External Debt Management

An Introduction

Thomas M. Klein
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External Debt Debt Management
An Introduction

Thomas M. Klein

The World Bank
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This monograph is part of a series of publications by the International Economics Department of the World Bank dealing with asset and liability management. It is directed primarily at staff of newly established debt management institutions within governments that are just launching borrowing programs. It has been designed particularly for those with daily responsibility for managing their country's external debt.

The major conclusion of the work is that successful debt management requires close collaboration between different elements of government concerned with external finance in order to have key information necessary to make informed decisions on the access to and uses of external finance. Specifically, it is important that the government unit with responsibility for meeting future debt service obligations should also play a major role in the decisions regarding foreign borrowing. Borrowing decisions are invariably complex. They require (a) realistic forecasts of major macroeconomic variables and of the balance of payments; (b) continuous analysis of external financial markets and foreign borrowing possibilities; and (c) current and comprehensive data on the country's external debt position.

A major topic is how to develop statistics on external debt. While this is only one of the three elements of debt management mentioned above, little attention has traditionally been directed to this subject, whereas economic forecasting and finance are topics on which there is substantial literature. Also, the development of data on external debt is an essential part of a country's relationship with the World Bank and other international organizations. The World Bank has formal requirements for the reporting of external debt by member borrowing countries. While this information is important to other lenders as well, being current on debt reporting to the World Bank is a prerequisite to having loans considered by its Executive Board. For this reason, the Bank's debt reporting procedures are here explained in...
detail, even though they are only a small part of a country’s debt manage-
ment responsibilities.

This monograph pulls together material from a number of published and
internal World Bank documents and from other literature on external debt
management. It has been prepared by Thomas Klein, at the time of writing,
a Senior Economist in the Debt and International Finance Division, under
the overall direction of Ronald Brigish.

This work would not have been possible without the collaboration of
several others. Thomas Duvall wrote Chapter 4 on the legal aspects of debt
management; Stijn Claessens, Chapter 10 on risk management, drawing on
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co-authored Chapter 9 on macroeconomic and projections issues. Malvina
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Earlier versions of this monograph were presented in seminars during
1992/93 for officials responsible for debt management in Albania, Armenia,
Belarus, Estonia, Latvia, Lithuania, and Ukraine. The manuscript was ex-
tensively revised following thoughtful comments by the seminar participants.

This publication will constitute essential background for future training
and technical assistance programs in asset and liability management, some
of which are being sponsored by the UNDP.

Masood Ahmed
Director
International Economics Department
This document is designed primarily for government officials responsible for managing the external debt of their countries, but it should also be helpful to those with a general interest in public sector financial management, observers as well as practitioners. The entire range of external debt management is discussed here: the organizational procedures for negotiating foreign loans and credits, the control and coordination of borrowing decisions, risk management, the administration of new loans, external debt accounting and statistics. Basic accounting principles are reviewed, and the use of computers is explored. As background, the document reviews trends in financial flows from industrialized to developing countries, the legal aspects of debt management, and external debt restructuring. The document contains a glossary of key terms and a bibliography of major books on debt management. Each chapter has references to articles, books and technical papers relevant to specific issues.
Debt Management Issues: An Overview

Foreign borrowing allows a country to invest and consume beyond the limits of current domestic production and, in effect, finance capital formation not only by mobilizing domestic savings but also by tapping savings from capital surplus countries. Foreign borrowing can lead to more rapid growth. However, if a country borrows abroad, it also must introduce debt management as a major policy concern. Inappropriate and excessive foreign borrowing will generate debt service obligations that will constrain future economic policy and, so, growth.

The objective of debt management policy is to achieve the benefits of external finance without creating difficult problems of macroeconomic and balance of payments stability. Part One deals with the process of foreign borrowing. It begins with a description of the financial flows from the industrialized countries to developing countries and to the newly independent nations of central and eastern Europe. It suggests institutional arrangements for efficient foreign borrowing, including the legal aspects of debt management. Part Two covers debt accounting and statistics, in particular the collection and organization of data to make informed decisions about debt management. Part Three concerns issues connected with the control of foreign borrowing, mainly, how to forecast future debt-servicing capacity.

Optimal Level of Borrowing

Why borrow abroad at all, if it is fraught with danger? To answer this question, let us consider saving and investment in a closed economy with no foreign borrowing. If the economy was a centrally-planned socialist state, investment decisions would be made by the central planning authorities. Domestic savings would be generated from turnover taxes and from cash surpluses of enterprises, and they would be allocated for investments—build-
ings, new machinery, improved roads, and so on—through decisions of the planning authorities. Allocation would reflect the state's priorities.

In a market economy, savings would be channelled into financial markets. Individuals and enterprises would place cash with commercial banks. The banks, in turn, would make loans, and part of the interest charge on their loans would be paid to depositors—the return on savings. When capital markets exist, governments and enterprises can sell securities direct to the public and hence mobilize savings, and by-pass the banking system.

In a market economy, investment projects generate a financial rate of return, and it is worthwhile for enterprises to borrow if that return is equal to (or exceeds) the market rate of interest. Enterprises would rationally make investments starting with the one offering the highest rate of return, moving on to the next highest-yielding project and so on. It would continue investing until the yield on its final project was no greater than the market interest rate. For any projects with a lower yield, borrowing would mean a loss to the enterprise. Government borrowing is more complex, since its services do not necessarily yield a financial rate of return. There is, however, a real economic and social rate of return on the investment—that is, the gains to society from the project. Large-scale borrowing, however, causes interest rates to rise. Therefore, public sector investment can be seen as moving down a schedule of rates of return and the absorption of savings moving up a savings supply schedule until the point is reached when the rate of return is equal to the real rate of interest paid on the increased borrowing.

In the absence of controls and major market distortions, the market interest rate would equate the supply of savings with the demand for investable funds. If the world was nothing more than a collection of closed economies, there would be wide variations in national equilibrium interest rates. Countries with high per capita national income and a large stock of modern, physical capital goods would have lower market interest rates than lower income countries, which would have lower savings and higher physical capital needs.

Global capital markets enable lenders to earn a higher rate of interest and borrowers to pay a lower rate of interest than otherwise would be possible, increasing welfare in both borrowing and lending countries.
Macroeconomic Considerations

How foreign borrowing affects macroeconomic stability can be best understood in the context of production, consumption, savings, and investment. In a closed economy (no foreign trade), production comprises goods and services for personal consumption (consumer goods), capital goods (buildings, plant and equipment, inventories used by enterprises), and goods and services used by the government, which can be both for consumption (for current use) or for investment. Where there is foreign trade, production also includes goods for export; imports are a supplement to domestic production. Thus, total production (Gross Domestic Product) plus imports comprises goods and services for personal consumption, for investment, for government use or for exports.

There is a relationship between production and income. Put simply, production creates incomes equal to the value of output. Some income is taken by the government in taxes; some is saved by the private sector; the balance is spent on consumption. Foreign borrowing is the excess of imports of goods and services over exports, and net borrowing creates debt, which can be repaid if exports exceed imports. In the absence of foreign borrowing (exports and imports are equal), private sector investment plus government spending is limited by the level of private sector savings and taxation. Economic growth, of course, could be accelerated with foreign borrowing, permitting imports to exceed exports and, at the same time, investment plus government expenditures to exceed savings plus taxes.

If a country borrows from abroad, it must pay interest on the outstanding debt and, as debt increases, interest payments needed to service the debt also rise. Thus, it is crucial that external borrowing leads to an increase in productive capacity. Not only must there be an expansion of goods for domestic needs (the rationale for borrowing in the first place), but also of exports to finance interest and amortization payments on the foreign debt. Failure to do so will mean debt service reaching an unacceptable proportion of exports and total production. In that case, commercial lenders, fearful of default, will be reluctant to make fresh loans (Underwood 1992, pp. 179–80).

There are standard indicators for measuring the burden of external debt: the ratios of the stock of debt to exports and to gross national product, and the ratios of debt service to exports and to government revenue. Although there is widespread acceptance of these ratios as measures of creditworthiness, there are no firm critical levels which, if exceeded, constitute a danger for the indebted country. However, the World Bank staff has proposed a set of parameters which it uses to demarcate “moderately” and “severely” indebted
Heavily indebted countries may be forced to make severe cuts to investment and consumption when faced with macroeconomic shocks.

Growth is the key to creditworthiness; but poorly designed investment will not result in growth. To invest borrowed resources badly is worse than not borrowing at all.

Debt can be permitted to grow faster than exports only for a limited time.

countries (see Chapter 9, p. 128). Other lenders, however, may have their own notion of what constitutes manageable debt service for any country.

Countries with a rapid export growth can support higher debt relative to exports and output. Heavily indebted countries, however, are vulnerable to severe macroeconomic shocks—sharply higher interest rates in the lending countries, for instance, or simply lenders cutting back on their commitments. Faced with these pressures, countries must then adjust by cutting private investment, decreasing government expenditures, and/or increasing government revenues. These last two options require reductions in private consumption—not just in absolute terms but relative to GNP if the desired increase in net exports is to take place (see Chapter 9).

There is a danger in such adjustment programs. Cuts in private investment or in the investment component of government spending, are likely to reduce growth and net exports and attempts to correct the debt problem could make it worse. It is better, then, if adjustment programs be supported by IMF and World Bank financial programs which can help prevent draconian cuts in private consumption—particularly for the vulnerable (low-income) members of the population.

Several important points emerge. First, growth is the key to creditworthiness and to the relaxation of credit ceilings imposed by concerned lenders. Second, a high rate of investment is a necessity, but it is not a sufficient condition for creditworthiness: investment must be efficient in the sense that investment returns exceed the cost of capital. To borrow resources that are invested unwisely is worse than not to borrow at all. Third, debt can grow consistently faster than exports only for a while and only when debt is small relative to exports. Fourth, the interest rate is not only the cost of an external loan. Each loan pushes the borrower nearer to its credit ceiling; this is a cost, in addition to the actual interest charges (Underwood 1992, p. 180).

Those concerned with macroeconomic policy must study the investment/growth/external borrowing relationships carefully. Projections must make realistic assessments as to how investment by the private and public sectors will affect growth. The terms of borrowing of new loans must be assessed against the country’s ability to make debt service payments while the investment program is in its gestation stage. These are critical inputs to the debt management process.

**Debt Management Failure**

During the debt crisis years (1980–91), more than 50 countries were forced to renegotiate their debts. Many others did not. Colombia, India, Korea,
Thailand, Malaysia, Singapore, and Indonesia were all large borrowers which did not have to restructure. What lessons may be drawn from these debt-management failures—and successes? Each country’s situation is complex but one element of economic policy stands out in countries with serious debt servicing problems—the inability to control fiscal deficits.

There are four major causes of fiscal deterioration (Tanzi 1985, pp. 65–67). First, windfall tax revenues resulting from a commodity (say, petroleum) price boom are used to increase consumption or finance investments with low returns, rather than for sound investments. A second problem can arise during a period of rising prices, when tax revenues do not increase in line with prices and the ratio of government revenue to GNP declines. The third difficulty occurs when government expenditures grow faster than revenues, usually as a result of political pressures for a major capital formation program, higher public sector wages, or to expand subsidies to enterprises. A fourth problem is the government’s reaction to declining terms of trade, which result in a deterioration of real incomes.

Countries that avoided serious difficulties in the 1980s were those that succeeded in controlling fiscal deficits; but, once a government deficit opens, it is politically difficult to close it. Fiscal deficits, of course, have to be financed. Evidence suggests that governments prepare expenditure programs and then attempt to secure their financing from external sources when domestic sources are insufficient. Put another way, the decision to run a fiscal deficit is not independent of the available financing:

Few developing countries follow the decision making process of industrial countries whereby the government first decides on its desired level of public expenditure, then forecasts its ordinary revenue (mostly tax revenues), and finally faces the question of how to finance the resulting deficit. In developing countries, determining expenditure levels and finding financing sources are likely to be largely simultaneous exercises, in which the availability of financing often determines the level and perhaps even the kind of spending (Tanzi 1985, pp. 72–73).

The moral is that the availability of finance can lead a government into developing a large fiscal deficit. Witness Poland’s experience with export credit financing and commercial bank borrowing in the early 1980s. It is important for governments to resist the temptation to secure prolonged external financing for fiscal deficits, because such financing can be abruptly cut-off when the seriousness of the deficits becomes apparent to lenders (as happened with Mexico in 1982, and Turkey in 1976).
The Issues

When considering an external borrowing program, a government must bear in mind that projected net export earnings (perhaps augmented by more borrowings and other foreign finance) must be sufficient to accommodate debt service obligations. Moreover, projected government revenue must be enough to provide the local currency equivalent of the government’s own debt service obligations, which will be met more easily if the projects financed are successful. Even where returns are more than adequate to cover costs, however, the government’s difficulty in raising adequate revenue may severely limit its ability to service debt.

To manage debt effectively, authorities must project the time profile of debt service obligations; they must accurately forecast export earnings, domestic revenues and future access to finance. They must also monitor the potential for prepaying or refinancing their debt to take advantage of new borrowings on better terms, to adapt loan maturities to project revenues or to cope with shortfalls in earnings from exports or unanticipated expenditures on imports.

Governments must view foreign borrowing in the broader framework of overall economic policy. Debt problems rarely arise when policies are chosen so that key economic variables (especially interest and exchange rates) convey true economic costs to decision makers and when governments underpin their public investment programs with effective measures for resource budgeting and for raising domestic savings. But, as the debt crisis showed, countries can find that they have “overborrowed” in deteriorating economic circumstances, and that they have become vulnerable to painful deflationary pressures and slow growth. Beyond good macroeconomic policy, the effective management of external debt comprises three specific interrelated processes—selecting the appropriate financing, deciding how much to borrow, and keeping complete and up-to-date records on debt.

Financing Techniques

Countries have a limited ability to support external borrowing. At the same time, the supply of finance is also limited. Consequently, borrowers must choose the best combination from the available sources of external finance to suit the needs of individual projects—and of the economy as a whole. The country clearly wishes to minimize the problems in servicing new debt, while making maximum use of grants and foreign loans on concessional terms. These are clearly the cheapest form of financing, but their availability
is generally restricted to the poorest developing countries; and, even for those countries, they are inadequate to meet needs. Maximum leverage can be obtained from concessional financing by combining it with other types of financing. Other sources of credits are export financing and loans from international commercial banks (see Chapter 2).

Authorities should ensure that credits from financial markets are part of a package that provides the best possible external financing mix for the economy, as well as for an individual project. For projects, the best mix could mean one with: (1) maximum concessional loans or minimum market finance, (2) the maximum capital that can be rolled over easily, or (3) the minimum debt service due in the years before returns materialize.

Authorities must also ensure that the aggregate financing package meets national financial priorities. This involves an assessment of such aspects as: the sources of finance, including the amounts that can be borrowed and the prospects for future supply; the currency composition of foreign borrowing that would minimize exposure to exchange-rate fluctuations; the exposure to interest rate fluctuations over the life of the loan; and the impact of new borrowing on the structure of debt service obligations. Such analysis is not easy. It must be performed effectively, however, if countries are to benefit from foreign credits, while avoiding balance of payments problems.

**How Much to Borrow**

The amount of debt to contract is a basic policy decision, which will depend on the skill and judgement of those making it. Formal models and technical analyses cannot substitute for good policymaking. But, they can help by providing information on the future implications of alternative borrowing strategies (see Chapter 9).

The amount that any country ought to borrow is governed by two factors: how much foreign capital the economy can absorb efficiently, and how much debt it can service without risking external payments problems. Each factor will depend on the quality of economic management. Borrowings can be on different terms and in different currencies, which complicates the policy decision. There may be uncertainty, too, about evolving debt servicing capacity (including the capacity to borrow to service the debt). Interaction between debt servicing capacity, the type of finance, and the borrowing decision increases in complexity as the number of loans increases.
Managing Risk

Countries are sometimes exposed to balance of payments shocks arising from unfavorable changes in the relative prices of exports and imports. Suppose that a country’s exports earnings are in dollars and its foreign debts are repayable in yen. A deterioration in the exchange rate of the dollar vis-a-vis the yen will add to the debt servicing obligation of the borrowing country. A similar problem can be caused by variable interest rate loans: an increase in the Euro-dollar rate will add to the country’s external debt burden. Falls in commodity prices for a country for which primary commodities are a major source of foreign exchange will also create debt servicing difficulties.

Fluctuations in commodity prices, foreign exchange rates and world interest rates are largely beyond the control of countries. It is possible, however, to hedge against this risk. Managing risk is part a part of debt management (see Chapter 10).

Knowing the Debt

Information on external debt and debt service payments is essential for the day-to-day management of foreign exchange transactions, as well as managing debt and for planning foreign borrowing strategies. At the most detailed level, the information enables central authorities to ensure that individual creditors are paid promptly; at more aggregated levels, debt data are needed for assessing current foreign exchange needs, projecting future debt service obligations, evaluating the consequences of further foreign borrowing, and the management of external risk.

The components of external debt statistics include details of each loan contract and its schedule of future service payments, figures on loan utilisations, and the payments of debt service obligations. From these data elements summary figures on foreign borrowing, outstanding debt, and projected debt service are assembled. The resulting statistics provide inputs for budget and balance of payments projections. With the help of a macroeconomic model, the debt office uses all this information to simulate the impact of alternative future borrowing patterns on the budget and balance of payments.

A Look Ahead

Debt management is a complex aspect of public administration and economic policy because it requires bringing together parts of government that have specific, specialized responsibilities. The aim of debt management is to en-
able the country to exploit current external financing possibilities without creating future balance of payments or government revenue problems. What would be excessive borrowing is hard to say. Those responsible for accelerating growth will have a natural bias towards optimism; those responsible for exchange rate and balance of payments stability will be inherently conservative. The knack is to reach some solid middle ground.

Any judgement on proposed future external borrowing, however, requires accurate and up-to-date figures on the debt service obligations of existing debt. Without a strong statistical base, projections become hypothetical. How to develop comprehensive and usable statistics, how to assess debt servicing capacity and how to coordinate the formulation of debt management policy are the issues addressed in this handbook.

References


Part One

Financing and Loan Negotiation Issues
While foreign loans are made one-to-one with individual borrowers, each acting independently, it is necessary to view foreign borrowing in aggregate to understand its relation to overall balance of payments financing and to discern trends in the supply of capital.

**Debt and Non-Debt Creating Flows**

The financing trends for developing countries and for former centrally planned economies reveals the extent to which balance of payments financing consists of foreign loans (Table 2.1). The amount to be financed is the sum of the deficit on goods, services and private transfers plus the transac-

<table>
<thead>
<tr>
<th>Table 2.1 External financing (US$ billions)</th>
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<tr>
<td>Developing countries</td>
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<tr>
<td>Balance to be financed</td>
</tr>
<tr>
<td>-----------------------------------------</td>
</tr>
<tr>
<td>Financing:</td>
</tr>
<tr>
<td>Non-debt creating flows</td>
</tr>
<tr>
<td>52.8</td>
</tr>
<tr>
<td>Official transfers</td>
</tr>
<tr>
<td>22.7</td>
</tr>
<tr>
<td>Direct investment</td>
</tr>
<tr>
<td>12.8</td>
</tr>
<tr>
<td>Net IMF credit and other</td>
</tr>
<tr>
<td>9.9</td>
</tr>
<tr>
<td>reserve-related liabilities</td>
</tr>
<tr>
<td>0.7</td>
</tr>
<tr>
<td>Net external borrowing</td>
</tr>
<tr>
<td>29.4</td>
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</table>

Former centrally planned economies

<table>
<thead>
<tr>
<th>Balance to be financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0</td>
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Financing:

Non-debt creating flows

1.0 | 1.0 | 2.5 | 3.8 | 2.9 |

Official transfers

0.0 | 0.2 | 0.1 | 0.7 | 0.4 |

Direct investment

0.1 | 0.8 | 2.4 | 3.1 | 2.5 |

Net IMF credit and other

reserve-related liabilities

-0.3 | -0.2 | 3.5 | 0.6 | 1.5 |

Net external borrowing

1.2 | 1.2 | 0.5 | -1.0 | 3.2 |

* a. Projection.

tions that underlie the net errors and omissions. This balance reflects the net inflow of financial resources from the rest of the world. It is conventionally grouped into three categories. First, there are “non-debt-creating flows,” consisting of official transfers (grants) and direct investment. Transfer payments are, in a sense, gifts, because they do not have to be repaid. Direct investment creates an equity position on behalf of an investor; it is not withdrawn on a fixed schedule as with a loan. The second category of finance consists of “reserve-related liabilities,” of which the most important component is net IMF credit. Finally, there is external borrowing, which comprises loans from official and private lenders, net of repayment.

For developing countries, external financing requirements for 1991–93 averaged $113 billion. Of this, 76 percent was provided by net external borrowing. External financing for the former centrally planned economies was small by comparison ($6 billion) owing to their lack of integration into world trade. Net foreign borrowing provided 46 percent of this finance.

There are three major sources of net external borrowing: official development finance, export credits, and private flows.

**Official Development Finance**

Official finance comes in two forms—aid, often referred to as official development assistance or ODA, and other official development flows.

**Official Development Assistance (ODA)**

ODA (as defined by the OECD Development Assistance Committee) consists of grants or loans by agencies of governments or multilateral organizations to promote economic development or welfare. Thus, military assistance and official export credits are excluded. To qualify as ODA, financial flows must be concessional, having a grant element of 25 percent or more. The grant element measures the degree of a loan’s concessionality—that is, the extent to which it approaches a grant. It is defined as the difference between the face value of the loan and its discounted present value, expressed as a percentage of its face value. Obviously, a grant, which does not require repayment, has a grant element of 100 percent (see Annex 2.1, page 22).

Although loans with a grant element as low as 25 percent are defined as concessional, the established norm for ODA is 86 percent. Anyway, that definition applies only to the financial terms of the loan. It does not include other costs of aid, such as the tying of procurement. If aid proceeds can only be used to procure goods in the country furnishing the aid, the cost of goods
could be higher than if they were procured through international competitive bidding. ODA also includes technical cooperation, which consists of grants to nationals of developing countries receiving education or training (in their home country and abroad) and payments to defray the costs of developing country personnel serving in an aid capacity in these countries.

Foreign aid comes from governments of industrialized countries. It has two components. A small portion consists of contributions to international financial institutions, such as the World Bank, regional development banks, and UN specialized agencies. The bulk comprises disbursements directly to beneficiary countries through national agencies such as the United States Agency for International Development, the French Caisse Centrale pour le Coopération Economique and the German Kreditanstalt für Wiederaufbau.

The objectives and priorities of foreign aid are established by national foreign donor governments. They also set the policies of multilateral lending agencies through established channels. Through the Development Assistance Committee of the OECD, there is international collaboration among donors to see that foreign aid resources are used effectively. The Committee attempts to reach a consensus on the level of foreign aid relative to GNP and to resolve problems such as aid tying. To help coordinate aid to individual countries, the World Bank chairs Consultative Groups and Aid Consortia. These groups normally meet at one to two year intervals. They provide a vehicle for both donors and recipients to discuss economic prospects of a particular beneficiary country and to coordinate national aid programs. The goals are to assure that priority needs are met and that bilateral donors do not duplicate one another’s efforts.

The World Bank Group lends to its member countries within the context of medium-term development strategies, which are arrived at after extensive discussions with the borrowing governments. Regional development banks, likewise, lend within the context of a development policy framework.

In the 1950s and early 1960s, donor countries gave assistance mainly in the form of loans. The terms of lending softened over the years, so as to ease the debt burden on the poorest countries. In the early 1990s, ODA loans and grants were roughly equal. In 1992, grant aid was about five and a half times the volume of ODA loans (see Table 2.2). However, in real terms, total ODA has remained virtually constant since 1985.

Other Official Development Flows

As mentioned above, some development-oriented finance from official lenders has little or no concessionality—IBRD loans, for example. Loans of this
nature are categorized “other official development flows” (ODF). From multilateral organizations, ODF includes disbursements from the hard windows of regional development banks as well as IBRD loans. Bilateral ODF has comprised mainly operations under debt restructuring agreements: the capitalization of interest payments, debt refinancing loans and the Japanese Export-Import Bank’s “recycling finance” under Debt and Debt Service Reduction Agreements (Brady Plan).

Some foreign aid is nonconcessional, but unlike commercial lending, is focused on development objectives.

World Bank loans have a nonconcessional grant element, because the World Bank functions as a financial intermediary, borrowing in financial markets and relending the proceeds. Interest charges on World Bank loans must cover its interest costs plus a fifty basis point spread to help meet operating costs. Regional development banks have similar considerations. Non-concessional foreign aid differs from market finance and export credits in that lending is noncommercial—that is, multilateral financial institutions are not profit maximizers but focus their operations on economic reconstruction and development.

### Table 2.2 Resource flows to developing countries (US$ billions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<tbody>
<tr>
<td>Official development finance (ODF)</td>
<td>7.5</td>
<td>17.4</td>
<td>33.7</td>
<td>43.9</td>
<td>61.3</td>
<td>60.8</td>
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<td>32.6</td>
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<td>48.6</td>
<td>52.6</td>
<td>57.4</td>
<td>58.3</td>
</tr>
<tr>
<td>Of which: bilateral</td>
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<td>10.6</td>
<td>19.5</td>
<td>24.6</td>
<td>36.4</td>
<td>36.3</td>
<td>39.2</td>
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<td>41.3</td>
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<td>Of which: multilateral</td>
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<td>8.0</td>
<td>11.0</td>
<td>12.3</td>
<td>13.4</td>
<td>16.1</td>
<td>17.0</td>
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<td>Of which: grants</td>
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<td>8.2</td>
<td>17.2</td>
<td>22.3</td>
<td>31.6</td>
<td>32.9</td>
<td>39.7</td>
<td>45.7</td>
<td>49.6</td>
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<td>Of which: loans</td>
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<td>6.1</td>
<td>9.8</td>
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<td>11.7</td>
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<td>12.2</td>
<td>16.9</td>
<td>12.7</td>
<td>14.0</td>
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<tr>
<td>Of which: bilateral</td>
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<td>0.6</td>
<td>2.0</td>
<td>3.7</td>
<td>7.3</td>
<td>5.2</td>
<td>6.7</td>
<td>4.9</td>
<td>6.0</td>
</tr>
<tr>
<td>Of which: multilateral</td>
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<td>2.5</td>
<td>4.7</td>
<td>7.6</td>
<td>6.6</td>
<td>7.0</td>
<td>10.2</td>
<td>7.8</td>
<td>8.0</td>
</tr>
<tr>
<td>Export credits (LT)</td>
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<td>15.4</td>
<td>0.8</td>
<td>-4.5</td>
<td>4.7</td>
<td>0.1</td>
<td>2.6</td>
<td>3.0</td>
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<td>82.4</td>
<td>33.2</td>
<td>43.4</td>
<td>47.7</td>
<td>64.6</td>
<td>61.2</td>
<td>114.8</td>
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<td>10.9</td>
<td>6.4</td>
<td>21.9</td>
<td>26.7</td>
<td>26.9</td>
<td>26.4</td>
<td>30.6</td>
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<td>2.5</td>
<td>8.0</td>
<td>-1.0</td>
<td>15.0</td>
</tr>
<tr>
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<td>0.6</td>
<td>1.1</td>
<td>4.2</td>
<td>1.5</td>
<td>1.3</td>
<td>4.5</td>
<td>13.0</td>
<td>14.2</td>
</tr>
<tr>
<td>Other private</td>
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<td>1.2</td>
<td>1.8</td>
<td>1.3</td>
<td>4.2</td>
<td>2.7</td>
<td>5.1</td>
<td>6.6</td>
<td>9.5</td>
</tr>
<tr>
<td>Grants by nongovernmental organizations</td>
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<td>0.5</td>
<td>-3.9</td>
<td>-2.1</td>
<td>-2.2</td>
<td>1.0</td>
<td>-0.2</td>
</tr>
<tr>
<td>Short-term flows</td>
<td>n.a.</td>
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<td>26.2</td>
<td>15.2</td>
<td>6.0</td>
<td>12.8</td>
<td>11.4</td>
<td>11.2</td>
<td>25.5</td>
</tr>
<tr>
<td>Export credits</td>
<td>0.0</td>
<td>2.6</td>
<td>2.2</td>
<td>3.2</td>
<td>2.0</td>
<td>4.8</td>
<td>4.4</td>
<td>-0.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Other financial credits</td>
<td>—</td>
<td>0.0</td>
<td>24.0</td>
<td>12.0</td>
<td>4.0</td>
<td>8.0</td>
<td>7.0</td>
<td>12.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Total net resource flows</td>
<td>21.2</td>
<td>27.4</td>
<td>162.1</td>
<td>93.6</td>
<td>102.3</td>
<td>123.9</td>
<td>143.4</td>
<td>146.1</td>
<td>215.4</td>
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</tbody>
</table>

Memorandum items: resource flows in 1991 prices and exchange rates

<table>
<thead>
<tr>
<th></th>
<th>1991</th>
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<td>Net resource flows</td>
<td>72.7</td>
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<tr>
<td>Official development finance</td>
<td>34.5</td>
</tr>
<tr>
<td>Official development assistance</td>
<td>29.9</td>
</tr>
</tbody>
</table>

- a. Provisional data.
- b. Excluding guaranteed financial credits, included in “export credits” above.
- c. Includes IMF Net Credits.

To provide loans to low-income countries, the World Bank Group lends through its soft-loan affiliate, the International Development Association (IDA). IDA credits are interest-free, but bear a 0.75 percent service charge. Maturities can be as high as 40 years, including 10-years grace. IDA credits, of course, are ODA flows.

**Export Credits**

Export credits are loans designed to finance specific purchases of goods or contractors' services. Disbursements are linked to shipments of contracted merchandise or the completion of agreed stages of work. Export credits may be extended

- directly by an exporter or by a contractor (suppliers credits),
- by the exporter's or contractor's commercial bank (buyers credits) or
- by specialized agencies of the exporter's government (official export credits).

Buyers credits are now more common than suppliers credits. Maturities are relatively short: three to seven years.

**Insured Private Export Credits**

To stimulate exports, governments of industrialized countries have each introduced export credit insurance through specialized agencies, some of which date back to the 1930s. For a small fee, these agencies insure export credits against the failure of the borrower's country government to permit transfer of debt service obligations. This insurance, or guarantee, does not always cover commercial risk—that is, the failure of the borrower to make payment through his bank in his national currency. Export credit insurance schemes are now universal to countries with capital goods exports. Indeed, it is difficult for exporters to compete internationally without this cover. Thus, not only do all industrialized OECD countries have such programs, but so, too, do Brazil, Mexico, India and others.

Through their insurance programs, export credit agencies made possible longer maturities than individual firms would offer independently. They also provided a subsidy on interest charges. However, export credit agencies now agree on common maximum maturities and interest subsidies to eliminate this type of competition. Today, interest rates on officially guaranteed private export credits are at (or close to) market rates.

Export credit insurance agencies often require that the borrower secure a guarantee. If the borrower is a public enterprise, a guarantee by the
state is normal. Private sector borrowers are usually asked to secure a guarantee by a recognized bank.

Official Export Credits

Governments of some industrialized countries have created specialized institutions to finance exports of high value products—such as aircraft and electrical generating equipment. These include the United States Export-Import Bank and the Japan's Export-Import Bank. Interest rates are market-related, but maturities are much longer than can be provided by private lenders. While finance through official export credit agencies is crucial for some products (like aircraft), government intervention in the export credit business is mainly to insure, or guarantee, private export credits.

OECD data indicate that net flows with respect to export credits averaged $12.3 billion a year in 1979–83, were a negative $1.5 billion in 1984–88, recovered to $4.7 billion in 1989 and averaged $1.9 billion in 1988–92 (see Table 2.2). Long-term export credits are not growing because developing countries and Eastern European countries are unable to support debt service on their relatively short-term maturities as a result of the debt overhang from the 1970s and 1980s.

Private Flows

Private source flows consist of export credits, international bank loans and bond issues, and foreign private direct investment. They also include a few grants—contributions by private nongovernment charitable organizations.

International Bank Lending

This was the most significant form of private flows to developing and East European countries in the 1970, particularly after the 1973 oil shock. Because of high petroleum prices, foreign-exchange reserves of oil-exporting countries (particularly for the less populated ones) soared. These reserves were placed by Central Banks into the Euro-dollar market, through international banks.

As the industrialized countries moved into recession, world interest rates fell and lending opportunities declined. Accordingly, banks with international lending facilities looked to expand operations in developing countries and, later in Eastern Europe. Between 1970 and 1975, net lending by banks rose from $3.0 billion to $17.5 billion. International banks pooled funds from
smaller, domestic banks, by forming lending consortia. By the end of the 1970s, consortia loans of over $100 million each were common. Lured by attractive interest rates, developing and East European countries took on huge loans. This recycling of so-called petrodollars, was encouraged by multilateral financial institutions as a way of reducing prospects of a global depression and maintaining growth in developing countries. Buoyant primary commodity prices helped insulate some developing countries from the first oil shock and provided some comfort to lenders that loans would be repaid.

What happened is well known. Both Europe and the United States suffered from rampant inflation in the mid-1970s, and there was a concerted effort by their Central Banks to end inflation by forcing up interest rates. Since nearly all lending was floating rate, borrowing countries found that the effective interest on their commercial bank debt soared from about 7–8 percent in 1976–78 to 15–18 percent in 1980–81. In August 1982, Mexico declared a moratorium on its external debt, and foreign lending by commercial banks ceased to all but a handful of countries. Commodity prices sunk to well below levels of the 1970s, and this reduced the debt servicing capacity of many low-income countries. The debt crisis had begun.

Net lending by banks fell from $21.1 billion in 1980 to $3.2 billion in 1985 and remained at low levels into the early 1990s (Table 2.2). There was a significant recovery in 1992 ($15.0 billion, compared to a net outflow of $1.0 billion in 1991), but only a few countries benefited from this revival.

Private lending to developing and former socialist countries picked up in the early 1990s, but the nature of flows has changed. The growth of private lending has shifted from commercial bank lending to bond and equity portfolio flows and more foreign direct investment (World Bank 1993(a), p. 13). Borrowing is less from governments and more from the private sector. On the supply side, nonbank institutional investors have become more important than commercial banks, reflecting financial disintermediation (World Bank 1993(a), p. 14). Access is not uniform. The countries that have been able to tap these sources are those that avoided debt restructuring in the 1980s (for example, China, India, Indonesia, and Korea) or that have followed a successful macroeconomic reform program in the wake of a debt reduction exercise with commercial bank creditors—Argentina, Chile, and Mexico, for instance (see World Bank 1993(a), pp. 15–19).

**Bonds**

Bonds were the major method of foreign borrowing in the 1920s, but they were much less important in the post-war years. The few countries that have...
FINANCE AND DEBT

successfully re-established access to international capital markets since the
debt crisis, however, have found them a useful, if limited, method of finance.
While bond issues averaged less than $1.5 billion per year in the late 1980s,
they advanced steadily in the early 1990s—$4.5 billion in 1990 and $14.2
billion in 1992. Major borrowers were in Korea, Mexico, Brazil, Hungary
and Argentina. While bond issues of developing countries were mainly in
US dollars, Latin American borrowers began to issue bonds denominated in
ECUs and Pesetas (see World Bank 1992, p. 69 and pp. 115–118, and World
Bank 1993(b) ch. 1 for more detail).

Foreign Direct Investment (FDI)

This represents equity investment by individuals or companies in the lending
country in an enterprise in the receiving or host country. Such investment
can be cash transfers or shipments of goods in exchange for a share in
ownership. FDI also includes reinvested earnings.

While private loans have declined sharply since the late-1970s and early-
1980s, FDI increased significantly in the latter part of the 1980s—to around
$26 billion in 1989–91 and more than $30 billion in 1992 (see Table 2.2).
FDI has been concentrated in a handful of East Asian countries, but recently
there has been an increase in flows to Latin America. FDI flows to European
countries have been modest, with most going to Turkey and Hungary fol-
lowing their progress in economic restructuring. Little FDI has gone to
Central and Eastern Europe, although there have been sizable commitments
to some countries, such as the former Republic of Czechoslovakia (World
Bank 1993(b), ch. 3).

In the past few years, there have been regulatory changes in some coun-
tries (Bulgaria, the former Czechoslovakia, Hungary, Poland, Russia, and
Yugoslavia) aimed at attracting FDI. Legislative changes allowing some even
(majority) ownership in various sectors, in addition to other reforms, could
make FDI attractive for foreign investors (World Bank 1991, p. 19). This
would bring in needed capital plus technical and managerial expertise with-
out adding to the host country’s contractual debt service burden.

Other Private Flows

The early 1990s has also seen an increase in equity investments. Some are of
external stock offerings, others the establishment of country funds. In addi-
tion, there has been some direct equity investment—that is, the purchase of
shares by foreigners in domestic markets (see World Bank 1992, pp. 113–
The beneficiary countries are those able to float bond issues and to attract foreign direct investment.

While there is some concern about the sustainability of the market finance witnessed in the early 1990s, these flows may prove to be more durable than those of the 1970s. Overall economic politics of borrowing countries has improved. Lending is to private sector borrowers and equity flows have introduced risk-sharing between borrowers and lenders (World Bank 1993(b), p.4).

References

Annex 2.1 Grant Element Calculation

The grant element is a measure of the degree of concessionality of a loan. It is calculated as the difference between the present value of the future debt service payments expressed as a percentage of the face value of the loan. This means that a grant will have a grant element of 100 percent and other lending some value less than 100 percent. Different creditors may give more favorable terms for different sectors of the economy or for different types of project. By using the grant element to analyze the degree of concessionality of loans, a government may compare loans it is receiving from different creditors to help determine its borrowing strategy.

The grant element depends on terms of lending (years maturity, years grace and rate of interest) and the discount rate. The grant element depends on how much is to be paid in debt service at different times; the less that must be paid in service and interest charges, and the more delay in repaying principal, the more concessional the loan. One issue in the grant element calculation is what rate of discount to use. From the debtor country’s point of view, the discount rate should be related to the yield on investments, i.e., the highest possible return for the use of the funds that may be borrowed. More precisely, it is the yield that can be obtained at the margin on investments. (Hawkins 1970, p. 32). From the creditor country’s point of view, the discount rate should...

Annex Table 1
Example 1: Interest rate is 5 percent, grace period is 5 years, and there are 15 years of principal repayments.

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance</th>
<th>Interest</th>
<th>Principal</th>
<th>Total</th>
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<tr>
<td>1</td>
<td>1500</td>
<td>75</td>
<td>0</td>
<td>75</td>
<td>68.18</td>
</tr>
<tr>
<td>2</td>
<td>1500</td>
<td>75</td>
<td>0</td>
<td>75</td>
<td>61.98</td>
</tr>
<tr>
<td>3</td>
<td>1500</td>
<td>75</td>
<td>0</td>
<td>75</td>
<td>56.35</td>
</tr>
<tr>
<td>4</td>
<td>1500</td>
<td>75</td>
<td>0</td>
<td>75</td>
<td>51.23</td>
</tr>
<tr>
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<td>1500</td>
<td>75</td>
<td>0</td>
<td>75</td>
<td>46.57</td>
</tr>
<tr>
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<td>75</td>
<td>100</td>
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<td>70</td>
<td>100</td>
<td>170</td>
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<td>1300</td>
<td>65</td>
<td>100</td>
<td>165</td>
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<td>100</td>
<td>5</td>
<td>100</td>
<td>105</td>
<td>15.61</td>
</tr>
</tbody>
</table>

Total of discounted payments: 986.14

The grant element is the face value of the loan ($1500) minus the present value of the future debt service payments (986.14) expressed as a percentage of the face value. Therefore the grant element is (1500–986.14)/1500 or 34.26 percent.
reflect competing uses of the loanable funds: what is the highest possible yield that could be obtained on an alternative financial investment.

To use the grant element as the means for comparing terms of borrowing, a common discount rate must be used. Accordingly, to make inter-country comparisons of the concessionality of loans, the OECD’s Development Assistance Committee has adopted 10 percent as the standard rate of discount to be applied in grant element calculations.

The two examples in this annex (Annex Tables 1 and 2) illustrate the grant element concept. Both examples assume that $1,500 is borrowed, that interest is payable annually on the outstanding balance of the capital from the time the loan is received, and that principal is repayable in equal annual installments. Each payment, of both interest and principal, must be discounted to determine its equivalent present value. The tables show the actual payments and their discounted equivalents, using a 10 percent discount rate. The logic behind discounting is that future payments are worth less now than current payments, since they could be invested to generate income. The first example generates a grant element of 34.26 percent, the second only 12.38 percent because of its higher interest rate and shorter grace period.

Annex Table 2
Example 2: Interest rate is 8 percent, grace period is 3 years, and there are 15 years of principal repayments.

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance</th>
<th>Interest</th>
<th>Principal</th>
<th>Total</th>
<th>Discounted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1500</td>
<td>120</td>
<td>0</td>
<td>120</td>
<td>109.09</td>
</tr>
<tr>
<td>2</td>
<td>1500</td>
<td>120</td>
<td>0</td>
<td>120</td>
<td>99.17</td>
</tr>
<tr>
<td>3</td>
<td>1500</td>
<td>120</td>
<td>0</td>
<td>120</td>
<td>90.16</td>
</tr>
<tr>
<td>4</td>
<td>1500</td>
<td>120</td>
<td>100</td>
<td>220</td>
<td>150.26</td>
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<tr>
<td>5</td>
<td>1400</td>
<td>112</td>
<td>100</td>
<td>212</td>
<td>131.64</td>
</tr>
<tr>
<td>6</td>
<td>1300</td>
<td>104</td>
<td>100</td>
<td>204</td>
<td>115.15</td>
</tr>
<tr>
<td>7</td>
<td>1200</td>
<td>96</td>
<td>100</td>
<td>196</td>
<td>100.58</td>
</tr>
<tr>
<td>8</td>
<td>1100</td>
<td>88</td>
<td>100</td>
<td>188</td>
<td>87.70</td>
</tr>
<tr>
<td>9</td>
<td>1000</td>
<td>80</td>
<td>100</td>
<td>180</td>
<td>76.34</td>
</tr>
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<td>66.31</td>
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<tr>
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<td>800</td>
<td>64</td>
<td>100</td>
<td>164</td>
<td>57.48</td>
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<tr>
<td>12</td>
<td>700</td>
<td>56</td>
<td>100</td>
<td>156</td>
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<td>100</td>
<td>116</td>
<td>22.95</td>
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<tr>
<td>18</td>
<td>100</td>
<td>8</td>
<td>100</td>
<td>108</td>
<td>19.42</td>
</tr>
</tbody>
</table>

|      | Total of discounted payments: | 1314.29 |

The grant element is the face value of the loan ($1500) minus the present value of the future debt service payments (1314.29) expressed as a percentage of the face value. Therefore the grant element is: (1500–1314.29)/1500 or 12.38 percent.

