Do the HIPC debt initiatives really achieve the debt sustainability objective? Uganda's experience

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ABSTRACT

Since the mid-1980s Uganda has had debt strategies that clearly laid down procedures for negotiating new loans and emphasized commitment to reduce the stock of debt. Over this period, the country went through six Paris Club negotiations, a number of other debt reduction operations and two Heavily Indebted Poor Countries (HIPC) debt relief initiatives.

Uganda is now categorized as a post HIPC country having entered the HIPC process in 1997 and accessing the second and last Enhanced HIPC debt relief initiative in 2000. Unfortunately, our analysis, using data for end June 2003 concludes that the country cannot yet sustain its debt mainly as a result of a substantial decline in export proceeds and increased disbursements from old and new loans.

This paper examines the country's state of external debt and the experience with the two HIPC initiatives. It highlights the salient facts as depicted by the debt numbers and their implications and raises the issues that require serious attention from all stakeholders.

Keywords: debt relief, debt sustainability, Net Present Value (NPV) of debt, non-OECD creditors, debt ratios, PEAP, PRSP and PAF
JEL Classifications: 011, 019, F34, F35

1.0 Background

International events in the 1970s and 1980s - particularly the oil price shocks, high interest rate, recessions in industrial countries and weak commodity prices – contributed heavily to the debt problem that engulfed many low income countries. During the 1970s, governments in poor countries borrowed heavily, based on the predominant development thinking that low income countries should invest in industry, particularly import-substitution industrialization and infrastructure. The prevailing view was that governments should play a leading role in this industrialization and as a consequence, the money was borrowed chiefly by states (and state-owned enterprises). But as commodity prices lumped in the early 1980s and oil prices rose, countries compensated for the fact that their imports were outstripping their exports with increased borrowing.

Domestic factors also played a significant role in the debt run-up. Many countries, both in the middle and low income categories, continue living beyond their means, with high trade and budget deficits and low savings rates. They borrowed more heavily, but often, this new borrowing was not translated into productive investments that would generate returns to service this debt. More specifically, poor public sector management, including, at times, poor project selection by donors, meant the loan funds which designed to increase productivity and generate exports failed to produce the expected yields and brought no long term benefit in terms of capacity to earn foreign exchange. Droughts, floods, civil wars, weak economic policies and poor governance all exacerbated the debt build up. Some loans were taken out simply to service debt.

In Africa debt started to grow during the 1970s and continued in the 1980s. The main source of loans in Africa was official creditors, particularly governments of industrialized nations.

1.1 HIPC Initiatives

The Heavily Indebted Poor Country (HIPC) Initiative was proposed by the World Bank and IMF and agreed by governments around the world in 1996. The initiative was launched in response to concerns that many low-income countries would face unsustainable external public debt burdens even after receiving traditional debt relief. Against this background, the goal of the HIPC Initiative was `to reduce the external public debt burden of all eligible heavily indebted poor countries to sustainable levels in a reasonably short period of time. The initiative was to make it possible for all HIPCs so designated to meet their current and future external debt service obligations in full, without recourse to debt rescheduling or accumulations of arrears, and without compromising growth.

It was the first comprehensive approach to reduce the external debt of the world's poorest, most heavily indebted countries, and represented an important step forward in placing debt relief within an overall framework of poverty reduction. While the initiative yielded significant early progress, multilateral organizations, bilateral creditors, HIPC governments, and civil society have

engaged in an intensive dialogue since the inception of the initiative about the strengths and weaknesses of the programme.

The target of the first initiative (HIPC-1) was to reduce the debt-export ratio to under 200 percent. In the same year, the Paris Club agreed on the Lyon terms within the HIPC framework for 80 percent relief on non-concessional bilateral debt for countries which were eligible for the HIPC initiative.

This initiative introduced two new elements compared to previous debt relief initiatives.

- First, it focused on the extent of debt relief that would be consistent with debt sustainability.
- Second, it included debt relief on debt owed to multilateral institutions.

The technical design of HIPC-1 was conceived along the lines of the traditional conditionality of the international financial institutions (IFIs). Indebted countries would reach the decision point if they stayed on track with an IMF programme over a period of at least 6 years and would receive permanent reduction in their official debt stock only after another three years of pursuing satisfactory policy. After nearly 3 years of implementation, only 6 countries had reached the decision point. These were Bolivia, Burkina Faso, Cote dÍvoire, Guyana, Mozambique and Uganda.

This rate of progress had proved debt relief to be too slow and too little to make a significant difference in the debt situation in the HIPCs. The concerns of the original HIPC framework were centred on the eligibility, where the policy makers were of the view that the criteria gave room for only few poor countries, and proposed for the revision of the framework to allow more poor countries to benefit from the relief. The HIPC framework was revised in 1999 after intensive pressures from non-governmental organizations (NGOs) and civil society at large, academics and debtor governments highlighting the inadequacies of the HIPC-1. These include the limited country coverage of the original initiative and the fact that it provided too little debt relief and the delivery was too slow.

The enhanced debt relief was first agreed at the Paris Club in Cologne in 1999 and was endorsed by the IMF and the World Bank at their annual meetings in September 1999. The Cologne terms within the HIPC framework suggested that the non-ODA credits were to be cancelled up to 80 percent or more if necessary in the context of the HIPC initiative. In addition, ODA credits were to be rescheduled at favourable interest rates, at least as favourable as the original concessional interest rates applying to these loans.

In 1999 the enhanced HIPC initiative (HIPC-2) was introduced with the aim of reducing debt stock of the HIPCs in terms of the debt-export ratio to under 150 percent. Out of the 42 countries in HIPC-2, 34 are in Africa. The enhancement of HIPC in this phase included four new elements.

- First, it reduced the time to the completion point to less than 3 years. The enhanced framework replaced the fixed three-year period between

decision and completion point with a floating completion point. Under pressure from Jubilee movement and others the process of reaching the decision point was accelerated such that by the end of 2000 some 22 countries had reached the decision point.

- Second, it reduced eligibility standards to allow more countries to access debt relief.

- Third, it provided for greater debt relief between the decision and completion points. At the decision point, annual debt service flows were to be reduced and at the completion point actual debt-stock reductions were to begin. Also, the enhanced initiative gave room for the provision of some interim relief between the decision and completion point. Most participating creditors begin providing debt relief immediately or soon after the decision point.

