economic cornerstone and informs the Initiative's economic targets. Debt Sustainability Analyses are conducted at the beginning and during the HIPC process. It is thereby not the absolute value of debt that is decisive for the Initiative, but whether, after relief, the debt can be serviced out of export earnings without compromising development goals or imposing excessive fiscal burden.

Debt sustainability has a wide variety of meanings and the concept is difficult to pin down. However, two broad perspectives can be distinguished.[162] The first relates to the debtor's ability or willingness to maintain debt service and avoid disruption of debtor-creditor relations: evidence of problems include the accumulation of payment arrears and debt rescheduling. This perspective on debt sustainability does not address the issue of debt servicing and its negative effects on development, i.e., when a country is forced to depress growth or neglect poverty reduction in order to fully service its debts. Accordingly, the second perspective on debt sustainability looks to the development dimension of debt. From this perspective, a country's debt is unsustainable if it adversely affects growth and poverty, regardless of whether is serviced or not.

In essence, the shift from the 1996 HIPC framework to the enhanced 1999 framework constitutes a programmatic progression from the narrow perspective of debt sustainability to the more development-focused perspective, in which (accordingly) the PRSP assumes a central role within the debt relief process. The increased awareness of the development dimension of debt as enshrined in the second perspective of debt sustainability has also been the driving force behind the enactment of the Multilateral Debt Relief Initiative as the HIPC Initiative's programmatic successor.

B. Debt Relief under the G-8: The Multilateral Debt Relief Initiative (MDRI)

Despite the significant rise in public spending on health, education and other poverty reduction investments in all HIPC countries through savings generated by the HIPC Initiative, the 27 countries receiving HIPC relief in 2003 still spent US $2.8 billion in repayments to credi-

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[162] *Hjertholm*, Debt Relief and the Rule of Thumb: Analytical History of HIPC Debt Sustainability Targets. WIDER Discussion Paper 2001/68, 2001.

tors. On average, debt repayments represented 15% of government revenues, rising to more than 20% in countries like Bolivia, Zambia and Gambia and exceeding the 30% benchmark in Malawi and Senegal. For Ghana, the share of government revenues dedicated to debt service amounted to 17%.[163] As a consequence thereof, UNDP feared that these large transfers were diverting resources from social policy areas, where progress is critical for achieving the Millennium Development Goals.

Thus, in June 2005, the G-8 proposed that the debts owed to the IMF, IDA and African Development Fund (AfDF)[164] should be cancelled completely. The proposal was initially presented in the G-8 Finance Ministers' June 2005 Communiqué entitled "Conclusions on Development." It was reaffirmed in the Statement on Africa signed by the G-8 Heads of States and Government at the Gleneagles Summit on 8 July 2005. The G-8 accord now envisions full debt relief HIPC countries that have successfully completed the HIPC process. It applies to HIPC countries that have already successfully reached the HIPC Completion Point and expands debt-relief to beyond what is possible under HIPC. Whereas the purpose of the HIPC program is to place participating countries in a status of sustainable debt, i.e., to bring their debt down to a manageable level, the G-8 resolution releases the countries from any financial obligation towards the International Financial Institutions, i.e., IMF, World Bank as well as, in this particular case, the AfDF. The remaining debt payments are instead supposed to be covered by the G-8. Unlike the HIPC Initiative, the MDRI is not comprehensive and does not propose any parallel debt relief on the part of official bilateral or commercial creditors or multilateral institutions other than IMF, IDA, and the AfDF. Thus, MDRI exists separately from the HIPC-Initiative, but it is operationally linked.

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[163] Figures taken from Chapter 3 of the Human Development Report: *UNDP,* Human Development Report 2005, 2005, <http://hdr.undp.org/reports /global/ 2005/>, at 89 (last visited 18/05/08).

[164] The African Development Fund (AfDF) was established in 1972 and commenced operations in 1974. Its current membership comprises 24 non-African State Participants and the African Development Bank.

