

Third Party Evaluation Report 2015  
Ministry of Foreign Affairs of Japan

# Evaluation of Debt Cancellation

March 2016

Mitsubishi Research Institute, Inc.



## Preface

This report under the title of “Evaluation of Debt Cancellation” was undertaken by Mitsubishi Research Institute, Inc., entrusted by the Ministry of Foreign Affairs of Japan (MOFA) in fiscal year 2015.

Since its commencement in 1954, Japan’s Official Development Assistance (ODA) has contributed to the development of partner countries and to find solutions to international issues which vary with the times. Recently, more effective and efficient implementation of ODA has been required not only in Japan but also in the international community. MOFA has been conducting ODA evaluations every year mainly at the policy level with two main objectives: to improve the management of ODA; and to ensure its accountability. The evaluations are conducted by third parties to enhance their transparency and objectivity.

This evaluation study was conducted with the objectives of reviewing Japan's overall policies on debt cancellation, drawing on lessons from this review to make recommendations for reference in policy planning on future assistance in this domain by the Government of Japan and its effective and efficient implementation, and ensuring accountability by making the evaluation results widely available to the general public.

Professor Hiroshi Sato served as a chief evaluator to supervise the entire evaluation process. Professor Sato has made enormous contributions from the beginning of this study to the completion of the report. In addition, in the course of this study both in Japan, and in Washington DC, we have benefited from the cooperation of Ministry of Foreign Affairs, Ministry of Finance, the Japan International Cooperation Agency (JICA), as well as government agencies and donors. We would like to take this opportunity to express our sincere gratitude to all those who were involved in this study.

Finally, the Evaluation Team wishes to note that the opinions expressed in this report do not necessarily reflect the views or positions of the Government of Japan.

March 2016

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Note: This English version of the Evaluation Report is a summary of the Japanese Evaluation Report of Evaluation of Debt Cancellation

## **Evaluation of Debt Cancellation (Brief Summary)**

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### **Period of the Evaluation Study**

October 2015 – February 2016

### **Field Survey Country**

Washington D.C., (case study countries: Iraq and Myanmar)

### **Background, Objectives and Scope of the Evaluation**

Debt cancellation is a type of aid scheme applied to recipient countries with excessive burden of external debt. Under the consensus of the main creditor countries, it is provided to debtor countries which have met certain conditions. The main platform for the discussion is the Paris Club. This third-party evaluation is a first ODA evaluation to be conducted on debt cancellation. All of Japan's debt cancellation treatments for ODA loans post-2003 is the subject of the evaluation. Iraq and Myanmar are treated as two case studies both being a recipient of relatively large amount of debt cancellation in the recent years. The evaluation was conducted in order to put together lessons learnt and policy recommendations for the future formulation of ODA policies and its implementation. It also serves to fulfill the accountability to the general public and to share the results with related organizations.

### **Brief Summary of the Evaluation Results**

#### **(1) Relevance of Policies**

The relevance of policies was assessed from five following perspectives: presence of a cross-cutting policy on debt cancellation, consistency with the needs of the recipient countries, consistency with Japan's higher policies, consistency with other international cooperation programs, consistency with the aid policies of other donors, Japan's comparative advantage. The team evaluates that Japan's debt cancellation policy is based on international donor harmonization and that its external relevance is well established.

However, Japan currently does not possess a cross-cutting policy which stipulates the objective and the status of debt cancellation under the broader ODA policy framework. Thus, its consistency with the Japanese internal policy remains difficult to be assessed objectively. Furthermore, due to the nature of debt cancellation which is governed under

international donor harmonization, Japan's debt cancellation method does not exhibit a notable comparative advantage. Although, the evaluation team found that in the example of Myanmar, the case study country, there was a distinct role taken by Japan in the course of preparing for international donor harmonization.

## **(2) Effectiveness of Results**

This section was evaluated from the following six perspectives: macro-economic effect, effect on investment and disposable public fund, poverty reduction, effect on fund procurement, effect on governance, effect on bilateral-economic relations. It was found that there was a significant level of effect on funds procurement and bilateral economic relations, though it should be noted that debt cancellation had not been the only reason that have incited the changes in these two indicators. Debt cancellation is limited in its developmental effectiveness due to its schematic constraint. It must be kept in mind that it mainly serves to assist pre-existing demand for expansion in development assistance and economic cooperation. Though in the case of the two case study countries, Myanmar and Iraq, the credit standing have recovered as a result of debt cancellation and thus led to the reinforcement of funds procurement ability and economic relationship. It may be evaluated that debt cancellation has become a catalyst for new financial cooperation.

## **(3) Appropriateness of Processes**

This section was evaluated from four perspectives: the presence of operation guidelines for the scheme, relevance of the operational structure, Structural understanding of the effects and implementation of monitoring, and cooperation with other donors and international organization. Overall the process taken by Japan on debt cancellation is assessed appropriate, although the transparency of this process to the general public is not satisfactory.

### **●Diplomatic Viewpoints**

Japan is one of the donors owing largest amount of ODA loans to the debtors, and its commitment to the donor harmonization is widely acknowledged in the international community. However, in terms of debt cancellation's contribution to the bilateral relationship, it is difficult for it to exert any outstanding effect in comparison to other donors, because it is a fruit of a multilateral process. Though it should also be added that when there is a pre-existing expectation in reinforcing Japan's economic relation with the debtor, and the condition is mature for ODA loans and private investment, debt cancellation has a potential of catalyzing a strong diplomatic effect.

## **Recommendations**

### **(1) Stipulation of consistency with higher policies**

In order to provide the accountability to the taxpayers and to ensure appropriate knowledge-sharing amongst the actors involved, it is recommended that a basic policy on debt cancellation is stipulated and that this policy clearly demonstrates its consistency with the Development Cooperation Charter and other aid policies.

## **(2) Improved transparency of the debt cancellation process**

The process over debt cancellation is highly confidential, and it is difficult for the general public or the people outside charge to clearly understand the specific steps leading up to a debt cancellation. It is therefore recommended that the government communicates to the public, the position and criteria on which Japan builds its decision over debt cancellation and what aspects are carefully considered when doing so.

## **(3) Structural understanding of the effects and implementation of monitoring**

Debt cancellation does not possess a measure of its own to analyze and monitor its effects. Therefore, it is recommended that certain indicators are prepared to observe its effect so as to help understanding the developmental effects provided to the given recipient.

Moreover, to prevent habitual default on the part of the debtors, it would also be useful to identify the reasons why the debtor country had accumulated its debt to an unsustainable level. It must be emphasized that solving the fundamental problem, underlying debt cancellation is just as important.

