IV

The IMF and Low-Income Countries

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Policies for Development: From Structural Adjustment to Poverty Reduction and Growth

A world where some live in comfort and plenty, while half of the human race lives on less than $2 a day, is neither just nor stable. Including all of the world's poor in an expanding circle of development—and opportunity—is a moral imperative.

George W. Bush
President of the United States
September, 2002

I see the thrust of the IMF's role in two major directions; first to ensure the smooth functioning of the international financial system and avoid financial crises, and second, assist low-income countries in fighting poverty and in integrating into the world economy. In this regard, I welcome the many initiatives that are underway.

Trevor A. Manuel[1]
Finance Minister of South Africa
September 26, 1999

The IMF was not designed as a development agency, nor does its mandate include the provision of development assistance. The Fund does, however, have as one of its purposes to "facilitate the expansion and balanced growth of international trade, and contribute thereby . . . to the development of the productive resources of all members."[2] From the beginning of its work with its member countries in 1946, the Fund has had to find the right balance between limiting its focus to macroeconomics and international finance and ensuring that this focus contributes to economic growth and sustainable development.

This balance is nowhere more delicately poised than in the Fund's relations with low-income countries. They primarily need external financial support for development in the form of grants or heavily subsidized long-term loans. Such support typically

[1]Statement to the Interim Committee (September 26, 1999); accessed at http://www.imf.org/external/am/1999/icstate/zaf.htm.

[2]IMF Articles of Agreement I(ii).

comes from the development agencies of wealthy countries ("bilateral" aid) and from multilateral agencies such as the World Bank and regional development banks. The IMF's role is to assist recipient countries to establish economic conditions that will optimize their ability to put development aid to good use and increase their ability to develop economically. In that context, a clean division between sound finance, a stable macroeconomy, and a sustainable international payments position on the one hand, and sustainable economic development and poverty reduction on the other, is neither logical nor possible. Poor countries cannot grow without stable economic foundations, and they cannot stabilize their economies for long without the means to develop.

At the outset, the Fund took the view that countries should borrow from it only to satisfy an immediate and very short-term balance of payments need arising from a shortage of the currency being borrowed. When Ethiopia—one of the world's least-developed countries—made the first request by any member to borrow from the Fund, in April 1947, the Executive Board reacted skeptically. Several Directors suspected that Ethiopia's need for dollars was neither immediate nor so temporary as to qualify for an IMF loan. The Board tabled the request pending further justification, and the matter lapsed.[3]

In the 1960s and 1970s, the number of low-income member countries in the IMF grew rapidly as a consequence of the end of the era of colonial rule. In response, the Fund established a number of special facilities open to all members but designed primarily to assist low-income and other developing countries. These innovations included the Compensatory Financing Facility in 1963, the Buffer Stock Financing Facility in 1969, the Extended Fund Facility (EFF) in 1974, the Oil Facility Subsidy Account in 1975, and the Trust Fund in 1976. These facilities were tailored to the needs of the poor—in some cases, by providing longer-term, less expensive loans; in others, by helping to cover the costs of the kinds of temporary shocks that hit poor countries the hardest. Although they certainly helped within their own narrow confines, the total impact of these facilities on financial stabilization, not to mention economic development, was limited.

In the 1980s, the IMF made a more concentrated and sustained effort to direct its work toward the needs of its low-income members, which by then totaled about 80 countries, or more than 40 percent of the membership. At first, this effort included softening the policy conditions on loans to countries that lacked the ability to carry out fully articulated reform programs. By the middle of the decade, this easing, which had been at least partly unintentional, was clearly only prolonging the structural adjustments these countries needed to undertake. More fundamentally, many low-income countries found themselves excessively burdened with external debt. Loans from the Fund were, in most cases, a very small part of the total, but lending to the poor on the same financial terms as to middle-income countries no longer seemed reasonable. Beginning in 1986, the Fund commenced lending through a new program, the Structural

[3]Minutes of Executive Board meetings 162 and 163 (April 23 and 24, 1947). Also see Horsefield (1969), pp. 189–90.

Adjustment Facility (SAF). In 1987, the SAF was supplemented by the Enhanced SAF, or ESAF. These new facilities not only made long-term, low-interest loans—they also were designed to support structural reform agendas suited to the needs of the poor.[4]

By 1990, the IMF's commitment to deep and broad engagement with low-income countries and to reducing poverty throughout the world was well established. In a report to the Development Committee that year, the staff elevated this commitment to a central principle:

> The primary role of the Fund is to promote, through its bilateral and multilateral surveillance, technical assistance, and financial support, sustainable growth of output and employment in its member countries and an open system of international trade and payments, thus helping create the conditions for lasting poverty reduction.[5]

To achieve that objective, the report pledged the institution to address the causes of poverty, including by

> efforts to . . . encourage member countries to . . . introduce targeted expenditures and social safety nets where necessary; . . . and, in consultation with the [World] Bank, catalyze external financial assistance for economic programs, in particular, for well-designed measures to mitigate any short-run adverse impact of such programs on the poor.[6]

For the next several years, the Fund devoted considerable effort to ensuring that Fund-supported programs included such mitigation measures wherever possible, although its ability to do so was circumscribed by its mandate and expertise in this area. If the authorities resisted targeting the poor in their expenditure choices, the Fund had little authority to force the issue. Moreover, the World Bank clearly had the lead role in advising countries on poverty-related structural policies. Within those limits, the Fund continued to press governments to take the issue seriously, and by mid-decade the staff believed it was making major progress.[7]

Meanwhile, hard questions were being raised, both inside and outside the institution, about the effectiveness of the SAF and the ESAF. Were they large enough and properly designed to serve their intended clientele? Were the policy conditions, with a heavy emphasis on a kind of structural adjustment perceived as emanating from Washington more than from the developing world, appropriate for this purpose? Was

[4]These developments in the 1980s are covered in Boughton (2001), Chapter 14. A major part of the rationale for lending to low-income countries through special trust funds such as the ESAF was that the IMF's Articles of Agreement do not permit differential pricing for the use of the Fund's general resources based on a country's income level.

[5]"Strategies for the Effective Reduction of Poverty in the 1990s," EB/CW/DC/90/9 (August 10, 1990), p. 7.

[6]"Strategies for the Effective Reduction of Poverty in the 1990s," EB/CW/DC/90/9 (August 10, 1990), p. 8.

[7]See "Social Safety Nets in Economic Reform," EBS/93/34 (March 4, 1993); minutes of EBM/93/79 (June 2, 1993), at which that paper was discussed; and "Social Dimensions of the IMF's Policy Dialogue," SM/95/13 (January 19, 1995). For a longer-term analysis of the early evolution of the Fund's work on poverty issues, see Bernstein and Boughton (1993); and Boughton (2001), pp. 687–701.

the IMF the right agency to be operating these facilities? As the decade progressed, the Fund responded in ways that deepened and broadened its involvement still further. By 1999, although the questions and the attacks continued, not least from a host of nongovernmental organizations (NGOs) working in low-income countries, it did not seem so unusual for the finance minister of South Africa to state that to "assist low-income countries in fighting poverty and in integrating into the world economy" was a fundamental function for the IMF.

This chapter recounts the ways in which the IMF's role expanded in the 1990s, focusing on four dimensions in particular. First, the ESAF was transformed from a modestly sized temporary lending window into a permanent and much larger fund. Second, the goal of ESAF lending was expanded to make sustained economic development and the reduction of poverty a more explicit and central target. Third, at mid-decade the IMF accepted that it should participate actively in a coordinated effort to reduce the debt burdens of the most heavily indebted poor countries. Fourth, the Fund engaged in innovative techniques to raise funds for these activities at a time when major creditor countries were reluctant to tap their own national budgets. In addition to these programs directed specifically at low-income countries, the Fund introduced or expanded other programs that benefited these countries principally though not exclusively. Those programs, including postconflict assistance and natural disaster relief, are discussed in Chapter 5.

Evolution of Concessional Lending

As a lending institution, the IMF was designed to enable it to charge interest rates that would cover its expenses, including both its cost of funds and its administrative budget. Although not subsidized, those rates typically were below market rates for most borrowers, because the IMF was not a profit-seeking institution and because its central role in the international financial system conferred a low risk of incurring losses. Even so, for many low-income countries, the Fund's standard rate of charge was still so high that their debt-service obligations could severely squeeze government budgets. Moreover, a basic sense of fairness dictated that the poorest countries should not be expected to pay as much as those with more advanced economies. Consequently, in the mid-1970s the IMF began looking for ways to reduce interest charges and other terms for its poorest members to very low ("concessional") levels.[8]

[8]In general, "concessional" refers to any loan on terms more favorable than commercial terms. In the IMF context, it refers to lending on terms (interest rate, maturity, and grace period on repayments) that are more favorable than those available to all members. In analyses of official development assistance, lending is considered concessional only if it is more favorable by a specified margin, which in the period covered here was generally 35 percent. That margin is often referred to as a "grant element"; that is, any concessional loan is equivalent to a weighted average of a grant and a loan on commercial terms. As long as the weight on the imputed grant element is at least 35 percent, then the loan qualifies as concessional.

By selling a portion of its gold holdings and soliciting contributions from donor countries, the IMF established pools of resources that could be lent to low-income countries on concessional terms or used to subsidize the interest charges on conventional loans. That shift began with the creation of a subsidy account for the Oil Facility in 1975 and continued on a much larger scale with the establishment of the Trust Fund, through which the IMF made concessional loans from 1977 through 1981. Both of those facilities entailed relatively light conditionality as well as low cost.

The IMF reinvested reflows from Trust Fund loans in a new account that funded the SAF, which began operations in 1986. When Michel Camdessus became Managing Director in 1987, he initiated a drive to raise more funds for this purpose from donors and creditors. Those funds effectively tripled the resources available for concessional lending and enabled the Fund to establish the ESAF later that year.[9] The SAF continued the low-cost structure of the Trust Fund, but it reintroduced policy conditionality similar to but less formal than that of arrangements financed through the IMF's General Resources Account (GRA). ESAF conditionality was similar to that for EFF arrangements.

When the ESAF began operations in 1988, 62 countries were deemed eligible to borrow from it. Of those, the two largest—China and India, together accounting for more than half of the total quota of the group—indicated from the outset that they did not intend to draw on the facility because they wanted to leave enough money for the rest. In the early 1990s, the Fund decided it could expand the pool of eligible countries without spreading the available funds too thinly.

The primary criterion for ESAF eligibility was the World Bank's determination that the country's per capita income and lack of access to other sources of external finance made it eligible for concessional loans from the International Development Association (IDA) of the World Bank Group. The IMF Executive Board, however, retained the right to depart from the Bank's list at any time. Over time, the Fund's list grew to 80 (Table 13.1), including several countries not eligible for purely concessional World Bank loans. About half of the countries on the list were in Africa, but the geographic diversity of the rest illustrates the continued ubiquity of extreme poverty at the end of the second millennium.

The big push to lengthen the list came in 1992, when the Fund added 11 countries. Two of those (Albania and Mongolia) were new members of the Fund. The others were granted eligibility as part of a general effort by the Fund to include countries that had been near the borderline in the 1980s and whose economic conditions were similar to countries already on the list.[10] A second group of new members, all from the former Soviet Union, was added in December 1993. A few more countries were added in the next three years. Cameroon and the Republic of Congo were made eligible after the devaluation of the CFA franc (see Chapter 14). Near the end of the decade, the Fund

[9]These developments are described in more detail in Boughton (2001), Chapter 14.

[10]See "Expansion of SAF/ESAF Eligibility," EBS/92/22 (February 11, 1992).

Table 13.1. Low-Income Countries: Members Eligible for ESAF Loans in the 1990s

Country	Added	Country	Added
Africa (42 countries)		Middle East and Central Asia (8 countries)	
Angola	4/7/1992	*Afghanistan*	
Benin		**Armenia**	12/15/1993
Burkina Faso		**Azerbaijan**	5/30/1995
Burundi		**Georgia**	12/15/1993
Cameroon	2/23/1994	**Kyrgyz Republic**	12/15/1993
Cape Verde		Pakistan	
Central African Rep.		**Tajikistan**	12/15/1993
Chad		Yemen, Rep. of	
Comoros		Other Asia (18 countries)	
Congo, Dem. Rep. of		Bangladesh	
Congo, Rep. of	5/30/1995	*Bhutan*	
Côte d'Ivoire	4/7/1992	Cambodia	
Djibouti		*China*[b]	
Egypt	4/7/1992	*India*[b]	
Equatorial Guinea		*Kiribati*	
Eritrea	1/5/1995	Lao PDR	
Ethiopia		*Maldives*	
Gambia, The		**Mongolia**	4/7/1992
Ghana		*Myanmar*	
Guinea		Nepal	
Guinea-Bissau		Philippines[c]	4/7/1992
Kenya		*Samoa*	
Lesotho		*Solomon Islands*	
Liberia[a]		Sri Lanka	
Madagascar		*Tonga*	
Malawi		*Vanuatu*	
Mali		Vietnam	
Mauritania		Europe (4 countries)	
Mozambique		**Albania**	4/7/1992
Niger		***Bosnia and Herzegovina***	8/19/1996
Nigeria	4/7/1992	**Macedonia, FYR**	2/23/1994
Rwanda		**Moldova**	3/23/1999
São Tomé and Príncipe		Western Hemisphere (11 countries)	
Senegal		Bolivia	
Sierra Leone		Dominica	
Somalia		*Dominican Republic*[c]	4/7/1992
Sudan[a]		Grenada	
Tanzania		Guyana	
Togo		Haiti	
Uganda		Honduras	4/7/1992
Zambia		Nicaragua	4/7/1992
Zimbabwe	4/7/1992	*St. Kitts and Nevis*[c]	
		St. Lucia	
		St. Vincent and the Grenadines	

Source: IMF staff reports.

Note: Countries listed in bold type were new members in the 1990s. Those shown in italics did not have a SAF or ESAF arrangement in the period through 1999.

[a]Ineligible owing to arrears to the IMF.

