The HIPC Initiative, MDRI and Nepal: A Re-examination[#]

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The HIPC Initiative was established in 1996 with the prime goal of reducing eligible countries' debt burdens to the thresholds fixed under the Initiative. There are both costs and benefits associated with participation under the Initiative. For many interim HIPCs, the challenges in meeting their completion point triggers pertain to maintaining macroeconomic stability, preparing participatory Poverty Reduction Strategy Papers (PRSPs) as well as other country-specific triggers. At the completion point, full debt cancellation under the MDRI is granted. Nepal is one of the ten pre-decision point countries potentially eligible for participation under the Enhanced HIPC Initiative. The possible conditions linked to the country's entry to the HIPC Initiative, the level of existing concessionary foreign assistance that could be non-concessionary and the likely possible debt situation after reaching the completion point are some of the issues that need a re-examination.

I. INTRODUCTION

After the upsurge in foreign debt owed by many low-income countries (LICs) throughout the 1970s and 1980s, low growth, declining commodity prices, and other economic shocks resulted in a number of countries possessing unsustainable debt burdens. By 1992, the 33 most indebted LICs incurred debts whose present value had more than doubled in ten years to over six times their annual exports. Beginning in the late 1980s, the Paris Club and other bilateral creditors rescheduled and forgave many of these debts. However by the mid 1990s, with an increasing share of debt owed to multilateral lenders such as the World Bank, the IMF and regional development banks, a new debt relief initiative was demanded, involving these creditors, to address the concern that poor countries' debts were hindering poverty reduction efforts.

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Accordingly, in 1996 the Heavily Indebted Poor Countries (HIPC) Initiative was launched by the IMF and the World Bank, with the goal of ensuring that no poor country experiences a debt burden it cannot manage. The Initiative demanded coordinated action by the international financial community to lower to sustainable levels the external debt burdens of the most heavily indebted poor countries. After a detailed assessment, the HIPC Initiative was enhanced in September 1999 to provide deeper and more rapid relief to a wider group of countries, and to reinforce the relationships between debt relief, poverty reduction and social policies.[1] The list of countries that have been qualified for, are eligible or potentially eligible and may wish to receive HIPC Initiative assistance (as of end-July 2007) is illustrated in Annex 1.

The Multilateral Debt Relief Initiative (MDRI), on the other hand, refers to the proposal made by the G8 in June that three multilateral institutions—the African Development Bank (AfDB), the International Development Association (IDA), and the International Monetary Fund (IMF)—cancel 100 percent of their debt claims on countries that have reached, or will eventually reach, the completion point under the Enhanced HIPC Initiative. The main objective was to free up additional resources to help these countries reach the Millennium Development Goals (MDGs).[2] In March 2007, the Inter-American Development Bank (IDB) joined these three multilateral institutions in providing 100 percent debt relief on eligible credits to post-completion-point HIPCs.

The rationale behind the HIPC Initiative was that debt-overhang has a negative impact on growth and investment because high debt service obligations reduce the flexibility of fiscal policy and the scope for public investment; moreover, they create uncertainty about future macroeconomic developments among potential domestic and foreign investors, and therefore raise the cost of borrowing. This is because creditors tend to require a higher marginal return when there is uncertainty over a country's future debt servicing capacity.

The higher cost of borrowing reduces the willingness of governments to undertake public investment, with attendant effects on private investment and growth. In addition, as governments are forced to divert resources to servicing debt and away from investment and social expenditure, the presence of a severe debt overhang can undermine a country's ability to pursue the MDGs. Debt service obligations can create fiscal constraints that distort effective resource utilization, and they diminish a government's capacity to form and shape a national development strategy. An underlying principle of the HIPC Initiative, therefore, was to use the newly freed public resources from lower debt service payments to increase social expenditures aimed at reducing poverty. [3]

As per the HIPC criteria, Nepal was found to be satisfying all the conditions needed to reach the decision point based on income and indebtedness criteria applied to end-2004 data. The Net Present Value (NPV) of external debt for end-2004 was estimated at almost 200 percent of exports of goods and services. Nepal could begin receiving interim relief on a provisional basis if it decides to enter the HIPC Initiative and its participation could

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[1] The continued efforts by countries toward macroeconomic adjustment and structural and social policy reforms—including higher spending on social sector programs such as basic health and education—comprise the core aspects of the Enhanced HIPC Initiative.
[2] For details, refer to African Development Bank Group (2006).
[3] This aspect of using the public resources from lower debt service payments is analyzed in UNCTAD (2006).

help release its resources from debt servicing obligations that will facilitate the country in implementing poverty reduction programs more effectively.

