

WP/01/144

IMF Working Paper

Debt Relief Under the HIPC Initiative: Context and Outlook for Debt Sustainability and Resource Flow

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IMF Working Paper

Policy Development and Review Department

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September 2001

Abstract

<p>The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.</p>
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This paper discusses the Heavily Indebted Poor Countries (HIPC) Initiative in the perspective of sizable historical debt relief and large positive net resource flows to HIPCs. It argues that, by substantially reducing HIPCs' debt stocks and debt service payments, the Initiative provides a solid basis for debt sustainability and room for increased social spending. For poverty reduction, HIPC relief is important but broader international support is needed. The paper maintains that, as experience has shown, external support can be effective only if it reinforces sound policies implemented by HIPCs themselves. Thus, debt relief and official development assistance are critical as "help for self-help."

JEL Classification Numbers: F34, F35, O11, O19

Keywords: debt relief, external debt sustainability, HIPC Initiative, poverty reduction

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I. INTRODUCTION AND SUMMARY

The external debt levels of low-income countries have mounted over the last two decades. At the same time, efforts have intensified to alleviate this burden. Since the late 1980s, when industrial countries first agreed to reschedule low-income countries' debts on concessional terms in the context of the Paris Club (Toronto terms), the degree of debt forgiveness (grant element) has been increased in several steps. By the mid-1990s, under what came to be known as Naples terms, Paris Club creditors were forgiving two-thirds of low-income countries' eligible debts. Despite these efforts, some low-income countries, especially those in sub-Saharan Africa, continued to face heavy external debt burdens and difficulties with servicing them, sometimes repeatedly resorting to debt rescheduling. This often reflected a combination of factors, including a lack of perseverance with structural and economic reform programs, a deterioration in their terms of trade, poor governance, and also a willingness of creditors to continue to provide new loans.

The Heavily Indebted Poor Countries (HIPC) Initiative, launched in September 1996 by the IMF and the World Bank, is an evolution of traditional debt relief efforts. Unlike them, however, the HIPC Initiative involves for the first time debt relief from multilateral financial institutions. The Initiative's main purpose is the reduction of eligible countries' external debt burdens to sustainable levels and the elimination of any debt overhang that might be a hindrance to growth and investment. The Initiative was reviewed and enhanced in late 1999 to provide faster and deeper debt relief to a larger number of countries. The enhanced Initiative is expected to benefit close to 40 low-income countries, of which 23 have reached their decision points and have started to receive debt relief as of July 2001.

The enhanced HIPC Initiative provides substantial debt relief to eligible countries by reducing their overall debt stocks by about one-half. Three points should be noted. *First*, this builds on debt reduction under traditional mechanisms over the last decade or so, which already reduced debts by about half for the countries that are expected to require HIPC relief. Combining traditional and HIPC relief over time, the external debt of these countries will be reduced in total by some 80 percent. *Second*, the Initiative lowers debt service payments for the 23 decision point HIPCs on average by about one-third to 8 percent of exports—this is less than half the debt service ratio paid by other developing countries. While debt service payments by HIPCs are declining, social spending is increasing and projected to reach more than three times the level of debt service payment by 2002. *Third*, the Initiative provides a solid basis for HIPCs to achieve debt sustainability and to exit the rescheduling cycle. It is a major step, but maintaining debt at sustainable levels over time is a more complex undertaking—which requires efforts both by debtors, on the one hand, and creditors and donors, on the other. For this, it is essential that debtors pursue sound economic policies, including good debt management. It is also essential that creditors/donors are ready to support HIPCs by providing adequate resources on appropriately concessional terms.

The Initiative is primarily concerned with achieving debt sustainability, but at the same time resources freed up by debt relief are to be channeled toward social expenditure and other poverty-reduction programs. In light of the latter and given that the countries targeted are

among the poorest in the world, there has been ample discussion on the HIPC Initiative's ability to make a substantial contribution to poverty reduction. It is important to keep the broader context in mind, namely that recent historical gross resource flows to HIPCs were three and a half times the level of debt service payments made. Thus in terms of these countries' future resource needs in support of their poverty reduction strategies (PRSPs), the contribution of the HIPC Initiative is important, but much broader international support is needed. Experience has shown that external support can only be effective if it reinforces sound policies implemented by HIPCs themselves and leads to higher resources being directed to social development and poverty reduction. Debt relief and ODA are most important not in isolation, but as help for self-help.

The paper is organized as follows. The next section discusses debt relief initiatives for low-income countries and their impact in terms of debt-stock reduction. Section 3 examines the flow impact of debt relief, and discusses its significance in terms of resources flows to HIPCs. Section 4 comments on the debt sustainability outlook and more broadly on the HIPC Initiative's contribution to, and the required international support for, poverty reduction.

II. DEBT RELIEF INITIATIVES FOR LOW-INCOME COUNTRIES—DEBT STOCK PERSPECTIVE

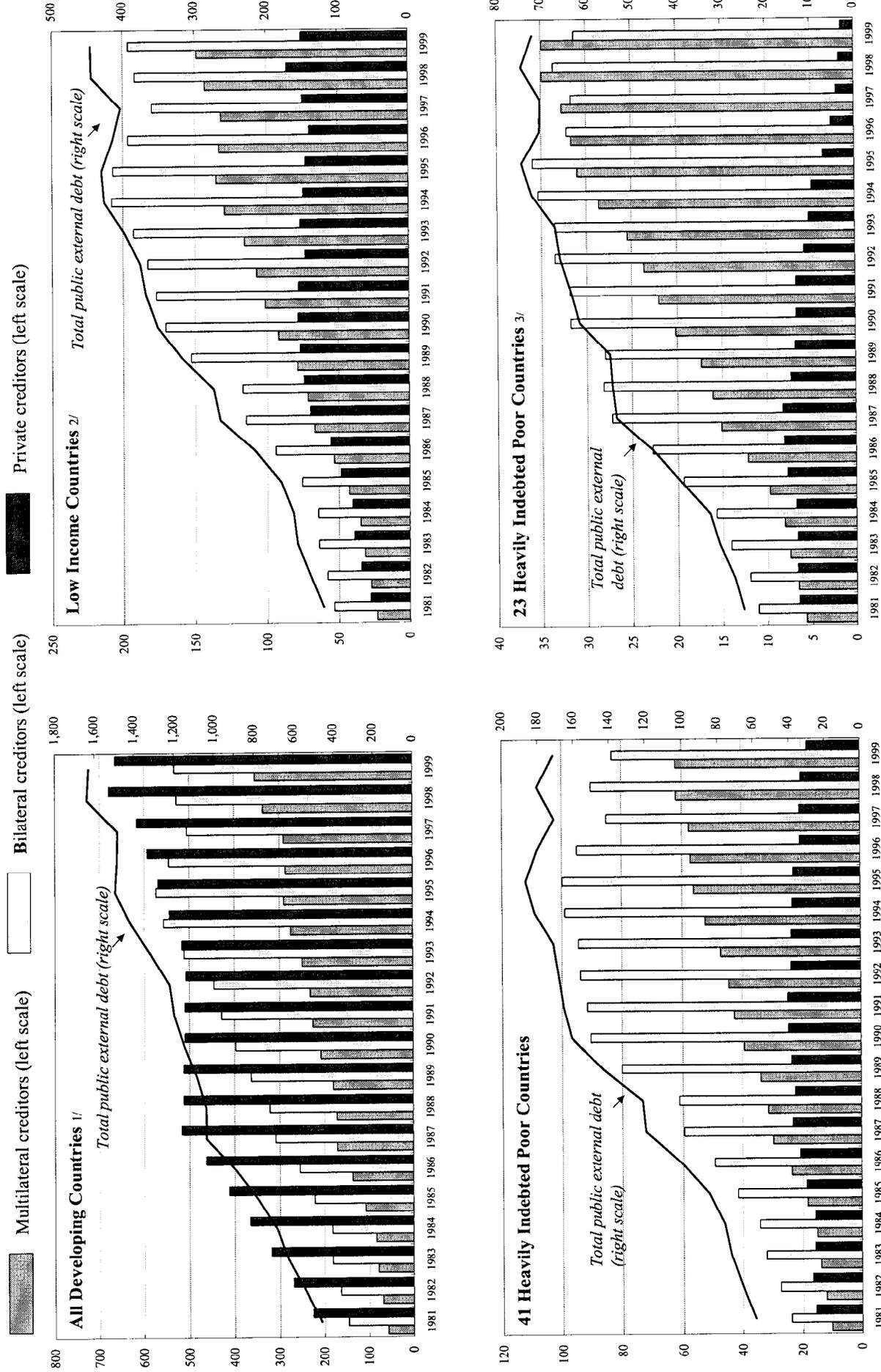
A. Evolution of Debt Stocks

The overall debt level of low-income countries rose significantly in the 1980s and 1990s (Figure 1). For the group of 41 HIPCs, the level of debt tripled from under US\$60 billion in 1980 to a peak of about US\$190 billion in 1995, then declined somewhat to about US\$170 billion by 1999. In contrast, the level of debt of all developing countries, and even of all low-income countries (LICs), continued to rise throughout the same period.²

The creditor composition of debt varies greatly: while private creditors have been the largest creditor group of all developing countries, their exposure to LICs, and even more so to HIPCs, increased slowly in the 1980s, but was stagnant for LICs in the 1990s and declined sharply for HIPCs, especially those 23 HIPCs that have pursued economic policies that allowed them to benefit from debt relief early on. At the same time, bilateral creditors remain the second largest creditor for all developing countries, and the largest creditor of LICs and HIPCs; as bilateral debt stocks have started to decline since the mid-1990—reflecting bilateral debt forgiveness as well as the beginning of stock-of-debt reduction packages from the Paris Club—multilateral creditors, whose exposure has risen steadily to all four country groups, have become the largest creditor group of the 23 decision point HIPCs.

² See Table 1 for a list of the countries in these groupings.

Figure 1: Total Public External Debt in Selected Country Groups, 1981 - 1999
By Creditor, In billions of U.S. dollars



Source: World Bank Global Development Finance, 2001.

1/ A group of 149 countries covered by the GDF. Of these, 137 report to the DRS, while World Bank estimates are used for the others.

2/ A group of 64 countries for which 1999 GNP per capita was no more than \$755 as calculated by the World Bank. Of these, 62 report to the DRS.

3/ HIPC which have reached the Decision Point under the Enhanced HIPC Initiative by July 2001.

Table 1: Developing Country Classification, 2001

Heavily Indebted Poor Countries (HIPC)	Other Developing Countries 1/		
	Low Income 2/	Middle-income 3/	
Decision Point reached by July 2001	<i>Afghanistan, I.S. of 6/</i>	Albania	Lebanon
Benin	Armenia	Algeria	<i>Libya 6/</i>
Bolivia 4/	Azerbaijan	<i>Antigua & Barbuda 6/</i>	Lithuania
Burkina Faso	Bangladesh	Argentina	Macedonia, FYR
Cameroon	Bhutan	<i>Bahrain 6/</i>	Malaysia
Chad	Cambodia	Barbados	Maldives
Gambia, The	Comoros	Belarus	Malta
Guinea	Eritrea	Belize	Mauritius
Guinea-Bissau	Georgia	Bosnia and Herzegovina	Mexico
Guyana 4/	Haiti	Botswana	Morocco
Honduras 4/	India	Brazil	<i>Namibia 6/</i>
Madagascar	Indonesia	Bulgaria	Oman
Malawi	<i>Korea, D.P.R 6/</i>	Cape Verde	Panama
Mali	Kyrgyz Republic	Chile	Papua New Guinea
Mauritania	Lesotho	China	Paraguay
Mozambique	Moldova	Colombia	Peru
Nicaragua	Mongolia	Costa Rica	Philippines
Niger	Nepal	Croatia	Poland
Rwanda	Nigeria	<i>Cuba</i>	Romania
São Tomé and Príncipe	Pakistan	Czech Republic	Russian Federation
Senegal	Solomon Islands	Djibouti	Samoa
Tanzania	Tajikistan	Dominica	<i>Saudi Arabia 6/</i>
Uganda	Turkmenistan	Dominican Republic	Seychelles
Zambia	Ukraine	Ecuador	Slovak Republic
Decision Point not yet reached	Uzbekistan	Egypt	South Africa
Burundi	Zimbabwe	El Salvador	Sri Lanka
Central African Republic		Equatorial Guinea	St. Kitts and Nevis
Congo, Democratic Republic of		Estonia	St. Lucia
Congo, Republic of		Fiji	St. Vincent and the Grenadines
Cote d'Ivoire 5/		Gabon	<i>Suriname 6/</i>
Ethiopia		<i>Gibraltar 6/</i>	Swaziland
Ghana		Grenada	Syrian Arab Republic
Lao People's Democratic Republic		Guatemala	Thailand
Liberia		Hungary	Tonga
Myanmar		Iran, Islamic Republic of	Trinidad and Tobago
Sierra Leone		<i>Iraq 6/</i>	Tunisia
Somalia		Jamaica	Turkey
Sudan		Jordan	Uruguay
Togo		Kazakhstan	Vanuatu
Sustainable cases		Kiribati 6/	Venezuela, Republica Bolivariana de
Angola		Korea, Republic of	Yugoslavia, Federal Republic of
Kenya		Latvia	
Vietnam			
Yemen, Republic of			

Source: World Bank Global Development Finance (GDF), 2001.

1/ A group of 149 countries covered by the GDF. Of these, 137 report to the World Bank Debtor Reporting System (DRS).

2/ A group of 64 countries for which 1999 GNP per capita was no more than \$755, as calculated by the World Bank. Of these, 62 report to the DRS.

3/ A group of 85 countries covered by the GDF for which 1999 GNP per capita was between \$756 and \$9,265, as calculated by the World Bank. Seventy-five of these countries report to the DRS.

4/ Classified by GDF as middle-income country.

5/ Decision point reached under original HIPC framework. Case will be reassessed under the enhanced framework.

6/ Country does not report to the DRS.

Scaling debt stocks against exports or GNP also shows a large buildup of burdens in LICs and HIPCs from 1980 to the early 1990s, and a modest decline since then (Figure 2). It also shows that the debt burdens of the HIPCs are much higher than, in fact a multiple of, the debt levels of LICs or all developing countries. Interestingly, the debt-to-GNP ratio of all developing countries has continuously risen from some 20 percent in 1981 to over 40 percent in 1999; LIC debt levels have risen slightly faster (possibly reflecting lower GNP growth), and stood at about 60 percent of GNP in 1999; this compares to a debt/GNP level of 110 percent for HIPCs.

Relative to exports, debt burdens of all developing countries and LICs peaked in the mid-1980s, then stagnated or declined. The build-up continued in HIPCs until the mid-1990s, in part reflecting the unsuccessful export performance of HIPCs that has led to a decline in HIPCs' share in world trade from 2.2 percent in 1970 to 0.7 percent in 1997.

