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**Statement by Mr. Misra and Mr. Srinivas on  
The Multilateral Debt Relief Initiative (G-8 Proposal) and  
Its Implications for the Fund—Further Considerations  
(Preliminary)  
Executive Board Meeting 05/94  
November 7, 2005**

1. We welcome the revised paper providing fresh contours for implementing the G – 8 proposal on debt cancellation. There is support for further debt relief by IMF as part of a larger international initiative for debt relief for low income countries. However we note that the Executive Board of the IDA has asked IDA staff to prepare a follow up paper that would assess in greater detail the financial and operational issues involved in implementation of the proposal. The status of discussions at the AfDF are not mentioned. Given that IDA and AfDF hold a dominant share in the debt proposed to be canceled could staff give a preliminary timeline on the status of discussions in these institutions.
2. The G 8 debt cancellation proposal would preserve the resources in the Reserve account of the PRGF Trust but fully drain the resources in the Special Disbursement Account (SDA) and significantly reduce the balance of the PRGF subsidy account. SDR 0.47 billion of the SDA is being moved to the PRGF subsidy account. A higher per capita income threshold could have been arrived at if the SDA were to be fully used for debt relief alone. This would deprive several similarly placed countries from similar treatment despite availability of resources. The burden of finding subsidy resources for the PRGF Trust has shifted from bilateral donors to the Fund resources itself.
3. In the discussion on the Exogenous Shocks Facility (ESF), the G 8 has recommended a fungible use of the PRGF Subsidy Account on the grounds that existing level of bilateral contributions contained therein, would adequately allow for an early activation of the ESF. If indeed there are sufficient resources in the PRGF subsidy account, then the first preference should be given to provide debt relief to all PRGF eligible IDA only countries. It cannot be that the PRGF subsidy account has enough resources to fund the ESF, but does not have any resources to fund widening of the debt relief proposal. A degree of consistency is required on the issue.
4. The G 8's commitments for debt relief has not been set in a specific time horizon. In past discussions, the G 8 commitment was to provide on a fair burden share basis upto USD 350 – 500 million for the interim PRGF, and on the same basis, to cover the cost of debt

relief for countries that may enter the HIPC process based on end 2004 debt burdens. Present projections indicate that an additional resource mobilization of SDR 210 million in subsidy contributions would suffice to fully implement the proposal. Despite G 8 contribution, the Fund has to find resources not only for the MDRI but also for future PRGF subsidy operations. It is now proposed that debt relief to non HIPCs below the threshold will be borne by SDA resources. Could the G 8 confirm their authorities commitment to finance the cost of debt relief for non HIPC beneficiaries of MDRI. On the protracted arrears cases, special provisions to expedite their inclusion in the MDRI are necessary. Of the options being proposed limited grandfathering is preferable to the rights accumulation program. The case for graded debt relief has not been included. Could staff clarify.

5. On Conditionality, although the last discussion did not see any degree of consensus the preferred view is for upfront and irrevocable debt relief to provide a predictable stream of resources. We could go with this view. Entry conditionality for completion point HIPCs and non HIPCs who will benefit from MDRI should be similar. Assessment for determining compatibility of macroeconomic policies with maintaining fiscal sustainability and low inflation have long been part of Fund's work and is acceptable entry conditionality. For assessment of satisfactory implementation of PRSP, staff has been preparing JSANs on the Annual PRSP reports and these could be used to determine satisfactory implementation of PRSPs. A PRSP that has not been updated for five years, should be considered as outdated and the country would have to resume the PRS process. A lot of work has been done on strengthening Public Expenditure Management (PEM) Systems under the HIPC initiative and an assessment of PEM systems should be an integral part of entry conditionality. For countries whose performance has lapsed in any of the above three criteria, clear evidence of improvement should be required before delivery of additional debt relief. These include (a) macroeconomic performance criterion for a duration of six months (b) satisfactory implementation of PRS for one year and (c) commensurate corrective action if lapse is of structural nature. The Fund and the Bank could explore ways to collaborate on a framework for monitoring and reporting on the use of resources freed by debt cancellation. Such monitoring on the Fund side could be included in Article IV discussions.

