



Policy Paper

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Policy for Providing Heavily Indebted Poor Countries Relief from Asian Development Fund Debt and Proposed Debt Relief to Afghanistan

Asian Development Bank

CURRENCY EQUIVALENTS

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Currency Unit	–	afghani/s (AF)
AF1.00	=	\$0.020
\$1.00	=	AF49.83

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AfDB	–	African Development Bank
GDP	–	gross domestic product
HIPC	–	heavily indebted poor countries
IBRD	–	International Bank for Reconstruction and Development
IDA	–	International Development Association
IMF	–	International Monetary Fund
NPV	–	net present value
OCR	–	ordinary capital resources
ODA	–	official development assistance

GLOSSARY

Common reduction factor	The proportion of debt relief that must be granted (in net present value terms) to bring a country's debt indicators below the thresholds of the Heavily Indebted Poor Countries (HIPC) Initiative.
Completion point	For a post-decision point country to reach the completion point, it must maintain macroeconomic stability under a poverty reduction and growth facility-supported program, carry out key structural and social reforms, and implement a poverty reduction strategy satisfactorily for 1 year. Debt relief is then provided irrevocably by the country's creditors.
Decision point	For a country to reach the decision point, it should have a track record of macroeconomic stability, have prepared an interim poverty reduction strategy through a participatory process, and have cleared any outstanding arrears. The amount of debt relief necessary to bring the country's debt indicators to HIPC initiative thresholds is calculated, and it begins receiving debt relief on a provisional basis.
Ring-fenced countries	Countries that meet the HIPC initiative's income and indebtedness criteria based on end-2004 data. Only countries within the ring fence can become eligible for relief under the HIPC initiative.
Sunset clause	The deadline for meeting the HIPC Initiative's eligibility requirements (31 December 2006).

NOTES

- (i) The fiscal year (FY) of the Government of Afghanistan ends on 20 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2007 ends on 20 March 2007.
- (ii) In this report, "\$" refers to US dollars.

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EXECUTIVE SUMMARY

The Heavily Indebted Poor Countries (HIPC) Initiative, launched by the International Development Association (IDA) and International Monetary Fund (IMF), provides debt relief to poor countries with levels of external debt that severely burden export earnings or public finance. The participation of the Asian Development Bank (ADB) in the initiative was discussed during the Asian Development Fund (ADF) VIII negotiations, but no member countries became eligible for HIPC during the ADF VIII period (2001–2004). In the ADF IX period (2005–2008), IDA and IMF found that several ADF borrowers met the income and indebtedness criteria of the HIPC initiative at the end of 2004. ADF donors voiced their support for ADB's participation in the HIPC initiative during the ADF IX midterm review meeting in December 2006, while reaffirming the need to maintain the financial viability of ADF and not impair future support for ADF countries. Subsequently, ADB received a request from the World Bank and IMF to participate in HIPC initiative debt relief to Afghanistan.

Eligibility for the HIPC initiative is limited to countries that meet income and indebtedness criteria (net present value [NPV] of debt-to-exports ratio greater than 150%, or NPV of debt-to-government revenues ratio greater than 250%) based on end-2004 data. Countries must also be eligible for concessional assistance from IDA and IMF. While six ADB member countries met the criteria, three have indicated they do not want to receive HIPC initiative debt relief. The other three—Afghanistan, Kyrgyz Republic, and Nepal—would need to request HIPC initiative support, have a track record of macroeconomic stability, have prepared an interim poverty reduction strategy paper, and have cleared any outstanding arrears to qualify for debt relief. Among ADF borrowers, only Afghanistan has reached this so-called decision point. Once a country reaches the decision point, it begins receiving provisional debt relief. To reach the so-called completion point, a country must maintain macroeconomic stability under an IMF-supported program, carry out the structural and social reforms agreed upon at the decision point, and satisfactorily implement a poverty reduction strategy for 1 year. At the completion point, the country receives the full amount of debt relief, which then becomes irrevocable.

Debt relief for Afghanistan under the HIPC initiative has been determined by the country's indebtedness levels at the end of FY2006 following the application of traditional debt relief. With outstanding ADF loans of about \$255 million in disbursed principal and capitalized interest in nominal terms, ADB is the third largest creditor after the Russian Federation and World Bank. Based on this outstanding loan amount, the projected reflows of principal repayments and interest are \$115 million in NPV terms. Using the common reduction factor of 51%, the cost to ADF would be \$58.8 million in NPV terms. During the remainder of ADF IX, lost cash flows from debt relief will be approximately \$0.5 million, which can be absorbed within the current resource envelope without reducing assistance to other ADF countries. Financing the costs of debt relief will be discussed during future ADF replenishment negotiations.

I. INTRODUCTION

1. The International Development Association (IDA) and International Monetary Fund (IMF) launched the Heavily Indebted Poor Countries (HIPC) Initiative in 1996. The initiative provides debt relief to poor countries with levels of external debt that severely burden export earnings or public finance. In 1999, the initiative was enhanced to enable more countries to qualify for HIPC relief. Participation in the initiative for lenders other than IDA and IMF is voluntary. The participation of the Asian Development Bank (ADB) in HIPC initiative debt relief was first discussed during the negotiations for the seventh replenishment of the Asian Development Fund (ADF)—or ADF VIII (2001–2004). At that point, ADB was considered unlikely to be called upon to participate. However, donors agreed to discuss how to finance any cost related to the HIPC initiative if and when the situation warranted it, while maximizing the use of internal resources of ADB. Donors agreed that any financing should not undermine the financial integrity of ADB or compromise the capacity of ADF.¹

2. No ADF borrowing country became eligible for HIPC initiative debt relief during the ADF VIII period. However, during the ADF IX period (2005–2008), IDA and IMF found that several ADF borrowers met the income and indebtedness criteria of the HIPC initiative at the end of 2004.² Of these, only Afghanistan has reached the decision point.³ For a country to reach the decision point, it should have a track record of macroeconomic stability, have prepared an interim poverty reduction strategy through a participatory process, and have cleared any outstanding arrears. The amount of debt relief necessary to bring the country's debt indicators to HIPC initiative thresholds is calculated, and it begins receiving debt relief on a provisional basis. ADF donors voiced their support for ADB's participation in the HIPC initiative during the ADF IX midterm review meeting in Frankfurt, Germany, on 4–5 December 2006. While proposing recourse to the use of internal resources, they also reaffirmed the need to maintain the financial viability of ADF and not to impair future support for ADF countries.⁴ On 7 May 2007, ADB received a request from the World Bank and IMF to participate in HIPC initiative debt relief to Afghanistan. However, ADB currently lacks the legal basis to provide such relief.

3. This policy paper outlines a proposal to enable ADB to provide ADF debt relief, and provides for application of such relief to Afghanistan. Attached to the policy paper is a draft report of the Board of Directors to the Board of Governors recommending (i) authorization for ADB to provide debt relief in accordance with the HIPC initiative to eligible ADF borrowers, and (ii) amendment of the relevant Board of Governors' resolutions to enable the provision of such relief. Subject to the Board of Governors' adoption of the proposed resolutions, the policy paper also seeks the Board of Directors' approval of (i) corresponding amendments to the Regulations of the Asian Development Fund (ADF Regulations), and (ii) provision of debt relief to Afghanistan under the HIPC initiative.

¹ ADB. 2000. *ADF VIII Donors' Report: Fighting Poverty in Asia*. Manila (R221-00, Revision 1, 2 November).

