



Redesigning debt

Lessons from HIPC for COVID, climate and nature

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The COVID-19 pandemic has put severe strain on the already stressed public finances of developing countries. The need for spending on health and welfare has not only led to increased borrowing, but also to deprioritising investment in addressing climate change and nature loss. Calls for additional debt relief are getting louder. To meet the multiple challenges of debt, climate change and biodiversity loss, a new model is needed.

Focusing on lessons from the Heavily Indebted Poor Countries (HIPC) Initiative, established 25 years ago by the World Bank and IMF, this paper proposes a new international debt relief initiative, which prioritises investment in climate and nature, to get developing countries' economies back on track post-pandemic.

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Summary

COVID-19 has placed severe strain on the public finances of developing countries. Debt levels that were already high before the pandemic increased further at a time when pressure to spend on health and social services became unavoidable. The G20's Debt Service Suspension Initiative (DSSI) launched in 2020 has gone some way to help the world's poorest countries cope with the fallout from the COVID-19 crisis, but calls for additional debt relief are getting louder. The worsening debt crisis has also meant that the challenges of addressing climate change and nature loss risk being deprioritised in countries' stressed budgets.

To ensure that the environmental agenda is not left out as developing countries try to get their economies back on track, a new debt reduction package linked with targeted investment to support action on climate and nature is needed. Such a package could draw lessons from previous initiatives, such as the Heavily Indebted Poor Countries (HIPC) Initiative, which was launched in 1996 by the IMF and World Bank to ensure that poor countries were able to manage their debt burden. The initiative claims to have provided close to US\$100 billion in debt relief¹ since then. Focusing primarily on lessons from the HIPC Initiative, this paper discusses proposals for a new facility for international debt relief for climate and nature. The strengths and limitations of the HIPC initiative highlighted in this paper can be useful to inform the design of a new global deal and make sure it generates much-needed consensus and engagement among the stakeholders who matter.

Two of the main strengths of the HIPC initiative that a new debt-for-climate-and-nature initiative can build upon are:

- Learning from the Poverty Reduction Strategy Paper (PRSP), which was the centrepiece for poverty reduction in HIPC, a global initiative on debt for climate and nature could focus on inclusive climate and biodiversity outcomes through commitments to key performance indicators (KPIs). These would be agreed between debtor and creditor and link debt relief with climate and nature, in the same way that HIPC was connected to poverty reduction.
- Achieving political consensus will be critical for the new initiative on climate and nature. HIPC, which was championed by the G7, including the UK, brought in strong political leadership to overcome vested interests and technical challenges. Similarly, the G20 and the leadership of the International Monetary Fund (IMF) and World Bank could champion the global initiative on debt and climate and nature.

Limitations that the new initiative can learn from include:

- The claims that HIPC did not do enough to prevent future rising debt burdens will have to be addressed within the new framework. The global initiative on debt, climate and nature must put in place the right framework to promote responsible borrowing, support inclusive growth, help countries adhere to sound public financial management and reduce wasteful public spending such as subsidies for fossil fuel energy.
- Insufficient national ownership in HIPC and limited engagement of affected poor women and men in many poverty programmes, which often suddenly stopped once the debt relief ran out, are important lessons to take on board. A new global initiative on climate and nature can avoid this through strong country engagement and more meaningful and credible national ownership around climate and nature actions.

Considering the strengths and weaknesses of the HIPC Initiative when designing a new platform will help to ensure that the debt relief also effectively contributes to financing climate, nature and biodiversity priorities. HIPC was considered a success in terms of development outcomes, but it has also been criticised for being unable to prevent a new build-up of unsustainable debt. A new initiative should aim to safeguard longer-term investment with high returns and positive environmental benefits (such as sustainable energy, climate-smart agriculture, labour-intensive soil and water programmes, and prevention of climate change damage), thus departing from the HIPC model, in which investment was partly fuelled by a debt-financed consumption-driven growth model.

Introduction

1

When the unexpected shocks from COVID-19 descended upon the global economy in early 2020, all aspects of economic and social life were put under severe strain. The risk of another wave of debt crises affecting many economies, especially in the global South, whose debt burdens were already alarmingly high, became a genuine reality. Government finances, especially in developing countries, faced acute pressures as revenue collection dramatically reduced and overall gross domestic product (GDP) contracted. At the same time, massive budgetary reallocation to finance urgent expenses in health and other essential services became inevitable. An equally important priority that risks being downgraded in those countries' heavily stressed budgets is addressing the combined impacts of climate change and nature loss.

Despite the decision from the international community to offer a suspension of debt service to improve the cash flow of low-income countries,² the debt problem is far from resolved. The call for more decisive actions on debt reduction has become louder, even after the establishment of the G20's Common Framework for Debt Treatment in November 2020.³ As the international community ponders further appropriate debt reduction solutions, the risk from climate change cannot be ignored. The economic costs of climate change are immense and may well undermine debt sustainability in many countries. Countries are committing themselves to significant spending on climate change adaptation and mitigation under the Paris Agreement at a time when they have very limited fiscal space. Environmentally

vulnerable developing countries in particular face pressures to adequately invest in essential climate change adaptation and mitigation efforts when they know that domestic resources are tight. High adaptation costs could make debt unsustainable as well. In recognising the myriad and daunting challenges posed by climate change, there is a genuine opportunity for low-income countries (LICs) to deal with their debt burden and in tandem tackle the challenge of climate and nature in their economies. Debt for climate and nature swaps can become one important avenue for dealing with investment in adaptation efforts while keeping debt sustainable. There is a compelling argument for investing the proceeds from debt reduction specifically into climate and nature actions.

With the expectation that the twin themes of debt and climate change will dominate the global agenda over the coming years and possibly beyond, this paper considers a platform for linking debt relief with targeted climate action based on upscaled global debt-for-climate-and-nature initiatives. It specifically focuses on drawing some pertinent lessons from past debt reduction experiences such as the Heavily Indebted Poor Countries (HIPC) Initiative, which continues to be relevant today for heavily indebted countries such as Somalia and Sudan. The paper also proposes how these lessons can be applied to an international debt-for-climate-and-nature framework that can benefit a broad range of countries – those which are debt distressed and beyond.

What could an international debt-for-climate-and-nature initiative look like?

2

According to the IMF, emerging and developing countries' debt was already high prior to COVID-19, reaching a peak of more than 170% of GDP in 2019 (Figure 1).⁴ With the pandemic worsening their economic plight, there is no doubt that many of those economies will require more decisive debt reduction to help them ease the fiscal pressure and deal with the economic downturn. As such, there is an expectation that some form of deeper debt relief would have to be agreed upon internationally. However, those who are keen to see a new path for global development, whereby resources released from debt reduction are better used, have been clamouring for more urgent actions besides merely approving a new debt deal for improving countries' finances.

