

Overview of the debt issue: debt sustainability and the role of debt relief

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Conference on Debt Relief in Africa
Brussels, 26 September 2012

- International mechanisms to promote (external) debt sustainability
 - The DSA/DSF framework
 - Sovereign debt workout mechanisms: debt restructuring and concerted debt relief initiatives
- International actors and types of debt relief interventions
- Aid modality equivalence of debt relief
- Measuring debt relief in theory and practice
- Assessing the international debt relief practice
- A forgotten dimension: intra-donor/creditor transfers
- Assessing individual bilateral donors
- Revisiting the international mechanisms

International mechanisms to promote (external) debt sustainability

- Debt evolution Monitoring Toolkit and Assessment Framework: Debt Sustainability Analysis (DSA) and the Debt Sustainability Framework (DSF)
- ‘Orderly’ sovereign debt workout mechanisms:
 - Debt restructuring fora (Paris Club,...) incl. debt relief
 - More comprehensive concerted debt relief initiatives
- International guidelines for responsible borrowing and lending
- (Donor-financed) monitoring (e.g. DeMPa) and Technical Assistance (TA) to improve debt management in recipient countries

Monitoring tool to assess current and future debt levels, according to 4 basic steps:

1. Deciding on the appropriate debt sustainability concepts and indicators

e.g. specific DSF LIC indicators and threshold values

2. Conducting consistent forward –looking analysis of the debt dynamics, based on chosen indicators, under a most-likely benchmark scenario, over MLT

see e.g. next slide for fiscal dynamics

3. Running stress tests using detailed alternative scenarios, tailored to relevant country vulnerabilities

Assess: level of (risk of) debt distress

4. Translating debt sustainability assessment into borrowing policies

e.g. minimum level of concessionality in new borrowing

(Fiscal) debt dynamics

- Conventional public debt dynamic analysis, starting from the budget identity, is determined by the combination of two terms, the endogenous dynamics of debt plus the primary fiscal balance (both expressed as a ratio to GDP),

$$\Delta d = [(r - g)/(1 + g)]d_{t-1} - fb^*$$

With d = debt-to-GDP ratio, r = real interest rate, g = real GDP growth rate, and fb^* is the primary fiscal balance (adjusted for non-debt financing)

- Reducing d requires
 - growth rate higher than interest cost (stop 'snowball')
 - primary fiscal surplus
 - **reduction of d through debt relief (debt restructuring)**

Sovereign external debt workout mechanisms: debt restructuring and concerted debt relief initiatives