² IDA and IMF. 2006. *Heavily Indebted Poor Countries (HIPC) Initiative—List of Ring-Fenced Countries that Meet the Income and Indebtedness Criteria at end-2004*. Washington, DC (11 April); and 2007. *Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Preliminary Document*. Washington, DC (27 March).

³ See Box 1 for an explanation of the decision point concept. Afghanistan reached the decision point on 9 July 2007. IDA and IMF. 2007. *Islamic Republic of Afghanistan Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Decision Point Document*. Washington DC (8 June).

⁴ The term "ADF countries" in this paper refers to countries that have access to loans on concessional terms and grants from the Asian Development Fund.

4. If an ADB member with outstanding loans from ordinary capital resources (OCR) requests HIPC initiative debt relief, only the ADF loans will be considered under this policy. Rescheduling or writing off of sovereign OCR loans is not contemplated under this policy.

II. HEAVILY INDEBTED POOR COUNTRIES INITIATIVE

A. Main Features

5. The HIPC initiative was established in 1996 to reduce the excessive debt burden faced by the world's poorest nations. In 1999, the international community endorsed modifications to the HIPC initiative, enabling more countries to qualify for HIPC assistance, accelerating and deepening the delivery of debt relief, and strengthening the link between debt relief and poverty reduction.⁵

6. A "sunset clause" was stipulated in the 1996 program of action to prevent the HIPC initiative from becoming a permanent facility, minimize moral hazard, and encourage the early adoption of reform programs. The program of action stated that "the Initiative would be open to all HIPC countries that pursue or adopt programs of adjustment and reform supported by the IMF and IDA in the next two years, after which the Initiative would be reviewed and a decision made whether it should be continued."⁶ The 1998 review of the initiative included a 2-year extension followed by two more extensions. In September 2004, IMF and IDA extended the sunset clause of the HIPC initiative to the end of 2006 and "ring-fenced" its application to countries satisfying the HIPC initiative income and indebtedness criteria using end-2004 data.

7. In April 2006, the executive boards of IDA and the IMF approved the list of ring-fenced countries.⁷ Although the list has been closed, the boards of IDA and IMF could amend it on a case-by-case basis to include additional countries whose data are verified to meet the relevant criteria. In August 2006, the boards of IDA and the IMF agreed to let the sunset clause take effect at the end of 2006 and to grandfather⁸ all countries that are assessed to have met the income and indebtedness criteria based on end-2004 data (footnote 5). While meeting the income and indebtedness criteria implies that a country is potentially eligible for debt relief under the HIPC initiative, it does not guarantee qualification for such relief. To qualify for HIPC initiative debt relief, countries would need to satisfy a number of conditions, as summarized in Box 1. Even if these conditions are met, qualification for debt relief under the initiative would be assessed only at the request of the country. Each country on the list can decide whether to avail itself of HIPC debt relief.

⁵ For details see *Modifications to the Heavily Indebted Poor Countries (HIPC) Initiative*, DC/99-25, September 17, 1999; and *Heavily Indebted poor Countries (HIPC) Initiative: Note on Modalities for Implementing HIPC Debt Relief Under the Enhanced Framework*, IDA/R2000-4, January 10, 2000.

⁶ IDA and IMF. 2006. *Heavily Indebted Poor Countries (HIPC) Initiative—Issues Related to the Sunset Clause*. Washington, DC (16 August).

⁷ IDA and IMF. 2006. *Heavily Indebted Poor Countries (HIPC) Initiative—List of Ring-Fenced Countries That Meet the Income and Indebtedness Criteria at end-2004*. Washington, DC (11 April).

⁸ Grandfathering means that all countries meeting the income and indebtedness criteria based on end-2004 data can qualify for HIPC debt relief whether or not they adopted programs of adjustment and reform supported by the IMF and IDA before the end of 2006.

Box 1: Enhanced HIPC Initiative Eligibility and Qualification Criteria

Assessment of Potential Eligibility. A country must have an unsustainable debt burden based on its indicators at the end of December 2004, even after full application of the traditional debt-relief mechanisms (such as the Naples terms under the Paris Club agreement). A country's debt level is considered unsustainable if the net present value (NPV) of debt-to-exports ratio is above 150%; or, for very open economies where the exclusive reliance on external indicators might not adequately reflect the fiscal burden of external debt, if the NPV of debt-to-government revenues ratio is above 250%. To qualify under the second criterion, a country's ratio of exports of goods and services to gross domestic product must be above 30% and its ratio of fiscal revenue to gross domestic product must be above 15%. A country must be eligible for concessional assistance from the International Development Association (IDA) of the World Bank and from the poverty reduction and growth facility of the International Monetary Fund (IMF).

Determination of Eligibility. Once a country is added to the list of ring-fenced countries (potentially eligible), it becomes eligible for debt relief under the HIPC initiative if it has ongoing programs with IDA and a poverty reduction and growth facility program with IMF.

Qualification for Debt Relief (Decision Point). To reach the decision point, a country must have a track record of macroeconomic stability, have prepared an interim poverty reduction strategy paper, and have debt burden indicators above the HIPC initiative thresholds using the most recent data for the year immediately before the decision point. In addition, World Bank, IMF, and the authorities must reach understandings on appropriate completion point triggers that need to be reached. At this stage, staff of IDA and IMF carry out a loan-by-loan debt sustainability analysis to determine the level of indebtedness of the country and the amount of debt relief it may receive. Once countries have acknowledged their intention to avail themselves of debt relief under the initiative, the boards of IDA and IMF decide whether to provide such relief. Following the boards' approvals, a country has reached the decision point and can begin receiving interim debt relief on a provisional basis.

Qualification for Completion Point. To reach the completion point, a country must maintain macroeconomic stability under an IMF-supported program, carry out key structural and social reforms as agreed upon at the decision point, and implement a poverty reduction strategy satisfactorily for at least 1 year. IDA and IMF boards decide when a country has completed the program. Following the boards' approval, a country reaches the completion point and debt relief becomes irrevocable. The HIPC framework also includes a provision by which additional debt relief—"topping-up"—could be committed at the completion point in exceptional cases when exogenous factors fundamentally change a country's economic circumstances. The period between a country's decision and completion points varies according to the pace at which a country implements its floating completion point triggers. Moreover, upon reaching the completion point, countries become eligible for 100% debt relief on their eligible obligations to the African Development Bank, IDA, and IMF under the multilateral debt relief initiative.

8. For a country that qualifies for the HIPC initiative, the level of debt relief is determined after the full application of traditional debt relief from bilateral and commercial lenders.⁹ The proportion of relief that must be granted to bring the country's debt indicators within the HIPC initiative thresholds is called the "common reduction factor". While harmonizing computation methods is essential, since HIPC is a joint effort by all international creditors, the mode of debt relief delivery can be creditor-specific as long as the net present value (NPV) amount of debt relief can be achieved. HIPC initiative debt relief can be delivered in a number of ways,

⁹ Traditional debt relief implies a stock-of-debt operation on Naples terms by the Paris Club and at least a comparable treatment by other official and commercial creditors on eligible debt (pre-cutoff and non-ODA). Under Naples terms, ODA credits are rescheduled at an interest rate as least as concessional as the original rate, with a 40-year maturity and 16-year grace period. Non-ODA credits are subject to a 67% debt reduction.

including reducing stock, providing grants, rescheduling debt repayments, or reducing debt service payments when they fall due. IDA and the African Development Bank (AfDB) commonly use debt service reduction and cancellation. To give considerable up-front benefits after reaching the decision point, IDA provides as much as one third of its debt relief in the interim period before the completion point, while AfDB provides up to 40%. IDA reduces nominal debt service payments by 50%–90%, whereas AfDB reduces debt service payments by up to 80%. To the extent possible, IDA provides its relief within 20 years, and AfDB does it within 10–40 years.

