HIPC Debt Relief: Which Way Forward?

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I would like to thank the House Subcommittee on Domestic and International Monetary Policy, Trade, and Technology 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), and of our relief and development agency, Catholic Relief Services, for many years. In my testimony today 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 USCCB over quite a few years.

Role of USCCB

But first let me briefly mention the very 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. In the mid-90's the Conference intensified its work on debt, inspired particularly by the words of Pope John Paul II when 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."

In 1998 the Conference sponsored a major three-day meeting to examine the moral and ethical dimensions of the debt crisis. The gathering brought together senior representatives of almost every actor who has a role to play in international debt. They came from the United States, Europe, Africa, and Latin America--Church leaders, government officials, academics, heads of international financial institutions, private bankers, Catholic Relief Services and international and national non-governmental organizations. Informed and enriched by the 1998 meeting, the Bishops Conference issued a new Statement in 1999 which provides a moral rationale for debt relief as well as ethical criteria for debt relief programs.

Simultaneously with the preparation of the new Statement, the staff of the Bishops Conference and Catholic Relief Services engaged in intensive advocacy for debt relief with the US Administration and the Congress. We played an active role, along with many other US faith-based organizations, in the worldwide Jubilee 2000 campaign. During that campaign we had the pleasure of working closely with members and staff of the House Financial Services Committee, which provided strong leadership in responding to the call of the many poor countries around the world for relief from the heavy burden of international debt that was seriously affecting the lives and dignity of millions of vulnerable people.

The Financial Services Committee Played an Important Role

It was Rep. Jim Leach, then Chairman of this Committee, who back in 1999 took the initiative to introduce the comprehensive debt relief bill, H.R. 1095. Among the original co-sponsors who became strong advocates for poor country debt relief were Reps. Spencer Bacchus, Barney Frank, and Maxine Waters. The bill attracted broad, bipartisan support, eventually some 140 co-sponsors. A companion bill was introduced in the Senate, and these two bills became a major vehicle for the dialogue of members of the US Jubilee 2000 movement with both the Congress and the Administration.

Of course, once the new program was adopted, it had to be funded, and once again it was members of this Committee who stepped to the fore. I will never forget the House floor debate on the Foreign Operations appropriations bill on a late summer night in the year 2000. Reps. Waters, Frank, Leach and Bachus all rose to speak movingly and forcefully about the importance of full funding for the HIPC program, and they were joined by quite a few others. And it was encouraging to hear speakers on both sides of the aisle talk about the responsibility of the United States to help the less fortunate around the world.

One of the most powerful statements was made by Spencer Bachus, who has spoken out frequently and eloquently about the moral imperative of debt relief. He put the issue into perspective: "[I]t is not a total solution to poverty, to hunger, to disease; but it is the first step. It is a necessary step. It is where the journey should begin to free these countries of the burden of debt, the chains of poverty, the shackles of despair, to enable them to minister to the economic and social needs of their people, their children." When the debate ended, the House voted to approve an amendment offered by Rep. Waters which tripled the appropriation for debt relief.

The Enhanced HIPC Program

While the Enhanced HIPC program, as finally adopted, did not provide the total cancellation of poor country debt which many in the Jubilee 2000 movement had called for, it was nevertheless a major advance over previous programs, promising much more debt relief, more rapidly, to many more countries. Moreover, at the time of the adoption of the new program, President Clinton announced that the US would go beyond the requirements of the program and cancel 100% of the debt owed to it by HIPC countries. Leaders of other creditor countries, including the United Kingdom, Canada, Italy, Australia and Denmark followed suit.

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.

The Enhanced HIPC Program Has Now Been in Effect For Over Four Years. What Are the Results?

Debt Stock Reduction Is Substantial

As of the latest information available from the World Bank and the IMF, in 2002 NPV terms, about $51 billion in debt stock reduction has been committed to 27 countries, 23 of which are in Africa. (Another eleven countries, many afflicted by conflict, are potentially eligible for relief, but have not yet qualified).

Poverty-Reduction Expenditures Are Increasing

According to World Bank and IMF figures, debt reduction in the 27 countries is projected to free up about $1 billion annually in debt-service savings during 2001-2005. While accounting data that would permit tracking these savings to specific expenditures is not available, poverty-reducing expenditures as a whole in these countries increased by over $1 billion in 2001 and are projected by the World Bank and IMF to continue growing by over $1 billion a year through 2005. In other words, poverty reduction expenditures appear to be increasing by more than the amount of the debt service savings. This is a hopeful sign that the poor are reaping the benefits of debt reduction.