The increase in LICs' debt levels over time reflected both a willingness on the part of debtors to take on more debt, and on the part of creditors to take substantial lending risks in order to help poor countries, while in the case of official bilateral creditors promoting their own exports. It also reflected factors such as terms-of-trade shocks, a lack of sustained macroeconomic adjustment and structural reform, weak debt management practices, governance problems and other political factors, civil war and social strife.³

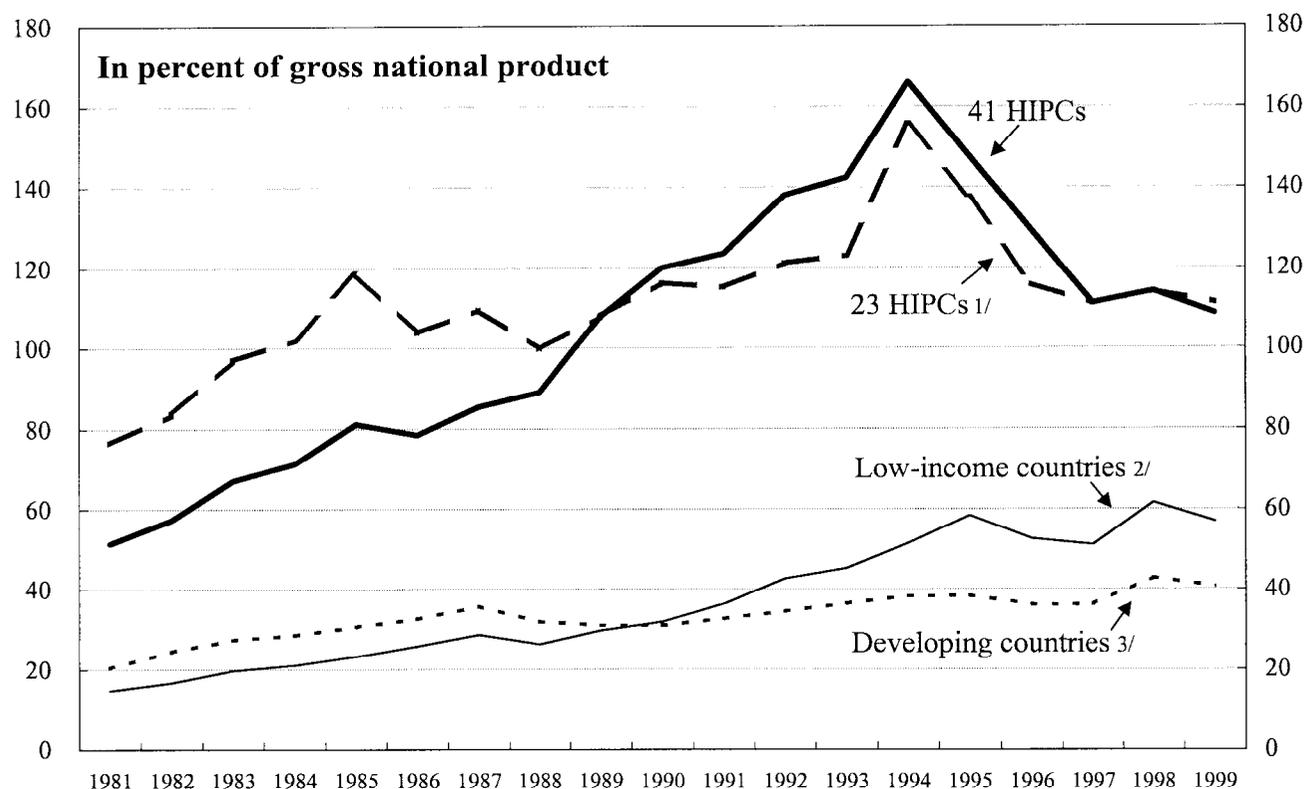
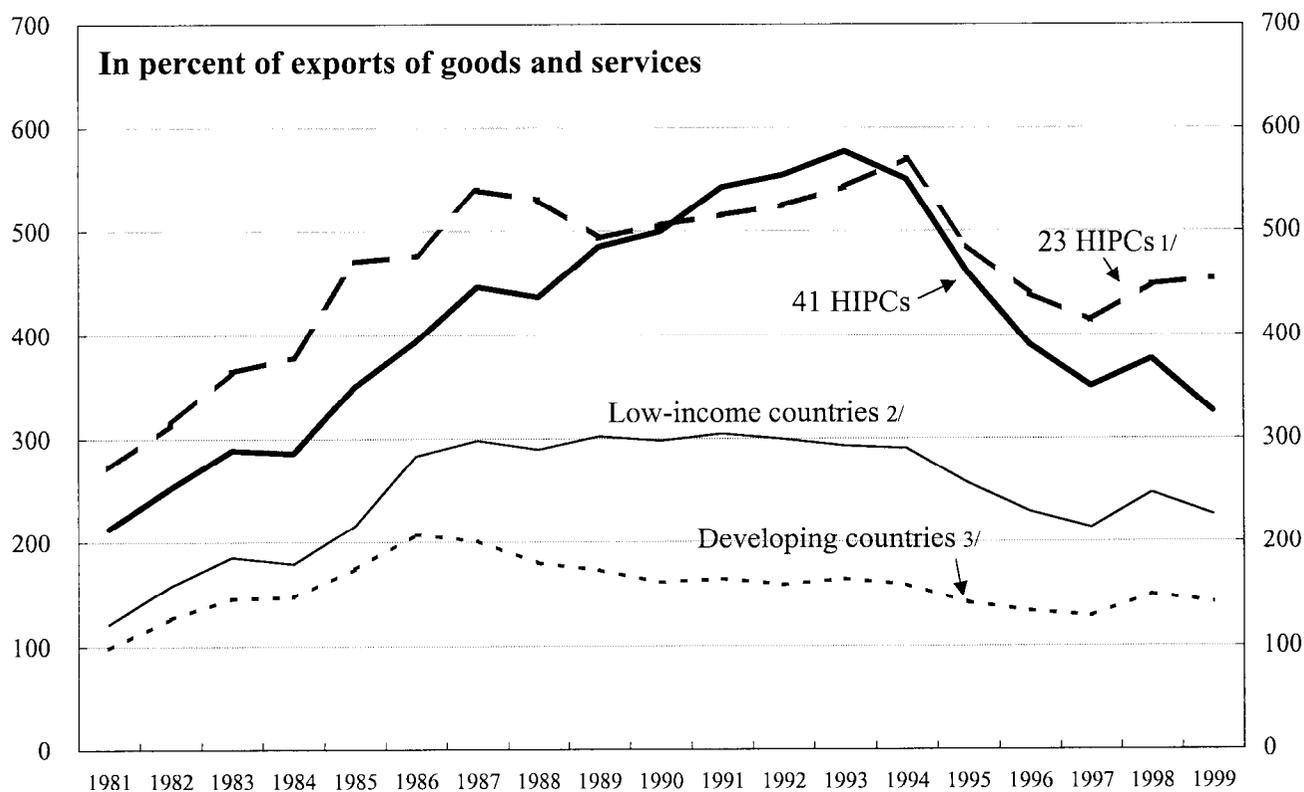
B. Evolution of Various Debt Reduction Mechanisms

Debt relief in the form of a restructuring or rescheduling of debt has been provided by creditors to debtors for a long time. The motivation is mainly to help the debtor over a period of payment difficulties, and to increase the creditor's perceived likelihood of collecting on claims held. In cases where the debtor is a government, creditors have fewer tools available to enforce payments than in the case of non-sovereign debtors where foreclosure and bankruptcy are options. Also, where several players are involved, debtors and creditors have often found it convenient for both sides to reschedule debt in a concerted framework. The Paris Club has provided such a framework for sovereign debt reschedulings (of government-to-government debt) mainly with OECD creditor governments since the mid-1950s.⁴

³ For a discussion of the factors leading to high indebtedness in a sample of ten low-income countries, see Brooks, Cortes, Fornasi, Ketchekmen, Metzgen, Powell, Rizavi, D. Ross and K. Ross, "External Debt History of ten Low-income Developing Countries: Lessons from Their Experience", IMF Working Paper, WP/98/72 (1998).

⁴ The Paris Club requires rescheduling countries to seek similar ("comparable") treatment from its other creditors. Only multilateral creditors are exempted as preferred creditors due to their cooperative character. For information about the Paris Club, see its website at www.clubdeparis.org.

Figure 2: External Debt in Selected Country Groups, in 1981 - 1999
(In percent of exports of goods and services, and gross national product)



Source: World Bank Global Development Finance, 2001.

1/ HIPCs which have reached the Decision Point under the Enhanced HIPC Initiative by July 2001.

2/ A group of 64 countries for which 1999 GNP per capita was no more than \$755 as calculated by the World Bank. Of these, 62 report to the DRS.

3/ A group of 149 countries covered by the GDF. Of these, 137 report to the DRS, while World Bank estimates are used for the others.

Such Paris Club reschedulings involved mainly cash-flow relief until 1988. The debt servicing problems of middle-income countries, for example in Latin America in the 1980s, were seen as liquidity problems and were largely remedied by stretching out payments to official bilateral creditors over time. Commercial creditors also provided cash-flow relief, but often in combination with a degree of debt reduction, e.g., through an exchange of claims for Brady bonds that provided some collateral. Table 2 shows that as of mid-2001 most middle-income countries have exited from the Paris Club rescheduling process.

In contrast to middle-income countries, it became increasingly clear that the mounting debt burdens of low-income countries reflected deeper problems—they were solvency problems that required not only a temporary reduction in debt service, but also a reduction in the level of debt. Paris Club creditors began to grant such debt reduction in the form of concessional flow reschedulings⁵ for low-income countries in late 1988 under the so-called “Toronto Terms” that involved a debt reduction of about one-third of the eligible amounts.⁶ The level of debt forgiveness was subsequently raised in steps: to London terms in late 1991 (50 percent debt reduction), and to Naples terms (two-thirds debt reduction) at the end of 1994 (Tables 3-4). This resulted in increasingly longer and lower payment profiles on restructured debt (Figure 3).⁷

Bilateral creditors not participating in the Paris Club—mainly oil exporters in the Middle East, but also China, Taiwan Province of China and a number of other developing countries, including some HIPC—provided more limited debt restructurings than other creditors, but in turn often saw their claims increasingly falling into arrears.

⁵ A flow rescheduling restructures typically debt service due during 1–3 years. Paris Club creditors provided restructurings of the stock of a country’s debt only since the adoption of Naples terms; this was seen as an exit treatment for countries with good economic policies.

⁶ The reduction factor applies to pre-cutoff date non-ODA debt in NPV terms. ODA debt is restructured at an interest rate no higher than the original rate over 40 years, including 16 years’ grace, which typically also implies an NPV reduction. Post-cutoff date debt is not subject to traditional relief mechanisms, but is taken into account under the HIPC Initiative. The cutoff date is set in the context of a country’s first Paris Club rescheduling in order to protect new lending by Paris Club creditors.

⁷ For a discussion of the motivations underlying traditional debt relief and the evolution of Paris Club terms see Daseking and Powell, “From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries”, *International Economic Policy Review*, Vol. 2, 2000, IMF, pp. 39–58.

Table 2. Status of Paris Club Rescheduling Countries as of End-July 2001

Low-Income 1/		Lower-Middle-Income 2/		Other Middle-Income		Total
Countries that graduated from reschedulings 3/						
** Albania	6/00 8/	Dominican Republic	12/99	Algeria	5/98	
**** <u>Bolivia</u>	7/01	Ecuador	4/01	Argentina	3/95	
** Bosnia/Herzegovina	4/00	<u>Egypt</u>	5/91	Bulgaria	4/95	
* Equatorial Guinea	2/96	El Salvador	9/91	Brazil	8/93	
** Cambodia	6/97	Gabon	12/00 4/	Chile	12/88	
** Haiti	3/96	Guatemala	3/93	Costa Rica	6/93 4/	
**** <u>Uganda</u>	9/00	Jamaica	9/95 4/ 6/	Croatia	12/95	
* Vietnam	12/93 4/	Kenya	6/01 6/	Macedonia, FYR	3/00 8/	
*** <u>Yemen, Republic of</u>	6/01	Morocco	12/92	Mexico	5/92	
		<u>Peru</u>	12/98 7/	Panama	3/92	
		Philippines	7/94 9/	Romania	12/83	
		<u>Poland</u>	4/91	Russian Federation	12/00	
				Trinidad and Tobago	3/91	
				Turkey	6/83	
Number of countries	9		12		14	35
Countries with rescheduling agreements in effect						
**** <u>Benin</u>	12/01	Djibouti	6/02			
**** <u>Burkina Faso</u>	12/01	Georgia	12/02			
**** Cameroon	12/03	Indonesia	3/02			
**** Chad	3/03	Jordan	4/02			
**** Ethiopia	3/04	Pakistan	9/01			
**** Guinea	4/04	Ukraine	9/02			
**** <u>Guinea-Bissau</u>	12/03					
** Honduras	3/02 8/					
**** Madagascar	2/04					
**** <u>Mali</u>	12/01					
**** Malawi	12/03					
**** Mauritania	6/02					
*** <u>Mozambique</u>	12/01 8/					
**** Niger	12/03					
**** Rwanda	12/01					
** Sao Tome and Principe	4/03					
**** <u>Senegal</u>	12/01					
**** Tanzania	3/03					
**** Zambia	3/02					
Number of countries	19		6		0	25
Countries with previous rescheduling agreements, but without current rescheduling agreements, which have not graduated from reschedulings						
Angola	9/90	Ghana	4/96 4/5/	Yugoslavia, FR 10/	6/89	
** Central African Republic, The	6/01	Nigeria	1/01			
*** Côte d'Ivoire	3/01					
** Congo, Republic of	6/99					
Congo, Democratic Republic of	6/90 11/					
Gambia, The	9/87					
*** <u>Guyana</u>	6/99					
**** Liberia	6/85					
** Nicaragua	2/01 8/					
** Sierra Leone	12/97					
Somalia	12/88					
Sudan	12/84					
** Togo	6/98					
Number of countries	13		2		1	16
All countries	41		20		15	76

Sources: Paris Club Secretariat; and Fund staff estimates.

Note: Stock treatment underlined. Dates refer to end of current or last consolidation period. In the case of a stock-of-debt operation, canceled agreements, or rescheduling of arrears only, date shown is that of relevant agreement.

1/ * denotes rescheduling on London terms, ** denotes rescheduling on Naples terms, *** denotes rescheduling on Lyon terms, and **** denotes rescheduling on Cologne terms.

2/ Defined here as countries that obtained lower-middle-income but not concessional terms with Paris Club reschedulings.

3/ For some countries, this inevitably represents an element of judgment: in certain circumstances, for example, if hit by an external shock, a country may need further reschedulings.

4/ Rescheduling of arrears only.

5/ Limited deferral of long-standing arrears to three creditors on nonconcessional terms.

6/ Nonconcessional rescheduling at the authorities' request.

7/ Agreement includes a reprofiling of the stock of certain debts at the end of the consolidation period.

8/ Including deferral of maturities.

9/ The 1994 rescheduling agreement was canceled at the authorities' request.

10/ Former Socialist Federal Republic of Yugoslavia.

11/ Last rescheduling on Toronto terms.

Table 3. Evolution of Paris Club Rescheduling Terms

	Lower-Middle Income Countries (Houston terms) 1/				Toronto Terms Options				London Terms 3/				Low-Income Countries 2/				Naples Terms Options 4/				Lyon Terms 5/ Options				Cologne Terms Options 5/ 6/									
	DR		DSR		LM		CMI		LM		DR		Flows		Maturings		DSR		LM		CMI		LM		DR		DSR		CMI		LM		DR	
	Since Sept. 1990	Oct. 1988-June 1991	Dec. 1991-Dec. 1994	Since January 1995	Dec. 1996-Oct. 1999	Since Nov. 1999																												
Grace (in years)	5-6 1/2	8	8	14	6	5	16	7/	6	--	3	8	20	6	8	8	20	6	8	8	8	20	6	8	8	20	6	8	8	20	6			
Maturity (in years)	9 1/2	14	14	25	23	23	23	25	23	33	33	33	40	23	40	40	40	23	40	40	40	40	23	40	40	40	40	40	40	40	23			
Repayment schedule	Flat/graduated	Flat/graduated	Flat/graduated	Flat/graduated	Flat/graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated	Graduated			
Interest rate 8/	M	M	R	M	M	R	R	M	M	R	R	R	M	M	R	R	R	M	M	R	R	M	M	R	R	R	M	M	R	R	M			
Reduction in net present value (in percent)	--	33	20-30	--	50	50	50	--	67	67	67	67	67	67	67	67	67	80	80	80	80	--	80	80	80	80	80	80	80	80	90 6/			
<i>Memorandum items</i>																																		
ODA credits																																		
Grace (in years)	5-6	14	14	14	12	12	12	16	16	16	16	16	20	16	16	16	20	16	16	16	20	16	16	16	16	16	16	16	16	16				
Maturity (in years)	10	20	25	25	30	30	30	25	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40	40				

Source: Paris Club.

1/ Since the 1992 agreements with Argentina and Brazil, creditors have made increasing use of graduated payments schedules (up to 15 years' maturity and 2-3 years' grace for middle-income countries; up to 18 years' maturity for lower middle-income countries).

2/ DR refers to the debt-reduction option; DRS to the debt-service-reduction option; CMI denotes the capitalization of moratorium interest; LM denotes the nonconcessional option providing longer maturities. Under London, Naples, Lyon and Cologne terms, there is a provision for a stock-of-debt operation, but no such operation took place under London terms.

