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# A Chameleon Called Debt Relief

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## Table of Contents


| | | |
|---|---|---|
| Abstract | | 5 |
| Acknowledgements | | 5 |
| 1. | Introduction | 6 |
| 2. | Debt relief as seen from an aid modality perspective | 7 |
| 2.1. | Conditionality and alignment | 7 |
| 2.2. | Cash flow equivalence between debt relief and aid | 9 |
| 2.3. | A chameleon called debt relief | 10 |
| 2.3.1 | Debt relief before the HIPC Initiative | 12 |
| 2.3.2 | Debt relief under the HIPC Initiative | 16 |
| 2.3.3 | Debt relief beyond the HIPC Initiative | 18 |
| 3. | Insights for debt relief policy | 21 |
| 3.1. | Assessing the chameleon | 21 |
| 3.1.1 | Debt relief effectiveness at output level | 22 |
| 3.1.2 | Debt relief effectiveness at outcome level | 22 |
| 3.1.3 | Debt relief relevance | 23 |
| 3.2. | Debt relief as disguised budget support | 24 |
| 3.3. | Debt-for-development swaps strike back? | 25 |
| 4. | Conclusions | 27 |
| References | | 28 |

## Abstract

This paper critically reviews three decades of official creditors' debt relief practice in Sub-Saharan Africa from a novel angle, i.e. along debt relief's similarities with other aid modalities. We show that debt relief is a true 'chameleon' which mimics different sorts of aid, from traditional project aid to multi-year general budget support. The 'colour' of this chameleon depends on the embedded conditionality, alignment and the budgetary resource effect of particular debt relief interventions. We argue that characterising debt relief from an aid modality perspective is helpful in better understanding its widely varying performance track record and holds important policy lessons for designing future operations.

**Keywords**: debt relief; HIPC; MDRI; aid modalities; budget support; Sub-Saharan Africa

**JEL codes**: F34; F35; H64

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# 1. Introduction

During the past three decades external debt relief has presented itself as an important form of assistance provided to developing countries in Sub-Saharan Africa and elsewhere; most of this relief has been bestowed by official creditors, who are at the same time Africa's principal donors of more traditional aid, or has been financed by them. In 1988 the Paris Club, an informal grouping of bilateral creditors, decided to grant low-income countries common debt rescheduling terms that included an element of debt reduction (the so-called 'Toronto-terms'). A more comprehensive debt relief scheme, involving debt owed to multilateral institutions and private creditors, was devised in 1996, with the start of the Heavily Indebted Poor Country (HIPC) Initiative, and extended in 2005, when the HIPC's successor, the Multilateral Debt Relief Initiative (MDRI), was launched. Recently, more ad-hoc debt relief has been granted to countries outside these major international initiatives, including through debt-for-development swaps, a technique borrowed from commercial debt swaps popular in the 1980s and early 1990s.

This paper critically reviews past sovereign debt relief practice from a novel angle, with a special focus on the African experience. We discuss and assess debt relief along its similarities with other types of aid. Although, intuitively, debt relief is most easily thought of as a kind of budget support (since it frees up resources in the government budget otherwise spent on servicing debt), we show that such an analogy is often incorrect. Instead, we argue that debt relief is a true chameleon; over time it has mimicked various, distinct forms of aid, ranging from old-style project aid, over balance of payment (BoP) aid in support of structural adjustment, up to sector budget support (SBS) and even multi-year general budget support (GBS). The exact 'colour' of the chameleon depends on the conditionality embedded in the relief operation, such as the degree of earmarking of freed-up funds, and the alignment with recipient country policies and systems, as well as on its budgetary resource effect. What is more, similar to a chameleon, debt relief has often taken on a colour close to that of the dominant mode of aid delivery at a given point in time. We believe that looking at debt relief from an aid modality perspective as proposed in the paper helps one better understanding debt relief's mixed performance track record and sheds new light on a number of related policy-relevant themes.

The remainder of the paper is structured as follows. Section 2 begins by laying out the conceptual framework which the paper will use to study debt relief, focussing on two main dimensions: first, the different forms of 'strings attached' to aid (and debt relief) interventions (i.e. conditionality) and their degree of alignment and, second, the cash flow equivalence between debt relief and aid. A third subsection then applies this framework to classify three generations of debt relief (pre-HIPC, HIPC and beyond-HIPC) into aid modality categories. These constitute the different guises of the chameleon called debt relief. Section 3 demonstrates the value added of the paper's aid modality perspective. First, we point out the parallels between the nature of particular debt relief interventions and the results of various evaluation studies on the effectiveness at output level, effectiveness at outcome level, and relevance of debt relief. In a second and third subsection we formulate a number of policy lessons for the design of future interventions, for when debt relief becomes a form of disguised budget support and with respect to the recent return of debt-for-development swaps. Section 4 concludes.

## 2. Debt relief as seen from an aid modality perspective

It is generally accepted that official debt relief is just another aid instrument at the disposal of donors-creditors (Berlage *et al.*, 2003). However, what is often far less well-understood, and almost never made explicit in the literature, is the fact that not all debt relief by bilateral and multilateral donors can be treated as being homogeneous. The main purpose of the current paper is to show that debt relief can take many forms and shows striking similarities with several other, particular aid modalities; hence our characterisation of debt relief as a chameleon. Before starting our classification of three decades of debt relief we introduce a number of concepts we need to point out debt relief's similarities with different aid modalities, in the spheres of aid conditionality and alignment, and of cash flow effects.

### 2.1. Conditionality and alignment

Conditionality is an important ingredient of (almost) any development aid intervention. In essence, conditionality is what distinguishes aid from other hard currency recipient country resources such as, say, those coming from oil (or other) exports, since it reduces the available policy space to use such resources freely (see Collier, 2006).[1] By attaching conditionality to their aid, donors attempt to influence, in a direct way, the utilisation of funds (through earmarking; see further), or, more indirectly, try to change recipient country behaviour, using either *ex ante* (by stimulating good behaviour) or *ex post* (by rewarding good behaviour) incentives. As we will point out in section 2.3, this also applies to debt relief interventions.

The kind of conditionalities preferred by donors has evolved over time, gradually moving away from strict ring-fencing of funds for particular aid projects to a more subtle 'nudging' of the recipient country through policy dialogue on poverty reduction and good governance (see Koeberle *et al.*, 2005). This important shift in donor thinking has led to the emergence in the late 1990s and early 2000s of what has been labelled the 'new aid paradigm' or 'new aid agenda', centred around the need for low-income aid recipient countries to develop home-grown Poverty Reduction Strategy Papers (PRSPs) (see e.g., Killick, 2004; Molenaers and Renard, 2009; White, 2001). These PRSPs set out a country's medium-term macro-economic, structural and social policies and programmes aimed at growth and poverty reduction (as well as the associated financial plans) and are prepared in a supposedly consultative manner by the government, domestic stakeholders and external development partners (bilateral and multilateral donors).[2]

Evidently, in concert with changes in conditionality sets, decades of development assistance have also altered the way policy makers think about what constitutes best practice in aid delivery. Most would now agree that 'old-style' project aid, whereby donors take the lead in deciding on and micro-monitoring every single dollar they provide, is neither an effective nor a sustainable form of aid. Also the Structural Adjustment Programmes (SAPs) of the 1980s and early 1990s accompanying the BoP support of the Bretton Woods institutions have been largely discredited for their dogmatic, one-size-fits-all macro-economic policy prescriptions (enshrined

[1] In engaging with the question of whether aid to Africa should be scaled up (and if so, under which conditions), Collier (2006) compares different forms of aid, *including* debt relief (next to technical assistance, projects and BoP support), to oil and other resource rents received by African governments. Our analysis is complementary to his, in the sense that this paper attempts to tease out the similarities *between* debt relief and other forms of aid. Unlike Collier, however, we do not conceptualise debt relief as a homogeneous category.

[2] The PRSP Sourcebook, which functions as a guide to assist low-income countries in developing and further strengthening their strategies for poverty reduction, can be found at http://go.worldbank.org/JFURoKRGDo.

in the Washington Consensus) and tunnel vision on economic growth (for a self-critical report, see Dollar and Pritchett, 1998).