1. MDRI as Operational Successor of HIPC

At the IMF-World Bank Annual Meetings on 24-25 September 2005 the International Monetary and Financial Committee (IMFC), an advisory committee to the IMF Board of Governors, and the Joint IMF-World Bank Development Committee reached an agreement on the G-8 proposal for 100% debt cancellation for the highly indebted poor countries. The cancellation is estimated at US $55 billion. Ghana is among the 19 HIPC countries that have already reached HIPC completion and could benefit immediately from the cancellation of their debts.[165]

On 7 November 2005, the IMF's Executive Board reached a consensus on the Fund's implementation of the G-8's proposal for debt relief and decided to call it the *Multilateral Debt Relief Initiative* (MDRI). The Board approved the decision to implement MDRI in the end of November 2005.[166]

Agreement hinged on three key issues that needed to be resolved:

(1) First, the problem of so-called additionality, i.e., the assurance that debt relief would not reduce the lending capacity of the IMF and World Bank. The issue of how to preserve additionality without affecting the finances of the World Bank was resolved in a letter to World Bank President Wolfowitz in which the G-8 pledged to cover the full cost to offset dollar for dollar the foregone principle interest repayments of the debt cancelled for the duration of the cancelled loans. Unlike World Bank debt relief, the IMF will cover the costs with its own resources.[167] The G-8 members also committed themselves to providing contribu-

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[165] The other 17 HIPC countries are Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

[166] *IMF,* IMF Executive Board Agrees on Implementation Modalities for the Multilateral Debt Relief Initiative. PIN No. 05/164, 8 December 2005.

[167] For a detailed account how the re-allocations of financial resources to IDA and the African Development Bank will take place and IDA's core estimated costs of providing debt relief under the G-8 proposal see *IDA,* The G8 Debt Relief Proposal. Assessment of Costs, Implementation Issues, and Financing Options, September 2005, <http://siteresources.worldbank.org/IDA/Resources/G8DebtPaperSept05.pdf> (last visited 17/05/08). And, *Development Committee,* Note on the G8 Debt Relief Proposal. Assessment of Costs, Implementation Issues, and Financing Options, September 2005, <http://siteresources.worldbank.org/DEVCOMMINT/Documentation/20656508/DC2005-0023(E)-DebtRelief.pdf> (last visited 18/05/08).

tions to cover additional needs related to the protracted arrears cases of Somalia, Liberia and Sudan and other countries that may qualify for HIPC assistance.[168]

(2) A second key issue was the uniformity of treatment: G-8 debt relief will only be available to HIPC countries. Relief is not available to (a) countries that have been servicing and paying their debt on time, (b) countries that have unsustainable debts, but do not qualify for HIPC,[169] or (c) countries that owe most of their debts to creditors not included in the G-8 proposal, such as Nigeria.[170] Categories (b) and (c) are often described as "Non-HIPC debt-distressed African countries." Category (b) countries generally missed the deadline for enlistment as HIPC participant due to the expiration of the HIPC-sunset-clause[171] or had not been enlisted as of 31 December 2004. December 31, 2004, was the cut-off day for being considered for future G-8 debt relief. In the meantime, however, Directors have agreed to extend the existing sunset-clause under the Enhanced HIPC Initiative by two years (to the end of 2006) to provide the remaining countries with the opportunity to estab-

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[168] On March 14, 2008, Liberia cleared its longstanding overdue obligations of US $888 million to the IMF. In response, the IMF Executive Board agreed to restore Liberia's voting and related rights and started to provide debt relief to Liberia, along with other creditors. *IMF,* IMF to Back Liberia With Debt Relief, New Financing. IMF Survey online, 18 March 2008, <http://www.imf.org/external/pubs/ft/survey/so/2008/new031808a.htm> (last visited 12/05/08). Also *IMF*, IMF Executive Board Fully Restores Liberia's IMF Status, Approves Financial Support Amounting to US $952 Million and HIPC Decision Point Designation. Press Release No. 08/52, 14 March 2008, <http://www.imf.org/external/np/sec/pr/2008/pr0852.htm> (last visited 12/05/08).

