



IEG REACH

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Based on *Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative*.

Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative

- The Enhanced HIPC initiative cut debt ratios in half for 18 countries, but in eight of these countries, the ratios have come to once again exceed HIPC thresholds. Debt reduction alone is not a sufficient instrument to affect debt sustainability, which also requires improvements in repayment capacity.
- HIPC has channeled additional development resources to qualifying countries – these countries have received an increased share of overall aid transfers. Net transfers to HIPC countries have doubled from \$8.8 billion in 1999 to \$17.5 billion in 2004, while transfers to other developing countries have grown by only one-third.
- Post-completion point countries started out with higher scores on key policy ratings than other low-income countries and they still score higher. HIPC countries that are not yet at completion point have on average the lowest ratings of all low-income countries. They face serious challenges in managing their economies, which will affect their prospects for reaping the potential benefits of debt reduction.
- Six of eight post-completion countries with new debt sustainability analyses have only a moderate risk of debt distress, but all remain vulnerable to export shocks and still require highly concessional financing and prudent debt management.

In the past decade, debt relief has become an increasingly significant vehicle for delivering development aid. This update builds on the findings of the 2003 evaluation of the Heavily Indebted Poor Countries (HIPC) initiative, “Debt Relief for the Poorest: An OED Review of the HIPC Initiative.” It finds that many of the original conclusions remain relevant for the HIPC initiative and are potentially instructive for future debt relief initiatives.

The 2003 evaluation found that the HIPC initiative would substantially reduce the excess burden of qualifying countries if the debt relief was delivered in full. But achieving a permanent exit from debt rescheduling, promoting growth, and releasing resources for social expenditures would require actions by governments and donors beyond the scope of the initiative.

Debt reduction is not sufficient for debt sustainability

The Enhanced HIPC initiative has reduced \$19 billion of debt¹ in 18 countries, thereby halving their debt ratios. But in 11 of 13 post-completion point countries for which data are available, the key indicator of external debt sustainability has deteriorated since completion point. In eight of these countries, the ratios have come to once again exceed HIPC thresholds.

New analyses present a more optimistic outlook for debt sustainability. Six of eight post-completion point countries are considered to have only a moderate risk of debt distress. But all remain vulnerable to export shocks

¹ In net present value terms in the year of decision point, with topping up calculated in the year of completion point

and require highly concessional financing and sound debt management.

Debt reduction alone is not a sufficient instrument to affect the multiple drivers of debt sustainability. Sustained improvements in export diversification, fiscal management, the terms of new financing, and public debt management are also needed, measures that fall outside the ambit of the HIPC initiative.

Debt relief has become a significant vehicle of resource transfer to HIPC countries

HIPC debt relief has been significantly additional to other net resource transfers, both in the aggregate, and for 21 of 28 countries. Net transfers to HIPC countries have doubled from \$8.8 billion in 1999 to \$17.5 billion in 2004, while transfers to other developing countries have grown by only one-third.

In 2005, eight more non-HIPC low-income countries have become potentially eligible for HIPC. The repeated extension of the deadline for eligibility has significantly expanded the reach of the initiative. The emergence of proposals for future rounds of debt relief suggests that debt relief is becoming an ongoing mechanism for resource transfer.

Maintaining policy performance is essential to reaping the benefits of debt reduction

Post-completion point countries started out with higher scores on key policy ratings than other low-income countries and they still score higher. Countries not yet at completion point—both decision point and pre-decision point countries—face serious challenges in managing their economies, which will affect their prospects for reaping the potential benefits of debt reduction. Even though the initiative has granted poorer performing countries more time to begin a reform program supported by the Bank and the Fund, they are held to the same performance requirements as countries that became eligible earlier. Fiscal and debt management are areas of particular weakness in many HIPC countries. Efforts arising from the HIPC initiative to upgrade countries' public expenditure management systems have resulted in only modest improvements.

Most creditors have committed their share of relief

The HIPC initiative was innovative in its attempt to seek a comprehensive approach to debt reduction amongst all creditors. The World Bank, the IMF and Paris Club creditors have committed most of their shares of debt relief. But the initiative's structure as a voluntary agreement has hindered efforts to achieve full participation of all creditors. The sluggish participation of commercial creditors and those not in the Paris Club—who were not involved in shaping the design—has generated a shortfall of 8 percent of total HIPC assistance, which affects some countries particularly.

Five implications for future debt relief efforts

- Debt reduction is not tantamount to debt sustainability. Future debt relief initiatives need to stress that debt sustainability requires other policy actions by governments and external partners to improve repayment capacity.
- Does debt relief add to or substitute for other aid flows? To demonstrate that future debt relief initiatives are additional, donors will need to establish what their net transfers would be in the absence of debt relief.
- The initiative is delivering an increasing share of concessional resources to HIPC countries. Since non-HIPC countries do not have access to these resources, donors will need to ensure that the resulting pattern of resource allocation rewards better performers overall.
- Debtors cannot oblige creditors to participate in debt relief under voluntary initiatives. Involving both creditors and debtors at the design stage of proposals for debt relief can be an important step for securing the cooperation of all creditors.
- Future debt relief initiatives may also be expected to continually revisit and extend deadlines for eligibility. Such extensions keep open the opportunity for countries to receive debt relief, while holding all countries to the same standards. On the other hand, they could provide countries with an incentive to increase their borrowing in order to avail themselves of debt relief.