The remainder of this paper is planned as follows. The next section discusses the operational framework of the debt relief initiatives after which some pros and cons of participation under these initiatives are examined. Section III reviews the external debt situation of Nepal and discusses some pertinent issues that need to be considered prior to the country's participation under the HIPC Initiative, if it so decides. The last section makes some closing observations.

II. THE HIPC INITIATIVE AND MDRI FRAMEWORK

Criteria

Generally, a country must satisfy a set of criteria in order for it to qualify for the HIPC Initiative assistance. Specifically, it must: (1) be IDA-only and Poverty Reduction Growth Facility (PRGF)-eligible, (2) face an unsustainable debt burden, beyond traditionally available debt-relief mechanisms[4], (3) have a track record of reform and sound policies through IMF- and IDA-supported programs, and (4) establish a track record of reform and develop a PRSP through the involvement of the civil society.[5]

For reaching the decision point, the first stage of qualification, a country needs to possess a track record of macroeconomic stability, have developed an Interim PRSP, and cleared any outstanding arrears. At the decision point, the country agrees to a list of completion point triggers, upon which it will 'graduate' from the HIPC Initiative. At this point, a debt sustainability analysis is undertaken to determine the level of indebtedness of the country and the amount of debt relief it may obtain. The amount of debt relief required to bring the country's debt indicators to HIPC thresholds is computed, and the country starts getting interim debt relief on a provisional basis.

The interim period between a country's decision and completion points varies depending on how fast a country can implement its poverty reduction strategy and maintain macroeconomic stability.[6] In order to arrive at the completion point, the country

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[4] A country's debt level is unsustainable if NPV of debt-to-export levels are above a fixed ratio of 150 percent, or, in countries where exclusive dependence on external indicators may not sufficiently demonstrate the fiscal burden of external debt, the NPV of debt-to-government revenues are greater than 250 percent.

[5] Details are provided in World Bank Independent Evaluation Group (2006).

[6] The average length of time that HIPCs spend between decision and completion points has increased since 2000, reflecting challenges in meeting completion-point triggers. Interim periods have ranged from three months in Uganda (which was a "retroactive" case for purposes of the enhanced HIPC Initiative) to more than six years in São Tomé and Príncipe. Although countries' experiences are diverse, two observations can be made. One, most HIPCs that reached completion point early had made substantial progress in economic reforms under the original HIPC Initiative. The average interim period for countries that participated in the original HIPC Initiative is nearly two years shorter than for those that joined under the enhanced HIPC Initiative (2 vs. 3.8 years). Two, post-conflict HIPCs have needed or may need longer interim periods to address institutional weaknesses and gather sufficient political support to implement sustained reforms. For more this, see IMF (2007).

is required to maintain macroeconomic stability based on a PRGF-supported program, undertake major structural and social reforms as agreed upon at the decision point, and implement a PRSP satisfactorily for one year. After attaining the completion point, the country obtains the full amount of debt relief, which then becomes irrevocable.

In an additional push to resolve the debt problem of the poorest countries, in July 2005 the G-8 announced the Multilateral Debt Relief Initiative (MDRI), which provides countries that have reached the completion point under the HIPC Initiative with 100 per cent debt cancellation of claims from multilateral financial institutions. The objective of the G-8 proposal is to complete the HIPC debt relief process by providing additional resources to support the countries' efforts to achieve the MDGs. The cancellation of the multilateral debt of these countries is expected to have a profound impact on the burden of their debt overhang and on the pursuit of their development objectives.[7]

The conditionality for procuring debt relief under the MDRI is the following: a) for pre-decision and interim HIPC countries: reaching of the completion point; b) for post-completion-point countries: satisfactory macroeconomic performance; satisfactory implementation of the PRS; improvements in governance and transparency; and c) for non-HIPC countries qualifying under the per-capita criteria, similar conditions are applicable as for the post-completion countries.[8]

Pros & Cons

Besides reduced external debt burdens, countries that choose to participate under the Enhanced HIPC Initiative benefit from debt relief in other ways. Some general advantages of participation could include the following:

- Members of the Paris Club normally provide debt relief above and beyond what is called for in the Initiative**.** In the past, many members of the Paris Club have granted total debt write-downs to HIPC countries.
- The reduction in debt service should allow for a significant rise in poverty reducing expenditures. In the countries that have reached the decision point, poverty-reducing expenditures have risen from an average 6.4 percent of GDP in 1999 to an estimated 9.1 percent in 2005.
- At the completion point full debt cancellation under the MDRI is granted.