Conversely, donor pledges in recent years, most notably the Paris Declaration on Aid Effectiveness (2005), Accra Agenda for Action (2008) and Busan Global Partnership for Effective Development Cooperation (2011), indicate increased attention to policy and system alignment. 'Policy alignment' signifies that donors commit themselves to base their support on developing countries' national development strategies, while 'system alignment' refers to them hinging on a recipient country's own institutions and systems for decision-making, implementation and monitoring and evaluation (M&E) where such institutions and systems are deemed reliable, effective and accountable (see OECD, 2008, 2011a).

These alignment principles can accommodate diverse modes of aid delivery, including 'new-style' projects that continue to earmark funds to specific, predetermined purposes but are better in line with recipients' policies and systems than their 'old-style' predecessors. Following the logic of the Paris Declaration and the new aid agenda, however, the dominant aid modality should progressively evolve to budget support, both SBS and GBS. These latter aid forms are per definition sector- or non-earmarked, meaning that donors pool their funds with regular government (tax) revenues, and leave it to existing country systems to spend resources according to sector/national priorities, based on mutual trust and regular policy dialogue between donor and recipient. In principle, when both donor and recipient are committed to development, budget support should be superior to other aid forms, say project aid (Cordella and Dell'Arricia, 2007).

Even if the just-described views on conditionality and alignment are generally subscribed to by the donor community, this is not to say that the transition of older towards newer (and supposedly more effective) aid modalities is complete (or will ever be complete, for that matter).[3] The latest monitoring survey on Paris Declaration commitments shows that some progress has been made but that the goals set for 2010 have been missed, often by a wide margin. On policy alignment, it is reported that only 41% of aid for the government sector is reported on-budget (against a target of 85%). Also system alignment goals are far from accomplished; 52% of government sector aid does not use countries' own public financial management systems (target: 45%) and the number of parallel project implementation units (PIUs), OECD jargon for donor structures set up to implement aid-funded activities, is still double of what it ought to be (OECD, 2011b). It is thus clear that different aid modalities, in and out of line with donors' stated preferences, coexist.

As we will show, debt relief is a true chameleon. Often it mimics the aid modalities that are considered best practice at the time. But, similar to traditional aid, disparate debt relief modalities may exist side-by-side. Before we categorise different debt relief interventions, however, let us first examine more closely the cash flow equivalence between debt relief and aid, another important dimension on which the appearance of the chameleon depends. To be sure, many of the effects that one may expect from debt relief are closely linked to the actual budgetary resources that are freed up by such an intervention.

[3] In fact, in the last few years one can observe in the practice of some donors, even those that started out as leading proponents of the new aid agenda and its emphasis on budget support, a tendency towards stricter earmarking and donor control on the aid given (see e.g., ICAI, 2012, p. 3). One reason may be the dire fiscal situation these donors find themselves in today, which increases the need to better demonstrate what has been achieved with tax payers' money (and hence induces a shift towards aid instruments that yield more easily identifiable results).

## 2.2. Cash flow equivalence between debt relief and aid

A traditional aid intervention is always to be seen as an increase in the international purchasing power of the recipient country; new aid constitutes an inflow of foreign currency, at least in a BoP sense, and, if granted to the country's government sector, also in a fiscal sense. In theory, debt relief brings about an equivalent net foreign currency cash flow effect, as foreign currency *out*flows, under the form of debt service payments, do no longer occur.

The nominal amount of debt cancelled is, however, not necessarily a good indicator of this net cash flow effect of debt relief (and therefore of debt relief's equivalence to new aid inflows), for a number of reasons. In the same way, nominal debt relief figures will in general not give a realistic approximation of the amount of additional resources that become available in the recipient country government budget, often referred to as 'fiscal space' (see Heller, 2005).

First of all, (budgetary) net cash flow gains from debt relief only gradually materialise over time, i.e. at the pace of the contractual debt service payments cancelled (the exact timing depending on the specific repayment terms and schedule). In order to be able to compare debt relief and aid inflows properly, one should use the *present value* (PV) of debt relief. This concept takes into account the time value of money, discounting payments that are due in the future at an appropriate discount rate (usually a market-based interest rate). The PV of debt relief is then the sum of all discounted future contractual debt service payments cancelled on the debt relieved. Whenever the debt concerned carries a below-market interest rate, and/or the repayments are due over a large time span (e.g., in the case of concessional loans), the PV of debt relief will be markedly lower than its nominal value. Even an intervention that yields considerable debt relief in PV terms may have limited debt service relief consequences in the short term if all original repayments would have taken place in the more distant future.

Second, when calculating the PV of debt relief one (implicitly) disregards the possibility that debt would not have been fully serviced in the absence of the debt relief operation. Such an assumption is unrealistic, especially for countries with debt service difficulties. If not all debt would have been serviced, the eventual cash flow effect of debt reduction is (at least partly) illusive, no more than an 'accounting clean-up of historical and future arrears accumulation' (Cassimon and Vaessen, 2007, p. 14). Only the share of debt service that would have been actually paid up to the creditor in the counterfactual no-debt-relief scenario generates real fiscal space. This brings us to the concept of the economic value (EV) of debt relief, which can be expressed as follows (Renard and Cassimon, 2001):

$$EV = \sum_{t=0}^{n} \frac{S_t (1 - d)}{(1 + i)^t}$$

whereby:

*EV* : the economic value of debt relief, representing the direct (budgetary) benefit of debt relief, comparable to a new foreign currency aid inflow;

$S_t$ : the contractual debt service (principal plus interest) in year *t*, from the present year *0* to the year *n* in which the final repayment would have been made;

*d*: the percentage of future non-payment in the counterfactual situation, i.e. the percent age of default by the debtor that would have taken place in the absence of the debt relief intervention;

*i*: the appropriate discount rate from the debtor country's perspective, i.e. the interest rate at which the country could bring the debt service payments forward in time.

The bottom line here is that, in order to equate the cash flow impact of debt relief with that of the aid intervention it mimics, say, GBS, one has to consider the EV rather than the nominal value of debt relief. Take the extreme case where the EV of debt relief is zero; then even a debt relief intervention that imitates GBS, at least from a conditionality and alignment perspective, may be completely fictitious, pure 'wind', from a cash flow perspective, as distinct from 'oil' as possible.[4]

The story does not end here. A third issue one needs to take into account when investigating debt relief-aid cash flow equivalence is that debt relief operations may lead to the crowding out of other, potentially more effective aid interventions. All too often it is assumed that debt relief comes on top of all other forms of donor support. However, full additionality should not automatically be taken as the default; substitution of donor effort may well be at play.[5] The degree of additionality is indeed one of the crucial elements in assessing debt relief operations (see section 3.1).

A last point worth making is that the literature on debt relief also considers the possibility that relief operations, by lowering the overall outstanding debt *stock*, could have beneficial cash flow effects beyond the simple cancellation of debt *service*. According to the theory of 'debt overhang', a country burdened by large debts has no incentive to engage in reforms to attract private (domestic and foreign) investment since any economic progress will benefit the country's creditors first (through increased debt service); hence, economic growth will be dim and debt will increase further (Bulow and Rogoff, 1991; Deshpande, 1997; Krugman, 1988). If we take this theory at face value, eliminating the overhang through (sufficiently large) debt stock relief has the potential to break that vicious circle and catalyse investment. This would give such debt relief an edge over new aid inflows.

Having introduced the necessary elements to compare debt relief with other, more traditional aid modalities, we now move to the actual classification of debt relief interventions into different categories. This is how we get to know the chameleon called debt relief in its various guises.

## 2.3. A chameleon called debt relief

For the purposes of our analysis we will consider three 'generations' of debt relief: the pre-HIPC era (1); the HIPC initiative itself (2); and those initiatives that go beyond HIPC (3).[6] Also, we differentiate between the relief given on debt owed by African countries to official/public creditors, i.e. (Paris Club) bilateral donors and multilateral institutions such as the IMF, World Bank and African Development Bank, and on debt owed to commercial/private creditors. Table 1 summarises the discussion contained in the following subsections.

[4] Note that this does not necessarily mean that the debt relief intervention is of no value to donor and recipient, since the conditionalities attached may have very useful indirect effects (a point to which we return in section 3.1). It only means that, unlike with a traditional aid inflow, the real resource transfer does not materialise.

