

DEBT RELIEF AS A PLATFORM FOR REFORM: THE CASE OF NIGERIA'S VIRTUAL POVERTY FUND

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ABSTRACT

In June 2005 the Paris Club group of creditors announced a US\$30 billion debt relief package for the Nigerian government, which included a US\$18 billion debt write off. This paper describes how these debt relief savings have been managed and spent, with a focus on the development and implementation of a comprehensive tracking system that aimed to effectively monitor debt relief expenditures. The paper argues that the Nigerian case implies debt relief can be a valuable tool for supporting public sector reform.

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¹ Department for International Development, UK (m-alsop@dfid.gov.uk) and University College London (d.rogger@ucl.ac.uk) respectively. Section 4 of the paper draws heavily upon Presidency of Nigeria (2007a), prepared by Rogger whilst working for the Nigerian Presidency. This paper reflects the views of the authors and not necessarily the institutions they are associated with. Both Alsop and Rogger are extremely grateful to the Nigerian Government for time spent working in the Debt Management Office (2004-6) and Presidency (2005-7) respectively. Specifically, Rogger worked in the Office of the Senior Special Assistant to the President on Millennium Development Goals, the office that designed and implemented the OPEN initiative. All omissions and errors are our own. A selection of related materials, including a more 'reader-friendly' version of this story has been provided at <http://www.newscentre.bham.ac.uk/debtrelief/index.shtml>.

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ACRONYMS

CBN	Central Bank of Nigeria
DMO	Debt Management Office
ECOWAS	Economic Community of West African States
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
MDGs	Millennium Development Goals
NEEDS	National Economic Empowerment and Development Strategy
OPEN	Overview of Public Expenditure in NEEDS
OSSAP-MDGs	Office of the Senior Special Assistant to the President on Millennium Development Goals
PSI	Policy Support Instrument
VPF	Virtual Poverty Fund

COMMENTS AND FURTHER DISCUSSION

The authors warmly encourage comments and invite questions regarding further details of anything discussed in this paper. We believe there is scope for utilising Nigeria's experience for the benefit of other nations receiving debt relief.

1. INTRODUCTION

Debt Relief and Reform

Recent history has seen acceleration in the breadth and depth of debt relief granted to heavily indebted nations. A number of researchers have questioned the extent to which this relief has benefited debtor countries, arguing that the financial gains are too small to have impact.² A number of these studies also state that debt relief has not changed the composition of public spending, or spurred public reform.

The impact of debt relief on public sector spending can work through a number of channels. It increases fiscal space by reducing debt repayments, increases the incentive to gather taxes or improve the efficiency of public services by reducing debt overhang, and can be utilised as a platform for public reform.³

This paper looks at a case study of the last of these channels: debt relief as a platform for public sector reform. Debt relief savings are often ‘ring-fenced’ from other public expenditures and denoted in some way as ‘special funds’. For example, in Uganda debt relief savings were committed to a ‘Poverty Action Fund’ or in Zambia to ‘Poverty Reduction Programmes’. These funds can be managed differently from other public expenditures, either focussed on particular sectors, or spent more transparently or efficiently.

If spent through the standard channels of government, they become an entry point to planning, budgeting, and implementing processes. Since debt savings are often a small proportion of the budget, challenges to implementing reforms are minimised, providing an opportunity for experimentation, domestication, and marketing of reforms. Key political actors who have fought for debt savings may provide support for such reform, and the highly politicised nature of debt relief can shield it from potential challengers. Finally, as debt relief is comprised of domestic rather than external funds, they allow domestic reformers with greater flexibility over their use.

The Case of Nigeria

The use of debt relief as a platform for public sector reform in Nigeria provides evidence that debt relief can have wider benefits for the recipient nation by changing the institutions through which public funds are spent.

In June 2005, Africa’s largest debt relief deal was granted to Nigeria by the Paris Club group of creditors. The US\$30 billion deal included an US\$18 billion debt write off. Nigeria’s debt deal was negotiated on the back of impressive economic and political reforms. However, recurring issues of corruption and accountability in the country

² See, for example, Chauvin and Kraay (2005), Easterly (2002), and Jain (2005), which are discussed at the start of section 5.3.

³ The issue of debt overhang is more fully discussed in Chauvin and Kraay (2005). The argument goes that “high debt service obligations reduce the incentive of debtors to engage in policy reforms that raise revenues available for debt service, since part of the additional revenues accrue to the creditor.” Once these are relieved, incentives for reform are strengthened.

continued to fuel scepticism in many quarters. Fears were expressed as to whether savings from the deal would be well-utilised, and not misspent or embezzled.

To showcase Nigeria's ability to spend funds honestly and competently, the government set up a comprehensive and robust tracking system that would transparently monitor and evaluate the impact of the gains from debt relief. At its foundation was an accounting mechanism like those of 'virtual poverty funds' (VPFs) utilised in other debt-relief recipient nations. However, Nigeria's virtual poverty fund went further, adding an office of public expenditure reform and an evaluation component to the traditional VPF. The debt relief, and the monitoring structures that surrounded it, were made into an opportunity to accelerate Nigeria's reform process.

The country's aspiration for debt relief had been a critical factor in the setting up of the Federal Government's Debt Management Office (DMO). Resources were then provided to build its capacity to negotiate a debt deal. However, once the debt relief had been secured, the DMO went on to restructure the domestic debt stock and develop the domestic bond market as a means for more effectively meeting the government's financing needs.

By developing and implementing a sustainable borrowing strategy the DMO plays an important role in reducing the risk of Nigeria returning to an unsustainable foreign debt burden in the future. Given the Nigerian experience, this paper argues that debt relief can be used as a platform for reforming national debt institutions, which are crucial to avoiding any future debt crises and to supporting economic growth and development via provision of long term local currency debt financing.

The Nigerian debt relief deal was accompanied by the implementation of a comprehensive tracking system for debt relief expenditures, and an associated office of public expenditure reform. The debt relief has not only injected needed cash into the social sectors of government, but provided an opportunity to change the way that cash is spent. Whilst debt relief funded social infrastructure, it also provided an opportunity to introduce a social protection strategy to the country, a new intergovernmental conditional grants scheme, and new ways of planning, budgeting, and executing projects.

The structure of the paper is as follows. Section 2 provides a brief overview of the context in which the debt relief was granted to Nigeria. Section 3 discusses the deal itself in more detail, as well as the impact and benefits of the deal for Nigeria. Section 4 discusses the development of a tracking system for the debt relief funds which integrated a standard 'virtual poverty fund' with innovative monitoring and evaluation, coordination, and reform mechanisms. Section 5 describes some of the challenges and lessons experienced in the implementation of this system, as well as the broader debt management strategy, and Section 6 summarizes the conclusions we have drawn from the Nigerian experience to date. An annex contains a brief review of virtual poverty funds associated with debt reliefs across the developing world.

2. A BACKGROUND OF ECONOMIC REFORM

In 1999, Nigeria transitioned to a democratic government under President Olusegun Obasanjo after more than a decade and a half of military rule. The government structures inherited by the new administration were characterised by a lack of accountability to the citizenry, and public institutions that were ineffective at providing public services worthy of the country's huge mineral resource wealth.⁴

The government's initial focus was on political stability, strengthening democratic practices, and tackling corruption. After winning a second term in 2003, and with the appointment of a formidable finance minister, Ngozi Okonjo-Iweala, the Obasanjo administration pursued a wide-reaching macroeconomic agenda. This agenda was primarily embodied within the National Economic Empowerment and Development Strategy (NEEDS; National Planning Commission, 2004) which focused on four main areas: improving the macroeconomic environment, pursuing structural reforms, strengthening public expenditure management, and implementing institutional and governance reforms.⁵ These will briefly be discussed in turn.

Efforts to improve macroeconomic stability centred upon the introduction of an oil price-based fiscal rule to de-link public expenditure from oil revenue earnings. All revenues earned from oil above a pre-determined benchmark price would be saved for leaner times. Before the rule, oil price volatility had fed directly through into the domestic economy via severe fluctuations in public expenditure and weak fiscal discipline. The immediate impact of introducing this rule was to turn a fiscal deficit of 3.5 per cent of gross domestic product in 2003 into a surplus of 11 per cent in 2005, and accumulate significant excess crude savings as well as foreign reserves.

The government introduced the 'Fiscal Responsibility Bill' which aimed to formalise this rule, and bind all three tiers of government (federal, state and local) to a medium term expenditure framework in an effort to improve budgetary planning and execution. These fiscal measures were complemented by improved monetary policy which significantly reduced inflation and together enabled strong growth in the economy driven by the non-oil sector, which grew by 8.26 per cent in 2005.

Structural reforms included privatisation, civil service reform, consolidation of the banking sector, and refinements of trade policy. Concerted efforts towards privatization of state owned enterprises and concessioning of key ports were accompanied by the deregulation of various economic sectors to encourage private sector participation, notably in telecommunications, power, and downstream petroleum sectors. Liberalization of the telecom sector was particularly successful, resulting in an increase in the number of telephone lines in the country from about 500,000 landlines in 2001 to over 32 million GSM lines at present (Okonjo-Iweala and Osafo-Kwaako, 2007).

