Final Report

Debt Forgiveness for Afghanistan

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for Afghan Affairs

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TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

LIST OF TABLES

GLOSSARY

Afs.	Afghanis (units of Afghan currency; in 1990 the free market, or "bazaar," rate has ranged from Afs. 470 = US$1 to Afs. 710 = US$1)
A.I.D.	U.S. Agency for International Development
CBO	Congressional Budget Office
CMEA	Council of Mutual Economic Assistance (group of Soviet bloc countries that provide development assistance)
DA	Development Assistance
DAC	Development Assistance Committee of the OECD
ESAF	Enhanced Structural Adjustment Facility (IMF loan program for low-income countries experiencing debt repayment and associated problems and willing to undertake policy reform)
ESF	Economic Support Fund
FAA	Foreign Assistance Act
FRG	Federal Republic of Germany
G-7	Group of Seven (consortium of industrialized countries: Canada, France, Germany, Italy, Japan, United Kingdom, and the United States)
IBRD	International Bank for Reconstruction and Development (also known as World Bank)
IDA	International Development Association (soft loan window of the World Bank)
IMF	International Monetary Fund
LBII	Louis Berger International, Inc.
LDC	less developed country
NA	Nathan Associates, Inc.
O/AID/Rep	Office of the A.I.D. Representative for Afghan Affairs (Pakistan)

ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OMB	Office of Management and Budget
OPEC	Organization of Petroleum Exporting Countries
Paris Club	informal association of multilateral, bilateral, and commercial creditors engaged in rescheduling official debt
PFP	policy framework paper (required for IMF and World Bank structural adjustment lending)
PL 480	Public Law 480 (designates U.S. Government program primarily concerned with providing surplus agricultural commodities to developing countries)
SAF	Structural Adjustment Facility (IMF loan program for low-income countries experiencing debt repayment and associated problems and willing to undertake policy reform)
SAL	Structural Adjustment Loan (World Bank loan designed to increase economic efficiency of debt-afflicted low-income countries through policy reform)
SDR	Special Drawing Rights (IMF currency equivalent units)
SECAL	Sector Adjustment Loan (World Bank loan similar to SAL but focused on a sector rather than on the entire economy)
SILIC	severely indebted low-income country
SPA	Special Program of Assistance (World Bank program of assistance tied in with IMF's structural adjustment activities)
Toronto terms	menu of options to be applied to the debt repayment problems of severely indebted low income countries
UN	United Nations
USG	United States Government
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees
USAID	A.I.D. mission

Chapter 1

INTRODUCTION AND EXECUTIVE SUMMARY

Introduction

This report was prepared in response to Delivery Order No. 11 under A.I.D. Contract No. 306-0205-C-00-9385-00 (Afghanistan Studies Project). The objectives of the delivery order are to

1. Describe the composition, terms, and servicing history of Afghanistan's debt to the U.S. Government in the context of Afghanistan's larger financial problems;

2. Relate Afghanistan's current and prospective financial problems to efforts of the U.S. Congress, the Administration, other countries, and multilateral institutions in finding solutions to Third World debt problems;

3. Analyze existing legislation, precedents, and practices with respect to forgiveness of debts by the U.S. Government that could be pertinent to the forgiveness of Afghanistan's debt;

4. Outline a rationale and plan of action for forgiveness of Afghanistan's debt to the U.S. Government that could be put forward by the A.I.D. mission when appropriate.

This report consists of five chapters. Chapter 2 discusses the amounts, terms, and debt servicing status of loans made to the Government of Afghanistan by agencies of the U.S. Government and by other creditors. Chapter 2 substantially updates financial information contained in Nathan/Berger's report <u>Afghanistan Macroeconomic Database Development</u> (January 1990) on the basis of data obtained from the International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), and agencies of the U.S. Government. The World Bank and the United Nations do not have recent data on Afghanistan's external debt.

Chapter 3 analyzes current and proposed U.S. legislation pertinent to the cancellation of Afghanistan's official debt to the United States. It also discusses efforts of the Administration and the Congress to find solutions to Third World debt problems. The chapter opens with a brief historical review of U.S. policy toward debt relief. It then discusses the coverage, requirements, and adequacy of pertinent provisions of the Foreign Assistance Act (FAA) in some detail. Pending legislation and legislative proposals are examined to determine the extent to which they fill gaps in the FAA, provide suitable alternative approaches, and supply precedents useful in cancelling Afghanistan's debt. The merits of special legislation for Afghanistan are considered.

Chapter 4 describes the recent history of international endeavors to deal with the Third World debt crisis—endeavors with which the United States has become very much involved in recent years. The chapter also describes the roles of key international institutions, defines important technical terms, and requirements for policy reform to which bilateral and multilateral debt relief measures are often linked.

Chapter 5 outlines rationales and alternatives for cancelling Afghanistan's debt to the United States. Several approaches to debt cancellation are presented, from which the U.S. Government may make a choice, as circumstances prove appropriate. The chapter ends with a summary of the case for cancelling Afghanistan's official indebtedness.

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Executive Summary

Debt Forgiveness Defined

"Official debt forgiveness" is the cancellation by an external creditor of all or part of a debtor government's obligations to make payments of principal and/or interest under an existing loan. Such cancellations usually are financed from official budgets of the forgiving creditor governments.

Debt forgiveness is perhaps the most dramatic and definitive of several types of "debt relief" which creditors may offer to debtor nations. Other forms include extension of grace periods, extension of periods for repayments, and reduction of interest rates. The effects of the various forms of debt relief can be evaluated quantitatively in terms of short-term cash flow effects (annual reductions in debt service payments) and in terms of present value (the value of all future payments discounted to the current year using a presumed market rate of interest).

Afghanistan's External Debt

The quality of data on Afghanistan's external data leaves much to be desired. Nevertheless, there is good information available from U.S. Government sources on the portion of Afghanistan's debt owed the U.S. Government. Other elements of Afghanistan's debt should be viewed as orders of magnitude subject to considerable revision.

Between 1953 and 1977, the U.S. Government made 30 loans to Afghanistan, all of them on a concessional basis, with extended maturities, generous grace periods, and lower-than-market rates of interest. By March 31, 1990, three of the thirty loans had been fully repaid. Maturity dates of the 27 U.S. loans outstanding range from 1997 to 2018. For the most part, Afghanistan has made its scheduled payments of principal and interest on time, and there are currently no U.S. arrears.

Afghanistan's official debt to the U.S. Government was $84.2 million on March 31, 1990. A.I.D.'s outstanding U.S. dollar loans to Afghanistan amounted to $63.5 million. 75 percent of the total. These loans were used principally for road improvements, transport equipment, electric power facilities, and agricultural inputs. Outstanding PL 480 loans were $19.8 million (24 percent of the total). A.I.D.'s local currency economic development loans accounted for the remaining 1 percent of the total.

Afghanistan's $84 million debt to the U.S. Government represents a small share of that country's external debt of some $3.6 billion. The Soviet Union held by far the largest share: $2.9 billion, or more than 81 percent of the total. Czechoslovakia had outstanding loans of $175 million, West Germany of $106 million, and Saudi Arabia of $30 million. Thus, if the United States were to spearhead a multilateral debt cancellation agreement in which all Afghanistan's principal bilateral creditors participated, the leverage effect of U.S. debt forgiveness would be very substantial.

International Developments

The practice of outright cancellation of the loans of severely indebted low-income countries is little more than a decade old in the thinking of most creditor governments. The 1980s was a decade in which efforts to provide official debt relief for such countries have been gathering momentum. During these years bilateral and multilateral debt relief activities became more closely linked.

To date, the largest single effort aimed at substantial official debt forgiveness for developing nations was that sponsored by the United Nations Conference on Trade and Development (UNCTAD) in a 1978 UNCTAD resolution. In response to that resolution, donor countries including Canada, Denmark, Finland, France, the Federal Republic of Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, and the United Kingdom cancelled debt amounting to some $3 billion.

In 1980, the World Bank introduced structural adjustment lending to developing countries in response to severe balance of payments crises in many of them. Structural adjustment loans (SALs) were supposed to overcome economywide weaknesses through such reforms as changes in trade and pricing policies, alteration of the size and configuration of government spending, privatization, and curtailing government controls on productive activities. Sector adjustment loans (SECALs) supported more narrowly focused programs of macroeconomic reform or provided a framework for sectoral investment, or both.

In early 1986 the International Monetary Fund (IMF) established the Structural Adjustment Facility (SAF) to provide financial assistance to low-income countries in response to balance-of-payments problems. In contrast to other IMF facilities that charge market rates of interest, SAF loans bore interest rates of only one-half of one percent. Payback periods also were extended. Resources available for the IMF's Structural Adjustment Facility were rapidly committed. Accordingly, an Enhanced Structural Adjustment Facility (ESAF) was established in late 1987 to provide substantially greater resources.

Recipients of SAL, SECAL, SAF, and ESAF loans are required to prepare a comprehensive policy framework paper (PFP) that specifies the policy requirements of an economic reform program. The IMF and the World Bank work together in assisting the borrowing countries with PFP preparation and subsequent loan negotiations.

In June 1988 seven leading industrialized countries, including the United States, met in Toronto and reached a significant agreement on concessional relief for severely indebted low-income countries (SILICs) in sub-Saharan Africa. They agreed that concessional debt be rescheduled over 25 years with 14 years of grace. Moratorium interest rates were to be at least as low as the rates on the original loans.

For nonconcessional debt, participating creditors chose from three options, one of which was partial debt forgiveness. In fact, much of the recent official debt relief for African countries has been more liberal in its terms than that contemplated by the Toronto terms. Rather than rescheduling concessional loans, several countries—including the United States—have opted for outright cancellation.

U.S. Policy and Legislation

U.S. policy on debt forgiveness moved slowly at the start but has gathered momentum. The United States did not participate in the debt cancellation initiative launched by UNCTAD in 1978. At the 1988 Toronto economic summit, the United States agreed to a menu of options that included debt forgiveness as an alternative for nonconcessional debt but did not commit itself to use the debt forgiveness option under any particular set of circumstances.

The Brady Plan, announced in early 1989, marked the first time that the U.S. Government officially called upon banks to forgive some of their loans. It seeks to assist both banks and governments to extricate themselves from the burdens of commercial debt. The Brady Plan calls for increased funding by multilateral and bilateral public organizations to underwrite some debts that remain after portions of pre-existing debts have been forgiven.

The Bush administration has collaborated with IMF/World Bank structural adjustment lending programs and with initiatives sponsored by the Paris Club to give relief to debt-burdened African nations. At the Paris Club sessions, the Administration, with congressional support, agreed to the forgiveness of more than $850 million in A.I.D. debt owed by African countries but favored preferential rescheduling terms (i.e., The Toronto terms) for other types of public debt owed the U.S. Government.

Under current provisions of the FAA, there are three main requisites for forgiveness of A.I.D loans to a developing country:

- The debtor country must be located in sub-Saharan Africa or qualify as a "least developed country," as designated by the United Nations General Assembly.
- It must have in place an International Monetary Fund (IMF) standby agreement, an IMF structural adjustment facility, or a World Bank structural adjustment program.
- Congress must make a suitable appropriation to cover the obligations to be forgiven, because the transaction is regarded as the equivalent of an expenditure for budgetary purposes.

Provisions of the FAA do not apply to PL 480 loans, but legislation is now in Congress that would provide for similar forgiveness of such loans.

Only sub-Sahelian African countries have been the beneficiaries of debt cancellation relief offered under the FAA. The OMB has resisted using this legislation for other debt-burdened least developed countries. For example, Bangladesh, which is far down on the poverty scale, has not received favorable treatment under the law.

Legislation currently pending before the Congress includes provisions that would

- Provide a procedure for forgiving PL 480 loans similar to that of Section 572;

- Give the President the authority to forgive interest and principal of official debt owed the USG by countries in Eastern Europe, Latin America and the Caribbean, and "any other severely indebted country" on the basis of specified political, economic, financial, and policy criteria; and

- Give the President authority to swap A.I.D. and PL 480 debt for environmental and development initiatives undertaken by Governments in Latin America and the Caribbean.

The latter legislative proposals are expected to be merged with the Administration's "Enterprise for the Americas," initiative, a comprehensive effort to revitalize the sagging economies of Latin America and the Caribbean in return for their implementation of various economic reform measures. Growing U.S. concern with economic and financial conditions in the Middle East, Eastern Europe, and the Americas probably will increase the acceptability of the debt cancellation concept.

The Economy of Afghanistan

Even before the Soviet invasion, Afghanistan was one of the poorest countries in the world. Soviet occupation has caused great harm to people, social systems, infrastructure, and productive facilities. There is little doubt that the country is in serious economic trouble and that its restoration will require substantial commitments of resources over many years.

Some 4.5 million Afghans are now refugees outside the country. Within the country, nearly 1 million persons were driven from the countryside to Afghan cities. Between 5 and 10 percent of the population has been killed. Few of the internal refugees within Afghanistan are likely to have found productive jobs in the cities where they have sought some degree of shelter from the war. The longer the country continues to suffer from the absence of peace, the more difficult will be the reabsorption of both internal and external refugees in fruitful pursuits.

Afghanistan's communist rulers have done great harm to the country's agricultural, industrial, and governmental sectors. Damage to the productive economy has been intensified by the prolongation of hostilities. Afghanistan's real gross domestic product declined by 3 per cent per capita per year from 1978-79 to 1986-87 and further reductions took place in 1987-88 and 1988-89. In 1988, the Office of the U.N. Coordinator for Afghanistan Assistance programs reported Afghanistan's GDP at $130 per capita, placing Afghanistan among the very poorest of countries in the world. The U.S. Government recently arranged to cancel debts of African countries with far higher per capita GDP figures.

Assuming the return of more than 4.5 million external refugees, Afghanistan's internal population could rise to about 17 million people. The country's population was a little more than 13 million before the Soviet invasion. In 1979 Afghanistan was marginally self-sufficient in food but suffered serious food deficiencies in years of water shortages. War has left the country replete with unexploded mines and massive deterioration of the country's roads, bridges, irrigation systems, farm animals, ruminant herds, and housing. Disruption of social institutions and the loss of working skills adversely affect the prospects for Afghanistan's future.

The tasks faced by Afghanistan in the 1990s and beyond are to

- Reverse the trend of economic, political, and social deterioration;
- Make the country's physical environment habitable;
- Help the refugees to return and reestablish productive lives; and
- Rebuild an economy that can sustain a population that may be 30 percent larger than before the war;

The levels of resources required to accomplish these tasks will dwarf the economic assistance costs incurred on all sides during the last decade. For the foreseeable future, Afghanistan's impoverished economy cannot possibly repay the country's existing international debt obligations.

