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Thematic Focus:

Debt Relief: "Where do we stand, where do we go?"

At a time when Europe and the US are struggling with their own debt challenges, the debt burden of developing countries no longer captures the headlines. Over the last decade in particular, significant efforts have been made by the international community to pursue a more comprehensive approach to debt relief. In this process, greater attention has been paid to strategies and mechanisms to improve the development and poverty impact of debt relief and the financial means thus released. This has been the case for instance with the "Heavily Indebted Poor Countries" (HIPC) Initiative and the Multilateral Debt Relief initiative (MDRI).

Conditionality has become one of the corner stones of debt relief schemes, notably through instruments such as debt swaps for development. In this respect, debt relief has been used more and more as another instrument by donors to pursue broader development objectives. As such, it draws interesting similarities with the direct budget support approach adopted by several donors.

So, is debt a problem of the past? Is the slate clean? Unfortunately not. Issues arise as to the long-term sustainability of the debt of developing countries, notably some African countries, which depends not only on domestic policies, but also external shocks. In the current precarious global economic environment, with highly volatile commodity prices, debt management and accumulation remains a cause for concern. What mechanisms can best mitigate these debt-related risks? Are vulture funds threatening the long-term sustainability of debt relief? With increasing emphasis from donors on blending grants and loans, on domestic resources mobilization and on policies promoting sustainable inclusive growth, can Africa avoid a new debt trap?



These are some of the systemic questions addressed in this issue of *GREAT Insights*, which draws on the joint efforts of the Dutch Policy and Operations Evaluation Department and the Office of the Special Evaluator of the Belgian International Cooperation. Articles in this issue also reflect on the impact and effectiveness of debt relief as a development instrument. Does debt relief have a real impact on sustainability and the borrowing capacity of developing countries? Has it contributed to better macro-economic policies and sustainable debt management? Does it have a measurable impact on poverty reduction? To which extent has the conditionality enshrined in debt relief agreements effectively contributed to improved governance and influenced development policies and programmes? What about the beneficiary countries ownership and appropriation? How to assess the effects of debt relief, and what do recent evaluations tell us? The case of the Democratic Republic of Congo and Nigeria are notably looked at more closely.

Results are of course mixed, and whether one sees the glass as half full or half empty is a matter of appreciation. We hope the various perspectives gathered in this issue provide useful insights, one of which being the continued relevance of improving debt management and pursuing comprehensive approaches to debt relief for sustainable development.

San Bilal

The Slate is Clean: What's Next?

Dominique de Crombrugghe de Looringhe and Ruerd Ruben

In the early 1970s, many developing countries took out loans from Western banks at favourable rates. Part of this money went into development projects with sometime negligible results; another part of the money also served wider political purposes or disappeared into private bank accounts of corrupt government leaders.



In the late 1970s, interest rates rose while commodity prices fell, which made it difficult for developing countries to repay their loans. Arrears and penalties became self-perpetuating and produced a snowball effect that drove the countries into a downward spiral and jeopardised their development. It took quite a while until the creditors came to terms with reality and accepted that the poor indebted countries would never be able to pay back their debts. This awareness opened the path for debt rescheduling and later debt cancellation.

Debt relief evaluation: a tool for development?

In the Netherlands, the request for a specific evaluation on debt relief came from Parliament following a presentation by the Policy and Operations Evaluation Department (IOB), in their Evaluation of the Dutch Africa policy. The Parliament wanted to know more about the effectiveness of debt relief as a tool for development. The scheduled massive debt relief to Nigeria was a case in point and provoked a wide political debate.

The Belgian Office of the Special Evaluator had already undertaken an evaluation regarding the Belgian policies and practices on debt relief, with Cameroun as a case study. Simultaneously, the Belgian Federal Parliament had focused attention on the debt waivers for the Democratic Republic of Congo and tried to find out whether debt cancellation really contributes to economic growth and structural poverty reduction.

It was quite straightforward for the Office of the Special Evaluator to accept the invitation of their Dutch IOB colleagues to join forces for an in-depth evaluation of debt cancellation measures in Nigeria and in the Democratic Republic of Congo (DRC) that took place at the beginning of the 21st century. Both agencies wanted to apply a rigorous framework for impact evaluation that would provide insights in the net results of debt cancellation.

We had three main sub-questions in mind: to what extent and under what conditions does debt relief

- make the debt sustainable
- improve the creditworthiness of a country
- contribute to poverty reduction

The results: implementation matters

The evaluations yielded contrasting results. Basically, debt relief has an effect on the debt stock, on debt flow and through conditionalities. However, the way in which debt relief schemes were designed and implemented played a crucial role for their effectiveness.

Nigeria, that was not a HIPC-country, was best off: the country negotiated full cancellation of USD 18 bn of foreign debt against immediate payment of USD 12 bn. This operation, achieved with strong internal and international political backing, promptly restored Nigeria's creditworthiness. The evaluation found that the conditionally imposed virtual poverty fund had an effect on social service provision for the poor.

Contrary to Nigeria, the DRC is a HIPC-country that went off-track on public finance management several times. Political will and direct intervention on the creditor side forced the DRC to revise contracts with China to avoid new unsustainable debt. Simultaneously, the creditors recognised that it had reached the completion point, which made possible substantial debt relief. The evaluation looked into the education sector for evidence of improvements following the debt cancellation. Some positive changes, notably in the payment of wages, were found that correlated with the debt relief, but these changes did not reach further than the headquarters of the ministry of education in Kinshasa.

New issues for the Debt Relief Agenda

Retracting from a relief logic that still prevails and that does not question the legitimacy of the debt claims, including the penalties on arrears, some creditors like Norway and the United Kingdom now talk openly about 'odious debt': a debt incurred during a dictatorship without the population ever having received any benefits from it, with the creditor turning a blind eye. From this point

of view, debt cancellation is not only about financial sustainability.

Another ongoing process is the fight against vulture funds and other rogue creditors, which buy up the debt of poor developing countries at very low prices and then sue them to enforce payment of the nominal value, including arrears of interest. Legislation outlawing the seizure of ODA-funds and state-to-state loans would imply an important step in that direction. Belgium has already passed a law to protect its ODA grants against seizure. The government also intends to audit the ethical basis of all sovereign credits on developing countries.

The way forward

Taking stock from the past is not enough. In 2012, the need for investment in developing countries remains more important than ever. How will the creditor community deal with these needs? Will they be able to draw lessons from past experiences and design firewalls to avoid renewed debt overhang? For a few – mostly fragile – countries, the signals are turning red again. Are debtor countries on their side willing to implement administrative and economic reforms, including anti-corruption measures and show political will to guarantee that the funds released will actually be invested in the country's economy and for the strengthening of the position of the poor?

These questions are still at the forefront of public debates about debt rescheduling or debt cancellation in countries with vulnerable economies. The joint evaluations of debt relief effectiveness provide some welcome insights to this debate. They can be accessed here: http://diplomatie.belgium.be/en/policy/development_cooperation/evaluation/conferences/

Authors

Dominique de Crombrugghe de Looringhe is Special Evaluator for the Federal Public Service Foreign Affairs, Foreign Trade and Development Cooperation, Belgium. Ruerd Ruben is Director of the Policy and Operations Evaluation Department (IOB), Ministry of Foreign Affairs, The Netherlands.

Assessing Donor-driven Debt Relief Initiatives: A Brief Overview of Theory and Practice

Danny Cassimon

Since the introduction of the 'Heavily Indebted Poor Countries' (HIPC) Initiative in 1996, its enhancement from 1999 onwards, and the further introduction, in 2005 of its successor, the Multilateral Debt Relief initiative (MDRI), debt relief has gained prominence as a potentially important 'alternative' modality of aid, next to more traditional aid modalities. What were the goals of the donor community in providing this kind of donor support, in theory and practice?



In this introductory contribution, we also briefly assess in general to what extent these goals were achieved, providing arguments for its development effectiveness and relevance as a donor instrument, which also legitimizes its eligibility for inclusion as Official Development Assistance (ODA). Along the way, we also show that different types of debt relief bear close resemblance to more traditional aid modalities mentioned above.

The theoretical case for debt relief

Clearly, the main goal of the donor community was to enable highly-burdened, poor debtor countries to 'clean their external debt slate'. This was not only to formally acknowledge what was partly a fact in most countries, i.e. that these countries were not capable of (fully) servicing their debt as contractually agreed, and that they merely accumulated payments arrears, or engaged in repeated debt rescheduling that transferred most of the payments to the future, further stockpiling debt. It was also to avoid the strong negative effects of a so-called high 'debt overhang' on the debtor country's creditworthiness, foreign as well as domestic investment behavior, and on the capacity and willingness of these debtor governments to undertake necessary but painful economic and institutional reforms (with most of the benefits accruing to external creditors). Cancelling debt could therefore materialize into large indirect effects on investment and economic growth. Different interpretations of what is a clean slate can be used; the most conventional one refers to cancelling the debt down to a 'sustainable' level, as defined by specific threshold indicators of capacity-to-pay.

As such, the main goal of debt cancellation was certainly not to provide debtor governments with additional direct (fiscal) cash flows (arising from debt servicing savings), something typical of traditional aid modalities. Determining the direct cash flow effect

of debt relief is not straightforward. First of all, a decision to cancel a given nominal amount of debt does not lead to immediate equivalent cash flow gains: they arise over a period of time, depending on the original debt service schedule of the debt. To take into account both the volume of debt relief and the time dimension, the Present Value (PV) of future debt service payments relieved is used as the appropriate summary indicator of the cash flow gains. Second, and more important, to the extent that the debt service due would not have been paid in the absence of debt relief, no cash flow savings materialize. As, in practice, forgiven debt often would have been serviced only in part, debt relief is more correctly measured as the PV of debt service that would have been serviced in the absence of debt relief. This is sometimes called the 'economic value' of debt relief. It measures both the direct cost to the creditor/donor, as well as the direct (cash flow) impact to the creditor. In some cases, the direct cash flow effect on recipient government resources may be close to zero, in others it may be substantial.

Thirdly, as with other aid modalities, debt relief comes with some strings attached by donors, which is a final way through which donors try to enhance the effectiveness of the use of debt relief. One way is by trying to steer the use of these debt relief cash flow savings. This can be done by micro-earmarking the use of resources (as is typical in for project aid), through sector-earmarking, or in support of a broad recipient country development strategy (so-called 'policy-alignment', typical for general budget support aid). Furthermore, the donor may wish to make use of a particular system of managing the funds, rather than using the recipient country system (so-called 'system-alignment'). Additionally, more broad conditions may refer to macro-economic stability and economic reform (similar to the SAP approach), strengthening the overall development-orientation of government actions, and improvements

in economic or institutional governance and public sector service delivery, again further reinforcing the indirect effects on economic growth and development in recipient countries.

The effectiveness of debt relief practice

How well has debt relief practice performed on these (three) predetermined objectives? In order to do so, it is useful to distinguish between three waves of debt relief, those before the HIPC initiative, the HIPC Initiative itself, and those that went beyond HIPC.

"(...) the main goal of debt cancellation was certainly not to provide debtor governments with additional direct (fiscal) cash flows (arising from debt servicing savings), something typical of traditional aid modalities".

Debt relief pre-HIPC

Pre-HIPC debt relief was largely confined to debt relief provided by bilateral official creditors gathered in the Paris Club, both on their concessional (ODA) claims, as well as on non-concessional loans (non-ODA loans, mainly export credits). From 1988 on, the Paris Club bilateral donors progressively included elements of debt relief along common terms in their rescheduling operations, first in terms

of debt service relief, later also on debt stocks. Although the debt relief share increased over time up to 67%, in general these operations are judged to have performed poorly in effectiveness terms. The operations did not result in restoring recipient country debt sustainability. Furthermore, the direct cash flow effect (economic value) of the debt relieved was deemed marginal.

The attached conditionality, basically referring to an IMF program SAP-logic without more explicit development orientation, was also deemed largely ineffective. Alternatively, debt relief was also embedded in small debt buy-backs or debt swaps in which debt was cancelled in return for counterpart local currency deposited in a separate fund, designated to earmarked development spending. Again, here, economic value was typically low, and conditionality inappropriate, in fact similar to traditional project aid.

The HIPC Initiative: results and assessment

As the economic and debt prospects of many low-income countries continued to look bleak, the international community launched the Heavily Indebted Poor Country (HIPC) Initiative in September 1996. From this point onwards, debt relief got on two distinct tracks: one for HIPCs, and one for non-HIPCs, largely being a continuation of pre-HIPC practices. The HIPC Initiative explicitly aimed at 'cleaning the slate', i.e. restoring debt sustainability, by cancelling the debt of eligible low-income countries to a sustainable level, defined in balance of payments terms (a PV of debt to exports threshold) or in fiscal terms (a PV of debt to fiscal revenue threshold). Harmonization of efforts between all creditors was assured by fair burden-sharing principles, based on relative exposure. In order to be eligible (i.e. becoming HIPC), the country had to be eligible for International Development Association (IDA) funds, and hold an unsustainable external debt as defined according to the sustainability levels mentioned above. In 1999, the initiative was enhanced by deepening debt relief - the balance of payments and fiscal thresholds were lowered to 150% and 250% respectively - and by strengthening the link with poverty reduction.

