

## Debt Relief for Poverty Reduction

It is internationally recognised that the debt burden of the world's poorest, most indebted countries has to be tackled if they are to set themselves on a path of sustainable growth, development and poverty reduction. Since 1999, the enhanced Heavily Indebted Poor Countries' (HIPC) Initiative has been providing faster, broader and deeper debt relief to poor countries committed to eradicating poverty. The objective is to provide a permanent exit from unsustainable debt burdens. In total, this debt relief package is worth US\$100 billion.

To date, 27 HIPC countries have qualified for this exceptional debt relief. Relief totalling more than US\$70 billion is being provided to these countries, reducing their debts by around two-thirds on average.

The international community has stated strongly that the rationale for debt relief is to allow countries to tackle poverty more effectively. HIPC debt relief releases resources for this purpose, and helps to re-establish a country's economic position. To this end, every HIPC country develops a national poverty reduction strategy, setting out how they will tackle poverty and specifying how the debt relief savings, and other development resources, will

be used. Civil society is involved in the development of these strategies, so that they command broad-based support.

### The Context

All countries have debt, it is a consequence of normal economic activity. When countries put the money borrowed to productive use, they benefit from faster economic growth and increased spending on social services.

But some countries, through adverse economic factors, misfortune, bad spending decisions, corruption or unwise lending or borrowing, acquired a level of debt that was too high for them to repay. The consequences of such high levels of indebtedness on the lives of the poor has aroused deep concern across the world, as shown by the huge popular response to the Jubilee 2000 campaign, and subsequent Jubilee Debt Campaign.

Debt relief is not new. Since the early 1960s, measures have been taken by government creditors (known as the 'Paris Club') to delay repayments, and more recently, to write off up to two-thirds of the face value of the debt. Commercial banks provide relief on comparable terms to the Paris Club, but most of the poorest countries have little

commercial debt. Some donors, such as DFID, have written off old aid loans. However, it was found that these measures were not sufficient to deal with the very high levels of indebtedness of some of the poorest countries.

The original HIPC Initiative, launched by the International Monetary Fund (IMF) and World Bank in 1996, recognised that exceptional relief was required to bring about a once and for all reduction

**Some one in five of the world's population live in extreme poverty. Governments worldwide have agreed to work together to halve the proportion of people living in extreme poverty by 2015, and to other targets including universal primary education and improved healthcare. The British Government is strongly committed to these targets.**

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## HIPC DEBT SUSTAINABILITY RATIOS

	Original	Revised
Debt to Export (%)	200 - 250	150
Debt to Government Revenue	280	250

in the debts of some of the poorest countries. For the first time, this included debt relief from multilateral institutions, such as the IMF, the World Bank, and the Regional Development Banks. The 1999 revision to the HIPC Initiative was a consequence of a review led by the UK Government, which believed improvements were necessary following the experiences of some of the first countries to qualify for HIPC debt relief.

Under the revised HIPC framework, each qualifying country receives more debt relief, with the amount provided being determined by the debt sustainability ratios. A country's debt is compared with (a) its export earnings and (b) government revenue, and relief is provided to bring the ratios down to the levels indicated above. Reducing the debt sustainability ratios has meant that more countries benefit from HIPC relief under the enhanced Initiative.

Countries deemed eligible on account of the level of their debt sustainability ratios qualify for debt relief in two stages. They reach the first stage, known as Decision Point, when they have demonstrated their commitment to

poverty reduction by pursuing sound policies and undertaking reforms agreed with the IMF. At this stage, they receive interim relief on the 'flow' of payments. When HIPC governments have demonstrated progress in tackling poverty, they reach the second stage, known as Completion Point. At this stage, they receive an irrevocable reduction in their 'stock' of debt. Under the original framework, Completion Point was reached after three years of implementing reforms but, as part of the HIPC revision, it was agreed that Completion Point would be 'floating'. Rather than coming after a fixed length of time, it would be dependent on HIPC governments demonstrating progress in tackling poverty by meeting the Completion Point conditions or 'triggers', which are linked to the national poverty reduction strategy. In the interim period between Decision and Completion Points, countries are not required to service their debt and cease to make payments. In this way, the enhanced HIPC Initiative delivers faster debt relief, and the savings feed directly into increased social expenditure from Decision Point.

