Proactive Release

Date: 25 July 2022

The following Cabinet paper and related Cabinet minute have been proactively released by the Minister of Foreign Affairs

Title	Reference
Minute of Decision – Report of the Cabinet External Relations and Security Committee: Period ended 10 June 2022	CAB-21-MIN-0218
World Bank Multilateral Debt Relief Initiative: Refresh of Aotearoa New Zealand's Commitment	

CAB-22-MIN-0218

Cabinet

Minute of Decision

Report of the Cabinet External Relations and Security Committee: Period Ended 10 June 2022

On 13 June 2022, Cabinet made the following decisions on the work of the Cabinet External Relations and Security Committee for the period ended 10 June 2022:

ERS-22-MIN-0020	**World Bank Multilateral Debt Relief Initiative: Refresh of Aotearoa New Zealand's Commitment** Portfolio: Foreign Affairs	CONFIRMED

Michael Webster
Secretary of the Cabinet

[IN CONFIDENCE]

Office of the Minister of Foreign Affairs

Chair, Cabinet External Relations and Security Committee

World Bank Multilateral Debt Relief Initiative: Refresh of Aotearoa New Zealand's Commitment

Proposal

1 I am seeking Cabinet approval for Aotearoa New Zealand to continue supporting the World Bank administered Multilateral Debt Relief Initiative (MDRI) at a total estimated cost of NZ$34.48 million over 2023 to 2044. This Cost will be met by Vote Foreign Affairs Non-Departmental Other Expenses – International Development Cooperation (Multi-Year Appropriation).

Relation to government priorities

2 This is a refresh of Aotearoa New Zealand's financial commitment in 2006 to the MDRI, which the World Bank requests periodically following revisions of MDRI costs. Supporting the MDRI aligns with the Government's support for multilateralism and for the Sustainable Development Goals (SDGs), particularly the targets for SDG Goal 17 (Partnerships for the Goals) relating to mobilising additional financial resources and assisting developing countries in attaining long term debt sustainability.

Executive Summary

3 The MDRI cancels historical debt (as at 2003) owed to the concessional financing arms of multilateral development banks (MDBs) by highly indebted poor countries (HIPCs), thus releasing resources for their development efforts. Donor contributions replace the lost loan repayments to ensure that debt relief does not weaken the financial positions of MDBs and their ability to provide fresh support to developing countries.

4 Aotearoa New Zealand joined the MDRI at inception in 2006, committing to contribute NZ$68.9 million through to 2044. The cost of the MDRI is periodically re-estimated by the World Bank, and has fallen due to exchange rate changes, lower interest rates and revisions to the list of countries eligible, but not yet qualifying, for the MDRI. For Aotearoa New Zealand, the cost is now estimated at NZ$60.9 million, of which NZ$26.4 million has already been paid.

5 With each re-estimation, donors refresh their commitment to supporting the MDRI. Aotearoa New Zealand is now asked to make a commitment of the balance of NZD$34.48 million, comprising:

5.1 a firm (unqualified) commitment to pay NZ$27.01 million from 2023 to 2033; and

5.2 a provisional (qualified) commitment to pay a further NZ$7.47 million from 2034 to 2044[1].

6 The MDRI has been well implemented and risks appropriately addressed by MDBs. The Initiative has delivered its intended impact, with low income country (LIC) debt levels falling from 110 percent of their aggregate GDP in 1994 to 34 percent in 2018, placing them in a better position than they otherwise would have been in to respond to the COVID-19 pandemic and war in Eastern Europe.

Background

7 The MDRI was instigated by the Group of Eight (G8) large developed countries at their 2005 Gleneagles Summit. The MDRI was intended to free HIPCs meeting qualifying conditions in 2003 from the financial burden of servicing pre-existing debt, thus releasing fiscal resources to accelerate their development and poverty reduction efforts.

8 Aotearoa New Zealand participation in the MDRI was approved in May 2006 by the then Ministers of Finance and Foreign Affairs. The MDRI became effective on 1 July 2006. Aotearoa New Zealand agreed to contribute a 0.13 percent share[2], equivalent to NZ$68.9 million, over 2007 to 2044. This comprised a firm commitment to make annual contributions totalling NZ$14.6 million from 2007 to 2016, and a commitment in principle, or provisional commitment, to contribute a further NZ$54.29 million from 2017 to 2044.

