



MINISTRY OF FOREIGN AFFAIRS

A Plan of Action

Debt Relief for Development



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FOREWORD BY THE MINISTER OF INTERNATIONAL DEVELOPMENT

In October 1998, one year into my first period as Minister of International Development, I presented the document Towards the Year 2000 and Beyond: The Norwegian Debt Relief Strategy. This was Norway's first coherent plan of action aimed at helping to solve the debt problems of developing countries. It has provided the foundation for Norway's debt policy for developing countries up to the present day.

Norway is and will always be a "small country". Nevertheless, Norway's debt policy has helped to influence the international agenda. The Debt Relief Strategy became one of many expressions of a significant strengthening of international debt policy towards the end of the 1990s. Since then, new mechanisms have been introduced and the conditions for debt relief have been substantially improved.

Despite this multilateral offensive, lasting solutions have been approved for only a few countries. Many countries are still struggling under their debt burdens. We still hear demonstrators chanting "Cancel the debt now!". The rich countries are still being accused of miserliness and procrastination. Some critical voices say that international debt relief efforts have failed. Others condemn the Heavily Indebted Poor Countries (HIPC) Initiative out of hand. Only just over four years after the HIPC Initiative found its current form, I respectfully maintain that this is an extremely hasty conclusion.

It is true that the debt relief process has been slower than could be desired. However, to say that this is due to the unwillingness of creditors is a facile argument. Why? Because debt relief alone is not a cure-all; because debt relief alone leads nowhere unless it is accompanied by a policy that promotes development. In this respect, the heavily indebted countries themselves have a great deal of responsibility. At the same time, we in the rich countries have an obligation to poor people in developing countries to ensure that debt relief benefits them.

It is a matter of quality assurance. In practical terms, it is especially a matter of developing countries formulating their own poverty reduction strategies so that the resources freed up by debt relief are really put to good use. This has often taken longer than many people believed beforehand, myself included. However, if we had reduced our requirements for the quality and coherence of development strategies, we would have done poor people a disservice. I believe that the future will show that what now appears to be lost time is in fact a good investment in effective, long-term development and poverty reduction.

More than five years after the Debt Relief Strategy was presented, the time has come to take stock, learn from the experience we have gained so far, react to the criticisms that have been raised, take the temperature of the international debt dialogue, try to look into the future – and reset our course. This updated debt relief strategy – the Plan of Action on Debt Relief for Development – is an attempt to do just that. As such, it also represents a concretization and amplification of the references to debt relief in the Norwegian Government's Action Plan for Combating Poverty in the South towards 2015, which was presented in 2002.

In many respects, this new plan will appear to be travelling along well-trodden paths. This is not a coincidence. It is simply because most of the measures that had priority in the original Debt Relief Strategy are as valid and relevant today as they were five years ago. In this respect, this Plan of Action entails consolidation.

However, we are also travelling along new paths. We intend to reinforce debt relief measures for countries emerging from war and conflict. We give priority to multilaterally coordinated debt swaps with countries that are not covered by the HIPC Initiative by cancelling debt on condition that these countries commit

themselves to implementing measures that promote development and reduce poverty. Furthermore, we help to dispel what has been something of a debt policy taboo by also advocating debt reduction for middle-income countries with obvious solvency problems. However, this type of debt relief must not take place at the expense of the poorest countries.

If countries whose debt is now being cancelled return in a few years with new problems, this will discredit current debt relief strategies. As in the original Debt Relief Strategy, we therefore advocate more systematic international cooperation to improve debt management in the poorest countries. Specifically, one of our suggestions is to establish a joint consultative group for all the players that currently provide technical assistance in this field. Here, as in other areas of international policy, we can achieve far more together than we do individually.

We also support a proposal by UN Secretary General Kofi Annan for the establishment of a special international working group, representing a wide range of interests, to study the question of a new international debt work-out mechanism.

It is important for the debt debate to have a solid grass roots base. I am, therefore, pleased that the debt debate arouses the interest of many people, both in Norway and in many other countries around the world. There is absolutely no doubt that the debt relief movement has helped to influence international debt policy in a direction that has been favourable for the developing countries. At the international level, the Jubilee movement has also made a significant, admirable contribution. Among other things, this movement must be given part of the honour for the significant strengthening of the HIPC Initiative. In Norway, the Norwegian Campaign for Debt Cancellation (SLUG) has made its mark as an important, knowledgeable source of information and influence.

In Norway, as in other countries, a debate on "illegitimate debt" has been in progress for several years. At its best, this debate has outlined possible new criteria for debt relief that will also apply to countries that do not qualify for it today. However, translating these ideas into

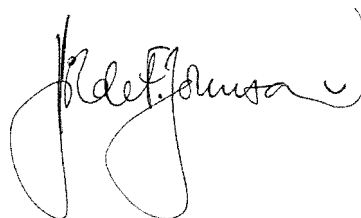
practical policies is a major challenge. The discussion of improvements to existing debt relief mechanisms aimed at the poorest countries must, therefore, not be "drowned out" by the illegitimacy debate.

The new approaches described in this plan will be launched at the same time as we continue our efforts to implement previous initiatives. Norway's debt relief policy is a mixture of pragmatism and ambitious political objectives. New unilateral measures and "the power of example" are considered on a continuous basis. However, they must constantly be weighed against international laws of gravity that no one can ignore.

The Debt Relief Strategy was in many ways a reaction to the Norwegian Ship Export Campaign of the 1970s and 1980s, during which Norwegian business interests overshadowed and dominated development policy considerations. I have myself called this campaign a disgrace. I stand by what I said. One of my goals is to cancel the debt that was incurred as a result of this campaign. In these efforts, I will nevertheless stick to international rules – and I will always ensure that the poorest countries have first priority!

My political commitment is based on ethical considerations. However, we must guard against making ourselves spokespersons for an apparently unassailable duty ethic that results in little more than symbolic policy. A policy that does not focus on the weakest members of society will fail. Poverty reduction must be the yardstick against which all instruments in all development policy are measured.

Hilde F. Johnson



World Debt Day
16 May 2004

1. SUMMARY: CONSOLIDATION AND NEW APPROACHES

Towards the Year 2000 and Beyond: The Norwegian Debt Relief Strategy was launched in October 1998. It was a plan for how Norway could help reduce the debt burden of the poorest and most indebted countries up to the end of the millennium. The Debt Relief Strategy comprised two main parts. The first part dealt with the multilateral and bilateral mechanisms through which Norway can provide debt relief, including concrete proposals for ways in which Norway could reinforce and utilize these mechanisms over the next few years. The second part was country-specific, containing proposals for what Norway could do for 22 poor indebted countries.

The overarching strategy was for Norway to actively support the growing political agreement on the need to find a lasting solution to the debt problems of the poorest countries through binding international cooperation. For the first time since Norwegian ODA loans were cancelled in the 1980s, we planned to use Norwegian debt relief strategically, both through unilateral measures and through our international commitments. We proposed cancelling claims of up to NOK 1.3 billion against certain countries in the next four to five years, provided that:

- debt relief was implemented as part of or following multilaterally coordinated debt relief operations, at a time when debt relief

would benefit the country and not other creditors

- a practical assessment was carried out in each case to ensure that debt cancellation would have a genuine impact on the developing country concerned and its impoverished people.

At the end of 2003, Norway had cancelled NOK 1.6 billion of developing countries' debt to Norway. The time has now come to review the experience gained from the Debt Relief Strategy and to stake out our future course.

Five years on, one of the most obvious conclusions is that much of the necessary work on debt relief still remains to be done. Several poor countries have still not qualified for the HIPC Initiative. Of the 27 qualified HIPC countries, only 13 have passed the completion point. Of the HIPC countries on which Norway has claims, only two – Tanzania and Benin – have put HIPC behind them and finally had their bilateral debt to Norway cancelled. Of the Debt Relief Strategy financing facility of NOK 3.17 billion, there still remains NOK 1.84 billion which – given Norway's unique budget model – can be used for debt cancellation without drawing on the development assistance budget. It is, naturally, a political goal to ensure that this facility is fully utilized. Equally naturally, this must take place in such a way that debt relief leads to genuine poverty reduction.

BOX I

The Debt Relief Strategy Financing Facility

The part of the Debt Relief Strategy that concerns cancellation of bilateral debt (government-to-government debt) is based on a budget model that is unique to Norway, known as the Debt Relief Strategy *financing facility*. The claims covered by this facility are mainly linked to export credits, guaranteed by the Guarantee Institute for Export Credits (GIEK) and granted in the late 1970s and early 1980s. Many of them were related to the Ship Export Campaign. Some of these guarantees were recommended by the Norwegian Agency for Development Cooperation (NORAD) as promoting development, while others were not submitted to NORAD for consideration. These claims must not be confused with development assistance loans (ODA loans) previously provided by Norway, which were all cancelled in the first half of the 1980s.

At the beginning of the 1980s there was widespread default on repayment of these credits because a great many borrowers in developing countries were in financial difficulties. GIEK's guarantee liability was then triggered, the Norwegian exporters were "bought out" by means of compensation payments and GIEK – on behalf of the Norwegian Government – became the new creditor. Since government guarantees had also been provided by the borrowers, the resulting claims became government-to-government debt. The accumulation of debt to Norway took place in parallel with a global accumulation of debt in developing countries, often referred to as "the global debt crisis".

All in all, NOK 3,300 million was allocated for GIEK's compensation payments from the central government budget, of which NOK 1,266 million was under the old general guarantee scheme and NOK 2,034 million was under the old special scheme for developing countries. NOK 510 million of this was charged against the development assistance budget. Before the Debt Relief Strategy was launched, debt relief amounting to NOK 127 million was provided under the special scheme, covered by previous allocations¹.

In accordance with the Debt Relief Strategy and the underlying recommendations from an inter-ministerial Committee of State Secretaries (Deputy Ministers)², in the Budget Proposition for 1999 it was proposed that all cancellation of Norwegian Government claims under the Debt Relief Strategy be implemented without making new allocations from the development assistance budget or other parts of the central government budget. The claims in question must have resulted from credits granted prior to the restructuring of GIEK in 1994 and must have been defaulted on prior to 31 December 1997. This applied to both debt cancellation based on multilateral agreements in the Paris Club and additional, unilateral debt cancellation based on the criteria laid down in the Debt Relief Strategy. Other debt relief measures under the Debt Relief Strategy were, in principle, to be covered by allocations from the development assistance budget.

During the debate on the 1999 central government budget, the Storting decided that bilateral debt relief could be provided *without new allocation* up to a limit of NOK 1,266 million for GIEK's old, general scheme and NOK 1,907 million for GIEK's old special scheme for developing countries, respectively. The total financing facility was therefore NOK 3,173 million. In other words, the total financing facility was equivalent to the sum of previous allocations from the central government budget for compensation payments under the schemes, with a deduction of NOK 127 million for the funds that had already been spent on debt relief. All bilateral debt cancellation under the Debt Relief Strategy – including any interest accrued after the Debt Relief Strategy was implemented – could thereafter be implemented without allocation, on the basis of annual resolutions in the development assistance budget. This budgetary compromise has subsequently been referred to in all central government budgets and has received broad-based support in the Storting.

The Debt Relief Strategy financing facility originally covered a group of 19 indebted low-income and middle-income countries that were *priority* countries and countries *eligible* for bilateral debt cancellation, respectively: Angola, Côte d'Ivoire, Ghana, Guinea, Somalia, Tanzania, Vietnam, Benin, The Gambia, Senegal, Sierra Leone, Zaire/DR Congo, Liberia, Sudan, Burma, Algeria, Ecuador, Jamaica and Peru³. In 2001 it was decided that the facility would also cover debt cancellation for the former Yugoslavia (Serbia-Montenegro), some of which will not start to run until 2005. In 2002 it was decided that the financing facility would also cover multi-year and ongoing debt relief for Egypt, through a lump-sum compensation of GIEK. As of today, the Debt Relief Strategy financing facility therefore covers 21 countries, although in such a way that any future or further debt relief for Egypt and Serbia-Montenegro (apart from the amounts to be disbursed in 2005) will *not* be covered by the financing facility.

Another obvious conclusion is that there is still a need for virtually all the instruments described in the original Debt Relief Strategy. The basic premises for Norway's debt relief policy will continue to be as follows:

1. *to strengthen and rationalise the multilateral debt relief mechanisms, because this is more crucial in solving the debt problems of*

poor and indebted developing countries than what Norway does with its relatively modest claims

2. *targeted, unilateral measures that will benefit countries' development and poverty reduction processes, with a special view to encouraging other, larger creditor countries to implement new, improved debt relief measures.*

¹ Cf. the guidelines in Proposition No. 103 to the Storting, cf. Recommendation No. 225 to the Storting (1991-92).

² Committee of State Secretaries to evaluate the budgetary consequences of the Debt Strategy. The Committee presented its report "Vurdering av budsjettmessige konsekvenser av gjeldsplanen" (Evaluation of the Budgetary Consequences of the Debt Strategy) on 25 August 1998.

³ This list is the same as the first 19 countries in Table 2 (page 10) of the 1998 Debt Strategy.

These basic principles entail a number of practical policy approaches that are as valid today as they were five years ago and therefore remain firm:⁴

Norway will ...

- actively support the HIPC Initiative for the poorest, most indebted countries and continue to work to ensure full financing for and further improvements to this scheme
- supplement HIPC debt relief with unilateral measures so that, on certain conditions, we cancel 100 % of HIPC countries' debt to Norway, and work to ensure that as many creditor countries as possible do the same
- actively support and influence the work of the Paris Club which, as regards bilateral debt, is the main arena for practical implementation of the HIPC Initiative and for debt negotiations with other countries
- work to ensure that all debt relief benefits debtor countries and not other creditors
- support international debt operations, especially the World Bank Fifth Dimension and Sixth Dimension facilities (the IDA Debt Reduction Facility) as an important supplement to bilateral debt cancellation
- contribute towards cancelling the debts of poor developing countries to other developing countries, provided that a special mechanism is established for this purpose and such support makes good use of development assistance funds
- consider supporting national debt funds to relieve the multilateral debt servicing burden of developing countries, both as a targeted debt policy instrument and as a special element of Norwegian budget support in general
- work to promote more systematic multilateral cooperation to improve debt management in the poorest countries, including by way of using development assistance funds, to help prevent new debt problems.

In the light of the review of our experiences so far and new challenges in the debt field, however, it is also necessary to update and further develop the range of instruments. The "expansion" of the Debt Relief Strategy can be briefly summarized as follows:

Norway will ...

- help to pave the way for HIPC treatment for countries that have been affected by war and conflict (post-conflict countries) by providing grants for coordinated operations to clear the arrears of individual countries to international financial institutions
- advocate measures which ensure that post-conflict countries who are candidates for HIPC treatment do not have to spend scarce resources on servicing external debt, and refrain from claiming current interest and principal repayments from such countries, and then consider 100 % debt cancellation as part of the HIPC treatment of these countries
- advocate multilaterally coordinated debt swaps with countries that are not covered by the HIPC Initiative (mainly middle-income countries), so that debt reduction is granted provided that these countries implement development or environmental measures with the funds that are freed up
- implement multilaterally coordinated debt swaps with Pakistan and Vietnam, and conduct negotiations on a multilaterally coordinated debt swap with Ecuador
- more generally, work to ensure that middle-income countries with structural payment problems also have sufficiently comprehensive debt agreements, if necessary with debt reduction, so that repeated, frequent debt negotiations are rendered unnecessary
- work to ensure that the Paris Club adopts a more flexible attitude to moving cut-off dates (which limit which debt can be renegotiated) in such a way as to take into account countries' solvency and creditworthiness

⁴ This list is not exhaustive

The Debt Relief Strategy in a Nutshell

Bilateral debt cancellation financed through the Debt Relief Strategy financing facility without budget allocation

- Up to 100 % debt cancellation for the current HIPC countries Ghana, Gambia, Senegal, Sierra Leone and D.R. Congo
- Up to 100 % debt cancellation for HIPC-qualified Guinea, provided that it returns to its currently interrupted IMF programme and thereby re-qualifies for HIPC treatment.
- Up to 100 % debt cancellation, including possible post-conflict/pre-HIPC forgiveness of payments as they fall due from Côte d'Ivoire, Angola, Somalia, Liberia, Sudan and Burma, provided that these countries emerge from war and conflict and/or improve their governance, qualify for HIPC treatment and thereby also for unilateral Norwegian debt cancellation
- Debt swap with Vietnam and, depending on the outcome of bilateral negotiations, with Ecuador

Support for international debt relief operations financed with budgetary allocation from the Fund for International Debt Relief Operations

- Support the HIPC Trust Fund, the World Bank's *Fifth and Sixth Dimension Facilities*, multilateral arrears-clearing operations, technical assistance for debt management, multilaterally coordinated operations to cancel debt between developing countries, interest subsidies for the IMF PRGF scheme and contributions to national debt funds
- Debt swap with Pakistan

- ➔ support the proposal of the UN Secretary General to establish a special international working group, representing a wide range of interests, to consider the question of a new international debt negotiation mechanism
- ➔ participate actively in international debate, introduce perspectives from civil society into the debate and, when this is considered appropriate, put controversial ideas on the agenda
- ➔ support a possible multilaterally based study of "illegitimate debt".

