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Indonesia's Debt-for-Development Swap Experience: Past, Present and Future

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ABSTRACT

This paper systematically reviews recent experience with debt-for-development swaps in Indonesia, the only debtor country where the number of such operations could warrant its qualification as a genuine government debt relief and development finance policy. First, we show that the 11 swaps Indonesia has signed with its bilateral creditors since 2002 perform rather erratically across four criteria: the increase of resources at the country and/or government budget level; the increase of resources for intended sector purposes; whether, taken together, these swaps ease debt burdens; and the extent of their alignment with government policy and systems. Second, the paper finds little evidence of learning on the Indonesian side. We believe Indonesia can take a more proactive stance in negotiating the economic terms underlying its debt swaps and suggest concrete ways to do so in future swap deals.

Key words: external public debt, debt relief, debt swaps, development aid, Indonesia

JEL codes: H63; F34; F35

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1. INTRODUCTION

Over the last 25 years, external debt restructuring operations negotiated between creditors and developing country debtor governments have included a substantial element of debt relief. These restructurings have ranged from creditor group-specific operations on common terms (such as in the Paris Club, an informal forum to deal with bilateral official debt) to more comprehensive, concerted schemes aimed at particular recipient country groups (most notably the Heavily Indebted Poor Country (HIPC) initiative and its successor, the Multilateral Debt Relief Initiative (MDRI)), next to ad hoc agreements, targeting either official debt only (e.g., the Paris Club deals with Iraq and Nigeria in 2004 and 2005) or privately held debt (e.g., the 2005 and 2010 global bond exchanges of Argentina).¹

Middle-income countries like Indonesia, that are not eligible for the most advantageous of such grand debt relief initiatives (due to their relatively moderate debt levels) but nevertheless want to bring down their external debt (and increase access to development funds), have resorted to the instrument of bilateral debt-for-development swaps. In a typical swap deal, the creditor cancels certain debt claims owed to it in exchange for the debtor's commitment to mobilise local currency 'counterpart' funds for shares in local companies or for social and environmental purposes. Building on debt-for-equity and debt-for-nature swaps with commercial, secondary market-traded debt in the 1980s, the Paris Club introduced a debt swap provision in its standard terms of treatment for highly-indebted lower middle-income countries (so-called Houston terms) in 1990 and in its treatment for low-income countries in 1991 (London terms). Under this provision all of bilateral debt classified as Official Development Assistance (ODA) and a capped amount or percentage of non-ODA (non-concessional) debt can be swapped on a voluntary basis (Moye, 2001; Ruiz, 2007a; Buckley, 2011).

Although debt swaps are typically lauded by the parties involved (and in the media) as mutually beneficial, this kind of operations does not carry the best of reputations. Assessments of the first wave of debt swaps and related instruments show that debtors typically paid too high a price for retiring their debt (Bulow and Rogoff, 1988); that swaps may complicate short-term macroeconomic and fiscal management (Mistry and Griffith-Jones, 1992); and that there was often very strict micro-earmarking of the local currency funds released through swaps to specific (NGO-operated) projects (Kaiser and Lambert, 1996). Our own evaluation of more recent individual cases of debt-for-development swaps in a variety of sectors, including a number of Indonesian operations, suggests that they share some of the deficiencies of their predecessors, but that better 'engineering' may help to overcome these flaws (Cassimon et al., 2008; Cassimon et al., 2011a; Cassimon et al., 2011b).

Still, given their typical piecemeal nature, single bilateral debt swaps, even those well-engineered, cannot pass for much of a debt relief policy. Debt swaps are too small to significantly reduce the external debt on countries' books, let alone eliminate debt overhang or induce other indirect macro-economic effects. More important in a middle-income country context (where excessive external debt is often less of a concern), such stand-alone swap operations do not generate sufficient finance to support larger national development programmes; their limited size generally implies they take the form of project aid. True, multiple creditors of one debtor country that are favourable to debt swaps could bundle their efforts and pool the

[1] For an historical overview of sovereign debt relief since the late 1980s, see Cassimon and Essers (2013) and references cited therein. A comprehensive list of sovereign debt restructurings (also those not including debt relief) over 1950-2010 can be found in Das et al. (2012).

resources generated by the relief given on their claims into one single fund, managed by (or at least in close cooperation with) the debtor itself (or even directly into the recipient's budget). Debt-for-development swaps would then move closer towards a HIPC/MDRI-type of setup, initiatives that have been shown to exhibit greater potential because of their sheer size and more appropriate conditionality (World Bank-IEG, 2006). For bilateral creditors, establishing multi-creditor debt swaps outside the HIPC/MDRI framework has, however, proven very difficult in practice.²

Another, perhaps more promising and realistic approach to scaling up may be for a non-HIPC debtor country that negotiates several debt swaps with different creditors to try and guard itself over the fiscal impacts of swaps, the harmonisation between them, and their alignment with the government's own systems and development policy. Taken together then, the swaps would constitute more effective tools of debt relief and development finance. With Indonesia being a steadfast supporter of debt swaps and having signed 11 swap agreements with four different bilateral creditors (Germany, the United States, Italy and Australia) since 2002, its experience with debt-for-development swaps makes an interesting case study in this respect. To our knowledge, this paper is the first comprehensive analysis of all Indonesia's debt swaps to date and, indeed, one among few studies to detail swap practice from a debtor country's perspective (bar assessments of single swaps).³ As such, we believe the Indonesian experience holds lessons for other non-HIPC debtor countries that may wish to seek debt swaps from their creditors.

The remainder of the paper is structured as follows. Section 2 briefly situates the recent experience with debt-for-development swaps in the broader historical perspective of external public debt restructuring in Indonesia. It also describes in detail the 11 swap operations that have been undertaken so far. Next, in section 3 we assess to what extent Indonesian debt swaps abide by four principles: i.e., whether they increase resources at the debtor country and/or government budget level; whether they deliver more resources for intended sector purposes; whether, taken together, they ease debt burdens; and whether they exhibit alignment with government policy and systems. Section 4 follows up on this systematic evaluation with a short discussion of the legal and institutional framework underlying Indonesia's overall debt swap policy and an evaluation of the degree of learning that has accompanied Indonesian signing of the 11 swaps.

Our analysis suggests great variation in debt swap arrangements, with no clear improvement over time of the economic terms of swaps or learning effects on the Indonesian side. We believe that, although creditors' own swap policies set the boundaries for negotiations and the Indonesian government itself may have had other, non-economic motives in agreeing to particular debt swap set-ups in the past, there is still room for Indonesia to take a more proactive stance and improve the economic terms of its future debt swaps. Hence, the final section of the paper offers concrete suggestions to make swap operations more effective tools of debt relief and development finance.

[2] A case in point is the recent attempt to coordinate debt relief to Egypt in support of economic transformation after the ousting of President Mubarak. In 2011 the US outlined their plans for a \$1 billion debt relief package involving a debt swap for investments aimed at stimulating entrepreneurship and job creation and invited other G-8 countries with claims on Egypt to join in a multi-creditor 'debt-for-jobs' swap. Eventually, interested bilateral creditors such as Germany, Belgium and Italy all worked out individual project aid-like swaps in different sectors (personal communication, Eddie Boelens, Belgian government representative to the Paris Club).

[3] One exception is Balce's (2011) account of a series of debt-for-development swaps (and swap proposals) in the Philippines.

2. AN OVERVIEW OF EXTERNAL PUBLIC DEBT RESTRUCTURING IN INDONESIA

2.1. Early Paris Club restructurings

Between 1966 and 1970 Indonesia concluded four consecutive agreements with its Paris Club creditors. The first three agreements in 1966, 1967 and 1968 involved short-term re-scheduling of 'Soekarno debt' (incurred before July 1966) under the Paris Club's so-called 'classic', market-based terms; a total of \$600 million of principal and interest due in these years was rescheduled, with moratorium interests on deferred obligations capitalised for later payment. By 1970 Paris Club members realised that, in order to regain creditworthiness on international capital markets and free up resources for development, a much broader and more concessional approach was warranted for Indonesia, including the participation of non-Paris Club, socialist creditor countries (which, through military loans, accounted for more than 60% of Indonesia's external public debt accumulated under Soekarno) (Cizauskas, 1979; Hoffert, 2001).

Eventually, it was agreed to consolidate the principal of the entire (pre-July 1966) Indonesian debt stock of around \$2.1 billion for repayment over 30 years at zero interest and to defer contractual and earlier moratorium interest payments, without further surcharges, to 1985-1999. In addition, because of the seriousness of Indonesia's economic problems, the Paris Club agreement included a 'bisque' clause which permitted Indonesia to unilaterally postpone up to half of its principal payments during the first six years, at an interest rate of 4% and to be repaid at the end of the agreed 30-year period. Indonesia made maximum use of this clause (which has not been offered to any other debtor country ever since). In many aspects, not the least its high degree of concessionality and flexibility, the 1970 Paris Club deal with Indonesia was a milestone in external debt rescheduling practice (Cizauskas, 1979; Cosio-Pascal, 2008; Gamarra et al., 2009). It would take almost 30 years, and a severe crisis of regional (if not global) proportions, before Indonesia returned to the Paris Club in search of new debt restructuring.

