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September 1, 1995

To: Members of the Executive Board

From: The Secretary

Subject: Official Financing for Developing Countries and Their Debt Situation

Attached for consideration by the Executive Directors is a paper on official financing for developing countries and their debt situation, which is tentatively scheduled for discussion on Friday, September 15, 1995. Concluding remarks and issues for discussion appear on pages 31-33.

Mr. Boote (ext. 34508) or Ms. Ross (ext. 37188) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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Official Financing For Developing Countries and Their Debt Situation

Prepared by the Policy Development and Review Department

(In consultation with other departments)

Approved by Jack Boorman

August 31, 1995

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Executive Summary

This paper summarizes recent developments in official flows to developing countries and their debt situation, and reviews reschedulings by Paris Club and non-Paris Club creditors, with special emphasis on the implementation and implications of Naples terms. It also examines issues related to debt sustainability for the heavily indebted poor countries.

Net Official Development Assistance (ODA), which constitutes the bulk of Official Development Finance, declined in real terms by 2 percent in 1994 primarily reflecting budgetary constraints. Total officially supported export credit exposure to developing countries and countries in transition increased from an estimated US$380 billion at the end of 1993 to around US$420 billion at end-1994. The most important source of higher exposure was a further increase in new export credit commitments, driven by more aggressive export promotion and a resurgence of import demand in many developing countries, especially certain large low-income countries.

The level of gross and net multilateral lending (including from the Fund) to developing countries in 1994 at around US$37 billion and US$14 billion, respectively, was broadly unchanged in U.S. dollar terms from the four previous years. Despite the rise in multilateral debt, multilateral debt service has remained broadly unchanged as a share of exports, reflecting the rising share of multilateral lending at concessional interest rates. In spite of increasingly concessional rescheduling, bilateral debt relief, and an increasing share of grants in official bilateral flows, official bilateral debt remains the fastest growing portion of developing countries' external debt.

Low-income rescheduling countries face extremely varied external and debt situations. For these countries, new external inflows in 1994 averaged more than three times actual debt service paid. Most countries would remain heavily dependent on further concessional inflows, even if their debt-service obligations were nil.

Paris Club creditors agreed on Naples terms for low-income rescheduling countries in December 1994. During the first seven months of 1995, 11 reschedulings were agreed under these terms--10 flow reschedulings and one stock-of-debt operation for Uganda. There appears little prospect for most low-income rescheduling countries to graduate from the rescheduling process in the absence of stock-of-debt operations. Most middle-income countries, in contrast, have graduated from the rescheduling process.

Less progress has been made by debtors in negotiations with non-Paris Club official bilateral creditors. For some countries in the former Soviet Union (FSU), there has been an extremely rapid rise in debt to other FSU countries, which will require strengthened debt monitoring and management. Fund staff have sought to assist in efforts of some of these countries and their non-Paris Club official creditors to reach appropriate debt-rescheduling agreements outside the traditional Paris Club framework.

A preliminary analysis of external-debt sustainability 1/ for heavily indebted poor countries was undertaken, pending the results of more detailed country-specific analyses that will be included in staff reports requesting Fund arrangements and Article IV reports for heavily indebted poor countries. The analysis undertaken here examined the impact of a hypothetical stock-of-debt operation by Paris Club creditors under Naples terms on debt service in 1995 for 27 low-income rescheduling countries, and attempted a partial assessment of debt sustainability in the context of such stock-of-debt operations for 14 of these 27 countries based on country-specific medium-term scenarios.

The results of the analysis suggest that a stock-of-debt operation on Naples terms, combined with comparable treatment from other bilateral official and private creditors, offers good prospects for the achievement of overall external debt sustainability and an exit from the rescheduling process for the majority of low-income rescheduling countries. This conclusion is obviously dependent on assumptions made regarding the response of export growth to adjustment and reform measures undertaken by these countries. Notwithstanding such debt relief, virtually all of the countries will remain heavily dependent on continued aid inflows. The prospects for a durable exit from the rescheduling process would be enhanced by

- debtor countries strengthening their adjustment efforts including broadening and diversifying their export base;

- creditor countries being prepared in some cases to top up previous concessional reschedulings;

- donors focusing highly concessional assistance on low-income rescheduling countries that steadfastly implement strong adjustment policies, particularly in the early years after stock-of-debt operations; and

- medium-term projections on which stock-of-debt operations are based incorporating a significant reserve build-up to provide a cushion against external shocks.

Even with these efforts, however, current Naples terms would appear insufficient to achieve debt sustainability 1/ for a number of low-income rescheduling countries, many of which face high debt service to multilaterals, including the Fund. Most of these countries will continue to be eligible for flow reschedulings from the Paris Club which will give them time to establish strong track records of adjustment and strengthen their external positions. The priority is to ensure over this period that countries that pursue ambitious adjustment and reform programs obtain sufficient external financing to attain their growth potential. In addition, as country circumstances evolve, creditors, including the

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1/ As defined in Box 8.

international institutions, might consider how the debt problems of these countries might best be addressed in a concerted way to achieve a durable exit from the rescheduling process.

For the heavily indebted poor countries which are not yet eligible for Naples terms, it is difficult at this stage to make any assessment of the current mechanisms for handling their external debt situations, although some of these countries would appear to face extremely heavy debt burdens.

Some countries face high debt service to the Fund on existing debt. The heaviest potential burden arises in arrears cases. The staff will reassess the modalities of handling such cases after RAPs, though it is expected that Zambia will be handled under existing mechanisms through a successor ESAF program following arrears clearance.

I. Introduction

The last comprehensive review by the Executive Board of official financing for developing countries and their debt situation was in September 1994. 1/ Since then, the three principal developments have been the agreement in December 1994--and subsequent implementation in selected cases--of Naples terms for low-income countries by Paris Club creditors, 2/ the increasing focus on the issue of multilateral debt, 3/ and the support provided by official creditors in early 1995 to Mexico. 4/ In addition to the annual review of developments in Official Financing for Developing Countries, this paper attempts to provide an assessment of the effects of stock-of-debt operations on Naples terms on the debt situation of the low-income rescheduling countries. 5/ In so doing, the paper takes a preliminary look at the extent to which stock-of-debt operations on Naples terms by Paris Club creditors, assuming comparable treatment by other official bilateral and private creditors, will produce a sustainable overall external debt position for these countries.

This paper is organized as follows. Section II summarizes recent developments in official bilateral flows, export credits, multilateral flows, external debt and debt service, and reschedulings by Paris Club creditors. Section III examines external debt-sustainability issues for heavily indebted poor countries. 6/ It describes proposals to increase the focus on debt-sustainability analysis in staff reports for heavily indebted poor countries and looks at the impact of hypothetical stock-of-debt operations on Naples terms by Paris Club creditors on debt service for 1995 for 27 low-income rescheduling countries, and on debt service and external financing over 20 years for 14 of these countries. Section IV presents some concluding remarks and issues for discussion. The paper is a

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1/ See Summing Up by the Chairman (Buff/94/92, 9/15/94).

2/ As described in "Recent Developments in Commercial Bank and Official Bilateral Debt Restructuring" (EBS/95/41, 3/17/95).

3/ See Concluding Remarks by the Chairman (Buff/95/18, 3/1/95 and Buff/95/33, 4/20/95), attached in the Appendix.

4/ For details of official support for Mexico, see Mexico--Staff Report (EBS/95/103, 6/14/95), page 3. This support is not reflected in the data used in this report as it occurred after end-1994. The implications of the Mexican crisis for private flows to developing countries are discussed in Private Market Financing for Developing Countries and Their Debt Situation (EBS/95/126, 8/1/95).

5/ The paper builds on the analysis contained in last year's paper, EBS/94/167, 8/23/94, pages 16-19.

6/ External-debt sustainability is defined in Box 8.

summary of the background paper, Official Financing for Developing Countries and Their Debt Situation, which contains a more detailed discussion of these issues. A paper on Limits on External Debt or Borrowing in Fund Arrangements is to be circulated separately and will be brought for Executive Board discussion after the Annual Meetings.

II. Recent Developments in Official Flows to Developing Countries, Their Debt and Reschedulings

1. Official flows 1/

Net official development finance (ODF) to developing countries, 2/ including disbursements from both multilaterals and bilaterals, at around US$66 billion in 1994, has declined by 16 percent in real terms since the peak in 1990. Net official development assistance (ODA) disbursed by DAC countries in 1994, which constitutes the bulk of ODF, rose in U.S. dollar terms to US$58 billion (from US$56 billion in 1993) but declined in real terms by 2 percent; 3/ such assistance constituted 0.29 percent of DAC countries' GNP in 1994, the lowest level since 1973 (Chart 1). This decline in overall net ODA in real terms reflects primarily budgetary constraints in most donor countries, which are likely to continue for the near future. 4/ The bilateral (as opposed to multilateral) share of net ODF has varied between 66 and 70 percent since 1990, with no discernible trend. Net official financing to countries in transition (not considered as developing countries for this purpose) remained large in recent years at around US$12 billion. 5/

1/ This sub-section is based on OECD (Development Assistance Committee) data, which are not consistent with the Berne Union and World Bank data used for sub-sections 2 and 3 below. Data on development flows exclude export credits as they are primarily trade-related (discussed in sub-section 2 below); Fund financing from the GRA is excluded while that from the Trust Fund, SAF, and ESAF is included. For further details, see Official Financing for Developing Countries background paper, Chapter II, Box 1.

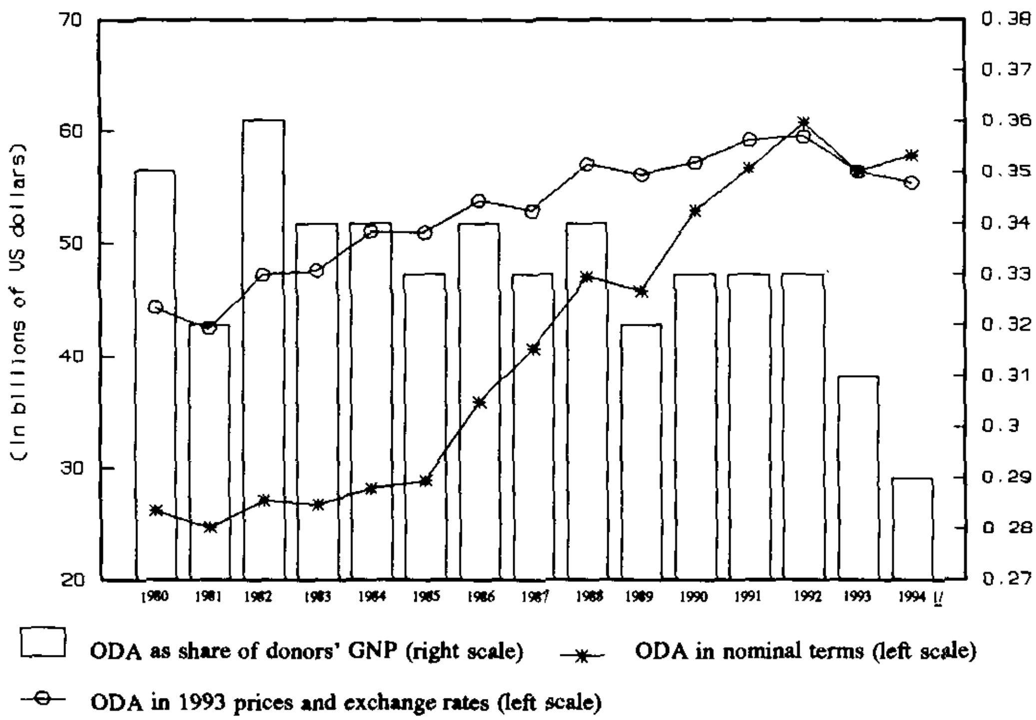
2/ The definition of developing countries used here and in subsections 2 and 3 below depends on the data source: see footnote 1 and background paper, Chapter II, Box 1.

3/ Adjusted by the OECD for inflation and currency movements; for a full explanation see background paper, Chapter II.

4/ See "Bilateral and Multilateral Aid Flows and Fund-Supported Programs" (SM/95/93 Supplement 1, 4/25/95) and Chairman's Summing Up (Buff No. 95/48, 6/6/95) for a discussion of the outlook for ODA.

5/ For details and country coverage, see background paper, Chapter II.

Chart 1. Net ODA Disbursements, 1980-94



Sources: OECD.

1/ Provisional

Within developing countries, most heavily indebted poor countries remained highly dependent on inflows of grants and concessional assistance from official donors (Box 1 and Table 1 describe the country composition of the heavily indebted poor and low-income rescheduling country categories used in this paper). For the low-income rescheduling countries, such inflows in 1994 were more than three times actual debt service paid; 1/ Box 2 summarizes the extremely varied external positions, financing and debt of the low-income rescheduling countries.

Box 1. Country Composition of the Group of Heavily Indebted Poor Countries

The analysis in the paper focuses on three groups of countries namely:

- all 41 heavily indebted poor countries;[1]

- 27 of these which are low-income rescheduling countries for which the effects of a hypothetical stock-of-debt operation on Naples terms on debt service in 1995 are examined (Section III, 2);[2]

- 14 of the 27 for which the impact of a hypothetical stock-of-debt operation on Naples terms on external financing and debt-service over the next twenty years is examined (Section III,3).[3]

This analysis is preliminary (in the sense that it anticipates more detailed country-specific analysis) and partial (in that it does not consider the possible dynamic effects of a debt overhang on investment and growth). Furthermore, the conclusions drawn become more tentative as they generalize from the 14 countries (for which detailed medium-term analysis was done) to the 27 countries (for which an assessment was made solely on the basis of 1995 debt service) to all 41 heavily indebted poor countries.

[1]For a full listing of these countries, see Table 1.

[2]Angola, Benin, Bolivia, Burkina Faso, Cameroon, C.A.R., Chad, Côte d'Ivoire, Equatorial Guinea, Ethiopia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Zaïre, and Zambia.

[3]Chosen as countries which could be relatively early candidates for a debt-stock operation (Bolivia, Ethiopia, Guinea, Guyana, and Sierra Leone) or because their debt burden is particularly difficult (Côte d'Ivoire, Honduras, Mauritania, Mozambique, Nicaragua, Senegal, Tanzania, Uganda, and Zambia).

