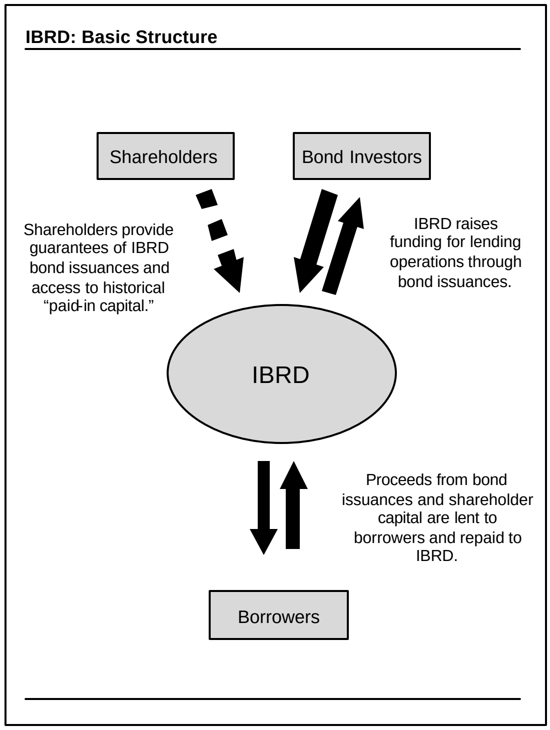
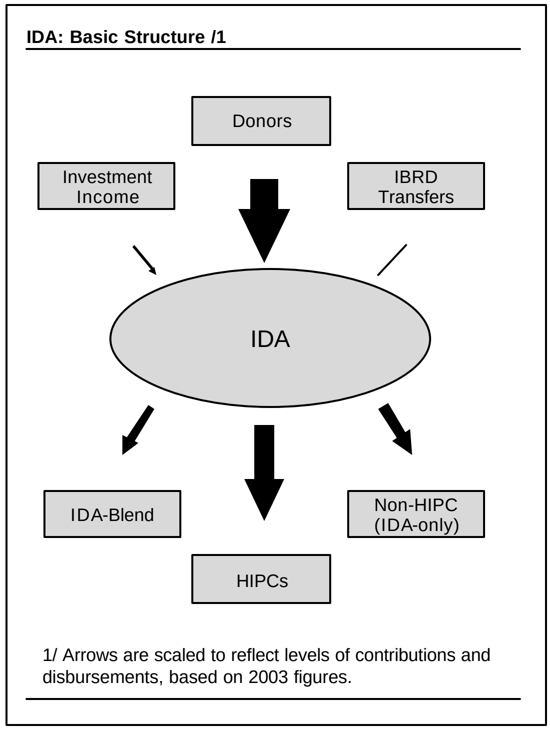
The U.S. Proposal:

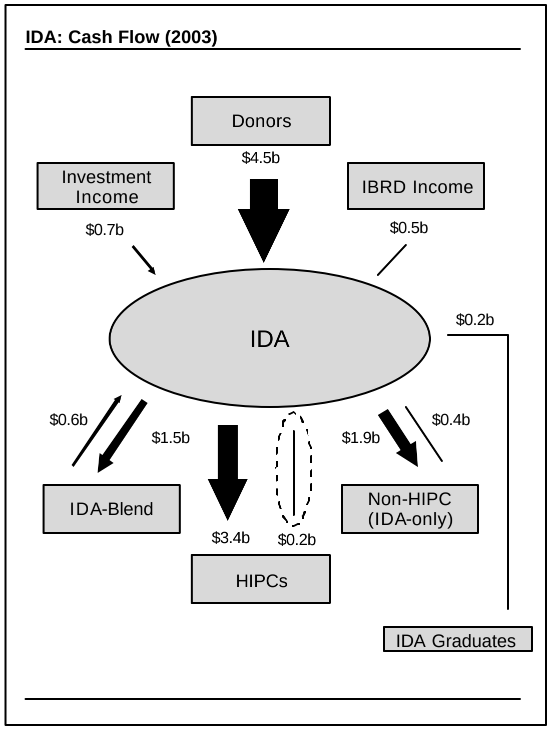
The Financial Mechanics of
Delivering 100 Percent Debt Relief



