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The COVID-19 Debt Initiative: International Call for Action in Support of IDA Countries

The attached document titled "The COVID-19 Debt Initiative: International Call for Action in Support of IDA Countries" prepared by the World Bank Group and International Monetary Fund for the virtual April 17, 2020 Development Committee Meeting replaces the version dated April 17, 2020 (DC2020-0004/1-P). The only changes are the country names below in Annex 1:

- Democratic Republic of the Congo – now reads – Democratic Republic of Congo
- New Guinea – now reads – Papua New Guinea

The COVID-19 Debt Initiative: International Call for Action in Support of IDA Countries

1. Introduction

IDA countries[1] are likely to be severely affected by the COVID-19 pandemic, which could wipe out a generation of economic progress and poverty reduction. These countries account for a quarter of the world population. (See Annex 1 for the list of countries). Close to a half billion of the extreme poor live in IDA countries—about two thirds of the developing world—with a poverty rate of 31 percent. The pandemic is expected to cause severe economic consequences for these countries, potentially overwhelming weak health systems and increasing the risk of social unrest and fragility.

Many IDA countries were already in a difficult debt situation—which will be exacerbated by the pandemic. Most IDA countries lack the resources necessary to mount an emergency response while maintaining adequate spending on health, education, social safety nets, and job creation. Remittances and exports have collapsed. The demand for imports of necessary medical equipment is increasing. Capital markets are seizing up, cutting off the limited access some IDA countries had in the recent past. The risk of social unrest is increasing amid signs of food shortages.

Fast, decisive, and broad-based international action is needed to help IDA countries meet their financing needs. Public and external financing needs are projected to increase sharply, creating financing gaps as the crisis evolves. The World Bank Group (WBG) and the IMF have moved quickly to mount a comprehensive and flexible response that builds on lessons learned from the avian flu outbreak in 2004 and the global financial crisis in 2008. But financing from IFIs and MDBs alone will not be sufficient to enable these countries to manage the severe health, economic, and social impacts of the pandemic.

The President of the World Bank and the Managing Director of the IMF have jointly called on all official bilateral creditors to temporarily suspend collection of debt payments (i.e. repayments and interest) from IDA countries that request forbearance. The objective is to help IDA countries meet the increase in resources they need to respond effectively to the COVID-19 crisis while avoiding a liquidity crisis that could trigger defaults and solvency problems and extend the duration of the crisis.

The initiative would be time-bound, providing rapid assistance when needs are high. It draws on lessons learned from addressing debt issues that low-income countries (LICs) have faced over the last 25 years, captured by the HIPC guiding principles. It also draws from the international community's response to past emergencies such as Hurricane Mitch (1998) and the Indian Ocean Tsunami (2004).

2. Net flows, debt service, and the COVID-19 crisis

On the eve of the COVID-19 crisis, debt vulnerabilities had become elevated in IDA countries. As of end-December 2019, 50 percent of IDA countries were classified by the IMF and

[1] The IMF uses the PRGT-eligibility framework, which is broadly aligned with the World Bank's IDA practices, with minor differences explained by differences in the mandates of the two institutions and the timing of their respective review cycles.

the World Bank as either in or at high risk of debt distress. Two important developments stood out[2]:

- **Increased debt-service burdens.** In a few IDA countries, the interest burden already exceeds pre-HIPC levels—and debt service burdens are highest in Sub-Saharan Africa. Overall external public and publicly guaranteed (PPG) debt-service-to-revenue ratios for IDA countries increased to about fifty percent, from 8 to an estimated 12 percent, between 2017 to 2019.

- **Changed composition of debt.** This has left IDA countries vulnerable to shocks. The share of variable-interest-rate external debt has increased, as has the share of commercial borrowing—in particular for fuel exporters and countries with access to capital markets. For countries with recent access to Eurobond markets, rollover risks have risen amid a decline in the average maturity on new external commitments. Particularly vulnerable are countries with a high proportion of debt redemptions relative to foreign exchange reserves.

Sizeable financing gaps are likely to open up because of pandemic needs. Current macro projections suggest that external financing needs in IDA countries would increase on average by close to 2 percent of GDP—although it could be as high as 8 percent in 2020 for countries dependent on export of commodities or tourism services. The risks, however, are heavily tilted to even worse outcomes.

The World Bank and the IMF, for their part, will substantially increase their provision of highly concessional financing to IDA countries but on their own cannot close these gaps. In crises, the role of World Bank and the IMF is to provide fresh financial support to help countries mount an emergency response while also supporting their long-term development efforts. Most of these resources are provided on highly concessional terms. In the wake of increasing debt difficulties in several IDA countries, IDA shifted towards enhanced provision of more concessional financing, including grants. Close to half of the 76 IDA countries are receiving all or half of their IDA resources on grant terms. Box 1 discusses in more detail the substantial resources that would be available to participating countries from the Bank and the IMF.

