

## DEBT RELIEF

### Introduction

1. Debt is a major development issue, and there is widespread support for lifting the burden of unpayable debt from the poorest countries.

2. Earlier sections of this report have shown that sums awarded as debt relief can be included within aid flows from DFID, CDC and ECGD<sup>1</sup>. This chapter considers five ways the UK provides assistance with debt and gives an explanation of each type of assistance and the way this is reported.

- debt relief on bilateral aid debts (owed by individual country governments to DFID).
- debt relief on bilateral export credit and CDC loans to governments.
- financial contribution towards the cost of the Heavily Indebted Poor Countries (HIPC) Initiative.
- multilateral debt relief for the poorest countries (under the developing G8 initiative for HIPCs and the UK initiative for non-HIPCs).
- co-funding of a capacity building programme to improve HIPC countries' debt management.

3. Important terms used in discussing debt relief are explained in Box 5.

### Box 5: Debt Terminology

A country's debt can be described in terms of 'principal' and 'interest'. The principal is the amount of the original loan still outstanding. A country's debt stock is the outstanding principal and interest combined (plus any penalties incurred for failure to maintain debt service payments).

Debt Relief can take various forms; the main ones are:

**Debt cancellation** (or stock relief) - partial or 100% reduction of amounts outstanding (principal debt and/or interest).

**Debt rescheduling** where payments (interest and/or principal) are delayed or rearranged.

**Flow relief** – partial or 100% relief on debt service payment (both principal and interest).

4. It should be noted that the decision to award a particular type of debt relief is usually made internationally and applied by all creditors participating in the agreement. Bilateral deals then take place between creditors and debtor governments. The Paris Club is the main forum for agreeing treatment of bilateral (government to government) debt. Debt relief is reported to the DAC as ODA/ OA at the time a bilateral deal is signed between the UK and a debtor country.<sup>2</sup>

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<sup>1</sup> See Box 1 for a description of CDC and ECGD.

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<sup>2</sup> Except for countries reaching Completion Point under HIPC, where the date of the multilateral agreement is used as the date for DAC reporting.

### **Box 6: The Paris Club**

The Paris Club is an informal group of official creditors (of which the UK is a permanent member) whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor nations.

To date, the Paris Club or ad hoc groups of Paris Club creditors have reached 393 agreements concerning 80 debtor countries. Debt treatment in the Paris Club can take various forms under, for example Toronto terms, Trinidad terms, Naples terms, Enhanced Naples/ Lyon Terms and Cologne Terms (dealing with the HIPC initiative). Details of each are given in the glossary.

### **DFID Bilateral Aid Debts**

5. DFID has cancelled nearly all of its aid debts to low income countries. These have been worth over £1.3 billion since 1978. Details of the annual flows involved in recent years are shown in Tables 1, 11 and 12 labelled as 'DFID debt relief'. (These figures also include debt relief under the Commonwealth Debt Initiative described below.)

6. In September 1997, the UK Government launched the **Commonwealth Debt Initiative** (CDI). This is a rare example of an arrangement that does not affect all donors, but covers only UK loans to the countries concerned. Under the CDI the UK agreed to provide relief on the remaining aid debts, worth £132 million of those poorer (lower-middle income) Commonwealth countries who were committed to the Millennium Development Goals, were

following sound economic policies, promoted accountable and transparent governance and were bearing down on corruption. To date 12 countries have benefited from this initiative.

7. The UK now reports cancellation of aid loans on a lump sum basis to the OECD-DAC in line with other donors. This means that all outstanding amounts on a loan are reported as forgiven in the year in which the agreement to cancel is made, rather than reporting debt forgiven year-by-year as repayments would have fallen due. This 'lump sum' approach applies to all debt relief except old DFID bilateral aid debts which are shown in *SID* according to an older reporting convention representing the 'benefit to country'. Here annual sums reported as debt relief reflect the money available to the country in the year in question that would otherwise have been spent on debt servicing<sup>3</sup>.