2.2. From Asian crisis to tsunami

Unlike during the Soekarno period, it was an unsustainable run-up in debt owed by the Indonesian private sector rather than government debt that preceded the 1997-1998 crisis in Indonesia (as it did in other East Asian economies). Seemingly solid macroeconomic fundamentals, a tightly-managed floating exchange rate and financial sector liberalisation had drawn in increasing sums of foreign capital, mostly of the unhedged, hard currency-denominated commercial bank loan type with, on average, short maturities (see e.g., Radelet, 1995). A combination of these initial mismatches, a fragile domestic banking sector and other imbalances left Indonesia vulnerable to sudden exchange rate movements. When the Thai baht collapsed in July 1997 it served as a wake-up call to investors in Indonesia. A rebalancing of portfolios caused a drastic depreciation of the rupiah and led to a severe deterioration of corporate balance sheets and a collapse of the banking sector (see, among many others, Goldstein, 1998; Corsetti et al., 1999; Radelet and Sachs, 2000; McLeod, 2004). Through bank restructuring and recapitalisation, bail-outs and guarantee schemes the Indonesian government accumulated large new liabilities which were financed by domestic bond issuance. End-1997 Indonesia subscribed to a new IMF stand-by arrangement and adjustment programme, which was supplanted by an extended version mid-1998 under president Habibie. As part of the broader adjustment process following the crisis the country turned to the Paris Club to secure a new round of external debt restructuring.

At first instance, a total of \$4.5 billion in amortisation of bilateral debt falling due between August 1998 and March 2000 was consolidated and rescheduled over 20 years with

a five-year grace period for ODA claims and over 12 years with a three-year grace period for non-ODA obligations. A second deal with Paris Club creditors was closed in April 2000, after yet another extended IMF arrangement; \$5.8 billion originally payable between April 2000 and March 2002 was now to be repaid over 20 years with a seven-year grace and over 15 years with a three-year grace for ODA and non-ODA debt, respectively. April 2002 saw a third agreement in which another \$5.4 billion due from April 2002 to December 2003 was deferred over 20 years with a ten-year grace (ODA) and over 18 years with a five-year grace (non-ODA). These last two debt rescheduling agreements were the first for Indonesia to also formally include the possibility of conducting bilateral debt swaps with ODA and part of non-ODA claims. Both Germany and France expressed their interest in such swaps at the time (Feridhanusetyawan and Pangestu, 2003). The US had already commissioned a study to look into the feasibility of debt swaps with Indonesia, particularly with applications in environmental conservation, around the time of the 1998 Paris Club deal (Guérin-McManus et al., 1998).

Although the 1998, 2000 and 2002 debt restructurings (and subsequent rescheduling of government debt from foreign private sector lenders in the London Club) did go some way in curtailing external debt service payments during the first post-crisis years, none of it was quite as far-reaching as the arrangements made back in 1970, when Indonesia's complete external debt stock was treated. Eurodad (2002) identifies at least four reasons behind the more parsimonious treatment of Indonesian debt in the wake of the Asian crisis: first, the fact that Indonesia was not eligible for the Paris Club's most advantageous terms (i.e., Naples or Cologne terms, offered to IDA-only borrowing countries⁴); second, the importance of Indonesia's debt stock (and the costs of relieving it) for bilateral creditors relative to those of other, severely indebted low-income countries; third, a belief that repeated short-term debt rescheduling would stem moral hazard problems with respect to reforms set by the IMF and other creditors; and fourth, the conceptualisation of the Indonesian debt crisis as one of liquidity rather than solvency problems.

When Indonesia's IMF programme expired end-2003 as scheduled, there was domestic pressure on the government not to seek further extensions (Feridhanusetyawan and Pangestu, 2003; Vieira da Cunha, 2009).⁵ This decision effectively cut off Indonesia from standard Paris Club debt rescheduling menus, for which having an on-track IMF programme is generally considered a precondition. In 2005, in the aftermath of the 2004 Boxing Day tsunami, however, Paris Club creditors granted Indonesia an exceptional one-year debt moratorium for \$2.7 billion in principal and interest payments due in that year.

[4] Indonesia was at the time classified as a 'blend' country, meaning that on the basis of its per capita income it was eligible to borrow from the World Bank's concessional International Development Association (IDA), but also was sufficiently creditworthy to borrow (non-concessionally) from the International Bank for Reconstruction and Development (IBRD).

[5] Grenville (2004) provides a detailed account of the troublesome relations between the IMF and Indonesian authorities during the Asian crisis. The decision of Indonesia in 2006 to use its foreign reserves to repay its outstanding IMF credits ahead of schedule has, by some commentators, also been interpreted as a move by the country to free itself from IMF influence (e.g., Griesgraber and Ugarteche, 2006, p. 352). Ito (2012) argues that the 'IMF stigma' is still at play today in Indonesia and many other Asian countries.

2.3. Recent debt swaps

After a brief overview of Indonesia's historical external debt restructuring, we now turn to a description of its recent experience with debt swaps, the focal point of this paper. All of these swaps concern bilateral debt which was consolidated following the 2000 and 2002 Paris Club agreements. As evident from Table 1, since 2002 Indonesia has signed 11 debt swaps, with four different creditors (Germany, the US, Italy and Australia) and with applications in various sectors (education, health, environmental conservation and reconstruction). When (and if) fully completed, this will amount to approximately \$385.1 million of debt relief and an equivalent of \$227.5 million of counterpart fund investments in total. The following subsections, organised by creditor, outline the particularities of each of these swaps.

Table 1. Indonesian debt-for-development swaps, 2002-2011

Creditor/swap	Date of swap agreement	Debt cancelled ^a (in millions)	Counterpart funds		Short description of eligible projects	Amount (in millions)	Local currency?
			Beneficiary sector	Amount			
Germany I	03.12.2002	€28.8	Education		Construction of learning resource centres	€12.8	Yes
Germany II	08.11.2004	€25.1	Education		Construction of junior secondary schools	€11.5	Yes
Germany IIIa	03.08.2006	€13.7	Environment		Financial assistance for environment-friendly investment by micro- and small enterprises	€6.3	Yes
Germany IIIb	03.08.2006	€13.7	Environment		Conservation of national parks in Sumatra	€6.3	Yes
Germany IV	18.12.2006	€21.8	Reconstruction/education		Reconstruction of schools in earthquake-hit areas	€10	Yes
Germany V	26.09.2007	€54.8	Health		Debt2Health: Global Fund-approved projects	€25	Yes
Germany VII	15.12.2011	€20.5	Education		Financing of Indonesian-German scholarship programme	€9.4	No
United States I	30.06.2009	\$29.9	Environment		TFCA: Conservation of ecosystems in Sumatra	\$29.9	No
United States II	29.09.2011	\$28.5	Environment		TFCA: Conservation of ecosystems in Kalimantan	\$28.5	No
Italy	09.03.2005	\$24.2	Reconstruction/multi-sector		Reconstruction of infrastructure; health, education and social empowerment programmes in tsunami-hit areas	\$24.2	Yes
Australia	15.07.2010	A\$75	Health		Debt2Health: Global Fund-approved tuberculosis projects	A\$37.5	No
TOTAL (EQUIVALENT)^b		\$385.1				\$227.5	

^a Includes principal and interest payments cancelled.

^b Exchange rates as at the date the agreements were signed.

Sources: compiled from original debt swap agreements.

2.3.1. Germany

Germany was the first creditor country ever to enter into a bilateral debt swap operation with Indonesia and has been, with seven swaps to date, the most active one.⁶ On 3 December 2002 both countries signed a first debt-for-education swap agreement (Germany I), stipulating that Germany would cancel claims worth €25.6 million and the accompanying interest payments in return for Indonesia's mobilisation of half the principal amount (€ 12.8 million) in rupiah for advanced teacher training over the years 2003-2005. More particularly, the local currency counterpart funds would be spent on the construction and equipment of 511 learning resource centres in 17 provinces, thereby supporting the existing German-Indonesian cooperation in the Science Education Quality Improvement Project (SEQIP). In accordance with German procedures, irrevocable debt relief on the claims was granted only after an independent auditor confirmed proper execution of the project.

