



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
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**IFAD'S PARTICIPATION IN THE
DEBT INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES**

I. INTRODUCTION

1. It is the objective of this paper to:
 - (i) inform the Executive Board on the status of implementation of the Debt Initiative for Heavily Indebted Poor Countries (HIPC) and IFAD's participation in the Initiative;
 - (ii) seek the Executive Board's approval of a new country case, Ethiopia, for debt relief under the initiative;
 - (iii) seek the Executive Board's approval to transfer to the IFAD Debt Initiative Trust Fund ('Trust Fund') the amounts necessary to help finance the projected costs of IFAD's debt-relief commitments under the Initiative for 2002 and 2003, as and when due; and
 - (iv) update the Executive Board on IFAD's efforts to mobilize additional external resources to help finance the Fund's participation in the Initiative.

II. STATUS OF IMPLEMENTATION OF THE DEBT INITIATIVE

2. **Updated cost estimates.** As shown in Table 1, the total cost of the aggregate Initiative in 2000 net-present-value (NPV) terms currently amounts to 33.2 billion United States dollars (USD) (or USD 41.6 billion, including Liberia, Somalia and The Sudan). A considerable contribution will be made by the bilateral creditors, and especially by the Paris Club under the long-standing proactive leadership of France, strongly supported by a number of other member countries of the Organisation for Economic Co-operation and Development (OECD).

**Table 1: Updated Estimates of Total Debt Initiative Costs
(in USD billion)**

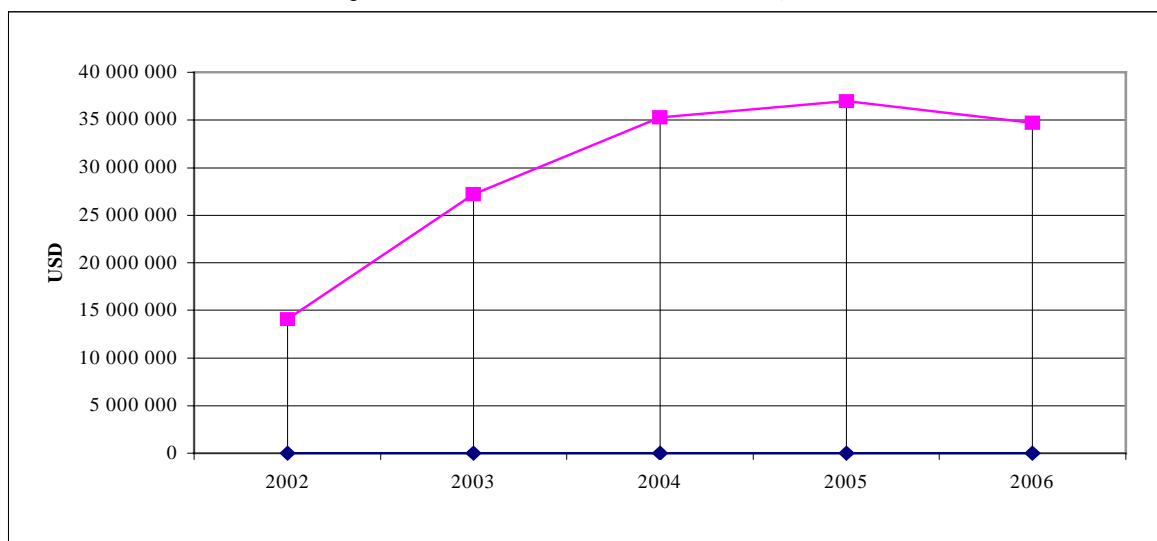
	Previous Estimate in 1999 NPV terms 32 countries	Updated Estimate in 1999 NPV terms 34 countries ^a	Updated Estimate in 2000 NPV terms 34 countries ^a	Percentage of Total Costs
Total costs (without Liberia, Somalia and the Sudan)	29.3	31.3	33.2	100
<i>Bilateral and commercial creditors</i>	15.1	16.1	17.1	51
<i>Multilateral creditors</i>	14.2	15.2	16.1	49
Total costs (including Liberia, Somalia and Sudan)	37.3	39.2	41.6	125

^a Including Comoros and Ghana

Source: IMF/World Bank staff estimates (September 2001)

3. The current estimate of the total NPV cost of IFAD's participation in the full Debt Initiative amounts to 230 million Special Drawing Rights (SDR) (USD 289 million), which corresponds to an approximate nominal cost of SDR 349.7 million (USD 439.5 million). These costs are projected to peak in 2005 at the level of USD 37 million.

