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Debt Relief for the Poorest

An Evaluation Update of the HIPC Initiative

INDEPENDENT EVALUATION GROUP

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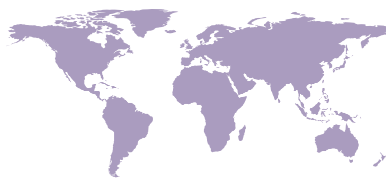

Debt Relief for the Poorest

An Evaluation Update of the HIPC Initiative

2006
The World Bank
Washington, D.C.

http://www.worldbank.org/ieg

© 2006 The International Bank for Reconstruction and Development / The World Bank
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Internet www.worldbank.org
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1 2 3 4 5 09 08 07 06

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ISBN-10: 0-8213-6656-4
ISBN-13: 978-0-8213-6656-1
e-ISBN 0-8213-6657-2
DOI: 10.1596/978-0-8213-6656-1

Library of Congress Cataloging-in-Publication Data has been applied for.

World Bank InfoShop
E-mail: pic@worldbank.org
Telephone: 202-458-5454
Facsimile: 202-522-1500

Independent Evaluation Group
Knowledge Programs and Evaluation Capacity Development (IEGKE)
E-mail: eline@worldbank.org
Telephone: 202-458-4497
Facsimile: 202-522-3125

Printed on Recycled Paper

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Acknowledgments

This evaluation was prepared by a team led by Shonar Lala and consisting of Rupa Ranganathan and Brett Libresco. Thomas M. Callaghy, Barry Herman, and Tony Killick acted as peer reviewers at different stages of the evaluation. Andrea Presbitero conducted a literature review as background for the evaluation. Yezena Z. Yimer provided logistical support to the team and managed the production of the report. William B. Hurlbut provided editorial assistance. Helen Chin edited the report for publication. Victoria Elliott provided overall guidance to the team as manager of the IEG Corporate Evaluation and Methods group, with substantial input into the formulation of the report.

The evaluation benefited from discussions with and the cooperation of the World Bank's Economic Policy and Debt Department. Helpful comments and assistance were received from the following Bank staff: Boris Gamarra, Thor-Jurgen Greve Loberg, Vikram Nehru, Jean-Francois Perrault, Francis Rowe, and Sona Varma. Inputs from the following persons and several IEG staff are acknowledged with gratitude: Yasmine Ahmed, Phillip Anderson, Elizabeth Currie, Ibrahim Levent, Tomas Magnusson, Steve Kayizzi-Mugerwa, Aimee Nichols, and Alagiriswami Venkatesan. Numerous other Bank staff provided comments on the report.

In addition, the evaluation benefited from the perspectives of participants of the final multi-stakeholder consultation on Sovereign Debt for Sustained Development, organized by the United Nations Financing for Development office in Geneva in June 2005.

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Foreword

In the past decade, debt relief has become an increasingly significant vehicle for delivering development aid. This update builds on the findings of the 2003 evaluation of the Heavily Indebted Poor Countries (HIPC) Initiative, *Debt Relief for the Poorest: An OED Review of the HIPC Initiative*. It finds that many of the original conclusions remain relevant for the HIPC Initiative and are potentially instructive for future debt relief initiatives.

Debt Reduction Is Not Sufficient for Debt Sustainability

The Enhanced HIPC Initiative has reduced $19 billion of debt[1] in 18 countries, thereby halving their debt ratios. But in 11 of 13 post-completion-point countries for which data are available, the key indicator of external debt sustainability has deteriorated since completion point. In eight of these countries, the ratios once again exceed HIPC thresholds.

New analyses present a more optimistic outlook for debt sustainability. Six of eight post-completion-point countries have only a moderate risk of debt distress. But all remain vulnerable to export shocks and still require highly concessional financing and sound debt management.

Debt reduction alone is not a sufficient instrument to affect the multiple drivers of debt sustainability. Sustained improvements in export diversification, fiscal management, the terms of new financing, and public debt management are also needed, measures that fall outside the ambit of the HIPC Initiative.

Debt Relief Has Become a Significant Vehicle of Resource Transfer for HIPCs

HIPC debt relief has been significantly additional to other net resource transfers, both in the aggregate, and for 21 of 28 countries. Net transfers to HIPC countries doubled from $8.8 billion in 1999 to $17.5 billion in 2004, while transfers to other developing countries grew by only a third.

In 2005, eight more non-HIPC low-income countries have become potentially eligible for HIPC. The repeated extension of the deadline for eligibility has significantly expanded the reach of the initiative. The emergence of proposals for future rounds of debt relief suggests that debt relief is becoming an ongoing mechanism for resource transfer.

Maintaining Policy Performance Is Essential to Reaping the Benefits of Debt Reduction

Post-completion-point countries started out with higher scores on key policy ratings than other low-income countries and they still score

higher. HIPC countries not yet at completion point—both decision-point and pre-decision-point countries—have, on average, the lowest ratings of all low-income countries. They face serious challenges in managing their economies, which will affect their prospects for reaping the potential benefits of debt reduction. Even though the initiative has granted poorer performing countries more time to begin a reform program supported by the World Bank and the International Monetary Fund (IMF), they are held to the same performance requirements as countries that became eligible earlier. Fiscal and debt management are areas of particular weakness in many HIPC countries. Efforts arising from the HIPC Initiative to upgrade countries' public expenditure management systems have resulted in only modest improvements.

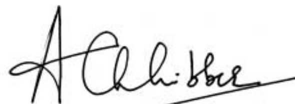
Most Creditors Have Committed Their Share of Relief

The HIPC Initiative was innovative in its attempt to seek a comprehensive approach among all creditors to debt reduction. The Bank, IMF, and Paris Club creditors have committed most of their shares of debt relief. But the initiative's structure as a voluntary agreement has hindered efforts to achieve the full participation of all creditors. The sluggish participation of commercial creditors and those not in the Paris Club—who were not involved in shaping the design—has generated a shortfall of 8 percent of total HIPC assistance, which affects some countries particularly.

Five Implications for Future Debt Relief Efforts

The experience under HIPC suggests five lessons for future debt relief efforts:

- Debt reduction is not sufficient for debt sustainability. Future debt relief initiatives need to stress that debt sustainability requires other policy actions by governments and external partners to improve repayment capacity.
- Does debt relief add to or substitute for other aid flows? To demonstrate that future debt relief initiatives are additional, donors will need to establish what their net transfers would be in the absence of debt relief.
- The initiative is delivering an increasing share of concessional resources to HIPC countries. Since non-HIPC countries do not have access to these resources, donors will need to ensure that the resulting pattern of resource allocation rewards better performers overall.
- Debtors cannot oblige creditors to participate in debt relief under voluntary initiatives. Involving both creditors and debtors at the design stage of proposals for debt relief can be an important step for securing the cooperation of all creditors.
- Future debt relief initiatives may also be expected to continually revisit and extend deadlines for eligibility. Extensions of the deadline keep open the opportunity for countries to receive debt relief, while holding all countries to the same standards. On the other hand, they could provide incentives to countries to increase their borrowings in order to avail themselves of debt relief.



Ajay Chhibber
Acting Director-General
Evaluation

Main Messages

- HIPC has channeled additional resources to qualifying countries.
- HIPC has reduced debt ratios to half their levels before debt relief. But debt ratios have increased since completion point, and in eight countries, once again, exceed HIPC thresholds.
- Six of eight post-completion-point countries with a new debt sustainability analysis have only a moderate risk of debt distress. But all eight remain vulnerable to export shocks and still require highly concessional financing and prudent debt management.
- Debt sustainability requires policy actions by governments and external partners to improve repayment capacity.
- Countries that are not yet at completion point face serious challenges in managing their economies that will affect their prospects for reaping the potential benefits of debt reduction.
- In future debt relief efforts, donors will have to ensure that the resulting allocation of concessional resources rewards better-performing countries overall.

Executive Summary

In the past decade, debt relief has become an increasingly significant vehicle for delivering development aid, with emerging debt reduction proposals now aiming to provide 100 percent debt cancellation. This review updates the March 2003 evaluation of the Heavily Indebted Poor Countries Initiative (HIPC), *Debt Relief for the Poorest: An OED Review of the HIPC Initiative*,[1] the findings of which are summarized below.

Since the 2003 evaluation, 12 countries have progressed to receiving irrevocable debt relief and two more countries have qualified for relief. About $50 billion has been committed in nominal debt service relief under the Enhanced HIPC Initiative[2] to decision-point countries, of which $15.4 billion has been committed since the previous evaluation. This update builds on the 2003 evaluation and finds that many of its conclusions remain relevant for the HIPC Initiative and are potentially instructive for future debt relief initiatives.

Findings from the 2003 IEG Evaluation of HIPC

The 2003 evaluation found the HIPC Initiative highly relevant in addressing a key obstacle facing many poor countries, and noted that the initiative would substantially achieve its goal of reducing the excessive debt burden of the qualifying countries, if the anticipated debt relief was delivered in full. But achieving the expanded objectives of the initiative—a "permanent" exit from debt rescheduling, promoting growth, and releasing resources for social expenditures targeted at poverty reduction—would require actions by donors and HIPC governments beyond the scope and means of the initiative. HIPC governments would need to have sound policy frameworks and balanced development strategies, and the international community would need to assist the countries with enhancing their exports and building needed institutional capacities, while ensuring that HIPC debt relief is truly additional to other aid flows.

Source: OED 2003.

Debt Sustainability. The Enhanced HIPC Initiative has reduced $19 billion of debt in 18 countries, thereby halving their debt ratios.[3] But in 11 of 13 post-completion-point countries for which data are available, the key indicator of external debt sustainability has deteriorated since completion point. In eight of these countries, the ratios once again exceed HIPC thresholds. Changes in discount and exchange rates have worked to increase debt ratios. The effect of improved exports and revenue mobilization on debt ratios has been offset by new borrowing. Six of eight post-completion-point countries with new debt sustainability analyses are considered to have only a moderate risk of debt distress, but all

remain vulnerable to export shocks and still require highly concessional financing and sound debt management. Debt reduction alone is not a sufficient instrument to affect the multiple drivers of debt sustainability. Sustained improvements in export diversification, fiscal management, the terms of new financing, and public debt management are also needed, measures that are outside the ambit of the HIPC Initiative.

Policy Performance. Countries past the completion point started out with higher scores on key policy ratings than other low-income countries and they still score higher. Countries not yet at completion point—both decision-point and pre-decision-point countries—have, on average, the lowest ratings of all low-income countries and face serious challenges in managing their economies that will affect their prospects for reaping the potential benefits of debt reduction. Even though the initiative has granted poorer performing countries more time to begin a reform program supported by the World Bank and the IMF, they are held to the same track record requirements as countries that became eligible earlier. Fiscal and debt management are areas of particular weakness in many HIPC countries.

Poverty Reduction. Debt relief was intended to contribute to poverty reduction. The requirement to develop and implement a country-owned poverty reduction strategy has been an important and beneficial outcome of the initiative. These strategies have tended to emphasize social sector spending rather than a more balanced approach to growth and poverty reduction. By continuing to track public expenditures deemed "poverty reducing," the initiative's approach to poverty reduction has leaned toward channeling additional resources to social expenditures. The emphasis on expenditures has prompted the Bank and the IMF to do more to upgrade public expenditure management systems in HIPC countries. These efforts have resulted in only modest improvements.

Creditor Participation. The HIPC Initiative was innovative in its attempt to seek a comprehensive approach among all creditors to debt reduction. The multilaterals and Paris Club creditors have committed most of their share of debt relief. But the initiative's structure as a voluntary agreement has hindered efforts to achieve full participation of all creditors. The sluggish participation of non–Paris Club and commercial creditors, who were not involved in shaping the initiative's design, has generated a shortfall of 8 percent of total expected HIPC assistance.

Additionality of Resources. HIPC has channeled additional development resources to its qualifying countries. Net transfers to HIPC countries doubled from $8.8 billion in 1999 to $17.5 billion in 2004, while transfers to other developing countries grew by only a third.

Debt relief has become a significant vehicle of resource transfer to HIPC countries. In the past year, eight additional non-HIPC low-income countries have become potentially eligible for HIPC. The repeated extension of the deadline for eligibility has significantly expanded the reach of the initiative. The emergence of proposals for future rounds of debt relief suggests that debt relief is becoming an ongoing mechanism for resource transfer.

Implications for Future Debt Relief Efforts. The experience under HIPC suggests five lessons for future debt relief efforts.

- Debt reduction is not sufficient for debt sustainability. Future initiatives need to be clear about the objectives of debt relief and how their outcomes will be measured. In addition, to ensure debt sustainability they need to stress the importance of other policy actions by governments and external partners to improve repayment capacity.
- Does debt relief add to or substitute for other aid flows? To demonstrate that future debt relief initiatives are additional, donors will need to establish what net transfers—both multilateral and bilateral—would be in the absence of debt relief.
- The initiative is delivering an increasing share of concessional resources to HIPC countries. Since non-HIPC countries do not have access to these resources, donors will need to en-

sure that the resulting pattern of resource allocation rewards better performers overall.

- Debtors cannot oblige creditors to participate in debt relief under voluntary initiatives. Involving both creditors and debtors at the design stage of proposals for debt relief can be an important step in disseminating information about the workings of the initiative and securing the cooperation of all creditors.
- Future debt relief initiatives may also be expected to continually revisit and extend deadlines for eligibility. Extensions of the deadline keep open the opportunity for countries to receive debt relief, while holding all countries to the same standards. On the other hand, they could provide incentives to countries to increase their borrowing in order to avail themselves of debt relief.

ACRONYMS AND ABBREVIATIONS

CP	Completion point
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee
DP	Decision point
DRF	Debt Reduction Facility
DSA	Debt Sustainability Analysis
E-HIPC	Enhanced Heavily Indebted Poor Countries (Initiative)
HIPC	Heavily Indebted Poor Countries (Initiative)
IDA	International Development Association
IEG	Independent Evaluation Group (formerly OED)
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
KKM	Kaufmann, Kraay, and Mastruzzi
LIC	Low-income countries
MDG	Millennium Development Goal
NPV	Net present value
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OED	Operations Evaluation Department (changed to IEG)
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development

Chapter 1: Evaluation Essentials

- This review updates the 2003 independent evaluation of the HIPC Initiative.
- HIPC objectives remain largely unchanged.
- Debt relief is becoming an ongoing mechanism for resource transfer.

Introduction

In the past decade, debt relief has become an increasingly significant vehicle for delivering development aid. The international community has recently galvanized itself to provide another round of debt relief.[1] This review updates the March 2003 evaluation of the Heavily Indebted Poor Countries Initiative (HIPC), *Debt Relief for the Poorest: An OED Review of the HIPC Initiative* (OED 2003).[2]

At that time, six countries had received irrevocable debt relief at completion point (CP) under the Enhanced HIPC (E-HIPC) Initiative,[3] and 20 had qualified and were receiving interim relief at decision point (DP) (see appendix A for a description of how the initiative works).[4] Since then, 12 of those countries have progressed to completion point, and two more countries have qualified for relief. Around $50 billion has been committed in nominal debt service relief to decision-point countries under E-HIPC, of which $15.4 billion has been committed since the 2003 evaluation (World Bank and IMF 2003a, 2005d). Table 1.1 classifies countries eligible under the E-HIPC according to their status: these groupings will be referred to throughout this paper.

The 2003 evaluation found the HIPC Initiative to be highly relevant in addressing a key obstacle facing many poor countries, and noted that the initiative would succeed in substantially achieving its fundamental goal of reducing the excessive debt burden of the qualifying countries, if the anticipated debt relief was delivered in full. But it found that achieving the expanded objectives of the initiative—a "permanent" exit from debt rescheduling, promoting growth, and releasing resources for social expenditures targeted at poverty reduction—would require actions by donors and HIPC governments beyond the scope and means of the initiative. HIPC governments would need to have sound policy frameworks and balanced development strategies, and the international community would need to assist countries to enhance their exports and build needed institutional capacities, while ensuring that HIPC debt relief is truly additional to other aid flows.

This update builds on the findings of the 2003 evaluation (box 1.1) to assess progress made under the E-HIPC, with a particular emphasis on the outcomes of debt relief in the 18 post-completion-point countries. The findings of this update will inform not only the ongoing implementation of the HIPC Initiative itself—

Table 1.1. Status of Countries under the Enhanced HIPC Initiative, February 2006

	Post-completion point	At decision point	Pre-decision point	Potentially eligible for HIPC
Early (before July 2002)	Bolivia, Burkina Faso, Mauritania, Mozambique, Tanzania, Uganda **(6)**	Benin, Cameroon, Chad, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Nicaragua, Niger, Rwanda, São Tomé and Principe, Senegal, Sierra Leone, Zambia **(20)**	Burundi, Central African Republic, Comoros, Côte d'Ivoire, Democratic Republic of Congo, Lao PDR, Liberia, Myanmar, Republic of Congo, Somalia, Sudan, Togo **(12)**	
Late (after July 2002)	Benin, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Nicaragua, Niger, Rwanda, Senegal, Zambia **(12)**	Burundi, Democratic Republic of Congo **(2)**		Bangladesh,[a] Bhutan,[a] Eritrea, Haiti, Kyrgyz Republic, Nepal, Sri Lanka,[a] Tonga[a] **(8)**
Total (as of February 2006)	Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia **(18)**	Burundi, Cameroon, Chad, Democratic Republic of Congo, Gambia, Guinea, Guinea-Bissau, Malawi, São Tomé and Principe, Sierra Leone **(10)**	Central African Republic, Comoros, Côte d'Ivoire, Lao PDR, Liberia, Myanmar,[a] Republic of Congo,[b] Somalia, Sudan, Togo **(10)**	Bangladesh,[a] Bhutan,[a] Eritrea, Haiti, Kyrgyz Republic, Nepal, Sri Lanka,[a] Tonga[a] **(8)**

Source: World Bank and IMF 2005d.

a. In September 2005, staff noted that they could not conclude firmly on Bangladesh, Bhutan, Myanmar, Sri Lanka, and Tonga's potential eligibility because of inadequate data. Further revisions to the list of potentially eligible countries are expected.

b. Since February 2006, the Republic of Congo has qualified for relief at decision point.

The 2003 evaluation found that achieving all the objectives of the HIPC Initiative would require actions beyond the initiative's scope.

from which as many as 18 countries still stand to receive relief—but also the design of future debt relief efforts.

This evaluation update contains four chapters in addition to this introduction. The next section of this chapter assesses how the initiative's objectives and design have evolved since 2003. Chapter 2 examines the extent to which creditors have committed HIPC assistance, and whether debt relief has been additional, which would be necessary to increase the fiscal space for social expenditures. Chapter 3 assesses the prospects for debt sustainability in countries that have reached completion point. Chapter 4 examines the quality of their policies, including macroeconomic outcomes. It also assesses these countries' progress toward poverty reduction and the Millennium Development Goals (MDGs). The update concludes in Chapter 5 with a summary of the key findings of the evaluation.

The 2003 evaluation recommended that the Bank clarify the purpose and objectives of the

Box 1.1. Findings from the 2003 Evaluation

Objectives and Design. The HIPC Initiative has acquired multiple objectives, while the instruments at its disposal have remained the same. The objective of promoting growth by removing the debt overhang has been maintained, the expectations of what it can deliver on debt sustainability have increased, and creating fiscal space for increased social expenditures has been added as an explicit objective. Debt forgiveness does not guarantee additionality, and without additional resources, it is unclear how the initiative, as it is designed, will create fiscal space. Management should clarify the objectives and ensure the consistency of the design with the main objectives.

Commitment of HIPC Assistance and Its Additionality. Achieving even the more modest objective of reducing debt to a level that provides countries with a reasonable chance of sustaining their external debts, would require full creditor participation to deliver the promised level of relief. The HIPC Initiative assumes that all creditors will participate, but cannot assure this. Achievement of the objective of increased fiscal space for social expenditures rests on the key assumption that debt relief will be additional to other aid transfers. There is not enough evidence yet to definitively determine the full impact of debt relief.

Debt Sustainability. While the use of the debt inventory methodology for assessing the current level of debt is a positive feature of the initiative, the methodological basis underlying the projections of future levels of debt remains unclear. The lack of transparency of the economic models behind these projections and the overly optimistic growth assumptions have made debt sustainability analyses ambiguous (in regard to their reliability as assessments of future debt sustainability). More realistic growth forecasts and better risk analysis of the projected debt burdens in the debt sustainability analyses would provide a better assessment of each country's likelihood of meeting the initiative's debt sustainability threshold.