A second and third German-Indonesian debt-for-education swap were agreed upon in November 2004 (Germany II) and December 2006 (Germany IV), respectively, and had a set-up similar to that of their predecessor. Under the second swap Germany would forgive €23 million of debt (plus interest) in exchange for the rupiah equivalent of €11.5 million to be spent on the construction of 100 new junior secondary schools in ten remote Eastern provinces during 2005-2007; the third debt-for-education swap cancelled €20 million for €10 million in rupiah targeted at the reconstruction and rehabilitation during 2007-2008 of 193 primary and 34 junior secondary schools in Yogyakarta and Central Java, areas that had been struck by an earthquake in May 2006. In December 2011 a fourth debt-for-education swap (Germany VII) was devised to finance a post-graduate Indonesian-German Scholarship Programme (IGSP); in exchange for €18.8 million of principal debt relief, Indonesia would make available, over the period 2012-2017, €9.4 million in scholarships for Indonesian PhD candidates and research fellows to study at German universities or work at German research institutes.

Indonesia and Germany also concluded two debt-for-nature swaps (Germany IIIa and IIIb) in August 2006, which both would entail a cancellation of €12.5 million and local currency counterpart funds equivalent to 50% of the principal forgiven. The first €6.3 million of freed-up funds would be used for the establishment of a credit line for investments in environment-friendly production technologies by micro- and small enterprises over 2006-2010. The second €6.3 million was to be directed to the conservation of tropical rainforests in Sumatra over 2007-2009, through improved management of the World Heritage national parks of Kerinci Seblat, Gunung Leuser and Bukit Barisan.

The German-Indonesian debt-for-health swap (Germany V) signed in September 2007 took a somewhat different approach. Of the €50 million cancelled by Germany, half would be transferred, in rupiah and over 2008-2012, to the Global Fund to Fight AIDS, Tuberculosis and Malaria (hereafter abbreviated as Global Fund), a public-private partnership and multilateral health financing institution, under its newly created Debt2Health conversion scheme. The Global Fund would use these funds to distribute grants to health organisations operating in Indonesia.

[6] To refer to the different swaps with Germany we follow the notation with Roman numerals as used by the Indonesian Ministry of Finance and German authorities. An eighth German-Indonesian swap (Germany VI) of €20 million, to support biodiversity, was under preparation but had not yet been signed at the time of writing.

2.3.2. United States

As mentioned earlier, the US were initially most enthusiastic amongst Paris Club creditors to engage in debt swaps with Indonesia, debt-for-nature swaps in particular. Building on their experiences under the Enterprise for the Americas Initiative (EAI) of the early 1990s, the US in 1998 introduced the Tropical Forest Conservation Act (TFCA), which enables debt-for-nature swaps with developing countries that have important tropical forests. Only in June 2009, however, did the US and Indonesia agree on such a swap, making it the 15th TFCA operation (and the largest to date). This first US-Indonesian debt-for-nature swap was designed as a subsidised bilateral swap in which the US government absolved Indonesia from \$29.9 million of its debt, thereby sponsored by Conservation International and local environmental NGO Yayasan Keanekaragaman Hayati Indonesia (KEHATI) for \$1 million each. In return the Indonesian government would deposit the full sum, in dollar (rather than rupiah) and respecting the original 2009-2016 debt service schedule, into a separate account from which periodical transfers are made to a trust fund administered by KEHATI. Upon approval by an oversight committee, KEHATI would then disburse grants to conservation NGOs operating in a selection of ecosystems in Sumatra.

A second, similar TFCA deal followed suit in September 2011. Indonesia committed itself to redirect \$28.5 million of cancelled obligations over 2011-2019 to project funding for conservation efforts in three districts of Kalimantan. This time, costs of US debt relief were partly covered by \$4 million in contributions from The Nature Conservancy (TNC) and Yayasan World Wide Fund for Nature (WWF) Indonesia. KEHATI was again appointed as the administrator of the swap's trust fund.

2.3.3. Italy

In March 2005, Italy and Indonesia settled a debt swap arrangement under which \$24.2 million and €5.8 million of debt service would be cancelled upon the government directing the local currency equivalent of such sums, over a period of maximum five years (2005-2009), to reconstruction efforts in the tsunami-hit provinces of Aceh and North Sumatra, including infrastructure building, health and education projects and social empowerment programmes. The actual selection of projects was divided into three phases and resulted in the counterpart funds being spent on a variety of initiatives, including irrigation systems, a fishing port and the government's Program Keluarga Harapan, a conditional cash transfer programme.

2.3.4. Australia

Australia has been the fourth, and so far last, creditor to enter into a swap deal with Indonesia. Following Germany's Debt2Health example, Australia in July 2010 promised to forgive A\$75 million worth of debt (due in euro and US dollar) under the condition that Indonesia would forward 50% of that amount to the Global Fund over 2010-2016, which would use it to finance tuberculosis programmes in the country. Important differences with the German deal, however, are that the debt forgiven under the Australian swap constitutes (previously rescheduled) *non*-ODA debt owed to Australia's export credit agency, and that counterpart payments have to be made in euro and US dollar (in correspondence with the currency composition of the original debt service).

3. ASSESSMENT OF INDONESIAN DEBT SWAPS

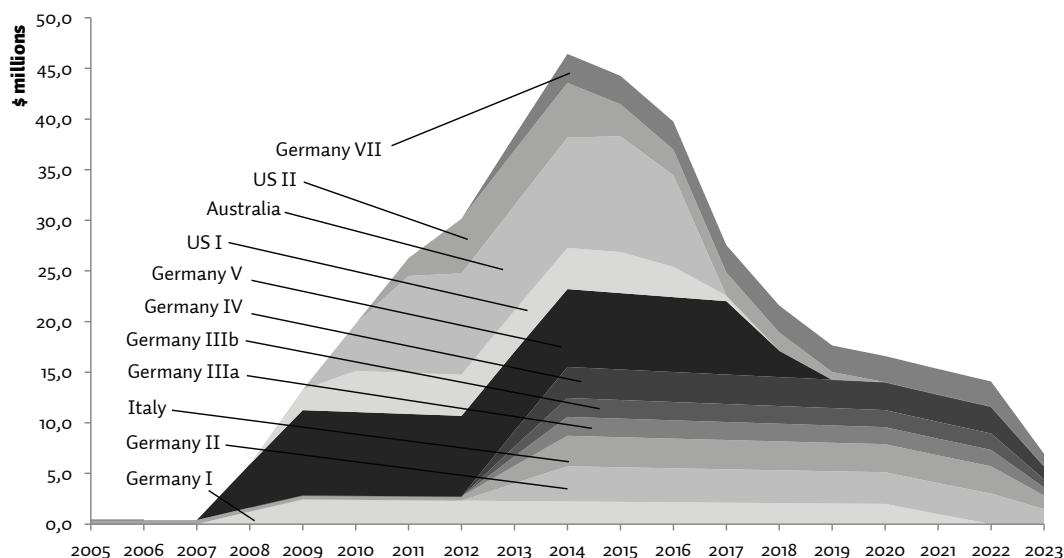
How can we evaluate the just-described debt swap interventions in a systematic manner? Elsewhere we have developed a framework for assessing (single) debt-for-development swap operations on the basis of four criteria (Cassimon et al., 2011b): whether these swaps increase resources at the debtor country and/or government budget level; whether they deliver more resources for intended sector purposes; whether they ease debt burdens; and whether they exhibit alignment with government policy as well as systems. In the remainder of this section we confront Indonesian debt swap practice with each of these points.

3.1. An increase of resources at the debtor country and/or government budget level?

Debt swaps, or other forms of debt relief for that matter, are meant to boost net external transfers to the recipient country. The cancellation of contractual debt service frees up foreign currency for alternative use; it thus augments the debtor’s net international purchasing power or ‘external space’. Moreover, relief on public debt allows the recipient government to divert fiscal resources, otherwise spent on debt service, to other ends such as, say, education or health expenditures, or just to bring down the budgetary deficit; hence debt swaps also create ‘fiscal space’. This story, while intuitive, needs however further qualification.

First of all, debt service savings are only realised gradually, typically over many years (possibly even decades), depending on the original, pre-swap debt service schedule. Figure 1, which presents the cumulative annual debt service savings resulting from Indonesia’s 11 swaps, shows that the total of \$385 million is saved over no less than 19 years, from 2005 to 2023, with maximum annual savings for the Indonesian government of just over \$46 million in 2014.

Figure 1. Debt service savings from Indonesian debt-for-development swaps, 2005-2023^a



^a Swaps are ordered by date of signing.

Sources: calculated from original (pre-swap) debt service schedules.

