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IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Consultation on the Seventh Replenishment of IFAD's Resources – Fifth Session

Rome, 14-15 December 2005

IFAD'S CONTRIBUTION TO REACHING THE MILLENNIUM DEVELOPMENT GOALS: REPORT OF THE CONSULTATION ON THE SEVENTH REPLENISHMENT OF IFAD'S RESOURCES (2007-2009)

The Consultation is hereby requested to consider the revised version of Section B, paragraphs 35 to 40.

Adoption of a Debt Sustainability Framework

35. Major donors are committed to increasing flows of official development assistance and reducing obstacles to the implementation of poverty reduction strategies in the poorest countries (including ensuring long-term debt sustainability). IFIs, too, are key actors in the global development assistance strategy. Nonetheless, it is evident that a drive on their part to substantially increase assistance threatens to conflict with the objective of containment of the impact of debt distress on poverty reduction. The Multilateral Debt Relief Initiative (MDRI) is being developed as one of the key responses to this issue. The MDRI is intended to provide very substantial further reduction of the public-sector debt of HIPC-eligible countries by their principal public-sector creditors – the IDA, the International Monetary Fund and the African Development Bank. Its details are currently being formulated and the scale and full implications of the MDRI will become clear only thereafter.

36. The MDRI could lower the number of HIPC countries at or near the debt distress threshold. However, the challenge will remain of avoiding adding to debt distress in the non-HIPC countries. The response to this challenge has been the adoption of a debt sustainability framework (DSF) for providing assistance to poor countries eligible for highly concessional assistance under the respective windows of a number of major IFIs (African Development Fund, Asian Development Fund and International Development Association, to date) within the context of each of their replenishment negotiations. The DSF is intended by the international community to provide a comprehensive and common framework for IFI assistance to poor countries through which individual IFIs will provide assistance on grant terms taking into account the results of country debt-distress risk analysis.

37. The country allocation (of assistance) made by each IFI will continue to reflect its performance-based allocation system (PBAS), and the content of the assistance programme will be ruled by the IFI's own country strategies and programmes agreed with each country within the framework of the country's own poverty reduction strategies.

38. The DSF provides for full compensation to participating IFIs in order to sustain their capacity to service future poverty reduction and development needs. This purpose is served by two mechanisms: full compensation for service charges forgone through (in the case of IDA) retention and management of part of the resources governed by its Modified Volume Approach (MVA); and full compensation for principal repayments forgone which will be financed through additional donor contributions on a pay-as-you-go basis. The MVA involves a discount applied to the PBAS allocation of countries eligible for assistance on grant terms under the DSF in order to address perverse incentives for countries to accumulate unsustainable debt levels.

39. In order to maintain and enhance its ability to effectively pursue its specific role and focus relative to rural poverty reduction in debt-distressed countries where there is a need for a coordinated effort to ensure that development assistance does not overburden debt-service capacity, IFAD should join other IFIs in adopting and implementing a DSF for the delivery of assistance to countries with high to moderate debt-distress risk. As in the case of other IFIs, the combined operation of the pay-as-you-go mechanism to compensate for principal repayments forgone and the MVA-linked approach to compensation for service charges forgone would result in the adoption of the DSF in IFAD having no overall impact on the Fund's resource position. In the light of the above, the Consultation recommends that:

- (a) Commencing in 2007, IFAD should adopt the IDA model of a debt sustainability framework to govern the allocation of assistance to countries eligible for highly concessional assistance and with high to moderate debt-distress risk.
- (b) The relevant articles of the Agreement Establishing IFAD should be amended to allow the operation of the debt sustainability framework.
- (c) The debt sustainability framework adopted by IFAD should be based on technical economic country analyses of debt-distress risk (and, eventually, forward-looking analyses of debt sustainability) produced by the relevant international institutions competent in that area, i.e. the International Monetary Fund and the World Bank, working in collaboration with the countries concerned.
- (d) IFAD Member States, and particularly those who are major contributors of official development assistance, agree to compensate IFAD fully for principal repayments forgone as a result of application of the debt sustainability framework within a pay-as-you-go mechanism as adopted in IDA 14.
- (e) IFAD management should submit to the Executive Board in September 2006 proposals for the operation of the debt sustainability framework, including provisions for: reporting on progress; the share and implications for IFAD's finances; the implications for IFAD's disbursements to developing countries; the implementation of the appropriate modified volume approach for the generation of compensation for service charges forgone; and IFAD's participation in the collaboration among MFIs for refining and reviewing methodologies used under the debt sustainability framework, as well as calibration of IFAD's approach with the approaches of other IFIs.

40. The Executive Board will review, in September 2006, the IFAD Policy for Grant Financing in the light of the adoption of the DSF, taking into account the impact of the Multilateral Debt Relief Initiative on the level of IFAD assistance projected to be provided on DSF terms.