[5] In fact, the OECD's Development Assistance Committee (DAC) aid accounting rules leave the door open for such substitution. In some instances, donors are allowed to bring in the full nominal value of debt relief as Official Development Assistance (ODA), the main benchmark for donor generosity used by the DAC. Of course, to avoid double counting, for relief on debt titles that already previously qualified as ODA, only the interest (and not the principal) component of the debt forgiven may be recorded as new ODA. For more on the complex matter of aid accounting (with applications to debt relief) we refer to Renard and Cassimon (2001). OECD-DAC (2000) provides a full, detailed account of official DAC rules for debt reorganisation and relief reporting by bilateral donors.

[6] The HIPC Initiative was chosen as a point of reference in the (more than five-decade long) history of debt relief because of its pivotal and still central role in international debt relief practice (see section 2.3.2). The three generations or phases of debt relief we identify should not be seen as strictly chronological and are, at least partly, overlapping.

### Table 1.: A chameleon called debt relief

| Generation of debt relief (per creditor type) | IMF programme? (Yes/No) | Type of earmarking | Explicit link to development or poverty reduction? | | System-aligned? (Yes/No) | Other conditions? | So debt relief looks very much like… | Aid cash flow equivalence |
|---|---|---|---|---|---|---|---|---|
| | | | Yes/No | Policy-aligned? | | | | |
| ***Official creditors*** | | | | | | | | |
| (1) Pre-HIPC Paris Club debt relief | | | | | | | | |
| debt service/stock relief | Yes | Non-earmarked | No | - | - | None | BoP support | Close to zero |
| debt-for-development swaps (first wave) | No | Micro-earmarked | Yes | Typically not | No | None | Old-style project aid | Close to zero |
| (2) HIPC Initiative | | | | | | | | |
| original (1996) | Yes | Non-earmarked | No | - | - | Triggers | BoP support | Partial |
| enhanced (1999) | Yes | Non-earmarked | Yes | Yes, with PRSP (NDS) | Yes, but… | Triggers | In principle GBS | Partial |
| (3a) Additional bilateral debt relief | Yes | Non-earmarked | Yes | Yes, with PRSP (NDS) | Yes | None | GBS | Close to nominal value |
| of which C2D | Yes | Macro-earmarked | Yes | Largely with PRSP | Yes | None | (Multi-)sector SBS | Close to nominal value |
| (3b) MDRI | Yes | Non-earmarked | Yes | Yes, with PRSP (NDS) | Yes | None | GBS | Close to nominal value |
| (3c) Debt-for-development swaps (second wave) | No | Micro-earmarking | Yes | No/Yes | No/Yes | None | Old-style project aid/ New-style project aid | Case-specific |
| ***Commercial creditors*** | | | | | | | | |
| (1) Pre-HIPC debt relief | | | | | | | | |
| London Club debt relief | No | Non-earmarked | No | - | - | None | Oil | Close to zero |
| debt swaps | No | Micro-earmarking | No/Yes | Typically not | No | None | Old-style project aid | Close to zero |
| large debt exchanges (e.g. Brady bonds) | No/Yes | Non-earmarked | No | - | - | Sometimes recaps | Oil/ BoP support | Secondary market value |
| IDA Debt Reduction Facility | Yes | Non-earmarked | No | - | - | None | BoP support | Secondary market value |
| (2) HIPC Initiative | Yes | Non-earmarked | Yes | Yes, with PRSP (NDS) | Yes, but… | Triggers | In principle GBS | Partial |

*Source: Authors' own elaboration.*

*Notes: HIPC= Heavily Indebted Poor Country; MDRI= Multilateral Debt Relief Initiative; PRSP= Poverty Reduction Strategy Paper; NDS= National Development Strategy; BoP= balance of payments; GBS= general budget support; SBS= sector budget support; C2D= Contrats de Désendettement et de Développement; IDA= International Development Association*

### 2.3.1 Debt relief before the HIPC Initiative

In the 1970s and early 1980s, official creditors' main motivation in assisting debtor countries with bridging periods of debt repayment problems (mostly due to a commodity price boom and bust, accompanying the oil crisis and a global recession) was to avoid imminent default and thus to increase chances of recuperating the whole of claims they held. Organised in the Paris Club, these creditors adopted an ad hoc, short-term perspective on debt relief, rescheduling debt service on a case-by-case basis and at market interest rates (Cosio-Pascal, 2008).[7] As a result, many debtor countries could not but return several times to the Paris Club. The Democratic Republic of Congo (then still Zaire), the first African country to solicit Paris Club assistance[8], signed four consecutive agreements with its major creditors in just six years (in 1976, 1977, 1979 and 1981).

The debt crises of the 1980s, triggered by the Mexican default in 1982, saw ever more countries turn to the Paris Club for debt restructuring. Between 1982 and 1987, no less than 24 Sub-Saharan African countries concluded Paris Club debt deals; most of them underwent at least two debt treatments (Côte d'Ivoire, the Democratic Republic of Congo, Madagascar and Niger each had four and Senegal had five). By the mid-1980s it became increasingly clear that repeated short-term debt service rescheduling would not solve the deeper-rooted problem of unsustainable debt burdens which many of the poorest developing countries continued to accumulate.

In 1987 the Special Program of Assistance for Africa (SPA) was established as an informal consortium of leading bilateral donors (and creditors) to debt-distressed African countries, together with the IMF and the World Bank's concessional lending arm, the International Development Association (IDA). In the SPA, traditional structural adjustment financing of the IDA and IMF was coupled with bilateral debt relief (on concessional ODA debt), with the resumption of economic growth as its primary goal. Under the SPA's 'fifth dimension', bilateral donors also provided extra financing to offset African debt service payments to the World Bank.

Following a G-7 summit in Toronto, in 1988 Paris Club creditors decided on a menu of restructuring options for the non-concessional (i.e. non-ODA) debt of low-income countries in Africa. These Toronto terms allowed for a debt *reduction* (rather than *rescheduling*) by up to 33% in PV terms, either through lowering principal repayments or by setting a below-market interest rate on the consolidated debt.[9] The percentage PV reduction of debt was raised to 50% when the London terms supplanted the Toronto terms in 1991. The London terms also contained a clause with the possibility of debt stock reduction three or four years after the initial agreement, given that countries maintained good relations with their creditors and stayed current on IMF programmes (Vilanova and Martin, 2001). Starting with Mali, again 22 African countries enjoyed these new Toronto and/or London debt treatment schemes between 1988 and 1994.

Another G-7 meeting paved the way for the introduction end 1994 of the Naples terms, augmenting debt reduction to a maximum of 67%. Besides another increase in conces-

[7] Technically speaking, short-term rescheduling at market interest rates yields no genuine debt *relief*, not in nominal terms and not in PV terms. Some individual Paris Club creditors complemented the ad hoc agreements on non-ODA debt by forgiving all or part of their concessional ODA loans to low-income countries (Gamarra *et al.*, 2009).

[8] Some sources regard the 1974 exceptional treatment of Ghanaian debt by its creditors as the first African Paris Club deal (Cosio-Pascal, 2008; Gamarra *et al.*, 2009). On the Paris Club's own website this early deal with Ghana is not listed. See http://www.clubdeparis.org.

[9] The menu also included a third ('commercial') option whereby the debt claims would be spread out over a longer (25-year) repayment period, but at a market interest rate. In this case there is neither a nominal, nor a PV reduction of debt.

sionality, the Naples terms broadened the stock approach to debt relief for those countries that could convince their creditors that they would no longer need further debt rescheduling upon receiving such a debt stock treatment. In February 1995 Uganda became the first country to benefit from a debt stock 'exit' arrangement (Gamarra *et al.*, 2009). The following months Chad, Guinea-Bissau, Mauritania, Senegal and Togo also entered into Naples terms agreements.

In addition, by 1990 the Paris Club had prompted a new Houston terms debt treatment, introducing a number of enhancements with respect to the earlier classic terms (but no debt reduction) for *lower middle-income* countries. Between 1990 and 1995, these Houston terms benefitted four African countries (Cameroon, Congo, Côte d'Ivoire and Nigeria) that were initially excluded from concessional treatments.

As listed in Table 1, all of the pre-HIPC debt service (and later, debt stock) relief in the Paris Club, be it under classic, Toronto, London, Naples or Houston terms, or just ad hoc arrangements, had essentially no other conditionality attached than the need for recipient countries to have an active IMF programme in place (and to show sufficient progress on that programme). There was no particular earmarking, and certainly not to development or poverty reduction spending. As such, this type of debt relief very much behaves like the typical BoP-cum-structural adjustment support granted by the IMF and World Bank in the 1980s and early 1990s. This is particularly clear for debt relief in the framework of the SPA, where it was part of a much broader BoP support package (see before).