Enhanced HIPC debt relief was granted after the successful completion of donor-imposed conditionalities, some comparable to an IMF program, others related to the elaboration and implementation of a broadly-owned recipient country development and poverty reduction strategy (the PRSP). On top of this, some country-specific 'triggers' were included on, say, the quality of public service delivery. It was engineered as a two-stage process: decision point is reached after complying

with some initial conditions (macro-stability, IMF-like reform, a preliminary PRSP strategy), followed by an interim period of further compliance with remaining conditionalities leading to completion point, where the debt stock is irrevocably reduced to the sustainability threshold. During the interim period, the country receives debt service relief, similar to final debt relief terms. As of now, 36 countries (including the DRC, discussed in this issue) have completed the trajectory.

All in all, this type of debt relief is largely similar to aid delivered as (general) budget support. What is less obvious is whether the HIPC initiative led to a substantial increase in direct cash flows (...)

Overall, this type of debt relief was deemed to be more effective. Not only did it succeed in restoring debt sustainability, at least in the short-term, but also conditionality was deemed to be more effective in removing debt overhang, improving economic and institutional governance and broad poverty orientation by the recipient country government. All in all, this type of debt relief is largely similar to aid delivered as (general) budget support. What is less obvious is whether the HIPC initiative led to a substantial increase in direct cash flows: in total, HIPC debt relief so far amounts to about 60 billion USD in PV terms, less than half of which can be considered as additional resources, but with large variations between HIPCs.

Beyond HIPC: budget support under a different name?

Although the HIPC approach in principle realized debt sustainability, some HIPC country creditors decided to go beyond HIPC terms granting additional debt relief to HIPCs (only), further cleaning the slate. Paris Club bilaterals decided to cancel their own remaining eligible claims, and, from 2005 on, some major multilateral creditors did the same through the MDRI. Also this type of debt relief was deemed effective, and as its economic value was judged to be close to its PV, it comes close to being truly identical to budget support aid.

The international community, and especially the Paris Club creditors, also engaged in a number of (sometimes large scale) debt relief interventions outside the HIPC framework, such as for Iraq and Nigeria (see the Nigeria case study for more details). This raises the issue of the considering debt relief for other, so far excluded, countries, for both motives of equity and appropriateness. In the absence of perspectives of new major initiatives in this respect, the debt swaps practice reappeared at the debt relief scene; it was usually promoted by sector multilaterals or global funds, or in the field of climate change. Overall, this approach remains ineffective, unless engineered very carefully.

Conclusion

Despite regaining debt sustainability due to HIPC debt cancellation, it is particularly worrisome that some HIPCs are once again experiencing debt sustainability problems. The current monitoring framework to prevent this, a combination of Debt Sustainability Analysis (DSA) and initiatives to promote responsible future lending and borrowing, although both valid, cannot in itself assure long-term sustainability, due in part to the remaining vulnerability of those countries to (negative) external shocks. As such, the international community should be more pro-active in designing innovative schemes to increase the contingent nature of debt claims, better matching debt service due with capacity to pay evolutions.

Author

Danny Cassimon is Professor at the Institute for Development Policy and Management (IOB) at the University of Antwerp.

Debt Relief as a Development Tool: The Role of the Paris Club

Clotilde L'Angevin

Debt relief granted by creditor countries to highly indebted countries significantly contributes to these countries' development needs, by providing regular and foreseeable fiscal space. For instance, in the framework of the HIPC initiative, funds initially due to be spent on external debt service to creditor countries can be redirected towards an increase in poverty-reduction spending.



More importantly, using the extra fiscal space to fund development needs makes it easier for countries to schedule poverty-reduction expenditures over the medium or long run (for example, for health or education programs over several years) than if they were to rely solely on grants, which are generally provided on an annual basis or in an even more unpredictable manner. Moreover, debt relief contributes to reestablishing external public debt sustainability which, in turn, allows countries to regain access to market financing through loans, provided that new debt increase remains sustainable.

In order to provide such debt relief, 19 creditor countries gathered to form the Paris Club, an informal group of official creditors representing sovereign states and whose role is to find coordinated and sustainable solutions to payment difficulties experienced by debtor countries. As debtor countries undertake reforms to stabilize and restore their macroeconomic and financial situation, Paris Club creditors provide appropriate debt treatments, through debt rescheduling, i.e. debt relief by postponement or, in the case of concessional rescheduling, through a reduction in debt service obligations during a defined period (flow treatment), or through a reduction of the debt stock as of a set date (haircut, or stock treatment).

Debt relief granted by the Paris Club relies on standard terms of treatment associated with eligibility conditions that have changed over the years. For the poorest countries, the Paris Club's terms have been increasingly generous. At the end of the nineteen-nineties, the international community acknowledged that the external debt situation of a number of low-income countries could only be resolved in a comprehensive way, including action by multilateral creditors which had been, until then, protected by their preferred creditor status. The Initiative for "Heavily Indebted Poor Countries" (HIPC Initiative) was launched in

1996 at the G7 summit in Lyon and reinforced in 1999. Its launch showed the willingness of the international financial community to tackle, in a comprehensive manner, the external public debt unsustainability of a number of low-income countries. All Paris Club creditors have moreover announced that they would provide debt forgiveness over and above the HIPC Initiative assistance, up to a full cancellation of claims.

Since the start of the HIPC initiative, debt relief granted to the 36 post-decision point countries at end-2011 amounts to almost 35 percent of these countries' 2010 GDP, around USD 128 bn in nominal terms. The total debt relief effort provided under the HIPC initiative is shared by multilateral creditors (44,5%), the Paris Club (36,3%), non-Paris Club bilateral creditors (13,1%) and private creditors (6,1%). Hence, the HIPC initiative represents a genuine and significant financial effort from Paris Club member countries, especially considering that they indirectly contribute to debt relief granted by multilateral creditors, as they are major shareholders of these international financial institutions.

According to the IMF and the World Bank, debt relief granted since the beginning of the HIPC Initiative reduced beneficiary countries' debt burden by about 90 percent relative to pre-decision point levels. Debt relief has also allowed beneficiary countries to reduce their debt service and to increase social spending. According to the IMF and the World Bank, for the 36 post-decision point countries, poverty reducing spending increased by more than 3 percentage points of GDP, on average, between 2001 and 2010, while debt service payments declined by a similar amount. Such progress is consistent with the HIPC initiative' objective, namely, to reallocate the increased spending capacity towards the fight against poverty and to accelerate progress toward the United Nations Millennium Development Goals.

Apart from the HIPC initiative, the Paris Club adopted a new framework for debt restructuring in 2003, the Evian approach. Through the Evian framework, the Paris Club's goal is to take into account debt sustainability considerations, to adapt its response to the financial situation of debtor countries, and to contribute to current efforts to ensure an orderly, timely and predictable resolution of economic and financial crises. The approach aims at providing a tailored response to debtor countries' payment difficulties. Countries with unsustainable debt may be granted a comprehensive debt treatment, provided that they are committed to policies that will secure an exit from the Paris Club process, in the framework of their IMF arrangements.

Author

Clotilde L'Angevin is Head of the International Debt division at the French Treasury and Secretary General of the Paris Club.

Thirty Years After the Outbreak of the 3rd World Debt Crisis: The Need for a New Deal on Debt

Jürgen Kaiser

Debt relief is like putting out a fire: It is absolutely necessary, but it does not guarantee that the house won't be on fire again. This is why a deliberately one-off relief scheme like HIPC has necessarily been an insufficient answer to a systemic crisis. As crises can arise any time and sometimes in places which have been considered as fire-proof for long, you need to have a fire-brigade, i.e. a mechanism, which makes sure that an appropriate crisis response can be found, whenever it is needed.



A brief look at the history of sovereign debt relief can reveal how far we are still away from such a functioning fire-brigade.

No success story at all

By the end of the 1980s it was already clear that the debt, at least of the poorest countries, would need a complete or almost complete cancellation – something in the range of what was implemented through the Multilateral Debt Relief Initiative (MDRI) as the culmination of the HIPC process 20 years later.

However, this debt relief was not provided; rather, the Paris Club sent countries down a 15 year long road of ever insufficient debt reschedulings, flow reliefs and partial write offs. From the Toronto Terms to the Cologne Terms, countries constantly received too little debt relief too late. This is why each of these frameworks had to be reformed, re-drafted, amended or abolished altogether.

As a consequence, countries were bleeding off scarce resources through an unaffordable debt service, while creditors pretended to be generous. People in the indebted countries were deprived of their right to have a functioning state. Some of the poorest were literally dying because states were unable to fulfil their duties regarding food security, health or public safety – thanks to creditors' unshakable belief that even out of poor, failing states one could squeeze 67%, 50% or 20% of contractual debt service.

And even when finally nearly total debt cancellation was provided after 2005, it was financed to a large extent by development aid budgets – so to say, by the developing countries themselves.

No thing of the past

For an illustration, we tend to point to Senegal who is the leader of the pack with 14 Paris Club reschedulings since 1980, including three final ones.

What is even more worrying to us is that creditors seem not to have learned anything from those 20 years: presently, 16 Low Income Countries have a high risk of (renewed) debt distress. Seven of them are post-Completion Point HIPCs. However, nobody on the creditors side, who for so long have set the tone on sovereign debt, has any clue, how one of these countries could negotiate any post-HIPC debt relief, as other creditor categories are of importance today.

What is even more worrying to us is that creditors seem not to have learned anything from those 20 years: presently, 16 Low Income Countries have a high risk of (renewed) debt distress.

One of these high-risk countries is Burundi. The East African nation should have received a topping-up of its HIPC relief, but was denied it, because the World Bank did not consider its own calculation errors as an "external shock", which in the eyes of the Bank and the Interna-

tional Monetary Fund (IMF) is the sole reason for anybody to obtain relief beyond what the International Financial Institutions (IFIs) have calculated as necessary.

Burundi has continued to be a high risk country ever since. Still the Bank and the Fund boards have just agreed to waive their non-concessional borrowing policy for Burundi, thus allowing for an 80m US-\$ dam project, that EximBank of India wants to finance at insufficiently concessional terms.

That dam may turn out to be a good investment. But it also may not. And if all of a sudden the roof is on fire again, there is still no fire brigade out there, since the HIPC was a one-off cancellation and since India is not a even a Paris Club member. So no one could say whether India would, in case of project failure, be bound by any rescheduling, or - like about half of official bilateral creditors - just will not care about any Paris Club decision.

One can also look at the Eurozone for an illustrative example. Everybody knew that the 109bn Euro haircut for Greek private investors early this year was insufficient in order to restore debt sustainability. Still, it was treated like a solution. And today we speak of the need for another haircut, which would necessarily also involve those claims that have come as public rescue financings.

For everybody who has been working on the so called third world debt crisis for a while, the way Europeans and the Troika at large treat the sovereign debt crisis in the European periphery is a striking déjà vu: You bail out private investors with bilateral and multilateral public money at first; you fail to restore debt sustainability, because debt levels are already way past that point; and you have to write-off the public rescue money in the end.

Why is that so?

One essential difference between a somehow functioning private debt-workout in our domestic contexts and the way sovereign insolvencies have been handled is the “independent expert” who does the assessment of the need for debt relief.

In the domestic context, it is, of course, not the banks that define the haircut that creditors of an insolvent corporate or private debtor need to accept in order to restore debt sustainability. This expertise needs to come from a neutral institution. Otherwise you have a classical conflict of interest and a recipe for exactly the process we have seen in the Paris Club from the 1980s to 2005.

There was no lack of insightful expertise in the 1980s. It pointed to the fact that something in the range of the “full cancellation”, something that we have seen from 2005 onwards, was actually necessary. The problem was that these suggestions had no chance of being listened to as long as the World Bank and IMF held the monopoly on assessing the debt situation. The IFIs was where debt relief was actually decided. The situation was akin to the local savings-and-loan deciding what could be taken out of indebted individual's home.

What would actually happen to this poor person's rights and human dignity? Easy to figure out, and that is exactly what happened to indebted sovereigns between 1982 and 2005: they fell prey to a harsh and senseless austerity, which only timidly started to be reformed in the last decade – and is still alive and kicking as one can see for instance in the critically indebted countries in the Caribbean today.

Not only the assessment

Of course, an independent assessment does not help you a great deal when it is your creditors that do the interpretation. Handing the role of an independent expert to an institution, which is neither debtor nor creditor, is only one essential element of a reform that we need if we are to avoid the next debt crisis to drag on like the last one. We also need to put the ultimate decision making into the hands of a neutral body.

