Technical Note 3 – Debt Relief

This note provides additional information to understand the Debt Relief statistics reported in the GPEX Tables.

Introduction

1. Debt is a major development issue. There is widespread support for lifting the burden of debt from the poorest countries. Debt relief frees developing countries from their debt service payments. They can then use these savings to contribute to poverty reduction.

2. The UK provides 100 per cent irrevocable debt relief for Heavily Indebted Poor Countries (HIPCs) on eligible debts owed to DFID, the CDC Group PLC and Export Credit Guarantee Department (ECGD)[1]. We make contributions to the international costs of HIPC and Multilateral Debt Relief Initiative (MDRI). Our contribution to the cost of HIPC debt relief is part of our overall replenishment funding of the World Bank and the African Development Fund (ADF). We also make full additional annual contributions to the World Bank and African Development Bank (AfDB) to compensate them for the costs of debt relief under the MDRI, as well as a contribution to the International Monetary Fund (IMF) in 2005/06. Our contributions to the World Bank and AfDB have been reported from 2006/07, when the MDRI was launched.

Debt Terminology

3. 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, plus any interest accrued (as well as any penalties incurred for failure to make debt service payments).

4. Debt relief can take various forms, including:
    - Debt cancellation (sometimes called stock relief) – partial or 100 per cent reduction of amounts outstanding (principal and/or interest);

[1] See Glossary for a description of CDC and ECGD.

- Debt rescheduling where payments (interest and/or principal) are delayed or rearranged;
- Flow relief – partial or 100 per cent debt service payments.

5. Decisions to award a particular type of debt relief, for example, under the HIPC Initiative, are usually made by international consensus. All creditors participating in the HIPC Initiative are then expected to deliver agreed (or better) terms. Bilateral deals can also take place between creditors and debtor governments. The Paris Club is the main forum for agreeing treatment of bilateral (government to government) debt.

The Paris Club

6. The Paris Club is an informal group of government creditors who work together to find co-ordinated and sustainable solutions to payment difficulties experienced by debtor nations. The UK is a permanent member of the Paris Club.

7. To the end of 2011, the Paris Club, or ad hoc groups of Paris Club creditors, has reached just over 423 agreements (with 2 in 2011 and 9 in 2010) concerning 88 debtor countries. Debt treatments in the Paris Club can take various forms. Details of the options and terms available are given in the Glossary.

The Heavily Indebted Poor Countries (HIPC) Initiative

8. The HIPC Initiative was launched by the World Bank and the IMF in 1996 to reduce the debts of the poorest and most indebted countries to sustainable levels. The majority of bilateral (government) and multilateral creditors (such as the World Bank, IMF and Regional Development Banks) have agreed to participate.

9. The HIPC Initiative was strengthened in 1999 and re-launched as the enhanced HIPC Initiative (e-HIPC). This provided more relief for more countries more quickly and it put poverty reduction at the heart of debt relief. To be eligible, countries must demonstrate their commitment to sound economic management (and the implementation of an IMF programme) and poverty reduction (through the implementation of a national Poverty Reduction Strategy Paper, PRSP). A PRSP analyses poverty in the country and sets out what the government will do to reduce it.

The strategy also contains expenditure frameworks which indicate how resources, including savings from debt relief, will be allocated.

10. Debt relief under HIPC is delivered in two stages. Initially countries work towards **'Decision Point'** by developing a PRSP, and establishing a track record of sound economic management, through an IMF Staff Monitored Programme (SMP). When these standards have been met, interim debt relief is delivered, meaning that debt service payments are considerably reduced. Countries then work towards **'Completion Point'** and irrevocable debt stock cancellation by implementing their PRSP for at least a year. They must also continue their sound economic management under an IMF programme, as well as implementing any other reforms ("triggers") they agreed to undertake at Decision Point. 'Decision Point' and 'Completion Point' status is decided by the Executive Boards of the IMF and World Bank and subsequently by the Board of the relevant Regional Development Bank. The Paris Club group then follows this lead.

11. Overall, debt relief worth over $100 billion has been agreed under HIPC for 36 countries so far. This has reduced their debts, on average, by around two-thirds, and freed up roughly $1 billion a year for spending on poverty reduction.

