

Telegrams: FINANCE, Lilongwe
Telephone: Lilongwe 789 355
Telex: 44407
Fax: 789 173
E-mail: minsecretary@finance.malawi.net

MINISTRY OF FINANCE
P.O. Box 30049
Lilongwe 3f
MALAWI

MINISTER OF FINANCE AND ECONOMIC PLANNING

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10th April, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, DC
UNITED STATES

Mr. James Wolfensohn
President
The World Bank
Washington, DC
UNITED STATES

Dear Sirs,

HIPC FINANCE MINISTERS NETWORK

I am writing as Chairman of the HIPC Finance Ministers' Network, which groups 33 HIPC Finance Ministers, to inform you and the members of the Executive Boards of IMF and the World Bank of the recent deliberations of HIPC Finance Ministers and senior officials on the Enhanced HIPC Initiative, and to request a reply before the Spring Meetings on a number of matters which are of urgent concern to HIPC governments for the future sustainability of the Initiative.

Meetings in Maputo, Lilongwe and London during November 2001-March 2002 brought together Ministers and senior officials of 33 HIPCs. They expressed strong support to the international community and in particular to the Bretton Woods Institutions, for the development and execution of the Enhanced HIPC Initiative and the renewed focus on Poverty Reduction as a cornerstone of development. They underlined their appreciation for the benefits these measures are providing to their countries in terms of reducing the debt burden and higher spending on poverty reduction. They also reiterated their full commitment to: designing and implementing poverty reduction strategies with full popular participation; mobilising external and domestic financing for poverty reduction in ways which ensure sustainable debt levels and financial market development; spending debt relief proceeds and other budget funds transparently and efficiently on poverty reduction; and establishing institutional structures and other prerequisites for national capacity-building in these areas.

However, they expressed strong concerns about four factors that risk undermining the credibility of the Initiative and the long-term sustainability of their debt. As you will see from the attached Declaration, in each of these areas, they have made suggestions for essential measures on which we would welcome your views and those of the Boards.

These factors are:

1. the non-participation of a significant number of creditors in the Initiative, which is becoming a critical issue as an increasing number of such creditors are demanding full settlement of debts;
2. the failure of the Initiative and other mechanisms available at an international level to take sufficient account of the risks of shocks due to commodity prices and aid shortfalls which are already undermining the debt sustainability of a significant number of HIPCs;
3. the slow progress in streamlining conditionality, introducing macroeconomic flexibility and Poverty and Social Impact Analysis, which is the main reason delaying completion points;
4. the need to establish a wider set of measures to ensure sustainable financing for poverty reduction.

We look forward to responses from the Bretton Woods Institutions as to the feasibility and potential timetable for these solutions, and any alternative suggestions you may have for resolving these problems, so as to improve the prospects for permanent debt sustainability for HIPCs.

Yours faithfully,

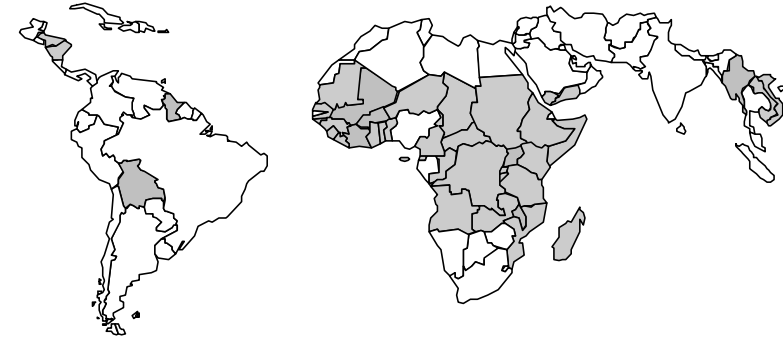
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MINISTER OF FINANCE AND
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CC : Hon. Gerald Ssendaula, Minister of Finance and Economic Development, Uganda
(in capacity as Chairman of the IMF & World Bank 2002-2003 Spring & Annual Meetings)
: Hon. Gordon Brown, Chancellor of the Exchequer, UK (in capacity as Chairman of the IMF International Monetary Committee)
: Kofi Annan, Secretary General of the United Nations
: Mark Malloch Brown, Administrator, UNDP
: Rubens Ricupero, Secretary General, UNCTAD
: Donald C. McKinnon, Secretary General, Commonwealth Secretariat
: Poul Nielson, Commissioner, Development & Humanitarian Aid Directorate, European Union
: Finance Ministers and Development Ministers of G7 & Austria, Denmark, Finland, Netherlands, Norway, Sweden, Switzerland
: Executive Directors representing HIPCs in IMF and World Bank



DEBT RELIEF INTERNATIONAL



IMPLEMENTING HIPC II:

Declaration of the 6th HIPC Ministerial Meeting

London, 5 March 2002

Non-Participation of Creditors

The Bretton Woods Institutions have made clear in several recent Board papers that non-participation of several creditors (principally non-Paris Club governments, smaller multilateral institutions and commercial creditors) in the Initiative is of growing concern. The lack of relief on such debt has meant that the present value sustainability thresholds established under the Initiative are not being attained by most countries, damaging their creditworthiness and growth prospects.