## Financing the HIPC Initiative

Governments provide relief to qualifying HIPC countries on debts they hold on a proportional basis. However, around half of this debt relief needs to be provided by multilateral institutions. Not all Multilateral Development Banks are able to cover the costs of providing their share of debt relief from their own resources, and therefore require additional funds. The HIPC Trust Fund was established to receive and manage contributions from governments.

The UK is the second largest bilateral contributor to the HIPC Trust Fund. In September 2002, we pledged a further US\$95 million plus our share of European Commission money (US\$30 million). This was additional to the US\$309 million, including our share of EC/European Development Fund money (US\$88 million) already committed. The UK has also contributed US\$43 million to assist the IMF with its costs of delivering HIPC debt relief. The European Commission has now committed US\$918 million to the Trust Fund bringing total pledges to almost US\$3.4 billion.

The table to the left shows the pledges made to the HIPC Trust Fund by November 2003.

## BILATERAL DONOR PLEDGES TO THE HIPC TRUST FUND

DONOR	PLEDGE total US\$ million
Australia	14
Austria	50
Belgium	64
Canada	165
Denmark	80
Finland	44
France	255
Germany	330
Greece	17
Iceland	3
Ireland	25
Italy	216
Japan	256
Korea	10
Luxembourg	4
Netherlands	242
New Zealand	2
Norway	106
Portugal	24
Russian Federation	10
Spain	164
Sweden	109
Switzerland	93
United Kingdom	434
United States	750
<b>Total</b>	<b>3467</b>

### Notes

1. Contribution from the European Commission is included in totals for member states.
2. In addition, the UK contributed £26.6 million to the HIPC Trust Fund for the IMF for debt relief to Uganda.

## Making HIPC More Effective

The UK is supporting a range of measures to ensure that the HIPC Initiative is as effective as possible. These measures include a capacity-building programme to improve countries' debt management, a donor funded technical assistance facility to provide legal advice to countries facing litigation from non-participating creditors and additional relief for countries that risk exiting the process with debts above the HIPC thresholds.

At the Annual Meetings of the IMF and the World Bank held in Dubai in September 2003, the international community reviewed the status of the HIPC Initiative and reconfirmed their commitment to its objectives, full financing and implementation. They confirmed that additional relief can be provided at Completion Point (so-called 'topping-up'), on a case-by-case basis, for those countries which risk exiting the Initiative with debts above the HIPC threshold due to external shocks. The IMF and the World Bank were encouraged to do further work on ways to help reduce the vulnerability of these countries to exogenous shocks, including commodity market and weather-related shocks.

## Debt Relief and Poverty Reduction

The central focus of the UK Government's international development policy is a commitment to the Millennium Development Goals, which include halving the proportion of people living in extreme poverty by 2015, and targets on universal access to primary education and basic health care provision.

Debt relief is a key element in meeting these targets. However, the link with pro-poor policies is crucial. Only in this way will the poor benefit from debt relief measures. If debt relief were unconditional, the consequence could be increased military or prestige spending leading to more debt.

In developing national poverty reduction strategies, HIPC governments involve their Parliaments, civil society and international donors in their discussions. The strategies analyse the causes of poverty, and set out how poverty will be tackled, specifying how resources, including savings from debt relief, are spent. It is important that the development of these strategies is transparent and participative, so that they are well grounded in a good understanding of poverty, and command broad based support. These strategies are now the basis on which the World Bank and the IMF provide assistance to HIPC and other poor

## DEBT RELIEF AGREED UNDER HIPC INITIATIVE (\$ MILLION, NET PRESENT VALUE)

	Nominal Debt Relief (US\$m)	Net Present Value (US\$m)
Benin	460	265
Bolivia	2,060	1,302
Burkina Faso	930	553
Cameroon	2,000	1,260
Chad	260	170
Congo, DR	10,389	6,311
Ethiopia	1,930	1,275
Gambia	90	67
Ghana	3,700	2,186
Guinea	800	545
Guinea-Bissau	790	416
Guyana	1,030	585
Honduras	900	556
Madagascar	1,500	814
Malawi	1,000	643
Mali	895	539
Mauritania	1,100	622
Mozambique	4,300	2,023
Nicaragua	4,500	3,267
Niger	900	521
Rwanda	800	452
Senegal	850	488
Sao Tome & Principe	200	97
Sierra Leone	950	600
Tanzania	3,000	2,026
Uganda	1,950	1,003
Zambia	3,850	2,499
<b>Relief under HIPC</b>	<b>\$51 billion</b>	<b>\$31 billion</b>
<b>Total relief under Cologne package</b>	<b>\$70 billion</b>	<b>\$43 billion</b>

