

AFRICAN DEVELOPMENT BANK



AFRICAN DEVELOPMENT FUND



PROPOSAL ON BANK GROUP CONTRIBUTIONS TO THE  
DEBT INITIATIVE FOR HEAVILY INDEBTED  
POOR COUNTRIES (**HIPCs**)

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PROPOSAL ON BANK GROUP CONTRIBUTIONS TO THE  
DEBT INITIATIVE FOR HEAVILY INDEBTED  
POOR COUNTRIES (HIPC<sub>s</sub>)

1. Introduction

1.1 During the deliberations on the paper presented by Management on the HIPC<sub>s</sub> Initiative', the Boards agreed on the principle of Bank Group participation, with two reservations, one on the principle of Bank Group participation, and the other on the use of ADF resources for the purpose. The Boards took note of the indicative estimates of the resources that would need to be generated by the Bank Group for application to the Initiative, on the basis of alternative Paris Club debt relief options. While welcoming the Initiative, the Boards underscored that direct Bank Group contributions would be limited by the financial constraints of the Institution.

1.2 The Boards requested Management to continue consultations with the Bretton Woods Institutions (BWIs), other MDBs and potential bilateral contributors; and to submit a revised proposal on Bank Group contributions, when further progress is made on the Initiative. This proposal responds to that request. It commences with brief highlights on the Initiative, followed by a summary of the decisions of the Development Committee; the cost of the Initiative and the share of the Bank Group therein. The proposal concludes with recommendations on possible approaches to Bank Group participation in the Initiative.

2. Highlights of the Debt Initiative

2.1 As presented in the earlier submission to the Boards, the objective of the Initiative is to reduce the external debt of countries retaining an unsustainable burden after full use of existing debt relief mechanisms. A country is considered in a sustainable situation if the full use of existing debt relief mechanisms is adequate to bring the net present value (NPV) of debt-export ratio to 200 per cent and the debt service-export ratio to 20-25 per cent. The BWIs undertook a debt sustainability assessment (DSA) for 41 HIPC<sub>s</sub>, of which 33 are in Africa, and categorized them into four groups, namely: sustainable, unsustainable, possibly stressed, and undetermined for lack of information. A total of 16 African countries were categorized as unsustainable and possibly stressed, and, hence, as potentially eligible for debt relief under the Initiative'.

2.2 The Initiative would operate in two stages. The first stage involves a three-year internationally supported economic reform program. At the completion of the first stage ("the decision point"), a comprehensive assessment would be made of a country's debt situation and prospects. If it is deemed that the country could attain a sustainable debt level,

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<sup>1</sup> *Approaches to Bank Group Participation in the International Initiative on External Debt of Heavily Indebted Poor Countries (HIPC<sub>s</sub>) (Doc. ADB/BD/WP/96/115 - ADF/BD/WP/96/87 of 11 September 1996).*

<sup>2</sup> The 16 African countries are Burundi, Cameroon, Congo, Côte d'Ivoire, Ethiopia, Guinea Bissau, Madagascar, Mozambique, Niger, Rwanda, Sao Tome and Principe, Sudan, Tanzania, Uganda, Zambia, Zaire.

#### 4. Costs of the Initiative

4.1 As presented in the earlier submission to the Boards, the cost of the Initiative has been estimated as the amount of assistance, beyond that available under current mechanisms, that would be required to reduce the NPV debt-exports ratio, as currently projected for the countries, to 200 per cent and the debt-service ratio to 25 per cent, at the completion date. Following the BWIs debt sustainability assessment, 19 countries (15 in Africa), are assumed to reach the decision point at the earliest feasible date<sup>4</sup>. Uganda, which has already received a stock-of-debt operation from Paris Club creditors on Naples Terms, is considered to have reached the decision point already, and could enter the second stage in the coming months<sup>5</sup>.