9. Under the HIPC initiative, 31 countries have qualified for debt relief. Of these, only Afghanistan is an ADF borrower. Further, 22 of these countries have reached their completion points and are receiving irrevocable debt relief. The nine countries that are between the decision point and the completion point are receiving interim debt service relief. Estimated debt relief under the HIPC initiative to the 31 countries that have reached their decision points was about \$44.9 billion in end-2006 NPV terms, including \$32.8 billion for the 22 completion point countries. In addition to the 31 countries that have qualified for the HIPC initiative, 10 countries that have not reached the decision point might qualify for HIPC initiative debt relief. Thus, the total cost of HIPC initiative debt relief for the 41 identified countries was estimated at \$67.6 billion in end-2006 NPV terms.

B. Financing Modes

10. In IDA's case, the main instrument for financing HIPC initiative debt relief was initially the HIPC Trust Fund established in 1996. The trust fund, which is administered by IDA, is structured to allow multilateral creditors to participate in the initiative in ways that are consistent with their financial policies. It also helps address resource constraints for certain multilateral creditors. The trust fund's two main sources of financing have been bilateral contributions and transfers from the International Bank for Reconstruction and Development (IBRD) net income and surplus. The trust fund either prepays, or purchases a portion of the debt owed to a multilateral creditor and cancels the debt; or pays the debt service as it comes due. However, from the IDA14 replenishment onward, donors have committed to covering IDA's debt relief costs under the HIPC initiative, and are providing HIPC initiative-related contributions directly to IDA under a burden-sharing arrangement. Under the current compensation arrangements, donor financing of HIPC initiative costs occurs on a pay-as-you-go basis.

11. As of 31 December 2006, estimated HIPC initiative debt relief by IDA totaled \$17.2 billion.¹⁰ IDA's HIPC initiative costs were financed primarily by transfers from IBRD net income to the HIPC trust fund before the IDA14 replenishment (FY2006–FY2008). About \$3.4 billion in debt relief was delivered before IDA14. IDA14 was the first replenishment in which donors started to finance forgone credit reflows due to the HIPC initiative on a pay-as-you-go basis. HIPC initiative debt relief to be delivered from FY2006 to FY2044 is estimated at \$13.7 billion. HIPC initiative costs during IDA14 are about \$1.8 billion. About \$1.4 billion of these HIPC initiative costs will be financed by donor commitments received under IDA14, after using the remaining \$384 million from earlier IBRD transfers to the HIPC trust fund. For the IDA15 period, HIPC costs of IDA are estimated at \$2.5 billion. Required donor contributions to cover HIPC initiative costs in IDA15 are projected at \$2.2 billion, after carrying over about \$279 million

¹⁰ This paragraph is based on IDA. 2007. *Multilateral Debt Relief Initiative (MDRI): Update on Debt Relief by IDA and Donor Financing to Date*. Washington, DC (February); and IDA. 2007. *IDA's Long-term Financial Capacity*. Washington, DC (February).

(reflecting the projected reduction of the estimated HIPC initiative costs during the IDA14 period).

12. The HIPC trust fund continues to provide needed financial support to eligible regional and subregional creditors. Bilateral pledges to cover debt relief costs of regional and subregional multilateral creditors (i.e., multilateral creditors other than the World Bank) totaled \$3.7 billion through May 2007.¹¹ Paid-in contributions to the HIPC trust fund were approximately \$3.2 billion; and regional and subregional creditors have received approximately \$2.5 billion, including \$1.8 billion to the AfDB. Donors have made new pledges of \$148 million, compared with an estimated financing gap of \$493 million as of May 2007.¹² The estimated financing gap consisted of \$210 million for regional and subregional creditors of African countries after estimated arrears clearance packages, and \$282 million for the International Fund for Agricultural Development. The Inter-American Development Bank has received \$205 million from the trust fund, but it has decided to finance further debt relief from internal resources.

III. ADB MEMBER COUNTRIES AND HIPC INITIATIVE DEBT RELIEF

A. Current Status of ADB Member Countries Under HIPC Initiative

13. In April 2006, IDA and IMF presented a list of 11 countries that met the HIPC income and indebtedness criteria at the end of 2004, and might wish to be considered for debt relief under the initiative (footnote 6). The country assessments were based on a combination of loan-by-loan and aggregate debt data at the end of 2004 and macroeconomic data for 2002–2004 (Table 1). When the list was prepared, IDA and IMF could not reach a conclusion on Afghanistan's classification because a large part of the country's potential external obligations was unverified or in dispute. Subsequently, IDA and IMF staff reconciled the country's loan data and prepared a detailed debt assessment, which indicated the country met the income and indebtedness criteria for HIPC initiative eligibility. The World Bank and IMF boards added Afghanistan to the list of ring-fenced countries on 19 April 2007.¹³

14. Afghanistan reached the decision point on 9 July 2007 and has begun receiving interim debt relief from IDA (footnote 3). Two other ADB member countries—Kyrgyz Republic and Nepal—are listed as pre-decision point countries by the World Bank and IMF. However, authorities from neither country have indicated that they would seek such assistance.¹⁴

15. Three ADF borrowers that met the income and indebtedness criteria at the end of 2004—Bhutan, Lao People's Democratic Republic (Lao PDR), and Sri Lanka—have indicated that they do not want to receive HIPC initiative debt relief (footnote 6). Bhutan authorities have

¹¹ IDA. 2007. *HIPC Debt Relief Trust Fund Support for Regional and Multilateral Creditors: Status Report and Funding Needs Update*. Washington, DC (June).

¹² The funding gap estimate was based on financing requirements for the 30 decision point countries as of 31 May 2007 plus the Central African Republic, Comoros, Cote d'Ivoire, Eritrea, Liberia, Somalia, Sudan, and Togo. Estimated relief for the non-African sunset clause countries was not included, except for International Fund for Agricultural Development countries. Countries that indicated they do not wish to receive HIPC initiative debt relief are also excluded.

¹³ IMF and IDA. 2007. *Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Preliminary Document*. Washington, DC (27 March).

¹⁴ Because the Kyrgyz Republic's indebtedness ratios at the end of 2006 were below the HIPC thresholds, it would no longer qualify for the HIPC initiative. Hence, although Kyrgyz Republic is still listed among the pre-decision point countries, IDA and IMF exclude it from their debt relief cost estimates. IDA and IMF. 2007. *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation*. Washington, DC (28 August).

Table 1: ADF Borrowers Meeting the Income and Indebtedness Criteria Under the Enhanced HIPC Initiative at the End of 2004
(%)

Country	NPV Debt-to-Exports Ratio (HIPC Threshold = 150%)	NPV Debt-to-Revenue Ratio (HIPC Threshold = 250%)
A. Countries That Might Wish to Be Considered for Debt Relief		
Afghanistan	585	—
Kyrgyz Republic	184	376
Nepal	198	261
B. Countries That Indicated They Would Not Seek Debt Relief		
Bhutan	299	204 ^a
Lao PDR	221	495 ^a
Sri Lanka	111 ^a	258

ADF = Asian Development Fund, HIPC = heavily indebted poor country, Lao PDR = Lao People's Democratic Republic, NPV = net present value.

Notes: Figures for countries other than Afghanistan are as of 7 April 2006, except as indicated. Figures for Afghanistan are as of 20 March 2007. Myanmar could not be assessed due to lack of available data.