## **(4) Establishing a mechanism to ensure the recipients commitment to poverty reduction expenditure**

Debt cancellation is a distinct form of aid in that it demands the debtors to commit to certain reform measures as an exchange to the debt treatment. If debt cancellation is to be defined as a form of development assistance, its expected effect materializes only after the newly formed financial surplus is used for poverty reduction. This is when a financial effect is translated to a developmental effect. However, it is difficult to actually prove this supposed cause-and-effect relationship. Therefore if debt cancellation continues to be conducted as a part of ODA policy, it is recommended that Japan, together with other donors, establishes an innovative effective mechanism to encourage the recipient to commit to poverty reduction expenditure.

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## Chapter 1: Principle of the evaluation

### 1-1 Background and purpose of evaluation

Official Development Assistance (ODA) is one of the pillars of Japan's contributions to the international community. Today, the implementation of ODA is expected to be more effective, more efficient and of higher excellence than it has previous been, and Ministry of Foreign Affairs has been making effort to enhance its work through ODA evaluations.

Many developing countries receive ODA loans from donor countries, and such aid is utilized by the recipients to assist their economic development. On the other hand, if a recipient country holds excessive debt, such burdens may obstruct the country's growth, contrary to the intended purpose. This issue known as of accumulated external debt has been recognized one of the issues faced by developing countries in regards to development assistance. It has been targeted most notably by the World Bank and the International Monetary Fund (IMF) initially under their Structural Adjustment Programs (SAPs) in the 70's. Debt cancellation is one of the most fundamental aid schemes applied to heavily indebted countries and is aimed at recovering the financial stability of the debtor country by forgiving debts under given conditions. The Paris Club is the principle platform for discussing debt cancellation, where under the consensus of the major creditor countries debt treatments are applied to debtor countries that have fulfilled certain conditions.

Since 2003, Japan has delivered 86 debt cancellations, a total of 2.165 trillion yen (ODA credits: 59 times, total 1.13 trillion yen). This evaluation is the first evaluation on ODA-related debt cancellation that is conducted at policy level. It was intended to comprehensively review ODA-related debt cancellation and to present recommendations and lessons learnt to contribute to future plans and implementation of ODA policies. It was conducted by analyzing the consistency of the debt cancellation practice with the higher policies which includes the international agreement in the Paris Club, and the Heavily Indebted Poor Countries (HIPC) Initiative, etc. This evaluation also considered the objective of debt cancellation to developing countries, and also reviewed its diplomatic impact as well as its primary developmental effects. The evaluation also published its findings in a reader-friendly manner to the general public as well as other donors and recipient countries in order to ensure its accountability.

### 1-2 Scope of evaluation

This evaluation was conducted in a comprehensive manner by including the development viewpoints - "Relevance of Policies", "Effectiveness of Results", "Appropriateness of Processes" - and diplomatic viewpoint. The evaluation conforms with the ODA Evaluation Guidelines (9th Edition), and uses the five criteria established by the OECD-DAC (Organization for Economic and Cooperation and Development -



Development Assistance Committee) as a reference.

“Relevance of Policies” evaluated the congruence of debt cancellation practice with development needs revealed in major international agreements concerning debt cancellation such as the basic principles of each Paris Club terms, HIPC Initiative, etc. We also reviewed the consistency between these international agreements and Japan’s higher policies on ODA, and the coordination with other donors. In doing so, we took note of the fact that there is no basic policy in Japan which directly addresses the debt cancellation scheme, and complemented this absence by referring to international agreements. Furthermore, for the two case study countries, Myanmar and Iraq, we also analyzed the Country Assistance Policy, economic cooperation policies and bilateral agreements that were in operation at the time of debt cancellation

“Effectiveness of Results” was assessed based on the Paris Club agreements and conditionalities provided by IMF upon debt cancellation. In particular, we focused on the macroeconomic and financial stability, and performed a quantitative analysis on the economic effect through an Input-Output analysis.

“Appropriateness of Processes” reviewed the meetings with other donors at Paris Club, and the decision-making process in Japan on debt cancellation following an agreement at the Paris Club.

From a diplomatic viewpoint, we examined the ripple effect of debt cancellation on bilateral relations, as well as the debt cancellation’s effect on Japan’s presence in international meetings such as the Paris Club.

Figure 1-1 is the framework of objectives organizing the related policies against this backdrop.

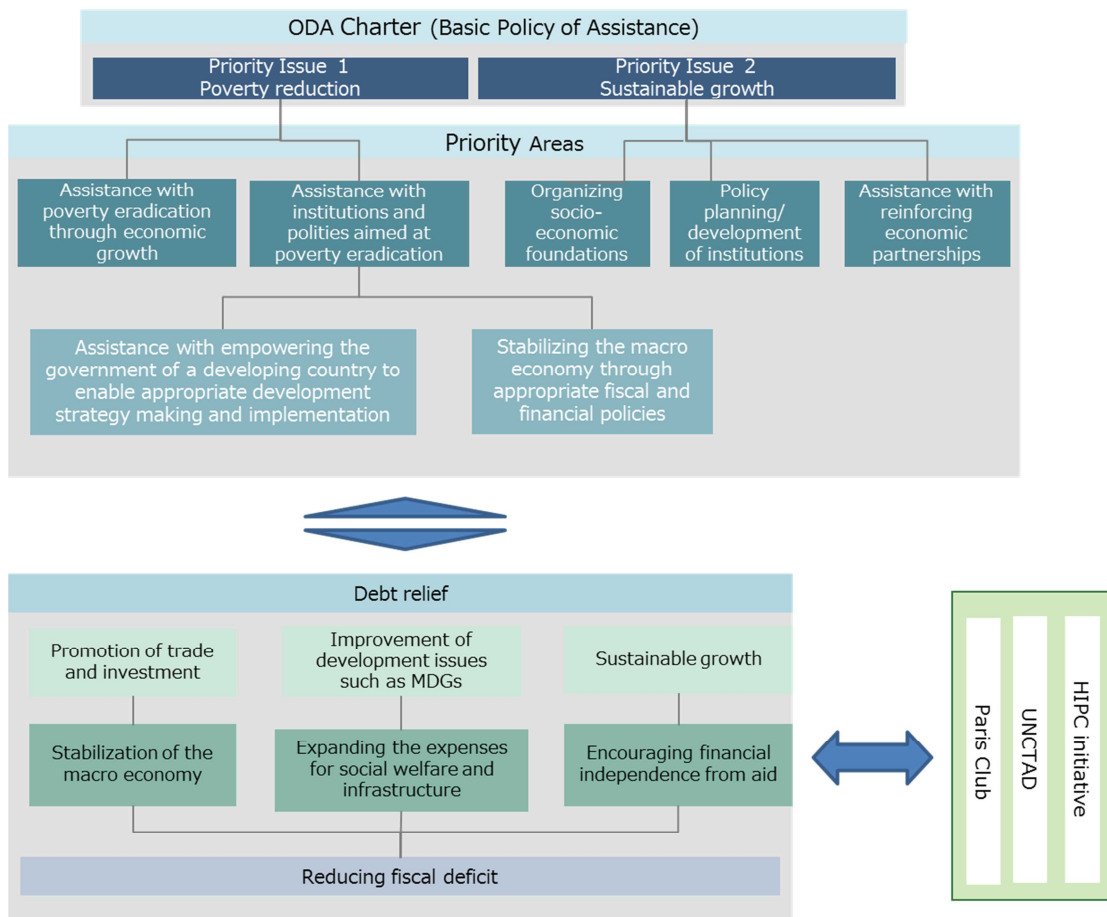


Figure 1-1 Framework of Objectives  
 (Created by the evaluation team based on related policies)

