

DEBT RELIEF IN DANISH DEVELOPMENT ASSISTANCE

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1. Background

Debt relief has long been an important part of the international and national debates on development assistance. In 1988 the Toronto-conditions was adopted by the Paris Club, which gave developing countries a debt relief on 33 pct. of the outstanding debt. Six years after the Napoli-conditions expanded the relief to 67 pct. and the Heavily Indebted Poor Countries (HIPC) initiative from 1996 increased the relief to 90 pct. Latest the “Multilateral Debt Relief Initiative” (MDRI) was negotiated under the G8 meeting in 2005 and adapted by the World Bank. The MDRI initiative allows all countries that have completed the HIPC-process to have an irreversible debt relief on 100 pct. of all loans from the International Monetary Fund (IMF) and the African Development Bank (AfBD) granted before 2004 and from the World Bank (WB) granted before 2003¹.

2. The Danish Debt Policy

Denmark has since the 1970s had an active debt policy and has adopted all the international agreements in relation to debt relief. The Danish bilateral contribution to debt relief is provided through the Official Development Assistance (ODA)-frame, § 6.3 of the Financial Bill. The debt of the developing countries to Denmark has emerged from two types of loans:

1. State Loans

State loans were interest free tied loans granted to developing countries from the beginning of the 1960s to 1988, and were reported as development assistance to Organisation of Economic Co-operation and Development (OECD)/ Development Assistance Committee (DAC) at the time of granting the loans. As far as reporting to OECD/DAC is concerned, the net development assistance - after deduction of repayment to Denmark of state loans - is reported as ODA to OECD/DAC. From 1998 repayments are done directly to the Ministry of Finance through § 7.13.35 of the Financial Bill. In 1972 Denmark started to cancel some state loans and in 1995 it was decided to cancel all state loans to Danida programme countries as well as to the Least Developed Countries. By 1998, total state loans debt by developing countries to Denmark was DKK 3.8 Billion. With cancellations of the state loans the Danish state renounces an income, it should have had. Cancellations of state loans do not negatively influence the ODA frame.

2. Export Credits

Export credits were granted through Danmarks Erhvervsfond (DE)². This type of credit started to develop in the beginning of the 1960s. The DE guaranteed repayment to Danish enterprises for their delivery of goods to developing countries. Debt has emerged as a consequence of the lack of repayment from developing countries for goods received from Danish enterprises. Goods were delivered to both state projects and companies, and to private companies on the basis of an issued state guarantee for repayment.

¹ www.um.dk.

² Today DE, created in 1960, is administered by Eksport Kredit Fonden (EKF), which has taken over the responsibilities for providing export credits.

Export credits were given on commercial terms and have, unlike the state loans, not been reported as ODA. It is especially this type of loan that has led to discussions during recent years, as the Danish debt relief for export credits is financed under the ODA-frame (§ 06.32.07). In the table below the size of the debt relief during recent years is shown.

Table 1. Danish debt relief to developing countries as stated in the Finance Bill § 06.32.07, 2001-2008 (DKK Million)

2001	2002	2003	2004	2005	2006	2007	2008*	2009*
89	298	110	257	308	166	671	451	261

Source: <http://www.oes-cs.dk/bevillingslove/>

*Budget

From 2001 to 2008 the accumulated sum of the debt relief is DKK 2.35 Billion. However much of this has been reversed to the state budget through transfers from DE³. Thereby funds granted for development assistance under the ODA-frame returns to the Danish Ministry of Finance as an income, in principle with a zero net result for the Danish state. Table 2 below shows the size of this transaction.

Table 2. Reversals from DE to the Ministry of Finance, § 8.32.03 of the Finance Bill, 2001 – 2008 (DKK Million)

2001	2002	2003	2004	2005	2006	2007	2008*	2009*
61	146	592	997	484	1.642	1.623	203	435

Source: <http://www.oes-cs.dk/bevillingslove/>

* Budget

From 2002 to 2008 an amount of DKK 5.75 Billion has been transacted from DE to the Danish treasury.

The explanation for this reversal is that the owner of the DE is the Danish state. When the Danish state signs a bilateral agreement about debt relief of export credits to the poorest developing countries, it is DE which amortises the debt. The principle is that DE will receive an amount from the ODA-frame as compensation. As DE does not have any expenses and is owned by the state, the amount of money granted as debt relief will be credited the Ministry of Finance as an income.

