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The HIPC debt relief initiative: Uganda's experience

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Discussion Paper No. 2001/94

The HIPC Debt Relief Initiative

Uganda's Experience

**E. S. K. Muwanga-Zake
and Stephen Ndhaye***

September 2001

Abstract

Since the mid-1980s Uganda has had debt strategies, which clearly laid down procedures for negotiating new loans and emphasized commitment to reduce the stock of debt arrears. Over this period, the country went through six Paris Club negotiations and debt reduction operations.

Uganda became the first country to qualify for the heavily indebted poor countries (HIPC) initiative and formally entered the HIPC debt relief process in April 1997, attaining its completion point in April 1998. Unfortunately, by January 1999 it was concluded that the country could not sustain its debt, mainly as a result of a substantial decline in export proceeds and increased disbursements from old and new loans. Having qualified for the first HIPC, Uganda had little difficulty in meeting the requirements for the enhanced HIPC. The government provided the required Poverty Reduction Strategic Paper (PRSP) and accessed the enhanced HIPC in February 2000.

This paper examines Uganda's experience with the two HIPC Initiatives and explains why it was relatively easy to qualify, concluding, however, that the country's debt may be unsustainable even after the HIPC Initiative. The reasons are explained.

Keywords: debt relief, debt sustainability, net present value (NPV) of debt, non-OECD creditors, debt ratios, PAPSCA, PEAP, PRSP, PAF

JEL classification: O11, O19, F34, F35

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Acronyms and abbreviations

AERC	African Economic Research Consortium
ALM	asset liability management
ESAUN	Economic and Social Affairs of the United Nations
GDP	gross domestic product
HDI	human development index
HIPC(s)	highly indebted poor countries
IFI	international financial institutions
IMF	International Monetary Fund
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MDF	multilateral debt fund
NFS	non-factor services
NGOs	non-government organizations
NPV	net present value
PAF	Poverty Action Fund
PAPSCA	programme for the alleviation of poverty and the social cost of adjustment
PEAP	poverty eradication action plan
PRSP	poverty reduction strategic paper
SAPs	structural adjustment programmes
UNDP	United Nations Development Programme
XGDS	export of goods and services

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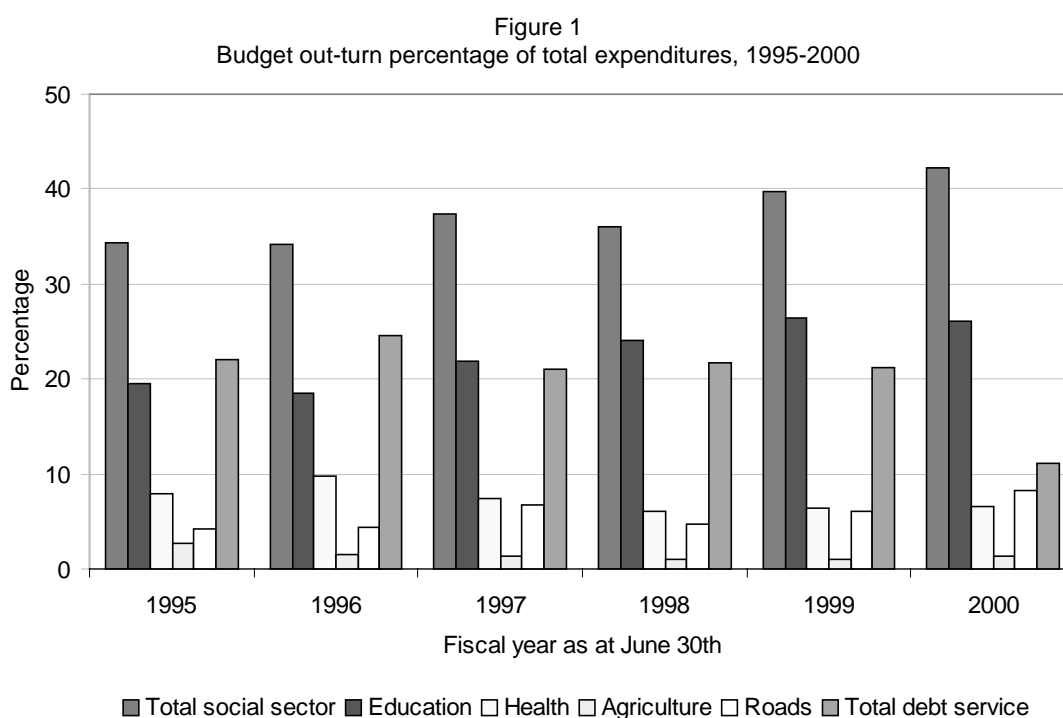
1 Introduction

1.1 Why is debt a problem?

The former International Monetary Fund President, Michel Camdessus, once observed that:

A satisfactory recovery of investment and output growth in the indebted countries will remain elusive as long as two major impediments continue to hold. First, the burden of servicing debt which entails so sizeable a net transfer of resources abroad and, second a level of debt of such magnitude as to turn away investors, concerned ... by their ongoing risk that the returns on their investment will be heavily taxed.

The servicing of debt absorbs budgetary and foreign exchange resources. In this situation, government spending on health, education and other social services will be reduced. In Uganda, records available indicate that expenditure on the social sector remained around 35 per cent of total government spending between 1996 and 2000 while that of debt service reduced slightly from 24 per cent in 1996 to around 21 per cent for most of the time. Some improvement in government spending on the social sectors is recorded during 1999 and 2000 at 39 per cent and 42 per cent, respectively. Details of the share of selected sectors in total expenditure are presented in Figure 1.



Source: Republic of Uganda (1998 and 2001)

Unsustainable debt levels affect economic performance in a number of ways. First, debt servicing reduces resources available for investment and government recurrent expenditures. Figure 1 on budgetary outturn compares allocation of budget resources for the fiscal years 1994/95–1999/2000. For most of the years indicated, the amount committed to debt service was higher than any committed to each of the social services.

A debt overhang may also be an obstacle to economic growth and investment. It is argued that high levels of debt create a high degree of uncertainty about the country's capacity to service its debt. High debt service is perceived by investors as a form of 'tax' on future incomes of the country.

Continued dependence on new inflows to cover debt service and constant rescheduling can impose significant administrative costs for policy-makers and increase uncertainty about government spending on new and on-going projects. Finally, unsustainable debt levels may also lead to instability in key economic variables such as inflation and exchange rates, by imposing pressures on foreign reserves and budget resources.

2 Evolution of Uganda's debt

2.1 The 1991 debt strategy

Prior to 1982, very little information existed on the composition, stock and payment schedule of external debt (Mbire and Atingi 1997). There was no basic institution in place to effectively manage debt through efficient data collection, assess the sustainability of debt and offer advice on existing international resources. The Treasury Department in the Ministry of Finance and the Public Debt Section and Accounts Department in the Bank of Uganda, handled both internal and external debt.