^a Figure taken from an alternate source and shown for illustrative purposes only. They may not be comparable with other figures.

Sources: International Monetary Fund (IMF). 2006. *Lao PDR: Staff Report for the 2005 Article IV Consultation*. Washington, DC (22 February); IMF and International Development Association (IDA). 2005. *Heavily Indebted Poor Countries (HIPC) Initiative—Status of Implementation*. Washington, DC (19 August); IMF and IDA. 2006. *Heavily Indebted Poor Countries (HIPC) Initiative—List of Ring-Fenced Countries that Meet the Income and Indebtedness Criteria at end-2004*. Washington, DC (11 April); and IMF and IDA. 2007. *Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Preliminary Document*. Washington, DC (27 March).

pointed out that the country's debt ratios are expected to decline significantly in the near future. Lao PDR authorities have indicated that their country is not ready to participate in the initiative. Sri Lanka authorities have indicated that their debt indicators at the end of 2004 would be below the relevant HIPC initiative thresholds if provincial revenues had been taken into account. They have also pointed out that all of their debt indicators have moved significantly below the HIPC initiative thresholds in 2005, even without taking into account provincial revenues. Although these three countries have indicated they do not wish to receive debt relief, they remain potentially eligible under the current HIPC framework (footnote 5). Another ADF borrower, Myanmar, could not be assessed due to lack of available data. As such, Myanmar is not included on the list.

B. The Case of Afghanistan

16. Afghanistan has made considerable progress in gaining control of its macroeconomic management and rebuilding the country, despite the ongoing conflict and fragile security situation (Appendix 1). However, the huge overhang of foreign debt hampers the country's development prospects. IDA and IMF estimated that the country had accumulated nearly \$12 billion in public and publicly guaranteed debt (\$11.6 billion in NPV terms) as of 20 March 2006, the bulk of which was owed to the Russian Federation.¹⁵ When the 80% up-front discount is applied to the Russian debt, which is consistent with the procedures agreed upon when the

¹⁵ Debt figures in this section are taken from IMF and IDA. 2007. *Islamic Republic of Afghanistan: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Preliminary Document*. Washington, DC (27 March).

Russian Federation joined the Paris Club in 1997, Afghanistan's external debt falls to \$3.0 billion (\$2.7 billion in NPV terms). Even with the 80% up-front discount, the NPV of the debt-to-exports ratio was estimated at 585% at the end of 2004, which is well above the threshold for HIPC initiative eligibility. As the national reconstruction effort continues—and in recognition of the country's progress in policy reforms—the international development community has begun to relieve some of Afghanistan's external debt burden. By freeing up resources that would otherwise service the debt, the Government can intensify its efforts to rebuild the country and reduce poverty.

17. Afghanistan's Paris Club creditors (Germany, the Russian Federation, and the United States) agreed on 19 July 2006 to provide debt relief. This agreement covers roughly \$2.4 billion due on official development assistance (ODA) and non-ODA debts (arrears and late interest due as of 31 March 2006, as well as the maturities falling due between 1 April 2006 and 31 March 2009). The accord also canceled \$1.6 billion and rescheduled \$0.8 billion. ODA credits are to be repaid over 40 years, with a 16-year grace period. For commercial credits, 67% were canceled and the remaining 33% were rescheduled over 23 years, with a 6-year grace period. This agreement on debt relief is only the first step. In the London Conference on Afghanistan, convened on 31 January 2006, the governments of Germany, the Russian Federation, and the United States agreed to cancel 100% of the country's debt once Afghanistan reaches the HIPC initiative completion point. After the full application of traditional debt-relief mechanisms, Afghanistan's debt in NPV terms is estimated at \$1.1 billion (as of 20 March 2006). This represents 306.2% of exports of goods and services.¹⁶

18. Possible debt service relief to Afghanistan under the HIPC initiative totals \$571.4 million in NPV terms (\$1.3 billion in nominal terms).¹⁷ IDA will provide assistance totaling \$75.2 million in NPV terms. Immediately following the approval of the decision point by the boards, IDA began to reduce debt service on debt outstanding and disbursed as of 20 March 2006. The OPEC Fund for International Development is assumed to reduce debt service starting at the completion point by \$1.0 million in NPV terms, until its contributions meet the requirement under the HIPC initiative. Paris Club bilateral creditors are assumed to provide debt relief of about \$419.7 million in NPV terms. Official bilateral creditors outside the Paris Club are assumed to provide relief on comparable terms.

19. All outstanding sovereign lending from ADB to Afghanistan is from ADF. The country does not have any arrears with ADB.¹⁸ As of 20 March 2006, ADB was the third largest creditor (after the Russian Federation and World Bank), with about \$255 million in disbursed principal and capitalized interest in nominal terms (8.4% of the total). Based on this outstanding loan amount, the projected reflows of principal repayments and interest total \$115.4 million in NPV terms (4.2% of the total). Using the common reduction factor of 51%, the cost to ADF in NPV terms would be \$58.8 million. The financial implications are discussed in more detail in section IV B.

20. The application of traditional debt relief will reduce Afghanistan's debt from \$2.7 billion in NPV terms to \$1.1 billion as of the end of FY2006. This is equivalent to an NPV of debt-to-

¹⁶ Based on the 3-year average of exports of goods and services (backward-looking, i.e., FY2004–FY2006); excluding transit goods.

¹⁷ This paragraph is based on the document cited on footnote 3.

¹⁸ For ADB to restart operations in Afghanistan in 2002, arrears on four ADF loans had to be settled. The Department for International Development of the United Kingdom provided the funds to settle the overdue loan service payments covering due dates 1 January 1992 to 15 July 2002 (approximately \$17 million). Afghanistan has not incurred any arrears with ADB since then.

exports ratio of 749% (as compared to the HIPC initiative threshold of 150%) and NPV of debt-to-revenues ratio of 659% (as compared to the HIPC initiative threshold of 250%). Under the HIPC initiative, Afghanistan's NPV of debt-to-exports ratio will be lowered to the required threshold as this would provide the country with the most relief. When the country reaches the completion point—estimated to be before the end of FY2010—the level of debt outstanding is expected to have fallen to \$826 million in NPV terms, including new borrowing, or roughly 95% of exports.

IV. IMPLICATIONS OF ADB PARTICIPATION IN HIPC INITIATIVE DEBT RELIEF

A. Legal Implications

21. The principle of strict separation of OCR and Special Funds resources is laid down in Article 10 of the Agreement Establishing the Asian Development Bank (the Charter). Article 10.2 provides that ADB's OCR "shall under no circumstances be charged with, or used to discharge, losses or liabilities arising out of special operations." Article 10.3 provides that "(e)xpenses appertaining directly to special operations shall be charged to the Special Funds resources."¹⁹ Thus, the losses and expenses ensuing from debt relief provided to ADF borrowers must be charged to ADF resources.

22. The use of ADF resources is subject to Article 19 of the Charter, which governs Special Funds. With regard to a small portion of ADF, consisting of resources set aside from ADB's paid-in capital and transferred to ADF in 1975, Article 19.2 applies. Article 19.2 provides that such set-aside funds

may be used to guarantee or make loans²⁰ of high developmental priority, with longer maturities, longer deferred commencement of repayment and lower interest rates than those established by the Bank for its ordinary operations. Such Funds may also be used on such other terms and conditions, not inconsistent with the applicable provisions of this Agreement nor with the character of such Funds as revolving funds, as the Bank in establishing such Funds may direct.

