DEVELOPMENT COMMITTEE
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# THE INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES
## Review and Outlook

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## ABBREVIATION AND ACRONYMS [1]

| | |
|---|---|
| DDSR | Debt and Debt-Service Reduction |
| DRS | Debtor Reporting System |
| DSA | Debt Sustainability Analysis |
| DRC | Democratic Republic of Congo |
| DAC | Development Assistance Committee of the OECD |
| ESAF | Enhanced Structural Adjustment Facility |
| GRA | General Resources Account |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| GUYSUCO | Guyana Sugar Cane Corporation |
| HIPC | Heavily Indebted Poor Countries |
| IBRD | International Bank for Reconstruction and Development |
| IDA | International Development Association |
| IMF | International Monetary Fund |
| ISF | Interest Subsidy Fund |
| MDB | Multilateral Development Bank |
| NPV | Net Present Value |
| NGO | Non-Governmental Organization |
| ODA | Official Development Assistance |
| OECD | Organization for Economic Cooperation and Development |
| SAF | Structural Adjustment Facility |
| SDR | Special Drawing Rights |
| UNCTAD | United Nations Conference for Trade and Development |

[1] Additional acronyms for multilateral development institutions can be found in Annex I, Appendix A.

# THE INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES

# REVIEW AND OUTLOOK

## I. INTRODUCTION

1. At their September 1996 meetings, the Interim and Development Committees endorsed the Initiative for Heavily Indebted Poor Countries (HIPC) and urged the World Bank and the IMF, working closely with donors and other creditors, to move swiftly to the implementation phase.[2] Since then, ten countries have been reviewed by IDA and IMF Boards for eligibility for assistance under the Initiative. Debt relief has been agreed for six, totaling about US$3 billion in net present value (NPV) terms, of which about 24 percent would be provided by the World Bank and 9 percent by the IMF. The implementation of the HIPC Initiative has been reviewed regularly by Executive Directors, and progress reports have been sent to the Interim and Development Committees on the occasion of their regular semi-annual meetings, in April and September 1997 and April 1998.[3]

2. When the Interim and Development Committees endorsed the Initiative, they agreed that it would remain open for two years to HIPCs that pursue or adopt programs of adjustment and reform supported by the IMF and IDA, after which a decision would be made whether it should be continued. The purpose of this paper is to take stock of what remains to be done at the end of the first two years and update the estimated costs of the Initiative.

3. The paper is organized as follows: Section II outlines the unfinished agenda and discusses some of the issues that can be expected to affect future implementation. Section III presents an updated estimate of the costs of the Initiative and provides comparisons with previous cost estimates. Section IV sets forth the next steps. Background material on the objectives and achievements of the HIPC Initiative in the first two years is provided in Annex I. Annex II discusses contacts with the public and non-governmental organizations (NGOs) on the Initiative.

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2 Communiqués of Interim and Development Committees, Washington D. C. of 9/29/1996 and 9/30/1996, respectively.

3 Reports to the Interim and Development Committees (ICMS/Doc/48/97/6 of 4/26/1997; ICMS/Doc/49/97/13 of 9/17/1997; ICMS/Doc/50/98/6 of 4/10/1998; and DC/97-8 of 4/26/1997; DC/97-17, Rev.1, of 9/20/1997; DC/98-7of 4/9/1998).

## II. THE UNFINISHED AGENDA

4. Considerable progress has been made in the implementation of the HIPC Initiative in its first two years. Ten countries have been reviewed for eligibility to receive assistance, and eight of these have reached their decision points.[4] A large number of countries, however, remain to be reviewed, including several which are experiencing, or just emerging from, conflict situations. The most important factor in rapid and full provision of assistance under the Initiative to all eligible countries will continue to be their progress in implementing reform programs supported by the IMF and IDA.

5. There are three particular mileposts in the HIPC process: (i) entry, when adjustment programs begin; (ii) the decision point, normally after three years; and (iii) the completion point, normally after a second three-year period. This section discusses prospects and issues relating to the progress made toward each milepost by the HIPCs. It also reviews briefly some of the issues related to the delivery of HIPC assistance, including the status and modalities of financing envisaged by the Bank, the IMF, and other multilateral creditors, as well as the link between debt relief and social development.

### The entry requirement

6. The first milepost toward establishing the policy track record necessary to qualify for HIPC assistance is the entry requirement. The Program of Action states that "the Initiative would be open to all HIPCs that pursue or adopt programs of adjustment and reform supported by the IMF and IDA in the next two years, after which the Initiative would be reviewed and a decision made whether it should be continued."[5] [6] Staffs have interpreted this to include any country which had an ESAF arrangement approved or midterm review completed starting one year prior to the inception of the Initiative, together with an ongoing Policy Framework Paper (PFP) and/or adjustment operations supported by IDA, as having met the entry requirement.

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4 The ten countries that have been reviewed are—in Africa: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Mozambique, Senegal, and Uganda; in South America: Bolivia and Guyana. For details on the implementation of the Initiative to date, see ANNEX I.

5 "A Program for Action to Resolve the Debt Problems of the Heavily Indebted Poor Countries -- Report of the Managing Director of the IMF and President of the World Bank to the Interim and Development Committees," September 20, 1996, page 2 (EBS/96/152, Revision 1 and SecM96-975/1).

6 The IMF ESAF-HIPC Trust Instrument contains similar language. In order to be eligible for assistance, a member must meet, *inter alia*, the following condition: the member was pursuing a program of adjustment and reform by October 1, 1996, or the member shall have adopted such a program in the two-year period beginning October 1, 1996, supported by the Fund through ESAF or extended arrangements, or, on a case-by-case basis as determined by the Trustee, a stand-by arrangement, a decision on rights accumulation, or financial support under the Fund's emergency assistance policy in post-conflict countries" (EBS/96/201, Supplement 5 of 2/6/1997).

**Table 1** - **HIPC Initiative--Country Status at end-July, 1998**

| Country [1/] | Entry requirement met: [2/] | Decision point reached | Completion point reached | Countries without Paris Club concessional rescheduling |
|---|---|---|---|---|
| Angola | | | | ✓ |
| Benin | ✓ | ✓ | | |
| Bolivia | ✓ | ✓ | | |
| Burkina Faso | ✓ | ✓ | | |
| Burundi | | | | |
| Cameroon | ✓ | | | |
| Central African Republic | ✓ | | | |
| Chad | ✓ | | | |
| Congo, Dem. Rep. of | | | | |
| Congo, Rep. of | ✓ | | | |
| Côte d'Ivoire | ✓ | ✓ | | |
| Equatorial Guinea | | | | |
| Ethiopia | ✓ | | | |
| Ghana | ✓ | | | ✓ |
| Guinea | ✓ | | | |
| Guinea-Bissau | ✓ | | | |
| Guyana | ✓ | ✓ | | |
| Honduras | ✓ | | | |
| Kenya | ✓ | | | ✓ |
| Lao P.D.R. | ✓ | | | ✓ |
| Liberia | | | | ✓ |
| Madagascar | ✓ | | | |
| Mali | ✓ | | | |
| Mauritania | ✓ | | | |
| Mozambique | ✓ | ✓ | | |
| Myanmar | | | | |
| Nicaragua | ✓ | | | |
| Niger | ✓ | | | |
| Rwanda | ✓ | | | |
| São Tomé and Príncipe | | | | ✓ |
| Senegal | ✓ | ✓ | | |
| Sierra Leone | ✓ | | | |
| Somalia | | | | ✓ |
| Sudan | | | | ✓ |
| Tanzania | ✓ | | | |
| Togo | ✓ | | | |
| Uganda | ✓ | ✓ | ✓ | |
| Vietnam | ✓ | | | |
| Yemen, Republic of | ✓ | | | |
| Zambia | ✓ | | | |
| **Number of countries** | **31** | **8** | **1** | **8** |

[1/] *40 of the original 41 HIPCs (excluding Nigeria, which is not IDA-only).*

[2/] *Countries which had IMF-/IDA-supported programs during September 1995-July 1998.*

7. Of the 40 HIPCs, 31 have met the entry requirement on the basis of the above definition (Table 1).[7] Twenty-eight would meet the requirement on the basis of an ESAF arrangement since September 1996 and IDA-supported adjustment programs that were broadly on track, and three other countries would meet the entry requirement on the basis of ESAF arrangements between September 1995 and September 1996.[8]

8. It is proposed that a country would need to pass the entry milepost only once, even if there are subsequent interruptions in program performance. Such interruptions could, of course, lead to a postponement of the decision and completion points, as considered appropriate by the Boards.

9. Based on the above interpretation, nine countries have not met the entry requirement thus far: **Angola**, **Burundi**, **Democratic Republic of Congo**, **Equatorial Guinea**, **Liberia**, **Myanmar**, **São Tomé and Príncipe**, **Somalia**, and **Sudan**. Of these, seven (all except **Angola** and **Equatorial Guinea**) appear likely—although data are often very poor—to have potentially unsustainable debt ratios. Nearly all have suffered recent conflicts, and many have arrears to the Bank and IMF.

10. **The two-year "sunset clause"** on entry that was approved in September 1996 reflects the intention that the HIPC Initiative would not be a permanent facility. The sunset clause gives countries an incentive to adopt IDA- and IMF-supported adjustment programs. It also limits the time available for build-up of new debt, and thus provides for relief on debt which mostly predates the Initiative. These factors are likely to be less relevant, however, for those countries which have not yet met the entry requirements. Nearly all of the 7 countries which could potentially become eligible for assistance with an extension of the sunset clause are just emerging from conflict, and some may not have reached the stage at which they are able to enter into IMF- and IDA-supported programs. Furthermore, for some of these countries, access to new loans—and thus the moral hazard concern—would be limited.

11. Balancing these considerations, the Executive Directors of the IDA and Fund agreed to an extension of the initial deadline **(sunset clause**) for meeting the entry requirement until end-2000. They also agreed that a comprehensive review of the Initiative would be undertaken as early as 1999.

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[7] For analytical purposes leading up to the HIPC Initiative, a group of 41 developing countries was set up, including 32 countries with a 1993 GNP per capita of US$695 or less and 1993 present value of debt to exports higher than 220 percent or present value of debt to GNP higher than 80 percent. The list also included nine countries that received concessional rescheduling from Paris Club creditors (or are potentially eligible for such rescheduling). Nigeria has since been excluded as it is not IDA-only, a prerequisite under the Initiative.

[8] Honduras (1995), Kenya (1996), and the Republic of Congo (1996). The Republic of Congo may, subject to the IMF Board's decision, also have met the entry requirement on the basis of the approval of IMF emergency post-conflict assistance in July 1998.

## The decision point

12. Eligible countries reaching their decision points have generally completed three-year track records of adjustment and reform. At end-July 1998, eight countries had already reached their decision points, and **Mali** is expected to do so in September 1998. **Guinea-Bissau**, which was considered by the Boards on a preliminary basis in April 1998, will need to be reassessed after the end of the recent conflict. Including the ten early cases, and based on the assumption of satisfactory performance under IMF- and IDA-supported programs of adjustment and reform, a total of 26 countries (two-thirds of all HIPCs) could have reached their decision points by the end of 2000 (Table 2). Altogether, about 15 of these countries are expected to qualify for HIPC assistance. This time line could be affected by delays in implementing adjustment programs, and as a consequence the timing of some decision points could slip. For those countries which have not yet met the entry requirement, decision points could be reached in 2001 or later.

13. **Post-conflict countries** represent a special challenge. Their needs are great, opportunities for progress substantial, but institutional and administrative capacity is often severely limited. Many post-conflict countries have a substantial debt burden, and might ultimately be eligible for HIPC assistance. A joint Bank/Fund issues note on providing additional assistance to post-conflict countries has been prepared for consideration by the Interim and Development Committees.

14. In recognition of the exceptional needs of these countries, it is proposed here to provide an additional element of flexibility in the evaluation of the first three-year track record period leading up to the decision point for post-conflict countries. Specifically, satisfactory performance under economic recovery and emergency assistance programs supported by the Bank and the IMF could be counted, on a case-by-case basis, toward reaching the decision point. If agreed, this could potentially advance the decision point for Rwanda to 2000.[9]

## Interim measures

15. Several forms of HIPC assistance are presently available during the interim period between the decision and completion points. Bilateral and commercial creditors are in general expected to provide flow reschedulings on eligible debt service involving an NPV reduction of up to 80 percent during the second stage. **Côte d'Ivoire** and **Mozambiqu**e, which had not already received stock-of-debt operations from Paris Club creditors, are receiving such assistance. The Initiative also envisages that multilateral institutions could, at their discretion, provide some of their assistance during the interim period. In this context, IDA is providing grants instead of loans to eligible countries.[10] In addition, under certain conditions, supplemental IDA allocations could

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[9] Such a policy would require a change in the IMF ESAF-HIPC Trust Instrument, which is under preparation. Currently, emergency post-conflict assistance by the IMF may satisfy the entry requirement for the HIPC Initiative, as set out above, but it is not counted toward satisfying the first three year track record because of uncertainties over the strength of the underlying program.

[10] The share of a country's program support to come from IDA grants (rather than loans) is determined on a sliding scale according to the projected NPV of debt-to-export ratio at the completion point. Grants would account for up to one-third, one-half, or three-fourths of the IDA lending program, depending on whether the projected debt-to-export ratio at the completion point (on a present value basis) was between 250 and 300

be made during the interim period.[11] The IMF may provide some additional ESAF access in cases where this was justified by a strong program and a balance-of-payments need.[12] During the consultation process, views of other multilateral creditors were sought on the possibility of providing interim assistance; none has indicated so far that it would be in a position to do so—other than, in a few cases, in the context of an early rescheduling of arrears on concessional terms.