9 The MDRI is limited to the cancellation of HIPC debt owed to the concessional financing arms of MDBs as at 2003[3]. It is financed by donors, who compensate the MDB concessional funds for the interest and principal payments forgone on cancelled debt when such payments are otherwise due. This ensures that the MDB funds are not financially weakened by providing debt relief and thus can continue to support the poorest countries.

10 To qualify for this debt relief, countries were required to meet performance criteria as assessed by the International Monetary Fund (IMF) and World Bank. These include adopting an IMF poverty reduction and growth facility programme, evidence of satisfactory progress in implementing this, and having a public expenditure management system that met minimum governance and transparency standards.

[1] The profile of MDRI costs (see also annex) is an aggregate of the profile of the underlying forgiven debt, which has varying loan repayment terms ranging up to 40 years, but mostly clustered around a 20 to 25 year loan repayment term. The last of the forgiven debt matures in 2044.

[2] This share is based on agreement among donors that the cost of the MDRI be shared through applying their respective shares at the time in contributing to the World Bank's International Development Association.

[3] A cut-off year of 2003 was chosen in order to avoid the moral hazard of countries borrowing excessively after discussion on possible debt relief had started, in the hope of gaining relief on such new debt.

11 The MDRI is administered by the World Bank. The MDBs whose members are participating in the MDRI are primarily the World Bank's International Development Association (IDA) and the African Development Bank's African Development Fund[3].

12 At present thirty eight countries benefit from the MDRI, of which thirty two are in Africa, five in South and Central America and one, Afghanistan, in Asia and the Pacific[4]. While a larger number of countries – especially in Asia – were eligible for MDRI debt relief at the time of its inception, they eschewed the opportunity to qualify, largely because they did not wish to become subject to an IMF programme or because of uncertainty over the possible negative impact on their credit rating.

Analysis

Cost of the MDRI

13 The cost of the MDRI is revised each time the World Bank's IDA is replenished. Changes in MDRI cost estimates reflect changes in exchange rates and interest rates, and updated predictions of when countries eligible for MDRI debt relief at inception will met the qualifying criteria[5].

14 MDRI costs were previously revised in 2019, during the IDA19 replenishment negotiations. Aotearoa New Zealand subsequently refreshed its commitments in 2020 (Cabinet minutes ERS-20-MIN-0011 and CAB-20-MIN-0260 refer), providing a firm commitment of NZ$29.8 million to 2031 and a reaffirmed provisional commitment from 2032 to 2044 of NZ$12.2 million.

15 The most recent revision of MDRI costs was undertaken in June 2021, in conjunction with the IDA20 replenishment negotiations that concluded at the end of 2021. This revision put the total cost of the MDRI from inception to 2044 at US$33 billion, markedly below the cost estimate in 2006 of US$37 billion.

16 The cost to Aotearoa New Zealand has accordingly also declined, from NZ$68.93 million in 2006 to an estimated NZ$60.9 million (see annex).

17 The World Bank is seeking a refresh of donor commitments based on the revised costs, together with an extension to 2033[6] of donor firm commitments. For Aotearoa New Zealand meeting this request at the level of our long-standing share of 0.13 percent (see paragraph 8 above) of total costs would mean providing:

4 Among the qualifying members of the Asian Development Bank (ADB) only Afghanistan sought relief under the MDRI. Afghanistan's concessional debt to the Asian Development Fund was written-off in 2017 when that Fund was restructured. Consequently the ADB no longer accesses the MDRI trust fund to cover Afghani debt service. The cancellation of debt under MDRI is irrevocable. Accordingly IDA continues to be reimbursed for debt service otherwise owed on Afghanistan debt incurred up to 2003. Afghanistan qualified for the MDRI in 2010.

5 HIPCs eligible for MDRI but not yet qualifying are Eritrea, South Sudan and Zimbabwe.

6 Setting the donor firm (or 'unqualified') commitments for this period gives both the World Bank and the benefitting country more certainty over financial resource flows associated with project financing and the MDRI. A 'provisional commitment' is indicative of an intention to meet obligations but subject to vote baselines still being adequate at the time.