From tables 1 and 2 above it can be seen that the amounts credited the Danish treasury is different from the amount granted as debt relief under § 6.3. There are several explanations for this. Firstly repayments have been received by DE from a number of countries that are not subject to debt relief financed from the ODA frame. Secondly, that part of the equity of DE which is higher than 12% of the total net liabilities of DE, should according to applied rules for capital management be reserved for transfer to the Ministry of Finance⁴. This also influences the size of the annual DE transfer to the Ministry of Finance.

³ Through EKF, administering DE that is reporting to the Ministry of Economy and Business (Økonomi og Erhvervsministeriet), § 8 of the Finance Bill.

⁴ Source: DE Annual Report 2007.

Nigeria as a Case

In 2005 the G8 countries finalised an agreement that creditors would give a debt relief of 67 pct. to Nigeria. Nigeria had a massive foreign debt equivalent to more than DKK 200 billion before the agreement in 2005.

Nigeria had a small debt to Denmark from one state loan (DKK 19.9 million in 1971) but a large debt due to lack of repayment of instalments and interest on export credits granted between 1978 and 1983 in connection with supply from Danish companies. In 2006 the accumulated export credit debt from Nigeria to Denmark reached DKK 3.167 Billion, of which outstanding interest payments were about DKK 1.8 Billion). The three major projects which received export credits (with a repayment guarantee issued by the federal Nigerian Ministry of Finance) were for a cement factory in Benin, 10 water supply systems in Lagos and 5 hospitals in Kwara.

The Mechanism

The bilateral debt relief from Denmark to Nigeria can be described as follows:

	Flows	Debt
1. Total debt (approximate)		DKK 3.167 Billion
2. Nigeria repaid arrears to DE	DKK 906 Million (Arrears)	DKK 2.261 Billion
3. 67 % of the debt of DKK 2.261 Billion is given as debt relief to Nigeria, paid from the ODA frame	DKK 1.515 Billion (67% of debt)	DKK 746 Million
4. The remaining debt of DKK 746 Million is reduced to a value of 60%, and paid by Nigeria to DE	DKK 446 Million (reduced value 60%)	DKK 446 Million
From these transactions there is an exchange rate loss on DKK 0.3 Billion ⁵ , paid from the ODA frame		

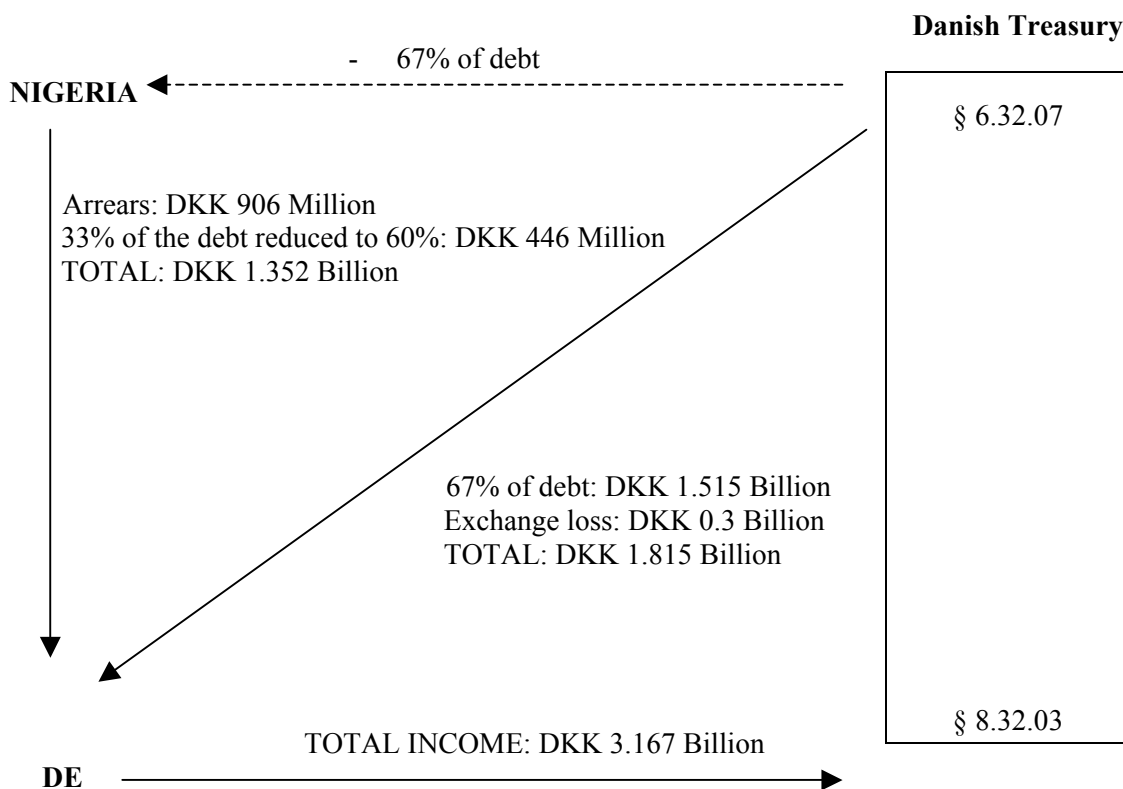
In total, DE receives:

- DKK 906 Million (arrears from Nigeria)
- DKK 446 Million (the remaining debt from Nigeria)
- DKK 1.515 Billion from § 6.3
- DKK 0.3 Billion from the ODA frame

The total amount of DKK 3.167 Billion received by DE corresponds with Nigeria's original debt to Denmark, i.e. the debt relief package is neutral for the Danish treasury. The amount charged to the ODA frame can be spread over a 10 years period in order not to over burden the ODA frame in any one year. The flows are illustrated in figure 1.

⁵ UM; FNG j.nr.:73.b.163

Figure 1. Danish Debt Relief to Nigeria



3. Discussion

Debt relief is a necessary tool to create a stronger foundation for national economies in the poorest countries as it can provide a greater economic scope. However, a number of critical issues can be raised to the current mechanism used in the Danish debt policy.

- Should debt relief be financed through the ODA-frame, as it means that the debt relief will be at the expense of other development programmes? The debt relief, charged to the ODA frame, is entered as an income in the Danish Finance Bill, i.e. the transaction is neutral to the Danish treasury. As shown in table 1, an accumulated amount of DKK 2.3 Billion from 2001 to 2008 is taken from § 6.3, resulting in the ODA-frame being drained for economic means and that other developing countries in reality pay for the bilateral debt relief of export credits.
- Will the increase in Gross National Income (GNI) finance the bilateral debt relief of export credits? The Minister for Development, Ulla Tørnæs has argued that an increase in GNI naturally will lead to an increase in ODA and in that way finance the debt relief:

“The government if necessary is willing to, in future years, to earmark more money to debt relief under the development assistance. That can happen without stopping existing programmes or projects as the government has secured that the Danish assistance is on at least 0,8 pct. of the GNI and that the development assistance will increase concurrently with the welfare increase in Denmark” (Tørnæs; UM nr. S 2722 (2.samling 2005))

From the Danida Annual Reports it can be seen that the debt relief in a number of years have been larger than the annual increase in ODA, including in 2006, the year after the statement by the Minister for Development. Following the logic in the statement that debt relief will not lead to reduction in other programmes or projects due to an increased GNI, it can be seen from table 3 that this must have happened in 2006, as the increase in ODA is lower than the debt relief. Likewise, following the above logic, with the current (November 2008) prospect of an economic recession including a possibility for a reduction in GNI, it can be assessed that debt relief will actually result in a reduction of other development programmes and projects.

Table 3. Increase in ODA 2001- 2008 (DKK Million)

	2001	2002	2003	2004	2005	2006	2007	2008*
ODA, § 6.3	13,600	12,956	11,497	12,137	12,645	12,770	13,895	14,554
Increase in ODA	2,141	-644	-1,459	640	508	125	1,125	659
Debt Relief	89	298	110	257	308	166	671	451

Source:

<http://www.um.dk/da/menu/Udviklingspolitik/OmUdviklingspolitik/FaktaOgTal/DanidasAarsberetninger/>

* Budget

- Does debt relief in reality means more resources to developing countries, as these do not actually receive funds? The countries are the poorest in the world and would in the fewest cases be able to repay all the loans including accumulated interest. Therefore some argue that debt relief does not make a big difference for national budgets in the developing countries. On the other hand, the rationale behind debt relief is that it - other things being equal - will give extra resources to the developing countries, as they get “clean books”. The extra resources will be at the availability of the Ministry of Finance in the given country for general budgetary purposes, i.e. in reality it is general budget support. In reality Denmark has therefore provided extra resources to the Ministry of Finance in e.g. Nigeria, without requiring the same type of conditions fulfilled as would normally be needed for provision of general budget support (that it is a Danish programme country, that programmes combating corruption are effective, that public financial management systems are effective and transparent, that good governance is widespread etc.).
- Are all the old export credits legitimate? Today there is a broad consensus not to mix the objectives of ODA and the wish to promote Danish companies in developing countries. Export credits did not have a specific development objective such as poverty reduction and the credits were often granted to military- and dictatorial regimes and were therefore not targeted the poorest population (Nigeria as an example). The credits can therefore not be considered exclusively as development assistance. Due to competition clauses it is not possible to know which Danish companies benefited from the credits and which specific development goals that were attached to the granted credits.