Reference

Borrowing and Debt Management

Governments have generally found it useful to centralize responsibility for negotiating foreign loans in the Ministry of Finance, because it is charged with the nation's overall financial management.

**Loan Negotiation by the Government**

As a nonspending Ministry, the Ministry of Finance is likely to be more effective in representing national, as opposed to sectoral, financial interests. Typically, loan negotiations by the government are coordinated by a small unit, which will here be called the “External Finance Unit.” It must have specialized staff to deal with the three broadly different types of loans that are available—concessional and other foreign aid, export credits and market finance. This section is based on an essay by Lars Kalderen (Kalderen 1992), former director of the Swedish National Debt Office.

**Concessional Assistance and Other Foreign Aid**

Countries wanting to tap concessional aid sources must have an administrative structure in the External Finance Unit that permits effective negotiation with donor governments and multilateral agencies. Complicating the negotiation process is the fact that donor governments have multiple constituencies to serve, and their individual interests must be reconciled. The utilization of public funds in aid programs must be carefully monitored by both donor and recipient governments to assure that the funds are being used for their intended purposes.

Several ministries or government agencies in the borrowing country must be involved in negotiations. There is the beneficiary agency that would make use of the aid to finance a specific project. There is often a Ministry
The External Finance Unit must establish priorities on the use of foreign aid in coordination with planning agencies, potential beneficiaries and the Central Bank.

It must also understand donors' objectives, constraints and administrative procedures.

Policy coordination is central to the negotiation process.

of Planning or of Economic Affairs responsible for devising long-term development programs; they interact with the World Bank and other lenders in discussing development strategies. Since the potential volume of concessional aid is limited, these Ministries must decide how to allocate available financial assistance among potential users in the recipient country. Then, there is the Ministry of Finance, responsible for loan negotiations. Finally, the Central Bank is likely to be involved in discussions on the mobilization of foreign-exchange resources and the interface with the domestic financial sector.

The External Finance Unit deals, on the one hand, with the foreign lender or donor and, on the other, with the Ministry of Planning and the beneficiary agency, which can be a government department or ministry. The External Finance Unit must understand each foreign lender's objectives, constraints and administrative procedures for arranging and disbursing loans and grants. Since all aid donors operate within the framework of an annual plan, formed well in advance of negotiations, the External Finance Unit can advise the Ministry of Planning and the Central Bank on the best deployment of concessional aid, looking ahead several years. The Ministry of Planning can use this information to determine priorities and to propose specific projects to be financed.

Loan negotiations can be complex. Let's look at a real-life case of an Indian delegation, which negotiated a large loan from the World Bank in the mid 1980s to finance a big hydro-electric plant. The project's benefits (from both increased electricity and agricultural production) were to be spread across four Indian States. The federal structure of the Indian Government dictated that the Central and State Governments harmonize their policies and programs. Hence, the Indian negotiating delegation comprised representatives from 15 separate governmental units—the Ministries of Finance of the Central Government and the four States; the Ministries of Power of the Central Government and of the four States, and the Ministries of Agriculture of the Central Government and of the four states. Notwithstanding the size of the group, discussions advanced expeditiously and details of loan contract were agreed.

The key to successful loan negotiations is coordination. The Government's negotiating position must be discussed within the country prior to negotiations, and briefs obtained from the political authorities on the boundaries of the Government's position. Only through such prior consultation can the External Finance Unit represent a coherent policy to the lending institution.

Once agreements have been reached, the External Finance Unit must be ready to monitor disbursements to sure that loan administrative proce-
Disbursement procedures do not delay execution of the project (Disbursement procedures are discussed in detail in Chapter 6.)

Lending agencies require reports on the implementation of projects they finance to ensure that loans or grants are being used for intended purposes. The External Finance Unit is generally responsible for seeing that reports for lenders are prepared by the beneficiary in a timely and careful manner. In addition, information on loan disbursements must be prepared for the group in the Ministry of Finance responsible for monitoring central government debt. Of these tasks, assembling data on loan disbursements is, perhaps, among the most troublesome aspect of monitoring central government debt (see Chapter 6). Care must be taken that disbursement data is consistent with data used in the balance of payments and with data used in public sector investment programs. Frequently, these data are inconsistent with one another and the External Finance Unit can do much to help avoid such troublesome anomalies.

Export Credits

As described in Chapter 2, export credits finance individual purchases of goods or contractors' services. They may be extended directly by the exporter (suppliers credits). More commonly, they are issued by the exporter's commercial bank-buyers credits. Large exports, such as aircraft, may be financed by a specialized government financial institution of the exporter's countries—an official export credit.

Export credits fell into disrepute in the 1960s and 1970s, after many developing countries took on more medium-term credits than could be serviced from export earnings. This led to debt servicing problems in the early 1960s by Argentina, Brazil, Chile, Peru, Ghana, and Indonesia. Between 1979 and 1985, more than 50 countries had to seek debt relief, in large part because of uncoordinated and excessive contracting of export credits (see Chapter 11 for details).

Even so, export credits are a useful supplement to concessional aid. Interest rates are generally subsidized by the lending-country government (although not as generously as in the 1960s and early 1970s). More important, most governments of countries exporting capital goods have export credit guarantee or insurance agencies that protect the lender from political or transfer risk in the borrowing country. Thus, export credits are often available when market finance is not. Of course, the Ministry of Finance of the borrowing country must carefully monitor the use of export credit finance to avoid over-borrowing.
Accordingly, the External Finance Unit of the Ministry of Finance should contain an Export Credits Section. The staff must be expert on export credit finance, having a background in commerce and banking. They must maintain contact with the major national export credit insurance agencies to be aware of their concerns regarding creditworthiness for export insurance cover and keep current on the various possibilities of export finance. They must also keep in contact with the commercial banks of exporting countries to know about their thinking regarding export credit finance. With this information, the External Finance Unit will then be in a position to advise potential borrowers and the Ministry of Finance on the volume, terms and conditions of export credit finance.

**Market Finance**

As described in Chapter 2, there has been a revival of market finance to developing countries and to Eastern Europe. While the sovereign lending of the 1970s is now limited, market finance is again available if there is promise of macroeconomic stability and sustained growth in the borrowing countries. Witness Mexico’s and Venezuela’s return to financial markets in 1991. To secure market finance the External Finance Unit must have the required specialized staff.

**Market Finance Section.** To arrange for the central government to borrow in its own name (or issue guarantees), the External Finance Unit must include a Market Finance Section. It should typically comprise three subgroups plus a Senior Debt Manager. One subgroup should consist of two economists (or two groups of economists, if the volume of work so requires). One economist should be an expert in international finance and would monitor borrowing condition in major financial centers (New York, London, Frankfurt, and Tokyo). He (or she) would advise about the possibilities of utilizing each major market, the type of financial instrument required and the relative costs of borrowing. The second economist would be an expert on macroeconomics, responsible for following economic conditions in his (or her) own country and be in a position to brief foreign bankers on local business and economic conditions. Having available up-to-date, comprehensive statistics and factual information on the economy and being able to answer questions on the economic outlook will increase the confidence of foreign lenders in the country’s ability to manage its affairs and thus enhance its borrowing possibilities.
The Market Group. This unit should be staffed with officers whose job it is to negotiate with banks for loans or to arrange flotations or placements of securities. They must know the current conditions of borrowing in individual markets, and they must build up good personal working relationships with key staff of foreign lending institutions. Both they and the international financial economist must visit financial centers regularly to maintain personal contacts, to learn of new borrowing instruments and to stay abreast of general developments in markets.

Another important function of the Market Group is to manage currency and interest-rate swaps on existing debt. This is a specialized skill. Such swaps must be carried out to minimize risks related to exchange-rate and interest-rate fluctuations (see Chapter 10).

The Treasury Group. It is responsible for arranging the draw-down and use of monies available through market borrowing. The staff also must be responsible for seeing that all fees, interest charges, and so on, are paid on time so as to protect the country’s credit standing. To do this, they must be in close touch with the relevant Central Bank staff. It is also important that the Treasury Group be represented in loan negotiations so that agreements will take account of problems involved in Treasury operations. People with good administrative skills and training in international finance are required for the Treasury Group. Knowledge of English, the key language used by the international financial community, is essential.

Senior Debt Manager. To coordinate market borrowing and bring together the work of these three functional groups, the Market Finance Section should be led by a Senior Debt Manager. Obviously, this individual should have a personal knowledge of the functions of each section, but the Senior Debt Manager must also have sufficient stature to command the respect of his or her own staff, of senior managers of the Government’s Finance Ministry and Central Bank, and of the potential lenders. The Senior Debt Manager must be constantly on the look-out for the best financing opportunities, and he or she must maintain the reputation of his or her country as a prudent and responsible borrower.

The External Finance Unit has specialized staff to negotiate loans from foreign bilateral and multilateral aid agencies, from banks and suppliers extending export credits and from financial markets. The work requires overall direction. This comes from a coordinating body whose policies are formulated at the highest levels of the Ministry of Finance and the Central Bank.
Governments must monitor private sector and nongovernment public sector borrowing in addition to controlling government.

Some countries require special authorizations of foreign borrowing.

Controlling Nongovernment Borrowing

Governments must also be concerned with external borrowing by nongovernment public sector agencies and with borrowing by the private sector. One can distinguish three different situations from the point of view of controlling mechanisms: (a) borrowing that takes place outside an exchange control system, without any control or registration, (b) no restrictions on borrowing but mandatory registration of foreign loans and (c) prior authorization of foreign borrowing (de la Dehesa 1985, p. 91):

Authorization Procedures

Requiring prior authorization for foreign borrowing may seem a prudent way of protecting a country’s long-term balance of payments position. But authorization procedures have a major drawback. If a firm has to subject its borrowing plans to a governmental administrative unit, it can lose flexibility to respond to market conditions, weakening its competitive position. This problem is particularly acute if there is a substantial delay between the time borrowing applications are submitted and when they are approved. Thus, there must be a prompt response to borrowing applications. The criteria for approval must relate to general balance of payments or market condition considerations. Countries with a strong balance of payments and only moderate indebtedness usually relax restrictions on external borrowings of enterprises.

In general, the rules for foreign borrowing are set by the Ministry of Finance and executed by the Central Bank, using its foreign-exchange control procedures. The Central Bank, in turn, frequently delegates administrative responsibility to authorized foreign-exchange banks. Often, relatively small credits are approved routinely or under a simplified process, with the administrative authorities concentrating on the larger applications. Some countries prohibit private firms from borrowing abroad directly but must channel borrowings through authorized foreign-exchange banks.

Finland, for example, has had an elaborate approval system for private sector external borrowing prior to 1986. Since then the system was gradually relaxed and, finally, by the end of 1990, totally removed. Under the approval system all proposed foreign loans with a maturity of more than one year had to be approved by the Central Bank of Finland. That system assured that “… foreign funds are used only for real investments and not for consumption. Furthermore, permission to import long-term capital is given only for projects that are expected to be economically viable and profitable”
Controlling Nongovernment Borrowing

(Pekonen 1985, p. 220). Since there were less than 100 firms with significant external borrowing, each was required to fill out an annual questionnaire on capital needs. The impact of proposed private sector borrowing on monetary targets was noted, and the timing would be adjusted accordingly.

Finnish private borrowers were given approval to borrow in advance of needs when market conditions were favorable. They were required, however, to deposit the funds with the Central Bank until needed. Short-term lending was not subject to control but it was monitored for statistical purposes.

Korea requires private firms wanting foreign capital to secure loans through a foreign-exchange bank. This is designed not so much to restrict private sector borrowing but to control its timing. The aim is to distribute annual external borrowings on financial markets by public and private sector borrowers “evenly in order to provide optimal conditions for tapping the markets, enabling borrowers to acquire capital at the lowest possible cost” (Kwon 1985, p. 233).

Controlling the timing of syndicated loans and bond issues so as not to disturb financial markets is a common practice for countries that are relatively new to world capital markets (Üçok 1992, pp. 78–79). In Indonesia, several large enterprises as well as the government have succeeded in marketing bonds. Because uncoordinated approaches resulted in lenders raising their spreads and shortening maturities, however, the Indonesian authorities introduced a queuing system in 1991.

Chile controls borrowing by commercial banks with indirect controls designed to affect the cost of foreign resources instead of using administered quantitative restrictions (Somerville 1985, p. 206). This is accomplished by setting values on key ratios, such as debt to capital and reserves and guarantees to capital and reserves. Nonbank borrowers are subjected to similar regulations.

**Registration of Private Sector Loans**

Some countries allow nongovernment foreign borrowing without prior approval but do require that loans be registered. This is typical of countries with no exchange controls on current-account transactions but with restrictions on capital-account transactions. Exchange-control authorities want to prevent capital outflows disguised as debt service payments. Accordingly, all applications for debt service payments must be verified against a schedule that had been registered with the exchange control authorities.

Other countries do not require prior approval, but ask that all loans be registered.

Finland had a system that reviewed investment priorities.

Korea's control system concerned the timing of market access, as in Turkey and Indonesia.
Guarantees

Central government finance ministries would like to be responsible only for the direct borrowing of the state. Ideally, public enterprises would borrow independently. Such enterprises, however, often can obtain term loans only if there is a central government guarantee. Thus, the central government must establish procedures and criteria for issuing guarantees. This is important, because if the enterprise cannot meet the interest and amortization charges as they fall due, the funds must come from the central government’s budget.

Project applications must be closely scrutinized to see if the proposed project is likely to generate the financial return anticipated. The financial condition of the enterprise must also be studied. While the project may seem satisfactory, the cash-flow and profitability of the enterprise may be too weak to ensure repayment of the loan.

Borrowing and relending is another method of securing external finance for public enterprises. The Ministry of Finance might borrow under its name and then lend the proceeds to public enterprises on the same terms on which it borrowed. For securing external finance for private enterprises, development loan funds are common. Often public agencies borrow in their own name and then use the proceeds to make local currency loans to private enterprises.

Notes

1. Mr. R. P. Brigish called my attention to this example.

References


Legal Aspects of Sovereign Lending

Thomas A. Duvall, III

Loan negotiations involve many elements, including financial and legal considerations. The borrower’s negotiating team should include lawyers who are skilled in the legal aspects of international borrowings.

From a legal perspective, the lending agreement should accurately reflect the financial understandings of borrower and lender and should not contain provisions which unduly constrain the borrower’s activities. At the same time, the borrower must understand and appreciate the lenders’ interests and concerns. Negotiations should strike the appropriate balance between the concerns of the borrower and the lenders while leaving the agreement as favorable as possible to the borrower. This chapter is designed to give external debt managers a flavor of the key legal issues which are likely to arise in the negotiation and administration of international lending agreements.

Broadly, these issues are authorization to borrow, the law governing the transaction, the forum for resolving any disputes and the effects of sovereign immunity, the principal obligations of the sovereign under international lending agreements, events of default and the potential consequences if the sovereign does not perform its obligations under the agreement.

Here, we deal primarily with unsecured lending, because, historically, most sovereign lending is unsecured. In the aftermath of the sovereign debt crisis, some lenders may, however, be unwilling to extend credit unless the borrower provides the lender with security, such as an offshore escrow account into which foreign exchange earnings of the borrower are placed in order to service the loan. The pledging of assets by borrowers may have serious financial implications and the advantages and disadvantages of secured financing should be carefully weighed. Moreover, borrowers would need to assess the feasibility of any secured borrowings under any negative pledge undertakings that the borrower may have made.
A government must assign specific authority to its legislative and executive branches with respect to foreign borrowing.

Legal Basis for International Borrowing

When a government wishes to arrange for foreign loans, it must first establish the legal basis for the authorization of such loans and define the executive branch’s autonomy. The executive will negotiate with foreign lenders, normally through the Minister of Finance. At the same time, the legislative branch of the government may wish to exercise some control over the executive’s contracting of external loans. A newly independent state must establish a legal basis for external borrowing that delineates the respective authority of the executive and legislative branches of government.

The division of responsibilities varies from country to country. In some cases, there may be a requirement that the legislature ratify or approve each individual borrowing. In other cases, the executive may have complete autonomy to contract foreign loans. Generally, however, foreign borrowings require some form of legislative approval.

The respective responsibilities of the executive and legislative branches are usually written in a country’s constitution. Most constitutions either include explicit provisions that refer to the involvement of the legislature in the approval process or contain general provisions on the functions of the executive and legislative branches of government which are interpreted to require the participation of the legislature in the approval of foreign borrowings.

When legislative approval is mandatory, foreign borrowing laws may either require legislative approval of all individual borrowings (and guarantees of borrowings) or authorize the executive to contract loans within limits. Such legislation might, for example, authorize the executive to borrow whatever it may from international financial institutions, such as the World Bank, or permit borrowings up to specified amounts or for specific purposes, such as the financing of imports or for economic development projects or programs. The enactment of enabling legislation that empowers the executive to contract loans within the limits of the legislation may facilitate international borrowings. Otherwise, lengthy delays may result if legislative approval or ratification of individual borrowings is necessary.

The Loan Agreement

Foreign borrowing takes place within a framework established through a loan agreement. The borrower obtains funds from the lender immediately and the lender understandably insists on the borrower signing a legally bind-
The loan agreement records the responsibilities of the borrowers.

Loan mechanics. This sets forth the amount of the loan, the procedures for draw-down, interest charges, and repayment mechanism.

Protection clauses. These spell out what is to be done in the event of default and also include warranties and covenants.

Change in circumstances. For Eurodollar loans and other loans based on a variable interest rate, the loan agreement must explain what adjustments in the payment arrangements are required as the cost conditions change in money markets. For example, there must be a mechanism for recalculating interest charges as the underlying Eurodollar deposit rate changes.

Relationship between banks. Financial credits often involve the lending of money pooled by several banks. The loan agreement must set forth clearly what are the responsibilities of the lending banks to each other.

Dispute resolution clauses. These include agreement on which courts have jurisdiction and what laws apply. If a sovereign state is the borrower, there may be a waiver of immunity.

Governing Law

In international lending, borrower and lenders will be from different countries, and the laws of more than one jurisdiction could apply to the loan. To provide certainty as to which country’s laws will pertain to the rights and obligations under the lending agreement, it is customary in international loans for the parties to the agreement to specify the law that is to govern the agreement. In general, the parties are free to choose which law.

Although sovereign borrowers have sometimes proposed that their law be the governing law, lenders normally insist that the law of another country apply. Usually, this will be the law of the jurisdiction where the lender is located or the law of another major commercial jurisdiction. The lender’s concerns are that the governing law be such that it will give effect to the parties expectations as expressed in the lending agreement and that the law will be applied in an impartial manner.
Once the lender has disbursed the funds, it has performed its obligations under the agreement and bears the full risk of the borrower performing its obligations. If the agreement were to be governed by the law of the sovereign borrower, there would be a risk that the sovereign borrower could change its laws and thereby frustrate the lender’s rights.

The selection of a foreign law to govern a lending arrangement may not cover all aspects of the arrangement, however. Questions related to the power to undertake the borrowing would normally be determined in accordance with the laws of the borrower’s country. For example, if the borrowing is secured by assets, questions on the security interest in the assets might be determined by the law of the country in which the assets are located. Such laws may impose limits on the amount of debt incurred by the government, government entities or the central bank. There may also be a requirement that individual borrowings be approved by governmental authorities. Similar restrictions may exist with respect to governmental guarantees of foreign borrowings by private companies. The constitutive documents of the borrower (the charter or statutes of the borrower) also need to be examined to ascertain that the borrower has the legal authority to borrow money. It will also be necessary to determine that the borrower has completed all the required steps under its constitution, and local law to authorize, execute, and deliver the borrowing.

Foreign lenders will also wish to know that all local governmental consents, such as those on exchange controls, have been obtained; that no local stamp duties are payable; and no filings are required for the extension, delivery or enforcement of the agreement. Finally, foreign lenders will also want to know that a foreign judgment obtained against the borrower with respect to nonperformance would be enforced in local courts without a re-examination of the merits of the judgment and that the borrower would not be entitled to sovereign immunity. Local counsel will normally be expected to provide legal opinions to foreign lenders on such matters.

Although loans from private lenders to a sovereign will usually be governed by the law of another jurisdiction, loans from international financial institutions, such as the World Bank, are normally governed by public international law.

**Forum and Sovereign Immunity**

In addition to stipulating the law which is to govern the rights and obligations of the parties under the agreement, it is usual to include provisions on forum and sovereign immunity. Forum refers to the court or other tri-
bunal which has jurisdiction to decide a particular dispute. Sovereign immunity is a judicial doctrine that precludes a party from suing a sovereign without the latter’s consent.

**Choice of Forum**

Parties to international lending agreements normally stipulate the forum in which any disputes are to be decided and judgement enforced. For loans from private creditors, lenders will usually want this forum to be the courts of the jurisdiction whose law governs the agreement. Another jurisdiction as the forum would create uncertainty because it could result in the courts of one jurisdiction applying an unfamiliar, foreign system of law. The underlying rationale, again, is to ensure certainty and predictability of any litigation. Other factors also taken into consideration in forum selection may include the speed with which courts are likely to render decisions and the extent to which the assets of the borrower may be attached prior to judgment to prevent their removal from the jurisdiction during litigation.

The reason for specifying a forum in the lending agreement is to confer jurisdiction on courts that might otherwise not have the authority to adjudge actions arising from the agreement. This is normally achieved by the express submission by the borrower in the agreement to the jurisdiction of the designated courts and by the appointment by the borrower of an agent in that jurisdiction for service of process.

It would be relatively unusual, however, for the lending agreement to provide that the specified forum would be the exclusive forum in which a party could institute legal proceedings. Lenders will normally seek to retain the flexibility to bring proceedings in any court that has jurisdiction over the borrower in order to maximize their potential recovery.

Unlike lending agreements of private creditors, disputes under World Bank agreements are settled by arbitration. Although this provision has never been invoked, the rationale is that disputes under an agreement between an international organization like the World Bank and a member state should not be decided in domestic courts. Commercial creditors, on the other hand, are generally unwilling to submit matters to arbitration because of possible delays in enforcing an award because it may not be possible to obtain prejudgment attachment—that is, a judicial order resulting in the seizure of a defendant’s property in order to secure a creditor’s claim in the event a judgment is rendered for the creditor. Arbitration is more likely to be used in complex commercial contracts that may raise complicated technical ques-
tions best decided by experts. Proceedings with respect to lending arrangements, however, are usually more straightforward and brought merely to enforce payment.

**Sovereign Immunity**

Where the borrower is a sovereign state, the ability of the courts of another state to exercise jurisdiction may be limited by sovereign immunity. Historically, sovereign states could not be sued in foreign courts. More recently, this doctrine of absolute sovereign immunity has eroded in many jurisdictions. Sovereigns continue to enjoy immunity from jurisdiction with respect to governmental acts but not for commercial activities. The distinction between governmental and commercial activities is not always clearly established, however.

To eliminate any uncertainty, it is customary for the borrower to waive sovereign immunity in the agreement. It is important, however, to distinguish between immunity from jurisdiction and immunity from attachment and execution of judgment. A waiver of immunity from jurisdiction means simply that the court has the power to adjudicate a dispute between the creditor and the sovereign debtor and to make a judgment. A waiver of immunity from attachment and execution means that a creditor who has obtained a judgment can enforce it by attaching the sovereign debtor’s assets located within the territory of the court’s jurisdiction.

Lenders will usually seek waivers with respect to both prejudgment and postjudgment attachment. Under a prejudgment attachment, a court may order the seizure of a defendant’s assets prior to adjudication to secure satisfaction of a judgment if awarded. In litigation against a sovereign state, such an order may be obtained without notice to the sovereign whose assets are to be seized.

The United States and the United Kingdom are two of the principal jurisdictions to whose courts sovereign borrowers will frequently be asked to submit. Both have statutes on sovereign immunity. Under United States’ law, a waiver of immunity from attachment can apply only to property used for commercial activity. Military property or diplomatic premises, for example, cannot be attached. In the United Kingdom, such a waiver covers all property of the state other than diplomatic premises whether or not commercial.

In both the United States and the United Kingdom, the assets of foreign central banks and monetary authorities are given special immunities from attachment to avoid discouraging them from maintaining foreign revenues there. In the United Kingdom, a central bank must expressly consent to
enforcement if it is a separate entity from the sovereign. In the United States, the property of a central bank held for its own account is immune unless the bank or its government has explicitly waived its immunity. In any event, in the United States the property of a central bank held for its own account is probably absolutely immune from prejudgment attachment even if the bank has waived immunity.

The principal assets of a sovereign state held abroad will often be foreign-currency reserves of its central bank. In such cases, and where the central bank is a separate legal entity from the state, lenders may demand that the borrower be the central bank or that the bank guarantees the loan.

Unlike private lenders, multilateral financial institutions, such as the World Bank, do not seek waivers of sovereign immunity. The General Conditions Applicable to Loan and Guarantee Agreements of the World Bank provide that the World Bank may only enforce awards and judgments against member states where such enforcement is possible under the local law.

**Principal Obligations of Sovereign Borrowers**

Obviously, the principal obligation of a sovereign or any other borrower under a lending agreement is to pay the amounts owed when due. Rarely, however, will this be the only obligation. Lending agreements normally contain covenants or undertakings by the sovereign intended to restrict its ability to engage in certain activities or to do certain acts. Such covenants should be designed to achieve a fair balance between the interests of lender and borrower. They should adequately protect the lender’s position without unduly burdening the borrower or subjecting the borrower to action because of trivial defaults. There are three covenants of particular importance—negative pledge, pari passu and mandatory prepayments.

**Negative Pledge Covenants**

Negative pledge covenants vary and are often heavily negotiated. The simplest form prohibits the borrower from pledging any of its assets to secure another loan. Another form prohibits the creation of security interests in favor of any other creditors unless equal and ratable security is granted to the creditor to whom the negative pledge is given.

When the borrower is a sovereign state, lenders may seek to ban the granting of security by agencies of the state, such as the central bank, as well as the state. The reason is that any diversion of the state’s resources, regardless of who technically holds them, could be prejudicial to the lender.
On the other hand, borrowers try to limit the scope of a negative pledge covenant to maximize flexibility in conducting their financial affairs. In the case of sovereign borrowers, it is not unusual for the negative pledge covenant to apply only to security created for external debt and not to security for domestic loans. The reason is that foreign lenders look mainly to the assets of the sovereign held outside its territories for repayment rather than domestic assets. Exceptions for trade finance and security given to finance the purchase price of property are also common. Other exceptions may include liens in respect of certain project financing transactions. It may also be possible for a borrower to negotiate a so-called “basket” exception, permitting it to create liens up to a predetermined amount.

The World Bank’s negative pledge clause requires that a lien to the benefit of an individual creditor be shared with the World Bank in proportion to the debt due to each of them....

... but it grants waivers in exceptional circumstances.

The World Bank requires a negative pledge undertaking in its General Conditions Applicable to Loan and Guarantee Agreements, which are incorporated into all loan agreements. This undertaking does not prohibit the creation of security interests, but it does provide that if the borrower (whether the state or any other entity) creates a lien on public assets as security for external debt with the effect of giving a priority to another creditor in respect of foreign exchange, such lien shall, unless the World Bank otherwise agrees, by that very fact equally and ratably secure the loans from the World Bank. This simply means that the creditor benefiting from the lien and the World Bank would share in the security in proportion to the debt due to each of them. Public assets are defined as those of the state or any political or administrative subdivision. In cases where the borrower is not the state, the World Bank’s negative pledge clause also requires the borrower to equally and ratably secure World Bank loans if the borrower creates any lien on any of its assets as security for any debt, whether foreign or (domestic) debt. The only two exceptions are for liens on property at the time of its purchase solely as security for the payment of the purchase price and for liens established in the ordinary course of banking transactions to secure a debt of not more than one year maturity.

The World Bank’s negative pledge clause is included in its General Conditions, and it is not negotiated on a case-by-case basis. Borrowers have at times asked the World Bank to waive its negative pledge clause for particular transactions. The World Bank does so only rarely—where, for instance, its exposure in a country is small and the waivers are not considered to pose any risk. Sometimes it has agreed to waivers on assets of public entities which operate autonomously and whose activities have no material significance to the state’s ability to service World Bank loans. More recently, it has agreed to waivers on collateral to secure exchange bonds issued as part of comprehensive commercial debt reduction programs. The World Bank has also agreed to a general waiver for a limited time to help project
financing(s) in some member countries in transition from managed to more market-oriented economies. Eligible countries must request such a waiver, and it would be applicable only to secured project financing(s) meeting criteria established by the World Bank.

There is some question as to the rights of a lender if its negative pledge clause is breached. Certainly, such a breach would be a default under the loan agreement and entitle the lender to take whatever actions are provided in the lending arrangement—suspension of further disbursements, acceleration of loan repayments, and so on. The lender might also seek legal redress against the borrower for breach of contract, such as an injunction against the granting of the security or damages from the borrower. There are some doubts, however, as to the effects of those negative pledge clauses that do not prohibit the establishment of security but instead provide that the lender share equally and ratably in the security. Some support the view that security given to a subsequent lender will have an equitable lien in favor of the lender that has such a clause. Others believe, however, a court would rule that the original lender has no rights with respect to such property and that the lender's only recourse is against the borrower for breach of contract.

**Pari Passu Covenant**

A negative pledge covenant in a lending agreement normally goes hand-in-hand with a pari passu covenant. This provides that the borrower's obligations under the loan will enjoy the same rank or status with its other obligations. Its general purpose is to prevent a borrower from granting a preference to other unsecured debt—that is, subordinating the loan to other unsecured debt.

With loans to corporate entities, the aim is to ensure that all unsecured creditors will be entitled to pro rata payments in the event of the liquidation of the borrower's assets. With loans to a sovereign state which are not subject to domestic bankruptcy laws and whose assets cannot be liquidated by judicial proceedings, the pari passu clause has a different function. It is generally believed that a pari passu covenant prevents the sovereign from discriminating between lenders by law or governmental decree which prefers some, unsecured creditors over others—for example, allocating reserves for the benefit of some creditors or devoting some government revenues to servicing specific debts.

In practice, it is unlikely that a standard pari passu clause prevents a sovereign from discriminating between creditors unless it establishes a legal basis for so doing. For example, many developing countries have continued to make payments to multilateral financial institutions, such as the World
Bank, even when they were unable to service commercial bank loans. The so-called “preferred creditor status” of the World Bank rests on practical considerations rather than legal grounds and, thus, is not thought to violate such countries’ pari passu undertakings.

Because such discriminatory actions between creditors (whether under the same or different loans) are unlikely to be addressed by the pari passu clause, lenders may seek to include other provisions in the lending arrangement, such as mandatory prepayment clauses and, for syndicated loans, sharing clauses.

**Mandatory Prepayment Clause**

A mandatory prepayment clause is a promise made by a borrower to a creditor to prepay proportionately the loan if the borrower prepays a loan or loans from other creditors before the scheduled date. Although such clauses have been included primarily in debt restructuring agreements, creditors may seek to include such clauses in other lending agreements. The theory would be essentially the same—that is, the lender would expect that all of the borrower’s lenders should be treated the same.

The scope of such a clause would be a matter of negotiation. If the parties agree to the inclusion of such a clause in a lending agreement, the negotiations would likely center around whether the clause would apply to the prepayment of all or only some categories of debt. In any case, the clause should apply only to voluntary prepayments.

**Events of Default**

International lending agreements usually provide for events of default and, if they occur, the lenders may terminate lending commitments and demand immediate repayment of all disbursements. Events of default fall into two categories. The first is the failure by the borrower to perform obligations under the lending arrangement, such as failure to pay amounts owed when due or failure to perform any of the covenants. The second relates to the general financial well-being of the borrower, which makes it likely that the borrower will not be able to perform its payment obligations. Although lenders may, naturally, wish that the events of default provisions be drafted precise as possible, borrowers naturally favor some latitude so that they do not find themselves in potential difficulty because of inadvertent or minor defaults. Generally, borrowers will attempt to ensure that only those events are included which, if they were to occur, would jeopardize the borrower’s ability to repay. They also want to make sure that the specified events do
not unreasonably restrict the borrower's freedom of action. In sovereign lending, the principal (but not the only) events of default are nonpayment, misrepresentation and breach of covenant, defaults by the borrower under other loans and material adverse change.

**Nonpayment**

Failure to pay any sum under the lending agreement when it falls due will undoubtedly be an event of default. This would include interest and principal as well as other amounts owing under the agreement. It may, however, be possible for borrowers to negotiate a short grace period so that the entire loan is not suddenly repayable.

**Misrepresentation and Breach of Covenant**

A breach of any representation or warranty made by the borrower in connection with the lending arrangement would normally be an event of default. This is because such representations and warranties reflect the basic factual and legal assumptions on which the loan has been made. If these prove to be false, the lender's prospects of repayment may be impaired. It is not unusual, however, for there to be a materiality qualification—that is, it would only be an event of default if the representation was inaccurate in a material respect. The borrower may also be allowed time to correct the misrepresentation, before it becomes an event of default. Similarly, a grace period might be included in the event of default because of failure to perform a covenant or other obligation, so as to allow the borrower time to comply.

**Cross-Default Clause**

A cross-default clause seeks to maintain equality among lenders. Such clauses usually come in two forms. One allows the lender to exercise remedies simply if an event of default occurs under any other of the borrower's lending arrangements. The other requires that other lenders accelerate their loan for the cross-default clause to be triggered.

The purpose of cross-default clauses, regardless of its form, is to preserve the equality of creditors in terms of legal remedies and bargaining. The theory is that if one creditor is seeking remedies against a borrower, other creditors should be able to do so as well. Creditors are likely to have two concerns. First, if a default has occurred under one agreement, the creditor may seek to negotiate preferential terms in return for not accelerating the
loan. Since cross-default clauses would give other lenders the right to accelerate their loans, the ability of a creditor and the borrower to agree to such an arrangement would be limited.

Moreover, the ability to attach a borrower’s assets is likely to be affected by the timing of enforcement. The first creditors to reach the courthouse are likely to have the best chance of attaching assets.

Borrowers, obviously, want to limit the scope of cross-default clauses. Sovereign borrowers will normally seek to ensure that cross-default clauses (like the negative pledge, pari passu and mandatory prepayment undertakings) apply only to external debt. Other topics for negotiation include whether the cross-default clause should be limited only to payment defaults or should also include defaults for breach of covenants; whether the borrower is given time to cure defaults under other agreements before the cross-default clause is triggered; and whether there is to be any threshold amount included in the clause—that is, whether a default with respect to a certain minimum amount of debt must occur before the cross-default clause is triggered.

**Material Adverse Change**

Sovereign loans often contain a broad event of default allowing lenders to end their commitments and accelerate the loan if there has been a material adverse change in circumstances that may impair the ability of the borrower to perform its obligations. This provision is designed to address unforeseen situations which may adversely affect the lenders’ position.

The uncertain reach of such a provision is likely to concern borrowers. However, it is unlikely that creditors could act on this provision in a capricious manner. As a general principle, a lender is likely to be able to terminate its lending commitments and accelerate a loan in such a case only if he has acted in good faith. If not, a court could decide that a lender’s actions were unjustified and award the borrower damages or order that the lender perform as agreed under the lending agreement. In view of this and the vagueness inherent in the clause itself, a lender would feel comfortable in acting on the basis of such a clause only in the event of a very serious occurrence that clearly demonstrates reasonable cause for believing that the prospect for repayment is in doubt.

**Remedies**

What might happen if a sovereign state is unable to make payments when due or if some other specified event of default occurs? What rights would
lenders have? And what remedies would be available? In such cases, agreements will usually provide that lenders can accelerate payment of the loan. They would also have the right to bring judicial action to recover unpaid amounts or for other remedies for breach of covenant. Lenders may also be able to exercise set-off rights and, in the case of secured loans, to take ownership of, and sell, the property securing the loan.

**Acceleration**

If an event of default occurs, agreements will invariably provide that lenders may cancel their commitment to make available any amount of the loan that has not been disbursed and to declare the entire loan to be immediately payable. Typically, lending agreements provide that default must be continuing when lenders decide to exercise their rights. Thus, if the borrower cures the default before that time, the lenders would no longer have the right to take action. Where there are a number of lenders (such as a syndicated loan), it is customary to provide that banks holding a certain amount of the loan must agree to acceleration for action to be taken.

**Remedies in the Absence of Acceleration**

Even if a loan is not accelerated other remedies may be available to a lender if a borrower fails to perform its obligations.

*Right to sue for unpaid amounts.* Each lender has the right to sue the borrower for unpaid amounts if the borrower fails to make a scheduled payment of principal or interest or other amounts due under the loan agreement. Thus, in a syndicated loan (even if the requisite number of banks have not agreed to accelerate the loan), each lender may bring legal action.

*Injunction and Specific Performance.* A lender might petition a court to enjoin a borrower from violating a covenant or to order that the covenant be performed. For example, if a borrower intends to pledge property in contravention of the negative pledge clause, the lender might bring action to enjoin the borrower from granting it or, depending on the wording of the negative pledge clause, to order that the lender share in the pledge. The lender might instead decide to proceed solely against the beneficiary of the pledge especially if the beneficiary knew of the violation of the covenant. The lender could ask the court to enjoin the lien or to order that the lender share in it. Alternatively, the lender might seek damages from the beneficiary on the
grounds that it was a wrongful interference with the lender’s existing contractual relations with the borrower.

**Set-Off**

Where the lender is a bank, the most useful remedy may be the ability of the bank to apply or set-off deposits of the borrower held by the bank against amounts due. As a general rule, a bank can exercise set-off rights without leave from a court. In other words, set-off is normally a self-help remedy that a bank can exercise without judicial intervention or restriction.

Set-off rights arise because funds held on deposit with a bank are not normally considered to be the property of the borrower which has deposited them. Instead, a deposit usually creates a debtor-creditor relationship between bank and depositor. Funds held on deposit thus represent a debt owing from the bank to the depositor.

As a matter of law, the right of set-off may exist only if both the borrower’s deposit with the bank and its obligation to repay the loan have matured. If the borrower’s deposit is a demand deposit it is mature when made. A normal loan is not due until stated maturity unless it has been accelerated. It is not unusual for lenders to include contractual set-off provisions in lending agreements to give them broader set-off rights than they would have under law.

**Potential Limitations on Remedies**

In addition to sovereign immunity, other factors may limit a lender’s actions following nonpayment by a sovereign borrower.

**Mutuality of Obligations**

As a matter of law, set-off may be exercised only where the parties are identical. For example, if a borrower has funds on deposit with a foreign subsidiary of a bank which has made a loan to the borrower, the bank cannot set-off the deposits against the loan. Similarly, a bank may not set-off deposits of one government entity against a loan made to another entity. It is, therefore, typical for a lender to obtain a guarantee from the central bank if the lender intends to rely on the credit of that entity in connection with a loan to a sovereign state.
Piercing the Corporate Veil

It may be that a state entity not a party to the lending arrangement has significant assets within a particular jurisdiction or funds on deposit with a particular bank. If the state defaults on a loan, the question may arise as to whether a creditor of the state could look to the assets of the entity to satisfy its claims where the state entity has not expressly guaranteed or otherwise assumed liability for the debt. Such assets might, for example, be deposits of the central bank or, say, aircraft belonging to a state-owned airline.

As a general matter, courts will respect the independence of a separate legal entity, except in extraordinary circumstances where the entity is determined to be the alter ego of the sovereign. In determining whether to disregard the separate juridical status of a government entities, a court would consider number of factors. If, for example, the sovereign’s laws authorize the entities to act for the government in a governmental function, a court might hold that the entity is an alter ego of the government. A court might also disregard the separate status of the entity for equitable reasons—such as to prevent fraud or injustice or for overriding public policy considerations.

Sharing Clauses

In syndicated loan agreements, a sharing clause is common. This maintains the relative position of the banks that are parties to the agreement by requiring that if a bank receives a disproportionate payment with respect to the loan it will share that payment ratably with the other banks. Typically, such clauses will provide that a bank must not only share disproportionate payments received directly from the borrower but also amounts received through set-off, litigation, or otherwise. Such a clause may therefore dilute the benefits to a creditor from exercising set-off rights or commencing litigation.

This is likely to be a particular deterrent in the case of agreements involving a syndicate composed of many creditors. Such clauses may be one reason why there was so little litigation against sovereign debtors in the debt crisis. Most sovereign debt was restructured with huge syndicates composed of most of the sovereign’s bank creditors. Thus, any bank that exercised set-off rights or recovered amounts with respect to its loan by litigation would potentially be obliged to share the proceeds with many other banks.

Interestingly, since the so-called Brady Plan of 1989, much restructured debt has been transformed into bonds. Unlike syndicated loans, bonds do not contain sharing clauses.

Assets of a state entity may be seized only if that entity is “an alter ego” of the government.

In syndicated loan agreements, a bank must share out payments received that exceed its proportionate share of debt service or other payments.
Act of State Doctrine

The Act of State doctrine restrains courts from judging the actions of foreign governments. The underlying premise is that courts of one country should exercise restraint if called on to adjudicate the validity of actions taken by foreign governments because they might interfere with the conduct of their own government’s foreign policy, the responsibility for which lies with a different branch of government.

The Act of State doctrine is different for sovereign immunity, which is simply a procedural question as to whether a court has jurisdiction over a foreign government entity. The Act of State doctrine is a defense by a defendant that the court does not have jurisdiction. The defendant might be either a foreign government entity which has waived sovereign immunity or a private party whose performance of an agreement has been affected by a foreign government action.

The Act of State doctrine, however, applies only to foreign government actions in its own territories and which are applicable there. Thus, courts have typically rejected Act of State defenses where a defendant has asserted that it was prohibited from making payments on a foreign loan by virtue of foreign-exchange restrictions imposed within its own territory or because of a moratorium declared by the government on payments on foreign debt.

Exchange Controls

A defendant might also argue that it should be discharged from its obligation to make payments on foreign loans because it is barred from doing so by exchange control restrictions maintained in accordance with the Articles of Agreement of the International Monetary Fund. Article III, Section 2(b) of those Articles provides as follows:

Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member.

This provision may lead a court of a jurisdiction which is a member of the IMF to hold that it does not have the power to enforce an agreement which the defendant is precluded from performing because of the imposition of exchange-control regulations. In practice, however, the chances of a successful defense on this ground are remote. It is likely that courts in England
and the United States (the two jurisdictions whose laws govern most international lending) would hold that a typical loan agreement is not an exchange contract (because it does not provide for the exchange of money). Courts in other jurisdictions might, however, reach the opposite conclusion.

References


Part Two

Debt Monitoring
Accounting Principles

Standards for the accounting of external debt stemmed initially from the efforts of the World Bank to collect detailed external debt data from all countries to which the World Bank lends. The Bank’s Debtor Reporting System Manual (World Bank 1989) defines the data elements that are to be included in these reports, and these definitions form the basis of an international standard of external debt accounting. Here, we shall describe the key elements of debt accounting and examine the accounting links between external debt statistics and the balance of payments, government finance statistics, the monetary survey and other statistical systems.