This issue is rapidly becoming critical as non-Paris Club governments, commercial creditors and 'vulture funds' that have bought debts from creditors are taking an increasing number of debtors to court and demanding payment at 100% of face value. The HIPC Ministerial Network is aware of 12 HIPCs who are currently fighting lawsuits. Immediate settlement of such debts has in the past cost countries upwards of US\$50 million in one year: similar payments now will ruin poverty reduction plans.

We would propose that solutions to this problem contain 5 elements:

For those creditors that are refusing to participate in the Initiative, but are not threatening legal action, the international community must accelerate its efforts to convince them to participate.

It should convene a conference of HIPCs, international financial institutions and non-OECD and other bilateral and multilateral creditors, to agree innovative mechanisms for relief. This should include where appropriate creditor countries which are not members of the BWIs or the UN. Funding mechanisms could include the IDA buyback facility, HIPC Trust Fund resources, and donor grants to relieve debts owed to countries that have themselves received concessional debt relief. The 12 HIPC creditor countries which are members of this network are prepared to come to such a meeting and to discuss positively all potential solutions to the problem.

In order to forestall the trend to legal actions the international community should envisage 4 measures:

- a) An international initiative led by the IMF and World Bank to inform all member states (creditors and debtors) about the degree to which IMFC and Development Committee communiqués and Executive Board decisions are legally binding on BWI member states. If necessary, we would suggest that the BWIs pass rapidly through their Executive Boards decisions committing member states in a binding manner to providing HIPC-comparable terms, and to opposing in their legal jurisdictions any settlement that provides terms that are more favourable than HIPC. This issue could be treated in discussions on "standstill" procedures, with special procedures for HIPC-related comparability clauses and rapid action to help with immediately foreseeable lawsuits.
- b) Initiatives by major international arbitration fora (such as ICSID and the International Chamber of Commerce) to ensure that their arbitration decisions find in favour of HIPC comparability.
- c) Initiatives by major creditor governments to incorporate similar provisions in their laws and procedures in order to prevent creditors from launching lawsuits in their jurisdictions.
- d) Legal technical assistance to HIPCs (as in IDA buybacks) in formulating legal instruments that can be passed into law rapidly and simply to prevent creditors from suing in HIPC jurisdictions.

Finally, we would like to stress that, contrary to appearances, some Paris Club creditors are not participating fully in the Initiative. The Paris Club has not finalised agreed minutes on interim relief for some small debtors, and bilateral agreements are coming through very slowly. Some G7 Paris Club creditors continue to exclude certain 'special' debts from relief, and some are providing 'cancellation' in ways that use the funds to pay for non-essential imports or NGO-led projects, and do not free funds for PRSP implementation. To us this represents a backtracking on commitments made at past G7 summits, and a worrying development for the sustainability of the Initiative. We urge the Spring Meetings and next G7 Summit to ensure that any such delays and obfuscations are eliminated rapidly.

External Shocks

External shocks have long been a principal cause of problems with the execution of economic reform programmes. Past response to such shocks has usually combined adjustment by the affected country and mobilisation (after some considerable delay) of additional aid. However, the recent falls in world commodity prices, the global recession and the effects of the 11 September tragedy, combined with the continuing effects of climatic shocks, and conflicts in HIPCs themselves or among their neighbours (in particular for landlocked and island nations), have made many HIPCs unsustainable once again. They have re-emphasised the importance of establishing mechanisms to pre-empt and overcome such shocks so that long-term debt sustainability can be maintained. In addition, the international community can no longer require a country to adjust to shocks: under a Poverty Reduction Strategy, such adjustment represents a cut in poverty reduction spending and an abandonment of Millennium Development Goals.

Our proposals in this area would be as follows:

- Comprehensive assessment of HIPCs' debt sustainability, to take into account all the sources of financing for attaining the Millennium Development Goals, and the combined burdens of external and domestic debt, to assure adequate funding for poverty reduction goals.
- More realistic long-term economic projections in such assessments, with baseline scenarios taking full account of past external shocks through volatility and probability analysis.
- Annual reassessments of sustainability between decision and completion points, and after completion points, in order to identify as fast as possible any renewed unsustainability of debt or reduction in anti-poverty spending, and to augment debt relief where necessary.
- Restoring a full safety margin to protect against future shocks. This would involve allowing the additional bilateral debt cancellations pledged by some creditor governments beyond Cologne Terms to be fully additional to HIPC relief, thereby bringing HIPCs' debt ratios down by an additional 25-30%. It would also imply presenting frankly in completion point documents the prospects for creditor participation, to assess the effects of non-participation on sustainability.
- Introducing rapid (and affordable) contingency financing mechanisms, through 'floating additional tranches' in IMF PRGF programmes which can be disbursed immediately in the event of shocks. These could be funded for individual HIPC PRGF programmes by upward adjustment of quota-based borrowing ceilings, and overall by the reallocation of developed country SDRs.
- Accelerating recommendations of the World Bank Task Force on Commodity Risk Management to provide countries and their poorer citizens with the means to protect themselves against shocks.

