MEFMI

Macroeconomic and Financial Management
Institute of Eastern and Southern Africa

A STUDY
ON THE COST AND BENEFITS OF DEBT RELIEF IN THE MEFMI REGION

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Abbreviations and Acronyms

ACP	African Caribbean Pacific
AfDB	African Development Bank
AfDF	African Development Fund
AIDS	Acquired Immuno-Deficiency Syndrome
BHA	Better Health for Africa
CIRR	Commercial Interest Reference Rate
CPIA	Country Policy and Institutional Assessment
DMO	Debt Management Office
DRI	Debt Relief International
DSR	Debt Service Ratio
EU	European Union
FDI	Foreign Direct Investment
G-8	Group of Eight
G-7	Group of Seven
GDP	Gross Domestic Product
IaDB	Inter-America Development Bank
IDA	International Development Association
IEG	Independent Evaluation Group
IMF	International Monetary Fund
HIPC	Heavily Indebted Poor Countries

HIV	Human Immunodeficiency Virus
LICs	Low Income Countries
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
NGOs	Non-Governmental organizations
NPV	Net Present value
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PSI	Public Sector Investment
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
STD	Sexually Transmitted Disease
SDR	Special Drawing Rights
UNCTAD	United Nations Conference on Trade and Development
TDB	Trade Development Board

Acknowledgement

This study has benefited from the input made by officials of the MEFMI Secretariat and those from seven MEFMI countries that obtained international debt relief, mainly through mechanisms of the Paris Club and more recently, the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDR) Initiatives. MEFMI Secretariat is very grateful to the officials who provided the information for this study. Due to the need for confidentiality of country-specific information and the sheer length of the list of people who contributed vital information to this study, it is not possible to mention their names.

The study also benefited immensely from existing national and international literature and publications. This includes information posted on various websites on the architecture of and experiences on international debt relief and poverty reduction.

Efforts were made during the study to authenticate all the country information contained in this study report.

The Secretariat extends gratitude to the Research Assistants, Mr. Martin Nsubuga of the Ministry of Finance, Planning and Economic Development, Uganda, and Mr. Willie Nakunyada from the Reserve Bank of Zimbabwe, who helped in gathering information for the report.

Abstract

While literature abounds on the explicit pecuniary benefits that accompanied the provision of debt relief, including through the mechanisms of the Paris and London Clubs, and more recently the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDR) Initiatives, it seems that not much research has been undertaken to quantify and analyze the direct and latent costs associated with these processes. This study attempts to contribute towards filling this void by comparing the cost of international debt relief incurred by the seven MEFMI beneficiary states to the benefits that accrued to them.

The study reviewed existing literature on international debt relief, with a focus on the seven MEFMI member states that benefitted. Surveys were also undertaken in the seven countries to ascertain details of key facts and obtain official views and perceptions on the pros and cons of debt relief. These helped to shape conclusions reached on the quantitative and qualitative dimensions of debt relief.

A key finding of the study is that, while international debt relief helped to significantly reduce the external debt of nearly all MEFMI countries that participated, the cost that the countries incurred in the process, though a relatively small percentage of the debt relief received, varied markedly amongst them. The reasons for these cost variations ranged from the frequency and duration over which individual countries were engaged in the various debt relief mechanisms, to differences in country administrative arrangements pertaining to the size of the country delegations that were engaged in the debt negotiations, as well as class of travel and the allowances disbursed. The location of the negotiations also affected the travel and subsistence cost incurred by the borrower countries. The prevalence of law suits, many of which borrower countries lost in their own jurisdictions, and the amounts the court awarded, also contributed to the escalation of the costs.

The study also revealed that, apart from explicit costs of negotiating debt relief, there were other 'hidden' costs entailed, such as the opportunity cost of delays in qualifying for and receiving debt relief owing to conditionality. Sustainability issues, to do with country absorptive capacity and the macroeconomic implications of radically increased fiscal expenditures linked to debt relief, were also other downstream challenges associated with the timing and volume of debt relief.

Furthermore, the study provided useful pointers to other socio-economic areas needing in-depth study, including the issue of domestic debt sustainability and quantification of the nexus between debt relief, investment, economic growth and income distribution within the broad objective of savings and mobilization development financing for poverty reduction in the context of attaining the millennium development goals (MDGs)

Overall, it is hoped that this study provides pertinent lessons on debt relief negotiations and related outcomes. The precedents contained in the report are also expected to help guide future debt policy making at the country level, while also serving as a capacity building tool for the MEFMI Secretariat.

While international debt relief helped to significantly reduce the external debt of all MEFMI countries that participated, the cost that the countries incurred in the process, though a relatively small percentage of the debt relief received, varied markedly amongst them.

CHAPTER 1: BACKGROUND

1.0 Introduction

Sustainable economic growth and development has for decades eluded many developing countries with Africa registering the lowest achievements. This reflects the debilitating effects of recurring conflicts, corruption, adverse weather conditions, lack of sound macroeconomic policies, and rapidly growing debt burdens. Unsustainable debt levels have accentuated the poverty levels of many developing countries whose efforts to pull large sections of their populations out of poverty have borne very little fruit.

Growing debt burden has presented serious development challenges in Africa, and retarded meaningful economic growth. This has affected the standard of living as well as the pace of development as governments devoted substantial resources to debt servicing at the expense of infrastructure development and social service delivery.

It is against this background that the efficacy of debt relief as a vital instrument for stimulating economic growth and effectively reducing poverty, gained prominence over the last two decades. Undoubtedly, greater emphasis has been placed on the benefits of debt relief, while a blind eye has been cast on the associated cost of negotiating for debt relief. In view of this, the overall cost and benefits of debt relief create scope for a detailed enquiry, particularly for countries in the MEFMI region. This study, therefore, strikes a fine balance between the price of securing debt relief and the benefits that recipients gained from the initiatives.

Greater emphasis has previously been placed on the benefits of debt relief, while a blind eye has been cast on the associated cost of negotiating for debt relief.

1.1 Evolution of Debt Stock

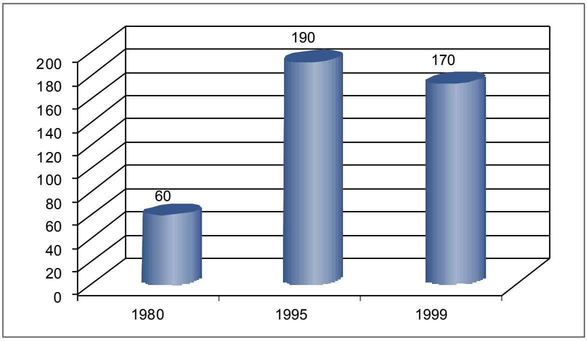
Many African countries attained independence over the past five decades. At their independence, basic services such as health and education could not cope with the growing demand of the population and the development aspirations of the newly independent states. Similarly, physical infrastructure such as roads, bridges, railway lines and airports, could not cater for Africa's rapidly growing transport and communication needs.

In order to address these inadequacies, most Governments contracted substantial amounts of loans from multilateral financial institutions, bilateral creditors as well as commercial creditors. The contracting of debt by developing countries was premised on vast growth potential, which was expected to spur development of these economies and enable them to fully repay and outgrow debt.

This notwithstanding, many countries adopted weak economic policies that severely compromised their ability to meet external debt service obligations. In addition, protracted conflicts, adverse external shocks in the form of deteriorating terms of trade, and misguided borrowing policies conspired to hamstring growth prospects in developing countries. As a consequence, external debt in many developing countries grew exponentially to unsustainable levels. Many developing countries found themselves trapped and entangled in poverty-debt cycles, which they could not break.

The overall debt levels of low income countries (LICs) rose significantly in the 1980s and 1990s. For the Heavily Indebted Poor Countries (HIPCs) the level of debt tripled from US$60 billion in 1980 to US$190 billion in 1995, before declining to US$170 billion in 1999 (Figure 1).

Figure 1: External Debt Stock for HIPCs (US$ Billion)



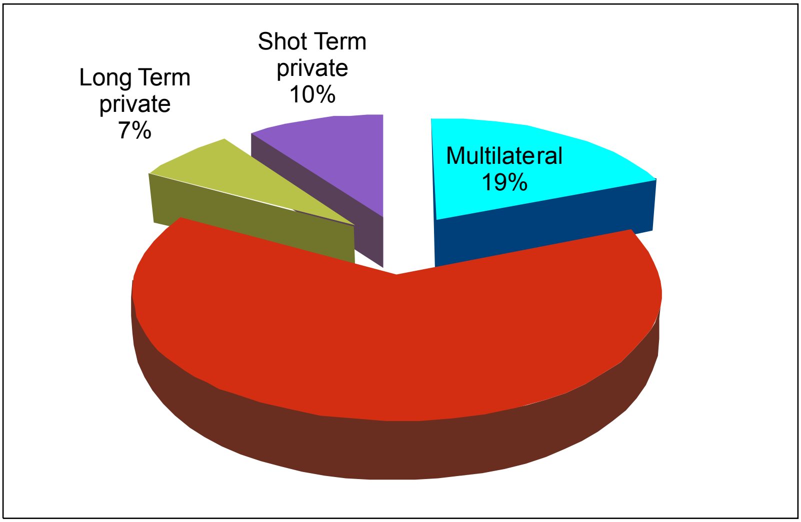
Source: IMF, 2001

Debt stocks in HIPCs grew at a faster rate than in LICs and all developing countries. The debt build-up was also accompanied by declining export performance in HIPCs from 2.2% of world trade in 1970 to a meager 0.7% in 1997 (IMF, 2001).

Additionally, debt levels in LICs rose over time as they contracted more debt, while the creditors were also taking substantial lending risks in a bid to assist poor countries and promote their export products (Abrego and Ross, 2001). These adverse developments, coupled with unfavorable socio-economic and political conditions occasioned numerous defaults and the subsequent accumulation of external payment arrears by many developing countries.

For the Heavily Indebted Poor Countries (HIPCs) the level of debt tripled from US$60 billion in 1980 to US$190 billion in 1995.

Figure 2: Composition of Debt for HIPC Countries end-1994



Source: World Bank, 1996

At the end of 1994, debt stock for HIPCs comprised of bilateral debt (64%), multilateral debt (19%), short term private debt (7%) and long term private debt (10%), as shown in Figure 2. It is against this background that the need for debt relief initiatives became imperative, prompting creditors to assist debt distressed economies to recover, improve standards of living and reduce poverty.

1.1 Evolution of Debt Reduction Mechanisms

The granting of debt relief initially in the form of debt restructuring and more recently through debt and debt service reduction to debt distressed countries has a long history spanning nearly three decades. The provision of debt relief was largely prompted by the need to assist debtor countries going through difficult periods and to enhance the creditors' perceived likelihood of recovering their claims. Where several players were involved, debtors and creditors often found it convenient to mutually reschedule debt through a concerted approach (Abrego and Ross, 2001).

It is against this background that the Paris Club provided such a framework for sovereign debt rescheduling for government to government debt, mainly involving OECD creditor governments, since the mid-1950s. Until 1988, Paris Club debt rescheduling- was largely in the form of cash flow relief. On the other hand, commercial creditors also provided similar relief, but often in combination with a degree of debt reduction.

It soon became apparent that the mounting debt burdens of LICs reflected deep-seated solvency problems, which required not only interim debt relief in the form of rescheduling, but also a reduction in the actual debt stock. Against this background, Paris Club creditors began to grant debt reduction in the form of more concessional debt service rescheduling for LICs in late 1988, starting with Toronto terms. Under the latter, debtor countries benefited from debt reduction of about one third of eligible amounts. Since then, the Paris Club terms have evolved towards more debt reduction over the years, as shown in table 1.

Table 1: Paris Club Rescheduling by Type of Terms

	Rescheduling Dates	**Frequency of Rescheduling**	**No. Of Countries**
Non-Concessional	Before October 1988	87	28
Toronto Terms	October 1988 - June 1991	27	19
London Terms	December1991-December1994	24	22
Naples Terms	Since January 1995	38	26
Lyon/Cologne Terms	Since 1996	21	18

Sources: IMF, 2001

Consequently the repayment periods became longer and repayment profiles on the restructured debt declined significantly, all making for lower present value of debt owed.

The mounting debt burden of LICs reflected deep-seated solvency problems, which required not only interim debt relief in the form of rescheduling, but also a reduction in the actual debt stock.

On the other hand, NonParis Club creditors consisting of oil exporting countries in the Middle East, China, Taiwan, and a considerable number of other developing countries, including some HIPCs provided limited debt restructuring compared to the OECD creditors. Consequently, arrears were progressively accumulated on their claims, as debtor countries sought to receive comparable debt relief as required under Paris Club rules.

Paris Club debt rescheduling was subsequently complemented by some unilateral initiatives geared at forgiving ODA claims, dating back to a resolution adopted in 1978 by the Trade Development Board (TDB) of UNCTAD. Similarly, donor governments granted debt reduction through other mechanisms such as debt swaps that delivered more relief and bilateral developmental assistance in the form of grants. Traditional debt relief mechanisms mentioned above also significantly reduced bilateral and commercial debt. However, debt owed to multilateral financial institutions such as the IMF, World Bank and the African Development

Bank (AfDB), which enjoyed "preferred creditor status", continued to weigh down on development efforts and poverty reduction initiatives in the developing countries.