23. The requirements in Article 19.2 mean that, to the extent that debt relief involves forgiveness of loan principal, the portion of ADF consisting of set-aside funds cannot be applied to debt relief. For the other ADF resources (donor contributions, investment income, reflows from ADF borrowers, and transferred OCR net income), Article 19.3 of the Charter applies. It provides that those funds may be used "in any manner and on any terms and conditions not inconsistent with the purpose of the Bank and with the agreement relating to such funds."

24. Article 1 of the Charter states that the purpose of ADB is "to foster economic growth and co-operation in the region"...and..."to contribute to the acceleration of the process of economic development of the developing member countries in the region." The debt relief provided under the HIPC initiative purports to contribute to the accelerated economic development of ADB's poorest member countries. As such, it is consistent with the purpose of ADB set out in the Charter, thus meeting the first requirement of Article 19.3.

¹⁹ ADB.1965. *Agreement Establishing the Asian Development Bank*. Manila.

²⁰ The term "loan" implies that at least the principal amount must be repaid.

25. The second requirement in Article 19.3 (i.e., that the use of the Special Funds governed by this provision must be consistent “with the agreement relating to such funds”) refers in this case to the agreement between ADB and the contributors to ADF, which comprises the agreement on the initial contributions and the agreements on the replenishments. Such agreements are set out in various resolutions of the Board of Governors. These, in turn, refer to reports of the Board of Directors to the Board of Governors, which for recent replenishments incorporate by reference a donors’ report, and the Regulations of the Asian Development Fund (ADF Regulations). Except for the Board of Governors’ resolution on the eighth replenishment (ADF IX), which allowed a portion of the contributions made for ADF IX to be used as grants, the resolutions of the Board of Governors specified that the initial contributions and subsequent replenishments were made “to finance the Bank’s concessional lending operations.”

26. The term “lending”, even on the most concessional terms, implies that eventually the principal amount of the loan must be repaid. Forgiveness of any portion of the principal of any loan was not foreseen in the agreements with ADF contributors and the resolutions of the Board of Governors reflecting those agreements. To enable ADB to participate in the HIPC initiative, a resolution of the Board of Governors is required authorizing a global amendment of its resolutions on the initial contributions to ADF and the ADF replenishments to the effect that ADF resources (other than the set-aside resources) may be used for debt relief.

27. Section 6.01 of the ADF Regulations provides that “the prior consent in writing of every Contributor shall be required before the coming into effect of any amendment [of the Regulations] modifying

- (a) the provisions of Section 3.01(a), which specify the manner in which ADB may use the resources of the Fund in its operations;”

28. Introducing debt relief in accordance with the HIPC initiative requires a modification, as specified in Section 6.01 (a) of the ADF Regulations. Currently, the ADF Regulations allow the use of ADF resources for the provision of loans on concessional terms and, in the event and to the extent so provided by a resolution of the Board of Governors authorizing an ADF replenishment, grants. ADF Regulations do not have a provision authorizing the use of ADF resources for forgiveness of any loan principal.

29. Written consent from every ADF donor has been obtained for the amendment of the ADF Regulations to allow the use of ADF resources (except the set-aside resources) for debt relief. Such amendment of the ADF Regulations may be approved by a special resolution of the Board of Directors, requiring at least a two-thirds majority of the total voting power of the members of ADB.²¹

B. Financial Implications

30. The amount of HIPC initiative debt relief ADB would provide is determined by (i) the ADF loan exposure to the country in NPV terms as of a reference date; and (ii) the common reduction factor needed to bring the country’s external debt ratios below the HIPC initiative thresholds (i.e., NPV of debt-to-exports ratio of 150%, or NPV of debt-to-government revenues ratio of 250% for very open economies). IDA and IMF calculate the common reduction factor, which is an integral part of the decision point document considered by their boards. For Afghanistan, the common reduction factor is 51% (footnote 3). Using IDA’s computational

²¹ See Article VI, Sec. 6.01 and Article I, Sec. 1.02 of the ADF Regulations.

assumptions (Appendix 2), the value of principal repayments and interest on the loans outstanding as of 20 March 2006 is estimated to be \$297.0 million in nominal terms and \$115.4 million in NPV terms. Applying the common reduction factor, ADB's HIPC initiative debt relief to Afghanistan would total \$58.8 million in NPV terms.

31. Table 2 shows the proposed approach for ADB to deliver debt relief to Afghanistan, which is aligned with the approach of IDA, by ADF replenishment period. The schedule is in Appendix 5. To provide debt relief of \$58.8 million in NPV terms within the next 20 years, about 75% would be deducted from the debt service payments on the outstanding balance as they come due.²² The outstanding balance is the disbursed amount as of 20 March 2006. Interim assistance will begin with payments due in the month following the Board of Directors' approval to provide debt relief under the HIPC initiative. It would continue until the country has reached the completion point, subject to the limitation of one third of total NPV of debt relief during the interim period. Interim relief between the decision point (July 2007) and the projected completion point (July 2009) is approximately \$1.6 million in nominal terms. Proposed ADF debt relief in nominal terms totals \$104.9 million.²³

Table 2: Proposed Approach to Delivery of ADF Debt Relief to Afghanistan
(\$ million)

Period	NPV of Debt Relief	Nominal Reduction of Debt Service Payments		
		Principal	Interest	Total
2005–2008 (ADF IX)	0.5	0.5	0.0	0.5
2009–2012 (ADF X)	3.8	3.9	0.2	4.1
2013–2016 (ADF XI)	16.9	16.7	6.6	23.3
2017–2020 (ADF XII)	12.4	14.6	6.5	21.1
2021–2024 (ADF XIII)	13.0	20.8	5.9	26.7
2025–2028 (ADF XIV)	12.1	25.0	4.2	29.2
Total	58.8	81.5	23.4	104.9

ADF = Asian Development Fund, NPV = net present value.

Notes: Principal and interest payments due to the Asian Development Bank correspond to prorated projections based on the disbursed and outstanding debt as of 20 March 2006, converted to dollars using the exchange rate as of the end of March 2006.

Source: Asian Development Bank.

32. ADB's participation in the HIPC initiative will result in lost cash flows of only \$0.5 million for the remaining ADF IX period. As most of Afghanistan's outstanding ADF loans are still within their grace periods, the lost cash flows comprise the foregone principal repayments and the lost interest payments from loans that were extended before 1980. This amount can be absorbed within the prudential financial margins of ADF IX without reducing assistance to other ADF countries. The bulk of the debt service reductions will fall due during the ADF XI period and

²² Upon approval of the Board of Directors, the full nominal amount of the principal component of the estimated debt relief (\$81.5 million for Afghanistan valued at the exchange rates in Appendix 2) will be recorded as a reduction in the outstanding ADF loans. This provisioning will be charged against ADF income in the income statement and will flow through to the equity section of the balance sheet. The actual dollar equivalent will depend upon the exchange rates prevailing at the time of Board of Directors approval.

²³ As per the schedule in Appendix 5, the total is \$104,917,816. This amount could change depending on the timing of the completion point.

beyond. As such, financing the cost of HIPC initiative debt relief to Afghanistan can be addressed during future ADF replenishment negotiations.

33. Although the financial impact of providing debt relief to Afghanistan alone is limited, other ADF borrowers might reach the decision point. To illustrate the possible magnitude of the impact, Table 3 shows the nominal value of loans outstanding to all ADF borrowers meeting the HIPC initiative income and indebtedness criteria at the end of 2004.²⁴ Afghanistan's outstanding loan balance of \$326 million is only about 1.5% of all ADF loans outstanding as of 31 March 2007. Including the other two pre-decision point countries increases the exposure to about 10% of ADF loans. However, such an outcome is very unlikely. The countries that have indicated they would not seek debt relief under the HIPC initiative accounted for about 15% of ADF loans outstanding.