Implementation Options

The main legislative and administrative implementation options for proceeding with debt relief are as follows:

1. Forgiveness of A.I.D. loans under existing legislation (Section 572).

2. Forgiveness of P.L. 480 loans under pending legislation.

3. Forgiveness of debt on the basis of legislative standards.

4. Special debt forgiveness legislation for Afghanistan.

5. Debt relief according to the "Toronto terms.

Of the five options identified, only the first four represent unambiguous debt cancellation. The rescheduling approach (Option 5) amounts to something other—and considerably less—than debt forgiveness. The United States could in the future, as the Soviet Union has in the past, provide Afghanistan with sufficient nonproject assistance and additional debt funding to permit the country to service some or all of its U.S. debt. But unless the Eastern bloc debt itself is cancelled, such U.S. financial assistance might be viewed as a potential source of funds for repaying Soviet or other non-U.S. debt obligations. Any debt relief device short of outright, across-the-board cancellation is likely to raise such issues.

Of the first four options discussed above, Option 4 (special country legislation) currently appears to be the best suited to Afghanistan's circumstances. Such legislation could clear up ambiguities in current laws and tailor a package that meets the country's needs. The least suitable for Afghanistan's circumstances is Option 3 (general legislative definition of standards of debt severity). Afghanistan's external debt profile fails to meet one of the criteria (interest payments of at least 20 percent of exports) included in statutory definition of severe indebtedness used in the International Development and Eastern European Recovery Act pending before Congress.

Option 1 (cancellation of A.I.D. loans under Section 572) and Option 2 (cancellation of PL 480 loans under pending legislation containing provisions similar to Section 572) would be sufficient if the Administration is prepared to use such legislation outside of sub-Saharan Africa.

Case for U.S. Cancellation

The case for the United States to cancel the official debt of a government of Afghanistan acceptable to the U.S. Government may be summarized as follows:

1. The economy of Afghanistan is not likely to be self-sustaining for a decade or more. The consequences of hostilities, environmental deterioration, political and social disruption, population growth and dislocation, loss of productive skills, and other difficulties

cannot be remedied quickly in a country that, before Soviet intervention, was one of the least developed and most impoverished in the world.

2. The people of Afghanistan are deserving of a generous form of debt relief by virtue of both their extreme poverty and the hardships they have endured in the cause of their freedom.

3. The United States already has cancelled the debts of developing countries far higher on the income scale than Afghanistan.

4. In recent years, the Government of Afghanistan could not have paid the debt service on its loans to the United States and other creditor countries in the absence of substantial Soviet nonproject assistance and highly concessional Soviet loans. Once a government is in place in Kabul that is acceptable to the United States neither the Soviet Union nor any other principal donor/creditor is likely to provide that government with a source of funds which it can use to repay its U.S. debt.

5. Forcing an independent Afghan government to default on its U.S. debt in order to qualify for new assistance would be counter-productive.

6. Cancellation of Afghanistan's official debt is more forthright and more conducive to Afghan self-discipline than alternative means by which the United States would provide the Government of Afghanistan with additional funds to enable it to remain current on its U.S. debt service.

7. The United States could provide a valuable leadership function in persuading some or all of Afghanistan's creditor countries to join it in debt cancellation.

Chapter 2

AFGHANISTAN'S EXTERNAL DEBT

Introduction

This chapter discusses the amounts, terms, and debt servicing status of loans to the Government of Afghanistan made by agencies of the U.S. Government, by other governments, and by other sources for which information is available. Discussed in the following sections are (1) the size and composition of Afghanistan's outstanding debt; (2) the status, terms, and servicing of loans to the Government of Afghanistan made by the U.S. Government, multilateral organizations, and other countries for which information is available; and (3) pertinent conclusions concerning Afghanistan's external debt.

This chapter substantially updates financial information contained in a Nathan Associates Inc./Louis Berger International, Inc. report[1] on the basis of data obtained from the International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), and agencies of the U.S. Government.

As discussed in the report, the quality of Afghanistan's external debt data leaves much to be desired. Nevertheless, U.S. Government sources can provide good information on the portion of Afghanistan's debt owed the U.S. Government. The general orders of magnitude of other elements of Afghanistan's debt seem reasonable, although the numbers shown are obviously subject to considerable revision.

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1. Nathan Associates, Inc. and Louis Berger International, Inc. Afghanistan Macroeconomic Database Development, A.I.D. Contract No. 306-0205-C-00-9385-00, Delivery Order 11, January 1990. (See Tables A-V-7 to A-V-10 in the statistical appendixes to that report.)

Amount and Composition of External Debt Outstanding

In March 1990 Afghanistan's outstanding external public debt was about $3.6 billion. Of this amount, the Soviet Union accounted for about $2.9 billion (more than 81 percent) as reported by the Da Afghanistan Bank. The $108.9 million share (about 3 percent) owed all creditors in the United States was of minor magnitude compared with that of the Soviet-held debt. Agencies of the U.S. Government reported that they held $84 million in Afghan debt at the end of March 1990. This is the amount that may be considered for possible debt forgiveness.

Of the $84 million owed entities of the U.S. Government, A.I.D. loans in U.S. dollars represented 75 percent of the total; PL 480 loans represented 24 percent; and A.I.D. loans in Afghan local currency represented about 1 percent. Although detailed information is available on the composition of Afghan debt held by the U.S. Government, little is known about the composition of the Soviet-held debt or the purposes for which it was incurred.

The amounts of the outstanding public and publicly guaranteed external debt, as of March 20, 1986, and March 20, 1990, are shown in Table 1. These figures were not made available to the IMF mission during the 1990 Article IV Consultations held in New Delhi in May 1990; however, they were received by the IMF in July 1990, just in time for the IMF Executive Board discussion of the 1990 Article IV Consultations Report. At the time of this report, the IMF staff had not yet had the opportunity to discuss these figures with the Afghan authorities.

Table 1 classifies Afghanistan's external debt by major creditor countries. There is a residual item which includes loans from multilateral institutions such as the International Development Association (IDA), which is part of the World Bank; the Asian Development Bank (ADB); the Islamic Development Bank (IDB); the OPEC Fund; various bilateral official creditors, and other creditors.

Notwithstanding the data shortcomings pointed out later in this section, the figures in Table 1 provide useful information about the changes in Afghanistan's external debt between 1986 and 1990. The data indicate that the stock of outstanding and disbursed medium- and long-term debt has increased by about one-third over the last four years from US$2.7 billion in 1986 to US$3.6 billion in 1990. The growth in Afghanistan's outstanding debt largely reflected new lending by the Soviet Union, mainly on concessionary terms. In 1990, the Soviet Union accounted for more than 81 percent of Afghanistan's outstanding eternal debt, compared with 77 percent in 1986. The trends in debt to other countries, mostly on concessional terms, reveal substantially increased obligations to Czechoslovakia, modest increases in

Table 1. Afghanistan: Outstanding Public and Publicly Guaranteed External Debt, 1985-86 and 1989-90
(in $U.S. millions)

	Debt Outstanding as of March 20, 1986			Debt Outstanding as of March 20, 1990		
	Disbursed	Undisbursed	Total	Disbursed	Undisbursed	Total
Total	2,743.3	764.6	3,507.9	3,613.3[a]	1,000.0	4,613.3[a]
Soviet Union	2,098.4	530.5	2,28.9	2,939.5	694.1	3,633.6
Czechoslovakia	117.3	32.7	150.0	174.9	15.3	190.2
United States	113.1	4.1	117.2	108.9	3.6	112.5
Germany, Federal Republic of	100.0	7.1	107.1	105.9	10.2	116.1
Saudi Arabia	23.2	31.8	55.0	29.6	25.4	55.0
Other[b]	291.3	158.4	449.7	255.3	251.4	506.7

[a]As reported by the Da Afghanistan Bank; slight differences in addition of one or more items.
[b]Includes IDA, ADB, IDB, OPEC Fund and other multilateral institutions; bilateral official creditors; and other creditors.

Source: Government of Afghanistan, Da Afghanistan Bank; cited from IMF Staff Report for the 1990 Article IV Consultations, Supplement 1.

obligations to the Federal Republic of Germany and Saudi Arabia (the latter because of disbursements of earlier commitments), and a decline in debt to the United States.

In Spring 1990, Czechoslovakia held nearly 5 percent of Afghanistan's debt, with outstanding loans of $175 million. West Germany held $106 million, representing about 3 percent. Saudi Arabia, with $30 million, had almost 1 percent of the country's external obligations. Multilateral institutions and other bilateral creditors (excluding the Soviet Union, Czechoslovakia, West Germany, the United States, and Saudi Arabia) held the remaining $255 million, or about 7 percent of Afghanistan's debt.

Afghanistan has received very limited external assistance in convertible currency in recent years. Inflows in nonconvertible currencies from the Council of Mutual Economic Assistance (CMEA) countries of the Soviet bloc, particularly the Soviet Union, have accounted for nearly all recent foreign aid. Most of the external borrowing has been on concessional terms with long maturities. The loans extended by CMEA countries bear interest rates in the range of 1.5 to 2.0 percent, and maturities ranging from 15 to 40 years, with grace periods of 5 to 10 years.

Data for the external debt owed the U.S. Government by the Government of Afghanistan are presented in Table 2. These figures have been compiled from U.S. Government sources and represent one component of Afghanistan's external debt that is both reliable and timely. The data in Table 2 have been derived from Appendix Tables A-1 to A-3, which are prepared on a loan by loan basis by A.I.D., the U.S. Treasury, and the Bureau of Management and Budget. There are currently no outstanding loans to Afghanistan by other U.S. Government agencies. Some problems of internal consistency among different U.S. data sources (Appendix Tables A-1 to A-3) as well as between Tables 1 and 2 are discussed later in this section. Table 2 includes A.I.D. loans (repayable in dollars and in local currency) and commodity assistance under PL 480, Title 1. The total outstanding debt to the U.S. Government (third column of Table 2), which amounted to $84,233,742 on March 31, 1990, represents the amount to be considered for possible debt forgiveness. The annual debt service payments (last column of Table 2), estimated to be $5,520,789 for FY 1990, represent the annual revenue loss to the U.S. Government that would result from full debt forgiveness.

A third set of Afghanistan's external debt data, compiled by OECD, is presented in Table 3, which classifies Afghanistan's external debt by maturity (long-term and short-term) and by type. For example, long-term debt is classified into OECD, multilateral, and non-OECD. Afghanistan's long-term obligations to OECD countries consist entirely of Official Development Assistance (ODA), financial markets, and other. Loans by multilateral institutions are wholly concessional. Debt to non-OECD countries is broken down by CMEA countries and Arab countries. Short-term credit is classified by bank loans and export credits.

Table 2. Official External Debt Owed the U.S. Government by Afghanistan and Annual Debt Service Payments
(in US$ millions)

	Disbursed [a]	Outstanding Balance	Terms (percentages, grace/ payback)	FY 1990 Debt Service Payments[b]
A.I.D. loans repayable in dollars (under Foreign Assistance and Related acts)	82,909,564	63,530,641[c]	(2.5-3.0 percent, 10/30)	4,056,000[d]
A.I.D. loans repayable in local currency (under Agriculture Trade Development and Assistance Act)	1,147,806	863,921[c]	(local funds)	60,000[e]
PL-480, Title I (under Agricultural Trade Development and Assistance Act)	30,029,545	19,839,180[a]	(2.5-3.0 percent, 10/30)	1,404,689[d]
Total	114,086,915	84,233,742		5,520,689

Note: Data derived from Appendix Tables 1, 2, and 3.

[a]As of December 31, 1989. [Source: Status of Foreign Loans (March 31, 1990), Department of Treasury.]
[b]Equivalent to annual revenue loss to U.S. Government in case of full debt forgiveness.
[c]As of March 31, 1990. [Source: Status of Loan Agreements (March 31, 1990), Office of Financial Management, A.I.D.]
[d]Report on Estimated Debt and Debt Service Owed to U.S. Government by Foreign Obligors, U.S. Treasury and Office of Management and Budget (June 1990).
[e]Estimated.

Following are some statistical inconsistencies affecting Tables 1-3.

1. The figures for Afghanistan's outstanding medium and long-term debt to the United States (as of March 20, 1990) in Table 1 ($108.9 million) are much larger than the figures for Afghan debt to U.S. Government agencies (as of March 31, 1990) in Table 2 ($84.2 million). As mentioned earlier, the data in Table 1 were supplied by Afghanistan authorities, whereas those in Table 2 are current figures supplied by U.S. Government sources and are more reliable. The total of Afghanistan's outstanding external debt to the United States in Table 1 (which is some $25 million higher

than that in Table 2) is hard to explain, because the debt owed non-U.S. Government agencies by Afghanistan, such as suppliers' credits and bank loans, is believed to be negligible. There has been virtually no inflow of suppliers' credits or bank loans from the United States into Afghanistan since the Russian invasion. Data in Table 3, while not strictly comparable, support this conclusion.

2. There is lack of consistency between Tables 1 and 4[2] even though the figures for both tables were provided by the same source—Da Afghanistan Bank. For example, the reduction in the outstanding amount of Afghanistan's debt to the United States in Table 1 between 1986 and 1990 is much less than the amortization payments shown in Table 4, even though it is known that no new loans were granted to Afghanistan during this period by U.S. Government agencies or private institutions.

3. There are minor discrepancies between Appendix Table A-1 (A.I.D. data as of March 31, 1990) and Appendix Table A-2 (Treasury data as of December 31, 1989) with respect to disbursed/utilized amounts and outstanding balances of A.I.D. loans repayable in dollars as well as some discrepancies for those repayable in local currency, as shown in Table 5. The discrepancy with respect to the outstanding balances is very small and may possibly be due to amortization payments received between December 31, 1989, and March 31, 1990. The discrepancy is somewhat larger with respect to disbursed/utilized amounts. A loan-by-loan comparison of the two sets of data shows that A.I.D. data contain loans that have been paid off in full, whereas Treasury data do not include such loans. After deducting such loans from A.I.D. data for loan utilizations (see adjusted figures for utilized amounts of A.I.D. loans in Table 5), it turns out that there is no longer any discrepancy between the two sets of data with respect to disbursed/utilized amounts of loans repayable in dollars, whereas some discrepancy remains with respect to the dollar equivalents of disbursed/utilized amounts of loans repayable in local currency.

4. The figures in Table 3 are not comparable with those of either Table 1 or Table 2 because

   a. The figures in Tables 1 and 2 are more recent, whereas 1987 is the most recent year in Table 3.

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2. Table 4 shows public and publicly guaranteed external debt services payments of Afghanistan, 1985-86 to 1989-90, as reported by the Da Afghanistan Bank.

