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United States Government Accountability Office
Washington, DC 20548

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Congressional Requesters

Subject: *Developing Countries: U.S. Financing for Multilateral Debt Relief Initiative Currently Experiencing a Shortfall*

A buildup of foreign debt throughout the 1970s and 1980s—combined with low growth, falling commodity prices, and other economic difficulties—left many poor countries with significantly more debt than they could repay. International efforts to provide debt relief to 41 such heavily indebted poor countries have been ongoing for over a decade, and these efforts culminated in the Multilateral Debt Relief Initiative (MDRI), which was announced in 2005. MDRI eliminates eligible debt that countries owe to four international financial institutions—the World Bank’s International Development Association (IDA), the International Monetary Fund (IMF), the African Development Bank’s African Development Fund (ADF), and the Inter-American Development Bank (IaDB).¹

To receive MDRI debt relief, countries must first complete the Heavily Indebted Poor Countries (HIPC) Initiative, which the World Bank and IMF created in 1996 to relieve the debt burden of poor countries. In response to concerns over the continuing vulnerability of these countries, the World Bank and IMF enhanced the initiative to provide additional debt relief in 1999. Recognizing that recipient countries needed further assistance, MDRI was created to help accelerate countries’ progress toward achieving the United Nations Millennium Development Goals.² Of the 41 eligible countries, 23 countries have received debt relief under both the MDRI and HIPC Initiatives, and another 10 countries are receiving debt relief under just the HIPC Initiative.

Donor governments (including the U.S. government) have agreed to help fund multilateral debt relief. Donor governments and each institution agree to the amount

¹IaDB was not included in MDRI but decided in 2007 to provide equivalent debt relief under a similar initiative. IaDB’s Fund for Special Operations is the entity responsible for providing debt relief. For the purpose of this report, references to MDRI also include the IaDB initiative. IMF, ADF, and IaDB plan to cancel all eligible debt that countries owed to them as of the end of 2004. IDA plans to cancel all eligible outstanding debt as of the end of 2003.

²The United Nations Millennium Development Goals, which have a target completion date of 2015, are to (1) eradicate extreme poverty and hunger; (2) achieve universal primary education; (3) promote gender equality and empower women; (4) reduce child mortality; (5) improve maternal health; (6) combat HIV/AIDS, malaria, and other diseases; (7) ensure environmental sustainability; and (8) develop a global partnership for development.

of MDRI costs each donor is to fund.³ To fund MDRI, governments may (1) provide funding in addition to their regular contributions or replenishments to the institutions,⁴ (2) provide their regular contributions early and generate credits through an approach known as early encashment,⁵ or (3) do both. If a government uses these early encashment credits to fully fund its share of MDRI, it is not required to provide additional funding for MDRI. The U.S. Department of the Treasury (Treasury) is currently using early encashment to fund the U.S. MDRI commitment. If the U.S. government provides full funding for IDA and ADF, then the early encashment approach will generate sufficient funding to cover MDRI during the current replenishment periods. However, in past replenishments, the U.S. government has not fully funded its replenishment contributions to international financial institutions on time, resulting in arrears to IDA and ADF totaling more than \$400 million as of the end of fiscal year 2007.

We have previously reviewed the HIPC Initiative and other debt-related issues.⁶ In response to your request for this report, we (1) estimated the overall cost of MDRI for four international financial institutions (IDA, IMF, ADF, and IaDB), and (2) evaluated the United States' approach to funding its share of MDRI costs. This is the first of two products we plan to issue in response to your interest in debt relief for poor countries. We plan to issue a report in early 2009 that will address financing for HIPC and MDRI, resources available to countries for spending on poverty-reducing activities, and tools to promote debt sustainability. Our 2009 report will provide details regarding debt relief provided under the HIPC Initiative, the U.S. contribution to this effort, and past and present HIPC Initiative funding tools.

To estimate the overall cost of MDRI, we compiled and analyzed data from the October 2007 IMF and World Bank report *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation*. We supplemented this data with information from documents provided by Treasury and the U.S. Executive Director (USED) offices at the international financial institutions. To identify U.S. contributions to MDRI costs, we reviewed data derived from documents provided by Treasury and the World Bank and ADF, since the U.S. government is helping to fund debt relief from these two institutions. To evaluate the United States' approach to funding its IDA and ADF MDRI costs, we reviewed data derived from Treasury, World Bank, and ADF documents. We estimated future total U.S. commitments in each IDA and ADF

³Treasury officials have noted that the amount of funding each donor government actually provides may differ from the original estimates due to changes during MDRI implementation. For example, if fewer countries receive debt relief than projected in a particular year, MDRI costs will be lower for that year.

⁴Replenishment refers to periodic contributions by member countries that are agreed upon by the institution's board of governors to fund concessional, or below market, lending operations over a specified period of time, normally every 3 years.

⁵According to Treasury officials, the United States and Japan are the only donors that use early encashment of their regular replenishment contributions to pay their share of MDRI-related costs at the World Bank.

⁶See Related GAO Products at the end of this report. Our previous work identified funding shortfalls associated with the HIPC Initiative.

replenishment period and then used this amount in a simulation model of the U.S. payment schedule in order to estimate the amount of early payment credits that would be earned annually if Treasury continued to use the early encashment approach. We compared the estimated credits earned for fiscal years 2005 through 2054 to the estimated U.S. MDRI commitments over the same period to determine if credits earned would be sufficient to fund these commitments. All figures provided in this report are expressed in end-2007 present value dollars unless otherwise noted.⁷ We assessed the reliability of the data analyzed and found the data to be sufficiently reliable for the purposes of this report.

We conducted this performance audit from December 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. (See enclosure I for more detailed information regarding our scope and methodology.)

