

# Meeting of Multilateral Development Banks on Debt Issues Washington D.C., July 9-10, 2008

## Chairman's Summary

### 1. Introduction

On July 9 and 10 the World Bank hosted the 2008 annual meeting of multilateral creditors in Washington D.C.<sup>1</sup> Representatives from sixteen multilateral financial institutions participated in the meeting,<sup>2</sup> and two bilateral creditors attended as observers.<sup>3</sup> The meeting focused on progress in implementing the HIPC Debt Relief Initiative and the Multilateral Debt Relief Initiative (MDRI), commercial debt under HIPC, the role of concessionality in debt sustainability, reporting on debt relief delivery and new MDB flows to LICs, and debt management capacity building in low-income countries. A summary of the discussions follows.

### 2. Discussions

**Status of HIPC and MDRI implementation:** World Bank staff presented an update on progress in implementation of the HIPC Initiative and MDRI based on preliminary findings of the "HIPC Initiative and MDRI Status of Implementation report".<sup>4</sup> Staff informed participants that, since the last annual MDB meeting in July 2007, The Gambia became the 23rd country to reach completion point, while the Central African Republic and Liberia had reached the decision point. To date, 33 countries have reached their decision points and have benefited or continue to benefit from HIPC assistance. The 23 post-completion point HIPCs have also received debt relief under MDRI from the four participating institutions, including the Inter-American Development Bank (IaDB). Staff noted that, while the HIPC Initiative has helped post-completion point countries significantly reduce debt burdens, the remaining HIPCs face difficulties entering or completing the HIPC process.

Staff reported on three interim HIPCs where progress toward reaching the completion point has been limited (DRC, Rep Congo, and Chad). The remaining 7 interim countries are advancing toward their completion points, albeit at an uneven pace. The prolonged interim periods could lead to negative implications in terms of the exhaustion of interim debt relief from creditors, difficulties servicing external debt obligations, weakened reform efforts, and the potential to foster non-concessional borrowing. In discussing the progress of the 8 pre-decision point

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<sup>1</sup> Since 2003, the MDBs have met on an annual basis, rather than on a semi-annual basis, which was the previous practice, with the understanding that ad-hoc meetings on special topics could be arranged between these annual meetings, if necessary.

<sup>2</sup> The following organizations were represented at the meeting: African Development Bank (AfDB), Arab Bank for Economic Development in Africa (BADEA), Asian Development Bank (AsDB), Caribbean Development Bank (CDB), CARICOM Multilateral Clearing Facility, Banque des Etats de l'Afrique Centrale (BEAC), Central American Bank for Economic Integration (CABEI), Corporación Andina de Fomento (CAF), European Commission (EC), European Investment Bank (EIB), Inter-American Development Bank (IaDB), International Monetary Fund (IMF), Islamic Development Bank (IsDB), Nordic Development Fund (NDF), West African Development Bank (BOAD), and the World Bank.

<sup>3</sup> The bilateral observers were the Kuwait Fund for Arab Economic Development (KF) and the Saudi Fund for Development (SF).

<sup>4</sup> Annexes I and II of the Chairman's Summary provide detailed information on the status of implementation of the HIPC Initiative, including modalities for the delivery of debt relief by each MDB, as well as total committed debt relief by country.

countries, staff noted that Cote d'Ivoire, Togo and Comoros are in the process of re-engaging with the international financial institutions (IFIs) and making progress to reach decision point. Of the remaining countries, the Kyrgyz Republic and Nepal have not yet indicated if they wished to avail themselves of the HIPC Initiative; Somalia and Sudan have protracted arrears to IFIs; and Eritrea has limited engagement with the IFIs.

Staff informed that, according to the preliminary costing update for the HIPC Initiative, the total cost for the 41 potentially eligible HIPCs is estimated at US\$71 billion in end-2007 NPV terms. Debt relief to the 23 post-completion point countries represents nearly half of this amount (US\$35 billion), while debt relief the 10 interim countries and 8 pre-decision point countries is estimated at US\$16 billion and US\$20 billion, respectively.<sup>5</sup> The total cost of MDRI debt relief for all potentially qualifying HIPCs is estimated at US\$33 billion in end-2007 NPV terms, with the qualifying post-completion point HIPCs representing nearly two-thirds of the total estimated cost.