[169] Haiti, Kenya and Kyrgyzstan have debt stock-to-export ratios that exceed 150% and therefore have unsustainable debts, but would first need to establish a track record with IDA before qualifying for HIPC eligibility.

[170] Nigeria owes the bulk of its debt (about 80%) to bilateral creditors rather than to the World Bank and the IMF. Scenario (c), however, should be considered an exceptional case because bilateral creditors have been refusing debt relief due to the country's oil wealth. If not mismanaged or embezzled Nigeria's oil revenues could be sufficient to cover its debt service.

[171] The sunset-clause of two years prevents the HIPC program from becoming a permanent facility. This was justified as a way to minimize moral hazard, but more importantly to encourage the speedy adoption of structural adjustment style reforms within beneficiary countries (on which debt relief is conditional), as well as limit the amount of debt relief committed by the multilateral institutions and rich country governments.

lish a policy track record that would allow their consideration for HIPC relief.[172] Whether the extension of the sunset-clause will automatically allow potentially qualifying countries to take part in the G-8 scheme remains unclear.[173]

(3) A third issue concerns whether the G-8 scheme should cover only fully disbursed credits or whether it should also cover the disbursed portion of projects that are still being implemented as of the cutoff date.

In order to prevent discrimination, G-8 debt relief will use per capita income to determine how debt relief will be provided by the IMF to various HIPCs. However, this will not provide a solution for countries that are tempted to default on purpose. Such "free-rider" behavior by countries falling in category (a) might be prevented, however, by the third key issue, namely, the conditions that will be placed on debt relief recipients.[174]

The delivery of MDRI relief hinges on the consent of the 43 members[175] that have made contributions to the IMF Subsidy Account of the Poverty Reduction and Growth Facility (PRGF) Trust, because portions of this trust will be transferred to the newly established MDRI-Trust.[176] Furthermore, the Boards of the IMF and World Bank would need to decide whether the countries that requested MDRI relief are eligible to participate. On 21 December 2005, the IMF Board decided that a first group of 19 countries qualified for immediate debt relief under the new

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[172] *IMF,* IMF Executive Board Discusses the Status of Implementation of the Enhanced HIPC Initiative, PIN No. 04/111, 30 September 2004, <http://www.imf.org/external/np/sec/pn/2004/pn04111.htm> (last visited 18/05/08).

[173] Documents of the Development Committee consider this possibility in their cost calculation as option, *Development Committee,* Note on the G8 Debt Relief Proposal. Assessment of Costs, Implementation Issues, and Financing Options, at 3. See also supra note 167.

[174] *IMF*, Ministers reach deal on historic debt cancellation scheme, 34 IMF Survey (2005) 290.

[175] The 43 contributors are Argentina, Australia, Austria, Bangladesh, Belgium, Botswana, Canada, Chile, China, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Iceland, India, Indonesia, Iran, Ireland, Italy, Japan, Korea, Luxembourg, Malaysia, Malta, Morocco, Netherlands, Norway, Pakistan, Portugal, Saudi Arabia, Singapore, Spain, Sweden, Switzerland, Thailand, Tunisia, Turkey, United Kingdom, United States, and Uruguay.

[176] For more detailed information on the MDRI-Trust account see *IMF,* IMF Executive Board Agrees on Implementation Modalities for the Multilateral Debt Relief Initiative. PIN No. 05/164, 8 December 2005.

initiative, including two non-HIPC countries.[177] Some months later, in April, the World Bank also announced MDRI approval.[178] The MDRI took effect on July 1, 2006.

To be eligible, Executive Directors agreed that in order to benefit from MDRI, post-Completion Point HIPC countries need to maintain their performance in key areas: (1) their macroeconomic performance, (2) the implementation of their Poverty Reduction Strategy, and, (3) their public management systems. For non-HIPC countries eligible for MDRI relief from the Fund, satisfactory performance in the same three areas is considered a requirement.[179]

Although MDRI is already operative, not all of the details have been worked out. This holds particularly true for the long term debt-relief commitment by the creditor countries. The maturity of IDA credits spans 40 years.