Expenditure-Tracking Management Is Improving

In 2002, as part of the PRSP process, the World Bank and IMF assessed the public expenditure management systems of 24 HIPC countries and found that all needed upgrading to be able to track poverty-reducing expenditures satisfactorily. According to the World Bank and IMF, a more recent review examined country progress in implementing action plans developed to strengthen tracking capacity, and found that three-quarters of the measures in the action plans had either been implemented or are under implementation.

Unprecedented Civil Society Participation is Occurring

The PRSP process has facilitated an active role for civil society groups in the monitoring of expenditures for poverty reduction. While the record of progress varies from country to country, Catholic Relief Services reports impressive examples of civil society participation in a number of countries, including Bolivia, Uganda, Malawi and Zambia.

The Case of Zambia

Zambia is a good example. The HIPC Tracking and Monitoring Team of Zambia was established in 2001 by the Minister of Finance as an autonomous organization and consists of seven non-governmental organizations. Represented are a local Catholic Research and Advocacy organization, an NGO coordinating committee, and several professional associations composed of accountants, economists, procurement experts and marketing specialists. (An elaborate system has been set up in spite of the fact that the post-Decision Point debt service-to-revenue ratio dropped the least of any HIPC country.)

According to the Team's reports, the programs and projects supported by HIPC resources are derived from the PRSP and are incorporated in the annual budget. HIPC-related expenditures are identifiable in all budgetary procedures. Over the past year and a half the Team has completed comprehensive, highly detailed reports on the use of HIPC resources in four major regions of the country. The report on the Copperbelt Province was based on physical inspections and financial audits in all provinces and districts which received funds. The report is frank and hard-hitting and contains highly specific findings and recommendations concerning wasteful and inefficient practices and inadequacies in implementation capacity as well as instances of misapplication of funds.

The Team's bottom line is that the HIPC funds disbursed between 2001 and 2003 in the Copperbelt Province had on average a positive impact on the poverty of the people. Expenditures were especially beneficial in health, education, water and sanitation. In other areas (road rehabilitation, forestry, land resettlement and social welfare), the impact had been below expectation as the resources disbursed had been misapplied or abused. The effectiveness of the monitoring system will depend on whether, and how well, the authorities act to correct the deficiencies.

The Case of Malawi

An equally impressive example can be found in Malawi. Catholic Relief Services reports that local civil society organizations came together to form a federation called the Malawi Economic Justice Network (MEJN). Once HIPC funds were granted, they worked closely with the Parliamentary Budget and Finance Committee to identify twelve key categories of priority poverty expenditures in the 2001-2002 budget. They persuaded the Malawi Ministry of Finance to produce periodic expenditure figures for each of these categories and worked with the Parliamentary Budget and Finance Committee to monitor the allocation of funds to the relevant line ministries.

The MEJN formed three sub-groups in the sectors of health, education and agriculture to monitor the delivery of services. They selected dozens of local districts and provided three- to five-day training to local leaders in the use of survey instruments. Local leaders used questionnaires to discover, for example, whether clinics had medicines, schools had books, and teachers were trained. The data was compiled and analyzed by experts, then used to publicize such findings as – (1) government spending on vital medicines for health clinics was 50 percent short of its commitment, (2) despite a 221 percent increase in spending on teaching materials, 41% of schools had not received any new materials during the first six months of the budget year, and (3) off-budget teacher salary increases of 68 percent had been approved.

The survey results were shared first with communities, then with the government, donors and other stakeholders. The MEJN developed a strategy to disseminate the results via radio, newspaper, and paid ads, and also used them to lobby Members of Parliament before their deliberations on the budget.

The monitoring exercise appears to have had a positive impact. For example, the national budget was recently revised, adding items such as salary increases, and shifting allocations from some non-priority items (foreign travel, expenditures of the office of President, etc.) to priority poverty programs. The Ministry of Education is using the findings in its own planning, and Parliament is using them to question the line ministries.

The broader point in the Malawi and Zambia examples is that the procedures instituted with the enhanced HIPC debt relief program appear to be making a contribution to the strengthening of democratic processes in a number of countries where historically weak governance has often led to serious neglect of the needs of the large majority of very poor and vulnerable citizens.

