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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Consultation on the Sixth Replenishment of IFAD's Resources – Third Session

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FINANCING IFAD'S PARTICIPATION IN THE DEBT INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES

I. OBJECTIVE OF THE PAPER

1. This paper provides an assessment of the total costs of IFAD's participation in the Debt Initiative for Heavily Indebted Poor Countries (HIPCs) and discusses the financing of these costs. It highlights the Fund's resource position and the fact that each United States dollar (USD) of debt relief amounts to one dollar less for the lending programme. There is a need to minimize this impact of IFAD's participation in the Initiative on its capacity to approve new loans. The objective of the paper is therefore to develop an approach to financing IFAD's costs that, by maximizing the additionality of the Initiative, balances use of internal resources with the need to sustain the level of IFAD's programme of work.

II. COSTS OF IFAD PARTICIPATION IN THE DEBT INITIATIVE

2. The Governing Council approved the framework for IFAD's participation in the *original Initiative*, at an estimated cost of USD 60-70 million, with Resolution 101/XX[1] of the Twentieth Session in February 1997.

3. At its Twenty-Third Session in February 2000, on the basis of documents GC 23/L.7 and GC 23/L.7/Corr.1, the Governing Council subsequently decided that IFAD would *fully participate in the enhanced Initiative*. The Fund estimated its nominal cost of the enhanced Initiative at USD 336 million[2].

[1] On the basis of documents GC 20/L.6 and GC 20/L.6/Add.1 (with Resolution 105/XXI, based on document GC 21/L.6, establishing the IFAD Trust Fund).
[2] The World Bank estimated IFAD's total debt initiative cost for 32 HIPCs at USD 228 million in end-1999 NPV terms.

4. The current tentative estimate of the total nominal cost of IFAD's participation in the full Debt Initiative amounts to *USD 453.4 million over the next 36 years*[3]. As shown in the second column of the table below, these costs will peak in 2005 at a level of about USD 38 million.

III. FINANCING THE DEBT INITIATIVE

A. Debt Initiative Rules and Practices

5. The international community expects all international financial institutions (IFIs) to participate fully in the enhanced Initiative. This ensures burden-sharing in the exit strategy from unsustainable debt for HIPCs. While all IFIs committed themselves to participating in the original Initiative, the significant increase in costs of the enhanced Initiative has caused serious concern. Without high levels of incremental donor financing, two of the Debt Initiative's critical design principles are compromised: the 'additionality' principle, and that of safeguarding the financial integrity of participating IFIs.

6. In order to mitigate the impact of debt relief on the resource base of participating IFIs and help multilateral creditors finance their participation, an **HIPC Trust Fund** ('the trust fund'[4]) was established under the administration of the World Bank. Many countries have contributed significant levels of resources to this fund. "The HIPC Trust Fund is an instrument of the donors to the trust fund. [It] provides funding to eligible creditors, based on the instructions of the donors." In principle, all IFIs that face constraints in participating in the Debt Initiative according to the base principles of additionality and financial integrity are eligible for access to the trust fund, if the donors to the fund so decide. Document REPL.VI/2/INF.4, "HIPC Debt Relief Trust Fund Support for Regional and Sub-Regional Multilateral Creditors", transmitted information from the World Bank on the structure and modus operandi of the trust fund. The document also presented the gap between the resources currently available and the resource requirements so far subscribed.

7. However, IFIs are also expected to mobilize *internal resources* within their financial capacity, but the balance between internal and external resources has not been defined and varies de facto from one institution to another. Participating IFIs have used a variety of financial approaches to internalize costs of the Debt Initiative, and institutions with a strong and diversified financial structure, in particular, have managed to do so. However, in many cases, additional external resources have been called upon as well. For instance, while the Inter-American Development Bank (IDB) will finance approximately 72.7% of its debt relief from its own resources, 27.3% will be financed from external resources through the trust fund under a multilateral arrangement. The African Development Bank (AfDB) will receive World Bank trust fund resources for about 84% of its debt initiative costs, while it will use USD 370 million or approximately 16.1% of its own resources to finance its debt relief.

