Building on International Debt Relief Initiatives
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Mr. Chairman, Members of the Committee,

I would like to thank the Committee on Foreign Relations for the opportunity to testify here today. Debt relief for poor countries has been a high priority for the United States Catholic Bishops Conference (USCCB) for many years.

In my testimony I will be focusing on a number of issues at a level of technical detail which the bishops would not normally address, and on which they, therefore, would not have a position. Thus I offer my testimony primarily as a former development agency official who has worked on debt and related issues with both the World Bank and the United States Catholic Bishops' Conference (USCCB) over quite a few years.

<u>Role of USCCB</u>

But first let me briefly mention the active role which the United States Catholic Bishops Conference has played in poor country debt relief. The bishops have issued two major statements on the issue, the first as far back as 1989 and an updated version in 1999. In the mid-90's the USCCB intensified its work on debt, inspired particularly by the words of the late, revered Pope John Paul II in his message on the coming Millennium. He recalled the biblical tradition of the Jubilee Year. It was a time to restore social justice and equity between peoples, to give a fresh start to the poor. He called on all Christians, in the spirit of the Book of Leviticus, "to raise their voice on behalf of all the poor of the world, proposing the jubilee as an appropriate time to give thought, among other things, to reducing substantially, if not canceling outright, the international debt which seriously threatens the future of many nations."

The USCCB and its relief and development agency, Catholic Relief Services (CRS), played an active role, along with many other US faith-based organizations, in the worldwide Jubilee 2000 campaign. Senators Biden and Lugar and quite a few other Senators provided strong bipartisan leadership and support in urging the U.S. administration to respond to the call of many poor countries around the world for relief from the heavy burden of international debt.

For the USCCB and CRS, support for poor country debt relief is part of a broader agenda that arises out of a conviction that the moral measure of our efforts is how we respond to "the least among us" (Mt. 25), both at home and abroad, and whether we seek justice for all. While debt relief and investments in development more generally are, for USCCB and CRS, primarily matters of moral responsibility, we believe that they contribute to a safer and more peaceful world and thus, in an important way, to the peace and security of the United States.

The Enhanced HIPC Initiative

The Jubilee 2000 campaign led, in the latter part of 1999, to the adoption by the major creditor nations and international financial institutions of a new debt relief program called the Enhanced Heavily-Indebted Poor Countries (HIPC) Initiative. It represented a major advance over the original HIPC program, promising much more debt relief, more rapidly, to many more countries. Also, the Enhanced HIPC program incorporated a new framework for the provision of debt relief and other external assistance to HIPC countries. This new approach, called the Poverty Reduction Strategy process (PRSP), contained elements that Catholic Relief Services, the bishops conference and many other non-governmental organizations had long advocated. The PRSP was intended to strengthen the poverty focus of development programs and to promote country ownership, transparency and civil society participation in their design and implementation. A major objective of these provisions, from our perspective, was to ensure participation of groups who could give voice to the needs of the poor, and who could help assure that the benefits of debt relief would reach the poor.

HIPC Debt Relief Was Uneven and Not Deep Enough to Give a "Fresh Start" to Poor Countries

As implementation of the enhanced HIPC program progressed, some of us noted that while substantial debt reduction was being committed to about two-dozen very poor countries, the amount of relief was uneven across these countries. Under the HIPC formula, the amount of the relief is determined, in most cases, by what is needed to bring the ratio of debt to exports down to a certain level. To us, what was most important, however, was the relation between debt service and government revenues. We wanted to know how much government revenue would be freed up for expenditures in education, health, clean water, rural roads and other investments that would create opportunities for the millions living on less than $2 a day to break out of the cycle of poverty and begin to achieve their human potential.

Unfortunately, what we found was a wide variance in the amount of debt service reduction being granted. For one or two countries, the debt service obligation was being brought down to around 5 percent of government revenues. For most of the remaining countries, however, this ratio was substantially higher and in several cases remained above 20%. This was disappointing news as, for us, what was important was to achieve the Jubilee objective of debt relief deep enough to give a "fresh start" to the poor. Moreover, the results seemed inconsistent with the Communiqué issued by the G-8 leaders at the 1999 Summit in Cologne, Germany. In announcing the new program, they succinctly stated: "The central objective of this initiative is to provide a greater focus on poverty reduction by releasing resources for investment in health, education and social needs."

