

INTERNATIONAL MONETARY FUND AND THE WORLD BANK

**Assistance to Post-Conflict Countries and the HIPC Framework**

Prepared jointly by the staffs of  
The World Bank: Resource Mobilization Department  
and  
The IMF: Policy Development and Review and Treasurer's Departments

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## Executive Summary

The past decade has witnessed a proliferation of armed conflicts in low-income countries. These conflicts are a major impediment to their economic and social development. They also have regional, and even global, implications through dislocation of economic activity, displacement of populations and rapid spread of disease, notably, HIV/AIDS. Most low-income conflict-affected countries are also heavily indebted and some have arrears to the International Financial Institutions (IFIs). They pose a special challenge to the international community because of the urgency of speedy and effective action to help break the cycle of violence, low growth, and poverty.

Both the Bank and the Fund have special policies and instruments in place to assist countries as they emerge from conflict. These policies and instruments have proved to be broadly effective. This paper describes the policies that guide Bank and Fund assistance to these countries, and considers how further to enhance them in specific areas. A main focus of the paper is how to ensure timely and adequate assistance to these countries within the HIPC Initiative framework. The main observations are:

- Bank and Fund staffs can help meet substantial needs for technical assistance, including by assessing needs early on, and formulating an action plan for delivering technical assistance into the medium term. Bank staff propose to finance such assistance in post-conflict countries with arrears by scaling up the Post-Conflict Fund and/or broadening the scope of pre-arrears-clearance IDA grants. Fund staff propose to seek additional support from the international community for the financing of its technical assistance.
- To improve the terms of the Fund's emergency assistance to low-income countries, Fund staff recommends renewed efforts to mobilize interest subsidies for these countries.
- The HIPC framework has sufficient flexibility to accommodate the special circumstances of post-conflict countries, including with regard to the length of track record to decision point, the requirements for completion point, the content of the track record, and the pace of delivery of interim assistance. The paper proposes that, for post-conflict countries, the track record prior to decision point would emphasize institution building and governance, and in the interim period the focus would be on developing mechanisms for tracking poverty-reducing resources. Assuming significant progress has been made towards governance, capacity building, monitoring, and macroeconomic stability, consideration could be given to having an early decision point for post-conflict countries combined with a relatively longer interim period.
- Bank staff propose to strengthen IDA's current approach to determining the size, and monitoring the use, of IDA allocations to post-conflict countries.

- Countries in arrears pose a particular challenge since the delivery of HIPC assistance requires that the country be in good standing with the IFIs. Fund staff believe that current policy provides adequate flexibility to address effectively the range of circumstances in post-conflict arrears countries. Bank staff also view their policies as adequate to address arrears problems in most cases; options for assisting borrowers with particularly large per capita arrears are being explored.
- The package of measures proposed by Bank staff would allow the Bank to contribute to the international effort of support for post-conflict countries by providing net positive transfers, in line with their urgent needs and ability to effectively use assistance, through all phases of recovery from conflict. The Bank's ability to do so depends on comparable action from other creditors and donors.

## I. INTRODUCTION

1. The past decade has witnessed a proliferation of armed conflicts in low-income countries, most of which have been domestic and in which civilian populations have been especially affected. This proliferation is a major impediment to economic development due to the cycle of conflict, low-economic growth, and poverty. Moreover, these conflicts have regional, as well as potentially global, implications through dislocation of economic activity, displacement of populations and rapid spread of disease, notably HIV/AIDS. Africa has been particularly hard hit, with conflict now directly or indirectly affecting almost half of sub-Saharan countries. The international community has recognized that unless contained, conflicts will prevent Africa from making progress towards the International Development Goals for 2015.
2. In addition to devastated economies that cannot generate the resources necessary to begin and consolidate a recovery process, most low-income conflict-affected countries also have unsustainable debt levels (Table 1). Many also have arrears to one or more of the International Financial Institutions (IFIs). These countries may as a result face serious difficulties to both consolidate peace by adequately funding recovery efforts, and to use resources to normalize relations with creditors and remain current on external debt service. In these situations, early access to debt-relief may be a critical component of the successful transition to peace and resumption of sustainable development. How to accomplish this poses a special challenge to the international community because of the urgency of speedy and effective action to help break the cycle of violence, low growth, and poverty.
3. In recent years, both the World Bank and the Fund have enhanced their policies and instruments for assisting post-conflict countries. In response to requests from the Development and Interim Committees, a joint Bank/Fund paper in September 1998 explored options for enhancing assistance to post-conflict countries, including those with high debt levels or with arrears to the IFIs.<sup>1</sup> These options were further developed in subsequent papers discussed by the Boards of the Bank and the Fund, and were considered by ministers at the Spring Meetings in 1999.<sup>2</sup> The joint Development Committee/IMFC Communiqué from the September 2000 Annual Meetings stated that “Ministers look forward to consideration of Bank and Fund post-conflict work at the time of the Spring Meetings.” In response to that request, and against the background of developments in post-conflict policy in recent years, the current paper focuses on specific areas where staff believe further attention is warranted, in particular how to help post-conflict countries qualify for assistance under the HIPC Initiative.

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<sup>1</sup> “Issues Note on Providing Additional Assistance to Post-Conflict Countries” (SecM98-729, 9/1/98).

<sup>2</sup> “Assistance to Post-Conflict Countries: Progress Report” paper prepared by Bank and Fund staffs for the Interim and Development Committees, April 21, 1999.

<b>Table 1. Conflict-Affected HIPCs</b> (Before possible decision point) <sup>1</sup>
<p>Angola<sup>2</sup>            Burundi            Central African Republic            Congo, Democratic Republic of, * # +            Congo, Republic of, * #            Ethiopia            Liberia * # +            Myanmar *            Sierra Leone            Somalia * +            Sudan * +</p>
<p><sup>1</sup> Includes HIPC-eligible countries that either currently are in a conflict or have been in conflict in the past few years. In addition, Eritrea has also recently become heavily indebted and may be eligible for HIPC Initiative relief.  <sup>2</sup> Angola is expected to achieve debt sustainability after receiving relief under traditional mechanisms.</p> <p>* Currently has arrears to IDA.            # Currently has arrears to IBRD.            + Currently has arrears to IMF.</p>

4. Section II of this paper reviews the ways in which the Bank and Fund seek to assist countries emerging from conflict. The remainder of the paper considers a range of issues that arise in ensuring timely and adequate assistance to the 11 conflict-affected countries that are eligible for HIPC Initiative debt relief but have not yet reached their decision points, and recommends specific ways to enhance the assistance. Section III considers ways to respond to their large needs for technical assistance and capacity building. Section IV considers how these countries' special circumstances can be taken into account within the existing HIPC Initiative framework, including the nature and length of track record, interim assistance, and completion point requirements. Section V looks at the special issues raised by post-conflict countries in arrears to IFIs. Section VI describes how these various policies fit together along a schematic time line. Section VII provides issues for discussion.

## II. CURRENT POLICIES FOR ASSISTING COUNTRIES EMERGING FROM CONFLICT

5. The proliferation of conflict, particularly in low income countries, has tested the ability of the international community to provide a timely and adequate response. This section looks at the roles the Bank and the Fund play in international assistance to post-conflict countries, and the specific policies that guide their involvement and assistance.

### A. Partnership for Post-Conflict Recovery

6. Countries emerging from conflict have suffered violence to their population and damage to their economic and social capital. Often, the administrative capacity of key economic institutions has been compromised; the ability of the authorities to provide basic services is limited or non-existent; there are unsustainable financial and economic imbalances; and the regulatory and institutional environment for private sector activity, especially investment, is significantly undermined. Once security conditions have improved, conflict-affected countries need substantial support for economic and social recovery, in parallel with the continued provision of humanitarian assistance to meet urgent needs.