However, the country should be clear on certain issues and misconceptions before considering participation in the HIPC Initiative. These include the following:

- Countries need to satisfy certain conditions in order to obtain relief under the Initiative**.** Though considerable efforts are devoted to identifying conditions that will maximize the Initiative's impact and safeguard financial resources, these conditions may require strong efforts on the part of the related authorities. The completion point triggers normally encompass the following: a) macroeconomic stability; b)

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[7] The effect of the cancellation of multilateral debt of the HIPCs on their development goals is analyzed in UNCTAD (2006).

[8] It should be noted that so far only two countries (Cambodia and Tajikistan) have been qualified under the per capita income criteria (that is, per capita income below $380) and this applies only to the outstanding debt to the IMF.

implementation of key structural reform measures, including social sector reforms under the World Bank and IMF programs; c) improvements in public expenditure management; and d) more spending in priority areas consistent with PRSP objectives.

- Some bilateral creditors may scale back new assistance for a few years after they grant debt relief.
- The HIPC Initiative is not a panacea**.** It helps lower poverty by re-directing the savings from debt relief to poverty reducing areas, but it cannot result in the complete eradication of poverty. Likewise, fiscal solvency is not guaranteed by the relief. The Initiative provides debt reduction and improves government balance sheets. Long-term debt sustainability is based on solid growth that relies on sound government policies, including prudent external borrowing and debt management.

The HIPC Initiative also possesses some limitations:[9]

- Eligible countries, even after reaching the completion point, are still liable to experience unnecessary delays in getting debt relief because some of the creditor nations and institutions want to limit their own costs as much as possible.
- Debt sustainability is linked to levels of export receipts while less emphasis is accorded to the social and human development such as education, health and poverty reduction.
- Continued servicing of debt at unsustainable levels undermines development priorities and needs of eligible countries.

Again, the HIPC Initiative has its own conditions, which have to be fulfilled by any prospective country before qualifying for the scheme. For example, Mozambique was required to open up its cashew nut industry by sending raw nuts abroad for processing. This happened despite the presence of a local processing plant. As a result, the country received lower prices from its cashew nuts while a large number of Mozambican workers lost their jobs.[10]

While the HIPCs as a group have made progress in terms of a number of debt indicators, such as the ratio of debt service to exports and debt service to government revenue, a number of completion point countries continue to have unsustainable levels of debt. According to World Bank estimates based on 2003 NPV debt ratios of 13 countries for which data was available, the debt ratios of 11 countries have deteriorated; of these, 8 countries have exceeded the sustainability thresholds. Moreover, one third of the completion point countries – Burkina Faso, Ethiopia, Guyana, Nicaragua, Rwanda and Uganda – are expected to exceed the sustainability thresholds in the medium term of the post-completion period.[11]

Long-term debt sustainability demands HIPCs to promote export growth and diversification. However, access for HIPCs' products to OECD markets continues to be a problem. Most HIPCs are very poor countries, thus benefiting under the Generalized System of Preferences (GSP) or are sub-Saharan African countries, thus covered by the American Growth and Opportunity Act (AGOA) or similar schemes conducted by some

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[9] These limitations have been extensively discussed by Olukoshi (1999), Kamidza *et. al* (2002) and ESCAP (2005).
[10] See Kamidza *et. a*l (2002) for further elaboration.
[11] These figures are taken from UNCTAD (2006).

other OECD countries. Many of these schemes grant duty and quota free access to a large number of export products originating in these countries. However, stringent rules of origin requirements act as obstacles in realizing the full potential of the preferential arrangements.

A recent paper has highlighted a number of structural factors affecting the external debt sustainability of HIPC completion point countries.[12] It reveals that (i) while comparing favorably with other LICs, the policy and institutional frameworks of completion point countries in general are still quite weak, and their debt management practices remain inferior to international standards; and (ii) their export base remains narrow and fiscal revenue mobilization falls behind, even compared with many other LICs. According to this research, completion point countries will continue to encounter a dilemma due to their large priority financing needs for development on the one hand, and the need to maintain long-term debt sustainability on the other. To attain debt sustainability, these countries need to maintain macroeconomic stability and deepen reforms to improve policy and institutional frameworks, strengthen debt management, mobilize domestic revenues, and generate a climate conducive to attracting foreign direct investment and diversifying exports.

The Independent Evaluation Group (IEG) of the World Bank has noted that countries not yet at completion point—both decision-point and pre-decision point countries—have, on average, the lowest ratings of all the LICs and are liable to grave challenges in managing their economies that will affect their prospects of garnering the benefit of debt reduction. Fiscal and debt management are the major areas of concern in many HIPCs.[13]

The HIPCs possess weak capacity to manage their public debt. The performance in public debt management has worsened in all the LICs. Experiences demonstrate that just debt reduction is not a sufficient mechanism to affect the multiple drives of debt sustainability. Sustained improvements in export diversification, fiscal management, the terms of new financing, and public debt management are required, actions that are beyond the purview of the HIPC Initiative.