Subsequently, with Senator Biden and other members of this committee taking a lead role, the Congress incorporated into the Global Health Act of 2003 major new provisions that authorized and encouraged the Administration to work to strengthen the HIPC program by tying the amount of the debt relief to the ratio between debt service to revenues and bringing that ratio down to a low level. Unfortunately, the Administration did not implement these provisions.

The MDRI

By 2004, there was a growing consensus among the U.S., the United Kingdom and other major creditor nations that the HIPC program was not providing debt relief deep enough to assure that HIPC countries would not soon return to a situation of "unsustainable external debt." The U.S. Treasury referred to a never-ending "lend and forgive" cycle whereby institutions such as IDA would make loans to poor countries and then have to make new loans so that the country would have enough funds to repay the previous loans . These concerns led to the adoption by the international community in 2005 of a new Multilateral Debt Relief Initiative (MDRI),

The essence of the MDRI is to provide qualifying HIPC countries with full cancellation of debts owed to the World Bank's International Development Association (IDA), the International Monetary Fund (IMF) and the African Development Fund (AFDF). The cancellation occurs once a country has reached its "completion point" under the HIPC program, that is, that it has fulfilled conditions related to economic management and progress under the country's poverty reduction strategy. So far 23 countries have received MDRI debt cancellation, with another 17 countries potentially able to benefit from it.

A notable omission from the MDRI agreement was the substantial debt owed by the five lowest-income Latin American and Caribbean countries to the Inter-American Development Bank (IDB). This omission was rectified in 2007 when the IDB agreed to give MDRI treatment to its HIPC borrowers. Since four of these countries had reached their HIPC completion points, they received immediate debt cancellation. The fifth country, Haiti, is expected to reach its completion point this year, hopefully within the next few months. Together with earlier agreements to cancel most bilateral debts, including 100% of debts owed to the United States, these new agreements are providing the kind of deep debt relief the Catholic Church has advocated for poor countries.

We were particularly pleased with the leadership of the Bush Administration in bringing about the MDRI and in encouraging the IDB to give similar debt cancellation to the Latin American and Caribbean HIPC countries.

What Have Debt Relief Programs Accomplished?

Twenty-three countries have reached the completion point, and thus have benefited from 100% cancellation of qualifying debts. These include Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, Gambia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia. An additional ten HIPC countries have reached their "decision point," which has enabled them to begin receiving debt service relief. These countries are Afghanistan, Burundi, the Central African Republic, Chad, the Democratic Republic of the Congo, the Republic of Congo, Guinea, Guinea-Bissau, Haiti and Liberia. Seven more countries remain potentially eligible for HIPC and MDRI relief: Comoros, Côte d'Ivoire, Eritrea, Nepal, Somalia, Sudan, and Togo.

How much debt has been cancelled to date? According to the most recent updates from the IMF and World Bank, debt relief under the HIPC Initiative and the MDRI has reduced the debt stock

of the 23 completion point HIPCs by a total of over $70 billion, in net present value terms, and when the additional 10 post-decision point countries reach their completion point, which is expected over the next two years, the total debt stock reduction should reach approximately $100 billion (NPV).

In 2007, annual debt service savings from the MDRI for the 22 post-completion point counties were expected to be $1.3 billion, equivalent on average to 1% of these countries' GDP. And we are talking about savings on long term debt, which means that similar amounts of savings will be realized every year for many years into the future. Moreover, the evidence is strong that the savings are being used to fight poverty. Total poverty-reducing expenditures in countries that have received debt relief have increased from $5.8 billion in 2000 to an estimated $17 billion in 2006, or from 7% to 9% of GDP, on average. This is actually much more than the debt relief savings, and the question arises whether, and to what extent, this increase-- beyond what would have been possible from debt relief alone -- is attributable to the fact that all countries receiving MDRI debt cancellation are implementing Poverty Reduction Strategies (PRSP).

As I mentioned earlier, the PRSP was established as part of the 1999 framework for the provision of HIPC debt relief. There have been criticisms of the PRSP, including that they reflect more the priorities of the international financial institutions rather than the countries, i.e., that they are not sufficiently "country-owned." While I have not seen an evaluation of the impact of the PRSP on expenditure patterns, the fact remains that the World Bank data shows a very large increase in poverty reducing expenditures in the HIPC countries. Citing 2005 World Bank research, the non-governmental organization DATA (Debt, AIDS, Trade, Africa) found that for every dollar freed up from debt service, African governments have increased social spending by two dollars.

