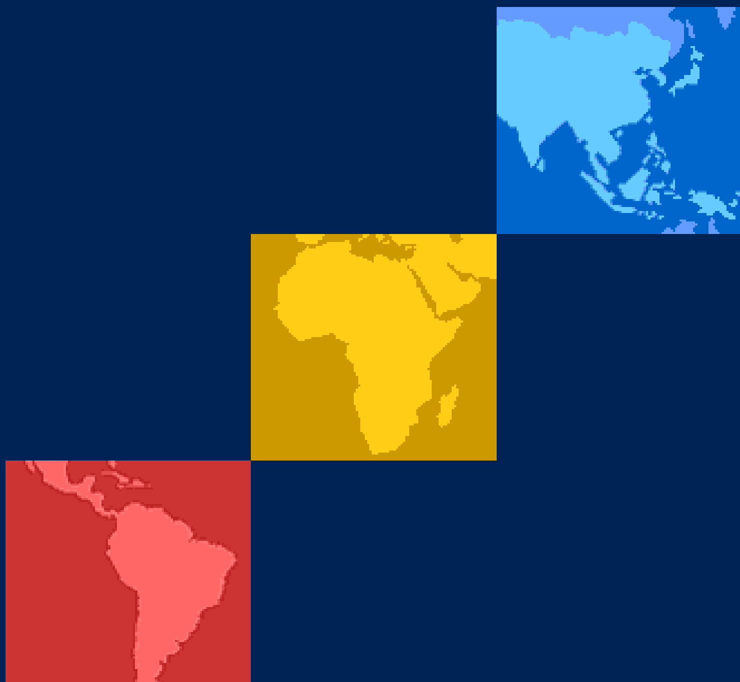

The aid architecture debate: beyond Busan

Debt relief as disguised budget support

Brussels, 30 March 2011

Danny Cassimon
Institute of Development Policy and Management
University of Antwerp

Problem statement

- Through the HIPC Initiative (1996/1999-)and its successor, the MDRI (2005-), debt relief (DR) has become an important ‘alternative’ aid modality, next to more traditional aid modalities (project aid, BOP support, sectoral (SBS) and general (GBS) budget support)
- At first glance, public DR bears close resemblance to grant-type GBS, as it increases ‘fiscal space’..

To what extent is there equivalence in practice?

OUTLINE

1. **Salient features of GBS**

2. **What determines the extent of similarity?**
   - **Nature of 'strings attached'**
   - **'Cash flow equivalence'**

3. **Yes, but… for HIPC/MDRI debt relief**

4. **Implications of co-existence of debt relief and GBS**

5. **Is debt relief practice always similar to GBS?**

6. **Recommendations**

Salient features of GBS

- GBS provides additional purchasing power to the government sector of the recipient country
- Policy-and system-aligned: 'intentional fungibility': pooling of aid with genuine public resources without earmarking use
- Based on continuing policy dialogue between donors and recipient country, with continuation depending on assessment of results

❖ GBS is aid modality best reflecting PD/NAA principles

Does debt relief always fit this picture?

- Donors may wish to earmark the use of the debt relief savings (not policy-aligned)
- Donors may wish to use their own procedures and systems in managing the funds (not system-aligned)

And

- The cash flow equivalence is not guaranteed…

Determining the cash flow equivalence of debt relief

- Debt relief savings only materialise in future, at the pace of the (contractual) debt service schedule of the debt relieved….

  (contractual) DR needs to be measured in present value (PV)

- … to the extent (only) that the debt would have been serviced in the absence of debt relief

  real cash flow gains from DR need to be measured in 'economic value', i.e. the PV of debt service relieved that would have been paid otherwise

- To compare it with annual aid (GBS) disbursements, annual cash flow gains are measured as real cash flow gains of debt service relieved, originally due during the particular year

So how does (enhanced) HIPC/MDRI debt relief perform?

Characteristics of the (enhanced) HIPC Initiative

- Targeting a particular set of countries, i.e. the Heavily Indebted Poor Countries: IDA eligible countries with an unsustainable debt, i.e. debt above a particular threshold level
- With HIPC DR bringing them back to a sustainable (i.e. threshold) debt level, with fair donor burden sharing of the effort
- Through a two-staged process, after reaching a set of donor-implied conditions:
  - Decision point: economic track record (IMF program) and preliminary PRSP; country starts receiving interim debt service relief
  - Completion point: full PRSP strategy, specific triggers…: country receives irrevocable stock relief

Enhanced HIPC DR ‘topped up’ by additional bilateral relief as well as additional multilateral debt relief (MDRI) for HIPCs only, on top of DR needed for debt sustainability

Is (enhanced) HIPC/MDRI quasi-GBS?

- Strict HIPC DR
  - Yes, because it is in principle policy-aligned (unearmarked) and system-aligned; in practice it might somewhat deviate
  - cash flow equivalence equal to EV (typically lower than contractual PV), estimated at around 30 billion USD in PV
- Additional bilateral relief
  - Yes, because no additonal strings attached
  - And cash flow equivalence close to PV, estimated at around 7.8 billion USD in PV terms
- MDRI
  - Yes, because no additonal strings attached (light check)
  - And again cash flow equivalence close to PV, estimated at around 29.6 billion USD in PV terms

Implications of co-existence of debt relief and GBS

- For recipient countries receiving both GBS and GBS-type DR
  - GBS-type DR functions as a long-term fixed tranche grant-form GBS, topping up genuine (shorter term) GBS
- For countries receiving only GBS-type DR (and no genuine GBS)
  - Presents donor inconsistency (especially for additional bilateral and MDRI DR) as recipient country is not eligible for genuine GBS but at the same time receives quasi-GBS through DR, unrelated to the achievement of debt sustainability
- For countries receiving genuine GBS only
  - Again presents similar donor inconsistency as countries that are eligible for genuine GBS, do not receive the long-term fixed tranche type of GBS, unlike HIPCs

Is debt relief practice always similar to GBS?

Not necessarily. Pre-HIPC debt relief practice, largely limited to Paris Club debt relief operations, was not:

- Pre-HIPC Paris Club debt reschedulings (so-called ‘consolidations’) included an (growing) element of DR but
  - conditionalities were limited to having an IMF programme, so it very much resembled aid deliverd through the Structural Adjustment Programme approach
  - cash flow equivalence was minimal as the EV was close to 0
- Through debt for development swaps, debt was cancelled in exchange for local currency counterpart funds at a discount but
  - Due to its micro-management and earmarking looks very much like (non-aligned) project aid
  - With again a close to 0 EV

Donor policy recommendations

- DR is best provided according to the PD principles, which results in DR being quasi-GBS
- In order to optimise cash flow equivalence, it should target debt with a high EV and debt service relief being highly ‘frontloaded’
- Donors should look at genuine GBS and GBS-type DR jointly, so as to avoid policy inconsistencies
- For countries ineligible for the major DR schemes, donors should refrain from again using debt swaps as a DR vehicle, unless it is carefully engineered (aligned) and scaled up, in which case it again verymuch looks like GBS

Thank you!

danny.cassimon@ua.ac.be

http://www.ua.ac.be/dev/aid_effectiveness