UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

PROCEEDINGS OF THE FIFTH INTER-REGIONAL DEBT MANAGEMENT CONFERENCE

Geneva, 20-22 June 2005

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Executive summary

This publication is a compilation of summaries of panel discussions and selected papers on themes deliberated by debt management experts and professionals at UNCTAD's Fifth Inter-regional Debt Management Conference, held in Geneva in June 2005. The conference was organized by UNCTAD's Debt Management and Financial Analysis System (DMFAS) Programme, with the aim of helping countries with developing and transitional economies build their capacity in debt management.

The conference panels covered the following themes: operationalizing debt sustainability, an inclusive approach to managing sovereign debt in good and bad times, debt crisis management, the changing role of the debt manager, recent experiences in the organization of debt management offices, delivering greater information and transparency in debt management, and debt relief.

The conference also served as a forum for the third and final round of the multi-stakeholder consultations on "sovereign debt for sustained development", coordinated by the United Nations Department of Economic and Social Affairs (UN-DESA), as a follow-up to the Monterrey Consensus. As such, certain panel themes were chosen to reflect some of the main concerns that had so far been raised in the consultation process. In addition, smaller groups met in informal sessions outside the main plenary to further discuss these themes. The outcome of these discussions is also included in these proceedings.

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Abbreviations

AfDB	African Development Bank
AfDF	African Development Fund
AFRODAD	African Forum and Network on Debt and Development
CPIA	Country Policy and Institutional Assessment
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DMFAS	Debt Management and Financial Analysis System (UNCTAD)
DSA	debt sustainability analysis
DSR	debt service ratio
DSF	Debt Sustainability Framework
ECA	export credit agency
EHIPC	Enhanced Heavily Indebted Poor Country (initiative)
EURODAD	European Network on Debt and Development
FTAP	Fair and Transparent Arbitration Process
G-7/G-8	Group of Seven/Eight countries
GDP	gross domestic product
HIPC	heavily indebted poor country
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association (World Bank)
IDS	Institute of Development Studies (Sussex, UK)
IFI	international financial institution
IMF	International Monetary Fund
LDC	least developed country
LIC	low-income country
MDB	multilateral development bank
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
NGO	non-governmental organization
NPV	net present value
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
PRGF	Poverty Reduction and Growth Facility
SAI	Supreme Audit Institution
SDRM	Sovereign Debt Restructuring Mechanism
UNCITRAL	United Nations Conference on International Treaded Law
UNCTAD	United Nations Conference on Trade and Development
UN-DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
WADMO	World Association of Debt Management Offices
WAIFEM	West African Institute for Financial and Economic Management
WCC	World Council of Churches

Opening statement

Carlos Fortin
Officer-in-Charge of UNCTAD

It is my pleasure to welcome you to the Fifth Inter-regional Debt Management Conference and to the subsequent meetings on debt and its management – the advisory group meeting of UNCTAD's Debt Management – DMFAS Programme, and the meeting of the World Association of Debt Management Offices (WADMO).

UNCTAD is also honoured to host within the context of the conference the third and final round of the multi-stakeholder dialogue on "Sovereign debt for sustained development" coordinated by the United Nations Department of Economic and Social Affairs. The multi-stakeholder consultations are a follow-up to the Monterrey Conference on Financing for Development, and to the Monterrey Consensus, which as you are aware includes various policy commitments on the issue of debt. Although the consultations themselves do not seek negotiated outcomes, they do aim to clarify views and help find common ground amongst all the different stakeholders involved in debt – Governments, international and regional institutions, civil society, academics, as well as the private sector. They will also hopefully enrich policy discourse in the High Level Dialogue on Financing for Development to be held next week in New York, as well as the High-level Plenary Meeting of the General Assembly, in September, which will look at achieving the Millennium Development Goals.

Our meeting this week immediately precedes the G-8 meeting in Gleneagles, United Kingdom, which will discuss different proposals for additional reduction in debt stocks or in debt service for heavily indebted poor countries (HIPCs) and non-HIPCs eligible for loans from the International Development Association (IDA) of the World Bank. Our deliberations take place against the backdrop of the debt cancellation for a number of countries, many of which are least developed countries (LDCs) and countries in sub-Saharan Africa, which the G-8 announced in London in early June. UNCTAD heartily welcomes this initiative, and hopes that its momentum will continue and benefit other highly indebted developing countries as well. The decision reflects a serious commitment on the part of the international community to enhance the capability of developing countries to reach the Millennium Development Goals.

The evidence is persuasive that the HIPC process has unlocked resources. It is also clear, however, that the process has fallen far short of what is necessary. To move forward, the Secretary-General of the United Nations has proposed that debt sustainability be redefined as the level of debt that allows a country to achieve the Millennium Development Goals by 2015 without an increase in its debt ratios. For most HIPC countries, this will require 100 per cent debt cancellation and exclusively grant-based finance. The G-8 decision was taken in this spirit. UNCTAD would therefore also encourage the G-8 members to consider significantly more debt reduction for the other many heavily indebted non-HIPC and middle-income countries than has yet been on offer.

Beyond the need for immediate debt relief, the long-term sustainability of debt depends on macroeconomic growth and export prospects of a country. UNCTAD's vision is therefore to assist developing countries to effectively integrate debt sustainability into a long-term development strategy. The challenge for debtor countries is to implement adequate debt strategies and put in place an appropriate institutional debt management framework, in order to achieve long-term debt sustainability and to turn debt-based finance into an efficient tool for investment and development, rather than a drain on resources. Moreover, debt sustainability requires comprehensive trade policy and development strategies to increase economic competitiveness. For example, in the processes of production and international trade, it is important that an increasing share of value added and of external financial resources remain in the developing countries, so that they are in a position to "sustain" – that is to service – their debt. Such a holistic approach to the debt issue can benefit from an enlightened industrial policy as part of a long-term development strategy. It would be geared to building supply capacity and enhancing productivity and innovation. To be successful, such strategies require a well-balanced interplay and consultations between the private and public sectors. And, as pointed out in the São Paolo Consensus adopted at UNCTAD XI, it requires policy space for Governments to shape policy in line with development objectives, institutional frameworks, and the commitments they have made to achieve the Millennium Goals of eradicating poverty and delivering socio-economic development.

Within this broader context of enabling debt sustainability, strengthening the capacity of developing countries to manage their debt needs to be an integral part of national economic and financial policy. It seems clear that the debt crises of recent decades are at least in part attributable to the fact that debtor countries have not been fully in a position to handle their public debt in tune with basic tenets of sound debt management. Debt management requires firstly, a public indebtedness strategy consistent with broad macroeconomic policy; secondly, a set of debt management tools such as accurate and up-to-date records of all public and publicly-guaranteed external loans; schedules on debt servicing obligations including contingent liabilities; the capacity to project the impact of borrowing decisions of various domestic entities on the country's overall debt profile, national budget and balance-of-payments and to benefit from innovations and instruments available in financial markets to reduce costs and risks to the debtor.

Developing countries and countries in transition face tremendous challenges in public debt management. Building debt management capacity is a long-term undertaking in which country situations vary widely. Each situation will depend on the type of financing to which a country has access, the exchange rate regime, the quality of its macroeconomic and regulatory policies, its overall institutional capacity, its credit standing and its debt management objectives. For all countries, public debt management is an area that requires increased professionalism.

Allow me to lay out the programme for this week. The Fifth Inter-regional Debt Management Conference will look at inclusive processes for managing sovereign debt in various economic situations and examine recent experiences in debt crisis management, in particular, the Argentinean and Iraqi cases. It will also look at the concept of debt sustainability and its operationalization. Against this policy background, the conference and subsequent meetings will highlight the changing role of the debt manager, recent experiences in the organization of a national debt office, as well as modalities for improved information and transparency in debt management. Finally, the conference will consider the issue of additional debt relief.

On Thursday, we invite you to attend the Fifth Meeting of the DMFAS Advisory Group. The meeting will discuss the technical assistance UNCTAD provides to countries through its Debt Management-DMFAS Programme, which has been collaborating with developing countries and economies in transition for more than 20 years. Today, DMFAS works at the country level with 95 institutions, essentially ministries of finance and central banks, in some 65 low and middle-income countries. These countries account for more than $560 billion of outstanding public and publicly-guaranteed long-term debt, an amount that represents approximately 40 per cent of the total long-term debt of all developing countries. The major activities of these projects are the installation of a standard computerized debt management system (the DMFAS), training and assistance in the effective use of the system, and debt management, as well as advice on various debt management issues, including the development of appropriate institutional and administrative structures. Thus, activities to strengthen national capacities are built into the programme and its projects. This is often undertaken in close collaboration with other international and regional organizations.

Furthermore, as indicated in a recent independent evaluation, this programme contributes towards the provision of what can be considered a global public good. By supporting the development of knowledge-based products and standards for debt management, DMFAS alleviates common constraints that developing countries face in recording and managing their debt. The acquisition of the system and the capacities related to its use help developing countries to reduce inefficiencies and to increase transparency and accountability by giving the legislative branch access to debt information when preparing and approving the national budget. Also, it helps countries to renegotiate their debt more effectively with the international community through the sharing of the same robust debt information and to reorganize their debt. Lastly, through its integration to Integrated Financial Management Systems, DMFAS systems contribute to the strengthening of national financial systems, and it supports countries' effort to integrate into the global financial economy.

The activities of the programme, along with its funding and financial sustainability, will be discussed at the meeting. In particular, there will be a presentation of the results of the programme's

Mid-term Review for 2002–2005. This will include recommendations on improving its governance, on further reinforcing its capacity-building activities, on the development of a new version of the DMFAS software, and on the adoption of a clear and strong decentralization policy. I would therefore, like to encourage you to provide your valuable input to that meeting as well.

On Friday, UNCTAD hosts the World Assembly of Debt Management Offices. I would like to remind you that the idea of this association stems from the first Inter-regional Conference on Debt Management, in 1997. At that time, participants agreed that there was a considerable need for a regular exchange of experiences, know-how and information on debt management among officials from debtor countries. At its General Assembly this Friday, issues related to the future of WADMO will be looked at, including its funding, activities, statutes and its secretariat. It will also discuss the advantages of integrated financial systems on debt management and the issue of recruiting, training and retaining qualified staff in a debt office, as well as other regional initiatives now taking place in the area of debt management, such as the first meeting of country debt managers from Latin America and the Caribbean, which took place in Rio de Janeiro in April.

This conference is unique in that it brings together debt policymakers, who decide on the long-term course of action, and debt managers – those responsible for the day-to-day operational management of debt. In addition, representatives from international organizations, bilateral donors, non-governmental organizations (NGOs), the private sector and the academic world join the government officials. This is an opportunity to share views and ideas, establish fruitful contacts and build consensus – one of the core functions of UNCTAD.

Allow me to especially acknowledge the crucial role of the debt managers among you since it is your responsibility to manage the national debt in the most effective way. I hope that the meetings here at UNCTAD will convey a sense of belonging to a distinguished group of professionals sharing common concerns and ambitions And it is in with this in mind that UNCTAD recently launched an Internet-based “Knowledge Network on Debt Management”, which aims to facilitate continuous interaction among all actors in governmental debt issues.

I am confident that this week’s meetings will be both challenging and stimulating. I wish you successful deliberations and look forward to the outcome of your discussions.

Keynote speakers

Resolving indebtedness for poor countries: a suggestion for a more permanent solution

Aruna Gnanadason
Coordinator, Team on Justice, Peace and Creation, World Council of Churches

At the outset, let me express my deep thanks for the invitation to the World Council of Churches (WCC) to take part in this important Conference. This is an opportunity to share with you the concerns of the faith communities on the unresolved debt problem. WCC holds that we have not yet found the best solution to this problem because unfortunately we continue to tinker with a system that has de-linked finance from development. The ecumenical movement has insisted, since its beginnings in the early part of the last century, that we as a world community are co-inhabitants of the one Earth – for this Earth we all share responsibility and from which we should all benefit equitably. We believe that we share a common destiny and this has been the basis for the theological conviction that "if one part suffers all suffer." At the heart of the commitment, then, is the search for an equitable and just world order.

The international debt crisis, which is part of a failing global financial system, has dramatically distorted this vision of equality. One part of the solution is the full, immediate and unconditional cancellation of all debts as a moral imperative. The jubilee movement, which is rooted in such a theological and spiritual basis, has articulated this moral imperative well. However, all debt relief initiatives to date have failed to address the magnitude of this moral crisis in our present world. They have not heeded the depth of the will for global solidarity expressed by the worldwide jubilee movement of people. Debt relief continues to be an expression of the exercise of power and control because of the conditionalities imposed by the international financial institutions (IFIs). (Though they deny this, our concern is that there is an implicit enforcement of such conditionalities embedded in the Poverty Reduction Strategy Papers. In fact, it is documented well, even by some World Bank economists, that some policy recommendations of the IFIs have only resulted in more hardships and more debts). The World Council of Churches therefore reiterates the call for a genuine jubilee, i.e. a truly new beginning in equity and justice for the developing world.

The fact that this concern is debated so much indicates an awareness in the international community that global indebtedness is a massive problem, more so for the poorest countries. While highly indebted rich countries have ways of mitigating this problem, poor countries do not have sufficient options but to sacrifice their peoples, their livelihoods, their environment, their natural resources and their sovereignty in dealing with this burden. The ecumenical movement has underlined that this is not just a matter of goodwill or of some minor adjustments, but is a matter of justice that requires permanent solutions. A global economic and finance system has been constructed that has resulted in the problems we face today. This system has to be changed permanently. But we believe this change can be achieved in carefully crafted stages with full commitment to a permanent solution.

From debt management to debt release opportunities – in search of a long-term solution

Since the 1970s, the WCC, its member churches and ecumenical partners have placed the debt crisis and its solution as an issue of high priority always speaking out in solidarity with victims of indebtedness in the poorest countries. At the General Assembly of the WCC held in Harare in 1998, for example, the churches emphasized that **unless present debt management plans are transformed into debt-release opportunities,** the devastating cycle of debt accumulation will repeat itself, condemning millions more people to even more suffering. The 1998 assembly emphasized, however, that it is not just the poorest countries that are trapped by the debt crisis, because countries arbitrarily defined as "middle income" are threatened, too. The Argentinean debt crisis was a clear example of this. WCC sees indebtedness as rooted in a global financial system that is neither equitable nor ethical. As this is a systemic problem, we therefore believe that it has to be addressed by the United Nations, in the long term. The United Nations and its agencies need to address the question and find the answers on how global trade and finance can be equitable and ethical in its manifestation.

New mechanisms of arbitration – a medium-term solution

In the medium term, the WCC stresses the critical need for new structures and mechanisms that involve participation and dialogue between creditors and debtors. It is important for the sake of global and historical justice to avoid a situation where creditors have become judge, jury, experts and bailiffs, all in one. We believe that past initiatives have been unsuccessful because of the absolute domination by creditors. Therefore, a major question we raise is, "How can we together resolve old debt burdens and prevent new ones through effective and participatory domestic and international economic management?" Both lenders and borrowers must take responsibility for the debt crisis. It is unjust that creditors dominate the debt relief process. The WCC is therefore in favor of developing an independent and transparent structure for governing relations between debtors and creditors. Such a mechanism would ensure that losses and gains be shared equally. We observe that, thus far, there are cases where debts have accrued due to failure in the recommended policies of creditors such as the World Bank and the International Monetary Fund (IMF). Yet such institutions have demanded full debt payment. In some indebted countries, we have evidenced a failure in the projects recommended by the IFIs. On their own evaluation, in some cases, more than 75 per cent of recommended projects actually had no economic returns. The IFIs tend to set unrealistic economic growth forecasts and expect countries to realize them. Yet these goals are set as the base for a poor country's ability to pay its debts. Capacity to repay the debts rather than facilitating and enabling poor countries to come out of poverty has been the focus of such lending.

In some cases, debt problems are accrued because creditors grant too little relief and too late. This delay allows debts to grow further. Another problem is that poor countries are facing trade barriers and very little possibilities to provide subsidies to their farmers. In the recent debt relief package proposed by the G-8, $40 billion to $55 billion are proposed as the amount of debt cancellation. But the countries to receive the cancellation have been forced to liberalize their markets fully without being able to subsidize their farmers. On the other hand, farm subsidies in rich countries continue to be over $300 billion annually! How could the Millennium Development Goals be met if debt is de-linked from just trade? WCC has insisted that justice and ethics need to become central in this discussion. This requires a change of heart by creditors and some genuine efforts to provide unconditional debt relief.

Taking a more holistic approach to debt – the case of ecological debt owed by rich nations

There are other historical concerns that need to be taken into account. Creditor countries almost all have a historical past of colonialism that included the plundering and exploiting of the resources of countries in the South. Some of the current unequal trade regimes and unsustainable and asymmetrical production patterns have their roots in this historical past. This has also led to the acceleration of ecological destruction in the last 50 years. It is a well-known fact that global corporations destroyed and continue to destroy with impunity the agricultural, fishing and forestry base of countries of the South. These corporations should be required to pay an ecological debt to the South. When it comes to this debt, countries of the South are the creditors. It is only when we understand debt in this holistic way that real change will be realized. The ecological footprint that the developed part of the world leaves on the Earth has to be translated into a debt that needs to be paid to poorer, low–energy consuming countries. WCC believes it is imperative to work out a plan of reparations for peoples of the South who have suffered from manifold injustices including slavery, exploitation, land disposition and racial discrimination. Compensation for ecological debt will be a way to compensate for the ecological damage done to these countries in the hands of colonial and imperial powers.

In search of a solution

Specifically, the WCC maintains that collective political will is urgently needed to develop an international, ethical lending-borrowing mechanism, which involves civil society, including religious organizations, in the process of debt relief and in preventing future debts and a continuing crisis. Such mechanisms must produce ethical, mutually responsible and transparent solutions, which not only satisfy requirements for economic efficiency, but also for the protection of basic human needs and rights as well as the rights of the environment. We are aware of several models that have been suggested but have not been developed to deal with insolvency.

Some NGOs have proposed the Fair and Transparent Arbitration Process (FTAP) and this has been supported by WCC to deal with the problem of insolvency. Other proposals are on the table as well. The latest model is the IMF's Sovereign Debt Restructuring Mechanism (SDRM), and this too has not been accepted because it is to be overseen by the fund's own executive board without the participation of the borrowers in determining a solution.

The task before us is twofold. Firstly, there is need to develop a mechanism that will be used to resolve insolvency; and secondly, to work out a lending-borrowing mechanism that will take into account not only the monetary and other terms of lending and borrowing, but which will be centered on ethical and human rights issues to prevent any further debt crises from occurring. WCC is confident that, with the necessary political will, there is sufficient technical knowledge to translate that will into a pragmatic programme under the auspices of the United Nations.

Insolvency accompanied by trade, investment and aid – short-term initiatives

Our concern is that present proposals for insolvency are based on fundraising rather than in addressing the issue of justice. If they remain at the fundraising level, the problem of debt in poor countries will not be resolved. These efforts need to be accompanied with just trade, investment and increased aid. The recently held meeting of finance ministers of the G-8 noted, "If sub-Saharan Africa could regain just an additional 1 per cent share of global trade, it would earn $70 billion more in exports – nearly five times what the region currently receives in overseas aid and debt relief combined".[1] We would underline that while any proposals for increasing trade possibilities for indebted countries in Africa is significant, what is really needed is just trade from which these countries could accrue their income. There is need to ensure that debt cancellation is linked to trade, aid and investments. Coherence of policies in this area is long overdue. Discussion in this area has mainly focused on ability to pay debts and its sustenance. This should actually be the next stage after cancellation has taken place.

It is essential to conduct an audit of illegitimate debts and odious debts and cancel them without conditionalities. A new mechanism to deal with such debts is not required, as the Odious Debt Doctrine could be applied. Of the more than $500 billion in external debts presently in discussion, 20 per cent of all debts of developing countries has been attributed to borrowing by dictators in 23 countries. Present generations of peoples should not pay a price for such unethical borrowing and lending from the past.

In conclusion, may I reiterate WCC's commitment to work for a long-term and durable solution to the problem of debt, not just for the 18 countries identified by the G-8, but for all indebted countries, so that the people will have a chance for sustainability and life? WCC looks forward with anticipation to the leadership of the United Nations in finding not just a critique of what has gone wrong thus far, but in proposing with the full participation of borrowers and particularly the civil society in these countries, including the churches, in finding permanent solutions. We look forward to the proposed study on debt and ethics, as this is the way the churches would like to proceed and commit ourselves to working with you on this. As the World Council of Churches prepares itself for its IXth General Assembly in February of 2006, in Porto Alegre, Brazil, we hope this process will lead us to even more concerted action for the sake of life with justice for the peoples of the Earth and the Earth itself.

[1] See http://www.hm-treasury.gov.uk/otherhmtsites/g7/news/conclusions_on_development.

New strategy for Ecuador

Luis Rosero
Under-secretary of Economic Policy, Ministry of Economics and Finance, Ecuador

My presentation will be brief, just to inform you of the new debt strategy the new Ecuadorian Government is developing. It is divided into three parts: introduction, new debt policy and key elements.

Introduction

My country has renegotiated its commercial debt on many occasions; the year 2000 was the last, when we switched from Brady bonds to global bonds. This was, however, a very onerous activity. One indicator, the world bonds over the 12-year period bear a 12 per cent interest rate. Secondly, regarding the Paris Club renegotiation, this is our eighth go and we are still having problems meeting our payments. Thirdly, we have a high debt burden, 48 per cent of gross domestic product (GDP) in 2004. This represents 33 per cent of the national budget.

These factors are seriously affecting our economic growth as well as our social policy, because when we divert resources to debt payment, other areas suffer, and most of these are social. Another important aspect is that previous Governments, especially the last two, favored debt payoff above all, thus limiting our ability to grow and develop a social policy.

At this time, we are in a critical situation of sustainability of payment; there is none. We need to arrive at a new strategy, some other way of managing our debt. And, in this significant forum, we would like to raise the possibility of speaking to the international agencies, to the creditors, to all who deal with our debt, to see how we can define this new external debt policy.

New debt policy

Specifically, what are the basic outlines which the Government raises through its Ministry of Economy in defining a new debt policy?

- **Commercial debt.** Management liabilities would permit creating longer time frames with longer grace periods. At present, we benefit from high oil prices. We are a marginal producer and can only pay because of the high cost of oil. But when this positive shock stops, we probably will not be able to pay. So we would like a long timeframe for our restructuring. Also, a buy-back. We have set up a fund to buy back at times we deem favourable.
- **Bilateral debt.** This includes writing off and swapping debt. This year, under the new Government, we have a swap with Spain to the tune of 50 million and Italy to the tune of 20 million. We hope to be able to continue swapping in order to lighten the debt burden.
- **Multilateral debt.** Two things arose: renegotiating longer maturities, and channeling credits to productive projects of the infrastructure nature.

Key elements

The key elements in defining our new policy are:

(a) The Ministry of Economy wishes to clearly indicate that payment of the debt depends to a large extent on the capacity for payment. In other words, Ecuador is not prepared to sacrifice economic growth to pay off its debt. We therefore require a definition of the terms of payment.

(b) Debt contracts should have contingency clauses; if there is an external negative shock, we could readjust our payments.

(c) The Government and particularly the Ministry of Economy would like to have a responsible debt. In other words, to limit indebtedness as it is necessary to set criteria for entering into new indebtedness. So, limit the possibility of further debt.

(d) To evaluate debt contracting systems; there will be no negotiations if they have not been previously evaluated and their priority nature determined.

(e) It is important to ensure transparency and the involvement of civil society; what is the Government doing with regards to external debt and how is the citizenry informed of the new commitments entered into by the Government when taking on debt?

(f) An international arbitration and auditing tribunal must be defined in order to know what debt must be paid off and what debt must be renegotiated.

To summarize, in the case of my country, we have a serious sustainability problem. Given external positive factors, at present, we can pay. But once these die off, we probably will not be in a position to pay down our debt or even service it. And that is why we say clearly that our new Government and the Ministry of Economy want to draft a new debt policy which will permit us in a serious and responsible way, in cooperation with the international and multilateral agencies, as well as with foreign Governments, to define a new policy, to draft a new strategy for paying off our debt.

Toward developmentally sustainable sovereign debt

Arjun Sengupta
Chairman, National Commission on Enterprises in the Unorganized and Informal Sector, Government of India

It is definitely a privilege to address this gathering on a subject that has been very close to my professional career. I have written quite extensively on the subject, especially when I was in the IMF, and after that. Anyway, that is history. But I thought I would take the opportunity to talk about a few things which people normally don't talk about in these kinds of debt management meetings.

Professional discussions on debt management are invariably cantered round the technical aspects of debt sustainability, and working out different methods of getting over a debt crisis, if that happens. These are technical issues on which many papers have been written and will be written. I don't think there is any unique solution to these problems because even to assess the debt sustainability indicators, there are many different approaches which can continue to be debated. I am not saying that these debates are useless; they are important. But it is difficult to get clear answers to all those questions, as the variables involved are dependent upon evolving contingencies.

Defining "sustainability"

I want to put this whole debate in a different perspective because I find that the debt management question in the context of sustainable development almost invariably centres round sustainable debt repayment. Of course, sustainability of debt repayment is very important because you cannot incur debt or creditors cannot provide additional debt if they are not reasonably reassured that they will get their payment. But the problem is that the variables that determine all kinds of indicators of debt sustainability – whether in terms of the index of net present value of the debt to fiscal revenue or GDP or exports, etc. – are functions of a number of variables that behave in all different manners in different situations. GDP growth is one element; export growth, international situations, sudden spikes in the interest rate and sudden changes in commodity prices are others. To an extent, some of these can be predicted, but to a very large extent, they cannot be predicted.

