

Multilateral debt: one step forward, how many back?

HIPC and MDRI Update

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European network on debt & development

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About this report

This report was written by Gail Hurley at EURODAD. It is a EURODAD paper but the analysis presented does not necessarily reflect the views of all EURODAD member organisations. Please send all comments and feedback to ghurley@eurodad.org

It builds on Eurodad's work on multilateral debt over many years. In particular, see:

- Devilish details: Implications of the G7 debt deal, June 2005:
www.eurodad.org/whatsnew/reports.aspx?id=736
- G8 Debt Deal One Year On: What Happened and What Happened Next?, June 2006:
www.eurodad.org/whatsnew/reports.aspx?id=318

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Introduction

In July 2005, G8 governments made a bold announcement that they had agreed to cancel up to US\$55bn owed by some of the world's most impoverished and indebted nations. This followed significant public pressure by social movements and non-governmental organisations (NGOs) around the globe. It took the IMF and African Development Bank (AfDB) six months to deliver on their side of the cancellation and one full year of arduous behind-the-scenes political negotiations before the World Bank finally started to deliver on its part of what has become known as the Multilateral Debt Relief Initiative (MDRI).

Some 29 beneficiary countries will save US\$1.25bn in debt service payments in 2007.¹ Their governments have pledged to use these resources to boost spending on a number of Millennium Development Goals (MDGs), including the social sectors and basic infrastructure development. These were some of the core objectives behind international campaigns for debt cancellation.

But the governments which benefited from debt service reductions also faced reductions in new finance, especially from the International Development Association (IDA – the concessional loan window of the World Bank) and Inter-American Development Bank (IDB). Although the IMF portion of the debt cancellation agreement is entirely additional, this is offset by the fact that other creditors have reduced levels of future concessional finance. This means that the MDRI has provided less additional money for countries to spend on poverty reduction than may have been suggested by official announcements.

From January 2006, a coalition of NGOs launched a campaign to extend the MDRI to further creditors. Eurodad, with other NGOs, argued that Heavily Indebted Poor Countries (HIPCs) in Latin American (Bolivia, Guyana, Haiti, Honduras and Nicaragua) had been unfairly treated because the MDRI deal had excluded debts owed to the Inter-American Development Bank while it had included debts owed to the African Development Fund (AfDF). These Latin American countries owed on average one-third of their debts to the IDB and would see a debt write-down of only around 30%.² In March 2007, the IDB's President Luis Alberto Moreno announced that his institution would be incorporated into the MDRI and will cancel US\$4.4bn owed by Bolivia, Guyana, Haiti, Honduras and Nicaragua. This paper unpacks the main features of the recent deal.

There have also long been questions about which countries are included in the HIPC and MDRI lists and about the onerous conditions faced by governments considering joining. In February 2007, the Kyrgyz Republic announced that it would *not* join the HIPC Initiative despite its eligibility. This followed a very vocal and public anti-HIPC campaign by civil society organisations in the country. This paper looks at the civil society anti-HIPC campaign in that country.

In 2005, donors pledged to reimburse the World Bank and African Development Bank for the funds they would lose through this debt write-off. How far has this promise been kept? And post-MDRI, what issues are capturing the "hearts and minds" of policy makers?

This paper analyses these new questions and updates civil society organisations and other stakeholders on the latest developments as they relate to the HIPC Initiative and the MDRI. We ask:

- Which countries are in and which are out of the MDRI?
- Which creditors are in and which have stayed out?
- What debts are in and what's left on the books after the MDRI?
- How much fiscal space has the MDRI really freed-up for the countries involved?
- Has the HIPC "medicine", i.e. conditions changed?
- What issues are now on the table post-MDRI?

Who's in and who's out?

The Multilateral Debt Relief Initiative is limited to a set of countries called the "Heavily Indebted Poor Countries" or HIPC.³ As reported in previous papers, the country list was arbitrary and left many other severely indebted and poor countries squarely excluded. These include Kenya, Lesotho, Ecuador, Peru, Vietnam, Indonesia, the Philippines and Bangladesh, to name just a few. Comprehensive debt cancellation for these excluded countries remains – at least for the moment – as elusive as ever despite research which shows that all will have to dramatically scale-up poverty-related expenditures if they are to reach the MDGs, and despite the odious and illegitimate nature of much of the debt on many of these countries' books.

Table 1 summarises which countries have benefited from full MDRI debt cancellation so far (22 in total) and those which still have still to complete the HIPC Initiative process in order to benefit.

Table 1: Who's in and who's out?
Countries covered by the Multilateral Debt Relief Initiative and current status

Countries which have qualified for HIPC and MDRI cancellation	Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé & Príncipe, Senegal, Sierra Leone, Tanzania, Uganda, Zambia
Countries at decision point	Burundi, Chad, Congo Republic, Democratic Republic of Congo, The Gambia, Guinea, Guinea-Bissau, Haiti
Pre-decision point countries	Central African Republic, Comoros, Côte d'Ivoire, Eritrea, Liberia, Nepal, Somalia, Sudan, Togo
Countries which received IMF-only debt cancellation under the MDRI4	Cambodia, Tajikistan
Countries where limited data availability means status uncertain	Bangladesh, Bhutan, Sri Lanka and Tonga
Countries that have rejected the HIPC Initiative	Kyrgyz Republic, Lao PDR

Source: World Bank and IMF websites, April 2007

Which creditors are in and which creditors are out?

The Multilateral Debt Relief, as agreed in 2005, covered three multilateral creditors only: the IMF, World Bank and African Development Bank. This is out of a total of 23 multilateral creditors which participate in the HIPC Initiative. Of these 23, only one further multilateral creditor – the Inter-American Development Bank – has since announced that it will also join the MDRI.⁵

The confirmation by the IDB in March 2007 that it would write-off US\$4.4bn in debt owed by the five Latin American HIPCs (Bolivia, Guyana, Haiti, Honduras and Nicaragua) followed significant political pressure by some Latin American Governments as well as civil society organisations in Latin America, Europe, the United States and Canada.

In previous reports, Eurodad highlighted the inequity in treatment between African and Latin American HIPCs. In "Justice for Latin America: The Case for Cancelling Inter-American Development Bank Debt,"⁶ NGOs pointed to the fact that for the four Latin American countries considered heavily indebted, the amount written down by the Multilateral Debt Relief Initiative would be only 30% on average, as these countries owed on average one-third of their debt stocks to the Inter-American Development Bank. However on 18 March 2007, the IDB's President, Luis Alberto Moreno, announced that US\$3.4bn in

principal payments and US\$1bn in interest payments would now be cancelled. Debt cancellation would have a cut-off date of end-2004.