[b]Volunteered to forgo borrowing.

[c]Removed on December 26, 1995, after recording increases in per capita incomes.

added Moldova to the list after a sizeable downward adjustment in the estimate of its per capita income.

The good economic growth of a few countries prompted the Fund to remove them from the ESAF eligibility list. The Philippines was added in February 1992, even though it was already strengthening its economy and regaining market access (see Chapter 12). At the time, it was borrowing through the GRA under a stand-by arrangement, which expired in March 1993. In 1994, although it could have borrowed from the ESAF, it chose to request an EFF arrangement and borrow on nonconcessional terms. Similarly, not long after the Dominican Republic was added in 1992, it underwent a strong economic recovery driven by the completion of a debt-restructuring agreement with commercial bank creditors and implementation of a GRA-supported adjustment program. Per capita income increased sufficiently to put it well above the threshold again. In December 1995, the Fund graduated those two countries and the small island country of St. Kitts and Nevis, none of which had ever borrowed from the SAF or the ESAF.[11]

The Original Temporary ESAF, 1987–93

In the late 1980s, the structural adjustment facilities got off to a slow start. The SAF, although popular with borrowers because of the relatively light policy conditions attached to its use, had limited resources. The ESAF offered larger loans, but it imposed more daunting hurdles in that countries had to meet upper-credit-tranche conditionality similar to that in the nonconcessional EFF. The staff was reluctant to recommend approval of weak programs, while countries were reluctant to subject themselves to the tough conditions. Moreover, other official creditors that linked their approval to implementation of an IMF-supported program, including the World Bank and the Paris Club, were usually satisfied if a country had a SAF-supported program. Given that qualifying for ESAF assistance seemed unlikely to catalyze any more outside financial support than the less stringent SAF, the authorities in many eligible countries considered the extra effort scarcely worthwhile.[12]

For a time, it looked as if the extra effort really was not worthwhile. A 1990 staff review of the SAF and ESAF found that many of the countries that had completed SAF-supported programs had fallen short of program targets for inflation control and external balance. Those same countries, however, had shown somewhat larger increases in economic growth than other low-income countries. If an economy could grow well with a relatively weak effort, why should the authorities subject themselves

[11]See "ESAF Eligibility—Dominican Republic, Philippines, and St. Kitts and Nevis," EBS/95/207 (December 5, 1995); and Decision No. 11181-(96/1) SAF, adopted December 26, 1995.

[12]"Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)—Review of Operations," EBS/90/106 (June 12, 1990), pp. 3 and 6.

to more stringent conditions? The staff view was that this good growth performance, which covered just a few years, would not be sustained without a stepped-up commitment to sound policies and the more intensive monitoring embodied in the ESAF.[13]

The IMF thus faced three interrelated challenges at the beginning of the 1990s for making its lending to low-income countries more effective. First, more countries needed to have strong enough policies to qualify for ESAF rather than just SAF support. That would make larger loans available to them—but first they would have to strengthen their economic policy programs. Second, the staff was looking for ways to reduce the qualification hurdles by making the facility more flexible and accessible. Third, the Fund had to attract more contributions to the ESAF so that countries qualifying for support from the facility could get greater access over a longer period.

The original intent of the ESAF was that it would be a temporary facility through which an eligible country could borrow under one three-year program and the Fund would complete all of its commitments within two years of the establishment of the trust. The access limit was set rather low in relation to each country's quota, on the assumption that most eligible countries would draw on the facility and the available money would therefore have to be stretched over a large number of borrowers. Repeat arrangements would be impractical, not only because the IMF had never had a mandate to provide continuing long-term financing but also because much of the donor financing for the ESAF was provided only for a fixed period. As a result, and even though the sunset clause had already been extended by a year, in 1990 management was trying to get approval for as many arrangements as possible before the November deadline. When it became apparent that the difficulty of getting agreements on programs to be supported by the ESAF was making this deadline unrealistic, the Executive Board extended the cutoff date repeatedly, first to November 1992, then for another two years,[14] until ultimately the ESAF could be converted into a permanent ("self-sustaining") facility.[15]

The first country to get an extension beyond the original three-year commitment was Bolivia. Its ESAF arrangement was approved in July 1988 and was later extended from its original expiration of July 1991, initially to mid-1992.[16] That extension, though, was not a fourth annual arrangement, just a delay in completion of the third year's program. On June 12, 1992, the Executive Board agreed in principle to consider

[13]"Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)—Review of Operations." EBS/90/106 (June 12, 1990), pp. 9–12.

[14]The cutoff dates refer to the deadline for the IMF's approval of an ESAF arrangement. For an arrangement approved on November 30, 1989 (the original cutoff date), disbursements could be made up to November 30, 1992. The principal outstanding would be amortized over a 10-year maturity, or potentially through November 2002.

[15]Self-sustaining meant that the ESAF Trust would have sufficient resources to lend a specified amount of money on a continuing basis, based on the availability of committed funds and assuming full and timely repayments from borrowers.

[16]For the history of relations with Bolivia in the 1980s, see Boughton (2001), pp. 484–90.

a fourth annual arrangement, which was approved on September 11, 1992, extending the arrangement to September 1993.[17] When it was about to expire, the Board extended the "fourth year" to May 1994, nearly six years after the arrangement's initial approval. A new ESAF arrangement succeeded it in December 1994. That arrangement also was extended until finally expiring in September 1998. Bolivia was granted a third arrangement, scheduled to run from September 1998 through September 2001 but later extended to June 2002. Finally, a fourth consecutive arrangement ran from April 2003 to March 2006, the only one in the series that was completed successfully and on time.

In all, Bolivia had virtually continuous ESAF support for 18 years. Although longer than for most other countries, this experience illustrates the difficulty many low-income countries faced in achieving a sustainable payments position.[18] In 1992, however, the Fund was still hoping to phase out its practice of offering long-term loans on concessional terms.

The Successor ESAF, 1994–96

When the major donor countries realized that many low-income countries were going to need both concessional support and externally monitored adjustment and reform programs for extended periods, they asked the Fund to explore ways to extend the life of the ESAF substantially.[19] Most people working on the issue in the Fund did not yet think that a permanent ESAF was either appropriate or necessary. Although financial viability remained a distant dream for many of the poorest countries, the staff calculated in 1993 that a multiyear extension of the ESAF could eventually make that dream a reality for most, after which the facility could be shut down and lenders to the trust could be repaid.[20]

Consideration of whether to keep extending the life of the ESAF hinged on two key questions. Was the facility working well and achieving its objectives? And was it

[17]In the terminology used by the Fund, an ESAF "arrangement" referred both to the overall (normally three-year) commitment to provide loans, conditional on the country satisfying the specified terms, and to each annual commitment and its associated conditions.

[18]The longest-running series of ESAF arrangements was for Mauritania, which had its first arrangement approved in May 1989 and then had nearly continuous arrangements running through 2009.

[19]"We call for an early decision by the IMF on the extension for one year of the Enhanced Structural Adjustment Facility and for the full examination of options for the subsequent period, including a renewal of the facility"; Economic Declaration of the G7 Summit at Munich (July 6–8, 1992), paragraph 20; accessed at http://www.g7.utoronto.ca/summit/1992munich/communique/index.html.

[20]The language chosen by the staff to express this hope was circumspect, but the meaning was plain: "There is, thus, a real need and opportunity to continue and accelerate the process of structural reform and macroeconomic adjustment which, together with continued concessional assistance and related debt relief, could be expected to accelerate countries' progress toward external viability"; "Operational Modalities and Funding Alternatives for an ESAF Successor—Preliminary Considerations," EBS/93/32 (February 26, 1993), p. 11.

appropriate for the IMF to lend repeatedly to countries that were far from being able to manage on their own, effectively turning the Fund into a provider of financing for development purposes?

The staff's own review of the ESAF in 1993 showed that the facility was working—most countries with ESAF-supported programs were seeing higher growth in exports and output with less price inflation than were other low-income countries. On the whole, they were receiving above-average increases in official development aid and were showing progress in liberalizing economic policies. About half of the 19 ESAF-supported countries were making headway toward achieving external financial viability, although none had yet met that goal (Schadler and others, 1993, pp. 22–29). These achievements, though modest, were nonetheless impressive because of the daunting initial conditions. These countries were among the least developed in the world, and global market conditions had worsened substantially during the period being reviewed by the staff.

This distinction between making progress toward external viability and actually achieving it differentiated the ESAF from the IMF's other longer-term facility, the EFF. The latter, funded by the IMF's general resources, was available to all members and did not make concessional loans, but the conditions on its use were otherwise similar to those of the ESAF. The distinction was that most countries eligible for concessional loans were heavily in debt; had very high external debt-service obligations in relation to export revenues; and were able to avoid default only by having recurring recourse to "exceptional financing," such as debt cancellations or rescheduling agreements. Even if they faithfully carried out an adjustment and reform program equal to one typically expected of a middle-income borrower, expecting them to stabilize the debt burden and escape from reliance on exceptional financing within the three-year term of a Fund-supported arrangement was not realistic. Hence the ESAF, in contrast to the EFF, required only that the applicant's program be designed to result in an expectation of progress toward viability.[21]

Although the second question—whether an ongoing ESAF was an appropriate activity for the IMF—was handled primarily as a normative and political issue, the inherent contradictions in the original design of the facility complicated the issue. If the eligible countries were not expected to achieve external viability by the end of a three-year arrangement, then the Fund could not reasonably expect to cut them off from ESAF support after one arrangement. Logic dictated the need for a quasi-permanent facility, but two obstacles intervened. First, donors and lenders to the ESAF Trust were not yet prepared to provide enough resources to fund it on an ongoing basis. Second, some major creditor countries were skeptical that the IMF—rather than an aid agency such as the World Bank—was the right organization to host such a facility.

[21]See remarks by Jack Boorman (Director, Policy Development and Review Department) at EBM/93/46 (April 2, 1993), p. 7.

Notwithstanding these concerns, by the time the Executive Board began to debate whether and how to establish a successor facility, the idea already had a strong political tailwind. The endorsement of a continuation by the Group of Seven (G7) summit in 1992 (see above, footnote 19) was accepted by most Directors as an *obiter dictum*. Although one G7 Director (Bernd Esdar, Alternate for Germany) stated in March 1993 that his authorities had "not yet come to a final conclusion," other skeptical Directors acknowledged that "the political decisions on having an ESAF successor have already been taken" (Godert A. Posthumus, the Netherlands).[22]

The real issue, then, was not whether to continue ESAF lending, but the way in which it should be structured and financed. After some debate, the Board decided to rely mostly on a new appeal to donors to contribute larger amounts of money and for an extended period. In addition, agreement was reached that the Fund would end the practice of supplementing ESAF arrangements with SAF arrangements. Instead, part of the balance in the account funding the SAF would be transferred to the ESAF Trust. A residual had to be retained to enable SAF loans to two countries—Sierra Leone and Zambia—that would be eligible once they completed Rights Accumulation Programs and cleared their arrears to the Fund (see Chapter 16). In the long run, all SAF resources were to be transferred to the ESAF Trust.[23] With this change, the Fund quietly ended the practice of having a relatively lightly conditioned facility to accommodate the needs of countries that could not yet qualify for ESAF support.

The successor ESAF took effect on February 23, 1994. With about $6.4 billion (SDR 4.5 billion) in assets, it was roughly 40 percent larger than the original ESAF. It would make loans on exactly the same terms, and it remained a temporary facility. The decision establishing it set a deadline of end-1996 for loan commitments and end-1999 for disbursements. The decision also implicitly enabled the Fund to approve a second three-year ESAF arrangement for any country that had already completed one under the original facility, but the intention remained that each country would have no more than one such arrangement under the successor.[24] Within a year, however, Camdessus had the staff exploring ways to create a permanent ESAF.

The "Permanent" ESAF, 1996–99

Initially, both the staff and the Executive Board balked at the Managing Director's suggestion to make the ESAF permanent. A February 1995 staff paper on the debt

[22]Minutes of EBM/93/33 (March 12, 1993), pp. 8 (Esdar) and 46 (Posthumus).

[23]See "ESAF Successor—Modalities and Proposed Decisions for Extension and Enlargement of the ESAF Trust," EBS/93/183 (November 19, 1993); and minutes of EBM/93/162 (November 29, 1993). The main decisions were made at EBM/93/170 (December 15, 1993), conditional on the completion of financing arrangements and approval by ESAF creditors.

[24]The first country to be granted a second full ESAF arrangement was Guyana. Its first arrangement was approved in July 1990 and completed in December 1993 after a brief extension. A new three-year arrangement under the successor facility was approved in July 1994.

service prospects for heavily indebted poor countries concluded that IMF financing on concessional terms "will continue to be required, though, as in the past, the Fund should not be expected to provide such financing on a continuous basis for individual countries or the group as a whole." The staff acknowledged that most of these countries would need further recourse to ESAF loans, but probably not beyond the end of the decade.[25]

The argument that led to this optimistic conclusion was constructed with some weak materials. One was an assumption that the generosity of bilateral assistance to low-income countries would not diminish and that bilateral debt forgiveness would be available on Naples terms (67 percent reduction in net present value). Another was that a favorable combination of economic policies and external market conditions would permit a steady rise in export revenues for low-income countries. When the Executive Board discussed the staff paper, many donor countries cited their own budget problems, indicating they would be hard-pressed to avoid shortfalls in development assistance. Directors also expressed skepticism about the projected growth in exports by low-income countries. At the outset of the Board meeting, Huw Evans (United Kingdom) set the tone by declaring, "It is not prudent to base policy upon such a combination of favorable outcomes. My conclusion is that, for this group of heavily indebted poor countries, there is significant evidence of difficulty in servicing multilateral debts; and that policies need to be developed to alleviate these difficulties."[26]

Evans and several other Directors favored making the ESAF permanent, but the Board as a whole was not yet prepared to take such a step. The majority view was that "it remained appropriate for the Fund to extend [loans on ESAF terms], while respecting the revolving character of our resources and the monetary character of our institution."[27] In other words, the Fund was prepared to extend the ESAF by a few more years, but it still expected that most eligible borrowers would be able to graduate from dependence on it early in the next decade.