Projected Total Annual Nominal Cost, 2002-06



4. **Status of implementation.** As of 31 October 2001, 23 countries¹ had become eligible for debt relief under the Initiative, and Ethiopia became eligible in December 2001. Bolivia, Mozambique, the United Republic of Tanzania and Uganda have reached their completion points under the enhanced Initiative; and Burkina Faso, Guyana and Mali have reached their completion points under the original Initiative. Five countries (Benin, Burkina Faso, Guyana, Mali and Senegal) are expected to reach their enhanced Initiative completion points early in 2002; and some of them (e.g. Burkina Faso) are likely to benefit from additional-relief decisions in the light of completion point reviews of their debt-sustainability analysis.

¹ In addition, Côte d'Ivoire has been declared eligible for debt relief under the original Debt Initiative framework, but the completion point has been delayed.



5. The same 23 countries have received commitments for a total of USD 34 billion in debt-service relief (including the more than USD 2.5 billion already received from multilateral institutions by October 2001). Their existing debt stocks will have been reduced from USD 54 billion to 21 billion in NPV after the full application of traditional and Initiative debt relief, together with additional bilateral debt relief beyond the Initiative. On average, Initiative debt relief will reduce debt-service payments from 26% of government revenue before this debt relief to less than 10% by 2005, and thus below the current average of 21% for developing countries not participating in the Initiative. As projected debt-service payments fall, average commitments for poverty-reducing social expenditures are expected to increase by more than 50% from 1999 to 2002, from USD 4.1 billion to 6.3 billion.

Table 2: The 42 Heavily Indebted Poor Countries

Countries with Enhanced Initiative Decision Points (24) as of December 2001	Countries Not Yet Arrived at the Decision Point (14)	Possibly Sustainable Country Cases
Benin, Burkina Faso, Cameroon, Chad, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Nicaragua, Niger, Rwanda, Senegal, Sao Tome and Principe, Zambia With Decision Points and Completion Points: Bolivia, Mozambique, United Republic of Tanzania, Uganda	Burundi, Central African Republic, Comoros, Congo, D.R. Congo, Côte d'Ivoire, Ghana, Laos, Liberia, Myanmar, Sierra Leone, Somalia, Sudan, Togo	Angola, Kenya, Viet Nam, Yemen

6. Major efforts are ongoing to bring the remaining 14 countries to their decision points as soon as conditions permit. It is expected that Ghana and Sierra Leone will reach their decision points in the coming months. However, about ten of the remaining countries are either emerging from armed conflict or facing significant arrears problems, or both. To ensure that their decision points are not delayed much longer after achievement of decision point conditions, it is expected that international financial institutions (IFIs) will be called upon to deal with the arrears issues in a proactive and creative manner. The first such country cases that may come forward for Executive Board consideration, possibly as soon as late 2002, are those relating to the Democratic Republic of the Congo and Sierra Leone, both with significant levels of arrears. The discussions on debt reconciliation, debt-sustainability analysis and arrears clearance capacity are ongoing.

7. IFAD has so far committed itself to providing debt relief to the 23 countries that had reached their decision point by 31 October 2001, for a total NPV amount of approximately SDR 132 million (USD 166 million). Assuming a prompt meeting of the completion point conditions and a relatively front-loaded modality for debt relief², this would amount to about SDR 191 million in nominal terms (USD 240 million), spread over varying periods of time depending on the country, and ranging from 2 years to 27 (for Sao Tome and Principe) or even 35 (for Nicaragua).

8. The debt relief actually provided by IFAD up to December 2001 amounts to approximately USD 14.9 million, of which about USD 9.7 million was covered by external resources and the remainder from IFAD's own resources.