The Compilation of External Debt by International Organizations

When the World Bank’s Debtor Reporting System (DRS) was set up, the aim was to make its debt accounting concepts as consistent as possible with the International Monetary Fund’s Balance of Payments Manual. The Organization for Economic Development and Cooperation (OECD) and the Bank for International Settlements (BIS) also generate statistics on external debt. The problem is that there are differences in the figures produced by the four organizations. Some reflect differences between debtor and creditor record-keeping, but others reflect differences between debt accounts and other financial records in debtor countries. These conceptual distinctions must be taken into account to maintain consistency between the various records of external borrowings and repayments and debt stock.

- The World Bank compiles a complete record of member borrowing countries’ external long-term debt to evaluate their capacity to service future borrowing.

The World Bank’s DRS Manual defines basic debt accounting principles.

The DRS was initially closely linked to the IMF’s Balance of Payments Manual. Today, one must also take into account the approaches of other international organizations in monitoring debt and debt-related flows.
• The BIS measures cross-border banking assets and liabilities of commercial banks to provide member central banks data for meeting monetary and regulatory responsibilities. Following commercial accounting procedures, maturity of claims is on a time remaining to maturity basis, compared with an original maturity basis for the World Bank's DRS.

• The IMF compiles balance of payments data, (that is, transactions between residents and foreigners) for member countries to provide both a basis for analyzing the international financial position of individual countries and for evaluating global trends. The balance of payments report includes figures on interest payments, loan disbursements, loan repayments and changes in liabilities, all of which are also covered by the DRS. In addition, the IMF compiles cross-border banking statistics, using a larger universe than the BIS.

• The OECD measures financial flows to developing countries, Eastern European countries and states of the former Soviet Union. The aim is to record the contribution of countries that are members of the OECD's Development Assistance Committee, particularly with respect to concessional aid (Official Development Assistance). Data are compiled by donor countries, and some flows and stock data have the same coverage as the DRS. This makes possible comparison of debtor and creditor country data for the same transactions.

**External Debt Defined**

In 1988, an International Working Group established a common definition of external debt. In an effort to avoid unnecessary discrepancies, these four organizations formed the International Working Group on External Debt Statistics in 1984. Four years later, the Group published a common definition for external debt and set out the debt concepts used by each of the agencies (OECD 1988). Collaboration has continued. A publication is nearing completion which attempts to reconcile stock and flow data on external debt (Debt Stocks, Debt Flows and the Balance of Payments).

The Working Group has proposed a standard definition for external debt (OECD 1988, p. 19):

Gross external debt is the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to nonresidents to repay principal, with or without interest, or to pay interest, with or without principal.
Gross debt is the stock of liabilities, on which debt service is calculated. ("Net debt" comprises assets less liabilities.)

A contractual liability is an obligation to make payments to an agreed schedule. (Equity participation is excluded.)

Principal and interest. “Principal with, or without, interest” means that interest-free loans are included in the core definition, and “interest, with or without, principal” includes loans of indefinite maturity (That is, perpetual bonds). Disbursed and outstanding means that debt includes only committed amounts drawn-down, not yet repaid, or canceled. It does not include future interest payments. Undisbursed amounts are excluded. (At times, it may be helpful to publish figures that include undisbursed balances, but this should be carefully distinguished from “disbursed and outstanding debt”). The definition also excludes “frame agreements” under which agreed-upon loan contracts are to be concluded in the future; only when loan contracts are signed and drawn down do they become part of gross external debt.

External debt is owed to nonresidents; residency is defined in relation to a territory, according to the IMF’s Balance of Payments Manual. Thus, residents comprise the general government, individuals, private nonprofit bodies, and enterprises all defined in terms of their relationship to the territory of that economy (IMF 1993, p. 21). All other agencies are nonresidents. For example, a Government of Brazil debt to Citicorp (New York) is an external debt, because the creditor institution is a resident of the United States. It is immaterial whether the debt is denominated in US dollars or in Brazilian currency. A government of Brazil debt to the Banco do Brasil (a major Brazilian commercial bank) in Rio de Janeiro that is denominated in US dollars is an internal debt, not an external debt, even when the debt is repayable in foreign currency. A government of Brazil debt to the London branch of the Banco do Brasil, however, is an external debt. The currency of repayment (probably US dollars or pounds sterling) is not the deciding factor because the creditor is located in the United Kingdom.

Accounting Relationships

Accounting records for external debt need keep track of only a few items. Some relate to stocks (amounts outstanding at any particular time); some relate to flows (transactions in a defined period, such as a calendar year). Stock concepts are disbursed and outstanding debt, undisbursed balances, and arrears of principal and interest. Flow concepts are loan commitments.
received, disbursements, amortization payments, interest payments, debt cancellations, debt write-offs, and amounts restructured.

Definitions

*Stock data* is compiled at the end of a given accounting period, say, the year to December 31, 1991, and includes:

- **Disbursed debt outstanding**: the outstanding balance of a loan. It is equal to the cumulative disbursements, less repayments, amount canceled and amounts restructured.
- **Undisbursed balance**: the amount of a loan committed but not yet disbursed.
- **Arrears of principal and interest**: Cumulative amount of debt service payments due but not yet paid. Arrears of principal and interest are recorded separately. In external long-term debt accounting, arrears should be included in disbursement debt outstanding but identifiable separately. However, when the arrears result from the inability of the authorities to provide foreign exchange (and not from the inability of the original debtor to provide national currency), some countries separate arrears from the original loans and treat them as short-term liabilities of the central bank. Even then it is necessary to be able to associate the arrears with the original obligation.

*Flow data* comprises:

- **Commitments**: The sum that the creditor has agreed to lend. Supplements to the original amount are also recorded as commitments.
- **Disbursements**: The amount of a loan that is utilized in the accounting period.
- **Interest**: The amount paid to the lender during the accounting period as compensation for use of his capital.
- **Amortization**: The principal repaid during the designated accounting period.
- **Total debt service payments**: The sum of amortization and interest payments.
- **Cancellations**, which are the annulment of undisbursed loan balances.
- **Write-offs**: The annulment of disbursed debt.
- **Restructurings**: are the amount of principal or interest payment due but deferred, rescheduled, refinancing or exchanged as a result of a debt-restructuring agreement; these may be rescheduling or debt-exchange arrangement. Debt relief as debt cancellation is treated as
Key relationships can be derived from the above definitions.

- **Availability of finance.** The available funds from a loan at any moment of time are equal to the original loan commitment amount plus any supplementary commitments, minus total disbursements and cancellations to date. This sum is often referred to as the "pipeline" of finance. Each loan record should show this relationship over time.

- **Stock of debt.** At the end of any time period, the stock of debt is equal to the stock of debt at the end of the previous time period, plus disbursements, minus amortization, principal rescheduled, and write-offs during the period. Rescheduled principal involves a transfer of the amount from the original loan to a new loan. Arrears of interest on long-term debt are shown separately, as part of short-term debt.

- **Loan commitment/debt outstanding.** This relationship is derived directly from the previous two definitions. The loan commitment value is the sum of disbursed debt plus the undisbursed balance. This is equal to the loan commitment value less write-offs, cancellations, amortization and rescheduled principal.

- **Arrears.** Arrears in total debt service at the end of any period equals the arrears in total debt service at the end of the previous period plus the debt service scheduled to be paid, but minus debt service paid, in the period. Arrears must be recorded separately for principal, interest and other charges.

**How to Organize Debt Statistics**

Myriad details in external debt accounting records must be organized by classification criteria to create summary statistics suitable for analysis (see Box 5.1). A fundamental distinction is that between short-term and long-term debt. Data on long-term public and publicly guaranteed debt is normally available to the statistician on a loan-by-loan basis; it can be arranged according to any number of criteria. Short-term debt can be obtained only on a highly aggregated basis, and so the possibilities of classification are limited. Another basic classification scheme is type of flow: figures on loan disbursements, debt service payments, debt restructuring and the accumulation of arrears all must be shown separately.

Two possible ways of grouping debt data are by type of borrower and type of creditor. Among borrowers, the direct debt of the central...
government should be shown separately. Within private sector debt, it is useful to identify separately debt that is guaranteed by the State, as such debts are in effect contingent budgetary liabilities. (Guaranteed debt of public enterprises and of other fiscally-autonomous agencies also must be identified.) Creditors can first be broken down into official and private lenders. Official creditors, in turn, can be multilateral or bilateral lenders. Private lenders are commonly grouped into bond holders, commercial banks, suppliers and other. A cross-creditor scheme often used is export credits. Private export credits consist of suppliers credits (credits extended by producers or contractors to finance their products) and buyers credits (loans by commercial banks to finance an export order by their customers). There are also official export credits: loans by specialized agencies like the U.S. Export-Import Bank to finance individual purchases of goods. These may be shown as one category of official flows or combined with private export credits to give a total picture of this type of finance.

### Box 5.1 Classification of debt-related flows

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<th>Long-term (more than 1-year)</th>
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<td></td>
<td>Other private</td>
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</tr>
</tbody>
</table>

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- a. Maturity is conventionally expressed on an original maturity basis, the time elapsed from the date of commitment.
- b. Often figures on private debt are included with public sector debt under the title, "Public and Publicly-Guaranteed debt."
- c. Commercial bank buyers credits are sometimes combined with suppliers.
The World Bank uses a basic presentation of debt statistics in its annual publication, *The World Debt Tables* (see Box 5.2). Long-term and short-term debt and the use of IMF credit are primary categories. In a second-level classification of long-term debt, public and publicly-guaranteed debt is shown separately from private nonguaranteed debt. This is done because public and publicly-guaranteed debt can be further classified by type of creditor, thanks to the underlying loan-by-loan records. Data on the nonguaranteed debt of the private sector, on the other hand, is available to the World Bank only on an aggregated basis. (See Appendix A, the World Bank's Debtor Reporting System.) The World Bank does not collect data on short-term debt through the Debtor Reporting System. Figures for short-term debt are available for some countries; for other, Bank Staff estimates short-term debt using, as a base, the BIS figures on cross-border banking claims. The results, like those on private nonguaranteed debt, are therefore tentative.

**Relation to Other Financial Accounts**

External debt accounts of any country should be consistent with the national income accounts, the balance of payments accounts and with government finance accounts, all of which reflect elements of a country's external debt statistics. Amortization and interest payments due on debt outstanding are a reflection of the size of the debt stock, which in turn grows as a result of loan disbursements. Debt service payments, debt restructurings and arrears accumulation are recorded in the national income accounts, the balance of payments, in government finance statistics and in monetary statistics.

**Box 5.2 The World Bank’s standard framework for presenting external debt statistics**

<table>
<thead>
<tr>
<th>Long-term debt</th>
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</thead>
<tbody>
<tr>
<td>A. Public and publicly guaranteed</td>
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<tr>
<td>Official creditors</td>
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<tr>
<td>Multilateral</td>
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<tr>
<td>Bilateral</td>
</tr>
<tr>
<td>Private creditors</td>
</tr>
<tr>
<td>Bonds</td>
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<tr>
<td>Commercial banks</td>
</tr>
<tr>
<td>Other private</td>
</tr>
<tr>
<td>B. Private nonguaranteed</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Short-term debt</th>
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</thead>
</table>

| Use of IMF credit |
National Income Accounts

National income accounts present a record of a nation’s production and income. Gross domestic product (GDP) records production, gross national income (GNI) records income earned by residents. The difference between GDP and GNI is income that residents earn by providing direct services—from labor and capital—to foreigners, net of similar services purchased from foreigners—that is, “net factor income from abroad” (see Box 5.3). This includes interest earned, minus interest due on the country’s external debt.

Government debt office records of interest payments are normally on a cash basis—that is, records show when payment is made. Interest payments and receipts in national income accounts are on an accrual basis to show how much interest was earned as contrasted to how much interest was received or paid. This difference in approach will lead to differences with the Ministry of Finance’s records of external debt. If figures are available that show how the accrual estimates are made, it should be possible to reconcile the two sets of accounts.

The Balance of Payments

The World Bank aligned its Debtor Reporting System Manual with several key principles of the International Monetary Fund’s Balance of Payments Manual. The definition of residency is the same. There is a common distinction between long-term and short-term debt (with long-term having an original maturity of more than one year); and, in both systems, the concept of

<table>
<thead>
<tr>
<th>Box 5.3 National income accounts</th>
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<tbody>
<tr>
<td><strong>Gross Domestic Product at market prices</strong></td>
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<tr>
<td>A. Domestic absorption</td>
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<tr>
<td>Consumption</td>
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<tr>
<td>Private</td>
</tr>
<tr>
<td>Government</td>
</tr>
<tr>
<td>Gross investment</td>
</tr>
<tr>
<td>Fixed capital formation</td>
</tr>
<tr>
<td>Changes in stocks</td>
</tr>
<tr>
<td>B. Resource balance</td>
</tr>
<tr>
<td>Exports of goods and nonfactor services</td>
</tr>
<tr>
<td>Imports of goods and nonfactor services</td>
</tr>
<tr>
<td><strong>Plus: net factor income from abroad</strong></td>
</tr>
<tr>
<td>Interest earned</td>
</tr>
<tr>
<td>Less: interest paid</td>
</tr>
<tr>
<td>Other factor income (net)</td>
</tr>
<tr>
<td><strong>Equals: Gross National Product at market prices</strong></td>
</tr>
</tbody>
</table>
the maturity of a debt is based on original maturity rather than time remaining to maturity (a concept commonly used in compiling banking statistics).

The balance of payments is a comprehensive double-entry record of transactions between residents of a nation and nonresidents. Balance of payments transactions are classified into:

- Transactions in goods, services and income.
- Transactions in financial claims.
- Transfer payments, which are offsets to the exchange of goods, services or financial claims without any quid-pro-quo (the items being transferred are, essentially, gifts).

Following the International Monetary Fund’s *Balance of Payments Manual*, transactions with respect to goods and services, income and current transfers are grouped together in the current account (see Box 5.4). Transactions with respect to financial claims are shown in the capital and financial account. Since the components of the balance of payments are assembled from different sources, there is likely to be some inconsistencies. Hence, there is a need for a balancing item, called net errors and omissions.

<table>
<thead>
<tr>
<th>Box 5.4 Balance of payments standard components</th>
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</thead>
<tbody>
<tr>
<td><strong>Current account</strong></td>
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<tr>
<td>A. Goods and services</td>
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<tr>
<td>B. Income</td>
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<tr>
<td>Compensation of employees</td>
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<tr>
<td>Investment income</td>
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<tr>
<td>Direct investment</td>
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<tr>
<td>Portfolio investment</td>
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<tr>
<td>Other investment</td>
</tr>
<tr>
<td>C. Current transfers</td>
</tr>
<tr>
<td><strong>Capital and financial account</strong></td>
</tr>
<tr>
<td>A. Capital account</td>
</tr>
<tr>
<td>Capital transfers</td>
</tr>
<tr>
<td>Acquisitions/disposals of nonproduced nonfinancial assets</td>
</tr>
<tr>
<td>B. Financial account</td>
</tr>
<tr>
<td>Direct investment</td>
</tr>
<tr>
<td>Portfolio investment</td>
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<tr>
<td>Assets</td>
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<tr>
<td>Liabilities</td>
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<tr>
<td>Equity securities</td>
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<td>Debt securities</td>
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<tr>
<td>Other investment</td>
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<td>Assets</td>
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<tr>
<td>Liabilities</td>
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<td>Monetary authorities</td>
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<td>General government</td>
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<tr>
<td>Banks</td>
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<tr>
<td>Other sectors</td>
</tr>
<tr>
<td>Reserve assets</td>
</tr>
<tr>
<td><strong>Net errors and omissions</strong></td>
</tr>
</tbody>
</table>

The current account records transactions in goods and services, income and current transfers. Interest payments on foreign debt are included here.
Interest payments on foreign debt are recorded in the “investment income” portion of the “income” component of the goods and services account. The balance of payments makes a distinction between earnings on direct investment, earnings from financial instruments (portfolio investment) and other interest, particularly payments on foreign loans (recorded as other investment). All categories include some interest on foreign debt. While direct investment income comprises primarily profits on the earnings of direct investment enterprises, it also includes interest payments on contractual loans.

The capital and financial account separates out reserve assets. All other capital is grouped under direct investment, portfolio investment and other capital. The last two categories are subdivided between foreign assets and foreign liabilities. There is a further subdivision by sector of domestic transactor: monetary authorities, general government, banks and all other sectors. The balance of payments records this subdivision for all relevant items in the capital account.

How debt-related transactions are recorded in the balance of payments is shown in Table 5.1. On the left side, aggregate balance of payments categories are listed. These are shown following the IMF’s “analytic format” as published in the IMF’s Balance of Payments Statistics Yearbook (the classification scheme shown there follows the IMF Balance of Payments

<table>
<thead>
<tr>
<th>Table 5.1 Recording debt-related transactions in the balance of payments</th>
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<tbody>
<tr>
<td><strong>Balance of payments aggregated presentation</strong></td>
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<tr>
<td>A. Current account</td>
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<tr>
<td>B. Direct investment and other long-term capital, excluding</td>
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<tr>
<td>groups F through H</td>
</tr>
<tr>
<td>Direct investment</td>
</tr>
<tr>
<td>Portfolio investment</td>
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<tr>
<td>Other long-term capital</td>
</tr>
<tr>
<td>C. Other short-term capital</td>
</tr>
<tr>
<td>D. Net errors and omissions</td>
</tr>
<tr>
<td>Total A through D (= overall balance)</td>
</tr>
<tr>
<td>E. Counterpart items</td>
</tr>
<tr>
<td>F. Exceptional financing</td>
</tr>
<tr>
<td>G. Liabilities constituting foreign authorities reserves</td>
</tr>
<tr>
<td>H. Total change in reserves</td>
</tr>
</tbody>
</table>

b. Section G is relevant only for countries whose currencies are used as foreign reserves by other countries.
Relation to Other Financial Accounts

The sum of lines A through D provides an overall balance, the measure of disequilibrium. The financing includes counterpart items, which records valuation changes in reserves, exceptional financing, and changes in reserves.

The right side of Table 5.1 lists the debt-related transactions recorded in the balance of payments. Interest payments are in the current account. Bond issues and redemptions, disbursements and repayments of long-term loans are recorded in Section B, with the exception of balance of payments support loans which are in Section F. Data on short-term capital borrowing is not normally available on a gross basis. Debt records, like the balance of payments, show net changes.

It is important that figures on international capital flows derived from external debt accounts be consistent with comparable figures presented in the balance of payments. In practice, this is not easy to accomplish. First, when debt statistics are often compiled by a Ministry of Finance and the balance of payments by the Central Bank, different data sources may be used for some entries, particularly with respect to nongovernment debt.

There are additional problems stemming from accounting differences (Box 5.5). First, loan commitments are monitored in external debt accounts, but they are not included in the balance of payments. Commitments represent a promise to make a loan whereas the balance of payments only records actual loan transactions.

Transactions between residents and foreigners in debt denominated in national currency are included in the balance of payments but not in records of external debt. When debts are canceled, debt accounts (as represented in the World Bank’s Debtor Reporting System) will not show the cancellation as flows, but only as stock adjustments. The balance of payments will record the cancellation transaction. In the balance of payments, arrears of principal of long-term debt are transferred from a long-term to a short-term liability. The long-term liability is liquidated and a short-term debt service.

<table>
<thead>
<tr>
<th>Item</th>
<th>Debt accounts</th>
<th>Balance of payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitments</td>
<td>Included*</td>
<td>Excluded</td>
</tr>
<tr>
<td>National currency debt</td>
<td>Excluded</td>
<td>Included</td>
</tr>
<tr>
<td>Debt cancellation</td>
<td>Stock adjustment</td>
<td>Transaction included</td>
</tr>
<tr>
<td>Arrears on principal</td>
<td>Retained in long-term debt</td>
<td>Transferred to short-term debt</td>
</tr>
<tr>
<td>Basis of recording debt service</td>
<td>Cash basis</td>
<td>Accrual basis</td>
</tr>
</tbody>
</table>

*Commitments are monitored but not included in the measurement of financial flows.
liability is created. In debt accounts, principal arrears are retained with the records of long-term debt.

A major potential discrepancy exits between external debt records and balance of payments figures for interest and amortization payments. Balance of payments accounting, like the National Income Accounts, calls for entering data on a full accrual basis; external debt records are normally on a cash basis. Interest and principal payments are recorded in the balance of payments for the time period when payments are accrued.

If payments are made in that period, there would be an offsetting entry for foreign-exchange assets or liabilities; if they are not paid, there would be an offsetting item in the capital account (short-term liabilities) representing the increase in arrears. Debt accounts, on the other hand, show only the cash disbursed for payment of interest. However, while debt accounts may differ from the balance of payments because one set of records is on an accrual basis and the other on a cash basis, it should be possible to reconcile the two.

Loan disbursement figures appear in both the balance of payments and debt records on a cash basis. Discrepancies can arise because a disbursement may be recorded at a different moment of time in the debt records than in the balance of payments. However, these timing discrepancies only become relevant if they place the disbursement into different accounting periods. Such differences in timing are harder to identify and to reconcile for disbursements than figures for debt service payments.

The balance of payments records disbursement figures for debt rescheduling that may not be included in external debt records. Whenever there is an increase in liabilities associated with rescheduling, there will be an offsetting disbursement. Entries of this nature will be made when there is a cross-classification of original debt and the restructured maturities between sector, between debt instrument or between maturity structure—for example, the consolidation of short-term into long-term debt.

The International Investment Position

One problem with harmonizing external debt accounts with balance of payments flows is that balance of payments compilers often have difficulty in reconciling stock and flow figures with respect to foreign financial assets and liabilities. The International Monetary Fund has asked reporting countries to submit tabulations on the stock of assets and liabilities along with annual balance of payments statements. Such reports are known as the International Investment Position (IIP), which is intended to be a comprehen-
sive listing of foreign financial assets and liabilities. In recent years, more attention has been paid to this issue, but not many countries have been able to compile an IIP. A recent study reports:

Countries reporting on their balance of payments accounts to the IMF are also requested to supply data on their IIP. However, whereas the 1991 issue of the Balance of Payments Statistics Yearbook contains BOP statements for 140 countries, it contains only 25 IIP statements. Most of the major industrial countries supplied statements, but only 10 developing countries. The IMF Working Party on the Measurement of Capital Flows made a special effort to obtain reports on IIP and reconciliations with the BOP as part of its study of the discrepancies in world capital flows and received IIP data from 38 countries, including 21 developing countries. But many of these statements covered only a few categories of assets or liabilities from available sources, such as banks' external positions or outstanding external public debt. Moreover, most of the developing countries could not supply adequate reconciliations between their flow and stock data. (OECD forthcoming, Chapter II)

To help remedy this situation, in the fifth edition of the Balance of Payments Manual, the conceptual framework has been expanded to cover explicitly the principles of preparing the IIP, as well as balance of payments (see Table 5.2). The International Monetary Fund has also prepared a companion volume to the Manual, the Balance of Payments Compilation Guide, which is intended to give practical advice to national compilers on the systematic collection of consistent data on stocks and flows and on how to present them in both the balance of payments and the IIP.

The primary breakdown of the IIP report is assets and liabilities, with subdivisions corresponding to the components of the balance of payments. It shows the stock of foreign assets and liabilities at the beginning and end of the reporting year and accounts for changes that take place during the year. These comprise capital flows (which should correspond with balance of payments entries), changes in the prices of marketed securities, changes resulting from exchange rate changes and other adjustments.

There are some difficult data problems in compiling the IIP. One is the reduced role of commercial banks in international lending: the well-defined structure of banking statistics makes a smaller contribution to the IIP. Survey methods that pick up balance of payments flows may not be well-suited to measuring stock positions, and new approaches must be developed. Valuation is another problem. The balance of payments entries for capital account

A relatively new International account, the International Investment position, should help clarify the linkage of balance of payments flows to changes in the stocks of debt.

The conceptual framework of the IIP was expanded in 1993; this should facilitate reconciliation of debt data with balance of payments flows.

The IIP has its own data problems.
Table 5.2 International investment position: standard components

<table>
<thead>
<tr>
<th>Change in position reflecting:</th>
<th>Position at start of year</th>
<th>Transactions</th>
<th>Price changes</th>
<th>Exchange rate changes</th>
<th>Other adjustments</th>
<th>Position at end of year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
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<td><strong>Direct investment abroad</strong></td>
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<td>Equity capital and reinvested earnings</td>
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<tr>
<td>Claims on affiliated enterprises</td>
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<td>Liabilities to affiliated enterprises</td>
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<td>Other capital</td>
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<td><strong>Portfolio investment</strong></td>
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<td>Bond and notes</td>
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Table 5.2 International investment position: standard components (continued)

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<th>Change in position reflecting:</th>
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(continued on next page)
Table 5.2 International Investment position: standard components (continued)

<table>
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<tr>
<th>Change in position reflecting:</th>
<th>Position at start of year</th>
<th>Transactions</th>
<th>Price changes</th>
<th>Exchange rate changes</th>
<th>Other adjustments</th>
<th>Position at end of year</th>
</tr>
</thead>
</table>

Other investment
  Trade credits
    General government
      Long-term
      Short-term
    Other sectors
      Long-term
      Short-term
  Loans
    Monetary authorities
      Use of Fund credit and loans from the Fund
    Other long-term
      Short-term
    General government
      Long-term
      Short-term
    Banks
      Long-term
      Short-term
      Other sectors
      Long-term
      Short-term
      Other sectors
      Long-term
      Short-term
  Currency and deposits
    Monetary authorities
    Banks
    Other liabilities
    Monetary authorities
      Long-term
      Short-term
    General government
      Long-term
      Short-term
    Banks
      Long-term
      Short-term
      Other sectors
      Long-term
      Short-term

a. Because direct investment is classified primarily on a directional basis—abroad under the heading "Assets" and in reporting economy under the heading "Liabilities"—claims/liabilities breakdowns are above for the components of cash, although these sub-items do not strictly conform to the overall headings of "Assets" and "Liabilities.

transactions should be recorded at the market values on the date of the transaction. Stocks of assets and liabilities are valued at the date of the IIP, normally the end of the calendar year. Market values and exchange rates will fluctuate during the year. The job of the statistician is to record these valuation changes and enter them in the IIP, so that it is possible to identify that component of the change in IIP values that is due to capital flows.

For those countries able to compile an IIP and reconcile the resulting stock figures with balance of payments flows, should we expect Central Bank IIP data to agree with Ministry of Finance records of external debt? The records of government debt offices are on a book value basis. Fortunately, the bulk of external debt would, for most countries, also be recorded at book value in the IIP. If commercial bank debt is traded on a secondary market, however, the appropriate IIP entry is the secondary market price, giving a discrepancy between IIP and debt office records. Nonetheless, the IIP is a useful vehicle for linking balance of payments flow data with stock values and for providing a basis for reconciling balance of payments records with those of government external debt offices.

**Relation to Government Finance Statistics**

External debt accounts must also be reconciled with records of government finance. The fiscal accounts of a country show the balance of expenditures of the central government and how they are financed. Expenditures include interest paid to foreigners by the government (and revenue will include interest on foreign assets). The financing of the be through external sources (net of amortization) plus debt domestic credit creation (see Box 5.6).

<table>
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<tr>
<th>Box 5.6 Fiscal accounts and external debt transactions</th>
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<tr>
<td><strong>Overall budget balance</strong></td>
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<tr>
<td>Total revenue</td>
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<td>(includes interest earnings on government foreign assets)</td>
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<tr>
<td>Total expenditures</td>
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<td>(includes interest payments on government foreign liabilities)</td>
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<tr>
<td>Balance</td>
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<tr>
<td><strong>Financing</strong></td>
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<tr>
<td>External</td>
</tr>
<tr>
<td>Loan disbursements</td>
</tr>
<tr>
<td>Less: amortization</td>
</tr>
<tr>
<td>Debt relief</td>
</tr>
<tr>
<td>Accumulation of arrears</td>
</tr>
<tr>
<td>Domestic credit (net)</td>
</tr>
<tr>
<td>Banks</td>
</tr>
<tr>
<td>Other</td>
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<tr>
<td>Total financing</td>
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Debt service payments are shown in the fiscal accounts on an accrual basis. Interest and amortization figures are for amounts due. Therefore, external financing includes debt relief and the accumulation of arrears, as well as loan disbursements net of amortization payments. To compile internationally comparable statistics on government finance, the International Monetary Fund has developed a data collection system known as the Government Finance Statistics (GFS).

There are some differences between debt and government finance accounts as represented by the World Bank’s DRS and the IMF’s GFS data systems. GFS accounts include short-term debt; the World Bank’s DRS system collects long-term debt only at the present time; but, of course, national debt offices should be compiling data on short-term debt for their own use.

GFS data are based on fiscal years. Since debt records of government are maintained in detail, however, it should be possible (with the help of a computer) to prepare debt tabulations on a fiscal year basis for the purposes of reconciliation. A more complex problem is that GFS data are produced in national currencies. Government finance accounts must be maintained in a manner that permits easy calculation of exchange rate valuation effects.

Relation to the Monetary Survey

Changes in a country’s foreign assets have an impact on the monetary base. Accordingly, central banks must maintain a monetary survey to understand the factors behind changes in the monetary base (see Box 5.7). Foreign debt is a negative foreign asset.

Summary

External debt is concerned with outstanding balances of contractual liabilities. The key data elements that must be tracked in an external debt accounting system are disbursed debt outstanding, undisbursed balances and arrears.

<table>
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<tr>
<th>Box 5.7 Monetary survey</th>
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<tr>
<td><strong>Change in assets</strong></td>
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<tr>
<td>A. Net foreign assets</td>
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<tr>
<td>Government</td>
</tr>
<tr>
<td>Nongovernment</td>
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<tr>
<td>B. Net domestic credit</td>
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<tr>
<td><strong>Change in liabilities</strong></td>
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<tr>
<td>A. Broad money</td>
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<tr>
<td>B. Other items, net</td>
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</table>
These are stock items in the sense that they represent amounts due or receivable at a moment of time. The flow data (transactions that take place during a defined accounting period) are loan commitments, disbursements, amortization, interest payments, cancellations and write-offs.

External debt accounting principles were defined by the World Bank when it established its Debtor Reporting System. These concepts are similar in many respects to the principles for the preparation of balance of payments accounts, national income accounts public finance and monetary accounts. Since each of these accounting records contains elements that relate to external debt, it is important that the methods of compiling each system be sufficiently transparent to permit a reconciliation of data.

References


Monitoring Government Direct Debt

Procedures for collecting data on external debt depend on whether debts are direct obligations of the central government. Government debt is serviced through the budget and is monitored by a unit linked closely to the budgetary process. This unit must collect transaction-by-transaction detail. Responsibility for paying debts not included in the central government’s budget lies with the individual borrowers. The central government requires information on such debts for national economic management, but needs to collect only summary statistical information.

A specialized unit must be established in the Ministry of Finance to manage central government direct debt. It will have administrative, accounting and statistical responsibilities. The administrative task is to assure that each principal and interest service payment falling due is paid on schedule. This requires: (1) that the debt office has details of all government loan contracts, (2) that the budget authorities have schedules of amounts due in the future so that budgetary resources are available when required, (3) that payment orders are issued in a timely fashion to the Treasury to make interest and principal payments on their appropriate due dates and, after budget funds have been allocated, that payment orders are transmitted to the Central Bank for remittance.

The accounting function is to record transactions in the loan record for each obligation. The first step is to note the amount committed and the prospective loan disbursement and repayment schedules. Next, the actual individual loan disbursements are recorded. Then, as debt service falls due, entries have to be made for the ordering and the execution of debt service payments. Finally, if the Central Bank cannot make remittances because of foreign-exchange shortages, a record must be kept of arrears.

From these accounting records, statistics can be compiled on transactions conducted during any period, such as a calendar year. Before comput-
ers were available, this was a formidable task; data for each loan had to be converted into a common currency using uniform exchange rates, posted on to worksheets and then aggregated. The work was slow and error-prone, and the format of the output difficult to change. Thanks to low-cost computers and specialized software, these mechanics can be preprogrammed and statistics prepared almost instantaneously.

### Debt Monitoring Tasks

The accounting responsibilities of the government debt office are to record details of loan commitments, monitor and record disbursements, note the payment of debt service and, when necessary, keep track of arrears.

#### Monitoring Loan Commitments

The first stage is to assemble complete information on new loans, establish a numbering system and record details systematically.

The debt numbering system must cover all public and publicly-guaranteed debt.

The debt office can monitor and manage the government’s debt only if records of loan commitments are complete. This task is easier if the authority to sign loan contracts for the central government is centralized and controlled by the Minister of Finance, although centralized borrowing authority does not necessarily mean centralization of loan contracts. The unit in charge of foreign borrowing must pass on to the debt office all new loan contracts and their debt service schedules. The debt office should keep in close contact with government loan negotiating teams to know which loans are pending.

For countries where the government debt office does not already have comprehensive records of the state’s external debt, an inventory of debt must be made. All known borrowers must be contacted, and, maybe, creditors to ensure that debt records are complete.

To keep track of government external debts, each loan should be numbered in a central register with a few key details of each loan (lender, borrower, date of agreement, descriptive title, currency of obligation and amount). Loan numbers are used only to identify loans; they can be assigned in the order in which loan contracts are received by the debt office.

The government debt office may also be responsible for monitoring all public and publicly guaranteed debt, not just government direct debt (see Chapter 12). Accordingly, debt numbering should be extended to all public and publicly-guaranteed long-term debt. This numbering system should be consistent with World Bank debt reporting requirements to avoid use of two numbering systems (see Appendix A).

The debt office must create a loan record for each new obligation, covering the borrower, lender, purpose of the loan, loan amount and
terms of repayment. This information can be used as classification criteria when preparing statistics. Also, the data on terms of repayment can be used (with the help of a computer) to project debt service payments due, as an alternative to recording detailed debt service schedules. In addition, the loan record also provides a framework for recording transactions when they take place.

**Monitoring Disbursements**

Timely data on loan disbursements are needed for several reasons. First, the debt office must keep track of available loan balances (commitments less disbursements made to date). These records of external financing must be consistent with records maintained elsewhere on public sector borrowing. Current figures on the amount of disbursed debt are also needed in order to estimate interest due to lenders. The problem is one of tapping information flows which are often difficult to access. For this reason, monitoring loan disbursements is the most troublesome accounting task facing the government debt office.

The problem of obtaining data on disbursements differs among the various categories of loans contracted by the government. These are:

- Loans disbursed in cash;
- Export credits (loans for single purchases of goods and services);
- Commodity loans.
- Project loans that consist of purchases from several suppliers;

**Cash loans.** These are for budget or balance of payments support or to finance the purchase of domestically-produced goods and services. Since cash is transferred through the accounts of the bank designated by the government as its receiving agent, such disbursements are generally easy to monitor. The name of the transfer agent will appear in the loan agreement; its financial statement will provide the underlying data source for cash disbursement. In practice, the records of the recipient agency would be used, as it would probably have other information on loan or aid utilization to report.

**Export credits.** This credit arrangement is simple, but data collection may be complex. Occasionally, credits are offered by suppliers, manufacturing firms selling goods on credit or contractors providing a service, such as road construction or building a factory. When goods are shipped, the borrower signs promissory notes. If the production of the purchased goods

There must be a loan record form (or computerized file) for each public sector debt.

Monitoring disbursements is difficult, because records of transactions do not go automatically to the debt office.

Data on cash loans can be obtained through the local transfer agency.

For export credits, the beneficiary agency must report disbursements to the debt office.
extends over time and is costly, the supplier will ask that promissory notes be signed at agreed-upon intervals (one or two progress payments and then the final payment).

With suppliers credits, there is a direct relationship between the lender and the borrower. More commonly, export credits are issued by the supplier’s or contractor’s bank. Goods are shipped or services provided, and promissory notes issued by the bank, which then pays the supplier. The borrowing government has a debt to a commercial bank rather than to the enterprise that provided the goods or services.

When export credits are central government debts or are debts guaranteed by the central government, the debt office is normally aware of the loan contract. It will know of the beneficiary agency, the foreign supplier or contractor and the creditor bank. What the debt office will not know is when the promissory notes are signed and when delivery of the goods or services took place. Considerable follow-up work is required. Beneficiary agencies must be instructed on how and when to report loan disbursements and summaries of the debt service schedules represented by the promissory notes. Disbursement dates should correspond to the dates on which the promissory notes are signed—that is, the creation of external liabilities. General experience has been that beneficiary agencies rarely make reports when required, and the debt office must follow up regularly.

Commodity loans. These loans finance imports of foodstuffs and, occasionally, manufactured goods by the borrowing government. Disbursement of commodity loans takes place when the goods are shipped from the lending country. When many goods are financed by a commodity loan, different government agencies will arrange importation. Normally, the goods are resold for domestic currency. These counterpart funds can be a major source of government revenue. If commodity aid is a significant part of a country’s foreign assistance, a special office may be necessary to negotiate the commodity aid grants and loans, to supervise their utilization and to control counterpart funds. The debt office should be able to rely on this agency to develop definitive records of disbursements.

Project loans. While export credits finance a single purchase, foreign aid finances purchases from a number of suppliers or contractors. Administrators of foreign aid must ensure that aid funds are used exactly as agreed. The borrowing government must establish an External Finance Unit to negotiate and to manage all foreign assistance (Chapter 3). For each project there will be a project implementation unit. It normally will be located in
Debt Monitoring Tasks

the beneficiary agency, and it would be in charge of procuring the goods and services to be financed by the loan.

There are three basic procedures for disbursing project aid: (a) the lender pays the supplier directly, (b) the borrowing government pays the supplier and is reimbursed by the lender, or (c) the lender advances cash to the borrowing government at intervals and the borrowing government pays for deliveries from this pool. The advances procedure and the direct payments procedure are the most common (Figure 6.1).

Under the direct payment procedure, the beneficiary agency, through its project implementation unit, invites bids and places orders after the loan agreement is signed and becomes effective. When the goods are shipped (and the transaction is verified), the lender is asked to pay the supplier, which it does upon receipt of appropriate documentation.

The advances procedure provides the government with a pool of cash out of which it pays suppliers for goods purchased for the project. When the loan is implemented, the lender will place funds into a special account set up under the control of the project implementation unit. The beneficiary agency through the project implementation unit orders goods (following a bidding process), and, when they are shipped, the supplier will be paid by the borrowing country's Treasury out of the special account created for this project. At monthly intervals, the lender will replenish the account on receipt of documentation for the funds spent in the previous month.

The structure of payments under the reimbursement procedure is similar, except that there is no special account. The Treasury pays the supplier after shipment of goods, and it is reimbursed (usually monthly) on submission of appropriate documents to the lender.

When should entries be made for loan disbursements? In direct payment procedures, when the lender pays the supplier; under reimbursement procedures, when reimbursements have been made to the borrowing government. Under the advances procedure, it is the periodic payments by the lender to the borrowing government that constitute disbursements. The rule is that disbursements are considered to have taken place when there is a draw-down of funds from the loan on behalf of the borrower.

The debt office must keep track of the transactions that take place for each loan if it is to monitor disbursements effectively. Debt office staff must reconcile their records at regular intervals with information maintained by people supervising execution of projects. Parallel with monitoring disbursements, the debt office should attempt to reconcile its figures with the records for related public sector accounts. The Treasury keeps consolidated records of central government revenues and expenditures. Loan disbursements on

Procedures will differ according to the method of disbursement.

The debt office must reconcile its disbursement records with those of other agencies.
Figure 6.1 Loan disbursement practices

(A) Direct payment procedure

The borrowing government

Ministry of Finance

External finance unit \rightarrow 1. Loan agreement signed

Treasury

4. Verification of shipment

7. Disbursement information

Debt office

Beneficiary agency/project implementation unit

2. Orders for goods

3. Shipment of goods

5. Request for payment

Supplier

6. Payment to supplier (loan disbursement)

Lender

8. Payment to supplier (disbursement)

(B) Advances procedure

The borrowing government

Ministry of Finance

External finance unit \rightarrow 1. Loan agreement signed

Treasury special account

3. Funds advanced (disbursement)

7. Request for payment

9. Disbursement information

Debt office

Beneficiary agency/project implementation unit

4. Orders for goods

5. Shipment of goods

2. Request for advance or replenishment

Supplier

6. Verification

Lender

government debt must be reflected in government revenue records, and those figures must be consistent with the debt office accounts. The debt office should verify loan disbursements with the Central Bank, which is responsible for balance of payments accounts. Debt office disbursement figures should be reconciled with the figures for public sector investment that are maintained by the Ministry of Planning. By careful coordination, it is possible for all related accounts of government external borrowing to be consistent—those of the individual loan project officers, those of the public sector investment accounts, consolidated government revenues and expenditures and the balance of payments.

**Monitoring Debt Service Payments**

The most important aspect of managing the direct debt of the central government is to see that each debt service payment is made on time and in the form required by the individual creditors. The Ministry of Finance commonly has this responsibility because ordering debt service payments is part of the budgetary process. Payment requests are normally initiated by a debt management unit within the Ministry of Finance. Registering this information requires two steps—recording the preparation and transmittal of a payment order, and confirming the execution of the payment.

Variable interest rate debt poses a special problem to the debt office. Normally, each interest payment is based on the interest rate at the time of the previous payment. For example, if debt service payments are due on the 15th of March and September, the effective interest rate for the September 15th payment will be that for the previous March 15th payment. The actual charge will be telexed by the creditor. Debt office staff should follow money-market conditions to approximate the interest charges due in the next few months. The information should be kept in a manner that permits entry of estimated values (based on some assumption of future interest-rate levels) which are replaced by the actual amount charged, taken from the telex advice of the creditor.

Because of overlapping responsibilities, the debt office, the governmental accounting unit (for example, the accountant general) and the Foreign Operations Department of the Central Bank each develop its own records of external debt transactions and, sometimes, of the stock of debt. The Foreign Department of the Central Bank must be responsible for informing the debt office of payments made. Computerized record-keeping facilitates this process. Even so, these records have to be compared and reconciled periodically. As a last resort, Ministry of Finance debt office officials can visit...
the Central Bank and examine all advices of foreign remittances by the Foreign Operations Department to find whether or not scheduled debt service payments have been made. Ideally, a common computerized data base should be established with responsibility assigned to each agency for the different tasks of managing the government’s external debt.

**Monitoring Arrears**

The balance of payments of developing countries and of most Eastern European countries deteriorated in the late 1970s and 1980s resulting in widespread delays in payments and in a build-up of arrears. Government debt offices had to keep track of arrears but found this task difficult. For most affected countries, data on arrears were not current and often incomplete. These difficulties were due to either (a) faulty accounting systems, (b) lack of information on whether payment orders issued by the Ministry of Finance were acted upon, or (c) an inability to organize statistics from the accounting records.