7. Especially for countries that have had a major domestic conflict, the recovery process is often lengthy and complex, and prone to frequent setbacks, and sometimes resumption of conflict. Success is aided by the direct participation in, and ownership of, the reconstruction effort by the country's communities and government at all levels, and also by broad and coordinated participation of key international actors, including UN agencies, bilateral donors, NGOs, and the IFIs. These broad partnerships can be critically important because the magnitude and diversity of the problems are frequently beyond the capability of any single institution to address.

8. The UN plays an especially important role in many post-conflict recovery efforts in supporting the political and security framework required for humanitarian, reconstruction and development aid to be effective. Effective UN peacekeeping operations have in many cases been critical to consolidation of a lasting peace, including by providing the stability and confidence necessary to begin the process of demobilization and reintegration. Often, the success of these operations has been a condition for ensuring broad international participation in recovery efforts. Coordinating with the UN humanitarian and development activities and agencies is also important for the establishment of the core functions of government, as well as in the mobilization of humanitarian and reconstruction assistance. As UN agencies sometimes are the only substantial international presence on the ground during and in the immediate aftermath of conflict, they can contribute a special understanding of the causes and dynamics of the conflict and the unique country circumstances.

9. Post-conflict recovery also benefits from the participation of bilateral donors who can be an important source of expertise and financing for humanitarian assistance and, subsequently, for reconstruction and development assistance. Bilaterals also can play an important role in supporting the consolidation of peace, both by supporting activities inside the country, including in the security sector, and mobilizing external political support.

10. The Bank and Fund usually become involved in post-conflict situations at an early stage, as soon as the security conditions permit, a credible political authority has been established, and their involvement can be productive. In this work, the Fund takes the lead on macroeconomic issues while the Bank focuses on reconstruction efforts and on helping the government define priorities for structural reforms. The Bank and the Fund both play a key role in mobilizing support from bilateral donors, who look to the Bank and Fund to guide their involvement.

11. Effective coordination of post-conflict assistance efforts is especially important to avoid the imposition of unnecessary burdens on government capacity, which is frequently especially fragile in post-conflict environments, and to ensure that available resources are channeled to the priorities set out in the national recovery plan. Coordination should include the preparation of damage and needs assessments, and of national recovery plans, which should clearly prioritize actions and investments. While the particular priorities will depend on the specific circumstances of each country, the key objectives will generally be to facilitate the transition to sustainable peace, and to support rapid economic and social development. To this end, the following may need to be considered: jump-starting the economy; re-establishing a framework of governance; rehabilitating social services; repairing key physical infrastructure; and helping war-affected populations and communities, including through programs in support of reintegration, income generation and other support for vulnerable groups such as orphans and female headed households.

## **B. Fund Policy**

12. The primary role of the Fund in post-conflict situations is to help the country restore macroeconomic stability and the basis for sustainable growth. The main elements of the Fund's post-conflict assistance typically include:

- Technical assistance to rebuild statistical and administrative capacity of key economic institutions responsible for making and implementing fiscal, monetary, and exchange rate policies.
- Policy advice to develop a macroeconomic framework and help in mobilizing donor support.
- Financial assistance once the situation is sufficiently stable for it to be used effectively.<sup>3</sup>

Recognizing the desirability of having financial assistance specifically tailored to the needs of post-conflict countries, in 1995 the Fund expanded its policy on emergency assistance to cover post-conflict situations. Emergency post-conflict assistance is designed for countries (i) which have an urgent balance of payments need to rebuild external reserves and meet external payments; (ii) where Fund support is part of a concerted international effort to assist

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<sup>3</sup> As with all Fund lending, the country also cannot have overdue obligations to the Fund.



the country in a comprehensive way; and (iii) where administrative capacity has been so disrupted by conflict that the country is not yet ready to develop and implement a comprehensive program that could be supported by a Fund arrangement, but where the authorities nevertheless have sufficient capacity for policy planning and implementation. Fund assistance and conditionality focus on rebuilding the administrative and institutional capacity required to put a comprehensive economic program in place. Once the country's capacity has been sufficiently strengthened, the country is expected to enter into a comprehensive program that could be supported by a PRGF or upper credit tranche arrangement. Countries which are poor and heavily indebted would also be eligible for assistance under the HIPC Initiative. Emergency assistance has proved to be an effective vehicle for helping post-conflict countries. Since 1995, eight countries have received this assistance from the Fund (Table 2). Five of these countries have successfully moved on to a PRGF or stand-by arrangement.

13. The Fund's emergency post-conflict assistance is provided from the Fund's General Resources Account and is therefore on non-concessional terms.<sup>4</sup> For low-income countries that use emergency post-conflict assistance, Fund policies provide that once the country is ready to move to a PRGF arrangement, access under the PRGF arrangement can be set high enough to allow the country to make early repayment of the GRA resources that were provided under emergency assistance, thus effectively putting the emergency assistance on concessional terms. There is nevertheless the initial period, normally expected to be about one year, when the more expensive resources are outstanding. During that period, bilateral donors are encouraged to provide interest subsidies to reduce the cost of the emergency financial assistance to concessional terms. If such subsidies were forthcoming, the Fund could set up an administered account for channeling the subsidies. Such interest subsidies would preferably be provided in addition to, and not as a substitute for, other assistance from bilateral donors.

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<sup>4</sup> GRA resources are provided to members at a rate of charge set at a level needed to cover the cost of funds plus a small margin for the cost of administering the Fund and to ensure adequate reserves. The current GRA rate of charge is about 4½ percent. The only concessional resources the Fund can provide to members are PRGF loans provided through the PRGF Trust. That Trust is administered by the Fund and receives contributions from members for the purpose of subsidizing the interest on PRGF loans. The Fund's Articles do not allow transfers between the Fund's General Resources Account and its administered resources, and the Fund Board has not been in favor of providing emergency assistance through the PRGF Trust.

**Table 2. Fund Emergency Post-Conflict Assistance**

Country	Date of Purchase	Purchases		In millions of U.S. dollars equivalent 2/	Current Fund Program
		In millions of SDRs	In percent of quota 1/		
Bosnia and Herzegovina	December 1995	30.3	25.0	45.0	Stand-by
Albania	November 1997	8.8	25.0	12.0	PRGF
Rwanda	April 1997	8.9	15.0	12.2	PRGF
Rwanda	December 1997	6.0	10.0	8.1	PRGF
Tajikistan	December 1997	7.5	12.5	10.1	PRGF
Tajikistan	April 1998	7.5	12.5	10.0	PRGF
Congo, Rep. of	July 1998	7.2	12.5	9.6	Emergency post-conflict
Sierra Leone	November 1998	11.6	15.0	16.0	Emergency post-conflict
Guinea-Bissau	September 1999	2.1	15.0	2.9	PRGF
Sierra Leone	December 1999	15.6	15.0	21.4	Emergency post-conflict
Guinea-Bissau	January 2000	1.4	10.0	1.9	PRGF
Sierra Leone	September 2000	10.4	10.0	13.3	Emergency post-conflict
Congo, Rep. of	November 2000	10.6	12.5	13.6	Emergency post-conflict
Yugoslavia, Fed. Rep. of	December 2000	116.9	25.0	151.0	Emergency post-conflict

Sources: Board documents; and IMF Treasurer's Department.

1/ In percent of quota in effect at the date of the purchase.

2/ Converted from SDRs using the U.S. dollar/SDR exchange rate prevailing at the time of approval of the emergency assistance.