Table 3. External Debt of Afghanistan
(in $U.S. millions)

	1982	1983	1984	1985	1986	1987
Long-Term						
OECD countries and capital markets	182	169	155	146	143	146
ODA	157	145	133	141	142	146
Official/off. supported	24	24	22	0	-	-
Official export credits	24	24	22	-	-	-
Guaranteed supplier credits	0	0	-	-	-	-
Guaranteed bank credits	0	-	0	0	-	-
Financial markets	1	-	-	5	1	-
Banks	1	-	-	5	1	-
Bonds	-	-	-	-	-	-
Other private	-	-	-	-	-	-
Multilateral	110	109	109	119	129	139
Concessional	110	109	109	119	129	139
Nonconcessional	-	-	-	-	-	-
Non-OECD creditor countries	508	531	602	852	999	1,196
CMEA	400	425	500	750	900	1,100
Arab countries	108	106	102	102	99	96
Other countries and unspecified	-	-	-	-	-	-
Subtotal	800	809	866	1,117	1,270	1,482
Concessional	775	785	843	1,112	1,269	1,482
Nonconcessional	25	24	22	5	1	0
Short-Term						
Subtotal	10	8	6	5	18	17
Banks	1	8	6	5	18	17
Export credits	9	0	0	0	0	0
Total external debt[a]	810	818	872	1,122	1,289	1,499

[a]There is no IMF credit.

Source: OECD, *Financing and External Debt of Developing Countries: 1988* Survey, Paris, 1989.

Table 4. Public and Publicly Guaranteed External Debt Service Payments by Afghanistan, 1985-86 to 1989-90
(in US$ millions)

	Year ended March 20				
	1985-86	1986-87	1987-88	1988-89	1989-90
Total	75.7	167.6	145.5	243.4	311.4
Principal	67.1	133.0	134.2	231.9	303.5
Interest	8.6	34.6	11.3	11.5	7.9
Soviet Union	-40.2	133.5	107.4	205.1	277.3
Principal	40.2	106.8	105.6	200.0	277.3
Interest	-	26.7	1.8	5.1	-
Czechoslovakia	13.3	8.0	12.4	16.5	14.7
Principal	11.5	6.8	9.4	15.2	12.1
Interest	1.8	1.2	3.0	1.3	2.6
United States	5.6	5.5	5.7	5.2	5.1
Principal	3.0	3.1	3.1	3.0	2.9
Interest	2.6	2.4	2.6	2.2	2.2
Germany, Federal Republic of	3.6	4.9	5.4	5.1	4.7
Principal	3.0	4.1	4.7	4.4	4.2
Interest	0.6	0.8	0.7	0.7	0.5
Other[a]	13.0	15.7	14.6	11.5	9.6
Principal	9.4	12.2	11.4	9.3	7.0
Interest	3.6	3.5	3.2	2.2	2.6
Memorandum item: Debt service payment as a share of total exports and services receipts (in percent)	10.9	30.5	24.5	44.5	73.4
Of which: Amortization	9.7	24.2	22.6	42.4	71.5
Interest	1.2	6.3	1.9	2.1	1.9

[a]Includes IDA, ADB, IDB, OPEC Fund, and other regional and multilateral institutions as well as bilateral donors.

Source: Da Afghanistan Bank.

b. Table 3 does not give a breakdown by creditor countries; hence, it is not comparable with Table 2 (which has data on loans granted by only one creditor country, the United States). The figures in Table 3 can be compared with those of Table 1 only with respect to Afghanistan's total debt.

c. Table 3 contains data on short-term as well as medium and long-term debt, whereas Table 1 includes only medium and long-term debt.

d. The figures for medium and long-term debt in Table 3 are not consistent with those of Table 1, as shown in Table 6. Even after taking into account the difference in dates, the OECD figures are so far below those of Table 1 (less than half) that a difference in coverage is clearly indicated. A possible explanation is suggested by the fact that most of the disparity is related to the debt owed CMEA countries; the Afghan authorities, the source of data in Table 1, presumably have better access to CMEA data than does the OECD.

In order to provide a complete picture of Afghanistan's external obligations, the balances in Afghanistan's bilateral payments agreements should be taken into account. Afghanistan has bilateral payments agreements with the Soviet Union, Czechoslovakia, Bulgaria, Hungary, and China; by far the most important of these agreements is the one with the Soviet Union.

Trade with the Soviet Union accounted for almost all bilateral transactions until 1985-86 when trade with Czechoslovakia became sizable and the share of the Soviet Union fell to 95 percent; this share subsequently declined to about 90 percent by 1989-90. The agreements with China and Hungary have been inactive for several years. The outstanding liability with China has remained unchanged since 1987-88 at about US$0.5 million. Exchange rates pertaining to trade under bilateral payments are determined under each agreement.

All transactions under these agreements are made in clearing account dollars, which until 1988-89 were converted by the central bank at the official rate. At that time, the rates were adjusted to Af 70.5 = US$1 for trade with the Soviet Union and Af 81.2 = US$1 for trade with Czechoslovakia. Export proceeds from bilateral sales retained in the central bank's clearing accounts can be used directly or transferred by the holder to any other party for financing imports.

Bilateral payment agreements generally have provisions governing "swing limits" or limits on reciprocal credit granted by one bilateral trading partner to another; amounts in excess of these limits are either to be settled in convertible currencies or to be converted into a consolidated debt (which

Table 5. Official External Debt of Afghanistan Owed A.I.D.: Comparison of A.I.D. and Treasury Data (in US$)

	A.I.D. Data (as of 3/31/90)			Treasury Data (as of 12/31/90)	
	Utilized	Utilized after Adjustment[a]	Outstanding Balance	Disbursed	Outstanding Balance
A.I.D. loans repayable in dollars	84,343,497	82,909,564	62,530,641	82,909,564	62,787,855
A.I.D. loans repayable in local currency	2,908,287[b]	1,741,876[b]	863,921	1,147,806	867,686

[a]Adjusted for loans paid off in full, which are not included in the Treasury figures for disbursed amounts.
[b]Not adjusted for principal reductions through exchange rate adjustments amounting to $992,676.

Sources: Appendix Tables A-1 and A-2.

Table 6. Total External Debt of Afghanistan: Comparison of IMF and OECD Data (in US$ millions)

	IMF Data		OECD Data
	As of 3/30/86	As of 3/30/90	As of 12/31/87
Total debt	2,743.3	3,613.3	1,499
CMEA	2,215.7	3,114.4	1,100
Other[a]	527.6	498.9	399

[a]OECD and other bilateral, multilateral, banks, etc.
Sources: Tables 1 and 3.

will then show up in external debt statistics). No recent information is available with respect to swing limits under Afghanistan's bilateral payments agreements. Afghanistan's negative balances under bilateral payments agreements reportedly rose from a negative (or net debit) total of $189 million at the end of 1985-86 to a negative total of $246 million at the end of 1989-90.

Loan Status, Terms, and Debt Service

In the years preceding 1978, the Government of Afghanistan received loans from the U.S. Import Export Bank, A.I.D., and the PL 480 program. All of the Export-Import Bank loans have now been paid off.

Appendix Table A-1 shows that A.I.D. made 22 loans to Afghanistan between 1953 and 1975, of which 19 were repayable in foreign currency and 3 were repayable in local currency. One foreign currency loan (made in the early 1950s) and one local currency loan (made in the 1960s) have been paid off. The grace periods of all A.I.D. loans outstanding have expired.

The 18 outstanding A.I.D. foreign currency loans bear interest rates ranging from 0.75 percent to 3.0 percent (Appendix Table A-1). Their maturity dates range from December 1997 to December 2015. Loan proceeds were used principally for road improvements, transport equipment, electric power facilities, and agricultural inputs.

The two outstanding A.I.D. local currency loans bear interest rates of 4.125 percent and 2.0 percent/2.5 percent, respectively (Appendix Table A-1). The two loans mature in April 2000 and February 2011 (Appendix Table A-2).

There were eight PL-480 loans dating from 1966 through 1977, of which one was fully amortized. The remaining seven bear interest rates of 2.5 percent or 3.0 percent. The maturity dates range from June 2008 to December 2018. These loans were used to purchase wheat, wheat flour, and other agricultural commodities (Appendix Table A-2).

Afghanistan's external debt service payments in the 5-year period 1985-86 to 1989-90 are shown in Table 4. Although Afghanistan's reliance on foreign aid has been large in recent years, the concessional nature of the loans, the high proportion of grants, and repeated reschedulings of debt obligations by the Soviet Union have kept Afghanistan debt servicing payments rather low, relative to outstanding debt. This does not, however, hold true of the debt service ratio, namely, the ratio of amortization and interest payments to receipts from exports of goods and services. With virtually all external debt extended on concessional terms and some debt obligations rescheduled by the Soviet Union, the interest payments on Afghanistan's external debt have been very low, generally less than 1 percent of total outstanding debt and only 0.2 percent in 1989. However, total debt service obligations have risen rapidly in the last 4 years as earlier loans have fallen due, and in 1989-90 debt amortization exceeded aid inflows for the first time. With recorded exports declining in recent years, the debt service ratio has risen greatly, increasing from 11 percent in 1985-86 to 45 percent in 1988-89 and 73 percent in 1989-90, when exports and services inflows were sharply lower. Of the total debt service payments, interest has represented a very small part. For example, total debt service payments in 1989-90 amounted to $311.4 million (more than four times those in 1985-86), of which $303.5 million represented amortization payments and only $7.9 million (a minuscule 2.5 percent) reflected interest payments.

Afghanistan remains current on all external financial obligations, including those to the World Bank. The 1990 Consultation Report indicates that the authorities have expressed to the IMF their determination to continue to meet all external financial obligations on a prompt and timely basis. During the 1980s various creditors, bilateral as well as multilateral, have reported temporary occurrence of debt service arrears from time to time; however, the Afghan authorities have managed to eliminate the arrears within a few months. For example, Appendix Table A-3 shows arrears of $1.38 million to the U.S. Government on September 30, 1989, of which $0.96 million reflected arrears in amortization payments and $0.42 million represented arrears in interest payments. These arrears have since been paid and Afghanistan is currently up to date in its debt service payments to the U.S. Government.

The history of Afghanistan's debt service arrears to IDA is somewhat more complicated. As with other creditors, temporary arrears in Afghanistan's debt service payments to IDA occurred periodically in the 1980s. In February 1985, the Government of Afghanistan requested rescheduling of IDA loans, a request that was declined by IDA. The arrears problem then became more serious and debt service arrears to IDA amounted to $810,000 by mid-1989. In August 1989, IDA declared Afghanistan ineligible (because of more than 60 days' delinquency) and suspended loan disbursements (a symbolic action because there were no loans to be disbursed). Shortly thereafter, the Government of Afghanistan paid the arrears except for a small amount of $25,000 that had been in dispute for 9 years (with the Government of Afghanistan claiming to have paid it and IDA denying its receipt). In early 1990, the delinquency issue arose once again, this time with reference to this small amount. IDA decided to write it off, but before it could communicate this decision, the Afghan government paid the delinquent amount (which had grown to $50,525 because of interest accrual on the original $25,000) in April 1990. Afghanistan's debt service payments to IDA are current at this time.

Conclusions

The principal conclusions of our review of available information on Afghanistan's external debt are as follows:

1. The outstanding balance of Afghanistan's debt to agencies of the U.S. Government on March 31, 1990, was $84,233,742. This is the amount, which consists entirely of A.I.D. and PL 480 loans made to the Government of Afghanistan before the Soviet invasion, that may be considered for possible debt forgiveness by the U.S. Government.

2. Afghanistan's current annual amortization and interest payments on its debt to U.S. Government entities amount to $5,520,689 per year.

3. Afghanistan's total external debt in March 1990 was on the order of $3.6 billion. Its annual amortization and interest payment in 1989-90 was about $311 million.

4. The Soviet Union holds slightly more than 81 percent of Afghanistan's external debt. The United States' share is only 3 percent.

5. Although there have been temporary arrears in Afghanistan's debt service payments from time to time during the 1980s, these arrears have been liquidated rather promptly. At the time this report was being prepared, Afghanistan's debt payments were current.

6. The data on Afghanistan's external debt are not carefully prepared, are subject to errors, and lack consistency—shortcomings similar to those of other Afghan economic data. Nevertheless, the broad outline of the Afghan debt problem is reasonably clear, and the available data provide a reasonable basis for prospective decisions on debt forgiveness.

7. Tables 1 and 4, which contain data submitted to the IMF by the Da Afghanistan Bank, represent the most complete and up-to-date data available at the time this report was prepared.

8. Table 2 in the text, based on the detailed information provided by U.S. Government agencies as set forth in Tables A-1 through A-3 in the appendix, represent the most complete and up-to-date information available at the time this report was prepared.

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Chapter 3

U.S. LEGISLATION ON FORGIVENESS OF OFFICIAL DEBT

Introduction

This chapter analyzes current and proposed U.S. legislation on the forgiveness of Afghanistan's official debt to the United States. It also discusses efforts of the Administration and Congress to find solutions to Third World debt problems.

Presented in the following sections are (1) a brief overview of the recent history of U.S. Government policies affecting debt reduction; (2) an analysis of existing statutory provisions that might be applied to Afghanistan; (3) a summary of proposed legislation pending before Congress; and (4) conclusions about U.S. legislation on forgiveness of official debt.

In Chapter 2 it was shown that more than three-quarters of Afghanistan's outstanding official debt to the U.S. Government (about $64 million of $84 million) came from A.I.D. foreign currency and local currency lending. PL 480 loans account for almost $20 million.

The Foreign Assistance Act (FAA) now provides a procedure by which the President may forgive principal and interest of loans that A.I.D. has made to the least developed countries, of which Afghanistan is clearly one. However, the provisions of the FAA do not cover debt acquired through the PL 480 program. Legislation has been passed by both houses of Congress (but which has not yet come out of conference) that would provide a procedure for forgiving PL 480 loans similar to that now applied to A.I.D. loans under the FAA.

Policy Overview

U.S. Government policy has responded to challenges posed by the Third World debt crisis on the basis of perceptions of its character and magnitude that have changed over the years. The financial difficulties of debt-burdened developing countries intensified in the 1970s and 1980s. Large amounts of the greatly expanding dollar accumulations of the OPEC nations were deposited in the United States and other industrialized countries. These funds were recycled to capital-hungry countries, often in magnitudes and under terms unwarranted by sound banking practices. These developments greatly aggravated and to some extent cloaked the official debt problems of many developing and some middle-income countries. However, the problem of the official debt of developing countries was not squarely addressed until late in the 1980s.

Legislation permitting some limited forms of official debt relief indeed was passed by the U.S. Congress during the Carter Administration but was never used. The Reagan Administration did not put forward debt-related initiatives in its early years. However, the Baker Plan, announced in 1985, encouraged debt-affected countries to adopt austerity measures and growth-oriented policies. It called for new lending by the commercial banks and by the World Bank to countries willing to adopt reforms. Nevertheless, the Baker Plan focused on commercial rather than official debt, on middle income rather than on developing countries, and on loan repayment rather than on debt forgiveness.