6. The cost of the proposal has come down following the use of differentiated country by country completion point dates as effective debt relief dates for 17 pre completion point countries for whom the benefit of the proposal stands significantly reduced as they would be making significant repayments to the Fund before they reach completion point. The reduction in future demand for PRGF resources remains notional at this stage as the debt relief by the Fund is only part of a larger international initiative. It has been proposed that proceeds from the early repayment of the PRGF Trust loans in the context of debt stock relief under HIPC Initiative and MDRI could be used to make an early repayment to PRGF Trust lenders. There is a rationale for continued Fund lending to post completion point HIPCs depending on their financing needs. If there are shortfalls in PRGF lending then the G 8 commitments not to undermine the Fund's lending capacity must be fulfilled.

7. We note that the use of SDA corpus under the G 8 proposal would not have an immediate effect on the GRA balance sheet or the GRA income position. The option of a

transfer of the SDA corpus to the GRA or transfer to the GRA of investment income of the SDA would be permanently removed.

## **LEGAL CONSIDERATIONS**

### **Uniformity of Treatment**

8. The Legal Counsel has clarified that the principle of uniformity of treatment is applicable among the developing countries to whom SDA assistance may be provided and a per capita income threshold can be used. On September 21, we had said that the G 8 proposal is given a semblance of equity by designing a threshold of USD 380 to conform to ‘uniformity’ and ‘capacity to pay’ by bringing two countries from IDA only LICs into the fold. This we feel is a conceptual manipulation, legally indefensible and at best tenuous as it leaves behind several IDA only LICs with similar economic status while covering HIPC with higher income levels. A further component i.e. alternate scenarios with income thresholds of 270, 380 and 400 have been evolved but HIPC debt cancellation out of PRGF subsidy resources and thereafter replenishment of the PRGF Trust by transfer from SDA is a jugglery that IMF itself will consider a poor banking practice. It would increase the Fund’s share in subsidy resources from the present 14 percent to nearly 50 percent. Mitigating the all or nothing consequences of a single threshold by providing graded debt relief to some LICs above the threshold has not been examined.

### **Protected Provisions – Section IX of the PRGF Trust Instrument**

9. The Legal Counsel has opined that the Fund has never interpreted Section IX of the PRGF Trust as meaning that the protected provisions could never be amended. Only unilateral amendment by Fund is prohibited and the protected provisions can be amended with consent of all third party contributors.

10. There are several aspects of this interpretation that we are not comfortable with. Firstly the Legal Counsel is indicating that the PRGF Trust betrays a lack of careful drafting in that there are differences between the amendment provisions of the PRGF Trust Instrument and the PRGF – HIPC Trust Instrument while it was not intended to be. The edifice of the PRGF Trust is built upon the concepts crystallized in the Purposes and the role of the Fund has been outlined in Section VII. Exercise of unlimited power of the Fund are limited by the provisions of Section IX. If by a majority decision we were to destroy the avowed purpose of Section IX and inter alia Section VII of the PRGF Trust, the decision would be looked upon as a measuring rod of the extent of the amending power of the Fund’s Executive Board.

11. The Legal Counsel says that the protected provisions of the PRGF Trust Instrument have been amended in the past. However we note that the amendments were for, transfer of resources from reserve account to subsidy account, and not for transfer from subsidy account to donors. Could the Legal Counsel give us a citation whether amendment to the protected provision has covered restitution to donors beyond the principle of uniformity of treatment.

12. The validity of each new amendment must be judged on its own merits. We fear that amending the PRGF Trust to specifically identify countries to provide debt cancellation on a non uniform basis would be damaging the basic structure of the Trust and therefore outside the amending power of the Fund. The consequence of this exclusion would be a limitation on the power of the Fund to breach principles of uniformity of treatment. If we were to use the limited amending power conferred upon us, we would be converting it into an absolute and unlimited power and it would have been meaningless to have placed a limitation on the original power of amendment. Uniformity of treatment remains mandatory and we cannot alter the basic structure of the PRGF Trust by amendment of Section IX.