In its communiqué on the Debt Service Suspension Initiative (DSSI) proposal,¹ the G20 called upon the IMF "to explore additional tools that could serve its members' needs as the crisis evolves, drawing on relevant experiences from previous crises".⁵ The need to tackle climate change and specifically to create the environments to enable people, biodiversity and ecosystems to flourish are important objectives for meeting commitments of the Sustainable Development Goals (SDGs). To ensure that the climate agenda is not left out as developing countries try to get their economies back on track from the pandemic, a new debt reduction package could be linked with targeted investment to support climate action. One such 'tool', as requested by the G20, could be a debt-for-climate-and-nature facility. If well-structured and widely endorsed, this could stimulate further investment in

BOX 1: DEBT MANAGEMENT FOR CLIMATE AND NATURE INITIATIVE

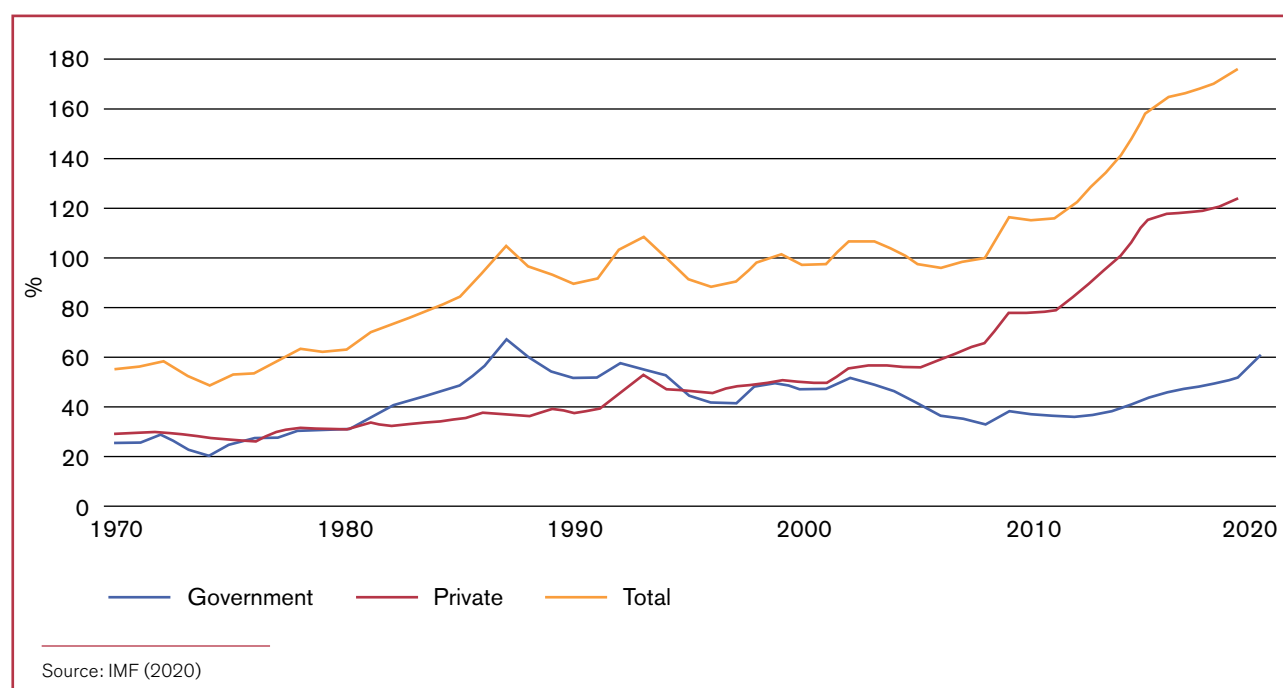
Learning from the past

Since the first debt-for-nature swap for Bolivia in the 1980s, a number of such transactions have been implemented in several countries, including more recently in the Seychelles and in the Caribbean. Debt swaps essentially involve reducing the debt owed to a creditor with the resulting savings in local currency being used for investing in climate and nature projects. The debt swaps so far have been limited in scope.

A more scaled-up debt-for-climate-and-nature initiative will be required to generate sufficient investment for supporting individual countries' plans for dealing with climate, nature and biodiversity targets. This upscaling can be used by channelling finances through budget support with appropriate fiduciary controls.

support of decisive climate action and contribute, in its own way, to the wider goal of limiting global warming to 1.5°C. At the same time, it could allow developing countries to translate their commitment to the Paris climate agreement into credible actions within their own development agenda. The overarching objective should

Figure 1: Emerging market and developing economies' debt as a percentage of GDP, 1970–2020



be for countries to reduce fiscal pressures from onerous debt repayments, improve nature and climate outcomes while also supporting post-pandemic, green recovery.

There is ample opportunity to develop an international climate-and-nature debt initiative by learning from programmes of the past. The structure of debt-for-nature swaps implemented in previous debt deals or independently such as in Bolivia (1987) and the Philippines (1993) showed that they could work, despite some technical challenges,⁶ and can still be a useful platform to scale up the intervention to match the quantum of actual debt relief currently required by the countries concerned. For instance, the Paris Club debt conversion schemes/swaps have only covered a tiny portion of the eligible debt to be restructured. Because other debt reduction options were preferred at that time, there was no indication that the debt conversion/swap was unable to reduce the debt burden and dedicate savings in debt service towards investment in climate and nature programmes. The new approach being proposed would allow the debt component that needs to be swapped to take centre stage. This is important because of the large amount of debt that would need to be considered within any debt reduction programme. The impact of the facility would be expected to be more significant than in previous initiatives.

On the climate and nature projects that should be targeted from savings generated from debt reduction, the debt-for-climate-and-nature programme should cover broader environmental areas than the previous debt-for-nature programme, which was rather limited. From activities such as protecting nature and natural parks in the past, a more comprehensive programme would need to be developed and rolled out to increase resources targeted towards nature and climate activities that contribute to economic development and poverty reduction (Box 2). Climate-and-nature debt management should be guided by strong climate science to ensure that the right intervention is chosen in the relevant recipient countries. Suggestions have been made for debt relief to be linked to investments in biodiversity, marine and terrestrial conservation, increased protection of marine and terrestrial protected

BOX 2: THE GLOBAL CLIMATE AND NATURE CRISIS

The world cannot ignore the dangers and risks from climate change, biodiversity loss and their dual impacts on the poor and the vulnerable.

Low- and lower-middle-income countries are on the frontline of such adverse climate impacts as floods, cyclones, droughts and sea-level rise. Economies are also facing large-scale ecological breakdown and biodiversity loss on an unprecedented scale. The profound loss and degradation of carbon- and species-rich ecosystems on land and in the ocean is a serious cause of concern.

Both climate change impacts and biodiversity loss are threatening to undermine development efforts while affecting especially the poor and vulnerable in societies.

The climate, nature and poverty crisis needs to be dealt with through joint initiatives, such as debt management for climate and nature.

areas, sustainable natural resource management and increased climate resilience. The actual intervention would inevitably be decided on a case-by-case basis depending on specific vulnerabilities faced by each country.

Concerns are already being voiced about the international community taking too long to develop and announce any new debt initiative, as happened in the past. Some actors are even warning of another lost decade as in the 1990s if nothing is done now. In light of this, there is merit in fleshing out some noteworthy lessons from the HIPC initiative that could help the international climate-and-nature debt initiative take shape and in particular to help fast-track its announcement. The following sections focus on drawing out those lessons and highlighting useful pointers from the manner in which the HIPC Initiative was conceived and implemented.

Learning from the Heavily Indebted Poor Countries Initiative (HIPC)

3

Before assessing the implementation of the HIPC, a comment on the rising debt levels currently threatening many developing and emerging market economies beckons. Although, as we will see below, HIPC can be considered as something of a success in terms of development outcomes, especially during the first decade of its operation, its legacy in leaving behind a sustainable debt framework in affected countries can be seriously questioned. Notwithstanding the high growth levels and associated poverty reduction initially seen, it has not been able to prevent a new build-up of unsustainable debt barely two decades on from the rollout of substantial debt relief. This has inevitably undermined the development and poverty reduction achieved through the initiative. As we discuss below, different analyses have revealed that the newly available borrowing space after HIPC has not always been used in the best way. More countries that had previously received debt relief from HIPC are showing signs of being in debt distress or at high risk of debt distress. Recipients of HIPC debt relief have been gradually filling the borrowing space created previously with fewer concessional external loans.

