

INTERNATIONAL MONETARY FUND

**The Multilateral Debt Relief Initiative (G-8 Proposal) and Its Implications for the Fund—Further Considerations: Supplemental Information**

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In consultation with other Departments

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## I. INTRODUCTION

1. **The Executive Board held an informal seminar on September 21, 2005 to discuss possible implementation modalities for the G-8 debt relief proposal.**<sup>1</sup> On September 24, 2005, the International Monetary and Financial Committee supported providing 100 percent cancellation of debt owed by HIPC's to the Fund, and considered that this would provide significant additional resources for countries' efforts to reach the Millennium Development Goals and reinforce long-term debt sustainability. The Committee welcomed the approach discussed in the Fund to ensure that its resources are used consistently with the principle of uniformity of treatment. It also stressed the importance of ensuring that the Fund's capacity to provide financing to low-income countries is maintained and therefore welcomed G-8 countries' commitment to provide additional resources. Following the agreement reached by the Committee, the Managing Director informed the IMFC that he would call on the Executive Board to complete its approval of the arrangements to deliver debt relief by the end of 2005. With this endorsement, staff intends to call this proposal the Multilateral Debt Relief Initiative (MDRI).

2. **This supplement responds to Directors' requests for clarifications of the staff's analysis in the areas of country coverage, conditionality, and certain specific legal aspects of the Initiative.** Section II discusses country coverage and the choice of the income cutoff. Section III covers conditionality issues. Section IV provides further discussion of certain legal aspects of the proposal. Section V discusses other provisions needed for the implementation of the proposal and points raised by Directors. Section VI proposes issues for discussion. A separate supplement discusses financing modalities for the MDRI. Once closure is reached on the outstanding issues, a paper would be issued setting forth the draft decisions, contributor actions and steps needed to effect the MDRI, consistent with the analysis in earlier papers and discussions.

## II. COUNTRY COVERAGE AND CHOICE OF AN INCOME CUTOFF<sup>2</sup>

3. **The general per capita income approach discussed in the main paper<sup>3</sup> meets uniformity of treatment requirements, while minimizing the additional costs of the Initiative compared to those contemplated in the G-8 proposal.** Under this approach, SDA resources would be used to provide MDRI debt relief to member countries below an

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<sup>1</sup> *The G-8 Debt Cancellation Proposal and Its Implications for the Fund—Further Considerations* (9/19/05).

<sup>2</sup> All debt and resource numbers are given in end-2005 NPV terms.

<sup>3</sup> In the supplement, the term "main paper" will refer to *The G-8 Debt Cancellation Proposal and Its Implications for the Fund—Further Considerations* (9/19/05).

agreed annual per capita income threshold.<sup>4</sup> Resources not subject to uniformity of treatment requirements (i.e., PRGF Subsidy Account resources attributable to third party contributors) could then be used to provide MDRI debt relief to those HIPC's identified by the G-8 that have per capita incomes above the designated threshold. Depending on the per capita income cutoff, additional contributions would be needed to subsidize the loan resources of the interim PRGF or to fund debt relief to HIPC's above the threshold.

4. **The G-8 Finance Ministers stated in their communiqué of June 16, 2005 that donors were committed to provide the extra resources necessary to give debt relief to the protracted arrears cases (Liberia, Somalia, and Sudan) as well as the costs arising from the inclusion of countries under the extended sunset clause of the HIPC Initiative.** These potential additional costs have not been included in the analysis of the MDRI's country coverage and costs that follows.<sup>5</sup> At the August 3 meeting, Executive Directors representing the G-8 reaffirmed that donors would provide the additional resources necessary for debt relief for the protracted arrears countries. In due course staff will prepare for Board consideration a separate paper with further analysis on possible alternatives to deal with the arrears clearance and debt relief of these countries in a manner that is comparable across the membership. Preliminary options and considerations are presented in Annex I. With regard to potentially eligible countries under the extended sunset clause, donors were also committed to finance debt relief on a fair burden-sharing basis. A preliminary list of thirteen potential sunset clause countries was presented to the Board in September.<sup>6</sup> A final list is expected to be provided for Board consideration in Spring 2006 (see Annex II).

#### **A. Per Capita Income Threshold of US\$380**

5. **As discussed in the main paper, a per capita income cutoff of US\$380 closely fits the financial arrangements contemplated under the G-8 proposal** (Table 1). This threshold would allow 37 countries to benefit from 100 percent debt relief. Debt relief for 21 HIPC's and two non-HIPC's (Cambodia and Tajikistan) with Fund credit outstanding and

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<sup>4</sup> MDRI relief is used in this paper to refer to debt relief after applicable debt relief under the HIPC Initiative for all HIPC-eligible countries, unless otherwise specified.

<sup>5</sup> As noted in *The G-8 Debt Cancellation Proposal and Its Implications for the Fund—Further Considerations* (9/19/05), however, SDA resources for HIPC relief would be available to all members (including sunset and protracted arrears cases) that reach the HIPC decision or completion point, while SDA resources for MDRI relief would be available to all qualifying members that have incomes at or below the threshold. If additional bilateral contributions for costs attributed to the sunset and protracted arrears cases are not immediately forthcoming, this would imply insufficient resources for all qualifying members, but would not mean that qualifying sunset and arrears countries would be ineligible for relief.