Note: Debt relief provided under the Cologne package is in the form of aid debt cancellation, traditional debt relief mechanisms of the Paris club and additional bilateral relief.

countries. Some governments, including the UK, have also committed to focusing their international development programmes on supporting these strategies. A DFID Background Briefing on Poverty Reduction Strategies is available.

### Progress to Date

To date (February 2004), 27 countries have qualified for debt relief under the enhanced HIPC Initiative. Of these, 17 countries have reached Decision Point and are receiving interim relief, and 10 have reached Completion Point and received a reduction in their debt stock. The table below provides details of the countries that have qualified and the debt relief agreed.

This relief will reduce the debts of these 27 countries by around two-thirds, on average. The impact on debt servicing shows that payment falls by about a third; this is less marked than the reduction in debt stock, as substantial portions of debt were not being serviced. For example, Mozambique's debt payments in the years 2000 – 2002 were around US\$50 million a year – less than half what they paid in 1998 (US\$104 million); without debt relief, Mozambique would have owed more than US\$450 million in each of the years 2000 – 2002.

HIPC governments have already begun to indicate how they plan to use the resources freed from debt relief.

Increases in education and health spending are expected to absorb about two-thirds of the total relief, with around 40 per cent directed towards education and 25 per cent to health care. Other priority sectors include HIV/AIDS, where almost every HIPC country is creating or strengthening education and treatment programmes, rural development and water supply, governance and institution building, and road construction.

The social expenditure of countries that have qualified for debt relief under the HIPC Initiative has already begun to rise – from US\$6,067 million in 1999 to US\$9,997 million in 2003; this is expected to increase further over the coming years. Poverty reducing expenditure is projected to be around five times more than spending on debt servicing in the years 2004 and 2005.

In 2000, Uganda became the first country to reach its Completion Point; this was followed by Bolivia, Mozambique and Tanzania in 2001, Burkina Faso and Mauritania in 2002, Benin, Mali and Guyana in 2003, and Nicaragua in early 2004. We hope that Nigeria and Ethiopia will reach their Completion Points shortly.

There are 10 HIPC countries with an unsustainable debt burden that have yet to qualify for debt relief under the enhanced HIPC Initiative. Seven of these are affected by conflict: Burundi, Republic of Congo, Cote D'Ivoire, Liberia, Myanmar, Somalia and Sudan. In the remainder, there are concerns about governance. The UK Government has announced that it will hold in trust any debt service payments received from these countries; this money will be returned for spending on poverty

reduction once these countries reach Decision Point.

The panel below shows the position of these remaining heavily indebted poor countries.

## UK Assistance on Debt

The UK has provided considerable assistance on debt, in addition to the contributions to the HIPC Trust Fund outlined. The Government has already cancelled the aid debts for all the poorest countries, not just HIPC countries, worth some £1.2 billion. The remaining debts owed by HIPC countries are to the Export Credits Guarantee Department (ECGD) and Commonwealth Development Corporation (CDC). The UK provides full debt relief on all these remaining debts for qualifying HIPC countries to free up more resources for investment in poverty reduction programmes – that is

### HIPC COUNTRIES THAT HAVE NOT QUALIFIED FOR DEBT RELIEF

#### Those that could qualify for relief

Burundi  
 Central African Republic  
 Comoros  
 Congo, republic  
 Cote D'Ivoire  
 Liberia  
 Myanmar  
 Somalia  
 Sudan  
 Togo

#### "Sustainable HIPCs"

Angola  
 Kenya  
 Vietnam  
 Yemen

#### Those not opting for debt relief

Lao PDR

Those countries classified as "sustainable" are thought to be able to achieve debt sustainability by traditional debt relief mechanisms, and not require HIPC levels of debt relief.

