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Enabling poor rural people
to overcome poverty

IFAD's participation in the Heavily Indebted Poor Countries Debt Initiative

Proposal for the Comoros and the 2010 progress report

Note to Executive Board representatives

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For: Approval

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Recommendation for approval

The Executive Board is invited to approve a new country case for debt relief under the Heavily Indebted Poor Countries Debt Initiative (the Comoros), and the submission of the substance of this paper to the thirty-fourth session of the Governing Council for information, in accordance with the recommendation contained in paragraph 24.

IFAD's participation in the Heavily Indebted Poor Countries Debt Initiative – Proposal for the Comoros and the 2010 progress report

I. Introduction

1. The objective of this progress report for 2010 is to:
 - Seek the Executive Board's approval of a new country case (the Comoros) for debt relief under the Heavily Indebted Poor Countries (HIPC) Debt Initiative;
 - Inform the Executive Board of the status of implementation of the HIPC Debt Initiative and of IFAD's participation in the Initiative; and
 - Seek the Executive Board's approval for submitting the substance of this progress report to the forthcoming session of the Governing Council for its information.

II. New country case: the Comoros

2. In June 2010 the executive boards of the International Monetary Fund (IMF) and the International Development Association (IDA) agreed to support a comprehensive debt reduction package for the Comoros under the enhanced Debt Initiative.
3. The Comoros is emerging from a long period of political instability punctuated by violent transfers of presidential powers since independence in 1975. Progress in nation-building and political reconciliation has been slow. In 2001, a new constitution created the Union of the Comoros, providing for each of the three islands to have its own president and parliament. As a result of disputed election results on Anjou Island, cooperation between the Union and island Governments disintegrated preventing the IMF Board from considering a Poverty Reduction and Growth Facility-supported programme that had been negotiated in late 2007. This adversely affected economic management, donor support and growth. As they gradually overcome a long period of political instability, the Comorian authorities have put in place an ambitious medium-term economic reform programme to rekindle growth and combat poverty more effectively.
4. Together with the IMF and the World Bank (IDA), other donors and creditors are gradually resuming support to the Comoros, including the African Development Bank (AfDB), the European Union, and development partners of the League of Arab States and of the Gulf region. Such support – including the close supervision of the ongoing IFAD portfolio (a mid-term review has just been completed) and the planned (2011) additional financing to the National Programme for Sustainable Human Development – is required because, with weak economic performance and

persistent political instability in recent years, poverty is widespread and the social situation remains dire. The last household survey, conducted in 2004, indicated that 37 per cent of households (44.8 per cent of individuals) live below the poverty line. The incidence of poverty varies across islands and is generally higher in rural areas.