**Table 2 - HIPC Initiative: Earliest Timing of Decision Points** [1/]

| 1997 | 1998 | 1999 | 2000 | 2001 or later |
|---|---|---|---|---|
| ***Decision point reached*** | ***Decision point reached*** | | | |
| Benin | Côte d'Ivoire | Chad | Cameroon | Angola |
| Bolivia | Mozambique | Guinea | Congo, Rep. | Burundi |
| Burkina Faso | Senegal | Nicaragua | Madagascar | Central African Rep. |
| Guyana | | Niger | Rwanda [2/] | Congo, Dem. Rep. |
| Uganda | ***Possible*** | Sierra Leone | | Equatorial Guinea |
| | Ethiopia | Tanzania | | Honduras |
| | Guinea-Bissau | Vietnam | | Myanmar |
| | Mali | Yemen | | São Tomé and Prínc. |
| | Mauritania | Zambia | | |
| | Togo | | | |
| (5 countries) | (8 countries) | (9 countries) | (4 countries) | (8 countries) |

*Source: IMF and World Bank staff estimates.*

*1/ The timing shown in this table assumes that countries would reach their decision point at the earliest possible date under the framework of the Initiative on the basis of uninterrupted satisfactory performance under IMF- and IDA-supported adjustment programs. It should be emphasized that, when uncertainties in timing of decision points arose, the earlier timing has been presented on this table in order to make conservative (higher rather than lower) estimates of costs.*

*The earliest decision points shown for Chad, Côte d'Ivoire, Ethiopia, Madagascar, Mali, Mozambique, Republic of Congo, Senegal, Sierra Leone, and Vietnam are one year later than had been shown in the 1997 costing analysis.*

*Of the 40 HIPCs considered in this paper, this table excludes: Ghana, Kenya, and Laos (which have never received a concessional rescheduling from the Paris Club); Liberia and Somalia (for which information is poor); and Sudan (for which no allowance has been made for possible participation in the Initiative).*

*2/ For Rwanda to reach the decision point in 2000, the IMF Board would need to agree to count performance under post-conflict emergency assistance toward the 3-year track record prior to the decision point, as is recommended as a possibility in this paper.*

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percent, 300 and 350 percent, or over 350 percent. See "World Bank Participation in the Heavily Indebted Poor Countries Debt Initiative" (IDA/SecM96-926 of 8/26/1996).

11 Supplemental IDA allocations would be used, if necessary, to ensure that HIPCs with outstanding IBRD debt receive positive net transfers from the Bank Group during their interim period.

12 "Statement by the Staff Representative on Uganda; Initiative for Heavily Indebted Poor Countries (HIPC)--Final Document", Executive Board Meeting 97/44, of 4/23/1997 (BUFF/97/43 of 4/23/1997).

16. Some creditors and debtors have suggested there may be a need for greater use of interim measures by multilateral institutions. Several different concepts and objectives appear to underlie these suggestions. First, interim assistance might be aimed at providing additional cash flow assistance during the interim period to ease liquidity constraints in this period, while at the same time reducing the overall NPV of debt (as done by Paris Club creditors). Second, delivery of NPV debt reduction could be advanced ahead of the completion point, with the aim of providing earlier debt relief, without any impact on cash flow during the interim period. This is the nature of the assistance provided by the substitution of IDA grants for IDA credits.

17. Third, interim assistance has also been suggested as a way of providing "neutrality" between the amounts of assistance to be delivered for different possible completion points within the range of 3 years from the decision point. In this context, neutrality might be defined in terms of cash flow during the interim period, or in terms of the total amount of assistance to be provided under the Initiative. The underlying thrust of this argument is that countries should not be penalized in terms of their HIPC assistance for later completion points—within this three year period—which would allow implementation of additional reforms. However, it would not be possible to deliver neutrality without a substantive change in the framework of the Initiative, since it would require setting the amount of assistance independent of the timing of the completion point. Furthermore, these concerns about neutrality particularly applied to countries which reached decision points early on, for which several options for shortening the second stage were under consideration. In the future, countries reaching their decision points will normally be expected to implement three years of adjustment policies between the decision point and the completion point.

18. Executive Directors of the Fund concluded that the Fund already had sufficient instruments in place for the interim period as described above, and they were not in favor of more formal interim assistance by the Fund.

**The completion point**

19. Countries reach completion points after establishing a further track record of adjustment and reform, including appropriate social development policies, normally for three years following the decision point. In recognition of past policy performance, the Boards decided to shorten the interim period by between one-half and two years for five out of the first six countries found eligible for HIPC assistance. As a result, **Uganda** has already received HIPC assistance, and **Bolivia** and **Guyana** will follow shortly. By end-2000, staffs expect that at least six countries will have reached their completion points and received HIPC assistance.

20. If a country experiences delays in meeting the performance requirements during the interim period, this may lead to delays in reaching the completion point, as is envisaged in the HIPC framework.[13] The IDA and IMF Boards would decide this on a case-by-case basis, and the completion point would not be reached for a given country unless both Boards agreed. The amount of assistance committed at the decision point would be presumed to remain the same as long as the projected NPV of debt-to-export ratio remained within the plus/minus 10 percentage point target range; the ratio at the new completion point would be based on the latest annual debt-stock and export data available. Significant delays in performance could require a country to return to the beginning of the second stage and staffs would seek a reassessment from the Boards of the appropriate timing of the completion point.[14]

**Delivery of HIPC assistance**

21. Both the World Bank and the IMF have established the modalities for delivering their share of HIPC assistance and have allocated sufficient funds to cover the costs of the assistance packages agreed to date. Both have stated their commitment to meet their full share of the cost of the Initiative as eligible countries advance in the HIPC process. Ensuring full financing of the Initiative by all participants remains a challenge, however, as indicated by the estimates of potential costs in Section III below.

22. **The Bank's participation** in the HIPC Initiative takes place primarily through the HIPC Trust Fund, which provides relief on debt to IDA, either through the purchase and subsequent cancellation of outstanding IDA credits or through servicing of a portion of the beneficiary country's IDA debt.[15] The Bank transferred US$750 million from IBRD net income and surplus to the HIPC Trust Fund, thereby front loading its contribution ahead of actual cash needs, which arise only when countries reach their completion points. In July 1998, the Executive Directors recommended to the IBRD Board of Governors another transfer of US$100 million from fiscal year 98 net income, which will be considered in early October, during the Annual Meetings. On a commitment basis, the Trust Fund has earmarked US$500 million for the six countries that have reached their decision point to date, leaving an uncommitted balance of about US$300 million (including accrued investment income). The remainder of the relief committed by the Bank to this group of countries (US$205 million in NPV terms) is being provided by replacing IDA credits with grants, which will amount to about US$660 million in nominal terms over the period of fiscal years 1998-2001 (Table 3). The Bank intends to meet all the costs of its participation in the HIPC Initiative from its own resources.

13 "The HIPC Debt Initiative—Elaboration of Key Features and Proposed Procedures" (SecM96-927 of 8/26/1996 and EBS/96/135 of 8/26/96).

14 An amendment to the IMF ESAF-HIPC Trust Instrument for this purpose is under preparation.

15 As a rule, IDA debt-service coverage is offered to countries with debt-service ratios above 20-25 percent of exports.

**~~Table 3~~ HIPC Initiative: Planned Modalities and Financing of World Bank for Decision Points through June 30, 1998[1/]**
**(Amounts in US$**

| | Decision point | Completion point | HIPC Trust Fund: IDA debt cancellation | | HIPC Trust Fund: IDA debt service coverage | IDA grants | | Total NPV relief |
|---|---|---|---|---|---|---|---|---|
| | | | NPV relief | Nominal value [2/] | NPV | NPV relief | Nominal value | |
| **Uganda** | Apr-97 | April-98[3/] | 84 | 204 | 52 | 24 | 75 | 160 |
| **Burkina Faso** | Sep-97 | Apr-00 | 44 | 82 | - | - | - | 44 |
| **Bolivia** | Sep-97 | Sep-98 | - | - | 54 | - | - | 54 |
| **Guyana** | Dec-97 | Feb-99 | 27 | 62 | - | - | - | 27 |
| **Côte d'Ivoire** | Mar-98 | Mar-01 | - | - | - | 91 | 314 | 91 |
| **Mozambique** | Apr-98 | Mid-99 | 234 | 512 | - | 90 | 270 | 324 |
| **Total** | | | **389** | **860** | **106** | **205** | **659** | **700** |

*Source: Completion point papers for Bolivia and Uganda; President's Reports and final HIPC documents for the other countries.*

[1/] *The final compositon of IDA HIPC relief--grants, debt service option, cancellation of IDA debt--is determined with the country authorities concerned and included in the completion point document.*

[2/] *Estimated, until the settlement date, when the values are finalized.*

[3/] *IDA debt relief agreement signed April 98.*

23. **IMF participation** takes the form of special ESAF grants at the completion point that are deposited into an escrow account to cover debt-service payments to the IMF under an agreed schedule.[16] To finance these grants, several countries have contributed or made investments for the benefit of the ESAF-HIPC Trust totaling SDR 35 million as of end-June 1998 (Box 1). In addition, in March and April 1998, the IMF Board decided that no reimbursement will be made to the General Resources Account (GRA) from the ESAF Trust Reserve Account for the cost of administering the ESAF Trust during the fiscal years 1998 and 1999 and that an equivalent amount will be transferred from the ESAF Trust Reserve Account to the ESAF-HIPC Trust. In May 1998, the IMF transferred SDR 41 million to the ESAF-HIPC Trust for fiscal year 1998 and expects to make a similar payment on a quarterly basis to the ESAF-HIPC Trust for fiscal year 1999. The IMF Board has also authorized the transfer of up to an additional SDR 250 million from the ESAF Trust Reserve Account to meet the IMF's commitments under the Initiative. IMF commitments for the six countries that have already reached their decision points amount to US$270 million (SDR 200 million). IMF staff expects that projected resources are sufficient to meet the Fund's commitments under the HIPC Initiative through 1999.

[16] The IMF might, in exceptional cases, provide concessional loans instead of grants, if necessary, to help smooth a country's debt-service profile. Currently, such loans are not expected to be needed.

**Box 1 – Contributions to the IMF ESAF–HIPC Trust at end-July, 1998**[1/]

- **Finland:** Grant contribution of SDR 2.3 million (Fmk 15 million), received in December 1996, earmarked for special ESAF operations to reduce the NPV of debt of eligible HIPCs.
- **Iran:** Subsidy contribution accruing from net income on five equal annual investments of SDR 1.0 million at 0.5 percent per annum; first investment made in May 1997, second in May 1998. All investments are repayable together in May 2007.
- **Japan:** Grant contribution of SDR 95.6 million in installments in Japanese fiscal years 1997 through 2001. First contribution of SDR 27.2 million received in March 1998.
- **Malaysia:** Subsidy contribution accruing from net income on two investments totaling SDR 20 million at 2 percent per annum, repayable after 10 years. The first investment of SDR 15 million was made in late June 1998.
- **Netherlands:** Grant contribution of f.100 million, earmarked for the interim ESAF, is to be made in ten equal annual installments; first installment received in March 1998.
- **Nigeria:** Grant contributions of SDR 1.08 million per year for 10 years. First contribution received in July 1997.

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[1/] *Includes also contributions for subsidizing the interest rate on interim ESAF operations to ESAF-eligible countries.*

24. **Multilateral Development Bank (MDB) participation in the HIPC Initiative.** Most MDBs have obtained the appropriate institutional approvals to enable them to participate in the HIPC Initiative, and have defined the modalities through which they intend to deliver their assistance (Box 2). These vehicles include: (i) channeling resources through the HIPC Trust Fund, either for debt-service reduction or debt buybacks; (ii) using similar, self-administered, trust funds; (iii) rescheduling current maturities or arrears on concessional terms tailored to provide the agreed NPV debt relief; and (iv) refinancing on grant terms.

25. Several MDBs face constraints in covering the full cost of their participation in the HIPC Initiative from their own resources. Some have opted to use the Bank's HIPC Trust Fund mechanism to help deliver their share of HIPC relief to individual countries, which enables them to receive additional contributions, beyond their own resources if necessary, from interested donors. Thus far, sixteen bilateral donors have made contributions or pledges to the HIPC Trust Fund to assist MDBs, amounting to about US$210 million (Box 3). In addition, the Bank's Interest Subsidy Fund (ISF) has been amended by the Board to allow contributors to use their share of the excess resources in the ISF for debt relief on multilateral debt under the HIPC Initiative. Nine countries have provided firm indications that they will make approximately US$90 million of ISF resources available to the HIPC Trust Fund, for an overall bilateral contribution of about US$300 million. Approximately US$80 million of these funds have been earmarked to help finance the share of HIPC debt relief to be delivered by the African Development Bank for countries that have already reached their decision points. Based on potential cost estimates, additional donor contributions will be needed to ensure that all multilateral institutions are in a position to meet their share of the cost of HIPC assistance.

**Box 2 – Delivery of HIPC Debt Relief from MDBs**

- **African Development Bank (AfDB)/ African Development Fund (AfDF)** will contribute between $260 million and $330 million of its own resources to the HIPC Trust Fund and use this facility to repurchase AfDB debt. The AfDB share will be supplemented with contributions to the HIPC Trust Fund from donors.
- **Arab Bank for Economic Development in Africa (BADEA)** will use concessional reschedulings to provide the necessary NPV relief.
- **Caribbean Development Bank (CDB) and Caricom Multilateral Clearing Facilities (CMCF)** have confirmed their participation in principle, and are in the process of finalizing the modalities.
- **Central American Bank for Economic Integration (CABEI)** has agreed to participate in principle. In the Nicaraguan case, CABEI intends to use concessional arrears clearance as part of its contribution.
- **Corporación Andina de Fomento (CAF)** exposure to HIPCs is limited to Bolivia. CAF will deliver its relief through two modalities: (i) prepayment, in the fall of 1998, of some of Bolivia's future debt maturities with CAF with resources from net profits; and (ii) provision of annual grants (over 9 years) to reduce debt service as it falls due. The remainder will be provided by donors.
- **East Africa Development Bank (EADB) and Eastern and Southern African Trade and Development Bank (PTA Bank)** have not yet determined modalities.[1/]
- **Economic Community of West African States, Fund for Cooperation Compensation and Development (ECOWAS Fund)** is in the process of assessing its participation in the Initiative.
- **European Union (EU)/European Investment Bank (EIB)**. The EU will provide grants to reduce debt service on EU loans.
- **Fund for the Financial Development of the River Plate Basin (FONPLATA)** exposure to HIPCs is limited to Bolivia. It will provide its debt relief through loan restructuring. A concessional credit will allow Bolivia to repay or reduce less concessional FONPLATA loans. FONPLATA's resources will be supplemented by donors.
- **Inter-American Development Bank (IDB)** will either subsidize debt service payments on its loans, write off loans, or both. The Ordinary Capital (OC) loans could receive an interest rate subsidy through the Intermediate Financing Facility Account (IFF) and/or Fund for Special Operations (FSO) loans could be subjected to a write-off of nominal amounts needed to achieve the NPV reduction.
- **International Fund for Agricultural Development (IFAD)** established a self-administered facility, which will provide debt-service relief.
- **Islamic Development Bank (IsDB)** will reschedule its stock of loans to provide the necessary NPV relief.
- **Nordic Development Fund (NDF)** will use the HIPC Trust Fund. The NDF is making country-specific contributions to the HIPC Trust Fund to cover its share of the NPV debt relief to the country. The HIPC Trust Fund will use that contribution to cover 100 percent of the country's debt service due to the NDF as it falls due, until the contribution is exhausted.
- **Organization of Petroleum Exporting Countries, Fund for International Development (OPEC Fund)** will provide concessional loans at the completion point to enable eligible HIPCs to refinance older less concessional OPEC Fund loans.
- **West African Development Bank (BOAD)** is assessing how its participation can be financed.