And what is even more important – and this is now much clearer than in the early Bretton Woods days – is that domestic debt and foreign debt cannot be separated. They are so closely related to each other in terms of interest rates, exchange rates, GDP growth and everything else. We cannot talk about foreign debt without talking about domestic expenditures, domestic receipts and all other similar variables. All these make debt sustainability very difficult to assess; you will have to make assumptions, whether you are creditors or whether you are national policymakers, of certain baseline scenarios of development of the trends of the different variables, on the basis of which you would say that it is most likely the country would be able to sustain a particular level of debt if, and that is very important, nothing untoward happens, if nothing unforeseen happens. And, almost invariably, something or other unfortunately happens.

Among those unforeseen are sudden changes in policies. Because of all the variables and the random element of uncertainty regarding the prices – international prices, domestic prices, export prices and interest rates – changes may be made in development policies. Some of the reasons can be related to political economy. When the development policies unfold, political interest groups may find their particular interests are not accommodated and call for further changes. But also, sometimes changes are made in response to the changing environment.

In spite of all these factors, debts will have to be incurred, creditors will have to provide credit and so some mechanism of debt sustainability will have to be assessed. What I am trying to point out is that even if we do not have a very clear view of what exactly is the indicator of debt sustainability, you can take a number of alternatives stands; you can still work out some mechanism or other to protect debt sustainability.

The question is debt sustainability has to be protected in terms of what? In terms of – and this is the point that one can elaborate further – what you can call "sustainable development" because developing countries incur debt for a purpose, and that purpose is development. And if the international community can come to an agreed view of the goals of development, then it is possible for us to build up a mechanism to protect such debt sustainability. Let me spell it out.

International consensus on development

Now more than ever, there is an international consensus about development. What exactly is the development that you would like to sustain? That development now is accepted as a continuous or regular improvement of well-being, and that well-being has been defined in terms of social development, in terms of education, health, food, nutrition and all such other variables as employment and social security. And these are considered to be the indicators of development. GDP growth, export growth and industrial growth are all instrumental variables; they are not the target variables. It is important to note this point.

Once we know that it is development that we need to sustain and that there is an international consensus, we can work out a mechanism to see that, if certain factors come up, certain untoward situations occur, one can protect debt sustainability. It means that, before the debt is incurred, there has to be an assessment of the repayment sustainability in terms of the variables taken as objectives. Now, those of you who are familiar with the IMF programmes will know this exercise very well, that if we have the targets set up, then we can build up a scenario related to certain instrumental variables. Through an iterative process, we can have values for the instruments and we can get values for the financing gap after taking into account the expected flow of resources, of debt-creating and other resources. And then if a financing gap actually arises, the fund and bank, etc. are expected to protect the debt sustainability by financing that gap through their mechanisms, through their financing instruments.

We can have similar exercises if we say the targets are, categorically, social development, Millennium Development Goals, or some specific goals that have to be fulfilled. Add to that employment; add to that social security. These will give you a clear a magnitude of instrumental variables such as public expenditure. Whether that public expenditure is financeable depends on the fiscal policy, the revenues that actually occur, which are again related to the GDP growth. All those can be determined together and you can have a model of development based on the targeted Millennium Development Goals or other social development goals. Once you have that, and this sounds very much like the old structural adjustment approach, but it is a different approach because here we are not talking about the sustainability of debt, or sustainability of foreign flows, so that if you have incurred debt it can be repaid. We are talking about sustainability of social development, clearly in terms of the targets, and the debt and the other things that emerge as instruments, as residual values. So this is a new kind of structural adjustment policy that we are talking about, leading to a design of policy that can be agreed on. Now, if this point is accepted, we have a mechanism of protection.

Why am I talking about protection? Because if you are a creditor and if you knew that if the baseline scenario continued, which would include adherence to the agreed-upon development policies, then if there is an unforeseen development, the international community will see to it that the country's repayment capacity is protected. A mechanism to create that kind of insurance, if a country is following the agreed-upon path of this kind of development, then the international community will make sure that unforeseen situations do not send the country off track and therefore make the debts incurred unsustainable. I don't know whether we could always fix it, but I think we most probably can, if there are no political problems coming up. In other words, if the different Governments agree upon the targets, then the values of the instrumental variables will emerge that will meet the test of political economy of conflicting interests.

A development compact

What would be the form in which this protection could be provided? I would suggest a new kind of development compact to be agreed upon. I am using the word "development compact"; there can be other words, but somehow this particular term has become very popular in other contexts. What it actually implies is that there is a compact between the international community and a developing country that is incurring debt for the purpose of development. What is the compact? The compact is, if the developing country concerned sticks to the development policies that are agreed upon, then the international community in the shape of international financial institutions and the bilateral donors – you cannot force the private sector to come into this – will make sure that if there is a sudden widening of the country's financing gap, it will be met.

I consider this to be a perfectly doable exercise, again taking the position of the experience of the IMF and World Bank structural adjustment programmes. Those exercises were undertaken to examine why a particular country suddenly became unsustainable in terms of its debt or the reason for a substantial fall in the country's GDP. Why? I find the Argentine representative is sitting here. There was a period when Argentina suddenly went completely off track. And the IMF papers came later to show that, very largely, that was due to, not so much Argentina's policy mistakes, but to international developments.

There may also be policy mistakes. Policy mistakes may be genuine or policy mistakes may be political economy oriented. If there were a genuine policy mistake, that mistake would be assessed as "unforeseen" and covered by the compact. If there was a policy mistake for political economy reasons, then it would be a mistake for which the country should be held liable and not be considered as "unforeseen." Now who is going to judge that?

So, one of then first points in this development compact model is that there must be a mechanism to assess why a particular process has gone off track. The creditors themselves cannot decide it alone; the fund board or the bank board alone cannot decide it. You will have to have a mechanism where there would be representatives of the IFIs no doubt, but there would be independent experts who would assess and find out whether these mistakes were genuine and unforeseen mistakes, and therefore should be compensated. If they were genuine mistakes, then the policies would have to be changed, which is something similar to the IMF conditionality aspect. In more cases than not, you would probably find that this was the case. Situations changed and the country could not manage that. So the first requirement of a development compact model would be to establish a mechanism to monitor, to review and to assess the reasons for such a failure.

Financing a warranted gap

Now, there was a system in the IMF called the "support group." It exists now in the World Bank in some form or other. There are inspection groups, which can actually assess debt. But this has to be credible; this has to be credible to the countries concerned, so this has to be a mechanism of independent experts and the IFIs together. But this is not all, because if it is found that there were genuine reasons why the country went off track, then there must be a mechanism to finance the new gap.

The IMF and the World Bank cannot always do their jobs because their resources are limited; their facilities are quite clearly constrained. But if this additional money is not coming from the international public sector, the private sector will not come forward and fill the gap. So what some of us have talked about – and this is not the first time; we have talked about this along time – is the need for a new contingent financing facility. A contingent financing facility would consist of contributions by different countries in the form of callable capital, which would be invoked only if this support group or a similar mechanism considered that the gap had to be met by calling upon this contingent financing facility.

Today, this has become much more realizable than yesterday. After the Millennium Declaration, especially in the Millennium Development Goals context, everyone is talking about revisiting the old 0.7 per cent of GDP as official development assistance (ODA). It is not universally accepted, but now an increasing number of countries share in that kind of commitment. I am saying that we should let that commitment be invoked, but only in the form of callable capital. This means that the United States can continue with its 0.2 per cent of GDP and the United Kingdom can continue with its 0.26 or 0.27 per cent until there is a situation where more money is needed, in which case their callable capital contribution would be invoked.

In other words, let us make a proposal or pursue the proposal that all countries will make a commitment to contribute up to 0.7 per cent of their GDP if this mechanism calls upon them to make the payments. We can immediately get a fund of more than $100 billion at this point. That money remains as a backdrop. I think it should be committed not only by the industrial countries, but by every country. Even India must pay a callable contribution of 0.7 per cent of GDP, you can probably say that there would be a couple of points added or removed in terms of per capita income so that the least developed countries are not asked to pay. Every country should make a commitment that they would make this amount available if called upon to do so and there has to be a mechanism of burden sharing. Also, there are many different models from which such burden sharing can be worked out.

So what does this mean? It means that you create a situation where you have a fund that is not used immediately, but which can be used if there is a real crisis. You don't have to wait for trying to get banks and other institutions to come together and come forward with one kind of package or another, which has been the basic problem. I think the Argentine crisis had a severe social cost. Very few people remember that in one and a half years, Argentina's poverty went up from 14 per cent to 59 per cent, just jumped in two years time. Just imagine the amount of suffering that country endured because, in spite of its crisis, the Argentines had to make substantial payments to various creditors. This could have been stopped in six months time if such a facility had been available.

The proposal is doable

The time has now come when we should go beyond these technical details of what debt sustainability exactly is, what exactly the variables that you have to consider are. They are important. I am not saying that they are not important, but they are not sufficient. If you can reach a conclusion on debt sustainability in that sense, you would probably be able to say, well, some more debt forgiveness should be provided. By the time the agreement is reached, the whole economy will go into even deeper crisis. Of course, these should be done because, as I said, debt repayment sustainability is an essential condition for any of the sustainability programmes.

But what I am saying is let us work towards a mechanism to protect debt sustainability. And everybody everywhere should know that if I am lending to Argentina or to Ecuador, and if they are following the policies that have been agreed upon, and if there is a mechanism to see that they are not going off track on the policies – those of you in the bank and fund, you know the language very well – if we could have a mechanism to see that they are not going off track, then we know, as a creditor I know, that my money will not be lost, that the debt will be repaid, that there will be an international system that will protect it. As we have seen again and again in all the debt repackaging arrangements, to make the private creditors come forward with new loans is the most important element in debt sustainability. The very assurance from the new mechanism would make the situation different in this regard as well.

I personally think the proposal is doable because all the elements are there. We know how to assess a country's policies. We know how to work out the specific indicators on the basis of which the country's performance can be examined. The only thing that I am talking about is changing the objectives, changing the targets; it is no longer balance of payments, it is no longer just GDP; they are all instrumental variables. The targets are basically certain indicators of social development. We can work out programmes like that. We know how to do it, and we also know that it is possible to provide that money. This is a very small amount of money, of callable capital of $100 billion, of which $20 billion or $30 billion is probably all that will be invoked at a particular point of a debt crisis.

Part 1

Key issues and concerns

Summary of panel discussion

Moderator: Mr. Jomo Kwame Sundaram, Assistant Secretary-General for Economic Development, United Nations Department for Economic and Social Affairs (UN-DESA)

Panellists: Mr. Barry Herman, Senior Advisor, Financing for Development Office, UN-DESA
Mr. Andreas Antoniou, Deputy Director, Economic Affairs Division, Commonwealth Secretariat
Ms. Shari Spiegel, Managing Director, Initiative for Policy Dialogue, Columbia University
Mr. Jurgen Kaiser, Financial Flows and Debt Relief Advisor, United Nations Development Programme (UNDP)

Mr. Herman began by providing feedback on the first two sets of multi-stakeholder consultations on debt sustainability that took place in Maputo, Mozambique, and New York earlier in the year. He reported that the consultations had revealed that the whole concept of making debt sustainability actually "operational" was still far from clear. Questions such as how to factor human development into debt sustainability, for example, still needed to be looked at. Other concerns that had been raised included (a) the need for increased information sharing between government agencies as well as with creditors and investors; (b) the importance of delivering committed debt relief by donors; (c) the need for international partners to strengthen their knowledge of local situations; and (d) the importance of domestic ownership of government policies. Regarding debt relief, Mr. Herman said that the whole concept of relief was often misconceived and stressed that the real question was not about how much relief to give HIPCs, but about whether to give them IDA loans or IDA grants. In other words, how much borrowing is it actually safe for a Government to undertake? Mr. Herman commented that answers regarding how to manage incurred debt are very sensitive to assumptions, so it is difficult to offer blanket solutions to debt management. Debt restructuring without a reduction in the present value in the debt is only refinancing. Refinancing is appropriate where there is liquidity problem, but useless where the problem pertains to debt sustainability and where the latter calls for a debt reduction.

Mr. Antoniou gave a report of the Commonwealth HIPC Ministerial Forum, held 15–16 March 2005 in Maputo. At the forum, the ministers had raised concern over a number of issues currently affecting the macroeconomic growth of the poorest countries, and subsequently progress in implementing the HIPC initiative by some of these. As such, they called for a number of actions to be taken by donors and the international community. These included actions for deeper and wider debt relief, for more comprehensive long-term debt sustainability analyses to be undertaken and actions for ensuring legal protection for HIPCs in dealing with commercial creditor litigation cases. Particular attention was given to the issue of high domestic debt burdens, as it was to the issue of public-private partnerships to promote infrastructure investment and service delivery in post-conflict countries.

Ms. Spiegel spoke on the Initiative for Policy Dialogue, founded by Joseph Stiglitz, a Nobel laureate economist, and which is based at Columbia University in New York. The initiative is built on the notion that policies have trade-offs and countries need to assess viable alternatives in policy making. The initiative hopes to make it easier for countries to explore these through its country dialogue programme, through task forces and through its journalism capacity-building. It consists of a global dialogue of top economists, policymakers, political scientists and civil society representatives from the North and South. The dialogue will be reflected in a series of books, including one on debt. The latter will include policy debate on debt sustainability, restructurings and bankruptcy frameworks. The initiative's present conclusion is that the status quo for dealing with debt problems is inefficient, with countries going to extremes to avoid default and doing so at great cost. Furthermore, restructurings have not necessarily allowed countries to grow again. She cited Argentina as an example. On debt sustainability, she observed that threshold numbers should be based on how much a country needs to grow rather than on past crises. She also warned debt managers to remain critical about those assumptions used in debt sustainability analysis, as even the slightest change in assumptions can lead to very different paths and projections.

Mr. Kaiser started by saying that UNDP was critical of the G-8 decision, taken at Gleneagles, to cancel the debt of 18 HIPCs. UNDP sees the decision as a step back from the HIPC initiative, in that it fails to provide a comprehensive approach to debt sustainability, and wrongly assumes that countries receiving restructuring would have sustainable levels of debt following the restructuring. Mr. Kaiser also called attention to the principle of safeguarding a country's essential needs when performing debt sustainability analysis and deciding on relief. He said that what constitutes an essential need should be determined by a neutral institution, and not by the debtor or creditor (including the IMF or World Bank) which can only lead to conflicts of interests. As such, UNDP advocates that a "second opinion" to existing debt sustainability analyses be given, based on transparent and fair procedures, and involving independent parties. He noted, however, that being able to produce neutral and comprehensive debt sustainability analysis was complex. This was because it was not easy to define sustainability, to know what type of financing (including relief) is actually needed to make debt sustainable and to know on what expenditure new financing should be used. As such, UNDP proposes a broader concept of debt sustainability, which satisfies the financial requirements for achieving a sustainable growth path necessary for achieving the Millennium Development Goals. In this sense, UNDP proposes that it undertake with countries a joint debt sustainability analysis on the basis of Millennium Development Goals, which would be subject to an independent evaluation.

Commonwealth HIPC Ministerial Forum
Maputo, Mozambique, 15–16 March 2005

Report of the meeting and key action points

Andreas Antoniou

I. Introduction

The Commonwealth HIPC Ministerial Forum held its seventh meeting in Maputo, Mozambique 15–16 March 2005. All 10 Commonwealth HIPCs were represented at either the ministerial or official level. Representatives from Kenya, Nigeria, the United Kingdom, IMF, the World Bank, the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI), the West African Institute for Financial and Economic Management (WAIFEM) and the civil society also attended by special invitation. But this year other specially-invited guests included Sao Tome and Principe and six French-speaking countries – Benin, Burundi, the Democratic Republic of the Congo, Mali, Niger and Senegal – together with the Intergovernmental Agency of la Francophonie. Other guests included regional capacity-building institutions such as the Centre for Latin American Monetary Studies, Bank of Central African States/Pôle-Dette, Debt Relief International, African Development Bank (AfDB) and Commonwealth Parliamentary Association.

The meeting was held as part of a cluster of meetings in Maputo during the week beginning 14 March. On 14–15 March, the IMF held a seminar on Foreign Aid and Macroeconomic Management. On 15 March (afternoon), there was a separate brief meeting of francophone HIPCs, organized by Debt Relief International, while on 16 March there was a United Nations-sponsored multi-stakeholder consultation on Sovereign Debt for Sustained Development.

The opening session was held on the evening of Tuesday, 15 March. Commonwealth Deputy Secretary-General Mr. Winston Cox welcomed the participants and the Prime Minister of the Republic of Mozambique, Ms. Luisa Dias Diogo, gave the keynote address and opened the meeting. Following her address, the Executive Directors of MEFMI and WAIFEM proposed a vote of thanks, with remarks about the situation facing their respective regions and institutions.

II. Action points deriving from the communiqué

Session 1: Scene setting: HIPC initiative, the issue of domestic debt and economic outlook

Implementation of the HIPC initiative

- Abolish the sunset clause to ensure all deserving HIPCs and potentially eligible countries receive adequate debt relief, and increase flexibility regarding the track record, arrears clearance (commending the AfDF facility) and use of debt relief funds for reconstruction and rehabilitation.
- Bring non–Paris Club bilateral official creditors on board, through targeted collective diplomatic initiatives, provide donor support to write of intra-HIPC debt, and expand the funding of the HIPC Trust Fund to ensure full participation of all multilateral creditors.
- Quickly implement the rapid reaction legal assistance by the Commonwealth Secretariat and extend it other HIPCs in collaboration with other development partners, including assistance in negotiating out-of-court settlements and refining domestic laws which, while respecting contractual obligations, would ensure that settlements were on terms equivalent to the HIPC Framework. There was also a need for legal protection in jurisdictions where commercial creditors resided.

Deeper and wider debt relief

- Those Paris Club creditors which had not provided 100 per cent relief on all past claims should do so rapidly.
- All HIPCs should receive up to 100 per cent multilateral debt relief after they reach their completion points and for the relief to consist of additional and predictable long-term financing for the Millennium Development Goals.
- Better use IMF gold to finance deeper debt relief by the IMF.

- Consider all other IDA-only countries for eligibility and benefit under the HIPC initiative and for deeper multilateral debt relief.
- Carefully consider requests for debt relief from blend countries, including through the Evian Approach.
- Significantly increase aid resources to prevent distortions in aid allocations, so that all poor countries benefit in an equitable way to achieve the Millennium Development Goals.

HIPCs and global economy

- Carefully manage windfall gains from commodity prices.
- Entrench macroeconomic stability, promote private investment, develop infrastructure, deepen institutional reform, improve governance, eliminate corruption and further advance pro-poor policies, including on education and health care, with a particular focus on HIV/AIDS.
- Improve access to products of particular interest to poor countries, revisit barriers such as rules of origin and product-specific standards that inhibit market access and product acceptability under preferential arrangements, and lower subsidies for agricultural products.
- Make progress on doubling aid, including the creation of the International Finance Facility.

Session 2 (a): Long-term debt sustainability and domestic debt

IMF/World Bank framework for debt sustainability

- Promote broader participation than that of the World Bank in the preparation of the World Bank's Country Policy and Institutional Assessment (CPIA).
- Give debt service to revenue the pride of place as the most important indicator for thresholds applied under IDA-14.
- Comprehensively cover all debt, including private and domestic debt, in Debt Sustainability Analysis (DSA), strengthen cooperation between the fund and the bank and fully involve low-income countries (LICs) themselves in the preparation of the DSAs.
- Replace as soon as possible the current methodology of debt distress classification with that in the Framework, for grant allocation under IDA-14.
- Consider a mechanism for grant allocation in the IMF.
- Provide 100 per cent grant financing to all LICs and HIPCs (by Development Assistance Committee donors which have not done so).
- Promote effective donor coordination to ensure debt sustainability in LICs.
- Provide adequate concessional financing and/or further debt relief for countries subject to exogenous shocks or export shortfalls due to adverse trends in commodity prices through the establishment of either a concessional contingency financing facility in the IMF and/or a real commodity price adjustment mechanism under the HIPC initiative and/or a shocks facility administered by IDA and/or AfDB funded with resources additional to the proposed IDA-14/ADF-X base cases.

Domestic debt

- Deal with high domestic debt service burden by reducing high cost of domestic borrowing through maintaining a low inflationary environment with low nominal and real interest rates, expanding longer-term issues without significant increases in yields, broadening the investor base and deepening the financial sector development.
- Recognize critical role for donors in reducing the domestic debt stock where this is high and for financial sector development that helps lengthen the maturity structure of debt and broaden investor base.
- Reduce volatility of aid flows and investigate mechanisms that could assist in providing bridging finance.
- Support efforts at improving domestic debt recording and management through Commonwealth Secretariat's CS-DRMS 2000+ software and capacity-building programme, and at carrying out DSA of total debt, including domestic debt, through MEFMI and WAIFEM training programmes.
- Promote further research and analysis in working out prudential domestic debt ratios in HIPCs and other LICs based on financial depth and financial sector development.
- Commonwealth should play a leading role in advocacy of a comprehensive approach to address the domestic debt problem within the context of the Debt Sustainability Framework.

Session 2 (b): Implications for domestic debt burden for capacity-building

Presentations by ComSec's Special Advisory Services Division and Matthew Martin from Debt Relief International

Lunchtime presentation: African Development Bank's Post-Conflict Facility

Session 3: Private-Public Partnership (PPP) investment in HIPCs and post conflict countries (PCCs)

Private-public partnerships

- Implement the recommendations of the study on how best to harness existing financing facilities to promote private-public partnership for infrastructure investment and service delivery in a few strategically chosen pilots to evaluate and test the feasibility of the proposed approach and its applicability internationally, and report back on the progress at the next meeting in Barbados.

Follow-ups

- Encourage the civil society to continue engaging with the Commonwealth HIPC Ministerial Forum.
- Welcome increased cooperation between Commonwealth Secretariat and the Intergovernmental Agency of la Francophonie, and participation and contribution from francophone HIPCs.
- (Chairperson will) forward statement to the Joint Implementation Committee of the IMF and the World Bank, the International Monetary and Financial Committee and the Development Committee, as well as the finance ministers of key Commonwealth donors;
- (Chairperson will) continue to promote action points from previous meetings, including on the issue of public-private partnerships.
- (Chairperson will) further consult other Commonwealth and international development partners to promote a comprehensive approach to the domestic debt problem.

Postscript

Statement by the Secretary-General regarding G-8 debt cancellation

"The G-8 and all those who have worked so hard to achieve this outcome on debt are to be warmly congratulated. The Commonwealth has been advocating root and branch debt relief for highly indebted poor countries for 20-odd years, and we are pleased that others have taken forward the work we launched so many years ago.

"We are especially delighted that one third of the first 18 countries to receive the full debt write-off are Commonwealth members, with others likely to benefit later on. The dam has been broken and the Commonwealth is now looking for similar positive advances on trade and aid for developing countries in order truly to make poverty history.

"The Commonwealth has shown conclusively that development and good governance are interwoven, and the G-8's debt initiative demonstrates clearly their recognition of this fundamental relationship."

Debt relief and other key issues

Jürgen Kaiser

The most recent decision by the G-8, though certainly providing some relief for the beneficiary countries, constitutes a setback from the conceptual point of view: it will bring us back to the times before HIPC, when debt relief was based on fixed relief quota in the Paris Club, debt sustainability was wrongly assumed to be guaranteed by relief under those quotas, and relief was deliberately piecemeal. We now have a situation where a small group of countries receives limited additional debt relief by some of its creditors, unrelated to any substantial consideration of debt sustainability as a global problem.

UNDP thinks that relieving countries from an unbearable debt, based on a thorough analysis of an individual country's debt sustainability, is a valid concept and should be pursued in international debtor-creditor relations. It needs, however, reframing from where it has arrived in the past years, notably in the context of HIPC and the bank/fund "Debt Sustainability Framework" (which has become kind of obsolete through the G-8 decision any way).

- The definition of what constitutes an essential need must be done by an independent institution, which is neither debtor nor creditor, in order to avoid the conflict of interest which has impaired DSAs by the IMF and the World Bank in the course of HIPC and elsewhere, as these institutions regularly happen to be countries' most important creditors.
- It must be done in a comprehensive manner, analyzing all obligations by a sovereign debtor, including domestic debt.
- These sound like logical and valid principles to apply. However, anybody working on sovereign debt issues knows that at least at three instances, it will be very difficult to put them into practice:

- Like IFI approaches, they assume that a clear line can be drawn between sustainable and unsustainable debt and rely on crude or blunt instruments to define the nevertheless clear edge between sustainable and unsustainable debt.
- They do not automatically resolve the question of how much new financing is to come from debt relief and how much from other sources.
- They tend to define priority expenditure narrowly in relation to social services while failing to consider the relevance of macroeconomic dynamics on pro-poor growth and productive expenditures.

UNDP responds to these shortcomings in two ways, on the conceptual side applying a broader concept of debt sustainability:

- Satisfying the financial requirements for achieving the sustainable growth path necessary for Millennium Development Goals achievement; this will involve the buildup of reserves for monetary stability, facilitating a sufficiently expansionary monetary policy to allow internal credit markets to function, and substantial public investment in the productive and infrastructure sectors of the economy.[2]
- Financing public investment sufficient to meet Millennium Development Goals 2 through 6.

As this broader definition is still anything but a clear-cut line between sustainable and unsustainable debt, it needs to be complemented by a process proposal which guarantees the highest possible degree of fairness and transparency, while balancing conflicting interests. To that end, we suggest using the instrument of a "peer and partner review", in order to have an independent view of countries' debt sustainability. A portfolio performance report implies the set-up of a committee composed of representatives of the parties, IFIs, United Nations organizations, civil society and academia, together with partners from other debtor countries, in order to analyse debt sustainability in the given case.