- Fourth, in an effort to make sure that resources arsing from debt relief are used for purpose of reducing poverty, the relief was tied to progress made in preparing strategies for reducing poverty in their own country contexts. These strategies have come to known as poverty reduction strategy papers (PRSPs). For a country to eligible for the HIPC Initiative it must have a PRSP in place by the decision point and should have made substantial progress its implementation by the completion point (Serieux, 2001).

The first three areas of enhancement, broader and deeper debt relief, and faster debt relief, are structural changes in the initiative. They lower the requirements necessary to qualify for the Enhanced HIPC Initiative and decrease the level of debt considered to be sustainable, thereby increasing the amount of debt relief.

The last area of enhancement is a conceptual shift in the framework. Under the original framework the poverty reduction aspect of the HIPC Initiative was only manifest in the conditionality of macroeconomic and structural\ policy reforms. The enhanced HIPC Initiative requires beneficiary governments to allocate specific amounts of money on poverty reduction projects. By doing this, the enhanced HIPC Initiative is directly imposing the requirement of good economic governance on the debtor through PRSP programme, forging a direct link between debt relief and poverty reduction (Numelley et al., 2003)

2.0 Objectives and justification of the study

Since the mid-1980s Uganda has had debt strategies that clearly laid down procedures for negotiating new loans and emphasized commitment to reduce the stock of debt. Over this period, the country went through six Paris Club negotiations, a number of other debt reduction operations and two Heavily Indebted Poor Countries (HIPC) debt relief initiatives.

Uganda is now categorized as a post HIPC country having entered the HIPC process in 1997 and accessing the second and last Enhanced HIPC debt relief initiative in 2000.

The main objective of the study is to analyse the debt sustainability of the country after exiting from the enhanced HIPC.

Specifically, the study

- examines the country's state of external debt and the experience with the two HIPC initiatives,
- highlights the salient facts as depicted by the debt numbers and their implications;
- assesses the debt sustainability after exiting the Enhanced HIPC; and
- finally, makes recommendations for future debt management.

2.1 Why is debt a problem?

Ordinarily, governments just like individual persons, borrow to finance envisaged gaps in their expenditure programs. The funding gap may be in the budget (either recurrent or development expenditure) or in the Balance of Payments (BoP) – the clearing account for the country's external obligations with the rest of the world. There is, therefore, no doubt that borrowing is essential and plays a crucial role in stabilizing economic and social aggregates.

In Uganda's case, borrowing during the last two decades has been applied to the following broad areas:

- Economic Recovery immediately after the fall of Amin's regime
- Infrastructure rehabilitation and development particularly roads
- Industrial rehabilitation
- Macro economic stabilization programs
- Poverty Eradication expenditures focusing on education, health, water and sanitation, agricultural extension and research and rural feeder roads.

Debt can, however, become a problem irrespective of its good intentions. Several reasons have been advanced against over borrowing.

2.2 The service burden

The servicing of debt (interest payment) absorbs budgetary and foreign exchange resources (direct cost of debt). The repayment of the principal loan amount (amortization) though not a direct cost, also absorbs budgetary and foreign exchange resources from the current resource envelop.

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**%** of total government spending between 1996 and end June 2003. Total debt service, on the other hand, reached a peak at 24% in 1996, slightly decreased to around 20% during following three years and significantly dropped to less than 5% since then. This was largely on account of enhanced HIPC debt relief as will be detailed later.

Details of the share in total expenditure by selected sectors are presented in Table 2 below.

Table 2: Budget out-turn as a percentage of total expenditure

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total Social Sector	34.3	34.2	37.4	36.0	39.8	34.5	35.2	37.1	35.0
Education	19.5	18.4	21.8	24.1	26.4	21.0	20.7	21.5	21.9
Health	7.9	9.8	7.4	6.1	6.3	11.4	12.2	12.5	12.0
Agriculture	2.6	1.5	1.4	1.1	1.0	0.7	0.8	1.5	1.1
Roads	4.3	4.3	6.8	4.6	6.1	1.4	1.5	1.6	0
Total Debt Service	22.0	24.6	21.0	21.7	21.2	11.1	4.7	3.6	4.6

Source: Background to the Budget 99/00 & 00/01 Ministry of Finance, Planning and Economic Development, Kampala

Debt servicing reduces resources available for investment and government recurrent expenditures. Table 2 on budget out turn compares utilization of budget resources for the fiscal years 1994/95 – 2002/03. For most of the years indicated, the amount committed to debt service was higher than that committed to each of the social services sectors indicated above except for the education sector and after fiscal year 2000 the health sector as well. During the last two years debt service has taken more resources than education as well.

2.3 Debt Overhang

A country or borrower is reported to experience a debt overhang when the external debt is perceived to exceed its long-term capacity to pay back[1]. It is argued "if a country is expected to service and repay its debt from its own resources, excessive debt creates disincentives associated with (present and anticipated) distortionary taxes"[2]. A high degree of uncertainty about the country's capacity to service its debt is perceived by investors as a form of "tax" on future incomes of the country. The argument is compounded by the fact that Uganda is a HIPC country.

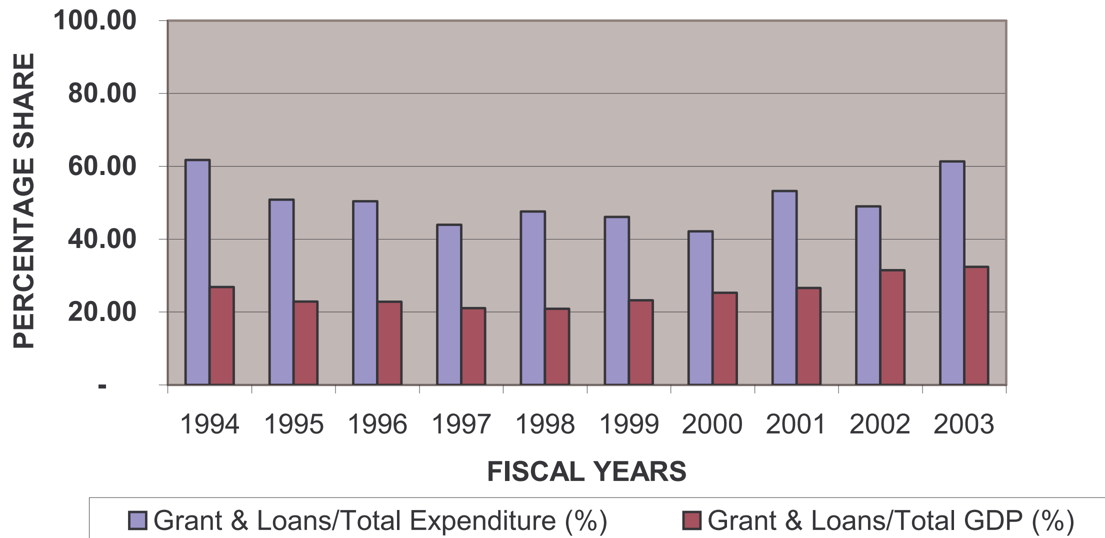
2.4 Aid Dependence

Continued dependence on new inflows to cover debt service and constant rescheduling can increase uncertainty about governments spending on new and on-going projects. For the last decade, Uganda has been depending on external assistance to cover over forty percent of the national budget (see Chart 1 below). Although it is internationally accepted that a dependence ratio of external assistance to GDP of 25 percent and below is sustainable, there is cause to worry for Uganda since the year 2000 this ratio has steadily increased to over 30