### 1-3 Method of evaluation / Framework of evaluation

#### 1-3-1 Method of evaluation

This evaluation sets specific criteria on aforementioned “Relevance of Policies”, “Effectiveness of Results”, “Appropriateness of Processes”, and diplomatic viewpoints based on the ODA Evaluation Guidelines (9th Edition). Moreover, literature review and interviews to related parties were conducted upon the analysis.

#### 1-3-2 Framework of evaluation

We laid down viewpoints such as “Relevance of Policies”, “Effectiveness of Results” as previously mentioned. Moreover, we created an evaluation framework which defines the assessment criteria and indicators for each of the viewpoint.

## Chapter 2: Case Study (Iraq and Myanmar)

### 2-1 Iraq

#### 2-1-1 Relevance of Policies

##### (1) Consistency with the development needs of the recipient

For the case of Iraq, the important background for the debt cancellation was postwar reconstruction. The country was in significant budgetary need in 2003 in the post-war national building process in order to service the reconstruction of government institutions (most importantly the security agencies) and social infrastructure that was destructed during the war. Although Iraq is an oil-producing country and it has recently grown to become a middle-income country, it was a heavy burden to allocate their budget for the repayment of the debt accumulated by the government prior to 2003. Thus, debt cancellation to Iraq at the time, was in this sense, consistent with the development needs of the country as well as their development policies based on those needs.

##### (2) Consistency with high-level policies

This section confirms the consistency of debt cancellation policies with the high-level policy, which in this case is Japan's Assistance policy for Iraq. "The Country Assistance Policy for Iraq" was referred to, as the relevant policy document. In this policy document published by Ministry of Foreign Affairs in 2012, the following three points were raised as the main objectives of aid to Iraq; "Peace-building and nation-building", "Energy security", and "Enhancement of the relationship in trade and investment between Iraq and Japan". Under these three objectives, the policy document states that "Transition from post-conflict reconstruction to self-sustainable development" is the Basic Policy of Assistance to Iraq. "Fair politics and Government" is raised as one of the main ideas which support the Basic Policy, and thus, debt cancellation to Iraq agrees with this policy framework.

It must also be noted that according to the evaluation principle, the reference should have been made to the policies that were in operation at the time of 2005 and 2008 when Japan's debt cancellation was executed. However, Country Assistance Policy for Iraq was issued for the first time in 2012. Therefore, upon the assumption that there were not significant change in the policy orientation between 2012 and 2005/2008, the consistency of higher policy can be confirmed.

##### (3) Consistency with international priority issues

In the "Priority Policy for International Cooperation" (2008), it was announced that Japan would "assist the peace-building, sustainable peace, and reconstruction in developing countries" as one of their priorities. It also stated that it would "prioritize reconstruction of Iraq and Afghanistan " as part of the broader policy to contribute to "stabilization and development in the Middle-East". Debt cancellation to Iraq agrees with

these policies.

Moreover, debt cancellation for Iraq was based on the ad hoc framework decided in Paris Club and it was an international consensus that there was a need for the assistance.

#### (4) Japan's comparative advantage

Japan's debt cancellation policy does not have a distinct feature in comparison to other donors. Though, in terms of volume, the total amount of debt cancellation (for ODA credits) is second highest after France amongst the Paris club members, and it may be assessed that there is a comparative advantage in the volume of debt cancellation.

#### 2-1-2 Effectiveness of Results

Looking at the inputs (the trend of debt cancellation volume) the ratio of debt cancellation to GDP was 5.0%~6.7% of Iraq's GDP between 2006 and 2008. Debt cancellation by Japan was equivalent of 0.9%~1.3% of GDP. This levels the amount of debt relieved by France and Germany and was one of the larger contributions amongst the donors.

As for the output, indicators relating to debt sustainability are yet to be statistically organized in Iraq, and it is difficult to analyze the effect of debt cancellation in the long-span. In the recent years, the political instability due to the rise of the Islamic State in Iraq and the Levant (ISIL) and the sharp drop in the oil price have led to the deterioration of the figures.

In the outcome, the effect on the macro-economics and the disposable fund and investment was considered. The Gross Domestic Product (GDP) was the main indicator studied for the macro-economic effect. However, it was difficult to analyze of the effect of the debt cancellation, independent from other factors, mainly because the influence from the drop in the oil price was thought to be considerable. In terms of disposable fund, the statistics were not organized for the period immediately after the debt cancellation. As for investment, the private investment on energy and communication was studied. However, an independent analysis of the debt cancellation also proved difficult for this indicator. The operation of private companies have not taken off as expected, which may have been a delay caused from security concerns. Though it may be added that input-output analysis proved that the financial surplus produced by debt cancellation was distributed to various sectors, generating a ripple effect in the economy. This analysis is based on the assumption that money is fungible and that alleviation of economic burden would impact on the investment on infrastructure etc.

The impact of debt cancellation was studied from the effect in the poverty reduction, fund procurement, governance, and economic relations. In terms of poverty reduction, the figures were not statistically organized, and the effect was difficult to be analyzed.

The fund procurement had risen significantly in the year of debt cancellation from the increase in ODA, and it was implied that the credibility of the debtor had improved by the debt cancellation. Judging from the achievement status of the conditionalities, approximately half of them are yet to be fulfilled and improvement in governance seems limited. Foreign Direct Investment (FDI) and import from Japan have both grown, implying that the bilateral economic relations with Japan have been reinforced.

In sum, although an analysis on the independent effect of debt cancellation proved difficult due to the limitation in data availability, security issues, and change in oil price, it was implied that recovery of credibility led to the reinforcement in the fund procurement and economic relations.

