

100% MULTILATERAL DEBT CANCELLATION

WHY IS MULTILATERAL DEBT CANCELLATION IMPORTANT?

A BRIEF HISTORY OF DEBT CANCELLATION

- For decades, sub-Saharan Africa spent billions of dollars each year repaying debts to the world's rich countries and international institutions such as the World Bank and International Monetary Fund (IMF).
- The origination of these debts was often dubious; the conditions placed on these poor countries by the IMF and World Bank for servicing these debts and securing new loans to ensure their ability to repay were often onerous and damaging.
- As donors sent development assistance to the poor countries, these same poor countries turned around and paid back old loans to donors.
- The Heavily Indebted Poor Countries (HIPC) Initiative successfully relieved up to \$56b in debt owed by the poorest countries of the world yet these countries continued to struggle under unsustainable debt burdens while simultaneously struggling to finance the fight against poverty.

WHAT DID THE G8 PROMISE?

PARAGRAPH 29 "The G8 has agreed a proposal to cancel 100% of outstanding debts of eligible Heavily Indebted Poor Countries to the IMF, IDA and African Development Fund, and to provide additional resources to ensure that the financing capacity of the IFIs is not reduced, as set out in the statement of 11 June. We welcome the agreement in principle by the Paris Club aimed at achieving a sustainable exit for Nigeria from its debt problems."

THE PROBLEM

Over the last several decades, poor countries accumulated large international debts, much of which was built up through poor lending decisions, support from Cold War allies, natural disasters, and decisions by corrupt dictators. These debts then became a serious impediment to poverty reduction and economic development in the world's poorest countries. Some poor countries spent as much as 25-30% of their annual budgets servicing this debt, much more than they spent on health and education combined. Most borrowed more money in order to cover their payments on old debt, creating a vicious cycle of indebtedness.

THE FIRST HIPC INITIATIVE

In 1996, the World Bank, IMF, and their member governments agreed to the first HIPC Initiative, which was designed to cancel some bilateral and multilateral debt for some of the poorest and most indebted nations in order to reduce their external debt burdens to "sustainable" levels. After adopting IMF- and World Bank-supported economic and governance reform programs for three years, poor countries would reach their "decision point" and could receive partial relief on debt service payments. Then, if reforms continued, they would reach "completion point" and become eligible for cancellation of some debt stock. Under this plan, however, only seven countries qualified for debt service relief and few resources were freed for poverty reduction and development.

THE SECOND ROUND

In 1999, under mounting public pressure brought on by the Jubilee 2000 movement, the G7 and later the Boards of the World Bank and IMF adopted the "Enhanced HIPC Initiative." It provided deeper debt relief for more countries more quickly than was planned for in 1996, and more directly tied the provision of debt relief to country-led poverty reduction plans. Each creditor government agreed to 90% cancellation of their bilateral debts. Some nations including the U.S., the U.K., Canada and Italy, agreed to cancel 100% and the World Bank and IMF agreed to partial cancellation.

Prior to the 2005 G8 summit, there were 38 countries enrolled in the Enhanced HIPC initiative (32 of them in Africa). Eighteen of these countries had reached completion point and had begun channelling the debt savings into poverty reduction

programs; another 10 had begun the process and were receiving interim relief. Despite this progress, the 1996 HIPC program was undermined by two key factors: (1) the International Financing Institutions (IFIs) resumed unsustainable lending practices and (2) countries experienced lower than expected growth performance. As a result, many countries continued to have difficulty meeting repayment obligations and were still spending too much money on debt, often taking on new loans to repay old ones.

COUNTRIES MAKING EFFECTIVE USE OF DEBT RELIEF SAVINGS

- Tanzania has used its savings from debt relief to increase education spending and eliminate school fees. An estimated 3 million children have returned to school.
- Uganda used the bulk of debt relief savings to fund universal primary education, more than doubling the school enrolment rate to 94%, which has contributed to Uganda's remarkable decline in HIV rates. Uganda also used this money to dig many clean water wells.
- Mozambique has used substantial debt savings to vaccinate children against tetanus, whooping cough and diphtheria, as well as to build and electrify schools.
- Cameroon used its debt savings to launch a national HIV/AIDS plan for prevention, education, testing, and mother-to-child transmission abatement.