This is like our broad vision for a future reformed debt negotiation process. However, we are facing a stark reality on the ground, with limited relief for some countries, but more in a critical situation of over-indebtedness, which needs adequate relief now. In the absence of a general over-

[2] Also as a safeguard against Dutch disease effects; see Roy & Vandemoortele, *Making sense of Millennium Development Goals costing*, UNDP, New York, August 2004.

haul of sovereign debt management, we therefore suggest to add to existing DSAs in line with HIPC, the Debt Sustainability Framework (DSF) or other traditional concepts of debt sustainability, an independent "second opinion" which is built on the financing needs for the Millennium Development Goals and the independent procedures suggested above.

In practice, under its current debt sustainability project, UNDP, as a non-partisan institution which is neither creditor nor debtor, is offering Governments to undertake a joint investigation into debt sustainability on the basis of the Millennium Development Goals, as outlined above, elements of which are:

- Analysis of Millennium Development Goals financing needs;
- Analysis of shock and other downside risks to a country's fiscal and external sustainability;
- Organization of a national roundtable to discuss findings, involving representatives of the country's civil society, IFIs and academia, in order to build a broader social consensus on the country's foreign financing policy;
- Feeding experiences from country studies into an overall reframing process, which will allow debtor countries to take a more proactive role in international debt management, as supported by the Secretary-General and demanded by the HIPC finance ministers at their most recent meeting in Maputo. We expect that addressing the need for redefinition from both angles will provide us with a productive balance between the debtor and the academic and other stakeholders' perspectives.

Where are we in this process?

- We have worked out an overall methodology, which is available here;
- We have started discussions with the Government, local IFI representatives, civil society in one post-completion-point HIPC country;
- Discussions are under way on the level of UNDP country offices in two more countries;
- We are organizing cooperation with our colleagues at UN-DESA as regards the conceptual process beyond the individual country studies;
- We have done a series of preliminary assessments of countries' debt sustainability in the light of the Millennium Development Goals; and
- We are open to discuss the programme with any Government which is interested in this fresh perspective on debt sustainability.

Part 2

An inclusive approach to managing sovereign debt

in good and bad times

Summary of panel discussion

Moderator: Mr. Reinhard Munzberg, Special Representative of the IMF to the United Nations

Panellists: Mr. Krishna Srinivasan, Deputy Chief, Crisis Resolution Issues Division, IMF
Mr. Khalid Sheikh, Senior Vice President and Head Emerging Market Analysis and Multilateral Organizations, ABN-AMRO, Netherlands
Mr. Alexis Milo, Head, Investor Relations Office, Ministry of Finance, Mexico
Mr. Oscar Ugarteche, Advisor, Jubileo Perú

Mr. Srinivasan noted that the rapid integration of global markets has offered countries considerable opportunities for growth and development, but that it is important they have in place policies that would allow them to manage the volatility associated with capital flows. He argued that, since crises can occur even when Governments are pursuing what would be regarded as conventionally sound policies, they have to pay much greater attention to factors such as debt sustainability and debt management. He talked of the complex global context in which debt managers today had to work, and cautioned that debt crisis prevention was still an art and not an exact science. He emphasized that prudent macroeconomic policies, along with sound debt management strategies, including appropriate debt structures, were crucial in helping countries reduce crisis vulnerability during good times and withstand losses in market access during bad times. During good times, he said, a country should focus on trying to mitigate risks, developing good investor relations, and building up a broad investor base. It should also ensure that appropriate measures (for example, collective action clauses in bond contracts) are adopted in order to facilitate coordination with creditors in the event debt restructuring becomes necessary in the future. He noted, however, that recent experiences indicate that there may be circumstances where the restructuring of an unsustainable debt level – complemented by the resolute implementation of appropriate policies – may provide the only feasible way to restore viability. In these circumstances, he noted that countries should, to the extent possible, seek voluntary agreements (for example, debt swaps) with their creditors, with a view to avoid default. In this context, he underscored the need for countries to be mindful of the possible adverse impact sovereign debt restructuring could have on the domestic banking system, among others.

Mr. Sheikh insisted that cooperation and strategic alliances among all sectors dealing with debt issues – the private business sector, the private financial sector, civil society, the NGO community and the public sector – were crucial for achieving debt sustainability. It was time, he said, to build bridges and create synergies between respective interests and ambitions, and that this was in everybody’s interests. He proposed four concepts, what he called the “4 I’s” to serve as guidelines: inclusiveness, innovation, information and integrity. Inclusiveness would mean that all stakeholders are part of a whole and that trust is indispensable among them. Innovation would involve a better consideration of the Millennium Development Goals and the Monterrey consensus in dealing with debt sustainability, an enhanced relationship between creditors and debtors through Investors Relations Programmes and enhanced risk management practices. Information sharing was important before, during and after debt crises, and it was necessary to be clear about what and how information should be shared. Regarding integrity, he said that this came from within and, if creditors believe debtors are acting in good faith, solutions are easier to work out.

Mr. Milo reviewed Mexico’s macroeconomic and public debt policy of recent years, a period of good times, and spoke of avoiding bad times by using the lessons learned in the 1990s. He said that there was a vicious cycle between debt market development, instability and vulnerability, and that debt management should focus on stopping these vicious cycles. He also warned that any deviation from responsible policies carried very high financial and reputation costs. Communication and transparency of information, he added, were also essential in order to stop volatility and contagious behaviour across financial markets, as well as being critical in gaining investor confidence. Mexico’s economy had improved, he said, by taking these factors into account, and by making a proactive debt management strategy a key element of its broader strategy to strengthening the Mexican financial system, increasing its fiscal discipline and reducing its public deficit. This had included the reshuffling of its debt portfolio. He explained that domestic debt now accounted for more of the debt portfolio than external debt. With an increase in bank credit and resulting investor interest, the average maturity of public debt had also significantly increased, resulting in a more comfortable schedule of debt payments.

Mr. Ugarteche reported that the current international financial architecture did not reflect international financial reality. He explained how more developing nations were creditors as well as major capital exporters than ever before, while the legal arrangements for this were still anchored on two domestic laws alien to all developing countries: the New York law and the London law. As such, he said, any international debt workout process was forcibly biased. He called for an international financial law and legal setting that would deal more universally and fairly with debt workouts. For this, he called for an international board of arbitration, in follow-up to the Fair and Transparent Arbitration Process (FTAP) and the demised Sovereign Debt Restructuring Mechanism (SDRM). All debt should be treated equally, he stressed, whether this be multilateral, bilateral or private debt. At present, multilateral debt was more favourably treated. Speaking on the reasons for the lack of economic lack growth in many developing countries, he called attention to the issues of low tax revenue, high debt payment budgets and negative net resource transfers of these countries. He also warned against the build-up of domestic debt, which might reduce exchange risk (as opposed to external debt) but still reduces investment capacity.

Proposal for a new international financial architecture: towards an international board of arbitration

Oscar Ugarteche
(co-signed by Alberto Acosta)

Background

There is evidence that the international financial architecture constructed after 1944 has become obsolete. The Bretton Woods institutions were designed for a world where fixed parity, with the United States dollar equal to gold, and capital flows from the United States to the rest of the world were the norm. Today, none of this still holds true. Massive negative net resource transfers from Laces to the developed nations over the past 25 years, and the devaluation of the United States dollar as the United States economy has become the largest single international debtor, have changed the grounds on which the architecture was designed.

Multilateral banks were added to the architecture and created for the reconstruction of Europe and Japan. Only in the 1960s did the World Bank become involved with developing economies. Regional development banks came to the fore as the end of colonialism became evident in the early 1960s, also duplicating roles. Since then, both have become major creditors and vital to the existing architecture. Since 1986, they have dropped project financing, where they have dismally failed, and considered policy-based lending as the new way forward.

Today, more developing nations are creditors and major capital exporters than ever before, while the legal arrangements for this are still anchored on two domestic laws alien to all developing countries: the New York law and the London law.

The Paris Club is a piece of the architecture designed in the mid-1950s, a decade after Bretton Woods, to help with official debt problems in a club of a few leading nations in a post–world war environment where only the most developed leading nations held any international public credit abroad.

Today this has changed, as China has become a leading official creditor, together with Brazil, Mexico and the Bolivarian Republic of Venezuela, to name but a few. It has sought a role in the transparency of the economic information from developing economies, but it does not practice such transparency and make the information available to the public. At this point, it neither represents all creditors nor is a vehicle for transparency.

International financial code

The growing complexity of creditors ranging from multilateral banks to Governments from developed and developing countries, to bondholders to private banks brings back to life the discussion held at the end of the 19th century on the nature of law to be used in the contracts. Up to now, the legal basis for all contracts is the New York Law and the London Law, and those courts are the ones that resolve the issues. It appears that, as with international trade law, it has become necessary to consider an international financial law and a new legal setting for the resolution of public international debt problems.

An international trade law is under construction through the United Nations Conference on International Treaded Law (UNCITRAL). This is one approach to the matter. The second approach is the one used for the International Penal Court. In all cases, there will be at least one major objection. This should not matter as long as most creditors agree that a new rule is needed and that a globalized world requires international laws.

Auditing of international loans

The evidence of modern international credit is that its use is not always transparent. Dictators have been known to take the money delivered by the IMF for balance of payments support, for example, and transfer it to foreign banks in their own name. Banks have lent money to dictators who were intermediaries to loans to their own countries in order to catch 5 per cent or 10 per cent of the total amount into their own bank accounts. Lending was done to an oil company in Argentina during the 1970s when it was clear that the money landed in the hands of the military for unknown purposes. Projects were financed by Governments of the G-7 that did not generate one penny of profitable income, as for example the nuclear reactor of Bataan in the Philippines, Karachipampa in Bolivia, and many others. It is clear that international loans for all sources need to be audited and that those which are tied to corruption need to follow adequate penal procedures. This should be a direct responsibility of all Governments and a condition for new lending.

A fair and progressive tax policy

Countries borrow because their tax revenues are too low for whatever investment requirements they have. Some even borrow to support consumption (balance of payments and budget support loans).

There is evidence that fiscal pressure defined as tax revenue/GDP is not increasing in many developing countries, mainly in Latin America and Africa. The existence of tax havens has made tax evasion and tax avoidance most popular and easy, while taxing foreign investment has become more difficult. At the same time, there is a pernicious tax race to the bottom to allure new investors into the country, thus eroding public revenues.

This has been partly offset by increasing consumption taxes, turning them into the main source of pubic revenues because they are easy to gather. It is necessary that developing nations have tax pressures in the range of 20 per cent of GDP at least, and that this be a part of the conditions set for any lending. Otherwise, the money lent will never be recovered and the country will become debt dependant.

Net resource transfers and economic stagnation

The evidence that, since 1980, resource transfers – defined as the inflows of new loans and new foreign investments minus the outflows of interest, capital, profits and depreciation paid abroad – are negative to the developing world with the exception of 1991–1997 seems to suggest that LDCs, with exceptions, have been exporting their savings and thus their investment capacity. This would be at the root of the stagnation issue.

Failure of adjustment policies and IFIs

Since the Argentina disaster of 2001, many issues related to IFIs have been raised.

Firstly, 15 years after economic reforms where introduced, there is little or no evidence of any economic growth. GDP per capita remained in the same place in 2003 that it was in 1980 for all of Latin America except Chile and Costa Rica, and for most of Africa. The only country with high growth and no debt is China, a member of the IMF that does not follow its recipes.

The IMF was designed to help maintain international economic stability after the depression of the 1930s. It cannot, however, affect the deficit of some leading nations while it seems not to have played its role as guarantor of creditors, economic policy and the nation in the set of crises started in 1998. It did not operate as a lender of last resort for Argentina and thus lost its credibility. Its mistakes have been bypassed in an international system with no checks and balances. The IMF strategy of short-term loans to ensure long-term economic policies through the conditions given the country has prevented it from being what it was meant to be in 1944: a lender of last resort, an emergency lender. Such an institution is needed, not to smother small and intermediate economies, but to help them overcome international shocks. Equally, to make sure that the poor nations do not end financing the rich nations, as has turned out to be the case for the last two and a half decades, with some exceptions. This does not ensure international stability.

The World Bank policy paradox

Export-led growth has not happened. Exports have more that tripled per capita since 1980, but GDP per capita has remained stagnant since then, having as a result unwanted international migrations with all of the negative effects for both economic development and for mature societies. This is a matter of reviewing what theory is being used and to what end and how it can be replaced. Stating today that workers' remittances are to be channelled into development ignores the negative net resource transfers issue and that the world economy might end up financing the rich nations not only from poor nations but with the savings from unwanted migrants.

The World Bank seems to have turned into a political party with a set of policy ideas, professionals that will make them happen and money to support them, instead of a development bank.

Social expenditures

Over the past 35 years, expenditures per capita on health and education have been reduced in most developing nations of Africa and Latin America, including Chile. The major causes have been low tax revenue, a high debt payment budget, and negative net resource transfers. IMF-recommended adjustments were made through consumption via a reduction in public wages and a reduction of social spending. For this reason, the Millennium Development Goals are hard to reach.

An international board of arbitrations for foreign debt

The conclusion proposed is that, firstly, foreign debt negotiations be held at the call of the debtor nation, with all types of creditors at the table. It is the only way to ensure comparability and non-discrimination. This board should have a secretariat, be broad based and not be the conventional ad hoc three-person institution.

For loans to be considered, they should be audited first and ensured that they are legitimate, and if this is not the case, those responsible be held accountable, and if there is suspicion of foul play with the knowledge of the creditors, the loans be annulled. Loans that never reached the people should not be paid by the people.

The International Board of Arbitration for Sovereign Debt should protect social spending and place minimum limits on GDP in order to make sure the Millennium Development Goals are reached by the debtor country.

Debt sustainability analysis must include all types of creditors and should ensure that net resource transfers are neutral in such a way that growth is not hampered by the debt payment mechanism. Projections should be independent and revisable upward as well as downward when the occasion warrants it, much like in the case of international trade with the acts of God clause.

The reason for including all creditors is that, for example in the Argentina case, bondholders took a fleecing while IFIs stayed safe, stating they were not a subject to negotiations (which is not necessarily true). The Paris Club, meanwhile, stated that it had a definitive debt settlement with the country (which is true) and therefore they could not negotiate again (which is also true).

Collective action clauses should be expanded in order to prevent vulture funds from operating. In Argentina, 25 per cent of bondholders have kept out of the conversion scheme, no multilateral debt has been restructured, and no official debt, Paris Club or otherwise, however small, has been touched, thus creating a bias.

Negotiations should be held using international financial law rather than domestic laws. The IMF should return to its initial role of emergency lender of last resort and not be included. The World Bank should return to infrastructure financing rather than its failed policy-based think tank role that homogenizes economic policy with little real results other than reducing inflation and ensuring income concentration, at the same time as export revenue increases and unwanted migration increases.

Economic policy should be left to the debtor countries with, if necessary, the assistance of the IMF but by no means compulsory conditionality. Civil society conditionality should exist instead with social expenditure in the forefront using international social, economic and cultural rights criteria. National central banks should do the debt sustainability projections with United Nations assistance from the DMFAS office. The IMF should stop its economic policy loans.

Part 3

Operationalizing debt sustainability

Summary of panel discussion

Moderator: Ms. Anh-Nga Tran-Nguyen, Chief, Debt and Development Finance Branch, UNCTAD

Panellists: Mr. Geoffrey Mwau, Senior Advisor to the Office of the Executive Director for the Africa Group I at the World Bank
Mr. Kamran Kousari, Special Coordinator for Africa, UNCTAD
Mr. David Beers, Managing Director, Sovereign and International Relations, Standard and Poor's
Mr. Charles Mutasa, Executive Director of the African Forum and Network on Debt and Development (AFRODAD)

The panel pointed out that there was still no correct distinction between liquidity and solvency problems. The world economy could be more effective, some of the speakers said, if liquidity problems could be dealt with through additional credit as opposed to lengthy and complicated debt rescheduling measures, which come at a high cost and effort for both debtors and creditors.

Mr. Kousari recalled UNCTAD's ongoing proposal that a group of eminent experts in debt and finance should be appointed jointly by debtors and creditors to undertake an assessment of debt sustainability with an agreement by creditors to write off debt deemed "unsustainable". The group should apply a wide set of development criteria for the assessment of debt sustainability, including the need to attain the Millennium Development Goals. He also evoked the need and maintenance of much higher levels of ODA in the medium term in order to raise domestic savings and investment in the longer term and thus reduce aid dependency. Furthermore, he stressed that growth-oriented strategies required much greater policy space in order for low-income countries to devise trade and industrial policies adapted to their specific economic and social conditions and to their endowments. The latter would imply much more flexible trade rules through special and differential treatment, reduction of subsidies in the North and improved market access.

Mr. Mutasa agreed that the frameworks so far constructed have still left the question of debt justice unanswered, and he called for a strategic compact between creditors and debtors capable of addressing sustainability challenges faced by the poor countries. As for the financing of debt cancellation, he suggested a tiered mechanism, where the first tier would be the sale of IMF gold, and the second the additional contributions by creditor countries as suggested in the current United Kingdom debt relief proposal. He also advocated for a fair and transparent arbitration mechanism that would deal with cases of illegitimate and odious debt as well as the repatriation of stolen wealth. He concluded that debt sustainability challenges would continue as long as the prescriptions for meeting them remain the monopoly of creditor institutions' self interest (playing judge and jury). He invited the agencies to think outside the box and to couple debt cancellation with homegrown development policies that would shelter the fragile post-dependency economies from the vagaries of neoliberalism.

Mr. Mwau cited country policy and institutional factors as well as exogenous shocks as key determinants for debt distress, which should be taken into account during DSA exercises. He stressed that DSA frameworks only made sense after debt relief had been granted. The DSA frameworks were designed to make informed lending decisions, i.e. determine the loans/grants mix that would prevent countries from getting into debt distress. The main issue, therefore, was to provide sufficient debt relief to countries in order to bring them to sustainable levels before applying DSA frameworks, thus allowing for a fresh start and valuable aid in the prevention of future crises. Finally, Mr. Mwau called for more collaboration between the World Bank and the IMF in order to arrive at more consistent DSA assessments.

Mr. Beers, speaking on the question of whether debt relief can deliver debt sustainability, said that he believed that it in some cases it could but that debt relief should not be regarded as a panacea, as it was not necessarily going to be the answer in all cases. He pointed to the fact that even with external debt relief, some countries would still struggle due to their significantly dramatic domestic debt burdens. Nevertheless, he saw debt relief as a positive opportunity for economic growth and poverty reduction for those countries that decided to link it with national improvements in governance, transparency and institutional capacity. Where political will and institutions were weak, however, Governments could only squander such opportunities. As such, he stressed that the international community must be realistic and modest in its expectations, as despite the evidence that pro-growth strategies may work, it had not yet come up with a way of engaging those countries where it knows the State is failing.

Debt sustainability in Africa

Kamran Kousari

We welcome the recent initiative to write off the debt of 18 HIPCs to the tune of some $40 billion, with another nine countries which will qualify once they come to the completion point. This covers another $11 billion, and eventually HIPC countries that have not yet come to the decision point, including some post-conflict countries, for some $4 billion. However, it is no secret that the HIPCs initiative does not include some equally poor countries that would otherwise qualify.

In our 2004 Report on Economic Development in Africa entitled *Debt Sustainability: Oasis or Mirage*, we argued that the criteria applied in debt sustainability analysis such as the net present value (NPV) of debt to exports and thresholds for fiscal sustainability were lacking in objectivity and were arbitrary. Sachs went somewhat further when he concluded, "the debt sustainability analysis of the HIPC initiative was based on the flimsiest of foundations".

Our report suggested that improving fiscal sustainability criteria might involve eliminating the two threshold ratios for the applicability of the fiscal window, i.e. the minimum requirements of export to GDP ratio of 30 per cent and government revenue to GDP ratio of 15 per cent. It also suggested that less emphasis be placed on the debt to exports ratios and more on a combination of an NPV debt to GDP indicator and NPV debt to government revenue together with an assessment of poverty levels and vulnerability factors to assess long-term debt sustainability. The initiative did not take into account the level of domestic debt in considering fiscal sustainability. It would need to be taken into account in the light of its broader macroeconomic and fiscal impact. Together, these could be the basis for assessing a cumulative amount of debt relief provided to the indebted countries.

Furthermore, the projections on growth rates were overly optimistic and were not based on historical growth trends, they did not take account of structural factors such as lack of diversified economies and export price volatility, and thus, underestimated the amount of relief required. As such, even countries that had arrived at completion point would find themselves in an unsustainable debt situation.

The report argued that the criteria for debt sustainability should be expanded to include human development indicators and the ability of countries to meet the Millennium Development Goals. In this wider context, we recommended that the debt of the poorest countries should be written off, since debt servicing at any level would be anathema to reaching the Millennium Development Goal targets. This was essential, as even a total write-off would have represented less than half of the resource requirements of meeting the poverty reduction targets of the Millennium Development Goals.

The fact that the Millennium Project Report and the Blair Commission report have come to similar conclusions, and the G-8 Finance Ministers of Finance have agreed to a debt write-off of the qualifying HIPCs, strengthens the argument that there is indeed a need for reflection as to how the whole issue of debt sustainability has been handled in the past and how it should be approached in the future.

As to the question of eligibility criteria applied in the HIPC initiative, the report found that the eligibility ratios were based neither on a comprehensive measure of poverty nor indebtedness; thus, neither the poorest or most indebted countries were HIPC eligible. In addition, the scope of country selection was too narrow since the "IDA-only" criterion disqualifies some otherwise debt-strapped countries. Thus, the IDA/PRGF (Poverty Reduction and Growth Facility)-only criterion could be replaced by a more meaningful set of criteria, such as UNDP's Human Poverty Index.

For example, Nigeria is one of the poorest countries in the world, with a per capita income of $290 (2002), ranking far below the average HIPC. Yet the IMF and World Bank have not classified Nigeria as an IDA/PRGF-only country as it is argued that, owing to its oil reserves, Nigeria does not rely on IDA/PRGF resources. At the same time, Nigeria's absolute poverty rate, i.e. those living under a $1 a day, has gone up from 36 per cent of the population in 1970 to 70 per cent in 2000. I understand, however, that Nigeria will be brought into the IDA/PRGF category soon.

Another example is Kenya, an HIPC country whose debt has been considered sustainable. Despite the fact that 62 per cent of the Kenyan population lives under $2 per day, and more than a quarter lives under $1 a day, the debt sustainability criteria applied the country do not make it eligible for relief under the initiative, nor does it figure among countries which the G-8 have considered for an eventual write-off.

On the positive side, the proposed Operational Framework for Debt Sustainability recognizes some of these weaknesses, including the need to achieve the Millennium Development Goals, but does not go far enough in giving operational meaning to the latter. Furthermore, it is designed to inform future lending and does not cover the HIPCs. It also relies on the Country Policy and Institutional Assessment (CPIA) as a criterion for assessing the likelihood of debt distress. The CPIA is a weak and subjective analytical tool and has been criticized for relying too much on the judgment of bank staff who use it as central determinant of credit worthiness.

This is why UNCTAD has been consistently proposing that the issue of debt sustainability should not be left to the judgment of creditors alone. We have suggested that a group of eminent experts in debt and finance should be appointed jointly by debtors and creditors to undertake an assessment of debt sustainability with an agreement by creditors to write off debt deemed unsustainable. Pending the recommendations of the group, debt service payments should be suspended, with no additional interest accruing to debtors. Such a group should apply a wide set of development criteria for the assessment of debt sustainability, including the need to attain the Millennium Development Goals.

Coming back to the question of domestic public debt, there are considerable differences among low-income countries as to the magnitude of this debt. Nevertheless, as a proportion of total public debt, between 2000 and 2002, for 10 of the 23 African HIPCs at decision or completion point, domestic public debt ranged from about 17 per cent for the United Republic of Tanzania to 47 per cent for Ghana to 48 per cent for Kenya (whose debt was deemed to be sustainable). The fiscal burden of public debt is even more important if interest payments are taken into consideration: a third of the interest payments of 12 out of the 23 HIPC countries is on domestic public debt. In some countries, that figure is much higher. For example, in Gambia, it represented 77 per cent of all interest payments, while for Kenya it represented 73 per cent.

The trends in macroeconomic indicators in a large number of African countries are influenced by the high domestic interest rates and short maturities on domestic instruments due to underdeveloped capital markets. The average maturity of African countries in domestic instruments is 231 days, while that of a group of selected emerging markets is about five years (1,945 days). This dominance of short-term paper in African securities markets increases rollover and markets risks, especially in countries with large outstanding domestic debt stocks. Furthermore, interest payments on domestic debt absorb a large proportion of the national budget at the expense of social and physical infrastructure development.

The shift from central bank financing to direct financing via the issuance of treasury bills and government bonds and their marketing via auctions to the banking system, and the move toward market-determined interest rates have injected new elements of instability into African economies. Rather than instilling greater fiscal discipline, this has resulted in greater accumulation of domestic debt in the context of shallow markets and led to high and volatile real interest rates. Higher interest rates have placed a burden on the private sector and have contributed to the stagnation of private investment.

As I indicated, a debt write-off, while welcome, would need to be supplemented by much higher levels of ODA. In our 2000 study on Capital Flows and Growth in Africa, we demonstrated that the immediate requirement for Africa was a doubling of aid and maintaining it at that level for 10 years to raise domestic savings and investment. This could lead to a virtuous process of growth and development, thereby attracting private capital flows and reducing aid dependency in the longer term.

This found favour in the Zedillo report on Financing for Development and more recently by the Blair Commission and the Millennium Project report. Recent announcements by the European Union with respect to increasing aid flows with a view to achieving the 0.7 per cent target by the year 2015 are also welcome.

Poor countries need adequate resources and debt relief to jump-start their economies. However, this is not sufficient to create conditions for a virtuous circle of growth and poverty reduction. National policies matter and here a major overhaul of conditionality is required, de-linking it from aid flows and lending. In the same vein, growth-oriented strategies would require much greater policy space in order for low-income countries to devise trade and industrial policies adapted to their specific economic and social conditions and based on their endowments. The latter would imply much more flexible trade rules through special and differential treatment, reduction of subsidies in the North, and improved market access.

