THE GROUP OF 8 EXTERNAL DEBT CANCELLATION
Effects and implications for Guyana

Introduction

Guyana is one of the most indebted emerging market economies in the world. In 2004, its total public external debt stock equaled 140% of GDP. In the same year the net present value of its public external debt stock reached 209% of central government revenue. The debt service is equivalent to 8% of its exports of goods and non-factor services and to 17% of central government revenue.

In spite of having benefited from a number of debt-reduction initiatives, the most current projections for 2005 to 2010 do not show a significant improvement in the debt situation. The debt stock as a percentage of GDP is estimated to increase from 2005 to 2008. By the year 2010 it is projected to settle at 139% of GDP (roughly the year 2004 level[1]). In the same vein, the ratio of the net present value of the external debt to government revenue is expected to rise to 241% by the year 2010.

Guyana is one the beneficiaries of a recent initiative undertaken by the G-8 (London, 11 June 2005) to cancel the debt owed by 18 Highly Indebted Poor Countries (HIPC) to the World Bank, the International Monetary Fund (IMF) and the African Development Bank.

There is no doubt that this initiative is a step in the right direction toward addressing the country's needs for development financing. It is, at the very least, of great symbolic importance and it raises the hope that the international community is committing to support the development of the country. That being said, the initiative has raised two major concerns, namely the conditions under which debt relief is granted and the extent of its economic impact.

This brief addresses both concerns for the case of Guyana. It is divided into three parts. The first deals with the terms and conditions of the G-8 debt write-off proposal. The second focuses on its possible impact on the fiscal accounts and the investment-savings gap. The final reflections are found in the conclusion.

[1] The projections were provided by the IMF and do not take into consideration the recent G-8 debt write-off initiative.

Terms and conditions of debt cancellation

The final terms and conditions of the debt write-off have not been settled yet. Available information indicates that the initial debt stock write-off is equal to US$337 million owed to both the International Development Association (IDA) and the IMF (US$249 and US$88 million, respectively). This represents a reduction of 33% and 35% of the value of the total and multilateral debt stock, respectively, at the end of December 2004. This is equivalent to a decline in the debt stock from 140% to 96% of GDP (see Table 1 below).

The G-8 agreement will also result in a decline in debt service payments of US$ 61 million (US$49 and US$12 million in principal and interest) between 2005 and 2010 (see Table 3 below). This is equivalent to 1.2% of GDP on average per year.

Table 1
Guyana
External debt stock as percentage of GDP and debt service ratios in percentage (2001-2005)

	2001	2002	2003	2004 a/	2004 b/	2005 b/
Total outstanding debt to GDP	**169.5**	**172.6**	**146.6**	**139.7**	**96.1**	…
Bilateral	49.8	48.6	16.1	10.9	10.9	…
Multilateral	112.9	115.7	123.0	126.3	82.7	…
Financial	0.0	1.2	1.2	0.4	0.4	…
Supp. Cr.	1.8	2.2	1.9	1.7	1.7	…
Compensation bonds	1.1	1.2	0.5	0.4	0.4	…
Loan bonds	3.9	3.8	3.8	0.0	0.0	…
Total external debt service to exports of goods and non-factor services c/	**11.2**	**9.1**	**10.0**	**8.2**	**8.2**	**7.1**
Bilateral	2.3	2.0	1.4	0.6	0.6	0.6
Multilateral	8.5	6.7	8.0	7.5	7.5	6.3
Financial	0.0	0.0	0.0	0.0	0.0	0.0
Supplementary Credit	0.0	0.0	0.2	0.2	0.2	0.2
Bonds	0.4	0.4	0.2	0.0	0.0	0.0
Total external debt service to government revenue c/	**24.3**	**18.3**	**21.3**	**17.2**	**17.2**	**14.2**
Bilateral	5.0	4.1	3.0	1.2	1.2	1.2
Multilateral	18.5	13.4	17.0	15.6	15.6	12.7
Financial	0.0	0.0	0.0	0.0	0.0	0.0
Supplementary Credit	0.0	0.0	0.4	0.4	0.4	0.4
Bonds	0.8	0.7	0.4	0.0	0.0	0.0

Note: a/ Refers to the pre-debt forgiveness situation at December 2004.
b/ Refers to the post-debt forgiveness situation at December 2004.
c/ Computations were undertaken assuming that the debt service is reduced by 8 million US$ in 2005.
… not available.
Source: The government provided the data for the debt service and the data for exports of goods and non-factorial services and government revenue were provided by the IMF.