Before debt relief is granted it should be known what the development objective of the financed projects were and if the projects had clear poverty alleviation goals. An analysis of the past practices in export credits in relation to the Danish development assistance objectives has never been conducted and ought to be done. This has been done in Norway where it turned out that a number of old export credits where considered to be illegitimate. E.g. did Norway support Norwegian shipping suppliers with credits of USD 80 Million, which according to the analysis

secured employment to a crises-torn shipping industry in Norway rather than development in the poorest countries. The Norwegian Minister for Development announced after the analysis that these export credits were a “*failure and a historical low ebb in the Norwegian development policy*”⁶. As a result, Norway took the progressive step and granted debt relief outside the ODA-frame. Norway has now established a depth plan that does not burden the ODA-frame.

- Why are export credits reported as ODA in connection with debt relief arrangements, when they were not reported as ODA at the time of granting? According to the DAC definitions, ODA is characterised as grants or loans to countries and territories on the DAC list of aid recipients (developing countries) which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c) at concessional financial terms (e.g. a loan must have a grant element of at least 25 pct.). In addition to financial flows, technical co-operation is included in aid. Grants, loans and credits for military purposes are excluded.⁷ An answer to the question has been given that debt relief of export credits according to DAC rules can be reported as ODA. However, the Danish government could work on changing the rules, and the rules does not specify that debt relief of export credits must be reported as ODA. The Norwegian export credits had a grant element of 25 pct. and the debt relief therefore did fulfil that DAC requirement. Norway, as the only country in the world, has anyway decided not to report their debt relief to DAC.⁸
- Why should Danish ODA be used for multilateral debt relief arrangements? The HIPC initiative has not led to a sustainable level of debt in all the involved countries, and debt relief from the multilateral financial institutions were therefore also agreed at the G8 meeting in Gleneagles in 2005. The MDRI means that the HIPC-countries will receive a 100 pct. debt relief from the IMF, WB and the AfDB. IMF will mainly finance the cost of the debt relief from own resources. About one-third of the loans provided by the WB and AfDB are financed from repayment of old loans. Debt relief without compensation to the multilateral financial institutions would therefore lead to lower lending capacity, i.e. reducing the possibilities of developing countries to receive loans in the future. Therefore the donor-countries outside G8 have agreed to pay a donor contribution to the WB until 2044 and to the AfDB until 2054 to cover the cost of the debt relief. This will result in a lower degree of flexibility within ODA frames of bilateral donors for a very long period of time. For Denmark this will mean that an additional amount of DKK 4.6 Billion (over the total period) will be taken from the multilateral ODA-frame. The projected expenses from 2006-2015 (and 2016-2054) are listed in table 4.

⁶ <http://www.ibis.dk/presse/showarticle.php?id=4122>

⁷ http://www.oecd.org/glossary/0,3414,en_2649_33721_1965693_1_1_1_1_00.html#1965544 As an example did DAC in 1993 decide that the USA debt relief to Egypt for military purposes could not be considered as ODA.

⁸ <http://www.netpublikationer.dk/UM/7919/html/chapter03.htm> Like Norway, USA has special policy on debt relief to developing countries. In every single case of debt relief the administration has to ask the Congress for the grant to finance the debt relief. The size of the grant depends on a risk assessment. Therefore the grant will in most cases be different from the total outstanding debt as the country in question is expected to repay a portion of the debt itself. The reporting to DAC is based on the outstanding debt.

Table 4. Expenses to the MDRI through § 6.37.01.10, 2006-2054 (DKK Million)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016- 2054
Expenses to MDRI	41	55	62	72	90	107	118	126	133	138	3,685

Source: UM, j.nr.: 73.C.27.f.5.

The Nordic countries and the Netherlands has stressed that the MDRI initiative should be additional, but only in the sense that it should not reduce the regular capital injections to the involved financial institutions – not in the meaning that it should be financed over and above the present ODA frames. The total transfer of resources to developing countries does therefore not increase by MDRI. Instead there will be a redistribution between aid provided directly by bilateral donors to developing countries and resources granted as loans by multilateral institutions to developing countries, in favour of the latter.