Expansion of the MDRI to incorporate other multilateral lenders represented an important precedent: other multilateral creditors could and should cancel more debt. However the way in which IDB debt cancellation has been implemented has attracted significant criticism from some governments and from civil society organisations. These are explored in the section on net-benefit for countries.

What about other multilateral creditors? The European Commission (EC) is another lender which has not been included in the MDRI. The European Commission has moved away from loan finance to become body which provides finance almost exclusively in grant form but there are still a small number of “older” EC loans which have not been cancelled either via HIPC or MDRI and which continue to be collected from low-income countries. The EC reports that it has cancelled €446mn in net present value terms (NPV) for 25 HIPCs as its contribution to the HIPC Initiative. However, this is out of a total of almost €952mn NPV. This means that over half, almost €506mn in net present value terms, is still left on the books of these heavily indebted poor countries.⁷ This does not represent a large amount of money for the wealthy European Union but it would represent an important extra boost for MDG-related expenditures for these impoverished nations.

Eurodad believes these minor outstanding sums should be cancelled immediately and urges civil society organisations across Europe to put pressure on national governments and the European Commission to stop claiming these amounts.

What debts are in and what’s left on the books?

How much debt will be written-off and how much will countries still have to pay-out? The table below shows that the total estimated cost of the MDRI for the 22⁸ already-qualified countries is US\$39.4bn. This covers IMF, IDA, African Development Fund and Inter-American Development Bank debt. If all HIPCs pass through the HIPC Initiative process and reach completion point over the next few years (a total of 40 countries), the cost of the initiative will reach US\$53.3bn for these same four multilateral creditors.

In 2007, the 29 decision and completion point countries will make debt service savings of approximately US\$1.25bn. But in the same year, they will still reimburse a total of US\$1.43bn in debt service to the IMF, World Bank, and African Development Bank. The IMF, AfDB and IDB all cancelled debts contracted until a cut-off date of end-2004. The World Bank, to save itself money, decided to include only debts contracted until end-2003.

Table 2: Estimated costs of the MDRI

Estimated cost in nominal terms (US\$ billions)	Total for already-qualified countries	Total should all other eligible countries receive cancellation
Total	39.4	53.3
Of which: - IDA	26.7	36.5
- IMF	3.0	4.1
- AfDF	5.8	8.3
- IDB	3.9	4.4

Source: Eurodad calculations based on IMF, World Bank and IDB data.

And what’s left on the books of beneficiary countries post-MDRI? The World Bank indicates that in net present value terms, the debt “on the books” of the 22 completion point countries pre-MDRI stood at US\$34.7bn. Post-MDRI, this has been cut to US\$15.4bn. Sub-Saharan African HIPCs (18 completion point countries) have seen their debt cut from US\$26.3bn to US\$9.3bn in net present value terms thanks to the

MDRI.⁹ For Sub-Saharan African countries, the MDRI has therefore slashed their debt by 64.4% on average.

As the following table indicates, countries that have benefited from debt cancellation have pledged to use the resources freed-up through reduced debt service payments to boost crucial poverty reduction expenditures and improve essential infrastructure. Both the G8 and more recently IDB President Luis Alberto Moreno, have stated that these were key aims of the Multilateral Debt Relief Initiative. But on closer inspection of the numbers, how true is it that the MDRI has contributed significant *additional* resources to poor countries to pay for much-needed MDG-expenditures? This is the topic of the next section.

Table 3: What countries have pledged to spend MDRI debt service savings on

Country	Debt service savings in 2006		Use of MDRI in 2006
	Millions of US\$	In percent of GDP	
Benin	15.6	0.3	In health and education, in the cotton sector, as well as for funding small-holder projects in agriculture.
Bolivia	40.9	0.4	There is no earmarked expenditure to be covered with MDRI debt relief.
Burkina Faso	17.6	0.3	In education, health, and rural infrastructure programs.
Cameroon	29.8	0.2	For pro-poor spending in line with PRSP priorities including infrastructure, social sector, and governance reforms.
Ethiopia	13.8	0.1	In view of cutbacks in donor support, MDRI resources may provide financing for poverty-reducing expenditures already envisaged in the authorities' medium term macroeconomic and fiscal framework.
Ghana	57.9	0.5	In energy and water, the rehabilitation of essential major highways and feeder roads in the main agricultural areas, education, health, and development of information and communication technology.
Guyana	6.4	0.8	The rehabilitation of drainage and irrigation infrastructure and farm to market roads, maintenance of education and health facilities, and acquisition of materials and supplies for education and health.
Honduras	27.6	0.3	For anti-poverty program including the elimination of fees for public schools.
Madagascar	34.3	0.7	For priority spending ministries in line with their Poverty Reduction Strategy.
Mali	27.0	0.5	The relief will be targeted at water supply and roads.
Mauritania	10.8	0.3	To finance social spending.
Mozambique	28.8	0.4	To finance "priority" pro-poor spending.
Nicaragua	17.7	0.3	On poverty reduction expenditures in the housing and water sectors and in the provision of medical supplies.
Niger	9.3	0.3	For programs in education, health and rural sector development.
Rwanda	9.7	0.4	Food imports and spending for the Lake Kivu methane gas project (to generate electricity).
São Tomé & Príncipe	-	-	Data not available
Senegal	48.5	0.6	For priority needs in the social services sector.
Sierra Leone	-	-	Data not available
Tanzania	82.3	0.6	To meet the foreign exchange cost of growth critical energy projects and food imports.
Uganda	57.9	0.6	Given Uganda's acute electricity shortage, the government is considering using the resources freed up by the MDRI to help meet Uganda's urgent electricity needs.
Zambia	23.8	0.3	MDRI savings will be used to increase spending on agricultural projects on small-holder irrigation and livestock disease control.

Source: Table adapted by Eurodad from IDA and IMF, "Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative—Status of Implementation", Aug. 2006, p. 64.

What's the net-benefit for countries?

In terms of extra additional resources in the budgets of beneficiary country finance ministries, what has the MDRI delivered? This is important because if a country receives US\$20mn in debt cancellation but at the same time receives a cut in new concessional finance of US\$20mn, the net-benefit is zero and the country still has to find funds from somewhere to invest in poverty reduction expenditures.¹⁰ The figures show that the MDRI is a mixed-bag of additional and non-additional resources. But on balance, the initiative does not offer a great deal of additionality.

