DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

DC2002-0020
September 21, 2002

HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE: STATUS OF IMPLEMENTATION

Attached for the September 28, 2002, 66th meeting of the Development Committee is a report entitled "Heavily Indebted Poor Countries (HIPC) Initiative: Status of Implementation" prepared by the staff of the World Bank and the International Monetary Fund which will be considered under Item I.2 of the Provisional Agenda.

* * *

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

Heavily Indebted Poor Countries (HIPC) Initiative: Status of Implementation

Prepared by the Staffs of the IMF and World Bank

September 19, 2002

Contents Page

Part II. Review of Debt Sustainability and Related Policy Issues

Executive Summary

- Twenty-six countries are benefiting from debt relief under the enhanced HIPC Initiative, of which six have reached the completion point. Since the spring, two countries (Burkina Faso and Mauritania) have reached completion points and two preliminary HIPC documents have been considered (Côte d'Ivoire and Democratic Republic of Congo). Bringing the remaining dozen countries to the decision point continues to be a challenge as these countries are mostly conflict-affected; and many of them have substantial arrears problems. To provide the opportunity for all eligible HIPCs to benefit from HIPC relief, it is proposed to extend the sunset clause of the Initiative by another two years to end-2004.

- Many countries in their interim periods may take longer than anticipated to reach their completion points due to the need to develop their PRSPs and overcome difficulties in the implementation of their economic adjustment and reform programs. The provision of interim assistance by major creditors supports the efforts of HIPCs, and lowers these countries' near-term debt-service costs substantially.

- As noted in the last progress report, the outlook for many HIPCs has deteriorated with the global economic downturn and the fall in commodity prices. Accordingly, some shareholders and external observers have made proposals for additional relief. The Initiative has the flexibility to ensure a sustainable exit from the Initiative by providing, when appropriate, additional debt relief at the completion point.

- To maintain long-term debt sustainability beyond the HIPC Initiative, HIPCs will have to achieve sustained economic growth and export diversification through sound economic management, and improved governance and institutions. The international community needs to provide strong support through adequate financing on highly concessional terms. An increase in grants will help ensure that external financing is consistent with the repayment capacity in countries that are particularly vulnerable, and the recent expansion of grants in the IDA-13 replenishment will contribute to this.

- Donor support has played a critical role in the provision of debt relief by multilateral creditors under the HIPC Initiative. However, the expected financing needs of the Initiative have not been fully met, including the potential costs of "topping-up". Recent indications of donor support could help meet these needs, but need to be converted into firm commitments. Any increase in debt relief, including through modifications to the Initiative, would require additional donor financing to avoid a weakening of the capacity of multilateral creditors to provide financial support to low-income countries, including the HIPCs.

- Full participation by all creditors is essential in order to ensure that the debt stocks of HIPCs are reduced to sustainable levels. The staffs are seeking ways to raise the participation of multilateral and non-Paris Club official bilateral and commercial creditors. This remains a key issue for the successful implementation of the HIPC Initiative.

I. INTRODUCTION

1. Part I of this report reviews progress in the implementation of the HIPC Initiative since March 2002.[1] Amongst other items, this includes updates on the status of implementation in countries during their interim period, the status of creditor participation under the Initiative, new information on the operations of the HIPC Trust Fund, and on creditor litigation against HIPCs. The report also proposes an extension of the sunset clause and moving to an annual review cycle.

2. As a follow up to the earlier analysis of long-term debt sustainability, Part II of this paper updates the HIPCs' external debt outlook and discusses key issues that are important for achieving long-term debt sustainability, including a review of long-term projections under the HIPC Initiative, an analysis of the impact of an increase in grant financing, and a brief account of proposals to modify the HIPC framework.

PART I. PROGRESS OF IMPLEMENTATION

II. IMPLEMENTATION UPDATE

3. Since March 2002, Burkina Faso and Mauritania reached their completion points and preliminary HIPC documents were considered for Côte d'Ivoire and the Democratic Republic of Congo. Looking ahead, in the next few months, Côte d'Ivoire is expected to reach its decision point, Mali its completion point, and a preliminary HIPC document is under preparation for the Central African Republic.

4. The implementation of the Initiative for the remainder of 2002 and into 2003 will continue to face the challenges noted in the Spring 2002 progress report. Twelve countries that are expected to require HIPC relief have not yet reached their decision points. Most of these countries are conflict-affected[2] and/or have substantial arrears problems, with inherent complexities in designing and implementing a viable reform package. Wherever possible, the staffs continue to work with the authorities in these countries to develop strategies for moving ahead.

---

[1] "Heavily Indebted Poor Countries Initiative—Status of Implementation," SM/02/94, March 25, 2002, http://www.imf.org/external/hipc, and IDA/SecM2002-0155, March 22, 2002, http://www.worldbank.org/hipc.

[2] For an in-depth analysis of the challenges facing post-conflict countries, see "Assistance to Post-Conflict Countries and the HIPC Initiative," IMFC/Doc/3/01/7 and DC2001-0014, April 20, 2001, http://www.imf.org/external/np/hipc and http://www.worldbank.org/hipc.

Table 1. Enhanced HIPC Initiative: Committed Debt Relief and Outlook

Status as of July 2002

(In millions of U.S. dollars) 1/

	Reduction in NPV Terms			Nominal Debt Service Relief			
	Original HIPC Initiative	Enhanced HIPC Initiative	Total	Original HIPC Initiative	Enhanced HIPC Initiative	Total	Date of Approval
Countries that have reached their Completion Points (6)							
TOTAL	**2,740**	**4,788**	**7,528**	**5,510**	**7,830**	**13,340**	
Bolivia	448	854	1,302	760	1,300	2,060	Jun-01
Burkina Faso	229	324	553	400	530	930	Apr-02
Mauritania	0	622	622	0	1,100	1,100	Jun-02
Mozambique	1,716	306	2,022	3,700	600	4,300	Sep-01
Tanzania	0	2,026	2,026	0	3,000	3,000	Nov-01
Uganda	347	656	1,003	650	1,300	1,950	May-00
Countries that have reached their Decision Points (20)							
TOTAL	**377**	**16,851**	**17,228**	**660**	**26,720**	**27,380**	
Benin	0	265	265	0	460	460	Jul-00
Cameroon	0	1,260	1,260	0	2,000	2,000	Oct-00
Chad	0	170	170	0	260	260	May-01
Ethiopia	0	1,275	1,275	0	1,930	1,930	Nov-01
The Gambia	0	67	67	0	90	90	Dec-00
Ghana	0	2,186	2,186	0	3,700	3,700	Feb-02
Guinea	0	545	545	0	800	800	Dec-00
Guinea-Bissau	0	416	416	0	790	790	Dec-00
Guyana	256	329	585	440	590	1,030	Nov-00
Honduras	0	556	556	0	900	900	Jul-00
Madagascar	0	814	814	0	1,500	1,500	Dec-00
Malawi	0	643	643	0	1,000	1,000	Dec-00
Mali	121	401	522	220	650	870	Sep-00
Nicaragua	0	3,267	3,267	0	4,500	4,500	Dec-00
Niger	0	521	521	0	900	900	Dec-00
Rwanda	0	452	452	0	800	800	Dec-00
São Tomé and Príncipe	0	97	97	0	200	200	Dec-00
Senegal	0	488	488	0	850	850	Jun-00
Sierra Leone	0	600	600	0	950	950	Mar-02
Zambia	0	2,499	2,499	0	3,850	3,850	Dec-00
Countries still to be considered (12)							
Côte d'Ivoire 2/	345	2,519	2,519	800	3,950	3,950	Mar-02 3/
Burundi	…	…	…	…	…	…	
Central African Republic	…	…	…	…	…	…	
Comoros	…	…	…	…	…	…	
Congo, Dem. Rep. of	0	5,773	5,773	0	9,800	9,800	Jun-02 3/
Congo, Rep. of	…	…	…	…	…	…	
Lao PDR	…	…	…	…	…	…	
Liberia	…	…	…	…	…	…	
Myanmar	…	…	…	…	…	…	
Somalia	…	…	…	…	…	…	
Sudan	…	…	…	…	…	…	
Togo	…	…	…	…	…	…	
Memorandum item:							
Debt relief committed under original and enhanced frameworks 4/	**3,462**	**21,639**	**25,101**	**6,970**	**34,550**	**41,520**	

Sources: HIPC Initiative country documents; World Bank and IMF staff estimates.

1/ In net present value (NPV) terms of the decision point year.

2/ It is suggested that debt relief under the original framework be overtaken by HIPC relief under the enhanced framework.

3/ Preliminary document issued.

4/ Countries that have reached their decision points under the enhanced HIPC framework through mid-February 2002 and Côte d'Ivoire, which had reached the decision point under the original framework earlier.

5. Twenty countries are currently in their interim periods. They have shown mixed economic performances. Of the ten countries mentioned in the Spring 2002 report as having encountered problems in the implementation of their macroeconomic programs, three countries have now resumed their PRGF-supported programs (Guinea, Niger, and Rwanda); another four countries are implementing corrective measures agreed with the IMF and World Bank staff in order to build a track record of policy performance for the resumption of a PRGF-supported program (Malawi, Nicaragua, Guyana, and São Tomé and Príncipe). The remaining three countries (Guinea-Bissau, Honduras, and Senegal) continue to have difficulties in the implementation of their economic reform programs. Madagascar joined this group due to prolonged domestic uncertainty following the presidential election dispute, which has delayed the second review of the program. Of the three countries that earlier experienced delays in preparation of their PRSP, the government of Mali adopted its PRSP in end-May 2002, and Benin and Cameroon have also made progress and are expected to finalize their PRSPs in the third quarter of 2002.

6. The HIPC relief committed so far to the 26 countries that have either reached their completion points or are in their interim period, together with debt relief under the traditional mechanism and additional bilateral debt forgiveness over and beyond the HIPC Initiative, represents a reduction in the outstanding debt stock of about US$40 billion in NPV terms, or a two-thirds reduction of the overall debt stock of these countries. The HIPC Initiative continues to provide substantial savings in terms of debt-service payments for HIPCs, notwithstanding the delay in bringing a number of countries to their completion points (Box 1). Compared with the levels recorded in 1998–99, average annual debt service due during 2001–05 for these countries is expected to be lower by almost 40 percent, with the savings averaging about US$1.3 billion per year. This relief in part enables countries to increase social expenditures, which on average could rise from 6 percent GDP in 1999 to 9 percent in 2002, a level almost four times that spent on debt service. Nevertheless, the amount of debt-service savings and the related increase in social expenditures in the near term vary across countries depending on their specific situations. As countries strive to implement their PRSP, poverty-reducing spending is expected to increase in all countries that are on track in their economic reform programs, with financing from increased revenue and international support in the form of new aid flows and debt relief.

Box 1. HIPC Initiative: Evolution and Achievements to Date

Evolution:
The HIPC Initiative was launched in 1996 and is aimed at providing comprehensive relief to reduce the debt burden for the world's poorest and most heavily indebted countries pursuing economic and social reform aimed at reducing poverty. The Initiative marked the first time that multilateral creditors provided debt relief. In 1999, a consensus emerged for a modification of the framework to provide three key enhancements:

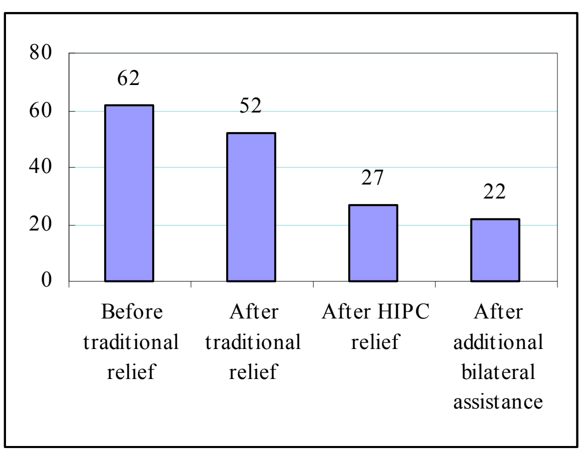
- **Deeper and Broader Relief:** External debt sustainability thresholds were lowered from the original framework providing more debt relief. Also, more countries have become eligible for debt relief and some countries became eligible for greater relief.

