DEBT RELIEF BY MULTILATERAL LENDERS:

Why, How and How Much?

BY MARINA ZUCKER-MARQUES, ULRICH VOLZ AND KEVIN P. GALLAGHER

DEBT RELIEF FOR A GREEN & INCLUSIVE RECOVERY

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ABOUT

A debt crisis is emerging in the Global South at the precise moment when substantial investment is needed to meet shared climate and development goals. Yet, the G20 Common Framework has been unable to engage all creditor classes or link debt relief to climate and development. The Debt Relief for Green and Inclusive Recovery (DRGR) Project, a collaboration between the Boston University Global Development Policy Center, Heinrich-Böll-Stiftung and the Centre for Sustainable Finance at SOAS, University of London, argues it is time for comprehensive debt reform. Utilizing rigorous research, DRGR seeks to develop systemic approaches to both resolve the debt crisis and advance a just transition to a sustainable, low-carbon economy in partnership with policymakers, thought leaders and civil society from around the world.

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The views expressed in this policy brief are those of the authors alone and are not reflective of the views of the publishing institutions.

ABBREVIATIONS

ADB	Asian Development Bank
AfDB	African Development Bank
AFESD	Arab Fund for Economic and Social Development
CAF	Development Bank of Latin America and the Caribbean
CCRT	Catastrophe Containment and Relief Trust
COP21	21st Conference of the Parties
CoT	Comparability of Treatment
DSSI	Debt Service Suspension Initiative
EIB	European Investment Bank
EMDEs	Emerging market and developing economies
FTT	Financial transaction tax
G20	Group of 20
HIPC	Heavily Indebted Poor Countries Initiative
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFI	International financial institution
IFTT	International financial transaction tax
IMF	International Monetary Fund
LIC	Low-income country
MAC	Market Access Countries
MDB	Multilateral development bank
MDRI	Multilateral Debt Relief Initiative
NCF	New Common Framework countries
NPV	Net present value
NV	Nominal value
ODA	Official development assistance
PCDR	Post-Catastrophe Debt Relief Trust
PPG	Public and publicly guaranteed
PRGT	Poverty Reduction and Growth Trust
PV	Present value
SDGs	Sustainable Development Goals
SDRi	Special Drawing Rights interest rate
SDRs	Special Drawing Rights
SIDS	Small Island Developing States
UNDP	United Nations Development Programme

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EXECUTIVE SUMMARY

As the sovereign debt crisis in the Global South continues to unfold, the lack of involvement of multilateral development banks (MDBs) in debt relief efforts has become a contentious issue among major creditors. Although the Group of 20 (G20) has explicitly called for MDBs to develop options to share the burden of debt relief efforts, MDBs have not presented any concrete and systemic plan thus far on how to contribute to debt relief efforts to countries applying for the G20 Common Framework. Combined with other points of dispute, the ongoing negotiations within the Common Framework have yielded disappointing results with little to no substantial debt relief provided despite protracted discussions.

This report aims to contribute to the ongoing debate over debt relief negotiations and MDBs in three main areas. First, we assess whether there are compelling reasons for including multilateral lenders in debt relief, considering the point of view of debt-vulnerable developing countries, the efficiency of current debt relief negotiations and the sustainability of MDBs' operational model. Second, we estimate the adequate level of relief MDBs should provide should they partake in debt restructuring, considering the high levels of concessional lending they provide, which can be considered "ex ante" debt relief. Finally, bearing in mind the importance of maintaining MDBs' preferred creditor status and high credit ratings for a low cost of funding, we discuss policy options to cover MDBs losses. Our suggestions draw on historical experiences of MDB involvement in debt relief (the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative), as well as emerging opportunities.

We argue there are four reasons to include MDBs in debt relief. First, debt-vulnerable countries rely substantially on these lending institutions. Second, providing debt relief is aligned with MDB goals and mandates, including achieving the UN 2030 Sustainable Development Goals (SDGs) and the Paris Agreement. Third, from the inception of the Common Framework, MDBs were explicitly requested by the G20 to be involved in relief efforts. The participation of MDBs allows for equitable distribution of the burden among creditors, thereby mitigating the perception of unfairness. Fourth, the prolongment of a debt crisis in the Global South is costly to MDBs, as their rules require them to increase the concessional/grant element as debt distress indicators of their most vulnerable countries deteriorate.

We find that MDB participation in debt restructuring could help unlock a multifold amount of relief by other creditors where debt relief would have greater leverage than new lending.

Main findings:

- For 61 countries identified as being in or at high risk of debt distress to achieve debt sustainability, we estimate more than $781 billion in debt (net present value) needs to be restructured across all creditor classes.
- Using a range of historical precedents for the size of relief needed (a reduction from 39 percent to 64 percent of net present value), we estimate that haircuts will have to amount to between $305 billion to $500 billion.
- The contribution of MDBs to the debt relief efforts can be less burdensome by adopting a "fair" comparability of treatment rule instead of a "flat" rate of debt relief.
- If all creditors of these 61 countries reduced their present value claims by the same proportion, the World Bank International Development Association (IDA) would bear $20 billion to $32 billion in losses. But under a "fair" comparability of treatment rule, IDA's contribution would account for only $3.5 billion to $23 billion, depending on the overall debt haircut needed by debtor countries.
- Considering the "fair" comparability of treatment, other MDBs (excluding IDA) would need to contribute between $33 billion and $75 billion, instead of $53 billion to $87 billion under a flat rate treatment.
- If all creditors were to participate in the debt restructuring of 61 countries in debt distress with an overall debt reduction of 39 percent, each dollar contributed by donors for debt relief through MDBs would translate into an additional $7 of total debt relief for countries in debt distress. This proportion exceeds average MDBs equity-to-loan leverage.

Key policy recommendations:

- All creditors, including MDBs, should participate in debt relief efforts and accept losses on their outstanding claims under a comparability of treatment rule that incorporates the cost of lending and concessionary elements.
- To compensate MDB losses, MDBs shareholders should:
    - **Revamp and expand existing debt relief initiatives:** Donor countries should contribute to a new round of debt relief through funds like the Debt Relief Trust Fund, which pools resources from donors and international financial institutions, and consider making debt relief

a regular component of concessional finance policies, with a dedicated portion of funding in each IDA replenishment specifically allocated to debt relief efforts.

- **Consider increasing MDB equity:** Explore avenues for increasing the equity of MDBs so that precautionary balances could be freed up and used partially for debt relief efforts without negatively impacting the institutions' credit ratings.
- **Revive efforts to establish an international financial transaction tax (IFTT):** While politically challenging, a well-designed IFTT on various financial transactions could generate substantial revenues, which could be directed toward MDBs to support debt relief and other development efforts. However, careful consideration is needed to avoid double taxation on private sector debt holders.

Including MDBs in debt relief is crucial to effectively addressing the mounting debt crisis in the Global South. Equitable burden-sharing among creditors is imperative to foster a fair and transparent process that encourages the participation of all stakeholders. While there are costs associated with providing debt relief, it is a prudent investment for the long-term stability and development of debt-vulnerable nations. Implementing policy options to support MDBs in shouldering these costs will be key to ensuring a sustainable future.

INTRODUCTION

Despite the worsening debt situation in developing countries, the ongoing debt relief negotiations within the Group of 20 (G20) Common Framework have yielded disappointing results. As of the writing of this report, there have been protracted discussions, but little to no substantial debt relief has been provided. One particularly contentious issue throughout the negotiations is the undecided participation of multilateral development banks (MDBs). The G20 has called on MDBs "to develop options for how best to help meet the longer term financing needs of developing countries, including by drawing on past experiences to deal with debt vulnerabilities such as domestic adjustment, net positive financial flows and debt relief," with explicit reference to past debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) (G20 and Paris Club 2020). However, views on this matter have been sharply divided. On one side, developed nations, including the United States and European countries, as well as institutions like the International Monetary Fund (IMF) and the World Bank, are resistant to the idea of MDBs incurring any losses. In contrast, China has consistently advocated for the involvement of MDBs, although there have been reports of a flexibilization in their stance during the 2023 IMF/World Bank Group Spring Meetings ("IMF's Georgieva Discusses" 2023; Cash 2023; G20 2020; van Staden 2023).

The resistance to MDBs participating in debt relief can be attributed to three main factors. First, it is argued that if MDBs absorbed losses, it would risk their preferred creditor status, an acknowledged practice to prioritize MDB repayment over other lenders. Accepting losses, it is argued, would adversely affect MDBs' credit rating, leading to increased borrowing costs that would ultimately be passed on to borrowing countries. While this risk could be eliminated by contributions from donor countries, there is often little willingness among advanced nations – the main shareholders of MDBs – to cover MDBs' losses.

Second, it is emphasized that MDBs' lending rates are significantly lower than commercial lending, and that a portion of their loans are often provided as grants that do not require repayment. From this perspective, MDBs argue that they already provide "ex-ante" debt relief and should not bear additional losses.

Lastly, MDBs highlight that their business operations are designed to be countercyclical as they provide financing even during crises. Instead of receiving debt write-offs from MDBs, developing countries could benefit more from fresh flows of funding, including increased grants and higher concessionary financing terms. Although MDBs' lending patterns differ

significantly from private flows, which strongly respond to fluctuations in business cycles, it is not always countercyclical. Except for World Bank lending, whose lending is often countercyclical, lending from regional development banks can be described as acyclical at best (Galindo & Panizza 2018). Moreover, given the funding constrains and the impediments to expand MDB balance sheets, the promises that by avoiding write-offs MDB lending could increases in the coming years should be taken with caution.

Despite the arguments against the involvement of MDBs in debt relief, from the point of view of debt-vulnerable developing countries, there are compelling reasons for including these creditors in debt relief negotiations. This report contributes to this discussion, giving special attention to a group of 69 countries referred to as the New Common Framework (NCF) countries, which have been identified by the IMF and the United Nations Development Programme (UNDP) as having unsustainable levels of sovereign debt and needing debt relief (see Annex 1 for the list of countries) (Ramos et al. 2023).[1] Due to lack of data availability, in this report we restring our analysis to a sample of 61 countries. Given the imminent need to ramp up investments for green and inclusive development to achieve the UN 2030 Sustainable Development Goals (SDGs) and make economies more resilient against climate change, it is key that a broad range of countries benefit from a fair level of debt relief in order to increase their fiscal space. This report estimates the cost of MDB debt relief considering different approaches of comparability of treatment and proposes policy options to include MDBs in debt relief without harming their credit ratings and compromising their ability to raise capital at favorable rates.

The report is structured as follows. Section 2 discusses the case for involving MDBs in debt relief. Section 3 considers approaches to ensure comparability of treatment among different creditors, considering the respective financing terms, and provides estimates of losses that creditors would face under different scenarios. Section 4 subsequently discusses how losses of MDBs can be covered by their shareholders. Section 5 addresses the trade-offs between granting debt relief by MDBs and providing new MDB financing. Section 6 concludes with key policy recommendations.

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1 The selection of these 69 countries is based on Ramos et. al (2023), who identified a group of countries that are either classified by the UNDP or the IMF as debt vulnerable. This comprises countries that were categorized by the IMF's recent Debt Sustainability Analyses as being in "high risk" of debt distress or in debt distress. From the UNDP, it includes all low- and middle-income countries that have a numeric credit rating under six or countries with sovereign bond spreads more than ten percentage points against US Treasury bonds.

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There are several political and economic reasons why it is crucial to consider the role of MDBs in the process of debt renegotiations. First, debt-vulnerable countries have a substantial reliance on these lending institutions. Second, providing debt relief is aligned with MDBs' goals and mandates, including achieving the SDGs and the Paris Agreement. Third, from the inception of the Common Framework, MDBs were explicitly requested by the G20 to be involved in relief efforts. The participation of MDBs allows for equitable distribution of the burden among creditors, thereby mitigating the perception of unfairness. Fourth, the prolongment of a debt crisis in the Global South is costly to MDBs, as their rules require them to increase the concessional/grant element as debt distress indicators of their most vulnerable countries deteriorate.[2] Lastly, the involvement of MDBs can facilitate the negotiation process and enhance debt restructuring for all creditor classes, ultimately leading to a more effective reduction of the overall debt burden. Including MDBs in debt negotiations can not only bring benefits to debt-vulnerable countries, but it can also have positive aspects for MDBs and their shareholders.

