Distr.
GENERAL
E/ESCWA/GRID/2004/5
1 November 2004
ORIGINAL: ENGLISH

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

EXTERNAL DEBT MANAGEMENT AND THE DEBT SITUATION IN THE ESCWA REGION: CASE STUDIES ON JORDAN AND LEBANON

United Nations
New York, 2004

05-0042

Distr.
GENERAL
E/ESCWA/GRID/2004/5/Corr.1
15 June 2005
ORIGINAL: ENGLISH

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

EXTERNAL DEBT MANAGEMENT AND THE DEBT SITUATION IN THE ESCWA REGION: CASE STUDIES ON JORDAN AND LEBANON

Corrigendum

Page 19, line 2

For $21 million read $21 billion.

05-0388

Preface

This study was produced by the Economic and Social Commission for Western Asia (ESCWA) and represents one of the activities completed under its programme of work for the biennium 2004-2005. The study has been carried out under the umbrella of the Monterrey Consensus, an outcome of the International Conference on Financing for Development (Monterrey, Mexico, 18-22 March 2002), bearing in mind the responsibility assigned to ESCWA to monitor progress made by its 13 members in improving regional access to financing for development. In response to that responsibility, and in recognition of the inclusion of debt relief and debt management within the framework of the Monterrey Consensus, ESCWA undertook the task of producing a study on the external debt situation in the ESCWA region, incorporating case studies on two heavily-indebted ESCWA member countries, namely, Jordan and Lebanon.

During the preparation of this study, ESCWA sought the assistance of Ibrahim Saidi and Bashir Al Zu'bi, who worked as consultants on the case studies.

CONTENTS

LIST OF TABLES

CONTENTS (*continued*)

Page

LIST OF CHARTS

ABBREVIATIONS AND EXPLANATORY NOTES

AFESD	Arab Fund for Economic and Social Development
AMF	Arab Monetary Fund
BIS	Bank for International Settlements
BSE	Beirut Stock Exchange
CD	Certificate of Deposit
CDR	Council for Development and Reconstruction
DAC	Development Assistance Committee
DMFAS	Debt Management and Financial Analysis System
DSA	debt sustainability analysis
ECES	Egyptian Centre for Economic Studies
EIB	European Investment Bank
EIU	Economist Intelligence Unit
EMTN	Euro Medium Term Note
€	euro
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GDP	gross domestic product
GNI	gross national income
HDI	Human Development Index
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Islamic Development Bank
IRFFI	International Reconstruction Fund Facility for Iraq
IMF	International Monetary Fund
JD	Jordanian dinar
KFAED	Kuwait Fund for Arab Economic Development
LDC	Least developed country
LL	Lebanese pound
MDG	Millennium Development Goals
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PPP	purchasing power parity
PRSP	Poverty Reduction Strategy Paper
T-bills	Treasury bills
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNITAR	United Nations Institute for Training and Research
VAT	value added tax
WADMO	World Association of Debt Management Offices
WTO	World Trade Organization

The following symbols have been used throughout the study:

A hyphen (-) indicates that the item is not applicable.
A dash (–) indicates that the amount is nil or negligible.
Two dots (..) indicate that data are not available or are not separately reported.
Parentheses ( ) indicate a deficit or a decrease, except as otherwise stated.
References to dollars ($) are to United States dollars, unless otherwise stated.

Executive summary

Participants at the International Conference on Financing for Development, which was held in Monterrey, Mexico from 18 to 22 March 2002 agreed that market forces alone could not achieve the United Nations Millennium Development Goals (MDGs). With this in mind, the Monterrey Consensus—an outcome of the Conference—identified six actions as being key to mobilizing financial resources for developing countries and thus facilitating the goal of reducing poverty. These actions included external debt relief, which is one of the components of Official Development Assistance (ODA), and also sustainable debt management. The issue of debt relief for the highly indebted developing countries and sustainable debt management strategies for low- and middle-income developing countries has been addressed through such ad hoc creditor associations as the Paris Club (also known as the Paris Club of Industrial Country Creditors), the London Club and the multilateral lending community through the Heavily Indebted Poor Countries (HIPC) Initiative, which was launched in 1996 by the International Monetary Fund (IMF) and the World Bank. Current debt relief and future access to debt financing are vital components in the economic development of the heavily debt-burdened economies of the Economic and Social Commission for Western Asia (ESCWA) region.

Current worldwide external debt problems began during the 1970s when international banks began to lend in earnest to developing countries, in the mistaken belief that sovereign Governments would always pay their debts, while apparently ignoring the fact that several countries had defaulted in the past. A number of developing countries faced debt-servicing problems and the international debt crisis began to unfold in the 1980s. Several international factors contributed to the debt crisis of the 1970s and 1980s, namely, a surge in oil prices, recession in the industrialized countries, high interest rates and weak commodity prices. Internal shocks also contributed to the debt crisis in developing countries, and these included high budget deficits, poor performance of debt-financed investment projects, low savings rates and massive capital flight.

External debt is held by developing countries in all regions of the world, with the highest level of debt in the Latin America and the Caribbean region, at $727.9 billion in 2002. The transitional economies in Europe and Central Asia held $545.8 billion, while the developing countries of East Asia and the Pacific held $497.4 billion in external debt. Total external debt for the six heavily-indebted ESCWA member countries, namely, Egypt, Jordan, Lebanon, Oman, Syrian Arab Republic and Yemen, amounted to approximately $87.4 billion in 2002. Estimates of Iraqi external debt, currently in arrears, range widely from $62 billion to $320 billion. Unless significant amounts of Iraqi debt are forgiven, this will add considerably to the debt burden of the ESCWA region. Among the six heavily-indebted ESCWA member countries, Egypt had the largest external debt in 2002, at $30.8 billion. The Syrian Arab Republic and Lebanon were close behind with $21.5 billion and $17.1 billion, respectively. When debt is considered relative to population, the country with the highest external debt per capita ratio in 2002 was Lebanon, with $3,881 per person owed to foreign creditors. Based on the external debt estimate of $89 billion in 2002, Iraq faced a comparably high per capita debt burden of $3,700 per person at that time. External debt per capita in Oman amounted to $1,933 in 2002, while Jordan and the Syrian Arab Republic bore per capita debt burdens of $1,557 and $1,265, respectively. The external debt per capita ratio for Egypt was one of the lowest in the region at approximately $463. Moreover, despite the fact that Yemen is the least developed member of ESCWA and has the lowest per capita income, its external debt per capita ratio was the lowest at this time, at $264.

Indicators of the burden of external debt on the economy of a country include the ratio of external debt to national income. Among the debt-burdened ESCWA member countries, the Syrian Arab Republic had the highest ratio at 108 per cent in 2002. Lebanon and Jordan followed with ratios of 94 per cent and 88 per cent, respectively. Egypt and Oman enjoyed significantly lower ratios of debt to national income, at 34 and 23 per cent, respectively. The debt to income ratio of Yemen, the only least developed country in the region, was moderate at 57 per cent. Another indicator of debt burden is the ratio of external debt to export earnings, which is based on the fact that external and foreign currency denominated debt must be paid with foreign exchange earnings, not local currency. According to this ratio, the most heavily-burdened ESCWA economy was Lebanon, with external debt amounting to over 700 per cent of export earnings in 2002. Both Egypt and the Syrian Arab Republic had ratios over 200 per cent in 2002, while Jordan had a ratio of 193 per cent for the same year, which was only slightly below that of Egypt. It is also possible to consider the share of long-term debt to total external debt on the basis that it indicates the burden of external debt in terms of how quickly principal must be repaid. In this regard, Egypt, Jordan, Lebanon and Yemen have relatively high ratios, which can partially be attributed to restructuring and economic reforms undertaken in the 1990s. Oman and the Syrian Arab Republic, however, were more heavily dependent on short-term debt, which accounted for over 25 per cent of their external debt burdens in 2002.

The composition of debt in the ESCWA region varies by individual country. Bilateral sovereign debt can be owed to single Governments or to their authorized institutions, for example, the Paris Club creditors, which include Kuwait and the United Arab Emirates, both ESCWA member countries, private suppliers, for example, commercial banks and bond-holders. Egypt and the Syrian Arab Republic hold the highest share of bilateral debt relative to total external debt of all ESCWA member countries for the period 1999-2002, at 84 and 96 per cent, respectively. The countries with the highest shares of multilateral debt relative to total debt were Lebanon and Oman, both at 71 per cent. Most of the debt-burdened economies of the ESCWA region currently have a high share of long-term debt. For example, Egypt, Jordan, Lebanon and Yemen held more than 80 per cent of their external debt with long-term maturities during the period 1999-2002. Egypt, Jordan, Lebanon, Syrian Arab Republic and Yemen depend most heavily on public sector creditors for their debt financing. However, the Gulf Cooperation Council (GCC) States have substantial collateral and future earnings, which facilitates access to private sector bank loans and securities' investors to finance development projects. For example, 43 per cent of external debt in Oman was financed by the private sector, while in neighbouring Yemen, there is no privately financed sovereign debt.

Numerous external factors have a negative impact on the debt situation in the countries of the ESCWA region, including regional conflicts, economic sanctions, inadequate flows of ODA and foreign direct investment, in addition to a scarcity of resources. Furthermore, certain domestic factors have hindered sustainable debt management in the region, for example, poor governance, weak tax administration, corruption and a lack of transparency. The external debt situations of heavily-indebted ESCWA member countries, namely, Egypt, Iraq, Syrian Arab Republic and Yemen are examined in detail within the study, and summarized in chapter V.

Jordan and Lebanon were chosen as case studies owing to the significant differences in their external debt situations and their solutions for sustainable debt management. These countries are good examples of the complexity of the external debt situation, both in terms of how a developing country can become heavily-indebted, possible means of resolving a debt crisis and developing sustainable debt management practices. The debt situations of these countries are examined in great detail in chapters III and IV, and summarized in chapter V.

Recommendations for heavily indebted ESCWA member countries and their creditors include the following: (a) international and regional creditors must increase ODA (debt relief) to the relevant countries as agreed within the framework of the Monterrey Consensus; (b) Governments in the ESCWA region must continue to exert efforts to reform their fiscal systems; (c) efforts must be exerted to improve the transparency of medium- to long-term debt management strategies, which are essential for encouraging private investors to hold public debt, thereby relieving the banking sector from directly holding a high proportion of public debt; (d) Governments must continue to exert efforts to privatize State-owned enterprises, using some of the proceeds to pay down debt principal; (e) Governments must continue to exert efforts to reform banking and financial regulations to provide sound domestic and regional investment environments; and (f) Governments must continue to exert efforts to build the capacities of their officials and upgrade their skills in the systematic collection of debt statistics and utilization of debt management software, namely, the Debt Management and Financial Analysis System of the United Nations Conference on Trade and Development. In this regard, ESCWA is a useful venue for assisting member countries through capacity-building activities in debt management.

Introduction

Participants at the International Conference on Financing for Development, which was held in Monterrey, Mexico from 18 to 22 March 2002 agreed that market forces alone could not achieve the United Nations Millennium Development Goals (MDGs). They also highlighted the fact that discretionary policies on the part of developed and developing country Governments were necessary to ensure that the benefits of globalization extended to developing countries. With this in mind, the Monterrey Consensus—an outcome of the Conference—identified six actions as being key to mobilizing financial resources for developing countries and facilitating poverty reduction, including that of pursuing external debt relief and sustainable debt management. This action is the subject of the present study on the external debt situation and debt management in member countries of the Economic and Social Commission for Western Asia (ESCWA). Moreover, it is an important issue in a regional context in terms of the need for sovereign debt financing to mobilize the necessary financial resources for economic development in the ESCWA region.

For the purposes of this study, external debt refers to sovereign debt owed by Governments or their authorized institutions. Debt owed outside the country, as opposed to domestic debt, places the Government and its citizens at risk of default in international financial markets. Moreover, external debt servicing must be paid from foreign exchange and therefore it exhausts export earnings and strains foreign currency reserves. Bilateral sovereign debt is owed to single Governments or their authorized institutions, namely, the Paris Club creditors, private sources, for example, commercial banks and bondholders. Multilateral creditors include such international financial institutions as the International Monetary Fund (IMF) and the World Bank, and also regional multilateral lenders, for example, the Arab Monetary Fund (AMF). The maturity of external debt is an important factor in determining the ability of a country to prevent default during a domestic economic crisis. Maturity of one year or less is considered short-term debt.

The debt situation varies considerably from one ESCWA member to another. Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates and Yemen all have different resources and population endowments. For example, some ESCWA member countries are labour importers with a good endowment of resources, namely, the Gulf Cooperation Council (GCC) States of Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and United Arab Emirates. High oil export revenues relative to population density mean that these countries have adequate domestic finances and easy access to international credit for oil- and gas-related development projects. Member countries with good endowments of resources but relatively large and poor populations, for example, the Syrian Arab Republic and Yemen, are not as well equipped to finance economic development. Finally, member countries with poor endowments of resources, low private savings rates relative to investment needs and large, poor populations, namely, Egypt, Jordan and Lebanon, have struggled to finance their economic development and relied, perhaps excessively, on external debt financing.

Chapter I provides a theoretical background to this study, and examines the debt situation in general, while chapter II reviews the debt and debt management situation in the region and with regard to individual ESCWA member countries.

In-depth case studies on Jordan and Lebanon are provided in chapters III and IV respectively, and conclusions and recommendations are presented in chapter V.

I. THEORETICAL BACKGROUND AND GENERAL DEBT SITUATION

A. THEORETICAL BACKGROUND: DEBT AND DEBT MANAGEMENT

Governments have three sources of revenues, namely, taxation, money printing and borrowing. Direct taxation through import duties, and income and sales taxes may be a limited source of revenue for a developing country as a result of low economic activity or the small size of the formal sector of the economy. Money printing provides revenues in that it can be an indirect form of taxation. However, printing money to raise revenues has negative consequences in terms of efficiency and equity, while financing through taxes often entails unacceptable sacrifices from the present generation in terms of financing capital projects that will benefit future generations.[1] With regard to borrowing, while it has its costs, particularly the burden of debt servicing, fiscal deficits and public debt have several benefits. Deficits eliminate the need for Governments to synchronize expenditure outflows with inflows from taxes and money printing in the short run.[2] Moreover, fiscal deficits serve to even out the cyclical nature of government revenues. For example, during a recession, tax revenues naturally fall, while demand for government services usually increases. In the event that a Government is limited to utilizing current earnings for spending purposes, the level of government services falls at the precise time that they are most needed by the people. Numerous developing countries are dependent on commodity exports, leaving their tax revenues vulnerable to international price swings in the traded commodity. By incurring a deficit during a recession or when international commodity prices are low and then repaying the deficit during an economic upturn, a Government may be able to provide better social services. Short-run cyclical deficit spending does not necessarily lead to excessive debt burdens on a healthy economy. Indeed, deficit spending has become an important activity for developing countries where stagnant private sector growth and large informal markets hinder tax revenue collection, and where the daily need for basic government services, including health care and education, puts a significant wedge between government revenues and the expenditures needed to reduce poverty and stimulate economic growth. Unfortunately, deficit financing of current consumption, as opposed to government investment in productive assets, can lead to debt servicing problems and default. Sustainable debt management requires sound investment decisions to ensure that future income is sufficient for the repayment of borrowed funds.

Another function of public debt is to finance intergenerational investment. When one generation of taxpayers invests in capital that will benefit future generations, debt financing allows those future generations to share in the cost of the investment, based on the fact that they will enjoy the benefit of future earnings.[3] For example, "using bank loans to finance projects whose real rate of return exceeded the real interest rate would allow higher future output at no cost in foregone current consumption".[4] Developing countries are able to benefit from government borrowing when funds are used judiciously to promote sustainable development. However, "borrowing to finance consumption or investment projects yielding returns below the interest rate … lead[s] to grief, either for the borrowing country which has to service the debt out of export earnings (leaving less to pay for imports) or to the lending bank", if the indebted country defaults on the loan.[5]

B. THE DEBT SITUATION AROUND THE WORLD

Current, worldwide external debt problems began during the 1970s, when international banks began lending in earnest to developing countries in the mistaken belief that sovereign Governments would always pay their debts, while apparently ignoring the fact that several countries had defaulted on their debts in the

---

1 Peter J. Montiel, "Debt management and macroeconomic stability", a paper presented at the Egyptian Centre for Economic Studies (ECES) conference on Fiscal Sustainability and Public Expenditures in Egypt, (Cairo, 19-20 October 2003), p. 5.

2 Robert J. Barro, *Macroeconomics*, (New York, John Wiley and Sons, 1984), p. 385.

3 Peter J. Montiel, "Debt management and macroeconomic stability", a paper presented at ECES conference on Fiscal Sustainability and Public Expenditures in Egypt, (Cairo, 19-20 October 2003), p. 5.

4 Richard Pomfret, *Diverse Paths of Economic Development*, (New York, Prentice Hall, 1992), p. 154.

5 Ibid, p. 154.

past.[6] A number of developing countries faced debt-servicing problems and an international debt crisis began to unfold in the 1980s. Several international factors contributed to the debt crisis in the 1970s and 1980s, when there was a surge in oil prices, recession in industrialized countries, high interest rates and weak commodity prices. Internal shocks also contributed to the debt crisis in developing countries, for example, high budget deficits, poor performance of debt-financed investment projects, low savings rates and massive capital flight.[7] The inability of some countries to meet their debt-servicing requirements put pressure on the international banking sector and threatened to become an international banking crisis. For example, 24 countries defaulted on loan payments in 1982. However, schemes to combat the problem were devised, including the 1985 Baker Plan, which incorporated debt rescheduling and new loans to prevent such an international banking crisis.[8] However, despite the fact that the international banking sector was able to recover, indebted countries were faced with rising debt and debt servicing obligations and a development crisis as government revenues and growing shares of export earnings were diverted to repay debt. The 1989 Brady Plan called for reductions in debt and debt servicing.[9]

Total external debt worldwide amounted to $2,338.7 billion in 2002. The total external debt for the six debt-burdened ESCWA member countries, namely, Egypt, Jordan, Lebanon, Oman, Syrian Arab Republic and Yemen, amounted to $87.4 billion. The largest share of this amount belonged to Egypt and the Syrian Arab Republic, for which external debt amounted to $30.8 billion and $21.5 billion, respectively. The share of external debt held as medium- to long-term loans averaged above 80 per cent for all regions of the world in 2002, with Latin America and the Caribbean, and also South Asia having the highest percentages (see table 1). The ESCWA region had an average ratio of 83 per cent external debt, which was carried as medium- to long-term loans. The sovereign Governments of the three regions of East Asia and the Pacific, Europe and Central Asia, and Latin America and the Caribbean had the lowest share of external debt, at less than 60 per cent. This figure suggests that the private sectors in these regions were successfully acquiring external financing. The percentage of total external debt owed to public institutions, as opposed to private sector lenders, was highest for the South Asia and Sub-Saharan Africa regions.

The circumstances of external debt financing differ for each country in the ESCWA region. The regional averages in table 1 cannot show which countries experienced debt flows in opposite directions from the regional averages. However, a number of observations can be made based on the information on net debt inflows for the region. First, the Europe and Central Asia region had the largest inflows of external debt in 2002, at $24.9 billion. In addition, this region made greater use of private creditors, as opposed to such official creditors as the World Bank and IMF, than other regions did. This situation can be attributed to the fact that the Europe and Central Asia region includes countries with economies in transition, which have basic infrastructure, education levels, political stability and other features that attract private lenders. By contrast, countries in other developing regions, including the ESCWA region rely more heavily on official lending sources. These government and multilateral institutions provide better terms with concessional loans as compared to private creditors.

The East Asia and Pacific region and the Latin America and the Caribbean region exhibited net debt outflows in 2002, indicating that they focused more on repaying previous debts than creating new loans in 2002 (see table 2). This regional average does not imply that countries in these regions did not experience net debt inflows or debt crises. Moreover, short-term debt versus medium- to long-term debt is crucial in analysing the potential of a country for default and the burden of debt servicing, as long-term indebtedness tends to be easier to manage than short-term loans. The external debt inflows of the Europe and Central

6 Ibid, p. 154.

7 Nigel M. Healey, "The international debt crisis", *Introduction to Development Economics*, third edition, Subrata Ghatak (ed.), (London and New York, Routlege, 1995).

8 The Baker Plan is named after former United States Treasury Secretary, James Baker. It called for banks to continue to lend to developing countries with the condition that debtor countries should adopt structural reform programmes that would allow them to repay their external debt in full. Ibid, p. 436.

9 The Brady Plan is named after former United States Treasury Secretary, Nicholas Brady. It relied on debt forgiveness as opposed to increased lending to indebted developing countries as a means of solving their debt crises. Ibid, p. 443.

Asian region in 2002 were mainly medium- to long-term. The East Asia and Pacific region had a net outflow of medium- to long-term external debt in 2002, while short-term debt inflows increased, raising the likelihood of a financial crisis within that region. However, regional averages of debt flows can be misleading. For example, in the ESCWA region, Egypt experienced a net outflow $0.6 billion in 2002, while Lebanon received a net inflow of $4.4 billion, which was primarily a factor of the debt-swap policy of the Government of Lebanon, whereby domestic currency debt was replaced with United States dollar-denominated eurobonds. Therefore, given that the debt situation in each ESCWA member country is unique, regional averages of external debt statistics must be interpreted with caution, and the circumstances of debt-burdened countries in the region must be examined on an individual basis.

TABLE 1. TOTAL EXTERNAL DEBT BY REGION, 2002

World Bank regional classifications	Total external debt	Medium- and long-term debt	Owed by the Government	Owed to public creditors
	(Billions of US dollars)	(Percentage)		
East Asia and the Pacific	497.4	80	56	37
Europe and Central Asia	545.8	86	57	30
Latin America and the Caribbean	727.9	90	58	25
Middle East and North Africa	189	80	77	48
ESCWA region[a/]	87.4	83	..	..
South Asia	168.3	96	88	63
Sub-Saharan Africa	210.3	86	80	68

Source: World Bank, *Global Development Finance 2004 – Harnessing Cyclical Gains for Development*, Appendix B: Summary statistical tables B.2-B.7, (World Bank, 2004), pp. 179-184.

Notes: Two dots (..) indicate that data are not available or are not separately reported.

a/ Excluding Bahrain, Iraq, Kuwait, Palestine, Qatar, Saudi Arabia and United Arab Emirates, owing to the unavailability of data.

TABLE 2. NET INFLOWS OF EXTERNAL DEBT BY REGION, 2002[a/]
(Billions of US dollars)

Region	Net debt inflow	From official creditors	From private creditors	Net medium- to long-term inflows	Net short-term inflows
All developing countries	7.3	4.1	3.2	1.8	1.4
East Asia and Pacific	(10.9)	(7.8)	(3.1)	(10.8)	7.7
Europe and Central Asia	24.9	2.2	22.7	21.2	1.4
Latin America and the Caribbean	(7.9)	12.7	(20.6)	(11.6)	(9.0)
Middle East and North Africa	0.9	(2.8)	3.8	3.0	0.8
Egypt	(0.6)	(0.7)	0.1	..	0.1
Lebanon	4.4	0	4.4	..	(0.1)
South Asia	0.4	(2.4)	2.8	0.5	2.3
Sub-Saharan Africa	(0.1)	2.2	(2.2)	(0.5)	(1.8)

Source: World Bank, *Global Development Finance 2004 – Harnessing Cyclical Gains for Development*, Appendix B: Summary statistical tables B.21 to B.26, (World Bank, 2004), pp. 198-203.

Notes: Parentheses ( ) indicate a negative amount.
Two dots (..) indicate that data are not available or are not separately reported.

a/ Excluding Bahrain, Iraq, Kuwait, Qatar, Saudi Arabia, United Arab Emirates and Palestine, owing to the unavailability of data.

C. INTERNATIONAL EFFORTS AIMED AT ACHIEVING SUSTAINABLE DEBT MANAGEMENT

The need for debt relief and sustainable debt management for debt-burdened developing countries has been addressed through various bilateral and multilateral bodies, namely, the Paris and London Clubs, Heavily Indebted Poor Countries (HIPC) Initiative, the United Nations Conference on Trade and Development (UNCTAD) Debt Management and Financial Assistance System (DMFAS) Programme and the Monterrey Consensus. These bodies are briefly reviewed below.

1. *The Paris and London Clubs*

The Paris Club is a non-institutional group of 19 governmental creditors and their institutions, which coordinate efforts to assist indebted countries in meeting their external financial obligations to Paris Club members.[10] The London Club, which comprises commercial banks, was founded in the 1970s. It has similar goals to the Paris Club, preferring partial debt relief for troubled debtors rather than default.[11] Paris Club assistance follows the guidelines of its Agreed Minutes and can include debt reduction, debt restructuring and dispute settlement between creditor and debtor countries. The Paris Club agreements incorporate a number of provisions, including comparability of treatment, debt swaps, *de minimis*, date of payment of non-consolidated amounts, entry-into-force, free transferability, goodwill clause, pullback and special account. Debtor countries that are eligible for Paris Club agreements are usually recommended by IMF after reform programmes and austerity measures have failed. In December 1994, the Paris Club agreed to implement the Naples terms, a new debt treatment which permitted debt cancellation for the poorest and most indebted countries at a rate of at least 50 per cent. In 1999, these terms were raised to 67 per cent.

A number of ESCWA member countries have benefited from debt relief under Paris Club debt treatments. A Paris Club agreement for Egypt was applied to approximately $21.2 billion of arrears as of 30 June 1991. Yemen received Paris Club treatment in 1996 for $112 million under the Naples terms. In 1997, Yemen received treatment for arrears that included rescheduling of non-Official Development Assistance (ODA) credits over a 23-year period and repayment of ODA credits over a 40-year period. In 2001, Yemen received Paris Club treatment on $420 million, of which $25 million was cancelled and $395 million was rescheduled under the Naples terms. Jordan received Paris Club treatments in 1989, 1992, 1994, 1997, 1999 and 2002. In 2002, Jordan received treatment on $1,170 million, including rescheduling of non-ODA credits over an 18-year period and repayment of ODA credits over a 20-year period.[12]

Debt relief is a component of ODA and one of the development financing activities within the framework of the Monterrey Consensus. Debt relief as a form of aid is controversial in that some people believe that countries that lack fiscal responsibility are rewarded through debt relief packages, while developing countries that successfully manage their debt are not recompensed. In addition, Governments that benefit from debt relief may be less likely to improve debt management practices or undertake the necessary fiscal reforms and austerity measures. Others believe that debts incurred under unusual circumstances, for example, wars, occupation, or dictatorship, should be forgiven. One example of this is the excessive debt burden of the Iraqi people, which has initiated discussions in the international community with regard to partial debt forgiveness. Discussions of Iraqi debt relief are fuelled by the high costs related to reconstruction of infrastructure and the concern that debt "incurred by a dictator for personal and nefarious purposes should be considered illegitimate and that the country's citizens should not be considered responsible for repaying

---

[10] Members of the Paris Club meet once every six weeks, and its permanent members include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland and United States of America. Non-member creditor countries are invited on a case-by-case basis, and these include: Argentina, Brazil, Israel, Korea, Kuwait, Mexico, Morocco, New Zealand, Portugal, South Africa, Trinidad and Tobago, Turkey and United Arab Emirates. See Paris Club. Available at: http://www.clubdeparis.org/en.

[11] Brendan I. Koerner, "What is the Paris Club?", 5 May 2003. Available at: http://slate.msn.com/id/2082575.