A lot of proposals have been made for this, from UNCTAD's pioneering work in the Trade and Development Report of 1986, building on proposals by academia, through the IMF's own

Sovereign Debt Restructuring Mechanism, the Dutch proposal for a debt chamber at the Permanent Court of Arbitration and NGO proposal for a Fair and Transparent Arbitration Process on Debt (FTAP). The latter is no less than an emulation of the chapter 9 of the US insolvency code (which deals with the insolvency of “municipalities”), and which has been serving that nation well for nearly a century.

These proposals are not pies in the sky. An independent assessment has actually been key to solving Indonesia's debt problem in 1969/1970. The Paris Club had been unable to agree on a restructuring of Indonesia's unus-

join the bandwagon, and we hope Belgium is going to be one of them. Quite a bit of literature on the various proposals is available. And the further work of UNCTAD is likely to provide a focus for a real political reform process.

Author

Jürgen Kaiser is Political Coordinator at erlassjahr.de

In the domestic context, it is, of course, not the banks that define the haircut that creditors of an insolvent corporate or private debtor need to accept in order to restore debt sustainability. This expertise needs to come from a neutral institution.

tainable debt, which was still a low income country in the range of 200 US-\$ per capita at the time, and whose most important creditor was the Soviet Union, which had no interest in supporting a regime that had just slaughtered half a million communists.

When a disinterested party – in this case a German private banker with no stakes of his own in that country – made the realistic proposal of a full repayment of the principal and the (nearly) complete cancellation of interest, which would amount to an Net Present Value reduction of around 50%, that was acceptable for everybody, because it restored Indonesia's fiscal viability. Additionally it treated creditors uniformly and thus allowed for a nearly universal acceptance.

Some governments like Germany, Argentina and Norway have committed to work towards such a comprehensive, fair and rules-based debt workout mechanism. More are invited to

What Comes After Debt Relief? Some Preliminary Thoughts

Jeffrey D. Lewis

With major debt relief initiatives (HIPC,¹ MDRI²) winding down, what comes next? How can we evaluate the success of these efforts which took decades? Has there been any lasting impact? Are there lessons for what might come next? These are important questions, often overlooked, when addressing the challenges related to debt relief, now and in the future.



In this article, we explore the “so what” dimension of the topic: (1) Does anything really change after a debt relief? (2) Does debt relief have effect on governance, macro-economic and development policy? and (3) Is debt relief an efficient development tool?

Looking back

Before trying to answer these questions, we should discuss where we are starting from: what has debt relief accomplished to date? From the standpoint of the original objectives, debt relief initiatives have clearly provided HIPCs with the opportunity for a fresh start. Debt relief has been substantial, debt sustainability has been advanced, and fiscal space created. We are all familiar with the broad scope of the outcome: the HIPC and MDRI initiatives have together decreased the external debt stock of 36 post-decision point countries by more than 90 percent, or by approximately one-third of their 2011 GDP. Although causality is hard to establish, lower debt service has been accompanied by an increase in poverty-reducing health, infrastructure, and education expenditures, which increased on average from 6.2 to 9.6 percent of GDP from 2001-2011. Moreover, none of the post-completion point HIPCs are in a debt distress situation. In sum, there is strong evidence that the HIPC and MDRI initiatives have successfully delivered substantial debt relief to the target countries, improved their macro fundamentals, and supported greater spending on development-related activities.

So if perhaps, as suggested by the title of a conference on this topic co-hosted by the Dutch and Belgian governments in Brussels on 26 September 2012, “the slate is clean”,³ we must turn to questions regarding the broader impact and implications, at both the country and global levels. First, are these debt reductions sustainable, and is the impact on recipient countries “catalytic”?

Second, are broad multilateral debt initiatives an efficient global means to promote development?

(...) there is strong evidence that the HIPC and MDRI initiatives have successfully delivered substantial debt relief to the target countries, improved their macro fundamentals, and supported greater spending on development-related activities.

Country Impact: mixed evidence

Looking first at the impact on countries in terms of sustainability and policy impact, the evidence is mixed. While none of the post-completion point HIPCs are currently in debt distress, one-fifth of this group (7 countries) is currently seen (using June 2012 prices) at high risk of debt distress. While this in part represents the use of different “measuring sticks” between HIPC and the current debt sustainability framework benchmarks, it also reflects the impact of substantial borrowing. For eight African countries, it took just 4 years to raise public debt to GDP levels one-third of the way back to pre-relief starting points. To some extent this expanded borrowing may represent good news, as stronger macro fundamentals facilitate access to global financial markets and “new sources of finance” (both in the form of bond issuance

and bilateral lending), it nonetheless points to concerns over the implications of a return to pre-relief debt levels, particularly if the new borrowing does not translate into productive investment and faster growth.

What about the broader “catalytic” effect on policies and programs? As already noted, provision of debt relief is associated with a 3 percentage point rise in “poverty-reducing” spending, although causation is hard to establish, especially since the global emphasis on achieving MDG targets led to targeted spending increases across all developing countries. In terms of the policy environment, HIPC countries (on their part) have been working both before and after the provision of debt relief to address the underlying factors that led to unsustainable debt levels – improving their macroeconomic policies, addressing governance issues, strengthening capacity and institutions.

This work has been vigorously supported through engagement with the international community, including reliance on the joint Bank-Fund Debt Sustainability Framework and a strong emphasis on debt management capacity building in dozens of low-income countries through efforts such as the multi-donor Debt Management Facility. Ratings for debt management policies under the Country Policies and Institutional Assessment (CPIA, which is one factor affecting IDA country allocations) have improved markedly over the last six years.

Do we have an development oriented global framework?

Beyond the impact on sustainability and policy at the country level is the broader question whether large multilateral debt relief initiatives are an efficient tool to promote broad development goals. Put differently, the question can be framed, if we were to find ourselves again in circumstances

(...) it points to concerns over the implications of a return to pre-relief debt levels, particularly if the new borrowing does not translate into productive investment and faster growth.

of widespread / global debt unsustainability, would we follow the HIPC/MDRI approach?

While answering this question in depth would require a major evaluation effort to identify the broad impact of the debt relief initiatives (as well as the “counter-factual” of what might have happened if there had been no comprehensive program), there are nevertheless a few preliminary observations that can be made.

First, the initiatives did have a strongly positive effect on the collective action problem by “crowding in” a broad range of creditors. While creditor participation has been voluntary, the emphasis on inclusivity has undoubtedly helped motivate participation by a broader creditor group, resulting in more substantial total debt relief. But achieving such broader buy in has not been without costs: any participant (or informed observer) would characterize it as a long, cumbersome, difficult and idiosyncratic process. Establishing eligibility through a set quantitative indicators also allowed frame the scope (and potential costs) of the initiative in ways that were helpful both to creditor and debtor countries, but also created some “threshold” effects, as countries near the cutoffs faced uncertainty over eligibility and moral hazard incentives.

Second, the impact on overall resource availability to support development efforts, in both HIPC participants and elsewhere, remains unclear. The critical question is whether HIPC/MDRI initiatives mobilized additional resources, or instead resulted in a reallocation of available funds. Data on ODA flows produced by the OECD DAC do show various “spikes” attributable to the provision of debt relief (both through HIPC and others), but these may not in fact represent “new resources” – if relief recipients were not in fact servicing their debts, then the decision by creditors to cancel those debts does not in fact generate new resources. In the case of MDRI, where multilaterals⁴ undertook to cancel their outstanding debts for countries

reaching the HIPC initiative completion point, the replacement of the reflows to those institutions by donors inevitably came at the expense of “new money” in at least some instances.

Third, the impact on development outcomes is limited but on balance positive. Beyond the increase in poverty-reducing spending that has already been noted, there is some additional empirical work that points to stronger performance by post-HIPCs across a range of social and economic indicators, but the results are by no means definitive.

Finally, on the underlying policy framework, there has been some tangible progress. The Debt Sustainability Framework developed in conjunction with debt relief efforts has emerged as a sensible and adaptive framework that can help countries address the debt sustainability challenge. Since 2005, more than 370 debt sustainability analyses have been produced for 73 different IDA-only countries using a framework that has been refined to include concerns over the impact of increased borrowing in local currency markets and the role of contingent liabilities. More broadly, there have been greater efforts by low-income countries to focus on macro fundamentals, including the link between fiscal and debt sustainability and the importance of maintaining or expanding policy “buffers” that made these countries more resilient in the face of the recent global economic crisis.

Conclusion

(...) provision of debt relief is associated with a 3 percentage point rise in “poverty-reducing” spending, although causation is hard to establish (...)

Returning to the underlying question – does anything change after debt relief? – I believe the available evidence supports a positive answer. Sizable debt relief has been provided (the primary objective), and it appears that overall, this improvement is being sustained. While providing debt relief does not guarantee sustainability, it also appears that policy environments have improved, debt management capacity and practices have been strengthened, and resources available to support development have grown. Much

indeed has changed, for the better.

Notes

1. HIPC—the Heavily Indebted Poor Countries Initiative—was launched in 1996 to ensure deep, broad and fast debt relief and thereby contribute toward growth, poverty reduction, and debt sustainability in the HIPC countries.
2. MDRI—the Multilateral Debt Relief Initiative—was launched in 2006 to provide additional support to HIPCs to reach the Millennium Development Goals.
3. http://diplomatie.belgium.be/en/policy/development_cooperation/evaluation/conferences/
4. MDRI relief is provided by International Development Association (IDA), International Monetary Fund (IMF), African Development Fund (AfDB) and Inter American Development Bank (IaDB).

Author

Jeffrey D. Lewis is Director of the Economic Policy and Debt Department at the World Bank. The views expressed here are those of the author and do not necessarily reflect those of the World Bank or its members.

Debt Relief: The Norwegian Approach

Per Kristian Roer

The Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI) remain the cornerstones of Norwegian debt relief policy. The achievements made from the inception of the HIPC initiative in 1996 up until today are remarkable. Norway will continue to ensure full financing of these schemes.



It is important to build on what works, and keep ourselves from reinventing the wheel. There are three topics regarding debt cancellation in the Norwegian government's political platform. The first one is working for international principles for responsible lending and borrowing. Secondly, Norway intends to work for a new international debt resolution mechanism. Lastly, we conduct reviews and audits of Norway's claims on developing countries.

Building on the HIPC initiative

The HIPC initiative is in a mature phase, but it remains imperfect. Many post Completion Point HIPC-countries are facing a renewed risk of debt distress. Post-conflict countries are struggling to qualify. There are still poor countries with a heavy debt burden not eligible for HIPC. There are HIPC-eligible Countries in fragile post-conflict situations not able to qualify.

The mix between domestic debt external debt and the mix of bilateral, multilateral and private debt is also changing: new emerging economies become more important and relevant creditors and the Paris Club creditors' claims are becoming smaller, relatively speaking.

More should be done to prevent debt accumulation (Public Debt Management) and a more comprehensive framework should be discussed for poor countries with an unsustainable debt burden.

Responsible borrowing and lending is increasingly coming to the forefront as an important policy issue and will require close cooperation of both debtors and creditors. Norway has worked with UNCTAD for the last three years to make international Principles on responsible lending and borrowing happen. They were launched in Doha in April and endorsed by many countries.

Based on UN Principles, the Norwegian government has decided to conduct a review/audit of all our claims on developing countries through an international tender totalling USD150 million over 7 countries and 34 contract. The purpose is not to cancel debt, but to put the spotlight on

responsible lending and on a creditor's shared responsibility. Norway believes that debt cancellation should also be based on an analysis of how the loans were given, and not only on the analysis of how much debt the developing countries can handle. In other words, debt cancellation is not only about sustainability.

The way forward

We think the global community needs to attack the problem in a more comprehensive, fair, predictable and preventive way. The asymmetric power between the debtor and the creditors and the ownership of the instruments should also be discussed. Consequently, we welcome the discussion on a new debt workout mechanism.

However, we need to be realistic and pragmatic. The discussion of improvements to existing debt relief mechanisms aimed at the poorest countries must not be "drowned out" by the struggle to make the instruments better. One should maintain what works and not "throw the baby out with the bath water". With this in mind, the missing links in the in the international financial architecture for debt restructuring are the following;

1. All types of debt should be systematically covered, including domestic debt and commercial debt .
2. The instrument should cover the period from an arrear clearance, and including a vulture fund operation where it is needed.
3. All creditors should be included. New emerging economies are becoming more important and the traditional creditors in the Paris Club countries smaller, relatively speaking.
4. Debt sustainability should not be the only yardstick. Not only how much debt a country can handle, but also an assessment of how the debt came about, should be included.
5. A more neutral judge – a less creditor driven restructuring. World Bank, IMF, Regional Development Banks and The Paris Club are all creditors.