Evaluating the cash flow effects resulting from particular debt relief interventions is always a daunting task since it requires estimating a counterfactual, i.e. the share of debt obligations that would have been repaid in the absence of the intervention (or *(1-d)* in the formula we presented in section 2.2). For the purpose of our conceptualisation of debt relief as an aid modality it suffices to say that most, if not all, of the pre-HIPC debt service and stock relief involved obligations that would not have been honoured in any case (in other words, *d* was close to 1). Much of the debt forgiven in pre-HIPC Paris Club deals was already in arrears; the agreements made were therefore primarily accounting exercises with very limited cash flow impact. The fact that the average African debtor country turning to the Paris Club between 1976 and 1995 did so more than four times[10], is testimony to the severity of debt servicing problems (and therefore to the likelihood of default) and further strengthens our assertions.

Another sort of pre-HIPC debt relief by official creditors is that provided through so-called 'debt-for-development swaps'. Since the inception of London and Houston terms, Paris Club menus offered the possibility of converting, on a voluntary and bilateral basis, ODA debt or part of non-ODA debt into commitments by the debtor country for 'counterpart' local currency investments with social, commercial or environmental finality. This debt swap provision built further on the debt-for-equity and debt-for-nature swaps that had been conducted from the mid 1980s onwards with claims of commercial creditors traded on the secondary market (see Buckley, 2011a; Moye, 2001; Ruiz, 2007). Examples of early, pre-HIPC debt-for-development swaps between official bilateral creditors and African debtor countries include the swap deals between France and the francophone governments of Cameroon, Congo, Côte d'Ivoire and Gabon following the set up of the US$ 800 million Libreville Fund in 1992.

In principle, most pre-HIPC debt swaps did not require the debtor's engagement

[10] The outliers are Senegal, Togo and the Democratic Republic of Congo which signed 11, 10 and nine agreements, respectively, with the Paris Club in that period. Angola, Ethiopia, The Gambia and Kenya, on the other hand, each had only one Paris Club deal.

in an IMF programme.[11] On the other hand, there was often a more explicit link to development or poverty reduction, accomplished by very strict *micro*-earmarking of the local currency funds released through the debt swap to specific aid projects. These funds were typically placed into counterpart accounts, outside the debtor government budget and bypassing the government's own public institutions and systems. Resource allocation was also regularly donor-imposed, rather than following national development priorities. In the Libreville initiative, for example, all projects to be funded by swaps needed separate approval by the *Agence Française de Développement* (Gamarra *et al.*, 2009). In this respect, early debt-for-development swaps very much resemble old-style project aid, exhibiting low levels of policy and system alignment. As with pre-HIPC debt service and stock relief, many of the swapped debt titles would not have been paid in absence of the swap operation. Hence, the expected cash flow effects are again near-zero.[12]

During much of the 1970s and 1980s relief on external debt owed to commercial creditors followed a pattern similar (but not identical) to that of official creditor debt relief. First, the London club, a special bank advisory committee whose composition reflected the size of individual banks' exposure to the non-performing loans in question, would reschedule principal repayments over a short period. 16 African countries, including some of the very poorest, were involved in such reschedulings between 1980 and 1988 (Gamarra *et al.*, 2009).

Around the same time, a secondary market for the discounted commercial debt of developing countries started to gain ground (see Buckley, 2011b). In this market, investors could purchase debt titles at reduced prices and redeem them with the debtor country in exchange for local currency to be used for buying shares in national companies. This debt-for-equity technique later served as a blueprint for debt-for-nature swaps, in which environmental NGOs acquired commercial debt, trading below par, and swapped it for local currency counterpart funds supporting in-country environmental projects. Following a boom of debt-for-equity conversions in Latin America (countries with substantial amounts of commercial creditor debt), also Zambia and Nigeria experimented with it. Soon after, commercial debt-for-nature swaps came to the African continent too; the first deals were concluded with Madagascar and Zambia, involving Conservation International and the World Wildlife Fund as investors (Deacon and Murphy, 1997). As indicated above, it were such operations that later inspired debt-for-development swaps with official debt.

When the idea that solutions to the debt crises in developing countries would require more than just postponing repayment or swapping *small* amounts of debt permeated the minds of policymakers, this also affected their view on how debt owed to commercial creditors should be dealt with, moving from piecemeal to comprehensive debt restructuring. Most notably, from 1989 onwards commercial creditors could take part in the Brady plan (named after the then US Treasury Secretary, Nicholas Brady), an exchange mechanism devised to support 'voluntary' debt stock and service reduction operations with debtor countries. Participating commercial creditors were given a choice of possible debt-reducing instruments (somewhat akin to the options in Paris Club menus): an exchange of the original loans for bonds with reduced principal; exchanges at par with lower interest rates; and a new money option (refinancing of old loans topped up with additional money) (see Claessens and Diwan, 1994; Vásquez, 1996).

[11] Evidently, as Paris Club consolidation agreements were conditional on having an active IMF programme, so were the debt swaps conducted under such agreements (albeit indirectly).

[12] The cash flow effect of swaps could even be *negative* in some years, to the extent that the required (local currency) counterpart funds exceeded the debt service cancelled.

Again, the Brady plan was targeted primarily at middle-income countries in Latin America, but also included deals with low-income Nigeria (1992) and Côte d'Ivoire (1997).[13] Interestingly, the deal with Nigeria contained a contingency clause allowing the holders of discounted bonds to recapture a portion of the debt reduction in case the export price of oil would rise above a predetermined threshold (which would improve oil exporter Nigeria's debt servicing capacity). Such explicit 'recap' clauses were also present in a number of other Brady deals but, strikingly, have never featured in official creditor debt relief.

1989 also saw the creation of the IDA Debt Reduction Facility (IDA-DRF). Under this World Bank-sponsored facility, low-income debtor governments were typically given grants to use the secondary market to buy back the remaining debts from their commercial creditors at large discounts, thereby effectively eliminating these external obligations; from 2004 on, the IDA-DRF has been explicitly linked to the HIPC Initiative (see section 2.3.2). So far 14 African countries have executed IDA-DRF operations, of which 11 were pre-HIPC.

How can we interpret these forms of private creditor debt relief from the perspective of our framework in Table 1? Unlike most pre-HIPC official operations, the majority of commercial operations did not formally require the debtor's engagement in an IMF (or any other medium-term adjustment) programme, with the notable exception of IDA-DRF buybacks. As such, the debt relief embedded in most of these pre-HIPC commercial operations does not resemble BoP support, contrary to official relief. The early London Club debt service reschedulings came with no further conditionalities or earmarking; so unlike any traditional aid intervention, they were very similar to freely usable resources such as oil revenues (in a Collier, 2006 sense). However, like pre-HIPC Paris Club debt service restructuring operations, much of the debt involved would not have been serviced in the absence of the London Club agreement, and hence, the expected cash flow effects were near-zero. Analogous to debt-for-development swaps contrived by official creditors, the small debt swap operations using commercial debt titles bought on the secondary market applied very strict micro-earmarking of the counterpart local currency funds to specific (often conservation-oriented) projects favoured by NGO investors, which made them again interchangeable with old-style project aid. The fact that secondary markets were active and that debt could be bought at highly reduced prices in those markets, ostensibly seems to indicate that 'bargain' deals were available, at prices closely reflecting the EV of the debt for the debtor. However, as Bulow and Rogoff (1988) showed most convincingly, these secondary market prices reflected the 'on-average' value of debt, not the lower ('marginal') value of small ('marginal') amounts of debt relief, as those debt titles relieved would, most likely, not have been repaid. So yet again, the cash flow effects of these swap deals were close to zero, and, counter-intuitively, debtor countries (or third parties financing these deals) were *over*paying commercial creditors.

