African Development Fund Series

Balancing Debt and Development

African Development Bank Group activities in support of debt sustainability

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Sustainable Debt and Poverty Reduction: The Nexus

Developing countries and the international aid community have long been aware that the growing debt levels of poor countries impede development and perpetuate poverty. In past decades, the most heavily indebted poor countries have spent more on debt service than on health and education combined[1]. While debt relief initiatives have alleviated debt burdens in recent years, weak macroeconomic fundamentals, the global economic and financial crisis and the growing accessibility of non-concessional financing[2] from the market or from non-traditional donors risk propelling debt levels back into the danger zone unless proactive measures are taken.

Established in 1964, the African Development Bank (ADB) Group is a regional multilateral development bank whose mission is to help reduce poverty, improve living conditions for Africans and mobilize resources for Africa's economic and social development. The ADB Group comprises both the ADB and the African Development Fund (ADF). The ADF's main objective is to give low-income regional member countries (RMCs) access to concessional loans and grants for poverty-reducing projects and programs and to provide them with technical assistance for studies and capacity-building activities.

An important part of the ADF's work consists of assisting African low-income countries to strengthen the sustainability of their debt. Working with a host of international and country-level partners, the ADF has helped RMCs exit from or avoid debt distress, build their debt-management capacity, and access financing for development programs at concessional rather than commercial rates. In 2009, the ADF enhanced this agenda with new policies and procedures. The present publication discusses the state of Africa's debt, explores issues regarding debt sustainability, and details the actions taken by the ADF and its partners to ensure that in future, Africa's debt does not impede but rather enables countries to achieve national development goals.

Debt Relief: Is It Enough?

Toward the middle of the 1990s, social and economic problems associated with developing countries' growing levels of national debt were provoking mounting calls for creditors to forgive all or part of their loans. In 1996, the international aid community responded by launching the Heavily Indebted Poor Country (HIPC) Initiative, a debt relief program designed to reduce the external debt burdens of the most heavily indebted poor countries to sustainable levels. In 2005, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI), under which the IMF, the World Bank, and the ADF provide 100 percent relief on the eligible debts of African countries completing the HIPC Initiative process.

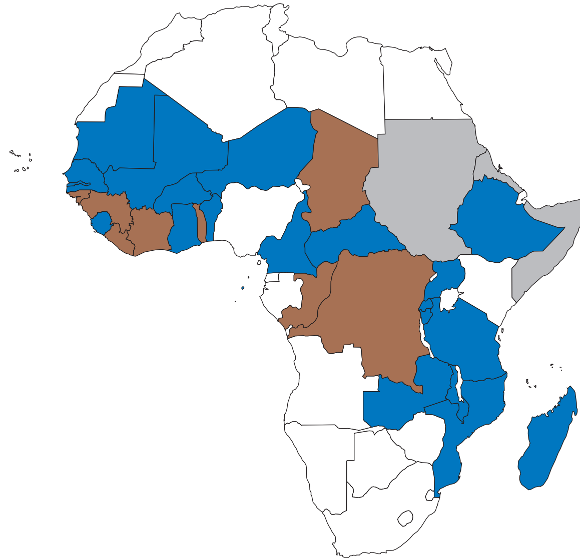
As of mid-2009, 21 low-income African countries had reached the HIPC completion point (table 1). The completion point is the point at which a country has implemented the policy reforms required by IMF and World Bank-supported programs in order to qualify for full debt relief under the HIPC Initiative and the MDRI. Another nine countries had reached the decision point—meaning that they had started undertaking reforms and developed national poverty reduction and development plans—and became eligible for interim relief of up to 40% in most cases.

By end-2008, the total estimated cost of debt relief for all eligible HIPCs (33 of which are in sub-Saharan Africa) was US$ 74.4 billion—more than six times the US$ 12.2 billion estimated in 1997. Of this amount, US$ 5.3 billion corresponded to debt owed to the ADB Group. By end-July 2009, US$ 2.5 billion in relief of ADB Group-held debt had been provided to completion and decision-point HIPCs. In addition, the ADB Group had provided US$ 575.41 million in arrears clearances to be computed as debt relief once the recipients reached the HIPC completion point. Arrears clearances are a pre-requisite for debt relief eligibility.

As a result of the debt relief provided by the ADB Group and other donors, the debt burden of Africa's completion point HIPCs has dropped by

