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# MODIFICATIONS TO THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE

Attached for the September 27, 1999 meeting of the Development Committee is a paper prepared by the staffs of the Fund and the International Development Association on Modifications to the Heavily Indebted Poor Countries (HIPC) Initiative as background to item 1.A of the Provisional Agenda.

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INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

**Modifications to the Heavily Indebted Poor Countries (HIPC) Initiative**

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## I. Introduction and Principles for change

1. In April, the Executive Boards of the Bank and the Fund discussed papers prepared by Bank and Fund staff that provided a broad summary of the proposals for changing the HIPC Initiative arising from the first phase of the consultation process.[1] Executive Directors welcomed the joint statement by the President of the Bank and the Managing Director of the Fund and expressed general support for the principles for change and the general approach set out in that statement.[2] The Interim and Development Committees endorsed these principles and called for the development of specific proposals to strengthen the Initiative. Subsequently, staffs have continued the consultative process. At the G-7 summit in Cologne in June, government leaders endorsed a number of specific suggestions of their finance ministers to provide "faster, deeper and broader debt relief for the poorest countries that demonstrate a commitment to reform and poverty alleviation",[3] which are summarized in Annex 1.

2. In light of these discussions, this paper builds on and modifies the current HIPC Initiative framework,[4] making a number of specific proposals to strengthen the Initiative that are consistent with the principles for change set forth by the President and Managing Director in their April reports to the Interim and Development Committees,[5] namely:

- *Additional*: Debt relief should reinforce the wider tools of the international community to promote sustainable development and poverty reduction.
- *An incentive to reform:* Debt relief should strengthen the incentives for debtor countries to adopt strong programs of adjustment and reform.
- *Focus on our poorer members*: Debt relief should target the poorest member countries for whom excessive debt can be a particularly severe obstacle to development.

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[1] *HIPC Initiative - Perspectives on the Current Framework and Options for Change* (EBS/99/52 and IDA/SecM99-155, April 2, 1999) and *HIPC Initiative - Perspectives on the Current Framework and Options for Change: Supplement on Costings* (EBD/99/52, Supplement 2 and IDA/SecM99-184, Supplement 1, April 13, 1999).

[2] *Statement by the President and the Managing Director on the HIPC Initiative* (BUFF/99/49 and IDA/SecM99- 184, Supplement 2, April 13, 1999).

[3] See *Report of G-7 Finance Ministers on the Köln Debt Initiative to the Köln Economic Summit, Cologne, 18-20 June, 1999,* (http://www.g8cologne.de/06/00114/index.html)

[4] The original framework and the modifications regarding the fiscal window are set out in *"A Framework for Action to resolve the debt problems of the Heavily Indebted Poor Countries"*, D/C96-5, dated April 12, 1999, and The *HIPC Debt Initiative—Guidelines for Implementation*, IDA/R97-35, April 22, 1997.

[5] *HIPC Initiative – Progress Report to the Interim and Development Committees*, DC/99-12 of April 21, 1999 and EBS/99/63 of April 22, 1999.

- *A clear exit from an unsustainable debt burden:* Debt relief should remove the debt overhang and provide an appropriate cushion against exogenous shocks. This implies, inter alia, that debt relief when given is provided irrevocably.

- *Applied retroactively:* Enhanced debt relief should be provided to all members, including those that have already reached decision and completion points under the Initiative, provided that they qualify under any revised thresholds.

- *Provided in a simplified framework.*

- *Accompanied by proposals for financing the cost to multilateral institutions.*

3. In line with the preceding, the proposed modifications include deeper assistance through lower sustainability targets and through the calculation of assistance based on decision point data rather than the current completion point projections (Section II.A); earlier assistance through interim assistance, floating completion points, the front-loading of debt relief after the completion point (Section II.B), and broader assistance to benefit more countries (Section II.C). Implementation arrangements are discussed in Section III as they concern debt sustainability analysis (DSA), delivery profile of assistance, performance, retroactivity, and participation by all relevant creditors. Cost estimates for the proposed enhanced Initiative are provided in Section IV, followed by Section V that puts HIPC Initiative debt relief in the context of a broader approach to poverty reduction and sustainable development. Finally, Section VI lists possible issues for discussion.

4. Companion papers (to be issued shortly) will discuss the financing of the Bank's and the Fund's shares of the costs under such a strengthened HIPC Initiative. Work is under way on a paper that will discuss the links between debt relief, social development and poverty reduction in recipient countries, which will be presented for discussion by the Boards in late August/early September. As an input into this preparation, conferences on this topic will be hosted by the US Government on July 26, 1999, by UNECA in Addis Ababa on July 29-30, 1999, and by the Commonwealth Secretariat in London on August 2-3, 1999.

## II. Possible Modification to Strengthen the HIPC Initiative Framework

### A. Deeper Debt Relief

5. The Development and Interim Committees voiced concerns that the target ranges under the Initiative may not provide a sufficient safety cushion to ensure a robust exit to debt sustainability. These concerns, which were also expressed in the course of the HIPC Initiative review, have been heightened by the significant declines in primary commodity prices and the still uncertain outlook for aggregate aid flows.

6. Staffs propose changes in the HIPC Initiative framework that aim at deepening the debt relief and would thereby:

- *increase the safety cushion* against an unanticipated and extended decline in export earnings;

- *increase the probability of a permanent exit from unsustainable debt*. The lower the targets are set, the greater is the likelihood that individual countries — with appropriately cautious debt management policies in the future— will avoid future debt-servicing problems, and will not be perceived as having a debt overhang;

- *result in lower debt-service payments*, and thereby provide more room for increased spending in priority areas such as primary health care and education.

7. Specifically, staffs suggest to enhance the Initiative through lower debt sustainability targets, and an earlier assessment date for the determination of assistance.

**Lower debt sustainability targets**

8. It is proposed to lower the sustainability target for the **NPV debt-to-exports ratio** from the present range of 200–250 percent to **a single target of 150 percent**. This would increase assistance and widen the circle of countries that would be eligible for assistance under the Initiative. A single point target would also simplify the implementation of the Initiative compared to the current target range, eliminating the setting of individual targets**—**based on country-specific vulnerabilities**—**for each HIPC.

9. It is proposed also to lower the sustainability target for the **NPV debt-to-revenue ratio from 280 percent to 250 percent**, and to lower the thresholds for countries to qualify for assistance under the fiscal window: for the **openness criterion from exports of 40 percent of GDP to 30 percent, and for the revenue threshold from 20 percent of GDP to 15 percent.** The maintenance of these thresholds**—**albeit at reduced levels**—**is recommended to avoid moral hazard related to revenue collection and to ensure that the fiscal window remains targeted to open economies where the NPV debt-to-export ratio may understate the overall debt burden.

10. For countries qualifying under the fiscal window, the target NPV of debt would be the lower of 250 percent of central government revenues or 150 percent of exports, to ensure that external debt sustainability is achieved from both external and fiscal perspectives. Therefore, the resulting NPV debt-to-export ratio could be below 150 percent. With the proposed changes, the NPV debt-to-GDP ratio for a country with a revenue effort of 15 percent of GDP qualifying under the fiscal window could be reduced to 37.5 percent, i.e. a third lower than under the current framework.

**Fixing HIPC Initiative debt relief as of the decision point**

11. The amount of assistance committed under the current HIPC Initiative framework is calculated at the decision point, but is based on projected data for the completion point. The staffs propose changing this procedure to base the calculation of HIPC Initiative assistance on actual data at the decision point.[6] This would have a number of advantages. It would simplify the implementation of the Initiative by avoiding the use of projected data. This would reduce uncertainty regarding the amount of assistance.[7] [8] Also, the amount of assistance would no longer be affected by the length of the second stage. This would provide financial neutrality with respect to the choice of completion points.

12. Such a change in the assessment date, if combined with unchanged sustainability targets, would tend to increase HIPC Initiative assistance. For most HIPCs, the NPV of debt-to-exports and to–revenue ratios tend to decline over time as exports and revenues rise faster than external debt. Thus, with the same target ratio, the assessment of assistance on the basis of actual data available at the decision point would provide deeper debt relief, and the benefits of export and central government revenue growth after the decision point would accrue fully to the debtor country.

13. Calculations based on actual data at the decision point would avoid the complication under the current framework that provision of interim assistance can affect the outcome against the agreed completion point targets.[9] Such a change in the assessment base would facilitate the provision of earlier debt relief in support of a HIPC's economic and social reform programs.

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[6] Data for the latest calendar year (or fiscal year where appropriate) available at the decision point: thus for 1999 decision points, calculations would generally be based on end-1998 data.

[7] Under the current procedure, a reassessment of assistance at the completion point is called for if the actual outcome deviates by more than +/-10 percentage points from the agreed debt sustainability target set at the decision point.

[8] At the regular multilateral development banks'(MDB) meetings on the HIPC Initiative, MDBs expressed interest in finding ways to reduce the risk that HIPC Initiative relief decisions would need to be reopened at the completion point. (See HIPC Debt Initiative, *The Chairman's Summary of the Multilateral Development Banks' Meeting*, IDA/SecM99-181, April 12, 1999; and IMF FO/DIS/95/57 of April 14, 1999).

[9] Under the current framework with completion point calculation, a significant advancing of interim assistance could affect the achievement of targets at the completion point. If significant assistance is advanced to the second stage and used to relieve debt service falling due before the completion point, this amount of assistance would no longer be delivered at the completion point. Hence the NPV of debt at the completion point (which encapsulates debt service from that point on) after delivery of the remaining assistance would be higher and the debt sustainability objectives might not be met.

## B. Earlier Assistance

14. The original focus of the HIPC Initiative was on removing the debt overhang and providing a permanent exit from the rescheduling process. HIPC debt relief can also be used to free up resources for higher social spending aimed at poverty reduction to the extent that cash debt-service payments are reduced. The provision of more debt relief as a result of the proposed lower targets and fixing debt relief as of the decision point will permit these twin objectives to be achieved to a greater extent. In order to strengthen the linkage between debt relief and poverty reduction, the staffs set out below a number of proposals to speed up delivery of assistance under the Initiative through interim assistance from multilateral institutions, floating completion points, and front-loading of debt relief after the completion point. Front-loading of assistance—both through interim relief and through the profile of delivery of assistance after the completion point—would, of course, need to be always consistent with the objective of medium-term debt sustainability. As will be discussed in more detail in the forthcoming papers on financing, faster delivery of HIPC Initiative assistance would accelerate correspondingly the need for securing financing of the cost to the Bank, Fund and other multilateral creditors.