MULTILATERAL LENDERS AS KEY CREDITORS OF DEBT-VULNERABLE COUNTRIES

The first and main reason for including MDBs in the debt renegotiation is the size of exposure to these creditors. Considering the 61 NCF countries for which data is available, altogether they have an external public and publicly guaranteed (PPG) debt stock of $992 billion (at nominal value, NV),[3] of which 29 percent is owed to MDBs and 11 percent to the IMF. Debt stock from the World Bank International Development Association (IDA) alone – the soft loan window of the World Bank Group for low-income countries – represents $84 billion, or 8 percent of their total debt stock, which is even higher than debt stock from Paris Club countries ($76 billion). Apart from IDA, other key multilateral creditors to NCF countries are the World Bank Group's International Bank for Reconstruction and Development (IBRD) ($47 billion, or 5 percent), the Inter-American Development Bank (IDB) ($26 billion, or 3 percent), the African Development Bank (AfDB) ($26 billion, or 3 percent) and the Asian Development Bank (ADB) ($26 billion, or 3 percent).

2 Grant elements and concessionality rates are equivalent terms (Scott, 2017).

3 Excluding IMF credits, the total external PPG debt stock (face value) accounts for $879.2 billion, of which is equivalent to $781 billion in present value.

Figure 1: New Common Framework Countries, Public External Debt Stock Composition in 2021, in billions (at nominal value)

Source: Compiled with data from World Bank IDS 2022 and Ramos et al. (2023).

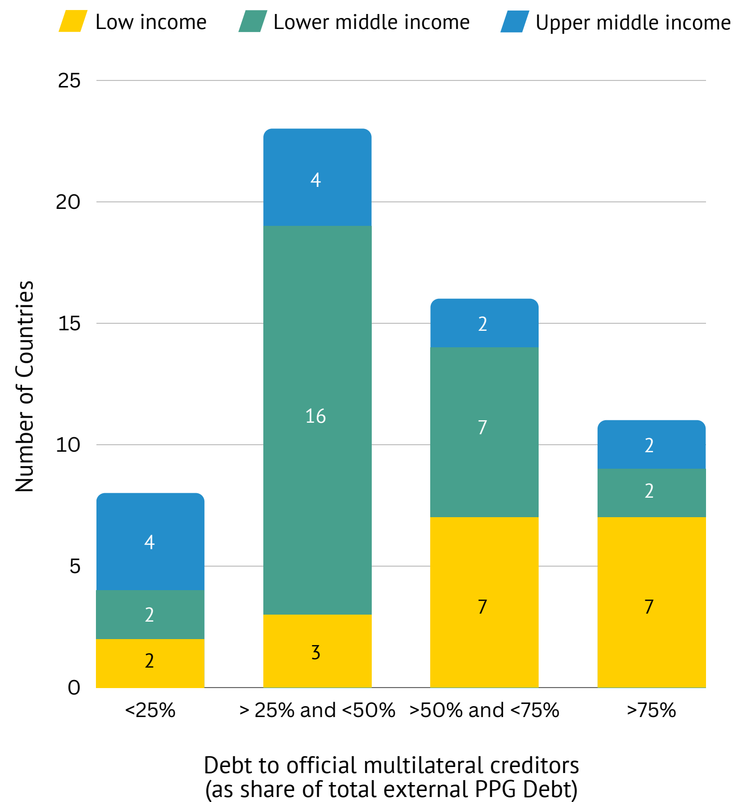
Note: IDA (International Development Association), IBRD (International Bank for Reconstruction and Development), IDB (Inter-American Development Bank), AfDB (African Development Bank), ADB (Asian Development Bank), EIB (European Investment Bank), CAF (Development Bank of Latin America and the Caribbean), AFESD (Arab Fund for Economic and Social Development), NCF (New Common Framework Countries).

The level of exposure to multilateral official lenders, including MDBs and the IMF, varies among countries, as shown in Figure 2a. For 27 debt-vulnerable countries, multilateral official lenders own at least half of their debt stock. This means that if the IMF's and MDBs' credit are excluded, these debtor countries would only have a limited portion of their total external debt available for restructuring. Consequently, even if bilateral and private debts were completely canceled, these countries may still face ongoing debt vulnerability. As Viterbo (2020) points out, excluding a high share of debt from restructuring would defeat the purpose of an international debt restructuring altogether. As she puts it, international debt restructuring aims "to give it a 'fresh start' that enables [the debtor country] to return to the path of economic growth in the long run. This is possible if, and only if, a significant portion of its total external debts is restructured" [emphasis added]. Moreover, as Figure 2a shows, given the higher exposure of low-income countries (LICs) to MDB lending, excluding MDBs from debt renegotiation would

disproportionally affect the poorest nations. Of the 11 countries with over 75 percent of debt stock owned by multilateral lenders, seven are LICs. Moreover, there are eight Small Island Developing Economies (SIDs) with debt stock to MDBs or the IMF above 50 percent (Figure 2b).

Figure 2: Debt Stock Exposure of New Common Framework Countries to Official Multilateral Creditors by Income Group, as a Share of Total Official Outstanding Debt (December 2021)

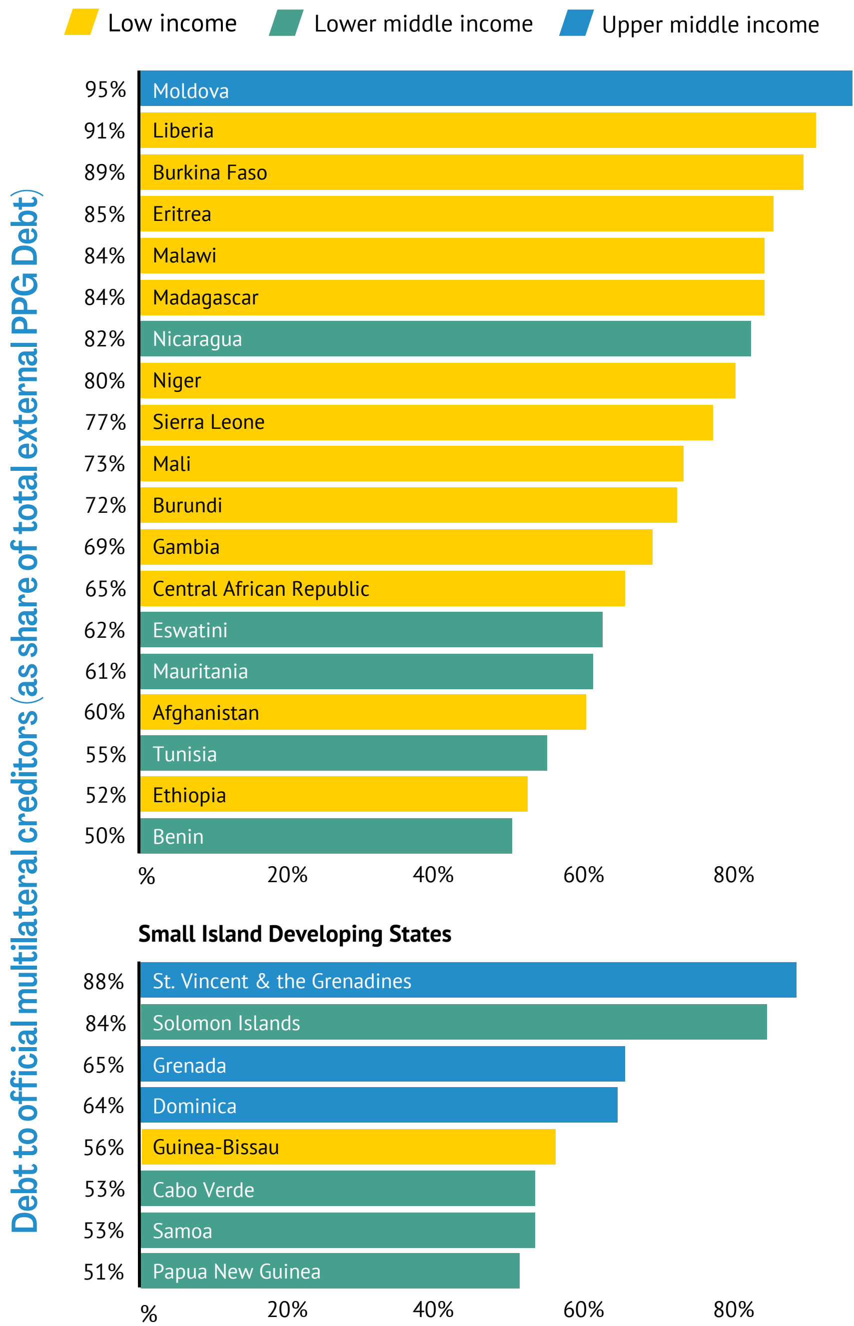
2a. Number of countries: up to 25%, between 25% and 50%, between 50% and 75%, above 75%



Source: Own elaboration based on WB IDS 2022. OBS. Income group as per 2022 WB classification

Note: Figure includes credits to the International Monetary Fund.

2b. Countries with debt stock to multilateral lenders above 50%



Source: Own elaboration based on WB IDS 2022. OBS. Income group as per 2022 WB classification

Note: Figure includes credits to the International Monetary Fund.

PROVIDING DEBT RELIEF IS ALIGNED WITH MDBS GOALS AND MANDATES

Including multilateral lenders in debt relief efforts would reinforce their core mandate of promoting economic development and poverty reduction, which is the second reason why they should participate in debt restructuring. To date, the HIPC Initiative from 1996, followed by the MDRI, were the largest debt relief programs implemented jointly by MDBs and the IMF. Although they cost multilateral creditors about $78 billion (in present value terms as of end-2017, $34 billion under HIPC and $44 billion under MDRI), studies suggest that such debt relief effort positively contributed to poverty reduction, public investments (Cassimon et. al 2015; Djimeu 2018) and growth (Hussain & Gunter 2005; Siddique et al. 2016) in developing countries.

MDBs are committed to the SDGs and the Paris Agreement[4] (AfDB et al. 2020), and they can reinforce their commitments not only by providing new lending but also through debt relief, as it would improve governments' fiscal space to spend on climate and development goals. Moreover, involving international financial institutions (IFIs) in debt renegotiation is compatible with the UN's *Guiding Principles on Foreign Debt and Human Rights*, according to which "[t]he renegotiation and restructuring [of sovereign debt] should be conducted in good faith and should cover all types of external debts owed to all types of external creditors, *including international financial institutions*" [emphasis added].[5]

FAIR BURDEN SHARING AND CONTRIBUTING TO THE G20 COMMON FRAMEWORK

A third reason for the involvement of multilateral lenders relates to a cornerstone of debt negotiations, which is "fair burden sharing." This principle posits that different creditors bear an equitable distribution of losses considering their exposure to risk, the terms of the loans and the creditor's financial capacity. At its inception in 2020, the G20 Common Framework has

4 Since 2015, during the 21st Conference of the Parties (COP21), a consortium of MDBs has expressed their support for the implementation of the outcomes of the Paris Conference. The COP21 declaration includes the African Development Bank Group, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Banks, the Inter-American Development Bank Group, and the World Bank Group (IFC, MIGA, World Bank). In recent declarations, the following MDBs also included the Asian Infrastructure Investment Bank, the Council of Europe Development Bank, the Islamic Development Bank, and the New Development Bank.

5 HRC, Guiding Principles on Foreign Debt and Human Rights (A/HRC/20/23), para 54.

mentioned the involvement of MDBs in debt negotiations within the section of "Comparability of Treatment with Other Creditors":

> *"Multilateral Development Banks will develop options for how best to help meet the longer-term financing needs of developing countries, including by drawing on past experiences to deal with debt vulnerabilities such as domestic adjustment, net positive financial flows and debt relief, while protecting their current ratings and low cost of funding" (G20 and Paris Club 2020, emphasize added).*

And although the G20 document mentions the lack of consensus on specifics regarding debt relief efforts, other previous experiences of MDB debt relief are referred to in the text:

> *"Different options were used in the past to deal with debt vulnerabilities, including domestic adjustment, increased net positive inflows or debt relief including through schemes such as the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI). There is currently no consensus on how these previous options might apply to current circumstances" (G20 and Paris Club 2020).*

Recently, during the 2023 BRICS summit in Johannesburg II, BRICS member countries reinforced the importance of fair-burden sharing among all creditor classes within the Common Framework:

> *"One of the instruments, amongst others, to collectively address debt vulnerabilities is through the predictable, orderly, timely and coordinated implementation of the G20 Common Framework for Debt Treatment, with the participation of official bilateral creditors, private creditors and Multilateral Development Banks in line with the principle of joint action and fair" (BRICS 2023).*

As of today, MDBs have not developed a concrete and systematic approach on how to contribute to burden sharing under Common Framework restructurings. There was ad hoc involvement in the case of Zambia from the World Bank and the AfDB. However, in the case of the AfDB, new commitments account for merely $300 million for the period 2022-2025, which is lower than the average commitment the AfDB made over the past decade

(2012-2021).[6] In the case of the World Bank, new commitments for the period 2022-2025 amount to $1.4 billion. Although this is higher than its historical commitment to Zambia, only $175 million is in the form of grants (IMF 2023b). Despite these issues with AfDB and World Bank participation in the case of Zambia, there no indication that a similar pattern of involvement will be replicated in other cases.

