AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

DEBT AND DEVELOPMENT: HOW TO PROVIDE EFFICIENT, EFFECTIVE ASSISTANCE TO THE WORLD'S POOREST COUNTRIES

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE AND TECHNOLOGY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

June 8, 2005

Printed for the use of the Committee on Financial Services

Serial No. 109–35

U.S. GOVERNMENT PRINTING OFFICE

25–875 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
RICHARD H. BAKER, Louisiana
DEBORAH PRYCE, Ohio
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
SUE W. KELLY, New York, *Vice Chair*
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
JIM RYUN, Kansas
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
CHRISTOPHER SHAYS, Connecticut
VITO FOSSELLA, New York
GARY G. MILLER, California
PATRICK J. TIBERI, Ohio
MARK R. KENNEDY, Minnesota
TOM FEENEY, Florida
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
GINNY BROWN-WAITE, Florida
J. GRESHAM BARRETT, South Carolina
KATHERINE HARRIS, Florida
RICK RENZI, Arizona
JIM GERLACH, Pennsylvania
STEVAN PEARCE, New Mexico
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
MICHAEL G. FITZPATRICK, Pennsylvania
GEOFF DAVIS, Kentucky
PATRICK T. MCHENRY, North Carolina

BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
BARBARA LEE, California
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
JOSEPH CROWLEY, New York
WM. LACY CLAY, Missouri
STEVE ISRAEL, New York
CAROLYN MCCARTHY, New York
JOE BACA, California
JIM MATHESON, Utah
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
ARTUR DAVIS, Alabama
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
DEBBIE WASSERMAN SCHULTZ, Florida
GWEN MOORE, Wisconsin,

BERNARD SANDERS, Vermont

Robert U. Foster, III, *Staff Director*

SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE AND TECHNOLOGY

DEBORAH PRYCE, Ohio, *Chair*

JUDY BIGGERT, Illinois, *Vice Chair*
JAMES A. LEACH, Iowa
MICHAEL N. CASTLE, Delaware
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
MARK R. KENNEDY, Minnesota
KATHERINE HARRIS, Florida
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. MCHENRY, North Carolina
MICHAEL G. OXLEY, Ohio

CAROLYN B. MALONEY, New York
BERNARD SANDERS, Vermont
MELVIN L. WATT, North Carolina
MAXINE WATERS, California
BARBARA LEE, California
PAUL E. KANJORSKI, Pennsylvania
BRAD SHERMAN, California
LUIS V. GUTIERREZ, Illinois
MELISSA L. BEAN, Illinois
DEBBIE WASSERMAN SCHULTZ, Florida
GWEN MOORE, Wisconsin
JOSEPH CROWLEY, New York
BARNEY FRANK, Massachusetts

CONTENTS

	Page
Hearing held on:	
June 8, 2005	1
Appendix:	
June 8, 2005	29

WITNESSES

WEDNESDAY, JUNE 08, 2005

Birdsall, Nancy, President, Center for Global Development	7
Kapoor, Sony, Senior Policy Advisor, Jubilee USA Network	9
McNamar, Tim , Member, Bretton Woods Committee	12

APPENDIX

Prepared statements:	
Pryce, Hon. Deborah	30
Biggert, Hon. Judy	32
Maloney, Hon. Carolyn B.	34
Waters Hon. Maxine	39
Birdsall, Nancy	41
Kapoor, Sony	54
McNamar, Tim	82

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Biggert, Hon. Judy:	
Additional questions for the record for Dr.Nancy Birdsall	99
Frank, Hon. Barney:	
″The Price Of Gold″, *New York Times*, June 3, 2005	100
Moore, Hon. Gwen:	
″Crumbs for Africa″, *New York Times*, June 8, 2005	101
Birdsall, Nancy:	
Written response to questions from Hon. Judy Biggert	102
Kapoor, Sony:	
Written response to question from Hon. Barney Frank	103
Written response to question from Hon. Carolyn B. Maloney	104
″Debt Relief and Financing The MDGs,″ *Communique on the 11th Meeting of HIPC Finance Ministers*, March 16, 2005	108
McNamar, Tim:	
Bretton Woods Committee Recommedations to New World Bank Management, June 1, 2005	112
″Wolfwitz and Oil: Facts and Opportunity,″ position paper	119

DEBT AND DEVELOPMENT: HOW TO PROVIDE EFFICIENT, EFFECTIVE ASSISTANCE TO THE WORLD'S POOREST COUNTRIES

Wednesday, June 8, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE, AND TECHNOLOGY
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:25 p.m., in Room 2128, Rayburn House Office Building, Hon. Judy Biggert [vice chair of the subcommittee] presiding.

Present: Representatives Biggert, Kennedy, Neugebauer, Price, Maloney, Waters, Sherman, Wasserman Schultz, Moore, and Frank.

Mrs. BIGGERT . [Presiding.] The Subcommittee on Domestic and International Monetary Policy will come to order.

Without objection, all members' opening statements will be made part of the record.

Good afternoon. It is my pleasure to welcome you today to today's hearing on ″Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries.″

We are here today to receive testimony from three witnesses regarding current thinking on how our international financial institutions can provide more effective relief to impoverished nations.