Table 3: Outstanding ADF Loans to Borrowers Meeting the Income and Indebtedness Criteria Under the Enhanced HIPC Initiative at the End of 2004
(as of 31 March 2007)

Country	ADF Loans Outstanding	
	(\$ million)	(% of total)
A. Countries That Might Wish to Be Considered for Debt Relief		
Afghanistan	326.6	1.5
Kyrgyz Republic	511.5	2.3
Nepal	1,366.8	6.3
Subtotal	2,205.0	10.1
B. Countries That Indicated They Would Not Seek Debt Relief		
Bhutan	99.0	0.5
Lao PDR	943.1	4.3
Sri Lanka	2,340.7	10.7
Subtotal	3,382.7	15.5
Total	5,587.6	25.6

ADF = Asian Development Fund, HIPC = heavily indebted poor countries, Lao PDR = Lao People's Democratic Republic.

Notes: Figures in columns might not add up to total due to rounding. Myanmar could not be assessed for HIPC eligibility due to lack of available data, but it could be added to the list later if it meets all of the eligibility criteria. As of 31 March 2007, Myanmar had \$466.8 million in ADF loans outstanding (equivalent to 2.1% of total ADF loans outstanding).

Source: Asian Development Bank.

C. Operational Implications

34. ADB's participation in HIPC initiative debt relief need not affect its forward program of assistance to a country that has reached the decision point. To be eligible for HIPC initiative relief, a country must have an interim poverty reduction strategy in place. Since ADB's country partnership strategies are aligned with these national poverty reduction plans, there is no a

²⁴ Should a country become eligible for HIPC initiative debt relief, actual relief provided by ADB would be less than the nominal amount of outstanding ADF loans. The magnitude will depend on the NPV of debt service on the disbursed principal, which is less than the nominal value of the loans due to the concessional terms of the debt, and the common reduction factor.

priori reason for debt relief to lead to revisions in the country program. Ongoing ADF loans also need not be affected. Although the amount of debt relief is based on the outstanding disbursed amount as of a certain date, for debt relief to undermine development efforts would run counter to the principles of the HIPC initiative. As such, the portfolio of ongoing projects should continue as planned. However, if the debt situation does not improve as envisaged due to external factors beyond the government's control following the decision point, ADB may consider providing additional debt relief (called topping up) to ensure the debt ratios at the completion point are sustainable. The additional assistance would be limited to the amount necessary to bring the debt indicators below the HIPC initiative thresholds. Because this would entail an additional financial burden on ADF, such relief would be subject to the approval of the Board of Directors.

35. Under the IDA14 grants framework, a country's grant eligibility is determined by its level of debt distress. High-risk countries receive 100% of their IDA allocations as grants, moderate-risk countries receive 50% grants, and low-risk ones receive all their allocations as credits. When debt relief is provided, the NPV of debt is brought below the HIPC initiative thresholds. This could lead to a shift in the proportion of IDA grants and credits in the assistance mix. Since ADB has aligned the ADF grant framework with that of IDA14, a similar shift in the grant-loan mix of assistance might arise when a country reaches the HIPC initiative decision point. Country assistance programs will need to be adjusted accordingly.

36. New sovereign or sovereign-guaranteed OCR loans will be provided prudently to countries receiving debt relief. OCR loans would be considered on a case-by-case basis only for revenue-earning projects that generate net foreign exchange above the foreign debt service requirement. Such projects will be discussed with other development partners from the project concept stage to ensure that the provision of such non-concessional assistance does not undermine the country's debt sustainability.

V. RECOMMENDATIONS

37. ADB is a partner in the international effort to restore the debt sustainability of its poorest member countries. As such, ADB should participate in the provision of debt relief in the event an ADF borrower reaches the decision point under the HIPC initiative. The debt relief should be provided in a manner that does not compromise ADB's financial integrity or compromise the capacity of ADF. To provide the legal basis for ADB to provide such support, I recommend that the Board of Directors approve:

- (i) adoption of the (draft) report to the Board of Governors attached as Appendix 3 and submission of this report with the proposed resolution to the Board of Governors; and
- (ii) submission of this matter to the Board of Governors under the special procedure provided under Section 3 of the By-Laws, with a request for a vote by telex, facsimile or e-mail within 30 days of the date of such request.

38. Subject to adoption by the Board of Governors of the resolution mentioned in paragraph 37(i) above, I recommend that the Board of Directors approve:

- (i) the amendments to the ADF Regulations set forth in Appendix 4, and

- (ii) the provision of debt relief for Afghanistan in the context of the HIPC initiative as described in this report.

39. Proposals for ADF debt relief to other countries becoming eligible under the HIPC initiative will be presented for Board of Directors' approval separately, as required.

AFGHANISTAN ECONOMIC AND DEBT SITUATION ASSESSMENT

A. Macroeconomic Management

1. Afghanistan's encouraging growth since 2002 has been supported by the Government's commitment to an ambitious reform agenda (Table A1.1). Since March 2004, the Government has been implementing an International Monetary Fund-led, staff-monitored program. The program's objectives—to maintain macroeconomic and financial stability, pursue essential structural reforms, and build statistical capacity—largely have been met. On 26 June 2006, IMF approved a follow-up, 3-year program for SDR81.0 million under the poverty reduction and growth facility.

Table A1.1: Key Economic Indicators

Item	FY2004	FY2005	FY2006	FY2007
GDP (current prices, \$ million) ^a	4,585	5,971	7,309	8,399
Real GDP Growth (% , constant market prices)	15.7	8.0	14.0	8.0
Inflation (%) ^b	24.1	13.2	12.3	6.4
Currency in Circulation (% change)	—	34.6	15.1	18.4
Government Revenues (including grants, % of GDP)	9.0	9.8	10.3	10.9
Government Operating Expenditures (% of GDP) ^c	9.8	9.4	8.9	10.5
Export Growth (% , based on \$ values)	36.1	21.6	22.2	13.3
Import Growth (% , based on \$ values)	51.8	18.5	14.6	18.8
Current Account Balance (% of GDP)				
excluding official transfers	(51.0)	(44.9)	(41.9)	(41.8)
including official transfers	3.0	1.8	0.6	(1.7)

GDP = gross domestic product.

^a Excludes the value of opium production, which is equivalent to about half of official GDP in some years.

^b Inflation rate based on consumer prices in Kabul plus five major cities only.

^c Excludes core budget development expenditures and externally financed development expenditures, which together amounted to 33.3% of GDP in FY2006.

Source: International Monetary Fund. 2007. *Islamic Republic of Afghanistan: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility*. Washington, DC (21 June).

2. A World Bank-led public finance management review¹ lauded the improvements made in budget management and execution. However, the review also noted the many remaining challenges: capacity shortages, boosting domestic revenue generation to move towards fiscal sustainability, large discrepancies in resource allocation between Kabul and the provinces, and concerns over transparency. In June 2004, Afghanistan introduced a “core” budget that consolidated the operating budget and the development budget. In June 2005, a new public financial management law was promulgated, providing stricter guidelines for budget formulation and execution, as well as a better framework for audit and external controls. Various Government accounts have been consolidated into the treasury single account, and the Government is committed to its “no-overdraft” policy.