14. To date, no subsidies have been provided specifically for this purpose, although bilateral donors frequently provide general support for current fiscal expenditures, including debt service payments.<sup>5</sup> Fund staff propose to make renewed efforts to encourage bilateral

<sup>5</sup> Interest subsidies were provided by the Netherlands, Sweden, and the United States for Rwanda's purchase under the CCFE in 1995 prior to the availability of emergency assistance for post-conflict countries. However, it took considerable time to find sources for the subsidies which delayed the provision of the CCFE purchase. In a few other cases, some donor countries (Denmark and the

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donors to provide interest subsidies. For the two low-income members which have used emergency post-conflict assistance and which have not yet moved to a PRGF arrangement, and another member for which emergency assistance is currently a possibility, the cost of interest subsidies to make the cost of post-conflict emergency assistance comparable to the cost of PRGF resources would be about US\$4 million per year.

### C. Bank Policy

15. The role of the Bank in conflict-affected countries is to support economic and social recovery and sustainable development through financial support and policy advice, with particular attention to human security and to the needs of war-affected populations.<sup>6</sup> The Bank's new operational policy on development cooperation and conflict governs the timing and composition of such assistance.<sup>7</sup> The policy mandates that the Bank should (i) support peace, and economic and social recovery with the timely use of the full range of policy advice and financing instruments in countries recovering from conflict, and (ii) continue limited engagement to identify opportunities for re-entry in countries in conflict. The policy puts a heavy emphasis on partnership with conflict-affected populations, governments and other donors and agencies in the international response.

16. The policy also formalizes several instruments for addressing the special problems of conflict-affected countries, including Watching Briefs and the Transitional Support Strategy (TSS). Watching Briefs are initiated in cases where regular Bank assistance is no longer possible because of conflict, with a view to monitoring country development so that the Bank can quickly provide support as soon as conditions permit. A TSS is a short- to medium-term plan that is formulated for countries where the Country Assistance Strategy (CAS) is no longer relevant because of the impact of conflict, or where the Bank is re-engaging after a protracted absence in a country emerging from conflict. The decision to proceed with a TSS involves complex judgments regarding the readiness of a country to make effective use of Bank assistance. It generally requires that active conflict has diminished and that there is a reasonable expectation of continued stability or a formal ceasefire. Furthermore, there needs to be an effective counterpart for the Bank, and strong international cooperation and the potential for a well defined role for the Bank. The TSS is closely aligned with the objectives and sequencing of priorities of peace accords and rehabilitation plans agreed to by parties to the conflict, and provides the strategic framework for the timing, volume and composition of

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Netherlands) have also given grant assistance to members (Ghana, Tanzania, Mozambique, and Uganda) to help meet debt service payments to the Fund.

<sup>6</sup> For more detailed information about the Bank's role in countries affected by conflict, see: *"The World Bank's Experience with Post-Conflict Reconstruction"*, *OED Review*, 1998; and *"Post-Conflict Reconstruction: The Role of the World Bank"*, 1998.

<sup>7</sup> "Development Cooperation and Conflict," World Bank Operational Policy 2.30. The policy was endorsed by Executive Directors in October 2000.

Bank assistance in support of these plans and priorities until such time as a complete and participatory CAS can be formulated. Where required, the TSS also includes provisions for exceptional support, consistent with the Bank's financial policies. In light of the magnitude of assistance that is often required, a TSS explicitly considers burden-sharing among donors, and provides specific guidance on how the Bank's exceptional assistance can be delivered.

17. Though the Bank has long been directly involved in post-conflict reconstruction, its role has changed considerably in recent years. Historically, the Bank's focus was on rebuilding infrastructure and providing advice and financial support for implementation of structural reforms necessary for growth. Recent assistance efforts have often consisted of more comprehensive and integrated reconstruction packages that have been specifically designed to take account of post-conflict realities. These packages often include support for community-based development, institutional capacity building and governance, and demobilization and reintegration of ex-combatants. Efforts to reintegrate displaced populations are also frequently supported, often in tandem with efforts to rehabilitate health and education services. The Bank's long-standing experience across a range of sectors has also allowed it to help governments improve aid coordination and mobilize support from other donors for priority economic recovery and reconstruction programs. The Bank's use of consultative groups (CGs) has been a particularly effective tool for mobilizing aid resources, including to facilitate the clearance of arrears, seeking a coordinated approach to macroeconomic issues, and providing information on needs and assistance flows.

### **III. PROVIDING TECHNICAL AND CAPACITY-BUILDING ASSISTANCE**

18. Substantial technical and capacity-building assistance is usually required to support reconstruction and recovery in post-conflict countries. Such assistance plays a critical role throughout the recovery process, particularly in the early stages of recovery, when the assistance can help restore macroeconomic stability and reduce the length of the transition period to a more normal situation, with an attendant reduction in need for expenditures on relief efforts. Through early engagement, the Bank and the Fund can help in the coordination of government and donor spending priorities, notably to help ensure that emergency relief efforts feed into long-term development priorities.

19. Many of the post-conflict HIPC-eligible countries do not have a recent track record of macroeconomic stability and structural reforms, which is a precondition for the HIPC assistance. These countries therefore need technical assistance not only for rapid restoration of the critical functions of government, and implementation of appropriate macroeconomic and sectoral policies, but also to meet the specific requirements for HIPC debt relief.

#### **A. Overall Technical Assistance Efforts**

20. While the Bank and the Fund can provide policy advice and technical assistance in their respective areas of competence, a considerable involvement of other donors through financial support and through direct provision of expertise will be required over an extended period for the post-conflict HIPCs. Because the authorities will only gradually build up their

own capacity to coordinate technical assistance and because reducing transaction costs associated with donor coordination is an important objective in a post-conflict setting, it is likely to be appropriate for the Bank and the Fund to jointly develop, at the government's request and in consultation with other providers of technical assistance, an early assessment of the medium-term technical assistance needs, along with an action plan for delivery of such assistance.<sup>8</sup>

21. This assessment would be grounded in the specific characteristics of post-conflict HIPC countries and lay out an effective response to the urgency of rebuilding and recovery, the need to enhance transparency of policies and accountability for the use of resources, and the HIPC Initiative requirements. For example, initial priorities could focus on rebuilding statistical capacity, re-establishing the government's capacity to prepare and execute budgets and implement monetary and exchange rate policy, reintegrating ex-combatants into private and public sectors for better security and stability, and bolstering governance by strengthening the core institutions needed to underpin economic recovery—including those that are important for supporting private investment.

22. The delivery of technical assistance has to be carefully sequenced so that the results are in place when needed at various stages of the HIPC framework. For example, the technical assistance should be successively delivered to rebuild the capacity for formulating and implementing a program (needed for a track record), to develop the statistical base (for calculating debt sustainability and HIPC eligibility), to design a poverty reduction strategy (for reaching a decision point), and to strengthen public expenditure management (for effectively using the debt relief). Technical assistance in these areas would typically constitute the core of a medium-term technical assistance action plan for a post-conflict country.<sup>9</sup>

23. Substantial resources will be required in order both to provide effective policy advice and technical assistance and to enhance coordination among all technical assistance providers. Currently, the Fund provides policy advice and technical assistance at no cash cost to low- and middle-income countries.<sup>10</sup> Extending the TCAP-type effort to all post-conflict HIPC countries would require an increase in the Fund's technical assistance resources, especially since a number of post-conflict HIPC countries in Africa may need such assistance simultaneously. A strong and timely response from the Fund to these countries' needs would, therefore, benefit from additional support from the international community.

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<sup>8</sup> This approach underlies the Fund's Technical Cooperation Action Plans (TCAPs), currently a pilot program for developing technical assistance plans for enhancing macroeconomic stability—primarily through assistance to central banks, ministries of finance, and statistical agencies.

<sup>9</sup> The Bank's contribution to the formulation and delivery of the action plan would be set out in its Transitional Support Strategy (as described in Section II above).

<sup>10</sup> The Fund can provide policy advice and technical assistance even to countries with arrears.