There is also a need for a frank and impartial assessment of the impact of macroeconomic policies applied in the context of adjustment in the past quarter century (including in the context of the poverty reduction strategy papers) and drawing lessons not only from past mistakes but also from successful experiences in Africa and elsewhere.

Operationalizing debt sustainability

Charles Mutasa

Introduction

The World Bank and IMF, as the leading lending agencies, have been under mounting pressure to deal with a wide range of debt sustainability challenges. The challenges have refused to subside. Instead, they continue to stimulate urgent need for a new debt sustainability framework and debt management orientation that can allow the borrowing economies to break the vicious circle of unending distress. The HIPC framework and the 2005 G-8 debt deal, which is generally a compromise of the United States and United Kingdom proposals, are yet to shake down into a coherent strategic compact (with the poor countries of the borrower economies) capable of addressing unsustainability challenges facing the debt burden of all the poor economies of the South.

The current initiatives to tackle the Third World debt crisis have been designed to provide sustainability measures and debt management orientations that are capable of guiding borrowing decisions of low-income countries in such a way as to match their need for funds with their ability to service debt. The debt initiatives proposed by the G-8 since 1996 have left unanswered the vital question of debt justice. In addition, this is where the problem hides as it surreptitiously haunts the economies of the debtor economies in a wide and sinister variety of ways. The situation holds for both HIPC and non-HIPC third world economies. But, whereas for the HIPC countries the exterior of the framework may still seem to hold some dim hope in the distant horizon, for those borrower economies operating outside the HIPC agenda, it no longer hides deepening disquiet among those that have yet to benefit from a one-fits-all approach to debt reduction mechanisms that continue to be foisted on them by the creditor institutions and their partners.

In the recent past, the bank and the fund have paradoxically demonstrated a generous willingness to admit the “systematic over-optimism” of the previous IFI debt sustainability calculations and measures. Evidence abounds and, once in a good while, obtrudes everywhere with such stubbornness that is hard to wish away. Growth projections, for instance, have registered five percentage points ahead of the stark reality on the ground, a fact that has actually stimulated and sustained the unrealistic need for excessive borrowing, drastically if not artificially undermining the rationality for debt relief efforts.

The 2005 G-8 Ministers’ Conference proposal

While the G-8 agreement is a step forward and sets an important precedent, we have long advocated for a 100 per cent unconditional cancellation of debt to all severely indebted poor countries. The deal only represents one eighth of what Africa needs in terms of debt cancellation, as this means cancelling only $40 billion of Africa’s burgeoning debt stock of over $330 billion. The $40 billion to be cancelled represents less than 10 per cent of debt cancellation required for poor nations to meet the Millennium Development Goals. The plan does not include middle-income countries that are heavily indebted and impoverished. The G-8 deal includes too few countries. Globally, the 18 countries that qualify immediately represent less than a third of countries (at least 62) that need full cancellation to meet the internationally-agreed Millennium Development Goals, which seek to halve extreme poverty by 2015.

Choosing 18 countries that have reached the HIPC completion point (14 of which are in Africa) to benefit from the deal is in itself a sign that debt cancellation is being treated as a question of charity and not global justice. The agreement does not address the real global power imbalances, but rather reinforces global apartheid. The question of creditor-debtor co-responsibility of the South’s debt remains unresolved, as issues of odious and illegitimate debts continue to be swept under the carpet. It is not a lasting solution in which all stakeholders – debtors and creditors – have a say. It is just a piecemeal measure that seems to deal with the symptoms of the problem, not the causes.

Conditionalities still remain a big deterrent to economic emancipation of the poor countries chosen to benefit from the deal. The economic policies mandated by the HIPC initiative will continue under the G-8 debt deal, including privatization of government-run services and industries, increased trade liberalization, and budgetary spending restrictions. These policies have not been proven to increase per capita income growth or reduce poverty as documented by both World Bank and civil society economists. The best way to resolve the debt crisis must be within an international framework in which both the creditors and debtors have an equal say. Continuous monopoly by rich countries to tell us the best way out of the debt and poverty vicious cycle is the greatest shortfall in global economic justice. The G-8 deal does not address the moral hazards and perverse incentives inherent in the debt relationship. Unfortunately and regrettably, the deal is not premised on the understanding of the historical loan contraction and debt management problems inherent in the developing world, and is likely to result in the recurrence/exacerbation of the debt crisis.

The viable option: debt cancellation

One major reason why the ongoing discussions about multilateral debt cancellation have not yet produced concrete results is that there is no agreement about the best way to fund the debt cancellation. We feel that the funding for debt cancellation should be evaluated in a tiered manner with the most desirable and least controversial source of funding being exhausted before the next tier is mobilized.

The first tier, which is both additional and does not require higher aid budgets, is the sale of IMF gold. The second tier is additional contributions by creditor countries as suggested in the current United Kingdom debt relief proposal. Together, these two sources of funds should generate enough resources to allow 100 per cent cancellation of multilateral debt for a number of the poorest countries in the world. If there is a requirement for residual funds, we believe as civil society that there exists a third tier of funds: The International Bank for Reconstruction and Development (IBRD), which can generate more resources without any significant impact on its operations.

This tiered approach lies at the heart of the civil society proposal for debt sustainability in LDCs, especially in Africa. In many ways, this proposal builds on aspects of the other two proposals presented by the United Kingdom and United States Governments, respectively, and is complementary to them. The proposal also serves as a compromise between the otherwise incompatible positions of the United Kingdom and United States proposals by offering a way of tapping multilateral resources (United States proposal) in a way that they are new and additional (United Kingdom proposal).

Fair and Transparent Arbitration Mechanism

Realizing the recurring nature of indebtedness and the fact that the HIPC debt relief initiative has not dealt with the problem of external debt comprehensively (which often worsens instead as has been the case in country after country), debt campaigners, while calling for 100 per cent multilateral debt cancellation, have also simultaneously advocated for a systemic resolution to the problems of unpayable sovereign debt. This is embodied in the Fair and Transparent Arbitration Mechanism, which seeks to enshrine the superiority of basic human rights, ascertain the legitimacy of creditor claims to deal with the issues of odious debt and give the affected people a right to be heard.

The Fair and Transparent Arbitration Mechanism will deal with cases of illegitimate and odious debts as well as the repatriation of stolen wealth to the debt-stricken nations of Africa. For example, in the Democratic Republic of the Congo, evidence has been presented that the official creditors and private creditors of the Mobuto regime knew, or should have known, there was a high risk that their loans, or a substantial part of them, would not be used to benefit the people of the Democratic Republic of the Congo.

One way of looking at resolving third world debts would be by first securing an agreement on the working definition of debt sustainability. This implies revisiting the concept of debt sustainability as given by the HIPC initiative, identifying its shortfalls and seeking ways of redressing them to enable the initiative to work better for the poor countries. The issues of both domestic and external debt, as well as the role of shocks in the fiscal and monetary policies of the poor country, become very important.

Definition of key terms

Debts are only considered “sustainable” when the debt service burden leaves the HIPCs with sufficient funds to meet their human rights obligations under the internationally-agreed Millennium Development Goals. Under the enhanced HIPC initiative, debt to export ratio and debt service to exports ratio have been used as criteria for debt sustainability calculations.

The mostly used indicators of external debt sustainability are the ratio of exports earnings to the net present value of all future debt servicing payments. Levels of 20 to 25 per cent (ratio of export to GDP) and 150 to 200 per cent (NPV debt/revenue) of these indicators have been considered as benchmarks. If these ratios were exceeded, the country would be facing imminent debt services problems. In line with such a definition, Kenya is among four poor countries (others are Angola, Viet Nam and Yemen) classified as having sustainable debt levels. This has denied it access to debt relief at a time when the country has been experiencing a net outflow of resources over the past several years. The main contributor to these outflows is the heavy debt service burden.

Some academics have argued that Kenya is officially on the HIPC initiative list, but is already considered to have a sustainable debt burden according to the official HIPC initiative criteria. Debt is considered sustainable when the ratio of the net present value (NPV) of debt to export is more than 150 per cent, or when the NPV of debt to revenues is more than 250 per cent. Since Kenya has an NPV debt to export ratio of "only" 148 per cent, it is considered potentially sustainable. That aside, one is tempted to believe that it is possible that Kenya's exclusion from receiving any benefit under the HIPC initiative has been due to concerns about governance in the country, particularly under the former president Daniel Arap Moi.

Recently, a fiscal indicator was introduced as a measure of debt sustainability. This is the ratio of debt stock as a percentage of domestically generated revenues. The benchmark is between 250 to 275 per cent. However, these are not the only indicators; other factors should be considered. These include a country's fiscal and foreign exchange reserve positions, the efficiency of foreign exchange markets, the pace and variability of exports, future financing gaps and the creditworthiness of the country.

Kenya's case highlights the narrowness of the HIPC debt sustainability criteria that compares external debt to exports. In reality, Kenya's problem lies not only in external debt, but also in internal debt. The amount of Kenyan internal debt reached \$3.1 billion in 2002, bringing the total level of public debt to \$7.97 billion, almost 70 per cent of the country's GDP. Since internal debt service accounts for 13 per cent of government expenditure, we believe it should be taken into consideration.[3] Kenya's debt sustainability is not enough to help it attain the Millennium Development Goals by 2015. In addition, the country's debt sustainability has the potential of being undermined by the HIV/AIDS pandemic.

The HIPC initiative

Many development agencies and sceptics have already pointed out the Heavily Indebted Poor Countries (HIPC) initiative launched in 1996 and its successor, the Enhanced Heavily Indebted Poor Countries (EHIPC) initiative's inability to achieve the promised objective of a "robust exit from the burden of unsustainable debts" for developing countries. Problems associated with the design and implementation of the initiative suggest that neither of the two HIPC versions has succeeded in providing adequate response to the Third World 's debt overhang. An analysis of key debt indicators shows that external debt and debt-servicing problems are most severe and persistent in the HIPCs, the target group of the initiative.

Throughout the process, creditors failed to put sufficient political will, resources and serious analysis into debt reduction operations. Debt reduction targets were set and reset arbitrarily – writing off 30 per cent, then 50 per cent, and so on – rather than based on serious assessments of the needs of each country. Despite the IMF estimates and claims through HIPC that Africa's debt service payments would only go as low as 17.1 per cent of export earnings in 2001 (down from 20.3 per cent in 1999, before rising again to 18.4 per cent in 2002. This remained a mirage. The process has been much slower than expected and the initiative is suffering from problems of underfunding, excessive conditionality, and restrictions over eligibility, inadequate debt relief and cumbersome procedures.

The HIPC initiative's focus on purely economic criteria in assessing a country's debt burden betrays an utter lack of concern for human development and for the capacity of poor countries to meet the needs of their own people. The socio-economic gains made because of enhanced debt relief are by no means universal and, where they exist, they are limited and precarious. The reason for such a significant discrepancy between the enhanced HIPC initiative projected and actual present values of Sub-Saharan Africa's debt to exports ratios include the fact that the projections were based on economic assumptions that were too optimistic. There was also a sharp decline in the prices of the commodities they export

[3] Jubilee2000 Research, November 2003, http://www.jubilee2000uk.org/databank/profiles/kenya.htm.

There are three main criticisms to HIPC. The first one is its “limited and narrow” criteria based on exports. Second is the primacy of debt and debt repayment. On this, NGOs have been arguing for an alternative debt sustainability analysis (DSA) based on the idea that the fulfillment of human development needs should come first, before the service of debt. The third criticism is that the creditors not only do analysis but also monopolize decision-making, prescribing solutions to the debt crisis. In a nutshell, the bank and the IMF are playing the role of judge and jury in this debt sustainability question.

Operationalizing debt sustainability

In order to operationalize debt sustainability, existing frameworks such as HIPC and the recently announced Country institutional Policy Assessment (CPIA) need a revisit. This is necessary in order to address the shortfalls of existing debt sustainability frameworks. A number of key issues in the HIPC initiative need to be addressed.

External shocks: Shocks have an impact on the size of the primary surplus. Examples of shocks are rises in the price of oil, high currency depreciation, rise in domestic interest rates famine, fall in prices of primary products, decline in rate of economic growth, a dramatic fall in foreign financing, and other contingencies

There is therefore a need to ensure adequate concessional financing and further debt relief for countries subject to exogenous shocks and export shortfalls due to adverse trends in commodity prices. It would be necessary to consider the establishment of a concessional contingency financing facility in the IMF and for a real commodity-price adjustment mechanism under the HIPC initiative involving a timeframe extending to 2010. Another possibility could be the establishment of a separate shocks facility administered by the IDA and/or the AfDB.

Domestic revenue: A low present value of debt to revenue ratio resulting from high domestic revenue implies that a country has a greater ability to service its domestic debt and vice versa for a high present value of debt to revenue ratio resulting from low domestic revenue. Domestic debt servicing in HIPCs remains high because of the relatively high interest service payments and short maturity structure. Reduction of domestic debt is key to establishing macroeconomic stability and boosting medium-term growth by freeing resources for the private sector

It is therefore necessary that domestic debt is included in considering debt sustainability of poor countries. Donors should play a critical role in reducing the domestic debt stock where this is high, especially in clearing arrears and reducing the stock of treasury bills. More importantly, donors must help by reducing the volatility in their aid flows, including investigation of mechanisms that could assist in providing bridging finance. Policies are also needed to broaden the investor base, including the promotion of investment by retail and institutional investors, and deepening of the financial sector.

Conditionalities: Policy conditions attached to loans differ from country to country. What is relatively common to them all is that they do not and have not worked for many Third World economies in general.

Over stringent criteria and privatization are the hobbyhorses of the neoliberal battery of prescriptions; they have come in handy as the all-pervasive conditionalities that have seen the African economy sacrifice some of the strategic entities to the private sector interests of the multinational corporations. Procurement procedures have received renewed reform attention, but without a corresponding decline in misappropriation of public resource.

Both the bank and the fund, having grudgingly admitted that their conditions have extended beyond their mandates and competency, have been engaged in backdoor review of their use of conditionalities. Though essentially cosmetic, the strategic shift has been accompanied by a relatively positive change in their discourse, leading to a post-Washington consensus embracing local ownership as a brand new strategic touchstone. However, even with the new nomenclature grafted on the mantra of “local ownership”, the fundamental picture has hardly changed. Under the pretext of building institutions for the precariously globalizing market, developing countries, especially in Africa, have been cajoled into embracing the neoliberal dogma and its trinity of privatization, deregulation and liberalization.

Non–Paris Club creditor participation: Debt relief from commercial creditors for HIPCs is the most difficult to obtain and will require added international efforts. A number of HIPCs are facing creditor litigation, mostly from commercial creditors, although few non–Paris Club creditors have also resorted to litigation or sold their claims in the secondary market. The current approach relies on moral suasion to dissuade them from such activities. A more proactive effort is required by Governments of countries where commercial creditors reside to urge them to use the IDA facility, and by donors to provide technical assistance to prevent or address potential litigation.

The issue of non-participating non–Paris Club bilateral official creditors needs to be addressed if the HIPC initiative is to help in delivering debt sustainability. Diplomatic initiatives must be made to bring non-participating non–Paris Club creditors on board for the provision of donor support to write off intra-HIPC debt. Negotiating out-of-court settlements and refining domestic laws that, while respecting contractual obligations, would also ensure that settlements were on terms equivalent to the HIPC framework. Equally important is the need to expand the funding of the HIPC Trust Fund to ensure full participation of all multilateral creditors.

Eligibility: The debt sustainability criteria used in HIPC are unduly restrictive. Debt represents a massive drain on some debtor countries' limited revenue base at a time when investment in human capital is desperately needed to underpin growth. Although the HIPC framework includes a fiscal sustainability threshold that sets an upper limit on the proportion of government revenues absorbed by external debt servicing, it has been designed in a way that excludes all but a handful of countries. Countries that do not meet the revenue collection and export targets needed to qualify are left out. In many cases, neither of these targets is relevant to the central problem facing some debtor countries, namely, a debt service burden which is unsustainable in relation to fiscal capacity.

IMF/World Bank framework for debt sustainability and CPIA

The new DSA presents some positive changes, Firstly, it moves from the one-size-fits-all approach of the HIPC initiative with the single thresholds toward a more case-by-case analysis adapted to each country's situation and taking into account in particular vulnerability to exogenous shocks. It is pleasing to note that the proposed thresholds would be treated only as indicative guideposts. The underlying empirical analysis would be reviewed periodically, and the World Bank's Country Policy and Institutional Assessment (CPIA) would be opened up to outside scrutiny. Secondly, it takes more consideration of revenues as a criterion as opposed to exports. Thirdly, it takes the debt service to revenue indicator more seriously. Another positive is that lending institutions are trying themselves to develop a framework that prevents the overlending that has happened in the past. However, the DSA needs comprehensive debt coverage, including private and domestic debt

The 16 CPIA criteria against which the institutional performance of countries is measured entail a methodological preference that casts serious doubt on the objective meaning of the results in respect to the overall rankings. Three key purposes of the CPIA can easily be identified: (a) allocating loan and grant resources; (b) determining the policy directions of new operations not only of the World Bank but also of other donors and creditors; and (3) influencing the debt threshold targets or how much a Government will be allowed to borrow or receive.

The entailed proposal is of special importance to low-income countries outside the HIPC initiative such as Kenya and Nigeria. Problems directly or indirectly related to the new framework have exposed the African economy to the all-pervasive risk of a new and largely multilateral debt management crisis as a direct consequence of the non-concessional loans fobbed off on its poorly performing economy. The assumption that aid works in good performers has been questioned by quite a few analysts. There seems to be a contradiction in that the way the CPIA works seems to be a way of bringing in conditionalities via the backdoor within a context of poverty reduction strategy papers that emphasize ownership. In other words, CPIA is a subjective instrument. In addition, it violates the bank's articles of agreement, which require that the bank not enmesh itself in domestic politics by judging the political choices of regimes.

The CPIA as a debt sustainability instrument presents some conflict of interest of the bank and the fund in trying to be independent and transparent as they play the role of being both the judge and jury. Although the CPIA is conceived as an allocation criterion, in the end it produces clear incentives for change in the sense that it becomes conditionality. It is also important to note that the

CPIA is too narrow to capture all political, social and economic dynamics such as migration, famine and epidemiological issues. Nevertheless, the need for more grant aid and concessional loans needs to be flagged out.

But whether a country – and specifically its Government – will be able to service its debt depends largely on its existing debt burden as well as the prospective path of its deficits, the financing mix between loans and grants, and the evolution of its debt repayment behavior and capacity to manage the debt. This includes the GDP, export of locally produced goods and government revenues. This means that any useful projections of the debt dynamics will need to provide a strategic linkage between microeconomic policies and debt sustainability options preferred by the debtor countries themselves.

Conclusion

In sum, debt sustainability challenges facing low-income countries – especially in Africa – will remain formidable and therefore nearly insurmountable if the prescriptions for meeting them remain the monopoly of creditor agencies' self-interest. A critical look at the policy implications of the framework for debt sustainability as understood from the perspective of the creditor agencies brings out the contours of a vicious circle. This circle will be difficult to break if neither creditors nor borrowing countries are bold enough to think outside the box of neoliberal fundamentalism, particularly in respect to policy responses to the debt unsustainability crisis. Nothing short of unequivocal debt cancellation, coupled with homegrown development policies geared towards sheltering the fragile post–debt dependency economies from the vagaries of neo-liberal capitalism is needed. As the failure of IMF/World Bank economic orthodoxy increasingly attracts virulent challenges from a wide variety of social movements across the world, the efficacy of their debt sustainability framework proposals will meet even stiffer opposition.

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Appendix 1: Country policy and institutional assessment criteria

The CPIA rates countries based on a country's current performance in relation to 20 criteria, which are split into four categories of economic management, structural policies, policies for social inclusion, and public sector management and institutions. In 2004, the CPIA was simplified by consolidating it from 20 to 16 criteria. Table 1 shows the old CPIA criteria while table 2 shows the revised CPIA criteria.

Table 1. Old CPIA criteria

Category	Criteria
Economic management	1. Management of inflation and current account 2. Fiscal policy 3. Management of external debt 4. Management and sustainability of the development programme
Structural policies	1. Trade policy and foreign exchange regime 2. Financial stability and depth 3. Banking sector efficiency and resource mobilization 4. Competitive environment for the private sector 5. Factor and product markets 6. Policies and institutions for environmental sustainability
Policies for social inclusion	1. Equality of economic opportunity 2. Equity of public resource use 3. Building human resources 4. Safety nets 5. Poverty monitoring and analysis
Public sector management and institutions	1. Property rights and rule-based governance 2. Quality of budgetary and financial management 3. Efficiency of revenue mobilization 4. Efficiency of public expenditures 5. Transparency, accountability and corruption in public sector

Table 2. Revised CPIA criteria

Category	Criteria
Economic management	1. Macroeconomic management 2. Fiscal policy 3. Debt policy
Structural policies	1. Trade 2. Financial sector 3. Business regulatory environment
Policies for social inclusion	1. Gender equality 2. Equality of public resource use 3. Building human resources 4. Social protection and labour 5. Policies and institutions for environmental sustainability
Public sector management and institutions	1. Property rights and rule-based governance 2. Quality of budgetary and financial management 3. Efficiency of revenue mobilization 4. Quality of public administration 5. Transparency, accountability, and corruption in public sector

Part 4

Recent experiences in debt crisis management

Summary of panel discussion

Moderator: Mr. Emmanuel Moulin, Secretary General, the Paris Club

Panellists: Mr. Sinan Al Shabibi, Governor, Central Bank of Iraq
Mr. Andres de la Cruz, Cleary, Gottlieb, Steen and Hamilton
Mr. Norberto Lopez Isnardi, General Director, National Debt Office, Argentina
Mr. Arturo Porzecanski, Stern School of Business, New York University

The panel looked at some recent examples of how countries faced with debt crises were dealing with such situations, principally in terms of restructuring. In particular, the panel discussed the extraordinary cases of Iraq, which had recently undertaken major debt restructurings, and of Argentina, which had just completed one of the largest sovereign debt restructurings in history.

Mr. Al Shabibi described the origins of the $120 billion Iraqi debt that his country had contracted since the early 1970s. He explained that it had first been built up through military expenditure, mainly during the Iran-Iraq war in the 1980s, and then through penalties after the Government had stopped servicing its foreign debt at the beginning of the 1990s, after the first Gulf War. He said that most of Iraq's debt was odious debt and had been contracted to destroy rather than to develop the country. He said that today, the Government of Iraq was conducting its debt restructuring negotiations with development as the objective and in order to bring the country back into the international community after years of isolation. Although Iraq could still be considered as a rich oil-exporting country, the reality on the ground, he said, was very different, and the oil industry's infrastructure was in desperate need of fresh investment. Through the debt restructuring, the new Government aims to create an enabling environment to attract the necessary funds to upgrade its oil-producing capacities. He explained that after having reached an agreement with IMF under its Emergency Post-Conflict Assistance Programme, a satisfactory deal had been obtained with the Paris Club creditors in November 2004. The $40 billion that it owed to those creditors would be reduced by 80 per cent in three stages: 30 per cent with immediate effect, 30 per cent after obtaining a standby agreement with IMF and the remaining 20 per cent after a successful implementation of the standby agreement. Iraq was currently negotiating the conclusion of the bilateral agreements with the Paris Club creditors and it hoped that additional relief on top of the 80 per cent would be granted by at least some of those creditors. He said that negotiations with non–Paris Club creditors were also ongoing but initial signs showed that they were not as reluctant to grant a similar reduction as that of the Paris Club creditors. He added that there was hope, however, that the debt owed to the Gulf countries, amounting to $50 billion, would be restructured according to the same terms as those obtained in the Paris Club. Regarding private debt, he said that this was marginal but would take time to restructure.

Mr. Isnardi explained the case of Argentina. His country had defaulted at the end of 2001 after a deep political, social and economic crisis, which had been among the deepest crises in its history. The major objective of the subsequent sovereign restructuring, which had taken place through a debt exchange offer, had been to ensure that the country's debt servicing remained within the country's payment capacities and to reduce the country's vulnerability to further external shocks. The offer had been mainly limited to bond debt, which represented the most significant portion of the defaulted debt, and which in itself represented a volume of approximately $81 billion, both domestic and external. It included the exchange of some 152 bond issues for new instruments, at par, quasi-par and discounted value, all with a GDP-linked security. The offer also concerned a very diverse set of investors (including local investors, individuals, pension funds, insurance companies, retail), which meant that different types of legislation had been involved in the restructuring process. Because of the swap, he said, overall debt sustainability indicators had improved, the total external debt had been significantly reduced and the debt's exposure to exchange rate variation had been reduced as the share of the public debt in domestic currency had greatly increased.

Mr. de la Cruz commented on the Iraqi and Argentine cases and the questions such restructurings raised, particularly in terms of litigation claims. He stressed the fact that the terms of the Iraqi debt restructuring obtained in the Paris Club would probably remain unique, due to the particular circumstances of the country. Regarding litigation from private creditors, he mentioned that certain Iraqi assets held in the European Union and the United States had been shielded from seizure as a measure to force private creditors to enter into restructuring agreements with the Government of Iraq. In the case of Argentina, he said, anticipation of litigation claims had been an important element of the debt restructuring, and the “now or never” exchange offer made had been conceived to discourage holdout creditors. The fairness of the offer, nevertheless, raised certain questions, and did not exclude possible future creditor-sponsored backlash. It also raised the question of whether private investors, faced with what they perceived as unsatisfactory sovereign rescheduling deals, would resort to taking a modern “gunboat approach” to recuperate their investments. As an example, the case of Italy was mentioned, where private creditors exercised strong pressure on the Government of Italy to purchase the Argentinean debt held by Italian private creditors and to negotiate on their behalf.