[1/] *During the final reconciliation process of Uganda's debt, it was learned that the Ugandan claims of these two African-based multilateral creditors on private borrowers were guaranteed by the Ugandan government and are therefore subject to action under the HIPC Initiative. These creditors, albeit small (about 0.5% of the MDB exposure in Uganda), have been contacted to request their participation.*

**Linking debt relief to social development**

26. The HIPC framework has always emphasized the need to link debt reduction with effective long-term policies for economic and social development and poverty alleviation.[17] Social development criteria are developed jointly with country authorities and explicitly incorporated into HIPC documents. During Board discussions, Directors often recommended that the savings obtained from HIPC debt relief be channeled to the social sectors. However, a simple one-to-one relationship between debt-service relief and social expenditures cannot always be easily established for a number of reasons.

27. First, HIPC debt relief is primarily targeted at lowering external debt to sustainable levels, with benefits accruing over time and not only in the short run. The time profile of HIPC assistance may differ from that of desirable changes in social spending. Second, the fiscal space created by HIPC debt relief for direct increases in social expenditures is determined by the size of the actual cash flow savings generated by debt reduction, which in some cases may not be very large in the early years, when compared to debt service paid in the past, especially in the case of countries where not all debt service due was in fact being paid. Third, governments are often faced with absorptive capacity constraints to implement social programs expeditiously and efficiently. HIPC debt relief should be used in such a way as to maximize development effectiveness. Finally, when considering the resources available for social development, it should be recognized that most HIPCs are already receiving large positive net transfers from creditors and donors that enable them to pursue their development agenda, and debt relief should not be seen as a substitute for continued inflows of development finance.

28. The Executive Directors of the IDA and Fund agreed that the link between the HIPC Initiative and social development should be viewed in the broader perspective of the overall poverty alleviation efforts supported by creditors and donors through various instruments, including lending, policy dialogue on poverty strategies and social sector expenditure reviews. Governments should be encouraged, as they are under the HIPC framework, to allocate larger shares of budgetary spending to priority sectors. IDA and other creditors and donors have developed new instruments (such as sector investment programs) to work together to alleviate absorptive capacity constraints and accelerate the pace of progress towards the poverty reduction and social development goals for the 21st century.[18] The Executive Directors of the IDA and Fund agreed that efforts should be made to integrate operational plans to achieve these targets into the social development performance monitoring programs developed under the HIPC framework.

[17] For more details on the linkage of debt relief to social development, see ANNEX I.

[18] These goals are based on UN Conferences and Resolutions and were set out in “Shaping the 21st Century: the Contribution of Development Cooperation”, issued by the OECD’s Development Assistance Committee.

**<u>Box 3</u> - HIPC Trust Fund – Bilateral Donor Funding**
**(as of August 10, 1998)**

***1. Total donor contributions paid in = US$140 million equivalent (in cash or promissory notes)***

| | | | |
|---|---|---|---|
| Canada[1] | $5.6 million | Netherlands | $38.0 million |
| Greece | $1.0 million | Norway | $26.0 million |
| Japan | $10.0 million | Sweden | $12.0 million |
| Luxembourg | $0.5 million | Switzerland | $14.0 million |
| Denmark | $22.0 million | U.K. | $10.5 million |

***2. Additional contributions pledged for 1998 = Approximately US$70 million equivalent[2]***

- Belgium has indicated it will contribute US$8 million (SDR6 million) in 1998 for the AfDB.
- Finland has indicated that it will make an initial contribution of about US$12 million (for the Core Component, Mozambique and Burkina Faso).
- Switzerland has pledged an additional US$14 million equivalent; this is expected to become available in the course of 1998 (once there are significant contributions from other donors).
- Portugal has indicated it will contribute US$15 million (for Mozambique--US$5 million of which for the gap fill effort).
- Spain has indicated it will contribute US$15 million (for Bolivia).
- Italy has indicated the intention to contribute (specifics yet to be determined).

**3. *Proposed contributions through reallocation of ISF (Interest Subsidy Fund) resources [3]= US$92 million***

| | | | |
|---|---|---|---|
| Australia | $5.3 million | France | $20.7 million |
| Canada | $22.0 million | Belgium | $3.7 million |
| Netherlands | $22.8 million | Luxembourg | $0.1 million |
| Norway | $4.4 million | UK | Up to $10.0 million |
| Denmark | $3.3 million | | |

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*[1] Contribution for Mozambique to help fill the gap (contribution agreement included C$8 million; initial payment of C$6 million received).*

*[2] In addition, Indonesia announced in Hong Kong that it would contribute US$10 million to the HIPC Trust Fund.*

*[3] The UK contribution is for the Mozambique gap fill effort. US$7 million of the US$22.8 million from the Netherlands, US$1.5 million of the US$3.7 million from Belgium, and US$5 million of the US$20.7 million from France is also for the Mozambique gap fill effort. Contributions will be made either by transferring funds from the ISF to the HIPC Trust Fund or by authorizing the use of funds in the ISF for the provision of debt relief under the HIPC Initiative.*

## III. UPDATED COST

29. This section presents estimates of the costs of the HIPC Initiative, which have been updated since the previous costing estimates of July 1997 based on new information.[19] The costing analysis is based on the most recent country-specific debt sustainability analyses presented to the Boards, supplemented in some cases by more recent information prepared by Bank and IMF staff. The country coverage is described in Box 4 and listed in Table 4. As in earlier costing exercises, a number of important caveats apply. The cost estimates rely on important assumptions, and on debt projections which have mostly not been fully reconciled between creditors and debtor governments (see Box 5). Therefore, the estimates need to be interpreted with caution and should be seen as subject to a substantial margin of uncertainty. In making these estimates, staffs have aimed to provide realistic but conservative estimates of costs; thus, in cases where a choice of targets or timing was required, the option implying a higher cost was used. The costing exercise is

**Box 4 – Country Coverage of Cost Estimates**

- The starting point of the costing analysis is the debt sustainability analysis (DSA) information available for 37 of the 40 HIPCs shown in Table 1. As in earlier exercises, the costing estimates do not include **Liberia** and **Somalia** for lack of sufficient information, and no allowance is made for the possible participation of **Sudan** in the Initiative.
- **Ghana**, **Kenya** and **Laos** have never received a concessional rescheduling from the Paris Club, and thus have not made full use of traditional mechanisms, a prerequisite under the Initiative.[1/]
- **Benin** and **Senegal** have reached their respective decision points, at which time it was confirmed that existing debt relief mechanisms were sufficient to attain a sustainable debt position.
- Twelve of the remaining *32* HIPCs appear to have sustainable external debt without HIPC assistance, on the basis of currently available DSAs: **Angola**, **Cameroon**, **Central African Republic**, **Chad**, **Republic of Congo**, **Equatorial Guinea**, **Guinea**, **Honduras**, **Sierra Leone**[2/], **Togo**, **Vietnam**, and **Yemen**.
- On the basis of current DSAs, and assumed target ratios of 200% NPV of debt-to-exports, the remaining twenty countries would require HIPC assistance. These are the countries included in the cost estimates and listed in Table 4.
- Formal DSAs are unavailable or out-of-date for some countries in this last group: **Burundi**, **Democratic Republic of Congo**, and **Myanmar**. For these countries (and other countries in conflict or post-conflict situations) information is very poor, and cost estimates involve considerable amounts of uncertainty.

[1/] In the case of **São Tomé and Príncipe**, which is included in the cost estimates, the country has yet to enter into Bank- and Fund-supported adjustment programs and receive a concessional rescheduling from the Paris Club

[2/] ***Sierra Leone*** *was initially not expected to require HIPC assistance, when assessed prior to the conflict. While it appears likely that there has been a deterioration of the export base since then, staff does not yet have sufficient information to assess whether Sierra Leone would require assistance.*

[19] "HIPC Initiative--Estimated Costs and Burden Sharing Approaches," EBS/97/127 of 7/7/1997 and IDA/SecM97-306 of 7/27/97.

not intended to prejudge the results of the country-specific tripartite debt sustainability analyses, or the Boards' decisions regarding the eligibility of individual countries to qualify for assistance under the HIPC Initiative, the NPV of debt-to-export targets, the decision points, or completion points to be set for those countries.

**Table 4 - HIPC Initiative: Countries Included in Costing Update**

| **Countries (20)** | **Cost projection based on:** | | | |
|---|---|---|---|---|
| | **Decision point commitment in principle (agreed NPV of debt-to-export target in parentheses)** | **Preliminary HIPC document discussed by IMF and Bank Boards (assumed NPV of debt-to-export target in parentheses)** | **Additional countries potentially eligible under openness/fiscal criteria (costs based on NPV of debt-to-fiscal revenue target of 280 percent) 1/** | **Other countries (assumed NPV of debt-to-export target of 200 percent)** |
| Bolivia<br>Burkina Faso<br>Burundi<br>Congo, Dem. Rep.<br>Côte d'Ivoire<br>Ethiopia<br>Guinea-Bissau<br>Guyana<br>Madagascar<br>Mali 2/<br>Mauritania<br>Mozambique<br>Myanmar<br>Nicaragua<br>Niger<br>Rwanda<br>São Tomé and Prínc.<br>Tanzania<br>Uganda<br>Zambia | Bolivia<br>(225%)<br><br>Burkina Faso<br>(205%)<br><br>Côte d'Ivoire<br>(141%)<br><br>Guyana<br>(107%)<br><br>Mozambique<br>(200%)<br><br>Uganda<br>(202%) | Guinea-Bissau<br>(200%)<br><br>Mali<br>(200%) | Nicaragua | Burundi<br>Congo, Dem. Rep.<br>Ethiopia<br>Madagascar<br>Mauritania<br>Myanmar<br>Niger<br>Rwanda<br>São Tomé and Prínc.<br>Tanzania<br>Zambia |

*Source: IMF and World Bank staff estimates, based on final and preliminary HIPC documents and most recent DSAs.*

*1/ "HIPC Initiative--Guidelines for Implementation", EBS/97/75 of 4/21/1997 and IDA/R97-35 of 4/22/1997.*

*2/ Country added since July 1997 costing analysis, "HIPC Initiative--Estimated Costs and Burden Sharing Approaches" (EBS/97/127 of 7/7/1997 and IDA/M97-306 of 7/7/1997).*

## Timing of decision and completion points

30. The timing of decision points which has been assumed for the purposes of these costing estimates is the earliest that might be proposed (Table 2). Based on actual performance under reform programs, some decision points may be reached later. All countries found eligible for HIPC assistance are assumed to have completion points three years following the decision point,

excepting those countries for which a shortening has been: (i) agreed by the Boards (**Bolivia**, **Burkina Faso**, **Guyana**, **Mozambique**, and **Uganda**); or (ii) proposed in the preliminary HIPC document (**Mali**).

**Box 5 – Assumptions used for Cost Estimates**

- **Sunset clause**: The estimates assume the Boards agree to extend the entry period for eligibility for the Initiative to countries that adopt Bank/Fund-supported programs by end-2000, as is recommended in Section II.
- **Macro-economic framework**: The estimates are based on the medium-term macro-economic framework developed by staff country teams, including especially the export and debt data and projections. In some cases, these data may be subject to wide margins of uncertainty.
- **Timing of assistance**: It is assumed that all countries which are potentially eligible for HIPC Initiative assistance actually request such assistance, and assistance is delivered without delays (meaning no slippages in implementing economic and social reform programs).
- **Debt sustainability targets**: An NPV of debt-to-export target of 200 percent is assumed in the baseline scenario for all countries, excepting countries which (i) have already reached the decision point, (ii) have had preliminary HIPC discussions at the Boards; or (iii) would be projected to qualify under the fiscal/openness criteria.
- **Burden-sharing**: For those countries which have already received commitments of assistance, the division of costs by creditor group reflects the amounts shown in each decision point document. For prospective cases, burden sharing is assumed to be fully proportional.
- **Russian claims** are included with those of other Paris Club creditors. The treatment of HIPC debt to the Russian Federation follows the September 1997 agreement on Russian participation as a creditor in the Paris Club, which provides for an up-front discount of 70 or 80 percent prior to the application of traditional concessional debt relief mechanisms (Naples terms).

### Aggregate cost estimates

31. In the current estimates, there are 20 countries for which costs are projected under the HIPC Initiative (Table 4). One country has been added since last year's costing estimates: **Mali**, for which a preliminary decision point discussion has already taken place. Of the 20 countries with cost projections, three are now expected to receive HIPC assistance under the fiscal/openness criteria: **Côte d'Ivoire** and **Guyana**, which have already reached their decision points, and **Nicaragua**.[20] [21]

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[20] Nicaragua is now expected to meet the requirements for eligibility under the fiscal/openness criteria as well as under the NPV of debt-to-exports framework of the Initiative. In the current costing projections, it would receive more assistance under the former. However, the amount of required assistance remains very close to that projected in July 1997.

[21] Mauritania is now expected to be eligible for more assistance under the NPV of debt-to-exports framework of the Initiative than under the fiscal/openness criteria.

32. Using the baseline assumptions, the estimated aggregate cost of the Initiative would be US$8.2 billion, in 1996 present value terms (US$9.4 billion in 1998 NPV terms) using a 7 percent discount rate, as in the earlier cost estimates (Table 5).[22] [23] This represents an increase of about 11 percent from the baseline cost estimate made in July 1997 of US$7.4 billion in 1996 NPV terms due to revisions in the underlying debt sustainability analyses. While a number of country estimates have changed, an increase in the potential assistance for post-conflict countries, and particularly the **Democratic Republic of Congo (DRC)**, mainly accounts for the higher cost estimate this year (Chart 1). The change for **DRC** is based largely on new projections of exports which incorporate a slower resumption in minerals export volume growth and lower world prices, together with higher debt through a longer buildup of late interest and arrears. Wide confidence intervals should be attached to the estimates for DRC and other post-conflict countries.[24] [25]

33. Following the practice of earlier costing analyses, country-specific estimates are not presented here, as they might create misleading expectations when in many cases data remain poor and could change substantially. At the same time, staffs will begin including a range of tentative cost estimates in the context of country-by-country debt sustainability analyses prepared jointly by Bank and IMF staffs.

