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IFAD'S PARTICIPATION IN THE DEBT INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES:

PROGRESS REPORT FOR 2003

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1. The purpose of the present paper is to provide the Governing Council with up-to-date information on the implementation of the Debt Initiative for Heavily Indebted Poor Countries (HIPCs) in 2003. This also includes a progress report on IFAD's participation, as approved by the Executive Board at its December 2003 Session (EB 2003/80/R.18/Rev.1).

A. 2003 Progress Report on Implementation of the HIPC Initiative

Estimated Costs of the HIPC Initiative

2. The total cost of the Initiative for 34 HIPCs is estimated at USD 39.4 billion in 2002 NPV terms, against the earlier USD 37.3 billion in 2001 NPV terms. Of these total costs, USD 33.3 billion is associated with the 27 countries that have reached their decision points. These costs are equally divided between bilateral and multilateral creditors, and in nominal terms represent about USD 51.1 billion in debt service relief over time. These estimates do not include Angola, Kenya, Viet Nam or Yemen, which are estimated to have debt ratios below Initiative thresholds.

3. In addition, the estimates do not include the costs for Laos, Liberia, Somalia and The Sudan due to data problems and in some cases protracted arrears. Preliminary calculations suggest that including these countries could increase the cost of HIPC Initiative relief by more than 25% (or USD 10.6 billion) to USD 50.0 billion in 2002 NPV terms. Most of these additional costs are concentrated in The Sudan. The cost of Initiative debt relief could further increase by an estimated USD 729 million because of topping-up of Initiative assistance at the completion point. Under the enhanced HIPC Initiative, in exceptional cases consideration can be given to providing additional debt relief at the completion point beyond that committed at the decision point. Eligibility for additional relief at the completion point is determined on a case-by-case basis and may be applied in cases where a country suffers from an exogenous shock that leads to a fundamental change in its economic circumstances. Current estimates suggest that seven of the 19 interim-period countries could have debt above HIPC Initiative thresholds when they reach their completion points.

Decision-Point Countries and Countries Moving to Completion Point

4. **Approvals**. The Democratic Republic of The Congo reached its decision point in June 2003, bringing the number of decision-point countries to 27 (see Table 1).

TABLE 1: THE 42 HEAVILY INDEBTED POOR COUNTRIES

27 Countries with Enhanced Initiative Decision Points	11 Countries Not Yet at Decision Point	4 Possibly Sustainable Country Cases
Cameroon, Chad, D.R. Congo (with interim relief from IFAD), Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau (with interim relief from IFAD), Guyana, Honduras, Madagascar, Malawi, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone (with interim relief from IFAD), Zambia ***and 8 at completion point:*** Benin, Bolivia, Burkina Faso, Mali, Mauritania, Mozambique, United Republic of Tanzania, Uganda *and Guyana under the original HIPC Initiative*	Burundi, Central African Republic, Comoros, Congo, Côte d'Ivoire, Laos, Liberia, Myanmar (no IFAD exposure), Somalia, Sudan, Togo	Angola, Kenya, Viet Nam, Yemen

5. Since late 2002, Benin and Mali have reached their **completion points**. As shown in Table 1, so far eight countries have reached their completion points under the enhanced HIPC Initiative, in addition to Guyana, which reached its completion point under the original Initiative. Looking ahead, Ethiopia, Guyana, Nicaragua, Niger, Rwanda and Senegal could reach their completion points by the end of 2003 or early in 2004.

6. Debt relief under the enhanced Initiative is provided on an irrevocable basis at the completion point after satisfactory completion of measures in three broad areas: maintaining macroeconomic stability; implementing a poverty-reduction strategy developed through a broad participatory process; and implementing social and structural reforms. Delays in reaching the completion point have been attributed to the challenge of maintaining macroeconomic stability and preparing and implementing poverty-reduction strategies. Most countries facing such challenges have either adopted the necessary policy changes or are making efforts to do so. Preparing fully participatory PRSPs has taken longer than expected, but 15 of the 19 interim-period countries have finalized them and are unlikely to be constrained by the one-year satisfactory implementation requirement from reaching the completion point in 2004. Good progress has been made in satisfying social and structural triggers. Although these triggers have not been the proximate cause of delays so far, they could cause delays in some countries in the future. The process of reaching the completion point has taken longer than anticipated and challenges remain in reaching the decision point, but existing standards for policy performance are being maintained to ensure that the Initiative's objectives are reached.