As discussed in the "Heavily Indebted Poor Countries Initiative" section of this chapter, the credibility of this optimistic view and the wisdom of the Fund's silo approach to its own role—its insistence on protecting its "monetary character"—came under increasingly severe attack in the course of 1995, especially from NGOs. By the time of the IMF/World Bank Annual Meetings in the fall, the Fund had come to accept that it should participate in an initiative to reduce the debt burdens of those heavily indebted poor countries that were demonstrating willingness and an ability to carry out strong economic policies over a multiyear period. To make that participation feasible, the Fund would have to keep the ESAF operating into the foreseeable future.

[25]"Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries – Preliminary Considerations," SM/95/29 (February 7, 1995). The quotation is from p. 17.

[26]Minutes of EBM/95/19 (February 24, 1995), p. 10.

[27]Summing Up by the Chairman, EBM/95/19 (February 24, 1995), p. 62.

After a year of debate focusing primarily on ways to finance the Fund's involvement, Camdessus sketched out a proposal under which ESAF lending would continue at least through 2004, financed mostly by bilateral contributions to the ESAF Trust Subsidy Account. With this compromise, the sunset clause would be extended by several years but would not be eliminated. If, by 2004, most eligible countries could be judged not to need ESAF financing any longer, the facility could be allowed to lapse. If not, the staff calculated that the total projected assets in the trust, including repayments of earlier loans, should enable the Fund to establish a permanent, self-sustaining ESAF at that time.[28]

From the ESAF to the Poverty Reduction and Growth Facility, 1999

As soon as the quasi-permanent ESAF was in place, the Fund undertook to evaluate more thoroughly the facility's achievements. Was it helping countries gain financial independence and sustainable growth? How could it be improved? The staff completed an internal study in 1997, and an external panel conducted an intensive independent analysis. The Executive Board discussed both reports, after which the staff prepared a distillation of the major findings and made recommendations for change.[29]

In addition to several recommendations to improve the Fund's policy advice and conditionality in ESAF-supported programs, these reviews highlighted a general weakness in program ownership and commitment by national authorities. The internal review reported that 28 out of 36 countries that had undertaken ESAF-supported reform programs had failed to complete the process within or close to the originally scheduled three-year period. It attributed these "significant interruptions" mainly to "factors outside the IMF's control—that is, major political upheavals . . . and flagging commitment" by the authorities (Schadler, 1997, p. 45). The subsequent external review, however, found that a major part of the problem arose from the way the staff was interacting with national authorities in low-income countries.

In principle, policy strategies were supposed to be devised jointly and cooperatively by the authorities of the country and the staffs of the IMF and the World Bank. In practice, in the belief that it was the only way to get agreement on a viable program,

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[28]Minutes of EBM/96/58 (June 19, 1996), and "Financing a Continuation of the ESAF and the Fund's Participation in the HIPC Initiative," EBS/96/133 (August 23, 1996). On December 9, 1996, the Executive Board formally adopted a slightly modified proposal to extend the commitment period through 2000, so that ESAF lending could continue through 2003; see "Enhanced Structural Adjustment Facility Trust—Extension of Commitment Period," EBS/96/180 (November 26, 1996), and minutes of EBM/96/110 (December 11, 1996), pp. 3–4.

[29]For the published versions of the evaluation studies, see Schadler (1997) and IMF (1998). The head of the external review committee that prepared the core of the latter report was Kwesi Botchwey (former finance minister of Ghana). Also see "Distilling the Lessons from the ESAF Reviews" (July 1998); accessed at http://www.imf.org/external/pubs/ft/distill/index.HTM.

the IMF staff often took the heavy-handed tactic of preparing a draft program in Washington and then discussing possible modifications with the authorities. The resulting strategy was embodied in a Policy Framework Paper (PFP) intended to present the country's own views. ESAF lending by the Fund and associated concessional lending by the World Bank were supposed to serve the country's goals expressed in the PFP. The external review found, however, that officials in low-income countries had become thoroughly disillusioned with a process that had been initiated with such promise a decade earlier:

> The predominant view is that . . . [preparation of] the PFP . . . has become a rather routine process whereby the Fund brings uniform drafts (with spaces to be filled in) from Washington, in which even matters of language and form are cast in colorless stone. . . . Many interviewees . . . found this atrophying of the PFP process to be particularly regrettable. (IMF, 1998, p. 36)

The most serious implication of this deterioration was that it tended to undermine the domestic political process through which policies should normally be formulated. To the extent that the government was agreeing to do whatever was necessary to satisfy the IMF's requirements for approving the ESAF arrangement, domestic political support for taking difficult measures was unlikely to be forthcoming, and the government was unlikely to have any real commitment to work on the task. Generating effective development strategies in ways that would lead national authorities and citizens to own them and take responsibility for them thus became a central theme of the effort to improve the track record of the ESAF.

Meanwhile, the World Bank was moving in the same direction. The President of the Bank Group, James D. Wolfensohn, averred in his Annual Meetings speech in 1998 that "we need a new development framework . . . that is not imposed by us on our clients but developed by them with our help."[30] To that end, the Bank committed itself to assisting each of its borrowing countries to prepare a Comprehensive Development Framework to define the country's development goals and the broad strategy it intended to adopt to achieve those goals.

These deliberations in the Fund and the Bank resulted in a decision to scrap PFPs altogether and to replace them with Poverty Reduction Strategy Papers (PRSPs). Whereas PFPs had been closely linked to the design of ESAF-supported programs, PRSPs would be broader, more comprehensive, and more linked to countries' development plans. The Executive Boards of both institutions would review each PRSP as an essential step preceding approval of loans on concessional terms. In proposing this initiative, the staffs of the Fund and the Bank stressed that each PRSP

> must be produced in a way that includes transparency and broad-based participation in the choice of goals, the formulation of policies and the monitoring of

[30] "The Other Crisis," address to the Board of Governors, Washington, DC, October 6, 1998; accessed at http://go.worldbank.org/UW7XZSD3K0.

> implementation—with ultimate ownership by the government. . . . Governments would be expected to take the lead both in drawing up a PRSP and in conducting consultations with civil society and other stakeholders.[31]

The decision to replace the PFP with the PRSP was more momentous than it might at first appear in that it accelerated an ongoing process of institutional evolution. For several years, the IMF had been taking small but decisive steps toward opening itself up to the outside world. Staff consultation missions were now meeting routinely with a wide array of government agencies and civil society, not just with finance officials. As discussed in Chapter 4, the Fund's archives were now open to outside researchers, and its website was becoming its most prominent means of disseminating information as widely as possible. To insist that low-income countries applying for loans must take the lead in preparing their own policy strategies and that they must do so through a participatory process with their own citizens was a natural but much greater next step. If pursued diligently and aggressively, it would mark a real break with the old ways of interaction between the Fund and its less-developed members.[32]

Improving the ESAF would do little good unless enough money could be raised from donor and creditor countries to finance a continuation of operations. The facility was still expected to begin running out of money near the end of the decade. As that date approached, staff and management intensified their efforts to raise additional funds. As discussed below, that endeavor required some fancy financial engineering as well as lobbying, but it eventually succeeded. By the fall of 1999, the IMF finally had—for the first time in its history—a permanent, self-sustaining facility offering concessional loans and grants to low-income countries.[33]

Endorsing the establishment of a permanent facility, the Interim Committee stressed that it did not want business as usual. Going forward, Fund-supported programs in low-income countries were to aim to promote economic and social development much more proactively than in the past:

> The cornerstones of the new approach, which should continue to be based on sound macroeconomic policies, are as follows:
>
> - A comprehensive Poverty Reduction Strategy Paper (PRSP) will be prepared by each country, with assistance from the World Bank and the IMF, and with strong country ownership based on public partnership, to guide the design of programs; the PRSP will need the approval of both Bank and Fund Boards.

[31]"HIPC Initiative—Strengthening the Link Between Debt Relief and Poverty Reduction," EBS/99/168 (August 26, 1999), p. 30.

[32]For an early assessment of the way this interaction process worked, see Robb and Scott (2001).

[33]Loans were provided through the ESAF; grants, through the HIPC Initiative. Whether the facility would really be self-sustaining would depend on the demand for loans. As envisaged in 1999, in the long run the trust would be able to lend about SDR 800 million a year. Larger operations would require additional resources; see "Update on Steps to Secure the Financing for the Continuation of the ESAF and the HIPC Initiative," EBS/99/143 (August 2, 1999), pp. 7–8.

- Social and sectoral programs aimed at poverty reduction will be taken fully into account in the design of economic policies for promoting faster sustainable growth.
- Greater emphasis will be accorded to good governance, in particular in all government activities, through greater transparency, effective monitoring procedures, anti-corruption initiatives, accountability, and the involvement of all sectors of society.
- High priority will be accorded to key reform measures critical to achieving governments' social goals.[34]

Through September 1999, discussions for this permanent facility used the same title as for the previous 12 years: the Enhanced Structural Adjustment Facility. In the course of trying to drum up contributions, however, Camdessus learned that a number of potential donors felt that the emphasis on "structural adjustment" was a political liability, making it difficult for them to support it. Consequently, he asked the Executive Board not only to expand the explicit purposes of the facility to include the reduction of poverty, but also to rename it accordingly. With uncharacteristic alacrity for a major policy change, the Fund acted on that proposal in less than two weeks. Securing the written approval of all creditors took another month, and on November 22, 1999, the ESAF vanished and was replaced by the Poverty Reduction and Growth Facility (PRGF).

The 1987 decision establishing the ESAF specified that loans from the trust were intended "to support programs to strengthen substantially and in a sustainable manner [low-income developing members'] balance of payments position and to foster growth." The 1999 amendment extended the final phrase to read, "and to foster durable growth, leading to higher living standards and a reduction in poverty." Although the extent to which the design of PRGF-supported programs differed from earlier ESAF-supported programs was hard to measure and was the subject of much dispute, the name change in combination with the advent of the PRSP process marked a turning point in the Fund's relationships with its poorest and least-developed members.[35]

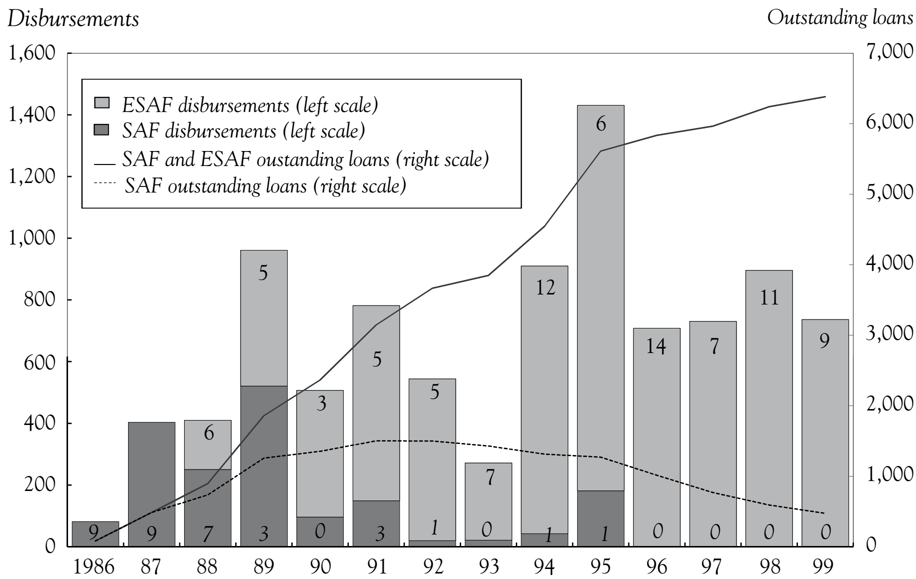
Concessional Lending in the 1990s

As a consequence of the expansion of the ESAF, concessional lending became a more substantial part of the IMF's financial activities in the 1990s (Figure 13.1). From 1986, when SAF lending began, through 1999, 57 countries availed themselves of one or more of the IMF's concessional lending facilities. Of those, 40 had two or more three-year arrangements. From 1997 on, more than half of all IMF lending arrangements in effect were ESAF arrangements. The amounts, however,

[34]Interim Committee communiqué (September 26, 1999), paragraph 5.

[35]The first PRGF loan was to Chad, approved by the Executive Board on January 7, 2000. For an evaluation of the PRGF, see Independent Evaluation Office (2004).

Figure 13.1. Total SAF and ESAF Lending
(In millions of SDRs)



Source: IMF financial accounts.
Note: Numbers at bottom of bars are the number of SAF arrangements approved each year. Numbers at top of bars, if any, are the number of ESAF arrangements approved each year.

remained small relative to the large loans the IMF was making to middle-income, emerging-market countries. At the end of financial year 1999, SAF and ESAF loans outstanding totaled the equivalent of $8.7 billion (SDR 6.4 billion), far below the $82.2 billion (SDR 60.7 billion) in outstanding loans made through stand-by arrangements and other GRA facilities.

Although the majority of ESAF-eligible countries were in sub-Saharan Africa, loans were distributed widely around the world. Of the top ten borrowers in the 1990s (Table 13.2), three were in East Africa (Kenya, Tanzania, and Uganda), two in West Africa (Côte d'Ivoire and Ghana), and one in southern Africa (Zambia). Three were in South Asia (Bangladesh, Sri Lanka, and Pakistan), and one in East Asia (Vietnam). One of the longest program engagements supported by SAF, ESAF, and PRGF lending—continuously from 1986 through 2002—was with Bolivia, in South America.[36]

The largest borrower was Zambia, which drew heavily on both the SAF and the ESAF after it settled its arrears in 1995. Those operations basically replaced Zambia's previous debts to the GRA with longer-term and less expensive obligations (see Chapter 16).

[36]See above, pp. 638–39.