A clear precondition for the bilateral debt relief that is proposed or outlined in this Plan of Action is that it must be possible to cover it within the Debt Relief Strategy financing facility. To the extent it may be relevant to grant debt relief for other, more recent bilateral claims than those covered by the Debt Relief Strategy, an unsolved budgetary issue emerges. The budgetary processing of such debt relief will have to be submitted to the Storting. Similarly, if the financing facility should be "used up" at some future date, new budgetary solutions must be sought. Any future bilateral debt relief that entails budget

allocation is not covered by this Plan of Action.

If we succeed in implementing all the bilateral debt relief measures outlined in this revised Plan of Action, it is assumed that this will absorb the entire Debt Relief Strategy financing facility that has not been utilized so far. However, there is a great deal of uncertainty about this, particularly as regards the extent to which countries that are currently affected by war and conflict and/or poor governance (Côte d'Ivoire, Angola, Somalia, Liberia, Sudan and Burma) will qualify for HIPC treatment. Furthermore, due to accruing interest, the total charge against the financing facility for each HIPC country will depend on how long it will take each country to complete its treatment. There is also uncertainty about whether the proposed debt swaps will be implemented as desired.

Specific decisions concerning Norway's debt relief measures will in any case be made through ordinary administrative procedures. In other words, the Debt Relief Strategy does not entail processing of country-by-country debt relief decisions. Like its predecessor, the expanded Debt Relief Strategy, is regarded as a "living instrument" and will be revised and updated as and when necessary.

2. INTRODUCTION

Borrowing money is not necessarily a negative thing. For developing countries with substantial investment needs, it is normal and natural to be in debt. When investments that are socio-economically profitable are financed by loans, an increase in a country's debt may help to accelerate positive economic and social development. The question of access to credit is therefore an important development policy issue.

A debt *problem* arises when a country is unable to service its debt without doing so at the expense of important social responsibilities. In many cases, not only is a country's debt a strain on the country's budget, in the form of debt servicing, but the amount of debt incurred often prevents the country from obtaining new resources, in the form of loans for necessary investments. In such cases there is a *debt overhang*.

In global terms, the net flow of borrowed capital to developing countries⁵ today is more or less neutral. In other words, on average, countries spend approximately as much on interest and repayments on existing loans as they receive in new loans. However, there are significant variations between regions and between countries.

Today, most of the poor countries with serious debt problems are in Africa. For these countries, debt is a serious obstacle to economic and social development. It leads to major balance of payments problems, lays claim to future revenues, creates an uncertain investment climate and ties up scarce administrative resources.

In the 1998 Debt Relief Strategy, reducing the burden of debt was regarded as a necessary

element of a coherent solution to break the vicious circle. However, it was recognised that debt relief was not sufficient to achieve a lasting solution to a debt problem. It was equally necessary for countries to pursue sound economic policies and make investments that were socio-economically profitable in order to lay the foundations for long-term growth, development and poverty reduction.

The value of debt relief will be seriously limited if a country pursues an economic policy that leads back to the same debt situation as it is being helped out of. Countries must also demonstrate their ability and willingness to utilise the resources that are freed up by debt relief for measures that promote development and reduce poverty. Debt relief without an accompanying strengthening of countries' own policies and efforts, for example in the field of production and tax collection, is unlikely to make a significant contribution to economic and social development. Debt relief alone is not a miracle cure.

All development assistance must be viewed in the light of the Millennium Development Goals. Debt relief and the PRSP process are important contributions towards the achievement of these goals, but debt relief alone cannot ensure that they are achieved.

This document is an updated version of *Towards the Year 2000 and Beyond: The Norwegian Debt Relief Strategy*. The fundamental principles are the same. In addition, this plan outlines new debt policy approaches that are consequent on the "expansion" of the Debt Relief Strategy⁶. This updated plan of action provides for unilateral Norwegian debt relief for (1) certain middle-income countries through multilaterally coordinated debt swaps

⁵ Whether or not it is particularly meaningful to regard all developing countries as a single group is highly debatable.

⁶ In summer 2001, the Stoltenberg Government decided to expand the Debt Relief Strategy, cf. Ministry of Foreign Affairs press release no. 121/01 of 20 July 2001. The Bondevik Government and a unanimous Storting have subsequently supported this expansion, which is translated into practical policies in this Plan of Action.

and (2) poor countries emerging from war and conflict. It also provides for debt reduction for middle-income countries as an element of multilateral agreements in the Paris Club.⁷ The strategy has been adjusted accordingly and reinforced on the basis of the experience gained from debt relief policy since 1998.

In an international context, Norway is a minor creditor. The effect of unilateral Norwegian debt relief measures is minimal in relation to the total debt burden of developing countries. A solution to the debt problems of developing countries requires binding international cooperation. Norway will continue to actively support international efforts to find lasting solutions to the debt problems of the poorest countries. In this respect, the multilateral financial institutions and international forums that deal with developing countries' debt play an important role. Norway has for many years been very active in these institutions. It is essential that the major creditors participate in international debt operations.

Nevertheless, strategic use of unilateral Norwegian debt relief may be effective in certain contexts. Norway's proactive role in the debt arena is therefore based on a pragmatic political analysis, the building blocks being both binding multilateralism and occasional unilateralism. The main aim of the plan is to identify the measures that will have the greatest impact on countries' total debt burden over time, on the robustness of their development programmes and on the living conditions of their impoverished people. One of the main issues is how Norway can apply and further strengthen international debt mecha-

nisms. Ensuring that debt relief takes place in a way that is not detrimental to the creditworthiness of debtor countries and thereby their possibilities for financing future investments and development programmes is a major challenge. For this reason, debt relief should not normally be granted for new credits.

The Debt Relief Strategy is a "living instrument". This means, among other things, that countries that are not eligible today may be included at a later date. Any changes in international framework conditions should lead to new evaluations of mechanisms and strategies. In its current form, the Strategy presents many practical proposals, but it also points to certain areas and issues that require further consideration. The Strategy will be further developed as these assessments are made.

The Debt Relief Strategy describes Norway's debt policy in a broad perspective. Specific *decisions* on Norwegian debt relief measures must and will take place through ordinary administrative procedures.

Norway will...

- regularly evaluate the areas of focus of the Debt Relief Strategy on the basis of the experience that is gained, new analyses/assessments that are undertaken and other changes in the preconditions for Norway's contributions towards relieving the debt burdens of developing countries
- continuously consult with stakeholders and interested parties in Norway and abroad in connection with this effort.

⁷ If this should be appropriate for countries and claims that are not covered by the Debt Relief Strategy financing facility, a budgetary solution must be in place.

3. CURRENT STATUS OF IMPLEMENTATION OF THE DEBT RELIEF STRATEGY

The overarching aim of the strategy was – and still is – to help reduce the debt burdens of the poorest and most indebted countries so that they do not impede economic and social development. The plan aims to free up resources for development-promoting purposes and help to re-establish these countries' creditworthiness. The overarching strategy was – and still is – to actively support international initiatives for a lasting solution to the debt problems of the poorest countries.

The Debt Relief Strategy presented proposals for Norwegian measures to relieve the debt burdens of many poor and indebted countries. As regards bilateral debt relief, the countries were selected by applying criteria for the burden of debt and economic and political conditions in developing countries against which Norway has claims and developing countries that have priority in Norwegian development cooperation. Through its active participation in international debt relief mechanisms, particularly the World Bank and the IMF Heavily Indebted Poor Countries (HIPC) Initiative⁸, Norway also supports debt relief operations for countries against which it does not have claims.

In connection with the debate on the 1999 central government budget, the Storting decided that all Norwegian bilateral debt forgiveness for low-income countries, both through the Paris Club and in the form of unilateral debt relief, would take place without charging it against the budget, provided that the Debt Relief Strategy financing facility, set

at NOK 3,173 million⁹, was not exceeded. On this basis, all Norwegian bilateral debt forgiveness under the Debt Relief Strategy has subsequently taken place *without being charged against the budget*.

In 2000, Norway was the first creditor country to provide the opportunity for 100 % debt forgiveness for all types of claims against the poorest countries. In the following period, many countries followed suit, including all the G7 countries, although they imposed many conditions. Today only a small minority of creditor countries do not provide a 100 % reduction on claims relating to the period before the respective debtor countries were first treated in the Paris Club¹⁰. A limited number of creditor countries, including most of the G8 countries, also grant 100 % debt reduction for debt incurred after this date. The extent to which both concessional credits¹¹ and commercial loans¹² are included in such debt relief also varies.

Norway has strongly emphasized the importance of presenting the main principles of the Debt Relief Strategy to central players in international debt policy, such as the World Bank, the IMF, the Paris Club and the current chairmanship of the G7/G8. Special presentations have been made in influential countries, such as the USA and the UK. Norway's debt policy has gradually attracted more attention than our creditor role merits. Norway has cooperated with the other Nordic countries, the countries in the Utstein Group¹³ and, on a case-by-case basis, with other countries.

⁸ See Chapter 6.1.

⁹ NOK 1,266 million under GIEK's old general scheme and NOK 1,907 million under GIEK's special scheme for developing countries respectively. See Box 1 for further details.

¹⁰ Known as pre-cut-off date debt.

¹¹ Known as Official Development Assistance (ODA) loans, i.e. loans subsidized by aid funds with a grant element of at least 25 %.

¹² Including export credits.

¹³ The Utstein Group was established as a forum for development policy cooperation between the Netherlands, the UK, Germany and Norway. Sweden and Canada joined later on.

There is now broad international agreement on most of the priorities set out in the Debt Relief Strategy. Norway has contributed to this through active efforts in all relevant multilateral forums. The HIPC mechanism has become more flexible and debt relief has become faster, deeper and broader. The Paris Club has introduced improved terms for HIPC countries and now, as a general rule, provides 90 per cent debt relief – known as Cologne Terms – to these countries.¹⁴

3.1. Forgiveness of bilateral debt

Priority was initially given to eight countries (Benin, Côte d'Ivoire, The Gambia, Ghana, Guinea, Senegal, Tanzania and Vietnam) against which Norway had claims and which, at the time the Debt Relief Strategy was introduced, were already being treated or were to be treated under the HIPC Initiative. Of these, Tanzania's and Benin's debts to Norway have

been cancelled. Vietnam, which has not been granted HIPC status, will nevertheless have all its debt forgiven under a debt swap agreement. The other countries have had their current interest and repayments cancelled and, as a result of their ongoing HIPC treatment, are in the process of meeting the conditions for final debt forgiveness.

In accordance with the principles of the Debt Relief Strategy, as of 31 December 2003 Norway had forgiven bilateral claims amounting to NOK 1.6 billion. More than NOK 1.3 billion of this was charged against the Debt Relief Strategy financing facility¹⁵. A breakdown of debt forgiveness by country may be seen in Table 1.

In principle, the Debt Relief Strategy provided for debt relief for 29 countries. Wars, conflicts, poor governance and the fact that not

Table 1.
Forgiveness of bilateral debt 1998-2003
(in NOK 1000, by country, as of 31 December 2003)

	Charged against facility	Charged against GIEK	Total debt relief
Senegal	191 393	33 776	225 168
Côte d'Ivoire	195 946	34 578	230 525
Guinea	61 689	10 886	72 575
Tanzania	86 447	15 255	101 703
Benin	229 055	40 422	269 477
Sierra Leone	32 890	5 804	38 694
Serbia-Montenegro ¹⁶	84 101	14 841	98 942
Egypt ¹⁷	227 000	40 059	267 059
D.R. Congo	99 581	66 387	165 968
The Gambia	65 357	3 440	68 796
Ghana	58 578	10 338	68 916
TOTAL	1 332 038	275 786	1 607 824

**Remaining funds in the Debt Relief Strategy financing facility
as of 31 December 2003: NOK 1,841 million**

¹⁴ Taking into account previous debt relief. In other words, total debt relief is calculated *cumulatively*.

¹⁵ The difference is ascribable to GIEK's loss provisions, which are regarded as GIEK's "own share" of cancelled debt. At the time, this share was estimated on the basis of the interest effect of the double allocation in connection with calculation of the amounts in the Debt Relief Strategy.

¹⁶ The Stoltenberg Government decided to include Yugoslavia – now Serbia-Montenegro – in the Debt Relief Strategy financing facility in 2001. However, the charge against the facility applies only to debt relief granted under a bilateral agreement in 2002 and debt relief that will be provided in 2005 (pursuant to a Paris Club agreement from 2001).

¹⁷ It was decided that this would be financed from the Debt Relief Strategy financing facility in 2002. Applies only to a bilateral agreement entered into in 1994 pursuant to an agreement in the Paris Club in 1991 and an associated debt swap. The amount charged against the financing facility is identical to a lump sum compensation of GIEK. No *further* debt relief for Egypt will be covered by the financing facility.

every country has had serious debt problems have limited the window of opportunity for bilateral inputs. With the expansion of the Debt Relief Strategy, however, steps are being taken to ensure that more countries will be eligible for debt relief from Norway.

A significant part of poor countries' debt to Norway is ascribable to the Ship Export Campaign in the 1970s and 1980s. Some of these claims have been cancelled. Efforts will be made to cancel the rest in a way that ensures the greatest possible development effect, insofar as this is possible within internationally recognized rules.

3.2 Debt relief under the Fund for International Debt Relief Operations (the Debt Relief Fund)

Norway's Debt Relief Strategy has sometimes been associated solely with bilateral debt forgiveness. However, Norway's contribution to international debt relief operations – the other main pillar of the Debt Relief Strategy – has also been a very important debt policy instrument. This contribution has been financed from the development assistance budget through the Fund for International Debt Relief Operations (The Debt Relief Fund)¹⁸.

Flexible budget funds, primarily through the Debt Relief Fund, have been crucial to Norway's high profile in the debt policy area, including its proactive role in important individual cases. It is often necessary to lead the way, as when the Nordic countries took the initiative to the establishment of the World Bank Fifth Dimension Facility at the end of the 1980s¹⁹, and when Norway exerted pressure to achieve organized financing of the HIPC mechanism by establishing the HIPC Trust Fund at the end of the 1990s²⁰. For a relatively small country like Norway, it is essential to be able to follow up political positions with practical financial instruments in order to succeed in international negotiations. This applies, not least, in the multilateral financial institutions and in forums such as the Paris Club.

Since it was established in 1988, total disbursements from the Debt Relief Fund have amounted to more than NOK 3.2 billion. Since the Debt Relief Strategy was launched in 1998, Norway has contributed NOK 915 million to the HIPC Trust Fund alone, which will refund parts of the debt relief provided by the multilateral financial institutions under the HIPC Initiative, so that other support for

BOX 3

The Debt Relief Fund: relevant applications

The Fund for International Debt Relief Operations can be used for:

- Contributions to the HIPC mechanism (the HIPC Trust Fund) to cover multilateral debt relief
- The World Bank **Fifth Dimension Facility** – to repay poor countries' remaining World Bank debt on ordinary terms (IBRD debt)
- The World Bank **Sixth Dimension Facility** (the IDA Debt Reduction Facility) – for very reasonably priced buyback and subsequent cancellation of poor countries' debt to commercial creditors (banks)
- Internationally coordinated operations to clear individual countries' arrears in multilateral financial institutions (the World Bank, the regional banks and the IMF)
- Measures to strengthen debt management capacity in poor and indebted countries
- Multilaterally coordinated debt swaps with countries that are not covered by the Debt Relief Strategy financing facility
- Multilaterally coordinated operations to cancel "South-South debt"
- Contributions to interest subsidies in the IMF's low-interest lending facility (PRGF)
- Contributions to national debt funds earmarked for servicing multilateral debt

¹⁸ Ch. 172, item 70 of the aid budget.

¹⁹ See Chapter 6.7.

²⁰ See Chapter 6.1.

developing countries from these institutions is not reduced as a result of their contribution to HIPC debt relief. This is substantially more than our “allotted” share, whether it is measured in terms of creditor size or the amount of funding provided. Table 2 provides a concentrated summary of the use of resources from the Debt Relief Fund.

Table 2
Allocations from the Debt Relief Fund
1988-2003 (NOK million)

World Bank Fifth Dimension Facility	1 524
HIPC Trust Fund	915
World Bank Sixth Dimension Facility	61
Other international debt operations	944
TOTAL	3 444

4. CRITICISM OF DEBT RELIEF INITIATIVES

At the end of the 1990s, the World Bank and the IMF, and indirectly the Paris Club as well, were under pressure, especially from civil society, to improve the HIPC mechanism. The main elements of this criticism were that debt relief was proceeding too slowly, was too limited and applied to too few countries. This criticism, which was made not least by the umbrella organization *Jubilee 2000*, made a positive contribution to the expansion of the HIPC mechanism in 1999, when a resolution was adopted to provide quicker, more robust debt relief. There is no doubt that this movement has helped to set the international debt policy agenda.

Nevertheless, some parts of the “debt relief movement” still criticize the scheme, and in some cases more or less write off the HIPC Initiative and advocate totally different debt relief mechanisms.