However it is useful however to look at each multilateral institution individually to see how debt cancellation will be delivered to understand why it is the case that there are different impacts on future resource flows to beneficiary countries.

IMF

The IMF part of the Multilateral Debt Relief Initiative is entirely additional because the institution is using its own internal resources to fund the cancellation. This amounts to a total of just over US\$4bn (US\$553mn through HIPC and a further US\$3.6bn through the MDRI) in cancellation for 31 countries (29 HICPs plus Cambodia and Tajikistan). This will result in an annual *IMF* debt service reduction for beneficiary countries in 2007 of 63% on average. This amounts to a total of US\$1.2bn in 2006 and 2007.¹¹

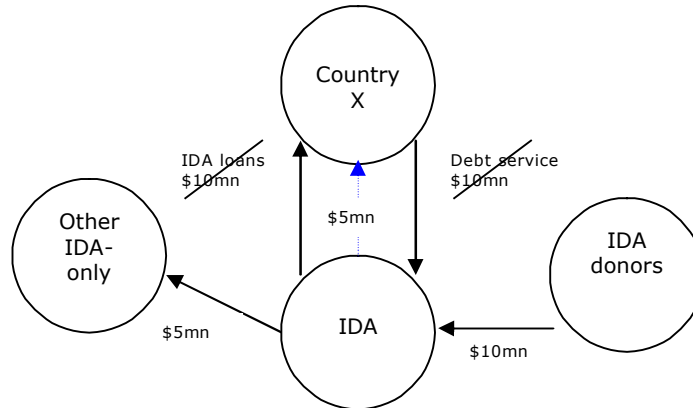
World Bank

According to the World Bank, 29 post decision point countries will benefit from an average reduction in debt service payments to the Bank of a massive 91% in 2007 (22 completion point countries receiving full MDRI debt relief and 7 decision point countries receiving interim or partial debt service relief). For financial years 2007 and 2008, this amounts to US\$820.5mn in debt relief from IDA. Debt service payments will be reduced to a total of US\$95mn to IDA in 2007.¹²

But as Eurodad has pointed out in earlier reports,¹³ these debt service reductions are offset by an equivalent reduction in future loans from IDA. Countries then have to “win-back” future concessional finance from IDA based on “good” policy performance (the Performance Based Allocation – PBA – system). The tool by which a country’s performance is assessed is the controversial Country Policy and Institutional Assessment (CPIA).

This is best shown by the diagram overleaf.

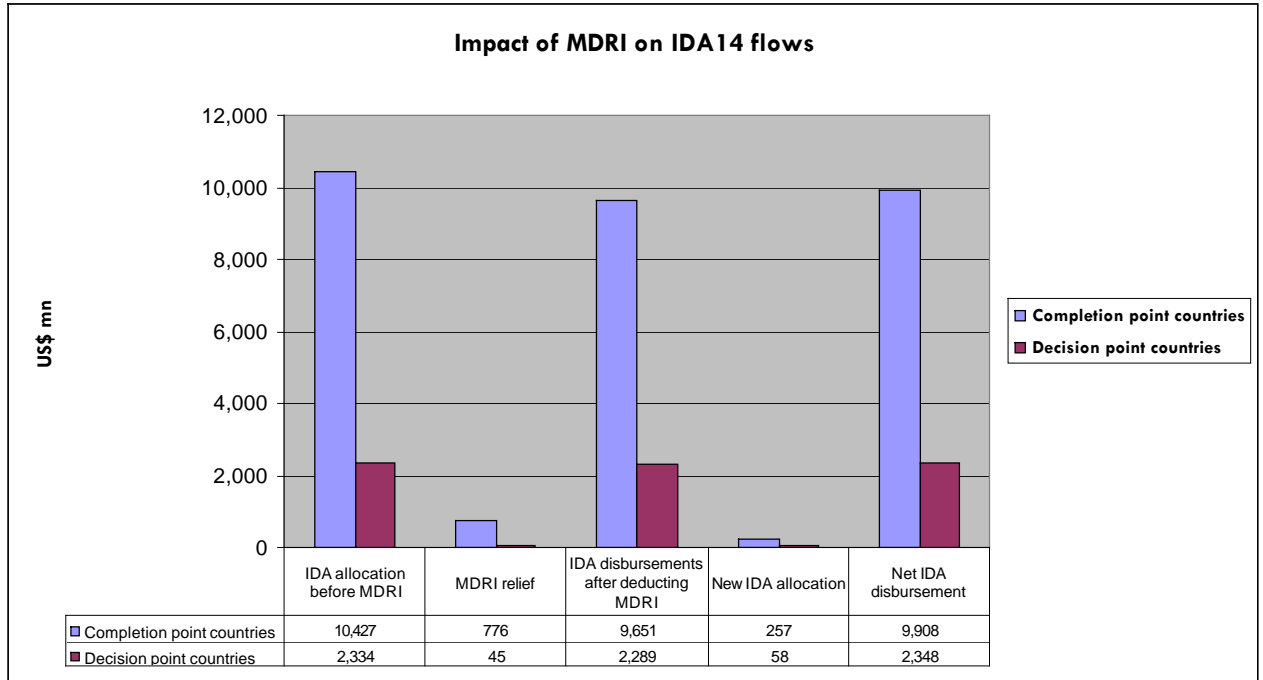
Figure 1. How the World Bank is delivering debt cancellation



The diagram shows that if country x paid IDA debt service of US\$10mn, this would be now cut by US\$10mn but it would then receive an equivalent cut of US\$10mn in new finance from IDA. For example, if our country's pre-MDRI IDA allocation was US\$20mn, it would now receive only US\$10mn in IDA funds post-MDRI. Donors would then compensate IDA for the US\$10mn it had written-off (in addition to their normal IDA contributions). In turn, IDA would redistribute this US\$10mn among all IDA-only countries (of which there are 80 in total) on the basis of a good (or bad) score under a CPIA assessment and their size. Our hypothetical country might "win" back between US\$5mn from IDA (the amount might vary in practice). This means that country x will now receive US\$15mn in total from IDA. If the MDRI was fully additional, it would have received US\$25mn.