Impact

Debt relief under the HIPC Initiative framework and the MDRI is estimated to have reduced the debt stock of post-decision-point HIPCs by US$96 billion in end-2006 NPV terms, but long-term debt sustainability remains a challenge.

In 2007, annual debt-service savings from the MDRI for the post-completion-point countries are expected to amount to US$1.3 billion, equivalent to about 1 percent of these countries' GDP on average. These savings vary considerably across countries, from 0.3 percent of GDP for Zambia to 1.8 percent of GDP for Guyana. All countries have simultaneously increased budgetary allocations to pro-poor growth programs. In general, countries that have benefited from the MDRI are expected to use the available resources to increase poverty-reducing spending and to help meet the MDGs.[14]

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[12] The structural factors are elaborated by Sun (2004).

[13] These concerns are elaborated in World Bank Independent Evaluation Group (2006).

[14] The discussion on the rise in poverty reducing expenditures for meeting the MDGs is given in IMF (2007).

The decrease in debt-service has been accompanied by an increase in poverty-reducing expenditures. Poverty-reducing expenditures in post-decision-point HIPCs have increased on average from under 7 percent of GDP in 2000 to 9 percent in 2006. In nominal terms, poverty-reducing expenditures amounted to US$17 billion in 2006, which represents an increase of US$3 billion since 2005.

Debt burden indicators have declined in post-completion-point HIPCs. Their debt-service-to-export ratios, on average, have been reduced from over 18 percent before the decision point to 8 percent four years after the decision point. The NPV of debt-to-exports ratio in post-completion-point HIPCs has declined in the four years after the decision point, with the cumulative reduction over five years amounting to 152 percentage points, of which 24 percentage points was due to a decrease in debt stocks and 128 percentage points were due to increase in exports.

Notwithstanding the decline in debt burdens, long-term debt sustainability remains a challenge for HIPCs. Although HIPC Initiative and MDRI debt relief have contributed to improved debt indicators, only about 50 percent of the post-completion-point HIPCs are classified as having a low risk of debt distress. This suggests that underlying vulnerabilities remain and must be addressed. While policies aimed at diversifying exports, strengthening institutions, and using external resources efficiently are paramount for long-term debt sustainability, prudent borrowing in line with a country's repayment capacity is also crucial.

III. NEPAL'S EXTERNAL DEBT AND ISSUES FOR CONSIDERATION

Outstanding External Debt & Creditor Composition

There has been a growing discussion relating to Nepal's participation under the HIPC Initiative after the country was found to be eligible for debt relief under this Initiative.[15] This part of this paper thus assesses the recent trends of external debt of Nepal. Some pertinent issues that need to be sorted out by Nepal prior to its decision on participation under the HIPC Initiative are also examined.

The outstanding external debt of Nepal went up to US$ 3.31 billion as at mid-July 2007 from US$ 2.66 billion as at mid-July 2001.[16] It rose at an average annual growth rate of 3.73 percent in the last six years. However, in the same period, the external debt/GDP ratio declined from 44 percent to 32 percent whereas external debt/revenue ratio fell from 401 percent to 271 percent. In other words, the external debt/government revenue and external debt/GDP ratios have been more favorable in 2006/07 in comparison to 2000/01. But, the external debt/exports ratio has risen from 229 percent in 2000/01 to 246 percent in 2006/07 (Figure 1 and Annex 3).

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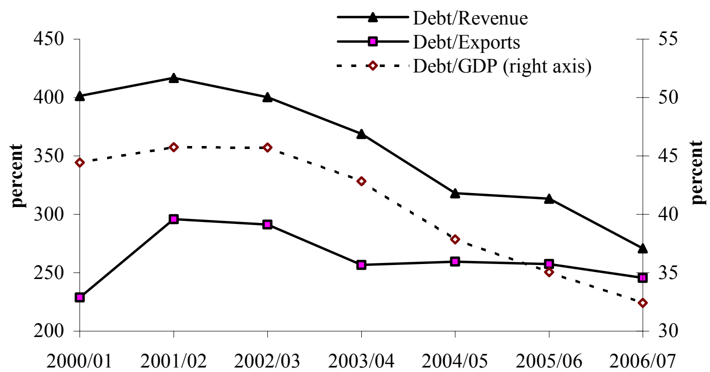
[15] The country was eligible for participation as a) it is IDA-only and PRGF eligible; b) it has a full PRSP in place since May 2003; and c) the NPV of debt-to-exports ratio is higher than 150 percent (or 198 percent) on end-2004 data.