4.1. The scope of the HIPC Initiative

Some people have advocated that the multilateral financial institutions should immediately cancel their claims. From a purely intuitive point of view, it may perhaps not seem unreasonable for these institutions to cancel debt in the same way as other creditors. However, total, immediate cancellation of the claims of all the multilateral financial institutions would mean that these institutions would not be reimbursed, by means of repayments on loans, for funds they have lent. It is totally unrealistic to believe that rich countries will increase their contributions to these institutions by so much and so quickly that they will be able to make up for this loss of resources. In practice, it would therefore be impossible to compensate for large-scale cancellation of multilateral debt.

Everything that is paid into the multilateral institutions’ development funds for the poor-

est countries (such as the World Bank’s IDA) goes out again in the form of financing for development programmes in these countries. Massive debt cancellation would therefore, to a large extent, affect the poorest countries themselves, since their source of essential development financing would dry up. In the case of middle-income countries, it is highly likely that massive debt cancellation from their borrowing window in these institutions (such as the World Bank’s IBRD) would result in more expensive loans because the creditworthiness of the financial institutions would be affected. In other words, immediate cancellation of multilateral debt would mean giving with one hand and taking back with the other.

In Norway’s view, it is important for debt relief, as far as possible, to be additional, i.e. to come in addition to and not instead of development aid and loans that can help promote further development. This is a fundamental principle of the HIPC Initiative and thus something that the donor countries are committed to. In Norway’s case, this is ensured by not charging bilateral debt relief against the development assistance budget. For the multilateral HIPC creditors, the additionality of debt relief is ensured partly by using internal funds that do not impact on their operational activities and partly by financing from donor countries through the HIPC Trust Fund, which is managed by the World Bank.

Norway will ...

- ➔ work to ensure that debt relief through multilateral institutions is not provided at the expense of other multilateral financing for the poorest countries

4.2. The pace of implementation of the HIPC Initiative

Despite the fact that the HIPC Initiative was strengthened in 1999, implementation has proceeded more slowly than anticipated. There are several reasons for this, the most important being *conscious focus on quality assurance*.

One of the main aims of debt relief is to ensure that the funds that are freed up help to promote development in the countries concerned. Consequently, to be granted debt relief under the HIPC Initiative, a country must first be able to refer to a period²¹ in which it has pursued an economically and socially responsible policy²². A country must also have in place a coherent, poverty-oriented development strategy (PRSP)²³. It is essential for the country's further development, and not least to ensure debt sustainability, that the country's PRSP meets qualitative standards and is formulated with the active participation of the country's population and its elected representatives. People must therefore accept that this work must take some time. This time is not wasted; it is a good investment in long-term poverty reduction. If we were to reduce the requirements for the quality of PRSPs in order to increase the pace of implementation of the HIPC Initiative, this would do impoverished people a disservice.

At the same time, we must recognise that debt relief is an urgent matter. In 2002, Norway and certain other countries therefore advocated that a preliminary draft of a PRSP (an "interim PRSP") should be sufficient for a resolution on debt relief to be passed. This was agreed in 2001.

Most HIPC countries are in sub-Saharan Africa. Many of these countries are in a situation of armed conflict. Consequently, several

countries are still not qualified for debt relief. Nor should they be, since debt relief would free up resources to buy weapons, etc. and thereby help to prolong the conflict.

For countries emerging from conflict, it is extremely difficult to implement the reforms and political measures that are necessary to achieve genuine poverty reduction – and thereby be granted debt relief under HIPC. The countries that have been or are in conflict include countries that owe debt to Norway, such as Sudan and Liberia. There can be no point in bringing such countries in for HIPC treatment before the conflicts have ended and relative political stability has been restored.

Part of the explanation for the slow pace of implementation under the HIPC Initiative is that some bilateral creditors who are not members of the Paris Club, as well as several smaller multilateral creditors, have delayed concluding the necessary agreements with debtor countries. However, some commercial creditors have refused to take part in the HIPC mechanism and have even tried to recover their claims through courts of law. There is every reason to criticise this.

Norway will ...

- work to ensure that the HIPC Initiative is implemented at a pace that ensures as much poverty reduction as possible for each dollar and krone of debt that is forgiven.

4.3 Conditions for debt relief

The fact that creditors impose conditions for implementing debt relief measures is sometimes criticised. Their demands are often set against the desires and needs of poor people in developing countries. However, the critics

²¹ This period was originally three years, but is now usually one year.

²² See the description of the various phases of the HIPC mechanism in Box 5.

²³ National Poverty Reduction Strategy Papers (PRSP) is a concept launched jointly by the World Bank and the IMF. The PRSP includes the macro-economic, structural and social aspects of the development process. The authorities of the country concerned are themselves responsible for the strategy paper, which must be formulated on the basis of broad-based consultations with civil society. In principle, the PRSP requirement means that countries must formulate their own policies and choose their own reforms. The intention is for all players in the development assistance arena to base their activities on the country's own development and poverty reduction strategy so that, with the authorities in the lead, they all pull in the same direction.

ignore the fact that much of the debt relief that is actually granted is *development motivated* and therefore based on the same goal as other development cooperation.

In other words, debt relief is granted on the basis of a credible poverty reduction and development policy. In the same way as other forms of development assistance, debt relief that is granted on the basis of other criteria is unlikely to benefit the country's population. There is a growing realization that debt relief alone does not lead to development, and that unconditional, immediate debt relief is not a viable path to follow. If debt relief is to benefit the poorest members of the population, a country must itself initiate comprehensive, coherent development strategies, with special focus on poverty reduction (PRSPs). These strategies specify how countries will manage and invest their national resources, development assistance and other external financing, and the funds freed up by debt relief.

The purpose of such conditions is to help ensure that the country pursues a policy that does not lead it back into a hopeless debt situation, and that the resources that are freed up are spent on development and poverty reduction. It has been shown that, although we may still be far from satisfied with the situation, the countries that are granted debt relief significantly increase the resources they spend on sectors such as health and education. If these countries' debt had been cancelled unconditionally, there would have been far less chance of debt relief benefiting impoverished people.

Many poor countries have a bad starting point in terms of corruption, human rights and democracy. Debt relief is not only a matter of freeing up funds but also of helping to make the governments of poor countries take responsibility for their populations – and thereby of democratization and strengthening human rights. The rich countries clearly have a responsibility for helping to relieve the debt burden, but the critics have often omitted to point out the responsibility of governments and elites in poor countries for their own populations.

Norway will ...

- work to ensure that, as a condition for debt relief, realistic demands are made for active, development-promoting policies in debtor countries, with emphasis on poverty reduction.

4.4. Debt relief and “structural adjustment”

Some critics believe that the conditions that are currently imposed for debt relief are a continuation of the “structural adjustment programmes” that were implemented in connection with loans from the international financial institutions 15-20 years ago. The critics are right in saying that many of these programmes failed, especially in the poorest countries. However, today's programmes are far removed from their less sophisticated and often stereotype predecessors.

Today, the emphasis is on the connection between macro-economic, structural and social conditions, with poverty reduction as the main goal and national ownership as a fundamental prerequisite. Today, many of the reforms focus on strengthening the education and health sectors and combating corruption. There is strong emphasis on poor people to the greatest possible extent being protected from the immediate negative consequences of necessary adjustment measures. There is, therefore, little sense in comparing the conditions that are set for debt relief – i.e. that developing countries must implement strategies and measures which ensure that debt relief benefits the poorest people – with the former “structural adjustment programmes”.

We should certainly not conceal the fact that today's economic reform programmes often appear to be drastic remedies. However, the critics must also realise that many countries need extensive reforms and restructuring measures to get their economies on an even keel. In the absence of a massive increase in aid from the rich world, many countries must unfortunately shoulder heavy burdens themselves. It is easy to criticise, but the critics often have a rather facile attitude to basic economic realities.

Norway has advocated greater flexibility in the macro-economic conditions and that reforms be better adapted to the situation in each individual country. We have brought up these matters both generally and in connection with specific country situations. The reforms are based on countries' own strategies in which, in contrast with the former structural adjustment programmes, there is emphasis on the active participation of civil society.

However, we must admit that several of the PRSPs that have been presented do not clearly reflect the necessary holistic thinking or the desired national ownership. There have also been PRSPs which, to too great an extent, are in the nature of unprioritized wish lists. Furthermore, some PRSPs have taken too little account of the country's unique political and social characteristics. In the years ahead, it will therefore be important to further develop the PRSP concept as a consistent, action-oriented and credible instrument for implementation of development measures. Not least, stronger national ownership will be important as a basis for negotiations on new concessional loans from the World Bank and the IMF.

Norway will ...

- continue its efforts to achieve greater flexibility in the macro-economic conditions that are set for indebted developing countries, and to promote further development and improvement of the PRSP concept.

4.5. "Illegitimate debt"

The criteria for debt relief are not carved in stone. On the contrary, they are the subject of continuous review. This process of change must be based on debate among both professionals and the general public. A discussion of fresh ideas and conceptual innovations must be welcomed.

International common law is based on the premise that new regimes take over the international obligations of their predecessors, regardless of the nature of the former regime. There are a few historical examples of this common law being challenged and wholly or partially set aside²⁴. The international debt relief movement has recently begun to refer to these examples in its arguments in favour of cancelling what is now called "illegitimate debt".

Non-governmental organizations usually define debt as being "illegitimate" when:

1. the debt was incurred by an undemocratic regime
2. the borrowed funds have been used for what are regarded as morally reprehensible purposes (such as the purchase of landmines or the financing of suppressive regimes)
3. repayment is a threat to fundamental human rights
4. the debt has grown to unmanageable proportions as a result of external factors over which the country has no control (e.g. higher market interest rates), and when
5. debt that was originally commercial is taken over by the government of a debtor country (through the triggering of government guarantees).

The sum of these criteria for "illegitimacy" is a very finely-meshed net, in fact it is so finely-meshed that it appears to catch all debt. If all these criteria are accepted (including items 4 and 5 above), to advocate cancelling "illegitimate debt" may easily be seen as a recommendation to *cancel all developing countries' debt*. This can hardly be regarded as either appropriate or desirable.

- For example, if a country takes up a loan at low market interest rates and interest rates subsequently rise, it is difficult to regard the resulting increase in debt as "illegitimate". Or vice versa, if a country takes up a

²⁴ After the USA took over Cuba from Spain in 1898, the US authorities refused to pay Cuba's debt to Spain on the grounds that the debt had been incurred on behalf of the Cuban people without their consent and with the use of armed force. Reference is also made to the debt settlement with Germany in 1953 and a debt agreement with Indonesia in 1967 as (partial) examples of cancellation of "odious" debt.

loan at what at a given time appears to be a favourable fixed interest rate and market rates subsequently fall, this cannot be used as an argument in favour of illegitimacy either. Both market loans and fixed interest loans entail interest rate risk. This risk applies to both the debtor and the creditor, and both parties must take this into account when they make their strategic choices.

- Nor is the fact that debt often occurs when government guarantees are triggered a good argument in favour of regarding this debt as “illegitimate”. The way credit functions today, government guarantees are usually a necessary precondition for credits for private companies in poor countries. When projects go wrong and the borrower cannot service the loans, it is not unreasonable for the government that has provided the guarantees to be held liable. If governments were permitted to provide guarantees without risk of having to step into the borrower’s shoes, this would result in careless project evaluation and lax provision of guarantees, which would have highly unfortunate results.

However, the part of the debt relief movement’s argument that is limited to “dictator debt” (cf. items 1-3 above) has immediate moral appeal. Most people would instinctively feel that it is unreasonable and unfair for poor people in today’s D.R. Congo to be liable for debt incurred by the brutal, corrupt dictator Mobutu; that today’s Iraq should be responsible for loans taken up by Saddam Hussein; that democratic South Africa should be liable for debt incurred by the apartheid regime; or that today’s Argentina should be liable for the part of its foreign debt that was incurred during the military dictatorship in the 1970s and 1980s.

Nevertheless, it is a long step from the moral appeal of the illegitimacy concept to its translation into practical-political action. This is partly due to extremely difficult *delimitation problems* and partly due to the fact that the *practical implications* of legitimacy-based debt forgiveness are extremely problematic.

The most important delimitation problems in

the illegitimacy debate include the following questions:

1. Who will – and how will they – decide which regimes are to be regarded as “undemocratic” and which heads of state are to be regarded as “dictators”? In some cases it will even be necessary to stipulate a dividing line in the same head of state’s period in power. Should Zimbabwe’s President Mugabe be regarded as an “illegitimate” borrower, and when did he become one? It is questionable whether it is possible to set objective criteria for this at all, or to establish non-partisan panels that are authorized to “judge” such cases.
2. How do we deal with loans that are provided for more or less undemocratic regimes but where the borrowed funds are nevertheless invested in future production capacity, employment and development, to the benefit of the impoverished people?
3. How do we deal with loans that were certainly provided for undemocratic regimes or regular dictatorships, but whose main purpose was actually to prevent a serious economic crisis? What if a refusal of the loan application would have helped to trigger the crisis? What if this would have most likely resulted in mass poverty and distress? Is it really very relevant to ask whether a loan of this type was granted at a time when generals were sitting in the government offices?
4. How do we deal with loans provided by commercial banks? For example, the apartheid regime’s debt consisted almost entirely of loans from commercial banks. Should it be a public responsibility to finance cancellation of this debt, which in the case of most creditors would have to come from development assistance funds? Should this be done even though South Africa does not have a serious debt problem?
5. How do we deal with loans taken up by democratic, and possibly even well-respected regimes when the purpose can nevertheless be described as “illegitimate” (the

purchase of landmines, for example). Is it reasonable to relieve the regime of responsibility for such a purchase?

Due to such delimitation problems, it is extremely difficult to use “illegitimacy” as a reasonable and fair guideline for debt relief. If one implication of the illegitimacy debate is that developing countries have no responsibility for having taken up loans for “illegitimate” purposes, this is a very problematic premise. Both debtor and creditor must clearly be responsible for ensuring that loans are financially justifiable, that the funds are spent on measures that promote development, and that they can in no way be instrumental in undermining fundamental human rights.

Multilateral creditors with active member states are the best guarantee that lending meets these requirements. For example, loans from the World Bank may not be used for military purposes, or for investments in the tobacco or alcohol industries. Loans are only granted after thorough assessments of the development effect of the investment or programme that is being financed. The conditions that are now imposed on borrowing countries, i.e. that they must present a coherent strategy for development (PRSP), help to ensure that borrowing countries, including civil society, maintain their responsibility for and their control of the use of the borrowed funds.

The main practical-political arguments *against* encouraging debt relief on the basis of legitimacy considerations are as follows:

1. To set aside the premise that a regime is also responsible for the debt of the previous regime would lead to unknown consequences for the flow of capital in the global financial markets. The result would most probably be that capital flows to countries with external financing needs would be reduced, while the associated interest costs would rise. In a world with a crying need for

all kinds of development financing, where loans from capital markets will be essential for success at a certain stage in the development process, and where, through the UN Millennium Development Goals, we aim to halve the most extreme poverty by 2015, this is a worrying scenario.

2. If, at a later date, we were to be able to define debt as “illegitimate” on the basis of factors that were impossible to predict when the loan was granted, the risk for all types of lenders might become extremely high. This in itself would mean less access to financing and more expensive loans, especially for the poorest countries.
3. If – contrary to expectations – we were to begin to cancel debt on the basis of a concept that has no precise, internationally agreed definition, this would give rise to a great deal of uncertainty among lenders and guarantors. This in itself would result in (yet another) obstacle for developing countries due to their reduced individual and collective creditworthiness. Many countries that are today balancing on a very thin knife-edge in terms of lenders’ creditworthiness assessments might experience a veritable “credit drought”.
4. In many cases, the demand for debt cancellation on the grounds of “illegitimacy”, sometimes defined as “dictator debt”, applies to *middle-income countries*²⁵. This has important implications in terms of debt volume. For example, the total foreign debt of Iraq, Argentina and the Philippines is estimated to be USD 309 billion²⁶. The debt of these three countries alone is more than three times as great as the total debt of the 27 countries that have so far qualified for the HIPC Initiative, which is approximately USD 99 billion²⁷. If debt cancellation based on legitimacy assessments were to become a reality, this would necessarily entail a dramatic change in the *distribution* of international debt relief. In

²⁵ In some cases this applies to countries that have substantial revenues from extractive industries.

²⁶ Iraq USD 120 billion (estimated), Argentina USD 137 billion and the Philippines USD 52 billion. Source: World Bank *Global Development Finance, 2003* and (for Iraq) preliminary estimates by the IMF and the Paris Club. Iraq’s war reparations are not included.

²⁷ Source: World Bank *Global Development Finance, 2003*.

practice it would be the relatively better placed developing countries that would benefit most from debt relief – at the expense of the poorest countries.