The figure overleaf shows the aggregate additionality of the MDRI under IDA 14 for the 29 countries which have reached either decision or completion point between financial years 2006 and 2008. It reveals that pre-MDRI, countries would have received almost US\$12.8bn in IDA resources. From this amount however US\$820.5mn has been cancelled and must be deducted. This leaves countries with US\$11.9bn. To this amount we must add US\$313.5mn in funds from the IDA 14 resource pool which corresponds to the 29 HIPCs "share" of the extra compensatory resources allocated across all 80 IDA-only countries on the basis of policy performance. This makes a grand total of US\$12.25bn. This shows that MDRI relief is not additional to what the country would have received in IDA disbursements without MDRI (US\$12.76bn). In other words, the countries will only get a net additional amount of US\$313.5mn out of US\$820.5mn because of the MDRI allocation system.

Figure 2: Impact of MDRI on IDA 14 flows



Source: Eurodad calculations based on data from the World Bank and Debt Relief International

The figure below takes a representative sample of countries which have so far benefited from full MDRI debt cancellation. The data show that the final result of the MDRI deal and associated IDA shifts will be that these governments will only have very slightly more money in their budgets to spend as a result of the MDRI despite their desperate needs for funds for poverty reduction.

Table4: Impact of MDRI on IDA 14 flows for selected countries

Figures in US\$m	IDA allocation FY 2006-08	MDRI relief 2007-08	IDA disbursements after deducting MDRI	PBA allocation	Net IDA disbursement
Ethiopia	2139	27	2112	52.8	2164.5
Ghana	783	100.5	682.5	19.35	702
Rwanda	295.5	6	289.5	7.35	297
Senegal	319.5	61.5	258	7.95	265.5
Honduras	201	30	171	4.95	175.5
Nicaragua	168	12	156	4.2	160.5

Source: Eurodad calculations based on data from the World Bank and Debt Relief International

African Development Bank

With respect to the African Development Bank, Sub-Saharan African HIPC's will receive an average annual debt service reduction to the AfDB of 46%. This amounts to US\$59.2mn in debt cancellation from the AfDB in 2007 for the completion point countries. But African HIPC's are still projected to make debt service payments of US\$241mn to the institution in 2007.¹⁴

However the same mechanism also comes into play at the AfDB as with IDA. Fresh disbursements from the institution will be reduced by the amount of debt cancelled and the country's net flows will remain unchanged. The AfDB's ability to provide future concessional resources via the AfDF (African Development Fund: the concessional arm of the AfDB) will also depend on how far donors eventually compensate the institution for foregone debt service.

Inter-American Development Bank

"[This "historic" decision] will help these countries free up resources to invest in quality education, health and other social services their citizens need to overcome poverty," IDB's President Luis Alberto Moreno, March 2007.

As announced in March 2007, the Inter-American Development Bank will cancel US\$4.4bn owed by five countries as its contribution to the MDRI. Debt service payments to the IDB will be reduced by an average of around 30% for five Latin American HIPC's.

But like the World Bank, it is important to highlight the devil in the detail. The cancellation will be financed through the IDB's Fund for Special Operations (FSO), the concessional loan window of the institution (equivalent to the World Bank's IDA), i.e. entirely through *internal* resources. This loan window provides grants and highly subsidised loans to the five Latin American HIPC's (Bolivia, Guyana, Haiti, Honduras and Nicaragua) and five other countries (Dominican Republic, Ecuador, El Salvador, Guatemala and Paraguay). Interest rates on FSO loans for the five HIPC's currently stand at just 0.25%.¹⁵

Under the March 2007 "historic" deal, the costs of debt cancellation will be offset by important cuts in new concessional loans by the FSO and by the cancellation of undisbursed amounts on "non-performing" loans, i.e. loans where the project has not been successful.

The cuts in concessional lending involve a 25% reduction in new IDB loan allocations for Bolivia, Guyana, Honduras and Nicaragua. This means that if debt service payments are reduced by an average 30% and new disbursements reduced by 25%, net additionality of the deal is around just 5%. This will reduce the IDB's allocation of resources to these countries from US\$400mn in 2007 to US\$287.7mn in 2008.

To illustrate how this will work in practice, take the example of Nicaragua. In 2007, Nicaragua will have its debt service slashed by US\$18mn thanks to this deal. Normally, the country would have been entitled to US\$94.5mn in new resources however this amount has now been subject to a 25% cut so that it will now receive only US\$70.9mn in 2007. This represents a "net loss" of US\$5.6mn. In the case of Guyana, the "net loss" will be US\$4.7mn.¹⁶

Secondly, by cancelling undisbursed amounts on existing non-performing projects, the IDB will generate a further US\$210mn to fund the plan. This means in effect that it is the borrower country alone which is held responsible and penalised for the failures in these particular loans when cumbersome and slow procedures within the IDB also contribute to the problem of aid effectiveness.

Finally, following the cancellation, the five Latin American HIPC's will no longer have access to just FSO resources but will receive a blend of FSO and OC funds (OC loans are on commercial terms akin to IBRD loans at the World Bank). This is best explained by the figure overleaf. The IDB calls this the "parallel loan" system.

Figure 3. The New Parallel Loan System at the IDB



Commenting in March 2007, Guyana's President Bharrat Jagdo said of the deal: "While [the decision] would bring tremendous benefits, on the other hand we are going to see a reduction in our access to the soft resources of the institution which brings additional challenges".¹⁷ In Guyana's particular case, it will now receive 50% in concessional FSO loans and 50% in market-rate OC loans.¹⁸ Haiti has been treated differently. It will receive grants only until it reaches completion point under the Heavily Indebted Poor Countries Initiative at which point it will then receive a blend of 50% grants and 50% loans from the institution. The IDB reports that Haiti will receive US\$50mn in grants from the FSO in 2007. However, prior to the cancellation, Haiti received US\$83.1mn in interest free loans from the FSO. Although it will not have to pay-back the new funds – which is positive – it will result in less money in Haiti's budget in 2007. It is clearly likely to feel this pinch.

So why has this complicated – and non-additional – approach to IDB debt cancellation been adopted? Predictably IDB staff papers had stressed the need to compensate the institution dollar-for-dollar for lost reflows. But discussions on donors stumping up the cost never went very far. Additionality was ultimately abandoned due to internal political squabbles and a reluctance of shareholders to make up-front guarantees over replenishment of the FSO (replenishment of the FSO will now be considered no later than 2013).¹⁹ But changes in the terms of new disbursements will in the end increase debt service burdens for countries over the medium term and in so doing jeopardise MDG related expenditures as well as the debt sustainability prospects of these countries. It also sends out a signal to the broader set of international creditors that it is fine to lend to these countries at less-concessional levels which raises concerns over potential free-rider behaviour. It will be the citizens of these Latin American countries that will pay the price for this.