² 100% of debt-service relief from the completion point onwards until the NPV target is reached, without interim relief, except for Guinea-Bissau.



III. A NEW COUNTRY CASE: ETHIOPIA

9. In November 2001, the executive boards of the International Monetary Fund (IMF) and the International Development Association (IDA) agreed to support a comprehensive debt-reduction package for Ethiopia under the enhanced Initiative. Ethiopia's eligibility for debt relief under the enhanced Initiative framework is a recognition by the international community of the overall quality of its record of macroeconomic, structural and social reforms, and of its progress in developing its interim Poverty-Reduction Strategy Paper (PRSP).

10. Improving agricultural productivity is one of the key challenges for Ethiopia's development. Agriculture accounts for 45% of the gross domestic product (GDP) and 85% of exports. Furthermore, 88% of the population lives in rural areas and is dependent on agricultural performance for its consumption. By 1999/2000, only 13% of potentially cultivable land was used, less than 3% of the cultivated area was under irrigation, and 95% of farming was for subsistence. The Government has sought to raise agricultural productivity by focusing on improving price incentives, cultivation practices and the distribution of fertilizer and seeds through its massive Extension Intervention Programme. However, despite significant growth of grain output and overall agricultural production in recent years, crop and livestock productivity remain among the lowest in Africa, and less than 40% of total agricultural output and 30% of food grains are marketed. Substantial increases in agricultural productivity will require: (i) emergence of a private-sector market for agricultural input supplies, which had thus far been delayed by the dominant role that the regional governments have come to play in the direct supply of inputs to farmers, and by the encouragement of party-owned enterprises to supply inputs; (ii) reduction of transaction costs by introducing grain grading and inspection, and by providing public information on grain prices; (iii) extension of the use of irrigation; and (iv) improvements in the security of land tenure. The completion point trigger for agriculture aims at improving productivity by enhancing the competitiveness of the fertilizer input market. It also seeks to reinforce the private sector's role in fertilizer provision and enable the Government to exit the Extension Intervention Programme after the demonstration phase, planned to last no more than two years. The Government's poverty-targeted expenditure plan aims to allocate Initiative debt-relief resources from 2000 to 2003 to increase capital and recurrent expenditures in the agriculture and natural resources sector from 2.4 to 3.8% of GDP. IFAD's programme of cooperation with the country fully reflects these concerns and objectives, in terms of both service delivery to farmers and the agenda for institutional and policy transformation.

11. In July 2001, the base year, Ethiopia's NPV of debt (after application of the traditional debt-relief mechanisms) amounted to 284% of exports. Under the enhanced Initiative, countries are eligible for assistance provided that the NPV of their external debt exceeds 150% of export revenues. To achieve this target, all multilateral creditors are expected to provide a reduction of 47.2% in the NPV of their outstanding claims as of 7 July 2001. Total relief from all Ethiopia's creditors would amount to USD 1.275 billion in NPV terms. Based on proportional burden-sharing, bilateral creditors will provide USD 482 million, and commercial lenders USD 30 million. Multilateral creditors will provide USD 763 million in debt relief in NPV terms. **IFAD's Executive Board is requested to approve IFAD's contribution to debt relief for Ethiopia in the amount of SDR 12.4 million (USD 15.5 million) in 2001 NPV terms.** Tentatively this would amount to SDR 17.2 million in nominal terms, spread over approximately ten years.

12. It should be pointed out that in the case of Ethiopia, while the NPV of debt-to-exports ratio has been projected to drop to 150% in the base year (2000/2001), it is expected to rise above that target level through 2006/07, and then fall significantly below 150% and remain at that level. Moreover, with the expected delivery of additional bilateral relief, beyond that committed under the enhanced Initiative framework, the sustainability target could be achieved immediately.