7. **Impact of the HIPC Initiative.** In 2002 NPV terms, **debt stocks** of the 27 HIPCs that have reached their decision points are projected to decline from USD 77 billion to 26 billion after the full delivery of traditional debt relief, assistance under the HIPC Initiative, and additional bilateral relief committed by several creditors. Debt-stock reduction in the eight countries that reached their completion points averaged more than 60% in 2002 NPV terms. The weighted average **NPV of debt-to-exports ratio** for the 27 decision-point countries is projected to decline from almost 300% before HIPC Initiative relief at the decision point to 128% by 2005 when most HIPCs are expected to have reached their completion points. The weighted average **NPV of debt-to-GDP** ratio is projected to decline from 60% before Initiative relief at the decision point to 30% in 2005. These projected levels are close to those of other low-income countries. Initiative relief is projected to substantially lower the **debt-service-to-exports ratio** for most HIPCs that have reached the decision point. By 2001, the average debt-service-to-exports ratio for HIPCs had already fallen to below the corresponding ratio in other low-income countries. The debt-service-to-exports ratio for the 27 decision-point countries declined from an average of 15.7% in 1998 and 1999 to 9.9% in 2002. Significant debt-service reductions start occurring before the completion point due to the provision of interim relief. Exceptions are countries with arrears, such as the Democratic Republic of The Congo, where debt-service ratios rise significantly after the enhanced decision point. The increase is partly due to the resumption of debt-service payments following the arrears clearance operation, as the Democratic Republic of The Congo had not been servicing most of its debt in the previous period. **Poverty-reducing expenditures** in the 27 decision-point countries were almost four times as great as debt-service payments in 2002. Their annual debt service is projected to be about 30% lower during 2001-05 than in 1998 and 1999, freeing about USD 1.0 billion in annual debt-service savings. Poverty-reducing expenditures, meanwhile, increased from about USD 6.1 billion in 1999 to USD 8.4 billion in 2002, and are projected to increase to USD 11.9 billion in 2005. Country authorities are putting in place public expenditure management systems that would ensure the efficiency of poverty-reducing expenditures.

8. A key premise of the HIPC Initiative – that **debt relief should be additional to other forms of external financing assistance** – appears to be borne out by the facts. For the 27 decision-point countries, both gross and net flows increased during 1997-2002. On a gross basis, official flows increased from about USD 8 billion in 1997 to almost USD 12 billion in 2002, with half of the increase due to HIPC Initiative relief. Net resource flows (i.e. the difference between gross resource inflows and debt service payments) also increased substantially once the enhanced Initiative got

underway. It should be noted, however, that official external financing flows to the 27 decision-point countries declined substantially in the mid-1990s (as they did to other low-income countries). The recent increase in these flows restores external financing to levels of the early 1990s. The overall increase in resource flows also masks differences across countries and the important role that programme and policy performance may have played in attracting official resources. Average external financing flows in 2000-02 increased in the majority of the 27 decision-point countries relative to average levels in 1997-99, but this was not the case in eight HIPCs. Five of these countries (Guinea-Bissau, Malawi, Nicaragua, Sao Tome and Principe, and Senegal) went through protracted interruptions in their PRGF-supported programmes, which dampened aid inflows. Two other countries (Mali and Mauritania) experienced delays in grant or loan disbursements. Rwanda benefited from very high inflows during the late 1990s, though they ebbed somewhat in the following years.

Remaining Countries

9. The HIPC Initiative is open to all eligible countries that establish a performance record leading to the decision point by the end of 2004 when the sunset clause takes effect. The sunset clause stems from the 1996 Program of Action, which established a time limit in order to prevent the HIPC Initiative from becoming a permanent facility and to encourage HIPCs to adopt adjustment programmes that could be supported by the IMF and IDA. Their executive boards subsequently agreed to two-year extensions in 1998, 2000 and 2002. Some HIPCs could start establishing a policy performance record before the sunset clause takes effect by the end of 2004, in order to reach the decision point.

