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Analysis of June 11, 2005 G8 Debt Proposal

**Prepared by
KAIROS: Canadian Ecumenical Justice Initiatives
and the Halifax Initiative Coalition**

June 2005

KAIROS: Canadian Ecumenical Justice Initiatives is a dynamic church-based social justice movement. KAIROS unites churches and religious organizations in a faithful ecumenical response to the call to "do justice, and to love kindness and to walk humbly with your God" (Micah 6:8). We deliberate on issues of common concern, advocate for social change and join with people of faith and goodwill in action for social transformation.

The Halifax Initiative is a coalition of Canadian environmental, development, labour, faith-based and human rights non-governmental organizations. The Coalition was formed in 1994 to work together to transform the international financial system and its institutions to achieve environmental sustainability, poverty eradication and an equitable redistribution of wealth.

Summary Analysis of the June 11, 2005 G8 Debt Proposal¹

On June 11, Finance Ministers from the G8 countries announced a debt remission proposal that would cancel multilateral debts owed to the World Bank, the International Monetary Fund (IMF) and the African Development Bank's African Development Fund (AfDF) by 18 low-income countries.

The G8 proposal offers 100% debt stock cancellation for debts owed to three multilateral financial institutions for the 18 countries that have reached their "completion points" through the Heavily Indebted Poor Country (HIPC) Initiative.² A further 9 HIPC "decision point" countries, who have not completed or have stalled in their World Bank/IMF programs, might qualify in the near term. The deal could also potentially be extended to the 11 remaining HIPCs that have not yet reached their decision points.

The G8 proposal to actually write off debts owed by HIPC completion point countries marks a breakthrough over the proposals by Canada and the United Kingdom to pay their debt service over a period of 10 years. However, the 18 countries initially covered in the current plan are fewer than the 22 countries (including 4 non-HIPCs) proposed by Canada or the 24 countries (including 6 non-HIPCs) proposed by the UK.

There are at least 62 countries that civil society assessments conclude need immediate 100% debt cancellation in order to meet the goals of halting the spread of HIV/AIDS and halving the proportion of their population living in extreme poverty, hunger and without safe drinking water.

How much money?

The debts to multilateral institutions owed by the 18 HIPC "completion point" countries are estimated to be nominally worth US\$40 billion. However, the actual cost to creditors in Net Present Value terms, that is the amount that would have to be invested today to pay off these debts over their full terms, is only about US\$15 to US\$17 billion.

The plan would see industrial countries reimburse the World Bank's International Development Association (IDA) and the AfDF. Their relative shares would be based on their historic contributions to these bodies. Therefore, for IDA Canada would pay about 4% of the cost and Britain about 10%.

The Finance Ministers' proposal promises to replenish dollar per dollar the money that was to flow back into IDA and AfDF through debt service payments. Donors would contribute matching funds to the IDA and AfDF to cover the costs of loan and grant repayments. Therefore, the commitment for additional resources is for all of IDA, rather than for each country.

The question of how to finance the write-off of debts owed to the IMF is more complicated. The G8 proposal states that the IMF fund its share of debt cancellation through the use of "existing IMF resources." This refers to the principal, worth about US\$3-4 billion, left from the 1999 revaluation when a portion of IMF gold was revalued to cover the cost of debt relief under the HIPC initiative.

The G8 proposal also insists that debt relief not "undermine the Fund's financing capacity." Hence the communiqué calls for donors, including oil-producing countries, to make extra voluntary contributions to cover debts owed by countries with relatively large IMF debts, such as Liberia, Somalia and Sudan should they ever qualify under the proposal.

¹ This analysis was prepared by staff of KAIROS and the Halifax Initiative.

² In order to qualify for the HIPC initiative countries deemed to have "unsustainable" debts must comply with conditions laid down by the International Monetary Fund (IMF) and the World Bank for a three-year period at which time they reach a "decision point" and are accorded some debt relief. After three more years of structural adjustment they reach the "completion point" and are accorded further debt relief. If a government fails to convince the IMF and the World Bank that it is living up to these policy commitments it is deemed to have fallen "off track", prolonging the period of structural adjustment it must endure before becoming eligible for full debt relief.

