

**AFRICAN DEVELOPMENT BANK**



**AFRICAN DEVELOPMENT FUND**



**THE DEBT PROBLEM OF THE HIPC<sub>s</sub>**

# INTERNATIONAL MONETARY FUND AND THE WORLD BANK

## A Framework for Action to Resolve the Debt Problems of the Heavily Indebted Poor Countries

Report of the Managing Director of the **IMF** and  
the President of the **World Bank**

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### I. Introduction

In October 1995, the Development and Interim Committees requested that the **Bank** and the Fund undertake **further** analysis of the debt problems of the heavily indebted poor **countries** (HIPCs). For cases where existing mechanisms appeared **inadequate** to enable countries with sound policies to achieve a sustainable debt position, the Bank and **the Fund** were asked to report with proposals for further action. On the basis of **staff** analysis, the Boards **of the** two institutions agreed that there is a significant number of HIPCs for whom the burden **of debt** was likely to remain above sustainable levels over the medium term, even with strong policy performance and full use of existing debt-relief mechanisms. They also suggested **a number** of guiding principles that should be the basis for any specific proposals. The present paper, which reflects discussions with major **MDBs** concerned, summarizes the conclusions of **this** analysis, lists the guiding principles, and sets out a broad framework of action which **respects these** principles, thus providing an approach to deal with the **debt** problem of HIPCs.

### II. Results of Analysis

Directors of both institutions broadly endorsed an analytical framework developed by the **staffs** for assessing the sustainability of **external debt** in these countries. As part of this framework, the country-specific analysis assumes that (i) countries adhere to sound economic adjustment and reform policies, (ii) existing mechanisms for rescheduling and reduction of commercial **and** bilateral official debt are fully exploited, and (iii) concessional financing can continue to be mobilized at around current levels to meet countries' external financing requirements. Based on **these assumptions**, the results indicate (see Table 1) that about half of the HIPCs are either at manageable debt and debt-service levels or can be expected to reach them within **five** years. The remaining half are about **evenly** split **between those** for which **debt** indicators can be expected to return to **manageable** levels in the medium **term**, i.e., between five **and** ten years, (the "possibly stressed") and those for which the restoration of **these** indicators to manageable levels would take longer **than** a decade (the "unsustainable" cases). These results, however, should not be **taken** to prejudge eligibility for the proposed initiative.

Director8 concluded that there was a **significant number of HIPC8--at least eight**, and some Director8 argued as **many as twenty--for whom the burden of debt was likely** to remain above **sustainable** levels over the **medium term, even with strong policies and full use of existing** debt-relief mechanisms. Most Directors considered that **additional** assistance was needed for these countries, to **ensure that their adjustment and reform efforts** would not be put at risk by continued high debt and **debt-service burdens**. They noted that the level and **creditor** composition of debt varied greatly across the **countries** concerned, and that this **should** be reflected in the design of any strategy to **address** these countries external debt problems.

**Table 1: Overall Assessments of Debt Sustainability for the 41 HIPC8**  
(as of January 31, 1996)

Countries for which detailed analysis is available			Other HIPC8 (preliminary assessments)			Not yet determined
Sustainable	Possibly Stressed	Unsustainable	Sustainable	Possibly Stressed	Unsustainable	
Benin	Bolivia	Mozambique	Angola	Congo	Burundi	Liberia
Burkina Faso	Cameroon	Sudan	C.A.R.	Ethiopia	Guinea-Bissau	Nigeria
Eq. Guinea 1/	Cote d'Ivoire	Zaire	Chad	Guyana	Nicaragua	Somalia
Guinea	Tanzania	Zambia	Ghana	Madagascar	Sao Tome-Principe	
Honduras	Uganda		Mali	Myanmar		
Kenya				Niger		
Lao PDR				Rwanda		
Mauritania						
Senegal						
Sierra Leone						
Togo						
Vietnam						
Yemen						
(13 countries)	(5 countries)	(4 countries)	(5 countries)	(7 countries)	(4 countries)	(3 countries)

1/ The assessment of Equatorial Guinea depends critically on the projected coming-on-stream of new oil production.

### III. Guiding Principles for Action

Directors agreed that the following broad **principles** should **guide further action**:

- **first**, that the objective should be to **target overall debt** sustainability on a **case-by-case** basis, focusing on the totality of a **country's** debt;
- **second**, that action should be **envisaged only when** the debtor has **shown**, through a track record of reform and sound **policies**, the **ability to put to good use** whatever exceptional support **is provided** to achieve a **sustainable outcome**;
- **third**, that new measures **should build**, as much as possible, on **existing** mechanisms;

- **fourth**, that additional action **for** the problem cases should be coordinated among all creditors involved, with broad and equitable participation;
- **fifth**, that any action to relieve the burden of debt owed to multilateral creditors should preserve the financial integrity of the institutions and their preferred creditor **status**, and be consistent with the constraints of their charters, in order that the institutions can continue to provide financing to all member countries on appropriate **terms**; and
- **sixth**, that new external finance for the countries **concerned** should be on **appropriately concessional** terms, so as to support **their efforts** to pursue reform and establish a track record of good policy.