[12] Paris Club. Available at: http://www.clubdeparis.org/en.

this debt".[13] In economic terms, Egypt, Jordan, Lebanon, Palestine and Syrian Arab Republic have all suffered from regional conflicts and instability, which have hindered FDI flows and the development of their tourism sectors, in addition to slowing down their economic growth in general. Regardless of the controversy, the share of debt relief in total ODA by Development Assistance Committee (DAC) donor countries rose significantly in 2002, from 4 to 6 per cent during the period 1996-2001 to over 9 per cent in 2002 (see table 3).[14]

TABLE 3. WORLDWIDE OFFICIAL DEVELOPMENT ASSISTANCE AND DEBT RELIEF, 1996-2002
(Billions of US dollars)

Type of aid	1996	1997	1998	1999	2000	2001	2002
ODA	55.6	48.5	52.1	56.4	53.7	52.3	58.3
Debt relief	3.4	3.1	3	2.3	2	2.5	5.3

Source: World Bank, "The changing landscape for official flows", *Global Development Finance 2004 – Harnessing Cyclical Gains for Development*, Box. 4.1, (World Bank, 2004), pp. 109.

2. *The Heavily Indebted Poor Countries Initiative*

The World Bank and IMF launched the HIPC Initiative in 1996[15] to address the problem of growing debt-servicing burdens relative to income growth and export earnings. The Initiative was revised in 1999 to combine traditional debt relief with country-specific policy reforms to boost long-term economic growth and encourage sustainable debt management. In order to qualify for participation in the HIPC Initiative, countries must face an unsustainable debt burden and have a history of IMF and World Bank sponsored economic reforms. Participants are the poorest and most indebted countries, many of which are in Africa. In 2002, the total cost of assistance to 34 countries within the framework of the HIPC Initiative was $39 billion, half of which was provided by bilateral creditors and half by multilateral lenders.[16]

According to the terms of the HIPC Initiative, a country that has an external debt to export earnings ratio greater than 150 per cent after traditional debt treatment strategies qualifies for HIPC treatment (see chapter II, section B, Yemen).[17] In such cases, the Government must prepare a national Poverty Reduction Strategy Paper (PRSP) in collaboration with civil society and non-governmental organizations, donors, and international institutions and must then demonstrate that progress has been made with regard to implementing the goals of the PRSP for a period of at least one year. The role of PRSPs within the framework of the HIPC Initiative is to ensure that countries have implemented policies that ensure that debt remains sustainable in the future once their debt has been reduced to sustainable levels.

3. *United Nations Conference on Trade and Development Debt Management and Financial Assistance System Programme*

This programme is aimed at enhancing the debt management abilities of "62 low and middle-income developing countries, whose economies account for more than $500 billion of outstanding public and public

---

[13] Michael Kremer and Seema Jayachandran, "Odious debt", policy brief No. 103, (Washington D.C., The Brookings Institution, July 2002). Available at: http://www.brookings.edu/comm/policybriefs/pb103.htm.

[14] Development Assistance Committee member countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and United States. See European Union. Available at: http://europa.eu.int.

[15] International Monetary Fund (IMF), "The logic of debt relief for the poorest countries", (September 2000). Available at: http://www.imf.org/external/np/exr/ib/2000/092300.htm.

[16] IMF, "Debt relief under the Heavily Indebted Poor Countries (HIPC) initiative", (April 2003). Available at: http://www.imf.org/external/np/exr/facts/hipc.htm.

[17] Ibid.

guaranteed long-term debt".[18] The programme assists countries in the development of institutional frameworks for debt management, teaches government officials how to produce accurate national debt statistics and provides for the installation of a computer software package, which is used to record, monitor and analyse debt data. The programme also provides technical assistance in general debt management training for government officials. Since 1986, six ESCWA members have participated in the programme. Egypt became involved with DMFAS in 1986, Jordan in 1998, Lebanon in 1993, Yemen in 1999, Palestine in 2000 and the Syrian Arab Republic in 2002.[19] The first interregional conference on debt management was organized by UNCTAD in 1997. Participants at the conference proposed that an international association of debt managers should be formed and, consequently, the World Association of Debt Management Offices (WADMO) held its first general assembly in April 2000. Among ESCWA member countries, only the Ministries of Finance of Lebanon and Jordan are members of WADMO.[20]

4. *Monterrey Consensus*

The Monterrey Consensus was an outcome of the International Conference on Financing for Development, which was held in Monterrey, Mexico, from 18 to 22 March 2002. Participants at the conference recognized that ODA alone would fall short of providing the development financing needed to meet MDGs, and that an annual minimum of $50 billion of additional aid for developing countries would be required to attain MDGs by the 2015 target date. This sum is almost double current ODA levels.[21] Thus far, a mere $16 billion to $18 billion in additional aid commitments have been pledged annually until 2006.[22] The question remains as to how developing countries can bridge the gap between required development finance and the limited availability of ODA. One way of doing this is through discretionary policies on the part of developed and developing country Governments, which are necessary to ensure that the benefits of globalization extend to developing countries by opening new avenues for development financing. In addition, six crucial actions were identified in the Monterrey Consensus as being key to mobilizing financial resources for developing countries and thus capable of facilitating the attainment of MDGs: (a) mobilizing domestic financial resources for development (b) mobilizing international financial resources, including FDI; (c) utilizing international trade as an engine for development (d) increasing international financial and technical cooperation for development; (e) pursuing external debt relief and sustainable debt management; and (f) addressing systemic issues, including enhancing the coherence and consistency of international monetary, financial and trading systems in support of development. The Monterrey Consensus provides a venue for follow up monitoring of activities to promote development finance. This report is part of the monitoring process for countries in the ESCWA region.[23]

D. DEBT MANAGEMENT AND RELATED INTERNATIONAL INITIATIVES

Fiscal debt management has a number of potentially positive and negative facets. Fiscal debt, particularly long-term fiscal debt, can be beneficial in that it tends to promote economic growth through wise government investment choices and this is an important component of financing for development. Public debt that is spent productively on infrastructure and poverty reduction projects can prevent a debt crisis situation from arising.[24] Moreover, it is important for developing countries to maintain creditworthiness to facilitate their access to loans for financing economic development. In cases where growth does not occur as

---

[18] United Nations Conference on Trade and Development (UNCTAD), "Debt management – DMFAS programme". Available at: http://r0.unctad.org/dmfas/.

[19] UNCTAD, "DMFAS countries (May 2004)", p. 3. Available at: http://www.unctad.org/dmfas.

[20] World Association of Debt Management Offices. Available at: http://www.wadmo.net/aboutwadmo.htm.

[21] Hilde Johnson and others, "Overcoming the obstacles", *Finance and Development*, vol. 40, No. 4, (IMF, December 2003), p. 33.

[22] Mark Baird and Sudhir Shetty, "Getting there", *Finance and Development*, vol. 40, No. 4, (IMF, December 2003), p. 18.

[23] United Nations, Department of Economic and Social Affairs, "Monterrey Consensus", *Follow-up Process to the International Conference on Financing for Development*. Available at: http://www.un.org/esa/ffd/.

[24] Emanuele Baldacci, Benedict Clements and Sanjeev Gupta, "Using fiscal policy to spur growth", vol. 40, No. 4, *Finance and Development*, (IMF, December 2003), p. 31.

expected, Governments must have access to credit to refinance existing debt. Public defaults on debt can also have a negative impact on the credit available to private sector borrowers in developing countries. When mismanaged, fiscal debt can weigh heavily on a developing economy in that it causes mounting debt servicing burdens and outflows of valuable foreign exchange earnings and Governments may even default on loan obligations. Governments of countries facing unsustainable debt servicing burdens or a debt crisis may resort to reducing vital government services. In this way, unsustainable fiscal debt can slow economic growth and development and even increase poverty. Sound use of debt financing is imperative in that it can stimulate economic growth and reduce poverty.

One common definition used to determine whether or not the debt of a country is overburdening its economy states that "debt becomes unsustainable when it accumulates at a faster rate than the capacity of the borrower to service it".[25] Therefore, the ratio of debt servicing to national income is used to measure debt sustainability. Another common measure is to compare external debt with export earnings, on the basis that external debt payments are made with foreign exchange and the ability of a country to accumulate foreign exchange depends on the value of its exports. This value can be influenced by changes in the volume of exports, and also in per unit price. For example, increases in world petroleum prices in 2003-2004 significantly increased the export earnings of oil-exporting indebted countries in the ESCWA region, namely, Oman, Saudi Arabia and the Syrian Arab Republic. Moreover, while the windfall profits from higher oil prices reduced the external debt to exports ratios, this does not indicate that debts were paid back or that debt levels are sustainable in the long term. Indeed, other, external factors can influence the debt burden of a country and have an impact on its debt management strategy. For example, external shocks can include commodity prices and regional conflicts. Developing countries must remain aware of the variables that can affect their debt situation but which are beyond the influence of their Governments. Sound debt management requires the systematic collection of reliable data and skilled civil servants capable of analysing the impacts of fiscal policy and external shocks from the global economy.

Bearing this in mind, it can be noted that a joint project has been established by the Bank for International Settlements (BIS), the Organization for Economic Cooperation and Development (OECD) and the World Bank, the objective of which is to compile and publish sovereign external debt statistics for policy makers, debt managers and market analysts.[29] Transparency and availability of debt statistics and best debt management practices are priority goals for bilateral and multilateral lending institutions as these are capable of reducing the risks of sovereign debt and international financial crisis. Lending decisions for creditors and debt management strategies for borrowers have been complicated in recent years owing to the fact that the choice of debt instruments and types of creditors available to borrowers have increased. The more complex nature of sovereign borrowing has increased the complexity of legal jurisdictions during debt default. The global community, particularly lenders, is concerned with finding ways of preventing or minimizing damage caused by sovereign debt default and any resultant international financial crisis. The international financial institutions are in the process of formulating a framework for dealing with unsustainable sovereign debt and the potential impacts of default on creditors, regardless of whether the credit originates from bilateral, multilateral, private or official sources. The goal is to formulate an orderly system, which is recognized internationally, for dealing with sovereign default. The proposal for a Sovereign Debt Restructuring Mechanism (SDRM) that is currently being drafted by IMF addresses the legal and institutional aspects of unsustainable debt and debt restructuring,[30] and includes a provision whereby creditors can vote by

---

[25] Christina Daseking, "Debt: How much is too much?", *Finance and Development*, vol. 39, No. 4, (IMF, December 2002). Available at: http://www.imf.org/external/pubs/ft/fandd/2002/12/daseking.htm.

[26] United Nations Conference on Trade and Development (UNCTAD), "Debt management – DMFAS programme". Available at: http://r0.unctad.org/dmfas/.

[27] UNCTAD, "DMFAS countries (May 2004)", p. 3. Available at: http://r0.unctad.org/dmfas/pdfs/brief-en.pdf.

[28] World Association of Debt Management Offices. Available at: http://www.wadmo.net/aboutwadmo.htm.

[29] Organization for Economic Cooperation and Development. Available at: http://www.oecd.org.

[30] IIMF, "Proposals for a Sovereign Debt Restructuring Mechanism (SDRM)". Available at: http://www.imf.org/external/np/exr/facts/sdrm.htm.

consensus on new terms for restructuring unsustainable sovereign debt while blocking minority creditors from countermanding decisions agreed by the majority. This would include a mechanism to prevent disruptive litigation against the sovereign debtor during debt restructuring negotiations. Other key aspects of the proposed SDRM include ensuring good faith on the part of the debtor, transparency requirements, seniority and protection for new private lenders and providing a forum for the resolution of disputes.

In addition, the United Nations Institute for Training and Research (UNITAR) was established in 1965 for the purpose of enhancing the effectiveness of the United Nations through training and research. In 1987, UNITAR aimed to provide training for government officials in the legal aspects of debt and financial management to "support the further development and strengthening of existing national capacities in dealing effectively with the legal aspects of debt".[31] UNITAR has since provided more than 100 debt training courses in 35 countries. Within this context it can be noted that ESCWA contributes to raising the awareness of member countries with regard to sustainable debt management in a number of ways, including publishing studies, holding training workshops jointly sponsored with UNCTAD and by ensuring that there is continuous monitoring and reporting of the activities of ESCWA members within the framework of the Monterrey Consensus.

[31] United Nations Institute for Training and Research (UNITAR), "UNITAR training programmes on legal aspects of debt, financial mangement and negotiation". Available at: http://www.unitar.org/dfm/What_we_do/Brochure.htm.

II. DEBT AND DEBT MANAGEMENT IN THE ESCWA REGION

A. THE DEBT SITUATION IN THE ESCWA REGION

Total external debt for the debt-burdened member countries of the ESCWA region was approximately $87.4 billion in 2002.[32] However, the debt situation differs substantially among ESCWA member countries, for the reason that these countries have different endowments of resources and populations. For example, some ESCWA member countries are labour importers with good endowments of resources, namely, Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates. Given low populations and high oil export revenues, these countries have adequate domestic finances and easy access to international credit for development projects. ESCWA member countries with good endowments of resources but large populations are not as well equipped to finance their economic development, and these include the Syrian Arab Republic and Yemen. Finally, ESCWA member countries with poor endowments of resources, namely, Egypt, Jordan and Lebanon have struggled to finance their economic development.

1. *Indebtedness, national incomes and development in the ESCWA region*

Income levels among ESCWA members vary significantly, ranging from the middle- to high-income oil-exporting countries, namely, Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and United Arab Emirates; to the medium- to low-income countries with diversified economies, for example, Egypt, Jordan, Lebanon and Syrian Arab Republic; the low-income members that have been affected by political instability, namely, Iraq and Palestine; and finally the only LDC among the group, Yemen. The United Nations Development Programme (UNDP) Human Development Index (HDI) ranks countries using a number of development indicators, including national income, for example, GDP per capita. As illustrated in table 4, the HDI ranking is highly correlated to GDP for the countries of the ESCWA region. External debt, managed wisely, is a vital financial resource in promoting economic growth and thus long-term economic development. According to UNDP, the ESCWA member countries with the highest development rankings were the GCC States, which had the highest per capita incomes. Bahrain, Kuwait, Qatar and the United Arab Emirates ranked in the "high human development" category, within the top 50 countries of the world. For these four countries, per capita incomes ranged between approximately $16,000 and $23,000 in 2002 (see table 4). Even though per capita income is high and Governments have access to oil revenues, these countries use external debt in the form of bank loans and securities issued abroad for development financing.

Among the ESCWA member countries listed under "medium human development", the ones with the least sustainably managed external debt were the countries with the lowest per capita incomes. For example, Egypt, Jordan, Lebanon and the Syrian Arab Republic had per capita incomes ranging between $3,000 and $4,500. Not surprisingly, Yemen, the least developed ESCWA member country, with a per capita income of $870 in 2002, ranked 149 out of 177 countries included in the HDI. These countries, which have a shortage of government revenue relative to development needs, have tended to resort to debt financing to fund economic development. This is a feasible solution for obtaining development finance in cases where the debt is sustainably managed. In other words, when the debt is used to finance investments that allow the Government to repay the debt and when the debt servicing burden is not so high that current government services are reduced, poverty increases, and Governments lose access to international creditors. In this context, these Governments most continue to have access to debt financing by improving skills in sustainable debt management.

The ability of ESCWA member countries to manage debt and employ sound fiscal policies varies across the region. For example, certain Governments in the ESCWA region have exerted intensive efforts to contain the debt problem in their respective countries. In this regard, progress was made in Egypt and Jordan in the 1990s. These countries, similarly to Yemen, implemented structural economic reform policies under the auspices of the World Bank and IMF. Moreover, with the aim of minimizing the adverse effects of the economic austerity measures undertaken, these Governments also established social safety nets to limit the

[32] Excluding Bahrain, Iraq, Kuwait, Palestine, Qatar, Saudi Arabia and United Arab Emirates. See World Bank, *Global Development Finance (GDF) Online*. Available at: http://devdata.worldbank.org/apponline/SMSeriesTab.asp.

impact of debt management policies on overall levels of poverty. Within this context, international lending institutions have become increasingly aware of the links between austerity programmes and poverty, and have recently endeavoured to improve public policy in developing countries without reversing advances made in alleviating poverty through services provided by Governments, namely, education and health care. This is a difficult juggling act, particularly for those poorer countries in which Governments have limited access to revenues for implementing development projects and providing social services. Therefore, despite advances in debt management in some ESCWA members, the debt situation continues to deteriorate in other parts of the region, particularly in Iraq, Lebanon and Palestine. For example, as of the end of 2001, the total external debt of Lebanon exceeded $12.4 billion (see table 5). The Government of Lebanon, therefore, curtailed its expenditures and implemented a tight monetary policy with relatively high interest rates to finance its growing external debt burden. The result of such severe measures constrained economic growth and development, and also aggravated the unemployment problem, thus contributing to poverty. In the cases of Iraq and Palestine, ongoing conflicts are hindering economic growth and preventing the implementation of sound fiscal policy, and Iraq, for example, is currently in default of its external debt.

TABLE 4. SELECTED ESCWA MEMBER COUNTRIES RANKED BY THE HUMAN DEVELOPMENT INDEX, 2002

Country (listed according to rank)	HDI rank (out of 177)	GDP per capita (US dollars PPP[a/])	HDI value
Bahrain	40	17 170	0.843
Kuwait	44	16 240	0.838
Qatar	47	19 844	0.833
United Arab Emirates	49	22 420	0.834
Oman	74	13 340	0.770
Saudi Arabia	77	12 650	0.768
Lebanon	80	4 360	0.758
Jordan	90	4 200	0.750
Syrian Arab Republic	106	3 620	0.710
Egypt	120	3 810	0.653
Yemen	149	870	0.482

Source: United Nations Development Programme (UNDP), "Human development Index: Monitoring human development: enlarging people's choices", *Human Development Report 2004; Cultural Liberty in Today's Diverse World*, (UNDP, 2004). Available at: http://hdr.undp.org/reports/global/2004/pdf/hdr04_HDI.pdf.

a/ Purchasing power parity.

2. *External debt and debt indicators in the ESCWA region*

(a) *External debt*

External debt refers to sovereign debt owed by Governments or their authorized institutions. External debt can be owed to public creditors, publicly guaranteed private creditors, or private creditors, and to bilateral or multilateral lending sources. It can also have long- or short-term maturity dates. Among the ESCWA member countries, Egypt had the largest value of external debt in the region in 2002 at $30.8 billion (see table 5). The Syrian Arab Republic and Lebanon were close behind with $21.5 billion and $17.1 billion, respectively. Other indebted ESCWA member countries facing heavy debt burdens include Jordan and Yemen. It should also be noted that the GCC States also carry external debt. However, much of this is private sector debt in the form of commercial bank loans or bond issues for resource development projects and does not cause problems in terms of sustainable debt management. Moreover, while Egypt carried the most external debt stock in 2002, it was not the highest in terms of debt per capita. Relative to the population of Egypt, the external debt per capita was approximately $463. The highest external debt per capita ratio in 2002 was Lebanon, with $3,881 owed per Lebanese to foreign creditors. This is a very heavy burden on the present population in terms of debt servicing payments and also on future generations with regard to repayment of the principal, depending on the time structure of the debt. Iraq also faces a very heavy external debt burden, which was approximately $3,700 per person in 2002. External debt per capita in Oman was $1,933 in 2002. Jordan and the Syrian Arab Republic carried per capita debt burdens of $1,557 and $1,265 respectively in that year, while Yemen, which is the least-developed ESCWA member country, and which has the lowest per capita income, had the smallest external debt per capita, at $264.

External debt can also be described as that which is owed outside the country or is denominated in foreign currency, and which places a Government and its citizens at risk of default in international financial markets or exposure to exchange rate risk. The debt servicing costs of foreign currency denominated debt must be paid from foreign exchange, thereby exhausting export earnings and straining foreign currency reserves. However, domestic currency denominated debt does not require foreign exchange, and in this regard, debt held by citizens is an internal transfer of wealth, rather than a net outflow from the country. In times of fiscal emergency, domestic debt can be paid down by indirect taxation related to printing money. For example, the Egyptian debt, which is nearly 100 per cent of GDP, is primarily domestic; however, after approving a 2004 budget that increases government spending significantly more than the expected revenue, Egypt has little hope of reducing its debt in the coming fiscal year. It can also be noted that the ratio of external debt to total public debt is growing rapidly in some ESCWA member countries, namely, Jordan and Lebanon, thereby putting these countries at an increasing risk of default in the event that foreign exchange is not sufficiently available to meet debt-servicing requirements. Lebanon has been the most active in recent years with regard to swapping domestic debt for external debt and renegotiating with creditors through the Paris Club. However, Lebanese efforts towards fiscal reform, particularly privatization, have been less successful and thus do not address the root causes of unsustainable debt.

The picture of the general external debt issue is not complete without shedding some light on debt servicing. In this context, Egypt, Jordan, Oman and the Syrian Arab Republic have managed to decrease their external debt service payments as percentages of their respective total budget expenditures significantly. In Egypt, the ratio of external debt service payments to total budget expenditures decreased from 31 per cent in 1990 to 8.5 per cent in 1998. Moreover, despite the fact that Jordan was able to slash its external debt service payments ratio to total budget expenditures from 66 per cent in 1989 to 34 per cent in 1998, it continues to have one of the highest ratios in the region. Oman decreased its external debt service payments ratio to total budget expenditures from 45 per cent in 1989 to 13.1 per cent in 1998. The most notable decline, however, was in the Syrian Arab Republic. The Government there was able to decrease its external debt service payments ratio to total budget expenditures to only 2.1 per cent in 1998 from a 24 per cent level in 1990. In Lebanon, however, the external debt service payments ratio to total budget expenditures increased from 4 per cent in 1993 to 10 per cent in 1998.[33] Lebanon is in the process of converting domestic borrowing to external borrowing. Within this context, the international community, particularly donor countries, must consider rescheduling or forgiving the external debt of some ESCWA member countries to soften the burden of high external debt on their economic growth and development. This is particularly true with regard to the countries with the most alarming external debt to earnings ratios, namely, Lebanon and Yemen.

It can be noted at this point that indicators used to measure debt burden on an economy include the ratios of external debt to national income, external debt to export value, and the share of long-term debt within total external debt (see table 6). For the ESCWA region as a whole, the external debt to national income ratio was approximately 36 per cent in 2000. In line with this indicator, the economies of Jordan, Lebanon, and the Syrian Arab Republic were the most heavily debt-burdened in 2002. Thus, while Egypt had the highest total external debt, its share of debt to annual income was only 34 per cent as opposed to the Syrian Arab Republic, where the debt to income ratio was over 100 per cent. Indeed, there is a wide variation among ESCWA member countries with regard to the severity of the debt burden. For example, as a result of recent economic reform policies and inflows of foreign aid, Egypt and Jordan managed to decrease their respective external debt to GDP ratios. Egypt decreased its debt burden ratio from 117 per cent in 1980 to 36 per cent in 1998. Jordan's debt to GDP ratio fell to 112 per cent in 1998, after registering 195 per cent in 1991. In the Syrian Arab Republic, the external debt to GDP ratio improved to 90 per cent in 1998 after deteriorating to an alarming 226 per cent in 1989 from a 21 per cent level in 1980. Lebanon's external debt

[33] ESCWA, *External Debt in the ESCWA Region*, (E/ESCWA/ED/2001/19), p. 39.

burden increased after 1995 when the Government began transferring part of its domestic debt into foreign debt, where interest rate charges were significantly lower. The external debt to income ratio in Lebanon was 31 per cent in 1998 and rose to 94 per cent by 2002. The external debt to GDP ratio deteriorated in Yemen in the early 1990s as a result of the economic reform and expansionary policies adopted by the Government after unification. Given the inflow of foreign aid and a positive growth rate in real GDP, the Government was able to decrease the external debt to GNP ratio from 186 per cent in 1994 to 104.8 per cent in 1998.[34]

The ratio of external debt to export earnings is another useful measure of debt burden, based on the fact that external debt must be paid with foreign exchange earnings, not the local currency. Using this ratio, the most heavily burdened ESCWA economy was Lebanon, with external debt over 700 per cent of export earnings in 2002 (see table 6). As the Lebanese economy is primarily a service and real estate sector, with little manufacturing activity, this ratio is particularly alarming. Both Egypt and the Syrian Arab Republic have ratios over 200 per cent and Jordan is only slightly below Egypt at 193 per cent. The share of long-term debt to total external debt indicates the stability of the external debt in terms of how quickly the principal must be repaid, and in this regard Egypt, Lebanon, Jordan and Yemen have high ratios, which can in part be attributed to restructuring and economic reforms undertaken in the 1990s. In addition, Oman and the Syrian Arab Republic are more heavily dependent on short-term debt, for over 25 per cent of their external debt burdens.

TABLE 5. EXTERNAL DEBT FOR SELECTED ESCWA MEMBER COUNTRIES, 1999-2002
(Millions of US dollars)

Country	1999	2000	2001	2002
Egypt	30 877	29 027	29 234	30 750
Jordan	8 106	7 366	7 480	8 094
Lebanon	8 205	9 856	12 450	17 077
Oman	6 839	6 564	6 025	4 639
Syrian Arab Republic	22 369	21 657	21 305	21 504
Yemen	5 403	5 615	4 954	5 290

Source: World Bank, *Global Development Finance (GDF) Online*. Available at: http://devdata.worldbank.org/apponline/ SMSeriesTab.asp.

TABLE 6. MAIN EXTERNAL DEBT INDICATORS FOR SELECTED ESCWA MEMBER COUNTRIES, 2002
(Percentage)

Country	External debt/ gross national income[a/]	External debt/ export value[b/]	Long term/ external debt[a/]
Egypt	34	200.7	89
Jordan	88	193.1	87
Lebanon	94	711.8	85
Oman	23	40.1	74
Syrian Arab Republic	108	276.2	74
Yemen	57	133.7	86

Source: Compiled by ESCWA from various sources (see below).

a/ World Bank, *Global Development Finance 2004 – Harnessing Cyclical Gains for Development*, table 3, (World Bank, 2004), pp. 2-4.

b/ Constructed from export data, including the following: World Bank, "Country at a glance" (Egypt, Jordan, Lebanon and Syrian Arab Republic), and "Yemen economic update". Available at: http://www.worldbank.org/data/; Ministry of National Economy, Government of Oman, *Statistical Year Book*, Issue 31, (August 2003). Available at: http://www.moneoman.gov.om/ mone/syb_page.htm.

[34] Ibid, table 42, p. 58.

(b) *Bilateral sovereign debt*

Bilateral sovereign debt is owed to single Governments or their authorized institutions, namely, the Paris Club creditors, private suppliers, including commercial banks and bondholders. In terms of multilateral debt, multilateral creditors include international financial institutions, namely, IMF and the World Bank, and regional multilateral lenders. In the ESCWA region, multilateral lenders are financed by international financial institutions and in part by the foreign exchange surplus in the oil-exporting ESCWA member countries through such regional institutions as AMF. Egypt and the Syrian Arab Republic held the highest share of bilateral debt relative to total external debt of all ESCWA member countries for the period 1999-2002, at 84 and 96 per cent respectively (see table 7). The countries with the highest shares of multilateral debt relative to total debt were Lebanon and Oman, both at 71 per cent.

TABLE 7. BILATERAL AND MULTILATERAL DEBT FOR SELECTED ESCWA MEMBER COUNTRIES, 1999-2002
(*Millions of US dollars*)

Country	1999	2000	2001	2002
Bilateral:				
Egypt	21 501	19 928	19 568	20 782
Jordan	3 700	3 493	3 940	4 245
Lebanon	335	315	292	289
Oman	457	463	485	336
Syrian Arab Republic	14 414	14 287	14 195	14 248
Yemen	2 190	2 700	2 177	2 683
Multilateral:				
Egypt	4 043	3 879	3 681	3 871
Jordan	1 805	1 716	1 820	2,012
Lebanon	613	616	664	720
Oman	277	520	805	809
Syrian Arab Republic	641	575	558	518
Yemen	2 154	1 656	1 727	9 751

Source: World Bank, *GDF Online*. Available at: http://devdata.worldbank.org/apponline/SMSeriesTab.asp.

