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Mr. Chairman: The record of the IMF and the World Bank in Africa is far from perfect. However I want to speak today in favor of continued strong United States financial and other support for the activities of these two institutions in that region. The United States is the largest single shareholder in both these institutions, and has an impressive record of benign and constructive influence on their policies and practices. Continued U.S. support for their programs in Africa should be linked to a strong commitment from the other shareholder governments and from managements of the World Bank and the IMF to be highly *selective* in their own future lending. Selectivity means focussing their large lending programs only on countries clearly able to use new resources well. The two institutions should also be pushed to take leadership in encouraging the other large donors, including in Europe, to be more selective in new lending and grant-making to African governments. A focus on selectivity is all the more important if the benefits of the HIPC program of debt relief are to be fully realized.

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The development challenge in Africa – including reducing poverty and dealing with debt and the AIDS pandemic -- will only be met when and where African governments sustain the policies and institutions that attract the local private investment that creates jobs and drives growth. Over the last decade, the World Bank and the IMF have provided only about 10 percent of all the transfers (in the form of loans and grants) that the countries of sub-Saharan Africa have received. Most of the transfers have come from grants of the European Union and the governments of Western Europe. However, the two international institutions, because of their combined involvement across the full range of macroeconomic, infrastructure, social and other programs with governments, are looked to by the other official donors for analysis of governments' policy and institutional readiness to benefit from donor transfers. In particular, the development community looks to these two institutions on issues of economic management and financial accountability to signal when and which countries in Africa will benefit. Their work is key to our understanding of whether not only donor but local tax revenues and other resources are being used well in the fight for improved lives in Africa.

To complement the activities of the financial institutions, the U.S. as well as other donor governments should directly increase funding for global programs such as tropical agricultural research and the recently announced Global AIDS Fund. These global programs hold great promise for directly helping the poor in Africa improve their own lives, including in countries where conflict, corruption and weak institutions make effective implementation of many development programs impossible. They are critical complements to the lending and policy dialogue with African governments which are the principal business of the World Bank and the IMF and which they are so well placed to do.

In the rest of my remarks I first explain why despite well-known problems, there is good reason to expect development progress in at least some African countries. I then summarize briefly the evidence regarding the past effectiveness of World Bank and IMF support in Africa. I emphasize the need for selectivity across countries in lending by these institutions, i.e. the need to confine large lending programs to countries able to use the resources well. Finally I discuss the benefits of the current debt relief (HIPC) program, the problems with faster or deeper relief, and comment briefly on the AIDS/HIV issue.

<u>Development assistance can make a difference in Africa.</u>

Over the last 50 years, the foreign aid and development programs of the U.S., including through the multilateral institutions, have been a success story in many countries. Though there are still millions of people in the developing world living in poverty, the fact is that in Latin America, Asia and much of Africa, infant mortality has been reduced, primary school enrollment is much closer to universal, and knowledge of and access to health care, clean water, new agricultural and other technologies have dramatically improved people's daily lives. Where countries have opened their markets, encouraged private initiative, and established reasonably good economic management, household income has grown rapidly. Of course development programs have not worked

well where there has been conflict and corruption – but they have and do work in the right circumstances. Africa's problems with high debt and with the HIV/AIDS pandemic should not obscure the general point that development progress is possible.

Despite its problems, there is a sound logic for continuing efforts to assist Africa get onto a sustained development path. Many countries in the region have taken firm steps in the last decade in the direction of sensible economic management. Governments have established greater fiscal discipline, opened their markets, and reduced the role of the state through privatization of mining, banking and agricultural marketing boards. This first round of reforms has not been without its own shortcomings and problems of implementation, and has not produced the kind of healthy growth Africa needs to reduce poverty. (In South Africa good economic management has not in itself been sufficient to ensure aggressive handling of the AIDS problem, though in other countries, such as Uganda and Senegal, it has certainly helped). However, the fact is that due to the first round of reforms, growth did rise in reforming countries in the early 1990s. It has slowed in the last few years primarily due to the intensifying problems of conflict (in and around Angola, Sierra Leone and Liberia, Sudan and the Horn, and the Congo – all affecting many neighboring countries in loss of trade and investment opportunities) and the continuing deterioration in the prices of most of Africa's export commodities except oil. (New transfers to Africa's non-oil exporters in the last three decades are only slightly greater in value terms than the losses associated with the large declines in the terms of trade for those countries' exports.)