⁴ Over the final decades of the 20th century, welfare outcomes in Nigeria stagnated, and in some areas worsened. For a discussion of Nigeria's welfare dynamic, see the National Bureau of Statistics 'Poverty Profile for Nigeria' published in November 2005, the forthcoming Nigerian Poverty Assessment, and the results of the Core Welfare Indicators Questionnaire for 2004, 2005, and 2006. These are available at the National Bureau of Statistics' web site, www.nigerianstat.gov.ng.

⁵ Excellent surveys of the achievements of Obasanjo's reform agenda can be found in Okonjo-Iweala and Osafo-Kwaako (2007), and Utomi et. al. (2007).

In 2004, the Federal Government adopted the ‘Service Compact with All Nigerians’ which committed the civil service to providing quality basic services to all citizens “in a timely, fair, honest, effective and transparent manner” (Federal Government of Nigeria, 2004). In an effort to improve efficiency, significant and challenging restructuring of the civil service was also undertaken. This included retraining programmes, redundancy packages, removing ghost workers from the government payroll and reviewing pay scales.

The Central Bank of Nigeria (CBN) launched an impressive bank consolidation exercise in 2004 to strengthen the financial sector and improve availability of domestic credit to the private sector. The minimum capital base for deposit banks was increased from approximately US\$15 billion to US\$192 billion. This resulted in a reduction in the number of deposit banks from 89 to 25 via several mergers, and helped these banks raise significant amounts from the domestic capital markets as well as attract FDI from abroad. The CBN’s supervisory powers were also strengthened, to improve regulatory oversight of the sector.

Trade reforms centred on liberalising Nigeria’s complex and opaque tariff regime by adopting the common external tariff of the Economic Community of West African States (ECOWAS). This helped reduce the simple (unweighted) average tariff rate from 29 to 18 per cent, and the weighted average tariff from 25 to 17 per cent (Okonjo-Iweala and Osafo-Kwaako, 2007).

Institutional and governance reforms focused on public procurement, public expenditure management, transparency in the oil and gas sector and fighting corrupt practices. In 2002, the ‘Due Process Certification Policy’ was put in place to improve federal procurement processes, and it resulted in significant efficiency savings on capital spending: approximately US\$1.5 billion since 2001. Efforts to improve transparency across all three tiers of government included the monthly publication of federal, state and local government revenue allocations from the central federation account – with roughly half of total government revenues accruing to state and local governments, this was a significant step.

Nigeria adopted the Extractive Industries Transparency Initiative in 2003, resulting in an independent audit of the oil and gas sector from 1999 to 2004. In addition, efforts to tackle corruption centred on the establishment of two new bodies: the ‘Economic and Financial Crimes Commission’ and the ‘Independent Corrupt Practices Commission’. These bodies successfully helped to secure a string of high level suspensions, dismissals, impeachments and convictions across judges, ministers, state governors and even a former Inspector General of Police, as well as the seizure of assets worth over US\$5 billion.

This background of economic reform is an important context within which to place the debt deal: without these impressive reform efforts, Nigeria would have failed to convince the Paris Club to consider a debt deal. Equally, as this paper argues, the debt deal itself helped to support the success of these reform efforts.

3. THE PARIS CLUB DEBT DEAL

The Obasanjo administration inherited a huge foreign debt portfolio. This had been amassed through previous borrowing by various military governments as well as government guarantees on trade and investment financing between private businesses in Nigeria and those in more developed economies.

In the case of government loans, these were sometimes poorly invested or projects were mis-managed. In the early 1980s oil prices declined and the government was not able to meet the repayments on these loans. In the case of guarantees by the Nigerian government to exporters and other private businesses, when Nigerian businesses failed to service these debts to companies abroad, the guarantees were invoked. These loans then became direct sovereign debts, and were added to the public debt stock. The government did not have an associated income stream with which to service these foreign currency obligations. When the government failed to fully service these growing debts, penalties or fines were incurred which added to the amounts falling due and compounded the problem further.

By the end of 2004, Nigeria's total external debt stock stood at US\$35.94 billion, roughly half of gross domestic product, and a significant drain on public resources.⁶ The present value of the debt stock was more than four times the government's annual revenue (DMO, 2005). The incumbent finance minister stated that "if Nigeria was to fully service its external debt, there would be little left for capital expenditure" (Okonjo-Iweala, 2005).⁷ Hence President Obasanjo determined to relieve Nigeria of this crippling burden and he launched a concerted campaign for debt relief, based within the context of the government's wide-reaching reform agenda.

3.1 PRE-DEBT DEAL

When Nigeria's Debt Management Office (DMO) was established in 2000, the core objective of debt policy in Nigeria was to achieve sustainability, and specifically, to reduce the burden of foreign debt. The only way to achieve sustainability was to target the Paris Club debt, which constituted 86 per cent of the foreign portfolio.

Rescheduling agreements had been signed with the Paris Club as recently as 2000, but these agreements did not contain provision for debt reduction; only rescheduling of the existing debts on new terms. These efforts proved insufficient to reduce the immense burden of the foreign debt stock, and Nigeria pursued significant debt reduction from her creditors.

The President gave his full backing to the ambitious debt relief campaign led by the Minister of Finance, in conjunction with the National Assembly and advocacy groups in Nigeria and abroad. Given Nigeria's history and perceptions of governance, as

⁶ To give a comparison of the scale of Nigeria's debts, the much publicised G8 Multilateral Debt Relief Initiative launched at Gleneagles in July 2005 was expected to provide about US\$37 billion in debt relief for 19 countries over 40 years.

⁷ In practice, Nigeria was only paying roughly US\$1 billion per year compared with, on average, the US\$2.1 billion that was due annually. Under-servicing the debt stock meant that penalties were incurred, raising the stock outstanding even further.

well as rising oil prices and accumulation of reserves, it was an immense task to convince creditors to write off any portion of Nigeria's debts. It is therefore important to note the unique combination of factors that led to the achievement of the Paris Club agreement.

Firstly, there were several technical criteria that it was necessary to address prior to negotiating debt relief with the Paris Club. Specifically, Nigeria's 'borrower' status within the World Bank Group prevented her receiving any debt cancellation, only rescheduling of existing debts on new terms. Similarly, the lack of a formal International Monetary Fund (IMF) programme for the country prevented the Paris Club from granting any debt cancellation deal.

In the 1980s, Nigeria had borrowed from the International Bank for Reconstruction and Development (IBRD), the non-concessional lending arm of the World Bank Group. Throughout most of the 1990s Nigeria had only borrowed from the International Development Association (IDA) – the World Bank's concessional lending arm. As a result, Nigeria was formally classified as a "blend" country, or one that is entitled to borrow from both lending arms, despite the fact that Nigeria had not borrowed from the IBRD since 1993. According to Paris Club criteria, only "IDA-only" borrowers are entitled to debt stock reduction, blend countries are only entitled to debt stock re-scheduling.⁸ Re-scheduling agreements had failed to solve Nigeria's debt problems in the past, and after concerted effort the World Bank board eventually reclassified Nigeria as IDA-only in June 2005, opening the door for a new debt relief deal.⁹

Another requirement for any country seeking to negotiate debt cancellation with the Paris Club is to have in place, and on track, a formal programme with the IMF. Nigeria had not had a formal IMF programme in some years, and did not wish to enter into the borrowing relationship that a standard Poverty Reduction and Growth Facility entailed.¹⁰ The IMF board therefore approved a new 'Policy Support Instrument' (PSI), which was first used with Nigeria.¹¹ A PSI is purely a formal monitoring and endorsement arrangement by the IMF of a country's nationally owned development strategy and reform programme. It does not constitute a new IMF programme or new conditionalities, and this was key to ensuring acceptance and domestic buy-in within Nigeria. The IMF's PSI framework is designed for low income countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their own policies. This creative new instrument from IMF provided the formal endorsement Nigeria needed to reach an agreement with the Paris Club.

The Nigerian authorities also engaged the Paris Club on issues of Nigeria's need for additional funds, and ability to use them effectively and transparently. To highlight the scale of need in the country, the government worked with the World Bank to make detailed estimates of the cost of meeting the Millennium Development Goals (MDGs)

⁸ Debt rescheduling refers to the formal deferment of debt-service payments and the application of new and extended maturities to the deferred amount.

⁹ For a valuable summary that helped to contribute to the debate, see Moss et al. (2004).

¹⁰ The Poverty Reduction and Growth Facility is the IMF's concessional facility for low-income countries.

¹¹ For more details on IMF's Policy Support Instrument for Nigeria, see: www.imf.org/external/np/sec/pr/2005/pr05229.htm

in Nigeria.¹² All members of the Paris Club had agreed to assist developing nations achieve the MDG targets, and thus they were a useful focus. These costs were then built into a standard IMF debt sustainability analysis – an assessment of a country’s ability to achieve its development targets given present and predicted debt stocks – to make the case that the debt burden, combined with the increased public expenditures required to meet the MDGs by 2015, was unsustainable.¹³ The exercise indicated the current level of debt was not consistent with the country achieving the internationally agreed targets.