(c) *Short- and long-term debt*

The maturity of external debt is important in determining the ability of a country to prevent default during a domestic economic crisis. Moreover, it determines the intergenerational distribution of project costs, which can require large levels of current financing to generate benefits for future generations. Debt is considered short-term if it has a maturity of one year or less. Long-term debt is preferable in financing development projects with long pay-off periods on the basis that short-term financing can result in an income transfer across generations. Short-term debt has the added risk of sovereign default in the event that a short-run economic downturn reduces the export earnings, foreign currency reserves and government revenues of a country. With regard to long-term debt, while a short-run reduction in government revenues may put a squeeze on the fiscal budget to meet debt-servicing payments, it will not necessarily result in a default of the principal. In this context, most of the debt-burdened economies of the ESCWA region currently have a high share of long-term debt. Egypt, Jordan, Lebanon and Yemen held more than 80 per cent of their external debt with long-term maturities (see table 8). Moreover, there was some progress in the economic reform process in the region during the 1990s, particularly in terms of fiscal and trade policies, for example, market liberalization and new taxes. In addition, significant efforts were made by some ESCWA member countries to reschedule debt to prevent default, and in this regard, Lebanon was particularly successful in both of its 2000 and 2002 meetings with creditors; Jordan was also successful in terms of debt swap schemes.

TABLE 8. SHORT- AND LONG-TERM DEBT FOR SELECTED ESCWA MEMBER COUNTRIES, 1999-2002
(Millions of US dollars)

Country	1999	2000	2001	2002
Short-term:				
Egypt	4 294	4 104	3 373	3 468
Jordan	871	706	447	536
Lebanon	2 202	2 541	2 658	2 547
Oman	1 835	1 299	1 266	1 188
Syrian Arab Republic	6 227	5 727	5 494	5 655
Yemen	473	774	518	341
Long-term:				
Egypt	26 583	24 923	25 861	27 282
Jordan	6 737	6 199	6 600	7 076
Lebanon	6 003	7 315	9 793	14 530
Oman	5 004	5 266	4 759	3 451
Syrian Arab Republic	16 142	15 930	15 811	15 849
Yemen	4 522	4 524	4 062	4 563

Source: World Bank, *GDF Online*. Available at: http://devdata.worldbank.org/apponline/SMSeriesTab.asp.

(d) *Categories of creditors*

Two main categories of creditors are available to sovereign borrowers, namely, other Governments and multilateral institutions or private lending institutions. The more diversified countries of the region, namely, Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen, depend most heavily on public sector creditors for debt financing (see table 9). This can in part be attributed to their poor overall credit ratings. For example, the long-term foreign currency credit ratings for Egypt and Lebanon were in the B categories, BB+ and B-, respectively, in August 2004.[35] Another reason for choosing public sector creditors is the availability of concessional loans, which have better terms than private lenders. Low-income developing countries do not have access to the volume of funds necessary for their development solely through private commercial creditors. The oil-exporting GCC States, however, have substantial collateral, future earnings and political stability to warrant their good credit ratings, which were A- for Bahrain and AA- for Kuwait, and also access to private sector bank loans and securities investors.[36] Even Oman, which has the lowest per capita income of the GCC States, illustrates the availability of private credit to finance development projects when linked to resource endowments of petroleum and natural gas. Forty-three per cent of external debt in Oman was financed by the private sector during the period 1999-2002, while in neighbouring Yemen, there was no privately financed sovereign debt during that period.

TABLE 9. PUBLIC AND PRIVATE SECTOR LONG-TERM DEBT FOR SELECTED
ESWCA MEMBER COUNTRIES, 1999-2002
(Millions of US dollars)

Country	1999	2000	2001	2002
Public sector:				
Egypt	26 268	24 508	25 340	26 623
Jordan	6 677	6 152	6 604	7 048
Lebanon	5 306	6 553	8 926	13 812
Oman	2 596	2 970	2 687	1 979
Syrian Arab Republic	16 142	15 930	15 809	15 848
Yemen	5 372	4 059	4 277	4 563
Private sector:				
Egypt	483	574	620	660
Jordan	41	35	32	28

[35] FitchRatings, "Sovereigns (issuers)". Available at: http://www.fitchratings.com.

[36] Ibid.

TABLE 9 (*continued*)

Country	1999	2000	2001	2002
Lebanon	697	762	862	718
Oman	2 408	2 296	2 068	1 471
Syrian Arab Republic	–	–	–	–
Yemen	–	–	–	–

Source: World Bank, *GDF Online*. Available at: http://devdata.worldbank.org/apponline/SMSeriesTab.asp.

Note: A dash (–) indicates that the amount is nil or negligible.

B. DEBT MANAGEMENT IN ESCWA MEMBER COUNTRIES

This section provides an analysis of the composition of external debt in the ESCWA region, and is therefore divided into three parts. In the first part, the composition of external debt in the diversified economies of Egypt, Jordan, Lebanon and Syrian Arab Republic are discussed. In the second, the cases of Iraq and Yemen are examined. Finally, the external debt of the oil-dependent economies of the GCC States, namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates are discussed. It must be noted that while the GCC States utilize external debt financing, primarily in the form of commercial loans, the composition of their debt is entirely different from that held by the other ESCWA member countries and thus is not useful for comparison purposes.

1. *ESCWA member countries with diversified economies*

(a) *Egypt*

External debt in Egypt grew significantly during the 1980s, from $21 billion to $45.5 billion between 1980 and 1989.[37] This trend was reversed in the 1990s, which can in part be attributed to a negative growth rate of the debt under debt rescheduling and debt forgiveness programmes, and to positive gains in national income growth. External debt in Egypt fell to approximately $30.75 billion by 2002. External sovereign debt in 2002 primarily comprised official bilateral loans from the Development Assistance Committee (DAC) creditors, amounting to 39 per cent, with bank loans accounting for 26 per cent, and non-bank trade credits 22 per cent (see table 10). Bank loans were not used by the Government of Egypt prior to 1996, but now account for the largest share of external debt. Furthermore, the reliance on DAC creditors and non-bank trade credits to finance the lion's share of external debt has been consistent over the past decade. The Government of Egypt approved an approximate doubling of the budget deficit to 7.5 per cent of GDP for 2004, primarily to provide more subsidies for the poor. The impact of this increase in the budget deficit is expected to affect creditor confidence in the long-term stability of Egypt.[38] For example, the ratio of external debt to export value in 2004 is forecast at 422 per cent,[39] up significantly from an already high level of 200 per cent in 2000.

(b) *Jordan*

The structure of external debt in Jordan in 2002 in terms of creditors consisted of 23 per cent multilateral claims, 18 per cent bank loans and 17 per cent non-bank trade credits, with 7 per cent being supplied by Brady bonds (see table 10). Debt cancellation and debt payment rescheduling are important in terms of enabling Jordan to avoid financial crisis from its overbearing debt burden. While Jordan has made significant progress in economic policy and legislative reforms, primarily to stimulate FDI and export growth, regional conflicts continue to push down growth in relation to national income. This in turn prevents progress in paying down the national debt. Jordan's heavy debt burden, at 88 per cent of 2002 national

[37] ESCWA, *External Debt in the ESCWA Region*, (E/ESCWA/ED/2001/19), table 3, page 12.

[38] TradeArabia, "Egypt faces huge budget deficit", 22 March 2004. Available at: http://www.tradearabia.com/.

[39] The Economist Intelligence Unit (EIU), "Forecast summary (table)", *Country Report: Egypt*, (United Kingdom, July 2004) p. 7. Available at: http://www.eiu.com.

income, cannot be relieved through internal austerity measures alone. Moreover, while recent improvements in tax policies, resulting in higher tax revenues, have given some relief to the government balance sheet, official development assistance must continue in the form of more debt relief. For example, Italy announced in September 2004 that it would cancel $19 million of Jordan's debt, following a previous cancellation of Jordanian debt in April 2003.[40] The debt situation and debt management policies in Jordan are reviewed in detail in chapter III, below.

(c) *Lebanon*

With regard to Lebanon, structure of the external debt in 2002 primarily comprised debt securities abroad, which accounted for 81 per cent of external debt (see table 10). Bank loans accounted for 14 per cent, while non-bank trade credits and multilateral claims accounted for 2 per cent each. Lebanon undertook an aggressive policy of debt swapping, which was successful in avoiding international default. However, the necessary domestic economic reforms, spending cuts, and privatization of State-owned assets, which were promised to international creditors, have not been implemented. For example, in the 2004 budget, the Government again approved the overspending of its revenues, thereby aggravating the already critical debt situation.[41] External debt in Lebanon is 94 per cent of the country's national income and over 700 per cent of its export earnings. The debt situation and debt management policies in Lebanon are reviewed in chapter IV, below.

(d) *Syrian Arab Republic*

The World Bank lists the Syrian Arab Republic as a severely indebted lower-income country. Most of the external debt of the Government was owed to former communist countries and some debt payments were suspended by the Government, which used the excuse that some of its sovereign creditors no longer existed.[42] Overdue debt accumulated in the late 1990s hindering Syrian access to international credit markets. Moreover, the collapse of the former Soviet Union, a supplier of significant financial and military aid, ignited an economic crisis in the Syrian Arab Republic. Worsening economic circumstances eventually forced the Government to approach IMF, the World Bank and OECD countries in an attempt to settle overdue debt to enable the country to re-enter the international credit market. In 1996, the Government negotiated a partial debt relief and rescheduling with France and in 1997, it began payments on debt owed to the World Bank. In 2000, both Germany and Japan wrote off parts of the Syrian Arab Republic's debt and rescheduled the balances. However, the large balance owed to the former Soviet Union and inherited by the Russian Federation has yet to be resolved. This can be attributed, in part, to the fact that the original debt agreements with the Soviet Union stipulated repayment in goods, which is what the Syrian Arab Republic would prefer, while the Russian Federation insists on repayment in cash. The result of successful efforts to negotiate debt forgiveness and begin rescheduled payments of external debt has been renewed access to international credit markets over the past few years. By 2002, the majority of the external debt, 60 per cent, was owed to bilateral DAC creditors (see table 10). Another 22 per cent was owed as non-bank trade credits, while 17 per cent was in the form of bank loans. Meanwhile, despite the fact that the future of sustainable debt management looks a little brighter for the Syrian Arab Republic in terms of avoiding further defaults, the external debt remains a large burden on the centrally controlled economy and the Government continues to fail to make real progress towards economic reforms. In this regard, the ratio of external debt to national income remains high, amounting to 108 per cent in 2002; the ratio of external debt to export value was 276 per cent in 2002, despite oil export revenues; and the ratio of long-term to total external debt in the same year was 74 per cent, lower than neighbouring countries that had made better progress in relation to the fiscal reforms necessary for encouraging economic growth.

---

[40] ArabicNews.com, "Italy cancels its due debts on Jordan", 1 September 2004. Available at: http://www.arabicnews.com/ansub/Daily/Day/040901/2004090106.html.

[41] Fiona O' Brien, "Bond swap is not enough for Lebanon's hefty debt", *The Daily Star*, 2 September 2004, p. 8.

[42] EIU, *Country Profile: Syria*, (2004), p. 43. Available at: http://www.eiu.com.

TABLE 10. EGYPT, JORDAN, LEBANON AND SYRIAN ARAB REPUBLIC: EXTERNAL DEBT STOCKS BY CREDITOR, DECEMBER 2002
(*Millions of US dollars*)

Creditor	Egypt	Jordan	Lebanon	Syrian Arab Republic
Bank loans	7 719	1 259	2 554	478
Debt securities issued abroad	1 500	81	14 471	–
Brady bonds	0	488	–	–
Non-bank trade credits	6 507	1 178	366	621
Multilateral claims	2 362	1 554	313	38
Official bilateral loans (DAC)[a/]	11 338	2 286	120	1 691

Source: Bank for International Settlements (BIS), Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF) and World Bank, "Joint BIS-IMF-OECD-World Bank statistics on external debt", (28 May 2004). Available at: http://www.oecd.org.

Notes: The statistics in table 2 were generated with the creditor report system (joint BIS-IMF-OECD-World Bank) and vary from external debt statistics in table 5, which were generated according to the debtor report system (World Bank, GDF).

A dash (–) indicates that the amount is nil or negligible.

a/ Development Assistance Committee.

2. *Iraq and Yemen*

(a) *Iraq*

The external debt situation in Iraq is dire and debt management strategies are currently on hold. It is unlikely that the unsustainable debt situation in Iraq will lesson without substantial assistance in the form of aid from donors and debt relief from creditors. The World Bank and United Nations, which are jointly tasked with managing the International Reconstruction Fund Facility for Iraq (IRFFI), estimate that Iraq will need $55 billion in aid by 2008.[43] This does not include the burden of repaying Iraq's massive external debt, which was estimated at $89.9 billion in 2002. External debt is expected to reach $100 billion in 2004.[44] However, estimates vary widely from $62 billion to $320 billion.[45] Such disparities can partly be explained by a disagreement between Iraq and several GCC States over $30 billion of assistance provided during the Iran-Iraq war, which Iraq claims were grants, and the creditors claim were loans. In addition, estimates vary according to whether they include accrued interest amounting to some $47 billion as of 2002. The undisputed amount owed to ESCWA member countries is approximately $50 billion (see table 11), bearing in mind that statistics on Iraqi debt owed to creditors in Egypt are not available. The debt burden on the Iraqi economy is illustrated by a relatively high ratio of external debt to export value, which was 68 per cent in 2002.[46] Estimates of external debt and the debt burden do not include war reparations payments approved under Security Council Resolution 687 (1991). Kuwait has reiterated its demand that reparations from the 1990-1991 Gulf war, estimated at nearly $98 billion, and owed to Kuwait and Saudi Arabia, must not be included in debt forgiveness schemes.[47]

Many of Iraq's sovereign creditors stand ready to provide debt relief in the form of debt forgiveness and debt swaps when an official Iraqi Government is in place. In the meantime, key creditor groups, including the Paris Club and AMF have already initiated some measures. For example, at the twenty-seventh meeting of the Board of Governors of AMF, which was held in Kuwait in April 2004, Iraq was granted an

[43] *The Daily Star*, "Iraq stares at gaping $3 billion budget deficit for 2004", (Middle East North Africa Financical Network (MENAFN), 5 March 2004. Available at: http://www.menafn.com/qn_print.asp?StoryID=43298&subl=true.

[44] EIU, "Iraq at a glance: 2004-2005", *Country Report: Iraq*, (United Kingdom, July 2004). Available at: http://www.eiu.com.

[45] The Brookings Institution, "Iraqi national debt: Creditors", *Iraq Index; Tracking Variables of Reconstruction and Security in Post-Saddam Iraq*, (February 2004), p. 13. Available at: http://www.brookings.edu/iraqindex.

[46] This ratio was based on statistics in EIU, "Iraq at a glance: 2004-2005: Forecast summary (table)", *Country Report: Iraq*, (United Kingdom, July 2004), p. 6. Available at: http://www.eiu.com.

[47] *The Jordan Times*, "Iraq war reparations not negotiable", 23-24 January 2004. Available at: http://www.jordantimes.com.

extended grace period to settle its loans with Arab creditors.[48] In addition, 19 Paris Club creditors with outstanding loans to Iraq worth approximately $21 billion, reviewed the situation in Iraq at a July 2004 meeting and agreed on the need to restructure the external debt of the country.[49] The Paris Club and various international financial institutions determined jointly that Iraq will be unable to begin repaying any of its external debt before the end of 2004. In this context, IMF and the Paris Club are exerting efforts to facilitate debt restructuring and repayment for Iraq that are similar to the debt relief strategy used to help Nigeria in 2000. The first step involves financial intervention by IMF linked to the adoption of a credible economic strategy when an official Iraqi Government is in place.[50] The second stage aims to reschedule Iraqi debt owed to the Paris Club creditors in 2005 or 2006, allowing time to negotiate a debt-reduction agreement that would depend on successful implementation of IMF-sponsored economic reforms. Finally, debt reduction, with some estimates as high as 80 per cent, will be phased in over a three-year period that is dependent on Iraq meeting IMF performance targets for each year.

TABLE 11. IRAQ: ESTIMATED EXTERNAL DEBT STOCKS BY SOVEREIGN CREDITOR, 2004
(Millions of US dollars)

Sovereign creditor	Estimated debt
Australia	499.3
Austria	813.1
Belgium	184.5
Brazil	192.9
Bulgaria	1 000
Canada	564.2
Denmark	30.8
Egypt	-
Finland	152.2
France	2 993.7
Germany	2 403.9
GCC States	30 000
Hungary	16.5
Italy	1 726
Japan	4 108.6
Jordan	295
Kuwait	17 000
Morocco	31.8
Netherlands	96.7
Poland	500
Republic of Korea	54.7
Russian Federation	3 450
Spain	321.2
Sweden	185.8
Switzerland	117.5
Turkey	800
United Kingdom	930.8
United States	2 192

Source: The Brookings Institution, "Iraqi national debt: Creditors", *Iraq Index; Tracking Variables of Reconstruction and Security in Post-Saddam Iraq*, (February 2004), p. 13. Available at: http://www.brookings.edu/iraqindex.

Note: Some creditor data were unavailable and are not included in this table, for example, data pertaining to Egyptian lenders. A hyphen (-) indicates that the item is not applicable.

[48] Salah Eldin ElTayab, "AMF allows Iraq more time to repay its debts", *Khaleej Times*, 15 April 2004. Available at: http://www.kahleejtimes.com.

[49] Paris Club, "Press release", 10 July 2003. Available at: http://www.clubdeparis.org/en/press_release/page_detail_commupresse.php?FICHIER=com10578674390.

[50] Lex Rieffel, "Reducing Iraq's foreign debt", The Brookings Institute, 6 February 2004. Available at: http://www.brookings.edu/views/op-ed/rieffel/20040206.htm.

(b) *Yemen*

Yemen is a least developed country (LDC), with the lowest per capita income in the ESCWA region. While the level of external debt to national income is low compared to other indebted ESCWA member countries, at 57 per cent in 2002, the ratio of external debt to export value remains fairly high. Yemen's debt is relatively long-term, with 86 per cent having maturity greater than one year. The majority of debt, 65 per cent, was held by multilateral creditors in 2002 (see table 12). The remaining components of Yemen's external debt were bank loans, amounting to 17 per cent, official bilateral loans, 14 per cent, and non-bank trade credits, 3 per cent. Yemen is in the process of implementing fiscal reforms under the guidance of IMF and the World Bank, which prepared a debt sustainability analysis (DSA) with the Government of Yemen in June 2000.[51]

As of 2000, over 70 per cent of sovereign debt in Yemen fell within the framework of debt reconciliation with the Russian Federation, multilateral creditors, and some commercial banks.[52] The Government began its modern debt reform programme in 1996, which was followed by debt rescheduling through the Paris Club in 1996 and 1997. The 1997 rescheduling included an 80 per cent debt discount on Russian credit obtained prior to 1992. Yemen faced a similar situation to that of the Syrian Arab Republic in terms of repaying bilateral debt owed to the former Soviet Union after its collapse. In addition, a World Bank grant permitted Yemen to forego payment of interest arrears and to buy back its commercial debt at 10 per cent of the principal amount. In terms of the Russian commercial debt, this was in addition to the 80 per cent reduction granted under the 1997 Paris Club agreement, which resulted in the repayment of Russian debt at a mere 3.4 per cent of the principal.

While Yemen is an LDC, it does not currently qualify for assistance under the HIPC Initiative in that its external debt is considered sustainable under traditional debt treatment scenarios. This has to do with the way in which the export value of Yemen was calculated in the DSA, to include exports by foreign-owned oil companies. The Government of Yemen has pointed out that export earnings by foreign companies, which are not available as revenue to the Government to service its debt, must be excluded from calculation of the external debt to export value ratio. If these exports had been excluded from the DSA calculations using 1999 data, Yemen would have qualified for HIPC relief.

It can also be noted that Yemen joined the UNCTAD-DMFAS programme in 1999. The DMFAS software was adopted at the Central Bank and the Ministry of Finance. Officials from the Central Bank endeavour to update the national debt database, using the data for the purpose of monitoring and internal reporting to assist the government in sustainable debt management.[53]

TABLE 12. YEMEN: EXTERNAL DEBT STOCKS BY CREDITOR, DECEMBER 2002
(Millions of US dollars)

Creditor	Yemen
Bank loans	465
Debt securities issued abroad	–
Brady bonds	–
Non-bank trade credits	88
Multilateral claims	1 769
Official bilateral loans (DAC)	390

Source: BIS, OECD, IMF and World Bank, "Joint BIS-IMF-OECD-World Bank statistics on external debt", (28 May 2004). Available at: http://www.oecd.org.

Note: A dash (–) indicates that the amount is nil or negligible.

---

[51] IMF, "Republic of Yemen: External debt sustainability analysis", (28 June 2000). Available at: http://www.imf.org.

[52] Ibid, p. 1.

[53] UNCTAD, "Yemen". Available at: http://r0.unctad.org/dmfas/countries/yemen.htm.

3. *Middle to high-income oil-exporting ESCWA member countries*

The six members of the GCC are resource-endowed countries, where petroleum and natural gas exports represent the lion's share of foreign currency earnings and government revenues. These countries utilize international financial markets efficiently to finance development projects in their primary export sectors and infrastructure development projects. These international finances, primarily commercial bank loans and non-bank trade credits, are typically linked to the revenue streams generated by the investments, and do not necessarily impose burdens on the GCC economies (see table 13).

Oman, the GCC State with the second lowest per capita income after Saudi Arabia, has an external debt to export value ratio of 40 per cent, which is modest compared to the ratios for other debt-burdened ESCWA member countries, for example, Egypt, Lebanon and the Syrian Arab Republic. In addition, Oman's ratio of external debt to national income was 23 per cent in 2002. Despite the lowest per capita income in the GCC, Oman has maintained good credit rating, as reflected by the high proportion of commercial bank loans in its external debt package. With high international oil prices prevailing over the past two years, Oman's revenue growth has allowed it to participate in the international credit market without risking its good credit rating.

Saudi Arabia held the second highest amount of external debt among the GCC States, second only to Bahrain. Saudi Arabia has the lowest per capita income of the GCC States, which can primarily be attributed to its high population. Saudi Arabian external debt in 2002 comprised 82 per cent bank loans, 17 per cent non-bank trade credits, and less than 2 per cent official bilateral loans from DAC countries (see table 13). Sixty per cent of Saudi Arabian external debt in 2002 had maturities of one year or less.[54] Moreover, while Saudi Arabian sovereign debt is approximately 85 per cent of national income, 75 per cent is held domestically by other Saudi Arabian government institutions, for example, pension funds.[55] Recent increases in oil prices have benefited Saudi Arabia by providing financing to pay off some domestic debt and build up foreign denominated assets.[56] However, despite the current creditworthiness of the Saudi economy fuelled by high oil prices, several negative fundamental factors remain. The government revenue is highly dependent on a single commodity export, oil, and its international price is volatile. Moreover, Government expenditures are bogged down by commitments to government salary expenses, military, socialized health care and education. With the anticipation of rising expenditures, and with the growing population continuing to face high unemployment rates in the private sector, the budget situation facing the Government could deteriorate quickly, particularly if oil prices retreat.

TABLE 13. GULF COOPERATION COUNCIL STATES: EXTERNAL DEBT STOCKS BY CREDITOR, DECEMBER 2002
(*Millions of US dollars*)

Creditor	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Bank loans	25 320	8 772	3 462	4 931	18 275	13 722
Debt securities issued abroad	325	750	–	3 491	–	230
Brady bonds	–	–	–	–	–	–
Non-bank trade credits	145	454	383	132	3 869	2 105
Multilateral claims	–	–	–	–	–	–
Official bilateral loans (DAC)	–	–	98	125	223	–

Source: BIS, OECD, IMF and World Bank, "Joint BIS-IMF-OECD-World Bank statistics on external debt", (28 May 2004). Available at: http://www.oecd.org.

Note: A dash (–) indicates the amount is nil or negligible.

---

[54] Bank for International Settlements (BIS), Organization for Economic Cooperation and Development (OECD), IMF and World Bank, "Joint BIS-IMF-OECD-World Bank statistics on external debt", (28 May 2004). Available at: http://www.oecd.org.

[55] MENAFN, "Saudi Arabia's sovereign ratings raised", 10 August 2004.

[56] Reuters, "Oil prices boom for Gulf States", 31 August, 2004.

III. CASE STUDY: JORDAN

A. OVERVIEW OF THE DEBT SITUATION IN JORDAN

In Jordan, as in many countries, public debt management focuses on the following: (a) ensuring that the stock and rate of growth of debt are manageable and sustainable over time; (b) ensuring that public obligations are fully met; and (c) reducing the susceptibility of the economy to contagion and financial risk. In this regard, significant success has been achieved, particularly within the framework of economic reforms, which were introduced in 1989 and which are reviewed in greater detail below. This is borne out by the fact that total external debt to GDP decreased from 120 per cent in 1992 to 78 per cent in 2003. Debt service on a commitment basis decreased during the same period, from 20 per cent of GDP to 9 per cent.[57]

The debt management policies of the Government have had an impact on, and have in turn been affected by, the structure and level of debt that has accumulated since the late 1940s, and which led to decades of borrowing and an amalgamation of discontinuities in policy. Prior to the 1990s, debt management policies simply enmeshed cycles of short-sighted strategies, ad hoc measures, a voracious appetite for debt with discontinuities and the absence of clear guidelines or benchmarks. However, with the introduction of economic reforms, prudence and long-term debt management objectives demanded by the Bretton Woods institutions have provided measurable successes in enabling the economy to avoid the devastation that results from poor debt management policies. In the past decade, borrowing has been motivated by Government attempts to bolster its foreign currency reserves to maintain the currency peg and finance certain national development needs. As a result, Jordan's debt burden seems manageable in the face of most external shocks, albeit not in very extreme cases.

1. *Background on the debt: beginnings and growth*

The seeds of Jordan's foreign debt were sown in 1949, with a JD 1 million loan from the United Kingdom, which remained the only creditor to Jordan until 1961, when Jordan decided to expand its borrowing base. The new creditors were the International Development Association (IDA), the Government of Kuwait and the former Federal Republic of Germany.[58]

The Jordanian economy, which enjoyed an unprecedented real growth in income from the 1970s to the mid-1980s, amounting to an average of 8.4 per cent during the period 1977-1985,[59] was boosted by foreign assistance and loans, workers remittances, primarily from the oil-exporting economies of the GCC States, and exports to regional markets. Assistance from the GCC States to Jordan, which was then at war with Israel, was generous with little or no conditions. However, bad spending habits accumulated along with the flow of assistance, including an ever-growing bureaucracy in the public sector.

Indeed, the bonanza that started in the 1970s could not continue forever. Oil prices, which had risen to record highs in that decade declined as the Organization of Petroleum Exporting Countries (OPEC) appeared to lose its control on the world market at a time when the industrialized world started to treat oil as a strategic reserve and to view OPEC members with apprehension. Economic growth in Jordan, which was indirectly dependent on oil, was severely curtailed in the mid-1980s, when there was a rapid decline in oil prices and a subsequent meltdown in regional oil economies.

However, instead of adjusting to lower aid and remittances, the Government resorted to external borrowing on commercial terms. During the period 1989-1991, consumption decreased to an annual average of 103.1 per cent from an average 112.5 per cent of GDP in 1976-1983.[60] Commercial short-term borrowing from abroad, from foreign banks and companies, increased from $823.8 million in 1984 to $1,849.1 million

[57] Todd Schneider, "External debt dynamics and sustainability", *Jordan: Selected Issues and Statistical Appendix*, IMF Country Report No. 04/121, (Washington D.C., IMF, May 2004), p. 64.