### Interim assistance

15. The bulk of debt relief provided under the current HIPC Initiative framework is delivered after a country reaches the completion point. The Initiative also envisages that all creditors, including multilateral institutions, could at their discretion provide some of this assistance during the interim period, that is between the decision and completion points. Such interim assistance is currently provided by bilateral creditors in the Paris Club through flow reschedulings on eligible debt service involving an NPV reduction of up to 80 percent (Lyon terms) during the interim period. Both Côte d'Ivoire and Mozambique are receiving or have received such assistance. The assistance provided beyond traditional debt relief mechanisms in cash-flow terms up to the completion point, and the NPV reduction (beyond Naples terms) already implemented before the completion points are both credited to the Paris Club at the completion point as part of its contribution under the Initiative. IDA also provides interim assistance by providing grants instead of credits to eligible countries as a portion of normal IDA lending programs.[10]

16. The purpose of such debt relief is to provide:

- *additional assistance during the second stage*, thereby easing resource constraints during this period, and thus allowing a HIPC to expand social expenditures focussed on poverty reduction; and;

[10] See *World Bank Participation in the Heavily Indebted Poor Countries' Debt Initiative*, SecM96-926, August 26, 1996. However, the substitution of IDA grants for IDA credits provides little interim cash-flow relief due to the extended grace period and low service charges of IDA credits.

- *earlier debt relief,* delivering NPV debt reduction after the decision point without weakening the policy requirements for the bulk of HIPC Initiative assistance to be received at the completion point. In this respect, interim relief would complement the decision point-based calculation proposed above.

17. Additional interim assistance from multilateral creditors could have the following characteristics:

- It would advance part of the assistance expected at the completion point and would be counted as part of the multilaterals' contribution to HIPC Initiative assistance (as is done now in the case of the Paris Club and IDA).

- It would be conditional on the maintenance of satisfactory performance under Bank- and Fund-supported programs.

- It would—as is currently the case—be provided irrevocably even if the country concerned subsequently veered off track and failed to meet the conditions required to reach the completion point.

18. Multilateral institutions, with the exception of the World Bank, have not provided interim relief, mainly because of financial constraints. In the context of the MDB consultations, some institutions are willing to discuss the possibility of providing interim relief on debt service flows so that HIPCs could be in a position to improve their social programs more quickly.[11] In light of the above considerations, a possible scheme for interim relief by the Fund is described in Annex II. The World Bank will elaborate any enhancements to its interim assistance in a forthcoming Board paper regarding its participation under an enhanced HIPC Initiative framework.

**Floating completion points**

19. A floating completion point approach would entail a country reaching its completion point under the Initiative when it had implemented a set of key, pre-defined structural reforms, provided the country remained on track with its macroeconomic performance. This approach is proposed to enable countries that meet ambitious policy targets early to shorten the interim period. Conversely, if these targets were not met, the completion point would be delayed (as under the current framework of the Initiative).

20. While a generalized shortening of the interim period may not provide sufficient time or incentive to secure implementation of key reforms, especially in those countries with weaker performance track records, a floating completion point could be linked to the implementation of crucial building blocks underpinning durable growth, debt sustainability and poverty reduction. It would complement the introduction of a decision point-based calculation proposed above which removes the link between the

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[11] See HIPC Debt Initiative, *The Chairman's Summary of the Multilateral Development Banks' Meeting,* IDA/SecM99-181, April 12, 1999, and IMF FO/DIS/99/57 of April 14, 1999.

timing of the completion point and the amount of assistance received. However, it could be argued that the importance of floating completion points, indeed of completion points themselves, is reduced by the widespread provision of interim relief which smoothes the delivery of debt relief under the Initiative.

21. A floating completion point approach would add a desirable incentive for countries to implement reforms quickly, and develop program ownership by empowering the government to affect the length of the interim performance period. It could also help countries focus on the key reforms needed for sustainable development and would highlight the responsibility of the beneficiary country for satisfying the reforms monitored under the HIPC Initiative. It would be desirable to strike an appropriate balance between meeting discrete actions or targets which could be transparently assessed, and overall progress in other areas where judgement would be required; a minimum critical mass of the first element would be required to make this approach effective.[12] However, it should be recognized that it may not be easy to identify and clearly define, with the countries involved, a small number of key elements that would adequately represent overall progress in macroeconomic, structural, and social areas, while at the same time providing for equitable treatment across countries. It is also crucial that floating completion points are introduced in a way that provides for a balanced assessment of a country's track record in the macroeconomic area, in pursuing structural reforms, and implementing poverty reduction programs.

[12] The conditionality for ESAF-/IDA-supported programs, however, would not be expected to change. Under the ESAF, in particular, for consistency between the macroeconomic and structural programs, certain measures that may "float" for HIPC purposes may still have a deadline for the purposes of disbursement under the ESAF.

**Box 1**
**World Bank Experience with "Floating Tranches"**

A floating tranche approach has been introduced in recent years in World Bank adjustment operations as part of a broader effort to improve the effectiveness of these operations through strengthened selectivity and design. The aim has been to avoid getting stuck in a predetermined sequential set of reforms, to increase flexibility in the timing of reforms, and to foster greater ownership. The experience with this approach has been encouraging. Half of 14 adjustment operations that were approved in FY 1996 and FY 1997 in sub-Saharan Africa, amounting to about $770 million, had different versions of floating tranches. The number of floating tranches in an operation varied from one to five, and some floating tranche operations had other regular tranches in addition. In an evaluation prepared by the Africa Region of the World Bank, experience with floating tranches was rated positively by task managers as disbursement pressures had been reduced and compliance with conditionality had increased.[1/]

A more extensive review just completed by the Bank's independent Operations Evaluation Department (OED)[2/] concluded that the flexible disbursements and more focussed conditionality have improved the effectiveness of adjustment lending. These operations contained about half the number of conditions of the average for adjustment operations. The OED review found that the countries where this approach has been used achieved better outcomes in terms of growth, fiscal adjustment, exchange and interest rate policy, and structural reforms than the comparator groups, despite similar initial conditions. The kinds of conditions included in floating tranches have covered a wide range. Typically, a floating tranche will include several conditions that will need to be met before disbursement can occur. Examples of conditions contained in floating tranches include financial sector reforms such as bank restructuring or passage and implementation of securities laws and regulations (e.g. Cameroon, Zambia); liberalization of maritime transport laws and institutions (Côte d'Ivoire); implementation of civil service reform (Malawi); tariff reforms (Uganda) and social reforms such as the replenishment of the Fund for Support of Women's Activities (Mali), and a series of actions in the health and education sector in Tanzania, including action plans or the issuance of ministerial circulars for transferring the management of primary schools to local school committees, reform of higher education and technical training, transferring the budget for health centers to district councils as grants to cover health worker salaries and other expenses.

1/ World Bank, *Higher Impact Adjustment Lending (HIAL) in Sub-Saharan Africa: An Update*, Chief Economist's Office, Africa region, November 25, 1998.

2/ World Bank, *Higher Impact Adjustment Lending (HIAL)*: *Initial Evaluation*, CODE99-61, July 7, 1999.

22. Implementation of such floating completion points will require difficult choices at the country-specific level. Box 1 notes that the Bank's experience with floating tranches has been favorable. However, it could be more challenging to define, with the countries concerned, the small number of key reforms required for durable growth, debt sustainability, and poverty reduction to which a floating completion point should appropriately be tied. In the light of these considerations, the staffs propose to review the country-specific application of floating completion points after 12 months, i.e. before the fall 2000 Annual Meetings.

### Front-loading of debt relief after the completion point

23. Under the current Initiative, the delivery of debt-service relief after the completion point has been front-loaded by the major IFIs involved in the case of Bolivia. This

Table 1. HIPC Initiative Assistance -- Implications for Multilateral Debt Service [1/]
Illustrative Cash Flow Relief:
50% or 90% of debt service due each year until completion of total NPV relief.
Current Framework and Proposed Enhanced Framework with Retroactivity [2/]
*(US$ billion)*

| | **Current Framework** | | **Proposed Enhanced Framework** | |
|---|---|---|---|---|
| | Under 50% debt service option | Under 90% debt service option | Under 50% debt service option | Under 90% debt service option |
| Scenario criteria | | | | |
| NPV debt/exports target | 200 | 200 | 150 | 150 |
| NPV debt/revenue target | 280 | 280 | 250 | 250 |
| Export/GDP, Revenue/GDP thresholds | 40/20 | 40/20 | 30/15 | 30/15 |
| Track record | Baseline | Baseline | Baseline | Baseline |
| Debt relief fixed at: | Completion point [3/] | Completion point [3/] | Decision point [4/] | Decision point [4/] |
| Average Annual Debt Service Due in 2000 - 04 | 1.7 | 1.7 | 2.2 | 2.2 |
| of which, Debt Service Relief | 0.3 | 0.4 | 1.1 | 1.6 |
| *( as % of total NPV reduction)* | *29%* | *39%* | *45%* | *65%* |
| Average Annual Debt Service Due in 2005 - 09 | 1.6 | 1.6 | 2.1 | 2.1 |
| of which, Debt Service Relief | 0.6 | 0.5 | 0.9 | 0.7 |
| *( as % of total NPV reduction)* | *39%* | *34%* | *27%* | *23%* |
| Average Annual Debt Service Due in 2010 - 14 | 1.4 | 1.4 | 1.8 | 1.8 |
| of which, Debt Service Relief | 0.3 | 0.3 | 0.6 | 0.3 |
| *( as % of total NPV reduction)* | *15%* | *14%* | *13%* | *7%* |
| Average Annual Debt Service Due in 2015 - 19 | 1.4 | 1.4 | 1.8 | 1.8 |
| of which, Debt Service Relief | 0.3 | 0.2 | 0.5 | 0.2 |
| *( as % of total NPV reduction)* | *10%* | *9%* | *8%* | *4%* |
| Average Annual Debt Service Due in 2020 - 40 | 0.8 | 0.8 | 1.0 | 1.0 |
| of which, Debt Service Relief | 0.1 | 0.0 | 0.1 | 0.0 |
| *( as % of total NPV reduction)* | *7%* | *5%* | *6%* | *1%* |
| *Memorandum items:* | | | | |
| Total Multilateral Debt Relief over time | | | | |
| (US$ billion, in 1998 NPV terms) | 4.4 | 4.4 | 9.8 | 9.8 |
| (US$ billion, in nominal debt service) | 8.6 | 8.1 | 17.9 | 14.5 |
| Number of Qualifying Countries | 22 | 22 | 28 | 28 |

Note: While on 90% of multilateral debt service is being covered by HIPC relief for individual countries, in the aggregate the average debt re
fraction of the total debt service due. This is because countries' decision points are spread over time. In addition, for some countries,
terminated within a few years, after which their debt service returns to the original schedule.

