

Commonwealth Secretariat



Commonwealth Ministerial Debt Sustainability Forum

The World Bank, 1818H Street NW, Washington, DC 20433, USA
9 April 2008

HIPC INITIATIVE, MDRI AND DEBT SUSTAINABILITY FRAMEWORK: RECENT DEVELOPMENTS & ISSUES

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March 2008

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EXECUTIVE SUMMARY

Implementation of the HIPC Initiative

All Commonwealth HIPCs have now reached the Completion Point (CP), with the Gambia joining their ranks in December 2007. Four issues remain of particular importance in relation to the implementation of the HIPC Initiative:

Challenges of reaching the Completion Point

2. Although Burundi and Haiti could reach the CP in 2008, the timetable of reaching CP has been slipping in practically all cases, partly due to the fact that many of these countries have needed longer interim periods to address institutional weaknesses and gather sufficient political support to implement sustained reforms. There is, therefore, a need for a more proactive approach by the international institutions to assist them in addressing the challenging environment they face, especially through additional programmes that strengthen institution-building in these countries.

Difficulties of Reaching the Decision Point (DP)

3. The difficulties in formulating viable macroeconomic and poverty reduction programmes in pre-decision point countries have been severely compounded by internal conflict, governance issues and in some cases, substantial arrears to the multilateral institutions. Of these, Liberia is now closest to reaching DP. It is expected to do so within months. It is also possible that Cote d'Ivoire, Comoros and Togo could reach the DP in 2008/09. Liberia's substantial arrears are being cleared through exceptional measures, especially through bridge loans by bilateral donors and subsequent IDA exceptional allocations and IMF programmes that pay off these bridge loans; thus effectively front loading HIPC debt relief. Under IDA-15 and AfDF-11, both these institutions have set up fragile states facilities to greatly enhance support to such countries. Apart from arrears clearance, an important priority for these initiatives should be to ensure that pre-decision point countries' capacities are increased so that they reach the HIPC DP as soon as possible.

Continued Limited Participation of Non-Paris Club Creditors

4. While the issue of the non-Paris Club creditors has been on the Commonwealth Ministerial Debt Sustainability Forum (CMDSF) agenda for more than five years, there has only been very limited progress. On the creditors' side, political factors, insufficient understanding of the HIPC Initiative and domestic legal as well as financial constraints, have been responsible. On the debtors' side the factors include: ambiguity about the status of debt, high cost of negotiation, reduced urgency due to MDRI relief, increased access to funding from these creditors and continued weak debt management capacity. For the purpose of encouraging participation by these creditors, the Paris Club has recently included a comparability of treatment clause in its agreements with CP HIPCs. IMF/World Bank involvement to date has been through discussing HIPC Initiative issues and sharing technical information with creditors. However, granting debt relief is essentially a high level political decision in creditor countries. In this respect, the CMDSF has repeatedly called, since its March 2003 Dar es Salaam meeting, for collective diplomatic initiatives, involving the Bretton Woods Institutions, key donors and HIPCs themselves, to encourage non-Paris Club

creditors' full participation in the initiative. CMDSF has also called in the past for donor assistance to cancel HIPC to HIPC debt.

Commercial Creditors and Litigation

5. Instead of providing comparable debt relief, a growing number of commercial creditors have been engaged in litigation against HIPCs, with a number having won lawsuits against them. To address some of the concerns, the international community has stepped up its efforts to discourage litigation against HIPCs: G7 and Paris Club have been intensifying their work on litigation with a view to identifying concrete measures; Commonwealth Secretariat has established a HIPC Legal Clinic; African Development Bank is exploring the possibility of establishing a technical assistance facility; and IMF/World Bank are providing contextual notes about various aspects of the HIPC Initiative whilst emphasising the need to operate with neutrality and impartiality in disputes among members. In this latter respect, the CMDSF has urged these institutions not to regard their proactive support for HIPCs in debt litigation as compromising their neutrality, as they will be supporting implementation of an initiative which they sponsored in the first place. The CMDSF have also repeatedly called for changes in the laws by governments of countries where commercial creditors reside to protect HIPCs from litigation and ensure that they, as a minimum, receive debt relief on terms equivalent to the HIPC Framework.

Implementation of the Multilateral Debt Relief Initiative (MDRI) and Related Initiatives

6. To date, all 23 post-completion-point HIPCs have qualified for MDRI and the related IADB initiative. This has resulted in debt relief on principal amounting to US\$38 billion in nominal terms. One of the major issues in relation to the MDRI and other related initiatives is their financing.

- Under both IDA-15 and AfDF-11 replenishments donors have made additional contributions to cover the MDRI costs incurred by these institutions over these replenishment cycles. Donors have given assurances that they would also provide compensatory financing in the future. However, as these compensation schemes spread very far into the future (40-50 years), there is always a possibility of donors renegeing at some point of time in the future. Thus the April 2007 Washington CMDSF pointed to the need for revisiting the proposal under which donors will provide the two institutions up-front the capital sum equivalent to the present value of the debt servicing cancelled over the next 40-50 years.
- Unlike IDA and AFDF, the cost of the IADB Fund for Special Operations (FSO) debt cancellation is being met internally, without any additional donor funding. This will reduce eligible countries' total resource allocations by 25 per cent and make them less concessional. In this respect, the April 2007 Washington CMDSF urged immediate negotiations for the replenishment of the FSO.
- With respect to the IMF, the original MDRI financing framework did not include Afghanistan, countries identified in the 2006 ring fencing exercise (Eritrea, Haiti, the Kyrgyz Republic and Nepal) and the three protracted arrears cases (Liberia, Sudan and Somalia). IMF will clearly need additional funding to support these cases. One possibility is generating these resources internally through gold sales.

7. CMDSFs have expressed concern about using existing Performance Based Allocation (PBA) for MDRI-induced compensatory finance from donors as this could discriminate against those countries which are furthest away from achieving the Millennium Development Goals (MDGs), thus negating the underlying rationale of MDG attainment that prompted MDRI launching by the G8. CMDSFs have strongly recommended that reaching the MDGs be weighted equally with country performance ratings in the formula for allocating MDRI-induced donor compensatory finance. IDA-15 and AfDF-11, while simplifying the PBA formula, did not give consideration to this proposal. However, both IDA and AfDF have established, as noted above, separate Fragile States Facilities, which will provide significant amount of additional resources above those allocated by the PBA formula. In so far as these fragile states have weak MDGs indicators, establishment of these facilities will help meet these important MDG needs.