Results in Brief

We estimate that IDA, IMF, ADF, and IaDB will provide, in present value dollars, almost \$29 billion in MDRI debt relief for 41 countries over the next several decades, with the U.S. government contributing about 15 percent of this amount.⁸ IDA is to provide the most debt relief, accounting for about \$18.5 billion or about 64 percent, of the total. IMF is to provide about \$4 billion in MDRI debt relief, and ADF and IaDB are to provide about \$3.7 billion and \$2.4 billion, respectively.⁹ As of the end of 2007, the 23 countries that were eligible for MDRI had realized about \$1.7 billion (6 percent) of total planned debt relief from the four international financial institutions. The amount of debt relief realized to date is small compared to the total planned amount of MDRI debt relief because MDRI has only been operational since 2006 and because countries will only realize benefits over the next several decades as annual debt obligations that were irrevocably cancelled would have come due. Donor governments have agreed to fully fund MDRI debt relief on a “dollar-for-dollar” basis to IDA and ADF.¹⁰ We project that the U.S. government will provide about \$3.8 billion to fund IDA MDRI costs and over \$400 million for ADF MDRI debt relief, which

⁷The present value of debt is a measure that takes into account the concessional terms that underlie most of these countries’ loans. Present value debt is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the market interest rate. The nominal value of the debt is greater than the present value.

⁸IDA and IaDB loans are repaid over a period of up to 40 years. ADF and IMF loans are repaid over a period of up to 50 and 10 years, respectively.

⁹The total nominal dollar amount of planned MDRI debt relief is almost \$55 billion, with IDA accounting for \$37.6 billion, IMF providing \$4.3 billion, ADF providing \$8.4 billion, and IaDB providing \$4.4 billion. These nominal dollar amounts do not take into consideration the time value of money.

¹⁰IMF and IaDB have used internal resources or made program alterations in order to fund all MDRI costs and, therefore, have not requested additional funding from donor countries for MDRI.

represents about 19 percent of MDRI debt relief provided by these two institutions and almost 15 percent of all MDRI debt relief provided.¹¹

Based on our projections, Treasury's early encashment approach does not fully fund the U.S. share of IDA MDRI costs, and may not fully fund the U.S. share of ADF MDRI costs by 2013. We project that the U.S. government will face a shortfall of approximately \$142 million in its existing IDA MDRI commitments by 2009 if it does not clear \$152 million of accumulated payments not yet provided to IDA during the current replenishment period.¹² Based on our assumptions about the growth of future U.S. commitments, and if the U.S. government fully funds its future IDA replenishment contributions and continues to use only early encashment, it could experience an IDA MDRI shortfall of \$108 million by 2014. This shortfall would begin to decrease by 2026 as U.S. MDRI commitments begin to decline. By 2044, when all IDA MDRI loans are expected to have expired, we project that the U.S. government would have generated a surplus in that replenishment period. In addition, we project that the U.S. government would face a shortfall to ADF for its MDRI commitment by 2013 that would increase until 2025 when, as with IDA, it would begin to decrease. By 2054, when all ADF MDRI loans are expected to have expired, we project that the U.S. government would have generated a surplus in that replenishment period. If the U.S. government does not pay its future contributions to IDA and ADF in full and on time, projected shortfalls in its IDA and ADF MDRI commitments could increase further. To offset these shortfalls, Treasury may need to request new appropriations, accelerate the early encashment schedule, or do both.

Background

MDRI expands upon the HIPC Initiative and represents the most recent effort to provide debt relief to heavily indebted poor countries. To receive MDRI debt relief, a country must meet all HIPC Initiative criteria. At a country's "decision point," IDA and IMF use certain criteria¹³ to determine whether a country qualifies for HIPC Initiative debt relief. If a country is determined to qualify, it can begin to receive interim HIPC debt relief. Subsequently, at the "completion point," when IDA and IMF

¹¹In nominal dollars, the U.S. government will provide about \$7.6 billion and \$1 billion for IDA and ADF MDRI costs, respectively, for a total of \$8.6 billion.

¹²The U.S. government has accumulated almost \$58 million in arrears to the current IDA replenishment period, which covers fiscal years 2006 through 2008. Furthermore, under fiscal year 2008 obligations, Treasury is withholding about \$94 million until the World Bank meets certain transparency and anticorruption requirements contained in U.S. law. If Treasury is unable to report that the World Bank has met the performance requirements, U.S. funding not yet provided to IDA could rise to \$152 million. Treasury officials are holding discussions with the World Bank on meeting the established requirements in fiscal year 2009. According to Treasury officials, while the U.S. government considers this funding to be "withheld payments," the World Bank considers it to be "arrears," as these payments are considered part of the expected U.S. commitment that has not been paid. IDA14 arrears and withholdings are expressed in nominal dollars.

¹³These criteria are: (1) eligibility only for concessional financing from the World Bank and IMF, (2) an unsustainable debt burden, (3) a track record of reform and sound policies, and (4) development of a poverty reduction strategy paper.

determine that the country has met additional criteria,¹⁴ the country can begin to receive full and irrevocable HIPC debt relief as well as additional debt relief under MDRI. As of June 2008, of the 41 countries that may benefit from debt relief efforts, 23 have reached the completion point,¹⁵ and 10 more have reached the decision point.¹⁶ An additional eight countries are considered “predecision point” countries and have not yet qualified for debt relief.¹⁷ In addition, IMF has determined that it will provide MDRI debt relief to member countries with debt outstanding to IMF and a per capita income below \$380 per year that do not otherwise qualify for debt relief.¹⁸

IDA, IMF, ADF, and IaDB Are Estimated to Provide almost \$29 Billion in MDRI Debt Relief

We estimate that IDA, IMF, ADF, and IaDB will provide almost \$29 billion in MDRI debt relief to eligible countries over the next several decades, with IDA providing almost two-thirds of this amount. As of the end of 2007, countries that had met program eligibility requirements had realized about \$1.7 billion in debt relief, or almost 6 percent of the estimated total amount, from the four international financial institutions. Donor governments have agreed to provide funding on a dollar-for-dollar basis to IDA and ADF to fully cover their MDRI costs. We project that the U.S. government will provide about \$3.8 billion to fund IDA debt relief costs and about \$400 million for ADF debt relief, which represents about 19 percent of total IDA and ADF MDRI debt relief and almost 15 percent of all MDRI debt relief.

