Debt Relief: Frequently Asked Questions

How did Heavily Indebted Poor Countries (HIPCs) become overly indebted in the first place?

International events in the 1970s and 1980s -particularly the oil price shocks, high interest rates, recessions in industrial countries and weak commodity prices - contributed heavily to the debt problem that engulfed many low income countries. During the 1970s, governments in poor countries borrowed heavily, based on the predominant development thinking that low-income countries should invest in industry, particularly import-substitution industrialization and infrastructure. The prevailing view was that governments should play a leading role in this industrialization and as a consequence, the money was borrowed chiefly by states (and state-owned enterprises). But as commodity prices slumped in the early 1980s and oil prices rose, countries compensated for the fact that their imports were outstripping their exports with increased borrowing.

Domestic factors also played a significant role in the debt run-up. Many countries, both in the middle and low income categories, continued living beyond their means, with high trade and budget deficits and low savings rates. They borrowed more heavily, but often, this new borrowing was not translated into productive investments that would generate returns to service this debt. More specifically, poor public sector management, including, at times, poor project selection by donors, meant the loan funds which were designed to increase productivity and generate exports failed to produce the expected yields and brought no long-term benefit in terms of capacity to earn foreign exchange. Droughts, floods, civil wars, weak economic policies and poor governance all exacerbated the debt build up. Some loans were taken out simply to service existing debt.

In Africa, debt started to grow during the 1970s and continued in the 1980s. The main source of loans in Africa was official creditors, particularly the governments of industrialized nations. The recession of the 1970s, and the emergence of foreign aid, caused loans to be provided on a large scale.

What did creditors do to address the debt burden in HIPCs?

At first, creditors including the multilateral agencies, believed debt problems in the borrowing countries were temporary. Commodity prices - the predominant export of many low-income countries - had risen by 12 percent a year between 1970 and 1980 before slumping heavily at the start of the 1980s and then failing to recover. In the early 1980s, debt payments were rescheduled in the belief that the borrowing countries' terms of trade would improve, while new concessional aid loans continued. The net flow of bilateral loans to Africa remained positive during the 1980s. In addition, western donors started to provide grants to African countries at a growing rate.

In the mid-1980s, western creditor governments united in the Paris Club to deal with payment problems by rescheduling debt. But this meant only a postponement of payment obligations while interest was being capitalized and therefore the nominal value of the loans increased.

Starting in 1988, official creditors also began to acknowledge that some of the loans would probably never be repaid, and they started to partially cancel them. This applied only to debts entered into before a certain date and only to debt service during a specific period. The percentage that was forgiven on this limited part of the debt service was gradually increased from 33 to 50 (1991) and 67 (1994) and to 80 percent in 1996. The remainder of the debt service was rescheduled on market terms. One condition for such an agreement with the Paris Club was that the country in question must have entered into an agreement with the IMF. The agreement with the Paris Club concerned debt service obligations falling due during the course of the IMF agreement.

In 1996, the World Bank and the IMF were the catalysts for the Heavily Indebted Poor Countries (HIPC) initiative, acknowledging that debt relief was also needed on multilateral debts. HIPC was enhanced in 1999, and has provided debt relief worth $99 billion to 36 heavily indebted poor countries.

Why did some low-income countries avoid a debt crisis?

Not all low-income countries suffered a debt crisis as a result of borrowings in the 1970s and 1980s. Countries in the so-called tiger economies of East Asia, China and India, dramatically cut their rates of poverty using concessional loans. The funds were used to diversify their exports away from a reliance on commodities which insulated them from the commodity price slump of the early 1980s. They were also able to attract significant investment and generate growth which contributed toward the reduction in poverty.

Which countries are eligible to participate in the Initiative?

The Initiative is open to the world's poorest countries, those that: (i) are eligible only for highly concessional assistance such as from the World Bank's International Development Association(IDA) and the IMF's Poverty Reduction and Growth Facility (formerly called Enhanced Structural Adjustment Facility); (ii) face an unsustainable debt situation even after the full application of traditional debt relief mechanisms; and (iii) have a proven track record in implementing strategies focused on reducing poverty and building the foundation for sustainable economic growth.

As of end-August 2006, there are forty countries identified as potentially qualifying for HIPC assistance. Of these, twenty-nine countries have reached decision point and twenty countries have reached completion point. Currently, there are eleven pre-decision point countries that have yet to benefit from the HIPC program.

How much debt relief will be provided under the HIPC Initiative?

HIPC debt relief to the 36 post-decision point countries amounts to $99 billion in 2014 PV terms.

What effect will the enhanced HIPC framework have on debt reduction?

Since 1999 poverty reducing expenditures of HIPCs have continued to increase while debt-service payments have been declining. Debt service payments of 36 post-decision point countries has declined from about 3.1 percent of GDP in 2001 to about 1.3 percent in 2014. During the same time, poverty-reducing expenditures have increased from about 6.5 percent of GDP in 2001 to over 8.2 percent in 2014.

Who determines that a country has reached completion point?

In order to reach completion point, a country must maintain macroeconomic stability under an IMF-supported program, carry out key structural and social reforms, and implement a poverty reduction support program (PRSP) for one year upon which Bank and Fund staff prepare recommendations to their respective Boards for consideration. The final determination is made by the Boards of the two institutions.

Are the standards for reaching the HIPC Initiative completion point too high?

It is important to maintain standards for policies and procedures as a prerequisite for sustainable economic growth and high-impact poverty reduction programs. The standards are designed to make sure that maximum benefits are attained through the Initiative and that the freed-up money is used well and reaches the poor.

What is topping-up?

HIPC assistance is determined when a country reaches its decision point. If a country's debt burden indicators deteriorate substantially due to exogenous factors that fundamentally affect the country's economic circumstances, it may receive additional HIPC assistance (topping-up) at completion point. For example, Burkina Faso, Ethiopia, Malawi, Niger and Rwanda have received topping-up of HIPC debt relief at completion point.

Why hasn't the HIPC Initiative guaranteed debt sustainability?

The HIPC Initiative is a debt reduction program. No amount of debt forgiveness can guarantee future financial solvency. Long-term debt sustainability depends on solid growth based on sound government policies, including prudent external borrowing and debt management.

For more information see **HIPC 2015 Statistical Update**