

More debt-distressed African countries could qualify for HIPC relief

Creditors making 'major changes' in debt relief for poor countries

By **Christina Katsouris**

Leaders of the seven major creditor countries have proposed significant changes to the Heavily Indebted Poor Countries (HIPC) initiative, aiming to give deeper debt relief to more countries sooner. The revisions are to be finalized in September at the International Monetary Fund (IMF) and World Bank annual meetings of finance ministers and central bank governors.

"We have decided to give a fresh boost to debt relief," the Group of Eight leading industrialized countries — the Group of Seven (G7) plus Russia — declared at the end of its 18-20 June summit in Cologne, Germany. Creditors claim the changes could eventually cancel \$100 bn of HIPC debt. But critics say the actual amount may be far less and that much more HIPC debt should be cancelled.

Pressure for change had been building since 1996, when the HIPC initiative was launched. Described as "great news for the poor of the world" by World Bank President James Wolfensohn, the initiative brought together all creditors — multilateral, Paris Club, other bilateral and commercial — as part of a scheme to provide 41 "debt-distressed" countries (33 of them African) with an "exit strategy" towards "sustainable" levels of debt. But by July 1999, HIPC had provided actual debt reduction to just four countries — Uganda, Bolivia, Guyana and Mozambique. Only three



Martin Godwin

"Break the Chains of Debt," demanded thousands of protesters in the UK, a week before Group of Seven creditor governments, meeting in Cologne, Germany, promised deeper relief for the poorest debtor nations.

more, Burkina Faso, Mali and Côte d'Ivoire were due to benefit by 2001.

Frustration over the slow progress prompted African, Western, and UN figures to criticise the scheme for providing "too little, too late." It also fuelled an increasingly prominent campaign by Jubilee 2000, an international coalition of non-governmental organizations (NGOs), religious bodies and prominent individuals, that has mobilized the public in mainly creditor countries and lobbied governments to "Break the Chains of Debt" (see page 16).

Such pressures were among the reasons why major creditors themselves began to call for better terms. In late January, Germany's

SPECIAL FEATURE

ECA Conference of African Ministers debates challenges of raising finance for the continent's development.

African governments have subscribed to the objective of reducing poverty by half by 2015. In order to do so, African economies need to maintain an annual average growth rate of 7 per cent, more than double the current level. Meeting in Addis Ababa in May this year, African ministers of finance, economic development and planning discussed how to mobilize domestic and external resources for poverty reduction, higher growth rates and sustained development.

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new Chancellor Gerhard Schröder set the agenda for the summit he would be hosting in June when he announced a “Cologne Initiative” designed to broaden access to an accelerated and more flexible HIPC package. Canada, the US and France followed suit, with the UK in turn reiterating the “Mauritius Mandate” it had proposed in 1997 to bring a maximum of HIPC candidates into the process by the millennium.

Towards ‘HIPC-2’

The main shortcomings of “HIPC-1” include its restrictive criteria for eligibility, any one of which can disqualify a country. Its guidelines deem debt to be sustainable at 200-250 per cent of exports, and 280 per cent of revenues, and generally exclude countries with lower debt-to-income ratios from receiving HIPC relief. Another flaw is the six years it usually takes to qualify for actual debt reduction for countries starting adjustment programmes after 1996.

The G7 — Russia was hardly involved — has now proposed lower “sustainability” targets. It says that debt should be cut to 150 per cent of exports or to 250 per cent of revenues, both in net present value terms (the discounted market value of the debt if repaid in one lump sum).

This would creak open the window for more countries to qualify for relief, admitting those excluded earlier because their projected ratios were deemed “sustainable.” The change also means more debt would be written off to achieve the lower targets.

Creditors also aim to lower the hurdles for HIPCs seeking relief on grounds of fiscal distress — those with insufficient domestic revenue to service debt. The rules currently limit the “fiscal window” to countries with larger export sectors and revenue bases. The rules were part of the compromise forged in 1997 between France and other major creditors that enabled Côte d’Ivoire to qualify,

while limiting other potential entrants. To date, only one other country, Guyana, has entered through this window.