Estimates show that between 2004 and 2010 the ratio of external debt service to exports will decrease from 8% to 4%. In the same period the ratio of external debt service to government revenue will decrease from 17% to 13% (assuming that Guyana does not incur new debt obligations).

The Government of Guyana is currently making efforts to involve the Inter-American Development Bank (IDB) in the debt write-off initiative. If this were to materialize, Guyana could benefit from substantial further debt relief depending on the extent of any IDB write-off, as over 41% (US$446 million) of the country's external debt is owed to the IDB. Importantly, Guyana would save average interest payments of US$6.7 million per year from 2005 to 2010 and average principal repayments of US$12.7 million for total average savings of US$19.4 million.

In terms of qualification and monitoring systems, there is still some uncertainty as to whether countries would have to go through a track record of governance performance. However, given that the initiative seems to be an extension of the Enhanced-HIPC and also the strong sentiment among some Organization for Economic Cooperation and Development (OECD) countries to have preconditions as a means of ensuring prudent use of the funds, countries might have to meet some benchmarks. While it is unclear how a debt write-off can be subjected to any conditionality, it must be said that in the end, the positive impact that this initiative might have on Guyana's development financing, however small, could depend crucially on the quality of governance in general and the soundness of economic policies in particular. Therefore, it should be a positive outcome if the debt relief would be used as a reference point for an enhanced policy dialogue with the international community.

These latest developments must be seen in the context of UN Secretary-General Kofi Annan's repeated calls for debt cancellation for the poorest countries. In his report to the General Assembly, the Secretary-General redefined debt sustainability as "the level of debt that allows a country to achieve the Millennium Development Goals (MDGs) and reach 2015 without an increase in debt ratios". The ability to achieve the MDGs depends, among other things, on alleviating the debt burden; in turn, achieving the MDGs will play a crucial role in enabling countries to attain greater debt sustainability through higher economic growth. The Secretary-General's Report has accordingly called for exclusively grant-based finance and 100% debt cancellation for HIPCs, and for more debt reduction than has yet been on offer for non-HIPCs and middle-income countries.

As the latest MDG status report reminds us "debt relief, while welcome, … does not necessarily address long-term development needs". To render debt relief meaningful and effective requires a comprehensive development strategy at the international level. ODA flows must be substantially increased and the international trading system needs to become genuinely development-oriented. Simultaneously, developing countries need space to adopt and implement development policies and strategies that are in tune with national objectives and institutions.

The effects of debt cancellation on the fiscal accounts and the investment-savings gap

The G-8 debt write-off will not significantly improve the fiscal outcome for 2005. The fiscal position will deteriorate relative to 2004 even when taking into account the effects of the debt relief on expenditures.[2]

Estimations carried out on the basis of IMF and official data indicate that the deficit of the non-financial public sector will increase from -8% of GDP in 2004 to -14% of GDP in 2005 taking into consideration grants (-14.8% to -21% without grants) (see Table 2 below).

This result responds mainly to the projected stagnation in current revenue and the significant increase in capital expenditure planned for 2005. The latter responds to transfers corresponding to the modernization of the Skeldon Sugar Factory and completion of other infrastructure projects.

The modernization of the sugar sector is fundamental to Guyana's economy as sugar remains the "backbone of the economy." It is an important contributor to total value added, growth, employment and foreign exchange earnings.