Debt Sustainability Framework (DSF) and Non-Concessional Borrowing

8. The joint Bank-Fund DSF, launched in April 2005, has passed from its initial stage of development to a mature phase of implementation, with annual Debt Sustainability Analyses (DSAs) available for the majority of IDA-only countries, significant improvement in DSA's analytical rigour, and a clear process established to translate DSF-risk ratings into IDA traffic lights for grant/credit allocation.

9. A key issue, however, concerns the borrowing space created by MDRI and the risk that non-concessional loans to grant-eligible post-MDRI countries may lead to a rapid re-accumulation of debt and thus undermine borrowers' debt sustainability. Low-income countries (LICs) require significant investments for making progress towards MDGs, While substantial enhancements of IDA and AfDF concessional windows under the latest replenishments are welcome, donors need to maintain the momentum to translate their Gleneagles aid targets into definite pledges and commitments.

10. In order to counter excessive non-concessional borrowing by grant-eligible countries, IDA developed a Non-Concessional Borrowing Policy (NCBP) in July 2006 and a similar policy is also currently being developed by the AfDF. DSF is an important tool to assess whether non-concessional borrowing can be undertaken without undermining debt sustainability. In this respect, recent baseline DSAs of Uganda and Ghana, both strong performers, incorporate a significant amount of non-concessional borrowing for specific infrastructure development. Where, however, IDA believes that a country has been less than transparent in its non-concessional borrowing or where such borrowing is unwarranted, it may apply disincentives. The first case to be assessed under the new policy has been Angola which has undertaken US\$ 15 billion of non-concessional borrowing since 2004 and for which IDA has hardened the terms.

11. Angola illustrates severe limitations of the NCBP in cases where IDA financing is small relative to other sources and underlines the critical importance of promoting greater outreach of the DSF among other creditors and strengthened debt management practices amongst borrowing countries themselves.

12. A number of multilateral development banks (AfDF, AsSF and International Fund for Agricultural Development (IFAD) have already incorporated or are contemplating incorporating elements of DSF into their own financing terms. There is also an ongoing dialogue with the OECD Working Group on Export Credits and Guarantees (ECG), which,

among other things, has agreed to share this information with Bank/Fund. However, there remains a need for OECD ECG to promote sound and sustainable lending practices, utilising the DSF. The World Bank has also been active in promoting understandings with emerging market creditors and discussions are taking place about the possibility of collaboration with emerging market creditors in individual African country cases. There has to be greater information sharing and transparency in the policies of these creditors, while the Bank needs to familiarise these creditors with the technical details of the DSF.

13. Many lenders, however, may not abide by the DSF guidelines and it is therefore in the country's own best interest to ensure judicious borrowing that does not undermine debt sustainability. But this cannot be achieved in many LICs without greatly expanded debt management capacity to manage new borrowing. While there are a number of international providers of technical assistance on debt management, there is no systematic approach. The World Bank has proposed a global partnership to strengthen debt and macroeconomic management in LICs and CMDSF believed that this partnership should be institutionalised.

14. Overall, it might be recognised that LDCs require considerable external financing for much needed infrastructure development which is also linked to MDG attainment. The pressure to resort to unsustainable borrowings would be significantly reduced if donors meet the internationally agreed aid target of 0.7 per cent of GNP.

1. IMPLEMENTATION OF THE HIPC INITIATIVE

At the time of the Georgetown CMDSF Meeting in October 2007, 22 Countries had reached the Completion Point (CP), while there were a further 10 Interim Countries which had reached the Decision Point, the latest addition being the Central African Republic in September 2007. Since that time, in December 2007 the Gambia reached CP, benefiting by HIPC debt reduction of 27.2 per cent or \$66.6 million in NPV terms (or about \$140 million in nominal terms). With Gambia's addition, all Commonwealth HIPCs have now reached the CP. (see Table 1).

2. Four issues remain of particular importance in the implementation of the HIPC Initiative. These include the challenges of reaching the Completion Point (CP); the difficulties of reaching the Decision Point (DP) in particular the need for clearance of substantial arrears in some cases; continued limited participation of non-Paris Club creditors; and the ongoing challenges of dealing with commercial debt and creditor litigation.

Challenges of reaching the Completion Point

3. There are currently nine Interim Countries. Two of these, which are the most recent additions, are Afghanistan and Central African Republic. They will require some time before they reach the CP. Of the others, at least two (Burundi¹, Haiti²) could reach the CP in 2008. But in three cases (Chad and Guinea which reached decision points as far back as 2000-01 and also Democratic Republic of (DR) Congo), the timetable of reaching CP in 2008 has been slipping due to interruptions in their IMF supported programmes and difficulties in meeting their completion point triggers³. CPs in Republic of Congo and Guinea-Bissau are unlikely before end 2009 but could be delayed until 2010.

4. Experience suggests that the length of time spent between DP and CP has increased since 2000. Although country experiences are diverse, part of the reason appears to be the fact that most of the HIPCs that reached HIPC CP early were those that had made substantial progress under the original HIPC Initiative. Secondly, many of the post conflict countries have needed longer interim periods to address institutional weaknesses and gather sufficient political support to implement sustained reforms. The current stance of the international institutions is to maintain the ongoing dialogue with these countries and provide technical assistance to countries in formulating and implementing viable macroeconomic and poverty reduction programmes. However, many of these countries, which have reached the Decision

¹ *Burundi* (DP 2005), has a satisfactory macroeconomic track record, completed its full PRSP in September 2006 and has improved its social indicators markedly. However, triggers in relation to the privatisation of the coffee sector have been delayed, which has also delayed the reaching of the CP

² *Haiti* (DP 2006) has been meeting its macroeconomic and structural criteria and has also completed its full PRSP. With the satisfactory implementation of the latter, Haiti is expected to reach its CP before the end of 2008.

