlands Development Programme with Egypt, 1975-1996 (Volume 1 - Summary Report). isbn 90-5328-198-3*

275 1998 **Egypt.** *Evaluation of the Netherlands Development Programme with Egypt, 1975-1996 (Volume 2 - Main Report). isbn 90-5328-199-1*

276 1998 **Egypt.** *Evaluation of the Netherlands Support to Water Management and Drainage, 1975-1996 (Volume 3 - Sub-Report). isbn 90-5328-185-1*

277 1998 **Bolivia.** *Evaluation of the Netherlands Development Programme with Bolivia. Main Findings and summary (Volume 1 - Summary Report). isbn 90-5328-205-X*

277 1998 **Bolivia.** *Evaluation of the Netherlands Development Programme with Bolivia. (Volume 2 - Main Report). isbn 90-5328-204-1*

278 1998 **The Netherlands Programme Aid to Bolivia** *(Volume 3 - Sub Report). isbn 90-5328-155-X*

279 1999 **Diamonds and Coals.** *Evaluation of the* **Matra** *programme of assistance to Central and Eastern Europe, 1994-1997 (Summary evaluation report). isbn 90-5328-229-7*

279 1999 **Diamonds and Coals.** *Evaluation of the* **Matra** *programme of assistance to Central and Eastern Europe, 1994-1997 (Evaluation report). isbn 90-5328-230-0*

280 1999 **Cofinancing between the Netherlands and the World Bank, 1975-1996** *(Volume I - Summary Report). isbn 90-5328-232-7*

280 1999 **Cofinancing between the Netherlands and the World Bank, 1975-1996** *(Volume 2 - Main Report). isbn 90-5328-231-9*

281 1999 **Hulp door handel**, *evaluatie van het Centrum tot Bevordering van de Import uit ontwikkelingslanden. isbn 90-5328-246-7*

282 1999 **Palestinian territories**, *review of the Netherlands development programme for the Palestinian territories, 1994-1999. isbn 90-5328-245-9*

283 1999 **Oret/Miliev review 1994-1999** *Assisting developing countries to buy investment goods and services in the Netherlands. isbn 90-5328-248-3*

284 2000 **Institutional Development** *Netherlands support to the water sector. isbn 90-5328-274-2*

285 2000 **Onderzoek naar de samenwerking tussen Mali en Nederland 1994-1998** *isbn 90-5328-278-5*

286 2001 **Smallholder Dairy Support Programme (SDSP) Tanzania** *Inspection of its identification, formulation and tendering process isbn 90-5328-298-x*

287 2001 **De kunst van het Internationaal cultuurbeleid 1997-2000** *isbn 90-5328-300-5*

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