ECESA/2

# United Nations

# FINDING SOLUTIONS TO THE DEBT PROBLEMS OF DEVELOPING COUNTRIES

*Report of the Executive Committee on Economic and Social Affairs of the United Nations*

*New York, 20 June 2001*

# FINDING SOLUTIONS TO THE DEBT

# PROBLEMS OF DEVELOPING COUNTRIES

**Report of the Executive Committee on**
**Economic and Social Affairs of the United Nations**

## I. INTRODUCTION

As we enter a new millennium, a refreshing urgency is inspiring the search for lasting solutions to the debt problems of developing countries, especially the poorest of them. The United Nations, as a universal organisation, includes in its membership debtor and creditor countries alike. As stated in Article 1 of the Charter, among the four main purposes of the United Nations is the achievement of international co-operation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and fundamental freedoms for all. An orderly, dynamic and balanced development of the world economy is therefore a prime concern and responsibility of the United Nations system, including all its component departments, agencies, programmes and funds.

One problem that has been the focus of much attention and contention over the years, with serious implications for the enjoyment of human rights, is that of foreign debt. The debt 'hangover' of many developing countries, and particularly of the heavily indebted poor countries (HIPCs), has not been resolved, despite important and significant measures and initiatives adopted by creditors at the national or multilateral levels. 'Policies of adjustment' and efforts to integrate HIPCs into the 'global economy' should be based on an examination of this phenomenon as it relates to other development priorities. A United Nations system that shares a common understanding on the problem, and agrees on a set of coherent policy responses from a wider development perspective, can complement the key role played by the Bretton Woods institutions on the debt issue. It can thereby be of service to creditor and debtor nations alike.

## II. RECENT DEBT SITUATION OF DEVELOPING COUNTRIES AND COUNTRIES IN TRANSITION

The nature of the debt problems of developing countries may vary from acute balance-of-payments difficulties requiring immediate action to longer-term situations relating to structural, financial and transfer-of-resources problems requiring appropriate longer-term measures. There are also cases where both types of difficulties are present.

The situations described above are also referred to as instances of illiquidity and insolvency. A liquidity problem may arise because of a bunching of debt obligations at a particular time, which cannot be fully serviced as the debtor may experience a shortfall in revenues. The debt can be repaid in full if either recourse to external funding is available on a temporary basis, or if the debt is restructured in terms of the stream of debt obligations so that they better match the debtor's flow of revenues. In the case of insolvency, however, the incapacity of the debtor to pay in full his debt obligations is not due to a temporary shortfall of his revenues, but result from a more structural problem of raising enough revenue in the long term to service his debt. Problems of insolvency cannot be tackled simply by re-scheduling debt, but may require a reduction of debt obligations to match the long-term capacity of the debtor to raise revenue. In practice, the distinction between illiquidity and insolvency problems is not easy to make. This is because it is often difficult to determine whether incapacity to pay is temporary or permanent.

The external debt situation of many developing countries remains a source of serious concern. By the end of the 1990s, the total debt of developing countries was estimated at $2,544 billion (see table 1). Long-term debt increased by $40 billion, while short-term debt fell slightly and represented 16 per cent of total debt at end-1999. The debt service ration remained broadly unchanged in 1999 at about 18-19 per cent. The ratio of total outstanding debt to exports fell to 137 per cent; and that of debt to gross national product (GNP) decreased slightly to below 42 per cent. Short-term debt corresponded to 53 per cent of the stock of foreign exchange reserves as compared with 59 per cent at the end of 1998 and with over 70 per cent at end-1997. By end-1999, the distribution of debt among different regions remained unchanged from a year earlier. East and South Asia accounted for 33 per cent of the total, Latin America for 31 per cent, and Europe and Central Asia for 19 per cent. Latin America has the highest ratio of debt service to exports, about 35 per cent, while the highest debt-to-exports ratio, 225 per cent, is recorded by Sub Saharan Africa.

Despite the slowdown of growth of the external indebtedness of the developing countries and countries in transition, debt and debt-servicing problems persist in a number of these countries. The problems of the heavily indebted poor countries (HIPCs)[1], which are structurally rooted, are far from being resolved, while other poor countries are also facing a mounting debt burden as a result of recent financial and economic crisis. The dramatic situations of countries affected by war and natural disasters require urgent assistance that should include significant debt relief. A number of middle-income countries in East Asia have overcome a first phase of an acute balance-of-payments problems that resulted from the recent financial crisis, but they still have to resolve their debt problems. Other middle-income countries that encountered serious payments problems, as a result of the contagious spreading from the Asian crisis are still struggling to cope with the problem.

The debt situation of many developing countries has dramatically worsened since the beginning of the 1990s. It then looked as if most middle-income countries were well on their way to graduating from the periodic re-scheduling of their debt, while the HIPCs and other low-income countries could reasonably expect to clear their debt overhang problems, with additional relief from both bilateral and multilateral creditors. Not only has the expected debt relief for the HIPCs been slow to come but the recent the recent decline in commodity prices as well as the slowdown in the world economy are now affecting the export growth prospects of many HIPCs and other commodity-dependent countries, both among the low-income and middle-income countries. If the global market for commodities remain depressed for several years and/or exports fail to grow in volume, the debt servicing capacity of these countries would deteriorate further over the medium term. Already, some

[1] The term "heavily indebted countries" is used here in the more generic sense, and does not refer specifically to the group of fourty-one countries included in the list defined by the IMF and the World Bank as potential beneficiaries of their debt relief initiative.

countries affected by adverse developments in the external environment have been forced to reschedule their debts, particularly with the Paris Club.

Click here to see Table -- External debt of developing countries and countries in transition

Beyond the immediate task of reducing the excessive debt burden of developing countries, thought should be given to the adoption of preventive measures to avoid unsustainable public and private debt in the future. Those measures should perhaps be aiming at ensuring responsible lending and borrowing behaviour, notably through increasing the accountability and transparency of borrowing and lending activities undertaken by public and private economic agents. The debt management capacity in debtor countries should also be strengthened.

## A. Debt of low-income countries

The debt problem of low-income countries has dragged on for more than a decade. This is despite the progressive improvement of debt rescheduling terms. The seriousness of this problem was recognised by the official creditor community in 1987, when the Paris Club decided to apply for the first time more concessional rescheduling terms to the low-income debtor countries in Africa (the so-called Venice terms). The concessionality of rescheduling terms has increased several times in subsequent years. The Toronto terms were introduced in 1989 (33% debt reduction), the London terms in 1991 (50% debt reduction), the Naples terms in 1994 (67% debt reduction), the Lyons terms in 1998 (80% debt reduction) for some of the HIPCs and recently new terms agreed at the Cologne Summit in June 1999 (up to 90% debt reduction or more). In 1996, the HIPC Initiative was launched, with a view to providing a framework for multilateral debt relief.

In 1997, when exports of HIPCs were at their highest level over the period 1990-1997, their nominal debt-to-exports remained high at 345%, while at the same time their arrears on debt payments totalled $54 billion. Excluding arrears, the nominal debt-to-exports ratio reached 252%, and the ratio of paid debt service-to-exports was equivalent to 15%. The estimated percentage of debt service paid to scheduled debt service (i.e. the sum of paid debt service and arrears) was only 14%. Total debt stocks amounted to $ 201 billion, of which 28% was multilateral debt.