In fact, as the same reasoning applies to all kinds of small buybacks and debt exchanges, such operations ideally needed to cover all outstanding debt to assure that observed secondary market prices were appropriate proxies for the EV of debt (relief). The Brady bond deals, as well as more recent debt exchanges, adhere to this principle. Typically, the Brady deals did not stipulate an active IMF programme, in which case the debt relief embedded would come close to being oil; in case a particular deal *did* require an IMF programme, debt relief bore closer resemblance to BoP support. As mentioned earlier, some deals included specific conditionali-

[13] In recent years there have been many other Brady-like bond exchanges (see Das *et al.*, 2012 for an overview). These (large-scale) exchanges of commercial creditor debt have not included African countries, with the exception of Côte d'Ivoire, which renegotiated in 2010 the Brady bonds on which it had defaulted.

ties by which future debt payments were made partly contingent on outcomes (implying explicit burden-sharing between debtors and creditors). Cash flow impacts of the Brady and similar operations are close to the observed secondary market value of the debt concerned. Finally, pre-HIPC IDA-DRF debt relief, due to its medium-term adjustment programme conditionality (but without further strings attached), is also equivalent to BoP support, with cash flow effects approximated by the secondary market price of debt.

### 2.3.2 Debt relief under the HIPC Initiative

Whereas by the mid-1990s the existing debt relief mechanisms seemed to have eased the debt problems of most middle-income countries, the economic prospects of a fair number of low-income countries bearing heavy external debt burdens continued to look bleak. One reason was the increasing share of debt owed to multilateral institutions by these latter countries, debt titles which had been kept out of all traditional debt relief initiatives up till then. In response to this situation, in September 1996 the World Bank and the IMF jointly launched the Heavily Indebted Poor Country (HIPC) Initiative, aimed at committing the international community to bring back to manageable levels the debt burdens of particular heavily-indebted poor countries with a proven track record of strong policy performance and exhibiting a willingness for macroeconomic and structural reform (see Boote and Thugge, 1997). The Paris Club signed in on the new approach and in November 1996 agreed on new Lyon terms for eligible HIPCs, increasing relief to a maximum of 80 percent of the PV of debt.[14]

The HIPC Initiative's objective was to engage in a comprehensive, one-off debt relief effort that would launch even the most-indebted poor countries on a path of economic growth and would free them for good from further debt rescheduling and reduction negotiations. Countries, at least those that could only borrow from the World Bank's IDA, were selected on the basis of their 'unsustainable levels' of debt, defined in terms of debt service-to-exports and debt stock-to-exports ratios above 20-25 percent and 200-250 percent in PV, respectively (i.e. after all other traditional relief mechanisms, such as a Naples terms treatment, had been exhausted).[15]

After having successfully implemented reforms through IMF- and IDA-supported programmes for three years, eligible HIPCs would reach their so-called 'decision point' at which the IMF and World Bank would decide on the amount of debt relief needed (through a debt sustainability analysis or DSA). Another three-year period of programme implementation would then be followed by the HIPC attaining its 'completion point', conditional upon meeting country-specific 'triggers' (in areas ranging from macroeconomic stability, public financial management improvement and debt data collection/publication to health and education sector reforms) and would result in full and irrevocable debt stock relief, bringing down debt to HIPC Initiative thresholds. This final debt reduction would entail the participation of the Paris Club, other bilateral creditors, commercial creditors and multilateral institutions (ideally) to come to an equitable sharing of the costs involved (Boote and Thugge, 1997).[16] Uganda (April 1997), Benin

[14] From this point onwards, international debt relief got on two distinct tracks: one for HIPCs, which would be broadened and deepened in the subsequent years (see further), and one for non-HIPCs, which would largely be a continuation of pre-1996 practices. As most African debtor countries classified as HIPCs we will focus our attention to the first track.

[15] In April 1997 eligibility for the HIPC Initiative was broadened to countries with particularly severe fiscal burden indicators. The threshold was set at a PV debt-to-fiscal revenue ratio of 280 percent (Gautam, 2003).

[16] Multilateral institutions are partly reimbursed by member (creditor) countries for forgoing incoming debt service. Other financing of debt relief costs has come from proceeds of the revaluation of gold (IMF) and profits of lending to middle-income countries (World Bank) (Cosio-Pascal, 2008).

(July 1997) and Burkina Faso (September 1997), which had already benefitted from debt stock reduction on Naples terms and had sustained records of strong performance on IMF programmes before the launch of HIPC, were the first African countries to reach their decision points.

In September 1999, after a thorough review and consultation process (and under the mounting pressure of civil society organisations such as the Jubilee 2000 movement; see Roodman, 2010), the World Bank and the IMF reinvigorated an *Enhanced* HIPC Initiative which was meant to avoid some of the flaws of the original initiative (Gautam, 2003). Four modifications stand out.

First, threshold indicators were lowered, most drastically to a PV debt stock-to-exports ratio of 150 percent, in order to bring more countries into the initiative and provide deeper debt relief for those that were already previously eligible. To assist in this respect, Paris Club creditors again augmented maximum levels of non-ODA debt cancellation in November 1999, with Cologne terms of up to 90 percent PV relief (or more if necessary) substituting the earlier Lyon terms for HIPCs. Second, a 'floating' completion point was introduced (replacing the fixed three-year interim period), to be reached upon the fulfilment of pre-agreed (at decision point) social sector objectives and structural reforms. Third, the enhanced framework opened up the possibility of providing (discretionary) interim debt relief between decision and completion point.

Fourth, and perhaps most importantly, was the establishment of a more explicit link between debt relief and poverty alleviation by means of making debtor countries' process under the HIPC Initiative conditional on the preparation and following up of their PRSPs (see section 2.1). The preparation of a PRSP (or at least an interim version thereof) became a condition to reach decision point. Attainment of the HIPC completion point further required countries to adopt a full PRSP and implement its strategies satisfactorily for minimum one year. PRSP conditionality originating in the HIPC Initiative was very much in accordance with the increasing international attention towards poverty reduction at the turn of the millennium (see e.g., World Bank, 2001) and the PRSP soon became a centrepiece in the IMF and World Bank's overall concessional lending framework.

As of January 2013, debt cancellation under the HIPC Initiative has been approved for 36 countries, 30 of which are Sub-Saharan African.[17] Of these 30 African countries 29 have already passed completion point and one (Chad) has reached decision point. Another three predecision countries (Eritrea, Somalia and Sudan) are considered potentially eligible in the future; their inclusion would bring the number of African HIPCs to a total of 33. According to the latest available estimates, total HIPC debt relief for the 30 post-decision African countries would amount to around US$ 66 billion in nominal terms (assuming full participation of all creditors) (IDA and IMF, 2011).[18] The Paris Club and the largest multilateral creditors, i.e. IMF, IDA and the African Development Bank (which together account for the largest share of the calculated cost of the HIPC Initiative) have provided almost their full share of HIPC debt relief. Contributions by non-Paris Club bilateral creditors, commercial creditors[19] and a group of smaller multilateral creditors are more erratic and in many cases not well-documented.

Turning back to our framework (Table 1), in the absence of any explicit link to a development or poverty reduction agenda (but *with* IMF programme conditionality and country-

[17] The six non-African HIPCs are Afghanistan, Bolivia, Guyana, Haiti, Honduras and Nicaragua.

[18] PV estimates of HIPC debt relief are only available for the whole group of post-decision HIPCs, including non-African countries (US$ 59 billion in end-2010 PV terms), and not for individual HIPCs.

[19] In a few cases, IDA-DRF operations have been set up to ensure commercial creditors' participation.

specific triggers attached), debt relief under the original HIPC Initiative clearly shares features with the more traditional BoP support, as did pre-HIPC debt service and stock relief in the Paris Club. This changed significantly when the Enhanced HIPC Initiative was introduced, complementing standard conditionalities with requirements linked to a recipient country-owned PRSP or other national development strategy documents[20]. HIPC debt relief is, at least in principle, *non*-earmarked, i.e. not tied to financing specific, predetermined activities. It is so-to-speak 'deliberately fungible': funds from debt relief are pooled with the budget and to be spent on the government's priorities as put forward in its national development plans (since 1999, at least). We prefer to label this as non-earmarked use, thereby highlighting the essence of (full) alignment with recipient development priorities, and government systems of planning, implementation and M&E.

However, even within the enhanced HIPC Initiative non-earmarking has not always been a matter of course. In some countries, in particular those whose public financial management systems have been felt to be lacking in quality, HIPC (usually interim) debt relief has relied on stricter forms of earmarking, in principle only as a temporary solution. Sometimes so-called 'institutional poverty funds' have been used, off-budget vehicles having all the characteristics of what we would call micro-earmarking. In other instances, donors have relied on intermediate types of earmarking, such as 'virtual fund mechanisms' (VFMs) in which HIPC relief and its designated expenditures were integrated into the budget, but tracked by means of separate budget lines (rather than being pooled with the rest) (see IDA and IMF, 2001). If non-earmarking is complete, and policy and system alignment are satisfied, the debt relief chameleon behaves much like GBS, albeit in a somewhat disguised way (see section 3.2).

