

**The Jubilee Act for Responsible Lending and Expanded Debt Cancellation of 2007  
(H.R. 2634)**

**Testimony for the House Financial Services Committee November 8, 2007**

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Mr. Chairman, Members of the Subcommittee,

I would like to thank the Financial Services Committee 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.

Role of USCCB

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, played an active role, along with many other US faith-based organizations, in the worldwide Jubilee 2000 campaign. Reps. Frank, Bachus, Waters, and former Rep. Jim Leach, among others provided strong bipartisan leadership 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.

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.

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.

Once the 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 Enhanced 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 Rep. 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.

#### 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 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 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 Reps. Smith, Payne and former Rep. LaFalce taking the lead role in the House, the Congress incorporated into the Global Health Act of 2002 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 22 countries have received MDRI debt cancellation, with another 18 countries potentially able to benefit from it.

A notable omission from the MDRI agreement was the substantial debt owed by five Latin American and Caribbean HIPC countries to the Inter-American Development Bank (IDB). This omission was rectified earlier this year when the IDB agreed to give MDRI treatment to its HIPC borrowers. Since all of these countries had reached their HIPC completion points, they received immediate debt cancellation. 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.

I believe other witnesses are going to discuss how much debt relief has been granted so far under the various debt relief programs and will also discuss how debt relief has contributed to poverty reduction in the HIPC countries. Therefore, I will not dwell on these matters, except to mention one specific case which I believe demonstrates in concrete fashion the very positive impact that debt relief can have, and is having, in poor countries.

### 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 ADB. 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 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 by the government. 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 timber 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 political opposition from some quarters, 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.

#### H.R. 2634'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 H.R.2634. 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 reduce 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 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. The 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.

When this exercise was conducted in 2005, it showed that 42 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.

One of the 18 non-HIPCs is Lesotho, a small land-locked African country. Upon learning of the MDRI debt cancellation agreement, Lesotho Finance Minister Timothy Thahane 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 debt cancellation provisions of H.R. 2634 would address the concern expressed by Minister Thahane and bring deep debt relief within the reach of virtually all the world's poorest countries. At the time of its introduction, Bishop Thomas Wenski, Chairman of the Committee on International Policy of the USCCB wrote to Reps. Waters and Bachus to express support for H.R. 2634. He said that despite important progress in debt reduction, "a substantial number of needy countries are not eligible for the existing debt relief initiatives. HR 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."

Some of us argued in 2005 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. Of course, this argument would have applied also to the original HIPC program where entry depended on having high levels of debt.

In any event, H.R. 2634 avoids this objection by limiting eligibility for debt cancellation to IDA-only countries. Almost all of these countries have per capita incomes below the historical standard for IDA eligibility, which is \$1065 in today's dollars. (IDA-only countries above this limit are primarily small island economies.) While this standard captures some countries with low levels of external debt, it includes only countries that have high levels of poverty and thus need to maximize the amount of resources they can marshal to promote human development and raise the living standards of their people. We believe that the IDA-only requirement is a reasonable standard for determining which countries should be eligible for debt cancellation.

#### What Will the Cost of the Debt Cancellation Be for the United States?

In response to requests, I have made a rough estimate of the amount of funds the U.S may need to commit through the next three IDA replenishment periods (FY 2008 through FY 2017) in order to finance the cost of H.R. 2634's debt cancellation. I am unable to provide a firmer estimate because much of the information required for an accurate estimate is not publicly available. For example, in calculating the cost of debt cancellation, the U.S. applies two factors

that reduce the cost below face value—net present value and a country risk discount. The 25% reduction I applied to the face value to reflect these two factors is only a very rough estimate.

Employing a number of assumptions—some of the main ones are discussed below—the cost to the U.S. of H.R. 2634 for IDA 15 (FY08-10) would be \$1.5 billion, for IDA 16 (FY11-13), \$3.5 billion and for IDA 17 (FY14-17), \$2.4 billion.