13. Ethiopia will reach its completion point under the enhanced Initiative when the following conditions have been met: (i) a continued commitment to the financial and economic programme supported by IMF's Poverty Reduction and Growth Facility (PRGF); (ii) completion of a full PRSP, through a participatory process, and a first annual report on the implementation of the poverty-reduction strategy, to be broadly endorsed by the IMF and World Bank executive boards; (iii) successful implementation of a number of reforms in key structural and social areas; and (iv) confirmation of the participation of other creditors in the debt-relief operation. As previously explained, a trigger in the agricultural sector for Ethiopia's floating completion point, of specific relevance to IFAD's programme with the country, is the satisfactory implementation of the action plan agreed with IDA and aimed at improving the competitiveness and efficiency of the fertilizer input market. This action plan includes monitorable indicators, with half-yearly assessment reports beginning in December 2002.

IV. TRANSFER OF RESOURCES TO THE IFAD DEBT INITIATIVE TRUST FUND ACCOUNT

14. At its Twenty-First Session, the Governing Council authorized the establishment of the Trust Fund for the purpose of financing debt relief once countries reach their completion points. As reported in document EB 98/65/R.8/Rev.1, at the time of the Governing Council's approval of IFAD's participation in the Initiative, it was understood that IFAD would periodically be required (as and when more countries qualify for actual debt relief) to transfer funds from its internal resources into the Trust Fund. The Trust Fund thus receives resources from IFAD itself and, so far, also from The Netherlands and Germany, which specifically earmarked these additional external resources to help finance IFAD's participation in the Initiative. The Trust Fund compensates the respective countries' loan fund accounts with IFAD for agreed reductions in their loan repayments under the Initiative; it reimburses the debt forgiven on a pay-as-you-go basis, and to the extent that resources are available.

15. The amounts transferred by IFAD to date amount to about USD 18.7 million, as authorized by the Executive Board in December 1998 and April 1999. As of 31 December 2001, payments made from the Trust Fund for debt relief totalled USD 14.9 million.

16. **The Executive Board is herewith informed that the President of IFAD will transfer from IFAD's internal resources to the Trust Fund account amounts equivalent to USD 14 million and 27 million, in 2002 and 2003 respectively, as and when required to help finance IFAD's Initiative commitments.** Also, should the balance of funds in the Trust Fund not be sufficient to meet the debt-relief payments as and when they fall due, the Executive Board will be informed about further transfers from IFAD's internal resources.

V. UPDATE ON IFAD'S EFFORTS TO MOBILIZE ADDITIONAL RESOURCES

17. **Additional external resources firmly pledged.** To support IFAD's resource requirements for the original Initiative, and to safeguard the Fund's capacity to finance new loans, the Government of The Netherlands pledged an amount of 26.62 million Netherlands guilders (approximately USD 15.4 million, at historic exchange rates) in complementary contributions within the framework of the Fourth Replenishment of IFAD's Resources. In addition, in 2001 the Government of Germany has earmarked 15 million Deutsche marks (about USD 7 million) of its contributions to the World Bank-administered Debt Initiative trust fund for debt owed to IFAD, to be disbursed over a three-year period. Beyond the Netherlands and German contributions, IFAD's participation in the Initiative is currently being financed from internal resources that would otherwise be available for commitment for additional loans and grants under the programme of work.



18. IFAD has further received formal commitments of: (i) up to USD 3 million from the country-earmarked resources pledged by Switzerland to the World Bank-administered Debt Initiative trust fund; (ii) 120 million Belgian francs (2.97 million euros) from the resources pledged by Belgium to the same World Bank-administered trust fund; and (iii) a complementary contribution for IFAD's Initiative requirements by Italy of 3.72 million euros. Some other Member States, such as Sweden, have indicated that they are also prepared to shoulder their fair share of IFAD's Debt Initiative financing burden.

19. **IFAD's broader effort for resource mobilization.** On 7 February 2001, the President of IFAD organized an informal meeting to develop, among IFAD Member States, a shared outlook on the Fund's resource position and its Initiative financing requirements, as well as a common understanding of the needed balance between internal and external resources to finance IFAD's participation in the Initiative.

20. Participants in the meeting noted and reaffirmed the core principles underlying the Initiative's design, as endorsed by the World Bank/IMF Development Committee in 1999. The first is the principle of additionality – debt relief is to be additional to new highly concessional development assistance in support of poverty-reduction programmes. The second principle is that debt relief should not undermine the financial integrity of participating IFIs. The importance of sharing the burden of the cost of the Initiative on an equitable basis was also considered to be a core principle.