- **Faster Relief:** A number of creditors began to provide interim debt relief immediately at the decision point. Countries could reach the completion point faster.

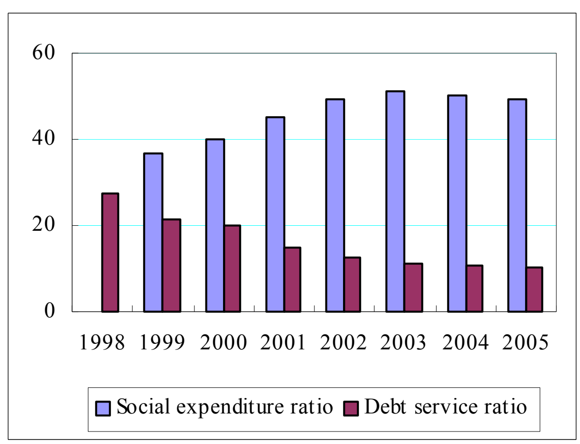
- **Stronger Link Between Debt Relief and Poverty Reduction:** Freed resources were to be used to support poverty reduction strategies–in the form of PRSPs–developed by national governments in consultation with civil society.

Achievements *(for the 26 decision point countries–as of July 2002):*
- Debt relief approved for 26 out of 38 countries projected to require relief. The countries yet to reach decision points face serious challenges as most are conflict-affected and/or have substantial arrears problems;
- Six countries reached completion points where debt relief is released unconditionally. Creditor participation is high but not complete;
- Twenty countries are receiving interim debt relief;
- Average NPV of external debt cut by approximately two-thirds (with other forms of debt relief);
- Debt service as a percentage of exports cut by half from 16.5 percent in 1998–99 to 8 percent in 2001-05 compared to an average for other developing countries of over 20 percent;
- Debt service as a percentage of GDP reduced from 4 percent in 1998–99 to 2 percent;
- Debt service as a percentage of government revenue reduced from 24 percent in 1998-99 to about 10 percent by 2005; and
- Social expenditures projected to increase substantially, in part financed by resources freed up by HIPC relief; poverty-reducing spending will rise from less than two times that on debt-service payments to more than four times.

Debt Stock Reduction in NPV of Debt
(In billions of U.S. dollars in decision point terms)



Debt Service Reduction and Social Spending
(In percent of fiscal revenue)



III. UPDATE OF COSTS

A. Projected Costs of HIPC Relief

7. The costs of providing debt relief under the Initiative to 34 countries are estimated at US$37.2 billion in 2001 NPV terms or slightly higher than the projections made last March of US$36.4 billion (Table 2 and Box 2). The revision in total costs reflects mainly (i) revision in debt data for Burkina Faso at its completion point; (ii) topping up of debt relief to Burkina Faso at its completion point (US$129 million in NPV terms); (iii) upward revision of costs for the Democratic Republic of Congo (by US$545 million) and for Côte d'Ivoire (by US$94 million); and (iv) slight revisions in decision point debt data for Mali and Benin in light of revised DSAs associated with their upcoming completion point documents. The costs of potential additional debt relief at the completion point for other cases are discussed separately below (see Section III-B).

Table 2. HIPC Initiative: Estimates of Potential Costs by Creditor Group 1/
(34 Countries)

	March 2002 Costing Exercise	July 2002 Costing Exercise 2/	July 2002 Share of Total Costs
	(In billions of U.S. dollars, in 2001 NPV terms)		(In percent)
Total costs	**36.4**	**37.2**	**100.0**
Bilateral and commercial creditors	**18.8**	**19.2**	**51.8**
Paris Club	14.1	14.3	38.4
Other official bilateral	3.2	3.2	8.7
Commercial	1.5	1.6	4.4
Multilateral creditors	**17.6**	**17.9**	**48.3**
World Bank	8.1	8.2	22.1
Of which : IDA	7.4	7.5	20.2
IBRD	0.8	0.8	2.2
IMF	2.7	2.7	7.4
AfDB/AfDF	3.0	3.2	8.5
IaDB	1.2	1.2	3.2
Other	2.6	2.6	7.0
Memorandum item:			
Total costs including Liberia, Somalia, and Sudan	45.3	46.0	123.7

Sources: HIPC Initiative country documents; and Fund and Bank staff estimates.

1/ All HIPCs, excluding Liberia, Somalia, Sudan, Angola, Kenya, Lao P.D.R., Vietnam, and Yemen.
2/ Reflects updated DSAs for Benin, Burkina Faso, Democratic Republic of Congo, Côte d'Ivoire and Mali.

Box 2. Historical Perspective on Costs of HIPC Relief

Since the HIPC Initiative was introduced in 1996, the costs of financing the Initiative have increased considerably. The first estimate of the costs of HIPC relief under the Original Initiative in 1996 was US$5.6 billion in 1996 NPV terms and covered the costs for 13 countries. Over time, the number of countries included in the costing exercise has increased, even though the number of countries eligible for relief under the HIPC Initiative has remained at 40–42. This is because the costing exercise is based on the availability of reliable debt data, the prospects for countries to qualify for HIPC relief, and countries' intention to seek debt relief. As a result of changes in these three factors, the estimated costs of debt relief under the HIPC Initiative has increased to US$37.2 billion in 2001 NPV terms for 34 countries. Other reasons for the increase in costs include:

- An increase in the number of countries included in the costing estimates from 13 in 1996 to 34 currently. These 34 countries reflect the entire group of potentially eligible HIPCs (42) but exclude those countries which are expected to be sustainable under the current framework (four countries: Angola, Kenya, Vietnam, and Yemen) as well as Lao P.D.R., Liberia, Somalia, and Sudan.

- The enhancement of the framework in September 1999 more than doubled the costs of the Initiative (see Box 1 for details of the changes to the framework).

- Changes in economic factors (i.e., value of exports due to changes in prices and/or quantities) and financial parameters (i.e., exchange rates and interest rates) have also served to increase the costs of the Initiative. The decrease in Commercial Interest Reference Rates (CIRRs), which are the basis for the discount rates used to derive NPV terms, observed over the past few years has also served to increase debt stocks and debt relief costs in NPV terms.

Costs of HIPC Relief
(In billions of U.S. dollars)

	Original Framework				**Enhanced Framework**			
	June 1996	July 1997	Aug. 1998	April 1999	Dec. 1999	Aug. 2000	Aug. 2001	Aug. 2002
Costs in NPV terms 1/	5.6	7.4	8.2	12.5	28.2	28.6	33.2	37.2
Costs in 2001 NPV terms 2/	7.5	9.9	11.0	14.9	31.7	32.1	35.2	37.2
Number of countries included for costing exercise	13 Burundi Ethiopia Guinea-Bissau Madagascar Mozambique Myanmar Nicaragua Niger Rwanda São Tomé and Príncipe Uganda Zaire Zambia	19 Added: Bolivia Burkina Côte d'Ivoire Guyana Mauritania Tanzania	20 Added: Mali	26 Added: Cameroon Chad Rep. of Congo Guinea Malawi Sierra Leone	32 Added: Benin CAR Honduras Lao PDR Senegal Togo	32 Dropped: Lao PDR Added: The Gambia	34 Added: Comoros Ghana	34

Source: HIPC Initiative documents; and staff estimates.

[1] Costs in 1996, 1997, and 1998 are in 1996 NPV terms; costs for April 1999 are in 1998 NPV terms; costs for December 1999 and 2000 are in 1999 NPV terms; costs for 2001 are in 2000 NPV terms; and costs for 2002 are in 2001 NPV terms.
[2] To convert to 2001 NPV terms, note that a constant discount rate of 6 percent per annum was used.

8. The costs of assistance remain broadly equally divided between bilateral and multilateral creditors. An estimated US$26 billion of HIPC relief in 2001 NPV terms has been committed to the 26 decision point countries (Table 3) corresponding to about 70 percent of the estimated total cost of HIPC relief.[3] For multilateral creditors, commitments already made reflect about 77 percent of their estimated total costs, while for bilateral creditors commitments already made reflect 63 percent of the total cost.

Table 3. HIPC Initiative: Breakdown of Potential Costs by Main Creditors and by Country Groups

(In billions of U.S. dollars, in 2001 NPV terms)

		Decision Point Cases (26)			Post-2001
	Total (34 countries)	Retroactive 2/ (8 countries)	New cases 3/ (18 countries)	Total (26 countries)	Other 4/ (8 countries)
Total costs	**37.2**	**7.4**	**18.7**	**26.0**	**11.1**
Bilateral and commercial creditors	**19.2**	**2.9**	**9.3**	**12.2**	**7.0**
Paris Club	14.3	2.2	6.5	8.7	5.6
Other official bilateral	3.2	0.6	2.3	2.9	0.3
Commercial	1.6	0.1	0.5	0.6	1.0
Multilateral creditors	**17.9**	**4.5**	**9.3**	**13.8**	**4.1**
World Bank	8.2	2.0	4.6	6.6	1.7
Of which: IDA	7.5	2.0	4.3	6.3	1.2
IBRD	0.8	0.0	0.3	0.3	0.5
IMF	2.7	0.7	1.4	2.1	0.6
AfDB/AfDF	3.2	0.5	1.3	1.8	1.4
IaDB	1.2	0.6	0.6	1.2	0.0
Other	2.6	0.7	1.5	2.1	0.5
Memorandum item:					
In percent of total cost	100	19.8	50.3	70.0	30.0

Sources: Country authorities; and IMF and World Bank staff estimates.

1/ Excluding Angola, Kenya, Lao P.D.R., Liberia, Somalia, Sudan,Vietnam, and Yemen.
2/ Benin, Bolivia, Burkina Faso, Guyana, Mali, Mozambique, Senegal, and Uganda. Côte d'Ivoire is a retroactive case but has not reached its enhanced decision point.
3/ Cameroon, Chad, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Honduras, Madagascar, Malawi, Mauritania, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Sierra Leone, Tanzania, and Zambia.
4/ Burundi, Central African Republic, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Myanmar, and Togo.

[3] One retroactive case, Côte d'Ivoire, reached its decision point under the original framework in 1998, but has not yet reached its completion point under the original framework, or its decision point under the enhanced HIPC Initiative.

B. Potential Costs of Completion Point Topping Up

9. Updated projections for the 20 countries that are in their interim periods show that the NPV of debt-to-exports ratio in 8–10 countries could be above the 150 percent threshold at their completion points. In total, the debt of these countries (in NPV terms) after additional debt forgiveness already announced by a number of bilateral creditors and in excess of the HIPC threshold could be in the range of US$0.4–0.7 billion (Table 4). This estimate is basically unchanged since March 2002 after allowing for the actual provision of topping up to Burkina Faso—those costs have been shifted into the estimates of overall HIPC relief discussed in Section A above. Other changes since the spring include new DSAs for several countries (Benin and Mali), a revision to the amount of additional bilateral relief in the case of Ethiopia, and revised export projections.