10. The Republic of The Congo could have a preliminary HIPC Initiative document prepared by the World Bank and the IMF before the end of 2003, barring unanticipated complications. The crucial process for settling outstanding arrears (a condition for a spring 2004 approval of the PRGF and a possible September 2004 decision point) is well underway; with a significant ad hoc meeting (hosted by the OPEC Fund for International Development and chaired by the World Bank) held in October 2003 in Vienna, Austria, in view of a forthcoming Consultative Group meeting.

11. Domestic conflict is a dominant factor in most HIPCs that have yet to reach the decision point. In most of these countries, continuing domestic conflict or unsettled transitions from post-conflict situations have hampered effective policy implementation and institution-building. Côte d'Ivoire did not reach its decision point, as anticipated in September 2002, because of civil strife that began in September 2002 and continued into 2003. Progress could not be completed for the Central African Republic due to a resurgence of domestic conflict. Elsewhere, lack of political consensus on important issues such as revenue sharing (the Comoros) or lack of effective implementation of economic and financial policies has been a key impediment in reaching the decision point. Another potential impediment is the settlement of protracted external payment arrears, including arrears to multilateral creditors. In several HIPCs, such as Liberia, Somalia and The Sudan, a concerted international effort would be needed to resolve outstanding arrears. Such an effort appears to be emerging in The Sudan. In a specific meeting in February 2003 (organized by IFAD and chaired by the World Bank) to review arrears clearance arrangements in HIPCs, representatives of multilateral development banks participating in the Initiative endorsed the principle of providing positive or at least non-negative net resource transfers to HIPCs in arrears clearance operations in the context of the Initiative. They also agreed on a stronger process of early consultation and communication.

B. IFAD's Participation in the HIPC Initiative

Country Cases Approved by the Executive Board in 2003

12. **Democratic Republic of The Congo.** Over the past two years, the Democratic Republic of The Congo has made remarkable progress in consolidating the peace process (although outbreaks of

violence continue to occur), stabilizing its economic situation, and creating conditions for sustainable economic growth and poverty reduction. An all-inclusive transitional government was nominated in June 2003, to be followed by free and transparent elections after two years; and the country established its track record of performance under programmes supported by the International Monetary Fund (IMF) and the International Development Association (IDA) (an IMF staff-monitored programme, a Poverty Reduction and Growth Facility (PRGF) arrangement, and renewed IDA lending with an economic recovery credit and the Emergency Multi-Sector Rehabilitation and Reconstruction Project).

13. The Government unified the multiple exchange rates and liberalized prices (including the introduction of a transparent and automatic mechanism for pricing petroleum products). The country broke the vicious circle of hyperinflation and depreciation, returned to normal budgetary procedures (centralization of revenue and expenditure, reduction of extrabudgetary channels, monthly treasury cash-flow plan) and strengthened public finances. However, while overall fiscal performance was broadly on track, the anticipated shift in the composition of expenditures towards pro-poor spending has not materialized (only 7% against the targeted 15%), owing to the shortfall in foreign-financed investment and social outlays, and an increase in security- and sovereignty-related expenditures. The Government has been able to initiate: the rebuilding of agricultural production and enhancement of food security; rehabilitation and reconstruction of critical infrastructure; restoration of essential social services; rebuilding of community infrastructure; and strengthening of its institutional and administrative capacity. Important changes in the judicial and regulatory environment are underway; and further reforms have been initiated in the banking sector (a new banking law, Central Bank independence in the conduct of monetary policy, a recovery plan for solvent commercial banks), in the public enterprises sector and on the governance front (development of an anticorruption strategy, public procurement procedures, government audits). Growth in 2002 was about 3%, and inflation 16% (down from 135% in 2001).