1/ Excluding IMF.
2/ HIPCs expected to qualify with decision point no later than 2000.
3/ Does not include interim cash flow relief.
4/ Includes cash flow relief during the interim period.

Source: Global Development Finance 1999 and staff estimates.

was necessary in order to deal with a hump in debt-service payments above the debt-service target of 20 percent. In the context of deeper debt relief and an enhanced focus on poverty reduction, a more widespread front-loading of the delivery of assistance could free up more resources for increased social spending provided such an increase can be effectively spent (e.g. provided that absorptive capacity constraints or implementation problems in executing the additional expenditure can be effectively be addressed).

24. For illustrative purposes, staffs have prepared scenarios detailing the potential cash-flow impact of HIPC Initiative relief provided by multilateral development banks on debt service to MDBs (Table 1).[13] The scenarios assume that either a uniform 50 percent or 90 percent of the debt service due is covered by HIPC Initiative assistance until the required NPV debt reduction is delivered. In order to give a better idea of potential savings in the short and medium terms, the savings are presented on the basis of five-year intervals. The effects of heavy front-loading of debt-service relief are particularly evident in the 90 percent scenario where debt-service obligations rise sharply in the 2005 – 2009 period compared to the previous five-year period: this illustrates that, in aggregate, front loading of debt-service relief on this scale would be unlikely to be consistent with longer-term debt sustainability. In practice, this constraint is appropriately assessed on a country-specific basis.

25. As in the case of interim assistance, it is not envisaged that all multilateral institutions would necessarily be able to front-load assistance because of resource constraints. Bank and Fund staff would discuss this with other multilaterals.

### C. Broader Assistance

26. The enhancements to the Initiative outlined above are projected to increase the number of countries that could qualify for assistance under the Initiative from 29 under the current framework to 36 countries. Based on the Spring 1999 costings exercise, Table 2 details the countries that may qualify for HIPC Initiative debt relief under the current and the proposed enhanced frameworks as well as the possible time schedule when they may reach their respective decision points. Eligibility would not be limited to the countries included in the group of 41 HIPCs that was established early on for analytical purposes. Rather, if a country meets the criteria of the proposed enhanced Initiative it could be eligible for assistance, i.e., a country is IDA-only and ESAF-eligible, has established a minimum three-year track record of satisfactory performance under Bank- and Fund-supported programs, and at the decision point has debt ratios after the full use of traditional debt relief mechanisms that are above the sustainability targets. Countries that have not yet adopted those programs would need to do so by end-2000, which is the deadline (sunset clause) for meeting the entry requirement. Due to the lack of sufficient data, the staffs have not been able to identify any additional countries currently meeting these criteria, though

[13] These calculations exclude debt service to the IMF as its assistance currently is repaid over a period no longer than 10 years, which is much shorter than that of most MDBs.

**Table 2: Countries expected to qualify for HIPC Initiative Assistance**

| Under the Current Framework (29 Countries) | Under Possible Enhanced Framework (36 Countries) |
|---|---|
| **Decision points reached in 1997 and 1998** | **Countries eligible for reassessment** |
| | **Benin** |
| Bolivia | Bolivia |
| Burkina Faso | Burkina Faso |
| Cote d'Ivoire | Cote d'Ivoire |
| Guyana | Guyana |
| Mali | Mali |
| Mozambique | Mozambique |
| | **Senegal** |
| Uganda | Uganda |
| **Decision points expected for 1999 and 2000** | |
| Cameroon | Cameroon |
| Chad | Chad |
| Congo, Rep. | Congo, Rep. |
| Ethiopia | Ethiopia |
| | **Ghana** |
| Guinea | Guinea |
| Guinea-Bissau | Guinea-Bissau |
| | **Honduras** |
| | **Lao PDR** |
| Madagascar | Madagascar |
| Malawi | Malawi |
| Mauritania | Mauritania |
| Nicaragua | Nicaragua |
| Niger | Niger |
| Rwanda | Rwanda |
| Sierra Leone | Sierra Leone |
| Tanzania | Tanzania |
| | **Togo** |
| Zambia | Zambia |
| **Decision points expected for 2001 or later** | |
| | **Central African Republic** |
| Burundi | Burundi |
| Congo, Dem. Rep. | Congo, Dem. Rep. |
| Liberia | Liberia |
| Myanmar | Myanmar |
| Sao Tome and Principe | Sao Tome and Principe |
| Somalia | Somalia |
| Sudan | Sudan |

Note: Country names that have been bolded, indicate that these HIPCs may qualify under the enhanced f

Haiti may be in this category. Eligibility for assistance under the Initiative will be assessed on a case-by-case basis as the issue arises.

## III. Implementation Arrangements

### A. Principles

27. The proposed enhanced HIPC framework would continue to be guided by the six principles[14] which were endorsed by the Development and Interim Committees in 1996: (1) the objective should be to target overall debt sustainability on a case-by-case basis, thus providing an exit strategy from the rescheduling process; (2) action will be envisaged only when the debtor has shown, through a track record, ability to put to good use whatever exceptional support is provided; (3) new measures will build, as much as possible, on existing mechanisms; (4) additional action will be coordinated among all creditors involved, with broad and equitable participation; (5) actions by the multilateral creditors will preserve their financial integrity and preferred creditor status; and (6) new external finance for the countries concerned will be on appropriately concessional terms.

### B. Debt Sustainability Analysis (DSA)

28. **The DSA at the decision point** under the enhanced framework would be simplified in a number of respects (see Box 2):

- The **test date for debt sustainability** would be the latest actual data available at the decision point, as opposed to projected completion point data under the current framework.

- The **assessment of debt sustainability** would be based on the NPV of debt-to-export ratio of 150 percent or the NPV of debt-to-revenue ratio of 250 percent for countries meeting the revised threshold tests of export-to GDP-ratio of at least 30 percent and a revenue-to-GDP ratio of at least 15 percent.

- The change from a completion  point to a decision-point based assessment would render the **"borderline"** outcome no longer relevant.

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[14] "*A Framework for Action to Resolve the Debt Problems of the Heavily Indebted Poor Countries*", DC/96-6, dated April 12, 1996.

**Box 2. Implementation of the HIPC Initiative: Major Changes**

**Simplification**

- Calculation of assistance at decision point on actual data not projections for the completion point.
- Apply single NPV debt-to-export target to all countries rather than decide target on a country-specific basis within target range.
- Elimination of borderline option.

**Modifications**

- Lower NPV debt-to-export (150 percent) and debt-to-revenue target (250 percent) with lower thresholds for latter (30 percent export-to-GDP, and 15 percent revenue to GDP).
- Floating completion points with the timing of completion points tied to implementation of key structural reforms.
- Earlier delivery of assistance both from decision and completion points.

**Principal Changes**

Elimination of:

—Projections of position at completion point as basis for assistance;

—Vulnerability analysis as a basis for country-specific determining targets;

—Target ranges for the completion point.

This will permit a much simplified preliminary HIPC Initiative document which could focus on the track record and proposed timing of decision point, key structural policies, and enhanced framework for poverty reduction.

**Forward-looking focus in decision point document switched to**:

- Identification of key structural policies to which floating completion points would be tied.
- Enhanced framework for poverty reduction (to be elaborated).
- Country-by-country assessment of appropriate levels for interim relief and front-loading of the delivery of assistance in the light of absorption capacity and projections of key debt indicators.
- Steps to improve debt management.

**At completion point:** discretionary reassessment for debt situation with the option of providing more assistance if, as a result of exogenous factors, there has been a major upward deviation in debt outcomes. This would be decided on a case-by-case basis consulting all creditors involved.

- With the shift to a single debt sustainability target, a **vulnerability analysis** would no longer be necessary to determine the debt sustainability target for a particular country. However, it may still be useful to include a sensitivity analysis in the DSA.

29. The DSA would continue to be a joint exercise of the HIPC government and of the staffs of the Bank and Fund and, where appropriate, other major regional development banks. In undertaking this exercise there would be no change to the other features of the calculation, namely, using actual data on (i) a three-year backward-looking average of exports; (ii) the latest year central government revenues; and (iii) the six-monthly average of the commercial interest reference rates (CIRRs) as currency-specific discount rates.[15]

30. The **DSA at the completion point** would aim at assessing the extent to which debt sustainability was being achieved. The enhanced framework seeks to provide deeper and earlier debt relief and thereby a significantly greater margin of safety against adverse economic developments. In addition, the upfront commitment by the international community to comprehensive debt relief would supersede the outcome test under the current framework, i.e., the evaluation of whether the NPV debt-to-export ratio at the completion point fell within +/- ten percentage points of the target agreed at the decision point.

31. The adoption of a decision point-based calculation of assistance implies **no automatic reassessment of the amount of assistance** provided at the completion point. However, the staffs recommend that the completion point document would still provide an assessment of the debt situation at the completion point. Although the risk remains that the outcome at the completion point could be significantly above the sustainability targets, this would be reduced by additional committed—and prospective—ODA debt forgiveness. There would be no presumption of additional assistance as the new targets would already provide a substantial safety cushion. If there was a fundamental change in a country's economic circumstances at the completion point (e.g. as evidenced by a long-term projection of the NPV of debt remaining at above 150 percent of exports), and the change was clearly due to an exogenous development, the international community retains the option to increase assistance at that time. This would, as under the current Initiative, require the consent of all creditors involved. It is the staffs' view that the likelihood of topping up at the completion point under such a proposal would be much reduced compared to the current framework (as has already occurred for Mozambique).