Analysis of the Debt Deal

The Finance Ministers debt deal represents a major step forward toward the 100% cancellation of multilateral debt for the poorest countries in three key areas:

- The deal marks acceptance by the G8 countries of the principle of 100% multilateral debt cancellation to deal with the debts of the world's poorest countries. More importantly it signals a recognition that previous debt relief initiatives like HIPC have failed;
- The deal accepts the principle that the IMF's share of debt cancellation can be funded through the use of its own resources. While the current deal relies on the use of resources from a previous sale of gold, the additional sale of IMF gold to fund debt cancellation is clearly back on the table;
- The G8 leaders have agreed to provide additional resources towards development assistance by increasing their support for the multilateral lending and some have committed to reaching the ODA target of 0.7% of GNI by 2015.

There are, however three serious limitations in the deal:

- The deal only applies to 18 Heavily Indebted Poor Countries with a possible extension to 20 other HIPCs when 62 countries need full debt remission to meet the Millennium Development Goals. The 18 countries involved will receive dollar for dollar reduced aid from the International Development Association (IDA). To receive new IDA flows, they will have to comply with controversial World Bank and IMF conditions and policy performance criteria.
- Countries that have not reached their completion points must still apply harsh IMF and World Bank adjustment measures before they qualify for debt cancellation. These measures have been shown to exacerbate rather than reduce poverty and have led to long delays for countries needing immediate debt cancellation;
- The World Bank's and IMF's dominant role in these countries will continue even after cancellation through assessments of "good governance" based on a weak and subjective analyses of their macro-economic policies.

The Road Ahead

The G8 Finance Ministers proposal will be tabled at the G8 leaders Summit at Gleneagles, Scotland from July 6-8. The leaders can improve on its recommendations before referring the proposals to the annual meetings of the World Bank and IMF on September 25, 2005 for approval by all shareholders.

Canada has provided leadership on the debt issue and played an important brokering role during the negotiations. In particular, it has championed the principle of "equity of treatment" for other low-income countries that do not qualify as HIPCs. Finance Minister Ralph Goodale confirmed that Canada will still cover its share of the debt servicing requirements of the four countries that are not eligible for HIPC but were on its original list of countries based on the "equity of treatment" principle. Canada should use this principle to call for a complete delinking of debt cancellation from the HIPC framework and its inappropriate conditions to extend the plan well beyond the 18 countries currently eligible.

In the short term Prime Minister Martin must take leadership at the Gleneagles Summit to:

- **EXTEND** the agreement for 100% cancellation of the debts owed to multilateral financial institutions to all impoverished countries that need debt cancellation in order to meet the Millennium Development Goals. It should champion the "equity of treatment" principle and call for the additional use of the World Bank's and IMF's internal resources as well as other innovative mechanisms such as coordinated taxes of international financial transactions, arms sales, aviation fuel or airline tickets.
- **ENSURE** that countries are free to implement their own national development strategies by ending IMF and World Bank Structural Adjustment Programs;
- **GUARANTEE** adequate financing for impoverished countries including through the dedication of 0.7% of Gross National Income to Official Development Assistance.

Analysis of the June 11, 2005 G8 Debt Proposal³

On June 11, Finance Ministers from the G8 countries announced a debt remission proposal that would cancel multilateral debts owed to the World Bank, the International Monetary Fund (IMF) and the African Development Bank's African Development Fund (AfDF) by 18 low-income countries. Relative to the amount of debt relief offered previously, it is a step forward. However, if one compares the quantity of debt relief proposed with the amount needed to actually make poverty history, then there is still a long ways to go. If one evaluates the G8's offer in *qualitative* terms, that is taking into account the conditions attached, then it is more likely to prolong poverty for countries seeking to qualify for the program than to end it.

Conditions Attached Likely To Prolong Not End Poverty

The major shortcoming of the G8 proposal is that it continues the practice of basing eligibility for debt cancellation on adherence to IMF and World Bank policy dictates that often serve the interests of creditors over those of debtors. After meeting with UK Prime Minister Tony Blair in early June to discuss the debt relief package, President Bush declared that "we're not interested in supporting [governments] that [don't] have open economies and open markets."

In order to qualify for the Heavily Indebted Poor Countries (HIPC) initiative countries deemed to have "unsustainable" debts must comply with conditions laid down by the International Monetary Fund (IMF) and the World Bank for a three year period. After three years of faithfully adhering to these policy conditions a country may reach the HIPC "decision point" and be accorded some debt relief. Then the country must undergo a further three years of structural adjustment before reaching the "completion point". If a government fails to convince the IMF and the World Bank that it is living up to these policy commitments it is deemed to have fallen "off track", prolonging the period of structural adjustment it must endure before becoming eligible for full debt relief.