**Accounting system difficulties.** Arrears are debt service due but not paid. The principle of accounting for arrears is that whenever a debt service payment is due and is not made, an increase in arrears by that amount (plus late payment penalties) is recorded. Also, whenever a payment is made other than on a due date, a decrease in arrears is recorded. There should be a tight relationship between the figures for payments scheduled and payments made. If a debt service payment was due and not made, the system should automatically generate an increase in arrears. Likewise, when a catch-up payment is made or when arrears are consolidated and rescheduled, accounting entries showing declines in arrears should be automatic.

A critical feature of an arrears accounting system is that correct figures be entered for debt service payments due. Debt office records will have figures for scheduled debt service payments. For official credits, they would be based on committed amounts; for commercial credits, on actual disbursements. These schedules will generate figures for amounts due on particular days, but it is necessary to override the figures from the original schedules with the figures that come from the creditor’s payment advices issued immediately prior to individual due dates. Otherwise, the debt office accounting system will generate erroneous figures for arrears.

**Lack of information on payments.** For even a well-designed accounting system to function, there must be a smooth flow of documents on debt ser-
vice payments. Reliable and swift communication between the government
debt office and the financial institution that serves as the government's paying
agent is essential. In many countries, the Foreign Department of the
Central Bank has this responsibility. The debt office will have recorded the
amount due on each payment date, but it must be informed promptly when
the payments are actually made. If the return flow of payment advices is timely
and reliable, then the absence of documentation can safely be interpreted as
a signal that the scheduled payments are in arrears.

A positive indication of arrears is also needed. The government debt office
has figures on arrears in the records for individual debts. The Foreign Depart-
ment of the Central Bank has as its source of information the payments
orders that it has received from the Ministry of Finance but not yet acted
upon. Periodically, these two sets of records must be reconciled: the arrears
figures in the Central Bank obtained by adding up the amounts due on pay-
ment orders not yet acted upon must be equal to the arrears figures that are
derived from the loan-by-loan accounting records.

Many creditors inform the government debt office of the amount of
arrears shown in their records. The reconciliation process must take into
account this information. Discrepancies must be investigated promptly and,
where needed, corrections made in the accounting records.

Wide differences between Ministry of Finance, Central Bank and credi-
tor arrears figures will cause senior officials in the government to lose con-
fidence in both the debt office and in the Central Bank. In addition, the
creditors find the lack of firm data on arrears disturbing. This will compi-
licate debt renegotiations and also further injure the government's creditwor-
thiness for new borrowing.

*Statistical system difficulties.* Reliable data on the arrears for individual
loans is only the starting point for statistics. Figures on arrears must be ex-
tracted from loan records, converted to a common currency and then or-
ganized by some useful criteria, such as by lender, creditor country and type of
credit. A computer is required to manipulate data even for a relatively small
number of loans because of the many data elements.

**Debt Records**

Records of the government's external debt must be kept loan by loan. The
unit responsible for managing the government's debt must maintain ac-
counts of central government debt—debt that is paid through the budget—
on transaction by transaction basis. The unit with policy responsibilities

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The Central Bank
and The Ministry of Finance
must reconcile their
respective records
of arrears frequently,
because compilation
methods differ.

Statistical procedures
are needed for preparing
summary data on arrears.
Records of individual debts must be linked and summarized in standard statistical reports. Monitors all external debt—both government and nongovernment debt. It produces standard statistics reports for use within the government, summary reports for publication and special tabulations needed for particular studies on external debt. While the underlying records must be loan by loan, figures used by the policy unit can be in more summary form, updated monthly. Input would be received from the office responsible for managing government debt and from the accounting offices of other debtors (see Appendix B).

References

Monitoring Nongovernment Debt

Macroeconomic and balance of payments management requires that full information be obtained on all external long-term debt, not just on central government's obligations. In addition, a knowledge of short-term, as well as long-term, debt is also required: changes in the stock of short-term debt immediately impact foreign exchange reserves and the exchange rate.

It is not obvious who should be responsible for compiling data on nongovernment external debt. It may be more efficient to put this responsibility outside the Ministry of Finance. The Central Bank, for example, is best placed to compile data on short-term and on private sector debt. Once data collection responsibilities are split, one agency must have the authority to assemble figures for the total debt of the country. Before deciding whether the “national debt office” should be separate from the government debt office, one must understand what is involved in securing data on nongovernment long-term debt and on short-term debt.

Public Enterprise Debt

The long-term debt of public enterprises may be partly guaranteed by the central government; information on that portion can—and should—be monitored by the government debt office loan by loan. It is preferable, however, to collect information on both guaranteed and nonguaranteed public enterprise debt at the same time, rather than to ask for separate reports. The procedures described here for collecting data on public enterprise debt are also appropriate to collecting debt data from other entities of the public sector whose obligations are not financed through the central government budget. This includes publicly-owned development banks, regional and municipal governments.
Details of loan commitments, transactions and stock of debt data should be collected quarterly, loan by loan.

New Loan Commitment Data

The countries that borrow from the World Bank must file quarterly reports on individual new long-term loan agreements signed in each calendar quarter, which implies that the necessary information be obtained from public enterprises promptly at the end of each quarter. The information is basic—the amount and purpose of the loan, and a description of borrower, lender, and terms of repayment. The forms for collecting commitment data from enterprises should conform to the requirements of World Bank reporting (see DRS Form 1, Appendix A, p. 165). Aside from fulfilling the World Bank’s reporting requirements, the information can be used to project public enterprise debt service obligations and, so, their impact on the balance of payments. The reports will have other uses—for example, the part external sources play in financing public enterprises.

Status of Debt Reports

Along with the detailed reports on new commitments, enterprises should report to the debt office, for each accounting period, on each debt that was outstanding at the beginning of the period and on each loan agreement that was signed during the period. This report, like the report on new commitments, is also governed partly by the World Bank’s Debtor Reporting System. The status of debt reports to the World Bank require figures on each debt for disbursed debt outstanding, undisbursed loan balances, amounts of arrears, if any, and disbursements and debt service payments made during the reporting period.

Status of debt reports to the World Bank are required only once a year, but meaningful surveillance of enterprise debt implies more frequent reporting (see DRS Form 2, Appendix A, p. 167). Most governments running a debt monitoring system ask enterprises to file reports quarterly.

Only summary data need be collected. For example, if the accounting period is three months, only the total disbursed on each loan in that time need be reported, not each individual disbursement or debt service payment. The reports are for statistical purposes; the detailed accounting records are only needed by the enterprise owing the debts.

An Example

Indonesia provides a useful example of a system for compiling data on public enterprise debt. The Bank of Indonesia requires that the reporting of...
new commitments be made in two stages. First, when a public enterprise receives permission to borrow from the Ministry of Finance, it must inform the debt office in the Bank of Indonesia of:

- The number and the date of the letter of permission from the Ministry of Finance.
- The name, address and status of the borrower; the type of investment; the type of product (goods or services) to be produced.
- The name and address of the lender.
- The amount and purpose of the credit.
- The terms and conditions of the loan (interest rate, maturity, grace period, amount of down payment, commitment and other fees).
- The disbursement schedule.
- The repayment schedule.

Second, when the loan becomes effective, the enterprise must report information on individual disbursements to Bank of Indonesia, including:

- The name and address of the lender;
- The amount disbursed;
- The local bank that received the disbursement;
- The terms of repayment;
- The country of the lender to which repayment must be made;
- The name of the bank through which repayments are to be made;
- The amount of the outstanding debt (the total principal to be repaid).

Verification

The data which the debt office receives on public enterprise debt should be verified. How?

First, check the consistency of current with past reports. Changes in debt outstanding should be accounted for by the transactions that took place during the accounting period. Debt service payments (or the changes in arrears) should correspond with the previously reported scheduled debt service payments.

Second, periodic reports from the public enterprises to the national debt office should be compared with other data sources. For example, figures on debt outstanding should be compared with balance-sheet data produced by the enterprises.

Third, the national debt office should make use of creditor information. Official lenders, such as the European Investment Bank and foreign governments, can make available to the national debt office figures on their total exposure to the country. Such reports make cross-checking feasible.
Fourth, there should be personal contact between the national debt office and the accounting departments of public enterprises. Through these visits, the national debt office can clarify its reporting requirements and clear up ambiguities.

Countries that have substantial borrowing by public sector agencies outside the central government should set up systematic cross-checking procedures. In Uruguay, for example, the Public Debt Department of the Central Bank verifies loans with creditors. The Central Bank also feeds back to enterprises reports about their foreign debt, including payments due by currency and creditor. By helping enterprises manage their debt, the Central Bank builds up good working relationships, secures timely reporting, and, consequently, has better statistics.

Problems in Reporting

Despite laws or government decrees requiring public enterprises to report debt data to the national debt office, enterprises are rarely responsive. In virtually every country where reporting requirements are introduced, some enterprises attempt to avoid filing reports. Statistical reporting takes place only when the enterprises know that penalties will be imposed and enforced if they fail to comply.

Even when enterprises do report, errors arise and the source of the problem must be found. While some may be resolved through correspondence or the telephone, debt office staff must plan to make personal visits to the accounting offices of the larger enterprises to resolve inconsistencies. Maintaining personal contacts between the debt office staff and the accounting departments of key enterprises is essential for maintaining reporting. Procedures for collecting data from public enterprises can also be used for securing debt information from local governments and from other public sector entities.

Making an Inventory

If the national debt office has just begun to monitor the external debts of public enterprises, the first stage must be to establish an inventory of all outstanding debts. This requires contacting the accounting office of each enterprise and requesting:

*The terms and conditions of each loan.* The essential information to collect is the name of the lender, creditor country, purpose of the loan, amount of the original commitment, amount and dates of supplemental...
commitments (or of cancellations), rate of interest, and a copy of the schedule of debt service payments.

*The status of debt as of the beginning of the current accounting period.* This should indicate disbursed debt outstanding, amount of the loan still to be disbursed and amounts of arrears, if any. The arrears figures should separate arrears of principal, interest and other service charges. All figures should be in the currency of obligation.

*Historical information on disbursements and debt service payments.* This enables the people responsible for national economic management to have complete figures on foreign borrowing by all sectors of the economy, by type of credit, type and origin of lender and by economic purpose. It should be feasible to obtain historical data on disbursements and debt service, by calendar year, for outstanding loans. To obtain complete historical data, the national debt office should try to collect information of all past loans, including loans that have been fully repaid. This historical part of the debt inventory, however, is of secondary importance.

**Private Sector Debt**

In a market economy, many private enterprises will borrow overseas. The approaches to collecting data are dictated by the existence, or absence, of government controls over private sector external borrowing. There are broadly, three situations concerning control over private sector borrowing:

First, many countries require private companies to receive advance permission from exchange control authorities to borrow abroad. After loans are contracted, borrowers must register disbursements received and debt service schedules with the Exchange Control Department of the Central Bank. The Central Bank then has information on private nonguaranteed debt almost as complete as on public and publicly-guaranteed debt. Many countries have such debt registration requirements. In Colombia, private enterprises must get approval from the Department of National Planning and the Monetary Board on repayment terms and financing conditions. Private sector borrowers in Brazil must seek permission from the Central Bank and in Chile the central bank is responsible for authorizing and registering private sector foreign borrowing.

Second, there are countries where private companies can borrow abroad without prior approval from central government. Companies must, however, register foreign borrowings before being allowed to purchase foreign
exchange from the banking system to service the debt. Foreign exchange control is maintained to prevent unauthorized transfers abroad of residents' assets—that is, to prevent export of domestic capital.

Third (and the most difficult situation from a statistician's point of view), is where countries have no restrictions on private capital outflows. Under these circumstances, data must be collected either through commercial banking records or by survey—private companies must be asked to fill out questionnaires.

*Exchange Control Data Sources*

When debt service payments fall due, the private sector debtor instructs his bank to transfer the appropriate sum. Before remittance can be made, exchange control authorities must check the application against the debt service schedule on deposit to assure that the amounts are consistent. Another approach is for the borrower to keep the original copy of his registration certificate so that he can purchase foreign exchange. The record of this transaction provides a basis for debt statistics. When the application for remittance is approved, the payment is noted by the exchange control authorities to prevent capital exports in the guise of duplicate debt service payments.

The payments schedules can also be the basis of estimating arrears: when amounts fall due and are not paid, the debt is presumably in arrears. Of course, it is possible for the exchange control authorities to authorize the remittance, but it might not be made because of a difficult balance of payments situation. Arrears arising from failure of debtors to pay in local currency can be distinguished from arrears arising from the monetary authorities' inability to obtain foreign exchange.

There is one major limitation on exchange control records as a source of private sector long-term debt. It is possible that the debtor may have access to off-shore foreign exchange resources. In this event, the Central Bank must investigate the extent to which data obtained from the debt registration system understates the true amount of private nonguaranteed debt.

If debts must be registered with the exchange control authorities, the debt service schedules that are deposited with the exchange control authorities become the basic information source. To make these schedules useful for statistical purposes, the date of the disbursement should be indicated. Note that disbursements can take the form of shipment of goods or contractors services, as well as cash transfers.

For private nonguaranteed debt, collection of information is generally more difficult, since the government is not normally involved in negotia-
tions. Legislation, however, can sometimes be used to require that prior permission to borrow be obtained from some government agency, typically the Central Bank, before any external loan is signed. Some countries apply a threshold amount below which permission is not required; this reduces the administrative burden for small loans, and, unless there are many such loans, does not statistically affect the overall picture. Further reporting should be required after the signing of the loan agreement to avoid the inclusion of debt for which permission is given to borrow but no contract is executed. This form of data collection is particularly effective in countries having strict foreign exchange control.

Private sector debt that is guaranteed by the government can be monitored with relative ease. When an enterprise requests that a loan be guaranteed, formal requirements for statistical reports can be made part of the guarantee process. Failure to provide this information would prejudice that firm’s ability to receive guarantees in the future. For private debt guaranteed by the government, a reporting system can be devised similar to that used for collecting data from public enterprises. None of this leverage is available for collecting information on private sector debt that is not guaranteed by the state and other sources of data must be used.

Using Direct Report Sources

Where there is no requirement that private sector nonfinancial borrowers register individual foreign debts and where banking system data are inadequate for monitoring private sector debt, direct reports or surveys are necessary. Some countries ask enterprises to prepare annual questionnaires on employment and finance. These can be a source of external debt data, if figures are requested on external long-term liabilities. In Mexico, for example, private firms must file monthly reports to the Subdirección de Estadística de la Deuda of the Ministry of Finance.

There are two problems with general financial surveys. First, they are complicated. They require careful attention to design; there must be pilot surveys to check the feasibility and usefulness of the proposed survey forms; there must be follow-up work with the actual survey to obtain a high response rate. Successful surveys require a dedicated effort by the responsible government agency.

The other problem is the attitude of private companies towards government requests for financial data. The management of these companies must be confident that the information supplied is to be used only for statistical purposes and that reports will remain anonymous and confidential. If the
private sector has doubts on this matter, the survey technique will be difficult to implement. Having effective legislation to guarantee the confidentiality of information helps to overcome resistance by private enterprises in responding. Mexico secures compliance by providing firms with an incentive to report: 15 percent of the reported interest payments are tax deductible.

**Commercial Banking Data Sources**

Many countries bypass the individual borrowers in data collection by obtaining needed figures from commercial banks. Commercial banks are highly regulated in all countries, and they have to file periodic balance sheet reports to their Central Banks with information on their foreign assets and liabilities. The reports on debt should separate long-term from short-term assets and liabilities.

*Balance sheet data.* The balance sheet report is the major source for the debt office in monitoring outstanding foreign debt of banks. Foreign debt data include deposits of foreign banks with local banks, deposits of foreign residents with local banks, and other foreign liabilities, such as bonds and notes issued by local banks. It is essential that the requirements which the Central Bank imposes on the commercial banks for reporting balance sheet data take into account the need to obtain data on external debt.

Particular attention must be paid to how external liabilities and assets are defined. The balance of payments concept of residency, and not nationality or currency, should be used to determine what is a foreign liability or asset. Foreign citizens and enterprises operating in the country or living there for more than one year are residents. Therefore, their claims are internal claims and are not part of external debt.

With the exception of liabilities on lines of credit, however, external debt data derived from the balance sheet do not contain all the desired information, as the data are not presented on a loan-by-loan basis. Flow data can be derived from balance sheet reports by calculating the difference between the amounts outstanding at the beginning and end of the reporting period. The debt office needs the figures on assets and liabilities by currencies to eliminate changes on stocks due to exchange rate movements. The resulting figures, however, are net flows; still unknown are disbursements and amortization. The debt office must use other sources for the missing data.

Since balance sheet reports do not contain information on the maturity of loans and deposits, the debt office cannot project the repayment schedule of the banking sector. To measure debt service, the banks should be asked to
report the distribution of foreign liabilities by maturity. Having these data enables the debt office not only to project future debt service, but also to separate flow data into disbursements and repayments. If the debt office does not have these data, it can use the debt distribution by original maturity to estimate debt service.

To project the interest burden and future flows, the debt office should have information about the cost of the debt. When actual debt service schedules are not available, it must estimate interest charges. Using these, together with maturity distribution data, the debt office can provide reasonable figures for interest payments.

In some countries, aggregated balance sheets that the debt office uses include only data on the deposit money banks. In those cases, the debt office must develop a reporting system for other financial institutions, such as development and mortgage banks.

Special problems arise with offshore banks, which take deposits from foreigners and lend primarily to nonresidents. If a country has offshore banking, external debt can be exaggerated. According to the accounting principle agreed to by international compilers of debt statistics (and to the principles of the Balance of Payments Manual), the liabilities of commercial banks should be measured on a gross basis. With offshore banks, however, the external debt of the countries will have nothing to do with the country’s current account. Some countries solve this problem by measuring the debt of the banking system on a net basis, but this is not recommended. A better approach is to separate the offshore activity from the overall debt.

Data on guarantees. The debt office should exploit not only balance sheet data of commercial banks but their information on guarantees. Commercial banks guarantee debts of private nonfinancial sector borrowers, particularly short-term obligations, such as acceptances and letters of credit. Such guarantees do not represent foreign debt but rather the debt of nonfinancial enterprises. The debt office must require separate reports on guarantee data, which is not contained in balance sheets. The reports can include either stock or flow data. They will cover only part of the private sector’s external debt, but they are important for cross-checking data prepared by the private sector.

Double Counting Problems. For public debt, central government and public enterprises sometimes borrow through local banks system instead of directly from foreign lenders. The loans may be denominated in foreign currency so that the ultimate borrower, not the commercial bank, assumes the exchange risk. In these instances, banks usually borrow “back-to-back”
Back-to-back lending poses specific problems. Abroad, to cover the currency risk and finance the loans. This might lead to double counting since the same debt could be measured twice: once through the government’s report on its external liabilities and again through the banks’ balance sheet reports to the Central Bank.

In many countries, the private sector can borrow in foreign currency from domestic banks; in some countries, the private sector is not allowed to borrow abroad and must go through local banks. (This enables the authorities to better control capital flows.) In these cases, the debt office usually has two sources of information. One from the private nonfinancial institutions, the application forms to the exchange control authorities, the other from the consolidated balance sheet of the banks.

It is recommended that bank data be used as the primary source, because bank records are normally more comprehensive. The use of private sector reports is recommended only if their debt does not appear in banks’ accounts. Private sector debt appears in the banks’ books twice: on the asset side as credits to the private sector and on the liabilities side as liabilities to foreigners. The debt office should always measure the liabilities side, since sometimes there are internal sources through which local banks can finance the private sector’s foreign currency needs.

Some estimating is inevitable. Terms and future debt servicing requirements of private debt are often not available. But, by using reported information together with a knowledge of international markets, reasonable estimates of current stocks and projections can be made. Reports from international institutions, such as the Bank for International Settlements (BIS), the International Monetary Fund (IMF), and the Organization for Economic Cooperation and Development (OECD), will provide figures for cross-checking against the information registered by the debt office. Periodic requests to creditors to verify the status of loans which they have extended to organizations in the country and reconciliations between different agencies such as the Ministries of Finance and Planning, the Central Bank, and the Office of the Accountant General, may also be used to confirm debt office records.

Using Trade-Related Sources

Another possible source of information is customs and trade information; documentation is normally needed to import goods. Some countries also require information on any financing of the goods; by including loan identification, the registration of the loan by the debt office can be verified.

A modified approach, directed at obtaining only limited information, is the use of a targeted questionnaire. The enterprises having trade-related
debt may be identified from customs forms. The first step is to persuade customs authorities to include a question on financing in the relevant forms. Tabulating these forms, the major debtor companies can be identified. While the customs forms themselves can be modified to include data on finance, they will rarely include enough information to suggest the repayments schedule, and frequently information on interest rates will be missing. So it is preferable to ask the companies that account for the bulk of export credits to respond to a questionnaire related to long-term external debt. For additional information on monitoring private sector debt, see Klein and Ozer (1990).

Using Creditor Sources

The BIS, the OECD and the IMF publish data on the external liabilities of private sector entities to international banks, and so their reports can be useful for cross-checking national data on private sector debt. It is important that discrepancies between national data and creditor-source data be discovered and reconciled, because commercial bank lenders follow these information sources closely. If there are unexplained differences between national data sources and cross-border banking statistics, they will lose confidence in the national statistics.

Many developing countries have made progress in measuring private nonguaranteed debt. The evidence can be seen in the comprehensive data assembled under the World Bank’s Debtor Reporting System (see Appendix A). When countries that are believed to have significant private nonguaranteed debt are unable to compile actual data, World Bank staff makes its own estimates. These estimates are added to reported data to arrive at a global figure for private nonguaranteed debt. In 1970, only 32 percent of estimated total private nonguaranteed debt was based on figures compiled by the debtor countries. This percentage rose to 58 percent in 1975 and 74 percent in 1980, and has remained close to that figure since.

Monitoring Short-Term Debt

Monitoring short-term debt—that is, loans with a maturity of one year or less—is a complex process, because there are many small transactions. If foreign trade is large relative to total production, there are likely to be many enterprises and banks that receive foreign credits. Because the transactions take place mainly through the banking system, Central Banks are best placed to organize information on short-term debt.
The first decision is whether only summary information is required or whether information is needed in connection with some system of controlling short-term borrowing. If just summary information is required, the statistical authorities need only obtain balance sheet data from enterprises and financial institutions with external short-term liabilities. If the Central Bank also wishes to control short-term borrowing, or at least have close surveillance of short-term borrowing, then reports on transactions are required. However, few countries have comprehensive statistics on short-term debt.

**Elements of Short-Term Debt**

Most short-term debt is trade-related. This consists of (a) loans under lines of credits to enterprises and to governments; (b) letters of credit opened by local commercial banks confirmed by foreign banks; and (c) overdrafts and other loans incurred by commercial banks in connection with trade transactions. Occasionally, the Central Bank will receive trade deposits under debt restructuring arrangements in which foreign commercial banks will agree to maintain trade credit facilities up to a minimum level.

Some short-term debts, however, are not trade-related. These consist of (a) foreign bank deposits with the Central Bank and with commercial banks; (b) loans of commercial banks not related to trade; and (c) loans to entities outside the monetary sector (that is, public and private enterprises, government units).

The debtors can usefully be separated into monetary and nonmonetary sector borrowers. The monetary sector, of course, consists of the commercial banks and the Central Bank. The nonmonetary sector is the rest of the economy—enterprises, the government and nonmonetary financial institutions.

**Information Flows**

Information flows stem from the control process, which is to ensure that short-term borrowings are (normally) to finance trade. Under certain circumstances, the exchange control authorities would place restrictions on the terms of borrowings. The Central Bank often will require prior approval for all lines of credit and for other loans received by the monetary sector. Central Banks normally delegate authority to the commercial banks for approving credits received under open accounts and acceptance credit arrangements. (Such authority is directed by guidelines set by the Central Bank.) Export advances, which are credits to exporters to finance production, usually do not require prior approval.
To give them flexibility in their foreign exchange operations, commercial banks normally are not required to seek prior approval for foreign borrowings, overdrafts or foreign deposits. Instead, commercial banks are subject to supervision to ensure that they are being operated prudently.

Borrowers other than monetary institutions should be asked to prepare daily and weekly reports. The daily reports cover transactions: how much was utilized and how much was repaid. The reports on loan utilizations provide figures in the currency of the transaction, the type of facility, the date payment is due, rate of interest, and the creditor and guarantor of the loan. The reports on repayment should show the creditor, due date, payment date, amount in currency of obligation, the distribution between principal, interest and fees and the servicing bank. Weekly reports provide information on balance sheet data with respect to individual lines of credits, and so on. For the monetary sector, the commercial banks should provide daily reports on lines of credit—the amount, the confirming bank, the importer, and maturity, as well as the amounts of the commodity imported and payments made. Summary reports are made on other types of short-term debt, and comprehensive balance sheet data should be submitted monthly. The Central Bank of the Philippines has pioneered a system for monitoring short-term debt along these lines. See Orbeta (1988) for details.

A National Debt Office

What agency should be responsible for collecting data on public enterprise debt, private sector debt and short-term debt? The unit responsible for monitoring central government debt should, logically, be in the Ministry of Finance, with close links to the budget office because the monitoring is tied to the budgetary process—both in budget preparation and in budget execution. Because monitoring nongovernment debt is not part of a government administrative process, the question of location is not so readily answered.

The banking system has many basic data sources. If exchange controls are in effect, they are managed by the central bank, and this is where data are to be found on private sector debt. If transactions on private sector debt are estimated from banking system data, again, the central bank would be a logical place from which to monitor. Short-term debt is based largely on banking data; once more, this points to the central bank as the appropriate agency to organize statistics.

With public enterprise debt, the answer is not clear-cut, as collecting data will be by a survey. This could be carried out from any office that is given the authority (and resources) to collect data. If records of indebtedness...
If nongovernment debt is a major share of total debt, the national debt office may best be located in the central bank.

The national debt office must be responsible for debt analysis; ability to perform this function is a consideration in deciding the locus of the national debt office.

ness are maintained by financial institutions involved in the guarantee process, however, the central bank may be appropriate institution for monitoring enterprise debt as well.

With some debt data monitoring functions allocated to the Ministry of Finance and some to the Central Bank, a third debt monitoring agency should be avoided. Bringing together the work of three agencies would be an unnecessary administrative complication.

Which agency should be responsible for assembling data on total external debt—government, nongovernment and short-term debt? The Government Debt Office? The Central Bank’s Debt Office? The answer really depends on who has responsibility for the analysis of the country’s debt situation. If this is with the Ministry of Finance, its debt office should be designated as the national debt office, and it would combine its data on government debt with information collected elsewhere and prepare statistics on total external debt. If the Central Bank has this analytical function, it would house the national debt office. Regardless of the location of a national debt office, the key to sound debt management is coordination. All institutions with debt management functions must be prepared to share data with others, and they must be willing to help build a common national data base.

With the responsibility for debt analysis and the assembly of data on the country’s total debt comes responsibility of disseminating statistics to other parts of the government. At the same time, summary statistics should be made available to the public through publications in standard statistical bulletins. The national debt office should be given the responsibility of filing external debt reports to the World Bank under the DRS and for preparing ad hoc statistics for other international organizations, such as the International Monetary Fund.

References


Computerization Issues

Thanks to revolutionary technology, microcomputers now contain substantial internal memory and computing power, and they are available at relatively low cost. Equally important, microcomputers can be used by people without specialized training. Accordingly, computers now are considered indispensable for debt accounting and statistics, and they are also helpful for many managerial functions. Parallel with new hardware, "off-the-shelf" computer software and new programming techniques have made it easier to develop specialized applications for both mainframe and microcomputers.

Computer-Based Debt Management Systems

A computer-based debt management system groups together debt management functions so as to order data and make calculations required for external debt management. This section incorporates portions of Valantin (1992). All computer-based systems have three components: the hardware, the software and the data base.

Components of the System

Hardware. Hardware is the physical equipment on which the system operates. This includes the computer, (mainframe, minicomputer or a microcomputer), and storage devices, such as disk drives, tapes or diskettes. Peripheral equipment, such as terminals to view data, printers and communication devices (modems) to link one computer to another are also needed. The specific equipment depends on (a) the amount of detail that is being dealt with, (b) the number of people using computers simultaneously and whether or not they are in the same location, (c) the need to communicate with other computer-based systems and (d) the operational environment (for

Hardware is the equipment on which the computer systems operates.
example, whether data is entered transaction by transaction directly into the system or in large batches at intervals).

Software. This is a program of instructions that can be communicated to the computer to direct its operation. There are two types of software—one giving commands to the computer (the operating system), and one directing the computer to perform specific functions (the application software).

Database. This includes the figures and basic information regarding debt entered by the user of the system, the data that are calculated by the system, and the basic definitions needed to organize data. Nine types of data are typically found in a computer-based debt-management system:

(a) The loan register, which contains basic data from the loan contract—the borrower and lender, signature date, loan amount, purpose, and so on.

(b) Planned transactions schedules, which include schedules for future disbursements, amortization and interest payments and fees. Some systems require entry of actual schedules; some call upon standard formulae for calculating these schedules; some allow both methods.

(c) Projected future transactions schedules, which are generated by the CBDMS system in response to the descriptions of planned transaction schedules. Such projections depend on the availability of estimates for future interest and exchange rates and assumed profiles of disbursement.

(d) Actual transactions data, which are the records of loan disbursements and debt—service payments, entered transaction by transaction, for government direct debt and possibly in summary form for nongovernment debt.

(e) Debt relationships, which show linkages that may exist between individual loan agreements. Such relationships are important for recording domestic on-lending and for calculating the impact of debt rescheduling.

(f) Exogenous data, which are required to make projections. They consist of files of historical exchange rates required to convert debt data from currencies of obligation into some common currency, the national currency of the country concerned, US dollars and perhaps SDRs. They also include records of the interest rates necessary for calculating charges on variable interest rate loans. In addition, they include economic data for calculating the debt burden, such as gross national product, exports and government revenue.
Utility information, which are strings of data, such as creditor names and addresses, country names, names of institutions and names of currencies. All such data are assigned codes, and groups of these codes are called "utility files."

Administrative data, which relate to controlling the flow of work that comprises debt management, such as the validation of data, authorizations to make debt service payments, budgetary allocations and evidence the requested debt service payments have actually been made.

Interfacing data, which make possible linkages with other systems. Much data in the debt system must be related to comparable figures in other data systems, particularly those used by the Central Bank for balance of payments recording, those used by the budgetary authorities, and those used by officials responsible for monitoring public—sector investment. This is accomplished by establishing a set of code numbers that are used in common by related users.

An integral part of the system, as with any computer-based system, is documentation. There must be a full description of how the system is structured and operates. There must be standard data entry forms, training manuals, and operating procedures. Without complete and up-to-date documentation, staff can only operate the system on the basis of oral instructions. This leads to inefficiency, errors and difficulties in training new staff.

Functions of the System

A computer-based debt management system is a facility for storing information related to debt management, retrieving and organizing this information in reports, carrying out an analysis of debt and relating debt information to other data systems.

Data entry, validation, and editing. Data entry, validation, and editing creates the external debt data base. New loans are registered and data for individual transactions are entered and verified. Validation is important. With the large volume of numbers being entered into the system, it is vital to check the internal consistency of new information.

Make projections of future transactions. The system will calculate the timing of disbursements of undrawn balances, payment of interest and fees and repayment of principal.
Produce standard reports. These reports are defined by the system, although, to create them, the user would have to indicate the characteristics of the report, using codes that are also part of the system, such as the period covered by the report and exactly what information to include. These reports could be for an individual loan or group of loans. They could be simply printouts of ledger accounts, or they could be the result of calculations made by the system, such as future debt service obligations. They would include standard reports required by the World Bank.

Querying and ad hoc reporting. The system should be able to extract information not covered by a standard report (the “querying” function). The user can establish some selection criteria which enable the system to identify relevant records and organize them into a report. The user should have the ability to define the scope of these reports.

System utility and maintenance functions. The system, must have routines that enable it to use the different parameters to define and generate reports. This includes having the capability to update lists of codes and incorporate supporting information, such as interest rates and exchange rates. There must also be routines to provide essential operating functions, such as backing up files and limiting access to certain routines to those with defined passwords.

Analytical and management tools. The system should provide information to debt managers that will help them decide whether or not to accept a borrowing proposal. For example, it should calculate the grant element of a loan, and it could make debt service calculations showing how the total of debt service obligations would be affected by taking on the proposed loan. Among the analytical uses, the system could calculate standard creditworthiness ratios, drawing upon debt data and macroeconomic indicators entered into the system. It could test the sensitivity of debt service to changes in interest rates and exchange rates.

Evaluate structural changes to the debt portfolio. The system should evaluate the consequences of refinancing or rescheduling and should be able to calculate the benefits of currency and exchange rate options and swaps.

Interfacing to external systems. The system should allow for the electronic transfer of data. For example, if a computer-based accounting system managed outside the debt office is the source of loan disbursement data, it
Examples of Computer-Based Debt Management Systems

Examples of Computer-Based Debt Management Systems

There are two computer-based debt management system in common use. One is supported by the Commonwealth Secretariat (CS-DRMS), originally used primarily by countries that are members of the Commonwealth but now available to other countries under license to the Crown Agents. Under the auspices of the Canadian Government, the International Development Research Center (Ottawa, Ontario), is making this system available to francophone Africa and to other countries. As of mid-1993, CS-DRMS is being used by five nonCommonwealth countries. To this end, IRDC is completing a French language version of the system and is planning a Spanish language version. The other major system was developed and is supported by UNCTAD. This system, known as DMFAS, is being upgraded under the joint auspices of UNCTAD and the World Bank, financed by UNDP. Some of the larger developing countries have developed their own systems—Brazil, Chile, Colombia, Mexico, and Turkey, for example (see Table 8.1).

The World Bank staff can assist in the development or improvement of a system. It conducts a “needs assessment” of debt management requirements, and this study can serve as the basis for technical assistance programs, staff training and possibly the provision of grant financing. These studies are carried out in collaboration with both the Commonwealth Secretariat and UNCTAD, depending on which system is chosen by the beneficiary government. Both the Commonwealth Secretariat and UNCTAD conduct their own needs assessments as part of their debt management advisory services.

CS-DRMS and DMFAS Systems

Both CS-DRMS and DMFAS are designed primarily for statistical purposes, but they can assist in debt accounting. These systems capture the basic loan
### Table 8.1 Computerized debt management systems

<table>
<thead>
<tr>
<th>Country’s own system</th>
<th>CS-DRRS (Com.-Sec)</th>
<th>DMFAS (UNCTAD)</th>
<th>Other proprietary systems</th>
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<td>Moderate number of debts</td>
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particulars and transactions for disbursements and debt service payments, and automatically calculate loan balances and arrears of principal and interest. They produce aggregate figures during processing runs (recommended to be done monthly). Each loan record stores the current balance of commitments, disbursements and debt service payments, and this provides instant access to the most up-to-date information on the status of a loan. In addition, aggregate data on each loan are stored in separate files, giving fast access to, typically, 10 years of both projected and historical annual figures. This file also provides quarterly and monthly figures. The number of years, quarters and months in this file can be adjusted to suit individual user needs.

Projected data are calculated in the currency of obligation and compared with actual transactions as they take place. Aggregate figures are stored in local currency for speed in reporting, but reports can be printed in any currency for which an exchange rate is available. Interest rates and exchange rates are maintained separately for each base interest rate and currency. Files exist for special identifier codes relating to country names, economic sector, etc. The user may store exogenous economic data with which to make creditworthiness calculations. Information on grants can be stored and maintained separately from data on loans.

Data are entered and edited interactively in both systems and there are provisions for checking the validity of data. There are special provisions for entering data that instructs the program how to reschedule debt and how to calculate the time path of future loan disbursements. CS-DRMS has a “multi-user capacity,” which means that several people may use the data base simultaneously for the entry of figures for making queries and for running reports. Likewise, UNCTAD’s new system.

Raw data are processed by the program in a series of discrete stages (modules). Each is devoted to a specialized task, such as the calculation of principle and interest payments, based on rules that are written into the program. Some rules can be modified by the user, such as the disbursement profile for different types of loans. If the program cannot manipulate the data of any particular loan, a special error handling module helps identify the source of difficulty (such as data entry errors not detected during entry validation).

Both CS-DRMS and DMFAS produce many standard reports on various aspects of external debt. Users can arrange for help in designing special reports for their particular countries. Both programs allow the user to select records from any table in the database. The information retrieved can be displayed on the screen (or printed) as is or modified. In addition to standard reports, users can design and write their own reports.
Analysis can be done without interfering with the database.

Security systems restrict access.

CS-DRMS has a Management Tools Module that allows users to manipulate data to see the effect of their analysis without interfering with the database itself. Examples of these management tools are studying the impact of new borrowing on future debt service, evaluating the impact of alternative debt restructuring scenarios, examining the consequences of alternative borrowing strategies, or loan offers. CS-DRMS can also analyze the effect of changes in interest rates or in exchange rates on future debt service obligations. Similar possibilities are available in DMFAS.

Attention has been given to the question of security. CS-DRMS runs under UNIX-Xenix which has a sophisticated built-in user security system. In addition, users are assigned a DRMS user identification and password that will allow them to use one of three security levels. One user may be a “database administrator” who is allowed the freedom to change any of the data in the system, including codes for controlling the software. Another person may be a “data entry user” who can change the loan data and some of the codes, but not those controlling the system. Others may be “data browsers” who can access information and print reports but cannot change any of the data. There is also an audit trail to report on who has been changing the data and a menu trail which traces access to the system. DMFAS likewise has several layers of access.

The CS-DRMS system was installed first in Sri Lanka in 1985. As of July 1993, it is operational in 38 countries. First developed for use on an IBM PC/XT, the current Version 5.5 is designed to run on microcomputers using the 386 microprocessor. It is based on the “C” programming language, the INFORMIX relational database management system, with a user-friendly screen-handling option (PERFORM), an interactive query system (SQL), and a report-writer (ACE). The bulk of CS-DRMS is written in the fourth generation language of INFORMIX (4 GL). The core of the system is a Loan Administration Module and a Management Tools Module. In addition, there is a Systems Administration and Maintenance Module.

Recently added features at CS-DRMS include a rewritten automatic link to the World Bank DRS; an easy method for outputting reports as ASCII text files, which can be imported into Lotus 123 and other spreadsheets or word processors; and a facility to store “value dates” and “amounts” as well as those for loan accounting. A new version, to be released in early 1994, will be language independent, available in French, as well as English, and with an automatic link to the World Bank’s Debt Strategy Module (see Chapter 9).

The DMFAS system was actively used in 20 countries as of end-1992. It has three modules: the DMS (Debt Monitoring System), the DRES (Debt Reorganization Subsystem) and the DPS (Debt Projections and Balance of...
Examples of Computer-Based Debt Management Systems

Payments Linkage System). It also has an interface to the World Bank’s Debt Strategy Module and a function to report to the World Bank’s Debtor Reporting system (as does the CM-DRMS). The DMS is the main module of the DMFAS, and most data used by the DMFAS is entered here. Although some data must be entered independently by the user into the DRES and the DPS, these two modules also use data taken from the DMS.

The DMS and DRES modules of the DMFAS are written in the COBOL (ANSI-74) programming language, permitting installation on either a mainframe or a microcomputer. Microcomputer users of the DMS and the DRES can benefit particularly from the speed and compatibility of the COBOL language. The current compiler for microcomputers is “CA-Realia COBOL” from Computer Associates.

The DPS module functions only on a microcomputer as it uses the software Lotus 123, Version 2. This offers no serious limitations as this module is only for analytical purposes and uses aggregated data. The DPS can also function as an independent system to the DMS. Users in developing countries find these technologically simple software tools helpful. They have few technical problems, it the system is thus easy to install and operate.

In September 1994, a new UNCTAD CBDMS is expected to replace DMFAS, will be released under the Joint Program between UNCTAD and the World Bank. This new system will make the most of recent computer technology by using Oracle’s relational database management system and

Box 8.1 CBDMS Information

Both the Commonwealth Secretariat and UNCTAD have published documents that describe their computerized systems.

UNCTAD
Address: Global Interdependence Division
  DMFAS Programme, Information and Liaison
  UNCTAD
  Palais des Nations
  1211 Geneva 10 Switzerland
  Phone: (41-22) 907-58-50
  Fax: (41-22) 907-00-45

Commonwealth Secretariat
Document: Advisory Services on External Debt Management
Address: Economic and Legal Advisory Services Division
  Commonwealth Fund for Technical Co-operation
  Commonwealth Secretariat
  Marlborough House, Pall Mall
  London SW1Y 5HX England
  Phone: (44-71) 839-3411
  Fax: (44-71) 930-0827
its fourth generation programming tools. The users of this new system will be able to carry out all the functions which the DMFAS provided, but in addition, will be able to:

• Capture and handle all debt instruments and flows swiftly and easily;
• Protect data with strong security measures;
• Allow the user to generate reports which meet specific requirements;
• Interface with other information systems (that is, accounting, budget, balance of payment systems);
• Run the system on a microcomputer, or a network.

The Brazilian System

A number of countries have developed their own computer-based debt management system. Brazil, for example. Its main system has been under continuous development since 1972, and is managed by a team in the Central Bank’s Data Processing Department (DEPRO); 20 professionals work exclusively on systems development and maintenance related to the sub-systems dealing with external debt, while another 20 work on other systems development. The total staff of the Department is 200.

The system is comprehensive and includes public and private sector borrowing, regardless of whether it is short-, medium-, or long-term in maturity. It comprises a series of modules of the Central Bank information systems that cover most of the work done at the Central Bank. The overall system (SISBACEN) runs on the Central Bank’s mainframe IBM 3090 computer that is interconnected to an additional Fujitsu FACON M-380 computer, an IBM 4131 for systems development, and an IBM 3080 for internal data analysis. Subsystems are developed using ADABASE management system, and there is a clearly defined data administration function that oversees the development and the use of associated files, programs, and information within these subsystems. Applications are written in COBOL, ASSEMBLER for specific technical functions, and NATURAL and ADABASE for inquiry and report generating language.

Information flows between related subsystems are updated automatically. In some cases, this connection is direct and on-line, and the subsystems communicate via accessing common data base files. In other cases, the information is extracted by a periodic batch process which then posts the information in a processed form to the data base files of the receiving system. It is not retranscribed manually; indeed, for a system that has 14 million records and 28000 transactions per day, as happens with the foreign exchange system, this would be impossible. Even payment order telexes are
generated automatically and transcribed by the Central Bank’s computer to
the appropriate telex network for onwards transmission. Roughly 80 per-
cent of accounting records of the Bank’s system are generated automatically
by various subsystems.