³ Both, *Chad and Guinea*, were originally expected to reach the CP by mid or end 2008. Chad is suffering some delays in meeting the completion point triggers. In the case of Guinea, a new PRGF programme is being approved and if it remains on track and the PRSP is satisfactorily implemented for a year, it could reach CP by early 2009. In the case of the *DR Congo* SMP implementation has been suspended, while there are expected to be delays in meeting the completion point triggers, delaying the CP originally expected in 2008.

Point, with great difficulty, also require a more proactive approach by the international institutions to assist them in addressing the challenging environment they face. In particular, they need to support additional programmes that strengthen institution building in these countries.

Difficulties of Reaching the Decision Point

5. There are currently nine ring-fenced (pre-decision point) countries, which had technically met the end-2004 income and indebtedness criteria to be so included, although two are unlikely to avail themselves of this debt relief⁴. To qualify for debt relief, these pre-decision point countries must put in place a track record of policy performance under IMF/IDA supported programmes and a satisfactory poverty reduction strategy. The difficulties in formulating viable macroeconomic and poverty reduction programmes in most of these countries have been severely compounded by internal conflict, governance issues and in some cases, substantial arrears to the multilateral institutions.

6. Of the pre-decision point countries, Liberia is now closest to reaching DP within months. In February 2008, the IMF and the World Bank deemed Liberia eligible for HIPC debt relief provided it satisfies the Staff Monitored Programme (SMP), reaches understandings on the Completion Point triggers and clears arrears with multilateral creditors. With respect to the latter, pledges are being formalised. It is possible that three further countries (Cote d'Ivoire⁵, Comoros⁶ and Togo⁷) could reach the DP in 2008 or soon thereafter, provided sufficient progress is made in clearing arrears and establishing a PRGF programme. In three countries, the date for the DP is uncertain or cannot be determined (Sudan⁸, Eritrea⁹ and Somalia¹⁰)

⁴ Although included and having a PRSP since 2003, *Kyrgyz Republic* made a decision not to apply for HIPC relief and has made encouraging progress in improving its debt situation. *Nepal*, which also has a PRSP since 2003 and has been emerging out of severe internal conflict, has not yet made a decision regarding participation in the HIPC initiative.

⁵ Cote d'Ivoire, following the Peace Accord in March 2007, is continuing to make progress on several fronts. It is expected that satisfactory implementation of the Emergency Post Conflict Assistance (EPCA) would be a bridge to new IMF supported PRGF programme. Since July 2007, Cote d'Ivoire has been current on its debt service obligations to the World Bank and the African Development Bank, and arrears to both these institutions should have been settled by April 2008. With an Interim PRSP has been in place since 2002 and institutional process for managing the PRS process since 2005, the government anticipates completion of the full PRSP by September 2008. With all the ingredients in place Cote d'Ivoire could reach DP by mid-2008.

⁶ Comoros has had IMF Staff Monitored Programme (SMP) since 2005 (and an I-PSRP since 2006) but initiation of a PRGF programme has been on hold due to inter-island issues. At the same time, the required financing assurances for a PRGF have been lined up following AfDB's approval for arrears clearance operation under its Post-Conflict Country Facility (PCCF), but a donor conference can only be scheduled once the political crisis is resolved.

⁷ Togo also has had an SMP, successful performance under which could pave the way for a PRGF programme, although it would first need to reach understanding on external arrears clearance. Draft I-PRSP, which has long been prepared, also needs to be submitted to IMF/IDA for approval.

⁸ In Sudan, the peace accord in Southern Sudan has been followed by conflict in Darfur. It has had a string of SMPs, the latest agreed towards the end of last year. The timing of the Decision Point remains uncertain because of the need for substantial arrears clearance and establishment of a policy track record. Although I-PRSP was drafted more than three years ago, it has never been submitted for IMF/World Bank approval.

7. It is important for the international community, together with the national authorities, to redouble their efforts so that countries, which are in a position to reach the DP, do so expeditiously. One key requirement for reaching the DP is clearance of arrears to multilateral institutions or programming of their clearance. Most HIPC^s have cleared arrears before qualifying for debt relief because of their relatively small scale, both in absolute and relative terms, in relation to the size of their economies, revenues, exports and multilateral creditors' possible allocations. However, for a number of countries arrears are very large in relation to these measures. Recently the international community undertook some exceptional measures in the case of Liberia, 96 per cent of whose external debt was in arrears as of June 2007:

- Arrears to IBRD and IDA were cleared in December 2007 through a bridge loan provided by a bilateral donor. Liberia then used the proceeds of an operation financed with an exceptional allocation of IDA resources, provided on grant terms, to repay the bridge loan.
- Arrears to the AfDB Group were also cleared in December 2007 through its Post Conflict Countries Facility (PCCF). The cost for clearing arrears is generally shared by the country, donors, and the PCCF, with the proportion of the cost covered by each participant determined on a case by case basis. For Liberia, one-third of the cost was financed by bilateral donors and two-thirds from PCCF resources. In recognition of Liberia's limited payment capacity, the country received bilateral donor assistance to finance the 1 per cent contribution that would otherwise have been required from them.
- Arrears to the IMF are also expected to have been cleared through a bridge loan obtained from a bilateral donor, which would allow new operations by the IMF financed by PRGF/ESF, which would be used to repay the bridge loan.
- Arrears clearance with remaining multilateral creditors still needs to be agreed and the authorities are continuing discussions with the remaining multilaterals to normalize arrears on terms consistent with Liberia's limited repayment capacity.

8. Both IDA and AfDF are also looking at further ways of enhancing support to fragile states (which would include most pre-decision point countries) under IDA-15 and AFDF-11 replenishments. In the past replenishments, IDA has deviated from the Performance Based Allocation (PBA) System to provide exceptional allocations to post-conflict and re-engaging fragile states. In the case of post-conflict states, improvements under IDA-15 include linking of post-conflict allocations to the overall size of the IDA envelope and lengthening the phase out period of post-conflict allocations from 3 to 6 years. For the re-engaging countries (after a prolonged period of inactivity), criteria for eligibility have been elaborated, with clear

⁹ Eritrea continues to be in a state of mobilisation. I-PRSP, drafted in 2003, has never been finalised. Although the government has expressed an interest in an SMP, it has so far not been concluded.