Thus, comprehensive debt relief requires creditor commitments up to 40 years in advance. However, some main creditor states' budget allocation requirements do not allow the government to undertake financial commitments longer than one year.[180] It should also be noted that creditor countries have been deterred not only by the commitment for future payments under potentially new government constellations, but also by the fact that this commitment includes the interest payments of the credit which increase its value every year over the period of maturity. As a result of these political and financial considerations, long term coverage of debt relief remains unstable and the governments' commitment is still vulnerable to future parliamentary approval.

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[177] *IMF,* IMF Executive Board Discusses the First Assessment of Eligible Countries under the Multilateral Debt Relief Initiative. PIN No. 05/168, 27 December 2005, <http://www.imf.org/external/np/sec/pn/2005/pn05168.htm> (last visited 18/05/08).

[178] *World Bank,* World Bank: Full Debt Cancellation Approved For Some Of The World's Poorest Countries. Press Release No. 2006/370/PREM, 21 April 2006, <www.worldbank.org>.

[179] *IMF,* IMF Executive Board Agrees on Implementation Modalities for the Multilateral Debt Relief Initiative. PIN No. 05/164, 8 December 2005. This document gives also further background information on the eligibility criteria, costs and financing of the MDRI.

[180] In the absence of regular enactment of foreign aid authorization bills in the United States, appropriation measures take place within the Foreign Operations Spending Bill on an annual (!) basis.

Additionally, it is questionable whether the legal basis for 100% debt cancellation is covered by the IMF and IDA Articles of Agreement. The IDA Articles of Agreement allow for a "relaxation or other modification of financing terms" according to Art. V, Sec. 3. IDA. Debt relief under HIPC has required a formal interpretation of Art. V IDA in order to grant partial debt forgiveness. Thus, in January 2000, IDA's Executive Directors decided that forgiveness of a portion of the debt service on IDA credits as it comes due is consistent with the IDA's Articles of Agreement.[181]

Total debt forgiveness under the MDRI will require further interpretation of the IDA Articles of Agreement, if not even their amendment. Given the fact, that IDA has so far always reconciled its operative work with its mandate by means of interpretation (see Part I B 2.1.), another interpretation of Art. V, Sec. 3 IDA by the Bank's Legal Counsel allowing to stretch the article's meaning as to include also total debt forgiveness under MDRI seems to be the most likely option. Unfortunately, the respective records of the Board or the Legal Counsel were not accessible to the author.

Also the IMF would need to reconcile total debt forgiveness under the MDRI with its Articles of Agreements, particularly, if total debt relief exceeds the Fund's financial capabilities. Art. I IMF sets out that the Fund shall be guided in all its policies and decisions by the purposes set forth in the Article. A lack of liquidity would contradict this prescription.

The IMF plans to finance MDRI with resources from the HIPC Umbrella Account and the Special Disbursement Account (SDA) of the Fund that is used for receiving and investing the profits of the aforementioned 1999 off-market gold sales.

As could be derived from IMF online information, the Executive Board decided to amend existing decisions and adopted new decisions regarding the use of SDA resources. The Board "authorized the use of a portion of the corpus of the 1999-2000 off market gold transactions to provide debt relief under the HIPC Initiative for all qualifying countries. In addition, the Board authorized the transfer of part of these resources

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[181] The relevant documents are not accessible. The information that an interpretation of Art. V, Sec. 3 IDA Articles was approved by the Executive Directors is derived from the *IMF,* Progress Report on Heavily Indebted Poor Countries Initiative of 14 April 2000. See fn. 144 and staff interviews.

to a new MDRI-I Trust to provide MDRI relief for PRGF-eligible members with per capita income at or below US $380."[182]

The use of SDA funds is consistent with the reading of Art. V, Sec. 12 (f)(ii) IMF which states that the assets held in the Special Disbursement Account Fund may be used at any time

> "for operations and transactions that are not authorized by other provisions of this Agreement but are consistent with the purpose of the Fund."