The countries that have graduated from HIPC and have their debts written off will no longer be forced to implement World Bank and IMF prescriptions as they did under the HIPC framework. However, they will not be totally free from World Bank and IMF surveillance as they will still have to meet the Bretton Woods institutions policy conditions before they can qualify for new loans. Moreover, the US and Canada are calling for a new kind of IMF surveillance that would entail the signing of Policy Support Agreements that would enable the Fund to oversee a country's economic policies even if it has no loans from the IMF.

Too often IMF-dictated fiscal restraints have prevented debtor countries from spending on health care or education. For example, curbs on public spending imposed on Zambia as conditions for IMF debt relief led to government decisions not to hire 9,000 teachers even though trained teachers were available and desperately needed.

Unilateral trade liberalization measures demanded by the IMF and World Bank have undermined agriculture and food sovereignty in many countries. Ghana was forced to open its market to imported tomatoes, pushing many of the 3 million Ghanaians who once grew tomatoes into poverty. The introduction of user fees for health care and education have kept the poor away from clinics and children out of schools. The privatization of water services has resulted in price increases beyond the reach of the poor, forcing women to walk many kilometers to fetch untreated water.

³ This analysis was prepared by staff of KAIROS and the Halifax Initiative.

Who is Covered and Who is Not

The G8 proposal offers 100% debt stock cancellation for debts owed to three multilateral financial institutions for the 18 countries that have reached their “completion points”. A further 9 HIPC “decision point” countries might qualify in the near term. Later the deal could potentially be extended to the 11 remaining HIPCs that have not yet reached their decision points but this is unlikely to happen soon as several of these countries are undergoing civil conflicts. It seems that other countries could potentially qualify for cancellation but they would have to enter and pass through the full HIPC process. (see country lists appended below)

Compared to the proposals that were put forward recently by France, Germany and Japan to offer additional temporary debt relief for only 5 countries, the G8 proposal is a significant improvement.

The G8 proposal to actually write off debts owed by HIPC completion point countries is also an improvement over the proposals by Canada and the United Kingdom to pay their debt service over a period of 10 years. But the 18 countries initially covered are fewer than the 22 countries (including 4 non-HIPCs) proposed by Canada or the 24 countries (including 6 non-HIPCs) proposed by the UK. (see country lists appended below)

The deal covers World Bank, African Development Fund and International Monetary Fund (IMF) debts, but it does not cover any debts owed to the Inter-American Development Bank by 4 Latin American and Caribbean HIPCs - Bolivia, Honduras, Nicaragua and Guyana. Nor does it cover debts owed to the Asian Development Bank by countries like Laos which might eventually qualify.

Seven low-income African countries (including Nigeria) and eight middle-income African countries (including South Africa) are not eligible for HIPC and therefore are excluded from the deal. (see country lists appended below) A special paragraph in the G8 Finance Ministers’ communiqué promises to deal with Nigeria’s debt in the Paris Club which only deals with bilateral (country to country) debts and has no jurisdiction over multilateral debts.

However, there are at least 62 countries that civil society assessments conclude need immediate 100% debt cancellation in order to meet the goals of halting the spread of HIV/AIDS and halving the proportion of their population living in extreme poverty, hunger and without safe drinking water. Only 5 % of developing countries’ population live in the 18 countries initially eligible. If the measure were extended to all HIPCs in the coming years this would still only affect 11% of the people in the developing world.

How much money?

The debts to multilateral institutions owed by the 18 HIPC Completion point countries are estimated to be nominally worth US\$40 billion. However, the actual cost to creditors in Net Present Value terms, that is the amount that would have to be invested today to pay off these debts over their full terms, is only about US\$15 to US\$17 billion. If the 9 HIPC decision point countries are included the total value of nominal debt remission could reach US\$51 billion.

The estimated annual debt service savings for eligible countries under the G8 proposal:

18 HIPC completion point countries	US\$1 billion
27 HIPC completion and decision point countries	US\$1.4 billion

How will it be paid for?