17.1 an unqualified (firm) expenditure commitment for 2023 to 2033, at an estimated cost of NZ$27.01 million; and

17.2 a qualified (provisional) commitment to meeting its share of MDRI costs over 2032 to 2044, at an estimated cost of NZ$7.47 million.

18 A further revision of MDRI costs is expected in 2024.

Governance

19 Officials advise that they are satisfied with the World Bank's implementation of the MDRI to date. Implementation is overseen by the boards of directors of the World Bank and IMF, and backed up in turn by reviews undertaken by donors during IDA replenishment negotiations (usually every three years) and the mid-term review of each replenishment (eighteen months after inception). Audited financial accounts of the MDRI Trust Fund are published annually.

Impact

20 The World Bank, IMF, other economic analysts and officials judge that the MDRI has delivered its intended impact to date. The aggregate debt of LICs (which are the targeted recipients of both IDA and the MDRI) fell from a peak of 110 percent of GDP in 1994 to a low of 29 percent in 2012.

21 Since then, the increase in LIC debt has been relatively modest, rising to 34 percent of GDP in 2018. This contrasts favourably with the rise in the aggregate level of debt of other (non LIC) developing countries, from a low of 27 percent in 2011 to 41 percent in 2018[7]. Rising debt since 2012 is attributed to economic pressures arising from a decline in commodity prices and the attractiveness of borrowing at very low interest rates.

22 Further, LIC economic growth rates rose over the two decades to 2018, though this cannot be unequivocally attributed only to debt relief as other factors were also in play. There is, however, evidence at a more granular level that debt relief for LICs did result in higher spending on infrastructure and social support.

23 Since 2018 new pressures have come to bear, such as responding to the impact of the COVID-19 pandemic and the economic fall-out of the invasion of Ukraine. These challenges would have been more difficult for LICs to deal with in the absence of the MDRI and the subsequent wider availability of grant finance from MDB concessional funds for those LICs at risk of debt distress.

Alignment with Aotearoa New Zealand Priorities

24 Aotearoa New Zealand supported the MDRI as one element in a 'reset' of HIPC debt owed to MDB concessional funds. This reset included the provision of grant financing by MDBs for low income developing countries at risk of debt distress (including small island developing states with limited borrowing capacity) and strengthened advocacy and technical assistance to improve the

[7] Source: World Bank, '*Global Economic Prospects*', January 2022. Beyond 2018 comprehensive GDP data for LICs is not yet available.

management of debt by such countries. This approach had the objective of freeing resources for the achievement of international development goals (presently the Sustainable Development Goals).

25 Aotearoa New Zealand is currently committed to contribute to the MDRI to 2031 and has repeatedly affirmed its provisional commitments to support the MDRI through to 2044. There is no major change in the MDRI environment or impact that would justify New Zealand's exit from the MDRI.

26 Ceasing to contribute, or lowering the level of contributions, to the MDRI would run counter to Aotearoa New Zealand's stated support to date of debt relief. Further, securing agreement on the MDRI both among donors and with the World Bank was hard-fought at the time. Choosing now, for no good reason, to withdrew from, or reduce support for, the MDRI, would significantly diminish Aotearoa New Zealand's standing in the donor community, and would damage our credibility with the World Bank, which has been an effective and valued development cooperation partner, globally and in the Pacific.

Financial Implications

27 Contributions to the MDRI are made annually. From 2006 to 2022 Aotearoa New Zealand has paid a total of NZ$26.40 million in contributions to the MDRI.

28 Issuing a firm commitment for the period 2023 to 2033 at our longstanding share of total cost would commit Aotearoa New Zealand to contributing a further NZ$27.01 million, at an annual average cost of NZ$2.46 million). A reaffirmed provisional commitment for the subsequent period, 2034 to 2044, entails provisionally committing to paying a further NZ$7.47 million, at an annual average of NZ$0.75 million. The annex provides a more detailed representation of these costs. These commitments, at well under 0.3 percent of the current International Development Cooperation Appropriation, are manageable and are not expected to displace any other planned expenditure.

29 Cabinet agreement to continue to contribute to the MDRI will have no impact on the operating balance or on debt. The expenditure on MDRI will be met from existing baselines of Vote Foreign Affairs Non-Departmental Other Expenses – International Development Cooperation (Multi-Year Appropriation).