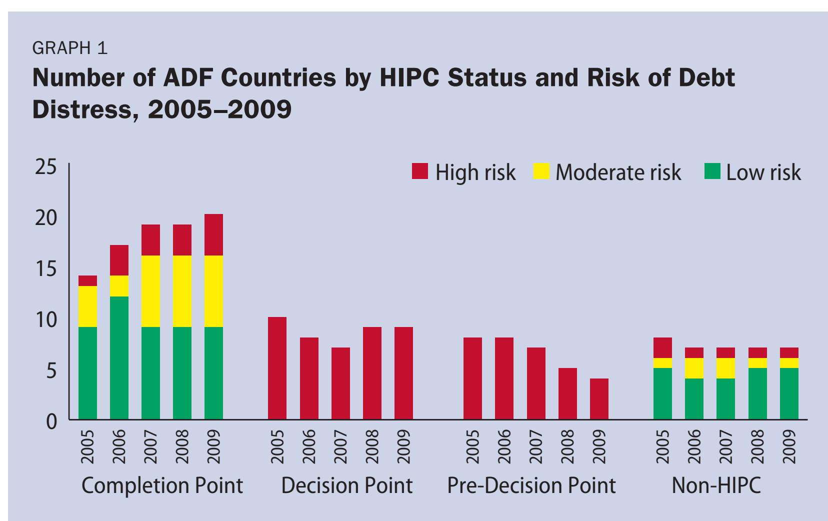
TABLE 1
African Countries' Status under the HIPC Initiative (end-July 2009)

Completion Point		Decision Point (and estimated time of Completion Point)		Pre-Decision Point	
Benin	Mauritania	Chad	2011, Q4	Comoros	2010, Q3
Burkina Faso	Mozambique	Côte d'Ivoire	2011, Q4	Eritrea	
Burundi	Niger	D. Rep. Congo	2010, Q4	Somalia	
Cameroon	Rwanda	Congo Rep.	2010, Q1	Sudan	
Central African Rep.	São Tomé & Príncipe	Guinea	2010, Q4		
Ethiopia	Senegal	Guinea-Bissau	2010, Q4		
Ghana	Sierra Leone	Liberia	2010, Q2		
Gambia	Tanzania	Togo	2010, Q4		
Madagascar	Uganda				
Malawi	Zambia				
Mali					
21		8		4	



80 percent on average compared to decision-point levels. Lower debt burdens have not only translated into lower debt distress risk, they have permitted these HIPCs to increase spending on poverty reduction commensurately.

But 11 of 21 completion point countries in Africa still have a moderate or high risk of debt distress after receiving debt relief, and even though seven new countries reached the completion point between 2005 and 2009, the number of countries ranked with a low risk of debt distress did not rise. The situation is alarming for decision point countries as well: even after receiving interim relief, all new countries in this category remain at high risk of debt distress. Overall, the number of ADF countries[3] in actual debt distress



GRAPH 1
Number of ADF Countries by HIPC Status and Risk of Debt Distress, 2005–2009

or in high or moderate risk of debt distress rose between 2005 and 2009 (graph 1).

These figures confirm that while debt relief initiatives have succeeded at reducing countries' stock of debt and freeing fiscal space for poverty-reducing expenditures, many African low-income countries remain vulnerable to fast-deteriorating debt positions due to their re-accumulation of debt faster than supported by the growth of their gross domestic product and exports or due to their vulnerability to external shocks. The deterioration of the debt distress risk of Ghana, a relatively strong post-completion point performer, in the second half of 2008 illustrates this vulnerability. Ghana's reclassification from low to moderate risk of distress resulted from its rapid accumulation of external and domestic public debt contracted on commercial terms, and high current account and fiscal deficits that expose it to structural vulnerabilities in the event of a reversal of favorable terms of trade.

As for the HIPCs that retained a high risk of debt distress even after reaching the HIPC completion point—Burundi, the Gambia, Rwanda, and São Tomé & Principe—part of the explanation lies in these countries' low export base, the poor or deteriorating quality of their policies and institutions, and the fact that their concentration in a small number of commodities increases their sensitivity to shocks such as droughts and price volatility.

A recent shock that has affected the economic fundamentals of many HIPCs is the global financial and economic crisis. It is still too early to predict the long-term impacts of the sharp declines in exports, falling gross domestic product, reductions in remittances, and decreases in foreign direct investment and trade. It is evident, however, that the crisis could worsen debt ratios and curtail governments' ability to maintain prudent risk levels while implementing counter-cyclical measures. Indeed, recent studies by the ADB and the IMF show that higher borrowing to offset the impacts of the

TABLE 2

IMF Simulation of the Impact of the Crisis on Risk of Debt Distress Classifications

Risk of debt distress			
Low	Moderate	High	In distress
Cameroon	Angola	Burkina	Burundi
Cape verde	Benin	Central African Republic	Comoros
Kenya	Chad	Congo, Rep. of	Democratic Republic of Congo
Madagascar	Ethiopia	Côte d'Ivoire	Guinea
Mali	Ghana	Djibouti	Guinea-Bissau
~~Mozambique~~	~~Lesotho~~	Gambia	Liberia
Nigeria	Malawi	Lesotho	Sudan
~~Senegal~~	Mauritania	Mozambique	Togo
Tanzania	Niger	São Tomé & Príncipe	Zimbabwe
Uganda	Rwanda	Senegal	
Zambia	Sierra Leone		

crisis could pose serious risks, particularly for low-income countries that are already struggling under a high debt burden.[4] For example, IMF debt simulations show that if a 30% reduction in aid and foreign direct investments is replaced by external borrowing to maintain investment expenditures, three ADF countries currently at low or moderate risk of debt distress (including two that have reached the HIPC completion point) could fall back into a high risk of debt distress (table 2).[5]