34. Aggregate costs for the countries considered so far under the Initiative have changed little since last year. The total cost for the eight countries which have reached the decision points, or had preliminary HIPC documents[26] are now estimated at US$2.8 billion in 1996 NPV terms. The costs estimated for the same group of countries (but with no costs expected for Mali) last year were US$3.1 billion. The decline in costs for this group is mostly accounted for by the lower assistance for **Côte d'Ivoire**, with the delay of almost one-year in its decision and completion points from those estimated previously.

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[22] Paragraph 37 below discusses the impact on overall costs of using a different discount rate.

[23] For a breakdown of costs in 1998 NPV terms, see Table 7.

[24] If Burundi, DRC and Myanmar were unable to agree to Bank and IMF-supported programs prior to 1999, aggregate costs would fall by around US$0.4 billion in 1996 NPV terms.

[25] Highly tentative estimates of total costs for Liberia and Somalia, based on debt data from the Debtor Reporting System and some creditors, suggest that total costs for these two countries would be around US$1 billion, about evenly divided between bilateral and multilateral creditors. For Sudan, total costs could be in the order of US$4 ½ billion, of which about one-third would fall to multilateral creditors. These figures were considered too tentative to be included in this year's costing update.

[26] Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Guinea-Bissau, Mali, Mozambique, and Uganda. Cost estimates for Guinea-Bissau are based on those presented in the preliminary HIPC document; the situation will need to be reassessed after the cessation of the current conflict.

**Table 5 - HIPC Initiative: Comparison with July 1997 Cost Estimates [1/]**
**(US$ billion in 1996 NPV terms)**

| | Total | | Countries at or approaching decision point [2/] | | Other countries which have met entry requirement [3/] | | Countries which have not met entry requirement [4/] | |
|---|---|---|---|---|---|---|---|---|
| | **July 1997 baseline** | **Current baseline** | **July 1997 baseline** | **Current baseline** | **July 1997 baseline** | **Current baseline** | **July 1997 baseline** | **Current baseline** |
| **Total costs** | **7.4** | **8.2** | **3.1** | **2.8** | **3.2** | **3.0** | **1.2** | **2.3** |
| **Bilateral and commercial creditors** | **3.2** | **4.0** | **1.4** | **1.3** | **1.2** | **1.2** | **0.6** | **1.5** |
| Paris Club [5/] | 2.6 | 3.5 | 1.2 | 1.1 | 0.9 | 0.9 | 0.5 | 1.5 |
| Other official bilateral [5/] | 0.4 | 0.5 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.0 |
| Commercial | 0.1 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| **Multilateral creditors** | **4.2** | **4.2** | **1.7** | **1.5** | **2.0** | **1.9** | **0.6** | **0.9** |
| World Bank | 1.6 | 1.7 | 0.8 | 0.7 | 0.7 | 0.6 | 0.2 | 0.4 |
| IMF | 0.8 | 0.7 | 0.3 | 0.3 | 0.4 | 0.3 | 0.1 | 0.2 |
| AfDB/AfDF | 0.7 | 0.7 | 0.2 | 0.2 | 0.3 | 0.3 | 0.1 | 0.2 |
| IDB | 0.4 | 0.4 | 0.2 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 |
| Other | 0.8 | 0.8 | 0.2 | 0.2 | 0.4 | 0.5 | 0.1 | 0.1 |

*Source: IMF and World Bank staff estimates.*

[1/] *Cost estimates were based on the fully proportional approach to burden-sharing; they reflect HIPC documents for those countries which have already reached the decision point.*

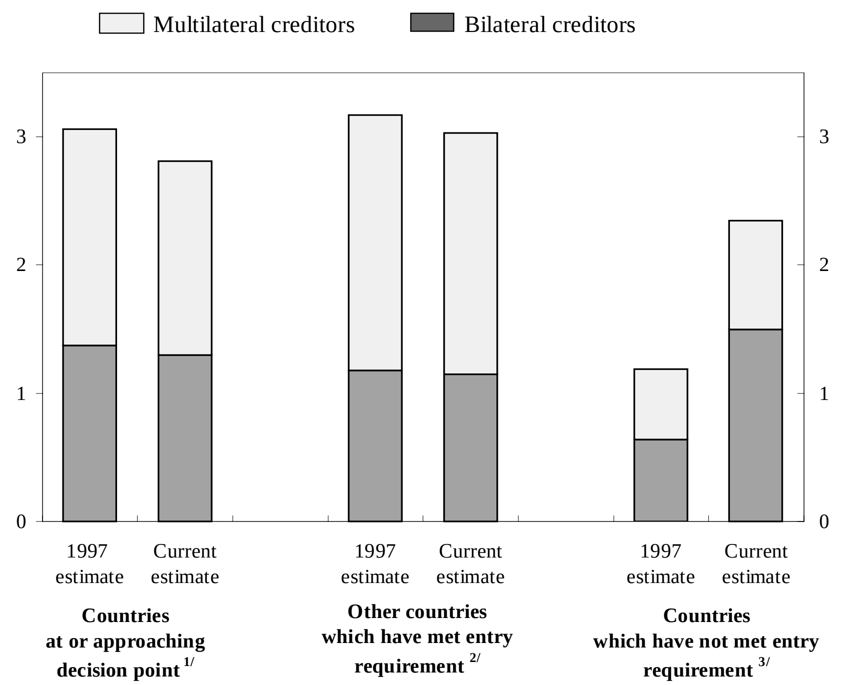
[2/] *Bolivia, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Guyana, Mali, Mozambique, and Uganda.*

[3/] *Ethiopia, Madagascar, Mauritania, Nicaragua, Niger, Rwanda, Tanzania, and Zambia.*

[4/] *Burundi, Dem. Rep. of Congo, Myanmar, and São Tomé and Príncipe.*

[5/] *Adjusted to include the costs for the Russian Federation together with Paris Club creditors.*

**Chart 1 - HIPC Initiative: Comparison of Current Cost Estimates with July 1997 Estimates**
**(US$ billion)**




[1/] *Bolivia, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Guyana, Mali, Mozambique, and Uganda.*
[2/] *Ethiopia, Madagascar, Mauritania, Nicaragua, Niger, Rwanda, Tanzania, and Zambia.*
[3/] *Burundi, Dem. Rep. of Congo, Myanmar, and São Tomé and Príncipe.*

35. However, the cost estimates for the group of countries that have not yet met the entry requirement has nearly doubled since last year. This wide swing reflects the poor quality of debt and exports statistics available, as well as a serious erosion of these countries' export bases. Cost estimates for these countries are not expected to stabilize before the underlying economic situations stabilize. As more stable conditions develop, staffs will prepare more detailed DSAs that would provide a firmer assessment of the debt situation of these countries and the likely debt relief required.

36. Alternative scenarios show the sensitivity of cost estimates to different assumptions (Table 6). Total costs would be an estimated US$7.1 billion in 1996 dollars if an NPV of debt-to-exports target of 220 percent were chosen for remaining eligible countries (except Nicaragua, which is now projected to be eligible under the fiscal/openness criteria). On the other hand, aggregate costs would be an estimated US$9.2 billion if each eligible country's export growth were lower by 2 percentage points in each year prior to the completion point.

**Table 6 - HIPC Initiative: Estimates of Potential Costs**

**(US$ billion in 1996 NPV)**

| | Baseline | Alternative Assumptions: NPV of debt-to-exports target of 220 % rather than 200 % [1/] | Alternative Assumptions: Export growth rate 2 percentage points lower in every year before completion point | Baseline excl. countries not yet meeting entry requirement [2/] |
|---|---|---|---|---|
| **TOTAL COSTS** | **8.2** | **7.1** | **9.2** | **5.9** |
| **Bilateral and commercial creditors**[3/] | **4.0** | **3.4** | **4.4** | **2.5** |
| Paris Club | 3.5 | 3.0 | 3.9 | 2.0 |
| Other official bilateral | 0.5 | 0.4 | 0.5 | 0.4 |
| Commercial | 0.0 | 0.0 | 0.0 | 0.0 |
| **Multilateral creditors** [3/] | **4.2** | **3.6** | **4.8** | **3.4** |
| World Bank | 1.7 | 1.4 | 2.0 | 1.3 |
| IMF | 0.7 | 0.6 | 0.8 | 0.6 |
| AfDB/AfDF | 0.7 | 0.6 | 0.8 | 0.5 |
| IDB | 0.4 | 0.4 | 0.4 | 0.4 |
| Other | 0.8 | 0.7 | 0.9 | 0.7 |

*Source: IMF and World Bank staff estimates.*

[1/] *For all countries for which costs are accounted here, excluding Uganda (which has reached the completion point); Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, and Mozambique (which have reached decision point); Mali and Guinea-Bissau (for which specific targets have been assumed based on preliminary discussions); and Nicaragua (which is estimated to receive assistance under the fiscal/openness criteria).*

[2/] *Burundi, Dem. Rep. of Congo, Myanmar, and São Tomé and Príncipe.*

[3/] *Proportional burden-sharing between creditors is assumed. The figures reflect HIPC documents for those countries which have already reached the decision point.*

37. The cost estimates are sensitive to the choice of a discount rate to discount costs to a single base year. Costs have been calculated for each country in NPV terms at their respective completion point, and then discounted to 1996 US dollar terms using a 7 percent discount rate, as in the earlier cost estimates. If instead a discount rate of 6 percent were used, which is closer to current market rates, total costs would be approximately US$0.4 billion higher (Table 7). In addition, costs stated in 1998 dollar terms would be higher by a further US$1.1 billion. Thus, aggregate costs at current discount rates (in 1998 NPV terms) would total US$9.7 billion.

**<u>Table 7</u> – HIPC Initiative: Baseline Cost Estimates under Different Discounting Assumptions** [1/]
**(US$ billion)**

| | **7 % discount rate and 1996 NPV terms (1)** | **6 % discount rate and 1996 NPV terms (2)** | **7 % discount rate and 1998 NPV terms (3)** | **6 % discount rate and 1998 NPV terms (4)** |
|---|---|---|---|---|
| **Total costs** | **8.2** | **8.6** | **9.4** | **9.7** |
| **Bilateral and commercial creditors** | **4.0** | **4.2** | **4.5** | **4.7** |
| Paris Club | 3.5 | 3.7 | 4.0 | 4.1 |
| Other official bilateral | 0.5 | 0.5 | 0.5 | 0.5 |
| Commercial | 0.0 | 0.0 | 0.0 | 0.0 |
| **Multilateral creditors** | **4.2** | **4.4** | 4.9 | **5.0** |
| World Bank | 1.7 | 1.8 | 1.9 | 2.0 |
| IMF | 0.7 | 0.7 | 0.8 | 0.8 |
| AfDB/AfDF | 0.7 | 0.7 | 0.8 | 0.8 |
| IDB | 0.4 | 0.4 | 0.4 | 0.4 |
| Other | 0.8 | 0.8 | 0.9 | 0.9 |

*<u>Source</u>: IMF and World Bank staff estimates.*

[1/] *Cost estimates were based on the fully proportional approach to burden-sharing ; they reflect HIPC documents for those countries which have already reached the decision point.*

**Costs by creditor group**

38. HIPC costs are divided between multilateral and bilateral creditor groups based on decision point agreements reached and, for future decision points, based on proportional burden sharing.[27] On this basis, baseline costs for multilateral creditors would be US$4.2 billion in 1996 NPV terms, or 51 percent of the total US$8.2 billion in costs (Table 5). Of this, the World Bank's and IMF's share would be, respectively, US$1.7 billion and US$0.7 billion. Bilateral and commercial creditors would meet just under half of total costs, or US$4.0 billion. In comparison with last year's estimates, the cost to bilateral creditors has risen while that of multilateral creditors is unchanged. This fluctuation in cost share is due to the different mix of country-specific costs, and most of the increase for bilateral creditors reflects the increase for the **Democratic Republic of Congo**. Indeed, costs excluding countries which have not yet entered the Initiative are lower in total and for each creditor group (Chart 1). Cost estimates for the group of mostly post-conflict countries are likely to remain volatile.

39. In some cases, the assistance provided by Paris Club creditors through Lyon terms (80 percent NPV reduction on eligible debt) and the assumption of comparable treatment from other bilateral and commercial creditors may not provide sufficient assistance to reach the bilateral creditors' required share of assistance. This has already occurred in the case of **Mozambique**. Based on current cost estimates, other such cases will arise in the future: **Guinea-Bissau**, **Democratic Republic of Congo** and **Nicaragua**, and--to a lesser extent--**Madagascar**, **Mauritania**, **Rwanda**, and **São Tomé and Príncipe**.

40. The G-8 Birmingham Communiqué called on countries to forgive aid-related bilateral debt or take comparable action for reforming least developed countries. Debt relief on official development assistance loans (ODA) beyond that required under Lyon terms[28] could reduce the extent of the problem for a number of the above countries. Based on available information (which may be incomplete), cancellation of ODA debt would eliminate the burden-sharing problem for at least one country**—Rwanda**.

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27 Proportional burden sharing requires that the amounts of total HIPC assistance required from bilateral and multilateral creditors should be based on their respective shares of the present value of outstanding debt projected at the completion point after traditional debt-relief mechanisms have been applied (i.e. a Naples terms stock-of-debt operation on all eligible bilateral debt with a 67 percent reduction in present value terms).

28 Under a Lyon terms stock operation (as under Naples terms), ODA loans are rescheduled over 40 years with 16 years grace at an interest rate at least as concessional as the original interest rate. Creditors may voluntarily undertake further action.

## Time profile of HIPC assistance

41. The time profile of commitments of HIPC assistance is shown in Table 8, based on the assumed earliest decision points presented in Table 2. On this basis, 44 percent of total commitments (in 1996 dollar terms) could be made by end-1998; 31 percent of total assistance had already been committed by end-July 1998. A further 28 percent of commitments would take place in 1999-2000, with the remainder for 2001 or later depending on the timing of difficult post conflict cases. The dollar amount of commitments which could take place in 1997-98 (under relatively optimistic decision point assumptions) remains similar to the projections made last year.