I will begin with my opening statement.

You may have noticed that I am not Chairman Deborah Pryce. I am Vice Chairman Judy Biggert. Chairman Pryce will have an opening statement for the record. She very much regrets that she has to miss this hearing today. She asked me to share with you her commitment to finding innovative ways to eliminate debt for countries that are showing reform.

Today is not the first time that this committee has focused on debt and development issues. I am sure that it will not be the last. The issues are broad-ranging and global and elicit the interests of many persons and parties, including in my congressional district just outside of Chicago.

In April of last year, I chaired a hearing of the subcommittee to receive a report issued by the General Accounting Office concerning the projected cost of the enhanced highly indebted poor country, HIPC, program. This report produced staggering, yet somewhat questionable numbers. It became clear from that report and from the testimony we received at the hearing that simply providing bil-

lions of dollars in aid and debt relief to developing countries is not enough. Money alone is not the answer. It clearly has not worked in the past.

We must find ways to provide more effective and efficient assistance to developing countries, and we must find ways to support developing countries' efforts to one day graduate from dependency on development assistance.

The Bush administration is taking quite a bold step in this area. It has called on the international community to provide up to 100 percent of debt relief for highly indebted poor countries and to provide more performance-based grants to them. In return, those countries would be asked to increase transparency in their decision-making, promote private sector development, and take other key steps toward self-sufficiency.

We meet this afternoon amidst a spirited global discussion about new strategies to help aid the poorest countries of the world. Our colleagues on the Joint Economic Committee have just released a new study on this topic and President Bush continues his discussions today with U.K. Prime Minister Tony Blair on this and other issues. The Group of Eight summit in July includes as a major item on the agenda debt and development issues.

As we move forward, it is clear that there is no one-size-fits-all solution to alleviating the debt burden of all poor countries in the world. Each poverty-stricken country is faced with unique economic and social challenges. Under the current system, countries must continue to undergo rigorous processes to qualify for debt forgiveness or no-or low-interest loans, technical assistance and other forms of aid.

Many believe this process should be improved. It is unfortunate when a country cannot qualify for aid due to its Government's unwillingness to set policies that will help to provide them with greater economic and social certainty. It is even more unfortunate for their citizens who are poor, uneducated, or dying of disease or malnutrition.

Regardless of which approach is ultimately taken, we must continue to work with our international partners to encourage HIPC countries to implement anticorruption measures, legal systems, and other important reforms. If the U.S. and her international partners provide debt relief to countries that are without sound Governments, infrastructure or legal systems, it is the equivalent of putting water in a sieve. It will not carry and it leaks through.

At the same time, we do not want to withhold funding if a country is on the road to reform. We need to find ways to strike this delicate balance. I understand that making these kinds of reforms is not easy, but these reforms are not luxuries. Encouraging impoverished countries to form democratic societies and free-market economies can have material human benefits as they alleviate the exposure to disease and poverty that too often accompany corruption and mismanagement. These reforms also can undermine the opportunity for terrorism-based ideologies to take hold in poor countries where it can be so easy to find a scapegoat.

I look forward to hearing from our witnesses on new proposals to finance debt relief and update the delivery of development assistance. We will hear from a range of views on the way to fund

debt relief. We will also hear a range of views on how funds can be mobilized to promote economic development. I look forward to hearing from our witnesses about their proposals to facilitate responsible and sustainable debt relief and development in impoverished countries.

With that, I will recognize the ranking member of the whole committee, my friend and colleague, Mr. Frank from Massachusetts, for an opening statement.

[The prepared statement of Hon. Judy Biggert can be found on page 32 in the appendix.]

Mr. FRANK . Thank you, Madam Chair.

I am very proud of the work that this committee is doing and has been doing on an issue that is as important for humanity as any I can think of. We talk a lot about faith, about religious values, about humanitarian values that come from secular purposes. They all come together here.

Members of this committee, the gentleman from Iowa, Mr. Leach, the gentleman from Alabama, Mr. Bachus, the gentlewoman from California, Ms. Waters, and myself took the lead with a lot of other members supporting us a few years ago when the House in a rare moment of independence wrote debt relief beyond what was being contemplated by the Administration at the time.

I think those of us who pushed for that have been vindicated by the good results that we have seen. I appreciate the spirit of cooperation that we have since had with regard to going forward on that. At the time, it was a situation where religious and secular believers in alleviating human suffering came together. It was the jubilee year that the Pope proclaimed. That was very helpful to us in getting votes.

There were people who have particular concern for those in Africa, because as we look at this question of worldwide poverty and the crushing debt, Africa is not the only place, but it is the single greatest locus of this problem, so I am pleased that we have been moving along.

I want to now also express my appreciation to the Bush administration. We have been told that we will soon be hearing about an agreement that is going to be announced between the President and Prime Minister Blair. And without trying to preempt it or get into the details, from what I have heard, this is a very big step forward in accepting the principle of 100 percent debt relief for the poorest countries, the highly indebted poor countries, and an issue that we had raised frequently here, one of the things that has made this agreement possible. Because in addition to the debt relief it will also mean that future aid will come in the form of grants and not loans. It does not make sense to give people debt relief and then the next day start indebting them again. You just start over that cycle.