30 MDRI payments for the next two years (totalling NZ$6.01 million) would fall within the current funding triennium and amount to 0.2 percent of the International Development Cooperation Appropriation for the current triennium. Subsequent payments under a firm commitment would fall under the next three funding trienniums. The cost to Aotearoa New Zealand of the MDRI will next be revised in 2024.

Risk and Risk Mitigation

31 At MDRI inception the perceived risk associated with debt relief, and the subsequent initiation of grant financing for countries in debt distress, was that recipient countries might use the consequent fiscal space to again borrow excessively from financiers other than the MDBs on non-concessional terms. A further risk was that countries might deliberately borrow excessively in order to qualify for grant financing through being classified as being in debt distress.

32 To counter such risks, the World Bank and other MDBs, and the IMF, put in place incentives to discourage such behaviour, largely through partially and temporarily suspending access to concessional financing. These institutions also provide technical assistance to improve debt management practices.

33 These risk mitigation measures have by-and-large been effective. Since 2006 only very few countries (at various times, Ethiopia, the Maldives, Mali, Nicaragua and Zambia) have temporarily lost partial access to IDA finance (up to 10 percent of their country allocation). When such countries have demonstrated improvements in their debt management, their access to IDA resources is fully restored, including access to the funding previously withheld.

34 In addition, in 2020 the World Bank and IMF launched a programme of outreach to non-concessional government, quasi-government and private sector lenders to advocate for more responsible lending practices that take into account a borrower's risk of debt distress and ability to service any additional debt. It is yet too early to assess the impact of this programme.

35 Overall officials assess that risks associated with the MDRI are well mitigated. In particular, the MDBs and IMF are continuing their strong advocacy to persuade developing countries to strengthen their debt management policies and practices.

Implementation

36 Not applicable.

Legislative Implications

37 There are no legislative implications.

Impact Analysis

Regulatory Impact Statement

38 No regulatory impact statement is required.

Climate Implications of Policy Assessment

39 There are no direct climate implications.

Population Implications

40 There are no population implications.

Human Rights

41 There are no inconsistencies with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Consultation

42 The New Zealand Treasury was consulted in the preparation of this paper.

Communications

43 No media interest on this is expected. I will work with officials to manage any interest that may arise.

Proactive Release

44 I intend to release this Cabinet paper, or parts of it, proactively.

Recommendations

45 I recommend that the Committee:

1 **Note** that Aotearoa New Zealand joined the World Bank administered Multilateral Debt Relief Initiative (MDRI) at its inception in 2006.

2 **Note** that the MDRI reimburses the concessional financing arms of multilateral development banks for the loss of debt service arising from the forgiveness of the debt outstanding in 2003 of the most indebted poorest countries, thereby ensuring that the MDRI does not weaken the financial positions of the banks.

3 **Note** that Cabinet last re-affirmed support for the MDRI in June 2020 (ERS-20-MIN-0011 and CAB-20-MIN-0260 refers) and that a further refresh of Aotearoa New Zealand's commitment, based on an update of its cost, will be sought in 2025.

4 **Agree** that Aotearoa New Zealand continue to support the MDRI for a total remaining cost of NZD$34.48 million, by providing:

(a) an unqualified (firm) expenditure commitment for 2021 to 2033, at an estimated aggregate cost of NZ$27.01 million, to be funded from existing baselines of Vote Foreign Affairs Non-Departmental Other Expense – International Development Cooperation (Multi-Year Appropriation); and

(b) a qualified (provisional) commitment to meeting New Zealand's share of MDRI costs over 2034 to 2044, at an estimated aggregate cost of NZ$7.47 million.