3/ These have also been called "Enhanced Toronto" and "Enhanced Concessions" terms.

4/ Until November 1999 included an option of a 50 percent level of concessionality for countries with a per capita income of more than \$500, and an overall net present value of debt/export ratio of less than 350 percent. For a 50 percent level of concessionality, terms were equal to London terms except for the debt-service-reduction option under a stock-of-debt operation that included a three-year grace period.

5/ These terms are to be granted in the context of concerted action by all creditors under the HIPC Initiative. They also include, on a voluntary basis, an ODA debt-reduction option.

6/ Creditors agree on a case-by-case basis on a net present value debt reduction of 90 percent

on pre-cut-off date commercial (non-ODA) debt, or more if this is required in the context of proportional burden sharing with other creditors to achieve debt sustainability in the debtor country. All creditors will seek to apply the DR option, but if that is not possible there is also a DSR option with very long maturities and grace periods.

7/ Fourteen years before June 1992.

8/ Interest rates are determined in the bilateral agreements implementing the Paris Club Agreed Minute. M = market rates; R = reduced rates.

9/ The interest rate was 3.5 percentage points below the market rate or half of the market rate if the market rate was below 7 percent.

10/ Reduced to achieve a 50 percent net present value reduction.

11/ Reduced to achieve a 67 percent net present value reduction; under the DSR option for the stock operation, the interest rate is slightly higher, reflecting the three-year grace period.

12/ Reduced to achieve an 80 percent net present value reduction.

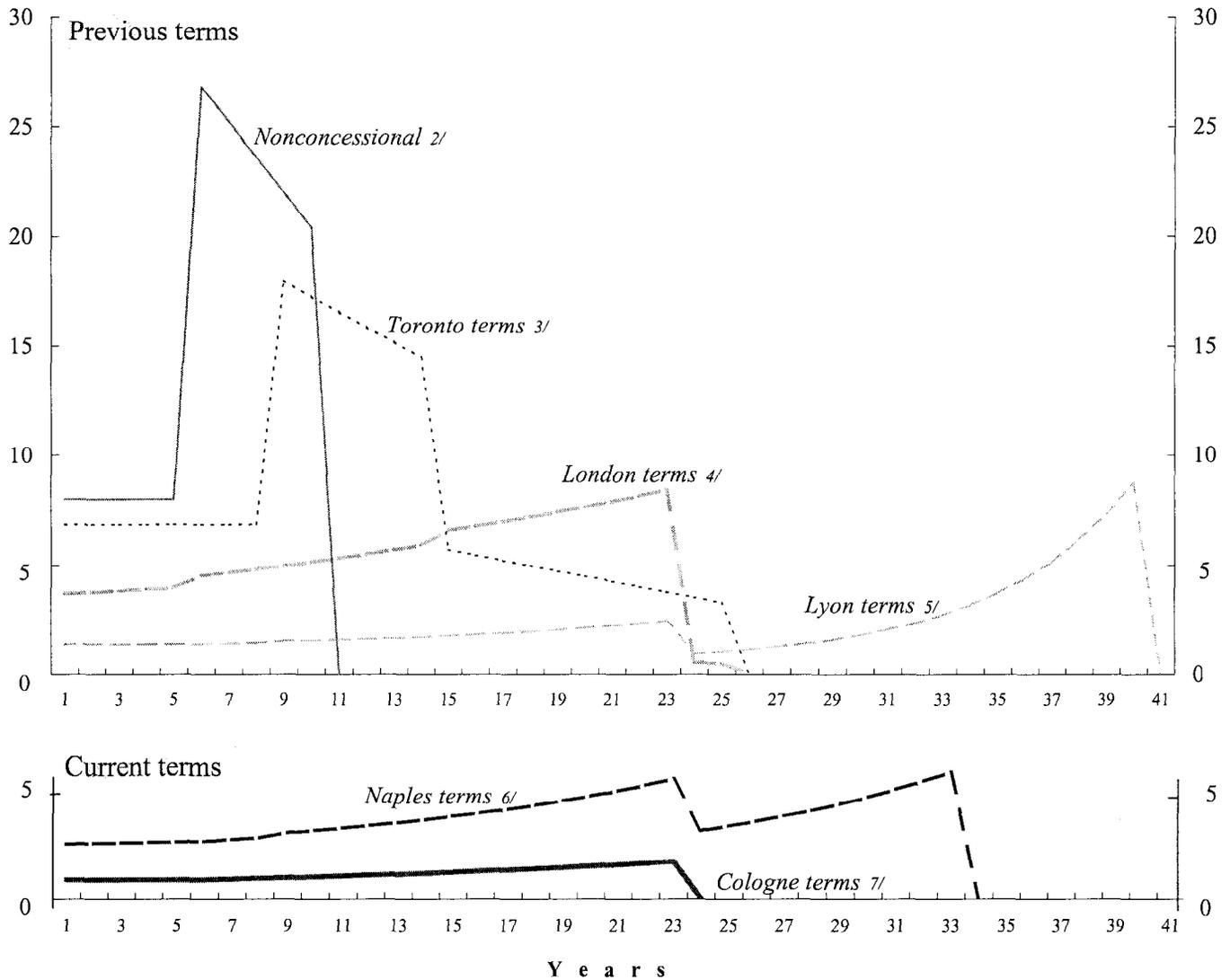
13/ The reduction of net present value depends on the reduction in interest rates and therefore varies. See Footnote 9.

Table 4. HIPC: Paris Club Reschedulings By Type of Terms, 1976 - July 2001

		Number of reschedulings	Number of countries	Amounts consolidated		Stock or flow reschedulings
				Total	o/w stock operations	
				(millions of U.S. dollars)		
Nonconcessional	Before October 1988	87	28	23,269	-	flow deals only
Toronto terms	October 1988 - June 1991	27	19	5,984	-	flow deals only
London terms	December 1991 - December 1994	24	22	8,774	-	flow deals only
Naples terms	Since January 1995	38	26	17,519	3,100	8 stock deals
Lyon/Cologne terms	Since December 1996	21	18	8,521	3,639	6 stock deals

Sources: Paris Club Secretariat, and IMF staff estimates.

Figure 3. Evolution of Paris Club Low-Income Rescheduling Profiles 1/
(In percent of amounts consolidated)



Sources: Paris Club Secretariat; and IMF staff estimates.

1/ Assuming a market interest rate of 8 percent. The payments profiles reflect the actual distribution of the debt reduction option (DR), debt service reduction option (DSR), the capitalization of moratorium interest option (CMI), or the long maturities option (LM).

2/ Assuming equal principal repayments over 10 years including 5 years of grace.

3/ Equal distribution among the options (DR, DSR, and LM).

4/ Distribution (in percent) of DR 40; DSR 45; CMI 10; LM 5.

5/ 80 percent reduction in NPV terms provided in the context of the original HIPC Initiative. Distribution (in percent) of DR 50; DSR 50.

6/ 67 percent reduction in NPV terms. Distribution among options (in percent): DR 45; DSR 45; CMI 10. The LM option is not included, given that any creditor choosing this option undertakes best efforts to change to a concessional option at a later date when feasible.

7/ 90 percent reduction in NPV terms provided in the context of the enhanced HIPC Initiative. DR option only.

Paris Club reschedulings were complemented by initiatives to forgive bilateral ODA claims, going back as far as a resolution adopted in 1978 by the Trade Development Board (TDB) of the UN Conference on Trade and Development (UNCTAD). Also, donor governments gave some debt reduction through debt swaps,⁸ and began to provide more and more of bilateral development assistance in the form of grants.⁹

HIPCs have experienced a withdrawal of private creditors over the years. Similar to non-Paris Club official bilateral creditors, these claims are often not serviced. IDA facilitated buybacks of about US\$7 billion in commercial debt of low-income countries at steep discounts with the help of grants from bilateral donors (Table 5).

These “traditional debt relief mechanisms” reduced bilateral and commercial debt, but not debt to multilateral organizations. As multilateral institutions continued to provide support to low-income countries’ policy adjustment efforts through (mostly concessional) loans—in the absence of significant grant resources—they accounted for an increasing share of new loan resources to low-income countries, which was reflected in an increasing share of multilateral debt in the total debt of low-income countries. To mitigate this, a number of bilateral creditors began to provide grants to help service multilateral debts of some HIPCs, e.g., Uganda.

In the 1990s calls from various quarters, including NGOs, sought a broader approach to reducing the debt burden of low-income countries. These efforts culminated in the adoption of the HIPC Initiative in the fall of 1996 and its enhancement three years later in 1999 by the membership of the IMF and World Bank.¹⁰ At the same time as the implementation of the HIPC Initiative is moving ahead, a number of industrial countries have committed to go beyond it and forgive all or part of the remaining claims (Table 6).

⁸ For information on debt swaps, see Appendix VI in: Ross, Harmsen, et al., *Official Financing for Developing Countries*, World Economic and Financial Surveys, IMF, 2001.

⁹ Some OECD DAC members no longer provide ODA in the form of loans: Australia, Canada, Denmark, Ireland, Luxemburg, the Netherlands, New Zealand, Sweden, Switzerland, the United Kingdom, and the United States. See OECD, “Debt and Development Co-operation: Debt Relief Actions by DAC Members”, OCDE/GD(97)134, 1997.

¹⁰ For policy and country documents and general information on the HIPC Initiative, see www.imf.org/external/np/exr/facts/hipc.htm.

Table 5. IDA Debt Buybacks: Summary of Completed Operations for HIPCs, 1991 to 2001
(End-March 2001)

(In millions of U.S. dollars)

Date Completed	Country	Principal and Interest Extinguished	Price in Cents Per dollar 1/	Percent Eligible Debt Extinguished	Total 2/ Resources Utilized	IBRD Resources Utilized
March 1991	Niger	207	18	99	19.37	8.42
December 1991	Mozambique	198	10	64	13.41	5.91
November 1992	Guyana	93	14	100	10.23	10.00
February 1993	Uganda	177	12	89	22.58	10.21
May 1993	Bolivia	170	16	94	27.26	9.81
August 1994	Sao Tome & Principe	10	10	87	1.27	1.27
September 1994	Zambia	408	11	78	24.99	11.76
September 1995	Sierra Leone 3/	286	13	73	31.53	21.00
December 1995	Nicaragua	1,819	8	81	89.20	40.75
January 1996	Ethiopia	284	8	80	18.83	6.18
August 1996	Mauritania	89	10	98	5.82	3.18
December 1996	Senegal 4/	112	20	96	15.00	7.46
December 1997	Togo	74	13	99	6.11	5.11
March 1998	Côte d'Ivoire 5/	2,027	24	100	173.90	20.00
March 1999	Guinea	61	13	75	8.67	5.59
August 1999	Guyana II	34	9	62	3.36	1.20
March 2001	Yemen	675	4	92	15.20	7.50
	Total	6,724.74	13.9 6/	86.29	486.73	175.35

Source: IDA.

1/ Of original face value of principal.

2/ Represent resources for IBRD, donors and contributions from certain recipient countries. These figures also include US\$15 million for technical assistance grants and closing costs, and other related expenses.

3/ Two tier operation. Commercial debt was bought back at 15 cents and suppliers credit at 8 cents.

4/ 16 cents for the cash buy-back and 20 cents for long terms exchange bonds.

5/ The numbers relate only to the cash buy-back component of the total debt under the operation since the Facility financed exclusively the cash buy-back option, as approved by the Executive Directors (Report No. P-7151-IVC). Other resources for the operation included IDA credits, French concessional financing, IMF credits and co-financing from the government of Côte d'Ivoire.

6/ Weighted average.

Table 6. Paris Club Creditors' Delivery of Debt Relief Under Bilateral Initiatives
Beyond the HIPC Initiative (August 1, 2001)

Countries covered	ODA (in percent)		Non-ODA (in percent)		Provision of relief	
	Pre-COD	Post-COD	Pre-COD	Post-COD	Decision point (In percent)	Completion point
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Australia	100	100	100	100 1/	1/	1/
Austria	Case-by-case (100)	Case-by-case (100)	Case-by-case (100)	-	Case-by-case	Case-by-case
Belgium	100	100	Case-by-case (up to 100)	Case-by-case	flow	Stock
Canada	- 3/	- 3/	100	100	100 flow	Stock
Denmark	100	Case-by-case	-	-	-	Stock
France	100	100	100	-	100 flow 4/	Stock
Finland	95	98	-	-	-	-
Germany	100	100	100	-	100 flow	Stock
Ireland	-	-	-	-	-	-
Italy	100	100	100	100	100 flow	Stock
Japan	100	100	100	-	-	Stock
Netherlands	100	100	100	-	90-100 flow 5/	Stock 5/
Norway	- 3/	- 3/	100	100 6/	100 flow	Stock
Russia	-	-	-	-	-	Stock
Spain	100	Case-by-case	Case-by-case	Case-by-case	-	Stock
Sweden	- 3/	- 3/	Case-by-case (100)	-	-	Stock
Switzerland	- 3/	- 3/	Case-by-case	Case-by-case	Case-by-case, flow	Stock
United Kingdom	100	100	100	100 7/	100 flow 7/	Stock
United States	100	100	100	100 8/	100 flow	Stock

Source: Paris Club Secretariat

1/ Australia: (a) post-COD non-ODA relief to apply to debts incurred before a date to be finalized; (b) timing details for both flow and stock relief are to be finalized.

2/ Canada: including Bangladesh. Canada has granted a moratorium of debt service as of January 2001 on all debt disbursed before end-March 1999 for 11 out of 17 HIPCs with debt service due to Canada. The debt will be written off at the completion point. The countries to be covered are: Benin, Bolivia, Cameroon, Ethiopia, Guyana, Honduras, Madagascar, Mali, Senegal, Tanzania, and Zambia.

3/ 100 percent of ODA claims have already been cancelled on HIPCs, with the exception of Myanmar's debt to Canada.

4/ France: cancellation of 100 percent of debt service on pre-cutoff date commercial claims as they fall due starting at the decision point. Once countries have reached their completion debt relief on ODA claims will go to a special account and will be used for specific development projects.

5/ The Netherlands: (a) ODA: 100 percent ODA: pre- and post-cutoff date debt will be cancelled at decision point; (b) non-ODA: in some particular cases (Bolivia, Burkina Faso, Mali, Ethiopia, Nicaragua, and Tanzania), the Netherlands will write off 100 percent of the consolidated amounts on the flow at decision point; all other HIPCs will receive interim relief up to 90 percent reduction of the consolidated amounts. At completion point, all HIPC countries will receive 100 percent cancellation of the remaining stock of the pre-COD debt.

6/ On debt assumed before December 31, 1997.

7/ United Kingdom: "beyond 100%": full write-off of all debts of HIPCs as of their decision points, and reimbursement at the decision point of any debt service paid before the decision point.

8/ United States: 100 percent post-COD non-ODA treated on debt assumed prior to 06/20/99 (the Cologne Summit).

Note: Columns (1) to (7) describe the additional debt relief provided following a specific methodology under bilateral initiatives and need to be read as a whole for each creditor. In column (1), "HIPCs" stands for eligible countries effectively qualifying for the HIPC process. A "100 percent" mention in the table means that the debt relief provided under the enhanced HIPC framework will be topped up to 100 percent through a bilateral initiative.

C. Relative Impact of Various Debt Reduction Mechanisms

What is the relative size of these various debt reduction mechanisms? Only rough estimates are available for the various elements of historical debt relief. As relief has been provided in a number of steps over time, comparing such estimates in present value terms at a given point in time necessarily involves large margins of uncertainty, but orders of magnitude still give a useful perspective.

Estimates of debt reduction in the context of the HIPC Initiative are based on existing debt stocks, i.e., after any debt reduction provided in the past. They then simulate the full use of traditional debt relief (stock-of-debt operation on Naples terms), and derive the further debt stock reduction that would be achieved by HIPC relief and additional bilateral debt forgiveness. For the 23 decision point HIPCs, total debt reduction is estimated at about two-thirds from existing debt stocks (Figure 4a).