WHERE ARE WE NOW AND HOW DO WE GET TO WHAT WAS PROMISED?

At the 2005 Gleneagles Summit, led by the U.S. and the U.K., G8 leaders took further action to speed and broaden debt relief by adopting the Finance Ministers' plan, called the "Multilateral Debt Relief Initiative" (MDRI). To implement the MDRI, G8 leaders worked with each of the multilateral institutions to design a plan which their shareholders and boards could take forward. Over the course of the past 11 months, these plans have been adopted and the MDRI has been set in motion. Details of the plans adopted by the World Bank, IMF and African Development Bank (AfDB) are below.

The G8 deserve credit for following through on this key promise, but going forward it will be critical for them to deliver the resources required to ensure that the debt cancellation is truly additional to existing support from these institutions. It is also vital that no new conditionality is attached to the debt deal (apart from those conditions established by the countries themselves to enable accountability and transparent management of funds to ensure that they are applied towards poverty alleviation) and also that there is a move from loans to grants for the poorest nations so that they do not re-accumulate unsustainable burdens.

IMF DEBT

QUALIFIED COUNTRIES: IMF staff successfully argued that the debt deal needed to ensure that the IMF's resources would be used consistently with the principle of "uniformity of treatment." This means the IMF set a standard measure by which to compare all poor countries (income level), which resulted in the IMF adding Cambodia and Tajikistan to its list of beneficiary countries (but they will not be added to HIPC as a whole). At the same time, staff argued that Mauritania should not receive immediate cancellation due to some recent policy issues, but would be reviewed in June 2006 and could be eligible along with other recipients if the review were favourable. In addition, since the time of the board agreement (April 2006), Cameroon reached completion point and will therefore receive immediate cancellation as well. The number of countries due to receive immediate cancellation therefore, is 20, with Mauritania eligible in the coming months.⁵ Over

“
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than war.”

DR. ADEBAYO ADEDEJI
African Center for
Development Strategy

time a total of 44 countries will become eligible when they reach completion point.

IMPACT ON QUALIFIED COUNTRIES: For the first 20 countries eligible, the IMF will cancel approximately \$3.6b over 10 years and, once all 44 countries are through the system (42 HIPC countries plus Tajikistan and Cambodia), this could result in total cancellation of approximately \$6b.

NEW RESOURCES: The IMF will use the principal generated by the 1999 revaluation of IMF gold (estimated at approximately \$4.5b) to finance IMF debt cancellation for all countries with per-capita income of \$380 a year or less and qualified countries with per-capita incomes above that threshold would be financed using resources from the Poverty Reduction and Growth Facility (PRGF) as well as from additional bilateral contributions.

IMPLEMENTATION: IMF debt cancellation became effective on January 1, 2006

WORLD BANK DEBT

QUALIFIED COUNTRIES: 18 of the 19 completion point HIPC countries⁶ will immediately receive World Bank debt cancellation—the exception being Mauritania. World Bank staff argued that Mauritania should not receive immediate cancellation due to some recent policy issues but would be reviewed in June 2006 and could be eligible along with other recipients if the review were favourable. The remaining HIPC countries will be eligible for debt cancellation once they reach completion point.

FINANCING: After considerable debate about ensuring that additional resources would be paid to cover the costs of the debt deal, the World Bank approved the G8 deal, emphasising the need for additional resources to provide “dollar for dollar compensation” for the World Bank’s International Development Association, or IDA (the World Bank’s concessionary lending arm for the poorest countries), “that is truly additional to existing commitments.” This is being achieved by scaling up contributions to IDA through the regular, ongoing financing mechanism and supplemented by certain donors wishing to contribute to filling the gap. It is

crucial that the resources are predictable and therefore efforts have been taken to ensure that donors are committed to ongoing payments.

IMPACT ON QUALIFIED COUNTRIES: The initial group of 18 countries will receive a total of \$26b in debt relief over the life of the program (about 40 years). An additional 24 countries could become eligible for the MDRI, resulting in total debt cancellation of \$37b over time.

