DEVELOPMENT COMMITTEE
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On the
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HIPC INITIATIVE -
A PROGRESS REPORT

Attached for the September 27, 1999 meeting of the Development Committee is a Progress Report on HIPC Initiative, prepared by the staffs of the International Monetary Fund and the World Bank, for consideration under item 1.A of the Revised Provisional Agenda

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HIPC Initiative—A Progress Report

Prepared by the Staffs of
the International Monetary Fund and the World Bank

September 22, 1999

Introduction

1. In April 1999, the Development and Interim Committees welcomed the progress made in implementing the Heavily Indebted Poor Countries (HIPC) Initiative and the comprehensive review of the Initiative. This involved an extensive external consultation process to solicit the views of all interested parties; many of the suggestions received during this consultation process are reflected in the design of the proposed enhancements to the framework. The Committees asked the Bank and the Fund to make specific proposals to strengthen the current framework, and endorsed a number of guiding principles for change. Reflecting the results of the two-stage consultation process, the Boards of the Bank and the Fund have recently endorsed—subject to the availability of funding—far-reaching proposals to enhance the Initiative by providing **faster, deeper, and broader relief** and by **strengthening the links between debt relief and poverty reduction**. They also have underscored the importance of retaining the basic elements that had guided the HIPC Initiative, including participation by all creditors, maintaining the financing integrity of multilateral institutions and support for strong policies of adjustment and reform. They also stressed that the financing of the enhanced framework needed to be secured before proceeding with its implementation.

Deeper, faster, and broader debt relief

2. The proposed enhancements of the HIPC Initiative are designed to increase the safety cushion and the prospects of a permanent exit from unsustainable debt To this end,

deeper debt relief will be provided through:

- A lowering of the NPV debt-to-export target from 200–250 percent to 150 percent.

- A lowering of the NPV debt-to-fiscal revenue target from 280 to 250 percent and a lowering of the qualifying thresholds from 40 to 30 percent (export-to-GDP ratio) and from 20 to 15 percent (revenue-to-GDP ratio).

- Calculation of debt relief based on actual data at the decision point rather than on projections for the completion point.

faster debt relief intended to free up resources for poverty reducing spending through:

- The provision of interim relief between the decision and completion points.

- The introduction of floating completion points which would shift the focus of assessment more toward achievements and outcomes rather than the length of the track record; this would permit strong performers to reach the completion point earlier by accelerating the implementation of key reforms while maintaining macroeconomic stability.

- Front-loading of the delivery of debt relief by IFIs to be considered on a case-by-case basis taking into account the country's absorptive capacity and the achievement of debt sustainability over the medium term.

These modifications also result in a **broadening of debt relief** by expanding likely eligibility from 29 to 36 HIPCs, and possibly other countries.

Linking debt relief to poverty reduction

3. In parallel, building on the extensive comments received in phase two of the HIPC Initiative review, including conferences held in Washington, Addis Ababa, and London, staff have proposed an enhanced framework for poverty reduction. This framework seeks to ensure a robust link between debt relief and poverty reduction by making HIPC debt relief an integral part of broader efforts to implement outcome-oriented poverty reduction strategies using all available resources. The framework recognizes that:

- poverty is multidimensional, and poverty reduction is a long-term effort that requires a sustained improvement in the capabilities and delivery of essential social services;
- sustained poverty reduction requires rapid economic growth; macroeconomic stability and structural reforms are essential to move to a higher path of sustained growth;
- broad-based participation of civil society and strengthened governance, including improved budgetary management and public accountability, is essential to the sustained implementation of an anti-poverty strategy; and
- focusing on transparent outcome-oriented goals (in the context of the international 2015 development targets) and establishing mechanisms for broad-based monitoring of related indicators—both intermediate and longer-term—is essential for the design and implementation of a poverty reduction strategy.