A more comprehensive perspective would also include the impact of debt reduction already provided in the past. Daseking and Powell¹¹ derived estimates of the impact of traditional debt relief mechanisms based on Paris Club information, and World Bank data (GDF; see Table 7). Combining this with other estimates of the Paris Club Secretariat and of IMF and World Bank staff in the context of the HIPC Initiative (Table 8), yields an overall debt reduction by some 80 percent over time for the 37 countries that are expected to require HIPC relief (Figure 4b).¹²

Traditional debt relief already provided to the 37 HIPCs over the 1988–99 period has been estimated at about US\$60–65 billion (in 1999 NPV terms). Additional traditional relief yet to be granted in the context of the HIPC Initiative (US\$36 billion) would bring the total traditional relief to about US\$100 billion. This compares with US\$39 billion of HIPC debt relief, and US\$9 billion expected from additional bilateral debt forgiveness.

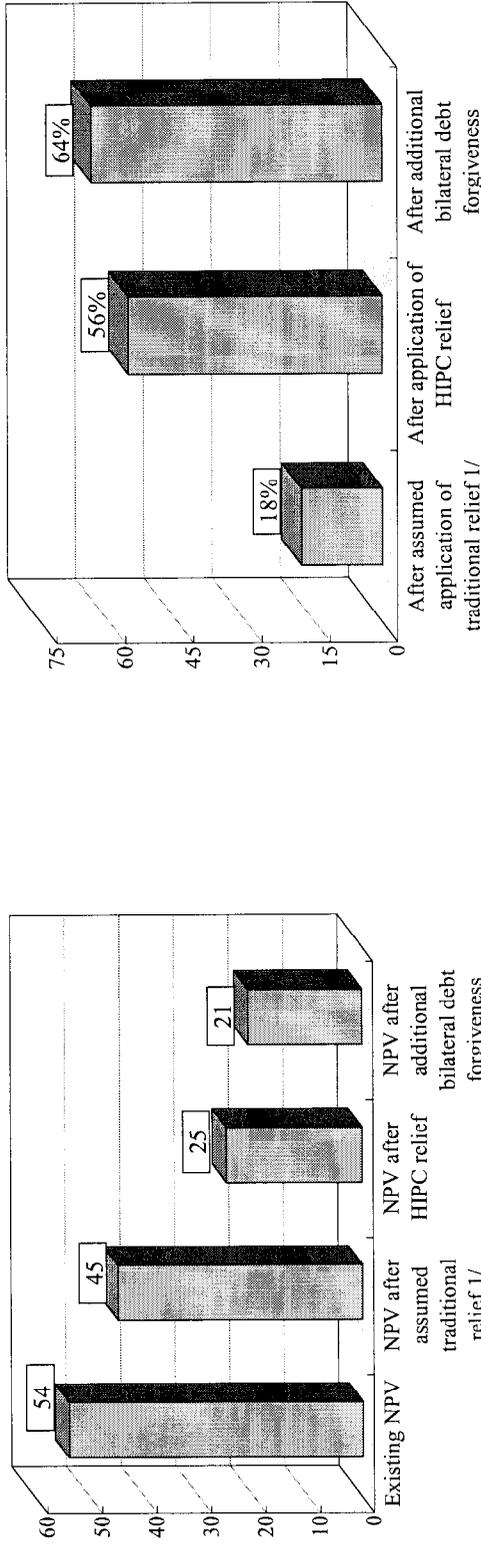
¹¹ See Footnote 6.

¹² Note that an element of measurement difficulties is reflected in the evaluation of the Russian debt relief efforts. Russia joined the Paris Club as a creditor in September 1997, and has reached agreements with most rescheduling countries on the same terms as those provided earlier by other Paris Club creditors, but has agreed with the Club that it would provide an up-front discount of 70–80 percent for low-income countries before the application of Paris Club terms largely reflecting valuation problems related to Soviet ruble- or Transferable ruble-denominated claims (largely of FSU origin). As Russian claims on developing countries were sizeable (partly reflecting the valuation of ruble-denominated claims), this accounts for a large share of the debt stocks and estimates of traditional debt relief.

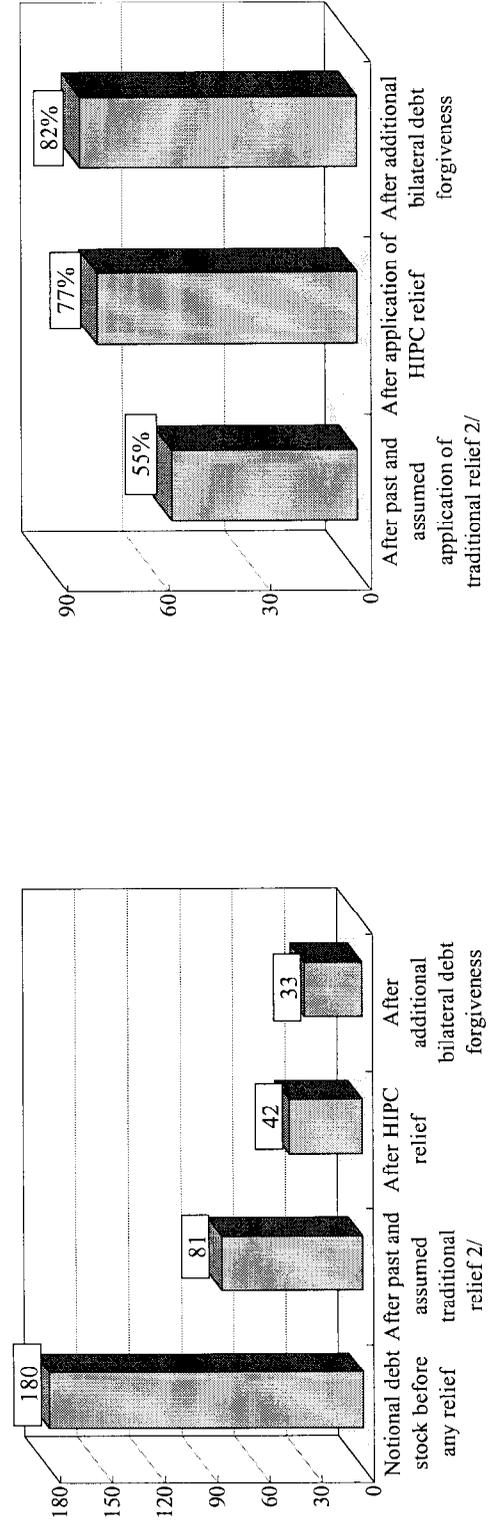
Figure 4: Reduction of Debt Stocks for HIPCs, as of July 2001

(US\$, billion, in decision point terms) Cumulative Reduction of the NPV (Percent change)

a. 23 HIPCs that Reached their Decision Points by July 2001 in Current Perspective (in decision point NPV terms)



b. 37 HIPCs Expected to Require HIPC Relief in Historical Perspective (in 1999 NPV terms)



Sources: HIPC Documents and Table 8.

1/ Traditional debt relief not yet provided as of decision point.

2/ Includes both traditional relief already provided in the past and yet to be provided in the context of the enhanced HIPC Initiative.

Table 7. Summary of Debt Relief Under Traditional Mechanisms for 41 HIPC
(In billions of end-1999 U.S. dollars)

Creditor	Estimated Actual Debt Relief				Hypothetical Debt Relief			
	1988-98		1988-99		GDF data 1/		Paris Club data & staff est.	
	Coverage	PV of debt reduction	Coverage	PV of debt reduction	Coverage	PV of debt reduction 1/	Coverage	NPV of debt reduction
Paris Club reschedulings (excluding Russia)	yes	...	yes	23	yes	...	yes	43
Russia-based on official exchange rate	yes	...	yes	34	yes	...	yes	40
up-front discount	...	...	yes	26	yes	...	yes	30
after up front discount	...	...	yes	8	yes	...	yes	10
Total Paris Club (including Russia)	yes	...	yes	57	yes	...	yes	83
OECD bilateral ODA forgiveness	yes, up to 1996	...	no	-	yes, up to 1996	...	yes	15-20
Non-Paris Club bilateral creditors	yes	...	no	-	yes	...	yes	13-16
IDA Debt Reduction Facility	yes	...	yes	5	yes	...	yes	13
Total PV of debt reduction								
excluding Russian claims		n/a		28		n/a		83-92
after up-front discount on Russian claims		n/a		36		n/a		93-102
including up-front discount on Russian claims		79		62		111		123-132

Sources: Agreed Minutes of Paris Club debt reschedulings; Paris Club Secretariat; World Bank Global Development Finance (GDF); and IMF staff estimates.

1/ Based on Daseking and Powell, op. cit.

Table 8. Tentative Estimates of Overall Debt Relief
(In billions of U.S. dollars)

	Historical Debt Relief 1999 NPV terms	Debt stocks 1/ Nominal terms		Future Debt Relief 1999 NPV terms			Total Historical and Future
		Traditional debt relief	HIPC relief	Additional bilateral relief 2/	Total		
1. Countries that have reached the decision point (23 countries)	...	54	75	10	20	4	34
2. Countries that have not reached the decision point (14 countries)	...	63	50	28	20	5	52
Total (1+2) (37 countries)	58-67	117	145	36	39	9	85
3. Countries not expected to require HIPC relief (4 countries)	20	39	45	9	--	--	9
Total (41 countries)	78-87	155	190	46	39	9	94

Sources: Table 4; HIPC country documents; Global Development Finance 2001; and IMF and World Bank staff estimates.

1/ Data from HIPC documents (group 1) or GDF (group 2). Debt relief figures for group 2 are estimates. Data for Chad, and Ghana are in 2000 terms. Data for Benin, Bolivia, Cote d'Ivoire, Mauritania, Mozambique, and Senegal and in 1998 terms. GDF data, which are for 1999, rely on country reporting and are not as comprehensive as the data used under the HIPC Initiative. Calculations of the NPV of debt in the GDF are based on a common (10 percent) discount rate, a methodology which differs from the currency-specific discount rates (or Commercial Interest Reference Rates) used in DSAs for the HIPC documents.

2/ Refers to debt relief pledged by individual bilateral creditors over and beyond HIPC debt relief.

3/ Includes Burundi, Central African Republic, Cote d'Ivoire, Democratic Republic of Congo, Ethiopia, Ghana, Republic of Congo, Myanmar, Sierra Leone and Togo.

4/ Includes Liberia, Somalia, and Sudan.

The impact of the various debt relief initiatives varies among recipient countries depending on the structure and creditor composition of their debt. The debt reduction factors under the HIPC Initiative, for example, vary between less than 20 percent for Honduras and Senegal, and over 80 percent for Guinea-Bissau and São Tomé and Príncipe (Figure 5).

Debt relief will leave HIPCs with debt levels comparable to those of other developing countries, and much lower debt service obligations. The existing debt stocks of the 23 decision point HIPCs after the delivery of committed debt relief are projected to be reduced by two-thirds. Compared to all non-HIPC developing countries, this is similar in terms of exports at under 130 percent, but these HIPCs' debt levels will be much lower relative to GDP (29 of GDP for the 23 HIPCs against 36 percent of GNP for other developing countries; Table 9). At the same time, debt service obligations of these 23 HIPCs will fall to less than half the average of other developing countries, as discussed below.

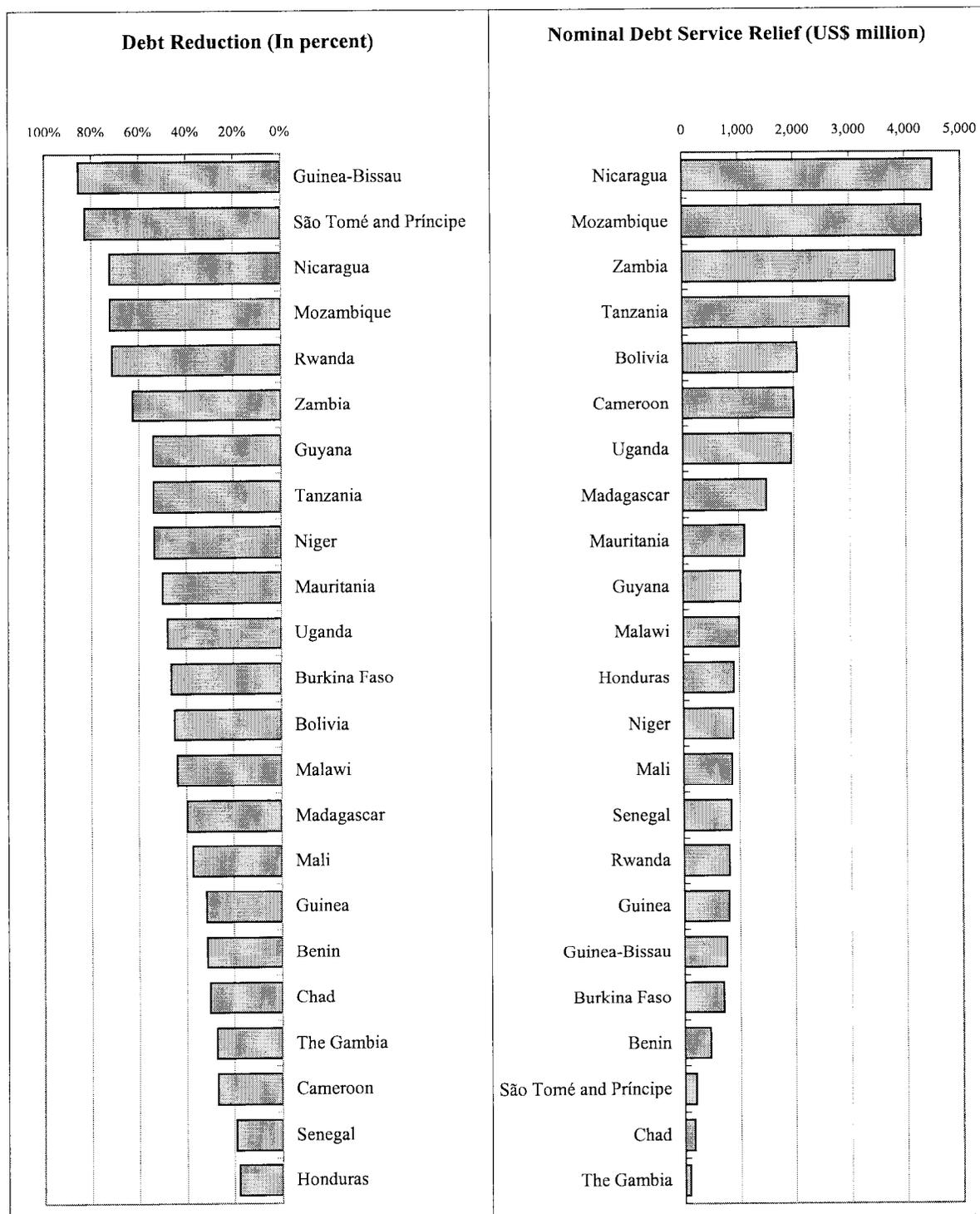
III. HIPC RELIEF IMPACT AND RESOURCE FLOWS TO HIPCS

Absolute debt service payments by developing countries and LICs rose by three and a half times during the 1980s and 1990s despite debt relief efforts (Figure 6). Debt service payments for all developing countries increased from about US\$110 billion in 1981 to US\$390 billion in 1999, and for LICs from US\$14 billion to US\$47 billion. Growth of debt service payments by HIPCs was less pronounced but still significant; for all 41 HIPCs, debt service paid was about US\$6 billion in the early 80s and peaked at US\$10 billion in 1995, reflecting an arrears clearance operation for Zambia, then stabilized at just under US\$10 billion. Debt service payments by the group of 23 decision point HIPCs exhibited a similar evolution: they rose from around US\$3 in 1981 to a (Zambia-induced) peak of US\$6 billion in 1995, and then stabilized at about US\$3½ billion.

As a proportion of export earnings, debt service payments for the various country groups averaged 15–25 percent in the early 80s, then rose to 25–30 percent by the mid-80s, before gradually getting back to 15–20 percent by the end of the 1990s. The ratio for HIPCs was higher than that for all developing countries until the mid-90s, when other developing countries experienced a sharp increase in the debt service ratio to over 20 percent, reflecting the increase in spreads paid by emerging market countries after the Asian crisis, and the loan support extended to overcome the crisis. Since the mid-1980s, the HIPCs' ratio of debt service to exports was consistently below the ratio for LICs. The debt service ratio for the 23 decision point HIPCs was higher than that for other HIPCs or LICs, reflecting the fact that they generally serviced their debts—sometimes with the help of donor grants, e.g., for multilateral debt service—while several other HIPCs accumulated arrears and made only small debt service payments.