1/ Source: IMF country staff reports.

Table 1. Country Composition of Forty-One Heavily Indebted Poor Countries 1/

	Paris Club treatment	World Bank classification	Included in 27 low-income rescheduling countries 2/	Included in 14 low-income rescheduling countries for which medium-term analysis done 3/
Angola	NCR 4/	SIMIC	✓	
Benin	CR	MILIC	✓	
Bolivia	CR	SIMIC	✓	✓
Burkina Faso	CR	LILIC	✓	
Burundi	NR	SILIC		
Cameroon	CR	SIMIC	✓	
C.A.R.	CR	SILIC	✓	
Chad	CR	MILIC	✓	
Congo	NCR	SIMIC		
Côte d'Ivoire	CR	SILIC	✓	✓
Equatorial Guinea	CR	SILIC	✓	
Ethiopia	CR	SILIC	✓	✓
Ghana	NR	SILIC		
Guinea	CR	SILIC	✓	✓
Guinea-Bissau	CR	SILIC	✓	
Guyana	CR	SILIC	✓	✓
Honduras	CR	SILIC	✓	✓
Kenya	ER 5/	SILIC		
Lao P.D.R.	NR	SILIC		
Liberia	NCR 4/	SILIC		
Madagascar	CR	SILIC	✓	
Mali	CR	SILIC	✓	
Mauritania	CR	SILIC	✓	✓
Mozambique	CR	SILIC	✓	✓
Myanmar	NR	SILIC		
Nicaragua	CR	SILIC	✓	✓
Niger	CR	SILIC	✓	
Nigeria	NCR	SILIC		
Rwanda	NR	SILIC		
São Tomé Príncipe	NR	SILIC		
Senegal	CR	MIMIC	✓	✓
Sierra Leone	CR	SILIC	✓	✓
Somalia	NCR 4/	SILIC		
Sudan	NCR 4/	SILIC		
Tanzania	CR	SILIC	✓	✓
Togo	CR	MILIC	✓	
Uganda	ER 6/	SILIC	✓	✓
Viet Nam	ER 7/	SILIC		
Yemen, Republic of	NR	SILIC		
Zaïre	CR	SILIC	✓	
Zambia	CR	SILIC	✓	✓

Sources: World Bank, World Debt Tables 1994-95, and Paris Club.

1/ Includes all 32 countries classified as SILICs by the World Bank in 1994 (see column 2). Includes 31 of 35 low-income rescheduling countries (Table 4, column 1) except Gambia and Malawi (classified by the World Bank as MILICs) and Cambodia and Haiti (LILICs).

2/ Countries for which the structure of debt service in 1994 is shown and the effects of hypothetical stock-of-debt operations on debt service in 1995 are examined. Twenty-seven of 31 low-income rescheduling countries included as heavily indebted poor countries (see footnote 1 above) were included: Viet Nam was excluded as an exit rescheduling and Liberia, Somalia, and Sudan were excluded due to date limitations (e.g., on arrears composition).

3/ The impact of a hypothetical stock-of-debt operation on Naples terms on external financing and debt service over the next twenty years is examined.

4/ Now eligible for borrowing from the World Bank exclusively on IDA terms ("IDA only").

5/ Kenya, at its own request, received a nonconcessional rescheduling of arrears only.

6/ Stock-of-debt operation.

7/ Concessional rescheduling of arrears only.

Classifications: Paris Club
CR - Concessional rescheduling
NR - Non-rescheduling country
NCR - Nonconcessional rescheduling
ER - Exit Rescheduling (rescheduling of arrears only)

World Bank
SILIC - Severely Indebted Low-Income Countries
SIMIC - Severely Indebted Middle-Income Countries
MILIC - Moderately Indebted Low-Income Countries
LILIC - Less Indebted Low-Income Countries
MIMIC - Moderately Indebted Middle-Income Countries

Box 2. External Positions of Low-Income Rescheduling Countries 1/2/

In aggregate in 1994:

- non-interest current account deficits[3] averaged over 40 percent of exports (of goods and services);

- while scheduled debt service averaged around 55 percent of exports, actual debt service, as a result of reschedulings and in some cases the accumulation of arrears, averaged around 20 percent of exports;

- new external inflows[4] (including grants) at almost 70 percent of exports averaged more than three times actual debt service paid (Chart 2);

- hence, even if these countries had no external debt at all, they would remain heavily dependent on further concessional inflows. This applies to nearly all of the low-income rescheduling countries in the sense that new inflows exceeded debt service paid in 1994 (Chart 3).[5]

The position differs widely from country to country. Thus in 1994:

- non-interest current account balances varied from surpluses (Cameroon, Côte d'Ivoire, Guyana, and Zaïre) to deficits exceeding 100 percent of exports (Mozambique and Nicaragua);

- scheduled debt service varied from less than 20 percent of exports (Burkina Faso and Chad) to more than 100 percent (Mozambique and Nicaragua);

- actual debt service ranged from less than 5 percent of exports (Chad and Zaïre) to more than 50 percent (Nicaragua and Uganda);

- countries are indebted to a variety of creditors including Paris Club official creditors, non-Paris Club official creditors (notably Russia), commercial banks and multilateral creditors (IMF, World Bank, and other multilaterals).[6]

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[1] Data source: Fund staff estimates. For more details including a country-by-country breakdown, see Official Financing background paper, Appendix I, Table 1.

[2] For country coverage see Box 1 and Table 1.

[3] Used as an indicator of a country's capacity to service debt out of its own resources.

[4] Excluding from IMF.

[5] Cameroon and Guyana are exceptions; for Guyana, new flows exceeded actual debt service paid in 1993 (although not in 1994).

[6] This issue is discussed more in Section III below.

2. Recent developments in export credits 1/

Total export credit exposure to developing countries and economies in transition increased from an estimated US$380 billion at the end of 1993 to around US$420 billion at the end of 1994. 2/3/ The most important source of higher exposure in 1994 was a further increase in new export credit commitments, driven in part by more aggressive export promotion as well as a resurgence of import demand in many developing countries. New export credit commitments to developing countries and countries in transition rose from US$70 billion in 1993 to US$90 billion in 1994. Within this overall increase in new commitments, there was a marked increase in new commitments to certain large low-income countries, particularly to China, India and Indonesia. While precise data is not available, of the US$90 billion new commitments in 1994, only about US$1 billion are reported by agencies to have been to heavily indebted poor countries.

3. Multilateral financing 4/5/

The level of gross and net multilateral lending (including from the Fund) to all developing countries in 1994 at around US$37 billion and US$14 billion, respectively, was broadly unchanged in U.S. dollar terms from

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1/ This sub-section is based on commitment data supplied by the International Union of Credit and Investment Insurers (the Berne Union); the disbursements of insured credits arising from these commitments often occur months or years later, and the Berne Union does not collect total data on repayments. Hence, it is not possible to get a clear picture of net flows from Berne Union data. For more detail, see the Official Financing background paper, Chapter III. For a detailed description of the role of export credit agencies in financing developing countries and economies in transition, see "Officially Supported Export Credits - Developments and Prospects" (SM/94/230, 8/26/94) and published in March 1995 as part of the World Economic and Financial Surveys series; the latter (Appendix I) contains a glossary of terms.

2/ Net ODF data from OECD (DAC) sources used in sub-section 1 above exclude export credits.

3/ About a quarter of this increase is attributable to the broadening of the Berne Union's country coverage.

4/ This sub-section is based on data from the World Bank's Debtor Reporting System (DRS) which is not consistent with the OECD (DAC) data used in sub-section 1 above. The coverage of developing countries is also not the same--for further details see Official Financing background paper Chapter II, Box 1.

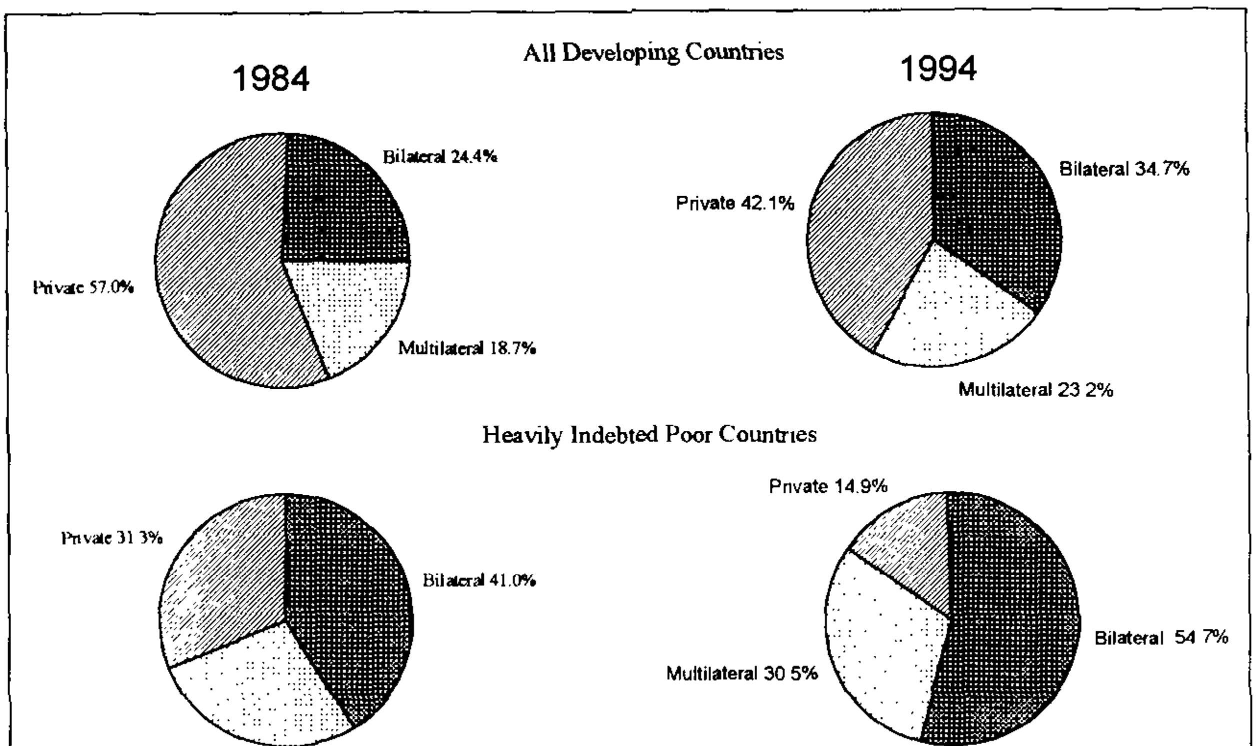
5/ For the multilateral institutions covered, see background paper Chapter IV. Grants from multilateral agencies--mainly the EU and UN--are excluded as non debt-creating flows (totaling around US$10 billion in 1993 according to OECD data).

the four previous years (Table 2). Following declines in 1993, 1/ both gross and net disbursements to heavily indebted poor countries rose by around US$1 billion in 1994, partly as a result of support for CFA franc countries' adjustment programs following the CFA franc devaluation, to reach record levels of over US$6 billion and US$3 billion, respectively. Virtually all of the heavily indebted poor countries continued to receive positive net disbursements from multilaterals in 1994.

4. External debt and debt service 2/

Despite increasingly concessional reschedulings, 3/ other bilateral debt relief, and an increasing share of grants in official bilateral flows, official bilateral debt remains the fastest growing portion of developing countries' debt. The share of official bilateral debt in total medium- and long-term public external debt of all developing countries has risen steadily over the past decade to reach over one-third by end-1994 (Chart 2 and Table 3). It has risen slightly faster than the share of multilateral

Chart 2. Developing Countries: Public External Debt by Creditor Groups



Source Table 3

1/ Attributable to lower net disbursements to several large countries, including CFA franc countries.
2/ This sub-section is based on World Bank (DRS) data.
3/ For details see sub-section 5 below.

Table 2. Multilateral Disbursements to, and Debt Service from, Developing Countries 1/

(In billions of U.S. dollars except where indicated)

	1985-89 Average	1990	1991	1992	1993	1994 2/
			(All developing countries 3/)			
Gross disbursements	26.0	36.4	39.1	35.6	37.1	37.5
Debt service	27.9	34.5	36.5	36.9	37.4	39.3
Net transfers	-1.9	1.9	2.6	-1.3	-0.3	-1.8
Net disbursements	9.1	15.4	17.7	13.8	15.2	13.7
Debt service (as percent of exports of goods and services)	4.5	4.2	4.1	4.1	4.0	3.9
			(Heavily indebted poor countries 4/)			
Gross disbursements	4.5	5.8	5.6	5.4	4.9	6.1
Debt service	3.2	4.1	4.3	3.6	3.7	4.0
Net transfers	1.3	1.7	1.3	1.8	1.2	2.1
Net disbursements	2.5	3.3	3.2	3.4	2.7	3.7
Debt service (as a percent of exports of goods and services)	8.7	8.3	9.1	7.4	8.0	8.7

Sources: World Bank Debtor Reporting System (DRS); and IMF staff estimates.

1/ Including the IMF.
2/ Preliminary estimates.
3/ For coverage, see background paper on Official Financing (Chapter IV).
4/ For coverage, see Table 1.

Table 3. Developing Countries: Public Medium- and Long-Term External Debt by Creditor 1/2/

	All developing countries 3/				Heavily Indebted Poor Countries 4/			
	1984	1990	1993	1994 4/	1984	1990	1993	1994 5/
	(In billions of U.S. dollars)							
Total external debt	642	1,104	1,246	1,331	77	186	191	200
	(In percent of total)							
Of which:								
Multilateral (including IMF)	18.7	22.1	23.3	23.2	27.7	25.5	29.1	30.5
Official bilateral	24.4	32.2	34.2	34.7	41.0	54.3	54.8	54.7
Private	57.0	45.7	42.5	42.1	31.3	20.1	16.0	14.9
Memorandum item:								
Share of multilateral debt on concessional terms (percent)	30.9	30.9	33.5	35.6	50.3	60.7	68.0	69.8

Sources: World Bank Debtor Reporting System (DRS); and IMF staff estimates.