Mr. Porzecanski also commented on the case of Argentina’s restructuring, comparing it to another example of sovereign restructuring – that of the Dominican Republic. In his opinion, Argentina had no reason to go into default in the first place. The default was still not settled, and it took place at a time when the country still had ample reserves available to cover debt service payments and neither endorsement nor negotiations had been sought with the IMF or the Paris Club creditor countries. In addition, he warned, a creditor backlash in the foreseeable future could not be excluded. Mr. Porzecanski commended the successful restructuring that had been conducted by the Dominican Republic. He said that in the latter country case, the country had been faced with a real liquidity crisis, which had been solved by avoiding default, obtaining IMF endorsement and by seeking a negotiated settlement with the Paris Club creditor countries. Therefore, multilateral creditors had provided fresh funds, 94 per cent of bondholders had participated in the restructuring and future lawsuits could be reasonably excluded.

Part 5

The changing role of the debt manager

Summary of panel discussion

Moderator: Mr. Udaibir S. Das, Chief, Exchange Regime and Debt and Reserve Management Division, IMF

Panellists: Ms. Aracelly Mendez, Director, National Debt Office, Panama
Mr. Mothae Maruping, Executive Director, Macroeconomic and Financial Management Institute of Eastern and Southern Africa
Mr. Philippe Anderson, Principal Financial Officer, World Bank
Mr. William Ortiz Linares, Chief, Internal Capital Markets Group, Department of Public Credit and National Treasury, Ministry of Finance and Public Credit, Colombia

This panel gave national, regional and international perspectives on what it saw as issues changing the role of the debt manager. It included presentations from two countries, one from a regional institution and the other from an international financial institution. All demonstrated the very dynamic nature of debt management and the increasing complexity of the role of the debt manager.

Ms. Mendez presented a historical perspective on the changing role of the debt manager in Panama in terms of four distinct time eras: multilateral, Brady, international capital market, and domestic capital market. During the multilateral era (1990–1994), Panama was recovering from an economic crisis following 20 years of a military Government. During this period, the debt management office focused mainly on paying debt (current and defaulted debt), but lacked a sound public debt strategy. In the Brady era (1995–1997), a debt restructuring plan was implemented via the issue of Brady bonds and debt composition shifted from commercial bank debt to Brady bonds. Credit risk ratings were also obtained. During the international capital market era (1998–2001), the country saw the privatization of decentralized institutions, the issuance of global bonds to finance the deficit and the strengthening of access to capital markets. This led to the reinforcement of market and risk analysis functions. Finally, with the current, domestic capital market era (2002–2005), an internal debt funding strategy was being implemented and public debt strategy has focused mainly on the development of domestic capital markets and the creation of an efficient short- and medium-term yield curve. She said project control functions have also become reinforced. She concluded that debt management offices were dynamic and there was a need for organizational charts and staff skill requirements to change as a country matures as a borrower. Countries at different levels of development also need different organizational structures for their debt office, she added, and these should be defined according to the types of financing sources available. There was also no unique organizational structure applicable to all debt management offices. She also pointed to the fact that as more functions are undertaken by a debt office, greater reliance on information management technology and team work skills are required.

Mr. Linares, speaking about Colombia, explained how the current structure of the Department of Public Credit and National Treasury had arisen from the merger of two separate departments, which were centralized in January 2004. He also described the activities of the department’s front, middle and back offices, which interact in a coordinated way with respect to development of financing operations in the domestic and international markets. In terms of changes in public debt treated, Mr. Linares presented a series of graphs that summarized changes in the public debt from 1998 to 2005.

Mr. Maruping described the debt manager’s role as one depending on the person’s caliber as well as on his/her country’s level of sophistication in terms of its debt portfolio, strategy and objectives. The role also depends on the development status of the country. Traditionally, the debt manager was simply the passive implementer of conservative exogenously determined debt strategies and was restricted mostly to performing routine debt operations such as loan servicing, recording and reporting. However, new challenges prompted a need for a change in this role. Factors which imposed risk included erratic donor flows, changes in terms of trade, swings in exchange rate and interest rates and even natural disasters (such as floods or earthquakes). Furthermore, debt instruments were not diversified enough to allow the spreading of risks across different maturities. Mr. Maruping also touched upon the problem of “brain drain", or staff turnover due to low remuneration and a lack of clear career paths in the civil service. He also spoke of the challenge of implementing best practices amidst dynamic sophistication in debt management techniques, systems and procedures and the resulting implications for front, middle and back offices. He said that a wider/diversified choice in sources of borrowing entailed the following challenges: (a) a greater need to monitor or manage risks; (b) the strengthening role of a middle office that conducts key analyses and guides strategy/policy; and (c) the assessment of the cost benefit of obtaining a sovereign risk rating. By way of conclusion, Mr. Maruping stated that debt managers should act as proactive agents of change and reform. They can do this by synchronizing interventions from domestic and external stakeholders and by fostering best practices in front, middle and back offices, with an emphasis on the centrality of strong middle offices that are well equipped and staffed. Debt managers should also enlist the support of policymakers in providing an effective legal and institutional environment for effective sovereign debt management.

Mr. Anderson explained how instruments such as swaps and a relaxation of capital controls had brought about new opportunities for debt managers. He explained how as the choice of funding sources expands, the complexity of the public debt management operation increases and requires new sets of skills to meet these new demands. He described the modern debt management office as one that combines sound practice of the financial and corporate sectors with public policy and economic analysis, in order to manage the unique challenges of a sovereign debt portfolio. He highlighted the fact that at all levels of development, building capacity would require significant commitment, investment and time. This, he said, was frequently underestimated.

The changing role of the public debt manager

Phillip Anderson

Introduction

Public debt management as we know it today, with its focus on risk management, evolved in the 1980s in a number of smaller Organization for Economic Cooperation and Development (OECD) countries. It was a response to both necessity and new opportunities. The necessity to improve public debt management arose from the escalation in public debt levels as a percentage of GDP, as well as increasingly risky debt structures, while the volatility of exchange rates and interest rates had also increased. The latter had been caused by the ending of the gold standard in the early 1970s, followed by increased inflation in the next decade.

At the same time, new ways of managing risk became available with the development of financial futures in the 1970s and, more importantly for public debt managers, the swap markets in the early 1980s. Other opportunities became available in the 1980s as capital market liberalization and financial deregulation made more markets available to sovereign borrowers and, conversely, allowed non-residents to participate in domestic bond markets. By the end of the 1980s, rapid financial innovation resulted in a vast array of structured financial products being offered to sovereign borrowers on a daily basis.

This convergence of large, volatile debt portfolios and greater financial choice led to the development of the modern debt management office. The new type of public entity combines sound practice of the financial and corporate sectors with public policy and economic analysis, in order to manage the unique challenges of a sovereign debt portfolio.

In this presentation, I will characterize how a public debt manager's role changes, depending on a country's economic and financial situation. Drawing on the World Bank's experience in working with a diverse group of countries, in terms of size, location and income levels, I will touch on the challenges and requirements for building capacity to meet these evolving needs. Finally, I will canvas some of the new roles that public debt managers are performing, making use of the advanced capacity in their organizations.

Defining terms

To set the scene, it is useful to clarify the public debt manager's role. The following extract from the Guidelines for Public Debt Management[4] provides a definition of public debt management:

> "Sovereign debt management is the process of establishing and executing a strategy for managing the Government's debt in order to raise the required amount of funding, achieve its risk and cost objectives and to meet any other sovereign debt management goals the Government may have set, such as developing and maintaining an efficient market for government securities."

In this context, the role of the public debt manager is distinct from those responsible for advising on fiscal policy. Fiscal policy, under a broad definition, relates to aggregate government spending and taxation and the microeconomic impacts of individual tax and spending policies. This will be the main determinant of the *level* of public debt over time, and debt sustainability analysis is a key input to determining prudent fiscal policy for a country.

Public debt managers, on the other hand, are concerned with the structure of the debt, in particular ensuring that the costs and risks of the debt portfolio are within acceptable tolerances. They are also responsible for efficient and prudent execution of transactions on the Government's behalf. Therefore, their main concern is the *composition* of the debt.

Changing role of the public debt manager

A useful way to characterize the changes in a debt manager's role over time is shown in figure 1 below. As the choice of funding sources expands, the complexity of the public debt management operation increases and requires new sets of skills to meet these new demands.

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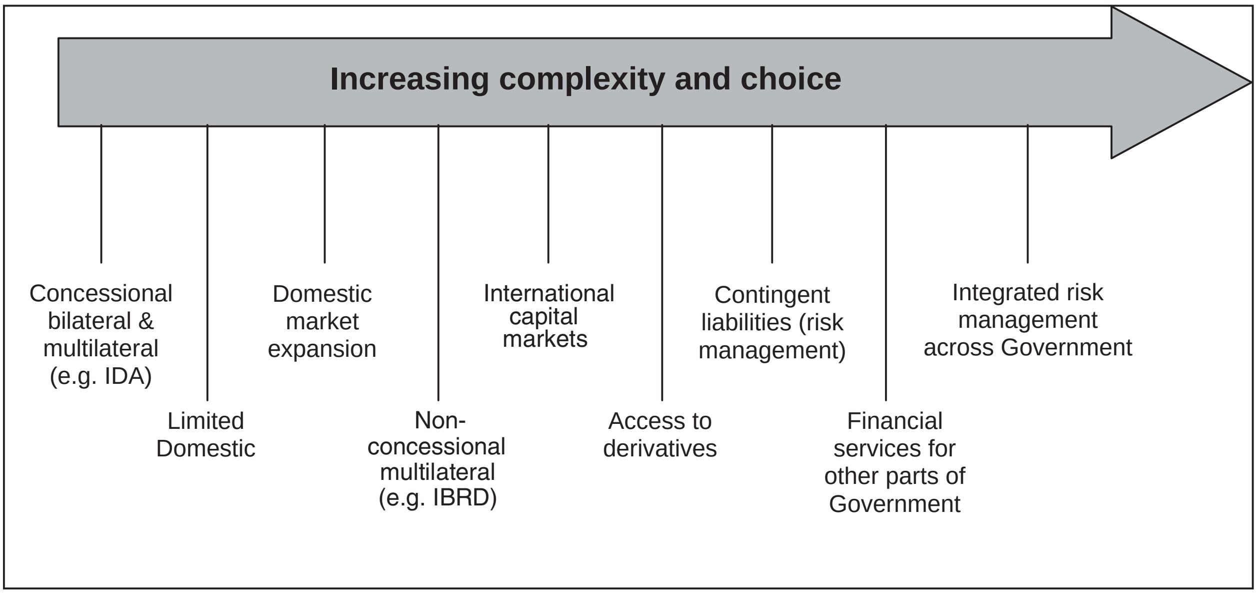
[4] IMF and World Bank. 2001, amended 2003.

Figure 1. Changing role of the public debt manager



At the left end of the spectrum, where a country largely is restricted to highly concessional financing from bilateral and multilateral sources, choice is very constrained. The creditors determine the terms and conditions of such borrowing and the volume is shaped by debt sustainability concerns.

As the domestic debt market develops and/or the country becomes eligible for IBRD-type loans, more alternatives exist and the debt manager must start to consider the cost/risk tradeoffs associated with different borrowing alternatives. Complexity increases further as the borrower gains access to the international capital markets and the use of derivatives, such as swap transactions.

Finally, the stages at the right end of the spectrum represent more advanced and complex tasks that the public debt manager may undertake, using the skills and systems that characterize a modern debt management office. I will touch on these roles at the end of the presentation.

It should be emphasized that this is a stylized view to illustrate how debt management may change through time. The sequence of the stages in figure 1 is not intended as a prescribed progression; it will vary from country to country. For example, access to non-concessional multilateral debt may occur before the domestic market develops to a significant degree, a process that may take a long time. Some countries gain access to the international capital markets while having income levels that continue to make them eligible for highly concessional financing.

Earlier stages: low-income countries

LICs are characterized by a reliance on highly concessional borrowing, with *limited choice* in the financial terms of the borrowing. The focus of analysis is on sustainability issues and attempting to define how much debt the Government can prudently carry. Domestic borrowing, where it occurs, is mostly from captive sources or is very short-dated.

In this environment, debt managers are concerned mostly with loan evaluation, debt recording and administration. Reporting requirements are shaped largely by the demands of bilateral and multilateral lenders. In addition, debt managers support debt sustainability analysis undertaken as part of macroeconomic management.

Based on experience in a number of countries, it is apparent that public debt managers in some LICS continue to face challenges. In the area of debt recording, while information technology systems are available to meet their needs, the processing around these systems can be unreliable. This results in a lack of timely and accurate data and reporting, missed payments and a lack of access to key documents. Inadequacies in these areas make it difficult to undertake any type of analysis and develop a debt management strategy.

A factor underpinning these difficulties is staff capacity constraints, it being difficult to recruit and retain qualified staff in core ministries. This may be compounded by key person risk and a lack of leadership. Before expanding the activities of the public debt manager, it is necessary to address the basic requirements of efficient public debt management.

A new activity: accessing financial markets

The move from borrowing from official sources to accessing the capital markets represents a major step up in complexity in all areas of the debt management operation.

The development of the debt management strategy becomes a more complex process, reflecting greater financial choice and more significant cost/risk tradeoff decisions. The public debt manager is required to undertake deeper analysis of these tradeoffs to assist decision makers, and many public debt managers use models in this process. The simpler models are scenario-based and future interest rates and exchange rates are deterministic in the analysis. In more advanced models, the variables may be modeled stochastically, although in emerging market and developing countries, where the history has been marked by many structural changes, this methodology will most likely yield results that are unusable. In the most ambitious analysis, interest rates and primary budget balances are modeled jointly within a stochastic macroeconomic model, which links financial and macroeconomic variables (although it should be noted that relatively few countries have undertaken the third type of analysis).

Execution of transactions in the financial markets requires different skills compared to dealing with official sources. Debt managers are required to assess proposals for market transactions and negotiate with banks, and therefore need a sound understanding of finance and market conventions, as well as negotiation skills. To develop the domestic government bond market, debt managers need to consider how to manage the primary market, e.g. the issuance techniques (uniform vs. multiple price auctions) and whether to introduce primary dealers.

Dealing in the financial markets brings with it **increased operational risks**, which need to be managed carefully. Stronger control systems, specialized auditing, segregation of responsibilities, particularly in data entry at transaction and back office trade confirmation, and well-designed procedures are all important. In addition, ethics and conflict of interest policies need to be introduced or revised, particularly as the Government is the dominant issuer in the domestic market.

The debt management unit will need to consider its **information technology requirements**, as existing systems may not handle the new types of transactions, including swaps.

The provision of information and financial reporting may need to be expanded and improved for private sector investors and credit rating agencies. Disclosure of the Government’s financial position and on materially important aspects of debt management operations is sound practice in any event. However, financing activities in the capital markets will place a greater focus on this. Some sovereign debt managers develop investor relations programmes to service more actively investors’ information requirements.

Building capacity

Considerable institutional capacity-building is required to meet the challenges of accessing markets, and countries have employed a number of approaches to achieve it. In some countries, **the central bank has played a role** or provided assistance, as the staff has some of the required skills from experience in areas such as managing foreign currency reserves and domestic liquidity management. However, if this approach is adopted, it is important to separate monetary policy from debt management objectives.

Countries are also able to benefit from **many sources of donor assistance**, including the World Bank. However, it is important to use these resources in ways that build capacity for the long term and institutionalize the experiences that are gained. Ongoing reliance on outside consultants will not achieve this.

Some countries have established new laws and an additional entity for new business. We would not recommend this approach if it can be avoided, as it leads to multiple debt managers, impeding strategy development and efficient execution.

Recruitment and retention of staff with the appropriate skills is a common challenge, due to inflexible employment conditions for public servants. Creative solutions as well as strong leadership that creates a sense of purpose in managing the largest financial portfolio in the country are required for staffing and training. Some countries provide access to world-class training opportunities (e.g. top academic institutions, vocational courses and on-the-job placements). Others countries have contracted skilled and experienced staff on fixed-term assignments, particularly when a significant expansion of capacity is implemented. Specific measures include temporary placements of private sector personnel in the debt management unit, or the use of longer-term advisors with specialist skills. Full use should be made of the flexibility that does exist for remuneration, including accelerated promotion, bonuses or a separate occupational pay scale.

An observation from many countries, at all levels of development, is that building capacity of debt management units requires significant commitment, investment and time. Frequently, this is underestimated.

Expanded roles for public debt managers

An advanced public debt management unit may be characterized as having:

- The ability to transact in derivatives markets (e.g. swaps and futures);
- The capacity to model cost and risk of the debt portfolio to assist in the development of the strategy;
- Advanced IT systems that handle all financial instruments, provide performance measurement information and meet all analytical and reporting requirements;
- The ability to manage all operational risks, and well documented procedures and policies; and
- Highly skilled staff, with experience in finance, markets and economics.

Having made the investment in a highly skilled and well-equipped debt management unit, some countries have expanded their units' role to provide a greater range of services. **Borrowing on behalf of government entities** and/or providing on-lending is a relatively common service that debt management units provide.

Cash management is also frequently allocated to the debt management unit, given that it has the expertise to undertake the transactions required to meet the short-term funding needs and invest the temporary surpluses of Government.

Another area is the **management of financial asset portfolios** under contract for other parts of Government. Some debt offices provide facilities for government entities to deposit surplus cash.

Similar to a centralized treasury in a diversified corporation, some debt management units **execute foreign exchange and derivatives transactions** for government departments and entities. In situations where these entities do not have sufficient business to maintain staff and processes for these operations, the debt management unit is able to provide efficient, centralized execution, using its infrastructure.

Public debt managers also **provide advice on capital markets activities** to other parts of Government, for example in relation to privatization, private-public partnerships or borrowing by other government entities.

In some countries, the debt management office **assists the Government manage contingent liabilities** by pricing and administering the use of guarantees. A debt office is well equipped to do this, as it has the skills in finance to undertake the analysis of price guarantees with a view to cost recovery, as well as the operational systems to manage their administration.

Finally, some Governments are assessing ways in which they are able **to manage risk across their entire balance sheets**. Governments typically have numerous entities (departments, state-owned enterprises, funds, etc.), the activities of which give rise to financial assets and liabilities. The objective of centralizing risk management would be to allow natural hedges to be identified, which may save transactions costs, or reveal large cumulative exposures unacceptable to Government which need to be reduced to protect the financial position. A debt management office is well placed as the Government's "residual risk manager" under this type of approach.

Part 6

Recent experiences in the organization of debt management offices

Summary of panel discussion

Moderator: Mr. Jaime Delgadillo, Senior Advisor, Crown Agents

Panellists: Mr. Mansur Muhtar, Director General, Debt Management Office, Nigeria
Mr. Dharma Bhakti, Director, External Fund Management, Ministry of Finance, Indonesia
Mr. Fred Jensen, Consultant, Public Debt Management
Mr. Chris Itsede, Director General, West African Institute for Financial and Economic Management

Mr. Mansur presented the experience of Nigeria, which had recently undergone major changes to its procedures as well as institutional arrangements for managing debt. These changes involved the consolidation, streamlining and strengthening of all debt management functions into a single specialized semi-autonomous entity – a process that had started in 2000. The new organizational structure had evolved progressively and was now based on a front, middle and back office configuration that allowed better organizational control and helped eliminate the overlap and duplication associated with the old arrangement, where several agencies had been involved, and where information flows had been weak and coordination poor. Because of the changes, debt management processes such as debt servicing had been made more efficient, roles and responsibilities made clearer, and debt data consolidated. He said that challenges remained, however, such as ensuring the most appropriate governance of the new arrangement (e.g. executive debt management committee), in moving towards a more active debt management (rather than mainly passive, i.e. debt servicing and rescheduling, based on the needs of the past), and in attracting and retaining qualified personnel. Another challenge, he said, pertained to sub-national debt as Nigeria has 36 States, each with autonomy in managing debt and with different legislation involved. As such, it was necessary to build a consensus between them and establish guidelines that would provide a framework for sub-national debt activities, including borrowing.

Mr. Bahkti briefly described the origins and composition of Indonesia’s debt, which was both external and domestic. He said that, historically, several government agencies have been involved in debt management and, within the same institution, many units with various functions. This scattered institutional structure, he said, had led to inefficient flows of information and meant debt management policies were not centralized and not properly conducted. As such, Indonesia was reforming its legal framework for managing debt and was looking to centralize its debt management functions, as well as reform its legal framework for debt management. Setting up a centralized autonomous debt office as such, he said, was therefore being considered.

Mr. Jensen said that it had now been widely accepted as best practice that debt management functions should be consolidated into a single debt management office consisting of back, middle and front office functions. The question over where to locate the debt management office, however, was less clear. For example, should it be located within the Government or be established as a separate more autonomous body? Many developed countries had set up separate debt offices in the past because such offices were freer from political pressure than those situated within the Government and were thus more in line with the private financial sector, permitting a more professional approach to the costs and risks of portfolio management. For such offices, however, there was a very strong need for strict monitoring and control by the Government to make sure that the agency implemented government strategy. The more recent trend, he said, was for a debt management office to still have an agency-like structure but be located within the Ministry of Finance. The rationale was that debt management is more than just an active management of a debt portfolio, but a vital part of the overall macroeconomic policies of the Government. There was also a trend among debt offices to think of risk in the debt portfolio in an asset-liability management framework, where the risk of debt is measured against the Government’s assets and other liabilities.

Part 7

Delivering greater information and transparency in debt management

Summary of panel discussion

Moderator: Mr. Jose Antonio Gragnani, Deputy Secretary of the Treasury, Ministry of Finance, Brazil

Panellists: Mr. Udaibir S. Das, Chief, Exchange Regime and Debt and Reserve Management Division, IMF
Mr. Kunibert Raffer, Professor, Department of Economics, University of Vienna
Mr. Brian Cooksey, Associate, Transparency International
Mr. Lucien Bembamba, General Director, Treasury and Public Accounting Department, Ministry of Finance, Burkina Faso

Mr. Gragnani started the discussion by underlining that debt management was rapidly involving and, with it, the need for transparency was becoming ever more important. This he linked to the diversifying investor base, new markets and foreign investment in local markets. Transparency, he said, was fundamental for the development of bond markets. In Brazil, he said, transparency was taken very seriously. Debt managers there work under a well-known and legally defined framework and have to regularly report to Congress. Debt management policies and debt statistics were also widely disseminated in a series of reports and press releases and an investor relations group played an important role.

Mr. Cooksey said that without significant improvements in transparency and accountability from all sides, the debt problems known to HIPC countries would never be resolved. The moral hazards inherent in the debt relationship between the lenders and borrowers, he said, already got in the way of delivering long-term benefits of aid. Of these moral hazards, he listed three: (a) the disbursement culture of the lending institutions – where loans were made without taking into account past project failure; (b) the lack of transparency in the contracting of loans and implementation of projects; and (d) the lack of accountability on both the lender and borrower sides for failed investments. Projects, he said, had failed routinely and repeatedly, and nobody was held responsible. Inappropriate policies, low capacity, corruption, waste and mismanagement were all factors that got in the way of translating aid into development. Short-term solutions such as debt relief, he said, did not address the moral hazards inherent in the debt relationship and a historical understanding and analysis of how a debt problem occurred in the first place was necessary to avoid a recurrence of the problem in the future.

Mr. Das first looked at some of the factors driving the need for transparency in debt management. These included (a) a stronger recognition of debt management linkages with macroeconomic and financial stability, in terms of both level and structure of debt; (b) the need for the adoption of more professional and systematic risk management practices by the public sector, such as those required by the private sector; and (c) the need for timely and good quality data disclosure. He also mentioned the need for improving available financial literature in order to help households who were assuming a lot of financial risk to make better-informed lending decisions. Referring to the IMF/World Bank “debt management guidelines” published in 2003, he said that some of the points made in this publication included the fact that transparency will help debt managers meet their objectives, in helping reduce uncertainty with regard to the intent of the actual debt management policies. They would also make it easier for the market to assess the objectives, strategy and instruments that are put to use. Nevertheless, he added, the guidelines point out that the enabling conditions must be in place for proper transparency. These include the appropriate legal foundation, debt management processes and attitude of the debt managers and decision-making authorities. In addition, challenges remained in defining best transparency and disclosure practices: for example, how to make transparent the fact that one is working under certain scenarios of unexpected shocks; or indeed what approach should be best taken in terms of disclosure of contingency items or in the tax treatment of securities. The IMF, he said, was making a cross-country study on transparency and disclosure practices. A more solid analytical framework, he added, was needed in terms of the costs and risks associated with transparency and its benefits.

Mr. Raffer deplored the lack of transparency in eligibility for debt relief and proposed the establishment of an independent body. He said that so far creditors rather than the rule of law or economic fundamentals have determined eligibility, which has only led to unsatisfactory results. He said a new transparent method was needed, based on objective transparent criteria, not on creditors' wishes. It must respect the very foundation of the rule of law that one must not be judge in one's own cause. He said that debt reduction should be available to any technically insolvent country – determination of which would be decided by an independent body. The process would emulate domestic debt reduction procedures. He recalled his proposal that arbitration be carried out by an independent body, based on United States Chapter 9 (municipal insolvency).

Mr. Bembamba examined the case of Burkina Faso in managing transparency and information regarding public debt management within the framework of its membership of an economic and monetary union, as well as within the national framework. He said Burkina Faso's membership in the West African Monetary and Economic Union, with a common currency, a common central bank and a common monetary policy, submitted it to rules regarding discipline, transparency and information, particularly regarding anything that could affect currency value, monetary reserves, inflation and so forth. In Burkina Faso itself, he said, indebtedness is being monitored and transparency promoted, especially since 1995, when a debt management strategy was created. An example of measures taken has been the setting up of a debt monitoring body that checks the conformity of any new loan or project with overall economic policy before its approval.