¹⁰ In Somalia, the political and security situation remains fragile, with a lack of fully functioning national authority and continued domestic conflict. In such a situation it is not feasible either to have a PRSP process or an IMF programme.

guidelines for determining the size of exceptional allocations. The proposed changes, with its financial implications, are part of the IDA-15 replenishment, with an additional SDR430 million for the current post-conflict recipients, SDR430 million for potential entrants, and SDR 110 million for those re-engaging with IDA. AfDF is also establishing a stand-alone Fragile States Facility (FSF) which will provide supplementary resources over and above the normal PBA allocations, more support for arrears clearance by integrating the PCCF with the FSF and enhanced capacity-building initiatives for these countries. An important priority for these initiatives should be to ensure that pre-decision point countries' capacities are greatly increased so that they reach the HIPC DP as soon as possible

Continued Limited Participation of Non-Paris Club Creditors

9. While all Paris Club creditors and almost all multilateral institutions have provided HIPC relief, the voluntary nature of the HIPC Initiative has contributed to the low participation of non-Paris Club official bilateral creditors. IMF/World Bank staff estimate that these creditors have only delivered around one third of the debt relief expected under the HIPC Initiative, with significant variation across countries (see Table 2):

- Only 6 countries have provided full HIPC Initiative debt relief, or less than 1 per cent of the total relief to be granted by non-Paris Club creditors to HIPCs.
- 23 countries accounting for about 66 per cent of the expected relief, have provided partial relief, with ten having provided more than two thirds of the expected relief and another two over 50 per cent; relief from the remainder is less or uncertain.
- 21 other creditors accounting for 34 per cent of the expected relief have not provided any relief.

10. While the issue of the non-Paris Club creditors has been on the CMDSF agenda for more than five years, there has only been very limited progress. A number of factors are responsible. On the creditors' side these include:

- Political factors (e.g. parliamentary disapproval in Libya, which had initially agreed to participate; need for highest political decision in Algeria; Polish decision subject to consultation with each HIPC partner).
- Insufficient understanding of the HIPC Initiative, including the concept of burden sharing (sometimes confusion with provision of traditional debt relief or contribution to IMF PRGF facility).
- Domestic legal constraints (particularly if the debt is held by the Central Bank (Columbia, Ecuador) or specialized agencies (Korea) or public enterprises or public credit agencies (Bulgaria, China and India, where negotiations have been protracted).
- Financial constraints (e.g. Uruguay, Honduras and indeed other HIPCs which are also creditors).

11. On the debtors' side the factors include:

- Ambiguity about the status of debt due to lack of billing by creditors, which may be perceived as waiver of obligation to pay (e.g. China, Libya) or confusion caused by public announcements which are not clarified (e.g. China, India).
- High cost of negotiation, particularly where creditors' claims are small (e.g. Tanzania has 20 such creditors with expected relief ranging from US\$1million to US\$35 million).
- Reduced urgency on the part of HIPC's due to a much lower debt burden resulting from HIPC and MDRI relief.
- Some HIPC's' increased access to credits from these creditors, reducing incentives to reach debt relief agreements.
- Continued weak debt management capacity in most HIPC's

12. For the purpose of encouraging non-Paris Club participation, the Paris Club has recently included a comparability of treatment clause in its agreements with CP HIPC's. The aim is to encourage them to start or resume negotiations with non-Paris Club creditors; to strengthen their debt management capacity by establishing a formal negotiating structure and a point of contact for all creditors; and to require them to report on the status every six months.

13. IMF/World Bank involvement to-date has been through discussing HIPC Initiative issues and sharing technical information during Article IV missions and other interactions with creditors, contacting these creditors directly when these countries reach decision or completion points, providing technical assistance to enhance creditors' understanding of the HIPC methodology, facilitating bilateral meetings between creditors and HIPC's during Annual meetings and other venues, and collecting information on the status of the delivery of HIPC assistance by these creditors. These technical level efforts need to be intensified. The idea of a scoreboard has been supported by the Executive Boards of the two institutions, although some Directors remain skeptical of its usefulness.

14. It has to be recognized that the decision to grant debt relief is not primarily a technical issue (as seen through IMF/World Bank initiatives) or within the powers of HIPC debtors alone to influence (as perceived by the Paris Club). It is dependent primarily on high level political approval in creditor countries. One idea suggested by the IMF/World Bank staff is high level contacts by the Management of the two institutions with creditors, but this has not been formally approved by the Executive Directors, partly reflecting the fact some of the Executive Directors come from the very countries which have not provided relief. There is also a problem of the limited capacity of the Bretton Woods institutions to influence countries which are currently not members (e.g. Taiwan Province of China and North Korea). Therefore concerted pressure is needed from all quarters. In this respect, the CMDSF has repeatedly called, since its March 2003 Dar es Salaam meeting, for collective diplomatic initiatives, comprising Bretton Woods Institutions, key donors and HIPC's themselves, to encourage non-Paris Club creditors' full participation in the initiative.

15. CMDSF has also called in the past for donor assistance to cancel HIPC to HIPC debt. In this respect, the buyback of debt owed to Tanzania by Uganda at 10 per cent of the face

value, funded by Austria, provides a useful pointer. There are only a handful of HIPC creditor claims. These could be dealt with through co-operation with donors at minimal cost

Commercial Creditors and Litigation

16. Although accounting for less than 4 per cent of the HIPC Initiative debt relief cost, commercial creditors have generally not committed to provide HIPC debt relief. On the other hand, a growing number of commercial creditors and distressed debt (vulture) funds have been engaged in litigation against HIPCs. A 2006 IMF/World Bank Staff Survey noted that 11 out of the 24 respondents had lawsuits filed against them by a total of 44 creditors. Six new legal cases have been reported since the 2006 survey, five against Nicaragua and one against Ethiopia. Some countries have reported being threatened by additional litigation (Sierra Leone and Cameroon). HIPCs facing most litigation cases are Nicaragua (9), Republic of Congo (8) and Uganda (8). Most lawsuits have been filed in the industrial country courts (USA, UK as well as British Virgin Islands). More than half of the litigating creditors have won lawsuits against HIPCs. For example, eight HIPCs¹¹ received judgments to pay US\$1 billion against original claims of US\$434 million. A few HIPCs have reached out of court settlements¹². International commercial arbitration proceedings are reported against three HIPCs¹³. Lawsuits against five HIPCs are still pending¹⁴

17. Creditor litigation has a number of negative consequences for HIPCs. Lengthy legal proceedings pose severe constraints on budgets and institutional resources. Also, low participation may delay the release of IMF interim debt relief. For example, as of end-2007, IMF did not have sufficient assurances of creditor participation to start disbursing interim debt relief to Rep Congo. Significant debt to commercial creditors may make it difficult for some pre-decision point HIPCs to meet the threshold for IMF interim assistance. Finally, commercial creditor litigation undermines the HIPC initiative goal of proportional burden sharing and prevents HIPCs from using resources freed by debt relief for intended purposes

18. To address some of the concerns, the international community has stepped up its efforts to discourage litigation against HIPCs.