The abstention of MDBs from debt restructuring in a systematic manner conveys an impression of unfairness and raises free-riding concerns to participating creditors. This perception can increase the resistance of other creditors to joining debt negotiations, making the overall process more challenging. For instance, MDBs are not the only financial institutions that have concerns over credit rating downgrades and funding costs when providing debt relief to their clients. Granting special treatment on these grounds sets a precedent for private creditors, who have their own unique concerns and financial limitations, to justify their exclusion from debt relief efforts (Rhodes & Lipsky 2023). Although credit ratings and funding concerns often set MDBs apart from other official lenders, the increasing complexity of the debt structure needs to be acknowledged and how exceptions can risk the success of the entire debt restructuring effort.

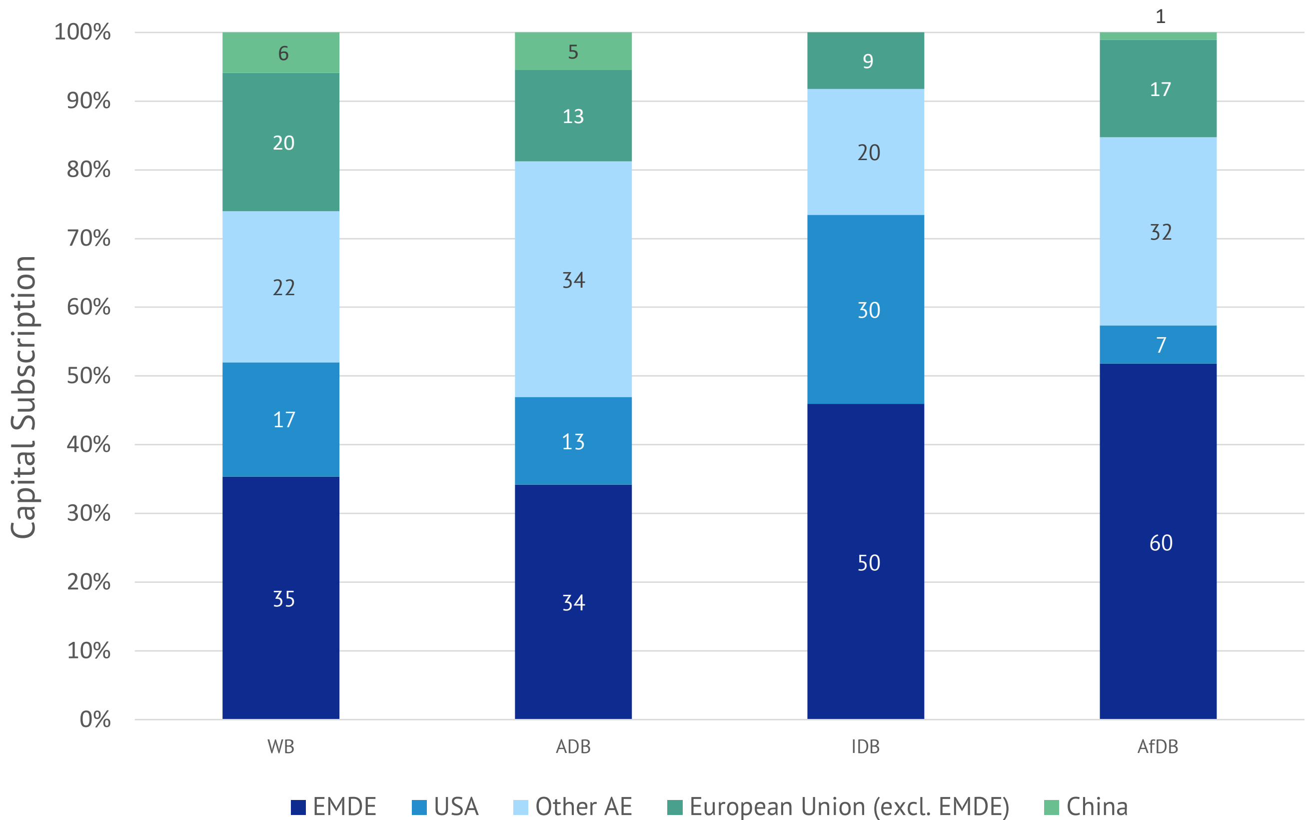
Another example concerns the recent involvement of China in debt negotiation: Brautigam and Huang (2023) note that the unequal participation of creditors in the G20 Debt Service Suspension Initiative (DSSI, valid between May 2020-December 2021) has generated an unfair impression to Chinese official lenders, which later reinforced Chinese demands for full creditor participation under the G20 Common Framework. Under the DSSI, private creditors were called to participate without any incentives (and on a voluntary basis), and MDBs were requested to "explore options," which left the *de facto* responsibility of providing support to poor nations only to official lenders. China was the largest contributor under the DSSI. Chinese participation accounted for 63 percent of all standstills, even though Chinese creditors held only 30 percent of debt service claims (Brautigam and Huang 2023). It should be noted, however, that MDBs contributed to the crisis responses to the COVID-19 pandemic by frontloading lending and increasing net flows to poor countries. However, the refusal of MDBs to participate in the DSSI and suspend debt payments generated an impression of unfairness.

6 The AfDB did not commit any resources in 2022 and 2025 but plans to disburse $150 in 2024 and another $150 in 2025 (IMF 2023). Between 2012 and 2012, on average AfDB committed $97 million per year according to data from WB IDR (2022).

According to Mingey and Wright (2023), China's total sovereign debt claims under negotiation between January 2020-March 2023 amount to over $78 billion, including both principal and deferred income. During the same period, China granted 16 write-offs to African nations, totaling $231 million.

Another issue that creates a perception of unfairness is related to the shareholder structure of large MDBs. Taking the World Bank as an example, although it has 189 members, the total subscription is concentrated in advanced economies, which together hold 59 percent of the subscribed capital. The largest shareholder is the United States, with 16.4 percent of subscribed capital. A similar distribution is found in other large MDBs, like the ADB, IDB and AfDB (see Figure 3). In that sense, the non-participation of MDBs may be interpreted as a bailout from creditors involved in debt relief efforts – including emerging market and developing economies (EMDEs) – to advanced economies that are the MDBs' main shareholders.

Figure 3: Capital Subscription of World Bank IBRD, Asian Development Bank, Inter-American Development Bank, African Development Bank

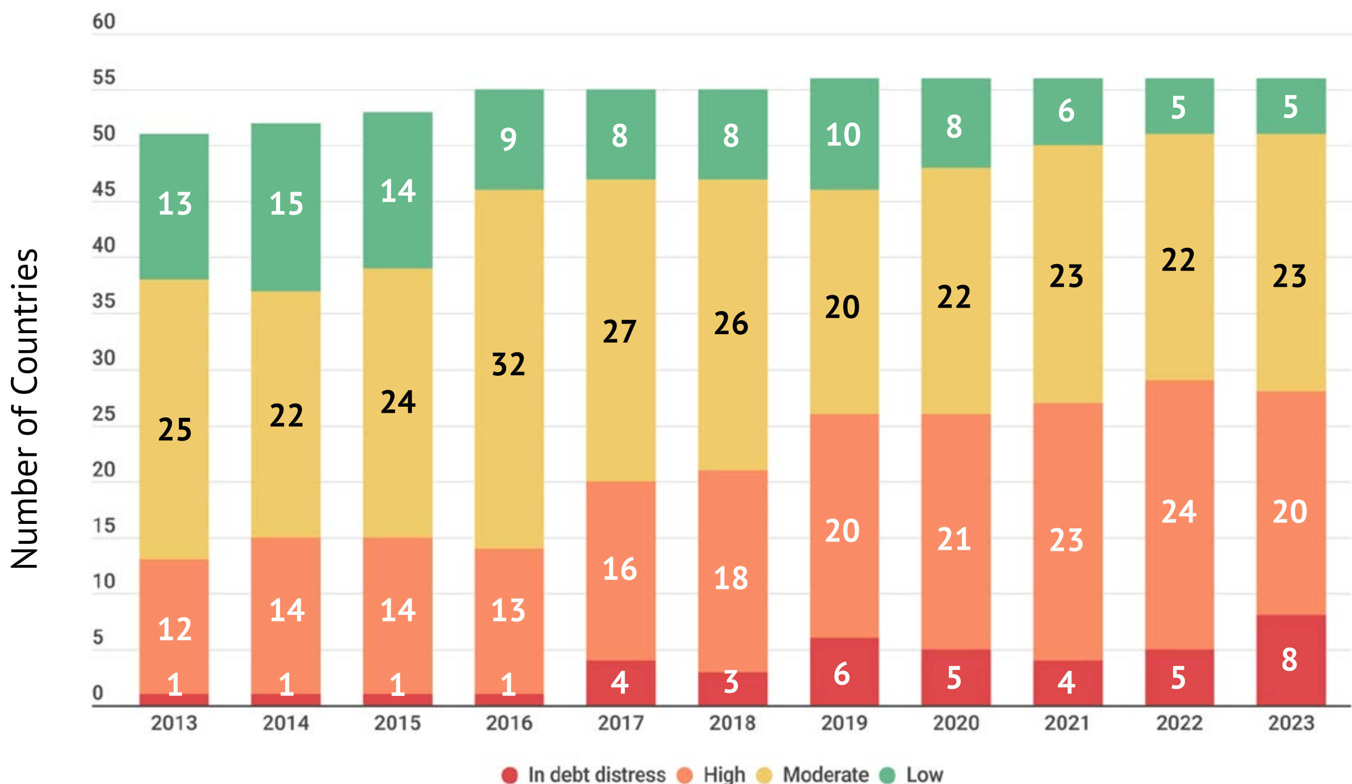


Source: Own elaboration based on WB (2023), IDB (2023), AfDB (2022), ADB (2018).

A PROLONGMENT OF A DEBT CRISIS IN THE GLOBAL SOUTH IS COSTLY TO MDBs

A fourth reason for the involvement of MDBs is that prolonging a debt crisis in the Global South is costly for MDBs. As part of their concessional policies, MDBs consider the debt distress classification of their clients – as per IMF/ World Bank debt sustainability analyses – to determine the proportion of grants and credits. For instance, IDA adopts a "traffic light" system. Countries that are only eligible to IDA and are at high risk or in debt distress (red light) can benefit from 100 percent grants, medium-risk countries (yellow light) from 50 percent, while low-risk countries (green light) cannot benefit from grants and receive 100 percent of IDA credit (World Bank 2007; World Bank 2023). Similar policies are followed by the concessional window of other MDBs, including the AfDB, IDB and ADB (AfDB 2019; ADB 2021; IDB 2023).

Figure 4: Number of IDA-only Countries by Debt Distress Classification, as per IMF/World Bank Debt Sustainability Framework, 2013-2023



Source: IMF Debt Sustainability Analysis List for LICs PRGT eligible countries.

Note: Data from 2023 (May) is currently available at the IMF website, but earlier lists retrieved from Internet Archive website. Data available: November 2013, August 2014, January 2015, April 2016, September 2017, January 2018, November 2019, September 2020, June 2021, August 2022 and May 2023. DSA classification is not available for some IDA-only countries.

Considering debt distress indicators when allocating grants are viewed positively by client countries for maintaining their debt sustainability and avoiding debt overhangs. But once many of the MDBs' clients are in debt distress, a policy of providing grants considering debt distress indicators brings substantial cost to MDBs. As Figure 4 shows, between 2013-2023, the number of IDA-only eligible[7] countries that could benefit from 100 percent grants (red light, with high risk or in debt distress) increased from 13 to 28. As of May 2023, only five IDA-only eligible countries do not receive grants related to debt distress indicators.