8. In 2004/05, £14.9 million is shown as DFID debt relief (see Tables 1 and 23)<sup>4</sup>.

### **Bilateral Export Credit Debt**

9. The Export Credit Guarantee Department (ECGD), like its counterparts in other developed countries, assists UK exporters to win business overseas by providing guarantees and insurance. Countries acquire debt when they default on

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<sup>3</sup> These amounts of debt relief were 'rolled up' and reported to the DAC at the time the change to lump sum reporting was made (1999).

<sup>4</sup> Within this sum, annual cancellation under CDI will be included in the UK ODA/ OA figures for 2004 or 2005 but the debts reported on the 'benefit to country basis' will not be included in ODA/ OA figures as the relevant sums have already been reported to the DAC.

paying for these goods and services. If countries face difficulties with meeting their debt repayments, assistance may be provided in the form of rescheduling and, for poorer countries, partial cancellation. Such arrangements are agreed in the Paris Club and are conditional on the country following sound economic policies, agreed with the International Monetary Fund (IMF).

10. Table 24 contains details of ECGD debt relief. It can be seen that the total ECGD debt relief for 2004/05 was £247 million. ECGD debt relief is merged with CDC debt relief in Table 2<sup>5</sup>.

### **CDC Debt**

11. As described in Box 1, CDC has a portfolio of loans to governments which can become eligible for debt relief under the HIPC or other debt relief deals. In 2004/05 £35 million of debts owed to CDC were reorganised (see Tables 23 and 24)<sup>5</sup>.

### **The Heavily Indebted Poor Countries (HIPC) Initiative**

12. The HIPC Initiative was launched by the World Bank and the IMF in 1996. It recognised that exceptional relief would be required to bring about a once and for all reduction in the debts of some of the poorest countries, and that this would need to include, for the first time, debt relief from multilateral institutions, such as the World Bank, the IMF and the regional development banks. The HIPC initiative was not aimed at eliminating the debts of these countries

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<sup>5</sup> ECGD/ CDC debt relief is reported as UK ODA/OA in the year in question on a net basis (ie with deductions for any repayments made).

altogether, but at reducing them to a sustainable level.

13. The experience of some of the first countries to qualify for HIPC debt relief led the UK Government to call for a fundamental review of the HIPC Initiative. In 1999, at the G8 Summit in Cologne, Heads of Government recognised the damaging effects of unsustainable debt on efforts to reduce poverty, and that more needed to be done. They outlined a substantial package of measures to address unsustainable debt, including major enhancements to the HIPC Initiative, and emphasised that the purpose of this was to enable governments to tackle poverty more effectively; the package could result in up to \$100 billion of debt being cancelled<sup>6</sup>. The enhanced HIPC Initiative was endorsed by the international community in September 1999. Under HIPC, \$56 billion is being provided to the 28 countries currently qualifying for debt relief<sup>7</sup>.

14. An important feature of the enhanced HIPC Initiative is the strengthening of the link between debt relief and poverty reduction. HIPC countries have to demonstrate commitment to poverty reduction through the production of a national Poverty Reduction Strategy Paper (PRSP) which analyses poverty in the country and sets out the actions government will undertake to tackle it. The strategies contain an expenditure framework indicating how resources, including savings from debt relief will be allocated.

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<sup>6</sup> This represents an estimate of the total outstanding debts that could be eligible for cancellation under the enhanced HIPC initiative.

<sup>7</sup> IMF and World Bank (2005) 'Heavily Indebted Poor Countries (HIPC) Initiative – Status of Implementation.

15. Under the HIPC Initiative countries reach '**Decision Point**' (at which point they start to receive flow relief) when they have an interim poverty reduction strategy paper, and a track record with the IMF – through its Poverty Reduction and Growth Facility (PRGF). Countries then reach '**Completion Point**' when they have developed a full PRSP and usually made progress in implementing it for a year. Upon reaching completion point countries receive irrevocable debt stock reduction. 'Decision Point' and 'Completion Point' status is agreed by the Executive Boards of the IMF and World Bank and subsequently by the Board of the relevant Regional Development Bank.