Eurodad had in fact argued that, where donors wanted to contribute to the cost of this cancellation they could do so, but the IDB was in excellent financial health and could also contribute internal funds necessary to pay for this deal. We revealed how the capital of the Bank stands at around US\$101 billion. Moreover, during the last five years the IDB's annual net income had consistently revolved around the US\$1 billion mark, and reserves linked to the Ordinary Capital loan arm had increased from US\$8 billion in 2000 to more than US\$14 billion in 2004. Eurodad proposed that the institution's net income be drawn-on to fund the cancellation. This way, debt relief could be delivered with additionality.²⁰

Any Changes to the HIPC Medicine?

Campaigners secured a significant victory in 2005 and 2006 when it was announced that no further conditionality requirements would be attached to debt cancellation under the MDRI. Completion of the HIPC Initiative – with its lists of conditions – was accepted as sufficient. Fears had been raised that countries would have to undergo further conditionality "health checks" and that relief under the MDRI could be delivered in a "phased" manner depending on the outcomes of these regular conditionality checks.

However this is little consolation to those countries which are "further behind" in the HIPC Initiative process and still have to comply with the programme's lengthy conditionality requirements. These

interfere in almost every aspect of countries' choices in terms of macroeconomic policies to pursue, institutional and social sector reform priorities, and have typically meant that it takes countries on average 6-7 years to complete the HIPC Initiative, delaying much-needed debt cancellation.²¹

Haiti: on the waiting-list for debt cancellation

In practical terms, this means that Haiti, the most impoverished country in the Western Hemisphere, cannot benefit from immediate and comprehensive debt cancellation under the MDRI, including from the Inter-American Development Bank which is one of Haiti's most important creditors. This is because it has not reached completion point under the HIPC Initiative and is not scheduled to do so until 2010. This is therefore the earliest date that Haiti's debt cancellation can become fully effective. Haiti owes a total of US\$1.2bn to external creditors and paid-out US\$133mn in debt service payments to external creditors in 2004.²² The country owes US\$534mn to the IDB. Under the IDB deal, Haiti will need to remain "on-schedule" with its debt repayments to the institution and in the meantime will receive "interim" debt service relief of just US\$20mn over two years until it completes the HIPC Initiative. This is money it can ill afford to lose given the critical social and economic situation in the country.

Camille Chalmers, Executive Director of Plate-forme Haitienne de Plaidoyer pour un Développement Alternatif (PAPDA) has expressed the concern that Haiti "has still not received any guarantees that the country will ever received the promised cancellation. [Creditors] are imposing on us two more years of the same policy conditions which are killing us".²³ But more than this, many civil society organisations point to the fact that Haiti's debt was extended irresponsibly by creditors to the corrupt Duvalier dictators in charge between 1957 - 1986 and can be described as odious. This makes delayed debt cancellation and lengthy conditionality demands on the country, in turn, illegitimate on the part of creditors.

Liberia: pay us our money and we'll cancel your debt

Liberia is another country which extraordinarily has still not yet been able to benefit from any debt cancellation under the MDRI. Since winning the war-devastated country's elections in November 2005 President Ellen Johnson-Sirleaf has commanded the universal respect of the international community. World Bank President Wolfowitz has described the new legislature in Liberia as "a powerful expression of the hope and opportunity that is emerging from the ashes of pain and suffering" and that he is confident that President Johnson-Sirleaf "is determined to bring real improvements in the lives of Liberians".²⁴ You would naturally assume that such expressions of confidence in Liberia's new government would prompt immediate and unconditional debt cancellation for a country where the debt situation is severe and poverty and reconstruction needs even more so.

At end-2005, Liberia's external debt stood at US\$3.7 billion, equivalent to a massive 3040% of exports on a net present value basis (the World Bank defines debt sustainable at a ratio of 150% of debt to exports). The country faces critical social and economic challenges. Liberians enjoy a life expectancy of just 39-40 years; 80% live below the poverty line; 76% are illiterate and there is 85% unemployment. So has Liberia's debt been cancelled under the MDRI? Not so.

In fact, Liberia has not even been able to start the HIPC Initiative process which would set it on the long bumpy road to eventual debt cancellation. This is because Liberia is in arrears to three major multilateral lenders to the tune of US\$1.47bn (US\$735.4mn to the IMF, US\$396.3mn to the World Bank and US\$256.9mn to the African Development Bank).²⁵ The international creditor community says these arrears need to be cleared before Liberia can "normalise" relations with the international financial community, and the government can gain direct access to new finance and start the HIPC Initiative process. It beggars belief however just how a government which commands annual budget revenues of approximately US\$80mn to meet the needs of around 3 million citizens can be expected to make such ludicrous debt repayments. Fortunately the international community has also recognised that this is indeed

absurd and there have been frantic behind-the-scenes political negotiations to try to rally donor support to fund this arrears clearance operation instead.²⁶

At the time of writing, a number of donors such as Norway and the UK had announced their intention to intervene to help pay-off Liberia's arrears to the multilateral institutions. However whether these same donors will then count this assistance as aid and reduce official development assistance either to Liberia or other poor nations as a result needs to be carefully monitored. In any case, Liberia still faces a long journey towards debt cancellation as it embarks on the numerous demands of the HIPC Initiative.²⁷ This angers many civil society organisations, both locally and around the globe, which believe that the country's critical situation demands immediate action. And similar to Haiti, loans were irresponsibly extended to the non-democratic regimes of Samuel Doe and Charles Taylor and the funds never used in the people's interest. Ezekiel Pajibo, Executive Director of Liberia's Center for Democratic Empowerment (CEDE) commented, *"the debt is almost entirely composed of accrued interest. We call for immediate cancellation of this unpayable and illegitimate debt burden, and if not we call on the Liberian Government to repudiate this debt"*.²⁸

Kyrgyz Republic Rejects HIPC

Developments have taken another interesting turn however with the announcement by the Kyrgyz Republic in February 2007 that the country would *not* enter the HIPC Initiative. It was in effect rejecting multilateral debt relief. The decision not to enter HIPC was announced after 17 members of the Kyrgyz cabinet (out of 18) had voted against the controversial initiative. The day was described by the Bureau on Human Rights and Rule of Law in Kyrgyzstan *"as a victory day"*. But why reject debt relief?

