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DEBT CONVERSION FOR HEALTH

This progress report is presented to the XXXVI Meeting of the Directing Council in response to Resolution XVIII of the XXXV Meeting of the Directing Council held in September 1991.

Since 1988, PAHO has been studying and reviewing the technical and ethical issues involved in using debt-for-health conversions to leverage financial resources for the health sector. More recently, PAHO has lead exploratory missions to several Member Countries to determine the feasibility of operationalizing this concept with both health and financial authorities. In addition, PAHO has distributed technical reports, contacted potential donors and other interested international organizations, and negotiated a debt-for-health conversion.

PAHO's initiative has coincided with a resurgence in international attention focused, in particular, on bilateral conversion. Three countries have made policy statements in support of the inclusion of bilateral conversions in renegotiations through the Paris Club: Belgium, Canada, and the United States of America.

The encouraging preliminary results from PAHO's investigations were discussed at the 109th Meeting of the Executive Committee, which strongly supported the continued effort to achieve fully the goals of the above-mentioned resolution, with renewed emphasis on promoting the concept of debt conversion and supporting Member Countries.

The Directing Council is asked to weigh the background and merits of this initiative, taking into consideration the importance PAHO and WHO have assigned to resource mobilization within the context of global economic uncertainty, and to consider the following resolution proposed by the Executive Committee:

RESOLUTION XI

DEBT CONVERSION FOR HEALTH

THE 109th MEETING OF THE EXECUTIVE COMMITTEE,

Having seen Document CE109/15 on "Debt Conversion for Health,"

RESOLVES:

To recommend to the XXXVI Meeting of the Directing Council the adoption of a resolution along the following lines:

THE XXXVI MEETING OF THE DIRECTING COUNCIL,

Considering the continuing need to identify resources for the promotion of activities for health and environment in the Region;

Taking into account the efforts being made by the Pan American Health Organization to stimulate investment in health and environment through promotion of the "Regional Investment Plan in Health and Sanitation"; and

Noting the changes in commercial debt markets and the substantial international movement towards the forgiveness of certain bilateral debt, and the official statements of some Member Countries of the Paris Club that they would consider debt conversion proposals during renegotiation of bilateral loans through the Paris Club,

RESOLVES:

1. To request the economic authorities in the creditor countries, when renegotiating the debt of the developing countries, to give priority consideration to the conversion of debt for resources to finance health programs.

2. To urge the economic authorities in the debtor countries to give priority to health projects whenever they carry out operations for the conversion of their external debt into resources for the financing of projects within their borders.

3. To request the Director:

a) To continue the Organization's efforts to help the Member Countries explore other alternatives for the financing of their health and

environmental programs not just through conversion of their commercial debt, but also through renegotiation, restructuring, and forgiveness of their public debt;

b) To encourage the interest of the international financial agencies, especially the Inter-American Development Bank, the World Bank, and the International Monetary Fund, in supporting health projects through their debt conversion mechanisms.

(Adopted at the eighth plenary session, 25 June 1992)

Annex

DEBT CONVERSION FOR HEALTH

CONTENTS

DEBT CONVERSION FOR HEALTH

1. BACKGROUND

The decade of the 1980s saw most countries in Latin America and the Caribbean suffer serious economic dislocations stemming from an economic crisis which proved to have greater stamina and force than previously expected. One of the major components of the crisis, and one which dominated much of the political and economic debate, was the debt crisis. The total debt equals almost three times the value of Latin American exports, while debt service now represents 22.3%. One of the immediate consequences of this net financial transfer abroad has been to reduce real wages and drastically curtail the social services benefiting the poor in most countries of the Region.

The continued severity of the crisis and the costly efforts represented by existing debt reduction strategies have led to the emergence of a number of proposals that have advocated more creative ways of dealing with the debt problem, with the aim to find some source of debt relief. Several of these proposals have promoted debt conversion schemes as a way to achieve that relief, while simultaneously leveraging local investments.

In 1984, Thomas E. Lovejoy, then Vice President of the World Wildlife Fund, first proposed that debt swap, which until then had been limited to commercial ventures, be used to support conservation efforts in developing countries. Over the past decade, 19 debt-for-nature agreements have been reached, providing relief on debt worth about US$100 million in face value, with a generation of funds for environment-related purposes of about $60 million.