[1] Jan Joost Teunissen and Age Akkerman, HIPC Debt Relief Myths and Reality, FONDAD, 2004.
[2] IMF and IDA, Debt Sustainability in Low-Income Countries-Proposal for an Operational Framework and Policy Implications, February 3, 2004.

percent by end June 2003.

CHART 1. AID DEPENDENCE RATIOS 1994 - 2003



Source : Bank of Uganda

2.5 Macroeconomic Instability

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.

3.0 Status of the external Stock of debt

3.1 Current Stock

Uganda's stock of external debt disbursed and outstanding as at the end of June 2003 was US$ 4.22 billion. This is an increase of 10.33 percent in total debt stock from the previous financial year as shown in Table 3.1.

Multilateral debt accounts for the largest proportion of the change in stock at 12.14 percent. This rise in debt stock is attributed to disbursements from new and old loans received during the fiscal year ending June 2003. Total disbursements over the financial year 2002/03 amounted to US$308 million. In addition, over the same financial year, the SDR, which is the base currency for 80% of Uganda debt stock, appreciated by 6.2 percent. The changes in the SDR exchange rates partly explain the increase in multilateral debt stock, given that over 80% of multilateral debt is denominated in SDR.

Bilateral debt stock accounted for 0.7% of the rise in stock over the period despite the numerous debt cancellations arising out of HIPC relief agreements concluded with creditors by the end of the financial year. The increase in bilateral debt stock is mainly on account of bilateral non-Paris Club debt. Uganda continues to default on payments due to these creditors until they offer HIPC relief. As a result of the non-payment, penalty interest accumulated over the period also increased the debt stock.

Table 3.1: Uganda's Debt Stock as at end of Financial Years 2001/2002 and 2002/2003 ***(US$ millions)*****:**

Category	2001/2002		2002/2003		Change in stock	
	US$	%	US$	%	US$	%
Multilateral debt	3,318.06	86.74	3,720.94	88.17	402.88	12.14
Bilateral debt	488.61	12.77	491.92	11.66	3.31	0.86
Others	18.53	0.48	7.37	0.17	-11.16	-60.23
Total	**3,825.19**	**100**	**4,220.23**	**100.0**	**395.04**	**10.33**

Source: TEDD-Bank of Uganda (BOU)

Debt by Creditor Category:

Disaggregation by creditor category (see Tables 3.1 and 3.2) shows that 88.17 percent of Uganda's debt stock is owed to multilateral creditors with the major creditors being IDA, ADF, ADB and IMF. Increased borrowing from these creditors is due to Government policy of borrowing on highly concessional terms.

Bilateral creditors account for 11.7 percent of total debt stock. Of the total bilateral debt, 75 percent is owed to bilateral non-Paris club creditor including Libya, India, Iraq and South Korea. The proportion of bilateral debt owed to Paris Club creditors has continued to decline as a result of their active support and participation in several debt relief initiatives. Uganda has negotiated HIPC relief

from all its Paris Club creditors with a number of them offering debt relief beyond the HIPC terms.

On the other hand, debt owed to non-Paris Club creditors, continues to grow. Government has stopped servicing this debt until the creditors have concluded debt relief agreements as is expected of them.

The proportion of debt stock owed to commercial creditors and other private financial institutions stands negligible at only 0.2 percent of total debt stock and much of this debt is in arrears. As is the case with non-Paris club creditors, Uganda is not servicing debts owed to these creditors. As a result however, some of them have sued government and Bank of Uganda in courts of law for non-payments. The results of the court proceedings have varied from case dismissals to excessively high awards to some creditors.

Table 3.2: Uganda Debt Stock at 30th June 2003 by Creditor Category ***(US$ millions)***

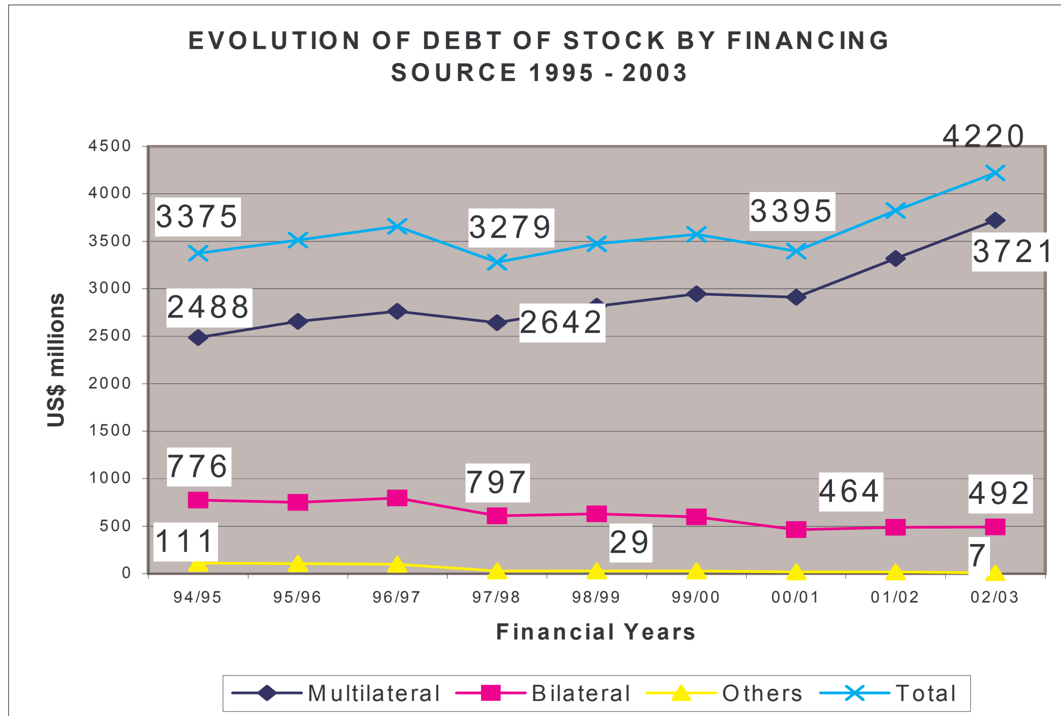
Creditor Category	Millions of US$	Percentage Share in total Debt (%)
Nominal debt stock	4,220.23	100.00
Multilateral debt	3,720.94	88.17
o/w IDA	2,878.01	77.35
o/w ADF/ADB	423.16	11.37
o/w IMF	242.32	6.51
o/w Other multilateral creditors	177.45	4.77
Bilateral Debt	491.92	11.66
o/w Paris Club	124.07	25.22
o/w Non-Paris Club	367.85	74.78
Other Private Banks	7.37	o.20