As a result of insufficient information and poor coordination, it became almost impossible to keep accurate records of the volume and structure of Uganda's external debt and to devise a time profile of the debt projections. Poor debt management created a problem of debt service for the country. Deliberate measures were taken by Government and Bank of Uganda starting late 1990 and early 1991 to address these ills. A firm of consultants, S. G. Warburg & Company Limited of United Kingdom, was contracted to establish consistent baseline data for effective debt management. As a result, the national stock of debt was derived, verified with the creditors and recorded centrally.

Since 1991, the government of Uganda has implemented a comprehensive external debt reduction strategy with considerable success in the form of:

- i) Paris Club debt rescheduling and stock reduction options;
- ii) A commercial debt buy-back;
- iii) Donor's contribution to service multilateral debt;
- iv) Strict limits on new non-concessional borrowing;
- v) Consistent implementation of economic recovery programme targets; and
- vi) Major efforts to improve the management of debt, fiscal policy and reserves.

The 1991 debt strategy also established clear procedures for negotiating new loans and emphasized commitment to significantly reduce the stock of arrears. A combination of prudent debt management and successful macroeconomic policies led to a fall from 65

per cent in 1991 to approximately 21 per cent in the year 1999/2000 in the ratio of the debt service to export of goods and services.

Unfortunately, the strategy was faced with a number of limitations, namely:

- i) The Paris Club rescheduling and reduction options reduced the debt stock by only 1 per cent up-front and the service by about US\$ 10 million a year because debt relief could apply only to debts contracted before 1981.
- ii) Strenuous attempts to negotiate debt reduction with non-OECD creditors met a lot of resistance.
- iii) Bilateral debt cancellations removed around 5 per cent of stock but also had negligible impact on service because they covered mostly concessional debt.

The strategy was enhanced in 1993 and 1995.

2.2 The 1995 enhanced debt strategy

By 1995 the measures implemented had led to a virtual elimination of commercial debt. On the negative side, however, the share of multilateral debt in the stock of debt rose to around 75 per cent. Given the 'untouchable' status of multilateral debt, Uganda's ability to negotiate further debt reduction became very constrained.

The enhanced external debt strategy was launched in July 1995 as a result of 'exit rescheduling' on Naples Terms from the Paris Club, i.e. no further relief could be sought. Having reduced the bilateral debt stock and rescheduled outstanding loans (with a commitment to seek comparable terms from non-Paris creditors) the issue of multilateral debt was deemed the most pressing. Also of note is the absence of any significant reduction in Paris Club post-cutoff debt. This is because a significant portion of Uganda's share of the Paris Club debt was post-cutoff, i. e. contracted after June 1981. Relief was extended on a pre-cutoff debts only.

In brief, the enhanced debt strategy had the following salient features:

- i) Clearing the bulk of accumulated arrears. These had, at some stage, caused legal action against the government and resulted in threats to seize assets, embargo on disbursements and inevitably programme and project implementation disruptions;
- ii) Stopping increases in the accumulation of penalty and late interest charges;
- iii) Reducing contractual debt service due to a level consistent with Uganda's ability to pay;
- iv) Contracting only loans with a grant element of 78 per cent and above; and
- v) Reviewing and rationalizing of the national debt portfolio.

The government has consistently implemented this strategy since then. The stock of arrears has been almost eliminated except for technical arrears on account of the

non-Paris Club creditors. Preference for filling the resource gap has been for grants and then very concessional loans. Debt service is timely and regular curtailing occasions for penalty interest.

2.3 Debt reduction operations in Uganda

Uganda has gone through a number of negotiations and agreements related to reducing the burden of debt servicing since the early 1980s. This was after the creditors appreciated the constraints the country was experiencing in the bid to try to retire debt falling together with arrears and, at the same time, attain some progress on its development goals. Debt reduction operations have varied depending on creditor category and the nature of the debt involved. Some of the major operations are summarized next.

2.3.1 The Paris Club

Debt relief negotiations with the Paris Club originally covered debt service falling payable between 12 and 18 months. This was later expanded to multi-year rescheduling agreement (MYRAs) and debt stock reduction. Uganda's experiences with the Paris Club with regard to the results of the negotiations over the years have been summarized in Appendix Table 1.

2.3.2 Debt buy-back and restructuring of unsecured commercial debt

The other approach in the process of debt reduction was in the form of debt buy-back. In February 1993, Uganda implemented a debt buy-back plan at 12 cents to the dollar to the tune of US\$ 151 million of eligible debt, representing 6 per cent of the total debt outstanding and disbursed, one-third of the total arrears or three-quarters of the commercial debt. The impact of this was a debt forgiveness amounting to US\$ 133 million (Mbire and Atingi 1997). Uganda became the fourth country to benefit from this facility after Niger, Mozambique and Guyana.

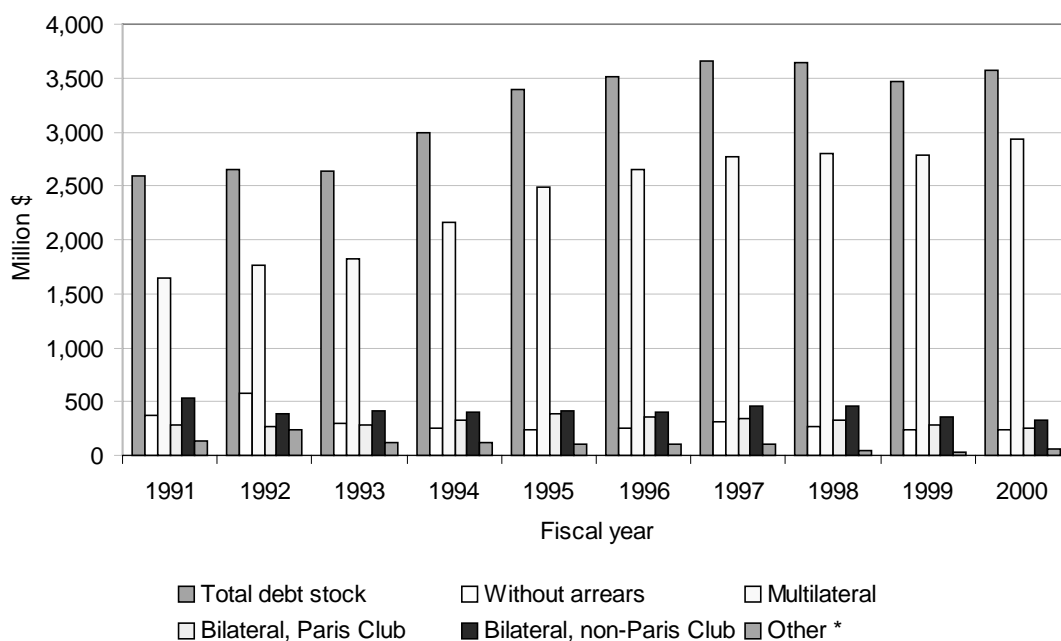
2.3.3 Debt conversion

The other operation was the debt-to-equity conversion. The total debt of US\$ 13.1 million, largely in arrears to private sector joint venture partners, was resolved under this conversion exercise. Operations were facilitated with an IDA debt restructuring facility of US\$ 10 million and OECD member grants of about US\$ 8 million.

