

# **Enhanced HIPC Initiative: Benefits and Implications**

**Abena D. Oduro  
Centre for Policy Analysis  
Accra**

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## **Enhanced HIPC Initiative: Benefits and Implications**

### **1.0 Introduction**

The HIPC Initiative aims at bringing down selected debt burden indicators to what is perceived to be sustainable levels. The HIPC Initiative has undergone some change since it was introduced in 1996. With the changes made in 1999, Ghana became eligible for debt relief under what is now known as the Enhanced HIPC Initiative.

The next section of this paper provides a short description of the enhanced HIPC Initiative. This is followed by a discussion on the implications of the HIPC Initiative as suggested by documents of the World Bank and the IMF. Section 4 presents the HIPC process as it happened in Ghana. The implication of HIPC for Ghana is discussed in section 5. Section 6 concludes the paper.

### **2.0 The Enhanced HIPC Process**

The enhanced HIPC Initiative has three inter-related components. The first is the calculation of the debt relief based on the debt sustainability analysis.

The second is the Poverty Reduction Strategy Paper (PRSP). This was not initially part of the HIPC Initiative, but introduced in 1999 in response to the demand to link debt relief to poverty reduction.

The third is the Poverty Reduction and Growth Facility (PRGF) of the IMF. This is the economic reform programme that is expected to inform, in particular, macroeconomic policy implementation during the HIPC Initiative process. Until 1999, the IMF macroeconomic reform programme to support the HIPC process

was the Enhanced Structural Adjustment Facility (ESAF), until it was changed to the Poverty Reduction and Growth Facility.

To be eligible for debt relief under the HIPC Initiative a country must qualify for concessional assistance under the IMF and World Bank. In addition it must face an unsustainable debt service even after the application of traditional debt relief mechanisms.

There are two important stages in the process of obtaining debt relief under the HIPC Initiative. The first is the decision point. To reach decision point the country must establish a three-year track record of reform and sound policies through IMF and World Bank supported programmes and should have developed a Poverty Reduction Strategy Paper (PRSP).

At decision point a debt sustainability analysis is conducted. If the debt sustainability indices are above the critical levels after traditional debt reduction mechanisms have been applied the country qualifies for assistance under the HIPC Initiative. A calculation will be made to determine the amount of debt relief that is required to bring the country's debt to sustainable levels. Some proportion of the debt relief will be provided during the interim period between decision and completion point.

To arrive at completion point the country must continue to pursue macroeconomic and structural reforms as agreed upon with the IMF and the World Bank. The country must also implement its poverty reduction strategy as developed in its poverty reduction strategy paper. A set of triggers agreed upon between the country and the World Bank and IMF will determine whether completion point has been arrived at.

## **The Poverty Reduction Strategy Paper**

At a minimum the poverty reductions strategy paper is expected to contain the following<sup>1</sup>:

- Medium and long-term goals for poverty reduction and social development
- A macroeconomic framework consistent with the poverty reduction and social goals (over a minimum three year period)
- The structural reforms and priorities and sectoral strategies (a three-year agenda) and associated funding needs (domestic and external) necessary to deliver growth and poverty reduction objectives.
- Anti-poverty and other social policies, linked to an analysis of the social impact of macro and structural policies, and associated funding needs (domestic and external)
- Overall external financing needs (including technical assistance needs and expected providers) for each year of the programme.

It is expected to be put together through a process of consultation and participation of civil society. The poverty reduction strategy paper is to “serve as the basis for designing Bank and Fund lending operations, and as a framework with which all ESAF – and Bank-supported programmes should be consistent”.<sup>2</sup> The poverty reduction strategy papers are to “become the centrepiece more generally in all ESAF arrangements”.<sup>3</sup> They were also expected to provide the framework for the design of other donor programmes.

## **The Poverty Reduction and Growth Facility**

In a document prepared by the joint staffs of the World Bank and IMF it was recognised that “entrenched poverty and severe inequality in economic opportunities and asset endowment can themselves be impediments to growth.”<sup>4</sup>

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<sup>1</sup> IMF and World Bank (1999, p. 30).