32. DSAs at both the decision and completion points in the future would provide a more detailed analysis of **debt service indicators**. Such analysis would include a comparison of debt service due and paid before and after the HIPC Initiative debt relief in absolute

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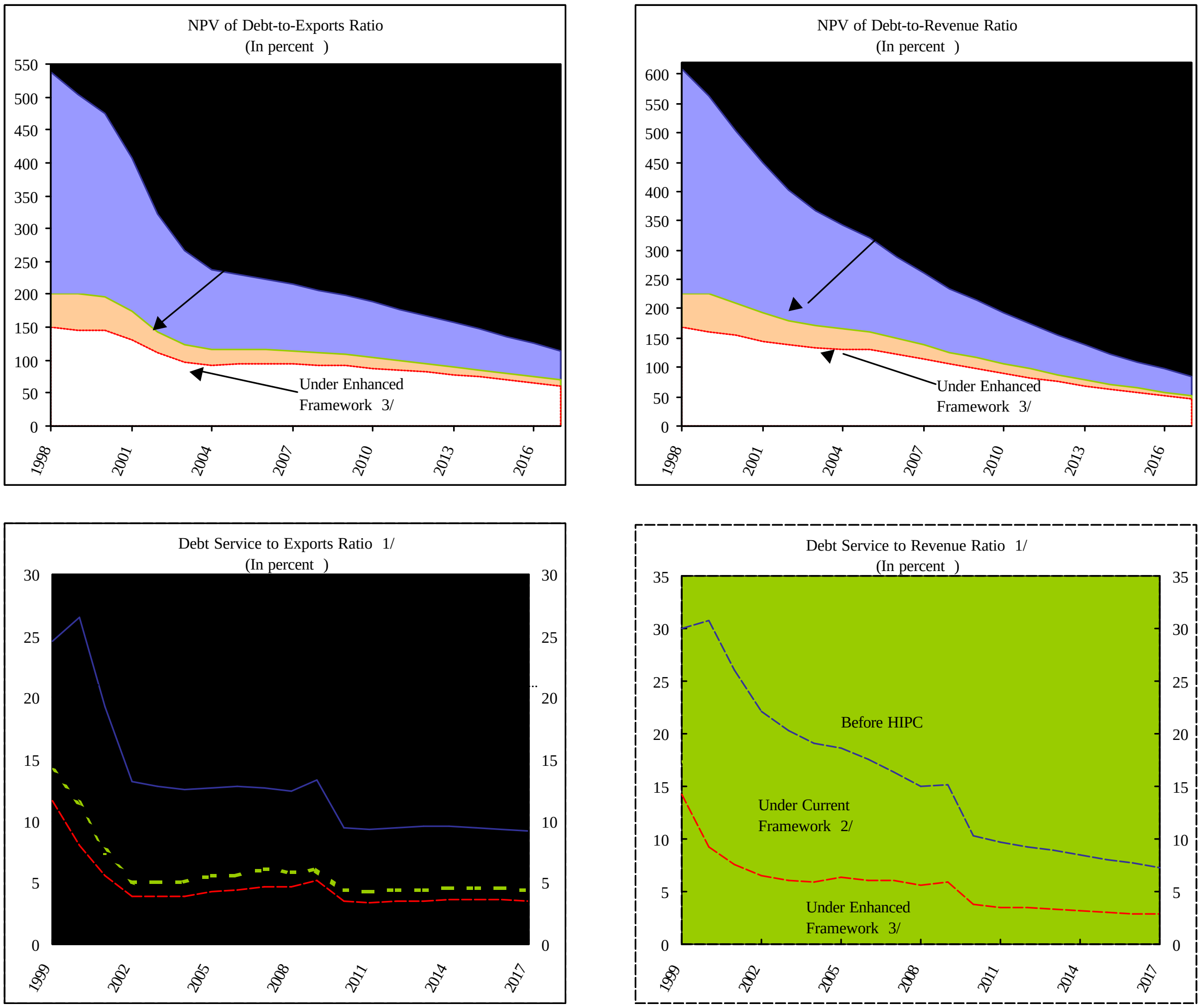
[15] During the HIPC Initiative review process, some government representatives suggested either the use of an average CIRR over a longer period or fixing the discount rate at e.g. 6 percent. While fixing the discount rate may have the appeal of simplicity and transparency, staffs continue to favor the use of a six-month CIRR average because (i) it represents the best proxy for the currency-specific cost of external borrowing, (ii) it is the best estimate available of future interest rates, and (iii) CIRRs are regularly published and, hence, readily available to the public.

## Chart 1. Mozambique: Impact of HIPC Initiative Assistance, 1998-2017




Sources: Mozambican authorities; and Bank and Fund staff estimates

1/ Includes new borrowing assumed for 1999-2017. Data before HIPC Initiative assistance includes the impact of debt relief on traditional mechanisms (Naples terms).
2/ Necessary to meet 200 percent NPV of debt-to-exports ratio.
3/ Necessary to meet 150 percent NPV of debt-to-exports ratio.

and relative terms. This would assist in assessing the potential impact of the relief on the balance of payments, the government budget and on social development programs.

33. Under the current framework, the **debt service-to-export ratio** is expected to fall within a range of 20-25 percent, or below, by the completion point. Under the enhanced framework, with deeper and earlier debt relief, it would be expected that this ratio would fall within a range of 15-20 percent, or below.

34. In the context of providing a stronger and clearer link between debt relief and poverty reduction, greater attention would be paid to the impact of debt relief on government budgets. While the capacity to service debt from a fiscal perspective depends on the full budgetary context, future DSAs would provide an analysis of the trend **of cash debt service in relation to revenues** and of the potential that debt relief could have in underpinning sustainable increases in poverty reduction programs (see Chart 1).

### C. Delivery profile of assistance

35. The decision point document would comment on the appropriate degree of **front-loading** of the delivery of assistance both through interim relief and through the profile of delivery of assistance after the completion point. This would be determined in the light of:

- any absorption capacity or implementation constraints in the country concerned in executing additional social expenditures;

- projections over the medium term of key debt sustainability indicators after assistance under the Initiative (both in relation to exports and revenue) which should show a continuing sustainable position; and

- creditors' constraints such as the profile of debt service falling due to them.

36. It would be desirable to ensure a declining trend in a country's debt and debt-service indicators after assistance under the Initiative. While some blips in the actual ratios may be unavoidable due to exogenous shocks, the delivery of assistance should aim ex ante at a steady declining trend of the NPV of debt-to-exports and- revenue ratios, and of the debt service-to-exports and -revenue ratios in order to provide a reasonable assurance that debt sustainability has been achieved and that debt problems will not re-emerge at a later stage.

### D. Performance Period and Criteria

37. The proposed introduction of a floating completion point would necessitate modifications to the assessment of performance to reach the completion point. The focus of the assessment would shift more towards particular achievements and outcomes rather than the length of the track record. In addition, the assessment would give more weight than under the current framework to social and poverty-related reforms. Sound

macroeconomic policies would continue to form an essential element of a comprehensive poverty reduction strategy.

38. To operationalize a floating completion point approach under the enhanced HIPC Initiative, the following procedures are envisaged:

- The staffs would *identify with the government key structural and social development actions or reforms*— including in the macroeconomic field— which would represent a significant move toward sustainable development. Achievement of these reforms would be transparently monitored and would constitute triggers for reaching the completion point.

- *Duration of interim period:* In designing these reforms, the staffs would have in mind an appropriate length of the second stage as under the current Initiative. Thus, in general, floating completion points would be tied to structural measures that were expected to take up to three years to implement, though if they were implemented earlier (later), the country concerned would reach its completion point earlier (later). For countries that have a recognized track record of good policy performance in the economic and social areas, and had adopted effective poverty action plans, the floating completion point would be tied to measures expected to take two years or even one year for exceptionally strong performers. [16]

- While consultations are ongoing regarding *the linkage between debt relief and poverty reduction,* many commentators have argued that the preparation of a well-specified poverty reduction plan elaborated with civil society participation would be essential. Substantial progress in implementing such a plan, including attainment of agreed social sector targets, could be among the requirements for reaching the completion point. However, it should be recognized that this can only be the start of a long process leading to effective poverty reduction. Within the time frame of the HIPC Initiative – even assuming a full three-year second stage – it would be expected that a convincing and durable process would be established with the participation of civil society and involving indicators of results which would, over time, lead to sustainable development and poverty reduction.

- On *macroeconomic stability*, staff would envisage that:

  (i) a minimum track record of three years solid economic performance under ESAF-supported programs, including performance prior to the

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[16] Under the current framework, an earlier "floating" completion point would require the setting of a date to determine the amount of assistance to be provided under the HIPC Initiative, which is currently based on delivering sustainability as of the date of the completion point. This issue would become moot with a shift in the assessment base to actual data at the decision point.

decision point, would need to be established before the completion point could be reached; and

(ii) appropriate macroeconomic policies would also need to be in place at the time of the completion point; and

(iii) achievement by the completion point of a macroeconomic position conducive to underpinning sustainable growth and poverty reduction, e.g. low inflation and low levels of reliance on bank financing of the budget deficit. These conditions are amplified in Box 3.

**BOX 3**
**MACROECONOMIC STABILITY AND A FLOATING COMPLETION POINT**

Poverty reduction requires sustainable growth and conducive macroeconomic policies. A judgement would be needed that macroeconomic policies have reached a **stable position** at the time of a floating completion point. To give concrete criteria for this decision, the following three tests would need to be met:

(i) A minimum track record of three years of solid and uninterrupted macroeconomic performance under Bank-and Fund-supported programs, *including* prior to the decision point, must be established before the completion point could be reached.

(ii) Appropriate macroeconomic policies would need also to be in place *at* the time of the completion point, which requires that ESAF-supported programs should be on track at the completion point. If structural reforms—monitored by the Fund and Bank and identified as conditions to reach the floating completion point—were not met, but the macroeconomic conditions had been observed, the program would still be considered off track for the purpose of the completion point.