4. The Boards of the Bank and the Fund in their discussions welcomed this broad-based consultative approach. They stressed that the process of poverty reduction would take time. The

HIPC Initiative should support policies to foster economic stability and rapid growth as well as actions directed specifically at reducing poverty, including improved access of the poor to basic services such as health, education, and clean water as well as promotion of rural development. They agreed that a country should elaborate, with assistance from the Bank, the Fund and others as appropriate, a **Poverty Reduction Strategy Paper (PRSP)**. In this endeavor, the Bank and Fund would provide assistance consistent with their respective mandates and expertise, with the Bank taking the lead on poverty issues and the Fund in the macroeconomic area. In principle, the PRSP should be in place by the decision point; during a transition period, the decision point could take place while a PRSP is being formulated but demonstrable implementation of the PRSP would be expected prior to the completion point. The PRSP should have the following characteristics:

- it would be produced by the authorities in close collaboration with Bank and Fund staff in a way that ensures transparency and broad-based participation in the choice of goals, the formulation of policies and the monitoring of implementation, with ownership by the government;
- it would ensure consistency between a country's macroeconomic, structural and social policies (including their sequencing) and the goals of poverty reduction and social development; and
- it would be endorsed by the Executive Boards of the Bank and the Fund as the framework for each institution's lending operations; it could serve as a basis for poverty-reduction support operations by other donors in the context of the Comprehensive Development Framework for each individual country. The PRSP would be published and would, over time, be expected to replace the policy framework paper (PFP).

5. For the **Fund**, the PRSP, as available, would provide the central policy framework for all ESAF-lending operations. Sustained poverty reduction requires rapid economic growth as well as macroeconomic stability and structural reforms that allow a transition to a higher path of sustained growth. These are the objectives of ESAF-supported lending which must be central to any poverty reduction strategy. In addition, ESAF-supported programs would give greater prominence to poverty reduction and eradication. This requires that the design of macroeconomic policies take into account the costs of social and sectoral programs aimed at poverty reduction while ensuring the need to preserve macroeconomic stability. Emphasis will also be accorded to good governance, in particular in government budgets, together with full transparency, effective monitoring procedures, accountability, and civil society involvement. This renewed focus on faster growth in ESAF-supported programs will be integrated into the comprehensive strategy for outcome-oriented poverty reduction set out in the PRSP, which will strengthen the ability of the ESAF to achieve its fundamental objectives.

6. The **Bank** has detailed proposals for strengthening further the poverty focus of its programs in low-income countries, including HIPCs[1]. In line with the Comprehensive Development Framework, this approach seeks to promote progress towards the international

[1] See World Bank *Building Poverty Reduction: Strategies in Developing Countries*, SecM99-604, August 26, 1999.

development goals for reducing poverty. It focuses on three key elements: first, a comprehensive understanding of poverty and its determinants; second, choosing public actions that have the highest poverty impact; and third, participatory settings of targets and monitoring of outcome indicators. The PRSP would provide an important vehicle for implementing this approach and assist countries in (i) the analysis of poverty; (ii) the selection of monitorable indicators; (iii) the design of programs; (iv) the monitoring of indicators; and (v) facilitating widespread consultation and participation on all of the above. In this context, the Bank would be ready to play an important role in providing technical support and advice to help countries design such poverty reduction strategies. The PRSP, once agreed, would thus set the basis for the Bank's Country Assistance Strategy (CAS) and its associated operational program in all IDA countries.

7. These proposals are ambitious and have implications for all of the programs that the Bank and the Fund support in low-income countries (i.e. those that are IDA and ESAF eligible) not just in the context of the HIPC Initiative. The Executive Boards agreed that implementation of PRSPs would need to be fleshed out in the context of discussions of individual country cases and would require closer collaboration between Bank and Fund staff.

Cost and Financing

8. The enhancements to the Initiative would result in a more-than doubling of the estimated **costs** from US$12½ billion to about US$27 billion in net present value (NPV) terms.[2] Of this, costs to the Bank would amount to over US$5 billion, to the Fund about US$2¼ billion, and to other multilateral institutions just under US$6 billion.[3] The financing of these costs provides formidable challenges to all creditors.

9. Securing the financing of the enhanced HIPC framework, remains the key challenge before staff can proceed with its implementation. In search for a satisfactory solution, staff are guided by the principles that: (i) debt relief be additional; and (ii) the financial integrity of multilateral institutions be maintained; and (iii) the recognition that multilateral institutions need bilateral support in order to deliver their share of the HIPC debt relief. Over the last few months, staff have engaged in a series of intensive consultations with donors and their respective Boards. The status of these consultations are summarized below.