5. In addition to this comes the practical-political reality that all creditor countries, with the exception of Norway, actually charge the bilateral debt relief that is provided against the *development assistance budget*, whether it is provided for poor countries or for middle-income countries. From this perspective, there is reason to note that the debt of the three countries named above is equivalent to between five and six global development assistance budgets. If we were to cancel “illegitimate” bilateral debt to middle-income countries on the scale many people in the debt relief movement now wish, this would bleed aid budgets dry worldwide and lead to massive cuts in the development assistance that today goes to the poorest people. *Global development assistance* would be redirected towards countries with more resources. This corresponds badly with the *poverty orientation* of other development policy.
6. Nor is multilateral debt relief free of charge; it also has to be *financed*. The development banks have very limited resources of their own for this purpose. Unless donor countries compensate the financial institutions with aid funds, massive multilateral debt cancellation would affect the developing countries themselves, including the poorest countries, because the institutions would have less money to lend. Unless such compensation is financed by a corresponding increase in aid budgets, other development assistance would necessarily decline. In the absence of a sharp increase in global aid funds, it is impossible to ignore this fact. In this case too, we risk that the countries most in need of development assistance would be the losers.

There is also an important *situational* argument against allowing the legitimacy debate to gain the central position that the debt relief movement now advocates: this debate may easily *direct attention away from important*

challenges under the HIPC Initiative. Among other things, an extensive illegitimacy debate might overshadow a necessary and highly desirable debate on the financing of multilateral debt relief under the HIPC Initiative – a question that is far from resolved. This would be very unfortunate.

For the HIPC countries, such as D.R. Congo, the illegitimacy debate would, in any event, be of limited practical importance. Most creditor countries, including Norway, will in any case cancel 100 % of their claims against these countries if they complete their HIPC treatment. If the motivation is somewhat different from that desired by the debt relief movement, the final result may well be the same.

A *tactical* argument must also be included in this evaluation. Norway is in a situation of having government-to-government claims against very few of the countries and regimes that have so far been central to the illegitimacy debate. For example, Iraq, South Africa, Argentina and the Philippines do not owe government debt to Norway. There is, therefore, a limit to how active Norway can be in relation to such issues in international debt negotiations in the Paris Club. It is important to ensure that we manage our proactive role among creditor countries in such a way that we are regarded as a serious, credible player; a player who, through cooperation with other creditors, can gain support for its views on important debt issues. This consideration must also weigh heavily in the evaluation of new debt initiatives and creative proposals in the debt area.

This does not necessarily mean that the debate on “illegitimate debt” is a blind alley. Firstly, the debate itself may result in loans not being granted for countries and regimes which, on moral grounds, *should not* receive them today. This would simply be a consequence of lenders choosing to pursue a more cautious policy than they would otherwise have done, well knowing that such loans might be the focus of stricter critical scrutiny than before. As long as this type of lending conservatism does not turn into a credit drought for countries that both need and deserve fresh capital, this type of effect would be positive.

Secondly, in some cases the debate entails stronger focus on countries emerging from war and conflict. Independently of the illegitimacy debate, Norway has taken the initiative in advocating that poor post-conflict countries should receive faster, deeper debt relief even before they are granted HIPC status²⁸.

Thirdly, we *cannot exclude the possibility* that, at some time in the future, it will be “lawfully” determined that dictators like Iraq’s Saddam Hussein or the Philippines’ Ferdinand Marcos have taken up loans that must be regarded as illegitimate²⁹.

Fourthly, this perspective might be helpful when democratic regimes try to reclaim personal assets which dictators have built up illegally, partly through loans. More than the lending itself, this type of activity represents the most illegitimate aspect of this complex problem. The new UN Convention against Corruption gives us new instruments in this area.

We can expect further work to be done on these issues. Norway is willing to support multilaterally-based studies in this area.

Norway will ...

- support a possible study of “illegitimate debt”, carried out by the relevant multilateral institutions, the goal of which is to make practical, implementable recommendations.

4.6. “Debt tribunals”

Over the years, many proposals have been launched for the establishment of new institutions in the debt field, often independent of the Bretton Woods institutions, in many cases inspired by US bankruptcy legislation, and in some cases linked to the UN. The purpose of such institutions has often been “arbitration” between creditors and debtors, possibly fol-

lowed by a “ruling” and often with the aim of promoting more comprehensive debt relief, on the basis of an assessment that this would be *fairer* than the current debt relief arrangements.

Many of these proposals have come from academic institutions, which in turn have inspired the international debt relief movement to promote these ideas itself. One of many examples is the proposal for Free and Transparent Arbitration Processes (FTAP), which has been promoted by the *Jubilee* movement and is now supported by the Norwegian Campaign for Debt Cancellation (SLUG).

The debt relief movement’s agitation in favour of alternative debt work-out mechanisms has in some cases also inspired international organisations to present their own proposals. Thus, in 1998³⁰ UNCTAD launched a proposal for an *international bankruptcy court*. In his Millennium Report³¹, UN Secretary General Kofi Annan suggested that the international community should consider the establishment of what he called a debt *arbitration process* with greater balance between the interests of creditor and debtor countries. Kofi Annan’s proposal was *not* explicitly linked to the illegitimacy debate. This link has subsequently been made by the debt relief movement itself.

In November 2001 Anne O. Krueger, Deputy Chairman of the IMF, presented a proposal for a comprehensive Sovereign Debt Restructuring Mechanism (SDRM) for earlier, quicker, cheaper and less painful debt settlement. The SDRM was originally conceived as a joint framework for settling the commercial and official debt of middle-income countries, with the IMF itself playing a central role. However, this proposal was significantly modified as the debate progressed. In spring 2003, the proposal was *de facto* put on ice, primarily due to opposition from the USA (who wanted a more “market oriented” version) and some middle-income countries (who

²⁸ See Chapter 6.5.

²⁹ In an editorial on 18 October 2003, *The Economist* advocated that the part of Iraq’s debt that was taken up by Saddam Hussein must be regarded as illegitimate on both economic-political and moral grounds.

³⁰ Trade and Development Report, 1998.

³¹ *We the Peoples. The Role of the United Nations in the 21st Century, 2000.*

feared that the SDRM might have a negative impact on their creditworthiness).

Nevertheless, work is still in progress on a couple of less ambitious instruments. They are *Collective Action Clauses* (CACs) to persuade commercial creditors to negotiate jointly and a *Code of Conduct* for commercial creditors and their interaction with official creditors. Norway welcomes this work, but regrets that it has not been possible to reach international agreement on an SDRM.

Since the SDRM debate, among other things prior to the 58th UN General Assembly in autumn 2003³², the UN Secretary General has, in a way, re-launched his proposal. Specifically, he proposes the establishment of an open and informal group of experts as part of the follow-up to the UN Conference on Financing for Development³³, with a mandate to formulate a proposal for a debt work-out mechanism that can achieve broad support. Norway supports this proposal, but it has so far met with opposition from influential circles. Norway will nevertheless continue its soundings on the proposal. If such a group were to be established, it must be on condition that all the institutions that have played a central role, both in connection with the UN conference and in the SDRM debate, such as the World Bank and the IMF, be included in this work. Both these institutions must be “on board” if a new debt negotiation mechanism is to be able to function in practice.

Norway will ...

- work to ensure that the debate on the SDRM is reopened, with a view to realizing as many as possible of the main intentions of this mechanism

- as part of this work, continue soundings in connection with the proposal of the UN Secretary General for the establishment of an international working group, representing a broad range of interests, to study the question of a comprehensive, practically implementable debt negotiation mechanism.

4.7 Unilateral debt forgiveness for middle-income countries?

In Norway, the illegitimacy debate has culminated in a demand from non-governmental organizations for the cancellation of middle-income countries' debt to Norway as well. However, unilateral, unconditional debt cancellation for middle-income countries is not desirable. As a rule, these countries do not have any instruments equivalent to the development strategies (PRSPs) of the poorest countries. Consequently, it is far more difficult to ensure that the resources freed up by debt cancellation will actually benefit the country's development and its impoverished people. If we cannot be reasonably sure that debt cancellation will result in poverty reduction, the basis for Norwegian debt relief will be invalid. In other words, if unilateral debt reduction for middle-income countries is to be considered, we must try to establish a substitute for the PRSP. This is also the core of the debt swap concept, for which Norway has launched an international initiative – both in the Paris Club and vis-à-vis the G8³⁴.

32 See *External Debt Crisis and Development. Report of the Secretary General (A58/290) and Implementation and Follow-up to Commitments and Agreements made at the International Conference on Financing for Development. Report of the Secretary General (A58/216)*.

33 Monterrey, Mexico, March 2002.

34 Reference is made to Chapter 6.6.

5. PRIORITY COUNTRIES IN NORWAY'S DEBT RELIEF POLICY

The Debt Relief Strategy covers developing countries against which Norway has claims, developing countries that have priority in Norwegian development cooperation, developing countries covered by the HIPC Initiative, and other developing countries which (on an ongoing basis) are included for political reasons. Developing countries are defined as the countries on the OECD Development Assistance Committee (DAC) list of countries which, on the basis of their revenue levels, are entitled to receive Official Development Assistance (ODA). However, countries against which claims have arisen after 31 December 1997 are not covered by the Debt Relief Strategy financing facility.

5.1. Countries against which Norway has claims

Table 3 shows all Norway's government-to-government claims at the end of 2003, compared with claims at the end of 1997.

5.2. Criteria for the selection of priority countries

In order to identify which countries are qualified for Norwegian debt relief measures, we must assess the country's debt burden and the economic situation of each country and take into account political considerations – including human rights, democracy and corruption – as well as special factors in the relationship between Norway and the debtor country concerned.

In accordance with Norwegian development policy, low-income countries should have special priority for debt relief measures. These are defined as developing countries which, on the

basis of their poverty level and lack of credit-worthiness, can only obtain loans through the World Bank International Development Association (IDA)⁴⁰. Of course, they must also have debt problems. Middle-income countries with serious debt problems should also be eligible for Norwegian measures, either bilaterally or through international debt operations.

To be eligible for Norwegian debt relief measures, a country must pursue a policy that demonstrates that it will be able to utilize the freed-up resources (which would otherwise have been spent on interest and repayments) for measures that will promote development and reduce poverty. The country must commit itself to implementing necessary economic reforms through programme cooperation with the International Monetary Fund (IMF) and/or the World Bank. To achieve an agreement with the IMF and/or the World Bank on support from these institutions' lending facilities for the poorest countries⁴¹, a country must have formulated a coherent Poverty Reduction Strategy Paper (PRSP).

Countries that are not expected to formulate a PRSP (mainly middle-income countries) must prove in some other way that debt relief will promote poverty reduction and development. Debt swap agreements, which specify what the freed-up funds will be spent on, are thus an alternative to PRSPs⁴².

In all cases, demands must be made for measures to combat corruption and promote good governance. The resources that are freed up by Norwegian debt relief must be spent on measures that, as far as possible, are integrat-

40 IDA – the World Bank International Development Association – lends funds to the poorest developing countries on extremely favourable terms: interest-free (only an annual administration fee of 0.75 per cent) and with a grace period of up to 10 years. The repayment period is up to 40 years.

41 At the IMF it is a Poverty Reduction and Growth Facility (PRGF) and at the World Bank it is IDA.

42 See Chapter 6.6.

Table 3.
Norway's claims against developing countries^{35 36}
Countries covered by the Debt Relief Strategy financing facility in bold face
(NOK million as of 31 December 1997 and 31 December 2003 by size in 2003)

Land	Debt 1997	Debt 2003	Regulated by agreement ³⁷	Outside agreement
Peru	759	583	583	0
Sudan	318	320	127	193
Ecuador	319	304	304	0
Egypt³⁸	306	256	256	0
Pakistan	0	255	255	0
Senegal	398	232	232	0
Burma	232	232	0	232
Côte d'Ivoire	319	191	191	0
Algeria	166	139	139	0
D.R. Congo	197	122	122	0
Croatia	181	103	103	0
Zimbabwe	0	101	0	101
Serbia-Montenegro³⁹	101	96	96	0
Guinea	125	89	89	0
Liberia	82	83	63	20
Indonesia	0	80	80	0
Sierra Leone	69	66	66	0
Jamaica	149	55	55	0
Vietnam	37	36	36	0
Ghana	202	8	8	0
Gambia	49	8	8	0
Angola	6	6	0	6
Somalia	6	6	0	6
Benin	225	0	0	0
Tanzania	77	0	0	0
Mexico	71	0	0	0
Venezuela	44	0	0	0
Albania	18	0	0	0
Iran	7	0	0	0
Bosnia	5	0	0	0
Macedonia	2	0	0	0
TOTAL	4.470	3.371	2.813	552
TOTAL Debt Relief Strategy countries	4.142	2.832	2.375	451

³⁵ Defined as countries on the OECD/DAC *List of Aid Recipients, Part 1: Developing Countries and Territories (Official Development Assistance)*.

³⁶ For countries such as Sudan, Liberia and Burma, accrued interest – which due to long-term arrears has not been calculated – may amount to substantial sums. These will come in addition to the figures in the table.

³⁷ Regulated through a multilateral framework agreement (Agreed Minute) in the Paris Club and in turn translated into a legally binding bilateral agreement with Norway.

³⁸ Only debt relief that has already been granted is covered by the Debt Relief Strategy financing facility.

³⁹ Only debt relief granted in 2002 and debt relief that will be granted in 2005 (pursuant to a Paris Club agreement from 2001) are covered by the Debt Relief Strategy financing facility.

ed into the country's overall development efforts.

The political situation in the country concerned must also be taken into account. Contraventions of human rights will reduce the likelihood of debt relief being granted. Debt relief must not benefit authoritarian regimes. When conditions improve, such countries will be assessed in relation to the recommendations laid down in the Debt Relief Strategy. The same applies to countries that no longer have a central authority, or are still in a state of civil war. When the situation changes for the better, such countries may also be given priority under the Debt Relief Strategy. A credible peace treaty after an armed conflict and a subsequent coordinated international effort to support stabilization

and reconstruction are regarded as being sufficient qualification for debt relief⁴³.

The Debt Relief Strategy also covers countries that already receive or will be eligible for debt relief under the HIPC Initiative but are not indebted to Norway. For these countries, Norway may provide assistance through the Fund for International Debt Relief Operations for a range of debt-related purposes.

5.3. Priority countries

The list of priority countries for debt relief from Norway, selected on the basis of the above criteria, may be found in Box 4 below. This list must *not* be regarded as final and binding for Norway's debt policy, but rather as a living instrument that offers possibilities for additions and deletions.

BOX 4

Priority countries for debt relief from Norway

Among the countries against which Norway has claims, the following have first priority⁴⁴:

Senegal, D.R. Congo, The Gambia, Ghana, Sierra Leone, Vietnam, Ecuador, Pakistan, Côte d'Ivoire, Guinea,⁴⁵ Sudan and Liberia,⁴⁶

These countries are eligible for HIPC debt relief, unilateral debt relief from Norway in addition to the HIPC terms, debt swaps (Pakistan, Vietnam and Ecuador) and unilateral post-conflict debt relief from Norway (Liberia and Sudan). With the exception of Pakistan, debt relief for these countries will be financed through the Debt Relief Strategy financing facility.

Among partner countries for Norwegian development cooperation against which Norway does not have bilateral claims, the following have priority:

Tanzania, Mozambique, Uganda, Zambia, Malawi, Bangladesh, Nepal, Ethiopia, Eritrea, Mali, Sri Lanka, Guatemala, Nicaragua, Kenya, Madagascar and Afghanistan

These countries are eligible for various types of international debt operations, financed from the Fund for International Debt Relief Operations (The Debt Relief Fund)⁴⁷.

⁴³ See Chapter 6.5.

⁴⁴ It is assumed that Angola, Somalia and Burma have a long way to go before relations with creditor countries and the international financial institutions are normalized. The disposition of the Debt Relief Strategy financing facility outlined in this Plan of Action nevertheless also allows for these countries to become eligible for Norwegian debt relief.

⁴⁵ It is assumed that Côte d'Ivoire and Guinea, which are currently "de-railed" from their IMF programmes, will come back on track and thereby qualify for debt relief under the HIPC Initiative (for which Guinea was qualified until 2003).

⁴⁶ In the case of Sudan and Liberia, the conditions are lasting peace solutions, that these countries clear their arrears vis-à-vis to the international financial institutions with the help of international support operations, and that they qualify for HIPC treatment.

⁴⁷ In the case of 11 of these countries (Tanzania, Mozambique, Uganda, Zambia, Malawi, Bangladesh, Ethiopia, Nicaragua, Afghanistan, Kenya and Sri Lanka) Norway has already supported one or more operations.

6. DEBT POLICY INSTRUMENTS AND AREAS OF FOCUS

There are several mechanisms available to Norway in its efforts to reduce the debt burden of the poorest developing countries. Most of these mechanisms have been developed and are administered by the multilateral financial institutions, and are regarded as effective means of alleviating the debt situation of developing countries. Creditor country status is a prerequisite for participation in some of these mechanisms.

Describing Norway as a “small country in the world” may be a somewhat hackneyed phrase, but it nonetheless has political significance in many contexts, particularly where debt is concerned. Norway is and will remain a small creditor, the very smallest in the Paris Club seen as a whole.⁴⁸ It can be tempting to take huge steps forward on our own. In the long run, however, a debt policy based on immediate, unilateral debt forgiveness would have very little positive effect, partly because we are small, partly because we would in practice be withdrawing from the fora in which new debt policy is formulated and partly because that type of unilateral debt forgiveness would primarily benefit other creditors.