3. In 2005, the Government established a fiscal policy unit and the Fiscal Coordination Committee. In late 2005, the Government adopted a medium-term fiscal framework with a view to moving towards a rolling 5-year, medium-term fiscal framework and a medium-term expenditure framework. The medium-term fiscal framework, which is closely aligned with the Government's new interim development strategy, is being refined further.

¹ World Bank. 2005. *Afghanistan: Managing Public Finance for Development*. Washington, DC (22 December).

4. By the end of FY2005, the execution rate of the development budget was only 43%, reflecting (i) low capacity, particularly in line ministries; (ii) poor prioritization of projects and coordination among Government agencies; (iii) unrealistic time, cost, and expenditure projections; and (iv) delays in project implementation due to deteriorating security. In FY2006, the Government increased its efforts to address the poor implementation performance. As a result, development expenditure reached 42% by mid-January 2007, and it is likely to reach about 55%–60% by the end of the fiscal year. To better reflect current spending capacities, the development budget was reduced by 5.1% at the midyear budget review.

5. Although revenue collection is improving, it needs to be enhanced significantly if the Government is to achieve its targets of collecting sufficient revenue to cover the wage bill by FY2010 and the full recurrent budget by FY2014. The Ministry of Finance is implementing a 5-year tax administration plan. A new income tax law was approved in November 2005, updating the 1965 version. The law established a two-tier income tax structure—10% for monthly incomes of up to AF100,000 and 20% for income above AF100,000 with a tax-free income threshold of AF12,500 per month. The law also provides for enforcement powers. A 10% services tax in telecommunications, restaurants, and hotels; a rental service tax; and an airport departure fee were also introduced. The Government has established a taxpayer register and is rolling out tax identification numbers. The Government also has been focusing on strengthening the large taxpayer unit, as well as improving tax and customs administration.

6. In FY2007, the current account deficit increased to an estimated \$3,557 million excluding grants; it showed a small deficit including grants amounting to 1.7% of GDP. The current account deficit is funded mainly by official transfers.

7. The current drivers of growth linked to the post-conflict reconstruction will not provide for sustained growth and poverty reduction. Similarly, the large donor- and drug-related inflows and their impact on aggregate demand and the labor market, coupled with the relatively strong currency and the absence of productivity improvements, have undermined external competitiveness, narrowing opportunities for expanding exports. Diversifying the economy, exploring opportunities for expanding the export base, and substituting some imports through domestic production will be some of the most important tasks over the next few years.

8. Since 2001, technical assistance—on the order of \$400 million annually for all levels of government, according to an Organization for Economic Cooperation and Development (OECD) estimate—has been instrumental in restoring essential administrative functions. The shortage of skilled labor, which affects the public and private sectors, is one of the main development challenges for the country in the coming years. Accordingly, still limited domestic capacity has often been complemented by external expertise, with increasing focus now on sustainable capacity development.

B. Development Assistance Coordination

9. Over the past 5 years, the degree of cooperation between the Government of Afghanistan and the international community has been extraordinary with respect to political normalization, as well as the country's reconstruction and development. In addition to the international meeting that led to the Bonn Agreements,² three major international funding conferences have been held: the April 2002 Tokyo Conference, the April 2004 Berlin

² Agreement on Provisional Arrangements in Afghanistan Pending the Re-Establishment of Permanent Government Institutions, Bonn, December 2001. These provisional arrangements are also referred to as the Bonn Process.

Conference, and the February 2006 London Conference. The London Conference resulted in \$10.5 billion dollars in donor pledges for 2006–2010. In addition, the London Conference produced the Afghanistan Compact, a unique agreement between the Government and its international partners that includes a series of time-bound benchmarks that are tracked through a series of sectoral consultative groups, a Government oversight committee, and a joint coordination monitoring board.³

10. In addition to the Afghanistan Compact mechanism, the minister of finance chairs the Aid Effectiveness Working Group, which meets regularly to discuss the development and implementation of the Government's core and development budgets, measures to improve public financial management, and aid effectiveness. The working group also assisted in the preparation of the Government's first report to the Paris Declaration Monitoring Group of OECD's Development Assistance Committee.

C. External Debt Situation

11. Afghanistan's external debt by creditor as of 20 March 2006 is shown in Table A1.2. Not shown in the table are the amounts forgiven by the governments of Denmark, Germany, the People's Republic of China, and Slovakia, which were written off before March 2006. Some small amounts owed to commercial creditors (less than 1% of total debt) remain in dispute and are also not included.

³ UN Security Council Resolution 1659 (2206). 2006. (15 February).

Table A1.2: Nominal Stock and Net Present Value of Debt by Creditor
(as of 20 March 2006)

Creditor	Debt Before Traditional Debt Relief				NPV of Debt After Traditional Debt Relief	
	Nominal Debt Stock		NPV of Debt		(\$ mill.)	(%)
	(\$ mill.)	(%)	(\$ mill.)	(%)		
Bilateral and Commercial Creditors	2,484.8	81.7	2,476.1	90.3	855.3	76.4
Paris Club Debt	2,386.2	78.4	2,377.5	86.7	822.7	73.5
Germany	43.9	1.4	43.9	1.6	13.6	1.2
Russian Federation ^a	2,230.6	73.3	2,224.1	81.1	737.2	65.8
United States	111.7	3.7	109.5	4.0	71.8	6.4
Other Official Bilateral Debt	98.6	3.2	98.6	3.6	32.6	2.9
Bulgaria	47.6	1.6	47.6	1.7	15.7	1.4
Croatia	0.4	0.0	0.4	0.0	0.1	0.0
Iraq	9.1	0.3	9.1	0.3	3.0	0.3
Kuwait	19.3	0.6	19.3	0.7	6.4	0.6
Saudi Arabia	22.2	0.7	22.2	0.8	7.3	0.7
Multilateral Creditors	557.3	18.3	264.7	9.7	264.7	23.6
Asian Development Bank	254.6	8.4	115.4	4.2	115.4	10.3
OFID	1.9	0.1	1.9	0.1	1.9	0.2
World Bank	300.8	9.9	147.5	5.4	147.5	13.2
Total	3,042.1	100.0	2,740.8	100.0	1,120.0	100.0

mill. = million, NPV = net present value, OFID = OPEC Fund for International Development.

Notes: All bilateral and commercial debt was accrued before the Paris Club cutoff date of 20 June 1999. Of the bilateral debt, only the amount from the United States was on official development assistance terms.

^a Figures are after the up-front 80% discount on Russian debt.

Source: International Monetary Fund and International Development Association. 2007. *Islamic Republic of Afghanistan Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Decision Point Document*. Washington DC (8 June).

AFGHANISTAN DEBT RELIEF—EXCHANGE RATE AND DISCOUNT RATE ASSUMPTIONS
(as of the end of March 2006)

Currency	Exchange Rate (\$ per unit of national currency)	Discount Rate (%)
Yen	0.00852	2.11
Special drawing rights	1.44085	4.54
US dollar	1.00000	5.32
Euro	1.21040	4.10
Swiss franc	0.76587	2.90
Won	0.00103	6.09
Norwegian krone	0.15198	4.42
Swedish krona	0.12834	4.08

Notes: The discount rates are the average commercial interest reference rates over the 6-month period before the reference date.

Sources: Organization for Economic Cooperation and Development and International Monetary Fund. *International Financial Statistics*.