Finally, debt cancellation is not sustainable, and it is not the last solution. The most

important issues are those that can help to avoid debt distress: domestic resource mobilization, taxes, innovative financing, amongst others. With regards to debt however, attention should be paid to the important work done by UNCTAD on Public Debt Management and Responsible Lending. UNCTAD launched new Principles on Responsible Lending and Borrowing in April. Many countries have endorsed them. We invite you all to join us.

Author

Per Kristian Roer was Senior Advisor in the Section for Multilateral Development Finance and Global Economy, Department for UN, Peace and Humanitarian Affairs at the Norwegian Ministry of Foreign Affairs at the time of writing; he now is Counsellor at the Norwegian Embassy in Jakarta.

Debt Sustainability and Borrowing Capacity in Africa

Yuefen Li

Debt relief is a learning process for both creditors and debtors. The original aspiration of HIPC, a permanent exit of debt trap by recipient countries, was ambitious.



Debt sustainability, however, can be transient and maintaining it is not easy. Domestic policies have an important role. Nevertheless, external factors can also have important positive or negative impact on debt sustainability. For instance, as the world enters the fifth year of the global financial crisis, the efforts made by developing countries to mitigate the negative impact of the crisis have consequently diminished the policy and fiscal buffers they have to shield their domestic economies from further external shocks. However, the recovery from the global financial and economic crisis has yet to be secured. Global economic growth is decelerating and significant uncertainties and downside risks remain, which are associated with lagging job growth in advanced economies, persisting debt difficulties in the euro zone and the imminent debt ceiling limit negotiations the United States, to name a few.

Global economic slowdown and debt sustainability

Developing countries are becoming increasingly vulnerable to external shocks. Now the slowing global growth and demand have reduced export revenues of developing countries. The uncertainties associated with these looming global problems have dampened investment. In addition, the uncertain global economic outlook is likely to continue to affect aid budgets, thus raising concerns about the predictability of planned aid in the years to come. ODA, excluding debt relief, declined for the first time in more than a decade, reflecting the impact of the global recession on donor aid budgets. Thus far developing countries as a group have appeared to be resilient to the negative effects of the crisis, owing to their good policies and strong growth in the past decade. However, further worsening of the world economy could prove to be devastating to debt sustainability of developing countries.

An International framework for debt management

As a matter of fact, some post completion point countries of the HIPC initiative have suffered from debt distress again. In 2012 of the 34 countries that have reached the completion point under the HIPC Initiative,

7 are classified as being at high risk of debt distress, 12 are classified as being at moderate risk, and 13 as low risk. The countries that have yet to reach the decision point under the Initiative face fragile political situations and their progress towards the decision point is uncertain. As the HIPC Initiative winds down, solutions to addressing persisting debt problems of developing countries post-HIPC Initiative should be explored. Solutions should not be restricted to countries that have benefited from the HIPC Initiative but should also be considered for countries that have not benefited from such assistance. Ideally, solutions to these problems would arise in a transparent and speedy manner but this has generally not been the case. This situation calls for deeper solutions to be found at the international level to effectively remedy future debt sustainability problems.

It is not only HIPC countries that are facing debt difficulties. Attention should also be given to developing countries that are facing debt difficulties and have not been eligible to benefit from international debt relief initiatives. For example, several small Caribbean economies (Belize, Dominica, Grenada and Jamaica) that are characterized by high levels of external debt and some Caribbean economies also have high levels of domestic public debt.

Flexible financing, responsible lenders and borrowers

Promoting economic growth is essential to maintain debt sustainability, which requires country specific strategies and policies. Financing is the life blood of economic growth. African countries, in particular, have huge infrastructure deficit, which requires to be redressed to support long term economic growth. The current policy framework relating to borrowing by these countries seems unduly restrictive. Consideration should be given to both the quantity of the borrowing as well as its quality, meaning impact on GDP growth. Greater flexibility is needed in this aspect.

To maintain debt sustainability, there should be clearly spelt out responsibilities of lenders and borrowers including the required procedures and institutions. Responsible

sovereign borrowing and lending to sovereigns is of great importance to debt crisis prevention and debt sustainability. This is the reason for UNCTAD initiative on the formulation of a set of Principles on Responsible Sovereign Lending and Borrowing, which have already enjoyed official support from 13 countries and have been discussed with more than 70 countries at regional consultation meetings.

The need for an international framework and forum

The global financial crisis and Euro zone debt crisis have revived the global dialogue on creation of a sovereign debt restructuring mechanism. Calls to consider more structured approaches to resolving debt problems have reemerged and have been repeatedly underlined in recent General Assembly resolutions on external debt. The lack of an established procedure and a clear set of rules for dealing with sovereign insolvencies often results in costly and lengthy debt renegotiations which, in some cases, do not even restore debt sustainability. These difficulties are not a recent phenomenon that countries are just now beginning to encounter. These inefficiencies were at the root of the original proposals supporting the creation of a mechanism for restructuring sovereign debt. The United Nations Conference on Trade and Development (UNCTAD) took the lead to organize a special event during the sixty-seventh session of the General Assembly to discuss the desirability and feasibility of formulating of sovereign debt restructuring and debt crisis resolution mechanism. Many participants agreed that this topic should be at the center of the debate on the reform of the international financial architecture. Many consider the United Nations as the ideal forum for this discussion.

Author

Yuefen Li is Head of Debt and Development Finance Branch at the United Nations Conference on Trade and Development (UNCTAD).

Is Debt Relief a Development Tool?

Arnaud Zacharie

External debt can be a heavy burden for development when debt service represents the major share of public spending and exports revenue of a developing country. Such a burden can reduce fiscal space and make developing countries vulnerable to external shocks. In this respect, debt relief is a *sine qua non* condition not only for a successful development financing strategy, but also for macroeconomic stability as it determines the ability of a country to implement countercyclical policies in the context of a crisis.



Nevertheless, a number of conditions are necessary for debt relief to be a real, long-term, development tool. This article highlights five necessary conditions to make debt relief an effective development tool: additional revenue, the issue of vulture funds, public debt management, conditionality and the model of development promoted.

Additional revenue

Debt relief must ensure sufficient additional revenue to finance a development strategy. This is not the case when debt relief is only implemented to clear arrears that were not paid for. Nor is it the case when debt relief is coupled with a simultaneous decrease in the amount of Official Development Aid (ODA). Regrettably, such situations have occurred in the past in a number of developing countries. These countries were not able to take advantage of an additional amount to finance their development strategy, since the overall amount of ODA was reduced and/or the debt relief went to finance past debt, instead of new projects.

Vulture funds

Additional revenue can be available for development, only if it is not confiscated by vulture funds in the first place. Such funds seek to bring an action against a poor country after having bought discounted debt bonds on secondary markets, in the hope of making this country pay the nominal amount of the debt. Vulture funds are free riders that refuse to respect a debt relief agreement, taking advantage of the absence of a multilateral arrangement to deal with country debts. This phenomenon underlines the necessity to adopt a sovereign debt restructuring mechanism that includes all creditors at the multilateral level.

Public debt management

Even when debt relief leads to additional revenue for a developing country, this will not be enough if the country in question does not promote sustainable public debt management. Indeed, an unsustainable debt burden is the consequence of wrong policies that have made a country unable to pay its external debt service. It is important to avoid repeating the same mistakes after debt relief. This means that debtors and creditors must respect responsible financing principles in order to ensure that the mistakes of the past will not happen again. This also means that a financing for development strategy should favour domestic resource rather than external borrowing. External borrowing makes developing countries vulnerable to external shocks, whereas domestic resource mobilization ensure more policy space and ownership to finance a long-term development strategy, without creating a new unsustainable external debt stock.

Conditionality

Debt relief is usually linked to conditionality imposed by creditors in order to ensure that the resources freed up will be invested effectively by the debtor. But past experience has showed that conditionality can be counter-productive when it means excessive austerity plans that worsen economic recession, unemployment and, eventually, lead to decreasing tax revenue and a growing fiscal deficit. Conditionality, undermining policy space, should ultimately be avoided.

Model of development

Finally, the effectiveness of debt relief depends of the model of development it is meant to support. The best way for debt relief to support development effectiveness is to be invested in the strengthening of productive

capacities and the creation of decent jobs, enabling a sustainable economic development process that ensures enough tax revenue to finance social sectors in the long term. This type of development model that promotes domestic savings does not make developing countries dependent on external aid or debt relief to finance their social development. Debt relief and development effectiveness are thus closely tied.

In conclusion, debt relief can be an effective development tool, but only when accompanied by a set of conditions that will ensure that it supports an effective and sustainable development process.

Author

Arnaud Zacharie is Secretary General of the Centre national de Coopération au Développement (CNCD – 11.11.11), an umbrella organization of over 90 development NGOs, unions and learning institutions in Belgium.

Cleaning the External Debt Slate: What Difference Does it Make for Development in the DRC?

Stefaan Marysse, Danny Cassimon & Karel Verbeke

On June 30th, 2010, at the celebration of its 50th anniversary of independence, the external debt slate of the DRC was cleaned by the international community within the framework of the HIPC/MDRI Initiatives. Both parties agreed on the cancellation of 7.3 billion USD of external debt after a decade of negotiations and the satisfactory implementation of a series of preconditions.



When the government of Joseph Kabila came to power in January 2001, it inherited an insurmountable external debt burden. The origins of this debt are to be found in the early seventies when a number of prestigious projects of President Mobutu were generously financed by Western governments in a cold war sphere. In the end however, the big infrastructure projects and industrial ventures did not materialize or did never live up to their potential, but the debt remained. Besides these white elephants, unfavorable price evolutions on the international market, corruption, nationalization and defensive lending by bilateral donors further increased the debt.

Their negative impact on debt sustainability became soon evident. From the middle of the seventies onwards, repeated debt rescheduling has been implemented, amounting to nine operations between 1976 and 1989. These first generation debt relief operations, which mostly rescheduled debts at market interest rates, failed however to restore debt sustainability. Due to ; the implosion of the formal economy in the late eighties and early nineties, the outbreak of the Great War (1998-2003) in the DRC as a consequence of civil war and genocide in Rwanda, the DRC government ultimately stopped all payments and merely accumulated arrears and penalty interests, of about 700 million USD annually. All this inflated the country's debt to more than 13 billion USD, of which 78% consisted of arrears, at the moment the country tried to reintegrate in the community.

Negotiating the deal

In line with the peace agreement of Sun City (2003), the DRC and its creditors agreed to initiate debt relief negotiations under the framework of the HIPC Initiative. As one of the poorest countries in the world, and facing debt levels six times the HIPC-thresholds,

DRC's eligibility for HIPC was never in doubt. The major obstacle for progress were the multilateral and bilateral arrears, which were cleared by bridge loans, followed by an initial debt restructuring including debt relief by Paris Club bilateral creditors in 2002. In July 2003 the country reached HIPC decision point after its government had shown sign of its good intentions by finalizing a first version of its poverty reduction strategy paper (PRSP) and by having successfully implemented an economic recovery program, including the elimination of hyperinflation, liberalization of the economy and the initiation of major structural reforms. From the decision point onwards, the DRC received large reductions on its debt service payments, in anticipation of a large, irrevocable cancellation of its stock of debt at completion point.

In order to reach that completion point, the country agreed with its creditors to comply with a set of preconditions, some of which were more traditional HIPC triggers: the participatory completion and successful implementation of a PRSP; satisfactory use of the budgetary savings from HIPC for pro-poor expenditures; and maintenance of macroeconomic stability as indicated by satisfactory performance under an IMF program. In addition, a number of country-specific triggers were listed: the implementation of better public expenditure management; enhanced governance and public service delivery in priority sectors and procurement; the adoption of satisfactory sector development strategies and related implementation plans for the social and rural sectors; and a more rigorous public debt management. Although macroeconomic performance went off track in 2006, mainly due to excessive expenditures during election time, and remained difficult afterwards due to the global economic and financial crisis, performance on these triggers was generally satisfactory.

The road to completion

As completion point came within reach, an unexpected obstacle brought completion of the process at risk. While the DRC government was on the one side engaging in a process of receiving debt relief, it was simultaneously negotiating with Chinese partners a on a new contract that foresaw access to mineral resources in exchange for infrastructure works funding. The Congolese government had to guarantee the investment for a total value of 9.5 billion USD. As this new debt would fully offset the debt relief foreseen, the international community, with the IMF on top, opposed the contract and forced both parties to re-negotiate the terms of the contract before for DRC could reach completion point. In November 2009, both parties agreed that the Congolese guarantee should only cover 3 billion USD of the contract.

