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# Status of Elements of the Debt Strategy as It Affects the Poorest Countries

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The debt strategy has been successful in resolving the global debt crisis. Almost all of the major debtor countries have put their external debt problems behind them. They have regained access to normal international capital flows, and have returned to healthy rates of economic growth.

This success has not been shared by the poorest and most heavily indebted countries, most of which are in sub-Saharan Africa. More than a decade of efforts to deal with external debt problems appears to have been in vain: external debt stocks have increased, scheduled debt service payments remain well beyond payments capacities, debt reschedulings continue to be a necessary component of balance of payments financing, and the restoration of external viability with growth appears for many a distant prospect.

But the debt strategy—designed as a process of cooperation between debtors and creditors—has not been a failure for the heavily indebted low-income countries. They benefited from a continued flow of net resources, achieved through comprehensive debt reschedulings combined with new large-scale financial assistance from bilateral and multilateral sources. The comprehensive cash-flow relief came until recently at the cost of a continuing buildup in restructured debt. But with further adaptations of creditors' instruments, all the elements are now in place for a durable resolution of the debt problems of the heavily indebted low-income countries.

All but a few of these countries are now implementing adjustment programs. They are, therefore, well placed to benefit from the full application of these instruments. The restoration of viable external situations and of economic growth has thus finally become a realistic prospect for the heavily indebted low-income countries.

## External Debt and Financing in Perspective

The provision of adequate financing on appropriate terms in support of adjustment efforts remains of critical importance for the heavily indebted low-income countries. Their balance of payments structure is dominated by a large—and in many cases increasing—gap between their own capacity to generate foreign exchange resources and their overall external resource requirements. For the heavily indebted low-income countries as a group, total external financial assistance from all sources, including through cash-flow relief, has in fact been about as large as their export earnings in every year over the past decade. The continued provision of such large transfers involved a wide variety of financing instruments and the continued adaptation of these instruments by each creditor group.

## Official Bilateral Creditors

Official bilateral creditors account for nearly two-thirds of the total debt of the heavily indebted low-income countries and are also their largest source of new financial assistance. A key element of creditors' continued willingness to provide new financing has been the maintenance of cutoff dates in successive reschedulings. This strategy of subordination enabled official bilateral creditors to provide new loans while at the same time granting cash-flow relief on existing "pre-cutoff date" official bilateral debt. At the same time, official bilateral creditors shifted new assistance increasingly to concessional loans or pure grant financing. Debt service on post-cutoff date debt has thus remained at very low levels in all but a few cases. Adherence to established cutoff dates remains a crucial aspect of external debt management and access to new concessional lending from bilateral sources.

Official bilateral creditors cover in Paris Club reschedulings both principal and interest payments. High scheduled debt service has, therefore, generally not been associated with heavy actual debt-service burdens. Creditors recognized that the resulting increase in the stock of restructured debt could only be contained by providing concessional rescheduling terms. Such concessions needed to be structured and implemented in ways that took into account budgetary realities and maintained the ability of individual creditors and donors to provide new financing.

Paris Club creditors took a first step with the implementation of Toronto terms in late 1988, which introduced a menu of rescheduling options with an average degree of concessionality of about 25 percent, but still relatively short grace and repayment periods. A second and more far-reaching step was the implementation in late 1991 of "enhanced concessions" or "enhanced Toronto terms" (now also called "London terms"), which provided for a 50 percent reduction. Agreement on further enhancements, called "Naples terms," was reached in December 1994.

The Naples terms recognize that a definitive solution to the debt problem requires two interrelated but distinct elements: a high degree of concessionality in reschedulings, and a fundamental restructuring of the stock of pre-cutoff date debt. Naples terms retain many elements of existing Paris Club practice, notably the close link between rescheduling agreements and IMF-supported programs but go significantly farther in several respects.

The level of concessionality will, for most low-income countries, be 67 percent. Eligibility will be determined on the basis of the degrees of poverty and indebtedness, though we would expect most low-income rescheduling countries to qualify.

While creditors will continue to tailor the extent of debt relief to countries' needs by varying the extent to which pre-cutoff date debt is covered, greater flexibility will be possible: debts previously rescheduled on concessional terms can be subject, on a case-by-case basis, to further restructuring.

- With the increase in concessionality, maturities were lengthened up to 33 years (under the debt-service reduction options), and to 40 years for rescheduled ODA debts.
- In a fundamental change from previous practice, Paris Club creditors are now prepared to implement a concessional restructuring of the entire stock of restructurable debt. This stock approach will be available for countries that have established a good track record under previous rescheduling agreements and IMF-supported programs, and provided there is sufficient confidence in the debtor's ability to respect agreements. For countries that have yet to establish a solid track record, flow reschedulings will continue, covering debt-service payments falling due during the consolidation period (which is invariably aligned with the period of countries' arrangement with the IMF).

## Multilateral Institutions

Multilateral institutions, and particularly the IMF and the World Bank, have been key players in the implementation of the debt strategy. They assisted debtor countries in the design and implementation of adjustment programs, thus setting the basis for financial support from other sources, and also provided direct financial assistance. The large-scale contributions by the multilateral institutions to the financing of the heavily indebted low-income countries led, of course, to an increase in multilateral debt. However, new financing has been provided on increasingly concessional terms, and debt-service payments on multilateral debt have, therefore, increased at a slower rate than the increase in overall indebtedness.