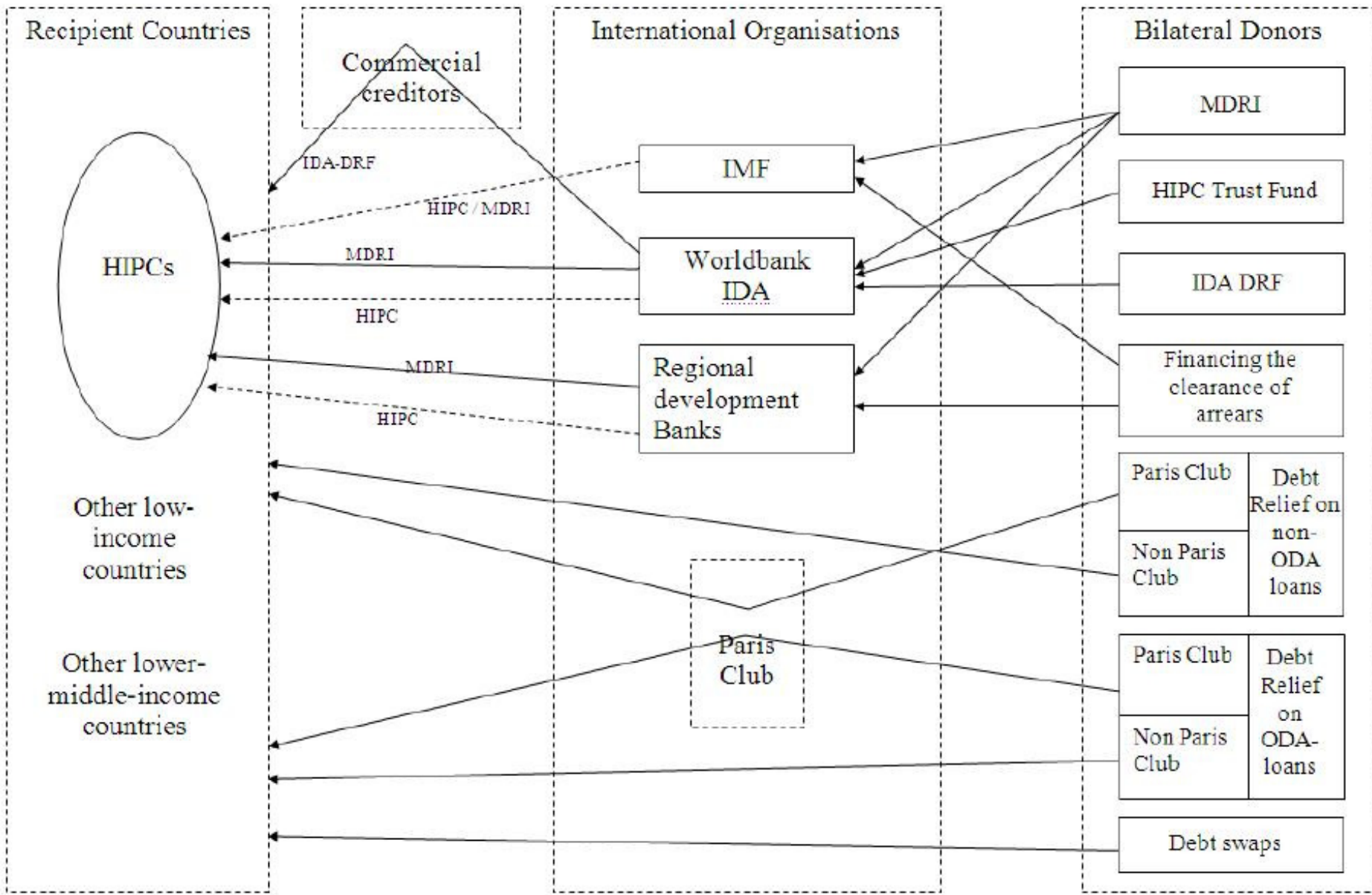
- Depending on the type of creditor...
- Distinguishing between three generations:
 - Pre-HIPC (and non-HIPC) debt relief
 - HIPC debt relief
 - Beyond-HIPC debt relief/MDRI
- Recent (2nd generation) debt-for development) swaps as a special case

	Bilateral (Paris Club)		Bilateral (non-Paris Club)		Multilateral		Commercial	
Before HIPC Initiative (1950s-1996)	<ul style="list-style-type: none"> - common terms for LICs (Toronto, London, Naples), LMICs (Houston) and other countries (classic) - debt swaps - parallel ODA relief 		<ul style="list-style-type: none"> - ad hoc debt relief 		<ul style="list-style-type: none"> - exceptional debt relief 		<ul style="list-style-type: none"> - London Club treatments - debt swaps - Brady deals - IDA-DRF buy-backs 	
HIPC Initiative (1996-...)	HIPCs	non-HIPCs	HIPCs	non-HIPCs	HIPCs	non-HIPCs	HIPCs	non-HIPCs
	<ul style="list-style-type: none"> - bringing debt down to debt sustainability thresholds through debt relief under Lyon (80%) and later Cologne (90%) terms 	<ul style="list-style-type: none"> - common terms - debt swaps - tailored debt relief through Evian approach 	<ul style="list-style-type: none"> - participation in bringing debt of HIPCs down to debt sustainability thresholds (varies per creditor) 	<ul style="list-style-type: none"> - ad hoc debt relief (including debt swaps) 	<ul style="list-style-type: none"> - bringing debt of HIPCs down to debt sustainability thresholds 	<ul style="list-style-type: none"> - exceptional debt relief 	<ul style="list-style-type: none"> - participation in bringing debt of HIPCs down to debt sustainability thresholds through London Club treatment, debt swaps, IDA-DRF buy-backs 	<ul style="list-style-type: none"> - London Club treatments - debt swaps - IDA-DRF buy-backs
Beyond HIPC Initiative (2006-...)	<ul style="list-style-type: none"> - providing 100% debt relief to post-completion point HIPCs 		<ul style="list-style-type: none"> - ad hoc debt relief (including debt swaps) 		<ul style="list-style-type: none"> - MDRI: providing 100% debt relief to post-completion point HIPCs (IDA/IMF/AfDB/IaDB) 		<ul style="list-style-type: none"> - London Club treatments - debt swaps - IDA-DRF buy-backs 	