Maintaining Policy Performance. The track record requirement for sustained policy and structural reforms has been applied flexibly to bring more countries into the program. But the progressive relaxation of the requirement for "millennium rush" countries that qualified in late 2000 raises the risk of not achieving the HIPC objectives, as these countries face a tougher challenge in meeting the necessary conditions to reach their completion point. It is critical to maintain the standards for policy performance to ensure that the risks to achieving and maintaining the initiative's objectives are minimized.

Balance between Pro-Poor Growth and Social Expenditures for Poverty Reduction. The initiative places a heavy emphasis on social expenditures as the primary means of poverty reduction. This is evident in conditions set for completion point and the focus in progress reports and the IMF's Poverty Reduction and Growth Facility (PRGF) reviews on tracking social expenditures. The initiative's performance criteria should be better balanced between growth-enhancing and social expenditure priorities and be supported by additional diagnostic work on the efficiency of public expenditures, identifying sources of growth and developing appropriate sectoral strategies as the basis of appropriate benchmarks.

Source: OED 2003.

initiative, which had progressively become more ambitious (see box 1.2). In its first progress report issued after the 2003 evaluation, the Bank stated that the key objective of E-HIPC was "to deal comprehensively with the overall debt burden of eligible countries by removing their debt overhang within a reasonable period of time and *providing a base from which to achieve debt sustainability* and exit the rescheduling cycle" (World Bank and IMF 2003d, emphasis added). This is a less ambitious formulation than the earlier one of providing a "permanent exit from rescheduling."

The poverty reduction objective of "freeing up resources for higher social spending" was neither specifically included in that progress report as an objective, nor explicitly removed. The Bank and the IMF continue to track debt service payments and "poverty reducing" expenditures in monitoring the HIPC Initiative, suggesting that the freeing up of resources for poverty reduction remains an objective. From the perspective of creditors and civil society, poverty reduction is the primary—if not the sole—objective of debt relief.[5] It has proved challenging for the Bank to

The key objective of the E-HIPC Initiative is to provide eligible countries a base from which to achieve debt sustainability.

Box 1.2. Findings from the 2003 Evaluation: Objectives and Design

As the 2003 evaluation noted, the E-HIPC Initiative has three objectives. Its original and first objective, to promote growth by removing the debt overhang, has remained consistent since the initiative was launched. The second objective, to help countries achieve debt sustainability, has become progressively more ambitious: whereas in 1995 it was expressed as reducing debt "as part of a broader strategy" to achieve long-run sustainability, in 1999 it became achieving "debt sustainability by [providing] a permanent exit from rescheduling." The objectives were also expanded to include a third goal: reducing poverty by "[freeing] up resources for higher social spending." On the design of the initiative, the 2003 evaluation found that debt forgiveness does not guarantee additionality, and without additional resources, it is unclear how the initiative, as it is designed, would create the fiscal space necessary to meet the third objective. The design would have been appropriate for a more modest objective of delivering debt relief to some of the poorest countries. Debtors had a limited influence on the design of the initiative.

Source: OED 2003.

HIPC has maintained its objective of freeing up resources for poverty reduction, and for some stakeholders, poverty reduction is the primary—if not the sole—objective of debt relief.

manage the enduring expectations of the international community for the initiative. The HIPC Initiative remains imbued with the responsibility of not just achieving debt sustainability but freeing up resources for achieving poverty reduction and the MDGs.

Design Allows Countries More Time to Become Eligible for Relief. Since March 2003, design changes have allowed countries, without an International Development Association (IDA)- or International Monetary Fund (IMF)-supported program in place, more time to become eligible for relief. The original two-year deadline for meeting the E-HIPC eligibility requirements has been extended three times (see appendix B for details).[6] Only four of the 14 countries that benefited from the extensions have managed to reach decision point since 1998.[7] Ten countries are still pre-decision point (see table 1.1).[8]

Debt relief is becoming an ongoing mechanism for resource transfer.

In 2004, when the deadline was extended to end-2006, the Executive Boards of the Bank and IMF decided to close the initiative to new entrants by "ring-fencing" a final list of countries potentially eligible for assistance under the initiative (World Bank and IMF 2004d). In September 2005, staff identified eight potentially eligible low-income countries (LIC) that were not on the original list of 38 countries (World Bank and IMF 2005d).[9] Staff had not assessed these countries' eligibility earlier, mainly owing to the lack of data on their debt.

The repeated extension of the deadline for eligibility and the resulting increase in the number of eligible countries has significantly expanded the reach of the initiative. The emergence of proposals for future rounds of debt relief suggests that debt relief is becoming an ongoing mechanism for resource transfer. This experience under HIPC suggests that future debt relief efforts may also be expected to continually revisit time frames for eligibility. Extensions of the deadline keep open the opportunity for countries to receive debt relief, while holding all countries to the same standards. On the other hand, they could provide incentives to countries to increase their borrowings in order to avail themselves of debt relief.

Chapter 2: Evaluation Essentials

- The HIPC Initiative was innovative in its attempt to seek a comprehensive approach to debt reduction involving all creditors.
- The main architects of the initiative—the World Bank, the IMF, and the Paris Club—have committed their full share of relief. Low participation of non–Paris Club and commercial creditors has resulted in a shortfall of 8 percent of total HIPC assistance.
- HIPC has channeled additional development resources to qualifying countries, both in the aggregate and for 21 of 28 countries. Net transfers to HIPC countries have doubled since 1999, while transfers to other developing countries have grown by only a third.
- In future debt relief efforts, donors will have to ensure that the resulting allocation of concessional resources rewards better-performing countries overall.

Delivery of Debt Relief

The HIPC Initiative was intended to provide a comprehensive and concerted approach across all creditors to relieving the external debt of HIPC countries. To reduce debt to a level that provides countries with a reasonable chance of sustaining their external debts would require that all creditors participate and deliver the promised level of relief. This chapter assesses how much debt relief has been committed, relative to the expected total amount at the initiative's inception, and whether debt relief has been additional to regular aid flows (see box 2.1).

Commitments and Delivery of Relief. The estimated total amount of HIPC debt cancellation to the 28 decision-point countries is $38.2 billion, with roughly half owed by multilateral creditors and half by bilateral and commercial creditors.[1] Of this total amount, $35 billion or 92 percent has been committed so far. This result demonstrates the ownership of the initiative by its main architects: the World Bank, IMF, and Paris Club creditors (figure 2.1). The relief that has not yet been committed is largely that expected from non–Paris Club bilateral (5.3 percent of the total amount) and commercial creditors (2.3 percent).

Creditors have not yet delivered the full amounts committed. HIPC countries have complained that they have still not received all the promised relief from certain Paris Club creditors or comparable treatment from non–Paris Club creditors (UN 2005a). The Paris Club Secretariat provides information on its Website about agreements concluded for cancellation or rescheduling of nominal debt under E-HIPC, but it does not share information on which agreements have actu-

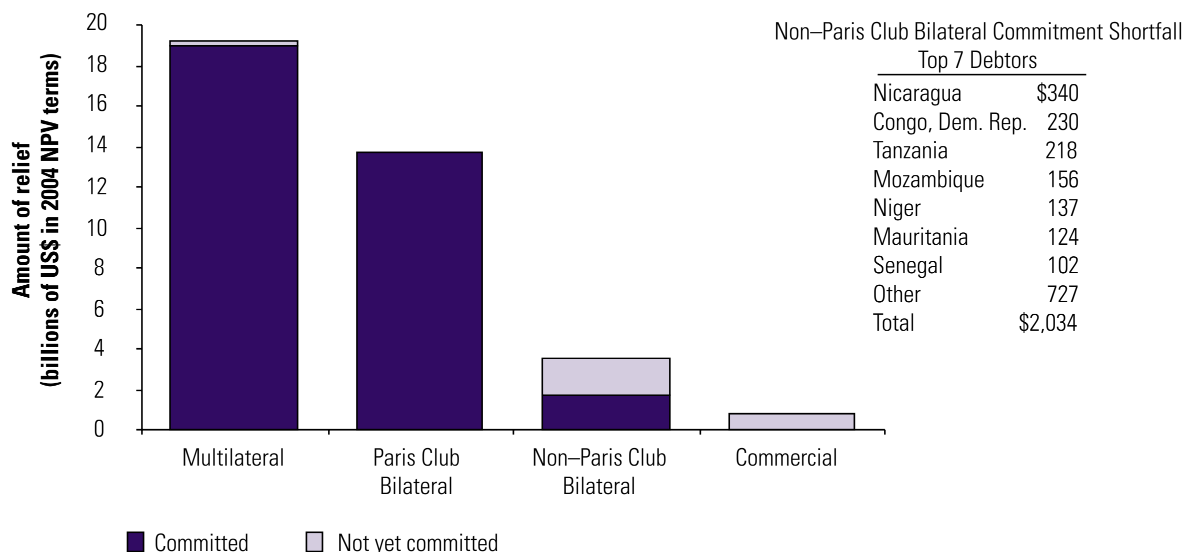
Box 2.1. Findings from the 2003 Evaluation: Debt Relief Commitment and Additionality

The 2003 evaluation found that the HIPC Initiative assumes, but cannot ensure, that all creditors will participate. Another necessary condition to achieving all three objectives simultaneously was that debt relief provided under the HIPC Initiative needed to be additional to other aid transfers, in order to free up resources for increased poverty-reducing spending. There was not enough evidence at the time of the 2003 evaluation to definitively determine whether debt relief had been additional.

Source: OED 2003.

More than 90 percent of promised debt cancellation has been committed.

Figure 2.1. Creditors' Commitments to HIPC Debt Relief



Source: World Bank and IMF 2005d.

ally been implemented. Creditors usually cited technical difficulties in making effective the agreements on individual loans as the reason for delays in removing debts from debtors' books (UN 2005a).

Non–Paris Club bilateral creditors, as a group, have neither committed nor delivered debt relief as planned. They have committed only 43 percent of their total share of relief, leaving a $2 billion shortfall. This shortfall affects some countries particularly—for seven countries, shown in the inset to figure 2.1, debt relief not yet committed by non–Paris Club creditors exceeds $100 million. In four countries, debt relief not yet committed by non–Paris Club creditors accounts for almost 20 percent of their expected HIPC relief, and in seven more countries, it is 10 percent or more. Even in countries where debt relief has been committed, debtor countries have often experienced long delays receiving debt relief from this group of creditors (UN 2005a and 2005b). They have delivered only $586 million or 16 percent of their share of relief, of which $423 million is accounted for by the cancellation of loans to Nicaragua by Guatemala.

Non–Paris Club bilateral creditors have committed less than half their share, leading to a $2 billion shortfall.

Some non–Paris Club bilateral creditors have failed to participate fully in the E-HIPC Initiative because they have not considered themselves bound by the agreement (UN 2005a). Most do not have a good understanding of what loans they were supposed to relieve under HIPC or how to calculate the amount of relief, and there is uncertainty about what loans are on their books due to poor credit recording systems (World Bank and IMF 2005d). They have also experienced difficulties changing their domestic laws to provide relief. In addition, some HIPC countries have not contacted all their creditors.

Most commercial creditors have not committed to providing their share of HIPC relief as figure 2.1 shows, and many have not even provided traditional relief.[2] Many HIPC countries were already in arrears to commercial creditors prior to the HIPC Initiative. Although commercial creditors' share of relief is just 2.3 percent, the relief could help contribute to normalizing HIPC countries' relations with them. Commercial financing will be essential in the long run for expanding HIPC countries' exports and growth. Not only have they not offered relief, more than a few have initiated litigation against HIPCs to recover debt, winning

judgments of at least $586 million in nine HIPC countries as of 2005, against claims of $281 million. No information is available on how much HIPC countries have actually paid in judgments.

The Bank has actively enlisted and encouraged the participation of both non–Paris Club and commercial creditors by drawing attention to noncompliers in its regular progress reports. Its missions at the country level have provided technical advice and information to debtors. In addition, the Bank's Debt Reduction Facility for retiring commercial debt owed by IDA-only countries has bought back principal on debt of $472.5 million in five HIPC countries since 1999.[3] It currently has resources equal to 15 percent of the approximately US$1 billion owed by HIPCs to commercial creditors. At the average cost of 14.3 cents to one dollar of principal, these resources should suffice to buy back the total amount (World Bank 2004), but only if creditors agree to negotiate and to eschew litigation to recover higher returns.[4]

The design of the initiative as a voluntary mechanism makes it impossible for the debtors to oblige all creditors to participate, in spite of theirs and the Bank's efforts. Creditors' imperfect understanding of HIPC methodology underscores the importance of including them—as well as their debtors—explicitly in the design of the initiative and improving debt management capacity in both groups.

Additionality of Debt Relief. A necessary condition to achieving the multiple objectives of the HIPC Initiative simultaneously is that debt relief be additional to other resource transfers, in order to free up resources for increased poverty-reducing spending. The 2003 evaluation found that debt forgiveness does not guarantee additionality. Assessing the additionality of debt relief under HIPC faces two main challenges. The first challenge is that the creditors use a variety of methods to account for debt relief that result in data that are not very reliable.[5] Second, assessing whether debt relief is additional to resource transfers requires a judgment about the counterfactual—that is, what resource transfers would have been in the absence of debt relief.

The 2003 evaluation found that although net resource transfers to HIPCs showed a downward trend from 1995 to 2000, it was too early to assess the additionality of HIPC debt relief. HIPCs, as a group, were receiving an increasing share of declining global resources, but they were not receiving more funds, in absolute terms, than they did prior to the initiative. Other studies on the period up to 2000 also find that debt relief has not been additional.[6]

Most commercial creditors have not yet committed to providing their share of HIPC relief.

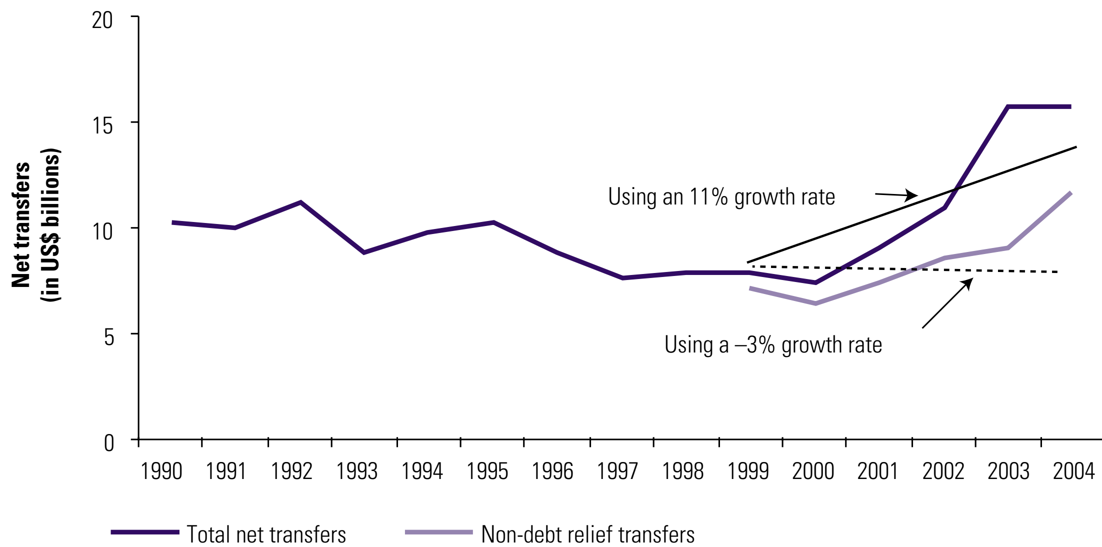
This update, which analyzes the period up to 2004, finds that in the aggregate, HIPC debt relief appears to have been significantly additional to other net resource transfers.[7] Net annual transfers to the 28 decision-point HIPC countries have increased substantially from $7.3 billion in 2000 (their lowest point in the decade) to $15.8 billion in 2004 (their highest) (see figure 2.2). Four billion dollars of this is attributable to debt relief; the remainder is non-debt-relief transfers. Did these non-debt-relief transfers increase at least as much as they would have in the absence of debt relief? Or did donors cut back on non-debt-relief transfers to provide debt relief? This question is key to establishing additionality.

One counterfactual scenario would be that net non-debt-relief transfers continued to decline modestly by 3 percent a year after 1999, as they did in the 1990s (dotted line in figure 2.2).[8] The 11 percent annual rate increase of non-debt-relief net transfers since then indicates that debt relief has been significantly additional. An alternative counterfactual would be that non-debt-relief transfers increased at 11 percent annually (bold line in figure 2.2), which is an estimated rate at which official development assistance (ODA) would have to increase in order to meet the MDGs.[9] The 11 percent annual increase of non-debt-relief transfers has met even this optimistic counterfactual, suggesting that donors have not, in fact, cut back on non-debt-relief transfers, and that debt relief was additional in the aggregate.

HIPC debt relief has been significantly additional to other net resource transfers.

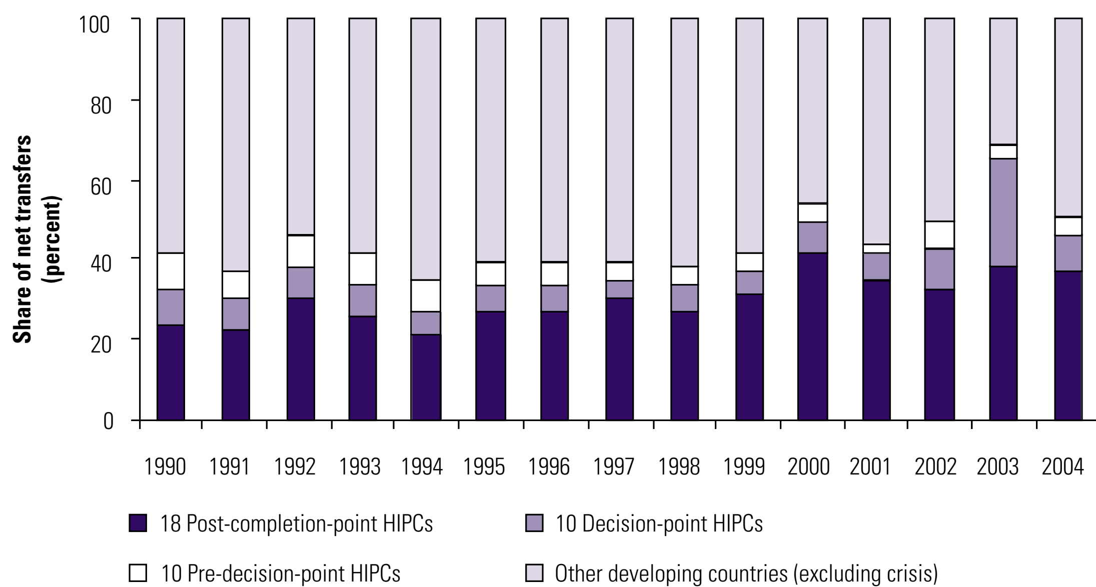
For most individual

Figure 2.2. Net Transfers to HIPC Countries Have Increased Since 2000



Source: OECD-DAC database.

Figure 2.3. HIPCs' Share of Aid Keeps Growing



Source: OECD-DAC database.

countries, too, debt relief has been additional. In 17 out of 28 countries, non-debt-relief transfers since 1999 outpaced the optimistic 11 percent annual increase required for the MDGs, indicating quite strongly that debt relief is not likely to have resulted in a cutback in non-debt-relief transfers in these countries. Four more countries have each outpaced or maintained their trend in the 1990s, suggesting debt relief has been additional in 21 out of the 28 countries. Only in seven countries did non-debt-relief transfers have a lower rate of growth than in the 1990s. For donors to demonstrate that future debt relief initiatives are additional, it will be important for them to establish what net transfers—both multilateral and bilateral—would be in the absence of debt relief.

HIPC countries' share of net transfers to all developing countries has increased substantially in past years (figure 2.3). On average, the 28 decision-point HIPC countries received 47 percent of transfers to all developing countries since 1999, compared with 33 percent from 1990 to 1999.[10] Commensurately, the share of non-HIPC developing countries declined from 60 percent between 1990 and 1999 to 48 percent, on average, since 1999.[11] The increased share of resources to HIPC countries suggests that debt relief has become a significant vehicle of resource transfer to this set of countries. In future debt relief efforts, donors will have to ensure that the resulting allocation of concessional resources rewards better-performing countries overall.

HIPC countries' share of net resource transfers to all developing countries has grown since 1999.