The foregoing implies that the oft-reported ‘one-shot’ nominal value of debt cancelled through a swap may not adequately capture the increase in available resources at the debtor country level. The present value (PV) of future debt service payments that are forgiven, discounted at the interest rate at which such amounts can be raised on international markets, is arguably a more appropriate measure of the value to the recipient. Column 2 of Table 2 presents the PV of debt relief for each of the 11 Indonesian swaps, calculated from the original repayment schedules of the debt forgiven and using the OECD’s commercial interest reference rate (CIRR) (at the time of signing the respective agreements) as discount rate.⁷ Comparing these PVs with the nominal figures of Table 1, we see sizeable differences. In the case of the swap deal with Italy, for example, where debt relief savings are realised over the full 19-year period (2005-2023; cf. Figure 1), the discrepancy between nominal and PV is large; differences are much smaller for the Australian Debt2Health swap, which relieves debt over seven years’ time (2010-2016).

Table 2. Indonesian debt-for-development swaps: PV of debt relief and counterpart funds

Creditor/swap	Debt cancelled (in millions, PV)	Counterpart funds (in millions, PV)	PV percentage reduction
Germany I	€15.9	€11.5	-27.8%
Germany II	€13.5	€10.4	-22.9%
Germany IIIa	€7.8	€5.6	-28.4%
Germany IIIb	€7.8	€5.6	-28.5%
Germany IV	€13.6	€9.4	-30.8%
Germany V	€41.3	€21.8	-47.1%
Germany VII	€16.5	€8.5	-49.0%
United States I	\$26.8	\$26.8	0%
United States II	\$26.9	\$26.9	0%
Italy	\$13.5	\$21.2	+56.5%
	€3.5	€5.1	+47.2%
Australia	A\$68.1	A\$34.0	-50.0%

Sources: calculated from original (pre-swap) debt service schedules and debt swap agreements; OECD (CIRRs).

A second qualification is that only that share of debt service that would have been effectively paid to the creditor in a no-debt-cancellation situation constitutes new resources, external and fiscal, for the debtor. One cannot simply take for granted that all debt would have been fully serviced in the absence of the swap, i.e., assuming the default probability to be zero. For Indonesia, a non-HIPC that has been servicing its external debt in recent years (and even paid off some of it in advance to the IMF; see footnote 5), this may seem a moot point. However, the repeated Paris Club reschedulings of Indonesian debt following the Asian crisis (see before) point at the existence of debt service problems at the time; problems that may have been avoided by those reschedulings. This suggests the possibility of less-than-full debt service (in the counterfactual no-swap scenario) cannot be ruled out completely, especially with respect to earlier debt swaps.

To illustrate, even in the case of the two TFCA deals signed with Indonesia in 2010

[7] CIRRs are currency-specific interest rates based on the bond yields of major OECD countries plus a margin that increases with the repayment period. They are used by the IMF, World Bank and Paris Club to calculate the PV of debt relief. Since CIRRs are calculated for OECD countries they can be considered lower-bound estimates of the cost of raising hard currency for a country such as Indonesia (which would be expected to pay an additional risk premium); the PVs of debt relief in Table 2 are therefore upper-bound estimates.

and 2011, the US Treasury, aware of the qualifications above, estimated the default risk-adjusted PV of the loan repayments prior to the swaps at \$22 million and \$24 million, respectively; this is substantively less than the nominal \$29.9 million and \$28.5 million and also lower than the naive, no-default PV figures we calculated in Table 2.⁸

Third, another common, albeit often implicit, assumption is that debt swaps (or debt relief more generally) do not crowd out other forms of donor support. Yet, debt swaps may not be entirely additional to other (potentially more effective) aid interventions. Indeed, under current ODA accounting rules of the OECD Development Assistance Committee (DAC), donors may find it easy to treat debt relief operations as substitutes for new aid: the full nominal value of debt relief can be counted as ODA.⁹ Since the nominal value of debt swap operations typically overestimates the cost to the creditor, donors may find such swaps an attractive option to boost their ODA figures, perhaps at the expense of other ODA categories.

Admittedly, it is virtually impossible to assess the degree of substitution between the debt swaps under consideration and other categories of ODA disbursed to Indonesia. But especially with traditional donor budgets now under pressure in Europe and the US because of the 2008 financial crisis' adverse fiscal legacies, full additionality of swaps (and other debt relief) cannot be regarded as being the default. We feel that the burden of proof lies with those creditors that claim additionality.

A fourth set of qualifications is specific to debt swaps. In exchange for the cancellation of debt service under a swap, the debtor country commits to making counterpart payments. Generally these payments are to be made in local currency and at a reduced rate, as in the first six Indonesian debt swaps with Germany (where counterpart funds amount to the rupiah equivalent of 50% of the principal of debt forgiven). Replacing hard currency obligations by local currency obligations benefits countries that experience severe foreign exchange shortages.¹⁰ The reduction applied to the swap counterpart payments should, at the least, reflect the incongruity between nominal and market value of the debt forgiven (in line with the first and second qualifications we raised); without such a reduction, no additional fiscal space will be generated by a swap. Moreover, there may be a conflict of timing between the typically slowly maturing debt service savings and often 'frontloaded' counterpart payments, to be made over the span of just a few years. If debt swaps are poorly structured they may *destroy* rather than create fiscal space for the recipient government (in the first years of the swap, or even over its full duration), in the sense that they force the government to already spend money that is not yet saved from the cancellation of debt service. This implies the government will (temporarily) have to increase the budget deficit or cut back on other categories of spending. If counterpart payments remain due in hard currency, a poorly structured swap could also reduce external space.

Let us now look at how these last qualifications play out for the full series of 11 Indonesian debt swaps. Figure 2 plots the combined annual debt relief savings from Indonesia's

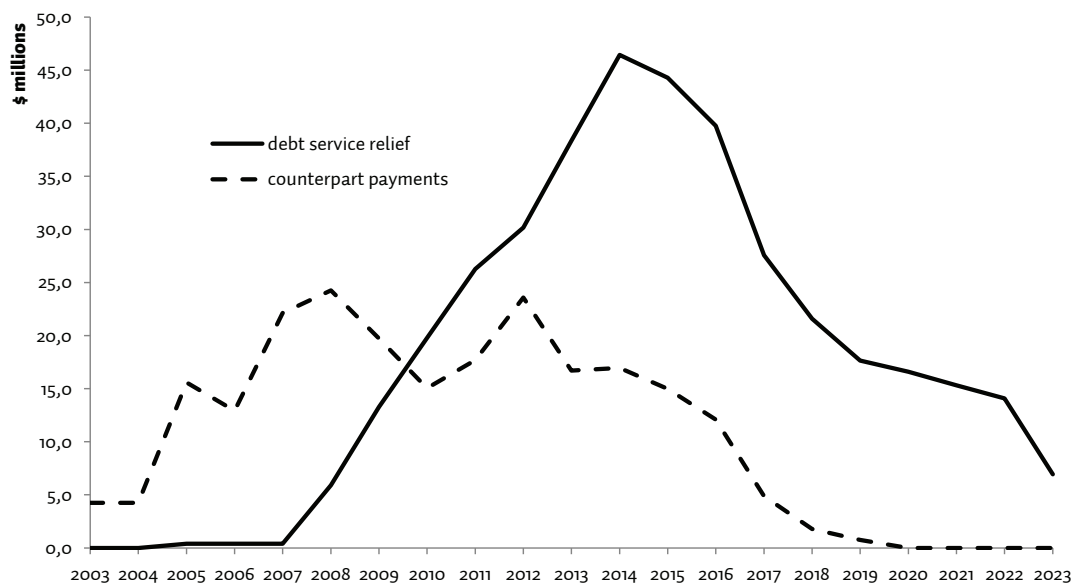
[8] Differences between the risk-adjusted PV figures advanced by the US Treasury and our own PV calculations may also be partly due to the use of different discount rates.

[9] To prevent double counting, for loans that already previously qualified as ODA and are later subject to debt swaps (as is the case for all Indonesian swaps except the one with Australia, which converts non-ODA debt) only the reduction in interest payments (and not the principal) can be recorded as new ODA. For the full set of complex rules governing debt relief accounting, see OECD-DAC (2000).

[10] This is arguably not an issue for Indonesia whose foreign exchange reserves have increased tremendously since the Asian crisis and stood at about \$86 billion in August 2013 (excluding gold and SDR holdings) according to figures reported to the IMF, comfortably above conventional thresholds of reserve adequacy (see Ruiz-Arranz and Zavadjil, 2012).

swaps and contrasts it with the combined counterpart payments made on these transactions¹¹; the vertical distance between the full and dashed line is a measure of fiscal space (making abstraction of default on the original debt, however). We clearly see that in the years up to 2009 combined counterpart payments exceed the amounts saved from debt relief (with a maximum of \$21.7 million in 2007), which implies extra pressure on Indonesia’s budget. Closer inspection learns that the swaps with Germany (I-IV) and Italy are the main culprits, due to their front-loading of counterpart payments. From 2010 onwards, fiscal space turns positive, as more debt service is cancelled than counterpart payments are to be made (the net gain peaks at \$29.5 million in 2014).