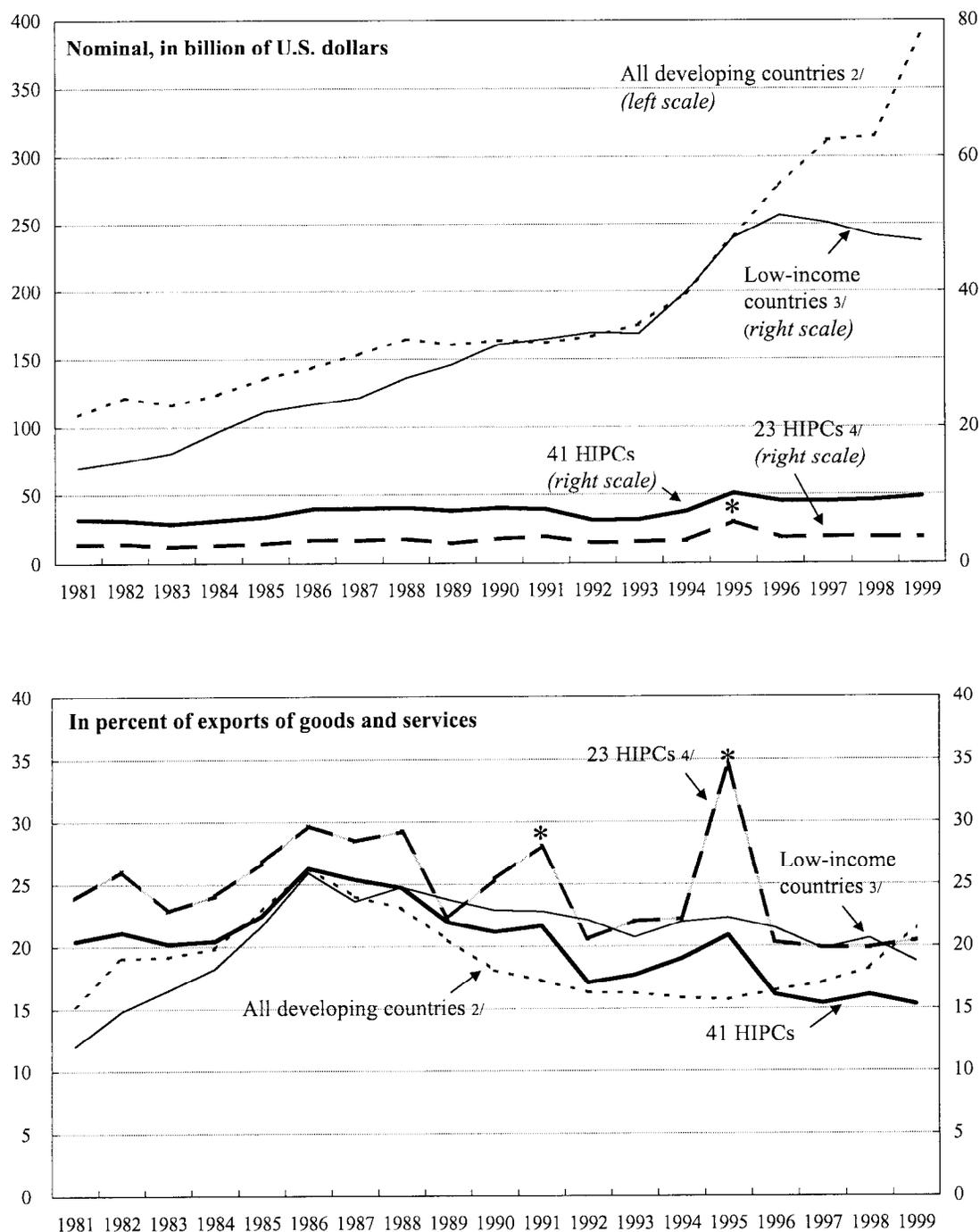
By the end of the 1990s, the group of 23 HIPCs had a total debt service ratio of slightly under 20 percent of exports, based on GDF data. The data reported in HIPC Initiative country documents show slightly lower actual debt service payments. This reflects in part the fact

Figure 5. Enhanced HIPC Initiative
 Comparative Debt Reduction and Debt Relief for 23 Decision Point Countries
 Status as of end July 2001



Note: -- Debt reduction is measured by the common reduction factor. This refers to the percentage by which each creditor needs to reduce its debt stock at the decision point so as to enable the country to reach its debt sustainability target. The calculation is based in net present (NPV) information.
 -- For Bolivia, Burkina Faso, Guyana, Mali, Mozambique and Uganda assistance under the original and enhanced frameworks is combined.

Figure 6: Total Debt Service Paid by Selected Country Groups; 1981 - 1999 ^{1/}
 (In billion of U.S. dollars, and percent of exports of goods and services)



Source: World Bank Global Development Finance of 2001.

1/ Principal and interest payments on total long-terms debt (public and publicly guaranteed and private non-guaranteed), including IMF credit, and interest on short-term debt.

2/ A group of 149 countries covered by the GDF. Of these, 137 report to the DRS, while World Bank estimates are used for the others.

3/ A group of 64 countries for which 1999 GNP per capita was no more than \$755 as calculated by the World Bank. Of these, 62 report to the DRS.

4/ HIPC which have already reached the Decision Point under the Enhanced HIPC Initiative by July 2001.

* Note: The peaks reflect arrears clearance operations in 1991 for Nicaragua with the IaDB and World Bank, and in 1995 for Zambia with the IMF. Net transfers to both countries were positive in these years.

that debt service paid by private entities in HIPCs (without a HIPC government guarantee) is not included in the HIPC Initiative calculations, and also the netting out of debt service grants against gross payments in the HIPC data, while GDF reports gross debt service paid. As recorded in the HIPC Initiative country documents, HIPC relief is projected to reduce the debt service ratio from 16 percent of export in 1998–99 to 8 percent 2001–05 (Tables 9–10 and Figure 7). Absolute debt service payments for these 23 countries averaged US\$2.8 billion during 1998–99, and will be reduced by about one-third to an average of US\$2 billion in 2001–05.¹³ Compared to payments that would be due during 2001–2005 in the absence of enhanced HIPC relief, the decline is about one-half. This holds in absolute terms as well as relative to exports, government revenue, or GDP (Table 10).

HIPC relief is substantial relative to pre-HIPC debt service and—as we shall discuss in the next Section—provides a strong basis for debt sustainability. Yet its magnitude is modest when viewed in a broader context, e.g., compared to net external resource flows to these countries. Historical net resource flows to the public sector of the 23 HIPCs, including grants and technical cooperation, have been sizeable—they averaged US\$5.9 billion annually during the 1980s (12.6 percent of GNP) and increased to US\$8.8 billion (13.7 percent of GNP) during the 1990s (Figure 8). Annual savings from HIPC relief, in contrast, are estimated at about US\$1 billion or 1½ percent of GDP for the period 2001–2005 compared to debt service payments in 1998–99 (Table 10). At the same time, spending on health and education is projected to rise by over 40 percent, or \$1.7 billion per year (Figure 7) between 1999 and 2002; in terms of GDP, social spending is to rise from 5.5 percent of GDP to 7 percent. This exceeds health and education spending for low-income countries (of 4½ percent of GDP) and almost reaches middle-income country levels (7.3 percent of GNP) of 1997 (Table 11). However, as these countries' social indicators suggest, it still falls short of needs.

Future resource requirements of HIPCs will remain high. The medium-term projections presented in the HIPC documents for the 23 decision point HIPCs showed net flows derived from balance of payments data; these data reflect grants more partially than the GDF data and generally do not include technical cooperation grants that are provided in kind, and are thus much lower than GDF data.¹⁴ Based on such balance of payments data, net flows amounted to US\$4.3 billion in the 1990s, and are projected to increase to US\$6.7 billion in the next 10 years; with GDP projected to rise, in relative terms net flows are projected to decline slightly from 6.7 percent of recipient GDP to 6.0 percent (Table 12). The grant element of the debt of these 23 HIPCs, which was less than 30 percent for debt outstanding at

¹³ This reflects payments in 1998–99 after delivery of relief to Bolivia, Guyana, Mozambique, and Uganda under the original HIPC Initiative framework. Before any such relief, debt service payments would have averaged US\$3.1 billion.

¹⁴ GDF data for the 23 decision point HIPCs show average annual grants of US\$5.5 billion or 8.5 percent of GNP in the 1990s, and technical cooperation grants of US\$2.2 billion or 3.4 percent of GNP.

Table 9. Debt Indicators in Developing Countries and HIPCs, 1999 1/ 2/

	Developing Country Average	Non-HIPC Developing Countries	All HIPCs, Before HIPC Relief	23 Decision Point HIPCs	
				Before HIPC relief (1999)	After HIPC relief (2003)
			(In percent)		(In percent)
NPV of debt-to-exports ratio	133	128	249	259	127
NPV of debt-to-GDP ratio	38	36	84	60	29
Debt service-to-exports ratio	20	21	14	16 3/	8 4/

Sources: World Bank Global Development Finance; and HIPC documents.

1/ Excludes Liberia and Somalia due to incomplete data.

2/ Weighted averages; 1999 figures for the first 3 columns based on data Global Development Finance data.

3/ Average for 1998–99 based on debt service paid.

4/ Average for 2001–2003.

Table 10. Impact of Debt Relief for the 23 HIPC's that Have Reached an Enhanced Decision Point 1/

	After Traditional Debt Relief (1)	After HIPC Assistance (2)	After Additional Bilateral Debt Forgiveness (3)	Percent Change (4) = (2 vs. 1)
Debt Stock (as of 1999, assuming that debt relief is provided unconditionally at the decision points)				
NPV Debt (in billions of U.S. dollars)	45	25	21	-44
NPV Debt/Exports (in percent) (19 countries) 2/	290	150	126	-48
NPV Debt/Revenues (in percent) (4 countries) 3/	278	250	164	-10
NPV Debt/GDP (in percent)	60	33	27	-44
Debt Service (in billions of U.S. dollars)				
Average paid, 1998-99	2.8	...	...	...
Average due, 2001-05 4/	3.6	2.0	...	-43
Debt Service Ratios				
Debt Service/Exports Ratio				
Average paid, 1998-99	15.8%	...	...	...
Average due, 2001-05 4/	14.1%	8.0%	...	-43
Debt Service/Revenues Ratio				
Average paid, 1998-99	23.3%	...	...	...
Average due, 2001-05 4/	20.3%	11.5%	...	-43
Debt Service/GDP Ratio				
Average paid, 1998-99	3.7%	...	...	...
Average due, 2001-05 4/	3.7%	2.1%	...	-43

Sources: HIPC decision point documents; and IMF and World Bank staff estimates.

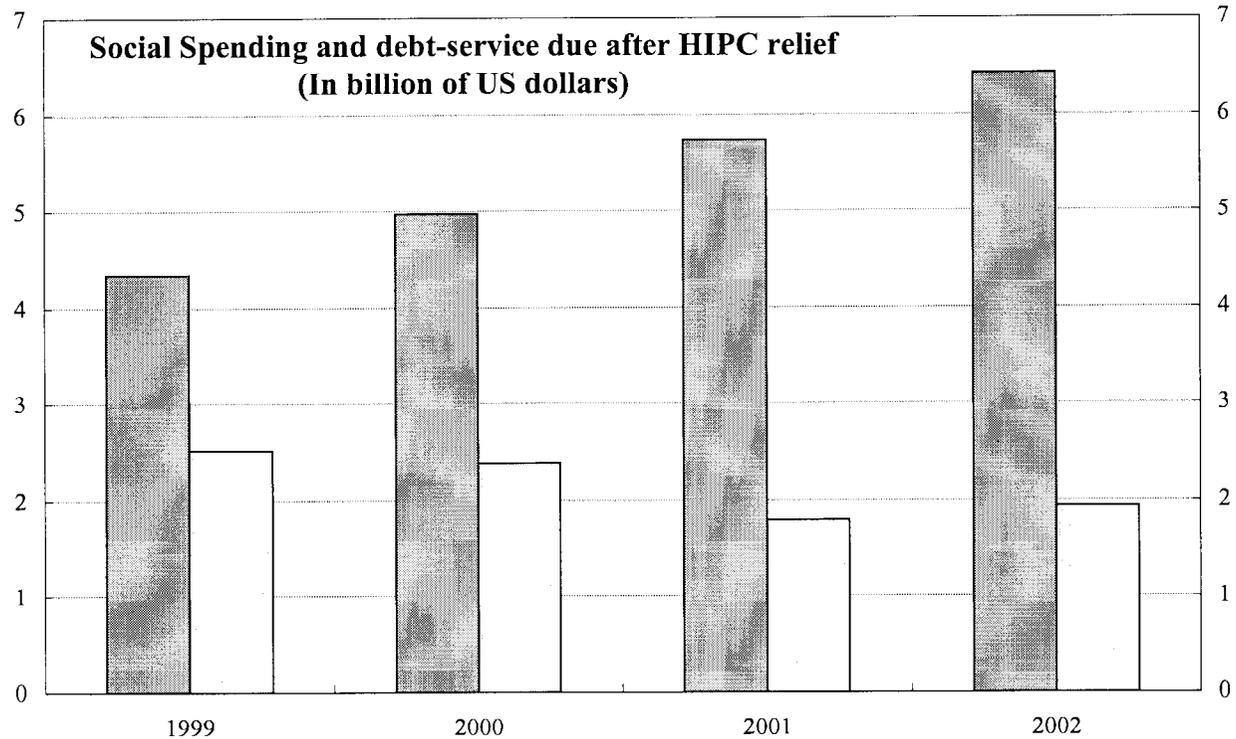
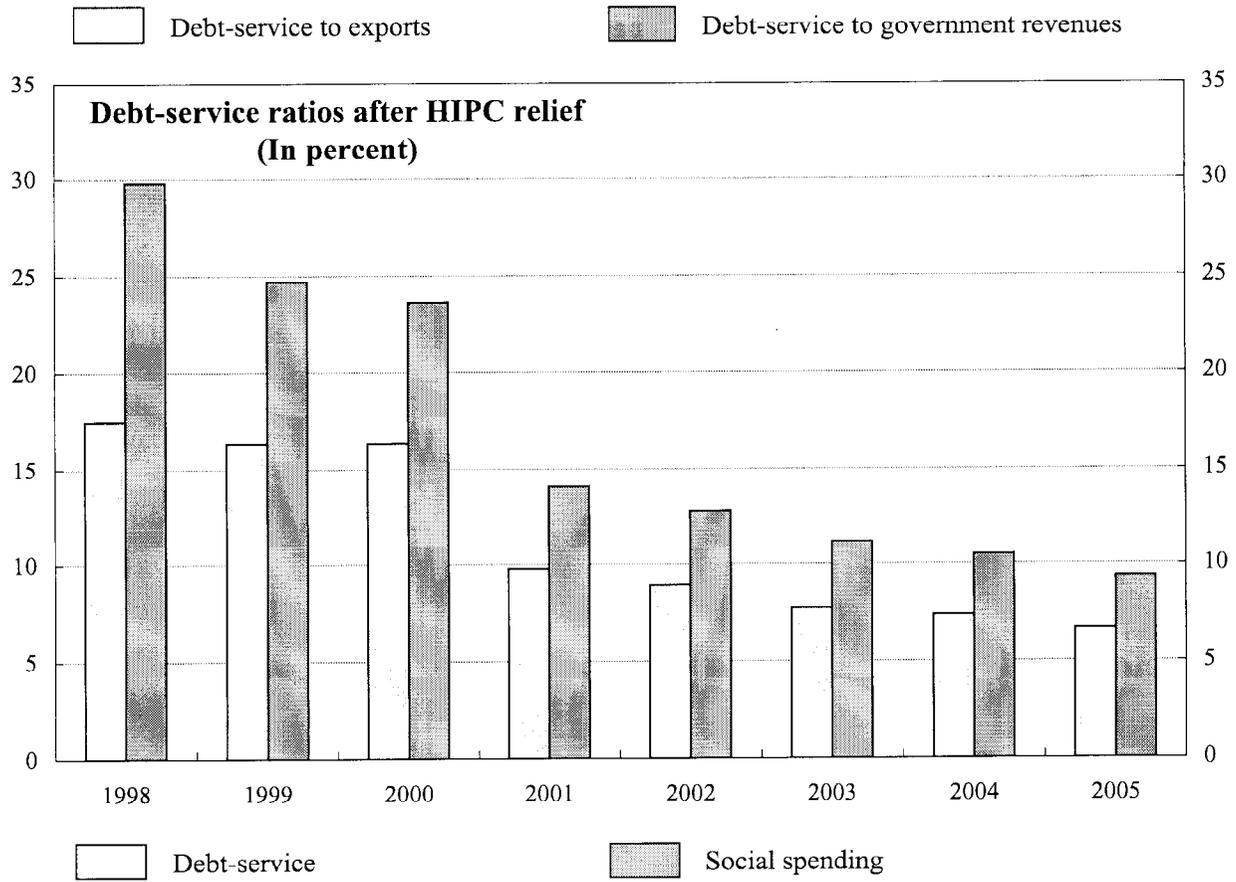
1/ Impact shown for those 23 countries that have reached their enhanced decision points by July 2001. All ratios are weighted averages.