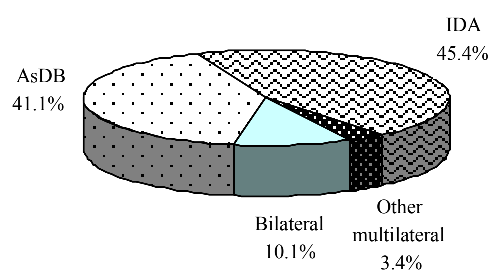
[16] External debt in this section refers to the medium and long-term external debt of the government only. The short-term loans, which includes trade credits and private external debt are very nominal and excluded.

FIGURE 1 : External Debt Stock Indicators



The share of multilateral creditors in the total external debt of Nepal went up from 84.5 percent in 2000/01 to 89.8 percent in 2006/07; correspondingly, the share of bilateral creditors went down from 15.5 percent to 10.1 percent in the same period. Among the multilateral creditors, the IDA ranks at the top since out of the nominal external debt-stock of US$ 3.31 billion at mid-July 2007, IDA alone accounts for 45.4 percent. The Asian Development Bank (AsDB) is the second largest creditor forming 41.1 percent of the country's outstanding external debt as at mid-July 2007 (Figure 2). Other important multilateral creditors of Nepal comprise of Organization of Petroleum Exporting Countries (OPEC), Nordic Development Fund (NDF), European Economic Community (EEC) and International Finance for Agriculture Development (IFAD). Among the bilateral creditors, Japan is the largest creditor constituting 7.2 percent of the total external debt as at mid-July 2007.

FIGURE 2: Creditor Composition in Outstanding External Debt Stock As At Mid-July 2007

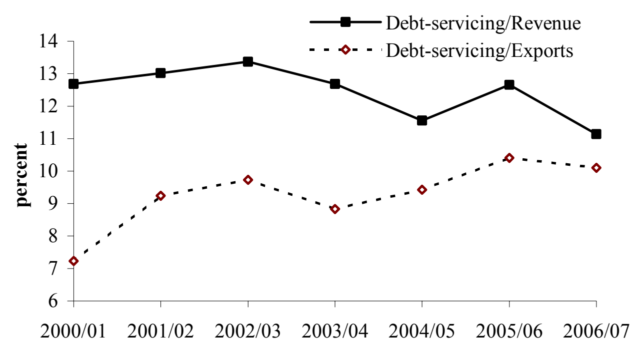


The analysis for Nepal's eligibility for HIPC initiative carried out by the IMF is based on the end-2004 data. Of the total external debt-stock of US$ 3.25 billion outstanding at end-2004, the IDA constituted about 46 percent while AsDB accounted for 41 percent. The net present value (NPV) of end-2004 level of external debt after traditional debt-relief stood at US$ 2.15 billion. With respect to debt-burden at end-2004, ADB loan constituted the heaviest debt-burden comprising about 47.2 percent of the total NPV of debt followed by IDA loan comprising about 40.4 percent of the total NPV of debt (Annex 2).

Debt-servicing and Debt-burden Indicators

External debt servicing, comprising both amortization and interest payment, had gradually gone up from US$ 84 million in 2000/01 to US$ 136 million in 2006/07. In terms of percentage of GDP, debt servicing has been fluctuating between 1.3 and 1.5 percent in the last six years. The debt-servicing/exports ratio increased from 7.2 percent in 2000/01 to 10.1 percent in 2006/07 whereas debt-servicing/revenue ratio dropped from 12.7 percent to 11.1 percent in the same period (Figure 3 and Annex 3). The major cause for the low ratios of debt servicing to export and revenue in comparison to the size of external debt-stock was the high concessionary terms on the loans contracted to Nepal.

FIGURE 3 : Debt Servicing Indicators



The debt-burden indicators are calculated separately and differently under the HIPC-DSA and LIC-DSA (low income countries' debt sustainability analysis) frameworks. The HIPC-DSA, which is conducted at decision point and again at completion point, is the basis for determining the amount of debt relief to be granted under the HIPC initiative. The LIC-DSA, on the other hand, is conducted annually for all LICs, including countries participating under the HIPC Initiative, and facilitates in deciding the terms of each country's IDA financing. For HIPC countries, the two DSAs are conducted in parallel. A principal difference between these two DSAs is that while the LIC-DSA considers a single discount rate, the HIPC-DSA uses currency-specific short-term interest rates for computing the NPV of external debt.