HIPC debt relief is expected to generate cash flows that are at least partially real, and not entirely fictitious (as most pre-HIPC Paris Club deals were), due to its greater concessionality and, importantly, the participation of multilateral creditors such as the IMF, World Bank and the African Development Bank. The latter enjoy a preferred creditor status, which implies that, most probably, their claims would have been redeemed in the absence of the HIPC process.

### 2.3.3 Debt relief beyond the HIPC Initiative

Over the years, most Paris Club creditors have voluntarily decided to go beyond their commitments under the HIPC Initiative, delivering full (100 percent) relief on the eligible debts owed by HIPCs at completion point. This has put pressure on multilateral institutions to do the same. Following the 2005 G-8 summit in Gleneagles, the IMF, IDA and African Development Fund settled on supplementing the HIPC Initiative with the MDRI, in which all remaining claims (disbursed before a certain cut-off date) of these three creditors would be forgiven for post-completion HIPCs. Unlike the HIPC Initiative, the MDRI does not prescribe parallel debt relief by bilateral creditors (Paris Club or not), commercial creditors and multilateral institutions other than the three mentioned.[21] Additional debt relief by non-Paris Club and commercial creditors beyond the HIPC Initiative remains very much ad hoc.[22] The nominal value of debt relief committed under the MDRI has been estimated at almost US$ 38 billion for the 26

[20] Over time (and increasingly so), debtor countries have decided to adopt names (and acronyms) for their national development strategy documents other than the generic 'PRSP'. Well-known examples include Uganda's Poverty Eradication Action Plan (PEAP) and Mozambique's Action Plan for the Reduction of Absolute Poverty (PARPA).

[21] The EU also decided to top up its HIPC commitments with extra debt relief on the European Development Fund's special loans, but only for eligible least-developed countries (LDCs).

[22] No comprehensive data is available for these creditor groups.

African HIPCs that had reached completion point by end-July 2011 (IDA and IMF, 2011).[23]

Typically, Paris Club creditors have not attached extra conditionalities when topping up HIPC debt relief, which makes these additional operations again similar to GBS. One exception that deserves mentioning here is the French *Contrats de Désendettement et de Développement* (C2D) mechanism. For the additional debt relief it provides to HIPCs, France has reverted back to limiting (re-earmarking) the use of freed-up funds to a set of jointly determined activities in several sectors, i.e. *macro-*, or *multi-sector* earmarking. In principle the activities spelled out in a C2D are aligned with PRSP priorities, but this is not necessarily the case for all of them. As such, this specific form of debt relief no longer mimics GBS, but rather (multi-sector) SBS, at best. Multilateral relief under the MDRI is also GBS-like, as it is granted quasi-automatically, without any further conditionality or earmarking, the moment HIPCs fulfil the necessary conditions to reach completion point.

Since these additional relief operations take place *after* debt sustainability has already been attained by means of the HIPC Initiative, the claims to which they apply can be assumed to have been fully serviced otherwise. Hence, the cash flow effects of beyond-HIPC relief are close to the full PV of debt, nothing like pre-HIPC and HIPC relief. Indeed, in IMF documents the MDRI has been described, above all, as an effort to support the progress of HIPCs towards the Millennium Development Goals (MDGs) by freeing-up additional donor resources, more so than as a mechanism to ensure debt sustainability.

Meanwhile, the Paris Club also sought a more tailored response to the debt situation of middle-income countries and other non-HIPCs. Under the Evian approach, adopted in 2003, Paris Club creditors agreed to take into account issues of debt sustainability of non-HIPCs (based on IMF analyses but with discrete decision power resting with bilateral creditors), differentiating between liquidity and solvency problems. In case of the latter, debt relief would be determined on a case-by-case basis and executed through a multi-year three-stage process. Arguably, the large-scale 2005 Paris Club debt treatment of Nigeria, which included a US$ 18 billion write-off, qualifies as a case where the Evian approach provided guidance, although, undoubtedly, political factors played an important role too (Cosio-Pascal, 2008).

The debt of non-HIPCs (and non-eligible debt titles of HIPCs; mostly pre-cut off debt) has furthermore been subject to a new wave of bilateral debt-for-development swap operations between Paris Club members and their debtors. These include, among other, debt-for-nature swaps enacted under the US Tropical Forest Conservation Act (TFCA), debt-for-health swaps under the Debt2Health Scheme of the Global Fund to Fight AIDS, Tuberculosis and Malaria, and debt-for-education swaps. Recent African examples are a TFCA debt swap to fund the conservation of national parks in Botswana (2006); a swap between Germany and Côte d'Ivoire supporting the Global Fund's fight against HIV/AIDS there (2010); and an Italian-Kenyan multi-sector debt-for-development swap programme (2006). Since the introduction of a new law on the management of external debt claims late 2006, Spain has also used debt swaps as an instrument to top up its relief to various African HIPCs (Burkina Faso, Cameroon, Ethiopia, Ghana, Mauritania, Mozambique, Senegal, Tanzania and Uganda).

The nature of the conditionality sets attached, including strict micro-earmarking, and the often limited degree of alignment of debt-for-development swaps give them an appearance close to old-style project aid, quite like their predecessors (and unlike other forms of beyond-HIPC relief). All of the recent Spanish swaps with African countries, for example, have

[23] The end-2010 PV of MDRI debt relief for all post-decision HIPCs together is estimated at around US$ 33 billion.

created separate (local currency) counterpart trust funds, managed and administered by bi-national committees consisting of both Spanish and debtor country members (generally people working in the ministries of finance and/or planning, national treasuries, and/or ambassadors). These are clear instances of parallel PIUs, with no consideration of the quality of recipient countries' own systems. Only if debt-for-development swaps are designed to be policy- and system-aligned, they are similar to what could be branded 'new-style' project aid, a practice more consistent with the new aid agenda. The cash flow equivalence of debt swaps with new aid is very much case-specific, depending on the type of underlying debt and the size and timing of the expected counterpart payments (see section 3.3).

## 3. Insights for debt relief policy

In this section we will show how our characterisation of debt relief as a chameleon allows one to better understand debt relief's mixed performance record, as evidenced in the literature, and to formulate some, albeit preliminary, policy lessons. We will limit ourselves to three areas. First, we link up different sorts of debt relief, the 'colour' of the chameleon if you will, with research evidence on debt relief effectiveness and relevance. Second, we zoom in on instances where debt relief mimics GBS and briefly dwell on the dilemmas that this may pose to policymakers. A third and last subsection deals with the capricious nature of debt-for-development swaps, instruments that seem to have gained renewed attention in recent years.

### 3.1. Assessing the chameleon

The empirical evaluation literature on international debt relief is growing but, arguably, still much more limited than the body of theoretical analysis. Focus is almost exclusively on HIPCs due to the paucity and fragmented nature of data on the amounts of debt relief granted outside the HIPC framework. Moreover, reviews of the more recent MDRI debt cancellation are only just now emerging since relief figures become available with a considerable lag.

This subsection briefly summarises the available (but sometimes tentative) evidence from cross-country studies. Following the evaluative logframe developed by Dijkstra (2003, 2011), we distinguish between, first, debt relief *effectiveness at output level*, i.e. the extent to which the inputs of donors' contributions to debt relief, policy dialogue and other conditionalities translate into outputs such as reduced debt stocks, diminished debt servicing, net fiscal space increases and improved governance; second, *effectiveness at outcome level*, i.e. the degree to which inputs via outputs lead to outcomes on the level of improved debt sustainability, debt overhang elimination and augmented pro-poor spending; and third, *relevance*, i.e. the scope for economic growth and poverty reduction impacts through the aforementioned inputs, outputs and outcomes.[24]

Judging by Dijkstra (2003)'s own analysis of eight country cases (including Mozambique, Tanzania, Uganda and Zambia), international debt relief during the 1990s performed rather poorly along these dimensions of effectiveness at output level, effectiveness at outcome level, and relevance; for all four African countries in particular, there were no noticeable improvements in debt sustainability, growth, public spending or social indicators.[25] Econometric analysis by Hernández and Katada (1996) on a sample of 32 low-income African countries for the period 1984-1993 also indicates that, unlike aid grants, bilateral ODA debt relief (from 1989 onwards) did not have an effect on the import capacity of these countries, reportedly because it failed to free up resources additional to new multilateral lending and grants of bilateral donors. In hindsight, the dismal performance of pre-HIPC and early HIPC debt relief during the 1990s should not come as a surprise, we argue, having noted that these sorts of debt relief very much resembled old-style project aid and BoP support disbursed during the heydays of structural adjustment, with limited cash flow effects to make things worse. Indeed, both project aid and

[24] Dijkstra herself uses the term 'efficiency' for what we indicate with 'effectiveness at output level'. Because in th e evaluation literature 'efficiency' generally refers to achieving certain goals at the lowest possible cost (or, broader, with the lowest possible use of resources of any kind), we think it is somewhat of a misnomer in this context.

