The HIPC Initiative:
Delivering Debt Relief to Poor Countries

By

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February 1999

Unsustainable debts have increasingly been recognized as a constraint on the ability of poor countries to pursue sustainable development and reduce poverty. In response, just over two years ago, the World Bank and IMF launched the Heavily Indebted Poor Countries (HIPC) Initiative. It was endorsed by some 180 governments represented at the Bank and the IMF as a sound and effective instrument to provide poor countries a way out of the debt trap. The HIPC Initiative is designed through a combination of substantial debt relief and important policy reform to help poor countries reduce their external debt to sustainable levels so they can focus on long-term poverty reduction and economic growth. HIPC debt relief is used specifically in cases where traditional debt relief mechanisms will not be enough to help countries exit from the rescheduling process (see Box).

What's new about HIPC? What is special in the HIPC initiative is the *comprehensive* way it attacks the debt problem in some of the poorest countries. If an external debt situation is unsustainable and a country has established a good record of implementing structural and social reforms, the HIPC Initiative provides comprehensive debt relief in order to remove the debt overhang. With HIPC debt relief, governments will have additional resources available to strengthen their social programs, especially in primary education and primary health. A second special aspect of the Initiative is the new dimension of multilateral debt relief. Before this Initiative, multilateral debt relief was taboo. This has changed now. For the first time, multilateral institutions like the World Bank and IMF are providing debt relief together with other bilateral and commercial creditors. A third aspect is the unprecedented degree of helpful participation and coordination between all actors involved – debtor governments, creditors, and donors – as well as the intense interest shown by NGOs, churches, and other groups in the Initiative.

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BOX: HIPC INITIATIVE FRAMEWORK

Eligibility. To obtain assistance under the HIPC Initiative, a country must be eligible for concessional assistance from the IMF and the World Bank, face an unsustainable debt burden even after the full application of ***traditional debt-relief mechanisms***, and establish a track record of reform and sound policies through IMF-and World Bank-supported programs.

Time Frame. The Initiative is set up in two stages. In the first stage, the debtor country pursues a strong adjustment and reform program, supported by the IMF and the World Bank, and receives flow reschedulings on concessional terms from bilateral creditors. The ***decision point*** is reached after the country has established a three-year policy track record. At this point, the international community, including the IMF and the World Bank, makes a commitment to provide sufficient debt relief to reduce the debt burden of an eligible country to sustainable levels at the ***completion point***, which is reached after a further period of strong policy performance with a focus on continuing structural reforms and a social policy actions. The required performance period is being implemented flexibly and shortened, on a case-by-case basis, for countries with sustained records of implementing economic and social reforms.

Debt sustainability. A country may be considered to achieve external debt sustainability when it is able to meet its current and future external debt-service obligations in full, without recourse to debt relief, rescheduling, or the accumulation of arrears. Sustainable debt levels under the Initiative are defined on a case-by-case basis as: the ***net present value*** of public and publicly guaranteed external debt in percent of exports within the range of 200–250 percent; the ratio of external debt service to exports within the range of 20–25 percent; or for very open economies with a heavy fiscal debt burden, despite strong efforts to generate fiscal revenue, a net present value of the debt-to-export ratio below 200 percent and a net present value of the debt-to-fiscal revenue ratio no higher than 280 percent.

1/ Traditional debt relief mechanisms involve debt reduction in the form of flow restructurings or stock-of-debt operations in net present value terms of 67 (or 50) percent from bilateral creditors on eligible debt (Paris Club Naples terms).

2/ The net present value of debt is a measure that takes into account the degree of concessionality, in contrast to the face value of the external debt stock, which is not a good measure of a country's debt burden if a significant part of the debt is contracted on concessional terms; for example, with an interest rate below the prevailing market rate. The net present value is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the market interest rate.

What are the dimensions? There are some 40 HIPCs worldwide that owe some $170 billion in external public debt (in 1996 dollars). While this amount is but a small fraction of the total debt of developing countries of more than $2 trillion, the debts of HIPCs are, on average, more than four times their annual export earnings, and well exceed their annual GNPs. These are about twice the levels considered to be sustainable. Thirty-three African countries are HIPCs, and many of these have debt that is unsustainable.