10. As noted in the Spring 2002 progress report, whether or not a country should be considered for topping up of HIPC relief, and if so, for what amount, will need to be evaluated on a case-by-case basis at the completion point in line with the currently agreed-upon methodology.[4]

IV. STATUS OF CREDITOR PARTICIPATION

A. Overview of Creditor Participation

11. Based on the most recent available information for the 26 countries that have reached their decision points under the enhanced HIPC Initiative, the average participation of creditors in providing HIPC relief to these countries (financing assurances) amounts to 88 percent of the total required HIPC relief. Among the six completion point countries, Bolivia and Uganda have a creditor participation of 95–96 percent of total relief; Burkina Faso, Mozambique, and Tanzania of 88–90 percent; and Mauritania 80 percent. Burkina Faso has not yet received financing assurances amounting to 80 percent of the total required for the topping up element of the HIPC relief, and staffs have contacted creditors on this. Among the 20 countries in the interim period, nine countries have commitments of more than 90 percent, nine countries have financing assurances of 80 percent or more, and two countries have assurances of less than 80 percent. For the latter two countries, Niger and Senegal, the participation of non-Paris Club creditors will be critical as a sizable amount of claims is held by these creditors. Côte d'Ivoire and the Democratic Republic of Congo are cases where only preliminary documents have been issued; financing assurances for these two countries are currently less than 80 percent.

[4] "The Enhanced HIPC Initiative—Completion Point Considerations," EBS/01/141, August 21, 2001, http://www.imf.org/external/hp/hipc, and IDA/SecM2001-0539/1, August 21, 2001, http://www.worldbank.org/hipc.

Table 4. Potential Cost of Additional Debt Relief at the Completion Point 1/

	Projection at Decision Point 2/		Spring 2002 Projections		Updated Projections 3/	
	After additional bilateral debt forgiveness		After additional bilateral debt forgiveness		After additional bilateral debt forgiveness	
	NPV/export ratio	Debt in excess of HIPC threshold	Range for NPV/export ratio 4/	Range for potential topping up 4/	Range for NPV/export ratio 4/	Range for potential topping up 4/
	(In percent)	(Millions of US$ NPV terms)	(In percent)	(Millions of US$)	(In percent)	(Millions of US$)
Benin	138	…	148 - 154	0 - 15	158-170	28-70
Chad	188	85	188 - 219	91 - 161	188-224	91-169
Ethiopia	149	0	164 - 186	129 - 339	137-159	0-88
The Gambia	153	4	162 - 177	15 - 32	162-174	14-30
Guinea-Bissau	107	…	147 - 152	0 - 1	147 - 152	0 - 1
Malawi	156	12	158 - 165	36 - 67	165-165	68-71
Niger	164	38	144 - 148	…	159-167	25-48
Rwanda	185	44	161 - 171	16 - 33	180-198	46-73
Senegal	112	…	157 - 158	94 - 110	158-159	111-128
Zambia	106	…	151 - 154	10 - 41	152-154	15-46
Cameroon	101	…	99 - 112	…	95-113	…
Ghana	82	…	…	…	82-83	…
Guinea	123	…	139 - 141	…	135-140	…
Guyana	57	…	68 - 76	…	69-77	…
Honduras	74	…	90 - 91	…	91-92	…
Madagascar	101	…	75 - 81	…	76-83	…
Mali	143	…	139 - 140	…	128-130	…
Nicaragua	93	…	108 - 117	…	108-117	…
São Tomé and Príncipe	139	…	124 - 140	…	132-143	…
Sierra Leone	139	…	…	…	139-150	…
Total		183		391-800		391-725
Excluding Chad 5/		98		300-638		300-555
Memo Item:						
Including Burkina Faso and Chad 6/		273		520 - 929		520 - 854

Source: World Bank and IMF staff estimates and projections.

1/ Consideration for topping up of HIPC relief will need to be evaluated on a case-by-case basis at the completion point in line with the currently agreed-upon methodology.

2/ For the year preceding the assumed completion point.

3/ The figures differ from those presented in the Spring 2002 report due to: a) revisions to the additional bilateral relief for Ethiopia; b) updated export projections; c) new DSAs conducted for certain countries; and d) Burkina Faso having passed its completion point.

4/ The range is calculated based on the debt ratio for the year preceding the assumed completion point and the ratio assuming a 1-year delay in reaching the completion point.

5/ High debt-to-export ratios for Chad are projected to be temporary due to an expected surge in oil-related exports from 2004 on. Thus Chad is not expected to require a topping up of HIPC relief at its completion point.

6/ Burkina Faso reached its completion point in April 2002, at which time debt relief was topped up by US$129 million in NPV terms.

B. Multilateral Creditors

12. The adjustments in assistance by multilateral creditors since the last review are minor. Such creditors account for US$17.9 billion of the US$37.2 billion in total costs for the HIPC Initiative in 2001 NPV terms, of which US$13.8 billion is to the 26 HIPCs that have reached their decision points. IDA, the IMF, the AfDB, and the IaDB are the largest multilateral creditors (Table 5). They, along with the majority of other multilateral creditors, are providing assistance to countries that have reached their decision points and have delivered their full share to countries that have reached their completion points.[5] The multilateral creditors that are providing HIPC relief or are committed to do so accounted for US$13.8 billion, or more than 98 percent of the debt relief that is currently expected from multilateral creditors. So far, multilateral creditors have delivered over US$3.2 billion in relief. IDA and the IMF represent 11 percent of total disbursements delivered to date under both the original and enhanced HIPC frameworks. The MDBs still not committed to delivering their share of relief under the Initiative are shown in Table 5.

13. For the **World Bank Group**, the financing of its overall HIPC relief will require not only the fulfillment of the existing funding, but also the financial support over the longer term by donors. A broadening of the list of countries (see Box 2), or any modification to the HIPC Initiative framework that raises the total cost of debt relief, will have cost implications for all creditors concerned, including the World Bank. In the absence of additional donor funding, this will reduce the resources available for new IDA lending.

14. The total cost to the **IMF** is estimated at US$2.7 billion (2001 NPV terms), of which US$2.1 billion is for the 26 decision point countries. The IMF has already committed to provide the latter relief in full; this amounts to US$1.9 billion (equivalent to SDR 1.6 billion) in decision point terms. Of this, SDR 0.8 billion in HIPC relief has already been delivered in the form of grants.[6] The IMF has secured sufficient resources to finance its participation in the HIPC Initiative (excluding the potential debt relief cost for Liberia, Somalia, and Sudan).[7]

---

[5] Administrative procedures are still underway to complete this process for Burkina Faso and Mauritania, which only reached their completion points in April and June 2002, respectively.

[6] No relief has been provided to São Tomé and Príncipe, which had no outstanding obligations to the IMF at the decision point, and Nicaragua, which has experienced track record interruptions in its PRGF arrangement. The release of the topping up amount for Burkina Faso is subject to satisfactory financing assurances.

[7] See "Update on the Financing of PRGF and HIPC Operations and the Subsidization of Post-Conflict Emergency Assistance" SM/02/273, August 21, 2002.

Table 5. Delivery of HIPC Relief by Multilateral Creditors

Status	Multilateral Creditor	Cost of HIPC Relief to 26 Decision Point Countries (In millions of U.S. dollars, in 2001 NPV terms)
Delivering or committed to delivering debt relief 1/	World Bank	6,556
	International Monetary Fund (IMF)	2,123
	African Development Bank (AfDB)	1,821
	Inter-American Development Bank (IaDB)	1,194
	Central American Bank for Economic Integration (CABEI)	539
	European Union/European Investment Bank (EU/EIB)	484
	International Fund for Agricultural Development (IFAD)	238
	Arab Bank for Economic Development in Africa (BADEA)	162
	OPEC Fund for International Development	152
	Islamic Development Bank (IsDB)	129
	Corporación Andina de Fomento (CAF)	102
	Arab Fund for Social and Economic Development (AFESD)	68
	Caricom Multilateral Clearing Facility (CMCF)	63
	West African Development Bank (BOAD)	45
	Fund for the Financial Development of the River Plate Basin (FONPLATA)	27
	Nordic Development Fund (NDF)	24
	Caribbean Development Bank (CDB)	19
	Banque Centrale des Etats d'Afrique de l'Quest (BCEAO)	6
	Nordic Investment Bank (NIB)	4
	Banque des Etats de l'Afrique Centrale (BDEAC)	1
Not yet approved debt relief for any HIPCs	Economic Community of West African States (ECOWAS)	15
	Arab Monetary Fund (AMF)	13
	Eastern and Southern African Trade and Development Bank (PTA Bank)	8
	East African Development Bank (EADB)	4
	Conseil de L'Entente (FEGECE)	3
	Fondo Centroamericano de Estabilización Monetaria (FOCEM)	2
	Fund for Solidarity and Economic Development (FSID)	1

Sources: HIPC documents; HIPC authorities; multilateral creditors, and Bank and Fund staff estimates.

1/ Several of these creditors are providing relief on a case-by-case basis, and have yet to agree to participation in the entire HIPC Initiative. Moreover, for a few of these creditors significant delays in developing the modalities and the actual delivery of debt relief have been experienced.

C. IDA-Administered HIPC Trust Fund

15. The HIPC Trust Fund helps support the provision of debt relief to eligible HIPCs by regional and sub-regional multilateral creditors and by the World Bank. It has long been recognized that the pledged funding of the HIPC Trust Fund would fall short of that required. In this context, in June 2002 the G-8 members agreed to fund their share of the shortfall, recognizing that it will be up US$1 billion.[8]

16. **World Bank Group Financing**. It is expected that future IDA debt service relief to eligible countries will average over US$500 million per year well into the next decade. The IBRD has so far allocated US$1.4 billion out of its net income and surplus to the World Bank component of the HIPC Trust Fund, out of a total pledge of US$2.15 billion in NPV terms over time. In the absence of additional donor contributions to finance IDA debt relief before the beginning of IDA14, estimated IBRD net income transfers of about US$240 million per year on average will be needed over the next four years in order to fulfill this pledge and enable the Trust Fund to reimburse IDA for the debt relief it will be providing over that period. On August 8, 2002, the World Bank Executive Board recommended to the Board of Governors the transfer of US$240 million of fiscal year 2002 net income to the HIPC Trust Fund. The financing of IDA's unfunded HIPC relief costs will be addressed in 2004 during the IDA14 replenishment discussions.

17. Because IBRD net income transfers to the HIPC Trust Fund cannot be used to provide debt relief for the three countries that have substantial levels of outstanding IBRD debt (Cameroon, Côte d'Ivoire, and Honduras), IDA debt relief grants and credits are being used to finance this debt relief. These grants and loans are estimated to total about US$700 million during the IDA13 period. These additional IDA funding requirements for debt relief for these three countries during IDA13 were taken into account in the development of the overall IDA13 replenishment package.

18. **Bilateral Donor Support**. As of end-June 2002 pledges by bilateral donors to the HIPC Trust Fund to support the debt relief provided by regional and sub-regional creditors totaled approximately US$2.5 billion[9] with paid–in contributions reaching US$1.7 billion. Payments received in FY02 totaled US$730 million from 16 donors including Euro 250 million (US$226 million) from the European Commission and US$239 million from the United States. Total outstanding pledges to the Trust Fund for these creditors as of end-June 2002 were correspondingly close to US$800 million. Almost all of these pledges are expected to be paid-in by the end of the year.

19. **Recipients of HIPC Trust Fund Support**. The AfDB is the largest recipient among the regional and sub-regional creditors. From its inception, the Trust Fund has entered into agreements providing US$818 million in donor resources to the AfDB. Other regional and sub-regional

---

[8] See The Kananaskis Summit Chair's Summary, The 2002 Summit, Kananaskis, Canada, http://www.g8.gc.ca/kan_docs/chairsummary-e.asp.