Not all the blame for another looming debt crisis should be directed towards HIPC when weak governance, poor public financial management systems and refusal or inability of countries to adhere to sound debt management principles are still common. But the current debt burden does raise questions about how future debt relief initiatives need to be carefully designed to provide strong incentives for preventing unnecessary and rapid accumulation of new debt. In particular, temporary improvement in development outcomes as a result of debt-fuelled increased consumption rather than via genuine productive investment-led growth should be avoided. Any new debt relief initiative therefore needs to be clearly aligned to sustainable investments over a longer time horizon than seen so far. We discuss the timeline of the HIPC post-relief design further on in this section, but we first outline the establishment of the initiative and the specific novel features it contained.

3.1 Development of the HIPC Initiative

The HIPC initiative emerged in 1996 at a time when international pressure to address the onerous multilateral debt burden of indebted countries was dominating the development agenda. Rather than dealing specifically with that type of debt, as had been done before,⁷ the framework that was launched and subsequently enhanced in 1999 provided a more comprehensive package of support, involving the World Bank, the IMF, other multilateral agencies as well as bilateral and commercial creditors. The initiative certainly went beyond the traditional debt relief mechanisms

BOX 3: ELIGIBILITY CRITERIA FOR HIPC INITIATIVE

The following rather strict criteria were defined to decide on which countries would be eligible for debt relief under the HIPC Initiative:

- **IDA-only country:** This means countries would have low income per capita, would have no access to private finance and must only receive concessional new commitment from multilateral development banks and the IMF. Eligibility for International Development Association (IDA) support was based on a country's relative poverty, defined in 1993 as gross national product (GNP) per capita of US\$695 or less.
- **PRGF eligible:** Countries should be eligible to receive support under the Poverty Reduction Growth Facility/ Poverty Reduction and Growth Trust of the IMF.
- **Track record:** Established track record of performance under a programme with the IMF and the World Bank.
- **Approval by World Bank/IMF Board of an Interim Poverty Reduction Strategy Paper (I-PRSP)** developed by the debtor country.

provided by official bilateral and private creditors. The framework was considered a landmark initiative as it was the first time that all those parties were brought together.

The programme was also designed to ensure that economies of poorest nations in the world were not choking under unmanageable or unsustainable debt burdens. Overall debt sustainability became the norm in deciding on the level of debt relief to be provided, under, admittedly, strict criteria. The objective of the debt relief was also to contribute towards higher economic growth and achieving debt sustainability in the group of indebted countries. The upgrading of the initiative in 1999 was specifically aimed at providing deeper, broader and faster relief while promoting a stronger link between debt relief and poverty reduction.

To be eligible to secure debt relief under the HIPC Initiative (see Box 3) countries had to meet clear criteria. The same criteria were used to measure and track progress. One criterion was for countries to establish a track record of performance under a programme with the IMF and the World Bank. Initially, countries were implementing Enhanced Structural Adjustment Facilities (ESAF) under which they were required to implement a broad range of reforms. These covered a commitment to put in place sound macroeconomic policies, actions

for promoting investment, measures for enhancing domestic revenue mobilisation and so on. So-called triggers (conditions) were in-built to track progress.

Whether a country would qualify to receive HIPC debt relief was usually determined on a case-by-case basis following the results of a tripartite (debtor country, IMF, World Bank) debt sustainability analysis (DSA) exercise. Two debt indicators have been used to measure whether a country's debt is unsustainable or not and if they can qualify to receive debt relief. The level of a country's debt is measured against its export receipts or its budget revenue receipts (Box 4).⁸ Most countries used the exports measure but some resorted to the budget revenue ratio to determine their sustainability. Based on the assessments carried out then, 39 countries were deemed to have qualified under the initiative (Annex 1).

BOX 4: INDICATORS USED TO MEASURE DEBT SUSTAINABILITY

- Present value (PV) of debt to exports ratio: > 150%
- PV of debt to budget revenue ratio: > 250%
- Access to debt relief via the fiscal window (debt/budget ratio) requires a country to meet two further thresholds:
- Openness criteria: export to GDP ratio of 30% or more; Revenue criteria: budget revenue to GDP ratio of 15%

Debt of a country is unsustainable if either of its debt ratios is higher than the above thresholds

The initiative has been implemented on case-by-case basis subject to countries satisfying the agreed criteria. Once a country has met or made sufficient progress in meeting the four criteria (Box 3), the IMF and World Bank would formally decide on its eligibility for debt relief and the international community would then commit to reducing debt to a level that is considered sustainable. This first stage under the HIPC Initiative is referred to as the decision point.⁹ Once a country reaches that point, it may immediately begin receiving interim relief on its debt service falling due. In order to receive full and irrevocable reduction in debt available under the HIPC Initiative (second stage), a country must make further progress on those reform and poverty reduction programmes. Once it has met those conditions, the country can reach its completion point,¹⁰ which allows it to receive the full debt relief committed at the decision point.

Though the initiative is technically closed and is not open to any new country, provision has been made to consider the case of few remaining eligible countries which have, for varying reasons, faced delays in satisfying all criteria to actually secure debt relief. That is how Somalia became eligible and started to receive partial debt reduction from 2020. Sudan has only recently been deemed eligible to qualify and reached the decision point milestone in June 2021.

3.2 Comprehensive HIPC debt instruments including terms

The comprehensiveness of the HIPC initiative, reflected by the broad debt coverage, is another useful factor to learn from. In the past, traditional debt relief mechanisms like the Paris Club¹¹ were used to specifically address the official debt burden, though there was provision for debtor countries to seek similar treatment from other creditors. Similarly, pressures from commercial debt had to be dealt with under the London Club.¹² Distinct from these, HIPC became the first initiative to solicit a coordinated effort between multilateral, bilateral and commercial creditors to reduce the external debt of the countries concerned. On the bilateral front, both Paris Club and other official creditors, including non-Paris Club creditors,¹³ were, at least on paper, expected to contribute their share of the debt relief package. The comparability of treatment¹⁴ across all creditors was an important factor to ensure the viability of the initiative. It was important that no creditor or its lending would receive special treatment by not participating in the debt relief deal and subsequently get paid in the normal manner once debt relief had been secured from other participants. In practice, and as we discuss later, not everything worked according to plan in terms of level of commitment from different creditor groups.

Paris Club debt

Debt owed to bilateral creditors within the Paris Club was ultimately mostly written off. In practice, debt relief from the Paris Club group of creditors had been provided under different terms and at different stages of the HIPC process, taking in account whether the eligible debt to be restructured was concessional (ODA) or not.¹⁵ Once a country qualifies for HIPC, the country receives Paris Club Naples terms,¹⁶ essentially a reduction in debt stock (equivalent to 67% of eligible non-ODA debt) while ODA debt would be rescheduled. At the second stage, the country receives 90% debt service (flow) reduction (Cologne terms)¹⁷ from Paris Club creditors. At completion point, 90% debt stock reduction (still under Cologne terms) is provided from the Paris Club though ultimately creditors agreed to provide 100% debt cancellation.

Debt conversion and the Paris Club: The majority of bilateral debt restructured under the Paris Club was rescheduled and subsequently written off. In addition, a debt conversion programme was introduced by the Paris Club from 1990, albeit with limited scope. Originally aimed at lower middle-income countries before being extended to severely indebted low-income countries, it was an option to provide further debt reduction through official debt conversion mechanisms. These included debt-for-equity, debt-for-development and debt-for-nature swaps. Certain limits were imposed on the extent of debt conversion permissible under the debt deal. For non-concessional debt, there was a limit of 10% or some US\$10 million, whichever was higher. There was no limit on ODA debt. In 1991, the debt conversion programme was extended to highly indebted LICs and was subsequently applied within the HIPC framework as well. Under the Cologne debt deal, the ceiling for non-ODA debt conversion was raised to 30% or up to SDR¹⁸ 40 million.