Four International Financial Institutions Are Estimated to Provide almost \$29 Billion in MDRI Debt Relief to Eligible Countries; Countries Have Already Realized \$1.7 Billion

We estimate that IDA, IMF, ADF, and IaDB will provide, in present value dollars, a total of almost \$29 billion in debt relief under MDRI over the next several decades. IDA is to provide about 64 percent, or about \$18.5 billion, of the total amount. IMF is to provide the second-largest share, at approximately \$4 billion. ADF is to provide about \$3.7 billion, and IaDB, \$2.4 billion (see fig. 1).

¹⁴These criteria are: (1) a further track record of good performance under IMF- and IDA-supported programs, (2) implementation of key reforms agreed upon at the decision point (known as floating completion point triggers), and (3) adoption and implementation of the poverty reduction strategy paper for at least 1 year.

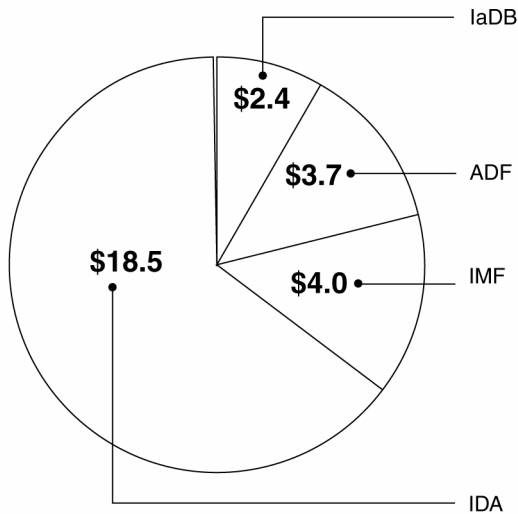
¹⁵Completion-point countries are Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, the Gambia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia.

¹⁶Decision-point countries are Afghanistan, Burundi, Central African Republic, Chad, Republic of Congo, Democratic Republic of the Congo, Guinea, Guinea-Bissau, Haiti, and Liberia.

¹⁷Predecision point countries are Comoros, Cote d'Ivoire, Eritrea, Kyrgyz Republic, Nepal, Somalia, Sudan, and Togo.

¹⁸Using this criterion, IMF has identified two non-HIPC Initiative countries, Cambodia and Tajikistan, as eligible for MDRI debt relief. As of the end of September 2007, IMF had canceled \$82 million and \$100 million of MDRI-eligible debt to these two countries, respectively.

Figure 1: Four International Financial Institutions' Shares of \$29 Billion in MDRI Debt Relief



Source: GAO analysis of World Bank and IMF documents.

Notes:

- (1) Amounts do not add to precisely \$29 billion due to rounding.
- (2) This amount includes IMF debt relief provided for Cambodia and Tajikistan.
- (3) Amounts are in billions of end-2007 present value dollars.

The total nominal dollar amount of MDRI debt relief is about \$55 billion, with IDA accounting for \$37.6 billion, IMF providing \$4.3 billion, ADF providing \$8.4 billion, and IaDB providing \$4.4 billion.

By the end of 2007, the 23 countries that had reached the completion point had realized debt relief of almost \$1.7 billion (6 percent of total planned debt relief) as their cancelled debt payments came due. IMF provided over half, or about \$940 million of MDRI debt relief, while IDA provided over \$560 million. ADF and IaDB provided \$82 million and \$90 million, respectively, in debt relief.

Because MDRI has only been operational since 2006, the amount of annual loan payments that would otherwise have already been due if the debts had not been forgiven under MDRI has been small compared to the overall amount of debt that has been cancelled. Furthermore, debt payments were originally structured so that countries were scheduled to make payments in limited amounts over many years. Therefore, although the four international institutions have already irrevocably cancelled all eligible debt, countries will only realize benefits as annual debt obligations would have come due over the next several decades.

Donor Governments to Pay IDA and ADF Debt Relief under MDRI

Governments that provide funding to the international financial institutions have agreed to fund MDRI costs. IDA and ADF will receive such support, and donor governments have agreed to provide funding that will cover all MDRI costs on a dollar-for-dollar basis, in addition to their regular contributions to these two institutions. IMF and IaDB are currently using existing internal resources to fund

MDRI and have not requested donor support. IMF has placed internal resources, including the profits from its 1999 and 2000 off-market gold sales, into trust funds to provide funding for MDRI debt relief. In order to obtain sufficient internal resources to fund debt relief, IaDB created a blended loan product made up of concessional funds and nonconcessional funds, according to Treasury officials. This blended product allows IaDB to continue to provide concessional lending while allowing borrowing countries to meet the concessional borrowing requirements set by IMF. Furthermore, Treasury officials noted that IaDB took other measures to obtain additional resources, such as canceling undisbursed portions of nonperforming concessional loans, to gain access to additional funding.

We project that the U.S. government will provide, in present value terms, about \$3.8 billion to fund IDA MDRI costs and over \$400 million for ADF MDRI costs. Our total projected U.S. contribution of \$4.2 billion is about 19 percent of the \$22.2 billion in planned debt relief for these two institutions and is to be provided over multiple decades to IDA and ADF.¹⁹ The U.S. contribution represents almost 15 percent of total MDRI debt relief to be provided by all four institutions.

U.S. Government Currently Has a Funding Shortfall for IDA MDRI and Could Experience Future Shortfalls

Treasury currently plans to fund U.S. commitments for MDRI by paying its regular contributions to IDA and ADF early. However, under this early encashment approach, the United States may have a \$142 million shortfall in IDA MDRI obligations by 2009 and may not fully fund its share of ADF MDRI costs by 2013. The IDA shortfall is due to the U.S. government not fully funding its commitments to IDA, thus limiting its ability to earn sufficient credits to meet its MDRI commitments. Based on our projections, even if the U.S. government funds its future IDA and ADF replenishment contributions in full and on time and continues to use early encashment, MDRI shortfalls for both institutions could continue for over 20 years. If the U.S. government does not pay its IDA and ADF contributions in full and on time, its projected shortfalls in MDRI commitments would increase further. To offset these shortfalls, Treasury may need to request new appropriations, accelerate the early encashment schedule, or do both.