To counter concerns over transparency, fungibility, and corruption, the Nigerian authorities set about establishing a virtual poverty fund (VPF) in late 2004 to improve the tracking of poverty reducing public expenditures through the Federal budget. With this VPF in place, the Nigerian government could make a credible case to the Paris Club that any savings of debt relief would be spent through the budget in MDG-related sectors, and transparently monitored and accounted for. This was an important contribution to the case for debt relief, and further details will be given in section 4 of this paper.

Finally, adherence to the oil price based fiscal rule, discussed in section 2, allowed the accumulation of government savings in light of rising crude oil prices. This served as a bargaining tool with the Paris Club, and allowed the government to firstly pay off the necessary arrears (to the tune of US\$6.4 billion), and then offer to buy back remaining debt after the 67 per cent write off (amounting to a further US\$6 billion). Without the high oil prices and the prudently accumulated savings, the deal would not have been possible.

3.2 THE DEBT DEAL

On June 30th 2005, Nigeria celebrated as the President addressed the nation and announced the success of negotiations for a comprehensive treatment of Nigeria’s debt with the Paris Club.

The debt deal consisted of three parts. Firstly, Nigeria was required to settle arrears owed to the Paris Club, consisting of principle, interest and late interest that have fallen due but have not been paid. Arrears clearance is a standard requirement of the Paris Club prior to commencement of any debt relief negotiation.

The arrears clearance allowed Nigeria to receive a reduction of their debt stock on Naples Terms. This simply meant that the Paris Club would write off 67 per cent of the total debt stock.¹⁴ This stock reduction was phased: arrears were paid in October 2005, and 34 per cent of the eligible stock was immediately written off. It was agreed

¹² The Millennium Development Goals are a series of eight time-bound development goals that seek to address issues of poverty, education, gender equality, health, the environment and global partnerships for development, agreed by the international community to be achieved by the year 2015. More information on the MDGs can be found at www.un.org/mdgs.

¹³ See Appendix III (F) of IMF (2005) for more details.

¹⁴ The name “Naples Terms” was coined after the first 67 per cent debt stock reduction was given in Naples, Italy in 1994.

that the remaining 33 per cent would be written off in March 2006 pending a satisfactory review of the IMF's PSI.

After arrears clearance and 67 per cent stock reduction, Nigeria would still be left with outstanding obligations to the Paris Club. President Obasanjo was determined to clear Nigeria of any further burden and opted to buy back the remaining US\$8 billion debt at a 25 per cent discount. This payment was made within six months of the arrears clearance in October 2005, and the combined total of arrears and buy back came to US\$12.4 billion, for an US\$18 billion or 60 per cent write off and discounts. The exercise involving the buy back was unprecedented in the Paris Club for a low-income country and was the second largest debt relief operation in the club's 50-year history, after Iraq.

Table 1. Summary of Nigeria's Paris Club Debt Deal

Debt Stock/Relief (US\$ billions)	Pre-Debt Deal	Post-Debt Deal
Paris Club debt	30.8	0
Debt obligations per annum	2.1	0
Debt service per annum	1	0
Debt Repayments (US\$ billions)		
Payment of arrears	6.4	-
Debt buy back	6.4	-
Debt relief	18	-

Notes: Paris Club debt figures as at 31st December 2004. Debt service differs from debt obligations since Nigeria did not pay her full obligations. This created the arrears that had to be paid to become eligible for debt relief.

3.3 THE GAINS OF DEBT RELIEF

The immediate impact of the debt deal was to make Nigeria's foreign debt stock sustainable. In terms of standard debt sustainability ratios, the present value of foreign debt as a percentage of gross domestic product fell from 52 per cent in 2004 to 4.8 per cent in 2006 (see table 2). The present value of debt to government revenue also fell from 412 per cent to 16.1 per cent over the same period, and the present value of debt to exports fell from 152 per cent to just 15.7 per cent. Debt service as a proportion of government revenue and exports also fell to 8.7 and 2.1 per cent, respectively.

Table 2. Debt Sustainability Ratios

Solvency Indicators (%)	Pre-Debt Deal	Post-Debt Deal
PV of Debt/GDP	51.4	4.8
PV of Debt/Exports	151.9	15.7
PV of Debt/Revenue	412.0	16.1
Liquidity Indicators (%)		
Debt Service/Exports	7.4	2.1
Debt Service/Revenue	20.1	8.7

PV stands for 'Present Value' and GDP for 'Gross Domestic Product'. Source of all figures is DMO, Nigeria.

At a broader level, debt relief can have serious macroeconomic consequences, in terms of credit availability and price, the level of foreign investment, and potentially inflation, the interest and exchange rate depending on the structure of debt relief expenditures. It is difficult to identify the macroeconomic impacts of debt relief in Nigeria, due to the diverse influences of the reform agenda. However, any negative effects of debt relief do not seem to have dominated the overall net positive trend in Nigeria's macroeconomic performance. In September 2007, the IMF's fourth PSI review stated "while benefiting from a positive external environment, a stronger policy framework was pivotal in delivering improved macroeconomic performance" (IMF, 2007).

In fact, the debt deal played an important role in securing the first ever international sovereign credit rating for Nigeria. In 2006 both Fitch and Standard & Poor's credit rating agencies gave Nigeria a BB- rating. This rating opens the door for greater foreign investment into Nigeria, which can help stimulate growth and development in the economy.

The reduction in debt stock, and the corresponding reduction in foreign debt servicing, immediately freed up resources. It released roughly US\$1 billion a year to the Nigerian government: US\$750 million in savings for the Federal Government, and an aggregate of US\$250 million to the state governments.¹⁵ As with all debt relief, this was not external financial assistance, but rather government funds that were no longer tied to debt repayments. These savings will be referred to as 'debt relief expenditures' or 'debt relief funds'.

In the first year alone, it provided funds for the training of 145,000 teachers, 166 new primary health centres across the country, 400,000 insecticide-treated bed nets, a million doses of anti-malarial medicines, 4000km of rural roads, amongst other projects across a myriad of sectors.¹⁶

¹⁵ The discussion that follows focuses mainly on the Federal portion of this spend, US\$750 million per year. The states have not implemented a uniform tracking scheme such as that presented here for the Federal Government.

¹⁶ More details of how debt relief gains have been spent can be found in Presidency of Nigeria (2007b) and in past budgets available at www.fmf.gov.ng.

As an example of the variety of sectors that have gained from debt relief since 2006, table 3 provides the distribution of debt relief gains in the 2006 Federal Budget.¹⁷ Whilst the US\$750 million was only a small fraction of the budget, roughly 5 per cent, it was a significant proportion of many sectors' budgets.

Table .3. Distribution and Relative Significance of Debt Relief in 2006 Budget

Sector	Debt Relief Allocation (US\$)	Debt Relief as % of Total Budget	Debt Relief as % of Capital Budget
Health	160,060,150	20%	54%
Education	147,473,742	12%	52%
Water Resources	140,074,924	23%	25%
Power and Steel Works	128,795,783	22%	23%
Works	74,060,150	11%	14%
Agriculture	70,676,692	31%	61%
Environment	11,165,414	25%	54%
Women's Affairs	7,518,797	40%	79%
Youth	7,443,609	5%	81%
Housing and Urban Development	3,721,805	6%	17%

All figures given are in US\$, converted from Nigerian Naira at a rate of 1:133 (author's calculations) and are for the 2006 Budget only. Source of all figures is from the Nigerian Budget Office of the Federation.

In Budget's 2007 and 2008, additional spends of US\$750 million on poverty reducing programmes and projects ensured increased spending on core social infrastructure.¹⁸ The funds were also used to introduce a series of innovative delivery mechanisms for social spending. US\$75 million was granted to the National Poverty Eradication Programme to fund Nigeria's first comprehensive social safety net scheme. The safety net scheme had previously been designed, but had not been able to secure funding from a disinterested National Assembly.

A further US\$150 million was put aside to increase the resources available for basic services at the local government level. The office managing the debt relief designed a conditional grants scheme that would both fund MDG-related projects at the state level, and through a matching component, leverage some of the US\$250 million of state debt relief towards MDG-related projects.

Both social protection and intergovernmental coordination are critically important in a poor, federal country like Nigeria. Until debt relief funds were made available,

¹⁷ The sectors chosen to benefit from debt relief were thought to be of greatest significance to the achievement of the Millennium Development Goals (see footnote 10 and associated text), with the greatest absorptive capacity, and with the greatest need for funds.

