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Effects of economic reform policies and foreign debt on the full enjoyment of all human rights

Note by the Secretary-General*

The Secretary-General has the honour to transmit to the members of the General Assembly the report of the independent expert on the effects of economic reform policies and foreign debt on the full enjoyment of all human rights, Bernards A. N. Mudho, submitted pursuant to Human Rights Council decision 1/102.

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* The present report was submitted after the deadline provided for in the relevant General Assembly resolutions owing to the need to reflect the latest information available.

Report of the independent expert on the effects of economic reforms policies and foreign debt on the full enjoyment of all human rights

Summary

The independent expert on the effects of economic reform policies and foreign debt on the full enjoyment of all human rights submits the present report in order to provide the General Assembly with a short update on recent developments concerning the Multilateral Debt Relief Initiative (MDRI), the current state of debate concerning the concept and implementation modalities of this new initiative, and its impact on the achievement of Millennium Development Goals (MDG) and human rights. The Multilateral debt relief initiative (MDRI), proposed by the Group of Eight (G-8) in Summer 2005, foresees a 100 per cent debt relief by the International Monetary Fund, the International Development Association (IDA) of the World Bank and the African Development Fund (AfDF) of the African Development Bank for the world's most indebted poor countries, in order to help them to achieve the Millennium Development Goals. The package has an overall volume of US$ 50 billion and envisions providing eligible countries with annual average savings on debt service of about US$ 1.25 billion over a period of 40 years.

However, the MDR initiative is not likely to resolve all foreign debt problems of poor countries once and for all. First, only countries that have successfully completed the Heavily Indebted Poor Countries (HIPC) Initiative are eligible (19 countries so far). Secondly, only three multilateral development banks participate in the debt relief initiative, leaving in particular Latin American and Asian countries with significant debt stocks. Although the Multilateral Debt Relief Initiative is highly welcomed as it provides poor countries with some much needed financial and policy space (that has now to be carefully and responsibly managed by beneficiaries), it should be kept in mind that low income countries' overall debt stock is estimated at about ten times MDRI's volume (US$ 500 billion) and that the concrete impact of MDRI on the achievement of MDG and associated human rights aspects will therefore be long-term and difficult to measure.

Consequently, the independent expert recommends the development of follow-up initiatives to MDRI, including further debt relief programmes by other multilateral institutions currently not participating and initiatives towards a permanent solution to the problems of bilateral and commercial debts. He also recommends to include further steps towards a more favorable trade system. In this context the independent expert recalls in particular the eighth MDG to "develop a global partnership for development", which explicitly calls for "an open trading and financial system that is rule-based" and a comprehensive solution to developing countries' debt problems.[1]

With respect to MDRI , the independent expert invites participating multilateral institutions to consider some improvement in the eligibility and implementation criteria. His suggestions relate in particular to (a) a more adequate weighing of MDG criteria in the formula for the reallocation of MDRI related additional funds, (b) the inclusion of non-HIPC countries into IDA and AfDF parts of the debt relief initiative, and (c) a revision of IDA's cut-off-date for eligible debt.

Contents

I. Introduction

1. In compliance with resolution 2005/19 of the Commission on Human Rights the Independent Expert has reported to the General Assembly at its sixtieth session. As requested by the Commission, the report submitted to the sixtieth session of the General Assembly paid particular attention to (a) the effects of the foreign debt and the policies adopted to face them on the full enjoyment of all human rights, in particular economic, social and cultural rights in developing countries; (b) measures taken by Governments, the private sector and international financial institutions to alleviate such effects in developing countries, especially the poorest and heavily indebted countries; and (c) new developments, actions and initiatives being taken by the international financial institutions, other United Nations bodies and intergovernmental and non-governmental organizations (NGOs) with respect to structural adjustment policies and human rights (A/60/384).

2. In his first report to the General Assembly the independent expert highlighted in particular the current situation of foreign debt and its impact on the enjoyment of human rights from a historical perspective, and reviewed new initiatives for debt relief, in particular the Group of Eight (G-8) proposal and their implications.

3. At the time the first report was submitted to the sixtieth session of the General Assembly, many implementation details of the new G-8 debt relief proposal were still under discussion within the decision-making bodies of the three multilateral institutions directly concerned and it was thus premature to comment on the potential impact of MDRI on the achievement of the Millennium Development Goals (MDGs) and on the full enjoyment of all human rights. The independent expert is therefore grateful for the opportunity to provide the members of the General Assembly, as a follow-up to his last report, with a short update on recent developments concerning MDRI, and a summary of the current debate concerning the concept and implementation modalities of this new initiative, and its impact on the achievement of MDGs and the full enjoyment of all human rights.