Even independently of crisis-related borrowing, however, analyses show that for many post-MDRI countries, debt ratios will converge to pre-MDRI levels in the long term unless macroeconomic fundamentals improve.[6] In other words, even after HPIC and MDRI debt relief, beneficiary countries still require substantial concessional resources to keep their debt sustainable. The fact that debt relief alone is insufficient to ensure long-term debt sustainability was emphasized in the Monterrey Consensus of 2002, which called for (i) comprehensive strategies for reducing the vulnerability of debtor countries; (ii) shared debtor/creditor responsibility for preventing and resolving unsustainable debt situations; and (iii) strengthened technical assistance for debt management and debt tracking. The global crisis has made these measures more necessary than ever.

The ADF and the Debt Sustainability Framework

In accordance with the Monterrey Consensus and with a view to helping low-income countries balance debt levels with their need for financing, in 2004 the International Monetary Fund and the World Bank, in consultation with the ADF, designed a comprehensive, internationally prescribed instrument: the Debt Sustainability Framework (DSF). The DSF acts as a complement to the HIPC Initiative and the MDRI and consists of a common donor approach to the challenges of debt distress and the re-accumulation of non-concessional debt by HIPCs. Since its adoption by the ADF in 2005, the DSF has informed the terms of ADF financing, including grant eligibility, and has framed the ADF's broader dialogue with low-income countries and development partners.

The DSF analyzes countries' debt sustainability using debt sustainability analyses (DSAs). DSAs guide low-income countries' borrowing practices so that countries match their financing decisions to their current and prospective repayment abilities. They also inform creditors' lending and grant-allocation decisions to ensure that resources are provided on terms that are consistent with low-income countries' development goals and their long-term debt sustainability. In addition, they inform policy and help to detect potential crises early so that preventive action can be taken.

The DSF was originally built on two pillars. The "static" pillar is based on a 1-year snapshot of debt indicators relative to external debt burden thresholds that took country policies and institutions into account. Under the "dynamic" pillar, the risk of debt distress is assessed in light of forward-looking scenarios. In 2005 and 2006, debt distress risk ratings were primarily based on the static pillar, due to the early stage of the framework's implementation. Since 2007, DSAs have been regularly conducted using the dynamic pillar.[7]

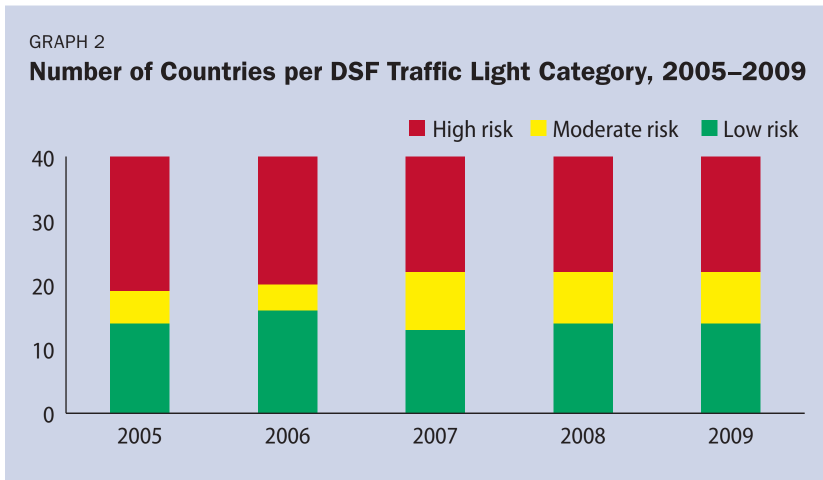
Currently, DSAs consist of three elements: (i) an analysis of a country's projected debt burden over the next 20 years and its vulnerability to external

TABLE 3
Debt Sustainability Analyses, August 31, 2009

Country	Latest DSA publication date	Risk of debt distress	ADF participation in mission	Latest DSA discussion by IMF Board (DSA not yet published)
Angola	25-Oct-07	Moderate		27-Mar-09
Benin	12-Aug-09	Moderate		…
Burkina	30-Jul-08	High		…
Burundi	10-Mar-09	High	Yes	…
Cameroon	12-Aug-08	Low		2-Jul-09
Cape Verde	16-Jan-09	Low		…
Central African Rep.	19-Aug-09	Moderate	Yes	…
Chad	23-Feb-09	Moderate		…
Comoros	2-Nov-09	In distress		…
Congo, Rep. of	21-Jul-09	High		…
Côte d'Ivoire	18-Jun-09	High	Yes	…
Djibouti	21-Jul-09	High		
D. Rep. Congo	24-Sep-07	In distress		…
Eritrea	…	High		21-Apr-08
Ethiopia	23-Sep-09	Moderate		…
Gambia	10-Mar-09	High		
Ghana	14-Aug-09	Moderate		…
Guinea	25-Jan-08	In distress		…
Guinea-Bissau	31-Jul-09	In distress		…
Kenya	18-Jun-09	Low		…
Lesotho	21-Apr-08	Moderate		9-Feb-09
Liberia	8-Jun-09	In distress	Yes	…
Madagascar	16-Jul-08	Low		…
Malawi	4-Jan-08	Moderate		…
Mali	14-Aug-08	Low		…
Mauritania	16-Jul-08	Moderate		…
Mozambique	30-Jul-09	Low		…
Niger	18-Feb-09	Moderate		…
Nigeria	14-Feb-08	Low		…
Rwanda	20-Aug-09	Moderate		…
São Tomé & Príncipe	12-Feb-09	High		
Senegal	9-Jul-09	Low		…
Sierra Leone	25-Jul-08	Moderate		…
Somalia	…	High		…
Sudan	11-Oct-07	In distress		26-Nov-08
Tanzania	5-Jun-09	Low		…
Togo	7-Nov-08	In distress	Yes	…
Uganda	5-Mar-09	Low		
Zambia	30-Jan-08	Low		…
Zimbabwe	5/11/2009	In distress		