Against this background, calls were made in various quarters including the NGO sector in the 1990s, in a bid to explore broader approaches to reduce debt burdens of low income countries (LICs). These concerted efforts culminated in the adoption of the HIPC Initiative in 1996 and its subsequent enhancement in 1999 by the membership of the IMF and the World Bank. Notwithstanding these significant strides made, there has, however, been extensive debate on the price that debt distressed countries had to pay in order to access debt relief under various initiatives. An in-depth analysis of the much needed resources spent on securing debt relief presents the scope for detailed research.

This study report is organised as follows: Chapter 2 reviews literature on debt relief mechanisms with special emphasis on the HIPC and Multilateral Debt Relief Initiative (MDRI). Chapter 3 reviews the cost and benefits of the HIPC initiative. Chapter 4 outlines the research objectives and methodology. Chapter 5 considers country cases with particular emphasis on the benefits derived from debt relief by MEFMI member states that benefited from debt relief. Chapter 6 focuses on a regional analysis of the cost of debt relief. Chapter 7 concludes with policy recommendations.

The mounting debt burden of LICs reflected deep-seated solvency problems, which required not only interim debt relief in the form of rescheduling, but also a reduction in the actual debt stock.

CHAPTER 2: THE HIPC INITIATIVE AND THE MDRI

2.1 Heavily Indebted Poor Countries Initiative (HIPC)

In the early 1980s, shortly after the beginning of what is commonly referred to as the debt crisis, the general belief was that countries experiencing debt service difficulties would gradually grow out of indebtedness and regain creditworthiness. For a variety of reasons (inadequate adjustment, adverse economic environment, and natural disasters) this expectation did not materialise, as became evident from the recurrent need to regularly reschedule previously rescheduled debt.

As a consequence, the Paris Club, an informal grouping of OECD donor nations agreed to concessionally reschedule the servicing of the debt of the poorest and heavily indebted countries. Under a "menu of options", debt service due and in arrears was reduced through either a partial cancellation of the debt service falling due, a reduction of the interest rate, or rescheduling for very long periods.

Notwithstanding the debt relief provided by the Paris Club on bilateral debt, most developing countries remained in debt distress. This was largely due to the substantial debt owed to multilateral financial institutions such as the IMF, the World Bank, and the African Development Bank (AfDB). To address the latter category of debt, the international financial institutions in 1996 agreed to provide debt relief under the Heavily Indebted Poor Countries initiative (HIPC).

The HIPC Initiative is a comprehensive approach to debt reduction for heavily indebted poor countries pursuing IMF, and World Bank, supported reform programs. It was launched in 1996 by the IMF and the World Bank, to enable poor countries pay back their loans without compromising economic growth and without building arrears. Since then, the international financial community, including multilateral organisations and governments has worked in close collaboration to reduce the external debt burden of the most heavily indebted poor countries to sustainable levels.

Notwithstanding the debt relief provided by the Paris Club on bilateral debt, most developing countries remained in debt distress due to the substantial debt owed to multilateral financial institutions such as the IMF, the World Bank, and the African Development Bank (AfDB), hence the launch of HIPC Initiative in 1996.

2.2 Beneficiaries of the HIPC Debt Relief Initiative

To date, debt reduction packages under the HIPC Initiative have been approved for 35 countries, 29 of them in Africa, providing US$51 billion in debt-service relief over time. Out of these, 26 countries have already reached their completion points and have received or are receiving irrevocable debt relief from the IMF and other creditors. Five additional countries are potentially eligible for HIPC Initiative assistance.

In addition, nine countries have reached their decision points and some of them are receiving interim relief under the HIPC Initiative. Five countries, which have been identified as potentially eligible for HIPC Initiative assistance, are yet to reach their decision points.

Table 2: Countries that Have Qualified / Eligible or Potentially Eligible and May wish to Receive HIPC Initiative Assistance (as of June 1, 2010)

Post-Completion-Point Countries (26)		
Benin	Guyana	Niger
Bolivia	Haiti	**Rwanda (MEFMI Region)**
Burkina Faso	Honduras	São Tomé & Príncipe
Burundi	Madagascar	Senegal
Cameroon	**Malawi (MEFMI Region)**	Sierra Leone
Central African Republic	Mali	**Tanzania (MEFMI region)**
Ethiopia	Mauritania	**Uganda (MEFMI Region)**
The Gambia	**Mozambique (MEFMI Region)**	**Zambia (MEFMI Region)**
Ghana	Nicaragua	
Interim Countries (Between Decision and Completion Point) (9)		
Afghanistan	Democratic Republic of the Congo	Guinea Bissau
Chad	Côte d'Ivoire	Liberia
Republic of Congo	Guinea	Togo
Pre-Decision-Point Countries (5)		
Comoros	Kyrgyz Republic	Sudan
Eritrea	Somalia	

Source: IMF Factsheet, 2010

In the MEFMI region, six (6) countries comprising Mozambique, Malawi, Zambia, Tanzania, Uganda, and Rwanda reached the completion point of the HIPC initiative (Table 2). As such, the study will place greater emphasis on the cost and benefits of debt relief in these MEFMI member states.

2.3 Multilateral Debt Relief Initiative (MDRI)

2.3.1 Debt Relief to Help Fight Poverty

Following extensive deliberations in June 2005, the Group of 8 (G-8) major industrial countries proposed that three multilateral institutions - the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF)cancel 100 percent of their debt claims on countries that have reached, or will eventually reach, the completion point. At this stage, a country becomes eligible for full and irrevocable debt reliefunder the joint IMF-World Bank enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative).

To help accelerate progress towards attainment of the Millennium Development Goals (MDGs), in 2005, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI). This Initiative allows for 100% relief on eligible debt by three multilateral institutions, the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF), for countries eligible for the HIPC Initiative. In 2007, the Inter-American Development Bank (IaDB) also decided on its own to provide additional ("beyond HIPC") debt relief to the five HIPCs in Latin America Hemisphere.

The HIPC Initiative entailed coordinated action by multilateral organisations and governments to reduce the external debt burden of the most heavily indebted poor countries to sustainable levels, if traditional mechanisms were proving inadequate. The MDRI was tailor- made to further provide full debt relief so as to free additional resources to help these countries advance towards attainment of the United Nations' Millennium Development Goals (MDGs) that focus on halving poverty by 2015.

A key difference with the HIPC Initiative is that MDRI does not require parallel debt relief from official bilateral or private creditors, or multilateral institutions beyond the IMF, IDA, and the AfDF.

To help accelerate progress towards attainment of the Millennium Development Goals (MDGs) in 2005, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI).

2.3.2 Track Record in Fighting Poverty

Countries that reach the Completion Point under the Enhanced Heavily Indebted Poor Countries (Enhanced HIPC Initiative), and those with per capita income below \$380 and outstanding debt to the Fund at end2004 are eligible for the MDRI. To qualify for debt relief, however, the IMF Executive Board required that these countries also be current on their obligations to the IMF, in addition to demonstrating satisfactory performance in Macroeconomic policies, Implementation of a poverty reduction strategy, and Public expenditure management.

2.3.3 Delivery of Debt Relief

The estimated total cost to the IMF of MDRI debt relief, excluding remaining HIPC Initiative assistance not yet delivered, is US$4 billion in nominal terms as of September 15 2009. Of this amount, US$3.4 billion has already been delivered. In addition, the cost of the IMF's debt relief to Liberia - both HIPC and beyond HIPC- was estimated at its decision point at SDR530 million (US$867 million) and would be covered by bilateral contributions.

The G-8 committed to ensure that proposed debt forgiveness neither undermines the ability of the three multilateral institutions to continue to provide financial support to low-income countries, nor the institutions' overall financial integrity. In this context, the G-8 has provided SDR100 million (end-2005 NPV terms) to the IMF as additional subsidy resources for PRGF-ESF lending in the wake of the MDRI.

Additional contributions will be needed to cover the cost of HIPC Initiative and MDRI debt relief to newly identified HIPCs and to countries with protracted arrears to the IMF. In this context, the G-8 committed that donors will provide the extra resources necessary for full debt relief for these countries. The IMF has also committed part of its own income from gold sales towards the provision of debt relief.

2.3.4 Follow-Up and Monitoring

The IMF and the World Bank are cooperating closely in the implementation and monitoring of the MDRI, particularly when it comes to assessing qualification for MDRI relief and monitoring MDG-related spending after debt relief has been provided.

As shown in Table 3, several countries across the globe qualified and benefited from the MDRI relief. A number of other countries were still in the process of qualifying by end of February 2010.

To qualify for debt relief, the IMF Executive Board required that countries be current on their obligations to the IMF, in addition to demonstrating satisfactory performance in Macroeconomic policies, Implementation of a poverty reduction strategy, and Public expenditure management.

Table 3: Country Coverage of the MDRI

	Eligible under the "MDRI-I Trust" (per-capita income at or below $380)	Eligible under the "MDRI-II Trust" (per-capita income above $380)
Countries that benefited from MDRI as of February 19, 2010		
"Completion point" HIPCs: 28 countries that have reached the completion point under the Enhanced HIPC Initiative	Afghanistan, Burkina Faso, Burundi, Ethiopia, The Gambia, Ghana, Madagascar, **Malawi**, Mali, **Mozambique**, Niger, **Rwanda**, São Tomé and Príncipe, Sierra Leone, **Tanzania**, **Uganda**	Benin, Bolivia, Central African Republic, Congo Republic, Cameroon Guyana, Haiti, Honduras, Mauritania, Nicaragua, Senegal, **Zambia**
Non-HIPC countries (2) with per capita income below $380 and outstanding debt to the IMF	Cambodia, Tajikistan	
Countries that will be eligible once they reach the completion point under the Enhanced HIPC Initiative		
"Decision point" HIPCs: 7 countries that have reached the decision point under the Enhanced HIPC Initiative	Chad, Democratic Republic of the Congo, Guinea-Bissau, Togo	Côte d'Ivoire, Guinea
	Liberia [1/]	
5 additional countries may wish to be considered for HIPC debt relief. They met the income and indebtedness criteria based on end-2004 data.	Eritrea	Comoros, Kyrgyz Republic, Sudan
	Precise data on the per capita income of Somalia are not available at this juncture.	

[1/] Liberia has no MDRI-eligible debt to the IMF but is expected to receive additional beyond-HIPC debt relief from the IMF to fully cover its remaining eligible debt outstanding at the completion point.

Source: IMF, 2010

CHAPTER 3: STUDY OBJECTIVES AND METHODOLOGY

3.1 Study Scope and Information Sources

The study used a survey conducted in seven MEFMI member countries targeting mainly those that benefited from the HIPC and MDR initiatives. A questionnaire tailor-made to capture both qualitative and quantitative costs and benefits of debt relief in the MEFMI region was deployed.

The questionnaire was administered to relevant senior Government officials from Central Banks, Finance Ministries, Debt Management Offices (DMOs) and other relevant government departments that participated in the debt relief negotiations within the MEFMI region. The MEFMI member states covered by the survey are Kenya, Malawi, Mozambique, Zambia, Tanzania, Uganda and Rwanda. Malawi, Mozambique, Zambia, Tanzania, Uganda and Rwanda have been code named countries A to F, not necessarily in that order, in Chapter 6 covering Analysis of Regional findings.

Follow up visits were made and interviews conducted with relevant officials from respective debt units in these countries to extract qualitative information on the cost and benefits of debt relief. Central banks as well as relevant government departments in member states were engaged with a view to firm up the debt profiles of each country and the level of debt relief provided. Supplementary qualitative information was also extracted in follow up meetings and associated interviews.

The study captured the cost and direct benefits relating to debt rescheduling and relief delivered through the HIPC Initiative and MDRI. In addition, an attempt was made to capture the benefits accruing in terms of increased anti-poverty interventions.

3.2 Study Objectives

Within the broad study objective of assessing the cost and benefits of debt relief to the MEFMI region, the survey sought to collect both qualitative and quantitative information from the relevant MEFMI member states. The information gathered provided the empirical evidence for the assessment of the cost and benefits of debt relief to the region.

MEFMI member states covered by the survey are Kenya, Malawi, Mozambique, Tanzania, Rwanda, Uganda and Zambia.

Cost Variables

The questionnaire captured information on the cost of debt relief particularly in respect of the following variables:

- Accommodation cost which vary directly with the size of the delegation;
- Number of trips made under the aegis of negotiating for debt relief;
- Traveling costs that were derived from the number of flights made in each trip;
- Subsistence costs including per-diems paid out to members of the debt negotiating team; and
- Any other relevant associated costs also extracted by the questionnaire.

3.4 Benefits Variables

Variables that represent benefits derived from debt relief in each country were also captured in the questionnaire with particular focus on the following:

- Interim debt relief provided by bilateral and multilateral creditors before the completion point;
- Full debt relief granted to each country at completion point;
- Debt relief provided by both Paris and Non-Paris Club creditors;
- Debt relief provided by Multilateral creditors such as the IMF, World Bank and the African Development Bank (AfDB);
- Financial resources deployed by Government to the social sectors of the economy such as health and education;
- Debt stocks at various stages of the relief process; and
- Historical and current Debt Sustainability indicators.