II. History and key features of the Multilateral Debt Relief Initiative

4. First debt relief initiatives date back as early as the 1970s when “Paris Club” bilateral creditors started writing off debts for some developing countries. Relief continued during the 1980s and 1990s when bilateral debt stocks where subsequently cut by 33 per cent under the Toronto terms for low income countries in 1988; 50 per cent under the London terms of 1991; 67 per cent under Naples terms of December 1994; and finally by 90 per cent under the Cologne terms of November 1999. However, during the 1990s it became increasingly clear that bilateral Paris Club debt reductions did not succeed in resolving poor country’s debt sustainability problems as many of them still exceeded the defined debt sustainability thresholds.[2]

5. In 1996 the World Bank and the International Monetary Fund (IMF) launched the Heavily Indebted Poor Country” (HIPC) Initiative in order to reduce developing country’s debt stock further. HIPC Initiative entailed coordinated action by multilateral organizations and governments to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. Under HIPC Initiative, eligible countries receive interim debt relief as soon as they meet certain policy

performance criteria ("Decision point"). Later on, irrevocable debt relief is granted if policy performance has stayed on track ("Completion point"). As of end August 2006, 40 countries are eligible for HIPC initiative, of which 19 have already reached the "Completion point": Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Uganda, United Republic of Tanzania, and Zambia. In addition, 10 more countries have reached the decision point: Burundi, Chad, Republic of Congo, Democratic Republic of the Congo, the Gambia, Guinea, Guinea-Bissau, Malawi, Sao Tome and Principe and Sierra Leone. Eleven countries could still reach decision point before the end of 2006: Central African Republic, Comoros, Côte d'Ivoire, Eritrea, Haiti, Kyrgyzstan, Liberia, Nepal, Somalia, the Sudan and Togo.[3]

6. In the context of ongoing debates on the MDGs, G-8 countries, as main shareholders of the multilateral development banks, proposed in summer 2005 that IMF, the International Development Association (IDA) of the World Bank and the African Development Fund (AfDF) of the African Development Bank fully cancel their debt claims on the world's most indebted poor countries. The proposal that led to the so-called MDRI was endorsed in July 2005 by G-8 summit held at Gleneagles, Scotland. The initiative was explicitly designed to provide HIPC countries with additional support to achieve MDGs.[4]

7. Under MDRI, HIPCs are eligible for full and irrevocable debt relief as soon as they have reached – or will reach –HIPC completion point. Debt cancellation under MDRI will come in addition to debt relief already committed under HIPC Initiative, but unlike HIPC Initiative, MDRI does not propose any parallel relief on bilateral or private debt, or on debt to multilateral institutions beyond IMF, IDA, and AfDF.

8. Although MDRI is an initiative common to three international financial institutions, the decision to grant debt relief is ultimately the separate responsibility of each institution and in fact the implementation provisions adopted by the respective governing entities differ in several points.

9. Initially, the 19 countries that have reached decision point under HIPC Initiative are expected to receive full cancellation of their eligible debt. The remaining 10 interim and 11 pre-decision point HIPCs would become eligible once they have completed the requirements for HIPC Initiative. Tajikistan and Cambodia as non-HIPC countries will benefit from IMF debt relief, as their per-capita income is below US$ 380, but not from cancellation of IDA debts.

10. IMF started implementing MDRI in January 2006 while IDA began providing relief on 1 July 2006. For AfDF, MDRI became effective on 1 September 2006.[5]

11. While IMF is supposed to use its own resources to cover the debt relief, IDA and AfDF will be compensated. In March 2006, donors agreed "to a financing package that calls for additional donor contributions over time to compensate IDA [and AdDF] "'dollar-for-dollar' for the debt relief provided. Donors have committed to ensuring that IDA's financial capacity is preserved so that

additional resources will be available to support the development efforts of poor countries."[6] The objective of this operation is to preserve the long-term financial capacity of IDA and the AfDF.