Multilateral debt

This was the first time multilateral debt reduction was included in any debt restructuring package. Interim debt relief was available at decision point followed by full debt relief at completion point. In 2005, to help accelerate progress toward the Millennium Development Goals (MDGs) prevailing then, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI)¹⁹ which allowed for 100% relief on eligible debts by the IMF, the World Bank and the African Development Bank. The Inter-American Development Bank also extended 100% debt relief to eligible HIPCs in 2007.

Non-Paris Club debt

Under the HIPC Initiative, there was an expectation that other creditors including non-Paris Club creditors would be prepared to provide comparable debt relief terms as those being offered by Paris Club creditors. Debtor countries were therefore expected to negotiate debt relief with those creditors concerned. In general, negotiation with non-Paris Club creditors has been quite tricky, as evidenced by some of them not fully delivering their share of debt relief. According to the IMF,²⁰ only 51% of non-Paris Club creditors have met their expected commitment under the debt reduction deal. Though China did participate in the HIPC debt relief deals, it has generally provided debt reduction outside the HIPC framework and through its own announcements such as during the Sino-African Cooperation Forum.

Commercial debt

Despite representing a smaller share of countries' debt portfolios compared to official debt, commercial creditors' participation in providing comparable debt relief was considered crucial. In practice, that was not so straightforward. In order to secure private participation, the World Bank had to bring the Debt Reduction Facility (DRF) within the HIPC Initiative around 2004. Established in 1999, that facility was initially used to support a commercial debt buyback scheme to purchase and retire developing countries' debt, usually at substantial discount.²¹ The scheme within HIPC identified the eligible commercial debt, determined the extent of discount to be agreed – which on average was 8.3 cents to the dollar – in line with the 'comparability of treatment' principle within HIPC, and finally purchased and retired the identified debt from the debtor's books. The DRF supported 25 operations leading to \$13.8 billion in external commercial debt being extinguished.²² However, full participation was not always possible for each creditor. Some commercial creditors resorted to legal routes to secure full payment of their outstanding liabilities. So-called vulture funds²³ used court rulings to seize foreign assets of HIPC governments.

3.3 Debt relief and poverty reduction

Poverty reduction strategies linked to debt relief

In attempting to bring different categories of debt under the debt deal, the aim of the HIPC framework was in line with the commitment to provide faster, broader, and deeper debt relief to countries in urgent need of such support. However, HIPC did not stop there. The approach, which was conceived and qualified as 'innovative' and 'transparent' at that time, was to link debt relief to poverty reduction strategies that were, at least on paper, owned by individual governments. As part of this transparent framework, national governments were invited to take the lead – in close consultation with civil society, including poor and vulnerable constituents – in formulating comprehensive national strategies for reducing poverty. That way, the delivery of debt relief which led to a reduction in debt service was conditional on countries demonstrating a commitment to direct the freed-up resources towards poverty reduction initiatives, hence directly helping the poor.

Countries received external support in drafting their interim and later full Poverty Reduction Strategy Paper (PRSP), which became part of the conditions when tracking eligibility and progress in moving along the HIPC process. As highlighted below, the design of PRSPs was not faultless despite attempts to get more stakeholders on board. But the participative nature of the exercise did somewhat help local staff in developing capacities in planning national and sectoral strategies such as in education, health and rural development.

Despite aiming to reduce poverty by freeing up resources for higher social spending, in reality, the initiative emphasised social expenditures as the primary route towards poverty reduction. This was evident in conditions established for reaching HIPC completion point and in progress reports by the IMF and the World Bank on tracking social expenditures.²⁴ Several studies have showed that more could have been done to deal with poverty reduction or achieving long-term debt sustainability, but expectations of the HIPC were overambitious. Statistics quoted by the IMF and the World Bank showed that both debt service reduction and a rise in social spending did take place in certain countries – at least over the post-debt relief years. For the 37 countries receiving debt relief, debt service paid declined by about 1.5% of GDP between 2001 and 2015. Though debt levels subsequently rose in those countries, this was due to decisions made by authorities to raise new, at times, onerous borrowing.²⁶

In terms of boosting social spending, again, figures quoted by the IMF showed that eligible countries were spending on average slightly more on health and education combined than on making debt service payments. Following the implementation of the HIPC Initiative, expenditures on health, education and other social services saw a marked increase. During 2001–02, spending in social sectors by 23 HIPCs was expected to rise to an annual average of US\$6.1 billion, compared to average social expenditure of US\$4.3 billion in 1999. At one point, social spending was on average about five times the amount of debt-service payments for countries that began to receive debt relief.²⁵ For the 23 countries that received HIPC assistance, the IMF estimated that about 40% of their annual debt relief would be spent on education and about 25% would be directed towards health care. A similar picture of higher spending in health and education emerged when looking at the pattern of expenditure from debt relief in countries such as Malawi, Madagascar and Democratic Republic of Congo (DRC). According to one independent evaluation of the HIPC initiative,²⁴ “poverty-reducing” expenditures in 28 countries that reached decision point increased from 6.4% to 8.1% of GDP from 1999 to 2004, about four times higher than their average debt-service payments in 2004. The report did raise doubts about whether HIPC

was able to have a more decisive impact on reducing poverty levels in the countries concerned.

Overall, it is difficult to categorically conclude on the extent of sustained increases in spending on social sectors in government budgets. The reduction in debt relief was more visible than spending in key sectors though some of the evidence pointed to rising expenditure in key sectors immediately after the debt relief was provided. This could be due to the in-built conditions in the programme which made it mandatory for countries to dedicate the savings from debt relief to specific poverty reduction measures.

But there was no evidence that any sustained spending in those social sectors continued afterwards. Was HIPC directly responsible for overall poverty reduction? In hindsight, expecting the initiative to radically address the more challenging issue of reducing poverty was probably a tall order, well beyond its actual remit and probably more than what one specific initiative could achieve.

Outside HIPC, there are other instances where the link between debt relief and its contribution to development outcomes and poverty reduction appeared to be more conclusive. For instance, in 2005 Nigeria reached an agreement on its US\$30 billion debt with the Paris Club. Creditors cancelled US\$18 billion of debt as Nigeria repaid the remaining US\$12 billion. With the cancelled debt registered as aid, the question was whether the debt relief secured had any impact on development in Nigeria. An evaluation carried out concluded that the debt deal did contribute to Nigeria's growth and poverty reduction efforts.²⁶ Strong design of the programme, the role of the UK in championing debt relief for Nigeria with other Paris Club creditors, clear conditions built into the debt relief deal and local political commitment to embrace wide-ranging reforms are some of the important lessons that any new debt initiative can take on board.

Performance indicators: triggers to measure progress and performance

Quite early in the HIPC process, countries would agree on a list of triggers to be used to measure progress before debt relief was provided. There are useful lessons to be learnt here for the new debt-for-climate-and-nature initiative. In practice, a list of completion triggers, which are essentially measurable objectives, must be in place. These relate to assessing performance under the IMF programme, progress made in improving governance or dealing with overall corruption and measures taken during implementation of at least one year of the poverty reduction strategy. In the case of DRC, a HIPC country, seven triggers to reach the completion point were defined, including one

on ensuring that savings generated from debt relief were being used for social spending.