1/ Includes publicly guaranteed debt.
2/ Coverage in the DRS of Russian claims on developing countries is incomplete. By way of illustration, if the data for 1993 is replaced by Russian figures, with ruble debt valued at the official exchange rate for the ruble as of end-1993 (Rub 0.5854 per US$1), for all developing countries total debt would be US$1.355 billion, with the respective percentages 21.4 (multilateral), 39.4 (bilateral), and 39.0 (private); for the heavily indebted poor countries total debt would be US$200 billion, and 27.8 percent (multilateral), 56.9 percent (bilateral) and 15.3 percent (private). These totals and this method of valuation are disputed by many debtors.
3/ For country coverage, see background paper on Official Financing (Chapter IV).
4/ For country coverage, see Table 1.
5/ Provisional estimates.

debt over this period; both have increased relative to private sector creditors (including commercial banks) whose share declined by 15 percentage points in the decade to 1994 to reach 42 percent. These trends are more pronounced in the case of the heavily indebted poor countries. In the decade to 1994, the share of private sector creditors in the heavily indebted poor countries' debt fell by some 16 percentage points to 15 percent of total debt as a result of debt-reduction agreements and much reduced new lending. By contrast, the share of official bilateral creditors has risen by 14 percentage points over the same period to reach 55 percent of total debt, while the share of multilaterals has risen by 3 percentage points, reaching 30 percent by end-1994. Both the composition of debt (by creditor groups) and the debt burden of the low-income rescheduling countries vary considerably from country to country (Box 2).

Notwithstanding the build-up of multilateral debt, multilateral debt service has remained broadly unchanged over the last decade at around 4 percent of exports of goods and services for all developing countries and 8½ percent for heavily indebted poor countries, as a result of new multilateral lending being provided on increasingly concessional terms (Table 2). The share of concessional debt in total multilateral debt of the heavily indebted poor countries has risen by some 20 percentage points in the last decade to reach 70 percent at end-1994 (Table 3).

External debt can also imply a heavy burden from the viewpoint of government budgets; this issue is looked at in Box 3.

Box 3. Fiscal Burden of External Debt

An issue of increasing concern has been the fiscal burden of external debt. The Official Financing background paper examines this for the heavily indebted poor countries.[1] Its principal conclusions are

- Based on 1994 data, around half of these countries face scheduled debt-service payments on public sector debt exceeding one half of government revenue. For more than one quarter of the countries, scheduled debt service exceeds total government revenue.

- Actual debt service paid on average was only one-third of scheduled debt service as a result of debt relief or the accumulation of arrears.

- In most cases, receipts of foreign grants--which are mostly project-related--exceeded actual debt service paid.

- For most of the countries, the assessment based on fiscal debt indicators parallels that on external indicators such as the debt-service-to-exports ratio.

- A minority of countries--such as Cameroon, C.A.R., Chad, Equatorial Guinea, Niger, Senegal, and Tanzania--faces relatively higher external debt burdens measured against government revenues than against exports. In some of these countries, this reflects relatively low revenue-to-GDP ratios.

A more thorough assessment of the fiscal sustainability of external debt would need to be made on a country-specific basis.

[1] See background paper, Appendix I, Chapter III.

5. Paris Club reschedulings 1/2/

a. Low-income countries

Paris Club creditors agreed on Naples terms for low-income rescheduling countries in December 1994 (for a summary of Naples terms see Box 4). During the first seven months of 1995, 11 reschedulings were agreed under these terms for low-income countries--10 flow reschedulings for Bolivia, Cambodia, Chad, Guinea, Guinea-Bissau, Haiti, Mauritania, Nicaragua, Senegal, and Togo--and one stock-of-debt operation for Uganda. 3/ All of these reschedulings involved a 67 percent net present value (NPV) reduction of eligible debt except for that for Guinea, which involved a 50 percent NPV reduction. In four cases (Chad, Guinea-Bissau, Mauritania, and Togo), the agreements provided for a topping up 4/ of certain debt previously rescheduled on Toronto terms to a 67 percent NPV reduction; this was also the case for the stock-of-debt operation for Uganda. In two cases, Guinea-Bissau and Senegal, reflecting extremely difficult financial positions, the agreements provided for an exceptional, but nonconcessional, deferral of arrears on post-cutoff date debt.

Most of the agreements--with Chad, Guinea-Bissau, Mauritania, Nicaragua, Senegal, and Togo--featured a goodwill clause stating that creditors agree to consider a stock-of-debt operation at a later date provided the debtor implements the agreement in full and continues to have an appropriate arrangement from the Fund (Table 5). 5/ For Bolivia, a possible stock-of-debt operation is envisaged later in 1995 provided creditors can reach a consensus to choose concessional options. For Guinea, the goodwill clause contained in the 1992 agreement continues to apply. The agreements with Cambodia and Haiti did not contain such a goodwill clause, as both countries have relatively small remaining debts to Paris Club creditors after the current rescheduling agreements. With these two exceptions, there is little prospect that most low-income rescheduling countries can graduate from the rescheduling process in the absence of stock-of-debt operations (as is discussed further in Section III below).

1/ There were no reschedulings in the last five months of 1994, partly because Naples terms were under consideration by Paris Club creditors, except for Equatorial Guinea in December. For details, see Official Financing background paper and EBS/95/41 (3/17/95), page 13, footnote 2.

2/ Table 4 summarizes the status of Paris Club rescheduling countries as at end-July 1995.

3/ For details of reschedulings, including coverage and terms, see background paper, Chapter V.

4/ For an explanation, see Box 4 ("Coverage").

5/ The date provided is either three years from the Agreed Minute, or, for countries with prior track records, at the end of the consolidation period.

Box 4. Paris Club Naples Terms

Key elements of Naples terms, which have replaced the previous concessional (Toronto or London) terms, for low-income countries are[1]

- Eligibility is decided by creditors on a case-by-case basis, based primarily on a country's income level. Countries which have previously received concessional reschedulings (on Toronto or London terms) are eligible for Naples terms.

- Concessionality. Most countries receive a reduction in eligible non-ODA debt of 67 percent in net present value (NPV) terms . Some countries with a per capita income of more than US$500 and a ratio of debt to exports in present value terms of less than 350 percent--decided on a case-by-case basis--receive a 50 percent NPV reduction.

- Coverage. The coverage (inclusion in the rescheduling agreement) of non-ODA pre-cutoff date debt is decided on a case-by-case basis in the light of balance of payments needs. Debt previously rescheduled on concessional (either Toronto or London) terms is potentially subject to further rescheduling, to top up the amount of concessionality given.[2]

- Choice of options. Creditors have a choice of two concessional options for achieving a 67 (or 50) percent NPV reduction,[3] namely:

  - a debt reduction (DR) option (repayment over 23 years with 6 years grace).

  - a debt-service reduction (DSR) option--under which the NPV reduction is achieved by concessional interest rates (with repayment over 33 years).[4] [5]

Also there is a commercial or long maturities (LM) option, providing for no NPV reduction (repayment over 40 years with 20 years grace).[6]

- ODA credits. Pre-cutoff date credits are rescheduled on the original concessional interest rates over 40 years with 16 years grace (30 years with 12 years grace for 50 percent NPV reduction).

Flow reschedulings--provide for the rescheduling of debt service on eligible debt falling due during the consolidation period (generally in line with the period of the Fund arrangement).

Stock-of-debt operations--under which the entire stock of eligible pre-cutoff date debt is rescheduled concessionally--are reserved for countries with a satisfactory track record for a minimum of three years with respect to both payments under rescheduling agreements and performance under Fund arrangements. Creditors must be confident that the country will be able to respect the debt agreement as an exit rescheduling (with no further reschedulings required) and there must be a consensus among creditors to choose concessional options.

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[1] For full details, see EBS/95/41, 3/17/95, pages 6-13.

[2] Under such topping up, the NPV reduction is increased from the original level given under Toronto or London terms to the new level agreed under Naples terms, namely 67 or 50 percent.

[3] For a 50 percent NPV reduction, the DSR option provides for repayment over 23 years with 6 years grace and the LM option for repayment over 25 years with 16 years grace.

[4] For flow reschedulings, there is no grace period and for stock-of-debt operations, the grace period is three years.

[5] There is, in addition, a capitalization of moratorium interest (CMI) option which also achieves the NPV reduction by a lower interest rate over the same repayment (and grace) periods as the DSR option.

[6] Creditors choosing this option undertake best efforts to change to a concessional option at a later date when feasible.

Table 4. Status of Paris Club Rescheduling Countries Since 1980 (as of July 31, 1995) 1/
(Dates refer to end of current or last consolidation period) 2/

Low-income 3/		Lower middle-income 4/		Other middle-income		Total
		Countries that have graduated from reschedulings				
Gambia, The	9/87	Dominican Republic	3/93	Argentina	3/95	
Malawi	5/89	Ecuador	12/94	Bulgaria	4/95	
** Uganda	2/95	Egypt	5/91 5/	Brazil	8/93	
* Viet Nam	12/93 6/	El Salvador	9/91	Chile	12/88	
		Guatemala	3/93 6/	Costa Rica	6/93 6/	
		Kenya	1/94 6/7/	Mexico	5/92	
		Morocco	12/92	Panama	3/92	
		Philippines	7/94 8/	Romania	12/83	
		Poland	4/91	Trinidad and Tobago	3/91	
				Turkey	6/83	
Subtotal	4		9		10	23
		Countries with rescheduling agreements in effect				
* Benin	12/95	Jamaica	9/95	Algeria	5/98	
** Bolivia	12/97	Jordan	5/97	Croatia	12/95	
* Burkina Faso	12/95	Peru	3/96	FYR Macedonia	6/96 9/	
** Cambodia	3/97			Russian Federation	12/95	
* Côte d'Ivoire	3/97					
* Ethiopia	10/95					
* Equatorial Guinea	2/96					
** Guinea	12/95					
** Guinea-Bissau	12/97					
** Haiti	3/96					
* Honduras	7/95					
* Mali	8/95					
** Mauritania	12/97					
** Nicaragua	6/97					
** Senegal	8/97					
* Sierra Leone	12/95					
** Togo	9/97					
Subtotal	17		3		4	24
		Countries with previous rescheduling agreements, but without current rescheduling agreements, which have not graduated from reschedulings				
Angola	9/90	Congo	5/95	Gabon	3/95	
* Cameroon	9/95 10/	Nigeria	3/92	Yugoslavia 11/	6/89	
* CAR	3/95					
** Chad	3/95					
* Guyana	12/94 12/					
Liberia	6/85					
Madagascar	6/91 13/					
* Mozambique	6/95 14/					
* Niger	3/95					
Somalia	12/88					
Sudan	12/84					
* Tanzania	6/94					
Zaire	6/90 13/					
* Zambia	3/95 15/					
Subtotal	14		2		2	18
All countries	35		14		16	65

Source: Paris Club.
1/ Includes agreements of the Russian Federation and Turkey with official bilateral creditors.
2/ In the case of a stock-of-debt operation, canceled agreement, or arrears only rescheduling, date shown is that of relevant agreement.
3/ "*" denotes rescheduling on London terms, and "**" denotes rescheduling on Naples terms (stock treatment underlined).
4/ Defined here as countries that obtained lower middle-income but not concessional terms with Paris Club reschedulings; stock treatment underlined.
5/ The last of three stages of debt reduction under the 1991 agreement has not yet been implemented.
6/ Rescheduling of arrears only.
7/ Nonconcessional rescheduling at the authorities' request.
8/ The 1994 rescheduling agreement was canceled at the request of the Philippine authorities.
9/ FYR Macedonia agreed to the terms and conditions of the rescheduling agreement, but has not yet signed the Agreed Minute.
10/ The second tranche of this agreement, covering the nine months through end-September 1995, will not be implemented.
11/ Former Socialist Federal Republic of Yugoslavia.
12/ Fund arrangement in place, rescheduling expected shortly.
13/ Last rescheduling on Toronto terms.
14/ An extension of the consolidation period through end-1995 has been requested.
15/ An extension of the consolidation period in line with the extension of the rights accumulation program (to November 1995) has been requested.

Table 5. Low-Income Rescheduling Countries: Consolidation Periods and Dates for Actual or Possible Debt-stock Operations 1/

	Date of actual/possible debt-stock operation specified in latest Agreed Minute 2/	End of current or last consolidation period	Period between end of consolidation period and stock-of-debt operation (in months)	Current and prospective (...) IMF arrangement	
				Type	End of Arrangement period 3/
Uganda	2/95 4/	Stock 4/	–	ESAF	9/97
Bolivia	1/95 5/	12/97	–	ESAF	12/97
Tanzania	1/95	6/94	7	...	...
Zambia	7/95	3/95	4	RAP	11/95
Mali	10/95	8/95	2	ESAF	8/95
Honduras	10/95	7/95	3	ESAF	7/95 6/
Guinea	11/95 7/	12/95	...	ESAF	9/96 8/
Benin	12/95	12/95	–	ESAF	1/96
Ethiopia	12/95	10/95	2	SAF	10/95
Sierra Leone	12/95 2/	12/95	–	ESAF	3/97
Mozambique	3/96	6/95 9/	9	ESAF	5/93 10/
Burkina Faso	5/96	12/95	5	ESAF	3/96
Guyana	5/96	12/94	17	ESAF	7/97
Cameroon	3/97 2/	9/95	18	SBA	9/95
Chad	3/97	3/95	24	ESAF	9/97 11/
Niger	3/97	3/95	24	...	...
Côte d'Ivoire	3/97	3/97	–	ESAF	3/97
C.A.R.	4/97	3/95	25	...	...
Nicaragua	6/97 2/	6/97	–	ESAF	6/97
Senegal	8/97 2/	8/97	–	ESAF	8/97
Equatorial Guinea	12/97	2/96	22	ESAF	5/96
Mauritania	12/97 2/	12/97	–	ESAF	1/98
Guinea Bissau	2/98	12/97	2	ESAF	1/98
Togo	2/98 2/	9/97	5	ESAF	9/97

Sources: Agreed Minutes of debt reschedulings; and IMF staff estimates.

1/ In accordance with normal Paris Club practice to base reschedulings on agreed terms of reference when the number of creditors involved is very small, the reschedulings for Equatorial Guinea (1992, 1994), Cambodia (1995), and Chad (1995) were not based on full-fledged Agreed Minutes. Equatorial Guinea obtained enhanced concessions (London terms), and Cambodia and Chad obtained Naples terms, but no date for a stock-of-debt operation was specified in the terms of reference.