During the second half of the 1980s, concern within the donor community grew as the financial problems of the Third World continued to mount. At the 1988 Toronto economic summit of the G-7, the United States agreed to a menu of options for dealing with nonconcessional loans to the poorest countries, of which partial forgiveness of debt was one option. Agreement to this menu did not, however, commit the United States to use the debt forgiveness option under any specific set of circumstances.

The notion of forgiving debt—both commercial and official—has gained greater acceptance as interest in revitalizing economies in Latin America and Eastern Europe and in stimulating increased North-South capital flows has grown. The Brady Plan, announced in early 1989, marked the first time that the U.S. Government officially called upon banks to forgive some of their debt. That plan seeks to assist both banks and governments to extricate themselves from the burdens of commercial debt. It calls for increased funding by multilateral and bilateral public organizations to underwrite some debts that remain after portions of pre-existing debts have been forgiven.

The Bush Administration has collaborated with IMF/World Bank structural adjustment lending programs and with initiatives sponsored by the Paris Club to give relief to debt-burdened African nations. The Administration, with congressional support, has agreed to the forgiveness of more than $850 million in A.I.D. debt owed it by African countries while providing preferential rescheduling terms (i.e., the "Toronto Terms") for other types of public debt owed the U.S. Government. International efforts to relieve Third World indebtedness are discussed in greater detail in Chapter 4.

The future of U.S. Government policy toward the debt crisis may well depend heavily on the performance of such Brady Plan "test cases" as Mexico and the Philippines. The size of the U.S. budget deficit may be a significant influence on the willingness of the Government to forgive more of the official debt of developing countries.

Current U.S. Statutory Law

Current U.S. statutory law (1) sets forth general requirements that apply to forgiveness of A.I.D. loans to developing countries and (2) establishes specific restrictions on A.I.D. assistance to Afghanistan. General requirements for forgiving A.I.D. loans and specific restrictions on Afghanistan assistance are discussed below. An assessment of the interaction of the two sets of statutory provisions is given in the conclusion of this chapter.

General Requirements for Forgiveness of A.I.D. Loans

There are three main requisites for forgiveness of A.I.D loans to a developing country:

- The debtor country must be located in sub-Saharan Africa or qualify as a "least developed country," as designated by the U.N. General Assembly.
- It must have in place an International Monetary Fund (IMF) standby agreement, an IMF structural adjustment facility, or a World Bank structural adjustment program.
- The Congress must make a suitable appropriation to cover the obligations to be forgiven, because the transaction is regarded as the equivalent of an expenditure for budgetary purposes.

The first two of these requirements are taken from the FAA and related legislation, as described next. The third requirement stems from law and practice governing the U.S. Government's budgetary process, as described later.

Afghanistan has been designated a "least developed country" by the U.N. General Assembly. The country does not, however, currently have in place an IMF standby agreement, an IMF structural adjustment facility, or a World Bank structural adjustment program. As discussed later, there are some uncertainties about the values to be placed on the forgiven debts of developing countries and about which government agency will be assigned these values for appropriations purposes.

Qualification Under the FAA

All A.I.D. Economic Support Fund (ESF) and Development Assistance (DA) loans are made under the authority of the FAA. Until 1976 the President's powers to relieve debt incurred under this act were quite narrowly circumscribed. Section 620(r), enacted in 1966, stated

> no recipient of a loan made under the authority of this Act . . . shall be relieved for the liability for the repayment of any part of the principal and interest of such a loan.

Under this provision, the President could authorize only the rescheduling of debt obligations—extending maturities or grace periods—but he did not have the power to waive the principal or interest.

During the Carter Administration the President's authority was broadened with the passage of Section 124 of the FAA. This amendment authorized the President to (a) forgive the interest payable in that fiscal year or (b) have the borrower deposit principal and interest payable that fiscal year in a local currency account. Although this section has never been applied by itself, it has served as a step toward enactment of the most significant debt reduction legislation to date, Section 572 of the 1989 Appropriations Act.

Under Section 572, the President may use the authority provided under Section 124 of the FAA to waive the aggregate amounts of outstanding principal and interest for all loans authorized under the FAA. The section states that such a waiver is eligible only for countries in sub-Saharan Africa or a country recognized by the U.N. General Assembly as a least developed country.[3] In addition, eligible countries must have in place an International Monetary Fund (IMF) standby agreement, an IMF structural adjustment facility, or a World Bank structural adjustment program.[4]

Since enactment of Section 572 in October 1988, the Administration has agreed to forgive the ESF and DA debt of 14 countries in Africa, estimated

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3. Includes 28 African countries plus Afghanistan, Bangladesh, Bhutan, Burma, Democratic Yemen, Kiribati, Tuvalu, Vanuatu, and Yemen.
4. The characteristics of each of these arrangements are described in the Chapter 4 of this report.

on the basis of a life of loan calculation, at $853 million ($582 million principal, $218 million interest, and $53 million of undisbursed funds).

Section 572 was initiated by the Congress, in particular the House Subcommittee on Foreign Operations, Export Financing, and Related Programs. At the time of passage the bill was strongly supported by both the House and the Senate for three primary reasons.

1. It had become evident that the likelihood of many of the low-income debtor countries becoming able to service their debt was more and more remote.

2. Although the U.S. Government had been active through the Baker Plan in trying to resolve the plight of the middle-income debtor countries, the policy had neglected the plight of the most disadvantaged debtor nations. By the late 1980s many Paris Club donors had announced sweeping debt forgiveness for many countries, particularly in Africa.

3. Without some form of relief many A.I.D. recipient countries were becoming ineligible for further assistance because of the Brooke Amendment, which blocks assistance to countries that fall far behind in repaying their loans to the U.S. Government.

Although the Executive Branch did not support the forgiveness legislation at the time, the Bush Administration now appears to view Section 572 as a sort of philosophical extension to the Brady Plan. This section has been used exclusively for African countries by the Administration. However, the prospects for its application to other eligible countries have been tempered by strong concern within the Administration over the growing government deficit. The Office of Management and Budget (OMB), for example, has opposed applying the section to eligible countries outside the sub-Saharan region.

Appropriation Issues

Forgiving the interest and principal owed by a foreign borrower requires funding legislation to appropriate the equivalent of the Government's revenue loss. The accounting treatment of debt forgiveness has proved to be a controversial and complex problem. The two main parties to this debate, the OMB and the Congressional Budget Office (CBO), which is Congress's own fiscal watchdog, have not agreed on how the debt forgiven under Section 572 should be handled for appropriation purposes. Differences of opinion center on two basic issues: (1) the valuation of the debt payments forgiven and (2) who must take the "budgetary hit" for the loss in revenues resulting from debt forgiveness.

Methods of budgeting debt forgiveness have proved important in the application of Section 572. Perhaps to soften the budgetary impact of the African debt forgiveness, OMB took the position that the debt being written off was worth about half its face value. Because the affected countries were not servicing their loans regularly (many had fallen into arrears), the revenue truly forgone would be considerably less than that implied in formal repayment schedules. The Administration took a similar position concerning Egyptian debt to the United States following its proposal to forgive all of Egypt's U.S. military assistance loans incurred under the FAA. However, whether the Administration, Congress, or both should determine the market value of forgiven debt has not been fully resolved.

Valuation and other appropriation issues may not be particularly troublesome for Afghanistan's indebtedness, if timely and decisive action is taken on cancellation. The country has serviced its debt regularly in the past and has no current arrears.

According to current procedures, A.I.D. loan commitments are recorded in the A.I.D. budget, whereas their debt servicing payments are entered into a general government account. This situation would appear to be favorable from the perspective of A.I.D., because it reduces the likelihood that debt forgiveness will have a negative impact on new A.I.D. appropriations. Most A.I.D. officials appear to believe that the effect of Section 572 on the agency's funding prospects has been minimal thus far (last fiscal year was the first year of forgiveness). However, some officials believe that these favorable circumstances may change if the Latin American Initiative (discussed later in this chapter) is put into effect.

The PL 480 Food Aid Program, by contrast, now has its own appropriation account through which repayments by developing countries are recycled directly back into the program. Last year repayments constituted approximately 75 percent of the program's total budget. Because debt forgiveness may directly reduce available resources, some program officials have mixed feelings about the benefits of debt forgiveness. Conceivably, a similar ambivalence could enter into the calculations of A.I.D. officials if the agency's budget—or particular missions—were to be charged directly with forgiven debt. Appropriations for the A.I.D. program have declined over the past few years, and this decline may well continue. If there were to be a direct trade-off between debt forgiveness and new program undertakings, enthusiasm for debt forgiveness procedure could be diminished.

Restrictions on U.S. Assistance to Afghanistan

In 1979, following the Soviet invasion and the killing of the U.S. Ambassador in Kabul, Congress enacted legislation prohibiting U.S. foreign aid to Afghanistan (22 USCS Section 2374, emphasis in original) as follows:

> None of the funds *authorized to be appropriated* under this Act may be used to furnish *assistance* to Afghanistan . . . until the President certifies that—
>
> (1) the Government of Afghanistan has apologized officially and assumes responsibility for the death of Ambassador Adolph Dubs; and
>
> (2) the Government of Afghanistan agrees to provide adequate protection for all personnel of the United States Government in Afghanistan.

These restrictions have prohibited American foreign aid to the Soviet-imposed regime in Afghanistan, but the prohibition certainly was not intended to punish the country's overwhelmingly anti-Communist citizens. By the mid-1980s, it became clear that U.S. assistance was needed to relieve the suffering of Afghans residing in resistance-held areas of Afghanistan and to stem the flow of refugees to Pakistan. Accordingly, in 1985, the Congress enacted an exception to the 1979 law to enable the President to use ESF funds for such purposes (emphasis supplied):

> (a) The President may make available funds . . . for the provision of food, medicine, and other *humanitarian assistance to the Afghan people*, notwithstanding any other provision of law.

The 1985 amendment provided the legal underpinning for O/AID/Rep's current Cross-Border Humanitarian program. It permitted the U.S. Government to mount programs of assistance to persons in Afghanistan, without thereby rendering assistance to the Kabul government.

Clearly, any decision by the U.S. Government to forgive Afghanistan's official debt would rest on a determination that the then-incumbent Afghan government merits such relief—or at least that forgiveness envisioned is in the best interests of the United States at the time it is offered. Conceivably, relief would be extended in circumstances under which the Presidential certification required by the 1979 law could be made easily.

It is also conceivable, however, that the U.S. Government may wish to proceed rapidly with debt forgiveness (e.g., at a critical point at which other creditors are prepared to participate in a general write-off of Afghanistan's debts) under circumstances in which the required Presidential finding could not be made (e.g., the Government of Afghanistan could not provide adequate protection for U.S. Government personnel in many parts of the country). In this situation, the legislative prohibition might then represent a statutory hurdle that a debt forgiveness initiative for Afghanistan would have to surmount.

To attempt to fit debt relief, extended directly to an Afghan government in Kabul, under the 1985 humanitarian exception to the 1979 prohibition on assistance to Afghanistan could stretch that exception well beyond its original intent—even though the effect of the forgiveness might be to benefit the Afghan people. A more persuasive argument against applying the prohibition is that forgiveness of Afghanistan's official debt does not constitute "assistance" within the meaning of the 1979 law. Debt relief is not often considered as foreign assistance, nor does it now appear to require the appropriation of funds under the FAA as referred to in the 1979 prohibition.

Nevertheless, the 1979 prohibition was enunciating a policy toward the communist Government in Kabul that Congress took seriously and intended to be broadly applied. It may be desirable to subject forgiveness of Afghanistan's debt to explicit substantive congressional approval. Special legislation specifically targeted to an independent Afghanistan's special circumstances would likely get wide congressional support.

A.I.D.'s General Counsel's office has not rendered an opinion on the meaning of the 1979 prohibition or on the meaning of the 1985 exception to that prohibition, as those two sets of statutory provisions might apply to debt forgiveness.

Recent and Pending Legislation Incorporating Debt Forgiveness Provisions

Briefly discussed in this section are debt forgiveness proposals pending before Congress. These proposals cover

- PL 480 loans to African and least developed countries,
- Loans to Eastern European, Caribbean, Latin American, and other heavily indebted countries,
- Caribbean debt-for-nature,
- Caribbean debt-for-development, and

- Enterprise for Americas initiative.

The first three of these proposals are of congressional origin. The last has been put forward by the Administration. Some of these proposals are not directly applicable to Afghanistan. Even when they are not so applicable, these proposals provide a measure of current interest in the subject and some suggest options that might be considered in the case of Afghanistan. Each legislative proposal is discussed below.

Congressional Debt Forgiveness Proposals

H.R. 3950 and S. 2830 (Food Bills)

H.R. (House of Representatives) 3950 and S. (Senate) 2830, commonly referred to as the Food Bills, each contain a provision proposed by the Administration to authorize the President "to waive payment of such aggregate amounts of principal and interest payable" for food aid obligations made under the PL 480, Title I, program. Under the House bill, eligibility would be similar to that under Section 572—a country in sub-Saharan Africa or a least developed country, as defined by the United Nations Development Programme. The Senate version would also include countries presently eligible for the IBRD Civil Works Preference assistance program or deemed a "food deficit country," applying a number of prescribed criteria. Both bills require an eligible country to be a participant in an IMF Structural Adjustment Facility/Standby Agreement or in a World Bank (IBRD) Structural Adjustment Program. The House bill would also include countries that may not be participants in IMF or IBRD programs but that are pursuing "national economic policy reforms . . . and long-term economic development."

Both the House and Senate have passed these bills, which are now in conference. No resistance from the Administration is expected because it originally proposed the provision.

H.R. 5153 (International Development and Eastern European Recovery Act of 1990)

Under Section 602 of this Act, the President would have the authority to forgive interest and principal of official debt[5] owed the U.S. Government by countries in Eastern Europe, Latin America and the Caribbean, and "any other severely indebted country." Although any forgiveness would be given on a case by case basis, all benefiting countries would have to be (a) moving

5. The exact type of official debt is not defined.

toward political pluralism, (b) undertaking market-oriented economic reforms,[6] (c) maintaining internationally recognized standards of human rights, (d) on friendly terms with the United States, and (e) pursuing measures to protect the environment. To be considered a "severely indebted country" a recipient would also have to meet such criteria as (1) ratio of debt to GNP greater than 0.50, (2) ratio of debt to exports greater than 2.75, (3) ratio of accrued debt to exports greater than 0.30, and (4) ratio of accrued interest to exports greater than 0.20.

Sponsored by Rep. Jim Leach (R-IA), the legislation was originally designed to assist only Eastern Europe. The bill was later expanded to include Latin America and the Caribbean, following the President's Latin America Initiative. In July the bill was passed by the House Committee on Banking, Finance, and Urban Affairs and is likely to be referred for consideration to the House committees on Foreign Affairs and on Appropriations. Although there appears to be support in the House for broadening the bill, the Administration is reluctant to extend it beyond Latin America and the Caribbean. The recent announcement to forgive Egypt's debt may, however, require the Administration to consider a more comprehensive forgiveness program.