3.5 Data Analysis

Information collected through the survey from each MEFMI member country was analysed separately before a regional analysis was made. The overall benefits of debt relief were then compared to the overall cost of securing debt relief, to come up with a complete analysis.

CHAPTER 4: COST AND BENEFITS OF HIPC INITIATIVE AND MDRI

The HIPC and MDR initiatives provided significant benefits to participating countries. However, the countries also incurred direct and indirect costs in the process. The following sections highlight the cost and benefits of these initiatives.

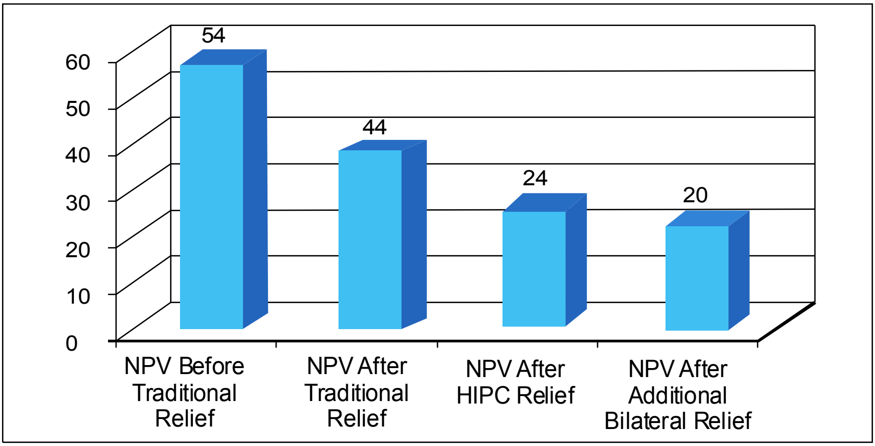
4.1 Benefits of the HIPC Initiative

Undoubtedly, debt relief provided under the HIPC initiative has been associated with numerous benefits including significant reduction in debt service, freeing up of resources for social spending, improvement in public debt management, and improved creditworthiness and accompanying pull on investment and offshore loan inflows.

4.1.1 Reduction in Debt and Debt Service

Countries that implemented the HIPC initiative have realised a significant reduction in their debt positions, bringing their debt ratios down in some cases below those of many non-HIPC countries (Figure 3). The debt burden in countries that reached the completion point is estimated to have fallen by about 90% after the full delivery of debt relief.

Figure 3: The Net Present Value (NPV) of Debt Stock (US$ billion) for 23 Countries that Reached Decision Points by May 2001

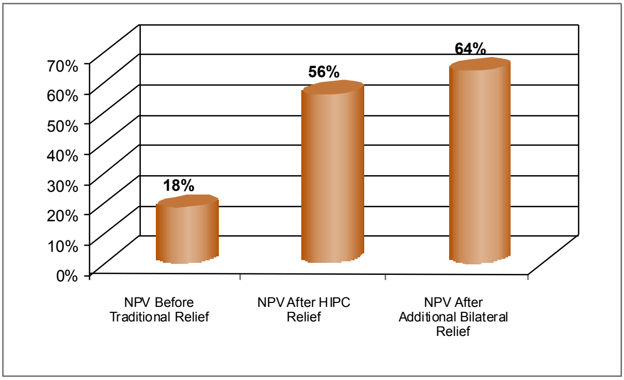


Source: HIPC Documents

> ***The NPV of public debt for the 23 countries that reached decision points by May 2001 declined by 56% after HIPC relief and by a cumulative 64% after additional bilateral relief.***

As shown in figure 4, the NPV of public debt for the 23 countries that reached decision points by May 2001 declined by 56% after HIPC relief and by a cumulative 64% after additional bilateral relief.

Figure 4: The Cumulative Reduction in NPV of Debt for 23 Countries that Reached Decision Points by May 2001



Source: HIPC Documents

The HIPC initiative has significantly reduced debt service in eligible countries. For, instance, debt service paid has on average declined by about 2.5% of GDP between 1999 and 2007 for the 35 countries receiving debt relief. In addition, there has been a significant improvement in debt sustainability in HIPCs, occasioned by the considerable reduction in debt stock on account of debt relief (Table 4).

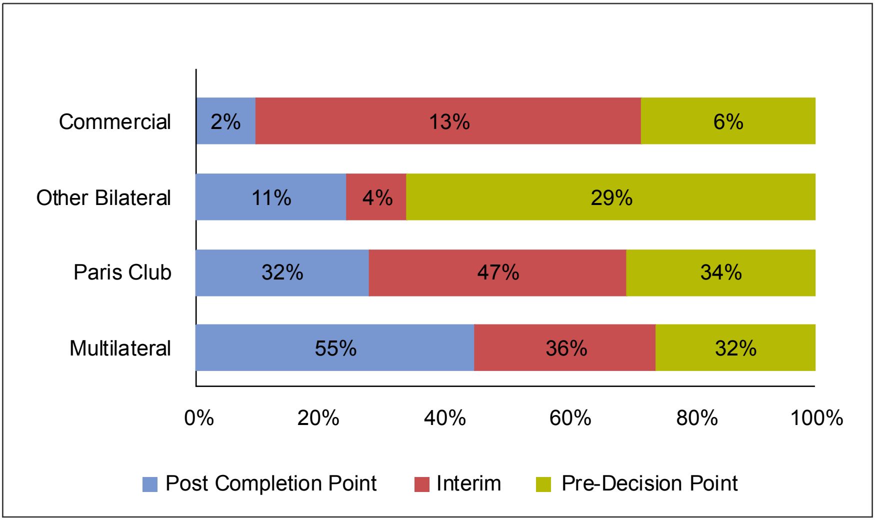
Table 4: Debt indicators of 35 Post Decision Point HIPCs

	1999	2009
NPV of Debt to Exports	457%	110%
NPV of Debt to GDP	114%	35%
Debt Service to Exports	18%	6%
NPV of Debt to Revenue	552%	6%
Debt Service to Revenue	22%	181%

Source: World Bank, 2010

The largest share of the total cost of the HIPC initiative was borne by Multilateral and Paris Club creditors as shown in figure 5.

Figure 5: Distribution of Potential Costs under the HIPC Initiative by Creditor (In end-2008 NPV Terms)



Source: IMF, HIPC and MDRI Implementation Status, 2009

Multilateral creditors bore the heaviest burden of debt relief at post-Completion Point (55%), interim period (36%) and pre-Decision Point (22%). On the other hand, Paris Club creditors have largely provided debt relief to HIPCs at Interim period (47%), Pre-Decision Point (34%) and Post-Completion Point (32%), apart from that delivered through multi-year rescheduling agreements that preceded HIPC and MDRI.

The IMF alone provided relief amounting to US$3.2 billion as of February 2010 (Table 5).

Table 5: Debt Relief Provided by the IMF under the MDRI as of February 19, 2010)

	SDR million	SDR million
HIPC Completion Point Countries	**2,185**	**3,168**
Afghanistan[3]	0	0
Benin	34	49
Bolivia	155	224
Burkina Faso	57	82
Burundi	9	13
Cental African Republic	1.9	2.9
Congo, Republic of	4.8	7.4
Cameroon	149	219
Ethiopia	80	115
The Gambia	7	12
Ghana	220	318
Guyana	32	46
Haiti[4]	0	0
Honduras	98	142
Madagascar	128	186
Malawi	15	22
Mali	62	90
Mauritania	30	45
Mozambique	83	120
Nicaragua	92	133
Niger	60	86
Rwanda	20	29
São Tomé and Príncipe	1	2
Senegal	95	137
Sierra Leone	77	115
Tanzania	207	299
Uganda	76	110
Zambia	398	576
Non-HIPCs	**126**	**182**
Cambodia	57	82
Tajikistan	69	100
Total	**2,319**	**3,360**

[1] For HIPCs, the amount of relief includes only MDRI assistance and excludes undisbursed HIPC assistance not yet delivered.
[2] Using the SDR/US$ exchange rates at the time of debt relief.
[3] Afghanistan did not have any MDRI-eligible debt outstanding to the IMF prior to December 2004, the MDRI-cutoff date.
[4] Haiti repaid all MDRI-eligible debt to the IMF prior to the completion point.

Source: IMF Factsheet 2010

In addition to traditional relief granted to debt distressed countries, the HIPC and the MDRI have provided significant debt relief as shown in table 6.

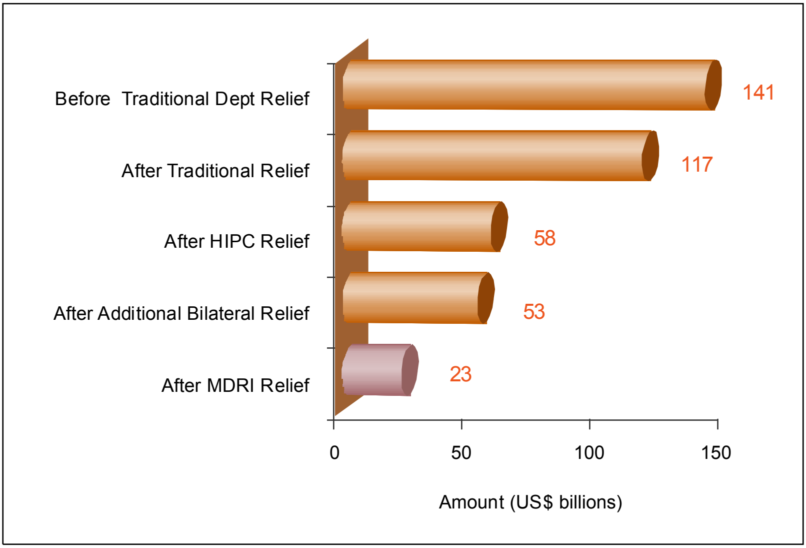
Table 6: Estimates of HIPC and MDRI Relief End 2009 NPV terms (US$ billions)

	World Bank Group Debt Relief			Total Debt Relief		
	HIPC	MDRI	HIPC & MDRI	HIPC	MDRI	HIPC & MDRI
All HIPCS	15.0	20.0	35.0	75.6	31.0	106.6
28 Post Completion Point HIPCs	11.0	16.9	27.9	42.0	26.6	68.6
7 Interim HIPCs	2.5	2.8	5.3	16.5	3.9	20.4
5 Pre-Decision Point HIPCs	1.5	0.3	1.8	17.0	0.5	17.5

Source: World Bank, 2010

The debt stock of 35 post decision point HIPCs declined dramatically by 80% from US$141 billion (in end 2009 NPV terms) before traditional debt relief to only US$23 billon after MDRI relief as shown in figure 6.

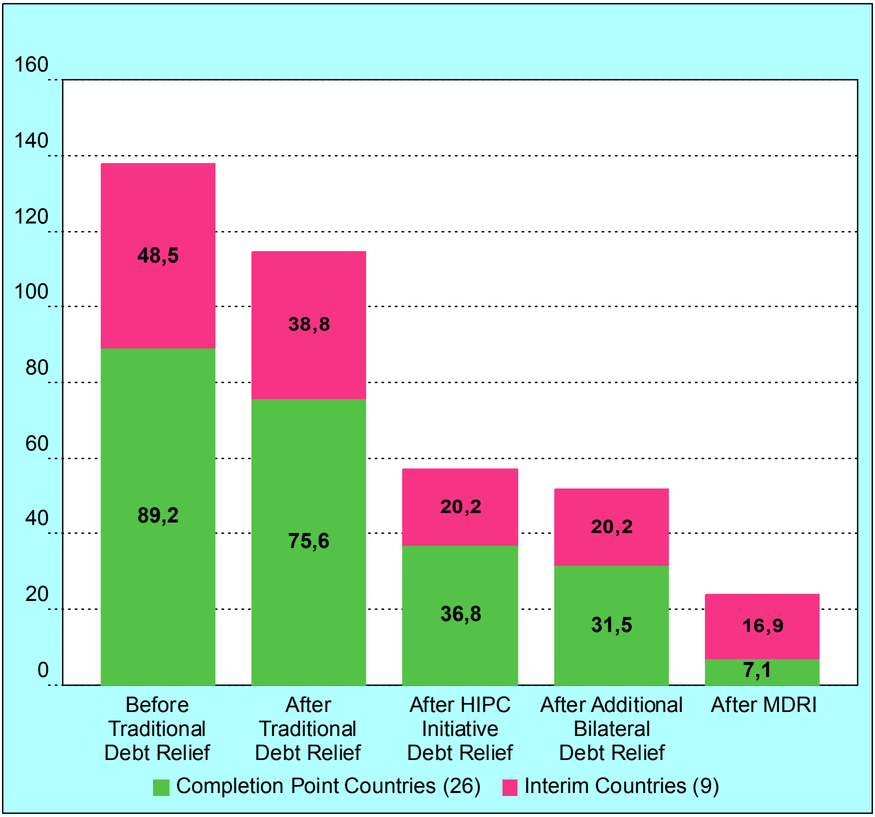
Figure 6: Debt Stocks for 35 post HIPCs, in US$ Billions, end-2009 NPV Terms



Source: Word Bank, 2010

The introduction of the MDRI, thus saw further reduction in debt stock for post decision point HIPC countries as well as interim countries (Figure 7). Among the completion point countries public debt declined from US$89.2 billion before traditional relief mechanisms to US$7.1 billion after the MDRI relief.