Chapter 3: Evaluation Essentials

- Current HIPC projections for growth and exports are more optimistic than even the high actual rates of recent years.
- HIPC has reduced debt ratios to half their levels before debt relief. But debt ratios have increased since completion point, and in eight countries, ratios once again exceed HIPC thresholds.
- Six of eight post-completion-point countries with a new debt sustainability analysis have only a moderate risk of debt distress. But all eight remain vulnerable to export shocks and require highly concessional financing and prudent debt management.
- Debt reduction alone cannot ensure debt sustainability but has to be accompanied by other efforts to improve repayment capacity.

Prospects for Debt Sustainability

The central objective of the Enhanced HIPC Initiative is to help countries by "providing a base from which to achieve debt sustainability and exit the rescheduling cycle" (World Bank and IMF 2003d). This chapter first examines whether the debt sustainability analyses (DSAs) conducted for the initiative provide a better analysis of the prospects for debt sustainability than before (see box 3.1), and then, whether their growth forecasts are more accurate. Finally, we determine each country's debt indicators at completion point and more recently, and assess the country's future prospects for debt sustainability.

Methodology of Debt Sustainability Analyses. Under the HIPC Initiative, the Bank and the IMF conduct DSAs at decision point and again at completion point. These analyses provide a current estimate of the net present value (NPV) of debt to exports or revenues, which is used to determine the amount of debt relief to be granted. DSAs also assess the future prospects for debt sustainability in HIPC countries.

The HIPC Initiative continues to use the same methodology (HIPC DSA) to determine each country's likelihood of meeting the initiative's debt sustainability threshold in the next 10 to 20 years. Meanwhile, the Bank and the IMF have introduced a new type of DSA, which is required to be prepared annually for all low-income countries, including HIPC countries.[1] The assessment of the likelihood of future debt distress under the new LIC DSA will feed into decisions about the terms of each country's IDA financing. For HIPC countries, the two DSAs are conducted in parallel.

Box 3.1. Findings from the 2003 Evaluation: Debt Sustainability Analyses

The 2003 evaluation found that the methodological basis underlying the projections of future levels of debt is unclear, and that the World Bank and the IMF have been too optimistic in the economic projections underlying the HIPC DSAs. The lack of transparency of the economic models behind these projections and the overly optimistic growth assumptions have made debt sustainability analyses ambiguous (in regard to their reliability as assessments of future debt sustainability). The evaluation recommended that the Bank and the IMF improve the transparency of the methodology and economic models underlying the DSAs and provide a better risk analysis of projected debt burdens in the DSAs and more realistic growth forecasts.

Source: OED 2003.

Two parallel debt sustainability analyses are conducted for HIPC countries.

The new LIC DSAs incorporate conceptual and methodological innovations that may make them better tools for assessing a country's future debt sustainability prospects (see table 3.1). First, they judge the likelihood of debt distress using benchmarks that depend on each country's policies and institutions. Second, they include domestic debt, which was excluded in the HIPC DSAs. Third, the alternative risk scenarios conducted for projections consider the impact of various shocks in addition to historical extrapolations. And finally, they use a single discount rate, eliminating some of the volatility in NPV calculations encountered in HIPC DSAs due to the use of currency-specific short-term interest rates.[2]

The new debt sustainability assessments may provide a better assessment of a country's prospects for debt sustainability.

HIPC DSAs are carried out at decision point and completion point for all HIPC countries, and remain the primary means of assessing a country's likelihood of meeting benchmarks for debt sustainability under the HIPC Initiative. The HIPC DSAs, while they lack the country tailoring offered by the LIC DSAs, continue to be used because they involve thresholds and debt indicators that are uniform across all HIPCs, ensuring equity in measuring and comparing outcomes. The two DSAs for each country are intended to be complementary. There is, nonetheless, a potential tension between the more thorough risk assessment offered by the LIC DSAs, and the uniformity of treatment offered by the HIPC DSAs.

Debtor countries have expressed the importance of understanding how DSAs are formulated, in order to improve the quality of economic and financial simulations that affect their funding arrangements (UN 2005b). Improved transparency from the Bank and the IMF would assist in strengthening countries' own capacities to predict debt dynamics (UN 2005a). The Bank has made vigorous efforts to disseminate the methodology of the LIC DSA through workshops for government officials, by publishing a user's guide to the LIC DSA and by making the templates available on the Internet.

Realism of Growth Forecasts. Each country's HIPC DSA makes assumptions about future growth

Table 3.1. New DSAs for Low-Income Countries Use Flexible Benchmarks While HIPC DSAs Use Uniform Thresholds

	HIPC DSA	LIC DSA
Principle	Rules to generate fully coordinated provision of debt relief by a large group of creditors	More flexible and relies on country-specific guidance of future financing decisions
Indicative thresholds	Uniform	Depend on the quality of countries' policies and institutions
Risk scenarios	Considers alternative scenarios	Considers various distress scenarios (high and low)
Debt indicators	External debt indicators, primarily as a percentage of exports or revenues	External and domestic debt indicators, as a percentage of GDP, in addition to exports and revenues
Exports/revenues	Backward-looking three-year averages, to even out volatility in export earnings and revenues	Current year
NPV of debt calculations	Calculated on a loan-by-loan basis	Projects aggregate debt service
Discount and exchange rates	Six-month averages of currency-specific long-term commercial interest rates	Single discount rate; *World Economic Outlook* exchange rates

Source: IMF 2003; World Bank and IMF 2004a, 2004b, 2005a.

rates of exports and GDP projections. These assumptions have profound implications for assessing the likely outcomes and overall success of the initiative. For instance, the higher the assumed export growth rate, the more likely it is that a country's projected debt-to-export ratio will reach a level defined as sustainable. An accurate projection is thus essential to projecting future sustainability.

Baseline projections for both export and GDP growth are less optimistic in more recent DSAs than those in earlier DSAs. On average, GDP growth projections from 2000–2010 were 0.42 percentage points lower, and export growth projections 0.11 percentage points lower, in completion-point DSAs, when compared with projections for the same year in decision-point DSAs (figure 3.1).[3] (Completion-point versus decision-point DSAs for the same country are used here as a proxy for later versus earlier DSAs.) In the 12 countries that have reached completion point since the April 2003 evaluation, the projections are even less optimistic. In these countries, recent projections for GDP growth were 0.67 percentage points lower than earlier projections; the difference was 0.27 percentage points for exports.[4]

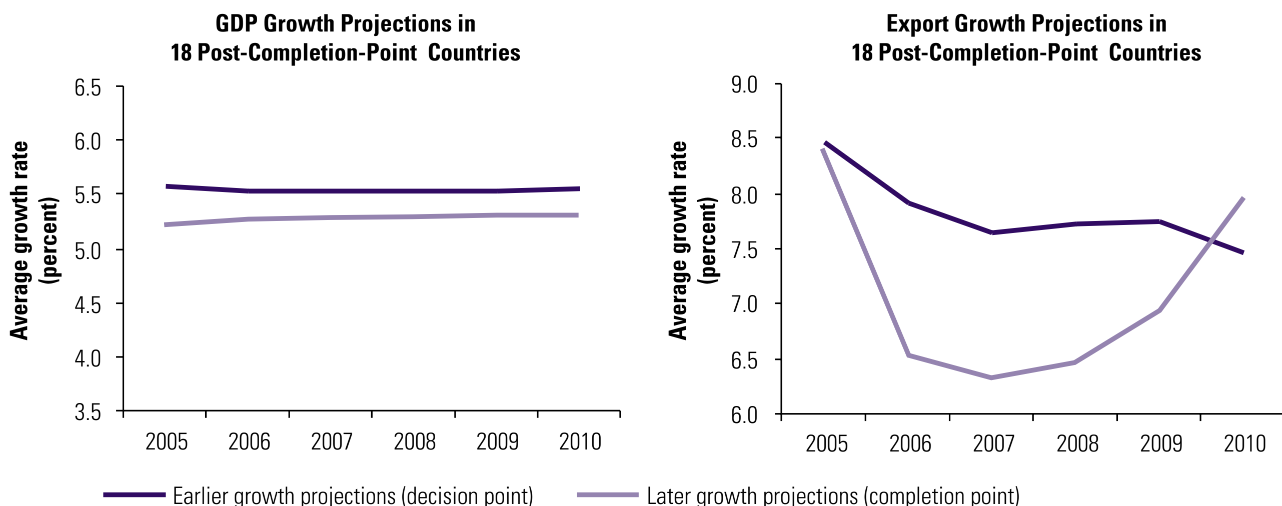
Although projections have been revised downward, many of them are still outside a 95 percent confidence interval for the estimated GDP and export growth rates over the period. Average GDP projections for 2005–2010 are more than twice their 1990–2000 averages, and more than 2.5 times their 1980–2001 historical averages (table 3.2).[5] Export projections are 1.7 times their 1990–2000 averages, and 2.5 times averages for 1980–2001.[6]

Recent economic projections for 2005–10 are less optimistic than projections made for the same period during the early years of the HIPC Initiative.

It is possible that growth in the next decade in the HIPC countries could exceed historical bounds for the 1980s and 1990s, owing to improved domestic and external factors or as countries emerge from conflict. And so far, actual GDP growth from 2000 to 2004 has been almost double the growth in the 1990s; export growth has been more than twice as high. But even these improved growth rates are lower than the DSA projections for the same period, as shown in table 3.2.[7] Actual GDP growth rates from 2000 to 2004 averaged 0.8 percentage points lower than the most recent projections, a difference

Current projections are more optimistic than even the high actual rates of recent years.

Figure 3.1. More Recent Projections Are Less Optimistic



Source: World Bank and IMF data.

Table 3.2. Projections Exceed Historical and Actual Growth Rates

	Projected mean 2005–2010	Historical mean 1990–2000	Difference	Historical mean 1980–2001	Difference	Projected mean 2000–2004	Actual mean 2000–2004	Difference
Export	7.3	4.3	3.0	2.9	4.4	10.5	9.5	1.0
GDP	5.3	2.5	2.8	2.1	3.2	5.2	4.5	0.8

Source: World Bank and IMF data.

that is statistically significant at 95 percent confidence. Actual export growth rates averaged 1 percentage point lower than projected, a difference that underestimates the ratio of NPV of debt to exports by close to a third over a 10-year period.[8]

HIPC Thresholds Achieved at Completion Point. Relief granted under the E-HIPC Initiative has reduced debt ratios to half their levels before HIPC relief.[9] In the 13 post-completion-point countries that qualified under the *export* criterion, the NPV of debt to exports has declined by about half, from a simple average of 310 percent prior to decision point, to 142 percent at completion point, as shown in column A of table 3.3.[10] For the five countries that qualified under the *fiscal* criterion, the NPV of debt to revenues has been reduced by more than half between decision point and completion point, from 445 percent to 181 percent.

Relief granted under E-HIPC has reduced debt ratios to half their initial levels.

At completion point, debt ratios in all but three countries were lower than the HIPC debt sustainability thresholds of 150 percent NPV of debt to exports, or 250 percent NPV of debt to revenues.[11] Although Uganda appeared to have been at 150 percent at completion point, a stock of debt was identified the following year that showed the level was 171 percent. Benin's NPV of debt to export stood at 155 percent at completion point but was anticipated to decline below 150 percent in 2005. Likewise, Zambia's was expected to go down from 174 percent to 140 percent in 2004.

Four countries, Burkina Faso, Niger, Ethiopia and Rwanda, received "topping up" at completion point, that is, debt relief beyond the amount agreed at decision point. "Topping up" is granted in exceptional circumstances if there has been a fundamental change in a country's economic circumstances at that time and if the change is clearly due to an exogenous development (World Bank and IMF 2001, 2004c). Reductions in SDR (Special Drawing Rights) and US dollar discount rates, exchange rates, export shocks, and unfavorable terms of new financing have all been considered exogenous developments that have affected a country's economic circumstances.[12] So far, every country that was projected to significantly exceed HIPC thresholds in the medium term past completion point has been considered and granted topping up.

Box 3.2. Findings from the 2003 Evaluation: Debt Sustainability Prospects

The 2003 evaluation found that the prospects for future debt sustainability in the six countries that had reached completion point at the time were tenuous for three and poor in two more. The prospects for debt sustainability depend on a number of factors affecting the country's repayment capacity, especially the levels and terms of new borrowings, the productive use of additional resources to generate revenues and promote growth, and export stabilization and diversification.

Source: OED 2003.

Debt Ratios Have Deteriorated Subsequently. In 11 out of 13 countries with current data,[13] debt ratios have deteriorated since completion point, and in eight of these countries, the ratios once again exceeded HIPC thresholds (see box 3.2). In the export cases, the NPV of debt to exports worsened by 25 percent, from an average of 142 percent to 174 percent; and for fiscal cases, the NPV of debt to revenues deteriorated by about

Table 3.3. Post-Completion-Point Countries' Debt Ratios Have Regressed

			Ratio of NPV of debt to exports or revenues					Growth in ratio: NPV of debt to exports or revenues	
			HIPC DSA			LIC DSA			
Country	Month of completion point (CP)	Export / fiscal case	Before relief at decision point	After relief at completion point	Current estimate (2003)	After relief at completion Point	Current estimate (2003, 2004, or 2005)	(*Column A*) Before relief to CP	(*Column B*) CP to current
Uganda	May-00	Export	240	171	258		179	–29%	51%
Bolivia	Jun-01	Export	217	117	176			–46%	50%
Tanzania	Nov-01	Export	324	105	140		120	–68%	33%
Burkina Faso	Apr-02	Export	279	150	199		183	–46%	33%
Mauritania	Jun-02	Fiscal	500	201	256		190	–60%	27%
Benin	Mar-03	Export	240	155	196			–35%	26%
Niger	Apr-04	Export	322	150	182			–53%	21%
Nicaragua	Jan-04	Export	540	138	164			–74%	19%
Guyana	Dec-03	Fiscal	543	206	243			–62%	18%
Mozambique	Sep-01	Export	200	113	130			–44%	15%
Ethiopia	Apr-04	Export	284	150	158		149	–47%	6%
Mali	Mar-03	Export	217	134	134	118	106	–38%	0%
Senegal	Apr-04	Fiscal	305	156	154			–49%	–1%
Honduras	Apr-05	Fiscal	304	188	188			–38%	n.a.
Madagascar	Oct-04	Export	248	137	137			–45%	n.a.
Zambia	Mar-05	Export	401	174	174			–57%	n.a.
Rwanda	Mar-05	Export	523	150	150	286	286	–71%	n.a.
Ghana	Jul-04	Fiscal	570	152	152			–73%	n.a.
Simple Average	Export	310	142	174			–50%	25%	
Simple Average	Fiscal	445	181	218			–56%	15%	

Source: Decision-point and completion-point documents; World Bank and IMF 2004c; LIC DSAs.

Note: Before relief at decision point = After original HIPC relief, if any, and after traditional debt relief mechanisms (Naples terms) as of the decision point reference year, which ranges from end-1998 to mid-2001. After relief at completion point = After unconditional and additional bilateral debt relief at the completion point reference year, which ranges from end-2000 to end-2003. n.a. = not applicable.

15 percent, from 181 percent to 218 percent (column B of table 3.3). A country's debt indicator is more likely to have increased the longer the interval since completion point.

What caused these reversals? Debt ratios change owing to several factors that act in different directions. The numerator, the NPV of debt, increases with new borrowing, and can increase or decrease, depending on the direction of changes in discount and exchange rates. The denominator, exports or fiscal revenues, depends upon a country's export or fiscal revenue performance. Figure 3.2 decomposes the average change in debt ratios since completion point into each of these various forces. Discount and exchange rates have increased the NPV of US dollar-denominated debt in all 13 countries, and have, consequently, increased debt ratios by about one-fifth in fiscal criterion countries, and almost one-quarter in export criterion countries. On average, countries' exports and rev enue mobilization have improved, which has lowered debt indicators.

After reaching completion point, debt ratios in a majority of HIPC countries have risen above HIPC thresholds.

Countries' improved exports and revenue mobilization have been offset by new borrowing.

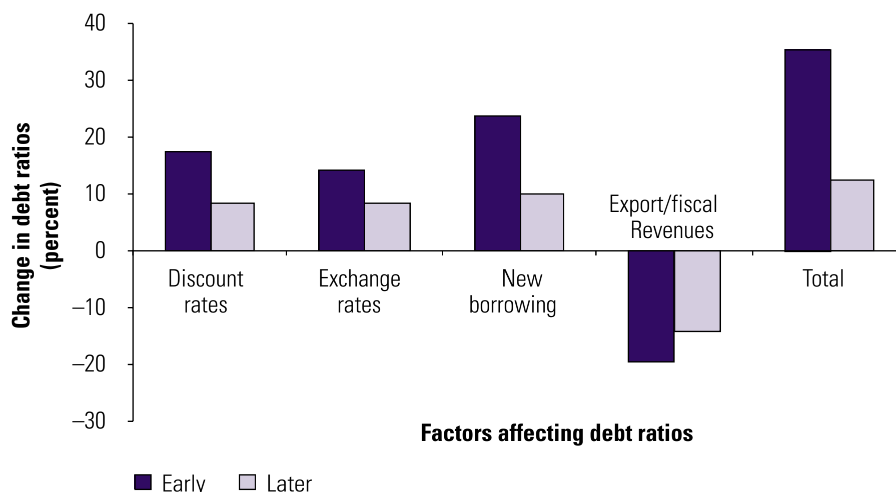
But this improved repayment capacity has been offset by increases in debt levels owing to new borrowings.

Higher borrowing in countries reaching completion point early has affected debt ratios twice as much as in later countries (figure 3.2). In both Mali and Senegal, which have maintained their debt ratios since completion point, new borrowing has been slightly less than anticipated and has barely increased debt ratios (by 11 percent and 4 percent, respectively). Mali also had a strong export performance and Senegal increased government revenues. By contrast, in Uganda and Bolivia, which had the highest increases in the NPV of debt to export, new borrowings were responsible for about a third of the increase (30 percent and 38 percent, respectively). A third of the loans contracted since 2000 by Bolivia have been nonconcessional, unlike the other countries. IDA accounted for two-thirds of Uganda's, and one-half of Senegal and Mali's new multilateral loans.

A Third of Countries Are Unlikely to Maintain HIPC Thresholds. The Bank's projections in HIPC DSAs for these countries indicate that six of the 18 post-completion-point countries: Burkina Faso, Ethiopia, Guyana, Nicaragua, Rwanda, and Uganda, will not be able to maintain the HIPC threshold ratios for the entire nine-year post-completion-point period. Figures 3.3 and 3.4 show the latest projections available for the respective debt indicators for these six post-completion-point countries.[14] These are baseline scenarios, which, as noted in the previous section, have in the past proven to be based on overly optimistic growth rates. Under more pessimistic assumptions about growth, additional countries are projected to remain above the threshold ratios.

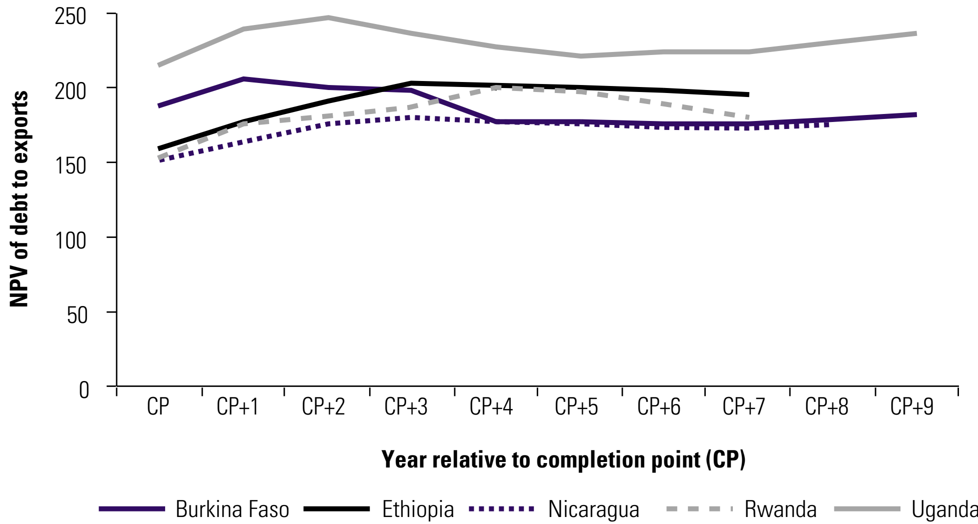
LIC DSAs Present a More Optimistic Outlook for Debt Sustainability. In spite of having exceeded targeted ratios under HIPC, countries may be sustainable in the long run. Indeed, LIC DSAs in eight post-completion-point countries find that the risk of debt distress is *moderate* in six, *high* in two, and *in debt distress* in none (see appendix E, tables E.1 and E.2).[15] In the six countries deemed to have a *moderate* risk of debt distress, most debt burden indicators remain stable and under the indicative thresholds during the projection period. In Mauritania, external debt indicators improve markedly over

Figure 3.2. Why Have Post-Completion-Point Debt Ratios Risen?