## DEBT RELIEF FOR MOZAMBIQUE

Mozambique is one of the poorest countries in the world: the Human Poverty Index gives a figure of 56.8 per cent of the population of 18 million people living in poverty. Mozambique's debt burden was accumulated primarily during the period of civil war 1978-92. Other factors that affected Mozambique's high level of debt include external shocks (terms of trade and weather-related), lack of adjustment and reforms, and creditors' financing and refinancing policies. By 1998, Mozambique's total foreign debt, even after repeated rescheduling and write-offs by various bilateral creditors, stood at US\$5.5 billion in nominal terms.

In April 1998, Mozambique became eligible for debt relief under the original Heavily Indebted Poor Countries (HIPC) Initiative. In June 1999, some US\$1.7 billion of Mozambique's debt was waived. In 2000, Mozambique qualified for additional relief under the enhanced HIPC Initiative, approved by creditor countries in November 1999. Cumulative debt cancellation reached US\$4.3 billion in nominal terms, reducing Mozambique's debt stock to around US\$750 million in net present value terms. In 2001, the Government of Mozambique completed the PARPA (Poverty Reduction Strategy Paper) process, leading to a further US\$53 million of debt relief.

Debt relief has led to a demonstrable increase in social spending in Mozambique, particularly in health and education. The medium term framework articulated in the PARPA sets out a re-definition of priority sectors with plans increasing spending consistent with the resource envelope. The six fundamental areas identified for action are education, health, agriculture and rural development, basic infrastructure, good governance, and macro-economic and financial management.

The Government of Mozambique has initiated steps to improve its capacity to manage debt. However, Mozambique will remain dependant on substantial concessional assistance in the medium term. Grants play an essential part in helping the government to manage its debt and meet its spending targets. Donors are working to ensure that debt relief, aid flows and government revenues are used in a coherent manner through aligning programming with PARPA objectives, co-ordinating donor funding, and using aid delivery mechanism to support public expenditure management reform.

100 per cent relief for these countries. A number of other governments, including Canada, France, Germany, Italy, Japan and the US, are also providing relief on their bilateral debts, on top of that delivered under the HIPC framework.

It is important that countries do not re-acquire very high levels of debts after they have received their debt relief. There are several factors which determine a country's ability to maintain sustainable levels of debt. One area is improving their debt management and developing a policy on future borrowing. DFID is co-funding the HIPC Capacity Building Programme, which provides technical assistance to build the capacity of HIPC countries to analyse and manage their debt position, and to negotiate debt relief with creditors and the International Financial Institutions. Another issue is more responsible lending. ECGD has committed itself to ensuring that the guarantees it provides for poor countries are not used for unproductive purposes, and the UK is pressing for international agreements on this issue. ECGD makes clear that it will ensure debt sustainability will be a prime determinant of the provision of its support for exports and investments to developing countries. In order to ensure that HIPCs (and other IDA-only countries) do not develop new unsustainable debt burdens, ECGD will

only provide support for exports or investments to these markets that meet Productive Expenditure Criteria.

Finally, external 'shocks', such as natural disasters or a marked decline in terms of trade, can pose a threat to a country's debt position. The UK Government remains ready to provide additional debt relief where necessary – so called 'topping-up' – to countries that have suffered a fundamental change in their economic circumstances due to external shocks.

Where governments are committed to eradicating poverty, debt relief can free up resources for investment in key programmes, and play an important part in our efforts to meet the Millennium Development Goals. But debt relief is only one of a range of measures through which poverty reduction can be achieved. Development assistance in other forms will continue to be essential. For some years, all UK bilateral aid to the poorest countries has been on grant terms, so as not to add to their debt burdens.

The UK Government announced in July 2002 that the UK level of official development assistance (oda) will increase by £1.5 billion to reach 0.4 per cent of gross national income (GNI) by 2005-06 – the biggest ever rise in UK aid. This is proof of the Government's continued commitment to make

progress towards meeting the UN target of an oda/GNI ratio of 0.7 per cent and means that the UK's aid ratio will be more than double the current G7 oda/GNI average. The UK Government has pressed others to follow our example and is pleased that in support of the Monterrey Consensus, the European Union made a commitment to reach an oda/GNI ratio of 0.39 per cent by 2006.

