

Box 1. Applying the Guidelines to HIPCs

The Heavily Indebted Poor Countries (HIPC) Initiative was launched by the World Bank and IMF in 1996 (and later enhanced in 1999) as a comprehensive effort to eliminate unsustainable debt in the world's poorest, most heavily indebted countries. Through the provision of debt relief to eligible HIPCs that show a strong track record of economic adjustment and reform, the Initiative was designed to help these countries achieve a sustainable debt position over the medium term. Insufficient attention paid to public debt management is widely thought to have been one of the most important factors that contributed to the accumulation of unsustainable levels of debt in these countries. Together with sound overall macroeconomic policy settings, prudent debt management in the HIPCs remains central to ensuring a durable exit from the unsustainable debt burden.

A recent survey by staffs of the World Bank and the IMF revealed that several very important weaknesses continue to exist in key aspects of debt management in the HIPCs, notably in the design of their legal and institutional frameworks, coordination of debt management with macroeconomic policies, new borrowing policy, and in the human and technical requirements for performing basic debt management functions.^{1/} In the area of the legal framework, while most HIPCs have an explicit legal instrument governing the debt office and its functions, the legal framework is not always clearly defined and adequately implemented. In addition, transparency and accountability in debt management, including public access to debt information, requires strengthening. Institutional responsibilities for debt management in many HIPCs are also not clearly defined and coordinated. Moreover, their debt management activities are undermined by a number of institutional weaknesses and low implementation capacity due to insufficient human, technical, and financial resources. To overcome these difficulties, a first step could be to implement clear and transparent legal and institutional frameworks. The Guidelines and the governance lessons drawn from the case studies can help HIPCs strengthen their legal and institutional frameworks for debt management. For example, they highlight some ways in which borrowing authority can be delegated from the Parliament and the Council of Ministers to debt managers with appropriate accountability mechanisms, the merits of centralizing debt management activities in a single unit, and some ways in which appropriate controls can be introduced to manage the operational risks associated with debt management activities. And, they illustrate how some countries have taken steps to obtain more control over contingent liabilities issued in the name of the government.

Regarding policy coordination, the survey showed that less than half of HIPCs have in place a comprehensive forward-looking strategy focused on medium-term debt sustainability. Many do not conduct a debt sustainability analysis on a regular basis, and very little coordination of information between debt offices and other agencies involved in macroeconomic management takes place. Clearly, coordination of debt management with macroeconomic policies, as well as regular conduct of debt sustainability analysis are critical, not only as part of the requirements for the HIPC process, but also if these countries are not to relapse into an unsustainable debt position. In particular, close coordination between the budget, cash management, planning functions, and the debt management office is essential. Again, the Guidelines and the lessons drawn from the case studies provide some insights into how they can develop debt management strategies that pay attention to the medium-to-long term implications of economic policies, and the resulting implications for debt sustainability. For example, they show how various countries have built linkages between debt managers, cash managers, and monetary and fiscal policymakers to ensure that relevant information is shared on a regular basis, and that their respective policies and operational activities are appropriately coordinated.

Unsustainable debt burdens in HIPCs have, in the past, also resulted from unsound policies regarding new borrowing even after benefiting from concessions, including rescheduling. To date, up to two-thirds of these countries still do not have in place a sound policy framework for new borrowing, a direct consequence of the fact that they have yet to develop a comprehensive debt strategy, and many lack complete information on the total debt they have incurred or guaranteed. Moreover, even though domestic debt is becoming an important aspect of fiscal sustainability in some low-income countries, including HIPCs, underdeveloped domestic financial markets seriously limit the role of domestic debt in most HIPCs. If they are to ensure long-term

Box 1. Applying the Guidelines to HIPCs (Continued)

sustainability beyond the HIPC completion point, however, they need to develop borrowing strategies that are clear, transparent and enforceable and begin to develop a domestic debt market so that they can broaden the range of borrowing options available to them. The Guidelines and the case studies offer some lessons on how they could implement a framework that could not only be used by them to develop an overall debt management strategy—including sound new borrowing policies—and develop their domestic debt markets, but would also allow debt managers in these countries to identify and manage the trade-offs between the expected costs and risks in the government debt portfolio. For example, they highlight the benefits of using an asset-liability management (ALM) approach to assessing the debt service costs of different borrowing strategies in tandem with the financial characteristics of government revenues, expenditures, and financial assets. They encourage debt managers to stress test the results obtained so that debt strategy decision-makers have an understanding of how the chosen strategy will perform in a variety of economic and financial settings. And, they note how increased transparency in debt management activities and the choice of borrowing instruments can be used to promote the development of a liquid market for domestic government securities.

To be able to develop strong systems for debt management in a manner consistent with the Guidelines, HIPCs will continue to need technical assistance to build their debt management capacity. Long-term debt sustainability should be viewed not only in relation to the debt burden but also in terms of the structures, processes and management information services required to manage the debt burden effectively. The HIPC process itself recognizes this by focusing on, among other things, the technical assistance requirements of HIPCs reaching the decision point. At the same time, the countries themselves must supplement the assistance efforts by ensuring that there are adequate numbers of motivated staff in debt offices that could benefit from technical assistance. In addition, full political support is critical to the success of any efforts to strengthen debt management capacity.

In general, while the Guidelines and the lessons drawn from the case studies should be useful for all countries striving to develop their policy frameworks and capacity for debt management, they are particularly relevant for HIPCs. For them, the Guidelines and lessons drawn can not only facilitate achievement of the decision and completion points of the HIPC process, more importantly they can help ensure that debt sustainability is maintained for many years to come.

^{1/} See *External Debt Management in Heavily Indebted Poor Countries*, Board Discussion Paper, IDA/SecM2002-0148, Washington D.C., 2002.