Annex. The HIPC Initiative

At their meetings in September 1996, the IMF's Interim Committee and the IMF and World Bank's Development Committee endorsed specific proposals put forward jointly by the IMF and the World Bank to address the problems of a limited number of HIPCs that follow sound policies, but for which traditional debt-relief mechanisms are inadequate to secure a sustainable external debt position over the medium term. The Committees requested the two institutions to proceed quickly with the implementation of the Initiative.

The Interim and Development Committees endorsed in September 1996 a program of action proposed by the Managing Director of the IMF and the President of the World Bank to resolve the debt problems of HIPCs. The HIPC Initiative represents a commitment by the international financial community to reduce to sustainable levels the external debt burden of an eligible country that successfully completes a period of strong policy performance. This would reinforce these countries' efforts toward macroeconomic adjustment and structural and social policy reforms and assure that a country's debt burden does not inhibit its capacity for sustained growth. Social development policies would be selected according to their importance in the debtor's reform program and effect on reducing poverty, including especially actions to improve basic health care and education. Procedures adopted for implementing the Initiative require all relevant creditors and donors to coordinate their action in the context of a number of steps to be taken at various stages, as outlined below and illustrated in Figure 2:

- *First stage.* Paris Club creditors will provide a flow rescheduling under Naples terms (up to 67 percent reduction of the NPV of eligible debt) along with comparable action by other bilateral and commercial creditors. Multilateral institutions and bilateral donors will continue to provide support under adjustment programs supported by the IMF and the World Bank. Countries would establish their first three-year track record of good performance.
- *Decision point.* Toward the end of the first stage, the IMF and the World Bank will agree with the country authorities on a DSA in consultation with other creditors concerned. Based on this analysis, if strong policies and a Paris Club stock-of-debt operation on Naples terms are sufficient to put the country in a sustainable external debt position within three years (completion point), the country would re-

quest such a stock-of-debt operation and would not be eligible for assistance under the Initiative. Alternatively, if the assessment indicates that a country's overall debt burden will not be sustainable by the completion point, it will be deemed eligible for and may request support under the Initiative. In borderline cases, the country may defer the stock-of-debt operation and request a further flow rescheduling under Naples terms and would be assured of additional action at the completion point, if needed to achieve debt sustainability.

- *Second stage.* For countries that are deemed eligible for support under the Initiative, the Paris Club—along with other bilateral and commercial creditors—will provide, on a case-by-case basis, flow reschedulings on more concessional terms involving an NPV reduction on eligible debt of up to 80 percent in present value terms. The country would establish a further three-year track record of good performance under adjustment programs supported by the IMF and the World Bank during which time some of the exceptional assistance committed by multilateral creditors could be provided, in addition to the flow rescheduling on enhanced terms agreed with nonmultilateral creditors.
- *Completion point.* The Paris Club will provide, along with other bilateral and commercial creditors, on a case-by-case basis, a stock-of-debt reduction of up to 80 percent in present value terms on eligible debt. Multilateral institutions will take proportional action to that provided by bilateral creditors as a group for the country to reach a sustainable debt situation, while ensuring broad and equitable participation by all creditors.

Eligibility

The Initiative would be open to all HIPCs that pursue programs of adjustment and reform supported by the IMF and the World Bank before October 1998, after which the Initiative would be reviewed and a decision made whether it should be continued. To qualify for exceptional assistance under the Initiative, countries would have to be eligible under ESAF and IDA-only and face an unsustainable debt situation after the full application of traditional debt-relief mechanisms and would have to demonstrate an appropriate track record of adjustment and reform. Whether or not a particular country would be eligible for action will be determined by the Executive Boards of the World Bank and the IMF at the decision point, based on DSAs prepared jointly by the staff of both institutions in close cooperation with the country authorities. Currently Bank and IMF staff members are preparing DSAs for several countries that could be considered likely, based on their track records of performance (see below), to reach their decision points in 1997.

Track Record of Performance

Debt is only one of the serious problems confronting the HIPCs and a track record of policy performance will be necessary to ensure a lasting solution not only to the country's debt problems but to its underlying economic difficulties; it will also be necessary in order to give confidence to creditors and donors that the exceptional assistance will be put to good use.

The required six-year performance period under the Initiative would be implemented flexibly on a case-by-case basis. The six countries (Benin, Bolivia, Burkina Faso, Guyana, Mali, and Uganda) that have already been granted a stock-of-debt operation by the Paris Club on Naples terms in 1995–96 can be considered to have established the track record required under the first stage of the Initiative. Other countries that have embarked on IDA- and ESAF-supported programs would be considered to be already engaged in the first stage. Exceptionally, the second stage of three years might be shortened for countries that have already established sustained records of strong performance (such as Bolivia and Uganda).

Action by All Creditors

All creditors are expected to participate in providing exceptional assistance beyond current mechanisms as required to reach debt sustainability—the fundamental objective of the Initiative. There is broad support from all creditor groups for a proportional approach, flexibly interpreted, toward sharing the costs of the HIPC Initiative between multilateral and official bilateral creditor groups. Under this approach, the costs of the HIPC Initiative would be shared by bilateral and multilateral creditor groups in proportion to the present value of their outstanding claims at the completion point. For this calculation, the claims of bilateral creditors would be measured after the full application of traditional forms of debt relief, that is, Naples terms from Paris Club creditors involving a 67 percent NPV reduction in eligible debt, and at least comparable action by other bilateral and commercial creditors. All creditors will be fully consulted on the action that would involve them under the Initiative.

- **Bilateral and commercial creditors**: Paris Club creditors are ready to go beyond Naples terms and provide NPV debt reduction of up to 80 percent, on a case-by-case basis. They have indicated a readiness to consider carefully the appropriate coverage of debt subject to 80 percent NPV reduction to achieve debt sustainability. Consistent with current practice, debtors would seek treatment on debt owed to other bilateral and commercial creditors on terms at least comparable to those agreed with the Paris Club.

- **Multilateral creditors** will take proportional action to that provided by bilateral creditors as a group so that the country can achieve overall debt sustainability. The assistance provided by multilateral creditors should involve broad and equitable participation by all creditors and should preserve the financial integrity of the institutions and their preferred creditor status. Multilateral institutions will participate in the Initiative through action to reduce the NPV of their claims either through the HIPC Trust Fund or through parallel action.

- **The World Bank** is committed to take action during the second stage—through the selective use of IDA grants and supplemental IDA allocations—and at the completion point. The principal vehicle envisaged for Bank participation, together with some other multilateral creditors, is a multilateral HIPC Trust Fund administered by IDA. The World Bank has set aside US$500 million from its IBRD surplus as an initial contribution to the HIPC Trust Fund. Funds transferred by the World Bank to the HIPC Trust Fund will be earmarked to provide relief on debt owed to IDA. Additional transfers of IBRD net income to the HIPC Trust Fund are envisaged, as needed, for the World Bank's contribution to debt relief, subject to the IBRD income allocation framework and the approval of IBRD's Executive Directors and Board of Governors.

- **IMF**: Implementation of annual ESAF arrangements will form the economic policy basis for the IMF's participation in the Initiative, and the needed financial resources will come from the pool of resources for ESAF operations. However, in the context of the Initiative, special operations will take the form of grants or highly concessional loans on extended maturities that will be used to retire obligations falling due to the IMF and result in a reduction in the NPV of IMF claims on the debtor country.