“Building on International Debt Relief Initiatives”

Testimony for the Senate Foreign Relations Committee

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Introduction

Senator Casey, Senator Lugar and distinguished members of the committee, I am delighted to have the opportunity to share with you my perspectives on international debt relief initiatives.

As many of you know, the Center for Global Development was founded in 2001 as an independent, non-partisan think tank dedicated to improving the policies of the rich countries as they relate to the world’s poor countries and poorest people. What you may not know is that it was a film growing out of the Jubilee debt movement, which portrayed the burden of debt in the world’s poorest countries, that inspired my co-founder and the Center’s principal benefactor, Edward W. Scott, Jr. that the rich world could do better for the poor -- including through better U.S. debt and aid policy. One result is that U.S. debt policy has been a core issue for CGD since its inception.[1]

I would like to make four points.

First: Debt relief is a highly efficient form of aid and has clearly helped foster social progress and economic growth in low-income countries

The U.S. and other donor countries have supported debt relief for low-income countries because lower debt burdens create fiscal space to raise spending on social programs and public infrastructure, improving lives while investing in long-term sustainable growth.

[1] CGD’s first book, *Delivering on Debt Relief: From IMF Gold to a New Aid Architecture* by president Nancy Birdsall and John Williamson, a senior fellow at the International Institute for International Economics, helped to frame the discussions on the future of the Heavily Indebted Poor Countries Initiative and how it is financed (see http://www.cgdev.org/content/publications/detail/2922/). The Center’s work played a catalytic role in the historic debt relief deal between Nigeria and the Paris Club of creditors in October 2005, resulting in Africa’s biggest ever debt reduction.

Debt relief, moreover, is a hyper-efficient way to deliver aid. For poor countries that are reasonably capable of national planning and sound economic management, the direct support provided by debt relief offers a cheaper, quicker and more effective alternative to traditional aid, which in many poor countries requires negotiating and implementing hundreds of different projects and programs with 50-plus donors, each with its own standards and reporting requirements. Debt relief encourages poor country ownership of development strategies and makes poor country governments directly accountable to citizens for their budget priorities and program implementation, instead of to international creditors.[2]

The results of past debt relief have been encouraging. Resources freed up from annual debt payments in the group of heavily indebted poor countries, or HIPCs, are associated with substantial increases in recipient governments' own spending on health, education, water, roads and other public infrastructure.[3] Also noteworthy though less remarked, the increased fiscal space due to debt relief (along with recent faster growth and recent stability in HIPC countries) has clearly played a role in helping low-income countries sustain sound macroeconomic programs, by permitting reductions in fiscal deficits and accumulation in some cases of reserves.[4] It is the resulting price stability and investor confidence that underline recent growth of more than five percent in many countries, including in sub-Saharan African countries that have benefited from debt relief programs.

Second: Debt relief itself is not a panacea

Debt relief alone does not generate growth or guarantee an escape from poverty.[5] Debt relief and aid can help support countries struggling to develop their own more accountable political and economic institutions – but it is those institutions and a country's own policies that ultimately matter for generating sustained private sector-driven growth and shared development.

Nor has or should debt relief be considered a substitute for traditional aid programs. New aid has and will continue to be the main vehicle for assistance. In 2004, for example, under the Multilateral Debt Relief Initiative, 15 African HIPCs paid on average $19

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[2] See Nancy Birdsall and Brian Deese, "Delivering on Debt Relief," Center for Global Development, April 2002, available at http://www.cgdev.org/content/publications/detail/2862/.
[3]See "Highly Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation," prepared by International Development Association and International Monetary Fund staff, September 2007, available at http://siteresources.worldbank.org/INTDEBTDEPT/ProgressReports/21656521/HIPCProgressReport20070927.pdf.
[4] Reductions in debt service from ten to five percent of GDP have been associated with increases in public investments by as much as one percent of GDP (see Benedict Clements, Rina Bhattacharya, and Toan Nguyen, "External Debt, Public Investment and Growth in Low-Income Countries," IMF Working Paper 03/249, 2003).
[5] See Todd Moss, "Will Debt Relief Make a Difference? Impact and Expectations of the Multilateral Debt Relief Initiative," Center for Global Development Working Paper Number 88, May 2006, available at http://www.cgdev.org/content/publications/detail/7912/.

million in debt service to the World Bank. That same year, they received $197 million in new World Bank aid and nearly $1 billion in total aid.[6]

Third: The Jubilee Act under consideration, despite its merits, raises several concerns

The latest Jubilee Act for Expanded Debt Relief and Responsible Lending has good language and the right overall intent regarding odious debt, vulture funds, and prudent post-debt relief lending. However, I have several concerns about the latest legislation.

First, some countries who might be eligible are making good efforts through prudent borrowing and debt management to obtain access to private capital markets at home and abroad. Were this legislation to become policy at the international level as it is now structured, it could create political pressure within those countries to opt in against their own long-term interests. Bangladesh and Vietnam would almost certainly not opt in anyway, for this reason. Mongolia and other countries in the future might. I am not confident this kind of "help" is ideal.