Figure 2. Debt service savings and counterpart payments of Indonesian debt-for-development swaps, 2003-2023



Sources: calculated from original (pre-swap) debt service schedules and debt swap agreements.

Another way of evaluating the fiscal implications of swaps is to calculate the PV of counterpart payments and compare it with the PV of debt relief (using the same discount rate) to get an idea of the time-adjusted reduction in payments due. Returning to Table 2, columns 3 and 4, we again observe great heterogeneity among the 11 Indonesian swaps. In PV terms the first five swaps with Germany (I-IV) entail sizeable percentage reductions in obligations, although considerably less than the nominal 50% advertised, again due to frontloading of counterpart payments. Mainly because of better-spread counterpart payments, PV reductions are very close to 50% for the Germany V and VII and Australian swaps. The TFCA swaps with the US do not involve any payment reduction (neither nominal, nor PV) as the original debt service schedule is maintained. The swap with Italy is the odd one out; the combination of very slowly maturing debt service savings and early, unreduced counterpart payments make that this operation increases the PV of Indonesia’s fiscal obligations.

[11] The annual counterpart payments are an approximation rather than observed flows. Most swap agreements just specify start and end dates within which such payments should be realised. For simplicity, we assume that Indonesia makes all of the proposed counterpart payments (which would result in maximum debt relief) and spreads these payments equally over the prescribed period.

3.2. An increase of resources for intended sector purposes?

To be sure, even if debt swaps do not automatically increase *overall* resources available to the recipient country and/or its budget (for reasons we discussed above), they are at least expected to shift away payments from servicing external debt to specifically targeted domestic sectors such as education, health, environmental conservation or reconstruction. In other words, the embedded earmarking of counterpart payments suggests that there will be a greater pool of funds going to deserving development purposes in the recipient country. So, do the swaps under consideration here translate directly in, say, an extra \$53 million spent on Indonesian education, an additional \$68 million in health expenditures, or \$74 million for conservation projects?¹² Again, things are not as simple as often portrayed. The validity of assertions about increases in the resources available for a particular sector rises and falls on additionality in both donor aid efforts and the recipient government's own expenditures in that field.

First, and related to our point on ODA accounting made in the previous subsection, debt swaps could (partially) substitute for other donor interventions aimed at the sector in question, and as such may not be (fully) additional. If a donor-creditor sets beforehand its preferred amount of aid to be spent on, for example, the education sector in Indonesia, the ODA generated by a swap operation might be deducted from that amount.

Similarly, the recipient government may decide to cut back on its own efforts in the sector targeted by a swap; confronted with an externally imposed schedule of required counterpart payments it could decide to trim down budget allocations for sector-related spending accordingly. Such 'fungibility' is a well-known issue that applies to most aid instruments, but is thought to be more problematic in the case of specifically targeted donor support, including project aid-like debt swaps (see Feyzioglu et al., 1998; Devarajan and Swaroop, 2000).

That said, it is anything but straightforward to evaluate the degree to which resources freed up by the 11 swaps come on top of other donor interventions and Indonesia's budgeted expenses in the respective sectors. On the latter, Pack and Rothenberg Pack (1990) found that foreign aid did not displace Indonesia's own development-related expenditures during 1966-1986 and that sector aid was mostly spent on the purposes intended by its donors. Of course such findings cannot be simply transplanted to more recent years. Much more detailed research, involving the establishment of historical baselines for government spending in different sectors (and subsectors) or other ways of constructing a counterfactual, would be needed to produce estimates of the importance of fungibility in the case of the debt swaps.

Still, it can be considered positive that in the agreement forged between the Indonesian government, Conservation International and KEHATI (under the first TFCA swap), it was stipulated that tropical forest areas whose species or ecosystems were not yet covered by Indonesia's own national Protected Area system would get priority in the selection process of grant proposals. Also Germany's official policy of allowing only new projects (or ongoing projects with jeopardised funding) to be financed by swaps can be seen as a deliberate move to curtail fungibility (Berensmann, 2007).

[12] These amounts correspond, respectively, to the sum of counterpart payments under the Germany I, II, IV and VII swaps (education); Germany V and Australia swaps (health); Germany IIIa and IIIb and both US swaps (conservation).

3-3- Lowering debt burdens?

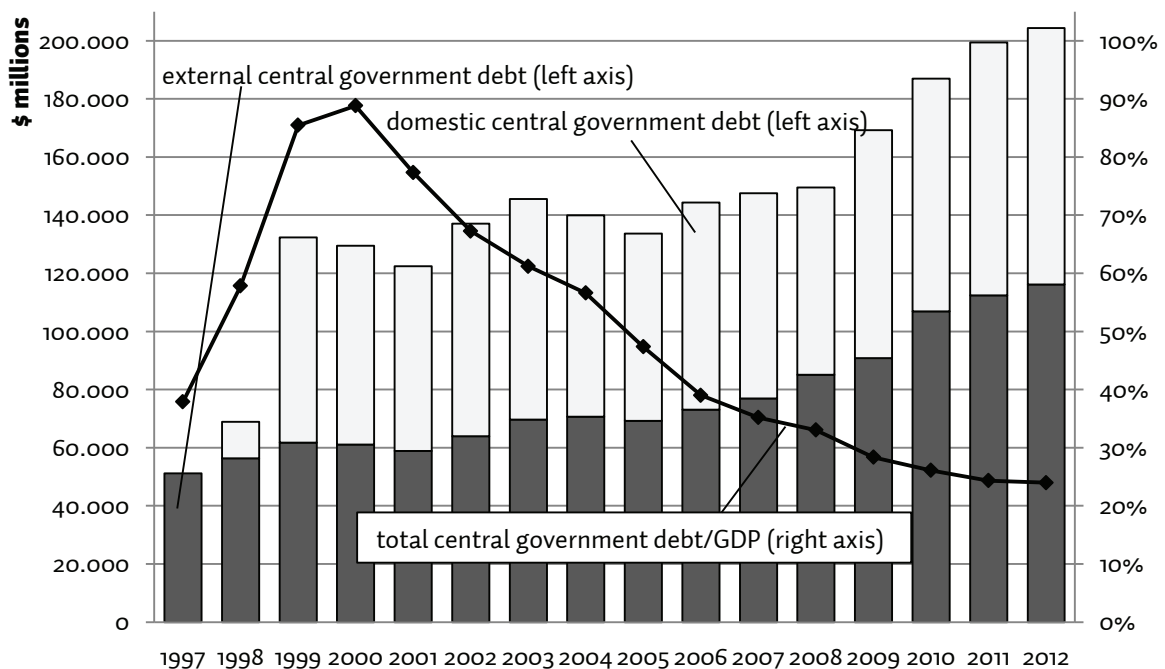
Debt swaps may have macroeconomic effects beyond a direct increase in resources. The debt relief inherent in swaps could break a vicious cycle in which excessive external debt leads to lower productive investment and depressed economic growth, and yet greater debt service difficulties, a situation known as ‘debt overhang’ (Krugman, 1988). Reducing or, better, eliminating debt overhang should in principle result in higher, self-reinforcing growth and investment, and hence, indirectly, to greater availability of domestic resources for development, this to the benefit of sectors such as education or health. Once again, however, we must make a number of important remarks.

For one, many researchers have found debt overhang theory to be relevant only under certain circumstances: for middle- rather than low-income countries (Pattillo et al., 2004; Depetris Chauvin and Kraay, 2005); at intermediate rather than very high or very low levels of debt; and solely for countries with a minimum level of institutional and policy quality (Cordella et al., 2005). Others see the coexistence of large external debt burdens and subdued growth as an expression of deeper systemic problems that could be economic, institutional or political in nature (Arslanalp and Henry, 2004). Cholifihani (2008), who uses a co-integration model to study the relation between public external debt service and output for Indonesia during 1980-2005, does find evidence supportive of debt overhang, but only with dampening effects on long-term growth.