POLICY FOR PROVIDING HEAVILY INDEBTED POOR COUNTRIES RELIEF FROM ASIAN DEVELOPMENT FUND DEBT AND PROPOSED DEBT RELIEF TO AFGHANISTAN

(Draft) Report of the Board of Directors
to the Board of Governors

1. During the Asian Development Fund (ADF) IX midterm review meeting in December 2006, ADF donors voiced their support for participation of the Asian Development Bank (ADB) in the Heavily Indebted Poor Countries (HIPC) Initiative launched in 1996 by the International Development Association (IDA) and International Monetary Fund (IMF), enhanced it in 1999 (HIPC initiative). At the establishment of ADF and its subsequent replenishments, the need for debt relief for ADF borrowers had not been anticipated. Thus, the resolutions of the Board of Governors on the establishment of ADF, the initial contributions to ADF, and ADF's subsequent replenishments did not provide for the use of ADF resources for debt relief. These resolutions must be amended to enable ADB's participation in the HIPC initiative.
2. Attached is a draft resolution of the Board of Governors authorizing the use of ADF resources for the purpose of providing debt relief under the HIPC initiative, and amending the resolutions mentioned in para. 1. The Board of Directors recommends the adoption of the draft resolution by the Board of Governors to enable ADB's participation in the HIPC initiative.
3. The Board of Directors is of the view that the decision on this matter should be taken as soon as possible and that the special procedure set forth in section 3 of the By-Laws of the Asian Development Bank should be invoked. The Board of Directors accordingly has authorized the President to transmit to each Governor the text of the draft resolution together with this report, with a request for a vote by telex, facsimile, or e-mail message within 30 days of the date of such request.

(DRAFT)

Resolution of the Board of Governors of the Asian Development Bank

PROVIDING HEAVILY INDEBTED POOR COUNTRIES RELIEF FROM ASIAN DEVELOPMENT FUND DEBT

WHEREAS:

(A) The Board of Directors has submitted to the Board of Governors a Report on the participation of the Asian Development Bank (ADB) in the provision of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative launched in 1996 by the International Development Association and International Monetary Fund, as enhanced in 1999; and

(B) In its Report, the Board of Directors has recommended that the Board of Governors authorize the use of Asian Development Fund (ADF) resources for the purpose of providing debt relief under the HIPC initiative and amend its Resolutions relating to the establishment of ADF, the initial contributions to ADF, and the subsequent replenishments thereof accordingly;

NOW, THEREFORE, the Board of Governors

RESOLVES:

1. The Report of the Board of Directors is hereby accepted and ADB is hereby authorized to participate in the provision of debt relief under the HIPC initiative to ADF borrowers that have reached the decision point as described in the HIPC initiative documents.
2. Paragraph 5(a) of Resolution No. 62 is hereby amended to read as follows (the amendment is indicated by underlining):
 5. (a) Resources of the Fund shall be used for financing concessional loans for projects and programmes of high developmental priority. Such loans shall principally be for foreign exchange costs, but may, in appropriate cases, include a reasonable portion of expenditures in local currency. The criteria to be applied in making such loans shall be as determined by the Board of Directors, in conformity with the purpose of the Fund. Resources of the Fund may also be used for the provision of debt relief under the Heavily Indebted Poor Countries Initiative established by the International Development Association and International Monetary Fund to such countries as may be determined by the Board of Directors.
3. The Resolutions relating to the initial contributions to ADF and the subsequent replenishments of ADF are hereby amended to authorize the use of such initial contributions and subsequent replenishments for the provision of debt relief under the HIPC initiative.

REVISIONS TO REGULATIONS OF THE ASIAN DEVELOPMENT FUND

1. A preamble is inserted in the Regulations of the Asian Development Fund as shown through underlining in Attachment 1 to this Appendix 4.
2. Article III, Section 3.05 of the Regulations of the Asian Development Fund is amended as shown through underlining in Attachment 2 to this Appendix 4.

**REGULATIONS
OF THE ASIAN DEVELOPMENT FUND**

DATED _____

The ASIAN DEVELOPMENT BANK (hereinafter called ADB) is empowered by its Articles of Agreement (hereinafter called the Articles) to establish and administer Special Funds and to carry out special operations financed from such Funds, including the making of loans of high developmental priority, with longer maturities, longer deferred commencement of repayment and lower interest rates than those established by ADB for its ordinary operations;

The Board of Governors of ADB, by Resolution No. 62, has authorized the establishment of a Special Fund to be known as the ASIAN DEVELOPMENT FUND (hereinafter called the Fund) which is intended to serve as an instrument for carrying out the concessional lending operations of ADB;

The Board of Governors, by Resolution No. 67 and Resolution No. 68, has approved arrangements for the establishment of the Fund and for the initial mobilization of resources in the form of contributions from developed member countries of ADB, and has directed the Board of Directors of ADB to make Regulations to govern the Fund and the administration of its resources;

The Board of Governors has from time to time adopted resolutions authorizing replenishments of the Fund, subject to the terms and conditions contained in the relevant authorizing Resolutions;

The Board of Governors has authorized ADB to provide, in addition to loans, financing in the form of grants for certain types of projects and programs as specified in the relevant authorizing Resolutions;

The Board of Governors has authorized ADB to use ADF resources for the provision of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative established by the International Development Association and International Monetary Fund to such countries as may be determined by the Board of Directors;

The Board of Governors has authorized ADB, in accordance with such determinations as may be made by the Board of Directors, (i) to convert ADF resources held in various currencies into the currencies which constitute the Special Drawing Right (SDR), (ii) to value disbursements, repayments and charges under loans from resources of the Fund in terms of SDR, and (iii) to determine in case of the withdrawal of a Contributor from the Fund or the termination of the Fund, the value of Contributors' paid-in contributions and the value of all other resources of the Fund, including set-aside resources and net income and surplus from ADB's ordinary capital resources transferred to the Fund, in terms of SDR;

ARTICLE III: OPERATIONS OF THE FUND

Section 3.01. Methods of Operations

(a) The resources of the Fund may be used by ADB, alone or in combination with any other Special Funds resources of ADB, to provide financing under loans (including technical assistance loans) on concessional terms, for projects and programs of high developmental priority. The term "project" as hereinafter used refers equally to a program. ADB may also use the resources of the Fund for the provision of debt relief as envisaged in the Heavily Indebted Poor Countries Initiative introduced by the International Development Association and International Monetary Fund.

(b) The resources of the Fund may be used by ADB, alone or in combination with any other Special Funds resources of ADB, to provide financing for grants for projects and programs of high developmental priority, in the event and to the extent that the relevant authorizing Resolution of the Board of Governors provides for such grant financing.

(c) Loans and grants shall be provided principally for specific projects, including those forming part of a national, sub-regional, or regional development program. ADB may also make loans and grants to national development banks and other suitable entities, in order that these entities may finance specific development projects whose individual financing requirements are not, in the opinion of ADB, large enough to warrant the direct supervision of ADB.

(d) Subject to the provisions of these Regulations, the policies and procedures to be applied by ADB in making loans and grants financed from the Fund shall be determined by the Board of Directors, giving particular recognition to the special responsibility of ADB to assist the less developed of its developing member countries.

**AFGHANISTAN: SCHEDULE OF DEBT SERVICE REDUCTION UNDER
THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE**
(\$)

Calendar Year	Nominal Amount to Be Reduced
2008	521,773
2009	1,036,280
2010	1,026,593
2011	1,016,906
2012	1,007,219
2013	5,272,448
2014	6,050,072
2015	6,002,184
2016	5,959,782
2017	5,325,186
2018	5,288,721
2019	5,252,256
2020	5,215,791
2021	5,179,325
2022	5,142,860
2023	7,954,209
2024	8,432,608
2025	8,608,326
2026	8,535,396
2027	8,462,466
2028	3,627,415
Total	104,917,816

Source: Asian Development Bank.