2.3.4 Multilateral debt fund

Despite the relief efforts outlined above, debt continued to rise in the 1990s, though at slower rate than in the second half of the 1980s (see Figures 2 and 3). By end June 1996, Uganda remained heavily indebted with a stock of external debt of US\$ 3.5 billion or 63 per cent of GDP, and of which 75.5 per cent constituted multilateral debt. Regarding sustainability targets, Uganda's NPV of debt was approximately US\$ 1.7 billion (after implementing Paris Club rescheduling and stock reduction), or 233 per cent of exports of goods and non-factor services—a clear indication that Uganda could not achieve debt sustainability within a reasonable period even with good performance.

Figure 2
Uganda's debt stock composition, 1991-2000



Note: * Other includes commercial debt and other loans.

Figure 3
Debt burden indicator, 1991-2000

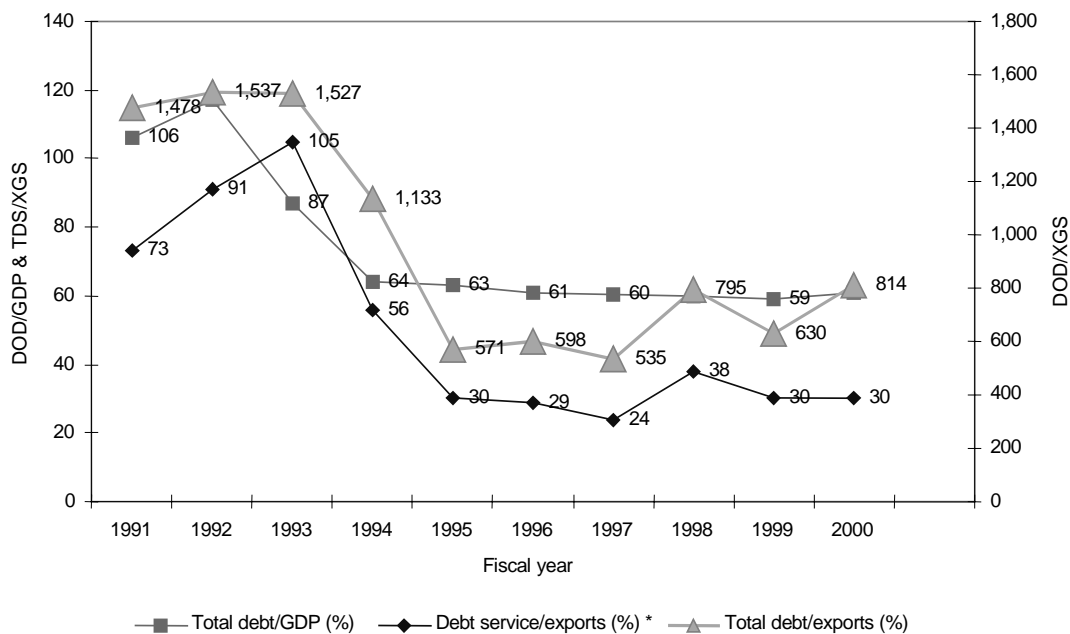


Figure 4
Contributions to the multilateral debt fund (%)

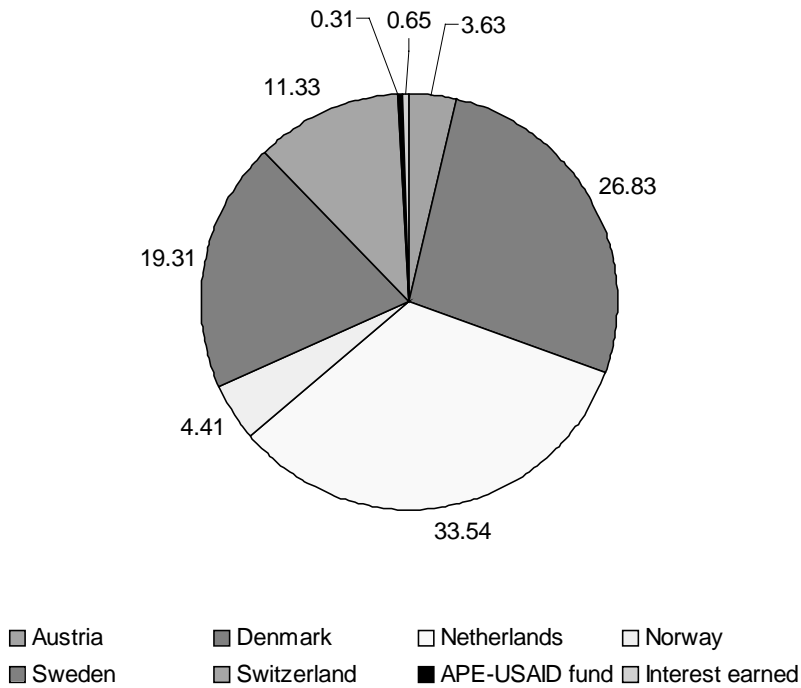
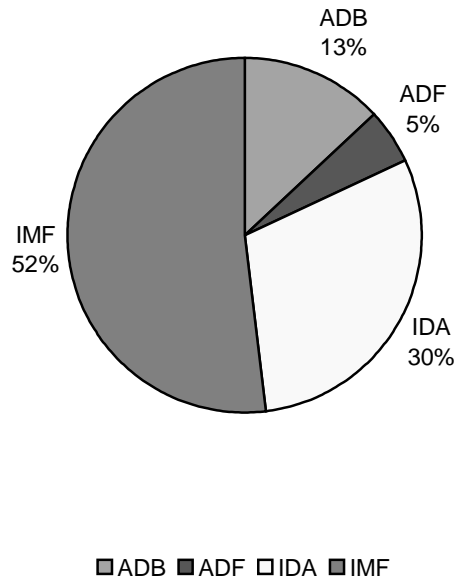


Figure 5
Use of the multilateral debt fund (%)



The high share of multilateral debt also represented a big barrier by way of debt relief options available to the government. The government, with the assistance of creditors, set up the multilateral debt fund (MDF) in 1997 to receive contributions from donors to be applied to servicing multilateral debt. Since its inception, the fund attracted contributions to the tune of US\$ 135 million, all of which applied to service debt owed to multilateral institutions. Contribution and application of MDF funds are detailed in Figures 4 and 5.

3 Debt sustainability

3.1 The concept

Sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding the accumulation of arrears, while allowing an acceptable level of economic growth (UNCTAD/UNDP 1996)

3.2 The HIPC debt relief initiative

The HIPC relief initiative, launched in September 1996, marks an important extension of previous debt relief initiatives. Its primary objective was to assist countries eligible to the HIPC debt initiative to reduce their debt burdens to sustainable levels that could be serviced without recourse to further rescheduling. Though debt burden was just one of the challenges faced by the HIPCs, it was hoped that the removal of the debt overhang via the implementation of the HIPC debt initiative would permit HIPCs to focus on the policies required to overcome other constraints to sustainable growth.