12. The table on the following page shows the progress of eligible countries through the HIPC Initiative. Thirty-four countries have now completed the HIPC Initiative and received irrevocable debt relief. Four other countries are receiving interim relief. A further four countries are eligible for HIPC but have yet to progress through the Initiative. For the remaining countries slow progress through HIPC is often the result of governance problems or conflict. A further two eligible countries, Sri Lanka and Lao PDR, have decided not to participate in HIPC.

Implementation status of Heavily Indebted Poor Countries (HIPC) Initiative

	Decision Point	Completion Point Date
Countries at Completion Point		
Afghanistan	July 2007	Jan 2010
Benin	July 2000	Mar 2003
Bolivia	Feb 2000	Jun 2001
Burkina Faso	July 2000	April 2002
Burundi	Aug 2005	Jan 2009
Cameroon	Oct 2000	Apr 2006
Central African Republic	Sept 2007	June 2009
Congo (Dem Rep)	July 2003	June 2010
Congo (Rep of)	Mar 2006	Jan 2010
Cote D'Ivoire	April 2009	June 2012
Ethiopia	Nov 2001	April 2004
Gambia	Dec 2000	Dec 2007
Ghana	Feb 2002	July 2004
Guinea	Dec 2000	Sept 2012
Guinea-Bissau	Dec 2000	Dec 2010
Guyana	Nov 2000	Dec 2003
Haiti	Nov 2006	June 2009
Honduras	July 2000	April 2005
Liberia	Mar 2008	June 2010
Madagascar	Dec 2000	Oct 2004
Malawi	Dec 2000	Aug 2006
Mali	Sept 2000	Mar 2003
Mauritania	Feb 2000	June 2002
Mozambique	Apr 2000	Sept 2001
Nicaragua	Dec 2000	Jan 2004
Niger	Dec 2000	April 2004
Rwanda	Dec 2000	April 2005
Sao Tome and Principe	Dec 2000	May 2007
Senegal	June 2000	April 2004
Sierra Leone	Mar 2002	Dec 2006
Tanzania	April 2000	Nov 2001
Togo	Nov 2008	Dec 2010
Uganda	Feb 2000	May 2000
Zambia	Dec 2000	April 2005
Countries at Decision Point (interim relief)		
Chad	May 2001	
Comoros	Jun 2010	
Pre-Decision Point Countries		
Eritrea		
Somalia		
Sudan		
In addition, two eligible countries have opted not to participate in HIPC at this stage:		
Lao PDR and Sri Lanka		

DFID Aid Debts

13. DFID has cancelled all of its eligible aid debts for low income countries by **Retrospective Terms Adjustment (RTA),** providing over £1.3 billion of debt relief since 1978.

14. Debt relief is cancelled by the benefiting country during the year the terms are agreed. However, for RTA, *Statistics on International Development* reflects the money available to the country each year that would otherwise have been spent on debt servicing by reporting annual sums of debt relief. This is, effectively, converting loans to grants.

15. The outstanding amount still to be reported under RTA reduced to a minimal level by 2006/07. As such, the outstanding sum that would normally be reported each year in SID was combined into a single lump sum that was reported in SID 2007. As such 2006/07 was the final year for which SID reported RTA debt relief[2].

16. In September 1997, the UK also launched the **Commonwealth Debt Initiative (CDI)** to provide relief on the remaining aid debts of lower-middle income Commonwealth countries. In order to benefit, countries were required to demonstrate their commitment to poverty reduction and the Millennium Development Goals, sound economic management, accountable and transparent governance and efforts to reduce corruption. To date, 12 countries (predominantly in the Caribbean) have benefited from debt relief under CDI. Under CDI, assessment either recommended the debt was written off in perpetuity or written off annually subject to assessment each time

Multilateral Debt Relief

17. Despite the successes of HIPC, debt owed by the poorest countries to multilateral institutions such as the World Bank, African Development Bank and IMF remained a significant burden to them. The UK therefore used its Presidencies of the G8 and EU in 2005 to promote 100 per cent debt relief by multilateral institutions to match the 100 per cent relief already being given by many bilateral creditors.

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[2] Due to a change of policy at the DAC all remaining RTA debt relief was reported to the DAC in a lump sum in 1999.

