Heavily Indebted Poor Countries Initiative

FACT SHEET
Annual Meetings 2004

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I: History of the Heavily Indebted Poor Countries Initiative (HIPC)

In 1996, the World Bank and the International Monetary Fund (IMF) launched the Debt Initiative for Heavily Indebted Poor Countries (HIPC) Initiative, which created a framework for all creditors, including multilateral creditors, to provide debt relief to the world's poorest and most heavily indebted countries, and thereby reduce the constraint on economic growth and poverty reduction imposed by the debt build-up in these countries. The HIPC Initiative was designed as one important building block in a broader development architecture of policies, programs and institutional development in support of sustainable growth and poverty reduction. The Initiative was modified in 1999 to provide three key enhancements:

- ***Deeper and Broader Relief.*** External debt thresholds were lowered from the original framework. As a result, more countries have become eligible for debt relief and some countries became eligible for greater relief.
- ***Faster Relief.*** A number of creditors began to provide interim debt relief immediately at the "decision point."[1] Also, the new framework permitted countries to reach the "completion point"[2] faster.
- ***Stronger Link Between Debt Relief and Poverty Reduction.*** Freed resources were to be used to support poverty reduction strategies through Poverty Reduction Strategy Papers, which are developed by national governments in consultation with civil society.

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[1] To reach decision point, countries should have a track record of macroeconomic stability, have prepared an Interim Poverty Reduction Strategy through a participatory process, and cleared any outstanding arrears. The amount of debt relief necessary to bring countries' debt indicators to HIPC thresholds is calculated, and countries begin receiving debt relief on a provisional basis.

[2] To reach completion point, countries must maintain macroeconomic stability under a PRGF-supported program, carry out key structural and social reforms, and implement a Poverty Reduction Strategy satisfactorily for one year. Debt relief is then provided irrevocably by the country's creditors.

II: Overview of the February 2003 OED Review of HIPC

In February 2003, the Operations Evaluation Department (OED) of the World Bank published a review of the HIPC Initiative. OED is an independent unit within the World Bank that reports directly to the Bank's Executive Directors. The goals of OED evaluation are to draw lessons from experience and provide an objective assessment of the results of the Bank's work. OED reviews help the Bank to improve its work by identifying and disseminating the lessons learned from experience and by framing recommendations drawn from the evaluation process.

The OED review of HIPC concluded that:

- The HIPC Initiative marks a major innovation in development finance and that the fundamental goal of the Initiative – to give a "fresh start" to the world's poorest countries and most highly-indebted countries by cutting their external debt to a manageable level – is likely to be achieved, provided that all creditors effectively deliver their full share of debt relief . In fact, twenty-seven countries are already benefiting from significantly lower debt service.
- The HIPC Initiative is highly relevant from political economy, economic and aid effectiveness perspectives.
- The HIPC Initiative has resulted in increased spending on social sectors and pro-poor growth.
- There is wide support for the HIPC Initiative among creditors, debtor countries, civil society, and the international community.

The report also highlights the key challenges facing the World Bank in implementing the HIPC Initiative, including:

- The need to manage expectations of what HIPC can – and was designed to – achieve given current funding levels, as well as policy and institutional constraints.
- Ensuring that the HIPC Initiative provides greater focus on pro-poor growth and a better balance among development priorities.
- Ensuring greater realism in growth projections and more transparency of the models underpinning debt projections.
- Maintaining strong policy performance standards as a prerequisite for HIPC relief.

III: Record of the HIPC Initiative to Date

A "Fresh Start" for the World's Poorest Countries. The Initiative is well on the way to achieving its fundamental goal – giving a "fresh start" to the world's poorest countries and most heavily indebted countries by cutting their external debt to a manageable level.

- Twenty-seven countries – two thirds of the HIPCs – have reached their "decision points" and are receiving relief that will amount to more than $ 54 billion over time.
- Of these twenty-seven, fourteen countries – Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Mali, Mauritania, Mozambique, Nicaragua, Niger, Senegal, Tanzania and Uganda – have reached their completion points. (The following six countries have reached completion point since September 2003: Guyana, Nicaragua, Niger, Ethiopia, Senegal, and Ghana).

