DEBT RELIEF AND SUSTAINABILITY, FINANCING THE MDGs, COMBATING CLIMATE CHANGE and BUILDING DEBT STRATEGY CAPACITY

Istanbul, 3 October 2009

This background note highlights key issues for discussion at the HIPC Ministerial Meeting in Istanbul on 3rd October. It focuses in turn on debt relief and sustainability; development financing; and debt strategy capacity-building. Ministers’ most recent declaration (October 2008) is in this folder, as are the Commonwealth/OIF Joint Ministerial Forum declaration of April 2009, and other key documents.

1. DEBT RELIEF AND DEBT SUSTAINABILITY

1.1 THE MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)

There has been no progress on any of the suggestions made by Ministers last year. In that light, Ministers may wish to reiterate their suggestions that

- negotiations on replenishing the IADB FSO should begin rapidly.
- MDRI should be extended to the AsDB, Caribbean Development Bank, East and West African Development Banks and other African and Latin American regional organisations.
- allocation of MDRI funds should be adjusted to take account of MDG financing needs.

1.2 HIPC INITIATIVE

HIPC progress has improved somewhat (see the HIPC and MDRI Progress Report in this folder), with 2 decision points and 3 completion points in 2008/09, and improving prospects for Afghanistan, Chad, Congo Republic, DRC, Guinea-Bissau, Liberia (CP) and Comoros (DP). To accelerate progress, Ministers may wish to reemphasise that HIPC progress should be linked only to progress with PRSPs, and all countries should reach completion point after establishing a 6 month track record.

As described also in the progress report, there has been very slow progress on creditor participation, with only Algeria and Oman moving forward among non-Paris Club bilateral creditors, and some increase in commercial creditors’ participation through IDA buybacks. Ministers may therefore wish once again to urge the international community to:

- provide financing to eliminate debts owed by HIPCs to other severely-indebted countries.
- make intensified diplomatic efforts to convince creditors such as Costa Rica, India, Iraq, Libya, Saudi Arabia and new EU members to participate.

New lawsuits have been launched against 4 countries in 2008/09, though several cases have been settled out of court (at relatively high percentages of face value). There has been progress in ensuring coordination among the different (AfDB, Commonwealth, IDA) legal technical assistance initiatives. Initiatives to pass legislation restricting lawsuits are also under way in the UK and US, building on an earlier law in Belgium, and Ministers may wish to a) welcome these initiatives and urge the UK and US governments to move forward rapidly with legislation; and b) urge the G8 and EU to push other creditor governments and commercial creditors to agree not to sell their debts to third parties.

1.3. DEBT SUSTAINABILITY AND REVIEW OF THE LIC-DSF

There are growing risks of unsustainable debt in post-completion point HIPCs (5 already have high risk of debt distress, and 11 moderate risk; and 7 will have their vulnerability increased by the global financial crisis). The main reasons for these high risks and vulnerabilities are exogenous shocks and
changes in CPIA ratings, not excessive new borrowings. Since this time last year, there has been
dramatic acceleration of concessional lending by multilateral organisations (especially AfDB, AsDB,
IDA and the IMF) but, especially given the temporary forgiveness of IMF loan interest until 2011-12
and the slight softening of IMF new lending terms, this does not look likely to cause any new debt
crisis. Ministers may therefore wish to welcome the interest holiday and softening of terms, while
urging that any additional profits from the high gold price be spent on a principal payment holiday.

At the last Annual Meetings and at the G20, African Ministers in particular asked for a review of the
DSF to make it more flexible, particularly with a view to providing more scope for less or non-
concessional borrowing for high priority projects, where this will not compromise debt sustainability.
The meeting will benefit from a special presentation by the President of the African Development
Bank, Donald Kaberuka, on this issue.

The Boards of the IMF and World Bank have already approved review documents which could
slightly increase flexibility (the document is enclosed in this folder), by: 1) analysing the impact of
investment on growth; 2) taking remittances into account where they are significant; 3) introducing
greater inertia in changing country thresholds due to changes in the CPIA; 4) reducing the discount
rate to 4%, which will reduce borrowing space somewhat for all countries; 5) allowing borrowing by
public enterprises whose debts pose a limited fiscal risk; and 6) reflecting country authorities’ views
fully in DSA.s, including alternative scenarios if needed.

However, based on their past views, Ministers may wish to urge a more fundamental review to: 1)
take more account of the impact of exogenous shocks on individual countries, and allow temporary
countercyclical borrowing to offset them; 2) include for all countries scenarios which fully fund
the MDGs; and 3) design and use clear thresholds for domestic debt and overall fiscal burdens.