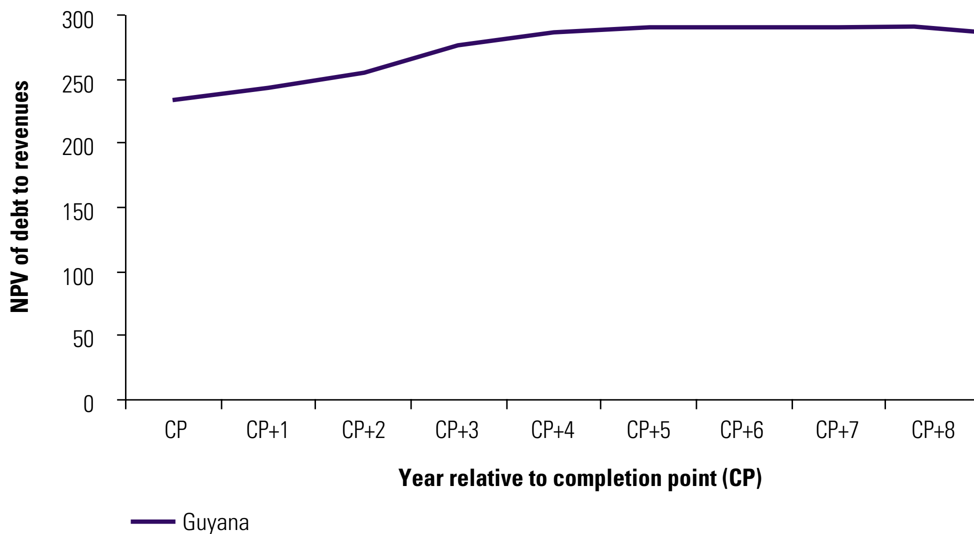
Source: World Bank and IMF 2004c.

Figure 3.3. Five Countries Are Projected to Exceed the 150 Percent Threshold of Debt to Exports Beyond Completion Point



Source: World Bank data.

Figure 3.4. Guyana Is Projected to Exceed 250 Percent Threshold of Debt to Revenues Beyond Completion Point



Source: World Bank data.

the medium term, spurred by oil revenues, and continue to decline over the long term. In Burkina Faso, the external debt indicator worsens in the medium term owing to expenditure run-ups and weak export growth; and in Mali it is marginally above the threshold toward the end of the projection period. In Ghana, Tanzania, and Uganda, debt indicators remain below the thresholds under the baseline scenario. Uganda's debt service continues to be manageable, reflecting HIPC assistance and the concessional nature of its debt.

Ethiopia and Rwanda are at a *high* risk of debt distress, both according to their HIPC and LIC

Countries are still vulnerable to export shocks, and require highly concessional financing and sound debt management.

DSAs. In Ethiopia's baseline scenario, external-debt-stock indicators will rise in the medium term, above thresholds, and then decline gradually. In the outer years, debt service rises moderately as a percent of exports, as concessional debt comes to maturity and HIPC debt service reduction is exhausted. But Ethiopia's external debt and debt service indicators are particularly sensitive to the terms of new borrowing and negative export shocks, although they deteriorate under most stress tests. Even after the full delivery of HIPC assistance and additional bilateral debt relief, the projected path of the external debt indicator in Rwanda signals poor prospects for debt sustainability despite low levels of debt service to exports.

HIPC cannot ensure sustainable levels of debt, regardless of the threshold.

Even HIPCs with moderate risks of debt distress are vulnerable to export shocks, and require highly concessional financing and sound debt management (see box 3.3 and appendix E, tables E.1 and E.2). The Bank is taking steps outside of the HIPC Initiative to address these issues, which affect the long-term debt sustainability of HIPC countries. Expanding and diversifying exports is discussed prominently as an objective of the Bank's assistance strategy in half of the 18 post-completion-point countries, and lending programs in 13 countries do include specific measures to increase and diversify exports, ranging from support of trade facilitation to investment promotion and strategic export-sector reforms. Country-specific analytical work on export promotion is planned in a third of the post-completion-point countries. IDA's support will take more account of debt sustainability because the new Debt Sustainability Framework will determine the mix of grants and loans in IDA support during the next three years (World Bank and IMF 2005a).

In summary, relief granted under the E-HIPC Initiative has reduced debt ratios to half their levels before HIPC relief. But debt ratios have deteriorated significantly since completion point in the majority of countries, with the increase in debt ratios correlated quite closely to the length of time since completion point. The methodology of HIPC DSAs has not changed and assumptions about growth, while more realistic, are still optimistic. The Bank and the IMF's new methodology for analyzing risks to debt sustainability in low-income countries may provide a better assessment of a country's future prospects. According to the new debt sustainability analyses, six of eight post-completion-

Box 3.3. Export Diversification, Highly Concessional Financing, and Prudent Debt Management Are Keys to Long-Term Debt Sustainability in Eight Countries

Mauritania remains vulnerable to fiscal policy slippages and external shocks. **Ghana's** external debt sustainability hinges strongly on continued access to concessional financing. It is also vulnerable to an export shock if it were to occur concurrently with an import shock. **Burkina Faso, Mali,** and **Tanzania** are vulnerable to poor export performance or less favorable terms of donor financing. Burkina Faso, moreover, would need to keep its macroeconomy stable and continue its efforts to mobilize revenues. Mali remains vulnerable to a nominal depreciation despite improved GDP growth and containment of inflation, and would need to accelerate its export growth and continue to receive highly concessional financing. **Uganda** is projected to rely heavily on donor support to finance its current account deficit. It is very vulnerable to macroeconomic shocks and imprudent debt management, and would be better protected if it embarked on a second generation of structural reforms. To safeguard its debt sustainability, **Ethiopia** needs to borrow prudently and on highly favorable terms, while managing its debt carefully. Finally, **Rwanda's** external partners would need to provide highly concessional financing and the government would need to swiftly diversify its exports in order to reduce Rwanda's vulnerability to shocks.

Source: LIC DSAs for Burkina Faso, Ethiopia, Mali, Mauritania, Rwanda, Tanzania, and Uganda; Poverty Reduction Support Credit program document for Ghana (World Bank 2005f).

point countries have only a moderate risk of debt distress. Even so, they are vulnerable to export shocks and require highly concessional financing and sound debt management.

The HIPC experience shows that debt relief, by itself, cannot ensure sustainable levels of debt, no matter what the threshold. It needs to be accompanied by significant efforts to improve repayment capacity. This limitation of debt reduction as an instrument should be recognized in defining the objectives of future debt relief efforts. Future debt relief initiatives should state how and by what method their outcomes should be measured. To ensure that stakeholders do not view debt reduction as sufficient for achieving debt sustainability, debt relief proposals should stress the importance of other policy actions by governments and external partners.[16]

Debt relief must be accompanied by significant efforts to improve repayment capacity.

Chapter 4: Evaluation Essentials

- Countries past completion point started out with higher scores on key policy ratings than other low-income countries and still score higher.
- Countries not yet at completion point have weak and declining governance and economic management indicators, which will affect their prospects for benefiting from debt relief.
- All countries have weak and deteriorating debt management capacity and the Bank has provided HIPC countries with little assistance in improving debt management capacity.
- Efforts arising from HIPC to upgrade countries' public expenditure management systems have resulted in only modest improvements.
- While post-completion-point countries have made modest progress toward attaining the Millennium Development Goals, the data are still limited.

Policy Performance and Poverty Reduction

In order to ensure that the initiative meets its objectives of contributing toward growth, debt sustainability, and poverty reduction, HIPC requires countries to demonstrate a track record of performance (see box 4.1). This chapter describes briefly some general trends in the macroeconomic performance of the 18 post-completion-point countries. It then evaluates the quality of policies and institutions in these countries, and examines their progress toward poverty reduction and the MDGs.

Macroeconomic Performance. Countries are required to remain on track under an IMF program for a minimum of six months prior to decision point and, again, prior to completion point. All 18 post-completion-point countries but one (Mauritania) are on track with an IMF-supported program, although eight have experienced some sort of slippage or delay since completion point (see appendix F).

Individual macroeconomic indicators have been better, on average, in post-completion-point countries since 1999 than in the five-year period before 1999. *Inflation* in the post-completion-point countries has fallen from 13.8 percent between 1994 and 1998 (the "early" period) to 6.6 percent since 1999 ("recent"), and *reserves* have risen in the recent period relative to earlier years. Both indicators reached average levels achieved in the IDA-only countries that are not HIPCs. The initiative aims to stimulate growth by removing the debt overhang. Real *GDP growth rates* have averaged about 4.3 percent recently in the completion-point countries, similar to the mean growth rates of 4.3 percent seen in the early period, and substantially higher than the average growth rates from 1980 to 1993 (1.7 percent) (see table 4.1). They are also higher than recent growth rates of decision-point HIPCs (2.7 per-

Box 4.1. Findings from the 2003 Evaluation: Maintaining Policy Performance

The 2003 evaluation found that the track record requirement of sustained policy and structural reforms in the HIPC Initiative had been applied flexibly to bring more countries into the program. But the progressive relaxation of the requirements in late 2000 jeopardized HIPC objectives, because these countries would face a tougher challenge in meeting the necessary conditions to reach their completion point.

Source: OED 2003.

Post-completion-point countries are growing faster than other low-income countries.

Table 4.1. Post-Completion-Point Countries Had the Fastest Growth in Recent Years

	Real GDP growth rates		
Country groupings	Old (1980–93)	Early (1994–8)	Recent (1999–2003)
18 Post-completion point	1.7	4.3	4.3
10 Decision point	2.2	1.2	2.7
10 Pre-decision point	0.5	7.0	2.7
30 Non-HIPC IDA-only	1.1	3.5	3.8

Source: World Bank World Development Indicators.

cent) and non-HIPC IDA-only countries (3.8 percent). It is still too early to tell whether, and to what extent, higher growth is a result of debt-stock reduction.[1]

Post-completion-point countries have not improved much in terms of *revenue mobilization* and *export performance*. Their revenue, as a percent of GDP, is about the same in the recent period (16.5 percent) as in the earlier period (16 percent). Their current account balances are worse, on average, in the recent period (–8.8 percent of GDP) relative to the earlier period (–6.9 percent of GDP), with deficits twice as big as those in non-HIPC IDA-only countries. They have improved, however, every year since 1999. In spite of having diversified their exports slightly (as measured by the Herfindahl-Hirschmann index of exports concentration), post-completion-point countries have not boosted exports, which have, on average, remained flat at around 26 percent of GDP from 1999 to 2003. While this is close to the average for developing countries, it is much lower than that of non-HIPC IDA-only countries, which have seen rates of closer to 40 percent of GDP. But post-completion-point countries also faced declining terms of trade during that time.

Countries past their completion point score highest on key policy ratings.

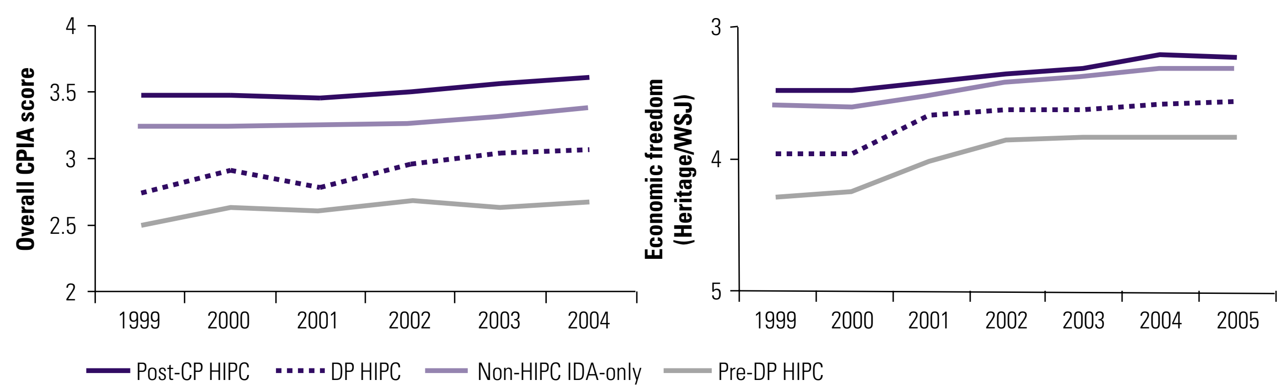
The 20 countries not yet at completion point have weak and declining economic management and governance indicators.

Fiscal Conditions Waived. As an indicator of how the HIPC Initiative's policy standards have been maintained, IEG tracked the waivers granted for completion-point conditions, since a waiver represents a relaxation of requirements. Thirteen of the 18 post-completion point countries had observed the benchmarks for structural and social reforms at completion point with some delays or with only one or two waivers. But the remaining five countries had received three or more waivers (see appendix G for more detail). In four of these countries, waivers were granted for targets missed in fiscal management. Two were for revenue shortfalls, and two for budgetary reporting and financial management conditions, which are relevant for future debt sustainability. The fiscal management rating of the Bank's Country Policy and Institutional Assessment (CPIA) has worsened or remained the same since 1999 in 13 of the 18 post-completion-point countries.[2]

Quality of Policies and Institutions. Since 1999, all low-income countries, whether HIPC beneficiaries or not, have improved their policy performance as measured by their aggregate CPIA score and by the Heritage Foundation/Wall Street Journal Index of Economic Freedom (figure 4.1). HIPC countries that reached completion point started out with higher scores, and still score higher than three comparator groups on all four subcomponents of the CPIA and for the CPIA overall. Their superior economic management, relative to other IDA-only countries is validated by the Heritage Foundation /Wall Street Journal "economic freedom" indicator, which finds they have economic policies that are more conducive to growth. Their governance, as measured by Kaufmann, Kraay, and Mastruzzi (KKM), is also slightly better than all comparator groups, and has improved on three of the six indicators (see appendix I).[3]

The HIPCs that have not yet reached completion point, by contrast, have been facing challenges in managing their economies in recent years. The 10 pre-decision-point countries exhibit the worst-rated CPIA scores and KKM governance indicators of all IDA-only countries (appendix I). Their ranking for all six KKM governance indicators, including control of corruption and government effectiveness

Figure 4.1. All IDA-Only Countries Have Improved Since 1999, and Post-Completion-Point Countries Score Highest



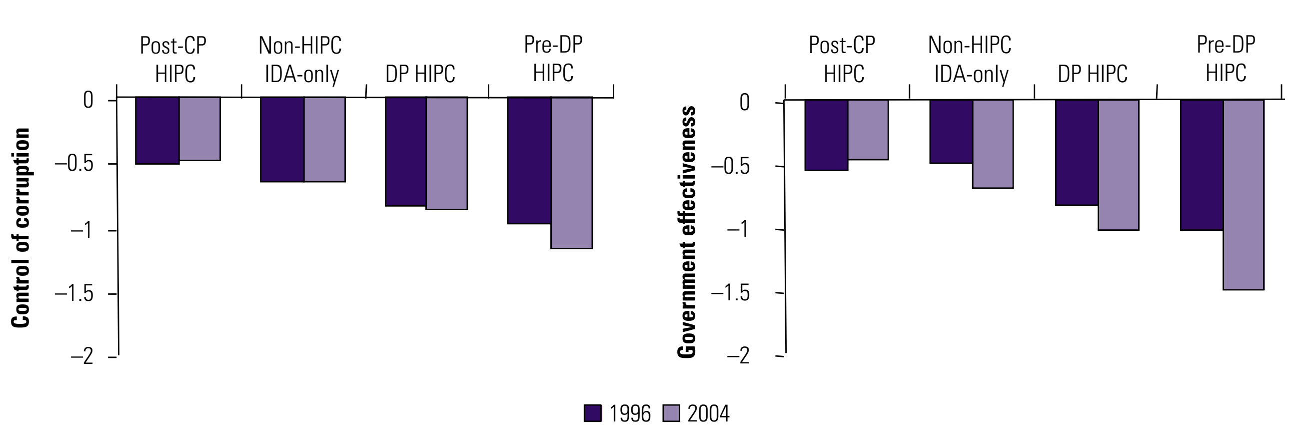
Source: World Bank; Heritage Foundation and Wall Street Journal 2005.

(shown in figure 4.2), declined in 2004 relative to 1996, and their economic management, as reflected by the CPIA, has worsened since 2002 (figure 4.3). Decision-point countries, too, have slipped. Seven of the ten decision-point countries have a worse CPIA score for economic management in 2004 than in 2001, driven mainly by worse public debt management and poor fiscal management.

Public debt management has been a particularly poor performing indicator. All low-income countries, including post-completion-point countries, have seen a worsening of their debt service and debt management capacity, as measured by the CPIA (figure 4.4). The decline in CPIA scores has been most marked in the decision-point and pre-decision-point countries. Bank assessments of debt management indicate that, in general, HIPC countries have a fair loan-by-loan record of their sovereign external debt, but not of loans taken on by state enterprises and the private sector, or of domestic debt.[4] Agencies responsible for debt management are generally careful to ensure that new loans meet country requirements for conces-

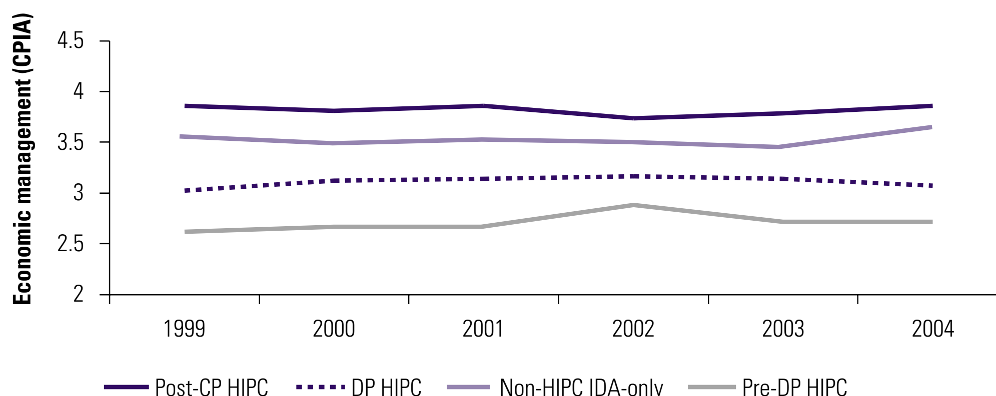
Ratings for debt management in all low-income countries are low and have been deteriorating.

Figure 4.2. Countries Not Yet at Decision Point Have the Worst Governance Indicators of All Low-Income Countries



Source: Kaufmann, Kraay, and Mastruzzi 2005.

Figure 4.3. Decision-Point Countries Have Worse Economic Performance Now Than in 2001



Source: World Bank data.

sionality, but are not able to analyze the impact of new borrowing on long-term debt sustainability and on macroeconomic scenarios. Countries' debt management units need to strengthen institutional frameworks, improve staffs' analytical skills and upgrade technical software.

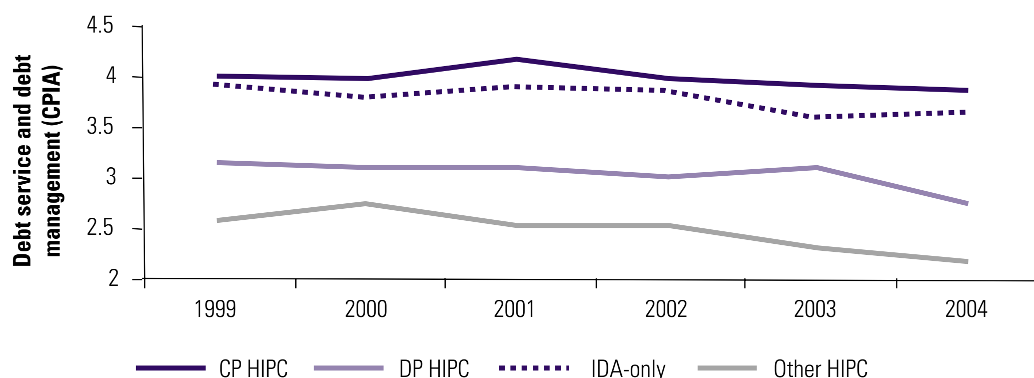
The 2003 evaluation found that the design of the initiative did not address this critical issue of capacity building for debt management, but rather assumed that efforts outside the initiative would provide the necessary assistance.[5] At the time of the evaluation, the Bank stated that it was attempting to step up its efforts to provide technical assistance for debt management in low-income countries. Currently, the Bank assesses debt management at decision point and at completion point for each country. In addition, the Bank's Banking and Debt Management group—which mainly provides advisory services to middle-income clients on sovereign debt management and debt market development—conducted pilot assessments of debt management capacity in three HIPC countries: Kenya, Nicaragua, and Zambia.[6] No Bank unit currently has the mandate to offer low-income countries capacity building or technical assistance for debt management.[7]

The Bank has provided HIPC countries with little assistance in debt management.