¹⁸ The funds were index-linked, and thus were nominally larger in 2007 and 2008. The Office of the Senior Special Assistant to the President on MDGs assessed the extent of fungibility in each budget (debt relief funds substituting for, rather than adding to, current social sector expenditures). It found robust evidence that social sector spending had risen as a result of the debt relief. It is also important to note that since aid flows are such a small proportion of Nigeria's social expenditures, any offsetting reductions in aid could not be of the magnitude of debt relief gains. In reality, aid flows to Nigeria (net of debt relief) have actually risen since debt relief.

neither a social safety net scheme, nor a broad-based conditional grants scheme, were thought to be close to becoming a reality. The flexibility of the virtual poverty fund made such innovations in public expenditure management possible. The debt relief was not aiming to provide additional funds to particular sectors only, but rather act as “an entry point for improvements in the way government worked at all tiers that would reinforce and introduce initiatives ... and then scale up the successes to the wider budget envelope” (Presidency of Nigeria, 2007b).

Combined with a series of planning and budgeting reforms made possible by the existence of the debt relief, these schemes were warmly welcomed by the national and international communities as real progress in developing Nigeria’s welfare state. The activities associated with the expenditure of debt relief were seen to have been one of the most effectively managed and positively impacting aspects of the government’s budgetary expenditures. The World Bank’s Public Expenditure and Financial Accountability Review (2007) called it a ‘critically important program’ of government.

4. NIGERIA'S VIRTUAL POVERTY FUND: OVERVIEW OF PUBLIC EXPENDITURE IN NEEDS

The deal was not without its critics and controversies. The payment of US\$12.4 billion to Paris Club members as part of the 'buy-back agreement', amongst other aspects of the debt deal, generated controversy in the Nigerian media, in the National Assembly and in the general populace.

There were accusations that the deal had not been an effective use of resources, and that national funds should never have been used to pay such "doubtful" debts; but should instead have been committed to much needed investments in infrastructure or such other development related expenditure. On October 2nd 2005, the Sunday Vanguard newspaper asked "How precisely does President Obasanjo propose to satisfactorily resolve [Nigeria's] problems through paying over to the Paris Club more than US\$12 billion of precious national savings for the privilege of indulging in debt buy back?" On November 5th 2005, This Day newspaper reported that members of the National Assembly were perturbed by the need for Nigeria to enter a buy back deal when "18 other countries were given 100 per cent debt forgiveness, 14 of them are from Africa and none of the presidents of these 14 countries did the global tour like President Obasanjo did."

Paris Club members themselves were uncertain as to what the yields of the debt relief would be and whether Nigeria would keep to its commitment to spend debt relief gains on pro-poor projects and programs. Whilst the debt deal had been founded on a faith that Nigeria would keep to her promises, the mechanisms to ensure compliance were limited.

There was therefore a need to overcome challenges of transparency and accountability in a context of historically-founded cynicism. The expenditure of debt relief gains had to be tracked in detail to demonstrate the use of debt relief funds, both to the Nigerian people, and the international community.

4.1 DESIGNING A VIRTUAL POVERTY FUND

Extensive discussions with Nigeria's development partners on how best to comprehensively track debt relief funds coalesced on 3 critical components for an effective system as follows:

1. Accurate receipts of expenditure would detail what debt relief had been spent on.
2. The outputs of these expenditures would be monitored to ensure the requisite quantity and quality had been supplied.
3. The outcomes relating to these outputs should be evaluated to identify what debt relief had achieved.

To tackle component 1, Nigeria drew on the experience of other countries that had undergone debt relief and set up tracking mechanisms: it was decided to employ a virtual poverty fund (VPF) in the budget to report on the nature of debt relief expenditures. A VPF is a coding system within an existing budget classification

structure that enables the ‘tagging’ and ‘tracking’ of poverty-reducing spending. Such a scheme does not involve the setting up of separate institutional arrangements, but rather creates a set of budget codes that labels a portion of government expenditures as poverty-reducing, funded by debt relief, or both. An automated accounting system is then required to report the relevant aggregates.¹⁹

It was widely agreed that such an initiative was the first step in a solution to the problem of demonstrating the use of debt relief funds. A series of budget control codes were created that would denote expenditures as funded by debt relief gains. These were integrated into the standard budget coding structure for the 2006 Federal Budget. The VPF also required some form of reporting platform. This was provided by the Office of the Accountant General of the Federation, who were developing an ‘Accounting Transactions Recording and Reporting System’ that would produce consolidated reports on debt relief expenditures.

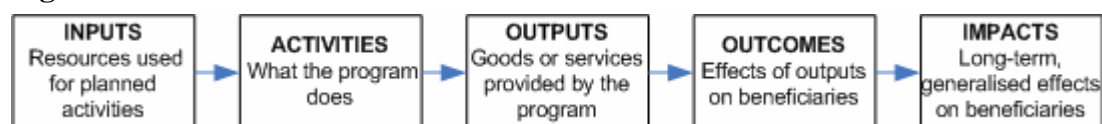
This traditional formulation of a VPF focused on tracking the activities of the debt relief programs through the monitoring of financial resources. For example, if US\$200 is budgeted for the drilling and setting of a borehole, then receipts data from the Ministry of Water Resources would report the nature of expenditures of the US\$200. Perhaps US\$10 was spent on a geophysical survey, US\$30 on renting a drilling rig, US\$50 on a motorised pump and so on. The accounting structure described above gives such a breakdown.

However, such a framework ignores whether receipts truly reflect realities on the ground, the quality of the outputs, non-financial inputs such as policy objectives, and the needs of beneficiaries and so on. In other words, a standard VPF does not tackle components 2 and 3 above – it is not designed to.

A recurrent criticism of the debt relief deal, typical of critiques of Nigerian federal expenditures, was that the funds would be wasted, and would not reach ‘the people’. Thus, simply tracking the receipts of expenditure was not going to be sufficient to prove to the nation that debt relief savings had been worthy of the US\$12billion initial payout. Receipts would not be sufficient evidence that funds had been appropriately utilised.

In a typical evaluation framework, the results chain runs from inputs to impacts, as described by figure 1.

Figure .1. Standard results chain evaluation framework



The standard VPF reported on the activities and outputs component of the standard results chain format.²⁰ It missed the other three components, and the reporting it did

¹⁹ Further discussion on virtual poverty funds can be found in IMF and IDA (2002), and, Williamson and Canagarajah (2003). A brief review of VPFs employed to date is given in Annex 1.

²⁰ See annex 1 for examples.

give was self-assessed by the Ministries, Departments and Agencies (MDAs) spending debt relief funds. Thus, there was a need to fill these gaps and check the reporting of the implementing agencies by providing independent verification.

In mid-2005, the Office of the Senior Special Assistant to the President on Millennium Development Goals (OSSAP-MDGs) was given the remit to guide the federal component of the debt-relief funds through the VPF to expenditures that would help Nigeria achieve the MDGs. The Federal Government did not have the remit to track the States portion of the funds, and thus the VPF was employed to track the Federal share of debt relief only.

In conjunction with the development of the standard VPF, and recognizing its limitations as indicated above, the OSSAP-MDGs began to build a broader tracking initiative entitled ‘Overview of Public Expenditure in NEEDS’ (OPEN) – a ‘new generation of VPF’ that included planning, monitoring and evaluation. The objective of OPEN was to assist in spending the debt relief funds effectively, and then monitor and evaluate the outputs and impact of the spend.

Referring back to figure 1, OPEN aimed to address each of the components of the results chain. It tied together appropriate planning procedures within the context of the government’s wider sector strategy process (inputs), facilitated implementation through a technical office cited in the Presidency (activities), formed the virtual poverty fund (outputs) and set up a monitoring and evaluation (M&E) mechanism (activities through impacts). Each of these is discussed further below.

4.2 IMPROVING PLANNING PROCEDURES

To effectively guide the planning process for use of the debt relief gains, the selection of which ministries were to receive the funds (largely those that had the institutional mandate for MDGs-related sectors such as Education, Health, and Agriculture) was coupled with the issuance of criteria for the spend.²¹ Projects eligible for funding by debt relief were required to demonstrate:

- i. Links to overarching policy thrusts such as sector goals, the MDGs or the national development strategy;
- ii. That they were “quick wins” for maximum output within the shortest period;
- iii. Evidence of pre-budget submission planning in the form of a workplan and cashflow for each project, and feasibility studies, where relevant;
- iv. Evidence of the inclusion of cross-cutting issues such as HIV/AIDS awareness and gender sensitivity in project planning;
- v. Detailed locations for each project with appropriate rationale, such as a geophysical survey in the case of a borehole project, or mappings of existing health facilities showing gaps;
- vi. Details of quantified project outputs and outcomes, and their relation to Nigeria’s achievement of the MDGs;

²¹ The criteria, and the corresponding planning procedures, were designed to fit within the context of the Federal Government’s Medium Term Fiscal Framework and Medium Term Sector Strategy process. Thus, they integrated into the broader reform efforts of the Government.

- vii. Key performance indicators for each project and baseline data by which to evaluate these indicators;
- viii. Details of the linkages between this project and other projects within and outside the sector; and
- ix. Details and evidence of appropriate monitoring and evaluation structures to supervise the projects.