<sup>2</sup> IMF and World Bank (1999, p. 30).

<sup>3</sup> IMF and World Bank (1999, p. 29).

<sup>4</sup> IMF (1999) **The Poverty Reduction and Growth Facility (PRGF)-Operational Issues**, December 13, Washington D.C. [www.imf.org/external/np/pdr/prsp/poverty2.htm](http://www.imf.org/external/np/pdr/prsp/poverty2.htm)

The paper then goes on to state that “to be effective and sustained, growth-oriented policies should be implemented in a framework in which the pressing need to reduce poverty is also a central objective. From this, and growing out of the analysis and recommendations made in the internal and external reviews of the ESAF, and from the constructive suggestions of many outside commentators, has come a commitment to making Fund-supported programmes for low-income countries better integrated with policies to fight poverty, better-owned and better-financed.”<sup>5</sup> This then is the justification for the transformation of the Enhanced Structural Adjustment Facility into the Poverty Reduction and Growth Facility.

The two major conceptual differences between the ESAF and the Poverty Reduction and Growth Facility are the objective of explicitly linking macroeconomic policy to poverty reduction and the emphasis on good governance<sup>6</sup>.

The joint staffs paper of December 1999 explicitly outlines the link between the poverty reduction strategy paper and the Poverty Reduction and Growth Facility. “The broadest and most fundamental changes to the work of the Fund arise from the fact that targets and policies embodied in PRGF-supported programmes will emerge directly from the country’s poverty reduction strategy...”<sup>7</sup> In addition “a current PRSP that has been endorsed... would be a condition for Fund approval of a PRGF arrangement, or for completion of a review thereunder”.<sup>8</sup> All of this is expected to occur within a context of participation. It was expected that “discussions on the macroeconomic framework will become more open and iterative. ...Key macroeconomic policies, including targets for growth and inflation, and the thrust of fiscal, monetary, and external policies, as well as

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<sup>5</sup> IMF (1999, p. 3)

<sup>6</sup> IMF (2001) **The IMF’s Poverty Reduction and Growth Facility(PRCG) A Factsheet.** Washington D.C. [www.imf.org/external/np/exr/facts/prgf.htm](http://www.imf.org/external/np/exr/facts/prgf.htm)

<sup>7</sup> IMF (1999, p.4).

<sup>8</sup> IMF(1999, p. 6)

structural policies to accelerate growth, would be subjects for public consultation.”<sup>9</sup>

### **3.0 The Implications of the Enhanced HIPC Initiative**

The modifications made to the HIPC Initiative in 1999 have important implications for the relationship between low-income countries and the Bretton Woods institutions. It also has ramifications for the policy making process in these countries.

- The procedure whereby the targets and objectives would be set would be a participatory one and not shrouded in secrecy
- The Fund programme would be designed to achieve the triple objectives of low inflation, growth and poverty reduction.
- Poverty reduction is now a priority. This is particularly important in countries where distribution issues, especially poverty reduction, was not a priority. It is an opportunity to change traditional biases in the allocation of resources.

The link between the PRGF and the PRSP places a number of responsibilities on low-income countries that would wish to access the facility. These are:

- To design a PRSP within the time frame required to obtain financing under the PRGF
- To design a PRSP that has targets and policies that can be embodied in the PRGF programmes
- To design a PRSP or accompanying documents that “...identify for each measure whether the Fund or Bank would take primary responsibility for supporting the Government’s policy formulation and for monitoring”
- The process as spelt out above has also implicitly shifted responsibility for the determination of the conditionalities from the IMF to the debtor countries. This

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<sup>9</sup> IMF (1999, p.4).

is because the PRGF is supposed to be derived or emerge from the PRSP and the PRSP is expected to be the responsibility of the government, having been arrived at through a participatory process.

These are not light responsibilities that have been placed on countries that are recognised as having capacity constraints.

#### **4.0 The HIPC Process in Ghana**

Although Ghana was eligible for debt relief under the enhanced HIPC Initiative in 1999, it was not until 2001 that the Government opted for debt relief under the Initiative. When Ghana became eligible for HIPC debt relief in 1999 its debt burden indicators were not significantly above the critical values. The amount of debt relief that Ghana would have qualified for was therefore not very large. Opting for the HIPC option was therefore not attractive given the “costs” of going HIPC. One of such costs was Japan’s warning that Ghana would no longer be eligible for loans.