- The G7 Finance Ministers agreed, in May 2007, to work together to identify measures to deal with litigations against HIPCs.
- Paris Club creditors confirmed their commitment not to sell their claims on HIPCs to creditors who do not intend to provide HIPC debt relief and in addition have agreed to intensify their work on litigation issues with a view to identifying concrete measures to tackle this problem.
- In September 2006, the Commonwealth Secretariat established a HIPC Legal Clinic to raise awareness about the risks and implications of litigation and the African Development Bank is also exploring the possibility of establishing a technical assistance facility.

¹¹ Cameroon, DR Congo, Rep Congo, Guyana, Nicaragua, Sierra Leone, Uganda, and Zambia

¹² Rep Congo, Guyana, Sierra Leone and Uganda

¹³ Cameroon, Ethiopia and Sao Tome Principe

¹⁴ Camerron, Honduras, Nicaragua, Sierra Leone and Uganda

19. The IMF/World Bank are providing contextual notes: factual information about various aspects of the HIPC Initiative including information on litigation. They are also encouraging countries to act swiftly to negotiate debt restructuring agreements. The World Bank, through its IDA Debt Reduction Facility, is assisting HIPCs to buy back their external debt from commercial creditors at a deep discount. These institutions, however, note their limited ability to encourage commercial creditor participation in the HIPC Initiative, particularly as they are constrained by the need for them to operate with neutrality and impartiality in dispute among members. In this respect, the CMDSF has urged these institutions not to regard their proactive support for HIPCs in debt litigation as compromising their neutrality. This is particularly so, as these institutions will be supporting implementation of an initiative which they sponsored in the first place.

20. The CMDSFs have also repeatedly called for changes in the laws by governments of countries where commercial creditors reside to protect HIPCs from litigation and ensure that they, as a minimum, receive debt relief on terms equivalent to the HIPC Framework. But IMF/World Bank foresee difficulties in doing this because of the ramifications on debtor-creditor relations. However, just as key countries enacted legislation on anti-terrorist financing in the wake of September 11 attacks, sensitization of key governments and political will is needed for such changes in legislation.

II. IMPLEMENTATION OF THE MULTILATERAL DEBT RELIEF INITIATIVE (MDRI) AND THE RELATED IADB INITIATIVE

21. The MDRI was launched in 2005 to provide 100 per cent debt cancellation to qualifying HIPCs from the IMF, IDA and the African Development Fund (AfDF). In 2007, the Inter-American Development Bank (IADB) launched its own parallel initiative to provide 100 per cent debt cancellation for five Latin American HIPCs. To date, all 23 post-completion-point HIPCs have qualified for the MDRI and the related IADB initiative. This has resulted in debt relief on principal amounting to US\$38 billion in nominal terms (see Table 1). All other HIPCs would qualify for debt relief under the MDRI once they reach their CPs.. The overall cost in nominal terms of MDRI to the key institutions is as follows:

- IDA: US\$33 billion of principal, of which US\$25.8 billion of principal cancellation has already been delivered to post-completion countries. In addition, forgone interest to these post-completion countries amounts to US\$2.5 billion.
- IMF: US\$4.3 billion, of which US\$3.1 billion has been delivered to post completion HIPCs and US\$182 million to two non-HIPCs, Cambodia and Tajikistan¹⁵
- AfDF: US\$7.4 billion in principal amounts of which US\$ 5.7 billion has already been delivered to post completion countries (which in addition have also benefited from US\$0.8 billion in forgone interest).

¹⁵ IMF also provided MDRI debt relief to two non HIPC countries with annual per capita income below US\$380 (Cambodia and Tajikistan) to fit the requirement that the use of IMF's own resources must be consistent with the principle of uniformity of treatment

- IADB 2007 Initiative: US\$3.4 billion in principal amount of which US\$3 billion has already been delivered to four Latin American post completion point HIPC. (These countries have also benefited from US\$0.9 billion in forgone interest).

Financing of MDRI and related initiatives

22. One of the major issues in relation to the MDRI and other related initiatives is their financing. For IDA and AfDF, a key aspect is compensatory financing from donors to ensure that their lending capacities are not impaired. Under both IDA-15 and AfDF-11 replenishments donors have made additional contributions to cover the MDRI costs incurred by these institutions over these replenishment cycles. At the time of the establishment of the MDRI, donors also gave assurances that they would provide compensatory financing in the future. However, these compensation schemes spread very far into the future (40-50 years) and there is always a possibility of donors reneging at some point of time in the future. Thus the April 2007 Washington CMDSF pointed to the need for revisiting the proposal under which donors would provide the two institutions upfront the capital sum equivalent to the present value of the debt servicing cancelled over the next 40-50 years.

23. Unlike IDA and AfDF, the cost of the IADB SFO debt cancellation is being met internally, without any additional donor funding. It will reduce eligible countries' total resource allocations by 25 per cent; make the terms of their borrowing less concessional (with a blend of concessional FSO and non-concessional ordinary capital resources (OCR); cancel undisbursed loan allocations; and exchange part of the allocations against countries' local currency contributions to the FSO. In terms of the overall impact of the package on resource flows between 2007 and 2015, it appears that Guyana, Haiti and Nicaragua are expected to lose. In this respect, the April Washington CMDSF urged immediate negotiations for the replenishment of the FSO.

24. With respect to the IMF, the original MDRI financing framework did not include Afghanistan; countries identified in the 2006 ring fencing exercise (Eritrea, Haiti, the Kyrgyz Republic and Nepal); and the three protracted arrears cases (Liberia, Sudan and Somalia). IMF will clearly need additional funding to support these cases. One possibility is generating these resources internally through gold sales.