16. In December 1999, the UK Government decided to go beyond the requirements of the HIPC Initiative by providing 100% cancellation of bilateral debts. For ECGD debts, this means that DFID provides additional resources to take debt relief from the 90% (or more) level countries are eligible for under HIPC, to 100%. Such support is recorded in DFID as 'Bilateral HIPC' payments. 'Bilateral HIPC' payments also include reimbursements under a 'Hold in Trust' Policy. In December 2000, the UK Government announced that it would not benefit from debt service repayments of the poorest countries, and that any payments received from HIPCs would therefore be held in trust until reimbursement on Completion Point. The only country so far eligible for such reimbursement has been Ghana.

17. In 2004/05 bilateral HIPC payments amounted to £12.5 million (these are classified as bilateral since the countries to which they are destined are known to DFID<sup>8</sup>). In Table 1, these payments are included within the category 'other financial aid'.

18. To help multilateral institutions provide their share of debt relief under HIPC<sup>9</sup>, donors contribute towards the HIPC Trust Fund. These sums appear as a DFID multilateral aid flow in Table 16. UK multilateral contributions to the HIPC trust fund amounted to £42 million in 2004/05.

19. Both the bilateral HIPC payments and multilateral contributions to the HIPC Trust Fund are reported as ODA/OA for the relevant year and identified as debt relief in DAC reporting.

20. By the end of June 2005, 28 countries had reached the point at which they begin to receive interim relief on their debt service payments (Decision Point), and 18 of these countries had received an irrevocable reduction in their stock of debt (Completion Point) – the implementation status of individual countries is shown over page.

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<sup>8</sup> See 'Classification of Bilateral and Multilateral Aid' on page 6.

<sup>9</sup> Under the HIPC initiative 50% of multilateral debt can be cancelled.

## Implementation status of Heavily Indebted Poor Countries (HIPC) as of end August 2005

Countries at Completion Point			Countries at Decision Point		Remaining Countries	Countries with sustainable debt
Country	Decision Point Date	Completion Point Date	Country	Decision Point Date	Country	Country
Benin	July 2000	April 2003	Burundi	August 2005	Burma	Angola
Bolivia	Feb 2000	Jun 2001	Cameroon	October 2000	Burundi	Kenya
Burkina Faso	July 2000	April 2002	Chad	May 2001	Central African Republic	Vietnam
Ethiopia	Nov 2001	April 2004	DR Congo	July 2003	Comoros	Yemen
Ghana	Feb 2002	July 2004	The Gambia	Dec 2000	Republic of Congo	
Guyana	Nov 2000	Dec 2003	Guinea	Dec 2000	Cote D'Ivoire	
Honduras	July 2000	April 2005			Laos (not opting for debt relief)	
Mali	Sept 2000	Feb 2003	Guinea-Bissau	Dec 2000	Liberia	
Mauritania	Feb 2000	June 2002	Malawi	Dec 2000	Somalia	
Madagascar	Dec 2000	Oct 2004	Sao Tome and Principe	Dec 2000	Sudan	
Mozambique	April 2000	Sept 2001	Sierra Leone	Mar 2002	Togo	
Nicaragua	Dec 2000	Jan 2004				
Niger	Dec 2000	April 2004				
Rwanda	Dec 2000	April 2005				
Senegal	June 2000	April 2004				
Tanzania	April 2000	Nov 2001				
Uganda	Feb 2000	May 2000				
Zambia	Dec 2000	April 2005				

21. Under traditional Paris Club terms and the HIPC Initiative, relief totalling more than \$70 billion has been agreed for the 28 countries, reducing their debts by around two-thirds on average, and freeing up resources for spending on poverty reduction. Several of these 28 countries did not meet the full set of normal HIPC requirements, however, the international community agreed to be more flexible in assessing their eligibility for relief, giving due weight to the depth of commitment shown over a shorter time period, and focusing on those reforms that are critical for poverty reduction.

22. Many countries eligible for the HIPC initiative have been held back by conflict and governance problems. More countries are expected to become eligible for HIPC in 2006.