An interim poverty reduction strategy paper for Ghana had been prepared in 2000. The preparation of this paper was necessary if Ghana was to access funds under the Poverty Reduction and Growth Facility. Ghana had begun accessing the Poverty Reduction and Growth Facility since 1999. The process of preparing a complete poverty reduction strategy paper began in July 2000. Thus by the time the decision to participate in the enhanced HIPC Initiative was taken in early 2001, Ghana had made considerable headway in the preparation of its poverty reduction strategy paper, i.e. the Ghana Poverty Reduction Strategy Paper and had already started implementing a macroeconomic programme under the Poverty Reduction and Growth Facility. Thus Ghana’s PRGF was not informed

by its poverty reduction strategy paper since the latter was not completed until early 2002.

A preliminary assessment of Ghana's debt sustainability indicators in June 2001 estimated that at end December 2000 the net present value of debt to revenue stood at 557% which was significantly higher than the critical value of 250%<sup>10</sup>. A subsequent estimate at the decision point in February 2002 (based on end-December 2000 figures) put the net present value of debt to revenue ratio at 570% and the net present value of debt to exports at 157%<sup>11</sup>.

The amount of debt relief that Ghana is expected to receive under the enhanced HIPC Initiative is calculated on the basis of the fiscal criteria. Ghana would get little relief if the export criterion had been used because its export to debt ratio is only 7 percentage points above the critical value. It is estimated that the total debt relief required to bring down the net present value of the ratio of debt to revenue to below the critical value of 250% is US\$2186m. The enhanced HIPC relief is expected to reduce debt service payments due by about US\$215m per year on average between 2002 and 2011. In 2002 the debt relief for Ghana is US\$249m. It is made up of US\$153m of traditional debt relief and US\$96m of HIPC relief. Twenty percent of the HIPC debt relief is to be used for domestic debt reduction and the remaining 80% is earmarked for poverty reduction programmes and activities.

To arrive at completion point Ghana is expected to have undertaken certain actions and achieved specific targets. These trigger points were identified by

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<sup>10</sup> *IMF and IDA (2001) Ghana. Enhanced Heavily Indebted Poor Countries Initiative – Preliminary Document. Prepared by the Staff of the IMF and World Bank, Washington D.C.*

<sup>11</sup> *IDA and IMF (2002) Ghana Enhanced Heavily Indebted Poor Countries (HIPC) Initiative Decision Point Document Prepared by the Staffs of the IMF and IDA, February, Washington D.C. The increase in the net present value of debt to revenue is largely due to the inclusion of loans to public enterprises for which the Aid and Debt Management did not have the information at the time that the preliminary estimate was made.*

“drawing on the priorities identified in the draft GPRS”<sup>12</sup> Considering that by April 2002 the process of prioritising the GPRS had not been completed the basis of the choice of these trigger points is unclear.

### **Ghana’s Completion Point Triggers**

- ◆ Formulation of the GPRS and its satisfactory implementation for at least one year
- ◆ Maintenance of macroeconomic stability
- ◆ Appropriate use of budgetary savings from HIPC relief

#### **Governance**

- ◆ Establishment of a procurement regulatory and oversight body to implement the new procurement code.
- ◆ Development of internal audit capacity through full staffing of internal audit positions.

#### **Public Expenditure Management**

- ◆ Regular publication of reports on cash expenditures and commitments by MDAs
- ◆ Installation of a computer based financial management information system on a pilot basis in the Ministry of Finance, CAGD and at least two key sector ministries.

#### **Social Indicators**

- ◆ Increase gross primary enrolment rates for girls from 72% in 2002 to 74%.
- ◆ Percentage of rural households with access to safe water to increase from 40% in 2000 to 46%.
- ◆ Share of district and sub-district in recurrent health expenditures to increase from 42% in 2000 to 45% .