There has been a strong argument for grants. Some of us were concerned that the problem was that the future funding that was being given had been coming from debt repayments, not the best source of revenue in the world, but still something. I congratulate the Administration for apparently agreeing that we will make up any shortfall in the future that would come from the fact that we are making grants and not loans. That is, there will not be the re-

flow of loans. We are going to, as I understand it, commit ourselves to supply any shortfall there.

So that was an important breakthrough in getting this agreement, the willingness of this Administration to agree that if necessary there will be more money coming. So I am very pleased to see this moving forward. There will be some accounting issues on how this is noted. We have already voted on some of the budget.

Let me say, I think we start from a reality which is if I were really dependent on any of this money being really paid back, I think I would be in big trouble. So to the extent that we are engaging in some accounting gestures, moves to account for the fact that we are not getting the money back, nobody is really getting hurt. We are acknowledging the reality that it is not likely that this money would be paid back, nor is it desirable that it be paid back. Accounting for that in an appropriate way is fine.

I have always felt, frankly, that we overvalued some of that debt. That is, I think if you tried to sell some of this debt on the market, it would not pay for your transaction costs, so recognizing that reality is reasonable. So I am very pleased with the administration's forthcoming approach with regard to the World Bank debt.

I will note that we are also apparently seeing some progress in conceptual terms on IMF debt. If you are a country that owes money, it really does not make any difference to you whether you owe it to the World Bank or the IMF if it is money that is not available to you. I am pleased to see that there is apparently an agreement in principle, in concept, to do a similar thing for the poor countries with the IMF.

There is still a question of how to pay for it. I continue to believe that an orderly managed sale of gold that the IMF has, for which the IMF has no great need, is the best way to do this. In the IMF, unlike us, it is in the business of making gold coins. I wish we were not in the business either because I think it causes us more grief for less return than anything else this committee does, but we are stuck with it. But the IMF is not. So I think they could monetize some of their excess gold in an orderly way.

In fact, I would ask, Madam Chair, to put into the record a New York Times editorial from June 3 calling for us to do that.

Mrs. BIGGERT . Without objection.

Mr. FRANK . We are not there yet. I hope we will get there, but I do not want to cavil. The fact is that we have a good agreement, I understand, on the World Bank debt being totally cancelled. Remember that we already cancelled the bilateral debt, so it is not a case of asking others to do what we will not do ourselves. We have now cancelled one of the two pots of, or are about to, multilateral debt.

The other pot also ought to be cancelled. I think that could be done with managed gold sales. Once again, gold sales were a part of the last effort. They worked well. They can continue to work. So this is a day I think for people to express, I hope, appreciation for the progress that has been made. All those other issues are still on the table.

Let me just close by saying I agree that money alone does not solve a problem, but what is also clear to me is that the absence of money exacerbates the problem. Forgiving the debt, I agree, is

not sufficient to solve the problems of poverty in Africa, but it certainly is necessary. If we do not begin by doing that, along with other measures, we will not get anywhere.

So I think today is a day on which I want to congratulate the Administration and urge that we take what I think is just the one last step of putting the IMF gold in. If they can come up with another way to do it, I will be willing to look at it, but I do think we now have a recognition that cancellation of the debt, and I ask a 30-second indulgence, let's be very clear.

The moral argument for canceling the debt, the debt would have to be repaid by very poor people who got very little benefit when it was incurred. There is no point in cracking down on debt collection when it comes from the people who were not the beneficiaries of the indebtedness. That is why we are not talking about an individual who borrowed money and forgiving that individual. We are talking about poor people who have been victimized, and debt cancellation is a way of recognizing that.

Thank you, Madam Chair.

Mrs. BIGGERT . The ranking member of the subcommittee, Mrs. Maloney, is recognized for an opening statement.

Mr. MALONEY. In the recognition of time, I will put my opening statement in the record, but I thank you and the ranking member and certainly welcome all of our guests.

I just want to mention that I was original sponsor of the Jubilee Act which would achieve debt relief for 50 nations. I hope to continue working towards that with all of you. The list of countries needing relief is not limited to the poorest countries. When we introduced the legislation to forgive the Iraqi debt, it was certainly an example of what the ranking member mentioned about the poor people who did not benefit from it would have to pay back the odious debt from an oppressive regime that put them in debt to buy palaces—I think there are 60 palaces they built—and to buy arms.

So I certainly hope that we can apply the same realization to achieve debt relief for South Africa, Haiti, and the Philippines. I truly believe the proposal that was put forward yesterday by the U.S., the U.K., and Canada is a very serious effort on all sides to achieve real debt relief for the most impoverished nations and give them a chance to move forward. I hope we have the political will and commitment to achieve the promise of this moment.

I understand that Mr. Kapoor is going to outline the proposal, but in brief it adopts the U.S. policy of 100 percent debt forgiveness for the current HIPC countries, but incorporates the British principle that the concessional facility, the International Development Association, or IDA, be replenished. As I understand it, the U.S. has now made a significant commitment to replenish the IDA in the amount needed to cover the reduction in re-flows to the IDA that will result from debt relief.