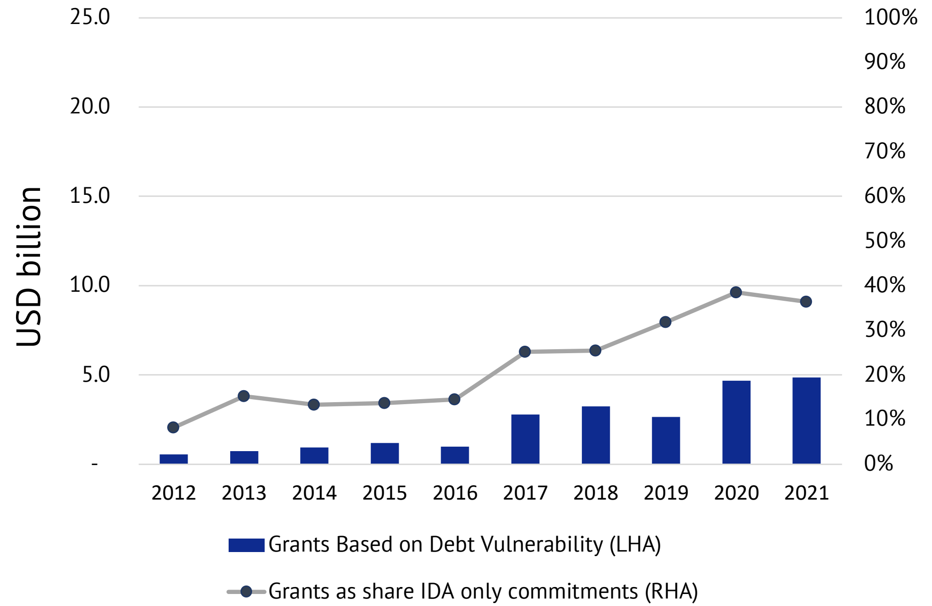
Diwan et al. (2023) estimate that since the inception of this concessional rule in 2005, IDA alone has provided $80 billion of grants to countries with debt vulnerability. According to our estimate for IDA-only countries shown in Figure 5a, IDA grants based on debt sustainability criteria grew from $0.6 billion (8 percent of IDA-only commitments) to $4.9 billion (36 percent of IDA-only commitments) between 2012-2021. In the 2012-2021 period, accumulated grants based on debt sustainability accounted for $22 billion.

If the current situation of debt vulnerability among IDA-only countries continues, grants linked to debt vulnerability from IDA could reach an accumulated amount of $24.3 billion over the next five years, assuming a steady IDA lending volume. Under a scenario where the trend observed from 2012-2021 persists, when grants linked to debt distressed increased by 27 percent per year, this type of grant could amount to $16 billion by 2026. In an extreme case, following a trend observed between 2019-2021, grants based on debt vulnerability could reach a staggering $22 billion in a single year by 2026 (assuming an annual increase rate of 35 percent). These projections illustrate that the prolongment of a debt distress situation among IDA clients – or even a further deterioration of the situation – poses a threat to the institution's business model, which relies in part on repayments from clients to support its capital base. As the debt situation worsens, IDA could become increasingly reliant on donor contributions to maintain the same lending capacity, let alone expanding it. Therefore, achieving the "green light" status (low risk of debt distress) for more countries is not only beneficial for the countries themselves but also crucial for maintaining a balanced model for IDA and other MDBs that adopt similar concessionally policies. Given the significant costs that prolonged debt distress in the Global South imposes on MDBs, it is in their best interest to prioritize the swift resolution of the current debt situation.

7 See annex 3 for the list of IDA eligible countries by lending terms (IDA-only or Blend)

Figure 5: Grants Based on Debt Vulnerabilities Indicators, World Bank-IDA to IDA-only Countries

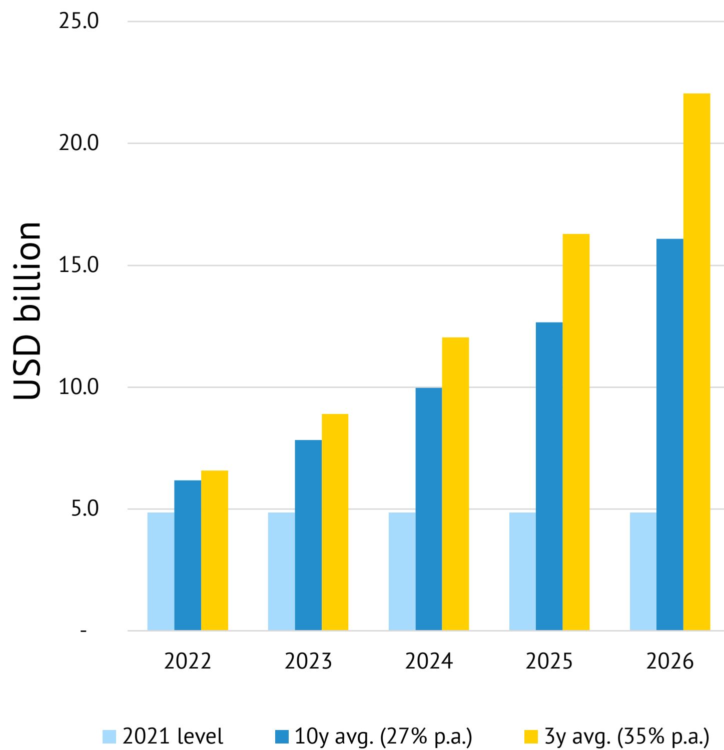
5a. Grants in USD billion (Based on Commitments) and as Share of Total Commitments to IDA-only Countries, 2012-2021



Source: Own elaboration based on World Bank IDS 2022, IMF Debt Sustainability Analysis List for LICs Poverty Reduction and Growth Trust (PRGT) eligible countries and WB (2023b).

Note: See Annex 3 for a list of IDA eligible countries based on lending terms. We do not include countries that can borrow from IBRD and IDA concomitantly (known as blend countries). Commitments to Sri Lanka were excluded from the estimation, as it was reclassified as IDA eligible during the 2023 Fiscal Year. For estimating grants based on sustainability indicators, it was accounted the debt distress classification of the previous year and IDA commitments of the following year. DSA list for 2012 not available, it was considered the DSA classification of 2011.

5b. Grants Volume in USD billion, 5-year Projection



Source: Own elaboration based on World Bank IDS 2022, IMF Debt Sustainability Analysis List for LICs Poverty Reduction and Growth Trust (PRGT) eligible countries and WB (2023b).

Note: See Annex 3 for a list of IDA eligible countries based on lending terms. We do not include countries that can borrow from IBRD and IDA concomitantly (known as blend countries). Commitments to Sri Lanka were excluded from the estimation, as it was reclassified as IDA eligible during the 2023 Fiscal Year. For estimating grants based on sustainability indicators, it was accounted the debt distress classification of the previous year and IDA commitments of the following year. DSA list for 2012 not available, it was considered the DSA classification of 2011.

FACILITATING THE NEGOTIATION PROCESS AND ENHANCING DEBT RESTRUCTURING FOR ALL CREDITOR CLASSES

The final reason for MDB participation in the current debt relief efforts is the potential to unlock the debt negotiation process and encourage the participation of all creditor classes. If MDBs agree to join – in terms that may vary, as the next section will show – not only will they be able to speed up the current debt negotiation, but they would also help preserve the long-term business model they depend on.

COMPARABILITY OF TREATMENT

THE COST OF BORROWING

Defining the burden sharing among creditors during a debt relief process is a highly complex exercise (Iversen 2023). To start, lending conditions are diverse and vary in multiple dimensions including different financing objectives, maturities, grace period, interest rate, collateralization and conditionalities, to mention a few parameters. Comparing net present value (NPV) of debt reduction granted by different creditors or creditor group is a challenge by itself (Lazard 2022). To add to the complexity, different creditors classes face unique impediments and implications when providing debt relief (including financial, legal, bureaucratic and political). For instance, while the private sector and MDBs are concerned with potential credit rating downgrades and increasing funding costs, official creditors may face political and bureaucratic hurdles. All these instances make inter-creditor negotiation a very convoluted process, especially now with an increasingly diverse number of creditor classes.

This report does not aim to give a final answer to these complex questions. However, by acknowledging the complexity, from the point of view of efficiency and effectiveness of sovereign debt restructuring, it is impractical to offer preferential treatment to some creditor classes based on their unique impediments, regulatory regimes, status, underlying borrowing cost or even by the virtue of their mission. As Lazard (2022) highlights, simplicity and unambiguity criterion have merits when defining the comparability of treatment. In the spirit of providing simplicity but fairness, for the reasons outlined in the previous section, we agree that all creditor classes should be included in debt relief efforts but to define how much each creditor should contribute, it is important to account for *cost of borrowing* from different creditors.

On the one hand, private lenders incorporate default risks in their lending practices. To account for a more equitable distribution of losses among creditors, it is crucial to consider the incorporation of default risks in pricing of private sector lending practices, as well as the distinct level of conditionalities offered by official creditors. Apart from compensating for risks such as uncertainty, price volatility, liquidity and correlations with risky assets, investors are also specifically compensated for the risk of default. According to Bank of America (2022), emerging market spreads generally exceed what would be required to compensate investors for historical default risks. The historical five-year rate of default on foreign currency sovereign debt is about 2 percent for bonds rated up to BBB, about 5 percent to BB- and 14 percent for B-rated bonds. As Figure 6 shows, these risks are priced. For

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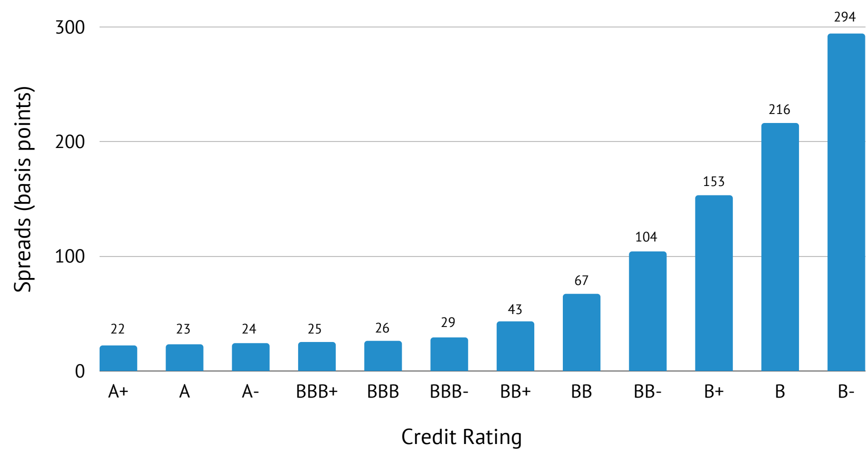
investment-grade countries, five-year spreads of about 20-30 basis points (bps) would be required to compensate for the historical probability of default, and it can reach 294 bps points for B- sovereign bonds. Moreover, it is observed that spreads generally exceed what would be required to compensate investors for historical default risks (Andritzky & Schumacher 2019; BofA, 2022; Meyer, Reinhart, & Trebesch 2022). Recent debt negotiations further support this notion. Taking the example of Zambia, it has been estimated that even if bondholders agreed to a 50 percent reduction in NPV, they could earn up to a 50 percent profit in comparison to what they would have gained from lending to the US government (Debt Justice 2023).

Figure 6: Five-year Spreads (bps) to Compensate for Historical Probability of Default by Rating



Source: Replicated from BofA, 2022.

Note from BofA (2022): Required spread calculated with simplified formula: Spread = [-(1-RR)/T]*[ln(1-PD)], where RR=Recovery Rate (in percent) and PD=Probability of Default (in percent). Calculation uses 25 percent Recovery Rate.

On the other hand, bilateral or multilateral creditors do not charge a premium associated to default risks. In contrast, official creditors – particularly IDA – often lend to developing countries at interest rates below market levels (hence, with grant element). Moreover, IDA specifically increases the grant element of loans as a country's debt distress situation worsens, as demonstrated by the traffic light policy discussed.

Figure 7 shows loan commitments and grant elements by creditor class for NCF countries. Although the private sector offered $653 billion of loan commitments from 2012-2021, its lending is often above the 10 percent per year rate, thereby yielding a "negative" grant element of 9 percent, or $56 billion, in that case. In contrast, official creditors provide positive grant elements at different levels. For the NCF countries, China provides the lowest share of

grant element (14 percent), followed by other official bilateral (18 percent), multilateral lenders excluding IDA (28 percent), Paris Club (29 percent) and IDA (42 percent). One of the justifications why MDBs should be exempted from debt restructurings is the high grant element of loans to countries with debt vulnerabilities (referred to as "ex-ante" implicit debt relief) (World Bank 2023). But as Figure 7 shows, this practice is not exclusive to IDA or MDBs in general, but a feature common also among other official lenders.

