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Enabling the rural poor
to overcome poverty

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

Proposal for the Democratic Republic of Sao Tome and Principe and 2007 interim progress report

Executive Board — Ninety-first Session
Rome, 11-12 September 2007

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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Recommendation for approval

The Executive Board is invited to approve a proposal for debt relief top-up under the Debt Initiative for Heavily Indebted Poor Countries (HIPC) (Democratic Republic of Sao Tome and Principe), and to take note of the transfer from IFAD's internal resources to the Trust Fund account, and of the status of implementation of the HIPC Initiative and IFAD's participation therein, in accordance with the recommendation contained in paragraph 14.

IFAD's participation in the Debt Initiative for Heavily Indebted Poor Countries – Proposal for the Democratic Republic of Sao Tome and Principe and 2007 interim progress report

I. Introduction

1. The purpose of this paper is to:
 - Seek the Executive Board's approval for debt relief top-up at completion point for the Democratic Republic of Sao Tome and Principe under the Debt Initiative for Heavily Indebted Poor Countries (HIPC);
 - Have the Executive Board take note that the President of IFAD has transferred from IFAD's internal resources to the Trust Fund account an amount equivalent to US\$10 million;
 - Inform the Executive Board of the status of implementation of the HIPC Debt Initiative and of IFAD's participation in the Initiative.

II. Country case for top-up: Sao Tome and Principe

2. In December 2000, Sao Tome and Principe reached its decision point under the enhanced HIPC Debt Initiative; and at its seventy-second session (document EB 2001/72/R.15), IFAD's Executive Board approved debt relief for the country for an amount of SDR 2.04 million in December 1999 net-present-value (NPV) terms. This was equivalent to a 83 per cent reduction of Sao Tome and Principe's debt outstanding with IFAD in December 1999. The approved NPV debt relief amounted to SDR 4.5 million in nominal debt-service relief on a pay-as-you-go basis.
3. In February 2007, Sao Tome and Principe reached its completion point. The debt situation had deteriorated between the decision and the completion point, primarily because of fundamental changes in the country's economic circumstances triggered by exogenous factors. Lower export prices largely owing to drought conditions, lower than expected tourism receipts and changes in cross-currency exchange rates are all unambiguously exogenous factors that lie beyond the control of the authorities.
4. In approving the completion point and recognizing the deterioration in the debt situation of Sao Tome and Principe during the interim period, the Executive Boards of the World Bank and the International Monetary Fund (IMF) approved a top-up of the debt relief approved at decision point for amounts equivalent to 44.7 per cent of the debt outstanding in December 2005, after delivery of the debt relief approved at decision point. The total additional assistance has been calculated by the IMF and World Bank at US\$25.0 million in NPV terms. This would bring the NPV of the debt-to-export ratio of Sao Tome and Principe to the 150 per cent threshold established under the enhanced HIPC Debt Initiative framework.
5. IFAD's Executive Board is therefore requested to approve a top-up of the debt relief approved for Sao Tome and Principe in an amount equivalent to SDR 268,000 (US\$383,000) in December 2005 NPV terms. The total amount of debt relief to be provided by IFAD would thereby amount to SDR 2.31 million in NPV terms (SDR 2.04 million in December 1999 NPV terms, and SDR 268,000 in December 2005 NPV terms).

III. Progress in implementation of the HIPC Debt Initiative

6. With the inclusion of Sao Tome and Principe, 22 countries have now reached completion point and eight are in the interim period between decision point and completion point (see table below). The pace at which countries in the interim period

have reached their completion points has accelerated over the last two years, as countries have made progress in implementing their macroeconomic programmes and poverty reduction strategies. Since September 2005, Cameroon, Malawi, Rwanda and Sierra Leone have all reached their completion points, with the IFAD Executive Board approving top-ups for Malawi and Rwanda. In addition, The Gambia could reach its completion point by the second half of 2007, and a decision point document could be ready for the Central African Republic in early 2008.