2/ The first Paris Club Agreed Minute incorporating London terms or Naples terms generally states that creditors will meet to consider the matter of the debtor country's stock of debt if for three years following the signing of the Agreed Minute the debtor country maintains satisfactory relations with the participating creditor countries, fully implements all agreements signed with them and continues to have an appropriate arrangement with the IMF. The clause for Cameroon was weaker, with creditors agreeing in principle to consider holding a meeting on the matter of the stock of debt. The agreements in 1994 with Sierra Leone, and in 1995 with Guinea, Nicaragua, Senegal, Mauritania, and Togo run beyond the original date for a stock-of-debt operation earlier envisaged.

3/ End of original arrangement period.

4/ The first stock-of-debt operation under Naples terms was agreed with Uganda, and provided a 67 percent net present value reduction. The stock operation was implemented earlier (February 1995) than the original date envisaged in the 1992 Agreed Minute (June 1995).

5/ Bolivia met the conditions for a stock-of-debt operation in March 1995, however, there was no consensus among creditors to choose a concessional option and creditors will consider a stock operation when such a consensus emerges.

6/ This was extended to July 1997.

7/ In the most recent Agreed Minute of January 1995, there is no reference to a stock-of-debt operation.

8/ A second annual ESAF arrangement was approved in September 1994, together with an extension of the original commitment period until November 1996.

9/ Consolidation period was extended.

10/ Mozambique's additional annual arrangement was approved on 6/15/94; in June 1995, the original commitment period was extended to December 1995, and the authorities have requested an extension of the consolidation period through end-1995.

11/ Board meeting scheduled for September 1995.

b. Middle-income countries

Most middle-income countries, by contrast, have graduated from the rescheduling process. Of the 30 middle-income countries that required Paris Club reschedulings in the past decade, 19 have now graduated, though some of the recent graduates (such as Costa Rica, the Dominican Republic, and Guatemala) have subsequently run up arrears to Paris Club creditors (Table 4). Moreover, the majority of the remaining middle-income countries with agreements now in force are expected to graduate at the end of their current consolidation periods. Four middle-income countries--Algeria, Croatia, the FYR Macedonia, and the Russian Federation--reached rescheduling agreements in the first seven months of 1995. All of these agreements incorporated graduated repayment schedules--involving short grace periods (2-3 years), with total debt-service payments (interest and principal combined) rising steadily over the repayment period (15 years). The agreement with FYR Macedonia--reflecting its exceptional circumstances--featured a deferral of arrears on post-cutoff date debt over 6 years.

6. Non-Paris Club bilateral creditors

Less progress has been made by debtors in negotiations with non-Paris Club official bilateral creditors. 1/ The Official Financing background paper (Chapter V) describes the agreements that have been reached over the past year. The largest single creditor in this group is the Russian Federation (for a description of Russia's claims on developing countries, see Box 5). For debtor countries that have reached rescheduling agreements with Paris Club creditors, the terms of these agreements prevent the debtor from reaching agreement with any other bilateral creditor that does not provide at least comparable treatment; however, they do not prevent the creditor offering, and the debtor agreeing, more generous terms. 2/ For a number of countries facing particularly severe debt and financing problems and with very large obligations to non-Paris Club official bilateral creditors, debt restructuring by these creditors would need to take fully

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1/ Under the Fund's long-standing practice of treating such creditors in parallel with Paris Club creditors, debts owed but not paid to non-Paris Club bilateral creditors are not treated as arrears for program monitoring purposes during the period specified in the Paris Club Agreed Minute for concluding bilateral agreements. If the debtor has not concluded agreements with its non-Paris Club creditors within this period, arrears will exist for program monitoring purposes unless the debtor is judged by the Fund to be making best efforts to conclude such agreements.

2/ Paris Club creditors also take into account the provision of new money by respective creditor groups in assessing comparability.

into account these countries' limited payments capacity. 1/ Early agreement would also be highly desirable so that normal relations with all creditors can be restored and the resulting debt-service obligations can be fully incorporated into medium-term macro-frameworks.

Box 5. Developing Countries' Debt to the Russian Federation

Based on the Russian authorities' data,[1] Russia is among the largest official bilateral creditors of developing countries. To summarize:

- According to the Russian valuation, Russian claims on developing countries inherited from the FSU exceeded US$170 billion at end-1993.

- On this valuation basis, Russia is a particularly important creditor of the heavily indebted poor countries. Two-thirds of the heavily indebted poor countries are indebted to Russia. Russia's claims account for around one quarter of these countries' total debt.

- Many of Russia's claims are disputed by debtors both in terms of coverage and in terms of valuation.

- Partly in consequence, only small payments have been received on this debt during the last five years.

- Russia has reached rescheduling and restructuring agreements, some involving substantial discounts, with several debtors (such as Bolivia 1990, Jordan 1992, and India 1993[2]).

[1]According to the Russian authorities, their debt should be valued at the U.S.S.R. Gosbank official ruble exchange rate (Rub 0.5854 per U.S. dollar as at end-1993) as was provided for in many of the debt agreements. For further details see Official Financing background paper, Appendix II.

[2]For details, see Official Financing background paper, Appendix II, Box 12.

An issue that has arisen over the last year or two was the need for certain countries of the former Soviet Union (FSU) to secure rescheduling agreements with their creditors, as a result of their extremely rapid build-up of external debt (described in Box 6). Paris Club rescheduling was not an option, as the debtors concerned generally had limited, if any, eligible debts to Paris Club creditors. 2/ Thus, the debtor was left to seek bilateral rescheduling agreements with its official creditors in the absence of the multilateral framework provided by the Paris Club. In some

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1/ Examples of such agreements already exist such as Russia's 1992 agreement with Jordan (see Official Financing background paper Appendix II, Box 12).

2/ Much of the debt also arose from the consolidation of payments arrears rather than from formal lending by government agencies (see Box 6).

cases, such as Ukraine, with a limited number of creditors involved, this process worked well. In others, such as Georgia, with a larger number of official creditors involved, in order to facilitate the process and obtain the financing assurances required for IMF support, the staff held meetings with concerned creditors. Most, though not all, official creditors agreed to undertake bilateral negotiations on the basis of the financing assumptions underlying the program. This is an evolving process--and not always a smooth one--where the staff is seeking to secure the financing assurances necessary for program approval with the cooperation of debtors and creditors concerned in the absence of the established multilateral framework provided by the Paris Club.

Box 6. External Debt of Certain Countries of the Former Soviet Union[1]

There has been a rapid build-up of external debt by certain countries of the former Soviet Union (FSU) such as Armenia, Georgia, the Kyrgyz Republic, and Tajikistan. In short:

- The build-up of debt to <u>non-FSU creditors</u> reflects bilateral and multilateral assistance in support of stabilization efforts and structural reforms as well as the use of import finance and, for Russia, the capitalization of interest on existing debt.

- The build-up of <u>intra-FSU debt</u>, mainly to Russia and Turkmenistan, reflects the conversion by Russia of correspondent account balances to state debts and the provision of new state credits; and the conversion of trade arrears to state debts.

- The sharp build-up of <u>trade-related arrears</u> results from the large rise in the price of energy imports (towards world market prices) in a system of traditional trade relations under which suppliers continued to deliver goods without payments.

- A factor in the debt build-up, was <u>inadequate debt-monitoring and control systems</u>; many countries have taken steps to set up and strengthen such systems.

- The profile of scheduled debt service for the medium term of several of these countries (notably Georgia and Tajikistan) raises the prospect of <u>further debt reschedulings</u> to reduce actual debt service to the country's payments capacity.

[1]For further details, see Official Financing background paper, Appendix II.

III. External Debt Sustainability for Heavily Indebted Poor Countries

1. Overview

The current mechanisms for handling the debt situation of the heavily indebted poor countries ensure that debt relief is given in support of adjustment by debtors on a case-by-case basis reflecting their highly varied external positions (see Box 2). The preliminary conclusions from the current analysis are that these mechanisms are likely to work for the majority of countries currently eligible for Naples terms in that they offer the likelihood of a durable exit from the rescheduling process consistent with the achievement of external-debt sustainability (for prospective debt service in 1995, see Chart 4 and for a definition of sustainability, see Box 8). These chances can be strengthened by actions by all of the principal parties--debtors, creditors, donors, and multilateral institutions--as discussed below. For a minority of currently eligible countries, existing mechanisms would not appear to provide good prospects for a durable exit from the rescheduling process. However, such countries may still be able to pursue policies conducive to adjustment and growth over the medium term with the support of flow reschedulings. 1/ But if these countries are ultimately to exit from the rescheduling process, with the advantages described below, they may eventually require some combination of higher debt relief from Paris Club creditors, more debt relief from other official bilateral creditors or commercial banks, or action to tackle their multilateral debt. Appropriate action would be most effectively tailored to individual circumstances as they become clearer in the adjustment process and as countries demonstrate through track records of adjustment that debt relief would be put to effective use. For the heavily indebted poor countries which are not yet eligible for Naples terms, it is difficult at this stage to make an assessment of the current mechanisms for handling their external debt situations, although some of these countries would appear to face extremely heavy debt burdens.

The current mechanisms for handling the external debt situations of the heavily indebted poor countries, including ensuring adequate financing to allow the countries to realize their growth potential, can be summarized as follows:

- The adoption by the country concerned of programs of adjustment and reform supported by the Fund and the World Bank and associated multilateral inflows.

1/ In fact, flow reschedulings--through the capitalization of interest in the consolidation period--initially provide for more debt relief and financing than equivalent in NPV terms stock operations. See Official Financing background paper, Appendix I, Chapter I.

- A consultative group meeting (generally annually) to secure the concessional bilateral assistance required from donors to finance the program.

- For countries unable to meet their debt-service obligations to official creditors in full, reschedulings by Paris Club creditors. For most of the heavily indebted poor countries, this involves a 67 percent net present value (NPV) reduction of debt service on eligible debt (flow reschedulings) under Naples terms 1/ with the prospect of a stock-of-debt operation for countries with three years of good track records under both Fund arrangements and rescheduling agreements.

- Comparable debt relief to that provided by the Paris Club by other official bilateral creditors and private creditors such as commercial banks.

This process has important advantages:

- it ensures that debt relief both under flow reschedulings (directly) and under stock-of-debt operations (via the required track record) is given in support of an adjustment effort by the debtor; and

- it provides for case-by-case treatment of individual debtors reflecting their very different external positions (see Box 2) both by creditors (with Paris Club creditors tailoring effective debt relief through the amount of debt rescheduled to financing needs) and by donors (in the Consultative Group process).

The staff has taken steps to strengthen country-specific debt-sustainability analysis in staff reports on heavily indebted poor countries (see Box 7). Pending results of this analysis, subsequent sub-sections present a preliminary assessment of the mechanisms described above from the viewpoint of external-debt sustainability. This concept is summarized in Box 8.

Sub-section 2 focusses on external debt-service obligations in 1995 resulting from hypothetical stock-of-debt operations for 27 low-income rescheduling countries, while sub-section 3 looks at prospective debt service and the external financing positions over 20 years for 14 of these countries that could be early candidates for stock-of-debt operations or whose debt burden is particularly difficult. 2/ It should be emphasized that the current analysis is only partial and the results need to be treated as preliminary. While analyses based on movements of the NPV of debt-to-exports ratios were not included for the 14 countries where detailed medium-term projections were made, these will be included in the proposed

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1/ For details, see Box 4.
2/ For an explanation of these groups and a listing of the countries involved see Box 1 and Table 1.

Box 7. Proposed Country-Specific Analysis of Debt Sustainability

In the light of the Board discussions earlier this year on multilateral debt,[1] the staff, in consultation with the World Bank, has prepared guidelines on the form debt-sustainability analysis should take in staff reports on members' requests for Fund arrangements and Article IV consultation reports for heavily indebted poor countries.[2] This analysis needs to be carried out on a country-specific, case-by-case basis given:

- the limitations of the stylized exercises--based on uniform assumptions of export growth--used in the multilateral debt papers earlier this year;[3] and

- the need for the projections to be made in the framework of policy discussions with the authorities--such as in the Policy Framework Paper process.

It should be recognized, however, that even in such a country-specific framework, it is difficult to project the response of countries to adjustment and reform, and the conclusions will remain highly dependent on the assumptions made (such as on exports and aid flows, where a wide range of views is possible).

The objective of the country-specific analysis is to provide, in collaboration with the World Bank, an assessment of:

- the sustainability of a country's external debt situation over the medium and long term, taking into account possible stock-of-debt operations, export growth prospects, and new borrowing consistent with the proposed adjustment path and consistent with achieving the country's potential growth rate;

- the robustness of these results to key changes in the overall parameters such as export growth and the volume and terms of available external finance, including grants; and

- the implications of this analysis for the terms of new borrowing.

The analysis will also include a discussion of the fiscal burden of external debt (see Box 3). The proposed amendments to the guidelines on external borrowing in Fund arrangements (see separate paper, forthcoming) are intended, inter alia, to bring a wider range of external borrowing within the purview of this analysis.

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[1] See Chairman's concluding remarks, March 1, Buff/95/19 and Joint Report to the Development Committee as circulated to Executive Directors by the Secretary on April 24, 1995 (corrected version), contained in the Appendix.

[2] The World Bank will be undertaking similar analysis in their Country Assistance Strategy papers.

[3] "Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries--Preliminary Considerations" (SM/95/29, 2/7/95), "Multilateral debt of the Heavily Indebted Poor Countries" (SM/95/30, 2/9/95), and "Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries - Further Consideration" (SM/95/61, 3/31/95) (the last two papers prepared jointly with World Bank staff).

Box 8. External Debt Sustainability

The external position of a country could be considered sustainable if the country is expected to be able to meet its external obligations in full without future recourse to debt rescheduling or relief or the accumulation of arrears, over the medium or long term. Reducing the burden of current and future obligations to sustainable levels could also eliminate a possible disincentive effect on investment and new capital inflows.

The key indicators for assessing sustainability could be:

- the ratio of scheduled debt service to exports of goods and services;
- the external financing gap--after allowing for expected inflows in the form of grant receipts, loan disbursements, and any commercial capital flows; and
- the ratio of the net present value of the debt to exports.