Secretary Snow indicated before the committee that Treasury would do so when we asked him in his last appearance, so I am delighted to learn that the Administration has made good on that promise. These developments are truly new and exciting, and I look forward to hearing the testimony and to seeing the results of the G-8 meeting in Scotland that is coming up in July.

So I place the rest of my comments in the record and look forward to the comments. Thank you.

[The prepared statement of Hon. Carolyn B. Maloney can be found on page 34 in the appendix.]

Mrs. BIGGERT . Without objection, all members' opening statements will be made part of the record.

With that, we will move to our panel of expert witnesses.

First of all, we have Dr. Nancy Birdsall, who is president of the Center for Global Development. She is the founding president, and prior to launching that center, she served for 3 years as senior associate and director of the Economic Reform Project at the Carnegie Endowment for International Peace, where her work focused on issues of globalization and equality, as well as on the reform of international financial institutions. Prior to that, she was executive vice president of the Inter-American Development Bank, and prior to that she was with the World Bank. So she brings a wealth of experience.

I would yield to the ranking member of the committee for an introduction of Mr. Kapoor.

Mr. MALONEY. I am really delighted to introduce Sony Kapoor, the senior policy adviser to Jubilee USA Network. I would like to thank him for coming all the way from London to offer his views and expertise to us today. We have worked with him, many of us on this committee, for a long time, both on my bill to forgive Iraqi debt and on the Jubilee Act with Representative Waters. I thank them for bringing Mr. Kapoor here today.

Sony Kapoor works on issues relating to international finance, development, and governance, both with nongovernmental organizations and various Governments. As the senior policy adviser to Jubilee USA Network, Christian Aid U.K., and the International Tax Justice Network, which advocates regulation of tax havens, he has testified on several occasions before the British Parliament and other international groups.

For the past 2 years, Mr. Kapoor has played a leading role in the international policy and advocacy effort around multilateral debt cancellation and other development issues. He has written extensively on debt and development financing. He is a member of the New Rules for Global Finance Coalition and has also written extensively on financial stability and taxation. He has a background in the financial services industry, having worked both as a banker and a derivatives trader.

He has a master's degree in international finance from the London School of Economics and an MBA in finance. He also holds an engineering degree from the Indian Institute of Technology.

We welcome you and thank you and Jubilee for all the work that you have done to help poor nations and to relieve debt around the world. We thank you.

Mrs. BIGGERT . Thank you.

Our next witness is R. Tim McNamar, who is a senior adviser to PricewaterhouseCoopers on advanced information technology for accounting. He also served in the Reagan administration as deputy secretary of the treasury. Since then, he has founded two Internet startups and served in senior management positions in a number of leading U.S. financial institutions.

Welcome.

With that, we will start with Dr. Birdsall.

Without objection, all of your written statements will be made part of the record. You will be each recognized for a 5-minute summary of your testimony. After that, each Member of Congress will have 5 minutes to ask questions of you all.

With that, Dr. Birdsall, you are recognized for 5 minutes.

STATEMENT OF DR. NANCY BIRDSALL, PRESIDENT, CENTER FOR GLOBAL DEVELOPMENT

Mr. BIRDSALL. Thank you very much, Vice Chairman Biggert, Ranking Member of the full committee Frank, Ranking Member Maloney, and other members of the subcommittee. I am very pleased to have this opportunity to speak with you today.

What I would like to do is talk about some broad issues of development policy into which the debt issues that many of you have raised come. I would like to emphasize a few points, and I will try to do that as I proceed.

As the vice chairman's introductory statement indicated, this is a big year on development, and it is a huge opportunity for the U.S. to reassert its leadership on development issues, both with Blair's visit, of course the G-8 summit, the appointment of Paul Wolfowitz to the World Bank, the U.N. Millennium Summit in September, and the Hong Kong ministerial meeting as part of the Doha Development Round in December.

So this is the moment for the U.S. There are some short-term issues that are arising obviously, some are reflected already in the statements, right now in Washington. In addition, there is an opportunity for this committee to work with Treasury and in particular with management at the World Bank to really set the tone for the next 4 or 5 years at least on what should be the direction of U.S. policy with respect to development.

I would like to raise five specific issues in the short time I have. The first has to do with aid effectiveness and aid accountability. On this score, what would be great to see is a commitment from the U.S., already indicated in the remarks of Mr. Frank, for increased levels of U.S. aid money to go through multilateral channels. That would make U.S. aid much more predictable, which is important for recipient countries who are trying to make investments, for example, in education that do not make sense if they cannot foresee some continuing flows in the future to finance teacher salaries and books and so on. The same would go for health.

In particular, more emphasis on pooling of Millennium Challenge Account funds with other donor funds to relieve the burden on developing countries who are trying to manage many, many sources of resources. And I would say a big push from this committee through the Treasury that at the World Bank and among other donors there be a new emphasis on creating an approach to having independent evaluation of the impact of development programs in order to justify and make more credible increases in the future in the budgeting for those programs.

The second issue I would raise very quickly is debt relief, which has been mentioned. It is very exciting to see the prospect of a compromise between the Europeans and the U.S. I would like to make

two quick points. One is that we estimate very crudely that that compromise in terms of what additional funds would be required to replenish IDA, to make up for the lost re-flows, is very small. Well, nothing is really small, but $200 million a year, which is a tiny proportion of our current foreign aid spending.