## **B. Bank Financing of Early Technical Assistance and Capacity-Building Efforts**

24. Like the Fund, the Bank also provides economic and sector analyses and policy advice at no charge to the country. In addition, such services and extensive support for capacity building are also provided by the projects and programs that the Bank finances through its lending. The Bank cannot, however, lend to a country which is not current on its obligations. In these situations, the Bank has in the past relied on: (i) grants from IBRD net income; (ii) donor-supported country-specific trust funds; and (iii) small grants from the Post-Conflict Fund (PCF). All three options have proven useful, but meeting the needs of the emerging set of post-conflict HIPCs will require levels of financing and donor support well above those that can be readily generated through these modalities.

25. Since 1999, the Bank has also been able to provide limited IDA grant financing to countries in arrears (see Section V.A). The use of such early recovery grants is restricted to situations where all creditors allow arrears accumulation, and where the country has made convincing steps towards social and economic recovery. These requirements may be too burdensome for countries where state institutions are not functioning. This type of IDA grant would therefore not be appropriate to finance the initial stage of engagement in the most severely devastated countries. Thus, the Bank is not now well positioned to provide adequate support to post-conflict countries arrears that must quickly take advantage of windows of opportunity to start and then consolidate economic and social recovery.

26. Expanded access to grant resources is therefore needed to ensure adequate Bank engagement as a country begins to recover after conflict. These resources would help countries begin the process of establishing a HIPC Initiative track record by supporting efforts to help rebuild key state institutions and consolidate governmental capacity to provide critical services. Grant resources are also needed to formulate and implement urgent measures to re-launch the economy, and to carry out technical studies for infrastructure rehabilitation and reconstruction programs. Finally, grant resources are indispensable to prepare and initiate community-based economic and social reconstruction programs which must complement and follow humanitarian interventions, though in some cases such programs may attract substantial grant co-financing from bilateral donors, thus limiting the need for IDA grants.

27. The Bank is currently studying options for financing and delivering technical assistance that would ensure that it could engage early and effectively in conflict-affected countries with large arrears, and to support the implementation of the early stages of the joint Bank/Fund medium-term technical assistance action plan . Bank staff will provide a detailed proposal on this issue following the Spring meetings. The two main proposals under consideration are:

- **Substantially Scaling up the Post-Conflict Fund (PCF)** and possibly earmarking new donor contributions for use in the remaining HIPC-eligible countries with arrears. To meet the need for financing of technical assistance and capacity building activities in these cases, the PCF would need to be able to provide annual grants up to \$10 million in

each country during the period before regular IDA pre-arrears clearance grants can be accessed.

- **Broadening the Scope of IDA Grants** and seeking donor authorization for IDA grants of up to \$10 million per country per year. Since these proposed grants would be small in size compared to the early recovery grants described in paragraph 21 (which IDA can already make under specific circumstances), their use would not require that all creditors agree to allow arrears to accumulate. The justification for these grants would be set out in a TSS. Advantages of an IDA-based approach include less immediate demands on strained aid budgets, flexibility to respond adequately and rapidly while reducing administrative burdens and avoiding allocating, and perhaps tying up, resources in a single-purpose trust fund.

### **Summary of Proposals**

- Bank and Fund staffs propose that they should together develop, in consultation with the government and other providers of technical assistance, an early assessment of the medium-term technical assistance needs of a HIPC-eligible country emerging from conflict along with an action plan for the delivery of such assistance.
- Bank staff are considering the options of substantially increasing the Post Conflict Fund and/or a broadening of the scope of pre-arrears-clearance IDA grants to ensure that the Bank can engage early in conflict-affected countries with large arrears.
- The Fund staff propose seeking additional support from the international community, possibly along the lines of the existing Administered Accounts for technical assistance, to enhance the Fund's ability to meet technical assistance needs of post-conflict countries.

## **IV. APPLYING THE HIPC FRAMEWORK TO POST-CONFLICT COUNTRIES**

28. The enhanced HIPC Initiative aims at accelerating and deepening HIPC debt relief and linking it more fully and transparently to poverty reduction. The need for accelerated assistance under the HIPC Initiative is particularly acute in post-conflict HIPC-eligible countries because these countries are likely to have major domestic financing needs for reconstruction and basic social services but at the same time may face difficulties in re-establishing their tax bases and administration. They are also likely to have large import needs and difficulties meeting their debt service obligations. At the same time, most of the people are living in absolute poverty, with the livelihoods and family support mechanisms of many of them disrupted by conflict and civilian population displacement.

29. As in other HIPC cases, it is crucial that the resources freed by debt relief under the HIPC Initiative are used well. However, many of these countries continue to face security threats, as well as significant difficulties with respect to governance. Moreover, the post-conflict HIPCs have weak administrative capacity for designing and implementing policies, and cannot adequately execute and monitor public expenditures in support of economic and

social recovery. This section considers how countries, with assistance from the Bank, the Fund, the UN agencies and other bilateral and multilateral partners, can best benefit from the HIPC Initiative in these situations, with specific focus on issues related to the country's track record and access to the decision point, the level and phasing of assistance, and requirements for the completion point.

### **A. Decision Point**

30. To qualify for HIPC assistance and to help ensure that the assistance will be used effectively for poverty reduction, an eligible country has to establish a satisfactory track record of sound economic policies and performance. Normally, this requires three years of satisfactory performance under Fund- and Bank-supported programs, of which one year should immediately precede the decision point. However, the Executive Directors of the Bank and the Fund have shown flexibility on the length of both the overall track record (e.g., Guinea-Bissau and São Tomé and Príncipe) and the one-year immediate track record (e.g., Niger). Bank and Fund staff recommend that this type of flexibility also be applied to the post-conflict HIPCs, but that any shortening of the pre-decision point track record for these countries be very carefully balanced against the progress made towards social and economic recovery.<sup>11</sup>

31. HIPCs that have just emerged from a conflict may also require flexibility on the content of their track record. Some post-conflict countries will not be able to implement full-fledged Fund- and Bank-supported programs (e.g., PRGF and PRSC) immediately after the conflict because of the damage to capacity. Recognizing this, the Fund in 1998 decided to consider, on a case-by-case basis, programs supported by emergency post-conflict assistance as part of the track record leading to the decision point. Taking into account the special circumstances of post-conflict cases, in assessing the track record for post-conflict countries Bank and Fund staff recommend that there be a particular focus on rebuilding the institutional and administrative capacity and on improving governance.

32. Post-conflict countries may also face constraints in formulating the required Interim Poverty Reduction Strategy Paper (I-PRSP) before the decision point due to capacity and data limitations. The Fund and Bank have been flexible in the expectations regarding the content of an I-PRSP and have not required a minimum threshold for consultation on an I-PRSP. Rather, an I-PRSP is expected to include a time-line and the consultation process by which the full-fledged PRSP will be prepared. It is also expected to spell out the authorities' commitment, plans and priorities for poverty reduction. This flexibility could also be expected to apply to post-conflict countries. Nevertheless, the authorities in post-conflict countries should be encouraged to start the preparation of an I-PRSP as soon as the political and security conditions permit, including possibly under a Bank or Fund-supported

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<sup>11</sup> The post-conflict countries with large arrears, especially to the IFIs, raise specific issues, which are discussed in Section V.



post-conflict program. It is expected that such I-PRSPs would reflect clearly the requirements for an orderly war-to-peace transition, including (i) measures to help stabilize the political and security situation and provide support for reconciliation and demobilization as appropriate, and (ii) measures to help restart economic activity.

33. While the limited capacity of post-conflict countries argues for flexibility on the assessment of the track record, it is important that the link between debt relief and effective poverty reduction policies not be weakened, if the objectives of the HIPC Initiative are to be met. Consequently, to reach the decision point, the authorities will be expected to display strong commitment to a program of economic reforms and demonstrate their readiness to orient public spending—including resources freed by debt relief—towards poverty reduction programs. The authorities will also be expected to ensure that principles of sound public expenditure management, including transparency, are also applied to military spending, and to show a clear commitment to adjusting military spending to be conducive to economic development and poverty reduction.