The levels of the above indicators that could be considered sustainable vary from country to country depending on specific macroeconomic and other circumstances. As important as the starting levels of such indicators is their trend over the projection period. A country's external debt position might generally be considered sustainable over the projection period if:

- scheduled debt-service ratios were declining to below 20-25 percent of exports of goods and services;
- financing gaps were eliminated; and
- the ratios of the NPV of debt-to-exports decline to below 200-250 percent of exports.

The definition of sustainability used here differs importantly from the normal Fund definition of medium-term viability which precludes recourse to further exceptional financing (such as the use of Fund resources). Given the heavy dependence of the heavily indebted poor countries on continued aid inflows including those of an exceptional nature, and the continued likely need for future use of ESAF resources, it would be extremely difficult for many of these countries to reach viability defined to exclude exceptional finance.

country-specific analysis. 1/2/ For many countries, the integration of the analysis into the policy dialogue was necessarily imperfect--reflecting the different stages of policy discussions. In the context of the country-specific work described above, the staff will continue to look at the issue of debt sustainability and will report in individual cases and periodically survey the general situation. The current analysis, however, provides a

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1/ Such an analysis was included in the May 1995 World Bank Country Assistance Strategy paper for Uganda which showed that this ratio fell from 318 percent in 1995 after the Naples terms stock-of-debt operation to 150 percent in 2002 on certain assumptions.

2/ Lack of necessary data--in particular on servicing of existing debt beyond 2014--precluded a dynamic analysis over time of the NPV of debt-to-exports ratios in this paper. This would be facilitated by a reconciliation of existing external debt-service data maintained by Fund Area Departments with data in the Bank's DRS.

first assessment of the likely results of stock-of-debt operations under Naples terms, bearing in mind the uncertainties of longer-term country-specific projections and, in particular, of the projections of aid flows on which most countries are heavily dependent.

The assessment of whether current mechanisms can achieve debt sustainability assumes the desirability of an eventual exit from the rescheduling process. The paramount advantage of such an exit is a return to normal relations with the international financial community, characterized by spontaneous financial flows and the full honoring of commitments. In addition, repeated reschedulings involve significant costs for policy makers and create uncertainty about future debt relief; and they may foster the belief on the part of borrowers that financial contracts need not be honored. Moreover, "debt overhangs" may have contributed to investment disincentives, potentially delaying private capital flows required to generate sustainable growth (though a review of this issue for heavily indebted poor countries found such effects difficult to identify given the multitude of other influences on investment and growth (see Box 9)).

Box 9. External Debt Overhang

The Official Financing background paper looks at the relationship between external debt and investment/growth in 39 heavily indebted poor countries.[1 2] It concludes that:

- The direct relationship between debt and investment or economic growth in heavily indebted poor countries seems to be weaker than in middle-income developing countries. It is difficult to disentangle the role of any debt overhang from other factors that have clearly worked to depress economic growth and investment in the heavily indebted poor countries.

- Total net flows mainly from official sources to these countries have remained strongly positive throughout the 1980s and 1990s despite their heavy debt burdens.

- Several countries, such as Bolivia, Guyana, and Uganda, have experienced rising investment and relatively buoyant growth in the 1990s despite heavy external debt burdens.

- Nevertheless, heavy external debt burdens may have been associated with disincentives to invest, which could have contributed to the relatively poor growth performance of some of these countries.

- Widespread acceptance of the proposition that external debt levels for many of these countries go beyond their debt-servicing capacity has been instrumental in the Paris Club's agreeing to implement increasingly concessional rescheduling terms for low-income rescheduling countries, involving most recently 67 percent NPV reductions for most countries under Naples terms.

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[1] See background paper, Appendix I, Chapter II.

[2] All 41 heavily indebted poor countries (see Table 1), excluding Angola and Somalia due to data limitations.

2. Twenty-seven low-income rescheduling countries: impact in 1995 of hypothetical stock-of-debt operations

This sub-section looks at the possible impact of hypothetical stock-of-debt operations on debt service in 1995 for 27 low-income rescheduling countries which are currently eligible for Naples terms from the Paris Club creditors. 1/2/ Box 2 and Chart 3 summarize the diverse external positions of these low-income rescheduling countries in 1994. Chart 4 summarizes the structure of projected external debt service in 1995--distinguishing between payments on restructurable (pre-cutoff date) and non-restructurable debt.

For all countries covered, debt service on post-cutoff date debt to Paris Club creditors is less than 5 percent of exports, except for Côte d'Ivoire (6 percent), Guinea-Bissau (17 percent), and Nicaragua (10 percent) (Chart 5). Several of these countries face high debt service to multilaterals (including to the Fund).

Chart 4 also shows the impact (marked with the star) of a hypothetical and illustrative stock-of-debt operation on Naples terms assumed to have taken place at the beginning of 1995. 3/ The hypothetical stock-of-debt operation assumed would reduce debt service on restructured debts in 1995 to below 5 percent of exports of goods and services for all but three countries. 4/ For 13 of the 27 countries concerned, 5/ overall debt service would decline to less than 20 percent of exports of goods and services following such an operation, while in nine other countries 6/ debt-service ratios would be between 20 and 30 percent (Chart 3). Two countries (Cameroon and Sierra Leone) face heavy short-term debt-service obligations in 1995 but these would be expected to fall in subsequent years, while the three remaining countries (Guinea-Bissau, Mozambique, and Nicaragua) face debt-service levels after this hypothetical stock-of-debt operation that would appear unsustainable.

1/ For a listing of countries, see Box 1 and Table 1.

2/ All have received concessional reschedulings from Paris Club creditors, with the exception of Angola which is now eligible for borrowing from the World Bank exclusively on IDA terms ("IDA only").

3/ For details, see Official Financing background paper, Appendix I, Chapter I. An NPV reduction of 67 percent is assumed for all countries except Cameroon, Guinea, and Honduras where a 50 percent NPV reduction is assumed (see Box 4). Key assumptions include comparable treatment by other bilateral and private creditors. No "topping up"--see Box 4 under "Coverage"--of debt previously rescheduled on Toronto or London terms is assumed.

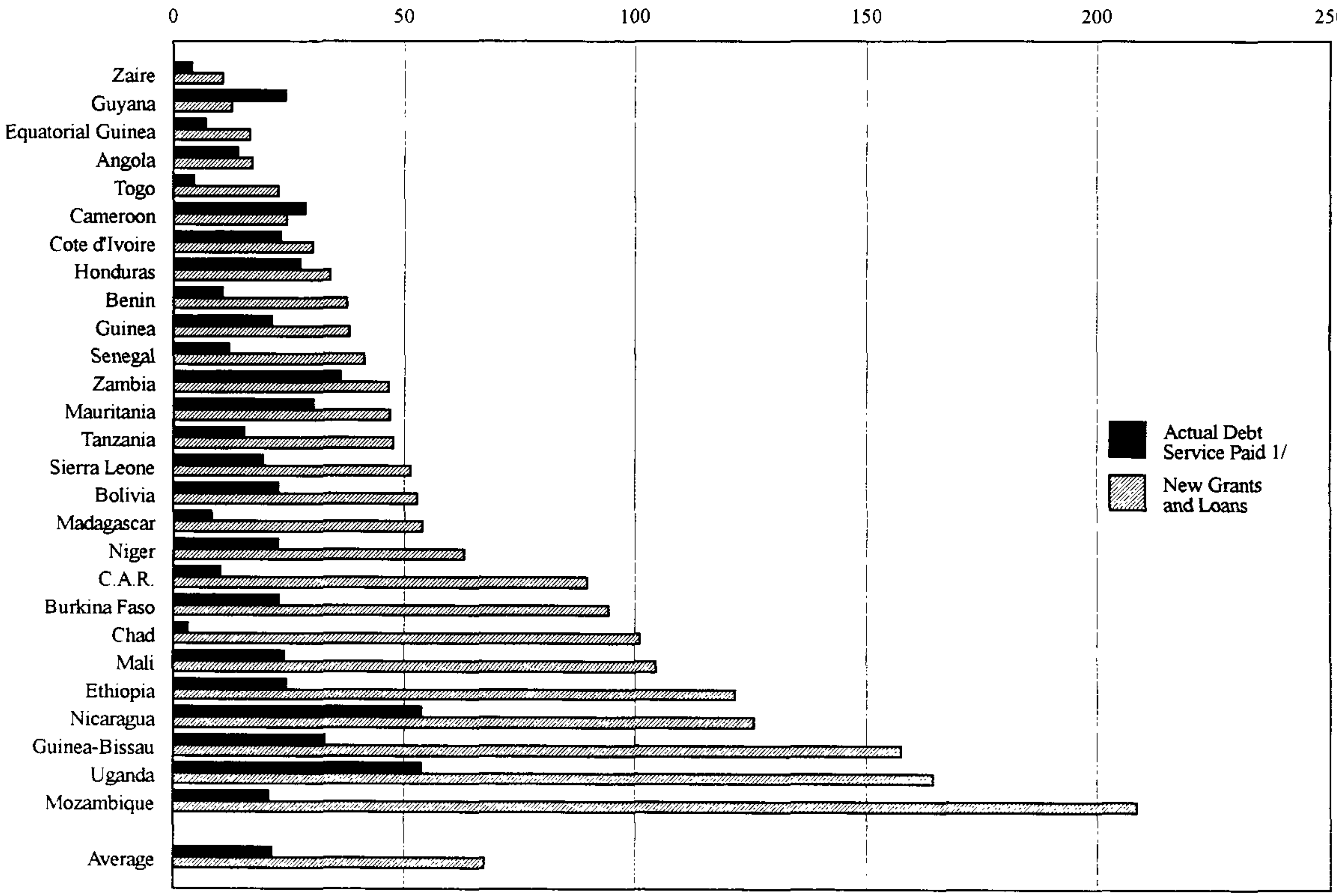
4/ Guinea-Bissau, Nicaragua, and Zaïre.

5/ Angola, Benin, Burkina Faso, C.A.R., Chad, Equatorial Guinea, Ethiopia, Mali, Mauritania, Niger, Senegal, Tanzania, and Togo.

6/ Bolivia, Côte d'Ivoire, Guinea, Guyana, Honduras, Madagascar, Uganda, Zaïre, and Zambia; Uganda after its February 1995 stock-of-debt operation.

Chart 3: Low-Income Rescheduling Countries: Actual Debt-Service Payments and New Financing, 1994

(In percent of exports of goods and services)

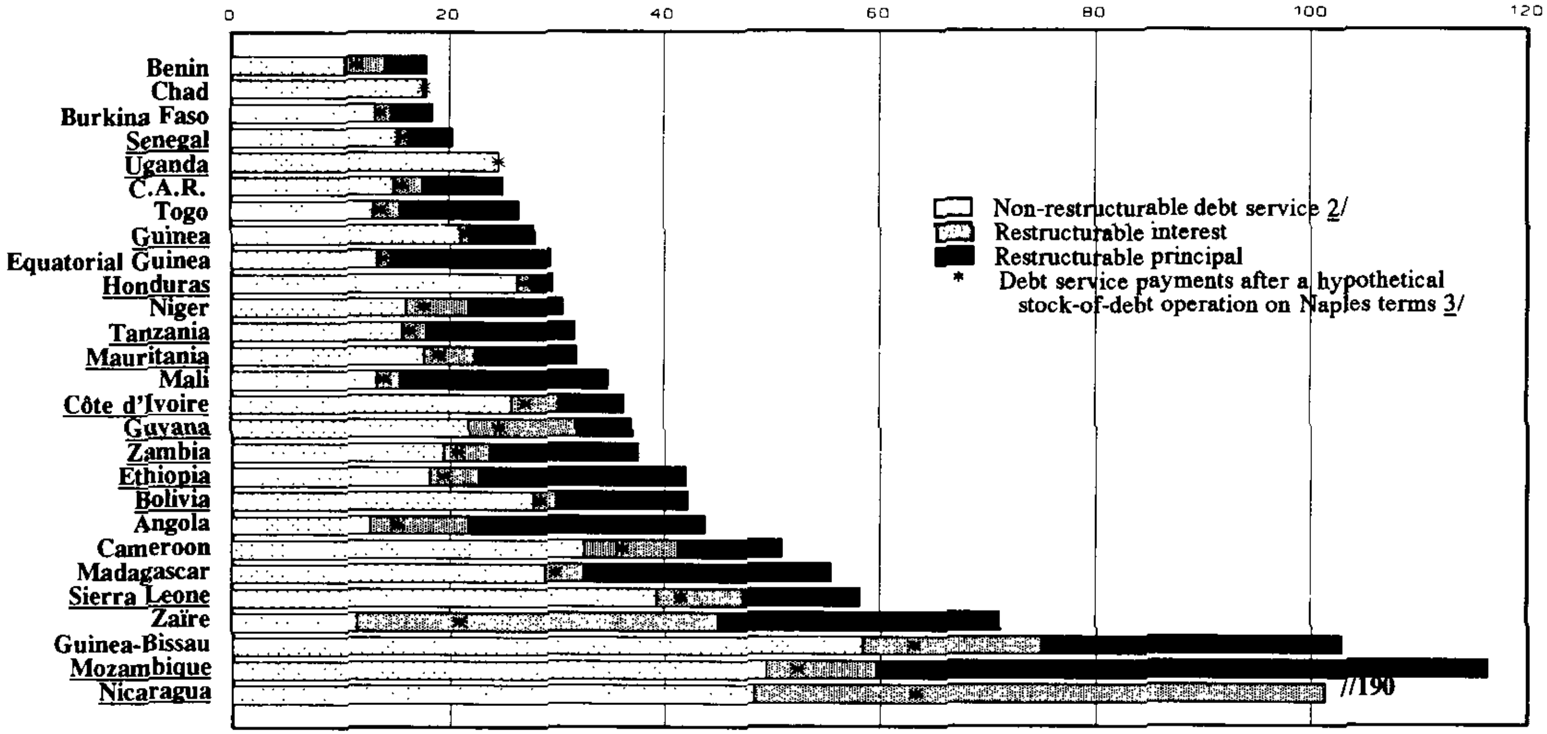


Source: Official Financing background paper (Appendix I, Chapter I, Table 1)

1/ Consists of scheduled debt service less debt relief and change in arrears.