4.2 The other countries are expected to reach their decision points in subsequent years<sup>6</sup>. For six of the 19 countries assessed as "possibly stressed" or "unsustainable", the results of the analysis show that there would be no cost to MDBs beyond the costs of current debt relief mechanisms. These six countries are Bolivia, Cameroon, Congo, Guyana, Cote d'Ivoire and Tanzania. For three additional countries (including Madagascar in Africa), enhanced debt relief from official bilateral and commercial creditors, with a NPV reduction of up to 80 percent, may be sufficient to bring their debt-export ratios to 200 percent by their completion dates. This leaves ten African countries that might qualify for multilateral action under the debt initiative, namely: Burundi, Ethiopia, Guinea Bissau, Mozambique, Niger, Rwanda, Sao Tome and Principe, Uganda, Zaire and Zambia.

4.3 The preliminary order-of-magnitude estimates of total potential costs of the Initiative at completion dates is about US\$5.6 billion in 1996 NPV terms, to be incurred over the period 1999-2003. This is based on a baseline annual export growth rate assumption of 6 percent<sup>7</sup>. Based on the 80 percent debt reduction expected from the Paris Club, and

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<sup>4</sup> No assessment has been made for Liberia, Nigeria and Somalia. Currently, Nigeria is not on IDA-only country, and hence is ineligible for support under the initiative. Though Sudan is considered potentially eligible for the second stage, according to the BWIs, no allowance has been made in the costing for its possible participation in the Initiative, in view of the uncertain timing surrounding the establishment of a track record to reach eligibility, and the scale of its debt burden.

<sup>5</sup> For example, costs are expected to be incurred on Uganda by 1999. With NPV debt-export ratio to be reduced from 265 to 200, the illustrative total cost at the completion point would be of the order of US\$ 428 million in 1999 NPV terms, distributed as follows: non-multilateral creditors US \$135 million; multilateral creditors about US\$ 305 million the IMF's by US\$ 82 million, the World Bank by US\$ 170 million, the African Development Bank Group by US\$ 33 million, and the others US\$ 20 million. Multilaterals with an exposure of less than US\$ 1 million to Uganda would not be expected to make a commitment but could take action if they chose.

<sup>6</sup> Category of eligible countries by possible timing of decision points: Bolivia, Guyana and Uganda, by end-1996. Countries that could be eligible by end-1997 include Côte d'Ivoire, Ethiopia, Mozambique; Cameroon, Guinea Bissau and Nicaragua by end-1998; Congo, Madagascar, Niger, Tanzania and Zambia, by end-1999; and Burundi, Myanmar, Rwanda, Sao Tome and Principe, and Zaire, beyond 1999.

<sup>7</sup> However, if export growth declines by 1 to 2 percent, the cost would increase to the order of US\$ 6.6 billion to US\$ 7.7 billion. The cost to MDBs would be in the range of US\$ 3.77 billion to US\$ 4.4 billion; and the cost to ADB in the range of US\$ 1.063 billion to US\$ 1.248 billion.

percent ADF loan cancellations (1994-September 1996), and, 5 percent of the Bank's net income to be available from 1997 to 2003.

5.1.3 As shown in Table 1, over the period 1997-2003, the Bank Group would generate, in 1996 NPV terms, UA 45.48 million under the first scenario, UA 147.08 million under the second scenario, UA 197.88 under the third scenario, and UA 205.57 million under the fourth scenario. Though the contribution from net income will be relatively modest, it could serve as a gesture demonstrating commitment to the Initiative, considering the efforts of the other MDBs and the size of ADB Group exposure.

5.1.4 The Bank Group share in the cost of the Initiative amounting to UA 604.15 million exceeds the resources that might be available under all four scenarios. The shortfall ranges from UA 558.67 million for Scenario 1 to UA 398.58 million for Scenario 4. It would be noted that under Scenario 4, which could generate UA 205.57 million, use of ADF-VII subscriptions would not be required.

5.1.5 Following the directives by the Boards, Management has continued consultations with the BWIs and potential bilateral contributors, of which some have indicated interest to provide additional resources. More recently, Bank staff presented the case for supporting the Bank Group at the meeting of Multilateral Creditors and Bilateral Donors on the HIPC's Initiative held in Paris during 13-14 November 1996. A number of donors expressed their intention to provide financial support to enable effective ADB Group participation in the Initiative.