34. For the Bank and Fund to be able to move ahead, the authorities would need to provide credible assurances that sufficient progress is being made to ensure that the resources from the HIPC Initiative will be channeled toward poverty reduction programs. In most cases, the full implementation of monitoring and safeguarding mechanisms would be achieved only after the decision point. Therefore, an interim system to track the composition of overall government spending on poverty-related programs, including special HIPC budgetary accounts (as was done, for example, in Cameroon) could be appropriate. Assessments of track records in post-conflict countries should extend beyond macroeconomic stability and also pay attention to consolidating peace and security, rebuilding institutional and administrative capacity, and improving governance.

35. It will be necessary in these situations to ensure that these countries have the capacity to use effectively HIPC assistance for poverty reduction. Any shortening of the track record for an early decision point would require significant progress on governance, capacity and monitoring and macroeconomic stability, and would be assessed on a case-by-case basis. In cases where an early decision point is judged to be appropriate on performance grounds, there would be an expectation of a relatively longer interim period to the completion point during which the country would receive debt relief (see Section IV.C). In order for many of these countries to meet the above requirements in time for an early decision point, extensive and timely technical assistance will be essential.

### **B. Level and Phasing of Assistance**

36. The reconstruction and poverty alleviation needs of post-conflict HIPCs argues for generous debt relief for these countries. The amount of assistance under the HIPC Initiative depends on the net present value (NPV) of a country's debt relative to the underlying economic indicators (exports or government revenue) at the decision point. After conflict, these debt ratios may be unusually high due to the adverse impact of the conflict on exports and government revenues. Consequently, the amount of debt relief provided would likely be

high compared to the amount that would have been delivered on the basis of ratios calculated in the absence of (possibly before) the conflict. While the recovery of economic activity might lead to lower ratios in the future, this is not certain and may take a long time. The unusually high ratios therefore also help ensure that these countries will receive the additional assistance required due to the devastation of their debt service capacity. For example, Guinea-Bissau required over 85 percent reduction in debt stock (the highest among 22 HIPCs that reached the decision point by end-2000) in order to achieve a sustainable debt target.

37. The urgent financing needs facing post-conflict countries suggest that it may be desirable in some cases to have HIPC assistance to these countries be relatively front-loaded—that is, to provide a relatively large share of HIPC assistance in the early years after the decision point, particularly during the interim period. The extent to which this is necessary, or even feasible, will clearly depend on the extent to which the country has large debt service payments falling due during this period. Under current Fund policy, interim assistance can be as much as 20 percent per year of overall Fund assistance, with maximum interim assistance equal to 60 percent of total assistance. IDA provides interim assistance of not less than 50 percent of the IDA debt service due per year, with maximum interim assistance equal to one-third of its total relief. While Fund lending has shorter maturities than Bank lending, the Fund's limits on interim assistance generally permit coverage of a large portion of the obligations falling due to the Fund in the early years, and frontloading beyond the Fund's current normal limits for interim assistance is unlikely to be necessary.<sup>12</sup> To ensure continuous relief of at least 50 percent annual debt service to IDA during the prolonged interim period that may be required in some cases, the Bank may need to consider front-loading assistance beyond the current limit of one-third of total relief. The degree of front-loading of assistance will, of course, also depend crucially on the country's administrative capacity to absorb and make effective use of the assistance, again highlighting the need for early technical assistance.<sup>13</sup>

### **C. Floating Completion Point**

38. To reach the completion point under the enhanced HIPC Initiative, a country is required to implement a comprehensive pre-defined set of key social and structural reforms while maintaining good macroeconomic performance. The timing of the completion point

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<sup>12</sup> In exceptional circumstances, the Fund's interim assistance can be raised to 25 percent annually and 75 percent in total, respectively. The Fund's Executive Board approved these higher limits in December 2000 for Zambia to accommodate an unusual bunching of repayments.

<sup>13</sup> For countries that had been in arrears to the IFIs and had been making little or no payments to them in the pre-arrears clearance period, HIPC debt relief following arrears clearance may not result in a release of cash resources, as debt service payments may actually increase. However, following arrears clearance, the countries should have access to gross inflows from the international community that more than compensate for the potentially higher debt service payments.

depends on the pace at which the country can formulate and implement its own poverty reduction strategy, sustain macroeconomic stability, and put in place monitoring and safeguarding mechanisms for good use of debt relief. Post-conflict countries may need more time than other HIPC countries to fulfill these requirements because of weak governance, limited capacity and security problems. Particularly in countries where the conflict has been domestic, tensions frequently linger after armed conflict has ended and the recovery of civil institutions to mobilize broad public participation may frequently be prolonged. Consequently, developing a PRSP based on participatory processes may prove particularly difficult in these countries. Furthermore, post-conflict countries often lack the kinds of data needed to prepare effective poverty reduction strategies. Therefore, many post-conflict HIPC countries are likely to require a longer interim period to meet these requirements, especially in cases when the track record leading to the decision point is shortened.<sup>14</sup> A longer interim period will not be detrimental to the country unless it runs up against the cumulative limit or time constraint on the delivery of interim assistance.

39. To ensure progress towards sustainable growth, the structural and social sector triggers for the completion point could be customized to reflect the particular priorities and needs of post-conflict countries. For example, improvement in fiscal management and demobilization of ex-combatants were part of the completion point conditions in Guinea-Bissau. In addition, the systematic inclusion of periodic independent audits of the use of HIPC resources could be required as a completion point trigger in all post-conflict countries.<sup>15</sup> Adequate technical assistance would be important to assist these countries in implementing these measures.

### **Summary of Proposals**

- Bank and Fund staffs propose that the HIPC Initiative framework be implemented flexibly to accommodate the special circumstances of post-conflict HIPC countries, including with regard to the length of the track record to decision point and the requirements for the completion point; the content of the track record; and the pace of delivery of interim assistance.
- The content of the track record to decision point should emphasize rebuilding the institutional and administrative capacity and improving governance. The emphasis in the interim period should be on developing the mechanisms to track all resources targeted at poverty reduction.

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<sup>14</sup> In the joint progress report on the HIPC Initiative presented to the International Monetary and Financial Committee in September 2000, Bank and Fund staff estimated that, based on the assessment made by authorities in decision point countries, the interim period is expected to average about 15 months. See IMFC/Doc/2/00/1, 9/8/00.

<sup>15</sup> Similar completion point triggers were used in the cases of Madagascar and Niger, for example.

- Assuming that significant progress had been made towards governance, capacity building, monitoring, and macroeconomic stability, consideration could be given to having an early decision point for post-conflict countries combined with a relatively longer interim period.
- Interim assistance could be front-loaded to the extent possible, taking into account the profile of debt service payments due and the absorptive capacity of the country.

## V. ISSUES IN HIPC ARREARS CASES

40. In several conflict-affected countries, the presence of large protracted arrears to IFIs may hinder the international community's efforts to provide assistance once the countries make decisive steps towards a sustainable peace. There are presently four conflict-affected countries that have large protracted arrears to the Fund, six that have arrears to the Bank Group and nine that have arrears to the AfDB (Table 3). Many of these countries are either still in conflict internally or externally, or have not yet put in place sound domestic policies which warrant the support of the international community.

41. **Principles of Assistance.** To limit moral hazard and protect the financial integrity of the Bank and Fund, any assistance to post-conflict countries in arrears must be governed by the same principles that govern the provision of assistance to other countries in arrears (in the Fund's terminology, uniformity of treatment must be maintained). In particular, assistance should be (i) linked to the establishment of a track record of policy performance; (ii) provided on appropriately concessional terms to the extent possible; and (iii) provided within a framework of concerted international action. Since the circumstances of these countries vary considerably, they should continue to be treated on a case-by-case basis within the broad principles laid out above. This section looks at ways in which the international community's approach to these countries could be strengthened. Although this section focuses on the Bank and the Fund, these countries are also in arrears to other IFIs whose policy constraints will also need to be taken into account when addressing individual country cases.