With respect to gold, I would like to indicate that at the Center for Global Development, including in my own work, we have indicated the logic of the orderly gold sales, which were mentioned already. I think that there is still room for a breakthrough there because of the strong support for debt relief in the Congress.

I would also mention very quickly, it is not raised in my written testimony, that we hope in the future when and if Nigeria, as it continues to demonstrate through its Government, its efforts on reforms, that there be an openness to joining in some debt relief for that country. It could be the anchor for security in all of West Africa.

A third issue to raise is something we call ″making markets″ for vaccines. The U.S. could take leadership at the G-8 summit in setting up, or at least agreeing that there should be set up and perhaps firmed up a year from now, what can be called an advanced market for the guaranteed purchase of malaria and AIDS vaccines.

This would create incentives for private R&D on the part of our pharmaceutical firms to finally address this critical problem. It is a way to spend money on aid effectively without worrying about absorption capacity in particular countries and potentially to save millions of lives, including of course in Africa.

The fourth issue is trade and market access. I have a colleague at the Center who has estimated that 500 million people could be lifted out of poverty were there liberalization of trade regimes around the world. In particular, the developing countries could benefit by up to $100 billion a year just from liberalization in the rich countries.

What we would like to see is the Congress engage in strengthening the African Growth and Opportunity Act, including by extending its duration, and we would like to see the leadership of the U.S. in the WTO base system on a program to help countries that are losing their preferences, seeing erosion of their trade preferences, cope with that problem through some kind of transitional assistance.

Finally, on the issue of U.S. leadership at the World Bank, where I am sure my colleague Mr. McNamar will have more to say, I would like to make two critical points where it is important for the Congress to provide encouragement, again through Treasury, to Mr. Wolfowitz. One is that he take the lead at the World Bank in creating some sort of a consortium of donors and possibly of developing country governments to address the problem of our lack of serious evaluation of the impact of programs. We are proposing that some sort of a club be set up that the members would pay modest dues, and that they would then sponsor selective impact evaluations. This could be done through contracts to third parties to ensure they were independent.

And second, that Mr. Wolfowitz take early steps to begin a process of creating a setting at the World Bank where the developing countries can be much better represented. A particular example

that would be appropriate in the short run, given the emphasis that Tony Blair and our European colleagues have been putting on Africa, would be that the U.S. agree to a proposal that for the time being two chairs be added at the World Bank to represent with two additional members the 48 African countries. That would be a modest step. It could be set up as an interim step.

I would like to say a final word with respect to the G-8, that the compromise on debt that looks like it is coming is very exciting. We think, however, that at the same time the U.S. should be the leader on the vaccine initiative. Such an initiative would be fully consistent with America's values, based on creating incentives for the private market to act, and consistent with America's strengths. It would be a tremendous innovation. I think in a decade we would look back on it as a major contribution that we had made to saving lives all throughout the poorest countries of the world.

Thank you very much, Madam Vice Chair.

[The prepared statement of Dr. Nancy Birdsall can be found on page 41 in the appendix.]

Mrs. BIGGERT . Thank you very much.

Now, Mr. Kapoor, you are recognized for 5 minutes.

STATEMENT OF SONY KAPOOR, SENIOR POLICY ADVISER, JUBILEE USA NETWORK

Mr. KAPOOR. Members of the committee, thank you so much for the opportunity to appear before the committee and testify about debt and development issues. I will try and be brief.

The situation for many developing countries is very grave. Each year, more than 6 million children die from malnutrition before their 5th birthday. We cannot keep ignoring this. The HIV-AIDS pandemic kills more than 2 million people every year and adds to the leagues of millions of orphans in Africa, creating long-term social and economic problems.

It is both in the interests of the United States as a compassionate Nation, as well as in the interests of the U.S. having strong economic partners to take the issues of development more seriously and act immediately.

Debt cancellation and development can bring resources and hope where there is none and also foster economic growth. Former Secretary of State Colin Powell has argued that development is a core national security issue and that the U.S. cannot win the war on terror unless we confront the social and political roots of poverty. So this highlights the importance, as previous speakers have done, of this particular issue.

My opinions have been formed on the basis of two strong experiences in my life. One is having grown up in India and being surrounded by poverty. The second is having worked in the financial services industry. To summarize two completely dichotomous fields of experience, what I try and do in my work is to try and bring together solutions that are acceptable to all sides, developing countries to the private sector, as well as to Governments in the rich countries. That is what I will try and highlight.

This is, as Nancy said, a very unique opportunity where there is an unprecedented attention on the issues of development. The U.S. is in a unique position to assume its natural leadership role, espe-

cially by advancing the bold agenda on debt cancellation and some of the other issues that Nancy highlighted.

There are three main issues in financing development today. One is how to enable developing countries to maximize domestic resources. The second is what mechanisms and sources of external funds exist that can be used to support these domestic resources. And the third is how can these domestic resources best be kept in the country, something I call ″plugging the leaks.″

Overseas development aid, foreign direct investment and portfolio flows all fall in the first category. I have addressed them in my revised written testimony. Plugging the leaks is also something I have addressed in my written testimony. I shall try and concentrate on debt. I have also in my written testimony addressed the issue of trade liberalization, the issue of restructuring the international financial institutions and other systemic issues.