III. Recent discussion on the impact of the Multilateral Debt Relief Initiative

12. The full benefit of MDRI from all three institutions, i.e. the total amount of debt cancelled, will be over US$ 50 billion: about US$ 37 billion for IDA, US$ 8.5 billion for AfDF and US$5 billion for IMF. About US$ 36 billion of this amount is expected to have been cancelled in 2006. Without MDRI, the global amount of US$ 50 billion would have been paid back over a period of about 40 years, which means that the annual saving on debt service by participating countries can be estimated at about US$ 1.25 billion in average over this period. Instead of being reimbursed to the three participating multilateral institutions, these funds can now be spent by beneficiary countries, on needs linked to the achievement of MDGs and associated human rights aspects.[7]

13. However, a closer look on the concept and implementation modalities of MDRI reveals several problematic aspects concerning its overall impact. It has already been mentioned that only a limited number of countries will directly benefit from MDRI, leaving other indebted low and middle income countries without additional relief. In this context, the independent expert welcomes IMF approach to apply strict uniformity of country treatment. This principle has allowed the inclusion of two non-HIPC countries with a per capita income level of less than US$ 380 in IMF part of MDRI. It is recommended that IDA, for reasons of equity, should consider a similar approach. This approach could result in taking on board all IDA-only countries, including those with indebtedness ratios below HIPC thresholds. [8]

14. MDRI does not introduce new conditionality to beneficiary countries, but as the completion of HIPC programme is a precondition to qualify for MDRI, the eligibility is in fact subordinated to HIPC conditionality, including structural reforms and criteria that are difficult to meet for a number of countries in the given timeframe. Within MDRI, for the 19 HIPCs that have already reached completion point, retroactive assessments have been conducted in order to determine whether there had been any deterioration in policy performance. According to IMF and World Bank information, Mauritania initially did not meet the eligibility requirements, but has since taken steps to improve its public finance management. Mauritania's participation was reconfirmed by IDA Board of Directors on 27 June 2006. For newly qualifying completion-point HIPCs (Cameroon was the first in May 2006), qualification for MDRI is automatic.[9] Once granted, MDRI debt cancellation becomes irrevocable for a given country and will not be subject to any ongoing performance monitoring by the multilateral banks. The budgeting and utilization of resources released will be the autonomous decision of the beneficiary countries which opens in fact an important economic policy space, allowing for progress towards the achievement of MDGs and the realization of human rights.[10]

15. For the envisaged benefits to be realized, the new policy space will need to be carefully and responsibly managed. Firstly, beneficiary countries should be particularly prudent concerning the future accumulation of debt. If the policy space were used for borrowing from non-concessional sources, debt levels could soon become unsustainable again. Secondly, beneficiary countries should

direct freed MDRI resources specifically towards the achievement of MDGs. In the same context it should be underlined that good governance, accountability and transparency are crucial elements to release the benefits created by this debt release. Civil society and its organizations should play an important role of monitoring the budgeting and spending of these additional resources.[11]

16. Since IMF has begun its implementation of MDRI in January 2006, there is already some evidence that beneficiary countries have started budgeting and directing the released resources towards poverty reduction. Government plans in this sense have been reported from Zambia, Tanzania and Ghana.[12]

17. While there is no additional conditionality on the debt relief operation as such, the implementation mechanism will favour countries with a good IMF / World Bank policy performance record. As described earlier, IDA and AfDF will deduce debt relief from the individual country allocations and redistribute these funds on the basis of policy performance criteria. Given that the central objective of MDRI is to achieve MDGs, the related indicators should be weighted in an adequate way, together with country performance indicators, in the formula for allocating these additional resources.[13]

18. The limitation of MDRI to only three multilateral development banks is likely to lead to considerable inequality in its impact on the debt stock of individual eligible countries. The degree to which the initiative will lead to a reduction of overall debt burden and consequently free resources for policy areas linked to the achievement of MDGs depends on the individual country's debt structure and its geographic location. In fact, no country has benefited from 100 per cent relief for all its debt through MDRI. For many African countries the three participating development banks are the main creditors and it is estimated that MDRI will wipe out 75-80 per cent of the total debt of countries like Uganda or Tanzania. Other countries will have a much lower portion of their debts cancelled, either because their debt portfolio includes more bilateral and commercial debts, or because their regional development banks are not involved in the initiative.[14] The latter is particularly the case for the Latin American countries that would qualify for MDRI, but also for countries with debt stocks with the Caribbean or the Asian Development Bank. Ongoing discussions amongst donors whether other selected multilateral development banks will join the initiative have to be closely followed.