The decision followed months of political chaos in the country and a year long campaign by local civil society organisations to convince the Kyrgyz people that *"HIPC was not going to resolve either debt problems or fight poverty"*, says Natalia Ablova of the Bureau on Human Rights and Rule of Law. President Kurmanbek Bakiev announced that *"a special six-member commission [had] considered this issue and decided that this initiative would have more negative than positive results"*. He would therefore seek other ways to solve Kyrgyzstan's debt problem.

The Kyrgyz Republic was classified as Heavily Indebted Poor Country in April 2006 and was declared eligible for multilateral debt relief from the World Bank and IMF. The country's debt burden had climbed steadily since independence from US\$609mn in 1995 (first available figures) to over US\$2.1bn in 2004, mostly owed to multilateral lenders.²⁹ But like other countries before it, the Kyrgyz Republic would need to pass through the economic conditionality requirements of the HIPC Initiative in order to qualify for cancellation at the end. Natalia Ablova says that this is the reason why Kyrgyz citizens - and eventually the government - rejected the programme. Ablova states: *"The imposition of HIPC 'triggers' (conditions that reduplicate usual set of privatisation and liberalisation schemes) alienated the Kyrgyz parliament and contributed to governmental crisis"*. In the country, public and parliamentary debates centred around the issue of the right of the country to choose its own macroeconomic policy paths and the HIPC issue was cast as one of a struggle for national sovereignty.

Not alone, but the Bank ain't listening

The actions of Kyrgyz Republic, although probably the loudest, are not unique. Lao PDR has also said it is not interested in the HIPC Initiative, although technically eligible. And when the World Bank approached Sri Lanka for talks about its potential eligibility for the programme in 2006, it received a frosty reception. So for now at least, these countries are out and regrettably there are no indications from the World Bank and IMF that it intends to re-examine the controversial conditions attached to the debt relief programme.

MDRI helps countries “come up for air”

According to some analysts, the importance of the MDRI should not however be assessed uniquely for its financial impact on beneficiary countries. A critical question is also whether – aside from relieving the debt overhang of indebted countries – the cancellation of debt, particularly from the international financial institutions, results in greater policy autonomy for the countries concerned. All countries have spent between 3 to 10 years jumping through the various conditionality hoops of the HIPC Initiative. These macroeconomic, institutional and social sector reform requirements have given the multilateral lenders a huge hold over southern countries’ policy choices. According to Soren Ambrose of Solidarity Africa Network in Action & 50 Years Is Enough, “*should countries remain resolute in not taking out future IMF/World Bank policy-based loans, it would also mean liberation from debts the institutions have manipulated to impose economic policies that have devastated these countries for up to 25 years. This new concession by the G8 could be the beginning of policy sovereignty and economic democracy for these countries.*” Because the debt cancellation is irrevocable and unconditional, the MDRI has given beneficiary countries important political breathing space. Says Ambrose, “*the political benefits of being freed from foreign domination are not reducible to numbers.*”³⁰

However although most post-debt cancellation countries in theory no longer need Fund resources or an IMF-supervised programme, it remains the case the IMF still plays an important signalling role for other forms of official development finance notably from multilateral lenders and bilateral donors and creditors. There are also indications that the IMF is “fighting back”. In 2005, the IMF developed the Policy Support Instrument (PSI). The instrument is designed for countries which no longer need IMF finance but wish to be monitored by the institution which in turn sends out a signal about the “quality” and “appropriateness” of the country’s policy choices. A good score could theoretically lead to greater levels of donor support. A number of post-cancellation countries have adopted a PSI – Nigeria, Uganda and Cape Verde – and several others are considering doing so including Burkina Faso, Ghana and Tanzania. Bolivia has however decided it no longer wants either direct or indirect IMF support or advice and other countries could potentially also follow suit. This shows the real potential the MDRI has in helping countries “come up for air”.

Kyrgyz Republic Rejects HIPC



Photo of protests against the HIPC Initiative in front of the office of the World Bank in Bishkek, Kyrgyz Republic.

Courtesy of Bureau on Human Rights and Rule of Law, Kyrgyz Republic.³¹

Are donors stumping up the cash?

As already widely reported, donors pledged to reimburse the World Bank and African Development Bank dollar-for-dollar for the monies they would lose as part of the Multilateral Debt Relief Initiative. The World Bank in particular made a huge fuss about “preserving the financial integrity” of the institution and this was the one issue which threatened to seriously derail the deal on several occasions. Following repeated official statements issued by the G8 and other European donors, the Bank caved in. So just how justified was the World Bank’s initial concerns and what is the current status of donor pledges to IDA?

Eurodad has examined data on the status of donor pledges as of 31 December 2006. For the remaining IDA14 period, the Bank reports that it will need a total of US\$819.3mn from donors in order to cover the MDRI costs to IDA. It has so far obtained US\$809.5mn in both qualified and unqualified commitments from donors, leaving a financing gap of US\$9.75mn (a “qualified” as opposed to an “unqualified” commitment means that the amounts of money in question have been subject to the adoption of necessary appropriation legislation).

Up until the MDG target date of 2015, the Bank’s figures indicate that it will require a total of over US\$7bn in compensatory finance for IDA from donors. So far it has received pledges (mostly unqualified commitments) of just over US\$5bn. This leaves a shortfall of just under US\$2bn.

But another test will also be the IDA15 replenishment negotiations, currently underway at the time of writing and due to be concluded in the first quarter of 2008. Over recent months, World Bank President Paul Wolfowitz has been touring the capital cities of donor and southern countries alike to plead for more resources for IDA. At the same time however, a number of donor governments and civil society organisations have raised serious questions however as to whether the Bank should receive this compensatory finance from donors and now a series of inter-linked scandals have come to light relating to President Wolfowitz and his appointees.³² This makes it very hard to judge the quantity and quality of funding that the Bank’s IDA window will receive.