[58] Ministry of Finance, Government of Jordan, "External loans: The Jordanian experience", a working paper, (Jordan, March 2000), p. 2, (in Arabic).

[59] Central Bank of Jordan, *Yearly Statistical Series (1964–1995); Special issue*, (May 1996), table 38, p. 48.

[60] Central Bank of Jordan, *Yearly Statistical Series (1964–2003); Special Issue*, table 36, (October 2004), p. 54.

in 1988 as foreign aid declined, debt service obligations proliferated and long-term credit became scarce.[61] By 1988, Jordan had exhausted its traditional sources of borrowing. The Government, therefore, ran increasingly larger budget deficits and took on additional foreign commercial loans to maintain consumption levels during the second half of the 1980s and the 1990s. Moreover, new credit sources were not on the immediate horizon.

Foreign debt, which had risen to $1,048 million in 1979, $2,297 million in 1980 and $2,747 million in 1982, grew to $6,564 million in 1988 and $6,611 million in 1989 with a debt service of $1,367 million (see table 15).[62] In 1989, prices jumped drastically, and the cost of living index was up on the previous year by 15.6 per cent, owing to record fiscal deficits and balance of payment difficulties.[63] Real GDP decreased by approximately 16 per cent and income per capita dropped to $1,313 (see table 15). The exchange rate fell by 50 per cent in real terms as foreign currency reserves at the Central Bank of Jordan were depleted. Financial instability created an increase in capital flight and bank failures, and a contraction of inward foreign investment. Coupled with a global slowdown and given the high real interest rates in the world markets, the debt burden was unsustainable.

The Government, therefore, confronted with a severe macroeconomic crisis in 1989, introduced a set of corrective measures as part of a medium-run economic adjustment programme, which was supported by an IMF Stand-by Arrangement and a trade and industry adjustment loan from the World Bank. As a condition for the provision of loans and facilities from IMF, the World Bank and other creditors, Jordan was required to adopt reform and stabilization programmes to tackle the weaknesses in its economy. Within the framework of such reform programmes, the Government was required to deal with a number of issues, including trade policy and market liberalization, institutional, legislative and regulatory reforms, and privatization.

This reform process has been partially responsible for reducing debt as a percentage of GDP. However, the results of this process have been mixed as a result of external factors and events, which went on to shape the socio-economic landscape in Jordan in the 1990s. One of these was the repatriation of close to half a million Jordanians after the Gulf war in 1990-1991; over $1.5 billion-worth of their savings doubled the gross domestic level in 1992 as compared to 1990 and had a positive impact on the economy in the short run, based on the fact that half the investment spending went into real estate and housing development. The impact lasted for two years and by 1996, as the regional situation worsened, Jordan, which had limited resources and job opportunities, was faced with the dilemma of employing returnees, many of whom were highly skilled.

In 1994, the United States forgave Jordan $700 million-worth of debt, thereby helping to lower the indebtedness of the country, albeit only temporarily. In addition, grants from other nations contributed to alleviating a portion of Jordan's debt burden after the signing of the Israel-Jordan Peace Treaty on 26 October 1994. Privatization proceeds amounted to $992.2 million as of 30 June 2004, of which a part was allocated to buy back a certain amount of Jordan's debt, covering the amortization of Jordan's Brady bonds, which had a nominal value of $456 million.[64]

Jordan's total domestic and external debt, at the end of 2003 reached JD 7,095 million or 101.5 per cent of estimated GDP, compared to JD 6,685 million or 100.5 per cent of GDP for 2002.[65] Debt as of the end of March 2004 was JD 6,975 million, or 92.4 per cent of estimated GDP.[66]

---

[61] Central Bank of Jordan, *Yearly Statistical Series (1964–1989); Special Issue*, (October 1989), table 41, p. 49.

[62] The JD/$ exchange rate prior to 1989 was $2.8.

[63] Central Bank of Jordan, *Yearly Statistical Series (1964–1995); Special Issue*, (May 1996), table 49, p. 62.

[64] Ministry of Finance, Government of Jordan, *Government Finance Bulletin*, vol. 6, No. 6, (Amman, July 2004), p. 12.

[65] Ministry of Finance, Government of Jordan, *Government Finance Bulletin*, vol. 5, No. 12, (Amman, January 2004), table 14, p. 65.

[66] Ministry of Finance, Government of Jordan, *Quarterly Bulletin*, (Public Debt Department, March 2004). Available at: http://www.MoF.GOV.Jo.

B. EXTERNAL DEBT

1. *Level of external debt and source of funds*

(a) *External debt*

In 1990, in the aftermath of the debt crisis of 1989, the outstanding balance of external debt as a percentage of GDP reached its peak, at 189.4 per cent. However, the introduction of economic reforms saw external debt as a percentage of GDP decrease sharply in the first half of the 1990s until 1995, when the impact of funds from the Jordanians who had been repatriated from Kuwait was diminished. From 1995 to 1999, the external debt to GDP ratio continued to float around the 90 per cent mark (see tables 15 and 16). A perceptible break in this trend occurred in 2000, when the economy benefited from significant proceeds related to privatization endeavours and the return of Jordanians to the Gulf as a result of a rise in oil prices and a subsequent boom, which boosted demand for Jordanian labour in those markets. Furthermore, while there had been no growth in productivity in the Jordanian economy in the second half of the 1990s, productivity increased during the period 2001-2002 primarily in the export sector, which became the biggest contributor to overall growth. From 2001 onwards, the level of external debt has remained below the 80 per cent mark with slight fluctuations.

External debt as of the end of March 2004 was JD 5,296 million ($7,469.3 million) with a servicing cost of JD 170.8 million ($240.9 million) for the first quarter.[67] Total external debt service, government and government-guaranteed, on cash basis amounted to JD 749.1 million ($1,057 million) in 2003, of which JD 627 million ($884.3 million) were principal payments and JD 122.1 million ($172.2 million) were interest payments. The outstanding balance of external public debt increased slightly at the end of 2003 by JD 42 million ($59.2 million) to JD 5,392 million ($7,604.7 million), or 76.9 per cent of nominal GDP, compared to JD 5,350 million ($7,545.6 million), or 80.4 per cent of GDP at the end of the previous year (including Brady bonds); outstanding external debt without Brady bonds was $7,226 million in 2002 (see tables 15 and 16).

Owing to a considerable rise in the exchange rates of major currencies against the dollar and the Jordanian dinar, which has been pegged to the dollar since 1995, outstanding external debt increased during 2003, despite an amortization of external loans that surpassed disbursements. Approximately half the adverse impact of the increase in exchange rates of major currencies against the Jordanian dinar came from the euro, followed by the Japanese yen, which accounted for 25 per cent of that impact, with the pound sterling, and special drawing rights (SDRs) making up the rest. Given the amount of rescheduled debt, debt service on a commitment basis rose to JD 943.3 million, of which JD 721.6 million and JD 221.7 million were principal and interest payments, respectively.[68]

Net external borrowing, or amortization less disbursements, during 2003 was JD 378 million. This included the amortization of Brady bonds and the conclusion of debt swaps agreements with Spain and the United Kingdom.[69]

The outstanding balance of external debt for the period 1989-2003 is illustrated in chart 1 below.

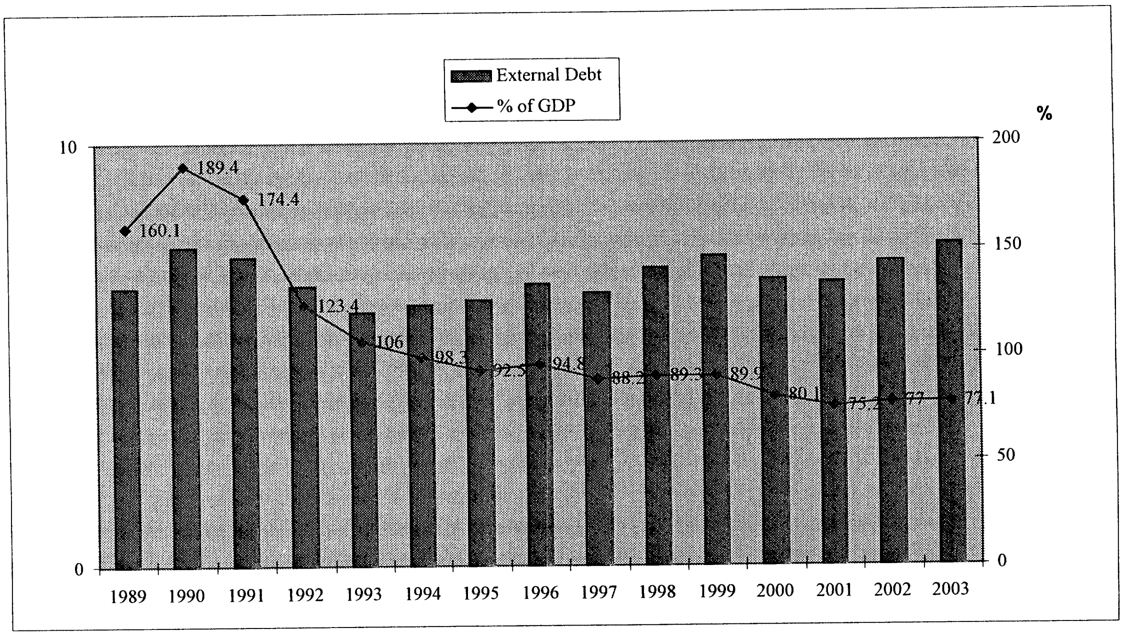
---

[67] Ibid.

[68] Ministry of Finance, Government of Jordan, *Government Finance Bulletin*, vol. 5, No. 12, (Amman, January 2004), table 3, p. 51.

[69] Ibid.

Chart 1. Outstanding balance of external debt, 1989-2003
(Billions of US dollars)



Source: Compiled by ESCWA from Central Bank of Jordan data.

(b) *Sources of funds*

The structure of external debt in Jordan during the period 1998-2003 remained almost unchanged (see table 14). The major sources of funds are illustrated in charts 2 and 3. Most notably, the shares of the main lenders grew during this period.

During 1998, industrial countries generated the majority of credit, which amounted to 54 per cent in total; multilateral institutions were the next largest provider, accounting for 28 per cent of all credit. The other six lending sources contributed relatively smaller levels of credit, amounting to 18 per cent in total (see chart 2).

In 2003, industrial countries contributed 60 per cent of credit to Jordan, with multilateral institutions providing 32 per cent and other sources providing minimal amounts (see chart 3).

Over the past six years, the share of the industrial countries increased from 54 per cent in 1998 to 60 per cent in 2003 (see charts 2 and 3, and table 14). This increase can be attributed to greater diversification of the country's debt resources, which is evidence of the faith of industrial nations and multilateral institutions to the economy of Jordan. This has been attributed to the following factors:

(a) The globalization of the economy, facilitated by the conclusion of negotiations to accede to World Trade Organization (WTO) in 2000 and the signing of an Association Agreement with the European Union in 1997, which became effective in May 2002;

(b) The privatization of a number of services, including Jordan Telecom and the sale of almost half of its shares to a consortium led by France Telecom for $508 million in 2000;

(c) The passing of over 200 laws since 1989, which have modernized the legislative and regulatory institutional settings in Jordan.

It can also be noted that there are two types of loans from industrial countries: bilateral and export credit loans (see table 14). Of these, bilateral loans made up 54 per cent of the loans from industrial countries in 1998, and 49 per cent in 2003. These loans were primarily from Germany, France, Japan, and the United States of America. Japan is the main source of this type of loan, accounting for some 66 per cent of bilateral loans in 1998 and 67 per cent in 2003.

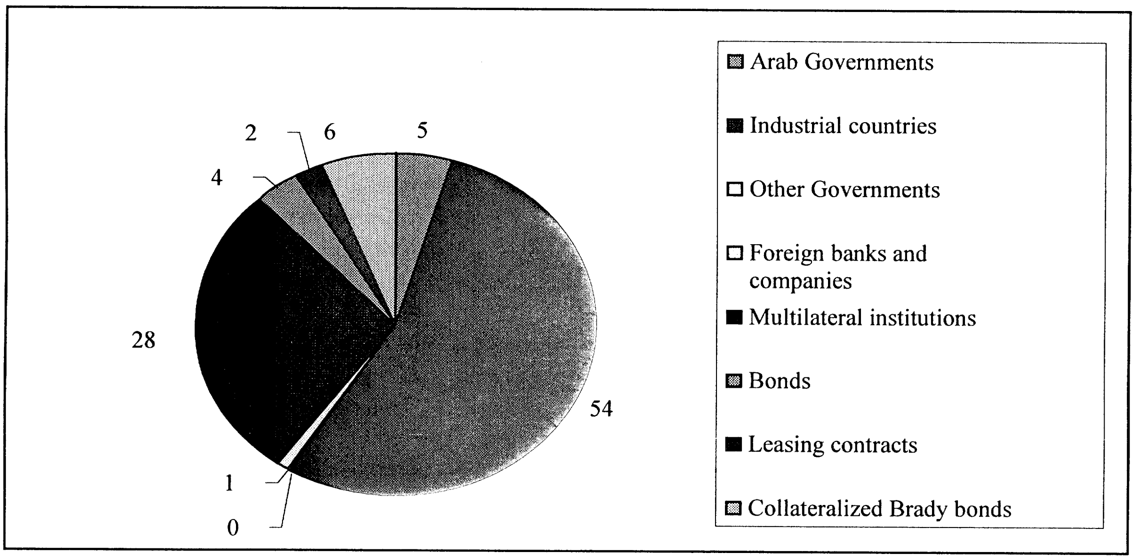
With regard to export credit loans, these accounted for 46 per cent of the debt from industrial countries in 1998 and 51 per cent in 2003. France and the United Kingdom were the major sources of this type of loan, accounting for approximately 65 per cent of export credit in 1998, and 58 per cent in 2003. The multilateral institutions come second as a lending source, with a share of 28 per cent and 32 per cent in 1998 and 2003, respectively. The multilateral institutions included IMF, International Bank for Reconstruction and Development (IBRD), European Investment Bank (EIB), Islamic Development Bank (IDB), AMF and Arab Fund for Economic and Social Development (AFESD). Of these, IBRD, IMF and AFESD are major donors to Jordan. Their shares of multilateral institutions loans in 1998 were 38.5 per cent, 22.1 per cent and 17.7 per cent respectively, while in 2003 their shares were 43.4 per cent, 17.2 per cent and 21.8 per cent, respectively. In 2003, the relative share of IMF decreased while the share of AFESD increased (see table 14).

Collateralized Brady bonds accounted for 6 per cent of total external debt in 1998. However, owing to the fact that these were amortized, this share dropped to zero in 2003. Arab Governments accounted for 5 per cent of the total disbursed external debt in 1998 and 2003. Loans from Arab Governments fall into two categories: (a) bilateral loans, which accounted for 12.6 per cent of all loans in 1998, and zero per cent since 1999; and (b) Arab Funds, namely, the Kuwait Fund for Arab Economic Development (KFAED) and the Saudi Fund for Development. Of these, KFAED accounted for 57 per cent of loans from Arab funds in 1998, and 59 per cent in 2003. However, the share of the Saudi Fund decreased from 40.3 per cent in 1998 to 48.5 per cent in 2003. Bonds as a source of lending represented 4 per cent of the total external debt in 1998 and their share decreased to 1 per cent in 2003.

In the long- and short-term loans category, the share of long-term loans of total loans increased from 88.4 per cent of the outstanding external debt in 1999 to 98.5 per cent in 2003. One reason for the decline in the share of short-term loans was the amortization of Brady bonds and other short-term debt by the Government, while adopting a policy of pursuing only long- to medium-term debt at favourable terms.[70]

Chart 2. Lending sources, 1998

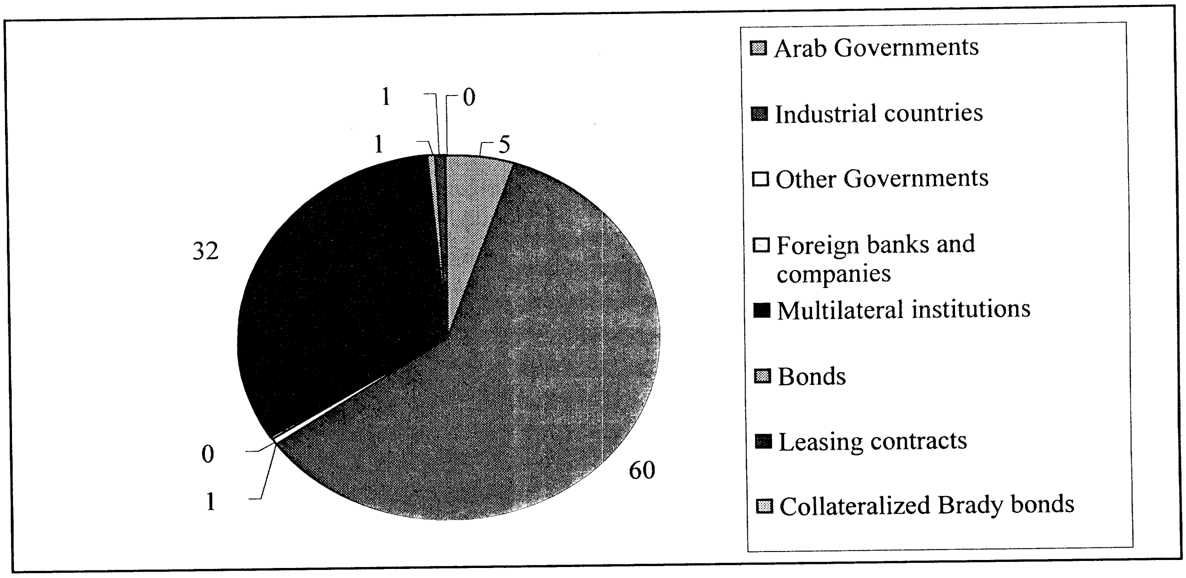
(*Percentage*)



Source: The shares of lending sources have been calculated by ESCWA, based on table 20 below.

[70] Central Bank of Jordan, *Monthly Statistical Bulletin*, vol. 40, No. 6, (June 2004), table 30, p. 53.

Chart 3. Lending sources, 2003
(Percentage)



Source: The shares of lending sources have been calculated by ESCWA, based on table 20 below.

TABLE 14. JORDAN: LENDING SOURCES, 1998-2003
(Millions of US dollars)

Lending sources	Outstanding external debt (disbursed)					
	1998	1999	2000	2001	2002	2003 December
1. Arab Governments	354.9131	307.3403	305.8593	374.6022	374.7292	409.8904
A. Bilateral loans	45.06228	–	–	–	–	–
B. Arab funds	309.8508	307.3403	305.8593	374.6022	374.7292	409.8904
Kuwait Fund for Arab Economic Development	178.3169	177.4988	176.8077	246.2982	245.2545	241.94
Saudi Fund for Development	124.9473	124.9896	124.9896	124.9896	124.9896	157.6968
2. Industrial countries	4 044.407	4 143.798	3 937.414	3 765.585	4 125.476	4 553.843
A. Bilateral loans	2 193.849	2 329.713	2 055.362	1 846.397	1 978.763	2 247.303
Germany	429.1283	365.6321	308.7648	288.9628	365.4205	469.0144
France	126.8373	114.6232	82.861	76.00646	89.84248	108.1918
Japan	1 457.239	1 658.151	1 475.25	1 287.54	1 374.731	1 515.813
United States	69.78659	87.13451	87.13451	84.24319	79.81454	75.38588
B. Export credit	1 850.558	1 814.085	1 882.052	1 919.188	2 146.713	2 306.54
Germany	17.40434	15.96573	20.32386	20.36618	19.60456	25.30258
France	625.188	560.7468	495.8684	499.8176	609.0248	762.1237
Japan	334.4905	370.7518	316.4514	272.4752	265.9591	259.9931
United Kingdom	576.4305	589.0677	560.9584	539.5767	620.3362	586.4443
United States	55.99288	35.64081	241.2207	311.8253	330.5554	356.6055
3. Other Governments	32.96105	33.25723	39.40658	39.40658	44.10321	43.84934
4. Foreign banks and companies	69.94174	59.99842	50.0551	40.09767	35.17538	25.07691
5. Multilateral institutions	2 124.923	2 321.786	2 252.437	2 317.414	2 518.706	2 457.241
International Monetary Fund	468.9862	498.4777	462.6958	433.1479	480.4246	421.9494
International Bank for Reconstruction and Development	818.1589	913.7558	893.4743	995.1077	1098.081	1065.797
European Investment Bank	230.8966	218.0478	229.1336	231.8416	265.0706	277.5808
Islamic Development Bank	124.5665	122.8035	115.1733	101.7322	103.5093	90.13866
Arab Monetary Fund	76.8527	60.6613	40.92981	40.63362	27.92592	20.84571

TABLE 14 (*continued*)

Lending sources	Outstanding external debt (disbursed) 1998	1999	2000	2001	2002	2003 December
7. Leasing contracts	165.2425	145.9341	124.4396	100.6179	77.81177	65.97851
Total	7 065.78	7 314.659	6 762.403	6 689.217	7 226.142	7 604.609
8. Collateralized Brady bonds	456.8004	456.8004	350.978	320.1185	320.1185	–
Grand total	7 522.58	7 771.459	7 113.381	7 009.335	7 546.261	7 604.609

Source: Ministry of Finance, Government of Jordan, *Government Finance Bulletin*, vol. 6, No. 1, (Amman, February 2004), p. 20.

Note: A dash (–) indicates that the amount is nil or negligible.

2. *Structure of the debt*

Outstanding external public debt increased during the period 1988-2003 by 15 per cent. It reached $7,605 million in 2003, up from $6,611 million in 1989. Moreover, despite the increase in the volume of the debt, it decreased as a percentage of GDP from 160.1 per cent in 1989 to 77.1 per cent in 2003, based on the fact that GDP increased at current prices by 138.8 per cent during the period (see tables 15 and 16).

Foreign reserves increased from $133 million in 1989 to $4,740 million in 2003, or by 346 per cent; as a percentage of external debt, foreign reserves increased from 2 per cent in 1989 to 62.3 per cent in 2003. As a third indicator of the ability to service the debt, the percentage of the external debt to exports decreased from 283.6 per cent in 1989 to 166.2 per cent in 2003.

The following indicators of the real ability to service the debt are illustrated in tables 15 and 16:

(a) The ratio of paid debt service, on a cash basis, to exports decreased from 26.2 per cent in 1989 to 23.1 per cent in 2003;

(b) The ratio of debt service, on a commitment basis, to exports witnessed a sharp decline from 58.6 per cent in 1989 to 29.1 per cent in 2003;

(c) The ratio of debt in service, on a cash basis, to GDP decreased from 14.8 per cent in 1989 to 10.7 per cent in 2003, while on a commitment basis, it decreased sharply from 33.1 per cent in1989 to 13.5 per cent in 2003;

(d) The implicit interest rate, or the ratio of interest to the outstanding external debt, decreased from 6.2 per cent in 1989 to 4.1 per cent in 2003;

(e) Other indicators imply that the per capita outstanding external debt decreased from $2,103 in 1989 to $1,389 in 2003, and the debt service per capita decreased from $435 in 1989 to $243 in 2003.

TABLE 15. JORDAN: INDICATORS OF EXTERNAL PUBLIC DEBT, 1989-1995
(*Millions of US dollars*)

	1989	1990	1991	1992	1993	1994	1995
Outstanding external debt (OED)	6611	7 616	7 346	6 625	6 008	6 189	6 299
Debt service (commitment basis):	1 367	1 323	1 279	1 133	1 015	914	917
Principals	954	871	829	700	624	557	540
Interest	413	452	450	434	391	357	378
Debt service (cash basis):	610	713	1181	802	594	500	476
Principals	388	261	708	509	429	271	239
Interest	222	452	473	293	165	229	237

TABLE 15 (*continued*)

	1989	1990	1991	1992	1993	1994	1995
GDP at current prices	4 128	4 020	4 213	5 367	5 665	6 297	6 812
Exports of goods and non-factor services	2 331	2 509	2 483	2 663	2 820	2 985	3 479
Imports of goods and non-factor services	2 962	3 466	3 428	4 324	4 494	4 395	4 902
Foreign reserves (FR)	133	303	825	769	595	431	427
Population (in millions)	3 144	3 468	3 701	3 844	3 993	4 139	4 291
Indicators of capacity to pay back debt:							
Ratio of OED to GDP (percentage)	160.1	189.4	174.4	123.4	106	98.3	92.5
Ratio of FR to OED (percentage)	2	4	11.2	11.6	9.9	7	6.8
Ratio of OED to exports (percentage)	283.6	303.5	295.8	248.8	213.1	207.4	181
Indicators of real capacity to pay back debt:							
Ratio of debt service (cash basis) to exports (percentage)	26.2	28.4	47.6	30.1	21.1	16.8	13.7
Ratio of debt service (commitment basis) to exports (percentage)	58.6	52.7	51.5	42.6	36	30.6	26.4
Ratio of debt service (cash basis) to GDP (percentage)	14.8	17.7	28	14.9	10.5	7.9	7
Ratio of debt service (commitment basis) to GDP (percentage)	33.1	32.9	30.4	21.1	17.9	14.5	13.5
Implicit interest rate (Interest/OED)	6.2	5.9	6.1	6.5	6.5	5.8	6
Liquidity indicators:							
Ratio of FR to debt service (cash basis) (percentage)	21.8	42.4	69.9	95.9	100.2	86.2	89.7
Ratio of FR to imports (percentage)	4.5	8.5	24.1	17.8	13.2	9.8	8.7
Federal reserves covering imports (in months)	0.2	1	4.2	3	2.2	1.7	1.5
Other indicators:							
GDP growth rate	(31.6)	(2.6)	4.8	27.4	5.6	11.1	8.2
Per capita OED (in US dollars)	2 103	2 196	1 985	1 723	1 505	1 495	1 468

Sources: Ministry of Finance, Government of Jordan, "External loans: the Jordanian experience", a working paper, (Amman, March 2000), p. 15, (in Arabic) and *Government Finance Bulletin*, vol. 5, No. 12, (Amman, January 2004), pp. 64-67.

Note: Parentheses ( ) indicate a negative amount.