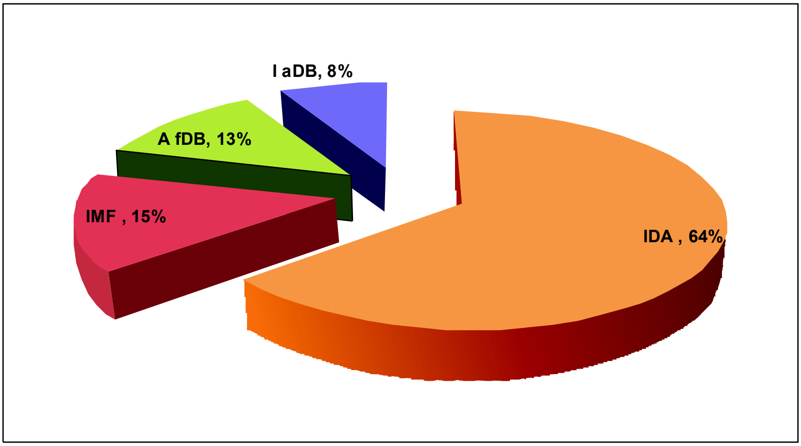
Figure 7: Post Decision Point HIPCs' Debt Stock under Different Debt Relief Stages (US$ billion, in end 2008 NPV Terms)



Source: HIPC, Implementation Status Report, 2009

In addition to debt relief granted under the HIPC initiative, multilateral financial institutions provided additional relief under the MDRI to help accelerate HIPC countries' progress in the attainment of Millennium Development Goals (MDGs) set for 2015.

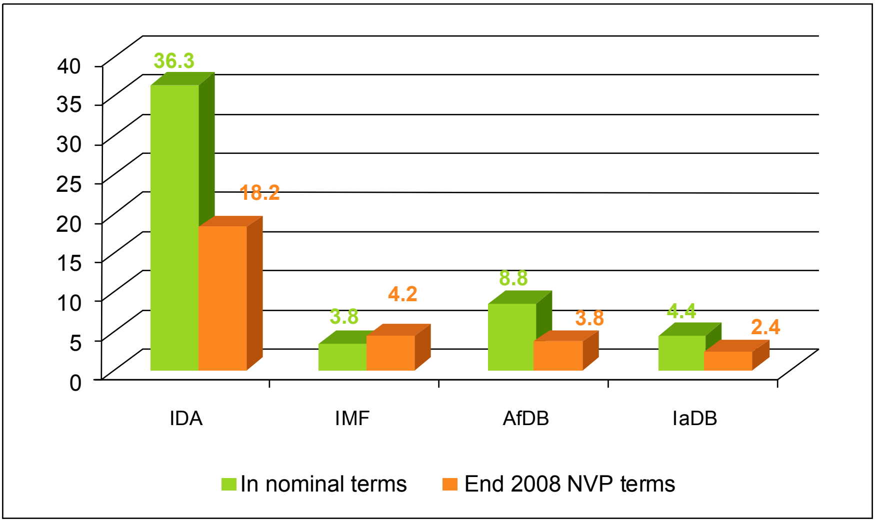
Figure 8: Distribution of Potential Cost Under MDRI by Creditor (%)



Source: HIPC, MDRI Implementation Status Report, 2009

IDA bore the largest share of debt relief (64%) under the MDRI. The balance was accounted for by the IMF which provided 15% of relief followed by AfDB at 13% and IaDB at 8% (Figures 8 and 9).

Figure 9: MDRI Cost By Creditor (US$ Billions)



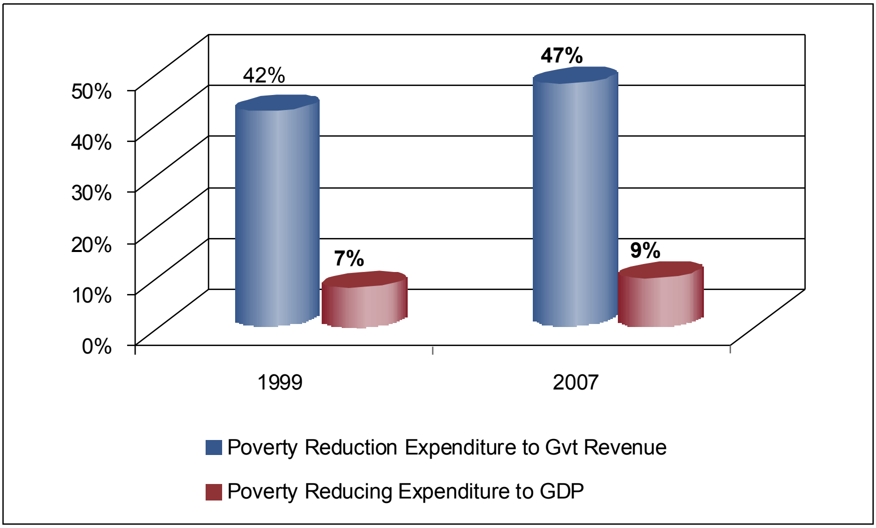
Source: HIPC, MDRI Implementation Status Report, 2009

4.1.2 Freed Resources for Social Spending

Debt relief under HIPC initiative freed resources that were initially targeted for debt service, towards increased social spending. In HIPC eligible countries, freed resources were used to support poverty reduction strategies developed by national governments.

Beneficiaries of the HIPC initiative have markedly increased their expenditure on health, education and other social services by about six times the amount of debt-service payments. Before the HIPC Initiative, eligible countries were, on average, spending slightly more on debt service than on health and education combined (Figure 10).

Figure 10: Poverty Reducing Expenditure in HIPCs



Source: World Bank, 2010

4.1.3 Improved Public Debt Management

Debt relief has also helped in improving public debt management as countries adopt cautious borrowing policies and strengthen their public debt management to avoid the costly mistakes that saw them accumulating debt to unsustainable levels. However, many countries remain vulnerable to external shocks, particularly those affecting exports as seen during the global economic crisis.

4.1.1 Foreign Direct Investment

Once a country is relieved of its debt burden investor perception improves appreciably resulting in an increase in foreign direct investment inflows on account of sound macroeconomic policies that accompany IMF/World Bank adjustment and reform programs. Furthermore, a country's risk premium improves, thereby enabling it to access funds from international capital markets at competitive interest rates. Although this has not been verified in the MEFMI countries covered, there is a general feeling that indeed debt relief helped to improve investor perceptions, post relief delivery. As a result, a number of countries have seen improved credit ratings and are seriously contemplating issuing sovereign bonds in the international capital markets, something they clearly were unable to do prior to debt reduction through the concerted debt relief.

4.2 Limitations of HIPC

Although the HIPC Initiative has significantly reduced debt in developing countries, it cannot guarantee a net increase in external financing. As such, debt problems are unlikely to be solved by the HIPC and MDR Initiatives alone, as some HIPC eligible countries are still spending more on debt than social services. As such, the risk of debt distress remains a challenge for some Completion Point HIPCs.

Given the voluntary nature of creditor participation in the HIPC initiative, the IMF and the World Bank have used moral suasion to encourage especially the non-Paris Club creditors to participate in the debt relief initiative and to deliver fully their comparable share of debt relief.

Depending on relationship between HIPCs and bilateral creditors, some creditors may have been reluctant to offer comprehensive or timely debt relief. Furthermore, smaller multilateral institutions, non-Paris Club official bilateral creditors, and commercial creditors, which collectively account for about 25% of total HIPC Initiative costs, have in some instances lagged behind in delivering their expected debt relief.

4.2.1 Unbalanced Approach to Growth and Poverty Reduction

Poverty Reduction Support Programs instituted under the HIPC initiative have placed strong emphasis on social sector spending to a number of social sectors mainly in the areas of health, education and access to water. This, however, militates against balanced approaches to growth with preference to investment in productive activities that ideally enhance growth and also ultimately reduce poverty. In this regard, there may be funding sustainability challenges of maintaining the social investments made through debt relief savings on the part of beneficiary governments.

4.2.2 Moral Hazard on Borrowing

There is a risk that, riding on the fiscal space created through debt relief, HIPC beneficiaries may relapse into debt distress in the absence of adequate post-HIPC debt management measures. This may partly be due to the significant improvement in the country's creditworthiness which may prompt the country to contract new debt in the international capital markets and from the new non-traditional donors.

There is a risk that, riding on the fiscal space created through debt relief, HIPC beneficiaries may relapse into debt distress in the absence of adequate post-HIPC debt management measures.

4.2.3 Entrenchment of the Donor-Dependency Syndrome

Although, successive reforms under HIPC helped beneficiaries to manage their fiscal balances more prudently, they have not reduced the countries' dependence on donor aid to finance their budgets. In Zambia, for instance, for the period running to 1996, over 50% of the aid was in the form of loans though grants subsequently became more prominent.

These flows have led to the Dutch disease[1] effects that have been the source of a significant rise in domestic debt and related servicing costs.

4.2.4 Strict Conditionalities

IMF and World Bank programs that accompany HIPC debt relief are usually inextricably bound in strict and sometimes unattainable targets. Most developing countries do not have the capacity to meet some of the targets due to underlying budgetary constraints. This further delays attainment of Completion Point, which is dependent on triggers outlined in the conditions.

4.2.5 Arbitrary Assessment Criterion

Arbitrary debt sustainability thresholds set by the HIPC initiative are deemed relatively subjective. Additionally, the assessment criterion does not deal with issues of domestic debt, which are important for fiscal sustainability. Furthermore, it does not measure the adequacy of public resources to address priority development programs after debt service has been made.

4.2.6 Insufficient Debt Cancellation

The HIPC framework has been construed as being designed by creditors to limit debt relief to levels within their capacity to fund relief. As a result, insufficient debt

[1] Dutch disease effects put appreciation pressures on the exchange rate which adversely affects a country's balance of payments position, with interest rate rising as a result of monetary authorities' attempt to contain the inflationary effects of the inflows on liquidity.

cancellation has been always offered, which means that debtor countries may not return to long term sustainability. Thus the funds availed by the initiative have been likened to pouring small cups of water into a bucket when what is needed were full jugs (Sony Kapoor, ***Plug The Leaks Or Waste The Aid, 2005***).

4.2.7 Lengthy Process

The HIPC process in some instances takes too long to implement and does not take into consideration the immediate and desperate poverty situations in many HIPC countries. Such delays have been associated with opportunity cost, and in some cases the debtor countries' debt situation has improved in the interim period, thereby limiting their case for maximum debt relief.

4.2.8 Costly Exercise

The negotiations for debt relief under the HIPC initiative are characterised by traveling and associated costs. It is argued that these costs have reduction effects on the benefits of debt reduction that accrue to indebted countries.

The negotiations involve traveling by delegates of the beneficiary country in its engagement of multilateral and bilateral creditors. The cost of traveling, accommodation, and daily allowances are substantial relative to the financial capacities of debtor countries, although, when compared to debt relief provided, they have remained relatively small.

4.2.9 Unemployment

HIPC conditionalities may entail public sector reforms. Such institutional reforms are usually characterised by the laying off of workers. This adverse development, however, militates against the key tenets of debt relief, which is poverty reduction. For instance, reforms undertaken in public enterprises in Country G resulted in the downsizing of the workforce at one of the key parastatal organisations.

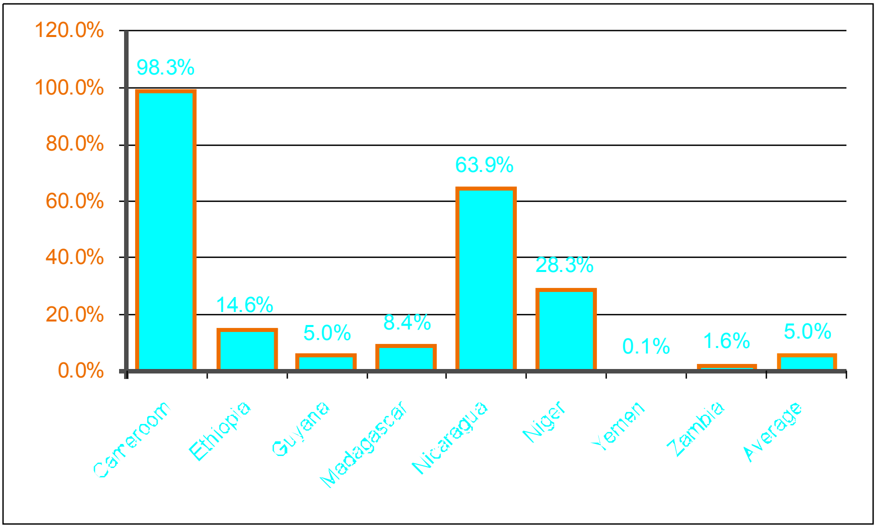
4.2.10 Lawsuits Against HIPC Countries

Countries eligible for HIPC have repeatedly complained about growing proliferation of lawsuits by creditors and third parties refusing to participate in the HIPC initiative.