[9] Excludes funding provided by bilateral donors to support debt relief to be provided by IDA or the IMF. It also does not include the funds provided to the Trust Fund by the Nordic Development Fund to finance its debt relief under the HIPC Initiative.

creditors receiving support from the Trust Fund include: IaDB US$78 million, CABEI US$44 million, CAF US$56 million, FONPLATA US$19 million, BOAD US$19 million, IFAD US$8 million, and CMCF US$2 million.

20. **Financing Requirements**. It is currently estimated that the financing required to support the debt relief of these creditors for the 34 HIPCs that have already reached their decision points or are expected to require HIPC relief in the future will fully exhaust the resources mobilized to date by the HIPC Trust Fund and will leave a potential funding gap of up to US$750–800 million. It is expected that donors will meet this fall to review the financing requirements of the HIPC Trust fund. Additional donor pledges to address this gap are needed by the end of 2002.

21. This estimated funding gap includes potential funding requirements for the HIPC Trust Fund that could be created by decisions to top up debt relief at completion point. It has been estimated that such topping-up could increase the financing requirements of the Trust Fund to support AfDB debt relief by as much as US$100 to US$150 million.

22. The above shortfall estimate does not include additional HIPC Trust Fund support for IFAD, beyond that which has already been specifically earmarked by individual bilateral donors as part of their contribution. Should donors decide to earmark additional support through the HIPC Trust Fund to IFAD, this will correspondingly increase on a one-to-one basis the financing shortfall faced by the HIPC Trust Fund.

23. **Multilateral Development Banks**. Since the last status report, there has been some discussion about identifying ways to enable Multilateral Development Banks (MDBs) which do not currently benefit from support under the HIPC Trust Fund, to participate in the Initiative. Up to now, eight MDBs have used the Trust Fund to help finance the delivery of their share of HIPC relief, but several other MDBs have approached the HIPC Trust Fund for possible financial support in order to be able to provide their required debt relief.[10] As Table 5 above shows, the HIPC costs for creditors which have yet to provide relief totals US$46 million in 2001 NPV terms.

D. Paris Club Creditors

24. Since March 2002, Paris Club creditors have provided completion point stock-of-debt relief on Cologne terms to Burkina Faso[11] and Mauritania. Upon reaching the decision point under the enhanced HIPC Initiative, Ghana received a flow rescheduling on Cologne terms. Paris Club creditors also started providing interim assistance to Ethiopia and Sierra Leone by reducing cash debt-service obligations under their existing Naples flow reschedulings further by 70 percent in approximation to the level of debt service under a Cologne flow rescheduling. Côte d'Ivoire, which

---

[10] As noted above, AfDB, IaDB, CABEI, CAF, FONPLATA, BOAD, IFAD, and CMCF have accessed the HIPC Trust Fund and the CDB was included as an eligible creditor within the context of the Latin American financing framework. For IFAD, donors have made specific allocations.

[11] They also committed to provide the topping up of relief, but have yet to agree the modalities for doing so.

had previously reached its decision point under the original HIPC Initiative, received a flow rescheduling on Lyon terms that will be topped up to Cologne terms when it reaches the enhanced decision point. After the clearance of some arrears, Paris Club creditors have agreed to provide interim assistance to Zambia. In addition, a number of Paris Club creditors have started to provide additional bilateral debt cancellation for the decision point countries.

E. Non-Paris Club Official Bilateral Creditors

25. Some progress has been made since the last report in securing the participation of non-Paris Club official bilateral creditors. India indicated its willingness to provide its share of HIPC relief. Saudi Arabia agreed to provide debt relief to Mauritania at its completion point; Côte d'Ivoire also agreed to deliver debt relief to Burkina Faso and other HIPCs; and the Republic of Korea has agreed to provide relief to Uganda. Overall, there are still 24 creditor countries that have not yet expressed their intention to provide relief (Tables 6 and 7). Participation by all creditors and the prompt delivery of the required debt relief by these creditors has become a pressing issue, especially for countries that have already reached their completion points. To secure the full benefit of HIPC relief as more HIPCs reach their completion points, it remains very important that all creditors fully participate in the Initiative.

26. In a small number of cases, non-Paris Club official bilateral creditors have resorted to litigation as a means of recovering assets. There have also been cases where non-Paris Club creditors have threatened to litigate against HIPCs and/or have chosen to ignore the requests for HIPC relief. This is particularly distressing for the completion point countries. A recent example is the case of Burundi which has initiated legal proceedings to recover debt owed by Uganda (US$15 million sought against US$1.5 million recorded at Uganda's completion point). The Burundi authorities have indicated to the staffs that they will not pursue legal action further.

27. As discussed in the Spring 2002 progress report, Bank and Fund staffs are seeking to raise the participation of non-Paris Club official bilateral creditors. In an effort to increase awareness of the need to participate in the HIPC Initiative, Bank and Fund managements sent letters to the Governors of the Bank and the Fund after the spring meetings calling on their authorities to participate in the HIPC Initiative and reminding creditors of their responsibilities under the Initiative as part of the international community. The staffs have had follow-up discussions with a number of creditors.

28. The staffs are in the process of examining ways to help HIPC creditors provide relief to HIPC debtors. One possibility being explored would be to use bilateral donor resources to finance relief for such claims, possibly through a separate trust fund. The resources required would be relatively small. Such a mechanism would have to reconcile outstanding issues, including establishing the eligibility for access to such a Trust Fund, whether to provide this support retroactively to cover debt relief already provided and the treatment of outstanding credits in the process of litigation.

Table 6. Delivery of HIPC Relief by Non-Paris Club Official Bilateral Creditors

Status	Non-Paris Club Official Bilateral Creditors	
Delivered debt relief on all claims on HIPCs	Argentina Brazil	South Africa Tanzania
Agreed to deliver debt relief on all claims on HIPCs	Côte d'Ivoire Egypt 1/ Honduras Hungary*	India* Morocco Pakistan*
Delivered or agreed to deliver debt relief on some, but not all, claims on HIPCs	Algeria * 2/ Bulgaria 3/ China* 4/ Costa Rica 5/ Czech Republic* 6/ Guatemala 5/ Kuwait*	Mexico* 7/ Poland* 8/ Republic of Korea* 9/ Saudi Arabia* Slovak Republic* 6/ United Arab Emirates* 10/ Venezuela 11/
Not yet agreed to deliver HIPC relief	Angola Burundi Cameroon Cape Verde Colombia* Cuba Democratic Republic of Congo Former Yugoslavia 12/ Iran Iraq Libya Niger	Nigeria Oman* People's Democratic Republic of Korea Peru* Romania Rwanda Senegal Taiwan Province of China Thailand Togo Zambia Zimbabwe

Sources: HIPC documents; HIPC authorities; and correspondence between Bank and Fund staff and creditor authorities.

* denotes creditors that have been in touch with Bank and Fund staff regarding the provision of HIPC relief.

1/ Egypt has written off its (small) claims on Tanzania, and has contacted Guinea about the delivery of HIPC relief.

2/ Algeria provided relief to Mozambique on Lyon terms in 1998 under the original HIPC Initiative. Mozambique has requested a topping up to Cologne terms under the enhanced HIPC Initiative.

3/ Bulgaria agreed to deliver HIPC relief to Nicaragua.

4/ In the context of a broader debt relief for 32 African countries, China has provided debt relief to 15 decision point HIPCs. The Chinese authorities have indicated that currently there is no political basis to provide debt relief to countries which do not have diplomatic ties with China.

5/ Guatemala has provided HIPC relief to Nicaragua, and Costa Rica has indicated its intention to provide relief to Nicaragua.

6/ The Czech and Slovak Republics have already provided relief on terms consistent with the HIPC Initiative to Nicaragua and have agreed to provide relief to Zambia, but have sold claims on other HIPCs to commercial creditors in the secondary market.

7/ Mexico rescheduled debt owed by Nicaragua in 1996.

8/ Poland has agreed to provide relief to Mozambique and Nicaragua, and to work toward finding a solution with Tanzania once the nature of the claims is established.

9/ The Republic of Korea has agreed to provide debt relief to Uganda.

10/ United Arab Emirates and Mauritania have begun negotiations for the delivery of HIPC relief.

11/ Venezuela wrote off its claims on Bolivia in 1997.

12/ Successor states.

Table 7. Non-Paris Club Creditors Which Have Yet to Commit HIPC Relief 1/
(In millions of U.S. dollars in 2001 NPV terms)

Total amount of HIPC relief (24 creditor countries)	**795.0**
HIPCs	27.4
Angola 2/	25.8
Burundi 3/	0.2
Cameroon 4/	0.0
Democratic Republic of Congo	0.3
Niger	0.3
Rwanda	0.6
Senegal 4/	0.0
Togo 4/	0.0
Zambia	0.2
Non-HIPCs	767.6
Bank/Fund members	461.5
Cape Verde	0.2
Colombia	3.9
Former Yugoslavia	56.3
Iran	54.0
Iraq	85.0
Libya	213.9
Nigeria	1.7
Oman	1.3
Peru	7.9
Romania	36.8
Thailand	0.4
Zimbabwe	0.1
Non-Bank/Fund members	306.1
Cuba	1.9
People's Democratic Republic of Korea	19.4
Taiwan Province of China	284.8

Source: HIPC country documents; and IMF and World Bank staff estimates.

1/ For 26 HIPCs which have reached decision points.

2/ Angola is believed to have a sustainable debt, and is not expected to require HIPC relief.

3/ Based on Uganda's completion point document, where total claims were shown as US$1.5 million. However, Burundi has initiated litigation for an amount of US$15 million against Uganda.

4/ Total claims are less than US$0.1 million.

F. Commercial Creditors

29. Debt relief from commercial creditors accounts for only 4.4 percent of HIPC relief, but is the most difficult to obtain and track, as these creditors generally have little interaction with the World Bank and the IMF. Securing their participation in the HIPC Initiative will require extra efforts by the international community. While small in NPV terms, commercial creditors can create pressure for settling claims because debtors may fear the impact of litigation and/or impairment of creditor-debtor relationships.

30. As noted in the previous progress report, commercial claims have been retired mostly under the IDA-administered commercial debt reduction facility and operations are currently under way in Cameroon and Tanzania. Mozambique is considering the possible use of the IDA-administered buyback facility to retire debt not treated in its 1991 IDA buyback. It is expected that more decision point HIPCs will use this facility in the future.

G. Creditor Litigation Against HIPCs

31. The issue of creditor litigation, and in particular that of vulture funds and other debt brokers purchasing HIPC debt in the secondary market and then seeking to maximize recovery through litigation, has received heightened public attention in recent years. Staffs conducted a survey among 28 HIPCs for which HIPC documents have been prepared. Of the 23 HIPCs that responded, 13 indicated that they were not facing any lawsuits, though they did note that they had yet to receive any HIPC relief from some of their non-Paris Club creditors. However, 10 HIPCs responded that they were facing litigation on credits held by commercial creditors and the governments of Iraq and Burundi. The information provided is summarized in Table 8 below. For some, such proceedings can be quite burdensome. Uganda is facing six cases of litigation, Sierra Leone five cases, Nicaragua three cases and the other HIPCs one or two cases each.