In the medium term, achieving more growth and reducing poverty faster requires a second round of reforms. These reforms include establishing and enforcing clear property rights, improving tax administration, developing incorruptible judicial systems and contract enforcement, and institutionalizing adequate public services, especially in health, education and transportation for the largely poor rural populations. But the first steps have been taken in many countries and are a sound start. Without them and the macroeconomic stability and predictable economic management they bring, future growth would be even less likely.

<u>Lending should be even more focussed on countries that are performing well.</u>

Much past development assistance has not been well spent, especially in Africa. The build-up of official debt (i.e. debt owed to donor governments and to the international institutions) of countries in Africa is sad testament to the problem. New projects and new lending went on in some countries for years despite poor results. However, our understanding of what makes for effective aid to poor countries has improved, and in the last decade the World Bank and the IMF have shown increasing willingness and ability, in their own lending programs, to exploit that improved understanding. That trend has to be reinforced and strengthened.

It is now amply documented that large infusions of development assistance only work, i.e. only help generate healthy growth and poverty reduction, when economic policies are sensible and public institutions function reasonably well in the recipient

countries. This is equivalent to saying that financial assistance only works when reasonably good government is already in place. (In fact many reforming countries, including Uganda, Ghana, and Viet Nam, received relatively little aid in the early years of their reforms). The assumption that World Bank and IMF loans could induce recalcitrant or incompetent governments to institute and sustain economic reforms has proven wrong. Indeed recent evidence suggests that when governments are not prepared themselves to undertake reforms, lending and donor-financed grants simply finance inaction and delay of necessary reforms – as shown by experience in Kenya and Zambia.

On the other hand, once reasonably competent government is in place, lending and other foreign assistance – for roads, schools, improved judicial and banking systems -- can make a huge difference in helping governments finance the programs that directly improve peoples' opportunities and well-being, and reinforce the political support they need to sustain sound economic management. Uganda, despite recent problems during its presidential election, is an example. In the last several years, the World Bank has supported major reform and new investments in its education system. Bank-sponsored household and community surveys showed that less than one-third of non-salary government spending was reaching the classroom. The government switched to a system of direct transfers to schools (with the amounts posted for the public at school entrances), eliminated school fees, and with financial support from the Bank increased substantially public spending on primary schooling. Bank support was tied to the improvements in the budgeting process. Primary school enrollment has doubled.

On the whole the evidence is that the World Bank, through its International Development Agency (IDA) concessional window lending, and the IMF have been reasonably selective in lending to countries in Africa, i.e. they have tended to do more lending (net of debt service, as a percent of country GNP) to countries with better policies and institutional capacity and higher levels of poverty. Over the last decade, they have been more responsive to changes in the countries' policy environment than the bilateral government donors (who until the 1990s were often driven by political considerations and by historical colonial ties). The effort to be selective intensified in the 1990s with the institution of a system in the World Bank of scoring countries in terms of their capability, and tying the proposed lending program to those scores. The record for the IMF and for other donors in general is less good in the case of those African countries that accumulated high levels of debt to the World Bank and the IMF. Those countries got continued inflows of donor money independent of their policies and management, an issue I return to below.

However even in the context of relatively good behavior, especially by the multilateral creditors, it is clear there is room for greater discipline in halting lending when countries' performance or policy environment deteriorates, such as today appears to be the case in Zimbabwe, the Central African Republic, and possibly Cote d'Ivoire, and more room for increasing support, especially for medium-term programs in education and infrastructure, to countries that have established a good record over several years, the case now in Uganda, Senegal and probably Mozambique. In the past mistakes were made in both directions. In the mid-1990s countries with mixed records of reform such

as Cote d'Ivoire and Zambia were getting the highest levels of aid per capita (from all donors), at twice the levels received by Uganda and Ghana with their good records over the prior decade. In the latter two countries, transfers were tapering off in the mid-1990s though their capacity to manage more programs was probably increasing.

The United States can take a clear position on the selectivity issue, both in the context of the follow-up to the HIPC debt relief program and during the discussions of the next IDA replenishment. The U.S. can press for improvement in the country performance rating system, for making the methods and the ratings more transparent and available, at the least to the research community, and for more public disclosure and monitoring of the use of the performance-based system. In addition, the United States could press for more explicit incorporation into the performance criteria of governments' efforts to meet the needs of the poor in such areas as health and education, as reflected in their public expenditures; and of governments' performance in reducing the corruption that erodes economic and democratic institutions, as reflected in financial management and commitment to the rule of law.