The projected rise in capital expenditures (equivalent to 6% of GDP) will amply surpass the rise in public sector savings resulting from the decrease in debt obligation payments (equivalent to 0.5% of GDP).[3] In the absence of any special arrangement for oil imports, public sector savings may also be reduced by the expected increase in the international price of oil.

Private sector net-savings will also register a decrease due in part to the disruptive effects of the January floods on income flows.

The imbalance between investment and savings will be reflected in the external current account result.

In short, debt relief will not significantly lessen the demand for foreign resources required to finance the investment needs of Guyana's economy (12% and 24% of GDP for 2004 and 2005).

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[2] The computations for government expenditures with the debt-service write off were undertaken taking into account the decomposition into interest payments and principal re-payments which is shown in Table 3.

[3] These figures refer to 2005 as most of the main macroeconomic variables were available only for that year. Such was not the case for 2006.

Computations carried out for 2006 taking into account a debt-service write off equivalent to US$10 million do not show a significant improvement in the fiscal accounts or an important decline in the required net foreign resource transfer. The fiscal deficit is projected to be within the vicinity of 12% of GDP and the net resource transfer is projected to reach 23% of GDP.

On the face of it computations would show an improvement in fiscal sustainability. However, when the sharp contraction in the rate of growth of real GDP (1.6% and -2.8% in 2004 and 2005) as a result of the floods that affected the country is factored into the calculations fiscal sustainability does not improve.

Most important even if it is assumed that Guyana is granted a complete interest rate payments write-off in 2005 (that is, nil external debt interest rate payments in 2005) the fiscal and financial situation of the government would worsen relative to the previous year (2004).[4]. Under this hypothetical scenario the overall fiscal balance of the non-financial public sector would yield a deficit of 11% of GDP (19% without grants) and the net foreign resource inflow would equal 22% of GDP (see Table 2 below).

Nonetheless, the debt relief initiative will free-up foreign exchange resources (that is, it will increase the supply of foreign exchange) available to finance the investment savings gap.[5] To that extent the debt relief initiative lessens partially the need for net external borrowing. The debt relief contribution is however small and is estimated at 0.7% of GDP for 2005.

Conclusion

The analysis above shows that the G-8 debt relief initiative is equivalent to roughly 1% of GDP on average for the time period for which it is granted (2005 to 2010).

The move towards debt relief will release foreign exchange resources and will reduce the need for net external borrowing. It is a necessary step in the right direction. However it is insufficient. It would not free the required resources to finance the social and infrastructure related expenditures required for the country's long-term development (it represents only 2% of the consolidated non-financial public sector expenditures).

There is also concern that the effect of the debt cancellation may be offset, at least in the short run, by the announced reduction of the price of sugar by the European Union (EU) over the next four years, which is expected to cost Guyana over US$ 40 million per year in export earnings. Since development finance garnered through trade (net exports) tends to have a larger positive multiplier effect on the economy, the resulting decline in net exports is expected to have an important dampening effect on economic growth unless offset by growth in other exports. In addition, with sugar contributing on average

[4] Obviously if the government does not pay any interest on the debt in 2005 the fiscal situation would improve relative to the alternative scenario for the same year incorporating interest payments.

[5] This effect is captured in the financing operations of the fiscal and external accounts. In the latter it appears under the rubric of exceptional financing.

17% to GDP, 25% to export earnings and over 11% to total employment, the fall-out from the price cuts could aggravate poverty, unemployment and worsen the living standards of already vulnerable groups. This could compromise Guyana's objective of achieving the Millennium Development Goals (MDGs).

Guyana could negotiate with the EU to have a more graduated reduction in the price of sugar and an increase in Aid funds and other resources for restructuring the sector, while at the same time moving downstream into value added products that are more competitive.