32. One promising development is that Del Favero, which had previously been pursuing legal action against Cameroon, has recently decided to rejoin negotiations in the London Club. In the case of Sierra Leone, threats of litigation have resulted in partial payments to creditors for small amounts. This is exceptional, however; although several creditors have received judgments against HIPC debtors, the HIPCs have yet to make payment to these creditors.[12]

33. Bank and Fund staffs have taken a number of measures to minimize the impact of creditor litigation against HIPCs. As HIPCs reach critical points under the Initiative, the staffs have regularly informed non-Paris Club official bilateral creditors of their expected participation; the issue of debt relief delivery has also been raised during consultation missions to the creditor countries. Moreover, staff and management have discouraged non-Paris Club official bilateral

[12] The recent case of Red Mountain's claims on Democratic Republic of Congo (DRC) preceded DRC's consideration under the HIPC Initiative.

creditors from selling HIPC debt in the secondary market, with a view to limiting the supply of debt that could form the basis for legal action by third parties. Looking ahead, in addition to continuing these efforts, the staffs will monitor closely lawsuits brought against HIPCs, and encourage a more active use of the IDA debt reduction facility to help retire debt to commercial creditors. These countries would also benefit from technical assistance in dealing with legal actions against them.

Table 8. Creditors Entering into Litigation Against HIPCs 1/

Creditor	Domicile of Creditor	HIPC debtor	Amount of Original Claim (US$ mn)	Judgement for Creditor (US$ mn)
Commercial				
TransRoad	Yugoslavia	Uganda		
Industry o14 Oktobar, Krusevac	Yugoslavia	Uganda		
Banco Arabe Espanol	Spain	Uganda		
Sours Fab Famous Rz Promet	Yugoslavia	Uganda		
		Sub-total	***14.5***	***33.8***
Scancem International	Norway	Sierra Leone		
Executive Outcomes	US	Sierra Leone		
J&S Franklin	UK	Sierra Leone		
Umarco	France	Sierra Leone		
Chatelet Investments Ltd.	Sierra Leone	Sierra Leone		
		Sub-total	***24.2***	***Not yet made***
Van Eck Emerging Markets Opportunites Fund	US	Nicaragua		
Leucadia	US	Nicaragua		
GP Hemisphere Associates	US	Nicaragua		
		Sub-total	***70.1***	***275.6***
Kintex	Bulgaria	Ethiopia		
Yugoimport	Yugoslavia	Ethiopia		
		Sub-total	***131.7***	***Not yet made***
Exim Bank	Taiwan Prov. of China	Niger		
Banque Belgolaise	France	Niger		
		Sub-total	***65.0***	***78.2***
Laboratorios Baco	Argentina	Honduras		
Booker Plc	UK	Guyana		
		Sub-total	***13.6***	***Not yet made***
Winslow	Bahamas	Cameroon		
Salah Turkmani	n.a.	Bolivia		
Red Mountain	US	Congo, D.R.		
		Sub-total	***17.8***	***28.4***
Non-Paris Club official bilateral				
Iraq		Uganda		
Burundi 2/		Uganda		
		Sub-total	***8.9***	***Not yet made***
Memo item:				
		Total	***345.8***	***416.0***

Source: HIPC authorities.

1/ Information as reported by individual HIPCs. The Bank and Fund have not made any independent inquiries into the accuracy of the information or the current disposition of the cases. As of July 2002, 13 HIPCs (Benin, Chad, Cote d'Ivoire, The Gambia, Ghana, Guinea, Malawi, Mali, Mauritania, Mozambique, Rwanda, Sao Tome and Principe, and Tanzania) had no cases pending against them. Responses have not yet been received from five countries (Burkina Faso, Guinea-Bissau, Madagascar, Senegal, and Zambia).

2/ Burundi has decided to suspend its court claim.

V. OTHER HIPC INITIATIVE ISSUES

A. Extension of the Sunset Clause

34. The establishment of a track record under IMF- and IDA-supported programs has been one of the main requirements for eligible members to qualify for assistance under the HIPC Initiative. The 1996 Program of Action had stated 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.” The inclusion of a sunset clause was intended to prevent the HIPC Initiative from becoming a permanent facility and was also meant to encourage HIPCs to adopt adjustment programs that could be supported by the IMF and IDA. In the event, the Boards reviewed the sunset clause in 1998 and in 2000 and agreed to a two-year extension at both junctures.

35. Since end-2000, the Democratic Republic of Congo started an adjustment program with IMF and World Bank support. However, eight among the HIPCs have yet to do so: Angola, Burundi, Comoros, Republic of Congo, Liberia, Myanmar, Somalia, and Sudan. Except Angola, all these countries are expected to require HIPC debt relief based on preliminary analysis of their debt situations. Staff propose that the sunset clause be extended by another two years to end-2004 to provide the opportunity for these countries to begin to establish a policy track record that would allow their consideration for HIPC relief.

B. Annual Review Cycle

36. Since the launch of the HIPC Initiative, staffs have reported every six months on the progress in its implementation. In light of the maturing of the HIPC Initiative and progress in its implementation, staff suggest in the future to move to a six-monthly statistical update on implementation, and an annual cycle for a more comprehensive analytical review. Periodic reports to the Boards on policy issues that arise would still be prepared as needed.

PART II. REVIEW OF DEBT SUSTAINABILITY AND RELATED POLICY ISSUES

VI. REVIEW OF DEBT SUSTAINABILITY IN HIPCS

A. Update of Country Debt Sustainability Prospects

37. Bank and Fund staffs reported in Spring 2002 that the global economic slowdown in 2001, together with a significant decline in many primary commodity prices, had led to a deterioration of many HIPCs' external debt indicators. These concerns have prompted public officials, academics, and non-governmental organizations (NGOs) to call for a better understanding of the causes and nature of the recent changes and to propose actions to ensure that the objectives of the HIPC Initiative are achieved. This review is based on a partial update of data utilized in the Spring 2002 paper.[13] It confirms that (i) for the group of HIPCs whose debt indicators worsened in 2001, the principal source of the deterioration was lower exports owing mainly to declining commodity prices; and (ii) while the world economy is recovering slowly, the prices of key export commodities of HIPCs continue to be depressed and are not expected to recover quickly. As a result, the HIPCs' debt sustainability outlooks remain broadly unchanged since this Spring. However, this assessment will have to be kept under close review in light of developments in the world economy and exchange rates.

Key Factors Affecting External Debt Indicators in 2001

38. Updated data confirm that debt-service ratios were reduced substantially for virtually all HIPCs in 2001 from the levels in 1999–2000, reflecting the impact of interim relief. However, interim relief has little effect on the debt stocks. The NPV of debt-to-exports ratios are estimated to have been higher in 2001 than the decision point projections in 15 out of the 23 countries for which updated data are available (Table 9).[14] Large deteriorations compared to the projections (larger than 15 percentage points) are estimated to have occurred in 11 countries, while the NPV of debt-to-exports ratio improved or remained essentially unchanged in eight countries. For those countries which had worsened NPV of debt-to-exports ratios and for which there are new estimates of debt stocks at end-2001 (eight countries), a decomposition of the changes in the ratios reveals that, on average, lower exports accounted for about 56 percent of the deterioration in the NPV of debt-to-exports ratios (Table 9). The NPV of debt for these eight countries has been revised for a number of reasons: higher than projected new borrowing; revisions to the debt

---

[13] This partial update includes new data on exports, revenue, GDP, and debt service in 24 countries. The NPV of debt figures are largely unchanged from the data set used in the Spring 2002 staff paper.

[14] This is the same coverage as in the Spring 2002 review and assumes that in countries for which updated debt data is not available, results are determined by changes in exports alone. Ghana and Sierra Leone both reached their decision points in early 2002 and thus are not included in the comparison of 2001 outturns vs. decision point projections but their medium-term debt outlooks are assessed in this review.

Table 9. HIPCs: Estimated NPV of Debt-to-Exports Ratios in 2001 Compared with Ratios Projected for 2001 at the Decision 1/

(In percentage points)

	Percentage Points Difference NPV of Debt-to-Export Ratio	Effect of NPV of Debt (Numerator) 1/ 2/	Effect of Exports (Denominator)
15 countries with worsened debt-to-exports ratios			
Benin	82	70	11
Burkina-Faso	88	57	30
Chad	. . . 3/	. . . 3/	4
Gambia, The	21	6	15
Guinea	. . . 3/	. . . 3/	25
Guinea-Bissau	. . . 3/	. . . 3/	99
Guyana	55	49	5
Honduras	. . . 3/	. . . 3/	12
Malawi	. . . 3/	. . . 3/	9
Mauritania	75	37	38
Nicaragua	12	-47	59
Sao Tome and Principe	. . . 3/	. . . 3/	45
Senegal	. . . 3/	. . . 3/	33
Uganda	44	19	25
Zambia	58	1	57
8 countries with improved/unchanged debt-to-exports ratios			
Bolivia	-36	-33	-4
Cameroon	-1	-2	1
Madagascar	-31	-7	-25
Mali	-8	10	-18
Mozambique	-34	-7	-27
Niger	. . . 3/	… 3/	-11
Rwanda	-49	3	-51
Tanzania	-41	-22	-19

Sources: Decision Point documents, and World Bank and Fund staff estimates.

1/ Reflects delivery of HIPC relief in line with the assumptions on completion point dates, which differ from figures in Table 4 which are based on the unconditional delivery of HIPC relief .

2/ Includes new borrowing and revisions in the outstanding stock. In the case of Benin, Burkina Faso, and Guyana, the higher NPV of debt is largely due to delays in reaching completion points, implying that the delivery of HIPC relief did not occur as early as originally projected. For countries with recent DSAs, changes in interest and exchange rates have also affected the NPV calculations.

3/ Insufficient information on the NPV of debt was available to make a complete assessment of the NPV debt-to-exports ratio. The estimated effect of exports (3rd column) shows the change in the ratio assuming NPV of debt was as predicated in the Decision Point.

Note: The decomposition of debt and export effects is derived as

$$\Delta(D_t/X_t) = (D_{t-1}/X_t)*(\Delta D_t/D_{t-1} - \Delta X_t/ X_{t-1})$$

where D is the NPV of the debt, X is exports, and Δ is the first difference operator.

stock at the decision point; delays in reaching the completion point compared with decision point projections (Benin, Burkina Faso and Guyana)[15]; and changes to discount and exchange rate assumptions. Exports were lower than projected at the decision point in 16 of the 23 cases and in 10 cases lower exports have contributed to at least a 15 percentage point decline in the NPV of debt-to-exports ratio.

39. Exports in HIPCs that experienced a deterioration in their debt indicators grew only by 3 percent, on average, compared to 12 percent recorded in other HIPCs (Table 10). Also, the export under-performance was significant compared to the average growth rates of 11–14 percent projected at the decision points. This reflected to a large extent a substantial drop in the prices of their key export commodities. On average, the export price index of these countries fell by 4.8 percent, compared to a decline of 1.1 percent in other HIPCs where debt indicators did not worsen. A review of these countries' export structure shows that their exports are concentrated heavily in cotton, coffee, cashews, fish, and copper—commodities that experienced large price reductions last year.[16] A broader measure of external conditions, the terms of trade, declined by 1.5 percent for the HIPCs with worse debt ratios, but rose by 3 percent for other HIPCs.

40. A much larger share of the HIPCs with worsened debt indicators experienced interruptions in their PRGF-supported macroeconomic programs in 2001 (over 50 percent) compared with other HIPCs (11 percent). Their programs had envisaged higher fiscal deficits (including grants) and new external borrowing relative to GDP than other HIPCs, and actual developments confirmed this. However, both groups of HIPCs had slightly higher fiscal deficits than projected and actually borrowed much less in 2001 than projected, in part reflecting lower disbursements from multilateral creditors in cases where programs supported by these creditors went off track. Exogenous shocks have contributed to the worse-than-expected outturns in fiscal and other macroeconomic policy performance in a number of cases.