#### **Decentralisation**

- ◆ Submission to Parliament of a Local Government Services Bill
- ◆ Develop a monitoring system to provide regular data on local government activities.
- ◆ Development of district composite budgets in pilot districts

#### **Energy**

- ◆ Maintain the automatic pricing formula in petroleum
- ◆ Full economic pricing in the electricity sector with provision of lifeline to allow access to electricity to low income consumers.

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36. IDA and IMF (2002) *Ghana Enhanced Heavily Indebted Poor Countries (HIPC) Initiative Decision Point Document* Prepared by the Staffs of the IMF and IDA, February, Washington

## **5.0 Implications of the Enhanced HIPC Initiative for Ghana**

The decision to opt for the HIPC Initiative was taken after Ghana had begun implementation of a Poverty Reduction and Growth Facility with the IMF. Thus the Poverty Reduction and Growth Facility could not be informed by Ghana's poverty reduction strategy paper as is to be expected from the reading of the documents of the joint staffs of the World Bank and IMF. The current Poverty Reduction and Growth Facility should come to an end in November 2002. It is expected that a new PRGF will have to be negotiated with the IMF for implementation during the period until completion point is reached. It is hoped that not only will the Ghana Poverty Reduction Strategy Paper provide a framework guiding the design of the new Poverty Reduction and Growth Facility, but also that the key targets of the Facility will be arrived at after a process of "public consultation".

The preparation of the Ghana Poverty Reduction Strategy Paper involved some consultation with civil society. Some dissatisfaction has been expressed about the nature of the consultation process. These criticisms bring a number of issues to the fore. At what stage in the process should consultations have begun? Should a bottom-up approach rather than a top-down approach have been adopted? Could the District Assemblies have developed district level poverty reduction strategy papers based on guidelines provided them by the National Development Planning Commission? Why was this not done? Despite the reservations, an important first step has been taken. It is recognised by both civil society and Government that there is a need to develop permanent structures to facilitate the process of dialogue and consultation. The National Economic Dialogue that took place in Accra in May 2002 is one such example. So far it happens only once a year. A mechanism that will make possible more frequent contact between Government and civil society is required.

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*D.C. p. 27.*

Partnership is a two-sided affair. Civil society must not only be willing but also able to participate in the process. However civil society recognises that it suffers from limitations that constrain its ability to effectively participate. The Executive Secretary of GAPVOD an umbrella organisation for civil society organisations stated that the inability to effectively participate “reflects our capacity weaknesses, the lack of resources as well as the level of maturity of the civil society movement in the country”.<sup>13</sup> The Chairman of the Civil Society Coordinating Council had this to say at the eleventh Consultative Group Meeting held in Accra:

“...we ought in all honesty to take a critical attitude to these limitations of process and be committed to rectifying them in our future relationships. This includes adequately supporting civil society organisations to participate effectively in the implementation of the GPRS in the next three years. Failure to do so will make the presence of civil society organisations at these meetings merely cosmetic”

The Enhanced HIPC Initiative requires that there is an increase in poverty related spending and activities as directed in the poverty reduction strategy paper. Ghana has classified public sector spending into poverty and non-poverty related categories (Table 1 for poverty related expenditures). This increase in poverty related spending is expected to be partly if not wholly funded from financial resources that would otherwise have been transferred abroad. The assumption is that the financial resources that should have been transferred abroad are available for spending in the domestic economy. Thus a component of the share of poverty-related spending should be additional because of the savings from HIPC debt relief and not due to a re-allocation from non-poverty related spending. For countries in which default in external debt payments has been an

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<sup>13</sup> Text from speech made at the Eleventh Consultative Group Meeting in Accra, April 2002.

Table 1. Classification of Poverty Related Expenditures.