More importantly the analysis presented shows that:

a) Guyana is sustaining a level of investment driven mainly by public expenditure, which cannot be financed from its current level of savings.

b) This level of investment is however necessary to develop the country's resources and provide a basis for diversification and long-term development of the economy. Capital spending is also necessary for the attraction of foreign private capital flows. According to a Foreign Investor Perception Survey undertaken by the World Bank in 2004 some of the most important foreign direct investment climate components include access to telecommunications, power supply, political stability, skilled labour, labour productivity, adequate shipping and port facilities.

c) With the present shortfall in savings, it is inevitable that Guyana will incur more debt in the future. Implementing measures and policies to increase savings or decrease expenditure to close the financial gap is not a realistic solution given Guyana's poverty status. The country has to rely on increased concessional foreign finance.

d) However, the G7 communiqué of June 2005 stating that there will be a reduction of gross assistance flows, by the same amount of debt cancellation is a source of concern. It implies that the debt cancellation will be accompanied by a corresponding dollar for dollar reduction in gross assistance flows.

e) Besides securing aid flows it would be important to improve foreign trade performance. In other words, the long-term development and diversification of Guyana's economy also requires that foreign trade performance conforms to fiscal policy objectives.

Table 2
Guyana
Non-financial public sector operations and selected national account aggregates
Realized and hypothetical scenarios
2003-2005 (in percentages of GDP)

	2003	2004	2005 a/	2005 b/	2005 c/
Non financial public sector					
Revenue	35.0	37.2	38.2	38.2	38.2
Central government	31.5	33.2	33.2	33.2	33.2
Public enterprises	3.5	4.0	5.1	5.1	5.1
Expenditure	48.3	52.0	59.7	59.4	56.8
Current	33.9	32.9	34.6	34.3	31.8
Capital	14.5	19.1	25.0	25.0	25.0
Primary balance with grants d/	-2.6	-1.1	-2.2	-1.9	0.7
Primary balance without grants	-7.3	-7.6	-9.4	-9.1	-6.5
Fiscal balance with grants	-8.6	-8.2	-14.2	-13.9	-11.4
Fiscal balance without grants	-13.3	-14.8	-21.4	-21.1	-18.5
National savings	9.7	10.6	6.5	6.8	9.4
Public sector savings	1.2	4.3	3.6	3.9	6.5
Private sector savings	8.5	6.3	2.9	2.9	2.9
Investment	21.0	22.9	31.6	31.6	31.6
Private sector investment	6.5	3.8	7.2	7.2	7.2
Public sector investment	14.5	19.1	24.4	24.4	24.4
Domestic Investment - Savings Gap d/	11.3	12.3	25.1	24.8	22.2
Domestic Investment - Savings Gap e/	11.5	14.2	28.0	27.7	25.2

Note:
a/ Preliminary budget estimates.
b/ Under the hypothesis that the government saves 8 million US$ in debt service payments.
c/ Under the hypothesis that no interest is paid on external debt obligations.
d/ The primary balance does not take into account the capital account. As a result if refers to the primary balance on the current account.
e/ Computations undertaken using IMF data.
f/ Computations undertaken on the basis of the Government of Guyana following publications: Estimates of the Public Sector for the year 2005. Vol. 1 and Budget 2005 (February 21, 2005).
Source: On the basis of IMF and Government of Guyana data and estimates.

Table 3
IMF and IDA debt service relief
2005-2010

IMF Debt Service relief				IDA Debt Service relief			
Year	**Principal**	**Interest**	**Total**	**Year**	**Principal**	**Interest**	**Total**
2005	4,252,764	721,882	4,974,646	2005	1,426,761.31	1,568,149.34	2,994,910.65
2006	6,541,373	641,567	7,182,940	2006	1,773,867.77	1,521,007.95	3,294,875.71
2007	5,721,500	566,418	6,287,918	2007	1,995,879.51	1,483,568.75	3,479,448.27
2008	6,063,963	512,682	6,576,645	2008	2,008,840.43	1,449,652.95	3,458,493.38
2009	6,981,719	470,361	7,452,081	2009	2,226,532.12	1,415,158.40	3,641,690.51
2010	7,428,644	433,234	7,861,878	2010	2,879,314.28	1,325,406.39	4,204,720.66

Source: Data from Official sources