Debt relief as aid/donor intervention

We assess here debt relief as an (**alternative**) **aid intervention of a bilateral donor**. An overview of actors leads to a taxonomy of possible interventions:

1. Debt relief granted by bilateral creditors on non-concessional (non-ODA) claims (e.g. in the Paris Club)
2. Debt relief granted by bilateral creditors on concessional (ODA) claims (e.g. in the Paris Club)
3. Financing IDA DRF operations
4. Contributions to HIPC Trust Fund
5. Contributions to financing the MDRI
6. Clearance of payments arrears to multilaterals
7. Debt (-development) swaps



Source: Authors' own elaboration.

Aid modality equivalence

- To what extent is debt relief equivalent to other aid interventions?
- Check conditionality and alignment equivalence
 - IMF program conditionality?
 - broad poverty conditionality
 - degree of earmarking
 - degree of policy alignment and system alignment (see table next slide)
- Conclusion: debt relief is a chameleon, sometimes it looks like project aid or SAP-lending, sometimes like (general) budget support, (G)BS.

Type/generation of debt relief	IMF Program? (Yes/No)	Explicit link to development or poverty reduction?		Other conditions?	Type of earmarking	System-aligned?	So debt relief looks very much like...
		Yes/No	Policy-aligned?				
Official creditors							
(1) Pre-HIPC Paris Club debt relief	Yes	No	-	None	-	-	BoP support/SAP
debt service (flow) relief	No	Yes	No	None	Micro-earmarked	No	Old-style project aid
debt swaps (1 st generation)	Yes	No	-	None	-	-	BoP support/SAP
debt stock relief							
(2) HIPC initiative	Yes	No	-	Specific triggers ⁽¹⁾	-	-	BoP support/SAP
original (1996)	Yes	Yes	Yes, to PRSP (NDS)		Non-earmarked	Yes, but... ⁽²⁾	In principle GBS
enhanced (1999)							
(3a) Additional bilateral debt relief	Yes	Yes	Yes, to PRSP (NDS)	None	Non-earmarked	Yes	GBS
o/w C2D	Yes	Yes	Largely to PRSP	None	Macro-earmarked	Yes	(Multi-)sector SBS
(3b) MDRI	Yes	Yes	Yes, to PRSP (NDS)	None	Non-earmarked	Yes	GBS
(4) Debt swaps (2 nd generation)	No	Yes	No/ Yes	None	Micro-earmarking	No/ Yes	Old-style project aid New-style project aid
Private creditors							
(1) Pre-HIPC buybacks/debt swaps	No	No	-	None	Micro-earmarking	No	Old-style project aid
(2a) HIPC	Yes	Yes	Yes	Triggers ⁽¹⁾	Non-earmarked	Yes, but... ⁽²⁾	In principle GBS
IDA Debt Reduction Facility	Yes	No	Not specifically	None	-	-	BoP support/SAP
(2b) Large debt swaps (Brady a.o.)	Yes/ No	No	-	Recaps ⁽³⁾	-	-	BoP support/SAP Oil