H.R. 5088 (Caribbean Debt-for-Nature) and
H.R. 5196 (Caribbean Debt-for-Development)

Both of these bills are focused on Latin America and the Caribbean.[7] Under H.R. 5088 the President would have the authority to swap debt (A.I.D. and PL 480) owed the U.S. Government by a country in the region to achieve a debt-for-nature agreement. H.R. 5196 is somewhat broader, allowing the President to either waive or swap debt obligations for more than just environmental purposes.

Although both of these bills were passed by the Western Hemisphere Subcommittee of the House Foreign Affairs Committee, they are expected to be merged with upcoming draft legislation for the Administration's "Enterprise for the Americas." This legislation is still being formulated.

Bush Administration Debt Forgiveness Proposals

Latin America Initiative

The Latin America Initiative, also known as the "Enterprise for the Americas," was announced by the Administration in late June 1990, just before the G-7 summit in Houston. The initiative is a comprehensive effort to revitalize the

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6. An IMF or IBRD program does not have to be in place.
7. Only Haiti is now eligible for relief under Section 572.

sagging economies of Latin America and the Caribbean. It is also viewed as supportive of the Brady Plan, which focuses on two countries in the region, Mexico and Venezuela, as major test cases. The initiative is expected to offer substantial debt reductions (A.I.D. and PL 480) to countries as part of an overall assistance package in return for their implementation of various economic reform measures.

Egyptian Debt Forgiveness

In recognition of Egypt's political and military support of the U.S. and U.N. positions on the Persian Gulf crisis, the Administration recently sought and received from Congress a waiver of Egypt's $7.1 billion of U.S. military debt obligations. The Administration had to obtain congressional authorization because Egypt was ineligible under Section 572.

Initial congressional response had been less than enthusiastic, not only for fiscal reasons, but also because the proposal was perceived to be an ad hoc approach to debt forgiveness. However, the willingness of the Congress to proceed with Egyptian debt cancellation suggests that individual country treatment is possible when a strong case for such treatment can be made.

Conclusions

The principal conclusions of our review of U.S. legislation on forgiveness of Afghanistan's official debt to the United States are as follows:

1. Although there was some concern with the financial difficulties of debt-burdened developing countries in earlier years, the problem was not squarely addressed until late in the 1980s. The Bush Administration, with congressional support, agreed to the forgiveness of more than $850 million in A.I.D. debt owed by African countries while providing preferential rescheduling terms for other types of public debt owed the United States Government.

2. Section 572 of the 1989 Appropriations Act provides a potential vehicle for forgiving much of A.I.D. loans ($64 million of Afghanistan's $84 million official debt to the United States). It is expected that the remaining $20 million in PL 480 loans will be covered by legislation now in House-Senate conference that should treat these loans in a fashion similar to that of Section 572.

3. For Afghanistan's loans to be forgiven under Section 572 procedures, the following legislative and administrative hurdles would have to be surmounted:

   a. either (1) the prohibition on assistance to Afghanistan must be found inapplicable to debt forgiveness for Afghanistan under 572 or (2) the President must certify to Congress that the Government of Afghanistan (a) has apologized officially to the United States and assumed the responsibility for the death of Ambassador Dubs and (b) has agreed to provide adequate protection for all personnel of the U.S Government in Afghanistan. Fulfillment of these conditions almost certainly would depend on a change in the Government of Afghanistan.

   b. The Government of Afghanistan must lay the groundwork for putting its financial house in order to the extent that it and the World Bank Group are able to put in place (1) an IMF standby agreement or (2) IMF structural adjustment facility, or (3) a World Bank structural adjustment program for Afghanistan. These could be difficult to establish in the very early stages of an acceptable new government.

   c. The Administration must decide, conceivably over the objection of the Office of Management and Budget, to apply debt forgiveness provisions to a non-African country.

   d. The Congress must appropriate funds equivalent to the receipts lost through the cancellation of Afghanistan's official debt to the United States.

4. As reported in the previous chapter, Afghanistan is fully paid in its obligations to the United States. That situation could change, if the Soviet Union were to reduce or withdraw its support for the present Afghan government.

5. Legislative proposals before Congress for application to other areas of the world suggest some interesting ideas for debt forgiveness for Afghanistan. These include "debt-swaps" in which the Government undertakes significant environmental protection and development initiatives in return for debt cancellation.

6. Under circumstances in which other creditors (and, in particular, the Soviet Union) were prepared to follow the lead of the United States in debt cancellation, the leverage effect of a U.S. initiative could be significant. However, procedures under existing legislation might be somewhat slow, either because of difficulties in providing Presidential certifications required under the 1979

prohibition on assistance to Afghanistan or because an IMF standby agreement (the least daunting of the three ways of meeting the financial restructuring pre-condition of Section 572) might take some months to put in place.

7. A.I.D. might give serious consideration to preparing separate debt forgiveness legislation for Afghanistan because

- The legislative and administrative hurdles applicable to the Section 572-type process may be too formidable and too slow to be applied to a possible high-leverage breakthrough situation in which the U.S. government would wish to move swiftly on debt reduction.

- The Mission may wish to design debt forgiveness provisions that permit it to reinforce particular elements of its program for dealing with Afghanistan's unprecedented resettlement and reconstruction problems.

- Congress has shown a special interest in Afghanistan's special circumstances and may decide that it wishes to establish a statutory framework that could expedite the country's recovery once its government has attained an independent status.

Initial congressional reactions to Administration proposals for debt reduction for Egypt, however, suggest that any proposals to treat Afghanistan as a special case ought to be carefully prepared and justified before presentation.

Chapter 4

INTERNATIONAL EFFORTS TO RELIEVE THIRD WORLD INDEBTEDNESS

Introduction

This chapter describes the recent history of international endeavors to deal with the Third World debt crisis—endeavors with which the United States has become very much involved in recent years. The chapter also describes the roles of key international institutions, defines important technical terms, and requirements for policy reform to which bilateral and multilateral debt relief measures are often linked.

The idea that outright cancellation of the official loans of severely indebted low-income countries may be a wise course for creditors to follow in well-defined circumstances is little more than a decade old in the thinking of most creditor governments. The 1980s was a decade in which decisions and actions to provide official debt relief for such countries gathered momentum. Bilateral and multilateral debt relief activities became more closely linked. The continuation of such momentum could be a significant influence on future U.S. policy positions including decisions on the cancellation of Afghanistan's external debt.

Presented in the following sections are (1) a discussion of international collaboration on debt forgiveness prior to 1988, (2) an examination of recent developments, (3) a prognosis of implications for Afghanistan's future, and (4) conclusions.

International Collaboration in Debt Forgiveness Before 1988

Debt Forgiveness as a Form of Debt Relief

"Official debt forgiveness" is the cancellation by an external creditor of all or part of a debtor government's obligations to make payments of principal and/or interest under an existing loan for which that government is the debtor or a guarantor. Such cancellations usually are financed from official budgets of the forgiving creditor governments.

Debt forgiveness is perhaps the most dramatic and definitive of several types of "debt relief" that creditors may offer to debtor nations. Other forms include extension of grace periods, extension of periods for repayments, and reduction of interest rates. The effects of the various forms of debt relief can be evaluated quantitatively in terms of short-term cash flow effects (annual reductions in debt service payments) and in terms of present value (the value of all future payments discounted to the current year using a presumed market rate of interest).

Paris Club

The Paris Club, formed in 1956, handles renegotiations of official bilateral creditor debt: principally foreign aid loans made by governments and government-guaranteed private sector export-import loans. From 1976 through 1988, official creditors, working through the Paris Club, provided $90 billion in debt relief to 43 countries through 126 reschedulings. The vast preponderance of this relief consisted of lengthening grace periods and maturities, and measures other than outright cancellation of official debt.

The Paris Club is a loosely organized informal organization. All of its official creditors normally attend discussions with a particular debtor. The IMF and the World Bank do not permit restructuring of their loans but often are vital participants in Paris Club proceedings at which other creditors restructure their loans to developing countries. IMF/World Bank conditionality is often applied to such restructurings.

UNCTAD Conference (1978)

To date, the largest single effort aimed at substantial official debt forgiveness for developing nations was that sponsored by the United Nations Conference on Trade and Development (UNCTAD). A 1978 UNCTAD resolution called for creditors "to convert the official debt owed by poorer countries to grants."[8] Donor countries acting on the resolution included Canada, Denmark, Finland, France, the Federal Republic of Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, and the United Kingdom.

UNCTAD estimates the total amount of official debt cancelled as a result of the resolution at $3 billion, through the end of 1988. The major beneficiary was sub-Saharan Africa: over $2 billion of the debt forgiven represented claims on low-income African countries, about 3 percent of the total outstanding debt of these countries at the end of 1988.

Table 7 shows a creditor-by-creditor breakdown of amounts forgiven for the period 1980-1988. Almost all the cancelled debt consisted of official development assistance credits carrying below-market interest rates and long repayment periods. The actual cash flow relief for debtor countries is relatively small, although the psychological impact can be significant.

The United States did not participate in this UNCTAD effort because its policy at the time precluded debt cancellation. The foundations of a major shift in U.S. policy came with the "Toronto terms" at the economic summit of the G-7 countries in 1988 and the announcement of the Brady Plan in 1989. Those developments are described in a later section.

World Bank/IMF Structural Adjustment Lending and Conditionality

Despite the UNCTAD debt cancellations and other forms of debt relief affording to Third World nations during the early 1980s, these countries' financial problems continued to mount. By the middle of the decade, it became clear that the IMF and World Bank would have to develop new lending programs and work together closely to avoid severe disruptions in many developing countries. In the latter half of the 1980s, the collaborative approaches of the two institutions in turn were coordinated with bilateral creditor/donor initiatives. The world's economic systems had become so closely bound that it became evident that collaborative solutions among countries and multilateral institutions were likely to yield the best results.

World Bank Structural Adjustment Lending

In 1980 the World Bank introduced structural adjustment lending to developing countries in response to severe balance-of-payments crises in many of these countries. Oil-importing nations began to suffer in the late 1970s as their terms of trade deteriorated and their real interest costs rose. By 1981 the oil-exporting countries also began to curtail their foreign

8. See UNCTAD Bulletin 246, August-September 1988, p. 6 (Geneva).

Table 7. Debt Forgiveness by Creditor Governments, 1980-88
(in US$ millions)

Country	Sub-Saharan Africa	Other developing countries	Total
Canada	566	0	566
Denmark	206	53	259
Finland[a]	-	-	-
Germany, Fed. Rep. of	342	0	342
Italy	12	0	12
Japan	34	314	347
Netherlands	81	76	157
Norway	111	0	111
Sweden[a]	9	0	9
United Kingdom	265	225	489
Total	1,625	668	2,293

[a]Although these countries did not report or reported little or no debt forgiveness in 1980-88, they converted a substantial dollar volume of official development assistance loans to grants in 1978-79.

Source: World Bank, *World Debt Tables, 1989-90. Vol. 1: Analysis and Summary Tables.*

investment and lending activities as oil prices fell. These severe balance-of-payments difficulties laid bare deep structural weaknesses engendered by years of poor policies and inadequate institutional performance.

The World Bank's structural adjustment loans (SALs) were designed to address these deep weaknesses by requiring fundamental economic reforms such as changes in trade and pricing policies, alteration of the size and configuration of government spending, privatization, and curtailing government controls on productive activities. Sector adjustment loans (SECALs) were designed to support more narrowly focused programs of macroeconomic reform and/or developing a framework for sectoral investment. Both types of loans usually were designed to disburse proceeds rapidly, often for general imports. Although there was no formal link between these loans and IMF standbys and Extended Fund Facilities, stabilization measures were usually supported or monitored by the IMF.

IMF Structural Adjustment Facilities

IMF programs also began to adopt a special focus on debt-afflicted developing countries in the early 1980s, applying guidelines which in fact had been reformulated in 1979. These guidelines encouraged early adoption of corrective measures for balance-of-payments difficulties and recognized the need for periods of adjustment longer than the 1 to 2 years that had previously been customary for standby arrangements. By the mid-1980s, it became apparent that the low-income countries required firmer and more supportive treatment from the IMF.

In early 1986, the IMF established its Structural Adjustment Facility (SAF) to provide financial assistance to low-income countries in support of balance-of-payments adjustment efforts. In contrast to other IMF facilities that have market rates of interest, SAF loans bore interest rates of only one-half of one percent annually. Payback periods also were extended beyond the customary length.

The resources available for the IMF's SAF were rapidly committed. Accordingly, an Extended Structural Adjustment Facility (ESAF) was established in late 1987 to provide substantially greater resources. It is expected that the level of SAF/ESAF lending in 1988-1990 will reach about $11.4 billion.

Collaboration in Structural Adjustment

Several innovations were introduced at the time the SAF was established in 1986. The recipient nation was required to develop a comprehensive policy framework paper (PFP) that explicitly incorporated the policy requirements of a reform program. A PFP also was required in the case of World Bank structural adjustment lending. A formal process of coordination was established in which the IMF and the World Bank worked together in assisting the country with PFP preparation. The two institutions subsequently engaged in joint negotiations with the borrower.

While assisting with the PFP, the IMF normally concentrates on matters of monetary and exchange rate policy while the World Bank concentrates on domestic resource mobilization, improvement of public sector performance, and reform of trade policies and practices. However, on occasion, the bank has been involved with the institutional dimensions of exchange rate policy and has worked closely with the IMF to reform interest rate policies. Initially the PFP process itself was more closely identified with the Fund than with the Bank and perhaps still remains so, but the roles of the two institutions have been more closely coordinated and brought into better balance.

A key objective of the PFP process is to channel the flow of additional financial resources from commercial, bilateral, and multilateral sources to eligible countries within a consistent policy framework. The process is designed to direct the additional resources to the most essential and highly productive sectors and projects. In so doing, it seeks to avoid overburdening the limited administrative capacities of recipient countries. The World Bank has primary responsibility for these mobilization and coordination functions.

World Bank's Special Program of Assistance for Africa

The World Bank usually employs consultative groups as a principal means of mobilizing and coordinating aid and official lending flows to individual countries. The Special Program of Assistance (SPA) for sub-Saharan Africa performs these functions for the low-income, debt-distressed countries in that region. The objective of the 3-year program (1988-90) is to help the economies of low-income debtor countries accelerate growth while restoring and sustaining normal relations between creditors and debtors.

SPA emphasizes policy reforms and associated balance-of-payments support. IDA-adjustment lending is a precondition. Twenty-three low income countries in Africa are now eligible for SPA funding.