HIPCs have already been receiving substantial debt relief through traditional channels such as Paris Club debt relief operations, forgiveness of aid debts, and commercial bank debt buy-backs at discounts in the order of 85 percent. These operations have provided debt relief of about $25 billion during 1990-96. But the HIPC Initiative reflects the decision of the international community that more needs to be done for some countries.

What has been the progress with HIPC thus far? Over the last two years, eligibility for HIPC debt relief has been reviewed for 12 countries, of which 10 qualify for debt relief packages.[2]

Seven debt relief packages have been approved for Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique, and Uganda, yielding debt service relief in excess of $6 billion (Table). In the cases of Uganda and Bolivia, the countries have

Table: HIPC Initiative--Commitments of Debt Relief as of January 1999

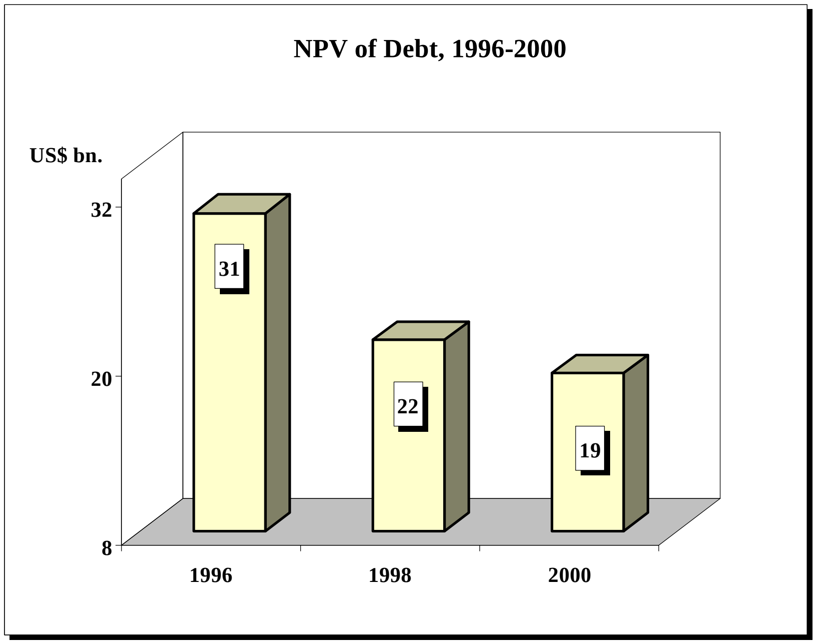
	Estimated total nominal debt service relief (in US$ mn.)	Date assistance to be released [1/]
HIPC debt relief already released:		
Bolivia	760	Sept. 98
Uganda	650	April 98
Commitments of HIPC debt relief:		
Burkina Faso	200	April 00
Cote d'Ivoire	800	March 01
Guyana	500	Spring 99
Mali	250	Dec. 99
Mozambique	2,900	June 99
Total	**6,060**	

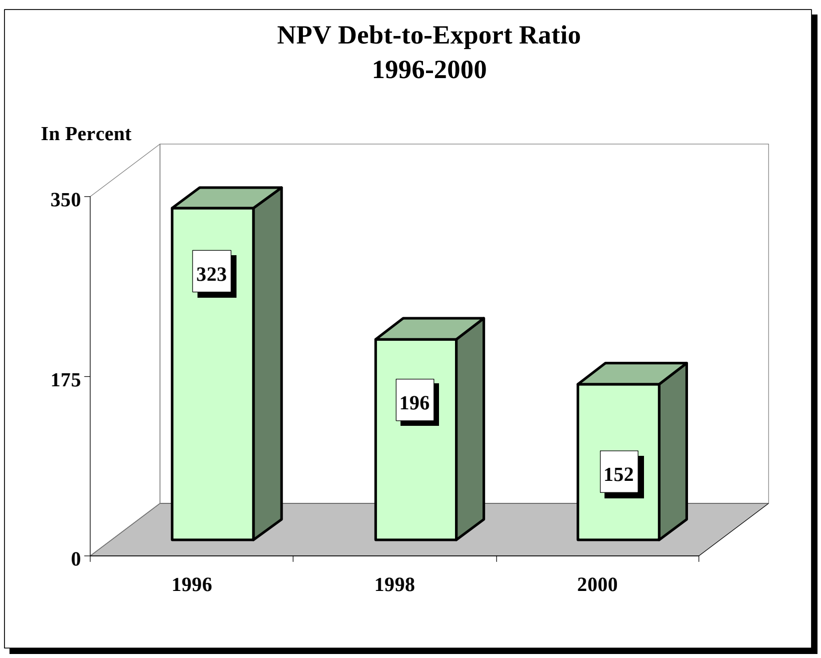
[1/] Based on continuing satisfactory economic performance and assurances of coordinated assistance by all creditors.