Table 5: Status of donor commitments to reimburse IDA

	Remaining IDA 14 period (FY 07-08) Figures in US\$m			Remainder first decade (FY 09-16) Figures in US\$m		
	Qualified	Unqualified	Total	Qualified	Unqualified	Total
	177.4	631.9	809.5	1,911.9	3,173.5	5,085.6
Financing gap			9.75			1,996.5
Total MDRI costs of IDA			819.3			7,082.1

Source: calculations by Eurodad from SDR to US\$ from official data³³

This means that IDA-only countries could face moderate to high declines in their level of new IDA allocations over time as a result of the MDRI if donors do not fully compensate or replenish IDA. A similar situation also faces the African Development Bank. Whether this is a good or a bad development is highly debated. There are those who believe very strongly in the importance of IDA as a source of interest-free funds for the world’s poorest countries, many of which are unable to access (or afford) alternative sources of much-needed finance on international capital markets. There are others that argue that the effectiveness of IDA resources is highly questionable, in part due to the highly politicised way in which funds have often been delivered. Moreover, the heavy conditionality burden attached to IDA funds coupled with the way in which resources are “won” in the first place (via controversial CPIA assessments) makes the fund a constant source of criticism.

Emerging policy issues post-MDRI

Guyana's new government has borrowed US\$900mn as of September 2006. The HIPC Initiative and MDRI combined saw Guyana's debt reduced from US\$2.1bn to just under US\$1bn, but it would appear that Guyana has borrowed almost the same amount all over again.

Source: Stabroek News, 18 March 2007

This report has unpacked some of the main recent developments related to the HIPC and MDRI debt cancellation initiatives. But these initiatives have also prompted new policy debates at the international level.

The main objectives of the HIPC Initiative and MDRI were to help countries increase MDG-related expenditures, boost economic growth by reducing the debt overhang and make countries creditworthy once again. To the extent that any or all of these objectives have been achieved is the subject of much academic and civil society debate, but it is the "creditworthiness" issue and its related implications which have captured centre-stage in post-MDRI policy debates.

A key concern is that countries will re-accumulate debt all over again to unsustainable levels. This is because significantly lower debt ratios in HIPC/MDRI beneficiary countries mean that they become attractive borrowers once again. This concern is compounded by a rapidly changing creditor landscape. Countries such as China, India, Brazil and Venezuela are stepping forward with offers of rapidly-disbursed and almost condition-free cash to low-income African and Latin American nations, especially those rich in natural resources. However some of the more "traditional" creditors also want to take advantage of some low-income countries' new-found creditworthiness following comprehensive debt cancellation. On 15 March this year at a roundtable in Washington DC, the U.S. Export Import Bank briefed more than 70 U.S. exporters on the potential for sales to Nigeria now that that country "is experiencing economic stability through improved debt management, privatization, deregulation, banking and trade policy reform, and government and institutional measures to create transparency and fight corruption."³⁴

This would appear to point to an inherent contradiction between major donors' discourse and the realities of their behaviour. On the one hand we have rich country governments emphasising the importance of the new World Bank/IMF debt sustainability framework for low-income countries as a promising instrument to ensure low-income countries do not take-on (and are not provided with) excessive amounts of new loans they can't afford.³⁵ On the other hand, these same governments almost all support national export credit agencies (ECAs) whose purpose is to support domestic industry to do business abroad. This clearly begs the question: where are rich countries priorities: with debt sustainability or with their national ECAs?

The clear weaknesses of HIPC and MDRI, and of the debt sustainability framework developed as the tool to prevent the need for further rounds of multilateral debt cancellation need to be clearly acknowledged.

This paper has already highlighted the "additionality" issue in detail. But an even greater problem is creditors' insistence on framing the sovereign debt debate uniquely within the "sustainability" optic and reluctance to recognise it as a "responsibility" issue. The following example is a good indication of the problem. At the annual conference of the Parliamentary Network on the World Bank (PNoWB) in March 2007, a Zambian member of parliament asked IMF Managing Director, Rodrigo de Rato whether he would support the development of a "responsible lending and borrowing framework under the scrutiny of parliamentarians, with the terms of the framework agreed jointly by both debtors and creditors". De Rato's response was typical. He replied that he "understood the question to be about debt sustainability" and the Bank/Fund debt sustainability framework for low-income countries was an important positive development. But this response ignores the heart of the issue.

The reality is that under the current global financing system, all claims on sovereign states are considered valid and the debtor must assume sole responsibility for the loan while the lender does not share any part of the risk. This implies a high degree of impunity for lenders and it has sometimes encouraged reckless behaviour by creditors because they are almost always guaranteed to recover their credits. A natural consequence of this has been the argument put forward by many civil society organisations and some Southern Governments that many debts are odious or illegitimate and should not be repaid.

It is coupled with the absence of any predictable, fair and transparent debt work-out procedure at the international level where debt crises do occur, for example akin to an international bankruptcy mechanism. This means that where debt problems do arise, no creditor is guaranteed the amount it will be able to recoup and the amount it will be forced to write-down because chaos generally reigns.

This analysis would seem to suggest that debt sustainability is just one aspect of broader responsible behaviour by creditors and debtors. Responsibility encompasses issues such as fair and transparent loan contraction processes, public and parliamentary scrutiny and participation, predictable and fair debt work-out procedures where problems do arise, and also the economic position of the debtor, i.e. debt sustainability considerations. The international creditor community's response to "responsibility" issues however has been to focus uniquely on the sustainability component of a much more complex issue.

The challenge to governments, civil society organisations and other stakeholders is to contest the idea that avoiding new rounds of debt is a sustainability question only. Eurodad proposes that creditors, debtors and other stakeholders seize the opportunity of a new phase in the sovereign debt debate to come together *as equal partners* to discuss a range of credible alternative policy proposals. These include *ex ante* proposals for "responsible lending and borrowing frameworks", which incorporate principles of creditor co-responsibility and *ex post* fair and transparent debt work-out procedures, such as an international bankruptcy procedures where debt crises do hit. These measures are vital if we are to avoid an "MDRI II" ten years down the line.

Conclusion

In the run-up to the G8 Gleneagles Summit in 2005, anti-debt campaigners around the globe united to argue that the debts of many developing countries could not and should not be repaid. Impoverished nations' scarce resources were better spent to educate and improve the lives of their citizens. Many of the debts were also odious or illegitimate and were irresponsibly extended by creditors for political ends. To the extent that the very clear benefits of debt cancellation are universally recognised by the international community it represents an important victory, even if campaigners were left frustrated that many more countries and many more debts should have been included in the final deal.