In general, for a country to qualify for debt relief, it must have established a six-year record of strong adjustment and reform under the International Monetary Fund-supported programmes, and reach its completion point three years after the decision point. It must also sustain strong performance of the macroeconomic policies together with structural and social policy reforms. In particular, a country would need to make considerable progress towards poverty alleviation by undertaking a prescribed programme of social spending as part of their structural adjustment programme. It was further expected that savings from the debt relief would be reallocated for priority spending in the social sectors, particularly education and health.

Sustainable levels at completion point would be defined on a case-by-case basis within the range of 200-250 per cent for the NPV of debt to export ratio and 20-25 per cent for the debt service to exports ratio. A country's target would, however, be determined by taking into consideration its vulnerability factors such as variability of exports, and with particular attention to fiscal indicators of the burden of debt service.

The government of Uganda thus embraced the HIPC Initiative with much optimism and anticipation, and committed itself to promoting rapid economic growth with equity. In recognition of its track record of a decade of adjustment, the country lobbied hard to persuade the Bretton Wood institutions and the G7 that it should receive both the decision and completion points early in 1997. However, several G7 governments opposed this idea and the completion point was fixed at April 1998.

3.3 HIPC delivery outturn versus expectations

Having established a satisfactory record of adjustment and reform supported by IMF and World Bank, Uganda became the first country to qualify for the debt initiative for the heavily indebted poor countries (HIPCs). Uganda formally entered the HIPC debt relief process in April 1997, and attained completion in April 1998. At this point, the country achieved debt relief equivalent to US\$ 347 million in NPV terms (or US\$ 650

million of relief on debt service over the next 30 years), a reduction of approximately 20 per cent of the NPV of the total debt stock.

Unfortunately, four years later agreements with some of the creditors are yet to be concluded. The summary of delivery profile by creditor is presented in Appendix Table 2. The total amount of relief to be received was US\$ 347 million in NPV terms, including US\$ 274 million in multilateral contributions and US\$ 73 million in bilateral contributions. This totalled US\$ 650 million in nominal terms.¹

3.4 Post-HIPC debt sustainability analysis

One year after attaining the completion point and accessing HIPC assistance, the Ugandan government with the assistance of Macroeconomic and Financial Management Institute for Eastern and Southern Africa (MEFMI) and Debt Relief International (DRI) organized and conducted a post-HIPC debt workshop in January 1999. The workshop reviewed the impact of debt relief under the HIPC Initiative and assessed Uganda's debt sustainability given the changed macroeconomic environment. The one-week workshop also aimed at training a core team of debt officials in debt sustainability analysis.

Analysis of available data and the adjusted macroeconomic assumptions yielded the following results:

- i) The present value of debt to exports ratio indicated that Uganda could not sustain its debt through exports following a substantial decline in export proceeds and projected increase in the NPV of debt arising from increased disbursements from old and new loans;
- ii) DSA based on external borrowing provides a partial picture of the country's debt service obligation. Introducing domestic debt analysis revealed that if the computation of original HIPC relief took into account the NPV of both debt categories, the relief would have been substantial and the NPV of the debt/export ratio would, other things remaining constant, be reduced to sustainable levels;
- iii) The country could not afford to borrow on non-concessional terms. For example, borrowing US\$ 10 million allowed in the debt strategy per year worsened the debt service burden by US\$ 30 million per annum. Uganda was, therefore, destined to remain an IDA only country;
- iv) The government was also urged to continue negotiating with non-OECD creditors, non-Paris Club governments and commercial creditors for comparable terms and to seek donor support for finding a solution to this problem because of its potential negative impact on debt sustainability.

¹ Estimates suggest that the decision to delay the completion point for Uganda to April 1998 denied the country US \$193 million in debt relief (56 per cent of the amount that was eventually granted) (Debt Relief International, March 1996).

3.5 Enhanced HIPC

As a result of the findings above and the fact that discount rates had considerably decreased for most currencies,² the NPV of external debt at end June 1999 had increased to US\$ 1,806 million against the projected US\$ 1,608 million at the completion point of April 1998. The ratio of NPV of debt to exports increased to 248 per cent at end June 1999 compared with the projected 207 per cent. The share of multilateral debt for the same period had also increased to 81 per cent. In line with the revised sustainability indicators, the World Bank and IMF estimated additional relief to be about US\$ 714 million in order to bring Uganda's ratio of NPV of debt to export to 150 per cent.

Having qualified for the first HIPC, Uganda had little difficulty meeting the requirements for the enhanced HIPC. The government was required to provide to the World Bank and IMF an acceptable Poverty Reduction Strategic Paper (PRSP) for the country. The Board and the Ministers attending the Annual Meeting of the IMF and World Bank early 1999 had endorsed the staff recommendation for a closer tie between debt relief and poverty reduction to make progress towards the international development targets.³ Fortunately, the government had prepared and implemented a poverty eradication action plan (PEAP) since 1997. PEAP drew on experiences from the programme for alleviation of poverty and social costs of adjustment (PAPSCA) whose aim was to alleviate poverty among the vulnerable groups being adversely affected by structural adjustment programmes (SAPs). This document together with the findings of the poverty assessment participatory survey formed the benchmarks for the country's PRSP that was approved by the donor community.

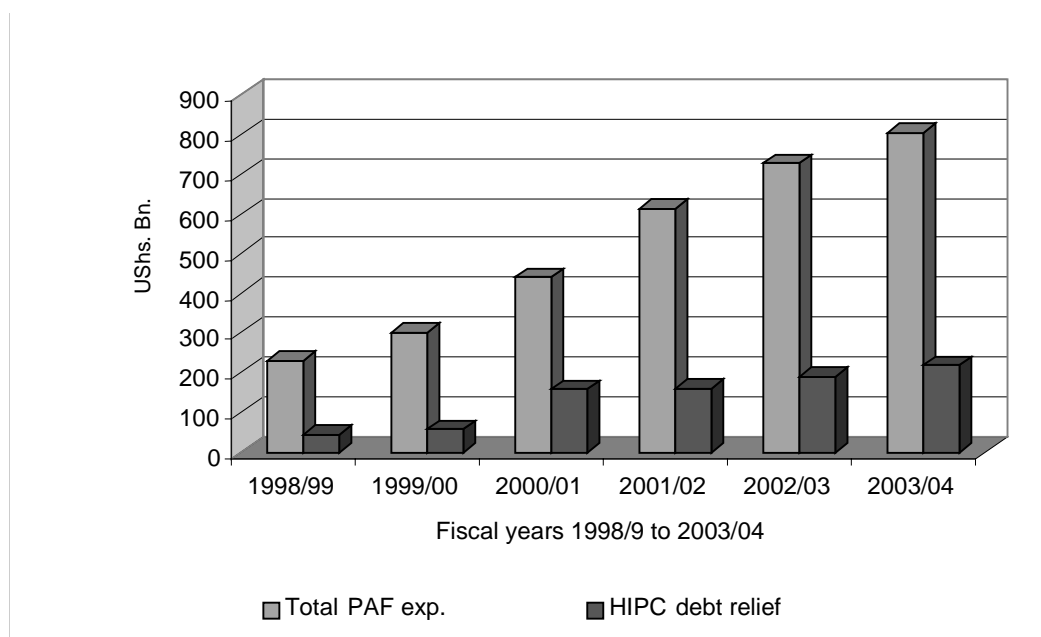
After a series of discussions with the donor community, Uganda accessed enhanced HIPC with effect from February 2000. The total amount of relief to be received is US\$ 656 million in NPV terms (US\$ 1.3 billion nominal terms) over a 20-year period. Details regarding the status of delivery of enhanced HIPC by the various creditors are presented at Appendix Table 3.