MDRI and MDGs

25. As conceived, before additional contributions are taken into account, MDRI relief from IDA and AfDF does not affect, for reasons of equity, the net resource transfers to all beneficiary countries (HIPCs and non-HIPCs) due to the netting off mechanism. However, CMDSFs have expressed concern about using existing performance based formula for allocating MDRI-induced compensatory finance from donors as this could discriminate against those countries which are furthest away from achieving the Millennium Development Goals (MDGs), thus negating the underlying rationale that prompted launching of the MDRI by the G8. CMDSFs have strongly recommended that reaching the MDGs be weighted equally with country performance ratings in the formula for allocating MDRI-induced donor compensatory finance. IDA-15 and AfDF-11, while simplifying the Performance Based Allocation (PBA) formula did not give consideration to this proposal. However, both IDA and AfDF have established, as noted above, separate Fragile States Facilities, which will provide significant additional resources above those allocated by the PBA formula. In so far

as these fragile states have weak MDG indicators, establishment of these facilities will help to meet these MDG related needs.

Other MDRI Issues

26. A number of other MDRI-related issues have also been reiterated by the CMDSFs in their previous meetings:

- While the MDRI is an initiative common to three institutions, their implementation modalities vary, with the implementation date in IDA at July 2006 (compared to January 2006 for IMF and AfDF) and the cut-off date for eligible debt in the case of IDA at end-2003 (compared to end-2004 for IMF and AfDF), primarily to reduce the amount of eligible debt for MDRI relief. CMDSFs have called for consistency between institutions and in particular for IDA to reconsider its stand
- The prospect of reduced MDRI relief for pre-completion point HIPCs, given that by the time they reach CP debts that are eligible for MDRI relief could have been fully or partially repaid. CMDSFs have called for exploration of a number of options, including delivery of MDRI to take retroactive effect from a particular common date (with refunds made for repayments already made on eligible debts) and/or delinking MDRI from the HIPC Process.
- The actual unintended non-uniform treatment between pre-completion point HIPCs with per capita income at or below \$380 vis-à-vis their non-HIPC counterparts, with the latter given fast track MDRI relief after one type conditionality check, while the former are required to reach the CP before qualifying for MDRI. The CMDSFs have called for uniformity of treatment.
- Need, for reasons of equity, to widen the scope for MDRI to include all IDA-only countries that wish to avail themselves of this option, as this could benefit IDA-only countries which do not qualify for HIPC relief because their indebtedness ratios are below HIPC thresholds, but would benefit from such relief in their pursuit of the MDGs.

III. DEBT SUSTAINABILITY FRAMEWORK (DSF) AND NON-CONCESSIONAL BORROWING

27. Following the implementation of the HIPC Initiative and the MDRI, IDA has taken a number of steps in order to help countries maintain debt sustainability. The joint Bank-Fund DSF, launched in April 2005, has passed from its initial stage of development to a mature phase of implementation. Annual Debt Sustainability Analyses (DSAs) are now available for the majority of IDA-only countries and for many countries they have been completed for the second or third time. There have also been improvements in the analytical rigour of forward-looking DSAs.

28. At the same time, the DSF-based grant allocation system has been functioning smoothly, with a clear process established to translate DSF-risk ratings into IDA traffic lights. For most of the 59 eligible countries, grant eligibility is now based on forward looking DSAs. The relationship between debt distress ratings and IDA traffic lights are guided by

clear rules, although some element of judgement has been incorporated for those cases where changed country circumstances are not reflected in available DSAs or in borderline cases.

29. A key issue, however, concerns the borrowing space created by MDRI and the risk that non-concessional loans to grant-eligible and post-MDRI countries may lead to a rapid re-accumulation of debt and thus undermine borrowers' debt sustainability. Low-income countries (LICs) require significant investments for making progress towards MDGs, which underlines the critical importance of enhancement of concessional resources by donor countries. In this respect, while substantial enhancements of IDA and AfDF windows under the latest replenishments are welcome, donors need to maintain the momentum to translate their Gleneagles aid targets into definite pledges and commitments. According to the November 2006 DSF review paper, failure to provide higher levels of concessional resources can lead to a return to pre-debt relief levels of indebtedness in 6 to 10 years in some cases.

IDA's Non-Concessional Borrowing Policy (NCBP)

30. In order to counter excessive non-concessional borrowing by grant-eligible countries, IDA developed a Non-Concessional Borrowing Policy (NCBP) in July 2006. In essence it provides a concessionality guideline for each country, considers when non-concessional borrowing is warranted and sets out disincentives for countries that undertake unwarranted non-concessional borrowing. A similar policy is also currently being developed by the AfDF.

31. DSF is an important tool to assess whether non-concessional borrowing can be undertaken without undermining debt sustainability. In this respect, recent DSAs of Uganda¹⁶ and Ghana¹⁷, both strong performers, incorporate a significant amount of non-concessional borrowing for specific infrastructure development. The baseline under both cases show continuing low risk of debt distress and other scenarios show even the possibility of accommodating higher levels of non-concessional borrowing, with however a note of caution that excessive levels of such borrowing can increase the risk of debt distress.

32. Where IDA believes that a country has been less than transparent in its non-concessional borrowing or where such borrowing is unwarranted, it may apply disincentives. The first case to be assessed under the new policy was that of Angola, a mineral resource rich country. Angola has contracted a substantial amount of non-concessional borrowing since 2004 (estimated at US\$15.5 billion or 35 per cent of GDP), some after the coming into effect of the NCBP. Angola has also not been transparent in revealing the terms of such borrowing. If Angola were to continue receiving grants, it was felt that this was an improper use of IDA grants. If the volume of funding was reduced, this would also curtail IDA's engagement with the country. The compromise was a decision to harden IDA terms for Angola.