already successfully completed the HIPC program and are receiving debt relief amounting to more than $1.4 billion in debt service reductions. HIPC and traditional debt relief will help these countries to return to a sustainable debt position. For these seven countries, total external debt (expressed in present value terms) will fall from $31 billion in 1996 to $19 billion in 2000 (Chart 1).

[2] The regular progress reports as well as country specific HIPC documents are now posted on the web of the Bank (http://www.worldbank.org/hipc) and the IMF (http://www.imf.org/external/np/hipc/hipc.htm)

Chart 1: HIPCs at the Decision Point *1/*





~~Source:~~ Preliminary and Final documents.

1/ Countries that have reached their decision points, include Benin, Bolivia, Burkina Faso, Cote d'Ivoire, Guyana, Mali, Mozambique, Senegal and Uganda. Includes effects of all forms of debt relief.

Debt relief packages have also been discussed preliminarily for Ethiopia, Guinea-Bissau and Mauritania which could potentially provide another $2.5 billion in debt service relief. Finalization of the debt relief packages for Ethiopia and Guinea-Bissau has been put on hold due to armed conflict. The package for Mauritania is expected to be finalized in the coming months. In two countries (Benin and Senegal) the debt situation was found sustainable after they received traditional debt relief, including a 67 percent stock of debt reduction granted by the Paris Club.

The amount of debt relief can vary greatly among countries, with HIPC assistance being sometimes very large relative to the size of their economies. The debt relief package approved for Mozambique is equivalent to 70 percent of GDP while the one for Guyana constitutes about 30 percent of GDP.

Most importantly, debt relief means that new resources are available for social services and poverty reduction. Governments that are going to receive HIPC debt relief have all announced that they intend to channel those resources that will be freed-up from debt service to the social sectors. Uganda is a good case in point: It is using the HIPC debt relief to help finance the country's universal primary education program.

Who pays for HIPC debt relief? To date, 54 percent of the approved debt relief under the HIPC Initiative has been covered by multilateral creditors, with bilateral creditors providing 46 percent (on top of the debt relief they have provided under earlier efforts).

The World Bank and IMF account for the largest shares of total costs among multilateral creditors, at 25 and 9 percent, respectively. In providing the debt relief, both the World Bank and IMF are committed to pay for their full share of the cost under the Initiative. To this end, the World Bank transferred $850 million to the HIPC Trust Fund, the Bank's principal vehicle to deliver the debt relief. The IMF has provided for $520 million so far to finance its share of the debt relief. However, not all multilateral institutions will be able to finance out of their own resources the needed HIPC debt relief. In support of these institutions' own efforts, the HIPC Trust Fund has already obtained about $450 million in bilateral contributions and pledges from 19 countries. These contributions demonstrate the continued strong support this Initiative enjoys in the donor community.

Why is the Initiative perceived so differently? Many governments, institutions, and civil society groups have strong feelings about debt relief, and there has been an intensive debate about the HIPC Initiative. NGOs and church groups, in particular, consider that the Initiative provides too little relief, too late. These concerns have also been voiced by various UN agencies. While Bank and Fund staffs welcome this vigorous debate, we do not share the pessimism of some observers about the Initiative.