Delivery of HIPC debt relief has been significant, mainly due to efforts by multilateral, Paris Club and some commercial and bilateral creditors. Non-Paris club creditors have delivered about 40% of expected share of debt relief. Staff informed that the estimated delivery of NPC creditors has been placed on the WB and IMF websites (Scorecard) in November 2007 and updated in April 2008. Some commercial creditors continue to resort to litigation, however, in the last year a range of instruments to support HIPC in litigation has increased. In this connection, the EC informed participants of recently approved EU External Relations Council Conclusions to help prevent litigation against HIPCs, and reference was also made to the AfDB's newly established legal facility.

Participants welcomed the briefing on implementation progress, and enquired about time prospects for advancing all remaining HIPCs through the process. The Chairman noted the flexibility in the Initiative in accommodating countries with special circumstances (fragile states) as these countries become ready to engage in the HIPC process. A discussion on country cases took place, in which the question of Zimbabwe and its potential eligibility was raised, including the political challenges in this case. The AsDB noted that Nepal was unlikely to avail itself of the Initiative. Concern about non-concessional borrowing practices by HIPCs and its implications for debt sustainability, was raised by the EC, in addition to concerns about the lack of transparency in some cases (e.g., the DRC).

Participants recognized the importance of collaboration to facilitate smooth arrears clearance for countries to enable them to reach the HIPC decision point as early as possible, and to coordinate on efforts to address the challenges faced by fragile states. In this connection, the African Development Bank (AfDB) presented its recently approved policy on enhanced engagement in fragile states, which is designed to help prevent countries from slipping back into conflict and crisis and is supported by a supplementary financing mechanism that is coordinated with on-going arrears clearance programs and funds targeted capacity building. The group was also informed that the EC has started a process to develop an approach for dealing with states in 'fragile situations'. Participants agreed that efforts to strengthen creditor coordination and dialogue were yielding positive results, but that more needed to be done to streamline the process.

In the context of the current oil and food price surges, participants expressed serious concern about the effects this is having on the fiscal position of client countries, underlining the risk of increased indebtedness in interim-countries. Moreover, since 2007 the number of post-completion

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<sup>5</sup> Multilateral creditors account for 46% of the total estimated cost, or US\$32.5 billion in end-2007 NPV terms.

point countries at a high risk of debt distress has gone up from one to four. Discussion centered on the various ways in which institutions are responding to help mitigate the risks involved with current external shocks. Some MDBs have either set up emergency funds, such as the World Bank's newly established Global Food Crisis Response Program (GFRP), a USD 1.2 billion facility. The AfDB has set up an emergency fund to respond to the food crisis. BOAD is helping mitigate the risks related to the food crisis by financing short- and long-term action through coordinated regional plans adopted by the WAEMU member states in April 2008. The Islamic Development Bank (IsDB), with support from the Kingdom of Saudi Arabia, and the EC have established special funds to address the food crisis. The AsDB informed that it has benefited from exchange rate movements and is planning to use the incremental funding to assist clients. In this vein, it was underlined that subsidies tend to be politically motivated and have negative fiscal effects. The representative from the Caribbean Development Bank informed that their initial response has been to step up policy dialogue.

Institutions with exclusively project financing operations, such as the Kuwait Fund, informed that they are responding by focusing on soft lending to projects that raise agricultural productivity. While participants agreed that the current crisis requires immediate action on the part of the international community long-term solutions are also required. Concern was also expressed about the lending terms of emerging creditors and the effect this might have on debt sustainability in post-completion point HIPC.

**Commercial debt under HIPC– update on the Debt Reduction Facility (DRF) for IDA-only countries:** World Bank staff presented an update on the recent developments on the DRF. Established in 1989, the DRF is a key instrument to promote commercial creditor participation in the HIPC Initiative. By promoting creditor participation, it helps (among others) reduce the risk of non-participating creditors taking advantage of debt relief provided by multilateral development banks and other participating creditors. Participants were informed of the operating rules of the DRF, including the Board's decision to extend the facility until 2012, and of modifications to the facility's policies and practices approved by the Board in April 2008. These modifications aim to enhance the facility's effectiveness in helping eligible countries reduce their sovereign external commercial debt.