41. The structural characteristics of these economies show that, on average, the countries with worsened debt indicators have a slightly higher export commodity dependence and a much greater volatility in historical exports, as compared to other HIPCs. These structural characteristics, together with the type of commodities they produce and export, were a contributing factor determining performance in 2001. A fuller discussion of the relative roles of domestic policies versus exogenous factors and judgment on whether the changes are temporary

[15] Delays in reaching completion when compared with decision point projections result in an increase in projected debt levels because the full impact of HIPC relief on debt stocks is projected at decision point to be provided at the completion point.

[16] The world price for coffee, the main export crop in five HIPCs, fell by 35 percent in 2001. Cotton, the main export in three HIPCs fell by 19 percent. Other commodities that constitute the primary export of at least one HIPC saw large price declines: cashews (a decline in prices of 69 percent), fish (21 percent), and copper (13 percent).

or permanent must take account of each country's specific situation. The country notes for each of the HIPCs in Annex II in the Status of Implementation report provide summary information on the latest projections of key external debt indicators, the status of the PRSP, and of HIPC relief.[17]

Table 10. HIPCs: External Debt and Other Indicators, 2001 1/

	Debt Indicators Worse than Decision Point Projection 2/ (15 countries)	Debt Indicators Improved/ Unchanged 3/ (8 countries)
	(Annual percentage change, or in units)	
Deviation of external debt indicators from decision point projection (in percentage points)		
NPV of debt-to-exports	44	-26
Debt service-to-export ratio	0.2	-3.2
GDP and Export performance		
Exports	3.0	12.0 4/
GDP	4.5	5.6
Incremental output to net external financing ratio 5/	0.45	0.69
External conditions		
Export price index 6/	-4.8	-1.1
Terms of trade index 6/	-1.5	3.3
Fiscal and borrowing policies		
PRGF status (share of countries on track, in percent)	47	88
Fiscal deficit (in percent GDP, actual) 7/	-6.0	-3.3
New borrowing (in percent of GDP)	6.7	3.8
Structural characteristics of economy		
Commodity export dependence 8/	63	48
Per capita income (in U.S dollars)	385	374
Memorandum items:		
Decision point projections		
Exports	11.3	13.8
GDP	5.5	6.0
Fiscal deficit (in percent of GDP) 7/	-5.6	-2.7
New external borrowing (in percent of GDP)	9.3	5.6
Incremental output to new borrowing ratio	0.94	0.83
Historical growth volatility 9/		
Exports	21.0	16.9
GDP	4.4	6.6

Sources: Decision Point documents; IMF World Economic Outlook, 2001; and World Bank and Fund staff estimates.

1/ All figures are simple averages, unless otherwise indicated.
2/ Countries with actual NPV of debt-to-export ratio in 2001 higher than decision point projections: Benin, Burkina Faso, Chad, The Gambia, Guinea, Guinea-Bissau, Guyana, Honduras, Malawi, Mauritania, Nicaragua, Sao Tome and Principe, Senegal, Uganda and Zambia.
3/ Countries with actual NPV of debt-to-export ratio lower than decision point projections: Bolivia, Cameron, Madagascar, Mali, Mozambique, Niger, Rwanda and Tanzania.
4/ This figure is heavily influenced by Mozambique. The weighted average is 9.8 percent.
5/ Estimated based on GDP growth and net external financing data.
6/ Weighted average; weights equal to country's share in total export of each group of countries.
7/ Central government, including grants.
8/ Defined as the ratio of three main commodities in total exports, based on 2001 data.
9/ Standard deviation from mean calculated based on data for 1992-2000 period.

[17] See "Heavily Indebted Poor Countries (HIPC) Status of Implementation" -IDA/SecM2002-0467, August 19, 2002; and SM/02/264, August 16, 2002.

Debt Sustainability Outlook

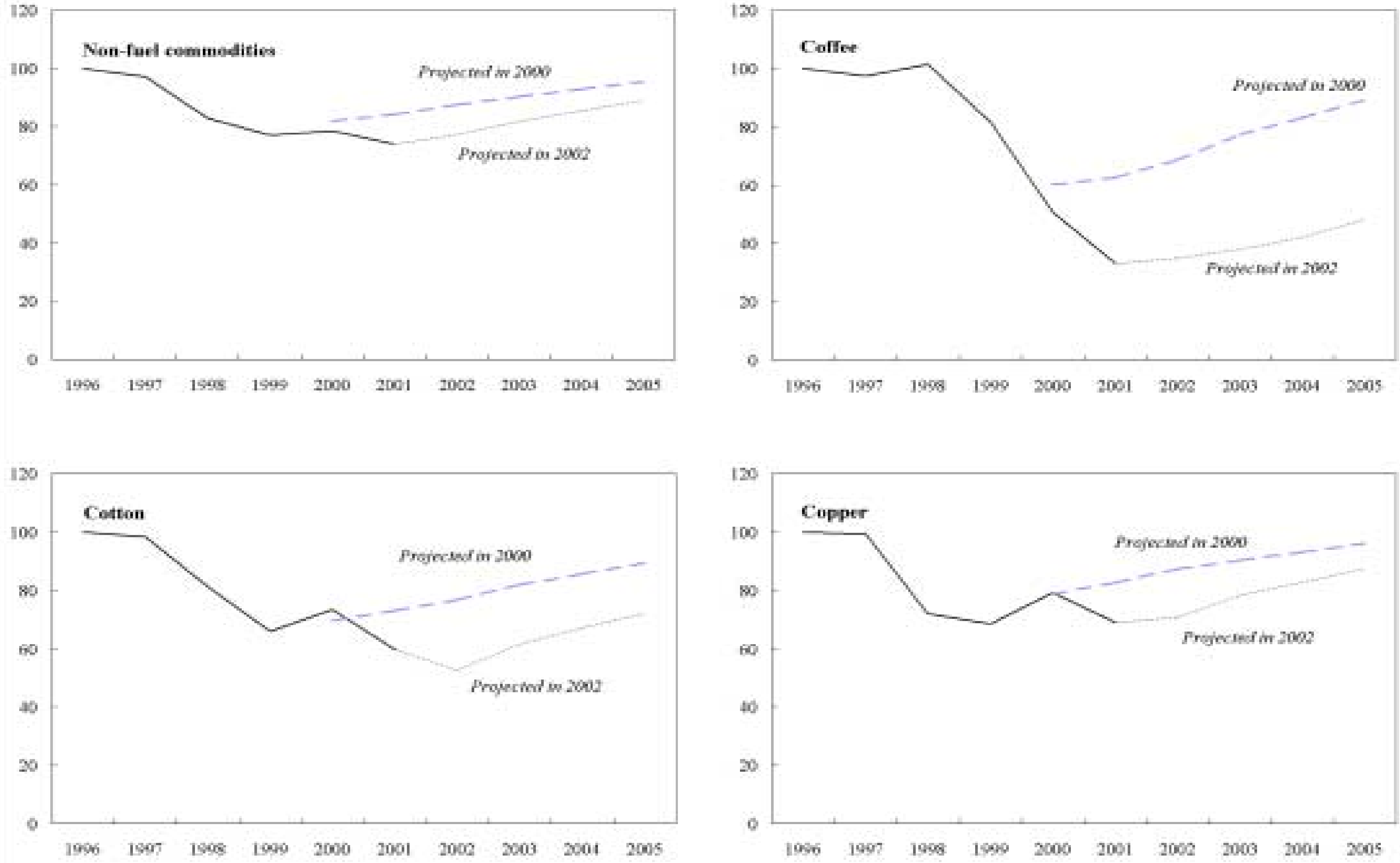
42. Although most commodity prices are forecast to rise over the medium term, the latest IMF and World Bank projections, which are similar to the projections made in the Spring of 2002, suggest that the recovery would be slow and key export commodity prices of the HIPCs would remain below the levels projected two years ago for quite some time (Figure 1). This will have adverse effects on future export earnings of the HIPCs and hence on the debt and debt service-to-exports ratios.

43. Of **the 20 countries in the interim period**, about half are expected to show NPV of debt-to-export ratios in excess of the HIPC sustainability threshold at the time of their completion points: Benin, Chad, Ethiopia, The Gambia, Guinea-Bissau, Malawi, Niger, Rwanda, Senegal, and Zambia. Five of these countries (Chad, Ethiopia, Malawi, Rwanda, and Zambia) had been anticipated to be above the threshold at the time of their decision points. Economic policy performance varies in this group of countries. Guinea-Bissau and Malawi have had extended program interruptions, due largely to problems in fiscal and public resource management, while Senegal experienced delays in implementation of its PRGF-supported program. Zambia's external debt indicators have deteriorated since the decision point as export earnings are projected to be lower reflecting lower world copper prices and the decision of a key foreign firm to discontinue its mining operations in Zambia. Two countries' NPV of debt-to-exports ratios are expected to fall to below 150 percent a few years after their completion points. After including additional bilateral assistance, Benin's debt-to-exports ratio will fall below 150 percent in 2005, and Chad's substantial new investments in the oil sector are expected to lead to a six-fold increase in exports by 2004. Among the countries that have qualified for debt relief under the Initiative's fiscal window, Ghana and Honduras are expected to have their NPV of debt-to-revenue ratios below the 250 percent threshold by the time of their completion points; the ratio for Guyana is projected to fall below the threshold soon after the completion point.

44. Among **the six completion point countries**, the Board approved topping up assistance to Burkina Faso to bring its NPV of debt to 150 percent of exports at the completion point, providing a good basis for the country to maintain debt sustainability over the longer term. The stock of Mauritania's external debt would decline to a sustainable level after HIPC relief at the completion point and after additional assistance committed on a bilateral basis by some Paris Club creditors. As indicated earlier, Bolivia, Mozambique, and Tanzania are expected to have their NPV of debt below 150 percent of exports in 2002–2010. Projected debt-service ratios are mostly favorable over the same period for Mozambique (below 5 percent) and Tanzania (below 8 percent), but relatively high in Bolivia (14–15 percent) owing largely to less concessional new borrowing after the completion point. As for Uganda, its NPV of debt-to-exports ratio has risen since reaching the completion point in 2000 mainly due to the collapse in coffee prices. The staffs have been working closely with the authorities to update their DSA (see Box 3), strengthen debt management capacity, including new borrowing policies, and increasing the effectiveness of Uganda's substantial use of foreign aid.

Figure 1: HIPCs: Main Export Commodity Prices, 1996 - 2005

WEO Projections Made at April 2000 and June 2002; Index: 1996 = 100



Source: IMF *World Economic Outlook* .

Box 3. Uganda: The Results of an Updated Debt Sustainability Analysis

Improvements in Indicators. An updated Debt Sustainability Analysis (DSA) was prepared jointly by the staffs in consultation with the Ugandan authorities based on external debt data as of end-June 2001.[1] The resulting debt-to-exports ratio was 171 percent—higher than the 128 percent projected in the enhanced HIPC decision point document[2], but considerably lower than the 210 percent estimated in the Long-Term External Debt Sustainability report[3]. An important factor underlying the deterioration of this ratio since projected at the decision point was lower exports attributed mainly to a sharp drop in coffee prices. Export earnings for 1998–2001 fell short of decision point projections by 16 percent. Coffee export revenues during this period were 36 percent lower than projected at the decision point, largely due to a 53 percent decline in coffee unit prices over the period (compared to the projected decline of only 1 percent) and in part as a result of decreases in coffee export volumes (18 percent relative to projections). Other debt sustainability indicators also improved since the April 2002 paper on long-term debt sustainability in HIPCs, including the ratio of debt service to exports, which remained well below the indicative HIPC target range.