Source: IMF.

GRAPH 2
Number of Countries per DSF Traffic Light Category, 2005–2009



and policy shocks, with baseline and shock scenarios; (ii) an assessment of the risk of debt distress during that time, based on indicative debt burden thresholds that depend on the country's policies and the quality of its institutions; and (iii) recommendations for a borrowing (and lending) strategy that limits the risk of debt distress.[8]

As of end-July 2009, 38 of 40 ADF-eligible countries had been assessed at least once with forward-looking DSAs (table 3).[9] DSAs are usually reviewed at least once a year. The ADB has contributed to the rating process since 2006.

Under the ADF's Performance-Based Allocation system, the ADF uses DSAs to classify countries into three "traffic light" categories, where red indicates a high risk of debt distress, yellow indicates a moderate risk, and green indicates a low risk. Countries in the red category qualify for 100 percent grants, countries in the green category qualify for 100 percent loans, and countries in the yellow category qualify for a 50/50 loan/grant combination. ADF loans are highly concessional with a 50 year maturity, a 10 year grace period and a 0.75 percent interest rate (also called service charge). Over the past 5 years, the number of grant-eligible countries (red and yellow countries, i.e., countries in high and medium risk of debt distress) has remained relatively stable, varying between 24 and 27 (graph 2).[10]

Doing More to Keep Debt Sustainable: The ADF's Non-Concessional Borrowing Policy

Although the DSF has helped reduce the debt stock of countries with a medium or high risk of debt distress by encouraging donors to provide more grants and concessional resources, many ADF countries continue to face very difficult budgetary choices. The amount of grants and concessional loans that these countries can access is far below the amount they need for their development. Meanwhile, an increasing number of non-traditional donors are offering large volumes of loans on non-concessional terms, and countries at low risk of debt distress and with a relatively good credit standing are tempted to go the market.

In response to this challenge, the ADF adopted its Policy on Non-Concessional Debt Accumulation in May 2008. Known as the Non-Concessional Borrowing Policy, or NCBP, this policy is designed to enhance creditor coordination around the DSF and discourage non-concessional borrowing by means of disincentives for recipient countries, including reductions in financing volumes and harder borrowing terms.

The ADF's adoption of the NCBP is rooted in the fact that the provision of grants and debt relief to eligible countries is intended to help bring their debt to sustainable levels and create fiscal space for priority development expenditures. Beneficiaries' accumulation of new debt on non-concessional terms, whether from public or private sources, can undermine these objectives and introduce free-riding, a situation in which the grants and debt relief provided by one or more parties cross-subsidize new borrowing from third-party lenders on non-concessional terms. This risk is particularly high in resource-rich countries where non-concessional borrowing can be secured by future export receipts.

To reduce the risk of free-riding, it is essential that donors adopt a collective approach to debt re-accumulation. The NCBP is therefore closely harmonized in both design and implementation to the IDA's approach[11] and the IMF's policy on concessionality.[12] It is also committed to methods that are

effective and possible to implement, and to a flexible, case-by-case approach. The NCBP is based on the following methods:

i. Strengthening partnerships and coordination with sister multilateral development banks and bilateral agencies to adopt a common strategy in dealing with the problem, including advocacy;
ii. Reinforcing reporting and monitoring through the creation of a non-concessional borrowing monitoring committee and the insertion of a clause in all ADB Group grant/loan agreements that requires borrowers to report all planned and new non-concessional borrowing;
iii. Enhancing cooperation with regards to capacity building in collaboration with other partners; and
iv. Applying disincentives.

With respect to this last point, the ADF has established a flexible set of volume reductions and hardened terms that allow it to make case-by-case decisions about RMCs that breach the NCBP. Hardened terms consist of shorter maturity and grace periods and/or higher interest rates that reduce the grant element or the concessionality of ADF loans.[13] The hardest terms are applied to resource-rich RMCs that consistently borrow on non-concessional terms. For emerging market low-income, low-risk RMCs in which capital

BOX 1

NCBP Disincentive Measures in Ghana

Ghana's non-concessional borrowing in 2007 consisted of (i) a US$ 750 million Eurobond issued on capital markets at a fixed coupon of 8.5 percent and a 10-year repayment of the principal; (ii) a US$ 292 million loan agreement with the Export-Import Bank of China for the Bui hydroelectric power plant subject to 6.1 percent interest, a 17-year repayment period, and a 5-year grace period; and (iii) a US$ 23.5 million loan from the Netherlands BMH Bank for the Barekese Water Supply Project.