2/ Assistance granted based on the NPV to exports target: Benin, Bolivia, Burkina Faso, Cameroon, Chad, The Gambia, Guinea, Guinea-Bissau, Madagascar, Malawi, Mali, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Tanzania, Uganda, and Zambia.

3/ Fiscal window cases: Guyana, Honduras, Mauritania, and Senegal.

4/ Debt service for 2000 is not included because many countries reached their enhanced decision point only in December 2000, or later. For Bolivia and Uganda the "Before HIPC Assistance" figures are after delivery of original HIPC relief.

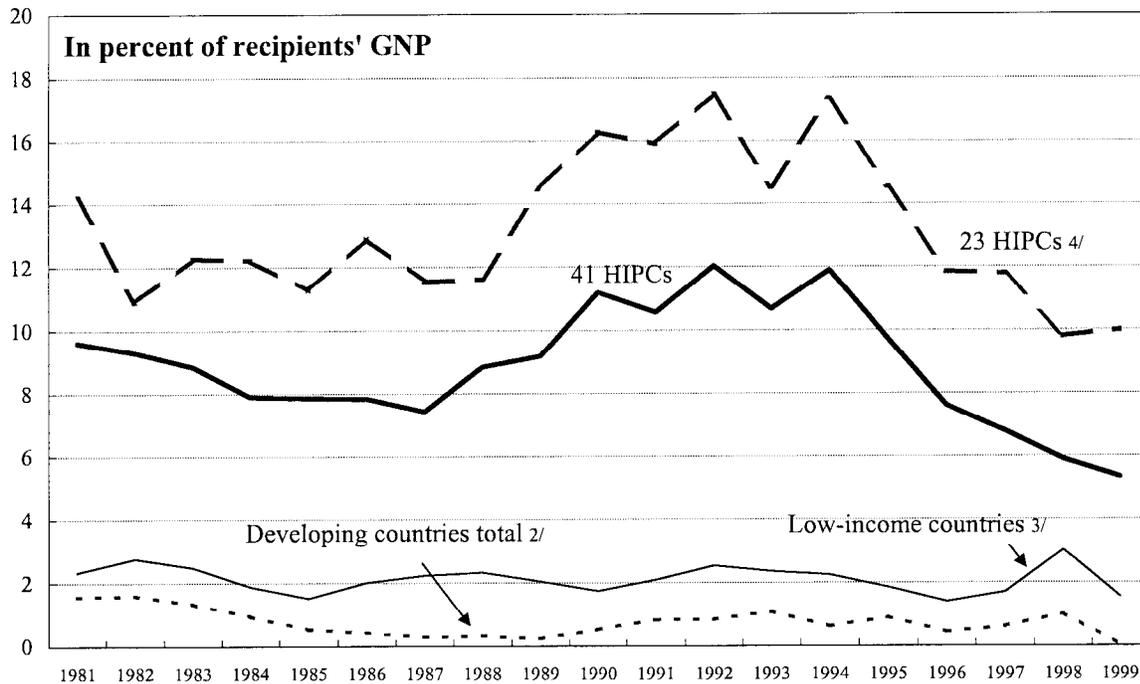
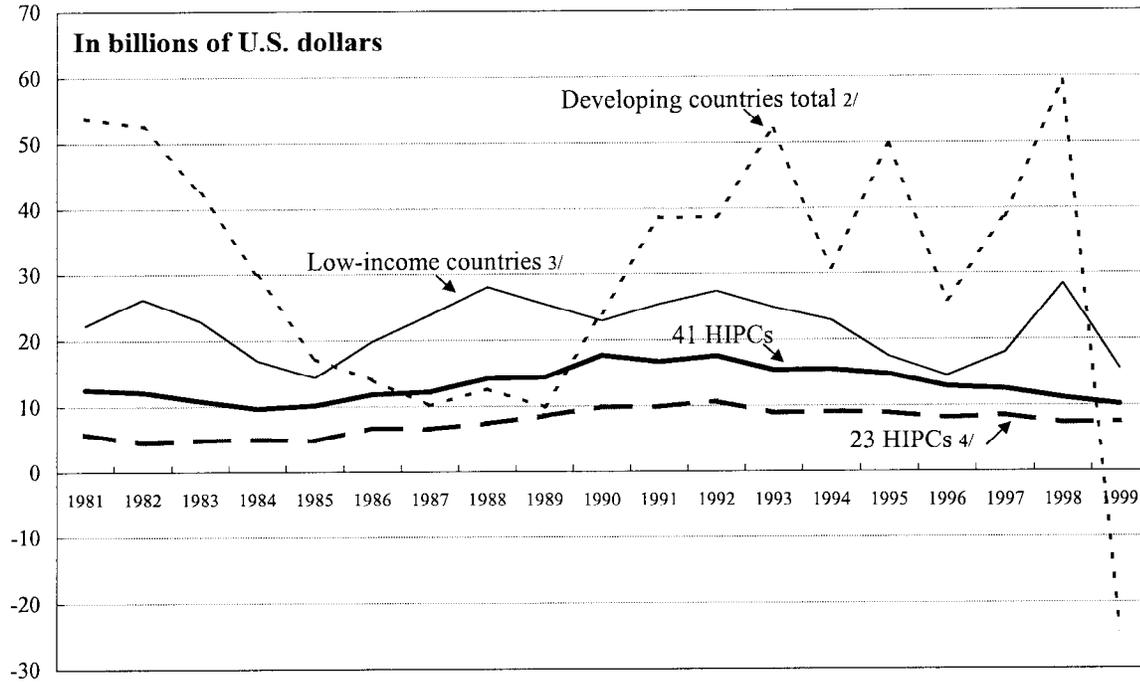
Figure 7: 23 HIPCs: Debt Service and Social Spending after HIPC Relief, 1998 - 2005 1/



Source: HIPC documents and staff estimates.

1/ HIPCs which have reached their Decision Points by July 2001.

Figure 8: Net Transfers on Public Medium- and Long-term Debt, 1981 - 1999 ^{1/}
 (In billions of U.S. dollars and percent of recipient's GNP)



Source: World Bank Global Development Finance of 2001.

1/ Including grants and IMF.

2/ A group of 149 countries covered by the GDF. Of these, 137 report to the DRS, while World Bank estimates are used for the others.

3/ A group of 64 countries for which 1999 GNP per capita was no more than \$755 as calculated by the World Bank. Of these, 62 report to the DRS.

4/ HIPC's which have already reached the Decision Point under the Enhanced HIPC Initiative by July 2001.

Table 11: Public Expenditure on Health and Education

	Health expenditure (in percent of GDP) 1/	Education expenditure (in percent of GNI) 2/
World	2.5	4.8
High-income countries 3/	6.1	5.4
Middle-income countries 4/	2.5	4.8
Low-income countries 5/	1.2	3.3
HIPCs (41) average	2.1	3.4
HIPCs (23) average 6/	2.6	2.0
<i>Memorandum items:</i>		
23 Decision Point HIPCs, based on HIPC documents		
Average total social expenditure		
	<i>in 1999 (estimated)</i>	5.5
	<i>in 2002 (projected)</i>	7.0

Sources: World Bank World Development Indicators (WDI) database, and HIPC Initiative country documents.

1/ 1997 data for world, middle-income, and low-income countries, otherwise 1998 data.

2/ In percent of Gross National Income, 1996 data.

3/ Countries for which 1999 GNP per capita was higher than \$9,265 as calculated by the World Bank.

4/ A group of 85 countries for which 1999 GNP per capita was between \$756 and \$9,265 as calculated by the World Bank.

5/ A group of 64 countries for which 1999 GNP per capita was no more than \$755 as calculated by the World Bank.

6/ HIPCs which have already reached their Decision Points under the Enhanced HIPC Initiative by July 2001.

Table 12. HIPC that Have Reached a Decision Point
Flows of Official External Resources

	New Borrowing 1/		Grants 1/ 2/		Debt Service Paid/Due 1/		Net Flows 1/ 3/		Grant Element in Borrowing	
	1990-99	2000-10	1990-99	2000-10	1990-99	2000-10	1990-99	2000-10	Existing debt at end-99	New borrowing 2000-10
(In millions of U.S. dollars)										
Benin	60.5	70.7	81.0	144.9	49.5	36.6	92.0	179.0		
Bolivia	375.9	352.8	208.3	125.9	127.6	295.9	456.6	182.8		
Burkina-Faso	109.9	133.5	120.5	64.5	151.5	33.8	78.9	164.2		
Cameroon	174.3	410.3	57.7	43.1	409.5	344.0	-177.5	109.3		
Chad	72.3	131.2	122.0	101.8	24.6	33.6	169.8	199.4		
The Gambia	27.1	23.5	36.0	28.4	27.2	13.9	35.8	37.9		
Guinea	169.7	197.7	130.9	111.6	176.2	99.4	124.4	210.0		
Guinea-Bissau	52.5	11.3	26.9	40.9	7.6	7.1	71.8	45.0		
Guyana	91.4	71.1	11.5	18.3	99.5	48.9	3.3	40.6		
Honduras	306.3	442.7	183.9	173.7	394.2	239.6	95.9	376.9		
Madagascar	98.3	175.6	98.8	228.7	108.2	91.9	88.9	312.4		
Malawi	175.8 4/	100.9	119.0	116.8	88.9	57.4	205.8	160.3		
Mali	188.1	158.7	188.1	161.6	129.7	71.4	246.5	248.9		
Mauritania	123.7	58.1	102.8	111.6	102.1 6/	55.5	124.5	114.3		
Mozambique	231.1	251.5	415.1	353.4	48.2	65.9	598.0	539.0		
Nicaragua	251.5	262.7	273.9	234.9	190.7	60.5	334.6	437.0		
Niger	29.5	175.2	133.5	112.4	39.1	37.9	123.9	249.7		
Rwanda	68.5 4/	437.5	252.8 4/	111.0 5/	22.2 6/	15.1	299.0	533.4		
São Tomé and Príncipe	19.9	10.3	17.7	16.5	1.3	2.4	36.3	24.4		
Senegal	263.0	158.5	288.5	122.9	230.5	148.5	321.0	132.9		
Tanzania	59.0	644.9	376.3	1016.9	135.3 7/	170.4	299.9	1491.4		
Uganda	455.1	309.5	103.8	394.2	212.0	83.3	346.9	620.3		
Zambia	428.9 8/	263.0	359.5 9/	220.3	443.7 8/	150.7	344.7	332.6		
Total	3,832.0	4,851.2	3,708.4	4,054.1	3,219.4	2,163.9	4,321.1	6,741.5		
(In percent of GDP)										
Benin	3.1	2.0	4.0	4.0	2.4	1.1	4.7	4.8	31.8	52.8
Bolivia	5.9	3.0	3.2	1.1	1.9	2.4	7.2	1.7	22.2 10/	26.3
Burkina_Faso	4.3	3.3	4.7	1.6	6.1	0.8	2.9	4.1	40.0	55.2
Cameroon	1.9	2.8	0.6	0.3	4.5	2.7	-2.1	0.5	15.4	41.5
Chad	4.8	5.3	8.1	4.1	1.7	1.3	11.2	8.2	44.9 11/	60.9 12/
The Gambia	7.5	5.5	10.1	5.1	7.7	2.5	10.0	8.1	42.9	52.1
Guinea	4.9	4.7	4.0	2.8	5.3	2.6	3.6	4.9	28.4	70.3
Guinea-Bissau	21.6	3.5	10.8	10.3	3.1	1.9	29.4	11.9	25.0	53.4
Guyana	19.3	8.4	2.0	2.1	19.1	5.4	2.2	5.0	23.3 10/	51.2
Honduras	8.3	4.3	4.7	2.2	10.2	2.8	2.9	3.7	23.1	50.7
Madagascar	3.0	3.0	3.0	3.5	3.3	1.5	2.7	5.0	32.5	51.3
Malawi	10.2 4/	5.2	6.8	5.6	5.0	2.8	12.0	7.9	43.2	71.5
Mali	7.5	4.1	7.5	4.1	5.1	1.8	10.0	6.4	...	55.5
Mauritania	12.0	5.5	10.2	8.8	10.4 6/	4.6	11.7	9.7	24.0	50.6
Mozambique	8.6	4.5	15.8	5.5	2.0	1.0	22.4	9.0	57.1 13/	77.5
Nicaragua	13.4	8.6	14.8	7.7	10.2	2.0	18.0	14.3	16.0	48.6
Niger	1.5	7.2	6.5	4.0	2.0	1.5	6.0	9.7	32.5	79.5
Rwanda	3.9 4/	15.6	18.2 4/	5.2 5/	1.4 6/	0.6	20.8	20.2	44.8	67.1
São Tomé and Príncipe	40.8	12.8	38.9	26.9	2.8	4.0	76.9	35.7	35.2	70.0
Senegal	5.4	2.3	6.0	1.7	4.8	2.1	6.6	1.9	32.1	63.4
Tanzania	0.9	4.7	7.1	7.7	2.2 7/	1.3	5.8	11.1	27.7	57.9
Uganda	12.1	3.1	2.6	4.0	5.6	0.8	9.1	6.3	10.1	69.2
Zambia	12.7 8/	6.5	10.6 9/	5.0	13.0 8/	3.5	10.3	8.0	22.6	53.6
Simple average	9.3	5.5	8.7	5.4	5.6	2.2	12.4	8.6	30.7 14/	57.8
Weighted average	6.0	4.3	5.7	3.6	5.0	1.9	6.7	6.0	27.8 14/	56.7

Sources: Calculations based on Decision Point documents, WEO database and staff estimates.

Note: These figures are based on Balance of Payments statistics reporting by the debtor countries.

1/ Annual averages.

2/ Official transfers.

3/ Defined as new loans plus grants minus debt service paid.

4/ 1992-99.

5/ 2000-06.

6/ 1994-99.

7/ 1993-98.

8/ Reflects clearance of arrears to the IMF in 1995. Excluding this operation, the ratios would be 8.2 and 8.4 percent for borrowing and debt service paid, respectively.

9/ 1990-98.

10/ 1998.

11/ 2000.

12/ 2001-2010.

13/ After traditional relief.

14/ Excludes Mali.

end-1999, is projected to increase substantially to more than 55 percent for new borrowing in the next decade (Table 12). Such increases in the supply of resources to HIPCs and the grant element involved will require a substantial effort on the part of creditors and donors.

Note that progress toward raising aid levels would have a much higher impact on poverty reduction than additional debt relief. Net ODA disbursements averaged 0.22 percent of donor GNP in 2000, with G-7 donors providing a much lower share of their income as aid than other OECD donors (Figure 9 and Table 13). Raising this by a mere 0.1 percent of GNP—rather than to the UN target of 0.7 percent—would provide an additional \$24 billion to developing countries, dwarfing the annual impact that debt relief can have.