¹⁶ Uganda baseline DSA assumes that the government would contract or guarantee debt on non-concessional terms up to US\$400 million, with an annual average disbursements of ¾ % of GDP, primarily to finance the Bujagali hydroelectric plant. An alternative high investment scenario was also developed to reflect even higher investment in infrastructure: Karuma and the oil sector US\$422 million during 2007/08 to 2010/11 and in other infrastructure projects US\$1.5 billion during the first decade and US\$2 billion in the subsequent decade. Public financing of these additional investments is assumed through a blend of 25% concessional and 75% non-concessional loans

¹⁷ The baseline scenario for Ghana assumes non-concessional borrowing of US\$200-350 million (2007-2011) and continued market access of 1% of GDP to 2026. Several additional scenarios of further high borrowing and low growth pay offs are also included in the case of Ghana.

33. Another case of a resource rich country, which appears to have contracted substantial non-concessional borrowing, has been DR Congo. This country is unique in that it has so far not reached the CP. Such borrowing by it could undermine DR Congo ever doing so and receiving full HIPC and MDRI relief.

34. The cases of Angola and DR Congo illustrate severe limitations of the NCBP in cases where IDA financing is small relative to other sources and the disincentive effect is small. They underline the critical importance of promoting greater outreach of the DSF among other creditors and strengthened debt management practices amongst borrowing countries themselves.

Promoting Creditor Outreach of DSF

35. IDA has been seeking to encourage other creditors to use the DSF as a guide for their lending policy. In this respect, a number of steps have been taken. DSAs have been made user-friendly and are now widely accessible on the IMF/World Bank websites. A more active role is also being promoted for the regional development banks in the DSF process. A number of multilateral development banks (AfDF, AsSF and International Fund for Agricultural Development (IFAD) have already incorporated or are contemplating incorporating elements of the DSF into their own financing terms. However, some MDBs are still lending on non-concessional terms to grant-eligible countries and there is a particular need to strengthen the outreach with these creditors, particularly as MDBs are likely to account for the bulk of the new borrowing by these countries.

36. The 2006 DSF review also highlights the threats to debt sustainability if significant new borrowing is contracted at or near market terms. In this respect, there is an ongoing dialogue with the OECD Working Group on Export Credits and Guarantees (ECG), which has agreed to reinstate a streamlined version of the commitment data on lending to IDA-only countries and share this information with Bank/Fund; and also to extend the statement of principles on unproductive expenditures from the group of HIPCs to all IDA-only countries. However, there is a need for OECD ECG to promote sound and sustainable lending practices on the basis of the DSF. The IMF/World Bank can provide advice in this regard.

37. The World Bank has also been active in promoting understandings with emerging market creditors. A MOU has been concluded with the Chinese Eximbank. Discussions are taking place about the possibility of collaboration with emerging market creditors in individual African country cases. Much more needs to be done in this regard. There has to be greater information sharing, including greater transparency in the policies of these creditors. The Bank needs to familiarise these creditors with the technical details of the DSF.

Promoting better debt management capacities in LICs

38. Many lenders, however, may not abide by the DSF guidelines if it is not in their interest to do so. In the final analysis it is in the country's own best interest to ensure judicious borrowing that does not undermine debt sustainability. However, many LICs have capacity constraints in undertaking their own DSAs and in debt management. This means there is urgent need for greatly expanded capacity building in LICs to manage new borrowing. A 2007 World Bank paper on strengthening debt management practices noted that while there were a number of international providers of technical assistance on debt management, each specialised in a particular area and there was no systematic approach. The

World Bank has proposed a global partnership to strengthen debt and macroeconomic management in LICs and CMDSF believed that this partnership should be institutionalised (in a form similar to the Integrated Framework for Trade Related Technical Assistance) to build debt management capacity and promote best practices.

Table 1: HIPC Initiative & MDRI: Committed Debt relief and Outlook (1)
(millions of US\$)

	Decision Point Date	Completion Point Date	Assistance Under HIPC Initiative in NPV terms at DP (3)(4)	MDRI Assistance in nominal terms (2)	Total HIPC+ MDRI in nominal terms
23 Completion Point Countries			45394	42123	87516
Benin	Jul-00	Mar-03	262	460	1558
Bolivia (5)	Feb-00	Jun-01	1330	2060	4861
Burkina Faso (5) (6)	Jul-00	Apr-02	553	930	2091
Cameroon	Oct-00	Apr-06	1267	4917	6183
Ethiopia (6)	Nov-01	Apr-03	1935	3275	6483
Gambia	Dec-00	Dec-07	67	140	514
Ghana	Feb-02	Jul-04	2187	3500	7301
Guyana (5)	Nov-00	Dec-03	591	1354	2059
Honduras	Jun-00	Apr-05	556	1000	3703
Madagascar	Dec-00	Oct-04	836	1900	4239
Malawi (6)	Dec-00	Aug-06	939	1600	3126
Mali (5)	Sep-00	Mar-03	539	895	2809
Mauritania	Feb-00	Jun-02	622	1100	1955
Mozambique (5)	Apr-00	Sep-01	2143	4300	6290
Nicaragua	Dec-00	Jan-04	3308	4500	6395
Niger (6)	Dec-00	Apr-04	644	1190	2216
Rwanda (6)	Dec-00	Apr-05	651	1316	1801
SaoTome Principe (€)	Dec-00	Mar-07	117	263	322
Senegal	Jun-00	Apr-04	488	850	3258
Sierra Leone	Mar-02	Dec-06	675	994	1638
Tanzania	Apr-00	Nov-01	2026	3000	6743
Uganda (5)	Feb-00	May-00	1027	1950	5372
Zambia	Dec-00	Apr-05	2499	3900	6599
9 Interim Countries			18810		18810
Afghanistan	Jul-07		571	1272	1272
Burundi	Aug-05		826	1465	1465
Central African Rep	Sep-07		583	740	740
Chad	May-01		170	260	260
Congo Dem Rep	Jul-03		6311	10389	10389
Congo Rep	Mar-06		1679	2881	2881
Guinea	Dec-00		545	800	800
Guinea Bissau	Dec-00		416	790	790
Haiti	Nov-06		140	213	213
Total Debt Relief Committed (7)			64204	42305	106508

Source: IDA/IMF HIPC Initiative & MDRI Status of Implementation Sep 2007, IMF press releases on Gambia and Central African Rep.