Treasury Currently Funds MDRI Commitments by Paying Regular Contributions Early

Treasury currently funds U.S. commitments to MDRI using credits earned from paying its regular replenishment contributions to IDA and ADF early, through a process known as accelerated or early encashment. Although one replenishment funds 3 years of commitments for IDA and ADF operations, governments may pay their share of a replenishment over a longer period of time. For example, the standard payment (or encashment) schedule allows governments to pay their share of the current IDA replenishment (known as IDA14) over 9 years and the current ADF

¹⁹For IDA MDRI, the U.S. share is 20.3 percent; for ADF MDRI, the U.S. share is 11.8 percent.

replenishment (known as ADF-10) over 10 years.²⁰ To fund its MDRI commitments, Treasury decided to pay the U.S. share of its replenishments over 4 years, rather than over the standard 9 to 10 years, beginning with IDA14 and ADF-10.²¹ Based on the methodology agreed upon by Treasury and IDA, an encashment credit is earned if the present value of the cumulative early encashment payment exceeds the present value of the cumulative standard encashment amount due in a replenishment period.²² Treasury expects the credits earned from early encashment to fully fund U.S. MDRI commitments for IDA14 (\$232 million), IDA15 (\$356 million), ADF-10 (\$15 million), and ADF-11 (\$26 million).²³ Treasury committed to financing MDRI over its full implementation period but has not identified a financing approach that extends beyond these replenishment periods. Treasury told us that financing future U.S. MDRI commitments through early encashment or other means would require new discussions with the Office of Management and Budget and possibly IDA and ADF.

Current IDA MDRI Shortfall Due to U.S. Payments Not Provided to IDA

During the current IDA replenishment period (IDA14), which covers fiscal years 2006 through 2008, the U.S. government took several actions that have resulted in smaller payments to IDA than planned, thus contributing to its current shortfall to IDA for MDRI. A rescission of 1 percent reduced the fiscal year 2006 enacted appropriation of \$950 million (the full amount pledged by the U.S. government) for IDA to \$940.5 million.²⁴ Additionally, the fiscal year 2006 appropriations law contained a requirement that 20 percent of the appropriated funds to IDA be withheld from disbursement until Treasury could certify that the World Bank had met anticorruption provisions related to procurement.²⁵ Since Treasury could not certify that the World Bank had met all the provisions, the subsequent fiscal year 2007 continuing resolution rescinded \$31.35 million from the fiscal year 2006

²⁰During the 3-year replenishment period, donors can provide their contributions by depositing promissory notes in three equal installments, though IDA and ADF withdraw (encash) these funds on a separate and longer schedule known as the standard encashment schedule.

²¹In previous replenishment periods, Treasury followed a 6-year encashment schedule.

²²The United States has an agreement with IDA whereby credits from early encashment can be estimated on an annual basis; however, credits can only be realized at the end of each replenishment period. The surplus can generate credit by earning interest. The interest rate is the agreed-upon replenishment discount rate, which reflects the income earned by the international financial institutions as they invest the surplus funds. In general, the discount rate equals the projected inflation rate plus the real interest rate.

²³MDRI commitment amounts are expressed in nominal dollars.

²⁴Foreign Operations, Export Financing, and Related Programs Appropriations Act, fiscal year 2006, Pub. L. No. 109-102, 119 Stat. 2172, 2193 (Nov. 14, 2005); Department of Defense, Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006, Pub. L. No. 109-148, sec. 3801, 119 Stat. 2680, 2791 (Dec. 30, 2005). Amounts are expressed in nominal dollars.

²⁵Foreign Operations, Export Financing, and Related Programs Appropriations Act, fiscal year 2006.

appropriation.²⁶ The total fiscal year 2006 appropriation therefore totaled \$909.15 million, \$40.85 million less than IDA would consider due for that year. For fiscal year 2007, the foreign operations appropriation passed under a continuing resolution and set IDA funding at the fiscal year 2006 post rescission level, which was \$940.5 million, adding \$9.5 million to the arrears owed to IDA.²⁷ The fiscal year 2008 appropriations law provides \$950 million to IDA but includes a rescission of \$7.7 million. Together, these three amounts totaled about \$58 million in reduced IDA funding. In addition, the 2008 appropriation law contains certain transparency and anticorruption provisions that the World Bank must meet or 20 percent of the funds must be withheld from disbursement.²⁸ Under its current obligations, Treasury is withholding about \$94 million (10 percent) from disbursement until the World Bank meets certain performance requirements. As a result, Treasury has not provided a total of about \$152 million to IDA during the current replenishment period. We project a U.S. MDRI shortfall to IDA of about \$142 million by July 2009²⁹ if this funding is not provided.³⁰

²⁶Revised Continuing Appropriations Resolution, 2007, Pub. L. No. 110-5, 121 Stat. 8, 24 (Feb. 15, 2007). Amounts are expressed in nominal dollars. Treasury noted that Congress withheld these funds from disbursement but also amended the fiscal year 2006 requirement by striking the word “certify” and requiring instead that Treasury give a report to Congress, which was submitted, on the extent to which the World Bank had completed the anticorruption provisions detailed in the previous year’s appropriations law.

²⁷Revised Continuing Appropriations Resolution, fiscal year 2007.

²⁸Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, 121 Stat. 1844, 2311, 2352 (Dec. 26, 2007).