Seven years after reaching decision point, at its 50th anniversary of independence, the DRC reached completion point of the HIPC Initiative. To bring debt burden down to the HIPC-sustainability threshold of 150% of exports, 7.3 billion USD of debt claims (in PV terms) were cancelled. Following the HIPC principle of equiproportionality, all donors had to reduce their debt by 82%. Multilateral creditors took up 2.6 billion of this relief, the Paris Club bilateral creditors added 4.1 billion USD. The share of remaining bilateral creditors was 229 million USD and that of the commercial creditors amounted to 315.5 million USD. Of these creditors, not all of them have already granted their part of debt relief.

Also in the case of DRC, both multilateral and Paris Club bilateral creditors went beyond their strict HIPC commitments. Paris Club creditors granted full debt relief on their remaining eligible bilateral claims, while participating multilateral creditors (World

Bank, IMF, African Development Bank) did so for their remaining eligible claims in the framework of the Multilateral Debt Relief Initiative (MDRI) and also the EU did an additional effort; this all led to a further debt reduction by about 7000 million USD in Present Value (PV) terms.

Did the cancellation of debt lead to direct resource savings in the government budget that could be put to use for other development-oriented spending? Not in a very direct way...

All in all, the debt relief operations would lead to a reduction of external debt to about 3 billion USD, or about 57% of exports, at the end of 2010, which was well below international thresholds of debt sustainability. In this particular sense, the external debt slate of the country was cleaned, i.e. made sustainable again. Forward-looking monitoring mechanisms, such as through regular Debt Sustainability Analysis (DSA) performed jointly with the IMF, should ensure that the external debt of DRC remains sustainable over time.

Impact on development

Besides a restoration of debt sustainability at least in the short term, the debt deal has led to other development-related achievements. Did the cancellation of debt lead to direct resource savings in the government budget that could be put to use for other development-oriented spending? Not in a very direct way, as the debt deal in fact increased debt service payments by the Congolese government, compared to the situation before decision point, when the Congolese government had stopped all debt service payments and accumulated arrears. In order to retain eligibility for IDA and IMF financing during the interim period, the government had to restore debt service in the interim period. This net negative effect (of about 772 million USD) was however more than compensated by an increase in aid to the country (about 1.71 billion USD) from the donor community as the DRC escaped its international isolation.

Moreover, taking into account the indirect fiscal effects, the picture becomes gloomier. With support of the international community, the DRC followed a path of economic liberalization, economic recovery, business climate improvement and economic growth. As a result of these efforts, and the broader stabilization efforts which continued upon the Sun City peace agreement, not only macroeconomic stability was restored, but more importantly, government tax revenues increased considerably, boosting fiscal performance by the country, a tenfold increase compared to the period of country isolation.

Further results are much more difficult to credibly attribute to the debt relief operation. At this level, interaction with other evolutions like the stabilization of the country or the re-engagement of the international community may play an equally-important role. Over the interim period, democratic governance has improved as illustrated by the relative successful completion of the elections in 2005-2006. Also economic governance has improved. While the Congolese GDP was on a downward slope from the mid-eighties onwards, the trend has been reversed since 2003. Economic growth has been positive since then and inflation has been kept under control. In this climate of macroeconomic stability, private investors were attracted, mainly in the mining and the building- or construction sector.

The impact on poverty is even more difficult to evaluate given that poverty statistics are unreliable. Overall, most poverty-related statistics show a positive trend, with most significant improvements in the health and education sectors. It is however fair to conclude that, due its (post-)conflict status, reconstruction of the state and institutional reinforcement were higher on the government's agenda than investments in social sectors. A large part of the funding has thus been used for a reinforcement of the central administration, which certainly is a prerequisite for effective poverty reduction in the longer term. The education sector, which has benefited most from HIPC spending, noted one of the most significant improvements in poverty-related outcome indicators, with e.g. schooling rates increasing substantially. However, to what extent this increase will lead to the improvement of more impact-related indicators, such as an increase of literacy rates, the quality of schooling, or a reduction in parents-based funding of schooling remains doubtful.

Conclusion

In sum, the debt relief exercise was relative successful in that the country could again catch up with the international community, restore its macro-economic imbalances, increase substantially budget revenue and enter a positive growth path. However - in view of the development and financing needs of a country, as big as western Europe, with a dire need of investment in infrastructure, renewable energy and proper management of the tropical forest for the benefit of the international community - the lending (and debt) capacity of the country is far off the target. If development lending needs would at least amount to a 150 billion dollar, but sustainable debt for the country is only estimated at some 10 billion dollar, one can measure what would really be needed not only for the DRC but for the international community as well.

The full report can be accessed here:
http://diplomatie.belgium.be/nl/binaries/evaluation_allegement_dette_rdc_rapport_principal_tcm314-187891.pdf
Momentarily only available in French. The English version is forthcoming and can soon be found here: http://diplomatie.belgium.be/en/policy/development_cooperation/evaluation/conferences/

Authors

Stefaan Marysse is Director of the Belgian Reference Centre for Expertise for Central Africa (E-CA — CRE-AC) and prof. dr. emeritus in Political Economy and Development at the Institute of Development Policy at University of Antwerp, where Danny Cassimon is a Professor and Karel Verbeke a Research Assistant.

Assessment of the Heavily Indebted Poor Countries Initiative in the DRC

Jean-Claude Lapole Kanga



At its independence, the Democratic Republic of Congo (DRC) inherited a tarnished slate. However, the country's debt increased rapidly after the political regime of the time introduced an economic system favouring the accumulation of debt following loans contracted to finance unsustainable or poorly managed projects. In addition, debt management was weak (irregular payment of the debt service). These two factors contributed to pushing the country's level of debt through the ceiling.

Between 1990 and 2001, public management tools were affected by the socio-political instability facing the country. Several attempts were made to save the country from the depths of debt insolvency, ranging from debt restructurings to debt cancellation in the framework of the Heavily Indebted Poor Countries (HIPC) initiative.

To its credit, the Heavily Indebted Poor Countries (HIPC) initiative (HIPC-I) reduced the scale of debt for the Congolese economy in the long term. It enabled the DRC to save its international reserves. The decision to join the initiative and the granting of related cancellations also led to structural reforms. Indeed, significant debt service relief helped to cope with the rapid increase in social spending and the pressure on public spending as a result of insecurity and the organisation of elections.

It took Congo seven years to reach the completion point (July 2010) of the HIPC process (see Box 1). This long interim period can be explained by two key factors: (i) the need for political conciliation for peace and (ii) questions of governance. All in all, the HIPC initiative helped to relieve the DRC's external debt stock, improve the management of the country's macro-economic policies and reduce poverty. Its impact is detailed below.

Impact of HIPC-I relief in the DRC

The HIPC-I was beneficial for the DRC in several respects. In order to fully understand these, it is necessary to consider the channels through which this initiative influenced the conduct of public affairs in the country.

(i) Through the provision of liquidity: Contrary to popular thinking, the HIPC-I did not inject ready cash to help finance public spending. The relief obtained was only virtual, since, overall, the country had not honoured its financial commitments (payment of the debt service). However, when the country reached the completion point and was able

to benefit from debt relief in the frame of the Multilateral Debt Relief Initiative (MDRI), sums corresponding to the IMF's cancelled debts were accounted for in the Treasury Account and used to finance social projects in 2011 and 2012 (mainly in education and health).

(ii) Through conditionalities: In order to comply with the requirements for reaching the completion point, the Congolese state made concrete commitments to implement economic measures and structural reforms (see box 1). The DRC was aware of the relevance of these reforms, but the HIPC-I speeded them up and reinforced their coherence.

(iii) Through renewed solvency after the debt's cancellation: The improvement of the debt stock situation is a sign for foreign investors.

It was planned that the Treasury would pay instalments corresponding to the cancelled debts into a specific bank account, something the country was unable to do because of its weak cash flow situation. Instead, it adopted a budgetary approach through an adapted classification ("HIPC" funds), which enabled it to monitor the relevant funds and to increase social spending, especially teachers' salaries.

Impacts on the DRC's economic policy

The HIPC-I has had an impact on how economic policy is managed in the DRC, mainly through the seven major completion point triggers (conditionalities), and as a result of their structuring effect on the economy.¹

Impact on the State's planning capacity

The drafting of the Poverty Reduction Strategy Paper (PRSP) in the frame of trigger 1 proved to be a very rewarding process for the DRC. Thanks to its participative nature,

this exercise helped the country to develop capacities and expertise in planning techniques.² The State also devoted itself to drafting sectoral strategies in the frame of triggers 5 and 6, in the three sectors selected as priority for 2003: Education, Health and Rural Development.

However, the drafting of general and sectoral strategies has not yet produced tangible results. The State's budget credibility and efficiency still leaves a lot to be desired.

Impact on the coordination of macro-economic policies

In accordance with the IMF's conditionalities, the efforts made by the Congolese government have focused on maintaining macro-economic stability (trigger 2) and creating a favourable climate for business. The Troika (Finance Minister, Budget Minister and Governor of the Central Bank, and their experts) regularly monitors these questions by holding weekly meetings to assess the country's macro-economic situation and mobilize resources needed to achieve these criteria.

This macro-economic policy, focused on a very restrictive budgetary policy, has helped to obtain encouraging results. The continued tightening of budgetary policy, accompanied by a careful monetary policy, has contributed to stabilising the Congolese franc and slowing down the inflation rate. Since 2010, the national currency has barely depreciated more than 1% against the American dollar and the inflation rate is under control and is now below the programmed rate.³ Growth, after the effects of the 2008-2009 international financial crisis, has continued its upward trend. It reached successively 5.4% in 2010 and 6.5% in 2011. Forecasts for 2012 are in the region of 7.2%.

Therefore, trigger 2 has reinforced the coordination of macro-economic policies in the

country and increased Congolese decision-makers' awareness of the macro-economic goals to be pursued. The Government has also devoted itself to dealing with unemployment and underdevelopment in general.

Impact on public finance management

The HIPC-I has helped to restore healthy budgetary practices in the country. Indeed, triggers 3 and 4 have helped the DRC to launch a major public finance reform programme, resulting in a Strategic Plan. This plan has already helped to produce results, such as, for example: restoring the budgetary cycle – from the Government's drafting of the budget, including its adoption in Parliament, to its promulgation by the Head of State – the adoption of a classification and a modern budgetary presentation which conforms with international standards, improved budgetary monitoring with regular budgetary reports, the modernisation of the public contracts system, the modernisation and simplification of the tax and customs system and the modernisation and simplification of the legal and regulatory framework for public finance.

The most recent increases in public spending (organisation of the fiftieth anniversary festivities, infrastructure modernisation works, SADC summit, organisation of 2011 elections, management of insecurity in the east of the country) have not led to budgetary slippages, unlike in previous years.

Impact on the DRC's debt policy

Granted, the burden of debt was written off after the completion point was reached. But it remains to be seen whether there is not a risk of the sovereign debt increasing again and returning to an unsustainable situation. As a reminder, in 2000, the debt stood at \$13 billion (\$10 billion of which representing interest and arrears, namely 78.2% of the debt stock).

In response to this problem, the DRC adopted (in the frame of trigger 7) a prudent and responsible debt policy based on three lines: (i) whenever possible, to resort to grants rather than loans; (ii) to only indebted itself on concessional terms, with a minimum rate of 35% of grants, and this only for the implementation of projects which are profitable, integrating or which have high growth potential; (iii) to effectively manage public debt, by seeking advice from the Finance Ministry for all public borrowing projects and centralising all public debt management by the General Directorate of Public Debt.

Impacts on the policy to fight poverty: the case of the education sector

It is very difficult to assess the impact of HIPC-I relief on poverty indicators. Nevertheless, the completion point has made room for

budgetary savings used to finance pro-poor spending (see above). This increase in public spending in priority sectors, although limited in terms of the scale of needs, is accompanied by a certain improvement in social indicators.⁴ Let us examine the case of the education sector.

The main indicators for the education sector improved after the completion point had been reached.⁵ The school enrolment rate remained almost stable for the 2010/2011 school year compared to the previous year (3.6% compared to 3.2%). However, the Gross Admission Rate (GAR) rose in relation to the previous year, from 107.7% to 117.3%, namely

an increase of about 10 points. And the Gross School Enrolment Rate (GSR) progressed slightly compared to the previous year, from 90.8% to 92.7%. An increase of 3.5% in the number of classes was also observed between 2010 and 2011 and, in comparison to the previous year, the number of students also increased at all levels of education.

The situation is certainly far from perfect. The students/class ratio progressed by 1 percentage point compared to the previous year, namely 39 compared to 38 in 2010 (nevertheless remaining below the official maximum of 50 students per class). And school fees paid by households remain too high and prevent access to schooling for many students.

The improvements observed are probably a result of the increase in spending in this sector. Indeed, it rose to 3.2% of GDP in 2011, from 2.4% of GDP in 2010, mainly for staff spending. In parallel to the number of students enrolled, the number of teachers, classes and students has also increased.