### 2-1-3 Appropriateness of Processes

Debt cancellation to Iraq was carried out in three phases based on the decision at the Paris Club. Debt cancellation was executed as Iraq achieved that conditions that were laid out at each phase. From the Japanese government, Ministry of Foreign Affairs, Ministry of Finance and Ministry of Economy, Trade and Industry (METI) participated in the Paris Club decision-making process. Although, Exchange of Notes was concluded between Japan and Iraq at the execution of actual debt cancellation, there are no minutes that were publicly opened citing discussions within the Paris Club meetings. There was not enough transparency ensured for the general public to understand the background of the decision. It should be noted that the lack of transparency is an issue that applies not only to Japan but is common to all member states.

#### (1) Implementation of monitoring and follow-ups

Japan does not conduct a monitoring independently for debt cancellation. Debt cancellation to Iraq was decided based on the IMF programs and the consensus of donor countries in Paris Club and IMF programs, and thus it was the fruit of the cooperation with other donors and international organizations. As for monitoring and follow-ups, the situation of Iraq was studied through IMF programs and other loan programs after debt cancellation.<sup>1</sup> Though, in either of these programs, the objective was not to assess the effect of debt cancellation. Moreover, although it was noted in the report published by IMF, that Iraq has not made progress in its program goals since 2011, no particular action was taken by Japan to address this situation.

#### (2) Cooperation with other donors and international organizations

As debt cancellation for Iraq was decided by the consensus amongst donors in the Paris Club, it was a result of cooperation between other donors and international organizations.

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<sup>1</sup> MOFA; from interviews to International Cooperation Bureau Country Assistance Planning Division III, JICA

#### 2-1-4 Evaluation from diplomatic viewpoints

Debt cancellation for Iraq was defined as a support for postwar recovery. The economy of the country was exhausted by the war and the internal governance had become vulnerable. Under such context, it was judged in the discussion led by the U.S. that it was difficult to sustain the external debt, with the rising budgetary demand amidst the post-war recovery process. Therefore, debt cancellation to Iraq can also be defined as an international cooperation for the Iraqi post-war reconstruction. Japan's commitment to this financial support with other donors can be recognized as a contribution to the international coordination for the stability in the Middle-East.

Bilateral economic relationship was studied as a reference for diplomatic impact. In Iraq, foreign enterprises have increased as economic activities gradually regained momentum in the post war reconstruction after 2003. However, the private sector also recognizes the high security risk in the country and the number of Japanese companies operating in Iraq remains limited. In terms of trade, although import from Japan has slightly increased though it is yet to level the amount of export (mainly oil). It is therefore difficult to conclude that debt cancellation had directly led to fortification of bilateral economic relationship.

## 2-2 Myanmar

### 2-2-1 Relevance of Policies

#### (1) Consistency with the development needs of Myanmar

After an installation of a new government in 2011, Myanmar set forward reforms for the liberalization of its economy and the political environment. The country was in need for financial resource to embark on reformation in the social sector such as education and healthcare. On the other hand, Myanmar was also accumulating its external debt. Coupled by their constant account deficit, it was likely to heighten its risk of aggravating their debt sustainability. It could therefore be assessed that debt cancellation was consistent with Myanmar's development policies and its development needs.

#### (2) Consistency with high-level policies

The Country Assistance Program for Myanmar is currently being put together and it was not in operation in 2013, at the time of debt cancellation. Therefore, this report has referred to the program loan "Social and Economic Development Support Program" that was signed between Japan and Myanmar in January 2013. It must be kept in mind that this program loan was inaugurated almost simultaneously with the debt cancellation.

This program loan states that its main objective is to "contribute to the stability of Myanmar's economy by contributing to the improvement in different sectors through by promoting reforms and political dialogue between Japan and Myanmar. This will be done through assisting the Myanmar government for their reforms in macro-economic

management, development policies, social sectors (education and healthcare) and governance. Amongst the target issues raised in this program, the section on “Macro-economics and Development Policies” include “the clearance of arrears”. Debt cancellation to Myanmar conforms with this principle.

### (3) Consistency with international priority issues

In their “Priority Policy for International Cooperation” (2012), Ministry of Foreign Affairs has announced “Measures contributing to the peace and stability of the international community” as one of the key areas. In this section, “Assistance to establish democracy in Asia” was put down as one of the aid principles. This would include the case for Myanmar, and thus debt cancellation to the country agrees with the principle.

Moreover, the debt cancellation to Myanmar was initially decided bilaterally between Japan and Myanmar. However after the “Tokyo Conference on Myanmar” (October, 2012) and the Paris Club meeting was held in January 2013 to decide debt cancellation to Myanmar. Thus, debt cancellation to Myanmar can be regarded as a consensus of the Paris Club creditors and it can therefore be understood as being part of international coordination.

### (4) Japan’s comparative advantage

Japan’s debt cancellation policy does not have a distinct feature in comparison to other donors. Though, in the case of Myanmar, Japan had taken lead in the process for debt cancellation and there was a stronger initiative taken by Japan compared to other donors. Moreover, in terms of volume, Japan was the largest creditor for Myanmar. The amount of debt relieved by Japan, which amounts to 1.9 billion was a prominent volume amongst the Paris Club creditors, which could be regarded as a comparative advantage.

## 2-2-2 Effectiveness of Results

Looking at the inputs (the trend of debt cancellation volume) the ratio of debt cancellation to GDP was 4.2% of Myanmar’s GDP in 2013. Debt cancellation by Japan consisted majority of this debt, being equivalent of 3.1% of the GDP.

As for the output (the influence of debt cancellation on financial situation), indicators relating to debt sustainability cannot be acquired periodically and it was difficult to analyze the effect of debt cancellation. It may be added that in recent years, the indicators for GDP, revenue, and export are all on the rise, reflecting the progress in these domains.

In the outcome, the effect on the macro-economy and the disposable fund and investment was considered. The Gross Domestic Product (GDP) was the main indicator studied for the macro-economy. Though the influence of economic sanction and the

trends of the domestic industries have been considerable and it was difficult to make an analysis of the effect of the debt cancellation, independent from other factors. In terms of disposable fund, the statistics were not organized for education, in the period after debt cancellation. The indicators have not changed for the healthcare domain, and the effect from the debt cancellation is thought to be limited. As for investment, statistics were not sufficiently organized to compare the indicators before and after debt cancellation. Based on the assumption that money is fungible, the input-output analysis proved that there could be ripple effect to the various sectors economically.

Impact had been studied from the effect in the poverty reduction, fund procurement, governance, and economic relationship. In terms of poverty reduction, the figures were not statistically organized, and the effect was difficult to analyze. The fund procurement had risen significantly in the year of debt cancellation and it was implied that the credibility of the debtor had improved by the debt cancellation. The conditionalities laid out in the IMF's Staff-Monitored Program (SMP) have all been accomplished and it can be regarded that there is an effect towards improvement in governance to a certain extent. Though it should be noted that SMP is not as severely controlled as other IMF programs. Import and Export to Japan have both increased after debt cancellation and it is implied that bilateral economic relationship has been enhanced.