(iii) For a country with particularly severe initial conditions, even the first two "tests" may not be sufficient to ensure a sustainable macroeconomic position is reached by the completion point. Thus, to reach the completion point, countries would need to have reached a macroeconomic position which was conducive to underpinning sustainable growth and poverty reduction. This would be decided on a case-by-case basis, based on: low inflation (probably single digit inflation), a fiscal policy consistent with a low and sustainable level of bank financing; and an adequate reserve cushion.

If a country meets the HIPC Initiative floating structural and social conditions at a time when the ESAF-supported program was off track, then adequate corrective measures would need to be taken before the completion point could be reached. If the interruption period was reasonably brief (say, six months or less), then the completion point could be deemed to have been reached when an ESAF program review is completed or a new arrangement approved. By contrast, in the case of an extended interruption (more than six months), the country could be required to complete a period of uninterrupted track record immediately prior to the completion point.

Inevitably, there will be a large element of judgement needed to determine whether the macro-stability criteria have been satisfied. It is expected that minor deviations would not necessarily delay reaching the completion point, but the IMF Board would need to judge that on the merits of each particular case.

- *Monitoring by Bank and Fund:* Both Bank and Fund Boards would need to agree to the specific conditions to which floating completion points would be tied. As under the current Initiative, both Boards would need to be satisfied in their respective areas of competence before assistance could be delivered at the completion point. The Fund would take the lead in defining and monitoring macroeconomic policies in the context of ESAF-supported programs, while the Bank would take the lead in defining and monitoring social policies and poverty reduction programs. Each organization would, in its areas of expertise, define and monitor the structural floating conditions, which are likely to be drawn from existing ESAF- and IDA-supported programs. Future preliminary and decision point HIPC Initiative documents will identify crucial areas of reform to which floating completion points could be linked and operationalize, on a case-by-case basis, the principles outlined above.

## E. Retroactivity

39. Additional assistance resulting from any modifications to the HIPC Initiative should be available to all eligible countries, including those that have already reached their decision and completion points under the Initiative, provided that they qualify. In implementing retroactivity, staffs propose an approach that would ensure that:

- Countries should not be penalized for early recourse to HIPC Initiative assistance, especially as this group will generally be among the stronger performers.

- Revised debt targets established under the Initiative should apply at the time that enhanced assistance is provided.

40. In addition, at the time any additional assistance is provided, the international community should reaffirm that the country's policy performance remains satisfactory. Also, to the extent that the enhanced framework entails a strengthening of social sector policies and poverty reduction efforts, enhanced assistance provided to countries that have already reached their decision or completion points should be subject to the same requirements as future qualifying countries.[17] Thus, for this group of countries, the Boards would need to specify in each individual case the actions that would need to be met for the enhanced debt relief resulting from the proposed changes to the Initiative to be delivered. However, existing commitments made on the basis of the current framework (e.g., for Mali, Burkina Faso, and Côte d'Ivoire) would be delivered as specified at their decision points.

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[17] The nature of the strengthened social policies will be discussed in the separate paper referred to paragraph 4.

41. Staffs have considered various possible approaches, including reassessing the required enhanced debt relief: (i) on the basis the historical decision point, i.e., assuming that the revised HIPC Initiative framework had been in place at the time; or (ii) based on countries' current situation so as to ensure that the country will now be at or below the newly established debt sustainability thresholds, based on the latest available data of exports, revenues, external debt, and discount rates. While the former approach has some appeal, it has the drawback that the economic environment may have changed markedly and in some cases, deteriorated which would not be reflected in this type of retroactive treatment and debt data may have been substantially revised. It would also involve difficult issues in the handling of payments that had already been made to creditors by countries that have reached the completion point. It might be preferable to adopt option (ii) above so that the concerned HIPCs would know at the earliest possible date of the additional assistance being committed by the international community consistent with meeting the new lower targets. Based on the information currently available to the staff, all nine countries[18] would qualify for assistance or additional assistance under the proposed enhanced Initiative under both options. The aggregate cost of option (i) would be US$4.9 billion, while option (ii) would cost US$4 billion.

42. Thus, staffs suggests to:

- *Use an updated debt sustainability analysis*, based on the latest available macroeconomic and external debt data as well as CIRR discount rates, as the basis for calculating the required topping-up of HIPC Initiative assistance. This would mean that for all affected countries updated DSAs would need to be prepared.

- *Submit proposals for enhanced assistance to the Boards* for approval in principle. The staffs envisage that: (i) for those countries that have already reached their completion points (**Bolivia, Guyana, Mozambique and Uganda**) the Boards would need to establish a second completion point, which would be met as soon as any required strengthening of social policies and macroeconomic stability was achieved. (ii) For those countries that have reached only the decision point there would be two approaches. **Mali and Burkina Faso** which are scheduled to reach their completion points by end-1999 and Spring 2000, respectively, would receive the assistance already committed. At these completion points, the staffs would make recommendations regarding topping up of assistance and the establishment of a new second stage with a floating completion point, triggered inter alia by measures to strengthen social policies. Similarly, new DSAs for **Senegal and Benin** would be prepared and, if assistance were needed, it could be delivered with a floating second stage. For **Côte d'Ivoire**, the staffs envisage that a new DSA would be presented that would establish the required additional assistance under the modified framework and the staff would set a second stage for this which, with a floating completion point, could allow the enhanced assistance to be delivered at the same time as the country reaches its

[18] Benin, Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique, Senegal, and Uganda.

completion point under the current framework of the Initiative, currently envisaged in 2001.

- Board approval in principle would then *allow the staffs to seek agreement to enhanced assistance from the Paris Club and other multilateral creditors* consistent with proportional burden sharing. It would also allow the identification of any additional financing required by multilateral creditors to cover their costs.

- Once the participation of all creditors in the enhanced HIPC assistance was confirmed, and their financing assured, *the additional assistance would be committed* by the Bank and Fund Boards.

- Enhanced assistance could be delivered to these countries in part during the interim period and the remainder once they have met the conditions for their new completion points.

### F. Participation by All Relevant Creditors

43. The proposals for an enhanced HIPC Initiative framework would build on existing mechanisms for providing debt relief from the Paris Club and other bilateral and commercial creditors as well as from multilateral creditors. In order to achieve the lower debt sustainability targets that would be fixed at the decision point, creditors and donors would need to take additional action beyond the existing mechanisms governing HIPC assistance.

- The **Paris Club** discussed the possible enhanced HIPC Initiative framework at its meeting in early July. It reaffirmed the need to retain the agreed proportional burdensharing formula and expressed its willingness to go beyond an NPV debt reduction of 80 percent and increase the debt relief to up to 90 percent and more on a case-by-case basis on eligible debt.

  In addition to the proposed enhancements to the HIPC Initiative, G-7 leaders have called for additional action on a bilateral basis on top of HIPC Initiative assistance, namely to forgive all ODA debt for HIPCs qualifying for assistance under the Initiative, and to give new ODA preferably in the form of grants. It is difficult to estimate the potential effect of this on HIPCs, which will vary across countries depending on the extent of their remaining ODA debts, as ODA debt data are particularly scarce and of poor quality. G-7 creditors estimate their ODA claims on all HIPCs at some $20 billion in nominal terms, of which just under $4 billion are on the nine HIPCs that have already reached their decision points, and, including these amounts, some $15 billion are claims on countries likely to qualify for assistance under the proposed enhanced framework. In addition, non-Paris Club bilateral creditors, including China and a number of Arab countries, hold sizeable ODA claims on HIPCs.

Table 3. Key Indicators under the HIPC Initiative
Based on Timing Under Current HIPC Initiative Framework 1/

| Country | Decision point date used in costing analysis | Latest data | NPV of debt-to-exports ratio at decision point 1/ 2/ (In percent) | NPV of debt-to-exports ratio at using latest data 1/ 2/ (In percent) | NPV of debt-to-revenue ratio at decision point 1/ 2/ (In percent) | NPV of debt to revenue ratio at using latest data 1/ 2/ (In percent) | Exports-to-GDP ratio at decision point 1/ (In percent) | Revenue-to-GDP ratio at decision point 1/ (In percent) |
|---|---|---|---|---|---|---|---|---|
| Angola | 2003 | | 99 | | 184 | | 73 | 33 |
| Benin | 1997 | 1998 | 173 | 131 | 260 | 181 | 26 | 14 |
| Bolivia 3/ | 1997 | 1998 | 239 | 216 | 180 | 150 | 19 | 23 |
| Burkina Faso 3/ | 1997 | 1998 | **247** | 257 | 219 | 204 | 8 | 12 |
| Burundi | 2002 | | 658 | | 377 | | 8 | 13 |
| Cameroon | 2000 | | 206 | | 329 | | 25 | 15 |
| Central African Republic | 2001 | | 233 | | 357 | | 17 | 10 |
| Chad | 1999 | | 188 | | 396 | | 18 | 8 |
| Congo, Dem. Rep. of | 2003 | | 336 | | 577 | | 26 | 13 |
| Congo, Rep. of | 2000 | | 243 | | 656 * | | 67 | 26 |
| Cote d'Ivoire 3/ | 1998 | 1998 | 184 | 169 | 356 * | 327 * | 44 | 21 |
| Equatorial Guinea | 2002 | | 33 | | 126 | | 95 | 19 |
| Ethiopia 3/ | 1999 | | 236 | | 185 | | 16 | 19 |
| Ghana | 1999 | | 175 | | 243 | | 27 | 18 |
| Guinea | 1999 | | 259 | | 493 | | 20 | 11 |
| Guinea-Bissau 3/ | 2000 | | 926 | | 794 | | 32 | 33 |
| Guyana 3/ | 1997 | 1998 | 158 | 151 | 412 * | 470 * | 103 | 33 |
| Honduras | 1999 | | 147 | | 323 * | | 47 | 18 |
| Kenya | 2000 | | 115 | | 112 | | 28 | 28 |
| Laos | 1999 | | 179 | | 441 | | 34 | 12 |
| Madagascar | 2000 | | 272 | | 488 | | 22 | 11 |
| Malawi | 1999 | | 238 | | 443 | | 26 | 16 |
| Mali 3/ | 1998 | 1998 | 220 | 221 | 315 | 324 | 22 | 15 |
| Mauritania 3/ | 1999 | | 253 | | 414 | | 42 | 28 |
| Mozambique 3/ | 1998 | 1998 | 555 | 548 | 665 | 638 | 26 | 20 |
| Myanmar | 2002 | | 214 | | 711 | | 8 | 2 |
| Nicaragua | 1999 | | 422 | | 661 | | 43 | 25 |
| Niger | 1999 | | 247 | | 430 | | 16 | 8 |
| Rwanda | 2000 | | 513 | | 258 | | 6 | 10 |
| Sao Tome and Príncipe | 2002 | | 739 | | 1165 | | 34 | 20 |
| Senegal | 1998 | 1998 | 131 | 132 | 273 * | 260 * | 46 | 23 |
| Sierra Leone | 2000 | | 361 | | 1,062 | | 19 | 7 |
| Tanzania | 1999 | | 254 | | 282 | | 15 | 13 |
| Togo | 1999 | | 151 | | 298 * | | 34 | 16 |
| Uganda 3/ | 1997 | 1998 | 294 | 246 | 285 | 260 | 12 | 10 |
| Vietnam | 1999 | | 57 | | 122 | | 48 | 21 |
| Yemen | 1999 | | 149 | | 196 | | 40 | 35 |
| Zambia | 1999 | | 428 | | 798 * | | 32 | 19 |