B. Implications for IFAD

IFAD's Current Debt Initiative Funding Position

8. The table shows that IFAD has provided USD 17.3 million of actual debt relief. This has been financed by: USD 6.4 million from IFAD's own resources, USD 7 million from the direct Netherlands contribution to IFAD's debt initiative funding, USD 2.7 million of German funding from IFAD-

3 The total net present value (NPV) cost of IFAD's participation in the full Debt Initiative amounts to SDR 230 million (USD 297 million), which corresponds to a nominal cost of *SDR 350.6 million (USD 453.4 million).*

4 All further references to 'trust fund' refer to the World Bank-administered HIPC Trust Fund.

earmarked resources in the trust fund, and USD 1.2 million from investment income on donor contributions to IFAD's debt initiative financing.

9. In order to support IFAD's resource requirements for the original Initiative, and to safeguard the Fund's capacity to finance new loans, The Netherlands pledged an amount of 26.62 million Netherlands guilders (approximately USD 15.4 million, at historic exchange rates) in complementary contributions within the framework of the Fourth Replenishment of IFAD's Resources. In 2001 Germany earmarked 15 million Deutsche marks (about USD 7 million) of its contributions to the trust fund for debt owed to IFAD, to be disbursed over a three-year period. IFAD has also received about USD 2.4 million from Belgium's contribution to the World Bank trust fund.

10. Beyond the Netherlands, German and Belgian contributions, IFAD's participation in the initiative is currently being financed from internal resources that would otherwise be available for commitment to new loans and grants under the programme of work. Concern has emerged that the high levels of debt relief due in the next ten years, particularly from 2002 to 2005, would affect IFAD's capacity to sustain its lending programme and compromise the integrity of its financial structure.

IFAD's Broader Effort in Resource Mobilization

11. On 7 February 2001, the President of IFAD organized an informal meeting to develop a shared outlook among IFAD Member States on the Fund's resource position and its debt initiative financing requirements, as well as a common understanding of the needed balance between internal and external resources to finance IFAD's participation in the Initiative.

12. Participants noted and reaffirmed the core principles underlying the Initiative's design, as endorsed by the World Bank/International Monetary Fund (IMF) Development Committee in 1999. The first is the principle of additionality – debt relief is to be additional to new, highly concessional development assistance in support of poverty-reduction programmes. The second principle is that debt relief should not undermine the financial integrity of participating IFIs. The importance of sharing the burden of the cost of the Initiative on an equitable basis is also considered to be a core principle.

13. The meeting recalled the Governing Council's endorsement of IFAD's full participation in the enhanced Debt Initiative, with the expectation that the Fund would make efforts to internalize costs, while at the same time minimizing the impact of participation in the Initiative on its annual lending programme. IFAD Member States were, however, also invited to provide the Fund with direct additional resources to help finance participation in the Initiative, or to facilitate IFAD's equitable access to resources from the trust fund.

14. Participants noted the information provided by the Secretariat on the resource position of IFAD, and on the present and expected future impact of participation in the Initiative on the resource structure of the Fund. This included an analysis of general resource requirements based on a stable lending programme; the resources available, including conservative investment-income projections in line with the new investment strategy; and greater recourse to advance commitment authority (ACA). The results of the analysis demonstrate that if no further additional resources were made available to the Fund, the institution would find itself with a permanent annual negative net resource balance. There was a discussion of the basic assumptions used in the analysis, noting the prudent orientation of some resource projections. It was clarified that even on more optimistic assumptions regarding investment income and future replenishments, the Fund would still have a negative resource position and would therefore need to use ACA. As a consequence, and in the absence of additional financing, the Fund will continue to be confronted with the reality of a **one-to-one relationship between IFAD's delivery of debt relief and new loans**.

15. The meeting came to the following broad conclusions:

(i) There was wide recognition that IFAD's participation in the Initiative has an impact on the Fund's capacity to provide new loans, and, given the resource projections, the lending programme will continue to be affected. There was agreement on the need to minimize the impact of participation in the Debt Initiative on IFAD's lending programme.