The debt overhang of the HIPCs is, thus, far from being lifted. A parallel can be made here with the debt crisis of the 1980s of the middle-income countries: after 7 years (from 1982 to 1989) the Brady plan helped to put an end to the debt problems by providing a significant debt relief. Before the modification of the HIPC agreed at the IMF/World Bank annual meetings in September 1999, the beneficial impact of the HIPC initiative on the debt overhang of these countries was limited. Fourteen HIPCs had their cases reviewed under the initiative. By July 2000, nine countries had reached their decision points under the enhanced scheme. Bolivia, Mauritania and Uganda were declared eligible for additional relief in February 2000, Mozambique and the United Republic of Tanzania followed in April 2000, Senegal in June 2000 and Benin, Burkina Faso and Honduras in July 2000. In all, these nine countries are estimated to receive more than $15 billion in nominal terms in addition debt relief, representing an average reduction in the present value (PV) of debt stocks of close to 45 per cent on top of traditional relief mechanisms. The objective was to have 20 HIPCs reach their respective decision points under the new framework by the end of 2000. It should be noted that the debts owed by some HIPCs to the former USSR have been significantly reduced, as the Russian Federation has reduced debts up to 90%.

The servicing of debt absorbs budgetary and foreign exchange resources, and in the absence of any benefits accruing from the investment of the original loan, will have a net negative effect on a government's ability to fund its social expenditure programmes. In this situation, government spending on health, education and social services will be reduced. If these services are efficiently organised, reduced expenditure on them will have an adverse social impact. It may also interfere with the promotion and protection of human rights. According to Article 22 of the Universal Declaration of Human Rights, every one is 'entitled to realization, through national effort and international co-operation, and in accordance with the organization and resources of each state, of the economic, social and cultural rights indispensable for his dignity . . .'. It is therefore of critical importance that debt servicing requirements not be permitted to detract funds from necessary spending in areas relevant for sustainable human development and for the promotion and protection of human rights, as defined in the principal human rights treaties. In poor indebted countries, this condition is often not fulfilled. Furthermore, for debtor countries which rely on one or a few agricultural or mineral exports, a high level of debt service will tend to accentuate monoculture-based agriculture and increase the rate of depletion of national resources beyond the limits of sustainability.

Debt relief is also needed by poor countries in a post-conflict situation to bring support to their economic recovery after prolonged periods of war or severe civil strife. A group of eleven HIPCs in sub-Saharan Africa[2] - all but one Least Developed Countries (LDCs) - has been identified as having exceptional needs for post-conflict economic rehabilitation assistance. For these countries, measures beyond the HIPC framework may be required, including new approaches for providing early assistance and lending into or providing assistance under arrears. Special consideration is also required for countries, such as those in Central America, that were struck by natural disasters with serious consequences on social and economic sectors. In these situations, a special "post-catastrophe" relief is needed and reconstruction must take precedence over external debt-servicing obligations. Moreover, in view of the recent changes in the world economic climate, the cases of the LDCs which carry a relatively heavy debt burden deserve a special consideration for an alleviation of their debt burden.

## B. Debt of middle-income countries

For the middle-income countries that have access to international capital markets, debt problems have also assumed dramatic dimensions. The causes of the debt crises share

[2] These countries are: Angola, Burundi, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Liberia, Rwanda, Sierra Leone, Somalia and Sudan.

some similarities, as well as some notable differences. In some countries, like those in East Asia, the debt crisis found its origin in a too rapid external liberalisation of the financial sector. In others, such as the Russian Federation and Brazil, the debt problems resulted mainly from the difficulties of raising government revenues sufficiently to reduce the large government budget deficits. One notable feature of the new international financial context is the high speed of contagion of crisis from one country to another. This has further diminished the policy autonomy of debtor countries and required drastic adjustment measures, including sudden large rises in interest rates and overshooting of exchange rate depreciations.

The debt problems of Asian countries affected by the recent crisis share some common characteristics. To a large extent, private sector corporations and banks contracted the new external debt. Rapid financial market and capital account liberalisation during the 1990s made possible large-scale private sector external borrowing, and during the year directly preceding the crisis a large exposure to short-term bank borrowing was built up due to lower interest rates on foreign borrowing than on domestic loans. Commercial loans have traditionally been the main source of external debt-financing in the region, although Indonesia has a relatively important amount of official concessional finance. Thus, a large proportion of external debt of the East Asian countries was owed by private financial and non-financial firms rather than by the public sector. Many of these firms were driven into serious financial difficulties and bankruptcy by the collapse of the currencies and hikes in interest rates, even though initially most of them had been solvent. To a large extent, weakness in the banking system had contributed to a misallocation of credit and to the build up of an asset bubble in the property sector, given the fast rate of credit growth in the financial system. A slowing down of exports and an appreciation of their currencies that were pegged to the US dollar triggered a speculative attack on their currencies. The inability to support the exchange rates led to the floating of their currencies and the withdrawal en masse of external financing, creating liquidity crises which were first addressed by huge bail-out packages mobilised by the IMF and some donor countries to avoid defaults by debtor countries. Debt re-structuring with foreign banks occurred at a later stage, and for some countries this process was much delayed and the problems of shortage of trade finance was not addressed in time to avoid a serious recession.

However, there has been considerable variation among the individual countries regarding changes in their external indebtedness, reflecting disparate movements in their incomes as well as differences in the extent of debt payment after the outbreak of the crisis. Thus, the Republic of Korea's classification has been raised by the World Bank from a "moderately indebted" to a "less indebted" middle income country, while Indonesia has been downgraded to a status of a "severely indebted" low-income country. The other three countries most affected by the crisis (Malaysia, the Philippines and Thailand) have remained as moderately indebted middle-income countries. As in almost every major financial crisis in emerging markets and elsewhere, management and resolution of the crisis in East Asia have necessitated massive intervention by the public sector with attendant consequences for public indebtedness and fiscal balances. Indeed, resolution of the domestic debt burden has constituted a more important problem for most countries in the region than the servicing of external debt. In this sense, the external financial crisis created a domestic debt overhang in the private sector whose resolution may require considerable public intervention.

The social impact of these crises has been huge. In Indonesia, its large population and relatively low per capita income level has led to especially dramatic deterioration in living standards and ignited serious social disorder. In the three most affected countries, Indonesia, Thailand and the Republic of Korea, the rate of unemployment has swelled alarmingly. Clearly, in such circumstances, many human rights are infringed. Rights enshrined in the International Covenant on Economic, Social and Cultural Rights include the right to work, the right to an adequate standard of living and the right to health and education. Other rights are designed to protect children, women and disadvantaged groups. It has become more difficult to ensure that such rights are complied with in countries badly affected by the recent financial crisis.