<sup>6</sup> *Heavily Indebted Poor Countries Initiative—Status of Implementation*.

per capita incomes of US\$380 or less, would be financed with the resources in the HIPC Umbrella Account for HIPC relief, and with general SDA resources for MDRI relief.<sup>7</sup> Debt relief for the remaining 14 HIPCs with incomes above the threshold would be financed in part by SDA resources transferred to the HIPC Umbrella Account for HIPC relief, and in part by a portion of the existing bilateral contributions in the PRGF Subsidy Account (for MDRI assistance).

6. **This threshold would balance the use of resources in the SDA and of third-party contributor resources in the PRGF Subsidy Account in a manner that minimizes the need for additional resources, thereby maintaining the Fund's future concessional lending capacity.** Under this approach, about SDR1.50 billion in SDA resources would be needed to cancel all the qualifying debt owed to the Fund after HIPC relief by PRGF-eligible countries with incomes at or below the US\$380 threshold. Of this amount, SDR 110 million corresponds to the cost of 100 percent debt relief for Cambodia and Tajikistan, the two non-HIPCs below the US\$380 income cutoff. A further SDR 1.12 billion in bilateral contributions available in the PRGF Subsidy Account would be needed to provide MDRI relief for those HIPCs that have incomes above this threshold.

7. After financing debt relief corresponding to the US\$380 threshold, resources of about SDR 0.72 billion would be available in the Subsidy Account and from the PRGF-HIPC Trust for subsidizing existing and future interim PRGF loans (see Table 1). However, an additional SDR 0.47 billion would remain available in the SDA that could also be authorized for PRGF subsidy purposes. Even assuming the latter authorization, new bilateral contributions of SDR 0.21 billion would be needed to bring total remaining subsidy resources to SDR 1.40 billion, which is the amount that would be required to allow full use of uncommitted interim PRGF loan resources of SDR 2.7 billion as well as all existing PRGF loans.

#### **B. Per Capita Income Threshold of US\$270**

8. **Some Executive Directors asked staff to analyze the financial implications of lowering the per capita income threshold to US\$270.** Under this option only the 35 countries as envisaged under the G-8 proposal would be eligible for 100 percent debt relief.<sup>8</sup> The two non-HIPCs (Cambodia and Tajikistan) would no longer be included. The financing of MDRI relief for the 12 HIPCs with per capita incomes below US\$270 would come from SDA resources, while MDRI relief for the other 23 HIPCs would be financed by existing bilateral contributions in the PRGF Subsidy Account supplemented by additional contributions.

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<sup>7</sup> Liberia and probably Somalia (both protracted arrears cases) and Afghanistan, Eritrea, and Nepal (potential HIPC sunset cases) also have per capita incomes below US\$380.

<sup>8</sup> Afghanistan and Eritrea (potential HIPC sunset cases) and probably Somalia (a protracted arrears case) also have per capita incomes below US\$270.

**Table 1. Sources and Uses of Financing**  
(In billions of SDRs; in end-2005 NPV terms)

	Per Capita Income Threshold		
	US\$270	US\$380 1/	US\$400
<b>A. Sources of financing at end-2005</b>	<b>4.66</b>	<b>4.66</b>	<b>4.66</b>
I. SDA	2.50	2.50	2.50
II. Umbrella Account	0.32	0.32	0.32
III. PRGF Subsidy Account	1.65	1.65	1.65
<i>Of which: Bilateral contributions</i>	1.41	1.41	1.41
IMF's SDA portion	0.24	0.24	0.24
IV. PRGF-HIPC Trust	0.07	0.07	0.07
V. Projected additional inflows 2/	0.12	0.12	0.12
<b>B. Financing needed for debt relief 3/</b>	<b>3.26</b>	<b>3.37</b>	<b>3.37</b>
I. SDA resources for:	1.15	1.94	1.94
HIPCs with per capita income below threshold	0.71	1.39	1.40
Debt relief to non-HIPCs below threshold	-	0.11	0.11
HIPC assistance at completion point for the 17 decision and pre-decision point countries	0.44	0.44	0.44
II. Umbrella Account	0.31	0.31	0.31
III. Financing for HIPCs above threshold	1.80	1.12	1.12
Bilateral contributions from the PRGF Subsidy Account	1.41	1.12	1.12
Additional bilateral contributions needed	0.39	-	-
<b>C. Remaining resources after debt relief</b>	<b>1.78</b>	<b>1.28</b>	<b>1.28</b>
I. Minus: Projected uses of interim assistance	0.09	0.09	0.09
<b>D. Resources remaining 4/</b>	<b>1.69</b>	<b>1.19</b>	<b>1.19</b>
I. SDA	1.26	0.47	0.47
II. Umbrella Account	-	-	-
III. PRGF Subsidy Account	0.24	0.53	0.53
o/w: bilateral contributions	-	0.29	0.29
IMF's SDA portion	0.24	0.24	0.24
IV. PRGF-HIPC Trust	0.07	0.07	0.07
V. Projected additional inflows 2/	0.12	0.12	0.12
Additional bilateral contributions needed 5/	-	0.21	0.21
<b>Memorandum items:</b>			
<b>Additional bilateral contributions needed</b>	<b>0.39</b>	<b>0.21</b>	<b>0.21</b>
<b>Resources available to subsidize interim PRGF loans</b>	<b>1.69</b>	<b>1.40</b>	<b>1.40</b>

1/ Consistent with Table 5 in SM/05/353.