19. Benefits for participating countries have been reduced from initially envisaged levels through the definition of "cut-off dates", i.e. the date up to which debt is cancelled. IMF and AfDF decided to cancel all debts disbursed before 2004, while IDA chose the end of 2003 as cutoff date. The choice of an earlier date has in fact resulted in a global diminution of relief of about US$ 5 billion.[15]

20. The impact of MDRI on the net resources flow to participating and non-participating developing countries is another important aspect to be analyzed. In fact, the implementation models chosen by IDA and AfDF will spread the initiatives benefits over a larger number of countries. In the case of IDA, the annual savings each beneficiary country realizes on debt service will be deducted from its respective annual IDA allocation. This feature has been introduced in order to help allay moral hazard and equity concerns generally associated with debt cancellation. In a second step, the amount IDA has saved by this deduction will be allocated to a bigger group of 67 countries according to IDA's

performance-based allocation (PBA) system. This feature is designed to maintain the link between IDA resource transfers and country performance. Consequently, fresh IDA allocations to countries receiving debt relief would be composed of their "gross" yearly allocations, minus their debt service forgone as a consequence of MDRI in the same year, plus their PBA-defined share of the global amount deduced from all countries during the first step.[16] AfDF is using a similar system, spreading funding for debt cancellation of (initially) 15 countries among a larger group of 40.[17]

21. As future "gross" allocations to countries are subject to several uncertainties (such as the amount of fresh resources made available to the multilateral banks in the future), the overall effect of the system on individual countries is difficult to predict. It is however not excluded that a number of HIPCs could face declines in their fresh allocations, if the deductions cannot fully be compensated by the "second step allocation", due to low country performances in the PBA system. In its own analysis, IDA does not exclude that in some cases fresh allocations could be below the pre-MDRI level. However, if foregone debt service is taken into account, no country will be worse off resources-wise than it was before MDRI.

22. The dependence of fresh allocation levels from PBA under MDRI makes country performance evaluation criteria a key element determining the impact of debt relief. The independent expert suggests that further analysis of these criteria be conducted with a view to improving its incentive mechanism regarding the promotion of human rights.

IV. Impact on the global achievement of the Millennium Development Goals

23. MDRI is welcomed as a first important step liberating funds urgently needed to progress toward the achievement of MDGs, which, in turn, with some additional measures could positively impact on the realization of human rights. It should however not be forgotten that the debt problem has not be resolved once and forever, as initially announced, and that poor countries continue to face important debt burden. In total, low-income country debt is currently estimated at around US$ 500 billion,[18] about ten times the amount cancelled by MDRI. There is a need for further comprehensive solutions to the debt problems of poor countries, including further debt relief by other multilateral institutions and for permanent solutions to the problems of bilateral and commercial debts.

24. While positive effects of MDRI will certainly be felt in some countries and sectors, many observers estimate that the overall impact of the initiative will be rather limited, compared to overall needs related to the achievement of MDGs. In fact, the gain of resources for participating countries is relatively small, due to very soft lending conditions offered by the involved multilateral banks. IDA loans, for instance, have to be reimbursed over 40 years, at 0.75 per cent interest rate, with a 10 year grace period. As a consequence, before MDRI, the 15 African HIPCs have paid on average US$ 19 million in debt service per year to IDA while receiving at the same time in average US$ 197 million in new IDA credits. The concrete impact of MDRI in this context will be long-term and difficult to measure.[19] Past experience with HIPC Initiative has shown that the country's poverty reduction expenditures have increased following the debt cancellation,[20] but were still below what was needed to make significant progress towards achievement of the millennium development goals.

25. Another critical point is the question of additionality of resources. In order to have a positive impact, debt relief operations have to be granted in addition to existing aid and must not be offset by a reduction in traditional bilateral or multilateral aid programmes. There is some doubt as to whether this principle has always been respected in the past. As the statistics of the Organisation for Economic Co-operation and Development (OECD) reveal, countries that benefited from HIPC Initiative have suffered from a sharp decline in traditional aid (i.e. development assistance less debt forgiveness) with the launch of HIPC Initiative at the end of the 1990s, a trend that continued until 2001. It was only in 2003 that Pre-HIPC Initiative levels have been reached again.[21]