TABLE 16. JORDAN: INDICATORS OF EXTERNAL PUBLIC DEBT, 1996-2003
(*Millions of US dollars*)

	1996	1997	1998	1999	2000	2001	2002	2003
Outstanding external debt (OED)	6 661	6 461	7 066	7 315	6 763	6 689	7 226	7 605
Debt service (commitment basis):	942	824	825	776	845	806	799	1 330
Principals	566	474	424	409	465	472	506	1 018
Interest	376	350	401	367	381	335	293	313
Debt service (cash basis):	555	529	510	499	646	602	582	1 057
Principals	275	280	242	263	383	364	394	884.3
Interest	280	249	268	236	262	237	187	172.2
GDP at current prices	7 027	7 324	7 912	8 134	8 447	8 901	9 383	9 860
Exports of goods and non-factor services	3 663	3 572	3 548	3 534	3 536	3 776	4 283	4 575
Imports of goods and non-factor services	5 416	5 186	5 090	4 990	5 796	6 026	6 240	6 747
Foreign reserves (FR)	697	1 693	1 170	1 991	2 763	2 578	3 495	4 740
Population (in millions)	4 444	4 600	4 756	4 900	5 039	5 182	5 327	5 476
Indicators of capacity to pay back debt:								
Ratio of OED to GDP (percentage)	94.8	88.2	89.3	89.9	80.1	75.2	77	77.1
Ratio of FR to OED (percentage)	10.5	26.2	16.6	27.2	40.9	38.5	48.4	62.3
Ratio of OED to exports (percentage)	181.8	180.8	199.1	207.7	191.3	177.1	168.7	166.2

TABLE 16 (*continued*)

	1996	1997	1998	1999	2000	2001	2002	2003
Indicators of real capacity to pay back debt:								
Ratio of debt service (cash basis) to exports (percentage)	15.2	14.8	14.4	14.1	18.3	15.9	13.6	23.1
Ratio of debt service (commitment basis) to exports (percentage)	25.7	23.1	23.3	22	23.9	21.4	18.7	29.1
Ratio of debt service (cash basis) to GDP (percentage)	7.9	7.2	6.4	6.1	7.6	6.8	6.2	10.7
Ratio of debt service (commitment basis) to GDP (percentage)	13.4	11.3	10.4	9.5	10	9.1	8.5	13.5
Implicit interest rate (interest/OED)	5.6	5.4	5.7	5	5.6	5	4.1	4.1
Liquidity indicators:								
Ratio of FR to debt service (cash basis) (percentage)	125.6	320.1	229.5	398.9	428	428.4	600.9	448.6
Ratio of FR to imports (percentage)	12.9	32.7	23	39.9	47.7	42.8	56	70.3
Federal reserves covering imports (in months)	2.1	5.4	4	7.1	7.9	7	9.6	11.6
Other indicators:								
GDP growth rate	3.2	4.2	8	2.8	3.8	5.4	5.4	5.1
Per capita OED (in US dollars)	1 499	1 404	1 486	1 493	1 342	1 291	1 356	1 389

Sources: Ministry of Finance, Government of Jordan, "External loans: the Jordanian experience", a working paper, (Amman, March 2000), p. 15, (in Arabic); *Government Finance Bulletin*, vol. 5, No. 12, (Amman, January 2004), pp. 64-67.

3. *The debt burden on the economy*

The debt service, namely, principals and interest, on a commitment basis amounted to some $1,367 million in 1989, decreasing slightly to $1,330 million in 2003 or approximately -2.7 per cent, which was the result of a decrease in the interest rate and agreements signed by Jordan to reschedule a significant portion of the debt (see tables 15 and 16). The debt service, on a cash basis, reached $610 million in 1989, and increased to $1,057 million or some 73.3 per cent, as a result of an increase in principals.

The indicators of the real ability to buy back the debt point to the fact that in the early 1990s the situation in Jordan was highly critical. The ratio of debt services on a commitment basis to exports was 58.6 per cent compared to 29.1 per cent in 2003. Furthermore, in 1989 the ratio of debt services on a commitment basis to GDP was 33.1 per cent compared to 13.5 per cent in 2003. Foreign reserves were $133 million in 1989 with a ratio to debt services on cash basis of 21.8 per cent compared to $4,740 million in 2003 and a ratio of 448.6 per cent (see table 15 and 16).

These indicators underscore that the Jordanian economy is in a less vulnerable position now than it was 15 years ago. The other indicators in tables 15 and 16 show that while foreign reserves increased drastically in 2003 compared to 1989, the per capita outstanding external debt remained high compared to per capita income. In other words, despite the fact that the ratio of per capita external debt to per capita income decreased from 160.1 per cent in 1989 to 77.1 per cent in 2003, the latter ratio remains high, albeit manageable. Indeed, the debt burden continues to exert a negative impact on the budget and balance of payments deficits.

4. *Government debt management policies*

After the crisis of 1989, the main objective of economic policy was to restore stability and confidence in the Jordanian dinar. Within the framework of two Stand-by arrangements in 1989 and 1992 with IMF, inflation was reined in and the Jordanian dinar was stabilized against the dollar and SDR in 1992. During the period 1992-1994, plans were formulated to reduce the reliance of the Government on Central Bank of Jordan direct credits. Macroeconomic stability was once again tested during the prolonged illness and death of King Hussein bin Talal in 1999 as the uncertainties surrounding his death and rumours regarding succession to the throne caused a decrease in demand for the Jordanian dinar in favour of foreign currencies. As Central Bank of Jordan reserves fell, the Government acted firmly and quickly with the support of IMF. The Central Bank of Jordan doubled short-term interest rates to defend the Jordanian dinar and the dollar peg and a crisis was averted.

The current debt management strategy is based on basic central, which were adopted during the economic reform and stabilization programmes agreed with IMF and the World Bank. The overall goal of these is to mitigate the impact of the debt burden and the associated risks though the proper management of debt. These themes incorporate the need to do the following:

(a) Restructure the external debt by moving short-term loans to medium- and long-term loans at low interest rates and converting all short-term loans to medium- and long-term loans;

(b) Restructure official debt with the Paris Club through the six restructuring agreements, which totalled $5,015.6 million in debt principle and interest charges, and which are reviewed below:[71]

(i) An agreement in 1989 treated $587 million of debt service to Paris Club creditors for the period July 1989 to December 1990;

(ii) An agreement in 1992 covered some $771 million in debt service to Paris Club creditors from the period January 1992 to June 1993;

(iii) An agreement in 1994 treated some $1.2 billion of debt service to Paris Club creditors for the period July 1994 to May 1997;

(iv) An agreement in 1997 covered some $400 million of debt service to Paris Club creditors for the period June 1997 to February 1999;

(v) An agreement in 1999 treated some $821 million in debt service to Paris Club creditors for the period 1 April 1999 to 30 April 2002;

(vi) An agreement in 2002 covered some $1.3 billion in debt relief for the period July 2002 to July 2007.

(c) Restructure the debt with non-Paris Club countries with conditions similar to those agreed with the Paris Club, and in this context agreements were signed with the following countries and funds:[72]

(i) Republic of Korea: agreements were signed in 1989 and 1992 to restructure a debt of $1.5 million;

(ii) China: an agreement was signed in 1992, to restructure a debt of $2.6 million;

(iii) Abu Dhabi Fund for Development: an agreement was signed in 1997 to reschedule a debt of 18.7 million United Arab Emirates dirhams;

(iv) KFAED: an agreement was signed in 2001 to reschedule a debt of $210 million;

(v) Saudi Fund for Development: an agreement was signed in 2002 to reschedule a debt of 611 million Saudi Arabian riyals.

---

[71] Todd Schneider, "External debt dynamics and sustainability", *Jordan: Selected Issues and Statistical Appendix*, IMF Country Report No. 04/121, (Washington D.C., IMF, May 2004), p. 68.

[72] Ministry of Finance, Government of Jordan, "Debt swap agreements", (Jordan, 2003), (in Arabic).

(d) Restructure external debt with the London Club through a market-based menu type of agreement, and in this context, an agreement was reached in 1993 to restructure over \$862 million in overdue principal and interest payments through the Brady Plan, which was signed between the London Club and the Government of Argentina in 1992. Moreover, over \$85 million in commercial bank debt was forgiven;[73]

(e) Pursue additional activities during the period 1989-2003, including the following:[74]

(i) Debt-buy-back, which is means of restructuring external debt. Jordan benefited from discounts on debt, from 50 per cent to 82.5 per cent off the face value of the debt. For example, Jordan agreed to buy back the debt that it owed to the Russian Federation, some \$789 million for \$138 million, with an 82.5 per cent discount. Jordan paid \$88 million in cash with the remaining \$50 million paid in the form of exports.

(ii) Debt swap, which is a tool that generates discounts off the face value of the debt, ranging from 47 per cent to 73 per cent. The net value of the debt is then allocated to finance projects. Different forms of this tool, with selected examples, are highlighted below:

a. Debt for charitable works swap: Jordan signed an agreement with Switzerland in 1993 to swap \$30.3 million-worth of debt at a 73 per cent discount rate off the face value of the debt for a commitment to finance some form of charitable project. The net value after discount, \$8.1 million, went towards financing projects in Jordan;

b. Debt for environmental protection swap: Jordan signed two agreements with Germany in 1995 to swap a portion of their bilateral loans, some \$55.5 million, at a 50 per cent discount rate off the face value of the debt for a commitment to ensure some form of environmental protection. The net value, \$27.7 million, was spent on sewage projects in Jordan;

c. Debt for aid swap: Jordan signed an agreement with France in 1994 to swap a portion of its debt, some \$5.1 million, for the commitment to finance vocational training projects;

d. Debt for export swap: Jordan signed agreements with Finland in 1997 and 1998 to swap debt worth \$4.5 million at a 40 per cent discount rate off the face value of the debt, for a commitment to export phosphate;

e. Debt for equity swap: Jordan signed an agreement with the United Kingdom in 1995 to swap \$60 million of its debt at a 50 per cent discount off the face value of the debt, for a commitment to establish new investments or buy shares in existing companies. Jordan signed similar agreements with France in 1996 and 1999 to swap \$65 million-worth of debt at a 47 per cent discount rate;

f. Debt for development projects swap: Jordan signed two debt for development swap agreements with France: one in 1994, for \$5 million, and another in 1999 for \$20 million. The net value of the debt after discounts was managed by a commercial bank in Jordan with the aim of financing development projects. Similar agreements were signed with Germany and Spain; Jordan also signed an agreement with the United Kingdom in 2003 to swap a debt of 74.1 million pounds sterling at a 38 per cent discount rate, and another with Spain in the same year, to swap a debt of \$12 million at a 50 per cent discount for a commitment to finance development projects in the country.

---

[73] Ministry of Finance, Government of Jordan, "External loans: The Jordanian experience", (Jordan, March 2000), p. 8, (in Arabic).

[74] Ibid, pp. 9-11, and Omar Samara, "External debt management: The case of Jordan", a masters thesis for Yarmouk University, Jordan, (May 1999), pp. 109-113, (in Arabic).

(iii) Debt forgiveness, which is a tool that enables the writing off all or part of a debt, thereby removing the debt obligation completely. However, one problem for Jordan was that the legislation of some countries does not allow them to forgive loans. This was the case with Japan, which until the 1990s was Jordan's primary source of foreign aid. Since the Japanese constitution did not permit debt forgiveness, Jordan negotiated for and obtained grants and financial assistance to cover some of the debt obligations. After the Israel-Jordan Peace Treaty of 1994, the United States and Jordan signed three debt-write-off agreements, for $220 million in 1994, $417 million in 1995 and $63.7 million in 1997; the total value of the debt forgiveness was $700.7 million. Similarly, the Government of the United Kingdom signed an agreement with Jordan in 1995 to write off the outstanding balance of the bilateral loans owed to it by Jordan, which amounted to $70.7 million.

In addition, new legislation was introduced, namely, the Public Debt Management Law of 2001. This was designed to monitor debt more effectively and to establish benchmarks for policy makers and practitioners. The Public Debt Management Law was ratified by Parliament in May 2001; it replaced the 30-year-old Law No. 1 of 1971. According to the new law, a ministerial committee headed by the Minister of Finance, including several cabinet members and the Governor of the Jordan Central Bank was to be established. The objectives of the Committee include establishing an overall strategy for public debt management, and establishing clear short- and long-term objectives, in addition to evaluating and assessing the recommendations made by competent authorities. The law also states that the Government is barred from relying on direct credits from the Central Bank, and most importantly, it places a ceiling on domestic and external debt, with the aim that by 1 January 1 2006 neither would exceed 60 per cent of GDP, and that by January 2008 total debt would not exceed 80 per cent of GDP.[75]

Overall, debt rescheduling is the most commonly used tool in terms of volume and frequency by the Government of Jordan; this is followed by debt forgiveness, debt-buy-back and debt swaps. Such transactions are expected to help to reduce external public debt and interest payments in the future. In this regard, the debt-buy-backs and swaps, including the early amortization of Brady bonds in December 2003, were in line with the government objective of decreasing total public debt to a maximum of 80 per cent of GDP in 2007.[76]

Commercial debt has almost disappeared, and has been replaced by multilateral and bilateral debt. The bilateral component of the debt is highly concessional with favourable repayment terms in relation to debt servicing and repayment periods. New loans contracted by the Government in 2001 and 2002 had a weighted average maturity of 20 and 11 years, respectively. The weighted average grant element in the loans contracted in 2001 and 2002, was 40 and 26 per cent, respectively. The trend improved in 2003 to a weighted average maturity of 19 years and a weighted grant element of 33 per cent.[77]

In the past decade, external debt in Jordan has been driven by efforts to amass a comfortable cushion in terms of foreign reserves to maintain the dollar peg and hence confidence in the Jordanian dinar, and also the decision to finance development spending through external loans instead of domestic debt. Foreign debt that was utilized to fund the reserves and budget support constituted some 44 per cent of the total external debt during 1992-2002. External borrowing, which financed such projects as the Plan for Social and Economic Transformation, accounted for 50 per cent of external new borrowing during the period 1992-2002. Moreover, on a net basis, the inflows exceeded the outflows as the majority of debt repayments were rescheduled during the past decade.[78]

---

[75] Mohammad Nassar, "Public debt management: Case of Jordan", (Central Bank of Jordan, February 2004), p. 8.

[76] Ministry of Finance, *Government Finance Bulletin*, vol. 5, No. 12, (Amman, January 2004), p. 72.

[77] Todd Schneider, "External debt dynamics and sustainability", *Jordan: Selected Issues and Statistical Appendix*, IMF Country Report No. 04/121, (Washington D.C., IMF, May 2004), p. 69.

[78] Ibid, p. 72.

TABLE 17. JORDAN: TOOLS FOR REDUCING EXTERNAL PUBLIC DEBT, 1989-2003
(*Millions of US dollars*)

Tool	Amount
Debt buy-back	1 518.8
Debt swap with investment	171.1
Debt swap with bonds	736
Debt swap for aid	5.1
Debt swap with exports	4.5
Debt swap for developmental projects	88.5
Debt swap for charitable works	72.3
Debt forgiveness	771.4
Total	3 367.7

Source: Data for the period 1989-1997 were obtained from Omar Samara, "External debt management: The case of Jordan", a masters thesis for Yarmouk University, Jordan, (May 1999), p.114 (in Arabic); data for the period 1998-2003 were obtained from Ministry of Finance, Government of Jordan, "Debt swap agreements", a working paper, (Jordan, 2003), and "External loans: The Jordanian experience", a working paper, (Jordan, March 2000), (both in Arabic).

5. *Conclusions and recommendations*

(a) *Conclusions*

The Government of Jordan has managed its public debt successfully in terms of minimizing reliance on external debt; for example, outstanding external public debt, government and government-guaranteed, amounted to $7,469 million, or 70.1 per cent of GDP, at the end of March 2004 compared to $7,605 million, or 77.1 per cent of GDP, at the end of 2003.[79]

The Ministry of Finance is attempting to minimize the cost of debt by reducing total outstanding debt, both domestic and external. This decreased from JD 7,095 million ($10,007 million), or 101.5 per cent GDP at the end of 2003 to JD 6,821 million ($9,620 million), or 90.3 per cent of GDP at the end of March 2004.[80]

Moreover, while debt service, whether on a commitment or a cash basis, creates a heavy burden on economic performance, the Government has successfully lessened the immediate burden of debt by rescheduling within the framework of Paris and London clubs agreements, in addition to other agreements, to cope with the targets of its economic adjustment programmes for the period 1989-2004.

One objective of debt management policies in Jordan is to help to maintain the stability of the exchange rate of the Jordanian dinar, and in this regard, the Government has been relatively successful over the past decade. However, in spite of their prudence in terms of approaching debt as a temporary solution, one problem remains: flexibility of outlays in the fiscal budget.

In this context, it must be noted that it is difficult to discuss the way in which debt is managed without examining how the money is spent. Rigidities in the budget of any country allude to future vulnerabilities. With regard to the case of Jordan, rigidities appear to have increased over the past decade. Moreover, in spite of the substantial savings on interest payments, the composition of current government expenditures remains inflexible, which is reflected in the fact that wages, pensions, military outlays and interest payments made up 81.6 per cent of the budget in 2001, compared with 74.3 per cent in 1992.[81] One area that requires

[79] Ministry of Finance, Government of Jordan, *Government Finance Bulletin*, vol. 6, No. 3, (Amman, April 2004), table 13, p. 20.

[80] Ibid, table 14, p. 21.

[81] Ministry of Finance,Government of Jordan, *Government Finance Bulletin*, vol. 5, No. 11, (Amman, December 2003), table 10, p. 17.

immediate attention, therefore, is the wages and salaries component of the budget in that the percentage of civil servants to the labour force continues to remain high and this limits the ability of the Government to utilize fiscal policy for enhanced growth through capital expenditures.

(b) *Recommendations*

Bearing in mind the information presented above, ESCWA makes the following recommendations:

(1) The Government must continue to search for debt swapping and forgiveness opportunities. Either option increases the economic ability to accumulate capital, whether domestic or foreign.

(2) The Ministry of Finance must establish a unit, to operate in addition to the one that already exists, to monitor and follow up on debt agreements, and also to emphasize the significance of allocating external debt efficiently.

(3) The Government must spend more of its external debt on productive projects and infrastructure to enable greater inflows of investments, and thus allow the expected rate of return on the investment of the debt to exceed the cost of public debt. In order to facilitate this, government outlay rigidities must be properly addressed and reduced, which entails a serious review of current budgeting allocations and principles. Furthermore, there must be a departure from present spending levels to free the Government from its dependence on foreign assistance in terms of financing development, thereby making development a national, home-grown endeavour.

(4) Negotiators must utilize and build on previous experiences to maximize the benefits of agreements. In this context, it can be noted that while six rescheduling agreements have been signed with members of the Paris Club since 1989, it has often been the case that different teams have negotiated the various agreements with little or no accumulated knowledge from past experiences.

(5) The Ministry of Finance must monitor exchange rate risks and offer advice regarding their impact on the Jordanian dinar and the overall debt. The unit currently established at the Ministry of Finance must be staffed with highly trained and motivated individuals who are capable of monitoring and analysing data. In particular, there must be careful assessment and management of the risks associated with foreign currency and short-term or floating-rate debt, with the aim of ensuring that there is sufficient cash or access thereto to avoid the risk of not being able to honour financial obligations as and when they arise.

(6) The Government of Jordan must take into account the political and regional instabilities that surround the domestic economic landscape and account for probable events, which if unexpected could prove disastrous and create additional future outlays.

IV. CASE STUDY: LEBANON

A. OVERVIEW OF THE DEBT STUATION IN LEBANON

1. *Historical background*

(a) *The conflict years*

The 15-year civil war in Lebanon, from 1975 to 1990, combined with regional instabilities caused significant damage to the public and private infrastructure of the country, and was accompanied by degradation in authority of the Government. The loss of physical assets and damage to infrastructure as a result of the conflict was estimated at $25 billion at the end of the war, with none of the principal sectors of the economy emerging unaffected.[82] The consequences of limited investment and maintenance expenditure over the conflict period compounded the problem in terms of unrealized development. Estimates of total direct and indirect losses were in excess of $100 billion.[83]

The erosion of Government authority and institutional capacities severely affected the Government's ability to collect revenues both during the conflict and in the subsequent period. Prior to the end of hostilities, the fiscal situation was already under the burden of the above-mentioned factors, in addition to having to cope with the pressing need for public spending on essential services. A cycle of repeated budget deficits resulting from necessary expenditure and a lack of revenues led to monetary expansion, inflation and a fall in the exchange rate. The result was the dollarization of the economy and a net outflow of capital, which placed additional pressures on the exchange rate causing it to fall even further.[84]

(b) *The post-conflict years*

By the end of the conflict, there was an imperative need for greater public expenditure on physical and social infrastructure, which was a necessity that could not be matched by revenues. There was also an urgent need to stabilize the economy, which in itself was a costly and conflicting requirement.[85] The tight monetary policy implemented by the Central Bank included maintaining a stable exchange rate by using a nominal anchor with the dollar and high interest rates on Lebanese pound assets to bring down inflation. This was largely executed through secondary debt market operations. With this in mind, the economic situation at the end of 1992, two years after the end of hostilities, was as follows: The value of the Lebanese pound (LL) had plummeted from LL 790 per dollar in December 1990 to LL 2,527 per dollar by September 1992; inflation was at 120 per cent; public debt already stood at approximately $3 billion, 40 per cent of GDP at the time; and the average interest rates on Government Treasury-bills (T-bills) had risen to 34 per cent.[86] The basic requirements of modern civil society in terms of traditional public services were non-existent, not to mention the additional expenditure required for such issues as the return of the displaced, who were estimated to amount to a quarter of the Lebanese population,[87] and the integration of militias into the armed forces and eventually back into civil society.

---

82 Ministry of Finance, Government of Lebanon, *The Lebanese Republic Country Profile*, (2002), p. 10. Available at: http://www.finance.gov.lb/main/aboutus/CountryProfile/CountryOverview.pdf.

83 Fouad Siniora, Minister of Finance, Government of Lebanon, "It's time to end the political squabbling and pass the financial reform agenda", *The Daily Star*, 26 April 2004.

84 Ministry of Finance, Government of Lebanon, *The Lebanese Republic Country Profile*, (2002), p. 10. Available at: http://www.finance.gov.lb/main/aboutus/CountryProfile/CountryOverview.pdf.

85 Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban (Central Bank of Lebanon), which took place in Beirut on 5 May 2004.

86 Banque du Liban, "Economic and financial data". Available at: http://www.bdl.gov.lb/edata/subseries.asp?SIID=7.

87 Ministry of Finance, Government of Lebanon, "Beyond reconstruction and recovery… Towards sustainable growth; A request for international support", (Beirut, 14 November 2002), a paper prepared for the Paris II Conference on 23 November 2002, p. 3.

Faced with such conditions, the Government embarked on an ambitious reconstruction programme in the hope of securing significant external financial assistance and a solid partnership with the private sector, neither of which was forthcoming within the time frame envisaged. In hindsight, betting on these potentialities and proceeding with massive spending on all levels without a realistic plan in terms of financing and repayment was not the wisest of policies. However, the need for significant government expenditure was to a large extent unavoidable and public sector borrowing was the only available avenue for financing these requirements.

In 1993, the ability of the Government to access medium-term domestic or external financing remained limited. The alternative was short-term borrowing in local currency for the majority of its expenditure needs. Maturities were short while interest rates were high as a result of monetary stabilization policies, namely, stabilizing the exchange rate and curbing inflation on the one hand, and the risk premium demanded by lenders on the other, which can largely be attributed to the perceived political and security risks of Lebanon at the time and also the credit default risk of the Government, which was based on the fiscal weaknesses it was experiencing. Real GDP growth rate estimates[88] averaged 7.2 per cent per annum between 1993 and 1995.[89] These conditions did not persist as real (private) sector growth did not take over from public sector instigated growth as the Government's ability to spend diminished with the increasing debt and its servicing cost. The existing fiscal deficit ballooned further as a result of the high cost of borrowing, regardless of Government efforts to increase revenues. The deficit was a direct consequence of reconstruction, and social and security outlays, and also the sterilization procedure undertaken by the Central Bank, namely, Banque du Liban, to control short-term financial capital flows. Given that these factors added to the high cost of borrowing, the self-perpetuating cycle was in motion.

2. *The evolution of public debt from 1996 to the present*

(a) *Domestic borrowing*

With limited access to medium-term financing in the immediate post-war period, the Government of Lebanon sought to finance reconstruction and recurring budget deficits principally through the issuance of Lebanese pound-denominated T-bills, with maturities of three, six and twelve months, and Treasury bonds (T-bonds) with maturities of twenty-four months.[90] In September 1995, the market experienced an extreme interest rate peak when one-year T-bill yields reached 37.85 per cent (see chart 4). According to Central Bank officials, interest rates on the primary market had decreased sharply and were not in line with market sentiments with respect to the exchange rate risk that Lebanese pound-denominated debt reflected. During that period, the yield curve on the Lebanese pound went beyond the acceptable spread between returns in Lebanese pounds and those in dollars. The country witnessed a massive dollarization in the market place, and to create demand for Lebanese pound-denominated assets an increase in the interest rates to record levels was required (see chart 4). The objective of stabilization was achieved, albeit at a cost. By 1996, the fiscal (budget) deficit had reached 20 per cent of GDP, with interest payments absorbing three quarters of total revenues.[91] It was during this period that new debt had to be issued at unprecedented high rates to honour debt servicing payments that were due. Total net debt had reached $13 billion, or 99 per cent of GDP in 1996, of which, $11.1 billion was short-term domestic debt in local currency.[92]

---

[88] There have been no official calculations of gross domestic product (GDP) since 1977. The debate concerning economic indicators and proper statistics is recurrent, and is considered to be an impediment to a real understanding of the economic situation in Lebanon, not to mention the fact that it is an essential ingredient in any economic development strategy.

[89] Ministry of Finance, Government of Lebanon, *The Lebanese Republic Country Profile*, (2002), p. 12. Available at: http://www.finance.gov.lb/main/aboutus/CountryProfile/CountryOverview.pdf.

[90] Ibid, p. 24.

[91] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004. All interest rate figures based on economic and financial data from the Banque du Liban website. Available at: http://www.bdl.gov.lb/edata/subseries.asp?SIID=7.

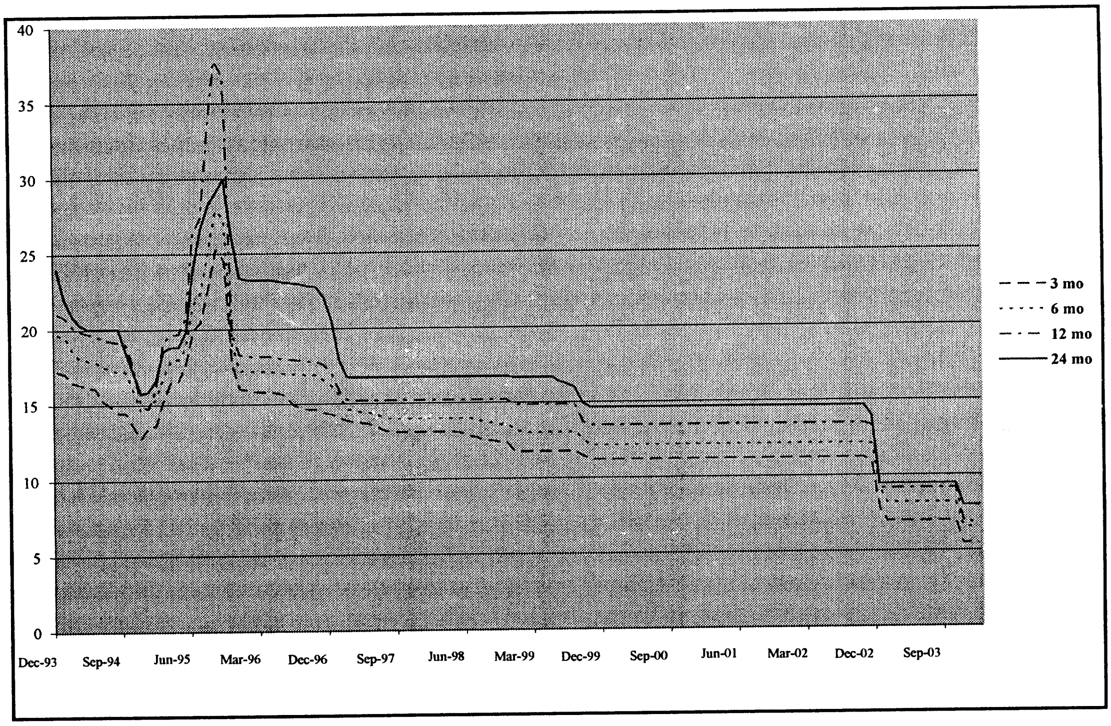
[92] Ministry of Finance, Government of Lebanon. Available at: http://www.finance.gov.lb/main/govfin/overview.htm.