- Reinforcing insurance mechanisms such as those of the Commonwealth Disaster Management Agency, to provide subsidised private sector insurance against some types of shocks.
- Ensuring that donors and multilateral institutions provide more predictable and stable aid flows, and avoid sudden suspensions due to individual conditions if PRSPs are generally moving forward.

Streamlining Conditionality

We wish to congratulate the Bretton Woods Institutions for their efforts to streamline conditionality under PRGFs and PRSCs, to define a new more flexible macroeconomic framework to maximise anti-poverty spending, and to develop poverty and social impact analysis (PSIA). However, progress in individual country negotiations has been slow, delaying an increasing number of countries in their progress through the HIPC Initiative. We therefore urge the BWIs to redouble efforts in three respects:

- Streamline conditionality more dramatically. The IMF should select 4-5 conditions that are essential to a pro-poor macro framework, and the World Bank a similar number of structural conditions that have a demonstrable direct positive impact on poverty reduction. Total combined PRGF/PRSC conditions should not exceed 10. Both institutions should verify closely that there is no 'conditionality fungibility' among their programmes, that other donors do not impose additional conditions, and that they avoid micro-conditions (such as precise percentages of spending on individual sectors or micro-institutional reforms). Compliance with conditions should be interpreted based on overall trends and efforts rather than individual performance criteria.
- Accelerate efforts to design more flexible growth-oriented macroeconomic frameworks. Encourage 'post-stabilisation' countries (defined in the recent Board paper SM/02/51 as those with inflation under 10% and cash budget deficits under 2% of GDP after grants) to think more closely about ways to increase growth and employment rather than further reducing inflation, about the supply-side (as well as demand-side) causes of inflation, and about defining sustainability of the budget deficit as including grants and debt relief. This will allow HIPCs to define alternative paths to poverty reduction, focussing more on growth and anti-poverty spending, and to maximise the mobilisation of concessional funding for poverty reduction spending.
- Dramatically accelerate PSIA in HIPCs. Analysis of the links between macroeconomic and structural policies and poverty reduction remains among the weakest areas of most PRSPs, and it is essential to equip countries with the tools to conduct their own PSIA rather than depending on outside assistance. These tools should have inputs from the BWIs and donors, but be administered and disseminated by independent capacity-building sources, to avoid conflict of interest for partners in the negotiation process of PRGF and PRSC frameworks.

Widening the Agenda for Financing Sustainable Development

HIPC relief is only a small part of the package needed for ensuring adequate financing to allow countries to meet the Millennium Development Goals. If we are to reach these goals through a joint effort, the following measures will be required by the international community:

- calculating the financing needs for each individual HIPC country to reach the MDGs and presenting such analysis in individual HIPC, PRSP, PRGF and PRSC documents;

- presenting aggregate needs systematically and comprehensively to BWI and UN meetings;
- limiting non-concessional lending where necessary to maintain long-term debt sustainability;
- a major increase in grant aid, to reach the UN targets of 0.7% of GNP as soon as possible;
- providing new finance in ways which support poverty reduction strategies, through:
 - ✓ untying all aid from the exports of the supplying country
 - ✓ moving from project support to budget support
 - ✓ establishing common disbursement, procurement, accounting, auditing procedures
 - ✓ maximising value for money of aid and accelerating efforts to eliminate corruption
 - ✓ providing aid only for productive purposes rather than white elephants or arms
 - ✓ making longer-term commitments of aid flows.

Finally, we also recognise the need to reduce aid dependence by mobilising our national resources for poverty reduction. We ask the international community to assist us in these efforts by:

- strengthening HIPCs' efforts to increase budget revenue, while remaining realistic about the limited and gradual prospects for increases;
- encouraging non-debt private sector flows (especially FDI) to HIPC countries as a top priority in order to maximise growth and long-term debt sustainability;
- providing free market access for the least developed countries and HIPCs, as well as removing subsidies and other structural barriers which impede market access even in the absence of tariffs;
- placing even more emphasis in PRSPs on increasing value added of export products and moving from raw materials to finished products, to take advantage of trade liberalisation.
- procuring wherever possible goods financed by aid (notably food aid) from HIPCs themselves.

We believe that the above measures will be essential to the success of HIPC efforts to reduce debt to permanently sustainable levels, and PRSP efforts to meet the Millennium Development Goals.