In the Republic of Korea and Thailand, macroeconomic stability has been largely re-established, with exchange rates and interest rates falling to more sustainable levels. Positive economic growth has resumed since 1999, with GDP growth rates estimated at 6.5 % for the former country and 4 % for the latter. In these countries, debt restructuring at the firm level still remains a pressing challenge that must be addressed before sustainable broad-based growth can resume. In the case of Indonesia, macroeconomic stabilisation remains incomplete and economic recovery is still out of reach ( with GDP growth rate remaining slightly negative in 1999), in addition to which the firm-level debt problem must be resolved. For Indonesia, the debt problem was deeper to begin with and, partly due to political uncertainty, its restructuring was also addressed at a later date than in the former cases. In all three countries, the debt problem is clearly placed in the private sector, distributed between the banking and corporate sectors in varying proportions. The classic transfer of private debt onto the public sector balance sheet has occurred in all three cases, as the government has been forced to issue debt in order to restructure the banking system. The estimated cost of banking sector restructuring to the governments of these three countries is likely to be substantial, potentially exceeding 10% of GDP. In the crisis-affected Asian countries, relatively strong fiscal position before crisis allowed these countries to relax their fiscal stance and to commit large public funds to recapitalize the banking system and speed up financial sector restructuring. In assessing the sustainability of the recovery in East Asia, it is important to note that the favourable global conditions, in particular the strength of the United States growth, had helped in this process. However, with the slowing down of the global economy, in particular the United States economy, the sustainability of the post-recovery growth in East Asia is now uncertain.

In the case of the Russian Federation, fiscal management has remained a central problem since the start of the transition to a market economy. The narrow tax base, characterised by a heavy reliance upon commodity exports (especially oil and gas) for tax revenue, has not generated sufficient tax revenue to meet expenditures. This imbalance has led to a large cumulative financing gap, which has been met through the issuance of domestic bonds by the Ministry of Finance (GKOs and OFZs). In the aftermath of the crisis in Asia, lower world prices for oil and other commodities negatively impacted both Russia's export performance and fiscal balance. It became difficult to market rouble-denominated debt, so in 1998 the Government tapped the Eurobond market at increasingly high rates of interest. Higher interest rates due to monetary tightening under an IMF structural adjustment program accentuated the domestic debt burden. By August 1998 the Government could not meet maturing domestic debt payments and announced a 90-day moratorium on payment of various debt obligations. The devaluation and default on domestic debt has devastated the already weak domestic banking sector, which had invested heavily in government debt.

In the first half of 1999, tighter macroeconomic policies were implemented. As a result, the depreciation of the ruble against the US dollar was halted, and inflation was reduced. Despite the large real depreciation, there has not been any significant increase in exports, as the economy was still facing structural bottlenecks in the production (for example extraction and transportation constraints in the production of oil and gas). The Government failed to address the long-standing problems of poor revenue performance and tax and expenditures arrears. Real GDP growth in 1999 was nil, although there was an improvement over 1998, which saw GDP growth declining by -4.5%. In July 1999, Russia rescheduled with the Paris Club creditors the debts contracted by or guaranteed on behalf of the Government of the former USSR. This rescheduling did not entail any partial write-off. Paris Club creditors also agreed to begin discussions on comprehensive solutions to Russian debt problems in Autumn 2000, provided that the Russian Government continues to implement the IMF programme. The improvement of the payments position of the Russian Federation has continued in 2000 with the strengthening of oil prices. This is manifested in a sizeable trade surplus and rising foreign exchange reserves. However, a number of structural and institutional shortcomings that led to the 1998 crisis are still present.

The Russian debt default in August 1998 had a tremendously destabilising effect upon international capital markets and Brazil and other emerging markets soon came under pressure. Brazil experienced towards the end of August 1998 massive foreign exchange outflows, which were stemmed by sharp increases in interest rates. By September 1998, access by emerging market borrowers to capital markets became even more restricted and costly.

Brazil, like the Russian Federation, suffers from a longstanding fiscal imbalance. The cumulative federal financing gap has been met by domestic debt issuance (much of the debt being short-term and on variable rate). Despite the signing of a three-year stand-by agreement with the IMF in November 1998, the government was forced to float the real in January 1999. Brazil is also reported to have won an informal agreement from a group of foreign bank creditors to roll over their short-term credit to Brazil around the time that the support package was agreed. Unlike the Russian Federation, Brazil has not been cut off from the international capital markets and has successfully launched an international sovereign bond issue. Also, the Brazilian banking system is in a much healthier state than in Russia.

In the first half of 1999, Brazil experienced a better-than-expected growth, although GDP growth rate was estimated to be negative for the whole. To the contrary, the economy grew by about 1 per cent in 1999, a much higher rate than generally forecasted, and registered an annual growth rate of more than 3 per cent in the first quarter of 2000. With low inflation (at less than 5 %) and a stabilization of the exchange rate, monetary policy was relaxed and interest rates reduced. However, real interest rates are still very high and the Government budget deficit remains important (estimated at close to 10 % of GDP in 1999).

In addition to the debt crises faced by these five countries, the two rounds of crises (East Asian and Russian) have significantly disrupted economic activity in a large number of developing countries. This has occurred mainly through the decline in international commodity prices, along with the reduction in external financial flows and higher cost of external credit since late 1997. This was the case of many countries in Latin America, such as Venezuela, Chile and Ecuador. In October 1999, the latter became the first country to default on Brady bonds when the Government announced its decision to reschedule its domestic and external debt, deferring payments up to seven years with a two-year grace period and reducing the interest rate. The dollarization plan announced in January 2000 and an open capital account effectively eliminated the distinction between domestic and external debt, aggravating the difficulties associated with the loss of confidence. In combination with political uncertainties, the decision to default led to capital outflow of some $2.5 billion in 1999, about 20 per cent of GDP. These outflows had to be financed through through deflation and drawing on international reserves.

## III. POLICY ADVOCACY

When advocating policy changes, it is necessary to be highly selective, if the policy messages are to achieve significant attention. The following issues deserve special attention, although they are not the only important policy issues in connection with debt.

### A. HIPC Initiative

#### 1. Original scheme

The HIPC initiative launched in 1996 was a major step towards addressing the debt problems of the poorest countries in a comprehensive way, and towards finding a lasting solution to their debt overhang. The debt sustainability criteria under the original HIPC framework used to determine which countries would benefit from HIPC assistance (beyond debt relief provided by the Paris Club on Naples terms) were based on the following threshold values: the ratio of present value of debt-to-exports should exceed a range of 200-250 per cent; the ratio of debt service-to-exports should exceed a range of 20-25 per cent; the ratio of present value of debt-to-fiscal revenue should exceed 280 per cent, provided that two other criteria are met, an export-to-GDP ratio of at least 40 per cent and a minimum threshold ratio of fiscal revenue-to-GDP of 20 per cent. These criteria were too stringent and did not reflect the debt servicing capacity of debtor countries (see below). The HIPC process was initially envisaged to take six years to complete. So it is hardly surprising that by mid-1999 only four countries (Uganda, Bolivia, Guyana and Mozambique) had benefited from the exit debt relief at the completion point.

The slowness of the process seems to have been due to two principal factors:

- The complexity of the process itself, based as it is on the implementation of two ESAF programmes (under the original HIPC framework) and on eligibility conditions determined by a country-specific debt sustainability analysis;

- The lack of adequate funding for an expeditious resolution of all eligible cases, without damaging the financial standing of the public institutions to whom the debt is owed.

2. United Nations comments and proposals

The comments made below reflect the United Nations position as it was defined before the Cologne Summit took place. (The eight-point proposal advocated by the United Nations is summarized in Box 1). The relevant issues were identified as the removal of financing constraints on the expeditious delivery of debt relief, and the use of a less stringent definition of debt sustainability. These two requirements were seen as since linked, a shortfall of resources resulted in stringent criteria, in order to limit the number of beneficiary countries.

