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Enabling poor rural people
to overcome poverty

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

Proposals for the Central African Republic and the Republic of Liberia and the 2008 progress report

Executive Board — Ninety-fifth Session
Rome, 15-17 December 2008

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document before the session:

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Recommendation for approval

The Executive Board is invited to approve two new country cases for debt relief under the Debt Initiative for Heavily Indebted Poor Countries (Central African Republic and Republic of Liberia), and the submission of the substance of this paper to the thirty-second session of the Governing Council for information, in accordance with the recommendation contained in paragraph 42.

IFAD's participation in the Debt Initiative for Heavily Indebted Poor Countries – Proposals for the Central African Republic and the Republic of Liberia and the 2008 progress report

I. Introduction

1. The objective of this progress report for 2008 is to:
 - Seek the Executive Board's approval of two new country cases (Central African Republic and the Republic of Liberia) for debt relief under the Debt Initiative for Heavily Indebted Poor Countries (HIPC);
 - 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: Central African Republic

2. In September 2007, 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 Central African Republic under the enhanced HIPC Debt Initiative.
3. For most of the period since independence in 1960, the Central African Republic has experienced political instability and successive periods of armed conflict, resulting in weak governance and poor socio-economic outcomes. A new constitution establishing a presidential system was adopted in December 2004, and presidential and parliamentary elections were held during the first half of 2005.
4. Sustained reconciliation and the strengthening of the democratization process are constrained by limited resources and deep-rooted challenges to the rule of law, both of which contribute to an erosion of public trust. The security situation has improved, but tensions linger and the situation remains fragile. This protracted, low-intensity conflict continues to pose challenges to the Central African Republic, hindering prospects for recovery and reconstruction, particularly in rural areas, and raising the risk of disorder in the region.
5. In this fragile security context, economic recovery remains modest while the financial situation continues to be difficult, undermining the Government's ability to provide services to its population. The donor consultations (in June and October 2007) in Brussels have underlined the need for stepped-up and coordinated actions from all partners to maintain a climate of security and to support the Government's efforts to achieve social and economic objectives.
6. The Central African Republic is one of the poorest countries in the world. Over a long period, real GDP growth has lagged population growth, resulting in a substantial decline in per capita income. Household survey data, collected in 2003 with the support of the United Nations Development Programme, suggest that more than two thirds of the population live below the (income) poverty line, with about one third in extreme poverty. Rural poverty has been intensified by the conflict, which caused population displacement and declining agricultural production, and by isolation resulting from the poor condition of rural roads. As such, the Central African Republic is unlikely to achieve its Millennium Development Goals by 2015. Public-sector contribution to the provision of basic social services is limited and inequitable, which adds to the vulnerability of the poor population, and

the private sector is not equipped to fill the gaps in the provision of these basic social services.

7. Nevertheless, since mid-2005, the Central African Republic has made significant progress in strengthening macroeconomic stability. The economy has gradually recovered despite a difficult external environment, political and social instability, fluctuating world oil prices, and a low level of foreign assistance. Real GDP grew by 4.1 per cent in 2006, supported by traditional exports (diamonds and timber), increased activity in the service sector, and to a lesser extent public investment. Inflation has declined; the twelve-month rate through June 2007 was 1.6 per cent, and implementation of macroeconomic and structural policies has generally been satisfactory. The Government's fiscal objectives have been achieved through tight control over expenditures, which is needed to address the unpredictability of programmed aid inflows.
8. In addition, although the Central African Republic ranks below the average for sub-Saharan Africa in governance indicators, particularly those measuring government effectiveness and rule of law, progress in governance has nonetheless been achieved, particularly in the transparency of public financial management. The Government has published fiscal, economic and judicial information on its website. A number of measures have been pursued to enhance the control and monitoring of public spending. These include efforts to strengthen the budget process through a new organic budget law and a new budget nomenclature to track revenue and expenditure from commitment to payment on a functional basis. Moreover, the authorities are committed to civil service reform, with a view to enhancing the efficiency and effectiveness of public spending, containing the civil service payroll and improving service delivery.
9. At the sectoral level, the authorities are pursuing measures to address the main obstacles to growth and poverty reduction. In the forestry sector, the Government is revising the legal and regulatory framework with respect to the environment and communities to improve transparency and increase domestic value added and tax collection. The Government is committed to ensuring compliance with the new forestry code and has banned the use of special forestry harvesting permits, which have enabled foresters to harvest without being in compliance with the code. In the transport sector, the Government plans to rehabilitate rural tracks and roads in agricultural areas, and open up isolated areas of the country.
10. Furthermore, the Government has relaunched the preparation of the full poverty reduction strategy paper (PRSP), and its priorities are to (i) consolidate peace and security, (ii) improve governance and institutional and administrative capacity, (iii) promote macroeconomic stability and economic growth, and (iv) improve access to essential services and infrastructure. The PRSP was completed and approved by the cabinet in June 2007. The Government finalized the first progress report on PRSP implementation for submission to IDA and the IMF in September 2008.
11. Average annual real GDP growth over the period 2007-2026 is projected at 4.2 per cent. This growth rate assumes the maintenance of security and political stability, improvements to the country's institutional and administrative capacity, and appropriate macroeconomic policies. This environment should lead to an increase in private investment, especially in the forestry, mining and telecommunications sectors. Public investment in infrastructure will help revive the agriculture sector, which dominates economic activity. The projected path of growth assumes the reengagement of the international community and a sustained increase in inflows of foreign assistance.
12. The Central African Republic's public and publicly guaranteed external debt was estimated at US\$1.1 billion in nominal terms at end-December 2006, equivalent to about US\$856 million in net present value (NPV) terms. Multilateral creditors accounted for 63 per cent of the total debt (in nominal terms). Bilateral creditors