All operations involving foreign exchange, carried out via authorized
commercial banks, are connected on-line to the Central Bank’s system
through a telecommunications network. In some instances, the commer-
cial bank’s own computer system is interconnected with that of the Cen-
tral Bank; in others, only an on-line terminal is connected. Around 600
external lines feed into the Central Bank’s computer system and update
information continuously. Thus, any foreign exchange transactions related
to foreign debt, such as the arrival of a drawing, or the payment of a debt,
is processed and available as part of the Central Bank’s data base moments
after the transaction occurs.

Although commercial banks in Brazil were at first reluctant to be con-
nected on-line to the Central Bank’s computer (primarily because of fears of
the cost), they now seem enthusiastic users. Besides providing easy facilities
for on-line entry of the appropriate transactions, the system provides banks
with regular reports, as well as an on-line query facility. Seventeen banks
have their own computer systems interconnected with that of the Central
Bank, and discussions are underway for defining standard data formats so
that banks with automated systems can download their data, or the approp-
riate aggregated data, from the data bases of the Central Bank.

The foreign exchange management subsystem provides all relevant trans-
action information for the external debt system. The basic entity is an ex-
change contract executed by a commercial bank in Brazil authorized to deal
in foreign exchange. The debt recording and management subsystems have
on-line access to all relevant transaction information. They also can access a
subsystem that provides up-to-date foreign exchange and interest rate in-
formation that is fed continuously by a unit with access to Reuters informa-
tion services as well as other sources.

In the area of external debt management, there are several subsystems
and data bases of direct relevance.

These include:
• Authorizations from the Central Bank to negotiate loan agreements;
• Foreign exchange transactions;
• Foreign exchange rates;
• External reporting (for example, the World Bank); and
• Special projects, such as 1983 money, 1983 rescheduling of short- and
  long-term obligations, and Paris Club rescheduling.
The subsystems have been designed to provide information to the management of the Central Bank, to the commercial banks as agents for borrower clients, and users within the government of Brazil such as the Ministry of Finance, Treasury, Senate, Ministry of Planning, and the Office of the President. Internal users within the Central Bank can write their reports using a subset of the national query language.

Basic loan information is entered into one subsystem that produces a formal debt registration certificate, which contains general information, as well as a detailed principal repayment schedule. The system calculates the projected interest payments according to the terms provided in the basic loan record. It handles various types of interest rates, including unusual combinations that are sometimes used in Brazil—for example, the average of a three-month and a six-month LIBOR. For variable interest rates, the system does not project or calculate future interest repayments for individual loans but various projection routines are used to produce reports based on expected interest rates and exchange rates in batch mode. The latter is expected to become an on-line option in the future.

When data are entered into a loan record, several validation checks are carried out. The certificate record must be linked to an authorization record within the system. Changes are made in the certificate record itself, unlike, say Argentina, where a new record must be created. In some cases, however, new records are created—as when, for instance, loans are consolidated to create a single new loan. There are roughly 120,000 certificate records in the system, including certificates for loans that have been paid and for loans consolidated. The system does not allow for certificates to be linked together (as in the case of syndicated loans), although this feature has been identified as desirable by some users.

Installing a System

When a computer-based debt management system is installed, there are normally old procedures in place for monitoring and managing external debt. At the end of the installation process, these will be replaced by new activities; in between, there is a transition period (see Figure 8.1).

Study of existing procedures. A computerized system requires that there is a smooth flow of data, defined in a uniform manner, into the computerized data storage system. At the start of the project, it is important to note all the institutions that are involved with debt management and their individual functions and responsibilities. What information agencies need for their own work
must be defined clearly. For example, one agency may require only information related to disbursements of aid-financed projects, but the office responsible for government accounts must have complete data on debt service obligations and payments. The flow of information required with each stage of debt management for all relevant institutions has to be documented carefully.

**Definition of goals.** These must be stated explicitly and agreed upon by all interested parties. First, there must be an understanding as to what debt to include. Public and publicly guaranteed? All public sector debt? All private sector debt, guaranteed and nonguaranteed? Domestic as well as external debt? All private sector debt, guaranteed and nonguaranteed? Domestic as well as external debt? Short-term and long-term? When the assignment of debt management responsibilities is divided between several agencies, the responsibilities of each agency must be clearly defined.

A crucial decision is in which institution should the system be installed. The computer system into which data are entered must be under the direction of a single agency. While there can be many users, located in different agencies, there can be only one “owner” who will be responsible for keeping the data base current. At the same time, if data comes from several sources, it is important that these sources are identified early in the planning stages and the appropriate support services are defined. The controlling agency must have easy access to raw data. Also, it must have responsibility for all aspects of debt management; it will be hard for an institution to give much attention to elements of debt management that are peripheral to its assigned responsibility.

A project manager must be appointed, a strong leader who can work well with the debt office staff, with representatives of other agencies and with the technical staff who are trying to install the system. When the system is ready to operate, there must be a system administrator with overall control.

**Figure 8.1 Installing a computer-based debt management system**

<table>
<thead>
<tr>
<th>Old routines</th>
<th>Transition period</th>
<th>New activities</th>
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<tr>
<td>Debt office activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Start of project</td>
<td>a</td>
<td>b</td>
</tr>
<tr>
<td>CBDMS installation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Study of existing procedures and institutional arrangements.
b. Definition of goals.
c. Initial project activities.
d. Software installation and data entry.

Source: Borresen (1992b)
responsibility for the system functioning but who is also able to answer technical questions and provide guidance to the debt management staff. The administrator must also organize staff training when work procedures are changed as a result of system upgrades.

Initial project activities. Staff will require some basic training on computers. The office will function much more effectively, if they are given systematic instruction on the fundamentals of computer operating systems and how to handle some application software—spreadsheet software (such as LOTUS-123), word processing software (such as WordPerfect) and possibly data base software (such as DBASE). Staff should understand file management procedures, so that everybody knows how to avoid losing data files through errors or accidents. The system administrator will require a special course, possibly overseas.

Another activity is the preparation of data for entry into the system. Each system requires that information on debt be entered according to a fixed format. Figures on existing loans must be prepared for entry in the system as soon as it is in place. To do this, a decision must first be made as to how much historical data should be placed on the system. If the system is being installed in, say 1994, how far back should the data records go? To 1990? To 1980? Some earlier year?

Once this has been decided, the basic descriptive information on each loan must be entered on the relevant coding sheet, and all transactions data back to the starting point for the system must be coded on sheets. At this stage, transactions should be verified. Coded data on terms and conditions of borrowing should be verified against the loan contract and subsequent correspondence. This would be a useful time to compare the debt office’s data with creditors’ records.

Careful provision must be made for the location of computers, printers and other peripheral equipment. It may be necessary to redesign offices to allow for an efficient positioning of staff and machinery. Some restaffing will be required.

Software installation and data entry. When the computer equipment is put into place and the system software installed, intensive training will be required for all staff using the system. Following this, the data on existing loans must be entered on to the system and carefully verified against the old records. For a period of time, the new CBDMS and the existing data monitoring system must be run in tandem. The existing system cannot be shut down until it is certain that it the data entry work is going well and that the
reports generated by the system are accurate—and, of course, to ensure that the system’s reports used for debt administration are exactly what are required. Staff must be trained in how to use the analytical facilities of the system. When all this is assured, debt management can move to the computerized system. This is usually done at the beginning of an accounting period, such as the start of a fiscal or calendar year. This project cycle is described in Box 8.2 and explained further in Borresen 1992(b) and Hunsberger 1987.

"Off-the-shelf" Application Software

Accounting Tools

Debt offices, smaller ones in particular, can make good use of standard spreadsheet, word processing and database software. Offices with fewer than four

Box 8.2 Project cycle for computer-based debt management systems

Whatever type of computer-based debt management system a country adopts, its development must follow some discrete stages. They are:

Initial assessment: The host country government, after initial discussions with the advisor, makes a project request. The advisor visits the country to assess the existing institutional arrangements for debt management, including procedures of contracting and monitoring debt, and to identify user needs. From this visit, the advisor prepares a report that explains what must be done to modify the existing institutional arrangements to make installation of a system feasible.

Institutional arrangements: The government takes action to establish appropriate institutional arrangements and procedures. A project manager is appointed to direct the installation of the system. It may be decided at this stage whether or not to employ an expatriate advisor.

Debt inventory: Information on existing debt is coded on the data entry sheets that are to be used with the new system. A decision is made on what the cut-off date will be for entering historical transactions. Staff is trained on how to interpret loan agreements and in how to code data in the format required by the system. The completed data entry sheets are reviewed by the experts responsible for installation. At this time, the arrangements for monitoring debt under the new system should be reviewed.

Training key staff: The key staff of the debt office are sent for external training to the office responsible for the system.

Installation: The system is installed in the debt office. Prior to this time, computers and peripheral equipment were purchased, and staff have been given general training on how to use microcomputers. The installation process involves training remaining debt staff on the system, entering the data on existing debt into the system and reviewing the institutional arrangements. The data base is audited to see that input data are correct. Sample reports produced by the system are checked.

Applications: Debt office staff are trained in report writing and the use of management tools contained in the system. Exercises are undertaken in analyzing debt data. The debt management staff are then ready to use the system in monitoring and managing external debt.

The new system is run parallel with the existing system for final checking.

Small offices should use standard spreadsheet or database software rather than try to install specialized software designed for team operations.
people working full time on recording external debt data and producing external debt statistics are not in a position to make use of the specialized computer-based systems. Experience has shown that when there is staff turnover in a small office, the system can continue to function only if an outside expert, with detailed knowledge of the system comes in to train replacement staff. This is very expensive; a suitable expert may not be available when needed; and often, in these circumstances, debt record-keeping stops.

Small offices are better advised to set up a simple record-keeping system using spreadsheet or data base software. The objective is to replicate on the computer debt record cards and forms (see Appendix B). The Debt and International Finance Division of the World Bank can advise on approaches that have been found successful and to put debt offices in contact with each other that face similar problems.

Management Tools

Ideally, personal computers should be on the desk of everyone who has to make decisions: they aid in the sifting of factual information, laying-out alternative courses of actions and estimating their consequences. Data base software enables a manager to extract data from a large field of information quickly, rather than request an assistant to examine piles of records and to copy out and present the information. The manager can examine figures that are interdependent in the sense that some figures result from an assumed relationship. By changing the assumption regarding that relationship, the manager can quickly perform a series of "what-if" calculations.

One should be able to transfer data from a computer-based debt management system to standard application software. Transferring data into spreadsheet software is most satisfactory when reports are being produced for single-purpose operations. Data base software is more suitable when periodic reports are to be produced in basically the same format.

When a computer-based system is installed, thought should be given to how data will be transferred. One can, of course, simply copy by hand figures from the systems standard reports into the software system. This is time-consuming and error-prone. Ideally, this can be accomplished by "automatic transfer of selected data from the actual data base of the core system into an independent report generator" (Borresen 1992c, p. 2). Or, a simpler approach is "the automatic transfer of standard reports (in ASCII format) from the core system directly into a spreadsheet..." which can be formatted to meet the needs in question. Summary data is then readily available to the debt manager to be manipulated according to his needs.
Spreadsheet software is a vital tool to the debt manager, who can record ideas and revise them much faster using word processing software than by dictating them to a secretary, waiting for a transcription and then revising them. In a short time, the manager can produce and modify several versions of a document, clarifying thoughts much more quickly than the secretary/typing process.

References


Part Three

Controlling External Debt
Foreign borrowing enables a country to invest or consume more than would be possible from its own resources. But, clearly, a country cannot borrow indefinitely. All is well if export earnings grow rapidly and provide the foreign exchange from which ever-increasing principal and interest payments can be met. But, if debt service obligations grow faster than foreign exchange earnings, a country can soon develop balance of payments difficulties. So, how to assess debt servicing capacity so that senior policy officials will know in advance when foreign borrowing will create serious pressures on international liquidity and the exchange rate?

The standard approach is to construct an economic model for projecting the balance of payments over a period of time. Balance of payments variables are linked to activities of key sectors of the economy. External borrowing is shown in detail, subdivided by economic sector, creditor source and type of credit. The growth of debt is linked to the need for external credits and the terms on which foreign loans are available. The model projects interest and principal payments and it relates them to exports, gross national product, government revenue. If the resulting ratios (creditworthiness indicators) are dangerously high, then action must be taken to bring them down. Policies can be adopted to make the economy less dependent on imports, to promote exports, and to improve the terms of borrowing.

The World Bank has developed a standard country simulation model, known as RMSM-X. While used primarily by the World Bank staff, the model can be adapted by researchers in individual countries. RMSM-X, (and other such models) build on the relationship between external debt, gross domestic product, and total expenditures. We start with an examination of macro-economic relationships, emphasizing their relationship to external debt variables. After looking at an outline of the model, we then note the need to maintain external debt records that are consistent with related financial sta-
MEASURING DEBT SERVICING CAPACITY

Meaningful projections cannot be made unless the base-year financial data are complete and reliable.

Macroeconomic Relationships

Consider a closed economy, where there is no foreign trade. Production consists of goods and services for consumption or investment. Consumption goods ($C$) can be for the government or the private sector. Investment goods ($I$) comprise buildings, plant and equipment and inventories used by enterprises; investment, too, is either by the government or private enterprises. The production relationship can be represented by a simple equation:

\[ Y(t) = C(t) + I(t) \]  
(1)

\[ C(t) = C_p(t) + C_g(t) \]  
(1A)

\[ I(t) = I_p(t) + I_g(t) \]  
(1B)

The $(t)$ designates a discreet time period, such as the calendar year, while the subscript $(p)$ and $(g)$ tell us which sector of the economy, private, government respectively is consuming or investing.

A mirror image of the production relationship is the income relationship, because production creates incomes equal to the value of output ($Y$). Some income is taken by the government as taxes ($T$); some is saved by the private sector ($S_p$); the balance is spent on consumption ($C_p$). We can represent this relationship as equation (2):

\[ Y(t) - T(t) = C_p(t) + S_p(t) \]  
(2)

Combining equations (1), (1a) and (2) we have:

\[ C_p(t) + C_g(t) + I(t) = C_p(t) + C_g(t) + S_p(t) + T(t) \]  
(3)

Simplifying and combining terms, we have:

\[ I(t) = S_p(t) + (T(t) - C_g(t)) \]  
(3A)

Equation (3A) shows that, in a closed economy, investment is equal to private savings and public savings (measured by government tax revenue minus government current expenditures, represented here by government consumption). Public and private savings, taken together, comprise domestic savings. If we introduce foreign trade and finance, investment can exceed domestic savings by the amount by which imports exceed exports. In equation (1) we add a term for exports ($X$), showing production of goods and services that are sold to nonresidents; and in equation (2) we add a term for imports ($IM$), showing the utilization of income for imported goods and services (except for interest payments on foreign debt, which will be introduced later). Modifying equations (1) and (2) and their combination in (3), we arrive at equation (3B):

\[ \text{The financing of investment through domestic savings and net foreign borrowing is a key relationship.} \]
\[ Y(t) = C(t) + I(t) + X(t) \]
\[ Y(t) = C_p(t) + S_p(t) + T(t) + IM(t) \]
\[ C_p(t) + C_g(t) + I(t) + X(t) = C_p(t) + C_g(t) + S_p(t) + T(t) + IM(t) \]
\[ (3B) \quad I(t) = S_r(t) + (T(t) - C_g(t)) + (IM(t) - X(t)) \]

Imports can exceed exports only if financing is available. Some of this financing may be in grants or direct investment; and, of course, foreign exchange reserves can be drawn down. If these nondebt creating flows are not available, however, imports can exceed exports only to the extent that foreign loans and credits can be negotiated.

Equation (3B) does not take into account the need to pay interest on the stock of debt. To keep the example simple, let \([i(t)]\) represent the average interest rate charged on external debt in period \(t\), and let \([D(t)]\) represent the stock of debt as of some point in time (such as the end of the calendar year). Interest on external debt can be represented as:
\[ i(t) \times D(t - 1) \]

The growth of debt during the year \(t\) can be represented as:
\[ (4) \quad D(t) - D(t - 1) = i(t) \times D(t - 1) + (IM(t) - X(t)) \]

If we divide both sides of the equation by \([D(t - 1)]\), then the left side represents the growth rate of external debt \([d(t)]\). The equation becomes:
\[ (4A) \quad d(t) = i(t) + (IM(t) - X(t))/D(t - 1) \]

Equation (4A) highlights the factors that make debt grow faster or slower (that is, larger or smaller values of \([d(t)]\)). First, \([d(t)]\) will be high if the average interest rate \([i(t)]\) is high or if the noninterest current account deficit \([IM(t) - X(t)]\) is high relative to the stock of debt of the previous period \([D(t - 1)]\). The size of the stock of debt is crucial, as with a larger stock of debt, larger interest payments are required. Of course, the fundamental factor causing debt to rise is the reliance on external resources to finance capital formation.

**The RMSM-X Modelling Framework**

The World Bank staff must project development prospects, external borrowing requirements and debt servicing capacity for all countries to which the Bank lends. A common approach (so that projections can be compared between countries) has evolved over the past 20 years; the current version is known as the Revised Minimum Standard Model extended (RMSM-X). RMSM-X has four sections: the RMSM-X (Projection) module, the Historical Data File, the Debt Module, and the Output File. A more detailed description is contained in the Bank’s training manual on RMSM-X (World Bank 1992).
The RMSM-X Module

The basic model separates economic activity into the public, private, financial, and foreign sectors.

Public sector. In most country models, the public sector includes only central government, with regional and local governmental transactions and nonfinancial public enterprises included with the private sector. This is not satisfactory. If statistics can be obtained for a consolidated public sector (central government, regional and local governments and nonfinancial public enterprises), it is preferable to define the public sector more broadly.

Financial sector. This comprises the monetary system: the central bank and deposit money banks (commercial banks). Again, if statistics can be found with enough detail, it is preferable to split this sector into two—the central bank and deposit money banks.

Private sector. The core of the private sector consists of households and privately-owned enterprises, and nonmonetary financial institutions. And, in the absence of consolidated public sector data, it includes local government and public enterprises.

Foreign sector. This is simply a mirror image of the balance of payments; the debit and credit signs are reversed.

The relationships of production and expenditure in RMSM-X are based on the fundamental accounting relationship which is standard to national income accounts. Gross domestic product at market prices must be equal, ex ante, to expenditures on consumption, investment, exports and imports. RMSM-X also incorporates budget constraints for each of the four sectors and demand and supply identities for some financial assets. For every sector total sources (revenues) must equal total uses (expenditures). For the financial assets (money, foreign assets, government bonds and domestic monetary credit) and for the GDP identity, the model requires that supply (sales) on these markets is equal to the demand (purchases).

As the basic model consists of nine equations (four sectors, one GDP identity and four financial assets) one can solve or 'close' the model by choosing eight endogenous/residual variables. As the model is solved in a recursive way, once eight equations are calculated the ninth can be deduced. Assump-
tions on how to project the remaining variables in the model have to be made by the user. As is explained in more detail below, there are three basic approaches to closing the model—that is, how to choose the appropriate endogenous variables—public closure, private closure, or a policy closure.

A central feature of RMSM-X is its reliance on flows-of-funds accounting. Expenditures (uses) by one of the four sectors also comprises receipts (sources) by the other three sectors. The flows-of-funds accounting distinguishes between current and capital transactions. For each sector, current income minus current expenditures is defined as savings, or the net accumulation of wealth. Savings is entered twice—as a use of funds in the current account and a source of funds in the capital account (Table 9.1).

The central government makes transfer payments and pays interest on bonds. These payments comprise the private sector's source of funds from the central government. Interest payments to banks and to foreigners (defined as nonresidents) are sources for the monetary and foreign sectors. The government spends money on goods and services which are consumed in the accounting period. This is government consumption. The difference between government current receipts and payments is government savings; these sums are posted as sources in the consolidated consumption and savings account. Government capital transfers are sources in the private sector capital account; government purchases of capital goods are sources in the consolidated investment account. Looking at the government sector's sources of funds, it receives from the private sector direct taxes plus nontax revenue. Central bank profits are its source of current account funds from the monetary sector. Current transfers to the government (less its own official current grants) are sources from the foreign sector. Receipts from indirect taxes less subsidies paid are central government current account sources from the consolidated production account.

Turning to the capital account, sources consist of the issuance of new bonds less repayment of old bonds, net borrowing from the monetary sector, net borrowing from abroad plus net capital official grants, and government savings (the counter-entry to government uses in the current account).

To make projections, one must establish behavioral relationships between the individual variables. Imports are broken down into six major commodities and related functionally (for example, by import elasticities) to disposable income, to gross domestic product or to gross domestic investment. Some variables are assigned predetermined values; the user assigns values for such items as current official transfers, worker remittances and direct foreign investment.

Sectors are linked by flows-of-funds accounts, which distinguish between current and capital transactions.

The central government's account illustrates key relationships.
The Debt Module

Key inputs are data on the stock of debt and its debt service schedule.

Since one of the objectives of RMSM-X is to calculate debt servicing capacity of the country, a key set of inputs relates to the country’s external situation at the beginning of the projection period. One must know the stock of debt. It must be disaggregated into debts of the three sectors, and it also must be disaggregated by creditor type (that is, loans from multilateral institutions, official bilateral lenders, export credits and financial credits). A related input is debt service on each of these categories of debt. Some loan

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<th>Foreign sector</th>
<th>Production account</th>
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a. Adj. wtr int: Adjustment with respect to interest.
b. Adj. wtr prin: Adjustment with respect to principal.
c. DFI: Direct foreign investment.
commitments have not been fully disbursed at the start of the projection period. Since the model has to calculate the debt service payments over the whole projection period, it is necessary to indicate how the pipeline commitments will be disbursed over time. These important input data come from the office responsible for compiling external debt statistics.

As the RMSM-X model is used for projection purposes in countries which depend on external finance, one must not only project the debt flows of the pipeline debt but must make provision for new borrowing. Assumptions must be made of autonomous borrowing. How much borrowing of what type will each sector take on each year? These assumptions are in terms of loan commitments. Related assumptions must be made also on the disbursement paths that these loans will take. Some variants of the model will allow domestic financing disequilibrium to spill over into residual borrowing (known in the model as “gap-fill”). The type of credits used to close the gap must be specified.

The model will calculate creditworthiness ratios. Their projected values will indicate the plausibility of the scenario that results from the economic relationships and external borrowing possibilities that the user specifies.

RMSM-X does consider the consequences of complex debt restructuring scenarios or adjustments to the currency composition of the debt. These assumptions are worked out in another projection framework, the Debt Strategy Module (DSM), and the results are then fed into the RMSM-X calculations.

**Historical Data File**

The RMSM-X projection model requires only one year historical data for transactions and two-years data for stocks. The input figures must be consistent with one another, and there must be entries (estimated if not actual) for all data elements. Here, we shall look at three problems in establishing a consistent data base: the difficulty of relating trade data to national accounts data, estimating transactions for the private sector and reconciling external debt and balance of payments figures for debt-related flows.

**Trade data.** RMSM-X treats exports and imports on a disaggregated basis—six standard categories of exports and imports of goods and services. Trade statistics are the source. At the same time, these figures must add up to exports and imports of goods and services as presented in the national accounts and the balance of payments.

**Private sector data.** Most country models derive figures on private sector transactions from the other entries in the accounts for the foreign, mon-
etary and government sectors plus the national income accounts. For example, figures for total consumption appear in the national income accounts. Figures for central government purchases of goods and services on current account may be obtained from the budget statement; the difference will be estimated private consumption.

**Debt and balance of payments data.** The country’s national debt management office will have figures on the stock of debt and on flows: disbursements received and principal and interest repaid. The balance of payments will also have figures for these flows. Since the balance of payments will represent the foreign sector in RMSM-X, it is essential that the flow data from the balance of payments and the debt office be made consistent by choosing one data source over the other, if necessary.

There are inherent problems in maintaining consistent figures between debt and balance of payments records of transactions related to international borrowing (see Chapter 6). It is the responsibility of top officials responsible for both sets of records to ensure that consistency between these data is maintained. Otherwise, when a projection exercise is undertaken using a modelling framework such as RMSM-X, crude estimates must be made, and the results of the projection exercise are compromised.

**Closure**

The model may be run on either an “availabilities” basis or on a “requirements” basis. The user of RMSM-X must decide what variables will be specified and what variables will be calculated by the model. There are two decisions to be made. First, is the amount and type of external borrowing to be predetermined, or is it to be calculated by the model? The first option is known as an “availabilities” model and the other a “requirements” model. The other decision is whether the model should calculate values of either the government or the private sector (public sector or private sector closures) or, on the other hand, whether the model should be used to generate the key macroeconomic variables, for example, growth and inflation, so as to evaluate an economic policy package (policy closure).

**The public closure.** The aim is to learn what values of government consumption, domestic borrowing from the monetary system and from the private sector and foreign borrowing are consistent with projected GDP growth and related variables. The path of real GDP is specified by the user. Investment is determined by the user’s assumption on the relationship of GDP growth and capital formation. Elasticity relationships determine ex-
ports and imports; private consumptions and private investment are specified as percentages of disposable income and GDP. Then, government consumption and investment are known.

Since the model requires a fixed relationship between money and GDP, the total credit of the banking system is known. With private credit specified as a percentage of nominal GDP, the amount of credit to the government is known. Private sector external borrowing is fixed, and so the foreign and government sectors are closed by calculating the disbursements required.

The private closure. The objective is to calculate values for private consumption, private borrowing from the monetary system, private purchases of government bonds and private sector borrowing from abroad. Values for the government sector variables are calculated independently; variables of the private sector are the residuals. In this version, the private sector takes on the amount of foreign borrowing needed to balance the model.

The policy closure. The policy closure is different in that it is an “availability approach” to foreign borrowing: the amount of foreign borrowing is fixed (that is, the supply of foreign capital is limited). The growth path of the economy must adjust to it rather than having the model generate figures on the foreign borrowing required to achieve economic performance targets. In the foreign sector, closure is obtained through adjustments of import levels. The purpose of this closure is to analyze what the impact of a feasible policy package, fiscal as well as monetary, is on GDP growth and inflation.

All solutions to RMSM-X require making a number of assumptions about the relationship between economic variables. Most assumptions will be simplistic. The usefulness of RMSM-X is to examine the consistency of this set of assumptions regarding the growth path of an economy separated into these four standard sectors. The results of each simulation must be examined carefully to see if the results are plausible. If they are not, assumed relationships must be modified and the model rerun.

Output Files

The RMSM-X generates all the variables that are necessary to fill the (standard) tables found in the annexes of country reviews and strategy papers of the World Bank. These tables are generally kept in a different module. The data from the RMSM-X module, the historical data file and the debt module are used to bring in the (macro) projections, the historical data and the

... or the private sector (private closure),...

... or by calculating the key macroeconomic variables (policy closure).

The model generates a complete array of mutually consistent economic data over time.
To provide a benchmark for creditworthiness indicators, one can distinguish severe and moderate indebtedness.

The traditional creditworthiness indication is the total debt service ratio. The ratio of interest to exports abstracts the effect from the impact of debt restructuring on creditworthiness. The ratio of debt to exports is a relatively stable indicator of debt burden.

MEASURING DEBT SERVICING CAPACITY

debt data, respectively. The set of tables gives detailed information of the national accounts, balance of payments, monetary survey, government accounts, and so on.

Creditworthiness Indicators

There are standard indicators for measuring the burden of external debt, but there are no firm critical levels which, if exceeded, constitute a danger point. Countries with relatively rapid export growth can support higher debt relative to exports and output. RMSM-X generates these key ratios. First, let us examine the indicators. By looking at debt burden ratios for key groups of countries, we can develop a sense of relative magnitude (Table 9.2). Severely indebted countries are those which have one of the two following indicators above critical levels over three years—the present value of debt to GNP of 80 percent, or the present value of future debt service to exports of 220 percent. Moderately indebted countries are those with either the first indicator in the range of 18 percent to 80 percent or the second indicator in the range at 132 percent to 220 percent. Forty-eight countries were classified as severely indebted in the World Bank's World Debt Tables, 1993/94 edition (World Bank 1993, p. 73–75). Of these, twenty-seven were in sub-Saharan Africa. This group also included such middle-income countries as Bulgaria, Poland, Argentina, Algeria and Mexico. Twenty-eight countries were classified as moderately indebted.

Table 9.2 gives values for the debt service ratio (TDS/XGS), the interest service ratio (INT/XGS), and the ratios of the total stock of debt to exports of goods and service and to gross national product (see glossary).

Total debt service ratio would be expected to vary widely between these groups of countries, but the range is surprisingly narrow. In 1985, the TDS/XGS ratio was 32.2 percent for severely indebted countries, 22.5 percent for the moderately indebted and 15.8 percent for other countries. This ratio, and, to a certain extent, the INT/XGS ratio reflects the impact of debt relief.

Since interest on debt to commercial creditors cannot be fully rescheduled, the INT/XGS ratio gives a better picture of the difference of debt service burdens between severely and moderately indebted countries and other countries. In 1985, the INT/XGS ratio for severely indebted countries was 19.5 percent, and for other countries 6.9 percent.

A more stable indicator of relative debt burden is the ratio of total debt to exports (EDT/XGS). In 1985, EDT was nearly three times the size of exports for severely indebted countries, while equal to only 87.7 percent of exports for other countries. In 1990, the contrast was starker: EDT/XGS
An Example

The debt to GNP ratio shows debt in terms of a country’s productive capacity.

An Example

Tables 9.3, 9.4 and 9.5 show how RMSM-X may be used. The starting point is the year 1991, which we shall call the “base year.” The economy is grow-

An Example shows the impact of an export shock and of recovery measures.

### Table 9.2: External debt indicators in developing countries, 1980, 1985, 1990, and 1992

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
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<tr>
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<td></td>
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<tr>
<td>EDT ($ Billions)</td>
<td>658</td>
<td>1,112</td>
<td>1,518</td>
<td>1,662</td>
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<td>TDS/XGS (%)</td>
<td>13.5</td>
<td>22.7</td>
<td>18.8</td>
<td>18.7</td>
</tr>
<tr>
<td>INT/XGS (%)</td>
<td>7.2</td>
<td>12.2</td>
<td>8.2</td>
<td>7.8</td>
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<tr>
<td>EDT/XGS (%)</td>
<td>89.0</td>
<td>172.0</td>
<td>162.0</td>
<td>174.4</td>
</tr>
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<td>26.4</td>
<td>35.7</td>
<td>36.7</td>
<td>37.6</td>
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<tr>
<td>Severely indebted countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EDT ($ Billions)</td>
<td>321</td>
<td>565</td>
<td>759</td>
<td>775</td>
</tr>
<tr>
<td>TDS/XGS (%)</td>
<td>23.4</td>
<td>32.2</td>
<td>26.4</td>
<td>28.9</td>
</tr>
<tr>
<td>INT/XGS (%)</td>
<td>12.1</td>
<td>19.5</td>
<td>11.4</td>
<td>11.4</td>
</tr>
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<td>EDT/XGS (%)</td>
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<td>288.7</td>
<td>323.2</td>
<td>326.1</td>
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<tr>
<td>EDT/GNP (%)</td>
<td>34.8</td>
<td>60.7</td>
<td>59.9</td>
<td>54.1</td>
</tr>
<tr>
<td>Moderately indebted countries</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EDT ($ Billions)</td>
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<td>321</td>
<td>491</td>
<td>562</td>
</tr>
<tr>
<td>TDS/XGS (%)</td>
<td>13.4</td>
<td>22.5</td>
<td>25.1</td>
<td>22.5</td>
</tr>
<tr>
<td>INT/XGS (%)</td>
<td>6.9</td>
<td>11.8</td>
<td>11.5</td>
<td>9.6</td>
</tr>
<tr>
<td>EDT/XGS (%)</td>
<td>95.4</td>
<td>166.5</td>
<td>182.9</td>
<td>203.2</td>
</tr>
<tr>
<td>EDT/GNP (%)</td>
<td>29.8</td>
<td>27.2</td>
<td>33.0</td>
<td>38.5</td>
</tr>
<tr>
<td>Other countries</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>EDT ($ Billions)</td>
<td>151</td>
<td>226</td>
<td>268</td>
<td>326</td>
</tr>
<tr>
<td>TDS/XGS (%)</td>
<td>6.8</td>
<td>13.8</td>
<td>12.4</td>
<td>10.9</td>
</tr>
<tr>
<td>INT/XGS (%)</td>
<td>4.1</td>
<td>6.9</td>
<td>4.4</td>
<td>4.7</td>
</tr>
<tr>
<td>EDT/XGS (%)</td>
<td>46.4</td>
<td>87.7</td>
<td>61.9</td>
<td>74.2</td>
</tr>
<tr>
<td>EDT/GNP (%)</td>
<td>15.9</td>
<td>22.4</td>
<td>19.5</td>
<td>21.3</td>
</tr>
</tbody>
</table>

Definitions:
- EDT: Total debt stocks, including short-term and IMF credit.
- TDS/XGS: Total debt service to exports of goods and services.
- INT/XGS: Interest payments to exports of goods and services.
- EDT/XGS: Total external debt to exports of goods and services.
- EDT/GNP: Total external debt to gross national product.

ing at 4.5 percent a year with a negative resource balance of 0.04 (4 percent) of GDP (Table 9.3). The external debt level is manageable, as is indicated by benign debt burden indicators. The economy is structured to grow at a steady 4 percent per year, with the debt service indicator falling thanks to an export growth equal to the growth of GDP through the year 2000.

Table 9.4 shows the impact of an export shock: because of a collapse of markets (or of export prices) export growth in 1992 is not 4.0 percent but a negative 2.0 percent. Recovery does not take place until late in the decade. The government, however, is committed to maintaining the overall growth rate of 4.0 percent. It does so by accelerating government capital formation, increasing the government deficit relative to GDP. This is only possible through foreign borrowing, which is reflected in a rise in the negative resource balance. Debt burden indicators advance into levels which cannot be sustained. Adjustment measures are introduced in Table 9.5. Public sector investment is braked, as well as the use of foreign credit relative to GDP. Debt burden indicators are still high, but the end of decade values are much less threatening than those indicated in Table 9.4.

The Debt Strategy Module

The Debt Strategy Module (DSM) is a modelling framework that can be used to supplement a comprehensive macroeconomic/balance of payments projection model. It is designed for use on a microcomputer to perform a broad range of debt analysis and simulations. The starting point is on debt out-

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**Table 9.3 Simulation example—Base case**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>GDP growth rate (%)</strong></td>
<td>4.50</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
</tr>
<tr>
<td><strong>Export growth rate (%)</strong></td>
<td>2.21</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
</tr>
<tr>
<td><strong>Shares of GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resource balance</td>
<td>-0.04</td>
<td>-0.05</td>
<td>-0.05</td>
<td>-0.05</td>
<td>-0.04</td>
<td>-0.05</td>
</tr>
<tr>
<td>Exports</td>
<td>0.19</td>
<td>0.18</td>
<td>0.18</td>
<td>0.18</td>
<td>0.18</td>
<td>0.17</td>
</tr>
<tr>
<td>Imports</td>
<td>0.23</td>
<td>0.23</td>
<td>0.23</td>
<td>0.23</td>
<td>0.22</td>
<td>0.22</td>
</tr>
<tr>
<td>Consumption</td>
<td>0.81</td>
<td>0.82</td>
<td>0.83</td>
<td>0.83</td>
<td>0.83</td>
<td>0.83</td>
</tr>
<tr>
<td>Investment</td>
<td>0.23</td>
<td>0.22</td>
<td>0.22</td>
<td>0.22</td>
<td>0.22</td>
<td>0.22</td>
</tr>
<tr>
<td>Private</td>
<td>0.17</td>
<td>0.16</td>
<td>0.16</td>
<td>0.16</td>
<td>0.16</td>
<td>0.16</td>
</tr>
<tr>
<td>Government</td>
<td>0.06</td>
<td>0.06</td>
<td>0.06</td>
<td>0.06</td>
<td>0.06</td>
<td>0.06</td>
</tr>
<tr>
<td><strong>Selected public service accounts (share of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government deficit</td>
<td>-0.05</td>
<td>-0.07</td>
<td>-0.07</td>
<td>-0.07</td>
<td>-0.07</td>
<td>-0.07</td>
</tr>
<tr>
<td>Foreign credit</td>
<td>0.02</td>
<td>0.02</td>
<td>0.03</td>
<td>0.03</td>
<td>0.04</td>
<td>0.03</td>
</tr>
<tr>
<td><strong>Debt burden indicators(%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt/GDP</td>
<td>44</td>
<td>42</td>
<td>40</td>
<td>39</td>
<td>38</td>
<td>37</td>
</tr>
<tr>
<td>Debt/exports</td>
<td>238</td>
<td>228</td>
<td>220</td>
<td>218</td>
<td>213</td>
<td>217</td>
</tr>
<tr>
<td>Total debt service/exports</td>
<td>37</td>
<td>33</td>
<td>28</td>
<td>26</td>
<td>22</td>
<td>19</td>
</tr>
</tbody>
</table>
standing subdivided by creditor type and (if desired) by currency. It can compute the consequences for debt service obligations of:

- New borrowing strategies;
- Sensitivity to changes in interest rates and exchange rates;
- Alternative options for restructuring debt.

The DSM contains preprogrammed standard tables for showing the results of simulations. There is a balance of payments table, one summarizing the country’s financial flows and debt and a cash-flow table that is useful

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**Table 9.4 Simulation example—Export shock**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>GDP growth rate (%)</strong></td>
<td>4.50</td>
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<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>5.00</td>
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<tr>
<td><strong>Export growth rate (%)</strong></td>
<td>2.00</td>
<td>-2.00</td>
<td>0.75</td>
<td>0.50</td>
<td>2.00</td>
<td>6.00</td>
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<tr>
<td><strong>Shares of GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resource balance</td>
<td>-0.04</td>
<td>-0.07</td>
<td>-0.08</td>
<td>-0.09</td>
<td>-0.08</td>
<td>-0.08</td>
</tr>
<tr>
<td>Exports</td>
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<td>0.17</td>
<td>0.17</td>
<td>0.16</td>
<td>0.15</td>
<td>0.15</td>
</tr>
<tr>
<td>Imports</td>
<td>0.23</td>
<td>0.25</td>
<td>0.25</td>
<td>0.25</td>
<td>0.23</td>
<td>0.22</td>
</tr>
<tr>
<td>Consumption</td>
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<td>0.83</td>
<td>0.83</td>
<td>0.84</td>
<td>0.84</td>
</tr>
<tr>
<td>Investment</td>
<td>0.23</td>
<td>0.25</td>
<td>0.25</td>
<td>0.26</td>
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<td>0.24</td>
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<td>Private</td>
<td>0.17</td>
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<td>0.16</td>
<td>0.17</td>
<td>0.17</td>
<td>0.17</td>
</tr>
<tr>
<td>Government</td>
<td>0.06</td>
<td>0.09</td>
<td>0.09</td>
<td>0.09</td>
<td>0.07</td>
<td>0.07</td>
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<tr>
<td><strong>Selected public service accounts (share of GDP)</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government deficit</td>
<td>-0.05</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.09</td>
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<td>0.08</td>
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<td>0.08</td>
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<tr>
<td><strong>Debt burden indicators (%)</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt/GDP</td>
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<td>66</td>
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<tr>
<td>Debt/exports</td>
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<td>32</td>
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</table>

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**Table 9.5 Simulation example—Export shock with adjustment**

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<td>4.00</td>
<td>4.00</td>
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<td>0.75</td>
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</tr>
<tr>
<td>Resource balance</td>
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<td>-0.07</td>
<td>-0.05</td>
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<tr>
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<tr>
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<td>0.17</td>
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<tr>
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<td>0.07</td>
<td>0.07</td>
<td>0.06</td>
<td>0.06</td>
</tr>
<tr>
<td><strong>Selected public service accounts (share of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government deficit</td>
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<td>-0.10</td>
<td>-0.09</td>
<td>-0.07</td>
<td>-0.06</td>
<td>-0.04</td>
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<td>0.05</td>
<td>0.03</td>
<td>0.01</td>
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<tr>
<td><strong>Debt burden indicators (%)</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt/GDP</td>
<td>44</td>
<td>45</td>
<td>46</td>
<td>46</td>
<td>42</td>
<td>36</td>
</tr>
<tr>
<td>Debt/exports</td>
<td>239</td>
<td>260</td>
<td>275</td>
<td>288</td>
<td>289</td>
<td>237</td>
</tr>
<tr>
<td>Total debt service/exports</td>
<td>37</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>30</td>
<td>35</td>
</tr>
</tbody>
</table>
...and to evaluate alternative debt rescheduling packages.

when examining the consequences of debt restructuring. The user can design output tables that meet his own requirements.

The debt detail used in the DSM is far greater than is needed for RMSM-X projections, so it is useful to run debt strategy simulations outside of the RMSM-X framework. The debt input data between the two models must, of course, be consistent. One uses the DSM and RMSM-X together by running debt strategy scenarios with DSM and then using summary output tables to provide the debt input data for alternative RMSM-X runs so as to see the feedback on the economy of the various debt strategy scenarios. The DSM is described in summary in World Bank, 1991 (a) and 1991 (b).

References


An important aspect of debt management policy is to control the risk of *external price fluctuations*. A borrowing country’s balance of payments is subject to shocks from three types of price changes that cannot be controlled by domestic economic policies. These are exchange rate fluctuations (between international currencies); interest rate fluctuations that are reflected in key money market rates such as the London Interbank Deposit Rate (LIBOR); and commodity prices. It is possible to protect the balance of payments from wide swings in these prices by hedging. A number of techniques have been developed.

Hedging is not aimed at improving systematically relative prices for the country concerned and differs from speculation in that it accepts market prices and trends, but aims to reduce risk by smoothing fluctuations around the trend. It provides insurance against price risks which take the form of substantial unanticipated fluctuations.

The need for hedging has become more apparent in the past 20 years because of increased volatility of exchange rates, interest rates and commodity prices. Countries are particularly exposed if: (a) they have large international borrowing requirements and the resulting external debt is denominated in different currencies, (b) if much external debt is variable interest rate obligations and (c) if trade in primary commodities is significant. Such exposures call for better risk management—that is, the use of financial techniques to minimize adverse changes in future net cash flows arising from changes in external prices.