IMPLEMENTATION: World Bank debt cancellation for the first 18 countries will be effective July 1, 2006, as that begins the next fiscal year for the Bank, with the possible addition of Mauritania pending a favourable review.

AFRICAN DEVELOPMENT BANK DEBT

On April 19, 2006, the African Development Bank (AfDB) approved \$9b to finance debt relief for money owed to the African Development Fund (ADF) by 33 low-income countries in Africa that will eventually become eligible—32 HIPC countries and Eritrea which becomes eligible under the sunset clause. Fourteen African countries⁷ will immediately receive \$5.5b in relief.

The delivery of the benefits under MDRI for AfDB is to be provided by July 2006 retroactively to January 1, 2006. The AfDB needed to receive donor-financing commitments by end of June 2006 in order to set this in motion. As of May 2006, donors had pledged to provide additional contributions to the regular AfDB replenishments, but Instruments of Commitment (IoCs) had yet to be deposited.

THE NIGERIAN DEBT DEAL

At the end of 2004, Nigeria owed its Paris Club creditors over \$30b, 88% of which was owed to the G8 donors. Following the July 2005 commitment to find a solution to Nigeria's debt crisis, a deal was agreed between Nigeria and its Paris Club creditors which would clear all of this debt.

Nigeria would first pay arrears of about \$6.4b on payments due under its previous Paris Club rescheduling agreement of 2000, as well as arrears on debt contracted after 1985, before any cancellation took place. This is a standard Paris Club procedure. The donors would cancel 67% of the remaining debt contracted before 1985, about \$18b. Nigeria would 'buy back' the remaining debt at a market-related discount using oil profits.

The bilateral agreements necessary to cancel this debt were finalized in late 2005 and early 2006. By the anniversary of the G8 summit, Nigeria will have paid the G8 donors around \$11b as part of the deal but the whole of this debt will have been cleared. The benefits to Nigeria include not only the transfer of funds previously used for debt service to poverty reduction (approximately \$1b in debt service savings annually), but the restoration of credit worthiness. At the same time, the \$11b that Nigeria paid in order to secure the deal represents almost half the sum given in aid to all of sub-Saharan Africa in 2005. DATA agrees with other campaigners that the G8 treasuries should return the bulk and preferably all of the Nigerian debt repayments toward African development.

Going forward a more fair and transparent process to mediate the origins of debts is needed. Much of the principal of the Nigerian debt, for example, derived from bad lending decisions made by western companies to corrupt dictators. Citizens of impoverished nations should not be deprived of much needed resources to pay back such illegitimate debts.

TOTAL

For the immediate beneficiaries, this plan will result in cancellation of \$35b over the life of the loans (an average of \$875m per year in savings). Once all 42 HIPC countries reach completion point, this will result in cancellation of up to \$60b over the life of the loans (an average of \$1.5b per year in savings).

HOW ARE THE G8 DOING?

By June 2006 the G8 had confirmed their commitments to the MDRI and started their internal processes toward securing the resources. Each country has a different approach to ensuring the long-term security of funding; therefore, measuring progress differs for each:

ACTION ON ENSURING COMPENSATORY FINANCE FOR THE MULTILATERAL DEBT RELIEF INITIATIVE CANADA

The allocations to the MDRI are made in the regular budget process for the federal government each year (around February). This year there is an allocation of CAD\$55m (US\$45.4) as Canada's share of the MDRI.

FRANCE

A parliamentary resolution binding the government to finance MDRI over the next 10 years has been approved. Yearly appropriation will take place through the budget process.

GERMANY

There is no binding legal instrument for the entire duration of the initiative. Medium-term financial planning has a much shorter horizon, and is only formally enforceable through the yearly budgetary appropriation.

ITALY

The instrument of commitment to pay the first two years of MDRI has already been deposited. The formal commitment holds for the entire time frame of the initiative (40 years for IDA and 45 for AfDB): to make this binding, the Italian Treasury is working on a multi-annual legislative instrument

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that will authorise participation in the initiative. In turn, this will allow the yearly appropriation in the budget law.