Increasing attention has recently been focused on this rise in multilateral debt and debt service. Some have argued that multilateral institutions, once an important part of the solution to the external debt problems of the poorest countries, have now become part of the problem; and a number of public and nongovernmental organizations have put forward proposals aimed at easing the burden of multilateral debt of the poorest countries.

A recent IMF-World Bank study of this issue found that, contrary to the assertions often made, multilateral institutions in the aggregate have continued to make positive and often large-scale net contributions to the financing of the heavily indebted low-income countries. In fact, multilateral net transfers have been positive for nearly every country in every year during the past decade. Negative net transfers on multilateral debt generally reflected the absence of an appropriate policy framework, but the multilateral institutions were quick to respond with significant financial support once countries adopted appropriate economic programs.

Future multilateral debt-servicing requirements are on a declining trend for most countries, reflecting the switch toward financing on increasingly concessional terms, particularly by the IMF and the World Bank. Multilateral debt-service ratios for the most heavily indebted low-income countries will decline over the coming decade, typically to below 10 percent, even on the basis of very conservative assumptions on export growth. For a few countries, however, particularly those where the share of concessional multilateral debt is still small (for example, Côte d'Ivoire), multilateral debt service will continue to represent a strain for some years to come. This underscores the need for all multilateral institutions to switch to concessional lending, and to link lending to an appropriate policy framework.

There is no evidence of a hump in multilateral debt-service payments for the vast majority of the heavily indebted poor countries, and multilateral institutions as a group can continue to provide positive net transfers without adverse implications for debt-service profiles for the foreseeable future. There are strains for some countries, but there is clearly no evidence of a widespread problem of multilateral debt and net transfers.

Looking at multilateral debt in the context of the total debt burden facing these countries, for most countries the total debt burden should be manageable provided that, for eligible countries, the new Naples terms are implemented flexibly, and nonmultilateral new finance is provided on highly concessional terms.

## Private Creditors

While official creditors have continued to finance the heavily indebted low-income countries, private creditors, and in particular commercial bank creditors, have shown little interest, except through short-term trade credits. Debt owed to private creditors accounts for a comparatively small share in total debt (about 10 percent), but the impact on scheduled debt servicing is much larger because of the commercial interest rates that apply to this debt.

Some countries have already been able to eliminate much of the government's nonguaranteed debt to private creditors through debt buyback and restructuring packages financed by the World Bank's Debt Reduction Facility for IDA-only countries and by bilateral donor contributions. Five operations have been completed to date under the Facility for African countries (Mozambique, Niger, São Tomé and Príncipe, Uganda, and Zambia). Nigeria and Benin have carried out commercial buyback operations from their own resources. A number of operations are under preparation (including, among African countries, Ethiopia, Guinea, Mauritania, Senegal, Sierra Leone, and Tanzania), and preliminary discussions are under way with a number of other countries. But progress has remained slow, in part because private creditors have seen little urgency in coming to definitive agreements.

Private debt is heavily concentrated in a few low-income countries, and in some of these, commercial bank debt in arrears is very large and the discount somewhat less than in the poorest countries (for example, Cameroon and Côte d'Ivoire). The costs of straight buybacks would severely strain the World Bank's Debt Reduction Facility. These cases will require an approach more along the lines of the Brady-type debt relief.

## What Remains to Be Done

All the elements are now in place for a successful resolution of the debt problems of the heavily indebted low-income countries. What are the remaining key issues for debtors and creditors in bringing together these elements?

- The single most important element remains the continued commitment on the part of the debtors to the sustained implementation of programs of macroeconomic and structural reforms. A record number of heavily indebted low-income African countries currently have or are about to have adjustment programs in place, and are well placed to benefit from the full application of creditors' recent adaptations of instruments.

- The two-stage approach adopted by the Paris Club under the Naples terms should be adequate to deal decisively with the external debt problems of all but a very few of the African low-income countries. Stock-of-debt operations will eliminate the uncertainties that continue to cloud these countries' prospects for external viability and restore an environment in which external debt contracts are no longer subject to renegotiations. The required period of sustained implementation of rescheduling agreements and adjustment programs can help generate confidence that the stock-of-debt operations will indeed be a durable exit from the rescheduling process.
- Remaining private debt issues need to be resolved. Commercial banks are now fully provisioned against losses in these countries, and they will need to show greater realism regarding the terms and conditions of debt and debt-service reduction agreements in line with the availability of resources and consistent with countries' medium-term payments capacity.
- The multilateral institutions, and in particular the IMF and the World Bank, have a continuing central role to play in assisting countries in the design and implementation of appropriate adjustment programs, and in providing direct financial assistance. This would increase multilateral debt further, but continued net transfers are consistent, on broadly conservative assumptions, with sustainable multilateral debt-service profiles for the vast majority of heavily indebted low-income countries.

Finally, while the instruments are now in place to deal decisively with remaining external debt problems, it is important to maintain a sense of perspective. Debt restructuring operations will bring scheduled debt-service payments down to manageable levels, but this alignment of debt-service profiles with payments capacities should not be expected to bring about an immediate increase in the availability of external resources. The poorest countries will continue to require large-scale financial assistance from the international community, and the bulk of this assistance will need to be provided on highly concessional terms if these countries are to succeed in creating the conditions for sustainable growth and development.