Table 13.2. Top 10 SAF and ESAF Borrowers

Country	Maximum Indebtedness: Millions of SDRs	Maximum Indebtedness: Equivalent Millions of U.S. Dollars	Date Maximum Reached
Zambia	853.4	1,162.9	March 1999
Pakistan	604.5	811.9	April 1998
Bangladesh	534.8	738.2	March 1993
Côte d'Ivoire	457.3	641.2	December 1998
Ghana	429.5	594.7	November 1991
Sri Lanka	427.3	600.0	April 1994
Uganda	294.9	396.1	April 1998
Kenya	277.3	407.9	November 1994
Vietnam	241.6	347.5	December 1996
Tanzania	234.0	319.2	August 1999

Source: IMF financial accounts.

Pakistan borrowed the next largest amount. Throughout the late 1980s and the 1990s, Pakistan was a regular borrower from both the general department and the concessional facilities of the IMF.[37] The Fund's support to the country rose further in 1997 after the election of a new government—led by the Muslim League under Prime Minister Nawaz Sharif—apparently ended a long-simmering political stalemate. That October, the Fund approved an arrangement to support a three-year program of macroeconomic stabilization and comprehensive structural reforms.[38] Despite doubts about the government's ability to carry out the program, the Fund committed more than $1.5 billion (SDR 1,137.3 million) to support it, of which 60 percent was to come from the ESAF Trust. Pakistan's ESAF debt peaked in April 1998 at the end of the first year of that arrangement. Lending was then interrupted for several months as a result of international sanctions responding to a series of test detonations of nuclear devices in May. In addition, the Fund objected to the authorities' insistence on containing capital outflows through exchange controls and a suspension of debt service to external bilateral and commercial creditors. Disbursements resumed in January 1999, but at a lower level, and much of the arrangement was left unused when it expired in October 2000.[39]

[37]For the background to lending to Pakistan in 1988–91, see Boughton (2001), pp. 655–59.

[38]See "Pakistan—Staff Report for the 1997 Article IV Consultation and Request for Arrangements Under the Enhanced Structural Adjustment Facility and the Extended Fund Facility," EBS/97/185 (October 3, 1997); and minutes of EBM/97/104 (October 20, 1997).

[39]On the resumption of lending, see "Pakistan—Staff Report for the 1998 Article IV Consultation, Second Review Under the Extended Arrangement and Request for Waiver of Performance Criteria, Request for the Second Annual Arrangement Under the Enhanced Structural Adjustment Facility, Use of Fund Resources—Request for Purchase Under the Compensatory and Contingency Financing Facility, and Exchange System," EBS/98/231 (December 29, 1998). Pakistan's total indebtedness under the combined arrangement, including both GRA and ESAF obligations, peaked in January 1999 at a level slightly less than $2 billion (SDR 1,405.6 million; 191 percent of the quota that was to take effect the next month). At that time, Pakistan was also completing negotiations for debt-relief agreements with official and commercial creditors (Sturzenegger and Zettelmeyer, 2006, pp. 135–46).

Heavily Indebted Poor Countries Initiative

Debt reduction for heavily indebted developing countries became widely accepted in the late 1980s. At the IMF, as elsewhere, the idea that such countries could grow rapidly enough to service and repay their debts fully had been discredited by 1987. Achieving and sustaining solid growth was not only inherently difficult and time-consuming—time during which the debt continued to accumulate—but if the debt was large enough, its very existence seriously impeded growth. This "debt overhang" discouraged investment and distorted economic incentives. A negotiated reduction in debt was therefore recognized as an integral and unavoidable component of the international debt-management strategy.

From Controversy to Acceptance

The G7 took the first modest step down the path toward debt relief at its summit meeting in Toronto in June 1988, when it agreed to consider debt-service-reduction operations through the Paris Club. Over the next three years, Paris Club creditors used these "Toronto terms" to cancel some $600 million in debt service payments owed by 20 low-income countries.[40]

When the gross insufficiency of the Toronto terms to relieve the excessive debt burdens of the most heavily indebted poor countries (which became known as HIPCs)[41] became clear, the G7 agreed in 1991, at its summit meeting in London, to offer more-generous terms aimed at cutting the net present value of debt repayments by half for qualifying countries. The Paris Club began offering "London terms" to HIPCs that December. When that plan also proved inadequate, the G7 agreed in 1994, at its summit meeting in Naples, to increase the concessionality to 67 percent from 50 percent. Two years later, the target was raised to 80 percent under what became known as the "Lyon terms."[42]

[40]This figure is the reduction in net present value of approximately $6 billion in scheduled debt service payments owed by the 20 countries; see *Annual Report 1992*, p. 41.

[41]The first official use of the acronym HIPC in the Fund was in a joint report by the Fund and the World Bank to the Development Committee in September 1995. The full phrase, "heavily indebted poor countries," was first used in this context by a former Executive Director, Jon Sigurdsson (minister of commerce and industry for Iceland), in a statement to the Interim Committee in April 1993; see minutes of ICMS/MTG/40/93/1 (April 30, 1993), p. 72; and "Progress Report on Multilateral Debt: A Joint Bank/Fund Background Note for the Development Committee," FO/DIS/95/42 (September 27, 1995).

[42]The British government pressed particularly forcefully for improvements on the Toronto terms and its successors throughout the 1990s, beginning with a 1990 proposal for a 67 percent reduction in present values (known as the "Trinidad terms," but not adopted at that time). For more detailed reviews of these developments, see Daseking and Powell (1999); and Rieffel (2003), Chapter 5.

The increasingly generous approach to forgiving bilateral official debt made a substantial difference to the indebted countries, but positive results still depended on improvements in economic performance beyond the reach of many of the world's poorest. Moreover, many of the countries that were beginning to develop more rapidly still faced major problems because they owed a large portion of their external debt to multilateral development banks and to the IMF, not to Paris Club creditors. Until the mid-1990s, multilateral debt was considered "off the table" in discussions of ways to help the HIPCs. No matter how much of their bilateral debt was written off, they were still saddled with more debt than they could afford to repay.

Four reasons were advanced for not considering forgiveness of debts to the IMF:

- First, the multilateral lenders, and the IMF in particular, are de facto preferred creditors. Official bilateral lenders rely on the IMF, with support from the World Bank and regional development banks, to provide primary financial assistance and to ensure that borrowers are using official credits effectively to promote growth and development. Recognizing the importance of this catalytic function, they generally agree to subordinate their own claims. If the IMF were to consider forgiving its own loans, it had to have assurances that its preferred creditor status would be preserved. Forgiving debt to the IMF to enable repayments to bilateral creditors would do little to help the indebted country.
- Second, the financial structure of the IMF generally requires burden sharing between creditor and debtor countries. Unless some means could be found to circumvent that requirement, roughly half of the cost of reducing obligations of low-income countries to the IMF would be borne by other borrowers, many of them nearly as poor as the most heavily indebted.
- Third, the financial assets of the IMF are a revolving fund. Unless the value of the forgiven debt was replenished by contributions from creditor countries, less money would be available for future lending, and the financial integrity of the institution would be threatened.
- Fourth, and most generally, the IMF's greatest concern was that sufficient real resources would flow from rich to poor countries on a continuing basis. If a campaign to forgive debts merely substituted for budgeted new aid funds, then it would have little or no long-run benefits.

The adoption of the Naples terms in 1994 alleviated the first of these objections. If the IMF and the Paris Club could work in tandem to reduce multilateral and bilateral debts, they could ensure that the HIPCs would get the direct benefits, and the Fund's status as a preferred creditor would not be compromised. The problem remained that budgeted bilateral aid—official development assistance (ODA)—was on a declining trend. If creditor countries took advantage of multilateral debt relief by further reducing ODA, the net benefit to the indebted countries could still be nullified. Overcoming that difficulty along with the second and third objections listed above would take a fair bit of ingenuity. Nonetheless, by 1995 the political momentum was shifting favorably because the economic and social imperative of relieving these debts could no longer be overridden.

Throughout the first half of 1995, a massive and widespread public campaign developed to pressure international financial institutions to forgive or at least reduce their claims on poor countries. British NGOs, including Oxfam and Christian Aid, wielded particular influence. Coalitions of northern-hemisphere NGOs formed to lobby for multilateral debt reduction under such banners as the Debt Crisis Network and the Jubilee 2000 Campaign. World religious leaders frequently spoke out about the social evils deriving from excessive debts owed by the very poor. The cumulative effect of this campaign was a heightened awareness of the issue in national legislatures and parliaments, which in turn applied political pressure on countries' representatives in the IMF and other multilateral agencies.

Initially, the staff resisted this pressure because it concluded that only a "very few" HIPCs faced unmanageable multilateral debt burdens. A staff study circulated in February 1995 found that "for all but a very few heavily indebted poor countries, multilateral debt service burdens should be manageable provided new multilateral lending is on appropriately concessional terms and supports, through strong conditionality, a policy framework which generates at least moderate real export growth."[43] Although many on the Executive Board took a dubious view of this optimism, no one disputed the conclusion of Eva Srejber (Sweden): "Any idea of debt forgiveness on behalf of the Fund should be quickly put to rest."[44] As discussed above (p. 642), the Board's focus at that time was on continuing to provide loans on concessional terms, not on forgiving the loans the Fund had already made.

Shortly after that Board meeting, the World Summit for Social Development, held in Copenhagen in March 1995 through the auspices of the United Nations, invited "the international financial institutions to examine innovative approaches to assist low-income countries with a high proportion of multilateral debt, with a view to alleviating their debt burdens."[45] Nonetheless, the Managing Director's April report to the Interim Committee on the ESAF and the HIPC Initiative gave no quarter on multilateral debt relief. Instead, it noted that the Executive Board had concluded the Fund "could best assist [HIPCs] through the continued availability of ESAF resources

[43]"Issues and Developments in Multilateral Debt and Financing for the Heavily Indebted Poor Countries – Preliminary Considerations," SM/95/29 (February 7, 1995), p. 4. The background paper for that conclusion, prepared jointly with World Bank staff, examined the debt burdens of 34 HIPCs in detail. Of those, only eight were projected to have unmanageable debt burdens, and the staffs concluded that even those could be made manageable by shifting some portion of development assistance from concessional multilateral loans to bilateral grants; see "Multilateral Debt of the Heavily Indebted Poor Countries," SM/95/30 (February 9, 1995).

[44]Minutes of EBM/95/19 (February 24, 1995), p. 28.

[45]"Report of the World Summit for Social Development (Copenhagen 6–12 March 1995)," p. 21; accessed at http://www.un.org/documents/ga/conf166/aconf166-9.htm.

on present terms. . . . A few Directors felt that . . . further consideration should be given to the possibility of an extension of maturities."[46]

On a personal level, Camdessus held deep sympathy for the plight of the poor, but he also was determined to preserve the financial strength of the IMF and to continue with the basic strategy of tying financial assistance to improvements in economic policymaking. At the April 1995 meeting of the Development Committee, he implicitly responded to the swelling chorus by asserting that the strategy already in place was sufficient and needed only to be pursued faithfully. For the HIPCs, he stated, "emphasis must be kept on helping them to deal with external debt burdens to the fullest extent possible through attracting foreign direct investment—although this might take time—and through continuation of concessional support in various forms from bilateral and multilateral donors and creditors."[47]

The political balance shifted further in the run-up to the June 1995 summit meeting of G7 countries held in Halifax, Nova Scotia (Canada). The G7 summit concluded that

> measures have to be taken to ensure that the burden of multilateral debt does not impede the growth prospects for the poorest countries. Exit strategies need to be found for countries with particularly high levels of multilateral debt, but with good track records. The IMF and World Bank should take the lead in developing a comprehensive multilateral approach to assist countries with multilateral debt and debt-service ratios above prudent levels in addressing their debt burdens, through the flexible implementation of existing instruments, *and new mechanisms where necessary* [emphasis added].[48]

The initial reaction to that dictum, in both the IMF and the World Bank, was still decidedly negative. Senior officials on both sides of 19th Street believed existing instruments could deal adequately with even the most severely indebted and poorest countries. Moreover, they saw multilateral debt relief as a raid on the institutions' resources by cash-strapped bilateral donors. Such a raid, they believed, would not provide much additional assistance to the poorest countries and would weaken the ability of both institutions to provide ongoing assistance to other developing countries. Soon, however, internal opposition began to soften and then to crumble.

The World Bank's position on multilateral debt relief shifted first, though only a little, not long after Wolfensohn assumed the presidency in June 1995. One of his first acts as President was to travel to Africa, where he met with officials and citizens of five

[46]"Report of the Managing Director to the Interim Committee on Strengthening the Financial Resources of the Fund," ICMS/Doc/44/95/6 (April 21, 1995), p. 12. That section of the report reproduced the Chairman's Summing Up of a Board meeting on the subject held on March 12, the same day the UN summit issued its communiqué.

[47]"Record of Discussion of the Fiftieth Meeting of the Development Committee," DC/95-9 (June 2, 1995), p. 3.

[48]"The Halifax Summit Review of the International Financial Institutions: Background Document," June 16, 1995; accessed at http://www.g7.utoronto.ca/summit/1995halifax/financial/index.html.

countries around the continent. The experience seems to have affected the former investment banker profoundly (Mallaby, 2004). He now believed that multilateral debt relief was essential for at least a dozen of the most affected countries, and he instructed his staff to look for ways to offer that relief. He still insisted, however, that relief should be provided without compromising the Bank's financial principles. In other words, the goal was to provide debt reduction or debt-service reduction (or both) on the Bank's claims without overtly writing down or even rescheduling those claims. To square that circle, the World Bank staff began exploring ways to set up a debt-relief facility for HIPCs outside the Bank, to be funded partly by the Bank and partly by bilateral contributions.[49]

Once Camdessus sensed that the major donor countries could be persuaded to accept the idea, he asked Boorman, as head of the Policy Development and Review Department (PDR), to devise a multilateral debt-relief plan that could be implemented consistently with the Fund's mandate and financial constraints. That reference to the Fund's mandate implied that any such plan would have to have three essential features: First, relief would be conditional on countries' willingness and ability to adopt strong economic policies. Second, relief should be granted only gradually over a period of several years, in response to the strengthening of policies. Third, the proposed debt-relief facility, like the ESAF, could be established within the IMF but would have to be funded primarily by donations and not by the Fund's own resources.