accounted for about 32 per cent, with Paris Club creditors having a relatively low share (7 per cent). Commercial creditors account for the remainder of the external debt stock.

13. Largely due to political and economic instability over the period 2001-2005, the Central African Republic 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, 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. In addition, the European Commission has indicated its intention to support the Central African Republic's arrears clearance to IFAD with a grant of EUR 3 million, which is currently being finalized.
14. The stock of the Central African Republic's external public and publicly guaranteed debt (estimated at US\$856 million in NPV terms) is equivalent to 470 per cent of exports of goods and services. The Central African Republic thus qualifies for debt relief under the HIPC Initiative, having an NPV of debt-to-exports ratio well above the 150 per cent threshold. Reducing the country's NPV of debt-to-exports ratio from 470 per cent to 150 per cent would require HIPC debt relief of US\$583 million in NPV terms. This implies a common reduction factor of 68 per cent. Based on proportional burden-sharing, multilateral assistance, including through IFAD, would amount to US\$365 million (in NPV terms) and bilateral and commercial assistance to US\$218 million (also in NPV terms).
15. The Executive Board is requested to approve: (i) the Fund's contribution to debt relief for the Central African Republic in the amount of 10.4 million special drawing rights (SDR) (or about US\$15.7 million) in 2006 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 12.2 million in nominal terms to be provided over a 12-year period.
16. Upon reaching the HIPC completion point, the Central African Republic will also qualify for additional debt relief under the Multilateral Debt Relief Initiative (MDRI). Three creditors will provide debt relief under the MDRI: the African Development Bank, IDA and the IMF. These creditors will provide 100 per cent debt relief on all debt disbursed. After delivery of HIPC and MDRI assistance, Central African Republic's NPV of debt-to-exports ratio is expected to fall significantly – to 53 per cent – the year following completion point.
17. The Central African Republic authorities have welcomed the opportunity to reach the HIPC decision point, as the only means to alleviate their unsustainable external debt burden. In their view, this debt burden draws scarce public resources away from the country's vast needs and prevents a scaling up of aid inflows that are required to restore the economic infrastructure and promote growth-enhancing and poverty-reducing social policies. They emphasize the current predicament of the country: a budget that provides only for minimal government services, resulting in, among others, the lack of basic health care, potable water, sanitation facilities and electricity for the majority of the population, and the impact of these factors on the fragile security in the country. The authorities stress that with strong programme ownership, they hope to reach the completion point as soon as possible. They recognize the importance of continuing strong relations with the international community, which is a critical source of financial and, importantly, technical assistance. In this regard, IFAD has initiated discussions with the Government to

¹ As at 31 December 2006, the Central African Republic's outstanding principal debt to IFAD stood at SDR 22.5 million; and this amount included the principal element of the SDR 3.8 million of arrears at that date. (Service charge arrears amounted at that date to SDR 1.4 million.)

restart the Fund's programme in the country. Under the current terms of the Debt Sustainability Framework, IFAD's future assistance will be on grant terms.