To date, 24 operations have been completed in 21 countries, with the result that approximately US\$9 billion in commercial debt has been extinguished. Future operations in Liberia and possibly Sierra Leone and/or DRC are planned. The challenges inherent in operating in fragile state environments was underscored by staff, as well as the importance of timeliness in delivering bilateral contributions and the need for innovative modalities as part of future DRF-supported operations.

Participants welcomed this initiative, and the recent modifications, noting its usefulness in helping to reduce potential litigation against HIPCs. But it was underscored that it would need to be complemented by other measures. In this connection, the discussant from the EC informed the meeting of the EU Council of External Relations Ministers position from May 2008 on adopting steps to address litigation against HIPCs, including their support of DRF-like commercial HIPC eligible debt buyback operations. Participants welcomed and endorsed the recent modifications to the DRF policies and practices, as adopted by the IDA Board in April 2008.

**The role of concessional lending in ensuring debt sustainability:** In the session on the role of concessional lending in ensuring debt sustainability, the IMF and Bank staff briefed the meeting on their respective policies in this regard. It was noted that the application of the debt sustainability framework (DSF) has helped refine the concessionality policy, which has allowed

for more flexibility. Case-by-case exceptions have been based on debt sustainability, availability of concessional resources, the strength of policy implementation, debt management capacity and the quality of the investment that was to be financed. Currently, this flexibility has implied that there are non-zero limits on non-concessional borrowing in about one third of the IMF's PRGF/PSI arrangements. The policy has also been adapted to more complex financing vehicles and, depending on debt sustainability considerations, higher minimum grant elements have been used.

Participants agreed that, despite having received HIPC debt relief, maintaining debt sustainability should not be taken for granted. Countries remain vulnerable to shocks. Hence, concessional external financing remains imperative and should be maximized for low-income countries. This will require continued creditor/MDB coordination. In this connection, the AfDB, EIB and the IaDB presented their respective modalities on concessionality. Participants reiterated the need to broaden the use of the debt sustainability framework as an appropriate first step towards tracking debt sustainability on a continuous basis, and to use tools to manage their external and domestic public debt in a prudent manner.

One participant noted that in the CFA zone countries, the size of their domestic public debt was increasing rapidly and their debt sustainability may be threatened. The representative from the IMF confirmed that the DSF considered both external and domestic public debt in assessing sustainability. The AfDB indicated that they had also recently approved a non-concessional borrowing policy for low-income countries that is consistent with those of the IMF and IDA. The representatives from the World Bank and the IMF confirmed that "leasing" transactions are included in their respective policies on non-concessional borrowing by low-income countries.

During the discussion, CDB informed that it supports debt sustainability objectives through policy based loans to help countries improve public financial management, and employs a mix of 'special development funds' – which are allocated among countries on the basis of country classification based on socio-economic conditions – and Ordinary Capital Resources to satisfy the grant element requirements.

**Reporting on debt relief delivery and new MDB flows:** World Bank staff reviewed past efforts to operationalize a reporting mechanism to compile data on debt relief delivered and new flows to HIPCs. In light of past difficulties, staff presented a new and simplified approach involving a lower level of detail (i.e. aggregated data) while preserving the ability to evaluate the impact of HIPC/MDRI debt relief and monitor the evolution of the debt situation. The World Bank would take the lead on compiling HIPC/MDRI debt relief data, and a database on new flows to LICs could also be contemplated in coordination with the IMF. The new approach would further reduce the level of effort required by making maximum use of existing data sources, such as the data provided previously by MDBs in the original reporting exercise and data from HIPC DSAs.<sup>6</sup>

Participants expressed support for a simplified approach and endorsed the proposal, underscoring the need to make appropriate use of the data compiled during the previous attempt, which involved a significant effort by a number of MDBs. Staff confirmed that those who had already contributed would see their transaction costs diminished. It was agreed that the new templates would be distributed to participants for their review, and that the data provided by MDBs covering all decision point and completion point countries would be an input in the

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<sup>6</sup> Staff proposed to produce a prototype of the simplified reporting templates on the basis of existing data sources for review by MDBs.

“HIPC/MDRI Status of Implementation Report” for 2009. This implies a reporting deadline of end-April 2009.

