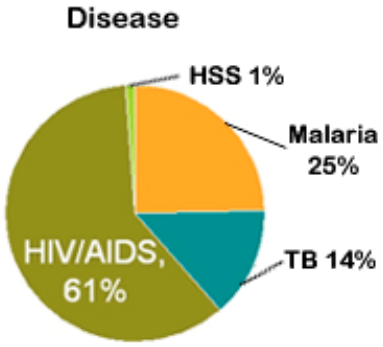
BROOKINGS
Global Health Financing Initiative
SNAPSHOT SERIES

Debt2Health: Debt Conversion for the Global Fund to Fight AIDS, Tuberculosis, and Malaria

Background

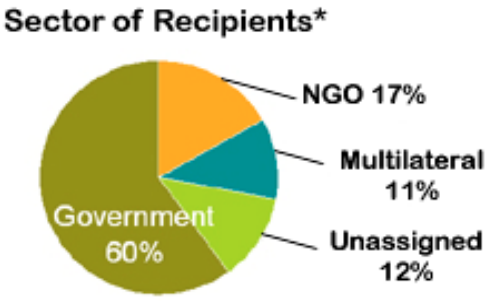
Despite significant increases in funding for HIV/AIDS, tuberculosis (TB), and malaria over the past decade, estimates suggest a continuing and substantial shortfall in funding. The Global Fund has projected, for example, that 5 million people in Africa would benefit from antiretroviral treatment that costs $1,000 per year, an outlay of $5 billion annually just for that purpose. In the six years from 2002 to 2008, the Global Fund has raised and committed $9.5 billion, just double the annual estimate for that single need. Total global needs for HIV/AIDS, TB, and malaria are estimated to be in the $15 billion per year range. Hence the Fund faces a perennial demand for additional funding and has been seeking new sources of revenue. One such effort is Debt2Health, which was approved by the Global Fund's board on April 26, 2007 in four countires (Indonesia, Kenya, Pakistan, and Peru) between 2007 and 2009.

Figure 1: The Global Fund: Distribution of Funds, by Disease, 2003–07



Figures 1 and 2 illustrate the Global Fund's record in providing assistance. As shown, HIV/AIDS receives more than half the funding, and governments account for about two-thirds of the Fund's grants. At the end of 2007, the Global Fund's assistance financed antiretroviral treatment for 1,400,000 HIV-positive people, treatment of 3.3 million people for TB, 46 million insecticide-treated nets, 28 million malaria treatments, HIV counseling to 17.8 million people, basic care and support to 1.7 million orphans, and community outreach services to 53 million people.

Figure 2: The Global Fund: Distribution of Funds, by Implementer, 2003–07



*Rounds 2 – 5 only. Information not available for Round 1.
Source: Global Fund Web site

This snapshot describes the Global Fund debt conversion mechanism, explains how it would work and discusses some strengths and weaknesses.

Global Fund Debt Conversion

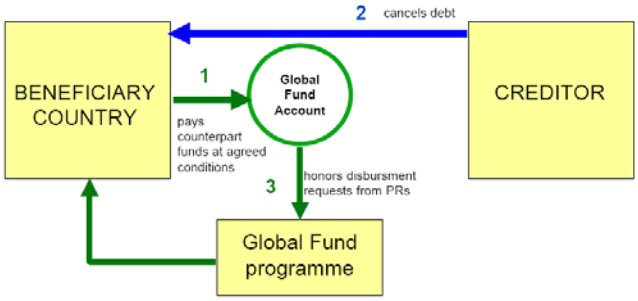
The idea of a Global Fund debt conversion (GFDC), subsequently called Debt2Health, was introduced at the International AIDS Conference in Barcelona in 2002. It was developed by a Global Aids Alliance and Advocacy International feasibility study in July 2005, with many more changes to bring it to the current pilot phase. The Global Fund sees four potential sources of debt for conversion: (1) bilateral concessional debt that is owed by 16 lower-middle-income countries that has already been rescheduled and can be converted now (this debt is the target of the pilot); (2) remaining commercial

and bilateral official claims on heavily indebted poor countries (HIPCs), most of whose debt has been canceled under the HIPC Initiative; (3) remaining multilateral claims on HIPCs, mostly by regional institutions in developing countries; and, (4) nonperforming debt owed by non-HIPCs to private entities that may convert it as an act of charity. The stock of debt in these four categories runs into many billions of dollars.

How does Debt2Health work?

Under the pilot approved by the Global Fund's board and illustrated in Figure 3, a creditor would write off part of a debt (step 2) once the beneficiary government pays its counterpart funds (step 1) to the Global Fund for approved projects in its country. Counterpart funds are the local currency equivalent of the present value of the remaining debt. In step 3 the Principal Recipient (PR) of an approved grant receives the funds, following regular procedures. The Global Fund is legally a party to the conversion agreement. Payment to the Global Fund can be in cash (in two installments) or promissory notes. Notwithstanding the currency of payment, the funds would be converted to a reserve currency such as the U.S. dollar. Through this program, the Global Fund obliges itself to earmark funds for a single country's programs.

Figure 3: Debt2Health Funding Mechanism



What are strengths and weaknesses of the Debt2Health mechanism?

The incentives for a creditor to participate in Debt2Health can be substantial. Debt conversion for bilateral donors is difficult and transaction-intensive. Partial cancellation of 50% typically means that half the present value of the loan is forgiven if the recipient country agrees to finance a development project or another activity with the remaining "counterpart funds" in local currency. Both parties must agree to the amount and use of the counterpart funds, which may involve developing, completing, and evaluating a new project or identifying an acceptable use for the funds, with monitoring of its implementation. If donor and recipient countries can substitute the Global Fund for this process – accepting its goals, procedures for selecting projects, and methods of accounting for results – the process of debt conversion could be simplified and become a practical means of support for the Global Fund. On the negative side, if debt conversions become an important tool for financing Global Fund activities, they could cause excessive earmarking to specific countries, but this is currently not a large risk.

However, for the debtor country, if the loan is not currently being serviced, a partial cancellation requiring counterpart funds would be more expensive than the status quo, so it is likely that only countries capable of making such payments could benefit. Yet a successful pilot might make the mountain of outstanding obligations of low- and middle-income countries a feasible resource for better health.

Present status and expected future directions

At the official launch of the Global Fund Debt2Health Initiative on September 28, 2007, Germany agreed to convert €50 million in debt when Indonesia contributes half of that amount through the Debt2Health mechanism. Germany will contribute a total of €200 million (US$260 million) of ODA (official development assistance) debt over the next two years at a discount of 50 percent for the beneficiary. An agreement with Pakistan is expected to come next, with Kenya and Peru following. Germany's commitment increases Global Fund resources by $125–130 million. The goal of the pilot program is to increase donor participation beyond Germany and to double this amount.