Fifty-thousand children die every day because of preventable poverty, and that is from hunger and lack of clean water and diseases which would be prevented if the money to treat them existed. This has been proven to be effective in the past. Many children have been vaccinated; many more have gotten access to clean water and past debt relief initiators have made a real tangible difference in these countries.

In 2003, Senegal and Malawi each spent about one-third of their Government revenue on debt service. These are just some of the African countries which spend more on debt than on health expenditure. This happens when life expectancy in countries such as Zambia, Mozambique, and Malawi is just about 37 years, which is less than half of what it is in the civilized world.

It is pointless and debilitating that the churning of resources, money going in as new aid, comes out almost immediately as debt servicing. This is part of the reason why there is a reluctance on the part of rich countries to put more money in because this money is seen to be coming out immediately as debt service. This is a problem which we need to address very seriously and immediately.

Debt cancellation is a very effective and efficient way of transferring resources to developing countries, not just for this reason, but also because of several reasons such as it provides direct budgetary support, reduced administrative costs. It is durable and predictable. It engenders a deeper sense of country ownership, which is extremely important for the development of long-term democratic institutions.

A high level of debt discourages private investment, which is very critical to the idea of U.S. foreign policy. Debt cancellation is also anti-inflationary and helps keep domestic interest rates low. There has been some skepticism expressed about how and why the money of debt cancellation that is released by debt cancellation be utilized. Past experience has been good on this front. Countries that received the very limited debt relief that was available under the Heavily Indebted Poor Country Program have doubled poverty reduction expenditures from 1999 to 2004 and saw no net increase in military spending.

After Mozambique was granted debt relief, it was able to offer all children free vaccinations. In Uganda, debt relief led directly to 2.2 million more people getting access to clean water. These are just

some of many, many real examples and tangible impacts on the lives of millions of people.

The issue of multilateral debt is particularly important, as it constitutes a growing and more pernicious part of debt. The reason it is more pernicious is because multilateral debt is almost always serviced because multilateral institutions are considered to be preferred creditors. Bilateral debt, a large proportion of it, was in arrears which was not being repaid. Hence, despite the fact that it existed on books, it was not actually diverting resources away from countries.

This has been, in part, the failure of the HIPC initiative, where a large proportion of the debt that has been cancelled has actually been debt that was worthless in any case, which has just been a paper transaction and, hence, has not resulted in new resources flowing to these countries. Multilateral debt, for every dollar cancelled, results in a dollar of additional resource to the country that it is cancelled for. That is why it is so important.

Various discussions over the past months have now been narrowed down to two major groups. One is the so-called U.S.-U.K. compromise, and the second is the new particularly dangerous proposal which has come out from Japan, France, and Germany, which is still in an informal format. The reason I call it dangerous is that despite this momentum which has been built up over 5 years, with the number of countries with the need for 100 percent cancellation, this new joint initiative which is still in its infancy actually will deliver debt cancellation only to about five countries.

It is very, very limited in its scope. It is extremely limited in the way it does it. And it treats countries on a case-by-case basis and deals with the debt sustainability framework, which actually the United States to its credit was pushing for grants, not loans, for all poor countries and has not been accepted by the Bank and Fund.

The U.S. and the U.K. proposal is extremely encouraging. It looks to cancel 100 percent of IDA and African Development Fund debt stock, which is the critical point because the U.K.'s original proposal was only looking at debt service through 2015. So this expands that. We really commend that.

The country list, unfortunately, still stays narrow. The country list from the beginning of the proposals being discussed last year has been steadily narrowed, and it is now likely that the actual list of countries within the HIPC initiative that will receive that cancellation is going to be somewhere between 18 and 33, which is not enough. The HIPC group of countries, they are extremely needy. They really need these resources, which will save lives.

However, they have already got more than their share of debt cancellation. They have attracted more than a fair share of overseas development aid, and other countries which were arbitrarily left off the initial heavily indebted poor country scheme will be at a further loss. This is not a fair proposition. These countries need debt cancellation as much as the HIPC countries do. We strongly request the members of the committee to agree with us on this issue and try and influence the U.S. Treasury to expend the country list.

In discussion, it is also reported that the Administration is calling for an inclusion of IMF debt, which is a very positive development because in the past few months, we had been extremely scared that the International Monetary Fund debt was left off the agenda. That is an unacceptable situation because IMF debt accounts for a significant proportion, up to 25 to 30 percent of the debt service that these poor countries will pay over the next 10 years leading up to the international development goals, the Millennium Development Goals in 2015. So it is extremely important that IMF debt be addressed.

The second reason is that IMF debt actually is less concessional and is more expensive than IDA debt. So for these two reasons and others, the IMF portion of the debt needs to be considered.

The current idea seems to be that the United States favors the use of sources of funds within the IMF, including the PRGF, the Poverty Reduction and Growth Facility, and the corpus, the principal from the gold transaction back in 1999, to cancel this debt. The U.K. Government favors the gold sales idea. We are hoping that a compromise can be struck.