Financial techniques of risk management are sophisticated, and when they are used inappropriately there can be serious losses. It is important that people develop a solid knowledge of international commodity, foreign exchange and financial markets and that there is an appropriate institutional framework.
Exposures

Exchange Risk

Exchange rate volatility became a problem for borrowing countries after the end of the Bretton Woods system in 1973 and major currencies began to fluctuate in value against each other. Look at the nominal effective U.S. dollar exchange rate and a measure of the volatility of this rate for 1975–91 (see Figure 10.1). For all borrowing countries, that is, countries for which external debt data are available through the World Bank's Debt Reporting System, as of end-1992 sixty-six percent of the debt stock consisted of nondollar currencies, of which the Japanese yen is the single most important one (see Table 10.1). Consequently, debt service in dollar terms is highly sensitive to cross-currency exchange rates. This exposure has increased for many countries, as their aggregate share in nondollar debt has risen steadily since the

Figure 10.1 Nominal effective dollar exchange rate, 1977-1992

Table 10.1 Currency composition of developing countries debt, 1970–92

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. dollars</td>
<td>47.3</td>
<td>47.2</td>
<td>38.4</td>
<td>38.3</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>2.3</td>
<td>6.1</td>
<td>10.2</td>
<td>11.2</td>
</tr>
<tr>
<td>U.K. pound</td>
<td>11.3</td>
<td>2.1</td>
<td>2.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Other currencies</td>
<td>27.5</td>
<td>34.6</td>
<td>36.8</td>
<td>35.6</td>
</tr>
<tr>
<td>Multiple currencies</td>
<td>11.6</td>
<td>10.0</td>
<td>12.5</td>
<td>13.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

mid-1980s. While much of the rise in nondollar debt can be explained by the decline in the value of the dollar since 1985, it is partly due to the increased borrowings in nondollar currencies in recent years.

**Interest Rate Risks**

Interest rates fluctuations, as evidenced by the six-month LIBOR, have been volatile (see Figure 10.2). High interest rates of the late 1970s and early 1980s contributed substantially to the balance of payments and debt management problems of countries that had floating-value borrowings from commercial banks—nearly all of Latin America, the Philippines, Nigeria and Poland. For the Latin America and Caribbean region, variable interest rate debt (including short-term debt) comprised 78 percent of total debt in 1980.

Partly because of Brady agreements, the proportion of variable interest rate debt has declined for the borrowing countries covered by the DRS. For all countries, the proportion has declined from 59 percent in 1980 to 49 percent in 1990; for Latin American and Caribbean, the proportions fell from 78 percent to 65 percent. For some, however, proportions have risen—Indonesia, for instance, up 15 percentage points in the past decade.

In absolute terms, interest exposure of borrowing countries remains large—a 1 percent movement in the 6-month LIBOR implies a change in debt service (on short-term, as well as on long-term debt) of about $6 bil-

**Figure 10.2 Nominal interest rates, 1965-92**

![Nominal Interest Rates, 1965-92](source: Claessens. Risk Management in Developing Countries. (1993), p. 6.)
Since reliance on commercial financing may grow, exposure to interest risk could become high.

**Commodity Price Risks**

Commodity prices, too, were volatile in 1963–89 (see Figure 10.3). Fluctuations in commodity prices resulted in big risks to many developing countries that depend on primary commodity exports for most of their foreign exchange earnings. Countries were also affected by commodity imports, such as grains, petroleum and Petroleum products.

**Market-Based Risk Management**

In so far as there was any risk management, it was done by means other than market instruments: lenders pushed interest rate risks to borrowers by substituting variable for fixed-rate contracts. Exchange rate risk could be covered in forward markets, but this only applied to short-term contracts. Fluctuations of some commodity prices were countered by relying on mechanisms designed to smooth price fluctuations. This included attempts to stabilize international commodity prices through commodity agreements, securing compensatory finance against the consequences of price changes, or insulating the economy by stabilizing the domestic prices. Such schemes, however, were unsatisfactory, and market-based mechanisms which use financial instruments for hedging offer much promise.

**Figure 10.3 Nominal commodity prices, 1962-90**

*(1985=100)*

Because there were no mechanisms to manage risk (or those used failed), there were ex post large adjustments to major price fluctuations in defaults and subsequent rescheduling of debt. Witness the 1980s response to the rapid rise in world interest rates. Financial instruments smooth such exposures without requiring substantial public sector resources, such as subsidies or financial reserves required for commodity stockpiling. Market instruments which involve the shifting of the price risk externally to consumers or dealers in industrial countries also provide price insurance over the short and long term.

Instruments for hedging may be short-dated (1 year, or less) or long-dated. Option and futures trading are short-term: Futures are agreements to purchase (or sell) a given asset at a future date at a preset price. Options are contracts which carry the right to buy (or sell) a fixed quantity of a currency or a commodity or to establish interest rates at a fixed price on, or before, a specified date. The right to buy is a call option; the right to sell is a put option.

Options allow for price insurance by guaranteeing a minimum price for example, for commodity exports by buying put options) or a maximum price paid, say, for currencies borrowed by buying call options). Exchange-traded futures and options can be used even by countries that do not have access to long-dated markets.

Long-dated instruments can have a maturity up to 20 years. These comprise swaps and options, and they permit longer term and more comprehensive risk management. The contracts are tailor-made instruments. They trade in the “over-the-counter” market which is made by commercial banks and other financial institutions. The instruments are essentially composed of two building blocks—swaps and options features, which can be combined with loans and bonds in a variety of ways. A swap is, in effect, a series of forward contracts extended to long-dated maturities. Swaps involve credit risk of both parties to the contract since one party must pay a net amount at the conclusion of the contract (see Box 10.1). Another commodity-linked instrument is the commodity-indexed loan (or bond), where the interest or principal due varies with the commodity price. Long-term options allow buyers to assure a minimum (or a maximum) price over a long period.

Exchange rate risks can be hedged by entering into a currency swap at the time of borrowing. Suppose a country has access to yen financing but would not like to increase the amount of yen-denominated debt in its portfolio. Assume that the borrower has secured a five year loan for Yen 10 billion, on which the interest rate is 5 percent. The borrower arranges, through his bank, a swap for a dollar-denominated debt. If the exchange rate is 125 yen per dollar, the dollar debt would be effectively $80 million; on which
the interest rate could be 10 percent. Annual debt service payments would be $8 million per year in place of Yen 500 million (see Table 10.2). We shall assume that both debts are repayable in a lump sum at maturity. This swap requires, of course, a partner that prefers a yen-denominated liability to a dollar-denominated liability. The original obligation is retained. The partner that sold the borrower the dollar-denominated debt accepted a yen-denominated debt that is a mirror image of the original loan. The borrower now has offsetting yen-denominated liabilities and assets. The result of the swap arrangement is to create a “synthetic” US dollar borrowing.

Interest rate swaps work in a similar manner. Suppose that a borrower obtains a three-year floating interest rate loan for $100. To reduce his exposure to interest rate fluctuations, he arranges, through his bank, a swap into a fixed-rate obligation which, let us assume will, say, bear 10 percent interest (including the cost of the swap). Through this swap, he has received a LIBOR-based floating rate asset to offset his original liability. The borrower has created a “synthetic” fixed-rate loan requiring payments of $5 interest every six months and the $100 principal repayment at the maturity of the loan (see Table 10.3).

### Box 10.1 Commodity swap

<table>
<thead>
<tr>
<th>Oil producer</th>
<th>$25 or $18</th>
<th>Intermediating bank</th>
<th>$25 or $18</th>
<th>Oil consumer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>$21</td>
<td></td>
<td>$21</td>
</tr>
</tbody>
</table>

- Denotes cash flows based on known prices
- Denotes cash flows based on future market prices

The diagram above shows a simplified case of a commodity swap, in which the intermediating bank executes offsetting swaps with an oil producer and consumer, thus intermediating the credit risk. The producer agrees to exchange cash flows with the bank as follows. Semi-annually over the period of the swap contract, which may be 5 years and based on a notional amount of 2 million barrels of oil per annum, i.e., 1 million barrels at each semi-annual payment date, the producer pays the then current market price and receives a fixed market price, say $21. Thus if the market price at a future point in time were $25 per barrel, the producer would make a net payment to the bank of $4 million (1 million barrels times ($25−$21)); if the price at a future point in time were $18 per barrel, the producer would receive a net payment from the bank of $3 million (1 million barrels times ($18−$21)). The consumer executes an exactly opposite contract with the bank, undertaking to pay at a fixed price and receive at a future market price. The net effect is that when the producer sells 1 million barrels of oil semi-annually to the consumer at the future market price, in accordance with normal market practice, both producer and consumer have in effect locked in a fixed price of $21 through a series of forward contracts.

a. The diagram depicts a simplified case in which the following features are omitted: presence of a syndicate of banks; presence of an off-shore escrow account; and presence of multiple consumers.
b. The cash flows passing through the intermediating bank would not quite offset each other exactly, thus allowing the bank to make a return for bearing the credit risk.
This insurance value of hedging can be obtained at a low cost. In general, the costs of participating in short-dated markets are small: transaction costs amount normally range from 1/8 to 1/2 of one percent of the contract value. Because the risk is born by the party most able to do so, it will often be the case that over time these instruments will carry lower costs for a country than traditional, commercial financing because of the improved creditworthiness resulting from a better match between debt obligations and the ability to service debt. Correspondingly, it should not be expected that the average price received will be higher (or paid to be lower) than without hedging. Whether the outcome is higher or lower will depend upon ex post trend in prices.

Despite the existence of risk management tools, most borrowing countries lack an overall, integrated approach to asset and liability management. Consequently, many countries have substantial mismatches between existing assets (which include commodity exports) and liabilities (which include commodity imports). To reduce these mismatches, market-based risk management instruments are helpful and could be used more extensively. But it is necessary to create the right institutions to carry out this work.

There is much literature on risk management. Shapiro (1986) is a good introduction, cast in terms of enterprise management. A more technical

Table 10.2 Borrowing and currency swap
(Yen borrowing and swap into US$)

<table>
<thead>
<tr>
<th>Year</th>
<th>Swap borrowing (Yen million)</th>
<th>Asset (Yen million)</th>
<th>Liability (US$ million)</th>
</tr>
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<tbody>
<tr>
<td>0</td>
<td>10,000</td>
<td>(10,000)</td>
<td>80</td>
</tr>
<tr>
<td>1</td>
<td>(500)</td>
<td>500</td>
<td>(8)</td>
</tr>
<tr>
<td>2</td>
<td>(500)</td>
<td>500</td>
<td>(8)</td>
</tr>
<tr>
<td>3</td>
<td>(500)</td>
<td>500</td>
<td>(8)</td>
</tr>
<tr>
<td>4</td>
<td>(500)</td>
<td>500</td>
<td>(8)</td>
</tr>
<tr>
<td>5</td>
<td>(10,500)</td>
<td>10,500</td>
<td>(88)</td>
</tr>
</tbody>
</table>

Yen 10,000 million at 5% Yen 10,000 million at 5% US$ 80 million at 10%

Spot exchange rate (year 0): US$1 = Yen 125

Table 10.3 Borrowing and interest rate swap

<table>
<thead>
<tr>
<th>Year</th>
<th>Floating rate borrowing (LIBOR)</th>
<th>Interest rate swap</th>
<th>Synthetic fixed rate borrowing</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>100</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>½</td>
<td>(LIBOR)</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>1</td>
<td>(LIBOR)</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>1½</td>
<td>(LIBOR)</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>2</td>
<td>(LIBOR)</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>2½</td>
<td>(LIBOR)</td>
<td>LIBOR (5)</td>
<td>(5)</td>
</tr>
<tr>
<td>3</td>
<td>(100+LIBOR)</td>
<td>LIBOR (5)</td>
<td>(105)</td>
</tr>
</tbody>
</table>

Objective: Transform a three-year floating rate USD borrowing at LIBOR flat into a three-year fixed rate USD obligation at 10% (s.a.).

References

Debt Restructuring

What happens when a country is unable to meet its scheduled debt service obligations? This problem arises when the central bank is unable to acquire the foreign exchange necessary for remitting debt service payments and countries must secure debt relief. Rather than allow this to take place through bilateral discussions between a debtor country government and individual creditors, creditor groups have established multilateral mechanisms for debt relief.

Since 1981, more than fifty countries have renegotiated their debts through some 250 multilateral agreements. While these arrangements have enabled debtor countries to deal with unmanageable arrears and perspective defaults in an orderly fashion, they have not been costless. Following applications for debt relief, it has been difficult for countries to reestablish commercial borrowing facilities. Debt restructuring should, needless to say, be avoided if at all possible.

Evolution of Multilateral Debt Relief

The need for debt relief first arose in the late 1950s when Turkey asked for a consolidation of arrears on short-term and medium-term commercial credits. These were restructured through a conference in May 1959 called by the Organization for European Economic Cooperation, which had been coordinating international aid efforts to Turkey. In 1961, Brazil and Argentina were unable to service medium-term suppliers credits. Since most had been guaranteed or insured by export credit agencies in the creditor countries, the Brazilian and Argentinian authorities approached the major creditor country governments to ask for debt relief on a bilateral basis. The creditor country governments agreed among themselves only to negotiate collectively, as they did in response to Argentina’s request to fund bilateral clearing accounts in May, 1956.
Debts to banks have been renegotiated through bank advisory committees since 1970.

Debts to multilateral organizations are not rescheduled.

A precondition to debt relief is macroeconomic adjustment.

Another requirement is that all creditors be treated equally.

The procedures developed in the negotiations with Brazil and Argentina formed the basis of the Paris Club, an ad hoc creditor-country organization for responding to requests for debt relief with respect to guaranteed export credits and intergovernment loans. Aid consortia were used to arrange debt relief for India and Pakistan in the late 1960s and early 1970s, but this approach was not continued. Debts to official creditors are now restructured exclusively through the Paris Club; debts to commercial banks through consortia of commercial banks. Noninsured suppliers credits and debts to governments that do not participate in the Paris Club are restructured through bilateral negotiations.

Loans from multilateral organizations are not subject to debt relief. The World Bank has argued that participation in debt renegotiation would impair its ability to sell securities on international capital markets. The contribution of the World Bank and other multilateral development institutions to countries in need of debt relief is to maintain, and, if possible, increase net lending.

A major concern by all creditors is debtor-country macroeconomic adjustment. Both Paris Club participating governments and BACs insist that the debtor country take vigorous measures to correct the balance of payments problem that led to debt relief. Otherwise, they fear that relief could be used to delay adjustment measures rather than to complement them. Consequently, before a debt relief agreement can be signed, debtor countries must first secure IMF upper credit tranche facilities to support their adjustment programs.

Often a country owes significant debts to both commercial banks and official creditors. Each creditor group is concerned that the foreign exchange freed by its extension of debt relief is not used to repay other creditors. Accordingly, the Paris Club and commercial bank advisory committees insist that the debt relief that they are prepared to offer be matched by other creditors. This is referred to as “equal treatment of creditors.”

The initial approach of multilateral debt relief was to provide relief from temporary debt servicing difficulties. By the late 1980s, it became evident that the debt overhang problem of many countries was such that year-by-year debt relief was not adequate (see Ahmed and Summers 1992, p. 4, Klein 1987, and World Bank 1992, pp. 73–107). Debt reduction, not just reordering maturities, became an object of debt relief.

The Paris Club

The French Ministry of Finance maintains a permanent secretariat to administer the Paris Club on behalf of the other creditor countries. It includes one
The senior official, who serves as President of the Paris Club. There is no permanent membership; all countries take part in meetings that have claims resulting from export credit insurance arrangements. Brazil has taken part in Paris Club meetings both as a debtor country seeking relief and as a creditor. Between 1981 and 1993 on average, 18 countries a year have sought debt relief from the Paris Club. Not surprising, the Club meets virtually every month.

Countries facing imminent default largely because of debt service due on officially-guaranteed export credits will approach the President of the Paris Club and ask to be considered for relief. The creditors at their monthly meeting will agree to hear that country's application, provided that an IMF-supported adjustment program is in place.

The face-to-face negotiations with the Paris Club normally last a day. The representatives of the creditor countries at the Paris Club decide on the period over which debt relief will be given (known as the consolidation period), the debts that will be included (current maturities, possibly arrears, possibly previously rescheduled debt) and the repayment terms on consolidated debt (grace and repayment periods). Both scheduled amortization and interest payments are normally restructured, although occasionally only principal will be rescheduled. Paris Club negotiations result in an agreed minute, which must be followed up with bilateral implementing agreements with each creditor agency. The interest on rescheduled debt (known as moratorium interest) is not arranged at the Paris Club but is negotiated bilaterally. Each national export credit insurance agency must charge an interest rate that reflects its own cost of borrowing.

The coverage of debt relief and the repayment terms vary, depending upon the circumstances of the debtor country. In recent years, middle-income countries whose need for debt relief is the result of a temporary liquidity problem, have been able to reschedule debts with 10-years maturity, including 5-years grace. This applies to both ODA and non-ODA debt. Severely indebted countries receive more generous terms. Consolidation periods are basically for one year, coinciding with an IMF program, although a country may be able to arrange for a 3-year consolidation period if an IMF Extended Fund Facility (EFF) or for low-income countries, an Enhanced Structural Adjustment Facility (ESAF) is in place. Debt relief is then extended in tranches so that the Paris Club creditors can verify that the promised adjustment program is still in effect, that comparable debt relief has been arranged with other creditors and that the debtor government is current on its obligations to participating creditor countries under the terms of the agreement.

If the debt problem appears unlikely to be resolved during the consolidation period, creditors will agree to consider additional debt relief (good-
Agreements with countries facing persistent debt problems feature "goodwill" clauses.

Each Paris Club agreement has a cut-off date.

will clause) if the country, on its part, continues to have an IMF-supported adjustment program. At the beginning of the debt relief process, Paris Club creditor countries will establish a "cut-off date". This means that all loan contracts signed after that date will not be eligible for debt relief by the Paris Club. The aim is to help the debtor country reestablish its creditworthiness by paying new obligations on their original schedules. Even though debt relief may extend over many years through a succession of Paris Club agreements, the cut-off date will remain unchanged.

Low-Income Countries

Since 1988, the Paris Club has made special arrangements for heavily indebted low-income countries and for heavily indebted lower-middle income countries that owe a large chunk of their debts to official creditors. Eligibility for special treatment is decided on a case-by-case basis, but Toronto Terms are restricted to countries designated by the World Bank as “IDA-only,” borrowers that have heavy debt-service obligations, low per capita income and chronic balance of payments problems. The Toronto Terms were introduced in October 1988 for severely indebted low-income countries. They have highly concessional repayment terms for ODA debt and a menu approach for repayment terms on non-ODA debt. ODA debt is repaid with a 25-year maturity, including 14-years grace. Moratorium interest rates would be at least as low as the original interest rates. For non-ODA debt, creditor countries can choose repayment terms from a menu of three options:

Option A. One-third of the consolidated debt is canceled and the remainder repaid with 14-years maturity, including 8-years grace. Moratorium interest rates are market related.

Option B. Repayment terms are 25 years, with 14 years grace (as with ODA debt). Moratorium interest rates are market related.

Option C. Repayment terms are 14-years including 8-years grace. Moratorium interest rates are reduced: either 3.5 percentage points below market rates or 50 percent of market rates, whichever gives the smallest reduction.

Between October 1988 and June 1991, 20 countries benefited from Toronto Terms. All were low-income African countries, except for Bolivia. While the menu approached made it possible for some creditor govern-
ments to introduce debt cancellation as a modality for debt relief, the consensus was that Toronto Terms did not provide adequate relief for low-income countries: too little debt could be canceled, the interest rate reduction option was too modest, and the agreements covered only defined consolidation periods.

In the wake of a number of proposals, most notably that of the then UK Chancellor of the Exchequer John Major, the Paris Club enlarged its menu approach to severely indebted low-income countries adopting “enhanced Toronto Terms.” Eligibility is the same as for the old Toronto Terms. ODA debt would continue to be rescheduled on a very long-term basis. For non-ODA debt, there would be two basic options:

Partial debt cancellation. The Paris Club will write-off 50 percent of eligible debt and reschedule the remainder at market interest rates with long repayment terms (23-years maturity, including 6-years grace).

Interest rate reduction. Alternatively, creditors can consolidate debt at concessional rates so as to reduce by 50 percent in net present value terms the payments due. The repayment terms are 23-years with no grace.

One major creditor country was unwilling to go along with these arrangements. To preserve debt relief arrangements within the Paris Club framework, this country could reschedule debt on Toronto Terms Option B (which, because of the market-based moratorium interest rate is nonconcessional). This country, however, is not a major creditor to most low-income African countries.

Enhanced Toronto Terms entail the rescheduling of debt over an initial one or two consolidation periods. Then, a goodwill clause provides for consideration, by the Paris Club 3-4 years after the initial agreement, of the remaining stock of debt for restructuring, with the proviso that the country in question remains on track with its adjustment and stabilization programs and current in its debt service obligations to Paris Club creditors. These agreements provide for the conversion of some eligible debt into local currency obligations: unlimited amounts of ODA debt and, for non-ODA debt, up to a ceiling of $10 million or 10 percent of total debt, whichever is the larger sum.

Between December 1991 (when Enhanced Toronto Terms first went into effect) and December 1993, sixteen countries benefited from these arrangements. All were low-income African countries, except Bolivia, Honduras and Nicaragua in Central America. One country, Benin, negotiated its second

Following lengthy discussions, including a far-reaching proposal by John Major (“Trinidad Terms”), the Paris Club agreed to “Enhanced Toronto Terms,” effective December 1991.

Enhanced Toronto Terms offer the possibility of cancelling part of the remaining stack of debt.
stage agreements in June 1993. Countries will become eligible for a final stage agreement beginning in December 1994. No country has yet reached the threshold of being considered for debt stock reduction.

**Lower-Middle Income Countries**

In September 1990, the Paris Club introduced special terms for severely indebted lower-middle income countries that have a high proportion of debt to official creditors and can demonstrate a heavy burden of overall indebtedness. Because these arrangements were agreed to at the July 1990 Houston G-7 Summit Meeting, they are sometimes referred to as “Houston Terms.” ODA debt is repaid on 20-years maturity, including 10-years grace, with moratorium interest charged at concessional rates no higher than the original rates. Non-ODA debt is repaid with 15-years maturity and up to 8-years grace. Moratorium interest rates are market-related. Houston Terms provided for the possibility of swaps, similar to the arrangements described above.

Countries are eligible for Houston Terms if they meet two of the following three criteria: per capita income in the range of $611 to $2,465 in 1990; a high proportion of debt to official creditors; and a heavy burden of overall indebtedness. Fourteen countries had benefited from these terms through end-1993, Jamaica, Morocco and Peru twice.

**Other Countries**

Since 1991 most countries receiving debt relief from the Paris Club were eligible for the above special terms. Other middle-income countries rescheduled debt on 10-years maturity, including 5-years grace. Moratorium interest was calculated at market rates. Some agreements were made in parallel with commercial bank restructuring.

One feature of debt relief agreements with middle-income countries is that they mostly cover public sector debt; private sector debts are paid following original schedules. This policy was adopted in 1985 with a view to enhancing the creditworthiness of the private sector. The debt servicing difficulties of the 1980s were due largely to large borrowing by the public sector; debt relief, accordingly, can be restricted to public sector obligations.

**Commercial Bank Debt Relief**

Multilateral debt relief is much more difficult to organize for commercial banks than for official creditors. Each national export credit insurer can
negotiate on behalf of any individual creditors. In contrast, there is no way to consolidate national commercial bank claims. Each creditor bank must approve the resulting agreement and, for loan syndication, the number is often in the hundreds.

The pattern of negotiations was established in a 1970 agreement between the Philippines and its commercial bank creditors: creditor banks would form a bank advisory committee (BAC) of about a dozen people who represent the major creditor banks. The composition of the BAC takes into account the nationality of the banks in the consortium so that the negotiations can make provision for the different tax and regulatory systems that affect banks of different countries.

The BAC negotiates an “agreement in principle” with debtor country representatives. After all creditor banks approve this agreement, it is signed. It takes effect when certain requirements are met, such as payment of fees and of arrears. As with the rescheduling of debts to official creditors, debt relief is not negotiated unless the debtor country has an adjustment problem in effect supported by an IMF program.

Commercial bank agreements restructure principal; consolidation of original interest is rare. Like Paris Club agreements, consolidation of short-term debt is also unusual (but, when it forms a major portion of arrears, there is often no option but to restructure). The initial terms for repayment of consolidated debt was around 7-years maturity with 3-years grace. After the Mexican debt moratorium, commercial banks had to supplement debt relief with “concerted lending”—loans made by the rescheduling banks in proportion to their exposure. This was done to enable the debtor country to pay interest on rescheduled debt.

The early 1980s saw a virtual cessation of voluntary commercial bank lending, even to countries that successfully implemented adjustment programs and debt relief packages. To create an atmosphere for restoring voluntary lending, commercial bank creditor groups introduced the multi-year restructuring agreement (MYRA). These agreements consolidated principal falling due over 3-5 years, gave repayment terms of over 12-years maturity and lowered spreads. Countries receiving MYRAs were not expected to require additional debt relief.

Unfortunately, the debt situation of countries receiving MYRAs was more protracted than had been anticipated, and the MYRA agreements themselves had to be restructured. In October 1985, the Baker Initiative was introduced. There would be three interlocking elements: (a) debtor country adjustment programs, (b) increased lending by commercial banks to support these policy efforts, and (c) continued monitoring by the IMF...
plus enhanced lending by multilateral development banks. This program, too, failed: net lending by the banks fell far short of expectations (see Husain 1989, pp. 13–14).

The process of combining concerted lending with debt restructuring was successful at the beginning of the 1980s, but such packages became increasingly difficult to negotiate by the mid-1980s. Agreements with Argentina in April 1987 and Brazil in 1988 introduced a “market-based menu approach.” This gave creditor banks a choice of restructuring options, which included the possibility of swaps into instruments that would not be subject to further restructuring, known as “exit vehicles” (see Lamdany 1989). Market-based debt restructuring evolved in 1989 to a program of officially supported debt and debt service reduction (DDSR) agreements (the Brady Plan).

In brief, DDSR agreements provide for a menu offering options to the creditor bank. One is a buy-back: the debtor government will repurchase debt at a discount that is agreed upon with the creditor banks. The second is a swap of debt into bonds at a discount. Such bonds would offer a market rate of interest. A third typical option is a swap at par into bonds that yielded a below-market interest rate. Finally, creditor banks with a permanent interest in the economy of the rescheduling country would make new money loans but would be able to convert part of their existing claims into conversion bonds. New money frequently takes the form of bonds, so as to protect the banks from further rescheduling.

The discount bonds and the interest-reduction bonds are normally fully collateralized for principal and partially collateralized for interest. To purchase this collateral (usually zero-coupon US government securities) and to finance the buy-backs, the debtor country government may borrow from the World Bank, the IMF and from supporting bilateral creditors (but only Japan has participated to date). This is the “official support” part of the DDSR program. Through 1993, Venezuela, Mexico, Uruguay, the Philippines, Nigeria, Costa Rica, Nigeria and Argentina have benefited from the Brady Plan.

Cost of Debt Relief

Multilateral debt relief has helped resolve the acute international liquidity problems faced by countries requesting debt relief and has taken place in an orderly manner. Each creditor has shared in the foreign exchange available for meeting debt service payments according to some formula; none received significantly preferential treatment. Debtor countries requesting debt relief, however, paid a price: it proved difficult to restore access to commercial

In 1987–88, a “market based menu approach” evolved, giving creditors a choice of rescheduling options.

The Brady Plan, March 1989, featured official financial support for debt and debt service reduction agreements.

Debt relief has a cost: it is very difficult for countries that have restructured their debts to renew access to commercial borrowing.
credits and to financial markets. Turkey is a good example. Because of massive short-term borrowing in the face of a deteriorating export earnings, Turkey, in 1976, was unable to continue debt service payments. Through a series of debt restructuring agreements over the next few years, it was able to resolve its immediate international liquidity problems. But, while it had been able to tap the long-term Eurodollar market in the early 1970s, for a decade Turkey was unable to float international bond issues.

Countries that were on the margin of having to seek debt relief during the 1980s but did not (for example, Colombia, Algeria, Kenya) were able to secure continuous private-source external financing. Countries that did ask for debt relief found themselves cut off from private-source credits, not just during the period of acute economic difficulties, but for years after. Of course, accumulating arrears is not an acceptable option to debt relief; when faced with the prospects of running up massive arrears, debt relief is an unfortunate necessity.

Most countries that required debt relief in the past 15 years had maintained large public sector investment programs in the face of deteriorating balance of payments difficulties. They delayed adjustment to external shocks and borrowed to finance the resulting balance of payments gap. Prompt adjustment measures to external shocks have enabled countries such as Korea to avoid debt restructuring and to continue access to commercial credits and to financial markets.

Notes

2. In an address before the Commonwealth Finance Ministers meeting in Trinidad on September 19, 1990, he suggested that the entire stock of debt be restructured rather than maturities falling due in a limited consolidation period, that two-thirds of the eligible debt be canceled, that the remaining one-third be consolidated and repaid with a 25-year maturity under flexible repayment schedules and that moratorium interest due during the first five years be capitalized and combined with the principal sum. See: World Bank 1991, p. 61.
4. For an evaluation of the Brady Plan, see World Bank, 1991, pp. 35-40. Subsequent editions have an update on agreements signed since the publication of the previous edition. World Bank 1993, p. 37, shows how to calculate the “debt reduction equivalent,” which takes into account not only the immediate debt reduction achieved through discounted exchanges and buybacks but also the benefit that is achieved over time by interest rate reduction, not of the cost of collateral.
References


Debt Management Institutions

Governments that borrow large sums and have a substantial external debt must be able to establish foreign borrowing and debt management policies in an orderly fashion and assure that those policies are implemented. There must be a high-level coordinating committee to make overall policy and to provide direction to the agencies involved with debt management. In turn, senior policy officials need a reverse flow of information from the implementing agencies.

Institutional Priorities

The responsibilities of debt management can be distributed between three specialized units—a Statistical Unit, a Control Unit and an External Finance Unit. The institutional priorities of external debt management are to define the functions of these units, to give them mandates and the resources to accomplish their mission and to coordinate their activities (see de la Dehesa 1985, p. 94, and UNCTAD 1989, pp. 3–5).

The Statistical Unit assembles timely information on the country’s total external debt (see Chapters 6 and 7). The Control Unit assesses the country’s ability to support future debt service payments (see Chapters 1 and 9). The External Finance Unit must assess what type of borrowing is appropriate at any given time (Chapter 3). This represents the active management of debt, in contrast with the Control Unit’s “defensive, or passive, management of debt” (de la Dehesa 1985, p. 95). The External Finance Unit implements the decisions of the high level coordinating committee; but, at the same time, it serves as its advisory unit.

The Location of Debt Management Units

Where these units will be located in a government administrative structure will vary between countries. Let us examine some of the possibilities.
The Statistical Unit

The choice is most often between the Ministry of Finance and the Central Bank. The Ministry of Finance is an attractive choice because it invariably already has a unit responsible for monitoring in detail loans that are serviced from the central government’s budget. This debt unit must assemble details on all external loans that are central government obligations. It prepares schedules of debt service payments. From these schedules, the debt unit assembles lists of service payments due each month, which are used by the budget office to estimate monthly total revenue and payments.

The Ministry of Finance’s debt unit becomes the official point of contact between the central government and individual creditors. Most important, it is this agency to which creditors send requests for payment when individual maturities fall due. After receipt of such a notice, the debt unit prepares an “order of payment” requesting that governmental funds be used to purchase the foreign exchange required to meet that payment. A budget control unit verifies that, in fact, this payment is in the central government’s budget. Then, the payment order is sent to the bank that executes foreign remittances on behalf of the government.

The Ministry of Finance’s debt unit, accordingly, has full accounting records on central government debt, and it is possible to use them as a source of statistics. The question is, should this debt unit also assemble statistics on other public sector debt and on the debt of the private sector? The alternative is to assign that responsibility to the Central Bank, which is the logical unit to collect data on private sector debt (Chapter 7).

In countries where external debt is largely central government debt, it makes sense to develop the Ministry of Finance’s debt unit into an organization capable of preparing comprehensive data on total external debt. In countries where private sector and public-enterprise debt is significant, the Central Bank will have to develop its own statistical unit. It would be possible for that group to prepare figures on total debt, making use of summary reports prepared by the Ministry of Finance’s debt unit on central government obligations. For example, Brazil, Spain, and the Philippines, countries with large private sector debt, have assigned the debt management Statistical Unit to the Central Bank.

Since either the Central Bank or the Ministry of Finance can establish a debt statistical unit, the decision often depends on which agency has the best administrative capability. In poor countries with severe budget constraints, the civil service is badly paid; working conditions are poor; buildings are inadequate; office equipment is in short supply. Staff morale and leadership
are generally poor. However, central banks, even in poor countries, offer better salaries and working conditions, as they have revenue for operations stemming from banking operations, independent of the central government budget. Such institutions are more likely to organize an effective debt management statistical unit.

The Control Unit

More than one unit of the central government makes medium and long-term economic forecasts. Their results often differ because of different underlying assumptions, but they all need inputs on external debt. If there is a Ministry of Planning, economic projections are a necessary part of developing public sector investment programs. Planning must take into account alternative scenarios of the evolution of the world economy and possibilities of national economic development. The constraints of meeting debt service payments must be built into this Ministry’s calculations.

Economic projections are required by the Ministry of Finance for budget planning. Expenditure requirements must reflect the need to service and repay the government’s external debt. The Central Bank must make forecasts that focus on the balance of payments. Here again, future debt service payments are a key input.

Thus, within the central government, there are three units making economic projections, each from a different perspective: long-term development planning, budget management, balance of payments management. The High Level Coordinating Committee must decide which group will be responsible for evaluating the debt supporting capacity of the central government and of the country as a whole. Which one depends on the structure of the policy dialogue within the country. Since budget and balance of payments management is central to the issue of foreign borrowing, the choice lies normally between the Ministry of Finance and the Central Bank. However, the group that ends up with this responsibility must be sensitive to the priorities and assumptions of the other two units so that a consensus can be reached on the plausibility of assumptions and results.

External Finance Unit

Borrowing in the name of the central government is best put under the control of the Ministry of Finance, because it has the ultimate responsibility for the country’s financial stability. Accordingly, this key support unit should be placed in the Ministry of Finance itself.
The High Level Coordinating Committee

At the apex of debt management, there must be a group that assembles all relevant information related to debt management and establishes the government's external debt management policy. The natural place for such a High Level Coordinating Committee is in the Ministry of Finance. That is where the External Finance Unit is situated, and the head of that unit is in a position to help establish debt management policy.

Debt management can be organized more intelligently, however, by drawing on the specialized knowledge of others. The Central Bank can report on recent and prospective balance of payments developments, the Ministry of Planning can remind the Finance Ministry of priority public sector investment needs required for development, major users of export credits can describe market conditions and financing possibilities, and representatives from the commercial banking community can report on market borrowing conditions.

Also, from the policy-making point of view, it is useful for the Finance Ministry to discuss the issues of debt management with those who will be affected by the policies and so reach decisions through consensus. The resulting policies are likely to be better appreciated and are more likely to be implemented smoothly.

The High Level Coordinating Committee should be chaired by the Finance Minister or a Deputy Minister. The External Finance Unit can provide secretariat services. The Central Bank should be represented by the Governor or a Deputy Governor. The Directors of the Foreign Department and of the Research Department of the Central Bank should also be permanent members. The Planning Ministry should be represented by its Director. The Ministry of Commerce and Industry should also be represented.

There are countries where the Ministry of Finance is not able to exercise full authority on economic policies, because sector ministries exercise considerable power owing to the nature of public enterprises under their direction (for example, petroleum extracting companies). In this situation, the High Level Coordinating Committee would be led by a super-ministry, such as a Ministry for Economic Coordination, which is designed to secure the overall coordination of all ministries having a role in economic policy. Where such a super-ministry does not exist, the High Level Coordinating Committee would have to be led by the Prime Minister's Office.

The Committee should meet at regular intervals, possibly monthly, to review the borrowing program over the next 6-12 months. It will determine the country's total external financing needs, taking into account both
The High Level Coordinating Committee

The government’s borrowing requirements and projections of the private sector’s net long-term and short-term borrowing. The committee must bear in mind the debt servicing requirements of existing debt, consider the possibility of refinancing existing public sector debt on better terms and evaluate the possible need to borrow to increase the government’s or Central Bank’s foreign-exchange balances.

To provide background for the meetings, participating agencies charged with preparing policy papers should send them in draft to other committee members so that they can be discussed at lower-level committee meetings before being put in final form for heads of agencies. This procedure would enhance the efficiency of the High Level Coordinating Committee itself.

Meetings of the High Level Coordinating Committee would provide guidance to all participating agencies. The Ministry of Planning would come away with an understanding of external borrowing possibilities. The Central Bank would know that it should take measures to induce would-be private sector borrowers to increase (or decrease) their use of external resources. The External Finance Unit would have approval for a government borrowing program, and it would have a clearer idea of what it should seek with respect to the currency composition of debt, the floating/fixed interest rate mix and the maturity structure of government debt.

Should the High Level Coordinating Committee prepare directives on policy matters or, rather, provide informal guidance for debt management? Kalderen, weighs on the side of informal guidance (Kalderen 1992, p. 95):

The Committee need not and probably should not take and put on record formal decisions, for instance, about raising a particular loan, as this might encroach on the prerogatives of one or the other of the participating agencies. Rather, it should function as an advisory group whose consensus recommendations could be relied upon as the best possible foundation for formal decisions by all the agencies concerned, and in particular the External Finance Unit.

Establishing a High Level Coordinating Committee for debt management is now a common practice in major borrowing countries. Malaysia has a Financial Resources Committee chaired by the Prime Minister. Thailand has a Committee for National Debt Policy, chaired by the Minister of Finance. In Turkey, there is a Committee on External Borrowings, chaired by the Minister of Finance.

Public debt policy in Brazil is coordinated by the Ministry of Planning with respect to borrowing from multilateral institutions. It chairs an Exter-

The Committee provides guidance to all participating agencies. A good secretariat is needed.

An important operating question is whether the committee should prepare directives or provide informal guidance.

There are many examples of such Committees.
nal Financing Committee which represents Planning, Treasury, Finance and the Secretary of Economic Policy. Public sector borrowing from all sources is managed by the National Monetary Council, chaired by the Ministry of Finance. The Council contains representatives of the Ministries of Planning, Labor, Social Security, and Industry and Trade, in addition to the agencies which sit on the External Financing Committee.

Korea, a country with substantial borrowing in foreign financial markets, faces problems additional to the traditional macroeconomic/balance of payments balance issue. The Ministry of Finance chairs a Foreign Capital Inducement Committee, which regulates both public and commercial borrowing. An important consideration is to control the demands on foreign capital markets with a view to distributing borrowing evenly so as to enable Korean borrowers to acquire funds at the lowest possible cost.

Indonesia provides an interesting case study. Indonesia is a low-income, oil-exporting, country that relies on a mix of both official and commercial borrowing. For more than a decade, it has enjoyed good and uninterrupted access to international credit because of its prudent debt management and macroeconomic policies. Control over public and public enterprise borrowing has been exercised by the Ministry of Finance, and by the Central Bank (Bank Indonesia) for public commercial loans for balance of payments purposes. Because of a long-standing open capital account policy, there have been no controls over private borrowing. However, after being faced with: (a) a sharp rise in overall external debt; (b) deteriorating terms of commercial borrowing, manifested by a rise in interest rate spreads and a shortening of maturities; and (c) demands for rising commercial financing, in both the private and public sectors, that could potentially outstrip a sustainable level of overall borrowing, the Indonesian Government formed a ministerial-level offshore Commercial Loan Team (COLT) in October 1991 to achieve better control over foreign commercial borrowing. The organization and early actions of COLT provide a useful case study in the operation of a High Level Coordinating Committee.

COLT was given the power to:
- Coordinate all public commercial borrowing, including borrowing by state enterprises and by the private sector when the Government was involved;
- Set annual ceilings on external commercial borrowing for public projects and to set guidelines regarding loan terms;
- Decide the priority and timing of approved loans;
- Require more reporting from both public and private sector borrowers regarding loan terms.
One feature of COLT is its secretariat, with key officials from the Ministry of Finance, the Bank Indonesia, the Planning Agency, and the Ministry of Economic Coordination. This secretariat is expected to bring to bear the statistical and analytical resources of their respective agencies. However, some observers feel that the Secretariat may be better served with a full-time staff and management.

Early actions by COLT were designed to slow down and coordinate demands on foreign capital markets to arrest the deteriorating terms of borrowing and to prevent public or quasi-public borrowing on account of large projects from crowding out private borrowing. Strict limits were imposed on foreign commercial borrowings by the public sector over the next five years. This is enforced by requiring borrowing permits and setting up a queuing system for accessing capital markets, for public sector borrowers, is supplemented by a Bank Indonesia queuing system for commercial banks. However, the private sector is exempted from much of the queuing system so that it can retain flexibility in securing finance.

**Summary**

Effective external debt management is the ultimate responsibility of the person in the government who is charged with overall financial management of the economy. This is normally the Minister of Finance. Because of his many responsibilities, he will be able only to give general direction to policy and must rely on collaboration with others, both within and outside of the Ministry of Finance. This requires solid staff work by an analytic unit (the Control Unit), by a loan negotiating unit (the External Finance Unit) and by an informational unit (Statistical Unit). It is essential to the process of External Debt Management, that there be a high level coordinating unit to organize the work of these key units and to make policy on the basis of their findings.

**References**


Appendix A

The World Bank's Debtor Reporting System

Countries that would like to borrow from the World Bank must submit detailed information on their external long-term debt—loans with an original maturity of more than one year. Reliable and timely external debt information is needed to allow the Bank to know a borrowing country's foreign debt situation and to assess its creditworthiness and overall economic management. Borrowing countries must be current in reporting debt to the World Bank before new loans can be submitted to the Board of Executive Directors for approval.

The World Bank has established procedures for collecting information on external debt under its Debtor Reporting System (DRS). It is operated by the Debt and International Finance Division of the World Bank's International Economics Department. The legal basis for the DRS lies in the Articles of Agreement, to which all countries subscribe when they join the Bank. Article III, Section 4, states that "... the Bank shall pay due regard to the prospects that the borrower... will be in a position to meet its obligations under the loan." The "General Conditions Applicable to Loan and Guarantee Agreements" state that borrowers must furnish information with respect to financial and economic conditions in their countries, including data on external debt.

Reporting Requirements

Initially, the World Bank requested only summary information on debt from borrowing member countries. However, even for countries with relatively good statistical services, reports were not comparable between years, and it was very difficult to make inter-country comparisons. Furthermore, the format for collecting aggregated data was fixed, and it was not possible to reorganize country debt data for different analytical purposes. Conse-
quently, in 1951, the Bank moved from an aggregated to a loan-by-loan data collection system.

The reports required by the Bank under the DRS for long-term debt are as follows:

**Form 1: Description of individual loans**

This form shows the amount of each loan, terms of repayment, names of the borrower and lender and descriptive detail.

**Form 1A: Schedule of debt service payments**

If the amortization and interest payments cannot be calculated according to some formula, then a copy of the schedule of interest and principal payments is requested.

**Form 2: Annual report on the status of public and publicly-guaranteed debt**

This report is filed three months following the end of each calendar year. It includes figures for each public and publicly-guaranteed debt on amounts outstanding and arrears at the end of the year and also figures on disbursements received, debt service paid and debt relief received during the year. Data are normally reported in the currency of obligation.