2/ Mainly reflects projected interest income on bilateral deposit agreements with the PRGF-HIPC Trust.

3/ Excludes HIPC assistance and MDRI debt relief to potential sunset clause countries and protracted arrears cases, as discussed in SM/05/353.

4/ Includes resources needed for repaying the PRGF Reserve Account associated with early transfers of SDR 43.5 million for HIPC disbursements.

5/ Amount needed to allow the full use of the available interim PRGF loan resources.

9. **Compared with the US\$380 per capita income cutoff, this threshold would change the composition of financing, as well as reducing the amount of debt relief by SDR 110 million.** Fewer SDA resources would be needed for debt relief, given the lower eligible debt stock owed by countries below the threshold. The need for bilateral contributions not subject to uniformity of treatment requirements would be higher at SDR 1.80 billion, and would exceed the level of bilateral contributions available in the PRGF Subsidy Account (SDR 1.41 billion). The adoption of the US\$270 threshold would thus necessitate additional bilateral contributions, estimated at SDR 0.39 billion. Any shortfall that would arise from a bilateral contributor not consenting to use its resources for MDRI debt relief would increase the need for additional bilateral contributions for that purpose. However, the reduced use of SDA resources would mean that a larger amount of resources could be made available to support the interim PRGF.

### C. Per Capita Income Threshold of US\$400

10. **Staff was also asked to analyze the implications of an income threshold of US\$400.** Compared with the US\$380 per capita income cutoff this threshold would add only one country (Nigeria) which had no debt outstanding to the Fund at end-2004.<sup>9</sup> Excluding the costs of the HIPC sunset and protracted arrears cases, the cost to the Fund of a US\$400 per capita income threshold would be unchanged compared with the US\$380 per capita income threshold. With the higher threshold, Lao PDR moves into the group of countries where MDRI relief would be financed by SDA resources. There would therefore be a modest increase in the use of SDA resources (of less than SDR 1 million) to cover the costs of debt relief to Lao PDR, and a corresponding reduction in the use of bilateral contributions.

## III. CONDITIONALITY

### A. HIPCs

11. **Conditionality for debt relief under the MDRI should be consistent across members.** In the case of pre-completion-point HIPCs, reaching the completion point would qualify them for debt relief under the HIPC Initiative and the MDRI. For post-completion-point HIPCs, staff suggested a strategy similar to the one applied to early HIPC decision and completion point cases after the HIPC Initiative was enhanced in 1999. Additional conditionality would not be required where members still meet the earlier requirements for debt relief. More specifically, and as discussed in the main paper, post-completion-point members would receive debt relief under the MDRI after the Board confirms that their performance in three key completion point areas has not deteriorated since they reached their HIPC completion point. Thus, these members would be assessed regarding (i) satisfactory

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<sup>9</sup> Afghanistan, Eritrea, Haiti, the Kyrgyz Republic, and Nepal (potential HIPC sunset clause cases) and Liberia and probably Somalia (both protracted arrears cases) also have per capita incomes of US\$400 or less.

macroeconomic performance, (ii) satisfactory implementation of their poverty reduction strategies, and (iii) a determination that public expenditure management systems had not deteriorated since the completion point. Having a Fund arrangement would not be required to benefit from the MDRI. For members whose performance has lapsed in any of these areas, debt relief under the MDRI would be delivered only after the Board determines that appropriate remedial steps had been taken.

12. **Following the Executive Board adoption of the requisite decisions to implement the MDRI, staff would bring to the Board an assessment of the recent performance in each of these three areas of all post-completion-point members.** The assessment would be prepared in collaboration with the World Bank, but would ultimately be the responsibility of Fund staff.<sup>10</sup> The Board would consider the relevant information and decide on each member's eligibility for debt relief under the MDRI. Country-specific decisions providing for the immediate delivery of MDRI debt relief could be taken once the Board's general decisions to implement the MDRI became effective (i.e., after receipt of the requisite consents). For post-completion-point members that require additional time to qualify for the MDRI, staff would propose remedial actions which could be incorporated into country-specific Board decisions for the members in question. The re-assessments for members that do not qualify for immediate delivery of MDRI debt relief would be prepared and submitted for Board consideration as soon as the remedial actions are taken and could be done in the context of regular country reports (program review and/or an Article IV consultation) or on a stand-alone basis.<sup>11</sup>

## B. Non-HIPCs

13. **To qualify for debt relief under the MDRI, eligible members that are not HIPC eligible would also need to demonstrate good economic performance.** Non-HIPCs have debt ratios lower than what is necessary to qualify them for assistance under the HIPC Initiative which suggests that the policies and timelines included in HIPC conditionality generally would not be germane to them. Uniformity of treatment does not require that all members eligible for debt relief under the MDRI be subjected to exactly the same conditions, but to conditions that are comparable once their specific circumstances are taken into account. Their lower debt ratios (themselves the product of relatively sounder economic

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<sup>10</sup> Staffs from the Bank and the Fund would collaborate closely in the preparation of these assessments, and whenever possible rely on each other's expertise. The process will be carried out in close collaboration with Fund area departments and World Bank regions. However, as is always the case, the decision of eligibility would be taken by each Board separately.