**Table 8 - HIPC Initiative: Estimated Annual Profile of Potential Costs Committed at Decision Points[1/]**
**(US$ billion in 1996 NPV terms)**

| | Actual | | Projection | | | | |
|---|---|---|---|---|---|---|---|
| | **1997** | **1998 Jan.-Jul.** | **1998 Aug.-Dec.** | **1999** | **2000** | **2001 and later** | **Total** |
| **Total costs** | **1.03** | **1.48** | **1.04** | **1.84** | **0.47** | **2.34** | **8.20** |
| Bilateral and commercial creditors | **0.30** | **0.86** | **0.41** | **0.78** | **0.11** | **1.50** | **3.95** |
| Paris Club | 0.26 | 0.69 | 0.30 | 0.66 | 0.09 | 1.47 | **3.47** |
| Other official bilateral | 0.04 | 0.17 | 0.10 | 0.11 | 0.02 | 0.01 | **0.46** |
| Commercial | 0.00 | 0.00 | 0.00 | 0.01 | 0.00 | 0.01 | **0.02** |
| **Multilateral creditors** | **0.72** | **0.61** | **0.63** | **1.07** | **0.36** | **0.85** | **4.25** |
| World Bank | 0.25 | 0.34 | 0.31 | 0.30 | 0.12 | 0.37 | **1.69** |
| IMF | 0.13 | 0.11 | 0.05 | 0.25 | 0.03 | 0.15 | **0.71** |
| AfDB/AfDF | 0.04 | 0.12 | 0.16 | 0.13 | 0.04 | 0.21 | **0.70** |
| IDB | 0.18 | 0.00 | 0.00 | 0.18 | 0.00 | 0.00 | **0.35** |
| Other | 0.13 | 0.05 | 0.11 | 0.22 | 0.17 | 0.11 | **0.79** |
| **Memorandum item** | | | | | | | |
| Time profile (in % of total cost) | 13 | 18 | 13 | 22 | 6 | 29 | 100 |

*Source: IMF and World Bank staff estimates.*

[1/] *Annual costs on a commitment basis at earliest possible decision point, for delivery in NPV terms at the completion point.*

## IV. NEXT STEPS

42. The following next steps were agreed by the Executive Directors of the IDA and Fund:

(i) Staff will prepare another update of the costing estimates in the summer of next year.

(ii) Staff will continue to prepare regular progress reports for the Boards and the Interim and Development Committees.

(iii) A comprehensive review of the Initiative will be prepared as early as 1999.

## OBJECTIVES AND ACHIEVEMENTS OF THE HIPC INITIATIVE

## IN THE FIRST TWO YEARS

1. The HIPC Initiative was born of the recognition, in the early 1990s, that while the external debt crisis had largely been solved for middle-income countries, there was still a significant number of low-income countries for which the burden of debt was likely to remain above sustainable levels over the medium term, even with strong policy performance and the full use of existing debt-relief mechanisms. The fundamental objective of the Initiative is to ensure for those countries with a track record of adjustment and reform a robust exit from debt rescheduling and the achievement of debt sustainability.

2. The guiding principles for action under the Initiative were stated in "A Framework for Action to Resolve the Debt Problems of the Heavily Indebted Countries."[1] This framework builds on pre-existing debt relief efforts, but contrasts with past approaches in four major respects: (i) it places **debt sustainability** as the explicit objective, so as to enable countries to focus on developmental objectives and ensure that reform efforts are not put at risk by high debt and debt-service burdens; (ii) it is comprehensive, in that assistance is provided by **all creditors**, including multilateral creditors; (iii) it is **participatory**, as the debt sustainability analyses which provide the basis for relief decisions are prepared jointly by the IDA, the IMF and the country concerned; and (iv) it broadens the scope of the performance requirements to include explicit **social criteria**, along with the macro-economic and structural aspects of policy conditionality typically associated with the traditional debt-relief mechanisms. It is consistent with past approaches, and indeed reinforces them, in that debt relief by the international community is linked to the adoption of appropriate policies by the debtor which should help ensure that this relief is put to effective use.

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1 DC/96-5 of 4/12/1996 and ICMS/Doc/46/96/3 of 4/15/1996.

## A. THE HIPC DEBT PROBLEM

**Debt stock indicators**

3. The debt of the 40 HIPCs[2] represents less than 10 percent of total developing country debt (Chart AI.1). Even though the debt of the HIPCs is on more concessional terms than that of other developing countries, the debt burden of this group of countries is far more severe, in relation to their capacity to meet debt obligations. By 1996, the ratio of the net present value (NPV) of debt of the HIPCs to exports had fallen by 23 percent, from about 600 percent in 1991 to 450 percent, largely reflecting increasingly concessional debt relief provided by bilateral and commercial creditors, but remained more than twice as high as those of all developing countries as a group. Within the HIPC group, individual country indebtedness ratios varied widely, ranging from below 200 percent to above 1,000 percent.[3]

**Debt service indicators**

4. The actual debt-service payments of the HIPCs, expressed in percent of exports, are approximately in line with those of all developing countries. However, in contrast to the situation in other developing countries, the debt service paid by the HIPCs is only around two-thirds of debt service due in 1995-97.[4] Arrears, debt forgiveness and restructurings make up the difference. High levels of gross new inflows of official resources have also contributed to the ability of HIPCs to make debt-service payments and finance development programs. The ratio of gross inflows (from long-term debt and grants) to debt service paid averaged about two to one for the HIPCs as a group during the 1990's (Chart AI.2) and ranged upward of four to one in half of these countries. Annual net transfers to the HIPCs on medium- and long-term resource flows (including grants) have averaged about 10 percent of GNP over the 1990-96 period.

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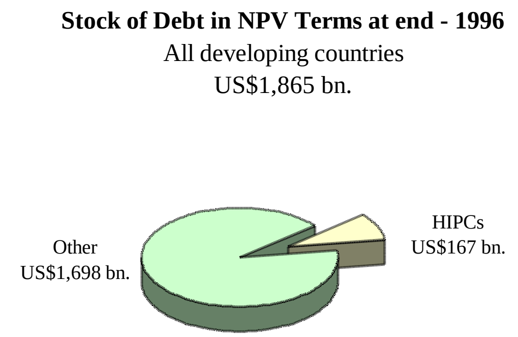
2 Excluding Nigeria (which is not IDA-only) from the 41 original HIPCs. For list of countries, see Table 1 in Section II of this paper.

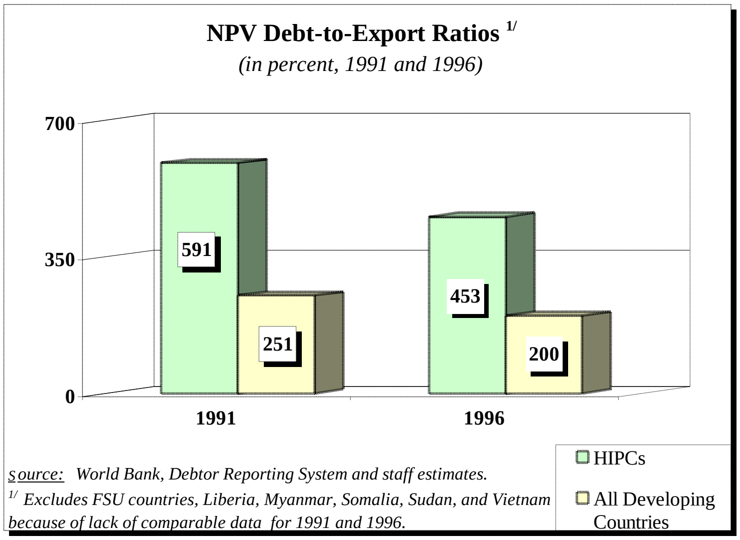
3 These data are not strictly comparable to the reconciled data which underlie country-specific debt sustainability analyses, and do not model the effect of a full use of traditional debt-relief mechanisms.

4 For a sample of 27 HIPCs, for which detailed data are available, the central governments of these countries paid on average 4.8 percent of GDP in debt service during the 1995-97 period, while debt service due amounted to 7 percent of GDP.

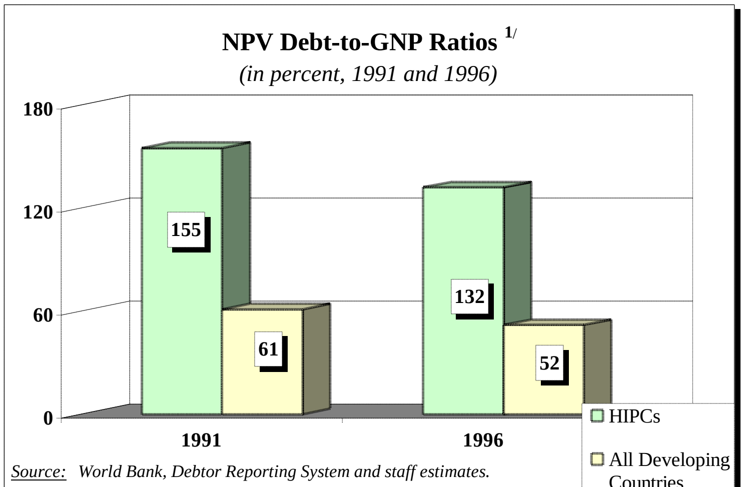
**Chart AI.1 - External Debt of Developing Countries**




*Source:* *World Bank, Debtor Reporting System and staff estimates.*

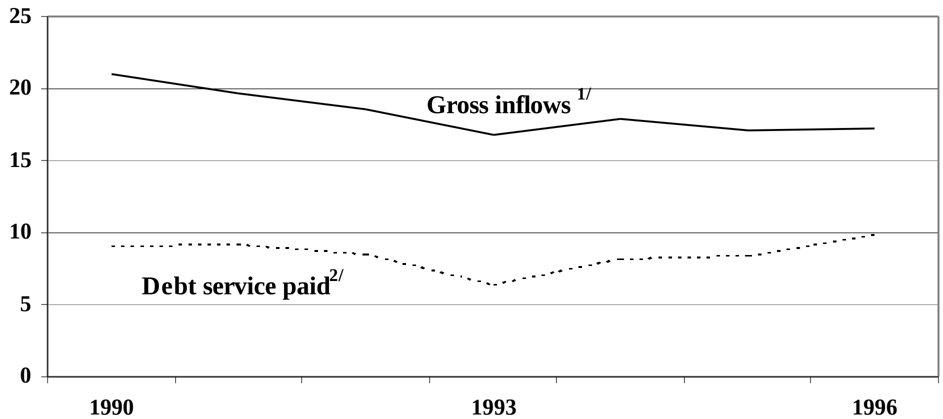



*Source:* *World Bank, Debtor Reporting System and staff estimates.*
*1/ Excludes FSU countries, Liberia, Myanmar, Somalia, Sudan, and Vietnam because of lack of comparable data for 1991 and 1996.*




*Source:* *World Bank, Debtor Reporting System and staff estimates.*
*1/ Excludes FSU countries, Liberia, Myanmar, Somalia, Sudan and Vietnam because of lack of comparable data for 1991 and 1996.*

**Chart AI.2 - Gross Resource Flows and Debt Service Paid by HIPCs, 1990-96**
*(US$ billion)*

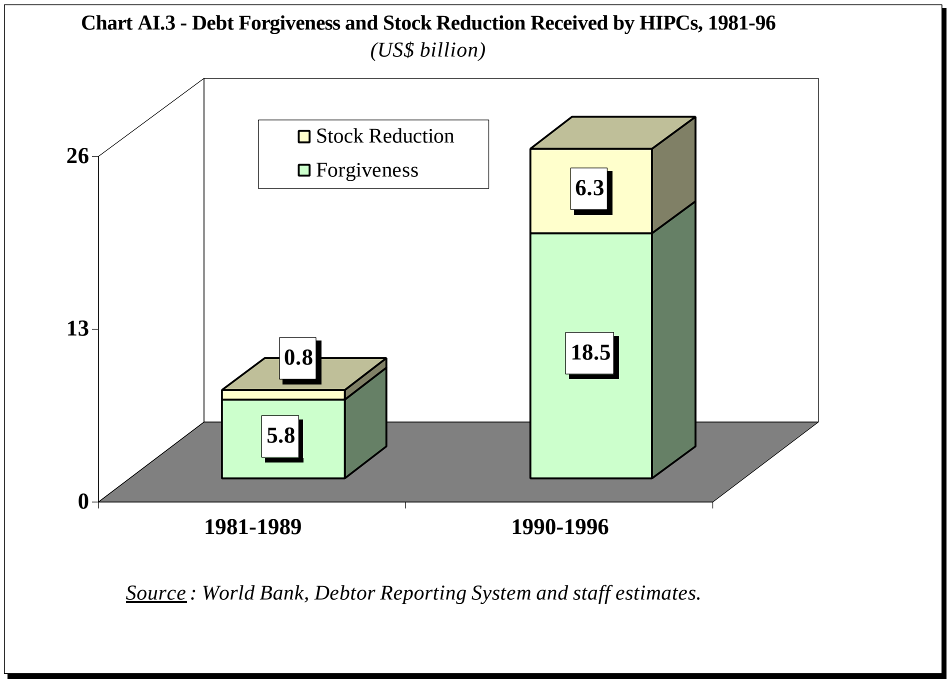



*Source: World Bank, Debtor Reporting Systems and staff estimates.*
1/ *Medium - and long-term loan disbursements and grants.*
2/ *Debt service on medium - and long-term debt.*

## B. TRADITIONAL DEBT RELIEF MECHANISMS

5. A key aspect of the HIPC Initiative is that it encompasses, and builds on, existing debt-relief mechanisms. A number of HIPCs can be expected to achieve debt sustainability solely on this basis, and those HIPCs for which these mechanisms are not sufficient can receive additional relief under the HIPC Initiative. The latter should not, therefore, be viewed in isolation.

6. A comprehensive study of the impact of traditional debt-relief efforts is not available. Partial estimates based on data from the World Bank's Debtor Reporting System (DRS) suggest that, during the 1980s, the HIPCs as a group received US$6 billion in debt forgiveness (mostly of ODA loans from bilateral official creditors) and US$1 billion in debt-stock reduction (Chart AI.3). In 1990-96, these amounts jumped to about US$19 billion and US$6 billion, respectively, reflecting the granting of debt-stock reductions by Paris Club creditors beginning in 1995 and the establishment of new mechanisms to support commercial debt buybacks for poor countries (see below).




