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U.S. DEPARTMENT OF THE TREASURY

Press Center



Assistant Secretary for International Affairs Clay Lowery Testimony Before the Senate Foreign Relations Committee

4/24/2008

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"Building on International Debt Relief Initiatives"

Washington – Thank you for the opportunity to discuss the Administration's strong leadership on international debt relief and the new proposals contained in the Jubilee Bill (S.2166).

Debt relief can be a valuable tool to help the poorest, most heavily indebted countries. It helps them re-establish a sound economic footing and reengage with the international community, supporting their efforts to lift people out of poverty. Debt relief can remove a significant barrier to economic growth when external debt levels become so high that they interfere with a country's basic economic sustainability. This is something that plagued many poor countries throughout the 1980s and 1990s. Recognizing the need for strong action, this Administration has been an ardent advocate of and critical leader in international initiatives to maximize the potential of debt relief as a responsible and effective tool of development. The two major debt relief initiatives that this Administration has supported, the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), are expected to provide over \$110 billion in debt relief to 33 heavily-indebted poor countries. Further, we anticipate that seven additional countries could still qualify under these initiatives.

Many of the goals of the proposed Jubilee Act (S.2166) are laudable. It is clear that all of the countries which are potentially eligible under this bill, the so called "IDA-only countries," face significant development challenges. The Administration shares the goal of increasing economic growth and obtaining greater financial stability in these countries. However, we cannot support this bill based on the answers to the following three key questions.

Is this bill sound policy? In countries where debts are sustainable, other development tools should take precedence over debt relief. We believe that debt relief is not the best development tool for the countries targeted in this bill. The aim of the HIPC initiative was to remove unsustainable debt levels for the most heavily-indebted poor countries, so that these countries could stabilize their economies and focus on growth and poverty reduction. It included requirements for sound economic policies so that debt relief was not simply "throwing good money after bad." For countries that are already able to successfully manage and service their debts, sound debt management can help them to transition gradually toward access to private capital markets. Furthermore, increased private investment and targeted development assistance are more focused ways to address the challenges these low-income countries face.

How will expanded debt relief be financed? Debt relief has a U.S. budgetary cost, just as new development assistance has a U.S. budgetary cost. We continue to face challenges in financing our commitments to existing debt relief initiatives, including in the multilateral development banks, which is why it is so important that Congress enact the President's full request for these programs. The Jubilee Bill represents an unfunded international mandate to fully cancel roughly \$75 billion worth of debts owed by the potentially eligible countries to official bilateral and multilateral creditors. As we learned during the financing of MDRI, it is unlikely that we could garner the necessary international support to finance multilateral debt relief with the internal resources of the international financial institutions (IFIs), meaning the U.S. would need to be prepared to make a significant contribution.

Is expansion of debt relief the right priority? Secretary Paulson and other senior Treasury officials meet regularly with the finance ministers, central bank governors, and private sector and civil society leaders from many of these countries. The priority they most often highlight is the need to spur long-term growth and reduce poverty by attracting investment, building core infrastructure, and strengthening their financial sectors. I would welcome closer collaboration with the Congress on ways in which the United States can support these countries' private sector development agendas.

Current Debt Relief Efforts

This Administration has led international debt relief efforts for the world's most heavily-indebted poor countries. Building on the work of the previous Administration and with strong Congressional support, we have deepened and broadened the Heavily Indebted Poor Countries

(HIPC) debt reduction initiative.

In 2005, the Administration, with bipartisan congressional support, initiated and negotiated the landmark Multilateral Debt Relief Initiative (MDRI). MDRI provides 100 percent cancellation of eligible debt obligations owed to the World Bank's International Development Association (IDA), the African Development Bank's African Development Fund, and the IMF, for poor, heavily-indebted countries that complete the HIPC initiative. We have also continued this work, designing an initiative and leading negotiations in cooperation with Brazil to forgive 100 percent of HIPC debts to the Inter-American Development Bank.