Industrial countries would reimburse the World Bank's International Development Association (IDA) and the AfDF. Their relative shares would be based on their historic contributions to these bodies. Therefore for IDA Canada would pay about 4% of the cost and Britain about 10%.

Estimates of the costs for some industrialized countries over a ten-year period:

- Canada would pay from C\$400 to C\$500 million.
- The United States between US\$1.3 billion and \$1.75 billion.
- Britain's share would be US\$700 million-\$960 million..
- Germany would pay US\$848 million-\$1.2 billion.

The Finance Ministers' proposal promises to replenish dollar per dollar the money that was to flow back into IDA and AfDF through debt service payments. Debt cancellation would be achieved by relieving countries of the burden of paying for debt servicing and the amount available for each country through IDA grants and loans would be reduced by an equivalent amount. Donors would contribute matching funds to the IDA and AfDF to cover the costs of loan and grant repayments. The G8 pledged that this money would be additional to current IDA resources; however additional resources would be disbursed based on World Bank formula's assessing "good governance." Therefore, the commitment for additional resources is for all of IDA, rather than for each country.

The commitment for to provide additional funds would be renegotiated every three years as donors negotiate IDA replenishment. During IDA 14 negotiations that have just concluded, donors agreed to increase their contributions by an average of 30% over the previous negotiations. For Canada, this increase resulted in a 40% increase in real terms from annual contributions of CDN \$230 million to CDN\$320 million.

The question of how to finance the write-off of debts owed to the IMF is more complicated. Initially the UK had proposed the sale of a proportion of the IMF's gold stocks to finance debt relief. The US, under pressure from gold mining corporations, refused to consider gold sales but did agree that the principal left in a fund first established in 1999 when a portion of IMF gold was revalued with the proceeds going towards debt relief, could be used.

The G8 proposal states that the IMF fund its share of debt cancellation through the use of "existing IMF resources." It also insists that debt relief should not "undermine the Fund's financing capacity." The G8 would allow the IMF to use the principal left from the 1999 revaluation worth about US\$3-4 billion. But this amount is not sufficient to cover the costs of writing-off all debts to the IMF owed by all 38 potentially eligible HIPCs. Hence, the communiqué calls for donors, including oil-producing countries, to make extra voluntary contributions to cover debts owed by countries with relatively large IMF debts, such as Liberia, Somalia and Sudan should they ever qualify under the proposal.

What has Canada done to date?

Canada has provided leadership on the debt issue and played an important brokering role during the negotiations. In particular, it has championed the principle of "equity of treatment" for other low-income countries that do not qualify as HIPCs. Finance Minister Ralph Goodale confirmed that Canada will still cover its share of the debt servicing requirements of the four countries that are not eligible for HIPC but were on its original list of countries based on the "equity of treatment"

principle. Canada should use this principle to call for a complete delinking of debt cancellation from the HIPC framework and its inappropriate conditions to extend the plan well beyond the 18 countries currently eligible.

Canada should also follow the UK's lead and conduct a review of the conditions attached directly and indirectly to development assistance or to debt relief to determine whether the conditions attached to HIPC are having the desired poverty alleviation results. The World Bank and IMF are reviewing their approaches to conditionality but this review must not be left solely in their hands. The World Bank failed to respond to the recommendations from the multiyear analysis of the negative impact of their conditions conducted by the Structural Adjustment Participatory Review International Network.

What's next?

The G8 Finance Ministers proposal will be tabled at the G8 leaders Summit at Gleneagles, Scotland from July 6-8. The leaders can improve on its recommendations before referring the proposals to the annual meetings of the World Bank and IMF on September 25, 2005 for approval by all shareholders. These improvements should include removing the conditions attached to qualifying for cancellation, expanding the list of countries immediately qualifying for debt cancellation, increasing the commitments for financing the development needs of the poorest countries, and improving the institutional coverage of the deal by including other regional development banks (IADB and ADB).

In the immediate term Prime Minister Martin must take leadership at the Gleneagles Summit to:

- **EXTEND** the agreement for 100% cancellation of the debts owed to multilateral financial institutions to all impoverished countries that need debt cancellation in order to meet the Millennium Development Goals. It should champion the "equity of treatment" principle and call for the additional use of the World Bank's and IMF's internal resources as well as other innovative mechanisms such as coordinated taxes of international financial transactions, arms sales, aviation fuel or airline tickets.
- **ENSURE** that countries are free to implement their own national development strategies by ending IMF and World Bank Structural Adjustment Programs;
- **GUARANTEE** adequate financing for impoverished countries including through the dedication of 0.7% of Gross National Income to Official Development Assistance.