Source: Authors' own compilation

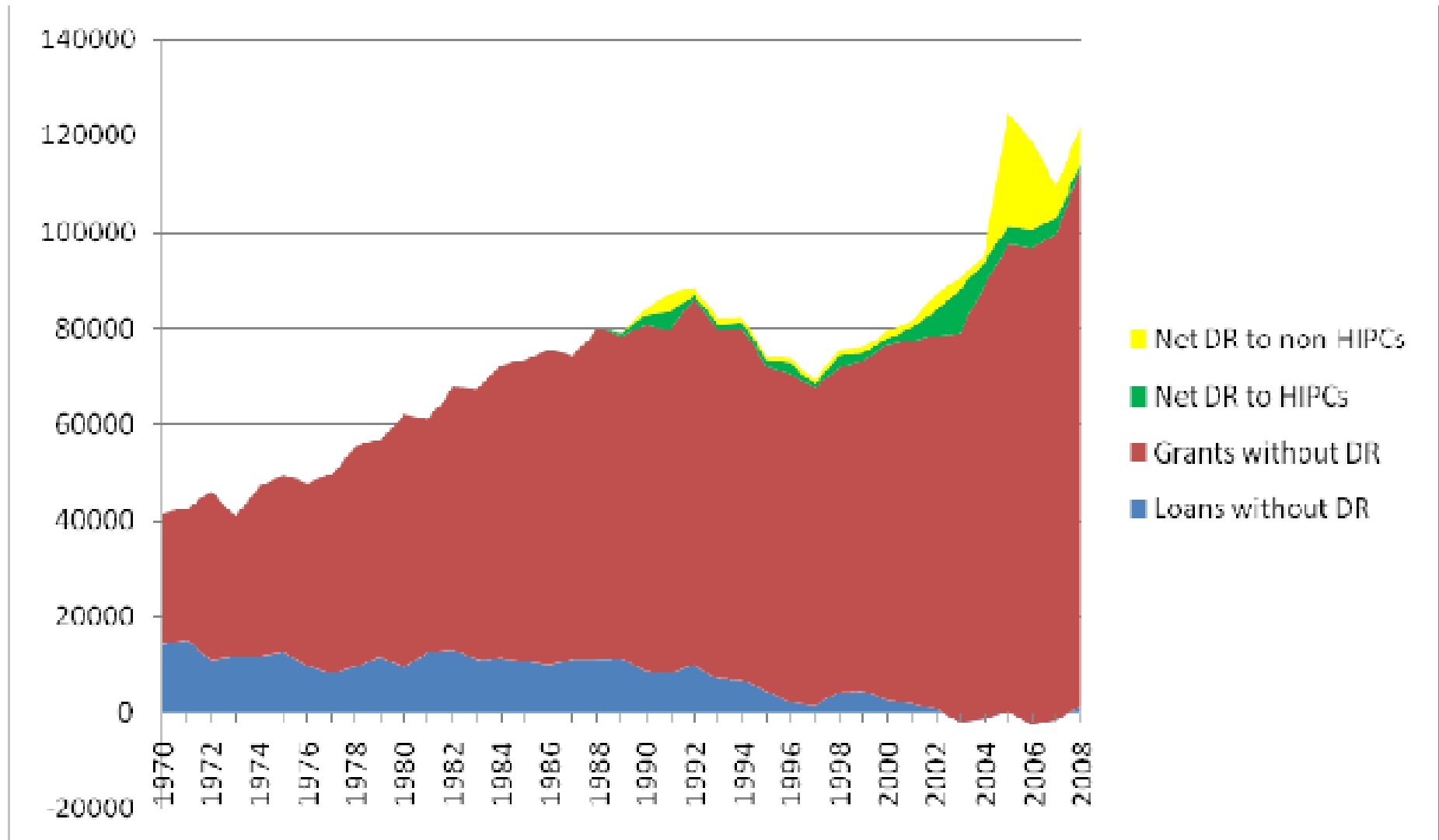
How to measure debt relief in theory?