18. The Central African Republic will reach its completion point under the enhanced HIPC Initiative when the following sector-specific triggers have been reached (in addition to the standard triggers): public financial management, natural resource (mining and forestry sector) management, civil service reform, and basic health provision, HIV/AIDS prevention and education reform. The Central African Republic is expected to reach its completion point by end-2009.

III. New country case: Liberia

19. In February 2008, the IMF and IDA executive boards agreed to support a comprehensive debt reduction package for the Republic of Liberia under the enhanced HIPC Debt Initiative.
20. Between the mid-1940s and the 1960s, Liberia's economy grew at rates ranging from 4 to 7 per cent annually. However, marginalization, mismanagement, and perceived inequalities in the distribution of benefits from national resources sowed the seeds for a 1980 coup. GDP growth fell from 5 per cent in the early 1970s to less than 1 per cent in the mid-1980s. After 1980, Liberia entered a protracted period of instability that included civil wars in 1989-1996 and 2000-2003. By 2003, most of the country's roads and railroads, electricity generation and transmission, and potable water and sewage systems had been destroyed.
21. After over 20 years of instability, the Comprehensive Peace Agreement reached in Accra, Ghana, in August 2003 initiated a political transition. The National Transitional Government of Liberia, established under the peace agreement, governed Liberia until the completion of legislative and presidential elections in October-November 2005. An elected government headed by President Ellen Johnson-Sirleaf assumed office on 16 January 2006.
22. Liberia is now one of the poorest countries in Africa. The 14-year civil war had a devastating impact on Liberia's economy, reducing real GDP to about 40 per cent of its pre-war level. An estimated 64 per cent of the population live below the national poverty line, with 48 per cent living in extreme poverty. Only an estimated 17 per cent of the labour force is formally employed. Surveys supported by the United Nations Development Programme and the Food and Agriculture Organization of the United Nations/World Health Organization show that many households face food insecurity and lack access to basic services. Indeed, 11 per cent of surveyed households were food-insecure, 40 per cent were highly vulnerable to food insecurity, 41 per cent were moderately vulnerable to food insecurity, and only 9 per cent were food-secure.
23. Since 2005, the economy has recovered strongly, underpinned by a relatively stable macroeconomic environment. Following modest growth of 2 per cent in 2004, real GDP growth is estimated to have increased to 9 per cent in 2007. The recovery has been supported mostly by a turnaround in agriculture and the impact of a large donor presence in the services sector.
24. In September 2005, the National Transitional Government of Liberia and its international partners signed the Governance and Economic Management Assistance Program (GEMAP). GEMAP is a direct response to the concerns of the Government and partners about the mismanagement of public resources in the post-conflict transition and the threat this poses to the peace process. An economic governance steering committee, chaired by the President and comprising administration officials and representatives of the Central Bank of Liberia, international partners and civil society, oversees GEMAP implementation. GEMAP has six components: (i) securing Liberia's revenue base; (ii) improving budgeting and expenditure management; (iii) improving procurement practices and the granting of concessions; (iv) establishing processes to control corruption;