In sum, although a thorough analysis proved difficult due to the limitation in data availability and impact of economic sanction it was implied that recovery of credibility led to the reinforcement in the fund procurement and economic relations.

### 2-2-3 Appropriateness of Processes

Japan's debt cancellation for Myanmar is decided in April 2012 by bilateral agreement, and it was executed in two phases. First debt cancellation whose Exchange of Notes was signed in January 2013, was founded on the TDB resolution. This is a resolution that requests creditors to treat the ODA loan credits that have reached the deadlines, as grants. The actual practice is left to each countries to decide and there are no specific rules as found in HIPC and Paris Club. The second debt cancellation was for the overdue charges which was decided in the Japan-Myanmar monitoring meeting based on the progress of the political and economic reforms. The Exchange of Notes was signed in May 2013 following the decision that both parties "confirmed the continuation of the reform efforts", and the debt cancellation was executed. This process is different to debt cancellation to other countries such as HIPC that is based on Paris Club agreement, and the transparency of the process is even more limited. Most notably, the reasons justifying the initial debt cancellation agreement that was held bilaterally is unclear (it is not based on the debt sustainability analysis of the IMF). On the other hand, it deserves certain credit that in the second debt cancellation, Japan urged other donors, in order to encourage the decision to be made in a multilateral framework.



#### (1) Implementation of monitoring and follow-ups

Out of the two debt cancellations executed for Myanmar, the second debt cancellation was led by Japan-Myanmar joint monitoring held in March 2013 regarding the political and economic reforms by the Myanmar government. After the debt cancellation, the second monitoring (September 2013), and the third monitoring (March 2014) have been held. Although the main target of the monitoring meetings was the “Social and Economic Development Support Program”, this program is part of the continuous process including debt cancellation. Therefore, it can be interpreted that monitoring and follow-ups have been held multiple times in regards to debt cancellation. It should also be added that this monitoring system follows the system adopted by IMF on their monitoring of the conditionalities. However, although the results of the accomplished reforms are reported the progress of the reform is not mentioned, and thus it is unsure how efficiently these meetings operated as a monitoring process.

#### (2) Cooperation with other donors and international organizations

In the case of Myanmar, Japan had already been considering debt cancellation and the inauguration of “Social and Economic Development Support Program” prior to the Paris Club decision. However, in order to emphasize international coordination on debt cancellation, it was proposed that final discussions are held in the Paris Club. After “Tokyo Conference on Myanmar”, Japan has led the decision making process amongst the Paris Club members and executed debt cancellation under the consensus with the other donors and international organizations.

#### 2-2-4 Evaluation from diplomatic viewpoints

After debt cancellation was decided in April 2012, mutual visits of VIPs have become more active. And debt cancellation has had an effect on the fortification of bilateral relationship to a certain extent. VIP visits was selected as a subject of analysis as an indicator which reflects the reinforcement of the diplomatic relations. After debt cancellation was conducted, it became possible to reinforce ODA loans, and incited by the ODA disbursement, private investment had also increased. This became the source of the diplomatic reinforcement which had become visible through the VIP visits. This is also founded on the fact that Japan had treated for 1.9 billion ODA credits which overwhelms the other donors in volume (the second largest debt cancellation was that of France: 590 million). Though after the Europe and the U.S. had alleviated economic sanction in 2012, economic relations had reactivated, and around the same time, Japan has also reinitiated its ODA loans to Myanmar. Thus, the influence over the diplomatic relations hadn't occurred independently from debt cancellation.

In terms of diplomatic impact, the operation of Japanese companies in Myanmar is increasing and the economic relations between the two countries is reinforced. It is one

way to see this as an effect of debt cancellation. But the installation of the new government of 2011, the liberalization of the political environment and the reforms towards open market and the alleviation of the economic sanction by Europe and the U.S. have all had a considerable effect. Therefore, it is difficult to evaluate the impact of debt cancellation by itself.

Furthermore, in the debt cancellation to Myanmar, it should also be considered that Japan had taken a lead role. Japan could have proceeded the negotiations alone but, it chose to encourage the issue to be discussed in the Paris Club. This initiative had come from the idea, for Myanmar which had been going through a rapid change, the process of reintegration into the international community had better included many countries. This allowed Myanmar's debt issue to be discussed with other donors and led to the debt cancellation by the World Bank and ADB. It can be assessed that Japan had contributed to the reintegration of Myanmar to the global economy by taking an important role in the process. It also serviced to the reinforcement of the bilateral relations between Myanmar and Japan.

## Chapter 3: Summary of Evaluation and Recommendations

### 3-0 Limitation of the Evaluation

It is to be noted here that this evaluation was limited by the availability of data. First of all, though quantitative analysis was the main method when evaluating the effectiveness of results, in many of the recipients that were subject of this evaluation, national statistics were still underdeveloped, which made it difficult for the evaluation team to obtain sufficient data. The team frequently encountered cases where the required data was only available for either prior to, or post debt cancellation. It was therefore not possible to conduct an exact same analysis to all the recipients across the board.

Secondly, in regards to relevance of policies and appropriateness of processes, data collection was also limited because the Paris Club, the main conference to discuss debt cancellation is confidential and the minutes of the conference or any other source citing the content of the discussion remains undisclosed. In order to evaluate the above two sections, the team compared the principles of the Paris Club and past debt cancellation records in order to scrutinize the principle and practice.

### 3-1 Summary of Evaluation

#### 3-1-1 Relevance of policies

Relevance of policies was evaluated from six viewpoints: (1) formulation of cross-cutting policies regarding debt cancellation, (2) consistency with the needs of the aid recipient, (3) consistency with Japan's higher policies, (4) consistency with other international cooperation/assistance projects, (5) consistency with aid policies of other donors, (6) Japan's comparative advantage. Integrating the assessment results of these viewpoints, this evaluation concludes that the consistency of Japan's debt cancellation policies is established externally. However, in terms of domestic consistency, consistency with the high-level policies is not demonstrated in an objective manner.<sup>2</sup>

Debt cancellation originally began as a multilateral scheme and Japan has provided debt cancellation in coordination with the international society. For this reason, if international agreements in HIPC, the initial summit, and the MDGs are defined as high-level policies, there is a strong consistency in Japan's policies on debt cancellation. In addition, as debt cancellation is established as a common framework based on discussions with other donors, debt cancellation is an aid scheme that is exceptionally in harmony with policies of other donors. On the other hand, in the domestic ODA policies, Japan does not state its basic policies (philosophy, way of thinking) on debt cancellation, nor does it show its consistency with the higher policies. From interviews

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<sup>2</sup> By "objective manner", the evaluation team refers to a condition where the principles and plans for the domain, and the consistency of its implementation with the high-level policy is clearly demonstrated to people outside the institution that is responsible, so that its objectivity is ensured. Thus when principles are shared only within the institution and the content is confidential, it is judged that the objectivity is not ensured because there are no means to prove its existence or content

to related parties, it can be deemed that debt cancellation is delivered in order to achieve purposes such as “poverty reduction”, “sustainability”, and “stabilization of international finance”, but these purposes have not clearly stipulated. At the moment, debt cancellation can be considered either as a tool for development assistance, or as a mean to manage unexpected default crisis. If it is to be defined as the former, it is necessary to explain debt cancellation together with its purpose and the expected effect on development. It should also be noted that debt cancellation includes not only ODA credits but also trade insurance, export and import finance, etc., and the very purpose of debt cancellation is not limited to development assistance. In order to earn public understanding for debt cancellation, it is particularly important to demonstrate the basic policy of debt cancellation and its continuity with high-level policies, maybe more so than other ODA measures.

