

Technical Note: G8 proposal for HIPC debt cancellation

The G8 have put forward a proposal to complete the process of debt relief for the Heavily Indebted Poor Countries by providing additional development resources which will provide significant support for countries' efforts to reach the goals of the Millennium Declaration (MDGs), while ensuring that the financing capacity of the IFIs is not reduced. This will lead to 100 per cent debt cancellation of outstanding obligations of HIPCs to the IMF and the concessional financing arms of the World Bank and African Development Bank. Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the MDGs and ensure that assistance is based on country performance. The G8 have asked the World Bank and IMF to report on improvements on transparency on all sides and on the drive against corruption so as to ensure that all resources are used for poverty reduction. The G8 believe that good governance, accountability and transparency are crucial to releasing the benefits of the debt cancellation. They commit to ensure this is reaffirmed in future bilateral and multilateral assistance to these countries.

For the IDA and the IMF, the G8 call upon all shareholders to support these proposals which will be put to the Annual Meetings in September, and to be implemented as soon as operationally feasible thereafter. For the African Development Fund, we will work with staff to have proposals agreed in the appropriate forum at the earliest opportunity.

1. International Development Association and African Development Fund

Under the proposal on-track HIPCs would have 100 per cent of their debts to IDA and AfDF cancelled when they reach Completion Point under the Enhanced HIPC Initiative, subject to an agreed cut-off date, after which new disbursements would not be eligible for relief. 18 countries¹ would immediately be able to benefit from this irrevocable relief, provided they were on track², with the remaining unsustainable HIPCs receiving relief as they reached the Completion Point. In the first instance, this relief would be accompanied by a reduction in each eligible country's IDA and AfDF allocation equal to the amount of the debt service (principal and service charge) it would have owed without the debt cancellation.

To ensure that additional resources will be available for poverty reduction, the proposal would provide additional contributions to IDA and AfDF, based on agreed burden shares, to match dollar-for-dollar the foregone principal and service charge repayments of the debt cancelled. Additional funds will be made available immediately to cover the full costs during the IDA-14 and AfDF-10 period. For the period after this, donors would commit to cover the full costs for the duration of the cancelled loans, which in some cases would be as long as 50 years, by making

¹ Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia.

² All countries receiving the relief must be current with their repayment obligations to the IFIs. In addition, countries must not have experienced serious lapses, including in governance, such that their IMF programmes would be at risk.

contributions additional to regular replenishments of IDA and AfDF. To ensure additionality, we ask that the World Bank and African Development Bank to come forward with proposals on how they can present the costs of this relief per donor, to be paid alongside the regular contributions to the core replenishments – for example, by separating the donor contributions required to offset foregone repayments associated with this debt relief proposal from core contributions.

This proposal would therefore provide recipient countries with the certainty of 100 per cent debt cancellation while preserving the institutions' financing capacity and ensuring that additional resources would be allocated in accordance with maximising their impact on poverty reduction across all low-income countries.

Allocation of Additional Resources

The additional resources will be allocated through each MDB's existing allocation mechanism on the basis of governance, need and ability to use the resources effectively for poverty reduction and growth. In this manner, all low-income countries would receive an increase in net assistance flows commensurate with performance levels. This approach serves several purposes: (1) reinforces existing incentives for countries to pursue responsible, pro-growth policies; (2) maintains equity between HIPCs and other low-income countries; and (3) addresses moral hazard problems since new development assistance is allocated based on current performance and not current debt payment obligations. This highlights the G8 countries' emphasis that good governance, accountability and transparency are crucial to releasing the full benefits of the debt cancellation.