Under sub-section (f)(ii) balance of payments assistance may be made available on special terms to developing countries in difficult circumstances, and for this purpose the Fund shall take into account the level of per capita income.

The third source of MDRI financing is meant to be the Fund's PRGF Trust Subsidy Account (see Part I 4.1.). In order to use the Subsidy Account's resources for MDRI all 43 contributors to the trust would need to agree. As an IMF Press Notice of December 2005 indicated, the provisions of the Fund's PRGF Trust Subsidy Account have been amended.[183] In this context, the Board decided furthermore to establish a separate MDRI-II Trust to which bilateral contributions from the Subsidy Account of the PRGF Trust could be transferred.

2. Subsequent Changes in Lending Policies

With MDRI being operative, IMF and World Bank are concerned that countries could continue to acquire new debts if lending policies of multilateral and bilateral creditors do not change. This concern has been the motivation behind recent efforts to change the lending strategy of the two Bretton Wood institutions.

At the 14th IDA replenishment session in April 2005, the IMF and World Bank introduced the Debt Sustainability Framework (DSF) as a new lending concept that was subsequently adopted by member states.[184] The new framework aims to address the risk of new debt for

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[182] *IMF,* IMF Executive Board Agrees on Implementation Modalities for the Multilateral Debt Relief Initiative. PIN No. 05/164, 8 December 2005.

[183] In more detail ibid.

[184] *IMF and IDA,* Debt Sustainability in LICs – Proposal for an Operational Framework and Policy Implications, 2004, <http://siteresources.worldbank.org

countries that have already benefited from debt relief and to preempt such debt with new criteria for the allocation of credits. In the future, the economic situation of a country shall determine to what extent the country is eligible for financing. Therefore, the economic assessment and the subsequent allocation of new credits are based upon a Debt Sustainability Analysis (DSA). In contrast to the DSA under the HIPC program, DSAs under the MDRI not only assess the external debt of a country, but also consider its internal debts. The results of the DSA then determine the form of financial support through IMF and World Bank. The DSA assessment supplements the existing Country Performance and Institutional Assessment (CPIA) Index, which has been the basis for IDA allocations. In the future, the results of the DSA are also meant to play an essential role in the Bank's Country Assistant Strategies (CAS).

Based upon the new DSF framework the results of the DSA inform whether country-specific resources are provided in the form of grants or loans. The decision mechanism is comparable to a traffic light analogy. Debt sustainability, i.e., the risk of running future debts, is classified into three groups. Where the DSA gives a "green light," only a minor risk of future indebtedness exists and the country will receive a 100% credit rating. If the light changes to "yellow," there is an increasing risk of future indebtedness and future resources will be provided in a 50% mix of loans and non repayable grants. If the DSA presents a "red light," there is a high risk of future indebtedness and the country will only receive grants.[185]

/EXTDEBTDEPT/Resources/debtSust-complete-paper.pdf> (last visited 18/05/08), *IMF and IDA,* Debt Sustainability in LICs – Further Considerations on an Operational Framework and Policy Implications, 2004, <http://siteresources.worldbank.org/INTDEBTDEPT/Resources/DSfullpapersept.pdf> (last visited 18.05.08), *IMF and IDA,* Operational Framework for Debt Sustainability Assessment in LICs – Further Considerations, 2005, <http://siteresources.worldbank.org/INTDEBTDEPT/Resources/032805.pdf> (last visited 18/05/08). In fact, proposals for debt management along the lines of the DSF have been already made by civil society at time of the conceptualization of the Enhanced HIPC Initiative and the Cologne Summit in 1999.

[185] On further DSF-related developments see *IMF,* IMF Executive Board Discusses the Application of the Debt Sustainability Framework for Low-Income Countries Post Debt Relief. PIN No. 06/136, December 7, 2006, <http://www.imf.org/external/np/sec/pn/2006/pn06136.htm> (last visited 18/05/08).