1/ Indicators provide the latest data which would be available to calculate assistance at the decision point, i.e., that of the previous year. For countries that have already reached their decision points, indicators are also provided based on the latest available data; provisional data for Benin, not yet incorporated into the database, suggest higher debt ratios than those in the table.
2/ NPV of debt measured after full use of traditional debt relief mechanisms.
3/ Ratios may reflect new information since most recent HIPC Initiative document.
* Indicates qualification, based on these preliminary data, under the fiscal criteria.

- **Non-Paris Club creditors and commercial creditors** would be expected to provide debt relief on comparable terms with the Paris Club agreement as is required of the debtor under that agreement. Given the difficulties individual HIPCs are encountering in obtaining such arrangements, efforts by all sides will need to be intensified in order to reach more satisfactory outcomes.

- **Multilateral creditors**: Many MDBs have been closely involved in the HIPC Initiative review process. In April and June 1999, multilateral creditors attended meetings chaired by the World Bank to discuss the HIPC Initiative and its possible enhancements. MDBs as a group supported the objective to strengthen the HIPC Initiative and further enhance its role in achieving the ultimate goal of social development and poverty alleviation in the HIPCs. They also emphasized that the Initiative should continue to be governed by the guiding principles (see para. 27) agreed in 1996, including the principle that any action to provide multilateral debt relief should preserve their financial integrity and preferred creditor status. Most multilateral institutions stressed that they would have serious difficulties in financing enhancements to the HIPC Initiative from their own resources and would need to rely on bilateral contributions to cover their full share of the expected additional debt relief .[19] Separate papers will discuss the financing requirements of the Fund and the Bank.

- Consultations with potential donors have been initiated at a meeting on June 29, 1999 in Paris.[20] Participants exchanged views on additional funding sources and mechanisms. They reaffirmed the goal of maximizing the availability of resources for the expanded HIPC Initiative framework, and that such resources should be provided in a way that did not compromise the resource transfer to other poor countries. In particular, they discussed approaches to donor funding of the overall multilateral financing gap including the concept of a concerted and equitable arrangement among donors. The discussions will continue in the coming months with the objective to define a robust financial strategy for an enhanced HIPC Initiative framework. To this end, it was agreed to meet again at the beginning of September.

## IV. IMPACT OF PROPOSED ENHANCED FRAMEWORK

### A. Cost Estimates

44. In this section, staffs present estimates of the costs of the HIPC Initiative under the current framework, and under the proposed enhanced framework based on the last estimates prepared in April 1999 which incorporated the latest country information

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[19] See, HIPC Debt Initiative, *The Chairman's Summary of the Multilateral Development Banks' Meeting*, IDA/SecM99-181, April 12, 1999; IMF FO/DIS/99/57 of April 14, 1999, and IDA/SecM99-400, June 29, 1999; IMF FO/DIS/99/93 of July 2, 1999.

[20] *HIPC Debt Initiative,* IDA/SecM99-431, July 14, 1999; and IMF FO/DIS/99/101 of July 21, 1999.

**Table 4. HIPC Initiative--Estimates of Potential Costs by Creditor**
**Current Framework and Proposed Enhanced Framework with Retroactivity**
**(US$ billion in 1998 NPV terms, all 41 countries excluding Liberia, Somalia and Sudan) 1/**

| | **Current Framework** | **Proposed Enhanced Framework** |
|---|---|---|
| **Scenario criteria** | | |
| NPV debt/exports target | 200 | 150 |
| fiscal window targets: | | |
| NPV debt/revenue target | 280 | 250 |
| Export/GDP, Revenue/GDP thresholds | 40/20 | 30/15 |
| Track record 2/ | Baseline | Baseline |
| Debt relief fixed at: | Completion point 3/ | Decision point 4/ |
| **Total costs (including retroactivity)** | **12.5** | **27.4** |
| Bilateral and commercial creditors | 6.3 | 14.2 |
| Paris Club | 5.2 | 11.5 |
| Other official bilateral | 1.0 | 1.7 |
| Commercial | 0.1 | 0.9 |
| Multilateral creditors | 6.2 | 13.3 |
| World Bank | 2.4 | 5.1 |
| IMF | 1.2 | 2.3 |
| AfDB/AfDF | 1.0 | 2.0 |
| IDB | 0.5 | 1.0 |
| Other | 1.3 | 2.9 |
| *Memorandum:* | | |
| Total cost for all 41 countries including Liberia, Somalia and Sudan | 19.0 | 36.1 |
| Total cost for all 32 program countries | 10.8 | 23.7 |

Source: *Heavily Indebted Poor Countries (HIPC) Initiative: Perspectives on the Current Framework and Options for Change, Supplement 3*; IDA/SecM99-187/2, May 12, 1999 and EBS/99/52, May 12, 1999, and staff estimates.

1/ Proportional burden-sharing among creditors is assumed.
2/ Baseline track record implies 3 years of reforms under Bank- and Fund-supported programs before the decision point can b reached, and a further three years of reform before the completion point can be reached.
3/ Debt relief set at the completion point means that the amount of assistance would be based on projections of debt and exports for the year prior to the completion point.
4/ Debt relief set at the decision point means that the amount of assistance would be based on actual debt and exports figures available the year prior to the decision point.

Table 5. HIPC Initiative: Total Potential Costs Committed at Decision Points 1/
Proposed enhanced framework with retroactivity
(41 countries excluding Liberia, Somalia and Sudan, in billions of U.S. dollars in 1998 present value terms)

| | Actual 1997 to mid 1999 | Mid-1999 to end-2000 | 2001 and later | Total |
|---|---|---|---|---|
| **Bilateral and commercial creditors** | **1.6** | **10.1** | **2.4** | **14.2** |
| Paris Club | 1.3 | 7.9 | 2.3 | 11.5 |
| Other bilateral creditors | 0.2 | 1.4 | 0.1 | 1.7 |
| Commercial creditors | 0.0 | 0.8 | 0.0 | 0.9 |
| **Multilateral creditors** | **1.7** | **10.1** | **1.5** | **13.3** |
| World Bank | 0.8 | 3.8 | 0.6 | 5.1 |
| IMF | 0.3 | 1.7 | 0.3 | 2.3 |
| AfDB/AfDF | 0.2 | 1.4 | 0.3 | 2.0 |
| IaDB | 0.2 | 0.8 | 0.0 | 1.0 |
| Other multilateral creditors | 0.2 | 2.3 | 0.3 | 2.9 |
| **Totals** | **3.3** | **20.2** | **3.9** | **27.4** |
| *Memorandum item* | | | | |
| As a percent of total assistance | 12.1 | 73.8 | 14.2 | 100.0 |
| Cumulative | 12.1 | 85.9 | 100.0 | |

Sources: Final HIPC documents and completion point documents, and IMF and World Bank staff estimates.

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

available to staff at that time.[21] The database, assumptions, and timing of decision points remain as described in Boxes 1–2 and Table 1 of the April 13, 1999 costings supplement. It should be noted, though, that the baseline for the timing of decision points, namely the earliest that might have been proposed in the spring of 1999 under the current framework, may be optimistic as it is subject to country performance. Policy slippages as well as armed conflict or domestic unrest in some countries could delay their decision points.

**Aggregate cost estimates**

45. Total costs for the HIPC Initiative under the current framework are estimated at US$12.5 billion in 1998 NPV terms.[22] The costs of the proposed enhanced framework are estimated at US$27.4 billion in 1998 NPV terms for all HIPCs excluding Liberia, Somalia, and Sudan. Including these countries, costs are estimated at US$36 billion. The underlying key indicators under an enhanced framework for all 41 HIPCs are shown in Table 3. As in earlier exercises, country-specific costings are not presented here as they might create misleading expectations on the amounts and timing of prospective HIPC Initiative assistance in cases where such estimates are very uncertain and could change substantially.

46. The cost estimates under the proposed enhanced framework as presented in Table 4 include the cost of retroactive treatment for the nine countries that have already reached their decision points, based on the application of the enhanced parameters at their actual past decision points. As noted above, the staffs see a number of problems with such an approach that would involve hypothetical recalculations based on a macroeconomic environment that may have changed significantly since. Cost estimates based on applying retroactivity to the latest (end 1998) data show that the aggregate cost would amount to US$26.6 billion compared to the US$27.4 billion in NPV terms shown above.

**Costs by creditor group**

47. Under the proposed enhanced framework, the shares of HIPC Initiative costs for bilateral and multilateral creditors are estimated to remain roughly equal. Overall costs to multilateral creditors are projected to rise from US$6.2 billion under the current framework to US$13.3 billion under the proposed enhanced framework (excluding Liberia, Somalia, and Sudan). Of this amount the World Bank's cost would be US$5.1 billion (up from US$2.4 billion) and the IMF's costs would increase from US$1.2 billion to US$2.3 billion.[23]

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[21] *HIPC Initiative—Perspectives on the Current Framework and Options for Change—Supplement on Costing*, EBS/99/52 and IDA/SecM99-155, Supplements 2 and 3 of 4/13/99 and 5/12/99, respectively.