## Official bilateral debt relief

7. **Paris Club creditors** have provided substantial debt relief to HIPCs over the years, through increasingly concessional debt-restructuring agreements with 30 HIPCs. In addition, a number of creditors have forgiven ODA loans. Russia, which is a major creditor of HIPCs, joined the Paris Club in September 1997 and has committed to provide substantial debt relief for rescheduling countries.

8. **Other official bilateral creditors, including developing countries,** have also provided relief to HIPCs. **Nicaragua**, for example, received over US$1 billion of debt relief from Mexico in 1996, and highly concessional treatment of its debt owed to other Latin American creditors.

## Commercial debt reduction

9. In contrast to the situation in the highly indebted middle-income countries, commercial debt has accounted for a relatively small share of the total debt of the HIPCs in recent years. The major mechanisms for commercial debt reduction are buybacks and operations offering creditors a menu of restructuring options designed to achieve debt- and debt-service reduction. Most of these operations have been supported by grants from the Debt Reduction Facility for IDA-only countries. In addition, in 1997, the IDA Board authorized the use of IDA credits in support of commercial debt and debt service

reduction (DDSR) operations for two HIPCs ( **Côte d'Ivoire** and **Vietnam**). The use of these mechanisms has helped many HIPCs to extinguish most of their commercial debt in recent years, and is expected to assist several more over the next few years.

10. Commercial debt reduction has been supported by **the Debt Reduction Facility for IDA-only countries**, with resources provided by the World Bank and other donors. Through June 1998, this Facility, established in 1989, had supported commercial debt buyback operations for 14 HIPCs, extinguishing a total of US$6 billion of commercial debt at an average discount of about 85 percent (Table AI.1). Operations currently under preparation or expected to enter the pipeline are expected to help eight HIPCs, including **Guinea**, **Guyana,**[5] **Tanzania** and **Yemen**. These operations will deal with an estimated US$2.3 billion of potentially eligible principal.[6]

11. **Commercial debt and debt-service reduction (DDSR) operations** for **Vietnam** and **Côte d'Ivoire** were concluded in March 1998, with the support of IDA credits and, in the case of Côte d'Ivoire, resources from the IMF, France, the Netherlands and Switzerland. The Vietnam operation helped settle about $800 million in commercial bank arrears, at a discount of about 57 percent. The Côte d'Ivoire operation resulted in a reduction of about US$5 billion (in NPV terms) of commercial debt, including interest arrears, involving an overall discount of about 77 percent.

**Multilateral debt**

12. Assistance with servicing multilateral debt has been provided by the World Bank and the AfDB through special programs, and in parallel by bilateral donors through contributions to Multilateral Debt Funds. Since 1988, the World Bank has used the **Fifth Dimension Program** to assist IDA-only countries that have outstanding IBRD debt. Under this program, which is financed from IDA reflows, IDA allocates annual supplemental credits that cover the largest part of interest due on IBRD debt.[7] In the ten years since its creation, the Fifth Dimension Program has provided about US$1.5 billion in supplemental credits to 20 HIPCs. In September 1997, the AfDB decided to establish a similar program for its own borrowers, the **Supplementary Financing Mechanism**, with resources sufficient to cover about 70 percent of interest payments due in 1998 from 15 potentially eligible countries. The IMF has provided effective help through the replacement of maturing nonconcessional General Resources Account (GRA) credit with concessional SAF and ESAF loans. **Multilateral Debt Funds** have been established in recent years by bilateral donors on behalf of a number of countries (including **Bolivia**, **Mozambique**, **Uganda**, and most recently **Guinea-Bissau** and **Rwanda**). These funds have provided HIPCs with grants to help service multilateral debt, and have become a bridge to assistance under the HIPC Initiative.

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5 Second phase of the 1992 buyback operation.

6 The total amount of debt to be extinguished is higher if interest arrears are included.

7 These supplemental credits usually cover 95 percent of the interest due on IBRD debt contracted prior to September 1988.

**Table AI.1 – IDA Debt Reduction Facility Operations for HIPCs, 1991 – 98**[1/]
**(US$ million)**

| Country | Year Completed | Principal and Interest Extinguished (US$ million) | Price in cents per dollar [2/] |
|---|---|---|---|
| ***HIPC*** | | | |
| Bolivia | 1993 | 170 | 16.0 |
| Côte d'Ivoire[3/] | 1998 | 2,027 | 24.0 |
| Ethiopia | 1996 | 284 | 8.0 |
| Guyana | 1992 | 93 | 14.0 |
| Mauritania | 1996 | 89 | 10.0 |
| Mozambique | 1991 | 198 | 10.0 |
| Nicaragua | 1995 | 1,819 | 8.0 |
| Niger | 1991 | 207 | 18.0 |
| São Tomé & Prín. | 1994 | 10 | 10.0 |
| Senegal | 1996 | 112 | 20.0[4/] |
| Sierra Leone | 1995 | 286 | 13.0 |
| Togo | 1997 | 74 | 12.5 |
| Uganda | 1993 | 177 | 12.0 |
| Zambia | 1994 | 408 | 11.0 |
| ***TOTAL*** | | **5,953** | **14.6** |

*Source: World Bank.*

[1/] *Through June 1998. Excludes a buyback operation for Vietnam in 1998 which did not receive financial support from the Facility--except for a $1 million technical assistance grant for its preparation.*

[2/] *Of original face value of principal. The discount would be higher if interest arrears were included.*

[3/] *Figures related only to the cash buyback component of the total debt under the operation since the Facility financed only the cash buyback option. Other resources for the operation include an IDA credit, French concessional financing, an IMF credit, and self-financing from theGovernment of Côte d'Ivoire.*

[4/] *16 cents for cash buyback and 20 cents for long term bonds.*

## C. ASSISTANCE UNDER THE HIPC INITIATIVE

### Countries reviewed for eligibility

13. During the first two years of implementation, ten countries were reviewed for eligibility for assistance under the agreed framework of the HIPC Initiative (Table AI.2). Eight of these were found to face unsustainable debt levels, after full use of traditional debt-relief mechanisms, and hence to require HIPC assistance. Debt relief was committed for six countries (**Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mozambique** and **Uganda**) and a decision is pending for **Mali**, which is being proposed for assistance. The Boards also discussed a preliminary HIPC document for **Guinea-Bissau**; the decision point for that country has been delayed by the outbreak of civil conflict. In two other countries (**Benin and Senegal**) traditional debt-relief mechanisms were found to be sufficient to enable them to achieve sustainable debt situations. The first country approved for HIPC debt relief (**Uganda**) reached its completion point in April 1998, and creditors are now delivering the promised assistance. Two other countries (**Bolivia** and **Guyana**) are close to their completion points.

### Decision and completion points

14. The HIPC process aims to graduate countries from debt rescheduling and to achieve debt sustainability. It is driven by the establishment of a track record of performance. Flexibility is provided in the agreed framework for credit towards a shortening of the first three-year stage leading to the decision point for programs already under way, as well as shortening, on an exceptional basis, of the period leading up to the completion point in the case of countries with sustained records of strong performance. The IDA and IMF Boards applied these principles to the early cases, which permitted early decision points and brought forward completion points.

## Table AI.2 - HIPC Initiative: The First Two Years

| | Decision Point | Completion Point | NPV debt/export Target (in percent) | Assistance at completion point (US$ million, present value at completion point) TOTAL | Bilateral | Multilateral | of which IMF | World Bank | Percentage reduction in NPV of debt [2/] | Estimated total nominal debt service relief (in US$ mn.) |
|---|---|---|---|---|---|---|---|---|---|---|
| *Decision point reached and assistance committed by Bank and Fund:* | | | | | | | | | | |
| **Uganda** [1/] | Apr-97 | Apr-98 | 202 | 347 | 73 | 274 | 69 | 160 | 20 | 650 |
| **Burkina Faso** | Sep-97 | Apr-00 | 205 | 115 | 21 | 94 | 10 | 44 | 14 | 200 |
| **Bolivia** | Sep-97 | Sep-98 | 225 | 448 | 157 | 291 | 29 | 54 | 13 | 600 |
| **Guyana** | Dec-97 | Feb-99 | 107 [3/] | 253 | 91 | 161 | 35 | 27 | 25 | 500 |
| **Côte d'Ivoire** | Mar-98 | Mar-01 | 141 [3/] | 345 | 163 | 182 | 23 | 91 | 6 | 800 |
| **Mozambique** | Apr-98 | mid-99 | 200 | 1,442 | 877 | 565 | 105 | 324 | 57 | 2,900 |
| **Total Agreed Debt Relief** | | ... | ... | 2,950 | 1,382 | 1,567 | 271 | 700 | | 5,650 |
| *Preliminary HIPC Document issued; targets based on majority view in preliminary discussions at Bank and Fund Boards, assistance based on preliminary HIPC documents and subject to change:* | | | | | | | | | | |
| **Mali** [4/] | Sep-98 | Dec-99 | 200 | 128 | 37 | 90 | 14 | 44 | 10 | 246 |
| **Guinea-Bissau** [4/ 5/] | late-98 | late-01 | 200 | 300 | 148 | 153 | 8 | 73 | | |
| *Debt judged sustainable:* | | | | | | | | | | |
| **Benin** | Jul-97 | | | | | | | | | |
| **Senegal** | Apr-98 | | | | | | | | | |

*Source: IMF and Bank Board decisions, completion point document, final HIPC documents, preliminary HIPC documents, and staff calculations.*

[1/] *Completion point reached in April 1998, actual NPV debt-to-export ratio is 196%.*
[2/] *In percent of NPV of debt at completion point, after full use of traditional debt relief mechanisms.*
[3/] *Eligible under fiscal/openness criteria; NPV of debt-to-export target chosen to meet NPV of debt-to-revenue target of 280 percent.*
[4/] *Reflects the view of most Directors advocating a target at the low end of the 200-220 percent range, with many recommending a 200 percent target. Also reflects recommendation in the final HIPC document for Mali.*
[5/] *The situation of Guinea-Bissau will need to be reassessed once the civil conflict has ended and a new economic and recovery program has been worked out with the authorities.*

15. **Decision points**. Some of the first ten countries reviewed for eligibility for assistance (**Bolivia**, **Guyana**, **Mozambique** and **Uganda**) had already demonstrated strong performance under Bank- and IMF-supported programs for long periods. A number of countries in the initial group (**Benin**, **Bolivia**, **Burkina Faso**, **Guyana**, **Mali** and **Uganda**) had also concluded stock-of-debt operations on Naples terms with Paris Club creditors in 1995-96. **Côte d'Ivoire**, **Guinea Bissau** and **Senegal** were completing programs supported by three-year ESAF arrangements from the IMF and IDA-supported adjustment programs were broadly on track. All these countries were, therefore, ready to reach their decision points, subject to preliminary debt data reconciliation, completion of their tripartite debt sustainability analyses (DSAs), and agreement on appropriate policies with IDA and the IMF. On this basis, five countries were able to reach their decision points in 1997, and three more in the first half of 1998.

16. **Completion points**. In line with the flexibility provided in the agreed framework of the HIPC Initiative, five of the six countries reaching their decision points which required assistance under the Initiative were granted a shortening of the second stage to the completion point. The shortening, in the case of countries with long-time and strong reform programs (**Bolivia**, **Guyana, Mozambique** and **Uganda)**, was to around one year, subject to continued strong performance.

**Performance monitoring**

17. For performance monitoring, the HIPC Initiative relies essentially on the macro-economic and structural conditionalities associated with policies supported by IMF ESAF arrangements and relevant IDA adjustment, sector and other operations. Social development criteria are developed jointly with country authorities and explicitly incorporated into HIPC documents in order to focus attention on country performance in this area.

18. **Macroeconomic and structural policy performance** targets typically involve fiscal and monetary policy targets, tax, civil service and budgetary reforms; restructuring of government expenditure in favor of the social sectors; continued exchange and trade liberalization if needed; financial sector reforms; public enterprise privatization and the development of appropriate regulatory frameworks for private sector activity; and the removal of policy-induced distortions and inefficiencies in public utilities, agriculture and other productive sectors (Box AI.1).

**<u>Box AI.1</u> - Macroeconomic and Structural Policy Performance Targets**

- **Uganda** agreed to adopt a value-added tax, pass a new income tax law and comply with ceilings on the size of its civil service; increase budgetary allocations for agricultural research and extension, primary health care and primary education; liberalize external capital transactions, cut tariff rates on an accelerated schedule and abolish remaining import bans; complete the financial sector reform program, and step up and extend the scope of the public enterprise privatization program.

- For **Bolivia**, the main targets are to complete public enterprise capitalization and to continue the process of strengthening financial sector supervision. Other key elements of the Bolivian program include improving governance through judicial and custom reforms, the beginning of a social dialogue on labor market reform, and adopting fiscal measures to absorb the up-front costs of the 1996 pension reform.

- **Guyana's** performance requirements emphasize improvements in their public finances, financial sector reforms (including reorganization of the Bank of Guyana), civil service reform, and restructuring/bringing to point of sale of all remaining public enterprises. The state sugar company (GUYSUCO) will be restructured and gradually submitted to competitive pressures so it can operate at world market prices by 2002.

- In **Mozambique**, the main focus of performance involves fiscal and public enterprise reform. Mozambique agreed to adopt a value-added tax and a new budgetary framework, reform expenditure management, decompress civil service salaries, and complete the privatization program. By mid-1999, only about 20 major enterprises will remain in public hands, most of them also destined to be either privatized or concessioned out to the private sector.

- **Burkina Faso** is in the process of modernizing its civil service, stepping up the pace of its privatization program, and completing the liberalization of the rice sector, the restructuring of agricultural services and the reorganization of the cotton sector.

- For **Côte d'Ivoire**, performance targets include control of the public sector wage bill and continued civil service reform, tax and expenditure management reforms, liberalization of the external marketing of cocoa and coffee, strengthening of the financial sector, and expansion of the privatization program.

19. **Social development criteria** have focused primarily on improvements in primary health and basic education, usually supported by programs financed by IDA and other multilateral and bilateral creditors and donors. Ongoing and new IDA operations, as well as programs supported by the IDB and the AfDB, provide the main framework for monitoring compliance. The actions agreed usually involve the elaboration of sector strategies, the definition of minimum packages of health and education services, plans for the decentralization of service delivery, improved quality, and the promotion of private participation. The government undertakes to increase budgetary allocations and develop monitoring systems for tracking outcomes in actual public expenditure and service levels. In both education and health, the key objectives are to increase access to, and quality of services. Particular emphasis has been placed on actions to reduce inequality of access to such services between urban and rural areas, and between boys and girls with respect to schooling.