- (v) supporting institutions that are key to promoting and sustaining government accountability and good financial management; and (vi) capacity-building.
25. The Government's medium-term policy framework, defined in its PRSP and presented to the Liberia Poverty Reduction Forum in June 2008, aims to promote rapid economic growth, create jobs, secure macroeconomic stability, reduce poverty and help Liberia make progress towards the Millennium Development Goals. Agriculture, the primary source of livelihood for most of the population, is a major component of economic revitalization. Many households reverted to subsistence farming during the war. However, few resources are available to smallholders, and the poor transportation network makes it hard for farmers to get products to market. Recovery has been quicker in the commercial plantation sector because the high price of rubber has spurred investment. The Government's strategy focuses on efforts to increase yields and production in key cash and export crops using both smallholder and commercial plantation sectors. It also supports measures to create efficient supply chains and more opportunity for value-added and off-farm employment, including the necessary infrastructure for cash and export crops. The Government has also taken steps to strengthen forest-sector management to ensure that the sector is managed in a sustainable manner and benefits the population.
 26. IFAD is contributing to these initiatives, with support offered by Italian supplementary funds (US\$2.5 million) for the development of a programme in Liberia to support vulnerable groups in rice production and productivity.
 27. Liberia's public and publicly guaranteed external debt was estimated at US\$4.7 billion in nominal terms at end-June 2007. At that time, Liberia's largest individual creditors were the IMF (17 per cent of total claims) and the International Bank for Reconstruction/IDA (9 per cent of total claims). The largest bilateral creditors are Germany and the United States (each holding 9 per cent of total claims).
 28. Most of Liberia's external debt (about 96 per cent) was in arrears at end-June 2007. Some 93 per cent of its debt to multilateral creditors was in arrears. Strategies for arrears clearance with Liberia's six smaller multilateral creditors have been agreed or are under discussion. Consistent with the standard HIPC Initiative methodology, clearance of arrears to multilateral creditors will be counted towards their contribution to debt reduction under the HIPC Initiative.
 29. Liberia's debt in NPV terms, after full application of traditional debt relief mechanisms, is an estimated US\$3,143.9 million (as at end-June 2007). This is equivalent to 1,576 per cent of exports of goods and services. Liberia would thus qualify for debt relief under the HIPC Initiative's export window, based on end-June 2007 data, having an NPV of debt-to-exports ratio above the 150 per cent threshold. The reduction of Liberia's NPV of debt-to-exports ratio from 1,576 per cent to 150 per cent would require HIPC debt relief of US\$2,845.5 million in end-June 2007 NPV terms. This implies a common reduction factor of 90.5 per cent after traditional debt relief, one of the largest common reduction factors thus far under the HIPC Initiative. Under a proportional burden-sharing approach, multilateral creditors would contribute approximately US\$1,425.8 million and bilateral and commercial creditors about US\$1,419.6 million.
 30. The Executive Board is requested to approve: (i) the Fund's contribution to debt relief for the Republic of Liberia in the amount of SDR 13.8 million (or about US\$21.0 million) in 2007 NPV terms;² and (ii) the provision of 100 per cent of debt relief during the interim period. The debt service relief is forecasted to amount to

² As at 31 December 2007, Liberia's outstanding principal debt to IFAD stood at SDR 10.2 million; and this amount includes the principal element of the SDR 7.8 million of arrears at that date (service charge arrears amount at that date to SDR 6.5 million).

approximately to SDR 14.2 million in nominal terms, to be provided over a three-year period.

31. On reaching the completion point under the HIPC Initiative, Liberia will qualify for MDRI debt relief from IDA and the African Development Fund; it will also qualify for beyond-HIPC assistance from the IMF. After the completion point, Liberia's NPV of debt-to-exports ratio will significantly fall, remaining below 17 per cent over the projection period (through 2026/27).
32. The delivery of HIPC assistance at completion point will be contingent on the fulfilment of completion point triggers: (i) prepare a full PRSP through a participatory process and satisfactorily implement it for at least a year, as evidenced by an annual progress report; (ii) maintain macroeconomic stability as evidenced by satisfactory performance under the IMF-supported Poverty Reduction and Growth Facility; and (iii) implement key governance, public finance, social-sector and debt management measures. These triggers are designed to ensure that, prior to the completion point, Liberia has transitioned from the current GEMAP-supported fiduciary arrangements to permanent systems and procedures to ensure efficient and effective use of public resources. In addition, the triggers will help ensure progress in other critical aspects of the poverty reduction strategy. It is expected that, if the country maintains macroeconomic stability and makes good progress on its PRSP, all triggers could be achieved within three years of the HIPC decision point.
33. Medium-term expenditure priorities identified in the Government's PRSP include the following in the agricultural sector: preparing a national food security policy; providing seeds and tools to smallholders through regional seed centres; rehabilitating 1,000 hectares and 100 abandoned fish ponds; assisting 2,000 coastal fishers; providing 1,000 short-cycle ruminants; revitalizing the tree crops subsector; increasing investment in commercial plantations; identifying impediments to private-sector participation in agriculture and endorsing appropriate incentives; reactivating extension services; and restructuring agricultural marketing credit and input supply through the private sector.