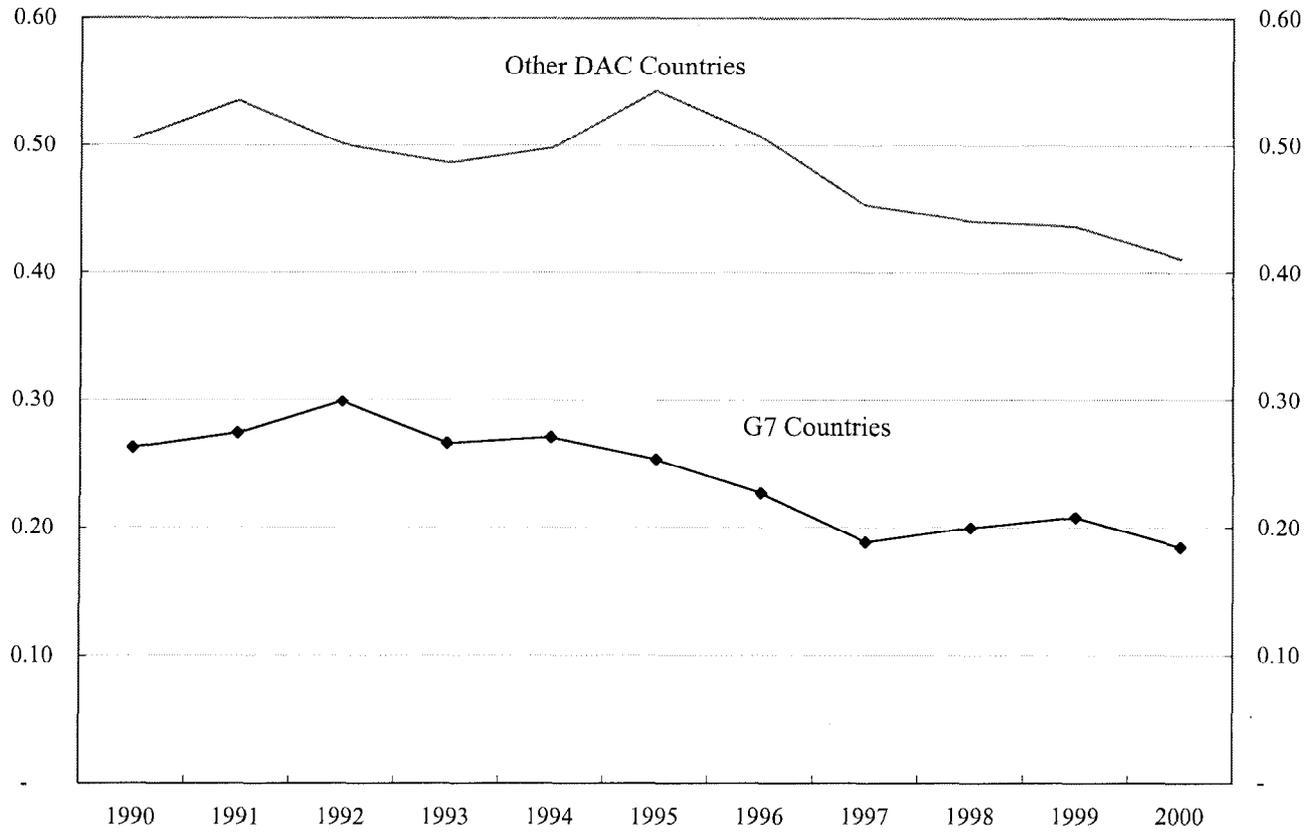
NGO campaigns often contrast debt service payments with selected measures of health or education spending with the intention to gather support for debt cancellation. This argument leaves out the support provided to low-income countries by external entities, which, as the numbers above suggest, for years has far exceeded debt service payments. In effect, over the last two decades, gross resource transfers to the 23 HIPCs have been three and a half times the amount of debt service paid. With reduced debt service payments and higher net transfers, this ratio is projected to increase further during the next decade.

The premise behind many NGOs' simple message is that lower debt service payments would leave more resources available to HIPCs to spend on poverty reduction programs. However, this may not be the case. In the past a number of donors have provided grants to cover debt service payments due by several HIPCs, particularly debt service due to multilateral creditors. It remains to be seen if these grant resources will continue to be available to HIPCs after the HIPC Initiative has lowered the level of debt service due. Also, a number of creditors engaged in defensive lending, i.e., provided new loans that helped cover the debt service falling due on existing loans; such practices presumably would not be continued after debt relief—though some creditors, instead of cancelling debt, will provide grants equivalent to debt reduction. Thus it is not clear whether higher debt relief would increase net transfers to low-income countries.

Higher debt relief could actually reduce net resource flows to HIPCs if a donor's aid budget is fixed in nominal terms, and the donor has to fund debt stock reduction out of a given aid allocation at one point in time rather than stretching the budgetary impact out over a number of years (as done, e.g., by France and Japan). In this situation, where there is a tradeoff between debt relief and other forms of development assistance, more debt relief would actually reduce the net cash resources available to recipient countries as the reduction of future debt service maturities is funded out of the current aid budget.¹⁵ Also, higher debt

¹⁵ An interesting discussion of these issues is forthcoming by G. Bird and A. Milne, "Debt Relief for Poor Countries: Distinguishing Rhetoric from Reality," mimeo, 2001. Also by them, "Debt Relief for Low-Income Countries: Is It Effective and Efficient," Surrey Center for International Economic Studies, Working Paper (2000).

Figure 9: Net ODA Disbursements by G7 and Other DAC Countries, 1990-2000 1/
(Percent of GNP)



Source: OECD.

1/ Aggregate net ODA disbursements for group total ratio to aggregate GNP, for each group. Data for 2000 are provisional.

Table 13: Net ODA Disbursements by Major DAC Countries, 1990-2000 1/

	At Current Prices							2000	Change 1999/00		Share of Donor's GNP 2000
	1990	1995	1996	1997 2/	1998 2/	1999 2/	2000 2/	At Constant 1999 Prices 3/	At Current Prices	At Constant 1999 Prices	
	(Billions of U.S. dollars)								(Percent)		
Canada	2.5	2.1	1.8	2.0	1.7	1.7	1.7	1.7	1.4	-2.2	0.25
Denmark	1.2	1.6	1.8	1.6	1.7	1.7	1.7	1.9	-4.0	7.3	1.06
France	7.2	8.4	7.5	6.3	5.7	5.6	4.2	4.9	-25.1	-13.9	0.33
Germany	6.3	7.5	7.6	5.9	5.6	5.5	5.0	5.8	-8.7	5.9	0.27
Italy	3.4	1.6	2.4	1.3	2.3	1.8	1.4	1.5	-24.3	-14.3	0.13
Japan	9.1	14.5	9.4	9.4	10.6	15.3	13.1	12.6	-14.8	-17.9	0.27
Netherlands	2.5	3.2	3.2	2.9	3.0	3.1	3.1	3.4	-1.9	10.0	0.82
Sweden	2.0	1.7	2.0	1.7	1.6	1.6	1.8	2.0	11.2	22.3	0.81
United Kingdom	2.6	3.2	3.2	3.4	3.9	3.5	4.5	4.7	29.2	35.6	0.31
United States	11.4	7.4	9.4	6.9	8.8	9.1	9.6	9.4	4.8	2.7	0.10
G7 donors	40.9	44.7	41.3	35.1	38.6	42.6	39.4	40.6	-7.3	-4.8	0.19
Other DAC donors 4/	12.0	14.2	14.2	13.2	13.5	13.8	13.6	15.0	-1.5	8.3	0.46
Total DAC	53.0	58.9	55.4	48.3	52.1	56.4	53.1	55.5	-5.9	-1.6	0.22
(in percent of GNP)	0.33	0.27	0.25	0.22	0.23	0.24	0.22	...	...	...	...

Source: OECD.

1/ Data are based on total amounts provided by donors. Excludes debt forgiveness of non-ODA claims. 2000 data are provisional.

2/ Not strictly comparable to earlier data due to the reclassification of some former ODA recipients to Part II of the DAC list of Aid Recipients.

3/ At 1999 prices and exchange rates.

4/ Includes Australia, Austria, Belgium, Finland, Ireland, Luxembourg, New Zealand, Norway, Portugal, Spain and Switzerland.

relief may lead to a reallocation of aid resources toward more indebted countries, rather than toward those countries that merit most support based on their own efforts.

Some critics have argued that debt writeoff is merely an accounting transaction. However, most official creditors keep claims on developing countries on their books at face value, i.e., they generally do not make an assessment of the residual value of a claim, in part because they do not intend to market the claim. Such creditors have to fund any reduction of a claim below its face value from current budget allocations. In order to protect the usable resources available to HIPC countries to fund their poverty reduction strategies, the premise of the HIPC Initiative was that debt relief should be additional to other aid flows.

IV. CAN THE HIPC INITIATIVE ACHIEVE ITS GOALS?

A. Debt Sustainability Outlook After HIPC Relief¹⁶

HIPC relief will reduce the level of debt of HIPC countries to that of other developing countries or below, and will lower debt service payments to historical lows. The level of relief provided under the HIPC Initiative should be sufficient for these countries to embark on a path of sustainable debt—barring shocks that fundamentally change these countries' macroeconomic conditions for a prolonged period of time. The challenge for HIPC countries is to remain on such a path—HIPC relief is a one-time step debt reduction, not an ongoing guarantee of debt sustainability. Long-term debt sustainability, in contrast, is a dynamic concept. It depends not only on (i) the existing stock of debt and its associated debt service, but also on (ii) the evolution of a country's fiscal and external repayment capacity, as well as on (iii) the growth and terms of new borrowing.

The HIPC Initiative can only deal with the existing stock of debt and with its associated debt service. The other two elements fall beyond the Initiative's scope and more under the responsibility of HIPC governments. They can only be addressed if HIPC countries successfully implement a complex set of policies that determine the likely future trend of economic growth and new external borrowing.¹⁷ These policies include sound macroeconomic management; growth-friendly structural policies, including infrastructure, trade, tax and social policies, regulatory frameworks that affect economic incentives and the incentives for

¹⁶ The debt outlook of the 22 HIPC countries that had passed their decision points at the time was analyzed in a joint World Bank/IMF paper, "The Challenge of Maintaining Long-Term External Debt Sustainability", www.imf.org/external/np/hipc/2001/lt/042001.htm. This subsection draws partially on that paper.

¹⁷ For an analysis of the relationship between "Economic Growth and Poverty Reduction in Sub-Saharan Africa," see paper by G. Moser and Toshihiro Ichida, IMF Working Paper, WP/01/112 (2001).

private investment and production; governance and a reduction in corruption; and social inclusion, which embraces the full participation of society through education and other social services that reach the poor. All of these elements should be reflected in a country's PRSP, the approach adopted in 1999 to help poor countries and their development partners strengthen the impact of their common efforts on poverty reduction.¹⁸

In the past in many HIPCs, a failure to implement such policies consistently and thoroughly, together with other factors such as external shocks, armed conflicts, etc., contributed to an unsustainable debt build-up. Long-term debt sustainability can only be achieved if these underlying causes of debt problems have been addressed. HIPC relief cannot by itself address them or change the underlying vulnerabilities of HIPCs.¹⁹

To maintain debt sustainability after debt relief and over the longer run, both players on the debt side need to act. As part of the policies outlined in their PRSPs, HIPC borrowers need to follow more prudent debt management policies, and pay more attention to the terms of new borrowing and debt service obligations falling due.²⁰ More timely and comprehensive debt accounting is also a crucial element in this. An active debt management strategy should be formulated and integrated into a country's overall macroeconomic management. This would also help improve overall economic management. Given that HIPCs' external debt has been primarily contracted by the public sector, and that their external-sector imbalances have been often the result of fiscal imbalances, a strong fiscal position and sound fiscal management are crucial. A solid and comprehensive fiscal framework is in fact a condition for effective debt management.

¹⁸ For policy and country documents on poverty reduction strategies and general information, see www.imf.org/external/np/prsp/prsp.asp. To date, 32 countries have prepared interim PRSPs, and 4 countries full PRSPs. Some 20 more full PRSPs are expected later this year. In light of this, the IMF and World Bank have launched comprehensive reviews of PRSPs and the IMF's concessional lending facility, the PRGF. More information is on the website.

¹⁹ Apart from their low-income levels, such vulnerabilities include their narrow export base that basically relies on a few export products, which makes them susceptible to externally-induced shocks; their small and declining shares in world trade; and their dependence on capital inflows, evidenced in the persistent an external current account deficits.

²⁰ For a few countries the decision point documents projected debt ratios to remain above 150 percent of exports at the completion point. In some cases projected export trends were a contributing factor, but the role of new borrowing in their future debt burdens was also important: for the seven countries with the highest remaining debt ratios, new borrowing between the decision and completion points accounted for almost 50 percentage points of the NPV-to-exports ratio at the completion point. This shows the importance of prudent new borrowing policies for HIPCs.

Creditors and donors, for their part, must ensure that HIPC relief is additional to other aid flows, and they should provide new resources on more concessional terms. They should direct aid flows more effectively to countries with solid and comprehensive poverty-reduction strategies—including a policy environment conducive to sustainable economic growth—and that are serious in their implementation efforts. Untying aid is another step creditors and donors should take to help HIPCs (and developing countries more generally) improve their economic situation, as well as trade liberalization that makes their domestic markets more accessible so that HIPCs can increase their export earnings and diversify their production and export base.

B. Debt Relief and Poverty Reduction

Putting debt relief resources to good use will be essential for creditor governments to be able to continue to support HIPCs and gain approval of their parliaments to maintain and possibly increase resources for development aid. But this holds not only for debt relief, but also, and perhaps more so, for the use of aid flows in general. Over the years a number of donors have resorted to providing project assistance over general budgetary support in an effort to have more control over the use of the funds and assurances that the money was not wasted. This has resulted in an inordinate administrative burden on recipient countries which had to cope with numerous reporting and documenting requirements that differed from one donor to the other.

The formulation of poverty reduction strategies by low-income countries and the participatory process leading to it seeks to improve on this state of affairs by clearly stating overall development priorities that reflect a national dialogue. These strategies seek to finance investment that will generate jobs and economic growth and allow a reduction in poverty, as well as to tackle more immediate humanitarian crises such as HIV/AIDS and other diseases. Significant and sustained poverty reduction in such countries can only result from sustained economic growth. Creditors and donors are adjusting their support mechanisms away from individual projects and keying them into country's PRSPs instead, relying on government's PRSP implementation reports rather than requiring individual donor-specific accountability.

By freeing up resources and helping to channel them toward social spending and other pro-poor programs, the HIPC Initiative makes an important contribution, but much more is needed as discussed above. Additional debt relief may not be the best means of achieving poverty reduction as it would likely be directed to those countries with the highest remaining debts, not necessarily the most needy or deserving countries.

For PRSPs to succeed, apart from aid flows, other sources of funding of social spending and other development priorities are clearly needed. These include, notably, the HIPCs' own resources, especially tax receipts. The generation of domestic revenue relative to GDP is low in many HIPCs, which contributes to the aid-dependency of many countries. This is an important element of macroeconomic policies in several countries, and points again to the need for HIPCs to achieve and maintain a strong fiscal position.

The challenge for many HIPCs is to ensure the effective and efficient use of all of the resources available to them. This means that they prepare well-designed poverty reduction strategies, and are able and willing to implement them. It also requires transparency in the use of public resources and accountability of the government. IMF and World Bank staff are working with HIPC governments to ensure that resources, in particular the proceeds of debt relief, are well spent. This means helping countries to ensure that money gets to areas like health, education, and other priority poverty reduction programs, and that it is used efficiently. But results cannot be guaranteed.

One problem is that very few HIPCs have adequate mechanisms to track where and how (extra) resources are spent. IMF, World Bank, and other donors are working to help build public expenditure management capacity.²¹ Also, in the past it has been hard to identify the benefits of higher social spending in improved social indicators. It is important to help the recipients of debt relief avoid frittering away the gains through inefficiency and corruption.

Finally, as these considerations suggest, the contribution of the HIPC Initiative to poverty reduction should not be seen in isolation or only in terms of resources freed up. For the HIPCs, the Initiative's implementation goes hand in hand with the PRSP process, and often resources from debt relief are crucial for PRSP implementation. The combination of debt relief and the PRSP process is potentially a quite powerful one if countries are serious about the formulation of their poverty reduction strategies and implementation. As recent literature on the effectiveness of foreign aid have concluded,²² aid is likely to have a significant impact on growth and poverty reduction if directed to countries that are in great need and have a policy environment conducive to putting resources to good use. The HIPC Initiative's requirement that countries accumulate a track record of good policy implementation before they start benefiting from debt relief is intended to ensure such a growth-friendly policy environment. Experience has shown that external support can only be effective if it reinforces sound policies implemented by HIPCs themselves and leads to higher resources being directed to social development and poverty reduction. Debt relief and ODA are most important not in isolation, but as help for self-help.