While Figure 4 and Annex 4 show the debt-burden indicators of Nepal computed under the HIPC-DSA framework, Figure 5 and Annex 5 depict the debt-burden indicators on the basis of the LIC-DSA framework. Based on the HIPC-DSA and on the end-2004 data, the NPV of debt to exports ratio of Nepal stood at 198 percent, which exceeds the HIPC threshold of 150 percent. Likewise, the NPV of debt/revenue ratio stood at 255 percent exceeding the HIPC threshold of 250 percent. Hence, on the basis of end-2004 data, Nepal qualifies for the participation under the HIPC initiative. As of mid-July 2007, the estimated NPV of debt to exports ratio and the NPV of debt to revenue ratio of Nepal have fallen to 175 percent (still above HIPC threshold) and 180 percent, respectively.[17]

With respect to debt sustainability under LIC-DSA, the indicative threshold is governed by the Country Policy and Institutional Assessment (CPIA rating).[18] Nepal is rated as a medium policy performer and thus the indicative thresholds for Nepal are set at NPV of debt/exports ratio of 150 percent and NPV of debt/revenue ratio of 250 percent. At mid-July 2007, the corresponding ratios stood at 160 percent and 176 percent, indicating a improvement in debt situation compared to a year earlier.

FIGURE 4: Debt-burden Indicators under HIPC Framework (in NPV terms)

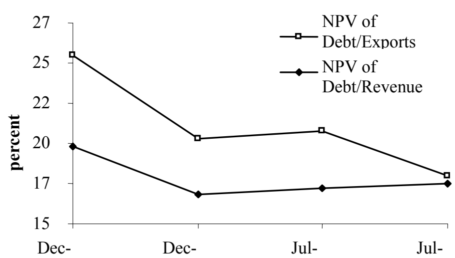
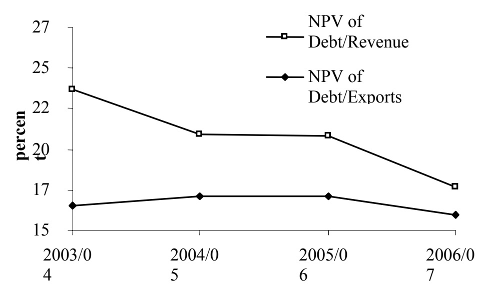


FIGURE 5: Debt-burden Indicators under LIC-DSA Framework (in NPV terms)



Preliminary Estimate of HIPC Debt relief

The amount of HIPC relief is the amount required to bring the NPV of debt to exports ratio (NPV after traditional debt relief and exports as a three year backward looking average) down to 150 percent. It is assumed that the traditional debt relief from the Paris Club and other bilateral creditors would be on Naples term, that is, reduction of NPV by 67 percent. Based on the data of end-2004, the possible HIPC debt relief to Nepal was estimated to be about US$ 521 million in NPV terms. However, based on the data available as at mid-July 2007, the NPV of debt to exports ratio of Nepal has declined to 175 percent. A rough estimate of the debt relief needed for bringing down this ratio to the

[17] The NPV of debt at mid-July 2007 is estimated one while the exports and revenues are the provisional figures.

[18] The CPIA is intended to evaluate the quality of a country's present policy and institutional framework. Quality implies how conducive that framework is to fostering poverty reduction, sustainable growth and the effective use of development assistance. From 1999 to 2003, the CPIA evaluated 20 broad areas, each with 5 percent weight in the overall CPIA rating. The 20 areas were further divided into four categories: economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions. For details, see World Bank Independent Evaluation Group (2006).

threshold level (that is, 150 percent) would be about US$ 315 million in NPV terms. In nominal terms, this is equivalent to US$ 462 million.

For Nepal, the MDRI relief package that follows the completion point is very significant. Under the MDRI, Nepal could get a substantial relief as all the debt obligations to IDA (cut-off date end-2003) and IMF (cut-off date end-2004) would be cancelled. Assuming that HIPC relief would start on 2008 and the completion point would be reached in 2011, the MDRI relief that could follow is estimated around US$ 700 million in NPV terms and US$ 1.03 billion in nominal terms.[19] Of the total MDRI relief, the relief of US$ 695 million in NPV terms would be provided by IDA while the balance would be provided by the IMF. Thus, if Nepal opts to participate in HIPC, and reaches the completion point, it could bring an estimated relief total of US$ 1 billion in NPV terms and nearly US$ 1.5 billion in nominal terms. This would lower the debt service of Nepal and help secure additional resource flows to attain the MDGs.