Norway is therefore definitely a multilateralist, in the field of debt policy and elsewhere. That is also why the HIPC Initiative is a cornerstone of Norwegian debt policy. The HIPC Initiative is not “made in Norway”, but we have influenced it to a greater extent than might be expected of a “small country”, and it is the best, most comprehensive debt policy instrument currently in existence.

However, binding multilateralism must never serve as an excuse for a lack of initiative on our part. Sometimes it makes sense to be out

in front leading the way, particularly when we can set the agenda and help create international momentum. As far as Norway is concerned, binding debt policy cooperation in international fora has always been accompanied by active unilateralism. In some areas, particularly as regards unilateral forgiveness of the debt of poor countries, we were the very first to take action. More recently, we have initiated new debt relief measures for post-conflict countries and middle-income countries. We have played, still play and will continue to play a proactive role in the field of debt policy.

6.1. Binding cooperation under the HIPC Initiative

In order to solve the debt problems of the poorest developing countries, the World Bank and the IMF, after lengthy negotiations in the governing bodies of these institutions, established the Heavily Indebted Poor Countries Initiative (the HIPC Initiative) in 1996. This initiative is aimed at reducing the debt burden of the poorest developing countries to a level that does not impede their economic and social development. Under the initiative, which covers around 40 countries (most of which are in Africa), the World Bank and the IMF will jointly carry out an analysis of each country to ascertain whether the country has an unsustainable burden of debt. One of the basic principles of the HIPC Initiative is that debt relief must be provided *in addition* to other development assistance. The initiative is estimated to provide debt relief totalling around USD 50 billion. On average, the debt of each country is expected to be reduced by two-thirds.

In 1999 the initiative was strengthened by including more countries and providing more

⁴⁸ Nevertheless, Norway may be a substantial creditor for some countries. For instance, Norway was Benin's third largest bilateral creditor (in terms of commercial credits) until the country's debt was forgiven as part of the completion of Benin's HIPC treatment in autumn 2003.

debt relief more rapidly. Furthermore, debt relief was linked even more closely to efforts to reduce poverty by requiring each country, with the active participation of its population, to present a Poverty Reduction Strategy Paper (PRSP), a development strategy in which poverty reduction is one of the primary objectives. Thirty-eight countries are eligible for debt relief under the HIPC Initiative, 27⁴⁹ of which have qualified for such relief. HIPC treatment of thirteen of the latter countries has been completed.⁵⁰ Most of the 11 countries that have yet to be included are in the throes of armed conflict and/or under poor governance.⁵¹ This means that they have not been able to implement PRSPs or other measures that are necessary to ensure that debt relief benefits the country's population.

The HIPC Initiative represents an important expansion of scope compared with previous debt relief initiatives, particularly since it gathers all creditors in a single, joint debt relief operation for each debtor country. All creditors must contribute to reducing this burden of debt to a sustainable level in relation to the country's anticipated export revenues and budget situation.

The HIPC Initiative represents an innovative approach to solving the debt problems of the poorest developing countries. The fact that this is largely a pioneering effort means that the economic analyses on which individual debt relief operations are based are somewhat uncertain. This uncertainty creates a need for a reasonable degree of flexibility as regards the eligibility criteria for debt relief under the initiative and measures to make the mechanism more robust.

The most important fora for discussing the HIPC mechanism are the governing bodies of the World Bank and the IMF. Norway participates in constituency groups in both institutions with the other Nordic countries and the Baltic states. There is close Nordic coordina-

tion on matters submitted for consideration, including HIPC issues.

In Norway, there is close contact between the Ministry of Foreign Affairs and the Ministry of Finance/The Central Bank, the authorities responsible for Norwegian participation in the governing bodies of the World Bank and the IMF, respectively. This type of ongoing contact is particularly important with regard to HIPC issues, which are dealt with by both institutions. The Ministry of Finance also takes part in discussions on Norwegian positions on HIPC issues.

Issues related to the participation of other multilateral financial institutions in the HIPC mechanism are dealt with by the governing bodies of the institutions concerned.

Responsibility for Norwegian participation in these fora lies mainly with the Ministry of Foreign Affairs. The same applies to responsibility for Norwegian participation in the Paris Club, where the HIPC participation of bilateral creditors is discussed.

In all these fora, Norway has attached importance to playing a consistent, active role in HIPC-related negotiations, with a view to ensuring that the detailed design of the HIPC mechanism conforms as far as possible to Norwegian policy.

6.1.1. Results and challenges under the HIPC Initiative

Twenty-seven countries currently benefit from debt relief under the HIPC Initiative. When these countries have completed the HIPC cycle, their debt will have been reduced by approximately USD 41 billion in nominal value. In real value, their debt will have been reduced by about two thirds.

Besides alleviating countries' burden of debt, one of the key goals of the HIPC Initiative is to ensure that the funds that are freed up by debt relief contribute to social and economic

⁴⁹ Benin, Bolivia, Burkina Faso, Mali, Mauritania, Mozambique, Tanzania, Uganda, Cameroon, Chad, Democratic Republic of Congo, Ethiopia, The Gambia, Ghana, Guinea, Guinea Bissau, Guyana, Honduras, Madagascar, Malawi, Nicaragua, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone and Zambia.

⁵⁰ Uganda, Bolivia, Mozambique, Tanzania, Burkina Faso, Mauritania, Benin, Mali, Guyana, Nicaragua, Niger, Ethiopia and Senegal.

⁵¹ Ivory Coast, Burundi, Central African Republic, Comoros, D.R. Congo, Laos, Liberia, Burma, Somalia, Sudan and Togo.

The Main Stages of the Debt Relief Process under the HIPC Initiative:

1. The countries concerned must draw up a coherent development strategy called a Poverty Reduction Strategy Paper (PRSP), which also forms the basis for the provision of other assistance by the World Bank and the IMF and, to a growing degree, by other donors. The PRSPs are updated regularly.
2. The World Bank, the IMF and the debtor country conduct a joint **debt sustainability analysis** to determine whether the country's debt situation is sustainable. If the country's foreign debt exceeds 150 % of annual export revenues and/or 250 % of the government's disposable income, the debt is regarded as unsustainable and the country may qualify for debt relief. In some cases where the country in question has a very open economy and is therefore particularly vulnerable to changes in external parameters such as commodity prices, the country may be eligible for debt relief even if its foreign debt and/or debt servicing burden are smaller than the above-mentioned criteria.
3. If the country qualifies for debt relief under the HIPC mechanism, it must, before debt relief is provided, carry out specific measures based on its PRSP in order to ensure that the debt relief contributes to development and poverty reduction. When these measures have been implemented, the country reaches the **decision point**, when the amount of debt relief that must be provided in order to render its debt sustainable is calculated on the basis of the above-mentioned criteria. As a rule, the Paris Club creditor countries provide 90 % debt relief when the decision point is reached. Other bilateral creditors are expected to do the same. On this basis, a calculation is then made of the amount of debt relief the multilateral creditors, such as the World Bank and the IMF, must provide to reduce the debt to the targeted level of sustainability. When the decision point is reached, agreement is also reached as to which further measures – which must be based on the country's PRSP – must be carried out in order for the country to be able to reach its **completion point**. Debt relief may be stopped during the interim period between the decision point and completion point if the conditions for debt relief are not met. The length of the interim period will depend on the implementation of the PRSP and associated conditions, but the period is normally two to four years.
4. When the **completion point** is reached, the volume of the country's debt is reduced so that its future debt situation is sustainable based on the criteria mentioned in point 2. This means that the country is guaranteed the agreed debt relief for a period that often extends 10-15 years beyond the completion point, depending on the situation in the individual country. Several of the Paris Club creditors forgive all remaining debt at the completion point. Norway was the first country to introduce this practice. The multilateral creditors continue to forgive a certain percentage of debt to ensure that the country's debt burden remains sustainable. When the completion point is reached, an updated debt sustainability analysis ("recalculation") is carried out. If the analysis shows that, due to exogenous shocks during the interim period, the debt ratios will exceed 150/250 %, a decision may be made to give the country additional debt relief ("topping up") in order to enable it to meet the debt sustainability criteria.

development in the countries concerned. It has therefore been emphasised that freed-up funds must be spent on measures that promote development, primarily in the health and education sectors, within the framework of a PRSP. Public expenditure is a key factor in combating poverty, and an important aspect of the PRSP approach is ensuring that the budget targets the poor to a greater degree. To strengthen the link between debt relief and poverty reduction, HIPC countries are required to document how public funds are used to reduce poverty. Over 25 multilateral and bilateral donors, including Norway, provide technical and professional assistance

to strengthen public administration in HIPC countries.

The World Bank has estimated that the first 22 countries to reach their decision points under the HIPC Initiative would increase their spending on social measures by an average of USD 1.7 billion per year in 2001 and 2002. Around 40 per cent of these funds were expected to be spent on the education sector and 25 per cent on the health sector. The funds would be spent on basic infrastructure, governance reforms and measures to combat HIV/AIDS. On average, these countries will have spent about seven per cent of their GDP

BOX 6

Country case: Tanzania's HIPC treatment

In April 2000 it was decided that Tanzania was to receive debt relief under the HIPC Initiative. The debt relief was to total USD 2026 million, which was a 54 per cent reduction in Tanzania's total debt as of 31 June 1999. During the period up to the completion point, Tanzania was to receive around USD 94 million in interim support from the World Bank and the IMF. Norway, for its part, cancelled approximately NOK 54 million of debt that fell due for payment during the interim period. In August 2000 Tanzania presented its first PRSP, which was approved by the Executive Boards of the World Bank and the IMF in the months that followed, with the support of the Nordic and other countries. In order to strengthen Tanzania's economic development and orient public budgets to a greater degree towards reducing poverty, structural and economic reforms were necessary. The reform process was launched prior to implementing debt relief. One of the criteria that had to be met in order to be eligible for debt relief was the implementation of measures to combat corruption. It was also required that at least 75 per cent of children under two years of age in Tanzania be vaccinated against measles, and that a national campaign to prevent HIV/AIDS be carried out. These and several other criteria were met, and Tanzania reached its completion point under the HIPC Initiative on 31 June 2001. In 2002, Norway cancelled the remainder of its claim against Tanzania, which amounted to over NOK 47 million. From 1998/99 to 2000/01, Tanzania increased its transfers to the education and health sectors by 88 % and 45 %, respectively. This growth is expected to continue.

on social measures in the period 2002-2005. In comparison, annual expenditure on debt servicing after HIPC treatment in the same period is estimated to be two per cent of GDP.

For the 27 countries that have received HIPC debt relief so far, the World Bank has estimated that debt servicing measured in relation to annual export revenues fell from an average of 16 % in 1998 to 10 % in 2002. Annual expenditure on interest and loan repayments will be about 30 % lower in 2001-05 than in 1998 and 1999. Expenditure on poverty reduction initiatives (particularly health and education programmes) in 2002 was almost four times as high as spending on interest and loan repayments. In 1999, the ratio was at best one to one. During this period, the HIPC countries' social-sector investments increased from around 6 % to around 9 % of GDP. In other words, a significant turnaround has taken place over a short period of time; the debt servicing burden has decreased substantially, while expenditure on health and education has increased significantly.

These positive trends are expected to continue. According to the World Bank's latest studies, direct, poverty-reducing expenditure in the 27 countries that have received HIPC debt relief is expected to *double* from around USD

6 billion in 1999 to USD 12 billion in 2005.

It has previously been unclear whether the debt relief provided so far under the HIPC Initiative has been given in addition to or at the expense of other assistance. In its latest analyses, however, the World Bank concludes that to all appearances the debt relief has been additional. In other words, the HIPC Initiative appears to function as intended in this respect as well.⁵²

When a country qualifies for debt relief under the HIPC Initiative and reaches the decision point, a calculation is made of the amount of debt relief that is necessary to ensure that the country's debt situation is sustainable⁵³ when HIPC treatment is concluded. This calculation requires that future export income and other national revenues and expenditures upon conclusion of debt relief also be computed. On several occasions, the amount of debt relief calculated at the completion point has proved to be insufficient to achieve a sustainable debt situation. This is due to both significant changes in commodity prices in the disfavour of developing countries and the weak economic policies of the HIPC countries themselves.

Furthermore, the economic growth calculations used by the World Bank and the IMF

⁵² It should be noted that Norway's bilateral debt relief under the HIPC Initiative *is guaranteed to be additional*, due to Norway's distinctive budget solution.

⁵³ In the HIPC context, a debt is defined as sustainable if it represents less than 150 % of the country's annual export earnings. The country's general economic vulnerability is also assessed.

have often been overly optimistic. This has made it necessary to recalculate the amount of debt relief at the completion point.

However, there is no *guarantee* that the recalculated debt relief will be sufficient to achieve a sustainable debt situation after the HIPC process has been completed. This will largely depend on the country's own policy and trends in external parameters, including international commodity prices and debtor countries' access to markets in industrialized countries. To the extent that ordinary HIPC debt relief proves to be insufficient to ensure sustainable solutions for developing countries, and this is due to exogenous economic shocks over which the countries have no control, Norway is in favour of a flexible "topping up" of debt relief under the HIPC Initiative.

There will presumably be growing discussion on the subject of debt sustainability, which may result in policy adjustments. Norway has initiated an ongoing research project in the World Bank on precisely this issue, which will naturally be followed up when the findings have been presented.

Norway will ...

- follow up an ongoing, Norwegian-financed study by the World Bank to ensure that poor countries achieve debt sustainability
- consider further financing of more work in this field

6.1.2. Long-term financing of the HIPC Initiative

The countries treated under the HIPC Initiative also receive assistance through the World Bank's International Development Association (IDA) Fund, and other similar development funds for the poorest countries. Cancelling these funds' claims against debtor countries will initially result in a corresponding reduction in the funds' future support for development programmes in poor countries. This will in turn give rise to the absurd situation that the poor countries themselves will be bearing a significant share of the burden of debt relief under the HIPC mechanism.

BOX 7

Method for calculating the need for debt relief at the HIPC completion point

While the HIPC mechanism requires all creditors to provide their share of debt relief proportionate to their relative size as creditor, Norway – and gradually several other creditor countries – have chosen to cancel all their claims, as a supplement to the HIPC Initiative. In practice, in most cases this is done by increasing the debt reduction from 90 % (taking into account previous debt relief) to 100 % (subject to a number of reservations stipulated by many creditor countries). This additional input can be seen as a "precautionary" insurance premium to ensure durable debt sustainability.

In autumn 2001, the World Bank and the IMF began to include this type of extraordinary bilateral debt relief when calculating total debt relief provided under the HIPC Initiative. This means that such unilateral debt relief is computed as part of the coordinated HIPC debt relief, instead of coming in addition to it, and thus does not function as an extra guarantee of debt sustainability. Furthermore, it means that the debt relief provided under the HIPC Initiative itself is less than it otherwise would have been. The creditors that provide 100 % debt reduction thereby subsidise those that do not, and the multilateral institutions' proportionate share of total debt relief is reduced. The debtor countries, for their part, are deprived of debt relief that was intended as additional assistance.

This unfortunate method of calculation is the result of the unwillingness of major creditor countries to participate in fully financing the HIPC Initiative. Norway is very dissatisfied with this arrangement. Efforts are being made to create a majority in favour of changing this aspect of the method. From summer 2003, Norway has postponed the decisions on extraordinary cancellation of debt until the countries in question have reached the completion point and the calculation of any extra debt relief under the HIPC mechanism has been carried out. In this way, Norway's extraordinary forgiveness of debt will not contribute towards reducing the financing obligations of other creditor countries, and the additional assistance provided will benefit only the debtor countries.

However, it is a basic principle that multilateral debt relief under the HIPC Initiative must not lead to a reduction in the assistance provided through such funds, but be additional to such assistance. This principle was established in a communiqué issued by the Development Committee⁵⁴ in autumn 1999 and has since been confirmed on several occasions.

In 1999 Norway played an important role in securing this principle. We put forward a demand for formal, regular negotiations between all donor countries throughout the lifetime of the HIPC Initiative on full financing of multilateral debt relief under the mechanism. This initiative was controversial when it was presented and was opposed by the G7 countries and others. After a series of consultations, including a meeting in summer 2000 between like-minded countries and the World Bank in Oslo, a procedure was adopted whereby negotiations are held on the replenishment of a HIPC Trust Fund in parallel with, but separately from, the regular negotiations every third year on the replenishment of IDA. In addition, an annual “technical meeting” is held to deal with current issues and financing needs under the HIPC mechanism. The Nordic countries acted as a block during these negotiations, which contributed to the good result.

So far, financing of the HIPC Initiative has been secured until around 2005, provided that all pledged contributions are paid in⁵⁵. Since multilateral debt relief under the HIPC Initiative is provided when payments fall due, when the debt should otherwise have been serviced by the debtor country itself, the debt relief covers a period of several years. This helps to spread costs over time. However, it is extremely important that efforts to fully finance the multilateral debt relief provided under the HIPC Initiative are successful, so as to make the financial situation of HIPC countries more predictable. This will require substantial additional voluntary contributions from donor countries to ensure that the abili-

ty of the multilateral institutions to assist the poorest countries is not reduced as a result of debt forgiveness.

Norway will ...