At the micro level, triggers relating to progress made in directing resources into social areas such as health and education were usually defined. In particular, the additional resources released from HIPC relief, were expected to be channelled according to priorities defined in a country's PRSP. The tracking of expenditures included outlays on basic health, primary education, agriculture, infrastructure, housing, basic sanitation, and HIV/AIDS programmes. More specifically, indicators used for the education sector included enrolment rate, number of enrolled students, number of teachers in place, enrolment of primary school education, pupil-to-teacher ratio. Besides tracking expenditure on education and health, triggers have also focused on improving the budgetary framework and enhancing monitoring and reporting. Again, in the case of DRC, triggers included improving public expenditure management through the implementation of a modernised budget execution system: adoption and implementation of a double-entry government accounting system and production of quarterly budget execution reports.

The lack of adequate statistics to track social spending did hamper effective verification on the ground. Technical assistance (TA) under different programmes was earmarked to assist those countries to develop and strengthen their national public spending management systems to ensure that budgetary savings from HIPC assistance could be well accounted for and effectively utilised in planned poverty-related activities. Thanks to the support available from development partners, including the IMF and the World Bank, to track HIPC spending, an increasing number of countries began to compile and report poverty-reducing spending as defined in their I-PRSPs and PRSPs.²⁴

Systems for managing debt relief funds

A review of how countries have managed savings from debt relief received under the HIPC Initiative points to different processes in place. In some instances, weaknesses in existing government systems and in the quality of public expenditure management systems have been highlighted as factors that could hinder the tracking of social spending. Some countries felt the need to put in place some form of reassurance that savings from debt reduction would be effectively channelled towards agreed social activities. This included establishing parallel mechanisms outside existing government systems to deal with the proceeds from debt relief.

For instance, Cameroon agreed to: establish a special treasury account at the Bank of Central African States (BEAC) where the government would deposit budgetary savings from HIPC relief; set up a monitoring committee (HIPC Consultative Committee) consisting of representatives from the donor community and civil society; and undertake and disseminate technical and financial audits to ensure effective use of these resources in the form of the delivery of goods and services.²⁷ Burundi also established a separate account to manage resources from debt relief outside the general budget.

Uganda, which was the first country to benefit from debt relief under HIPC, established a Virtual Poverty Fund (VPF) for tracking social expenditures in the budget. That involved using a special code under the existing budget classification that enabled savings from debt relief to be tagged. In particular, Uganda set up its Poverty Action Fund (PAF) to ringfence resources for implementing poverty-reduction activities.²⁸ Such a virtual system was accepted by the IMF and the World Bank until the weaknesses in government systems was dealt with. DRC had initially planned for the treasury to transfer funds in different instalments and equivalent to debt relief received into a dedicated bank account. Shortage of resources at that time prompted the country to adopt the budgetary approach whereby classification was adapted to set up a ringfenced HIPC fund.²⁹ Monitoring and tracking of social spending was done that way.

Some countries did not feel the need for such ringfencing of resources from debt relief. Instead, they continued to use the government system in the normal manner to deal with funds from debt reduction. Malawi and Tanzania, which had this type of flexible approach found it difficult to identify expenditure from debt relief going to specific social sectors. To address these problems, countries began to receive support to establish comprehensive expenditure tracking systems to enable across-the-board reporting of public expenditures, including those financed by debt relief.

Such experiences should inform how a new debt-for-climate-and-nature initiative would manage flows within the budgetary system. For instance, a virtual climate and nature fund could be established within the government system, which would receive local currency resources generated from debt reduction savings. Investment in climate and nature priority projects could then be made from that fund using clear criteria on how such resources are to be spent. Monitoring of project implementation could be tracked by using appropriate key performance indicators (KPIs).

3.4 Effectiveness of HIPC in delivering on its objective

The HIPC Initiative achieved its core objective of substantially reducing the debt stock of eligible countries and easing the debt service pressure on government budgets, especially after the implementation period. Official figures showed that HIPC (together with MDRI) provided around US\$99 billion in debt relief. In terms of investment in poverty reduction, the overall results are not so evident. During the initial period and in order to comply with relevant expenditure triggers, there was evidence that some of the savings generated from debt relief were directed towards a few key social sectors considered to be priority in individual PRSPs. A plus point for HIPC was that it was the first such facility to bring the different stakeholders together under the initiative to deal with the different types of debt in the countries concerned.

Another positive legacy of the initiative was the implementation of wide-ranging reforms in most countries, especially in the early period. Though dealing with poverty reduction as a key objective was naturally too daunting for the programme to address on its own, it did help in building local capacity to develop poverty reduction strategies based on broad-based consultation, improving competences in developing and using public expenditure systems as well as enhancing public financial management systems (PFM) in governments. Triggers related to macro framework allowed countries to appreciate the integrated nature of economic and social reforms.

Notwithstanding these benefits, not everything has been rosy with the initiative. As discussed above, the fiscal and borrowing space created by substantial debt relief from HIPC only decades ago appears to have been misused in many cases. Various analyses by the IMF have shown that the newly available borrowing space after HIPC has not been used in an optimal way.³⁰ The fiscal position of LIDCs has weakened over the past years. In 2010–14 and 2017 fiscal deficits widened in nearly 70% of that group of countries. In 2018, 14 LIDCs that had previously received HIPC/MDRI debt relief were considered to be in debt distress or at high risk of debt distress. The interest-to-revenue ratio was rising above the pre-HIPC completion point level in 50% of the countries that benefited from HIPC debt relief.

The quality of borrowing in supporting investment has also been questioned. Only about a third of the countries reviewed showed evidence of higher public borrowing being fully matched by a scaling-up of investment. In nearly 50% of cases, investment showed a declining trend despite higher public borrowing. This indicates that there was no provision in the design of the initiative to promote a sustainable development path

over a longer timescale. Instead, only a small part of new borrowing after HIPC was being directed towards productive investments that would have helped make economies stronger.

The time horizon for HIPC was therefore mainly focused on a priori development incentives. Longer-term debt sustainability targets were not seriously considered. For this reason, the claim that HIPC has led to another debt crisis two decades later cannot be completely dismissed. Also, ensuring that debt relief was conditional on promoting sustainable investments well over a longer time horizon was not explicitly built into its design. Efforts to promote inclusive growth and sustainable finances were missing. These are important lessons to take on board when designing any new debt initiative.

As noted above, PRSP has been a key centrepiece for linking debt relief to poverty reduction. Those who participated in the formulation of poverty-reducing strategies acknowledged that the process was much better than what went before. However, PRSPs did not fully achieve the objective of encouraging the development of a country-owned and credible long-term strategy for growth and poverty reduction. By focusing mostly on social sector spending, other aspects of a broader strategy to encourage poverty-reducing growth were missed. More often, the so-called ownership was achieved within a small circle of key officials who would drive the PRSP process at the expense of broader and important groups of domestic stakeholders. At the same time, the perception that the whole approach was dictated by external partners, especially the IMF and the World Bank was difficult to brush aside.³¹

One other salient limitation in the actual design of the PRSP was the absence of a gender dimension. Despite the majority of the poor in developing countries being women, inherent poverty analysis under PRSPs did not explicitly focus on specific impacts around gender and women. Where some aspects of gender issues have been brought in, they have in the main been rather fragmented.³² Given the clear linkage between women in poor communities and climate issues, the gender dimension needs to be well articulated in any debt-for-climate-and-nature platform.

The HIPC Initiative has faced its fair share of criticism from different quarters throughout its implementation. Operationally, questions have been raised about its perceived complexity,³³ the extent of conditionalities included, the duration of mandatory reform programmes to be implemented, including evidence of track record, whether the ESAF programmes adopted by countries were adequate, and the time it would take for countries to receive much-needed debt relief. On the latter point, while it is true that conceptually the framework allows for six years to complete the process, the HIPC Initiative did allow for case-by-case flexibility in fast-tracking

debt relief to beneficiaries. Countries such as Zambia did receive relief within a much shorter time frame. For instance, though the World Bank provides one third of its total relief during the interim period, by reducing annual debt service by 50% or more, the reduction made available did increase to 80–100%.