The adherence to these criteria entailed improved planning procedures relative to the inadequate processes that existed in the MDAs.²² To facilitate the communication of and adherence to the criteria, the OSSAP-MDGs provided training to relevant MDA staff, and assigned its staff members to each of the ministries. These OSSAP-MDGs 'desk officers' had relevant sector expertise and thus were able to work competently on technical issues.

The result was improved planning in the MDAs. MDA staff members have reported that they had learnt much through interactions with OSSAP-MDGs during the 2006 budget process, and the new capacity was reflected by the improved quality of submissions for the 2007 budget. The desk officers were key in assisting the MDAs to produce the relevant documents, and in keeping them a priority, as was the directive that debt relief funds would not be forthcoming if the above criteria were not met.

4.3 FACILITATING AND TRACKING IMPLEMENTATION

OSSAP-MDGs also played a 'coordination role'. Along with the conditions detailed above, OSSAP-MDGs required that each ministry set up OPEN 'task teams' encompassing officers from across program, research and budgeting departments.²³ During the implementation of projects, the sector desk officers from OSSAP-MDGs liaised with OPEN task teams to monitor progress in implementing debt relief funded projects and programs. This set-up allowed continual monitoring of where resources were flowing, and why. Such close collaboration also enabled OSSAP-MDGs desk officers to identify bottlenecks in implementation both within the ministries and in other related agencies of government. Where necessary, the SSAP assisted in the loosening of these bottlenecks, and thus facilitated the effective implementation of projects.

The result was improved communication between the ministries and other institutions involved in the implementation process, such as the procurement regulator, the Budget Monitoring and Price Intelligence Unit. However, the task teams had mixed success as a model for improving the effectiveness of expenditure. Some were made up of members unable to effectively communicate the status of debt relief funded projects, whilst others had limited influence over the implementation of projects.

²² Where these criteria were not adhered to, the ministry was sanctioned, penalised in the budget appropriation, and if needed fundamentally restructured, such as the merging of the Ministry of Environment with the Ministry of Housing when the former showed itself incapable of spending government resources effectively.

²³ Task teams vary in size and precise composition from Ministry to Ministry; the smallest being five members, the median 29 members, and the largest 40 members.

4.4 ESTABLISHING AN M&E MECHANISM FOR *OPEN*

Finally, a monitoring and evaluation (M&E) component was needed to ‘close the loop’ of the service delivery chain by verifying outputs, reporting on outcomes and impacts and linking them back to inputs.²⁴ Due to the shortcomings of the government’s existing systems of M&E, it was decided an independent M&E mechanism would be built whilst the governments own processes were strengthened. Private sector experts and civil society were invited to work together to assess the impacts of debt relief spending, and report back to OSSAP-MDGs and the President. They were provided with one per cent of the debt relief funds to undertake these activities, and were protected by formal guarantees of independence.

To address the longer term need for improved M&E within the federal MDAs, the development of a results-based institutional framework for M&E was initiated. This component aimed to strengthen the capacity of the Budget Office of the Federation Budget Monitoring and Evaluation department to execute its primary mandate of designing and implementing a unified national M&E system. A baseline diagnostic study of the current state of M&E systems within the Federal Government was undertaken (see Haden et al., 2006), and the government is currently strengthening its own capacity to monitor and evaluate public funds. Ultimately, the procedures will be rolled out to all other MDAs and some selected States. Thus, debt relief was a platform for broad institutional reform.²⁵

Adding an office of coordination and the evaluation components to the standard VPF was key in the systems success. As traditionally defined, a VPF is merely an accounting platform. In a country in which computing infrastructure can fail for a variety of reasons, cultures are more familiar with ‘people-based’ solutions, and institutions are not strong enough to ensure quality public good provision, it is key to have real consultants in the Presidency and in the field operationalising the tracking system.

²⁴ The M&E component is the most innovative element of *OPEN*. Whilst many of the planning and accounting procedures utilised in the scheme have been used elsewhere, many of the activities under the M&E component are original in their combination or application. Whilst it will not be discussed fully here, the reader is directed to Presidency of Nigeria (2007a) for further discussion.

²⁵ More on this in section 5.

5. DEBT MANAGEMENT, PUBLIC SECTOR REFORM AND THE CHALLENGES AHEAD

A shadow of scepticism has stalked the granting of debt relief over the last decade. In the April 2006 edition of 'African Affairs', Todd Moss stated that "the actual short-term financial impact for the [recipients of debt relief] is unlikely to have a meaningful effect on either government finances or on poverty reduction anytime soon." His argument was that debt relief funds were too small to have a certain, significant impact. Due to the limited capacity to spend in most poor countries, he asserted, increasing resources would not improve development outcomes anyway.²⁶

Moss's argument overlooks the possibility of debt relief as a mechanism for reform in itself. By improving the quality of institutions through which funds are spent, debt relief could not only increase the effectiveness of its own expenditure, but that of the wider budget envelope.²⁷ The value of a dollar is defined by the institutions through which it passes.

The focus debt relief gave Nigeria's reform process, and the Economic Team that managed it, as well as the institutional reforms associated with its debt restructuring and expenditure, are examples of such debt-relief driven institutional progress. By encompassing debt relief in a series of 'special privileges', such as the virtual poverty fund, and perception by government officials that this was 'special' money, meant Nigeria could use debt relief as an effective tool for reform.

5.1 THE IMPORTANCE OF SOUND PUBLIC DEBT MANAGEMENT

International best-practice in public debt management recommends the creation of an autonomous agency responsible for managing sovereign debt. Until 2000, no such agency existed in Nigeria. Whilst the federal DMO may have eventually been instituted, the concerted campaign for debt relief provided critical impetus and ensured that the DMO was effectively resourced to achieve the country's goal of debt relief. This meant that a strong, capable debt management agency was created more quickly, and with greater public support, than it otherwise would have been.

The debt deal in 2005 not only removed a significant financial burden from the government, allowing it to spend its resources on public service delivery and social sectors, but it enabled the DMO to refocus its energy on the core business of public debt management – "establishing and executing a strategy to manage the government's debt in order to raise the required amount of funding, pursue its cost and risk objectives, and to meet any other public debt management goals the

²⁶ Other authors make similar claims. For example, Chauvin and Kraay (2005) states "The present value of debt relief granted to low-income countries ... is actually quite small when compared with foreign aid, or with the value of total tax revenues that it is intended to augment ... the median present value of all debt relief between 1989 and 2003 was between 9 and 12 percent of GDP in 1988... In contrast, the present value of all net aid receipts of these countries over the same period was more than an order of magnitude larger, at 126 percent of GDP, and the present value of tax revenues was greater still at 142 percent of GDP."

²⁷ Generally, aid does not flow through core institutions of government in the same way debt relief has in Nigeria. Where it does, such as budget support, there are opportunities for public sector reform in the same vein as described here.

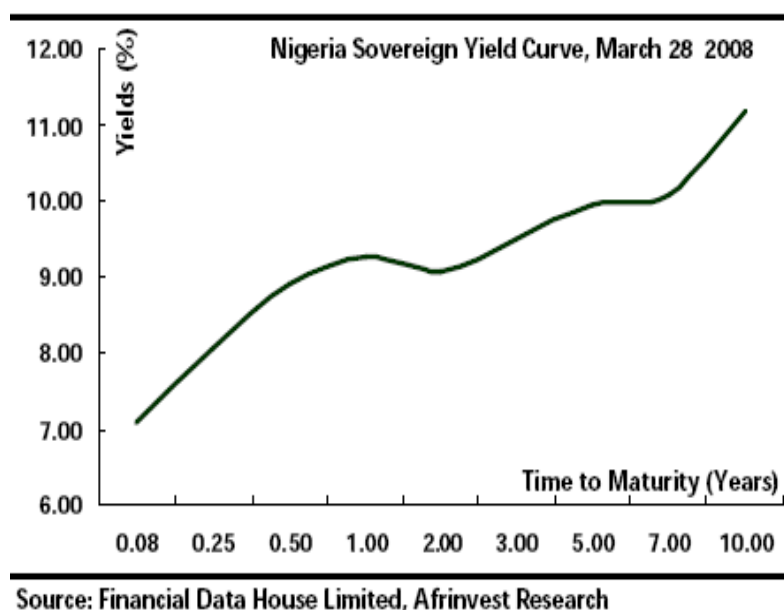
government may have set, such as developing and maintaining an efficient and liquid market for government securities” (IMF and World Bank, 2002).

The importance of sound public debt management cannot be overemphasised. Although by no means a panacea, it is part of the process for governments in low income countries to move away from reliance on unpredictable and unsustainable donor funding, as well as develop their own capital markets for both public and private long term debt financing. In the climate of a post-debt relief world for many developing countries, sound public debt management practices will also help avoid a return to unsustainable debt accumulation and crisis.