The ADF assessed Ghana's non-concessional borrowing in light of sector and country-specific circumstances. Approved in 2005, Ghana's Growth and Poverty Reduction Strategy had noted the insufficiency of domestic and concessional sources to finance the country's development plan, particularly as regarded energy and transport. To facilitate these investments, Ghana undertook policy and institutional reforms such as electricity tariff readjustments, public enterprise modernization and the creation of a Project Finance Analysis Unit to monitor and evaluate new investment projects. Part of the Eurobond proceeds and financing arrangements with the Export-Import Bank of China were planned for energy investments to keep up with the growth in demand and mitigate the country's vulnerability to drought-induced power supply disruptions.

A joint IMF-World Bank DSA conducted in April 2007 had incorporated some non-concessional borrowing into the baseline scenario, but not to the magnitude and extent eventually contracted. A more recent IMF-World Bank DSA undertaken in June 2008 classified Ghana at a moderate risk of debt distress, which status represented a slight deterioration compared to the previous rating. This deterioration was due to the rapid accumulation of external public debt contracted on commercial terms and high current account and fiscal deficits.

In view of Ghana's increased access to capital market financing, and given Ghana's Country Policy and Institutional Assessment (CPIA) rating and green light status, ADF Management decided to apply moderate ADF terms to Ghana. These translated into a reduction of the maturity period of ADF loans from 50 to 40 years.[14] All other terms remain unchanged.

markets have shown interest in financing projects, the ADF accommodates some non-concessional borrowing in recognition that these loans will help countries reach the Millennium Development Goals. Finally, for HIPCs in the interim period, the ADF's grant agreements include a clause to the effect that the borrower will not receive extended interim debt relief if it contracts non-concessional debt during the interim period. An internal cross-departmental NCBP committee reviews issues as they arise.

The ADF has only applied disincentive measures once since the NCBP was adopted. This took place in Ghana (box 1).[15] Three other ADF countries—Kenya, Tanzania and Zambia—were reportedly considering raising capital through the Eurobond market in 2008, but for economic reasons, these projects were not completed. The extension of a large non-concessional loan to the Democratic Republic of Congo by Chinese entities is also being closely monitored, but the decision depends on the conclusion of discussions between the ADF, the IMF and the IDA on one hand and Democratic Republic of Congo authorities on the other, with regard to reducing the amount of the debt and increasing its concessionality.

Monday, 10th August, 2009.
Is it far from Kampala to Moroto?
1. Musoke is a tall boy.
2. He is brown.
3. He is handsome.
half-cakes
mice

Revising the DSF and the NCBP: Balancing Debt and Development

Implementing the NCBP has drawn attention to several challenges:

- The lack of data on debts contracted with commercial and non-traditional donors that do not participate in donor reporting systems, as is the case of China in the Democratic Republic of Congo, slows or prevents the ADF's analysis of low-income countries' non-concessional borrowing and inhibits its implementation of the NCBP.
- The IDA's experience in Angola suggests that in resource-rich countries that have the possibility of borrowing several times the amount of concessional resources available to them, the NCBP's ability to deter non-concessional borrowing will be limited. In these cases, traditional donors will play a key role in helping countries to strengthen their debt management capacity.
- It is difficult to determine the right type and amount of disincentive to apply, particularly for low-risk, well-performing countries with access to non-concessional financing (including capital markets) to finance their development needs in the absence of sufficient concessional financing.

As a consequence of these challenges, both donors and ADF countries have suggested that the NCBP be revised to allow for more country-specific conditions and greater flexibility. This suggestion echoes a G20 request made in April 2009 that the IMF and the World Bank review the flexibility of the DSF.[16] The goal of the review was to implement measures that offset the impact of external shocks and/or finance certain public investments whose strong growth impacts can be demonstrated, while protecting the debt sustainability of developing countries.

In close collaboration with the ADB, the IMF and the World Bank therefore reviewed the DSF and proposed adjustments that were approved by the World Bank and IMF Boards of Directors on 27 and 31 August 2009.[17] All of the adjustments were designed to increase the accuracy of the DSF without

jeopardizing debt sustainability. Accordingly, DSAs will do more to consider the link between public investments and growth; will be more flexible in interpreting the influence of remittances on the risk of debt distress; and will introduce greater inertia in the ratings used to determine debt distress thresholds, so as to avoid cases where the deterioration of a country's rating to just below the applicable boundary in a given year leads to the immediate application of a lower debt distress threshold.[18] The changes, which will be implemented in 2010, also mandate that new DSAs better reflect the views of country authorities and be more flexible in their treatment of the debt of public enterprises when such debt does not confront governments with significant fiscal risk.