Increased Spending and Focus on Poverty Reduction Strategies. As the HIPC Initiative evolved, the provision of debt relief was linked to the preparation of Poverty Reduction Strategy Papers (PRSPs), which are comprehensive, country-authored plans – prepared in consultation with civil society and other partners – that set out a country's macro-economic and fiscal priorities to foster pro-poor growth, governance and sectoral programs, and ongoing and proposed poverty reduction policies.

- As noted, the OED report identified the need to ensure that the HIPC Initiative provides greater focus on pro-poor growth and a better balance among development priorities. The World Bank has and will continue to help HIPC governments ensure that savings from debt relief are directed toward pro-poor growth, including infrastructure, as well as spending on social programs, where appropriate.
- The individualized and country ownership aspect of the PRSP process enables HIPCs, which are diverse economically, politically and geographically, to set their own priorities for spending the funds available to them. For example, as part of the PRSP process:
    - **Ghana's** savings from HIPC funds helped provide microcredit to about 43,000 farmers and it also funded 563 sanitation and 141 water projects. HIPC funds also contributed to the construction of 509 new classroom blocks for basic level education in all districts.[3]
    - **Senegal** developed community based health care services thereby creating and strengthening basic community health services in rural areas.

Progress Report of the HIPC Initiative and Lower Debt Service.

- Debt service committed so far to the twenty-seven countries that have either reached their completion points or are in their interim period, together with other debt relief, represents a two-thirds reduction of the overall debt stock of these countries.
- Debt service-to-export ratios have also been substantially reduced, to an average of 10 percent. Savings from lower debt service payments have contributed to a substantial increase in poverty-reducing expenditures.
- Poverty-reducing expenditures on average have risen from 6.4 percent of GDP in 1999 to 7.9 percent of GDP in 2003, a level almost four times that spent on debt service.

HIPC Provides for "Topping-Up" to Correct for Unforeseen Events. One significant design improvement in the enhanced Initiative is that it retains flexibility to review a country's debt conditions at the completion point and assess whether additional debt relief is required to cope with unexpected increases in the burden of debt. This feature prevents HIPC countries from being penalized for events outside their control – such as a decline in export prices before the completion point – that make it more difficult for them to service their debt. However, in no case should an estimate indicating that a country is projected to have external debt above the thresholds under the HIPC Initiative be taken as an expectation that it would be eligible to receive topping-up assistance. These countries' eligibility for topping-up will depend on a comprehensive assessment to be made at the completion point based on actual debt data and other data.

Burkina Faso, Niger, and Ethiopia have received topping up assistance. Total topping-up relief to these countries amounts to $978 million in NPV terms.

[3] 2003 Annual Progress Report of the Ghana Poverty Reduction Strategy

IV: HIPC Challenges – Debt Relief is Part of a Multifaceted Endeavor

The OED review reports that the HIPC Initiative is providing deeper, faster debt relief to the world's poorest countries. But achieving long term sustainable growth and poverty reduction is a multifaceted task, and it is important to also understand and address the challenges faced by the Initiative:

- ***Understanding the HIPC Initiative's Objectives.*** By helping reduce the stock of debt in HIPCs, the Initiative was designed to contribute toward growth and poverty reduction in these countries with the understanding that debt relief is only one component of a larger poverty reduction strategy that requires a broader set of actions by HIPCs themselves and by the international community. The Bank will work together with stakeholders to help illuminate the objectives of the Initiative and improve two-way communications to ensure that the full objectives of HIPC – as well as its limitations – are owned by all stakeholders, including reinforcing the need for the international community to meet its commitments and helping HIPCs understand what steps they need to take toward sustainable poverty reduction.

- ***Adequate Resources Required.*** Continued financial support from the international community is essential to the HIPC Initiative to provide countries with the proper resources to reach the MDGs.. World Bank President James Wolfensohn and IMF Managing Director de Rato have called for rich countries to meet the UN target for development assistance of 0.7 percent of Gross National Product (GNP). (See financing section below.)