The UN took the view that prior conditions and safeguards built into the original HIPC initiative needed to be reduced, to make receipt of debt relief less of an obstacle race. Initially, eligible countries, in order to receive multilateral debt relief, had to carry through two consecutive three-year ESAF programmes, and make progress on social sector reforms. This was deemed excessive: a single IMF programme was considered sufficient to ensure that debt relief finally goes to countries with reasonably sound macroeconomic policies.

The UN stated that the list of countries to be included in the HIPC category needed to be kept under continuous review. About six LDCs were not originally covered[3], although on the basis of their debt indicators they would have been classified as severely or moderately indebted, thus being vulnerable to adverse external developments. Three quarters of the HIPCs had met the entry requirements at the end of 1998; the remaining nine countries (not including Nigeria) had become potentially eligible as the sunset clause was extended to the end of the year 2000. This clause was recommended for review: although the HIPC initiative should not become a permanent mechanism, its closure before all poor countries having debt servicing difficulties were given a chance to be included was regarded as retrograde. The reason was that eventually other debtor countries, such as low-income countries which had not been granted Paris Club concessional re-schedulings or were assumed to have exited from such re-schedulings, could also need HIPC assistance.

- *Debt sustainability criteria* were proposed as follows.

Eligibility criteria, based on threshold and target values of debt indicators should not be based on arbitrary assumptions (influenced by underfunding of the initiative), but should reflect the real debt servicing capacity of debtor countries. The ultimate objective is to provide a clear exit from an unsustainable debt burden. HIPC debt relief should seek in the

[3] See footnote 3 .

first instance to remove whatever is the binding constraint, be it scarcity of foreign exchange or lack of budgetary resources.

The original target value of NPV of debt-to-exports ratio appeared to be too high, in comparison with the real debt servicing capacity of HIPCs. Indeed, the debt situation of the HIPCs over the period 1990-97 can be summarised by the following indicators, averaged over the period and over the whole group of HIPCs:

- The nominal debt-to-export ratio amounted to 405 % on average;

- Total payments arrears represented about 27% of total nominal debt stock; total nominal debt stock without payments arrears was equivalent, on average, to 300% of exports (roughly equivalent to NPV of debt-to-exports of 150 %[4]);

- The paid debt service-to-exports ratio reached 18%, while payments arrears far exceeded paid debt service and were equivalent on average to more than 600 % of paid debt service.

The foreign exchange constraint as measured by debt-to-exports or debt service-to-exports ratios is not the only constraint on the debt servicing capacity of the HIPCs. The budgetary constraint can be as severe, and in countries belonging to the CFA franc zone, it is even the primary one. The fiscal criterion of the original HIPC scheme appeared to be too high. To begin with, the additional two criteria on export-to-GDP and fiscal revenue-to-GDP ratios were unnecessary. The export-to-GDP criterion purports to restrict the consideration of the fiscal constraint only to countries with a large export sector. This is highly questionable, as countries with a small export sector could equally face a constraining fiscal shortage. The second criterion, related to fiscal revenue-to-GDP, aims at avoiding problems of moral hazard, whereby debtor governments would not provide necessary efforts to increase fiscal revenue in order to get debt relief. This argument did not apply to countries whose policies, and especially government measures to raise fiscal revenue, are monitored by the IMF in the framework of their ESAF programmes. Furthermore, very few HIPCs can achieve a target of 20 per cent of fiscal revenue-to-GDP.

A ceiling for a share of fiscal revenue to be allocated to external debt service was proposed as a benchmark for assessing the level of debt relief needed. In general, even **one quarter of fiscal revenue** used for external debt service may be considered as a relatively high ratio in HIPCs, given the competing claims for the financing of infrastructure, social and human development[5].

---

[4] The present value of debt is lower than the nominal value of debt, if the discount rate (equivalent to commercial market rate) is higher than the original interest rate of the debt contract (which in the cases of the HIPCs is often a concessional rate). As a rule of thumb, the present value could be equivalent to half the nominal value.

[5] Analysis of available information on the budget revenues and expenditures of twelve HIPCs shows that for those countries which have a high level of fiscal revenue (i.e. ratios of fiscal revenue-to-GDP close to 20%), the ratios of external debt service-to-fiscal revenue are hovering around 25%. For

In order to reach sustainable levels of debt in poor countries, donors might need to go beyond the commitment made to forgive bilateral ODA debt to qualifying countries. ODA debt forgiveness for all HIPCs was recommended, as these are all poor countries and such a policy would be in line with UNCTAD Resolution 165 (S-IX). In the cases of post-conflict countries, countries affected by serious natural disasters and countries with very low social and human development indicators, the UN proposed full cancellation of their bilateral debt[6]. And finally, it suggested that Paris Club debt eligible for reduction should also include post cut-off date debt, as for many HIPCs this debt is important.

- *Financing*

The most important point about the financing of the HIPC initiative is that debt relief for the poorest countries should not be provided **at the expense of ODA** funding for development programmes and projects in these and other countries, which are also dependent on aid for their welfare and development prospects. The financial standing of multilateral development banks and their ability to provide support to all member countries also needs to be safeguarded.

Concern was expressed about the ability of multilateral development banks to meet the cost of HIPC debt relief from their own resources. Another fear was the additional cost that can be charged on lending to middle-income countries, resulting from the need for these institutions to raise income for the financing of the HIPC initiative. Thus, to the extent that relief on multilateral debt for the HIPCs is funded by provisions from net income of multilateral institutions, this is likely to have negative consequences for their lending policies: (a) pressure on net income of the multilateral banks has led to some increases on the interest spreads charged on loans to middle –income countries; (b) reduction in resources allocated to other programmes funded by net income, such as technical assistance and grants made to governmental and non-governmental organisations, and a weakened ability of multilateral development banks to grant concessional loans in the future.

Bilateral contributions are needed to allow more multilateral debt relief. It was seen as essential that debt relief be financed by resources that are **additional** to previously envisaged budgetary ODA allocations. To ensure this additionality it was suggested to treat the HIPC initiative as an exceptional programme, to be financed by supplementary budgetary resources, in the same way as funding to countries affected by natural disasters or other emergencies. Additionality could also be allowed by a general allocation of SDRs[7]

---

countries whose capacity to raise fiscal revenue is very low, the ratios of external debt service-to-fiscal revenue are very high.

[6] The President of the United States announced at the IMF/World Bank meeting in September 1999 that his country is committed to forgive 100 per cent of bilateral debt owed by HIPCs.

[7] A general allocation of SDRs would not be objectionable in the present context where there is no threat of global inflation and where there is a shortage of liquidity in developing countries and countries in transition to finance their imports. Besides HIPCs, middle-income debtor countries also need additional liquidity for economic recovery.

and the cession by creditor countries of their allocations as grants to those in need of debt relief (thus foregoing the earning of market interest rates on SDRs).

The funding mechanisms suggested were:

- partial sales of IMF gold;

- a prompt and substantial general allocation of SDRs, which could be used to further finance debt relief, industrialized countries and other countries in a position to do so being invited to earmark their allocations for this purpose;

- donor countries committing themselves to additional bilateral contributions to the multilateral HIPC trust funds as necessary to ascertain the achievement of debt sustainability targets for individual countries.