That sketch became the basis for the model that the staffs of the IMF and the World Bank would work out together over the next several months. Throughout the summer, however, Boorman and his staff remained skeptical that the scheme would succeed. As late as September 25, a working draft approved by the Fund team still emphasized the obstacles more than the possibilities. "Bank staff have examined a debt reduction fund that could provide a solution" to the debt overhang problem, it noted. "This proposal, however, raises potential problems including those of moral hazard and the effect on multilateral development banks' balance sheets."[50] Still, both Camdessus and

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[49]See memorandum from Boorman to the Managing Director, "Multilateral Debt," July 19, 1995; IMF archives, PDR/AI (Mr. Boorman's files), Accession 1996-0233, B9351. In response to a September 14, 1995, article in the *Financial Times* reporting on a leaked internal discussion paper, the Bank's External Affairs Department informed the Bank staff that Bank management had asked them "to explore alternative options which would . . . provide an exit strategy for poor countries facing an unsustainable debt situation . . . and not undermine the existing financial policies of the international financial institutions, including the Bank's policy not to reschedule or write off debt"; attachment to a note from Boorman to the Managing Director, "Multilateral Debt," September 14, 1995; IMF archives, PDR/AI, Accession 1999-0347.

[50]Attachment to memorandum from Boorman to Masood Ahmed (Director, International Economics Department at the World Bank), "Issues Note on Multilateral Debt," September 25, 1995; IMF archives, PDR/AI, Accession 1999-0347.

Wolfensohn fully supported the proposal.[51] On October 5, they submitted a more upbeat joint report to the Development Committee that countenanced multilateral debt relief, albeit still in quite cautious tones, especially as regards the IMF.

> The work now underway explores whether there is a case for a wider range of approaches and instruments than previously considered that could be developed within these institutional constraints. The work looks to ways to help pay part of the obligations owed to multilateral creditors, for those countries where action by commercial and bilateral creditors is not sufficient to restore debt sustainability. In the case of the IMF, such measures should be consistent with the Fund's Articles of Agreement and its monetary character.[52]

The Managing Director's public remarks to the plenary session of the IMF/World Bank Annual Meetings a few days later conveyed an even stronger commitment that the Fund was prepared to participate in the process.

> The implementation by the Paris Club of the Naples terms for debt reduction is an important contribution to easing the burden of bilateral official debt. We also need to consider very seriously the treatment of the multilateral debt of a small number of highly indebted poor countries. In this regard, you can count on our joint commitment to implement vigorously the important work program that Jim Wolfensohn and I have submitted to the Development Committee.[53]

Next, the initiative needed approval by the Executive Board, several members of which were not yet persuaded of the wisdom or the necessity of forgiving multilateral debt. When the Board first considered a specific proposal, in February 1996, the major donor countries were split. The United Kingdom, the United States, Canada, the Netherlands, and most developing countries were open to the idea, but Germany, Japan, and the Nordic-Baltic group were skeptical. Two key issues emerged.

First, did HIPCs (other than the few most desperate cases) really need multilateral debt relief? Was it reasonable to assume that, in the absence of such relief, heavily indebted and very poor countries could successfully implement the kinds of economic policies needed to restore and maintain good economic growth? The Dean of the Board, Alexandre Kafka (Brazil), summed up the view of many Directors by saying that "no debt relief is useful without strong adjustment policies. But also, no strong adjustment is likely, without debt relief for HIPCs." On the other side, Bernd Esdar (Alternate, Germany) concluded that "the current already very generous set of debt

[51]Perhaps because of the Fund staff's reluctance, the mythology took hold that the initiative came primarily from Wolfensohn, with Camdessus and the IMF as reluctant partners (Mallaby, 2004, pp. 114–15). Internally, senior staff of both institutions came to believe that each of their own groups had originally been in the lead.

[52]"Progress Report on Multilateral Debt," DC/95/16 (October 5, 1995), p. 2.

[53]Address to the Board of Governors (October 10, 1995); accessed at http://www.imf.org/external/np/sec/mds/1995/mds9514.htm.

instruments are fully able to cover the debt problems of highly indebted poor countries."[54]

Second, even if HIPCs were saddled with debilitating debt overhangs, was it appropriate for the IMF to get into the business of debt forgiveness? Srejber adhered to the strong opposition she had expressed earlier (see above, p. 651) and now went even further, arguing that the ESAF should be phased out: "further concessional lending or even debt forgiveness on behalf of the Fund is not in line with the monetary character of the Fund," she concluded. Hachiro Mesaki (Japan) added "that we should avoid any measures that could undermine the creditworthiness of the Fund as a monetary institution."[55]

Despite these misgivings, the political momentum for action continued to build, and Camdessus and Wolfensohn continued to spur their staffs to work together to devise a feasible plan. By September, the plan was close to its final form, and the Interim Committee endorsed it under the provisional title of the "Joint Program of Action."

A key element—probably *the* key element that forged the compromise everyone could accept—was that each eligible country would have to establish a six-year track record of good policy implementation before the Fund and the World Bank would grant full and final debt relief. In practical terms, that meant that an HIPC would be expected to carry out an ESAF-supported program for three years, after which it would reach a "decision point" and be granted interim relief. After the country completed a second three-year arrangement, it would reach the "completion point" and be granted the full amount of available relief. The length and difficulty of this process would turn out to be the most controversial feature of the plan because it meant that for a very long time the debt-relief results would be negligible and would be confined to very few countries. In the middle of 1996, however, this element was thought to be necessary, and in any event it was all that could be achieved politically.

A second key element was that the IMF would not directly forgive any outstanding debt. Instead, it would establish a separate trust account that would make grants to qualifying HIPCs in association with the concessional loans being made through the ESAF. Those grants would be placed in escrow until the country reached the decision and completion points, at which time the funds would be used to repay a portion of the country's outstanding debts. As discussed in the next section, the way in which this trust was to be funded remained to be decided.

Finally, on February 4, 1997, the Executive Board approved the HIPC Initiative (as the joint program was to be called) and established the ESAF-HIPC Trust. Informally, this account was usually just called the HIPC Trust. Formally, it was the "Trust for Special ESAF Operations for the Heavily Indebted Poor Countries and Interim ESAF

[54]Minutes of EBM/96/13 (February 20, 1996), pp. 13 (Kafka) and 17 (Esdar).

[55]Minutes of EBM/96/13 (February 20, 1996), pp. 20 (Mesaki) and 25 (Srejber).

Subsidy Operations."[56] The formal name of the HIPC Trust was changed in 1999 to reflect the conversion of the ESAF into the PRGF.

On a related issue, the Fund also agreed in 1997 that ESAF resources could be used by eligible borrowers to help cover the up-front costs of Brady-type debt- and debt-service-reduction agreements with commercial creditors. The World Bank's Debt Reduction Facility (see Chapter 9) was large enough to handle most countries' needs in that regard, but Côte d'Ivoire was looming as an exception. With that case in mind, the Executive Board approved an enabling decision in July.[57]

Operations

Who were the HIPCs? The joint staff papers of 1995 identified 41 countries with low per capita incomes (approximately equivalent to eligibility for IDA loans) and with debt and debt-service burdens above thresholds that had been set more or less arbitrarily.[58] The debate in the Executive Board mostly concerned the extent to which that list should be shortened. At one extreme, Directors from some of the countries on the list argued that all should be eligible. At the other, a few Directors argued that only four to eight countries really qualified. The others, they suggested, could repay their debts if they tried hard enough. In the end, the Board decided that all countries that met the specified criteria would be eligible to be considered for support, but it set a time limit on qualification. In addition to being ESAF-eligible and having at least a "borderline" unsustainable debt burden, a country would have to be receiving at least Naples-terms relief on its bilateral debt and be

[56]The text of the original trust document may be accessed at http://www.imf.org/external/pubs/ft/history/2011/index.htm.

[57]The proposal proved to be controversial, owing to issues of concessionality, additionality, and burden sharing, but a consensus was soon reached; see "Use of ESAF Resources for Commercial Debt and Debt Service Reduction Operations," EBS/97/42 (March 11, 1997); "Use of ESAF Resources for Commercial Debt and Debt Service Reduction Operations—Further Considerations," EBS/97/94 (June 4, 1997) and Suppl. 1 (June 30, 1997); and minutes of EBM/97/64 (June 25, 1997), pp. 4–46, and EBM/97/67 (July 2, 1997), pp. 8–24. The procedure was applied only to Côte d'Ivoire, in March 1998; see Chapters 9 and 14.

[58]The initial analytical thresholds were specified as ranges, to be applied judgmentally case by case. In general, a country would be judged to have an unsustainable debt burden if its annual debt-service obligations exceeded 20 to 25 percent of its export revenues and the net present value of its external debt exceeded 200 to 250 percent of its export revenues. Countries would be considered to be "possibly stressed" if their ratios were in an intermediate range. The staff acknowledged that the "empirical support for the particular threshold ranges used is weak, and these are therefore somewhat arbitrary"; see "Debt Sustainability Analysis for the Heavily Indebted Poor Countries," SM/96/22 (January 31, 1996), p. iii. For more background, see "Analytical Aspects of the Debt Problems of Heavily Indebted Poor Countries," SM/96/23 (January 31, 1996).

carrying out an IMF-supported adjustment and reform program no later than October 1998.[59]

These requirements were daunting. In a preliminary analysis aimed at estimating the initiative's potential cost, the staff determined that nearly half of the HIPCs (18 out of 41) had "sustainable" debt burdens and thus were not expected to qualify. Another four were likely to be ineligible because of outstanding arrears or because they were eligible for nonconcessional loans from the World Bank. That left a pool of 19 potential beneficiaries.[60] To qualify to be put on a track toward debt relief, each one would have to complete a three-year IMF-supported program (normally through the ESAF). By the end of the 1990s, seven countries reached that decision point and had funds set aside for future relief (Table 13.3).

Of the eight countries initially judged to have unsustainable debt burdens, only one (Mozambique) reached the decision point during the first three years of the initiative. The others all were judged not to be making satisfactory progress toward getting economic policies on a sustainable path. Two countries, the Democratic Republic of the Congo and Sudan, first had to settle their arrears to the IMF. Two others, Burundi and Guinea-Bissau, were bogged down in internal conflicts. The other three—Nicaragua, São Tomé and Príncipe, and Zambia—were making some progress toward viability, but not yet enough for the Fund to approve them for HIPC relief.

The one country in this group that reached the decision point was also put on a fast track to complete the process. As discussed in the next chapter, Mozambique was implementing courageously strong economic policies in the face of horrific environmental and social conditions. Its economy was growing well as a result, but the Fund and other agencies all recognized that Mozambique's performance inevitably would falter without multilateral debt relief. When the country completed its second three-year ESAF arrangement in June 1999, it reached the completion point and obtained approximately $1.7 billion in debt relief, of which $125 million was from the IMF.[61]

The Mozambique relief operation was the largest in this period. Four of the other six operations were for countries that initially had been considered borderline qualifiers. Relief operations for two of those, Côte d'Ivoire and Uganda, are discussed in the next chapter. The other two "possibly stressed" countries, Bolivia and Guyana, were in South America. Bolivia reached its completion point in September 1998 with the successful conclusion of its second ESAF-supported program. Guyana encountered more

[59]See Section III, paragraph 1, of the trust instrument, accessible at http://www.imf.org/external/pubs/ft/history/2011/index.htm.

[60]"Technical Note on Preliminary Costing of the Proposed Framework for Resolving the Debt Problems of the Heavily Indebted Poor Countries," SM/96/127 (June 4, 1996), pp. 3–5.

[61]These figures are in net present value terms. The "headline" figure—the estimated relief to be doled out over a period of years—was much larger. For details, see "Mozambique to Receive US$3.7 Billion in Debt Relief Through the HIPC Initiative," NB/99/35 (June 30, 1999); accessed at http://www.imf.org/external/np/sec/nb/1999/nb9935.htm.

Table 13.3. Debt Relief for Heavily Indebted Poor Countries, 1996–99

Country	Initial Assessment of Debt Sustainability	Decision Point	Completion Point	Relief from IMF (Millions of dollars)	
				Committed	Granted
Africa					
Angola	Sustainable (prelim.)				
Benin	Sustainable				
Burkina Faso	Sustainable	September 1997		10	
Burundi	Unsustainable (prelim.)				
Cameroon	Possibly stressed				
Central African Rep.	Sustainable (prelim.)				
Chad	Sustainable				
Congo, Dem. Rep. of	Unsustainable				
Congo, Rep. of	Possibly stressed (prelim.)				
Côte d'Ivoire	Possibly stressed	March 1998		23	
Equatorial Guinea	Sustainable				
Ethiopia	Possibly stressed				
Ghana	Sustainable (prelim.)				
Guinea	Sustainable				
Guinea-Bissau	Unsustainable				
Kenya	Sustainable				
Liberia	Undetermined				
Madagascar	Possibly stressed				
Mali	Sustainable	September 1998		14	
Mauritania	Sustainable				
Mozambique	Unsustainable	April 1998	June 1999	125	125
Niger	Possibly stressed				
Nigeria	Undetermined				
Rwanda	Possibly stressed (prelim.)				
São Tomé and Príncipe	Unsustainable (prelim.)				
Senegal	Sustainable				
Sierra Leone	Sustainable				
Somalia	Undetermined				
Sudan	Unsustainable				
Tanzania	Possibly stressed				
Togo	Sustainable				
Uganda	Possibly stressed	April 1997	April 1998	69	69
Zambia	Unsustainable				
Asia					
Lao PDR	Sustainable				
Myanmar	Possibly stressed (prelim.)				
Vietnam	Sustainable				
Latin America					
Bolivia	Possibly stressed	September 1997	September 1998	29	29
Guyana	Possibly stressed	December 1997	May 1999	35	35
Honduras	Sustainable				
Nicaragua	Unsustainable				

Table 13.3. (continued)

Country	Initial Assessment of Debt Sustainability	Decision Point	Completion Point	Relief from IMF (Millions of dollars) Committed	Granted
Middle East					
Yemen, Rep. of	Sustainable				
Total				305	258

Sources: Initial assessment of debt sustainability: "Technical Note on Preliminary Costing of the Proposed Framework for Resolving the Debt Problems of the Heavily Indebted Poor Countries," SM/96/127 (June 4, 1996), Table 1; Debt relief: *Annual Report 2000*, Table 5.2.