#### IV. A Framework for Action

**Table 2** provides an overview of the proposed framework.

The suggestion is to build on the existing three-year track record needed to **qualify** for a stock-of-debt operation from Paris Club creditors (this would be the first stage of the process).. During the following **three** year period (the **second stage**) the international community would continue to support the country in its **efforts** to undertake a broad-based program of macro-economic and structural reforms. *In* all programs with these countries there would be particular emphasis on improving the quality of public expenditures, strengthening institutional capacity and enhancing the delivery of social services. Through action taken by creditors during and, at the conclusion of the second stage, and as a result of the country's own **efforts** at adjustment and reform, the country's overall debt would be reduced to a sustainable level.

Under **Naples** terms, Paris Club creditors currently offer a stock-of-debt operation involving a 67 percent net present value (**NPV**) reduction in eligible debt to most low-income countries which have **successfully** completed a three-year IMP-supported adjustment **program** and have good payments records. This **stock-of-debt** operation has to be an "**exit**" rescheduling in that no **further reschedulings will** be required. For countries for which Naples terms would not offer the prospect of an exit rescheduling, the proposal is that at the end of the first stage the international community would, (i) begin to provide extraordinary support, which would continue for a subsequent three-year adjustment period, to support **development** and to help ease the debt burden; and (ii) provide a firm undertaking that this **will** be supplemented at the end of the second stage by concerted and comprehensive action to ease debt-service burdens, as needed to achieve debt sustainability at that point, provided the country sustains and commits to continue sound policies,

**Specifically**, during the second stage:

- The country would **undertake a second three-year adjustment program** supported by **the Fund** and the Bank.
- **During** this period, Paris Club creditors would provide flow reschedulings involving NPV concessionality of up to 90 percent (as needed on a case-by-case basis). Paris Club creditors would also undertake to **provide at the end of the period a stock-of-debt operation** with NPV concessionality of up to 90 percent (based in each case on the projected need for relief to achieve sustainability at that point), **subject to satisfactory implementation** of the program. **Other** official bilateral and commercial creditors would offer similar terms. <sup>1/</sup>
- **During** this period, donors and multilateral institutions would also provide **enhanced** assistance in the form of grants or **concessional** loans, In some cases these could be used to assist with debt **service** payments..
- Multilateral institutions would complement the relief provided as indicated above by **other** creditors. As a group, they would **undertake--provided performance was sustained** and if such further action was necessary--to reduce the present value of their claims on the sovereign **borrower** of the country at the **end** of the **period to a level which would be consistent** with an **overall** sustainable level of debt, taking into account all the actions outlined above. This would be achieved in a manner consistent with the **multilaterals' financial policies and preferred creditor** status; there would be no **write-down of multilateral** debt.
- The multilateral institutions would contribute according to their **exposure** to the **sovereign borrower** of the country and **consistent with their own charters, and** on a broadly **equitable basis**. Contributions could take the form of grants or highly concessional loans, possibly earmarked to pay debt service or to **prepay outstanding debt**. **Multilateral development** banks might contribute via a multi-country or **single-country** trust fund, to which donors could also choose to **contribute**. The IMF might **contribute through the enhanced** structural adjustment facility.
- Finally, it is **proposed** that the **program would remain available for two years**, at the end of which a comprehensive review would be held to decide whether to continue with the program.

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<sup>1/</sup> **Commercial** bank debt for most of these countries has already been handled or is **currently** in the process of being **addressed** through the IDA administered Debt Reduction Facility for DA-only Countries. This Facility has been **funded** from transfers **from IBRD** net income and donor funding and co-financing.

## V. Conclusion

What is outlined above is a broad **framework** for possible action consistent with **the** guiding principles agreed by the Executive Boards. There are many important aspects that need to be fleshed out. These include the nature of the commitments to ease the burden of debt offered at the **beginning** of the second stage and how these commitments might be **implemented**, and how the roles of the various creditors and donors should best be coordinated. There will also need to be consultations with the Paris Club **regarding** the proposal to increase **concessional**ity up to 90 percent. Moreover, each institution will need to consider ways in which it can participate in and contribute to **this** initiative consistent with its own charter. Considerable further work, in consultation with **all** interested parties, will be required to arrive at a fully agreed program of action.

Do Ministers agree that

- this framework provides an appropriate basis for **further** work,
- the objective **should** be to produce a program of action, in **consultation** with concerned bilateral creditors/donors, the Paris Club and multilateral institutions, for consideration at the next meetings of the Development **and** Interim Committees?

**Table 2. Summary of the HIPC Initiative**