Chart 4. Low-Income Rescheduling Countries: Structure of Scheduled Debt-Service Payments, 1995 1/

(In percent of exports of goods and services)



Source: Official Financing background paper (Appendix I, Chapter I, Table 2). For countries underlined, the effects of hypothetical stock-of-debt operations on Naples terms through 2014 were examined (see Section II and Background Paper, Appendix I, Chapter I).

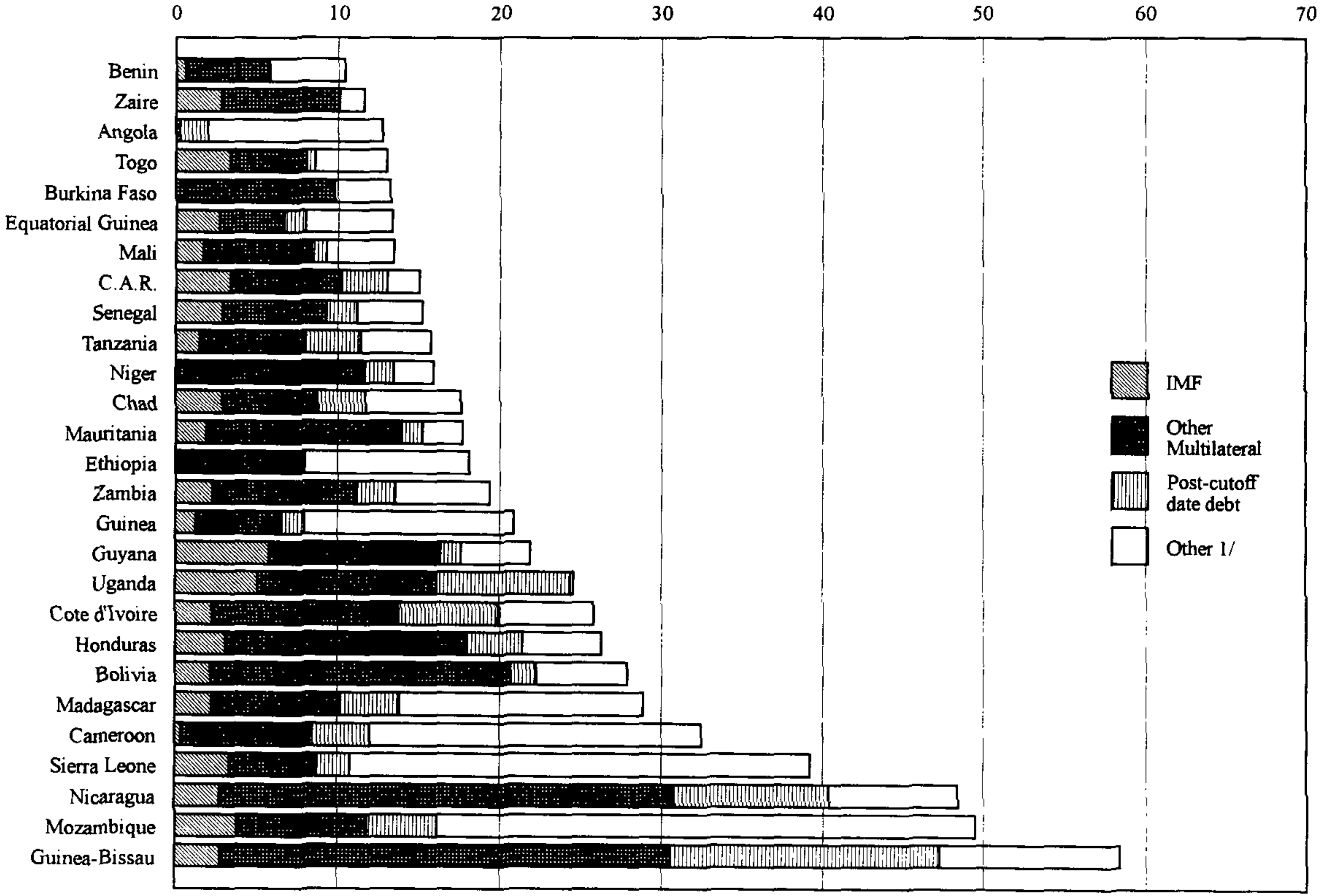
1/ The debt is restructured into a mortgage type repayment schedule under which principal payments would initially be eliminated or restricted to a very small fraction. Hence, in early years after a stock-of-debt operation, payments on restructured debt would be limited to about 33 percent (with 67 percent NPV reduction of the stock) of currently scheduled restructurable interest payments. Total payments on restructured debt thereafter would rise by about 3 percent a year in nominal terms. For further background see Official Financing background paper, Appendix I, Box 3.

2/ For details see Chart 5.

3/ After February 1995 stock-of-debt operation in the case of Uganda.

Chart 5: Low-Income Rescheduling Countries: Structure of Scheduled Debt-Service Payments on Non-Restructurable Debt, 1995

(In percent of goods and services)



Source: Official Financing background paper (Appendix I, Chapter I, Table 2)

1/ Includes short-term debt, new borrowing, gap financing, debt service from previous reschedulings on concessional terms, and private sector debt.

Beyond 1995, with the repayment profile under Naples terms, the restructured debt-service obligations would rise at about 3 percent per annum in nominal terms, which would be consistent with unchanged or decreasing debt-service ratios on this debt provided nominal exports grow by at least this amount. For most countries, the structure of debt service in 1995 would appear representative of the future debt-service profile. However, this is not true of all cases, particularly for countries that face large obligations to the Fund. The following section looks in detail at the effect of a hypothetical stock-of-debt operations for 14 of these countries through 2014.

3. Medium-term analysis for 14 selected low-income rescheduling countries

The analysis in sub-section 2 above focuses on the impact of a hypothetical stock-of-debt operation on debt service in 1995 on existing debt for 27 low-income rescheduling countries. The background paper (Appendix I, Chapter I) extends this analysis for 14 of these countries over the next 20 years, incorporating new lending on the basis of country-specific medium-term scenarios. These countries were chosen as they could be relatively early candidates for a debt-stock operation (Bolivia, Ethiopia, Guinea, Guyana, and Sierra Leone) 1/ or because their debt burden is particularly difficult (Côte d'Ivoire, Honduras, Mauritania, Mozambique, Nicaragua, Senegal, Tanzania, Uganda, and Zambia). Most of the remaining 13 low-income rescheduling countries not covered in this forward-looking analysis either face relatively less heavy debt burdens (with debt service after hypothetical stock-of-debt operations of 18 percent or less in 1995 2/) or are less advanced in their adjustment programs. 3/ It should be emphasized that coverage is not comprehensive, and there are several other heavily indebted poor countries which face extremely difficult debt situations.

The analysis seeks to assess whether the countries concerned can achieve external-debt sustainability (as discussed in Box 8) as a result of stock-of-debt operations on Naples terms. The main conclusions of this medium-term analysis for the 14 countries are:

- On the assumption of continued strong adjustment efforts, 10 of the 14 countries considered would appear to reach sustainable medium-term external positions (as defined in Box 8) after a hypothetical stock-of-debt

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1/ See Table 5.
2/ Benin, Burkina Faso, C.A.R., Chad, Equatorial Guinea, Mali, Niger, and Togo.
3/ Such as Angola, Madagascar, and Zaïre.

operation on the terms assumed above. 1/2/ This would also appear to be the case for Sierra Leone, though given the steep decline in exports in recent years and the current difficult security situation, the prospects for sustainability would appear more uncertain.

- Mozambique, Nicaragua, and Zambia face such large debt burdens that stock-of-debt operations on Naples terms would likely not result in sustainable external positions. 3/ While for Zambia (and Mozambique) the topping up by Paris Club creditors 4/ of debt previously rescheduled on Toronto and London terms would ease financing pressures to a considerable extent, Zambia would continue to face very high debt-service obligations to the Fund following clearance of arrears and replacement of the current Rights Accumulation Program by an ESAF arrangement, and would require substantial balance of payments assistance during the peak years of ESAF repayment.

- The results are dependent on the country-specific assumptions made on export growth and the terms of new financing. Average growth of exports of around 15 percent a year was projected for 1995 and 1996 (based on PFPs) 5/ but a sharp decline in the rate of growth in the next years; growth of around 7 percent a year was projected by 2014; in virtually all cases a decline of aid flows in real terms was assumed. If export growth were lower by 1 percent per annum--which by the end of the projection period would result in exports more than 20 percent lower than under the base case--or if external finance were provided at interest rates on average 1 percent per annum higher, and no other adjustment occurred, significant external financing gaps would emerge for most of these countries. This does not imply that in all cases sustainability would be threatened: in many cases, countries could adjust, for example, by lowering imports or shifting more resources to the export sector, though in some cases this could be at

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1/ See footnote 1, page 24 and Official Financing background paper, Appendix I, Chapter I.

2/ Of these countries, four (Ethiopia, Mauritania, Senegal, and Tanzania) are projected to have debt service in 1995 after a hypothetical stock-of-debt operation below 20 percent of exports and six (Bolivia, Côte d'Ivoire, Guinea, Guyana, Honduras, and Uganda) debt service between 20 and 30 percent of exports.

3/ Mozambique and Nicaragua both face debt service after hypothetical stock-of-debt operations of over 40 percent of exports in 1995; while Zambia's prospective debt service is only 21 percent, it faces high future debt service to the Fund as noted in the text.

4/ For an explanation, see Box 4 under "Coverage".

5/ For 1995, export growth in the major coffee-producing countries (Ethiopia, Honduras, Nicaragua, Tanzania, and Uganda) is projected to be boosted by the full-year effect of the surge in coffee prices that took place in the second half of 1994. For the remaining nine countries, the growth in exports in 1995 is projected to average 8 percent. For details, see background paper, Appendix I, Chapter I, Box 4. The assumptions are broadly consistent with those in the latest WEO.

the expense of potential growth. These issues would have to be explored further in the country-specific debt-sustainability analysis. Some countries--such as Ethiopia, Honduras, Sierra Leone, and Zambia--are more vulnerable to external shocks because their export base is less diversified than in other cases (such as Bolivia, Côte d'Ivoire, Guyana, and Tanzania).

- Virtually all of the 14 countries will remain heavily dependent on continued large net resource flows on concessional terms regardless of what is done on their debt. External-debt sustainability can be reached only on the assumption of the continuation of such inflows.

4. Conclusions and next steps

Table 6 and Box 10 attempt to bring together (1) the analysis above on the impact of hypothetical stock-of-debt operations in 1995 on 27 low-income rescheduling countries (sub-section 2) and the more detailed medium-term analysis in sub-section 3 for a more limited set of 14 of these countries, and (2) the earlier stylized analysis on multilateral debt for all heavily indebted poor countries. 1/ Table 6 shows the structure of the existing external debt of the 41 heavily indebted poor countries by principal creditors. 2/ Box 10 presents a preliminary categorization of those same countries by their external-debt situations and the prospects for achieving medium-term sustainability. The country groupings proposed are inevitably judgmental and will need to be refined by detailed country-specific analysis, particularly for the countries not covered by the medium-term analysis summarized above.

The above analysis suggests that Naples terms from Paris Club creditors combined with comparable, or in some cases more generous, 3/ treatment from other bilateral official and private creditors offer the prospect for achievement of debt sustainability and for an exit from the rescheduling process for the majority of the low-income rescheduling countries. However, this conclusion is dependent on achieving the assumed export growth or further adjustment by the country concerned. Virtually all of the countries will remain heavily dependent on continued (although, in the scenarios,

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1/ "Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries--Preliminary Considerations" (SM/95/29, 2/7/95), "Multilateral debt of the Heavily Indebted Poor Countries" (SM/95/30, 2/9/95), and "Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries - Further Consideration" (SM/95/61, 3/31/95) (the last two papers prepared jointly with World Bank staff).

2/ For country coverage, see Box 1.

3/ In cases where the creditor or group of creditors concerned has very large claims on a particular debtor, the creditor would need to take fully into account the debtor's limited payments capacity.

Table 6. External Debt of Heavily Indebted Poor Countries: Characteristics of Existing Debt

	Total external debt (end-1993)		NPV of total debt service to exports 1/ as at end 1993	Eligible for Paris Club stock of debt operations on Naples terms 2/	Debt by principal non-Paris Club creditor group 3/				
	Total US$ billion	Of which multi-lateral (percent)	(percent)		Commercial banks	Russia	Multilaterals (M) IMF	World Bank	Other
Angola	9.7	1	243	4/		✓			
Benin	1.5	49	137	✓					
Bolivia 5/	4.2	52	349	✓					✓
Burkina Faso	1.1	73	108	✓					
Burundi 6/	1.1	83	408	7/			✓ 8/	✓	✓
Cameroon	6.6	21	255	✓	✓			✓	
C.A.R.	0.9	63	240	✓					
Chad	0.8	76	157	✓					✓
Congo	5.1	11	341	4/	✓				✓
Côte d'Ivoire 5/	19.1	16	483	✓	✓			✓	
Equatorial Guinea	0.3	41	343	✓					
Ethiopia 5/	4.7	40	373	✓		✓			
Ghana	4.6	68	225	7/			✓ 8/		
Guinea 5/	2.9	41	237	✓		✓			
Guinea-Bissau	0.7	49	1,105	✓		✓		✓	✓
Guyana 5/	1.9	40	410	✓			✓ 8/		✓
Honduras 5/	3.7	54	258	✓		.		✓	✓
Kenya	7.0	43	227	4/9/				✓	
Lao P.D.R.	2.0	24	233	7/		✓			
Liberia 6/	1.9	37	295	4/			✓ 10/11/		
Madagascar	4.6	34	647	✓					
Mali	2.7	45	286	✓		✓			
Mauritania 5/	2.2	37	313	✓	✓				✓
Mozambique 5/	5.3	18	1,106	✓		✓	✓ 8/	✓	
Myanmar 6/	5.5	25	431	7/	✓				
Nicaragua 5/	10.4	11	2,632	✓		✓	✓ 8/		✓
Niger	1.7	47	318	✓					
Nigeria	32.5	13	242	4/7/	✓				
Rwanda 6/	0.9	76	304	7/			✓ 8/	✓	✓
São Tomé & Príncipe	0.3	57	1,049	7/				✓	✓
Senegal 5/	3.8	51	174	✓					
Sierra Leone 5/	1.4	25	594	✓	✓		✓ 11/		
Somalia 6/	2.5	36	3,086	4/		✓	✓ 10/12/	✓	✓
Sudan 6/	16.6	17	2,750	4/	✓		✓ 10/12		
Tanzania 5/	7.5	35	453	✓					
Togo	1.3	54	180	✓					
Uganda 5/	3.1	68	812 13/	14/		✓ 11/	✓	✓	
Viet Nam	24.2	1	596	9/	✓	✓			
Yemen, Republic of	5.9	19	289	7/		✓			
Zaïre 6/	11.3	24	616	✓			✓ 8/10/		✓
Zambia 5/6/	6.8	37	489	✓			✓ 10/11/		

Sources: World Bank Debtor Reporting System; and IMF staff estimates.