Delivering greater information and transparency in debt management

Kunibert Raffer

Lack of transparency on decision-making is one fundamental problem of present debt management. Erroneous perceptions on costs of debt reduction and on the legal status of creditors have unnecessarily complicated the search for viable and sustainable solutions. Delivering better information and increasing transparency are thus mandatory for improving debt management. This paper focuses on four important issues, namely:

- Transparency in eligibility for debt reduction;
- Improving sustainability estimates by using all available information;
- Clarifying erroneous perceptions on the status of creditors; and
- Transparency regarding the real costs of debt relief.

Transparency in eligibility

No transparent criteria regarding eligibility for debt reductions exist. Creditors have arbitrarily decided on thresholds, countries and amounts of debt reductions for decades. Until 1988, when the United Kingdom's laudable initiative led to the Toronto Terms, creditors decided unilaterally that no debtor country was eligible, insisting on full repayment, claiming that countries would "grow out of debts". Under the so-called "Baker Plan", some countries were to receive new funds to make this growth possible. It was not transparent how the list of beneficiaries had been produced, nor was it clear from the outset how many countries were eligible. Objective criteria for the choice of countries do not exist. Many critics argued that United States interests would explain the list.

In 1989, the "Brady Plan" officially introduced debt reductions for middle-income countries. This idea was first propagated by the Brazilian Finance Minister, Bresser Pereira in 1999. It originated in a debtor country, and was immediately turned down by the United States Treasury. Japan's Finance Minister, Miyazawa Kiichi, supported it before it finally became the "Brady Plan". Eventually, creditors recognized the urgent need for debt reduction, but no objective eligibility criteria were established.

Without clear economically founded criteria, creditors have granted too small reductions too late. This shortcoming may have allowed official creditors to avoid short-term accounting problems, but unpayable debts and problems have grown. The history of Paris Club "Terms" illustrates this perfectly: each new "Term" had to increase the percentages of debt reduction because prior percentages had been insufficient. One has to concur fully with Krueger (2001: 8) that delaying needed reductions has caused considerable damages: "too many countries with insurmountable debt problems wait too long, imposing unnecessary costs on themselves, and on the international community".

Having advocated sovereign insolvency for nearly two decades, repeatedly drawing attention to this kind of damage, I might recall that official creditors forced debtor countries to wait. These creditors continue to oppose any meaningful mechanism of debt reduction. If the United Kingdom's bold and economically sound proposal of doubling Toronto reductions, the so-called Trinidad Terms, had been accepted early on, much damage would have been averted from debtor countries. The accumulation of further unpayable debts would have been slowed down considerably, if not stopped in some cases. In spite of this merit, these Terms were not based on objective or transparent criteria either.

James Wolfensohn is to be commended for introducing the first HIPC initiative, which broke the last taboo, reducing multilateral debts, once the manifest need to do so could no longer be denied. Its second version, HIPC II, remained as unsuccessful as the first. While eligibility thresholds were lowered, the new ones were just as arbitrary. Because of absolute creditor domination, this was to be expected: too little was given too late. The problem has been prolonged instead of solved. Calls for another improved HIPC initiative, HIPC III, were already heard.

The IMF's Sovereign Debt Restructuring Mechanism (SDRM) for middle-income countries again lacks clear eligibility criteria. Doubts are justified whether it would not have worked (for the important differences between the SDRM and my proposal cf. Raffer, 2003, 2005a, 2005b). So far, creditors rather than the rule of law or economic fundamentals have determined eligibility – with unsurprising results.

This lack of transparency can be illustrated with two examples. Nigeria was classified HIPC initially, but was removed from the list in 1998 as no longer meeting the criteria. Its indicators were 250.14 and 11.22 in 1998. However, the low debt service ratio (DSR) resulted exclusively from the fact that Nigeria – unable to pay as due – had accumulated huge arrears. Simply by adding interest arrears Nigeria's DSR would have been slightly above 35 per cent in 1997. Adding all principal arrears shown by IBRD for 1997 would have produced a DSR of 90.93 (Raffer and Singer, 2001:192; regarding technical problems of this widely used debt indicator cf. Raffer, 2004b). A DSR of 11.22, below the official threshold, was certainly helpful in justifying removal. However, the lack of IDA-only status, a criterion wholly dependent on arbitrary decisions by creditors, also "excluded" Nigeria. Nigeria is now to get substantial debt relief by the Paris Club. This was announced after Nigeria had suddenly been moved to IDA-only status, as the Club's press release of 29 June 2005 explicitly declares.

Indonesia, once presented as a miracle by the Bretton Woods institutions, became a Severely Indebted Low Income Country because of the Asian crisis. It was denied HIPC status, although simple divisions of total debts in present value terms and debt service by export revenues showed a debt-exports ratio of 251.75 and a DSR of 33 in 1998. Economically, and judged by HIPC-relevant debt indicators, it should have been certified an HIPC. However, as the amount of debts was substantial ($150.8 billion), this would have been costly. Creditors denied HIPC treatment on economically unconvincing, bureaucratic grounds (Raffer and Singer, 2001: 191f).

Without transparent rules and economically sound thresholds, debtors remain at the mercy of creditors. IMF's Jack Boorman concluded: "On the political front, the constraints to funding debt relief have been severe and the generosity of some of the major creditor countries has been limited, not least because of the weak constituencies for foreign assistance in some of the larger countries" (*IMF Civil Society Newsletter*, August 2004: 9). While all other debtors in distress have enforceable and publicly known rights, the globe's poor are at the mercy of their creditors' generosity – or rather lack thereof. This is a double standard upheld although technical mechanisms to assure equal treatment exist. The difference between debtors protected by the rule of law and Southern debtors including their people shows down to tiny linguistic details. The word "forgiven" is never used for any debtor but a Southern country, because insolvency relief is a "right" of any other insolvent debtor. Debtor protection based on human rights is a matter of course. Other debts are reduced, written down, etc., according to transparent legal norms, but never "forgiven". This latter expression – in the North otherwise reserved for sins – is exclusively used in the financial sphere in connection with debt reductions of Southern countries.

If economically sound eligibility criteria had been established early on, the debt problem would have been considerably defused. IBRD (1997: 42) acknowledges that substantial shares of present debts were caused by creditors delaying necessary reductions over years:

> "The surge in borrowing, coupled with increasing reliance on rescheduling and refinancing, increased the nominal stock of debts of HIPCs from $55 billion in 1980 to $183 billion in 1990 ... by the end of 1995 it had reached $215 billion."

Slower growth during the period 1990–1995 reflects shifts towards grants, higher concessionality, and the first effects of debt cancellations. UNCTAD (1998: 127) estimated two thirds of the increase in Sub-Saharan debt since 1989 to be caused by arrears. If official creditors had not blocked a quick and fair solution over decades, total debts would be much lower.

Creditors as a group will now have to accept larger losses in order to make debtor economies sustainable than would have been necessary some 20 years ago. As the structure of creditors has changed dramatically over the last two decades, not each single creditor need necessarily be worse off. Bondholders, practically non-existent in 1982, are now an important creditor class in quite a few cases, while banks have been able to reduce their exposure. This is not without considerable costs, as debt reductions of 35 or 45 per cent under "Brady Deals" document. Formulations such as "bailing-in the private sector" are therefore patently unjustified.

Quite noteworthy distributional effects exist, exacerbated by the fact that IFIs have been able to secure privileged treatment of de facto preferred creditors, mostly in breach of their own constitutions. This undue privilege is especially problematic for the poorest countries, where multilateral claims are a substantial percentage of sovereign debts and IFIs have influenced economic policies substantially. Unfortunately, official creditors have repeatedly attached conditionalities to debt relief that are not necessarily connected to economic necessities.

At present, any cancellation is in the end based on generosity; there is no right to it. It is granted to some countries, not to others, for some types of debts, but nor for others. Reductions should, of course, be accepted if granted, because getting quickly rid of the debt overhang must have priority for debtor economies. But a new transparent method is needed, based on objective, transparent criteria, not on creditors' wishes. It must respect the very foundation of the rule of law that one must not be judge in one's own cause. Debt reduction must be available to any technically insolvent country.

Determining whether a country is technically insolvent is a thorny problem, which can be solved by emulating the solution found domestically. National laws give neutral entities the authority to determine whether a debtor's situation warrants starting formal procedures of debt reduction. Courts are disinterested actors, neither creditors nor debtor. Internationally, this must also be done by an independent body. My proposal of arbitration based on the United States Chapter 9 (municipal insolvency), also called FTAP (Fair and Transparent Arbitration Process) by many NGOs, would accommodate this demand (for details cf. Raffer, 1990, 2005a, 2005b). An ad hoc arbitration panel established by creditors and debtors, the usual way in international law, would have to either endorse or reject a debtor's demand immediately on being formed. It has to reject the debtor's demand if clearly unfounded, denying this debtor any advantage from starting the procedure. A neutral entity, not creditors, would and must decide – as demanded by the rule of law. Decisions must be taken in a transparent way. Allowing procedures to start would recognize that there is a need to discuss debt reduction. Debt sustainability, and thus the specific amount of debt reduction needed, or whether any reduction is needed, would emerge from the proceedings, like in the case of domestic debt reduction procedures.

Sustainability estimates based on all available information

The success of any debt reduction hinges on whether it is sufficient for a "fresh start". Granting too little might offer short-term comfort to creditors but does prolong the problem, creating damages to debtor economies. For decades, overly optimistic forecasts have inflicted damages on countries, rendering strategies based on such forecasts, especially debt reductions, useless. Overoptimism and lack of transparency have supported the policy of official creditors to grant insufficient reductions.

Attention was drawn to this undue optimism long ago. Suffice it to cite the United States General Accounting Office (GAO, 2000) assessing HIPC II on congressional request. Debt sustainability depended on annual export growth rates above 6 per cent in United States dollars over 20 years – in four cases even above 9 per cent. Understandably, the GAO doubted whether such rates could actually be maintained for that long. Like other creditor initiatives before, HIPC II was again built on fragile, overoptimistic assumptions and forecasts. With good reason, the Zedillo Report states that HIPC II has "in most cases" (Zedillo et al., 2001: 21) not gone far enough to reach sustainable debt levels, suggesting a "re-enhanced" HIPC III (*ibid.*: 54).

Meanwhile, IMF and IDA (2004: 13) declared:

> "Past experience suggesting a systematic tendency toward excessive optimism… a common theme behind the historical rise in low-income countries' debt ratios, was that borrowing decisions were predicated on growth projections that never materialized… analysis of projections made by fund staff over the period 1990–2001 suggests a bias toward over-optimism of about 1 percentage point a year in forecasts of low-income country real GDP growth. The bias in projecting GDP growth in U.S. dollar terms, however, was considerably larger, at almost 5 percentage points a year."

The document called for "well-disciplined projections, including by laying bare the assumptions on which they are predicated and by subjecting them to rigorous stress tests that explicitly incorporate the impact of exogenous shocks" (*ibid*.). These are very basic requirements of projections, not observed by IFIs so far according to the IMF's and IDA's opinion. The same happened in the

Commonwealth of Independent States: "overoptimism by multilaterals contributed to the high debt levels" (Helbling et al., 2004: 1). Suffice this to show how urgently change is needed. Although these biased estimates are severely at odds with acceptable standards of good governance, official creditors supported IFIs, allowing this kind of forecasting to go on for decades.

Allowing one (group of) creditor(s) to determine sustainability risks being unfair to other creditors, unless all creditors are to reduce by the same percentage. Only in this special case, no conflict of interest exists. Otherwise, lower sustainability levels (i.e. higher losses for discriminated creditors) protect the viability of preferred creditors, as discussed below. Therefore, even exempt creditors have an economic self-interest if they estimate sustainability. De facto preference granted to IFIs by powerful countries forces bilateral creditors and the private sector to bail out IFIs. The present way of determining sustainability has been particularly unfair to the private sector and debtors.

In my model, sustainability would not be determined by any creditor, but would emerge from a negotiation process, giving all those affected the possibility to defend their interests in a process chaired by an independent body. In addition to the parties, creditors and the debtor, the affected population would have a right to be heard, as in United States Chapter 9 cases. Having all facts on the table would practically restrict the panel's decisions to breaking deadlocks affecting minor sums. Unlike sustainability estimates in the past based on overoptimistic IFI-projections, results based on all relevant information would be much better and more sustainable. The private sector and the debtor would have more say in the final outcome, which is likely to improve results.

Creditor status: are IFIs legally preferred?

Although the status of preferred creditor is alien to the statutes of IFIs, the impression has been continuously created that multilateral claims are entitled to preferential treatment. This perception is completely unfounded. In granting reductions, the Paris Club has not demanded comparable multilateral reductions. However, such decisions by some creditors differ fundamentally from a legal right of being exempt, even though the private sector has usually acquiesced. There exists no legal obligation to grant such treatment.

Most multilateral development banks (MDBs) have a statutory obligation to grant relief. The IBRD's Articles of Agreement, for example, recognize default as a fact of life. Article IV, Section 4 speaks of a "relaxation of conditions of payment; modify the terms of amortization or extend the life of the loan". Article IV.6 demands a special reserve to cover what Article IV.7 calls "Methods of Meeting Liabilities of the Bank in Case of Defaults". Detailed rules on how to proceed follow. As the bank is only allowed to lend either to members or to other borrowers if member States fully guarantee repayment (Article III.4), the logical conclusion is that default of member States was definitely considered a possible, and maybe even an occasionally necessary, solution. The IBRD's founders understandably wanted lending to be subject to some market discipline, and designed mechanisms that would allow the bank to shoulder its fair share of the risks involved. By contrast, other creditors, especially in the private sector, have no similar obligation. Logically, this supports the view that MDBs are meant to grant relief well before others, that their statutes legally subordinate multilateral claims. Their task of fostering development would explain this decision of their founders.

Under pressure from private business, in 1993 the IBRD waived the negative pledge clause in its loans, which would have guaranteed that no creditor's claims could have preference over the bank's (Caufield, 1998: 323). If the IBRD had been *de jure* preferred, there would have been no need for such clause, indeed no point in waiving it, as legal norms always prevail. By waiving this right, the IBRD acknowledged that its claims should not be treated in the same way as private claims, but should be subordinated to them.

The Agreement Establishing the Inter-American Development Bank (IADB) provides for "Methods of Meeting Liabilities of the Bank in Case of Defaults" (Article VII, Section 3). Charges should first be made "against the special reserve provided for in Article III, Section 13", which is to meet the IADB's liabilities in the case of debtor default. The Agreement Establishing the Asian Development Bank similarly demands a special reserve to meet liabilities in the case of default (Article 17). Article 18 gives the detailed description of how to proceed (cf. Raffer, 2004a: 69). The case of the African Development Bank is slightly different. The first version of the agreement establishing it, dated 4 August 1963, is similar. Article 22 even foresaw reserves to cover special funds. The agreement's present version (after the last revision of July 2002) has recently become available on the AfDB's homepage. Article 20 (Special Reserve) was completely deleted, possibly in reaction to the bank's downgrading from triple-A by Standard and Poor's in the 1990s, and its reform. Article 21 still stipulates what should be done in the case of default by borrowers. Having to call capital early on rather than use reserves could be intended as a disciplining measure on borrowing members. Article 21 and the history of the statutes do not support the argument that unconditional full repayment is intended.

The European Bank for Reconstruction and Development writes off losses and submits to arbitration (also foreseen for the IBRD) – which proves that multilateral development banks, if properly managed, can survive financial accountability and market risk.

IDA's Articles of Agreement are somewhat vague. Pursuant to Article V.3, "Modifications of Terms of Financing," IDA may "agree to a relaxation or other modification of the terms on which any of its financing shall have been provided". In the case of maturities of 35, 40, or even 20 years with 10-year grace periods and "no interest charge" (IDA prefers to call its 0.75 per cent interest rate a service charge), this leaves few realistic alternatives other than outright reductions. IDA is a fund fed by periodic replenishments and reflows. Reducing reflows is immediately possible without endangering the fund. The argument that amortizations are needed to refill IDA, which would preclude debt relief, is no longer valid since IDA started to distribute grants. Like cancelled IDA debts, grants do not create reflows. If grant financing does not endanger the functioning of IDA, neither can debt relief. The common problem of debt relief persists, of course. Unless reductions are financed additionally, loanable funds decrease. Real lending capacity must be assessed on a "net base". Programme credits just granted to allow reflows "on time" must not be counted. Merely substituting (over)due credits by new ones, they do not constitute new resources. The additionality problem also exists with ODA. If debt reductions are covered by ODA budgets without making additional resources available, net ODA decreases. The recent G-8-decision at Gleneagles to cancel the debts of some countries vis-à-vis IDA and the African Development Fund (but not vis-à-vis their Inter-American equivalent) proves that debt reduction is possible in the case of such funds. The choice of countries and institutions once again highlights creditor arbitrariness.

The IMF knows that it enjoys no legal or contractual preferred creditor status, as can be read on its very own homepage (Boughton, 2001). Trying to find arguments in favour of preference after 1986, the IMF could not deny this fact (*ibid*.: 820). Its own executive directors emphasized a need to treat the IMF "in practice" preferentially – strictly legally, this is an irrelevant view to which anyone is, of course, entitled. The Interim Committee endorsed this view and "urged all members, *within the limits of their laws*, to treat the fund as a preferred creditor" (*ibid.*: 821, emphasis added). The qualification "within the limits of their laws" shows that even this IMF organ could not bring itself to demand unconditional preferred creditor status for the fund from its members. The committee accepted that national laws may forbid any such treatment.

A thorough analysis of IFI preference in international law was published by Rutsel (1990). Her conclusion is that "general international law contains no compulsory standard of conduct requiring the preferential treatment of any external creditor, including the Fund." (*ibid*.: 825) She goes on to argue that the IMF's Articles of Agreement "contained a provision suggesting that others would have preference on the Fund" (*ibid.*) before the Second Amendment. The author refers to Schedule B, paragraph 3 on the calculation of monetary reserves on which repurchase obligations were based. It can be argued that the exclusion of holdings "transferred or set aside for repayments of loans during the subsequent year" was done "to give preference in repayment to lenders other than the Fund." She argues that the intention of deleting this calculation and with it Schedule B, paragraph 3 from the statutes by the Second Amendment "was not to repudiate the underlying thought that it was beneficial to encourage bank lending by giving banks and others a preference in repayment" (*ibid*.: 814). Her conclusion is corroborated by the statutes of MDBs, as well as by the IMF's attempts to gain legal preferred creditor status via the SDRM.

Unfortunately, rather than clearly making the IMF financially accountable when conditionality was introduced, as economic reason would demand, initial intentions were blurred. Still, the IMF's statute contains "a presumption against a preferred creditor status" (*ibid*.: 814).

However, the IMF has no explicit statutory obligation to grant debt relief. By contrast, it may be argued that important multilateral development banks violate their own constitutions by not giving members in default relief as stipulated. This open breach of their statutes makes meaningful and sustainable solutions of overindebtedness more difficult, inflicting damages on borrowing members, as Krueger rightly remarked. The fact that some members' statutory rights have repeatedly been infringed is a problem unless one accepts a global system of legal double standards.

The argument in favour of preference is also based on economic grounds. Economically, however, there exist very good reasons not to prefer the public international sector. To save space, I refer for more detailed arguments to Raffer (1993, 2004a). There is the need to connect decisions and results, which forms the basis of any successful market economy.

IFIs strongly influence use of loans, exerting massive pressure on debtors – to the extent of provoking doubts whether countries "owned" their economic policies. They routinely take economic decisions but refuse to shoulder the risks directly connected with these decisions. IFIs insist on full repayment, even if damages are negligently caused by their staff, and must be paid by borrowers. A high rate of IFI failures therefore renders adjustment programmes necessary, administered by IFIs, just as failed programmes are likely to call for new programmes, as long as unconditional repayment to IFIs is upheld. This logical mechanism might be described somewhat cynically as "IFI flops securing IFI jobs" (Raffer, 1993: 158). It is at severest odds both with economic reason and with the role of jurisprudence as the *ars boni et aequi*. No protection granted by contract or tort law to anybody else applies to the poorest of the globe. Even willfully and unlawfully inflicted damage presently confers no right to compensation. In spite of official declarations on human rights and equality of human beings, there seems to be one law for the rich in OECD countries and another for the poor. This perverted incentive system is also a severe market imperfection, totally at odds with any market economy.

Arguably, no multilateral debt problem would exist if normal accountability, liability standards, and tort laws applied to Southern debtors. Only IFI clients have to pay for their consultants' negligence, which increases unpayable debts. The establishment of the IMF's Independent Evaluation Office and the IBRD's Inspection Panel is a commendable step in the right direction, but does not change the underlying problem. While officially recognizing fault, they do not provide real relief or economic redress. Simply thumbing through their internal publications provides many examples of unmet due diligence encouraged by the present, systemically perverted incentive system.

Continuous IFI overoptimism as one source of high debt levels was already mentioned. Suffice it to quote some of the Independent Evaluation Office's findings on Argentina. According to this official IMF organ, the September 2001 "programme was also based on policies that were either known to be counterproductive ... or that had proved to be ineffective and unsustainable everywhere they had been tried... [A]s expressed by FAD [Fiscal Affairs Department] at the time." (IMF-IEO, 2004: 91) The board supported "a programme that Directors viewed as deeply flawed" (*ibid*.: 81). The "September 2001 augmentation suffered from a number of weaknesses in programme design, which were evident at the time. If the debt were indeed unsustainable, as by then well recognized by IMF staff, the programme offered no solution to that problem." (*ibid*.: 89) The IMF not only "failed to use the best analytical tools" (*ibid*.: 109), but "Available analytical tools were not used to explore potential vulnerabilities in sufficient depth" (*ibid*.: 110). The IMF was again and repeatedly unduly "optimistic" in its forecasts, as this report documents. This is just a small choice from a limited part of the period evaluated for one single country. One cannot help but concur with the statement of the Argentine Governor: "Recognizing errors is, however, just the first step in a healthy self-criticism exercise. The second step is bearing responsibility for failures, namely sharing the burden of redressing their consequences" (*ibid*.: 119) IFI-statutes would allow if not encourage this.

The real costs of debt reductions

Concerning debt reductions, creditors routinely present costs that sound prohibitively large. Economically, though, these figures are untenable. One wonders how official creditors could have avoided knowing that most claims carried at nominal values in their books are only worth a fraction. The *Washington Post* (16 March 1999) reported that $3 billion of "forgiven" debt would actually mean "maximum budget cost" of $190 million (or 6.33 per cent of face value), as the rest had been "essentially written down or written off as incollectible." At the Cologne Summit, German Chancellor Schröder said in an interview that essentially debts were forgiven that could not have been collected anyway. I called these lost claims "phantom debts". They accumulate and exist only on paper – in the books of creditors. Economically, they are unreal because they are technically irrecoverable (cf. Raffer, 2002). They cannot be cashed. Unlike official creditors, the private sector appropriately takes economic values into account, both via secondary markets and by provisioning against losses. Caused by official creditors unwilling to grant needed reduction in time, phantom debts have been boosted to ever more unrealistic levels. Using economically irrelevant nominal values makes debt reduction to sustainable levels appear costlier and costlier on paper. However, as deleting phantom debts simply acknowledges facts, this does not really cost creditors a single cent. Money already lost cannot be lost again. Deleting phantom debts simply means putting an end to playing the Emperor's New Clothes, acknowledging the naked economic truth. It is "generosity for free". On the other hand, debtors get no real relief, as this part of their debts could not have been paid anyway.

The present practice of including phantom debts at face value when estimating the "costs" of debt reductions exaggerates real economic costs substantially, especially for Sub-Saharan Africa. Appropriate debt relief looks more expensive and difficult than it actually is. Minds more critical than mine might even argue that creditors equating nominal values and real costs are bailing out themselves rather than helping debtors. Secondary market prices – or estimates where no secondary markets exist – would be better and economically more appropriate.

Real costs of reductions to creditors are not the only issue in need of clarification. There also exists some confusion about the costs of debt relief and their effect on debtors. It has repeatedly been claimed that reductions would involve additional costs to debtors, in particular with regard to multilateral debts. Especially those debtors not in default would be burdened by paying for reductions granted to others. Economically and mathematically, this is wrong. Debtors have already paid the costs of multilateral debt reductions and financed loan loss reserves at the IMF and MDBs. IFIs have charged the costs of loan loss provisions to all their clients. This is a normal, economically sound and commendable business practice among lenders. Lenders routinely face a certain amount of losses – just as grocers must cope with the fact that some apples rot before they can be sold. Prices or fees charged to clients must include margins to cover such losses, since they are part and parcel of doing business. IFIs have charged such margins and built up reserves. The question of how high reserves one needs (which depends on how much relief is necessary to allow debtors a fresh start) may be legitimately discussed. However, the usually produced impression that debtors have not yet paid for their relief at all is wrong.

Precautionary balances, as loan loss reserves are called by IFIs eager to avoid this term, range from 13.9 per cent (of the IMF in April 2005) to over 30 per cent of credit outstanding (which the Asian Development Bank had already put aside as of the end of October 2003). This means that substantial chunks of losses have already been paid for by all borrowers as an insurance fee against default. Arguing that countries would have to start paying for reductions if they were granted reductions means economically demanding that debtors pay twice in order to get relief once.

Concluding remarks

This paper discussed some misperceptions prevalent in the discussion on sovereign debts in order to clarify these issues. It hopes to contribute to making debt management both economically more efficient and fair to all those affected by debt problems.

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Providing more information and transparency in debt management: the Burkina Faso experience

Lucien Marie Noël Bembamba

It is well known that today, public affairs management – especially public finance management – needs to be increasingly conducted according to certain standards. These standards are encompassed in the notion of good economic governance, the principles of which are:

- Transparency;
- Rigour;
- Integrity; and above all
- Accountability.