The HIPC program of debt relief: more now is no panacea

Of the 33 countries in sub-Saharan Africa eligible for the HIPC program of debt relief, 19 have reached the initial decision point. The debate about debt relief has focussed largely on the timing and size of the program, with proponents of more debt relief arguing that faster and greater relief would free up resources for countries to spend more on social and other poverty reducing programs. Unfortunately the facts do not square with that idea. The HIPC-eligible countries in Africa have received in the last two decades annual inflows from donors consistently greater than the debt service they were paying out. They were not, in effect, "taxed" but on the contrary were "rewarded" for the debt they were accumulating. Higher levels of debt and debt service led to higher inflows of new resources. Indeed recent studies indicate that once countries in Africa had accumulated a level of debt to the IMF and the World Bank exceeding about 50 percent of their GNP, the donors as a group abandoned any pretense to selectivity and simply made transfers, largely in grant form, sufficient to ensure those countries would not fall into arrears with the multilateral creditors. (Arrears to the multilaterals are particularly feared because they lead to loss of trade credits and sudden cut-off from all other borrowing.) In that sense, the donors as a group as well as the debtor countries had fallen into what might be called a high multilateral debt trap.

For that reason, it is difficult to argue that the "burden" of debt service in the countries with high debt and high multilateral debt has been in itself the fundamental cause of insufficient public spending on health and education. The fundamental cause has been the poverty and lack of growth that led to the debt accumulation in the first place. Nor is it clear that simply eliminating all the debt would in itself guarantee higher spending on these social programs or in itself deliver more growth and poverty reduction.

In the last decade there were repeated rounds of partial debt relief. But since the donors as a group were financing the debt service of the debtor countries, debt relief often

led to no net increase in transfers. Donors, from relatively fixed aid budgets, financed the costs of debt relief by reducing new transfers. To use a crude example, a country like Malawi was receiving about $20 per person per year for donor-managed health, schooling, road and other projects in the 1990s, and paying back about $10 per person per year in debt service. In the past, debt serviced reduction programs that reduced Malawi's debt service to $5 per year would also lead to a reduction in the value of new donor projects to, say, $16 per year, for at best a small net gain in annual net donor inflows from $10 ($20 minus $10) to $11 ($16 minus $5) per person per year.

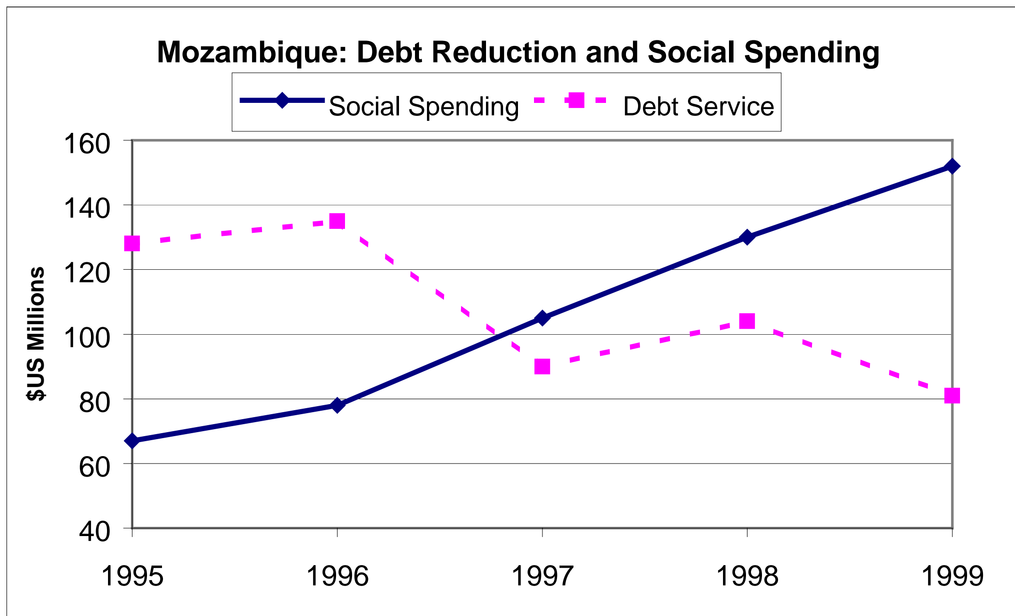
The benefits of the HIPC program as currently designed will thus come not in the widely expected form of "relief" from burdensome debt service liberating governments to spend more on their people. The benefits instead will come in one or both of two other forms.