Unanticipated New Borrowing Is Not Occurring

The fears of debt relief critics -- that once HIPC countries received debt relief they would resume earlier patterns of irresponsible borrowing-- appear to be unfounded. The World Bank and the IMF recently did an analysis of the 27 HIPC countries which have passed their Decision Point to determine which ones were likely to have debt in excess of HIPC thresholds (mainly debt stocks above 150 percent of exports) at the completion point. They found that after full HIPC relief, nine countries would still have debt above the HIPC thresholds. In examining why this was occurring, they observed that it was not the result of unanticipated new borrowing. In fact, the nine HIPCS had borrowed slightly less than anticipated. What was driving the key debt ratios above HIPC thresholds was exogenous factors: the depreciation of the US dollar, the decline in the discount rate because of declining market interest rates, and a decline in export earnings. One of the lessons of this experience is the importance of making the HIPC debt relief deep enough to provide an ample cushion against events over which they have no control.

Additionality Is Occurring–for the HIPCs

Finally, there is the question of additionality. One concern had always been that donors might offset the cost of HIPC by reducing their aid programs by an equivalent amount, leaving the HIPC countries no better off than before. The good news is that this apparently is not happening. The latest HIPC progress report shows that net resource flows to the 27 HIPC beneficiaries have increased substantially since they began receiving HIPC relief. There are some down sides to the picture, however. First, official flows to these countries declined substantially in the mid-90's. Thus the recent increases only restore external aid to the levels of the early 90's. Second, according to the World Bank's Operations Evaluation Department, the downward trend in aid which occurred in non-HIPC countries has not been reversed, at least not through the year 2000. If this means that HIPC relief is coming at the expense of assistance to countries which have perhaps managed their external finances better than the HIPC countries, it is a disturbing development. It highlights the importance of making sure that important new aid initiatives such as the Millennium Challenge Account and the 2003 HIV/AIDS Act are additional to existing funding for core development accounts.

What are the problems or deficiencies in HIPC implementation?

Progress Toward the Completion Point Has Been Slow

There are a number of concerns with how the HIPC program is being implemented. In the first place, HIPC is in its fifth year yet only 11 of the 27 HIPC beneficiaries have reached their Completion Point. There are a variety of reasons for this, but, under the HIPC, rules it means that the majority of the HIPC countries are unable to receive more than one-third of their committed debt relief.

Zambia is a case in point. My understanding is that the completion point is being held up because pressures to increase salaries led to an overshooting of the wage bill target agreed with the IMF. The salary increases resulted from contracts negotiated with public employee labor unions last year. The World Bank examined the wage bill problem as part of a comprehensive report published last November and entitled "Zambia Public Expenditure Management and Financial Accountability Review." It says:

> Even with excellent policies and procedures, sound financial management would be difficult to achieve without properly motivated and skilled staff. Low remuneration in the public sector is a major factor contributing to the problem of poor productivity, motivation and recruitment and retention. At a time when government is seeking efficiency improvements, in part by reducing the size of the civil service, there exist significant staff shortages in a wide range of professional and technical jobs owing to poor pay compared to that available in the private sector and within regional labor markets.
>
> The real wages for civil servants has declined since the mid-1970's. While this decline to some degree mirrors the overall macroeconomic decline of the country, real public service pay declined much faster than did real GDP per capita from 1975 to 2000....
>
> The problem of low pay ... notwithstanding, the wage bill in Zambia has remained large relative to overall government expenditures, thereby crowding-out operational expenditures. The challenge for Zambia is therefore how to design and implement a pay reform strategy that is consistent with the macroeconomic goal of containing the size of the wage bill (as a proportion of GDP).

The World Bank report outlines a broad strategy for addressing the issue, but the challenge is an enormous one– how to make wages sufficiently remunerative to attract as well as retain qualified staff while at the same time minimizing the cost. It is difficult to see how it can be dealt with effectively except, at best, over the medium term. In the meantime, Zambia continues to be plagued by a heavy burden of past debt. In fact, the fiscal bind which Zambia finds itself in can be attributed in large measure to its heavy debt service obligations. According to the projections in the latest IMF and World Bank status report, Zambia's debt service will be an extremely high 31 percent of government revenues in 2004.

Paraphrasing Spencer Bachus, debt relief is not a panacea. It will take much more than debt relief for the HIPC countries to emerge from poverty. But by delaying full debt relief, it is restricting the ability of HIPC countries to create the kind of fiscal space so important for moving ahead to address in a more effective way the human needs of their people. The IMF and World Bank should reexamine the conditions for reaching the Completion Point, particularly those that are unrelated to assuring that the debt relief savings will reach the poor. In doing so, they should take into consideration that they have continuing relationships with all these countries and that economic performance concerns can be addressed in the context of new lending.