Second, the legislation risks further undermining already weakened U.S. credibility with its traditional allies in the donor community. It assumes and calls for internal financing of new debt relief obligations by the multilateral banks that are owned in common with other nations at a time when the U.S. has not fulfilled its own commitments on existing debt relief programs and to the multilateral development banks themselves. (As committee members will know, the FY08 budget cuts slashed our current debt relief obligations from $200 million to $30 million to offset other accounts, and the U.S. still has close to $1 billion in outstanding arrears to the World Bank and other multilateral development banks ($385 million to the International Development Association of the World Bank and a total of $872 million to the multilateral development banks.)

Finally, the current language in the bill, because it relies on internal financing by the World Bank and multilateral development banks of any new debt write-offs, appears and could end up robbing Peter to pay Paul – that is financing debt relief for some poor countries on the backs of other poor and relatively poor countries. As in the case of the Inter-American Development Bank (IDB) financing of the Multilateral Debt Relief Initiative (MDRI), it may ultimately be other low-income countries that indirectly pay the cost in the form of reduced overall availability of concessional money. In the case of the multilateral banks in general, their internal financing without compensating contributions from the U.S. and other donors may mean that ultimately all developing country borrowers pay somewhat higher interest charges on standard loans to ensure prudential standards (which are admittedly highly conservative) are met.

[6] See Todd Moss, "Will Debt Relief Make a Difference? Impact and Expectations of the Multilateral Debt Relief Initiative," Center for Global Development Working Paper Number 88, May 2006, available at http://www.cgdev.org/content/publications/detail/7912/.

Fourth: Consider a better Jubilee bill to help poor countries minimize and better manage debt

I urge the committee to continue to improve this legislation, with an eye to moving it forward only when the Congress has passed appropriations to fulfill the current arrears noted above. How might the bill be improved?

First, the bill could call on the U.S. Treasury to work with the World Bank and the other multilateral development banks on development and application of a simplified and more transparent approach to judging the ability of poor countries to borrow in the future (the "debt sustainability framework"). For example, countries with per capita income of as little as $500 have clearly not managed sustained past growth for one reason or another. It would make sense to provide only grants, not loans, to these countries.[7]

Second, the legislation could encourage the U.S. Treasury to work with its counterparts in the World Bank and International Monetary Fund to develop a facility, possibly at the IMF, that would provide temporary financing to relieve debt service burdens in the case of shocks to low-income countries' economies beyond their own control.[8] Low-income countries face much higher risks of costly natural disasters and terms of trade and other shocks (recent price hikes for oil and food may be examples that apply to oil and food importers, though there is a question of whether the price increases are temporary or more permanent) than does the U.S. and other OECD countries.[9] Such an insurance approach would help allow low-income countries with good growth prospects to borrow reasonable amounts on reasonable terms, while minimizing the risk of a new round of debt relief in the future due not to their own poor risk management but bad luck. If structured carefully, it would also contribute to the kind of confidence in the stability of poor countries that is vitally important to private sector development and growth.

Third, the bill could allow for the U.S. to unilaterally write off the U.S. bilateral debt of eligible IDA countries; such a provision could be triggered once the U.S. has fulfilled its existing international commitments.

With these modifications, a Jubilee bill would be a mechanism to effectively channel the strong public support for debt relief into demand for a better structured, overall approach to debt relief *and* related initiatives that the U.S. and other donors could take to help low-income countries.

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[7] See Nancy Birdsall, Devesh Kapur et al., "The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank," Center for Global Development, June 2005, available at http://www.cgdev.org/content/publications/detail/2868.

[8] See Nancy Birdsall and Brian Deese, "Delivering on Debt Relief," Center for Global Development, April 2002, available at http://www.cgdev.org/content/publications/detail/2862/.

[9] See Table 1: Volatility of GDP, by region and Table 2: Terms of trade volatility and shock frequency, 1975-2005 for data on the heightened vulnerability of low-income countries to trade volatility and shock frequency (tables attached at end of document).