Conclusion

The HIPC-I has contributed to improving the management of the DRC's macro-economic policy and to freeing budgetary resources for social sectors. However, questions of governance have been an obstacle to an injection of ready cash from technical and financial partners after reaching the completion point. We can only suppose that, if financial governance had been better, budgetary support would have increased and enabled projects in social sectors to be financed. This would have legitimised the HIPC-I for the Congolese population. The fact that debt relief is not materialised by new financial flows leads some Congolese to conclude that "Before or after reaching the HIPC-I's completion point is the same thing."

Notes

- 1 <http://www.imf.org/external/pubs/ft/scr/2010/cr10360.pdf>
- 2 e.g.: setting up of the PRSP Draft Coordination Unit
- 3 The exchange rate fluctuates around 920 FC per American dollar. The inflation rate fell from 53.4% in 2009 to less than 4% in 2012, with 9.8% in 2010
- 4 The lack of reliable statistics does, however, hamper the reliability of any form of interpretation.
- 5 See Annuaire statistique de l'Enseignement Primaire, Secondaire et Professionnel, Année scolaire 2010-2011 (Statistical Directory for Primary, Secondary and Professional Education, school year 2010-2011), August 2012

Author

Jean-Claude Lapole Kanga is *Directeur de Cabinet Adjoint* at the *Ministère du Budget* in the Democratic Republic of Congo.

Triggers and Completion Points in the HIPC Initiative

Debt relief from participating creditors becomes irrevocable at the completion point. Earlier, the country agrees on a list of completion point triggers, measurable objectives upon achievement of which the country will "graduate" from the HIPC Initiative. These include a continued track record of satisfactory performance in an IMF program and the implementation for at least one year of the Poverty Reduction Strategy. Some triggers may relate to progress in social areas such as health and education, while others may relate to improving governance or fighting corruption to ensure that debt relief assistance will be well-used. In the Democratic Republic of Congo, the seven triggers to reach the completion points were:

- 1) Poverty Reduction Strategy Paper. Completion of a full PRSP through a participatory process and its implementation for one year.
- 2) Macroeconomic stability. Continued maintenance of macroeconomic stability after reaching the decision point.
- 3) Use of budgetary savings. Use of budgetary savings resulting from enhanced HIPC Initiative-related debt service relief during the interim period for poverty-related expenditures.
- 4) Public expenditure management.
 - a) implementation of a modernized budget execution system; b) adoption and implementation of a double-entry government accounting system and a new chart of accounts; and c) production of quarterly budget execution reports (...).
- 5) Governance and service delivery in priority sectors.
 - (a) Completion of a budget-tracking exercise on health, education, rural development and infrastructure expenditure(...); and (b) Adoption and implementation of a new procurement code and key implementing decrees.
- 6) Social and rural sectors. Adoption of satisfactory sectoral development strategies and related implementation plans for health, education and rural development.
- 7) Debt management. Installation and full activation of a computerized debt recording system, covering all public and publicly guaranteed debt, as well as public enterprise debt not carrying the guarantee of the State (...).

Source: IDA/IMF: DRC – Enhanced Heavily Indebted Poor Countries (HIPC) Initiative: Completion Point Document; Multilateral Debt Relief Initiative (MDRI), June 15, 2010; and Debt Relief and Development at a glance, World Bank.

Debt Relief and Development: The Case of the 2005 Debt Relief Agreement in Nigeria

Geske Dijkstra



In 1999 Nigeria became a democracy again after a long period of dictatorship. One of the top priorities for the newly elected President Obasanjo was to clear the huge foreign debt that the country had built up in previous decades. Most of this debt was with bilateral official creditors, united in the so-called Paris Club.¹ But debt relief to Nigeria was controversial. Although the country has a low income, it has large oil reserves with which it should be able to pay its debt. Furthermore, the country is notorious for its corruption and for irresponsible economic policies.

Nevertheless, in 2005 Nigeria and the creditors Club reached an agreement on the US\$ 30 billion debt with the Paris Club. The creditors cancelled US\$ 18 billion, and Nigeria repaid US\$ 12 billion. Most of the US\$ 18 billion was registered as aid, justifying the question whether the cancellation contributed to development in Nigeria. A team of consultants linked to Ecorys and OPM carried out this evaluation for two of the creditors involved, namely the evaluation departments of the Dutch and Belgian Ministries of Foreign Affairs.² Much to everybody's surprise, we concluded that the debt deal did contribute to Nigeria's growth and poverty reduction.

Tracing the effects

We followed a theory-based evaluation methodology. According to theory, debt relief may have an impact on economic growth through a reduction in debt service flows or a reduction in the debt stock. A reduction in debt service flows may make more money available for government investment in social services or in physical investment, which in turn may lead to improvements in the well-being of the population and to higher incomes. A reduction of an unsustainable debt stock may lead to a return of investor confidence in the economy, as possible foreign and domestic investors no longer need to fear that their profits will be taxed away in order to pay-off the government debt. A third possible effect of effect debt relief is through the conditions that are usually attached to it. If these were good conditions and if they are implemented, this may also

lead to higher economic growth and more poverty reduction.

A first step in the evaluation is therefore to assess whether the 2005 debt relief agreement led to a reduction in debt service and debt stock. We needed to know to what extent Nigeria would have paid this debt if there would not have been an agreement on debt relief. Due to a rising oil price from 2003 onward, Nigeria was economically able to pay the full amount of debt service due of around US\$ 3 billion. However, servicing this debt was politically difficult. Many people felt that the debt was illegitimate, having grown so much due to irresponsible dictators in the past. After interviewing many stakeholders, we concluded that most likely the country would have paid only US\$ 1 billion a year: one-third of the amount due, but just enough to maintain some relation with the creditors. This means that in the absence of an agreement, the debt stock would have continued to increase with the amounts due and not paid, plus the interest on these non-paid amounts. While Nigeria's actual foreign debt stock declined from US\$ 34 to US\$ 4 billion (only 2% of GDP), without the debt deal it would have risen to US\$ 54 billion.

With respect to the debt service flow the situation was different. Nigeria had to pay US\$ 12 billion up front as part of the agreement. This was much more than the US\$ 1 billion annually that it would have paid otherwise. Yet, because the country was able to pay the US\$ 12 billion from accumulated reserves, the US\$ 1 billion in forgone annual debt service was felt as "savings".

There were clear conditions attached to the debt relief agreement with Nigeria, and they were very effective, especially before the agreement but also to some extent after it. When President Obasanjo began to talk about debt cancellation, the creditors made it clear that changes in economic policies were necessary, first (in the early 2000s, The UK and the US made some specific promises: if Nigeria was to reform its economic policies and to reduce its level of corruption, they were willing to champion debt relief with the other Paris Club creditors). In his first term, not much happened in this respect. But when President Obasanjo was re-elected in 2003, he appointed a new economic management team headed by former World Bank director Ngozi Okonjo-Iweala. This team implemented many policy reforms. It no longer immediately spent the extra income from a higher than expected oil price, but began to save it on an excess crude account. It also improved debt management, implemented anti-corruption policies, cleaned the banking sector and improved poverty reduction policies.

The Paris Club deal itself was accompanied by a two-year IMF programme. The policy conditions of this agreement were based on the government's own programme. But we found that the bi-annual monitoring by the IMF helped to maintain strict fiscal and monetary targets and also to keep the earlier started reform programme on track. The debt deal was also accompanied by a government promise to use the US\$ 1 billion in saved debt service for a "Virtual Poverty

Fund” (VPF). This Fund came into being and it meant additional spending on essential social services, albeit somewhat lower than the US\$ 1 billion. Ministries and state governments could apply for this money according to strict procedures and on the basis of matching. As a result, the VPF had a positive impact on the capacities for planning and implementing social projects beyond the VPF money itself.

Results

All in all, the debt relief agreement had several positive effects on the economy. First, the external debt became very sustainable and this, together with improved macro-economic policies, restored investor confidence. In 2006 Nigeria obtained its first ever credit rating from Fitch in 2006, later followed by the same BB-minus from Standard and Poor's. Foreign direct investment increased. And while before 2005 most of this investment was directed to the oil sector, substantial amounts were now also invested in other sectors such as telecommunication and banking. The more prudent macro-economic policies made it possible for Nigeria to pay the US\$ 12 billion up front and also reduced inflation. In addition, the accumulated savings helped to cushion the effects of the world wide recession in 2008-2009.

It is difficult to investigate the effect of the debt relief on growth directly, but we know from theory that lower inflation, improved investor confidence and more foreign investment all have a positive influence.

It is difficult to investigate the effect of the debt relief on growth directly, but we know from theory that lower inflation, improved investor confidence and more foreign investment all have a positive influence. In the period 2003-2009, economic growth was high, around 7% on average. Another indication for an effect

of the debt deal is that from 2004 onward, the growth in the non-oil sectors was higher than in the oil sector. Growth was also particularly high in the agricultural sector, probably implying that the poor also benefited. Economic growth, together with improved policies from 2003 onward, probably also had a positive effect on some social indicators. Between 2004 and 2009, primary school enrolment rates and the proportion of births attended by a skilled health worker increased, while infant mortality decreased.

Sustainability

An important question was also whether the positive results are sustainable over the medium term. The answer is mixed. The IMF programme only covered the years 2005-2007 and already during this period the discipline to maintain macro-economic prudence and to continue implementing other reforms gradually waned. Telling was also that the leader of the economic management team was removed from her position in 2007 and went back to Washington - to return after the 2011 elections. While in 2008 and 2009 it was justified to use the accumulated savings for stimulating the economy in the context of the global recession, this was no longer the case in 2010 when the Nigerian economy recovered strongly. Yet, politicians continued to deplete the oil savings account. The institutions established for fighting corruption are still there, but appear to be less active than before. This is also reflected in a slight deterioration of Nigeria's ranking in the Transparency Index, after years of gradual improvement. On the other hand, the Virtual Poverty Fund still exists and can be expected to continue fostering Nigeria's achievement of the Millennium Development Goals.

Conclusion

The development effects of the Nigerian debt relief were far more positive than in many other countries. One of the reasons was that the Nigerian debt was eliminated completely so that the country could really make a fresh start. But the effect of the conditions was also stronger than elsewhere, especially before the agreement. The country wanted the debt relief badly and was willing to undertake far-reaching reforms. Even if not all of these policy changes can be sustained, the debt deal already had positive effects on the welfare of the more than 150 million people in Nigeria.

The full report can be accessed here: http://diplomatie.belgium.be/nl/binaries/1_IOB_nr_340_Main_report_EN_tcm314-140813.pdf

Notes

1. The Paris Club is an informal group of official bilateral creditors that negotiates collectively on debt restructuring with debtor countries.
2. IOB and SEO, "Mutual interests - mutual benefits: An evaluation of the 2005 debt relief agreement between the Paris Club and Nigeria", main report, 2011. The authors were Geske Dijkstra (team leader), Christian Hiddink, Bola Akanji, Sanga Sangarabalan, and François-Xavier de Mévius.

Author

Geske Dijkstra is Professor of Governance and Global Development, Erasmus University Rotterdam; and since 2011 part-time evaluator with IOB, Evaluation Department of Ministry of Foreign Affairs in The Hague.

Sustainability of the Debt Relief: Nigeria's Case

Abraham Nwankwo

Starting from the mid-1980s, Nigeria's external indebtedness ratios stayed at critical levels, surpassing the thresholds for sustainability. Nigeria approached the Paris Club for the rescheduling of its debts three times 1986, 1989 and 1991 without any stock reduction. Rather, the debt stock continued to grow with the capitalization of arrears. Between 1992 and 1999, there was a virtual breaking off of negotiations and unilateral curtailment of debt service payments by the then Nigerian military government.



Following the restoration of democratic governance in 1999 and the establishment of the Debt Management Office (DMO) in 2000, negotiations were resumed in what led to the last rescheduling agreement with the Paris Club in the December of that year. The rescheduling agreement was treated in Houston Terms, which provided for the rescheduling of Paris Club debt totalling about US\$ 21 billion over 18-20 years. The agreement still left Nigeria's debt sustainability at precarious levels, since there were only flows re-profiling without any stock reduction.

By December 2004, Nigeria owed about US\$ 36 billion to external creditors, with US\$ 30.8 billion (about 85.82%) being owed to the Paris Club. It was evident that for Nigeria's debt to become sustainable, it had to secure substantial debt relief from the Paris Club. In 2005, Nigeria obtained a 60% debt write-off of its Paris Club debt. The total relief package amounted to US\$ 18 billion write-off, with Nigeria expected to pay off the balance of approximately US\$ 12.4 billion to the creditors over a period of six months to completely exit from debt. By April, 2006 with the payment of the required balance, Nigeria exited the Paris Club debts. This was followed by the redemption of London Club debt (Par Bonds and Promissory Notes) and part of associated Oil Warrants. The external debt thereafter dropped to a sustainable level of US\$ 3.5 billion.