The World Bank reported commitments of about $5.4 billion in co-financing and coordinated financing mobilized for sub-Saharan countries through SPA as of May 1989. By contrast, low-income countries in Asia, where there are few such special programs, have received very limited increases in assistance—certainly smaller than the growth of their needs.[9]

Recent Developments

Toronto Terms

In June 1988, seven leading industrialized countries[10] reached a precedent-shattering agreement in Toronto on concessional relief for severely indebted low-income countries (SILICs) in sub-Saharan Africa. They agreed that rescheduled concessional debt is to be repaid over 25 years with 14 years of grace. Moratorium interest rates were to be at least as low as the rates on the original loans.

For nonconcessional debt, participating creditors choose from a "menu" of three options.

> Option A. Cancel one-third of the eligible maturities and reschedule the remainder over 14 years with 8 years of grace. Moratorium interest rates (those applied to the rescheduled amounts, after partial cancellation) are based on market rates of interest.

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9. World Bank Country Economics Department, Adjustment Lending Policies for Sustainable Growth (1990), p. 65.

10. The Group of Seven (also called G-7) countries are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

Option B. Reschedule over 25 years with 14 years of grace and base moratorium interest rates on market rates.

Option C. Reschedule over 14 years with 8 years of grace and base interest payments on market rates reduced by 3.5 percentage points or by half, whichever is less.

As of the end of July 1990, 18 countries had been granted Toronto terms reschedulings. Six countries had debts rescheduled twice on Toronto terms. All are low-income countries whose only access to the World Bank is through the International Development Association.

The Toronto terms apply only to countries that are following IMF or World Bank-supported adjustment policies, and that have persistent debt servicing problems and balance-of-payments difficulties. Failure to meet policy reform requirements rules out some severely indebted countries.

All major donor countries in the Organization for Economic Cooperation and Development (OECD) have implemented or announced plans to cancel or convert bilateral loans owed by low-income countries, mainly in Africa, into grants or to finance debt service coming due with grants. The amount of debt to be forgiven or converted during 1988-90 is projected to be about $5.5 billion, one-quarter of the end-1987 bilateral concessional debt of the severely indebted low-income countries. Virtually all the debt forgiven is concessional, arising from earlier Official Development Assistance (ODA) activities. Hence the future cash flow relief afforded is considerably less dramatic than would appear from the amounts of debt forgiven. The psychological effect is strongly positive, and debt relief may help some countries avoid debt reschedulings in the future. As a result of this ODA debt forgiveness, cash debt service is projected to be about $100 million lower in 1990, about 0.7 percent of exports. Under Toronto terms, all rescheduled concessional debt is to be repaid over 25 years with 14 years of grace. Moratorium interest rates are at least as low as the rates on the original loans.

Cash flow savings continue after the consolidation period, but these savings depend on the magnitude and interest in the rescheduled debt under Toronto terms. The net present value of scheduled debt service payments is a useful method of comparing alternative forms of rescheduling. Through the end of July 1990, Toronto term reschedulings had reduced the present value of scheduled debt service by more than $800 million, or about 20 percent, compared with standard reschedulings.

Outright Cancellation of Concessional Debt

Much of the official debt relief for African countries since the Toronto summit has turned out to be more liberal in its terms than that contemplated by the Toronto summit. The Toronto terms envisioned cancellation only for nonconcessional debt (Option A), and that would apply only to one-third of the scheduled maturities. However, much of the official lending to African governments has been on a concessional basis, for which the Toronto terms did not provide cancellation[11]. However, rather than renewing these loans on a highly concessional basis, some governments simply cancelled them in their entirety.

- Belgium. In July 1989, the government announced it would cancel about $180 million worth of bilateral official debt owed by 13 African countries. The largest portion of the cancelled debt was owed by Zaire ($126 million). In addition to bilateral debt, the Belgian Government stated that it would cancel $152 million of Zaire's commercial debt guaranteed by the Belgian government and its export credit guarantee agency.

- France. The government announced in May 1989 that it would cancel concessional debt owed by 35 of the poorest African countries. The total amount of debt forgiveness is estimated at $2.4 billion.

- Germany. The government agreed to cancel official development assistance debt obligations of six low-income sub-Saharan African countries not covered by the 1978 UNCTAD resolution. The debt affected totaled DM 2.6 million (about US$1.4 billion). The cancellation was contingent on implementation by the recipient country of an adjustment program in cooperation with the IMF or the World Bank.

- United States. In 1989 the United States announced its intentions to forgive roughly $1 billion of loans to sub-Saharan African countries. As of the summer of 1990, debt relief agreements had been signed with 14 eligible countries, covering $852 million. Eight sub-Saharan countries were found to be ineligible under U.S. legislation. Botswana, Swaziland, and Zimbabwe were doing

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11. Under Toronto terms, all rescheduled concessional debt is to be repaid over 25 years with 14 years of grace. Moratorium interest rates are to be at least as low as the rates on the original loans. This long-term rescheduling at concessional rates reduces the net present value of scheduled concessional debt service payments. For example, $100 of current debt service payments of concessional debt rescheduled at 2 percent interest and with these maturity terms would have a grant element of almost $65. Thus, although there was to be no straight cancellation of concessional debt under the Toronto terms, the financial effects of its rescheduling provisions are similar to those of a partial cancellation.

sufficiently well economically that they have not received IMF or World Bank adjustment assistance. Liberia, Ethiopia, Somalia, and Sudan were not following reform programs required as a condition to cancellation. The U.S. decision on cancellation of Zambia's debt awaited the submission, by that country's government, of a PFP acceptable to the IMF and the World Bank.

Recent Measures Not Limited to African Countries

The World Bank and IDA have established, or are considering establishing, facilities which may provide assistance to debt-afflicted developing countries outside as well as inside Africa.

A $100 million IDA Debt Reduction Facility was established in 1989 to provide relief to severely indebted low-income countries. This facility can provide grants of up to $10 million to countries with appropriate adjustment programs and debt strategies to buy back or exchange commercial bank debt at a market-related discount. To date, 15 severely indebted low-income countries have requested access to this facility. The total amount of debt under discussion is about $2 billion. Negotiations are most advanced for Bolivia and Mozambique. If all such countries eventually make use of the facility, its resources may need to be replenished. One factor that has contributed to delays in drawing on the resources of the facility is the reluctance of some banks to participate, in part out of concern to avoid setting precedents for other countries where exposure is larger.

A supplemental IDA adjustment credit program, which is not limited to sub-Saharan African countries, was launched in 1989, following the September 1988 approval by the Governors of the World Bank of an allocation of 10 percent of IDA reflows and investment income to eligible countries in proportion to their IBRD interest payments. Under this program, credits totaling about $80 million were provided to nine severely indebted low-income countries in FY 1990, equivalent to about 60 percent of the annual World Bank lending to these countries.

The latest addition to the debt relief tools is the initiative, as agreed in principle at the IMF-World Bank annual meetings in Washington, D.C., in September 1990, for the IMF and World Bank to increase their concessional lending to LDCs affected by the Persian Gulf crisis.

Implications for Afghanistan

It has been seen that multilateral institutions and creditor countries have shown considerable flexibility in dealing with the Third World debt crisis. The pace of change has been rapid, particularly in the latter half of the 1980s. It has also been seen that the debt relief afforded has been almost totally limited to sub-Saharan Africa and has strongly emphasized IMF/World Bank conditionality.

If the pace of change that has marked developments in the last few years continues, it is conceivable that multilateral institutions and the principal creditor nations will have effectively widened their geographic focus to other continents by the time debt relief for Afghanistan is ready to be considered. There are indeed signs that such a broadening of focus might occur as a result of developments in Latin America, in Eastern Europe, and in the Persian Gulf. But the widening use of debt cancellation practices cannot be predicted with confidence.

It seems clear that Afghanistan's external financial relationships would quickly deteriorate without substantial outside support, but the country's circumstances are by no means identical to those of African SILICs for which the Toronto summit accomplished so much. Afghanistan is up to date on its debt service to the United States. It has no current standby agreement or adjustment lending program in place. It cannot be said to have had an independent economic policy for more than a decade. Even with a new and representative government in place, it is not likely to have many economic options for some time to come. Although Afghanistan's policy regime before the Soviet invasion was hardly ideal in terms of current IMF/World Bank policy prescriptions, the bulk of Afghanistan's current debt derives from the period of Soviet domination rather from the pursuit of traditional policies.

The CMEA countries, which certainly do not belong to the Paris Club, hold the preponderant portion of Afghanistan's external debt. Thus far, neither the Soviet Union nor its former Eastern bloc partners have been brought into debt relief efforts in their roles as creditor nations. Czechoslovakia, a former Eastern bloc country whose economic viability now is of great interest to the West, now holds a greater share of Afghanistan's debt than does the United States.

Conceivably, Afghanistan could become a test case that would bring the Soviet Union and some of its former Eastern bloc associates into a multilateral/bilateral debt forgiveness process. In any case, the circumstances of debt relief for Afghanistan are likely to prove rather unusual, if not unique. They well could require initiative and inventiveness on a scale out of proportion with the relative size of the Afghanistan's debt, but of utmost urgency because of the magnitude of war damage and the economic burdens associated with resettlement.

Conclusions

The principal conclusions of our review of international efforts to relieve Third World indebtedness, as they pertain to the needs of an independent Afghanistan, are as follows:

1. The idea of cancelling official debt gained momentum during the 1980s and achieved a critical breakthrough at the G-7 Toronto economic summit in 1988.

2. A significant amount of debt relief has occurred in the past 2 years. Outright forgiveness of concessional debt, rather than technical application of the Toronto terms, has accounted for much of this activity.

3. The principal efforts at Third World debt relief have taken the form of collaborative action among bilateral creditors and multilateral institutions. UNCTAD led a most successful debt cancellation effort in the early 1980s. The World Bank and the IMF took on important leadership and catalytic functions through their structural adjustment facilities, programs, and related coordination activities. The G-7 countries and the Paris Club have played important roles in debt relief activities.

4. Recent bilateral debt relief efforts have incorporated IMF/World Bank conditionality and have relied on the outcomes of the IMF/World Bank policy framework paper (PFP) process. Severely indebted low-income countries that have not met IMF/World Bank policy reform requirements have been excluded from debt relief.

5. Debt relief efforts for SILICs thus far have been concentrated on the sub-Saharan countries of Africa. The needs of SILICs in Asia have not yet received equivalent attention.

6. If the pace of change that has marked developments in the last few years continues, it is likely that multilateral institutions and the principal creditor nations will have effectively widened their geographic focus to other continents by the time debt relief for Afghanistan is ready to be considered. Even if that should not prove to be the case, the special circumstances of Afghanistan warrant highly innovative treatment.

Chapter 5

DEBT RELIEF FOR AFGHANISTAN

Introduction

This chapter outlines rationales and implementation options for cancelling Afghanistan's debt to the United States. Several approaches to debt cancellation are presented, from which the U.S. Government may make a choice, as circumstances prove appropriate.

Discussed in this chapter are (1) the status of and prospects for the Afghan economy, (2) statutory and administrative options for implementing debt relief, and (3) the case for debt cancellation for Afghanistan.

Status of and Prospects for Afghanistan's Economy

Afghanistan has been a client state of the Soviet Union since the communist coup against the Daoud Government in April 1978. The extent of overt Soviet control has varied somewhat during the past 13 years, reaching its highest levels overall during the 1979-1989 Soviet invasion. Nevertheless, Moscow's strong political, military, and economic influence over the Kabul government has extended from the early days of the first Communist coup to the present.

Bilateral assistance from the Organization for Economic Cooperation and Development (OECD) was sharply curtailed after the 1979 invasion, as was assistance from multilateral institutions such as the World Bank and the Asian Development Bank. The Kabul government has received very little aid since the Soviet occupation from sources outside the Eastern bloc.

Even before the Soviet invasion, Afghanistan was one of the poorest countries in the world. Since then, war and government policies have caused great harm to people, social systems, infrastructure, and productive facilities. Despite the lack of reliable statistics and detailed information about damage and economic conditions in Afghanistan, there is little doubt that the country is in serious economic trouble.

Some 4.5 million Afghans are now refugees outside the country. Within the country, a little less than 1 million persons moved from the countryside to Afghan cities. Between 5 and 10 percent of the population has been killed.[12] Few of the internal refugees within Afghanistan are likely to have found productive jobs in the cities where they have sought some degree of shelter from the war. The longer the country continues to suffer from the absence of peace, the more difficult will be the reabsorption of both internal and external refugees in fruitful pursuits. A sizeable continuous rural-urban migration could pose very large obstacles to restoring a viable economy.

The changes that Afghanistan's Communist rulers imposed on the agricultural, industrial, and governmental sectors when they took power had negative effects on the country's productive economy. These have been intensified by the prolongation of hostilities. The Kabul government's own calculations show that real gross domestic product declined by 3 per cent per capita per year over the 8-year period from 1978-79 to 1986-87. Further reductions took place in 1987-1988 and 1988-1989.[13]

In 1988, the Office of the U.N. Coordinator for Afghanistan Assistance Programs reported Afghanistan's GDP at $130 per capita.[14] That figure places Afghanistan among the very poorest of countries in the world—in a state of poverty well below that of many sub-Saharan African countries.[15] The U.S.

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12. There is a considerable variety of opinions about the numbers of refugees, war deaths, and other demographic impacts of events in Afghanistan. The most systematic and thoughtful study of these questions is contained in Thomas H. Eighmy, Afghanistan's Population, Inside and Out (O/AID/Rep, May 1990). We have, for the most part, used Dr. Eighmy's estimates in this report. Whether these estimates, or other, larger numbers are used, the implications are profound.

13. Country Presentation by the Government of the Republic of Afghanistan to the United Nations Conference on the Least Developed Countries (1990), p. 2.

14. First Consolidated Report, Office of the United Nations Coordinator for Humanitarian and Economic Assistance Programs Relating to Afghanistan (Geneva, September, 1988), p. 23.

15. Other estimates place Afghanistan per capita GDP at figures as low as $125 and as high as $160 per capita. The latter figure would still rank Afghanistan among the poorest countries in the world. See World Development Report (Oxford University Press: June, 1990), p. 180, and Abdul Aziz Ferogh, The Current Political and Economic Situation in Afghanistan (Nathan/Berger Joint Venture: September 1990), pp. 8-11. Since per capita figures are profoundly affected by population estimates as well as estimates of national product, considerable caution in their use is advisable. See

Government recently made debt cancellation arrangements for countries with far higher per capita GDP figures: Cameroon ($1,152 per capita), Côte d'Ivoire ($683 per capita), Ghana ($374 per capita), Benin ($389 per capita), Kenya ($329 per capita), Nigeria ($290 per capita), Niger ($266 per capita), and Uganda ($244 per capita).