Box 1: WBG and IMF response to COVID-19

As part of the WBG's response to COVID-19, IDA is expected to commit over $50 billion over the coming 15 months, on grant and highly-concessional credit terms, primarily through front-loading of IDA19 in fiscal year 2021 (starting July 1st 2020). This amount is more than 12 times greater than the debt-service payments IDA is expected to receive from IDA19-eligible countries (about $4 billion). IDA's *net transfer* to IDA countries is expected to reach an estimated $23 billion in the coming 15 months, assuming a significant shift of IDA lending towards development policy operations. (Unless otherwise noted, dollar volumes are specified as U.S. dollars in this paper).

The IMF is responding through a proposed increase of access limits under the RCF and RFI (emergency financing facilities), laying the basis for the Fund to provide close to SDR 20 billion to PRGT-eligible countries in the coming near term. In addition, the approval of the reforms to the Catastrophe and Containment Relief Trust (CCRT), will lay the basis for debt relief for the poorest PRGT-eligible members, which could amount to SDR 700 million over two years (with sufficient donor commitments).

[2] IMF and World Bank (2020) The Evolution of Public Debt Vulnerabilities in Lower Income Economies.

Debt service payments to official bilateral creditors in 2020 are estimated to amount to about $14 billion in IDA-eligible countries. For these countries, the share of debt service payments to multilateral, bilateral and commercial creditors is estimated at 36, 38 and 25 percent, respectively.

Table 1. Estimated 2020 Debt Service for Public and Publicly Guaranteed External Debt

(in USD billions, based on end 2018 data)

	All IDA-eligible	IDA-Only*	IDA-eligible SSA	High Risk & In Debt Distress
Multilateral	13.0	3.9	5.4	2.2
Bilateral	13.8	3.7	6.1	4.1
of which: Non-Paris Club	*10.1*	*2.9*	*4.7*	*3.2*
Commercial	9.3	2.9	7.1	4.7
of which: Bonds	*5.4*	*1.2*	*3.6*	*1.9*
Total	**36.2**	**10.6**	**18.6**	**11.0**

Source: World Bank International Debt Statistics (IDS) as of March 20, 2020.

*Only includes non-gap IDA-only countries in line with World Bank (2018) "Addressing Debt Vulnerabilities in IDA countries", and World Bank (2019) "Addressing Debt Vulnerabilities in IDA countries: Options for IDA 19." See also Annex 1.

Notes:

1/ Reflects the debt service on the stock of medium and long-term PPG external debt disbursed and outstanding as of end-December 2018 on all IDA-countries, except for inactive countries as per Annex 1.

2/ Consistent with IDS coverage, figures reflect data for 67 out of 76 IDA countries as of FY20.

3/ Non bond commercial debt includes exports credits, debt to private financial institutions and supplier credits.

3. The COVID-19 Debt Initiative

Official bilateral creditors are called upon to provide a time-bound suspension on debt service payments from May 1, 2020 until June 30, 2021[3]**—**to all eligible countries requesting forbearance, without application of penalty interest or late fees.[4] The objective is to help IDA countries meet an increase in liquidity needs, to enable an effective response to the crisis and to limit its duration.

All IDA countries or PRGT-eligible countries that are in current standing with their debt service vis-à-vis the IMF and the World Bank as of FY2020 would be eligible to participate. Countries that are in arrears to the World Bank or the IMF[5] would not be eligible for new IFI finance. But to the extent they are current on any debt service to bilateral official creditors, those creditors should consider suspending these payments.

The IMF, World Bank, and MDBs that are already providing highly concessional resources would support this initiative by frontloading highly concessional financing. In addition to IDA and the IMF (see Box 1), other MDBs have taken decisive steps and announced packages to help the poorest countries during this crisis. Regardless of the support modality, all

[3] Given the fast-evolving crisis, a moratorium of this length seems necessary to fully assess its economic and social impact.

[4] The request could be in the form of an official letter from the debtor countries to the WB and the IMF.

[5] This includes inactive countries.

multilateral creditors would be expected to provide positive net flows to beneficiaries during the duration of the debt service suspension.

The initiative would comprise the following building blocks:[6]

- *Ensure that countries have sufficient liquidity to meet urgent crisis needs*. The objective is to provide a time-bound suspension of debt service to mitigate the economic and social impact of the COVID19-crisis.

- *Good stewardship of freed resources.* Beneficiary countries would commit to direct the resources freed up under the initiative towards mitigating the economic and social impact of the COVID-19 crisis, in close coordination with the World Bank and IMF staffs. [7] A monitoring system would be put in place to ensure adequate use of resources.