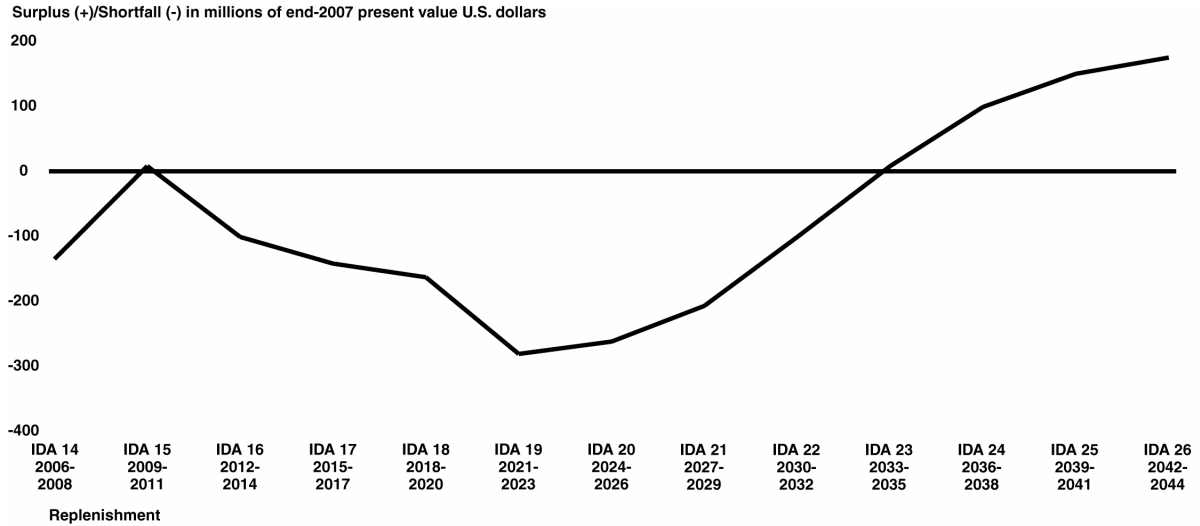
²⁹Since Treasury has chosen an early encashment schedule that goes beyond the 3-year replenishment period, the replenishment shortfall or surplus can accrue outside this 3-year time frame. For IDA14, Treasury staff confirmed that any shortfall or surplus would be accrued by 2009 rather than 2008. The additional year is a result of the 4-year early encashment schedule, whereby the U.S. government would still be encashing a payment in the last year. For all other IDA replenishment periods, and for ADF as well, there is some uncertainty with regard to when MDRI shortfalls or surpluses occur. Therefore, throughout this report we will refer to the MDRI shortfall or surplus as accruing at the end of the 3-year replenishment period rather than at the end of the payment period. However, in our calculations we assume that all future total IDA shortfalls or surpluses accrue by the fourth year, as in IDA14, and by the fifth year of the ADF early encashment schedule, unless otherwise noted. Because the U.S. government begins its 4-year early encashment schedule for ADF in the second year of the replenishment period, we assume that the total ADF shortfall or surplus is accrued by the fifth year.

³⁰Treasury and the World Bank are currently discussing a fiscal year 2008 congressional requirement to withhold \$94 million from the World Bank. Treasury staff told us that although these provisions are difficult to implement quickly, they expect some of the provisions to be met by the World Bank in fiscal year 2009. For fiscal year 2009, Treasury has requested new appropriations to cover \$42 million in arrears to IDA14. If this amount of funding is provided and if Treasury reports the World Bank’s full compliance with the performance requirements and pays the full \$94 million, the United States’ remaining IDA14 arrears would total \$16 million. In this case, the United States would not earn sufficient encashment credits to fully finance its MDRI obligations for IDA14 and experience a shortfall of about \$7 million. Treasury and IDA agreed upon an encashment methodology for IDA14 whereby the United States is expected to fully fund its IDA commitment of \$2.85 billion; otherwise, encashment credits would be more than proportionately reduced. IDA15 MDRI encashment credits would be totally eliminated if U.S. replenishment arrears were to exceed about 9 percent. Alternatively, the ADF has an encashment method whereby encashment credits are proportionately reduced if the United States has across the board rescissions.

Credits Earned from Early Payments Are Insufficient to Fully Fund Future U.S. MDRI Commitments

If the United States provides its future payments to IDA in full and on time and only uses early encashment to finance MDRI, we project that credits earned from early encashment would be insufficient to fully fund U.S. MDRI obligations to IDA by 2014 and to ADF by 2013. Shortfalls to IDA would increase with each replenishment period, rising to \$288 million by 2023, as shown in figure 2.³¹

Figure 2: Credits Earned from U.S. Early Encashment for IDA14 through IDA26



Source: GAO analysis of Treasury and IDA data

Notes:

(1) To project whether credits earned from early encashment would fully fund annual U.S. MDRI commitments, we used conservative assumptions regarding the growth rate of future U.S. replenishment obligations to IDA and assumed the U.S. government would continue meeting its funding obligations in full and on time under an early encashment schedule. We assumed that U.S. IDA commitments would grow at the same rate as corresponding projected total IDA commitments for IDA16 through IDA20. For the remaining replenishments, since projected total IDA commitments were not available, we estimated an average increase in nominal dollar replenishment of about 7.1 percent, the average growth rate of the prior five IDA commitments and projected U.S. IDA commitments for IDA21 through IDA26. The discount rate is 3.5 percent for IDA14 and 4 percent for all other replenishments. Treasury's funding approach for IDA14 involves a percentage breakdown of 80 percent-20 percent for each of the 3 years of replenishment funding. Under this approach, 80 percent of 1 year's funding is provided in the first year of the early encashment schedule and 20 percent in the second year. Under this funding stream, it will take 4 years to fully fund the United States' 3-year replenishment contribution to IDA. For IDA15 and all future replenishment periods, the funding approach accelerates further to 90 percent-10 percent over 4 years.