(ii) There was broad support for the principle of equitable access by IFAD to the trust fund. In addition, there was general agreement that the issue of IFAD's access to the fund should be taken up at the next trust fund technical meeting, as part of the formal review of global financing requirements for the Initiative. Some participants indicated their country's willingness to support access by IFAD to the trust fund through existing procedures; other participants also indicated their country's willingness to provide direct contributions to IFAD. Many participants stressed the importance of fair burden-sharing.

(iii) While agreement had not yet been reached on the proportion of IFAD's debt initiative requirements to be met with additional external funding, there was recognition that IFAD's position regarding the Initiative was closer to that of AfDB than that of IDB, given the level of IFAD's exposure to HIPCs in Africa.

(iv) IFAD would continue its dialogue with Member States to obtain feedback in preparation for the next trust fund technical meeting. To this effect, IFAD management would prepare a proposal for an appropriate ratio of internal to external resources for the financing of IFAD's debt initiative requirements. The view was expressed that on the basis of this proposal, it would be useful to have another meeting of Debt Initiative donors before the next technical meeting.

Additional Pledges to Date

16. IFAD has received formal commitments of: (i) up to USD 3 million from the country-earmarked resources pledged by Switzerland to the trust fund; and (ii) a complementary contribution of 3.72 million euro by Italy for IFAD's debt initiative requirements. Some other Member States, such as Sweden, have indicated that they are also prepared to shoulder their fair share of IFAD's debt initiative financing burden.

Balance between Internal and External Resources

17. Regarding the expectation that IFIs mobilize *internal resources*, as stated in paragraph 7 the balance between internal and external resources has not been defined and depends on the financial position and capacity of the participating IFIs. In the light of the 27.3% of debt relief financed by IDB from World Bank trust fund resources and the 84% of AfDB, it is important to ensure a level of additionality of resources also for IFAD's participation in the Debt Initiative comparable to that provided to other IFIs. This might be through equitable access to the trust fund, commensurate with the access of other IFIs, and/or through access to direct funding for the Debt Initiative.

18. In defining the balance between internal and external resources for IFAD, it is recommended that the following considerations be taken into account:

(i) IFAD's resource base is limited, as highlighted in the financial scenarios discussed in the framework of the Consultation on the Sixth Replenishment.

(ii) During the last two IFAD replenishments, 22% of total contributions have been made by the developing countries of Lists B and C. This compares with an average of 2.1% for the International Development Association (IDA), 4.6% for the African Development Fund (AfDF) and the Asian Development Fund (AsDF), and 8.3% for the Fund for Special Operations of IDB. Thus a substantial share of IFAD's core resources consists of replenishment contributions from developing countries. A significant proportion of debt relief under the Initiative is therefore being financed by developing countries themselves. This raises the serious concern for developing Member States that the contributions they provided to IFAD for poverty eradication are being eroded.

(iii) Close to 40% of IFAD's lending programme is committed to sub-Saharan Africa, which has the majority of HIPCs. Consequently, IFAD is heavily exposed to HIPCs and the cost implications of the debt initiative. The Fund's exposure is thus much more in line with that of AfDB than that of IDB.

(iv) If a lack of additional external resources for IFAD's participation in the Debt Initiative would lead to a reduced lending programme, Africa and the group of highly concessional borrowers (accounting for 70% of IFAD's lending) would be heavily affected.

19. **Recommendation**. Based on the above discussion, it is recommended that the balance for IFAD between internal and external resources be close to that of AfDB. Taking into account IFAD's institutional and lending programme characteristics, which are closer to those of AfDB, it is recommended to seek external funding for about 66% (2/3) of IFAD's total debt initiative costs. As illustrated in the table below, this ratio has the following positive aspects:

(i) In no year would IFAD's internalized costs of the Debt Initiative exceed the equivalent of one average loan from IFAD, i.e. USD 15 million; a consideration of importance for the List C countries on the Executive Board.

(ii) Incremental external resource requirements (over and above the pledges already provided) would amount to only 60% of IFAD's costs.