The two means of financing not only provide for different repayment terms (or no repayment at all), but also differ with respect to the amount of available capital. A country receiving grant financing is entitled to 20% less financial resources than a country with a credit line.

The allocation of grant and loan resources according to the DSA benchmarks (red, yellow and green light) is meant to reduce the risk of future debt for low income countries *ex ante* and to offer incentives for better economic performance. Thus, the allocation of financial resources is dependent not only on the DSA results, but also on the results of certain criteria accounting for good policies and good governance, the so-called "performance based allocation" (PBA). The rating takes place according to a specific index, the Country Policy and Institutional Assessment (CPIA).

For clarification purposes, it should be noted that the debt sustainability analysis under the DSF framework can be distinguished from the DSA under HIPC since both are based on different economic parameters. The DSA under the new "traffic light" lending policies of the DSF includes an assessment of external and internal debts and is focused on the prevention of future debts. In contrast, the earlier DSA, which is used as the economic basis for the conceptualization of HIPC reforms (as outlined in the HIPC documents), focuses on the current status of indebtedness.

The focus on external debts and the debt-to-exports threshold of the Debt Sustainability Analysis under the HIPC Initiative were strongly criticized due to two reasons: First, many HIPC countries are characterized by their external vulnerability to shock (the reason why a topping-up had to be introduced). Their small economies show a high dependency on rain-fed agricultural production and one or two export commodities. This high concentration of exports on a limited range of commodities leaves these countries sensitive to external shocks in commodity prices and vulnerable to climatic conditions. Hence, export earnings as means to calculate future debt sustainability has shown to be unpredictable and therefore of only limited use.

The second criticism addresses the fact that while external publicly guaranteed debts are repaid with foreign exchange, export earnings alone do not adequately reflect the resources available to HIPC governments for meeting their debt servicing obligations or, crucially, their poverty reduction expenditures.

Both points of critique have been considered for the new DSA concept under the DSF. At the moment, both DSA schemes continue to exist side by side and are progressively adjusted. Hence, the reader should be aware that the DSA currently exists in two different contexts. The DSA calculations at the HIPC Completion Point continue to use the old methodology.

This distinction might appear minor and merely to be of economic importance. However, the reader should be aware that the DSA is a powerful tool and the question of what policies are considered for economic analysis matter: If internal indebtedness is integrated into a debt analysis, the analysis will necessarily address domestic financial and economic policies as subject for reform. Thus, though economic in nature, the subject of investigation may be politically sensitive and may once again provide fodder for debating the mandate of the organizations.[186]

C. Case Study: The Contemporary History of Debt Relief in Ghana

In order to give some substance to the concept of debt relief and to provide a socio-scientific link to this topic, this section will contextualize HIPC theory within Ghana's experience of the HIPC process.

Ghana was the first Sub-Saharan country in colonial Africa to gain its independence in 1957. A long series of coups resulted in the suspension of the constitution in 1981 and a ban on political parties. A new constitution, restoring multiparty politics, was approved in 1992. Lt. Jerry Rawlings, the head of state since 1981, won the presidential elections in 1992 and 1996, but was constitutionally prevented from running for a third term in 2000. John Kufour, who defeated former Vice President, Atta Mills, in the elections, succeeded him. It was the newly-elected Kufour government that decided to participate in the HIPC Initiative in 2001.

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[186] Part of the new Debt Sustainability Framework is the so-called Country Policy and Institutional Assessment (CPIA) index which assesses the quality of a country's present policy and institutional framework. The index has been the subject of vigorous debate regarding the extent to which it focuses on internal domestic politics. Discussing this aspect in further detail would distract from the subject of this investigation. However, the World Bank's homepage further details the assessment process and its criteria and thus offers plenty of options for pondering the usefulness of the assessments from an economic perspective and their legal difficulties with respect to the Bank's non-political mandate.

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