[25] To our knowledge, there are no noteworthy comprehensive empirical studies dealing with pre-1990 debt relief. Both data availability/q uality and the (related) fact that debt relief did not feature as a priority issue on the international agenda at that time could explain this.

structural adjustment support have been heavily criticised, even by donor organisations themselves, for failing to bring about the promised development results. Debt relief that imitates these forms of aid can evidently not be expected to do much better.

Empirical evidence on international debt relief into the new millennium looks, in some aspects, more encouraging.

### 3.1.1 Debt relief effectiveness at output level

First and foremost, there seems to be convincing proof of debt relief effectiveness at output level. When the MDRI will be fully executed, total (external) debt stocks of the current 36 post-decision point HIPCs will be almost 90% lower in end-2010 PV terms than before traditional (pre-HIPC) debt relief. Debt service payments of these same countries have come down by almost three percentage points of GDP, on average, between 2001 and 2010. Both outputs are to be ascribed primarily to the enhanced HIPC Initiative and MDRI (IDA and IMF, 2011).

In addition, using panel VAR techniques, Cassimon and Van Campenhout (2007, 2008) show that HIPC debt relief (up to the mid-2000s) has on average reduced domestic borrowing and increased government recurrent primary spending for different samples of HIPCs. In fact, they find that the fiscal response effects of HIPC debt (service) relief are most similar to those of programme grants (such as SBS and GBS). This corresponds well with our analysis in section 2.3.2.

On the crucial question of whether debt relief crowds out traditional aid, Powell and Bird (2010) aver that in Sub-Saharan Africa the donor community has treated post-2000 debt relief as a complement of rather than as a substitute for other aid interventions (see also Cassimon and Van Campenhout, 2008). Dömeland and Kharas (2009) are more reticent in their claims; they argue that there are no significant differences between the resources received by HIPCs and non-HIPCs but that the HIPC Initiative may have simply prevented a decline in net transfers to HIPCs. The available evidence thus seems to suggest that HIPC and beyond-HIPC debt relief have created *real* fiscal space (compared to a situation where there had been no such debt relief, at the minimum).

Several studies have found recent debt relief to be positively associated with improvements in recipient countries' governance quality (see e.g., Depetris Chauvin and Kraay, 2007; Freytag and Pehnelt, 2009) but causality is difficult to establish (Presbitero, 2009).

### 3.1.2 Debt relief effectiveness at outcome level

Second, with respect to the effectiveness at outcome level of debt relief, Beddies, Dömeland, Le Manchec, and Mooney (2009) indicate that, at end 2007, post-completion HIPCs had a rosier debt outlook and lower risk of debt distress than other HIPCs and low-income non-HIPCs. The ongoing global financial and economic crisis has so far not translated into new systemic debt sustainability problems for HIPCs according to IMF and World Bank (2010). A protracted crisis, coupled with more stringent financing conditions, might nevertheless lead to renewed debt distress in the not-too-distant future, even for African post-completion HIPCs (Hernández and Gamarra, 2011).

Cassimon and Van Campenhout (2007, 2008) uncover a positive trend in HIPC government investment in the years following debt forgiveness (albeit with a certain lag), in ac-

cordance with debt overhang theory. A recent working paper, which extends the study period up to 2011, conforms the positive results HIPC debt relief has had on public investment, but fails to find an equally strong impact for the MDRI (Cassimon *et al.*, 2013). More indirect evidence supporting the argument that concerted debt relief can eliminate debt overhang comes from Raddatz (2011); he employs an event study methodology to show that stock market prices of South African multinationals with subsidiaries in African HIPCs react positively to announcements about major debt relief initiatives. Conform expectations, the price effects are greater for announcements about the MDRI and enhanced HIPC (that provide deeper and broader relief) than for news on the original HIPC Initiative.

Has debt relief led to increased pro-poor spending? IDA and IMF (2011) allege that, over the 2001-2010 period, poverty-reducing expenditures by post-decision point HIPCs (as defined in their respective PRSPs) have risen by just over three percentage points of GDP, or by approximately as much as the decline in debt service over that period; there is however great heterogeneity of such expenditures at the country level, with some interim- and post-completion HIPCs seriously lagging behind (Presbitero, 2009). Moreover, most econometric studies find the effect of HIPC debt relief on government spending in the education and health sector not to be significant when controlling for other factors (Crespo Cuaresma and Vincelette, 2008; Depetris Chauvin and Kraay, 2005; Schmid, 2009), or to be significant only when accompanied by positive institutional change (Dessy and Vencatachellum, 2007). So, whereas in the past decade government spending on poverty reduction purposes has definitely increased for some (if not most) HIPCs, debt relief may not necessarily have played an important role.

### 3.1.3 Debt relief relevance

Third and last, on debt relief relevance, in other words its potential to eventually generate economic growth and reduce poverty in recipient countries, the verdict is still out. Taken together, the results of Depetris Chauvin and Kraay (2005), Presbitero (2009) and Johansson (2010) seem to suggest that a debt relief-growth nexus, if it exists, is certainly not omnipresent and may exhibit non-linear characteristics.

Probably even more difficult to verify is a causal link between debt relief and poverty reduction. Looking at the progress of post-completion HIPCs towards achieving the MDGs, it appears that many of them will likely miss the goals set by 2015. African HIPCs lag behind, especially on eradicating extreme poverty and hunger and on improving maternal health (MDGs 1 and 6) (see IDA and IMF, 2011). That said, in spite of their sobering conclusions on public expenditures, Crespo Cuaresma and Vincelette (2008) and Schmid (2009) *do* find seemingly robust evidence of HIPC debt relief lowering primary schooling drop-outs and reducing infant mortality rates, respectively. HIPC conditionality, which induces economic and political reforms and strengthens the links between debt relief, poverty reduction and social service delivery, is advanced as a possible explanatory factor. This hypothesis asks for further scrutiny, however.

In view of all the above, one could cautiously conclude that the chameleon called debt relief has changed its colour for the better. In contrast with pre-HIPC and early HIPC debt relief, more recent operations under the enhanced HIPC Initiative and MDRI have, on average, succeeded in making debt stocks and service sustainable, generating fiscal space and augmenting public investment. We argue that at least part of the differences in assessment can be attributed to debt relief's equivalence with certain aid modalities, in terms of conditionality sets and cash flow effects. The direct impact of HIPC/MDRI relief on governance, pro-poor spending

and, ultimately, growth and poverty reduction in Africa and elsewhere is perhaps more elusive (which is not very different from what evaluations of direct budget support find; see e.g., IDD and Associates, 2006). Rigorous empirical study of these and other potential effects of debt relief should be seen as an ongoing research programme. Nevertheless, one needs to keep 'expectations… modest and time horizons long' (Moss, 2006, p. 293).