The Amount of Committed Debt Relief Is Uneven

I would also like to highlight two other concerns. The first has to do with the amount of the relief being offered. As you know, the amount of debt reduction provided under the program is measured primarily in terms of the relation between debt stock and exports. What is most important, however, is the relation between debt service and government revenues. When we examined the first figures published by the IMF and World Bank after the initial 22 countries qualified for relief, 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 what was important was to provide 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 when 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."

To correct this problem, the HIPC formula should be revised in line with the original provisions of HR 1095, so that no country would have to pay more than 10 percent of government revenues in debt service. Moreover, many of the countries heavily burdened with external debt are being devastated by the HIV/AIDS pandemic. Thus, for countries suffering from a public health crisis, measured in terms of the incidence of HIV/AIDS, the debt service- to-revenue ratio should be reduced to no more than 5 percent.

Thanks to the leadership of Sens. Santorum and Biden in the Senate and Rep. Chris Smith and members of this Committee in the House, an amendment was inserted in the 2003 HIV/AIDS Act which incorporated the essence of the 5 and 10 percent proposal, while allowing flexibility to adopt other formulas such as debt service to GDP, as long as it produced substantially the same result. Unfortunately, the Administration has treated the language of the amendment as advisory and has not initiated the international consultations necessary to bring about a revision in the HIPC criteria. We are hopeful that with the aid of the many Congressional supporters of debt relief, the Administration can be encouraged to start the consultations.

<u>HIPC Goals Cannot Be Achieved Unless the Financing Gap Is Filled</u>

This brings me to the other main concern. Part of the reluctance to move forward arises because of the shortfall in the amounts necessary to finance the existing HIPC program, a topic that is reviewed in the GAO report, *Achieving Poor Countries' Economic Growth and Debt Relief Targets Faces Significant Financing Challenges*. It would be devastating to the HIPC beneficiaries to contemplate the possibility of receiving anything less than the full debt relief promised under the existing program because of funding shortfalls, or to see it blocking any possibility of increasing the amount of the relief.

It is very important, therefore, to examine how substantial this issue really is. The analysis of the GAO report is presented in terms largely of net present value (NPV). This is the discounted sum of amounts required over a period of 16 years to write off debt service as it becomes due. I think it is important also to convert the NPV into annual requirements, because this will show the actual budgetary impact from year to year. I have tried to make some rough estimates of what this impact might be, and if my figures are anywhere close to being accurate, the issue should be much more manageable than it may seem The shortfall has several components, and, because of the importance of the issue, I would like to address each one separately.

The first shortfall is in the HIPC Trust Fund, which finances part of the HIPC costs of regional multilateral banks such as the African Development Bank. A shortfall of $650 million was identified some time back, and the major donor countries agreed to cover it. The US needs to provide $75 million to complete its agreed share of this shortfall. The President's request to include this amount in the FY05 budget should be approved. The GAO report says that a gap in HIPC Trust fund financing will emerge several years from now. I am not clear whether any portion of this gap would be covered by the $650 million which the creditors have already agreed to provide. Assuming it is not, the US share of this gap, according to the GAO, could be an additional $130 to $350 million. However, these funds would not be needed until 2008 and would be required over a ten-year period. Thus, the annual cost to the US would be very small: $13 to $35 million per year.

The Inter-American Development Bank apparently does not have a financing gap. However, the GAO report indicates that this is being accomplished by a planned $600 million reduction in their projected lending during 2009 to 2013 to countries eligible for their concessional window, the Fund for Special Operations (FSO). This suggests that funding for HIPC will come at the expense of the poorest countries in Latin America and the Caribbean. It would be important to assure that this does not happen. The first point to make is that one must deal with many uncertainties in trying to project lending needs five to ten years from now. Thus the $600 million figure must be regarded as highly tentative. Moreover, if the $600 million does become a firm figure, it breaks down to $120 million on an annual basis. The IDB is a strongly capitalized institution with a large portfolio and no non-performing loans. In 2003 alone, it disbursed $8.9 billion. In this context, and assuming appropriate advance planning, finding another $120 million in 2009 for the FSO countries would not seem to present a major hurdle, especially if IDB gives appropriate priority to its poorer members. If it does become necessary to turn to the shareholders, one alternative might be to finance a portion of the shortfall through the HIPC Trust Fund, in which case the maximum annual US share might not exceed about $25 million.