At the same time, the IMF reviewed the way concessionality limits are fixed in programmes. If applied
flexibly, this could make a more fundamental change to LIC borrowing space, by:
- establishing a more transparent link between concessionality limits and DSF results, and more
transparent criteria for varying borrowing space and providing exemptions in IMF programmes.
- clarifying that public enterprise debt will be exempted from limits if fiscal risk is limited.
- including assessment of public financial (and debt) management capacity as a factor in deciding
country borrowing space. This is welcome but partly uses flawed CPIA methodology.
- Overall, it intends to provide more borrowing flexibility in two ways:
  - on a loan-by-loan basis for countries with lower debt vulnerabilities and lower capacity, by
    granting more exceptions for nonconcessional borrowing where these will be consistent with
    low debt vulnerability, and with absorptive capacity
  - by setting limits in a more flexible way for countries with higher capacity, based on average
    grant elements or an overall limit on PV of debt. However, this may imply only scope to vary
    individual loan terms without lower concessionality in the overall portfolio or higher
    borrowing space, and only 8 LICs (3 HIPCs) fall into the “high capacity” group.

- However, for countries with higher debt vulnerability and lower capacity, it would become
  slightly less flexible, moving to or keeping minimum grant elements higher than 35%. In other
  words, borrowing space will shrink or stay low for many fragile states.

Ministers may wish to reiterate their strong commitment to minimise non-concessional borrowing
and avoid unsustainable debt, and call for several measures to underpin this commitment:
- a sharp increase in grants and concessional loans, especially for agriculture and infrastructure,
  and for fragile states which can least afford to borrow;
- reducing the capacity level needed to qualify for major flexibility under new limits.
- making a strong effort to ensure that “flexibility” by moving to non-loan specific limits
  translates into a lower average grant element and therefore higher borrowing space.
2. FINANCING THE MILLENNIUM DEVELOPMENT GOALS

2.1 AID QUANTITY AND REPLENISHMENTS

As expected, no progress was made at the G8 Summit on improving progress to meet the 2005 Gleneagles aid pledges or 0.7% of GNI in aid. However, there have been two recent positive developments: President Obama has indicated that the G8/G20 in 2010 must focus on agreeing a new set of targets for aid for the MDGs; and at the UN General Assembly meeting, an international taskforce on innovative financing for health systems committed US$5.3 billion of funding for free health care in low-income countries (see documents in this folder). Ministers may wish to welcome the health care funding and urge its extension to a wider range of countries, and urge that the G8 and G20 in 2010 make commitments even more ambitious than Gleneagles in order to assist low-income countries to recover from the financial crisis and come closer to meeting the MDGs.

While the G20 agreed to allow MDBs to frontload their lending against the financial crisis, this will mean that MDBs come up against their lending limits more rapidly. Ministers may therefore wish to urge rapid replenishments of MDB concessional windows, and considerable capital increases, especially given that they may be able to access hard window MDB funds for key projects.

2.2. FINANCING AGAINST CLIMATE CHANGE

The meeting will benefit from a special presentation on this issue by the President of Guyana, H.E. Bharrat Jagdeo. The aim of this presentation will be to make five key suggestions for Ministerial action points on this issue during the Annual Meetings and in the build-up to the UN Climate Change Conference in Copenhagen. Ministers may wish to react to these and make additional suggestions.

3. FUTURE CAPACITY-BUILDING AND MEETINGS

3.1. DEBT STRATEGY CAPACITY-BUILDING

The HIPC Debt Strategy and Analysis Capacity Building Programme (HIPC CBP) will end at the end of 2009. Donors will thereafter continue to fund activities to support country capacity-building on debt strategy, by channelling funds through the CBP regional partner organisations (BEAC/BCEAO Pole-Dette, CEMLA, MEFMI and WAIFEM), which will contract Debt Relief International to assist them in providing multi-regional products and technical support for regional and national events as necessary. Some countries which are not part of regional organisations may also receive direct support from DRI if donors agree to provide funds. During this session of the meeting, each regional partner will talk briefly about their plans for the future. In response, Ministers may wish to:

- Indicate what degree of importance they attach to continued capacity-building in this area
- Comment on the plans presented by regional organisations
- Underline their determination to continue adopting and implementing strategies, improving institutional and legal frameworks and implementing capacity-building plans, as well as their commitment to continue providing financial contributions to regional organisations.

3.2. FUTURE OF MINISTERIAL MEETINGS

This is the last Ministerial Meeting to be held under the auspices of the HIPC CBP. Given that these meetings have been co-sponsored by the Commonwealth Secretariat and the OIF for the last four years, and that the Commonwealth and OIF held their first joint Ministerial Forum on Debt Sustainability in April 2009, CBP partners strongly hope that the Commonwealth-OIF cooperation will continue in order to provide them with an ongoing forum through which low-income countries can express their views on debt and development financing issues to the international community. Ministers may wish to express their views on this issue as well as on whether LICs which are not Commonwealth or OIF members would hope to participate in such a forum (as they did this April), and whether financing would be needed for this.