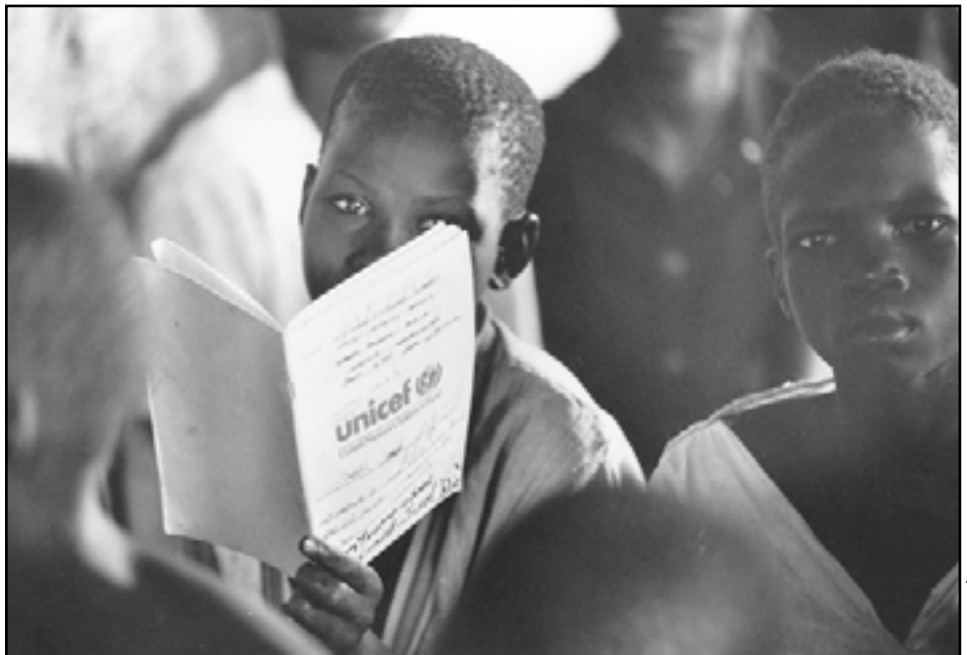
The new revision would admit countries with exports-to-gross domestic product ratios of at least 30 per cent, and revenue-to-GDP ratios of at least 15 per cent, instead of the current 40 per cent and 20 per cent respectively.

Perhaps the most far-reaching G7 proposal is to shorten the six-year qualification period for debt reduction. Current guidelines divide the period into two three-year phases, during which a country must meet the targets of an enhanced structural adjustment facility (ESAF), under IMF surveillance. The first phase takes a country to “decision point,” when final target

should be allowed to advance the completion point through improved performance,” adding: “The second stage could thus be shortened significantly if a country meets ambitious policy targets early on.” Despite the vagueness, some analysts say this will shorten the period to three years, although a country is expected to maintain adjustment policies after getting debt relief.

Creditors also recommend that multilateral institutions such as the World Bank, IMF and African Development Bank provide interim relief prior to debt reduction, in the form of reduced debt service payments. This would provide faster relief than under HIPC-1, which converts long-term credits into grants.

Debt cancellation under HIPC is intended to free up more public spending for education and other vital social needs.



ratios of debt are set, and the second to “completion point,” when debt is reduced. The point of the six years is to establish a “track record” of good performance.

Creditors have shortened the qualification period for countries which began adjustment programmes before HIPC was launched in 1996: Uganda, which had undergone a decade of exemplary adjustment, reached completion in April 1998, some 18 months after HIPC-1 was launched, while Mozambique completed in just under three years.

Still six years, or less?

The language of the G7’s new proposal on the timing of relief suggests much will remain discretionary. The G7 said that “debtor countries

The G7 also urges multilateral institutions to increase the amount of debt that is reduced immediately after completion point — known as “front loading” — in order to lower debt service payments in the early years. Two of the next three scheduled HIPC beneficiaries may have to pay higher debt service than before. Front loading and the interim assistance would also liberate more funds for investment in poverty reduction.