Source: TEDD-BOU

3.2 Evolution of Uganda's debt

3.2.1 External Debt Trends

Fig. 3.2: Evolution of Uganda's Debt Stock by Financing Source 1995-2003:



Uganda's stock of external debt has grown by about 25% from US$3,374.80 million in 1994/95 to US$ 4,220 million as at end June 2003. The proportion of debt owed to multilateral creditors has increased by 14% from 74% in 1994/95 to 88 percent in 2002/03. Over the same period, the proportion of debt owed to bilateral creditors has declined from 23% to 12% and for the other category of creditors from 3% to near zero. Figure 3.1 above summarizes the changes in Uganda's debt stock over this period.

The principal causes of the increase in debt stock include disbursement from new loans by government and disbursements from the old ones. Between July 1999 and end June 2003, government contracted new loans with a face value of approximately US$1.2 billion. Over the same period, disbursements amounted to US$662 million. It is also worth noting that without any new borrowing from July 2003, the stock of debt was expected to increase by US$1.1 billion on account of additional drawings from loans already signed.

3.2.2 The 1991 Debt Management 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 in Accounts Department in the Bank of Uganda handled both internal and external debt. Poor debt management created a problem of debt service for the country.

As a result of insufficient information and poor co-ordination, it became almost impossible to keep accurate records of the volume and structure of Uganda's external debt and to devise the time profile of the debt projections. 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 date 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:-

- Paris Club debt rescheduling and stock reduction options
- A commercial debt buy-back
- Donor's contribution to service multilateral debt.
- HIPC I & II debt relief initiatives
- Strict limits on new non-concessional borrowing.
- Consistent implementation of economic recovery program targets, and.
- Major efforts to improve the management of debt, fiscal policy and reserves.

The 1991 Debt Management 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 the debt service to export of goods and services ratio to fall from 65% in 1990/91 to approximately 21% in the year 1999/2000.

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

- The Paris Club rescheduling and reduction options reduced the debt stock by only 1% up-front and the service by about US$10 million a year because debt relief could only apply to debts contracted before 1981.

- Attempts to negotiate debt reduction with non-OECD creditors have continued to receive resistance.

- Bilateral debt cancellations removed around 5% of the debt stock but also had negligible impact on service because they only covered mainly concessional debt.

3.2.3 The 1995 Enhanced Debt Strategy.

By 1995 the measures implemented had led to a virtual elimination of commercial debt. However, the share of multilateral debt in the stock of debt rose to around 75%. 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. Moreover, there was no significant reduction in Paris Club Post cut off debt. Debt relief was extended only on pre cut off debt and yet a significant portion of Uganda’s share of Paris Club debt was post cut off i. e. contracted after June 1981.

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

- Clearing the bulk of accumulated arrears. These had, at some stage, caused legal suits against government and resulted in threats to seize assets, embargo on disbursements and inevitably, program and project implementation disruptions.

- Stopping increases in the accumulation of penalty and late interest charges.
- Reducing contractual debt service due to a level consistent with Uganda’s ability to pay.
- Contracting only loans with a grant element of 78% and above.
- Reviewing and rationalizing of the national debt portfolio

Government has consistently implemented this strategy since then. The stock of arrears has almost been eliminated except for the technical arrears on account of the non-Paris Club creditors. Preference for filling the resource gap has been for grants and then highly concessional loans. Debt service is timely and regular curtailing occasions for penalty interest.

3.2.4 Debt Reduction Efforts in Uganda

Uganda has gone through a number of negotiations and agreements related to reducing the burden of debt servicing since the early 1980’s. This is after the creditors appreciated the constraints the country was experiencing in a bid to try and retire debt falling due together with arrears and at the same time attain some progress on its development goals. The debt reduction operations have varied

depending on creditor category and the nature of debt involved. Some of the Major operations are summarized below.

- **The Paris Club**

Debt relief negotiations with the Paris Club originally covered debt service falling due between 12 and 18 months. This was later expanded to Multi-year rescheduling agreement (MYRA's) and debt stock reduction. Uganda's experience with the Paris Club over the years with the results of the negotiations has been summarized in Appendix 1.

- **Debt Buy back and Restructuring of unsecured Commercial Debt**

In February 1993, Uganda implemented a debt buy-back plan in which commercial creditors were offered a cash payment of 12 cents for each US dollar in arrears. Commercial debt amounting to US$153 million was bought back. The operation represented 6% of the total debt outstanding and disbursed and one third of the total arrears or three quarters of the commercial debt at the time (end December 1992). The impact of this was a debt forgiveness of US$133 million. IDA supported the operation with a US$13.4 million grant: US$10 million directly from the facility and US$3.4 from the governments of Switzerland, the Netherlands, Germany and the European Community also contributed aid. Another debt buy-back operation was concluded for the debt arrears due to Tanzania where debt was bought back at US cents 15 for each US dollar. Recent successful negotiations were concluded with Fourways during 2000, where Government paid US$1.24 million compared to the original US$10.32million.

Uganda became the fourth country to benefit from this facility after Niger, Mozambique and Guyana and the operation was facilitated with an IDA Grant.