Interest rates on local debt in December 1996 ranged between 14.3 per cent and 20.5 per cent for the four maturities mentioned above, which was a reflection of the risk placed on Lebanese debt as it faced the aforementioned fiscal pressures.[93]

Given that the uncertainty surrounding the public finance situation was high and the market was not willing to carry longer maturity denominations of local currency debt, longer maturity instruments in local currency could not be issued successfully at that time.

A comprehensive illustration of short-term interest rates is highlighted in chart 4.

Chart 4. Short-term secondary market interest rates, December 1993 - September 2003



Source: Banque du Liban, "Economic and financial data". Available at: http://www.bdl.gov.lb/edata/subseries.asp?SIID=7.

(b) *External borrowing*

As a matter of record, Lebanon had very minor external public debt prior to the 1975-1990 conflict, and with a single insignificant exception, had always been current on its debt servicing, including during the conflict period. The exception mentioned above refers to a debt to the Commodity Credit Corporation of the United States. This loan fell into arrears in April 1986 because the Ministry of Finance, which coordinates external debt service, was unaware of its existence owing to the loss of records during the conflict period. The Ministry of Finance assumed responsibility for the debt and it was cleared in 1995.[94]

In 1993, the external debt of Lebanon stood at $462 million, mainly in the form of soft loans.[95] As a sovereign debt issuer, Lebanon made its first foray into international capital markets in 1994 with a $400

[93] Figures based on data from the Banque du Liban web site. Available at: http://www.bdl.gov.lb/edata/subseries.asp?SIID=7.

[94] Ministry of Finance, Government of Lebanon, *The Lebanese Republic Country Profile*, (2002), p. 25. Available at: http://www.finance.gov.lb/main/aboutus/CountryProfile/CountryOverview.pdf.

[95] Based on Central Bank data, provided during interviews with Central Bank officials.

million eurobond issue, which had a three-year maturity and a coupon rate of 10.125 per cent.[96] This marked a major shift in debt management policy and the ability of the Lebanese Treasury. Local currency short-term high-interest debt had been placing unsustainable pressure on the fiscal and monetary situation of the Government, and therefore, the Government sought to alleviate this by issuing medium-term foreign currency debt. Furthermore, while Lebanon had begun extending the maturity profile of its public debt through eurobond issues, the substantial economic growth witnessed during the first half of the 1990s, which can be attributed to massive government spending and stabilization policies, decelerated to reach zero per cent in 2000.[97] In addition to this internal situation, the Asian financial crisis in 1998 made it increasingly difficult for Lebanon to access international financial markets.

Market conditions allowing, the Government increasingly resorted to internal borrowing in foreign currency, tapping the significant pool of savings of the banking system. Concerns over the fiscal deficit and rising debt levels resulted in a widening of the interest rate spreads of the new foreign currency debt with respect to United States Treasury benchmarks. The obvious effects on government revenues related to the slowdown and increased borrowing at higher costs gave rise to a renewed cycle of increasing government deficits.[98] The situation in 2000 was as follows: GDP growth had stagnated; gross public debt had reached $24.5 billion representing 153 per cent of GDP (see table 18). The fiscal deficit was close to 25 per cent of GDP with even the primary balance, namely, revenues less non-interest expenditures, in deficit, by 7.5 per cent of GDP.[99] These worsening conditions could not be sustained.

TABLE 18. LEBANON: EVOLUTION OF PUBLIC DEBT, 1996 – JANUARY 2004[a/]

	1996	1997	1998	1999	2000	2001	2002	2003	Jan. 2004
	(Millions of US dollars)								
1. Gross domestic debt	11 101	12 749	13 973	16 355	17 501	18 179	16 303	17 296	17 696
2. Public external debt[b/]	1 907	2 392	4 048	5 381	6 977	9 322	14 180	15 080	15 119
Gross public debt (1 + 2)	13 008	15 142	18 021	21 736	24 477	27 501	30 484	32 376	32 815
3. Public sector deposits[c/]	2 494	906	1 380	2 581	1 695	1 233	1 910	1 945	2 249
4. Net domestic debt (1 - 3)	8 607	11 843	12 593	13 774	15 805	16 947	14 393	15 351	15 447
Net public debt (2 + 4)	10 514	14 236	16 640	19 155	22 782	26 267	28 573	30 430	30 566
	(Percentage of GDP)								
Gross public debt	99	103	114	136	153	170	181	185	179
Net public debt	80	97	105	120	142	162	170	174	167

Source: Ministry of Finance, Government of Lebanon. Available at: http://www.finance.gov.lb/main/govfin/overview.htm.

a/ Debt figures differ from previously published figures owing to the continuous implementation of DMFAS.

b/ Includes accrued interest, and comprises soft loans and eurobonds.

c/ Represents public sector deposits with the Central Bank and commercial banks.

(c) *Adjustments for an untenable situation*

In late 2000, the Government decided—within an IMF informal medium-term framework—to initiate structural reforms and stimulus programmes to revive the economy and set the fiscal situation on a positive path. The general programme was presented at the Paris I Conference, which took place on 27 February

[96] Ministry of Finance, Government of Lebanon. Available at: http://www.finance.gov.lb.

[97] Ministry of Finance, Government of Lebanon, *The Lebanese Republic Country Profile*, (2002), p. 12. Available at: http://www.finance.gov.lb/main/aboutus/CountryProfile/CountryOverview.pdf.

[98] Ministry of Finance, Governement of Lebanon, "Beyond reconstruction and recovery... Towards sustainable growth; A request for international support", (Beirut, 14 November 2002), a paper prepared for the Paris II Meeting on 23 November 2002, p. 5.

[99] Ibid, p. 5.

2001. The Government of Lebanon was assured that real progress in the implementation of the programme would result in external support.[100]

In terms of fiscal adjustments, and despite the need to stimulate economic growth, the initial focus was on controlling non-interest expenditures.[101] Non-interest expenditure had dropped nearly 22 per cent by 2001. The primary balance improved by 9.8 per cent, from a deficit of 7.6 per cent to a surplus of 2.2 per cent by the third quarter of 2002. Expenditure improvements partially reflected the measures that were taken to rationalize public sector employment, for example, restructuring the State-owned Middle East Airlines, Tele-Liban and other measures.[102]

With regard to revenues, the Government was faced with the problem of increasing revenues while also needing to stimulate the economy. Income tax revenues improved slightly in 2001 despite the fact that customs duties, the largest segment of revenues at the time, declined as a result of the recession and the stimulus package that was implemented through a reduction of these duties, which were the largest source of revenue for the Government at that point.[103] Revenues in 2002 markedly improved, by 28 per cent, mainly as a result of the introduction of a value added tax on consumption with some exemptions on basic items, including flour and sugar, withholding tax on interest and the 'deduction at source of salary' income tax. Revenue improvements partially reflected an institutional strengthening in tax administration (automation) and the widening of the income tax base.[104]

The reforms that were undertaken were clearly bearing some fruit, albeit not enough to reverse the debt dynamic. Debt accumulation in 2001 continued at a slower pace, which can largely be attributed to the high interest payments, which created scarcity in the sources of funding. The Government turned to the Central Bank during this period to finance the budget deficit, and its domestic currency public debt portfolio shot up from $1.1 billion to $4.1 billion between 2000 and 2001, including some $1.04 billion in eurobonds.[105] Market confidence in the Government's handling of its finances was at an all-time low. Central Bank officials outlined the situation as follows: The Paris II Conference, which took place on 23 November 2002 was an expected development at the time, where external friendly financing was forthcoming. The market was not willing to take on more debt, given the obvious circumstances, and therefore the Central Bank intervened, buying T-bills from the Government and reselling to the market at lower rates, between 2 and 4 per cent spreads. The Central Bank was willing to bear the cost of attracting demand in favour of Lebanese pound-denominated T-bills on behalf of the Treasury temporarily, which explains the stability of secondary market rates at 14 per cent.[106]

By the end of 2002, the gross debt to GDP ratio had reached 181 per cent, or a staggering $30.5 billion (see table 18), while debt servicing was absorbing 80 per cent of government revenues thus exceeding all tax

---

[100] Ibid, p. 6 and Annex I.

[101] The public sector in Lebanon is overstaffed and is generally characterized by low productivity. It is a signifiant drain on Government resources, with approximately 40 per cent of its annual budget allocated to salaries and compensation packages.

[102] Ministry of Finance, Governement of Lebanon, "Beyond reconstruction and recovery... Towards sustainable growth; A request for international support", (Beirut, 14 November 2002), a paper prepared for the Paris II Meeting on 23 November 2002, pp. 6-7.

[103] Lowering customs duties also falls within the framework of the Government's overall trade liberalization strategy, its Association Agreement with the European Union and eventual accession to the World Trade Organization.

[104] Ministry of Finance, Governement of Lebanon, "Beyond reconstruction and recovery... Towards sustainable growth; A request for international support", (Beirut, 14 November 2002), a paper prepared for the Paris II Meeting on 23 November 2002, pp. 5-7.

[105] Ibid, p. 8.

[106] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

revenues.[107] The reforms and stimuli undertaken at the Paris I Conference had set the climate for Paris II. The objective of the conference was to secure support for the reduction of the stock of public debt and to reprofile its maturity, composition and cost. It had become evident that Lebanon would not be able to reverse its debt trap without external support.

B. EXTERNAL DEBT

1. *Levels of debt and sources of funds*

(a) *Levels of debt*

The need for Lebanon to extend and smooth the maturity profile of its public debt and lower its cost with regard to the government budget remains evident. Local currency debt bears an exchange rate risk premium, whereas foreign currency debt is not burdened with exchange-rate risk to a large extent and mainly reflects the credit default risk of the Government of Lebanon. This exchange rate risk continues to be a major contributor to Lebanon's inability to attract the market to Lebanese pound-denominated medium- and long-term sovereign debt instruments at an acceptably low cost. This situation has improved, to a certain extent, in the wake of the Paris II Conference.

In the early stages of the post-conflict period the external debt of Lebanon consisted entirely of soft loans. This was more a reflection of Lebanon's inability to issue foreign currency debt instruments, with longer maturities, than a planned policy. These loans had been given to Lebanon on a concessional basis at very low rates and for specific development and reconstruction projects. However, a change occurred in 1994; while such loans made up a high ratio of overall debt in the early stages of the charted period, they slowly became less significant as overall external debt levels rose as a result of the regular eurobond issues that the Government had executed.

The focus of this case study, however, is not official credits in the form of soft loans given to Lebanon by multilateral and bilateral international sources, but rather private credits in the form of market instruments,[108] namely, eurobonds. As a matter of record, as of February 2004, soft loans stood at their highest levels, some $2.6 billion, or a ratio of 17 per cent of the overall external debt (see table 19).[109] The jump in levels of these loans from $1.84 billion[110] in 2002 to their present levels constitutes the partial execution of the $1.3 billion that was offered to Lebanon through the Paris II Conference, in the form of various loans, all of which were allocated for specific socio-economic development projects and all of which were long-term concessional loans at favourable rates.[111] Moreover, the eurobond issuance strategy was a simple one at first and entailed the need to do the following: extend the maturity profile of Lebanese public debt; vary the currencies of issuance from Lebanese pounds to shift the global debt risk profile away from exchange rate risk; and aim to secure the lowest possible cost for the Treasury. The Ministry of Finance's skills in actively constructing the foreign debt portfolio from a debt management perspective were previously rather underdeveloped, but have improved over the years.

As of February 2004, foreign currency debt, excluding concessional loans stood at its highest levels, at some $12.8 billion. This consisted of all market-issued eurobonds, in addition to the eurobonds issued under the Paris II Conference to lender countries, the Central Bank and the local banking sector (see table 19). The jump in the level of foreign currency debt from $7.6 billion in 2001 to its current levels is the result of the

---

[107] Ministry of Finance, Governement of Lebanon, "Beyond reconstruction and recovery... Towards sustainable growth; A request for international support", (Beirut, 14 November 2002), a paper prepared for the Paris II Meeting on 23 November 2002, p. 8.

[108] Market debt is defined as gross public debt, excluding the portfolios of the Central Bank, public institutions, bilateral and multilateral loans, and debt issued to the Paris II lender countries.

[109] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

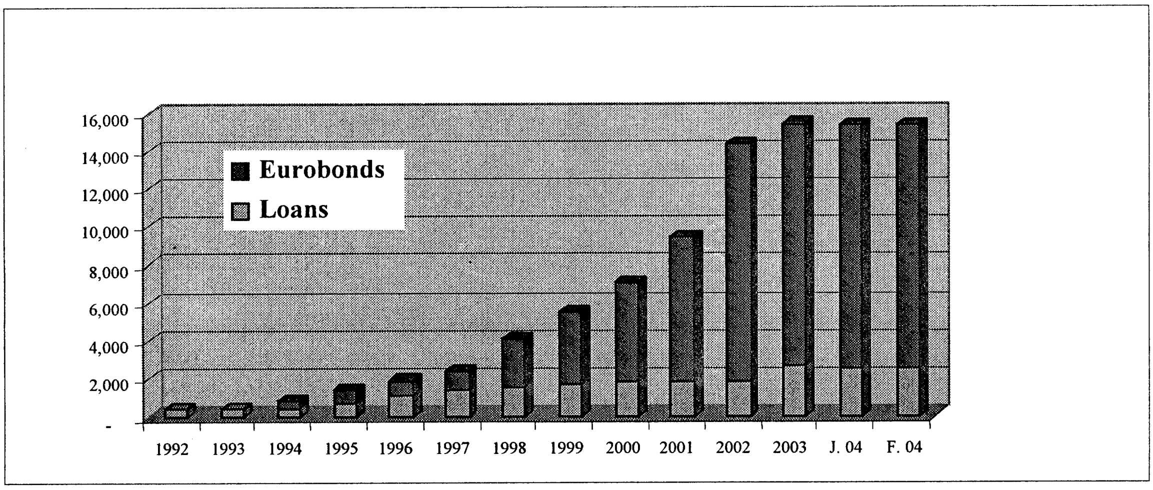
[110] Ibid.

[111] Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), p. 7.

Paris II aid package offered through bilateral and multilateral agreements among donor countries, commercial banks and the Central Bank. These funds have largely replaced short-term local currency debt without drastically increasing the overall debt levels that Lebanon carried prior to the conference. The overall level of foreign debt of Lebanon stood at $15.4 billion in 2004, or a ratio of approximately 47 per cent of gross public debt.[112]

A stark graphical representation of the external debt situation since Lebanon first ventured into foreign currency debt as a source of financing for its budget deficits is presented in chart 5. Note the differentiation between soft loans and market type debt or eurobonds. Lebanon's outstanding external public debt, from 1994 to February 2004 is illustrated in table 19.

Chart 5. Total external public debt, including loans and eurobonds, 1992 – February 2004
(*Millions of US dollars*)



Source: Based on Central Bank data, which was provided during interviews with Central Bank officials.

TABLE 19. LEBANON: OUTSTANDING EXTERNAL PUBLIC DEBT, 1994 – FEBRUARY 2004[a/]
(*Millions of US dollars*)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	February 2004
Loans	472	624	1 077	1 372	1 586	1 730	1 766	1 787	1 843	2 597	2 585
Disbursements	105	246	488	376	268	327	211	191	158	769	3 957
Principal repayments	88	104	21	30	80	131	141	146	177	181	7
Interest, commission and charges	25	36	50	81	81	87	99	81	89	94	3
Eurobonds	400	700	800	1 041	2 499	3 685	5 260	7 613	12 512	12 790	12 781
Issued amounts	400	300	100	644	1 450	1 251	2 013	2 900	5 920	1 592	
Principal repayment				400		400	500	1 165	1 479		
Coupon payment		40	69	77	88	210	344	551	801	1 055	38
Commission	6	3	1	7	13	9	33	11	4	2	
Total outstanding	872	1 324	1 877	2 413	4 085	5 415	7 026	9 400	14 355	15 387	15 366

Source: Based on Central Bank data, which was provided during interviews with Central Bank officials.

a/ Debt figures differ from previously published figures owing to the continuous implementation of DMFAS.

[112] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

(b) *Sources*

Lebanon's foreign debt has a unique characteristic, which is that it is actually foreign currency debt and not foreign debt in the true sense of the word, as the vast majority of it is held by local entities, albeit in foreign currencies. This fact largely explains why Lebanon has survived repeated internal and external economic, political or security shocks over the years under debt burdens that would otherwise have caused severe economic crises.

Moreover, an important feature of the economy of Lebanon that has played to its advantage over the years is its liberal financial system, which is characterized by free capital flows, combined with a regulated and conservatively-run banking sector. A second important advantage is that Lebanon has always been a net exporter of human capital, boasting an international diaspora that exceeds the local population, according to many accounts. The effect of these two factors is a consistent net capital inflow from Lebanese expatriates working abroad, who send money home, either to supplement the income of their families or to save and invest locally at a later stage, and the presence of regional investors, who bank and invest in Lebanon. While the high interest rate climate fostered by the Government and Central Bank has helped to preserve this positive trait, it has come at a significant cost in terms of the public finance situation. For example, Lebanon is a net importer of goods and its trade balance, or current account, is always negative; however, the overall balance of payments is nearly always positive, which can be generally attributed to the circumstances outlined above. Another factor affecting this situation is 'invisible trade' or export of such services as tourism and financial services. In 2003, Lebanon exported goods and services worth $1.5 billion, while imports reached $7.2 billion. Lebanon's capital account registered a net inflow of $9 billion over the same period.[113] These turned the balance of payments in favour of Lebanon. What this means is that Lebanon attracts capital and stores it in its banking system. Lebanon's official estimate of GDP for 2003 was $18 billion, while bank deposits stood at $48.5 billion for the same period, translating into a ratio of bank deposits to GDP of some 270 per cent and banking sector assets to GDP of 330 per cent,[114] one of the highest in the world. These flows are not what are classified as 'hot money', coming in to take advantage of the high interest rate climate and are not at risk of flight at the first hint of trouble, particularly given that most of these capital flows come from expatriates and Gulf Arabs who are relatively familiar with the country.

As a result of its economic problems, Lebanon experienced a massive dollarization of the economy, which has persisted at relatively high levels. At the end of 2003, foreign currency deposits within the banking system formed 66.2 per cent of overall deposits, down from 69.4 per cent the previous year.[115] This translates into a simple formula for both the Government and the banking sector whereby deposits are predominantly in dollars and therefore the demand for dollar-denominated debt from the banking system is ever-present. Accurate figures concerning the amount of locally held Lebanese eurobonds are not published as such, however, there is a solid consensus both among private sector experts and Central Bank officials that the amount of market-type foreign currency debt held within the Lebanese banking sector is in excess of 90 per cent.[116] This ratio clearly points to the fact that Lebanese foreign debt is actually foreign currency debt held primarily by local private parties, namely, banks or individual investors. The impact of this condition on Lebanon's debt dynamics has been positive in the sense that as foreign debt problems usually evolve, foreign-held government debt is at a significantly higher risk of being dumped based on the fact that economic turmoil scares off foreign investors, causing major capital outflows. Had it not been for this factor, Lebanon's debt to GDP ratio would have led to a complete economic meltdown in most situations.

---

[113] Banque Audi, *Quarterly Economic Report*, (Fourth quarter, 2003), p. 4. This period does not reflect the recurrent levels of capital inflows as these are included as a component of Paris II-related funds; however, the same conditions with respect to capital inflows, albeit at tamer levels, have persisted as a regular feature of the balance of payments.

[114] IMF, "Lebanon 2004 article IV mission – Concluding statement", (8 March 2004), p. 6.

[115] Banque Audi , *Quarterly Economic Report*, (Fourth quarter, 2003), p. 6.

[116] Based on interviews with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004 and Marwan Barakat, Head of Economic Research at Banque Audi, which took place in Beirut on 23 April 2004.

Moreover, within the context of Paris II, sources of financing for Lebanese foreign currency debt have become more diversified. Indeed, Lebanon has already received and utilized funds from Paris II lenders. The sources of bilateral funding pledged to Lebanon under the Paris II Conference are illustrated in table 20. In addition to the bilateral financing received as a result of the Paris II Conference, the Government negotiated an agreement with commercial banks to subscribe to a zero-coupon (interest-free) eurobond equalling 10 per cent of each bank's deposits in all currencies. This amounted to approximately $3.6 billion at the time. The Government also reached an agreement with the Central Bank that mainly involved debt exchange or cancellation and roll over schemes worth approximately $4.1 billion.[117] In terms of sources of funds for Lebanon's foreign currency debt thus far, three major suppliers have been identified. First and foremost, the local banking sector; second the Central Bank; and finally bilateral and, to a lesser extent, multilateral international lenders.

TABLE 20. DISBURSEMENTS FROM PARIS II LENDER COUNTRIES
(Millions of US dollars)

Countries	Disbursements
France	540[a/]
Kuwait	300
Malaysia	300
Oman	50
Qatar	200
Saudi Arabia	700
United Arab Emirates	300
Total	2 390

Source: Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), p. 10.

a/ Counter value of contributions in euros at $/euro rate of $1: 1.08.

2. *Structure of the debt*

(a) *Eurobonds*

In 1994, Lebanon issued its first eurobonds with a three-year maturity, which was a significant step up from the longest maturity, which was two years at the time, on the local currency denominated T-bond. The Government was successful in extending the maturity profile of its debt portfolio and also in issuing in various hard currencies. Lebanon's outstanding market-type foreign debt portfolio of eurobonds, with a comprehensive six-year projection of the principal and coupon repayment schedule in terms of foreign currency debt in 2004 is highlighted in table 21. Any additions to the debt portfolio alter this picture, as does the rolling over of any issues into new issues. Paris II-related bilateral issues, the Central Bank roll over financing plan, and the commercial bank zero-coupon scheme are included in table 21. All market issued paper (non-Paris II-related) is structured without a grace period for principal repayment and interest is distributed to holders through biannual coupons while the principal settlement is structured in the form of a bullet payment at the maturity of the issue. Structural details of Paris II instruments are reviewed below. It can also be noted that 2005 and 2006 constitute repayment or maturity peaks of large proportions.

[117] Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), pp. 8-13.

TABLE 21. LEBANON: OUTSTANDING EUROBOND PORTFOLIO WITH PROJECTIONS OF DEBT SERVICING, 2004-2009

PRINCIPAL (millions of US dollars/euros)	2004	2005	2006	2007	2008	2009
$200 due March 2004	184 025 000	–	–	–	–	–
$850 due December 2004	844 000 000	–	–	–	–	–
$1 000 due March 2005	–	900 000 000	–	–	–	–
€ 550 due March 2004	363 857 832	–	–	–	–	–
$850 due June 2005	–	847 000 000	–	–	–	–
$450 due September 2005	–	416 995 000	–	–	–	–
$1 150 due April 2006	–	–	1 110 000 000	–	–	–
$350 due May 2006	–	–	348 558 000	–	–	–
$500 due June 2006	–	–	104 700 000	–	–	–
$750 due August 2006	–	–	640 573 000	–	–	–
€ 300 due October 2006	–	–	322 119 200	–	–	–
$100 due July 2007	–	–	–	100 000 000	–	–
$400 due October 2007	–	–	–	368 668 000	–	–
$ 750 due August 2008	–	–	–	–	750 000 000	–
$ 650 due October 2009	–	–	–	–	–	635 500 000
$400 due May 2016	–	–	–	–	–	–
$1 870 due January 2018[a/] [d/]	–	–	–	–	187 000 000	187 000 000
$950 due December 2017[a/]	–	–	–	–	95 000 000	95 000 000
€ 500 due February 2018[b/]	–	–	36 660 000	73 320 000	73 320 000	73 320 000
$700 due March 2018[a/]	–	–	–	–	35 000 000	70 000 000
$200 due May 2018[a/]	–	–	–	–	10 000 000	20 000 000
January 2003 $: Zero coupon[c/]	–	77 313 000	–	–	–	–
February 2003 $: Zero coupon[c/]	–	72 580 000	–	–	–	–
February 2003 €: Zero coupon[c/]	–	19 584 994	–	–	–	–
March 2003 $: Zero coupon[c/]	–	109 330 000	–	–	–	–
April 2003 $: Zero coupon[c/]	–	54 851 000	–	–	–	–
April 2003 €: Zero coupon[c/]	–	87 355 892	–	–	–	–
May 2003 $: Zero coupon[c/]	–	108 831 000	–	–	–	–
May 2003 €: Zero coupon[c/]	–	181 756 614	–	–	–	–
TOTAL PRINCIPAL	1 391 882 832	2 875 597 500	2 562 610 200	541 988 000	1 150 320 000	1 080 820 000
Coupon (millions of US dollars/euros)						
$200 due March 2004	15 642 125	–	–	–	–	–
$850 due December 2004	80 180 000	–	–	–	–	–
$1 000 due March 2005	92 250 000	46 125 000	–	–	–	–
€ 550 due March 2004	26 379 693	–	–	–	–	–
$850 due June 2005	79 406 250	39 703 125	–	–	–	–
$450 due September 2005	36 487 063	36 487 063	–	–	–	–
$1 150 due April 2006	109 612 500	109 612 500	54 806 250	–	–	–
$350 due May 2006	36 598 590	36 598 590	36 598 590	–	–	–
$500 due June 2006	10 993 500	10 993 500	5 496 750	–	–	–
$750 due August 2006	67 260 165	67 260 165	67 260 165	–	–	–
€ 300 due October 2006	28 588 079	28 588 079	28 588 079	–	–	–

TABLE 21 (*Continued*)

PRINCIPAL (millions of US dollars/euros)	2004	2005	2006	2007	2008	2009
$100 due July 2007	7 500 000	7 500 000	7 500 000	7 500 000	–	–
$400 due October 2007	31 797 615	31 797 615	31 797 615	31 797 615	–	–
$750 due August2008	75 937 500	75 937 500	75 937 500	75 937 500	75 937 500	–
$650 due October 2009	65 138 750	65 138 750	65 138 750	65 138 750	65 138 750	65 138 750
$400 due May 2016	46 500 000	46 500 000	46 500 000	46 500 000	46 500 000	46 500 000
$1 870 due January 2018[a/ d/]	74 800 000	74 800 000	74 800 000	74 800 000	72 930 000	65 450 000
$950 due December 2017[a/]	47 500 000	47 500 000	47 500 000	47 500 000	46 312 500	41 562 500
€ 500 due February 2018[b/]	31 059 167	30 974 306	30 974 306	28 178 981	24 531 650	20 745 147
$700 due March 2018[a/]	35 000 000	35 000 000	35 000 000	35 000 000	35 000 000	32 375 000
$200 due May 2018[a/]	10 000 000	10 000 000	10 000 000	10 000 000	10 000 000	9 250 000
TOTAL COUPON	1 008 630 996	800 516 192	617 898 005	422 352 846	376 350 400	281 021 397
TOTAL (principal and coupon)	2 400 513 828	3 676 113 692	3 180 508 205	964 340 846	1 526 670 400	1 361 841 397

Source: Ministry of Finance, Government of Lebanon. Available at: http://www.finance.gov.lb/main/govfin/projections.htm.

Notes: A dash (–) indicates that the amount is nil or negligible.
Amounts translated into dollars at the rate prevailing on 12 March 2004.
External debt incurred by Lebanon during the projected period may differ significantly from the amounts shown.

a/ Part of the Paris II Eurobond issues.
b/ Loan in Euro, structured similar to Paris II Eurobond issues.
c/ 2 year zero-coupon Eurobond issue subscribed to by commercial banks as part of Paris II package.
d/ Central Bank financing.