**Box AI.2 – Social Development Policies**

- **Uganda** has defined a goal of achieving universal primary education by the year 2003, as it shifts the emphasis of education sector spending towards primary education.
- **Bolivia** targeted an increase in the rural primary education ratio for females from 56 percent in 1997 to 68 percent by the year 2000 and planned to increase basic immunization coverage from 80 percent in 1997 to 85 percent in 2000.
- **Mozambique**'s key targets include an increase in gross primary education enrollment rate from 62 percent in 1996 to 79 percent in 2000 and an increase in immunization coverage from 58 percent in 1996 to 80 percent in 2000. Mozambique also planned to increase the proportion of health centers staffed with trained personnel from 70 percent in 1995 to over 80 percent in 2000 and to increase the share of centers stocked with essential drugs from 40 to 50 percent.

20. Social development policies are long-term issues, and it is therefore difficult to define precisely the outcomes to be achieved in the short term as a result of the agreed action programs. However, an effort has been made to specify quantitative targets for several key indicators that can be monitored (Box AI.2). Despite the uncertainty attached to social development targets, they can provide an indicative basis for tracking the impact of policy measures over time and evaluating overall country performance. Moreover, the elaboration of the social targets, and their subsequent monitoring, have helped focus the attention of government authorities at the highest level on concrete social development action programs, and simultaneously provided the impetus for a closer integration of social policies into the policy dialogue of the country with the Bank and the IMF. This new emphasis, which will need to be sustained beyond the completion point, should help

consolidate the link between debt relief and social progress which is one of the main objectives of the HIPC Initiative; some countries (e.g. Bolivia) have included such social targets as a key component of 3-year Policy Framework Papers that extend beyond the completion point. The staff also intend in future documents to draw out the links between the HIPC social targets and the UN human development targets for the 21st century agreed by the OECD Development Assistance Committee.

**Debt sustainability targets**

21. The debt sustainability targets agreed have reflected the objective to achieve a robust exit from debt rescheduling for the countries concerned. The HIPC framework provides for consideration of country-specific vulnerability factors, including the concentration and variability of exports and fiscal indicators of the burden of debt service.[8] The targets for NPV of debt-to-export ratios have been fixed at or near the bottom of the 200 to 250 percent debt sustainability range for **Burkina Faso** (205 percent), **Mozambique** (200 percent) and **Uganda** (202 percent). For **Bolivia**, a 225 percent ratio was agreed, since Bolivia is one of the least vulnerable of the HIPCs under consideration. In the cases of **Côte d'Ivoire** and **Guyana**, which qualified for HIPC assistance on the basis of the fiscal/openness criteria[9], the application of the guidelines resulted in NPV of debt-to-export targets of 141 and 107 percent, respectively.

22. The maximum debt-service targets of 20-25 percent of exports considered in the framework of the Initiative have generally not been binding. In five of the six qualifying countries, the debt-service ratio has been projected to be below 20 percent at the completion point even without HIPC relief. In the case of **Bolivia**, however, the debt-service ratio (before HIPC debt relief) was expected to remain above the 20-25 percent sustainability range agreed under the framework for several years after the completion point. Creditors have therefore been urged to front load their assistance under the Initiative—as is being done by the Bank and the IMF—and thus reduce debt-service obligations to as close to 20 percent of exports as possible.

**Level and impact of HIPC assistance**

23. The HIPC assistance committed to the six qualifying countries that reached their decision points by July 1998 amounts to about US$3 billion in NPV terms, and US$5.6 billion in estimated nominal debt-service relief over time. In NPV terms,

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8 Joint IDA and IMF Paper, "HIPC Cap Paper for the Preliminary Documents for Bolivia, Burkina Faso, Côte d'Ivoire and Uganda" (IDA/SecM97-104 of 4/2/1997 and EBS/97/59 of 4/1/1997).

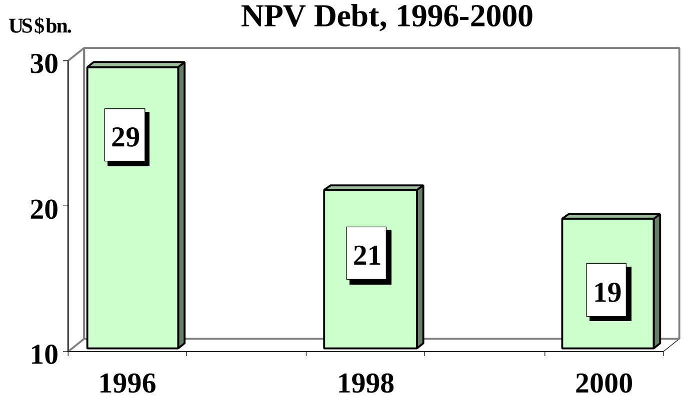
9 These criteria were agreed in April 1997, for countries where a large export base could exaggerate the capacity to service external debt, in relation to other measures, such as fiscal revenues. For such countries, which are also making a strong effort to generate fiscal revenues, an NPV debt-to-export target below 200 percent is set with the objective of reducing the NPV of debt-to-fiscal revenue ratio to 280 percent at the completion point. (See "HIPC Debt Initiative: Guidelines for Implementation", IDA/R97-35 of 4/22/1997 and EBS/97/75 of 4/21/1997).

bilateral creditors as a group agreed to provide about 46 percent of the total and multilateral institutions 54 percent. Based on their respective shares of the debt, the World Bank is providing about 45 percent of the total multilateral debt relief agreed so far, the IMF 17 percent, the IDB 13 percent and the AfDB 12 percent. Creditors are committed to deliver the agreed debt relief at the countries' individual completion points. The Bank will provide some relief earlier by substituting IDA grants for IDA credits during the interim period for eligible countries. The Paris Club has also provided interim debt relief for countries which did not have existing stock-of-debt operations—namely **Côte d'Ivoire** and **Mozambique**—by increasing the NPV reduction under flow reschedulings from 67 to 80 percent.

24. For the six qualifying HIPCs that reached their decision points so far, the reduction in NPV of debt from HIPC assistance at the completion point is projected to range from 6 percent in **Côte d'Ivoire** to 57 percent in **Mozambique**. The HIPC assistance package for Mozambique is by far the largest of those approved; to ensure debt sustainability at the completion point, Mozambique is expected to receive assistance of over US$1.4 billion in NPV terms, or US$2.9 billion in nominal debt-service relief, equivalent to 70 percent of GDP.

25. The debt burden of the eight countries that reached their decision points in the first two years of the HIPC Initiative (including the two HIPCs deemed sustainable) is expected to drop substantially over the medium term. The NPV of debt of these countries is projected to decline by a third between 1996 and 1998 and an additional 7 percent by the year 2000 (Chart AI.4). This trend reflects both debt relief under traditional mechanisms and the projected impact of HIPC assistance.

**Chart AI.4 - HIPCs at the Decision Point [1/]**
**NPV Debt, 1996-2000**




*Source: Preliminary and final HIPC documents.*

[1/] *Benin, Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mozambique, Senegal and Uganda.*

**Sustainable cases**

26. **Benin** and **Senegal** reached their decision points on the basis of established performance track records. Accordingly, DSAs were conducted jointly with the authorities on a loan-by-loan basis in June 1997 for Benin and in February 1998 for Senegal. The DSAs concluded that these two countries would have sustainable debt burdens after making full use of existing debt-relief mechanisms, with NPV of debt-to-export ratios below 150 percent; they therefore did not require assistance under the HIPC Initiative. Both countries have taken full advantage of available debt relief programs, including, in the case of Senegal, the support of the IDA Debt Reduction Facility to extinguish virtually all its commercial debt in 1996. Paris Club creditors agreed to a comprehensive stock-of-debt operation on Naples terms with Benin in October 1996, and with Senegal in June 1998. Both countries have succeeded in emerging from their heavy external debt problem through a combination of adjustment and structural reform efforts which have resulted in growing exports, prudent debt management and debt relief.

**Countries reaching their completion points**

27. **Uganda** became the first country to reach its completion point under the HIPC Initiative in April 1998. An updated DSA found the NPV of debt-to-export ratio at the completion point—at 196 percent after the committed debt relief—lower than the target of 202 percent, but well within the plus/minus 10 percentage point margin envisaged under the HIPC framework. Paris Club creditors of Uganda agreed in April 1998 on a stock-of-debt reduction of 80 percent under Lyon terms. As a result of HIPC assistance, Uganda's debt service will be reduced by about 20 percent, compared to that after traditional debt-relief mechanisms, or US$30 million annually over the next ten years, and by about US$22 million, or 10 percent, for the following decade. Uganda is expected to use the savings to support the implementation of a number of social programs, including, in particular, the Universal Primary Education Plan and the Poverty Eradication Action Plan.

## D. IMPLEMENTATION OF THE HIPC INITIATIVE

28. The comprehensive and participatory approach of the HIPC Initiative created the need for a high degree of cooperation among the parties concerned with its implementation. This section reviews the collaborative processes that have evolved over the past two years to foster consensus and facilitate coordination among creditors, as well as to ensure direct involvement of the debtor countries in the HIPC process.

**Debtor country involvement**

29. **The debt sustainability analysis (DSA)**, which provides the basis for an initial assessment of eligibility for assistance under the HIPC Initiative, is a joint undertaking by IDA, the IMF and the government of the debtor country. The country authorities are responsible for updating their debt records and reconciling them with the claims records of the creditors. Bank and IMF staffs provide assistance in analyzing the NPV of the

outstanding debts in the country as well as facilitating the debt-reconciliation process as needed. The staffs also reach agreement with the government on the medium-term macroeconomic and policy framework for the DSA, usually in the course of joint Bank-IMF PFP/ESAF missions.

30. **Debt management capacity.** The intensive data requirements of the DSA exercises have brought to the fore the continuing weaknesses of debt management in the HIPCs. In many of the early cases considered for eligibility, debtor country records were incomplete and the reconciliation with creditor claims has been a difficult and time-consuming process, usually requiring considerable assistance from Bank and IMF staff. Assessments of debt-management capacity, which are carried out by staff in the context of the joint DSAs, indicate that, despite substantial amounts of technical assistance in the past, many HIPCs still lack well functioning debt-management systems, and most have not developed the tools and analytical capacity to evaluate debt-relief options and to assess debt sustainability in the context of alternative macro-economic policy frameworks. Constraints have included inefficient administrative structures, outdated computer equipment and software, and the inability to retain skilled personnel.

31. The HIPC Initiative has given a new impetus to the donor community’s technical assistance efforts in the area of debt management. The Bank and the IMF have joined other international organizations and interested bilateral donors in helping to develop capacity for debt management among the HIPCs. UNCTAD and the Commonwealth Secretariat have provided computer hardware, debt-management software and training to a number of HIPCs, and intergovernmental programs (such as the Capacity Building Program operated by Debt Relief International) are financing follow-up training and advisory assistance. Most importantly, the keen interest of HIPC country authorities in the HIPC Initiative appears to have raised the level of local ownership of, and commitment to capacity-building efforts, which may enhance the effectiveness of technical assistance programs in this area.

## Coordination with Multilateral Creditors

32. The Bank has taken the lead in the effort to enlist the support of multilateral development banks (MDBs) for the HIPC Initiative. This has involved an extensive consultation process, as well as efforts to assist the MDBs in designing the modalities of their participation in the HIPC Initiative and securing the necessary financing. Since November 1996, semi-annual meetings of the representatives of some 25 MDBs with claims on the HIPCs have been held under the chairmanship of the Bank and with the participation of the IMF, to discuss the implementation of the Initiative and the status of their participation in it[10]. In addition, a meeting took place in Vienna in early 1997, in cooperation with the OPEC Fund, to discuss the Initiative with a smaller group of MDBs, and a seminar was held with the Board of the AFDB in Abidjan in early 1998.

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[10] For list of participating multilateral development institutions concerned, see Appendix A.

33. Between seminars, there is a regular exchange of correspondence between the Bank and the MDBs. After a preliminary DSA has been considered by IDA and IMF Boards, these documents are sent to the MDBs concerned and they are asked to indicate their willingness to participate in the Initiative. Once a critical mass of creditors agree, and a country arrives at the decision point, the MDBs are informed of IDA and IMF Boards' decisions on eligibility, targets and burden sharing, and are asked to confirm their participation in the Initiative for that country, including which modalities they might use to deliver their assistance.

34. Given their lending experience in the countries concerned, MDBs have provided feedback on the DSAs of the HIPC cases considered. They have also been active in each case in the debt reconciliation process. There has been a particularly close interaction with the two principal regional development banks with major exposure to the HIPCs, the AfDB and the IDB, which have participated in DSA missions to countries where they are key creditors.

35. The seminars and meetings with the MDBs have facilitated a better understanding of the parameters of the Initiative and its application to specific cases. As is the case with the Bank and the IMF, MDBs' participation modalities must be tailored in such a way as to maintain their financial integrity and safeguard their preferred creditor status. Many MDBs have specific guidelines that forbid rescheduling of debts. Exceptional efforts have been made so that to date, most MDBs have obtained the appropriate institutional approvals to enable them to participate in the HIPC Initiative, and most have defined the modalities through which they intend to deliver their assistance. These include: (i) using the HIPC Trust Fund, either for debt-service reduction or debt buybacks; (ii) using similar, self-administered, trust funds; (iii) rescheduling current maturities or arrears on concessional terms tailored to provide the agreed NPV debt relief; and (iv) refinancing on concessional terms.[11]

**Coordination with Official Bilateral Creditors**

36. **Coordination with Paris Club creditors** in implementing the HIPC Initiative has been close. IMF staff has taken the lead in consultations with bilateral creditors, working with Paris Club creditors both in assisting the reconciliation of debt figures, and in seeking creditors views' on the DSA assessments and their commitment to providing the assistance envisaged under the HIPC Initiative. This has been a particularly lengthy process in the case of Mozambique, as the bilateral effort required for fully proportional burden-sharing exceeded Lyon terms (80 percent NPV relief on eligible medium- and long-term debt). After prolonged but constructive discussions, it was agreed that the difference between the two approaches would be covered by a combination of additional exceptional efforts from bilateral creditors and donors, and the Bank and the IMF, but that this should not be a precedent for future cases.

[11] For details, see Box 2 in Section II of this paper.

37. **Non-Paris Club bilateral creditors** have also been kept informed. At an early stage in the HIPC process, debtors typically send requests to all of their creditors to reconcile their debt data, and IMF and Bank missions often catalyze this process. In cases where a non-Paris Club bilateral creditor accounts for a significant share of a HIPC's debt, efforts are made to consult such a creditor on HIPC issues. Representatives of the major Arab development funds (the Abu Dhabi, Kuwait and Saudi Funds) have also been attending the MDB meetings as observers.