A proposal submitted in September 1988 by the Health Policies Development Program within the Pan American Health Organization (PAHO)[1] suggested that Latin American and Caribbean debt be converted into a fund for health. This prompted PAHO to recognize debt conversion schemes as a potentially significant way to assist Member Countries in procuring additional health resources, while offering some relief on their remaining debt. Meetings and consultations within the Organization to further discuss the viability of such a scheme, as well as the alternative of converting debt through the Paris Club, were held with several experts and recorded in a first document produced by PAHO on debt conversion.

In continuing to consider this issue, a second document was prepared within PAHO outlining the mechanics of debt-for-health swaps. Upon its completion, this document served as a basis for a presentation made on the subject at the Fourteenth Meeting of the Subcommittee on Planning and Programming of the Executive Committee,

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[1]CEPAL, Balance Preliminar de la Economía de América Latina y el Caribe, Santiago, Chile, December 1991.

held at PAHO Headquarters in April 1990. The presentation generated much interest, and was well received by the Subcommittee members. A series of questions was asked focusing mostly on certain technical aspects and the potential roles of the Organization in undertaking debt-for-health swaps. Recognizing the potential benefits of debt conversions for the health sector, the Subcommittee proposed that the application of debt for health be further explored without additional delay. It was suggested that particular attention be given to the macroeconomic implications of debt conversions and the potential ramifications of undertaking somewhat different, although not mutually exclusive, alternatives which have been proposed to carry out debt-for-health swaps.

In response to the Subcommittee's request, a working group was subsequently formed within PAHO to investigate the questions raised on the issue of debt conversions, and the number of ways PAHO might participate in assisting Member Countries explore further this concept. Building on the two previous documents, the group's research and findings were compiled in a third document.

2. DEBT-FOR-HEALTH CONVERSIONS: A REVIEW AND UPDATE OF THE ISSUES INVOLVED

Although there are numerous variations to the concept of debt conversion, the basic transaction remains the same: the exchange of outstanding government obligations for other obligations, generally denominated in domestic currency rather than in foreign exchange. In the case of debt-for-health conversion, a portion of a government's outstanding foreign debt is exchanged for the commitment of that government to invest local currency in priority health projects.

To date, the conversion of debt has mostly been undertaken with debt owed to commercial banks or other public lending institutions. Potential investors for this type of activity are numerous. They include, multinational corporations, particularly if the funds of these swaps are to be allocated to health projects involving the purchase of products which they manufacture. Multilateral development banks and bilateral donor agencies willing to use development assistance funds or unallocated resources as capital to buy debt are also likely investors, as are nonprofit organizations and charitable organizations which more and more have access to funds for debt conversion schemes.

Another means of undertaking debt conversions can be with bilateral debt. Creditor governments supporting the use of this alternative include those of Belgium and the United States of America who have already officially stated that they would entertain this option within the renegotiation of bilateral loans made to third world countries through the Paris Club. The United States also opened up new possibilities to convert bilateral debt owed by the Latin American governments through the Enterprise for the Americas Initiative. In June 1992, Canada announced an extensive bilateral debt conversion program for nine countries in the Region in the areas of environment and

sustainable development. The advantages of trading bilateral debt are essentially twofold. On one hand, major impediments to converting private commercial debt would be overcome, namely the unwillingness of commercial banks to trade debts they are holding at deep discounts for fear of contaminating the remainder of their portfolio. On the other hand, creditor countries would have the opportunity to obtain funds for additional assistance for the Region, without having to levy additional taxpayers money, particularly in the wake of the demands imposed by a number of other priority areas, such as the economic reconstruction of Eastern Europe and the former Soviet Union.

Although each country has its own and unique manner of approaching the mechanics of debt conversion, the following steps must be taken if this transaction is to be completed successfully. First, preliminary discussions are held with a number of interlocutors from diverse sectors to determine the feasibility of a debt-for-health conversion, most importantly with the ministries of health, planning, finance and the central banks. Based on the information gathered during these conversations, profiles of the proposed health projects are then developed to approach potential debt holders and investors, both public and private. Once the viability of the health project is determined, the transaction of purchasing the debt or returning the debt title to the countries occurs. Local currency funds are then made available for the agreed health project.