Valid questions have been raised on the adequacy of linking ESAF to achieving poverty reduction, prompting suggestions that debt relief should be integrated into broader development strategies of the relevant countries. What has been agreed, as evidenced by findings from the World Bank,³⁴ is the importance of ownership by the debtor government of whatever reform is being put in place. This is a key pillar on which any new debt initiative should rely.

Another element that can easily be overlooked is the limited capacity in the countries in question to participate in, sometimes, complex negotiations with different creditors. Such limitation was well evidenced from the very beginning, including: in carrying out the DSA; negotiating with Paris Club and non-Paris Club creditors; understanding how debt relief from multilateral debt should be treated; and engaging with commercial creditors, including on how to use the DRF to conclude commercial debt buyback. As a result, the governments of Austria, Canada, Denmark, Ireland, Sweden, Switzerland and the UK funded a HIPC Debt Strategy and Analysis Capacity-Building Programme (CBP) to assist HIPC governments in improving their debt strategy formulation and implementation and contributing towards poverty reduction through enhanced macroeconomic management. The programme's objectives were to allow the governments concerned to develop full independent capacity to design and execute their own national debt strategies and to maintain a high level of overall debt management during and beyond the HIPC initiative. Such a programme must also be a key requirement to accompany any new initiative.

3.5 Changing landscape since HIPC was conceived

The landscape for dealing with debt relief has changed since the HIPC initiative was conceived. More importantly, compared to the time when official Paris Club creditors predominated in countries' debt portfolios, the changing structure and composition of recent borrowing has seen a higher share of debt being owed to a new group of creditors such as China and India. At the same time, many countries have seen a sharp rise in private debt, including from the international capital markets. As discussed previously, this was the type of borrowing that HIPCs struggled to comprehensively renegotiate.

Other official creditors besides the Paris Club have generally been reluctant to negotiate with HIPC countries and provide comparable treatment. The lower commitment to deliver their share of debt relief can still be a cause of concern. China's growing share of lending in countries' debt portfolios would have to be addressed, and not having China on board will be a serious limitation. The Chinese government's commitment to participate in a global initiative such as the DSSI is welcome and it is hoped that at the country level debt relief has been made available across all types of debt. It is a positive sign that China did provide about 85% of the HIPC Initiative debt relief as at September 2018,³⁵ which is significantly more than the average 51% relief from non-Paris Club creditors as a group. In this light, it is important to assess its contribution to debt reduction for Somalia and Sudan – the two countries that are currently going through the HIPC process. China's presence within the Creditor Committee under the Common Framework for Debt Treatments for Chad is also encouraging. The G20 will have a critical role in getting the group of non-Paris Club creditors fully on board.

Regarding commercial debt, solutions adopted by the HIPC framework could again become useful. Options such as the DRF, managed by the World Bank, to conclude commercial debt buyback may well become necessary again. The Institute for International Finance which represents the cause of private creditors did react to the call from the G20 for debtor countries to seek comparable debt treatment from private creditors under the Common Framework. It also expressed strong support from its members “for the far-reaching G20 agenda promoting a multilateral approach to crisis recovery, climate resilience and broader sustainable development objectives”.³⁶ It is hoped that such endorsement can translate into more concrete and positive actions from this group of stakeholders in the context of the new global debt initiative for climate and nature outcomes.

What has also changed since the HIPC Initiative was established in 1996 is the greater awareness of climate and nature issues globally and the development of climate strategies, especially in LICs and emerging market economies. There are ample lessons to learn from the HIPC initiative when designing and putting together the international debt-for-climate-and-nature initiative to support post-pandemic inclusive green recovery. Some key pointers are reflected upon in the final section of the paper below.

Forward-look



Lessons a climate-and-nature initiative can learn from HIPC

As the signs of an imminent debt crisis become harder to ignore, the HIPC Initiative, which continues to deal with the debt burden of countries like Somalia and Sudan, can provide useful pointers for crystallising a new international debt-management-for-climate-and-nature initiative. As a framework that is well-known by the international community, useful lessons can be learnt from its 25 years of operation. Considering its limitations and strengths will help to ensure that the debt relief so urgently required by many developing countries can also effectively contribute to financing climate and biodiversity priorities. The aim will be safeguarding longer-term investment with high returns (eg sustainable energy, prevention of climate change damage) in those countries, thus moving away from the HIPC model in which investment was partly fuelled by a debt-financed consumption-driven growth model. A new debt relief initiative for post-COVID-19 recovery that prioritises climate and nature should consider the following recommendations.

- **Comprehensive framework for debt integrated with the Paris Agreement:** Achieving political consensus is the single most important step for the new initiative. HIPC, which was essentially championed by the G7, and in particular the UK, brought in strong political leadership to overcome vested interests and technical challenges. Similarly, a global initiative on debt and climate can be championed by the G20 and the leadership of the IMF and the World Bank. The comprehensive framework established for HIPC and which worked well in bringing all parties together will be equally useful for the new initiative. In particular, it can help in securing the buy-in and the enhanced international coordination required by the proposed initiative. In trying to build consensus, the international community, including the G20 and creditors, already know how the HIPC framework, covering 39 countries, operated, including the manner in which overall debt sustainability was linked to countries' macro framework. That could make it easier for all parties to arrive at a consensus in a short time and make it possible to roll out the debt-for-climate-and-nature initiative sooner rather than later.
- **Longer-term horizon on sustainable public finances and inclusive growth:** The claim that HIPC did not do enough to prevent future rising debt burdens will require some attention in the new framework. The proposed global initiative on climate and nature should put in place a framework that can help minimise future debt crises by ensuring that responsible borrowing becomes embedded in national implementation. At the same time, it must ensure that investments, including in climate and nature, such as renewable energy, climate-smart agriculture and labour-intensive soil and water conservation, lead to inclusive growth. Sound public financial management is essential to reduce wasteful public spending such as subsidies for fossil fuel energy, and to generate increased public revenues through climate taxation and increased natural resource taxation.
- **Debt at scale: targeting different types of debt:** HIPC involved a coordinated effort by multilateral, bilateral and commercial creditors, whereby the comparability of treatment worked relatively well. Similarly, debt relief targeted under the climate and nature deal must be sufficiently large, which requires targeting different types of borrowing instruments in countries' debt portfolios. In principle, nothing should be excluded. Also, the changing nature of the structure and composition of developing countries' debt has highlighted the importance of engaging with bilateral creditors outside the Paris Club, especially China. The share of private debt in debt portfolios is increasing. HIPC showed that non-Paris Club creditors were not always compliant in meeting their debt reduction commitments. Additional efforts are needed to address this. At the same time, the flexibility shown by HIPC when dealing with commercial debt is also an important lesson to use when operationalising the new debt management initiative.
- **Using the climate agenda to build interest in debt relief:** It is recognised that the current political economy context for debt relief is different from the context pertaining decades ago for HIPC. As previously indicated, official debt, including especially multilateral lenders, held a large amount of debt then. This meant they could be credible first movers in driving the debt relief agenda while also creating the impetus to bring other actors on board. That is no longer the case. A different approach may be required now, given that the biggest debt holders are changing. It is important that these are involved at the outset, otherwise the impact on debt restructuring will be insufficient. A strong case can be made for leading the new initiative on debt relief through the climate action agenda. For instance, how can creditors such as China and non-Paris Club members be given public plaudits for their support of the green economy and further enhance their environmental credentials when they do engage in debt relief for climate and nature? There are also domestic political agendas for China in terms of compliance with their net-zero carbon targets by the year 2060. Private creditors can also be incentivised to engage in debt management for climate and nature given their increasing commitments to embracing greener portfolios.