An important assumption is that IDA and the other international financial institutions (IFI's) would be replenished "dollar for dollar" for the foregone principal and interest payments of the debt cancelled. This is the principle adopted for the MDRI and would be in line with the requirement of "additionality" contained in Section 3 (a) (5) of H.R. 2634.

The bill requires that, to the extent possible, the financing of debt cancellation costs should be provided from internal resources of the IFI's, e.g., by transferring net income from the ordinary capital operations of the World Bank to IDA. The IMF is financing its costs under the MDRI from internal resources (although funding for a few potential beneficiaries has not yet been identified). The assumption for purposes of the H.R. 2634 cost estimate is that the IMF will finance its costs entirely from internal resources (e.g., through the revaluation of a portion of its substantial holdings of gold). Thus, the cost of the IMF's debt cancellation is not included in the cost estimate. In the case of the World Bank, it is not possible to determine in advance how much its shareholders would decide could be transferred to IDA, and as the other IFI's are not as strong financially as the Bank, the cost estimate assumes a worst-case scenario, i.e., that the costs of the IFI debt cancellation (other than the IMF) are financed entirely from donor contributions. The U.S. share of these contributions is assumed to be 20%.

The cost estimate may also be overstated in another sense. There are 24 countries potentially eligible to receive H.R. 2634 debt cancellation. Nine of them have relatively good financial management ratings, as judged by the World Bank's latest Country Policy and Institutional Assessment (CPIA), and I have assumed that they would be the first to qualify for the new debt cancellation. The nine countries are Cape Verde, Georgia, Kenya, Lesotho, Moldova, Mongolia, Samoa, Vietnam and Vanuatu. To facilitate a complex calculation, I have assumed that the nine would receive debt cancellation in 2008, an additional nine in 2011, and the six weakest performers in 2014.

There is likely to be slippage in the assumed schedule given the need to reach an international agreement on new debt cancellation, and the time needed thereafter for the IFI's to actually grant the relief. (H.R. 2634 does not preclude the IFI's from requiring the countries to go through the "decision point" and "completion point" process applicable to HIPC's, but it precludes the IFI's from imposing "harmful economic and policy conditions" as specified in Section 4.) A slippage in the schedule would have two effects: first, the overall cost would be reduced as the countries would in the meantime be making payments on their outstanding debt; and, second, the amount required to cover cancellation costs during 2008-2010 (IDA 15) might be sharply reduced. (See additional key assumptions in the attached note.)

Also, Vietnam, although a large IFI debtor, may decide not to take advantage of H.R.2634 debt cancellation. It may not want to send a signal to the international capital markets that it needs

debt cancellation from the IFI's. Without Vietnam, the cost estimate for FY08-10 would drop almost in half, to \$800 million, with smaller reductions in later years.

#### 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 not a panacea. Even if the debt of poor countries were 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 their resources are not sufficient for them to do it alone. They need aid and just policies from the wealthier countries.

Attachment to Testimony of Gerald F. Flood  
Note on Cost Estimates

The cost estimates assume a "cut-off point" of 2005. In other words, the cancellation will apply only to the outstanding amount of fully disbursed and disbursing loans as of the end of 2005. (The cut-off point for the MDRI is 2003.)

It is assumed that the losses to IDA will be reimbursed in essentially the same manner as under the HIPC program, i.e., IDA will be reimbursed each year for the amount of debt service that it will not be receiving during that year because of the cancellation. The amounts included in each three-year IDA replenishment represent the amounts committed (in the case of the U.S. "appropriated") by the donors to enable IDA to have assurances that the necessary funds will be available to cover these losses year-by-year. These commitments are made in three year bites but are paid into IDA ("encashed") over a nine-year period. In effect, IDA plans nine years ahead when it determines the size of IDA replenishment it needs. The MDRI, however, was an unplanned event, so replenishments up to that point included no funds for MDRI reimbursement. Thus, IDA 15 has to "catch up" by including all the funds necessary to cover the nine year planning horizon. By IDA 16 they would have caught up, so that IDA 16 (and subsequent replenishments) would only have to include funds necessary to cover an additional three-year period. It is assumed also that the reimbursements for the Asian and African Development Banks will be handled in the same manner as IDA.