5. Economic conditions in the Comoros have yet to recover from the effects of persistent political instability and the recent global crises. Real GDP growth was only 1 per cent in 2008; it picked up to 1.8 per cent in 2009, driven by donor-funded public works, remittances-based private sector construction, and expansion of the financial sector. Nevertheless, some progress has been made towards achieving several Millennium Development Goals (MDGs), including MDG1 to eradicate extreme poverty and hunger, although malnutrition for children is currently assessed as off-track.
6. The Government's medium-term reform programme, anchored in its Poverty Reduction and Growth Strategy Paper (PRGSP), aims to invigorate economic growth and improve living conditions within a stable macroeconomic environment. Beyond smallholder agriculture, economic recovery is to be driven by accelerated (donor-funded) public works and increased investment in tourism. The reform agenda is focused on improving the business environment and governance to encourage investment and expanded infrastructure, as well as supporting agricultural productivity and diversification. The main risks to the medium-term outlook are political tensions between the Union and Island authorities, a slower-than-expected pace of reform implementation, and uncertainties in the pace of the global economic recovery.
7. The PRGSP, officially adopted by the Government on 10 September 2009, is the country's first full poverty reduction strategy paper (PRSP). It was developed through a thorough and inclusive participatory process, which brought together numerous stakeholders – representatives of civil society, traditional and religious leaders, NGOs and development partners. For a fragile state, where a rapid succession of political upheavals has hampered policy formulation and implementation over so many years, completing a full PRSP is in and of itself a noteworthy achievement. The PRGSP sets an ambitious policy agenda including strengthening key sectors of the economy with the highest growth and poverty reduction potential: tourism, agriculture and fishing.
8. At end-2009, the Comoros' public and publicly guaranteed external debt was estimated at US\$286.8 million (including arrears) in nominal terms. This corresponds to US\$213.1 million in net present value (NPV) terms. Multilateral creditors accounted for slightly over three fourths of the total debt stock in nominal terms, with liabilities to IDA alone constituting 42.0 per cent of total external debt. Other multilaterals with substantial claims on the Comoros are the AfDB (13.3 per cent of total external debt), the Arab Bank for Economic Development in Africa (9.6 per cent), the IMF (3.5 per cent), the Islamic Development Bank (3.3 per cent) and IFAD (2.8 per cent).
9. Largely due to political and economic instability over the 2007-2009 period, the Comoros accumulated payment arrears to nearly all of its creditors. Since then, however, the country has cleared or signed arrears rescheduling agreements with several creditors, and has initiated negotiations with other multilateral creditors. With regard to the discussions with IFAD, in October 2010, the Government made the first payment of Euro 134,616 and has indicated that the balance will be paid by end-2010. The NPV of arrears due to IFAD have, following confirmation by the debt management department of the World Bank and the HIPC Trust Fund, been included as part of the agreed debt relief at decision point and the calculation of the common reduction factor.
10. The Comoros qualifies for debt relief under the HIPC Initiative's "export window" based on end-2009 data. After full application of traditional debt relief mechanisms,

the country's NPV of debt is estimated at US\$257.4 million at end-2009, equivalent to 343 per cent of exports of goods and services. The amount of debt relief needed to bring the Comoros' NPV of debt-to-exports ratio down to the HIPC threshold of 150 per cent is estimated at US\$144.8 million in end-2009 NPV terms. This implies a common reduction factor of 56 per cent. Based on proportional burden-sharing, multilateral creditors' assistance would amount to US\$111.2 million, and bilateral and commercial creditors' assistance to US\$33.6 million (in NPV terms).

11. The Executive Board is requested to approve: (i) the Fund's contribution to debt relief for the Comoros in the amount of 2.0 million special drawing rights (SDR) (or about US\$3.2 million) in 2009 NPV terms;¹ and (ii) the provision of 100 per cent of debt relief during the interim period. The debt service relief is forecast to be approximately SDR 2.9 million in nominal terms, to be provided until debt relief is exhausted (currently forecast for 2026).
12. The unconditional delivery of HIPC Initiative assistance, together with traditional debt relief, would drive down the Comoros' NPV of debt-to-exports ratio from 343 per cent as at end-December 2009 to approximately 142.7 per cent by 2012. With Multilateral Debt Relief Initiative (MDRI) and Least Developed Countries Initiative (LDCI) relief added, the NPV would fall to 86.5 per cent of exports of goods and services in 2012, as a result of cancellation of debt to IDA, AfDB and the European Investment Bank. Additional relief from bilateral creditors would lower the NPV of debt to exports to 86 per cent. The NPV of debt is projected to decline further over the long term. With both HIPC and MDRI debt relief, the NPV of debt would continue to decline to 80.2 per cent of exports of goods and services by 2029, reflecting projected growth in exports and the authorities' prudent borrowing policy. The sensitivity analysis indicates that the Comoros' ability to service external debt after HIPC relief is very vulnerable to external and growth shocks.
13. The Comoros will reach its completion point under the enhanced HIPC Initiative when, in addition to the standard triggers, the following sector-specific triggers have been reached: policy measures adopted aimed at improving public financial management and governance; social sectors strengthened; growth supported; and debt management improved. The Comoros is expected to reach its completion point by mid-2012.
14. The Government is committed to ensuring that assistance under the HIPC Initiative is used to fund activities identified in the PRSP. For agriculture and food security, the medium-term expenditure priorities include:
 - Expand income-generating activities at the community level, including those that increase food production and/or facilitate the supply of food products to markets and the population; and
 - Expand availability of quality services to producers – advice, agricultural education and training, and research and development for improving the supply of agricultural inputs.