All sectors of Afghanistan's national economy have contracted with the exception of government services, which accounted for a substantially expanded share of GDP. Inflation has grown from 18 percent to 29 percent to 92 percent per annum in the past 3 years. Prices continue to escalate, driven mainly by domestic demand resulting from budget deficits, supply constraints, and increasing costs of transportation.

Since Moscow withdrew its troops from Afghanistan, the Soviet Union has accounted for reduced (though still dominant) shares of Afghanistan's shrinking export and import trade. In 1988-89 the Soviet Union accounted for 62 percent of Afghanistan's exports and 54 percent of Afghanistan's imports, according to the Kabul government's statistics. Preliminary figures for 1989-90 indicate that the Soviet Union's share of exports declined to 45.6 percent and its imports to 48 percent following withdrawal of its troops.

Total estimated international reserves were a little less than $400 million in 1989-90. Afghanistan has a paid-in IMF quota of SDR 86.7 million, which is currently equivalent to US$125 million. It has no current standby agreement. Normally the IMF is prepared to extend standby credit for 25 percent of quota with virtually no conditionality and 50 percent of quota with only modest conditions. In Afghanistan's case, 50 percent of quota ($62.5 million) is equivalent to about the value of one month's official imports as estimated for 1989-90.

Afghanistan's external debt more than doubled between 1977 and 1986 and has risen quite rapidly in recent years. Repeated reschedulings by the Soviet Union have softened the impact of debt service. Much of the debt service has been funded from Soviet assistance. According to official figures, debt service payments rose from 10.9 percent of imports in 1985-86 to 73.4 percent in 1989-90[16]. However, because of the low interest rates on Soviet loans, the interest portion of debt service has remained relatively low. In 1989-90, the interest portion of debt service was reported as less than 2 percent of exports, well below the 20 percent figure included among the criteria for case-by-case basis consideration under the Eastern European Recovery Act pending before Congress.

Thomas H. Eighmy, Afghanistan's Population, Inside and Out (O/AID/Rep, May 1990).

16. See Table 4 in Chapter 2.

In the past 12 years, the Afghan economy has become critically dependent on foreign aid—Soviet aid. Nonproject assistance is reported to have grown from $65 million in 1978-79 to $250 million in 1987-88. Since then it has averaged about $245 million a year. Project assistance increased from $170 million in 1978-79 to $214 million in 1988-89 and then declined sharply to $150 million in 1989-90. Some of this project assistance had been designed to support Afghanistan's economic integration into the Soviet economy.

The portion of the economy of Afghanistan presided over by the Kabul government is being kept afloat by Soviet nonproject aid and concessional loans. Western and multilateral economic aid supports much of the large refugee population in Pakistan and provides some humanitarian aid for populations in areas within Afghanistan controlled by resistance organizations. Faced with an uncertain future, the Soviet leaders appear to have cut back sharply on project assistance, but have retrenched only modestly on the nonproject assistance upon which its client is critically dependent. Although the Kabul government has adopted some austerity measures, reports indicate increasing inflation and declining living standards.

Assuming substantial return of Afghanistan's more than 4.5 million external refugees, the country's internal population could rise to about 17 million people. Afghanistan's population was just over 13 million before the Soviet invasion.[17] In 1979 Afghanistan was marginally self-sufficient in food, suffering serious deprivation in years of water shortages. War has left the country replete with millions of unexploded mines, disrupted lives, and old scores to be settled. Given the damage and deterioration of the country's roads, bridges, irrigation systems, farm animals, ruminant herds, housing; the disruption of social institutions and relationships; and the loss of working skills during the years many Afghans spent in refugee status, the prospects for Afghanistan's future are daunting.

The tasks faced by Afghanistan in the 1990s and beyond are to

- Reverse the trend of economic, political and social deterioration;
- Make the country's physical environment habitable;
- Help the refugees to return and reestablish productive lives; and
- Rebuild an economy that can sustain a population that may be 30 percent larger than before the war.

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17. Thomas H. Eighmy, Afghanistan's Population, Inside and Out (O/AID/Rep, May 1990), Annex 1, p. 11.

The levels of resources required to accomplish these tasks will dwarf the economic assistance costs incurred on all sides during the last decade. For the foreseeable future, Afghanistan's impoverished people cannot possibly repay the country's existing international debt obligations. The principal alternatives are to load the country with levels of indebtedness it cannot bear, to persuade donors to provide the funds for debt repayment, or for creditors simply to cancel their debts.

Legislative/Administrative Implementation Options

Individual Options

This section provides a brief analysis of five possible implementation options to achieve debt forgiveness for Afghanistan. A more detailed discussion of U.S. legislation is contained in Chapter 3. The Toronto terms are detailed in Chapter 4. Implicit in all of these options is the assumption that a solution, acceptable to the U.S. Government, has been reached among the parties to the conflict in Afghanistan, and that a government is in place in Kabul that the United States wishes to help. The five options examined are as follows:

1. Forgiveness of A.I.D. loans under existing legislation,
2. Forgiveness of P.L. 480 loans under pending legislation,
3. Forgiveness of debt on the basis of legislative standards,
4. Special debt forgiveness legislation for Afghanistan, and
5. Debt relief according to the "Toronto terms."

This list is not intended to be exhaustive. There are doubtless other options as well as many variations of these options. An appropriate strategy to obtain debt forgiveness, under a given set of circumstances, may involve the simultaneous pursuit of more than one option.

Forgive A.I.D. Loans Under Existing Legislation

Use existing provisions of the Foreign Assistance Act (Section 572 of the 1989 Appropriations Act) to cancel A.I.D. loans.

Principal requirements for implementing this option are as follows:

Least Developed Country Qualification. Afghanistan clearly meets the requirements of the law that it qualify as a least developed country as designated by the U.N. General Assembly. It is likely that Afghanistan will remain in this classification for the foreseeable future.

Administration Policy Toward Non-African Countries. Although Afghanistan meets the "least developed country" criterion under Section 572, the Administration's reluctance to extend the use of this section of the statute beyond sub-Saharan Africa would have to be overcome. Recent unsuccessful attempts to grant Bangladesh debt forgiveness—despite its meeting all of the criteria set out in Section 572—is evidence of this reluctance. The Administration, especially the Office of Management and Budget, appears to be concerned that a non-sub-Saharan precedent would increase pressure for granting debt relief to much larger borrowers such as India and Israel. However, countries such as India and Israel do not qualify for forgiveness under Section 572, because they are not included on the United Nations Development Program's list of least developed countries.

The problem of precedent has not proved to be a rigid barrier in the Administration's application of the Toronto terms. The Administration has agreed to reschedule Bolivia's debt and has proposed to provide debt relief to Latin America and the Caribbean, as well as Egypt. Extending forgiveness beyond sub-Saharan Africa should become less and less a precedent-creating issue in the future.

IMF/World Bank Program Participation. Under Section 572, Afghanistan would be required to have in place an IMF Standby Agreement, an IMF Structural Adjustment Facility, or a World Bank Structural Adjustment Program. Although Afghanistan is still a member of both institutions, its contact with each has, over the past decade, been extremely limited. The last World Bank mission to the country was in 1978. Until a few months ago, there had not been an IMF supervision mission (e.g., data collection) for several years. How and especially when a formal program could be put in place by either institution is difficult to assess. On the surface, it appears that an IMF standby agreement could be put in place quickly. However, such an arrangement would bear higher interest and might ultimately impose more stringent conditionality than the other IMF/World Bank options. Putting a structural adjustment program in place could be quite time consuming, particularly during the initial stage of economic restoration.

Restrictions or Assistance to Afghanistan. As discussed in Chapter 3, either the President will have to make the findings required under existing legislation with respect to apology for the death of Ambassador Dubs and adequate protection for U.S. Government personnel in Afghanistan or an interpretation will be required to the effect that this section does not apply to debt forgiveness.

Forgive PL 480 Debt Following Passage of Pending Legislation

Use provisions contained in House and Senate Bills now in Conference to cancel U.S. PL 480 loans to Afghanistan.

The Food Bills (currently being considered in conference by the House and the Senate) contain provisions for the most part similar to those in Section 572 permitting the cancellation of the principal and interest of PL 480 loans. Considerations applicable to application of Section 572 probably will apply to forgiving PL 480 loans, although it is conceivable that geographic and conditionality limitations will be less narrowly applied.

Forgive Official U.S. Loans Utilizing Legislative Standards of Debt Severity

Use provisions of the International Development and Eastern European Recovery Act to forgive A.I.D. and PL 480 loans.

Section 602 of the International Development and Eastern European Recovery Act of 1990 would apply a series of legislatively designated standards to define "severely indebted countries." As has been seen earlier, Afghanistan currently does not meet one of these standards (interest payments of at least 20 percent of exports), essentially because of the Soviet Union's recent policy of rescheduling its loans on highly concessional terms.

Section 602 does not specify which "official debt" it would include, though it would no doubt cover all A.I.D. loans. Afghanistan's location could be a factor in the administration of Section 602, if the statute is passed. The legislation was originally conceived to assist the countries of Eastern Europe and later was expanded to include other countries. It could be argued that needs of a new government in Afghanistan derive from adverse circumstances similar to those that affected the Warsaw Pact countries in the past.

Special Debt Forgiveness Legislation for Afghanistan

Create legislation specifically tailored to the needs and circumstances of Afghanistan that forgives all U.S. official loans to the Government of Afghanistan.

Special legislation could be designed to deal with the cancellation of Afghanistan's debts and perhaps other matters pertaining to the country's recovery. Such legislation would

- Establish that Afghanistan is the intended beneficiary of the debt cancellation process that it incorporates;
- Remove existing ambiguities about the application of restrictions on assistance to Afghanistan to debt cancellation; and
- Establish conditions for debt relief that are appropriate to Afghanistan's special circumstances.

Such special legislation would call for readily available evidence that the country's needs are so severe that it warrants special legislation. The recent approval by Congress of Administration recommendations concerning the cancellation of the military debt of Egypt (not a sub-Saharan country) to the United States demonstrates the feasibility of individual country treatment when there is a strong case for such treatment. The President indicated that he would like Egypt's forgiveness to be viewed as a special case, not affecting the obligations of other foreign U.S. Government borrowers. Afghanistan's debt could be treated in a similar fashion.

Reschedule A.I.D. and PL 480 Loans According to the Toronto Terms

Apply Toronto terms with respect to concessional debt: repayment over 25 years with 14 years of grace.

As discussed in Chapter 4, the Toronto terms for official bilateral debt rescheduling reflect an agreement reached by a number of Paris Club creditors following the G-7 economic summit meeting in 1988. They do not provide for cancellation of concessional debt, but they do permit debt relief through rescheduling. Rescheduling of debt is less likely to run afoul of statutory restrictions on assistance to Afghanistan than is outright cancellation. Many African countries have received relief from nonconcessional and concessional debt under the Toronto terms. However, the recent addition of Bolivia to the list of U.S. recipients of relief under these terms extends the geographic boundaries of prior practice, which previously were limited to sub-Saharan Africa.

Use of the Toronto terms requires IMF or World Bank arrangements programs in place. Typically the Administration also requires the country to have a debt-service ratio to exports of 30 percent or more. According to Kabul government statistics, Afghanistan already meets that standard.

Assessment of Options

Of the five options identified, only the first four represent unambiguous debt cancellation. The fifth option could substantially reduce immediate cash flow requirements as well as the present value of Afghanistan's debt to the United States, but the rescheduling approach amounts to something other, and considerably less, than debt forgiveness. There are, of course, still other ways of relieving Afghanistan's debt burdens. As the Soviet Union did in the past, the United States could provide Afghanistan with sufficient nonproject assistance and additional debt funding to permit the country to service some or all of its U.S. debt. But unless the Eastern bloc debt itself is cancelled, there might be a question concerning whether U.S. resources in fact are being used as a source of funds to repay Soviet or other non-U.S. debt obligations. In fact, since money is fungible, any debt relief device short of outright, across-the-board cancellation is likely to raise such issues. That is why most varieties of debt relief take the form of agreements among creditors. That is also a strong argument for cancellation of official debt by all of Afghanistan's creditors.

Of the first four options discussed above, Option 4 (special country legislation) currently appears to be the best suited to Afghanistan's circumstances. Such legislation could clear up ambiguities in existing laws and tailor a package that meets the country's current needs. Of the debt-cancellation legislation considered in this chapter, the least suitable for Afghanistan's circumstances is Option 3 (general legislative definition of standards of debt severity). Because of Afghanistan's special relationship to the Soviet Union since 1978, the country's external debt profile fails to meet one of the criteria, namely, interest payments of at least 20 percent of exports, included in statutory definition of severe indebtedness used in the International Development and Eastern European Recovery Act pending before Congress. There is a possibility that, at the time action is required, Afghanistan would not meet a sufficient number of criteria to qualify under the law. Given a policy determination to provide U.S. assistance to the Government of Afghanistan, it would be short-sighted and unwise to insist that the country await an external cash-flow crisis in order to qualify for appropriate relief.

Option 1 (cancellation of A.I.D. loans under Section 572) and Option 2 (cancellation of P.L. 480 loans under pending legislation containing provisions similar to Section 572) are probably sufficient but are second-best solutions that can be used if the Administration is prepared to use such legislation outside of sub-Saharan Africa. Such legislation is most likely to be suitable under circumstances in which the United States undertakes debt cancellation on its own or in collaboration with other OECD nations.

Case for Debt Cancellation

As has been seen earlier in this report, the United States holds a relatively small share of Afghanistan's external debt and that the most successful bilateral debt cancellation efforts have resulted from collaboration among creditor nations and multilateral institutions. As discussed in this chapter, cancellation of Afghanistan's debt to the United States might be pursued by the United States alone, by the United States in collaboration with other non-Soviet creditors, or by the United States in collaboration all willing creditors, including the Soviet Union.

Given this background, the case for the United States to cancel the official debt of a Government of Afghanistan acceptable to the U.S. Government may be summarized as follows:

1. The economy of Afghanistan is not likely to be self-sustaining for a decade or more. The consequences of hostilities, environmental deterioration, political and social disruption, population growth and dislocation, loss of productive skills, and other difficulties cannot be remedied quickly in a country that, before Soviet intervention, was one of the least developed and most impoverished in the world.

2. The people of Afghanistan are deserving of a generous form of debt relief both by virtue of their extreme poverty and the hardships they have endured in the cause of their freedom.

3. The United States already has cancelled the debts of developing countries far higher on the income scale than Afghanistan.

4. In recent years, the Government of Afghanistan could not have paid the debt service on its loans to the United States and other creditor countries in the absence of substantial Soviet nonproject assistance and highly concessional Soviet loans. Once a government is in place in Kabul that is acceptable to the United States neither the Soviet Union nor any other principal donor or is likely to provide that government with a source of funds that it can use to repay its U.S. debt.