Core Issues

Some issues need to be considered prior to Nepal's decision on participation under the HIPC Initiative. First of all, Nepal's participation in the HIPC Initiative demands that it satisfy a range of completion point triggers, which are basically the conditions for reaching the completion point. It is argued that difficulties could arise in implementing the completion point triggers especially in the changed political context where consensus-building through a participatory mode is required. However, it should be remembered that the details of the completion point triggers would be finalized only through negotiations after Nepal reaches the decision point. Moreover, waivers have been made on completion point triggers.[20] It is possible to have a general idea on what would be the possible reform measures required to reach the completion point by reviewing the completion point triggers of the countries that have already entered in HIPC Initiative.[21]

There could be an increase in country risk associated with being classified under the HIPC category. This may make it difficult for the government to raise money from the international capital market if it wants to finance specific projects. This was one of the reasons cited by some countries such as Sri Lanka and Laos for not participating under the HIPC Initiative.[22]

If Nepal opts for participation under the HIPC Initiative, it would be the second Asian country, after Afghanistan. As under the MDRI where the IMF, the IDA of the World Bank, the IDB and the AfDB are to cancel 100 percent of their debt claims on countries that have reached, or will eventually reach, the completion point under the HIPC Initiative, in the Nepalese perspective it is important to be clear on whether or not AsDB

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[19] This is just a rough estimate calculated by deducting amount of HIPC relief that would be provided by IDA and IMF from the NPV of debt outstanding to IDA and IMF (of the borrowings made till end-2003 and end-2004 respectively) as at 2011.

[20] The waivers are discussed at length in World Bank Independent Evaluation Group (2006).

[21] To have a general idea on the completion point triggers of individual countries, refer to IMF (2008) and Pant and Subedi (2006).

[22] Details of these countries for not participating under the HIPC Initiative are given in IMF (2006) and Dahal (2006).

would be also participating. This is because the AsDB is the second largest creditor of the country's outstanding external debt as at mid-July 2007.

Another concern relates to Japan which is a major bilateral creditor and has been providing support since a long time. It is uncertain whether Japan will continue with the present aid package to Nepal if the country decides to participate as Japan is one of largest G8 creditors contributing to the HIPC Fund. It is believed that the modalities on which the HIPC Initiative is based does not permit the Japan Bank for International Cooperation, the major window for assistance from Japan, to lend to participants.[23] Thus, one issue is how the debt relief will impact other aid flows particularly future grants and loan commitments from different donors presently assisting Nepal in its development process.

V. CONCLUSION

The HIPC Initiative has played an instrumental role in lowering the debt stocks of the post-completion-point HIPCs, but only this is not enough to ensure long-run debt sustainability in these countries. Long-term sustainability also depends on more efforts from both the HIPCs and the creditors to ameliorate export diversification, fiscal and public debt management, and to procure new financing on more generous terms and conditions.

Currently, Nepal is one of the eight pre-decision point countries considered for participation under the HIPC Initiative. The expected decision point is uncertain. For Nepal, the debt relief from participation under the Enhanced HIPC Initiative may not be that valuable when compared to the relief emanating from the MDRI. However, to be eligible for the MDRI relief, it is mandatory for the country to reach the completion point of the HIPC Initiative.

The possible conditions and the reform measures that need to be additionally implemented if Nepal were to participate under the HIPC initiative, the level of existing concessionary foreign assistance that could be non-concessionary and the possible debt situation after reaching the completion point are some of the major issues that need a re-examination. In the ultimate analysis, it is important for the country to formulate a 'debt reform plan' and to strengthen its debt management capacity. Experiences of other countries show that after being provided debt relief countries easily fall back into debt distress due to poor public debt management practices.

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[23] Japan Bank for International Cooperation has a statutory mandate to undertake lending and other operations for the promotion of Japanese exports, imports and economic activities overseas.

ANNEX 1: List of Countries That Have Qualified for, are Eligible or Potentially Eligible and May Wish to Receive HIPC Initiative Assistance (as of March 2008)

Post-Completion Point Countries (23)[a]		
Benin	Honduras	Rwanda
Bolivia	Madagascar	Sao Tome & Principe
Burkina Faso	Malawi	Senegal
Cameroon	Mali	Sierra Leone
Ethiopia	Mauritania	Tanzania
The Gambia	Mozambique	Uganda
Ghana	Nicaragua	Zambia
Guyana	Niger	
Interim Countries (10)[b]		
Afghanistan	Republic of Congo	Guinea-Bissau
Burundi	Democratic Republic of Congo	Haiti
Central African Republic	Guinea	Liberia
Chad		
Pre-Decision-Point Countries (8)[c]		
Comoros	Kyrgyz Republic	Sudan
Cote d'Ivoire	Nepal	Togo
Eritrea	Somalia	

Source: IMF (2008)

a Countries that have qualified for irrevocable debt relief under the HIPC Initiative and have received MDRI relief.

b Countries that have qualified for assistance under the HIPC Initiative (i.e. reached decision point), but have not yet reached completion point.

c Countries that are potentially eligible and may wish to avail themselves of the HIPC Initiative.