More Emphasis on Public Expenditure Management. The 2003 evaluation found that the HIPC Initiative had resulted in the Bank and IMF making a substantial effort to track progress and build capacity for public expenditure management systems in HIPC countries (OED 2003). And as a result of the HIPC-tracking exercise, countries agreed in 2002 to detailed implementation action plans to improve their public expenditure management (World Bank and IMF 2003b). These efforts continue, with the Bank refining its assessment criteria in 2004 (World Bank and IMF 2005c). Since then, the Bank has carried out assessments of HIPC public expenditure management using 16 indicators, with an additional indicator added in the area of public procurement systems.

Many Countries Still Require Substantial Upgrading of Budget Systems. More than half of the countries have implemented at least 40 percent of the actions in their plans, resulting in a moderate improvement in HIPC countries' public expenditure management systems since 2002. But 16 of the 23 countries assessed in 2002, and again in 2004, still require substantial upgrading of their budget formulation, execution, and reporting, to reliably track public spending, and five require some upgrading (table 4.2). Budget reporting improved the most with 14 countries meeting more benchmarks since 2002, and only four

Figure 4.4. Debt Service and Management Capacity Have Worsened in All Low-Income Countries



Source: World Bank data.

countries' reporting deteriorated. Budget formulation and execution, however, showed a mixed record with as many countries meeting fewer benchmarks as those improving.[8] The three countries assessed for the first time in 2004 were all found to need substantial upgrading. Countries performed poorly on public procurement systems: no country surveyed met the benchmark for this new indicator.

Poverty Reduction. The enhanced HIPC Initiative was intended to contribute to poverty reduction in two ways. First, it aimed to reduce poverty by "[freeing] up resources for higher social spending . . . " (World Bank and IMF 1999a). Second, countries were required to complete a country-owned poverty reduction strategy and implement it for one year to reach completion point. The 2003 evaluation found that the initiative emphasizes social expenditures as the primary means of poverty reduction. This was evident in conditions set for completion point and the focus in Bank and IMF progress reports on tracking social expenditures. Has the balance

Table 4.2. Most HIPC Countries Require Substantial Upgrading in Public Expenditure Management

	Little upgrading	Some upgrading	Substantial upgrading
2002		Benin, Burkina Faso, Chad, Guyana, Honduras, Mali, Rwanda, Tanzania, Uganda **(9)**	Bolivia, Cameroon, Ethiopia, The Gambia, Ghana, Guinea, Madagascar, Malawi, Mauritania, Mozambique, Nicaragua, Niger, São Tomé and Principe, Senegal, Zambia **(15)**
2004	Tanzania, Mali **(2)**	Guyana, Burkina Faso, Benin, Rwanda, Uganda **(5)**	Ethiopia, Ghana, Honduras, Senegal, Chad, Cameroon, Nicaragua, Guinea, Malawi, Niger, Bolivia, Madagascar, Mozambique, São Tomé and Principe, The Gambia, Zambia **(16)**
Assessed only in 2004			Sierra Leone, Guinea-Bissau, Democratic Republic of Congo **(3)**

Source: World Bank and IMF 2005c.
Note: The number of countries is indicated in parentheses.

in the initiative between pro-poor growth and social expenditures shifted?

Two-thirds of countries assessed still require substantial upgrading of their public expenditure management systems.

Countries Track "Poverty-Reducing" Expenditures. Additional resources made available from HIPC relief, if any, are supposed to be allocated according to a country's priorities as expressed in its Poverty Reduction Strategy Paper (PRSP). Largely as a result of the initiative taken by the Bank and IMF to track HIPC spending, an increasing number of HIPCs are now reporting poverty-reducing spending as defined in their Interim Poverty Reduction Strategy Papers (I-PRSPs) and PRSPs. In 2005, 19 countries reported such spending, compared with only four in 2002. The definition of "poverty-reducing" spending is country-specific and includes, for example, outlays on basic health, primary education, agriculture, infrastructure, housing, basic sanitation, and HIV/AIDS programs. "Poverty-reducing" expenditures in 28 countries that reached decision point increased from 6.4 percent to 8.1 percent of GDP in 1999 to 2004, about four times as great as their average debt-service payments in 2004.

Tracking "poverty-reducing expenditures" is an imperfect measure for incremental changes in spending attributable to HIPC, because they are defined differently across countries, and even within countries over time.[9] To investigate changes in expenditures more broadly since the inception of HIPC, taking account of the fungibility of resources, IEG analyzed sectoral expenditures as a share of GDP and government expenditures. Governments are increasing their expenditures on education as a share of GDP and total expenditures (based on data for five countries), but they are spending the same, or less, on health, agriculture, and transportation (figures 4.5 and 4.6).[10] These results support the finding of the 2003 evaluation that the HIPC Initiative's emphasis has been on expenditures in the social services, and mainly on education.[11]

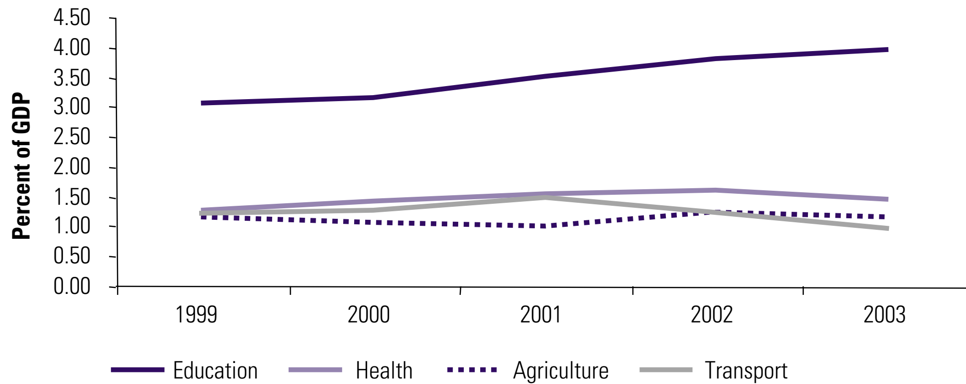
Governments are spending more on education, but the same or less on health, agriculture, and transportation.

HIPC Conditions Are More Focused on Quality of Services and Expenditure Tracking. For the two countries that have reached decision point since the 2003 evaluation, the Democratic Republic of Congo and Burundi, HIPC conditions are less oriented on increasing budgetary expenditures on education and health than had been the case for earlier decision-point countries. Recent conditions are more focused on improving the quality of social and other services, establishing better budget monitoring and executing systems, and improving debt-reporting systems.[12]

Quality of Growth in Poverty Reduction Strategies Varies Considerably. Twenty-five of the 28 decision-point countries have now completed poverty-reduction strategies, with an average time of almost four years of implementation as of March 2006. The conclusions of a 2004 PRSP evaluation regarding the quality and impact of these strategies remain relevant (see box 4.2). Countries are increasingly making growth a central element of their poverty-reduction strategies, but the quality of growth strategies in PRSPs varies considerably, and improved growth analytics are needed at the country level (World Bank and IMF 2005b). Poverty-reduction strategies pay little attention to integrating trade or taking into account the social impact of macroeconomic policies. National strategies focused largely on allocating public expenditures to reduce poverty, but did not consider the full range of policy actions required for poverty reduction (OED 2004). Within the domain of public expenditures, the majority of funds were allocated to expanding service delivery in the social sectors, and much less to investments to remove bottlenecks in economic or productive sectors.

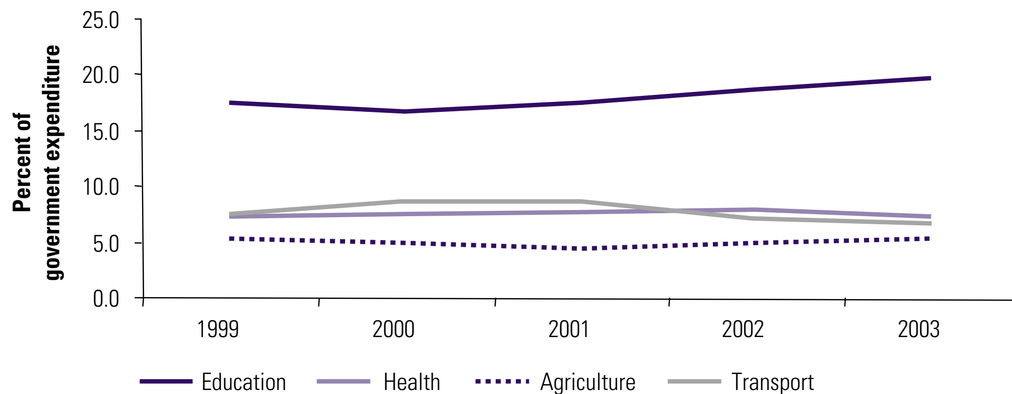
Modest Progress in Achieving the Millennium Development Goals. This section examines post-completion-point countries' progress since 1999 in key development outcomes. Table 4.3 shows

Figure 4.5. Spending on Education as a Share of GDP Has Increased Significantly in Five HIPC Countries



Source: World Bank.

Figure 4.6. Spending on Education as a Share of Government Expenditures Has Increased Significantly in Five HIPC Countries



Source: World Bank.

progress on the MDGs in the 18 post-completion-point countries. Countries have made progress in improving gender equality and reducing child mortality, and more modest progress in primary education, ensuring environmental sustainability, and developing global partnerships for development. However, on development goals such as poverty and infectious diseases, there has been no measurable change. On maternal health, there is very little information available to accurately assess progress to date, with no data available on any of the two indicators, in any of the 18 countries for more than one year since 1999. Data availability of MDGs is crucial to show HIPC countries' progress on key development outcomes.

In conclusion, sustained macroeconomic stability and strong fiscal management are essential for growth, debt sustainability, and poverty reduction. Poor fiscal management and the failure to adjust to evolving economic circumstances, combined with adverse terms of trade and weather shocks, were significant contributing factors for the buildup of external debt in many of the HIPCs (OED 2003 and others). In light of the initiative's objective to deal comprehensively with the overall debt burden of the heavily indebted countries, the initiative should monitor closely the fiscal, debt, and public

Box 4.2. Poverty Focus of National Strategies Has Improved, but Better Customization Is Needed

Poverty-reduction strategies are relevant to the needs of low-income countries and have improved the poverty focus of national development strategies (OED 2004). Consultations undertaken for the poverty-reduction strategy process have opened up the space for policy dialogue and provided a constructive framework for donors' dialogues with governments. But poverty-reduction strategy processes and content need to be customized to country circumstances in order to support a balance in accountabilities between governments (to their domestic constituents for improved policies, governance, and development results) and donors (to provide more and better aid in ways that support, rather than detract from, domestic accountability), according to a joint Bank and IMF review of the poverty-reduction strategy approach (World Bank and IMF 2005b).

expenditure management record of countries prior to granting them irrevocable debt relief at completion point. Maintaining standards for policy performance is critical for the countries not yet at completion point because of their relatively weaker track records in managing their economies.

The initiative's emphasis has been on channeling additional resources toward social expenditures. Poverty reduction strategies, too, have emphasized social sector spending instead of a more balanced approach to growth and poverty reduction. In order to ensure debt sustainability and continued progress toward poverty reduction and the MDGs, a wide range of tools and ongoing assessments are essential.

Table 4.3. Post-Completion-Point Countries: Modest Progress on MDGs, but Data Are Limited

		Data available for . . .		
	Number of indicators for monitoring progress	Number of indicators	Average number of countries	Improvement between 1999 and 2004?
Goal 1: Eradicate extreme hunger and poverty	6	2	1	No change
Goal 2: Achieve universal primary education	4	3	13	Yes (modest)
Goal 3: Promote gender equality and empower women	4	3	4	Yes
Goal 4: Reduce child mortality	3	3	18	Yes
Goal 5: Improve maternal health	2	0	0	Unknown
Goal 6: Combat HIV/AIDS, malaria, and other diseases	5	5	14	No change
Goal 7: Ensure environmental sustainability	7	3	17	Yes (modest)
Goal 8: Develop a global partnership for development	8	7	11	Yes (modest)

Source: United Nations Statistics Division.

Findings

Since the 2003 evaluation of the HIPC Initiative, 12 countries have progressed to receiving irrevocable debt relief and two more have qualified for interim relief. This update finds that many of the conclusions of the 2003 evaluation remain relevant for the HIPC Initiative and potentially instructive for future debt reduction initiatives.

Debt Sustainability. The HIPC Initiative has reduced debt ratios by half, on average, in 18 countries. But in 11 of 13 countries with available data, the key indicator of external debt sustainability has deteriorated since completion point. In eight of these countries, the ratios once again exceed HIPC thresholds. Changes in discount and exchange rates have worked to increase debt ratios. Countries' improved exports and revenue mobilization have helped to lower debt indicators, but this improved repayment capacity has been offset by increases in debt due to new borrowing. Six of eight post-completion-point countries with new debt sustainability analyses are considered to have only a moderate risk of debt distress, but all remain vulnerable to export shocks, and require highly concessional financing and prudent debt management.

HIPC countries have weak capacity to manage their public debt. In fact, performance in public debt management has deteriorated in all low-income countries. HIPC countries in particular need help in analyzing the impact of new borrowing on their long-term debt sustainability. Currently there is no systematic program by which the Bank assists low-income countries to build the needed capacity for debt management.

Debt reduction alone is not a sufficient instrument to affect the multiple drivers of debt sustainability. Sustained improvements in export diversification, fiscal management, the terms of new financing, and public debt management are needed, measures that are outside the ambit of the HIPC Initiative.

Policy Performance. Countries past completion point started out with higher scores on key policy ratings than other low-income countries and still score higher. Countries that are not yet at completion point—both decision-point and pre-decision-point countries—have, on average, the lowest ratings of all low-income countries and face serious challenges in managing their economies, which will affect their prospects for reaping the potential benefits of debt reduction. Even though the initiative has granted poorer performing countries more time to begin a reform program supported by the Bank and the IMF, they are held to the same track record

requirements as countries that became eligible earlier. Fiscal and debt management are particular areas of weakness in many HIPC countries.

Poverty Reduction. Debt relief was intended to contribute to poverty reduction. The requirement to develop and implement a country-owned poverty-reduction strategy has been an important and beneficial outcome of the HIPC Initiative. These strategies have tended to emphasize social sector spending rather than a more balanced approach to growth and poverty reduction. By tracking public expenditures deemed to be "poverty reducing," the initiative's approach to poverty reduction has encouraged countries to increase their social expenditures. The emphasis on expenditures has prompted the Bank and the IMF to do more to upgrade public expenditure management systems in HIPC countries. These efforts have resulted in only modest improvements.

Creditor Participation. The HIPC Initiative was innovative in its attempt to seek a comprehensive approach among all creditors to debt reduction. The multilaterals and Paris Club creditors have committed most of their share of debt relief. But the initiative's structure as a voluntary agreement has hindered efforts to achieve full participation of all creditors. The sluggish participation of non–Paris Club and commercial creditors—who were not involved in shaping the initiative's design—has resulted in a shortfall of 8 percent of total expected HIPC assistance.

Additionality of Resources. HIPC has channeled additional development resources to its qualifying countries. Net transfers to HIPC countries doubled from $8.8 billion in 1999 to $17.5 billion in 2004, while transfers to other developing countries grew by only a third. Debt relief has become a significant vehicle of resource transfer to HIPC countries. In the last year, eight additional non-HIPC low-income countries have become potentially eligible for HIPC. The repeated extension of the deadline for eligibility has significantly expanded the reach of the initiative. The emergence of proposals for future rounds of debt relief suggests that debt relief is becoming an ongoing mechanism for resource transfer.

Implications for Future Debt Relief Efforts. The experience under HIPC suggests five lessons for future debt-relief efforts.

- Debt reduction is not sufficient for debt sustainability. Future initiatives need to be clear about the objectives of debt relief and how their outcomes will be measured. In addition, to ensure debt sustainability they need to stress the importance of other policy actions by governments and external partners to improve repayment capacity.
- Does debt relief add to or substitute for other aid flows? To demonstrate that future debt relief initiatives are additional, donors will need to establish what net transfers—both multilateral and bilateral—would be in the absence of debt relief.
- The initiative is delivering an increasing share of concessional resources to HIPC countries. Since non-HIPC countries do not have access to these resources, donors will need to ensure that the resulting pattern of resource allocation rewards better performers overall.
- Debtors cannot oblige creditors to participate in debt relief under voluntary initiatives. Involving both creditors and debtors at the design stage of proposals for debt relief can be an important step in disseminating information about the workings of the initiative and securing the cooperation of all creditors.
- Future debt relief initiatives may also be expected to continually revisit and extend deadlines for eligibility. Extensions of the deadline keep open the opportunity for countries to receive debt relief, while holding all countries to the same standards. On the other hand, they could provide incentives to countries to increase their borrowings in order to avail themselves of debt relief.

APPENDIXES

APPENDIX A: GUIDE TO THE HIPC INITIATIVE

To be eligible for the HIPC Initiative a country must:

- Face unsustainable debt situation after the full application of the traditional debt relief mechanisms (such as the application of Naples terms under the Paris Club agreement). A country's debt level is considered unsustainable if debt-to-export levels are above a fixed ratio of 150 percent, or, in countries with very open economies where the exclusive reliance on external indicators may not adequately reflect the fiscal burden of external debt, the debt-to-government revenues are above of 250 percent.
- Be only eligible for highly concessional assistance from the International Development Association (IDA), the part of the World Bank that lends on highly concessional terms, and from the IMF's Poverty Reduction and Growth Facility (PGRF).
- Establish a track record of reform and develop a Poverty Reduction Strategy Paper (PRSP) that involves civil society participation.

In order to reach **decision point,** a country should have a track record of macroeconomic stability, have prepared an Interim Poverty Reduction Strategy Paper, and cleared any outstanding arrears. At which point, staffs of the World Bank and IMF carry out a loan-by-loan debt sustainability analysis to determine the level of indebtedness of the country and the amount of debt relief it may receive. The amount of debt relief necessary to bring countries' debt indicators to HIPC thresholds is calculated, and countries begin receiving **interim debt relief** on a provisional basis.

The interim period between a country's decision and completion points varies, according to how rapidly a country can implement its poverty reduction strategy and maintain macroeconomic stability.

For a country to reach **completion point** it must maintain macroeconomic stability under a PGRF-supported program, carry out key structural and social reforms as agreed upon at the decision point, and implement a PRSP satisfactorily for one year. Once a country reaches completion point it receives the full amount of debt relief, which now becomes irrevocable.

The framework also includes a provision by which additional debt relief, **"topping-up,"** could be committed at the completion point in exceptional cases when exogenous factors cause fundamental changes to a country's economic circumstances.

Source: Adapted from *Steps of the HIPC Initiative: A Guide*, available at http://www.worldbank.org/debt.

First Stage

Country establishes a three-year track record of good performance and develops together with civil society a Poverty Reduction Strategy Paper (PRSP); in early cases, an interim PRSP may be sufficient to reach the decision point.

- *Paris Club* provides flow rescheduling as per current Naples terms, i.e., rescheduling of debt service on eligible debt falling due during the three-year consolidation period (up to 67 percent reduction on eligible maturities on a net present value basis).
- *Other* bilateral and commercial creditors provide at least comparable treatment.
- *Multilateral institutions* continue to provide support within the framework of a comprehensive poverty reduction strategy designed by governments, with broad participation of civil society and the donor community.

EITHER

Paris Club stock-of-debt operation under Naples terms and comparable treatment by other bilateral and commercial creditors
is adequate
for the country to reach sustainability by the decision point.

====> Exit

(Country is not eligible for HIPC assistance.)

OR

Paris Club stock-of-debt operation under Naples terms and comparable treatment by other bilateral and commercial creditors
is not sufficient
for the country to reach sustainability by the decision point.

====> Decision Point

(World Bank and IMF Boards determine eligibility.)