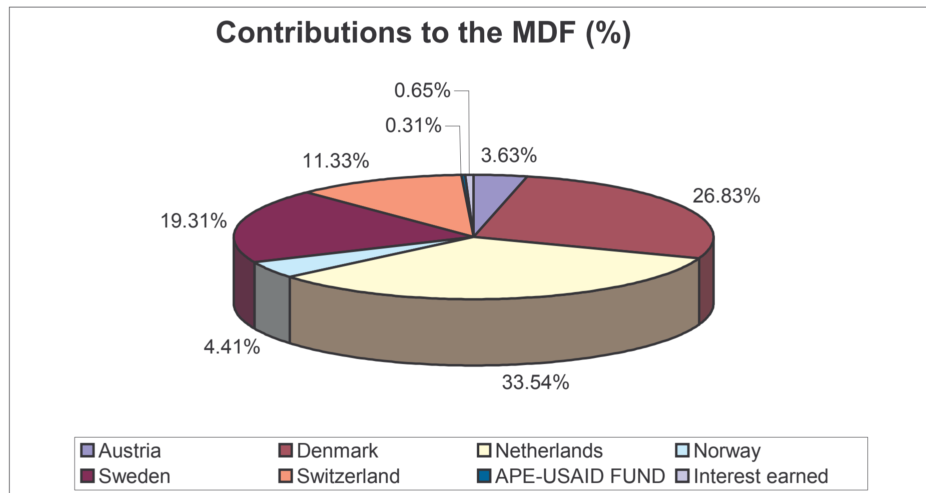
- **Debt Conversion**

The other operation was the debt to equity conversion – a process by which creditors were requested to consider converting part or all of their debt into equity in local enterprises. A total debt of US$13.1 million largely in arrears to the private sector joint venture partners was resolved under this conversion exercise. The operations under this head were facilitated with an IDA debt restructuring facility of US$10 million and OECD member grants of about US$8 million.

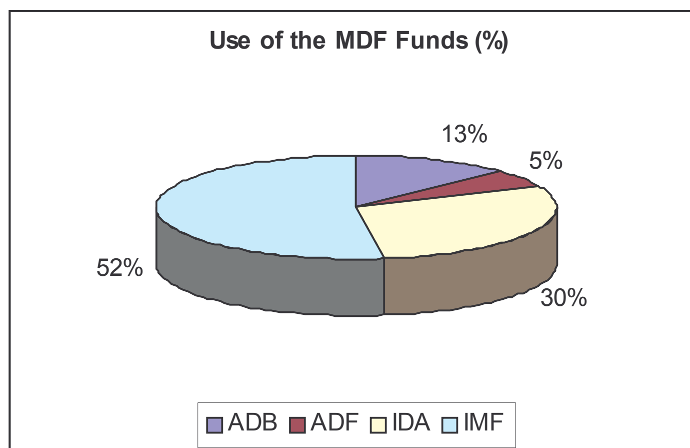
- **Multilateral Debt Fund**

The high share of multilateral debt also represented a big barrier by way of the debt relief options available to the government. 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 and all was applied to service debt owed to multilateral institutions. Contribution and application of MDF funds detailed are presented in Graph 1 and 2 below.

Graph 1



Graph 2



- **The HIPC Debt Relief Initiative**

The HIPC relief initiative, launched in September 1996 marked 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 can be serviced without recourse to further rescheduling. Though the debt burden was just one of the challenges faced by 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.

Sustainable levels at the completion point would be defined on case by case basis within the range of 200-250% for the NPV of debt to export ratio and 20-25% for the debt service to exports ratio. A country's target would however be

determined taking into consideration its vulnerability factors such as variability of exports, and with particular attention to fiscal indicators of the burden of the debt service.

- **HIPC I**

Uganda formally entered the HIPC debt relief process in April 1997, and attained completion point in April 1998. At this point, the country achieved debt relief equivalent to US$ 347 million in NPV (net present value) terms (or US$ 650 million of relief on debt service over the next 30 years), a reduction of approximately 20% of the net present value of the total debt stock.

- **Enhanced HIPC (HIPC II)**

After one year of implementing the 1st HIPC relief agreements, a study was conducted on the country's debt sustainability. As a result, the findings pointed to the fact that discount rates had considerably decreased for most currencies[3], 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% at end June 1999 compared with the projected 207%. The share of multilateral debt for the same period had also increased to 81%. In line with the revised sustainability indicators, the World Bank and IMF estimated additional relief necessary to bring Uganda's ratio of NPV of debt to export to 150% to be about US$714 million.

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 of the delivery profile by creditor under HIPC 1 and Enhanced HIPC are presented in Annex 2

4.0 External debt issues

4.1 Debt data coverage

Under the HIPC Initiatives, the Bretton Woods institutions have specified that, for the calculation of debt sustainability ratios, the debt coverage is limited in all cases to public and publicly guaranteed external debt (IMF and World Bank, 1996). These include all medium- and long term borrowings of the central government , the central bank and parastatals from multilateral institutions (including the IMF), bilateral governments (Paris Club and non-OEDC and commercial credits from banks, exporters and suppliers whether or not the government directly guarantees them.

[3] The CIRR for the US$ decreased from 6.7 percent (at end-June 1997) to 6.0 percent (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$ and SDR, other things being constant, increased the NPV of debt for Uganda by US$100.00 million and increased the NPV of debt to export ratio by about 20 percentage points.

However, many have argued that, in order to assess the overall sustainability of a country's total debt burden, other categories of debt should be considered [4]namely:

- Private sector borrowings not guaranteed by government. This debt is particularly important to countries where foreign loans are financing large private sector projects, such as in the mining sector, which are expected to contribute significantly to export earnings.
- Short-term external debt (whether owed by government or by private sector). In many countries, this is significant (and often it is public or publicly guaranteed). Central bank lines of credits, which are often not reported to the World Bank, are also often important.
- Domestic debt of the government. In order to evaluate the debt burden on the government budget, domestic debt needs to be taken into account. Since domestic and external debt are alternative ways of financing the government deficit, calculation of the fiscal effects of relief on external debt needs to take into account whether the gains will be diverted to servicing domestic debt. Equally, a switch in government borrowing from external to domestic debt can present a falsely optimistic picture of the fiscal burden if only external debt is examined. In addition, with the liberalization of foreign exchange flows in many HIPCs, the boundaries between external and domestic debt is becoming increasingly blurred, especially when countries issue domestic debt denominated in convertible currencies such as US$ or Euros.

To date, the IMF and World Bank have made it clear that additional types of debt (private sector, domestic) are not to be included in the debt sustainability ratios that are crucial for calculating the amounts of relief needed under the initiative.