Mrs. BIGGERT . Mr. Kapoor, if you could sum up and we will get to the questions.

Mr. KAPOOR. Thirty seconds?

Mrs. BIGGERT . Yes.

Mr. KAPOOR. Excellent.

There have been several misunderstandings of what we have proposed about dealing with the issue of IMF gold. I am very happy to answer those questions and clear those misunderstandings. I am also happy to answer all questions about other things that I have not addressed.

In summary, there are four more issues in tackling the problem of development. What we need to do is we need to free up more policy space for countries. This could help them have domestically owned and flexible policies which are conducive to the local circumstances. We cannot push for a one-size-fits-all approach because countries are extremely different in their local circumstances, educational infrastructure, raw commodities, and basic country development.

We are also very aware of the issue of the debate about increased aid without increasing aid effectiveness. I think that is something that Nancy will speak more about.

And last of all, we reiterate the importance of stopping the leakage of billions of dollars from these countries in the form of dirty money flows, capital flight, and debt servicing.

Thank you very much.

[The prepared statement of Sony Kapoor can be found on page 54 in the appendix.]

Mrs. BIGGERT . Thank you.

Mr. McNamar, you are recognized for 5 minutes.

STATEMENT OF TIM MCNAMAR, MEMBER, BRETTON WOODS COMMITTEE

Mr. MCNAMAR. Thank you, Madam Chairwoman and Ranking Member Maloney. I am privileged to testify—and I do regard it as a privilege, make no mistake—before your committee today.

I was actually thinking, having been gone 25 years, how proud my father, who is long deceased, would be of me. My family has not done this before. We are not very good at this, but we love our country. I am here as a great unequivocal supporter of the World Bank. I am going to say some critical things, make no mistake, and I would hope you would take that as, if you will, tough love, because I believe in the World Bank.

I am privileged to have testified with Barney Frank and Jim Leach before. I do not think they excoriated me, but I cannot remember. Maybe the scars have healed over. I am not sure. But you have a very complex and difficult task before you. I would like to tell you I have the answers. I do not. I know a few of the questions and maybe a couple of the answers, but that is about it. This is hard stuff, but it is stuff that, if I may say so, America has to step up to because there is no one else. It is our responsibility to the world, make no mistake. We have to do this.

Democrats and Republicans can disagree on how to do it. We cannot disagree on our responsibility. There is no second choice. There is no other choice. Just as we fought the Cold War, we have to work on this.

Let me make a couple of points at the outset. I am here speaking for myself and as a representative of the Bretton Woods Committee, which as I am sure many or all of you know, is a bipartisan group that supports the Bretton Woods institutions. It is composed only of Americans only because we can come here in Congress and testify without registering as a foreign agent as you would have to. But we believe in this.

And I have been here for a couple of years now and wrote a book on Enron. I learned about something called XBRL, which I will tell you in a minute, which is extensible business reporting language, which is the kind of thing that will put you to sleep except it is revolutionary.

How many people in this room understood when Netscape came out it was revolutionary? This is revolutionary. I did not invent it. My firm does not own it. Actually, we lose money on it. Okay? Just to be very clear. But the world will be better because of it and it is imperative that the developing world and the multilateral development banks push it. I am going to say something in a minute. It turns out that the Inter-American Development Bank is at the forefront of recognizing this. They deserve credit. My view, correct or incorrect, is that the World Bank needs to catch up.

But I do want to talk about technology because that is in the title of the committee and that is what you are concerned about. I am going to say something a little provocative. I will say a whole bunch of things. I do not believe that the international finance facility proposed by Gordon Brown is quite correct. I do not think it is good enough. But I recommend the British and I commend Gordon for having tried.

Does it look too much like what I saw in 1985? Yes. The fact of the matter is that he is trying and he put something out there and I commend him for doing that. We need to keep getting these things coming as opposed to saying, oh no, the U.S. is opposed to it. That is not the answer. The U.S. is not necessarily opposed.

I want to talk about change technology and development. I remember as a child getting under the desk to protect myself from an atomic bomb attack. It did not come in Oklahoma because they did not have aerial refueling. The Germans did not have the bomb. The world has changed since then. I kissed my parents good-night from Ann Arbor during the Cuban missile crisis because I was not going to wake up the next morning and they were not either. The world has changed.

I do not think we grasp that enough. Ideas, trends, thoughts about the World Bank and IDA have shifted with time, perhaps not enough. I think the United States's support for the World Bank in fact has been quite good. I would offer you a thought. Probably you have read this. It is called a Guide to the World Bank, published by the World Bank. I actually read the whole thing last week in preparation for this testimony. I was embarrassed.

How many of you have read this book? I hope everybody is going to raise their hand. If you do not, I commend it to you.

Mr. FRANK . We have no idea what that book is.

Mr. MCNAMAR. I am sorry. Thank you. This is ″The World is Flat: A Brief History of the 20th Century″ by Thomas Friedman of the New York Times, the number-one bestseller for the last 8 weeks or 10 weeks.

Mr. FRANK . We have been in session for the last 8 weeks.

[Laughter.]

Mr. MCNAMAR. One of these books is out of date. Unfortunately, the committee has the responsibility to figure that out. I do not, but you do. And you have to figure out what are the things you would like to urge the U.S. Treasury to urge the World Bank or the Inter-American Development Bank or the IMF to do. And I urge you to read both books.