- *Debt transparency*. Eligible countries would commit to fully disclose their PPG debt—and to reconcile it against creditor statements. The World Bank and IMF could provide technical assistance to support the debt reconciliation process.[8] This process could also be supported through the World Bank's Sustainable Development Finance Policy (see Box 2).

- *Debt Sustainability*. The World Bank and IMF staff would work with countries to evaluate their financing needs and debt-sustainability outlook based on the reconciled data and longer-term debt service requirements and liquidity needs.[9]

- *Broad-based and equitable participation*. Participation by all official bilateral creditors would be critical (especially given the importance of non-Paris Club creditors in foreign lending in recent years). Commercial creditors could provide treatment on terms at least comparable with those granted by official bilateral creditors.

- *Creditor outreach*. Broad-based participation and equitable burden-sharing will require extensive creditor outreach by the World Bank and the IMF to all creditors, as well as by the G20 and others, along with strong MDB coordination. The World Bank and the IMF have a longstanding practice of coordination on debt issues, including through the implementation of the joint Bank-Fund Multi-Pronged Approach to addressing debt vulnerabilities in low-income countries.

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[6] These building blocks draw on the HIPC guiding principles (SecM96-927, August 26, 1996), though this suspension of debt service is designed as a time-bound liquidity relief initiative.
[7] This could, for example, consist of a supplementary budget with adjustments made to debt service and an at least equivalent contingency added for COVID-19 related expenses with proper controls on its use.
[8] In addition, to the extent that official bilateral creditors hold collateral from relevant debtors in the form of cash, or funds held in escrow accounts, the World Bank and the IMF encourage official bilateral creditors to release such collateral so as to provide relevant IDA countries with increased liquidity to respond to the pandemic.
[9] Countries that are determined at a point to have unsustainable debt situations could pursue further debt relief with their creditors.

- *Multilateral creditors would provide external finance on grant or highly concessional terms*. Actions by multilateral creditors will preserve their financial integrity and de facto preferred creditor status.
- *New external finance would be predominantly on appropriately concessional terms and consistent with the new Sustainable Development Finance Policy (See Box 2).*

The World Bank and the IMF would report on the progress of this work to the Development Committee at the 2020 Annual Meetings.

Box 2: The Sustainable Development Finance Policy

As part of its 19th replenishment, IDA will introduce the Sustainable Development Finance Policy (SDFP) to create incentives for countries to borrow sustainably and promote coordination between IDA and other creditors in support of countries' efforts. Building on its predecessor, the Non-Concessional Borrowing Policy (NCBP), the SDFP will require most IDA countries to define and implement Policy and Performance Actions to optimize their access to IDA highly concessional resources. These actions will be focused on debt transparency, debt management, and fiscal sustainability. In particular, in the context of this international call for action, the SDFP will initially have a strong focus on debt transparency and sound debt management. The SDFP will reinforce the existing emphasis of the IDA resource-allocation system on performance, with a focus on addressing debt vulnerabilities. Countries making progress on these criteria will enjoy full access to IDA resources, while others will have less access and could face less favorable terms.

IDA will complement these borrower actions with an extended program of outreach to creditors that promotes—with other multilaterals and other creditors—good credit practices, including debt transparency from the creditors' side. By focusing upfront on debt transparency and providing greater clarity on the debt owed to different creditors, the SDFP will complement the debt-relief initiative. Updated DSAs will underpin both initiatives.

This policy is tightly coordinated with the IMF's ongoing review of its Debt Limit Policy. IDA is also reaching out to other multilaterals to foster the principles underpinning the SDFP.

Annex 1. List of IDA eligible and PRGT-eligible countries in FY2020

IDA-only (non-gap and gap countries) (59)	Afghanistan, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Côte d'Ivoire, Democratic Republic of Congo, Djibouti, Eritrea[2/],Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Kiribati, Kosovo[1/], Kyrgyz Republic, Lao P.D.R., Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Marshall Islands, Mauritania, Micronesia, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Rwanda, Samoa, São Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan[2], Syria[1/2/], Tajikistan, Tanzania, Togo, Tonga, Tuvalu, Uganda, Vanuatu, Yemen, Zambia
Blend (17)	Cameroon, Cape Verde, Republic of Congo, Dominica, Fiji[1/], Grenada, Kenya, Moldova, Mongolia[1/], Nigeria[1/], Papua New Guinea, Pakistan[1/], St. Lucia, St. Vincent and the Grenadines, Timor-Leste, Uzbekistan, Zimbabwe[2]

[1/] Not eligible for PRGT.

[2/] Inactive IDA countries.