Debt-for-health conversions have the potential to benefit every party involved. Recipient countries benefit, on the one hand, by reducing both the amount of their foreign currency debt and overall debt servicing. And on the other, they also benefit by paying the social commitment acquired through this exchange in local rather than in foreign currency. Moreover, by channeling the converted funds toward priority health projects, the recipient countries are able to improve the health of their populations, which is one of the determining factors in economic recovery. Banks and other debt holders benefit by disposing of assets which probably would not have been liquidated otherwise. And donors benefit because they stand to receive a high rate of return with limited funds.

Debt-for-health conversions are not without risks. For example, upon cancellation of the debt, a debtor country government may find that it cannot or will no longer convert the debt in local currency proceeds. Or, nongovernmental organizations (NGOs), targeted as recipients by some debt swap programs, may not always possess the technical and managerial capacities to participate in debt-for-health swaps. Also, if appropriate safeguards are not incorporated, experience clearly reveals that some of the benefits of undertaking swaps may be unevenly distributed, particularly when private sector firms are involved.

Numerous questions have been raised regarding the macro-economic implications associated with this type of transaction for the debtor countries. Perhaps the most frequently raised question revolves around whether the application of this mechanism is likely to have a detrimental inflationary impact on the debtor country's economy.

However the amount of resources presented for exchange into local currency through debt-for-health conversions are not large enough to have appreciable inflationary repercussions. By way of illustration, the first two debt-for-health swaps that took place in Ecuador represented only .097% of gross domestic product. Moreover, countries have the ability to control inflationary pressures, by imposing ceilings, issuing local currency bonds, or by matching the release of local currency to the cash flow of the health project.

Another question which is often raised regarding possible costs to the debtor nations is whether debt conversions generate additional investment, i.e., whether debt swaps are likely to benefit project funding locally. If there is no element of additionality, it is often said that the debtor country risks giving up hard currency that would have been forthcoming without receiving any other added benefits. On the other hand, it could also be argued that, in the absence of a debt conversion program, the poor economic performance of many debtor countries may deter investors from financing projects altogether. Moreover, through participation in a debt conversion program, an investor may be more liable to increase the size of a previously planned project. In the end, the answer to the question of whether a swap generates additional resources should be determined on a case-by-case basis.

Debt-for-health swaps may also lead to a need for hard currency because health projects often require imported inputs. This situation may, however, be avoided by specifying that a fixed percentage of the resources remain in hard currency to satisfy the demands generated by projects.

The final set of questions often raised relates to whether debt-for-health swaps may be regarded as mere instruments to bail out commercial banks, or subsidize private sector enterprises willing to provide funding in exchange for preferential treatment. With respect to commercial banks, it should first be noted that the amount of loans made by these institutions to Latin American countries are relatively negligible in relation to their total assets to be able to consider swaps as instruments to assist banks. Moreover, the accounting losses incurred by the banks at the time a loan is sold at a discount amounts, in effect, to a subsidy to both the investor and the debtor country. As for the private sector, caution should be exercised, since local needs may be obscured during project design and development.

Modalities of debt-for-health swaps are generally regulated by the legal structure and related administrative practices in the debtor countries. Based on available information, legislation regulating debt conversion has been identified in numerous Latin American countries, ranging from the creation of advisory bodies to define and develop debt swap strategies, to state endorsement, to the creation of conditions required to stimulate long-term capital investment.

The implementation of debt-for-health conversion programs requires dealing with a number of issues. Perhaps the most crucial issue is sustainability, which refers to the capacity of a country to sustain the programs, activities and levels of benefit to the population and its health once the project has come to a close. Swaps only generate funds on a temporary basis. Thus, it is important that plans be made to provide support for the program upon depletion of the funds. Moreover, projects that are more comprehensive in scope than selective, and include social participation, may more readily find advocates within the community to assist in finding ways of continuing the services.

No less important is the issue of additionality. If governments operate under severe budgetary constraints, there is a risk that funds will be withdrawn from other sectors, in which case the investment is not additional. For instance, if funds are reallocated from other social sectors such as health, welfare or education, the gains may be seen as limited and questionable. On the other hand, if relatively large funds are reallocated from areas which have higher priority to the health sector budget, it may have an adverse effect on the country's development objectives.

The question of social impact of projects financed through debt swaps is also of significant importance, particularly when used as a justification for the project or as one of the principal criteria for the evaluation of its merit. One of the main factors which determines the social impact of the health project is the selection of the target population. Ideally, the projects selected should be those that reach the maximum numbers of persons with effective interventions while achieving cost-efficiency.