After going through the processes mentioned above, one may be tempted to ask what contribution is HIPC debt relief making towards poverty alleviation? Figure 6 summarizes the total government budget for the poverty action fund (PAF) within the medium-term expenditure framework and its major sources of funding. It depicts the relative contribution of HIPC savings that for most of the time is projected to be below 30 per cent.

² The CIRR for the US dollars decreased from 6.7 per cent (at end June 1997) to 6.0 per cent (at end June 1999). The discount rate for the SDR decreased from 5.7 percent (end-June 1997) to 4.9 percent (end June 1999). It is estimated that this decrease in discount rates of US dollar and SDR, other things being constant, increased the NPV of Uganda's debt by US\$ 100 million and increased the NPV of debt/export ratio by about 20 percentage points.

³ Debt Relief International (1999).

Figure 6
HIPC contribution to PAF



3.6 Non-OECD creditors

One of the constraints impacting directly on the delivery of HIPC is the debt owed to non-OECD creditors. The country's debt to this category of creditors is significant, totalling at end June 1993 US\$ 232.80 million. As at 31st December 2000, this amount had increased to US\$ 287.39 million with US\$ 165.20 million (57.48 per cent) representing accumulated arrears. During 1992/93 the government concluded some agreements with non-Paris Club creditors for rescheduling of maturities totalling US\$ 17.4 million and arrears of US\$ 60 million. Negotiations are continuing with non-Paris Club creditors, although with little success is being registered. Unfortunately, the amount to be forgiven increases with each successive debt relief strategy and some of the countries are HIPCs as well. The governing policy guided by agreements with Paris Club creditors and multilateral agencies is to receive comparable treatment from the non-Paris Club creditors.

However, debt relief in general and HIPC in particular is largely a political process and its success is underpinned by the political goodwill of the stakeholders involved. There is no clear legal framework for enforcing compliance with HIPC agreements for this category of creditors and some have taken government to courts of law demanding for repayment of outstanding amounts. Without prejudice to the outcome from the courts of law, there is a high level of uncertainty as to what will happen if the debtor is called upon to honour the terms of the original agreements. As can be deduced from above, the amount of arrears is higher than the country's annual debt service prior to the HIPC Initiative.

Attainment of comparable terms for non-PC creditors has proved to be a real problem for Uganda. Four years after qualifying for HIPC, negotiations are yet to be concluded with a number of creditors. Table 1 summarizes the status of negotiations between the government and creditors involved.

Some of the creditors are also HIPCs, and cannot, therefore, provide relief on similar terms as the more affluent countries and multilateral creditors. Consequently, they are re-affirming their demand for full payment of the principal, arrears and interest.

India, Nigeria and Libya have proposed debt-for-equity swaps for Uganda but the stipulation by these creditors has been that the entire debt amount be converted into equity in local enterprises of their choice. Libya, in the most recent round of negotiations, suggested an export swap but it also was to cover the entire amount of outstanding debt. Thus, there is little prospect of going into debt swaps measuring in terms comparable to IDA.

Also, there are some small multilateral/regional institutions (EADB, PTA Bank, HABITAT etc.) who hesitate to participate in the programme until they find a donor to finance this operation.

Table 1
Status of relief negotiations with non-Paris Club creditors

Creditor	Status as at June 2001
Abu Dhabi	No response
Burundi	Demanding full payment
Nigeria	Demanding full payment
Libya	Demanding full payment
India	Demanding full payment
Pakistan	No response
Saudi Fund	Agrees to offer relief on eligible debt
Rwanda	No response
Kuwait Fund	Agrees to offer relief on eligible debt
Iraq	Demanding full payment
Tanzania	Accepted 15 per cent buyback of verified debt and awaiting verification of outstanding debt
South Korea	Agrees to offer relief on eligible debt
China	Cancelled part of the debt and agreed to reschedule the remaining debt

3.7 Effects of enhanced HIPC Initiative on debt sustainability

After the enhanced HIPC, most of the debt (83 per cent) in NPV terms is outstanding to multilateral creditors. Only 6.4 per cent in NPV terms is outstanding to the Paris Club. It is therefore unlikely that there will be a formal Paris Club meeting because Uganda has already received the exit treatment from the club under the Cologne Terms. This is the maximum possible under current international law, making HIPC III unfeasible now.

It was expected at the last Paris Club meeting in September 2000 that the extended debt relief would enable the country to exit with a sustainable debt. Unfortunately, this has not been the case. There have been new debt disbursements and non-delivery of HIPC relief by some multilateral and non-OECD creditors. These have resulted in a rise of

NPV of the debt to about US\$ 1,340 million as opposed to about US\$ 1,100.00 projected at the decision point.

The country has also experienced several shocks that led to a drop in average exports proceeds from the projected US\$ 713 million to about US\$ 662 million. There has also been an escalation of oil prices from US\$ 16 to US\$ 36 (at the pick) per barrel. Other contributing factors include the ban on Uganda fish exports to the European Union and the fall in tourism due to insurgency in the western and northern parts of the country. The increase in NPV and the drop in exports have resulted in the country's debt reverting again to unsustainable levels. The NPV/XGS now stand at about $1340/662=202$ per cent, well above the threshold of 150 per cent

In these circumstances, the country appears to have only the following options:

- i) Persuade donors to avail grants for balance of payments and budget support;
- ii) Persuade multilateral creditors to front-load their relief and provide short-term credit. Government should finalize HIPC agreements with IFAD, EU/EIB, NDF, OPEC, IDB, PTA Bank and Shelter Afrique. Although there are regulations within each agency on the delivery of relief, it is possible to negotiate better terms;
- iii) Conclude the HIPC delivery agreements with bilateral creditors;
- iv) Press very hard to ensure that non-OECD countries provide the HIPC relief;
- v) Improve exports and government revenue;
- vi) Reconcile the data with major creditors and then firm up the data on NPV computation, including the issue of whether non-OECD arrears should be included or not. There always is a need to carefully cross-check computations done by the creditor.