III. Progress in HIPC Debt Initiative implementation

15. Since the inception of the HIPC Initiative, there has been substantial progress with respect to the implementation of HIPC debt relief. Nearly 90 per cent of eligible countries (35 out of 38²) have passed their decision points, qualifying for HIPC assistance. Twenty-eight countries have now reached the completion point and seven are in the interim period between the decision and completion points (see table below). The pace at which countries in the interim period have reached their completion points has accelerated over the past two years as countries have made

¹ As at 31 July 2010, the Comoros's outstanding principal debt to IFAD stood at SDR 4.96 million, and this amount included the principal element of the SDR 126,000 of arrears at that date. (Service charge arrears amounted at that date to SDR 26,000.)

² Kyrgyzstan, Lao People's Democratic Republic and Nepal have withdrawn from the HIPC Debt Initiative.

progress in implementing their macroeconomic programmes and poverty reduction strategies. Since December 2008, Burundi, the Central African Republic, the Democratic Republic of the Congo, Haiti, Liberia and the Republic of Congo have all reached their completion points and IFAD has commenced the agreed levels of debt relief.

16. At its December 2009 session, the IFAD Executive Board approved a decision point document for debt relief for Côte d'Ivoire. Of the other decision point countries, Guinea-Bissau and Togo are making good progress and could reach their completion points by end-2010, while Côte d'Ivoire could do so in 2011.
17. Maintaining debt sustainability beyond the completion point remains a concern, particularly during the current financial crisis. Debt sustainability analyses confirm that post-completion point countries are in a better debt situation than other HIPC countries and also than non-HIPCs. But their debt sustainability outlook remains vulnerable to shocks and is highly sensitive to the terms of new financing. Only about 40 per cent of post-completion point HIPCs currently have a low risk of debt distress according to the most recent debt sustainability analyses; and the number with a high risk rating is increasing. This highlights the need for post-completion point HIPCs to implement sound borrowing policies and strengthen their capacity in public debt management. Those multilateral creditors that have committed to participate in the HIPC Initiative together monitor the levels of debt relief through the annual monitoring survey carried out by the World Bank. IFAD participates in the survey, reporting all debt information as part of its responsibilities in the Debt Sustainability Framework and in liaison with the World Bank and regional development banks.

A. Total cost of the HIPC Debt Initiative to IFAD

18. The total NPV cost of the Fund's participation in the overall HIPC Debt Initiative³ is currently estimated at SDR 306.7 million (equivalent to approximately US\$476.7 million), which corresponds to an approximate nominal cost of SDR 460.0 million (about US\$715.3 million).⁴ The current cost estimates are likely to increase as a result of delays in countries reaching decision and completion points, worsening economic conditions leading to the need for completion point top-ups, and continuing low discount rates. Total debt relief payments are estimated at US\$70.7 million for 2010.

B. IFAD commitments to date

19. To date, IFAD has committed the required debt relief to all 35 HIPCs that have reached their decision points. IFAD's total commitments so far (including the Comoros) amount to SDR 244.4 million (approximately US\$379.9 million) in NPV terms, which amounts to SDR 365.8 million (approximately US\$568.8 million) of debt service relief in nominal terms.

C. Debt relief provided

20. As at 30 September 2010, IFAD has provided US\$286.1 million in debt relief in nominal terms to the 28 completion point countries.

³ IFAD participation comprises all eligible HIPC Debt Initiative countries, including pre-decision point countries.

⁴ Base estimates at exchange rates prevailing on 30 September 2010.