<sup>11</sup> The Bank would take the lead, in consultation with FAD, in updating, as needed, diagnostic assessments of public expenditure management systems and in designing remedial measures to compensate for any deterioration in these systems since the completion point.

management policies in the past) make non-HIPCs closer in circumstances to post-completion-point than to pre-completion-point HIPCs. Thus, entry conditionality for that group would focus on the assessment of their performance in the three key areas outlined above for post-completion-point HIPCs, and required remedial actions if their performance is found lacking.

14. **The assessment of the macroeconomic performance of eligible non-HIPCs with a Fund-supported program in place will be straightforward.** The assessment would be based on the outcome of the latest review under the program, assuming that it was completed less than six months earlier. If the latest review has been completed more than six months earlier, the assessment should indicate if the macroeconomic conditions at the time of the review remain valid. If the program is off track or if the country does not have a Fund-supported program in place, a minimum of six months of a satisfactory track record of strong policy actions meeting the upper credit tranche conditionality would be required for the delivery of debt relief.<sup>12</sup>

15. **Regarding implementation of the poverty reduction strategy and the quality of public expenditure management, progress would be assessed over the previous 3-5 years.** The assessment would need to take into account differences in country circumstances. The objective would be to ensure that (i) the country has in place a poverty reduction strategy in the form of an interim or a full PRSP and has satisfactorily implemented this strategy for at least six months; and (ii) the quality of public expenditure management systems would allow resources freed by debt relief to help meet the MDGs.<sup>13</sup> As in the case of HIPCs, the assessments in these fields will be prepared in coordination with the World Bank. Should an eligible non-HIPC fall short of this standard and need more time to qualify for the MDRI, staff would propose required remedial actions which could be incorporated into country-specific Board decisions.

### C. Post-Debt Relief Monitoring

16. **The IMFC requested regular progress reports on the implementation of the MDRI and on the subsequent progress of beneficiary countries toward growth and poverty reduction.** An update on the status of all members benefiting from the MDRI, their progress in the three key areas and expected approval dates would be presented to the Board before the Spring or Annual Meetings following the effectiveness of the relevant decisions. Subsequent MDRI status reports would be prepared in conjunction with the regular joint

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<sup>12</sup> While not analogous, it should be noted that under the enhanced HIPC Initiative a minimum of 10 to 12 months of track record under a Fund arrangement has generally been required between decision and completion point.

<sup>13</sup> For non-HIPCs, no comprehensive assessment of PEM systems has been undertaken.



Bank-Fund HIPC Initiative status reports. The implications of the MDRI for the debt sustainability framework will be addressed in the review of the framework scheduled for Spring 2006.

17. **The design of appropriate fiscal and financing policies after debt relief would be a central element of policy discussions with beneficiary countries.** Staff would provide policy advice and technical assistance, as needed, to guide the use of the resources freed by the debt relief in the context of Article IV and program discussions. Staff reports for Article IV consultations and program reviews should provide country-specific information on the use of additional resources provided by debt relief. Thus, Fund and Bank staffs would continue to monitor the size, composition and quality of poverty-reducing expenditures as designated in the country's PRSP, and progress toward the MDGs. Aggregate information and analyses would also be included in HIPC Initiative status reports.

#### **D. Administrative Costs**

18. **Administrative costs (staff resources and related costs) associated with implementing the MDRI are expected to be around US\$2.6 million.** This represents a one-time cost for the preparation and implementation of the MDRI. Most of the costs associated with entry conditionality dovetail with surveillance and program work and thus will require relatively minimal additional staff resources. For decision and pre-decision-point cases, entry conditionality under the MDRI is the same as the conditionality under the HIPC Initiative. For most post-completion-point countries, qualification to receive debt relief can be assessed under existing Fund arrangements or in the context of an Article IV consultation. To a large extent, the administrative costs associated with the monitoring of the resources freed up by debt relief are already part of current Fund operations and are expected to be integrated into the Fund's program and surveillance operations. Additional costs would be incurred in connection with the financial operations and accounting activities associated with the MDRI, but they will also to some extent coincide with those required for the delivery of HIPC assistance.

#### **IV. LEGAL CONSIDERATIONS**

19. This section addresses the principal legal issues that were raised during the recent Executive Board informal seminar.

##### **A. The Use of Special Disbursement Account Resources**

20. **Under the approach identified in the main paper, resources from the Special Disbursement Account would be used to provide MDRI debt relief to PRGF-eligible members with an annual per capita income of US\$380 or less.** During informal discussions, several Directors asked staff to elaborate further on the assessment in the main paper that such an approach is consistent with the requirement of uniformity of treatment.