Figure 7: NCF Countries: Accumulated Loan Commitments and Grants (billion USD) and Average Grant Elements by Creditor Classes (%), 2012-2021

Source: Own elaboration based on World Bank IDS 2022.

Note: The grant element of a loan is the grant equivalent expressed as a percentage of the amount committed. It is used as a measure of the overall cost of borrowing. To obtain the averages, the grant elements have been weighted by the amounts of the loans. The grant equivalent of a loan is its commitment (present) value, less the discounted present value of its contractual debt service; conventionally, future service payments are discounted at 10 percent. Commitments cover the total amount of loans for which contracts were signed in the year specified. Debt from private creditors includes bonds that are either publicly issued or privately placed; commercial bank loans from private banks and other private financial institutions; other private credits from manufacturers, exporters, and other suppliers of goods, and bank credits covered by a guarantee of an export credit agency. NCF (New Common Framework)

Despite private lenders charging higher costs (factoring in the risk of default upfront) compared to official lenders, Schlegl et al. (2019) shows that private debt is senior to official debt. Over the past 40 years, not only have

arrears to private creditors been fewer, but they also face a smaller haircut in the event of debt restructuring (Schlegl, Trepesch, & Wright 2019).

BURDEN SHARING: LEGALIST VERSUS ECONOMIC APPROACHES[8]

When it comes to debt restructuring, the IMF/World Bank Debt Sustainability Framework defines the global debt relief quantum considered necessary to restore a country's debt sustainability.[9] The challenge then is to define how to distribute this total debt reduction among creditors.

The first and most common way to compute the "level of pain" in a debt restructuring process is by reducing each creditor's claims by the same rate based on their PV claims, as defined in the IMF/World Bank Debt Sustainability Framework for low-income countries. This approach is referred to by Lazard (2022) as the "economic" approach. For example, if the IMF defines that the country needs to reduce the total PV debt by half, all creditors will have to give a 50 percent discount on their PV claims. But as noticed by Lazard (2022), under the "economic" approach, creditors with concessional claims may end up subsidizing the debt restructuring in sharing the (remaining) grant element of their claims with the broader universe of creditors. Thus, the "economic" approach enhances private creditors' recovery.

Considering the different lending terms of creditors, it is possible to provide a more nuanced (but still direct) approach to burden sharing. In other words, by pricing the risk of default upfront, private lenders essentially acknowledge that they have capacity to absorb higher relative losses compared to other creditors. As for-profit organizations, private creditors not only incorporate their cost of capital in lending practices, but also an additional cost related to the risk of default. Therefore, allocating a larger share of the debt relief responsibility to private (as share of their PV claims) lenders seems justifiable, as it recognizes the differential risk assumed by various types of creditors. At the same time, grant elements provided by the official sector can be understood as a financial relief provided in advance, which justifies a smaller relative "ex post" contribution in debt restructuring efforts.

8 While there is a third approach called market-based, we have excluded it from our analysis due to its unrealistic application and potential to create uncollaborative behavior among creditors towards the debtor (Lazard 2022)

9 It is beyond the scope of this paper to discuss the issues with the current IMF/World Bank Debt Sustainability Framework. This topic is analyzed by Guzman & Heymann (2015); the need to integrate climate and nature into DSAs is analyzed by Maldonado & Gallagher, 2022; Kraemer & Volz, 2023.

The best approach that translates this difference in cost of borrowing would be the "legalist" approach, as referred to by Lazard (2022). Under this approach, every dollar of debt that has financed the government's budget should contribute equally to restoring the debt sustainability going forward. In that sense, the "legalist" approach computes the total debt relief efforts necessary to restore debt sustainability (as defined by the IMF's Debt Sustainability Analysis) not in terms of PV of individual creditors, but in terms of NV. Apart from allowing to account for "ex ante" and "ex post" debt relief efforts combined, other advantages of the "legalist" approach is simplicity and transparency of information. In other words, by using nominal values, it is possible to circumvent the confidentiality issues faced in an increasing number of sovereign debt agreements (Lazard 2022). Diwan et. al (2023) provide a method analogous to the "legalist" approach (Lazard 2022) – based on nominal value equalization – and the authors emphasize that such an approach proportionally weights larger losses with less concessional lenders, therefore providing a fairer distributional outcome.

ESTIMATING THE LEVEL OF RELIEF PROVIDED BY MDBS

In the following section, we estimate the debt relief efforts considering two approaches. The first one is the "economic" approach as defined by Lazard (2022), which we refer to as the "flat rate" Comparability of Treatment (CoT). The second approach is the "fair" CoT, the method of which was developed by Diwan et al. (2023), analogous to the "legalist" approach from Lazard (2022).

The "fair" CoT considers as the point of departure a necessary global effort to restore the country to sustainable levels (as share of total debt in PV terms, as potentially informed by an IMF/World Bank Debt Sustainability Analysis). It then distributes that burden considering a "ex ante" relief (the grant element) of different creditors and converges the "ex post" debt reduction needed towards a new average level of concessionality common to all creditors in terms of nominal values of the old debt. Creditors that are further away from this targeted average (e.g., the private sector) will bear a greater burden. Conversely, if a creditor is already more concessional than the average of all creditors (e.g., IDA), their required additional effort will be relatively smaller (or even unnecessary). In practical terms, if the necessary global debt relief is relatively small and some creditors have already offered high grant elements, their "ex ante" contributions may already suffice, and they might not need to contribute further. However, when total debt relief efforts are more significant (e.g., 70 percent of total PV debt, instead of 10

percent), even more "generous" creditors with high concessional elements in their lending would need to increase their contributions to achieve the required global debt relief for debtor countries. As highlighted by Diwan et. al (2023), this distribution considering "ex ante" cost of lending can provide a fairer overall distribution of burden.

In our estimation, we divide all creditors into six groups: private lenders,[10] China, Paris Club,[11] Other Official Bilateral,[12] MDBs (excluding IDA) and IDA. According to a comprehensive study of past sovereign debt restructurings, the average haircut on sovereign debt with foreign private creditors (comprising bank debt and bonds) in the "modern era" (post-1970) was 39 percent, while under the HIPC Initiative, debt restructuring reached up to 64 percent (Marchesi, Masi & Bomprezzi 2023; Meyer et al. 2022; Ramos et al. 2023; World Bank 2022). We consider these two historical debt reduction benchmarks for our scenarios: a 39 percent and a 64 percent reduction.

PV calculations are commonly used by the IMF/World Bank Debt Sustainability Analysis to measure necessary total debt relief efforts. Mathematically, the PV of debt is equal to the sum of all future debt service payments (principal and interest), discounted to the present using a given discount rate. There is no information publicly available on PV disaggregated by individual creditor or creditor group, neither complete data on future cash flows. To overcome this lack of data, we estimated PV by creditor groups based on weighted average of grant elements during the last ten years (between 2012-2021, following information as per Figure 7). As grant element of a debt is the difference between the PV of debt and its NV (expressed as a percentage of the NV of the debt), it was possible to estimate PV owned to specific creditor groups (Diwan et al. 2023; World Bank 2023). Apart from considering the whole group for which data is available (61 countries), we also estimated debt treatment for a subgroup of NCF countries, composed by countries that either are IDA-eligible or SIDS (41 countries).

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10 Including bond holders, commercial lenders and other private creditors.

11 Paris Club permanent members include Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom, United States (Paris Club 2023).

12 Saudia Arabia, Kuwait, India, United Arab Emirates and all other bilateral official creditors excluding China and Paris Club countries.

DEBT RELIEF FOR ALL NCF COUNTRIES

As Table 1 shows, NCF countries hold a total external PPG debt of $879.2 billion in nominal terms (excluding IMF credits). Given a total grant equivalent of $98.1 billion, the total external PPG debt accounts for $781.1 billion in NPV. A 39 percent "haircut" would imply a total PV reduction of $304.6 billion, while a 64 percent "haircut" would imply a reduction of $499.9 billion.

Table 1: NCF (61) Countries, PPG External Debt, as of 2021

	Nominal value (outstanding debt as of 2021) (a)	Grant element (b)	Grant equivalent (c= a*b)	Present value (a-c)
Private	379.1	-9%	-35.7	414.7
China	102.1	14%	14.3	87.8
Other bilateral	45.7	18%	8.0	37.7
Multilaterals (excl. IDA)	189.5	28%	53.5	135.9
Paris Club	76.4	29%	21.9	54.6
IDA	86.5	42%	36.1	50.4
Total	879.2		98.1	781.1

Source: Own elaboration based on WB IDS 2022 and authors' calculations.

Note: Estimation of grant element is based on commitment loans, and considering a ten years average (2012-2021).

Table 2 summarizes the results for burden sharing under "flat rate" and "fair" CoT. Considering a 39 percent haircut, if all creditor classes receive the same discount rate on their PV claims, MDBs (excluding IDA) would need to bear $53 billion in losses while IDA alone would be resposible for $19.7 billion. But with the "fair" CoT accounting for the grant element of the lending, their haircut would be 24 percent and 7 percent, respectivelly, instead of 39 percent each. This new ratio would save $35.8 billion to MDBs as a group, as the new contribution for MDBs (excluding IDA) would be $32.5 billion and IDA, $3.5 billion.

Among many contentious points delaying debt negotiations (e.g. domestic debt restructuring, sharing information on debt sustaintability analysis and debt carrying capacity), the participation of MDBs has been a crucial point. This means that, if IDA agreed to join debt relief efforts, it would need to provide only $3.5 billion of relief to help unlock the debt negotiation stalemate for IDA countries. By doing so, it could faciliate the participation of all creditors. This estimated contribution from IDA is smaller than the current annual expenditure on grants connected to debt vulnerabilities for

IDA-eligible countries of $4.9 billion (according to the traffic light system, as estimated earlier). In other words, by part-taking in debt relief, IDA would actually be better off than by abstaining if such a "fair" CoT were to enable debt relief involving all creditors. When considering MDBs as a group, each dollar contributed by donors for debt relief through MDBs translates into $7 of total debt relief for NCF countries. This proportion exceeds MDBs equity-to-loan leverage, suggesting that in pecuniary terms, support from MDBs through debt haircuts would have higher impact than additional lending.

Table 2: NCF (61) Countries, Inter-creditor Burden Sharing According to Distinct Comparability of Treatment Rules and Haircut Levels

			39% haircut					64% haircut				
			Flat Rate CoT		Fair CoT			Flat Rate CoT		Fair CoT		
	Grant element	Present value	Rate	USD bn	Rate	USD bn	Diff. CoT rules	Rate	USD bn	Rate	USD bn	Diff. CoT rules
Private	-9%	414.7	39%	161.7	50%	209.3	47.6	64%	265.4	71%	293.5	28.1
China	14%	87.8	39%	34.2	37%	32.5	-1.8	64%	56.2	63%	55.2	-1.0
Other bilateral	18%	37.7	39%	14.7	34%	12.9	-1.8	64%	24.1	61%	23.0	-1.0
Multi-laterals (excl. IDA)	28%	135.9	39%	53.0	24%	33.3	-19.7	64%	87.0	55%	75.4	-11.7
Paris Club	29%	54.6	39%	21.3	24%	13.1	-8.1	64%	34.9	55%	30.1	-4.8
IDA	42%	50.4	39%	19.7	7%	3.5	-16.1	64%	32.3	45%	22.7	-9.5
Total/ Average	**11%**	**781.1**	**39%**	**304.6**	**30%**	**304.6**	**-**	**64%**	**499.9**	**64%**	**499.9**	**-**

Source: Own elaboration based on WB IDS 2022 and authors' calculation.

On average, loans to NCF countries had a grant element of 11 percent, and the grant elements from all official creditor classes are higher than this average. Hence, according to the "fair" CoT rule, they would all contribute with a relatively smaller haircut compared to the flat rate CoT. In the case of China, contributions to debt relief would decline from $34.2 billion to $32.5 billion, for other bilateral official from $14.7 billion to $12.9 billion, and for Paris Club countries from $21.3 billion to $13.1 billion. To achieve the required overall debt reduction, the haircut from private lenders would increase from 39 percent to 50 percent, or from $161.7 billion to $209.3 billion.