### A. Bank and Fund Policies and Proposals

42. **Financial Assistance Prior to Arrears Clearance.** In addition to the need to rebuild institutions and strengthen policies common to all countries attempting to emerge from conflict, countries that have accumulated substantial arrears to IFIs and other creditors face a particular financing challenge. The financial policies of both the Fund and the Bank do not permit them to extend new loans or credits to countries in arrears. This can make it difficult for these countries to access sufficient external financing in the critical early post-conflict recovery period. Moreover, other creditors may also be unable to provide new financing in the pre-arrears clearance period.

**Table 3. External Debt of Conflict-Affected HIPC's**

(In millions of U.S. dollars)

	Angola	Burundi	C.A.R.	Congo, Dem. Rep. of	Congo, Rep. of	Ethiopia	Liberia	Myanmar	Sierra Leone	Somalia	Sudan	Total
Total Debt Stocks <sup>1</sup> (as of end-1999)	10,871	1,131	913	11,921	5,031	5,551	2,152	5,999	1,249	2,627	16,273	63,718
Public and publicly guaranteed	9,248	1,050	830	8,187	3,932	5,360	1,063	5,333	938	1,860	8,852	46,653
Multilateral	312	899	612	2,230	600	2,741	398	1,251	530	729	2,011	12,313
Of which:												
IBRD	0	0	0	82	67	0	125	0	0	0	3	277
IDA	214	599	403	1,235	166	1,739	103	723	300	409	1,208	7,099
AfDB	51	9	3	494	194	195	56	--	--	4	87	1,093
AfDF	29	202	140	190	11	653	57	--	126	91	237	1,736
Bilateral	3,351	150	185	5,453	2,551	2,490	460	3,555	402	1,097	5,494	25,188
Private creditors	5,584	1	32	504	782	130	205	527	6	34	1,347	9,152
Private nonguaranteed	--	--	--	--	--	--	--	--	--	--	496	496
Short-term debt	1,624	70	60	3,217	1,070	96	446	666	117	491	5,372	13,229
IMF credit	0	12	23	516	29	95	645	0	195	277	1,554	3,346
Arrears <sup>2</sup> (as of end-Jan. 2001)												
IBRD	--	--	--	120	56	--	292	--	--	--	--	468
IDA	--	--	--	167	7	--	26	56	--	74	174	504
IMF	--	--	--	504	--	--	626	--	--	270	1,440	2,840
AfDB	21	6	3	740	81	--	142	--	--	9	49	1,051
AfDF	--	4	12	38	--	--	3	--	--	23	24	104
Debt ratios												
Total debt stocks to GDP (in percent)	175	143	87	223	227	86	480	92	188	...	159	...
Total debt stocks to export (in percent)	204	1,824	473	951	284	607	3,611	372	1,358	...	1,958	...

Sources: *Global Development Finance 2001*; *World Economic Outlook 2001*; IMF; AfDB; and the World Bank.

<sup>1</sup> Data are from the World Bank's *Global Development Finance* except for debt to IMF. Data include arrears on contractual interest except in the case of IBRD, IDA, IDB, and AfDB, but exclude all penalty interest. IMF credit includes interest arrears and special charges.

<sup>2</sup> Includes all principal and interest arrears as of **end-January 2001**.

43. To give IDA the capacity to provide support during this period when most external financing is constrained, IDA was authorized in 1999 to provide limited pre-arrears clearance grants (see Section III.B). These grants would support early, pre-arrears clearance recovery efforts in the context of an agreed economic recovery program and a concerted international assistance effort.<sup>16,17</sup> Such grants can only be used as a last resort where other sources are inadequate or inappropriate. This IDA provision has not been used because no eligible candidate has made sufficient progress towards peace. To ensure that these funds are used in support of reconstruction efforts, the Bank would approve IDA grant financing only if other creditors were at the least not making a net withdrawal of financial resources from the country. Moreover, the Bank will also not be able to forego payments on arrears unless all creditors do the same.

44. Under the Fund's arrears strategy, payments to the Fund have been considered to be an important part of a pre-arrears clearance track record. Nevertheless, recognizing that competing claims from multilateral institutions for payments from heavily indebted post-conflict countries in arrears to these institutions may not be sustainable, the Fund Board agreed in April 1999 that the Fund would consider relaxing its calls for payments as a test of cooperation, provided that the country is judged to be cooperating on policies and that all other multilaterals take at least comparable action. Judgement as to the level of payment needed to sustain cooperation with the Fund would be made on a case-by-case basis, taking into account the country's debt service capacity. Given the range of circumstances and payments capacities in the post-conflict arrears countries, Fund staff recommend that this case-by-case approach to payments to the Fund be maintained.

45. **Timing of Arrears Clearance.** Delivery of assistance under the HIPC Initiative requires the country to be in good standing with the IFIs. Since Fund HIPC assistance is delivered in the context of a PRGF arrangement and Fund policy does not permit lending to a country in arrears, arrears to the Fund must be cleared before the country can reach the joint HIPC decision point. Under current policy, arrears to the Bank must also be cleared before the country can reach the HIPC decision point. Although simultaneous clearance is preferred, Bank and Fund policies allow for sequential clearance of arrears between the two institutions, and with the regional banks in appropriate circumstances, provided there is an agreed plan for clearance of the arrears to the other institution(s).

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<sup>16</sup> Such grants were authorized as part of IDA12 Replenishment Agreement, "Additions to IDA Resources, Twelfth Replenishment" (IDA/R98-195, 12/23/98).

<sup>17</sup> The Fund and the Bank have agreed that these IDA post-conflict financial grants can count towards the Bank's share of the debt relief under the HIPC Initiative once it is agreed by all creditors that the country is ready to prepare a track record towards the HIPC decision point.

46. Prior to clearance of arrears to the Fund and the resumption of Fund lending, a country is expected to establish a track record of policy performance and payments to provide assurances that the country will not fall back into arrears. The Fund has developed different types of policies to facilitate members' efforts to build a track record, including rights accumulation programs (RAP).<sup>18</sup> A country emerging from conflict may at first only be able to establish an informal track record under a staff-monitored program, but it is subsequently expected to establish a track record for arrears clearance under a program with upper-level conditionality.<sup>19</sup> The Fund is flexible on the length of track record, which is decided case-by-case based on the size of the country's arrears and its economic conditions. No minimum period has been established and, in practice, track records under rights accumulation programs have ranged from 18 months to 3 years. The period of track record required for arrears clearance and that required for a decision point under the HIPC Initiative are likely to substantially overlap if not coincide, and thus the HIPC requirements discussed in Section IV would also probably need to be met during roughly the same period.

47. In the case of the Bank, the length and content of a pre-arrears clearance program of policy reform is determined on a case-by-case basis, and by the availability of donor resources to contribute to arrears clearance. IDA resources that support an arrears clearance plan can only be provided in the context of an appropriate macroeconomic policy framework, as demonstrated by compliance with a Fund-supported program (including a RAP). The Bank has no minimum period for arrears clearance, but in cases where adjustment financing is required, the Bank will normally require two satisfactory reviews under a Fund program.

### **Proposal**

- To ensure a well-coordinated response to the special problems associated with arrears clearance, the Bank and the Fund would prepare an arrears clearance plan with the member in consultation with each other and other major creditors, as soon as a post-conflict country with arrears has re-established peace, has made adequate progress on rebuilding administrative capacity and restoring macroeconomic stability, and has re-established contacts with the international community. This plan would include agreement on the length and content of the track record required for arrears clearance, as well as on the types of assistance the Bank and the Fund would provide in the pre-arrears clearance period.