In order to ensure that health projects that are financed by swaps correspond to the needs of the population, it is important that the process of norm setting be appropriately regulated and coordinated by the recipient governments. Since governments ultimately share the responsibility with people for their health, they have the obligation to set the norms and standards for the health sector. Thus, it is important that mechanisms be set up to safeguard such a role.

Finally, it is important to use debt conversions to promote the kind of health interventions which will have a positive impact. Monitoring and supervision activities are essential to demonstrate the ethical principles involved, as well as to reinforce the original intent on which the project is based. Setting up criteria with which to evaluate a project requires care, as there is a tendency to concentrate on highly visible and easily measurable indicators. This approach may bias project activities toward short-term results to the neglect of more lasting changes in behavior or attitude.

A number of international and multinational organizations already have experience in the area of debt conversion. For instance, the United Nations Children's Fund (UNICEF) was a recipient in 1988 of a debt instrument for Sudan donated by a commercial bank for a water project. UNICEF also designed with the IDB a standing

loan fund for Latin America and the Caribbean for social investments using the debt swap mechanism, although to date no investments have ocurred due to lack of funds. CARE (Cooperative Aid for Relief Everywhere) has also been active in pursuing debt swaps, signing a $3.5 million debt swap agreement in April 1990 with the Government of Ecuador to fund projects to protect the environment. The United States Agency for International Development (USAID) initiated in 1989 a debt swap mechanism to finance through foreign assistance funds the purchase of debt currently owed by developing countries to foreign creditors for conversion into local currency bonds. In 1988, USAID also funded the creation of the Debt-for-Development Coalition, which provides information on policies and programs of organizations interested in promoting and pursuing debt conversions, as well as technical assistance in designing and structuring debt swap programs.

During a debt-for-health conversion PAHO could be required to perform several functions for both the debtors and the creditors. For instance, PAHO could provide technical assistance to develop appropriate health projects and work with its local counterparts to promote debt conversion. In addition, PAHO could administer and oversee the disbursement of project funds, as well as monitor and supervise the implementation of health projects. Given that PAHO not only has a mandate, but has demonstrated a capacity, to mobilize resources in the Region, it could also encourage potential private investors or bilateral and multilateral donors to provide funding for debt swaps. Finally, PAHO could act as a coordinator establishing working networks among the various players in both creditor and debtor countries to facilitate the exchange of information and avoid intrasectoral competition.

3. PROGRESS REPORT

As a follow-up to the mandate given to the Director by the Directing Council, a project team was formed under the supervision of the Health Policies Development Program. The activities pursued by this group have been numerous and essentially have included the following:

3.1 Technical Report

A technical report, compiling all three aforementioned documents, was prepared in both English and Spanish. It was distributed to all PAHO Member Countries and Representations, as well as to other WHO regional offices, UN agencies and bilateral donors.

3.2 Information Pamphlet

A brochure containing basic information on the debt-for-health conversion process is being designed in both English and Spanish. Written for an audience without prior

experience in the area of debt conversion, it provides a synopsis of the economic ramifications of debt servicing, the steps to follow in implementing this type of transaction, and the actors involved. It also provides answers to the most frequently asked questions on the matter. A distribution plan is being developed, and the brochure will be availabe to the PAHO/WHO Representatives (PWR) in the Member Countries.

3.3 Country Visits

Fourteen Member Countries were visited and consulted regarding the feasibility of pursuing debt-for-health conversions. In collaboration with the local PAHO offices and the Ministries of Health, discussions were held with a number of interlocutors within the Ministries of Finance, Planning, the Central Bank and the Treasury. These exploratory missions generated much interest on the part of Member Country governments. A number of Ministers of Health requested that PAHO assist them in further exploring this issue both with the financial authorities of their respective countries and with debt holders, particularly those within the bilateral arena. Most recently a mission to Costa Rica worked with the PWR on project proposals. These visits have provided an opportunity to gather information relevant to the debt swap process.

On the basis of the level of interest of Member Countries and the prevailing health and economic conditions, eight countries were tentatively selected for subsequent activities described in section 4 of this document. They include: Bolivia, Costa Rica, Ecuador, the Dominican Republic, Guyana, Honduras, Mexico and Peru. The list is not all encompassing and requests from other countries are anticipated.