21. **Article V, Section 12(f)(ii) authorizes the Fund to use SDA resources to provide balance of payments assistance on special terms to developing countries, and specifically provides that, for this purpose, the Fund shall take into account the level of per capita income.** Relying on this provision, the Fund has generally used the IDA-eligibility per capita income threshold as a basis for limiting eligibility for all its concessional assistance, including under the Structural Adjustment Facility, Enhanced Structural Adjustment Facility (which became the PRGF in 1999), and the HIPC Initiative.

22. **However, as discussed in the main paper, a per capita income threshold that is lower than the IDA income threshold could be used as a basis for providing SDA resources, including as grants for debt relief, to only a subset of PRGF-eligible members.** In establishing this lower threshold, the Fund could take into consideration the finite nature of SDA resources. Indeed, the IDA income threshold itself was lowered in the 1980s because of the shortage of IDA resources.<sup>14</sup> From a policy perspective, it may be considered preferable to mitigate the “all-or-nothing” consequences of a single threshold by providing some degree of graduated assistance based on income levels. However, there is no legal requirement to provide for such gradation.

23. **The approach of providing Fund debt relief to members with the lowest incomes (e.g., based on an annual per capita income threshold of US\$380) is consistent with the requirement that SDA resources under Article V, Section 12(f)(ii) be used for “balance of payments assistance.”** As discussed in the main paper, the Fund has long considered that all low-income members have *a priori* a protracted balance of payments problem. Debt relief in connection with debt owed to the Fund by those members with the very lowest income levels would strengthen their external positions, thereby helping to address their protracted balance of payments problem.

24. **Moreover, the Fund may decide that, among those members that are below the specified per capita income threshold, it will only provide debt relief with respect to obligations owed to the Fund.** As noted in the main paper, the possibility of providing financing for the purpose of assisting members to meet their obligations to the Fund is specifically referred to in the Commentary to the Second Amendment, which notes that balance of payments assistance under Article V, Section 12(f)(ii) “can include, for example, subsidies for the payment of charges levied in connection with the use of resources in the General Resources Account.”<sup>15</sup> Moreover, the HIPC Initiative itself follows the approach of providing assistance only in connection with obligations owed to the Fund, as Fund debt

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<sup>14</sup> See “IDA Eligibility, Terms and Graduation Policies,” IDA Report No. 26498, 01/01/2001.

<sup>15</sup> See “Proposed Second Amendment to the Articles of Agreement, A Report by the Executive Directors to the Board of Governors (1976), p. 47.

relief is available under that Initiative only where a member has outstanding debt to the Fund.<sup>16</sup>

## **B. The Use of Contributor Resources in the PRGF Trust Subsidy Account**

**25. Under the MDRI, provisions of the PRGF Trust relating to the Subsidy Account would, upon the request of third party contributors to that account, be amended to allow for the transfer of resources originally contributed by third parties for subsidies under the PRGF Trust to a newly established account to be administered by the Fund.**

The resources transferred to and held in this account would be used to provide MDRI debt relief to qualifying members in the group of 35 HIPCs identified in the G-8 proposal whose annual per capita income exceeds US\$380. As discussed in the main paper, the Fund has the authority to establish, upon request, an account to administer resources provided by contributors only for the benefit of specified members.

**26. Also described in the main paper, the amendment of the PRGF Trust Instrument to allow the above transfer of resources would require: (a) a decision by the Fund adopted by a majority of the votes cast and (b) the consent of all contributors to the Subsidy Account.** The establishment of a new administered account to receive the resources from the Subsidy Account and make them available to the qualifying HIPCs would also require a Fund decision adopted by a majority of the votes cast.

**27. During the informal seminar on the main paper, some Directors requested further analysis of the legal feasibility of amending the PRGF Trust Instrument to provide for such a transfer of contributor resources.** In particular, these Directors noted that Section IV, paragraph 6 (which would need to be amended to allow for the pre-termination transfer of third-party resources from the Subsidy Account) is one of the “protected” provisions that is specifically excluded from amendment by Section IX of the PRGF Trust Instrument.<sup>17</sup> The question was raised as to whether (i) the Fund as Trustee may amend a protected provision such as Section IV, paragraph 6, and (ii) assuming that an amendment could be effected, whether it only requires the consent of all contributors to the Subsidy Account or, alternatively, also requires the consent of all PRGF-eligible members.

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<sup>16</sup> See, e.g., Decision Point Decision for São Tomé and Príncipe, 12/20/00 (no HIPC assistance was committed to São Tomé and Príncipe at the decision point since the member had no eligible debt to the Fund at that time).

<sup>17</sup> Section IX of the PRGF Trust Instrument provides as follows: “*The Fund* may amend the provisions of the Instrument, except this Section and Section I, paragraphs 1 and 2; Section III, paragraphs 4 and 5; Section IV, paragraphs 4 and 6; Section V; Section VI; Section VII, paragraphs 2(a) and (b); Section VIII, paragraph 2(b).”