### 3.2. Debt relief as disguised budget support

Rather than being stand-alone aid modalities, enhanced HIPC debt relief, additional bilateral relief to HIPCs and MDRI assistance are, in principle, very similar to GBS (or SBS in the case of the French C2D). In section 2.3.3 we have argued that especially the latter two, bilateral 'topping up' and the MDRI, which both provide relief that goes beyond what is strictly needed to achieve debt sustainability, can be expected to increase the pool of non-earmarked budgetary resources available to recipient country governments. Just like modern-time 'partnership' GBS (a term used by the OECD) these initiatives are, together with donor-recipient policy dialogue, part of a broader package, aimed at assisting countries with the implementation of their PRSPs. We believe understanding the close similarities between particular forms of debt relief and GBS is important for policy, even if (and perhaps, exactly because) the conclusions of such an exercise could make some donors feel uneasy.[26]

For countries that qualify for both substantial amounts of GBS and GBS-like debt relief, e.g. 'donor darlings' Mozambique, Rwanda and Uganda, that debt relief becomes a (disguised) supplement to the genuine (undisguised) GBS they receive, with the additional bonus that it is all in grant form. To make things more complicated, the supplementary debt relief is *de facto* multi-annual quasi-GBS, extended irrevocably over the full debt service horizon. This may not sit well with the genuine GBS it accompanies, which was originally promoted by the World Bank and OECD as a longer-term oriented aid modality supporting technocratic governance reform but, in practice, is often granted only on a one to three-year basis and subject to suspension or delay when donors perceive a breach of the political principles in the donor-recipient aid contract (Molenaers, 2012).[27] While the greater predictability of GBS-like debt relief is a boon to the recipient government, some donors may lament the loss of political leverage and general flexibility it entails (given of course that they adopt this paper's aid modality equivalence perspective).

The fact that some countries, e.g. the Central African Republic and the Republic of Congo, receive HIPC/MDRI and other quasi-GBS debt relief but no noteworthy sums of genuine GBS is puzzling, to say the least. How to explain that donors do not deem these countries eligible for GBS, yet through additional bilateral debt relief and MDRI, provide them with quasi-GBS that is *not* linked to achieving debt sustainability? [28] One could also reverse the question and wonder why a (small) number of other countries, most notably Vietnam, are eligible for GBS but not for quasi-GBS relief that is unrelated to their debt sustainability outlook.

[26] The similarities between debt relief and GBS are recognised as such, explicitly, by the OECD (see Lister and Carter, 2007, pp. 1-2) and, more implicitly, by the World Bank when it defines budget support as '[d]onor instruments… that support the implementation of a country's medium-term poverty reduction strategy and consist of regular (annual) disbursements of untied resources to the budget' (Koeberle and Stavreski, 2006, p. 6). But, to our knowledge, debt relief-GBS parallels have not been explored in greater detail in the literature so far.

[27] For an example, see Molenaers *et al.* (2010, pp. 26-31) on GBS donors' reaction to electoral problems in Mozambique.

[28] Similarly, it seems odd that most NGOs have always strongly advocated these sorts of debt relief, while at the same time many of them are reluctant to embrace the use of GBS.

We argue that donors should look at GBS and GBS-like debt relief jointly, so as to avoid policy inconsistencies. The reality is different, however, most clearly for bilateral donors. Decisions on HIPC and beyond-HIPC debt relief are taken in different fora and by different actors than those on GBS; bilateral debt relief is largely decided on in the Paris Club, an informal meeting of creditors who are represented by donors' ministry of finance staff, whereas on GBS, typically, donor departments of development cooperation (and by extension often, ministries of foreign affairs) have the final say. We believe the judgement to give long-term, fixed-tranche quasi-GBS debt relief to countries should *prima facie* feed into discussions about genuine GBS provision, and the other way around. Having a single locus of decision-making would be helpful.

### 3.3. Debt-for-development swaps strike back?

As indicated in section 2.3.3, debt-for-development swaps are again mushrooming in the health, education, conservation and other sectors. Even when focusing only on debtor countries or debt titles outside the HIPC Initiative and MDRI, in the sense that these swaps return to the 'discredited' practice of micro-earmarking (mimicking old-style project aid) they may seem like an unfortunate anachronism, out of step with the new aid agenda's best practices.[29]

Elsewhere we have critically examined recent individual cases of debt-for-development swaps, in a variety of sectors (Cassimon *et al.*, 2008, 2011a, 2011b). Overall and unsurprisingly so, these case studies hint at low debt relief effectiveness at output and outcome levels. Of course, in principle, debt-for-development swap operations could be 'engineered' to better accommodate potential problems. As an onset we propose the following, non-exhaustive checklist for improving upon debt swap performance.

First, for the sake of generating positive net cash flows for the recipient, swaps should preferably target non-concessional debt titles (whose relief implies large and quicker gains) that are likely to be serviced (see section 2.2). Also, to create fiscal space (or at least to not destroy it) and to ease budgetary pressures on the debtor country government, counterpart payments should incorporate a discount, reflecting the possibility of non-repayment of the original obligations (if any) as well as timing differences between the old and new payment schedules.

Second, debt-for-development swaps should respect principles of additionality, complementing rather than substituting for other forms of donor support. Admittedly, other than through civil society or donor peer pressure, however, real additionality is difficult to enforce.

Third, in line with commitments made in Paris, Accra and Busan, the support freed up by swaps should be policy-aligned with debtor country national development strategies (as detailed in their PRSPs) and, where feasible, system-aligned with the country's own existing (government) systems and institutions. Such alignment, making swaps behave like new-style project aid, would greatly enhance country ownership, reduce transaction costs and contribute to capacity building.

Fourth, current debt-for-development swaps re piecemeal operations, typically well below US$ 100 million each. Only if they were large enough, swaps could be expected to induce more indirect effects such as debt overhang elimination in recipient countries. One prom-

[29] However, if one takes into account that off-budget (project) aid and parallel PIUs are still very much present in today's aid landscape (see section 2.1), debt swaps may not be that much of an anachronism altogether. Indeed, renewed interest in swaps by some donors could be read as an example of how the pendulum of donor preferences swings back to stricter earmarking and control of tax-funded aid money (see footnote 3).

ising avenue, at least for a limited selection of non-HIPC countries, may be to convince creditors that are favourable towards debt swaps to pool the resources generated by the relief given on their claims into one single fund, managed by (or at least in close cooperation with) the debtor country itself (or, if possible, directly into the country's budget). Debt-for-development swaps would then move closer towards a HIPC/MDRI-type of setup, initiatives which we have shown to exhibit greater potential because of their sheer size and more appropriate form of conditionality.

# 4. Conclusions

Throughout our review of debt relief by official and commercial creditors to Sub-Saharan African countries since the 1980s, we have shown how, like a chameleon, this debt relief mimics different aid modalities; its ultimate guise or 'colour' depending on the sorts of conditionality attached, the alignment with recipient country development policy and systems, and the expected cash flow effects. For example, Pre-HIPC debt service and stock relief have behaved similar to BoP support under structural adjustment, but without any noticeable budgetary consequences. With the introduction of the HIPC Initiative, and especially with its enhancement in 1999, most official debt relief began to generate real fiscal space; also since 1999, HIPC debt relief has been linked explicitly to poverty reduction through PRSP conditionality, making it in some instances a GBS-like intervention. Large commercial debt exchanges such as the Brady deals, if without the usual IMF programme requirement or recap clauses, may have been much akin to 'oil', freely spendable resources to the amount of the secondary market value of the debt exchanged.

While interesting in itself, our categorisation of debt relief from an aid modality perspective also offers insights relevant for the understanding of debt relief's varying performance and for the design of future interventions. Browsing the literature on debt relief evaluation we must conclude that more recent debt relief operations have been assessed as more effective than their predecessors, at least partly due to more appropriate conditionalities, better alignment and greater cash flow effects. In other words, it seems that the chameleon has changed its colour for the better. That being said, the impact of debt relief, even in its modern guises, on recipient country's governance, economic growth and poverty reduction remains hard to pin down. Of course, policy dialogue and conditionalities attached to debt relief take time to bite. And, more so than with aid, debt relief's fiscal gains to the recipient are typically spread out over longer periods. While more research is needed in these areas, one should bear in mind the limits to what debt relief can realistically achieve.

Lastly, we have briefly highlighted some tensions inherent to the two forms of debt relief that are now most common, first, the quasi-GBS debt relief of bilateral topping up of HIPC commitments and MDRI, and second, a new wave of debt-for-development swaps that is making its return to the scene. We argue that there are policy inconsistencies in giving certain countries debt relief that acts as a kind of longer-term, fixed-tranche, grant-type GBS, but denying them access to genuine, direct GBS (or the other way around). One way to mitigate such inconsistencies is to discuss both forms of aid in one single forum, which is very different from current practice. The use of debt-for-development swaps, on the other hand, risks to catapulting donors back to the era of old-style, micro-earmarked project aid, out of step with best practices. Only if properly engineered as larger (perhaps, multi-creditor) and additional instruments, designed to respect recipients' fiscal space and aligned with their policies and systems, new-style debt swaps would have a place in the current aid architecture.

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