In 2006, The World Bank's Independent Evaluation Group did an update of an earlier evaluation of the HIPC program. It took a closer look at public expenditure patterns in countries benefiting from the HIPC program. It found that the majority of funds were allocated to expanding service delivery in the social sectors, and much less to investments to remove bottlenecks in economic or productive sectors. More specifically, based on data from five countries, it found that governments were increasing their expenditures for education, both as a share of total expenditures and as a share of GDP, but that spending for health, agriculture and transportation had shown little change.

Improving the quantity and quality of education is, of course, critical for poverty reduction, and the focus on education should not in any way be denigrated. Nevertheless, as more debt relief savings have become available in the past few years, both by more countries fulfilling the conditions for HIPC debt relief and by the implementation of the MDRI program beginning in 2006, it becomes particularly important to increase expenditures for the productive sectors and other social sectors, such as health. It is thus encouraging that countries are using the savings generated by the MDRI program in 2006 for a more diversified range of poverty reduction activities. For example, according to the World Bank as supplemented by on-the-ground information provided by the Jubilee USA Network,

- Ghana is using the $57.9 million in 2006 savings in the energy and water sectors, for the rehabilitation of essential major highways and feeder roads in the main agricultural

areas, as well as in education, health, and development of information and communication technology;
- Cameroon is using its savings of $29.8 million for infrastructure, social sector and governance reforms;
- Mali is using its $27 million in 2006 savings for water supply and roads;
- Uganda is using its $57.9 million on improving energy infrastructure to ease acute electricity shortages, as well as primary education, malaria control, healthcare and water infrastructure (specifically targeting the poor and under-served villages); and
- Zambia is using its savings of $23.8 million to increase spending on agricultural projects, such as smallholder irrigation and livestock disease control, as well as to eliminate fees for healthcare in rural areas.

But looking at the impact of debt relief programs at the "macro" level does not tell the whole story. There are examples of the use of debt relief savings at the local level, which, while they may not be reflected in national statistics, are improving the lives of thousands of poor people. Let me give you just one example from the experience of Catholic Relief Services.

A HIPC Success Story

Catholic Relief Services has been active for many years in Cameroon. Working closely with the local Catholic Church, it has financed health, education, and community development projects in various parts of the country. In recent years it had not partnered with the government in any of its projects. Then came the HIPC program. When Cameroon qualified for HIPC debt relief a few years ago, a HIPC funding committee was set up consisting of government, civil society, church and donor representatives, with observers from the World Bank, IMF and the African Development Bank. The committee's job is to assure that the funds generated by HIPC debt relief are used to carry out the country's poverty reduction strategy (PRSP). It approves the allocation of HIPC funds to specific projects and monitors their implementation.

CRS and other development agencies operating in Cameroon have long viewed community forestry as an important grassroots participatory strategy for fighting poverty. Uncontrolled exploitation of forestry resources by logging companies has been a long-standing problem in Cameroon. A 1994 law allows villages in and around large forest concessions to obtain authorization from the government for the sustainable management of forest resources for community benefit. Yet by 2003, very few community forestry projects had been approved. It was at this time that CRS developed and presented to the HIPC Committee a forestry project that would operate within a Catholic diocese that abounds in forestry resources. The project would mobilize 25 rural communities to manage their forests in a profitable and environmentally sustainable manner. Moreover, a portion of tax revenues owed by logging companies would be collected by the communities and reinvested in community development projects.

The HIPC Committee was convinced of the technical merits of the CRS project and, in spite of opposition from the Minister of Forestry, approved it and arranged for project funds to be released directly from the Ministry of Finance to the project managers. This was an important breakthrough in the country, and CRS and a broad group of allies are now well-placed to lead the effort to expand community forestry projects throughout Cameroon.

The Role of Civil Society

There are other examples of organizational arrangements designed to assure that debt relief funds reach the poor. In Uganda, resources freed up by debt relief are channeled through the Poverty Action Fund, which is overseen by representatives from government, national NGO's, churches, unions and international organizations. In Nigeria, the new Virtual Poverty Fund plays a similar role. These models can and should be replicated in other nations. I agree with Neil Watkins, National Coordinator of the Jubilee USA Network, that parliamentarians and civil society organizations, particular those local organizations that give voice to the needs of the poor, have an important role to play in assuring accountability from national governments regarding the use of funds released by debt relief, as well as government expenditures more broadly.