The focus on professional debt management post-debt deal has paid dividends for Nigeria, and will continue to do so. It allowed the DMO to lower the cost of raising funds for government through a concerted effort at restructuring the domestic debt stock, put in place measures to prevent the accumulation of unsustainable foreign debt again, and make impressive progress at developing the domestic bond market.

With regards to foreign debt, the DMO developed the ‘Guidelines on External Borrowing’, as well as supporting the passing of the Fiscal Responsibility Bill. The Guidelines specify criteria relating to the terms of new borrowing, and the purposes for which new borrowing can be contracted. By ensuring that new external borrowing must be on concessional terms (i.e. low interest rate, long maturity and grace periods), and that new funds borrowed must be put to productive use, the Guidelines help to ensure in part the future sustainability of Nigeria’s debts.

The DMO extensively restructured Nigeria’s domestic debt portfolio, extending the maturity structure of the initially very short term Treasury Bill debt stock, and in 2005 commenced a textbook bond market development programme. This began with the initial issuance of 2 and 3 year bonds for which there was investor appetite, and gradually and predictably increased to issues of 5, 7 and now 10 year bonds. The regular monthly issuance of the federal government bonds of increasing tenor generates a sovereign yield curve which serves as a benchmark for pricing other securities, including corporate bonds (see figure 2).

Figure .2. Benchmark Sovereign Yield Curve

This is a very powerful strategy to support growth by generating long term funding sources for government financed development projects such as infrastructure, but more importantly, will help to realise the potential of Nigeria’s vibrant private sector to create wealth and jobs by opening this new source of domestic financing.

5.2 REFORMING PUBLIC SERVICE DELIVERY

Debt relief funds could have been spent through a mechanism parallel to, and not integrated with, the national budget. However, it was decided to spend debt relief savings on capital projects through standard government channels, with the intention of impacting on the efficiency and effectiveness of the sectors. Thus, the aims of the debt relief spend were twofold: use the debt relief gains to fund projects that would assist Nigeria achieve the MDGs, and improve the institutions governing wider government expenditures.

As discussed in section 4, a coordination office for the management of debt relief gains was set up. The Office of the Senior Special Assistant to the President on MDGs (OSSAP-MDGs) was given the mandate to build the capacity of government towards achieving the MDGs. Its focus was on the identification and resolution of bottlenecks to efficient and effective public service delivery. The expenditure of debt relief gains was an entry point to the ministries and agencies of government, whilst the overarching mandate enabled a focus on development as a whole, be it a need to better work with local government counterparts, or the resolution of a dispute with the procurement watchdog.²⁸

This approach was seen broadly as a success. As one development partner involved with the office stated, “the key lesson from the offices experience to date relates to the

²⁸ Since OSSAP-MDGs was external to the sectors, and judged on the quality of the debt relief spend, its incentives were to implement projects effectively and accountably.

importance of having a dedicated government unit that focuses on a set of core cross-cutting issues within the governance and finance management agenda.” Another argued that “the experience of the OSSAP-MDGs shows a small unit, strongly supported and led politically can make a difference in addressing the challenge [of the MDGs and NEEDS]” (Presidency of Nigeria, 2007b).²⁹

The planning criteria set up by OSSAP-MDGs for accessing debt relief funds incentivised improved planning procedures in the ministries.³⁰ This was apparent from the consistent improvements in the quality of budget submissions and ministry activities observed by OSSAP-MDGs. Since the same ministry officials worked on both debt relief and non-debt relief expenditures, lessons learnt via OPEN were transferred from the debt relief spend to the wider budget of the ministries, departments and agencies.

To ensure ministry officials had the skills required to implement the requirements for OPEN funds, selective training was provided to relevant government officers and civil servants. It was targeted at reducing specific bottlenecks that impeded the implementation of debt relief projects. Members from MDAs within which OPEN processes would be institutionalised were selected for secondment to OSSAP-MDGs to become part of the reform team itself. This allowed their input into the reform process and their engagement with the processes of reform.³¹

Important components of public service delivery effectiveness, such as a robust monitoring and evaluation mechanism for government, simply did not exist. As Haden et al. (2006) states, M&E in Nigeria had been “partial, superficial and sporadic”. The provision of one per cent of debt relief for internal M&E by MDAs was both a ‘quick-fix’ to gain some monitoring data, but also a research exercise that aimed to understand the true fault lines in the ministries monitoring procedures. Since so little M&E had been taking place, some MDAs built original forms of M&E on top of old processes. Such experimentation allowed OSSAP-MDGs to better understand the capacity for M&E within government systems. The office is currently designing and instituting a new system of M&E using another per cent of debt relief. The debt relief was a unique opportunity to reform federal M&E systems, with a focus on monitoring the MDGs, but with an impact on the wider M&E system.

The M&E reforms and the debt relief had positive externalities for the private sector and the government’s relations with civil society. The M&E initiative utilised the private sector and civil society for independent inspection of government projects. However, organisations in these sectors had limited capacity to do beneficiary impact before the debt relief. OSSAP-MDGs allocated resources to them for training, but did not meddle in the proceedings. Beyond capacity, the experience of working together on the debt relief projects has inspired a new perspective of government in both sectors, especially in civil society.

²⁹ Further discussion on the donor communities’ assessment of OSSAP-MDGs and the VPF can be found in World Bank (2007).

³⁰ These were laid out in section 4.2.

³¹ There is hidden capacity throughout the Nigerian civil service, and innovative methods of tapping into and building this capacity should be explored.

Other activities can be referenced here, and are summarised in Presidency of Nigeria (2007b). However, the message is clear. Nigeria's debt relief was more than just an injection of cash into public finances. It was able to be utilised as a platform for wider public expenditure management and public service delivery reform.

5.3 ENSURING SUCCESS: THE STORY BEGINS

In other research, the overall impact of debt relief continues to be unclear. Whilst there is little in the way of complete analysis or country case studies to compare the Nigeria case with, Chauvin and Kraay (2005) argue that debt relief has had no perceptible impact on the composition or effectiveness of public spending. Some sceptics, including Easterly (2002) and Jain (2005) have argued that debt relief, or the Heavily Indebted Poor Countries process can make public policy worse.

On the other hand, Arslanalp and Henry (2005) argue "both borrowers and lenders can benefit from debt relief when the borrower suffers from debt overhang", whilst World Bank (2006) paints a broadly positive tone as to the policy trajectory of post-completion point countries of the Heavily Indebted Poor Countries Initiative.

Against this mixed picture, the Nigerian case, as summarised in the preceding sections, paints a success story. However, debt relief is only a drop in the ocean of reform that is needed in Nigeria. It is important to condition our arguments and set the positive aspects of the Nigerian case against future challenges. Whilst debt relief was a success, it has not been a silver bullet for the country. Its institutions continue to provide ineffective and inefficient public services to the majority of its people. Rather than being the solution, the OPEN initiative has highlighted the scale of the challenge in Nigeria, and the volume of work that lies ahead.

The extent to which the positive gains of debt relief might be overshadowed by wider trends in the Nigerian polity is still uncertain. Some of these trends may be related to aspects of the debt relief. The aim of this paper is to argue that debt relief can be used as a mechanism for institutional change. We are not providing a wider assessment of the net impacts of debt relief, partly due to the uncertainty over the following issues.

Debt relief is only the first step in debt sustainability. The much lauded debt relief deals announced in recent years should not be seen as the final crowning achievement of much hard work by many sides. Debt relief should be seen as the starting point for the development of a robust debt management strategy to support future growth and development. As World Bank (2006) states, "Future debt relief initiatives need to stress that debt sustainability requires other policy actions by governments and external partners to improve repayment capacity." Alarming, the report goes on to state that all HIPC countries studied have "weak and deteriorating debt management capacity". The same effort that was exerted in achieving debt relief should now be channelled into supporting capacity building in debt management for low income countries.

Nigeria currently has a strong and able debt management office. The central position of the DMO in government policy must be sustained if the country's debt portfolio is to continue to be manageable. This position is being supported by the UK's

Department for International Development (DFID), who through Crown Agents, are supporting the DMO through a 5 year capacity building project,³² and by the US Treasury, through the provision of a long term, embedded technical adviser.

Similarly, the successful expenditure of the debt relief was not guaranteed by its granting, nor is its continued success. The people involved, their personal contact with institutions of government, and the political context were of critical importance.

The effectiveness of the debt relief spend was greatly supported by the committed and able team at OSSAP-MDGs. The Senior Special Assistant to the President herself had broad experience within the private sector, government, and civil society, and thus was able to reach each constituency. She was widely respected within the civil service, had a wide-ranging knowledge of Nigeria's political context, and a proven commitment to the development of the nation. Being a member of government enabled her far wider access to government than external actors.

Similarly, the office she established drew on competent and dedicated professionals from both the public and private sectors and thus enabled the professional presentation of the concepts underlying the VPF and initial results convincingly to all stakeholders. This professionalism allowed the Special Assistant to build a robust reputation with which to carry out the President's wishes and attracted the support of the international partners. The significance of a professional and politically astute manager and a dedicated support team should not be underplayed.