Delivery of Relief. Although the revised DSA assumed full delivery of HIPC relief, some of Uganda's creditors have yet to sign HIPC debt-relief agreements, while other creditors have signed agreements that fall short of providing the prescribed NPV reduction. Some commercial creditors have also resorted to litigation to seek full payment of outstanding obligations. Non-delivering creditors are concentrated in non-Paris Club bilateral creditors, small multilateral creditors and commercial creditors. Taking into account only the HIPC assistance for which agreements had been signed, under-delivery of debt relief (traditional relief as well as original and enhanced HIPC relief) adds US$323 million in NPV terms to the outstanding stock of debt as of end-June 2001, equivalent to 48 percent of exports. The challenge facing Uganda is to secure debt relief from these creditors to the fullest extent possible.

New Financing. New financing beyond that anticipated at the decision point did contribute to the increase in the debt-to-export ratio as of end-June 2001. An increase in the concessionality of new borrowing, including more use of grants, will gradually assist in reducing Uganda's debt-to-exports ratio. Over the longer term, a continuation of sound domestic economic policies combined with measures by the international community to ensure access to concessional financing will be critical to Uganda's ability to achieve long-term debt sustainability and mitigate the potential impact of external shocks.

The Way Forward. Uganda's debt sustainability concerns are being addressed in the context of the updated PRSP, which inter alia emphasizes export promotion and diversification, a gradual fiscal consolidation that does not jeopardize poverty reduction programs, and greater use of grant financing. The updated debt sustainability analysis is based on the revised macroeconomic framework of the PRSP. Uganda's adjustment efforts continue to be supported by IDA (which approved a second PRSC on July 23, 2002) and by the Fund (a new PRGF arrangement is scheduled to be considered by the Fund's Board in mid-September 2002).

---

[1] See "Uganda: Updated Debt Sustainability Analysis and Assessment of Public External Debt Management Capacity," IDA/SecM2002-0419, July 16, 2002, forthcoming in the IMF.
[2] See "Uganda – HIPC Debt Initiative: Second Decision Point Document," January 20, 2000, IDA/R2000-9 and Corrigendum, IDA/R2000-9/1, January 27, 2000,and EBS/00/6, January 19, 2000. The same external debt and export data sets and debt indicators were used in the enhanced HIPC Completion Point document, IDA/R2000-37, April 5, 2000, and Corrigendum, IDA/R2000-37/1, April 13, 2000, and EBS/00/67, April 5, 2000.
[3] "The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability," IDA/SecM2002-0162, March 27, 2002, and SM/02/95, March 26, 2002.

B. The Role of Projections Under the HIPC Initiative

45. Eligibility for and the amount of debt relief under the HIPC Initiative are determined on the basis of actual information. However, economic projections do play an important role in assessing long-term debt sustainability, as the latter depends critically upon future GDP and export growth, which generate the resources for future debt servicing. Staffs' review of the export projections embodied in decision point documents suggests that earlier projections turned out to be optimistic in two-thirds of the countries reviewed, but exports were higher-than-projected in the other third that were less affected by external shocks.[18] It also confirms an earlier finding that projected future growth for decision point HIPCs was significantly higher than may be expected on the basis of past export performance alone.[19] Average annual export growth for 26 HIPCs was projected at 7.5 percent in the decision point documents compared with only 4.7 percent achieved over the previous 30 years.

46. This difference reflects several factors. Projections made in 2000 and early 2001 were constrained by the information available at the time and did not anticipate the global economic downturn and significant declines in commodity prices in 2001. In addition, projections are typically projections of trends that do not directly reflect the high export volatility observed historically in HIPCs. An analysis of 26 HIPCs that have reached their decision points to date indicates that export volatility (defined as the standard deviation around a 10-year trend) varies on a country-by-country basis from 7 percent to 36 percent with an average of 15 percent. Export volatility is significantly correlated with export concentration. Perhaps more importantly, while it is not unrealistic to anticipate that HIPCs will grow at a faster pace after the decision point because debt relief presents the opportunity for a break with the past, earlier projections often contained overly optimistic macroeconomic assumptions, reflecting assumptions about full implementation of policy reforms or inadequate analysis of the likely sources of growth and of the expected impact of planned policies.

47. Improving projections in the future is a challenge involving efforts on several fronts. Macroeconomic projections in HIPCs are inherently difficult and subject to large margins of error as these countries are facing a highly volatile external environment and great uncertainty regarding the effects of government policies. In light of this, and as discussed in the PRSP progress report, staffs are encouraging countries to develop alternative macroeconomic scenarios, including a policy-based "optimistic" scenario and a conservative scenario that would reflect a country's vulnerabilities and the uncertainties of the external environment.[20] Bank and Fund

---

[18] See Annex IV of "Heavily Indebted Poor Countries (HIPC) Status of Implementation" – IDA/SecM2002-0467, August 19, 2002; and SM/02/264, August 16, 2002.

[19] "The Challenge of Maintaining Long-Term External Debt Sustainability," SM/01/94, March 21, 2001, http:/www.ifm.org/external/np/hipc, and IDA/SecM2001-0202, March 20, 2001, http:/www.worldbank.org/hipc.

[20] "Poverty Reduction Strategy Papers—Progress in Implementation," SM/02/250 and IDA/SecM2002-0453, August 2002.

staffs will be expected to base their own growth projections on a thorough analysis of the likely sources of growth and presenting such analyses explicitly in discussions with the authorities, as well as in staff documents. This should allow a better acknowledgement of the limitations arising from export concentration and volatility by underscoring the policy-based nature of the projections, and by subjecting these projections to vigorous stress testing. While such alternative scenario projections are a useful tool in macroeconomic management, and facilitate the development of contingency plans, a timely policy response, including adjustment where warranted, in the amount and terms of new borrowing, is essential to prevent an accumulation of unsustainable debt in the future.

VII. ADDRESSING WORSENED DEBT SUSTAINABILITY OUTLOOKS

48. In considering how to address worsened debt sustainability prospects, it is important to recall that sustainability is determined by a combination of factors notably the country's existing stock of external debt, the future development of fiscal and external repayment capacity which is linked closely to economic growth, and the future availability and concessionality of new external financing. The HIPC Initiative is designed to deal with the first of these three determinants—i.e., the existing stock of debt—by providing debt relief and reducing the net present value of external public debt to 150 percent of a country's exports (or 250 percent of government revenues) at a given point in time. As stated in earlier staff papers, debt relief under the HIPC Initiative provides a basis, but no guarantee, for long-term debt sustainability in HIPCs. This raises two issues: (i) at what level of debt should the Initiative provide for the HIPCs to exit from debt relief; and (ii) what can be done to maintain external debt sustainability beyond the completion point when the HIPC Initiative process ends. These issues are discussed below both in terms of the HIPC Initiative framework and recent calls to modify it.

A. Ensuring a Sustainable Debt Position for Countries to Exit from the HIPC Initiative

49. HIPC relief is committed at the decision point, and, once fully delivered, would bring a HIPC's NPV of debt to 150 percent of exports (or 250 percent of revenue where the fiscal window applies) at the decision point. However, if the external outlook deteriorated or economic performance was worse than expected, some countries could have a debt ratio at the completion point which exceeds the level that was envisaged in projections made at the decision point and the HIPC threshold level. The current framework of the HIPC Initiative has the flexibility to respond to a deterioration of the debt sustainability outlook for countries that have yet to reach their completion point. Burkina Faso was the first case to demonstrate this flexibility. The operational framework for providing additional assistance at the completion point beyond that committed at the decision point was endorsed by the Boards in September 2001.[21] Central to the approach is a comprehensive assessment based on actual debt and other economic data available

---

[21] "The Enhanced HIPC Initiative—Completion Point Considerations," EBS/01/141, August 21, 2001, and IDA/SecM2001-0539/1, August 20, 2001. For consequential changes to the Fund's PRGF-HIPC Trust Instrument, see EBS/02/104, June 13, 2002.

at the completion point on whether a country's economic circumstances have been fundamentally changed due to exogenous developments. Key principles guiding this assessment include:

- given that the sustainability thresholds under the enhanced HIPC Initiative already provide a substantial safety cushion, additional debt relief would only be granted in exceptional cases;

- exogenous factors must be clearly demonstrated to have fundamentally changed the economic circumstances of a country and adversely affected its prospects for long-term debt sustainability; and

- that additional assistance, if granted, should be based upon a full account of all debt relief including additional debt forgiveness beyond HIPC relief provided and/or committed by official bilateral and commercial creditors.

50. In developing the current guidelines for the topping up of assistance at the completion point, there were considerable discussions on the level of additional debt relief and whether it should be provided to all countries with a NPV of debt-to-exports ratio exceeding the HIPC threshold. Three proposals, which have also been suggested more recently, were noteworthy and are discussed below.

51. **Topping up to the NPV of debt-to-exports ratio at the completion point that was projected at the decision point**. One option that was considered was to top up relief not to bring the NPV of debt-to-exports ratio to 150 percent, but only to the level for the completion point that had been anticipated at the decision point. The estimated costs for potential topping up under these assumptions would amount to US$0.2–0.5 billion, about half of the costs under the current methodology (see Table 4). The debate at the time recognized the moral hazard risks associated with the completion point topping up and the importance of not providing additional assistance to compensate for poor policy implementation. Nevertheless, it also recognized the large uncertainty associated with projections, which vary across countries and could not be applied as a topping up criterion without compromising equal treatment of deserving cases. In addition, topping up at the completion point could not be automatically linked to any particular debt sustainability threshold because a high level of debt may sometimes be economically justifiable if it finances productive investment that would enhance long-term debt sustainability. Chad provides a good example of a country where the NPV of debt-to-export ratio is projected to be well above the HIPC threshold for several years because it is borrowing to finance petroleum sector development.

52. **Exclusion from topping up of unanticipated new borrowing during the interim period**. Another consideration was whether topping up at the completion point should be provided for new borrowing during the interim period which is over and above that anticipated at the decision point. The rationale behind such an exclusion would be to remove moral hazard for additional borrowing during the interim period. This was not pursued for the reasons similar to those elaborated in the preceding paragraph.

53. **Exclusion of additional relief provided by official bilateral creditors in the calculation of topping up**. There were also proposals to use topping up to provide a larger

cushion against future shocks. Several bilateral creditors proposed that additional bilateral relief be excluded from the calculation of topping-up of HIPC assistance at the completion point. If topping-up were to be calculated before additional bilateral relief, 14–15 HIPCs, including half of the completion point cases, would likely have debts at the completion point in excess of the HIPC Initiative thresholds by an amount of about US$2.0–2.4 billion. As higher HIPC relief would replace a part of additional bilateral relief, the net additional relief for HIPCs—assuming all of the excess debt were to lead to topping up—could amount to about US$1.5–1.8 billion (or US$1.1 billion after accounting for current estimates of topping up, as shown in Table 4 above). One consideration in assessing this option was that this additional relief would need to be provided mainly by multilateral creditors and non-Paris Club creditors. The provision of existing relief by the former was not fully funded and many of the latter were already reluctant to provide the debt relief currently required. Also, it was considered that such a cushion would not be equitable across countries because the amount of debt to be forgiven by these bilateral creditors over and beyond the HIPC Initiative may not be evenly distributed across deserving cases.

54. In approving the current methodology for topping up and in subsequent discussions on completion point cases, Executive Directors stressed the importance of achieving the objectives of the HIPC Initiative by providing a solid basis for HIPCs to maintain long-term debt sustainability once they exit from the HIPC Initiative process.