- ***Strong Policy Performance.*** Improving standards of economic performance for HIPCs is essential to continued success of the Initiative. In establishing the framework for the enhanced HIPC Initiative, the stakeholders – including the development finance institutions, donors, NGOs and civil society – agreed that bringing countries into the HIPC process more quickly helps, not harms, their chances of establishing a strong track record of policy reform, and of speeding their progress. In fact, as the HIPC Initiative has evolved, greater emphasis has been given to the standards and goals defined within each country's Poverty Reduction Strategy Paper. (See above.)

- ***Ensuring Transparency and Realism in Economic Projections.*** The Bank agrees that transparency and realism in projections are essential.
    - Debt relief through HIPC is calculated on factual historical data, and the key assumptions and forecasts are indicated in the HIPC country documents as well as in the Country Assistance Strategies and Poverty Reduction Strategy Papers. Indeed, the OED report commended the debt inventory in Debt Sustainability Analyses as reflecting a major improvement. The macroeconomic analysis behind debt sustainability assessments is assembled by the IMF, which publishes regular data on all its members, including HIPCs.

    - The Bank and Fund continues to explore ways to improve the realism of economic projections to reflect the challenges posed by the volatility of export and market performances, and the weaknesses in the data reporting of some HIPCs. Since 2001, the Bank and Fund have taken steps on a country-by-country basis to more critically examine the risks of over dependence on primary commodities, volatility of commodity prices and vulnerability to the global economic market. The Bank has started to better address these issues through the Country Assistance Strategies.

- ***International Effort is Required.*** The HIPC Initiative is a joint effort by the international community. The many stakeholders in the debt relief process, including civil society, creditors in the private and public sectors, and the recipient countries must be consulted and broad support is required for continued progress.

V: The Road Ahead

- ***Status of HIPC implementation.***
  - Twenty-seven countries are benefiting from debt relief under the enhanced HIPC Initiative, fourteen of which have reached the completion point.
  - Bringing the remaining eleven countries to the decision point continues to be a challenge as these countries are often conflict-affected, and many have substantial debt arrears problems.
  - The "sunset clause" was included in the HIPC Initiative to prevent the Initiative from becoming a permanent facility, minimize moral hazard, and encourage the early adoption of reforms. It was extended on three occasions in the past, and is now set to become effective at end 2004, after which HIPCs that have not met the eligibility criteria would not be able to obtain debt relief under the Initiative. At present, eleven countries originally identified as HIPCs have yet to reach decision point, of which five do not meet the eligibility criteria and therefore could potentially lose access to debt relief under the Initiative. The Fund and IDA Boards agreed to extend the existing sunset clause by two years to end-2006
- ***Focus on Long-Term Sustainability.*** The NPV of debt ratios have climbed for most post-completion point countries since the completion point. Most of the increase is due to interest and exchange rate changes while high exports lowered the debt ratio significantly. Therefore, a broader set of actions is required by HIPCs and the international community to achieve long-term debt sustainability.
  - HIPCs must continue to improve their economic and social policies as embodied in their PRSPs.
  - Creditors must ensure that debt relief is additional to the prevailing level of development assistance, and that future assistance is provided on appropriately concessional terms.
  - Industrialized countries must respond with opened markets — as gains from increased trade can exceed the debt relief HIPCs are receiving.
  - Notwithstanding HIPCs' high vulnerability to shocks, sound economic policies and close monitoring using the framework of debt sustainability analysis for low-income countries would help prevent the re-emergence of unsustainable debt in these countries.
- ***Financing.***
  - It remains critical that Multilateral Development Financial Institutions receive adequate financing to cover the cost of debt relief. The total cost for the HIPC Initiative stands at an estimated $54.5 billion in 2003 NPV terms, divided roughly evenly between bilateral and multilateral creditors. Bilateral and commercial creditors account for $29.4 billion and multilateral creditors account for $25.2 billion, respectively in 2003 NPV terms. Of the $35.7 billion in NPV terms required under the Initiative for the twenty-seven countries that have reached the decision point, multilateral creditors account for more than $18.2 billion.