JAPAN

The Japanese government finances IDA and AfDB through “Government Financing Bonds” (“Shushi-Kokusai”). Cancelling portions of IDA/AfDB debt is done on a yearly basis. The procedure itself is different between AfDB and IDA depending on the exact terms of financing of each instrument/institution.

U.K.

The U.K. submitted its “Instruments of Commitment” for financing the IDA part of MDRI to the Bank in mid-May. This was approved by a debate and vote in the Parliamentary Standing Committee on Delegated Legislation. It sets out the payment schedule for the next 40 years, starting with £27m (US\$49m) on January 15, 2007. The language makes these commitments absolutely firm for 10 years, but payments for years 11 to 40 are subject to revision, and need to be finally approved by another parliamentary process in 2016.

U.S.

The U.S. Administration submitted its “Instruments of Commitment” to IDA in mid-May and to AfDB in mid-June. It provides a commitment to finance the foregone principal and interest repayments associated with MDRI. Annual payments are subject to annual approval by Congress. The 2006 obligation was met.

G8 POLICY PROMISES TO BACK DEMOCRACY ACCOUNTABILITY AND TRANSPARENCY IN AFRICA - SO CALLED ‘BOTTOM UP CONDITIONALITY’

PARAGRAPH 31 “It is up to developing countries themselves and their governments to take the lead on development. They need to decide, plan and sequence their economic policies to fit with their own development strategies, for which they should be accountable to all their people.”

The G8 Communiqué refers to letting Africa drive the development process, noting that democratically elected, transparent and accountable African governments should be given the policy space to plan and sequence their own trade and development strategies.

This may sound like a lot of jargon, but it was and is an important victory for Africa. On the one hand it enables African governments to push back on debt relief and aid policy conditionalities which might benefit donors and creditors more than their African citizens. But even more importantly it shows that finally the G8 recognized that previous policy conditionalities had sometimes undermined national-level democratic accountability in Africa. Sometimes the way development assistance and debt relief is done can sever a government’s accountability to its citizens as it makes them more responsive to their funders than their constituents. However, this new kind of policy conditionality, this bottom-up policy conditionality, forces African governments to re-link with and open up to their citizens.

This new policy space must be filled by an increasingly vibrant African civil society and increasingly free media. It can also be supported through targeting development assistance towards training journalists, strengthening public expenditure tracing and management systems, and adopting policies like Uganda’s Poverty Action Fund or Nigeria’s new Virtual Poverty Fund – both cases where increased resources from development assistance and debt relief are more transparently managed and the accounts made more open to public scrutiny. This is how to link development assistance and

debt relief to fighting poverty. This not only strengthens transparent governance in a country – it also ensures greater aid effectiveness. Developing indicators by which to measure whether the G8 are keeping to the spirit of this promise is the next challenge.

MOVING FORWARD

While debt cancellation alone will not generate all the resources needed by poor countries, the money freed up from debt relief has consistently been put to good use. Maintaining lower debt ratios over time will contribute to macroeconomic stability and development of the private sector, both of which will help to increase economic growth and reduce poverty levels.

The G8 has clearly kept its Gleneagles commitment to multilateral debt cancellation. They must continue to deliver the additional resources to ensure that all countries promised will receive the debt cancellation once they qualify. Ultimately, more indebted poor countries such as Lesotho and Kenya should be eligible for the same debt relief, on the same strict anti-corruption conditions, and donors should also work to adopt a fair and transparent process for odious debts.

Donors and recipients need to watch closely another critical factor—the amount of new debt accumulated. While not part of the G8 commitments, lengthy negotiations have continued among donors about ensuring that countries resume borrowing on a gradual and prudent basis. This would mean an increased use of grant financing in the interim to prevent a rapid re-accumulation of unsustainable debt. While some agreements have led to greater grants, early data suggests many HIPC countries are slipping back into debt. The success of the G8's debt cancellation deal will ultimately be judged not only by the amount of debt cancellation agreed to in 2005, but by how long countries remain out of debt into the future. Breaking the “lend-and-forgive” cycle is critical to the long-term predictability of financing for poor countries and their ability to beat AIDS and extreme poverty. Finally, a more satisfactory means of arbitrating the origins of debts should be established so that odious and illegitimate debts are dealt with through an appropriately fair and transparent process.