Conclusion

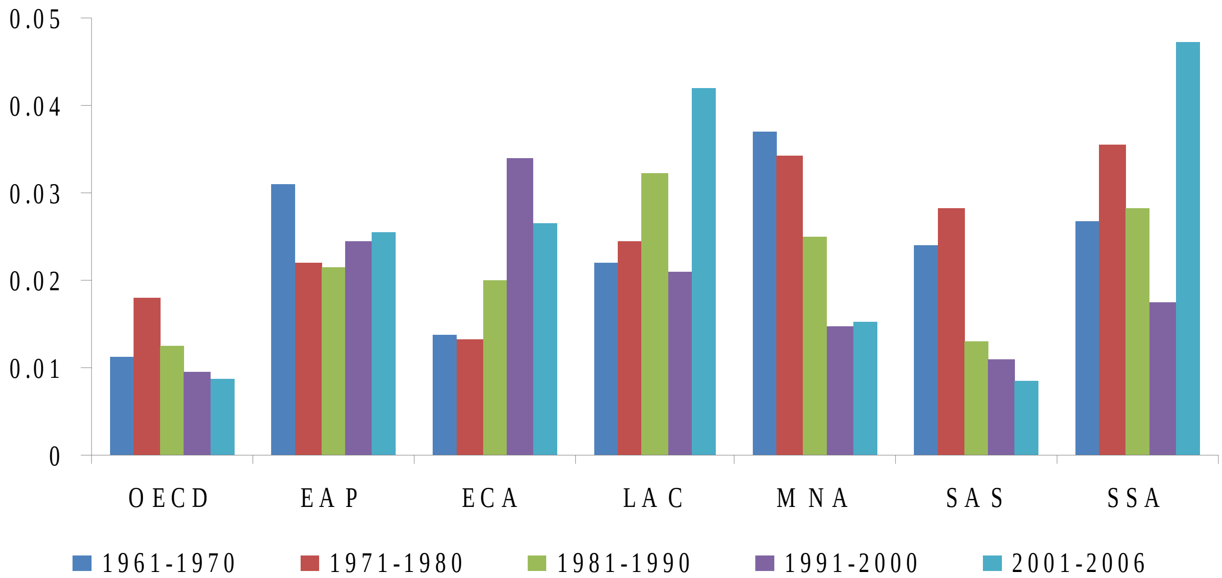
I am delighted to see the commitment of the U.S. Congress to debt relief and the robust support from American religious leaders and other advocates. I support debt relief from the U.S. in principle for good performing countries as an efficient and effective mechanism for helping countries create the fiscal space to increase spending on social programs and other investments necessary to improve lives and create long-term sustainable growth.

However, I hesitate to endorse this bill as currently structured, and indeed any bill for new debt relief, until the existing arrears on U.S. commitments to debt relief and the international institutions have been fully funded.

Finally, I urge the committee and other members of Congress to help translate the public interest and support for debt relief into more ambitious legislation – not just for debt relief itself but for a complete overhaul of U.S. foreign assistance and development programs – along the lines outlined by my colleague Steve Radelet in testimony before the House Foreign Affairs Committee yesterday.[10] I hope that the next administration, together with the Congress, will find a way to reflect Americans' growing commitment to better lives in poor countries not only in debt relief programs, which are reaching their limits in any case, but via a broader set of development-friendly policies consistent with our national values and our interest in global as well as American security and prosperity.

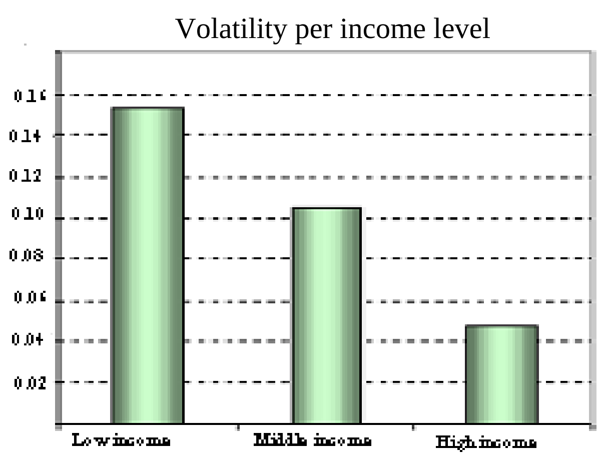
[10] See Steve Radelet, "Seizing the Moment for Modernizing U.S. Foreign Assistance Reforms: Testimony for the House Committee on Foreign Affairs," Center for Global Development, April 23, 2008, available at http://www.cgdev.org/content/opinion/detail/15863/.

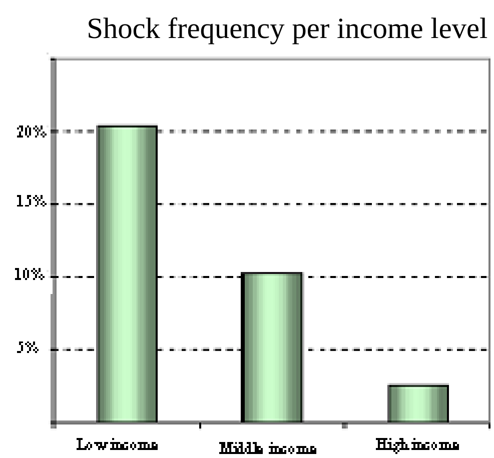
Table 1: Volatility of GDP, by region



Source: Guillermo Perry, Center for Global Development, calculations based on WDI and IFS data (April 2008).

Table 2: Terms of trade volatility and shock frequency, 1975-2005





Source: C. Calderón, World Bank (2007).