At least 20 HIPC countries, notably, Angola, Bolivia, Cameroon, Congo Republic, Cote D'Ivoire, DRC, Ethiopia, Guyana, Honduras, Madagascar, Mozambique, Nicaragua, Niger, Sao Tome, Principe, Sierra Leone, Tanzania, Uganda, Yemen and Zambia have been subjected to or threatened with lawsuits since the HIPC initiative was launched in 1996 (Figure 11).

The proliferation of lawsuits emanates from the fact that the HIPC initiative has no legal force in individual national legal jurisdictions unless passed into law with enforcement provisions through a specific legal instrument.

Figure 11: Law Suits Cost as a % of Budget Revenue



Source: HIPC CBP: Negotiating Debt Reduction in the HIPC Initiative and Beyond

4.2.11 Vulture Funds

Vulture Funds are financial agencies that specialize in buying up the debt of poor nations at a discount and then claim full or premium value payment of the debt plus interest at re-negotiated terms.

These entities work like circling vultures that patiently wait to pick up the remains of a rapidly weakening debtor and later claim huge interest repayments through litigation. Their activities tend to be quite secretive, and many of them are based in tax havens.

In other cases, there is limited or no information on who owns these organizations. Often subsidiary companies are set up by larger hedge funds simply to pursue one debt, and then shut down after winning those assets.

As such, there are growing concerns that Vulture Funds may wipe out the benefits which international debt relief was supposed to bring to poor countries.

CHAPTER 5: COUNTRY CASES

HIPCs in the MEFMI region borrowed in the 1970s and early 1980s, largely for human, physical and social infrastructure development in these newly independent states. Deep-seated balance of payments disequilibria emanating from persistent and unsustainable current account deficits also prompted the contracting of new loans in the region.

Other key factors that contributed to the accumulation of public debt in the MEFMI region were political instability in some countries, adverse weather conditions, deteriorating terms of trade, and lack of meaningful economic adjustment and reform programs.

5.1 HIPC Initiative in the MEFMI Region

Against this background, public debt rose drastically in the HIPCs. Accordingly, these countries sought for debt relief under the HIPC initiative. Depending on the pace of reforms, the countries reached decision and completion points at different times as shown in Table 7.

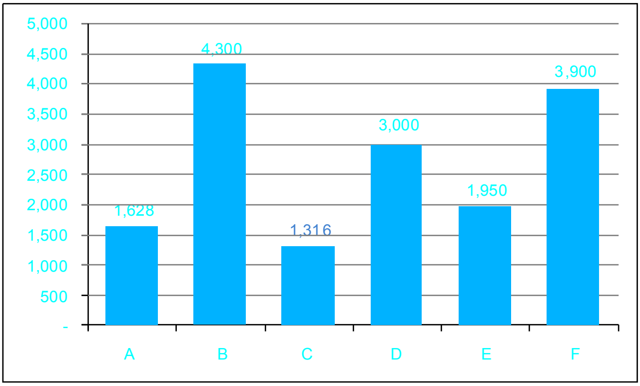
Table 7: Enhanced HIPC and MDRI Milestones

	Decision Point Date	Completion Point Date	MDRI Delivery Date
Country A	Dec - 00	Aug - 06	Sept - 06
Country B*	Apr - 00	Sept - 01	Jan - 06
Country C	Dec - 00	Apr - 05	Jan - 06
Country D	Apr - 00	Nov - 01	Jan - 06
Country E*	Feb - 00	May - 00	Jan - 06
Country F	Dec - 00	Apr - 05	Jan - 06

Source: HIPC, MDRI Implementation Status, 2009
**Also reached completion point under the original HIPC Initiative*

Within the context of the HIPC Initiative, Multilateral Financial Institutions (MFIs) provided assistance amounting to an estimated US$16,094 million to MEFMI HIPCs. Countries B, D, and F were the largest beneficiaries of relief delivered by MFIs, as shown in Figure 12.

Figure 12: Estimated Assistance Delivered by MFIs under the HIPC Initiative (US$ Million in Nominal Terms)

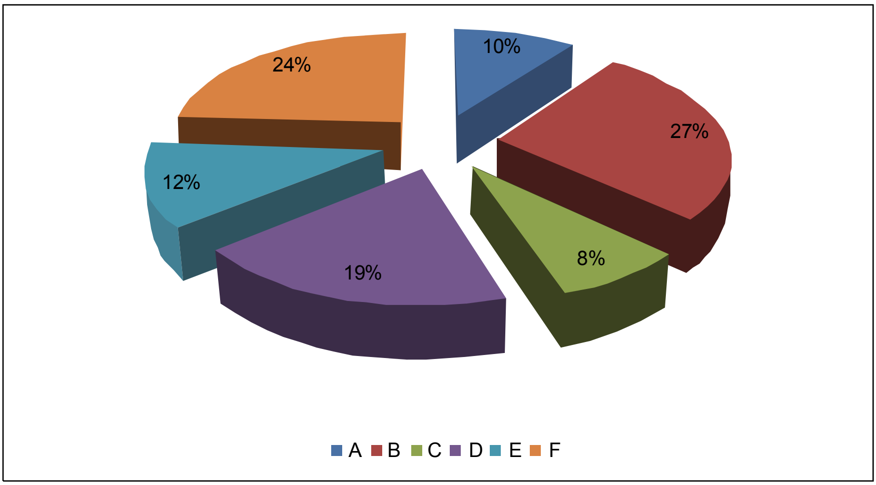


Source: HIPC, MDRI Implementation Status, 2009

Country B is estimated to have received the highest amount of assistance totaling US$4.3 billion, followed by Country F which received US$3.9 billion worth of relief. The third largest recipient of relief in the region was Country D, receiving US$3 billion (Figure 12).

Consequently, in terms of proportions Country B received 27% of relief that came from MFIs into the region, while Countries F, D, E, A and C received 24%, 19%, 12%, 10% and 8% respectively (Figure 13).

Figure 13: Share Debt Relief by MFIs under the HIPC Initiative

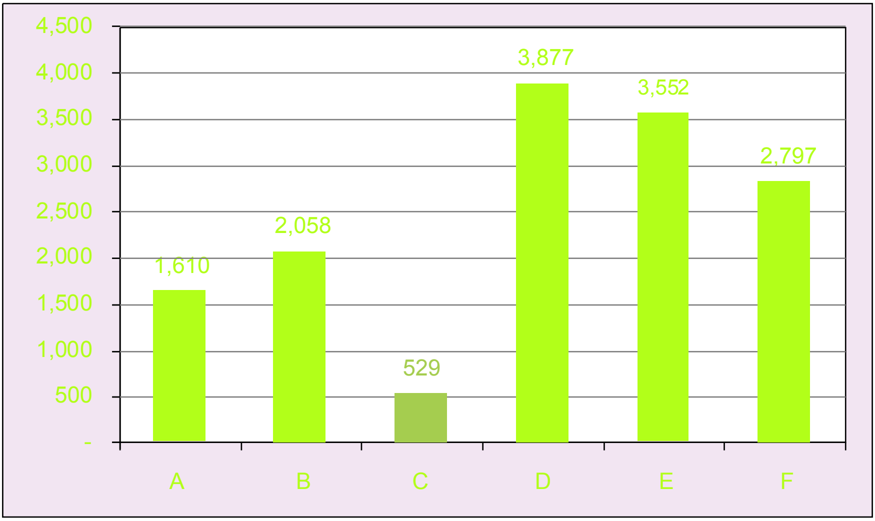


Source: HIPC, MDRI Implementation Status, 2009

5.2 Multilateral Debt Relief Initiative (MDRI)

MEFMI HIPCs automatically qualified for further debt relief under the MDRI upon attainment of their respective Completion Points. Assistance amounting to an estimated US$14,423 million was provided under the MDRI to help accelerate progress towards attainment of the MDGs by 2015.

Figure 14: Assistance Delivered by MFIs under the MDRI (US$ Million in Nominal Terms)



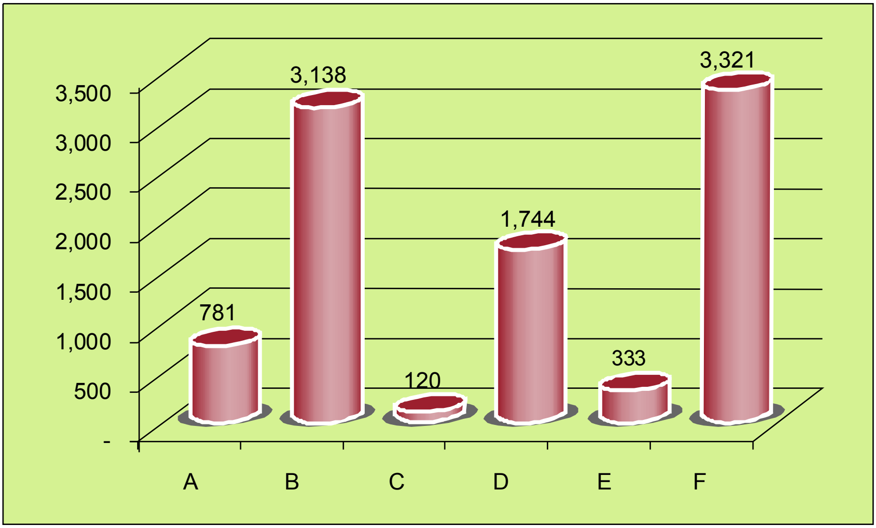
Source: HIPC, MDRI Implementation Status, 2009

Country D, Country E, Country F and Country B, received the highest assistance in the form of debt relief under the MDRI as shown in figure 14. Country A and Country C, however, received relatively lower assistance, reflecting significant relief already granted under the HIPC initiative.

5.3 Paris Club and Non Paris Club Debt Relief

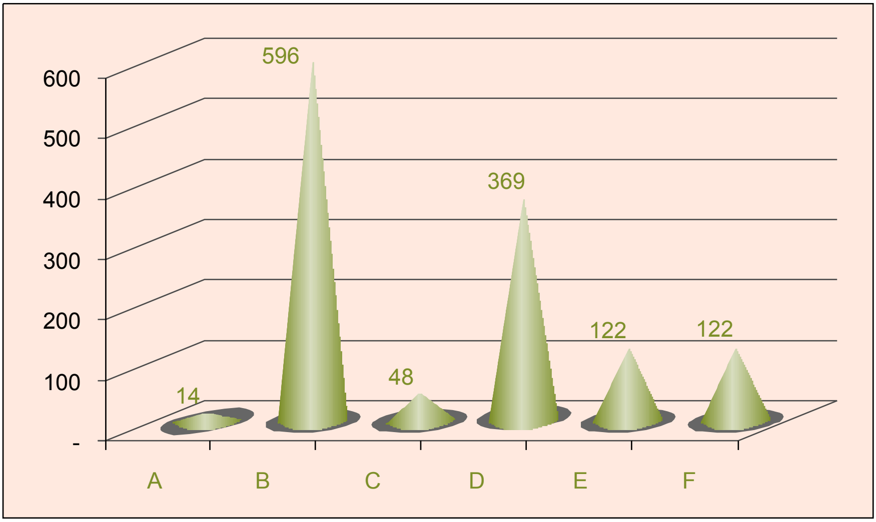
Paris Club creditors also provided debt relief in concurrence with MFIs under the HIPC debt relief initiative amounting to an estimated US$9,438.7 million. In this regard, official bilateral Paris Club creditors provided much of the relief to Country B, Country F and Country D as shown in the figure 15.
The highest amount of relief received in the region from Paris Club creditors was US$3.3 billion by Country F, while the lowest went to Country D at US$120 million. The amounts received largely reflected the structure of debt portfolio in each country. Where the debt composition was biased towards Paris Club creditors, a lot more relief would be expected.

Figure 15: Assistance Provided by Paris Club Creditors (US$ Million in Nominal Terms)



Source: HIPC, MDRI Implementation Status, 2009

Figure 16: Assistance Provided by Non-Paris Club Creditors (US$ Million in Nominal Terms)



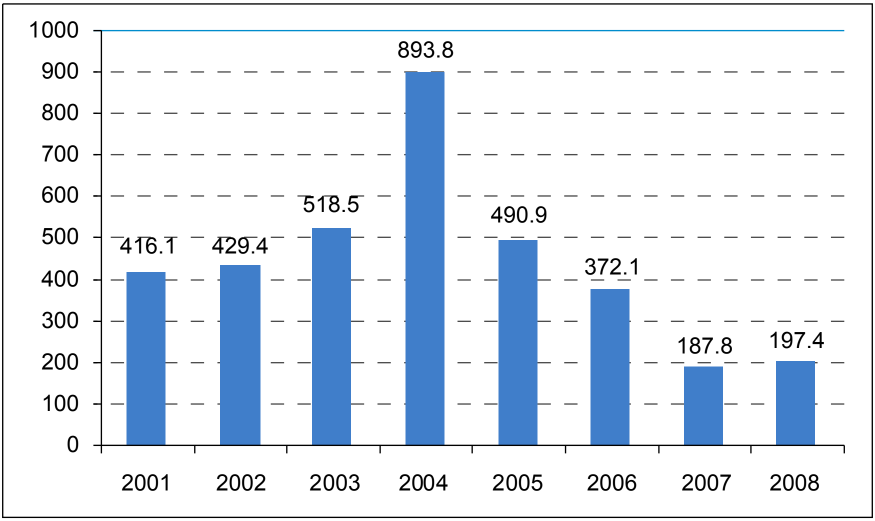
Source: HIPC, MDRI Implementation Status, 2009

Similarly, official Non-Paris Club creditors extended debt relief to MEFMI HIPCs, amounting to US$1,270 million. Countries B and D benefited the most from assistance granted by Non-Paris Club creditors, receiving equivalent of US$596 million and US$369 million respectively. The lowest amount of relief from Non-Paris Club creditors amounted to US$14 million (Figure 16).

