Innovative financing mechanisms for South East Asia

POLICY BRIEF 6: DEBT BUYDOWNS OR CONVERSIONS

Description

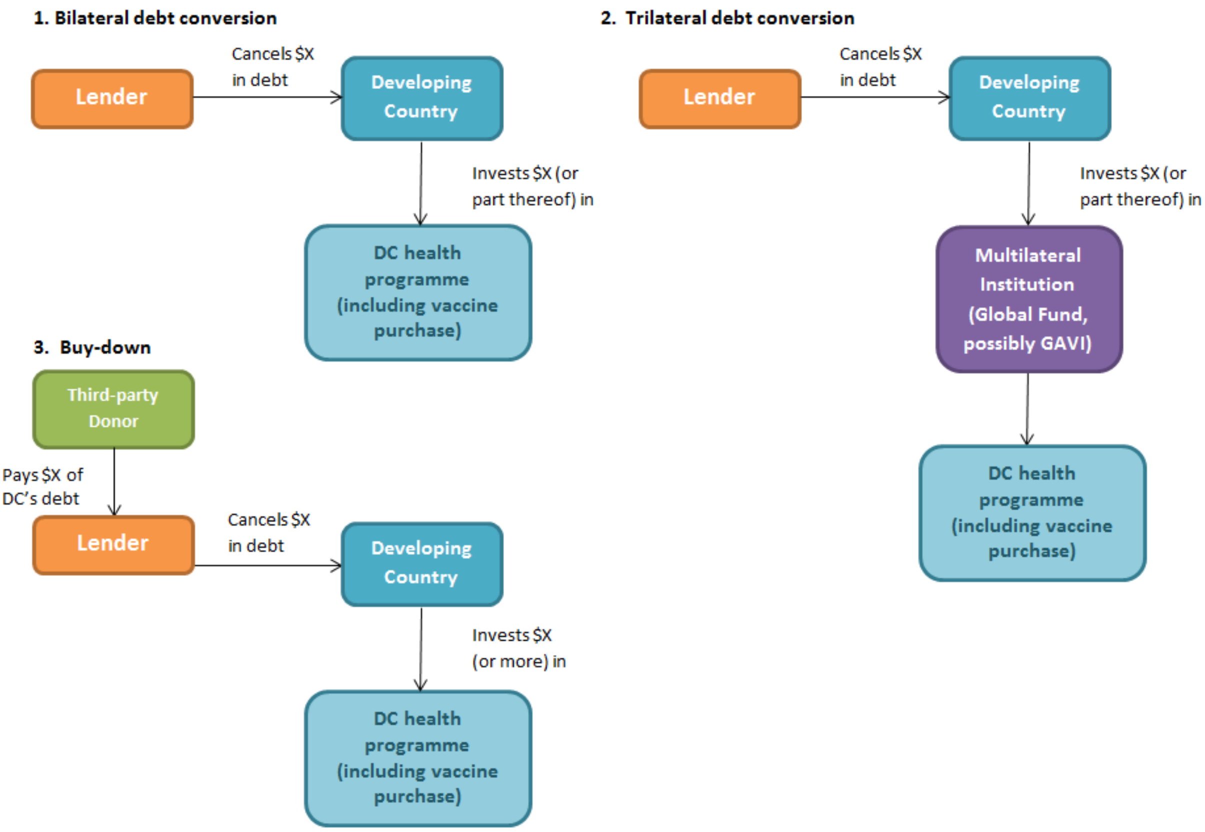
Debt conversions and buy-downs are two mechanisms for decreasing developing country debt, and using the freed-up resources to fund health programmes.

There are two types of debt conversions:

- **Bilateral** (involving two parties). A lender agrees to forgo payment of part of a developing country's (DC's) debt, on condition that the DC invests an agreed amount in the health sector
- **Trilateral** (involving three parties). As above, but the DC must invest the agreed amount *through a multilateral institution*. The best known example of this is Debt2Health, where countries such as Germany and Australia have forgiven debt to various DCs, on condition that they invest in the Global Fund to Fight AIDS, TB and Malaria. The Global Fund then re-invests these funds in the DC's own health programmes (see diagram).

The debt can be cancelled as soon as the DC's up-front investment is made (as with Debt2Health), or after the programme has been successfully completed ('performance-based debt conversion').

In a **buy-down**, a third-party donor (e.g. the Bill and Melinda Gates Foundation) pays part of a loan on behalf of the DC. This is called 'buying down' a loan, and frees up funds to be directed to the DC's health programmes. Buy-downs can also be performance-based – this means the third-party donor only pays off the DC's debt if specific performance targets are met.



POLICYCURES
Level 10, 46 Market Street, Sydney NSW 2000, Australia
Tel: +61 (2) 9262 5211 Fax: +61 (2) 9262 5233
Email: info@policycures.org Website: www.policycures.org

Status

Already widely used. Under the Debt2Health program, Germany has cancelled US$60m of Indonesia's debt and US$50m of Pakistan's debt (resulting in US$30m and US$25m re-invested in health programmes through the Global Fund, respectively). Australia has cancelled US$80m of Indonesia's debt, resulting in US$40m re-invested in health programmes through the Global Fund.

The Investment Partnership for Polio (a partnership of the World Bank, the Gates Foundation, Rotary International and the UN Foundation) agreed to buy down US$85m in debt owed by Nigeria and Pakistan, resulting in US$190m for polio eradication (including vaccination) in the two countries. The Partnership will pay off the debt on completion of successful polio vaccination programmes, including meeting performance targets for immunisation coverage.

GAVI is currently looking into a results-based financing arrangement that would involve donor buy-downs of low interest rate IDA debt.[i]

Volume of potential revenue

Single debt conversions have raised up to US$40m (for multiple health programmes, to be disbursed over a period of up to eight years).[ii] Single buy-downs have raised up to US$190m (for a single health programme across multiple countries).[iii] Collectively, SE Asian countries have over US$400bn in existing external debt. This means that the revenue raised through these mechanisms could potentially be very large, depending on the willingness of lenders to participate.[iv] However, debt buy-down and conversion are not an on-going source of revenue as once the debt is gone, it's gone.

Pros & Cons

Pros	Cons
• Funding flows are generally predictable and stable, once amounts and purposes have been agreed, and if the debt conversion or buy-down is used to fund immunisation, it may facilitate/enhance national ownership of immunisation budgets	• Sustainability is low (debt conversions and buy-downs need to be negotiated on an individual basis, and there is no guarantee of further debt cancellation)
• External debt in SE Asia is large (>US$400bn), meaning a potentially large volume of revenue can be raised	• Revenue raised depends on lenders' willingness to forgo debt repayment, and may change with political priorities
• Established mechanism (for bilateral debt conversions and buy downs), with proven experience in the immunisation context	• A new mechanism would need to be established for trilateral debt conversions,[v] potentially with GAVI as the third party rather than the GFATM, which does not purchase dengue products (see diagram)
• Quick implementation (about one year to implementation for debt conversion; about eight to 16 months for buy-downs)	• For performance-based mechanisms, funding is less predictable (it would depend on the country meeting vaccination targets)
• Economic benefits to the DC from improved credit status	

[i] See 'Low-interest loans from multilateral organisations' backgrounder for country IDA eligibility
[ii] Under the Debt2Health program
[iii] It is estimated that every US$1m in buy-down funding results in US$2m to US$3m in project funding
[iv] Key lenders to the region, including Australia, Germany and the Gates Foundation, have already participated in debt conversions and buy-downs, indicating that lenders' willingness to participate could be quite high
[v] The Global Fund Debt2Health could not be used for dengue vaccine purchase