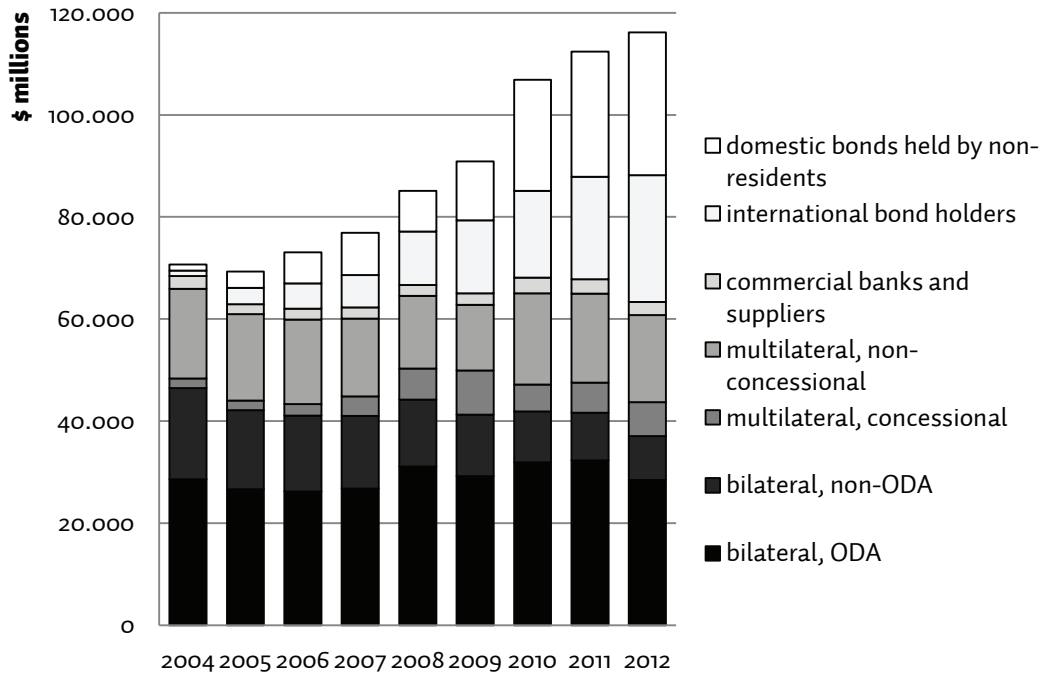
Even when debt overhang is present, it can only be breached when debt relief reaches some critical mass (Bulow and Rogoff, 1991), an insight which has been instrumental for the shift from small- to large-scale debt relief schemes, including the Brady deals and the HIPC initiative, since the 1990s. Clearly, each of the Indonesian debt-for-development swaps by itself cannot make a dent. The question then remains whether a series of 11 swaps can?

Figure 3. Indonesia’s total and external public debt

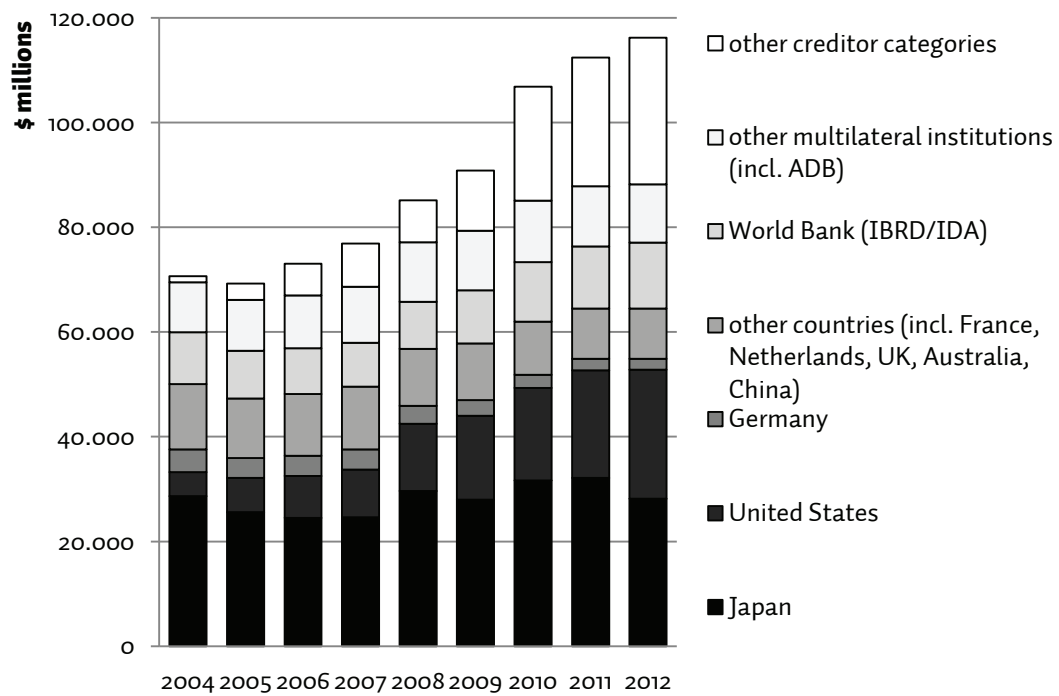
Panel (a) Domestic and external central government debt, 1997-2012



Panel (b) External central government debt by creditor type, 2004-2012



Panel (c) External central government debt by creditor nationality, 2004-2012



Sources: Bank Indonesia and Indonesian Ministry of Finance.

To put things in perspective, Figure 3 gives an overview of Indonesia's total and external public debt situation (central government only).¹³ As evident from panel (a), before the Asian crisis domestic public debt was practically non-existent; it only came into being by government issuance of recapitalisation bonds to troubled domestic commercial banks and repayment bonds issued to Bank Indonesia (to compensate the latter for its liquidity support during the crisis) (Feridhanusetyawan and Pangestu, 2003; McLeod, 2004). Since 1999, however, the share of domestic public debt in total public debt has varied between 43% and 53%.¹⁴ Moreover, owing to rapid growth and prudent fiscal policy, the Indonesian government has in recent years been able to present favourable debt sustainability figures, both in terms of external debt and total public debt (see IMF, 2012). For example, the ratio of total public debt to GDP has steadily declined from a peak of 89% in 2000 to about 24% in 2012; external public debt to GDP is now down to less than 14%. These observations seem to suggest that external debt relief should not be an absolute priority for the Indonesian government.

Even if external debt relief would be deemed an important policy objective, the debt swaps Indonesia has concluded over the years do not constitute an effective means towards that goal. Taken together, the 11 swaps have relieved Indonesia from just a tiny fraction of its total external public debt, which should dash any hopes for an observable impact on the Indonesian economy.¹⁵ Panel (b) of Figure 3 further shows that the bilateral official debt targeted by the swaps accounts for an ever-declining share of Indonesia's external public debt, mainly due to a rapid increase in international bond issuance and non-resident participation in the domestic bond market. Germany, with whom Indonesia has effected seven out of 11 swaps, is a relatively unimportant creditor to the latter, especially when compared to the US and Japan (cf. Panel (c)).

3.4. Alignment with government policy and systems?

Donors have always wanted to make sure that the funds they make available by means of aid are put to good use by recipient countries. To this end they have thought up different ways to influence how such funds are being spent, with preferences about control mechanisms and the kind of conditionality that should be attached to aid instruments evolving over time. This also applies to extra donor funds resulting from debt relief.

In early debt-for-development swaps, as practised during the 1980s and 1990s, official creditors and international NGOs often had a great say in selecting the beneficiary projects and did everything in their power to track to the maximum extent possible the cash flow freed up by debt service cancellation. Counterpart funds were typically set up outside recipient government budgets and managed by newly established committees with their own planning, implementation and monitoring and evaluation procedures. Such a 'micro-earmarking' approach may enhance donors' commitment to satisfactory project outcomes, lowers fiduciary risk and enables donors to make the results of their debt relief visible to domestic constituencies. On the other hand, it generally makes donors myopic to the bigger picture of recipient government spending, thus increasing chances of fungibility. Also, the creation of systems that run in parallel with those of the government itself (and in which the government often played only a subordinate role) brings with it extra transaction costs, hinders longer-term capacity building and

[13] We classify public debt into external and domestic components according to the residency of creditors (i.e., external debt is debt owed to non-residents), following official definitions.

[14] Rupiah-denominated public debt has exceeded foreign currency public debt in all years since 1999, except in 2008 (when its share was 47%).

[15] To illustrate, compare the \$385.1 million in debt cancelled through the 11 swaps with \$81.9 billion, the average outstanding external public debt over 2002-2011.

reduces ownership of the recipient country over the projects in question.

For these reasons, most debt relief in recent years, the majority granted under the HIPC/MDRI framework, is ‘non-earmarked’, or ‘sector-earmarked’ at most: the proceeds from debt cancellation are pooled with the debtor government’s (sector) budget and to be spent according to national development priorities, as formulated in the debtor’s Poverty Reduction Strategy Paper (PRSP), or similar development plans.¹⁶ So, when providing aid through debt relief or other modalities, donors nowadays try not to dictate policy but to support recipient countries’ own development strategies (while using their influence more indirectly through broader policy dialogue), and to leave more of the planning, implementation and monitoring and evaluation of aid projects and programmes to country institutions and public systems (where these are deemed effective, accountable and transparent). The will to have more of such ‘policy and system alignment’ is apparent from the High-Level Forum on Aid Effectiveness declarations to which donors subscribed at meetings in Paris (2005), Accra (2008) and Busan (2011).¹⁷

In January 2009, the Indonesian government stressed the importance it attaches to the aid effectiveness agenda by signing the Jakarta Commitment, a roadmap to implement the principles agreed on in Paris and Accra in the country by 2014, with 22 of its bilateral and multilateral donors. Through the Jakarta Commitment the Government of Indonesia (2009) asks its development partners again ‘[to] align themselves more fully with the Government programmes and systems’ (p.2), ‘[to] put higher priority on programme based approach[es]’ (p.4) and ‘[to] reduc[e] the number of ad hoc freestanding trust funds’ (p.4).¹⁸ The Director-General of Debt Management is one of three signatories to the Jakarta Commitment for the Indonesian government, and also co-chairman of the Steering Committee of the Aid for Development Effectiveness Secretariat (A4DES), an overarching government body charged with implementing the Jakarta Commitment.