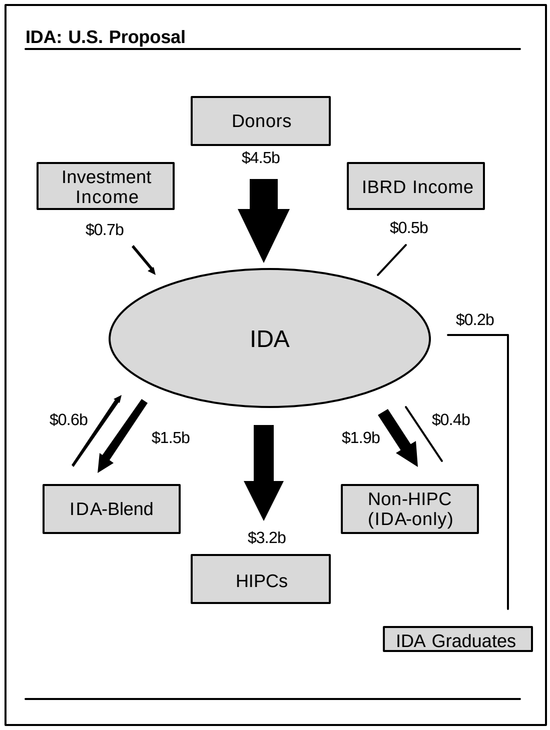
<u>IBRD Structure</u>: The above diagram represents how the World Bank's International Bank for Reconstruction and Development (IBRD) operates. The IBRD, the financing arm for middle-income and creditworthy borrowers, finances its operations through shareholder capital (provided historically) and ongoing bond issuances, which are guaranteed by the Bank's shareholders, such as the United States. These bond guarantees enable the IBRD to borrow on AAA terms. As can be seen in the diagram, IBRD uses funds to support development projects in borrowing countries. These countries service these loans, and these repayments enable IBRD to repay its investors.



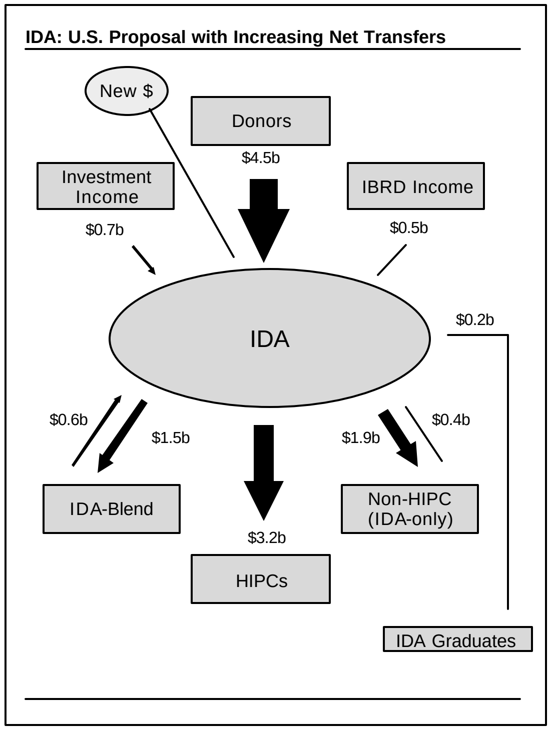
<u>IDA Structure</u>: The International Development Association (IDA) is the World Bank's concessional financing arm, which provides concessional loans and grants to the poorest countries in the world. As the diagram above shows, IDA is not structured the same way as IBRD or any other banking institution. IDA derives its funding primarily from donor contributions, which are then disbursed to IDA countries. Unlike the IBRD, IDA does not have an equity base or liabilities to external investors – whatever is contributed to the fund is channeled to borrowing countries.



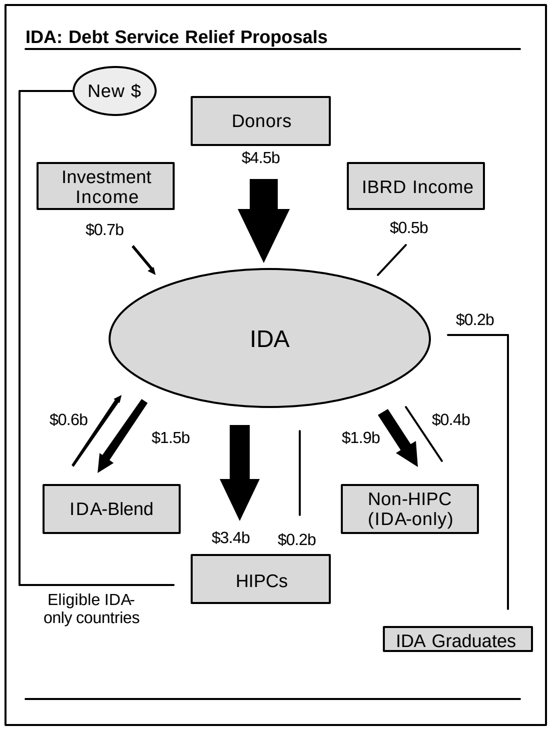
IDA Cash Flow: The above diagram shows the cash flow structure of IDA with actual 2003 figures. As can be seen, borrowing countries make repayments to IDA, which are then re-disbursed to borrowers. The scale of reflows is small compared to disbursements primarily because of the concessionality of IDA's financing and the significant nominal growth in disbursements over history. The reflows from the Heavily Indebted Poor Countries (HIPCs) were roughly $0.2 billion, compared to $3.4 billion in disbursements, and are highlighted in the dotted oval. In 2003, HIPC reflows accounted for only 3% of IDA's total new disbursements.