- One is if the larger and more visible HIPC program of debt relief leads to *additional* net transfers from donors (so that in the example above a country like Malawi ends up after debt relief still receiving close to $20 in new inflows per person per year, while paying in debt service $5 instead of $10), at least for countries that are performing well.

In the short run this seems possible, with some additional commitments from donors (the U.S. appropriation of some $400 million last year is an example), especially if limited donor funds are better focussed on those countries best able to use them. This sort of country *selectivity* would ensure better use of aid and should encourage higher total commitments of aid in the future, especially from the United States (which spends much less given the size of its economy than the European donors). In fact a poorly understood benefit of the HIPC program is that it helps the donors escape the multilateral debt trap described above, in effect liberating them to reintroduce selectivity in their lending and grant-making.

- The second benefit will come because the countries' economic policymakers and political leadership will have returned to them the management of their own resources.

Instead of receiving from literally dozens of different donors dozens of different forms of in-kind resources, often tied (to use of Italian consultants, or textbooks printed in the U.S., or construction materials from the European Union), countries will be able to take greater charge of their own destiny. In the above example it is worth noting that a country receiving $20 of in-kind assistance still had to generate $10 in tax revenue to finance its debt service. With more of its assistance in the form of debt relief instead of hundreds of discrete projects, it can make its own spending more predictable and manageable, using a lower proportion of its own revenues for debt service and a higher proportion of aid for own-managed programs. The graph illustrates the relationship between reduced debt service and higher social spending, including financed by new aid, in Mozambique.



Source: World Bank; Mozambique authorities and staff estimates. Data on debt service reflect actual debt service for 1995-1999.

Because of their broad knowledge of the economies and the sectoral issues and public expenditure patterns within every country, the IMF and the World Bank are particularly well placed to provide leadership in signaling when and which countries in the region are in a position to use new donor resources effectively. This requires of course that they become not only more selective, but more transparent in their choices.

In short, I would now put more emphasis on post-HIPC country selectivity as a key to making aid effective, rather than on a complete write-off of the debt of all countries. In some countries, deeper debt relief might well help somewhat more, and is morally compelling if the debt was taken on by prior kleptocratic or military governments. But donors, including the two multilaterals, can anyway "reward" countries that are burdened by bad histories and are now managing well in the form of new transfers. This can be done better than in the past, through broad budget support for social and other medium-term development programs (rather than uncoordinated in-kind projects tied to donor-specific procurement). A complete debt write-off would constitute the worst form of moral hazard, seeming to punish countries that had accumulated less debt, and reducing the repayments to the IMF and the World Bank, which are important sources of future lending. Ironically the main beneficiaries would be the World Bank and the IMF, whose balance sheets would be cleansed and accountability for past errors made less visible, at the cost of future transfers to worthy country recipients.

New U.S. appropriations for the HIV/AIDS global fund should be much larger.

I hope others on this panel will speak directly to the logic of much more generosity by the United States in this area. A global fund can accelerate the time when a

vaccine or other control methods such as microbicides can bring prevention. A global initiative can bring the kind of international cooperation that would reduce the fears of pharmaceutical firms of parallel imports of generic drugs undermining their patent rights in rich country markets. That would encourage competitive differential pricing and open the door for use of generics in poor country markets without undermining the property rights of firms in rich country markets. Brazil's example shows that rising to the terrible challenge of caring for people with AIDS can catalyze broader and deeper initiatives to reform public health care systems. The World Bank can play an important role within countries, in supporting the infrastructure, training and service delivery needed. At the same time, much can be done to relieve the terrible human costs of the epidemic in Africa short of the kinds of structural economic reforms and sustained competence in economic management discussed above. The United States should be prepared to provide much greater financial and moral leadership than its initial commitment to the global fund signals.

The 1998 global financial crisis was a healthy reminder that we live in an increasingly interdependent world. Development assistance is in the interests not only of the millions of people in the developing world, but of all Americans. As I am sure the members of this committee know, polls show that Americans favor higher levels of such assistance than the United States now spends. That reflects not only their generosity but their intuition that development assistance is a critical input to a future world that is less divided in material terms and thus a more stable and safe global neighborhood for our children and grandchildren.

The IMF and the World Bank are central to the promotion of growth and stability across the globe, and to the reduction of poverty. In recent years, they have promised greater emphasis on poverty, the environment, and support for anti-corruption measures; reduction of their own administrative overhead (in the case of the World Bank); and greater openness and accountability. The United States has played the key role in promoting and monitoring these changes, and must continue to do so.

Sources

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