(iii) The maximum annual incremental external resource requirement would amount to USD 23.5 million in 2006, with an average of USD 7.5 million per annum.

IV. CONCLUSION AND RECOMMENDATION FOR FOLLOW-UP

20. In order to mitigate the impact of IFAD's participation in the Debt Initiative on its lending programme, the Fund has two avenues through which it can mobilize additional external resources:

First, IFAD's Member States could directly provide IFAD with additional resources to help finance its participation in the Initiative, following the initiative of The Netherlands, and Italy's pledge; and

Second, they could provide IFAD with access to the World Bank trust fund, following the example of Germany and Belgium, and Switzerland's pledge, at the level recommended in paragraph 19 above. This would need to be done in the context of the forthcoming technical meetings for the trust fund and its replenishments.

21. The Consultation is therefore invited to:

(i) take note of the information provided in the paper;
(ii) consider the issues highlighted in the paper, in the context of the Consultation's considerations of IFAD's resource base;
(iii) endorse the principles and thrust of the proposed approach (including the recommended 66% external funding ratio); and
(iv) agree on the approach to be followed for IFAD to gain access to the core funds of the World Bank trust fund and on next steps.

IFAD's Debt Initiative Costs and Financing Requirements

(in USD)

	Total Nominal Costs for IFAD	**Sources of Financing**								
		IFAD's Own Resources	Debt Initiative Contributions – Investment Income	Netherlands Direct Contribution	Italy's Pledge	**World Bank HIPC Trust Fund**				
						Germany	European Union's pledge	Switzerland's pledge	Belgium	Other (assuming 66% external funding ratio)
Relief provided to date	17 320 363	6 378 382	1 242 005	7 008 638		2 691 338				
Remainder 2002	**14 462 320**	**4 917 189**		**1 455 695**		**1 845 212**			**2 385 675**	**3 858 549**
2003	27 899 734	9 485 910		1 455 695	1 166 667	1 845 212	1 000 000	1 000 000		11 946 251
2004	36 233 118	12 319 260		954 761	1 166 667			1 000 000		20 792 430
2005	37 965 577	12 908 296			1 166 667			1 000 000		22 890 614
2006	35 616 127	12 109 483								23 506 644
2007	34 306 951	11 664 363								22 642 588
2008	30 272 669	10 292 707								19 979 961
2009	28 015 115	9 525 139								18 489 976
2010	24 766 855	8 420 731								16 346 124
2011	22 380 047	7 609 216								14 770 831
2012	19 697 484	6 697 145								13 000 340
2013	16 879 641	5 739 078								11 140 563
2014	14 638 121	4 976 961								9 661 160
2015	10 943 200	3 720 688								7 222 512
2016	10 119 848	3 440 748								6 679 100
2017	9 614 310	3 268 865								6 345 444
2018	8 120 111	2 760 838								5 359 273
2019	8 051 410	2 737 479								5 313 930
2020	7 982 708	2 714 121								5 268 587
2021	7 243 471	2 462 780								4 780 691
2022	6 890 278	2 342 694								4 547 583
2023	6 829 835	2 322 144								4 507 691
2024	5 917 584	2 011 979								3 905 605
2025	4 227 170	1 437 238								2 789 932
2026	2 869 167	975 517								1 893 651
2027	869 632	295 675								573 957
2028	769 824	261 740								508 084
2029	584 812	198 836								385 976
2030	280 219	95 275								184 945
2031	277 956	94 505								183 451
2032	275 692	93 735								181 957
2033	273 429	92 966								180 463
2034	271 165	92 196								178 969
2035	268 901	91 426								177 475
2036	147 169	50 038								97 132
2037	110 465	37 558								72 907
Total	**453 392 478**	**154 642 901**	**1 242 005**	**10 874 789**	**3 500 000**	**6 381 762**	**1 000 000**	**3 000 000**	**2 385 675**	**270 365 346**
Share of total costs	**100**	**34**	**0**	**2**	**1**	**1**	**0**	**1**	**1**	**60**