2. The International Monetary Fund

The proposal for the IMF is to provide 100 per cent debt stock relief based on the same eligibility (i.e. a country having reached the Completion Point under the Enhanced HIPC Initiative and provided they were on track), subject to a cut-off date of 1st January 2005, after which new disbursements would not be eligible for relief. Until this proposal is implemented current policies regarding repayment of outstanding obligations continue to apply. Repayments due prior to the implementation date will not be affected by this proposal. The substantial proportion of outstanding debts to the IMF from these countries is in the form of PRGF loans. The G8 believe that the very small amounts of GRA debts outstanding to eligible HIPCs should also be eligible for relief, subject to an assessment from Staff on the options for overcoming any legal and technical obstacles. The costs of fully covering IMF debt stock relief, without undermining the Fund's financing capacity, should be met by the use of existing IMF resources. While the proposal is clear that debt relief should be provided on an irrevocable basis, it could be financed on a flow basis if that is a more efficient option. We ask the IMF to review the options. In situations where other existing and projected debt relief obligations cannot be met from existing IMF resources (e.g. Somalia, Liberia, and Sudan), donors would commit to provide the extra resources necessary. The proposal also commits participants to provide (on a fair burden share basis) resources, if necessary, to cover possible costs of relief for potential new entrants to the Initiative based on end-2004 data.

IMF Internal Resources

The principal outstanding to the 35 unsustainable HIPCs (excluding the arrears cases) stands at around 4.1 billion SDR. Of this, around 2.8 billion SDR relates to the 18 post-Completion Point HIPCs.

The proposal envisages using a combination of internal resources to fund the relief. These internal resources are currently being used to finance HIPC relief or to subsidize lending to the HIPCs. The self-sustained PRGF, which will be operational in 12-18 months time and is based upon resources currently in the Reserve Account, would not be affected by any of these measures, and its 0.6 – 0.7 SDR billion financing capacity would not be reduced. The G7 agreed in April that the self-sustained PRGF should be adequately equipped to be responsive to short-term adjustment needs and to meet future demand as assessed by the IMF.

In identifying existing internal resources, relief would be financed in the first instance through amounts already set aside to pay for HIPC relief: the resources in the HIPC Umbrella Accounts (c. 0.5 billion SDR) and the interest generated in the Special Disbursement Account (c.0.3 billion SDR).

Secondly, there is the corpus of the 1999 off-market gold transactions, which amounts to 2.2 billion SDR. While the interest earned on this is currently being used to subsidize HIPC relief, the corpus itself was not committed.

Thirdly, there are resources currently in the PRGF Subsidy Account. Of the 1.8 billion SDR currently in this account, approximately 0.8 billion SDR will be needed to subsidize lending committed during the interim PRGF to non-HIPCs. Provision will be required for continued lending to pre-Completion Point HIPCs. Debt relief in the IMF (and IDA and AfDF) can be expected to reduce countries' financing needs, and therefore the need for PRGF resources. However, further lending may be required for post-Completion Point HIPCs during the interim PRGF and further on.

Globally and on this basis the G8 have committed to meeting the full costs to the IMF, IDA and African Development Fund. The G8 will provide on a fair burden share basis resources to cover difficult-to-forecast costs, in excess of existing resources, over the next three years. Subject to further analysis by the institutions, the G8 have committed to provide up to \$350-500 million to the IMF for the interim PRGF. The G8 are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens. The G8 will seek equivalent contributions from other donors to ensure all costs are covered and will not jeopardize the ability of these institutions to meet their obligations.

Ensuring Long-Term Debt Sustainability

The G8 share the common objective of ensuring that countries do not immediately reaccumulate debt levels that could become unsustainable. The strategic provision of MDB grants is a key tool in ensuring that a new build-up of unsustainable debts does not re-occur. At the same time, the G8 recognize the role of IDA and the AfDF as providers of concessional loans as well as grants. The G8 do not therefore anticipate a substantial increase or decrease in the level of grants envisaged under IDA-14 and

AfDF-10 agreements to be provided to HIPC's as a consequence of this relief. We will work with Staff of the IFIs to ensure that appropriate mechanisms – compatible with the Debt Sustainability Framework – are put in place to meet these goals.

The future borrowing behaviour of countries will have to be monitored to ensure that they do not borrow excessively from sources other than IDA and the AfDF. For example, the export credit agencies of G8 and other countries will need to take into account the fragile financial condition of these countries in order to exercise the restraint in lending that is necessary. We therefore look forward to work from the World Bank, IMF, and OECD to address these issues.

Support For Countries Facing Exogenous Shocks

This proposal also entails establishing a new trust fund that will support poor countries facing commodity price and other exogenous shocks. Voluntary contributions for subsidies and loanable resources will be invited, including from oil-producing states. These resources will complement an exogenous shocks window in the PRGF Trust.