14. In spite of this progress, the country has a per capita gross domestic product (GDP) of USD 99 (2002), and an estimated 80% of the population live on less than USD 0.2 per day. The United Nations Development Programme's Human Development Index 2001 ranked the Democratic Republic of The Congo 167th out of 175 countries. Infant and child mortality rates are well above the high averages for sub-Saharan Africa. The number of people newly infected with HIV increased by a factor of 16 between 1990 and 2000; by 2000, about 1.1 million people were living with HIV/AIDS, and close to one million children had been orphaned by AIDS. Life expectancy declined from 52 years in 1994 to 41 in 2001. Malaria kills 500 000 people per year, while 12.5 million people were infected with sleeping sickness in 2000. In addition, the incidence of tuberculosis and diarrhoeal diseases has increased significantly; 37% of the population have no access to formal health care; and only 18% of households have access to hygienic latrines and 41% to potable water. Some 41% of children under five in the eastern provinces are malnourished, 26% severely so. The child vaccination rate is 29%. Only 17% of the children of the legally required age of six years are enrolled in primary school; and the rural enrolment rate is 10%. Although the Millennium Development Goals appear hard to reach unless growth is sustained at the unattainable level of 8%, the Government remains determined to make significant progress toward achieving them.

15. Rural development is a key instrument for reducing poverty and improving food security. During the next three years of reconstruction, the Government intends to focus on improving agricultural production capacity, enhancing the efficiency of domestic marketing and formulating a comprehensive development strategy. These efforts focus on the rehabilitation of rural access roads and tracks, and the provision of agricultural extension services to farmers, combined with the distribution of seeds and pesticides. The Fund's ongoing country strategy and programme development work is supportive of these goals; and its partnerships with the Belgian Survival Fund and other stakeholders will be crucial for the implementation of such a strategy.

16. **HIPC Initiative for the Democratic Republic of The Congo.** In July 2003, the IMF and World Bank executive boards agreed to support a comprehensive debt-reduction package for the Democratic Republic of The Congo under the HIPC Initiative. The country's eligibility for debt relief under the enhanced HIPC Initiative is evidence of the international community's recognition of its remarkable progress over the past two years in establishing an all-inclusive transitional government, consolidating the peace process, stabilizing the country's economic situation, and creating conditions for sustainable economic growth and poverty reduction.

17. In December 2002, the base year, the country's net present value (NPV) of debt-to-exports ratio stood at 758% and its NPV of debt-to-revenue ratio at 1 794% (after application of the traditional debt relief mechanisms). In order to achieve the target NPV of debt-to-exports ratio of 150%, provided for under the enhanced HIPC Initiative, all multilateral creditors need to provide a reduction of **80.2%** in the NPV of their outstanding claims as at end-December 2002. As a consequence, after a fragile interim period with additional borrowing to finance reconstruction, the NPV of debt-to-exports ratio is expected to drop to 97% in 2009, the NPV of debt-to-revenue ratio to below 250% in 2007, and the debt service ratio to 13.4%. Total relief from all of the Democratic Republic of The Congo's creditors would amount to USD 6.3 billion in NPV terms. Based on proportional burden sharing, multilateral assistance would amount to USD 2.5 billion in NPV terms, Paris Club creditors would provide USD 3.5 billion, non-Paris-Club official bilateral creditors would provide USD 219 million, and commercial lenders USD 161 million. At its December 2003 Session (document EB 2003/80/R.18/Rev.1) the Executive Board approved the Fund's contribution to debt relief for the Democratic Republic of The Congo in the amount of 9.126 million Special Drawing Rights (SDR) (or about USD 12.3 million) in 2002 NPV terms.[1] This amounts to debt service relief equivalent to SDR 13.80 million in nominal terms to be provided over a 19-year period, unless arrears are internalized (see below).

18. The country will reach its completion point when the following conditions have been met: (i) maintenance of a stable macroeconomic environment, as evidenced by satisfactory performance under a programme supported by an arrangement under the IMF PRGF, and specific structural reform measures in the areas of governance (including the evaluation by user groups of the quality of public services), government financial management, tracking of public expenditures and improvement of the business environment; (ii) completion of a poverty-reduction strategy paper (PRSP) through a participatory process (planned for end-2005) and a first annual report on the progress of implementation, both broadly endorsed by the IMF and World Bank executive boards; (iii) implementation of a set of measures specifically related to poverty reduction; and (iv) confirmation of the participation of other creditors in the debt relief operation. The Democratic Republic of The Congo is expected to reach its completion point by the end of 2006.