(b) *Paris II refinancing*

The Paris II Conference resulted in commitments earmarked for debt reduction and management totalling $3.1 billion, which was in addition to the above-mentioned $1.3 billion in soft loans. Of the $3.1 billion, Lebanon has already received and utilized approximately $2.4 billion for debt retirement or replacement of maturing issues.[118]

Bilateral funding, from donor countries, amounting to $1.85 billion, were structured into eurobonds with a 15-year maturity, a 5-year grace period for principle repayment and a 5 per cent annual coupon rate payable semi-annually (see table 22). This coupon rate represented a spread of approximately 85 basis points over the 10-year United States Treasury note at the time. The Government of France extended a 500 million euro (€) loan, ($540 million at a dollar/euro rate of 1.08), through the Agence Française de Développement, which was structured with the same maturity and coupon rate as the eurobonds, albeit with a shorter three-year grace period for principal repayment.[119] The coupon repayment structure of the French loan can be observed in table 21, as can the first two amortized principal repayments of the other Paris II bilateral eurobond issues beginning in 2008.

At the end of 2002, the Central Bank held government T-bills, T-bonds and eurobonds worth approximately $4 billion in its portfolio. The agreement reached between the Government and the Central Bank involved the following three steps: (a) the cancellation of $1.79 billion-worth of two-year Lebanese pound-denominated T-bonds against reserves due to the Lebanese Treasury as per Article 115 of the Code of Money and Credit;[120] (b) an exchange of $1.87 billion-worth of dollar-denominated eurobonds ($1.04

[118] Ibid, p. 8.

[119] Ibid, pp. 8-11.

[120] Mainly revaluation of the gold reserves of the Government of Lebanon in the custody of the Central Bank. Ibid, p. 12.

billion) and Lebanese pound-denominated T-bills ($0.83 billion) into a 15-year 4 per cent coupon eurobond with a five-year grace period for amortized principal repayment (see table 22); and (c) the rolling over of $0.43 billion of principal and interest on maturing T-bills held by the Central Bank into a new five-year 4 per cent special T-bill.[121]

The commercial banks, as part of the Paris II debt rescheduling and cost reduction programme, agreed to subscribe to a two-year zero-coupon eurobond issue for approximately 10 per cent of their overall deposits, which amounted to $3.6 billion at the time. The scheme gave the banks the option to either subscribe to this issue in cash or through the delivery of previously issued T-bills and eurobonds. At the end of this issue, approximately 85 per cent of subscription was executed using cash and securities maturing within three months, while the remainder was in the form of securities with maturities of longer than three months. The securities exchange operation in terms of the sizes of the tranches of the zero-coupon eurobond issued, the currency and maturity are highlighted in table 22. The cash-type operation lasted from May until August 2003.

The proceeds from the Paris II lender countries arrived during the first quarter of the year, giving the Treasury ample liquidity. Exchanging securities already held by commercial banks first, better matched the cash flow needs of the Treasury at the time. The cash contributions that followed, under the commercial banks' scheme, along with the Paris II proceeds were used exclusively for the retirement of the principal and repayment of interest of maturing debt on a weekly basis.[122] This process lasted for nine months, during which the Treasury abstained from issuing new short-term bills on the local primary market.

TABLE 22. PARIS II EUROBONDS: CENTRAL BANK, BILATERAL LENDERS AND COMMERCIAL BANKS' SCHEME

Eurobond	Issue amount	Outstanding amount	Coupon rate (percentage)	Issue date (month/day/year)	Maturity date (month/day/year)
Central Bank and bilateral lenders (millions of US dollars):					
$ 1 870 due December 2017[a/]	1 870 000 000	1 870 000 000	4	12/31/2002	12/31/2017
$ 950 due December 2017[b/]	950 000 000	950 000 000	5	12/27/2002	12/27/2017
$ 700 due March 2018[c/]	700 000 000	700 000 000	5	3/7/2003	3/7/2018
$ 200 due March 2018[d/]	200 000 000	200 000 000	5	5/27/2003	5/27/2018
Total	3 720 000 000				
Commercial banks:					
January 2003: $ tranche	77 313 000	77 313 000	-	4/16/2003	1/18/2005
February 2003: $ tranche	72 580 000	72 580 000	-	4/16/2003	2/18/2005
February 2003: € tranche	16 027 000	19 584 994	-	4/16/2003	2/18/2005
March 2003: $ tranche	109 330 000	109 330 000	-	4/16/2003	3/18/2005
April 2003: $ tranche	54 851 000	54 851 000	-	4/22/2003	4/18/2005
April 2003: € tranche	71 486 000	87 355 892	-	4/22/2003	4/18/2005
May 2003: $ tranche	108 831 000	108 831 000	-	5/20/2003	5/16/2005
May 2003: € tranche	148 737 000	181 756 614	-	5/20/2003	5/16/2005
Total	659 155 000				

Source: Ministry of Finance, Government of Lebanon. Available at: http://www.finance.gov.lb.main.govfin/external.

Note: Amounts calculated according to a euro/dollar exchange rate of 1.222.
A dash (–) indicates that the amount is nil or negligible.

a/ Banque du Liban.

b/ Kuwait, Oman, Malaysia and United Arab Emirates.

c/ Saudi Arabia.

d/ Qatar.

[121] Ibid, p. 12.

[122] Ibid, pp. 12-13.

(c) *Impact of Paris II on the debt structure*

In the period prior to the Paris II conference, annualized public debt growth had reached 14.3 per cent per annum. This growth rate slowed down significantly to 2.8 per cent in 2003, owing to fiscal improvements, which included a primary surplus of 2.7 per cent to GDP, and the cancellation of $1.79 billion-worth of Lebanese pound-denominated T-bills from the portfolio of the Central Bank. Public debt, however, was still growing.[123]

The composition of public debt shifted markedly, in terms of type, as a result of a drop of 15 per cent, or $5.5 billion, in market debt in favour of lower-cost longer-maturity Paris II bilateral type debt.[124] With gross public debt at approximately $32 billion as of May 2004, market debt, including domestic and foreign debt, stood at $19.8 billion, or 61 per cent.[125]

The cost of public debt also changed drastically as a result of the Paris II refinancing package (see table 23). The overall weighted average cost of total outstanding public debt clearly shows the reductions achieved both on domestic debt and foreign debt.

In terms of total cost reduction, the average cost of Lebanese public debt fell by 3.61 per cent from 11.97 per cent prior to Paris II to its November 2003 level of 8.36 per cent. Lebanon's gross public debt weighted average maturity was extended from just under four years to five years as approximately half of Paris II-related eurobond issues have a maturity of fifteen years.[126]

TABLE 23. LEBANON: OVERALL WEIGHTED AVERAGE COST OF OUTSTANDING PUBLIC DEBT
(Percentage)

	Date	Total debt	Domestic debt	Foreign currency debt
Before Paris II	November 2002	11.97	13.82	9.21
After Paris II	November 2003	8.36	9.23	7.39
Change		(3.61)	(4.59)	(1.82)

Source: Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), p. 16.

Note: Parentheses () indicate a negative amount.

3. *The debt burden on the economy*

Public debt levels experienced by Lebanon over the past eight years, where the ratio of debt to GDP rose above 100 per cent to reach a peak of 185 per cent in 2003, have been known to cause economic meltdowns. However, the idiosyncrasies of the Lebanese economy and its financial sector have combined to skirt this potentiality. That is not to say that Lebanon is impervious to economic collapse nor has it been fully immunized through the Paris II measures that have been taken. Lebanon's debt levels have imposed a great cost on the economy, with over 45 per cent of the annual budget of the Government allocated to debt servicing.[127] The ability of the Government in terms of spending has been severely impaired and the debt has greatly limited its fiscal manoeuvring space. Major shocks to the economy and serious imbalances cannot be addressed through fiscal measures under such circumstances.

---

[123] Ibid, p. 14.

[124] Market debt is defined as gross public debt, excluding the portfolios of the Central Bank, public institutions, bilateral and multilateral loans, and debt issued to the Paris II lender countries.

[125] Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), p. 14.

[126] Based on an interview with Rola Rizk, Head of Economic Unit, Ministry of Finance, Governement of Lebanon, held in Beirut on 28 April 2004.

[127] Banque Audi, *Quarterly Economic Report*, (Fourth quarter, 2003), p. 5.

The need for monetary stability in the form of a stable exchange rate and low inflation required Lebanon to maintain relatively high interest rates on local currency instruments to shore up demand for Lebanese pound-denominated assets. This has had a direct negative effect on the levels of government debt and its cost, which in turn, has affected the risk premium on government debt in that it has elevated the level of debt and servicing costs by raising the Government's risk of default. The net effect of this is elevated interest rates that have in effect nullified the potential of monetary measures as an instrument used to address growth and employment concerns.

While high interest rates have been advantageous to the banking sector to a large extent, they have been detrimental to the wider economy in that they have skewed bank financing towards the public sector, leaving the private sector with a severe shortage of financing and investment. Exports have suffered from the same problem, namely, high financing costs. While steps taken within the framework of the Paris I Conference reforms and stimulus package have helped to alleviate this impediment to the export sector, these measures remain partial and palliative in comparison to the potential effects of cheaper funding for the private sector at large.

The Paris II measures have had a positive impact on average lending rates. Average lending rates in Lebanese pounds dropped by 4 percentage points, from 16.1 per cent to 12.04 per cent, between 2002 and 2003. Average dollar lending rates dropped by nearly 1 percentage point, from 9.62 per cent to 8.63 per cent, over the corresponding period.[128] Barring any shocks, this is expected to eventually translate into higher volumes of financing for the private sector over the next two to three years. This will in turn boost growth, as investments in new projects and lower financing for existing businesses—which increases profit margins—contributes to economic growth and employment. It must be noted that banks are being extremely cautious during this period of flux, and therefore the trickle-down effect from lower government borrowing rates to lower bank lending rates is taking more time than the private sector would like.

Moreover, high interest rates have also negatively affected the development of financial markets. While the causes of Lebanon's stunted equity and capital markets run further and wider than elevated interest rates, such rate levels have skewed capital investment from the markets to interest-bearing deposits and government debt instruments, promoting saving and thus depriving the real sector of non-bank financing and investment and effectively inhibiting economic growth.

The Government has enjoyed a comfortable set-up in that over the years high levels of locally held capital and the banking sector have tended to allow for elevated levels of debt to GDP ratios. Moreover, and partly as a result of Government lobbying, IMF has recently started to accept that when money supply in its broad sense (M3) is nearly three times the size of Lebanon's GDP,[129] it may be possible to allow for a higher debt to GDP ratio without the imminent risk of collapse.[130] Nevertheless, neither IMF nor the Government of Lebanon advocate such elevated levels of debt to GDP ratio, particularly for prolonged periods of time. According to private sector economic analysts, the net effect of the positive bank deposit situation as Lebanon has shifted more of its debt from Lebanese pounds to hard currencies is that the banking sector's risk, as the majority holder of Lebanese foreign sovereign debt, has become highly correlated to the credit default risk of the Government.[131] This has also placed the healthiest sector of the economy under the burden of Lebanon's public debt problem.

---

[128] Ministry of Finance, Government of Lebanon, *One-year Progress after Paris II*, (December 2003), p. 19.

[129] M3 = M1 (Lebanese pounds in circulation + Lebanese pound sight deposits) + M2 (other Lebanese pound deposits) + deposits in foreign currencies.

[130] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

[131] Based on an interview with Marwan Barakat, Head of Economic Research at Banque Audi, which took place in Bierut on 23 April 2004.

4. *Government debt management policy*

(a) *Paris I*

The Government has taken a serious position towards reversing the debt dynamics in Lebanon. The proposals offered at the Paris I Conference were the first in a series of steps aimed at addressing some of the systemic conditions causing or contributing to the public debt problem.

On one front, the need to stimulate the economy was a clear priority in that a stagnating economy simply meant fewer revenues for the Treasury. Lowering import duties, in line with Lebanon's international trade agenda with the European Union, and with its eventual accession to the WTO, and providing incentives and subsidized financing for export-, industry- and tourism-oriented projects were also amongst the measures taken to stimulate real sector growth. These measures have translated into a noticeable rise in GDP growth with estimates varying between 2.5 per cent[132] and 3 per cent[133] for 2003. New tax administration procedures of various types were also implemented. The new value added tax has been the centrepiece of the Government's revenues-increase drive, and this has resulted in a 14.1 per cent year on year rise. Despite all this, the budget deficit exceeded its 27 per cent forecast significantly, at 37.2 per cent.[134]

On the expenditure front, the Government had outlined several steps, some of which have been implemented, while others have yet to be put in place. The general orientation of the strategy is to redefine the role of Government by downsizing and outsourcing non-core functions, for example, telecommunications, water, electricity and others, through a privatization process. In terms of what has been achieved to date, this strategy still has a long way to go. Still, expenditures over the short run have been squeezed and certain Government-owned enterprises, namely, Middle East Airlines have been restructured and their costs rationalized. In 2003, fiscal expenditures overshot their target by some 13 per cent as a result of higher than expected debt servicing costs and unexpected transfers to cover the deficits of the national electricity company, Electricité du Liban.[135]

(b) *Paris II*

The Paris II Conference was an attempt to provide assistance to Lebanon in restructuring its public debt situation, which was something that the country could not achieve solely through its own efforts. Preconditions, some of which were met, had been set during the Paris I Conference. There were also other conditions that Lebanon promised to fulfil at the Paris II Conference, including most importantly, privatization and the use of the proceeds from that activity to pay down debt.

Privatization and/or securitization of the future cash flows of public services has been a cornerstone of the debt reduction strategy of the Government, with the goal that proceeds from the sale of public utilities or the securitization of their cash flows will be used to reduce the debt stock and restructure the remainder, thereby lowering the cost and lengthening its maturity profile. In this regard, mobile phone licenses were the first to be earmarked for privatization. However, political obstacles have affected real progress on this front, and the whole process has been put on hold until more favourable valuations for the telecommunications sector arise.

One of the important side effects of Paris II was the favourable climate it created on the local debt market, whereby the Government was able to attract demand for a three-year T-bond, thus filling a gap in the maturity yield curve between the standard two-year T-bond and the eurobond issues with maturities of five years and longer. The Central Bank has played a pivotal role in making this possible in that it has been

---

132 Banque Audi, *Quarterly Economic Report*, (Fourth quarter, 2003), p. 1.

133 IMF, "Lebanon 2004 article IV mission – Concluding statement", (8 March 2004), p. 1.

134 Banque Audi, *Quarterly Economic Report*, (Fourth quarter, 2003), p. 5.

135 Fouad Siniora, Minister of Finance, Government of Lebanon, "Translation of the public budget and annex budgets for 2004", original draft proposal, (2004), p. 20.

issuing two- and three-year certificates of deposit (CDs) in return for dollars to the banking sector to mop up the excess liquidity resulting from the maturing of debt that was not being rolled over during the nine-month period after the Paris II Conference. The Central Bank took this opportunity to replenish its foreign currency reserves, which stood at approximately $12 billion in 2004. These CDs were then substituted for the three-year T-bond, when the Government returned to the local market in November 2003.[136]

(c) *The risk/cost trade-off*

At the core of any debt management discussion is the risk/cost trade-off. In this context, one consideration is whether or not the Government needs to issue short-term debt at a lower cost and place itself at a higher risk of default in the event of shocks to the economy. Another is whether or not it should issue long-term debt, spreading the repayment burden over a longer, more manageable time frame, albeit at a costlier rate. This is of course, a crude oversimplification. The trade-off is dictated by special circumstances, which are related to the particularities of Lebanon. Lebanon's stated position, for some 10 years now, has been to strive for the longest possible maturity profile at the lowest possible cost for its public debt, both internal and foreign.[137]

At one time, Lebanon could issue nothing but short-term local currency debt. These conditions changed as Lebanon tapped international capital markets for financing. The inherent risk of local currency debt issuance for a developing country, as the debt level rises to unmanageable levels, lies in resorting to currency devaluation to reduce the value of public debt. Lebanon avoided the devaluation option in the early stages of the debt cycle by tapping its robust and liquid banking sector and through the firm monetary policy of the Central Bank. As the debt problem developed, the Government addressed the devaluation risk by increasingly issuing debt in foreign currencies. In 2004, nearly half of Lebanon's debt was denominated in foreign currencies, making the currency devaluation option virtually ineffective in terms of reducing the value of the public debt. In any case, devaluation of the Lebanese pound would have had such a detrimental effect on the one single factor that has been Lebanon's saviour over this period, namely, bank deposits, which means that it was never a viable option. Moreover, what confidence Lebanon had built up, and the credibility that its Central Bank and financial sector enjoyed, would have been lost and the final result would most probably have been economic collapse.

The foreign currency debt issuance strategy pursued by the Government of Lebanon has, to a large extent, been a risk/cost trade-off. Local currency debt maturities have been short owing to the exchange rate risks involved. The markets would have required a currency risk premium on medium-term maturity Lebanese pound-denominated debt instruments that would have resulted in unjustifiable cost levels in terms of interest rates. Eurobond issues solved both these problems by avoiding the exchange rate-related premium and also establishing longer repayment horizons. The exchange rate devaluation risk receded as a larger ratio of the public debt was moved to foreign currency-denominated instruments. With reference to the Paris II eurobonds, they have generally been structured with a five-year grace period on principal repayment during which interest is paid, followed by ten years of amortized principal repayment. Avoiding bullet repayments as bonds mature smoothes out the repayment profile significantly, making it more manageable, particularly in the potential presence of shocks to the economy.[138]

(d) *Centralization, coordination and sharing of information*

In the immediate post-conflict period, the Central Bank was one of the few truly functional public financial institutions, and this partly explains why it initially managed the local currency debt portfolio on behalf of the Treasury. Indeed, the Central Bank continues to perform local currency primary market

[136] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

[137] Based on an interview with Jihad Azour, Advisor to the Minister of Finance, Government of Lebanon, which was held in Beirut on 22 April 2004.

[138] Based on an interview with Rola Rizk, Head of the Economic Unit, Ministry of Finance, Governemnt of Lebanon, which took place in Beirut on 28 April 2004.

functions of auctioning T-bills and T-bonds. The Ministry of Finance, however, has slowly assumed its responsibilities as the manager of the debt portfolio as a whole and has been the sole manager of all foreign debt issues on behalf of Lebanon. The third institution concerned with debt management is the Council for Development and Reconstruction (CDR), the government agency responsible for nearly all reconstruction functions. This body is by proxy responsible for the vast majority of soft loan type foreign debt extended to Lebanon. Debt management has been the responsibility of these three institutions in Lebanon since the end of the conflict, and the legal framework has been clearly outlined with regard to the respective scope of their responsibilities.

In 1993, the Government of Lebanon obtained DMFAS software from UNCTAD through a grant from the World Bank as part of a capacity-building effort that remains ongoing. This software is installed at the Central Bank, the Ministry of Finance and CDR. This programme is a comprehensive recording, monitoring and analytical software that enables the relevant agencies to produce accurate and current data on the debt situation, for example, on local, foreign and soft loans, with projections of the current debt portfolio and expected payments. The majority of data tables in this study are either taken directly from the DMFAS programme or derived from tables produced by it.[139] This programme is also used to monitor and analyse liquidity and monetary data, and offers agencies a relatively comprehensive viewpoint of the financial situation in Lebanon. This set-up is quite solid in terms of sharing information and coordination. Macroeconomic theory advocates the separation of monetary policy from public finance policy, and from debt management in particular. In the case of a country the size of Lebanon, where the financial system allows for free capital flows and suffers from a huge public debt problem, monetary conditions are de facto linked to the overall fiscal and debt situations, whether one wishes this to be the case or not. Moreover, the Central Bank of Lebanon is solely and independently responsible for setting and conducting monetary policy, albeit in very close coordination with the Ministry of Finance.[140]

The monetary stabilization policy that the Central Bank has been conducting for the past 12 years has largely been executed through the secondary debt market, whereby the Central Bank intervenes, for example, buying or selling and executing swap operations, to achieve the required demand levels for Lebanese pound-denominated assets to maintain a stable exchange rate and to keep inflation in check. Prior to the Paris II Conference, in terms of local debt and the primary auction process, the Central Bank intervened to affect rates, volumes and prices; given that the Ministry of Finance returned to the primary market in November 2003, this is no longer the case. The Central Bank, however, reserves the right to influence stocks of debt in Lebanese pounds through swaps and secondary market operations from a monetary standpoint, while maintaining close coordination with the Ministry of Finance with respect to the overall debt situation. Concentrated debt maturities expose the country to default risk in the event that they mature during periods of high instability, for example, political, security or economic downturns, as this creates a bid for dollars. In such cases, the foreign currency reserves of the Central Bank and the stability of the Lebanese pound would be endangered. In addition, the main objective of swap operations conducted by the Central Bank has always been to smooth out the maturity profile of T-bills and to extend maturities as much as possible, while preserving monetary stability.[141]

(e) *Strategy, legality and ability*

The strategy of issuing foreign currency debt in eurobonds has been developed over time as the level of public debt increased, and what has been implemented over the past five years is significantly different from the preceding period. The strategy takes into consideration the Government's borrowing needs in foreign currency, the maturity profile from a risk management point of view, and market conditions. While the strategy is updated on an annual basis, it remains flexible enough to meet requirements with the best

---

[139] Ibid.

[140] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

[141] Ibid.

possible conditions. The level of foreign debt, however, is determined as part of the overall economic policy of the Government.[142]

The Paris II type of foreign debt developed by the Ministry of Finance was designed to fulfil the two following objectives: (a) to secure the longest possible maturity at the lowest cost; and (b) to determine jointly the structure of these instruments with the various funding countries and agencies.[143] According to the Ministry of Finance, there is a present target duration for foreign debt. For example, the maturity peaks of 2005 and 2006, $2.9 billion and $2.6 billion respectively, dictate that these are not years in which to target new maturities (see table 21). The strategy of the Ministry entails smoothing out the maturity profile by issuing for years where there are no maturity peaks to avoid the large and potentially destabilizing maturities observed for 2005 and 2006. This has been reflected in the structure of the Paris II debt whereby principal repayment is amortized over 10 years, helping to smooth out that section of the Government's foreign debt maturity profile.[144]

Foreign currency borrowing is executed under the annual budget law. Article 5 of the budget law authorizes the Ministry of Finance to issue Eurobonds throughout that year, specifying the reason for foreign currency debt issuance as better management of the country's debt, and allowing for longer maturities and lower costs than those achievable through domestic borrowing. All of Lebanon's sovereign debt issues are listed abroad in Luxembourg, and more recently, on the Beirut Stock Exchange (BSE), and are subject to New York capital markets debt laws.[145]

Lebanon pre-emptively prepares for its expected annual issuances through the Euro Medium Term Note (EMTN) programme. This capital market tool allows frequent debt issuers to prepare, beforehand, the required documentation for all issuances that may take place during that year, thus cutting the time to go to market from a month to less than a week. This programme also acts as an indicator to the markets as to what the Government's borrowing ceiling will be for that period. For instance, Lebanon prepared for and indicated a ceiling of $1.9 billion of foreign currency borrowing for 2004.[146]

Over the years, the abilities of the Ministry of Finance as an issuer have grown and increased in complexity and sophistication. Lebanon has issued eurobonds with maturities ranging from three to fifteen years, with both fixed and floating rates, denominated in dollars, euros and deutsche marks. The Ministry has also been able to tap the markets independently, with six transactions in total, without the need for intermediary investment banks, a fact that has helped to lower the fees and coverage it has to pay dramatically when it does contract investment banks to manage issues.[147]

(f) *Risk management*

Lebanon's rush into foreign debt issuance has slowly but surely been followed by institutional capacity-building of debt management techniques, albeit at a slower pace. Through the use of DMFAS software by all public debt managing institutions, Lebanon has reached a more sophisticated understanding of its future liabilities. The Ministry of Finance is currently upgrading the institutional set-up for debt management through the establishment of a centralized middle office dedicated to the analysis of the debt risk by using a portfolio approach. The risk model used analyses the debt by first establishing a benchmark

---

[142] Based on an interview with Jihad Azour, Advisor to the Minister of Finance, Ministry of Finance, Government of Lebanon which took place in Beirut on 22 April 2004.

[143] Ibid.

[144] Based on an interview with Rola Rizk, Head of the Economic Unit, Ministry of Finance, Government of Lebanon, which took place in Beirut on 28 April 2004.

[145] Ibid.

[146] Ibid.

[147] Based on an interview with Jihad Azour, Advisor to the Minister of Finance, Government of Lebanon, which took place in Beirut on 22 April 2004.

portfolio of debt maturities that the Government should ideally aim for, based on the current debt situation, projected future liabilities and expenditure needs. From this position, the model determines which durations need to be targeted for new issues to achieve the best possible maturity/cost trade-off for the Government. This asset liability approach to debt management will eventually integrate and rationalize local debt in a single risk management office at the Ministry of Finance: such debt is currently managed by the Central Bank; with the foreign currency component of that debt managed by the Ministry of Finance and soft loans allocated to CDR. The World Bank has been providing the technical assistance for this consolidation process.[148]

(g) *Markets, confidence and dissemination of information*

Uncertainty is equated with risk, and therefore, it is one of the most disliked factors in financial markets. Bearing this in mind, Lebanon has taken several measures to develop its sovereign debt markets, particularly the local market. Lebanon issues standardized instruments, starting with the three-month T-bill and ending with the recently introduced three-year T-bond, covering the majority of the short-term yield curve. All these instruments have fixed interest rates, which contribute to standardization. The Central Bank holds regular weekly primary market auctions for the various maturities as needed by the Treasury and also with reference to market demand. In addition, the Central Bank intervenes in the secondary market both from a monetary and a market-making standpoint. The Ministry of Finance and the Central Bank claim to be acutely aware of the importance of abiding by the market mood with respect to spreads between United States Treasuries and local Treasuries, maintaining an ample differential between the two to justify the risk of carrying Lebanese pound-denominated instruments.[149] All of these actions have contributed to creating a relatively active and liquid market for Lebanese pound-denominated debt, thus reducing uncertainty.

On the foreign debt front, things have not developed in a similar fashion for obvious reasons, one of which is that control over foreign currency debt is limited by a number of factors, including the fact that maturity horizons stretch out much further, issuance is infrequent in comparison to local debt, currencies often differ and interest rates can be fixed or floating. The stated position of the Ministry of Finance on issuance vis-à-vis the market and demand is that it always takes into consideration the liquidity levels in foreign currency within the local banking system when it wishes to come to market.[150] With the high levels of dollarization in the Lebanese financial system, and the volume of bank deposits, the liquidity available for dollar-denominated debt is expected to be high; however, the Government must not consider this pool of funds captive to its needs.

The factors that compensate for the natural deficiencies of issuing in foreign currencies are transparency and credibility. In this regard, the EMTN programme used by the Ministry of Finance is useful in giving the markets an indication of how much new debt the Government plans to issue over the coming period. This offers a certain level of transparency. Credibility is as important in the market, and while the Government has a very detailed picture of its liabilities and the maturity profile of its debts, market participants and analysts seem to agree that the Ministry of Finance has not made a strong enough effort to clearly state its debt management objectives in terms of debt retirement and roll-over steps that need to be taken. The uncertainty related to this lack of active engagement with the markets has created a sense on unease in the market, in the context of such elevated levels of debt and the size of maturing issues. As one market participant put it: "...when it comes to debt management you can state ahead of time when your issues are (two to three years in advance), and no specific dates have to be given. They (the Government) can say that they will take cues from the market because it's the market that decides when it wants to borrow and

[148] Based on an interview with Rola Rizk, Head of the Economic Unit, Ministry of Finance, Government of Lebanon, which took place in Beirut on 28 April 2004.

[149] Based on an interview with Youssef El-Khalil, Senior Director of the Financial Operations Department of Banque Du Liban, which took place in Beirut on 5 May 2004.