4.2 Methodology

The key ratios used by the Bretton Woods Institutions to evaluate debt sustainability involve calculating the present vale of debt and relating it to exports or budget revenue. The rationale for using present value, instead of nominal vale is that the present value takes into account the terms and concessionality of the loan portfolio and therefore reflects accurately the cots of servicing the debt in today's money. The idea underlying the present value calculation is that money paid today is more burdensome than money paid in the future because of the opportunity cost and inflation. This means that a debt service payment of say $100 today will in real terms cost less if paid next year.

The general formular for calculating the present value of a payment is

$$PV = S/(1+r) + S^2/(1+r)^2 + \ldots\ldots\ldots\ldots + S^n/(1+r)^n$$

Where PV = Present value of the stream of future payments
S^n =debt service payments in time period n
R =discount rate.

[4] See Government of Bolivia (1996); Government of Uganda (1995); Martin (1996) and UNCTAD/UNDP (1997).

Implementing the HIPC Initiative involves two sets of PV calculations:

- The PV before debt relief and new borrowing, which means that service on all future disbursements must be excluded;
- The PV after debt relief and new borrowing simulations, when service on new disbursements will be included.

For the first of these calculations, PV is calculated accurately only if projected debt service payments on un-disbursed amounts are excluded. In addition, in order to calculate PV correctly, all future service must be included – implying that the projection period must be as long as the longest maturity period on a loan, currently up to 50 years.

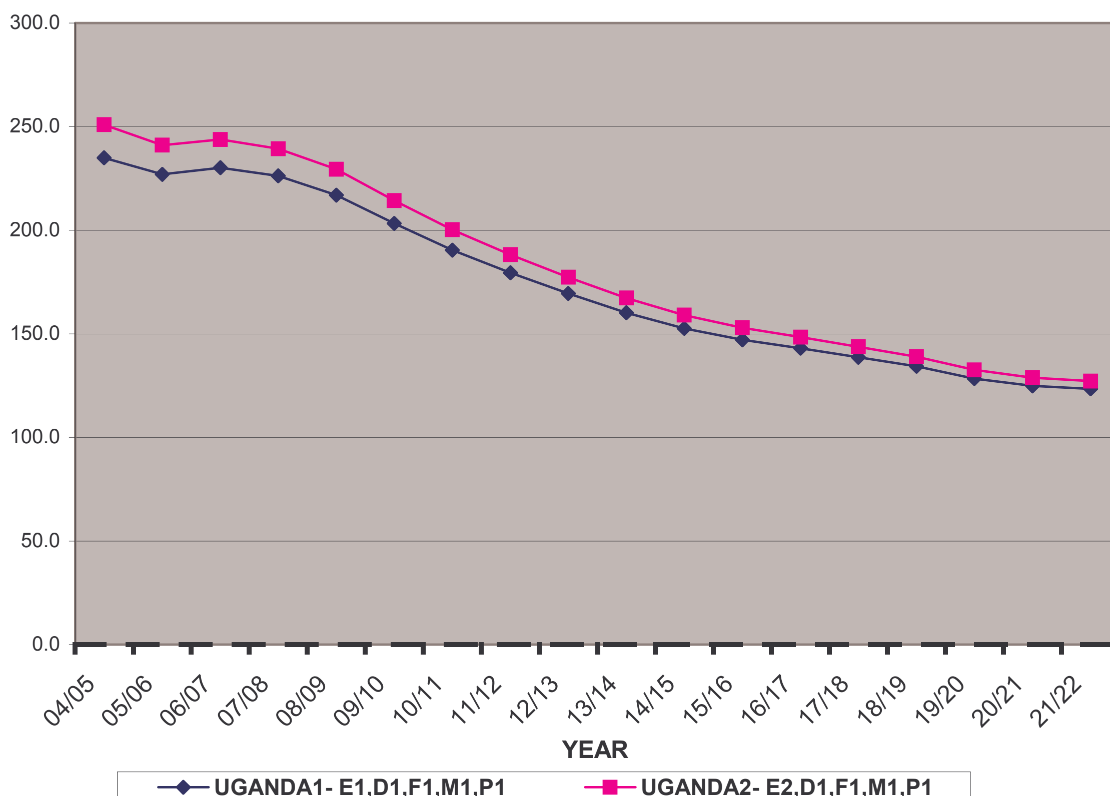
A second set of PV issues revolves around the interest rate to use to discount the stream of projected debt service payments. In principle, the discount rate should represent the alternative cost of borrowing in financial markets (though few HIPCs can actually borrow in the markets).

For HIPC Initiative purposes, the Bretton Woods Institutions use the currency-specific Commercial Interest Reference Rates (CIRRs) agreed by the OECD for officially supported export credits of the OECD countries. For the non-OECD currencies, the US$ CIRR rate is also used for the Chinese Yuan, Iraqi Dinar, and the Russian Rouble. The CIRR rate for the SDR is used for all other currencies, including the African Development Bank and Inter-American Development Bank Units of Account and IBRD pooled loans.

4.3 Debt sustainability analysis (DSA) results

The DSA results are presented below.

The analysis considered about five scenarios but in this paper only two scenarios are discussed. Scenario 1 - Uganda 1 - simulated the results on the assumption that Uganda gets full HIPC debt relief as agreed at the completion point. The second scenario – Uganda 2 (realistic HIPC) - evaluates the same data but on the assumption that not all the debt relief will be realized. This 2 were simulated and are presented in chart 4.1 and table 4.1 below.



Notes :

E1	External Debt maximum HIPC debt relief
E2	External Debt realistic debt relief
D1	Domestic Debt current portfolio structure
P1	Poverty Reduction Strategy PEAP updated projections
M1	Macroeconomic Strategy updated LTEF projections
F1	New External Financing Strategy current projected flows

Table 4.1: External Debt Sustainability Analysis Results - June 30th 2003

Ratios	**Threshold**	**Strategy (June 2003)**	
		Uganda 1	**Uganda 2**
PV/XGS	150%	260.4%	279.5%
TDS/XGS	15-20%	9.2%	9.4%
PV/XGS (10YRS)	2013	169%	177%

The First Criterion: Present Value of Debt to Total Export of Goods and Services (PV/XGS)

From the chart and table above, it can be seen that as of June 2003, the PV/XGS exceeds the threshold for both Uganda 1 and Uganda 2 scenarios. The ratios are 260% and 279% respectively. Thus, using the PV/XGS criterion,

Uganda is not sustainable under both the full HIPC implementation and the realistic scenarios.