## 5.2 Options for Bank Group Contributions

5.2.1 Bank Group participation in the Initiative could be at two levels. Firstly, actions during the interim period through the instruments of regular concessional operations; and secondly, actions in concert with the other MDBs, at the completion point. Such actions may be effected either through contributions to the Trust Fund, or with parallel measures by the Bank Group administering its own resources independently. The advantage of an independent arrangement rests primarily on the Bank Group retaining full control of its own resources in having them deployed as deemed appropriate solely by the Group.

5.2.2 If the Bank Group elects to participate in the Initiative by contributing to the HIPC's Trust Fund, the following would be among the accruing advantages:

- i) Bilateral contributions to the Trust Fund will be used to cover some of the obligations of the regional banks, principally that of the ADB Group, since the World Bank will meet its obligations from its own contributions;

- ii) Some bilaterals have expressed preference for contributing to a common Trust Fund managed by IDA;
- iii) The World Bank's extensive experience in interacting with donors is likely to yield more bilateral resources to cover Bank Group obligations;
- iv) There will be savings on administrative overheads and responsibilities as the Trust Fund will be administered by the IDA without a fee;
- v) The Trust Fund may facilitate some flexibility in burden-sharing among MDBs, as concessions may be made to institutions with difficult circumstances; and,

Based on the above considerations, it is proposed that the Bank Group participates in the Initiative through the Trust Fund. The Bank Group, if necessary, can exercise the latitude of pulling out its contribution at any time it desires.

## 6. Conclusions and Recommendations

6.1 As the Boards fully appreciate, the HIPC's Debt Initiative is a path-breaking international action which is designed to extricate mostly low-income African countries from the rescheduling cycles ensuing from the debt overhang and ushering in, instead, external sustainability -- thereby enhancing prospects for capital flows and economic growth, generally. The benefit of the Initiative would also accrue to the Bank Group through addressing current arrears and preventing future accumulation among participating HIPC's. This is because such countries would be expected to remain current on debt service to MDBs and the Paris Club -- with positive impacts on the Institution's cash flow and the Bank's net income. Clearly, therefore, the Bank Group has important stakes in working for the success of the Initiative -- both on account of its significance in enhancing the socio-economic prospects of member countries, and, also, because of the beneficial effects on the longer-term standing of the Institution itself. But even then, the financial situation of the Institution places constraints on the size of direct financial contribution by the ADB Group to the Initiative.

6.2 Following approval by the Boards of the principles of Bank Group participation in HIPC's Initiative, Management has continued to consult with other MDBs and bilateral donors about developments in respect. to the Initiative. As requested by the Boards, this submission proposes Bank Group contributions to the Initiative, through the Trust Fund managed by IDA, given the clear advantages that would accrue to the ADB Group from this arrangement. The legal opinion, presented to the Boards separately, confirms that such participation would be consistent with the respective agreements establishing the Bank and the Fund.

6.3 The Boards are hereby invited to consider and decide on the Scenario under which the participation of the Bank Group could be effected, it being understood that Management favors participation under Scenario 4.

## ANNEX A

**HIPCs Debt Initiative: Estimated Annual Profile of Potential Costs**  
(In 1996 NPV terms)  
(US\$ billion)

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Creditor Group	1999-2000	2001	2002	2003	Total
Official Bilaterals	0.267	0.333	0.600	1.200	2.400
Multilaterals	0.640	0.160	1.440	0.960	3.200
World Bank	0.220	0.055	0.495	0.330	1.100
IMF	0.316	0.040	0.360	0.240	0.800
ADB	0.174	0.044	0.392	0.262	0.872
Others	0.086	0.021	0.193	0.128	0.428
<b>TOTAL</b>	<b>0.907</b>	<b>0.493</b>	<b>2.040</b>	<b>2.160</b>	<b>5.600</b>

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