Furthermore, as for the consistency with the needs of the recipient country, consensus platforms such as the Paris Club have established a decision-making structure on assessing the eligibility of the countries as well as debt sustainability, which is thoroughly consistent with the recipient needs. However, as for the conditionalities that are demanded in many cases to the recipient at the time of debt cancellation, it does not only address the needs of debtor countries but also those of creditor countries: avoiding moral hazard and implementing least necessary debt cancellation. Therefore, conditionalities does not correspond one by one to the request of the recipient country, but they are rather set out as a “requirement” for structural improvement of the recipient country. In the debt cancellation process, these conditionalities can be assumed as being part of the needs of the recipient country. Though, it should be noted that in the short term, conditionalities may limit the policy options for the recipient country.<sup>3</sup>

Lastly, in terms of aid modality Japan only practices debt forgiveness, and follows an international consensus in its decision. It does not have an operation of its own through debt swap scheme. The objective of this evaluation is to assess this aid scheme as a system, and in this sense Japan does not possess any distinct advantage in its scheme compared to other donors. Though it is to be noted that in the case of Myanmar (case study), there was an example where Japan had taken initiative in the execution of debt cancellation. Though this is a practice that was identified in a specific case and it is not a structural advantage, and it is difficult to be recognized as a comparative advantage of the scheme. As debt cancellation is habitually, executed multilaterally, this nature makes it difficult to exert comparative advantage.

### 3-1-2 Effectiveness of Results

Effectiveness of results was evaluated from six viewpoints: (1) impact on

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<sup>3</sup> The mid-long term in this case implies larger objective in development such as “poverty reduction”. Short-term options are means that are chosen to achieve that goal. When structural conditionalities are given to the recipient, this means that they are demanded to choose specific policy options are to be implemented in order to reach a mid-long term goal

macroeconomics, (2) impact on disposable public funds/investment, (3) poverty reduction, (4) impact on fund procurement, (5) governance, (6) impact on the reinforcement of economic relations. Of these viewpoints, (4) and (6) had particularly strong connections to debt cancellation. The most immediate reason is that the credibility of the country concerned improved by having its accumulated debt relieved. As for ODA loans, many donors including Japan cannot grant a new loan if the recipient country possess arrears, and thus debt cancellation paved a way for new financial assistance. For the same reason, in the case of economic relations, private companies judged that the risks were smaller due to the introduction of public fund after debt cancellation. This firstly makes an opportunity for private investment. It also becomes an opportunity for companies to seek a contract from ODA-related projects, which leads to stronger economic ties. On the other hand, one must take into account the impact of other significant influences that occurred at the same time as debt cancellation. This includes factors such as alleviation of economic sanctions, as described in the case of Myanmar in Chapter 2. Moreover, it should be noted that an increase of ODA loans and a reinforcement of economic relations are not the natural results of debt cancellation. In other words, it must be noted that these effect arise from composition of different factors and it is not an effect that is accredited independently from debt cancellation. The demand for private investment and the priority of ODA loans and its volume is present independently of debt cancellation. The cancellation of arrears serves only to clear out the obstacles for them to be put in actual practice. Cases like Myanmar where private investment and ODA loan had increased dramatically is a most desired scenario for the recipient. Though it is unrealistic to expect the same extent of impact on all recipients and our quantitative analysis confirm this idea. In particular, private investment is strongly influenced by how the companies evaluate the risks and business potential in the country concerned. Debt cancellation therefore only serves to prepare the conditions for the reinforcement of economic relations and does not incite the needs directly. Its effects are most strongly exerted when there is a significant expectation from the private sector on the country as a growing market.

As for other indicators, the data were insufficient, making analysis difficult, or the impact on the target country seemed inconsistent and a comprehensive conclusion could not be drawn. On the other hand, the Input-Output analysis of the case study countries (Iraq and Myanmar) found that on the condition that money is fungible, debt cancellation has an economic impact on sectors contributing to the development and the poverty reduction of the country. Due to the nature of debt cancellation which forgives the repayment of loan for a development project that is already disbursed, it is difficult to prove that there is a direct developmental effect. Though as seen in the case of Iraq and Myanmar, there were examples where debt cancellation recovered the country's credibility, leading to increase in fund procurement and reinforcement in economic relations. In conclusion, debt cancellation does not produce direct effect on

development, but rather assist the development assistance or strengthening of economic relations when demands for such matters already exist.

### 3-1-3 Appropriateness of Processes

Appropriateness of processes was evaluated from four viewpoints: (1) guidelines for scheme operation, (2) relevance of the implementation system, (3) Structural understanding of the effects and implementation of monitoring, (4) coordination with other donors and international organizations. Overall, Japan's delivery of debt cancellation follows an appropriate process. However, due to the fact that there are numbers of related actors in this matter, and many processes are technical, the result being that its transparency of debt cancellation is not sufficiently ensured for the general public.

Improving the transparency of processes is essential to explain the appropriateness of implementation to the public. It is reasonable that certain information must be kept confidential for the internal coordination prior to international meetings. On the other hand, today debt cancellation is explained to the public through a press release on individual cases. However, as the Paris Club is a closed circle and contains intricate, technical provisions, it is difficult for the general public to fully understand the background of the debt cancellation implementation only through this press release. In order to earn full understanding of the public, it is necessary to indicate "the basic philosophy on debt cancellation" as mentioned above, and to distinguish between international principles and Japan's policies, and general principle from individual cases. It should also explain the conditions imposed on the recipient country if there are any. Only when such explanations are made, can the public understand debt cancellation.

Moreover, interviews with persons involved confirmed that guidelines for application were set within the institutions. It is comprehensible that these guidelines are not open to public due to the sensitivity of the debt issue, but they should also be associated with "the basic philosophy on debt cancellation". Only by doing so, Japan can provide a integrated explanation on 1) the international framework and 2) the principles under such framework that Japan's debt cancellation adheres to, and achieve better accountability.