[22] Excluding Liberia, Somalia, and Sudan. Total costs including rough estimates for these countries are about US$19 billion. The caveats of footnote 4 of the April costings supplement related to the weakness of estimates for these countries continue to apply.

[23] This is equivalent to SDR 2.7 billion on the "as needed basis" used in financing analysis for the ESAF-HIPC Trust.

Table 6. Illustrative Estimates of Cash-Flow Impact of HIPC Initiative Assistance Based on Impact of First Seven Cases

| | Average Debt Service Paid 1993-98 | Average Debt Service Due Between Completion Point and 2005 | |
|---|---|---|---|
| | | Current Framework 1/ | Enhanced Framework 2/ |
| | | **(In millions of U.S. dollars)** | |
| Burkina Faso | 61 | 67 | 44 - 50 |
| Bolivia | 329 | 344 | 304 - 319 |
| Cote d'Ivoire | 810 | 654 | 487 - 509 |
| Guyana | 112 | 75 | 64 - 67 |
| Mali | 76 | 108 | 87 - 91 |
| Mozambique 1/ | 112 | 71 | 52 - 62 |
| Uganda | 155 | 142 | 93 - 103 |
| **TOTAL** | **1655** | **1462** | **1130** - 1202 |
| | | **(Percentage change)** | |
| Burkina Faso | | 10 | -28 - -18 |
| Bolivia | | 4 | -8 - -3 |
| Cote d'Ivoire | | -19 | -40 - -37 |
| Guyana | | -33 | -43 - -40 |
| Mali | | 42 | 14 - 20 |
| Mozambique 1/ | | -36 | -54 - -44 |
| Uganda | | -8 | -40 - -33 |
| **Memo item:** | | | |
| Average change (weighted) | | -12 | -32 - -27 |
| Average change (unweighted) | | -6 | -28 - -22 |
| | | **(As percent of exports)** | |
| Burkina Faso | 21 | 13 | 8 - 10 |
| Bolivia | 27 | 17 | 15 - 15 |
| Cote d'Ivoire | 20 | 9 | 7 - 7 |
| Guyana | 17 | 9 | 7 - 8 |
| Mali | 15 | 12 | 10 - 11 |
| Mozambique 1/ | 27 | 7 | 4 - 5 |
| Uganda | 32 | 13 | 8 - 10 |
| **AVERAGE** | **22** | **11** | **8 - 9** |

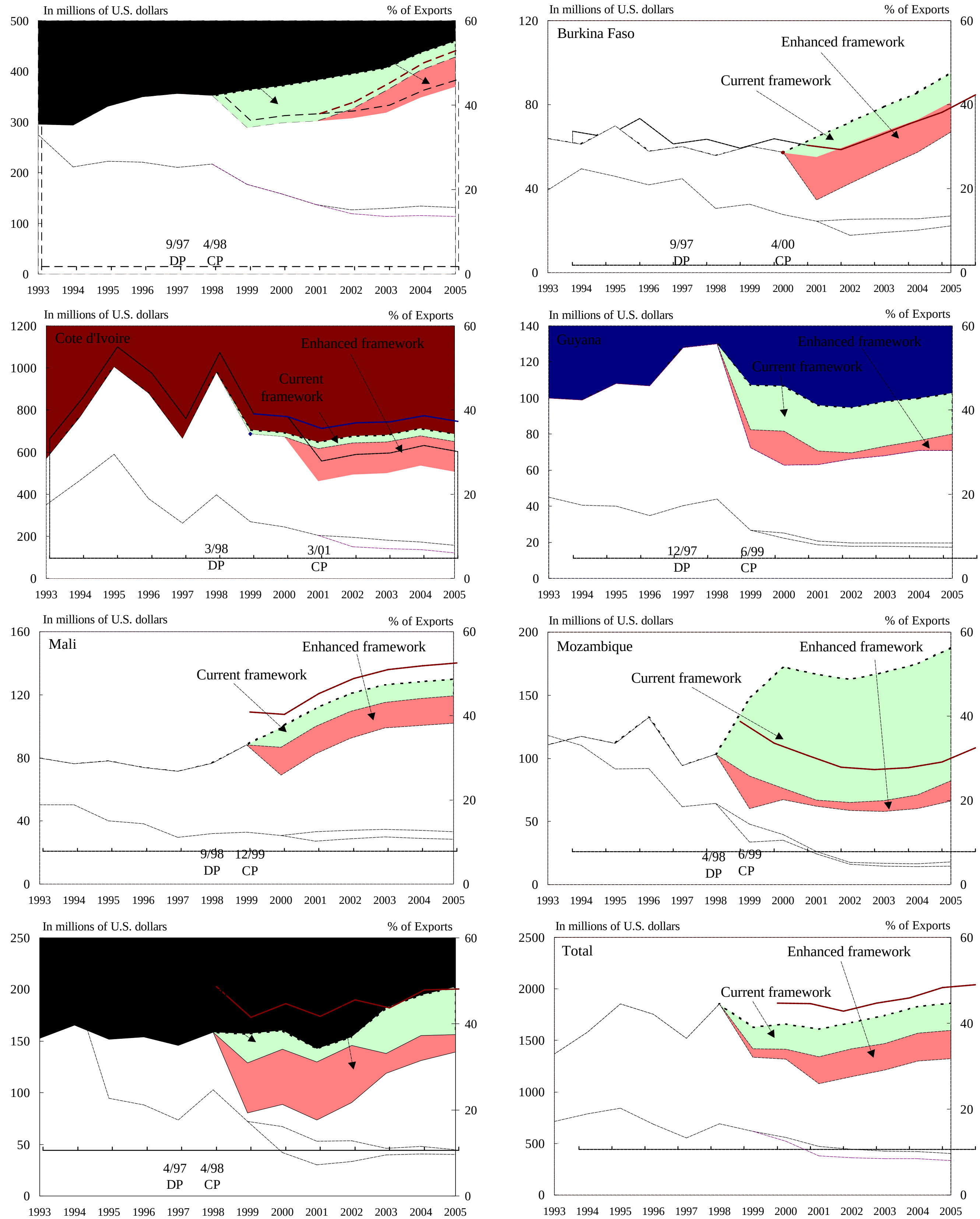
Source: Bank and Fund staff estimates.

1/ Figures underlying Chart 1 of IDA/SecM99-187/2 and EBS/99/52, page 46, except for Mozambique which has been revised, reflecting additional assistance committed at the completion point.
2/ Figures are highly illustative based on assumption of between 25-30 percent of all World Bank assistance over years 1-5, and 70-100 percent of IMF assistance in years 1-5.

Chart 2: Debt Service Paid and Projected (after HIPC Initiative Assistance) for Countries Which Have Reached the Decision Point, 1993 - 2005
(In millions of U.S. dollars and percent of exports)

**Scenario 250/30/15/150**

- Debt service paid through 1998 and due after HIPC assistance under the current framework (left scale)
- Debt service due after traditional debt relief mechanisms
- Debt service due after enhanced HIPC assistance
- Debt service paid or due after HIPC assistance under the current framework in percent of exports of goods and services (right scale)
- Debt service due after enhanced HIPC assistance (right scale)




Source: Country authorities and staff estimates. DP = Decision Point CP = Completion Point

● Some 40 percent of paid debt service reflected arrears clearance; in 1993-94, coffee prices/exports were less than half of their 1995 levels.

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**Time profile of debt relief commitments**

48. The time profile of commitments of assistance under the proposed enhanced framework is shown in Table 5, based on the assumed earliest decision points indicated in Table 3. On this basis, commitments (in 1998 NPV terms) to date amount to 12 percent of total projected cost. It is assumed that, through end-2000, (i) all nine countries that have already reached their respective decision points, would be reassessed on the basis of end-1998 data; and (ii) 19 other countries could qualify for HIPC Initiative debt relief. Under this scenario, creditors would be required to make debt relief commitments, amounting to a cumulative 86 percent of total cost expected under the enhanced framework (excluding Liberia, Somalia, and Sudan). This projection is of course subject to change. Past experience has shown that delays in implementing reform programs and conflict have resulted in some countries reaching their decision points later than originally scheduled. In most cases, such delays would mean that the decision point could slip into the next year, thereby shifting part of the cost to a later date. The staff will attempt to bring all the nine countries that have reached the decision point, and as many other countries as possible for early discussion of HIPC documents to the Boards, at the earliest feasible dates. It is currently envisaged that preliminary documents for 3 countries (Tanzania, Honduras, and Nicaragua) will be circulated to the Boards before the 1999 Annual Meetings, and for about 10 countries by the 2000 Spring Meetings though this latter number is obviously dependent on country performance.

### B. Illustrative Effects on Debt Service due after HIPC Initiative Debt Relief

49. As noted earlier, the enhanced HIPC Initiative framework proposed would further reduce debt-service ratios and provide more fiscal space for potentially increased social spending in priority areas. This is illustrated in Table 6 which for the seven countries that have reached their decision/completion points, shows the estimated impact on debt service paid of the lower export and fiscal targets/thresholds proposed and the assessment of assistance based on actual data at the decision point. For these countries as a group, the average debt service payable over the 5 years following the completion point under the current framework is estimated to be about 12 percent lower than what was actually paid on average during 1993–98 with a wide dispersion among countries.[24] [25] Under the

[24] The main reason for the modest decrease in debt service (in U.S dollar terms) is that countries that have benefited from assistance under the Initiative have received immediate comprehensive cash-flow reschedulings as part of program financing in advance of the completion point. Flow reschedulings (which normally include interest falling due) are likely to have a slightly greater cash-flow impact than Paris Club stock-of-debt agreements provided at the completion point. In addition, many countries have in the past accrued substantial arrears to non-Paris Club bilateral creditors and Russia; this has tended to lower debt-service payments before the completion point. As the full implementation of the HIPC Initiative for a country requires the full participation of all creditors, this in turn requires the regularization of external arrears. In some cases, especially where the stock of arrears is large, this may result in higher debt service payments than before the regularization of arrears. This said, the debt service-to-export ratio is projected to average less than 10 percent by 2005 for these seven countries in aggregate.