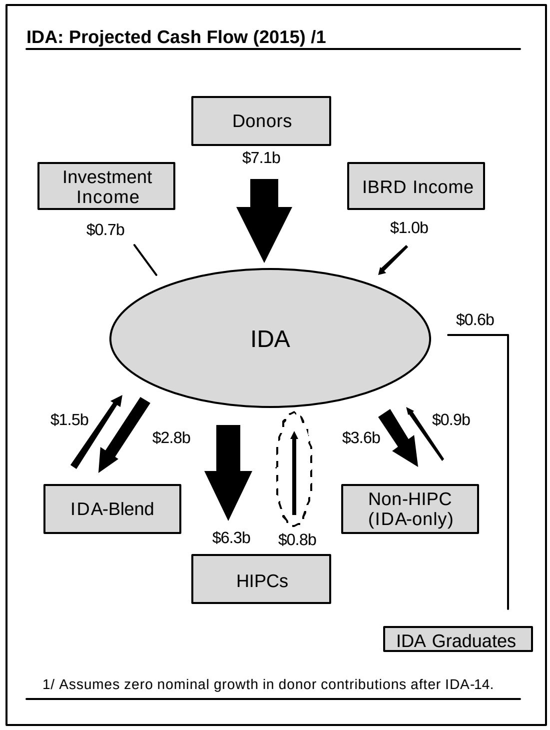
<u>USG Proposal</u>: The U.S. proposal would deliver 100% debt relief by relieving HIPCs of their reflow obligations and adjusting the gross assistance flows by the amount that is forgiven. Importantly, net transfers would not decline for any IDA-eligible country (HIPC, Non-HIPC IDA-only, or IDA-Blend). Maintaining constant net flows across countries ensures that no country receives more favorable treatment than others because of debt relief and that no country benefits merely from having borrowed too much in the past. In other words, the U.S. proposal ensures equity of treatment of IDA countries and reduces moral hazard. It should be noted that reflows, instead of being returned to IDA, would simply stay in the borrowing country, so the total amount of resources available to the country – net transfers plus additional saving from cancelled reflows – do not decline.



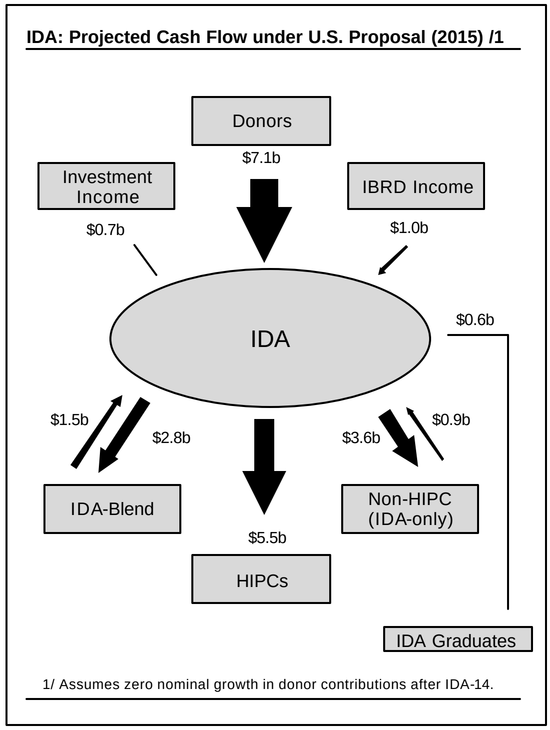
<u>Increasing Net Transfers</u>: If donors chose to increase net transfers, as has been done throughout history, the U.S. would propose that new contributions go through IDA and it's performance-based allocation system in order to ensure that assistance is channeled to those countries that can most effectively use it. This would ensure that net transfers would increase based on country performance and would be most consistent with the commitment made in Monterrey to provide funds to good performers, maximizing development effectiveness.



Debt Service Relief: Other proposals that seek to pay for countries' debt service would circumvent the IDA performance-based allocation system. Countries that are selected would receive increased net transfers in amounts that depend not on performance but on projected debt service burdens that arise from past lending decisions. Moreover, these proposals do not cancel the debt, thereby ensuring that the debt sustainability debate will continue in the future. This approach introduces equity and moral hazard concerns, and does not constitute the most efficient financing modality for development effectiveness for moving toward the Millennium Development Goals.



Future Financing: Assuming no further increase in donor contributions in nominal terms – an unlikely and overly conservative assumption – the above diagram illustrates IDA's projected cash flow in 2015. HIPC reflows grow to $0.8 billion by 2015 but are still small compared to disbursements from IDA.



Impact on Financing: This picture represents IDA's cash flow under the U.S. proposal in 2015. Note that HIPCs continue to receive substantial development assistance from IDA, even under the overly conservative assumption of zero nominal growth in donor contributions. Over time, increased donor contributions, increased reflows from other IDA countries and expected graduation of IDA borrowers will more than offset any HIPC reflows that are foregone. Moreover, it is important to remember that these "lost" reflows will be staying in the countries that IDA was set up to assist.