But as this paper shows, concerns with developing country debt and the ways in which debt cancellation are delivered by no means ended with the "historic" G8 Summit announcement in Gleneagles in 2005. The benefits of debt cancellation have not been truly additional, and countries have found that while they have received with one hand, creditors have taken with the other leaving them with little extra money in their budgets. This problem has been compounded by the fact that debt cancellation operations have generally been counted by richer countries as official development aid. The conditions attached to debt cancellation in order to benefit from both HIPC and MDRI remain onerous and controversial, with the World Bank and IMF still seemingly unwilling to budge despite years of complaints from HIPC Governments and NGOs. We have seen recently that a number of countries are rejecting HIPC debt relief as a result.

The "forgiveness" of debts does not follow the logic of shared responsibility for the debt crisis. Debts are "forgiven" or "relieved" by creditors without any reflection on creditors' behaviour in the past nor the establishment of robust mechanisms to enforce future responsible behaviour by creditor and debtor nations. Says Jubilee South: *"any debt relief initiative, if it is to benefit affected populations, must contribute to breaking the cycle of economic and political dependency of developing nations and promote sovereignty and autonomy. It must also recognise the illegitimacy of the claims, a large part of which were contracted by non-constitutional or corrupt governments, without citizens' consent"*.³⁶

The Multilateral Debt Relief Initiative has helped some countries break-free from the grip of the multilateral institutions, and in particular the IMF. Beneficiary countries can now say they no longer want the IMF's policy advice because they no longer want its money. They will decide for themselves which macroeconomic policies they wish to pursue and which governments and institutions they turn to for future financing. On the other hand, the MDRI has dramatically failed to address issues of creditor co-responsibility and illegitimate debt. In fact the Bank and Fund have opted to focus on only one component of broader "responsibility" issues, namely the sustainability question. But a policy of voluntary "enhanced coordination" between creditors under the debt sustainability framework would seem unable to address many of the concerns related to reckless behaviour by creditors and the principles of fair dealing which most Northern Governments claim they adhere to. It seems unlikely therefore that this mechanism will achieve its stated aim of avoiding new rounds of irresponsible and unsustainable debt. Instead, the political moment is ripe to seriously investigate ex ante proposals for "responsible lending and borrowing frameworks" and ex post fair and transparent debt work-out procedures, such as an international bankruptcy procedure.

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4 The IMF awarded debt cancellation to these two countries because the internal funds it wanted to draw on insisted upon "equal treatment" between countries. The IMF therefore set a threshold of US\$380 per capita income per year and any country below this threshold would receive IMF-only cancellation. This incorporated these two further countries in the agreement.

5 For a list of the 23 multilateral creditors which are part of HIPC but not MDRI, see: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:21050877~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html> (p. 72)

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7 European Commission, "Commission Participation in the HIPC Initiative", 2006 Status Report, AIDCO C4/AT D(2007), EUROPEAID, December 2006

⁸ Figures exclude São Tomé & Príncipe, which qualified in March 2007.

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10 Donors have repeatedly stated that debt cancellation operations will free-up additional resources for investment in the MDGs, and in this sense additionality is a key principle. Others however have argued that additionality is less important because what matters is that unpayable and illegitimate debts have been cancelled. Countries freed from an unbearable debt overhang and newly solvent have much more freedom to decide whether or not to engage with the international financial institutions. They are therefore in a stronger position to be able to pursue their own development priorities. For an excellent analysis of the MDRI and some of these questions, see Ambrose, Soren, Solidarity Africa Network in Action & 50 Years Is Enough, "Assessing the G8 Debt Proposal & Its Implications", Sep. 21, 2005. See also: Tan, Celine, TWN Global Economy Series no. 9 Debt and Conditionality: Multilateral Debt Relief Initiative and Opportunities for Expanding Policy Space, March 2007: <http://www.twinside.org.sg>

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15 The FSO is financed through the two means: repayments from borrower countries and periodic replenishments. This means that if FSO resources are used to cancel debt, adequate future replenishment of the fund becomes critical if countries wish to retain access to the same level of concessional resources in the future.

16 Thanks to Debt Relief International for analysis and figures related to this section.

17 As reported in Stabroek News, 18 March 2007

¹⁸ Bolivia and Honduras will receive a blend of 70% OC loans and 30% FSO funds. Guyana and Nicaragua will receive a blend of 50% OC and 50% FSO finance post-cancellation.

19 The United States (the IDB's major shareholder) had repeatedly stated that it wanted to separate negotiations on debt cancellation from negotiations on replenishment of the FSO, however this made many other shareholders uneasy. Meanwhile, several Latin American countries, which are major shareholders in the IDB, had complained that they would be reluctant to contribute to the cost of this cancellation as donors because they also had severe debt burdens and large numbers of citizens in poverty. These issues complicated negotiations on the deal.

²⁰ See: Eurodad, Civil Society Briefing on 'Inter-American Development Bank: internal resources to pay for HIPC debt cancellation and their implications', 31 March 2006

21 HIPC Initiative conditionality requirements include: (i) satisfactory macro-economic performance under an IMF poverty reduction and growth facility (PRGF) program or equivalent; (ii) satisfactory progress in implementing a poverty reduction strategy (PRS); and (iii) the existence of a public expenditure management (PEM) system that meets minimum standards for governance and transparency in the use of public resources.

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23 Jubilee South (Americas), "El BID aprueba un alivio ¿para quiénes?, 19 March 2007

²⁴ See:

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²⁵ Central Bank of Liberia

²⁶ It should be kept in mind that the treatment Liberia receives is certainly being influenced by the "threat" of having Somalia and Sudan join MDRI as parallel cases. Both hold US\$2.9bn and US\$440mn in multilateral debt respectively. Politically more sensitive as they are, both will certainly request a treatment not less favorable than Liberia once they manage to knock at the door of the MDRI.

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32 See: www.worldbankcampaigneurope.org and www.worldbankpresident.org

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34 Is US Ex-Im Bank promotion of Nigeria exports a free rider threatening more debt? www.eca-watch.org/problems/debt/ECAW_US_ExIm_Nigeria_29mar07.htm

35 Under this framework, the Bank and Fund will conduct an economic assessment of individual countries' vulnerabilities to debt distress: the more vulnerable and/or severely indebted the country, the more grant – not loan – finance should be made available to it by the international donor community. The framework has received broad endorsement by many of the "traditional" donors around the globe as a promising instrument to avoid new rounds of unsustainable debt. See World Bank, Debt Sustainability Website for an overview:

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