10. Regarding the **Fund** and the **Bank**, Executive Directors had several discussions on how the cost of the enhanced framework could be financed. Consultations with Board members are continuing on an urgent basis, with a view of reaching a broad based consensus on the respective financing packages before the Annual meetings.

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[2] This estimate excludes costs for Liberia, Somalia, and Sudan. Total costs including these three countries are estimated at approximately US$19 billion under the initial framework, and $36 billion under the enhanced framework.

[3] Of which, the African Development Bank US$2 billion, the Inter-American Development Bank US$1 billion, and other multilateral institutions just under US$3 billion.

11. There have been continuing consultations with **other multilateral institutions**, including a special MDB meeting at end-June 1999 to discuss the changes to the HIPC Initiative and its financial implications. While MDBs remain committed to the HIPC Initiative objectives, they foresee serious difficulties in being able to expand the scope of their own contributions under the enhanced HIPC Initiative framework. There is recognition that many of these institutions will require bilateral contributions to help meet the additional cost. In this context, the resources needed by these other MDBs to fund their cost share in the enhanced Initiative have yet to be identified. The next MDB meeting will be held in early October, and consultations with potential donors will need to intensify in order to enable these other MDBs to participate under the enhanced framework.

12. **Bilateral creditors** have made valuable progress and committed themselves in the **Paris Club** to finalize in their October session the modalities through which they will provide their share of HIPC Initiative assistance, including increasing debt reduction in NPV terms to up to 90 percent and more, if needed, on commercial claims, as well as additional relief on ODA claims—up to full cancellation—on a bilateral basis. As a number of HIPCs have noted problems they have encountered in obtaining the necessary debt relief required from **official bilateral creditors not participating in the Paris Club**, staffs will explore ways in which such assistance can be facilitated and emphasize the need for all creditors to contribute their part in making the Initiative a success and providing HIPCs a durable exit from their debt problems. However, it is important to recognize the special problem of some non-Paris Club creditors of HIPCs that are themselves low-income countries.

Implementation

13. In the three years since the adoption of the HIPC Initiative, nine countries have reached their decision points and preliminary discussions have been held for another five countries, bringing the total number of countries that have entered the HIPC Initiative process to 14 so far. Four countries—Uganda, Bolivia, Guyana, and Mozambique--have also reached their completion points, and a total of over US$2.7 billion (in NPV terms) in assistance has been released to them, resulting in future debt service relief of some US$5½ billion.[4]

14. Since the spring meetings, **Guyana** and **Mozambique** have reached their completion points under the Initiative. For Mozambique, the assistance that had been committed at its decision point was increased in light of adverse external developments to allow Mozambique's debt to be brought down to the 200 percent target for the NPV of debt-to-exports ratio. Assistance released to these two countries amounted to US$2 billion in NPV terms, and was expected to lead to nominal future debt service savings of about US$4.1 billion. Preliminary discussions were held for **Nicaragua**, and **Tanzania**, all of which are expected, along with **Mauritania**, to reach their decision points over the next few months.

[4] Overall, a total of US$3.4 billion in assistance has been committed to the countries that have passed their decision points under the Initiative, resulting in an estimated US$6.8 billion in future debt service savings (see Table 1).

15. We expect a heavy work program on HIPC papers until the spring meetings of the Committees: we plan to reassess the assistance required by most, if not all, of the nine early HIPC cases (Benin, Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique, Senegal, and Uganda) in light of the decisions adopted on the proposed enhancements of the Initiative. It is also expected that in addition to the 14 countries mentioned above, decision points could be reached by the 2000 Annual Meetings for another ten or so countries.

Conclusions

16. The proposed enhancements to the HIPC Initiative are ambitious. Their implementation, particularly through elaboration of Poverty Reduction Strategy Papers, will have important and far-reaching implications for the operations of the Bank and the Fund. We will flesh out the program over the coming months as individual country cases are prepared. Clearly, the extent to which donors integrate their operations into the nationally-owned PRSP will influence its effectiveness.