Applied to public debt management, these principles take on a special importance. Two points worth considering can be highlighted:

- Debt is a way of obtaining public resources and these resources must be obtained and managed in a way that conform to the rules of public financial management.
- Debt mortgages a nation's future. If ill-managed, it may mortgage a country's capacity to develop. A number of countries are today faced with a debt crisis due to the bad debt policies of the past.

All these considerations totally justify that the principles of good economic governance, especially transparency and the obligation to report, be fully applied to public debt management.

I am now going to share with you Burkina Faso's experience in this matter.

I will focus on three aspects:

(a) Transparency and information regarding public debt management within the framework of Burkina Faso's membership of an economic and monetary union;

(b) Transparency and information regarding public debt management within the national framework; and

(c) Inadequacies and perspectives for improvement.

I. Monetary and economic union

Burkina Faso is a French-speaking country in Western Africa. It belongs to the West African Economic and Monetary Union, which today has eight member States: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.

I would like to highlight two main characteristics of this Union.

(a) **Monetary union:** We have a common currency, a common central bank and a common monetary policy. The current rules in this union impose rigour and discipline regarding anything that could affect currency value, monetary reserves, inflation and so forth. In particular, public borrowing, by the central bank and by the banking sector in general, is strictly controlled and regularized. Furthermore, direct lending from the Central Bank to the State has been suspended for several years.

(b) **Economic Union:** We are currently involved in a process of economic integration, which focuses on the common market and emphasizes the convergence of policies and economic performance.

In this context, we have a multilateral surveillance mechanism based upon convergence criteria. Among the criteria are domestic as well as external debt indicators. Each semester, an evaluation is done and the results are made public.

To sum up this first part, the fact that Burkina Faso belongs to an economic and monetary union submits it to rules regarding discipline, transparency and information in certain areas, one of which is public debt management.

II. Measures at the national level

I will deal with this aspect in two parts: transparency and information.

A. Transparency

As with the majority of countries, we have seen in the past inadequacies in initiatives, in actions and in the management of debt. This has led to an indebtedness that didn't give proper attention to borrowing risks in terms of sustainability, profitability and productivity, notably in terms of resource allocation.

As such, in 1995, we introduced a borrowing strategy that includes an institutional and regulatory framework in order to better coordinate debt management.

The institutional framework is based on two main provisions:

(a) Only the Ministry of Finance is now able to financially commit the State. In the past, any ministry could borrow;

(b) The establishment of an auditing body that supervises all borrowing contracted by the State, its sub-entities and by all state enterprises. This body is called the Public Debt National Committee. Its opinion is required before any borrowing. Its opinion is based on, notably:

  (i) The conformity of a project and the reason for borrowing in terms of general policy objectives and also in terms of the relevant sector policy of the relevant ministry;

  (ii) Financial conditions, concessionality; and

  (iii) The impact of new borrowing on the debt profile in terms of debt sustainability ratios. (Since obtaining HIPC completion point).

Apart from this institutional framework, we have better regulated the indebtedness process regarding the role and responsibilities of the different actors involved.

As to debt management, we have a public debt office, the organization and functioning of which have been described in written documents and a procedures manual, with the computerized support of DMFAS and Debt Pro.

Hence, we have put in place an institutional and regulatory framework as well as procedures in order to ensure better transparency in the management of public debt.

B. Information

As mentioned before, good economic governance principally implies the obligation to report. The main beneficiaries of this information are:

- Authorities and institutions (Government, parliament and judiciary authorities, especially the Audit Office);
- Technical and financial partners (creditors and sponsors);
- The general public (citizens); and
- Financial markets.

I would like to highlight different forms of information:

- Official publications: Those that are required by law and which deal with general statistics (outstanding debt, debt service, structure) as well as activity reports on the structures involved in public debt management (Public Debt National Committee, Public Debt Office). These are addressed to Government and are then published. The content varies and covers aspects such as debt analysis.
- Other publication forms: These include the websites for the Ministry of Finance (www.finances.gov.bf) and the Public Treasury (www.tresor.bf), and publications regarding public offerings.

III. Improvement perspectives

With the current debt situation, it is necessary for us to improve transparency and communication. In this context, the following main points need to be addressed:

- The adoption of a framework dealing with the organization of resource mobilization, which deals with two main areas of concern: Parliament's involvement and what provides a consensus on the objective of debt management;
- A strengthening of the monitoring and control of the structures involved in debt management, the objective being to ensure that activities are in conformity with the objectives set;
- Integration of all external financing into the national budgetary process, including the elaboration, implementation and monitoring phases of projects, the principle difficulty being that, as of today, we have difficulty in fol-

lowing the implementation of externally financed projects in terms of national budgetary procedures (The main obstacle is the availability of reliable and detailed information from the actors involved.);

- Redefine and clarify the role of actors;
- Efforts by partners and creditors to provide information; and
- Credit rating.

Conclusion

Debt is a hot issue and concerns not only specialists. As such, it is necessary to further improve good governance in this field, in order to make States more transparent and especially more accountable to the general public.

Part 8

Additional debt relief

Summary of panel discussion

Moderator: Mr. Vikram Nehru, Director, Economic Policy and Debt Department, World Bank

Panelists: Ms. Eulalia Ortiz Aguilar, Advisor to the Ministry of Economy, Spain
Mr. Joseph Thornton, Head, HIPC and Sustainable Financing Branch, International Poverty Reduction Team, United Kingdom Treasury
Ms. Gail Hurley, Policy and Advocacy Officer, European Network on Debt and Development (EURODAD)

Mr. Thornton outlined the details of the latest G-8 proposal for debt relief and referred to the G-8 finance minister meeting in June 2005. He said it was hoped to reach a formal agreement at the World Bank and IMF annual meetings in September 2005. He said that the proposed relief would be provided to HIPCs that passed the completion point (currently 18 countries) and would cancel 100 per cent of their debt owed to the IDA, African Development Fund (AfDF), and IMF. Additional donor contributions, he said, would then be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems, but without new conditionnalities. Donors would be asked to provide additional resources to replace foregone reflows to IDA and AfDF. Foregone reflows to the IMF, he added, should be financed through the IMF's internal resources, and only when necessary would additional resources be provided by the donors. Non-HIPCs, he said, would also receive some aid on a bilateral basis. He added, however, that some costs would be hard to foresee, for example, as new countries qualify under the HIPC initiative. He went on to say that even 100 per cent relief is not enough and that debt relief per se cannot ensure debt sustainability. New financing for HIPCs should increasingly come from grants rather than loans. The new G-8 proposal for debt relief, he said, still needs to be discussed in detail by the boards of the concerned institutions and their final decisions will define the exact implementation procedures of the relief. Mr. Thornton said that not all multilateral creditors had been involved in the new proposal, only those having the biggest claims in the countries most affected by the debt problem. However, additional relief provided by other multilateral institutions was also welcome. He stressed that the IMF's solvency should not be endangered in any way by the proposal, and that it was important that no cap be placed on new financing from IDA and the AfDF. In addition, he said, a new trust fund would be created to support poor countries facing external shocks. The G-8 also called on other countries, including oil-producing states, to contribute to this new trust fund.

Ms. Aguilar expressed the views of Spain on multilateral debt relief and said that Spain was one of the biggest contributors to the HIPC initiative, which she praised as giving positive results. She also said that Spain was engaged in systematic bilateral additional debt relief on a voluntary basis. Regarding the merits of the recent G-8 proposal on debt relief, she said that the relief should be used to free up resources that could be used for poverty reduction. Debt relief, she added, should not be seen as a panacea but must be part of a global strategy of development both by the donors and by the beneficiaries. The details of the recent debt relief proposal were yet to be defined, but Spain would support the initiative, and contribute its fair share.

Ms. Hurley pointed to the advantages and limitations of the new debt relief that had recently been granted to the 18 HIPC countries having passed the HIPC completion point. She said that it was necessary to combat any "spin" of the 100 per cent debt cancellation by G-8 Governments because the proposed plan excluded many countries that needed debt cancellation from achieving the Millennium Development Goals by 2015. The list of HIPC countries was an arbitrary list drawn up by creditors, which left many other poor equally deserving countries squarely excluded, including Haiti and Kenya, for example. It also did not cover debts owed to many other creditors, such as the Inter-American Development Bank (IADB). She gave Honduras as an example, which owed 40 per cent of its external debt to that institution. She said that there should be a push for all multilateral, bilateral and commercial creditors to participate in debt relief and that powerful countries need to exercise pressure on those who did not participate. In addition, she said, the recent relief decision was paradoxical because, while it was only applicable to HIPC countries, creditors were admitting that the HIPC Debt Initiative did not solve the debt problem in the first place. Furthermore, Ms. Hurley objected to the idea of performance-based conditionalities, such as the Country Policy and Institutional Assessment (CPIA), which were being placed on new financing because they allowed creditors to exercise domination over “policy space” in debtor nations, and did not respect the sovereignty of the countries involved. She said that relations with poor countries should be centred on solidarity rather than conditionalities, and that there should be a shared responsibility between creditors and debtors, with both taking responsibility for bad loans. Debt relief should not be considered as an act of charity but rather as an act of justice, she added. The recent debt relief as well as the HIPC Initiative, she said, does not address the fundamental power imbalances prevailing between creditor and debtor nations, and therefore cannot solve the debt crisis in the long term.

Devilish details: implications of the G-7 debt deal

Gail Hurley

Executive summary

This weekend's debt deal by G-7 finance ministers received massive media coverage in the South and North alike. The determined efforts of debt campaigners around the globe undoubtedly pressured Northern Governments and the IFIs to look seriously at the debt issue. It is because of us that Governments and officials were forced to recognize that existing debt relief initiatives were wholly insufficient and that a new deal had to be struck. While the final deal had some better features than had been expected recently, campaigners need to be very clear about what this deal actually represents and its serious limitations. There is broad agreement among civil society organizations that the deal does not go nearly as far as the overblown rhetoric that accompanied its release. In addition, it has some worrying strings attached.

On the positive side, the final deal does include IMF debts and does offer permanent debt stock cancellation. There is also an indication that the country list may grow from its current very limited number.

The deal as presented by G-7 finance ministers last weekend covers 18 countries, i.e. those that have reached "completion point" under the HIPC initiative. A further nine countries – currently at the HIPC "decision point" – could become eligible for this deal over the next couple of years. Other countries could also conceivably be included, since work is reportedly under way on an expanded list of HIPCs. See the annex for the full HIPC listing with countries' status under the initiative.

Of the 18 countries covered, the proposed deal is not nearly as generous as G-7 finance ministers would have us believe. If we take the text of the ambiguous and vague communiqué at face value, the 18 countries involved will receive dollar for dollar reduced aid from the International Development Association (IDA). To receive new IDA flows, they will then have to comply with controversial World Bank and IMF conditions and policy performance criteria. In addition, the G-7 statement implies that a new layer of anti-corruption/good governance conditions may be added.

In sum, the deal does not represent the "historic breakthrough" claimed by United Kingdom Chancellor Gordon Brown or "the most comprehensive statement that finance ministers have ever made on the issues of debt, development, health and poverty". A coalition of United Kingdom NGOs has calculated that, rather than the announced "100 per cent debt cancellation" deal, it is in fact a 10 per cent deal. In addition, these figures only cover low-income countries. There has been no mention at all by policymakers of the debt distress faced by any middle-income countries. There remains much to be done to ensure campaigners; the broader public is not misled and that the debt campaign goes on.

In this briefing, EURODAD outlines some of the key areas of concern on:

- Country lists;
- Conditionality;
- Extra money to spend;
- Which debts are included;
- 100 per cent debt cancellation rhetoric; and
- Inequality in debtor-creditor relations.

We also include some key facts and statistics on the debt deal. The briefing is intended to assist civil society colleagues to understand better the details of the deal, what it will mean for the countries involved (and excluded), and how it will be implemented in practice. This will help us with our continued advocacy on the debt issue in the coming weeks and months. This advocacy will be essential: at this point, the deal remains a G-7 proposal only. It will have to pass two further stages before it can be implemented.

Firstly, the proposal will need to be presented to the governance structures of the World Bank and IMF before it can become policy. In the communiqué, G-7 finance ministers propose that the boards of the IMF and World Bank look at these proposals at the forthcoming annual meetings of these two institutions. Secondly, IDA donors beyond the G-7 will need to agree to put extra resources into this deal to cover the cost of the cancelled debt to IDA.

There is therefore still time to push for a much better deal – and indeed the deal as proposed by the G-7 could change shape over coming months as it passes through these two further phases of negotiation

Table 3. Not 100 per cent debt cancellation: key facts

Issue	Fact
Number of Southern countries covered	Only 18 countries are covered, potentially rising to 27 over the next two years. There are many more low-income and middle-income countries that need partial or 100 per cent debt cancellation.
On average, the 18 eligible countries will save $1 billion in debt service each year over the next 10 years	**This deal therefore cancels only 10 per cent of the debts that need to be cancelled.** The 62 countries that need 100 per cent debt cancellation to achieve the Millennium Development Goals by 2015 pay over $10 billion in debt service to the multilaterals per year.[5]
Claim of "$40 billion cancellation" deal	The deal is worth $40 billion in nominal terms, but will be delivered over a 40-year time period. The net present value of the deal is $17 billion.
Net gain for poor countries	Countries will receive a **dollar for dollar reduction in IDA flows equivalent to the amount cancelled.** They will then receive new money based on policy performance. This reinforces harmful World Bank/IMF conditionality and for poor performers will result in no net gain from this deal.
Rich countries cancelled $30 billion in debt owed by Iraq in 2004	This was more in one day than has been delivered to the whole of the African continent over the last 10 years.

Not 100 per cent: many countries excluded

The deal is based on the list of HIPCs as drawn up by creditors in 1996 on a flimsy analytical basis and in a way that deliberately excluded some key countries. This leaves many countries (such as Angola, Haiti, Kenya, Kyrgyzstan, Viet Nam, etc.) squarely excluded. Some commentators believe therefore that for non-included countries, debt relief remains as elusive as ever since creditors will point to the extraordinary efforts they have undertaken for the chosen few.

Work is reportedly underway within the World Bank on an expanded country list of HIPCs with Eritrea, Haiti and Tajikistan potential future candidates for HIPC status. Should these countries also become HIPCs, they could also become eligible for this deal after on average six years of implementing bank and fund conditions.

Not 100 per cent: many debts excluded

The deal includes debts to three multilateral institutions only: the IMF, World Bank and AfDB. Ghana, for example, has debts to nine multilateral organizations. Five Latin American countries owe the IADB over $3.3 billion in debt service payments over the next 10 years. Debts to the Caribbean Development Bank are also excluded by this deal. This means that these Latin American countries will continue to accumulate (and service) debt with these two institutions, and in the case of the Caribbean Development Bank, loans are on much less concessional terms.

[5] In the Balance, May 2005. A joint briefing paper by Jubilee Debt Campaign, ActionAid and Christian Aid, setting out why debts must be cancelled now to meet the Millennium Development Goals: http://www.jubileedebtcampaign.org.uk/?lid=659.

All in all, there are 19 multilateral creditors, many of whom have not even cooperated in the HIPC initiative. There may be even less incentive now to do so, given that 18 debtors will have improved solvency positions. Upcoming meetings of the multilateral development banks will provide key advocacy opportunities for campaigners.

Private sector debts are also not considered, yet these debts remain a key concern for many middle-income countries, many of which are also in debt difficulties. Yet the continued approach of the G-7 has been to focus on the limited (and arbitrary) HIPC country list.

Nevertheless, it is significant that IMF debts have been included in the deal. IMF debt is extremely onerous: for HIPCs, debt service to the IMF over the next five years constitutes half of all debt service obligations to the main multilateral institutions.

IMF debt cancellation will not, however, be financed via gold sales, as campaigners had hoped, but via resources generated by the 1999 sale-buyback agreement combined with additional bilateral contributions. This compromise leaves many campaigners disappointed, since the IMF's vast undervalued gold resources will remain idle rather than put to productive use (undervalued by approximately $35 billion). It is also dependent on donors contributing more cash to cover the costs of IMF debt cancellation, as well as an expanded country list: will they necessarily want to do that?

Table 4. Who can expect what? Some country examples (millions of dollars)[6]

Country	Debt Service after full HIPC relief in 2006	Debt Service to World Bank/IMF/ AfDB	Reduced debt service	% Relief	New debt service ratio	Internal debt service ($ equivalent)
Niger	30.9	17.4	13.5	56%	1.9%	n.a.
Zambia	86.3	32.4	53.9	38%	3.0%	70
Bolivia	344.6	83.0	261.6	24%	10.5%	515
Ethiopia	54.3	15.9	38.4	29%	8.6%	n.a.

Controversial conditions

Because this deal extends to HIPC "completion point" countries only, controversial World Bank and IMF conditions remain firmly in place. This situation is clearly worse for the countries that have not yet reached "completion point" and are still struggling to implement the conditions needed to reach this point. The good thing about the deal is that it provides out and out debt stock reduction (rather than rich coun try Governments paying the debt service on behalf of countries every year). Once granted, debt cancellation is irreversible and means that Southern Governments can potentially stop having to implement so much conditionality. However, if they want to get future financing from the World Bank and IMF, these Governments will have to again submit themselves to bank/fund conditions.

[6] Table from Erlassjahr.de: http://www.erlassjahr.de.

In the communiqué, G-7 finance ministers also place a lot of emphasis on “good governance, accountability and transparency”, which are portrayed as “crucial to releasing the benefits of the debt cancellation”[7] Again, many campaigners will be seriously concerned at what may be viewed as apparent moves to strengthen conditionality and the controversial CPIA. CSOs need to monitor this actively, including rumoured new World Bank transparency conditions. Many NGOs have pointed out in the past that the boundaries between so-called “good governance” conditions and “economic policy conditions” is often quite hard to draw, with policy reforms such as privatization sometimes being promoted on an anti-corruption basis.

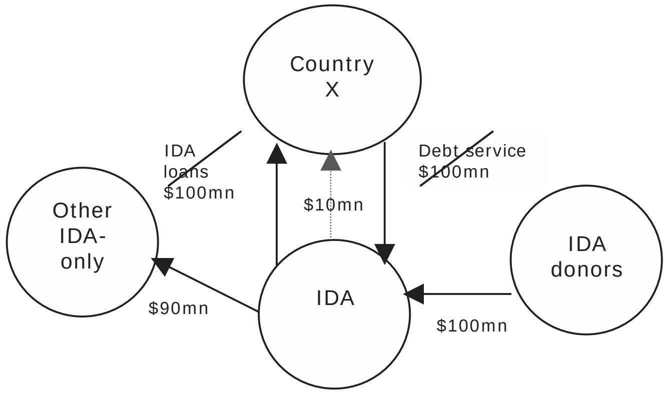
How much will countries benefit?

An impression has been given that African Governments will instantly have more money to spend on development. However, while the 18 eligible countries will indeed receive 100 per cent debt stock cancellation, this will be accompanied by a corresponding dollar for dollar reduction in gross assistance flows. The G-7 communiqué reads: “For IDA and AfDF debt, 100 per cent debt stock cancellation will be delivered by relieving post–completion point HIPCs that are on track with their programmes of repayment obligations and adjusting their gross assistance flows by the amount forgiven”.

Donors will then take the amount forgiven and put it into IDA as a whole. This amount will then be redistributed across all IDA-only countries according to the current Performance Based Allocation system, which in turn is based on the controversial CPIA (Country Policy and Institutional Assessment). Put simply, it reinforces conditionality and the CPIA.

For example, if country X currently pays $100 million per year in debt service to IDA and AfDB, this will stop. In return, IDA allocations to country X will be slashed by the same amount, i.e. $100 million. This $100 million will then be paid into IDA as a whole and redistributed across the 66 IDA-only countries on the basis of supposed “good” policy performance as determined by the CPIA. Country X may still receive new grants but this is extremely unlikely to be as much as the $100 million it lost out on. In addition, for countries with a very low CPIA score, the net increase in resource flows from this deal will of course be zero. Figure 2 below illustrates how the proposed mechanism will work.

Figure 2. Example of debt relief mechanism



On a positive note, it does mean that non-HIPCs will have access to these new resources but for many HIPCs, there will be very limited increases in their net transfers. And let’s not forget that this debt cancellation will be paid for out of aid budgets, rather than over and above aid budgets.

Who’s in charge?

Commentators have been quick to point out that this deal does nothing to address fundamental power imbalances in the international debt architecture. Charles Mutasa of African Forum and Network on Debt and Development (AFRODAD) concludes, “The agreement does not address the real global power imbalances. We reiterate our position that the debt crisis needs a lasting solution in which all stakeholders – debtors and creditors – have a say”. Any agreement must therefore be evaluated in relation to whether steps have been made to place debtors and creditors on an equal footing. Here this deal fails. It makes no mention of the underlying mechanisms that perpetuate the debt-poverty trap and does not acknowledge any creditor co-responsibility in the accumulation of unsustainable and in many cases odious debts.

The African NGO Statement on Debt stresses “Creditor nations and the International Financial Institutions (IFIs) need to acknowledge publicly the roles they played in exacerbating indebtedness in poor countries”. It goes on

[7] The full G-7 Finance Ministers’ communiqué text is available at: http://www.hm-treasury.gov.uk/ otherhmtsites/ g7/news/ conclsions_on_ development_110605.cfm.

to say, "Cancelling Africa's debt should, however, not be seen in isolation from the broader objective of putting the continent on the path to sustainable growth and development through the creation of a level playing field in the area of global trade. The failure to link Africa's debt crisis to the impact of the predominantly hostile global trading environment under which it has to operate has in most cases resulted in piecemeal measures that end up dealing with the symptoms of the problems and not the causes." For the full statement, coordinated by AFRODAD, see: http://www.eurodad.org/articles/default.aspx?id=611.

Key concerns and next steps

This deal is a step in the right direction, but serious concerns clearly remain. Most importantly, this proposal will not solve the debt crisis.

NGOs cannot therefore simply abandon campaigning on the debt issue in the run-up to the G-8 Summit. This would be a mistake. It would also send out the wrong message to Governments, the media and the public alike. There are still major questions unresolved on:

- Country lists;
- Conditionality;
- Extra money to spend;
- Which debts are included;
- 100 per cent debt cancellation rhetoric; and
- Inequality in debtor-creditor relations.

This deal does not meet civil society demands as outlined in declarations such as the GCAP Johannesburg Declaration, the African NGO Statement on Debt and the South-North Working Group Statement on Debt.[8] CSOs therefore need to complain very vocally about the misleading sale of this deal and ensure that the media, public and other civil society groups are not taken in. We need to continue to push to broaden this deal much further, but also monitor very closely its implementation to see what this deal really will mean for different countries.

For any questions, suggestions or for further clarifications and updates, contact Gail Hurley at ghurley@eurodad.org.

With kind thanks to the following people for their suggestions and comments:

- Alex Wilks, EURODAD;
- Romilly Greenhill, Action Aid;
- Erlassjahr.de; and
- South-North debt working group.

[8] See: http://www.eurodad.org for these statements.

Annex

HIPC countries and status under initiative

The HIPC initiative currently identifies 38 countries (32 of them in Sub-Saharan Africa) as potentially eligible for HIPC initiative debt relief		
Completion point countries (18)	**Decision point countries (9)**	**Not yet at decision point (11)**
Benin	Cameroon	Burundi
Bolivia	Chad	Central African Republic
Burkina Faso	Democratic Republic of the Congo	Comoros
Ethiopia	Gambia	Republic of Congo
Ghana	Guinea	Côte d’Ivoire
Guyana	Guinea-Bissau	Lao People’s Democratic Republic
Honduras	Malawi	Liberia
Madagascar	Sao Tome and Principe	Myanmar
Mali	Sierra Leone	Somalia
Mauritania		Sudan
Mozambique		Togo
Nicaragua		
Niger		
Rwanda		
Senegal		
Uganda		
United Republic of Tanzania		
Zambia		

Part 9

The multi-stakeholder consultation on

“Sovereign debt for sustained development”

The multi-stakeholder consultation on "Sovereign debt for sustained development"

Background

One unique aspect of the Fifth Inter-regional Debt Management Conference was that it incorporated two series of discussions in a small, informal roundtable format that allowed for a more intensive give and take than in the large plenary sessions. These discussions, which took place in the morning and afternoon of 21 June 2005, were divided into one series that addressed issues of primary concern to low-income countries and a second series that took up issues facing Governments that access international private funds for sovereign borrowing.

These discussions marked the conclusion of a set of multi-stakeholder consultations on debt that began with a meeting in New York on 7–8 March 2005, mainly addressing concerns of middle-income countries, followed by a meeting in Maputo, Mozambique on 15–16 March 2005 focused on concerns of low-income countries (the latter organized jointly with the Commonwealth secretariat). These meetings had been planned by an inter-agency team comprising UN-DESA and UNCTAD from the United Nations, the International Monetary Fund (IMF) and the World Bank. Detailed reports on each of the consultations and specially prepared background material were carried on the Financing for Development webpage (see www.un.org/esa/ffd), and were summarized by the secretariat in a report to the United Nations General Assembly.[9] While the topic of sovereign debt for sustained development was only one of five sets of multi-stakeholder discussions that had been organized in 2004–2005, the General Assembly singled it out in its draft resolution A/C.2/60/L.51 on "External debt crisis and development", wherein it took note "of the contribution provided by the multi-stakeholder dialogues on sovereign debt organized by the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat" (paragraph 25).