- From a creditor perspective, debt relief is correctly measured in its **(Net) Present Value**, i.e. the present value of all contractual future debt service relieved
- Nominal versus NPV may make a huge difference (see example of PC debt rescheduling Cameroon)
- However, from a donor and recipient country perspective, a more appropriate measure is its **'economic value'**: i.e. *the present value of all debt service that would have been effectively paid (in the absence of the debt relief)*. This indicates the direct net cash flow effect for the debtor
- In principle this should also be reflected in ODA-accounting of debt relief, but this is not the case

Measuring debt relief in practice

- Debtor-based nor creditor-based data provide consistent, comprehensive debt relief data
- Data are usually a mix of nominal and (N)PV figures, not in *economic value*; also in ODA accounting of debt relief (for DAC members)
- Available data point at DAC countries debt relief in the range of 150 billion USD
- Comprehensive and consistent data only for HIPC(s), amounting to about 120 bn USD in (N)PV terms
- Debt relief also important part of ODA in recent years, but HIPC share is limited (see next figure)

Figure 2.3.a.: Evolution of ODA and its components (in constant 2008 mio US\$)



Evaluating debt relief

As debt relief is part of aid interventions, it should be assessed according to a number of general aid effectiveness criteria, but also to what extent it:

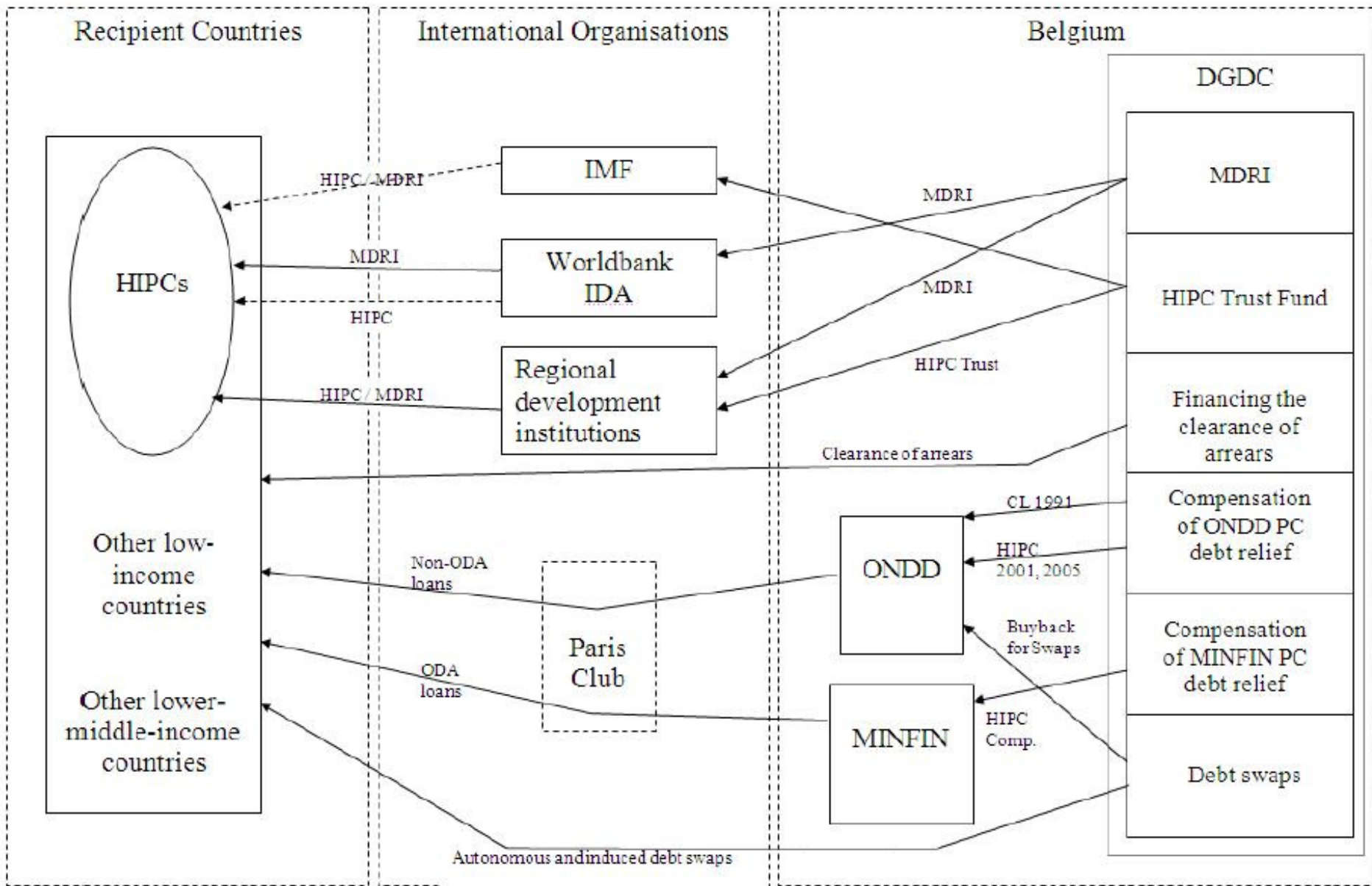
- Led to a sustainable debt (ST versus MLT)
- Removed debt overhang
- Increased the creditworthiness of the country
- Freed up real resources from debt service to be used for development purposes (i.e. how considerable was its economic value, leading to 'increased fiscal space')