Higher ceiling on bilateral relief

Another major G7 proposal is to raise the current cap on bilateral debt relief to 90 per cent, and “more for individual cases if needed.” This is a logical corollary to reducing the “sustainability” ratios. It also addresses countries that

HIPC-1: the story so far

have predominantly bilateral debt.

A basic principle of HIPC-1 is that of “equal burden sharing” among all creditors. Part of the deal was that for HIPC qualifiers, the Paris Club would raise its 67 per cent ceiling on debt relief to 80 per cent of eligible bilateral debt. But in Mozambique’s case, 80 per cent was still insufficient to enable bilateral creditors to fulfil their part of the deal to reduce the country’s debt to 200 per cent of exports.

When Mozambique reached completion point in June 1999, there was a financing gap of \$170 mn between the respective “burdens” of its multilateral and bilateral creditors. With the Paris Club resisting pressure to raise its ceiling, the impasse was resolved after tough negotiations between creditors, when some Paris Club members agreed to provide the required financing. Analysis by NGOs suggests that 11 other countries could face financing gaps at the 80 per cent ceiling.

Finally, the G7 plan calls on all bilateral creditors to cancel debt arising from official development assistance (ODA), which would extend a practice implemented by many G7 countries already.

Qualified welcome for HIPC-2

The G7 proposals have been broadly welcomed as an important step forward, but with reservations and outright criticism from some quarters. “Crumbs of comfort,” said Jubilee 2000/UK, which argues that the IMF should no longer have a central role in approving debt relief. Oxfam, a UK-based NGO, fears the IMF could frustrate plans to speed up assistance: “In the past, the Fund has employed an overly narrow and rigid mode of judging performance.” It warned that “narrow IMF conditions should not delay debt relief.”

The new-look HIPC reflects a compromise between those creditors insisting on more conditions and others pressing for less. Such differences were evident in creditors’ submissions to a review of HIPC last April: *HIPC: Perspectives on the Current Framework, and Options for Change*. Canada, Germany and the UK called for the track record period to be halved, while France said it should be reduced on a “case-by-case basis taking past track

- When creditors launched the initiative in 1996, they listed 41 countries as potentially eligible for HIPC treatment. These were: Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Côte d’Ivoire, Equatorial Guinea, Ethiopia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Kenya, Laos, Liberia, Madagascar, Malawi (which replaced Nigeria on the original list), Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, Yemen, Zambia. Since then, creditors have reviewed the eligibility of 12 HIPCs.

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- So far only four countries have had their debt reduced: Uganda, which received \$347 mn (in net present value terms) in April 1998; Bolivia, which received \$448 mn in September 1998; and Guyana and Mozambique, which reached completion point this year, with deals worth \$253 mn and \$1.7 bn respectively. All would be entitled to deeper relief under HIPC-2.

- Creditors have approved debt reduction for a further three countries, provided they maintain appropriate macroeconomic policies: Mali is scheduled to get

HIPC’s changing criteria

	HIPC-1	HIPC-2
Debt* sustainability ratios		
debt/exports	200-250%	150%
debt/revenues	280%	250%
GDP-related ratios		
exports/GDP	40%	30%
revenues/GDP	20%	15%
Time until actual relief	6 years	3 years +

* Measured in “net present value” terms: the discounted market value of debt if repaid in one lump sum.

Source: UN Africa Recovery

relief this year, Burkina Faso in April 2000, and Côte d’Ivoire in March 2001.