²¹ See the joint IMF/World Bank paper "Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs)", <http://www.imf.org/external/np/hipc/2001/track/>.

²² See, e.g., World Bank, "Assessing Aid: What Works, What Doesn't and Why", (<http://www.worldbank.org/html/extpb/assess.htm>); Tsikata, Tsidi M., "Aid Effectiveness: A Survey of the Recent Empirical Literature", Policy Development and Review Department, IMF, Working Paper, PPAA/98/1 (1998).

The Debt Initiative for Heavily Indebted Poor Countries— Key Features and Progress

To address the problems of poor countries, the World Bank and the IMF jointly launched in September 1996 the Initiative for the Heavily Indebted Poor Countries (HIPC) to reduce the external debt burdens of all the eligible HIPCs to sustainable levels, provided they carry out strong programs of macroeconomic adjustment and structural reforms. In October 1999, the modalities of the Initiative were revised in light of the increased emphasis on poverty reduction in IMF- and Bank-supported programs. The Initiative built on earlier debt relief from official creditors, mainly in the context of Paris Club reschedulings.

This Appendix gives a summary of the key features of the HIPC Initiative, the enhancements to the framework adopted in the fall of 1999 and progress in implementation thus far.

The Key Features of the HIPC Initiative

The Initiative is intended to deal comprehensively with the overall external debt burden of eligible countries within a reasonable period of time. A country can be considered to achieve external debt sustainability if it is expected to be able to meet its current and future external debt-service obligations in full, without recourse to debt relief, rescheduling of debts, or the accumulation of arrears, and without compromising economic growth. Debt relief under the HIPC Initiative is provided in two stages (Figure A1):

In the **first stage**, the debtor country needs to demonstrate the capacity to use prudently whatever debt relief is granted by adhering to IMF- and World Bank-supported economic adjustment programs. During this period, the country will receive debt relief from Paris Club creditors under traditional mechanisms (usually a flow rescheduling on Naples terms) and concessional financing from the multilateral institutions and bilateral donors.

At the beginning of the **second stage**, when the *decision point* under the Initiative is reached, the Executive Boards of the IMF and World Bank determine on the basis of the results of a debt sustainability analysis whether the full application of traditional debt relief mechanisms (Paris Club stock-of-debt operation on Naples terms involving a 67 percent NPV reduction with at least comparable action from non-Paris Club official bilateral and commercial creditors) would be sufficient for the country to reach sustainable levels of external debt, or whether additional assistance would be required under the Initiative. In the latter case, the IMF and the Bank would commit to granting debt relief, provided the country continues implementing macroeconomic reforms and structural adjustment policies, including strengthened social policies aimed at reducing poverty. At the same time, Paris Club creditors provide additional debt relief through a flow rescheduling, and commit to providing at the end of the second stage, when the *completion point* has been reached, a stock-of-debt operation. The full amount of debt relief by the IMF and the World Bank will be provided at the completion point as well, on the condition that other creditors (including multilateral

development banks, commercial creditors and non-Paris Club official bilateral creditors) participate in the debt relief operation on comparable terms.

How the enhanced HIPC Initiative works

Following extensive consultations with interested parties from civil society and the Group of Seven meeting of heads of states in Cologne in June 1999, the Boards of the IMF and the World Bank agreed to a revision of the HIPC Initiative, to make debt relief broader, deeper and faster, while strengthening the link between debt relief and poverty reduction. While the principle of providing debt relief in two stages and the crucial importance of implementing IMF- and Bank-supported adjustment programs remained unchanged, the number of eligible countries increased, the amount of debt relief each eligible country will receive was raised, and its delivery accelerated. The modalities of the enhanced HIPC Initiative can be summarized as follows:

Targets of debt relief

- The external debt burden of a poor country is deemed sustainable, if the net present value of debt does not exceed 150 percent of exports or 250 percent of fiscal revenue. Under the original Initiative, the target for the NPV of debt-to-exports ratio was 200–250 percent, and for the debt-to-revenue ratio 280 percent.
- Eligibility for assistance under the fiscal window is subject to thresholds for the openness of an economy (export-to-GDP ratio) of 30 percent (was 40 percent under the original Initiative) and for the revenue effort (revenue-to-GDP ratio) of 15 percent (was 20 percent).²³

Assessment base

- The calculation of debt relief is based on actual debt data at the decision point; under the original Initiative, the committed debt relief was based on projections for the completion point. In most cases, this change in the calculation is likely to result in higher assistance since the debt ratios typically decline as economic reforms take hold. As a result of this change, there will no longer be a need for automatic reassessment at the completion point of the amount of assistance to be provided.

²³ The fiscal window under the Initiative has been established to ensure that highly indebted poor countries with very open economies may have access to debt relief, even if they do not meet the minimum NPV of debt/export ratio. The identification of countries with exceptionally open economies is based on the exports/GDP ratio. The threshold for the revenue/GDP ratio aims to exclude those countries from debt relief under the fiscal window that exceed the targeted NPV of debt/revenue ratio because of serious shortcomings in their revenue mobilization efforts.

Delivery of assistance

- The delivery of debt relief by the IMF and the World Bank under the enhanced HIPC framework starts in the form of *interim assistance* immediately after reaching the decision point, with the remainder of the debt reduction provided at the completion point.²⁴ Other multilateral institutions are expected to provide assistance on comparable terms. In contrast, under the original framework, debt relief was provided by international financial institutions only after reaching the completion point.
- Paris Club creditors will provide assistance through a flow rescheduling on Cologne terms (with 90 percent NPV reduction), covering the period of the second stage followed by a stock-of-debt operation at the completion point to deliver the balance of the required debt relief. Under the original framework, Paris Club creditors provided debt relief on Lyon terms, with 80 percent NPV reduction.
- Other official bilateral and commercial creditors are expected to provide comparable debt relief.

Conditionality

- During the second stage, the country will need to make significant progress in stabilizing the economy, implementing structural reforms, and reducing poverty. The completion point will be reached when the country has met the agreed conditions for a floating completion point, which include the following:
- The debtor country will need to continue to implement the financial and economic programs supported by the IMF's Poverty Reduction and Growth Facility and the World Bank aimed at achieving stable macroeconomic conditions.
- To strengthen the link between debt relief and poverty reduction, the enhanced Initiative requires the preparation and implementation of a nationally owned, comprehensive poverty reduction strategy, as reflected in a Poverty Reduction Strategy Paper (PRSP).²⁵ A PRSP, prepared in broad consultation with civil society, should be in place and broadly endorsed by the Boards of the IMF and the Bank when a country reaches its decision point under the enhanced HIPC Initiative. During a transition period, a decision point may be agreed before the completion of a full PSRP on the basis of an *interim PRSP*,

²⁴ In general, interim assistance provided by the IMF is subject to an upper limit of 60 percent of total assistance under the Initiative, and may not exceed the annual amount of debt-service obligations due to the IMF.

²⁵ The strategy should include measures to improve the delivery of social services, improve expenditure controls and budget management, and strengthen external debt management.

which summarizes the government's objectives of its poverty reduction strategy. In all cases, substantial progress in implementing the poverty reduction strategy is an important condition for reaching the completion point under the Initiative.

- Other creditors will need to confirm their participation in the debt relief operation.

Duration of the second stage

- Under the original framework, the length of the period between the decision and completion points (the second stage) was at least three years, assuming that the country would implement IMF- and Bank-supported medium-term adjustment program according to schedule. The enhanced Initiative has adopted a more flexible approach with a *floating* completion point that will be reached when key structural reforms and certain major poverty reduction measures specified in the PRSP have been implemented, which could take less than three years.

Implementation

Thirty-seven countries are expected to qualify for assistance under the enhanced HIPC Initiative, most of which are in sub-Saharan Africa. As of end-July 2001, 23 countries had reached their decision points under the enhanced framework (Benin, Bolivia, Burkina Faso, Cameroon, Chad, Gambia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Tanzania, Uganda, and Zambia), and Uganda and Bolivia had also reached their completion points (Table A1). Total committed assistance to these 23 countries is \$34 billion in future debt service savings, or \$21 billion in NPV terms, representing an average debt reduction in net present value terms of more than 55 percent on top of traditional debt relief mechanisms. In addition, Côte d'Ivoire had reached its decision point under the original framework; the assistance committed to Côte d'Ivoire will be reassessed under the enhanced Initiative.

Total costs of the HIPC Initiative are estimated at \$33 billion in 2000 NPV terms (or \$42 billion including the difficult cases of Liberia, Somalia, and Sudan), which fall about half to multilateral creditors and half to other creditors (Table A2). The costs of HIPC relief for the 23 countries that have already passed their enhanced decision points account for almost two-thirds of the total cost of the Initiative, and this would rise to over 70 percent once the three countries for which preliminary documents have been issued have reached their decision points possibly later this year.

For more information on the HIPC Initiative, see the IMF and World Bank websites, where all related policy and country documents are posted in www.imf.org/hipc

Table A1. HIPC Initiative: Status of Country Cases Considered Under the Initiative, August, 2001

Country	Decision Point	Completion Point	Target		Assistance Levels 1/					Percentage Reduction in NPV of Debt 2/	Estimated Total Nominal Debt Service Relief (In millions of U.S. dollars)
			NPV of Debt-to-Gov.		(In millions of U.S. dollars, present value)						
			Export	revenue	Total	Bilat-eral	Multi-lateral	IMF	World Bank		
Completion point reached under enhanced framework											
Bolivia					1,302	425	876	84	194		2,060
<i>original framework</i>	<i>Sep. 97</i>	<i>Sep. 98</i>	225		448	157	291	29	54	14	760
<i>enhanced framework</i>	<i>Feb. 00</i>	<i>Jun. 01</i>	150		854	268	585	55	140	30	1,300
Uganda					1,003	183	820	160	517		1,950
<i>original framework</i>	<i>Apr. 97</i>	<i>Apr. 98</i>	202		347	73	274	69	160	20	650
<i>enhanced framework</i>	<i>Feb. 00</i>	<i>May 00</i>	150		656	110	546	91	357	37	1,300
Decision point reached under enhanced framework											
Benin	Jul. 00	Floating	150		265	77	189	24	84	31	460
Burkina Faso					398	56	342	42	162		700
<i>original framework</i>	<i>Sep. 97</i>	<i>Jul. 00</i>	205		229	32	196	22	91	27	400
<i>enhanced framework</i>	<i>Jul. 00</i>	<i>Floating</i>	150		169	24	146	20	71	27	300
Cameroon	Oct. 00	Floating	150		1,260	874	324	37	179	27	2,000
Chad	May. 01	Floating	150		170	35	134	18	68	30	260
Gambia, The	Dec. 00	Floating	150		67	17	49	2	22	27	90
Guinea	Dec. 00	Floating	150		545	215	328	31	152	32	800
Guinea-Bissau	Dec. 00	Floating	150		416	212	204	12	93	85	790
Guyana					585	220	365	74	68		1,030
<i>original framework</i>	<i>Dec. 97</i>	<i>May 99</i>	107	280	256	91	165	35	27	24	440
<i>enhanced framework</i>	<i>Nov. 00</i>	<i>Floating</i>	150	250	329	129	200	40	41	40	590
Honduras	Jun. 00	Floating	110	250	556	215	340	30	98	18	900
Madagascar	Dec. 00	Floating	150		814	457	357	22	252	40	1,500
Malawi	Dec. 00	Floating	150		643	163	480	30	331	44	1,000
Mali					523	162	361	58	182		870
<i>original framework</i>	<i>Sep. 98</i>	<i>Sep. 00</i>	200		121	37	84	14	44	9	220
<i>enhanced framework</i>	<i>Sep. 00</i>	<i>Floating</i>	150		401	124	277	44	138	28	650
Mauritania	Feb. 00	Floating	137	250	622	261	361	47	100	50	1,100
Mozambique					1,970	1,235	736	140	434		4,300
<i>original framework</i>	<i>Apr. 98</i>	<i>Jun. 99</i>	200		1,716	1,076	641	125	381	63	3,700
<i>enhanced framework</i>	<i>Apr. 00</i>	<i>Floating</i>	150		254	159	95	16	53	9	600
Nicaragua	Dec. 00	Floating	150		3,267	2,145	1,123	82	189	72	4,500
Niger	Dec. 00	Floating	150		521	211	309	28	170	54	900
Rwanda	Dec. 00	Floating	150		452	56	397	44	228	71	800
Sao Tome & Principe	Dec. 00	Floating	150		97	29	68	-	24	83	200
Senegal	Jun. 00	Floating	133	250	488	193	259	45	124	19	850
Tanzania	Apr. 00	Floating	150		2,026	1,006	1,020	120	695	54	3,000
Zambia	Dec. 00	Floating	150		2,499	1,168	1,331	602	493	63	3,820
Decision point reached under original framework											
Côte d'Ivoire	Mar. 98	Mar. 01	141	280	345	163	182	23	91	6 3/	800
Total assistance provided/committed					20,833	9,779	10,955	1,755 4/	4,951		34,680
Preliminary HIPC document issued 5/											
Ethiopia	...	...	150		1,028	352	649	37	395	42	1,650
Ghana	...	...		250	2,096	1,002	1,095	122	767	55	3,200
Sierra Leone	...	...	150		551	188	326	121	119	79	867

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

1/ Assistance levels are at countries' respective decision or completion points, as applicable.

2/ In percent of the net present value of debt at the decision or completion point (as applicable), after the full use of traditional debt-relief mechanisms.

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 1,386 million at an SDR/USD exchange rate of 0.7900, of May 1, 2001.

5/ Figures are based on preliminary assessments at the time of the issuance of the preliminary HIPC document; and are subject to change.

Table A2. HIPC Initiative: Estimates of Potential Costs by Creditor Group

	March 2001 Costing Exercise 1999 NPV terms (32 countries) ^{2/}	Updated Costing Exercise 1999 NPV terms (34 countries) ^{3/}	Updated Costing Exercise 2000 NPV terms (34 countries) ^{3/}	(In percent of total costs) (34 countries) ^{3/}	Total 23 decision point countries (In 2000 NPV terms)	Future decision point countries ^{1/} (11 countries)
Total costs	29.3	31.3	33.2	100.0	20.7	12.5
<i>(In billions of US dollars)</i>						
Bilateral and commercial creditors	15.1	16.1	17.1	51.4	9.8	7.3
Paris Club	11.3	12.0	12.8	38.4	7.0	5.8
Other official bilateral	2.6	2.7	2.8	8.5	2.6	0.3
Commercial	1.2	1.4	1.5	4.5	0.3	1.2
Multilateral creditors	14.2	15.2	16.1	48.6	10.9	5.2
World Bank	6.3	7.0	7.4	22.4	4.9	2.5
<i>Of which: IDA</i>	5.6	6.3	6.7	20.1	4.6	2.1
IBRD	0.7	0.7	0.8	2.3	0.3	0.5
IMF	2.2	2.4	2.5	7.5	1.7	0.8
AfDB/AfDF	2.4	2.5	2.6	8.0	1.3	1.3
IaDB	1.1	1.1	1.1	3.4	1.1	0.0
Others	2.2	2.3	2.4	7.4	1.8	0.6
<i>Memorandum item:</i>						
Total costs including Liberia, Somalia, and Sudan	37.3	39.2	41.6	125.4	...	...
in percent of total costs	n.a.	n.a.	n.a.	n.a.	62.0	38.0

Sources: Enhanced Initiative for Heavily Indebted Poor Countries - Review of Implementation (EBS/00/166, 8/14/00 and SecM2000-487, 8/14/2000); country authorities; and Fund and Bank staff estimates.

1/ Burundi, Central African Republic, Comoros, Democratic Republic of Congo, Republic of Congo, Cote d'Ivoire, Ghana, Ethiopia, Myanmar, Sierra Leone, and Togo.

2/ Excluding Comoros, Eritrea, Ghana, Lao P.D.R., Liberia, Somalia, and Sudan.

3/ Excluding Eritrea, Lao P.D.R., Liberia, Somalia, and Sudan.

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