[150] Based on an interview with Rola Rizk, Head of the Economic Unit, Ministry of Finance, Governemnt of Lebanon, which took place in Beirut on 28 April 2004.

when it doesn't".[151] This market consensus relates specifically to the large maturities of 2005 and 2006. These concerns stem from the fact that these maturities could have been dealt with quite easily, and to the unprecedented cost advantage of the Government in the wake of the Paris II-induced confidence; the fact that they were not dealt with has baffled the market. The situation in 2003 was ideal, with United States interest rates at their lowest in decades and vast amounts of liquidity sloshing about in the banking system after Paris II and all the subsequent inflows.

Another factor that contributes to market unease with regard to the debt management style of the Government is the 2004 issuance schedule. No segment of the $1.9 billion EMTN indication was executed in the first quarter of 2004, while elections were scheduled to take place at the end of 2004 and parliamentary elections have been scheduled for the summer of 2005. Potential regional instability is an added uncertainty that may affect the Government's ability to issue, and also costs, if and when it does issue. The positive conditions seen in 2003 were still prevailing in 2004 but perception was that the Government had moved too slowly, which can transmit unfounded negative signals to the market. In mid-2004, the Ministry of Finance came to market with a seven-year $950 million eurobond and a five-year €200 million eurobond. The United States bond was oversubscribed and closed at $1 billion, while the euro-denominated bond closed at €225 million. By emerging market standards and Lebanon's sovereign debt rating, the rates offered were quite low, namely, 7.78 per cent and 7.25 per cent respectively. Nonetheless, the appetite for these new issues was obvious.[152]

There is another factor that markets find objectionable with regard to the debt management strategy pursued by the Government, and that is the fact that Lebanon aims to issue debt at rates that most analysts believe do no reflect the credit default risk of Lebanon. According to some analysts, the Government is clearly taking advantage of the locally available pool of funds, and is transferring its default risk to the banking sector as the majority holder of sovereign debt at what is considered an unjustifiably low cost. The interest rate differential with respect to the United States benchmarks is very narrow in comparison to emerging market standards, and questionably so given the risks that Lebanon's sovereign debt still carries and the conflict such 'low' rates create with a monetary policy that aims to attract capital towards Lebanese assets.

5. *Conclusions and recommendations for Lebanon*

(a) *Conclusions*

Lebanon's public debt situation is not enviable. After the 15-year long conflict, there was an unavoidable need for government spending that could not be matched by revenues. Local financing at high rates and short maturities was the only avenue available at that time. A bet was made on rapid improvements in the local and regional situation that would have allowed for a smoother transition out of this state of indebtedness. This failed to materialize. Political impasses, fiscal and monetary constraints and new security instabilities aggravated the situation even further. Foreign currency debt was seen as an alternative, and a way out of the costly and risky local debt cycle. However, given the debt cost and debt level dynamics that had transpired, the debt management capabilities of the Government took longer than expected to develop to acceptable standards. In the meantime, spending beyond the available means continued unabated.

Lebanon's first significant attempts at addressing the issue of its indebtedness were witnessed with the Paris I and II Conferences, where it was realized that left to its own devices, the country could not resolve its impending catastrophic debt situation. The market had clearly signalled its lack of acceptance in terms of continuing to take on government debt at the levels offered, and this was based on the fact that the risks were not adequately reflected in the expected returns, and also that the magnitude of the problem, namely, a debt to GDP ratio of more than 180 per cent, which necessarily meant that none of the stakeholders would be immune from a potential financial crisis.

---

[151] Based on an interview with Nabil Chaya, Head of Capital Markets, Banque Audi, which took place in Beirut on 29 April 2004.

[152] Banque Audi, *The Weekly Economic & Market Report*, Week 20, (8-14 May 2004), p. 1.

The Paris I and II Conferences have altered the economic landscape of Lebanon in more ways than simple debt restructuring. Paris I reform and stimulus measures have already affected economic growth levels and if pursued further, will continue to provide substantial windfalls for Lebanon in terms of efficiency, productivity and competitiveness, thereby resulting in economic growth. Moreover, while Government expenditure has been contained within several contexts, it remains unchecked in many others. Government revenues have also improved markedly. The planned measures will further enhance the revenue potential of the Treasury, if and when they become operational.

The Paris II Conference attained its stated objective, which was to give Lebanon a real chance for reversing the debt situation it was mired in. The measures taken within the context of that conference addressed two issues related to the public debt by resorting to the same instrument, namely, bilateral funding at special rates. The first issue to be addressed was to reduce the market exposure of Lebanese sovereign debt, or in other words, to alter significantly the composition of the funding sources of the debt, thus partially relieving both the banking sector of the credit default risk of the Government and the Government of market pressure to increase returns on government debt in line with the perceived risk. The second issue mainly concerned replacing existing short-term high cost debt in local currency with 'subsidized' long-term foreign currency debt structured on friendlier repayment terms. Total market exposure, including both domestic and foreign debt, was reduced by 10 per cent to 74 per cent in 2004.[153] Moreover, the weighted average maturity of all public debt has been extended by one year to five years, and the weighted average cost of all public debt has dropped by 3.61 per cent.

Lebanon's foreign currency debt stood at some $15.4 billion in 2004, approximately 47 per cent of the gross public debt. Of this $15.4 billion, approximately $2.6 billion were long-term concessional loans from international institutions and lender countries.[154] This leaves approximately $12.8 billion in market-type eurobond debt. In addition, $2.4 billion was held by the Paris II donor countries while $1.87 billion was held by the Central Bank, both segments of which are structured with long maturities, low interest rates and no shock-inducing bullet-type principal payments at maturity. In terms of the Government's real market foreign currency debt exposure, this stood at some $8.53 billion, or 55.4 per cent in 2004. The commercial banks' zero-coupon contribution scheme within the Paris II framework is included here as it is market-held debt. This breakdown raises an important question concerning the extent of the real exposure of the Government to the market and what this means in terms of debt management. In this context, talk of an elevated debt to GDP ratio and its impending calamitous effect on Lebanon's economy does not necessarily seem to be realistic in terms of the above breakdown of the foreign currency component of the public debt.

The Government has relied heavily on the banking sector's pool of capital to fund its repeated budget deficits, while the banking sector has been handsomely compensated with high returns for carrying this burden. As Lebanon's debt composition has slowly shifted towards foreign currency-denominated debt, the risk of financing the public sector has become a less appealing prospect for banks. Being the majority holder of foreign currency public debt, the banking sector's risk profile has become increasingly aligned with the credit default risk of the Government. If the banking sector-held debt were in Lebanese pounds, the transfer of the risk of default to the banking sector would not exist based on the fact that the Central Bank could theoretically print money and pay off the Government's debt. The risk would have predominately been an exchange rate risk and this would have been borne ultimately by depositors in Lebanese pounds and not by the banks themselves. However, the option of devaluating the currency was not palatable, hence the shift into foreign currency debt to reduce the Government's and investors' exposure to exchange rate risk. This shift from an exchange rate risk to a credit default risk of the Government was thus borne by the banking sector, as the majority holder of the foreign currency debt.

[153] Fouad Siniora, Minister of Finance, Government of Lebanon, "Translation of the public budget and annex budgets for 2004", original draft proposal, (2004), p. 15.

[154] Long-term loans at low concessional rates are not as significant as they may seem. Inflation reduces their real value over time, causing them to have less impact on the Government's ability to repay. This type of debt becomes problematic within the larger framework of financial collapse. However, these types of loans tend to be rescheduled when the situation dictates it.

Finally it can be noted that Lebanon's stock market capitalization is strikingly low at 10 per cent to GDP. The lack of capital market financing "...deprives the economy of an important source of long-term financing and risk diversification... it increases exposure of banks to government and dependence of government on banks".[155]

(b) *Recommendations*

Based on the information presented above, ESCWA makes the following recommendations:

(1) In terms of foreign debt management over the short term, active management coupled with more transparency towards the market must be encouraged. Cost reductions are potentially achievable as are more comfortable maturity structures with the establishment of a 'market-engaged' approach by the Treasury, whereby a medium- to long-term set of goals is conveyed to the market. This will help to reduce anxiety in the market with regard to the actions of the Treasury and will allow commercial banks, which effectively constitute the market, to better manage their own assets and liabilities. This argument becomes more cogent within the context of rising interest rates in the G10 countries. Banks will start seeking more investments abroad, as the uncertainty of investing in Lebanese sovereign debt becomes relatively less attractive.

(2) The following two factors, which seem to be present, must be combined in a positive public-private partnership: the institutional capacity to analyse the foreign debt situation and to find creative, cost-effective and risk-reducing structures; and the willingness of the market to react positively to a clear and realistic debt management strategy.

(3) Over the long term, attention must be paid to certain structural components of Lebanon's foreign debt. Lebanon has essentially survived the extreme pressures of the debt burden over the years owing to one central factor: bank deposits that happened to exceed GDP by 2.7 times, as of the end of 2003, in the local banking sector, whose consolidated balance sheet currently exceeds GDP by 3.3 times. The total public debt to GDP ratio, 185 per cent, as an indicator of financial collapse has proved to be less alarming with regard to Lebanon than to other countries, and there has been tacit acceptance of this fact on the part of IMF.

(4) The relevant parties must note that a reduction in the magnitude of the debtor-creditor relationship between the Government and the banking sector over the medium to long term is key to the economic survival of Lebanon. The potential of the banking sector as a central growth driver and stability provider of the economy is apparent through its 330 per cent assets to GDP ratio. Funding the public sector has resulted in a crowding-out effect with respect to private sector investment initiatives and real sector growth.

(5) The relevant parties must note that Paris II bilateral type financing as an alternative to market financing is not a viable source over the long term. Measures to widen the investor base in Lebanon's foreign currency public debt have recently been stepped up with the listing of three eurobonds on BSE. Market analysts welcome this move but believe that this will do little in terms of widening the investor base over the short term. Lebanon's sovereign debt was just as accessible to individual investors through banks and financial intermediaries prior to their listing on the BSE.

(6) A clear and comprehensive plan for the development of capital markets, including the adoption of regulatory frameworks and reforms in corporate governance must be developed, and is an essential step in the context of debt management over the medium to long term.[156]

(7) While the subject matter of this case study is foreign debt management, it must be re-emphasized that even the best debt management is no substitute for sound fiscal policy, and therefore, efforts must be exerted to promote such a policy. Sound fiscal policy requires a modern legal and administrative framework accompanied by an efficient, streamlined and productive public sector. Lebanon has yet to take the difficult decisions required for a less costly and more efficient public sector. Until the essential reforms are undertaken, all Lebanese debt management strategies will lack specificity, based on the fact that the causes behind the debt problem will persist, namely, unjustifiably high expenditures and low government revenues.

---

[155] IMF, "Lebanon 2004 article IV mission – Concluding statement", (8 March 2004), p. 6.

[156] Ibid, p. 6-7.

V. CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS

In summary, total external debt for the six heavily indebted ESCWA member countries was estimated at approximately $87.4 billion in 2002. Among these countries, Egypt had the largest value of external debt in the region in that year, at $30.8 billion. The Syrian Arab Republic and Lebanon were close behind with $21.5 billion and $17.1 billion, respectively. In Egypt, the external debt per capita was approximately $463. Meanwhile, the highest external debt per capita in 2002 was held by Lebanon, with $3,881. Iraq also faced a very heavy external debt burden at that time, approximately $3,700 per person. External debt per capita in Oman was $1,933 in 2002. Jordan and the Syrian Arab Republic carried per capita debt burdens of $1,557 and $1,265 respectively in the same year. At the same time, Yemen had the lowest per capita income, and its external debt per capita was also the smallest at $264. The Syrian Arab Republic had the highest ratio of external debt to national income, at 108 per cent in 2002. Lebanon and Jordan had the next highest ratio, at 94 and 88 per cent respectively. Egypt and Oman enjoyed significantly lower ratios of debt to national income, at 34 and 23 per cent, respectively, while Yemen had a moderate debt to income ratio of 57 per cent. Using the ratio of external debt to export value, the most heavily burdened ESCWA economy was Lebanon, with external debt over 700 per cent of export earnings in 2002. Both Egypt and the Syrian Arab Republic had ratios over 200 per cent and Jordan was only slightly below Egypt at 193 per cent in 2002. In terms of long-term debt to total external debt, Egypt, Lebanon, Jordan and Yemen have high ratios, which can in part be attributed to restructuring and the implementation of economic reforms in the 1990s. Oman and the Syrian Arab Republic, however, were more heavily dependent on short-term debt, for over 25 per cent of their external debt burdens in 2002.

It can also be noted that the composition of debt in the ESCWA region varies according to individual countries. Egypt and the Syrian Arab Republic held the highest share of bilateral debt relative to total external debt of all ESCWA member countries for the period 1999-2002, at 84 and 96 per cent respectively. The countries with the highest shares of multilateral debt relative to total debt were Lebanon and Oman, both at 71 per cent. Most of the debt-burdened economies of the ESCWA region currently have a high share of long-term debt, which is important in terms of debt sustainability and to avoid default. Egypt, Jordan, Lebanon and Yemen held more than 80 per cent of their external debt with long-term maturities for the period 1999-2002. On the one hand, the more diversified economies of such countries as Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen depend most heavily on public sector creditors for debt financing. On the other hand, GCC countries have higher international credit ratings and lower risk ratings, thereby enabling easier access to private sector bank loans and securities' investors for debt financing. For example, 43 per cent of external debt in Oman was financed by the private sector during the period 1999-2002, while there was no privately financed sovereign debt in neighbouring Yemen during the same period.

Another point that is worthy of note is that several ESCWA member countries have received Paris Club debt treatments. A Paris Club agreement for Egypt was applied to some $21.2 million of arrears as of 30 June 1991. Yemen received Paris Club treatment in 1996 for $112 million under the Naples terms. In 1997 Yemen received treatment for arrears that included rescheduling of non-ODA credits over a 23-year period and repayment of ODA credits over a 40-year period. In 2001, Yemen received Paris Club treatment on $420 million, with $25 million cancelled and $395 million rescheduled under the Naples terms. Jordan received Paris Club treatments in 1989, 1992, 1994, 1997, 1999 and 2002, and also received treatment on $1,170 million in 2002, including the rescheduling of non-ODA credits over an 18-year period and repayment of ODA credits over 20 years.

Furthermore, several initiatives aimed at tackling debt in the developing world have been established in recent years, including the HIPC Initiative, which was launched by the World Bank and IMF in 1996. The participants of this initiative are the poorest and most indebted countries in the world, many of them in Africa. In 2002, the total cost of assistance to 34 countries through the HIPC Initiative was $39 billion, half of which was provided by bilateral creditors and half by multilateral lenders. However, despite the fact that Yemen is the only LDC in the ESCWA region, it did not qualify for HIPC assistance as its debt is considered manageable through the application of traditional debt treatment scenarios. For example, HIPC requires a ratio of debt to export value exceeding 150 per cent, whereas the external debt to export ratio for Yemen was 134 per cent in 2002.

Another useful initiative is the capacity-building DMFAS programme of UNCTAD, which endeavours to enhance the debt management abilities of developing countries by helping to set up institutional frameworks for managing debt in those countries, and also teaching government officials how to produce accurate national debt statistics. Six ESCWA member countries participated in DMFAS, with Egypt joining the programme in1986, Lebanon in 1993, Jordan in 1998, Yemen in 1999, Palestine in 2000 and the Syrian Arab Republic in 2002.

Numerous external factors have negatively affected the debt situation in the countries of the ESCWA region, including regional conflicts, economic sanctions, inadequate flows of ODA and FDI, and resource scarcity. Domestic factors that have hindered sustainable debt management in the region include poor governance, weak tax administration, corruption and non-transparency. In this context, the external debt situations in certain heavily-indebted ESCWA member countries, namely, Egypt, Iraq, the Syrian Arab Republic and Yemen are briefly reviewed below, followed by a more detailed summary of the two case studies on Jordan and Lebanon:

(a) External debt in Egypt grew significantly during the 1980s, from \$21 billion to \$45.5 billion between 1980 and 1989. This trend was reversed in the 1990s, which can in part be attributed to a negative growth rate of the debt under debt rescheduling and debt forgiveness programmes, and to positive gains in national income growth. Egyptian external debt fell to approximately \$30.8 billion by 2002;

(b) The external debt situation in Iraq is dire and debt management strategies are currently on hold. The World Bank and United Nations, which are jointly tasked with managing IRFFI, estimate that Iraq will require \$55 billion in aid by 2008. This does not include the burden of repaying Iraq's massive external debt, which reached \$89.9 billion in 2002 and which estimates put at close to \$100 billion in 2004. Moreover, estimates of Iraq's external debt and its debt burden do not include war reparations payments approved under Security Council Resolution 687 (1991). Kuwait has reiterated its demand that reparations from the 1990-1991 Gulf war, estimated at nearly \$98 billion, and which are owed to Kuwait and Saudi Arabia, should not be included in debt forgiveness schemes. Still, key creditor groups, namely, the Paris Club and AMF, have already initiated some international and regional debt relief measures. At the twenty-seventh meeting of the Board of Governors of AMF in Kuwait in April 2004, Iraq was granted an extended grace period to settle its loans with Arab creditors; and at a July 2004 meeting, 19 Paris Club creditors with outstanding loans to Iraq worth approximately \$21 million reviewed the situation vis-à-vis Iraq and agreed on the need to restructure external debt in the country;

(c) The World Bank lists the Syrian Arab Republic as a severely indebted lower-income country. Most of the external debt of the Government was owed to former communist countries and some debt payments were suspended by the Government, using the argument that some of its sovereign creditors no longer existed. The ratio of external debt to national income remains high, amounting to 108 per cent in 2002. The ratio of external debt to export value was 276 per cent, despite the fact that the Syrian Arab Republic has oil-export revenues. Moreover, the ratio of long-term to total external debt was 74 per cent, a less-sustainable ratio than neighbouring Jordan and Lebanon, both of which have aggressively managed their external debt portfolios in the past decade;

(d) The level of external debt to national income in Yemen is low compared to other indebted ESCWA member countries, amounting to 57 per cent in 2002. In addition, Yemen's debt is relatively long-term, with 86 per cent having maturity greater than one year. As of 2000, over 70 per cent of sovereign debt in Yemen came under a debt reconciliation agreement with the Russian Federation, multilateral creditors and some commercial banks. Yemen is currently in the process of fiscal reforms under the guidance of IMF and the World Bank, which prepared a DSA report with the Government of Yemen in June 2000.

With regard to Jordan and Lebanon, these countries were chosen as case studies owing to the significant differences in their external debt situations and their solutions for sustainable debt management. Moreover, they are good examples of the external debt situation, both in terms of how a developing country can become heavily indebted and the possible paths to resolve a debt crisis and develop sustainable debt management practices. In the case of Lebanon, the external debt accrued primarily as a result of the need for financing reconstruction and economic development after 15 years of civil war. With regard to Jordan, the economy suffered from the effects of several regional conflicts, economic sanctions on a major trading partner, and a general shortage of natural resources that limited internal financing necessary for economic development and poverty reduction. While Lebanon moved towards swapping its domestic currency debt for foreign currency debt at lower interest rates as a solution to avoiding debt crisis, the debt management strategy in Jordan included reducing exposure to foreign currency risk by increasing the share of domestic debt relative to external debt. The bilateral component of the Jordanian debt is highly concessional with favourable repayment terms in relation to debt servicing and repayment periods. In addition, Jordan's commercial debt has almost disappeared, and has been replaced by multilateral and bilateral debt, while Lebanon has moved towards eurobond markets for debt financing.

Jordan's total debt, both domestic and external, at the end of 2003 reached JD 7,095 million or 101.5 per cent of estimated GDP, compared to JD 6,685 million or 100.5 per cent of GDP for 2002. Debt as of the end of March 2004 was JD 6,975 million, or 92.4 per cent of estimated GDP. Jordan's creditors include Arab sources, namely, Governments, Arab Funds, for example, KFAED and the Saudi Fund for Development; industrialized countries, including Germany, France, Japan, United Kingdom and United States; other Governments; foreign banks; and multilateral institutions, for example, IMF, IBRD, EIB, IDB, AMF and AFESD. In the past decade, borrowing has been motivated by the attempts of the Government to bolster its foreign currency reserves to maintain the currency peg and finance some of the development needs of the nation. As a result, Jordan's debt burden seems manageable in the face of most external shocks, albeit not in very extreme cases. The ratio of paid debt service, on a cash basis, to exports decreased from 26.2 per cent in 1989 to 23.1 per cent in 2003. The ratio of debt service, on a commitment basis, to exports witnessed a sharp decline from 58.6 per cent in 1989 to 29.1 per cent in 2003. The ratio of debt service, on a cash basis, to GDP decreased from 14.8 per cent in 1989 to 10.7 per cent in 2003, while on a commitment basis it decreased sharply from 33.1 per cent in 1989 to 13.5 per cent in 2003. The implicit interest rate, defined as the ratio of interest to the outstanding external debt, decreased from 6.2 per cent in 1989 to 4.1 per cent in 2003. Other indicators imply that the per capita outstanding external debt decreased from $2,103 in 1989 to $1,389 in 2003, and the debt service per capita decreased from $435 million in 1989 to $243 million in 2003. Despite the fact that foreign reserves increased drastically in 2003 as compared to 1989, the per capita outstanding external debt was still high compared to per capita income.

The current debt management strategy of Jordan is based on five basic central themes, which were adopted during the economic reform and stabilization programmes agreed with IMF and the World Bank. The overall goal of these is to mitigate the impact of the debt burden and the associated risks through the proper management of debt, by ensuring the following are carried out: (a) restructuring the external debt by moving short-term loans to medium- and long-term loans at low interest rates and converting all short-term loans to medium- and long-term loans; (b) restructuring official debt with the Paris Club through six restructuring agreements, which totalled $5,015.6 million in debt principal and interest charges; (c) restructuring debt with non-Paris Club countries at conditions that were similar to those agreed with the Paris Club; (d) restructuring external debt with the London Club through a market-based menu type of agreement, whereby in 1993 an agreement was reached restructuring over $862 million in overdue principal and interest payments through the Brady Plan. Moreover, over $85 million in commercial bank debt was forgiven; and (e) carrying out additional activities during the period 1989-2003, for example, debt-buy-back, and debt-swap, and pursuing debt-forgiveness on the part of creditors. The debt-buy-backs and swaps, including the early amortization of Brady bonds in December 2003, were in line with the government objective of decreasing total public debt to a maximum of 80 per cent of GDP in 2007. The Government of Jordan has managed the public debt in a successful fashion in terms of minimizing the reliance on external debt; for example, the outstanding external public debt, government and government-guaranteed, amounted to $7,469 million, or 70.1 per cent of GDP, at the end of march 2004 compared to $7,605 million, or 77.1 per cent of GDP at the end of 2003.

With regard to Lebanon, its foreign debt profits form a unique characteristic, which is that it is actually foreign currency debt and not foreign debt in the true sense of the word, based on the fact that the vast majority of this type of debt is held by local entities, albeit in foreign currencies. This explains, to a large extent, why Lebanon has survived repeated internal and external economic, political and security shocks over the years, under debt burdens that would otherwise have caused severe economic crises. An important feature of the economy in Lebanon that has played to its advantage over the years is its liberal financial system with free capital flows, combined with a regulated and conservatively run banking sector. Lebanon attracts capital and stores it in the banking system. Lebanon's official estimate of GDP for 2003 was $18 billion, while bank deposits stood at $48.5 billion for the same period, translating into a ratio of bank deposits to GDP of some 270 per cent and banking sector assets to GDP of 330 per cent, one of the highest in the world. While high interest rates on public debt had been advantageous to the Lebanese banking sector to a large extent, they have been detrimental to the wider economy in that they had skewed bank financing towards the public sector, leaving the private sector with a severe shortage of financing and investment. Public debt levels experienced by Lebanon over the past eight years, whereby the ratio of debt to GDP rose above 100 per cent to reach a peak of 185 per cent in 2003, have been known to cause economic meltdowns. However, the idiosyncrasies of the Lebanese economy and its financial sector have combined to skirt this potentiality. That is not to say that Lebanon is impervious to economic collapse nor has it been fully immunized through the Paris II measures that have been taken. Debt levels in Lebanon have imposed a great cost on the economy, with over 45 per cent of the annual budget of the Government allocated to debt servicing. The ability of the Government to spend has been severely impaired and its debt has greatly limited its fiscal maneuvering space. Major shocks to the economy and serious imbalances cannot be addressed through fiscal measures under such circumstances.

In addition, Lebanon recently undertook an aggressive policy of debt-swap, from domestic currency debt to primarily dollar-denominated eurobonds at a lower interest rate to reduce the burden of debt servicing. In the period prior to the Paris II Conference, annualized public debt growth had reached 14.3 per cent per annum. This growth rate had slowed down significantly to 2.8 per cent in 2003, as a result of fiscal improvements, for example, a primary surplus of 2.7 per cent to GDP, and the cancellation of $1.79 billion of domestically denominated T-bills from the portfolio of the Central Bank; nonetheless, public debt was still growing. The composition of public debt shifted markedly, in terms of type, owing to a drop of 15 per cent, or $5.5 billion, in market debt in favour of lower cost longer maturity bilateral-type debt. The cost of public debt also changed drastically as a result of a refinancing package. The overall weighted average cost of total outstanding public debt clearly highlights the reductions that have been achieved both on domestic debt and foreign debt. The debt-swap policy was successful in avoiding international default, however, the necessary underlying economic reforms, spending rationalization and privatization of State-owned assets, which were promised to international creditors at the Paris I and Paris II Conferences have not been fully realized. For example, in the 2004 budget, the Government approved another budget deficit. It can also be noted that Lebanon's external debt in 2002 was 94 per cent of its national income and over 700 per cent of its export earnings. Without the continued flow of remittances from Lebanese working abroad, the Lebanese debt situation would be unsustainable. It can also be noted that Lebanon's rush into foreign debt issuance has slowly but surely been followed by institutional-capacity building of debt management techniques, albeit at a slower pace.

B. Recommendations

The following recommendations for heavily indebted ESCWA member countries and their creditors are based on the above analysis of the external debt situation in the ESCWA region and the two case studies on Jordan and Lebanon:

(1) Given that debt relief is particularly important for the heavily-indebted ESCWA member countries suffering from the ill effects of regional conflicts, international and regional creditors must increase ODA (debt relief) as agreed within the framework of the Monterrey Consensus.

(2) Governments in the ESCWA region must continue to exert efforts to reform their fiscal systems, including broadening the tax base, improving tax collection, instituting modern legal and administrative frameworks, and raising the productivity of the public sector. Rationalization of government expenditures with government revenues is expected to reduce the heavy burden of external debt and debt servicing on economic growth and development in the region.

(3) Efforts must be exerted to improve the transparency of medium- to long-term debt management strategies, as this is essential in encouraging private investors to hold public debt and thus relieve the banking sector from directly holding a high proportion of the public debt.

(4) Governments must continue to exert efforts with regard to privatizing State-owned enterprises, using a portion of the proceeds to pay down debt principals. This is expected to directly reduce the burden of debt financing on their economies, in particular the drain on foreign exchange to service external debt and foreign-currency denominated domestically-held debt.

(5) Governments must continue to exert efforts to reform banking and financial regulations to provide sound domestic and regional investment environments. A healthier financial and banking sector can better serve the debt financing needs of the region and improve the efficiency of debt management policies.

(6) Governments must continue to encourage the capacity-building efforts of their officials in upgradings their skills in the systematic collection of debt statistics and the use of debt management software, for example, DMFAS, for debt monitoring and debt policy analysis. ESCWA is a useful venue for assisting member countries through capacity-building activities in debt management.