(2) Treasury staff have emphasized that total IDA requirements could grow more slowly or decrease as countries graduate from IDA assistance or other events reduce IDA needs. This would have an impact

³¹For IDA, the baseline analysis shown in figure 2 assumes a 90 percent-10 percent funding approach for IDA15 and onwards over a 4-year period. Under this approach, 90 percent of one year's funding is provided in the first year and 10 percent in the second year. Even if Treasury accelerated the early encashment schedule during IDA16 and subsequent replenishment periods to 100 percent over the 3-year replenishment period, it would still experience a shortfall of \$99 million that would rise to almost \$288 million by 2023. The shortfall accrues on the third year under a 3-year early encashment schedule.

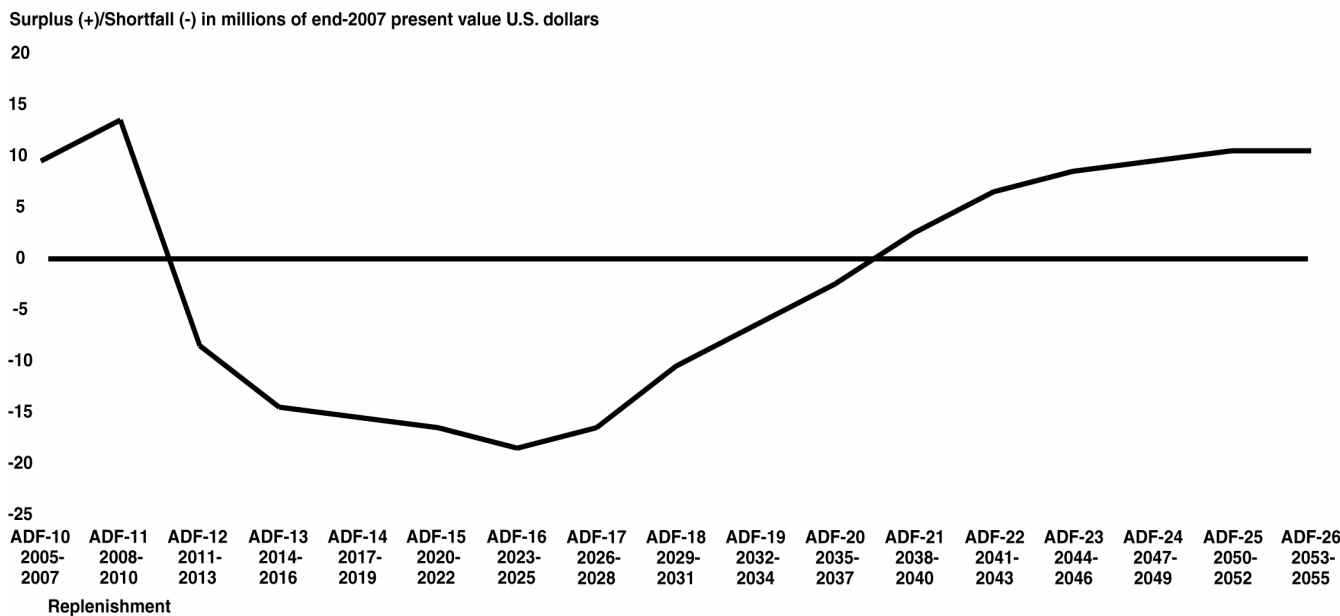
on the amount of early encashment credits generated and could lead to higher level of shortfalls or reduction in surpluses.

(3) Amounts are in millions of end-2007 present value U.S. dollars.

The projected shortfalls in a replenishment period would begin to decrease by 2026 as U.S. MDRI obligations started to decline (based on the established contribution schedule). The United States would generate a surplus of \$92 million during the 2036-2038 replenishment period. Furthermore, by 2044 (when all relevant IDA loans are expected to have expired for eligible countries), we project that the U.S. government would have generated a surplus of almost \$168 million in the final replenishment period covering MDRI.

Similarly, we project that the United States would experience a shortfall to ADF by 2013, if it continues to use an early encashment approach, although its \$22 million accumulated surplus from previous replenishment periods could offset the shortfall. Nonetheless, the shortfalls would increase during subsequent replenishment periods, rising to almost \$19 million by 2025, as shown in figure 3.³²

Figure 3: Credits Earned from U.S. Early Encashment for ADF-10 through ADF-26



Source: GAO analysis based on Treasury and ADF data.

³²For ADF, the baseline analysis shown in figure 3 assumes a 60 percent-40 percent funding approach for ADF-10 and onwards over a 4-year period. Even if Treasury accelerated this approach to 80 percent-20 percent (over 4 years) and then to 100 percent (over 3 years) during ADF-13 and subsequent replenishment periods, it would still experience shortfalls of \$12 million under the 80 percent-20 percent approach and \$9 million under the 100 percent approach during ADF-13. The shortfalls would rise by 2025 to almost \$17 million under the 80-20 approach and \$15 million under the 100 percent approach. The shortfall accrues on the fourth year under a 3-year early encashment schedule.

Notes:

(1) To project whether credits earned from early encashment would fully fund annual U.S. MDRI commitments, we used conservative assumptions regarding the growth rate of future U.S. obligations to ADF and assumed the U.S. government would continue meeting its funding obligations in full and on time under an early encashment schedule. For ADF, we estimated an average increase in nominal dollar replenishment of 6.1 percent, and used it to project U.S. ADF commitments from ADF-12 through ADF-26. The discount rate is 3.1 percent for ADF-10 and 4.69 percent for all other replenishments. The funding approach for ADF-10 and ADF-11 involves a percentage breakdown of 60 percent-40 percent for each of the 3 years of replenishment funding. Under this approach, 60 percent of 1 year's funding is provided in the first year of the early encashment schedule and 40 percent in the second year. Under this funding stream, it will take 4 years to fully fund the United States' 3-year replenishment contribution to ADF.

(2) Treasury staff have emphasized that total ADF requirements could grow more slowly or decrease as countries graduate from ADF assistance or other events reduce ADF needs. This would have an impact on the amount of early encashment credits generated, and could lead to higher level of shortfalls or reduction in surpluses.