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

<i>Completion point countries (22)</i>	<i>Decision point countries (8)</i>	<i>Pre-decision point countries (10)</i>
Benin	Burundi	Central African Republic
Bolivia	Chad	Comoros
Burkina Faso	Republic of the Congo	Côte d'Ivoire
Cameroon	Democratic Republic of the Congo	Eritrea
Ethiopia	Gambia (The)	Kyrgyzstan
Ghana	Guinea	Liberia
Guyana	Guinea-Bissau	Nepal
Honduras	Haiti	Somalia
Madagascar		Sudan
Malawi		Togo
Mali		
Mauritania		
Mozambique		
Nicaragua		
Niger		
Rwanda		
Senegal		
Sierra Leone		
Sao Tome and Principe		
Uganda		
United Republic of Tanzania		
Zambia		

A. Total cost of the HIPC Debt Initiative at IFAD

7. The total NPV cost of the Fund's participation in the full HIPC Debt Initiative is currently estimated at SDR 311.3 million (equivalent to approximately US\$471.9 million), which corresponds to an approximate nominal cost of **SDR 456.3 million (about US\$691.5 million)**.¹ The current cost estimates are likely to increase as a result of delays by countries in 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 to be approximately US\$40.0 million in 2007.

B. IFAD commitments to date

8. To date, IFAD has committed the required debt relief to all 30 heavily indebted poor countries (excluding Haiti, which has not yet been approved) that have reached their decision point. IFAD's total commitments so far amount to SDR 214.3 million (approximately US\$324.8 million) in NPV terms, or **SDR 323.3 million (about US\$489.9 million)** of debt service relief in nominal terms.

¹ 30 June 2007 base estimates at exchange rates prevailing at 30 June 2007.

C. Debt relief provided

9. IFAD has thus far provided US\$155.0 million in debt relief to the 22 countries that have reached completion point. The total debt relief outstanding (i.e. still to be provided by IFAD) at December 2006 is US\$155.4 million.²

D. Financing of IFAD's debt relief

10. IFAD is funding its participation in the Debt Initiative through external contributions (paid either directly to IFAD or transferred through the World Bank-administered HIPC Trust Fund) and its own resources. External contributions (paid or pledged) amount to about US\$79.1 million (48 per cent). IFAD's own resource contributions amount to about US\$80.0 million (49 per cent) under two separate Executive Board-approved transfers in 1998 and 1999, a transfer in 2002 of US\$41.0 million, and a further transfer of US\$10 million in March 2007, of which the Executive Board took note. The balance has been covered by investment income from the IFAD HIPC Trust Fund balance.
11. As at end-June 2007, the balance in IFAD's HIPC Trust Fund was US\$5.2 million. With the estimated payments to be made in 2007, **the Executive Board is herewith informed that the President of IFAD transferred from IFAD's internal resources to the Trust Fund account amounts equivalent to US\$10 million in July 2007.** The first transfer from the World Bank-administered HIPC Trust Fund is expected in the second half of 2007.

E. Update on the HIPC Trust Fund and IFAD's resource mobilization

12. 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 World Bank-administered HIPC Trust Fund. This was agreed at the HIPC information and funding meeting held on 19 November 2006 in Washington, D.C. It was recognized that such access would add to the overall financing requirements of the HIPC Trust Fund, which will mean approximately US\$282.0 million in additional donor funding for IFAD. Technical discussions with the World Bank-administered Trust Fund are currently under way for an initial payment to IFAD to meet the agreed 67 per cent contribution to outstanding debt relief for countries that have already passed Completion Point. It is anticipated that an initial payment of US\$104.1 million will be made. Subsequent grant agreements with IFAD will be concluded as additional countries reach Completion Point. The total financing gap (in terms of needed commitment authority) for the HIPC Trust Fund, taking into account IFAD's and the African Development Bank's funding needs, is estimated to be US\$212 million. This includes pledges made at the Trust Fund meeting in June 2007 and the World Bank Trust Fund managers are now assessing the current level of additional funding required.
13. 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 directly with additional resources to help finance its participation in the Debt Initiative.

IV. Recommendation

14. It is recommended that the Executive Board:
- (a) Approve the proposed top-up of IFAD's contribution to the reduction of the debt of the **Democratic Republic of Sao Tome and Principe** to IFAD as of December 2005 (see paragraph 5 above), in an amount equivalent to SDR 268,000. This relief will be provided in accordance with the terms of the following resolution:

² This excludes Sao Tome Principe and Sierra Leone, which both reached Completion Point in 2007.

“RESOLVED: that the Fund, upon the decision of the Executive Board, shall lower the value of Sao Tome and Principe’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, and up to the revised aggregate net-present-value (NPV) amount of up to SDR 2.31 million (consisting of SDR 2.04 million in 1999 NPV terms and SDR 268,000 in 2005 NPV terms).”

- (b) Take note that the President of IFAD has transferred from IFAD’s internal resources to the Trust Fund account an amount equivalent to US\$10 million;
- (c) Take note of the status of implementation of the HIPC Initiative and IFAD participation therein.