While in Zambia recently, Neil saw firsthand the powerful role played by civil society groups such as Civil Society for Poverty Reduction, Jubilee Zambia, and others in pressuring the government to be more transparent and accountable for use of aid, debt relief, and new borrowing. Civil society is working in partnership with reform-minded parliamentarians in Zambia to put forward an agenda to make the budgeting process more transparent and participatory and to involve civil society in monitoring the implementation of poverty reduction programs financed by the national budget. These efforts and others like them should be embraced and promoted by all those who advocate debt cancellation and responsible lending and borrowing.

S. 2166's Debt Cancellation Would Fill an Important Gap in the HIPC and MDRI Programs

I would like now to turn to the rationale for the debt cancellation called for by the Jubilee Act for Responsible Lending and Expanded Debt Cancellation (S. 2166). It is clear that the debt reduction that has been granted to poor countries through successive debt relief initiatives represents a major accomplishment within the overall effort to address global poverty. However, we believe there is more to be done. There are a substantial number of poor countries that have not benefited from the HIPC program, let alone the MDRI. The disparity of treatment between HIPC poor countries and non-HIPC poor countries became clear in 2004 when the World Bank and IMF conducted an examination of "debt sustainability" in countries that, because of very low per capita incomes or other special circumstances, are eligible to receive only IDA funds from the World Bank. These are the so-called IDA only countries. A primary objective of the exercise was to determine which countries should receive their future IDA financing either wholly or partially in the form of grants.

As a result of the debt sustainability analysis (DSA), it was concluded that that 47 countries were at sufficiently high risk of debt distress to be eligible for grant financing. The list included 29 HIPC countries plus 18 other countries. This meant that there were 18 non-HIPC countries rated as having a risk of debt distress equal to, or greater than, the HIPC countries. Like the HIPC's, they would get grants going forward, but unlike the HIPC's they would get no debt relief. Because of the ten-year grace period on the repayment of IDA credits, the non-HIPCs would begin receiving the financial benefit of grants (rather than loans) only after ten years. In the meantime they would carry the full burden of existing debts and be unable to free up resources

badly needed to move them towards achieving the Millennium Development Goal of reducing extreme poverty in half by 2015.

When the results of the DSA became available, some of us argued that the HIPC and MDRI programs should be expanded to include all countries qualifying for grant financing. Objections were raised in some quarters that making additional countries eligible for debt cancellation on the basis of their level of debt distress would create moral hazard problems, i.e., encourage countries to borrow more so that they would qualify. S. 2166 would address this concern by making "IDA-only" status the standard of eligibility for debt cancellation. Almost all IDA-only countries have per capita incomes below the historical standard for IDA eligibility, which is currently $1065. (IDA-only countries above this limit are primarily small island economies.)

The IDA-only standard captures all non-HIPC countries eligible for IDA grants. These currently include Lesotho, Djibouti, Angola, Kyrgyz Rep., Tajikistan, Mongolia, Cambodia, Samoa, Solomon Islands, Tonga, and Yemen. (It also includes Myanmar, which is not eligible for U.S. assistance.) The IDA-only standard would also bring in some countries with external debt that is considered "sustainable" by the World Bank. Excluding several highly vulnerable small island economies, there are six such countries (Bangladesh, Georgia, Kenya, Moldova, Nigeria and Vietnam). Of the six, all but two (Moldova and Georgia) have per capita incomes lower than $2 a day. Of course, debt cancellation will only occur if countries apply for it, and I believe there is a strong likelihood that at least Vietnam will not apply. The government is in the process of gaining access to international capital markets and is not likely to want to send a signal that it needs debt relief

The rationale for including the grant eligible countries is, in my view, quite strong. Whether not one agrees with the World Bank's definition of "sustainable" debt, the rationale for including the six I just mentioned is also strong for a number of reasons:

- First, and most important, the IDA-only standard means that all potential beneficiaries of the debt cancellation provisions of S. 2166 are countries that have high levels of poverty and thus need to maximize the amount of resources they can marshal to promote human development, raise the living standards of their people and achieve the Millennium Development Goal of cutting extreme poverty and hunger in half by 2015.
- Second, the IDA- only standard will assure equity of treatment among all the poorest countries. The International Monetary Fund (IMF) addressed this point in an issues paper prepared a few months before the MDRI was approved at the Gleneagles Summit in 2005. In commenting on eligibility criteria for new debt relief, the IMF said: "Regarding country coverage, *all* low income countries could potentially be made eligible. (Emphasis added.) A main argument was: "Earmarking debt relief to HIPCS only is difficult to justify, because the HIPC Initiative will have already sharply reduced previous cross-country differences in debt indicators."
- Third, making all IDA-only countries eligible addresses concerns about redistributing aid resources away from poor countries that are not eligible for debt relief. The concern is that an aid donor will finance the cost of giving debt cancellation to poor country A by reducing the amount of aid it grants to poor country B. Making all of the poorest countries eligible for debt cancellation obviates this problem.