V. Conclusions and recommendations

26. The independent expert welcomes the Multilateral Debt Relief Initiative (MDRI) for the full cancellation of Heavily Indebted Poor Countries (HIPC) debt claims to the International Monetary Fund (IMF), the International Development Association (IDA) and the African Development Fund (AfDF). An estimated annual amount of US$ 1.25 billion will be released by the initiative and can be spent by beneficiary countries without additional conditions. Beneficiary countries have the corresponding responsibility to ensure the enabling environment by carefully managing the additional policy space, so that the resources provided translate into real progress toward the realization of human rights, via the achievement of the Millennium Development Goals (MDG). Good governance, accountability and transparency have to be considered crucial to release the benefits created by this debt release.

27. In the same context, the important role of non-state actors has to be emphasized. The independent expert invites civil society and its organizations to play an active role in monitoring the budgeting and spending of additional MDRI resources, in order to ensure their utilization in coherence with the full enjoyment of human rights and the achievement of MDGs.

28. With regards to the very important remaining debt stock of poor countries, more has to be done if debt relief is to have a tangible impact on the achievement of MDGs and associated human rights. There is a need for comprehensive follow-up initiatives in order to tackle the debt problems of poor countries, including further debt relief by other multilateral institutions currently not participating in MDRI, such as the Inter-American Development Bank, the Asian Development Bank and the Caribbean Development Bank. There is also a need for progress towards a permanent solution to the problems of bilateral and commercial debts.

29. Resources provided to poor countries in the context of debt relief initiatives should not be granted at the expense of ongoing traditional development aid, if debt relief is to produce an overall benefit. The independent expert invites the donor community to ensure the additionality of resources in order to avoid that the impact of positive debt relief on the achievement of MDGs is offset by fewer MDG support to other sectors or other countries.

30. The independent expert welcomes the strict equity of treatment applied by IMF, allowing two non-HIPC countries to benefit from MDRI on grounds of their low per capita income levels. He invites IDA and AfDF to consider adopting similar approaches.

31. The independent expert regrets that IDA has fixed the end of calendar year 2003 as "cut-off date" for eligible debt to be cancelled. This shift from the initial G-8 proposal will result in significant loss of debt relief. He invites IDA to reconsider this decision.

32. Facilitating the achievement of MDGs has been the key objective of MDRI. This fact should be adequately reflected in the formula used by IDA and AfDF to reallocate MDRI- country's savings on debt service.

[1] http://www.un.org/millenniumgoals/#

[2] Moss, Todd: "Will debt Relief make a Difference ?"; Center for Global Development, Mai 2006, p.6

[3] See: The Word Bank, web site on debt relief: http://web.worldbank.org; Home > News > Issue Briefs > Debt Relief

[4] G8 Finance Ministers' Conclusions on Development, London, 10-11 June 2005

[5] African Development Bank web site, press release of September 5, 2006

[6] The World Bank, Multilateral Debt Relief Initiative Fact Sheet, July 2006. http://siteresources.worldbank.org/INTDEBTDEPT/Resources/mdri_eng.pdf

[7] idem

[8] International Monetary Fund, Multilateral Debt Relief Initiative Fact Sheet, August 2006. http://www.imf.org/external/np/exr/facts/mdri.htm

[9] The Word Bank, Multilateral Debt Relief Initiative Fact Sheet

[10] The World Bank, Multilateral Debt Relief Initiative Fact Sheet, July 2006. http://siteresources.worldbank.org/INTDEBTDEPT/Resources/mdri_eng.pdf

[11] Some examples are quoted in : "G 8 Debt Deal one year on: What happened and what next ?"; EURODAD Report, June 2006. p. 10.

[12] Jubilee Debt Campaign, The Multilateral Debt Relief Initiative: The good, the bad and the ugly; June 2006; p. 3

[13] A similar proposal has been made by the Commonwealth HIPC Ministerial Forum, Livingston, Zambia, 10-12 April 2006

[14] EURODAD, p.6

[15] Jubilee Debt Campaign, p. 3

[16] IDA Resource Mobilization Department, FRM, "IDA'S Implementation of the Multilateral Debt Relief Initiative", March 2006

[17] Jubilee Debt Campaign, p. 2

[18] The World Bank, Online Database External Debt.

[19] Moss, Todd, p. 11

[20] idem, p. 10

[21] UN, Recent developments in external debt, Report of the Secretary General (A/61/152) 14 July 2006