- Creditors examined, then excluded Benin and Senegal. They said the use of pre-HIPC debt relief mechanisms would have reduced Benin’s debt-to-export ratio at completion point to 187 per cent. Despite severe fiscal strains — a debt-to-revenue ratio of 166 per cent — Benin was excluded on fiscal grounds because current rules limit HIPC relief to countries with “open economies and larger revenue bases.” Senegal was also ruled out because its debt-to-revenue ratio was projected at 242 per cent. Both countries would be admitted under HIPC-2.
- Preliminary debt sustainability analyses concluded that Ethiopia, Mauritania and Guinea-Bissau would be expected to qualify. However, both Ethiopia and Guinea-Bissau need to be reviewed again because their programmes have been derailed by conflict and other developments.
- Fifteen countries were due to have debt sustainability analyses (and, in some cases, possible decision points) in 1999, World Bank and IMF documents suggest: Chad, Ghana, Guinea, Honduras, Laos, Malawi, Mauritania, Nicaragua, Niger, Republic of Congo, Tanzania, Togo, Vietnam, Yemen and Zambia.
- Those scheduled for later analyses are: Rwanda (2000), Cameroon (2000), Central African Republic (2001) and Kenya (2000).

record in adjustment policies into account.”

Divergences were also clear during World Bank/IMF Board discussions before Cologne. “Many directors favoured little or no general shortening of the track record period to reach completion point, stressing the need to provide sufficient time and incentives for countries to undertake required structural reforms,” the minutes say.

More generally, the G7 proposals fall well

short of debt lobbyists’ recommendations: Jubilee 2000 and others called for a one-off cancellation of all HIPC debt. Oxfam had argued for a 15 per cent ceiling on revenues allocated to debt service, and for the debt-to-revenue target to be reduced from 280 to 150-170 per cent. With other coalition members, it had also called for far greater linkage between debt relief and investment in poverty reduction, with a “human development window” provid-

ing additional benefits to countries making credible commitments to spend debt service savings on poverty reduction.

Debt campaigners have challenged the G7's claim that HIPC-2 could reduce \$100 bn of debt. They allege the G7 has "cooked" the books by including several countries which are unlikely to qualify because of conflict and protracted stand-offs with creditors. These include Liberia, Democratic Republic of Congo, Angola, Sierra Leone and Myanmar. Christian Aid, a UK-based NGO, calculates that the G7's proposals bring only \$16 bn in additional debt cancellation.

The new deal on paper

Extrapolating from recent World Bank/IMF projections of various countries' debt ratios at completion, *Africa Recovery* estimates that on paper, the changes would enable between

six and 10 more countries to qualify for HIPC treatment.

For example, the new sustainability ratios would re-admit Benin — deemed in 1998, with Senegal, to have "sustainable" debt ratios — on the grounds of a debt/export ratio projected at 187 per cent at completion point. The Central African Republic and Chad should qualify on similar grounds, with ratios of 175 per cent and 218 per cent respectively. Madagascar and Mali are also contenders, with projected ratios of 223 per cent and 221 per cent, along with Tanzania (233 per cent).

New ratios for countries under fiscal stress — a debt-to-revenue ratio of 250 instead of 280 per cent — would also admit Togo. Although Togo had a debt-to-revenue ratio of 291 per cent, it was excluded under HIPC-1 because its export-to-GDP ratio is 34 per cent and its revenue-to-GDP ratio is 16 per cent. Cameroon, hitherto a borderline case because of its 220 per cent debt-to-export ratio, should now qualify unequivocally.

Questions remain over Ghana and Senegal, for which stress indicators appear on the borderline relative to the new sustainability targets. Ghana's projected debt-to-export ratio of 138 per cent could worsen if the price of cocoa and gold fall much further. Senegal's debt-to-revenue ratio of 242 per cent is already slipping over the 250 per cent mark, officials say.

The new sustainability ratios provide for deeper relief to these and another 16 countries, including some which have already qualified for full HIPC treatment such as Burkina Faso and Côte d'Ivoire. It would also provide additional relief retrospectively to Uganda and Mozambique.

The new deal in practice

But many of the new qualifiers, and other candidates for deeper debt relief, may not be making claims in the foreseeable future. Nine potentially eligible countries have not met the basic policy criterion of having some form of adjustment programme in place, and seem unlikely to do so because of civil or military conflict or poor relations with the IMF and World Bank.

According to the Bank/Fund *Perspectives* document, countries without adjustment programmes are: Angola, Burundi, Democratic

Republic of Congo, Equatorial Guinea, Liberia, Myanmar, São Tomé and Príncipe, Somalia and Sudan.