**Form 3: Corrections and revisions**

This form was originally designed to inform the World Bank of corrections, or revisions, to Forms 1, 2 or 4. However, most debt offices find it more convenient to send in a xerographic copy of the original report with marked-in revisions. When countries report debt using electronic data communications methods, the revisions can be incorporated in these reports.

**Form 4: Annual report on the status of private nonguaranteed debt**

This is a summary report showing data on the same indicators as Form 2. However, data are not shown loan by loan, but are aggregated by type of debtor and by type of creditor.

Copies of these forms may be seen at the end of this Appendix. They are explained in detail in the World Bank's *Debtor Reporting System Manual*.

Since DRS data are mounted in a computer, debtor country names and individual debts must be represented by numerical codes. The reporting country selects the debt number; it can contain no more than seven digits. In Form 1, which reports each new loan commitment to the World Bank, several cat-
egories of information are requested. First, there is the debt number assigned to this loan. Next, there is information about the borrower: its name and institutional characteristics.

Form 1 asks whether the loan is guaranteed within the debtor country (e.g., by the central government) and whether or not it is financed by the budget. There are questions related to the lender: its name, the creditor type (i.e., commercial bank, international agency, etc.), and whether the loan is guaranteed within the creditor country (as is often the case with export credits). The amount of the loan (normally reported in the currency in which the loan is to be repaid) and the date of commitment (signature date) and the purpose of the loan is requested. Most important, Form 1 asks for information on the rate of interest and the terms of debt service payments.

After the Form 1 reports are received, the Debt and International Finance Division of the World Bank creates a loan record file in its computerized record files. With this information, it is possible to make projections on future debt service payments. Debt service schedules are not stored in these record files, but are calculated as needed unless the schedule is irregular. In that event, the schedule should be reported on DRS Form 1A and submitted with the Form 1 for that loan.

The Form 2 report informs the Bank of the status of each loan at the end of the calendar year. The report calls for both stock and flow data. The amount of disbursed debt and the available undrawn balance are shown as of the end of the year. Debt outstanding comprises principal only, and it is equal to the cumulative disbursements less cumulative amortization and write-offs or restructuring of disbursed sums. Interest payments due in the future are not included in debt outstanding. If any debt service payments due prior to the end of the reporting period have not been paid, they are considered to be in arrears; the stock of these arrears are also reported on Form 2. The flow data reported on Form 2 are: commitments made during the year (including supplements to earlier loans), disbursements that had taken place during the reporting period, interest and principal payments made during the year and amounts of principal and interest that had been rescheduled during the year. The Form 2 report also calls for reporting of cancellations and write-offs. Cancellations are the annulment of disbursed amounts; write-offs the annulment of disbursed debt.

The Form 2 has a column for each loan to be reported. Loans are identified by debt number, and the currency in which the figures are reported must be noted. Obviously, it is important that debt numbers not be changed once assigned. Data reported on Form 2 cannot be processed if the figures are not consistent with the previous year’s reports. If prior year figures for
transactions or amounts outstanding have been revised, it is essential that these revisions be reported at the time of the Form 2 report.

When the Debt and International Finance Division receives the Form 2 report, each loan record file is updated. The figures in each column of the Form 2 report are added to the individual computerized debt record files. From this information, it is possible to prepare tabulations of debt outstanding and of debt-related flows. The tables can be aggregated in a wide variety of ways. The information contained in Form 1 provides classification criteria, which make it possible to tabulate debt outstanding and debt-related transactions by individual creditor countries, by creditor type, by currency of repayment and by economic sector.

The Form 4 report on private nonguaranteed debt asks for data in aggregate, rather than loan by loan. The figures are to be reported in US dollars. Data are collected on both a debtor-type basis and a creditor-type basis. To obtain debtor-type information, separate Forms 4 are requested for (a) commercial bank debt, (b) the debt of direct investment enterprises and (c) all other debtors. The information contained in each report are entered into the computerized data system, and figures on total private nonguaranteed debt are generated.

The Form 4 report calls for figures on the stock of disbursed debt outstanding and the amount of arrears as of the end of the reporting period. It also requests flow data: disbursements received, debt service paid and amounts rescheduled. Commitment and undisbursed loan information is not requested. The figures should be broken down by creditor-type: commercial banks and other financial institutions, foreign parent companies and affiliates, exporters and other private lenders and, finally, official lenders (governments and international organizations). Consolidated debt service schedules are requested as well.

DRS Forms 1, 2 and 4 all relate to long-term debt. Short-term debt does not fall under the DRS, although debtor-country data are desired. When debtor country information on short-term debt is not available, figures are estimated from data collected by the Bank for International Settlements and the OECD from creditor sources.

Timing and Quality of Debt Reports

Countries must send in the DRS Form 1 reports at the end of each calendar quarter. The reports are due at World Bank Headquarters in Washington at the end of the month following each calendar quarter. The Form 2 and Form 4 reports are due by March 31st following the end of the reporting year.
When a World Bank loan or an IDA credit is signed, the borrowing government must submit a formal statement that its debt reports are complete. If the World Bank staff judges that external debt reports are apparently incomplete, are long overdue or are of unacceptable quality, loan submissions will be delayed.

**Tape Reporting**

Most countries maintain their external debt information on a computer. The Debt and International Finance Division encourages such countries to report their debt on computer diskettes or magnetic tape.

Some countries use specialized PC-based debt management computer software developed by UNCTAD or the Commonwealth Secretariat. These systems contain a “bridge facility” which can generate data output consistent with DRS reporting requirements. Those files can be transferred to a diskette and used by the Debt and International Finance Division staff to update country data records. Other countries develop their own computerized debt management system.

What is required is that a data output file be created which has fields corresponding to all the data elements required by Forms 1, 1A and 2. This is a flat, or sequential, file. (Private nonguaranteed debt, being so summary, can be reported easily with hard copy.)

In order to do this, the computer programmer must create several sets of cross-reference files that contain codes for country names, currencies, etc. The Debt and International Finance Division will supply its own codes for these files to facilitate the programming work in the reporting country and to make the electronic communication of data more effective.

Countries that wish to introduce an electronic data communication system for their external debt to meet DRS requirements should write to the Division Chief, Debt and International Finance Division, International Economics Department, World Bank, Washington, DC 20433. The facsimile number is: (202) 477-0661.

The Debt and International Finance Division can advise with tape reporting and thus help assure the usefulness of the communication system.

**Uses of Reported External Debt Data**

The individual loan information is kept confidential. Only staff with responsibility for entering data have access to the DRS forms, and those forms are stored in a secure manner. From the computerized file of DRS reports, sum-
mary tabulations can be prepared for the use of the World Bank country economists that show the structure of the debt and the profile of future debt service payments. These figures provide inputs to balance of payments/macroeconomic models and to analyses that helps assess country creditworthiness. Aggregated projections for all countries, or for groups of countries, are used as inputs for global modelling.

Summary information is published in an annual statistical compendium, *The World Debt Tables*, which is made available to the general public. The World Bank shares summary debt data files with the International Monetary Fund, the OECD and other interested international organizations. However, the loan-by-loan DRS reports are not circulated outside the Debt and International Finance Division.

**Accounting for Debt Restructuring**

Countries that restructure debt must maintain accounting records showing the changes in the stock of debt that result from different actions. For example, if a government takes part in a discounted buy-back of debt, there is a reduction in debt, partly as a result of the repurchase and partly as a result of the creditors accepting its reduced market value. Similarly, there must be records showing the results of debt-equity swaps, swaps for discount bonds, write-offs, etc.

Conventional debt relief operations also require special accounting notations. When officially-guaranteed private export credits are rescheduled, the consolidated debt becomes a liability to the export credit guarantee agency in the creditor country; the shift of liability from the private lender must be noted. A common accounting error to lump the rescheduling of individual maturities with actual payments; they must be shown separately.

Further detail is given in the *Manual for Reporting External Debt*.

**Technical Assistance**

When countries have difficulties compiling data on external debt, the Debt and International Finance Division helps organize technical assistance programs to improve the quality of external debt management. The Debt and International Finance Division also organizes training courses and seminars for government officials responsible for debt management, often in partnership with other international agencies.
**WORLD BANK DEBT REPORTING SYSTEM**

**FORM 1: DESCRIPTION OF INDIVIDUAL EXTERNAL PUBLIC DEBT AND PRIVATE DEBT PUBLICLY GUARANTEED**

**NOTE:** Consult instructions on the reverse side of this form.

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<th>9. PRINCIPAL PAYMENTS</th>
<th>17. CURRENCY IN WHICH</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Pattern of Repayments (mark one)</td>
<td>1. Amount is reported</td>
</tr>
<tr>
<td>1. Equal payments</td>
<td></td>
</tr>
<tr>
<td>2. Annuity</td>
<td></td>
</tr>
<tr>
<td>3. One lump sum</td>
<td></td>
</tr>
<tr>
<td>4. Other (provide schedule on Form 1A)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Repayment Based on (mark one)</th>
<th>2. Debt is repayable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total commitment</td>
<td></td>
</tr>
<tr>
<td>Each Drawing</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. If Repayment is Based on Drawings</th>
<th>18. TYPE OF INTEREST OR BASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. No. of months from drawing to first principal repayment:</td>
<td>1. Interest free</td>
</tr>
<tr>
<td>b. No. of principal payments on each drawing:</td>
<td>2. Interest included in principal</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>10. PRINCIPAL REPAYMENT DATES</th>
<th>18. INTEREST RATES OR MARGINS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. First</td>
<td>1. 1st fixed rate % 3. 2nd fixed rate %</td>
</tr>
<tr>
<td>2. Final</td>
<td>2. 1st variable margin% 4. 2nd variable margin%</td>
</tr>
<tr>
<td>3. No. of payments per year</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>11. CONSOLIDATION PERIOD</th>
<th>20. INTEREST PAYMENTS DATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>From</td>
<td>1. First</td>
</tr>
<tr>
<td>To</td>
<td>2. Final</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>11a. In column 3 of Form 1A with amounts rescheduled each year</th>
<th>21. COMMITMENT CHARGE (rate %)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>22. NOTES</th>
<th></th>
</tr>
</thead>
</table>

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## WORLD BANK DEBT REPORTING SYSTEM

### FORM 1A: SCHEDULE OF DRAWINGS AND PRINCIPAL AND INTEREST PAYMENTS FOR INDIVIDUAL EXTERNAL PUBLIC DEBT AND PRIVATE DEBT PUBLICLY GUARANTEED

<table>
<thead>
<tr>
<th>DATE</th>
<th>SCHEDULE OF RESCHEDULINGS</th>
<th>ESTIMATED FUTURE PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>MONTH</td>
<td>YEAR</td>
<td>(1)</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td></td>
</tr>
</tbody>
</table>

### NOTES:

---

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### WORLD BANK DEBT REPORTING SYSTEM

**FORM 2: INDIVIDUAL EXTERNAL PUBLIC DEBTS AND PRIVATE DEBTS PUBLICLY GUARANTEED**

**CURRENT STATUS AND TRANSACTIONS DURING PERIOD**

**NOTE:** Consult instructions on the reverse side of form.

<table>
<thead>
<tr>
<th>ITEM</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>02</td>
<td>DEBT NUMBER</td>
</tr>
<tr>
<td>03</td>
<td>CURRENCY REPORTED</td>
</tr>
<tr>
<td>010</td>
<td>DEBT OUTSTANDING DISBURSED</td>
</tr>
<tr>
<td>100</td>
<td>UNDRAWN BALANCE</td>
</tr>
<tr>
<td>200</td>
<td>PRINCIPAL IN ARREARS</td>
</tr>
<tr>
<td>300</td>
<td>INTEREST IN ARREARS</td>
</tr>
<tr>
<td>400</td>
<td>COMMITMENT</td>
</tr>
<tr>
<td>500</td>
<td>DRAWINGS</td>
</tr>
<tr>
<td>600</td>
<td>CANCELLATIONS</td>
</tr>
<tr>
<td>700</td>
<td>WRITE-OFFS</td>
</tr>
<tr>
<td>800</td>
<td>PRINCIPAL PAID</td>
</tr>
<tr>
<td>900</td>
<td>INTEREST PAID</td>
</tr>
<tr>
<td>20R</td>
<td>PRINCIPAL ARREARS RESCHEDULED</td>
</tr>
<tr>
<td>30R</td>
<td>INTEREST ARREARS RESCHEDULED</td>
</tr>
<tr>
<td>80R</td>
<td>PRINCIPAL RESCHEDULED</td>
</tr>
<tr>
<td>90R</td>
<td>INTEREST RESCHEDULED</td>
</tr>
</tbody>
</table>
WORLD BANK DEBT REPORTING SYSTEM

FORM 3: REVISIONS OF FORMS 1 AND 2

NOTE: Please consult instructions on the reverse side of this form.

<table>
<thead>
<tr>
<th>Debt Number</th>
<th>Period ended /</th>
<th>Item or Column (describe)</th>
<th>Revised data /</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(month, year)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1/ For Form 2, enter the date of the form being revised.

2/ If an amount, indicate the currency in which reported.

NOTES:
**WORLD BANK DEBT REPORTING SYSTEM**

**FORM 4: EXTERNAL PRIVATE NON-GUARANTEED DEBT**

*(in thousands of U.S. dollars)*

**NOTE:** Consult instructions on the reverse side of this form.

### PART A. CURRENT STATUS AND TRANSACTIONS DURING PERIOD

<table>
<thead>
<tr>
<th>TYPE OF CREDITOR</th>
<th>DRAWN AND OUTSTANDING (1)</th>
<th>DRAWINGS (2)</th>
<th>PRINCIPAL PAID (3)</th>
<th>INTEREST PAID (4)</th>
<th>PRINCIPAL RESCHEDULED (5)</th>
<th>INTEREST RESCHEDULED (6)</th>
<th>DRAWN AND OUTSTANDING (7)</th>
<th>PRINCIPAL IN ARREARS (8)</th>
<th>INTEREST IN ARREARS (9)</th>
<th>END OF PERIOD</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRIVATE BANKS AND OTHER FINANCIAL INSTITUTIONS</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>FOREIGN PARENTS AND AFFILIATES</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>EXPORTERS AND OTHER PRIVATE SOURCES</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>OFFICIAL GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<td>TOTAL</td>
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</tbody>
</table>

### PART B. ESTIMATED FUTURE PAYMENTS OF PRINCIPAL AND INTEREST

#### PRINCIPAL

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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<tbody>
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<td>FOREIGN PARENTS AND AFFILIATES</td>
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</table>

#### INTEREST

<table>
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<tbody>
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</tr>
<tr>
<td>FOREIGN PARENTS AND AFFILIATES</td>
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</tr>
<tr>
<td>EXPORTERS AND OTHER PRIVATE SOURCES</td>
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<td></td>
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</tr>
<tr>
<td>OFFICIAL GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS</td>
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</tbody>
</table>
Appendix B

External Debt Accounting Forms

Most countries use a computerized accounting system for keeping records of external debt. A newcomer to the task of debt monitoring would find it difficult to understand the underlying accounting relationships of a computer based debt monitoring system (CBDMS), because these relationships are incorporated into the system’s software, out of the user’s sight. When working with a CBDMS, a person is aware only of data entry screens and standard output formats. To understand how to get from input to output, it may be helpful first to study a set of old-fashioned forms that are maintained manually. Such a set of basic forms are presented here. Following that, an example is given of the loan data input section of a typical CBDMS.

Manual Accounting Records

Let us assume that there is a Debt Management Department in the Ministry of Finance which is responsible both for managing the direct debt of the central government and for assembling comprehensive statistics on the entire external debt of the country. The Debt Management Department must work with a Treasury Department in the Ministry of Finance which is responsible for keeping records of government receipts and expenditures, including disbursements and repayments of foreign loans. The Debt Management and Treasury Departments interact with each other and also with a Budget Department that requires annual estimates of debt service payments.

The Debt Management Department’s first responsibility with respect to government debt, accordingly, is to tell the Budget Department what sums must be provided for in the annual budget. Then, during the course of the year, the Debt Management Department must instruct the Treasury to release budgeted funds for debt service payments as individual obligations fall due. To perform these functions, the Debt Management Department has to have detailed records of government obligations.
For its statistical work, the Debt Management Department must collect information not just on debt that is serviced through the central government budget but also on debts of public and private enterprises. Data collection procedures are needed for this purpose. The Treasury Department, on its part, must keep transaction-by-transaction records of government direct debt, because Treasury is responsible for controlling all government cash receipts and expenditures.

What follows are examples of accounting forms that are essential to the needs of the Debt Management Department and of the Treasury Department. The forms shown here are very stylized; in practice additional information may be needed and arranged in a different fashion.

**Debt Management Department Forms**

**Data Collection Responsibilities**

The Debt Management Department will be collecting information on external debt from several different sources. The Central Bank would normally supply information on short-term debt and on the long-term debt of the banking system. The Central Bank might also obtain debt data from the private sector. The Treasury Department would supply information on government and government-guaranteed debt. Data on other loans, such as debts of public enterprises, would have to be collected from the individual debtor institutions by the Debt Management Department itself.

**Form A1: Master List of External Debt Commitments.** The Debt Management Department must keep up-to-date a complete list of public and publicly guaranteed long-term debts. This list includes the debts of public enterprises and of local government as well as the debts of the central government. The Debt Management Department should arrange to receive copies of all public sector loan agreements. Form A1 extracts essential data for ready reference. Form A1 needs to contain only minimum information that identifies the borrower and lender, shows the commitment date and the amount of the loan. However, it would be useful to allow space for some simple notations. Full detail on the individual loans would be maintained in Form A2A. When a new loan is recorded in Form A1, the Debt Management Department will assign a debt number which can be used for identification. This number is also required for the World Bank’s Debt Reporting System.

**Form A2A: Individual Loan Record: Basic Information; Debt Service Schedule.** The upper part of this form describes the characteristics of the
loan, giving details of the borrower and the lender, amount and repayment terms of the loan. The lower portion of the form reproduces the debt service schedule. While not shown on this form, it might also be useful to obtain estimates on the timing of loan disbursements.

**Form A2B: Individual Loan Record: Transaction and Status.** The actual disbursements, payments, and outstanding amounts are recorded here for each debt that is serviced through the central government budget. The figures would not be for individual transactions but for the totality of transactions during a standard accounting period, say each month. From these entries, debt outstanding can be calculated. If the payments fall into arrears, the changes in arrears and the cumulative amounts are to be recorded. In the event of a debt refinancing (or a restructuring under a debt relief accord), provision would have to be made for recording this information. Additional columns would be required in this form. The figures on amounts outstanding are here calculated from transactions data. From time to time they should be verified against the creditor data.

In collecting information on government direct debt, the Debt Management Department would work with the Treasury Department, which would be responsible for monitoring transaction-by-transaction data on government direct debt. How this is done is explained in the note to Form B2C, below.

**Form A3: Debt Data Collection Form.** This form concerns public sector debt not serviced through the central government budget. For these obligations, the Debt Management Department does not have the same access to transaction-by-transaction records for individual loans as it does for government debt through the Treasury Department. The Debt Management Department must ask each debtor agency to extract summary data from its accounting records each month and send them to the Debt Management Department on Form A3.

**Debt Management Responsibilities**

**Form A4: Budget Preparation Form.** This form is used to provide the Budget Department of the Ministry of Finance with annual estimates of debt service. All debts covered by the budget are listed. The form should also show debts guaranteed by the government, to be noted as contingent liabilities. If the government has borrowed money for relending to fiscally autonomous borrowers the budget estimates should show the amounts of debt service that will be collected from those borrowers. In the sample Form A4 shown here, budget estimates are being prepared for 1994. At the same
time, the Debt Management Department informs the Budget Department of the most recent estimates for the current year (1993) plus the final figures for the past year (1992).

Form A5: Schedule of Debt Service Due Monthly. This is a key form for planning purposes. The Debt Management Department must know what payments are falling due, in order to initiate the debt service; the Treasury Department and the Central Bank should have this information to assist with government cash management and with foreign exchange management.

Form A6: Payment Order. The Debt Management Department must prepare formal instructions requesting payment of individual debt service obligations. When signed by the appropriate official, it would authorize the Treasury to release budgeted funds for this purpose, and the Central Bank would then purchase the foreign exchange required.

Treasury Department Forms

Form B1: Master List of Government External Debt Commitments. This form is identical to Form A1 of the Debt Management Department, except that it is restricted to loans covered by the government budget.

Form B2A: Individual Loan Record: Basic Information; Debt Service Schedule. This form is similar to Form A2A of the Debt Management Department. Like Form B1, Forms B2A and B2B are used only for loans covered by the government budget. Form A2A covers all public sector debt.

Form B2B: Individual Loan Record: Disbursements History. The top portion of this form will contain figures relating to the original loan commitment, supplementary commitments, cancellation of commitments and undisbursed balances. The main body of the form will contain figures, transaction-by-transaction on disbursements and cumulative disbursements in the currency of obligation. Disbursement figures are also shown in domestic currency.

Form B2C: Individual Loan Record: Transaction and Status. Here, the actual debt service and outstanding amounts would be recorded. Disbursement figures are carried forward from Form B2B. If debt service falls into arrears, the changes in arrears and cumulative amounts would be recorded.

In the event of a debt refinancing (or a restructuring under a debt relief ac-
Computersized Accounting Loan Records

In the example of this Appendix, it would suffice for the Treasury to keep such records because of its responsibility for controlling government cash flow. The Debt Management Department would secure monthly summaries for its Form A2B from the Treasury Forms B2B and B2C, possibly using Form A3 for this purpose.

Form B3: Payment Orders: Control Register. Payment orders, originated by the Debt Management Department, will pass through the Treasury Department to the Central Bank. The Treasury must keep track of payment orders, noting when they were sent forward and when they were returned with an advice that payment was made. Form B3 serves this purpose.

Computerized Accounting Loan Records

The Debt Management Department, instead of recording information on Forms A1, A2A and A2B, today can use a CBDMS. In place of forms are data entry screens, such as those shown here from the Commonwealth Secretariat's CS-DRMS system.

Two screens from CS-DRMS are reproduced in Chart C1. They show how some of the characteristics of a loan extended by the Caribbean Development Bank to the “Development Finance Corporation” of a fictitious country, “Erehwon.” The screen, “Loan/Grant Details 1,” calls for entering the debt number, the title of the loan, co-financing, the name of the lender and the borrower. Note that there are two debt numbers shown here: an Erehwon number and an IBRD number. It is strongly recommended that national debt offices avoid having two sets of numbers; the number used for the debt office’s own purposes should, ideally, be the same as the number used for IBRD reporting, so as to avoid possible confusion.

In the screen, “Loan/Grant Details 2,” one records the agreement and effective dates, the currency of obligation, the amount of the loan and the closing date for disbursements. In other screens, additional information is recorded, such as the purpose of the loan and the due dates for principal and interest payments.

In Chart C2, screens are shown for entering actual transactions. The upper screen shows the recording of the principal repayment on this loan that was made on November 29, 1988; the lower screen shows the record-
ing of an interest payment effected on the same date. The figures in the individual loan records are normally recorded in the currency of obligation, US dollars in this instance.

The information recorded in the individual loan record provides the basis for a report on the history and status of loans, one-by-one. From such loan-by-loan tabulations, summary reports can be prepared that focus on one particular aspect of the country’s external debt (amount outstanding as of a particular date, classified according to some desired criterion), transactions that have taken place over a period of time, or forecasts of debt service due over a period of time. An example of such a report for an individual loan is shown in Table C1, a 4-page tabulation, called CS-DRMS Report 102, “Individual Loan/Grant (Consolidated) with Forecasts.”

This report organizes all of the data recorded in the loan record file. This report is shown in US dollars, which, coincidentally, is the currency of obligation of the loan shown here. But reports such as these need not be in the currency of obligation. The first entry is the loan commitment, which was on March 3, 1983. The loan was drawn-down in two disbursements, the first on May 21, 1983, the second on November 21, 1983. Columns (6) and (7) show the remaining available loan balance and the disbursed debt outstanding. Columns (2) through (5) provide space for reporting scheduled (forecast) principal and interest payments which the system calculates using the formulae chosen by users, as well as actual payments. As can be seen, on August 15, 1983, the first interest payment and service fee was made exactly as scheduled.

Amortization payments began on August 15, 1988 and were made as scheduled. On November 15, 1988, debt service payments fell due but were not made. Therefore, entries were made for arrears. When these payments were made on November 29, arrears were settled.

The transactions in this report go through August 15, 1989. The report makes projections of debt service due after September 30, 1989, showing payments due and the resulting debt outstanding. The projections conclude in April 2008, but only the first four pages of the tabulation (which go through August 15, 1995) are shown here.

Such reports are generated with the help of a computer and require software that can store information and make the requisite calculations. To produce reports like this, the system contains a number of support files, such as for exchange rates. The characteristics of computerized debt management systems are explained in Chapter 8. The forms shown here are reproduced from the Commonwealth Secretariat TAG’s brochure.
Form A1  Master list of external debt commitments

Sample country
Ministry of Finance
Debt Management Department

<table>
<thead>
<tr>
<th>Loan number</th>
<th>Signing date</th>
<th>Borrower</th>
<th>Lender</th>
<th>Creditor country</th>
<th>Purpose/project</th>
<th>Loan amount</th>
<th>First</th>
<th>Final</th>
<th>Interest rates (%)</th>
<th>Remarks</th>
</tr>
</thead>
</table>
Form A2A  Individual loan record: basic information; debt service schedule

Sample country
Ministry of Finance
Debt Management Department
Debt no.
Loan agreement amount: Original: Additions: Cancellations: Total

Name and address of the beneficiary ________________________________

Name and address/country of the creditor ________________________________

Debtor guarantor ___________ Creditor guarantor ___________

Type of credit ___________ Purpose ___________

Dates: Loan approval ___________ Effective ___________

Interest rate/charges information ________________________________

Payment dates ___________ Conditions ________________________________

Currencies: Reporting ______ Denomination ______ Payment ______

Other information:

Disbursements schedule information:

Initial closing date: ________________________________

Revised closing date: ________________________________

Notes:

Schedule of debt service

<table>
<thead>
<tr>
<th>Date</th>
<th>Principal</th>
<th>Interest</th>
<th>Other charges</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>
Form A28  Individual loan record: transaction and status

Sample country
Ministry of Finance
Debt Management Department

Debt no. ____________________  Commitment amount:  

<table>
<thead>
<tr>
<th>Original:</th>
<th>Addition:</th>
<th>Cancellation:</th>
<th>Total:</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Date (1)</th>
<th>Disbursements (2)</th>
<th>Debt service</th>
<th>Change in arrears</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Principal (3)</td>
<td>Interest (4)</td>
<td>Other (5)</td>
</tr>
<tr>
<td></td>
<td>Principal (7)</td>
<td>Interest (8)</td>
<td>Other (9)</td>
</tr>
</tbody>
</table>

Reporting explanatory notes:
Col. 2. Disbursements. These reflect the transfers of funds, or the receipt of goods, or other events resulting from utilizing the loan.
Cols. 3–6. Debt service. This covers amounts of principal repaid, and payments for interest, commitment charges, front-end fees, and others.
Cols. 7–10. Change in arrears. Entries are made for an increase in arrears when a debt service is made after the payment due date. Cumulative arrears are included in the outstanding amounts of arrears (Cols. 14–17). Principal in arrears are included in the disbursed outstanding amounts (col. 12).
### Outstanding amounts

<table>
<thead>
<tr>
<th>Adjustments</th>
<th>Disbursed</th>
<th>Undisbursed</th>
<th>Principal</th>
<th>Interest</th>
<th>Other</th>
<th>Total</th>
<th>Remarks</th>
</tr>
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</table>

**Cols. 11. Adjustments.** This entry includes a reduction in the undisbursed balance (e.g., cancellation), or a reduction in outstanding disbursed amount (e.g., write-off or debt forgiveness). Adjustment entries are also made for debt restructurings when all or a portion of a debt is consolidated with other obligations and a new debt is created. An explanatory note is required in col. 18.

**Cols. 12-17. Outstanding amounts.** These cover outstanding balances on the disbursed outstanding (the amount of the loan disbursed, net of repayments); undisbursed outstanding amount (available for use, and representing amount of the commitment less disbursements and cancellations); principal in arrears (cumulative amount of principal due but not paid if any and included in the amount disbursed and outstanding; interest and other charges in arrears (cumulative interest due but not paid and including interest on principal installments in arrears; interest payments due in foreign currency but paid into blocked accounts should be considered to be in arrears, unless the funds in question have actually been transferred to the creditor's account).
Form A3  Debt data collection form (summary of status and transactions for all external debt)

Sample country
Ministry of Finance
Debt Management Department

<table>
<thead>
<tr>
<th>Reporting agency:</th>
<th>Reporting period:</th>
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<tbody>
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<table>
<thead>
<tr>
<th>Date (1)</th>
<th>Loan number (2)</th>
<th>Currency (3)</th>
<th>Original/additional loan agreement amounts (4)</th>
<th>Disbursements (5)</th>
<th>Principal (6)</th>
<th>Interest (7)</th>
<th>Other charges (8)</th>
<th>Total (9)</th>
</tr>
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</table>
### Change in arrears

<table>
<thead>
<tr>
<th>Principal in arrears (10)</th>
<th>Interest/other charges (11)</th>
<th>Total (12)</th>
<th>Disbursed (13)</th>
<th>Undisbursed (14)</th>
<th>Principal in arrears (15)</th>
<th>Interest/other charges in arrears (16)</th>
<th>Remarks (17)</th>
</tr>
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</tbody>
</table>
Form A4  Budget preparation form
Sample country
Ministry of Finance
Debt Management Department

<table>
<thead>
<tr>
<th>Loan/credit particulars</th>
<th>1992 actual debt service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In loan currency</td>
</tr>
<tr>
<td></td>
<td>Principal (2) Interest (3) Other (4) Total (5)</td>
</tr>
<tr>
<td>I. Government direct debt</td>
<td></td>
</tr>
<tr>
<td>A. Signed loans:</td>
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<tr>
<td>1.</td>
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<tr>
<td>2.</td>
<td></td>
</tr>
<tr>
<td>B. Loans under negotiations:</td>
<td></td>
</tr>
<tr>
<td>II. Government guaranteed debt*</td>
<td></td>
</tr>
<tr>
<td>A. Signed loans:</td>
<td></td>
</tr>
<tr>
<td>B. Loans under negotiations:</td>
<td></td>
</tr>
<tr>
<td>III. Recoveries of principal and interest on relent loans*</td>
<td></td>
</tr>
</tbody>
</table>

Note: This form shows figures for three years. The current year is 1993. The year for which budget estimates are being made is 1994. The immediate past year is 1992. It is included to show the final figures.
a. Estimates on debt contracted by other enterprises but with government guarantee are recorded here.
b. Estimates on loans relent by the government to the sub-borrowers.
APPENDIX B: EXTERNAL DEBT ACCOUNTING FORMS

| Cols. 10–25. Budget estimates. Estimated debt service both in foreign and local currency equivalent amounts to be incorporated in the annual budget of the government. |
| Col. 17. Remarks. This may include currency exchange conversation rates between the local and foreign currencies. |
Form A5  Schedule of debt service due monthly
Sample country
Ministry of Finance
Debt Management Department

Month: __________________

<table>
<thead>
<tr>
<th>Due date</th>
<th>Loan particulars</th>
<th>Loan number</th>
<th>In loan currency</th>
<th>In domestic currency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Principal</td>
<td>Interest</td>
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<td>Other</td>
<td>Total</td>
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<td>Principal</td>
<td>Interest</td>
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<td>Other</td>
<td>Total</td>
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<td>Remarks</td>
<td></td>
</tr>
</tbody>
</table>
Form A6  Payment order

Government of sample country
Ministry of Finance
Debt Management Department

Date: __________________________

To:
The Manager
Treasury Department
Ministry of Finance

Subject: Payment of principal installment, interest/charges due on ____________
in respect of ____________ loan no. of ____________ million.

Sir:

The next payment in respect of the above-mentioned loan falls due on ____________. Accordingly we request that ___________ be permitted to remit the following amounts in currencies indicated below to the credit of depository banks as per notice dated ____________ which will be presented by ____________.

<table>
<thead>
<tr>
<th>Currency payable of principal</th>
<th>Amount</th>
<th>Interest charges</th>
<th>Commitment charges</th>
<th>Total in words/figure</th>
</tr>
</thead>
</table>

The amount in foreign exchange is to be debited to the allocation of debt service for _____________. The local currency funds will be provided by the ____________ _____________.

Sincerely,

(Signature/name/position)

Copy to:
1. (Name of agency and address) with reference to demand notice dated ____________ addressed to you and copy to the Ministry of Finance. Arrangements may be made to remit the above amounts at least a week ahead of the due date to ensure receipt of funds by the Depository Bank by due date; information re date of remittance together with the local currency equivalent of the payment made to be sent to the Debt Management Department, Ministry of Finance.
2. The Manager, (Foreign Operations Department).
3. Director, Debt Management Department, Ministry of Finance.
4. Director, Treasury Department, Ministry of Finance.
5. Director, Budget Department, Ministry of Finance.
Form B1  Master list of government external debt commitments

Sample country  Ministry of Finance  Treasury Department

<table>
<thead>
<tr>
<th>Loan number</th>
<th>Signing date</th>
<th>Borrower</th>
<th>Lender</th>
<th>Creditor country</th>
<th>Purpose/project</th>
<th>Loan amount</th>
<th>Principal payment dates</th>
<th>Interest rates (%)</th>
<th>Remarks</th>
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</table>
Form B2A  Individual loan record: basic information; debt service schedule

Sample country
Ministry of Finance
Treasury Department

Debt no.
Loan agreement amount: Original:
Additions:
Cancellations:
Total

Name and address of the beneficiary

Name and address/country of the creditor

Debtor guarantor: Creditor guarantor:

Type of credit: Purpose:

Dates: Loan approval: Effective:

Interest rate/charges information:

Payment dates: Conditions:

Currencies: Reporting: Denomination: Payment:

Other information:

Disbursements schedule information:

  Initial closing date:  
  Revised closing date:  

Notes:

Schedule of debt service

<table>
<thead>
<tr>
<th>Date</th>
<th>Principal</th>
<th>Interest</th>
<th>Other charges</th>
<th>Total</th>
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Form B2B Individual loan record: disbursement history

Sample country
Ministry of Finance
Treasury Department

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<th>Debt no.</th>
<th>Loan agreement amount:</th>
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<th>Exchange rate</th>
<th>Undisbursed balance in loan currency</th>
<th>Remarks</th>
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</table>
Form B2C Individual loan record: transaction and status

Sample country
Ministry of Finance
Treasury Department

<table>
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<tr>
<th>Date (1)</th>
<th>Payment order number (2)</th>
<th>Disbursements (3)</th>
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<table>
<thead>
<tr>
<th>Debt Service Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>In loan currency</td>
</tr>
<tr>
<td>Principal (4)</td>
</tr>
<tr>
<td>Interest (5)</td>
</tr>
<tr>
<td>Other (6)</td>
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<tr>
<td>Total (7)</td>
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<tr>
<td>In domestic currency</td>
</tr>
<tr>
<td>Principal (8)</td>
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<tr>
<td>Interest (9)</td>
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<tr>
<td>Other (10)</td>
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<tr>
<td>Total (11)</td>
</tr>
</tbody>
</table>

Reporting explanatory notes:
Col. 3. Disbursements. These reflect the transfers of funds or the receipt of goods, or other events resulting from utilizing the loan.
Cols. 4-7. Debt service in loan currency. This covers the amounts of principal repaid, and payments for interest, commitment charges, front-end fees, and others.
Cols. 8-11. Debt service in domestic currency equivalent. This is the equivalent to the amounts reported in cols. 4-7.
### Change in arrears

<table>
<thead>
<tr>
<th>Principal (12)</th>
<th>Interest (13)</th>
<th>Other (14)</th>
<th>Total (15)</th>
<th>Adjustments (16)</th>
<th>Disbursed (17)</th>
<th>Undisbursed (18)</th>
<th>Principal (19)</th>
<th>Interest (20)</th>
<th>Other (21)</th>
<th>Total (22)</th>
<th>Remarks (23)</th>
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</thead>
</table>

### Outstanding amounts

<table>
<thead>
<tr>
<th>Arrears</th>
<th>remarks</th>
</tr>
</thead>
</table>

Cols. 12–15. Change in arrears. This covers changes in arrears and is reflected in the outstanding amounts of arrears (cols. 19–22).

Col. 16. Adjustments. This covers any entry representing a reduction in the undisbursed amount (e.g., cancellation), or a reduction in outstanding disbursed amount (e.g., write-off or debt forgiveness). Adjustment entries are also made for debt restructurings when all or a portion of a debt is consolidated with other obligations and a new debt is created. An explanatory note is required in Col. 23.

Cols. 17–22. Outstanding amounts. These cover outstanding balances on the disbursed outstanding (the amount of the loan disbursed, net of repayments); undisbursed outstanding amount (available for use, and representing amount of the commitment less disbursements and cancellations); principal in arrears (cumulative amount of principal due but not paid, if any, and included in the amount disbursed and outstanding); interest and other charges in arrears (cumulative interest due but not paid and including interest on principal installments in arrears; interest payments due in foreign currency but paid into blocked accounts should be considered to be in arrears, unless the funds in question have already been transferred to the creditor’s account).
Form B3  Payment orders: control register

Sample country
Ministry of Finance
Treasury Department

<table>
<thead>
<tr>
<th>No./date of authority (1)</th>
<th>Due date of payment (2)</th>
<th>Loan number (3)</th>
<th>Amount authorized</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Principal (4)</td>
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<tr>
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<td>Interest (5)</td>
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<td>Other (6)</td>
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<td>Total (7)</td>
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</tbody>
</table>

Note: Cols. 1–14. This record can be maintained to monitor the progress of expenditures both in foreign and in local currencies. Here, particulars of the remittances authorized, the due dates (col. 2), the number and date of the authority issued (col. 1), amounts in authorized foreign currency (cols. 4–7) and in domestic currency equivalent (cols. 9–12), will be recorded, and entries authenticated through initials (col. 13).
### APPENDIX B: Forms

#### In domestic currency

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<th>Other (11)</th>
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### Chart C1 CS-DRMS sample loan characteristics entry screens

**PERFORM:** Query Next Previous Add Update Remove Table Screen...

**Searches the active database table**

**LOAN/GRANT DETAILS 3**

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| Liabilities Cross-checked with Creditor (Y/N) | [N] on [1989/04/21] |

**Loan Processed** [Y] Last Amended [1989/12/04] By [JUNE]

**PERFORM:** Query Next Previous Add Update Remove Table Screen...

**Searches the active database table**

**LOAN/GRANT DETAILS 4**

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**USER-DEFINED FIELDS**

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| External Loans 3 | [ ]        |
| External Loans 4 | [ ]        |
| External Loans 5 | [ ]        |
| External Loans 6 | [ ]        |
| External Loans 7 | [ 0]       |
| External Loans 8 | [ 0]       |
| External Loans 9 | [1901/01/01] |
| External Loans 10| [1901/01/01] |
### Chart C2 CS-DRMS sample transaction entry screens

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**Searches the active database file**

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**PERFORM: Query Next Previous Add Update Remove Table Screen ...**

**Searches the active database file**

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Table C1 Individual loan/grant (consolidated) with forecasts

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Table C1 Individual loan/grant (consolidated) with forecasts (continued)

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Table C1  Individual loan/grant (consolidated) with forecasts (continued)

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Glossary

Thomas M. Klein, Hugh Doreset and Malvina Pollock

agreed minute
The agreed minute sets out the common terms of a debt rescheduling agreed between creditors of the Paris Club and a debtor country and is signed by representatives of the creditor countries who are obliged to recommend its terms to their governments. The agreed minute specifies which debt service will be rescheduled and over what period: for instance, an agreed minute may stipulate that 90 percent of debt service falling due within a given 12 month period will be consolidated into loans having a maturity of 10 years with an initial grace period of 4 years during which no payments of principal are made. The rate of interest charged on rescheduled debt is a matter for negotiations leading to a bilateral agreement between the debtor country and each individual Paris Club creditor.

amortization
The same as principal repayments.

annuity
A loan where the payment stream is calculated in a way that results in the sum of principal repayment and interest payment being equal for each payment. In the early part of the repayment period, less of each payment goes towards principal and more towards interest; as more payments are made, the portion of each payment going towards interest decreases as the outstanding amount is reduced with a corresponding increase in the amount going towards principal.

arbitration
The reference of a dispute to an impartial person or group chosen by the parties to the dispute in lieu of litigation. The parties agree in advance to abide by the award of the arbitrator.

arrears
The total of scheduled debt service payments that have fallen due but remain unpaid.
| **asset and liability management** | Adjustment of the structure of a country's assets and liabilities to minimize adverse changes in future net cash flows arising from changes in external prices. See also *hedging*. |
| **attachment** | The seizing of property, by virtue of a judicial order, for the purpose of securing satisfaction of a judgement. *Prejudgment attachment* is the legal seizure of a defendant's assets prior to judgement in order to secure satisfaction of a judgment that may ultimately be given. *Postjudgment attachment* (or execution) is the legal seizure of a defendant's assets following a judgment against the defendant in order to enforce the judgment. |
| **balance of payments (BOP)** | A comprehensive double-entry accounting statement of a country's transactions between its residents and foreigners during a given period of time. The main components are: (a) transactions in goods, services, and income; (b) transactions in financial claims; (c) transfer payments, which are offsetting entries to one-sided transactions. This flow oriented concept is related to the stock oriented *international investment position*. See also *capital and financial account* and *current account*. |
| **bank advisory committee (BAC)** | Representatives of commercial bank creditors that respond to a request for debt relief from a debtor country government. The restructuring of commercial bank debt in the 1980s involved several hundred banks for the larger debtor countries. Consequently, the composition of a BAC must represent the different nationalities and classes of creditor banks. The head of a BAC would normally be from the bank with the largest exposure. The BAC's task is to negotiate an "agreement in principle" with the debtor country government which then is ratified by all creditor banks. See also *London Club*. |
| **Bank for International Settlements (BIS)** | Established in 1930 by intergovernmental convention, the Bank for International Settlements promotes cooperation among central banks of its member countries (24 European countries and 5 other countries) and international organizations. It functions as an agent and trustee: (a) as agent for the European Monetary Co-operation Fund, (b) as agent for the private ECU clearing and settlement system and (c) as trustee for certain international government loans. From time to time the BIS provides bridging finance for member central banks. Headquarters: Basel, Switzerland. |
| **base date** | The date agreed by commercial banks as the date on which their loan exposure to a debtor country will determine their contributions to a given... |
amount of new money for the debtor. This date need not be the same as the cut-off date. For instance, commercial banks may agree to reschedule debt service on all loans signed before January 1, 1991 (the cut-off date) and to provide new money to the debtor in relation to each bank's claims on the debtor country as of June 30, 1990 (the base date).