Second, whilst the debt relief funds provided a fiscal incentive to comply with debt relief criteria, officials were influenced by the persuasive and targeted communications of OSSAP-MDGs. The initiative had to be sold, often at a personal level, to the key officials whose work the reforms would affect.

The third key factor in the VPFs success was the garnering of adequate political will to enable difficult but necessary reforms. Without support at the highest political level – that of the President and National Assembly – the significant reforms discussed here would not have been possible. This was aided by the labelling of debt relief as 'special money' that had political support, high visibility, and accountability processes surrounding it.

The extent to which these conditions can be easily replicated will depend on country context, and the character of the wider reform agenda. Without a determined and reformist president, debt relief in Nigeria may not have provided the benefits it did. Similarly, that the debt relief had become such a national issue, with many members of the Economic Team playing important roles in its granting, provided buy-in to important political constituencies. There is no reason why some proportion of the budget cannot be housed in a special poverty fund and given the privileges debt relief funds in Nigeria. Politically, conceptually, this is just easier if it is debt relief. Debt relief that has been fought for and won.

³² Crown Agents won an award for the DFID funded DMO support project in 2006. For more details, see www.crownagents.com/news.asp?step=2&contentID=782®ionID=6&countryID=182§orID=0&serviceID=0&themeID=0

Finally, like debt relief, the VPF should be seen as a stepping stone, and not as an end in itself. It should be seen as a mechanism for introducing reforms, not for sustaining them. As Williamson and Canagarajah (2003) argue for the case of Uganda, “such devices should be treated from the outset as transitional ... otherwise, they can seriously distort public expenditure allocations and management systems.”

Given these caveats, the Nigerian case continues to be a debt relief success story, and the tale implies that it isn't how much debt relief you get that counts, it's what you do with it.³³

³³ Referring back to evidence that states debt relief has limited impact on reform processes, we argue that unless debt relief has been used as a platform for reform, there are limited reasons why such an effect might be found in the data. Weak budget classification systems are likely to be a poor platform for public sector reform in ex-heavily indebted poor countries.

7. CONCLUSIONS

This paper describes the negotiation, granting and expenditure of debt relief for Nigeria. This debt relief released annual savings of US\$1 billion for expenditure on pro-poor projects. Reflecting on the impact of debt relief in Nigeria, we argue that to date the impact has been positive. Debt relief can be a success.

Debt relief in itself is not a sufficient condition for that success however. Like any cash flow problem, it must be effectively managed. Nigeria's 'virtual poverty fund', OPEN, integrated a standard accounting mechanism with machinery for coordination, monitoring and evaluation, and reform. By granting these 'special privileges' to debt relief funds, they were more easily directed to pro-poor expenditures, and more able to have impact on public expenditure processes.

Debt relief can be a platform for public sector reform, in institutions of debt management, ministries of finance, and in sector ministries. It can be worth more than its nominal value, by improving the public systems through which it flows. The impact of a dollar reflects the institutions through which it is processed.

There are caveats to this success. Debt relief has not been a silver bullet for Nigeria. Its institutions continue to provide ineffective and inefficient public services to the majority of its people. The OPEN initiative has highlighted the scale of the challenge in Nigeria, and the volume of work that lies ahead. OPEN itself is still in its initial stages. Historically high oil prices have made debt relief and its associated reform feasible, but such reforms have not been tested in an environment of public penury. Nothing guarantees continued success of Nigeria's debt relief story.

At the heart of continuing success is sound public debt management. Debt relief for Nigeria allows the government to focus on financing its development needs in a cost-effective, prudent and sustainable manner. Sound debt management practices will help avoid unsustainable debt crises in the future, and by focussing on domestic debt market development, the government can help to realise the potential of Nigeria's vibrant private sector to create wealth and jobs by opening up this new source of financing. Maintaining the capacity to achieve this will require continued competence and professionalism from the debt management office.

Finally, debt relief and the virtual poverty fund will only be stepping stones to improved public institutions in Nigeria. It is important that the virtual poverty fund, and the lessons it encompasses, are eventually subsumed into standard agencies of government.

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World Bank 2006 'Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative' Washington: World Bank

Available on-line at: <http://go.worldbank.org/5FR2WBDR41>

World Bank 2007 'Nigeria: A Fiscal Agenda for Change' Public Expenditure Management and Accountability Review Series Washington: World Bank

ANNEX 1: A REVIEW OF VIRTUAL POVERTY FUNDS³⁴

A1. BACKGROUND

In 2002, the International Monetary Fund (IMF) and International Development Association (IDA; an arm of the World Bank), concluded an exercise examining the ability of Highly Indebted Poor Countries (HIPC) to track poverty-reducing expenditures in their budgets. Following on from their tracking exercise, the World Bank and IMF proposed that ‘Virtual Poverty Funds’ (VPFs) were good bridging mechanisms for tracking pro-poor expenditures whilst budget-wide mechanisms were being established.³⁵

A VPF is a mechanism that:

- Tags specific poverty-reducing expenditures *within* the budget, using or adapting existing budget classification systems (which together constitute the virtual fund);
- Monitors the performance of these expenditures; and,
- Often links specific resources to the budget allocations for these expenditures.

About two-thirds of the HIPCs decided to use either pre-existing classification systems or a virtual fund to identify and track relevant poverty-reducing spending (IMF and IDA, 2001, see table 2). The next section details a number of individual country experiences. For brevity’s sake, not all countries applicable are discussed. A more complete review, along with data sources, is given as an external table (table AA1, available at <http://www.newscentre.bham.ac.uk/debtrelief/index.shtml>). The two sections complement each other, the narrative giving greater details where relevant. Another external table, table AA2 (also available at <http://www.newscentre.bham.ac.uk/debtrelief/index.shtml>) details literature associated with the VPF discussion.

A2. COUNTRY EXPERIENCES

A2.1 NIGER: Aligning Expenditures and Goals

Like in so many of the VPF countries, tracking of pro-poor expenditures arose as part of the HIPC process. Thus, the platform on which Niger’s VPF was constructed was its debt relief.

Niger’s Poverty Reduction Strategy Paper (PRSP) prepared in January 2002 listed priority actions to be carried out in a given timeframe. To ensure that the HIPC relief

³⁴ The review relies heavily on the Public Expenditure Management Country Assessment and Action Plans published jointly by the International Monetary Fund and World Bank and related papers. Thus, the focus is on HIPC countries. Further work would be needed to identify expenditure tracking systems in non-HIPC countries.

³⁵ Other examples of bridging mechanisms include:

- controlling the use of cash releases for poverty-reducing spending rather than providing global allocations to ministries. This allows for the tracking of resources earmarked for poverty-reducing spending (e.g. Ghana and Malawi); and,
- renewed efforts to capture more donor project information, thereby improving the coverage of what is being reported (e.g. Burkina Faso and Uganda).

was effectively applied to reducing poverty, the government selected a list of projects from the budget designed to meet basic needs nationwide (school and health huts, wells, small-scale dams, very small loans for economic activity, etc.). These projects were couched within the framework of the PRSP so to:

1. Align the projects with the countries Poverty Reduction Strategy
2. Ground the projects inside a coherent budget process
3. Improve the transparency and accountability of project selection

The chosen expenditures were codified in the budget and tracked. A sub set of these programs was chosen by the government's cash-flow committee as expenditure to be safeguarded. The implementation of these projects were regrouped under the name "Presidential Program" and closely monitored by the Presidency.

A2.2 GHANA: Steps to a VPF

In February 2002, the Government of Ghana completed an exercise which identified poverty-related expenditures in the national budget. The output is summarised in table A3 below.

Table .A3. Poverty Related Expenditures in Ghana, 2002 – 2004
Source: IMF and IDA, 2004

(in % of GDP unless otherwise specified)	2002	2003	2004
	Est.	Est.	Proj.
Total Poverty Related Expenditure 1/	4.8	6.5	6.9
as a % of Total Expenditure	21.7	27.3	28.5
Basic Education	2.8	3.6	3.3
Primary Health Care	0.6	1.0	1.5
Agriculture	0.2	0.2	0.2
Rural Water	0.1	0.1	0.2
Feeder Roads	0.3	0.5	0.4
Rural Electricity	0.1	0.1	0.2
Other Poverty Related Expenditure	0.7	1.2	1.1
Memorandum items:			
Total Expenditure 2/	21.9	23.7	29.0
Total Expenditure 2/ (billions of cedis)	10,716	15,673	19,173
Nominal GDP (billions of cedis)	48,862	66,158	78,650

Source: Ghanaian authorities and staff estimates and projections

1/ Excluding externally financed expenditures

2/ Including externally financed expenditures and excluding interest

Subsequently, a 'Poverty and HIPC related Accounting Manual' was adopted in July 2002. This laid the foundations for the country's VPF. A system called the National Expenditure Tracking System (NETS) was then put in place to track poverty. The NETS system is operated by the Accountant General's Office to track domestically-financed budget execution of discretionary expenditures by MDAs (including funding from HIPC relief).