38. Typically, all non-Paris Club bilateral creditors are notified through memos from the staff to their Executive Directors after IDA and IMF Boards have discussed preliminary and final HIPC documents, informing such creditors of the Boards' discussions and of the implications of the Boards' decisions for their claims. The responsibility for arriving at agreements with non-Paris Club creditors on terms at least comparable with those granted by Paris Club creditors (as required under a Paris Club rescheduling agreement) lies with the debtor concerned.

## Appendix A

### HIPC Initiative: List of Participating Multilateral Development Institutions

- African Development Bank (AfDB)/African Development Fund (AfDF), Abidjan, Côte d'Ivoire
- Arab Bank for Economic Development in Africa (BADEA), Khartoum, Sudan
- Arab Fund for Economic and Social Development (AFESD), Safat, Kuwait
- Arab Monetary Fund (AMF), Abu Dhabi, United Arab Emirates
- Asian Development Bank (ADB), Manila, Philippines

- Banque Centrale des Etats d'Afrique de l'Ouest (BCEAO), Dakar, Senegal
- Caribbean Development Bank (CDB), St. Michael, Barbados
- Caricom Multilateral Clearing Facilities (CMCF), Port of Spain, Trinidad
- Central American Bank for Economic Integration (CABEI), Tegucigalpa, Honduras
- Conseil de l'Entente, Abidjan, Côte d'Ivoire

- Corporación Andina de Fomento (CAF), Caracas, Venezuela
- East Africa Development Bank (EADB), Kampala, Uganda
- Eastern and Southern African Trade and Development Bank (PTA Bank), Nairobi, Kenya
- Economic Community of West African States, Fund for Cooperation Compensation and Development (ECOWAS Fund), Lomé, Togo
- European Union (EU), Brussels, Belgium and European Investment Bank (EIB), Luxembourg

- Fund for the Financial Development of the River Plate Basin (FONPLATA), Santa Cruz de la Sierra, Bolivia
- Inter-American Development Bank (IDB), Washington DC, United States
- International Fund for Agricultural Development (IFAD), Rome, Italy
- Islamic Development Bank (IsDB), Jeddah, Saudi Arabia
- Nordic Development Fund (NDF) and Nordic Investment Bank (NIB), Helsinki, Finland

- Organization Arabe des Pays Exportateurs de Pétrole (OAPEP), Kuwait City, Kuwait
- Organization of Petroleum Exporting Countries, Fund for International Development (OPEC Fund), Vienna, Austria
- West African Development Bank (BOAD), Lomé, Togo

## OUTREACH AND EXTERNAL COMMENTS

## ON THE HIPC INITIATIVE

1. The HIPC Initiative and its implementation have been closely followed by the public, NGOs, churches, and the press. Staffs have regularly briefed these external audiences on progress in the implementation of the Initiative as well as on its objectives and design. In addition, staffs have participated in numerous seminars, including those sponsored by NGOs, governmental, intergovernmental, and religious organizations. The Bank also hosted a conference in Paris in February 1998 with IMF participation, and a joint Bank/IMF seminar is planned for the Annual Meetings. The February meeting was attended by representatives of other international financial institutions, and European NGOs and governments. In the course of all of these exchanges, many comments were received on (i) the framework of the Initiative, and (ii) dissemination of information on it. This section summarizes the main points made by these groups and staff responses, but is not intended to provide an exhaustive description of the breadth and depth of the dialogue staffs have had over the last two years with interested external audiences.

### Comments on the HIPC Initiative framework

2. The Initiative has been welcomed by a broad spectrum of observers as an important breakthrough in addressing the debt burdens faced by poor countries. It has been acknowledged that the Initiative has introduced a new paradigm by defining as its central objective the attainment of external debt sustainability for the debtor country. The flexibility shown during the course of implementation, such as the introduction of the fiscal/openness criteria for eligible countries, has been welcomed. The coordinated assistance from all creditors, including multilateral institutions, and the active participation of debtor countries in the process have also been widely welcomed. At the same time, the framework has been subject to a number of critical comments.

3. **Definition and targets of debt sustainability**. It has been argued that the target range for the NPV of debt-to-export ratio is too high either to attain the stated objective of debt sustainability or more broadly to ensure the expansion of public expenditures on basic social services. Some groups have recommended targets below 200 percent (e.g. 150 percent) and debt-service ratios below 20 percent, while others have argued for maximum relief on humanitarian rather than debt sustainability grounds, with recommendations ranging from partial to total cancellation of external debt of poor countries.

4. **Fiscal criteria.** A number of commentators think that the framework gives insufficient attention to the fiscal burden of public debt. They argue that debt relief should not be based only on the foreign exchange burden of public debt, but also directly on the government's debt-servicing capacity, as this would establish a more direct link to social expenditures, and increase debt relief. These commentators recognize that this would likely complicate the framework as it would also require dealing with domestic debt and tax and expenditure issues. However, they feel that complementing the current

framework with a fiscal criterion, could likely result in lower debt-sustainability targets than under the current approach.

5. **Timing of debt relief.** The performance period to receive HIPC debt relief has frequently been perceived by outside commentators as too long and as unnecessarily delaying and reducing the potential benefits of the HIPC Initiative. In particular, in the early cases (e.g. **Uganda** and **Bolivia**), where countries had already established track records of more than the required six years of good policy performance, there was criticism that the shortening of the interim period should have been more pronounced or even that the decision point should have coincided with the completion point. Some observers have argued that more weight should be given to past performance and the depth of reform, rather than only the length of the track record. They also stressed that delays in the receipt of HIPC debt relief have a high cost in terms of forgone social services.

6. **Interim relief.** It has been argued that measures to provide assistance during the interim period should be strengthened. Observers have argued that if the interim period is to be as long as three years, interim measures should provide greater cash-flow relief, and more multilateral creditors should provide interim relief to allow for needed expansion of development expenditures.

7. **Performance criteria.** Many observers accepted the need for conditionality to lessen the moral hazard problem and ensure that HIPC debt relief is put to good use. Nevertheless, they felt that conditions are too stringent. In particular, the tight link to IMF/ESAF-supported programs has been objected to, particularly by those who have concerns about the design of these programs generally. Conditionality under IDA and IMF adjustment operations has been criticized for not giving sufficient weight to poverty reduction objectives. The social development criteria have sometimes been seen as adding conditionality; and some observers have advocated instead providing a positive incentive for stronger programs to support human development by permitting lower debt-sustainability targets in countries with particularly strong programs in this area. On the other hand, some observers have been concerned about the absence of conditionality after the completion point, and the risk of misuse of funds or of the re-appearance of debt problems.

8. **Eligibility.** Some groups consider the eligibility criteria to be overly restrictive. They criticize the restriction to poor countries below the IDA operational cut-off as excluding some highly indebted countries that could benefit from relief, though most commentators agree that the poorest countries should have the highest priority in concessional debt relief. Some have suggested that human development criteria be developed as substitute for the NPV of debt-to-export and debt-service-to-export ratios as measures of sustainability. Others have questioned why it is necessary to exhaust traditional mechanisms in a few cases where multilateral debt is dominant while the benefits of bilateral debt relief may be offset by reduced flows of new aid.

9. **Poverty dimension.** Observers have commented that there should be a closer and more visible link between HIPC debt-relief and poverty reduction. Specifically, some have called for debt-relief efforts to be explicitly integrated into a broader strategy to

combat poverty as reflected in the human development targets set in "Shaping the 21st Century: the Contribution of Development Cooperation", issued by the OECD's Development Assistance Committee (DAC).

10. **Financing of the Initiative.** Commentators favoring an expansion of the HIPC Initiative have recommended that net additional resources need to be made available by bilateral and multilateral creditors and donors for debt relief. They recommend more progress in increasing Official Development Assistance (ODA) levels towards attaining the UN target of 0.7 percent of GNP. They also call for ODA to be more effective and better targeted to benefit poor people. Other groups have pressured their governments and legislatures to increase funding for the Initiative.

**Staff responses**

11. In carrying out the dialogue with outside audiences, staffs have stressed that the HIPC Initiative reflects a broad-based consensus of member governments. Its design has necessarily reflected a balancing of diverse interests but responds to a widely shared sense of collective responsibility to address unsustainable debt in a way that promotes poverty reduction.

12. Regarding **debt sustainability** targets, staffs have pointed out the research findings on which these target ranges were based.[1] In addition, staffs have drawn attention to the fact that the Boards have agreed targets towards the lower end of the range in most cases, and agreed to NPV of debt-to-export targets below 200 percent under the fiscal/openness criteria. Moreover, debt-service ratios after HIPC assistance have typically been below the 20 percent threshold.

13. With regard to the **fiscal criteria**, staffs have pointed out that the Initiative was created to help countries achieve *external debt sustainability.* In this context, the HIPC Initiative has tried to balance the various theoretical considerations in a workable approach that centers on exports as a reliable and comparable measure across countries. Apart from the export-based debt indicators, fiscal indicators are taken into account in the vulnerability analysis. Moreover, the framework was modified to incorporate a fiscal/openness eligibility criterion to address situations in highly open economies where the use of exports may exaggerate the country's payment capacity. To address moral hazard, this fiscal/openness criterion is only applied in countries with sufficiently strong revenue performance (i.e., a revenue-to-GDP ratio of at least 20 percent).

14. On the **timing of debt relief**, staffs have stressed that, to be effective, debt relief needs to be combined with adjustment and reform over a sustained period of time. Thus, the requirement of a track record of strong policy performance is intended to ensure that countries that reach their completion points have well-rooted policies consistent with a viable and sustainable debt strategy. The HIPC Initiative process encourages countries to

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1 S. Claessens, E. Detragiache, R. Kanbur and Peter Wickham, "Analytical Aspects of the Debt Problems of Heavily Indebted Poor Countries", in Z. Iqbal and R. Kanbur, External Finance for Low-Income Countries, Washington, D.C., 1997, pp. 21-49.

tackle the whole range of factors currently limiting their growth performance, including poor infrastructure, the lack of effective policy making institutions, and governance problems. Such difficult issues will take time to be resolved. Nevertheless, the flexibility embodied in the HIPC Initiative provides credit for past performance. As a result, Uganda has already reached its completion point in April 1998, to be followed by Bolivia in September 1998 — within one year after reaching their respective decision points—and a number of other countries, including Guyana and Mozambique, are expected to follow soon. In fact, five of the six countries to which HIPC assistance has been committed through August 1998 have been granted a shortening of the second stage in recognition of their long records of good policy performance.

15. Regarding **interim relief**, staffs have noted that IDA, the Paris Club, and some other bilateral creditors are delivering a portion of the HIPC assistance during the interim period. Moreover, the Fund and the Bank, together with other multilateral institutions, provide substantial financing during the period between the decision and completion points through the provision of ESAF and IDA loans. Most multilateral creditors, including the IMF, have chosen to address possible financing needs in the interim period with their normal concessional lending instruments, while providing their share of HIPC assistance entirely at the completion point.

16. On the issue of **performance criteria**, staffs have emphasized that the link of HIPC assistance to ESAF and IDA conditionality reflects the objective to support sustainable development and poverty reduction. In light of the mismanagement and corruption that have in many cases contributed to the build-up of debt problems and the many weaknesses in debtors' capacity to address basic social needs, staff have stressed the need to ensure that the resources released by debt relief would be used wisely. Debt relief without true adjustment and reform would be wasted.

17. In discussing the **eligibility criteria** under the HIPC Initiative, staffs have explained that the IDA-only and ESAF-eligibility requirement establishes a desired link to the poverty status, i.e., per capita income, of a country. As has been pointed out, this link reflects a broad-based consensus of member governments that the poorest countries should have the highest priority in benefiting from debt relief.

18. With regard to the **poverty dimension** of the HIPC Initiative and calls for a more visible link between HIPC assistance and poverty reduction, staffs have pointed out that the HIPC Initiative has always emphasized the need to integrate debt reduction with effective long-term policies for economic and social development, including specifically the alleviation of poverty. For this reason, social development criteria are developed jointly with country authorities and explicitly incorporated into HIPC conditionality. The staffs have argued that the link between the HIPC Initiative and poverty reduction objectives needs to be viewed in the broader perspective of the country's overall poverty alleviation efforts. These are supported by the international community through various instruments, including lending, policy dialogue, and social expenditure reviews. In the case of IDA, the HIPC Initiative is embedded in the country assistance strategy that guides IDA's overall support to poverty alleviation in a variety of sectors. In the case of the IMF, the link between HIPC assistance and ESAF-supported programs is designed to ensure that debt relief is used in a framework that promotes high-quality, pro-poor

growth. Bilateral ODA also has a major role in poverty reduction, as is recognized in the OECD/DAC 2015 targets; movement toward these targets is being monitored under the HIPC Initiative.

19. Staff have encouraged the support outside groups have given to the need for full financing of the Initiative, and more generally, for substantial ongoing flows of official development assistance to poor countries.

20. Staffs have also emphasized that external debt needs to be seen in the context of the wider relations between HIPCs and the international community. For HIPCs on average, debt service paid is less than government budgetary expenditures on health and education, even though the reverse is true for some countries. As a result of incomplete accounting, budgetary spending in these sectors often does not capture the substantial outlays financed directly (outside the budget) by bilateral donors and NGOs. In addition, in the 1990s HIPCs have received, on average, about twice as much by way of external assistance—grants and concessional loans—than they paid by way of debt service; in some HIPCs (such as **Mozambique**, **Tanzania**, and **Uganda**) the ratio is much higher. Net transfers to HIPCs average around 10 percent of GDP. Even if all external debt of HIPCs was forgiven in 2000, as some observers favor, most HIPCs would remain heavily dependent on aid inflows.

**Dissemination of information**

21. A major complaint by outside audiences has been that they do not get sufficient access to key information and documents and, hence, could not adequately participate in the debate about HIPC debt relief for individual countries. In the dissemination of information, staffs have had to strike a balance between being responsive to concerns expressed by outside commentators and maintaining the integrity of the confidential consultative process with the county concerned and among creditors and donors.

22. Staffs have prepared regular press releases and other public information documents, and have maintained websites on the Initiative. To open further the process and improve transparency about the basis of decisions made under the Initiative, the Boards decided earlier this summer that the final decision point and completion point documents will be made public after consultation with the countries concerned, beginning in September 1998.