It was emphasised that a reformed HIPC initiative should be seen as a one-off operation. Once their debt overhang is lifted, HIPCs must be able to make a fresh start, using new aid flows in an efficient way to remove the structural obstacles to their development. These countries will still have to rely for some time on new concessional external sources of finance.

- *Linkage with poverty reduction*

The UN view was that, in addition to enhancing HIPCs' external viability, reducing fiscal pressure and creating room for transferring resources to social expenditures should also be a key concern under the HIPC initiative. Debt repayment should not take precedence over the fulfilment of human needs and human rights. Merit was seen in establishing a link between debt relief and poverty reduction, and in channelling resources freed up from debt service to finance social and human development projects. However, it was held that any such link should not take the form of additional conditionality imposed on the debtor countries; even "benign conditionalities" in this respect could have the effect of further slowing down the HIPC process. Social policies and expenditures were monitored under ESAF programmes, and debtor countries had to show satisfactory progress on social sector reform before decisions on delivery of HIPC assistance are made.

### 3. Recent modifications: the Cologne debt initiative

Against the shortcomings of the original HIPC framework and the worsened external situation of the HIPCs, the Bretton Woods Institutions initiated a review process in early 1999 which attracted proposals from non-governmental organizations, creditor governments and international organizations, including those of the United Nations that have just been outlined (see Box 1).

In June 1999 the G-7 Cologne Summit made recommendations known as "the Cologne debt initiative" for the enhancement of the HIPC initiative, aiming at making debt relief deeper and faster, and also expanding the number of eligible countries and strengthening the link between debt relief and poverty reduction. These recommendations, which were subsequently endorsed at the IMF and World Bank annual meetings in September 1999, modify the original HIPC initiative in the following way:

BOX 1

UNITED NATIONS PROPOSALS FOR AN ENHANCED INITIATIVE ON HIPC DEBT RELIEF

- Review the list of HIPCs in order to ensure that all poor countries facing debt servicing difficulties will be considered under the initiative.

- Shorten the time frame for implementation to three years, so that final debt relief can be provided after the first track record of three years of ESAF programmes.

- Apply less restrictive eligibility criteria, notably by reducing the thresholds of debt-to-exports and debt service-to-exports ratios. (Be guided by the fact that over the recent period 1990-97, HIPCs were able to service debt, on average, for up to 18 % of their exports and that their nominal debt stock, excluding payments arrears was still equivalent to 300 % of exports.) For certain countries facing very severe foreign exchange constraints, the thresholds could be lower than the general eligibility level. The aim should be to provide a real exit from debt re-scheduling.

- Set a ceiling for the share of fiscal revenue allocated to external debt service, and provide additional debt reduction if necessary to meet this benchmark. 25 % of fiscal revenue allocated to external debt service is an excessive burden for HIPCs.

- Cancel HIPCs' ODA debts, and extend at least 80 % debt reduction on other official bilateral debts to all HIPCs; consider full cancellation of bilateral official debts for post-conflict countries, countries affected by serious natural disasters and countries with very low social and human development indicators. Paris Club debt eligible for reduction should also include post cut-off date debt.

- Full funding of the initiative through partial sales of IMF gold, a new general allocation of SDRs and additional bilateral contributions to multilateral Trust Funds for debt relief.

- Take steps to reverse the current trend of declining ODA and budget new aid funds for social and human development projects and poverty reduction, and adopt procedures to release resources for HIPC relief without impinging on regular ODA budgets: debt relief should not be given at the expense of ODA.

- Linkage between debt relief and poverty reduction, with debtor countries determining their own national priorities. In this respect, increase collaboration with NGOs and the private sector to raise funds for debt relief and development projects in HIPCs.

- *Deeper debt relief* is to be achieved by lowering the debt sustainability targets:

- for NPV debt-to-exports ratios: from 200-250 per cent to a unique ratio of 150 per cent.

- for NPV debt-to-fiscal revenue ratio: from 280 per cent to 250 per cent; the two accompanying eligibility criteria have also been reduced: for the exports-to-GDP ratio, from 40 per cent to 30 per cent, and for the fiscal revenue-to-GDP ratio, from 20 per cent to 15 per cent.

The Paris Club has agreed to increase its debt relief under the enhanced HIPC framework by providing a deeper degree of debt cancellation of up to 90 per cent or more for the very poorest among eligible countries. For poor countries not qualifying under the HIPC Initiative, the Paris Club could consider a unified 67 per cent reduction under the Naples terms and, for other debtor countries applying for non-concessional reschedulings, an increase on the limit of debt swaps would be agreed.

Moreover, for qualifying countries, forgiveness of bilateral ODA debt is envisaged, through a menu of options, on top of the amounts required to achieve debt sustainability. New ODA should preferably be extended in the form of grants.

- *Faster debt relief*: the two three year-stages of implementation is maintained, although it is specified that the second phase can be shortened if a country meets ambitious policy targets early on ("floating completion points"). The international financial institutions can provide "interim relief" for qualifying countries, before completion point. After completion point, these institutions could frontload the provision of debt relief.

In future, the amount of debt relief is to be determined at the decision point, based on actual data. There would be a retroactive implementation, as additional assistance resulting from any modification to the HIPC initiative should be available to all eligible countries, including those that have already reached their decision or completion points under the present framework. The enhanced HIPC initiative is expected to expand eligibility from 29 countries to 36 countries[8], and possibly to other countries.

- *Financing*: in order to meet the increase in costs, and in recognition of the importance of maintaining an adequate concessional lending capacity by the international financial

[8] Within the existing list of 41 HIPCs the seven additional eligible countries are: Benin, Senegal, Ghana, Honduras, Lao PDR, Togo, Central African Republic. The IMF and World Bank staffs estimate that under the enhanced HIPC framework: (i) 9 countries are eligible for immediate reassessment: Benin, Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique, Senegal, Uganda; (ii) 19 countries will have their decision points in 1999 and 2000: Cameroon, Chad, Republic of Congo, Ethiopia, Ghana, Guinea, Guinea-Bissau, Honduras, Lao PDR, Madagascar, Malawi, Mauritania, Nicaragua, Niger, Rwanda, Sierra Leone, Tanzania, Togo, Zambia; (iii) 8 countries will have their decision points in 2001 or later: Central African republic, Burundi, Democratic Republic of Congo, Liberia, Myanmar, Sao Tomé and Principe, Somalia, Sudan.

institutions, the G-7 Governments stated in Cologne that they were prepared to support a number of mechanisms:

- The IMF's costs should be met by : the use of premium interest income; possible use of reflows from the special contingency account or equivalent financing; cautiously-phased sale of part of IMF gold reserves;

- The multilateral development banks should identify "innovative approaches" which maximise the use of their own resources;

- The costs to the international financial institutions will also require bilateral contributions and considerations will be given to an expanded HIPC Trust Fund;

- There should be an appropriate burden sharing of costs among donors.

Overall costs of the enhanced initiative are estimated at $ 36 billion in 1998 NPV terms (or roughly equivalent to $ 72 billion in nominal terms[9]). Added to this amount are ODA claims from OECD countries on qualifying HIPCs of the amount estimated at $15 billion which can be cancelled. Non-OECD countries are also holding large ODA claims on HIPCs, perhaps of comparable size.