All creditors (multilateral, bilateral, and commercial) commit debt relief to be delivered at the floating completion point. The amount of assistance depends on the need to bring the debt to a sustainable level at the decision point. This is calculated based on the latest available data at the decision point.

Second Stage

Country establishes a second track record by implementing the policies determined at the decision point (which are triggers to reaching the floating completion point) and linked to the (interim) PRSP.

- World Bank and IMF provide interim assistance.
- Other multilateral and bilateral creditors and donors provide interim debt relief at their discretion.
- All creditors continue to provide support within the framework of a comprehensive poverty-reduction strategy designed by governments, with broad participation of civil society and donor community.

"Floating" Completion Point

- Timing of completion point is tied to the implementation of policies determined at the decision point.
- All creditors provide the assistance determined at the decision point; interim debt relief provided between decision and completion points counts toward this assistance.
- Paris Club goes beyond Naples terms to provide more concessional debt reduction of up to 90 percent in NPV terms (and if needed, even higher) on eligible debt so as to achieve an exit from unsustainable debt.
- Other bilateral and commercial creditors provide at least comparable treatment on stock of debt.
- Multilateral institutions take additional measures, as may be needed, for the country's debt to be reduced to a sustainable level, each choosing from a menu of options, and ensuring broad and equitable participation by all creditors involved.

Source: *HIPC Debt Initiative: Flow Chart* available at http://www.worldbank.org/hipc/about/FLOWCHRT4.pdf.

APPENDIX B: EXTENSIONS OF THE DEADLINE FOR HIPC ELIGIBILITY, 1998–2004

In 1998, staff proposed a two-year extension of the sunset clause to allow nine countries that were potentially eligible for assistance, but still emerging from conflict, access to debt relief through the initiative (and following that, access to new loans) (World Bank and IMF 2004d).[1] The Board agreed to extend the deadline for entry to 2000.

In 2000, six of the nine countries had not yet managed to meet the entry requirements, this time for the Enhanced HIPC Initiative, mainly due to conflict and social and political strife.[2] Staff recommended an elimination of the sunset clause so that these countries would not be constrained by a time limit to reach the decision point. The Board was not in favor of this suggestion, so the sunset clause was extended for another two years.

By 2002, only one of the six countries had made progress toward the entry requirements and another six were considered potentially unsustainable.[3] This time, staff were in favor of extending the sunset clause for another two years for these 12 countries because it would provide an opportunity for countries to establish a policy track record. While the Board voted to extend the clause, some directors expressed concern about further extension on moral hazard grounds. Recognizing that the extension up to 2004 was not enough time for all remaining HIPCs to qualify for the initiative, some directors suggested extending the clause in the future only on a case-by-case basis.

In July 2004, the Board considered a fourth extension of the sunset clause. Staff presented the Board with four options. Option 1 was to let the sunset clause take effect; this option would leave a number of HIPC countries without a mechanism to deal with excess debt burdens. Option 2 was to extend the sunset clause for another two years. Option 3 was to identify and grandfather all IDA-only countries found to have potentially unsustainable debt levels as of end 2004 and allow them a five-year period to reach the decision point. Option 4 was to allow any IDA-only country found to have potentially unsustainable debt levels a five-year period to reach decision point, but only apply relief to end-2004 debt. Directors rejected options 1 and 4 and asked staff to reflect further on the way to proceed.

In September 2004, the Board agreed to extend the sunset clause for another two years.

APPENDIX C: COUNTRY GROUPINGS

Post-Completion-Point Countries (18 countries)	Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia
Decision-Point Countries (10 countries)	Burundi, Cameroon, Chad, Dem. Rep. of Congo, The Gambia, Guinea, Guinea-Bissau, Malawi, São Tomé & Principe, Sierra Leone
Pre-Decision-Point HIPCs (10 countries)	Central African Republic, Comoros, Rep. of Congo, Côte d'Ivoire, Lao PDR, Liberia, Myanmar, Somalia, Sudan, Togo
Non-HIPC IDA-only Countries (30 countries)	Afghanistan, Bangladesh, Bhutan, Cambodia, Eritrea, Haiti, Kenya, Lesotho, Nepal, Solomon Islands, Timor-Leste, Rep. of Yemen, Angola, Cape Verde, Djibouti, Kiribati, Maldives, Samoa, Vanuatu, Albania, Sri Lanka, Tonga, Kyrgyz Republic, Moldova, Mongolia, Nigeria, Tajikistan, Vietnam, Armenia, Georgia
Developing Countries[a]	
Crisis Countries (3 countries)	Thailand, The Philippines, and Indonesia
Lower-Middle-Income Countries (40 countries)	Albania, Algeria, Belize, Bosnia and Herzegovina, China, Colombia, Cuba, Dominican Republic, Ecuador, Arab Rep. of Egypt, El Salvador, Fiji, Guatemala, Islamic Rep. of Iran, Iraq, Jamaica, Jordan, Kazakhstan, Macedonia FYR, Marshall Islands, Micronesia, Morocco, Namibia, Niue, Palestinian Admin. Areas, Paraguay, Peru, Serbia and Montenegro, South Africa, Sri Lanka, St. Vincent and Grenadines, Suriname, Swaziland, Syria, Tokelau, Tonga, Tunisia, Turkey, Turkmenistan, Wallis and Futuna
Other Low-Income Countries (16 countries)	Armenia, Azerbaijan, Georgia, India, Kenya, Dem. Rep. of Korea, Kyrgyz Rep., Moldova, Mongolia, Nigeria, Pakistan, Papua New Guinea, Tajikistan, Uzbekistan, Vietnam, Zimbabwe
Low-Income Countries (20 countries)	Afghanistan, Angola, Bangladesh, Bhutan, Cambodia, Cape Verde, Djibouti, Equatorial Guinea, Eritrea, Haiti, Kiribati, Lesotho, Maldives, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu, Rep. of Yemen

a. Based on DAC country classifications.

APPENDIX D: COMPARISON OF ECONOMIC PROJECTIONS TO HISTORICAL TRENDS

Table D.1. Comparison of Economic Projections to the 1980–2001 Historical Trend

	2005–2010 Export projection	1980–2001 Historical trend			2005–2010 GDP projection	1980–2001 Historical trend		
		Estimate	Low	High		Estimate	Low	High
Benin	8.4%	3.8%	2.8%	4.8%	5.3%	3.4%	3.0%	3.7%
Bolivia	7.8%	3.0%	1.7%	4.4%	5.3%	2.5%	1.9%	3.0%
Burkina Faso	9.0%	2.9%	1.6%	4.2%	5.5%	3.5%	3.3%	3.7%
Burundi	9.3%	6.0%	4.3%	7.7%	5.0%	0.9%	0.1%	1.7%
Cameroon	6.5%	0.2%	–0.7%	1.1%	6.3%	0.7%	–0.1%	1.6%
Chad	56.1%	6.3%	4.4%	8.3%	11.6%	3.4%	2.8%	4.1%
Congo, Dem. Rep. of	10.9%	–0.5%	–3.0%	2.1%	6.5%	–3.1%	–3.9%	–2.2%
Ethiopia	8.5%	2.0%	0.6%	3.4%	6.0%	2.5%	1.9%	3.1%
Gambia, The	6.1%	5.0%	3.7%	6.4%	5.7%	3.3%	3.1%	3.5%
Ghana	4.8%	6.9%	5.2%	8.6%	5.0%	3.9%	3.6%	4.3%
Guinea	7.0%	2.3%	1.4%	3.2%	5.6%	4.1%	3.9%	4.2%
Guinea-Bissau	9.5%	7.1%	4.9%	9.3%	6.1%	2.9%	2.3%	3.6%
Guyana	1.7%	5.5%	3.8%	7.3%	2.4%	1.6%	0.6%	2.6%
Honduras	7.5%	6.2%	5.0%	7.4%	4.5%	3.1%	2.9%	3.3%
Madagascar	10.1%	5.4%	4.2%	6.7%	6.4%	1.5%	1.1%	1.8%
Malawi	4.7%	3.1%	1.9%	4.2%	4.8%	3.0%	2.6%	3.3%
Mali	5.0%	6.6%	5.7%	7.5%	5.7%	2.8%	2.2%	3.3%
Mauritania	8.5%	1.2%	0.3%	2.2%	6.9%	3.0%	2.7%	3.4%
Mozambique	10.5%	5.8%	2.9%	8.6%	6.5%	3.6%	2.5%	4.6%
Nicaragua	6.6%	3.5%	0.5%	6.6%	4.5%	0.4%	–0.4%	1.2%
Niger	5.4%	–2.0%	–3.1%	–0.9%	4.3%	1.2%	0.7%	1.7%
Rwanda	8.1%	–2.1%	–4.4%	0.1%	4.6%	–0.2%	–1.5%	1.2%
São Tomé and Principe	8.6%	1.1%	–0.5%	2.8%	2.0%	1.8%	1.7%	1.9%
Senegal	6.1%	2.6%	1.8%	3.4%	6.0%	2.9%	2.5%	3.2%
Sierra Leone	7.9%	–2.8%	–4.5%	–1.0%	4.9%	–2.3%	–3.0%	–1.6%
Tanzania	8.7%	4.7%	3.8%	5.7%	6.0%	3.1%	2.8%	3.5%
Uganda	6.5%	3.8%	1.1%	6.4%	5.1%	5.6%	5.0%	6.1%
Zambia	4.5%	0.3%	–0.9%	1.5%	5.0%	0.7%	0.5%	1.0%
Average	9.1%	3.1%	1.6%	4.7%	5.5%	2.1%	1.6%	2.7%
Average (excluding Chad)	7.3%	3.0%	1.5%	4.6%	5.3%	2.1%	1.6%	2.6%

Note: Projections are simple averages drawn from individual country decision-point (for DP countries) and completion-point documents (for CP countries). Historical data come from the World Bank's database system and are not available for every country in every year. Exports refer to the exports of goods and nonfactor services in constant 1995 US$. GDP is also measured in constant 1995 US$. Historical growth rates were taken as the coefficient on a regression of the natural log of GDP on time (year) and the natural log of exports on time (year). The low to high range corresponds to a 95 percent confidence interval for the estimated GDP and export growth rates over the period. Projections that exceed historical bounds are highlighted.

Table D.2. Comparison of Economic Projections to the 1990–2000 Historical Trend

	2005–2010 Export projection	1990–2001 Historical trend Estimate	Low	High	2005–2010 GDP projection	1989–2001 Historical trend Estimate	Low	High
Benin	8.4%	4.2%	1.5%	6.9%	5.3%	4.7%	4.5%	4.9%
Bolivia	7.8%	5.2%	2.9%	7.5%	5.3%	3.9%	3.6%	4.2%
Burkina Faso	9.0%	–1.2%	–3.8%	1.4%	5.5%	3.9%	3.5%	4.3%
Burundi	9.3%	7.6%	1.8%	13.3%	5.0%	–2.6%	–3.8%	–1.5%
Cameroon	6.5%	0.6%	–2.1%	3.4%	6.3%	1.7%	0.3%	3.1%
Chad	56.1%	2.5%	–2.0%	7.0%	11.6%	1.9%	0.8%	3.0%
Congo, Dem. Rep. of	10.9%	–0.5%	–7.6%	6.6%	6.5%	–5.0%	–6.4%	–3.7%
Ethiopia	8.5%	7.5%	3.5%	11.4%	6.0%	4.1%	2.6%	5.5%
Gambia, The	6.1%	0.0%	–2.2%	2.3%	5.7%	2.9%	2.3%	3.5%
Ghana	4.8%	10.9%	8.6%	13.2%	5.0%	4.2%	4.1%	4.3%
Guinea	7.0%	–1.8%	–2.7%	–0.8%	5.6%	4.3%	3.9%	4.6%
Guinea-Bissau	9.5%	11.8%	4.0%	19.5%	6.1%	1.2%	–1.0%	3.4%
Guyana	1.7%	9.6%	6.0%	13.1%	2.4%	5.2%	4.1%	6.4%
Honduras	7.5%	11.3%	9.4%	13.2%	4.5%	3.1%	2.7%	3.6%
Madagascar	10.1%	8.4%	6.3%	10.5%	6.4%	2.0%	1.2%	2.9%
Malawi	4.7%	2.1%	–1.6%	5.9%	4.8%	3.7%	2.5%	4.8%
Mali	5.0%	4.9%	3.0%	6.8%	5.7%	4.0%	3.3%	4.7%
Mauritania	8.5%	1.2%	–2.6%	5.0%	6.9%	4.3%	3.9%	4.7%
Mozambique	10.5%	10.4%	9.0%	11.8%	6.5%	6.2%	4.8%	7.5%
Nicaragua	6.6%	15.3%	9.5%	21.0%	4.5%	3.7%	2.9%	4.5%
Niger	5.4%	0.0%	–2.4%	2.4%	4.3%	2.3%	1.4%	3.3%
Rwanda	8.1%	0.3%	–7.9%	8.5%	4.6%	–0.3%	–5.8%	5.3%
São Tomé and Principe	8.6%	5.3%	2.7%	8.0%	2.0%	1.8%	1.6%	1.9%
Senegal	6.1%	–0.2%	–1.9%	1.5%	6.0%	3.5%	2.7%	4.4%
Sierra Leone	7.9%	–9.9%	–14.3%	–5.5%	4.9%	–5.2%	–6.4%	–4.0%
Tanzania	8.7%	3.4%	1.7%	5.0%	6.0%	2.9%	2.4%	3.4%
Uganda	6.5%	15.1%	8.4%	21.9%	5.1%	6.9%	6.4%	7.3%
Zambia	4.5%	–2.4%	–5.1%	0.3%	5.0%	0.5%	–0.3%	1.3%
Average	9.1%	4.3%	0.8%	7.9%	5.5%	2.5%	1.5%	3.5%
Average (excluding Chad)	7.3%	4.4%	0.9%	7.9%	5.3%	2.5%	1.5%	3.5%

Note: Projections are simple averages drawn from individual country decision-point (for DP countries) and completion-point documents (for CP countries). Historical data come from the World Bank's database system and are not available for every country in every year. Exports refer to the exports of goods and nonfactor services in constant 1995 US$. GDP is also measured in constant 1995 US$. Historical growth rates were taken as the coefficient on a regression of the natural log of GDP on time (year) and the natural log of exports on time (year). The low to high range corresponds to a 95 percent confidence interval for the estimated GDP and export growth rates over the period. Projections that exceed historical bounds are highlighted.

APPENDIX E: DEBT INDICATORS AND SUSTAINABILITY ASSESSMENTS IN EIGHT POST-COMPLETION-POINT COUNTRIES

Table E.1. Medium-Term Projected Debt Indicators in Eight Post-Completion-Point Countries

Threshold	NPV of external debt to GDP	NPV of external debt to exports	Debt service to exports	NPV of public debt to GDP	NPV of public debt to revenues	Debt service to revenues
Moderate						
Burkina Faso	**40**	**150**	**20**		**250**	**30**
Baseline	23	224	9	23	153	6
Alternative: 10-year historical average	19	190	8			
Alternative: Less favorable terms of borrowing	26	257	11			
Alternative: Real GDP shock	27	224	9			
Alternative: Export/primary balance shock	25	354	14			
Mali	**40**	**150**	**20**		**250**	**30**
Baseline	28	99	6			
Alternative: 10-year historical average	35	125	7			
Alternative: Less favorable terms of borrowing	30	105	7			
Alternative: Real GDP shock	30	99	7			
Alternative: Export/primary balance shock	32	151	9			
Mauritania	**50**	**200**	**25**		**300**	**35**
Baseline	25	46	3	42	166	13
Alternative: 10-year historical average	66	119	7	74	284	28
Alternative: Less favorable terms of borrowing	27	48	3			
Alternative: Real GDP shock	32	46	3	68	265	25
Alternative: Export/primary balance shock	69	430	17	68	268	28
Tanzania	**50**	**200**	**25**		**300**	**35**
Baseline	19	95	6			
Alternative: 10-year historical average	22	113	7			
Alternative: Less favorable terms of borrowing	22	110	7			
Alternative: Real GDP shock	20	95	6			
Alternative: Export/primary balance shock	25	203	11			
Ghana	**40**	**150**	**20**		**250**	**30**
Baseline						
Alternative: 10-year historical average						
Alternative: Less favorable terms of borrowing			n.a.			
Alternative: Real GDP shock						
Alternative: Export/primary balance shock						

(*Table continues on the following page.*)

Table E.1. Medium-Term Projected Debt Indicators in Eight Post-Completion-Point Countries (continued)

Threshold	NPV of external debt to GDP	NPV of external debt to exports	Debt service to exports	NPV of public debt to GDP	NPV of public debt to revenues	Debt service to revenues
Moderate Risk						
Uganda	**50**	**200**	**25**		**300**	**35**
Baseline	23	160	8	29	143	13
Alternative: 10-year historical average	25	175	8	29	158	11
Alternative: Less favorable terms of borrowing	25	176	8			
Alternative: Real GDP shock	24	160	8	28	150	14
Alternative: Export/primary balance shock	25	252	11	29	160	14
High Risk						
Rwanda	**40**	**150**	**20**		**250**	**30**
Baseline	24	256	9			
Alternative: 10-year historical average	32	337	13			
Alternative: Less favorable terms of borrowing	27	282	10			
Alternative: Real GDP shock	25	256	9			
Alternative: Export/primary balance shock	26	429	15			
Ethiopia	**40**	**150**	**20**		**250**	**30**
Baseline	25	179	7	54	214	6
Alternative: 10-year historical average	25	168	7	61	236	7
Alternative: Less favorable terms of borrowing	29	194	5			
Alternative: Real GDP shock	28	179	7	63	244	7
Alternative: Export/primary balance shock	27	228	9	59	201	6

Source: World Bank and IMF LIC DSAs.

Note: Variables that are above policy-dependent thresholds are highlighted. Figures for Mali, Mauritania, Burkina Faso, and external indicators for Ethiopia are average projections from 2006 to 2010. Figures for Tanzania and Rwanda, and total public debt indicators for Ethiopia are average projections from 2005 to 2009. Figures for Uganda are average projections from 2007 to 2011.

Table E.2. Assessment of Debt Sustainability in Eight Post-Completion-Point Countries

Baseline scenario	Alternative scenarios and shocks	Policy implications
Burkina Faso (Moderate)		
Under the baseline scenario, all but one external debt indicator maintain a stable path for the entire projection period and remain well below their respective thresholds. The medium-term deterioration in the NPV of debt to exports is due to several factors including the medium-term run-up in expenditures, compounded by relatively weak export growth in the short term. The temporary breach of that threshold is not indicative of a fundamental debt problem.	The projections for external debt indicators are most vulnerable to subdued export projections, a combination of shocks, and if the terms of financing worsen. Furthermore, if domestic revenue mobilization is lower than anticipated, the various debt ratios would not improve over the long run.	The results from the alternative scenarios underscore the need for authorities to continue to implement their program of sound macroeconomic policies and reforms, including achieving higher export growth, in tandem with maintaining efforts to improve revenue collection. Burkina Faso would also need to continue to attract financing at favorable terms in order to contain the risks to maintaining external debt sustainability.
Mali (Moderate)		
Under the baseline scenario, Mali's external-debt ratios are projected to remain below or close to indicative thresholds. The debt-to-exports ratio increases over the projection period and is marginally above the debt burden threshold toward the end of the projection period.	Stress tests for export shocks, a 30 percent devaluation scenario, and using historical averages result in debt-to-GDP and debt-to-exports ratios that exceed thresholds over the medium term. The tests show that despite improved GDP growth and containment of inflation, Mali remains vulnerable to exogenous shocks.	Accelerating export growth and maintaining highly concessional loan assistance are important factors in maintaining debt sustainability. The low level of the baseline debt-to-export indicator highlights the importance of maintaining a high degree of concessionality in future lending to Mali.
Mauritania (Moderate)		
External-debt and debt-service indicators improve markedly in the medium-term baseline scenario spurred by oil revenues, and are expected to further improve over the long term, despite the moderation of real GDP and exports growth as oil production gradually disappears. The combined level of domestic and external public debt is relatively high and raises legitimate concern as to its sustainability. However, given the favorable medium-term outlook, it is expected that Mauritania's public debt sustainability indicators will fall into a comfortable range and continue to improve over the long term.	Mauritania's debt sustainability outlook is highly sensitive to negative export shocks, but robust to a shock that would affect oil exports. Alternative scenarios for "no reform" and shocks to real GDP growth give similar results, and given the implicit resource constraints, both appear highly unlikely.	Mauritania is sensitive to external shocks and policy slippages.