As for implementation system, Development Assistance Policy Coordination Division, International Cooperation Bureau, MOFA, which is in direct charge of Paris Club is in charge of the operation. Operation is executed in cooperation with departments in charge at Ministry of Finance and at Ministry of Economy, Trade and Industry, though issues were identified in the monitoring methods following debt cancellation. Depending on the content of "the basic philosophy on debt cancellation", a more systematized monitoring may be required.

### 3-1-4 Evaluation from a Diplomatic Viewpoint

Diplomatic viewpoint was evaluated from two perspectives: (1) diplomatic importance, and (2) diplomatic impact. The former looked at the reinforcement of the diplomatic relations between Japan and the recipient. The latter looked at a) contribution to international coordination regarding cooperation for development, and b) strengthening of bilateral economic relations. Firstly, for (1) diplomatic importance, examples of Iraq and Myanmar demonstrated that expressions of gratitude by high-level government officials and VIP visits reflect a certain extent of effect. However, because debt cancellation is conducted by several donors at once, recipients treat all donors equally instead treating certain bilateral relations in a special manner. Myanmar is an exceptional case where debtor recognizes that Japan had a comparative advantage in that it actively took initiative towards a multilateral debt cancellation.

Consequently, debt cancellation exerts a stronger impact as a ripple effect: (2) diplomatic impact. In summary, in terms of a) contribution to international coordination regarding cooperation for development, debt cancellation exerts a direct effect. Whereas it is extremely difficult for debt cancellation to independently exert a diplomatic effect on b) strengthening of bilateral economic relations. As previously stated, debt cancellation is a form of aid based on an international coordination. Therefore, Japan coordinates well with other donors, and competently fulfills its role as a donor within an international framework. Notably, as Japan owns the one of the largest claims to ODA credits, the absolute amount of relief granted by Japan is substantial, and Japan's contribution is recognized by other donors as well.

As for bilateral economic relations, the incitement of ODA loans and private investment are the two factors most strongly related to debt cancellation. On the first point, debt cancellation does not directly lead to an increase of ODA loans; it is merely a prerequisite to provide ODA loans. Thus, in countries where loans were in demand but were hindered by overdue debts, a correlation exists between debt cancellation and an increase of ODA loans. Many debtor countries struggling to procure funds welcome an increase of ODA loans, and this helps to deepen bilateral relations diplomatically. On the second point, private investment is incited when private companies hold high expectation either for the contract with aid related projects following the above-mentioned increase in ODA loans, or political backing as a result of stronger economic ties, or both. Specifically for those countries that were under economic sanctions, the clearance of large arrears and the resumption of ODA loans, is usually understood by the private sector as a strong political message. Nevertheless, similarly to ODA loans, the premise for private investment is that demands for entering the market exist prior to debt cancellation

In sum, Japan's debt cancellation plays a significant role in international coordination. However, for bilateral economic relations, it is difficult to prove that there was a visible effect that is automatically exerted from debt cancellation. The effect of

debt cancellation usually become apparent mainly as a ripple effect. When certain conditions are met, it serves as a condition, or as a booster for preexisting aid or private investment. The conditions are that the demand for investment had existed prior to debt cancellation. Myanmar was exactly this case with the given conditions, which led to the country experiencing a particularly strong economic impact.

### 3-2 Recommendations based on evaluation results

The following describes the recommendations based on this evaluation. Debt cancellation is a very unique form of an aid tool. It is not a financial assistance based on planning and discussions made in advance. It rather exempts the repayment of past ODA loan ex post facto as opposed to the original plan. Therefore, it is important to verify upon its implementation the purpose and the philosophy a debt cancellation will be based on. For this reason, it is necessary to demonstrate “the basic philosophy of debt cancellation” from high-level policies to the actual implementation and prepare a reference for those in charge of implementation and for the public to assess the consistency of policies based on the philosophy.

Next, decisions on debt cancellation are made within a multilateral framework, and creditor countries present principles and conditions to debtor countries as a single creditor group. Therefore, a donor cannot display originality, and it is rather desirable that a uniform action is taken. There had been cases like Myanmar where Japan played an active role in consensus building. Though this is an example seen in this individual case, and it is not system that can be the subject of evaluation to represent all debt cancellation cases. Therefore, when Japan does exert comparative advantage, it is when it can be done so in the case-by-case operation, and thus it is not a feature that is shared by debt cancellation as a whole.

Lastly, not all credits subject to relief are executed in the name of ODA. Usually in development assistance, developmental ground goals are first established, and then specific details are decided in order to achieve those goals. However, in the case of debt cancellation, it is aimed to clear the arrears as a whole and thus credits from trade insurance and export finance are treated equally as ODA, and there is no differentiation in the intended purpose at start time of loan. As a result, goals that are to be achieved through debt cancellation are mixed. The following recommendations add that it is essential to first take into account these particularities of debt cancellation, and then coordinate with other related ministries or appeal to multilateral schemes when considering counter-measures.

- (1) Indicating basic principles in accordance with higher policies, and sharing the principles among related parties

As shown in this evaluation, the purpose of debt cancellation is set in international schemes, and consistency with the international trend is secured. Nonetheless, its



position among Japan's development cooperation policies is not clearly stated. Although interviews with related parties indicated that debt cancellation has been delivered to promote "poverty eradication", "sustainable growth", and "stabilization of international finance", there was no identified objectivity on the fact that debt cancellation has been formulated into a cross-cutting basic principle has not been ensured. The evaluation team does not intend to oppose against these principles for they both follow the international trend that is stipulated in the international framework. However, the aforementioned nature that is distinct to debt cancellation should be considered if enough explanation is to be provided for the citizens to understand the situation. Debt cancellation is a treatment where the creditor country renounces the recovery of its credits from an economic cooperation which was initially disbursed as a loan. It is possible that one considers this as an emergency measure to an unexpected situation. This is why it requires a thorough explanation when trying to define debt cancellation as an aid tool which possess a developmental effect by itself.

When stipulating a basic policy, it is necessary that the five following elements are aligned together and explained as a consistent sequence: 1) the objective of this tool (philosophy, way of thinking), 2) the developmental effect that is to be obtained by this tool, 3) the content of international coordination, 4) the principles under the consensus, 4) the position taken by Japan on this international framework, 5) the general process that is followed when applying this policy. At the moment, we can confirm that there are press releases for individual cases of debt cancellation which includes the basic information. We also found from our interviews that there are principles within the ministries, but the contents remain confidential. However, in order for the public to understand the general principle, it requires all the aforementioned elements to be integrated as one cross-cutting policy. It is also essential that the consistency of this policy with the high-level policies such as Development Cooperation Charter (revised ODA Charter) is stipulated so as to be apparent to the general public.