- *Link with poverty reduction*: the new HIPC initiative should be built on an enhanced framework for poverty reduction. This is critical to ensure that more resources are invested in health, education and other social needs. The IMF Enhanced Structural Adjustment Facility (ESAF) will be replaced by the new Poverty Reduction and Growth Facility (PRGF) to make sustainable poverty reduction a central objective. In the context of the PRGF, a Poverty Reduction Strategy Paper (PRSP) will set out the government's poverty reduction plan, and would be produced by the national authorities with the assistance of the IMF and World Bank. PRSP would guide all lending operations by both institutions as well as donor support. PRSP should be in place when a country reaches its decision point under the HIPC Initiative. Moreover, there should be broad-based participation with transparency and accountability to ensure effective use of debt relief.

## 4. The enhanced HIPC initiative: policy conclusions

Even after the recent modifications brought by the Cologne debt initiative, the eight-point proposal, as advocated by the United Nations (see Box 1) remains relevant. The following comments are made in further elaboration of the UN proposals.

- The list of HIPCs eligible for assistance, although enlarged by the recent initiative, needs to be kept under continuous review in order to ensure that all poor countries facing debt servicing difficulties will be considered .

[9] As a rule of thumb the present value could be equivalent to half the nominal value (see footnote 5).

- The time frame needs to be firmly shortened to three years.

- The new target value of NPV of debt-to-exports set at 150 % appears to be in line with the average ratio of stock of debt (excluding payments arrears) to exports, noted above. However, it still remains to be seen that this level of outstanding debt will produce a sustainable debt service ratio. Moreover, the fiscal criterion is still high, and the two related conditions concerning export-to-GDP and fiscal revenue-to-GDP need to be abandoned. A ceiling for the share of fiscal revenue allocated to external debt service below 25 % would be appropriate.

- Paris Club debt reduction to the equivalent of 90 % or more and ODA debt cancellation, as recommended by the G-7, are much welcome. Paris Club debt eligible for reduction should also include post cut-off date debt. In addition, full cancellation of bilateral official debts for post-conflict countries, countries affected by serious natural disasters and countries with very low social and human development indicators should be given serious consideration.

- Progress was made at the IMF and World Bank annual meetings in September 1999 on financing the HIPC Initiative, notably new pledges of contributions to the IMF and World Bank trust funds, and agreement on financing of the IMF's participation through gold sales. The IMF Board of Governors adopted a resolution enabling off-market transaction of up to 14 million ounces of gold, as a one-time operation of a highly exceptional nature. Nevertheless, it would be naïve to assume that financing will cease to be an important constraint. Enlargement of the number of beneficiary countries and lowering the debt sustainability targets will bring additional costs. If commodity prices are further depressed in the wake of the global financial crisis, the total cost of accelerated debt relief is likely to rise. The financing of the enhanced HIPC intiative should still not be provided **at the expense of regular type of ODA**.

- Concerning the linkage with poverty reduction, the question is whether the new IMF Poverty Reduction and Growth Facility will increase the policy burden for HIPCs and consequently slow down the debt relief process by setting new requirements in the form of social policy conditionalities, on top of macro-economic and structural reform conditionalities. It also needs to be ensured that the learning process implied in the PRSP and efforts to enhance ownership do not further slow down the implementation of the HIPC initiative. Uncertainties remain as regards the implications of the new policy emphasis on poverty reduction. For example, there is no clear perception as to which social policies would be the most effective in reducing poverty. It is not clear either as to which goals and quantified indicators should be selected to evaluate the effectiveness of the new strategies. The effectiveness of the linkage between debt relief and poverty reduction programmes will also depend on how it is going to be made. If it is through debt conversions or through local currency debt swaps, attention should be given to the related high inflationary risks for HIPCs (see below), especially if the primary reason for the inability to service external debt is a budgetary constraint. Furthermore, given the existence of high levels of payments arrears, the conversion of scheduled debt service into budgetary expenditures for social and human development will put insurmountable budgetary pressure on debtor countries. It is, therefore, essential that debt relief should be complemented by new aid flows to provide full funding of social expenditures.

## B. Debt conversion

The debt crisis of the early 1980s gave rise to a number of mechanisms for reducing the debt burden of heavily indebted countries, among which are various types of debt conversions. Chile institutionalised the first debt conversion program in May 1985. The relative success of the program encouraged a number of other Latin American countries to follow suit, and debt conversions expanded rapidly in late 1980s.

Originally, only commercial (London Club) debt could be converted. However, since 1991, official bilateral (Paris Club) debt has also become eligible for conversion. Currently, all the Paris Club eligible debt contracted on concessional terms and up to 20 % of debt contracted on commercial terms can be converted.

In the cases of the HIPCs, it is unlikely that debt conversion can play an important role in alleviating their debt burden. Since multilateral debt (which roughly accounts for 25 % of their debt stock) is not eligible for conversion, and there is little commercial debt (which was almost totally bought back under the IDA buy-back facility), the only source for conversion is provided by Paris Club debt. Yet, there are a number of difficulties related to Paris Club debt conversion. First, there is no secondary market for official bilateral debt, making it difficult for investors to obtain information on discount levels, and complicating the tasks of debtors in defining local currency pay out levels. Second, administrative costs tend to be high, as investors need to negotiate debt purchases with each of the Paris Club creditors. Third, Paris Club creditors often disregard prices of secondary commercial debt when setting prices for the bilateral debt, producing cases where some of the official bilateral debt is overpriced from the viewpoint of potential investors. Fourth, in the case of a flow rescheduling, the consolidated amounts tend to be relatively small, as compared with the level of outstanding stock of debt.

Other problems are related to structural deficiencies in debtor countries. For a conversion scheme to be efficient, a set of laws need to be put in place as well as a tight monitoring system to avoid "round tripping"[10]. In addition, for a conversion program to be successful, it should not have inflationary consequences. This means one of three things:

- either the local currency pay out must not be large (in which case only a small part of the debt is converted);

[10] Round tripping is an operation whereby an investor purchases the debt at a discount from a creditor, receives the local currency payout from the debtor government, and instead of investing the money in a local project buys foreign currency and transfers it out of the country, reducing, thus, the debtor country's foreign exchange reserves. For example, round tripping took such proportions in Tanzania that the World Bank had to ask the Government to discontinue the debt conversion program.

- or a conversion must be done for assets rather than cash (for example debt for equity swaps);
- or the increase in the domestic money supply needs to be neutralized through various schemes involving the issue of government bonds, requiring, thus, the existence of domestic capital markets.

The HIPCs do not have large privatisation programs as did Latin American countries in the 1980s and early 1990s, nor do they possess the necessary resources or adequate capital markets to engage in somewhat complex financial operations to neutralise additional liquidity. Therefore, the inflationary risk of debt conversion in these countries is high.

For these reasons, it has been advocated recently that another mechanism involving pay out in local currency for servicing the external debt might be more appropriate for HIPCs. These proposals are based on the idea that if a country pays debt service in foreign currency to a creditor, it could instead pay the same amount in local currency that would be used within the country for social or developmental projects. Thus, the argument goes, instead of transferring money abroad, it would be used domestically for developmental purposes.