The Largest Shortfall Is in the IDA Component

The largest shortfall in HIPC financing is in the IDA component. According to the GAO report, the IDA gap is estimated at $6.5 billion. This translates into a need for about $584 million on average through 2020. The main point I would make is that this gap assumes that the IBRD would cease net income transfers to IDA for HIPC debt relief after 2005. These transfers have been made at a rate of about $240 million a year. To my knowledge these transfers have had no significant impact on the World Bank's financial situation, and it would seem that a viable option would be to continue to make income transfers at least at the current level. I am not privy to the World Bank's financial projections and priorities, but I note from its recent Annual Report that the $240 million allocated to HIPC last year was taken from total allocable net income of $3.05 billion. The HIPC allocation still allowed $2.4 billion to be added to general reserves, continuing the upward trend which has led to an increase in the World Bank's equity (excluding callable capital) of 43% since 1998 and has brought the ratio of usable equity to loans up to 25%.

If IBRD net income transfers continue at the rate of $240 million a year, this would lower the average annual gap to around $345 million. If the US were to contribute 20% of this shortfall, the annual requirement would be about $70 million, or $210 million per replenishment.

Other Gaps May Arise in the Future

Another gap in the existing program arises from the fact that four countries potentially eligible for HIPC relief, i.e., Laos, Liberia, Somalia and Sudan, have not been included in the World Bank/IMF costing exercise. The World Bank's preliminary estimate is that the net present value of the cost of HIPC debt reduction in these countries would be in the range of $10 billion. These estimates are highly tentative, as pointed out in the GAO report, and they may be understated. The bulk of the costs relate to the Sudan, which would create substantial costs for the US. This is because the US would be committed to canceling Sudan's substantial US bilateral debt, as well as contributing to a portion of multilateral costs. However, Sudan is embroiled in internal conflict and has major governance problems, so it seems unlikely that it would qualify for HIPC relief anytime in the near future. The timing of possible debt relief for the other three countries is also highly uncertain.

Topping Up Needs To Be Financed

The final funding shortfall is related to the provision in the enhanced HIPC program for "topping up" debt relief at the Completion Point for countries who have experienced exceptional exogenous shocks "that cause a fundamental change" in a HIPC country's economic circumstances. It hasn't been clear how this language would be interpreted. However, the World Bank and the IMF have made an estimate of topping up costs. They say that because primarily of movements in exchange rates, changes in discount rates, and declines in commodity prices, about seven to nine countries would qualify for topping up. They recently updated the cost estimate. It is now $1.8 billion with almost one-half attributable to Ethiopia and Niger. The IDA share of this cost is $1 billion.

According to press reports a few days ago, agreement has been reached among the major creditors, after reportedly stiff opposition from the US and Germany, to provide Ethiopia and Niger with $800 million in "topping up" relief. I do not know what kind of burden sharing has been agreed, but it would seem reasonable for the World Bank to finance a substantial share of its costs–one option might be 50 percent (or $500 million)–from it own resources. On this basis, and otherwise using normal HIPC burden sharing arrangements, the US share of the remaining $1.3 billion over 16 years might be around $20 million annually.

<u>The US Contribution to the HIPC Shortfall, Which Should Be Manageable, Is Essential to Achieving HIPC Goals</u>

By adding up the numbers emerging from the alternatives I have suggested, I have come up with an estimate of the overall cost of filling the gaps in the various components (excluding Sudan and the other uncertain countries). Time has not permitted a deeper analysis or a careful vetting of these numbers, but in any event, my rough estimate of the average amount that would have to be budgeted on an annual basis for 2005 through 2008, is $150 million. Obviously the GAO calculation is different, and there may be other options that should be considered, but the United States has made a heavy commitment to the success of the HIPC program and the additional amount required should be manageable, even in a period of budget stringency. Past experience shows that other creditors will only act when the US does. It is, therefore, critical to the the achievement of the goals of HIPC that the US exercise leadership and commits its fair share of the shortfall.

The above estimates do not include the incremental cost of implementing the 5-10 percent provisions included in the HIV/AIDS law. The Treasury Department made an estimate of this cost in its October 2003 Report to Congress on Proposed Modifications to the HIPC Initiative, H.R. 1298. The total for the three-year period 2003-2005 comes to $1,284 million. The average annual cost is $428 million. The figures are not broken down, so it is not possible to determine what portion of the cost would fall on the US. However, under existing HIPC burden sharing arrangements, the US would be expected to pay a share of the costs of the African Development Bank and other regional multilateral banks receiving financial assistance through the HIPC Trust Fund. A very rough estimate of the share of the regional banks in the total cost is 30 to 35 percent. Applying the assumptions used in the GAO report, the annual US contribution to the HIPC Trust Fund would be between $15 million and $40 million, a very modest amount in US budgetary terms. The US might also be asked to contribute to a portion of the IDA share of the costs, but this should add only about $10 million to US costs.