IFAD Member States participating in the HIPC Debt Initiative, by stage

<i>Completion point countries</i>	<i>Decision point countries</i>	<i>Pre-decision point countries</i>
Benin	Chad	
Bolivia (Plurinational State of)	Côte d'Ivoire	Eritrea
Burkina Faso	Comoros ^a	Somalia
Burundi	Democratic Republic of the Congo	Sudan
Cameroon	Guinea	
Central African Republic	Guinea-Bissau	
Congo	Togo	
Ethiopia		
Gambia (The)		
Ghana		
Guyana		
Haiti		
Honduras		
Liberia		
Madagascar		
Malawi		
Mali		
Mauritania		
Mozambique		
Nicaragua		
Niger		
Rwanda		
Sao Tome and Principe		
Senegal		
Sierra Leone		
Uganda		
United Republic of Tanzania		
Zambia		

^a Subject to approval by the Executive Board at its December 2010 session.

D. Financing of IFAD's debt relief

21. IFAD is funding its participation in the HIPC Debt Initiative through external contributions (paid either directly to IFAD or transferred through the HIPC Trust Fund administered by the World Bank) and its own resources. External contributions (paid or pledged) amount to about US\$193.7 million (59.4 per cent). IFAD's contributions from its own resources amount cumulatively to about US\$124.7 million (38.2 per cent). The Executive Board approved several transfers in 1998-2003 and in 2006, and a further transfer of US\$25 million was executed in 2007. **The Executive Board is herewith informed that, with value date of 1 October 2010, IFAD has transferred from its own internal resources to the Trust Fund account an additional amount equivalent to US\$30.0 million.** The rest has been covered by investment income from the IFAD HIPC Trust Fund balance as at end-September 2010.
22. To mitigate the impact of debt relief on IFAD's resources available for commitment to new loans and grants, IFAD's Member States have supported the Fund's formal access to the HIPC Trust Fund administered by the World Bank. This was agreed at the HIPC information and funding meeting held on 19 November 2006 in Washington, D.C. It was recognized that IFAD's access would add to the overall financing requirements of the HIPC Trust Fund. The first transfer from the World Bank-administered HIPC Trust Fund (US\$104.1 million), following the receipt and signature of the grant agreement, was received by IFAD in October 2007. A second series of separate grant agreements was received in May 2009 for supporting debt relief for The Gambia, Sao Tome and Principe, and Sierra Leone, totalling approximately US\$18.1 million from the HIPC Trust Fund administrators. Grant agreements for a third tranche from the Debt Relief Trust Fund of US\$46.2 million are under final preparation for transfer to IFAD in 2010.
23. While giving priority to ensuring that the HIPC Trust Fund is adequately financed, Management will also continue to encourage IFAD's Member States to provide the Fund with additional resources directly to help finance its participation in the HIPC Initiative.

IV. Recommendations

24. It is recommended that the Executive Board:

- (i) Approve the proposed contribution to the reduction of the Comoros's debt to IFAD as of 31 December 2009 (see paragraph 11), in the amount of SDR 2.0 million in end-2009 NPV terms. This relief will be provided in accordance with the terms of the following resolution:

"RESOLVED: that the Fund, upon the decision of the Executive Board, shall reduce the value of the Comoros's debt to IFAD through the reduction by up to 100 per cent of its respective semi-annual debt-service obligations to IFAD (principal and service charge/interest payments), as these fall due, up to the aggregate NPV amount of SDR 2.0 million in end-2009 NPV terms."
- (ii) Take note that the President of IFAD has transferred from IFAD's internal resources to the Trust Fund account an amount equivalent to US\$30 million; and
- (iii) Take note of the status of implementation of the HIPC Debt Initiative and IFAD's participation therein, and approve the submission to the Governing Council – in the form of an information paper – of the relevant sections of this paper, appropriately revised to incorporate the above decisions of the Executive Board, as the 2010 progress report.