- Linking debt reduction to climate and nature:** The enhanced HIPC initiative placed emphasis on countries demonstrating a firm commitment to channel resources from debt relief to addressing poverty issues. The PRSP was at the core of such efforts. The sustained link between debt relief, poverty reduction and social policies provide ample lessons for the new debt initiative to link debt reduction with scaled-up climate and nature programmes. Learning from the way the PRSP was used to direct resources to poverty reducing activities, a global initiative on debt for climate and nature should focus on inclusive climate and biodiversity outcomes. The new initiative will therefore require a climate and nature equivalent modelled to some degree on PRSPs and making better use of key performance indicators for climate and nature. This can combine elements of different climate-related strategies already in place or being developed within the countries in question. For instance, the climate and nature strategy can draw from nationally determined contributions (NDCs), which many countries agreed to put in place when they signed up to the Paris Agreement, national biodiversity strategies and other plans related to nature in the country. Climate and nature strategies can also be enriched by global efforts such as the LDC Initiative for Effective Adaptation and Resilience (LIFE-AR). The vision for LIFE-AR is for all 47 LDCs to deliver climate-resilient development pathways by 2030 and net-zero emissions by 2050 to ensure that societies, economies and ecosystems thrive.
- Local ownership remains critical:** Eligibility under the HIPC framework was directly linked to reaching agreement on a new PRSP drawn up through active consultation, primarily with civil society and other local stakeholders, to ensure local ownership. In driving reform, developing local climate strategies and implementing climate and nature projects, local ownership must remain a critical target for the new debt initiative. The PRSP experience shows that efforts must be made to make country ownership a reality. In PRSPs, technical assistance from donors was often too central to the process and there was a general failure to expand 'ownership' and participation beyond a small circle of senior officials. Making country ownership a reality in terms of broad engagement of society will remain challenging. With greater fiscal decentralisation, whereby more responsibilities are devolved to the local level and closer to local communities, better and more active sub-national ownership should gradually take place in target countries. This is critical given that climate adaptation programmes are important for local communities and at grassroots level.
- Criteria used to measure progress: Key performance indicators (KPIs):** The HIPC framework has highlighted concerns, including within recipient countries, regarding the nature of conditionalities or triggers used to track progress and performance on reform plans and poverty reduction before any debt relief could be released. Key concerns were related to the degree of ownership of and commitment to the programmes by debtor governments. Conditions that countries could not 'own' were not easy to roll out. KPIs for climate and nature activities would have to be developed and used within the proposed debt-for-climate-and-nature initiative to assess outcomes. It is important that the right indicators are developed, taking into account the local context and the types of projects being tracked. They should also be well understood by local stakeholders and must remain relevant to them. These KPIs will also need credible processes for monitoring and verification).³⁷
- Planning for longer-term investment while managing expectation:** It is also important that the new initiative does manage expectations in terms of what it can achieve. HIPC showed that the aim of delivering on poverty reduction was too broad to be achieved by one single initiative although savings from debt relief enabled an increase in poverty-reducing expenditures. The climate and nature debt deal will focus on providing additional finance to support climate and nature projects, with a longer time horizon, while putting in place safeguards for longer-term investments in the economy compared to HIPC. Additional financing sources will be needed to deal with the challenge of climate change. If countries decide to establish 'virtual climate funds', they should be retained over time to continue to fund climate action and to achieve the SDGs over a longer timescale.

- **Gender:** Gender issues, which were not prioritised in the PRSPs, should be included in the new initiative to ensure that their impacts on and contributions to climate and nature are fully taken on board. Gender should be incorporated into the diagnostic/policy work that would underpin the planning for action in debt for-climate-and-nature deal. The participation of indigenous peoples, who have a special place in biodiversity conservation, must be factored into the preparation of diagnostics and policy proposals. Meaningful participation of poor women and men at the front line of climate change will be critical in design and implementation, identification of KPIs and involvement in continued monitoring and verification.
- **Flexibility within the initiative:** Despite initial criticism that the HIPC process would take too long and fail to provide relief in a timely manner, there was flexibility during implementation, especially in fast-tracking the support needed by countries. Such flexibility to deal with individual countries' situations should also be factored into the climate and nature initiative.
- **Country coverage:** The indicators to decide on eligibility for joining the HIPC framework were relaxed in 1999, hence allowing more countries to benefit from debt relief. Notwithstanding that, questions remained about the rigid nature of the criteria that were used and excluding other countries which genuinely needed support. Eligibility for the new climate and nature initiative is likely to become an issue and must be addressed. It has been suggested that rather than rigid ratios, the maximum affordable level of debt service should be used to determine the level of debt reduction required on a case-by-case basis. Recent data has shown that small island developing states are facing financial difficulties and may require urgent support on the debt front.³⁸ The coverage of countries that could be eligible for the new deal will no doubt have to be addressed. A menu of options covering different categories of eligible countries could be one possibility to investigate.
- **Coverage of both debt relief and voluntary debt reduction:** Besides debt reduction, the HIPC framework did bring in improvement in debt management as a condition to measure performance under agreed reform plans. In a similar vein, the international initiative may consider not only countries in debt distress but others that will be keen to engage in voluntary debt reduction in an effort to release additional financing for climate and nature projects. Such interests must be encouraged.

There is growing consensus that addressing the debt burden of developing countries cannot be delayed for long. There is an urgent need for meaningful solutions that go beyond what has been unveiled so far. Actions to avert the ripple effects of a debt crisis in the context of post-pandemic, green recovery should be a worthy objective for decision makers to support. As the international community considers an adequate response, this paper has shown how the HIPC framework can provide useful lessons for building a credible platform for a scaled-up international debt initiative for climate and nature. The time is right for such an initiative to address the twin challenge of the looming debt and environmental crises, releasing much-needed finance for climate and nature action while making a decisive impact on development outcomes.

Abbreviations and acronyms

BEAC	Bank of Central African States
DRC	Democratic Republic of Congo
DRF	Debt Reduction Facility (World Bank)
DSA	Debt sustainability analysis
DSSI	Debt Service Suspension Initiative from the G20
ESAF	Enhanced Structural Adjustment Facilities
G7	Forum of the group of seven of the world's largest advanced economies and wealthiest liberal democracies
G20	Forum of the group of 20 of the world's largest economies including the European Union
GDP	Gross domestic product
HIPC	Heavily indebted poor countries
IDA	International Development Association (World Bank)
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
KPI	Key performance indicators
LDC	Least developed countries
LIC	Low-income countries
LIDCs	Low-income developing countries
LIFE-AR	LDC Initiative for Effective Adaptation and Resilience
MDRI	Multilateral Debt Relief Initiative (IMF)
ODA	Official development assistance
PAF	Poverty Action Fund
PFM	Public financial management
PRSP	Poverty Reduction Strategy Paper
SDGs	Sustainable Development Goals
SDR	Special drawing rights
VPF	Virtual Poverty Fund

Annex 1: List of countries that qualified for the HIPC Initiative²⁰

POST-DECISION-POINT COUNTRIES (37)		
Afghanistan	The Gambia	Nicaragua
Benin	Ghana	Niger
Bolivia	Guinea	Rwanda
Burkina Faso	Guinea-Bissau	São Tomé & Príncipe
Burundi	Guyana	Senegal
Cameroon	Haiti	Somalia
Central African Republic	Honduras	Sierra Leone
Chad	Liberia	Tanzania
Comoros	Madagascar	Togo
Republic of Congo	Malawi	Uganda
Democratic Republic of Congo	Mali	Zambia
Côte d'Ivoire	Mauritania	
Ethiopia	Mozambique	
PRE-DECISION-POINT COUNTRIES (2)		
Eritrea	Sudan	