Also in August 2009, the Board of Directors of the IMF approved a new matrix to determine concessionality limits for low-income countries.[19] Instead of the previous one-size-fits-all approach, non-concessional debt accumulation rules now vary according to the country's debt vulnerability, its macroeconomics, its debt management capacity, and the qualitative assessments of IMF staff. Once a country is classified using the new matrix, the IMF defines appropriate debt limits: minimum concessionality requirements with non-zero limits on non-concessional borrowings if appropriate; present value targets or average concessionality requirements for countries with higher capacity; and, for the most advanced low-income countries meeting certain criteria, the complete elimination of concessionality requirements. The IMF expects to complete its first set of ratings by end-2009.

As regards the review of the ADB's debt re-accumulation instrument (the NCBP), the ADB will collaborate closely with the IDA and the IMF in order to ensure that the three institutions maintain a coordinated approach to the accumulation of non-concessional debt, thus continuing to leverage collective donor action. In consideration of the ADB's continental mandate, special attention will be paid to concerns specific to African low-income countries.

Building Debt-Management Capacity

Although circumstances are worsening as a result of the global financial crisis, many ADF countries are in a much better fiscal situation than they were pre-debt relief, thanks to the HIPC Initiative, the MDRI, and the use of the DSF by several major multilateral donors to determine the conditions of their financial assistance. Despite the positive results of debt-related initiatives, however, there is ample evidence of a great need for debt management capacity building to help countries reap the benefits of debt relief and avoid falling back into debt distress. Of Africa's 40 ADF countries, 23 (58 percent) have a poor or medium rating on the debt policy component of the CPIA.

Countries' need for strong debt management capacity is reinforced by the fact that with the great majority of countries expected to reach the completion point in coming years, the HIPC Initiative and the MDRI will be winding down, causing the international community to turn its focus to the issue of debt management: developing strong and sustainable debt strategies and debt management instruments, especially in the wake of the diversification and increasing complexity of financing products available to low-income countries from traditional and non-traditional donors. Capacity will also play a key role in defining acceptable non-concessional borrowing levels for low-income countries under the IMF's new concessionality limits matrix.

Under its Governance Strategic Directions and Action Plan for 2008–2012, the ADB Group has scaled up its support to ADF countries as regards debt management capacity building. As a result, most of the ADF's governance projects now include components of public financial management reform. In this regard, the ADF has worked either directly or through regional intermediaries such as Africa Regional Technical Assistance Centers, the West African Institute for Financial and Economic Management, the Macroeconomic and Financial Management Institution of Eastern and Southern Africa, and regional economic commissions such as the Common

BOX 2

Capacity Building for Debt Management: The ADB in Action

When RMCs identify a significant concern regarding their capacity to manage debt, the ADB works with them to design appropriate policy reforms and capacity-strengthening initiatives. Institutional support projects (ISPs) to build capacity for debt management are currently taking place in the **Central African Republic, Burundi, Comoros, the Gambia, Guinea, Sierra Leone,** and **Togo**. Typically, ADB support entails technical assistance, the strengthening of the legal/institutional framework for debt management, computerization and training. The ADB is also working with RMCs to strengthen capacity for debt management as part of broader economic and financial governance reforms supported through policy-based loans (typically, debt management is included in the government's overall performance assessment framework). More recently, specific policy-based loan programs were being designed to address specific debt management issues, such as the enablement of debt restructuring.

One ISP that is demonstrating measurable results in achieving debt management capacity building is taking place in **Sierra Leone**. The Bank is assisting Sierra Leone's Public Debt Management Unit in a two-phase project that has supplied professional staff and provided training to support HIPC trigger monitoring until the completion point and DSA. The project also provided technical input for Paris Club bilateral negotiations. The project is now in its second phase, that of financing critical activities to meet best practices. These activities include the formulation of comprehensive national legislation for debt management, the production of a procedural manual and the integration of debt management software. The reforms implemented under the ISP have helped Sierra Leone's CPIA debt management rating rise from 2.9 out of 6 in 2001 to 3.5 out of 6 in 2007.

Market for Eastern and Southern Africa and the West African Economic and Monetary Union.

In implementing debt management strategies, the ADB considers it essential that debt management be considered in the broader context of the sound management of public resources in general and revenue policies in particular, specifically with respect to taxes, debt and aid. Measures to enlarge fiscal space include tools other than debt: for example, enhancing domestic revenues (both tax and non-tax revenues, especially in resource-rich countries), which are often deficient in low-income countries; rationalizing public expenditures and making them more effective and efficient; and developing donor engagement strategies to secure the predictable delivery of aid commitments. The ADF approaches debt management capacity building as part of a broader agenda in support of good financial governance, including the development of effective and efficient tax policy and administration frameworks, anti-corruption measures and domestic revenue mobilization.