(3) Amounts are in millions of end-2007 present value U.S. dollars.

The projected shortfalls in a replenishment period would then begin to decrease as U.S. MDRI obligations start to decline (based on the established contribution schedule). By 2040, the U.S. MDRI obligation shortfalls would end and, by 2054 (when all relevant ADF loans are expected to have expired for eligible countries), we project that the U.S. government would have generated a surplus of approximately \$10 million during the final replenishment period covering MDRI.

The United States' Financing Shortfall for MDRI Could Increase If It Does Not Meet the Early Encashment Schedule

If the United States does not fully fund its early encashment schedules for IDA and ADF, its projected shortfalls for MDRI could increase further. For example, if the U.S. government were to pay 5 percent less than its annual committed amounts for IDA15, its IDA MDRI shortfall would be \$176 million; if rescissions were to continue and exceed 8.8 percent of the annual committed amount there would be no encashment credits generated to fund IDA MDRI obligations for that replenishment period. If the U.S. government were to pay 5 percent less than its annual committed amounts for ADF-11, its ADF MDRI surplus would be reduced to \$11 million by 2010.³³ To offset these shortfalls, Treasury may need to request new appropriations, accelerate the early encashment schedule, or do both.

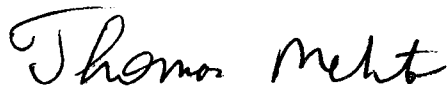
Agency Comments and Our Evaluation

We provided a draft of this report to the Department of the Treasury. In its written comments, Treasury said it appreciated GAO's analysis of and contribution to this issue. Treasury also emphasized the analysis showing that continued arrears to the development banks jeopardize the ability of the United States to meet its commitments to debt relief. Treasury made two technical points stressing that (1) U.S. commitments to MDRI have been made in nominal dollars, and (2) U.S. contributions to IDA and ADF are negotiated on a replenishment-by-replenishment basis. In our report, we provide amounts in both present value and nominal value

³³In this scenario, we estimate a 5 percent across the board rescission of U.S. contributions during IDA15 and ADF-11. In both cases, we assume all future replenishments periods are fully funded.

dollars where relevant. Since donor financing for MDRI debt relief will be provided over a 50-year period, we found it useful to take into consideration the time value of money and express costs in comparable present value dollars. We also note that contributions are negotiated for each replenishment. Treasury's letter is reprinted in enclosure II. Treasury staff also provided us with technical comments that we incorporated into the report as appropriate.

We are sending copies of this report to other interested Members of Congress, the Secretary of the Treasury, the World Bank, IMF, AfDB, and IaDB. We will also provide copies to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>. If you or your staffs have any questions about this report, please contact me at (202) 512-9601 or melitot@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report include Cheryl Goodman, Assistant Director; Leslie Holen; Bruce Kutnick; Farahnaaz Khakoo; and Debbie Chung.

A handwritten signature in black ink that reads "Thomas Melito". The signature is written in a cursive, flowing style.

Thomas Melito
Director, International Affairs and Trade

List of Requesters

The Honorable Joseph R. Biden, Jr.
Chairman
Committee on Foreign Relations
United States Senate

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Luis Gutierrez
Chairman
Subcommittee on Domestic and International
Monetary Policy, Trade, and Technology
Committee on Financial Services
House of Representatives

The Honorable Donald Payne
Chairman
Subcommittee on Africa and Global Health
Committee on Foreign Affairs
House of Representatives

The Honorable Maxine Waters
House of Representatives

The Honorable Barbara Lee
House of Representatives

Enclosure I: Objectives, Scope and Methodology

Our objectives were to (1) estimate the overall cost of the Multilateral Debt Relief Initiative (MDRI) for four international financial institutions: the World Bank's International Development Association (IDA), the International Monetary Fund (IMF), the African Development Bank's African Development Fund (ADF), and the Inter-American Development Bank (IaDB); and (2) evaluate the United States' approach to funding its share of MDRI costs.

To estimate the overall cost of MDRI, we compiled and analyzed data from the October 2007 IMF and World Bank report *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation*. We also incorporated data from the October 2007 International Development Association Resource Mobilization report *Multilateral Debt Relief Initiative (MDRI): Second Update on Debt Relief Costs and Donor Financing, as of September 30, 2007*. We supplemented these data with information from documents provided by the U.S. Department of the Treasury (Treasury) or the U.S. Executive Director's offices at the international financial institutions. Since debt relief will be delivered over 50 years, we are expressing all costs in end-2007 present value dollars. This process takes into consideration the time value of money and uses a discount rate of 4.6 percent. We used this discount rate because World Bank and IMF documents have used this rate for similar calculations. To estimate the U.S. contribution to MDRI costs, we reviewed data derived from documentation provided by Treasury as well as the World Bank and ADF since the U.S. government is helping to fund debt relief from these two institutions. Total U.S. costs are estimated by applying the projected U.S. share of total donor costs (20.3 percent for IDA and 11.8 percent for ADF) and are expressed in end-2007 present value dollars. We assessed the reliability of data analyzed and found the data to be sufficiently reliable for purposes of this report.

To evaluate the United States' approach to funding these costs, we reviewed data derived from World Bank and ADF documentation provided by Treasury. In order to estimate credits earned from early U.S. payments, we needed to know the total U.S. replenishment commitment to IDA and ADF for this period; however, data on total U.S. commitments are not available beyond fiscal year 2011. Therefore, we estimated future total U.S. IDA commitments by applying the projected growth rate of total IDA commitments during the same period, assuming that they both grow at the same rate. However, total IDA commitment estimates were not available beyond 2026 (replenishment period IDA20); therefore, for all future replenishment periods we applied a projected growth rate of 7.1 percent, the average increase in the nominal dollar replenishment of IDA16 through IDA20. We assumed that future U.S. ADF commitments would remain constant in real terms to that of ADF-12. We estimated future total U.S. ADF commitments would increase by 6.1 percent in every replenishment period.³⁴ After estimating the total U.S. commitment to IDA and ADF, we used this amount in a simulation model of the U.S. payment schedule in order to determine the amount of credits that would be earned during each replenishment period. In estimating the credits, we used a 3.5 percent discount rate for IDA14 and 4

³⁴ADF assumes that baseline donor contributions will increase with inflation at the rate of 2 percent annum.

percent for all other IDA replenishments, and a 3.1 percent discount rate for ADF-10 and 4.69 percent for all other ADF replenishments. Treasury provided us with the discount rates for IDA14 and IDA15, as well as ADF-10 and ADF-11. For future replenishments, we used the discount rates from the most current models (IDA15 and ADF-11).