Note: "Prelim." means that the staff made only a preliminary assessment because data were not sufficient for a detailed assessment of debt sustainability.

difficulties and reached the completion point only after making a good start on its third ESAF arrangement, in May 1999.

The Fund's other debt-relief operations in the 1990s assisted two countries in the CFA franc zone that initially had been judged to have sustainable debt burdens: Burkina Faso and Mali.

In March 1997, the staff completed a more detailed debt-sustainability analysis for Burkina Faso. Most of the country's external debt was on concessional terms, so its ratio of scheduled debt-service payments to projected export revenues appeared sustainable. Nonetheless, the staffs of the Bank and the Fund concluded that Burkina Faso—one of the poorest countries in Africa and with an unusually high ratio of debt to exports—should be eligible for debt relief. Moreover, the authorities had already established a five-year track record of good policy implementation, and the 1994 devaluation of the CFA franc had led to an acceleration of economic growth. On those grounds, the staff recommended making Burkina Faso eligible for HIPC debt relief and bringing the target completion date forward by one year, to September 1999.[62]

When the Executive Board took up the staff proposal, everyone agreed that Burkina Faso should qualify for relief. The only point of contention was whether the interval to the completion point should be accelerated from three years to two. Karin Lissakers (United States), with support from several other Directors, objected that the strict requirements of the initiative were being watered down inappropriately. After some discussion, the Board agreed on a compromise of two and a half years, which put the completion point in April 2000. Burkina Faso thus reached the decision point, and the Fund (acting as trustee for the HIPC Trust) committed $10.4 million to be disbursed at the completion point.[63]

[62]"Burkina Faso—Preliminary Document on the Initiative for Heavily Indebted Poor Countries (HIPC)," EBS/97/51 (March 26, 1997); and "Burkina Faso—Final Document on the Initiative for Heavily Indebted Poor Countries (HIPC)," EBS/97/155 (August 19, 1997).

[63]Minutes of EBM/97/93 (September 8, 1997), pp. 11–45. As a sweetener, the compromise also involved lowering the target debt ratio from 210 percent of annual exports to 205 percent. That shift implied that the present value of the relief would be roughly unchanged. Burkina Faso actually reached the completion point a few months later than anticipated, in July 2000.

Mali's situation was similar to Burkina Faso's. Its ratio of debt-service payments to exports was well below the 20 percent threshold considered to be potentially unsustainable. Its debt stock, however, was high in relation to exports; its income level was extremely low; and its export revenues were vulnerable to a variety of adverse shocks such as drought or weak external markets. After reassessing debt sustainability in 1997, the staff recommended, and the Executive Board accepted, that Mali should be eligible for HIPC debt relief. In September 1998, the Board approved the decision point for Mali and set an accelerated target for reaching the completion point in December 1999. By that time, the schedule called for Mali to have completed the current ESAF arrangement and to have embarked successfully on the next one. On that understanding, the Fund (as trustee) set aside $14 million for servicing Mali's outstanding obligations at the completion point.[64]

Altogether, as listed in Table 13.3, the IMF committed $305 million from the resources of the HIPC Trust to help cover future debt-service obligations of these seven countries. By the end of 1999, 85 percent of that commitment ($258 million) had been delivered in the form of grants to the four countries that had reached the completion point. Under the terms of the trust, those grants were paid into an escrow account known as the "umbrella account for HIPC operations." The balance in that account was used to cover a specified portion of scheduled debt service falling due over the next several years.

Enhancement

In the year of this jubilee ye shall return every man unto his possession.

Leviticus 25:13

After the first two years of HIPC debt-relief operations, it was abundantly clear that a sizeable number of countries needed such relief and that the requirement of a six-year track record before delivery of real relief was a major bottleneck. Political pressure associated with the looming approach of the millennium reinforced that simple logic. In 1999, a nearly universal desire to intensify and accelerate assistance to poverty-stricken countries as a way to commemorate the arrival of the twenty-first century elevated the enhancement of the HIPC Initiative into an ethical necessity.

In essence, 1999 brought a resumption of the outrage against unpayable debts that had flared up so strongly four years earlier. The Jubilee 2000 Coalition, Oxfam, Christian Aid, the Catholic Fund for Overseas Development, and the European Network for Debt and Development were especially influential in stoking a campaign throughout

[64]Minutes of EBM/98/99 (September 15, 1998). Also see "Mali—Preliminary Document on the Initiative for Heavily Indebted Poor Countries (HIPC)," EBS/98/28 (February 9, 1998); and "Mali—Final Decision Point Document on the Initiative for Heavily Indebted Poor Countries," EBS/98/150 (August 24, 1998). Mali reached the completion point in September 2000.

Europe and North America for deeper and faster debt relief for the poorest countries. The IMF staff took that movement to heart and also conducted its own outreach exercise. That outreach included a series of eight consultation meetings with civil society in Africa, Europe, and Central and North America and solicitation of public input through the IMF website. Meanwhile, finance officials in the major industrial countries were developing their own proposals for change.[65]

By the time of the April 1999 meeting of the Interim Committee, the only question was how, not whether, to strengthen the HIPC Initiative. The committee's communiqué asked the Fund to devise a specific proposal by September that would "provide a clear exit from unsustainable debt burdens" for qualifying countries and that would "enhance the link between HIPC Initiative assistance and poverty reduction."[66]

As a measure of the growing political importance of the issue, the major industrial countries preferred not to leave the preparation of this proposal to the staff of the Bretton Woods institutions. Instead, the finance ministers of the G7 countries quickly sketched out the "Köln Debt Initiative," which they presented to the G8 heads of state and government (comprising the G7 plus the Russian Federation) for the summit meeting to be held in Cologne, Germany, in June. Part of that proposal was to deepen Paris Club debt reductions even further. In what would become known as the Cologne terms, starting in November 1999 bilateral creditors were to forgive HIPC debts by up to 90 percent, compared with the previous ceiling of 80 percent. The main thrust of the proposal, though, was to enhance the multilateral HIPC Initiative.[67]

After the summit leaders endorsed the G7 proposal, the Fund and Bank staffs worked out the details for its implementation. The Fund's Executive Board approved most of the changes in principle in August, after which attention turned to the task of raising enough money to pay for them. Final approval for the enhancements came in January 2000, after the fundraising effort concluded.[68]

The enhancement of the HIPC Initiative introduced three critical changes to the way the IMF would compute and deliver debt relief.

[65]For an overview of these various developments, see "HIPC Initiative—Perspectives on the Current Framework and Options for Change," EBS/99/52 (April 2, 1999). For an introduction to the ethical issues, see Donnelly (2007).

[66]Paragraph 4 of the Interim Committee communiqué (April 27, 1999); reproduced in *Annual Report 1999*, p. 188.

[67]See "Report of G7 Finance Ministers on the Köln Debt Initiative to the Köln Economic Summit," Cologne, Germany, June 19–20, 1999; accessed at http://www.g8.utoronto.ca/finance/fm061899.htm. (Cologne is the French name for Köln and is the commonly used name in English.)

[68]The joint IMF–World Bank staff response to the G7 proposal was "Modifications to the Heavily Indebted Poor Countries (HIPC) Initiative," EBS/99/138 (July 23, 1999). That paper was discussed by the Fund's Executive Board on August 5, 1999, at which time Directors gave preliminary approval to the proposed enhancements; see minutes of EBM/99/89 (August 5, 1999), pp. 3–57. The paper and the Summing Up of the Board meeting are available at http://www.imf.org/external/np/hipc/modify/hipc.htm. The formal decision to amend the trust so as to incorporate these changes was adopted on a lapse-of-time basis on January 27, 2000; see Decision No. 12132-(00/9) PRGF.

First, it compressed the timetable for countries with good policy track records. In particular, the gap between the decision point and the completion point would no longer require the country to complete a second three-year policy program. Instead, the gap would be closed "when a member has satisfactorily implemented a set of predefined key policy reforms, has a stable macroeconomic position, and has kept on track with its Fund-supported program. In addition, the member shall have prepared a PRSP and implemented this strategy for at least a year by the completion point."[69] This compression from three years to as little as one was characterized as a "floating completion point."

Second, the standard for assessing the sustainability of a country's debt burden was made more ambitious. Notably, instead of regarding a ratio of debt to export revenues as high as 250 percent to be sustainable, the Fund would now regard anything greater than 150 percent as unsustainable. As before, the standard could be set lower than this threshold under extenuating circumstances.[70]

Third, instead of waiting until the completion point to award grants to qualifying countries, the Fund and the World Bank could begin providing relief grants at the decision point. To qualify, a country would have to be judged to have a satisfactory record of "adjustment and reform efforts and overall progress in poverty reduction."[71]

These changes meant that many more countries would qualify and that the Fund would be making grants much earlier than had been expected under the original terms. The enhancements would be expensive and could be adopted only if donor countries would sharply increase their contributions or if the IMF could mobilize more of its own resources, or both. The staff estimated that existing commitments would have to be almost tripled in size—and quickly—for the enhancements to be fully funded.[72]

As discussed below, raising the funds took some creativity, but the task was completed before the end of 1999. The Enhanced HIPC Initiative took effect in January 2000, and it led quickly to a sharp acceleration in grants to HIPCs. After an initial three years (1997–99) in which the original HIPC Trust awarded grants totaling $258 million to four countries, the pace quickened. Over the first three years of the enhanced initiative, the trust disbursed close to $1 billion in grants to 25 countries. From all participating creditors, the reduction in the net present value of HIPC debts

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[69]Decision No. 12132-(00/9) PRGF (January 27, 2000), paragraph xiii.

[70]In 2002, the Fund greatly refined its analysis of debt sustainability by replacing these mechanical ratios with forward-looking analyses tailored to each country's circumstances. For a review, see Barkbu, Beddies, and Le Manchec (2008).

[71]Decision No. 12132-(00/9) PRGF (January 27, 2000), paragraph xiv.

[72]See "Update and Steps to Secure the Financing for the Continuation of the ESAF and the HIPC Initiative," EBS/99/143 (August 2, 1999). For an overview of the 1999 enhancements, see Andrews and others (1999).

amounted to $3.5 billion under the original initiative and a further $21.7 billion under the first three years of the enhanced initiative.[73]

Financing the Facilities

Raising money to lend to poor countries, or to provide grants, was a constant challenge. The IMF could not use its general resources for this purpose because the Articles of Agreement require that those resources be available for all member countries on an equitable basis. The "seed money" for concessional lending came from the sale of a portion of the Fund's stock of gold in the 1970s. The market price of gold was much higher than the official price at which the Fund had valued its holdings, so the auctions generated profits that could be retained and used to establish the original Trust Fund. When Trust Fund loans were repaid, those proceeds were recycled into the SAF and eventually into the ESAF. Additional loans and grants from member countries and central banks to the ESAF Trust increased the pool of available funds.[74] The challenge in the 1990s was to replenish and augment those resources so that the ESAF (and its successor, the PRGF) could be converted into a permanent lending facility with sufficient funds to be a real help and also to finance the IMF's contributions to the HIPC Initiative. Because the continuation of ESAF lending and the ability to provide associated grants through the HIPC Initiative were so closely linked, the financing discussions gravitated toward a joint proposal for funding the two operations together.

This fundraising campaign began with the move to create a successor to the original temporary ESAF. Throughout 1993 and into 1994, staff, management, and Executive Directors made an intensive effort to persuade as many member countries as possible to help finance an enlargement of the facility. By February 1994, when the original ESAF finally was allowed to expire, some 43 members—half of them developing countries—had agreed to lend a total of some $6.4 billion (SDR 4.6 billion) to the expanded trust and to contribute $1.8 billion (SDR 1.6 billion) to enlarge the subsidy account to cover the difference between the trust's lending rate and the rates at which it was borrowing. These contributions were expected to enable close to $7 billion (SDR 5 billion) in new ESAF lending, about equal to the amount the original ESAF had lent during its six-year life.

[73]"Heavily Indebted Poor Countries (HIPC) Initiative—Statistical Update," (March 10, 2003), Tables 2 and 7A; accessed at http://www.imf.org/external/np/hipc/2003/update/031003.htm. In all, 26 countries received relief under the enhanced initiative through 2003. One country—São Tomé and Príncipe—had no outstanding obligations to the IMF and so received relief only from other creditors.

[74]These developments are covered in de Vries (1985), Chapters 33 and 34; and Boughton (2001), Chapter 14.

Once the successor ESAF was in place, a new campaign was required so that lending could continue beyond the end of the decade. Throughout 1995 and much of 1996, staff and management devoted considerable energy to persuading ESAF creditors to renew and enlarge their commitments. Because so many of the creditors had to cope with their own domestic budgetary problems and political opposition, several of them insisted that the Fund should find a way to help finance the continuation of ESAF lending from its own assets. In particular, the United States, the United Kingdom, several other countries, and eventually the Managing Director argued that the time had come for the Fund to sell a further portion of its gold stock and use the proceeds in some fashion to finance ESAF lending.[75] As Lissakers (United States) argued, "the Fund and its members can ill afford to allow a valuable asset to lie fallow." A sizeable minority, led by Stefan Schoenberg (Germany), insisted there was "no reason for the Fund at present to sell gold in any amount." Any decision to sell gold required the approval of members holding 85 percent of the voting power, and in 1995, seven Directors with about 30 percent of the vote expressed opposition.[76]

The pressure for the IMF to sell gold did not arise from an immediate shortfall of ESAF resources. Its sale was thought to be necessary to ensure that the Fund could continue lending during 2001–04, when it would be fulfilling commitments made through 2000. After that time, as discussed above, the intention was still to phase out the concessional lending facility. Specifically, lending projections made in 1995 showed that the funds already in the trust or being raised in 1996 would enable lending to continue through 2000, and additional funds would have to be raised by then to finance an interim facility for the period 2001–04.