As I mentioned earlier, these debt relief initiatives are expected to provide over \$110 billion in debt reduction to 33 countries that have already qualified under the HIPC initiative. Further, we anticipate another seven countries could qualify under these initiatives. These two initiatives continue to provide benefits to countries such as Afghanistan, Liberia and Haiti. In 2007, Afghanistan became the thirty-first country to qualify for debt relief under the HIPC initiative. After years of conflict, Liberia is now rejoining the international community. Debt relief for Liberia under HIPC and MDRI, with eventual cancellation of over \$4 billion in debts, is an important part of this transition. However, even under these well-established initiatives, the process is not always easy and international support is not always firm. In the case of Liberia – a country whose debts were clearly unsustainable and for which the U.S. provided strong leadership and intense engagement – the international effort to clear its \$1.4 billion in arrears to the international financial institutions took over 18 months and almost failed on a number of occasions.

Debt Sustainability

To help ensure that gains from debt relief are not wasted, the Administration has worked through the international financial institutions, such as the World Bank and IMF, to put in place an internationally agreed debt sustainability framework to help guide future lending and borrowing. We are also working through the OECD to operationalize that framework with a set of principles and guidelines that commit export credit agencies to follow sustainable lending practices and consider IMF and World Bank recommendations when extending new export credits to low-income countries. This Administration also led efforts in the multilateral development banks to increase the level of grants for the poorest countries. In 2001, IDA provided less than one percent of its financing for the poorest countries in the form of grants. Today, as a result of U.S.-led efforts, over 40 percent of funds from IDA to these countries are in grants. For instance, the World Bank is providing \$82 million in grants to Haiti through the first half of this year. These efforts will help ensure that poor countries will not re-accumulate unsustainable debts in the future.

Mismatch of Tools and Objectives

Debt relief is a valuable tool, but it must be balanced against other policy instruments, such as direct development assistance. It is not always the right response to address a country's development needs. The Jubilee Bill (S.2166) targets a group of countries that face tremendous development challenges. However, debt relief is most appropriate when the debt itself is a barrier to development, as is the case with the countries eligible for the HIPC initiative. This is not the case for the countries targeted in this bill, many of which are experiencing robust growth and reductions in poverty levels. In fact, many of these countries have such manageable debt positions that they are either seeking access to private capital markets – as in the case of Vietnam – or are repaying their debts early – as with Angola and Nigeria.

Of the eight countries that some supporters of the bill have suggested would be immediately eligible, none faces a high risk of debt distress. This means that the immediate impact of the bill, if agreed to internationally and if funded by the U.S. Congress, would be to forgive the debts of countries that are able to service their debts – countries for which debt is a minor issue compared to the challenges they face in tackling issues such as promoting growth. For such countries, targeted development aid and our support for efforts to attract investment are more immediate.

Our experience with HIPC and MDRI has shown that debt relief alone is not enough to address these countries' long-term challenges. For example, Rwanda benefited from \$1.8 billion in debt relief under these initiatives, but it is still considered to be at high risk of financial distress. The reason is not that it has borrowed irresponsibly – its debt levels are still low. The reason is that it has a small and vulnerable export base that cannot provide a consistent source of government revenue. The key to supporting a sustainable path for countries such as Rwanda is assistance to directly improve their economic growth potential, not more debt relief.

Countries must also develop and implement effective policy reforms to ensure that savings from debt cancellation – and in fact all development assistance – can be used effectively for poverty reduction efforts. This is why international debt relief initiatives have been conditioned on the adoption of sound macroeconomic policies. Debt relief simply will not have the intended benefits if it is delivered in an environment of macroeconomic instability. Placing blanket restrictions on the types of economic reforms that are appropriate can make it difficult to implement policies tailored to a given country's situation.

Potential Costs of Expanded Debt Relief

There is also the issue of cost. Debt relief must be financed, just as development assistance must be financed, and we should not enter into negotiations without a sense of the costs that could be incurred. The budget impact of pursuing the program described in the bill (S.2166) would be substantial. Expanded debt relief would be a commitment to replace costs over 30 to 40 years, and we need to consider the total, long-term U.S. government exposure to such an initiative.