### **Multilateral Debt Relief**

23. Despite the successes of HIPC, debt owed by the poorest countries to multilateral institutions such as the World Bank, African Development Bank and IMF – is a significant burden. Such payments represent up to 80% of some poor countries' debt repayments.

24. On 11<sup>th</sup> June 2005, G8 Finance Ministers therefore agreed a proposal for new multilateral debt relief going beyond the terms available under the HIPC initiative. This has now been agreed at the World Bank and IMF annual meetings and the agreement process is progressing the African Development Bank.

25. Under the proposal, qualifying HIPC countries will receive 100% cancellation of their debts to the IMF and the concessional lending arms of the World Bank (IDA) and the African Development Bank (the African Development Fund). The combined eligible debts of the current 38 HIPCs to these institutions could be worth up to \$55 billion, all of which could be cancelled.

26. To qualify for this relief, countries must meet their Completion Point conditions under the HIPC Initiative. For countries that have already passed Completion Point this assistance will be given provided countries are on track with their IMF programmes and continue to demonstrate a strong commitment to poverty reduction.

27. Donors will fully compensate the Banks for the repayments they forgo each year – that is, the debt service that HIPC countries would otherwise have paid. These additional funds will then be allocated to all poor countries using the institutions' normal (performance-based allocation) systems.

28. The UK has also developed a separate Multilateral Debt Relief Initiative (MDRI) that will cover non-HIPC but poor countries (and HIPCs until the G8 initiative on multilateral debt relief takes over). Under MDRI the UK will pay its share (10%) of the debt service owed by qualifying countries to IDA and the African Development Fund.

29. These recent initiatives on multilateral debt have not resulted in any flows in 2004/05, but will be reported in next year's *SID*.

## **HIPC Capacity Building Programme (CBP)**

30. DFID co-funds, with Austria, Canada, Denmark, Ireland, Sweden and Switzerland, a programme of technical advice and assistance for HIPC countries to develop their debt management capacity. Under this programme, HIPC countries are assisted to establish the level of debt they hold and negotiate their HIPC debt relief. Debt relief under HIPC can be provided in the form of debt stock reduction (cancelling the value of loans) or debt service reduction (forgoing debt service payments). The best balance between these alternatives will vary country by country - for example, it depends in part on how effectively a government could spend additional resources to tackle poverty. The CBP helps HIPC governments to consider their options. The programme also assists HIPCs to develop a debt management strategy to plan and manage future borrowing. HIPCs receiving significant assistance from the CBP are: Angola, Benin, Bolivia, Burkina Faso, Cameroon, Central African Republic, Chad, Congo Republic, Ethiopia, Gambia, Ghana, Guinea, Guyana, Honduras, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia. DFID has so far provided over £4m to the CBP.

31. DFID also provides technical assistance in debt management for some non-HIPC countries, and is supporting developing countries' participation in Bank of England training courses, which include

debt management. Such sums appear as 'technical cooperation' in Table 1.

## **Reporting of Debt Relief**

32. The various components of UK debt relief are summarised in Table 23. Total debt relief represented £69.6 million (2%) of the DFID programme in 2004/05 and £351.4 million (8%) of total GPEX in the same year. DFID debt relief is shown for individual countries in Table 12. Countries receiving non-DFID debt relief are shown in Table 24.

33. Table 14 reports bilateral debt relief reported to the DAC in 2003 as £49 million (all classed as ODA) and notes also just over £0.5 million in multilateral payments to the HIPC Trust Fund. (For 2004 the equivalent figures are much higher at £433 million bilateral debt relief and £39 million multilateral debt relief.) The sums reported to the DAC are lower than those shown in Table 23 since we report a net figure to the DAC (ie the difference between loans repaid and debts forgiven in the year in question) whereas elsewhere we show the total debt relief forgiven<sup>10</sup>.

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<sup>10</sup> Debt relief reported in *SID* under the heading 'DFID debt relief' (except the CDI component) is not included in current ODA/ OA figures as the relevant sums have already been reported. HIPC related payments and money for the CBP are included in the total ODA figures (although CBP payments are not identified as debt relief).