For that purpose, Camdessus devised a proposal under which the IMF would stand ready to sell up to 5 million ounces (4.8 percent) of its gold, but only if bilateral contributions to the trust fell short of what was needed. All of the profits from the gold sales (referred to as the "corpus") would be retained by the IMF but would be invested in interest-bearing securities. The interest income would be used to top up the ESAF Trust as needed to sustain its lending operations.

The Executive Board accepted that general proposal in September 1996. The provision for gold sales, however, was never formalized in a Board decision, because at this time it was only a contingency plan and was still opposed by a few Directors. The German government was most strongly opposed to gold sales, even to the idea of the Fund being open to them on a contingency basis. As pointed out by Bernd Esdar, who had succeeded Schoenberg as Executive Director for Germany, the existence of such an option would create a free-rider problem—a disincentive for countries to offer bilateral

[75]As noted, the original funding for the IMF's concessional lending came from the sale of gold in the 1970s. In 1993, the Fund pledged 3 million ounces of gold to be sold if needed to cover potential losses in the ESAF Trust, but that pledge was never activated (see Chapter 16).

[76]For the initial positions of the staff and the major creditor countries in these discussions, see "Gold in the Fund," SM/95/69 (April 21, 1995); and minutes of EBM/95/54 (June 2, 1995). The quotations are from the minutes, pp. 8 (Lissakers) and 18 (Schoenberg).

contributions to the ESAF or the HIPC Trust.[77] Nonetheless, the Executive Board accepted without objection the Managing Director's proposal that a decision should be made at an appropriate time, "only after all efforts have been made to secure the maximum feasible bilateral contributions, being understood that we only talk here about the exclusive use of the interest income on the investment of profits generated through such sales" of gold. The ambiguity of this implicit agreement—the absence of a formal decision or a binding commitment—would haunt the Fund for years to come.[78]

The issue of selling gold lay dormant for the next three years but arose anew at the G8 summit meeting in Cologne, Germany, in June 1999. By that time, the purpose was not primarily to help finance ESAF lending, but rather to help strengthen and deepen the IMF's contribution to multilateral debt relief through the HIPC Initiative. To get deeper debt reduction for low-income countries, the summit asked the Fund to consider the "use of interest on the proceeds of a limited and cautiously-phased sale of up to 10 million ounces of the IMF's gold reserves." The staff, however, remained worried that once the gold was gone, the temptation for creditor governments to press the Fund to spend the proceeds would be too great to resist. In addition, and more important from a practical perspective, governments in gold-producing countries feared the depressing effect on the market price if the Fund were even to announce that it was considering putting millions of ounces up for sale.

The pressure to mobilize gold could not be ignored without eviscerating the ESAF Trust and undermining the HIPC Initiative. At the time of the Cologne summit, the IMF and its major creditor countries were committed to "enhancing" the HIPC Initiative by scaling down the hurdles that countries had to clear to qualify for debt relief. Enhancing debt relief, in turn, would require more money, while at the same time a serious move was under way to convert the ESAF into the PRGF as a permanent lending facility.

Some means had to be found to mobilize gold over the objections of those countries that opposed selling any. After some brainstorming, the staff came up with

[77]Minutes of EBM/96/87 (September 13, 1996), p. 12. The German and other European Directors had made a similar objection in 1995 when Camdessus had proposed using the Fund's general resources to finance an increase in the stand-by arrangement for Mexico, as a contingency plan if bilateral support fell short of target. In that case (see Chapter 10), the objection proved to be correct. Bilateral support did not materialize, and the Fund was obliged to finance the increase with its own resources.

[78]Minutes of EBM/96/89 (September 18, 1996), p. 16. The intended restriction on the use of the proceeds from gold sales was stated a little more plainly in the IMF Annual Report, albeit in the passive voice. Summarizing the Board discussion, the report concluded, "It was also understood that it would be only the proceeds from the investment of the profits from the sale of such gold that might be used to contribute to the financing" (*Annual Report 1997*, p. 121; accessed at http://www.imf.org/external/pubs/ft/ar/97/pdf/file09.pdf). A decade later, when a decline in lending income forced the Fund to look for new income sources, proposals to sell gold and use the corpus of profits to cover current expenditures were more difficult to resist than they would have been had a formal decision to the contrary been made earlier.

an alternative proposal under which the Fund would sell the gold off-market to the central bank of a member country and then buy it back. Even though both transactions would be made at the same price, they would generate a "profit" that the Fund could invest. The explanation for this apparently magical result is that the Fund is required by its Articles of Agreement to value its gold at the price at which it acquired it ("historical cost"). Before the swap, it would value the gold at SDR 35 per ounce. After selling the gold at the market price and then buying it back, it would value that portion at the higher price. On the liability side of the IMF balance sheet, the counterpart to the increase in gold valuation would be an entry for the resources of the Special Disbursement Account (SDA). The Fund could then swap an equivalent amount of its currency holdings for interest-bearing government securities, which would be held in the SDA rather than in the General Resources Account (GRA). The income on that investment could in due course be transferred to the ESAF Trust.

When this gold-swap proposal was floated internally in August 1999, it was shot down by the Legal Department because the 1978 amendment of the Articles of Agreement had terminated the right of the IMF to purchase gold.[79] Camdessus then asked the lawyers to suggest other options, which they did. Instead of selling and repurchasing the gold, the Fund could sell gold to a member country that had a repayment due on an outstanding loan. The member could then use the gold to repay the loan, and the effect on the balance sheet would be identical to that of a sale and repurchase.

The Executive Board reacted negatively when it first discussed this proposal at the end of August. Several Directors felt that doing off-market swaps instead of outright sales of gold would be confusing and opaque and would do nothing to rationalize the Fund's asset portfolio. Others argued that it would be better to spend the profit rather than investing it and just using the flow of income for ESAF financing. Camdessus managed to deflect that argument by reminding the Board that it had agreed in 1996 to retain the corpus in the Fund, but the absence of a formal decision at that time complicated the case and left some Directors unsatisfied. More generally, no one viewed the proposal as anything better than an "eighth-best solution," as characterized by Riccardo Faini (Italy).[80]

Despite the widespread distaste for what many saw as a clever gimmick, the absence of a better option gave the proposal momentum. The staff calculated potential demands on the ESAF Trust at nearly SDR 4 billion, of which less than a third was on hand or pledged (Table 13.4, Part A). The reluctance of major donors to raise their contributions reflected not only domestic political pressures against foreign aid, but

[79]Neither the proposal nor its rejection was new. In 1990, the U.S. authorities had proposed that "gold swaps at par might be undertaken as a means of generating income-producing resources." The staff responded then that the IMF "has no authority to enter into gold 'swaps' (sale and repurchase)"; see "Statement by [Thomas C. Dawson II, the U.S. Executive Director] on the IMF Arrears Strategy," BUFF/90/24 (January 30, 1990), p. 6; and "Statement by the Staff Representative at Executive Board Informal Session 90/6," BUFF/90/30 (February 1, 1990), p. 1.

[80]Minutes of EBM/99/95 (August 30, 1999), p. 61.

Table 13.4. Financing of the PRGF-HIPC (formerly ESAF-HIPC) Trust, 1999
(Millions of SDRs, on an "as-needed" basis)

A. Financing options, August 1999		
Total anticipated financing requirement		3,940
Amounts already on hand or pledged		1,190
Confirmed bilateral pledges	800	
Contributions by the IMF[a]	390	
Amounts anticipated or under discussion		2,010
Indications made for additional bilateral contributions	500	
Further IMF contribution by terminating the practice of reimbursing the GRA for the cost of administering the trust	250	
Investment income from the profits on off-market gold transactions totaling 10 million ounces	1,260	
Subtotal		3,200
Shortfall to be filled by additional contributions		740
B. Financing secured, September 1999		
Total financing requirement		3,940
Bilateral contributions and pledges		1,500
IMF contributions		2,440
Investment income from the profits on off-market gold transactions totaling 14 million ounces	1,800	
Other transfers to the trust	640	

Sources: Part A: Minutes of EBM/99/95 (August 30, 1999), pp. 68–69; Part B: BUFF/99/126 (September 28, 1999).

Note: The amounts in this table are computed on an "as-needed" basis, meaning that they are not deflated to present values. If, for example, one country was expected to be granted relief in 1999 and another in 2002, the two amounts would be added together without any adjustment for the difference in timing.

[a]Transfers from the Reserve Account and transfers of income from the Supplemental Reserve Facility.

also a genuine concern that donating money to the ESAF would result in shortchanging financing for the International Development Association, the World Bank's concessional lending agency. The staff proposal, while retaining the corpus as an investment account, would cover half of the unfunded balance. Without it, the Fund had virtually no chance of fully financing the facility.

In the fall of 1999, in contrast to 1996, a real decision on gold had to be made quickly. The financing shortfall had to be filled because the Interim Committee was scheduled to meet on September 26 and its members were insistent on making the resolution of this matter the centerpiece of their agenda. Throughout the first three weeks of September, Camdessus, the staff, and the Executive Directors made a rigorous effort to secure additional bilateral support from a large number of countries. They succeeded to a great extent, but it also became evident that the mobilization of 10 million ounces of gold was not going to suffice to close the gap between the target number and bilateral contributions. Accordingly, the ceiling was raised to 14 million ounces. Even so, on Friday, September 24, two days before the ministerial meeting, a gap of almost SDR 200 million remained, mainly because several of the largest shareholders were balking at raising their commitments proportionately to those of many of the smaller countries. Camdessus applied as much verbal pressure as he could, at one point singling out France and the United Kingdom for shame and telling the Executive Board that "if this effort failed, and the financing package could not be put in place, the failure would have to be traced to the lack of contribution among key G–7 players."[81]

The effort went right to the wire, concluding with a rare Saturday night meeting of the Executive Board, starting at 10:00 p.m. on the eve of the Interim Committee meeting. By then, it had become a battle of wills between the British authorities, who wanted a greater portion of the trust enlargement to be financed by gold transactions, and Camdessus, who was insisting that the British shortfall (in relation to its IMF quota) was giving other countries an excuse to withhold their own contributions. Because the British were among the most ardent advocates of the enlargement, and their chancellor of the exchequer, Gordon Brown, was Chairman of the Interim Committee, they were widely viewed as the linchpin of the package.

In the end, the British relented. On the day of the Interim Committee meeting, Development Secretary Clare Short announced that the United Kingdom would contribute an additional $50 million to the HIPC Initiative. That triggered contributions from several other countries, and two days later Camdessus announced the essential completion of the financing package.[82] Support continued to trickle in from around the world, and by the end of the financial year, a remarkable tally of 93 countries, including nearly 60 developing and 10 transition countries, had made bilateral contributions in some form. The total amounts, however, were disappointingly small. Camdessus's plan to keep gold sales as a contingency plan in case bilateral contributions fell short may indeed have backfired, as the German Director had warned three years earlier. Of the total $5.4 billion (SDR 3.94 billion) in the package, only 38 percent came from bilateral donors and lenders.[83] The off-market gold transactions would cover almost half of the total, and the IMF would cover the rest through transfers from other operations (Table 13.4, Part B).

Bilateral contributions to the PRGF Trust and the PRGF-HIPC Trust were to be made in a wide variety of forms, ranging from simple outright grants to loans at market interest rates. Much of the grant money was to be placed in a subsidy account within the PRGF Trust to cover the difference between the low interest rate on loans and the rate the Fund had to pay to borrow the money.

The most common source of grants was countries relinquishing their claims on the IMF's second Special Contingent Account (SCA-2). That account was established in 1990 to accumulate SDR 1 billion to cover potential losses on loans in arrears (see Chapter 16). The SCA-2 was funded through 1997 by contributions from creditors via a decrease in remuneration on reserve-tranche balances, and by indebted countries via an increase in the interest rate charged on outstanding balances. The SCA-2 was

[81]Minutes of EBM/99/109 (September 24, 1999), p. 7.

[82]See BUFF/99/126, revised September 30, 1999.

[83]For a complete schedule of sources of financing for the trusts through April 2000, see *Annual Report 2000*, Appendix IX; accessed at http://www.imf.org/external/pubs/ft/ar/2000/eng/index.htm.

established as a temporary account, with the proviso that any money remaining in the account after the settlement of outstanding arrears was to be returned to the contributing countries. By 1999, the Executive Board determined that this money was no longer needed. On December 8, the Board terminated the account and agreed to pay out the balance to contributors, many of whom had already agreed to transfer their share back to the HIPC Trust. Over the next few months, this plan generated close to $800 million in voluntary transfers.

Aside from these transfers, the Fund raised direct bilateral contributions for the PRGF Trust (Table 13.5) from 42 countries plus the Organization for Petroleum Exporting Countries (OPEC) Fund for International Development, and for the PRGF-HIPC Trust (Table 13.6) from 34 countries (for a combined total of 58 contributors to one or both). Including transfers of funds raised by terminating the SCA-2 account, 93 countries helped fund the PRGF-HIPC Trust.[84] That list was especially remarkable in that it included 10 African and 45 other developing countries. The bulk of the money still came from the major creditors, but fulfilling the international commitment to reduce the debt burdens of the poorest countries really had become a nearly universal effort.

Next, the gold transactions needed to be carried out to effect the Fund's contribution. That move required a formal decision by the Executive Board, enacted with a majority of 85 percent of the voting power. To clarify the context and put some political weight behind this unusual operation, the Interim Committee decided to pave the way by asking the Board of Governors to adopt a resolution supporting it. Accordingly, on September 30, 1999, the Governors adopted Resolution 54-10, endorsing the transactions as "a one-time operation of a highly exceptional nature."[85] The resolution also implied that all of the proceeds would be retained in the IMF: the original book value in the GRA and "the balance in the Special Disbursement Account *for investments* for the benefit of the ESAF-HIPC Trust" (emphasis added).