An important international initiative in the area of debt management capacity is the recently created Debt Management Facility (DMF). The DMF was set up after the HIPC conference of October 2008 to scale up capacity building for debt management in a coordinated manner, with Africa's main technical assistance providers acting as implementing partners.[20] Administered by the World Bank, the DMF addresses debt assessment, program design, technical assistance for the development of debt management strategies, monitoring, knowledge dissemination, and training. Initial financing

was received from several donors and Austria, Belgium, Canada, the Netherlands, Norway and Switzerland are current contributors.

In consideration of the DMF's central coordination and harmonization role in the debt management capacity-building area, the ADB Group decided in 2009 to become a donor to and key partner of the DMF. Participating in the initiative will allow the ADB to contribute to debt management capacity-building activities in Africa while continuing to strengthen its own abilities to support debt management reform and build capacity for financing programs in ADF countries in a more systematic and strategic manner. This will be particularly helpful in fragile states, which tend to have the lowest debt management capacity and the highest debt vulnerability.

Welcome!
Welcome!
Welcome!

Collaboration between the ADF and Its Partners

Most ADF countries have many financing partners, including in some cases the providers of non-concessional financing. Actions to support debt sustainability, such as the DSF, can only have a significant impact if a critical mass of donors embraces a coordinated approach. The DSF is currently used by the Bretton Woods Institutions, the ADB Group, the Asian Development Bank and the International Fund for Agricultural Development. The ADF and these institutions collaborate actively to improve the DSF; perfect its implementation; render the DSF more easily understandable by low-income countries; and increase its use by bilateral donors, commercial creditors and others.

Since 2007, ADB Country Teams have provided systematic inputs into the DSF and have participated in selected DSA missions with Bretton Woods Institutions staff. ADB teams also collaborate systematically on HIPC, MDRI and NCBP issues, both at the country implementation level and during regular updates of the overall framework.

The ADF also participates regularly in donor and recipient roundtables and other fora on debt sustainability, where it is increasingly visible as the continent's voice and honest broker. Within ADF countries, debt sustainability and management issues are being raised in an increasingly coordinated manner in joint donor thematic groups or as part of multidonor/borrower dialogues for budget support operations.

A key forum for discussing and coordinating debt management issues is the international financial institutions' annual meetings on debt issues. The ADF is a regular participant (box 3).

The ADF's participation in these meetings and in the DMF are part of its strategy to significantly scale up its collaboration and coordination on debt issues with African low-income countries, the Bretton Woods Institutions, bilateral donors to the DMF and the main sub-regional debt management capacity-building organizations that act as DMF implementing partners. For

BOX 3

The International Financial Institutions' Meetings on Debt Issues

The international financial institutions' annual meetings on debt issues gather representatives from international financial institutions and observers from bilateral creditors (nine international financial institutions and two bilateral creditors in 2009) to exchange experiences and discuss issues pertaining to debt sustainability and debt management. The meeting is a key forum for increasing coordination on several issues:

- Increasing challenges in structuring arrears clearance for pre-decision point countries;
- Countries' HIPC and MDRI implementation status and some countries' difficulty in reaching the completion point;
- Grandfathering of new countries into the HIPC Initiative framework;
- Non-concessional borrowing by HIPCs;
- Commercial debt;
- Implementation and possible changes to the DSF;
- Debt management capacity building and technical assistance in low-income countries; and
- The impact of the global crisis on debt sustainability trends.

Participants share their experience and discuss new proposals and initiatives. The meeting is also an occasion to discuss new research on debt management issues and adopt common strategies where possible.

example, the ADB will host the DMF's first Stakeholder Forum in Tunis in the first quarter of 2010 to discuss the impact of the crisis on debt sustainability with the continent's debt managers and their partners from the donor community.

Finally, the ADB Group has assumed a lead role in coordinating efforts to support African governments in debt recovery litigation issues, which have become particularly prominent in the context of HIPC/MDRI debt relief. The African Legal Support Facility (ALSF) was launched in 2009 to enhance RMCs' access to sound technical legal advice when dealing with debt recovery lawsuits by vulture funds. The facility supplies resources, has created a knowledge database, and conducts capacity building activities such as training in the debtor country.

Conclusion

The global financial crisis has spotlighted borrowers' and donors' need to strengthen their response to debt management and debt sustainability in Africa. In the absence of sufficient concessional resources, many African low-income countries face difficult trade-offs between short-term financial needs and sustainable long-term debt. The credit crunch is changing the nature and the terms of the debt available on the market, and low-income countries must weigh new options in a changing environment.

It has become clear that, post-HIPC and MDRI debt relief, the main issue for both borrowers and donors will be low-income countries' capacity to manage their debt at sustainable levels. Good capacity in this regard is vital if low-income countries are to realize the full benefits of debt relief and avoid falling back into debt distress.

To respond to this challenge, the ADB Group is growing its capacity and interventions in the debt management field. In addition to the ADF's fast-growing support for capacity building as regards economic and financial governance, the ADB has become a donor to the newly created, multidonor Debt Management Facility and is scaling up its cooperation both with its traditional partners and with new donors in this regard.