**Capacity building and TA in low-income countries:** IMF staff presented training and outreach programs related to the Debt Sustainability Framework (DSF), underlining that the DSF’s effectiveness ultimately depends on its broader use by borrowers and creditors. The need for MDB collaboration on the quality of information was also stressed. Participants were informed that both the Bank and the Fund have actively undertaken outreach efforts with nearly all major multilateral and bilateral creditors to LICs. As a result of the outreach, an increasing number of creditors are incorporating elements of the DSF into their financing terms. As of now, the AfDB, the IaDB, the AsDB and IFAD incorporate elements of the DSF into their own financing terms. In addition, many DAC creditors explicitly use the DSF to guide their lending terms and the OECD Working Group on Export Credits and Guarantees adopted in January 2008 a set of lending guidelines that adhere to IDA and IMF concessionality requirements for LICs. The Fund and the Bank have also begun engaging in discussions with the main emerging creditors with a view to improving mutual understanding and information sharing, and a study group on debt sustainability was recently established by the G20. The AsDB, the EC and the IaDB noted the need to strengthen cooperation in the preparation of debt sustainability analyses.

Outreach targeting client countries has been conducted through missions and efforts to involve the authorities in the DSA production process. The Bank and the Fund, in partnership with regional capacity building institutions, have organized training workshops on the DSF. To date, training events have been organized in partnership with CEMLA, the Commonwealth Secretariat, MEFMI, Pôle Dette and WAIFEM. Regional technical assistance centers have also organized national workshops in collaboration with other providers in response to increasing demand. Since 2005, workshops have been organized in Africa, Asia and Latin America.

Bank staff reported on efforts to provide technical assistance, complementing the Debt Sustainability Framework, to develop Medium-Term Debt Management Strategies (MTDS). A toolkit is being developed jointly by the Bank and the IMF, including a guidance note on the process of designing and implementing a debt management strategy in a LIC context, a template for strategy documentation, and quantitative cost-risk analysis tools. The Bank and the IMF staff have drafted the MTDS guidance note, designed the template for strategy documentation and have a beta version of the cost-risk analysis tool. These tools have been piloted in Bangladesh, Ghana and Cameroon and two other pilots are planned (Nicaragua and Moldova). Consultation on the methodology will be carried out as needed with regional development banks and other institutions, including the private sector.

As part of the World Bank’s scaled up work program on debt management, participants were updated on progress in applying the Debt Management Performance Assessment (DeMPA) tool, which is a methodology for identifying strengths and weaknesses in debt management operations through a comprehensive set of indicators spanning the full range of government debt management functions. As of end-June 2008, in addition to the five field tests conducted as part of the development phase of the tool, thirteen DeMPA missions have been undertaken, many of them jointly with regional debt management TA providers.

Participants were also informed about plans to establish a Debt Management Facility for Low-Income Countries (DeMFLIC) that would be a multi-donor trust fund for an initial period of four years. It would channel additional donor funds to scale up TA activities, including the preparation of reform plans to strengthen debt management. The Chairman informed that this facility will be launched at the Debt Conference scheduled for October 30 & 31, 2008 and be

operational by calendar year 2009. The facility also proposes a debt managers' practitioners' program, which is conceived as a network of debt managers; the participants were requested to explore ideas, suggest priority activities and identify proper candidates for this program.

During discussion, participants underscored that these were timely and important initiatives and expressed an interest to scale up their collaboration with the Bank and the Fund in this and the various other programs. Participants expressed appreciation for the efforts to develop the DeMPA and MTDS tools as global public goods, as well as for the logical evolution of these debt management capacity building products. However, care needs to be taken to ensure that future capacity building and outreach is more collaborative and systematic and not on a 'silo' basis.

### **3. Other Issues**

The representative from the Nordic Development Fund (NDF) noted that the concept of odious debt is attracting increased attention from *inter alia* civil society groups and academia. The Chairman informed that the Bank has been engaging representatives of civil society, government officials, academia and other stakeholders on this issue and has addressed the issue in the context of responsible lending. Bank documentation will be made available to participants, including a note prepared by the Chairman as background to a related debate at the Bundestag, minutes from a workshop held in April and a research paper on odious debt issued earlier in the year.

It was agreed that the next annual meeting would take place in a year's time. In the interim period, participants agreed to advance the agenda on debt sustainability, debt management capacity building, and other related issues, including through active participation in other relevant fora.