It should be noted that with improvements in exports sector, Uganda expects to be sustainable in 2 to 3 years. The relief now required is, therefore, to cover the 2 to 3 year period.

4 Lessons from HIPC for Uganda

Damoni Kitabire, the former Director of Economic Affairs Department in the Ministry of Finance, Planning and Economic Development, Uganda (DRI 1999) has given what could be taken to be the main reasons for the HIPC process moving so quickly in Uganda. These are outlined below.

4.1 Design a pre-HIPC debt strategy

The earlier a country designs and implements its own strategy, the more influence it will have in HIPC decisions. Uganda designed its first strategy in 1991 and updated it in 1995.

4.2 Build local technical capacity

The HIPC Initiative is immensely complex, requiring techniques which many countries do not have, such as computerized debt sustainability analysis, loan-by-loan calculations of present value, 20-year projections of multiple macroeconomic scenarios, and precise costing of social sector expenditures for reaching international development targets. From 1995, Uganda concentrated its efforts on acquiring these skills, supported by Debt Relief International and MEFMI. Thus a local level of technical competence, including a computerized database, was building up.

4.3 Communication with donors, NGOs and civil society

Donor coordination was intensified in Kampala in 1995 by establishing quarterly meetings with donors to discuss the MDF and other debt and macroeconomic issues. These meetings were essential to transmit Uganda's views on debt relief throughout the construction and implementation stages of the initiative.

A major reinforcement of the change in the country's new borrowing policy was the inclusion of provisions in the constitution of 1995, which vest all new borrowing powers with Parliament, which has become an essential scrutineer of all new loans. Another crucial aspect has been communication with civil society.

4.4 Work constructively with the Bretton Woods institutions

The HIPC process marked a major step forward from traditional debt relief mechanisms by giving Uganda an important say in determining its debt relief needs. To maximize this input, it was essential that the country worked constructively with the staffs of IMF and World Bank, and ensure that they:

- i) Adopted data as the baseline for validation with individual creditors. Debt recording in the excellent DMFAS system needed to be supplemented by a labour intensive validation of data with each creditor.
- ii) Took account of the country's debt policies. For example, the need to continue paying strategic creditors who were providing positive net inflows rather than suggesting blanket remedies such as Paris Club comparable terms for all creditors.
- iii) Adjusted their macroeconomic projections, especially of exports and budget revenue, to levels considered by Ugandan officials to be more realistic.
- iv) Adapted the HIPC indicators to the country's needs. Uganda was fortunate that HIPC indicators had not been cast in stone. Exports have been volatile over the last ten years, so exports were measured on the basis of a three-year average.
- v) Adopted the social sector spending priorities. HIPC coincided with the Government's poverty eradication plans.

4.5 Do not relax after the decision point

Between the decision and completion points, there are three main types of work to be done to ensure that maximum entitlement to debt relief is obtained.

It is necessary to:

- i) Update debt sustainability analysis right through to the completion point. The initiative allows flexibility on the amount of relief provided depending on interim debt and macroeconomic developments;
- ii) Negotiate the form and timing of relief to be provided by all creditors; and
- iii) Ensure all creditors provide relief. With the exception of Tanzania, Uganda has had major problems getting non-OECD creditors to reduce its debt on terms comparable with the Paris Club.

4.6 Design a post-HIPC debt strategy

A workshop was held in January 1999 to review sustainability after HIPC I, and the country is currently reviewing sustainability after HIPC II. Indeed, consideration this time is being given to all debt including domestic debt and private sector external debt.

4.7 Be aware of key political issues

After all the technical calculations have been done, and in spite of the best efforts of the staff of Bretton Woods institutions, debt relief will depend to a considerable extent on the political objectives of G7 governments. Certain issues are not officially subject to tripartite agreement between the Bretton Woods institutions and the debtor government. These include the timing of relief and the exact agreed percentage ratios considered to be sustainable for the debtor country.

5 Conclusions and recommendations

The country has gone through six Paris Club negotiations and debt reduction operations since the mid-1980s. Since 1997 there have been two HIPC Initiatives, but the debt is still unsustainable. This paper explains why the country went through the HIPC process fairly quickly and highlights the reasons why the debt has remained unsustainable. The following conclusions can however be made.

5.1 Paris Club

The HIPC Initiative has resulted in a 62.34 per cent drop in the stock of debt outstanding to the Paris Club creditors, going from US\$ 324 million in June 1998 to US\$ 122 million in June 2001, accounting presently for only 6.4 per cent of the debt in NPV terms. There are positive indications that some of the Paris Club creditors are considering extending 100 per cent debt cancellation for the HIPCs. In fact, the United Kingdom and Finland have already cancelled 100 per cent of all debt payable to them

by Uganda. It is, therefore, recommended that other Paris Club members endorse the same policy.

Uganda is trying to finalize all the remaining bilateral agreements and requests for additional grants to offset some of the shortfalls in the balance of payments and budget support accounts.

5.2 Multilateral creditors

The multilaterals are the largest creditors, and they should be requested to reconsider extending relief—but not necessarily as HIPC III—to cover the relief expected from non-OECD sources. The expected relief in the interim period was not received in full; for example, only US\$ 4.8 million out of possibly US\$ 118 million was received as IDA. ADB has hesitated up to now to give actual relief, insisting that their debt be serviced and that they will refund that money when they conclude agreements with the HIPC Trust Fund. In reality, this reduces the NPV of their relief.

5.3 Bilateral non-OECD creditors

Attainment of comparable terms from non-Paris Club creditors has proved quite difficult for Uganda. It is, therefore, necessary to continue to appeal to these to consider extending relief while seeking support from the rest of the international community.

5.4 Unrealistic assumptions

Some of the assumptions made in the HIPC process are not realistic; for example, the debt-stress indicators employed as HIPC sustainability targets were intended to be rule-of-thumb measures but are generally interpreted as ‘switching values’, below which countries are expected to avoid debt service problems and vice versa. They do not take into account the fact that countries experience the debt problem for a variety of reasons, at different levels of debt, at different times and with different impacts on their economies. The targets are not well supported in analytical terms.

On the projection of macroeconomic variables, the issues concern the fact whether the projections are realistic or if a country has the capacity/capability to project. While Uganda may have reasonable capacity to do the projections, most of the variables are not entirely within the control of the country. GDP, exports, tax revenue, exchange and interest rates are usually influenced by external factors like weather changes, commodity prices, etc.

5.5 Improvements

The following improvements are also recommended in terms of delivery and formula to determine debt relief:

- i) Cancellation is the best option for providing debt relief. Rescheduling simply buys time by postponing payments and hence the problem;

- ii) For purposes of enforcing compliance and ensuring that all relief is delivered, all creditors should make their contribution through the HIPC Trust Fund. The Fund would then ensure that the debtor country receives the programmed relief at the appropriate time even when other creditors are yet to meet their obligations. This also reduces the risk of political goodwill that may delay bilateral negotiations;
- iii) The DSA model for domestic debt being developed by MEFMI could be improved upon and used to address foreign debt as well. This model could improve on the quality of sustainability indicators and lend them to more rigorous analysis.