- seek to achieve a reasonable and increased degree of *flexibility* in the HIPC mechanism:
 - countries that are borderline cases with regard to qualifying for HIPC treatment must, after a detailed assessment, be eligible for inclusion in the scheme
 - temporary hitches in reform programmes must not result in countries having to begin anew on the process of building up their track record
 - in the event of unforeseen, exogenous economic setbacks for individual countries, the debt relief required to ensure these countries a sustainable debt situation must be recalculated
 - final debt forgiveness must take place when there are grounds for it (floating completion point), rather than in accordance with a previously established schedule
- work to achieve reasonable *burden sharing* among the various stakeholders by ensuring that the G8 countries are aware of their particular responsibility and that all the multilateral institutions assume their share of debt relief
- work to ensure that binding *multilateral negotiations* are held at regular intervals on *full financing* of multilateral debt relief to achieve full compensation for IDA
- continuously urge other donor countries to pay their pledged contributions to the HIPC Trust Fund so as not to affect the operations of the multilateral institutions

⁵⁴ The Development Committee is a joint committee for the World Bank and the IMF, which meets at ministerial level twice a year to discuss North-South resource flows and selected topics from the international development agenda.

⁵⁵ As of 31 January 2003, the countries that have contributed to the financing of the HIPC have paid in around USD 2.2 billion of pledged contributions, which total approximately USD 3.4 billion, to the HIPC Trust Fund.



- make active efforts to ensure that bilateral and multilateral creditors that have not yet committed themselves to providing debt relief under the HIPC mechanism contribute their proportionate share of total debt relief as soon as possible
- build *alliances with other countries*, particularly with the other Nordic countries, the Utstein countries and Switzerland, in the ongoing negotiations and consultations on HIPC-related issues
- give high priority to the *financing of the HIPC Initiative* when allocating Norwegian budget funds to international debt schemes
- consider *unilateral forgiveness of all Norwegian government claims* against countries that have completed the HIPC process
- work to ensure that the World Bank and the IMF, when calculating a country's debt sustainability, avoid using overly optimistic estimates of the country's economic growth, export revenues and foreign currency earnings
- seek to change the current method of calculating necessary additional debt reduction when a country reaches its completion point in the HIPC Initiative, to ensure that extraordinary debt relief provided by Norway and other creditor countries is not included in the analyses.

6.2. Efforts coordinated through the Paris Club

The Paris Club is an informal, international forum of creditors, whose primary function is to find coordinated, sustainable solutions to the payment difficulties experienced by debtor countries. The Club conducts internal negotiations on debt treatment principles and negotiations with individual countries on deferment of payment or debt reduction. The institution serves as both a special-interest organization for creditor countries and, to an increasing degree, as a development policy forum.

The Paris Club bases its activities on five main principles:

1. The decisions of the Paris Club are based on a case-by-case assessment of the *special needs of the debtor country*.
2. *Consensus*. It only makes decisions on which there is a consensus among all the participating creditor countries.
3. *Comparability of treatment* of creditor countries. This means that no creditor can demand larger payments or different, more favourable terms than those decided in the Paris Club. In addition, the debtor country commits itself to seek comparable terms from creditor countries that are not members of the Paris Club and commercial creditors.
4. *Creditor solidarity*. No creditor can seek to obtain more favourable terms than those granted under a Paris Club agreement. Members must also exercise restraint as regards granting more concessional terms than those allowed under Paris Club agreements. The purpose of this is to prevent one creditor's indulgence from undermining other creditors' chances of recovering the debts due to them.
5. *Conditionality*. The Paris Club will only negotiate with debtor countries that are pursuing an IMF programme.

Like other countries, Norway also uses the Paris Club to recover as many as possible of its outstanding claims on relatively prosperous, economically developed countries, which should be expected to pay their debts. When countries like these default on their payment obligations, being able to fall back on the Paris Club's creditor solidarity may prove to be crucial.

However, countries with that kind of solvency are in a clear minority among the countries that have government debts to Norway. For us, therefore, the Paris Club is as much a development policy forum as a forum for credit recovery. The debt relief that is granted to poor countries can be regarded as a form of budget support. When Norway provides extraordinary bilateral debt relief and support for international debt operations for individual countries, it is natural to view such assistance

BOX 8

More information on the Paris Club

The Paris Club has no legal status and no statutes. In principle, it is a “non-institution” although its mode of operation makes it a *de facto* international organization. It has a secretariat, headed by a secretary general with 12-15 part-time employees, which is fully funded by France. The Club was established in 1956, when Argentina’s debt was rescheduled for the first time. It has 19 permanent members, 18 of which are OECD countries. Russia became a member in 1996. Norway, Denmark, Spain, Italy and the USA are primarily represented by their Ministries of Foreign Affairs, while the others are primarily represented by their Ministries of Finance.

The IMF and the World Bank participate in all meetings. Other international organizations (such as UNCTAD) and financial institutions take part on an ad hoc basis. Other creditor countries, such as Brazil, Korea and Israel, also participate on an ad hoc basis in debt negotiations when invited to do so by the Paris Club, and have rights and duties on a par with the member countries. The Norwegian delegation is headed by the Multilateral Bank and Finance Section of the Norwegian Foreign Ministry’s Department for Development Cooperation Policy. The delegation includes a representative of the Norwegian Guarantee Institute for Export Credits (GIEK).

The Paris Club holds meetings lasting 2-5 days in ten months of the year, usually with no meeting taking place in February and August. A regular aspect of all meetings is the *tour d’horizon*, when the debt situation of selected debtor countries is reviewed. The agenda is determined by demand. It is sufficient that one creditor country requests that a certain debtor country be discussed during the “tour”. These country reviews allow for exchanges of up-to-date information, early notification of payment problems and the preparation of debt negotiations with individual countries. The basic outline of future debt agreements often emerges during the “tour”. The reviews are also used to draft joint letters to the competent authorities in debtor countries, which are primarily the Ministers of Finance.

The Paris Club reschedules government-to-government claims that mainly arise from defaults on government-guaranteed export credits and development assistance loans (ODA debt) as well as, to a lesser extent, on governmental loans granted on commercial terms. The claims must be long-term, i.e. they must have a maturity of at least one year. As far as Norway is concerned, this largely applies to export credits guaranteed by the Guarantee Institute for Export Credits (GIEK). Debt negotiations are conducted with countries whose payment obligations exceed the financial capacity of their national economy, with the result that they experience balance-of-payment problems. During the negotiation sessions, the French Chair negotiates with the debtor country on behalf of the Paris Club members on the basis of an agreed mandate. The sessions are often as much a “tug of war” between the various member countries as between the chairmanship and the debtor country.

In practice, the Paris Club helps to fill funding gaps in debtor countries’ IMF loan programmes, whether they are one-year or multi-year programmes. Debt negotiations must be formally requested by debtor countries. In a normal year, negotiations are held with 15-20 countries through which debts totalling USD 20-30 billion are either forgiven or deferred. (By comparison, development assistance provided by OECD countries totals USD 50-60 billion per year.) The debts of the poorest countries are forgiven. On the whole, middle-income countries are granted deferment of payments.⁵⁶ The majority of the countries negotiated with are among the poorest countries, which are treated under the terms of the Heavily Indebted Poor Countries (HIPC) Initiative.

So as not to impair the debtor country’s creditworthiness during a restructuring phase, a cut-off date is always set the first time a debtor country’s debt is restructured under a Paris Club agreement. This enables the country to have access to new credits after that date, but the creditor will then be guaranteed that the new claim will not be included in subsequent debt relief operations. This is basically also in the debtor country’s interest. However, old – often 20 year-old – cut-off dates are becoming a problem that at worst, in some cases, may undermine the credibility of debt agreements.

The debt relief terms agreed upon, which are set out in the *Agreed Minutes*, are to be regarded as non-binding recommendations to member countries. In practice, however, they are followed up as if they were legally binding, through bilateral debt agreements, so that all creditor countries grant the debtor country the same main terms. However, the interest terms are determined bilaterally. Most Paris Club agreements, and the underlying debt sustainability analyses, are based on the assumption that the debtor country will be granted equal or comparable terms by both commercial creditors and non-member countries (*comparability of treatment*).

⁵⁶ See, however, the description of the Evian approach in Chapter 6.2.1. and Box 9.

Methodological issues are also discussed at the majority of sessions to clarify the Club's existing policy and the way it is implemented in practice, resolve any disagreements or reach agreement on new debt relief terms. Such discussions are usually initiated by individual creditor countries, but may also be held at the request of the Secretariat. In recent years, Norway has been the country that has most frequently proposed such discussions, primarily with a view to improving debt relief terms for the poorest countries, and since 2002 for middle-income countries as well.

A regular meeting is held annually with influential representatives of commercial creditors, as well as occasional meetings prior to negotiations with individual countries. The purpose of these meetings is primarily to exchange information on debt agreements that have already been entered into, but also to exchange views on upcoming negotiations. An underlying motive for both parties is to check that official and commercial creditors offer reasonably comparable terms to individual debtor countries (*comparability of treatment*). The Paris Club has been one of several arenas for discussions concerning the establishment of a new Sovereign Debt Restructuring Mechanism (SDRM) and a code of conduct for official and commercial creditors.

The Home Page of the Paris Club may be found at www.clubdeparis.org

in conjunction with other Norwegian budget support for the same countries – and vice versa.

Norway's work in the Paris Club is intended to be an important element of our overall efforts to reduce poverty, cf. the Norwegian Government's *Action Plan for Combating Poverty in the South towards 2015*. It is important that the views expressed by Norway are in conformity with the goals we are seeking to achieve in various fora – in this case particularly the IMF, the World Bank, the UN and the Paris Club.

The Paris Club has a set of standard terms for debt relief, among which the following are most commonly used today:

1. *Houston terms*: no debt reduction, but payment deferments for *middle income countries*, normally over 15-20 years with a maximum of 10 years' grace.
2. *Naples terms* (introduced in 1994): 67 % debt cancellation for poor countries that are eligible for HIPC treatment, while the remainder of the debt is repayable over a period of 23 years with six years' grace.
3. *Cologne terms* (introduced in 1999): usually 90 % debt cancellation⁵⁷ for *HIPC countries*, taking account of earlier debt relief, first (in the interim period) through forgiveness of interest and payments as they fall due, then (at the completion point) through forgiveness of the remaining debt.

Since most of the Paris Club's member countries now "top up" the Cologne terms with extraordinary contributions (to 100 % debt reduction, subject to reservations), there is obviously very limited potential for improvement in this respect.

6.2.1. The Evian approach

There is greater potential for improvement where middle-income countries are concerned, depending upon the political will of the creditor countries. The G8 summit in Evian in June 2003 culminated, among other things, in a request that the Paris Club further develop its policy instruments for middle-income countries in particular. No new standard terms were desired, but there were calls for more flexible solutions based on long-term debt sustainability analyses, rather than merely more short-term analyses of payment capacity. There is agreement that the Houston terms, which are based on the latter, have not been very successful, particularly because a number of the debtor countries have frequently had recourse to the Paris Club.

The Paris Club carried out internal negotiations on the Evian approach in summer and autumn 2003. Norway played an active role in these negotiations in consistently and vocally supporting the French G8 Chair, which both was the real initiator of the approach and drove the idea forward within the G8 commu-

⁵⁷ Taking account of previous debt relief, on claims that have arisen prior to the country's cut-off date.

nity. The question of adopting a more open attitude towards *debt reduction*, also for non-HIPC countries, was particularly controversial. It took time to reach a final compromise, but in the end the main intentions behind the new orientation were essentially maintained.⁵⁸

There may be reason to note that the Evian approach does not apply only to middle-income countries that might aspire to debt reduction; rather, it constitutes a flexible framework for *all countries* that are not eligible for the HIPC mechanism, whether they wish to seek deferred payments or debt reduction.

As stated above, the Evian approach is *not* a question of introducing standardized terms for the treatment of middle-income countries, like the terms for HIPC countries. On the contrary, this approach serves to consolidate the Paris Club's well-established *case-by-case principle* and fundamental *ad hoc* approach to the debt problems of middle-income countries.

Nor, basically, is there anything genuinely new in the possibility of debt reduction for middle-income countries; Egypt, Poland and the former Yugoslavia (Serbia-Montenegro) have all previously obtained substantial debt

BOX 9

The main elements of the Evian approach

1. From now on, **debt sustainability** considerations are also to be a determinant factor for the debt relief that is provided to non-HIPC countries (chiefly middle-income countries), as is already the case for HIPC countries. Thus a fundamental difference in the way poor and middle-income countries are treated has – in principle – been eliminated. However, it remains to be seen to what extent this policy will be applied in practice.
2. Countries with a debt burden which the IMF and creditor countries agree will not be sustainable in the long term – i.e. countries that have a **solvency problem** – will be eligible for **debt reduction**, not just deferred payments. The IMF will carry out debt sustainability analyses, but in such a way as to leave the conclusion to the creditor countries in the Paris Club.
3. Countries that are considered to have only temporary **liquidity problems** will, on the other hand, only be eligible for **debt rescheduling** on “traditional” terms, as is the case today. Provision is even made for less concessional deferments of payment than the current minimum terms for countries that only have short-term problems.
4. Debt reduction operations in respect of countries that have indisputable liquidity problems are to take place in **stages** (usually three), with close linkages to the IMF programme requirements (conditionality) and clear criteria for responsible debt management. The stages are to culminate in “exit solutions” based on debt reduction that is tailored to the needs of each individual country.
5. This type of comprehensive final debt treatment could comprise flexible instruments such as debt buybacks, **debt swaps** and debt relief that is activated or terminated by special “triggers” (contingency relief).
6. This approach calls for **closer coordination with commercial creditors**, particularly when the latter play a significant role, where comparability of treatment poses a challenge and where comprehensive debt treatment is envisaged for countries that it is agreed have solvency difficulties. Coordination could be ensured through preliminary meetings to exchange information, views and positions prior to the respective creditor groups' negotiations with the countries concerned.
7. The approach **provides for a more active updating of the cut-off dates of debtor countries**, which distinguish in time between older debt that can be rescheduled and more recent debt that is not negotiable. The need to adjust cut-off dates – like the need for debt reduction, if appropriate – must be assessed in relation to the long-term sustainability of the (remaining) debt and countries' creditworthiness.

⁵⁸ The “Evian approach” is published on the Paris Club's home page www.clubdeparis.org, both in the form of a summary press release and a more extensive working paper.

reduction through negotiations with the Paris Club. The genuinely new aspect of the Evian approach lies rather in the introduction of a *sustainability criterion* for debt relief assessments, and the fact that this is set out in published documents.

Naturally, the scope of such a “debt sustainability” criterion is debatable, given the fact that *no* operational criteria have been adopted to determine when the debt or debt servicing burden of a middle-income country is to be regarded as a solvency problem (as has been the case for HIPC countries). Today there is no support for introducing this type of absolute criteria. However, the possibility of introducing less “mechanistic” indicators should not be ruled out.

Nor is the adjustment of cut-off dates in itself a dramatic break with the past, given the fact that the Paris Club has, on certain occasions, had to reschedule post cut-off date debt to create credible debt solutions. Nonetheless, as in the description of debt reduction, the possibility of more actively updating cut-off dates is *new* in the sense that it has been set down in writing and duly publicised.

Dividing debt relief for insolvent countries into stages will give creditor countries an opportunity to link debt relief closely and continuously to demands for economic reforms in debtor countries. The Paris Club’s requirement that debtor countries must continuously pursue an economic reform programme in cooperation with the IMF in order to be eligible for debt relief has, if anything, been *strengthened* by the Evian approach.

The possibility of using debt swaps represents a fresh approach in the sense that these can conceivably be incorporated as *part of*, and not just be used in addition to, Paris Club agreements. This means that Norway’s proposal of multilaterally coordinated (collective) debt swaps may become more relevant.

The Evian approach is not a quick fix. The framework will gradually take clearer shape as it is applied to specific cases. Kenya was the first country on which the Evian approach was used, when its debt was rescheduled in

January 2004. The approach can be regarded as the Paris Club’s preliminary contribution to better, more predictable crisis management for middle-income countries whose debt burden is incompatible with durable growth and development. As such, it represents a timely and important step on the road towards an even better global debt policy.

Norway will ...