Usually, to reach a deal with the Paris Club, a country was required to have a formal agreement with the IMF. Nigeria did not, but signed up to a new framework with the IMF known as a Policy Support Instrument (PSI). This was essentially an arrangement for IMF to officially endorse the National Economic Empowerment and Development

Strategy (NEEDS), Nigeria's home-grown locally driven economic reform program. The reforms have proved to be effective before and after the debt relief.

Analytical and policy initiatives

Following the achievement of relief from external debt burden, the DMO had to re-direct efforts towards the real job of public debt management, which is to mobilize resources to close the financing gap, towards the generation of growth and development. In graphic terms, while initiatives taken to obtain debt relief and achieve debt sustainability could be likened to filling a hole, which is essentially a negative function, using debt resources to fuel growth and development is like building a mountain which is a positive function.

First, was the commencement of Debt Sustainability Analysis (DSA) by the DMO in 2005 using the WB/IMF's Debt Sustainability Framework-Low Income Countries (DSF-LIC) Template in conjunction with the Central Bank of Nigeria, National Planning Commission, National Bureau of Statistics and the Budget Office of the Federation. The WB/IMF provided initial technical support up to 2007. The DMO conducts the DSA every year with the local stakeholders. Secondly, in order to be effectively guided in its new focus, the DMO formulated a five-year National Debt Management Framework (NDMF, 2008-2012). The broad strategy is "to ensure that National and Sub-national Governments subscribe to the principles of prudent and sustainable borrowing, and effective utilization of resources, and to create a robust domestic debt market supportive of private sector development." The NDMF contains guidelines on external and domestic borrowings

and initiatives for the development of debt management institutions in the country. Thirdly, is the commencement of workshop on National Medium Term Debt Management Strategy (MTDS, 2012-2015) in 2012 structured along the WB/IMF Analytical Toolkit and guidance note for developing the MTDS for a medium performer economy. The purpose is to operationalize the debt management objective of meeting government financing needs at lowest cost consistent with prudent degree of risk.

Institutional building initiatives

A special initiative in developing the domestic debt market in particular and public debt management in general, is one that recognizes that Nigeria is a country of Fiscal Federalism. In this regard, the DMO is implementing a programme of assisting each State of the Federation have its own debt management institution, called Debt Management Department (DMD). This is a case study of cooperation in a strong federalist country, as all States have subscribed to the programme. The Template developed by the DMO along with the States is at different stages of implementation in all the States of the Federation. The key objectives include: coordination and regulation of borrowing; maintaining macroeconomic stability by regulating fiscal expansion; entrenching fiscal responsibility; and, facilitating the development of reliable debt data database for States. The major area of activities and achievements so far include: strengthening of legal framework for public debt management; capacity building for sub-national debt managers; and, reconstruction of domestic debt data of States. As at end-September 2012, the domestic debt data reconstruction (DDR) which is part of the final stages of the development

of public debt management institutions in States, had been completed in all the States. The goal is that by the end of 2012, every State in the Federation will have a functional DMD.

Development of the domestic bond market as alternative borrowing source

One of the implicit, but unmistakable, lessons from the crisis of Nigeria's unsustainable external debt was the need to have a reliable domestic debt market as a viable alternative source of borrowing by the government. This would among other benefits protect the country from volatilities inherent in foreign borrowing. In line with this, the sovereign bond issuance, which had been discontinued for about 18 years, was re-suscitated in 2003. The progress made in the pursuit of this objective could be observed in the structural transformations of the debt market.¹

First is the introduction, between 2003 and 2008, of long dated debt instruments, which span from 3 years to 20 years. Before the resuscitation of the sovereign bond market, the government borrowing from the domestic market was mainly in the form of 91-day Nigerian Treasury Bills (NTBs). This meant that inappropriately, short-term liabilities were used to fund economic and social projects, which were essentially long-term assets.

Secondly, the overall success of the approach of raising money for government through the issuance of bonds is shown by the high level of oversubscription which stood between 64% and 150% in response to the offers made between 2005 and 2011. In this regard, the objective of developing an alternative funding source for government was also achieved.

The third arm of the structural transformation, is that whereas 91-day NTBs accounted for 63% of the domestic public debt portfolio in 2002, and active long-dated Federal Government of Nigeria (FGN) bonds were nil, by 2009 and 2011, the share of NTBs had dropped to about 25% and 31%, while FGN Bonds accounted for about 61% and 63%, respectively. This meant a more optimal asset-liability matching.

Fourthly, there was also a transformation in the holding structure. In 2002, the Central Bank of Nigeria (CBN) held about 46% of the total domestic debt outstanding, while the non-bank public held only about 15%. By 2009 and 2011, the CBN holding had dropped to 10% and 6%, respectively, while the holding of the banks and discount houses had risen to about 40% and 67%, respectively. This shift has two major salutary implications: one, it means that monetary financing of fiscal deficit has been control-

led and that the CBN, which is the monetary authority, has been insulated from the conflict of doubling as a fiscal agent; two, it means that the investor base for sovereign debt instruments had been diversified and, indeed, that there has been a democratization of market participation.

Another flank of the transformation is the introduction and progression of the secondary market for FGN bonds, where the Primary Dealer Market Makers (PDMs), which are licensed by the DMO to deal on FGN Bonds. The effective functioning of the secondary market is a major factor that has encouraged the emergence of a sustainable long-tenured bond market of up to 20 years. Market capitalization of outstanding FGN Bonds stood at 3,192.30 trillion Naira (N) as at end-June 2012.

The recent inclusion of the FGN Bonds in the globally traded JP Morgan's Government Bond Index-Emerging Markets (GBI-EM) is an independent external recognition that the transformation of the domestic bond market has been executed in a manner that has enhanced the quality and strength of the domestic financial markets.

Overall economic performance and debt sustainability

The debt relief had some positive impact on macroeconomic stability and growth. It enabled the government to plough the savings of over US\$1 billion annually from external debt servicing into the development of infrastructure in critical sectors of the economy. The enhanced creditworthiness of the country also resulted into increased inflow of foreign direct investment. Overall, real GDP real growth rate averaged 7.6% between 2003 and 2011 with a low growth volatility of about 1.9% making Nigeria among the top growth emerging market economies during the period.

The link between the transformation of the domestic debt market and economic growth could also be inferred from the portion of the deficit in the annual budgets, which was funded domestically. Deficit financing from the domestic debt market grew from N27 billion in 2005, to as much as N852 billion in 2011. In addition to general budget support, proceeds of domestic bond issuance were also used to fund special government stimulus spending initiatives between 2008 and 2010. It would be recalled that due to the global financial crisis which caused dramatic shrinkage of economic activities, many governments, prominently in the advanced economies adopted countercyclical, interventionist spending.

The above coupled with the need to fund the infrastructure deficit in the country contributed to the growth of domestic debt

portfolio over the period.

As at end-December 2011, Nigeria's Total Public Debt/GDP ratio was about 20.12% as against the peer group (medium performers in the WB/IMF Country Policy and Institutional Assessment (CPIA) Framework) threshold of 40%. The Debt Sustainability Assessment (DSA) conducted in May 2012 showed that the Present Value (PV) of Debt/Export, PV of Debt/Revenue, Debt Service/Export and Debt Service/Revenue ratios under a pessimistic country-specific scenario stood at 6.0%, 32.1%, 0.3% and 1.5% as against the thresholds of 150%, 250%, 20% and 30%, respectively. Hence the country is operating within acceptable limits.

Conclusion

Public debt management is an integral part of modern, money-based economies. In the Nigerian case, professional public debt management came about as a salutary response to external debt overhang. But beyond solving the legacy problem of external debt overhang, Nigeria's DMO has organized itself as a platform for growth, development and poverty reduction. In view of this posture, the country's public debt management will continue to be proactive, creative and dynamic so as to appropriately respond to new realities that emerge on the country's transformation trajectory, whilst ensuring continued debt sustainability.

Notes

¹ For details of the analysis below, please refer to the full slide presentation submitted to the organizers of the Debt Relief Conference.

Author

Abraham Nwankwo is Director-General, Debt Management Office, Abuja, Nigeria.

Debt Relief and MDGs in Nigeria:

Progress achieved by the Office of the Senior Special Assistant to the President on MDGs

Christopher U. Otabor



Six years after Nigeria gained her independence from her British colonial masters, the first coup d'état took place in 1966. This event was to set the stage for successive military rule with its attendant colossal waste, underdevelopment and accumulation of external debts, which at the dawn of democracy in 1999 became a major stumbling block to Nigeria national development.

In the year 2000, world leaders met in New York at the millennium summit to sign the millennium declaration which underpins the eight millennium development goals. Though Nigeria was a signatory to that document, however, not much was achieved by way of a concerted effort towards achieving the millennium development goals until the year 2005 when Nigeria was able to secure debt relief from her Paris club of creditors with the able leadership of President Olusegun Obasanjo and support from Dr Ngozi Okonjo-Iweala, the then minister of finance of Nigeria and others.

Managing debt relief in Nigeria: the institutional structure

The debt relief came with its own conditionalities that were to guide the use of the gains from that gesture till date. One billion dollars became available to the government of Nigeria annually to be plunged directly into developmental processes in Nigeria, thus bringing a massive boost in financing for the MDGs.

To manage the savings from the debt forgiveness by the Paris club of creditors, president Olusegun Obasanjo set up the Office of the senior special Assistant to the President on MDGs (OSSAP-MDGs), an office with status equivalent to that of a junior minister, headed by the senior special assistant to the president on MDGs who reports directly to the president. This office has driven development throughout the entire country as it relates to MDGs not only in terms of direct funding from the debt relief gains (DRGs) but also in terms of stimulating partnership between the three tiers of government (local, state and federal) towards the realization of the MDGs.

The conditional grants scheme, a flagship program of the OSSAP-MDGs has attracted international recognition for its ability to stimulate investment in the MDGs by the various tiers of government. In this scheme, DRG funds are made available to states and local governments who are willing to match same with equal amount

of funds to execute specific MDGs oriented programs and projects as approved by the office after fulfilling specific requirements. The community health insurance scheme providing healthcare for over six hundred thousand women and children in various states of the country is a good example of how the conditional grants scheme work. Financing for such insurance cover is shared by both the state government and the federal government through the DRG funds.

Earlier on, a national needs assessment and baseline facility inventory has been done in order to direct scarce resources to areas where they are most needed. States and local governments requests for funds are evaluated based on the needs assessment and compliance with public finance management structure. The OSSAP-MDGs also work with the federal ministries, departments and agencies by making funds available to them and tracking the use of such funds.

Building an efficient monitoring and evaluation framework

A cornerstone for the success so far recorded by the OSSAP-MDGs is the effective monitoring and evaluation framework. This sets the office apart from the traditional government style that is froth with several bottlenecks. The MDGs monitoring and evaluation system engages private monitoring and evaluation firms as well as registered civil society organizations to ensure value for money in the expenditure of the DRG funds.

Some of the areas of investment of the DRG funds include the following: health, education and basic infrastructure. The recruitment and training of midwives, for example, under the midwives service scheme, has brought about a dent in the maternal mortality ratio in Nigeria. The Routine immunization program against vaccine preventable childhood killer diseases countrywide has been largely funded by the debt relief gains over the past

seven years through the National Primary Healthcare Development Agency and the Federal Ministry of Health. Several hundred thousand children have been saved through this program.

Concerning education, following the needs assessment carried out in the country, it was observed that a critical factor militating against the attainment of universal basic education in Nigeria is the dearth of qualified teachers. To bridge this gap, the OSSAP-MDGs has invested the DRG funds in the past few years to recruit and train teachers to fill the existing human resource gap. This and other investment in educational infrastructure has improved enrollment amongst school-aged children.

Funds derived from DRGs transferred to sub-national entities, which are counterpart funded, have been invested in basic infrastructural development in the area of education, primary health care, provision of portable and safe water supply, small-scale agriculture, social safety nets and entrepreneurial development.

From the fore going, it can be deduced that debt relief has worked greatly for Nigeria as a country, the lives of the poor and vulnerable have been touched in many positive ways. Though reports suggest that Nigeria is among the countries that are least likely to meet the millennium development goals come 2015, the country has recorded significant achievements in the direction of the goals. This modest achievement is directly linked to the debt relief granted Nigeria by the Paris Club of creditors and the judicious administration of the DRG funds.

Author

Christopher U. Otabor is Head of the Special Projects Unit in the Office of the Senior Special Assistant to the President on MDGs.

EPA Update

This section covers recent EPA developments to all ACP and EAC regions.
Stay tuned for coverage of negotiations in other regions.

Quentin de Roquefeuil

All ACP

ACP Heads of State Summit in Equatorial Guinea, Mohamed Ibn Chambas resigns from ACP Secretary General to take on UN Special Representative position

ACP Heads of State and Government met in Malabo, Equatorial Guinea from December 13th to 14th for a high-level Summit on the theme “The future of the ACP in a changing world: challenges and opportunities”.