19. **Arrears settlement by the Democratic Republic of The Congo with IFAD.** For over a decade, the Democratic Republic of The Congo has been confronted with a build-up of arrears, which, in the case of IFAD, culminated in the suspension of the country portfolio in February 1993. On 31 December 2002, the base date for the HIPC Initiative, arrears to IFAD amounted to about SDR 6.20 million, and arrears continued to accumulate. At its Seventy-Eighth Session in April 2003, the Executive Board approved the arrears settlement plan for the Democratic Republic of The Congo (see document EB 2003/78/R.8), and the country portfolio is being reactivated. The Government of Belgium, in the perspective of the imminent decision point under the Initiative, provided 2.975 million euro (about USD 2.70 million, historically) of financial assistance, partly for the down payment of the arrears settlement plan, and partly for the subsequent requirements of debt service

[1] As of 31 December 2002, the Democratic Republic of The Congo's outstanding principal debt to IFAD stood at SDR 18.15 million; and this amount *includes* the principal element of the SDR 6.20 million of arrears at that date (inclusive of service charge arrears amounting to SDR 1.91 million). The total debt outstanding for the purpose of the HIPC Initiative amounts to SDR 20.89 million in nominal terms, SDR 11.38 million in NPV terms.

relief. Based on the comparable precedents of Guinea-Bissau and Sierra Leone (respectively documents EB 2001/72/R.15 and EB 2002/76/R.9, both drawing on the policy decision set forth in document EB 2000/71/R.12), IFAD's Executive Board also approved at its December 2003 Session (EB 2003/80/R.18/Rev.1): (i) the integration of the arrears settlement plan for the Democratic Republic of The Congo into the NPV of debt relief for the country; and (ii) the provision of 100% of debt relief during the interim period. The residual of the financial contribution from Belgium will be entirely allocated to support this approach, and will be complemented with the Fund's own resources, unless other resources can be mobilized.

20. **Burkina Faso.** The decision of IFAD to participate in debt relief for Burkina Faso under the original HIPC Initiative was made by the Executive Board on the basis of document EB 97/62/R.10/Rev.1, and document EB 2000/70/R.12 for the original top-up at completion point. The Fund's commitment to participate in the enhanced HIPC Initiative was made on the basis of document EB 2000/71/R.12. Its aggregate commitment to contribute to debt relief for Burkina Faso at decision point under the enhanced Initiative amounts to SDR 5.18 million in 1999 NPV terms, which includes the amount approved earlier under the original Initiative framework.

21. In April 2002, the IMF and IDA executive boards agreed that Burkina Faso had satisfactorily fulfilled the conditions necessary to reach completion point under the enhanced HIPC Initiative and thus qualified for delivery of the full amount of debt relief committed at the enhanced Initiative decision point of July 2001. However, in reviewing the country's debt sustainability in March 2002 on the basis of end-2001 data, the World Bank and IMF established that the total approved amount of debt relief leaves Burkina Faso's NPV of debt-to-exports ratio at end-2001 with a debt hump of almost 200% for a prolonged period of time. This is mainly the result of lower exports due to falling world cotton prices (partly a consequence of heavy subsidies in industrialized-country markets) and crop damage from agricultural parasites. In the light of this significantly worsened outlook and as provided for under the policy framework of the HIPC Initiative, the IMF and IDA executive boards agreed that Burkina Faso: (i) had experienced a fundamental negative change in its economic circumstances; and (ii) qualified for exceptional topping-up of debt relief in order to mitigate adverse developments in the country's debt ratios, resulting from exogenous shocks to its exports, and to achieve debt sustainability.

22. To reach the 150% target NPV of debt-to-exports ratio, all multilateral creditors were expected to increase their contributions to debt relief for Burkina Faso by revising the common debt-reduction factor from 19.7% (of end-1999 NPV of debt) at the enhanced Initiative decision point to 29.9% in end-2001 NPV terms.

23. **Review of top-up at completion point.** At its Seventy-Sixth Session in September 2002 (document EB 2002/76/R.9), the Executive Board approved the completion-point top-up of the earlier agreed enhanced Initiative relief from IFAD. Due to differences in the methodology and parameters used for the calculation of the debt relief and the top-up between the original and enhanced Initiatives, the top-up proposed for Executive Board approval in 2002 was not adequate. The Executive Board approved at its December 2003 Session (EB 2003/80/R.18/Rev.1) a revised IFAD contribution to debt relief for Burkina Faso in the aggregate amount of up to a maximum of SDR 7.18 million (about USD 9.0 million; and split in SDR 2.70 million in 1999 NPV terms and SDR 4.48 million in 2001 NPV terms[2]), *inclusive* of the relief approved by earlier IFAD Executive Board decisions and already provided. Tentatively, this would amount to SDR 10.80 million in nominal terms, spread over approximately nine years. Because the country has reached its completion point under the enhanced Initiative, the Executive Board decision would become effective immediately.