B. Recent Proposals to Modify Debt Relief

55. The HIPC Initiative continues to be a prominent focus of public attention. The recent deterioration of external debt indicators has prompted proposals from NGOs, academia and other sources for forestalling a relapse by HIPCs into an unsustainable debt position, including proposals to deepen and broaden the scope of debt relief. Staffs welcome the dialogue on the critical issues of achieving external debt sustainability in HIPCs and would need to assess such proposals/recommendations carefully on their possible merits/drawbacks. Bank and Fund staffs will continue to work closely with HIPCs to find solutions to their debt problems in the context of their PRSPs and Fund- and Bank-supported programs.

56. Many of the proposals put forward are consistent with and supportive of efforts already being pursued by the Bank and the Fund within the framework of the enhanced HIPC Initiative. They include the close monitoring of debt sustainability, programs to strengthen the capacity of HIPCs for debt management, better and fuller disclosure of new lending on the part of creditors and fuller creditor participation in HIPC relief.

57. Other proposals call for extending relief beyond the HIPC Initiative. They fall into three broad categories:

- **Linking debt relief explicitly to the Millennium Development Goals (MDGs).** Under these proposals,[22] debt relief would be calculated in such a way as to close the "residual

---

[22] Eurodad, "Putting Poverty First", October 2001, http://www.eurodad.org/.); Jubilee Plus, "The Unbreakable Link – Debt Relief and the Millennium Development Goals", February 2002, http://www.jubilee2000uk.org/index.htm).

financing gap" and thereby enable social sector expenditures to be increased sufficiently for HIPCs to meet the MDGs. In some proposals, the amount of debt relief would be determined by an independent review panel with representatives of both creditor and debtor countries.

- **Linking debt relief to particular levels of debt service.** These proposals aim to modify the enhanced HIPC framework by calculating debt relief on the basis of debt service rather than the stock of debt.[23] Particular benchmarks that have been proposed include reducing debt service to no more than 2 percent of GDP, or reducing budget outlays for debt service to no more than 10 percent of annual budget revenues (excluding grants). In the case of countries afflicted with a health crisis, it has been proposed that debt service should amount to no more than 5 percent of government revenue.

- **Deepening and broadening debt relief.** It has been proposed that debt relief be furnished to a broader range of poor countries including Indonesia, Nigeria, Pakistan, and Zimbabwe. It has also been proposed that a contingency facility be established to protect HIPCs from exogenous shocks for a ten-year period after the completion point.[24]

58. The intended benefits of these proposals are clear. Several additional issues, however, would need to be considered in their evaluation. First, each proposal involves additional costs, calling into question their feasibility when the existing initiatives are not yet fully financed. There are no reliable estimates of the cost of scaling up debt relief to achieve the MDGs. Total cancellation of the 26 decision point countries' existing external debt would increase the debt relief costs for these countries from US$26 billion under the HIPC Initiative (Table 3) to US$48 billion in NPV terms. Preliminary estimates of the cost of additional debt relief that would allow the debt service-to-fiscal revenue ratios (after accounting for additional bilateral relief already committed) to fall to 10 percent each year in 2002–05 for the decision point HIPCs could amount to US$1.2 billion; the cost could increase to US$3.8 billion if the ratio was to fall to 5 percent. Broadening the HIPC Initiative to include countries such as Indonesia could increase the cost by some US$60 billion, according to the proposal's proponents.

59. Second, debt relief, while critical in removing the burden of existing debt, can only realistically be expected to contribute a relatively small part of the financing needed to achieve the MDGs. The bulk of the external financing needed to meet the MDGs will have to be from new flows.

60. Third, new financing may be a more appropriate instrument for dealing with future economic shocks. New financing, as compared to debt relief, can be tailored to the resulting needs and is not a function of a country's debt level. It is more flexible, and could be provided in

---

[23] See, for example, debt relief bill in U.S. Congress (H.R.4524); also N. Birdsall and J. Williamson, "Delivering on Debt Relief: From IMF Gold to a New Development Architecture," Institute of International Economics, April 2002.

[24] Birdsall and Williamson (April 2002) propose both broader debt relief and a contingency facility.

a more timely way when needed. This underscores the central importance that HIPCs, in the context of implementing their own poverty reduction strategies, increase the effectiveness of using external financial resources by pursuing sound economic management, good governance and improved institutions. This should help attract not only official aid, but also private, non-debt creating flows, including foreign direct investment.

61. Fourth, it has been pointed out that repeated debt relief can have adverse effects by reducing the incentives for creditors to lend even for good projects to these countries. It would also have a detrimental effect on the creation of a credit culture. Building such a culture, in which borrowers understand they need to repay and creditors have the trust that this obligation will be honored, is crucial for financing economic activity and development. Since this is a cumulative process, it is in the long-term interest of the debtors not to resort to more debt relief once their debt burden is reduced to sustainable levels. Repeated debt relief would also limit the pool of resources available to multilateral creditors to provide financial support to other low-income countries.

C. Maintaining External Debt Sustainability Beyond the HIPC Initiative Framework

62. Beyond the HIPC Initiative, the benefits of improvements in the use of resources by the debtors and responsible lending by their creditors have been recognized. The former would go a long way to strengthen debtor countries' repayment capacity and the latter would contribute to a sustainable debt profile over the longer term.

63. To maintain debt sustainability, HIPCs have a responsibility to adhere to sound macroeconomic policies and implement structural reforms to diversify their production and export base away from commodity dependence, and to strengthen growth and export performance overall. They should utilize their Poverty Reduction Strategy Papers (PRSPs) as the main vehicles for addressing these tasks, by taking the central role in diagnosing country-specific challenges, deepening ownership of economic development strategies, and improving governance and institutions and hence the effectiveness with which they utilize resources, including foreign aid. In this regard, it is important that HIPCs continue to improve their public expenditure management systems, building on the progress made in this area under the HIPC Initiative.[25]

64. In addition to ensuring improvements in a country's repayment capacity**,** strengthened debt management, including prudent policies on new borrowing, is important in improving debt sustainability prospects, especially for countries where debt ratios are not expected to fall below the HIPC thresholds for a number of years (Box 4). Irrespective of export performance, HIPCs undertaking new borrowing should aim to adhere to the following key principles: limiting or avoiding nonconcessional borrowing; integrating plans for new borrowing with the broader macroeconomic and fiscal framework and tailoring new borrowing to a country's debt-servicing capacity; following best practices in debt management; and ensuring a productive use of funds to

---

[25] For progress in improving the tracking of poverty-reducing public expenditure and public expenditure management system in PRSP countries, see "Poverty Reduction Strategy Papers—Progress in Implementation," SM/02/250 and IDA/SecM2002-0453, August 2002.

assure sufficient returns to repay future obligations. The latter element is of utmost importance and much caution should be exercised before contracting new debt unless prospects for sufficiently high returns are very good.

Box 4. Strengthening Debt Management Capacity in HIPCs

Following a 2001 survey and the presentation of the March 2002 report to the World Bank and IMF Boards[1], Executive Directors recommended that staffs explore proactive measures to improve the coordination of donors, technical assistance providers, HIPCs and multilateral institutions so as to strengthen debt management capacity in HIPCs. The survey also revealed substantial demand by HIPCs for improvement in information sharing among HIPC debt management agencies, and for support from technical assistance providers to strengthen cooperation and coordination. Staffs have continued to work with donors, technical assistance providers and HIPCs in order to strengthen the mechanisms for improving debt management capacity.

Recognizing the importance of debt management capacity building, staffs are currently evaluating potential measures to: (i) strengthen the linkages between HIPC country level debt management and broader country economic management; (ii) establish a stronger communication link between agencies as a means of collaborating capacity-building measures; and improve efficiency by reducing duplication and strengthening complimentary; (iii) improve country ownership of debt management; and (iv) establish a set of HIPC debt management standards. A number of measures could be implemented without delay:

- As part of a comprehensive approach to strengthen HIPCs' debt sustainability prospects, with the assistance of their development partners, HIPCs are expected to prepare and update their own DSA regularly as they reach the completion point. Uganda's recent DSA provides a good example. This could be part of the macroeconomic framework defined in the PRSP and be followed up in subsequent PRSP progress reports.

- Stronger monitoring of new borrowing both by debtors and creditors is also key to maintaining such sustainability. Domestic debt should be included as part of a systematic and regular monitoring of overall public debt. Moreover, creditors should take on increasing responsibility for disclosure of the terms and conditions of outstanding credits.

- A key measure for maintaining long-term external debt sustainability is an institutionalized periodic review of the effectiveness of external financing by HIPCs themselves. This could be done as part of periodic public expenditure review or review of the public investment program.

---

[1]See "External Debt Management in HIPCs," SM/02/92, March 22, 2002, http://www.imf.org/external/np/hipc, and IDA/SecM2002-0148, March 21, 2002, http://www.worldbank.org/hipc.

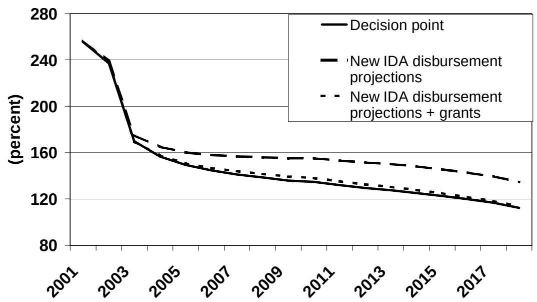
65. On the donor/creditor side, responsibility lies in the provision of adequate external financing on sufficiently concessional terms in support of HIPCs' poverty reduction and growth strategies without jeopardizing their external debt sustainability. This includes an increase in grant financing from both bilateral and multilateral development partners. The recently concluded 13th IDA replenishment agreement to provide a proportion of IDA resources in the form of grants to particularly vulnerable low-income countries will be an important step forward in this regard (see Box 5). The effect on the debt ratios of a substitution of part of HIPCs' new borrowing with grants would be small in the short term, but the cumulative impact could be significant over the longer term. More concessional financing from the international community would help ensure that new external financing is consistent with the payments capacity in

countries that are particularly vulnerable. Over the longer term, however, the international community must help these countries to regain their creditworthiness and reduce reliance on grants.

Box 5. The Impact of an Increase in IDA Grants on HIPCs' Debt Sustainability

Over the past two years, IDA lending to the ten countries that were projected in the progress report of last spring to have their NPV of debt-to-exports ratios above the HIPC threshold at the completion point[1] has been slightly greater than was anticipated in the decision point documents and future lending is also programmed at higher levels in many cases. As a result, the NPV of debt-to-exports ratios in these countries may therefore increase beyond the levels previously projected. At the same time, IDA donors have recently agreed that up to 40 percent of financial support to HIPCs under the thirteenth replenishment of IDA resources (IDA-13) may be furnished in the form of grants.

Chart 1: Weighted average of the debt-to-exports ratio for the ten countries



As a result of increases since decision point in projected IDA disbursements, the NPV of debt-to-exports for the ten countries is projected to average 155 percent in 2010 compared with 135 percent projected in the decision point documents. By 2018 the average ratio is now projected at 135 percent compared with the previous estimate of only 112 percent.

If the ten countries would qualify to obtain 40 percent of IDA resources in the form of grants, the likely impact would be to offset almost completely by 2018 the effect on the debt-to-exports ratio of larger-than-anticipated IDA lending. With 40 percent of new IDA financing being furnished in grant form, the NPV-of-debt to exports ratio would average 114 percent in 2018 which is very close to that projected in the decision point documents.

It is clear that the beneficial impact on HIPCs' long-term debt sustainability outlooks of shifting IDA lending toward partial grants can be magnified if other creditors followed suite to adjust their financing terms to increase their concessionality.

[1]Benin, Burkina Faso, Chad, Ethiopia, Gambia, Guinea-Bissau, Malawi, Rwanda, Senegal, and Zambia. Burkina Faso reached its completion point subsequently in April 2002.