Also, several countries with adjustment deals in place have an interrupted track record. In 1997, creditors anticipated that some 28 countries could reach decision point by 2000. Nine of these — Chad, Republic of Congo, Côte d'Ivoire, Ethiopia, Madagascar, Mauritania, Senegal, Togo and Vietnam — had their programmes delayed on grounds of policy slippage. Armed conflict has delayed progress in Sierra Leone and Guinea-Bissau, and contributed to the policy slippage in Ethiopia and Republic of Congo.

A better deal for those who make it

For all such problems, countries that make it through the policy hoops will get a materially better deal under HIPC-2 than under HIPC-1. One of the key problems with HIPC-1 is that it underestimates a country's vulnerability to external shocks, and thus its capacity to "exit" from debt distress. Creditors calculated that Uganda's debt would be sustainable at 201 per cent of exports and put together a debt reduction package in 1998. Barely a year, later, a dive in the price of coffee, Uganda's main export, returned its debt to unsustainable levels. The new ratios in HIPC-2 take more account of external vulnerability, and are generally more realistic and manageable.

'Front loading'

Deeper relief and front loading should also enhance debtors' cash flow much earlier. This is a considerable improvement on HIPC-1, which does not significantly change debt service payments in the early years, as the *Perspectives* document concedes: "For the first seven countries to reach decision point, scheduled debt service payments after receiving prior HIPC assistance are not dramatically different from the actual debt service paid for the period prior to the decision point. Indeed, debt service owed by Burkina Faso and Mali [is] expected to increase."

Among the reasons for the initial appearance of little or no gain under HIPC-1 is the "regularisation" of relations with creditors, a necessary pre-condition for any debt reduction

HIPC-2: Potential African beneficiaries and new qualifiers		
Country	Debt/ export ratio	Debt/ revenue ratio
Benin*	187	166
Burkina Faso	250	203
Cameroon	219	278
Burundi	567	462
Central African Rep.	175	288
Dem. Rep. Congo	270	466
Chad	218	308
Congo Rep.	187	410
Ghana	138	175
Côte d'Ivoire	146	293
Madagascar	223	327
Ethiopia	251	184
Mali	221	324
Guinea-Bissau	783	666
Mauritania	266	363
Senegal*	126	242
Mozambique	548	638
Tanzania	233	243
Niger	248	274
Togo	136	291
Rwanda	534	200
São Tomé & Príncipe	651	971
Sierra Leone	262	427
Uganda	246	260
Zambia	446	634

* Both would requalify

Source: UN Africa Recovery

deal. This means taking into account all obligations due, rather than debt actually serviced in previous years. So any country that has not been meeting most of its debt service payment obligations could find itself paying out more after a HIPC deal, unless debt reduction is substantial.

Details on the likely impact of HIPC-2 on specific countries are scant. For Mozambique, which reached completion point on one of the better HIPC-1 packages in July this year, the deal reduces the debt-to-export ratio to 200 per cent this year from the 466 per cent projected for end-1998. The IMF estimates that HIPC-1 reduces Mozambique's average debt service during 1999-2005 to \$73 mn, substantially better than the \$104 mn paid last year and the \$169 mn Mozambique would have paid without a HIPC deal.

The Fund says the Cologne plan would reduce Mozambique's debt service even more. But, as HIPC-1 is scheduled to reduce Mozambique's debt-to-export ratio to 132 per cent by 2005 anyway, it is not clear how HIPC-2 will enhance Mozambique's position.

The other critical issue posed by the new plan is funding. The IMF estimates the total cost to creditors of HIPC-2 at around \$27.5 bn — more than double the \$12.5 bn projected for HIPC-1, and excluding bilateral cancellation of ODA debt.

Since creditors lack sufficient funds and commitments to fully finance HIPC-1, prospects for funding HIPC-2 are unclear. The *Perspectives* document notes that HIPC-1 has already overshot the August 1998 cost projections by 29 per cent, because countries with declining export earnings require creditors to provide more relief.