3.4 Realization of a Debt-for-Health Swap

Negotiations are presently under way with UNICEF to finalize PAHO's involvement with that agency in a debt-for-health conversion program in Bolivia, using a CAN$3 million contribution from the Canadian International Development Agency (CIDA). With this amount, it is foreseen that debt with a face value of up to US$18 million will be purchased, then redeemed in local currency for approximately US$5 million. Although UNICEF is the recipient of these funds, an agreement was reached involving the Ministry of Health, PAHO, UNICEF and CIDA that a portion of these funds be used to finance a project in maternal and child health in Bolivia.

3.5 Partner Contact

In addition to UNICEF, a number of important contacts and inquiries were made. The Inter-American Development Bank (IDB), the International Monetary Fund (IMF), and the World Bank have been approached. USAID and CIDA have dedicated substantial resources to debt swapping and to the creation of two broker entities, the Debt

for Development Coalition (USAID) and the Debt for Development Initiative (CIDA), to assist Canadian and American nonprofit organizations in pursuing conversion programs in developing countries. Both were consulted in the initial stages of project development and provided useful documentation regarding their respective experiences. The Fund for Private Assistance in International Development (PAID) was also contacted.

3.6 Donor Solicitation

In collaboration with the PAHO Office of External Relations Coordination (DEC), the project team has been developing a donor strategy, focusing primarily on bilateral donors. The reasons for pursuing bilateral donors are twofold. On one hand, a window seems to be opening for this type of transaction. A number of creditor governments, particularly those that are members of the Paris Club, have already expressed considerable interest in including in the menu of options of debt rescheduling agreements the alternative of swapping a percentage of the bilateral debt of a number of debtor countries from the Region. On the other hand, in dealing with bilateral donors, the inclusion of brokers and commercial banks as participants is eliminated, therefore reducing the number of actors involved and simplifying the negotiation and implementation process.

With the approval and support of the Member Country, the proposed course of action is to approach relevant creditor country authorities to discuss the possibility of converting their bilateral loans into additional resources for priority health projects.

3.7 Creation of an Interprogram Advisory Committee

An interprogram advisory committee was formed within PAHO to act as a steering group for the debt conversion initiative. The committee is headed by the Director and is composed of the heads of the following offices: Analysis and Strategic Planning (DAP), External Relations Coordination (DEC), Health Systems Infrastructure (HSI), Health Manpower Development (HSM), Health Policies Development (HSP), Health Situation and Trend Assessment (HST), Health Programs Development (HPD), Environmental Health (HPE), Maternal and Child Health (HPM), and Communicable Diseases (HPT).

4. PRIORITIES FOR ACTION

In order to complete the mandate set forth by the Governing Bodies of PAHO in relation to debt-for-health conversions, the activities listed below will be pursued within the next few months. The implementation of these measures will not require any increase in the Organization's budget.

4.1 Continuing the Exploration of the Debt-for-Health Mechanism

Studies and experience to date demonstrate that debt conversions have the potential to leverage additional resources for priority health projects. In times of economic and budgetary constraints throughout the world, both debtor and creditor countries are urged to pursue the exploration of this mechanism as a means to generate additional resources.

4.2 Assisting Interested Countries to Develop a Comprehensive Debt Swap Strategy

Concrete efforts will be made to facilitate appropriate communication channels and greater collaboration between the health and financial authorities of the countries. Ongoing dialogue between the health authorities and the Ministries of Finance and Planning, the Central Bank, the Treasury and PAHO are critical for this type of transaction. Without this dialogue, other social sectors are liable to take priority over health and receive all the benefits from this type of initiative.

Efforts will be undertaken to assist countries in entering into negotiations with debt holders and donors, and with international financial institutions, like the World Bank, the IDB or the IMF. Upon request, emphasis will also be placed on exploring the possibility of including debt conversion schemes in the menu of options of debt rescheduling agreements negotiated within the Paris Club.

Project funds generated through this type of initiative are finite. Therefore, in planning and developing projects, highest priority will be given to projects that are sustainable and that involve community participation, so as to enable the people to carry on with the project activities once funds have been depleted.

4.3 Promoting Debt for Health Conversions

Promotion will be pursued within PAHO programs and with individual country authorities, so as to sensitize both health personnel and grassroot organizations on this issue, and with international organizations in order to realize the potential of this initiative, especially in reference to bilateral debt.