Sustainability can only be attained in the years ending June 2006 and 2017 when the ratios will be 147% and 148% under Uganda 1 and Uganda 2 respectively. It is also worth noting that the PV/XGS ratios under Uganda 2 are higher than those under Uganda 1. This is because Uganda 2 is the realistic scenario where it is presumed that Uganda shall pay creditors who have successfully sued Government and will continue to accumulate arrears on the account of non –Paris club creditors who have not yet provided relief, until they offer relief as is expected of them under the HIPC initiative.

The second Criterion: Total Debt Service to Total Export of Goods and Services (TDS/XGS)

The results show that the TDS/XGS ratio is 9.2% for Uganda 1 and 10.63% in Uganda 2. These ratios are below the threshold range of 15-20% implying that Uganda's external debt is sustainable. Uganda 2 yields a higher debt service to exports ratio than Uganda 1 because of the effect on debt flows arising out of servicing debt to those creditors who have sued Government.

This ratio and that of Total Debt Service to Domestic budget revenue (TDS/DBR) were not used for assessing Uganda's sustainability. The two measures are more relevant to economies that are more open (with export values to GDP higher than 30%)

4.2 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. As at end June 1993, Uganda owed US$232.80 million to this category of creditors. As at 3Oth June 2003, this amount had increased to US$367.85 million with US$ 305.98 million (83.2%) representing accumulated arrears. During the year 1992/93 government concluded agreements with some non-Paris Club creditors for rescheduling of maturities totaling US$17.4 million and arrears of US$60 million. Negotiations are continuing with Non-PC creditors although little success is being registered. Unfortunately, the amount to be forgiven increases with the 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 the 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.

Attainment of comparable terms for non-PC creditors has proved a real problem for Uganda. Six years after qualifying for HIPC, negotiations are yet to be concluded with a number of creditors. Table 4.2 below summarizes the status of negotiations between government and each of the creditors involved.

Table 4.2 Status of Relief Negotiations with Non Paris Club and Other Creditors

CREDITOR	STATUS AS AT JUNE 2001
Abu Dhabi	No response
Burundi	Demand full payment
Nigeria	Demand full payment
Libya	Demand full payment
India	Demand full payment
Pakistan	No response
Iraq	Demand full payment
Tanzania	Accepted 15% buyback of verified debt and awaiting verification of outstanding debt
PTA Bank	Demand full payment
EADB	Relief agreement concluded 2004

5.0 Conclusions

The country has gone through Paris Club negotiations and a host of other debt reduction operations since the mid-1980s. The country is now categorised as a post HIPC after accessing the two HIPC initiatives. However, the debt is still unsustainable. The paper has explained what government has tried to do in order to contain the debt position within manageable limits. It has also highlighted reasons why the debt has remained unsustainable.

In fact, the HIPC Initiative is a debt reduction programme. No amount of debt forgiveness can guarantee future financial solvency. Long-term debt sustainability depends on solid growth based on sound government policies, including prudent external borrowing and debt management.

The following conclusions however deserve to be noted:-

5.1 Paris Club

The HIPC initiative has resulted in a 62.34% drop in the stock of debt owed to the Paris Club creditors from US$324 million in June 1998 to US$124 million by end June 2003 accounting for only 3% of the total stock of debt. Most Paris Club creditors have gone beyond HIPC terms and offered the country 100% debt cancellation. These include United Kingdom, Finland, Japan, Italy and France. Their current strategy is to provide assistance in form of grants.

5.2 Multilateral Creditors

These are the largest creditors, they should therefore be urged to reconsider extending additional assistance in whatever form possible to assist in concluding relief agreements with the non-OECD.

5.3 Bilateral Paris Club Creditors

Uganda is trying to finalise 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.

5.4 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 them to consider extending relief while seeking support from the rest of the international community.

Generally, debt relief itself does not necessarily bring about long-term debt sustainability. While donors and creditors can play an important role, the responsibility of achieving long-term debt sustainability ultimately lies with the country. What are required are the sound policy and institutional frameworks, adequate debt management capacity, and a diversified export base.

Maintaining external debt sustainability is also affected by the ability of a country to mobilize domestic revenues. Specifically, weak fiscal revenue mobilization can unduly constrain the ability of a country to meet expenditure priorities and cope with shocks and leave the country excessively dependent on external aid flows and borrowing, which can be volatile and expensive.

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Appendix 1

Debt Reduction Efforts - Bilateral Debt *(US$ millions)*

	PC1 (1981)	***PC2 (1982)***	***PC3 (1987)***	***Toronto Terms (1989)***	***Enhanced Toronto (1992)***	***Naples Terms (1995)***	***Lyon Terms (1998)***	***Cologne Terms (2000)***
Pre Cut-off Debt								
France	R	R	R	9.91	7.91	11.84	43.44	6.30[C]
Germany	R	R	R	D	1.06	D	D	0.90[C]
Italy	R	R	R	R	R	R		99.20[C]
U.K.	R	R	R	R	R	17.48	13.60	9.00[C]
USA	R	R	R	R	R	D	.79	0.20[C]
Israel	R	R	R	R	R	NE	7.20	4.80[C]
Sub Total Pre-Cut off Debt								**120.40[C]**
Post Cut off Debt								
France	**NE**	NE	NE	NE	NE	NE	NE	2.30[*] 8.07[**]
Italy	**NE**	NE	NE	NE	NE	NE	NE	15.89[***]
Norway	**NE**	NE	NE	NE	NE	NE	NE	5.08[C]
Sweden	**NE**	NE	NE	NE	NE	NE	NE	0.80[C]
Spain	**NE**	NE	NE	NE	NE	NE	NE	6.90[C]
Austria	**NE**	NE	NE	NE	NE	NE	NE	0.06[C]
Finland	**NE**	NE	NE	NE	NE	NE	NE	5.00[C]
Japan	**NE**	NE	NE	NE	NE	NE	NE	51.60[**]
Sub Total Post Cut off 95.70[C]								
Non Paris Club								
China	**NE**	NE	NE	NE	NE	NE	NE	**16.00[C]**
Saudi Fund	**NE**	NE	NE	NE	NE	NE	NE	5.63[R]
Kuwait Fund	**NE**	NE	NE	NE	NE	NE	NE	**25.62[R]**
Sub Total 23.96								
Grand Total				**9.91**	**8.97**	**29.32**	**65.32**	**239.10**

Source: TEDD-BOU

Footnotes:

R: Rescheduling D: Deminimus NE: Not Eligible C: Cancelled

* Amount obtained from Cologne terms of 18% reduction of debt, prior to additional 100% cancellation.