18. In 2005, the G8 agreed a proposal for a **Multilateral Debt Relief Initiative (MDRI)** that would cancel 100 per cent of the remaining debts of HIPCs to the concessional lending arms of the World Bank (IDA), IMF and African Development Bank (AfDB). Following agreement by the Boards of Governors of the World Bank, IMF and AfDF, the MDRI was implemented in 2006. Overall MDRI is worth over $50 billion to 40 countries, resulting in 100 per cent debt cancellation when countries reach HIPC 'Completion Point'. So far, MDRI has delivered over US$51 billion worth of debt cancellation.

19. Donors agreed to fully compensate the Banks for the debt service that HIPC countries would otherwise have paid. These additional funds will be allocated to all poor countries using the institutions' performance-based allocation systems. After 'Completion Point' is achieved, no further conditions are attached to MDRI and post-Completion Point HIPCs receive this automatically as soon as they qualify for HIPC debt cancellation.

20. The UK has committed to paying its share of the costs of the MDRI at the World Bank and African Development Bank by additional contributions to IDA and AfDF from 2006/07 onwards. Under this commitment the UK has already contributed £250 million to IDA and £44 million to the AfDF in debt cancellation. The costs of MDRI debt relief at the IMF were largely met from internal resources. The G8 however, agreed to provide additional resources to the IMF to ensure that it was able to continue to lend on concessional terms. In March 2006, the UK made a payment of £14 million to the IMF as part of this.

21. In addition to participation in the MDRI, the UK has its own initiative to pay its share (10 per cent) of qualifying non-HIPC poor countries' debt service to IDA and AfDB until 2015 under the UK Multilateral Debt Relief Initiative (UK MDRI). In 2008 the UK changed the eligibility criteria for the initiative, in order to provide a clearer focus on good public financial management as a basis for countries being able to demonstrate the debt relief will be used for poverty reduction. In 2010 countries were also asked to set out how they use the funds provided by the UK under the scheme. In 2012 five countries are eligible for this support: Lesotho, Nepal, Samoa, Vanuatu and Vietnam.

23. DFID debt relief given under RTA, CDI, HIPC and MDRI in recent years is included in Tables 3, 4, 13, and 14 under 'DFID Debt Relief'.

UK Aid Debts

24. UK debt relief under the **Heavily Indebted Poor Countries (HIPC) Initiative** covers debt relief on bilateral export credit and CDC loans to governments.

25. 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 for contracts. Developing countries can acquire debt, however, if they default on paying for these goods and services.

26. 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 generally agreed in the Paris Club and are conditional on the debtor country following sound economic policies, agreed with the International Monetary Fund (IMF). Bilateral export credit debt is UK official debt, and so is eligible for debt relief under HIPC and other internationally agreed debt relief deals.

27. The UK exceeds its commitment under HIPC by providing **100 per cent cancellation** of bilateral debts for qualifying countries. 100 per cent debt service relief is provided from Decision Point and 100 per cent cancellation at completion point. ECGD meets the costs of the relief agreed at the Paris Club and DFID pays for whatever additional relief is needed to bring the total to 100 per cent. DFID payments to ECGD under this HIPC 100 per cent relief policy are recorded as **'Bilateral HIPC'**. 'Bilateral HIPC' payments also include reimbursements to countries under the 'Hold in Trust' Policy[3].

28. Table 5 contains details of debt relief given by ECGD. The total ECGD debt relief for 2011/12 was approximately £91 million[4]. ECGD and CDC debt relief are combined in Table 2 under Debt Relief[5].

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[3] From December 2000, the UK has held in trust any debt service payments received from pre-Decision Point HIPC countries. This money is then reimbursed for spending on poverty reduction when the country reaches Decision Point.

[4] The debt formally written off was for Iraq £275,377,243.98 and US$ 8,431,264.73 (effective date 16/12/08)

29. CDC (as described in the Glossary) had a portfolio of loans to governments. These are now 'DFID Public Sector Loans' managed by Actis but referred to as 'CDC Loans'. From 2008 these loans have been managed and administered directly by DFID. This is UK official debt and so is eligible for debt relief under HIPC and other internationally agreed debt deals.

[5] ECGD/ CDC debt relief is reported as UK ODA in the relevant year on a net basis (i.e. with deductions for any repayments made).