<b>Sector</b>	<b>Category</b>
Education	Basic Education including non-formal education Community Secondary Schools Technical/vocational education.
Health	Primary Health Care (District/sub-District services), public health and exemptions
Works and Housing	Water and Sanitation Rural Housing Drainage
Food and Agriculture	Extension Irrigation Storage Marketing
Roads and Transport	Feeder Roads Road safety
Energy	Rural electricity Renewable Energy
Manpower Development and Employment	Social Welfare Vocational training/Skills Development
Local Government and rural Development	Governance Community Development Slum Upgrading
Trade and Industry	Agro-industry
Environment	Environmental Protection.
Justice	Legal Aid
Women Affairs	Women Centres Children's Centres
Others	HIV/AIDS Human Rights Safety Disaster Management Participation

alternative the HIPC Initiative may put some strain on domestic budgeting. In 1999 and 2000 Ghana was in arrears in its external payments. That Ghana has had difficulties in meeting its external debt payments in the past does not imply that the problem will resurface in the future. What it does mean is that there must be careful scrutiny of both poverty and non-poverty related spending.

The HIPC process has some built in mechanisms aimed at ensuring the use of funds for poverty related spending. A special fund has been created at the Bank of Ghana to receive the savings from HIPC debt relief. Codes have been developed to track poverty related spending and staff have been trained for this purpose. One of the completion point triggers is the implementation of the GPRS for at least one year. It is critical that a situation be avoided where, in the face of budgetary difficulties, because of the need to meet HIPC obligations, non-poverty related spending is sacrificed. Some categories of non-poverty lending (for example university education, urban roads and other infrastructure) may be crucial for ensuring growth and development. Spending on this category of activities should at least be maintained in the coming years.

There was the fear that participating in the HIPC Initiative would make it difficult for Ghana to access the international capital market. Debt relief has been provided to middle income countries in the past and this did not prevent them from accessing the international capital market once their economies were perceived to be back on track and able to generate the expected returns on investment. One effect of Ghana going HIPC is that Japan no longer gives Ghana loans, but still maintains grants. Probably given the difficult balance of payments situation that the economy has faced it would be a sensible policy to concentrate on highly concessional flows and wait until the country is truly on a stronger footing before non-concessional flows are accessed<sup>14</sup>.

## **6.0 Conclusion: The Way Forward**

Civil Society Organisations have been allocated some responsibilities under the HIPC Initiative. These are:

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<sup>14</sup> This assumes that grant flows will be adequate to meet the financing requirements of the Ghana Poverty Reduction Strategy.

- To participate in the formulation of the poverty reduction strategy paper
- To participate in the monitoring and evaluation of the implementation of the poverty reduction strategy.
- To participate in the dialogue that should precede negotiations of a new Poverty Reduction and Growth Facility.

These responsibilities raise several issues:

- What must civil society do to build its capacity to perform these functions?
- What must civil society do to increase and sustain dialogue with policy makers at both the national and local level?
- What must civil society do to ensure that its concerns are heard not only by Government but also by the development partners, particularly the IMF and the World Bank who are holding the purse strings.

All parties involved require a change in mind-set if the new processes suggested by the HIPC Initiative are to yield positive results. On the one hand Government will have to take even greater strides towards openness and transparency and in making information more readily available at the national and district levels. Second, the IMF and World Bank should realise that with the changes made in 1999 a new dimension to the relationship with countries has been introduced. There is a need for both organisations to be ready to listen to the concerns of civil society and make available the required information if a position that is acceptable to all parties is to be arrived at. Third, civil society should recognise that it is a diverse body with many and varied interests. There is therefore a need to develop sophisticated negotiating skills in order to arrive at a consensus, not only between civil society and government but also amongst civil society itself.

The participatory approach being proposed by the HIPC Initiative is not without its risks and challenges. The process of arriving at agreement amongst all three parties concerned may be slower than during the period when negotiations were limited to the Bretton Woods organisations and government. At a time when

countries may be in desperate need for external assistance participation and consultation may be a stumbling block. However it is quite obvious that there is need for much greater transparency in the relationship between governments and the Bretton Woods institutions on the one hand the citizenry on the other. The challenge is for us to develop a system that works.

Will Ghana's debt burden become sustainable after it has gone through the HIPC process? This is not a certainty. Some countries have gone through the HIPC process and still have unsustainable debt burdens. Whether Ghana will benefit from a lower debt burden because of having participated in the HIPC process depends very much on the design and implementation of the poverty reduction and growth facility, the implementation of the poverty reduction strategy paper, whether development partners will continue to provide the required support and conditions in the international economy.