28. The following may be noted with respect to the amendment provision (Section IX) of the PRGF Trust Instrument:

29. **The limitation on the Fund’s authority to amend protected provisions precludes the Fund from amending these provisions *unilaterally*.** As evidenced by the Executive Board’s own decisions, the Fund has never interpreted Section IX as meaning that protected provisions could never be amended.<sup>18</sup> Rather, the Board’s long-standing position, as demonstrated by its decisions, has been that the clause in Section IX that deals with protected provisions is an exception to the general principle that the Fund may unilaterally amend any of its decisions, including the PRGF or any other trust instrument. Therefore, what is prohibited by the reference to protected provisions is only their unilateral amendment by the Fund. Rather, such amendments require the consent of all third party contributors and/or lenders to the PRGF Trust that would be affected by the amendment.<sup>19</sup> This has been the position on numerous occasions in which protected provisions of the PRGF (ESAF) Trust have been amended.<sup>20</sup> However, neither at the time of the establishment of the PRGF/ESAF Trust, nor at the time of the Board’s consideration of these amendments, was there any indication that staff or the Executive Board believed that an amendment of a “protected provision” required the consent of all PRGF eligible members.<sup>21</sup>

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<sup>18</sup> Regarding the interpretive implications of operational decisions, see Sir Joseph Gold, *Interpretation: The IMF and International Law* (1996), at p. 3: “Every action of the IMF every day expresses or implies some interpretation of its law. A common belief is that interpretations are decisions of the organization taken under the provisions that govern authoritative interpretation or other decisions that explicate the law of the IMF but which are considered informal because they are not taken under the provisions on authoritative interpretation. Even if an action is not in itself a decision of the one or the other kind, or is not expressly justified by reference to a decision of either kind, the action will imply a view about the meaning of some element or elements of the IMF’s law. If this analysis were not true, the conclusion would have to be that the organization takes actions with the understanding that they are not in accordance with applicable law or are taken without concern as to their validity.”

<sup>19</sup> This interpretation is supported by Sir Joseph Gold, *ibid.*, at p. 78 (“The excepted provisions may be subject to amendment with the consent of lenders, although this is not said”).

<sup>20</sup> Various precedents are identified in footnote 39 of *The G-8 Debt Cancellation Proposal and Its Implications for the Fund—Further Considerations* (9/19/05).

<sup>21</sup> This conclusion also reflects the important distinction between all PRGF eligible members and those PRGF-eligible members to whom a commitment or disbursement of resources has been made under a PRGF arrangement. Specifically, the Fund’s authority to amend the PRGF Trust for the purpose of changing the use of, or removing contributor resources held

(continued...)

30. **Moreover, the conclusion that Section IX of the PRGF Trust Instrument allows amendment of protected provisions with the consent of affected contributors/lenders is consistent with the text of the comparable amendment provision of the PRGF-HIPC Trust Instrument.** The amendment provision of the PRGF-HIPC Trust explicitly provides that, while all provisions of the PRGF-HIPC Trust may be amended, certain provisions may only be amended with the consent of contributors.<sup>22</sup> When drafting this provision, it was staff's intention to make explicitly applicable to the PRGF-HIPC Trust the interpretation that had been consistently given to Section IX of the PRGF Trust with respect to amendments of that Trust, as described above. It was never intended that these two trusts would operate in a fundamentally different way with respect to the scope of amendment authority; i.e., it was not intended that the amendment of the protected provisions of the PRGF Trust required the consent of PRGF-eligible members, while the amendment of the protected provisions of the PRGF-HIPC Trust did not require consent of HIPC-eligible members.

31. **Finally, the above interpretation is also supported by the nature of the provisions that are "protected."** The provisions of the PRGF Trust Instrument that are protected under Section IX are those that affect the interests of contributors or lenders, including provisions relating to matters such as: (a) the purpose for which contributor and lender resources may be used, (b) the terms of the Reserve Account that secures loans made by lenders to the Loan Account, and (c) the subsequent disposition of unused contributor resource in the Trust. If it had been the intent of the Executive Board to preclude

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in, the Subsidy Account may be constrained to the extent that such actions would prevent the Fund from providing to members with outstanding PRGF loans or existing PRGF arrangements the current level of subsidies that resources in the Subsidy Account would have permitted. However, to the extent that such an entitlement exists, it would arise from the commitment made by the Fund *under the relevant PRGF arrangements*, and not from the terms of the PRGF Trust Instrument. In particular, in the context of a PRGF arrangement (and unlike the GRA), the importance of the Fund's commitment under an arrangement relates not only to the availability of Fund resources to the member, but also to the availability of subsidies that enable the concessional interest rate under the PRGF. This does not mean that the Fund has an obligation to obtain subsidies if none are available in respect of already committed resources; it may suggest, however, that there are limits on the Fund's ability to agree to a transfer of resources that were previously available for subsidy purposes. In any event, there would be sufficient subsidies remaining under the overall MDRI operation to continue the subsidization at current rates of all currently outstanding PRGF loans plus all outstanding commitments under existing PRGF arrangements.