** Amount obtained from additional relief leading to 100% cancellation of debt. Uganda continues to service maturities as they fall due but the creditor is expected to refund.

*** Amount obtained from additional relief leading to 100% cancellation of debt.

Appendix 2

1ST HIPC PROJECTED RELIEF AND ACTUAL DELIVERIES

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

CREDITOR	DEBT RELIEF DELIVERY MECHANISM	EXPECTED NPV (US$M)	ACTUAL NPV (US$M)	NOMINAL VALUE (US$M)	REMARKS
IDA	Total commitment	152.00			HIPC saving of US$18M per annum for 1st five years. Followed by $ 8 million per annum until 2038 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. 1998/1999 –26.5%, 1999/2000 – 20.9%, 2000/2001 – 19.2% 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	-	-	1ST HIPC signed relief through rescheduling.
OPEC		1.54	-	-	Still negotiating 1ST 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			
GERMAN	No Relief	-	-	-	Paid
FRANCE				7.20	Stock of Debt Reduction
USA				0.75	Stock of Debt Reduction
UK				13.00	Stock of Debt Reduction
ISRAEL				7.20	Stock of Debt Reduction
ITALY	Rescheduled				RESCHEDULED
NON-OECD (NON – PARIS)		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

CREDITOR	DEBT RELIEF DELIVERY MECHANISM	EXPECTED NPV (US$M)	ACTUAL NPV (US$M)	NOMINAL VALUE (US$M)	REMARKS
COMMERCIA L CREDITORS		10.20			Only Four ways has yet accepted a buyback at 12% on US$ 9.9M and $ 0.27M and was paid.
FOURWAYS	Accepted 12% buyback	1.19	0.32	9.90	Accepted buyback of US$9.9M and $ 0.27M
F.H INTERNATION AL					Still negotiating buyback of 12%
TRANSROAD					Sued Government, won the case and have been paid.
BANK ARABE ESPANOL					Sued Government, won the case and have been paid.
FAP-FAMOS & 14OCTOBAR (Yugoslavia)					Sued Government, won the case and have been paid.
TOTAL		**US$347M**			

ENHANCED HIPC DELIVERIES

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

CREDITOR	EXPECTED NPV US $	NORMINAL VALUE	REMARKS
IDA	356.6m	$629m	Delivery through debt service of eligible debt on stock DOD by June 99. (including the 20 credits from 2003).
IMF	90.9m	SDR 5.60m SDR 2.60m SDR59.90m	Interim HIPC Interim HIPC Enhanced HIPC For 2000/2001 53.8% (19.2% 1st HIPC & 34.6% Enhanced) was effective Sept.2000 others see details in IMF Table
ADB/F	59.28m	89.56m	Debt service reduction commenced January 2002 duration of reduction for 13 years.
IFAD	10.10m		Agreed to provide debt service reduction of US $ 12 m
EU/EIB	14.14m		Cancelled one loan fully and partially cancelling 2nd loan.
NDF	3.70m		Debt service reduction on eligible debt
OPEC	5.10m		No agreement reached yet on both HIPC 1 & II. Not servicing maturities.
BADEA	4.10m		Rescheduled over 19 years effective 15/1/2001
EADB	0.70m		EADB willing in principle but still awaiting HIPC TRUST FUND for assistance.
IDB	0.52m		Delivery through rescheduling over 19years.
PTA Bank	0.48m		Shown no commitment to participate as yet.
Shelter Afrique	0.07m		Have been paid.
Paris Club	73.13m	US$152.1m	a) US$120.5m representing 100% cancellation on precut off date. b) US$73.9m representing 18% cancellation on post cut off and 100% on Finland, 100% grant from Japan. c) Agreed minute 12th September 2000. The cancellation on post cut-off was increased to 18% after Sweden agreed to participate as per 14th November 2000, amendment of Paris Club Agreed minute. d) We have signed all Paris club- Bilateral Agreements with all our Paris Club Creditors.
			Pre-cut-off (France, Germany Israel, Italy, UK, USA) Post-cut-off (Austria, Finland France Italy, Japan, Norway Spain &Sweden)
Non Paris Club UAE Burundi China India Iraq Kuwait Fund Libya Nigeria North Korea	29.04m 0.319m 0.127m 2.771m 5.236m 0.007m 6.640m 8.179m 0.900m 0.310m		Apart from China the rest not Yet. We are not servicing the debt No correspondence. Have filed a suit in our courts but IMF is assisting to see that Burundi extends its relief. Written off part of the loan and expected to reschedule the remaining part. Indian authorities have offered relief on the government portion of debt. Negotiations for the balance is on-going with ECGD. Filed a case against the Attorney General and worn the case. Uganda government has appealed. Have signed an agreement offering an NPV relief of 37.5% of all debt. Recently communicated their willingness to offer Uganda, debt relief. No agreement in place

Pakistan Saudi Fund South Korea Tanzania	0.268m 1.527m 0.559m 3.202m		Has been fully paid In principle willing to participate but no agreement so far. Have signed an agreement offering an NPV relief of 37.5% of all its debt. South Korea has expressed a willingness to participate and IMF is already offering a hand in the negotiations. The outstanding portion of debt requires verification, but there is no immediate hope of solution. However a 15% Buy back offered and implemented on the verified portion still stands.
Commercial Creditors	8.009m		
Italy	0.113m		No correspondence
Panama	0.004m		No correspondence
Spain(Bank Arabe Espanol)	0.518m		Bank of Uganda was sued and lost the case. The creditor was paid US$ 2,651,860.11.
UK(Transroad	4.985m		Uganda government was sued and lost the case. Transroad awarded a total of US$ 20,578,469.36 inclusive of costs. Government has already paid these funds.
Yugoslavia (Oktobar 14 & Sours Fab Famous)	2.389m		Uganda government was sued and lost the case. Oktobar 14 was awarded a total of US$ 8,986,920.4 and Sours Fap Famous US$ 1,488,214.45. Government has already paid part of these funds.
TOTAL	**655.75m**		

Sources: Ugandan authorities; and staff estimates.
Figures are based on end-June 1999 data, using end June 1999 exchange rates and the six–month average Commercial Interest Reference Rate CIRR) at end- June 1999.

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