(*Table continues on the following page.*)

Table E.2. Assessment of Debt Sustainability in Eight Post-Completion-Point Countries (continued)

Baseline scenario	Alternative scenarios and shocks	Policy implications
Tanzania (Moderate)		
Under the baseline scenario, debt indicators that are currently below the indicative debt-burden thresholds are projected to further improve over the projection period.	The baseline assumes that Tanzania's marked improvements in the recent past will be sustained and, hence, is more optimistic than the 10-year historical scenario. The bound tests reveal that the only significant threat to debt sustainability would result from a year of poor export performance, or to a lesser extent, a reversal of Tanzania's economic performance to historical levels.	The exercise highlights the importance of strengthening and diversifying Tanzania's export sector to reduce its vulnerability to weather and terms-of-trade shocks. Tanzania must also sustain and deepen reforms, including improvements in the business environment, agricultural policies, and infrastructure investment. Finally, Tanzania's dependency on foreign aid also makes it highly vulnerable to a significant decline in donor grants.
Uganda (Moderate)		
Uganda's debt-burden indicators remain below the policy-dependent thresholds under the baseline scenario. The NPV of debt-GDP drops below 13 percent by the end of the projection period. Uganda's debt service payment continues to be manageable, reflecting the delivery of HIPC assistance as well as the fact that most of Uganda's debt has been contracted on concessional terms.	Adverse macroeconomic shocks and imprudent debt management would worsen Uganda's NPV of debt-to-exports ratio significantly. Uganda is projected to rely heavily on donor support in order to finance its projected current account deficit.	Uganda can be better protected from risks through second-generation structural reforms. These reforms will help diversify the export base and strengthen export competitiveness. While these measures reduce the vulnerability to exogenous shocks, the implementation of prudent debt management policies and efficient allocation of donor support is required to keep debt burden indicators low in the long term.
Ghana (Moderate)		
Under the baseline scenario, Ghana's external debt ratios will remain well below the indicative debt burden thresholds. The NPV of debt to exports will almost double by end-2025. Debt service ratio will decline, highlighting the concessionality of Ghana's new borrowing.	The NPV of debt to exports and debt to GDP increases sharply when the terms of new borrowing are made less concessional. Under a "double" trade shock that involves a fall in exports and a rise in imports with no adjustment, external debt stock indicators surpass indicative thresholds.	Minimizing the risk of debt distress is contingent on sustained good macroeconomic performance and continued access to concessional financing, as well as to robust export growth. The sustainability of total public debt hinges, in particular, on prudent fiscal management, with strengthened expenditure control and sustained performance in revenue generation. While Ghana's strong economic performance in recent years, coupled with the incidence of positive external shocks (namely the high price of cocoa and gold) has placed the country in a relatively comfortable situation, the recent rise in oil prices has negated part of these gains and highlighted, once again, the country's vulnerability to exogenous shocks.

Table E.2. Assessment of Debt Sustainability in Eight Post-Completion-Point Countries (continued)

Baseline scenario	Alternative scenarios and shocks	Policy implications
Rwanda (High)		
Even after full delivery of HIPC assistance and additional bilateral debt relief, the projected path of the NPV of debt to exports under the baseline signals a high risk of debt distress despite low levels of debt-service-to-exports ratio.	Under the 10-year historical scenario, the debt-service–to-exports ratio exhibits an upward trend and by the end of the projection period, it would be more than six times the level projected under the baseline. The significant deterioration of debt and debt-service indicators under the historical scenario underscores the critical importance of realizing the ambitious export growth and grant-financing projections under the baseline. Rwanda's debt indicators experience a considerable deterioration under most of the stress tests proposed.	Donors and creditors will need to coordinate carefully to ensure that external financing is provided on terms compatible with longer-term debt sustainability. And the government will need to swiftly implement its export promotion strategy in order to strengthen Rwanda's repayment capacity and reduce its vulnerability to shocks
Ethiopia (High)		
Under the baseline scenario, external debt stock indicators are projected to rise in the medium term and then projected to decline gradually. External-debt service absorbs about 6 percent of export revenues during the next 15 years, rising to a moderate 8 percent during the last years as concessional debt comes to maturity and debt service reduction under HIPC is exhausted. Public-debt indicators are projected to decline comfortably to contain inflationary pressures and provide sufficient credit to facilitate private sector development.	Ethiopia's external-debt and debt-service indicators are particularly sensitive to the terms of new borrowing and negative export shocks, although they deteriorate under most stress tests. Under both the historic and the most extreme stress scenarios, the ratios of NPV of debt-to-GDP and exports stay above the appropriate upper benchmarks for most of the projection period even though the debt-service ratio remains within the manageable range. Permanently lower GDP growth relative to the baseline, and a return of primary fiscal deficits to the high levels of the 1990s, would modestly increase total public debt indicators over a 20-year horizon.	Ethiopia will need to follow a prudent borrowing strategy with new borrowing on highly concessional terms and with an increased reliance on grant financing, as well as a comprehensive debt-management strategy to safeguard against a reemergence of an external debt burden.

APPENDIX F: COUNTRIES WITH MACROECONOMIC SLIPPAGES OR DELAYS SINCE COMPLETION POINT

Country	After completion point	Most recent macroeconomic performance
Benin	Broadly satisfactory macroeconomic performance from 2001–2003, but no significant progress in poverty reduction; protracted delays for some structural reform; 2004 slowdown partially owing to weak administration of cotton crop; 2004 fiscal deterioration.	Good performance for a decade, but since 2003, uneven progress in structural reform; slow growth; policy slippages; but new commitment to reform agenda.
Bolivia	PRGF went off track in second half of 2001; new informal program for 2002, with poor performance—fiscal targets missed, privatization delayed, wages increased, fuel prices frozen; recent civil disturbances threaten political stability; fiscal deficit doubled over two years (2001–2003), weak real growth for four years.	On track with only one quantitative and one structural target missed; political tensions remain; fiscal situation improving after marked deterioration.
Ghana	Starting in 2000, marked improvement in macroeconomic management; in 2004, broadly appropriate macroeconomic policies; fiscal management has improved, but there was still some slippage; some progress in structural reforms.	Strong growth and poverty reduction; progress in structural reforms led to strengthened financial sector; petroleum product deregulation.
Guyana	Macroeconomic performance broadly in line with PRGF program; one quantitative and three structural performance criteria missed; growth fell short of expectations in 2003 and 2004; high public saving; underlying inflation was moderate.	Missed two quantitative and three structural performance criteria, in addition to criterion on contracting nonconcessional debt; facility extended to severe floods; macroeconomic stability maintained in crisis situation; slow growth.
Mali	Despite crisis in bordering Côte d'Ivoire, broadly satisfactory macroeconomic performance from 2002–2003; further progress in structural reform implementation; satisfactory fiscal performance.	Mixed program implementation in 2004; low growth due to below-average rainfall and locust attacks; disappointing progress on structural reforms, particularly privatization.
Mauritania	Long-standing good relations with IMF; strong chance for success because authorities maintain ownership and are committed to reform; stable macroeconomy and good performance on key structural reforms, though little effort in capacity building.	July 2003 PRGF program irretrievably off-track; 1.5-year budget deficit at 50 percent of GDP; misreported data to appear to comply; policy slippages revealed serious governance issues; new economic team shows fiscal/monetary restraint.

(*Continues on the following page.*)

Country	After completion point	Most recent macroeconomic performance
Nicaragua	Overall positive performance since 2002, but political situation a cause for concern, with periodic stand-offs between the legislature and executive; PRGF program frozen since September 2004 due to budget based on optimistic revenue projections that were inconsistent with IMF program.	Broadly satisfactory economic performance; political environment difficult for maintaining policy consensus; structural reform agenda moving slower than expected; back on track in January 2006 after corrective measures were taken.
Uganda	In 2001–2003, continued to implement disciplined financial policies and sound structural reforms; fiscal deficit widened in 2002 owing to sharp increase in expenditures; low inflation maintained.	Mixed performance: four quantitative targets missed, both structural criteria met but eight of 10 structural benchmarks missed.

APPENDIX G: ACHIEVEMENT AND WAIVERS OF COMPLETION POINT CONDITIONS

Country	Waivers	Completion point trigger waived or delayed
Benin	None	Barely missed targets in health and education; bank privatization, other benchmarks delayed.
Burkina Faso	None	All targets met or exceeded.
Madagascar	None	Barely missed teacher-recruitment target; budgetary execution laws late; repetition rates and primary school completion rates below targets; tax revenue short of target.
Mali	None	Initial delays caused some education targets to be only partially met; recruitment of health sector workers below target.
Mozambique	None	Missed target for strategic plan owing to expanded scope; some setbacks for structural reform.
Tanzania	None	Delay in poverty analyses; exceeded requirements for several triggers; observed all quantitative criteria and most benchmarks.
Uganda	None	All conditions met.
Bolivia	One	Missed one fiscal target, but made advancements in tax administration and budget management; faced social unrest.
Ghana	One	Committed to reform petroleum pricing, but has not implemented it; perception of corruption.
Honduras	One	Did not comply with Basel Core Principles.
Nicaragua	One	Has not divested from all public power-generating units, but not advisable anyway.
Rwanda	One	Delay in privatization of one state-owned tea factory.
Guyana	Two	Did not reduce by 1,000 the core civil service, but reduced by 2,500 elsewhere; partially completed, and then reformulated and completed new public sector modernization plan; policy drift during last few years; fiscal progress has eroded.
Niger	Two	Delay in impact evaluation of public health expenditure on poor; did not meet overly ambitious target for repetition rates.
Ethiopia	Three	Severe drought delayed agricultural reform; census needed to confirm education reform; began consolidation of budgets.
Senegal	Three	Child immunization target missed; utilization rates of primary health care centers missed; fiscal balance target missed, but owing to IMF requirements.
Zambia	Three	International bidding documents for power company were not issued; unable to sell national bank; partially met trigger for pilot implementation of financial management information system; unpredictable fiscal policy.
Mauritania	Five	Technical delays in privatizing utility; did not comply with risk-exposure ratio for banks; missed target for poverty reduction; missed target for survival rate at fifth grade and primary/secondary school enrollment; barely missed child vaccination target.

APPENDIX H: MEASURES OF POLICY PERFORMANCE

I. Country Policy and Institutional Assessment

The World Bank's Country Policy and Institutional Assessment (CPIA) is intended to assesses the quality of a country's present policy and institutional framework. "Quality," according to the instructions for preparing the ratings, means "how conducive that framework is to fostering poverty reduction, sustainable growth and the effective use of development assistance."

From 1999 to 2003, the CPIA assessed 20 broad areas (shown in table H.1), each with a 5 percent weight in the overall CPIA rating. Each of the 20 areas was further defined by a number of criteria that are included in the instructions for preparing the rating. The 20 areas are grouped into four categories: economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions.

In 2004, only 16 questions were asked (table H.2). Question 4 (on management and sustainability of the development program) was excluded from the economic management aggregate. Questions 6 (on financial stability), 9 (on goods and factor markets), and 10 (on policies and institutions for environmental sustainability) were excluded from the structural aggregate. The social aggregate excluded question 15 (on monitoring and analysis of poverty outcomes and impacts) and now includes question 10 (on policies and institutions for environmental sustainability) from the structural aggregate.

Countries are rated on the current status of their policies, in relation to the guidelines, and to benchmark countries that are rated first, and results are provided to staff rating other countries. The guidelines direct staff to assess the countries on the basis of their currently observable policies, and neither on the amount of improvement since the previous rating, nor on intentions for future change, unless the latter are virtually in place.

Countries are rated on a scale of "2" (unsatisfactory) to "5" (satisfactory), in one-half-point increments, in each of the 20 areas, with a "3" indicating moderately unsatisfactory and a "4" indicating moderately satisfactory. If a "5" has been sustained for three or more years in an area, the rating in that area is increased to a "6," signifying a sustained commitment to and support for the policy. If a "2" rating has been sustained for three or more years in an area, a rating of "1" is assigned reflecting an entrenched and intractable policy environment.

Table H.1. Components of the Country Policy and Institutional Assessment Index, 1999–2003

Question	Policy area	Coverage
A: Economic Management		
1	Management of inflation and macroeconomic policy	Macroeconomic policies (exchange rate, monetary and fiscal policy) that address inflation and internal and external imbalances.
2	Fiscal policy	Size of the fiscal balance and the composition of government revenue and spending to assess their compatibility with adequate provision of public services for economic growth, favorable macroeconomic outcomes, and a sustainable path of public debt.
3	Management of public debt (external and domestic)	Capacity to manage public debt, external and domestic, and service it now and sustainable into the future. Two separate but linked dimensions for assessment are (i) debt service capacity and (ii) debt management capacity.
4	Management and sustainability of the development program	Degree to which the management of the economy and the development program reflect three elements: technical competence; sustained political commitment and public support, and participatory processes.
B: Structural Policies		
5	Trade policy and foreign exchange regime	Degree to which the policy framework fosters trade and capital movements.
6	Financial stability	Assesses the structure of the financial sector, and whether the policies and regulations that affect it are conducive to diversified financial services, provided in a context of integrity and with a minimal risk of systemic failure.
7	Financial sector depth, efficiency, and resource mobilization	Degree to which policies and regulations affecting financial institutions foster the mobilization of savings and efficient financial intermediation.
8	Competitive environment for the private sector	Degree to which firms face competitive pressure to behave efficiently or be forced to exit.
9	Goods and factor markets	Policies that affect the efficiency of (i) goods markets and (ii) factor markets for labor and land.
10	Policies and institutions for environmental sustainability	Extent to which economic and environmental policies contribute to the incomes and health status of the poor, by fostering the protection and sustain able use of natural resources and the management of pollution.
C: Policies for Social inclusion/Equity		
11	Gender	Extent to which the country has created laws and policies, and institutions to enforce them, that promote equal access of males and females to productive and economic resources, human capital development opportunities, and equal status and protection under the law.
12	Equity of public resource use	Extent to which the pattern of public expenditures and revenues favors the poor.
13	Building human resources	Extent to which the programs and policies that affect the access to and quality of (i) health care and nutrition services; (ii) access to and quality of education, training, and literacy; and (iii) prevention of HIV/AIDS and other communicable diseases.
14	Social protection and labor	Government policies in the area of social protection and labor market regulation reduce the risk of becoming poor and assist those who are poor to mitigate and cope with further risk to their well-being.

Table H.1. Components of the Country Policy and Institutional Assessment Index, 1999–2003 (continued)

Question	Policy area	Coverage
15	Monitoring and analysis of poverty outcomes and impacts	Quality of systems to monitor poverty outcome/impact indicators and their use in formulating policies.
D: Public Sector Management and Institutions		
16	Property rights and rules-based governance	Extent to which private economic activity is facilitated by an effective legal system and rule-based governance structure in which property and contract rights are reliably respected and enforced.
17	Quality of budgetary and financial management	Extent to which there are (i) a comprehensive and credible budget, linked to policy priorities, which in turn are linked to a poverty reduction strategy; (ii) effective financial management systems to ensure that incurred expenditures are consistent with the approved budget, that budgeted revenues are achieved, and that aggregate fiscal control is maintained; (iii) timely and accurate fiscal reporting, including timely and audited public accounts and effective arrangements for follow-up; and (iv) clear and balanced assignment of expenditures and revenues to each level of government.
18	Efficiency of revenue mobilization	Overall pattern of revenue mobilization—not only the tax structure as it exists on paper, but revenues from all sources as they are actually collected.
19	Quality of public administration	Extent to which civilian central government staffs (including teachers, health workers, and police) are structured to design and implement government policy, and to deliver services effectively.
20	Transparency, accountability, and corruption in the public sector	Extent to which (i) the executive can be held accountable for its use of funds and the results of its actions by the electorate and by the legislature and judiciary; and (ii) public employees within the executive are required to account for the use of resources, administrative decisions, and results obtained.

Table H.2. Components of the Country Policy and Institutional Assessment Index, 2004

Question	Policy area	Coverage
A: Economic Management		
1	Macroeconomic management	Macroeconomic policies (exchange rate, monetary and fiscal policy) that address monetary/exchange policy with clearly defined price stability objectives and aggregate demand policies that focus on external balance.
2	Fiscal policy	Short- and medium-term sustainability of fiscal policy and its impact on growth. The extent to which primary balance is managed to ensure sustainability of public finances; public expenditure adjusted to absorb shocks and provision of public goods including infrastructure consistent with growth.
3	Management of public debt (external and domestic)	Extent to which the debt management strategy is conducive to minimize budgetary risks and ensure long-term debt sustainability and whether external and domestic debt are contracted with a view to maintaining debt sustainability and the degree of coordination between debt management and other macroeconomic policies. Capacity to manage public debt, external and domestic, and service it now and make it sustainable into the future. Two separate but linked dimensions for assessment are (i) debt service capacity and (ii) debt management capacity.
B: Structural Policies		
4	Trade policy and foreign exchange regime	Degree to which policy framework fosters trade. Measures two areas: (i) trade regime restrictiveness and customs and (ii) trade facilitation.
5	Financial sector	Assesses the structure of the financial sector, and the policies and regulations that affect it. Covers three main areas: (i) financial stability, efficiency, and depth; (ii) resource mobilization; and (iii) strength.
6	Business regulatory environment	Degree to which the legal, regulatory, and policy environment helps or hinders private business in investing, creating jobs, and becoming more productive.
C: Policies for Social Inclusion/Equity		
7	Gender equality	Extent to which the country has created laws and policies, and institutions to enforce them, that promote equal access of males and females to productive and economic resources, human capital development opportunities, and equal status and protection under the law.
8	Equity of public resource use	Extent to which the pattern of public expenditures and revenues favors the poor and is consistent with national poverty reduction priorities.
9	Building human resources	Extent to which the programs and policies that affect access to and quality of (i) health care and nutrition services; (ii) access to and quality of education, training, and literacy; and (iii) prevention of HIV/AIDS and other communicable diseases.
10	Social protection and labor	Government policies in the area of social protection and labor market regulation reduce the risk of becoming poor and assist those who are poor to mitigate and cope with further risk to their well-being.
11	Policies and institutions for environmental sustainability	Extent to which environmental policies foster the protection and sustainable use of natural resources and the management of pollution.

Table H.2. Components of the Country Policy and Institutional Assessment Index, 2004 (continued)

Question	Policy area	Coverage
12	Property rights and rules-based governance	Extent to which private economic activity is facilitated by an effective legal system and rules-based governance structure in which property and contract rights are reliably respected and enforced.
D: Public Sector Management and Institutions		
13	Quality of budgetary and financial management	Extent to which there are (i) a comprehensive and credible budget, linked to policy priorities, which in turn are linked to a poverty reduction strategy; (ii) effective financial management systems to ensure that incurred expenditures are consistent with the approved budget, that budgeted revenues are achieved, and that aggregate fiscal control is maintained, (iii) timely and accurate fiscal reporting, including timely and audited public accounts and effective arrangements for follow-up; and (iv) clear and balanced assignment of expenditures and revenues to each level of government.
14	Efficiency of revenue mobilization	Overall pattern of revenue mobilization—not only the tax structure as it exists on paper, but revenues from all sources as they are actually collected.
15	Quality of public administration	Extent to which civilian central government staffs (including teachers, health workers, and police) are structured to design and implement government policy and deliver services effectively.
16	Transparency, accountability, and corruption in the public sector	Extent to which (i) the executive can be held accountable for its use of funds and the results of its actions by the electorate and by the legislature and judiciary; and (ii) public employees within the executive are required to account for the use of resources, administrative decisions, and results obtained.

II. Heritage Foundation/Wall Street Journal Index of Economic Freedom

The Heritage Foundation/Wall Street Journal (HF/WSJ) Index of Economic Freedom measures the degree of government involvement in production, distribution, or consumption of goods and services. To rate each country, raters consider 50 different variables grouped into 10 broad areas.

Each country's overall score is based on an average of the 10 individual factor scores. Each factor is scored against factor-specific criteria on a scale of "1," signifying a set of policies and institutions that are judged to be most conducive to economic freedom, to "5," for policies and institutions that are least conducive.

The specific rating ranges in the HF/WSJ system are 1.00–1.95 = free; 2.00–2.95 = mostly free; 3.00–3.95 = mostly unfree; and 4.00 and above = repressed.