5.4 Declining Debt Service

In the backdrop of debt relief granted to MEFMI HIPCs under the HIPC and MDRI initiatives, debt service payments declined sharply by 77.9% from a peak of US$893.8 million in 2004 to US$197.4 million in 2008 (Figure 17).

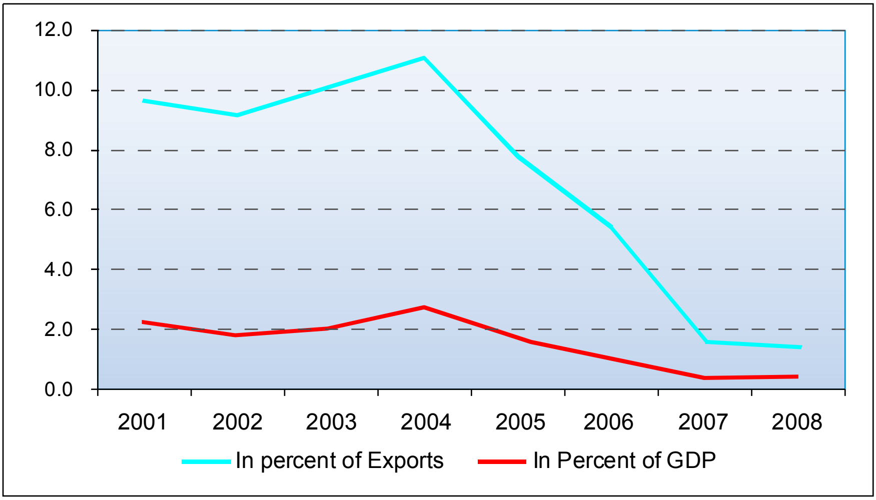
Figure 17: Debt Service Payments for MEFMI HIPCS (US$ Million)



Source: HIPC, MDRI Implementation Status, 2009

Accordingly, the debt service as a percentage of export of goods and services declined in tandem from a peak of 11.1% in 2004 to 1.4% in 2008 (Figure 18).

Figure 18: Debt Service Ratios (%) for MEFMI HIPCs

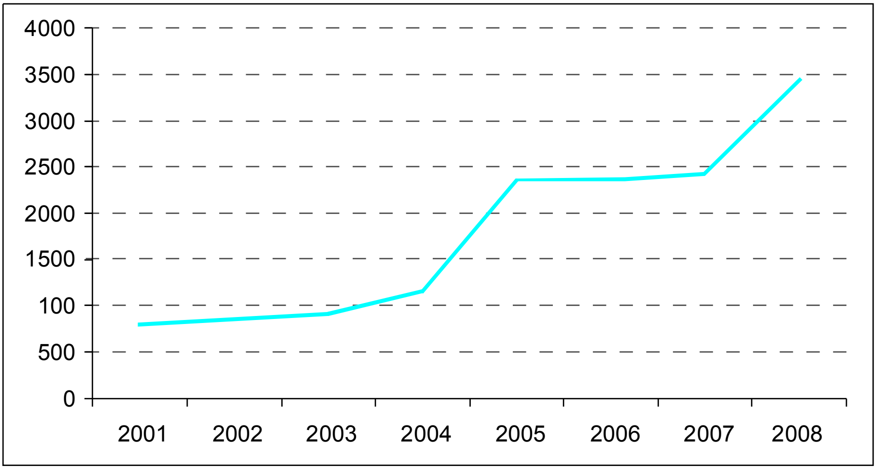


Source: HIPC, MDRI Implementation Status, 2009

5.5 Increased Poverty Reduction Expenditures

In the context of debt releif under the aegis of the HIPC initiative, poverty reducing expenditures in MEFMI HIPCs increased by 284% from US$1,669 million in 2001 to US$6,414 million in 2008 (Figure 19).

Figure 19: Poverty Reducing Expenditure for MEMFI HIPCs (US$ Million)



Source: HIPC, MDRI Implementation Status Report, 2009

Substantial increases in budgetary allocations towards pro-poor expenditure particularly in the social sectors notably health, education, water and sanitation as well as road construction have significantly reduced poverty levels in HIPCS within the MEFMI region.

5.6 Attainment of Millennium Development Goals

Despite significant strides made in the area of poverty reduction, partly through funds freed via debt relief, a sizeable number of MEFMI HIPCs are not on course to achieve MDG targets pertaining to saving children's lives, making motherhood safe, stopping HIV/AIDS and other diseases, protection of the environment and building global partnership for development. It is recognised that while the debt relief accelerated the progress towards achievement of MDGs, more interventions will be required by the beneficiary countries to fully realise the MDGs.

Table 8 provides a snapshot of the status of progress by each of the MEFMI HIPCs towards achievement of MDGs. The Table reveals that there are several areas that will require special attention in each of the six (6)countries. A good example is the protection of environment where only one country is on track to achieve the MDGs. The same pattern appears on performance regarding global partnerships for development where only one country is showing progress. The best performing area seems to be the goal of ending poverty and hunger, where all countries except Country C are on track.

Table 8: MEFMI HIPCs' Progress towards Achieving the MDGs

Country	End Poverty & Hunger	Education for All	Gender Equality	Save Children's Lives	Make Motherhood Safe	Stop HIV/AIDS and Other Diseases	Protect Environment	Build Global Partnership for Development
Country A	On Track	Possibly on Track	Off Track	On Track	Off Track	On Track	On Track	Off Track
Country B	On Track	Off Track	Off Track	On Track	Off Track	Off Track	Off Track	Off Track
Country F	On Track	On Track	On Track	Possibly on Track	Possibly on Track	Possibly on Track	Off Track	Off Track
Country C	Off Track	On Track	On Track	Off Track	Off Track	On Track	Off Track	Off Track
Country E	On Track	On Track	Progress	Off Track	Off Track	Off Track	Off Track	Progress
Country D	On Track	On Track	On Track	Possibly on Track	Possibly on Track	Possibly on Track	Off Track	Off Track

Source: Global Monitoring Report, 2009

Regrettably, Country A, Country B and Country D have made limited progress in the attainment of MDGs. This notwithstanding, Countries C and E made meaningful and significant progress in the attainment of most MDG targets. It is against this background that poverty reduction initiatives should be sustained to spur the region to better standards of living, meaningful economic growth and development.

It is recognized that while the debt relief accelerated the progress towards achievement of MDGs, more interventions will be required by the beneficiary countries to fully realize the MDGs.

5.7 Country Credit Ratings

The provision of debt relief contributed to improved country credit ratings in the region with member states classified either as medium or strong performers (Table 9). This may be due to numerous reforms implemented by countries during the relief process.

Table 9: IDA Country Performance Ratings (CPR)

Country	2006	2007	2008	2009[2]
Country A	3.37	3.41	3.41	3.39
Country B	3.23	3.37	3.44	3.82
Country C	3.52	3.63	3.56	3.86
Country D	3.82	3.74	3.61	3.96
Country E	3.54	3.54	3.52	4.04
Country F	3.25	3.27	3.32	3.00

Source: World Bank, 2009

5.8 Improved Foreign Direct Investment (FDI) inflows

In response to improved country performance ratings, foreign direct investment (FDI) inflows into MEFMI HIPCs improved significantly (Figure 10). In addition, sound policies pursued by MEFMI HIPCs under the guidance of the IMF and the World Bank, which have also been HIPC/MDRI conditionality, helped to significantly boost investor confidence.

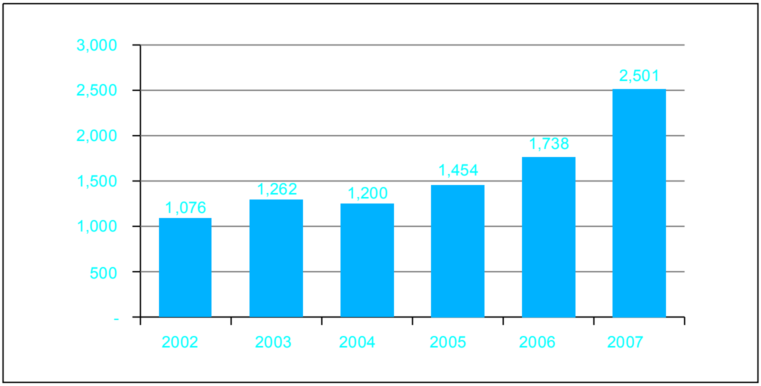
[2] CPIA ratings for clusters A, and B (Economic Management, Structural Policies, Policies for Social Inclusion/Equity)

Table 10: FDI Inflows by Country (US$ Million)

Country	2002	2003	2004	2005	2006	2007
Country A	6	10	16	27	30	55
Country B	348	337	132	108	154	427
Country C	7	5	11	14	16	67
Country D	430	527	470	568	522	600
Country E	203	211	237	380	400	368
Country F	82	172	334	357	616	984
Total	**1,076**	**1,262**	**1,200**	**1,454**	**1,738**	**2,501**

Source: World Investment Report 2005, 2008, 2009

Figure 20: Total Foreign Direct Investment (FDI) Inflows (US$ Million)



Source: World Investment Report 2005, 2008, 2009

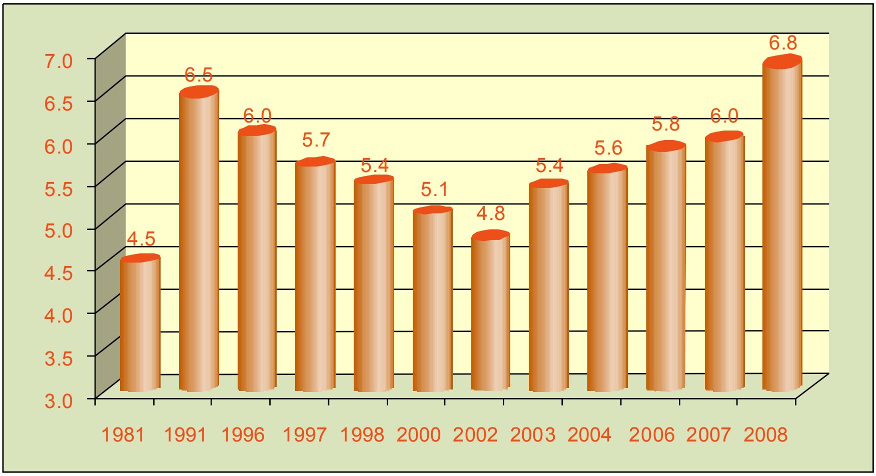
Foreign Direct Investment (FDI) inflows also increased by 132.4% over a five (5) year period, from US$1,076 million in 2002 to US$2,501 million in 2007 as shown in Figure 20.

5.9 The Kenyan Experience

Economic performance in Kenya has been modest since the 1980s and 1990s, reflecting the adverse repercussions of several factors including frequent droughts, internal instability emanating from clashes between ethnic groups especially during election years, the influx of refugees from neighboring countries facing political instability, and deterioration in terms of trade which often affected traditional agricultural exports.

These negative developments affected the country's export capability as well as its ability to service external debt obligations. Against this background, Kenya's external debt rose from US$4.5 billion in 1981 to US$6.5 billion in 1991 before declining to US$ 5.7 billion in 1997 and further to US$ 4.8 billion by 2002 (Figure 21). Between 1991 and 2002 the country went through a number of traditional debt relief mechanisms mainly through the Paris Club and London Club rescheduling.

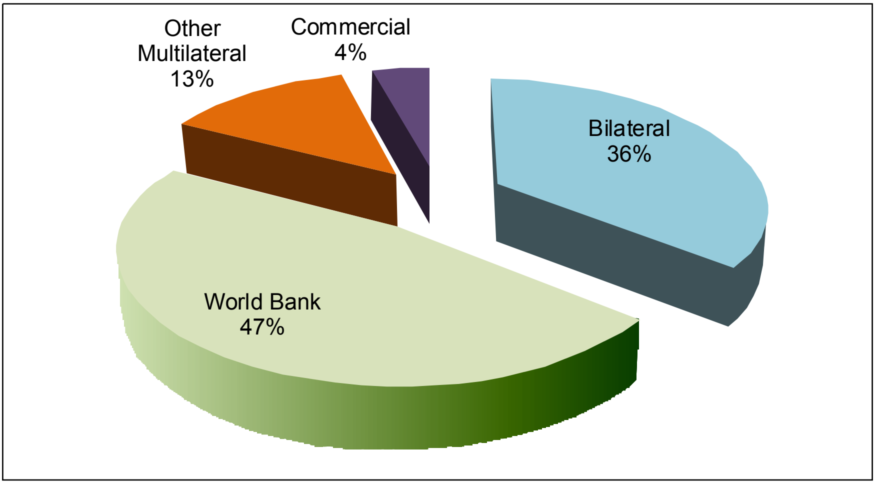
Figure 21: Kenya's External Debt (US$ Million)



Source: African Development Bank, 2003 and Ministry of Finance, Kenya

After 2002 there was a further accumulation of public debt in nominal terms and by end 2008, Kenya's nominal public external debt was estimated at US$6.8 billion. The bulk of Kenya's debt is owed to multilateral financial institutions with loans from World Bank accounting for 47% of the total debt in 2009 (Figure 22).