1/ Using World Bank methodology (see SM/94/237, Annex, Chapter II); debt ratios allow cross-country comparison of the debt-service burden but must be interpreted with care (see Box 2, SM/95/30, 2/9/95).

2/ ✓ indicates whether Paris Club concessional rescheduling has taken place.

3/ The following rules of thumb were used in these columns: for multilaterals, ✓ where debt service to that multilateral group in 1995-2014 exceeds 5 percent for more than 2 years, assuming U.S. dollar 3 percent growth in exports 1995-2014, see charts in Appendix I, SM/95/90, 2/9/95; for commercial banks, ✓ where bank debt is significant; for Russia, ✓ where Russian debt exceeds one-fifth of total debt on their valuation. For a fuller discussion of assumptions on multilateral debt see SM/95/30, 2/9/95.

4/ Non-concessional rescheduling–Angola (1989), Congo (1994), Kenya (1994), Liberia (1984), Nigeria (1991), Somalia (1987), Sudan (1984).

5/ Examined in more detail in the Official Financing background paper; see Appendix I, Chapter 1.

6/ Subject to greater uncertainty as an arrears case, or lack of current IMF involvement.

7/ Not (yet) eligible for Naples terms.

8/ Faces debt service to the IMF in 1995-2014 in the range of 5-10 percent of exports for more than two years assuming export growth of 3 percent per annum in U.S. dollar terms.

9/ Exit rescheduling; no stock-of-debt clause.

10/ Assuming clearance of arrears with associated financing aid, described in Section III.3 of "Issues and Developments in Multilateral Debt and Financing for Heavily Indebted Poor Countries–Preliminary Considerations" (SM/95/29, 2/7/95).

11/ Faces debt service to the IMF in 1995-2014 in the range of 10-20 percent of exports for more than two years assuming export growth of 3 percent per annum in U.S. dollar terms.

12/ Faces debt service to the IMF in 1995-2014 of more than 40 percent of exports for more than two years assuming export growth of 3 percent pr annum in U.S. dollar terms.

13/ Before February 1995 stock-of-debt operation; estimated at 318 percent in 1995 after operation.

14/ Stock-of-debt operation agreed in February 1995.

Box 10. Heavily Indebted Poor Countries: Prospects for Medium-Term Sustainability[1]

This box is a first attempt to assess the prospects for external-debt sustainability for all 41 heavily indebted poor countries based on the partial analysis described in Section III. The composition of the groups is judgmental and is subject to change as a result of both more detailed country-specific analysis and country developments as adjustment strategies are implemented supported by existing mechanisms.

Focussing initially on the 27 low-income rescheduling countries,[1] based on the effects of a hypothetical stock-of-debt operation on debt service in 1995 and the more detailed medium-term analysis of 14 of these countries, there would appear to be four groups:

- For 18 low-income rescheduling countries a stock-of-debt operation on Naples terms from Paris Club creditors, once the country concerned has established a strong track record of adjustment, would appear to provide a good prospect for achieving sustainability and thereby an exit from the rescheduling process, based on assumptions of continuing adjustment and aid inflows and comparable action by other creditors. These countries are Benin, Bolivia, Burkina Faso, C.A.R., Chad, Côte d'Ivoire, Equatorial Guinea, Ethiopia, Guinea, Guyana, Honduras, Mali, Mauritania, Niger, Senegal, Tanzania, Togo, and Uganda.[2] Two of these countries--Côte d'Ivoire and Ethiopia--would need large concessions from commercial banks and Russia, respectively, consistent with their payments capacity. Uganda has already received a stock-of-debt operation from Paris Club creditors, though it still faces a heavy burden of multilateral debt.

- For four low-income rescheduling countries (Cameroon, Madagascar, Sierra Leone, and Zaïre) a stock-of-debt operation under Naples terms from Paris Club creditors might in due course achieve sustainability and thereby an exit from the rescheduling process, though because of relatively high debt burdens, this prospect appears less secure than for countries in the category above.[3] Of these countries, only Sierra Leone has a current arrangement with the IMF; it is, therefore, somewhat early to make an assessment for the three other countries.

- Four low-income rescheduling countries--Guinea-Bissau, Mozambique, Nicaragua, and Zambia--on current analysis, appear to have little prospect of achieving sustainability through an exit from the rescheduling process via a stock-of-debt operation under Naples terms even on favorable assumptions, due to their extremely heavy debt burdens. Nicaragua faces an extremely large debt to Russia (as does--to a lesser extent--Mozambique), Guinea-Bissau and Zambia face large multilateral debt service, the latter to the IMF assuming successful completion of the current Rights Accumulation program.

- One low-income rescheduling country (Angola) is not currently eligible for Naples terms from Paris Club creditors (it received a nonconcessional rescheduling in 1990 though is now IDA-only). Given the uncertainties facing Angola as it emerges from internal conflict, it would appear too early to make an assessment of its external sustainability though it faces a large debt to Russia.

The remaining 14 countries can be divided into two groups, namely:

- Four countries that appear to have sustainable external positions without further action by Paris Club creditors. These include Ghana and Lao P.D.R. (which have never rescheduled; Lao P.D.R. would, however, require debt relief from Russia) and Kenya and Viet Nam, (which have received exit reschedulings, though Viet Nam still requires debt relief from Russia and commercial banks).

- Ten countries that have not received concessional reschedulings from the Paris Club. Five countries have never had reschedulings (Burundi, Myanmar, Rwanda, São Tomé and Príncipe, and Yemen). The remaining five countries have received non-concessional reschedulings (Congo and Nigeria received lower middle-income country terms in 1994 and 1991, respectively, and Liberia, Somalia, and Sudan received earlier reschedulings on non-concessional terms.) Given that these countries have not yet entered into the process of establishing track records of adjustment, it would be premature to make any firm assessment of the prospects of achieving sustainability and an exit from the rescheduling process via stock-of-debt operations, for which these countries are not yet eligible, and some may not need. However, it would appear that, on current information, five of these countries (Burundi, Rwanda, São Tomé and Príncipe, Somalia, and Sudan) face extremely difficult external debt situations.

[1] For a listing of countries concerned, see Box 1 and Table 1.

[2] The eight countries not covered in the medium-term analysis described in sub-section 3 (Benin, Burkina Faso, C.A.R., Chad, Equatorial Guinea, Mali, Niger, and Togo) all have debt service in 1995 after a hypothetical stock-of-debt operation of 18 percent or less of exports.

[3] Cameroon's Paris Club stock-of-debt clause, contained in its 1994 agreement, is weaker than the customary clause with creditors agreeing in principle to hold a meeting on the matter of Cameroon's stock of debt.

declining) aid inflows. The prospects for a durable exit from the rescheduling process would be enhanced by:

- debtor countries strengthening their adjustment efforts;

- creditor countries being prepared in some cases to top up previous concessional reschedulings;

- donors focussing highly concessional assistance on the low-income rescheduling countries that persist with strong adjustment policies, particularly in the early years after stock-of-debt operations; and

- significant reserve build-ups being incorporated in medium-term projections, on which stock-of-debt operations are based, in order to provide a cushion against external shocks, given that all debt service to Paris Club creditors after a stock-of-debt operation is non-restructurable.

Even with these efforts, however, based on the present analysis, Naples terms combined with broadly comparable treatment from other official bilateral and private creditors would appear insufficient for four low-income rescheduling countries 1/ and might not suffice for a further four of these countries 2/ to attain sustainability. These are tentative judgements which may change as these countries progress with their adjustment efforts supported by the mechanisms described above and as further analysis is pursued. As these countries' circumstances evolve and as adjustment continues, creditors, including the international institutions, might consider whether their debt problems need to be addressed in a concerted way, but tailored on a case-by-case basis, to achieve debt sustainability and a durable exit from the rescheduling process.

The low-income rescheduling countries' situation--their records of adjustment and the structure of their debt--differ widely and need to be kept under close review. These countries face high debt service to a variety of creditors (Table 6), including in some cases to the Fund and/or other multilaterals. 3/ They will be eligible, or continue to be eligible, 4/ for flow reschedulings from the Paris Club which will give them time to establish strong track records of adjustment and strengthen their external positions. Other official bilateral creditors and private creditors should also provide at least equivalent debt relief; where they are dominant creditors, more generous relief may be necessary in the light

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1/ Guinea-Bissau, Mozambique, Nicaragua, and Zambia.

2/ Cameroon, Madagascar, Sierra Leone, and Zaïre.

3/ As is indicated in Table 6, footnotes 11 and 12, three low-income rescheduling countries face potential debt service to the Fund of over 10 percent of exports assuming a 3 percent annual growth of exports in U.S. dollar terms. One of these countries is currently in arrears (Zambia), while Sierra Leone is a post-arrears case; the remaining country is Uganda.

4/ With the exception of Uganda, given its stock-of-debt operation.

of the payments capacity of the countries concerned. The priority will be to ensure over the period ahead that these countries obtain sufficient external financing and mobilize sufficient domestic financing to attain their growth potential. For its part, the IMF could best assist the countries' adjustment efforts by helping provide such external finance through continued--and where appropriate enhanced--support under a permanent ESAF.

Of the remaining 14 heavily indebted poor countries, four countries appear to have sustainable external positions without further action by Paris Club creditors: Ghana and Lao P.D.R. which have never rescheduled, and Kenya and Viet Nam which have received exit reschedulings (Box 10). For the remaining ten heavily indebted poor countries which are not yet eligible for Naples terms, 1/ it would appear too early to make an assessment of the effectiveness of current mechanisms for handling their debt situations, including potential stock-of-debt operations under Naples terms. On current information, five of these countries 2/ would appear to face extremely difficult debt situations, including some countries with large obligations to the Fund. 3/ A more considered assessment should realistically await the sustained implementation of appropriate adjustment policies, with application of current mechanisms in the early phases of adjustment programs.

IV. Concluding Remarks and Issues for Discussion

Executive Directors may wish to comment on the following observations.

1. Naples terms can represent a decisive breakthrough for most eligible countries. Provided coverage is appropriately tailored to individual country circumstances, and at least comparable treatment is provided by other official bilateral and private creditors, stock-of-debt operations under these terms offer good prospects for an exit from the rescheduling process and for the establishment of external sustainability for many, though not all, eligible countries once the countries concerned have demonstrated strong track records of adjustment. Thus, for most countries,

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1/ The countries which have not yet had concessional reschedulings from Paris Club creditors (see Box 10 last category), namely: Burundi, Congo, Liberia, Myanmar, Nigeria, Rwanda, São Tomé and Príncipe, Somalia, Sudan, and Yemen; Angola could also be considered to be in this category.

2/ Burundi, Rwanda, São Tomé and Príncipe, Somalia, and Sudan.

3/ Liberia, Somalia, and Sudan face debt service to the Fund of over 10 percent of exports assuming a 3 percent annual growth of exports in U.S. dollar terms (Table 6, footnotes 11 and 12). All of these countries are currently in arrears (for details of assumed arrears clearance see SM/95/29, pages 11-12; ESAF resources were assumed up to 255 percent of quota with the remainder on GRA terms).

the current mechanisms are sufficiently powerful to handle their heavy debt burdens.

2. Most heavily indebted poor countries, even after stock-of-debt operations, will remain highly dependent on aid inflows. The chances of a durable graduation from rescheduling would be enhanced if donors increase the share of highly concessional assistance directed to those countries which persevere with strong adjustment programs and if donors maintain strong support for such countries after stock-of-debt operations.

3. The heavily indebted poor countries should themselves continue to pursue strong adjustment and structural reform policies designed inter alia to broaden and diversify their export base. Programs which are intended to serve as the base for stock-of-debt operations need to provide for a substantial reserve build-up to strengthen the capacity to withstand shocks.

4. Several countries will face relatively high total debt-service burdens, even after Paris Club stock-of-debt operations, partly due to their high debt to multilateral institutions. These countries will remain heavily dependent on new inflows, including from multilaterals, which need to be provided on appropriately concessional terms.

5. For some of the low-income rescheduling countries, the burden of total debt service--including to multilaterals--is such that a stock-of-debt operation on Naples terms would not appear sufficient to achieve medium-term sustainability. It is of immediate concern that these countries receive sufficient concessional external finance to realize their growth potential in support of sound programs. These countries differ widely as regards both the state of their adjustment efforts and the creditor composition of their debt. As they establish track records of adjustment under flow reschedulings, further consideration might be given by all their creditors to concerted action, tailored on a case-by-case basis, to establish external sustainability and provide a durable exit from the rescheduling process.

6. For heavily indebted poor countries that are not yet eligible for Naples terms reschedulings from Paris Club creditors--including some countries with large arrears to the Fund--it is difficult at this stage to assess whether existing mechanisms involving potential stock-of-debt operations could provide an exit from the rescheduling process; some of these countries face extremely heavy debt burdens.

7. The heaviest potential burden of debt service to the Fund arises in the large protracted arrears cases, for most of which settlement does not appear to be in early prospect. As resolution of these countries' arrears problems comes into clearer vision, the staff will explore possibilities for funding clearance of arrears in such cases in ways that reduce the risk of future problems. Assuming Zambia's arrears are cleared later this year as expected, it is planned to proceed under existing mechanisms through a successor ESAF program following arrears clearance.

8. Concern about the sustainability of both total and multilateral external debt service should be reflected in a greater focus on these issues in country-specific medium-term analysis for heavily indebted poor countries. This analysis should in particular focus on the appropriate terms of new borrowing, the sensitivity to changes in assumptions on exports and new inflows, the implications of external finance for growth and the fiscal implications of external debt.