- urge as many creditor countries as possible to *cancel 100 %* of the debt of the poorest countries, as Norway currently does and will continue to do
- work to ensure that all debt relief benefits the *debtor countries*, and not other creditors
- work to ensure that *countries emerging from war and conflict* (post-conflict countries) are given debt relief on better terms than the present ones
- work to ensure that *middle-income countries* facing payment difficulties also obtain credible debt agreements, if necessary by means of debt reduction, so as to avoid the necessity of frequently repeated Paris Club negotiations
- promote consideration, under the *Evian approach*, of the introduction of a set of tentative “markers” (rather than absolute indicators) for evaluating the solvency of debtor countries and, if appropriate, their need for debt reduction
- advocate that several creditor countries jointly carry out *multilaterally coordinated debt swaps* with middle-income countries, whereby debt is forgiven on condition that the debtor countries use the freed-up funds to carry out development or environmental projects
- work to achieve recognition by the Paris Club of such debt swaps as a *real option* in its standardized swap clauses, on a par with bilateral debt swaps

- work to ensure that the Paris Club liberalizes the way it practices the *volume limitations* that apply to debt swaps, preferably by *discontinuing* the limitations on swaps motivated purely by development objectives
- work to ensure that creditors with claims that are below the minimum amounts required for inclusion in the Paris Club agreements exchange these *de minimis* amounts for debt management measures in the debtor countries, rather than requiring that the funds be repaid
- promote a flexible attitude towards *moving the country-specific cut-off dates* in cases where such dates produce an obviously unreasonable outcome and jeopardize the credibility of debt settlements
- advocate that the Paris Club give the public even greater *access* to information on its work, such as through its home page on the Internet
- build *alliances* with other like-minded creditor countries

6.3. Unilateral reduction of bilateral debt for HIPC countries

If a debtor country has an unsustainable external debt, it is necessary to have an agreement that ensures equal treatment of all its creditors. In this way, a situation in which one or more creditors might be tempted to speculate in the debt relief provided by other creditors can be avoided. The HIPC mechanism coordinates debt reduction by indicating a sustainable level of debt for debtor countries and by prescribing the amount of debt reduction each creditor must provide in order to achieve this level. Unilateral debt reduction given in addition to the prescribed HIPC debt relief will, in principle, not affect the sustainable level of total debt that it has been determined that the debtor country is to end up with. It will only reduce the debt reduction that other creditors have to provide in order to achieve that level. Unilateral debt reduction that in reality benefits other creditors, rather than the debtor countries, is bad debt policy.

Unilateral debt reduction will only have an effect for the debtor country after the country has been through a multilaterally coordinated debt relief operation, or at least after all the calculations of the creditors' coordinated debt relief have been carried out. Additional debt relief provided on top of a multilaterally coordinated operation will make the operation more robust. It will reduce the risk of unforeseen events and changed international parameters creating a new unsustainable debt situation. Of course the more countries that give extraordinary debt relief, the stronger this effect will be.

To ensure that extraordinary Norwegian debt relief cannot be taken into account in the debt sustainability analyses on which the multilateral debt relief operation is based, from now on a unilateral decision by Norway to provide such relief will not be made until after a binding agreement on the various elements of the multilateral operation has been concluded, or after it has been ensured in some other way that extraordinary debt relief provided by Norway will not be included in the debt sustainability analyses. For HIPC countries, the operation will take place at the completion point.

Unilateral debt relief provided by Norway must not be perceived as an automatic consequence of a completed exit operation, but must be decided on formally after a case-by-case assessment. This will ensure that unilateral debt relief given by Norway will be provided on top of the negotiated multilateral debt relief.

The above-mentioned risk of unilateral debt relief only benefiting other creditors will be avoided if the debt is forgiven as amounts fall due in a situation where a country is servicing its debts. A decision by Norway must again be taken after a case-by-case assessment, so that unilateral debt relief provided by Norway cannot be "built in" to the basic debt sustainability analyses.

In accordance with the adopted method of calculating any topping up that may be necessary of the debt relief provided under the HIPC mechanism, all decisions to provide uni-

lateral debt relief taken before the time of calculation will be included in the calculation and will thus reduce the topping up of the debt relief. Consequently, the assessment of unilateral debt relief provided by Norway will be carried out after the above-mentioned calculation has been made. The amounts that fall due in the interim period can be added as they fall due to the Norwegian claim (capitalized) and then be included in a Norwegian assessment of unilateral debt relief after the calculation of the necessary multilaterally coordinated topping up of debt relief has taken place. This laborious procedure is necessary due to the current method of making topping up calculations, which has been adopted by the Executive Boards of the World Bank and the IMF.⁵⁹ Efforts should therefore be made to change this resolution, so as not to include the unilateral debt relief provided by creditor countries and thereby ensure that all of it benefits the debtor country as an extra buffer against future exogenous shocks. Until this happens, it is important that as many creditor countries as possible follow Norway's example.

According to the criteria for country selection (and after the unilateral cancellation of all claims against Tanzania and Benin has been carried out), six HIPC countries with debts owing to Norway may be eligible for unilateral reductions: The Gambia, Ghana, Guinea, D.R. Congo, Senegal and Sierra Leone. In addition, there is Côte d'Ivoire, which was very close to achieving HIPC status in 2003. HIPC candidates such as Burma, Sudan, Liberia, Angola and Somalia may also be considered provided they emerge from war and conflict, improve their governance and qualify for HIPC treatment.

Norway will ...

- on a case-by-case basis consider *100% unilateral reduction* of Norwegian official claims against countries that have completed their HIPC treatment, based on the criteria set out in this plan of action

- promote a *change in the method* of calculating topping up of HIPC debt relief to ensure that all unilateral debt relief benefits the debtor country and not other creditors
- encourage other creditor countries, until the method is changed, to follow the procedure used by Norway to ensure that debt relief nevertheless benefits debtor countries
- consider unilateral forgiveness of Norwegian claims that fall due for *post-conflict countries* that have achieved Naples terms in the Paris Club and are expected to be eligible for HIPC treatment at a later date.

6.4. Support for clearance of multilateral debt arrears

In order for a country to be eligible for debt treatment under the HIPC Initiative and achieve Cologne terms in the Paris Club⁶⁰, the country must be up-to-date on its debt servicing. However, the poorest countries, particularly countries that have emerged from conflict, are often far behind with their debt payments and thus have substantial arrears. In the Paris Club, bilateral arrears are dealt with by restructuring the country's debt on Naples terms (67 % debt reduction) and by postponing the date for paying the remainder of the debt including arrears. The terms are "topped up" to Cologne terms when countries reach their decision point under the HIPC.

Arrears payable to multilateral institutions will not only impede the implementation of the HIPC mechanism, they will also prevent access to new financing from these institutions. It is therefore very important to deal with these arrears at an early stage of a post-conflict situation. This can be done in two ways: either a donor country can grant funds to cover the arrears or it can provide a bridge loan. Under the bridge loan procedure, which is used particularly when the arrears are substantial, one (or more) donor countries provide

⁵⁹ See Box 7.

⁶⁰ See Chapter 6.2.

the debtor country with a loan equivalent to the outstanding amount. The debtor country uses this loan to pay its debt to the multilateral financial institution concerned. The institution simultaneously grants a new loan to the debtor country which it then uses to pay back the bridging loan. This brings the debtor country up to date again with its debt servicing payments. After completing this procedure, the country can obtain normal support from the multilateral financial institution and debt treatment can be initiated under the HIPC Initiative. Norway has participated in such operations on several occasions with Norges Bank as the lender. After a bridge operation, the debtor country will still be in debt to the multilateral financial institution, but will no longer be considered to be in default. Arrears can also be cleared by means of a combination of grant financing and bridge loans.

Norway will ...

- ⇒ participate in coordinated arrears clearance operations by providing grants to help pave the way for HIPC treatment of poor developing countries that are eligible for such treatment
- ⇒ as part of this process, consider participation in future bridge loan operations to enable post-conflict countries to receive new assistance from multilateral financial institutions

6.5. Special unilateral debt forgiveness for post-conflict countries

Countries that have recently emerged from war and conflict are in particular need of financial assistance. Reconstruction will require substantial resources. The country will have major import needs. At the same time, its weakened private sector will only be able to earn limited export revenues, or for that matter generate other income.

In such cases, the servicing of external debts will complicate and prolong reconstruction efforts. Rapid, deep debt relief will often be essential. Provided such countries are eligible

for the HIPC Initiative, every effort should be made to ensure that they qualify for it. In order to obtain debt relief under the HIPC Initiative, however, a country must have pursued a responsible social and economic policy for some time. A country that has recently emerged from conflict will normally not have been able to do this.

In connection with pre-HIPC debt treatment in the Paris Club, post-conflict countries will normally be unable to obtain more than a maximum of 67 % debt reduction (Naples terms), after which the remaining debt will be subject to deferred payments. Normally, certain interest payments and repayments will then accrue *before* the countries reach the decision point in the HIPC scheme. Some creditor countries will choose to invoice, i.e. collect, these due payments.

For post-conflict countries, even minor payment obligations will be a heavy burden. Norway sees little point in requiring debt servicing from countries that receive international assistance for sorely needed reconstruction during the period immediately after the conflict has ended. When the situation has stabilized, in the form of a state of peace that is recognized and supported by the international community and a legitimate government is in power, accelerated debt relief for post-conflict countries can make a vital contribution to economic and political stabilization, poverty reduction and reconstruction. It is important to give the new regime a more predictable economic situation, with the possibility of a planning horizon that can ensure the reconstruction of the country. The prospect of early debt relief may in itself spur the settlement of ongoing conflicts.

Norway can further contribute to debt relief for post-conflict countries in two ways: by providing support for clearance of the countries' debts to multilateral institutions and by cancelling debt service payments when they fall due prior to HIPC treatment.

In addition, of course, there is the ordinary HIPC treatment, where post-conflict countries

are dealt with in the same way as every other HIPC country. Apart from Serbia-Montenegro, all the post-conflict countries against which Norway has outstanding claims are HIPC candidates. This enables Norway to reduce its bilateral claims by 100 % when these countries eventually reach their completion point under the HIPC Initiative.

Norway will ...

- work to ensure that *post-conflict countries* that are eligible for HIPC treatment do not have to use scanty resources, which are critically important at the stabilization and reconstruction stage, for debt servicing
- advocate that the Paris Club establish a general principle whereby *interest and repayments are either forgiven as and when they fall due or are capitalized*, until the countries reach their decision point under the HIPC Initiative
- *refrain from collecting interest and repayments* from such post-conflict countries, either by forgiving them when they fall due or by capitalizing the amounts
- (after a country-by-country assessment) *forgive any interest or principal that have been capitalized* at a time when such unilateral debt relief will benefit the debtor country and not other creditors

6.6. Multilaterally coordinated debt swaps with non-HIPC countries

A debt swap is a transaction whereby a creditor country's claim against a debtor country, quoted in "hard" currency, is converted to an obligation to the creditor country other than servicing of the original debt owed. There are many types of debt swap operations. The most common are commercial operations, in which a claim is converted into equity capital in local companies, or to specifically defined advantages for the creditor country's private-sector investments in the debtor country. The Debt Relief Strategy does not include this type of commercial debt swap operation. Instead the strategy deals with *development-motivated* operations whereby a debtor country's debt is converted into an obligation for the debtor country to use a specific amount in *local currency* for specifically agreed measures, for instance in the health, education or environmental sector. The advantages of this type of debt swap operation are obvious. They intensify cooperation between creditor and debtor countries on development and environmental programmes, they help channel much-needed local funds to development assistance projects, and they reduce the debt burden. In some ways, debt swaps are a kind of budget support. Like ordinary *budget support*, debt swaps also entail setting conditions for the way funds are to be spent.

BOX 10

Cancellation or capitalization of the pre-HIPC maturities of post-conflict countries

If Norway unilaterally cancels a post-conflict country's pre-HIPC maturities, Norway will, when a post-conflict country achieves HIPC status, report a somewhat lower claim that would have been the case without such pre-HIPC debt relief. This will reduce the debt relief need of the country in question under the HIPC Initiative, if only marginally. Other creditor countries will then be able to give the country marginally less HIPC debt relief, while the total amount of debt relief will ultimately be the same. Rather than providing additional debt relief for the country, the only thing that has been achieved is to redistribute the burden among the creditor countries. The logic is completely analogous to the situation that arises when unilateral measures are taken during the actual HIPC treatment.

Unless the unilateral cancellation by Norway of pre-HIPC interest and repayments owed by post-conflict countries can be excluded from the HIPC debt sustainability analyses, an analogous response to this problem would be to **capitalize** the maturities rather than cancelling them. The decision about whether these capitalized amounts should also be forgiven can then be taken after the country has completed its HIPC treatment, analogously to Norway's adaptation to the prevailing HIPC methodology. If appropriate, the capitalized amounts could be forgiven at the decision point. In that way, the main purpose of the extra contribution is achieved: to provide the country with more debt relief than it would otherwise have received, as an extra helping hand during a critical stage of development.

Schemes of this nature can also have a number of disadvantages. The operations are often complicated and demanding in terms of administrative resources, for the debtor and the creditor countries. It will put particular strain on the debtor country if many of its creditors wish to establish this type of fund. At worst, debt swap operations might also undermine the debtor country's own decision-making bodies, since the creditor country will normally focus on its own priorities when determining how the freed-up funds should be used. If a third party such as a non-governmental organization is introduced as the implementing body, this might be perceived as a disregard of the country's own public administration. If debt swaps are used to a great extent, moreover, they might have an inflationary effect and/or supersede other means of financing development measures by the debtor country.

In the light of the above purely *bilateral* debt swaps are difficult to combine with the emphasis that is placed on the importance of developing countries pursuing a coherent policy and their own ownership of this policy.

However, the disadvantages of debt swap operations can be counteracted through a coordinated approach by several creditor countries. If several creditor countries make a concerted effort to implement collective debt swaps instead of "going solo", the administrative burden on the debtor country could be reduced to a minimum. If, in addition, an effort is made to coordinate debt swaps with nationally adopted development strategies and adapt the volume of the swaps to the countries' macro-economic framework, debt swaps could be an effective development policy instrument. The development effect of this type of coordinated effort could be far greater than what can be achieved through dispersed targeted interventions. Multilaterally coordinated debt swaps entail the transfer of the principle of donor coordination to the arena of swaps, which has hitherto been extremely "bilateralized".

Such multilateral debt swap operations could bring increased debt relief for developing countries, since creditors who would not otherwise be willing to provide bilateral debt relief outside the Paris Club agreements would be motivated to participate. Among the difficult problems that will be encountered is the problem of agreeing on the modalities and objectives of such multilateral debt swap operations, and of finding a suitable institutional framework.

Debt swaps are not an option for HIPC countries, whose bilateral debt will be cancelled over time in any event, whereupon there is no point in taking any additional measures. Consequently, debt swaps are only relevant for *non-HIPC countries*. These are chiefly middle-income countries, which at present normally do *not* qualify for debt reduction, but only for debt rescheduling, in the Paris Club.⁶¹ Nor is it possible at present, due to the Paris Club's principle of comparability of treatment of creditors, to unilaterally cancel bilateral claims against such countries. On the other hand debt swaps, which can be regarded as an *alternative route to debt reduction*, are fully accepted, albeit within a limited volume specific to each country (usually 15 or 20 % of outstanding debt or a maximum amount of SDR 15 or 20 million).

In a way, HIPC debt relief can be regarded as a multilateral debt swap, whereby a coordinated group of both bilateral and multilateral creditors forgive debt on condition that the debtor countries commit themselves to implementing poverty-reducing measures in accordance with their own development strategies (PRSPs). One of the main challenges related to debt swaps with middle-income countries is to achieve a similar process.

If mechanisms can also be identified in middle-income countries to ensure that the resources freed up through debt relief are utilised by the debtor country to promote development and reduce poverty, this will pave the way for implementation of multilaterally coordinated debt swap operations for these countries.

⁶¹ See, however, the description of the Evian approach in Chapter 6.2.1.

Multilaterally coordinated debt swaps. Example: Poland

In 1992, for the first and so far only time, a multilaterally coordinated debt swap was initiated for Poland. Under the swap, 10 % of Poland's maturities to six creditor countries were forgiven in return for which the equivalent amount (in Polish zloty) is to be spent on environmental investments in Poland. During the period 1992-2010, the mechanism will mobilize USD 600 million, NOK 180 million of which will be provided by Norway.

The funds freed up through this debt-for-environment swap are administered by the ECOFUND, which was established by the Polish authorities as an independent foundation. The creditor countries are represented on the ECOFUND's Supervisory Council. Besides Norway, the USA, France, Switzerland, Sweden and Italy are participating in the debt swap.

The ECOFUND is the only example to date of a genuine multilaterally coordinated ("multi-creditor") debt swap. The lessons learned from this joint undertaking should, however, have significant value when transferred to other indebted middle-income countries.

After Pakistan renegotiated its debt in the Paris Club in December 2001, Norway launched the idea of supplementing the postponement of debt repayments granted to Pakistan with a multilaterally coordinated debt swap operation, in which interested creditor countries would participate. We launched this initiative, not solely in the interests of Pakistan, but also with other highly indebted middle-income countries in mind. A Norwegian "think piece" on the format of this type of debt swap has been circulated internationally in various versions, most recently in the Paris Club and to the French G8 chairmanship in May 2003 and at UNCTAD in Geneva in November 2003. It outlines three different options for multilaterally coordinated debt swaps:

1. Debt swaps in cooperation with other creditor countries: Several creditor countries swap debts for an agreed common objective in a debtor country, possibly also by entering into a joint framework agreement with the country concerned. Functions such as allocation of funds, oversight, control, auditing, reporting and evaluation are assigned to a separate institutional body (commission, foundation, facility or the like) which is tailored to the requirements of each individual case. The efficiency gain lies in the fact that the maze of bilateral agreements and follow-up mechanisms is eliminated and resources are pooled to achieve common objectives.