- Fourth, there is the point made in "*Delivering on Debt Relief*", by Nancy Birdsall and John Williamson (2002): "The danger of giving complete debt relief to a limited group of countries is that the countries that built up the deepest debt problems in the past are likely to include the countries that were most prone to waste external resources. We therefore believe that there is a strong case for making virtually all low-income countries eligible for inclusion in the HIPC Initiative."

This last point reminds me of the statement made by Lesotho Finance Minister Timothy Thahane upon learning of the MDRI debt cancellation agreement. He told Reuters that one of the reasons Lesotho was not classified as a HIPC country was that it had never defaulted on its debt. "It is important," he said, "that those who have paid their debts well, who run their mega-finances well, should be rewarded with debt forgiveness."

The companion bill to S. 2166 in the House is H.R. 2634. When this bill was introduced in the House a year ago, Bishop Thomas Wenski, Chairman of the Committee on International Policy of the USCCB wrote Reps. Waters and Bachus to express support. He said that despite important progress in debt reduction, "a substantial number of needy countries are not eligible for the existing debt relief initiatives. H.R. 2634 represents a major new step towards correcting this deficiency and making debt cancellation a reality for virtually all very poor countries that have participatory processes and financial management systems sufficient to assure that debt cancellation savings will be used to benefit the poor. We look forward to working with you and your Congressional colleagues to help complete the unfinished business of poor country debt relief." As you know, H.R. 2634 passed the House last week with strong bipartisan support, and we were very pleased that this happened during the very days when our Holy Father, Pope Benedict XVI, was visiting our nation's capital.

I'd like to touch on several other issues.

Additionality

One objective of USCCB advocacy for debt relief has always been to assure that the debt relief received by a poor country frees up additional resources for combating poverty. In other words, we did not want donors to reduce other aid to that country in order to offset the loss resulting from debt cancellation (nor, as discussed above, did we want the loss offset by reduced aid to other poor countries.) We were, therefore, pleased to note the finding on this issue by the Independent Evaluation Group (IEG) of the World Bank in its 2006 HIPC update. It said that, with respect to the 28 countries that had reached their decision point, HIPC debt relief "appears to have been significantly additional to other net resource transfers." Between 1999 and 2004, net annual transfers attributable to debt relief increased by $4 billion, while other net annual aid transfers increased by $4.5 billion.

Arrearages to IDA

My understanding is that the U.S. has outstanding arrearages to IDA and regional development banks of almost $600 million. It will clearly hamper the Administration's effort to carry out the mandate of S. 2166 if these arrears are not cleared up quickly. S. 2166 calls for the cost of the

bill's proposed multilateral debt cancellation to be financed, to the extent possible, by the multilateral institutions themselves. We believe that substantial resource should be available for this purpose particularly from the IMF (gold sales) and the World Bank (which has accumulated reserves sufficient to bring its equity- to- loans ratio well above the range its Management considers necessary for long-term capital adequacy).

Moreover, we estimate that probably 8 to 9 countries of about 24 potentially eligible countries currently meet the financial management conditions for receiving the debt cancellation called for in the bill. (The nine are Lesotho, Kenya, Cape Verde, Mongolia, Moldova, Georgia, Samoa, Vanuatu, and, if it participates, Vietnam). Thus the need for financing to cover the cost of the debt cancellation is likely to be spread out over a number of years. Nevertheless, I expect that significant funding will be still required over time from the U.S. and other governments of the richer countries to finance multilateral debt cancellation. It will be very difficult for the U.S. to negotiate an agreed financing framework for new debt cancellation if it is not meeting existing commitments. I, therefore, very much support the inclusion in S. 2166 of the kind of "Sense of Congress" provision included in the House bill (H.R. 2634) that calls for the U.S. to pay off the outstanding arrearages to IDA and the regional banks.

Debt Relief Is Part of a Broader Agenda

A final point that is important to emphasize is that while new debt cancellation would be a major achievement, debt relief is in no way a panacea. Even if the debt of poor countries were reduced to zero tomorrow, it would not end poverty. The problem is much too large, complex and deep-seated for that. It must be addressed first and foremost by the countries themselves, with their governments and people working together on a variety of fronts for the common good. But their resources are not sufficient for them to do it alone. They need aid and just policies from the wealthier countries.