In case NCF countries would receive a HIPC-like debt reduction of 64 percent NPV (Table 2, right side), the efforts from IDA following the "fair" CoT would account for $22.7 billion ($9.5 billion less than with the flat rate CoT), which would correspond to a 45 percent haircut instead of 64 percent. For MDBs excluding IDA, the contribution would be $75.4 billion (55 percent haircut) and $11.7 billion lower compared to the flat rate rule. The increase from the 39 percent case is substantially higher for IDA because, as the overall debt reduction increases, efforts from all creditors need to increase to avoid leaving one creditor (the least concessional) to completely write off their debt.

Table 3 demonstrates how the involvement of all creditors following a fair CoT can efficiently equalize debt relief efforts and incorporate the "ex ante" debt relief of all creditors. When no creditors participate in debt restructuring, debtors only receive support based on the concessionality rate in lending, with the private sector having a negative rate of 9.41 percent and IDA having the highest at 41.72 percent for the case of the NCF countries.

If NCF countries needed to reduce their PV debt by 64 percent, it would amount to a $499.9 billion reduction of their PV claims. In terms of NV of their claims, the same effort would result in a $598 billion, or 68.02 percent NV reduction. In case all official lenders were excluded from debt relief efforts, even if the private sector completely cancels its debt claims, it would not be sufficient to reduce the overall debt to sustainable levels. Such an approach would not only be inefficient (as debt sustainability cannot be achieved) but unfair, as the private sector's contribution would be disproportionately high compared to others who only contributed with an "ex ante" debt relief below the private sector share. If all creditors participate except IDA, their global individual effort would be 70.89 percent, and no creditor would need to completely cancel their debt. But this case would continue to be unfair because while IDA's "ex ante" debt relief would only account for 41.72 percent, all the others would be contributing with 70.68 percent. So, if IDA increases its "ex post" contribution to reach a total effort of 68.02 percent in nominal terms, it would lead to a situation where all creditors contribute equally, considering both their "ex ante" and "ex post" debt relief efforts.

The last column of Table 3 shows that with the "flat" CoT, even if all creditors participate, their efforts would differ in terms of the NV of the old debt. In this case, while the private sector would contribute 60.61 percent, IDA's contribution would end up being 79.02 percent.

Table 3: NCF Countries: Fairness in Comparability of Treatment

Considering a 64 percent haircut in PV, equivalent to 68 percent in nominal value of the old debt

Increasing Number of creditors →

	Conces-sionality rate in lending	Fair CoT						Flat rate CoT
		Only private	Only private & China	Only private & China & other bilateral	All cred-itors but Paris Club & IDA	All cred-itors but IDA	All creditors	All creditors
Private	-9.41%	122.47%	99.45%	92.36%	75.40%	70.89%	68.02%	60.61%
China	14.00%	14.00%	99.45%	92.36%	75.40%	70.89%	68.02%	69.04%
Other bilateral	17.54%	17.54%	17.54%	92.36%	75.40%	70.89%	68.02%	68.02%
Multilaterals (excl. IDA)	28.25%	28.25%	28.25%	28.25%	75.40%	70.89%	68.02%	74.17%
Paris Club	28.61%	28.61%	28.61%	28.61%	28.61%	70.89%	68.02%	74.30%
IDA	41.72%	41.72%	41.72%	41.72%	41.72%	41.72%	68.02%	79.02%
Result		**Not fair!**	**Not fair!**	**Not fair!**	**Not fair!**	**Not fair!**	**FAIR!**	**Not fair!**

Red Numbers: "ex ante" debt relief/nominal value of the old debt

Black Numbers: ("ex ante" + "ex post" debt relief)/nominal value of the old debt

Source: Authors' elaborations.

DEBT RELIEF FOR IDA-ONLY AND SIDS NCF COUNTRIES

In case the international community wants to prioritize debt relief for the most vulnerable groups, they could consider focusing debt relief efforts on IDA-eligible countries (the poorest group) or SIDS with debt vulnerabilities. Altogether, we identify 41 countries (see detailed list in Annex 2), of which 27 of them are IDA-only eligible countries, eight are both IDA-only and SIDs and six are SIDs but with IBRD or blended lending conditions.

As Table 4 shows, for this group of countries, total external PPG debt accounts to $186.8 billion in nominal terms (excluding IMF credits). Give a total grant equivalent of $46.9 billion, the total external PPG debt accounts for $140 billion in NPV. A 39 percent "haircut" would imply that $54.6 billion would have to be written off, while a 64 percent "haircut" would amount to $89.6 billion.

Table 4: NCF Countries Subgroup (IDA-only Eligible or SIDS, 41 countries) – PPG external debt (nominal value, grant element, grant equivalent and present value), as of 2021

	Nominal value (outstanding debt as of 2021) (a)	Grant element (b)	Grant equivalent (c=a*b)	Present value (a-c)
Private	45.5	-5%	-2.3	47.7
China	31.0	20%	6.3	24.6
Other bilateral	19.7	30%	5.9	13.7
Multilaterals (excl. IDA)	36.0	31%	11.3	24.7
Paris Club	13.8	40%	5.5	8.3
IDA	41.0	49%	20.2	20.8
Total	**186.8**		**46.9**	**140.0**

Source: Own elaboration based on WB IDS 2022 and authors' calculations.

Note: Estimation of grant element is based on commitment loans and considering a 10-year average (2012 to 2012).

Compared to the whole group of 61 NCF countries, for this subgroup of 41 countries, the costs of debt relief would be substantially lower, specifically for MDBs. As Table 5 shows, in the case where a 39 percent haircut is applied using the flat rate CoT, IDA would bear $8.1 billion in debt relief compared to $2.1 billion under the fair CoT. IDA's fair contribution is roughly a third of what it spent in grants to debt vulnerable countries in 2021 ($4.9 billion, according to estimation on the traffic light system). With a haircut of 64 percent, IDA would bear $9.8 billion in losses under a fair CoT ($3.6 billion less than with the flat rate CoT). IDA's contribution to debt relief would be less than the grants given to debt vulnerable countries in 2020 and 2021 combined.

Table 5: NCF Countries subgroup (IDA-only eligible or SIDS, 41 countries) – Inter-creditor Burden Sharing According to "Flat Rate" and "Fair" Comparability of Treatment Rules

			39% haircut					64% haircut				
			Flat rate CoT		Fair CoT			Flat rate CoT		Fair CoT		
	Grant element	Present value	Rate	USD bn	Rate	USD bn	Diff. CoT rules	Rate	USD bn	Rate	USD bn	Diff. CoT rules
Private	-5%	47.7	39%	18.6	56%	27.0	8.3	64%	30.6	74%	35.5	4.9
China	20%	24.6	39%	9.6	43%	10.5	0.9	64%	15.8	66%	16.3	0.5
Other bilateral	30%	13.7	39%	5.4	35%	4.7	-0.6	64%	8.8	61%	8.4	-0.4
Multi-laterals (excl. IDA)	31%	24.7	39%	9.6	33%	8.2	-1.4	64%	15.8	61%	15.0	-0.8
Paris Club	40%	8.3	39%	3.3	24%	2.0	-1.2	64%	5.3	55%	4.6	-0.7
IDA	49%	20.8	39%	8.1	10%	2.1	-6.0	64%	13.3	47%	9.8	-3.6
Total/ Average	25%	140.0	39%	54.6	39%	54.6	-	64%	89.6	64%	89.6	-

Source: Own elaboration based on WB IDS 2022 and authors' calculation.

For the other MDBs, a 39 percent haircut would imply $8.2 billion in losses considering the fair CoT ($1.4 billion less than with the flat rate CoT), and a global 64 percent debt reduction would account for $15 billion in the fair CoT ($0.8 billion less than with the flat rate CoT).

For this subgroup, the grant element from China (20 percent) is smaller than the average for the whole group of 61 NCF countries. Along with the private sector, China would then bear a higher cost for debt relief under the fair CoT rule than with the flat rate CoT. The difference is about $0.9 billion for the 39 percent haircut case and $0.5 billion under the 64 percent haircut case.

POLICY OPTIONS: HOW COULD MDB LOSSES BE COVERED?

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Considering an involvement of multilateral creditors in debt restructuring requires not only an examination of the amount of their potential contribution but also the options to cover these losses. Since MDBs are crucial players in financing development and green transitions, it is important that they maintain a high credit rating to support a low-cost funding. This section explores policy options to cover MDB losses, based on previous experiences of debt restructuring and potential innovative policies.

LESSONS FROM PREVIOUS EXPERIENCES

The involvement of multilateral creditors in debt relief is not a novelty. In the past, multilateral debt restructuring has taken place, albeit in exceptional cases and through ad hoc procedures. Notably, there are three major debt relief efforts involving multilateral creditors: 1) The HIPC Initiative in 1996, 2) the MDRI in 2005 and 3) the IMF's Post-Catastrophe Debt Relief Trust (PCDR), which in 2010 was transformed into the Catastrophe Containment and Relief Trust (CCRT).

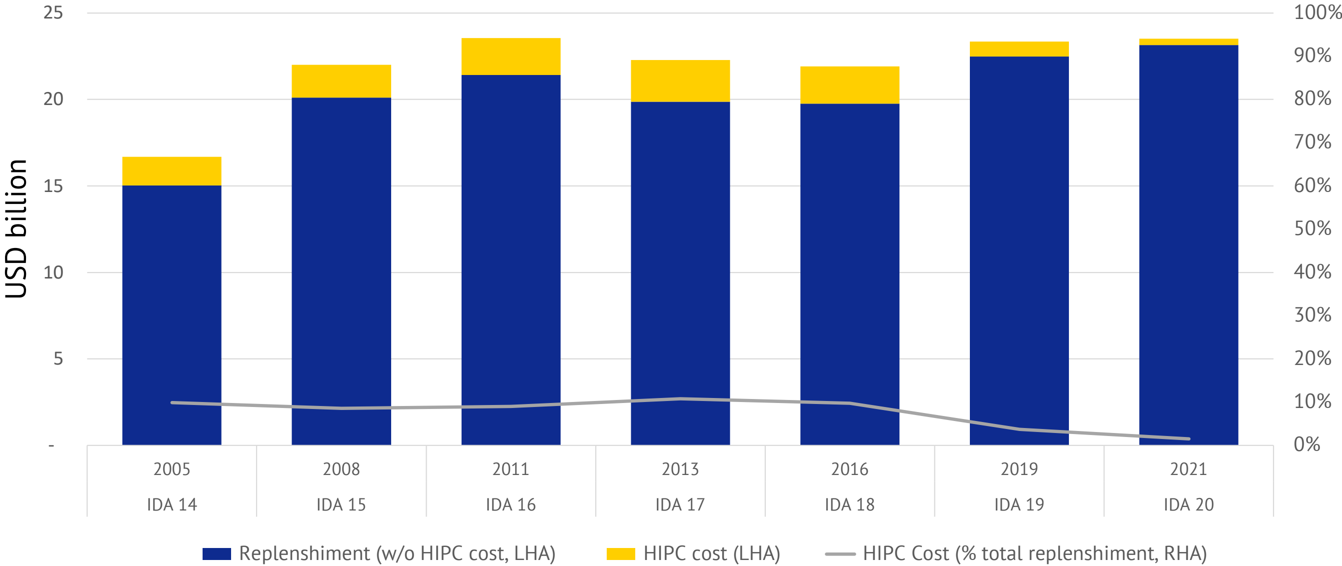
In all three cases, debt relief was made possible through a combination of donor contributions and the utilization of internal resources from international financial institutions. Essentially, debt repayments from countries in distress were shouldered by donor countries and the IFIs themselves (Viterbo 2020). An example of internal resource utilization is the IBRD operational profits (which was channeled to IDA via the Debt Relief Trust Fund, see the following). Apart from operational results, the IDB also used converted local currency assets, which had been previously donated by regional borrowing countries. Another example is the IMF, which used the proceedings of off-market gold sales[13] (IDB 2001; IDB 2006; IMF 2000).