'Academic' focus on costs

Critics argue that the focus to date on total costs is rather academic, given that relief is committed and disbursed on a "pay as you go" basis, well spread over time. And since only four countries have reached completion point, demands on creditors have been relatively modest. But faster implementation and front loading under HIPC-2 should require creditors to mobilize commitments and cash more rapidly.

There is no data on projected contributions for HIPC-2 yet, nor any comprehensive plan for raising cash beyond a commitment by some creditors to sell part of their gold reserves. The IMF says it is "ready to play its part" in financing its share of the costs of an enhanced initia-

Some sensitive issues of deeper debt relief

World Bank Vice-President for Africa Callisto Madavo spoke with *Africa Recovery* in New York in early June 1999.

Major creditors have engaged in "some one-upmanship, a sort of competition" to announce proposals for improving the HIPC package, Mr. Callisto Madavo, a World Bank Vice-President for Africa, told *Africa Recovery* a couple of weeks before the Cologne summit of the Group of Seven in June. But "people have been rather silent about how it is going to be financed," he observed, asking whether creditors are prepared to "dig deep into their pockets... without playing a game in which the contribution to HIPC is taken at the expense of official development assistance flows."



Mr. Callisto Madavo

But HIPC countries also have responsibilities, and it would be a "tragedy and a hoax of the first order" if debt relief goes into "supporting airports at villages of presidents in Africa, or buying executive jets," Mr. Madavo added. Asked to defend this simple version of the "moral hazard" issue (where fresh lending and debt relief supposedly "reward" bad practices), he conceded that the "chances of such misuse of funds are minimal." Still, he insisted, the subject must be kept alive.

On the distribution of debt-relief costs — known as "burden sharing" — between and among multilateral and bilateral creditors, Mr. Madavo said this complex issue must be handled with sensitivity and in a spirit of solidarity "to make sure that everybody does in fact make a contribution." France, for example, is "much more exposed in Africa than, say, the US. So depending on the solution chosen, the impact on the bilaterals could fall very differently, and that needs to be harmonized." Among multilaterals, he said resources would have to be found for the African Development Bank which "does not have the capacity to carry" some of its debt relief obligations. The World Bank could itself face extra costs of some \$2.5 bn, and would have to "ask for some contributions" from bilaterals so it could fulfil its own obligations.

Asked if he recognized the category of "odious debt" — debt incurred by a previous regime for repressive and/or corrupt practices — Mr. Madavo said: "One would be lying if one did not admit that there are dimensions of this debt problem where that is very much there. The question is: how do you define it? How do you handle it in a way that you don't in some sense begin to undermine the sovereignty and credibility of governments in developing countries? What you are saying is that there are going to be certain debts that were incurred and should be honoured and other debts that should not be honoured. What are the criteria you are going to use to make these distinctions? I'm not running away from that issue. I'm just pointing to the complexity because it has all kinds of other implications. Who is going to decide?"

But "odious" debt is very important for such countries as the Democratic Republic of Congo and Rwanda, *Africa Recovery* insisted. "Agreed," said Mr. Madavo, concluding the interview with an enigmatic smile.

— Nii K. Bentsi-Enchill

tive through gold sales. "Management is committed to conducting such sales," it said in June. Some expect the sale will involve around 5-10 mn ounces of gold. The UK recently sold 803,768 ounces to help finance HIPC.

Funding plans already under attack

However, such funding ideas have come under attack in recent months. The US Congress strongly opposes the IMF's plan to sell gold, and could well block any sale. The World Gold Council and African gold producers have stepped up their criticism of official gold sales

in general. Sales and talk of more sales to fund HIPC have helped to drive the gold price down to around \$250-\$260 an ounce, with serious consequences for South Africa and Ghana, where some 2,000 mineworkers have already been laid off.

Moreover, new donor commitments to Kosovo and plans to stabilize the Balkan region after the recent war between NATO and Serbia, are expected to be funded from aid budgets. This raises questions about how much the European Union and bilateral creditors will contribute. ■