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<sup>18</sup> The rights approach was introduced by the Fund in 1990 as part of its strengthened cooperative strategy to assist the 11 countries with large protracted arrears at the end of 1989 to normalize relations with the Fund. Only three countries—Liberia, Somalia and Sudan—are still eligible for the approach. The Democratic Republic of the Congo was not in arrears to the Fund at end-1989 and therefore is not eligible for the rights approach.

<sup>19</sup> Rights accumulation programs have the equivalent of upper credit tranche conditionality.

48. **Modalities of Arrears Clearance.** Once a country has established an adequate track record, arrears to the Fund are usually cleared through a bridge loan, provided by bilateral creditors, leading to a new successor arrangement with the Fund. The successor arrangement usually provides the country with a small amount of net additional resources.

49. Current Bank policy is also to rely on bilateral donor contributions to clear arrears. In cases where sufficient donor contributions are not available, the Bank also relies on bridge financing. Over the last few years, Bank staff have also developed a number of alternative instruments that would allow it to take a more flexible approach to assisting countries with large and protracted arrears. These proposed instruments, which are described in two previous papers for the Development Committee, include arrears accumulation in the pre-arrears clearance period, rescheduling and/or refinancing of arrears to IDA, and Fifth Dimension-type credits to ensure positive transfers to finance reconstruction efforts after arrears clearance.<sup>20,21</sup> The use of these instruments has, however, not been approved by the Bank's Board. Instead, Bank management would incorporate for Board consideration these instruments as part of Bank assistance packages to countries with large and protracted arrears as they begin the process of normalization. The Bank's Board would then make the final decision regarding the appropriateness of these instruments on a case-by-case basis. All instruments that apply to IDA have been endorsed by IDA donors.<sup>22</sup> These instruments should provide the Bank with sufficient flexibility to address arrears problems in most cases. Bank staff are, however, exploring additional options for assisting borrowers with particularly large per capita arrears.

50. **Financial Assistance Post-Arrears Clearance.** To ensure long-term debt sustainability, post-conflict HIPCs need both deep debt relief and positive net flows on appropriate terms, subject, of course, to satisfactory policy performance. In addition to the support that the IFIs can provide, these countries will need substantial support from bilateral donors in the post-arrears clearance period.

51. For low-income countries, the successor Fund arrangement following the clearance of arrears to the Fund would normally be expected to be under the concessional PRGF. However, for countries with large arrears, the size of the successor arrangement may need to exceed the 185 percent of quota exceptional limit on the use of PRGF resources. The arrears of Liberia, Somalia, and Sudan are at present above 185 percent of their quotas.<sup>23</sup> In these

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<sup>20</sup> "Assistance to Post-Conflict Countries: Progress Report" (DC/99-9, 4/2/99).

<sup>21</sup> It is IBRD policy not to reschedule/refinance borrowers' obligations (at the country level), except in exceptional circumstances. This policy has strong support from IBRD's shareholders. Moreover, rescheduling/refinancing post-conflict HIPC countries' IBRD obligations on IBRD terms (IBRD could not provide any concessionality) would not help to reduce these countries' debt burdens.

<sup>22</sup> *Additions to IDA Resources: Twelfth Replenishment*, (IDA/R98-195, 12/23/98).

<sup>23</sup> Under the Fund's Eleventh Review of Quotas.



cases, a blend of General Resources Account (GRA) and PRGF resources will be required. In such cases, resources to subsidize GRA lending would need to be identified. The Fund would also need to ensure that the modality of arrears clearance employed would take into account the need to avoid the bunching of debt service payments in the medium term.

52. The Bank's assistance in the post-arrears clearance period would be mainly in the form of credits on standard IDA terms. Where necessary, IDA would continue the current practice of providing grants to deliver a part of HIPC debt relief during the interim period.

53. IDA is also developing a methodology for consistent application of the flexibility it has in allocating IDA resources to post-conflict countries, including to those with arrears. On the basis of IDA's strengthened performance-based allocation framework, these countries typically only qualify for very low allocations. The new methodology would provide IDA with a more systematic basis for making allocations that respond directly to the situation of countries that are in transition from war to peace. By establishing eligibility criteria, allocation norms and indicators relevant to evaluating post-conflict country performance, the new approach would ensure greater cross-country consistency. The indicators used to track performance would be specifically tailored to the circumstances of post-conflict countries, and include indicators in areas such as public security, national reconciliation, basic economic management, governance and the restoration of basic public services.

## **Proposal**

- IDA is considering a strengthened methodology for allocating resources to post-conflict countries, that provides a more systematic basis for ensuring that the volume of assistance is responsive to the magnitude of early reconstruction needs, but time-bound and programmed to return to normal levels in a relatively short time. The methodology is now being applied on a trial basis to countries emerging from conflict, and will be discussed with IDA donors during the IDA13 replenishment process.<sup>24</sup>

### **B. Cost of HIPC Assistance to Countries with Large Protracted Arrears**

54. Cost estimates for the Enhanced HIPC Initiative include the costs of assistance for the Democratic Republic of Congo, but not for Liberia, Somalia, and Sudan. Substantial additional resources will be required for these countries, once they have restored peace and normalized relations with bilateral donors and creditors. Preliminary estimates indicate that the cost of assistance to these three countries under the HIPC Initiative would be about US\$8 billion in end-1999 NPV terms for all creditors. The cost to the Fund is estimated to be about US\$1.1 billion while the cost to the Bank would be about US\$0.7 billion in end-1999

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<sup>24</sup> In their ongoing work on IDA terms for the 13<sup>th</sup> Replenishment of IDA, Bank staff are also examining the possibility of selectively using grants in post-conflict countries where economic prospects are highly uncertain and the debt-servicing capacity may remain impaired for an extended period.

NPV terms. This compares to a total financing cost of US\$3.6 billion (end-1999 NPV terms) for the Fund's current participation in the HIPC Initiative (US\$2.2 billion) and the continuation of the PRGF (US\$1.3 billion), US\$6.3 billion for the Bank's participation in the HIPC Initiative, and US\$29.3 billion for all creditors.