<u>Achieving Poverty Reduction Goals Requires a Comprehensive Approach</u>

The GAO Report makes the very important point that even if the HIPC program is fully financed, substantial additional external assistance will be required to enable HIPC countries to achieve growth and poverty reduction targets. Debt relief is not a panacea. Even if the debt of HIPC countries is reduced to zero, it will not end poverty. The problem is too 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 they are too poor to do it alone. They need aid and support from the wealthier countries.

The GAO has made estimates of the amount of external assistance required through 2020 for the 27 HIPC qualifiers to achieve growth and poverty reduction targets. One can certainly raise questions about the numbers. I would like to know, for example, to what extent the $153 billion in what is called “expected development assistance” reflects current assistance trends or implies a step-up in foreign aid. Also to what extent are these amounts consistent with what development experts have estimated as necessary to achieve important Millennium Development Goals? With respect to the export projections, there are ample grounds for believing that the World Bank and IMF projections are too optimistic, and I am happy to note that the World Bank seems to agree that it needs to make them more realistic. At the same time, is it not too pessimistic to take the historical data as the most likely indicator of future performance? The time horizon used is 18 years, and I remain hopeful that ongoing efforts to improve development efforts in many of the HIPC countries will yield sufficient progress over this span of time to reduce export volatility.

Moreover, in the strategy it lays out for dealing with the expected export shortfall, the GAO assumes that it would be addressed entirely through additional aid. This overlooks an important dimension: external trade. Countries can achieve substantial economic benefits by more open trade, provided it is also fair trade. The World Bank estimates that trade barriers in Europe, the United States and Japan cost poor nations more than $100 billion per year.

<u>Longer-Term Approaches Are Needed To Protect Against Future Debt Crises in Poor Countries</u>

. There is one part of the GAO analysis that I think warrants particular attention. This is the discussion of post-HIPC forms of debt relief. The debt relief provided by HIPC is no guarantee that the countries will avoid serious debt servicing difficulties in the future, no matter how much their debt management improves. Low income countries are particularly susceptible to exogenous shocks, whether from financial or product markets or from natural phenomena, and they cannot count on repeated HIPC-type debt reduction exercises. The topping up exercise implicitly recognizes this problem, but it does not provide relief beyond the completion point. Nancy Birdsall and John Williamson of the Center for Global Development propose one method of dealing with this in their book, *Delivering on Debt Relief.* They recommend safeguarding countries, through a ten-year contingency facility, against being pushed back into unsustainable debt levels by circumstances beyond their control.

Birdsall and Williamson also endorse the suggestion made by President Bush in 2001 that IDA should convert about half of its loans into grants. In fact, IDA is already moving in this direction in the on-going IDA 13. It expects that 18-21 percent of its development assistance during 2003 through 2005 will be delivered in the form of grants. The GAO outlines a similar strategy in its report and estimates that almost all the 27 HIPC countries could achieve debt sustainability if multilateral creditors converted an average of one-third of their new loans to grants. Their cost estimate for this conversion is $8.5 billion. I have not examined the assumptions underlying these estimates, and I am not clear, for example, how they define “debt sustainability,” but I support the general thrust of this strategy.

In fact, the Catholic Bishops Conference supported the expansion of IDA’s grant authority in IDA 13. However, they also emphasized the importance of early consideration of the implications of the conversion on the financial situation of IDA. Currently internal sources, primarily reflows from past lending, account for roughly 40 percent of IDA’s commitment authority. If these reflows are seriously depleted, it could cause IDA to sharply scale down its lending to the world’s poorest countries. It is true that the loss of reflows would only begin to affect IDA’s finances after the ten year grace period on their loans, but, after that, losses would begin to mount rapidly. At the time of the IDA 13 negotiations, the World Bank calculated that if donors were to begin making contributions immediately, the total contribution from all donors would be $400 million (presumably $80 million from the US) during IDA 13. If, however, they chose to wait, the required contributions would rise sharply. Unfortunately, to my knowledge, the US and most of the other donors have chosen to wait. The matter will require urgent attention in the IDA 14 consultations which have recently begun.