In time, private sector external debt and public domestic debt will also need to be taken into account when computing DSA:

- iv) With improved tools, relief should be continuously evaluated so that each fiscal year's contribution is determined by the performance of essential variables in the preceding year and possibly adjusted for the previous quarter within the fiscal year. This, however, should be done within the total agreed relief programme.
- v) Tying debt relief to poverty eradication only is being viewed as diversionary. Poverty eradication needs to be looked at within the general development framework since it needs more than availability of funds to fight poverty. Indeed, there is already a debate as to whether investing the HIPC relief funds in the social sector will alleviate poverty.

5.6 Post-HIPC management plans

Adoption of the asset liability management (ALM) framework is certainly a must if countries have to be in a position to manage their debt in a viable manner. HIPCs in general, however, have to go beyond efficient debt management. There is need to pay more attention to the use of borrowed resources to ensure that value is received in turn and capacity for repayment has been created.

Deliberate measures to promote exports and government revenue must also be explored. These must also be political and public commitment to fight corruption and reduce the diversion of funds.

Appendix Table 1
Paris Club terms

Eligible debt	Terms of rescheduling	Comments
PARIS I, November 1981		
Arrears as at 30 June 1981 and maturities falling due on bilateral debt and insured credits.	10% of maturities paid in 5 semi-annual instalments with one year of grace	No cancellations/write-off
	90% of maturities paid in 10 semi-annual instalments for 5 years with 5 years of grace	Participants France Germany
	85% arrears paid in 7 semi-annual instalments with five years of grace	Italy UK
	15% arrears paid in 4 annual instalments with one year of grace	USA
	Market interest rates	
PARIS II, December 1982		
Arrears as at 30 June 1982 and maturities due between 1 July 1982 and 30 June 1983.	10% paid in 5 annual instalments with one year of grace	No cancellations. There were no arrears.
	90% of maturities paid in 10 semi-annual instalments for 5 years with 5 years of grace	Participants France Italy UK USA
	Market interest rates	Note Deminimis cases: Germany and Israel
	Deminimis SDR 500,000	
PARIS III, June 1987		
Arrears as at 30 June 1987 and maturities due between 1 July 1987 and 30 June 1988.	100% of maturities paid in 18 semi-annual instalments after 7 years of grace over 8 years	Ministry of Finance to deposit at least SDR 1.1 million each month for 9 months out of which repayments were to be made.
	100% of maturities paid in 18 semi-annual instalments after 6 years of grace over 8 years	
	Arrears and amortization arising out of 1981 and 1982 rescheduling also rescheduled	Participants France Italy UK and USA
	Market interest rates Deminimis SDR 500,000	Note Deminimis cases: Germany and Israel
PARIS IV, January 1989		
Arrears as at 30 Dec. 1988 and maturities due between 1 Jan. 1989 and 30 June 1990.	Toronto terms , i.e. one of the three options	
	Option A 33.33% stock reduction in NPV of the consolidated maturities cancelled 67.67% rescheduled at market rate of interest Repayment period of 14 years with grace period of 8 years	Option A France
	Option B 100% consolidated debt rescheduled at market rates over 25 years including a grace period of 14 years	Option B USA
	Option C 100% consolidated debt rescheduled at market rates over 14 years including a grace period of 8 years Deminimis SDR 500,000	Option C Israel Italy and UK Observers Germany < Deminimis

Table (con't)		
Eligible debt	Terms of rescheduling	Comments
PARIS V, June 1992		
Arrears as at 30 June 1992 and maturities due between 1 July 1992 and 30 June 1994	Enhanced Toronto terms:	
	Option A Further upgrade to 50% NPV reduction Balance rescheduled at market rate of interest	Option A France and Germany
	Option B 100% rescheduled Repayment period of 23 years with grace period of 6 years Deminimis SDR 500,000.	Option B Israel, Italy and UK Observers USA < Deminimis
PARIS VI, February 1995		
Debt rescheduled under Paris Club 1 to 4	Naples terms, i.e.	This was meant to be an exit for Uganda from all Paris Club arrangements.
	Further reduction of up to 67% NPV (from 1987 Paris Club)	
	Balance rescheduled at market rate of interest	Option A France
	Repayment period 23 years with 6 years of grace	Option B Italy UK
	50% cancellation & 50% rescheduled (from Paris Club 1989)	Observers Germany < Deminimis Israel < Deminimis USA < Deminimis
	100% debt service option (debt rescheduling) from 1987 & 1989 Paris Club	
	Payable in 40 years with 8 years of grace	
	Debt reduction on the 1987 Paris Club was 67%	
	Debt reduction on the 1989 Paris Club was 67%-eDR _{b2}	
	Debt swaps on voluntary basis, may sell or exchange in framework of debt for nature, debt for aid, debt for equity swaps or other local currency debt swaps Deminimis SDR 500,000	
PARIS VII (HIPC), 1998		
Debt rescheduled under Paris Club V and VII.	Lyon terms, i.e.	Under the HIPC Initiative it was expected to provide an exit strategy from rescheduling process i.e. provide sustainable debt level.
	Option A Further reduction of up to 80% NPV 60% cancelled from Paris Club 1992, resulting from Paris Club 1981, 1982 and 1987	
	70% cancelled from Paris Club 1992, resulting from Paris Club 1989.	Option A France Israel USA
	40% cancelled from Paris Club 1995	
	80% cancelled from Paris Club 1987 and 1989	
	Balance rescheduled at market rate of interest	
	Repayment period 23 years with 6 years of grace	Option B Italy and UK
	Option B Debt service (debt rescheduling)	
	Payable in 40 years with 8 years of grace	Observers Germany
	Option C Debt swaps on voluntary basis	

Table (con't)

Eligible debt	Terms of rescheduling	Comments	
PARIS CLUB (HIPC II), August 2000			
Enhanced HIPC	Option A	Relief	Sign*
Stock to pre-cutoff debt as at 1 September 2000.	Pre-cutoff debt 100% stock of debt reduction (cancellation)	Option A	120.50 m
Interest accrued from last maturity date until 31 August 2000 to be paid before 31 March 2000		France	✓ 6.30 m
		Germany	✗ 0.90 m
		Israel	✗ 4.80 m
		Italy	✗ 99.20 m
		UK	✓ 9.00 m
		USA	✗ 0.20 m
Stock on post-cutoff debt as at 1 September 2000 on agreement signed between 1 July 1981 and 1 July 1999	Option B Post-cutoff debt 18% stock of debt reduction (cancellation)	Option B	74.00 m
		France	✓ 2.30 m
		Italy	✗ 2.90 m
		Norway	✓ 0.05 m
		Sweden	✓ 0.70 m
		Spain	✓ 6.90 m
		Austria	✓ 4.50 m
	Option C Post-cutoff debt 100% stock of debt reduction (cancellation)	Option C	5.00 m
		Finland	✓ 5.00 m
	Option D Post-cutoff debt Refinance through grants 100% of ODA claims	Option D	51.60 m
		Japan	✗ 51.60 m