Results from the Paris Declaration Monitoring Survey point to noticeable improvements in the aid given to Indonesia in terms of its alignment with government policy and systems between 2007 and 2010, although challenges remain (OECD, 2011). In 2010 around 95% of aid to the Indonesian government was reported on-budget, compared to 70% in 2007. The share of such aid using country systems of public financial management (PFM) and country systems of procurement increased from 71% to 86% and from 56% to 70%, respectively. The number of project implementation units (PIUs) parallel to country structures went down from 86 to 58. The percentage of bilateral aid tied to the purchase of goods and services from the donor, however, rose to 27% in 2010 from only 6% in 2007 (due to the practices of a handful of relatively important donors, i.e., Japan, South Korea and the Netherlands). At first sight, Indonesia’s recent debt swaps, sticking to narrow, project-based earmarking, seem at odds with overall trends toward greater policy and system alignment. Yet, before passing judgement, let us examine in greater detail the swaps’ adherence to these two principles.

[16] Since 1999 the preparation of a PRSP is a precondition for low-income countries to get HIPC/MDRI debt relief and access to new concessional World Bank and IMF financing. For more information, see <http://www.imf.org/external/np/exr/facts/pdf/prsp.pdf>.

[17] High-Level Forum outcome documents, background studies and monitoring surveys can be found at <http://www.oecd.org/dac/effectiveness>.

[18] The Jakarta Commitment also has its critics, especially within civil society, as is clear from statements by the International NGO Forum for Indonesian Development (INFID). See e.g., <http://infid.org/pdfdo/1374171721.pdf>.

3.4.1. Policy alignment

To get an idea of whether the swaps have been policy-aligned we check the coherence between the projects they fund and Indonesia's own development strategies, both on a general level and for specific sectors.

Following Indonesia's first direct presidential election in 2004 the country adopted a system of five-year National Medium-Term Development Plans (RPJMNs), elaborated under the authority of national planning agency Bappenas, that are framed within a broader 20-year National Long-Term Development Plan (RPJPN 2005-2025). A quick glance at these plans learns that education, health, environmental conservation and post-tsunami reconstruction all featured prominently in the RPJMN 2004-2009 and are listed among the country's 11 national priorities in the RPJMN 2010-2014.

How do the swap-financed projects align with Indonesian sector policy? Here the evidence is mixed, depending on the swap in question. For example, elsewhere we have shown how the Germany I and II swaps were much in line with Indonesia's education sector objectives of improving access to junior secondary schools and the quality of basic education (Cassimon et al., 2011a). Conversely, whereas the training of Indonesian post-graduate students and researchers may be a worthy objective, limiting the receiving institutions to creditor country-based universities and research institutes, as in the Germany VII swap, is a form of tied aid and could even conflict with the Indonesian Ministry of National Education's strategic goal of providing internationally competitive (in-country) higher education services across Indonesia. We are also fairly positive on sector policy alignment in the case of the two TFCA swaps with the US (see Cassimon et al., 2011b). Limiting deforestation and other ecosystem losses, especially in Sumatra but also in the Kalimantan region, received ample attention in the Indonesian Ministry of Environment's 2007 National Action Plan Addressing Climate Change, and debt swaps were explicitly mentioned as possible, non-conventional financing instruments in that document. On the other hand, only one Indonesian government official could be a permanent voting member in each of the TFCA swaps' oversight committees (which make all important decisions, including those on grant proposal selection), limiting the government's control over the actual conservation projects implemented and reducing ownership. More problematic in terms of ownership are the German and Australian swaps under the Global Fund's Debt2Health initiative, since they put the Global Fund, a non-state actor, in charge of managing the swap counterpart funds and let it distribute project grants according to its own criteria (Cassimon et al., 2008). This risks diverting resources away from Indonesian health priorities.

3.4.2. System alignment

Also with respect to the extent of system alignment, there are noticeable differences between the debt swaps. The Germany I and II swaps, for example, avoided setting up parallel structures as they were implemented within the framework of the long-standing German-Indonesian SEQIP partnership. Indonesia's Ministry of National Education was itself responsible for the execution of the approved project and all related costs, including the development of the curricula of the learning resource centres. Construction and the distribution of materials was left to local contractors, parents and residents. Committees composed of school boards, teachers and other local community members took responsibility for the management of the newly constructed centres. Only monitoring and auditing procedures were imposed by Germany's development bank KfW (Cassimon et al., 2011a). A rather different picture emerges when we consider

the Germany VII swap, where the Indonesian government is required to contract the German Academic Exchange Service (DAAD) as the agency implementing the scholarship programme. As the counterpart funds of the swap are used exclusively to pay for the DAAD's services (including administrative costs), all money remains in German hands, i.e., a clear example of aid tying. Other examples of limited system alignment are found in the two TFCA swaps. In these operations, strict ring-fencing of swap proceeds, through the establishment of off-budget accounts, separate trust funds from which grant disbursements are made and accompanying oversight committees, created structures that mostly bypass existing Indonesian government systems for conservation (Cassimon et al., 2011b). Similarly, the two Debt2Health swaps, which use the Global Fund as an intermediary to distribute grants through its own channels, lead to a duplication of mechanisms in Indonesia's health sector.¹⁹

What is more, there is no or little apparent harmonisation between debt swaps conducted with the same creditor, or between swaps that are targeted to the same sector (whether or not these are with the same creditor). German swaps cover the education and health sector, as well as conservation and reconstruction; and even the four German debt-for-education swaps all target very different subsectors. The US TFCA swaps both stick to protecting ecosystems, but in different areas and with completely separate management structures that involve different third-party actors.²⁰ We could also not find concrete evidence of the first TFCA swap building further on earlier conservation projects financed by the Germany IIIb swap in Sumatra, although the three national parks that were the focus of the latter are also eligible for project finance in the former. The use of Italian swap proceeds is only geographically restricted and in itself split over smaller projects in various sectors. Funds coming from the German and Australian Debt2Health swaps are, in principle, pooled together with the rest of the Global Fund's budget for Indonesia²¹, but given the ownership problems we highlighted before, that may not be much of an advance.

Having examined Indonesia's 11 debt swaps in detail by means of our four criteria, in the next section we attempt to form an idea about the Indonesian government's policy stance on the use of debt swaps. More particularly, we first look at the existing legal and institutional framework around Indonesia's debt swap practice and then discuss the extent of learning accompanying this practice.

[19] Interestingly, according to the Paris Declaration Monitoring Survey Germany scored much better on the overall use of country systems of PFM and procurement than the US and the Global Fund in 2007 and 2010 (OECD, 2011).

[20] Next to one Indonesian and one US government official, the first TFCA swap's oversight committee consists of sponsors Conservation International and KEHATI as permanent members, and Transparency International Indonesia, Syia Kuala University and Indonesia Business Links as designated members. In the second TFCA swap the oversight committee includes TNC and WWF Indonesia (permanent), and think tank Yayasan Pelangi Indonesia (designated). The two swaps only have their administrator, KEHATI, in common. But even here, different staff members of KEHATI administer the two swaps.

[21] The debt swap agreements nevertheless appear to suggest that grants made with swap funds will be explicitly accounted for as 'Debt2Health grants' when disbursed by the Global Fund.

4- ASSESSMENT OF THE INDONESIAN DEBT SWAP POLICY

4.1. Legal and institutional framework

When a team of researchers from Conservation International in 1998 studied the feasibility of conducting debt-for-nature swaps in Indonesia they found that '[m]ost government officials interviewed had limited knowledge of the debt swap concept', and that '[a]t this stage, the [government] ha[d] no expressed policy on debt-for-nature or debt-for-development swaps' (Guérin-McManus, et al., 1998, p. 18). Much has changed since.