Figure 22: Composition of Kenya's Debt, June 2009



Source: Ministry of Finance, Kenya

5.9.1 Debt Sustainability Analysis

Against the background of relatively high debt levels, the Kenyan government sought for relief under the HIPC initiative. To this end, the IMF and the World Bank undertook a Debt Sustainability Analysis (DSA) for Kenya in 2009. The results of the DSA, however, revealed that the country faces a low risk of external debt distress, and thus did not qualify for debt relief under the HIPC initiative.

Kenya is, therefore, unique amongst HIPCs in the MEFMI region as it did not benefit from any HIPC debt relief initiatives. This notwithstanding, in 1994, Kenya negotiated for debt rescheduling with the London Club particularly in view of its inability to settle debt obligations falling due. Kenya's debt had fallen in arrears to most of its bilateral creditors and preferred to negotiate for rescheduling. In 2000, there was another round of rescheduling this time under the Huston terms, which provided 50% debt relief. This was achieved by once again rescheduling the flows on all the debt.

While there were better terms on the table, i.e. Naples terms, Kenya was mindful of its main bilateral creditor, which was not in favor of debt cancellation as provided for under the Naples terms. If Kenya went for debt cancellation, its main creditor would have withdrawn its support to the country and that would affect most of the projects which were still in their infancy with disbursements still being expected from the main creditor. Thus, for strategic reasons and to protect its credit rating, Kenya opted for less favorable terms. The opportunity cost though was that Kenya lost the chance to receive highly favorable debt relief terms for which it was eligible.

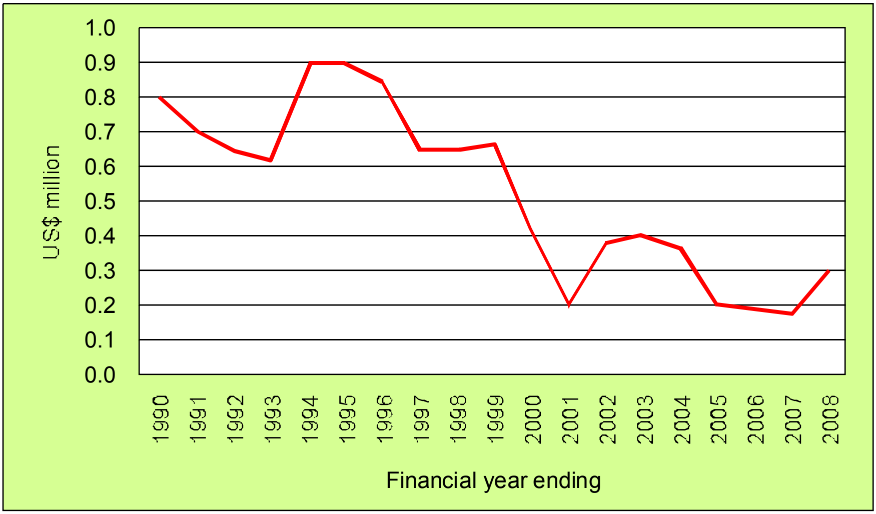
5.9.2 Debt Swap

Despite the aforementioned constraint, Kenya benefited from debt swaps from other bilateral donors under the "debt-for-development" swap arrangement. In this regard, one of the donors channeled US$40 million from the debt swap to benefit the health, education and water sectors over a period of 10-years. Likewise, proceeds from the debt swap with the second donor were channeled to promoting the education sector in Kenya. This, alongside the Houston terms provided by the Paris Club enabled the country to reduce its external debt burden to sustainable levels.

The country's external debt reduction strategy yielded desired results as it improved its sovereign credit rating which enabled Government to locally access financing for its development projects after rescheduling its current repayment profile. The latter covered both arrears and flows, plus previously rescheduled loans. This greatly improved Kenya's cash-flow without need for excessive external borrowing to finance Government priority projects.

Kenya derived immense quantitative and qualitative benefits from debt relief. Evidently, its external debt service declined significantly, as shown in figure 23, following the series of rescheduling coupled with slowdown in accumulation of new external debt.

Figure 23: Kenya's Total External Debt Service, 1990-2008



Source: Ministry of Finance, Kenya

Of Kenya's bilateral debt, US$585 million was rescheduled in 1994, US$350 million rescheduled in 2000 while only US$300 million was rescheduled in 2004.

The terms were, however, highly non-concessional.[3] In addition, in 2000 and 2004 both ODA and non-ODA debt was rescheduled. The ODA was rescheduled for 20-years maturity including 10-years of grace period while non-ODA was rescheduled for 15-years maturity including 5-years of grace period. In both cases, the original contractual interest rates were maintained. These measures, however, did not result in the reduction of the country's nominal stock of debt as the rescheduling terms were less concessional.

Unlike some HIPCs, Kenya did not receive any direct grants in the form of debt relief but still directed debt relief proceeds towards social service expenditures.

[3] 10-years maturity including 2-years of grace period while maintaining the original contractual interest rates in 1994

CHAPTER 6: ANALYSIS OF REGIONAL FINDINGS

Like other HIPCs the world over, MEFMI member states derived immense benefits from debt relief under the Paris Club, HIPC, and MDRI debt relief initiatives. For the MEFMI HIPCs considered in this study, debt relief was granted by Paris and some Non-Paris Club bilateral creditors as well as the delivery of assistance under the HIPC and MDRI initiatives. Six HIPCs in the MEFMI region secured debt relief amounting to an estimated US$41,225.7 million in nominal terms by the end of July 2009 (Table 11).

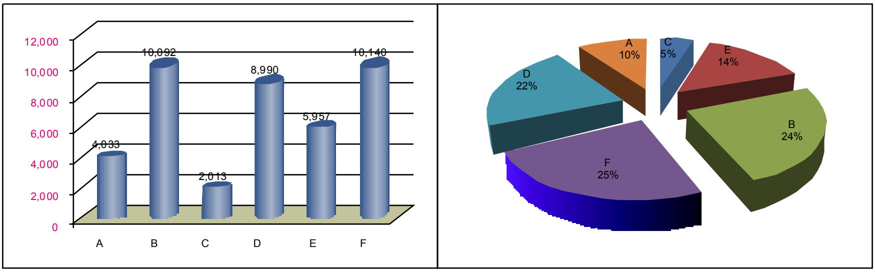
Table 11: Estimated Debt Relief to MEFMI Member States (US$ million in Nominal Terms) as at end July 2009

	Assistance Delivered by MFI Under HIPC	Assistance Delivered by MFI Under MDRI	Total Paris Club Debt Relief Provided	Non Paris Club Debt Relief	Total Debt Relief
Country A	1,628	1,610	781	14	4,033
Country B	4,300	2,058	3,138	596	10,092
Country C	1,316	529	120	48	2,013
Country D	3,000	3,877	1,744	369	8,990
Country E	1,950	3,552	333	122	5,957
Country F	3,900	2,797	3,321	122	10,140
Total	**16,094**	**14,423**	**9,438.7**	**1,269.99**	**41,225.69**

Source: HIPC, MDRI Implementation Status Report, 2009

Of the total assistance delivered within the context of debt relief to the MEFMI region, beneficiaries comprised of Country F (24.6%), Country B (24.5%), Country D (21.8%), Country E (14.4%), and Country A (9.8%) and Country C (4.9%), as shown in Figure 24. Variations on the level of assistance delivered by creditors reflected differences in levels and structures of their respective external debt burdens.

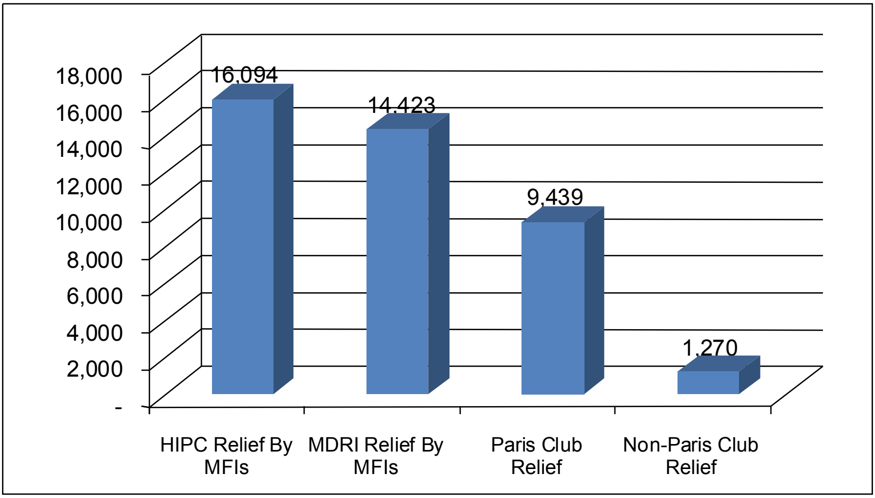
Figure 24: Estimated Debt Relief Granted to MEFMI Member States in Nominal Terms (as at end July 2009)



Source: HIPC, MDRI Implementation Status Report, IMF, 2009

As indicated in Figure 25, Multilateral Financial Institutions (MFIs) provided the largest share of debt relief under the HIPC and MDRI initiatives, accounting for an estimated US$30.8 billion (74.6%), while the balance is accounted for by debt relief granted by Paris Club creditors (US$9.5 billion) and Non-Paris Club Creditors (US$1.3 billion).

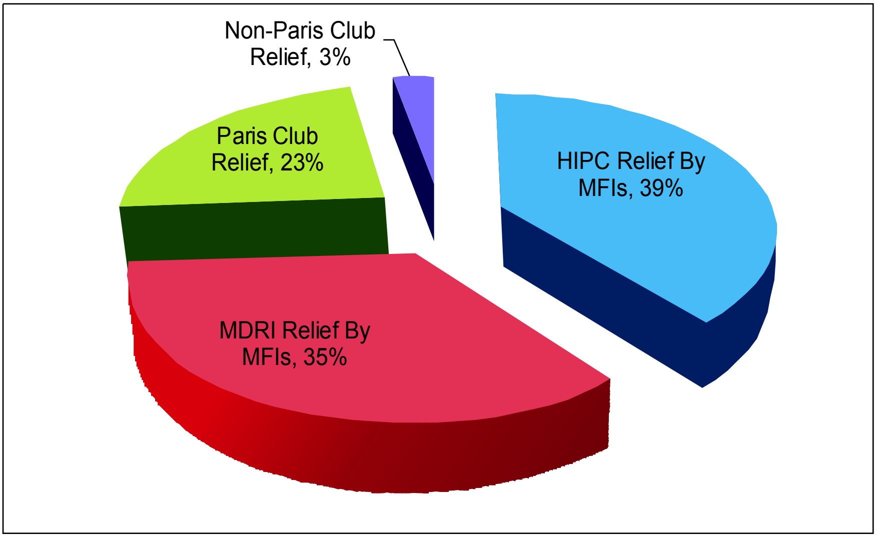
Figure 25: Debt Relief by Creditor in Nominal Terms (as at End July 2009)



Source: HIPC, MDRI Implementation Status Report, 2009

In terms of composition of relief 39% was HIPC relief provided by MFIs while 35% was provided by MFIs through the MDRI. The rest of relief was provided by Paris Club and Non-Paris Club creditors at 23% and 3% of total relief respectively (Figure 26).

Figure 26: Composition of Debt Relief to MEFMI Member Countries



Source: HIPC, MDRI Implementation Status Report, 2009

Reflecting this positive development, debt stocks in HIPCs within the MEFMI region declined to sustainable levels, based on the relevant external debt sustainability ratio thresholds.

6.1 Costs of Debt Relief

Notwithstanding notable positive benefits of debt relief to the MEFMI region, there were costs incurred in negotiating for debt relief in the form of travel, accommodation and subsistence costs. In some instances, debt relief initiatives prompted lawsuits by some creditors who were unwilling to participate in the HIPC process. In this regard, the MEFMI region secured debt relief at an estimated total cost of US$23.8 million, largely consisting of legal costs (US$21.6 million), interest cost (US$1.4 million), travel expenses (US$648,544) and accommodation and subsistence cost amounting to US$224,942.