Notes

- (1) Committed debt relief under the assumption of full participation of creditors
- (2) Nominal MDRI costs include principal and interest forgone for all multilateral participants except IMF which only includes principal
- (3) Topping Up and assistance provided under the original HIPC Initiative are expressed in NPV terms at the time of the DP
- (4) No totals are shown as the amounts are in different NPV terms (according to the date of the DP)
- (5) Also reached completion point under the original HIPC Initiative. Amounts include original debt relief
- (6) Assistance includes topping up at completion point
- (7) the total also includes IMF MDRI relief of US\$182 million to two non-HIPCS :Cambodia and Tajikistan

Table 2: Debt Relief Committed and Delivered by Non-Paris Club Creditors to Completion Point (CP) HIPCs (1)
(in millions of US\$ 2006 NPV terms unless otherwise indicated)

Creditor Country	No of CP HIPCs		HIPC Assistance Costs		HIPC Assistance Delivered	
	Total	Relief Provided	NPV terms	% of total Cost	NPV terms	% of total assistance
1. Full Delivery of HIPC Relief (6 Creditors)						
Jamaica	1	1	0.2	0	0.2	100
Morocco	1	1	2.8	0.1	2.8	100
Rep Korea	2	2	7	0.2	7	100
Rwanda	1	1	0.7	0	0.7	100
South Africa (2)	2	2	6	0.2	6	100
Trinidad and Tobago (2)	1	1	0.6	0	0.6	100
Total			17.3	0.5	17.3	100
2. Partial Delivery of HIPC Relief (23 Creditors)						
Algeria	11	1	240.3	6.9	12.5	5.2
Argentina	2	1	4.9	0.1	3	59.9
Brazil (2)	2	1	8.5	0.2	6.5	76.8
Bulgaria	6	3	107.7	3.1	83.3-93.2	77.3-86.5
Burundi (3)	1	1	0.2	0
China (4)	20	17	281.1	8	95.3-140.8	33.9-50.1
Cuba	2	1	2	0.1	0.2	8.4
Former Czechoslovakia (5)	5	3	48.9	1.4	38.9	79.7
Former Yugoslavia (5)	6	1	86.6	2.5	0.0-36.8	0-42.4
Guatemala (6)	2	1	470.8	13.4	464.4	98.6
Hungary	4	3	18.8	0.5	13.7	72.7
India (7)	7	5	37.7	1.1	12.1-33.5	32.0-88.9
Kuwait (8)	18	14	302.2	8.6	206.1	68.2
Libya	13	3	276.8	7.9	26.2-46.3	9.5-16.7
Mexico	2	1	66.5	1.9	54.2	81.5
DR Korea	7	1	29.6	0.8	2.1	7.2
Poland	4	2	20.8	0.6	13.8	66.3
Romania	3	1	38	1.1	33.5	88.1
Saudi Arabia	13	10	161.5	4.6	76.3-125.9	47.3-77.9
Tanzania (3)	1	1	4.2	0.1
United Arab Emirates	9	1	28.2	0.8	0-2.6	0-9.3
Venezuela	4	1	72	2.1	26.7	37.1
Total			2307.3	65.9	1168.8-1359.1	50.7-58.9
3. No Delivery of HIPC Relief (21 Creditors)						
Angola	4	0	25.2	0.7	0	0
Cape Verde	1	0	0.3	0	0	0
Columbia	1	0	4.8	0.1	0	0
Costa Rica	2	0	495.5	14.2	0	0
Cote d'Ivoire	2	0	13.2	0.4	0	0
DR Congo	1	0	0.4	0	0	0
Ecuador	1	0	0.5	0	0	0
Egypt	1	0	0.5	0	0	0
Honduras	1	0	127.4	3.6	0	0
Iran	2	0	70.9	2	0	0
Iraq	9	0	110.8	3.2	0	0
Niger	1	0	0.4	0	0	0
Nigeria	1	0	2.1	0.1	0	0
Oman	1	0	1.6	0	0	0
Pakistan	1	0	1.3	0	0	0
Peru	1	0	9.9	0.3	0	0
Portugal (2)	1	0	7.5	0.2	0	0
Taiwan China	7	0	303.5	8.7	0	0
Uruguay	1	0	0.7	0	0	0
Zambia	1	0	0.2	0	0	0
Zimbabwe	1	0	0.1	0	0	0
Total			1176.5	33.6	0	0
Grand Total			3501	100	1186.1-1376.4	33.9-39.3

Sources: IDA/IMF HIPC Initiative & MDRI Status of Implementation Sep 2007 based on HIPC documents; country authorities; and fund and bank staff estimates

1/Estimates are based on information received as of October 2007 and are for creditors who have claims on post-completion-point countries only

2/While not a member of the Paris Club, Brazil has agreed to participate in the Paris Club rescheduling meeting for most HIPCs and provided substantive debt relief in the context of the Paris Club. South Africa has been classified as a Non-Paris Club for Mozambique and Malawi. However, South Africa

did not participate in the Paris club exit meetings for Benin and Malawi. Similarly, Trinidad and Tobago has been classified as a non-Paris club for

Nicaragua. However, it has provided debt relief to Nicaragua outside of the Paris Club. Brazil has been classified as non-Paris Club

for Bolivia and Guyana, although it actually participated in Paris Club meeting for Bolivia. Brazil did not participate in the Paris club meeting for Nicaragua.

Taking into consideration all relief provided outside the Paris club would increase the HIPC debt relief provided by Brazil to US\$550.1 million and its share

of HIPC debt relief provided as a non-Paris club creditor to 96.2 percent. Portugal has also provided debt relief under the Paris club.

3/In these cases, there is only one debtor. Debtors have indicated that some relief has been provided but the information received is insufficient to

quantify it.

4/The debt relief estimates for China are based on debt cancellations data provided by debtors.

5/Partition of HIPC loans outstanding at decision point and the associated debt relief between the Czech Republic and the Slovak Republic, as well as

among members of the former Yugoslavia is being determined with the help of the authorities. The table will be updated once the information is

available.

6/Guatemala claims that Nicaragua were taken over by Spain in a debt swap. Spain has agreed to provide HIPC debt relief to Nicaragua on those claims.

7/In June 2003, India announced its intention to write off all non-export credit claims on HIPCs. However, several agreements remain unsigned. India has

not yet agreed to provided full relief on export-credit claims.

8/Debt relief estimates for Kuwait are based on detailed loan by loan information provided by Kuwait Fund for Arab Economic Development

(KFAED).