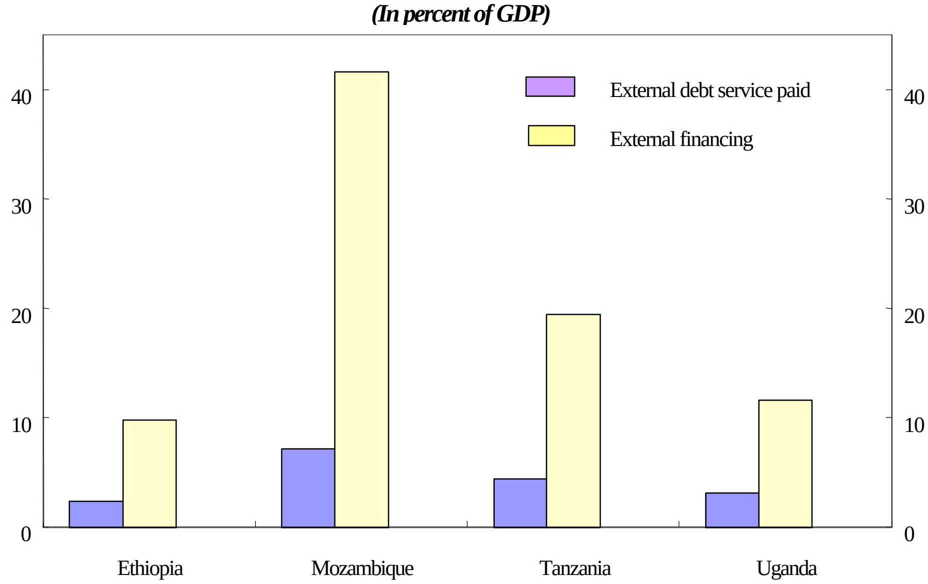
In our view the international community have reacted with determination and flexibility in applying the HIPC Initiative, providing the maximum debt relief possible in most cases and letting countries benefit from the relief between one and two years earlier than called for under the framework. As a result, Uganda and Bolivia are already receiving debt relief. In addition, we have begun to explore special ways of assisting the many heavily indebted countries that are emerging from conflict.

It is welcome that the HIPC Initiative has been catalytic in mobilizing governments around the world, international institutions, NGOs, and religious organizations to stay focused on the need to deal urgently with the debt problem faced by the poorest countries. At the same time, we all should be aware that debt relief alone will not solve the development problems of these countries, especially poverty. Debt relief should be seen as an integral part of the broader development agenda, and integrated into an overall strategy of poverty alleviation. A key element of all strategies to reduce poverty must be a well-specified plan of reform in the countries, which has broad political support.

From a financial point of view, debt relief is part of an overall support package that includes grants and highly concessional credits. In this context, it is often forgotten that most HIPCs are already receiving substantial net inflows from creditors and donors. HIPCs receive on average twice as much by way of external assistance—grants and concessional loans—than they pay by way of debt service, and in some HIPCs (such as Mozambique, Tanzania, and Uganda) this ratio is much higher (Chart 2). On average, net inflows of external assistance to HIPCs are equivalent to around 10 percent of GDP and remain essential for HIPCs to continue their recent improvements in social indicators.

Chart 2: Debt Service Paid and External Financing, 1993 - 97

(In percent of GDP)



Source: IMF and World Bank Staff estimates.

The continuing debt debate is an opportunity to re-focus the need for our continued commitment to development. This requires resources that have become increasingly limited in recent years, and net official development assistance (ODA) has fallen to a historic low of 0.22 percent of donor GNP in 1997 (compared to a UN target of 0.7 percent). This declining trend in aid needs to be reversed. In this context, debt relief should certainly not be seen as a substitute for continued inflows of development finance.

The Initiative has received strong support but has also been vigorously questioned. As part of an ongoing process of consultation with civil society in all parts of the world, staff and management from the World Bank and IMF have participated in more than 100 seminars, meetings, and conferences on all aspects of the Initiative.This necessary and healthy debate will be continued in 1999 when a review of the HIPC Initiative will be undertaken, examining the strengths and weaknesses of this Initiative. To build on this existing consultative process as we carry out this comprehensive review, a request has been made for the many organizations dedicated to the complex challenge of development and poverty reduction to provide their views on the HIPC Initiative and suggestions for improvement.

The challenge ahead

With good progress already made, the focus needs to be on maintaining the momentum of implementation. This depends most importantly on country-specific situations—as the delays in approving a package for Guinea-Bissau have clearly demonstrated. Provided that countries remain on track with the implementation of their reform programs, by 2000, as many as 25 countries may have been reviewed for eligibility. Of these, we expect that about 15 may qualify for HIPC debt relief.

The Initiative calls upon creditors and debtors alike to work towards a way out of the debt trap and to focus scarce resources on sustainable development and reducing poverty. The Bank and Fund are determined to help HIPCs emerge from poverty, and the HIPC Initiative plays an important part in this process. It cannot, however, achieve this alone. The HIPC Initiative has made unprecedented progress in the past two years, and there is more to come.