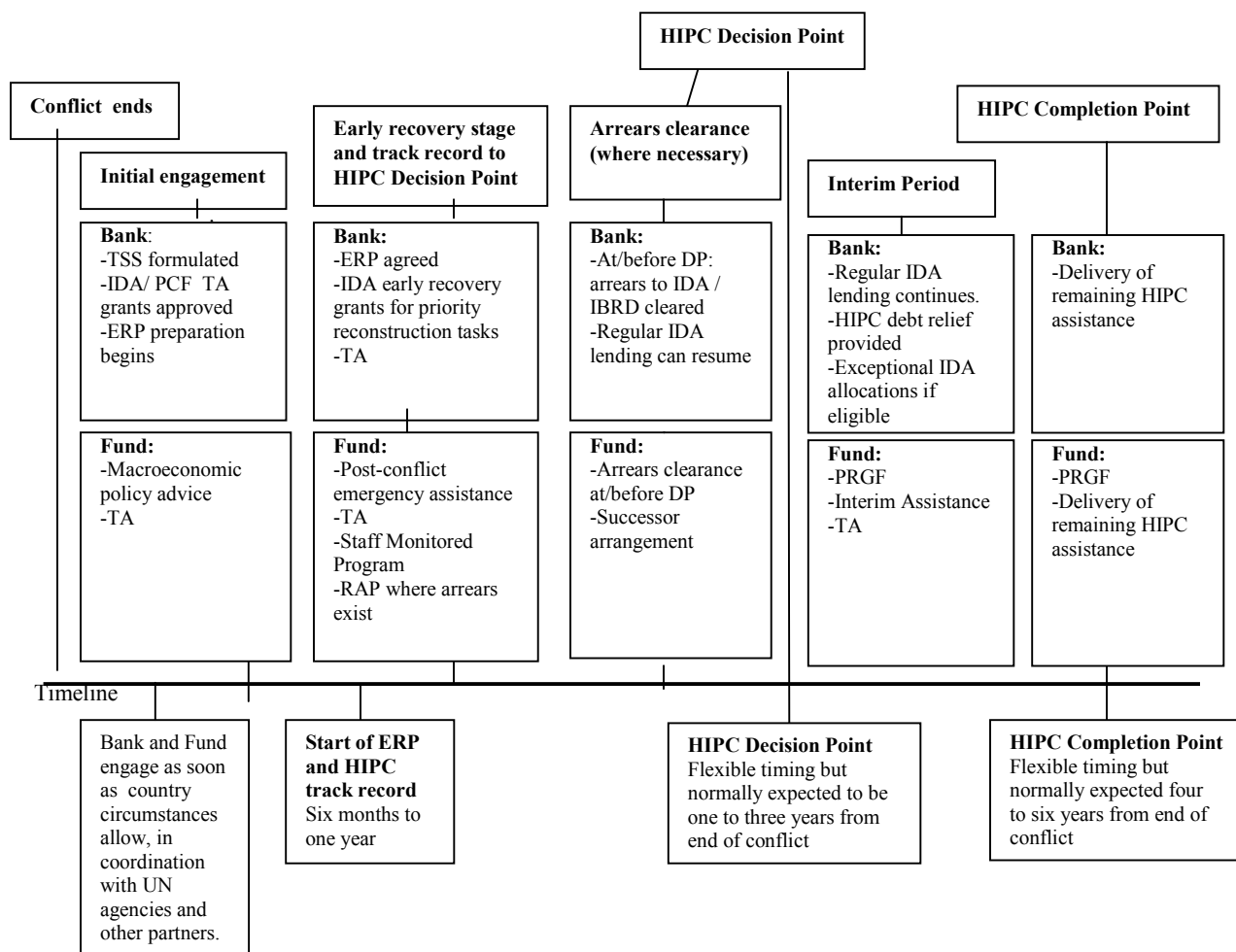
55. Many of the conflict-affected HIPC-eligible countries are also in arrears to the African Development Bank (AfDB). The financial policies of the AfDB, like those of the Bank and Fund, do not permit it to reschedule or lend into arrears. Moreover, the AfDB has no mechanisms to enable it to provide technical assistance or grant financing to post-conflict countries in arrears. Exceptional bilateral support will be required to help these countries clear their arrears to the AfDB and to enable the AfDB to provide these countries with assistance under the HIPC Initiative.

## VI. IMPLEMENTING ASSISTANCE TO POST-CONFLICT COUNTRIES

56. With expanded options for early support, and a stronger, more coordinated approach to technical assistance, the Bank and the Fund will be positioned to provide more effective support for social and economic recovery, normalizing relations with creditors and entering the HIPC process. A flexible approach to the application of the requirements of the HIPC framework, as provided for above, will further enhance the prospects of these countries to make a successful transition from war to a sustainable peace. Consolidating progress towards a sustainable peace and restarting social and economic recovery requires working closely with the country and its international partners as its institutions begin to acquire strength and legitimacy. Once a country emerges from conflict, Bank and Fund staff can work together with the authorities, UN and bilateral agencies and other stakeholders to help formulate a broad plan to address the particular problems facing the country. The plan's implementation will depend on the progress made by the country at each stage of the plan. Chart 1 below illustrates how the proposed approach could work in practice and indicates the possible timing of the successive stages following the end of the conflict and the first engagement of Bank and Fund staff in the country.

57. **Initial engagement.** It is envisaged that Bank and Fund staff will become engaged in the country as soon as security conditions permit and a credible government authority is established. During this period of initial engagement, usually expected to last six months to one year, Bank and Fund staff will jointly assess the technical assistance needs and begin preparing a medium-term technical assistance action plan, in consultation with other agencies. The Fund will provide technical assistance for administrative capacity-building and macroeconomic policy advice as well as make preparations for a post-conflict program, possibly supported by post-conflict emergency assistance if the country is eligible (including the absence of arrears). During this period, the Bank will formulate a Transitional Support Strategy, help begin preparations of an economic recovery program, and provide financing in the form of IDA and/or PCF grants to support technical assistance and capacity-building efforts.

**Chart 1. Outline of Proposed Approach for Assisting Post-Conflict HIPC-Eligible Countries**



58. **Early recovery period.** After six months to one year, it is envisaged that the country will enter an early recovery period and start building a track record leading to the HIPC decision point. The length of this period is flexible but for most countries would be expected to be between one and three years from the end of the conflict. During this period, the country will continue to receive policy advice and technical assistance from the Bank and the Fund in the context of an agreed action plan. If eligible, the member will also receive post-conflict emergency assistance from the Fund possible leading to a program under a PRGF arrangement. Where the country is in arrears, once the country has consolidated its administrative capacity and made sufficient progress towards restoring economic stability, the Bank and the Fund will begin to prepare an arrears clearance plan with the country and its other creditors. Subject to agreement by all creditors to allow arrears accumulation, the

country could, where other sources of financing are inadequate or inappropriate, also receive IDA early recovery grants in the context of an agreed Economic Recovery Program. It will also start to build a track record towards arrears clearance to the Fund.

59. **Arrears Clearance/Decision Point.** Post-conflict countries would normally be expected to have an early decision point as described in paragraph 30. In cases where countries are not current on their obligations to the Bank and the Fund, arrears would normally be cleared using procedures set out in this paper. After clearance of arrears to the Fund, the Fund would provide assistance under a successor arrangement, including PRGF resources to countries that are eligible, and whose size will depend on the member's need including that originating from the clearance of arrears. IDA would begin to approve normal lending operations.

60. **Interim Period.** The duration of the interim period leading to the HIPC completion point is flexible, in part depending on the duration of the early recovery period leading to the HIPC decision point. However, it is expected that for most countries, the completion point would be reached between four and six years from the end of the conflict. During the interim period, the Bank will provide support through IDA credits and/or grants, and HIPC debt relief. The Fund will provide support through the PRGF and interim assistance.

## VII. NEXT STEPS

61. The discussion of this paper with the Boards of the Bank and the Fund suggested a strong consensus that the two institutions have a significant role to play from an early stage as countries begin to emerge from conflict. There was also broad agreement that, while the policies that guide Bank and Fund assistance to conflict-affected countries have generally been effective, enhancements would be desirable in some areas including to fully respond to the complex challenges that face the 11 pre-decision point HIPC countries affected by conflict. The Bank and the Fund will elaborate on the proposals contained in the paper as follows:

### **Bank staff will prepare:**

- for Bank Board consideration, a proposal for strengthening Bank capacity to deliver and finance early technical and capacity-building assistance to countries as they begin to emerge from conflict, including by scaling up the Post-Conflict Fund and/or modestly expanding the use of IDA grants.
- for Bank Board consideration, a review of options and mechanisms for clearing arrears to post-conflict countries with large protracted arrears.
- for the consideration of IDA13 Deputies, a new methodology for the allocation of IDA resources to post-conflict countries, consistent with IDA priorities and performance standards, and adapted to the particular circumstances and reconstruction needs of these countries.

**Fund staff will prepare for Fund Board consideration:**

- a proposal to set up a multi-donor Fund Administered Account for interest subsidies for the Fund's post-conflict emergency assistance to low-income countries.
- a proposal on how the Fund could meet the technical assistance needs of post-conflict countries, especially those that will also need assistance in meeting the requirements of the HIPC Initiative, and an assessment of the resource requirements and options for financing.