5. Forcing an independent Afghan Government to default on its U.S. debt in order to qualify for new assistance would be counter-productive.

6. Cancellation of Afghanistan's official debt is simpler, more forthright, and more conducive to Afghan responsibility and self-discipline than are alternative means by which the United States could provide the Government of Afghanistan with the funds it needs to remain current on its U.S. debt service.

7. The United States could provide a valuable leadership function in persuading some or all of Afghanistan's creditor countries to join it in debt cancellation. Multilateral debt relief would provide a

> realistic and constructive beginning for donor collaboration in the long and difficult undertaking required to return Afghanistan to self-sufficiency.

In one sense, the justification for cancellation of Afghanistan's loans is the classic case for a bankruptcy procedure in a domestic context. Raised to the international plane, it argues that the debtor country, the creditor countries, and their respective economies are all better off for wiping the slate clean and making a new beginning. In another sense, the case for cancellation is essentially ethical: after suffering so much for so long for the restoration of their freedom and independence, the people of Afghanistan do not deserve to be saddled with an impossible burden.

APPENDIX

Afghanistan's External Debt

Appendix Table A-1. Status of A.I.D. Loans to the Government of Afghanistan as of March 31, 1990
(in US$)

Loan No. New Old	Name of Borrower/Code Title of Loan Interest-Grace % & Period/ Amortization % & Period		Auth. date Agrmnt. date Initial amort. date	Agreement amount	Amount utilized	Principal repayments	Other principal reductions exchange rate adjustment	Balance outstanding	Interest collection
	Afghanistan								
	Loans Repayable in Dollars								
306-B-001 ICA 2	Government of Afghanistan Commodity Assistance 2.500% 70 Mos./ 2.500% 28 Yr. 2 Mo.	G	01/07/53 01/08/53 01/15/59	1,433,933.19	1,433,933.19	1,433,933.19		0.00	747,001.64
306-B-002 ICAX 06-2	Government of Afghanistan Project Assistance 3.000% 43 Mos./ 3.000% 36 Yr. 0 Mo.	G	06/26/56 06/29/56 12/01/61	5,000,000.00	5,000,000.00	2,571,833.66		2,428,166.34	3,628,817.51
306-B-003 ICAX 06-3	Government of Afghanistan Project Assistance 3.000% 48 Mos./ 3.000% 36 Yr. 0 Mo.	G	06/27/57 06/26/57 04/01/62	5,750,000.00	5,750,000.00	2,955,609.28		2,794,390.72	4,141,612.07
306-H-004	Government of Afghanistan Ariana Airline .750% 120 Mos./ .750% 30 Yr. 0 Mo.	G	12/25/62 03/23/63 09/19/73	2,519,399.06	2,519,399.06	1,404,239.47		1,115,159.59	386,478.98
306-H-005	Government of Afghanistan Transport Equipment .750% 120 Mos./ .750% 30 Yr. 0 Mo.	G	10/04/63 12/03/63 06/08/75	1,930,532.06	1,930,532.06	917,715.83		1,012,816.23	296,030.63
306-H-006	Government of Afghanistan Herat Islam Qala Road .750% 120 Mos./ 2.000% 30 Yr. 0 Mo.	G	06/29/64 01/12/65 10/17/76	7,683,091.13	7,683,091.13	2,835,953.15		4,847,137.98	2,213,396.66
306-H-006A	Government of Afghanistan Herat Islam Road Amend. 1.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	G	10/05/67 10/28/67 12/29/77	711,000.00	711,000.00	209,200.81		501,799.19	239,625.49
306-H-007	Government of Afghanistan Transport. Maintenance & Equipment .750% 120 Mos./ 2.000% 30 Yr. 0 Mo.	G	09/14/64 11/07/64 06/23/75	276,224.66	276,224.66	110,620.39		165,604.27	83,889.83
306-H-009	Government of Afghanistan Kandahar Diesl Elec. Generators 1.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	G	02/21/66 11/05/66 04/16/80	799,972.31	799,972.31	199,043.14		600,929.17	248,268.82

(continued)

Appendix Table A-1 (continued)

Loan No. New / Old	Name of Borrower/Code Title of Loan Interest-Grace % & Period/ Amortization % & Period		Auth. date Agrmnt. date Initial amort. date	Agreement amount	Amount utilized	Principal repayments	Other principal reductions exchange rate adjustment	Balance outstanding	Interest collection
	Afghanistan Loans Repayable in Dollars								
306-H-010	Government of Afghanistan Agricultural Commodities 1.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	G	01/17/66 06/22/66 06/12/76	1,243,604.41	1,243,604.41	311,990.00		831,614.41	419,984.11
306-H-012	Government of Afghanistan HAVA/HACU Equipment Loan 1.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	G	06/21/67 05/13/66 01/05/81	3,866,610.06	3,866,610.06	702,317.05		3,184,293.01	962,161.44
306-H-013 306H013	Government of Afghanistan Kajakai Hydroelectric Power Plant 1.000% 120 Mos. 2.500% 30 Yr. 0 Mo.	G	06/21/67 05/13/68 02/26/80	11,732,537.32	11.732,537.32	2,879,624.71		8,852,912.61	3,407,374.91
306-H-013A 306H013	Government of Afghanistan Kajakai Hydroelectric Power Plant 2.00% 120 Mos./ 3.000% 30 Yr. 0 Mo.	G	06/27/72 11/11/72 03/01/84	2,994,134.76	2,994,134.76	431,835.61		2,562,299.15	976,986.22
306-H-014	Government of Afghanistan Land Inventory 1.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	G	06/29/67 06/17/68 09/30/81	364,238.54	364,238.54	70,576.41		293,662.13	92,414.57
306-H-016	Government of Afghanistan Diamonium Phosphate 2.000% 120 Mos./ 3.000% 30 Yr. 0 Mo.	G	02/25/69 04/21/69 01/29/80	1,190,970.25	1,190,970.25	280,855.06		910,115.19	548,125.95
306-H-017	Government of Afghanistan Fertilizer Distribution 2.000% 120 Mos./ 3.000% 30 Yr. 0 Mo.	G	10/13/72 11/01/72 04/06/83	19,441,597.09	19,441,597.09	2,808,342.15		16,633,254.94	6,844,418.09
306-T-019	Government of Afghanistan Agricultural Inputs Loan 2.000% 120 Mos./ 3.000% 30 Yr. 0 Mo.	G	06/26/75 08/13/75 12/22/85	7,957,491.66	7,957,491.66	771,031.35		7,186,460.31	2,419,603.61
306-W-018	Government of Afghanistan Kajakai Hydroelectric Power Plant 2.000% 120 Mos./ 3.000% 30 Yr. 0 Mo.	G	08/10/74 06/29/74 01/13/85	7,500,000.00	7,500,000.00	775,539.71		6,724,460.29	2,164,384.82

(continued)

Appendix Table A-1 (continued)

Loan No. New Old	Name of Borrower/Code Title of Loan Interest-Grace % & Period/ Amortization % & Period	Auth. date Agrmnt. date Initial amort. date	Agreement amount	Amount utilized	Principal repayments	Other principal reductions exchange rate adjustment	Balance outstanding	Interest collection
	Afghanistan							
	Loans Repayable in Dollars							
306-W-018A	Government of Afghanistan G Kajakai Hydroelectric Power Plant 2.000% 120 Mos./ 3.000% 30 Yr. 0 Mo.	12/27/74 01/28/75 08/26/85	1,928,160.58	1,928,160.58	147,597.04		1,780,563.54	652,322.46
	TOTAL		84,343,497.08	84,343,497.08	21,812,856.00		62,530,641.08	30,374,898.01
	Loans Repayable in Local Currency w/o NOV Afghan Afghanis		L/C Units	L/C Units	L/C Units	L/C Units	L/C Units	L/C Units
306-D-011	Government of Afghanistan G Economic Development 4.500% 24 Mos./ 4.500% 10 Yr. 0 Mo.	05/10/67 05/27/67 03/12/70	5,500,000.00 1,166,421.34	5,500,000.00 1,166,421.34	5,500,000.00 731,110.56	4,35,310.78CR	0.00 0.00	1,114,012.56 143,349.69
306-D-15	Government of Afghanistan G Economic Development 2.000% 120 Mos./ 2.500% 30 Yr. 0 Mo.	12/15/67 06/17/68 02/08/81	5,479,406.98 1,143,105.16	5,479,406.98 1,143,105.16	899,026.08 66,919.76	862,148.91CR	4,580,380.90 214,036.49	1,854,135.95 180,151.71
306-G-008	Government of Afghanistan G Economic Development 4.125% 36 Mos./ 4.125% 27 Yr. 0 Mo.	06/29/65 07/21/65 08/20/73	48,798,954.00 593,760.17	48,798,954.00 593,760.17	13,055,309.36 258,658.80	304,784.07	35,743,644.64 649,884.44	32,608,189.22 594,687.28
	Total Afghan Afghanis Total U.S. Dollars Equivalent Exchange Rate Adjustments		59,778,360.98 2,908,286.67	59,778,360.98 2,908,286.67	19,454,335.44 1,051,690.17	0.00 0.00 992,675.62CR	40,324,025.54 863,920.93	35,586,337.73 918,188.68
	Country Total Afghanistan Dollars and Dollars Equivalents Exchange Rate Adjustments		87,251,783.75	87,251,783.75	22,864,546.12	0.00 992,675.62CR	63,394,562.01	31,293,086.69

Source: A.I.D., Office of Financial Management, *Status of Loan Agreement*, March 31, 1990.

Appendix Table A-2. Long-Term Foreign Loans and Credits of U.S. Government Agencies to the Government of Afghanistan, by Program, as of Dec. 31, 1989
(in US$ or equivalents)

Countries, programs and subprograms		Signature date	Maturity date	Amortization rate	Amount of principal		
Treasury number	Purpose of loan or credit				Disbursed	Amortized	Outstanding
Afghanistan							
Under Foreign Assistance and Related Acts:							
Country Loans:							
560020	Project Assistance	56-06	97-12	3.000	5,000,000	2,571,834	2,428,166
570047	Project Assistance	57-06	98-04	3.000	5,750,000	2,955,609	2,794,391
620250	Ariana Airline	63-03	03-09	0.750	2,519,399	1,362,937	1,156,462
630211	Transport Equipment	63-12	05-06	0.750	1,930,532	917,714	1,012,818
640187	Herat Islam Qala Road	65-01	06-10	2.000	7,683,091	2,835,953	4,847,138
640243	Transportation Maintenance and Equipment	64-11	05-06	2.000	276,225	110,620	165,604
660021	Agricultural Commodities	66-06	08-06	2.500	1,243,604	311,990	931,614
660044	Kandahar Diesl Electric Generator	66-11	10-04	2.500	799,972	199,043	600,929
670072	HAVA/HACU Equipment Loan	68-05	11-01	2.500	3,886,610	702,317	3,184,293
670073	Kajakai Hydroelectric Power Plant	68-05	10-02	2.500	11,732,537	2,716,290	9,016,248
670074	Land Inventory	68-06	11-09	2.500	364,239	70,576	293,662
670724	Herat Islam Road Amend.	67-10	07-12	2.500	711,000	209,201	501,799
691001	Diamonium Phosphate	69-04	10-01	3.000	1,190,970	264,332	926,638
721023	Kajakai Hydroelectric Power Plant	72-11	14-03	3.000	2,994,135	395,785	2,598,350
721054	Fertilizer Distribution	72-11	13-04	3.000	19,441,597	2,803,342	16,638,255
741025	Kajakai Hydroelectric Power Plant	74-06	15-01	3.000	7,500,000	775,540	6,724,460
741025A	Kajakai Hydroelectric Power Plant	75-01	15-08	3.000	1,928,761	147,597	1,780,564
751025	Agricultural Inputs Loan	75-08	15-12	3.000	7,957,492	771,031	7,186,460
	Program Total				82,909,564	20,121,711	62,787,851

(continued)

Appendix Table A-2 (continued)

Countries, programs and subprograms					Amount of principal		
Treasury number	Purpose of loan or credit	Signature date	Maturity date	Amortization rate	Disbursed	Amortized	Outstanding
Agricultural Trade Development and Assistance: Currency Loans to Foreign Governments:							
650158	Economic Development	65-07	00-08	4.125	887,254	237,369	649,884
670726	Economic Development	68-06	11-02	2.500	260,552	42,750	217,802
	Subprogram Total				1,147,806	280,119	867,686
Long-Term Dollar Sales:							
660200	Wheat and Wheat Flour	66-12	87-02	2.500	1,292,000	1,291,832	168
670037	Sales of Agricultural Commodities	67-07	08-06	2.500	4,360,689	1,805,290	2,555,398
680033	Sales of Agricultural Commodities	68-07	09-11	2.500	3,712,391	1,552,239	2,160,152
710005	Wheat and Wheat Flour	71-03	11-06	3.000	3,372,315	1,158,120	2,214,195
710027	Wheat and Wheat Flour	71-08	11-09	3.000	6,853,474	2,348,864	4,504,610
730001	Wheat and Wheat Flour	73-02	13-06	3.000	1,887,840	460,179	1,427,661
760015	Fats and Oils (vegetable/animal)	76-08	16-12	3.000	2,683,513	480,042	2,203,471
770021	Wheat and Wheat Flour	77-12	18-12	3.000	5,867,323	1,093,797	4,773,525
	Subprogram Total				30,029,545	10,190,363	19,839,180
	Program Total				31,177,351	10,470,482	20,706,866
	Country Total				114,086,915	30,592,193	83,494,717

Source: U.S. Treasury, *Status of Foreign Loans*, March 31, 1990.

Appendix Table A-3. Estimated Debt and Debt Service Owed the U.S. Government by the Government of Afghanistan, by Program (in US$)

Country name	FY 1989 Principal paid	FY 1989 Interest paid	FY 1989 Interest capitalized	FY 1989 Rescheduled principal	Arrears as of 9/30/89 principal	Arrears as of 9/30/89 interest	FY 1990 Projected principal	FY 1990 Projected interest	FY 1991 Projected principal	FY 1991 Projected interest	FY 1992 Projected principal	FY 1992 Projected interest	FY 1993 Projected principal	FY 1993 Projected interest
Afghanistan														
EXIM:														
Direct Loans	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Guarantees														
PL-480: Direct Loans	571000	412000	0	0	440844	310447	840660	564029	840660	540052	840660	516075	840660	492040
CCC:														
Direct Loans														
Guarantees														
AID: Direct Loans	2445000	1839000	0	0	522970	110229	2384000	1672000	2459000	1613000	2533000	1542000	2611000	147800
HG: Guarantees														
Afghanistan: Sub-total	3016000	2251000	0	0	963814	420676	3224660	2236029	3299660	2153052	3373660	2058075	3451660	197009

Source: U.S. Treasury and Office of Management and Budget, June 1990.

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