9. For some of the countries in the FSU, there has been a rapid rise in external debt over the last three years. These countries' focus on debt monitoring and management needs to be strengthened. The staff has sought to assist attempts by some of these countries and their non-Paris Club official creditors to reach appropriate debt-rescheduling agreements outside the traditional multilateral framework provided by the Paris Club.

It is proposed, subject to Board approval, that the material in this paper and the Official Financing background paper, except for the medium-term country-specific projections, and certain sensitive Paris Club information, be published in the World Economic and Financial Surveys series and in a preprint version before the Annual Meetings.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

BUFF/95/18

March 1, 1995

Concluding Remarks by the Chairman
Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries - Preliminary Considerations
Executive Board Meeting 95/19 - February 24, 1995

This discussion was intended to be preliminary, and I will therefore only offer some concluding remarks to prepare for the discussion we will have on March 29, to further consider ways to tackle the problems of multilateral debt and financing of heavily indebted poor countries. My concluding remarks therefore are intended to reflect the current thinking of the Executive Board.

Directors commended the quality and coverage of the staff papers and expressed satisfaction with the close cooperation they reflected with the World Bank. A number of Directors considered that the staff tended to underestimate the magnitude of the multilateral debt problem of the heavily-indebted poor countries. Other Directors believed that, on the basis of the available analysis, the majority of the countries with multilateral debt problems should be able to manage their multilateral debt service with continued net multilateral transfers, provided that these countries generate at least moderate real export growth.

The discussion suggested that part of the difference in views on this basic point can be traced to different assessments of the realism of the assumptions underlying the analysis. For instance, is an annual real export growth rate of 3 percent, as assumed in the projections incorporating new lending, a minimum to be expected in many cases, or is it on the optimistic side, particularly in light of likely overall resource flows? It was widely agreed that more in-depth assessments are required on the basis of country-specific scenarios. Longer-term assessments should be placed in the context of comprehensive macroeconomic and financial frameworks, and should include more explicit discussions of the plausibility of medium-term financing plans, including aid and new disbursements, and of the interrelationships between overall external resource flows and economic growth.

Directors agreed broadly with the conclusion that all new multilateral and bilateral lending to these countries should be on concessional terms, and that all creditors should be encouraged to shift to concessional lending. We need to give further thought to how to push this forward. The Fund could do more in this area by extending the maturity coverage under borrowing ceilings in its arrangements with member countries and by tightening the definition of concessionality. It was observed that this will require a careful balancing of the need to ensure the availability of

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adequate financial support for adjustment programs and the need to limit future debt-service burdens. Several speakers stressed the importance of the PFP process and the need to strengthen it further.

On the Fund's financial involvement in these countries, speakers noted that for most countries prospective debt-service burdens to the Fund will be lower over the next decade than they have been in the past, mainly as a result of the introduction of the SAF/ESAF. There was broad agreement that ESAF terms are consistent with sustainable debt-service burdens in most cases and that it remained appropriate for the Fund to extend such assistance, while respecting the revolving character of our resources and the monetary character of our institution. Most speakers noted the desirability of continued Fund support for these countries, which implies the longer-term availability of financing on ESAF terms. At the same time, there was a general view that the Fund would need to do more, and that greater ESAF concessionality would be needed to deal with some of the most difficult cases, including the extreme cases of arrears to the Fund at present. We will come back to these issues on the basis of a staff paper outlining the possibilities, including options for funding from the Fund's own resources.

In brief, I would conclude from this discussion that, while there does not seem to be at this stage a generalized problem of debt to the multilateral institutions, it was agreed that there are a number of countries for which debt service--and the debt overhang to multilaterals--is at a level that would clearly impede development prospects in the future. For the Fund, the clear implication is the need to have available resources on ESAF terms for the foreseeable future. However, there appears to be no need for major changes in the Fund's facilities, or in their concessionality, for most of the poorer members. Directors agreed that we should reassess the means available to the Fund to deal with the remaining protracted arrears cases, and to assure the viability of some additional countries with prospective heavy debt burdens by complementing the mechanisms already put in place by others, including by Paris Club creditors. In this connection, Directors welcomed the new Naples terms and their recent application to help deal with Uganda's debt problem. The forthcoming discussion in March will also provide the basis for the Board's report to the Interim and Development Committees.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

BUFF/95/33
Corrected: 4/20/95

April 18, 1995

Concluding Remarks by the Chairman
Developments in Multilateral Debt and Financing
for the Heavily Indebted Poor Countries and Further
Consideration and Possible Modalities for Continued
Fund Involvement in Low-Income Countries, Including
the Most Heavily Indebted Countries, Through the ESAF
Executive Board Meeting 95/39 - 4/12/95

We have had a constructive, though preliminary, discussion. I will attempt to summarize the main points made by Directors and would report to the Interim Committee and, as mandated, to the Development Committee along these lines. Indeed, we will need to return to this topic after the meetings in light of the Committee's guidance.

With regard to the joint Bank/Fund follow-up paper on multilateral debt and financing for the heavily-indebted poor countries, Directors welcomed the additional sensitivity analysis of the impact on the debt burden of alternative assumptions about export growth and the volume and terms of new lending by multilateral institutions. Most Directors agreed with the general thrust of the conclusion that, for the majority of heavily-indebted poor countries, multilateral debt service burdens should be manageable, provided new multilateral lending is on appropriately concessional terms and supports a policy framework, which generates at least modest real export growth. Nevertheless, there are some countries that would face very heavy burdens, and we will seek to better identify the true problems in further analysis, which will be focussed on individual cases.

* There was broad agreement that there would be a need for a continuation of ESAF-type concessional operations. Most also welcomed the prospect, or were ready to explore further the possibility, of a self-sustained ESAF financed through resources that will reflow to the Special Disbursement Account (SDA) from the ESAF Trust Reserve Account, which, under current projections, would begin to become available in the year 2004, or possibly before, as pointed out by some Executive Directors.

Most Directors also welcomed early consideration of possible ways to finance ESAF-type concessional operations in the "interim period," after the full commitment of present ESAF resources and before the SDA resources would become available. I have noted the view that we should not proceed with undue haste and we will not. But the issues are complex and in the view of most a beginning is timely. A number of Directors stressed the considerable uncertainty attached to the likely timing of full commitment of existing ESAF resources. Several Directors, including some representing ESAF creditors, also considered that it would be useful to explore with the present ESAF Trust creditors the possibility of an earlier transfer of resources to the SDA through reducing the coverage of claims on the Trust Loan Account. Slower commitments and/or lower coverage in the Reserve

* For "Directors agreed" read "There was broad agreement"

Account could reduce funding needs in the interim, and we will explore these possibilities as we move forward. Some Directors also pointed to the need for individual countries to reduce reliance on Fund support over time, in line with the temporary nature of Fund financing, including from ESAF.

For the "loan element", most Directors supported that further consideration be given to a combination of funding alternatives, including the use of the General Resources Account in the framework of extended arrangements, though others did not favor that approach. For the subsidy component, in light of suggestions by some Executive Directors, a few Directors supported the idea that members consider ways to utilize resources refunded to them from the SCA-2 to help fund a continuation of ESAF operations, which could cover up to a third of the projected subsidy requirements in the interim period, or that we seek alternative bilateral sources of financing. Others were opposed to that approach, but were open to exploring bilateral funding. For the remaining subsidies, many Directors thought that the possibility of gold sales should be further pursued, but others were firmly opposed to gold sales. Among those who favored utilization of gold, the prevalent view was to use the investment income from gold sales profits. In this connection, and on the use of gold more generally, Directors expressed interest in a wider discussion of the role of gold in the Fund on the basis of the forthcoming paper by the staff, which I mentioned earlier, would be circulated to Executive Directors before the Interim Committee meeting.

For some of the protracted arrears cases, Directors considered that the debt-service prospects were likely to be so severe that concessional resources would be the most appropriate form of Fund support in the period following clearance of arrears. The timing of possible requirements is particularly uncertain, but we will factor these into our work on needs and funding modalities as well as we can. However, given the magnitude that may be involved, assistance will be needed from the international community as a whole, and not only the Fund.

Directors discussed the question of an extension of maturities for ESAF loans under an "interim ESAF" for a category of ESAF-eligible countries. Most Directors considered that the present terms of the ESAF remained appropriate, and that for those countries that may face continuing heavy debt burdens and balance of payments problems, the Fund could best assist them through the continued availability of ESAF resources on present terms. These Directors generally considered that retaining present terms would better enable the Fund to tailor its financing to the particular situation of each member. That approach would also maintain conditionality and monitoring of members' policies over what may, in a few cases, have to be prolonged periods, avoiding the long periods without such monitoring that could result from an extension of maturities. Nevertheless, a few Directors felt that this approach would not adequately address the problems related to debt "overhangs" and the need of members for assurances that debt service to the Fund would be kept at manageable levels. In their view, further consideration should be given to the possibility of an extension of maturities. The staff will give further attention to this in preparing our next document.

CORRECTED VERSION

Multilateral Debt: Joint Report to the Development Committee

A number of governments have suggested that the burden of multilateral debt on the poorest countries needs to be eased, and have made proposals to this end. At the Madrid meetings, the Interim and Development Committees asked the Boards of the Fund and the Bank to examine this issue, noting in particular the special needs and problems of the post-chaos countries and of the poorest, most indebted countries.

On the basis of papers produced by the staffs of the Fund and the Bank working together, the two Boards have now considered this question. Their main conclusion is that, for the majority of the heavily indebted, poor countries, multilateral debt-service burdens should be manageable and that continued net transfers from multilateral institutions would be consistent with declining or stable future debt-service ratios. However, it is critical that new multilateral lending be made available in adequate amounts and on appropriately concessional terms and that it supports a policy framework which generates real export growth. The Boards also agreed that the Fund and Bank should take steps to enable the necessary conditions to be met, including further strengthening of the Policy Framework Paper process to ensure that it includes an analysis of the country's overall external debt situation and its sustainability over the medium- to long-term and, in particular, that the volume and terms of multilateral lending are consistent with countries' repayments capacities. On the Fund side, it implies a tightening of the definition of concessionality under borrowing ceilings in Fund arrangements. On the Bank side, it implies more systematically addressing debt sustainability issues in Country Assistance Strategies.

The Boards also noted that a small number of countries, including especially the large arrears cases, will still face heavy multilateral debt-service burdens, and they have asked the staff to do further work on identifying and analyzing these problem cases over the coming months.

For the Fund, the Enhanced Structural Adjustment Facility (ESAF) has so far proven an important lending instrument to support strong adjustment programs of the poorest countries on appropriately concessional terms. The joint paper underlines the importance of the continued availability of Fund support from the ESAF for the heavily indebted poor countries, a view which
* has been broadly agreed by the Executive Board of the Fund. Most Executive
* Directors are ready to explore the options for moving toward a "self-sustained" ESAF financed through resources that will flow to the Special Disbursement Account from the ESAF Trust Reserve Account, which on current projections could become available in 2004, and for financing ESAF operations in the interim period, including through the use of donor contributions and the Fund's own resources.

The Executive Board has also discussed the financing needed to deal with the protracted arrears cases. The timing of program formulation and subsequent clearance of arrears before a Fund-supported program is

* Indicates corrected sentence.

particularly uncertain in these cases, but the needs and funding modalities will be factored into ongoing work on the ESAF.

The Executive Board has discussed the question of an extension of maturities for ESAF loans for a category of ESAF borrowers facing high debt service to the Fund. Most Directors agreed that the present terms for the ESAF remain appropriate for the time being and that for those that may face continuing heavy debt-service burdens and balance of payments problems over the medium term, the Fund could best assist through the continued availability of ESAF resources on current terms tailored to the needs of the individual country at the time. This would also imply continued
* conditionality and monitoring of members' policies. Nevertheless, a few Directors felt that further consideration should be given to the possibility of an extension of maturities and the staff will give further attention to this issue.

Finally, in terms of borrowing ceilings in Fund arrangements in general, the Fund staff are preparing proposals for the extension of the maturity coverage and for the tightening of the definition of concessionality to ensure that lending to the heavily indebted poor countries is on appropriately concessional terms.

For the Bank, work on the impact of past and present IBRD and IDA lending on low-income countries is continuing. Consistent with the conclusions of joint Bank/Fund analysis, the main focus will be case-by-case. As discussed with the Bank's Executive Board, debt sustainability issues will be systematically addressed in each country assistance strategy (CAS). Twenty of the heavily indebted poor countries (including all major potential problem cases) are scheduled to have CAS discussions at the Board during the next 15 months.

The Bank has demonstrated that it is equipped to respond with flexibility--as described in the Memorandum distributed to Executive Directors on March 1, 1995 on "The World Bank and the Debt of the Heavily Indebted Poor Countries." The response has included: (i) making additional heavily indebted poor countries eligible for highly concessional IDA credits; (ii) using "Fifth Dimension" supplemental credits to assist IDA-only countries with IBRD debt-servicing while they undertake adjustment programs; and (iii) providing exceptional IDA allocations in cases of arrears clearance and comprehensive debt workouts. In addition, the Debt Reduction Facility for IDA-only countries, financed by IBRD net income, helps alleviate the non-official debt burden. In the case of heavily indebted poor countries with sound policy performance, these measures have until now proven an adequate response to their external financing needs. The sustainability of this approach is, of course, subject to sufficient availability of IDA resources.

In discussing the February 6 Joint Paper, as well as the March 1 Memorandum, World Bank Executive Directors requested that additional options for IDA assistance to the heavily indebted poor countries be explored. A

* Indicates corrected sentence.

note from IDA's management reviewing a number of possible options for further financial support to IDA-only heavily indebted poor countries has been prepared and is scheduled to be discussed on May 12. The options in that note (softening of IDA terms and expansion of the Fifth Dimension program) will be evaluated in terms of their debt relief effect and of their impact on IDA's finances and operating principles. The guidance of Executive Directors will be sought, in particular, on the desirability of any actions beyond case-by-case measures based on new IDA lending on existing terms.

Depending on the outcome of the discussion with Executive Directors, IDA's management will determine whether to raise the issue of additional measures in support of heavily indebted poor countries at the meeting on the Eleventh IDA Replenishment scheduled for the end of June.