Treasury and IDA agreed upon an encashment method, whereby encashment credits are calculated by multiplying the credit face value percentage by the actual total U.S. payment for that replenishment period. The credit face value is equal to the difference between the present value of the total actual early encashment payments and the present value of the total standard schedule payment amount, divided by the present value of the total standard schedule payment amount. Treasury and ADF have agreed upon a similar method for calculating encashment credits with a subtle difference in the calculation of the credit face value. The credit face value is equal to the difference between the present value of the annual actual U.S. payment expressed in percentages of the total actual U.S. payment and the present value of the annual regular encashment schedule expressed in percentages of the total commitment, divided by the present value of the annual regular encashment schedule expressed in percentages of the total commitment. We compared the credits earned from fiscal years 2006 through 2044 (for IDA) or through 2054 (for ADF) to the U.S. MDRI commitment over the same period to determine if credits earned are sufficient to fund U.S. MDRI costs. According to Treasury, encashment credits would be more than proportionately reduced if there are arrears in payments to IDA using this methodology. Additionally, we estimated future credits earned under a 5 percent rescission in the early encashment payments during IDA15 and ADF-11, and for IDA15 we estimated the level of rescission, which will lead to no early encashment credits. We assumed that for all other replenishment periods, the U.S. government fully funds its commitments to the institutions. The U.S. model was developed by the World Bank and provided by Treasury and the USED offices at the World Bank and ADF. All costs for these simulations are expressed in end-2007 present value dollars. We assessed the reliability of data analyzed and found the data to be sufficiently reliable for purpose of this report.

We conducted this performance audit from December 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Enclosure II: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

JUL 10 2008

Thomas Melito
Director, International Affairs and Trade
Government Accountability Office
441 G Street N.W.
Washington, DC 20548

Dear Mr. Melito:

Thank you for the opportunity to comment on your recent report regarding U.S. financing for the Multilateral Debt Relief Initiative.

The United States has consistently provided strong international leadership on debt relief for the world's most heavily-indebted poor countries. In 2005, with strong bipartisan congressional support, the Administration initiated and negotiated the landmark Multilateral Debt Relief Initiative (MDRI), and continued this work through a related agreement in the Inter-American Development Bank. However, for the United States to provide credible leadership – both on debt relief and more broadly within the international financial institutions – we must fulfill our commitments to help finance these initiatives. As this report describes, continued arrears to the development banks jeopardize the ability of the United States to meet its commitments to debt relief. We agree with your assessment that the risk of a near-term shortfall is greatest at the World Bank, where we anticipate the United States will have \$385 million in arrears to the International Development Association (IDA) and up to \$94 million in withheld payments by the end of fiscal year 2008.

The findings of the report illustrate the importance of full funding of Treasury's budget requests for IDA and the African Development Fund (AfDF), not only because of the valuable new development assistance that these institutions provide, but also for the United States to meet its commitments to help finance debt relief. In fact, our fiscal year 2009 budget request for payment of IDA arrears is specifically targeted at helping to fulfill our MDRI commitments. However, if the necessary appropriations are not made, the United States risks falling short on its commitments to MDRI, less than four years after this landmark international initiative began.

There are two technical points that we would like to highlight regarding the report. First, it is important to note that while the report frequently uses "present value" dollars, U.S. funding commitments for MDRI are in nominal terms. The United States has committed to provide \$7.6 billion for IDA and \$1 billion for AfDF over four decades in order to help support approximately \$55 billion in debt relief under MDRI. We understand your economic rationale for using present value terms, but focusing on the nominal amounts is extremely important as we seek to concretely meet U.S. commitments.

A second point is regarding your assumptions on the growth rates of U.S. contributions to the IDA and AfDF replenishments. The United States determines its contributions to IDA and the

AfDF on a replenishment-by-replenishment basis, based on an assessment of the needs and the policy frameworks in place at the time of replenishment negotiations (every three years). We realize that you needed to select certain assumptions in order to produce the long-term projections contained in this report. However, we must stress that the replenishment projections should not be viewed as a U.S. commitment or as prejudicing the outcome of future replenishment negotiations.

We appreciate GAO's analysis and contribution to this issue, and look forward to continued work with Congress to ensure that the United States meets its commitments to debt relief.

Sincerely,



Kenneth L. Peel
Deputy Assistant Secretary
Development Finance and Debt

Related GAO Products

Developing Countries: Challenges in Financing Poor Countries' Economic Growth and Debt Relief Targets. [GAO-04-688T](#). Washington, D.C.: April 20, 2004.

Developing Countries: Achieving Poor Countries' Economic Growth and Debt Relief Targets Faces Significant Financing Challenges. [GAO-04-405](#). Washington, D.C.: April 14, 2004.

Developing Countries: Switching Some Multilateral Loans to Grants Lessens Poor Country Debt Burdens. [GAO-02-593](#). Washington, D.C.: April 19, 2002.

Developing Countries: Challenges Confronting Debt Relief and IMF Lending to Poor Countries. [GAO-01-745T](#). Washington, D.C.: May 15, 2001.

Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges. [GAO/NSIAD-00-161](#). Washington, D.C.: June 29, 2000.

Developing Countries: Status of the Heavily Indebted Poor Countries Debt Relief Initiative. [GAO/NSIAD-98-229](#). Washington, D.C.: September 30, 1998.

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