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The HIPC Initiative

3.1 The Highly Indebted Poor Country (HIPC) initiative was launched by the International Monetary Fund (IMF) and the World Bank in 1996, and links bilateral and multilateral debt relief with structural reforms in the economies of participating nations. The HIPC initiative was the first attempt to create a comprehensive debt relief framework involving multilateral, bilateral and commercial creditors. The principal objects of the plan are that restructuring debt repayments to a sustainable level, debt forgiveness, promoting economic reform and investment in social infrastructure will provide conditions to attract foreign investment in a developing nation's economy. Up to 41 countries may be eligible for debt forgiveness under the HIPC initiative and it is open to those countries which are:

- eligible for concessional assistance from the World Bank's International Development Agency (IDA) or the IMF's Enhanced Structural Adjustment Facility (ESAF), and thus cannot afford access to commercial credit;
- face an unsustainable debt burden even after attempting to reschedule their debt repayments; and
- have demonstrated over time a good track record of implementing social and economic reforms.[1]

3.2 Debt forgiveness under the initiative has been made conditional on developing countries liberalising their economic sectors and reducing the state's role in the economy. The ESAF is an attempt to correct perceived deficiencies in the economies of developing countries. The IMF hopes that this process will build confidence in these economies, thereby attracting

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1 The World Bank Group, 'Frequently Asked Questions', September 1999, http://www.worldbank.org/hipc/faq/faq.html, 26 September 1999.

foreign investment and stimulating growth, which in turn may reduce unemployment and poverty. For example, these measures may require:

- balanced or near balanced budgets which may require higher taxation;
- inflationary controls;
- the dismantling of government owned monopolies and removing subsidies for basic foods and local industries;
- the removal of policies that protect domestic industry such as reducing tariff barriers; and
- the devaluation of local currencies.

3.3 Under the original HIPC initiative, countries had to meet targets for a period of three years before a debt relief package is agreed ('the decision point'), and then another three years before debt relief is delivered ('the completion point').

3.4 During the first three-year period, a HIPC works with the World Bank and IMF to establish a record of good economic policies and sustained poverty reduction through the ESAF. At the end of this three-year period it is decided whether a country's debt level is sustainable. For those countries with unsustainable debt burdens after full use of existing debt relief mechanisms, a package of debt forgiveness is identified.

3.5 The second three-year period is designed to ensure that countries reaching their completion points have well established policies consistent with a viable and sustainable development strategy.[2]

Criticisms

3.6 Criticisms of the HIPC initiative have focused on the strict qualifying criteria, the limited amount of debt forgiveness and the long compliance period that countries must adhere to before debt forgiveness is offered.

Strict qualifying criteria

3.7 The HIPC process is seen by some as imposing too many and inappropriate restrictions on granting debt forgiveness. In particular, debt forgiveness is to be granted according to a country's debt-to-exports ratio, although this does not account for the individual government's ability to

2 The World Bank Group, 'Frequently Asked Questions', September 1999, http://www.worldbank.org/hipc/faq/faq.html, 18 October 1999.

service debt from its national budget. Therefore, it has been suggested that limits be placed upon the amount of debt servicing that governments of HIPCs repay as a proportion of GNP.[3]

3.8 Additional criteria have been added in an attempt to ensure that HIPCs make investments in social infrastructure, although the best method for ensuring that money is spent in this area remains to be determined.

3.9 As evidenced in the IMF's response to the Asian currency crisis of 1997, severe austerity measures may have serious economic, social and even political consequences.[4] In response, the Commonwealth Secretariat has suggested that the ESAF should only be applied after an assessment of the impact on the most vulnerable groups in society.[5]

3.10 The United Nations Children's Fund (UNICEF) suggests such austerity programs affect the poor and children the most, especially in the short term. For example, removing subsidies on food will increase food prices and increase malnutrition; removing support for local industry will cause businesses to close and increase unemployment; and reductions in social welfare spending will affect the health and education of current and future generations.

Limited amount of debt forgiveness

3.11 The original HIPC initiative was criticised by several NGOs as providing insufficient relief for debtor countries. Many countries that qualify for the initiative pay only a fraction of the debt service due, because of existing rescheduling by agreements with the IMF. Under the initiative, their total debt will be reduced, although their repayments will remain high in the short term. For example, Mozambique's annual debt servicing bill would only have been reduced from US$108 million to US$96 million.[6] The issues of how such countries can adequately fund basic services remained to be resolved.

3.12 The HIPC initiative after the review process would forgive approximately US$27 billion in existing debt. This would save HIPCs even more in the long term by removing their obligation to repay the interest on these loans as well. By comparison, the Jubilee 2000 campaign calls for much deeper

3 Community Aid Abroad, April 1999, *Oxfam International Submission to the HIPC Review*, p. 9.

4 Larry Elliott and Alex Brummer, 3 July 1998, 'The IMF: One Size Does Not Fit All' in *The Guardian*, London.

5 Commonwealth Secretariat, 'Implementing the HIPC Initiative: Sharing Experiences', 3 August 1999, http://www.thecommonwealth.org:8080/htm/info/info/press/9947.htm, 18 August 1999

6 Community Aid Abroad, April 1999, *Oxfam International Submission to the HIPC Review*, p. 9.

and broader debt forgiveness - between US$160 billion and US$300 billion for 52 countries.

Long compliance period

3.13 Prior to the HIPC initiative, poor countries had to comply with three years of IMF reforms before receiving debt forgiveness from Paris Club creditors. The HIPC initiative added another three years to this - although the revised HIPC initiative has added some additional flexibility for those countries that meet conditions early.

3.14 Only five countries, Uganda, Bolivia, Guyana, Mozambique and Mali would have received debt forgiveness by the year 2000 under the HIPC initiative.[7]

G7 debt forgiveness proposals

3.15 In a series of three meetings from 12-20 June 1999, the finance ministers of the Group of 7 industrialised nations (G7), then the G7 leaders and then the G8 leaders agreed the Cologne (Köln) Debt Initiative. The deal signed at Cologne increased the amount offered under the HIPC initiative to give relief from debt to some of the world's poorest nations. It was agreed in principle to cancel US$27.4 billion in debt, which would reduce the debt service payments of up to 33 countries. The extra money agreed at Cologne should provide faster, deeper and broader debt relief by:

- allowing flexibility in the six year waiting period before completion points;
- front loading of the delivery of debt relief from the completion point.
- lowering of the debt-to-export target from the previous range of 200-250 per cent to 150 per cent and relaxation of other criteria;
- bilateral forgiveness of Official Development Assistance (ODA) debt for HIPCs qualifying for HIPC initiative assistance (on top of the above targets) and new ODA preferably in the form of grants; and
- forgiving up to 90 per cent and more where needed of eligible debt by the Paris Club.[8]

7 Community Aid Abroad, April 1999, *Oxfam International Submission to the HIPC Review*, p. 14.

8 The International Monetary Fund, 'Overview: Transforming the Enhanced Structural Adjustment Facility (ESAF) and the Debt Initiative for Heavily Indebted Poor Countries (HIPCs)', 24 September 1999, http://www.imf.org/external/np/esafhipc/1999/index.htm, 18 October 1999