17. Do Ministers endorse

(i) the proposed enhanced Initiative; and

(ii) the proposed comprehensive framework for poverty reduction as a centerpiece for Bank/Fund lending operations in low-income countries?

Do Ministers have views on how the effectiveness of PRSPs could be enhanced through donor action?

18. A remaining difficult issue is that of financing the costs of the Initiative. Strong efforts will be needed from all creditors and donors to finance the enhanced Initiative. Do Ministers:

(i) have suggestions regarding the overall approach to financing the Initiative, including meeting the Fund and Bank shares; financing of the costs of other IFIs, including the role of bilateral contributions; burden sharing; maintaining the financial integrity of MDBs, and additionality?

<u>Next steps</u>

19. We will report further on progress on funding to the next meeting of the Committees as well as on progress in implement the PRSPs along with implementation of the Initiative.

HIPC Initiative: Status of Country Cases under Currently Agreed Initiative
(Assistance will be Reassessed under Enhanced Initiative once Approved)

Country (In order of expected decision point within groups)	Decision Point	Completion Point	NPV of Debt-to-Export Target (In percent)	Assistance at Completion Point (In millions of U.S. dollars, present value, at completion point)					Percentage Reduction in NPV of Debt 1/	Estimated Total Nominal Debt Service Relief (In millions of U.S. dollars)	Satisfactory Assurances from Other Creditors
				Total	Bilateral	Multilateral	IMF	World Bank			
Completion point reached											
Uganda	Apr. 97	Apr. 98	202	347	73	274	69	160	20	650	Received
Bolivia	Sep. 97	Sep. 98	225	448	157	291	29	54	13	760	Received
Guyana	Dec. 97	May 99	107 2/	256	91	165	35	27	24	410	Received
Mozambique	Apr. 98	Jun. 99	200	1,716	1076	641	125	381	63	3,700	Received
Decision point reached and assistance committed by IMF and World Bank											
Burkina Faso	Sep. 97	Apr. 00	205	115	21	94	10	44	14	200	Being sought
Côte d'Ivoire	Mar. 98	Mar. 01	141 2/	345	163	182	23	91	6 3/	800	Being sought
Mali	Sep. 98	Dec. 99	200	128	37	90	14	44	10	250	Being sought
Total assistance provided/committed (of seven countries)				3,355	1,618	1,737	305 4/	801	20	6,770	
Preliminary HIPC document issued; targets based on majority view in preliminary discussions at IMF and World Bank Boards; assistance based on preliminary HIPC documents and subject to change											
Ethiopia	1999 5/	2002	200	636	225	411	22	214	23	1,300	...
Guinea-Bissau	2000 6/	2003	200	300	148	153	8	73	73	600	...
Mauritania	Jul. 99 7/	2002	200	271	114	157	21	43	25	550	...
Nicaragua	[late 1999] 8/			...	...	...	...	...	...	...	...
Tanzania	[early 2000] 8/			...	...	...	...	...	...	...	...
No assistance required under current Initiative											
Benin	Jul. 97	...	...	...	...	...	...	...	...	...	...
Senegal	Apr. 98	...	...	...	...	...	...	...	...	...	...

Sources: IMF and World Bank Board decisions, completion point documents, decision point documents, preliminary HIPC documents, and staff calculations.

1/ In percent of net present value of debt at completion point, after full use of traditional debt-relief mechanisms.
2/ Eligible under fiscal/openness criteria; NPV of debt-to-exports target chosen to meet NPV of debt-to-revenue target of 280 percent, as projected at the decision point.
3/ Nonreschedulable debt to non-Paris Club official bilateral creditors and the London Club, which was already subject to a highly concessional restructuring, is excluded from the NPV of debt at the completion point in the calculation of this ratio.
4/ Equivalent to SDR 212 million.
5/ Country case is delayed due to conflict
6/ Debt situation needs to be revisited once a track record of policy implementation under the post-conflict recovery program has been established.
7/ Boards agreed that Mauritania was ready to reach the decision point in July 1999 when the new ESAF arrangement was approved by the Fund Board. The formal decision point is expected in the fall of 1999, when assistance could be committed on the basis of the proposed enhanced HIPC Initiative framework.
8/ Consideration likely under proposed enhanced Initiative.