21. The meeting recalled the Governing Council's endorsement of IFAD's full participation in the enhanced Debt Initiative, expecting the Fund to make efforts to internalize costs while at the same time minimizing the impact of participation in the Initiative on its annual lending programme. IFAD Member States were, however, also invited to provide the Fund directly with additional resources to help finance participation in the Initiative, or to facilitate IFAD's equitable access to resources from the World Bank-administered Debt Initiative trust fund.

22. Participants noted the information provided by the Secretariat on the resource position of IFAD and on the present impact of participation in the Initiative on the resource structure of the Fund and its expected future impact. This included an analysis of general resource requirements based on a stable lending programme; the resources available, including conservative investment income projections in line with a new investment strategy; and greater recourse to the advance commitment authority (ACA). The result of the analysis demonstrates that if no further additional resources were made available to the Fund, the institution would find itself with a permanent annual negative net resource balance. There was a discussion of the basic assumptions used in the analysis, noting the prudent orientation of some resource projections. It was clarified that even on more optimistic assumptions regarding investment income and future replenishments, the Fund would still have a negative resource position and therefore need to use ACA. As a consequence, and in the absence of additional financing, the Fund will continue to be confronted with the reality of a one-to-one relationship between IFAD's delivery of debt relief versus new loans.

23. The meeting came to the following broad conclusions:

- (i) There was wide recognition that IFAD's participation in the Initiative has an impact on the Fund's operations; and, given the present and future resource projections, the lending programme will continue to be affected. There was agreement on the need to minimize the impact of Debt Initiative participation on IFAD's lending programme.
- (ii) There was broad support for the principle of equitable access by IFAD to the World Bank-administered trust fund. In addition, there was general agreement that the issue of IFAD's access to that trust fund should be taken up at the next Trust Fund



technical meeting, as part of the formal review of global financing requirements for the Initiative. Some participants indicated their country's willingness to support access by IFAD to the World Bank trust fund through existing procedures; other participants also indicated their country's willingness to provide direct contributions to IFAD. Many participants stressed the importance of fair burden-sharing.

- (iii) While agreement had not yet been reached on the proportion of IFAD's Debt Initiative requirements that should be met with additional external funding, there was recognition that IFAD's position regarding the Initiative was closer to that of the African Development Bank than that of the Inter-American Development Bank, given the level of IFAD's exposure to HIPC in Africa.
- (iv) IFAD would continue its dialogue with Member States in order to obtain feedback that would allow it to prepare for the next Trust Fund technical meeting. To this effect, IFAD management would prepare a proposal for an appropriate ratio of internal to external resources for the financing of IFAD's Debt Initiative requirements. The view was expressed that on the basis of this proposal, it would be useful to have another meeting of Initiative donors before the next technical meeting.

VI. RECOMMENDATIONS

24. It is recommended that the Executive Board:

- (i) take note of the status of implementation of the Debt Initiative and IFAD's participation therein;
- (ii) approve the proposed contribution to the reduction of the debt to IFAD of Ethiopia, as of 7 July 2001, for an amount of SDR 12.4 million in 2001 NPV terms. This relief will be provided according to the terms of the following resolution:

RESOLVED: that the Fund, upon declaration at the completion point by the International Monetary Fund and the World Bank that Ethiopia has satisfied the conditions for debt relief under the Debt Initiative for Heavily Indebted Poor Countries, shall reduce the value of the debt to IFAD for Ethiopia, through the reduction by up to 100% of its respective semi-annual debt-service obligations to IFAD (principal and service-charge/interest payments), as these fall due after the respective completion point, and up to the aggregate SDR net-present-value amount of SDR 12 400 000 in 2001 NPV Terms;

- (iii) take note that the President of IFAD will transfer from IFAD's internal resources to the Trust Fund account amounts equivalent to USD 14 million and 27 million in 2002 and 2003 respectively, as and when required; and
- (iv) take note of and support IFAD's efforts to mobilize additional external resources to help finance the Fund's participation in the Debt Initiative.