<sup>22</sup> Section VI of the PRGF-HIPC Trust Instrument reads as follows: "The Fund may amend the provisions of the Instrument, except that any amendment of Section I, paragraph 2, Section IV, Section V and this Section shall require the consent of all contributors to the Trust."

amendments that would adversely affect the interests of PRGF-eligible members, there are other important provisions that would have been protected, *but have not been*. For example, the Fund has the authority to unilaterally amend, through a decision adopted by a majority of the votes cast, both the list of members that are eligible for assistance under the PRGF and the level of subsidy that can be made available to them. Perhaps most importantly, Section VIII of the PRGF Trust Instrument enables the Fund to unilaterally terminate the Trust, as it provides that the Trust is to remain in effect for only so long as this is necessary, “*in the judgment of the Fund,*” to conduct the business of the Trust.<sup>23</sup>

## V. OTHER ISSUES

### 32. **Executive Directors requested staff to provide a comparison between the amount of debt relief provided by the Fund under the MDRI Initiative and ODA flows.**

Table 2 shows that the stock of Fund debt to be cancelled under the MDRI accounts for about 4 percent of the cumulative net ODA resources received by the 18 post-completion-point HIPCs over 1996-2004.<sup>24</sup> It would be equivalent to about 3.4 percent of their GDP, compared to yearly net ODA inflows of 13.3 percent of GDP on average during the same period. The ratio varies significantly across countries, however, with expected debt relief from the Fund accounting for less than 2 percent of GDP and ODA in Mozambique to 10 and 13 percent, respectively, in Zambia.

## VI. ISSUES FOR DISCUSSION

### 33. **In view of proposals included in the main paper and in this supplement paper:**

- Do Directors agree with the approach identified in the main paper to meet uniformity of treatment requirements in the context of the MDRI?
- Do Directors agree that qualification criteria for post-completion-point HIPCs should comprise satisfactory macroeconomic performance, satisfactory implementation of the PRS, and sustained improvements in the areas of public

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<sup>23</sup> By analogy, general principles of trust law—at least in the United States—support the interpretation that, given the Fund’s broad authority to terminate the Trust, it does not need the consent of all PRGF-eligible members to amend it. See, e.g., American Law Reports, Annotated, Second Series (62 ALR2d), 1958, p. 1413: “Ordinarily a general power to revoke the trust will be interpreted as authorizing the settlor not only to revoke the trust in part by withdrawing a part of the trust property from the Trust..., but also to modify the terms of the trust, and it will be unnecessary for the settlor first to revoke the trust and then to create a new trust.” See also, Section 602(a) and Commentary of the U.S. Uniform Trust Code (“A power of revocation includes the power to amend”).

<sup>24</sup> Following the onset of the HIPC Initiative in 1996.

expenditure system management, governance and transparency? Do Directors agree that remedial actions would be needed before the delivery of MDRI debt relief in case of lapses of performance in any of these criteria?

- With respect to the inclusion of non-HIPCs, do Directors agree that entry conditionality should be broadly similar to the criteria applied to post-completion-point HIPCs?
- Do Directors agree with the modalities proposed for post-debt relief monitoring?
- Do Directors think that specific modalities should be considered in due course for the treatment of protracted arrears cases?

**Table 2. Debt Relief Under the MDRI and Net ODA Flows to HIPCs 1/ 2/**

	MDRI in percent of GDP	MDRI in percent of Exports GS	MDRI in percent of net ODA	Net ODA in percent of GDP
Benin	1.2	8.8	2.7	9.0
Bolivia	2.8	9.4	4.6	8.0
Burkina Faso	1.6	17.0	2.8	12.3
Ethiopia	1.8	8.9	2.3	13.5
Ghana	3.7	10.7	7.5	9.4
Guyana	8.6	9.0	7.2	15.6
Honduras	2.0	5.1	4.2	7.8
Madagascar	4.1	13.2	5.6	10.7
Mali	2.0	7.9	3.3	12.4
Mauritania	3.9	11.6	3.7	19.1
Mozambique	2.3	7.6	1.9	25.9
Nicaragua	4.1	11.4	3.8	17.7
Niger	3.4	20.2	5.1	12.8
Rwanda	3.8	39.4	2.9	18.5
Senegal	1.7	6.4	3.9	8.9
Tanzania	2.8	14.2	3.9	11.9
Uganda	1.5	12.2	2.2	11.5
Zambia	9.5	26.5	13.2	14.9
<b>Completion point HIPCs</b>	3.4	13.3	4.2	13.3

Sources: Fund Staff estimates, OECD database, and WEO database.

1/ Projected Fund credit outstanding at end-2005. GDP and exports for 2005 based on data from the WEO database.

2/ Net ODA accumulated flows during 1996-2004



## **Annex I. Debt Relief for the Protracted Arrears Cases**

1. As described in the main paper, delivering debt relief under the MDRI to the three protracted arrears cases—Liberia, Somalia, and Sudan—will require special provisions. Under the MDRI, members are expected to remain current on obligations falling due to the Fund and lending after the January 1, 2005 cutoff date is not eligible for MDRI assistance. However, all Fund credit to the three arrears cases is overdue and immediately payable; and members cannot reach either the HIPC decision or completion point (and thus cannot qualify for MDRI assistance) until after all arrears to the Fund have been cleared.<sup>25</sup> Arrears clearance would extinguish the debt of the three protracted arrears cases outstanding at the cutoff date. It would also very likely be quickly followed by large new Fund disbursements, with the result that these members would continue to have substantial obligations to the Fund that would not qualify for MDRI relief. Further consideration therefore needs to be given to how to permit these three protracted arrears cases to benefit from the MDRI while ensuring consistent treatment of members. As discussed below, the two most feasible options would involve (i) eliminating the constraint posed by the cutoff date, by allowing for limited “grandfathering” of debt held by the protracted arrears countries as of the cutoff date, or (ii) eliminating the requirement that countries with arrears to the Fund cannot reach the HIPC decision or completion points, in cases where they are satisfactorily performing under a rights accumulation program (RAP).