This would firstly serve to fulfill the accountability to the taxpayers themselves. It would also ensure the external accountability to prove appropriate communication between the people and organizations involved.

Furthermore, when conducting debt cancellation, the subjected debt is constituted not only by ODA credits but also by Other Official Flows (OOF) credits. For ministries other than ministry of foreign affairs, debt cancellation is not conducted as a mean for development assistance. When stipulating the principles for debt cancellation, such background must also be mentioned with the fact that debt cancellation is not only governed by ODA policies, so that debt cancellation's position within ODA policies is demonstrated effectively.

## (2) Improving transparency of the debt cancellation process

Debt cancellation is founded on a consensus by the international community

through the Paris Club. Meanwhile the conference is highly confidential and also includes many complicated technical rules. Although there is the cabinet approval as one mean to notify the general public after the international agreement is finalized, it is difficult the citizens or anyone that is not the main persons responsible, to understand the process leading up to the debt cancellation. Debt cancellation has a distinct nature amongst the ODA tools in that it places particularly strong emphasis on international coordination. Therefore, when exercising this aid scheme, it may be the case that the process is more strongly governed by the principles and rules stipulated in the international framework than Japan's internal process. However, many people including taxpayers and those not directly in charge, are not familiar with this international framework that the donors follow. At the moment, the operational guideline is not open to the public. Nor is the basic policy clearly stipulated. It is therefore, difficult to assess the appropriateness of the operational guideline in relation to the higher policies. It would be necessary that Japan explains externally the position, principles and the operational process in relation to debt cancellation so as to improve its transparency to ensure the accountability to the public.

### (3) Structural understanding of the effects and implementation of a monitoring system

Debt cancellation does not possess a system of its own to understand the effect nor to monitor post-relief situation. Therefore, it cannot analyze the effect on the recipients accurately. At the moment, the monitoring function is substituted by the reports by IMF or the results obtained from other aid programs in that country. However, the former report makes an analysis on behalf of all the creditor countries as a whole and its publication is not periodic. The main indicators analyzed are those in relation to debt sustainability. As for the later, its primary objective is to understand the achievements for each of the aid programs themselves and they do not directly answer the effect of debt cancellation. These reports only serve as a minimal substitute to cover up for the absence of a system to structurally understand monitor the effect of debt cancellation.

If debt cancellation is to be defined as a tool for development assistance seeking a developmental effect instead of an emergency measure to an unexpected situation, its developmental effects must be accurately understood under the ODA policy. At the moment, the indicators and system for analyzing the debtor countries prior to debt cancellation is well established internationally. However, there is not a clear consensus over the effect that is expected in a debt cancellation and what indicators should be used in order to assess this. Currently, the situation of the debtor country is understood through aid projects initiated after the debt cancellation in order to complement the existing reports published by international organizations. However, the qualitative and quantitative data that is collected is not structurally organized to account for the effects. It is recommended that indicators are selected for monitoring (they do not necessary have to demonstrate a strict cause-and-effect relationship, but they must be indicators

that can be logically agreed amongst people involved). It is also desirable that there is a mean to periodically review these indicators in order to assess to what extent each debt cancellation cases have contributed to the initial objective and to generate an impact. This would allow the effect of debt cancellation to be organized under a consistent framework. Though it must be noted that this should be put forward not by Japan by itself, but in coordination with other debtors and creditors involved.

Moreover in relation to debt cancellation there is constantly a concern over a moral hazard on the part of the debtors. What should be prevented with at most attention is that the same debtor country falls continuously into default and receive debt cancellation multiple times. It is important to analyze why a debt which was initially considered repayable developed into arrears, and that these causal factors are addressed in order to prevent the reoccurrence of the issue.

When carrying out a structural study of effects, and post-relief monitoring, an analysis of the cause of arrears, and the following up of the situation would further leverage the development effect of debt cancellation.

#### (4) Establishing a mechanism to ensure the recipients commitment to poverty reduction expenditure

Debt cancellation is a distinct form of aid in that it demands the debtors to commit to certain reform measures as an exchange to the debt treatment. Though as we have shown in the section "Effectiveness of results", in many countries the structural adjustment conditions is not continuously implemented. This is a vulnerability of the debt cancellation as a framework. Although governance commitments are demanded as a condition to the debt cancellation, it does not possess the authority to make the debtors continue complying to them after debt cancellation.

Especially, if debt cancellation is to be defined as a measure for development assistance, it is difficult to presume that there had been sufficient developmental effect only by the improvement of the broad budgetary status. It is only when this budgetary surplus is used for the means of poverty reduction that financial effects translate to developmental effects.

There are two measures that may be considered to address this issue. The first is to introduce the debt-swap tool that is already practiced amongst other donors. In a conventional debt swap process the creditor first asks the debtor to refund the debt first, then that given amount of fund is partially or entirely reimbursed as a grant. This does not only produce a budgetary surplus, but restructuring the fund as a grant project, it ensures a certain ownership of the donors in regards to the nature of the expenditure. Moreover, it was found that in Germany, there were cases where debt cancellation process only proceeded after it was confirmed that the respective debtor had expended for the poverty reduction.

On the other hand, some insists that debt swap does not necessary contribute to

the development of the recipients. Therefore, measures to ensure the recipients' expenditure commitments should not only be limited to debt swap. There should also be commitment by the donors to develop a new aid scheme. As one example, the concept of cost-share technical assistance may be applied. When there was a commitment by the debtor country to initiate a program for poverty reduction, the creditor also adds in some fund to leverage this program. In other words, after debt cancellation, Japan and recipients can jointly fund a project. This would encourage not only the donors but also the debtors to make poverty reduction expenditures. By leveraging the project initiated by the debtor, it would increase both developmental effect as well as expenditure commitment.

As there is principle of solidarity in debt cancellation, there is limitation as to how much Japan is able to do by itself in the operation. It may also be an option to propose a periodical inspection of the budget distribution of the debtor, within the multilateral framework. Considering that the IMF and the World Bank occasionally publishes the statistics including the average amount of poverty reduction expenditure amongst the debtors as a whole, it would be feasible to propose a country based breakdown of this analysis and the periodic publication of the results.

For many developing countries whose fund procurement depends on development assistance, the burden of external debt is substantial and there is a considerable financial effect of being exempted from its repayment. However, unless there is no poverty reduction commitment from the debtor its developmental effects can only be measured indirectly. It is recommended that a mechanism is established to ensure the poverty reduction expenditure by means such as, debt swap, multiple-phased debt cancellation with the condition of expenditure commitment, and presentation of the expenditure breakdown. These measures would also enable the debtors to require political commitment for structural reform. Though the above mentioned measure would only stand true if debt cancellation is to be asked for developmental effects.