In December, the time for action arrived. Two countries—Brazil and Mexico—had large repayments falling due. On December 8, the Executive Board gave its final approval to the technical decisions needed to carry out the off-market transactions.[86]

[84]For the full list of HIPC contributors, see *Annual Report 2000*, Appendix Table II.11, p. 127.

[85]See http://www.imf.org/external/pubs/ft/sd/index.asp?decision=54-10.

[86]See "Off-Market Gold Sales, Acceptance of Gold in Payment of Repurchase Obligations and Use of Proceeds of Gold Sales Placed in Special Disbursement Account," Decision No. 12063-(99-130), December 8, 1999; *Annual Report 2000*, p. 148; accessed at http://www.imf.org/external/pubs/ft/ar/2000/eng/pdf/file5.pdf. The Board made several related decisions at the same time or shortly afterward, aimed at shifting part of the burden of the cost of the operations away from developing countries. In the absence of offsetting action, the cost of the increased remuneration to creditors resulting from the reduction in GRA currency holdings after the off-market gold transactions (see text) would be borne in large part by developing countries with outstanding debts to the Fund. To mitigate that effect, the Executive Board agreed to place a ceiling on the ratio of the rate of charge to the SDR interest rate, reduce the amount of net income that would be set aside to cover potential loan losses, and devote a portion of interest income from the Supplemental Reserve Facility to cover the expenses of the trust. For a discussion, see minutes of EBM/99/130 (December 8, 1999). All of these policy decisions were published in *Annual Report 2000*, pp. 144–49.

Table 13.5. Contributions to the PRGF Trust (as of April 30, 2000)

	Millions of SDRs			Millions of U.S. Dollar Equivalent		
		Loans[b]			Loans[b]	
Contributor	Subsidies[a]	Prior to Enlargement	For Enlargement	Subsidies	Prior to Enlargement	For Enlargement
Argentina	13.6			18.2		
Australia	2.3			3.1		
Austria[c]	34.7			46.5		
Bangladesh	0.3			0.4		
Belgium[c]	73.3		200.0	98.1		267.8
Botswana[c]	0.9			1.2		
Canada	128.6	300.0	400.0	172.2	401.7	535.7
Chile[c]	2.9			3.9		
China	5.7		100.0	7.6		133.9
Czech Republic	6.0			8.0		
Denmark	38.3			51.3		
Egypt	6.0		100.0	8.0		133.9
Finland	22.7			30.4		
France		800.0	1,100.0		1,071.3	1,473.1
Germany	120.3	700.0	700.0	161.0	937.4	937.4
Greece[c]	22.3			29.9		
Iceland	2.6			3.5		
India	4.2			5.6		
Indonesia[c]	2.4			3.3		
Iran, Islamic Rep. of[c]	0.6			0.9		
Ireland	2.4			3.3		
Italy	135.2	370.0	460.0	181.1	495.5	616.0
Japan	468.4	2,200.0	2,150.0	627.2	2,946.1	2,879.2
Korea, Rep. of	29.9	65.0	27.7	40.0	87.0	37.1
Luxembourg	5.2			7.0		
Malaysia[d]		40.0	40.0		53.6	53.6
Malta[d]		1.4	1.4		1.8	1.8
Morocco	4.2			5.7		
Netherlands	77.8		250.0	104.1		334.8
Norway	28.1	90.0	60.0	37.6	120.5	80.3
OPEC Fund for International Development			37.9			50.8
Pakistan[d]			10.0			13.4
Portugal[c]	1.6			2.2		
Singapore[d]		40.0	40.0		53.6	53.6
Spain		220.0	192.0		294.6	257.1
Sweden	110.9			148.5		
Switzerland	20.6	200.0	151.7	27.6	267.8	203.1

Table 13.5. (continued)

	Millions of SDRs			Millions of U.S. Dollar Equivalent		
		Loans[b]			Loans[b]	
Contributor	Subsidies[a]	Prior to Enlargement	For Enlargement	Subsidies	Prior to Enlargement	For Enlargement
Thailand[d]		20.0	40.0		26.8	53.6
Tunisia[d]			3.6			4.8
Turkey	2.0			2.7		
United Kingdom	285.2			381.9		
United States	106.1			142.1		
Uruguay[d]			7.2			9.6
Total[e]	1,765.4	5,046.4	6,071.4	2,364.1	6,757.8	8,130.5

Source: *Annual Report 2000*, pp. 212–13.
[a]Direct contributions to the subsidy account (unless otherwise indicated).
[b]Loan account includes loans prior to and for enlargement of the PRGF.
[c]Net income transferred from administered accounts.
[d]Borrowing agreements with the subsidy account.
[e]Columns may not add to total because of rounding.

Six days later, the process was under way. Brazil made a repayment to the IMF of $1.98 billion for principal due on its SRF loan of December 1998 (see Chapter 12). By channeling the repayment through the off-market gold entries, this transaction enabled the Fund to transfer about $1.6 billion (SDR 1.19 billion) from the GRA to the SDA to be invested in interest-bearing government securities.[87] Over the next four months, the Fund engaged in a series of similar transactions with Mexico to bring the total amount transferred to $3 billion, or SDR 2.2 billion (Table 13.7).[88]

As important as this series of transactions was for financing the HIPC Initiative, the "profit" that it generated was a misnomer. As noted above, the resources transferred to the trust resulted not from the revaluation of the gold stock, which was only a bookkeeping entry, but rather from the exchange of currencies for interest-bearing securities. The reduction in currency holdings, however, increased the remunerable reserve tranche positions of creditor countries. The gain came from the difference between the rate of return on the investment account and the rate at which remuneration was paid on reserve tranche positions. That net return was small relative to the nominal profit on the gold transactions, although it could be bolstered by investing in medium-term and thus higher-yielding assets than the short-term securities on which the

[87]The currencies transferred to the SDA were placed in the IMF's account at the Bank for International Settlements, which then invested the balance in behalf of the Fund.

[88]Because the price of gold rose when these transactions were taking place, the total amount of gold mobilized for this purpose was just 12.9 million ounces, not the full 14 million that had been approved as the maximum allowable amount.

Table 13.6. PRGF-HIPC Trust: Cumulative Contributions (as of April 30, 2000)

Contributor	Thousands of SDRs	Thousands of U.S. Dollar Equivalent
Australia	91.90	123.10
Bangladesh	11.60	15.60
Barbados	2.50	3.30
Belize	0.40	0.50
Cambodia	0.30	0.40
Canada	329.30	441.00
China	131.30	175.90
Cyprus	5.40	7.30
Denmark	61.20	82.00
Finland	22.50	30.10
France	387.00	518.20
Greece	22.00	29.50
Iceland	0.90	1.20
Ireland	39.40	52.70
Israel	11.90	15.90
Jamaica	18.00	24.10
Japan	665.60	891.30
Korea, Republic of	106.30	142.30
Luxembourg	4.90	6.50
Malta	7.10	9.50
Mauritius	0.40	0.50
Netherlands	69.50	93.00
Nigeria	11.00	14.80
Norway	72.50	97.10
Philippines	45.00	60.30
Portugal	44.30	59.30
Samoa	0.03	0.04
San Marino, Republic of	0.30	0.40
Slovak Republic	26.70	35.70
Slovenia, Republic of	3.10	4.20
South Africa	9.00	12.00
Swaziland	0.20	0.30
United Kingdom	235.50	315.40
United States	2,219.30	2,972.00
Total[a]	4,656.20	6,235.30

Source: *Annual Report 2000*, p. 225.
Note: This table excludes transfers from Fund accounts, which are included separately in the source table.
[a]Columns may not add to totals because of rounding.

remuneration rate was based.[89] The real benefit was that the securities income (the gross return on the "profit") could be transferred to the trust, while the remuneration expense was borne by the GRA.

[89]The staff presentation to Executive Directors in August 1999 estimated the profit on transactions in 10 million ounces of gold to be SDR 1,550 million. The estimated annual net income, however, was just SDR 26 million (the difference between investment income of 78 million and increased remuneration expense of 52 million), a net return of 1.7 percent; minutes of EBM/99/95 (August 30, 1999), p. 6. The net return turned out to be a bit larger (2.4 percent in financial year 2001).

Table 13.7. Off-Market Gold Transactions, December 1999–April 2000

	Brazil	Mexico	Mexico	Total
Date of transaction	December 14, 1999	December 17, 1999	February to April, 2000	
A. Ounces of gold	7,074,317	655,578	5,214,357	12,944,253
B. Historic cost (A × 35 SDR)	247,601,107	22,945,237	182,502,502	453,048,846
C. Market price per ounce (US$)	279.60	280.30	285.89	282.17
D. Market value, in dollars (A × C)	1,977,979,130	183,758,566	1,490,751,263	3,652,488,960
E. Exchange rate (SDR per U.S. dollar)	0.727	0.731	0.743	0.734
F. SDR value (D × E)	1,438,155,000	134,257,500	1,107,609,997	2,680,022,497
G. "Profit" transferred to investment account, in SDR (F − B)	1,190,553,893	111,312,263	925,107,495	2,226,973,651

Source: "Off-Market Gold Sales—Mexico," EBS/00/69 (April 7, 2000).

Table 13.8. PRGF Trust and SDA: Combined Balance Sheet (as of April 30, 2000)

	Thousands of SDRs	Equivalent Thousands of U.S. Dollars
Assets	**10,596,104**	**14,189,773**
Cash and equivalents	346,144	463,539
Investments	4,463,020	5,976,653
Loans receivable	5,769,166	7,725,779
Interest receivable	17,774	23,802
Liabilities and resources	**10,596,104**	**14,189,773**
Resources	4,305,726	5,766,013
Balance, beginning of the year	4,098,988	5,489,160
Contributions	115,809	155,086
Transfers from the SDA	168,572	225,743
Transfers through the SDA to the PRGF-HIPC Trust	−69,267	−92,759
Operational income	−8,376	−11,217
Investment income	162,189	217,195
Interest on loans	29,080	38,942
Interest expense	−199,452	−267,096
Other expense	−193	−258
Borrowings	6,223,794	8,334,594
Interest payable	66,391	88,908
Other liabilities	193	258

Source: *Annual Report 2000*, pp. 207, 210.

Note: The combined balance sheet includes the Loan Account, Reserve Account, and Subsidy Account.

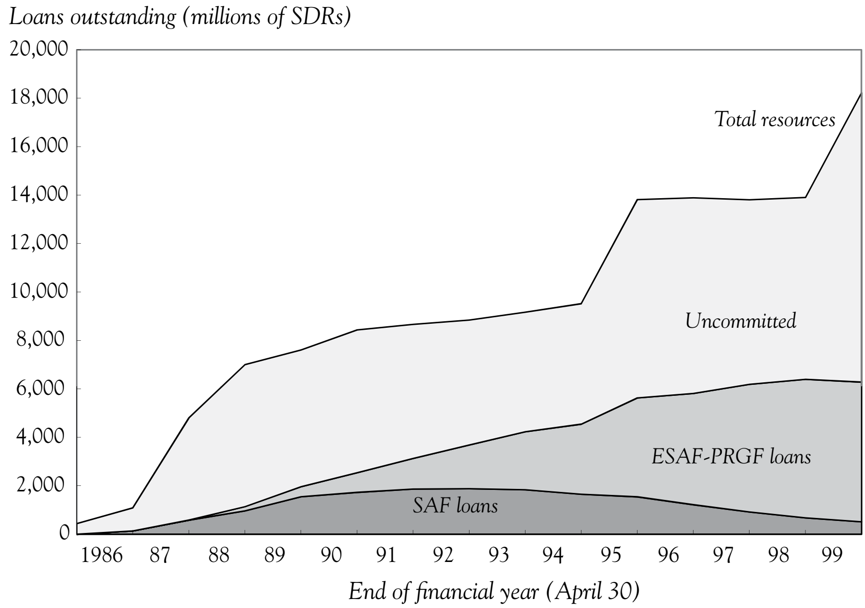
Table 13.9. PRGF-HIPC Trust and Related Accounts: Combined Balance Sheet (as of April 30, 2000)

	Thousands of SDRs	Equivalent Thousands of U.S. Dollars
Assets	**834,865**	**1,118,009**
Cash and equivalents	600,736	804,476
Investments	221,135	296,133
Loans receivable	10,757	14,405
Interest receivable	2,237	2,996
Liabilities and resources	**834,865**	**1,118,009**
Resources	511,051	684,374
Balance, beginning of the year	99,651	133,448
Contributions	412,333	552,176
Grants	−139,986	−187,462
Disbursements	0	0
Transfers	128,437	171,996
Operational income	10,616	14,216
Investment income	11,734	15,714
Interest expense	−1,078	−1,444
Other expense	−40	−54
Borrowings	323,175	432,780
Interest payable	626	838
Other liabilities	13	17

Source: *Annual Report 2000*, pp. 219, 222, 223.
Note: The combined balance sheet includes the PRGF-HIPC Trust subaccount, PRGF subaccount, and HIPC subaccount.

At the end of this process (as of end-April 2000), the PRGF Trust had $14.2 billion in assets, of which about $6.5 billion was available for future lending (investments plus cash and equivalents, as shown in Table 13.8). In addition, the PRGF-HIPC Trust (Table 13.9) held $1.1 billion in assets, not including commitments by donors to provide further grants or loans as needed. Adding in undrawn commitments to the PRGF Trust and the resources of the SDA, total available resources for assistance to low-income countries amounted to more than $24 billion (SDR 18.2 billion). Two-thirds of that amount was still uncommitted (Figure 13.2). Accumulating these resources had taken several years, but the IMF now had the means to take on the dual task of providing concessional loans and grants to the world's poorest countries for the foreseeable future.

Figure 13.2. SAF, ESAF, PRGF, and HIPC Resources and Loans Outstanding



Source: IMF financial accounts.
Note: Total resources include assets in the Special Disbursement Account and the ESAF, PRGF, and HIPC Trusts plus undrawn borrowing arrangements.

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