Evaluating the debt relief practice

- The pre-HIPC int'l debt relief practice was generally seen as *inappropriate* (Dijkstra, 2003), both in terms of conditionality, alignment, as well as net cash flow effect
- HIPC/MDRI debt relief performs rather well on the criteria highlighted, but doubts remain about its impact on growth and poverty; it is also largely *coherent with aid effectiveness principles*
- Additional bilateral HIPC/MDRI relief alters the perspective used, from focusing on debt sustainability to focusing on financing development, which introduces a bias for non-HIPCs. It is fully equivalent to (multi-year) (G)BS
- Excluded non-HIPC LICs and LMICs also use debt-for-development swaps which have to be engineered properly in order to avoid ineffective practices

Intra-donor institutional structure and transfers

- In assessing bilateral donor policies, intra-donor transfers have to be taken into account
- Belgium as a case study: 3 main agencies involved: MINFIN, the ECA ONDD and DGDC
- MINFIN (bilateral ODA loans) and ONDD (non-ODA claims) active in Paris Club rescheduling (1-2)
- DGDC active in the other operations (4-7)
- Intra-creditor compensation agreements
 - 1991 financial reorganisation loan ONDD
 - 2001-2005 HIPC CP (only) compensation (MINFIN, ONDD)may reduce effectiveness of debt relief intervention



Assessment of the bilateral donor, e.g. Belgian practice

- Debt relief decisions largely internationally- driven: Paris Club; IMF-WB for HIPC
- Policy space for pro-active policy rather limited
 - Some initiatives by MINFIN, DGDC
 - Little leverage on actions by ONDD
- Assessment of Belgian debt relief practice largely congruent with (changing) assessment of international practice; Belgian DR policy also largely *coherent*
- Compensation agreements reduce effectiveness despite attention for 'economic value' logic

International mechanisms for (external) debt sustainability revisited

- DSA/DSF monitoring and assessment, current debt workout mechanisms and international guidelines for responsible borrowing and lending do not prevent that countries again move into debt distress
- Debt relief statistics and ODA accounting of debt relief can be improved
- Debt relief interventions with non-HIPC LICs/LMICs should be scaled up and engineered better as to increase effectiveness
- Technical Assistance (TA) to improve debt management can be further optimized
- Intra-donor agency transfer mechanisms should become more transparent