**base rate**
A recognized and published interest rate, for example LIBOR, used to determine the rate to be used for variable interest rate loans. The rate for the loan is determined by adding the spread to the base rate.

**Berne Union**
An informal association of export credit agencies whose members exchange information and seek to establish common standards, for instance on the appropriate down payment and repayment periods for various kinds of exports. The 50 members meet twice a year. They also maintain informal credit ratings of the borrowing countries.

**bilateral agreement**
This is the agreement signed by a debtor country and each of its creditors in the Paris Club. The bilateral agreement incorporates the common rescheduling terms of the agreed minute, lists the specific maturities that are to be rescheduled and also the rates of interest on the rescheduled debt. These rates of interest are negotiated bilaterally between the debtor and each of the creditors in the Paris Club and they may differ from one creditor and the next.

**borrower (or debtor)**
The organization which is responsible for servicing the debt.

**Bretton Woods**
The intergovernmental agreement reached at a conference held at Bretton Woods, New Hampshire, during the summer of 1944 that led to the establishment of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), often referred to as the World Bank.

**buy-back**
The purchase by a debtor of its own debt, usually at a discount. The debtor reduces its obligations while the creditor receives some payment. Although in contravention of standard commercial bank loan agreements, a debtor government may buy back its own debt on the secondary market.

**cancellation**
An agreed reduction in the undisbursed balance of a loan commitment. Compare write-off.
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<th>Term</th>
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<td>capital and financial account</td>
<td>That portion of a nation’s balance of payments which includes borrowing and lending (whether public or private), investment and capital transfers. See current account and also grant.</td>
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<td>capitalized interest</td>
<td>Scheduled interest payments which are converted, through an agreement made with the creditor, into disbursed and outstanding debt. Rescheduling agreements frequently include a condition that some percentage of interest due during the consolidation period will be capitalized.</td>
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<td>central bank</td>
<td>The financial institution that holds reserve deposits of commercial banks, serves as a lender of last resort to commercial banks, and holds deposits of the central government and may lend to it. It is the agency for managing a country’s monetary and banking system through regulations and through intervention as a buyer or seller in the market for government securities. It normally has the authority to issue bank notes which comprise part of the country’s stock of legal tender. It also holds foreign exchange assets and has the responsibility for intervening in foreign exchange markets to influence foreign exchange rates.</td>
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<td>cofinancing</td>
<td>The process in which a major lending institution, such as the World Bank, secures the participation of other lenders in the financing of individual large projects, thus leveraging the initiating lender’s own financial resources. Cofinancing operations of the World Bank have included parallel loans from regional development banks and bilateral official lending institutions, support from export-credit agencies and private market access for the borrower itself facilitated by partial World Bank guarantees.</td>
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<td>commercial risk</td>
<td>The risk of nonpayment by an enterprise arising from default, insolvency, or failure to take delivery of goods that have been shipped according to a supply contract.</td>
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<td>commitment</td>
<td>An obligation to furnish resources of a given amount under specified financial terms and conditions.</td>
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<td>commitment charge (or fee)</td>
<td>This is the charge made for holding available the undisbursed balance of a loan commitment. Typically it is a fixed rate charge (for example, 1.5 percent) calculated on the basis of the undisbursed balance.</td>
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<td>commitment date</td>
<td>The date on which the commitment occurs.</td>
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comparable treatment
An understanding in a debt restructuring agreement that the debtor will secure equivalent debt relief from other creditors.

cessionality level
See grant element.

consolidation period
In a debt restructuring agreement, this is the period of time during which debt service payments are to be consolidated and rescheduled or deferred.

contingencies
These represent conditions, situations or circumstances included in existing loan agreements that involve uncertainty and that could result in gains or losses if certain specific eventualities occur. For example, guaranteed loans represent contingent liabilities since they obligate the government to indemnify a lender in the event of a borrower default.

covenant
A promise by the borrower in a loan agreement to either perform, or refrain from performing, a certain act. See mandatory prepayment clause, negative pledge clause and pari passu clause.

credit
This term has several meanings regarding finance. (1) An amount of money that is available for disbursement by a lender. See also commitment. (2) The time allowed for repayment for goods or services received on trust (for example: “90-days credit”). (3) A reputation of financial reliability and trust (“The credit of enterprise x is good.”). (4) In bookkeeping, an entry of a payment received.

creditor
The one who provides money or resources and to whom payment is owed, under a specific loan agreement.

critical mass
This is the minimum amount of bank commitments to a commercial bank new money package extended under a debt restructuring arrangement giving reasonable assurance to the IMF that the financing assumptions of an adjustment program are realistic and that the program can be submitted to the IMF Executive Board for approval.

cross-default clause
A provision in a loan agreement entitling the creditor to accelerate the loan if the borrower defaults on another loan.

currency of denomination
The currency in which a loan amount is expressed.
currency of repayment  The unit of account in which a loan is to be repaid.

currency of reporting  The unit of account in which amounts are reported to statistical agencies, such as the World Bank under its Debtor Reporting System. The currency of reporting may be different from the currency of repayment.

currency of transaction  The medium of exchange in which an individual transfer occurs. The medium of exchange of one transaction (e.g. disbursement) does not necessarily determine the medium of exchange of another (e.g. repayment).

currency swap  An agreement to swap the debt servicing liability of a loan with repayments due in one currency with that of a loan with repayments due in a different currency. This can help debtors achieve a closer balance between foreign exchange receipts and payments denominated in different currencies. The mechanism provides protection against losses caused by exchange rate fluctuations.

current account  Transactions in: (a) goods (exports and imports) and services (such as transportation and insurance); (b) income (such as interest receipts and payments); and (c) current transfers (such as workers remittances and inter-government grants for consumption purposes). See capital and financial account.

current maturities  Maturities falling due during the consolidation period of a rescheduling.

cut-off date  This is the date that separates loans that are eligible for rescheduling from those that are not. An agreement may reschedule all debt service on loans contracted before January 1, 1992 (the cut-off date). Lenders attach considerable importance to the maintenance of the original cut-off date in subsequent debt renegotiations so as not to put new lending at risk of rescheduling, and borrowers recognize this as being in their interests too.

DAC  See Development Assistance Committee.

de minimus creditors  To simplify implementation of the a Paris Club agreement, minor creditors are exempted from debt restructuring. The limit defining a minor creditor range from SDR 250 thousand to SDR 1 million of principal and interest payments falling due during the consolidation period, depending on the size of the debtor country.
**debt and debt service reduction (DDSR)** Debt restructuring agreements between sovereign states and consortia of commercial bank creditors involving a combination of buy-backs, the exchange of bank loans at a discount for bonds or the exchange of bank loans for bonds at par but which lend below-market interest rates. In most instances, the new financial instruments are secured with U.S. Treasury bonds. DDSR agreements are characterized by a “menu approach”, allowing individual creditors to select among several DDSR options. Under the Brady Plan of March 1989, these arrangements are supported by loans from official creditors.

**debt/equity swap** An arrangement which results in the exchange of debt claims at a discount for equity in an enterprise. An investor purchases title to a foreign currency denominated debt in a secondary market at a discount. Under the debt/equity swap program, the debtor country government will exchange the debt for local currency at face value (with the government normally retaining some finds as a means of capturing a portion of the secondary market discount). The investor will then carry out an approved equity investment project. The difference between the face value and the market value of the debt provides an incentive to the investor. The debtor country government, on its part, must be prepared to spend the financial resources to retire debt. In a large debt/equity swap program there is a risk of inflationary pressure in the debtor country.

**debt for development swap** Financing part of a development project by the exchange of a foreign currency denominated debt for local currency at a substantial discount. The process normally involves a foreign nongovernment organization which purchases the debt from the original creditor at a discounted market price using its own foreign currency resources, and then resells it to the debtor country government for the local currency equivalent (resulting in a further discount). The NGO in turn spends the money on a development project, previously agreed upon with the debtor country government.

**debt for nature swap** Similar to a debt for development swap, except that the funds are used for projects that improve the environment. Such an agreement may be made by a creditor country that is adversely affected by pollution caused within the debtor country, for example Swedish concern for the effect on the Baltic by pollutants from Eastern Europe.

**debt restructuring** Any action by a creditor that officially alters the terms established for repayment in a manner that provides a reduction in near-term debt service.
obligations (debt relief). This includes buy-backs, debt and debt service reduction exchanges, forgiveness, rescheduling, rephasing and refinancing.

debt service  
All payments made against the loan, that is, principal repayments plus service payments. One must distinguish actual from scheduled debt service payments: the latter are the principal and interest payments that are contractually required to be made through the life of the debt. The "actual payments" are those that, in fact, were executed.

debtor  
See borrower.

default  
The failure to meet any obligation or term of a credit agreement or contract. A payment that is overdue or in arrears is technically in default since, by virtue of nonpayment the borrower has failed to abide by the terms and conditions of the credit. In practical terms, when a loan or credit is considered in default will vary by agency.

deferred payments  
Specific debt service obligations that a creditor agrees to permit the debtor not to pay, pending the negotiation of a debt restructuring agreement.

deposits  
In the context of the Paris Club deposits were first introduced in 1983 for debtor countries that had a history of running into arrears. After the signing of the agreed minute, the debtor makes monthly deposits into the central bank of one of the creditor countries in amounts roughly equal to the moratorium interest that is expected to fall due on the rescheduled debt owed to all Paris Club creditors combined. The debtor then draws on the deposited funds to make moratorium interest payments as soon as the rates of interest are agreed bilaterally with the individual Paris Club creditors.

Development Assistance Committee (DAC)  
Established in 1960 as the Development Assistance Group under the Organization for European Economic Co-operation and continued under the Organization for Economic Co-operation and Development as the DAC. The objective of the DAC is the expansion of the volume of resources made available to the underdeveloped countries and the improvement of their effectiveness. The Committee periodically reviews both the amount and nature of its Members' contributions to aid programs, both bilateral and multilateral. The DAC does not disburse assistance funds directly but is concerned instead with the promotion of increased assistance efforts by its Members. The members of the DAC are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy,
Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, the United States and the Commission of the European Communities.

disbursed and outstanding debt
The amount that has been disbursed from a loan commitment but has not yet been repaid or forgiven.

direct investment
Transactions that provide a foreigner (the direct investor) with an equity position in a company, done with the objective of obtaining, or enhancing, a lasting interest. The recipient enterprise is considered to be a direct investment enterprise if a foreign direct investor owns 10 percent of the ordinary shares or voting power. The components of direct investment are equity capital, reinvested earnings or the taking on of intercompany debt.

disbursement
Resources, such as goods, services, or funds, taken by the borrower against a loan agreement.

down payment
This term commonly means an amount paid by the buyer to the seller at the time of purchase, when the purchase is to be paid for in installments. In the context of the Paris Club it refers to the small proportion of debt that may not be consolidated and that must therefore be paid on the original schedule. For instance, an agreement may consolidate and reschedule over 8 years 90 percent of debt service falling due in 1987, while requiring that the unconsolidated 10 percent by repaid earlier, say 2.5 percent on schedule, as a down payment and 7.5 percent over 2 years.

drawing
See disbursement.

enhanced surveillance
Under Article IV of its Articles of Agreement, the IMF monitors the economic progress of countries which are no longer using IMF resources, but which are continuing to receive debt relief under multiyear rescheduling agreements. Countries are authorized to release edited versions of IMF staff reports (i.e. without any reference to the views of the IMF Executive Board) to their official and commercial creditors.

equal principal repayments
A fixed schedule of equal installments of principal adding up to the face value of the loan. The amount of each installment may be calculated in relation to either the amount of the total commitment or of each disbursement. Compare annuity.
exchange of information clause

In Paris Club agreements this clause covers several aspects of exchange of information. The debtor country agrees that the IMF will keep the Chairman of the Paris Club informed of its performance and status under its IMF credit facility. The Paris Club creditors agree to inform the Chairman of the dates on which they sign their bilateral agreements with the debtor country. The creditors agree also to provide to other participating Paris Club creditors, on request, copies of their bilateral agreements with the debtor country.

export credit

A loan extended to finance a specific purchase of goods or services from within the creditor country. Export credits extended by the supplier of goods are known as suppliers credits; export credits extended by the supplier’s bank are known as buyers credits. See also official export credit agency.

export credit agency (see official export credit agency.)

exports of goods and services

The total value of goods and all services sold to the rest of the world.

fixed interest rate

A rate of interest that is defined in absolute terms at the time of the loan agreement, for example, 8.5%. Compare variable interest rate.

forgive

See cancellation and write-off.

frame agreement

A line of credit which concerns the provision of resources consisting in whole or in part of ODA and requires ratification before concrete financial arrangements are made. The characteristic of a frame agreement is that additional substantive negotiations will occur between the donor country and the recipient country on the selection of the goods or products for which funds under the frame agreement may be released, following one or more implementing commitments.

futures

Markets exist for buying and selling futures of many things, including currencies, interest rates, and commodities. Most commonly used in debt management are currency futures. The currency futures market allows the purchase of a given amount of a particular currency at some predetermined fixed exchange rate. This provides protection against a major disadvantageous change in the exchange rate, however, it risks losing in the case of advantageous exchange rate movements.
See gross national product.

This clause was introduced into Paris Club agreements from 1978 for debtors requiring relief beyond the usual consolidation period of 12 to 18 months. Under the standard goodwill clause, the Paris Club creditors agree in principle, but without commitment, to consider subsequent debt relief applications favorably for a debtor country that remains in compliance with its IMF program and that has sought comparable debt relief from other creditors. See also improved goodwill clause and MYRAs.

The period between the commitment date of the loan and the date of the first principal repayment. The term applies to both new and rescheduled loans.

An exchange of goods, services or financial instruments with nothing being received in return—also known as a transfer. A capital grant (or transfer) involves (a) the exchange of a fixed asset or (b) the forgiveness of a liability. A current grant (or transfer) involves the exchange of goods or services designed for consumption or the exchange of financial instruments not earmarked for the purchase of a fixed asset. See also technical cooperation grants and grant-like flows.

The measure of concessionality of a loan, calculated as the difference between the face value of the loan and the sum of the discounted future debt service payments to be made by the borrower (i.e., the grant equivalent) expressed as a percentage of the face value of the loan. By convention, a 10 percent discount rate is used. See also concessionality level.

Transactions involving the sale of commodities against payment in the recipient country’s currency or loans in a foreign currency repayable in the recipient country’s currency. These transactions are treated as grants in the OECD/DAC statistics because their repayment does not require a flow of foreign currency across the exchanges. They are nevertheless counted as external debt, since the creditor is nonresident and subsequent use of the repayments by the creditor involves forgoing the corresponding inflow of foreign exchange.

The measure of the total domestic and foreign output claimed by residents of an economy, less the domestic output claimed by nonresidents. GNP does not include deductions for depreciation.
guaranty of a loan  An undertaking usually by a bank or a government agency to pay part or all of the amount due on a debt instrument extended by a lender in the event of nonpayment by the borrower.

hedging  The process of controlling the risk of adverse effects of external price fluctuations. It is not aimed at improving relative prices, rather at limiting the impact of drastic change. The three external type of change that can cause adverse conditions are: exchange rate fluctuations, interest rate fluctuations, and commodity price changes. Hedging techniques involve the use of futures and options trading, and currency swaps and interest rate swaps.

IBRD  See World Bank Group.

IDA  See World Bank Group.

IFC  See World Bank Group.

IMF  See International Monetary Fund.

Implementing agreements  These agreements spell out in detail and put into effect debt restructuring arrangements. They are legally the equivalent of a new loan agreements.

Imports of goods and services  The total value of goods and services purchased from the rest of the world.

Improved goodwill clause  This clause was first introduced into Paris Club agreements in 1983. It goes beyond the standard goodwill clause by specifying the future consolidation period.

Indebtedness  The financial obligation to make payment in cash, goods or services to a creditor in accordance with contractual or other arrangements.

Insured export credit  An export credit guaranteed by an official agency of the lender’s government, that will protect the lender against political or transfer risks in the borrowing country which prevents the remittance of debt service payments. See also official export credit guarantee agency.

Interest payments  Payments made in accordance with the contractual terms of a loan that specify the rate of interest that are to be applied, and the way in which the interest is to be computed. The loan may have fixed or variable interest rates.
**Interest rate swap**  
An agreement to swap the *debt servicing* liability of a loan with a *fixed interest rate* with that of a loan with a *variable interest rate*. For example, a government of a developing country may be able to borrow at comparatively better terms at variable rates than fixed rates, while for an enterprise in an industrialized country the inverse is true. Each may prefer its liabilities in the other form, they therefore borrow and arrange a *swap*. Normally, the differential in the rates is insured with a broker to protect the more sound *borrower.*

**International investment position**  
The stock of external financial claims and liabilities as of a given moment of time. Changes in the international investment position are reflected in the *balance of payments.*

**International reserves**  
The sum of a country’s monetary authorities holdings of *Special Drawing Rights* (SDRs), its reserve position in the *IMF*, its holdings of foreign exchange and its holdings of gold (valued at year-end London prices).

**International Monetary Fund (IMF)**  
Created in 1945 along with the World Bank by the Bretton Woods conference, the IMF provides a permanent forum for its 178 member countries to examine the economic policies of individual countries and of the world as a whole, in particular as they affect international financial relationships. The objective of this surveillance is to help assure orderly foreign exchange arrangements and to promote a stable exchange rate system. The IMF provides financial assistance to member countries in relation to their quotas for overcoming balance of payments difficulties. The IMF has the authority to create an international reserve asset, the *Special Drawing Right* (SDR), for distribution among its members. However, to do this, the IMF must determine that there is a long-term global need to supplement existing reserve assets. The last SDR allocation was on January 1, 1981.

The financial resources of the IMF consist of regular and special facilities. The regular credit facilities comprise: (1) purchases of foreign currencies equal to a country’s quota. This is done in four credit tranches; availability of the second through the fourth tranche is conditional upon the implementation of policies designed to eliminate the underlying causes of the balance of payments difficulties. Credit tranche resources are often secured under *stand-by arrangements*. (2) The Extended Fund Facility, which supports medium-term programs; resources are provided over a 3-year period (on occasion, 4-years) in larger amounts than under ordinary purchase arrangements; annual performance goals are required.
The IMF's special facilities are: (1) The systemic transformation facility (available through 1994) for countries shifting from centrally-planned to market-based systems. (2) The compensatory and contingency financing facility designed to help countries compensate for a temporary shortfall in export earnings or an excess in cereal import costs owing to factors largely beyond the country's control. (3) The Buffer Stock Financing Facility. (4) The Structural Adjustment and Enhanced Structural Adjustment Facilities that provide resources to low-income countries facing protracted balance of payments problems; medium-term macroeconomic and structural adjustment programs are required. Headquarters: Washington, D.C., USA.

**late interest charges**  This is the additional interest that may be levied on obligations overdue beyond a specified time.

**lender**  See creditor.

**liability**  An amount owed (i.e. payable) by an individual or entity for goods or services received, expenses incurred, assets acquired, construction performed, and amounts received but not yet earned.

**LIBOR**  See London Interbank Offered Rate.

**line of credit**  An understanding or statement of the intention to provide credit up to a ceiling over a specified period of time, usually one year.

**loan**  An agreement in which a lender undertakes to make specified resources available to a borrower. The amount of funds disbursed is to be repaid (with or without interest and late fees) in accordance with the terms of a promissory note or repayment schedule.

**loan agreement**  The legal evidence of an agreement to lend once certain preconditions have been met.

**local costs**  The costs of a project that are incurred in the borrowing country. Official lenders normally finance foreign exchange costs only.

**local cost financing**  The amount earmarked for expenditures in the borrowing country to purchase goods and services related to the execution of specific projects.
**London Interbank Offered Rate (LIBOR)**

The London Interbank Offered Rate (LIBOR) is a benchmark interest rate used to determine the cost of borrowing for banks in the interbank market. It is calculated as the weighted average of the bid rates at which banks are willing to lend money to other banks. LIBOR is expressed in different currencies and for different time periods, such as the six-month dollar LIBOR or six-month Deutsche Mark LIBOR. This rate is used to determine the approximate cost to banks of funds which they obtain in the interbank markets, and it is commonly the base on which their lending margins are fixed. Thus, an original loan agreement or a rescheduling agreement may stipulate the interest rate to the borrower at LIBOR plus a margin, such as dollar six-month plus 1.5 percent, adjusted semi-annually for changes in the LIBOR rate. See also variable interest rate.

**London Club**

A term commonly used for a group of commercial banks that join together to negotiate the restructuring of their claims against a sovereign debtor. There is no organizational framework for the London Club comparable to the Paris Club.

**long-term external debt**

Debt that has an original or extended maturity of more than one year.

**lump sum payment**

Repayment of the total amount of a loan commitment in a single amount at maturity. However, interest is normally payable at regular intervals (quarterly, semiannually, etc.) during the life of the loan.

**mandatory prepayment clause**

A covenant of a borrower in a loan agreement that it will make a ratable prepayment of the loan if it prepays other debt.

**margin**

See spread.

**maturity**

The debt service amounts to be paid on a particular date. Final maturity date is the date of the last payment due on the loan. Maturity period is sometimes used to denote the entire period over which principal repayments are being made for the loan. See also grace period.

**mixed credit**

A form of associated financing typically structured as a combination of a concessional loan or grant and a nonconcessional portion such as an officially supported export credit.

**moratorium interest**

Interest charged on rescheduled debt. In the Paris Club, the moratorium interest rate is negotiated bilaterally by the borrowing country with each individual creditor and therefore, differs from one creditor to the next. In the London Club, where all creditors are deemed to have access to funds
at comparable rates, the *moratorium interest* rate applies equally to all *rescheduled* obligations under a given agreement.

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<tr>
<td><strong>most favored nation clause</strong></td>
<td>Agreements concluded in the <em>Paris Club</em> require the <em>debtor</em> to obtain debt relief from <em>creditors</em> outside the <em>Paris Club</em> on terms no more favorable than those obtained from <em>Paris Club creditors</em>.</td>
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<tr>
<td><strong>multi-year rescheduling arrangement (MYRAs)</strong></td>
<td>At the G-7 meeting in June, 1984 multi-year <em>rescheduling agreements</em> were encouraged for borrowing countries “which are themselves making successful adjustment efforts”. Commercial banks introduced MYRAs that year. They were characterized by consolidation periods in excess of three years, longer repayment periods and lower moratorium interest rates. The <em>Paris Club</em> negotiated two MYRAs in 1985 parallel with commercial bank accords; both had to be cancelled, and the <em>Paris Club</em> discontinued this practice. The <em>DDSR</em> agreement supplanted the use of MYRAs by commercial banks.</td>
</tr>
<tr>
<td><strong>multilateral development banks (MDBs)</strong></td>
<td>Another term for international financial institutions, such as the <em>World Bank Group</em> and the <em>regional development banks</em>.</td>
</tr>
<tr>
<td><strong>MYRA</strong></td>
<td>See <em>multi-year rescheduling arrangement</em>.</td>
</tr>
<tr>
<td><strong>nationalization</strong></td>
<td>A process through which privately owned (including foreign owned) enterprises are taken over by the state. The state normally assumes, together with the assets of the enterprise, any outstanding external debt.</td>
</tr>
<tr>
<td><strong>negative pledge clause</strong></td>
<td>A covenant of a borrower in a loan agreement that seeks to prohibit or restrict the borrower from pledging its assets to secure the claims of other lenders.</td>
</tr>
<tr>
<td><strong>net transfers</strong></td>
<td>Loan <em>disbursements</em> minus repayments of <em>principal</em> minus <em>service payments</em> during some period. See also <em>net flows</em>.</td>
</tr>
<tr>
<td><strong>net flows</strong></td>
<td>Loan <em>disbursements</em> minus <em>principal repayments</em> during some period. See also <em>net transfers</em>.</td>
</tr>
<tr>
<td><strong>new money</strong></td>
<td>Loan <em>commitments</em> made by commercial banks to a debtor country government as part of a <em>debt restructuring</em> package. The provision of new money was introduced in the early 1980s to make it possible for debtor countries to meet their interest payments on rescheduled commercial bank obligations at comparable rates, the <em>moratorium interest</em> rate applies equally to all <em>rescheduled</em> obligations under a given agreement.</td>
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</table>
non-consolidated debt. Each creditor bank was required to provide new money in proportion to its exposure as of a base date. The Paris Club itself has no facility for lending money to troubled debtor countries but has, instead, rescheduled interest as well as principal, unlike the commercial banks which, with rare exception, reschedule principal only. In a few cases, Paris Club creditors have provided new financing, but this has been done outside the framework of the debt renegotiations.

non-consolidated debt This is debt that is wholly or partly excluded from rescheduling. It has to be repaid, or close to, the terms on which it was originally provided.

non-discrimination clause In Paris Club agreements this is the same as the most favored nation clause.

ODA See official development assistance.

OECD See Organization for Economic Co-operation and Development.

official creditors Public sector lenders. Some are multilateral, consisting of international financial institutions such as the World Bank and regional development banks. Others are bilateral, being agencies of individual governments (including central banks).

official development assistance (ODA) Flows to developing countries and to multilateral institutions provided by official agencies, including state and local governments, or by their executive agencies, each transaction of which meets the following test: a) it is administered with the promotion of the economic development and welfare of the developing countries as its main objective, and, b) it is concessional in character and contains a grant element of at least 25 percent.

official development finance The sum of official development assistance and less concessional official flows (other official development flows).

official export credit A loan to finance the purchase of goods from the creditor country, where the creditor is an agency or institution of the official sector of the country’s government, which can therefore influence the terms. See export credit and official export credit agency.

official export credit agency An agency within a creditor country that provides loans to finance the specific purchase of goods for export. These official export credits are used to
finance major capital goods such as aircraft or electrical generating equipment. Repayment terms may also be longer than on private-source export credits. Interest rates are normally related to the creditor government’s cost of borrowing plus a margin.

**official export credit guarantee**  
*(insurance) agency*  
An organization that provides guarantees or insurance to exporters against the risks of payment delays or default. Cover can be provided for commercial as well as political risk. Export guarantees are provided by government agencies, but Germany and the Netherlands conduct export credit insurance through private companies, subject to governmental direction.

**OOF**  
See other official flows.

**options menu**  
As part of commercial bank, and at some recent Paris Club rescheduling agreements, a set of possible terms is agreed upon this is the options menu. From this menu, the creditors can choose among alternative modalities of debt restructuring.

**Organization for Economic Co-operation and Development (OECD)**  
An association of twenty-four industrialized countries who pledge cooperation in: (1) sustaining economic growth and employment while maintaining financial stability; (2) contributing to “sound expansion” in member and non-member countries in the process of economic development; and (3) contributing to the “expansion of world trade on a multilateral, non-discriminatory basis.” To achieve these objectives, the OECD has established a number of specialized committees. The OECD came into force in September 1961, replacing the Organization for European Economic Co-operation which had been created to help coordinate Western Europe reconstruction from the Second World War. Headquarters: Paris, France.

**original schedule**  
The schedule of debt service payments that exists prior to debt restructuring. Reschedulings frequently require that some percentage of each payment be made according to the original schedule.

**other official development flows (ODF)**  
Less concessional development-oriented official flows. Multilateral other ODF consists of disbursements from the IBRD and regional development banks on terms that are too hard to qualify as ODA. Bilateral ODF includes mainly refinancing loans and the capitalization of interest in debt restructuring agreements.
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<tr>
<td>other official flows (OOF)</td>
<td>The resources transferred from donor governments which are not classified as official development assistance. This concept is used by the OECD to measure flows from DAC countries to developing countries and to multilateral organizations.</td>
</tr>
<tr>
<td>pari passu clause</td>
<td>A covenant of a borrower in a loan agreement that the loan will enjoy the same status as other obligations; i.e. that the loan will not be subordinated to the borrower’s other senior indebtedness.</td>
</tr>
<tr>
<td>par value</td>
<td>Under the fixed exchange rate system that existed from 1945–73, a par value stated the units of a nation’s currency per U.S. dollar at which the government would buy or sell its currency to maintain its value in foreign exchange markets. The U.S. dollar was linked to gold at the rate of $35 per ounce. Par values were established in agreement with the International Monetary Fund. After 1973 the system of par value fixed exchange rates was abandoned.</td>
</tr>
<tr>
<td>Paris Club</td>
<td>This is the forum in which debt restructuring has been provided since 1956 by official creditors. The common feature of participating creditor countries is that they each have a system of export credit insurance, because the primary type of claim rescheduled under the Paris Club is guaranteed (or insured) private export credits. The Chairman of the Club and a small secretariat are provided by the French Treasury.</td>
</tr>
<tr>
<td>percent of payments consolidated</td>
<td>The percentage of each payment included within the consolidation period of a rescheduling agreement that is to be rescheduled. Typically, some percentage is consolidated, while the balance is either written-off or paid according to the original payment terms. The consolidated amounts form the disbursed and outstanding amount of a new loan.</td>
</tr>
<tr>
<td>percentage cover</td>
<td>The proportion of any loss suffered by the exporter on which the export credit agency will pay claims.</td>
</tr>
<tr>
<td>PL 480</td>
<td>PL 480 provides for the sale of surplus United States farm products to developing countries; the grant of commodities to foreign governments; the barter of strategic materials and the export sale of surplus farm products under long-term credit arrangements. Title I deals with sales for foreign currencies. It spells out sales policies, the mechanisms for making maximum use of private trade channels and emphasizes marketing to developing countries.</td>
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</table>
TITLE II authorizes the transfer of United States farm products to foreign governments for economic development. 

TITLE III authorizes barter and the donation of surplus farm products to United States voluntary agencies carrying on overseas relief operations. 

TITLE IV provides for agreements with foreign governments and with private organizations for the dollar sales and delivery of United States surplus agricultural commodities for periods of up to ten years.

**political risk** The risk of actions by the government of the borrowing country that prevent, or delay, repayment.

**postjudgment attachment** See attachment.

**prejudgment attachment** See attachment.

**prepayment** The partial or full repayment or repurchase of outstanding loan principal and interest by the borrower. This may be made at a discount from the current outstanding principal.

**previously rescheduled debt** Debt that has been rescheduled on a prior occasion. This type of debt was generally excluded from further rescheduling in both the Paris and the London Club until 1983. Since then however, previously rescheduled debt has been rescheduled again for more than twenty countries facing acute payments difficulties.

**principal outstanding** The amount of principal disbursed and not repaid.

**principal repayment schedule** The repayment stream of principal by due date and installment amount.

**principal repayments** The payments which are made against the drawn and outstanding amount of the loan.

**private creditors** Lenders not part of the public sector, comprising bondholders (of bonds that are either publicly issued or privately placed), private banks and other private financial institutions, manufacturers, exporters and other suppliers of goods on credit.
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<tr>
<td>private nonguaranteed debt</td>
<td>The external obligation of a private debtor that is not guaranteed for repayment by a public entity of the debtor country.</td>
</tr>
<tr>
<td>promissory note</td>
<td>A written promise to repay a loan (either with or without interest). The note specifies the terms of the repayment of principal and interest, and can include the amount of principal installments, the rate of interest, the calculation of interest the due dates and the maturity date.</td>
</tr>
<tr>
<td>public debt</td>
<td>The external obligation of a public debtor, including the national government, a political subdivision (or an agency of either), and autonomous public bodies.</td>
</tr>
<tr>
<td>publicly guaranteed debt</td>
<td>The external obligation of a private debtor that is guaranteed for repayment by a public entity.</td>
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<tr>
<td>pull-back clause</td>
<td>This clause in a debt restructuring agreement declares that an agreed minute is “null and void” unless certain actions have been taken before specific dates.</td>
</tr>
<tr>
<td>refinance</td>
<td>The extension of a new credit, the proceeds of which are to be used to make payments due under a previously existing credit.</td>
</tr>
<tr>
<td>regional development banks</td>
<td>Multilateral organizations that are set up to provide and administer loans, normally at concessional terms, to member countries. Membership is limited to a geographic region.</td>
</tr>
<tr>
<td>reschedule</td>
<td>A scheme of debt restructuring in which some or all debt service falling due during a defined period (the consolidation period), possibly including amounts in arrears at the start of the period, will be consolidated and repaid on new terms. Effectively, the amounts involved form the outstanding amount of a new loan with terms defined at the time of the rescheduling. The rescheduled amounts may include both principal and capitalized interest. Rescheduling debt is one means of providing a debtor with a period of reduced debt service, as a means to allowing economic recovery.</td>
</tr>
<tr>
<td>rescheduling agreement</td>
<td>An agreement between a creditor, or a group of creditors to reschedule debt. The agreement may also include other debt restructuring strategies such as write-offs or swaps. See also Paris Club, and London Club.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>revolving credits</td>
<td>A loan agreement which makes repaid amounts available to be redrawn at the borrower's discretion.</td>
</tr>
<tr>
<td>roll over</td>
<td>Extension of credit is essentially routine and, upon repayment funds are relent to the same borrower for similar purposes.</td>
</tr>
<tr>
<td>SDR</td>
<td>See Special Drawing Rights.</td>
</tr>
<tr>
<td>secondary market</td>
<td>The market through which creditors sell ownership of loans. The loans are normally sold at a discount, the level of which is determined by the creditworthiness of the debtor.</td>
</tr>
<tr>
<td>service charges</td>
<td>All charges that must be paid as a price for the loan, such as: interest, commitment fees, management fees.</td>
</tr>
<tr>
<td>service payments</td>
<td>Amounts actually remitted by the borrower to repay a debt.</td>
</tr>
<tr>
<td>settlement date</td>
<td>This is the date by which a debtor is required to have cleared arrears not included in a rescheduling agreement. In the case of the Paris Club, the settlement date is often three months after the signing of the agreed minute.</td>
</tr>
<tr>
<td>sharing clause</td>
<td>A provision in a syndicated loan agreement requiring a lender which receives a disproportionate payment with respect to amounts due under the loan to share that payment ratably with the other lenders which are parties to the agreement.</td>
</tr>
<tr>
<td>short-term external debt</td>
<td>Debt that has an original maturity of one year or less.</td>
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<tr>
<td>sovereign debt</td>
<td>See public debt.</td>
</tr>
<tr>
<td>sovereign immunity</td>
<td>The legal doctrine that precludes judicial actions against a sovereign state or entity without its consent. Historically, sovereigns enjoyed absolute immunity. In most jurisdictions, sovereigns now enjoy only restricted immunity.</td>
</tr>
<tr>
<td>Special Drawing Rights (SDRs)</td>
<td>An international reserve asset created by the International Monetary Fund (IMF) and allocated to its members to supplement existing reserve assets. The SDR was created in 1970. It was designed to be an international payments facility that would supplement gold and dollars in settling balance</td>
</tr>
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</table>
of payments accounts. The IMF must determine that there is a long-term global need to supplement existing reserve assets before allocating SDRs. The last allocation was made on January 1, 1981. SDRs can be exchanged through the IMF for national currencies, or held by a country as reserve. They are only traded between central banks, they are not used in commercial transactions. The SDR is the unit of account of the IMF and of other international and regional organizations. The SDR value is determined daily as the weighted average of the deutsche mark, French franc, Japanese yen, pound sterling and the US dollar. The weights are based on relative values of exports of goods and services and of their relative importance as reserve assets.

**spread (or margin)** A percentage to be added to some defined base interest rate, such as LIBOR, to determine the rate of interest to be used for a loan.

**stand-by arrangements** An understanding between the IMF and a member country that purchases can be made under that country’s credit tranche facilities up to an agreed amount during a specified time period—typically 12-18 months. IMF resources are made available under stand-by arrangements in installments, and conditions must be met regarding, typically, credit policy, government or public sector borrowing, foreign trade policies and use of foreign credits.

**Standstill** This is an interim agreement between a debtor country and its commercial banking creditors that principal repayments of medium- and long-term debt will be deferred and that short term obligations will be rolled over, pending agreement on a debt reorganization. The object is to give the debtor continuing access to a minimum of trade-related financing while negotiations take place and to prevent some banks from abruptly withdrawing their facilities at the expense of others.

**stock of debt** The amount outstanding as of a moment of time. Examples are: disbursed and outstanding debt (the amount drawn and not yet repaid); undisbursed balance (the amount of a loan commitment that is still available to be drawn); arrears (amounts which were due but have not yet been paid). The concept of debt stock contrasts with that of financial flows, which measures transactions during a given period of time.

**suppliers credit** A loan extended by an exporter to finance the purchase of that exporter’s goods or contractual services. See also export credit.
swaps

The exchange of debt or debt servicing liability for example: for debt with different terms (currency swaps or interest rate swaps), some form of equity in an enterprise (debt/equity swap), or for application of the equivalent funds with the objective of preserving the environment (debt for nature swap).

technical cooperation grants

Two basic types of technical cooperation exist:

FREE STANDING TECHNICAL COOPERATION (FTC) which is the provision of resources aimed at the transfer of technical and managerial skills or of technology for the purpose of building up general national capacity without reference to the implementation of any specific investment projects.

INVESTMENT RELATED TECHNICAL COOPERATION (IRTC) which is the provision of resources directly aimed at strengthening the capacity to execute specific investment projects.

tied aid credits

Loans or grants or associated financing packages containing a grant element of greater than zero percent which are limited to the procurement of goods and services from the donor country. If no such restriction exists, it is termed untied aid.

Toronto Terms

Special rescheduling terms for heavily-indebted low-income countries that were in effect from October 1988 until December 1991, when they were supplanted by the “Enhanced Toronto Terms”. Originally eligibility for these terms was limited to “IDA-only” countries in Sub-Saharan Africa. The terms have now been extended to IDA-only countries outside Africa. Toronto terms were innovative in that creditors could select a modality of debt relief from a menu of three options:

OPTION A: PARTIAL CANCELLATION — one third of the consolidated debt service is cancelled and the remaining two thirds is rescheduled over 14 years, including an 8 year grace period. A market based interest rate is charged on the rescheduled amount.

OPTION B: EXTENDED MATURITIES — the consolidated debt service is rescheduled over 25 years, including a 14 year grace period. A market based interest rate is charged on the rescheduled amount.

OPTION C: CONCESSIONAL INTEREST RATES — the consolidated debt service is rescheduled over 14 years, including an 8 year grace period. The interest rate charged on the rescheduled amount is the market rate reduced by 3.5 percentage points, or by half if the market rate is less than 7 percent.

ODA DEBT — the above options apply to commercial credits (in this con-
text defined as direct or guaranteed export credits). All creditors are expected to reschedule their ODA loans over 25 years, including a 14 year grace period. The interest rates are to be at least as favorable as the original terms for these loans.

Under the Enhanced Toronto Terms, there are two main options:

**PARTIAL DEBT CANCELLATION** — write-off 50 percent of debt service due during a defined consolidation period and reschedule the remainder over 23 years, including six years grace. Moratorium interest is set at market rates.

**DEBT SERVICE REDUCTION** — reschedule debt over 23 years, but with no grace period, setting moratorium interest at a rate sufficiently low to reduce the present value of debt service by 50 percent.

One major Paris Club creditor country was unable to offer concessional debt relief; it offers Option B as under the original Toronto Terms. A key feature of this new approach is that the Paris Club will meet to consider restructuring the remaining stock of debt following three to four years following signature of the first Enhanced Toronto Terms agreement. This action is contingent on successful implementation of the signed Paris Club accords, continuation of IMF programs and comparable debt relief with other creditors.

**tranche**
A set of disbursements under a loan, the repayment of which are under their own specific terms, rather than under a set of general repayment terms established to govern repayment of amounts outstanding as a result of all disbursements.

**transfer clause**
A provision that commits the debtor government to guarantee the immediate and unrestricted transfer of foreign exchange in all cases where the private sector pays the local currency counterpart for servicing its debt to the Paris Club creditors.

**trigger clause**
Such clauses are typically included in MYRAs. They automatically trigger the effectiveness of later phases of the agreements when certain conditions are met. Most of the trigger clauses are linked to the satisfactory conclusion of the periodic reviews under the IMF program.

**Trinidad Terms**
At a meeting in Trinidad, Mr. John Major (currently Prime Minister of the United Kingdom) suggested that the Toronto scheme could be replaced by what has come to be called the Trinidad scheme. Under this proposal,
the whole stock of eligible debt would be restructured, instead of only the debt service due during the consolidation period. Two thirds of the debt would be cancelled. The remainder would be repaid over 25 years with a complete moratorium on payments during the first five years. The interest payments during the first five years would be capitalized and repaid over the subsequent 20 years. Mr. Major also proposed that the payments would be graduated, i.e. steadily growing to better fit the increasing export capacity of the debtor country. While Trinidad Terms were not adopted, debate led to the Paris Club’s Enhanced Toronto Terms.

**undisbursed balance** The amount of a loan commitment that is still available to be drawn.

**untied aid** See tied aid credits.

**variable interest rate** A rate of interest that is computed by adding a spread to a predetermined base rate. For example, 1.25% over LIBOR. Compare fixed interest rate.

**Venice Terms** Extended repayment terms that were extended by the Paris Club to low-income countries in 1987-1988 prior to the adoption of the Toronto Terms.

**World Bank Group** The “World Bank” refers to the International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA). The “World Bank Group” consists of the World Bank plus the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The World Bank Group’s objective is to raise living standards in developing countries by channeling financial resources from developed countries.

IBRD — Established 1945; membership in June 1993 of 176 countries. Capital subscribed by member countries; lending operations financed mainly by borrowing in world capital markets. With loan maturities between 15-20 years with 5-years grace and interest rates related to the cost of borrowing, IBRD loans are directed towards relatively advanced developing countries. The IBRD and IDA, in addition to lending funds, provide economic advice and technical assistance and serve as a catalyst to investment by others.

IDA — Established 1960. Lending operations financed principally by periodic contributions (“replenishments”) from developed countries, supplemented by transfers from net earnings of the IBRD. Loan maturities are
30-40 years with 10-years grace; interest free but 0.075% service charge. Eligibility for IDA credits limited to very poor countries, those with an annual per capita gross national product of $765 or less (in 1991 dollars).

IFC — Established 1956. Promotes growth in the private sector of member countries by helping mobilize domestic and foreign capital for this purpose: it lends and invests to private enterprises without a host government guarantee. (IBRD loans and IDA credits, in contrast, are to governments or must be guaranteed by the host government.)

MIGA — Established 1988. Encourages equity investment and other direct investment flows to developing countries through the easing of non-commercial investment barriers.

The World Bank has traditionally financed infrastructure, such as roads and railways, but at the center of its development strategy are investments that affect directly the well-being of the masses of poor people by making them more productive. World Bank poverty reduction efforts include investments in education, the environment and the expansion of economic opportunities for women. Headquarters: Washington, D.C., USA.

The reduction of the disbursed and outstanding debt or payments due through forgiveness of the amounts by the creditor. Compare cancellation.
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