Regarding donor contributions, resources came from three different channels. First, there were direct donations to MDBs. For instance, in the case of the IDB, Canada, the United States and other member countries outside the North American continent directly donated almost $500 million

13 Back in 1944, the IMF's initial quota was paid in gold, so as a historical legacy the fund is one of the world's largest official holders of gold with about around 90.5 million ounces (or 2,814.1 metric tons). Although based on historical cost, the IMF gold is valued at about $4.1 billion, at market prices it accounts for over $155 billion. In 1999, a total of 12.944 million troy ounces of gold, equivalent to SDR 2.680 billion, were sold and accepted back immediately at the same price, in settlement of Brazil and Mexico members' obligations to the IMF. Thus, despite the fact the gold sold by the IMF did not leave the bank, it was revalued with market prices, hence generating a profit, which was channelled to the HIPC Initiative. In addition to gold, the IMF participation was financed by bilateral contributions (International Monetary Fund 2000).

to the IDB to fund the HIPC Inititative (Inter-American Development Bank 2000). The second channel was through the Debt Relief Trust Fund (formerly the HIPC Debt Initiative Trust Fund), which pooled about $5.7 billion from donor countries and received $2.7 billion from the World Bank IBRD's operational results. This pool of resources was then redistributed among MDBs, mostly to IDA (about $3.5 billion), followed by the AfDB ($2.9 billion) and the remaining was distributed among ten other IFIs. Finally, in the case of IDA, which provided the highest volume of debt relief, donors continued to provide resources specific to meet the forgone credit reflows due to the HIPC Initiative. As Figure 8 shows, during the 2005 IDA replenishment, about 10 percent of resources were destined to cover HIPC costs. Over time, the total volume to HIPC and its share over the total resources is declining. During IDA's last round of replenishment (IDA 20, connected to the fiscal years from 2023-2025), IDA received $23.5 billion of which only 2 percent referred to HIPC costs (accounting for $360 million).

Figure 8: IDA Replenishment by Donor Countries, 2005-2021



Source: IDA replenishment reports.

In 2020, during G20 discussions on the DSSI, the Chinese Minister of Finance Liu Kun recommended the creation of a World Bank fund like the IMF's CCRT to support poor countries servicing their debt and flagged that China would be willing to contribute (Brautigam & Huang 2023). In practice, many institutional arrangements and practices used during the HIPC Initiative could be reactivated to the same purpose as recommended by China's Finance Minister. For instance, the Debt Relief Trust Fund, which gathered resources from donors and IBRD's operational resources, which still exists but at the writing of this report, has only $229 million available in its balance.

Donor countries, including China and advanced economies, could revamp contributions to this fund to finance a new round of MDB debt relief.

Moreover, MDBs' shareholders that provide donations to finance concessional finance could make debt relief specific contributions a common practice. For instance, in every IDA replenishment, donors could stipulate that 5 percent (or another appropriate share) would be dedicated to debt relief efforts and support reestablishing debt sustainability in developing countries. Because concessionary policies are attached to debt sustainability indicators (the traffic light system), a portion of IDA replenishment is used to support countries in debt distress situations, but there are serious problems with the current system. First, it continues to give support to debt-distressed countries but without any incentive to reestablish debt sustainability – with the implication that IDA money implicitly finances a bailout of private creditors of IDA countries, as suggested by Diwan and Le Houerou (2023). Second, IDA donors have highlighted that debt relief should not reduce IDA's capacity to support poverty reduction and development (World Bank 2008). But the current system does not record the support through the traffic light as debt relief, so in practice while IDA replenishment has been stagnant since 2008, resources available to new investments have been declining.

Regarding debt relief efforts from the IMF, the Catastrophe Containment and Relief Trust (CCRT) already represents an institutional layout to support debt relief from the IMF. The CCRT should be amplified to meet the needs of developing countries. In fact, during the pandemic, the IMF provided $965 million in debt service relief to 31 countries through the CCRT (International Monetary Fund 2022). But as a result of the COVID-19 crisis, the CCRT has been left "almost depleted" (IMF 2023). It is crucial that CCRT funding is replenished; one alternative is to make use of a modest share of IMF gold sales to that end. Currently, the IMF still holds around 90.5 million ounces (or 2,814.1 metric tons) of gold, which is equivalent to $162 billion at a market price of $1,800 per ounce (IMF 2023c). By selling only a tiny fraction of gold stocks, the IMF could not only provide more subsidized credit to low-income countries (as suggested by Sobel 2023), but also support debt relief to countries in need.

Apart from increasing the resources available to the CCRT, the IMF should overhaul the CCRT eligibility policies which are currently very restrictive. Countries need to be Poverty Reduction and Growth Trust (PRGT) eligible and have per capita income below the IDA cutoff, which currently makes

only 29 countries eligible to IMF debt relief.[14] Moreover, although it is welcome that since 2015 the IMF has expanded the types of disasters triggering debt relief – including since then public health diseases – the Fund must be bolder. Given the context of increasing climate risks and development challenges, not only severe and intense shocks should trigger access to CCRT. Other cases should be considered too, including debt-vulnerable countries struggling to invest in climate adaptation, as well countries with milder but recurring climate shocks.

One may argue that supporting MDB debt relief is too costly to donor countries and to the IFIs themselves, indicating a "donor fatigue" among wealthy nations. Indeed, since the 1970s, advanced economies have not abided by their promise to donate 0.7 percent of their gross national income to developing countries as official development assistance (ODA). In the accumulated, high-income countries have failed to deliver a total of $5.7 trillion in aid, which could have been essential to improve the socio-economic conditions for many nations (Seery 2023). Moreover, donor contributions to IDA have been stagnant since 2011 (as shown in Figure 8) and giving the increasing volume of grant elements connected to debt distress factors, new lending to low-income countries has been in fact declining. IMF Managing Director Kristalina Georgieva has urged donor countries to step up and provide funding to the PRGT, which supports low-income countries with interest-free loans. Without such support, the PRGT cannot meet the high demand for concessional funding amid the global crisis (Reuters 2023). These are some examples of lack of support from wealthier nations to developing countries. Without question, solving the debt crisis in the Global South is going to be costly, but the price of inaction is much higher.

NEW OPPORTUNITIES

In addition to replicating past experiences, the international community can explore new ideas and seize new opportunities. One potential avenue for MDB shareholders to consider is increasing the equity of these institutions. By doing so, they would free precautionary balances that could be partially used for debt relief, without affecting their credit ratings. Currently, the World Bank alone has $30 billion in its balance sheet registered as precautionary balances. Potentially, a part of these resources could be used for

14 Considering countries eligible to PRGT and with income level below $1,255 of current IDA cut-off, countries eligible to PRGT include: Afghanistan, Burkina Faso, Burundi, Central African Republic, Chad, DR Congo, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mozambique, Myanmar, Niger, Rwanda, Sierra Leone, Somalia, South Sudan, Sudan, Tajikistan, Tanzania, Togo, Uganda, Yemen, Zambia.

debt relief in case fresh funding is canalized. That way, debt write-offs would not impact MDBs' credit ratings or borrowing costs since a commitment of MDB shareholders to increase MDBs' equity would give a strong signal of support that could counterbalance the impact of debt relief.[15] Increases of the paid-in capital of MDBs by advanced economies would be the preferred way to raise equity, but given the thin support to inject "taxpayers'" money on MDBs, there are proposals to increase MDB equity through hybrid capital. For instance, the equity of MDBs could be increased through rechannelling Special Drawing Rights (SDRs) as suggested by the AfDB proposal (AfDB 2022), by SDR-denominated bonds (Paduano & Setser 2023) or by attracting foreign exchange reserves through Sustainable Future Bonds (Zucker-Marques & Gallagher 2023). Moreover, with a new capital injection, the overall lending capacity of the MDBs would increase leading to a future larger operational result. Part of the increased operational results could be designated for debt relief initiatives.

Theoretically, SDR resources could be directly used to support MDBs in their debt relief efforts. However, there are technical and regulatory obstacles that need to be addressed. The first technical challenge relates to the structure of SDR interest rates. When countries draw down their SDR holdings bellow allocation levels, they are required to pay an interest rate (referred to as SDRi) (Arauz, Cashman & Merling 2022). The SDRi is determined by the three-month yields of government bonds from SDR currencies, including the US dollar, UK pound sterling, Japanese yen, euro and Chinese yuan (IMF 2023a).

Between 2008 and mid-2022, SDRi remained low between 1 percent and 2 percent. But with the current interest rate rise in developed countries, in 2023, SDRi increased rapidly to about 4.5 percent. Consequently, if countries choose to redirect SDRs towards supporting MDBs' debt relief, and their SDR holdings are lower than the allocated amount, they would be required to pay perpetual interest rates on their contribution. The current structure of SDRi – which could be reformed in the future (Paduano 2022) – discourages the use of SDRs for debt relief purposes. Instead of rechanneling SDRs, countries could donate SDRs, but this brings even more hurdles. First, donating SDRs does not eliminate the need to pay SDRi on the difference between holdings and allocation. To avoid that, countries would need to replenish

15 Among many criteria to assess credit rating, agencies consider potential support from shareholders. Effectively providing new resources is not only an effective back up but a sign of commitment from shareholders. For details on the methodologies of rating agencies for supranational institutions, see, for instance, Fitch Ratings (2023).

their SDR account by either selling foreign exchange or, for countries that hold currencies that are part of the SDR basket, they could incur in a budgetary expenditure. In that case, SDR donations would account to a budgetary expenditure, requiring approval by the parliament (Plant 2021).

Another option that is technically viable but politically challenging, is the creation of a tax à *la Tobin* to finance MDBs debt relief. A Tobin tax is a financial transaction tax (FTT) originally proposed on currency exchange transactions to discourage speculative trading and stabilize financial markets. FTT could be broader than just currency trading, and the concept can encompass various types of financial transactions, such as stock trades, derivatives and other speculative activities in the financial markets. By enforcing a very marginal rate of 0.05 percent over foreign exchange transactions, an international financial transaction tax (IFTT) could yield annual revenues of around $650 billion per year (Kumar & Gallagher 2023). Resources generated from such IFTT could be channeled to MDBs, including to debt relief efforts. However, in case that an IFTT is chosen to finance MDBs debt relief, in practice some private sector participants would be "doubled taxed," as they would be directly providing debt relief on their debt and indirectly financing an official effort through the IFTT.

TRADE-OFFS BETWEEN MDB DEBT HAIRCUTS AND ADDITIONAL FUNDING

Debt relief can take various forms, such as partial or complete write-offs of outstanding debt obligations, extending repayment periods, reducing interest rates and others. NPV calculations are commonly used to measure debt relief efforts, providing a standardized framework for comparing different relief formats offered by diverse creditors. For instance, Wang and Qian's research (2022) shows that forgiving 15 percent of the debt obligation, referred to as a "haircut," can be similar to extending debt repayments by ten years (without altering the interest rate) when assessed in terms of NPV. Regarding MDBs' involvement in debt relief efforts, there is an ongoing debate regarding whether securing a future positive "net flow" of resources with higher levels of concessional funding and grants, could potentially offset the need for a haircut. In financial terms, to be considered equivalent to a haircut, the new financial flows from MDBs should consist of 100 percent grants.

But even if they are equal in NPV terms, different forms of debt relief can generate distinct economic consequences. For advanced and emerging market economies, Reinhart and Trebesch (2016) find that debtor countries see substantial economic improvements with direct debt write-offs, while softer forms of debt relief operations like maturity extensions and interest rate reductions usually do not lead to higher economic growth or improved credit ratings. Under soft forms of debt relief, countries may incur in a subsequent default, which can be reduced by directly providing principal haircuts (Schröder 2014). These findings indicate how creditors assess risks in distinct circumstances of debt relief and their willingness to provide fresh capital that promotes growth. As argued by Baqir et al. (2023), the success of debt restructuring hinges on unlocking growth prospects in a sustainable manner, which is especially challenging in a world economy with diverging growth rates between the Global North and South, loss of comparative advantages in developing economies, climate change and rising interest rates (Rodrik 2022; World Bank 2021). Under these circumstances, debt reduction not only needs to be deeper, but creditors need to provide new affordable finance with longer time horizons (Baqir et al. 2023). Hence, to help address this current twin crisis of debt and development, the first-best solution would be for MDBs to concede immediate debt relief and subsequently increase the volume of new grants and concessional finance. This would require substantive additional support from MDB shareholders and innovative ways to increase their capital base. The recent report from an Independent Expert Group commissioned by the G20 recommended MDBs at least triple their financing, and there are proposals to increase MDB equity by rechannelling SDRs and foreign exchange reserves which could give substantial lending headroom ("The Triple Agenda" 2023; AfDB 2022; Paduano & Setser 2023; Zucker-Marques & Gallagher 2023).

Executive Summary

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However, under a situation of limited funds available for MDBs, choosing between debt write-offs and additional funding present important trade-offs for debtor countries. These trade-offs can have varying implications depending on the size of debtor countries and their attractiveness to private investors. Table 6 provides a summary of the key aspects associated with each possibility for both Market Access Countries (MAC) and/or larger economies versus Non-Market Access Countries (Non-MAC) and/or smaller economies.