- Limited grandfathering—One alternative would be to exempt the protracted arrears cases from the cutoff date with respect to the amount of Fund credit outstanding to them as of that date, while at the same time creating a notional repayment schedule pursuant to which the amount of this grandfathered debt would be gradually reduced over time. One could assume, for example, that the arrears as of end-2004 are replaced with a notional PRGF loan as of that date, or somewhat earlier, which would create a hypothetical repayment profile for these countries. This would place the protracted arrears cases on a more equal footing with other pre-decision point cases while giving them a grace period of up to 5½ years on principal payments. The full amount of grandfathered debt would remain eligible for MDRI relief during the grace period; afterwards, the amount of debt eligible for MDRI relief available would decline and would fall to zero by the end of the ten-year maturity period of PRGF loans. This option removes the automatic ineligibility for MDRI relief that the cutoff date poses for the protracted

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<sup>25</sup> See EBS/01/122, 7/23/01, p. 12 (no commitments or disbursements of HIPC assistance can be made when a member is in arrears to the GRA, PRGF Trust or SDR Department, as the PRGF-HIPC Instrument requires that members have established a track record of performance under Fund-supported programs before reaching the decision or completion point, and “payment arrears to the Fund represent nonobservance of program requirements” that precludes consideration of decision or completion point requests).

arrears cases, while at the same time creating some incentives for these countries to reach their completion points quickly.

- **Modified RAP Approach**—Another approach would be to eliminate the requirement that members must clear their arrears to the Fund before reaching the HIPC decision or completion point, in cases where the member is successfully implementing a RAP. Under this approach, the member would enter a RAP prior to the decision point and accumulate “rights” to future debt relief as it reaches completion point.<sup>26</sup> The cost of debt relief would be covered by bilateral contributions, for which commitments would need to be made at the time of Board approval of the RAP. Unlike the traditional approach, no bridge loans would be necessary to settle arrears, and the Fund would not need to enter into a new financial arrangement with the member prior to the decision point. The outstanding amount of arrears, though, may be reduced, as the member is also expected to make payments to the Fund in line with its payment capacity and that, at a minimum, are sufficient to meet new obligations falling due. This approach would put these countries on a more similar footing with other HIPCs, which are also expected to make payments to the Fund before they reach the completion point. Second, it would not require bridge loans for arrears clearance nor new Fund lending after the arrears are settled. Third, the rights approach is a tested instrument and well known to the members in protracted arrears to the Fund and to the donor community. On the other hand, this approach would not allow the Fund to provide balance-of-payment support to these countries before they reach the completion point. Moreover, this approach would mark an important departure from existing policies, in that it would change the assessment of the kind of program (i.e., a program with no arrears to the Fund) that the Fund has so far required be in place before a member could qualify for commitments or disbursements of HIPC assistance.

2. **The cost of full debt relief for the three members in protracted arrears will amount to SDR 1.8 billion, corresponding to the stock of arrears outstanding to the Fund as of end-2004.** This figure could vary marginally, depending on whether these countries will be able to make payments sufficient to cover forthcoming obligations prior to the completion point.

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<sup>26</sup> RAPs already count towards the track record for decision points under the HIPC Initiative; however, as noted above, even in cases where a RAP provides the track record, members are required to clear arrears before they can actually reach the decision point.

## **Annex II. Countries that could be Eligible under the Sunset Clause of HIPC Initiative**

1. Member countries that could become eligible for HIPC assistance under the extended sunset clause, will also be eligible for MDRI debt relief once they reach their completion point. Donors have committed to finance the debt relief of sunset clause countries on a fair burden-share basis. A preliminary list of thirteen potential countries was presented to the Board in September. These include six of the pre-decision point countries already identified (Central African Republic, Comoros, Republic of Congo, Côte d'Ivoire, Lao PDR and Togo), plus the three protracted arrears cases (Liberia, Somalia, Sudan), as well as Eritrea, Haiti, Kyrgyz Republic, and Nepal.
2. The list of potentially eligible countries under the extended sunset clause could be expanded by five additional countries (Bangladesh, Bhutan, Myanmar, Sri Lanka, and Tonga). However, detailed loan-by-loan data is needed to make a final determination. Fund and Bank staffs are providing technical assistance to these countries with data reconciliation and missions to some of them are planned already. Outstanding Fund debt for these five countries amounted to SDR 338 million at end-2004.
3. A final list of sunset clause countries together with updated cost estimates will be presented to the Boards of the Fund and the World Bank in the Spring 2006.