The Treasury Department estimates that the budget cost to forgive the nominal debt owed to the United States alone, including loan guarantees, by all of the IDA-only countries that do not currently qualify under the HIPC Initiative would be approximately \$1 billion. This cost estimate assumes that all IDA countries qualify in FY 2008 and would change depending on the year each country qualified for debt relief. These countries also owe approximately \$32 billion in nominal debt to the World Bank and IMF and roughly \$15 billion to the major regional development banks. While the bill is not explicit about whether negotiations on expanded debt relief should include comparable debt relief from other bilateral creditors, I note that the total official bilateral debt owed by potentially eligible countries under this bill is approximately \$30 billion.

While the bill calls for international financial institutions to fund debt relief from internal resources to the extent possible, the availability of such resources is very likely to be limited. Our recent experience with funding for debt relief under MDRI is a good example of what we are likely to encounter. We began those negotiations in 2004 with a similar goal of seeking no additional donor resources, while providing increased debt relief to HIPC initiative countries from finances of the international financial institutions. However, there was no international support for this proposal. In the end, donors were required to compensate, dollar-for-dollar, for MDRI debt relief at the World Bank and African Development Bank. The U.S. is bearing about 20 percent of the costs of MDRI at the World Bank and about 12 percent at the African Development Bank.

It is uncertain, at best, whether other creditor governments would be willing to agree to additional debt relief of this magnitude, particularly if we are unwilling to provide additional funds. If negotiations for expanded debt relief were to follow our experience with MDRI, the U.S. would need to be prepared to make a significant contribution, likely at the expense of other development assistance priorities.

Continued Financing Needs for Current Initiatives

The United States is far from making good on its commitments to the current debt reduction initiatives – which seek to help the poorest, most heavily-indebted countries. The Administration has continued to request, but has still not received, sufficient appropriations to fully fund U.S. bilateral HIPC debt relief to the Democratic Republic of the Congo. The U.S. also has an outstanding pledge of \$75 million to the HIPC Trust Fund, which is needed to support HIPC debt relief at the regional development banks. U.S. support for debt relief under MDRI is funded through our contributions to the IDA and African Development Fund replenishments. However, we have consistently received less than our full request for these replenishments. The result is that, in fiscal year 2008, we anticipate the U.S. government will have over \$870 million in arrears to the multilateral development banks, including \$385 million to IDA alone. In fact, our arrears request this year is specifically targeted at fulfilling our commitment to MDRI.

Targeting the Correct Priorities

When we meet with developing countries, debt relief appears to be far down the list of their priorities. Indeed many of these countries see strengthening the environment in which the private sector can flourish and drive economic growth as their primary development challenge. This means improving the business climate, meeting infrastructure needs, integrating into the global economy, and strengthening financial sectors.

To underscore what we at Treasury hear from our counterparts in many low-income countries, let me share with you a recent discussion that Secretary Paulson had with the finance ministers from six African countries. One minister noted that his president's top priority was increasing electricity generation. Another spoke eloquently about the costs that poor energy and transport infrastructure impose upon his country's ability to grow and create jobs. And all of the ministers and central bank governors asked Secretary Paulson to work with them to find additional ways to attract foreign investment to their countries. Secretary Paulson wants to find ways to shine a light on this core challenge in these countries. We believe that these issues, rather than debt relief, are the real priorities for spurring growth and poverty reduction in these countries.

Conclusion

Rather than embark on expanded debt relief, the United States should focus on three things. First, it should fulfill its commitments to current debt relief initiatives and meet our other multilateral commitments. Second, it should continue to provide direct development assistance to poor countries through bilateral and multilateral mechanisms aimed at increasing economic growth and reducing poverty. Finally, we need to find ways to work with countries to build their capacity to handle more open trade and investment.

Thank you for your consideration of these issues. I look forward to working with you further to support our current debt relief efforts and to develop the best possible policies in this area. I welcome your questions.