Besides sound debt management strategies, long-term debt sustainability also rests on low-income countries' access to larger volumes of concessional financing. The ADF has been instrumental in this regard. In recent years, the ADF has provided substantial amount of resources for debt relief operations, thus allowing countries to redirect resources to poverty-reducing and growth-generating priorities. It has also significantly increased its overall commitments to low-income countries and catalyzed public and private investments to an unprecedented degree, leveraging an average of US$ 5 for every US$ 1 it invested in cofinanced projects between 2002 and 2008. In addition, the ADF has focused its interventions on sectors that are key to long-term economic growth.

With these actions, the ADB Group is helping African low-income countries to engage with development partners on terms that will enhance and not undermine their development. With the collaboration of its partners around the world, the ADB and the ADF will continue to pursue debt sustainability programs and other measures with a view to fostering Africa's economic progress and facilitating the continent's pursuit of its potential.

Notes

1. http://imf.org/external/np/exr/facts/hipc.htm.
2. Throughout this paper, concessional financing refers to financing with a grant element of 35 percent or higher. For more information about the calculation of the grant element, see www.imf.org/external/np/pdr/conc/index.htm.
3. For a RMC to qualify as an ADF country, its 2008 per capita gross national income could not exceed US$ 1,135.
4. African Development Bank. May 8, 2009. *Africa and the Global Economic Crisis: Strategies for Preserving the Foundations of Long-Term Growth*; and International Monetary Fund. March 2009. *The Implications of the Global Financial Crisis for Low-Income Countries*.
5. These simulations were carried out for illustrative purposes and should not be considered actual debt projections and debt sustainability analyses at the country level. See International Monetary Fund. March 2009. *The Implications of the Global Financial Crisis for Low-Income Countries*.
6. www.imf.org/external/np/exr/facts/jdsf.htm.
7. See African Development Fund. December 2006. *Progress Report on Application of the DSF*; International Development Association. 2006. *Debt Dynamics and Financing Terms: A Forward-Looking Approach to IDA Grant Eligibility*; and International Development Association. September 2007. *The Role of IDA in Ensuring Debt Sustainability: A Progress Report*.
8. See http://www.imf.org/external/np/exr/facts/jdsf.htm.
9. Eritrea has been assessed but its final assessment has not been approved and published by the IMF's Board of Directors.
10. The number of countries in each category presented in this figure corresponds to the country classification used at the time of the ADB's annual performance-based allocation exercise at the beginning of the calendar year. It varies slightly from the data reported in Table 3, which was updated at end-August 2009.
11. International Development Association. June 19, 2006. *IDA Countries and Non-Concessional Debt: Dealing With the 'Free Rider' Problem in IDA14 Grant-Recipient and Post-MDRI Countries*.

12. International Monetary Fund. August 2009. *Debt Limits in Fund-Supported Programs—Proposed New Guidelines.*
13. African Development Bank. September 3, 2008. *Information Note on Application of Non-Concessional Debt Accumulation Policy to Ghana,* ADB/BD/IF/2008/186 ADF/BD/IF/2008/169.
14. If a "red light" or "yellow light" country breaches the NCBP, the policy would reduce the volume of grants provided to this country by 20 percent to 40 percent and if such a country consistently borrows from third parties at non-concessional terms, the policy would suspend access to grants, and harden terms—possibly in combination with further volume cuts. For all "green light" countries breaching the NCB policy, hardened lending terms are applied. These include moderate terms (40 years maturity, 10 years grace period, 0.75 percent services charges and 0.5 percent commitment fees), i.e., a grant element of less than 60 percent; hardened terms (20 years maturity, 10 year grace period and same charges), i.e., a grant element of less than 45 percent; and, in the case of resource-rich countries, a higher level of hardened terms (applying all elements of hardened terms plus interest rates at 200 basis point below ADB fixed lending rate), i.e., a grant element of less than 20 percent.
15. IDA decided to apply blend terms to Ghana, i.e., a maturity of 35 years instead of 40.
16. G20. April 2, 2009. *Leader's Statement.* London: Paragraph 25.
17. International Monetary Fund and World Bank. August 2009. *A Review of Some Aspects of the Low-Income Country Debt Sustainability Framework.*
18. For instance, Burkina Faso's reclassification in 2009 from moderate to high risk of debt distress resulted mainly from deterioration in the 3-year average of its Country Policy and Institutional Assessment rating to just below the point at which indicative thresholds for DSF debt ratios are lowered. As a result, Burkina Faso exceeded the new indicative net present value of debt-to-exports ratio threshold by a small amount. The proposed adjustment would have meant that the lower threshold would only apply if the deterioration of Burkina's 3-year moving average had been confirmed the following year.
19. International Monetary Fund. August 2009. "Changing Patterns in Low-Income Country Financing and Implications for Fund Policies on External Financing and Debt."
20. The DMF's implementing partners are the United Nations Conference on Trade and Development (UNCTAD), the Commonwealth Secretariat, the Macroeconomic and Financial Management Institution of Eastern and Southern Africa (MEMFI), Pole Dette, the West African Institute for Financial and Economic Management (Waifem), and Debt Relief International.