2. Debt swaps in cooperation with a multilateral institution: A creditor country enters into an agreement with a debtor country and a multilateral development bank (one of the regional development banks or the World Bank), whereby funds freed up by a debt swap are to be channelled to an agreed development project or programme which the bank in question is funding in the debtor country. The funds are thus to be considered "topping up" of these projects or programmes, thereby making it possible to carry out additional activities that would not otherwise have been implemented. Based on an understanding with the creditor country, most of the responsibility for quality assurance and reporting is assigned to the development bank, which already has well-established routines for this type of function. The rationalisation gain lies in the elimination of the need for a special bilateral monitoring mechanism, while limiting the extra administrative burden placed on a third party. Furthermore, by carrying out what amounts to a "piggy-back swap" on a multilateral institution in this way, it is possible to avoid bilateral special interests dominating the use of the funds.

3. Debt swaps in cooperation with other creditor countries, based on a development bank program: This "hybrid model" is the result of several creditor

countries jointly carrying out a debt swap with a debtor country, but instead of creating a customized follow-up mechanism from scratch, parts of the programme portfolio of a multilateral development bank in the debtor country concerned are chosen as channels for the freed-up funds. This amalgamation of options 1 and 2 above – where several creditors join forces in a “piggyback swap” on a development bank – can also occur when several creditor countries join in an “option 2” debt swap where there was originally only one participating creditor country. In these cases, the efficiency gain can be doubled, partly through the synergy inherent in multi-creditor cooperation and partly by avoiding having to establish new mechanisms for basic follow-up functions.

In principle, Norway is ready to carry out multilaterally coordinated debt swaps along

the lines of all three of the above-mentioned options, depending on the possible constellations of cooperation for the debtor countries concerned. It must be noted, however, that only a few countries are eligible for such swaps with Norway, simply because Norway has claims against very few middle-income countries whose debt burden constitutes a serious development problem.

As in the case of other Norwegian bilateral debt relief, GIEK will also receive compensation for debts forgiven through debt swaps, taking into account GIEK's own loss provisions. Since Pakistan is not covered by the Debt Relief Strategy financing facility, compensation for the debt swap with Pakistan will be provided from the Fund for International Debt Relief Operations. Compensation for the debt swaps with Vietnam and Ecuador will be charged against the Debt Relief Strategy financing facility.

BOX 12

Priority countries for multilaterally coordinated debt swaps

Pakistan, after conducting a dialogue with Norway, has initiated the establishment of a Social Sector Development Fund (SSDF), through which funds generated by debt swaps will be channelled to poverty-reducing measures. So far, Norway and Canada have stated that they are willing to participate. Germany and Italy have also shown interest in implementing debt swaps with Pakistan but if so, and unfortunately, bilateral swaps. The Paris Club's maximum limit on debt swaps with Pakistan is 20 % of outstanding claims or SDR 30 million (equivalent to about NOK 300 million), whichever amount is highest. Since Norway's claim amounts to about NOK 255 million (as of 31 December 2003), this ceiling is not a limitation as far as we are concerned. Norway's debt swap with Pakistan is scheduled to run for a period of ten years (2003-12). As of February 2004 the debt swap had not yet been implemented, as the Canadian-Pakistani negotiations have yet to be finalized. During the debt swap period, all interest and repayments will be forgiven as they fall due, in return for which Pakistan will implement specific development measures in the social sector, financed by the countervalue of the amounts forgiven in Pakistani rupees. Special priority will be given to measures to promote girls' education. The volume of the debt swap, which largely depends on interest rate levels during the lifetime of the swap, is expected to lie somewhere between NOK 105 and 170 million. By comparison, Canada's debt swap has a limit of CAD 447 million. It involves so-called ODA debt arising from development assistance loans at a heavily subsidized rate of interest. In other words, the real difference in volume between Norway's and Canada's contributions is considerably smaller than indicated by the figures alone. Pakistan is not covered by the Debt Relief Strategy financing facility, and the debt relief will therefore be charged against the “Debt Fund” (chapter 172, item 70) in the central government budget.

Vietnam has requested Norway to implement a debt swap. The original intention was to provide the country with debt relief under the HIPC Initiative. Any additional Norwegian bilateral debt relief would in such case have been a supplement to the HIPC Initiative. Vietnam's economic situation has improved, so that the country now appears to have a sustainable debt burden and is no longer dependent on debt relief under the HIPC. However, the country is still indebted, and reducing its burden of debt would be an extremely important contribution to its development. Norway therefore plans to provide unilateral debt relief to Vietnam through a debt swap operation. The Paris Club's maximum limit for debt swaps with Vietnam is 20 % of claims or SDR 20 million, whichever amount is highest. Since Norway's claim amounts to about NOK 36 million, this ceiling places no limitation on Norway's freedom of action. The plan is to implement the debt swap in cooperation with the Asian Development Bank (ADB), by using the freed-up funds, converted into Vietnamese dong, to “top up” a major water resource management project under the auspices of

the ADB. Under this plan, the entire body of claims would be forgiven, either in a one-time operation or in stages over a period of two to three years. If this plan is accepted by Vietnam, the debt forgiveness will be charged against the Debt Relief Strategy financing facility.

Ecuador has also requested that a debt swap be implemented with Norway, as a supplement to the country's agreements with the Paris Club, most recently in April 2003, to defer debt repayments. So far, no other creditor countries have been interested in a multi-creditor swap. Norway has therefore proposed a debt swap in cooperation with the Inter-American Development Bank (IDB), or possibly the World Bank. The Paris Club's maximum limit for debt swaps with Ecuador is 20 % of total claims or SDR 20 million, whichever amount is highest. As far as Norway is concerned, this imposes a ceiling of around NOK 200 million. Since our bilateral claim (which is dependent on the rate of exchange of the USD) amounts to approximately NOK 304 million (as of 31 December 2003), the maximum we can swap (based on current rates of exchange) is about 2/3 of the bilateral debt. Any debt swap implemented with Ecuador would be charged against the Debt Relief Strategy financing facility.

Among the other non-HIPC countries against which Norway has claims, **Peru, Jamaica and Algeria** are in principle also candidates for debt swaps with Norway which, if implemented, would also be financed from the Debt Relief Strategy financing facility, provided that there are sufficient funds to do so. Given the current outlook as regards the need to draw on the facility, there will only be sufficient funds if some of the potential HIPC countries do not qualify for HIPC debt relief, and will thus no longer aspire to unilateral debt relief from Norway. For the time being, these poorer countries will have first priority as regards the unutilised portion of the facility.

Norway will ...

- *refrain from implementing purely bilateral debt swap operations*
- *implement multilaterally coordinated debt swaps with Pakistan and Vietnam, with a standing invitation to other creditor countries to join them, and negotiate a multilaterally coordinated debt swap with Ecuador*
- *urge other countries to implement multilaterally coordinated debt swaps, also with countries against which Norway has no claims*
- *initiate efforts to make multilaterally coordinated debt swap operations explicitly recognized options in the Paris Club*
- *urge creditors with de minimis claims to exchange them for a commitment by the debtor country to invest in debt management tools, rather than requiring that the debts be paid back*
- *advocate that the Paris Club either remove or grant exemptions from its limitations on the volume of debt swaps, provided the swaps concerned are purely development-*

motivated and cannot be inherently disadvantageous for other creditor countries.

6.7. Support for the World Bank's Fifth Dimension Facility

In 1988, on the initiative of the Nordic countries, a debt relief mechanism called the Fifth Dimension Facility was established to provide relief for poor (current IDA) countries' servicing of old marked-based loans from the World Bank.⁶² The need for this mechanism is diminishing as the volume of old IBRD debt is reduced.

Under this mechanism, a small portion of the repayments to the IDA are used to pay interest on old IBRD debts for countries that now only receive IDA credits. Furthermore, some donor countries, including Norway, contribute by also covering repayments of remaining IBRD debts.

In total, the Fifth Dimension Facility has contributed around USD 1.5 billion to some twenty-odd countries, particularly African countries. In addition, Norway has contributed over NOK 1.5 billion to cover repayments for a number of countries, cf. Table 4.

⁶² IBRD loans. The candidate countries are Bangladesh, Cameroon, Chad, Congo-Brazzaville, Côte d'Ivoire, Ghana, Guyana, Honduras, Kenya, Lesotho, Liberia, Malawi, Sri Lanka, Tanzania and Zambia.

Table 4.
Norway's contributions to the World Bank's Fifth Dimension Facility (NOK million as of 31 December 2003)

Country	NOK million
Zambia	331
Nicaragua	250
Tanzania	241
Malawi	182
Uganda	160
Bangladesh	125
Honduras	65
Ethiopia	50
Ghana	36
Kenya	32
Sri Lanka	20
Guyana	20
Senegal	12
Total	1,524

In special cases, the funds provided by Norway under the Fifth Dimension Facility to repay IBRD debts could conceivably be matched by a commitment by the debtor country to initiate specifically agreed priority development measures, preferably in connection with existing programmes that are multilaterally financed and monitored.

One example of such an operation is Norway's financing of Kenya's IBRD repayments for 2004 (approx. USD 4.5 million). In the light of Kenya's substantial financial difficulties and the new government's prioritization of anti-corruption measures, Norway has decided to cover these repayments in return for a commitment by Kenya to allocate a specific amount to finance additional anti-corruption measures. These measures will strengthen a current public sector reform project that is mainly financed by the World Bank and monitored by Bank staff. This will thus be a kind of multilaterally coordinated debt swap.⁶³

In the African Development Bank (AfDB), the bank's management has proposed the establishment of a mechanism similar to the World Bank's Fifth Dimension Facility. However, in the AfDB the repayments to the bank's fund for the poorest countries (the AfDF, equivalent to the IDA in the World Bank) are not big enough for the interest payments to be subsidi-

dized from that source. The mechanism in the AfDB will therefore be more dependent on financing from donor countries. The establishment of the mechanism has been accepted in principle, but the details and financing have not yet been clarified.

Norway will ...

- support continued transfers from the repayments made to the IDA to subsidize interest rate payments on IBRD loans for IDA borrowers (Fifth Dimension)
- contribute towards financing IDA countries' repayment of IBRD loans
- encourage other countries to contribute to IDA countries' repayment of IBRD loans
- explore the possibility of linking contributions to the Fifth Dimension Facility to a commitment by debtor countries to initiate specific development measures
- work to establish a corresponding facility at the African Development Bank (AfDB) and contribute financing for this facility

6.8. Support for the World Bank's Sixth Dimension Facility

In 1989, as part of the efforts to help the poorest developing countries deal with their commercial debt (debts to commercial banks and financial institutions), the World Bank established the IDA Debt Reduction Facility, also called the Sixth Dimension Facility. So far, the World Bank has allocated USD 300 million of its net surplus to the facility, which is supplemented by funds from donor countries.

The World Bank assists the countries concerned to negotiate an agreement with the commercial banks whereby the World Bank will buy back their outstanding claims, at greatly reduced prices, on the secondary hand market for this type of debt claim. The facility finances the costs incurred by the country in connection with such buybacks. In the end, the commercial debt that is the object of the operation is completely cancelled.

⁶³ Cf. chapter 6.6.

Commercial debts are basically expensive debts that generate high interest costs. Admittedly, the countries concerned now do little to service debts of this type, which were largely contracted many years ago. However, it is crucial to the country's future creditworthiness that an arrangement also be reached with its commercial creditors.⁶⁴ The buyback must be made while the debtor country is still considered to be poor and heavily indebted, so that the price of the claim is sufficiently low.

At the end of 2002, the World Bank had carried out 17 operations of this type, thereby eliminating USD 6.4 billion of the commercial debts of the poorest countries. The facility has proved to be very cost-effective, since the average price of buybacks has been 15 % of the nominal value. The Sixth Dimension Facility plays an important role in the efforts to facilitate the access of developing countries to commercial capital by improving their creditworthiness. Norway has participated in such debt relief operations for Guinea, Yemen, Honduras and Cameroon, contributing a total of NOK 61 million.

Norway will ...

- support the use of internal World Bank resources for the buyback and cancellation of IDA countries' commercial debts
- participate with financing for countries where this is considered effective and appropriate

6.9. Support for liquidating South-South debt

Several of the poorest, most heavily indebted countries have debts to other developing countries in the same category. Although this does not pose any major problem, there is little point in maintaining such claims while the same countries are being granted deep debt reduction by other creditors.

It is self-evident that reciprocal claims should be balanced against each other so that one of the countries ends up with a net outstanding claim, which could then be cancelled by means of a grant from a third party.

⁶⁴ We are now seeing positive indications that commercial banks are behaving far more responsibly than they sometimes did before. Recently, around 70 banks agreed to follow the same standard for environmental and social assessments linked to loans. The standard was established by the World Bank's private sector window, the International Finance Corporation (IFC).

In the same way as for unilateral Norwegian debt forgiveness, this should be done on condition that the final decision on implementation for the individual country is not made until a multilaterally coordinated operation has been carried out. In other words, South-South debt should be cancelled in connection with and concurrently with the HIPC Initiative.

Norway will ...

- consider contributing to the *cancellation* of the debt of poor developing countries to other poor developing countries, on a net basis, provided that a special multilateral mechanism is established for this purpose

6.10. Support for national debt funds

Several of the poorest, most heavily indebted countries, such as Uganda and Mozambique, used to have their own national debt fund. The purpose of these funds was to service the countries' debt to the multilateral financial institutions (the World Bank, the International Monetary Fund (IMF) and regional and sub-regional development banks). To the extent that Norway's priority countries choose to establish new funds of this type, support for the funds can free up financial resources which the countries can then reallocate from debt servicing to development programmes.

Norway will ...

- consider *supporting national debt funds*, both as a targeted debt policy instrument and as a special element of more general Norwegian budget support

6.11. Support for national debt management

To ensure that a country's debt burden is within the limits of its national economic sustainability, active debt management is vitally important. To be able to prepare meaningful budgets and economic analyses, most countries today need to have a complete overview of their debt situation. Debt management policy must be seen in close conjunction with all other macroeconomic policy. This is far from the case in many developing countries.

In order to help these countries, during the debt crisis in the 1980s UNCTAD, the UN forum that deals with issues related to trade and development, developed a computer-based debt management tool, the Debt Management and Financial Analysis System (DMFAS). The programme has since been upgraded and is now used by 60 countries. Under the DMFAS programme, countries are provided with important technical assistance aimed at improving debt management.

In addition to the DMFAS programme, the World Bank has developed a computer programme called the Debt Sustainability Model – Plus (DSM+). The World Bank works closely with UNCTAD to integrate elements of the two systems. In addition, there are a number of regional centres, all of which are engaged in work on related issues.

In 2000, Norway initiated efforts to rationalise this work. As a result of this initiative, a multi-year, multi-donor fund was established to secure the financing of the DMFAS programme, and it was resolved that annual consultation meetings should be held between user countries, other interested countries and various institutions that address debt management issues. Norway's initiative led to the establishment of a better foundation for the DMFAS' work, including stronger, more predictable financing of this system.

As countries complete the HIPC process, measures that ensure that their debt burdens remain sustainable will become increasingly important. The immediate gain realized by implementing a debt management system can be considerable for debtor countries, for instance in the form of reduced charges for overdue payment and interest on arrears, as well as better terms for new loans.

Norway has advocated significantly strengthening cooperation between current contributors to debt management, such as the World Bank, the IMF, the DMFAS, Debt Relief International and the Commonwealth Secretariat. The DMFAS could play a pivotal role in this work. The object must be to substantially enhance the exchange of information and experience, which can then be used

to refine policy instruments and improve the overall effect of measures. An annual international meeting (consultative group), scheduled in connection with already existing debt conferences held by UNCTAD and the World Bank and thus alternating between Geneva and Washington, would be able to fulfil this increasingly important function.

Norway will ...

- promote *more systematic cooperation* within the multilateral system to improve debt management in heavily indebted countries
- continue to work closely with the *DMFAS*, also by contributing to funding for the programme
- initiate efforts to establish a joint consultative group (*Consultative Group on Debt Management, CGDM*) for all institutions working on these issues, with participants from both user countries and interested creditor and donor countries
- consider *co-financing with the World Bank* and possibly other multilateral financial institutions programmes to improve the poorest, most heavily indebted countries' management of their debt obligations
- follow up and contribute to the *IMF's Technical Subaccount and Afritac*
- consider making *bilateral contributions*, preferably in cooperation with other donors, towards strengthening debtor countries' debt administration and negotiating capacity and competence
- advocate that member countries of the Paris Club implement debt swaps where *de minimis claims* are used to finance better debt management tools in poor countries, rather than requiring that the money be repaid.

Published by:
The Norwegian Ministry of Foreign Affairs
7. juni plass/Victoria Terrasse,
P.O. Box 8114 Dep, 0032 Oslo, Norway
E-mail: infosek@mfa.no

This publication can also be downloaded from the Internet: <http://odin.dep.no/ud>

Public institutions may order additional copies of this publication from:
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Kopi- og distribusjonsservice
P.O.Box 8169 Dep. 0034 Oslo, Norway
E-mail: publikasjonsbestilling@ft.dep.no
Telefax: +47 22 24 27 86

Publication number: E-775 E
ISBN: 82-7177-760-2

Cover/illustrations: Corbis/Scanpix

Designed and printed by: www.kursiv.no 06/2004 – circulation 2500