On trade issues specifically, the Sipopo Declaration, issued at the end of the Summit, takes stock of ACP Trade and Development efforts before going into specific policy issues in the Group’s commercial ties with the EU. Observing that the Group’s integration in the world trading system is weak, and that past efforts to diversify the economic and export base of ACP economies “have achieved limited progress”, the Group reaffirms its determination to take specific policy reforms and measures to develop key sectors, such as tourism or niche products. Additionally, the Declaration underlines the importance of Infrastructure and Trade Facilitation measures.

In this light, the ACP calls for “additional resources” to be made available as part of an EPA package, and for “binding provisions that will deliver on development”, combined with wording that would allow an EPA signatory state to monitor the development impact of an agreement on its population, with the possibility of rescheduling commitments made. On the current impasse in EPA negotiations the Group suggests dropping problematic issues “that are not germane to the WTO”.

Echoing a proposal issued by the African Union last year, the Declaration also calls for establishing a common and enhanced trade preference system for Least Developed Countries (LDCs) and Least Industrialized Countries (LICs), a proposal that would end the current split in EPA negotiating countries between those eligible for the Everything But Arms (EBA) initiative and other, more developed countries that could only rely on the less generous Generalized System of Preferences (GSP) should they opt out of EPA negotiations.

The ACP Group also takes a strong stand against the amendment of Market Access Regulation (MAR) 1528 maintaining quasi Duty Free Quota Free preferential market access for countries negotiating EPA having signed an Interim EPAs (IEPAs). Regular

readers will remember that the European Commission had proposed earlier last year to amend the regulation to provide for the removal of countries that do not show signs of commitments to the ratification and implementation of their IEPAs by 2014.

While the final “deadline” is still under discussion in Brussels (see previous issues), the move was widely criticized by ACP countries as an attempt to push them into the signature of rushed IEPAs, while the Commission reminds that MAR 1528 always had a temporary nature.

Additionally, the Group expressed concern at the EU’s new GSP, whose main new feature will be to exclude Upper-Middle Income Countries (UMICs) from its remit. Namibia, Botswana and Palau are ACP countries directly concerned by this change.

The Declaration also announces the creation of a “High-level panel” tasked with giving “political impetus to the negotiations, and to find solutions to the contentious issues”. The exact composition of the panel is not known as of yet, but it will comprise of six Heads of State and Government, drawn from the African Union, who will have one representative on the panel, one member from the CARIFORUM grouping, and one additional from the Pacific ACP States, as well as three Members of the Troika of the European Union. The first meeting of this panel is expected in January 2013, preceded by a preparatory joint Experts meeting with officials from the European Commission.

Apart from trade relations, the “Sipopo Declaration” addressed issues that have risen to the top of the ACP agenda in past months. One could cite development financing and “differentiation” between countries on the basis of needs and performance, or, as the theme of the summit suggests, the future of the ACP Group itself, whose future after the expiry of the Cotonou Agreement in 2020 has been the subject of intensive discussions in Brussels.¹

In other news, the Secretary General of the ACP Group, Dr. Mohamed Ibn Chambas has been nominated Joint Special Representative for Darfur, Head of the African Union-United Nations Mission in Darfur (UNAMID) by African Union Commission Chairperson Nkosazana Dlamini Zuma and United Nations Secretary-General Ban Ki-Moon. According to sources, he is to resign from his post as ACP Secretary General in February.

EAC

EAC and EU technical officials meet in Kampala

The least EAC-EU negotiating session took place from 6th to 9th November last year in Kampala, Uganda. A somewhat quiet round according to sources, Technical Officials were able to reach a common understanding on several issues relating to Rules of Origin (RoOs), Institutional Arrangements and Dispute Settlement provisions. Thornier issues have been delegated to Senior Officials level, who should meet at some point in February.

On RoOs, it seems that the definition of “ACP states”, fishery and fish products related matters and cumulation with South Africa stand out as particularly divisive. They will require further work by Senior Officials, as will several chapter and heading-specific issues. The timeframe of the asymmetry granted to RoOs is also a point of contention.

The Dispute Settlement (DS) chapter also came closer towards finalisation, with the provisions related to the review of compliance measures with panel rulings and the amendments clause nearly agreed upon. Nevertheless, DS scope, timelines and Interim measures, amongst others, have been deferred to the February meeting. Procedural matters relating to Arbitration are also still under discussion.

Note

- 1 For the full text of the declaration, see http://www.acp.int/sites/acpsec.waw.be/files/Final%20ACP2806512%20Rev%208%20Draft_Sipopo_Declaration.pdf

Monthly highlights from ECDPM's Talking Points

www.ecdpm-talkingpoints.org

Aid for Trade needs to shift from policy to greater action, Talking Points, Dan Lui, January 11, 2013

Trade ministers and officials from South and North, academics, and donors will gather at the OECD in Paris next week for a policy dialogue to discuss the future of the Aid for Trade initiative. Conceived in 2005 in the context of the WTO Doha Round, Aid for Trade aims to improve the trading prospects of developing countries through targeting aid to this sector. In the seven years since its launch, there has already been a fair amount of navel-gazing amongst policymakers on questions of how to 'operationalise' such a broad and ambitious agenda. In the (...)

Aid and beyond: mobilizing more resources for financing development, Talking Points, Geert Laporte, December 14th 2012

This article was published on 7 December and is available on the website of Friends of Europe. The scenario is quite familiar. If budget cuts are to be made in times of crisis, development spending is the first and easiest target for European policymakers. In preparing for the 2013 budget, several EU member states seem to have forgotten about their longstanding commitments to reach the 0.7% target of GDP as Official Development Assistance (ODA) by 2015. Cutting development budgets first is also common practice in EU institutions. In trying to broker a compromise deal on (...)

ACP-EU cooperation: discussing the long-term future in the near future, Talking Points, Niels Keijzer, December 7th 2012

European Heads of State were recently advised to bring more than one shirt to the 22-23 November summit to discuss the EU budget. Those who specialise in the relations between the EU and the African, Caribbean and Pacific (ACP) countries will definitely also need a few more shirts during the next few weeks. From 27-29 November the ACP- EU Joint Parliamentary Assembly (JPA) convened in Suriname, a destination European MEPs only agreed to on condition that the country's president Desi Bouterse would not turn up. During this meeting the ACP Secretary (...)

The impact of private sector for development, are we using the same language? Talking Points, Anna Rosengren, January 18, 2013

A whole new range of actors is placing private sector development centre of their attention and operations. While a wider set of players can provide significant strength and dynamic to any activity, it also brings confusion and incoherence. A useful first step would be to get a better common understanding of the actual impacts of private development activities, to define different measurement tools, and to reflect on their implications for policy. (...)

Monthly highlights from ECDPM's Weekly Compass Update

www.ecdpm.org/weeklycompass

ACP Secretary General to resign despite detailed summit plans, Weekly Compass, Issue 133, 11 January 2013

Senior delegates from 63 of the 79 African, Caribbean and Pacific (ACP) countries, including some 15 Heads of State, attended the ACP Summit last December. The summit declaration highlights members' determination to "stay united as a Group" and retain relevance by "enhancing the ACP-EU relationship as a unique North-South development cooperation model, while developing South-South and other partnerships." A new working group will reflect on the response of the ACP Group to global challenges. Officials also decided to set up a high-level panel to advance trade negotiations with the EU. Shortly after the summit, the African Union announced that the ACP Group's Secretary General had been appointed the African Union-UN Special Representative for Darfur. The ACP remains silent on this and has not yet named a successor.

Post-2015: who proposed what again? Weekly Compass, Issue 133, 11 January 2013

As the debate on what will replace the Millennium Development Goals after their expiry date in 2015 intensifies, the number of proposals for new targets is increasing. On its portal post2015.org, ODI tracks emerging proposals and provides an overview of ideas by sector in a handy table that is updated regularly. The growing list is not yet complete and, in an effort to capture all proposals, ODI invites readers whose ideas have not been included in the list to point to these.

What reforms matter for Africa in 2013, Weekly Compass, Issue 133, 11 January 2013

Continuous positive change in Africa has transformed the "hopeless continent" into a rising region in the past few years. Optimistic outlooks predict that many African economies will continue to grow in the near future, though the continent still faces numerous challenges. A new report by the Brookings Institution outlines what will be the key issues for 2013 and ways to leverage opportunities so that Africa "can continue the emerging momentum". Top priorities for 2013 include employment policy reform, tackling the energy poverty gap, and broader issues of insecurity.

EC proposes to set up special body for blending development finance, Weekly Compass, Issue 132, 14 December 2012

Blending - the complementary use of grants and loans in external assistance to increase the volume of development finance - has emerged rapidly and is now common practice. This week, an expert group coordinated by the European Commission published its conclusions on the potential benefits of establishing an EU Platform for External Cooperation and Development as a way to improve the quality and efficiency of EU development finance. The report proposes the platform focus on reviewing and guiding existing blending mechanisms, streamlining cooperation, and developing new financial instruments. A European Think-Tanks Group study has shown that there is limited evidence base on positive effects of blending.

ACP-EU Trade Calendar

February 2013

- 14-16 ACP-EU JPA - Regional Meeting (Caribbean)
- (TBC) EAC-EU Senior Officials meeting, Mombasa, Kenya
- (TBC) PACP Trade Officials meeting
- (TBC) West Africa regional consultations on EPA
- (TBC) SADC EPA Working Group on Market Access

March 2013

- (TBC) Pacific EPA Joint Technical Working Group
- 11-16 EU-SADC Technical Working Group on Market Access and Senior Officials

Resources

The Road to the 2014 Summit: Challenges for Africa-EU Relations in 2013, James Mackie, Anna Rosengren, Quentin de Roquefeuil, Nicola Tissi, Policy and Management Insights 4, December 2012

EU Budget Consensus at the Expense of Development - State of Play and Options in Front of Negotiators (revised version) Laura Mayer, Andrew Sherriff, ECDPM Briefing Note 46, December 2012

The AU Joint Ministerial of Agriculture and Trade: Preparations and key messages, Francesco Rampa, ECDPM Briefing Note 45, November 2012

Gearing up for the 2013 EEAS Review: Opportunities, challenges, and possible approaches, Florian Krätke, Andrew Sherriff, ECDPM Briefing Note 44, November 2012

Focusing on what matters in Aid-for-Trade: Increasing effectiveness and delivering results, Yurendra Basnett and Jakob Engel, ODI Briefing Paper 79, January 2013

Inequality of Opportunity, Income Inequality and Economic Mobility – Some International Comparisons, Paulo Brunori, Francisco H.G. Ferreira and Vito Peragine, World Bank Working Paper 6304, January 2013

Piecing it together: Post-conflict survey in Africa of Networked, Multilevel Governance, David K. Leonard, IDS Bulletin 44.1, January 2013

Localizing Development: Does Participation Work? Chazala Mansuri and Vijayendra Rao, World Bank Policy Research Report, January 2013

Financial Sector Development in Africa: Opportunities and Challenges, Thorsten Beck and Samuel Munzele Maimbo (ed), The World Bank, January 2013

Putting inequality on the map, Sara Murawski, The Broker, December 2012

Development Community vs. Financial Industry: Clash of Civilisations or Strategic Partnership, I. Olivié and A. Pérez, ARI Paper, Elcano Royal Institute, January 2013

Secret structures, hidden crimes: Urgent steps to address hidden ownership, money laundering and tax evasion from developing countries, Alex Marriage, Eurodad, January 2013

Private Chinese investment in Africa: myths and realities, Xiaofang Shen, World Bank Policy Research working paper no. WPS 6311, January 2013

The Future of Foreign Aid: Development Cooperation and the New Geography of Global Poverty, Andy Summer and Richard Mallet, Palgrave Pivot, December 2012

Support to enhance private investment for infrastructure in developing countries, OECD Issue Paper DCD/WKP(2012)1, December 2012

A comprehensive regional industrial policy for SADC, Harry Zarenda, tralac Working Paper No. S12WP10, December 2012

Small producer agency in the globalised market: making choices in a changing world, Bill Vorley, Ethel Del Pozo-Vergnes and Anna Barnett, iied and Hivos, November 2012

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Editor:
Sanoussi Bilal

Co-editor:
Quentin de Roquefeuil

Production:
Claudia Backes and
Yaseena Chiu-van 't Hoff

**HEAD OFFICE
SIÈGE**
Onze Lieve Vrouweplein 21
6211 HE Maastricht
The Netherlands Pays Bas
Tel +31 (0)43 350 29 00
Fax +31 (0)43 350 29 02

**BRUSSELS OFFICE
BUREAU À BRUXELLES**
Rue Archimède 5
1000 Brussels Bruxelles
Belgium Belgique
Tel +32 (0)2 237 43 10
Fax +32 (0)2 237 43 19

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