In 2001, a decree of the People's Consultative Assembly, Indonesia's main legislative body, urged the government to reduce the burden of external debt on the budget by seeking debt restructuring, either through debt service rescheduling (as in 1966-1970, 1998 and 2000), exchanging relatively expensive debt for more concessional (IDA) loans, or by means of debt swaps. This was the first time the concept of debt swaps appeared in an Indonesian official text (personal communication, Widjanarko Soebadhi, Indonesian Directorate General of Debt Management). In later Debt Management Strategy documents, for the 2005-2009 and 2010-2014 periods, debt swaps are also mentioned as part of Indonesia's efforts to bring down its external debt stock and as instruments of development financing. Logically, because of Indonesia's changes in public debt composition (outlined earlier), the cost and risk management of domestic debt and further domestic capital market development are given much more prominence in these documents.

Turning to the institutional setting, it should be noted that, while several Indonesian government agencies are involved in the negotiation, implementation, monitoring and evaluation of debt swap proposals, there are no standard operating procedures to date (personal communication, Widjanarko). Typically, a bilateral creditor approaches the Indonesian Coordinating Ministry for Economic Affairs with an offer to convert certain debt titles into development-related spending. This Coordinating Ministry then takes the overall lead on the Indonesian side in further elaborating the proposal. The Ministry of Finance is responsible for negotiating the financial aspects of the debt swap, budget allocation and administrative matters. Of particular importance is the Debt Management Office (DMO) subdivision (officially called Directorate General of Debt Management), which was created in its present form in 2006 after consolidating Indonesian expertise on domestic and external debt previously found in separate units. The DMO's Front Office assists in analysing and negotiating debt swap terms, whereas its Back Office is tasked with registering, administering and verifying the swap agreements; making sure the correct counterpart payments are made; and reconciling all financial information and reporting on the debt swap. Bappenas coordinates planning activities such as the preparation and evaluation of project proposals. The line ministries can suggest priority (sub)sectors for swap financing to Bappenas. Sometimes they are also involved in the actual implementation of the projects (e.g., the Ministry of National Education in the Germany I and II swaps). The Coordinating Ministry for Economic Affairs holds evaluation meetings where all different stakeholders to ongoing debt swaps are invited and questioned about swaps' progress. The results of such meetings are said to serve as inputs for reviewing future swap proposals (personal communication, Widjanarko).

4.2. Learning effects

An important question that comes to mind when assessing Indonesia's debt swap policy is whether, over the span of 11 debt swaps, there are signs of learning by the Indonesian government, i.e., evidence suggesting improvements over time in the swap terms concluded with bilateral creditors. From the swap details presented in previous sections, and despite the array of government agencies implicated in debt swap life cycles, it seems that such learning has been very limited, if not absent. For each of our assessment criteria, there is no clear positive evolution in swap performance over time. On the contrary even: early debt-for-education swaps with Germany were, to some extent, fiscally more interesting for Indonesia than the later Italian and US TFCA swaps, and better aligned with government systems than both the TFCA and Debt2Health swaps.

But if debt swap arrangements are far from optimal and Indonesia has not been able to wrest better economic terms from its creditors throughout the years, why has the Indonesian government continued to engage in such swaps?

One hypothesis is because creditors tell it to. It may well be that the relative strengths and weaknesses of individual swaps reflect relative strengths and weaknesses of the respective *creditor's* (and not *debtor's*) policy with regards to debt swaps; policies that are in turn embedded in creditor-specific legal documents and/or informal rules and preferences (see Ruiz, 2007b; Buckley, 2011). Surely, debt swap negotiations take place within boundaries set by what creditors allow and favour themselves. For example, the TFCA allows only concessional credits extended under (specific sections of) the Foreign Assistance or Agricultural Trade Development and Assistance Acts to be converted, and solely for tropical forest conservation purposes. Unlike the US, Germany often grants substantial reductions on swap counterpart payments. And in Italian legislation there is an explicit reference to the possibility of debt relief in case of natural disasters and humanitarian crises, which served as the basis for its 2005 swap with Indonesia. Allegedly, the 2010 Debt2Health operation only saw the day of light after long, intense advocacy by Australian civil society and the Global Fund itself as well as a change of Australian government (Webb and Fletcher, 2011).

An alternative, non-competing explanation for the observed debt swap arrangements is that the Indonesian government based its decisions also on other, non-economic motivations. For example, it has been suggested that, as an emerging powerhouse in Asia, Indonesia wanted to become a donor to the Global Fund itself and that using a debt swap was a cheaper option than direct donations. Moreover, the ring-fencing of the swap ensured money would flow back to Indonesia rather than to Global Fund projects in other countries (personal communication, Robert Filipp, former Head of Innovative Finance at the Global Fund). As such, it seems that ownership and system alignment were traded off against political motivations and prestige. Similar trade-offs might have been at play in other debt swaps too.

An historical reconstruction and in-depth study of negotiations for each individual swap, well beyond the scope of the current paper, would be needed to get a better understanding of the validity and relative importance of the just-mentioned hypotheses on why Indonesia agreed to debt swaps with (economically) unfavourable features. That aside, we feel there are still opportunities for the Indonesian government to improve the economics and aid effectiveness of future swaps.

5. CONCLUDING REMARKS

This paper has studied 11 debt-for-development swaps Indonesia concluded with its bilateral creditors Germany, the US, Italy and Australia between 2002 and 2011. Since the termination of its last IMF programme in 2003, such debt swaps have been one of few instruments available to Indonesia to reduce, in absolute terms, its external public debt service and debt stock.

The results of a systematic evaluation of the Indonesian swaps across four criteria are mixed, to say the least. First, whereas the debt swaps under study, overall, lead to a (modest) increase in resources at the country level, about \$385 million over a nearly 20-year period, strong frontloading of counterpart payments in a number of swaps actually shrunk the fiscal space available to the Indonesian government in the first couple of years. Second, as with other specific donor interventions, it remains difficult to estimate to what extent the swaps' contribution to the education, health and environmental conservation sectors and reconstruction is truly additional to other donor aid and to the Indonesian government's own expenditures in these fields. Third, even taken together, the little debt relief provided by the swaps is too insignificant to make a difference in Indonesia's public debt burden, especially since more than 40% of public debt is now owed to domestic creditors and, thanks to solid growth and fiscal prudence (and, to some degree, previous debt restructurings), the medium-term outlook for debt sustainability is auspicious. Fourth, swap-financed interventions generally appear to be in line with the Indonesian government's national development and sector-specific policy. Nevertheless, decision-making structures in some of the swaps limit the government's ownership over projects. Alignment with existing government systems is often weak, due to the establishment of separate, ring-fenced trust funds that operate according to their own procedures. The lack of system alignment extends to the inter-swap level; different debt swaps' set-ups are not at all harmonised between them, not even those conducted with the same creditor or within the same sector.

Another key finding is that, despite reference to debt swaps in debt management strategy documents and the range of Indonesian government agencies involved in negotiating, implementing, monitoring and evaluating swaps, there is little evidence of learning on the Indonesian side. Swap conditions vary quite a bit and have not visibly improved over time in terms of more (budgetary) resources or better alignment. Whereas further swap-specific analysis would be necessary to unravel whether this is mainly because of creditors' policies and preferences, trade-offs by the Indonesian government itself based on political and other not purely economic motives, or for different reasons, we do believe Indonesia finds itself in a sufficiently strong bargaining position to seek economically more advantageous deals. A good starting point would be for the Indonesian government to compile a set of principles and/or minimal guidelines to which debt swap proposals by creditors should adhere. Such a 'checklist', we suggest, should include (but would not be limited to) the following.

First, all parties to the swap agreement should be made aware of the exact debt claims that will be subject to conversion. To boost the transfer of purchasing power from creditor to debtor, swaps would then preferably be made with larger debt titles that are due over a relatively short period of time and that would most likely have been serviced in the absence of the swap arrangement. Second, to increase transparency, swaps should be negotiated on the basis of PV figures of their implied debt service savings and counterpart payments, and the details of such PV calculations (including the discount rate used) should be made available to all stake-

holders. Third, reductions in swap counterpart payments should be applied at the minimum to cancel out differences between the nominal and market value of the debt forgiven, i.e., to take into account the time aspect of debt service and possibility of non-repayment (if applicable). This would avoid augmenting fiscal pressures on the Indonesian government. Fourth, to the extent possible, the donor-creditor should be made to commit to not using debt swaps as substitute for its other support, overall and sector-specific, to Indonesia. In return, the Indonesian government could promise to use swap proceeds for projects or programmes that would otherwise not have been financed by its own budget. Line ministries could perhaps beforehand prepare a shelf of projects with high social returns that would only be implemented if more funds were available. Both donor and recipient commitment to additionality are, admittedly, hard to verify ex post. Lastly, Indonesia should remind its creditors of the promises they made with regards to policy and, especially, system alignment and inter-donor harmonisation of their support in Paris, Accra and Busan and when signing the Jakarta commitment. The government's side of the bargain would then be to work hard to improve upon the effectiveness, efficiency and accountability of its own systems and institutions.

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