Note: Sign* Bilateral agreement signed or ready for signature

Generally, the Paris Club negotiations had a number of constraining factors:

- i) Initially the Paris Club could not reschedule or reduce any debt contracted after the cutoff date, in the case of Uganda, 1 July 1981. For example, as at end of June 1992 Uganda's outstanding debt to the PC creditors was US\$ 279 million with US\$ 81 million in arrears and penalty interest and US\$26 million in current maturities for 1991/92. Of the total outstanding amount, only 42 per cent (US\$ 118 million) was contracted before 1 July 1981 and US\$ 50 million represented arrears and pre-cutoff date maturities eligible for rescheduling in the June 1992 agreement;
- ii) The PC negotiations were conducted annually implying Uganda had to seek annual debt relief from PC creditors;
- iii) Maturities and arrears on post-cutoff debt had to be paid promptly resulting into sustained debt overhang;
- iv) Whenever a rescheduling was agreed on PC loans it was associated with stringent terms - no grace periods, short repayment periods and no reduction of principal and interest. The debt service that falls due is not deferred and arrears once rescheduled are not eligible for further deferrals. Most of these constraints were, however, eased when Uganda accessed the enhanced Toronto Terms and the Naples Terms in 1995.

Appendix Table 2
First HIPC projected relief and actual deliveries

The total amount of relief to be received was US\$ 347 million in NPV terms including multilateral contribution of US\$ 274 million and bilateral contribution of US \$73million.
This totalled US\$ 650 million in nominal terms

Creditor	Delivery mechanism	NPV (US\$ million)		Nominal value (US\$ million)	Remarks
		Expected	Actual		
IDA	Total commitment	152.00			HIPC saving of US\$ 18 million per annum for 1 st five years. Followed by 8 million per annum until 2036/37 Amounts falling due on the 20 credits to be serviced 100% from the HIPC Trust Fund
	O/w grants		24.00	75.00	
	Loans, 13 credits (cancelled)		84.00	204.00	
	20 credits; Debt service for 5 years (1998/99-2002/03)		52.00	60.40	
IMF	HIPC Trust Fund	62.40	62.40	68.90	Debt service relief applies to only principle and on declining basis, i. e. 26.5% (1998/99); 20.9% (1998/99) 19.2% (2000/01), etc. Interest earned on Trust Fund account is ploughed back into the Fund.
ADF		19.50	19.50	22.00	ADB hard window loans used to deliver entire relief.
ADB	Cancelled 5 loans	6.80	6.80		
IFAD	HIPC Trust Fund	5.70	5.70	SDR 4.71	To service loans falling due in next 5 years.
NDF	HIPC Trust Fund	1.15	1.00	SDR 0.70	To service loans falling due in next 5 years.
EIB	Cancelled 4 loans	6.70	6.70	ECU 8.10	
BADEA	Rescheduled arrears	3.40	3.10	0.00	BADEA rescheduled arrears of US\$ 11.40 million to deliver relief in NPV terms
IDB		2.30	-		1 st HIPC agreement in final stage
OPEC		1.54	-		Still negotiating 1 st HIPC
EADB		0.77	-		Agreed to offer relief after receiving a donor
PTA		0.77	-		Agreed to offer relief after receiving a donor
Paris Club	80% reduction from 67%	46.40			
Germany	No relief	-	-	-	Deminimus, i.e. amount outstanding negligible
					Table con't.

Table continues

Creditor	Delivery mechanism	NPV (US\$ million)		Nominal value (US \$ million)	Remarks
		Expected	Actual		
France				7.20	Stock of debt reduction
USA				0.75	Stock of debt reduction
UK				13.0	Stock of debt reduction
Israel				7.20	Stock of debt reduction
Italy	Rescheduled				Rescheduled
Non-OECD (non-Paris Club)		28.20			Negotiations have been made with India, Burundi, Libya, Iraq and Nigeria but so far with no positive results except Tanzania agreement reached.
Tanzania	15% Buyback			9.00	Accepted buyback at 15% to settle \$67.5 million
Commercial creditors		10.20			Only Fourways has accepted a buyback
Fourways	12% Buyback	1.19	0.32	9.90	Accepted buyback at 12% on US\$ 9.9 million and US\$ 0.27 million and was paid.
F.H International					Still negotiating buyback of 12%
Transroad					Transroad and Bank Arabe Espanol have already sued the Bank.
Bank Arabe Espanol					
Fap-Famos & 14 Octobar (Yugoslavia)					Fap-Famos & 14 Octobar (mining equipment and machinery factory, Yugoslavia) have already written to Bank of Uganda with the intention of instituting a law suit for nonpayment.
TOTAL		US\$ 347			

Appendix Table 3
Enhanced HIPC deliveries

The total amount of relief to be received is US\$ 656 million in NPV or US\$ 1.3 billion in nominal terms.

Creditor	Debt relief	Expected NPV US \$ (million)	Nominal value	Remarks
IDA	20 Credits under 1 st HIPC up to 2003	356.6	\$629 m	Refund Interim HIPC Refund on Debt service from 15 February to 1 June 2000 for 2000 54% is the percentage reduction of debt service after original HIPC. 2000-2019 Enhanced of 54% will apply after 2003 on the 20 credits
			US\$ 0.547 US\$ 4.3 m	
IMF		90.9	SDR 5.60 SDR 2.60 SDR 59.90	Interim HIPC Interim HIPC Enhanced HIPC For 2000/01 53.8% (19.2% 1 st HIPC & 34.6% enhanced) was effective September 2000. For others, see details in IMF Table
ADB/F		59.28	89.56	Duration of reduction 13 years effective 1 February 2000 up to 2012
IFAD		10.10		Not yet
EU/EIB		14.14		Not yet
NDF		3.70		Not yet
OPEC		5.10		Not yet
BADEA		4.10		Rescheduled over 19 years effective 15 January 2001
EADB		0.70		EADB was informed about the availability of funds with the World Bank
IDB		0.52		Not yet
PTA Bank		0.48		Not yet
Shelter Afrique		0.07		Not yet
Paris Club		73.13	US\$ 152.1 m	US\$ 120.5 million representing 100% cancellation on pre-cutoff date. US\$ 73.9 million representing 18% cancellation on post cutoff and 100% on Finland, 100% grant from Japan. We are yet to sign the bilateral agreements with all the Paris Club creditors. 1 st Agreed minutes 12 September 2000. The cancellation on post cutoff has been increased to 18% after Sweden agreed to participate as per 14 November 2000, amendment of Paris Club Agreed minutes. UK, Italy and Germany; Reconciliation has been finalized awaiting the bilateral agreements Austria, Spain and France have already signed the bilateral agreements Sweden draft agreement in place Israel, Norway and USA have not communicated yet

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