The budget and MTEF documents for 2003 and 2004 identified poverty related expenditures by MDAs that were subsequently monitored throughout the year. Modifications were introduced within the consolidated line item budget in the form of a special poverty related coding. On the basis of NETS reports and supplementary information of extra-budgetary poverty spending, a unit in the MoF generates quarterly reports of actual poverty-related expenditures about 8 weeks after the end of each quarter. The reasonably detailed information is then reported quarterly to Ghana's main development partners.

A2.3 TANZANIA: Evolving the nature of the fund

In July 1998, donors to Tanzania established the Multilateral Debt Fund (MDF) for servicing debt obligations to multilateral financial institutions. Funds were disbursed according to debt obligations falling due. The resulting budgetary savings were channelled to expenditures in priority sectors. Thus, the donors wanted information on where these 'virtual debt-relief savings' were going.

Coordination with donors was promoted through quarterly meetings, where the government reported on its fiscal performance and, more specifically, on poverty-reducing spending. Disbursements into the MDF reached US\$185 million in 1999/2000, more than twice the initial contributions in 1998/99.

As Tanzania reached the decision point under the Enhanced HIPC Initiative in March 2000 and began receiving interim relief, funds in MDF quickly exceeded the amounts needed for multilateral debt service. Recognizing the fungibility of resources, the authorities began to monitor increases in total expenditures on priority sectors in order to provide assurance to donors and other stakeholders on the effective use of debt relief. At the same time, donors decided to extend general budgetary support for financing poverty-reducing programs. This led to de-linking of contributions to MDF and cash releases to priority sectors from the timing of debt-service payments.

Contributions to MDF were discontinued, and a new Poverty Reduction Budget Support (PRBS) fund became operational in December 2000, along the lines of a VPF. Initially, only broad sectors were tracked, such as 'Health' and 'Education'. However, by 2003 poverty-reducing expenditures were identified at the item level within the existing budget classification, effectively tightening their ring-fencing. Poverty expenditures are reported in the quarterly budget execution reports. These reports are submitted for consideration by the Cabinet and published on the MOF web site.

A2.4 THE GAMBIA: Identifying What Is and What Is Not a Poverty Reducing Expenditure

Any country that tracks its expenditures on poverty reduction programmes must first identify what it classifies as poverty related. In the Gambia, an interdepartmental task force was set up to identify expenditures that are directly related to poverty. The budget lines identified comprised both recurrent and development expenditures. This approach built an understanding of the process within relevant sections of

government. In the budget for 2003 and 2004, an auxiliary code was assigned to these line items to facilitate tracking of such expenditures.

A2.5 BURKINA FASO: Tracking Poverty Reducing Expenditures Over Time Using the VPF

In Burkina Faso the ‘Special Account for the Fight Against Poverty’ is credited with debt relief funds under the HIPC Initiative and used to finance additional expenditure for the priority sectors. Special account expenditures are classified in line with the budget classification adapted for special accounts.

Using records from the Special Account would allow comparing poverty reduction related expenditures over time. However, there are a number of issues to take into account:

1. Government definitions of poverty related programs before and after the adoption of the PRSP differ.
2. Implemented rather than appropriated poverty reduction expenditure is monitored imperfectly by government departments.
3. Classifications are not discriminatory enough to identify poverty reduction expenditure fully.
4. The Special Account is not exhaustive, because it includes only expenditure financed from HIPC Initiative.

Better monitoring of poverty reduction expenditure would require integrating a complete classification of poverty-reducing expenditures into the functional classification. The Government is identifying the various lines of expenditure of previous years in order to provide a more accurate account of the efforts made to increase appropriations for the priority ministries, and an analysis is under way with a view to separate out those lines of expenditure in the 2005 budget act.

A2.6 ZAMBIA: The Need for Tracking Beyond Capital

In 2001 the Government of the Republic of Zambia (GRZ) introduced into the budget classification system a separate new budget code for Poverty Reduction Programmes (PRP) financed under the HIPC initiative, in order to separately identify, budget and track these resources. In other words, it created a VPF.

The main drawback to this system resulted from the weaknesses of the classification system. Most of the items tagged as poverty reducing were currently capital expenditures and grants, which are easier to identify as poverty related. Considerable current resource inputs associated with PRP were not reported. It was also difficult to discern whether the classification really matched the priorities of the PRSP, as no process like that of Niger’s occurred.

In order to reflect the nature of GRZ poverty reducing expenditures more comprehensively, in 2003 the MoF prepared a list of all budget line items related to Zambia’s Poverty Reduction Strategy (PRS) and the Transitional National

Development Plan (TNDP). The MoF allocated the PRP, PRS and TNDP new budget codes at the subsidiary level (i.e. below subhead). Further refinements are currently being planned by the MoF.

A2.7 HONDURAS: Communicating the VPF

On April 30, 2002, Honduras' Poverty Reduction Fund (PRF) was created by law as a financial instrument for tracking poverty reduction related expenditures. The Honduran Government have successfully integrated a communications strategy for the PRF within the law.

The government have endeavoured to place all key documents on the internet. The 'Strategy for Poverty Reduction' (SPR) is available through the web page of the Secretary of the Presidency of the Government of Honduras at <http://www.sdp.gob.hn/ERP.htm> and in English through the IMF's web page at <http://www.imf.org/External/NP/prsp/2001/hnd/01/083101.pdf>.

Each budget document since 2002 has contained an annex detailing poverty reducing expenditures in the budget, containing tables with a breakdown by Poverty Reduction Strategy program, funding source (differentiating between loans, grants, debt relief funds and national funds), etc. An example of the annex (that of 2004) can be found at <http://www.sefin.gob.hn/presupuesto2004/index.htm>.

The Law establishes that the 'Technical Support Unit' co-ordinate the preparation and diffusion of progress reports of the SPR. The implementing regulation of the law provides that the following reports be considered part of the monitoring and evaluation system of the SPR:

- Reports on the physical and financial implementation of the SPR programs and projects. These reports are to indicate approved expenditure, commitments, payments, and outstanding appropriation. (Available at <http://www.sefin.gob.hn/erp.html>, updated monthly)
- Evaluation reports based on progress in the achievement of objectives and targets of the SPR. To this end, the authorities are developing an Integrated System to track the SPR which will be shared widely.

A3. COMMON THEMES AND DIFFERENCES

Whilst tracking poverty expenditures does not necessarily entail the need for a VPF (see the entry for Cameroon in table AA2), it has been a useful *interim* solution for many HIPC countries whilst they construct a stronger public expenditure management system. Not least because of the broad range of lessons that can be shared by other HIPCs learnt in their setting up of a VPF.

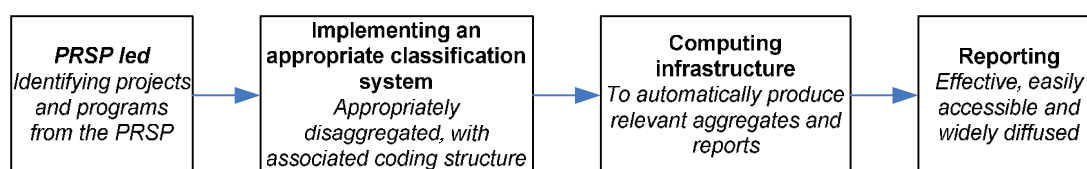


Fig.1. Setting Up a VPF: Global Trends

Section 2 and table 1 have laid out the experiences of many of the HIPC countries in setting up a VPF. Whilst timing, logistical and impact issues are difficult to gauge from the available literature, there seem to be a number of trends in implementation. Figure 1 attempts to summarise the key trends.

Debt relief seems to have been a key initiator for many VPFs.³⁶ As part of the HIPC process, some form of PRSP is required to reach completion point. This often acts as a reference from which projects and programmes that are poverty related can be derived.

Some countries, such as Cameroon, The Gambia, Madagascar, Mali, Mauritania, Niger, and Zambia, have started by tracking the use of HIPC assistance rather than all poverty-reducing expenditures. This is not sufficient to ensure that such funds are additive to current poverty-reducing spending, and these countries are moving beyond tracking of HIPC assistance only.

For some countries, the setting up of virtual funds had involved making changes to their existing budget and accounting systems prior to the introduction of new computerized systems. In Zambia, for example, a table is being used to map from administrative and economic classifications onto a program classification so as to track relevant poverty-reducing spending. In a similar vein, other countries are introducing new reporting templates to track spending on tagged budget lines (e.g. Mauritania, Mozambique and Tanzania).

In many countries, reporting is still in its infancy. Many countries analysis is used for internal government purposes and to satisfy donor demands. However, Honduras has pioneered the release of VPF data to the general public. Budget documents contain additional information on all poverty-reducing spending in 2002, monthly updates on expenditures are published on the internet and a system is being constructed to evaluate the outcomes of the VPF.

³⁶ This may be a product of the fact that it is HIPC literature, which I have focussed on, that uses the VPF terminology, but such tracking systems exist elsewhere.