Endnotes

- 1 World Bank (2018), HIPC Initiative, Relieving the World's Poorest Countries of Unmanageable Debt Burdens. World Bank, Washington DC. <https://www.worldbank.org/en/topic/debt/brief/hipc>
- 2 G20 (2020) Communiqué, 15 April 2020, Annex II: Debt Service Suspension Initiative for Poorest Countries – Term Sheet.
- 3 The Common Framework for Debt Treatments beyond the DSSI was announced by the G20 in November 2020. It is an agreement whereby the G20 and Paris Club countries have agreed to coordinate and cooperate on considering debt treatments – on a case-by-case basis – for those 73 LICs that are eligible for DSSI.
- 4 Ayhan Kose, M, Ohnsorge, F, Nagle, P and Sugawara, N (2020) Caught by the cresting debt wave, Finance & Development, June 2020, World Bank, Washington DC.
- 5 G20 (2020) Communiqué, Finance Ministers and Central Bank Governors Meeting, page 2.
- 6 Some concerns on past debt swap deals had been raised. These related to their negligible contribution to debt reduction, at times complex nature of debt swap transactions, countries often lacking resources to make upfront payment under the debt swap deal in local currency and mixed evidence on the effectiveness of debt for nature swaps.
- 7 The HIPC Initiative was the framework that considered different types of debt in one go. Previous debt deals focused on pressures resulting from specific types of debt. Multilateral debt was never included in any debt deal prior to HIPC.
- 8 The ratios are computed in PV (not nominal) terms. The present value (PV) of debt is the sum of all the future debt service obligations – interest and principal – on existing debt, discounted at market interest rates. Loans in different currencies are discounted using a discount rate linked to each currency. HIPC debt relief calculation used the three-year average of export of goods and services ending in the last year for which actual data is available.
- 9 Decision point: The HIPC Initiative is implemented under a two-step process. The first step is the decision point. Once a country reaches its decision point, it may immediately begin receiving interim relief on its debt service falling due. Prior to this happening, it needs to complete the four conditions defined in the framework.
- 10 Completion point: this is the time when the eligible country receives the full debt relief committed at the decision point. Prior to this happening, it must have fulfilled all conditions in terms of reforms and implementing the PRSP.
- 11 Paris Club: Established in 1956, the Paris Club has been an important forum for providing debt relief to countries in need. It renegotiates loans provided by bilateral members as well as credits from the private sector that have been guaranteed by export credit agencies of those creditors. There are currently 22 permanent member countries in the Paris Club.
- 12 London Club: The London Club is an informal arrangement which has been especially active in dealing with the rescheduling of commercial bank debt of sovereign governments.
- 13 Non-Paris Club creditors: This group refers to official creditors which are not part of the Paris Club.
- 14 Comparability of treatment is a principle that has been brought in from the Paris Club into the HIPC Initiative to ensure all creditors are treated in the same manner in terms of debt relief provided to a debtor country. The latter is required to negotiate similar terms with all creditors.
- 15 ODA and non-ODA: Credits and loans (official debt) granted by a bilateral creditor and export credits guaranteed by the creditor's official agencies are covered under the Paris Club negotiation. Official Development Assistance (ODA) is concessional debt while non-ODA debt would be non-concessional and include export credits.
- 16 Naples terms are provided under the Paris Club for highly indebted poor countries. Non-ODA debt is cancelled to 67% of stock and ODA debt rescheduled at original or more favourable interest rate, over 40 years with 16 years' grace.
- 17 Cologne terms are provided under the Paris Club for HIPC eligible countries. Non-ODA debt is cancelled to 90% of stock or more while ODA debt is rescheduled at original or more favourable interest rate, over 40 years with 16 years' grace.

- 18 The SDR is an international reserve asset, created by the IMF to supplement its member countries' official reserves. Its value is based on a basket of the following five currencies: the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen and the British pound sterling. The SDR value in terms of the U.S. dollar is determined on a daily basis. It is linked to the spot exchange rates observed at around noon London time, and posted on the IMF website.
- 19 MDRI: This initiative is a proposal that was proposed by the G8 in June 2005, which called for the cancellation of 100% of the claims of three multilateral institutions, the IMF, World Bank's International Development Association (IDA), and the African Development Fund (AfDF). Countries that have reached, or will eventually reach, the completion point under HIPC would receive such additional relief.
- 20 IMF (2021) Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative. International Monetary Fund, Washington DC.
- 21 Several countries received funding from DRF to retire portions of their commercial debt with huge discount. The extent of discount received has varied across countries. On average, the price was 7.1 cent to the dollar.
- 22 CDC (2020) Revisiting HIPC as Part of the COVID-19 Response: How did Commercial Debt Relief for Poorest Countries Work Last Time? Center for Global Development.
- 23 Vulture Funds refer to entities that have purchased sovereign government debt at a discount and used legal means to demand full payment (principal and interest) from those governments.
- 24 Independent Evaluation Group (2006) Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative. IEG, World Bank, Washington, DC.
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- 30 See for instance, IMF (2018 and 2019) Macroeconomic Developments and Prospects in Low-Income Developing Countries and IMF (2020) The Evolution of Public Debt Vulnerabilities in Lower Income Economies.
- 31 IMF (2004), Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility. International Monetary Fund, Washington DC.
- 32 Christian Aid (2003) Failing women, sustaining poverty: Gender in Poverty Reduction Strategy Papers, Report for the UK Gender and Development Network. Christian Aid, London.
- 33 The whole process for meeting all conditions, especially track record and many rounds of negotiation with different creditors has been considered to be too lengthy. The flexibility shown during implementation has mostly worked in favour of countries in urgent need of debt relief.
- 34 World Bank (1997) Adjustment Lending in Sub-Saharan Africa: An Update. World Bank, Washington DC.
- 35 IMF (2019) HIPC Initiative and MDRI, Statistical Update. International Monetary Fund, Washington DC.
- 36 IIF (9 April, 2021) IIF Letter to the G20 on Common Framework, Debt Transparency, ESG Considerations. Institute for International Finance, Washington DC.
- 37 Steele, P, Patel, S and Beauchamp, E (2021) Key performance indicators for climate and nature outcomes in debt management in West Africa. IIED, London.
- 38 Bouhia, R and Wilkinson, E (30 March 2021) Small-Island Developing States need urgent support to avoid debt defaults. ODI, London.

The COVID-19 pandemic has put severe strain on the already stressed public finances of developing countries. The need for spending on health and welfare has not only led to increased borrowing, but also to deprioritising investment in addressing climate change and nature loss. Calls for additional debt relief are getting louder. To meet the multiple challenges of debt, climate change and biodiversity loss, a new model is needed.

Focusing on lessons from the Heavily Indebted Poor Countries (HIPC) Initiative, established 25 years ago by the World Bank and IMF, this paper proposes a new international debt relief initiative, which prioritises investment in climate and nature, to get developing countries' economies back on track post-pandemic.

IIED is a policy and action research organisation. We promote sustainable development to improve livelihoods and protect the environments on which these livelihoods are built. We specialise in linking local priorities to global challenges. IIED is based in London and works in Africa, Asia, Latin America, the Middle East and the Pacific, with some of the world's most vulnerable people. We work with them to strengthen their voice in the decision-making arenas that affect them – from village councils to international conventions.



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