Table H.3. Components of the Heritage Foundation/Wall Street Journal Index of Economic Freedom

Factor	Variables considered
Trade policy	• Weighted average tariff rate • Nontariff barriers • Corruption in the customs service
Fiscal burden of government	• Top income tax rate • Marginal rate for average taxpayer • Corporate tax rate • Government expenditures/GDP
Government intervention in the economy	• Government consumption/GDP • Government ownership of businesses and industries • Share of government revenues from state-owned enterprises and government ownership of property • Economic output produced by the government
Monetary policy	• Weighted average inflation rate from 1992 to 2001
Capital flows and foreign investment	• Foreign investment code • Restrictions on foreign ownership of business • Restrictions on the industries and companies open to foreign companies • Restrictions and performance requirements on foreign companies • Foreign ownership of land • Equal treatment under the law for both foreign and domestic companies • Restrictions on repatriation of earnings • Availability of local financing for foreign companies
Banking and finance	• Government ownership of banks • Restrictions on the availability of foreign banks to open branches and subsidiaries • Government influence over the allocation of credit • Government regulations • Freedom to offer all types of financial services, securities, and insurance policies
Wages and prices	• Minimum wage laws • Freedom to set prices privately without government influence • Government price controls and the extent to which they are used

Table H.3. Components of the Heritage Foundation/Wall Street Journal Index of Economic Freedom (continued)

Factor	Variables considered
Wages and prices (continued)	• Government subsidies to businesses that affect prices • Government role in setting wages
Property rights	• Freedom from government influence over the judicial system • Commercial-code-defining contracts • Sanctioning of foreign arbitration of contract disputes • Government expropriation of property • Corruption within the judiciary • Delays in receiving judicial decisions • Legally granted and protected private property
Regulation	• Licensing requirements to operate a business • Ease of obtaining a business license • Corruption within the bureaucracy • Labor regulations, such as established work weeks, paid vacations, and parental leave, as well as selected labor regulations • Environmental, consumer safety, and worker health regulations • Regulations that impose a burden on business
Black market	• Transparency International Corruption Perceptions Index, OR the following factors: • Smuggling • Piracy of intellectual property in the black market • Agricultural production supplied on the black market • Service supplied on the black market • Transportation supplied on the black market • Labor supplied on the black market

III. Governance Matters: Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi (2005)

Kaufmann, Kraay, and Mastruzzi of the World Bank have prepared indicators every two years since 1996 that capture six key dimensions of institutional quality or governance.

1. Voice and accountability: measures political, civil, and human rights.
2. Political instability and violence: measures the likelihood of violent threats to, or changes in, government, including terrorism.
3. Government effectiveness: measures the competence of the bureaucracy and the quality of public service delivery.
4. Regulatory burden: measures the incidence of market-unfriendly policies.
5. Rule of law: measures the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence.
6. Control of corruption: measures the exercise of public power for private gain, including both petty and grand corruption and state capture.

For 2004, these indicators are based on 352 different underlying variables, measuring perceptions on a wide range of governance issues. The variables are drawn from 32 separate data sources, constructed by 30 different organizations worldwide. They present estimates of the six dimensions of governance for each country, as well as margins of error capturing the range of likely values for each country and period. These margins of error are not unique to perceptions-based measures of governance, but are an important feature of any measure of governance, "objective" or "subjective."

The six governance indicators are measured in units ranging from about –2.5 to 2.5, with higher values corresponding to better governance outcomes.

APPENDIX I: PERFORMANCE ON GOVERNANCE INDICATORS

	Voice and accountability		Political stability		Government effectiveness		Regulatory burden		Rule of law		Control of corruption	
	2004	Change since 1996	2004	Change since 1996	2004	Change since 1996	2004	Change since 1996	2004	Change since 1996	2004	Change since 1996
Post-CP HIPC	–0.2	Improved	–0.4	Worsened	–0.5	Improved	–0.3	Worsened	–0.6	No change	–0.5	Improved
DP HIPC	–0.8	Improved	–0.8	Improved	–1.0	Worsened	–0.9	Worsened	–1.0	Worsened	–0.9	No change
Non-HIPC												
IDA–only	–0.5	Worsened	–0.5	Worsened	–0.7	Worsened	–0.6	Worsened	–0.6	No change	–0.6	Improved
Pre-DP HIPC	–1.3	Worsened	–1.4	Worsened	–1.5	Worsened	–1.4	Worsened	–1.5	Worsened	–1.2	Worsened

Source: Kaufmann, Kraay, and Mastruzzi 2005.

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ENDNOTES

Foreword

1. In net present value terms in the year of decision point, with topping up calculated in the year of completion point. "Topping up" refers to debt relief beyond the amount agreed at decision point (see chapter 3).

Executive Summary

1. The Operations Evaluation Department (OED) is the former name of the Independent Evaluation Group (IEG) of the World Bank.

2. The original HIPC Initiative, agreed to in 1996, was modified as the Enhanced HIPC Initiative in 1999 (World Bank and IMF 1996, 1999a).

3. Debt-stock reduction is measured in net present value terms in the year of decision point with topping up measured in the year of completion point.

Chapter 1

1. See Development Committee 2005; G-8 Finance Ministers 2005; IMF 2005a through 2005e; and World Bank 2005a, 2005b, and 2005c.

2. The Operations Evaluation Department (OED) is the former name of the Independent Evaluation Group (IEG) of the World Bank.

3. The original HIPC Initiative, agreed to in 1996, was modified as the Enhanced HIPC Initiative in 1999 (World Bank and IMF 1996, 1999a).

4. The 2003 evaluation used country status under E-HIPC as of July 2002. This update uses country status as of February 2006.

5. The international community agreed at Monterrey that "continued efforts are needed to reduce the debt burden of heavily indebted poor countries to sustainable levels" (UN 2002). Monterrey also included an agreement that "future reviews of debt sustainability should also bear in mind the impact of debt relief on progress toward the achievement of the [Millennium Development Goals]." More recently, heads of state have emphasized that "debt sustainability is essential for underpinning growth and [have underscored] the importance of debt sustainability to the efforts to achieve national goals, including the Millennium Development Goals" (UN 2005c). For civil society views on the linkages between debt relief and poverty reduction, see Jubilee Research 2002, 2004; CAFOD 2003; among others.

6. This so-called "sunset clause" had multiple purposes: to prevent the initiative from becoming a permanent facility, to minimize moral hazard, to limit the time available for the buildup of new debt and to encourage early adoption of reform in HIPC countries. This deadline has been extended every two years from 1998 to 2006—the first time for eligibility under the original HIPC Initiative and, subsequently, for eligibility under E-HIPC.

7. The four countries are Burundi, the Democratic Republic of Congo, Guinea, and São Tomé and Principe. A fifth, the Republic of Congo, reached the decision point in March 2006.

8. Five out of the 10 have become eligible for the initiative (four out of nine, excluding the Republic of Congo).

9. The pool of HIPC countries had been extended before to include the Comoros, the Gambia, and Malawi, as analysis of their debt revealed they were in an unsustainable position (in 1999, 2000, and 2001 respectively). Further revisions to the list of potentially eligible countries are expected. See footnote in table 1.1.

Chapter 2

1. Estimated amounts of debt relief in this chapter are in 2004 net present value terms. The source of the data is World Bank and IMF 2005d, table 2 and appendix table 11a; and World Bank and IMF 2003c, table 1.

2. Traditional relief is relief provided by bilateral and commercial creditors under mechanisms that were agreed to prior to the HIPC Initiative.

3. The Debt Reduction Facility (DRF) was recently extended for 3 years, replenished by $50 million, and enhanced to consolidate debt buy-back operations across multiple HIPC countries in order to cut its costs.

4. This average cost is per dollar of principal bought back in HIPC countries since 1999. This assumes all costs will be borne by the DRF; usually, donors and, sometimes, recipient countries provide additional financing.

5. See Birdsall and Williamson (2002), for instance, who note that the official data on grants, subsidized loans, and interest payments—some paid, some reduced, some forgiven, and some owed but not paid—are difficult to unravel or separate.

6. Birdsall and Williamson (2002) show that from 1990 to 1999, as debt relief programs intensified, total ODA declined. Birdsall, Claessens, and Diwan (2002) find that debt reduction in the 1990s crowded out other forms of disbursements. Powell (2003) concludes that from 1996 to 2000, additional real resources have not been made available to debtors, although there is no evidence that debt relief has lowered the levels of other aid flows.

7. This exercise uses official flows data, official development assistance (ODA) and non-ODA on aid to developing countries, collected annually from members of the OECD's Development Assistance Committee (DAC). Debt relief is largely debt relief on ODA and consists of debt forgiveness grants, and new ODA resulting from concessional rescheduling operations, net of offsetting entries for the cancellation of any ODA principle. Debt relief is mainly relief provided by DAC donors, IDA, and a few non-DAC bilaterals, as other donors do not report thoroughly the amounts of debt relief they provide.

8. The annual rate of increase of net transfers from 1990 to 1999 in the 28 HIPC countries was –3 percent.

9. This growth rate was derived from the UN Millennium Project Report (2005) estimate of the additional annual ODA increases required over 2003 levels to meet the MDGs. The ODA levels required in 2015 correspond to 0.54 percent of gross national income, which is less than the 0.7 percent of the target agreed to at Monterrey.

10. Country groupings used are 18 post-completion point, 10 decision point, 10 pre-decision point, and 76 other developing countries (non-HIPC, lower-middle-income countries and low-income countries, as defined by DAC, excluding countries that experienced the Asian crisis—the Philippines, Thailand, and Indonesia). Appendix C provides a list of countries that compose each category.

11. If we include the Asian crisis countries, the decline in the share of non-HIPC developing countries is even more dramatic, from 63 percent of aid between 1990 and 1999 to 35 percent since 1999.

Chapter 3

1. As of mid-February 2006, LIC DSAs had been prepared in 14 HIPC countries.

2. For more information on this, see UNCTAD 2004 as well as the World Bank and IMF policy papers on the new LIC DSAs.

3. DSA projections were taken from HIPC decision-point and completion-point documents. Export growth projections were calculated from projected levels of exports of goods and nonfactor services. GDP growth projections were available directly in the documents. The historical growth rates were calculated from actual levels of GDP and exports of goods and nonfactor services in constant 2000 US$, as reported in the *April 2005 World Development Indicators* (World Bank 2005d) and *2005 Global Development Finance* (World Bank 2005e) These results were found by testing the null hypothesis that individual country-year decision-point projections were equal to country-year completion-point projections, against the alternative hypothesis that decision-point projections were greater than completion-point projections. For GDP and export growth in all CP countries, there were 148 and 147 paired observations. For GDP and export growth in new CP countries, there were 90 paired observations. For GDP growth rates, we could reject the null in favor of the alternative with 99 percent confidence. For export growth, we could not reject the null with 95 percent confidence. The p-values were less than 0.01 and 0.44 for GDP and export growth.

4. The 12 new CP countries are Benin, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Nicaragua, Niger, Rwanda, Senegal, and Zambia. The p-values in these 12 countries were less than 0.01 and 0.35 for GDP and export growth.

5. Analysis for this section excludes Chad, whose new oil pipeline is expected to generate exceptionally

high growth. There were only four countries in which 2005–2010 export projections were within or below the 1980–2001 historical range, and 13 within or below the 1990–2000 range. Moreover, there were only three country projections with projections below (and 25 above) the relevant 1980–2001 historical mean, and five below (and 22 above) the relevant 1990–2000 mean. Furthermore, there were two countries in which GDP projections were within or below the 1980–2001 historical range, and only 5 within or below the 1990–2000 range. There was one country projection below (and 27 above) the relevant 1980–2001 historical mean, and two below (and 26 above) the relevant 1990–2000 mean.

6. Appendix D, tables D.1 and D.2 compare average DSA-projected GDP and export growth for 2005–2010 in each of the 28 decision-point countries, to statistical bounds of 1980–2001 and 1990–2000 historical data.

7. Table 3.2 presents statistical estimates of the difference between projected and observed growth rates, based on a comparison of paired observations (for individual countries in individual years). The 2000 to 2004 time frame was chosen because actual data were only available through 2004, and projections were only available for a majority of countries (19 of the 28) starting in 2000, so the sample covers a limited time frame. Even within these few years, IEG studied 116 paired observations for export growth and 123 for GDP. These results were found by testing the null hypothesis that the most recent GDP and export growth projections (whether made at decision point or completion point) were equal to those that actually occurred against the alternative hypothesis that the projections were greater than those that actually occurred. Our results indicated that we can reject the null for GDP growth at a 95 percent level of confidence in favor of the alternative hypothesis. We could not reject the null for export growth. Excluding Chad, the point estimates become 10.3 percent projected and 7.4 percent actual for a difference of 2.9 percent, significant at a 95 percent level of confidence.

8. The tendency toward overoptimism has been noted in other studies. The Independent Evaluation Office of the IMF finds that actual GDP growth in 159 IMF programs fell short of projected growth in a two-year period by an average of 1.5 points (IEO 2003). A possible explanation for this overoptimism is the incentive of staff to overpromise in order to show medium-term viability of the balance of payments (IEO 2002).

9. The main indicator used to measure debt sustainability under the HIPC Initiative, for countries that qualified under the export criterion, is the ratio of NPV of public and publicly guaranteed long-term external debt to the average of the past three years of exports of goods and nonfactor services. For fiscal countries, the ratio is the NPV of debt to revenues.

10. Ratios prior to decision point include relief granted under the original HIPC Initiative and under traditional debt relief mechanisms such as the Naples terms. Ratios for completion point assume unconditional delivery of HIPC relief at completion point as well as additional bilateral debt relief.

11. Under the HIPC Initiative, countries receive debt relief to bring their ratios at decision point down to the target levels. Their completion-point ratios do not necessarily have to be 150 percent of NPV of debt to exports, or 250 percent of NPV of debt to revenues. However, this paragraph uses these as rough benchmarks to assess debt ratios at completion point.

12. In Rwanda, Niger, and Ethiopia, reductions in Special Drawing Rights and US dollar discount rates accounted for more than half of the unanticipated increase in debt ratios, while in Ethiopia and Rwanda, exchange rates were also a prominent factor. Faltering coffee prices affected Rwanda adversely, and price shocks, parasites, and crises in neighboring countries compromised Burkina Faso's cotton and agricultural exports. Unfavorable terms of new borrowings were responsible for one-fifth to one-third of unanticipated increases in Rwanda and Niger.

13. The most recent data for the NPV of debt is 2003; the Bank does not track these data regularly after completion point. In the five most recent completion-point countries, the reference year for completion point was the end of 2003, so a comparison would be uninformative.

14. Projections were updated as of August 2004 for 13 countries, and as of completion point for five countries that reached completion point after August 2004. Data are from the World Bank's Economic Policy and Debt Department and from completion-point documents.

15. LIC DSAs jointly conducted by the Bank and IMF include an assessment of the risk of external debt distress based on the following classifications. **Low risk:** All debt indicators are well below relevant country-

specific debt-burden thresholds. Stress testing does not result in indicators significantly breaching thresholds. **Moderate risk:** While the baseline scenario does not indicate a breach of thresholds, stress testing shows a significant rise in debt-service ratios over the projection period and/or a breach of debt thresholds. **High risk:** The baseline scenario indicates a breach of debt and/or debt-service thresholds during the projection period. This is exacerbated by stress testing. **In debt distress:** Current debt and debt-service ratios are in significant and/or sustained breach of thresholds. Mauritania and Ethiopia's LIC DSAs did not contain a risk classification. Using the guidance shown, IEG determined that Mauritania was at a moderate risk and Ethiopia at a high risk of debt distress.

16. For instance, debtor countries have already expressed their concern that the G-8 proposal for 100 percent debt cancellation aims to deepen relief for countries that were supposed to have been placed in a "sustainable situation" at completion point, implying that HIPC had not achieved its objective (UN 2005b).

Chapter 4

1. The literature on the effects of debt relief on growth is not conclusive. Empirical studies have estimated that debt relief, as designed by the HIPC Initiative, could contribute roughly a one-percentage-point increase in per capita GDP growth (Pattillo, Poirson, and Ricci 2002; and Bhattacharya and Clements 2004). Another study finds that in countries with good policies and institutions, the debt overhang affects growth negatively at intermediate levels of debt, but not at high or low levels (Cordella, Ricci, and Ruiz-Arranz 2005).

2. This chapter draws on different measures of policy performance. The first measure is the World Bank's Country Policy and Institutional Assessment (CPIA), which intends to assess the quality of a country's policy and institutional framework or "how conducive that framework is to fostering poverty reduction, sustainable growth, and the effective use of development assistance." The second is the Index of Economic Freedom from the Heritage Foundation/Wall Street Journal, which assigns scores to countries based on the level of economic freedom in the economy. (The lower the Index of Economic Freedom, the better the quality of policies in a country.) Third, IEG looked at governance indicators prepared by Kauffman, Kraay, and Mastruzzi (KKM) of the World Bank. Appendix H provides a detailed description of each of these indicators and its components.

3. The KKM governance indicators are constructed on a scale of –2.5 to 2.5 where a score of –2.5 indicates a very poor institutional score and 2.5 a very good one, relative to other countries ranked.

4. IEG analyzed assessments of public debt management capacity conducted for 12 "late" completion-point countries and the one "late" decision-point country.

5. UNCTAD's Debt Management and Financial Analysis System, the Commonwealth Secretariat, Debt Relief International, and the IMF are the main suppliers of technical assistance in debt management to low-income countries. The regional agencies, WAIFEM (West African Institute for Financial and Economic Management), MEFMI (Macroeconomic and Financial Management Institute of Eastern and Southern Africa), Pôle-Dette in Africa, and CEMLA (Center for Latin American Monetary Studies) in Latin America, are devoted to capacity building in debt management.

6. Phase one of the pilot program (the Central Government Debt Management and Domestic Debt Market Development Program) was a joint World Bank-IMF program launched in 2001, with two objectives. The first was as a demonstration program within the World Bank to build knowledge about designing reform and capacity-building projects in these areas. The second objective was for each country in the pilot program to design a program of reforms and capacity building, based on a detailed diagnostic, to improve the country's capacity in central government debt management and in the maintenance and development of the domestic debt market.

7. The Banking and Debt Management unit has recently disengaged from working on low-income clients although it will conduct follow-up work in Kenya and Zambia on implementing reform plans, and will likely work on one low-income country, Mongolia, in phase two.

8. For the 23 countries assessed in 2002 and 2004, budget formulation improved in nine countries and declined in eight. Six countries showed improvement in execution, while eight showed a decline.

9. For example, although health and education are two functional classifications where data are available, what constitutes educational expenditure may vary depending on whether countries include only primary education or also secondary or tertiary. Second,

it is extremely difficult to unbundle the definition of "poverty-reducing" expenditures because countries do not provide a disaggregated functional classification. Although health and education are included in this category, other elements that are incorporated into the poverty-reducing expenditure vary across time and between countries.

10. Expenditure in education, as a share of GDP, is very highly and significantly related with net resource transfers to these countries (showing a regression coefficient of 0.9; author's calculations).

11. This emphasis is supported by data available in four countries on the allocation of "HIPC funds" (Burkina Faso, Ghana, Niger, and Chad), which shows that education and health have received the bulk of the funds (about one-fifth to one-quarter), followed by water (14 percent) and then transport (10 percent).

12. Both countries are required to complete a poverty reduction strategy, maintain macroeconomic stability, and use budgetary savings from debt relief for poverty-reducing expenditures, as identified in their poverty reduction strategies. In addition, both countries have in common, conditions that emphasize measures to improve governance and the delivery of services in key sectors (including education and health in both, justice in Burundi, and rural development and infrastructure in the Democratic Republic of the Congo), establishment of public expenditure management systems, and measures to improve debt management. Conditions in education and health are process and outcome type measures. For instance, Burundi is required to increase children's immunization rates. Burundi also has to make progress on its demobilization program and carry out structural reforms in the coffee sector.

Appendix B

1. The nine countries that had not yet met the eligibility requirement at the time were: Angola, Burundi, the Democratic Republic of the Congo, Equatorial Guinea, Liberia, Myanmar, São Tomé and Príncipe, Somalia, and the Sudan. Bank staff considered Angola and Equatorial Guinea potentially sustainable without relief under the original HIPC Initiative.

2. The six countries were Burundi, the Democratic Republic of Congo, Liberia, Myanmar, Somalia, and the Sudan. Guinea and São Tomé and Principe had met the entry requirements, and Angola was deemed potentially sustainable without assistance.

3. The Democratic Republic of the Congo was the only country that had started an adjustment program with the Bank and IMF. The list of HIPC countries that were to be considered potentially unsustainable was expanded to six countries: Côte d'Ivoire, the Central African Republic, the Comoros, the Republic of Congo, Lao People's Democratic Republic, and Togo.

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ISBN 0-8213-6656-4