Appendices

Country Coverage

The deal is immediately applicable to HIPC Completion Point countries and could be extended to other HIPC countries as they reach their completion point.

Immediately covered	Could be covered	May potentially be covered, but unlikely in near term
HIPC Completion Point (18)	HIPC Decision Point (9)	HIPC Pre-decision point (11)
<ul style="list-style-type: none">▪ Benin▪ Bolivia▪ Burkina Faso▪ Ethiopia▪ Ghana▪ Guyana▪ Honduras▪ Madagascar▪ Mali▪ Mauritania▪ Mozambique▪ Nicaragua▪ Niger▪ Rwanda▪ Senegal▪ Tanzania▪ Uganda▪ Zambia	<ul style="list-style-type: none">▪ Cameroon▪ Chad▪ Democratic Republic of Congo▪ The Gambia▪ Guinea▪ Guinea-Bissau▪ Malawi▪ São Tomé Príncipe▪ Sierra Leone	<ul style="list-style-type: none">▪ Burundi▪ Central African Republic▪ Comoros▪ Republic of Congo▪ Côte d'Ivoire▪ Lao PDR▪ Liberia▪ Myanmar▪ Somalia▪ Sudan▪ Togo

Countries in the Canadian and UK proposals no longer covered under the G8 plan

Were to be immediately eligible	Were to be potentially eligible
<ul style="list-style-type: none"> ▪ Mongolia ▪ Nepal ▪ Sri Lanka ▪ Vietnam <p>The UK proposal included these same 4 countries and 2 others:</p> <ul style="list-style-type: none"> ▪ Albania ▪ Armenia 	<ul style="list-style-type: none"> ▪ Angola ▪ Afghanistan ▪ Bangladesh ▪ Bhutan ▪ Cambodia ▪ Eritrea ▪ Haiti ▪ Kenya ▪ Kyrgyz Republic ▪ Lesotho ▪ Moldova, Rep. of ▪ Soloman Islands ▪ Tajikistan ▪ Timor Leste ▪ Yemen, Rep. of

African Countries left out of the G8 Proposal

Low-income countries not eligible for HIPC	Middle-income countries not eligible
Angola	Botswana
Equatorial Guinea	Cape Verde
Eritrea	Gabon
Kenya	Mauritius
Lesotho	Namibia
Nigeria	Seychelles
Zimbabwe	South Africa
	Swaziland

Key terms explained

The Heavily Indebted Poor Countries (HIPC)

How HIPC Works – from Government of Canada “Helping the Poorest – An update on Canada’s Debt Relief Efforts.” January 2005

http://www.fin.gc.ca/toce/2005/cdre0105_e.html

Before a poor country is accepted into the HIPC process, it must first seek the debt relief options available through traditional avenues such as the Paris Club. To get advanced debt relief offered by the HIPC Initiative, countries must then work through three phases.

Phase 1: The Pre-Decision Point

To be considered for HIPC assistance a country must:

- face an unsustainable debt burden;
- have established a track record of reform and sound policies through IMF- and World Bank-supported programs; and
- have developed a plan to pull their country out of poverty: a Poverty Reduction Strategy Paper (PRSP).

Once a country has made progress in meeting these conditions, the Executive Boards of the IMF and the World Bank can formally decide that a country is eligible for the HIPC Initiative. Once that happens, the international community that supports the HIPC Initiative then commits to reducing the country’s debt. This is called the **decision point**, and it launches the next phase.

Phase 2: Interim Period

Once a country reaches the decision point, it may immediately begin receiving **interim relief** on its debt service payments. To receive the full debt reduction available under the HIPC Initiative, however, the country must continue to build a track record of good performance under IMF and World Bank programs.

The length of this interim period depends on:

- the successful implementation of key policy reforms specified at the decision point;
- the maintenance of macroeconomic stability; and
- the adoption and implementation of a PRSP for at least one year.

Once a country has met these criteria, it can reach its **completion point**.

Phase 3: Completion Point

A country that has reached the completion point has met all criteria and qualifies for full debt relief under the HIPC Initiative. At this point, lenders are expected to provide the full relief promised at the beginning of this process.