Such arguments are valid if the primary constraint on the debtor country comes from the lack of foreign exchange. However, if the primary reason for the inability to service external debt is a budgetary constraint, debt servicing will run into arrears even if the pay outs are in local currency, unless additional money is printed, resulting in more inflation. The allocation of local currency as a result of a debt swap would often occur outside adopted budgets, which could have unfortunate macro-economic consequences (such as printing more money, reducing other budget items, increasing taxes or raising loans in the national private sector).

Local currency pay out would entail other difficulties for the debtor. First, the operations are often demanding in terms of administrative resources, and close co-ordination with creditor countries is needed to manage local currency counterpart funds. Both creditors and debtors might incur substantial costs of planning and monitoring debt swap programmes. The administrative costs will be high if each bilateral creditor will want to implement its own scheme. Secondly, the debtor country would not have any influence on the projects to be financed, as the creditor country would normally look to its own development and/or environmental policies as a basis for identifying projects.

These potential pitfalls do not necessarily imply that mechanisms to allow debt servicing in local currency are not useful. There are examples, such as reforestation programs, and other debt-for-environment swaps where this mechanism has given positive results. If significant additional debt relief can be obtained through this mechanism, it would be preferable to co-ordinate the operations among creditor countries and to establish a multilaterally coordinated debt swap mechanism, but at the initiative of the debtor country.

The debtor country will have to control the macro-economic consequences of such swaps: it should be left to the debtor to decide at what pace it will undertake the swaps and to determine the priority list of projects.

**C. Debt of middle-income countries**

The issues concerning the prevention and management of financial crises in middle-income countries have been adequately treated in the earlier report of the Executive Committee on Economic and Social Affairs on a New International Financial Architecture. The present report builds on this work and elaborates more on an orderly debt restructuring process, including internationally sanctioned standstills through IMF lending into arrears.

The abrupt cessation of private external lending, especially of trade finance, which accompanied payments difficulties of countries in crisis had brought severe disruptions in their economic activities and in many cases had further weakened their capacity to pay. Furthermore, the financial crisis at the end of 1990s, has been addressed either by a declaration of a debt moratorium, as in the case of the Russian Federation, or by the provision of official financial rescue packages under the leadership of the IMF to bail-out private creditors.

Such responses remain unsatisfactory. On the one hand, a unilateral debt moratorium can cut debtors off from sources of external finance for a long time. For emerging market countries that rely on private sources of capital, moratorium can be a powerful source of contagion, transmitting difficulties rapidly to other countries as investors withdraw from other markets for fear of similar losses. This has been observed following the moratorium declared by Russia in August 1998, which has immediately affected Brazil. Furthermore, debtors declaring a moratorium may face legal actions from creditors for seizure of debtors' assets abroad.

On the other hand, the bail-out financial packages mobilised by the IMF and provided under tight conditionality have raised some concerns, besides questions concerning the appropriateness of IMF policy prescriptions. These concerns are related to two particular issues:

- the adequacy of IMF emergency lending: in the light of the Asian financial crisis, the sheer size of financial rescue packages and the rapid contagion of liquidity crisis have raised doubts about the capacity of the IMF to mobilize emergency financing of the magnitude required by the countries in distress. In this respect, the G-7 has announced progress towards agreeing the IMF Quota increase and the New Arrangements to Borrow, which together would provide additional resources to the IMF of $90 billion. Despite the increase in IMF resources, is IMF lending sufficient in cases of a global liquidity crisis?

- equitable burden sharing and moral hazard: IMF bail-out packages can create a moral hazard for at least some lenders who have not been forced to bear the full risk of the credits they have extended. Providing official financial assistance might shield creditors and investors from the consequences of bad decisions and sow the seeds of future crisis. It is, thus, necessary to involve private creditors more fully in sharing the burden of emergency financing.

***IMF lending into arrears***

For these reasons, some formal framework is needed to allow payments suspensions that are part of a process of co-operative and non-confrontational debt renegotiations between debtors and creditors. There seems to be some convergence of views that an IMF policy of lending into arrears could provide a solution. The IMF would continue to provide financing to countries even when those countries implement an adjustment and reform plan and seek a negotiated restructuring with creditors in good faith. That arrangement would involve private creditors in negotiating terms of a restructuring. The provision of financial support by the IMF can improve the bargaining position of the debtor, and, combined with the adjustment programme, can signal to the unpaid creditors that their interest is best served by quickly reaching an agreement with the debtor. At the same time, suspension of payments will lower the immediate foreign exchange requirements and reduce considerably the size of a rescue package. A faster disbursing mechanism should also be utilised by IMF to provide trade finance and address the import needs of debtor countries.

Temporary suspension of payments may require the use of exchange controls in order to stem a "rush for exit" by holders of claims, including domestic holders, and some form of protection against legal actions on debtors' assets abroad. It has been suggested that recourse to IMF Article VIII 2 (b) can serve both purposes.

IMF lending into arrears might fail to prevent contagion, because any temporary suspension of payments might trigger fear that other countries might follow suit. But it can provide needed interim finance and can secure a rapid restoration of access to external finance.

***Contingency clauses***

Consideration could also be given to include clauses in debt contracts that would allow for an automatic extension of maturities in times of acute liquidity crisis. The question of moral hazard can be addressed by limiting these cases to liquidity crisis arising from external shocks, beyond the control of debtor countries, such as sharp fall in the terms of trade or sudden withdrawal of foreign capital because of contagion. One caveat to such a proposal is that the inclusion of such clauses could raise the cost of financing, as lenders might ask for compensation for assuming increased risk, and the higher cost would have to be weighed against the perceived usefulness of such clauses in addressing unforeseen events. It should be noted that to avoid any additional source of discrimination in the market such clauses can equally apply to industrialized countries.

***Debt restructurings***

Experiences have shown that an early debt restructuring is often followed by an early recovery. The Republic of Korea negotiated a restructuring of its short-term debt with its creditor banks, soon after signing the IMF agreement, and Thailand obtained an agreement by banks to restructure its short term about six months after the crisis. Indonesia is reported to negotiate debt restructuring only about a year after the start of the crisis. It is a coincidence that the two first countries have recovered more quickly. An early restructuring helps to provide a breathing space to debtors, while also lifting the uncertainties about payment obligations. In this respect, IMF lending into arrears could also assist debtor countries to reach an early debt restructuring with creditors.

There is an additional problem that eventually might need to be addressed. In the 1980s the practice of syndicated bank lending to sovereign debtors facilitated the debt restructuring process which took place within the informal setting of the London Club. In the 1990s, the size, sophistication and heterogeneity of recent capital flows have reduced the relevance of the procedures used in the past to ensure an appropriate private sector role in resolving severe international financial crisis. In the case of bonds, there exists no framework for an orderly renegotiation of those debt securities. Serious consideration should be given to the G-10 proposal for inclusion of special clauses in debt contracts to allow for collective representation of creditors and qualified majority voting on changing the terms of the contracts, and to force sharing of proceeds of debt repayments. The inclusion of such clauses would need to be consistently applied among developing and developed countries alike.

***Transparency and accountability***

Another lesson drawn from the Asian crisis is the importance of the question of transparency and accountability. A lack of transparency and accountability can exacerbate financial weakness at the firm and national levels and complicate efforts to resolve crisis. Action is needed to improve the transparency and accountability of:

- the private sector (including national firms and banks, but also international investment banks, hedge funds and other institutional investors);

- of national authorities (for dissemination of regular and timely information about foreign exchange liquidity and external debt positions, including short term debt);

- and of international financial institutions.