ANNEX 2 : Debt-stock By Major Creditors As At End-2004

	Nominal (mil. US $)	% Share	NPV (mil. US $)	% Share
External debt stock	*3250.8*	*100.0*	*2153.5*	*100.0*
a. Multilateral	*2962.9*	*91.1*	*1970.0*	*91.5*
o/w AsDB	1342.7	41.3	1017.3	47.2
o/w IDA	1494.6	46.0	869.3	40.4
o/w IMF	22.1	0.7	16.5	0.8
o/w IFAD	66.0	2.0	41.3	1.9
b. Official Bilateral	*287.9*	*8.9*	*183.5*	*8.5*
Paris Club	252.6	7.8	163.6	7.6
o/w JAPAN	167.6	5.2	122.7	5.7
Non Paris Club	35.3	1.1	19.9	0.9
o/w KUWAIT	6.9	0.2	4.0	0.2

Source: Financial Comptroller General Office (FCGO) and computations.

ANNEX 3 : External Debt and Debt Service (US $ in million)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	(in millions of US $						
Outstanding external debt stock	*2657.9*	*2734.3*	*2892.3*	*3115.5*	*3096.2*	*3132.5*	*3310.3*
of which							
IDA	1102	1156	1234	1381	1414	1434	1502
AsDB	1043	1132	1147	1207	1199	1235	1359
IFAD	55	57	60	63	62	63	65
Japan	291	317	305	316	300	268	239
France	40	44	47	48	43	42	42
Korea	9	10	11	11	12	11	13
Debt-service	*84*	*85*	*97*	*107*	*112*	*127*	*136*
Amortization	61	62	71	78	83	97	107
Interest payment	23	24	26	29	30	30	29
	(in percent)						
Debt/GDP	44	46	46	43	38	35	32
Debt/Exports*	229	296	291	257	260	258	246
Debt/Revenue	401	417	400	369	318	313	271
Debt-servicing/GDP	1.4	1.4	1.5	1.5	1.4	1.4	1.3
Debt-servicing/Exports*	7.2	9.2	9.7	8.8	9.4	10.4	10.1
Debt-servicing/Revenue	12.7	13.0	13.4	12.7	11.6	12.7	11.1

* Exports refer to export of both goods and services

Source: Nepal Rastra Bank (NRB), FCGO and computations.

ANNEX 4 : Debt-burden Indicators (in percent)

	HIPC threshold	Dec-2004	Dec-2005	Jul-2006	Jul-2007
NPV of debt/Exports[1]	*150*	197.8	168.6	171.9	175.1
NPV of debt/Revenue[2]	*250*	254.9	202.8	207.6	179.5
Revenue/GDP[3]	*15*	11.5	11.6	11.5	11.7
Exports/GDP[3]	*30*	15.8	15.2	14.9	13.7
Memorandum items:		(US $ in million)			
Nominal debt stock		3250.8	2979.3	3132.5	3310.3
NPV of debt (after traditional debt relief)		2153.5	1973.7	2075.2	2192.9
Exports [1]		1088.5	1170.4	1207.5	1252.1
Revenue[4]		794.1	893.0	939.1	1064.8
GDP[4]		6893.2	7695.6	8130.8	9108.4

Note:

1 exports refer to last three-year average of export of goods and non-factor services

2 revenue refers to current year revenue of the central government excluding grants

3 both numerator and denominator are calculated as average of last 3 years.

4 calculated as average of last 3 years

Source: NRB, FCGO and computations.

ANNEX 5 : Debt-burden Indicators (LIC-DSA)

	*Indicative threshold**	2003/04	2004/05	2005/06	2006/07
NPV of debt, in percent of					
Exports	*150*	164.9	170.9	171.0	159.9
GDP	*40*	27.5	24.9	23.3	21.1
Revenue	*250*	236.8	209.5	208.1	176.3
Debt-service, in percent of					
Exports	*20*	8.8	9.4	10.4	10.1
Revenue	*30*	12.7	11.6	12.7	11.1
Memorandum items:		(US $ in million)			
NPV of debt (LIC-DSA)+		2000.5	2038.3	2080.0	2154.0
Exports		1213.5	1192.9	1216.2	1347.4
GDP		7274.0	8179.5	8939.0	10206.8
Revenue		844.7	973.1	999.5	1222.0
Debt-service		107.2	112.4	126.5	136.1

Note:
+ : For 2006/07, rough estimate is used.
* : Based on Nepal's CPIA rating as a medium policy performer.

Source: NRB, FCGO and computations.

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