2 Subject to final debt relief reconciliation with the World Bank and the Government. In the event of downward revisions, the adjustment will be made automatically, without reverting to the Executive Board.

Current Estimate of Total HIPC Initiative Costs to IFAD[3]

24. The total NPV cost of the Fund's participation in the full HIPC Initiative is currently estimated at SDR 234.3 million (USD 313 million), which corresponds to an approximate nominal cost of SDR 352.5 million (USD 471 million). These costs, on an annual basis, will amount to USD 37.8 million in 2004, and are projected to reach a peak in 2005 at a level of USD 39.8 million in nominal terms. This will reduce the debt of 38 HIPCs to IFAD by 52%, from USD 597 million to 284 million in NPV terms, essentially over a 20-year period.

IFAD Commitments So Far

25. With the approval for the Democratic Republic of The Congo, IFAD has so far committed itself to providing debt relief to the 27 countries that have reached their enhanced Initiative decision point, for a total NPV amount of approximately SDR 178.2 million (USD 238.2 million). Assuming prompt fulfilment of completion-point conditions and a relatively front-loaded modality for debt relief, this would amount to about SDR 258 million in nominal terms (USD 345 million) spread over varying periods of time, depending on the country, ranging from two to 27 years (for Sao Tome and Principe) or even 35 (for Nicaragua).

Debt Relief Delivered by IFAD

26. As shown in Table 2, the debt relief delivered by IFAD up to 30 September 2003 amounts to approximately SDR 20.6 million (USD 27.5 million) in NPV terms, excluding the post-conflict cases where IFAD is providing interim relief. This has been funded from external contributions (35%) as well as IFAD's own resources (65%).

TABLE 2: DEBT RELIEF PROVIDED
(as at 30 September 2003)

Country	**Relief Provided (in SDR, in NPV terms)**
Benin	24 971
Bolivia	5 064 436
Burkina Faso	1 699 186
Guyana (original Initiative)	630 000
Mali	1 835 865
Mauritania	632 029
Mozambique	3 324 830
Tanzania, United Republic of	1 650 606
Uganda	5 782 792
Total	**20 644 716**

IFAD Resource Mobilization Efforts

27. In accordance with IFAD document REPL.VI/3/INF.3, and in order to mitigate the impact of the Fund's participation in the HIPC Initiative on its resources available for commitment for new loans and grants, IFAD is actively mobilizing additional external resources. Its three-pronged resource mobilization strategy pursues: direct contributions from donors to IFAD; donor contributions earmarked to IFAD and channelled through the World Bank-administered HIPC Trust Fund; and, more crucially, the Fund's access to the core funding of the World Bank-administered HIPC Trust

[3] In view of current exchange rate developments, and in order not to provide different figures too frequently, this IFAD-related section continues to provide USD estimates on the basis of the July 2002 exchange rate (SDR 1.00 = USD 1.33644) rather than the current rate of about 1.4, unless otherwise specified.

Fund. Table 3 shows the results of these sustained efforts at end September 2003. The external resources currently mobilized amount to about 13.3% of the Fund's total Initiative nominal costs.

TABLE 3: DONOR CONTRIBUTIONS PAID, PLEDGED OR ACTIVELY UNDER CONSIDERATION[a]
(as at 30 September 2003)

Donor	Amounts in current USD
Belgium	2 713 086
Germany	6 988 921
Iceland	250 000
Italy	4 314 084
Luxembourg	800 193
Netherlands	12 311 737
Norway	5 700 000
Sweden	17 000 000
Switzerland	3 000 000
European Commission	9 697 750
Total	**62 775 771**

[a] It should be noted that these pledged resources are disbursed over time, in tranches, and therefore the USD value differs from the pledged amount due to fluctuations in exchange rates.