The international community should intensify efforts to implement these recommendations. It is worth noting in particular the establishment of the Inter-Agency Task Force on Finance Statistics. This includes international institutions such as the IMF, OECD, World Bank, BIS, UN (UNCTAD), the European Central Bank, and Eurostat. Its remit is to examine modalities to improve the compilation and dissemination of data on external debt and reserve assets.

## IV. CONCERTED ACTION BY THE UNITED NATIONS

As regards concerted debt-related actions and technical assistance, the need for co-ordination is particularly felt in the areas of debt conversion and debt management. As far as debt conversion is concerned, agencies have shown interest in channelling resources freed under debt relief schemes to development programmes, notably in the social and human development sectors. However, as discussed above, a number of considerations have to be assessed before embarking on debt conversions and local currency swaps, in particular the absorption capacity of debtor countries. It is essential that appropriate mechanisms be put in place to ensure effective co-ordination among donor agencies and to secure real benefits to debtor countries, and that debtor countries be fully in charge. In the first instance, agencies should assist debtor countries to develop national strategies and projects for social and human development. Insofar as debt conversion can bring additional relief and resources for development purposes, debt swaps should be co-ordinated among bilateral and multilateral donor agencies and be implemented at the initiative of debtor countries. The costs of such operations should be carefully evaluated, as they can be high in regard of the limited amount of debt reductions that could be obtained through this route. In connection with a multilaterally co-ordinated debt swap mechanism, UNDP has proposed to assist debtor countries to establish the National Partnership Facility to channel resources to national programmes for social and human development. Through this facility, UNDP in co-operation with and at the initiative of the debtor country, can assist the latter to strengthen its capacity to design a human and social development programme which could be financed partly by debt relief and partly by new aid flows.

In order to disseminate and advocate UN position on the debt problems of developing countries, the UN can develop an advocacy partnership framework, in co-operation with NGOs and other civil society organization, as well as sympathetic creditor countries

Debt relief should be a once-and for-all operation. The best guarantee that debt will remain at sustainable levels after the completion point is an improvement in domestic public financial management, especially debt management. The UN should play its part in strengthening the capacity of debtor countries to implement an effective debt management policy. One lesson learned from the 1980s debt crisis and the recent financial crisis is that it is essential to have accurate information on the debts incurred, including short-term private debt. Furthermore, an effective debt management includes such aspects as elaboration of strategies, institutional issues, legal matters, co-ordinating, registering and channelling of information flows for operations and decision making.

In view of the ongoing HIPC process there is also a special need to ensure the concerned debtor countries' ownership of debt sustainability analysis and ability to participate as equal partners in the process. The capacity of HIPCs to apply the methodology of debt sustainability analysis and appraise the implications of debt relief should be strengthened. The quality of governance can also be strengthened by the full exercise of civil and political rights in decision taking procedures concerning debt and other issues.

United Nations technical assistance has already played an important role in developing debt management capacities. In the early 1980s, UNCTAD developed an effective framework analysis for debt management and the computer-based debt management tool, known as the Debt Management and Financial Analysis System (DMFAS). This software, subsequently upgraded, is today installed in 50 user countries, of which 19 are HIPCs. The DMFAS Programme has recently established an interface with the Debt Sustainability Model (DSM+) developed by the World Bank for debt sustainability analysis. UNDP has been the traditional partner and sponsor of the DMFAS Programme; co-operating agreements have also been established with other players in this area, such as the Commonwealth Secretariat.

**External debt of developing countries and countries in transition** ( Back )

(Billions of United States dollars)

| | *All developing countries* | | *Sub-Saharan Africa* | | *Middle East and North Africa* | | *Latin America and the Caribbean* | | *East Asia and the Pacific* | | *South Asia* | | *Europe and Central Asia* | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *1998* | *1999* | *1998* | *1999* | *1998* | *1999* | *1998* | *1999* | *1998* | *1999* | *1998* | *1999* | *1998* | *1999* |
| Total debt stocks | 2 536.0 | 2 554.0 | 230.1 | 231.1 | 208.1 | 214.2 | 786.0 | 792.7 | 667.5 | 659.4 | 163.8 | 170.7 | 480.5 | 485.9 |
| Long-term debt | 2 030.3 | 2 070.7 | 180.3 | 179.1 | 164.1 | 169.4 | 640.5 | 649.0 | 517.1 | 530.6 | 154.2 | 159.9 | 374.2 | 382.8 |
| Public and publicly guaranteed | 1 529.2 | 1 580.1 | 171.1 | 169.4 | 159.6 | 161.4 | 424.2 | 440.6 | 337.7 | 365.0 | 143.1 | 147.2 | 293.5 | 296.6 |
| Private non-guaranteed | 501.1 | 490.6 | 9.1 | 9.7 | 4.5 | 8.0 | 216.3 | 208.4 | 179.4 | 165.6 | 11.1 | 12.7 | 80.8 | 86.2 |
| Short-term debt | 411.9 | 402.3 | 42.5 | 44.7 | 41.0 | 41.8 | 123.5 | 122.6 | 119.1 | 106.1 | 7.2 | 8.5 | 78.6 | 78.6 |
| Arrears | 128.0 | .. | 63.2 | .. | 12.1 | .. | 11.9 | .. | 17.1 | .. | 0.8 | .. | 22.9 | .. |
| Interest arrears | 36.2 | 40.7 | 20.2 | 20.4 | 2.4 | 2.4 | 3.6 | 3.6 | 2.0 | 2.0 | 0.3 | 0.3 | 7.7 | 12.0 |
| Principal arrears | 91.8 | .. | 43.0 | .. | 9.7 | .. | 8.3 | .. | 15.1 | .. | 0.5 | .. | 15.3 | .. |
| Debt service paid | 316.1 | 349.4 | 14.1 | 15.2 | 22.6 | 21.1 | 125.3 | 140.6 | 84.8 | 103.5 | 16.4 | 15.2 | 52.9 | 53.7 |
| Debt indicators (percentage) | | | | | | | | | | | | | | |
| Debt service/ Exports of goods and services | 18.5 | 18.7 | 14.7 | 14.8 | 14.3 | 11.0 | 33.6 | 34.5 | 13.3 | 14.8 | 18.9 | 14.5 | 14.7 | 14.8 |
| Total debt/ Exports of goods and services | 148.0 | 136.6 | 238.7 | 225.1 | 131.2 | 111.3 | 210.5 | 194.6 | 104.9 | 94.4 | 189.2 | 162.5 | 133.7 | 133.7 |
| Total debt/ GNP | 42.2 | 41.5 | 72.2 | 75.8 | 35.8 | 44.2 | 40.9 | 46.2 | 40.2 | 34.8 | 29.1 | 28.2 | 49.0 | 42.2 |
| Short-term/ reserves | 58.9 | 53.1 | 139.9 | 135.5 | 62.4 | 60.1 | 74.7 | 74.7 | 40.0 | 30.9 | 19.2 | 21.3 | 76.3 | 72.8 |

*Source*: World Bank, *Global Development Finance 2000* (Washington, D.C., 2000).
*Note*: Two dots (..) mean data unavailable.