On the one hand, with a debt haircut, MAC countries would achieve a clean balance sheet that would help to improve their sovereign credit rating and reduce the cost of capital. Although they would not receive additional grants or concessional loans from MDBs, the restored debt sustainability situation could improve private investors' risk assessment, thereby fostering a new wave of private investment and spurring economic growth. For smaller countries without market access, while debt haircut would enhance their fiscal space, it may not necessarily stimulate investments from private creditors.

On the other hand, opting for additional grants would keep both groups of countries in a debt overhang situation, limiting their fiscal space and ability to attract private investors. Non-market access and smaller countries face even lower chances of attracting private investors under this scenario, but some projects may be financed with MDB resources in the short-term. The question that arises then is whether new grants would be sufficient to put the country onto a new development path. Clemens et al. (2012) shows that, despite being positive, the impact of aid on growth is modest. Moreover, according to Dreher et al. (2017), although aid from China, the United States and the Organisation for Economic Co-operation and Development's Development Assistance Committee produce similar impact on economic growth of recipient country, there is no such evidence for the World Bank. It may be the case that World Bank aid does support economic growth, but with much longer lag effect than that of other donors. Under any circumstance, the promise that new funding from MDBs will support countries to "grow out of their debt" should be taken with caution. Even by providing new loans in highly concessional terms, if MDB lending takes too long to impact economic growth, it can further deteriorate debt sustainability of recipient country, making the debt relief process all the more imperative.

Table 6: Comparative Analysis of MDB Debt Haircut or Additional Grants for Countries with and without Market Access

	Market access countries/ larger economies	Non-market access countries/small economy
Debt haircut	1. Reduced nominal debt burden, larger fiscal space. 2. Improved risk assessment may spur a new wave of private investment. 3. Although with higher cost compared to MDB financing, the country could receive new wave of private investment and spur economic growth.	1. Reduced nominal debt burden, larger fiscal space. 2. Improved risk assessment would not necessarily spur a new wave of private investment. 3. Green investments would be neither invested by private markets nor MDB grants.
Additional grants	1. Debt vulnerability indicators remain high. 2. Fails to attract private investment. 3. Some projects would be financed at low cost by MDBs, but they may not be enough to support the country to grow out of the debt.	1. Debt vulnerability indicators remain high. 2. Fails to attract private investment, but the pro bability of this occurring is low anyway. 3. Some projects would be financed at low cost by MDBs, which will not necessarily translate into sustainable development and higher growth rates.

Source: Authors' own elaboration.

It is important to consider that prioritizing an increase in future grant volumes instead of immediate debt relief does not eliminate the necessity of enhancing donor support. In order to sustain and augment the level of lending by MDBs on concessional terms, while simultaneously providing distressed countries with 100 percent grants, it would be imperative for donors to increase the volume of their contributions. By opting for a strategy that focuses on future grant allocations, it becomes crucial for donors to actively step in and amplify their financial contributions. This is necessary to ensure that MDBs can continue providing loans at favorable terms. while also accommodating the provision of grants to countries experiencing significant economic distress.

Moreover, it is essential to re-evaluate the current strategy for providing grants and loans, giving priority to lending that enhances the impact on economic development. Ball et al. (2021) argues that when borrowed funds are directed towards public investment (that generates cash flows), it results in a sounder debt sustainability situation compared to when financing is channeled to consumption spending. With the current debt sustainability framework, it is not possible to discriminate between different types of lending, but it would be possible by incorporating a balance sheet approach as suggested by Ball et al. (2021). In that sense, channeling borrowed funds specifically towards productive investments is potentially beneficial not just for supporting a green transition but also for maintaining debt sustainability (Wang & Xu 2022).

CONCLUSION: POSSIBLE WAYS FORWARD

The ongoing debt relief negotiations regarding the G20 Common Framework have been disappointing. Among the contentious issues in these negotiations is the involvement of MDBs, which have not yet put forward concrete and systematic plans for burden-sharing in the Common Framework debt relief efforts, despite direct requests from the G20.

Our report emphasizes the importance of including MDBs in debt restructurings. First, many debt-vulnerable countries have high exposure to MDB lending, making their inclusion necessary to solving the debt crisis. Second, involving MDBs ensures equitable burden sharing among creditors, which helps mitigate perceptions of unfairness and encourages the participation of all creditor classes in the debt negotiation process. Moreover, solving the debt crisis among low-income countries is paramount to the business model of MDBs, as a protracted debt crisis would have significant costs for the concessionary arm of these institutions. Apart from donor contribution and access to capital markets, MDBs rely on reflows from clients to maintain a balanced business model. Therefore, it is in the best interest of both debt-vulnerable countries and MDBs to have a swift debt resolution. MDB shareholders should consider that by actively contributing to the resolution of the current debt crisis they also contribute to a sustainable business model for their institutions. Finally, providing debt relief through MDBs would be an effective use of taxpayer money given the capacity to leverage resources. When considering MDBs as a group, each dollar contributed by donors for debt relief through MDBs translates into $7 of total debt relief for 61 countries in debt distress studied in this report. This proportion exceeds current MDB equity-to-loan leverage, suggesting that in pecuniary terms, support from MDBs through debt haircuts has higher impact than additional lending from MDBs.

Determining the burden sharing among creditors during a debt relief process is a complex task due to diverse lending conditions and unique impediments faced by different creditor classes. This report does not seek to provide final answers to this, but for the sake of simplicity and fairness, we suggest that inter-creditor burden sharing arrangements should consider the price of debt. By incorporating risk-based pricing and considering concessionality levels, a more nuanced and fair distribution of losses can be achieved across creditors. While debt relief does come with costs, it is economically efficient to support debt-vulnerable countries and steer them towards sustainable development. This not only benefits the countries themselves but also reduces the need for ongoing grants tied to debt distress indicators. By taking these measures, the international community can effectively navigate

the complex landscape of debt relief and pave the way for a more sustainable future for all parties involved.

According to our estimations, in 2021 alone, IDA spent $4.9 billion in grants that would not be liable if less countries were debt vulnerable. This type of expenditure can increase even further in case the current debt crisis deteriorates. Considering the fair CoT rule adopted in this report, by accepting $37 billion in losses, MDBs including IDA could unlock $305 billion of overall debt relief to 61 countries when using the historical average of sovereign haircuts with foreign private creditors post-1970. In such a scenario, the cost of debt relief for IDA ($4 billion) would be smaller than its current grants tied to debt distress. If debt relief was provided only to a group of 41 IDA-eligible countries and SIDS facing sovereign debt distress, the costs to MDBs and IDA together would amount to only $10 billion – helping to achieve an overall debt write-off of $55 billion.

Finally, this report shows that there are viable options for shareholders to support MDBs' debt relief efforts, maintaining their high credit rating. Experiences with past debt restructurings show that a combination of donor contributions and internal resources from IFIs can enable debt relief without undermining the credit ratings of MDBs. Reviving institutional arrangements such as the World Bank's Debt Relief Trust Fund and increasing the equity of MDBs are practical approaches to generate resources for debt relief without compromising credit ratings.

To better reflect the current economic and political influence of developing countries in MDBs' shareholder structure, there is a clear need to enhance the voting power of these underrepresented economies. There have been longstanding calls for reforms within the Bretton Woods institutions, particularly the IMF and the World Bank. Augmenting the capital of these institutions could present an opportune moment to enact such reforms (Bretton Woods Project 2010).

Additionally, donors and MDBs could explore innovative alternatives. Among them, an FTT could fund MDBs' debt relief by targeting various financial transactions. Applying a 0.05 percent rate to foreign exchange transactions could generate roughly $650 billion annually (Kumar & Gallagher 2023). Although politically challenging to implement and adding costs to the private sector, an FTT has the potential to generate more than sufficient resources to finance debt relief in countries that most need it.

Ultimately, the decision between providing debt haircuts or increasing grants involves difficult trade-offs. Deciding against the participation of MDBs in debt restructuring risks that countries that urgently need debt relief will not get it, undermining their prospect for achieving the SDGs and the Paris Agreement. Moreover, there is a risk that the provision of new financial support by MDBs to debt-distressed countries whose debt is not restructured will not suffice to restart growth and that the transfers will effectively finance a bailout of other creditors. Prioritizing debt haircuts, coupled with increased grants and concessional finance, can effectively address debt distress and support sustainable development. To sustain these efforts, it is crucial for donors to actively contribute and enhance financial support to MDBs, ensuring the availability of concessional loans and grants for countries in need.

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ANNEXES

Executive Summary

Introduction

The Case For MDB Involvement

Comparability of Treatment

Policy Options: How Could MDB Losses Be Covered?

Trade-Offs Between MDB Debt Haircuts And Additional Funding

Conclusion: Possible Ways Forward

References

Annexes

Annex 1: List of New Common Framework Countries

Country name	
Afghanistan, Islamic Republic of	Lebanon
Angola	Liberia
Argentina	Madagascar
Belarus, Republic of	Malawi
Belize	Maldives
Benin	Mali
Burkina Faso	Marshall Islands**
Burundi	Mauritania
Cabo Verde	Micronesia, Federated States of**
Cameroon	Moldova, Republic of
Central African Republic	Mozambique
Chad	Nicaragua
Comoros	Niger
Congo, Democratic Republic of	Nigeria
Congo, Republic of	Pakistan
Cuba**	Papua New Guinea
Djibouti	St. Vincent and the Grenadines
Dominica	Samoa
Ecuador	Sao Tome & Principe
Egypt	Sierra Leone
El Salvador	Solomon Islands
Eritrea	Somalia
Eswatini, The Kingdom of	South Sudan**
Ethiopia	Sri Lanka
Gabon	Sudan
Gambia, The	Suriname**
Ghana	Tajikistan, Republic of
Grenada	Tonga
Guinea-Bissau	Tunisia
Haiti	Tuvalu**
Iraq	Ukraine
Kenya	Venezuela**
Kiribati**	Zambia
Kyrgyz Republic	Zimbabwe
Lao People's Democratic Republic	

Source: Ramos et al (2023).

Note: ** No International Debt Statistics data available.

Annex 2: List of New Common Framework Countries That are Eligible to IDA-only, or SIDS

Country name		
Afghanistan	Kyrgyz Republic	Solomon Islands
Benin	Laos	Somalia
Burkina Faso	Liberia	South Sudan*
Burundi	Madagascar	Sudan
Central African Republic	Malawi	Tajikistan, Republic of
Chad	Maldives	Tonga
Comoros	Mali	Tuvalu*
Congo, Democratic Republic of	Marshall Islands*	Zambia
Djibouti	Mauritania	Belize
Eritrea	Micronesia*	Cabo Verde
Ethiopia	Mozambique	Cuba*
Gambia, The	Nicaragua	Dominica
Ghana	Niger	Grenada
Guinea-Bissau	Samoa	Papua New Guinea
Haiti	Sao Tome & Principe	St. Vincent and the Grenadines
Kiribati*	Sierra Leone	Suriname*

Source: Authors' elaboration.

Note: *No International Debt Statistics data available.

Annex 3: World Bank IDA Borrowing Countries by Lending Terms

IDA-Only		Blend
Afghanistan	Mali	Cabo Verde
Bangladesh	Marshall Islands	Cameroon
Benin	Mauritania	Congo
Bhutan	Micronesia (Federated States of)	Dominica
Burkina Faso	Mozambique	Fiji
Burundi	Myanmar	Grenada
Cambodia	Nepal	Kenya
Central African Republic	Nicaragua	Nigeria
Chad	Niger	Pakistan
Comoros	Rwanda	Papua New Guinea
Congo, Dem. Rep. of the	Samoa	Saint Lucia
Côte d'Ivoire	Sri Lanka*	Saint Vincent and the Grenadines
Djibouti	Sao Tome and Principe	Timor-Leste
Eritrea	Senegal	Uzbekistan
Ethiopia	Sierra Leone	Zimbabwe
Gambia	Solomon Islands	
Ghana	Somalia	

Annex 3 continuation

Guinea	South Sudan
Guinea-Bissau	Sudan
Guyana	Syrian Arab Republic
Haiti	Tajikistan
Honduras	Tanzania, United Republic of
Kiribati	Togo
Kyrgyzstan	Tonga
Lao People's Dem. Rep.	Tuvalu
Lesotho	Uganda
Liberia	Vanuatu
Madagascar	Yemen
Malawi	Zambia
Maldives	Kosovo

Source: World Bank (2023b).
Note: *Sri Lanka was readmitted to IDA during the Fiscal Year 2023.

DEBT RELIEF FOR A GREEN & INCLUSIVE RECOVERY

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