The intention in organizing the roundtable discussions was to encourage an uninhibited exchange. The strategy to bring that about began with asking participants to spend the first day of the conference (20 June) and part of the morning of the second day in the plenary, in an essentially passive mode, listening to panel presentations on key policy issues (those presentations are reflected in other chapters of these Proceedings). The second aspect of the strategy was to bring together people from Governments, international organizations, private financial institutions and civil society, some of whom address each other in the normal course of their work, but few of whom rarely if ever sit together with so many diverse stakeholders at the same table. Thirdly, to encourage a frank exchange, the discussions were held under the "Chatham House Rule", that is, participants were made to understand that while they could use the discussions as background in their subsequent work, none of them were to publicly identify the views expressed by any of the participants, all of whom in any case were to speak in their personal capacities. Participants were free to raise any issue of concern to them. However, the Financing for Development Office tried to help focus the discussion and avoid duplicating what had been said in earlier roundtables – which had been rich but did not warrant repeating – by offering a set of questions about possible next steps after the consultations, based on the discussions in those earlier meetings (see the annex to this chapter).

About 50 individuals participated in the roundtables. The secretariat selected individuals from among the participants to moderate the different discussions. On the last day of the conference, the moderators, assisted by a team drawn from the staff of UNCTAD and UN-DESA, reported back to the plenary on the discussions, as outlined in the following summaries.

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[9] United Nations. Follow-up to and implementation of the outcome of the International Conference on Financing for Development. Addendum. Multi-stakeholder consultations on financing for development. Report of the Secretary-General (A/60/289/Add.1).

Roundtable 1: Issues of primary concern to low-income countries

Mr. Geoffrey Mwau, Senior Advisor in the Office of the Executive Director for Africa Group I, World Bank, moderated the roundtable on issues of primary concern to low-income countries. Nineteen participants from Governments, international organizations and NGOs contributed to the discussion. It focused on issues underlying the first three questions posed for discussion by the secretariat, as well as an additional issue raised by an official participant who was concerned about misclassification of a country for aid and debt-relief purposes and its consequences.

Additional debt relief and future financial assistance

Shortly before the conference, the finance ministers of the Group of 8 (G-8) proposed that the international community write off the remaining debt that 18 HIPCs still owed to three multilateral institutions: IMF, the World Bank and AfDB. The 18 countries had reached the "completion point" in the debt relief programme of the HIPC initiative. The new proposal thus embodied an acknowledgement that countries exiting from the HIPC programme required additional debt relief to help them attain the Millennium Development Goals by the internationally agreed target date of 2015. Moreover, the proposal was not to be limited to the 18 countries, but would be available as well to additional HIPCs when they also attained their "completion point". There was thus considerable interest in understanding the new proposal.

Some of the participants in the roundtable who had been closer to the analytical work underlying the proposal than others shared their understanding regarding eligibility criteria for the new initiative, how it would work, and implications for new external financing for countries granted the additional relief. The latter question received the most attention. At the heart of the discussion was the debt-sustainability assessments for low-income countries that IMF and the World Bank jointly prepare, which are used to determine how much assistance – from IDA of the World Bank, in the first instance – should be accorded in the form of grants and how much as loans. New assessments would have to be made for countries receiving the additional relief. It was said that countries judged to have the capacity to start borrowing again after the additional relief would be "eased into new borrowing" over time.

This was apparently not the view, however, of all the G-8 member countries. It was said that some G-8 countries would like to end the "lend and forgive" cycle for poor countries, and would like to see the new financing for low-income countries in the form of grants only. This point would have to be settled by policymakers. Some technical aspects of the initiative also needed to be determined, such as the cut-off date of loans eligible to be written off (e.g. whether relief would be extended only on loans that had been fully disbursed, or whether loan commitments would be included on which some drawdown had begun, and so on). Moreover, a number of participants noted that while the initiative included relief from debt servicing owed to the AfDB, it did not cover and should be extended to comparable relief from obligations that non-African HIPCs have to their regional development banks.

In any event, the executive boards of the participating institutions still had to determine how to fund the relief. That is, the now-standard practice is that some arrangement is made to cover the obligations being forgiven. In previous forgiveness exercises on multilateral debt, earnings on capital gains from revaluation of IMF gold, donor contributions and profits from World Bank operations have been used. Policymakers were to work on that issue in the ensuing months. However, one participant claimed that, according to its Articles of Agreement, the World Bank at least did not have to receive payment from an alternative source in lieu of the debtor's repayment and instead could decide to "relax and modify" the repayment terms of the loans. But another participant noted that whether or not this pertained to the bank's standard loans, usually denoted as those of the International Bank for Reconstruction and Development (IBRD), it would not apply to IDA loans, which are the ones at issue in this instance, as IDA is a trust operated by the bank for the donors.[10]

[10] However, it might be relevant to the IBRD loans at issue in the alleged case of mistaken country classification noted below.

There was considerable discussion of another question that had concerned several participants, which was how multilateral assistance would be allocated in the post-HIPC era. As regards the allocation of IDA resources to individual low-income countries, the answer was that they would be governed as before by the World Bank's Performance-Based Allocation System, which seeks to take account of both the needs of each country and its ability to use the IDA resources effectively, as judged by the bank staff. The World Bank uses GDP per capita as a proxy for needs, and its CPIA index serves as a proxy for the effectiveness of resource use. Once each country's IDA allocation is determined, the bank/fund DSA is brought into the picture to determine how much of the IDA allocation should be provided as grants instead of as concessional loans. Thus, the grant-loan split is determined independently of the size of the country's IDA allocation.

Debt sustainability

While the discussion in this roundtable focused on low-income countries, those countries share with middle-income countries being subject to analyses undertaken by IMF under its Debt Sustainability Framework (DSF) as part of the annual IMF "Article IV" consultations with member countries. Several speakers highlighted the importance that all relevant parties participate in the evolution of the DSF, in particular developing countries, and in its implementation at the country level. This pointed to a general imperative for capacity-building in these countries so that they could locally prepare their own scenarios of alternative futures and their implications for debt burdens under the DSF as a basis for discussion with the multilateral institutions, let alone for domestic policymaking. There was broad support for enhancing the capacity of countries to conduct their own analysis, as evidence was cited that the quality of the DSA is better in countries that are able to prepare their own economic and financial simulations.

In addition to the need for capacity-building, some participants saw a lack of clarity in what approach to take in assessing debt sustainability. This concern had been underlined by the G-8 proposal to deepen relief for countries that were supposed to have been placed in a "sustainable" situation at the completion point of their HIPC programme and yet needed additional relief so they might have a better chance to reach the Millennium Development Goals. The word "sustainable" was evidently being reinterpreted by the G-8.

Regarding the determinants of debt sustainability, studies were cited that showed that had the HIPCs been able to achieve GDP growth equivalent to the average growth of low-income countries, their debt burdens would not have become unsustainable (no judgment was offered as to why economic growth of these countries was relatively low). A related point was raised concerning the relation between government expenditure and growth, which has gathered increased importance now that additional public resources are to be freed by the G-8 proposal for the HIPCs. It was stressed that the allocation of public resources should be more carefully examined, and that a thorough analysis is needed for selection of publicly financed projects, which should be undertaken in an efficient and transparent decision-making process so the best projects would be selected and financed.

In response to the secretariat's first question addressed to this roundtable (see annex), some participants advocated research-oriented seminars at this point rather than additional multi-stakeholder consultations on debt sustainability. Indeed, both UNCTAD and UNDP had recently embarked on organizing such activities, including multi-stakeholder consultations at the national level. However, a participant from a developing country Government called for continuing to bring together Governments, civil society, multilateral institutions and donor Governments to work on these issues. Her concern that there was too much confusion regarding debt relief and sustainability was echoed by another developing–country government participant, who avowed that each stakeholder has his or her own concept of sustainability, and it was necessary to get more clarity. Another official participant emphasized that the Bretton Woods institutions hold many seminars and that something deeper than a seminar was needed. It was further argued that when civil society "pushes back" with their analyses of country situations and critiques of proposed principles for the international community to apply, as on debt sustainability, the international financial institutions become more careful in their own analytical work.

Paris Club and debt workout mechanisms

On the question of the functioning of the Paris Club, it was pointed out that it worked closely with IMF, and that a fund programme was a prerequisite for Paris Club negotiations. However, the Paris Club did not add more conditionality than that already agreed to under a fund programme, with one exception: a few countries include human rights questions in bilateral agreements to implement a Paris Club "agreed minute". For a country to obtain a Paris Club agreement, it is also necessary to have a good track record of cooperation with its creditors. On the secretariat's question about a proposal to deal with liquidity problems with more multilateral resources and to apply debt reduction only when addressing solvency problems, the broad view was that, in practice, distinguishing between the two is often difficult.

It was argued that the Paris Club was relatively efficient as a negotiating forum to decide debt relief compared to the time needed for a country to negotiate with its commercial bank creditors in a London Club arrangement. This notwithstanding, Paris Club agreements do not bind non–Paris Club official creditors and debt-crisis countries often experience long delays when trying to deal with unpayable debts owed to this group of creditors. Participants generally agreed that the comparability of treatment of private and official creditors in a debt workout was a sound principle, but, as one participant pointed out, there are currently no international structures to ensure that Paris Club and non–Paris Club creditors actually give comparable treatment.

A structure such as the IMF-proposed Sovereign Debt Restructuring Mechanism might have been a step in that direction; however, the proposal did not win enough support for discussion of it to continue at IMF. A number of other proposals have been put forward by international organizations and civil society. One such idea mentioned in the roundtable was to explore developing a mechanism modeled on Chapter 9 of the bankruptcy law of the United States, which applies to municipalities.

Responding to another question put by the secretariat, various participants proposed that issues related to the Paris Club be addressed within the existing international framework, and that there is no need to create a new multi-stakeholder working group to deal with this topic. Participants saw that the Paris Club has evolved over the years, and that it is a more transparent institution than it was 10 years ago. It was pointed out that, in the last few years, UNCTAD and the Paris Club secretariat engaged in joint training seminars for debtor countries, a practice that could not have been envisaged a decade ago.

South-South debt question

Participants broadly agreed that, while there was a problem of South-South debt, it was not of such magnitude as to justify the creation of a multi-stakeholder working group to consider it. Nevertheless, it was stressed that the coordination of creditors is an important issue, as uncoordinated lending at concessional and commercial interest rates might result in renewed debt sustainability problems in a number of post-HIPCs. It was emphasized that a number of international organizations are concerned by such practices, and that efforts are being made to improve coordination among creditors.

Some participants claimed that debtor country Governments have not exhibited a similar level of collaboration so far. Nevertheless, cross-border cooperation among civil society organizations in debtor countries appeared to function well, in the sense that there were a number of examples in which NGOs created a common position on debt issues for a whole region. It was suggested that more effective cooperation among Governments could strengthen their position in the international financial system.

Who pays for errors?

Discussants agreed not to deliberate on the last two questions on the secretariat's list. Rather, they devoted considerable attention to a problem that was by a participant said to have arisen from World Bank misclassification of her country. When the country entered the transition process from a centrally planned economy to a market-based system, the World Bank classified the country as middle-income. However, this assessment proved to be faulty, and was recognized as such by the bank. The country was reclassified as an "IDA-only" country (meaning it was judged of sufficiently low income to borrow from the World Bank only on IDA's concessional terms). The difficulty for the country was that during the period of its initial classification, a number of non-concessional IBRD loans had been extended. It was said that the country finds it hard to service these obligations and would like to see them converted into IDA loans.

Participants pointed out that something like this problem had arisen in the 1980s for developing countries that had been reclassified from IBRD to IDA borrowers. In that case, a portion of funds received from overall IDA principal repayments was set aside for special additional loans to selected "IDA-only" countries that had once been IBRD borrowers. These were countries that had seen their per capita income fall so low as to only be able to take new loans on IDA terms. Eligible countries then used these "Fifth Dimension" loans to pay interest on their outstanding IBRD debt. The case at hand differs from the Fifth Dimension programme in that the reclassification to IDA-only status was said to have not been the result of a severe decline in GDP per capita (although that had happened as well), but of acknowledged error in GDP measurement.

One of the participants noted that this was an example of a more general critique one could make of the international financial institutions, in that borrowing countries are held responsible for repaying loans even when the loans were based on "bad advice". In commercial law, a private firm can apparently contest the obligation to another firm in such a situation, but not in relations between a sovereign borrower and a multilateral institution. This, he said, was unfair to the borrowing countries.

Roundtable 2: Issues for Governments accessing international private financing

Mr. Nazem Abdalla, Team Leader for Regional Integration and Financing for Development at the United Nations Economic and Social Commission for West Asia in Beirut; and Mr. David Beers, Managing Director for Sovereign and International Public Finance Ratings at Standards and Poor's in London, jointly moderated Roundtable 2. The discussion focused on issues for Governments accessing international private financing. Twenty-nine people attended the roundtable, representing Governments, central banks, NGOs, private sector companies, international organizations and United Nations regional commissions. The dialogue was lively and challenging, with participants discussing and – unique in the series of roundtable discussions – taking straw polls on proposals contained in each of the five questions that the secretariat had presented as a basis for discussion.

Impact on policymaking of the focus on debt sustainability

Participants reached informal consensus in favour of calling for an international discussion of the impact on policymaking of the focus on debt sustainability. Emphasis was first placed on the importance of including in the concept of debt sustainability more than the question, "Does a country pay up?" It was suggested that the starting places to look for relevant criteria for debt sustainability was in the IMF Debt Sustainability Framework and the United Nations Secretary-General's linkage, as contained in his report "In larger freedom,"[11] of debt sustainability and the financing of the Millennium Development Goals. Research being conducted by NGOs was also offered as a possible basis for further inquiry.

Several participants called for broadening the approach to debt sustainability and policymaking. They stressed that the issue should not only be considered within the HIPC context, but should be used by countries accessing capital markets as well. The discussion also emphasized that an examination of broader aggregates than just the standard indicators is essential to investors who seek to understand the strategy of a country and its economic outlook in order to get a good perspective on investment opportunities.

It was felt that no single model of debt sustainability can be used in policymaking. That is why, for instance, the ratios used by the IMF and World Bank for HIPC relief or for classifying low-income countries for eligibility for grant financing may need to be adapted before being used by individual countries. Participants also believed that several lessons could be drawn from past experiences and should be leveraged to analyze potential impacts of policymaking on debt as well as vice versa. In particular, experience has shown that static approaches often proved to be wrong, as changes in key elements such as world commodity prices could affect debt sustainability analyses of concerned exporting countries.

Issues of volatility and uncertainty were discussed, in particular with regard to the role of official foreign reserve holdings. Reserves can serve to reduce uncertainty in a context of generalized risk arising from foreign exchange markets, commodities or interest rates, but discussants noted that priority policy concerns often differed among countries. China and India were mentioned as cases in which exchange rate policy shapes decisions on reserve accumulation. This was possibly gaining importance in other Asian countries as well. On the other hand, Brazil and Turkey were said to run primary surpluses and accumulate reserves mostly to build investor confidence. The opportunity cost on policymaking of holding high levels of reserves versus investing in development projects was also mentioned as among elements worth working on in a proposed international discussion. Countries focusing on sustaining investor confidence through high levels of reserves may leave essential services unfunded, raising questions in the minds of investors about the long-term political sustainability of such a focus.

Finally, just as there are different approaches to debt policy among developing countries, other actors also take different considerations into account when assessing debt sustainability strategies. For example, the private sector, when considering investment opportunities, tends to focus on the financial repayment capacity of a country rather than on the Millennium Development Goals (even though there is increasing awareness of the initiative). It was also noted that private investors

[11] United Nations. In larger freedom: towards development, security and human rights for all. Report of the Secretary-General (A/59/2005).

tend not to focus on long-term growth, as they do not hold their financial assets for long periods. In contrast, NGOs tend to pay more attention to the Millennium Development Goals as a way to gauge the sustainability of indebtedness and place emphasis on a country's sustainable development capacity. The different approaches of the various actors need to be taken into account if there is to be a full discussion.

Debtor-creditor transparency

Participants agreed that the creation of a multi-stakeholder working group on debtor and creditor transparency could be beneficial, as they were all in favour of more transparency on debt issues. Examples of efforts to improve transparency were given, including Mexico's Investor Relations Office. Other examples focused on the need for greater transparency in specific areas were provided, regarding for instance IMF Article IV reports, which are not always made available by Governments, IMF Executive Board decisions, and decisions of national export credit agencies (ECAs).

It was felt that transparency was a shared responsibility. Creditors in particular need to enhance their role in that regard. Creditor reporting was described as often insufficient and some called for establishing standards on minimum disclosure to constituencies, in particular for ECAs. ECAs illustrate how public information can often be insufficient on the official creditor side. European ECAs, for instance, offer limited access to inquirers even for important projects, and non-disclosure policies generally make it very difficult to understand creditors' decision-making processes.

The so-called "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" were also discussed as a way to increase transparency by providing guideposts for cooperative behaviour of all concerned parties. The use of standardized information templates was highlighted as a useful way to increase transparency. As some templates already exist, it was proposed that examining them in the context of identifying best practices would be useful.

The need for civil society in debtor countries to be informed of agreements made between their Government and creditors was also emphasized, as information was apparently often withheld by the relevant authorities. The lack of information hinders the ability of members of civil society to engage in dialogue at the national level.

Additional mechanisms for improved debt workouts

The proposal to create a multi-stakeholder working group to explore additional mechanisms to improve debt workouts was widely supported and discussed at length. Participants agreed with the proposal that the working group examine such issues as a code of conduct for sovereign debtors and their creditors, operationalization of the doctrine of "odious debt", and provision of arbitration or mediation services to facilitate dispute settlement. While there was no agreement on the shape that an additional mechanism or mechanisms should take, there was a feeling that if an assured international debt workout mechanism existed, it would make creditors and debtors more cautious in lending and borrowing, which would be good.

Participants suggested that a multi-stakeholder working group could examine the seniority of creditors' claims, as there is an ongoing debate as to whether certain creditors should have priority over others.[12] They also highlighted the possible need to address issues such as "rogue" creditors, "rogue" debtors and the creation of an international legal framework. Discussants considered a number of related questions, such as what happens when a sovereign debtor does not want to come to the table and whether or not that is a legitimate option.

Regarding the question of creating an international legal framework for debt workouts, doubts were raised about the feasibility of such a framework in the light of the diverse interests and incentives across actors. Participants noted that such efforts might encounter similar challenges to those faced in the creation of the International Criminal Court, which enjoyed broad international support but in which not all countries were willing to participate. However, it was pointed out that the presence of such diverse interests could in fact justify the formation of such a mechanism to facilitate a clean agreement process. The opinion was also expressed that the public sector approach to re-

[12] This topic had been raised as well in the other roundtable, where it was noted that there was no legislation requiring that the multilaterals be accorded "preferred creditor" status, meaning obligations to them had to be repaid before those of any other creditors. It was simply a convention, albeit one that the major shareholders in those institutions preferred to maintain and that the bilateral and private creditors accepted.

structuring has become too politicized and that an enforceable mechanism may be useful.

There was interest as well in the concept of "odious" debt, but it needed to be defined clearly and made operational. The participants discussed the issue at length, but did not arrive at an agreement on how to approach the problem. Some participants felt that they should have a general definition, whereas others believed that time could be better spent by working on a case-by-case basis to identify what specific debts should be labelled as odious. Some participants noted that efforts to identify odious debt were being undertaken independently by some legal and academic writers, but that those involved were not well informed about each other or interacting adequately. A working group could begin a more systematic consideration of the issue. Within this context, the discussants also raised the point that some *ex ante* assessments of odious debt might well conflict with actual behaviours *ex post.*

Other issues

Discussants agreed that a study group was not required to examine proposals to bring new financial instruments to market to share sovereign credit risk, such as internationally marketed local currency bonds, GDP bonds, commodity bonds or catastrophe bonds. A few felt the topic was not a high-priority issue: markets will tend to offer any kind of financial instrument if there is a demand, and in the absence of demand such instruments are probably irrelevant. The work being undertaken by IADB and IMF was also mentioned and examples of existing instruments offered by multilaterals and Governments were provided, such as commodity-indexed bonds from the World Bank and GDP-indexed bonds recently introduced by Argentina.

Discussants decided not to discuss the proposal that a multi-stakeholder working group be formed to consider ways to better inform small investors about risky international investments. Some felt this issue could be incorporated in the work on issues of transparency.

Conclusion

The secretariat's central hypothesis in organizing the multi-stakeholder consultations on "sovereign debt for sustained development" was that stakeholders from Governments of North and South, international institutions, the private sector and civil society could fruitfully talk to each other about debt. This hypothesis was built on the experience of the Financing for Development process that had prepared at the Monterrey Summit in March 2002. Never before had members of all the relevant stakeholder groups come together simultaneously for informal exchanges on issues of financing as it related to development, facilitated by the United Nations in effective cooperation with the other "major institutional stakeholders" (Bretton Woods institutions and the World Trade Organization). The chemistry in the meetings that built toward Monterrey worked. Did that reflect a unique set of circumstances or could it be replicated and for a more detailed level of inquiry? The experience of the debt meetings in New York, Maputo and Geneva, in which IMF and the World Bank provided important assistance to the United Nations team, says it could.

Indeed, in considering proposals arising from the previous discussions, the Geneva roundtables were able to distinguish those on which there was more and less enthusiasm for continued inquiry. In particular, views converged around the prospect of value added from an additional period of multi-stakeholder discussion on three specific themes:

- Elaborating the concept of debt sustainability, its application and impact on policy;
- Enhancing debtor and creditor transparency; and
- Exploring potential additional mechanisms for improved debt workouts.

Such discussions might well facilitate and complement efforts that should be made to move work on these topics forward in the forums responsible for making international policy.

In sum, the Geneva discussions were frank, in some instances more than lively (albeit at other instances less energetic), but always of serious purpose. They often converged toward common understandings and sometimes even agreement. If the participants took away a greater appreciation of different views, and if this helps inform discussions in policymaking forums, the multi-stakeholder consultations on debt will have been a resounding success. Only time will tell.

Annex: Secretariat proposals for consideration in roundtables

I. Issues of primary concern to low-income countries

Should there be a multi-stakeholder working group on debt sustainability?

This would be about the concept of "debt sustainability" and its application, in particular by low-income countries, not the current focus on grants versus loans of the International Development Association (IDA). It could take up how to operationalize the Secretary-General's call in his "In larger freedom" report to redefine debt sustainability as that debt level that allows a country to both achieve the Millennium Development Goals and reach 2015 without an increase in its debt ratios. It could also address technical issues such as how to account for arrears, contingent liabilities, and consider "social stress testing".

Should there be an international discussion of the Paris Club, including by the Bretton Woods institutions and debtor Governments, as in the Executive Board of IMF?

The Paris Club is an informal club that makes its own rules, but it is also part of the international financial architecture. It has responded to attacks with several reforms (greater transparency, meeting with private creditors, the HIPCs initiative and Evian Approach), but Paris Club debt treatments are still very complicated and protracted processes. In addition, for liquidity problems, there could be an alternative to expensive Paris Club arrangements, namely additional IMF lending. When should the international community lend or reschedule?

Should developing countries form a working group to develop processes and principles for resolving South-South debt problems?

There are numerous difficult cases of official creditors from Southern countries having claims on other Southern countries, including HIPCs. Some South-South debt is resolved as part of HIPC programmes, but there is a lot of unresolved debt and no clear approach to resolving it.

Should there be a system of independent and credible monitors to help fully implement HIPC and other agreements by monitoring implementation of commitments of the debtor and its creditors?

As sovereigns and multilateral institutions accord most debt relief for low-income countries, there is no enforcement mechanism on the creditors. There is, however, close monitoring of the debtor Government by IMF. The monitor could "name and shame" the recalcitrant creditors and call for pressure for them to meet their obligations.

Do we need a multi-stakeholder discussion process on how to close the "financing gap"?

There has been a lot of focus on raising official development assistance (ODA) in general and on delivering additional HIPC relief, although the modalities are not yet fully agreed. The discussion of grants versus loans in IDA masks a broader question: usually grants and loans finance different kinds of activities. Will aid allocations overall be distorted by a generalization of the IDA debt-sustainability analysis? In any case, this takes us only part way to closing the gap.

II. Issues of primary concern to countries accessing financial markets

Should there be an international discussion of the impact on policymaking of the focus on debt sustainability?

One way countries have sought to build investor confidence is to run large primary budget surpluses, which ensures resources are available to service debt in the short run. However, if essential services are underfunded, the policy can be politically unsustainable. In addition, are some countries building up official reserves to excessive levels to minimize default risk at too great an opportunity cost in terms of foregone investment and growth?

Should there be a multi-stakeholder working group on debtor-creditor transparency?

There has been a general policy thrust towards making more information available, but is it all the right information at the right time? What information should private and official creditors reveal? What should be in the standard templates used to inform the investor community?

Should there be an independent study group on bringing new financial instruments to market to share credit risk in sovereign debt in different ways?

There have been a number of proposals – such as internationally marketed local currency bonds, GDP or commodity bonds, or catastrophe bonds – and some issues have been sold. However, these seem to be largely niche items and some proposals of only a year ago have already disappeared (see issues paper). Is there a role for policy in helping to introduce innovative financing instruments?

Should a multi-stakeholder working group be formed to consider ways to better inform small investors about risky international investments?

Consumer-investor protection through appropriate provision of information may require strengthening, based on the European experience with Argentine bonds. There do not seem to be adequate safeguards or industry standards or codes. Would such a working group raise consciousness of the issue and perhaps lead to stronger guidelines?

Should a multi-stakeholder working group be formed to explore additional mechanisms for improved debt workouts?

The flurry of proposals and consideration of reform has largely passed, with only minor changes in how sovereign debt crises are treated. The proposals had been tabled out of dissatisfaction with the existing system. The proposals were rejected, not because the existing system was considered ideal, but because the proposals were deemed worse by a large number of stakeholders. Nevertheless, interest continues in exploring ideas such as a code of conduct for sovereign debtors and their creditors, operationalizing the doctrine of "odious debt", or offering mediation or arbitration services to facilitate effective and fair dispute settlement. Is it time to return to reform discussions (as recommended by the Secretary-General in his report to the coming High-Level Dialogue on Financing for Development)?

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