Table 12: Estimated Costs of Debt Relief (US$) in Nominal Terms

Country	Total Costs Associated with Debt Relief[4]
Country A	**83,159**
Country B	**87,100**
Country C	**202,500**
Country D	**30,000**
Country E	**22,079,357**
Country F	**1,330,867**
Total	**23,812,983**

Source: Survey on Costs and Benefits of Debt Relief to the MEFMI region, 2010

6.2 Travel and Accommodation Costs

Countries that undertook data reconciliation before delivery of debt relief, incurred high costs as they had to engage individual creditors in this exercise. Country E's debt negotiating team traveled to each of its 10 Paris Club creditors with a view to reconcile data on external debt. Concomitantly, travel, accommodation and subsistence costs incurred were relatively high. Conversely, Country A and Country C only traveled to France for meetings with the Paris Club at Decision Point and at Completion Point. As a result, the cost of securing debt relief in their cases was reasonably affordable.

Country C negotiated for debt relief most cost effectively, as their debt negotiating team comprised of only 3 officials. As a result, travel, accommodation and subsistence costs were substantially minimized. In this regard, countries negotiating for debt relief should carefully consider the number of trips as well as an optimal size of the debt negotiating team in order to minimize associated costs.

Travel costs incurred by Country E's negotiating team were actually not high as most of the negotiations were held in the country. The creditors travelled to Country E for purposes of reconciling and verifying debt stock position before a final agreement was signed. However, Country E participated in the Paris Club Meetings, Paris Club 6 after the 1st HIPC Initiative Completion Point and, thereafter, the Paris Club 7 after the Enhanced HIPC Initiative.

The Country E debt negotiating team only traveled to one none-Paris Club creditor on two occasions in an attempt to negotiate for debt relief. In this regard the team traveled to an African creditor country and successfully negotiated for debt relief on

[4] Includes travel expenses, subsistence allowances, accommodation expenses, legal costs associated with law suits and interest costs.

the second attempt.

Countries negotiating for debt relief should carefully consider the number of trips as well as an optimal size of the debt negotiating team in order to minimize associated costs.

6.3 Interest Costs

Significant interest costs were incurred by Country E following its attainment of Decision Point status (Table 13). Some of Country E's non-Paris Club bilateral creditors accrued interest between the completion point date and the dates when the debt relief agreements were concluded. These amounts were required to be paid first before implementation of the respective debt relief agreements. While this cost was attributed to a few creditors, the amounts are, however, noteworthy.

Table 13: Interest Costs

Creditor	Interest charged (US$)
Kuwait	796,889.27
Saudi Fund	233,752.54
S. Korea EXM Bank	346,625.84

Source: Ministry of Finance, Country E

6.4 Legal Costs

Countries F and E incurred relatively high costs amounting to US$1.3 million and US$22.1 million, respectively in securing debt relief. This largely reflects substantial legal costs prompted by non-payment to creditors who declined to provide debt relief, under the equitable burden sharing conditionality of the HIPC initiatives.

In the case of Country F, Donegal International of Romania and Connecticut Bank of Commerce from the USA sued the country for debts amounting to US$0.3 million and US$15.4 million respectively. Judgment was awarded in favor of the creditors resulting in additional legal costs being incurred, in spite of the noble debt relief efforts under the HIPC and MDRI initiatives. ABSA Ltd of South Africa also took legal action against Country F with claims amounting to US$95 million (Table 14). The case is, however, still pending before the courts.

Table 14: Commercial Creditor Lawsuits against HIPCs

HIPC Debtor	Creditor	Domicile of Creditor	Court location	Status of Legal Action	Original Claim (US$ million)	Amount Claimed by Creditor (US$ million)
Country E	Banco Arab Espanol	Spain	Country E	Judgment Awarded	1.0	2.7
	Transroad Ltd	UK	Country E	Judgment Awarded	4.0	16.7
	Industry Machinery 14 Oktobar	Former Yugoslavia	Country E	Judgment Awarded	7.0	8.9
	SOUR Fap Famous	Former Yugoslavia	Country E	Judgment Awarded	0.3	1.4
	Iraq Fund for International Development	Iraq	Country E	In court	6.0	6.4
	Sheller Afrique	Kenya	Country E	Out of Court Settlement	0.1	0.1
Total for Country E					**18.4**	**36.2**
Country F	Connecticut Bank of Commerce	USA	USA	Judgment Awarded	0.9	0.3
	Donegal International Limited	British Virgins Islands	UK	Judgment Awarded	15.4	55.0
	ABSA Ltd. of South Africa	South Africa	Country F	On-Going	95.0	95.0
Total for Country F					**111.3**	**150.3**

Source: HIPC, MDRI Status Implementation, IMF/IDA, 2008 &2009

Country E was not spared by commercial creditors and leads the MEFMI region with about six (6) lawsuits filed against the country as shown in the table above. In all the court cases resulting from Country E's pursuance for debt relief from its commercial creditors, the Government lost five (5) of them. In this regard the courts awarded a total of US$19.6 million to Country E's creditors on their various claims (Table 15).

Table 15: Court Claims by Country E's Creditors (US$ unless otherwise in loan currency)

Creditor	Original Claim (U$)	Court Award Including Interest	Status
Banco Arabe Espanol	1,000,000	2,651,860	Paid as Awarded by Court
Transroad Ltd	3,992,550	6,695,919	Paid as Awarded by Court
Industry Machinery 14 Oktobar	6,982,585	8,862,713	Paid as Awarded by Court
SOUR Fap Famous	335,111	1,422,721	Paid as Awarded by Court
Iraq Fund for Development	I.D.1,351,809.66	6,432,809	Case still outstanding

Source: Ministry of Finance, Country E

The Government of Country E only appealed against claims by the Iraq Fund for International Development. In this case, the Government declined to pay as controversy was still prevailing on who is supposed to recover the debt on behalf of Iraq.

Government had received letters from Iraqi Government in which Iraq stated that they had never authorised any individual or institution to represent them to recover the debt from Country E. Iraq further revoked any such authority to represent them if it ever existed. Despite the Iraqi pronouncements, Country E had continued to receive several letters demanding payment for the full amount as awarded by the courts. This is one of the most delicate cases in Country E's external debt portfolio especially when the original loan currency was in ID (Iraq's local currency) whose currency has deteriorated significantly against the US dollar yet the court award was in US dollars.

6.5 Other Qualitative Costs

In Country F, reforms in public enterprises required as triggers under the HIPC initiative entailed the downsizing of operations to minimise operational losses and enhance operational efficiency. Regrettably, these reforms were accompanied by the retrenchment of workers. This exacerbated the country's poverty levels and partially offset the core overarching objective of poverty reduction.

Additionally, the conditionalities and triggers attached to the provision of assistance under the HIPC initiative subordinated other national goals and objectives. In this regard, there was temporary loss of sovereignty as other strategic entities and institutions were forced to streamline their operations in a way that undermined their core mandates.

Since the attainment of Completion Point under the HIPC initiative and subsequent debt relief under the MDRI, some Paris Club creditors have been reluctant to extend new credit particularly to Country F. Some bilateral creditors in the Paris Club may now be hesitant to extend new credit to post-Completion Point HIPCs as they fear that the HIPCs may slip back into debt traps and default on new obligations.

CHAPTER 7: CONCLUSION AND POLICY RECOMMENDATIONS

7.1 Conclusion

The study confirmed that debt relief undoubtedly provided the following immense benefits to the MEFMI HIPCs including:

- Irrevocable debt relief;
- Reduced debt service payments;
- Increased expenditure towards poverty reduction;
- Improved standard of living;
- Rejuvenation of economic activity;
- Stable macroeconomic environment;
- Pursuance of sound macroeconomic policies; and
- Improved investment climate.

Country F, Country B and Country E received assistance amounting to US$10,140 million, US$10,092 million and US$8,990 million respectively, thereby making them the largest beneficiaries of debt relief under the HIPC and MDRI initiatives in the region. Country E, Country B and Country C also received assistance amounting to US$5,957 million, US$4,033 million, and US$2,013 million respectively.

Nevertheless, significant costs were also incurred in the form of travel, accommodation and subsistence as well as legal in the case of Country F and Country E. Overall, the benefits of debt relief far outweigh the costs, but particular attention has to be paid to the minimisation of such costs, if the benefits of debt relief are to be maximised.

7.2 Policy Recommendations

7.2.1 Database Management

Great prominence should be attached to the strengthening of external debt databases in the region to avoid exorbitant costs associated with the reconciliation of debt statistics, which precedes debt relief. The compilation of accurate debt statistics remains key to making informed debt policy decisions.

Capacity building in the area of external debt database management should be sustained to ensure the availability of comprehensive timely and accurate data on external debt.
This would provide substantial impetus to efforts geared at timely enunciating appropriately informed and sound debt policies.

The benefits of debt relief far outweigh the costs, but particular attention has to be paid to the minimisation of such costs, if the benefits of debt relief are to be maximised.

7.2.2 External Debt Management

A neat balance is also required between the contraction of new loans and keeping external debt at sustainable levels. In this regard, there is need to strengthen external debt management to avoid relapse of post-Completion Point countries into debt distress.

Most importantly, external shocks such as the Global Financial Crisis, that plunged the world economy into a recession, undermine developing countries' capacity to service debt obligations. In this regard, strong external debt management policies would ensure that Post Completion Point HIPCs weather the external shocks with minimal effects on debt sustainability.

Most HIPCs in the MEFMI region rapidly accumulated new debt stocks soon after receiving relief under the HIPC initiative. The MDRI, however, came just in time before debt stocks accumulated to unsustainable levels. In view of this development, debt negotiations should primarily be forward looking, particularly with a view to make well calculated future borrowing plans. Furthermore, HIPCs should prudently contract new loans that enhance productive capacities of their economies to guarantee timely settlement of debt obligations when they fall due. While focus on the concessionality of loans remains important, borrowed funds should be put to productive use.

7.2.3 Poverty Reduction

In addition, poverty reduction efforts should be sustained to enable the region to achieve MDGs by 2015. The infrastructure, namely roads, schools and hospitals that was developed during the debt relief processes should be repaired and maintained to ensure that the standards of living are maintained at higher levels.

This can be complemented by a shift from heavy reliance on debt creating flows such as loans to non-debt creating flows such as foreign direct investment (FDI) and portfolio investment.

While focus on the concessionality of loans remains important, borrowed funds should be put to productive use.

7.2.4 Risk Management

Debt relief has unlocked new borrowing opportunities for post Completion Point HIPCs. Against this background, MEFMI HIPCs should develop comprehensive risk management frameworks tailor made to monitor terms and conditions of new borrowings, with a view to avoid drifting back to debt distress. In the same vein, MEFMI HIPCs, should implement sound borrowing policies and strengthen their capacity to manage public debt.

7.2.5 Short Term Vs Long Term Benefits of Debt Relief

The reclassification of a country to a HIPC country has had negative short term connotations. This is particularly the case when countries perceive that the attainment of HIPC status is an embarrassment that undermines national pride. This short term denial mode, is however, far outweighed by the medium to long term benefits that accrue to a country that undergoes the HIPC process to Completion Point as has been aptly demonstrated in preceding chapters of this paper.

In this regard, developing countries should not feel offended by the terminology of debt relief as this neither changes their status as a debt distressed country nor improve their situation.

7.2.6 Size of Debt Negotiating Team

Debt negotiating teams varied from delegations of three (3) officials to as large as delegations of (six) 6 officials. The study found out that the costs of debt relief depends to a larger extent on the size of the debt negotiating team.

The constitution of a reasonably sized debt negotiating team would help in the significant reduction of costs of securing debt relief. Travel, accommodation and subsistence costs of negotiating for debt relief vary directly with the delegation size. Against this background, countries should constitute optimal delegation sizes to ensure cost effectiveness and help maximize the benefits of debt relief, as well as curb unnecessary costs associated with larger delegations.

Countries should constitute optimal delegation sizes to ensure cost effectiveness and help maximize the benefits of debt relief, as well as curb unnecessary costs associated with larger delegations.

7.2.7 Accumulation of Interest

It is noteworthy that there was a lag between the Completion Point date and dates upon which individual creditors' debt relief agreements were concluded. In this regard, countries that are preparing for debt relief must be mindful of the accumulation of interest, including penalty charges between those periods, which some bilateral creditors made a subject for negotiation. This cost turned out to be significant as was the case with Country E. Ideally, reference should be made of the outstanding debt as of the completion date.

7.3 Areas for Further Study

7.3.1 Domestic Debt Sustainability

The region has other non-HIPC eligible countries, whose debt is severely constraining sustainable economic growth and development. In this regard, the study can be extended to explore the debt situation in other non-HIPC eligible countries and proffer alternative debt strategies that each country can pursue. To the extent that debt relief was only confined to external debt, there is, thus scope to broaden the study to analyse the evolution and sustainability of domestic debt in MEFMI HIPCs.

7.3.2 Econometric Study on Impact of Debt Relief

In addition, there is scope to expand the study by undertaking an econometric analysis on the relationship between debt relief, investment, growth and poverty reduction. This study would quantify, by use of econometric models the impact of debt relief in the MEFMI region.

7.3.3 AID versus Debt Relief

The tradeoff between aid and debt relief continues to be a topical subject. As such, there is scope to extend the study to focus on the aid lost by countries when they attained Decision Point status against the benefits of debt relief.

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