[25] The simple unweighted average of the percentage changes in debt service of these seven countries was a 6 percent decline. This is higher than the 2 percent decline shown in Table 13 of the April costings supplement due to the additional assistance committed to Mozambique at the completion point.

proposed enhanced framework, aggregate debt service payable after the completion point would drop by 27 percent compared to payments made from 1993-98 based on the current profile of delivery of assistance.[26] The decline in the average debt service-to-exports ratio for these countries is even more marked. Compared to the average ratio prevailing during 1993–98, the debt service ratio would be cut in half to 11 percent under the current framework and fall by some 60 percent to a ratio of 8-9 percent under the proposed enhanced framework. If assistance were front-loaded, as discussed above, there would be a decline of around 35 percent compared to payments made earlier (see Chart 2). In all qualifying countries, the NPV of debt is estimated to be reduced by around 40 percent on top of traditional debt relief mechanisms (such as Naples terms from the Paris Club).

## V. HIPC Debt Relief as Part of a Broader Approach to Poverty Reduction

50. Debt relief is not an objective in itself but rather a means to promote the wider goals of poverty reduction and sustainable development**. To be effective, the proposed enhanced Initiative needs to be reinforced by:**

- *An enhanced framework for poverty reduction*. Staff will make proposals in this regard in a paper to be issued in early August.
- *Policies in HIPCs designed to promote growth, sustainable development and poverty reduction,* including lower spending on unproductive and inefficient activities and higher, more effective, social spending.
- *Increased aid flows*—preferably in grant form—in support of such policies.
- *Restraints on commercial export credit lending* to HIPCs, with no such loans for military purposes.
- *Unrestricted access to industrial country markets* for the export products—which are largely raw materials and agricultural products—of low-income countries.

51. While these wider policies are largely beyond the scope of this paper, they will be needed to secure the success in meeting these wider objectives of the proposed enhanced Initiative.

[26] This makes no allowance for the proposed ODA debt cancellation or the provision of new ODA in grant form.

## VI. Issues for Discussion

52. This paper has provided a number of specific proposals to strengthen the HIPC Initiative. They aim at delivering deeper, faster, and broader debt relief, as well as simplifying the framework where possible. The proposals follow the principles for change set out by the President of the Bank and the Managing Director of the Fund and endorsed by the Boards. As was emphasized in the Progress Report by the Managing Director and the President, agreement on enhancement of the Initiative needs to proceed in parallel with agreement on additional financing for multilateral creditors in general, and the Bank and Fund in particular. Companion papers on financing for IDA and the IMF contributions to the Initiative will be issued prior to the Board discussion. Pending discussion of these papers, Directors' **preliminary views** are sought on the following proposed enhancements to the Initiative (Box 4).

### Deeper relief

53. Do Directors support the proposed changes to the debt sustainability targets under the Initiative to provide a greater cushion for the achievement of debt sustainability, namely a lowering of the NPV of debt-to-export target to 150 percent, and the NPV of debt-to-fiscal revenue target to 250 percent, with a lower threshold level for the degree of openness of an economy of an export-to-GDP ratio of 30 percent, and a threshold for the revenue effort to 15 percent of GDP?

54. Do Directors support a change in the assessment base for the assistance required under the HIPC Initiative from the data projected for the completion point to the actual data at the decision point?

### Earlier relief

55. Do Directors support the provision of faster, more front-loaded relief with the objective of freeing up more resources for increased social and other poverty-reduction expenditures subject to a country's capacity to make effective use of this earlier assistance, the maintenance of medium-term debt sustainability, and the debt-service profile falling due to creditors?

**Box 4**
**Proposed Enhancements of HIPC Initiative**

**Deeper debt relief by:**

- 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 through**

- The provision of interim relief between the decision and completion points.
- The introduction of floating completion points permitting strong performers to reach the completion point earlier, subject to safeguards on macroeconomic stability.
- Front-loading of the delivery of debt relief by IFIs subject to constraints of absorption capacity and the continued achievement of debt sustainability over the medium term, as well as the debt-service profile due to creditors.

**Results**

- Greater safety margin for the achievement of debt sustainability.
- More freeing up of resources earlier for enhanced focus on poverty reduction.
- Expansion of eligibility from 29 to 36 HIPCs, and possibly other countries.
- Increase in overall costs (excluding Liberia, Somalia, and Sudan) from US$12½ to US$27 billion.

56. Do Directors support the provision of interim assistance by the IMF and the World Bank and other multilateral creditors? Do IMF Directors agree with the suggested levels and modalities of interim relief from the Fund?

57. Do Directors support the introduction of floating completion points tied to key structural reforms designed to mark a significant advance toward debt sustainability and sustainable development, with the introduction of the safeguards proposed to ensure macroeconomic sustainability?

58. Do Directors agree that the country-specific application of such floating completion points should be reassessed after 12 months, i.e. before the fall 2000 Annual Meetings?

**Implementation arrangements**

59. Do Directors agree with the proposed simplifications in implementing the Initiative consequent on the proposed changes, namely the fixing of the debt relief as of the decision point, the dropping of the target ranges at the completion point, country-specific vulnerability analyses, and the category of "borderline" cases? This will enable the preparation of a simpler preliminary HIPC Initiative document focussing on the track record and timing of decision points, key structural policies, an enhanced framework for poverty reduction, the appropriate front-loading of assistance in the light of capacity constraints and medium-term projections of key debt ratios and the steps required to strengthen debt management.

60. With the adoption of a decision point-based calculation of assistance, it is proposed that no automatic reassessment at the completion point of the amount of assistance would be provided. However, the international community could—on a discretionary basis—top up assistance if exogenous shocks have led to a major deterioration in the debt situation. Do Directors agree?

61. It is envisaged that a more detailed analysis of debt service indicators should be provided. It is proposed that, while not binding, the debt-service-to-export ratio should fall within the 15-20 percent range or below. An analysis of the trend of the debt-service-to revenue ratio and the overall budgetary context would also be included in future HIPC Initiative documents. Do Directors agree with this approach?

62. The proposed introduction of a floating completion point would shift the focus of the assessment of country performance more towards particular achievements and outcomes rather than the length of the track record. In addition, the assessment would give more weight to social and poverty-related reforms (to be elaborated in the context of an enhanced framework for poverty reduction) though it should be recognized that this can only be the start of a long process leading to effective poverty reduction. Do Directors agree with the suggested approach?

63. Do Directors agree with the proposed mechanism for retroactivity, namely for countries that have already passed their decision points to benefit from the proposed enhancements to the framework based on their current (end-1998) situation based on adequate policy performance including the social content of their program?

**Wider issues**

64. The effectiveness of the proposed enhanced Initiative depends on the broader policy framework related to poverty reduction and sustainable development such as the adoption of appropriate polices in HIPCs, the support of such policies by aid flows, better access for HIPC exports to industrial country markets, and restraint on export credit lending to HIPCs, particularly for military equipment. Do Directors have views on how progress can be best be encouraged on these broader policy issues?

65. Do Directors agree that this paper should be published once discussed by the Boards?

**ANNEX I**

**HIPC Initiative: Report of G-7 Finance Ministers on Köln Debt Initiative - Summary**

The G-7 Finance Ministers' report, endorsed by the G-7 leaders proposes:

**An enhanced framework for poverty reduction** including poverty reduction plans, budgetary transparency, and dialogue with broader segments of society; specific plans are requested from the Bank and Fund by the Annual Meetings.

**Faster debt relief through:**

- Floating completion points;
- Interim relief by IFIs;
- Front-loading of the delivery of debt relief from the completion point.

**Deeper and broader debt relief by:**

- A lowering of the NVP debt-to-export target from the current range of 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 percent to 30 percent (export-to-GDP-ratio) and from 20 to 15 percent (revenue-to GDP ratio).
- Bilateral forgiveness of ODA debt for HIPCs qualifying for HIPC Initiative assistance (on top of the above targets) and new ODA preferably in the form of grants.
- Forgiveness of up to 90 percent and more where needed of eligible debt by the Paris Club.
- For countries not qualifying for HIPC Initiative assistance, a unified 67 percent NPV reduction under Naples terms (with the abolition of the current 50 percent option), and for nonconcessional reschedulings, an increase in the limit on debt swaps.

**On financing**

- For the Fund, use of premium interest income, possible use of SCA-2 or equivalent financing and use of interest on the proceeds of a limited and cautiously-phased sale of up to 10 million ounces of the Fund's gold reserves.
- For multilateral development banks, innovative approaches maximizing the use of their own resources complemented by bilateral contributions (with appropriate burden sharing) to an expanded HIPC Trust Fund.

The report calls for concrete proposals to be agreed by the time of the Annual Meetings.

**ANNEX II**

## Modalities of Providing Fund Interim Assistance

Interim relief would advance assistance due at the completion point. It would be in the form of grants to cover debt service falling due to the Fund. The amount of HIPCs' debt service due in the interim period would therefore define a cap on the amount of assistance to be provided.

The amounts of interim assistance could be determined on a case-by-case basis on certain criteria such as:

- total debt service (after rescheduling) and its profile in terms of exports during the second stage;
- the share of multilateral debt in total debt;
- the overall NPV of debt and projected movements in the NPV of debt-to-exports ratio between the decision and completion points;
- the profile of debt service falling due to the Fund; and
- the country's capacity to make effective use of the freed-up resources to increase social expenditures.

A maximum amount of IMF interim assistance would be envisaged, namely a fixed share of the IMF cost at the completion point (say 20 percent of the assistance committed by the Fund at the decision point during each of the 2-3 "second stage" years). In practice, total debt service falling due to the Fund could, in many cases, limit assistance below these maximum amounts. This could involve a significant degree of front loading as up to 60 percent of the Fund's total assistance could be disbursed in the first 3 years of a 13-year repayment period (3 years before and 10 years after the completion point assuming at a 3-year second stage).

It would be important to ensure that interim relief—as well as the delivery of debt service from the completion point on—was consistent with a declining trend in the NPV of debt-to-export ratio after assistance under the Initiative. An excessive front-loading of overall relief would threaten the re-emergence of debt problems indicated by subsequent increases in the debt service and NPV of debt-to-export ratios. The amount of interim relief consistent with declining trends in these ratios will need to be derived on a case-by-case basis in the light of prospective actions by other creditors. The proposed scheme for interim relief assumes the early availability of the financial resources required.