IV. Progress in HIPC Debt Initiative implementation

34. Since the inception of the HIPC Initiative 12 years ago, there has been substantial progress with respect to the implementation of HIPC debt relief. More than three quarters of eligible countries (33 out of 41) have passed their decision points, qualifying for HIPC assistance. Twenty-three countries have now reached the completion point and nine 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 progress in implementing their macroeconomic programmes and poverty reduction strategies. Since September 2005, Cameroon, the Gambia, Malawi, Rwanda, Sao Tome and Principe, and Sierra Leone have all reached their completion points, with the IFAD Executive Board approving top-ups for Malawi and Rwanda.
35. A decision point document is being prepared for the IMF and World Bank executive boards for Togo, and, upon formal approval and ratification, a new country case will be presented to IFAD's Executive Board at its April 2009 session. It is anticipated that Burundi, Haiti and Guinea could reach their completion points in early/mid-2009.
36. 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 HIPCs 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 have currently 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 HIPC countries to implement sound borrowing policies and strengthen their capacity in public debt management. IFAD is supporting this through its participation in the Debt Sustainability Framework, reporting of all debt information, and liaison with the World Bank and regional development banks.

A. Total cost of the HIPC Debt Initiative to IFAD

37. The total NPV cost of the Fund's participation in the overall HIPC Debt Initiative³ is currently estimated at SDR 313.6 million (equivalent to approximately US\$483.6 million), which corresponds to an approximate nominal cost of SDR 460.0 million (about US\$709.4 million).⁴ The current cost estimates are likely to increase as a result of countries' delays 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 at US\$38.4 million for 2008.

B. IFAD commitments to date

38. To date, IFAD has committed the required debt relief to all 32 HIPC countries that have reached their decision point. IFAD's total commitments so far amount to SDR 238.5 million (approximately US\$367.8 million) in NPV terms, which amounts to SDR 349.5 million (approximately US\$539.0 million) of debt service relief in nominal terms.

C. Debt relief provided

39. As at 30 September 2008, IFAD has provided US\$210.0 million in debt relief to the 23 completion point countries.

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

<i>Completion point countries (23)</i>	<i>Decision point countries (9)</i>	<i>Pre-decision point countries (8)</i>
Benin	Burundi	Comoros
Bolivia	Central African Republic ^a	Côte d'Ivoire
Burkina Faso	Chad	Eritrea
Cameroon	Congo	Kyrgyzstan
Ethiopia	Democratic Republic of the Congo	Nepal
Gambia (The)	Guinea	Somalia
Ghana	Guinea-Bissau	Sudan
Guyana	Haiti	Togo
Honduras	Liberia ^a	
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 2008 session.

³ This includes all eligible Debt Initiative for HIPC countries including pre-decision point countries.

⁴ 30 June 2008 base estimates at exchange rates prevailing at 30 September 2008.

D. Financing of IFAD's debt relief

40. IFAD is funding its participation in the HIPC 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\$80.3 million (28.1 per cent). IFAD's own-resource contributions amount to about US\$94.7 million (33.1 per cent) under Executive Board-approved transfers in 1998, 1999, 2002 and a further transfer of US\$25 million in 2007. The rest has been covered by investment income from the IFAD HIPC Trust Fund balance.
41. 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 this 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. Separate grant agreements for supporting debt relief for the Gambia, Sao Tome and Principe and Sierra Leone, totalling approximately US\$18.1 million, are being finalized with the HIPC Trust Fund administrators. 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\$308 million. 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.

V. Recommendations

42. It is recommended that the Executive Board:
- (i) Approve the proposed contribution to the reduction of the Central African Republic's debt to IFAD as of 31 December 2006 (see paragraph 15), in the amount of SDR 10.4 million in end-2006 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 Central African Republic's debt to IFAD through the integration of its arrears to IFAD into the debt relief and 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 10.4 million in 2006 NPV terms. The debt relief will be provided during the interim period, i.e. between the decision point and the completion point, but it will only become legally effective at completion point for the country."
 - (ii) Approve the proposed contribution to the reduction of the Republic of Liberia's debt to IFAD as of 30 June 2007 (see paragraph 30), in the amount of SDR 13.8 million in 2007 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 Republic of Liberia's debt to IFAD through the integration of its arrears to IFAD into the debt relief and 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 13.8 million in 2007 NPV terms. The debt relief will be provided during the interim period, i.e. between the decision point and the

completion point, but it will only become legally effective at completion point for the country.”

- (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 2008 progress report.