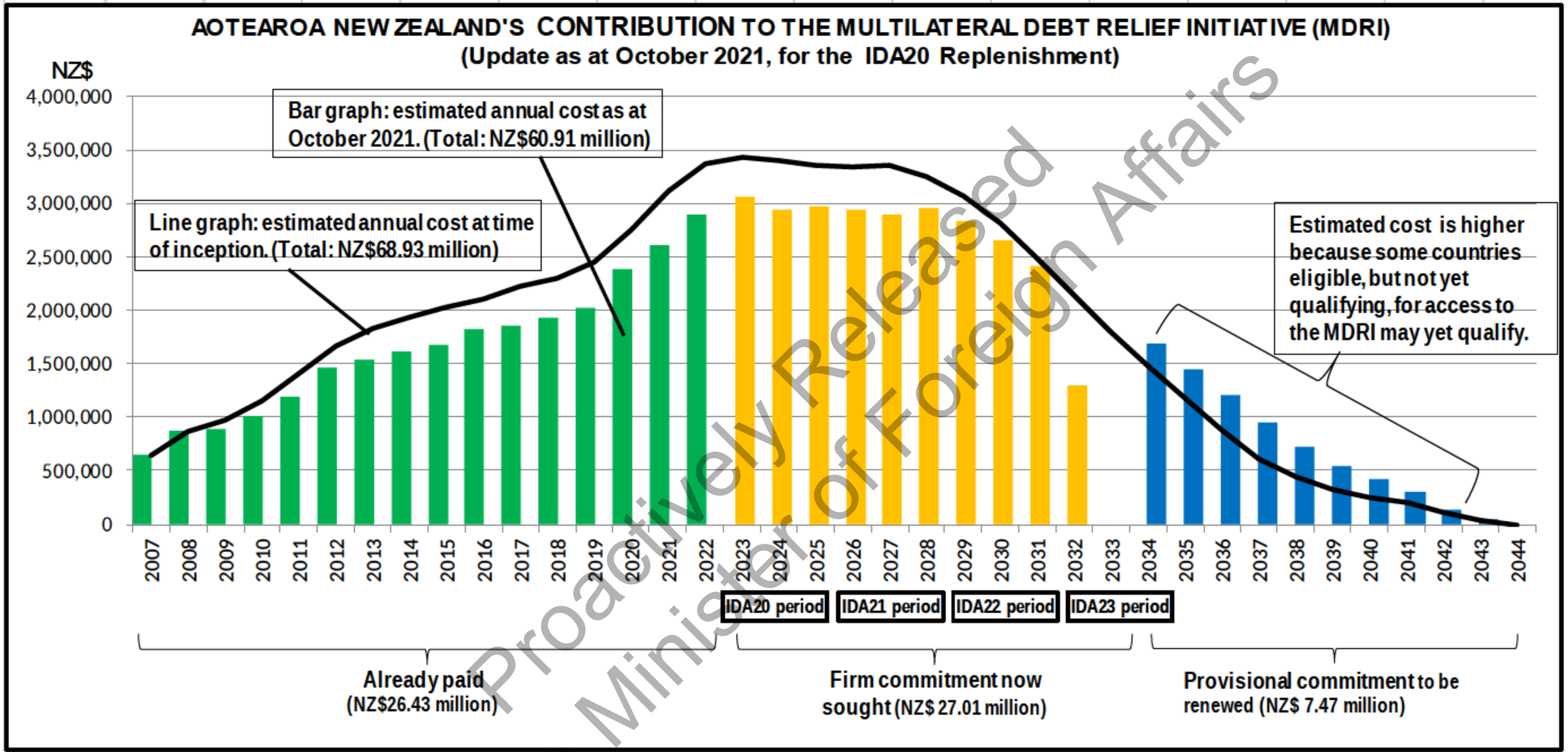
5 **Note** that the World Bank will next revise the cost of the MDRI in 2024, following which a further refreshed commitment by Aotearoa New Zealand will be sought.

Authorised for lodgement

Hon Nanaia Mahuta

Minister for Foreign Affairs / Minita Take Aorere

Annex


AOTEAROA NEW ZEALAND'S CONTRIBUTION TO THE MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)
(Update as at October 2021, for the IDA20 Replenishment)
NZ$
4,000,000
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
Bar graph: estimated annual cost as at October 2021. (Total: NZ$60.91 million)
Line graph: estimated annual cost at time of inception. (Total: NZ$68.93 million)
Estimated cost is higher because some countries eligible, but not yet qualifying, for access to the MDRI may yet qualify.
2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039 2040 2041 2042 2043 2044
IDA20 period
IDA21 period
IDA22 period
IDA23 period
Already paid (NZ$26.43 million)
Firm commitment now sought (NZ$ 27.01 million)
Provisional commitment to be renewed (NZ$ 7.47 million)