You will be appalled at the one, and you will be frightened by the other. I did not say ″enlightened.″ I said ″frightened.″ And do you know what? You have to figure out what you are going to do and what your second choice is, because my view is you do not have a second choice. The United States does not have a second choice. You have to support the World Bank and IDA unequivocally.

Does that mean they cannot change? Absolutely not. They need a lot of changes. I look at how the African Development Bank suffers. I look at the Millennium Challenge Corporation's effort. That is an experiment, no bones about it. But you know what? It may be directionally correct or the right answer. I do not know. You, unfortunately, have the responsibility that I do not have to decide that.

I will give you an example. I had lunch yesterday at the Inter-American Development Bank. We have been chatting with them about this EBRL thing, which is basically the XML with some improvements. This is the web-based language that businesses use. Okay? And they have figured it out, grasped, grabbed on to, and believe that if their countries in Latin America that do not do this, there is something called a development gap, that is, the left-behind.

They are going to take a role, and I do not know exactly what it will be, but they are going to take a role to trying to make this

happen because if they do not, their countries are not going to progress like they should, have the per capita income increase, the improvements in living standards and healthcare and all the other good things that go with that. That is development.

Your responsibility, which I am so glad I do not have, is to make sure that our multilateral development banks do that. It turns out that there is one in the world, the Inter-American Development Bank, that is ahead of the curve. I commend them. This is forward thinking. This is getting the fact that this book is history. It is not even good history. And this book is the future. And they want to improve their peoples' lives, their constituents, their countries' lives.

We have a new paradigm for development. We have two choices. We can say, oh, that is not true, and reject it because the World Bank is doing in 2005 what it did in 1955. Or they can do something different. Do I think that technology and call centers in Kenya are going to solve all the world's problems? No. That is foolish. Do I think it is a component of development that if I dare say so, this is probably arrogant, but a lot of people call me arrogant so we will take that.

Mrs. BIGGERT . Could you sum up your testimony?

Mr. MCNAMAR. Yes. I am arrogant and the committee has not heard it before, and that ought to be a concern.

[The prepared statement of Tim McNamar can be found on page 82 in the appendix.]

Mrs. BIGGERT . Thank you.

We will now turn to the questions.

Mr. MCNAMAR. Madam Chairman?

Mrs. BIGGERT . Yes?

Mr. MCNAMAR. May I ask that my oral testimony be submitted, only because there are a couple of attachments that I think the committee might find useful?

Mrs. BIGGERT . Your written testimony?

Mr. MCNAMAR. Oral.

Mrs. BIGGERT . Oral. It will be in the record, without objection.

Mr. MCNAMAR. Thank you.

Mrs. BIGGERT . I will now yield myself 5 minutes for questions.

Dr. Birdsall and Mr. Kapoor, is it your testimony that you support 100 percent debt relief for HIPC countries?

Mr. BIRDSALL. Yes. My testimony is that we support 100 percent debt relief for HIPC countries who have met certain standards of eligibility.

Mrs. BIGGERT . Okay.

And Mr. Kapoor?

Mr. KAPOOR. It is my testimony that we support 100 percent debt cancellation not just for HIPC countries, but for all impoverished countries that need resources and are having to repay debt at the cost of human lives.

Mrs. BIGGERT . Okay. Then is it your testimony that you support ending the cycle of lend-and-forgive so that poor countries are not receiving loans to service existing and increasing debt?

Mr. KAPOOR. Absolutely not. We are strongly in favor of getting out of the lend-and-forgive cycle. We have been extremely strongly supportive of the U.S. initiative to give grants only and not loans

to especially the poorest countries. We believe that 100 percent debt cancellation is a way of wiping the slate clean. One-hundred percent debt cancellation wiping the slate clean and a combination shift to grants not loans is the only way we can get out of the lend-and-forgive cycle. That is what we support.

Mrs. BIGGERT . Okay.

Dr. Birdsall?

Mr. BIRDSALL. Yes. And I would like exactly the same. It does not make sense really to make loans to countries where in the future we expect to have to make more loans so that they can repay the initial loans. But in particular, what I would recommend is that the Congress work with Treasury to encourage the World Bank to establish a kind of second window inside IDA with some clarity on which countries are eligible for grants.

Certainly, all those that get 100 percent debt relief should have grants going forward, but what would be simple and straightforward is to establish an income per capita level below which countries should get grants until they move beyond that income per capita level. This would be absolutely no different from the existing distinction between poor countries who are eligible for IDA and the middle-income countries that are eligible for the IBRD window at the World Bank.

Mrs. BIGGERT . So then is it your testimony that IBRD reserves could be mobilized to support the debt relief?

Mr. BIRDSALL. I am not prepared to suggest that, but I think that the debt relief should be supported by contributions, new contributions to the IDA for those poor countries and to the African Development Bank, and by sale of limited managed sale of IMF gold.

The problem with attacking, in a sense, the reserves of the IBRD is not about the financing. In the medium term, that might make sense. My concern about that and our concern at the Center for Global Development is that the middle-income countries would end up financing in part indirectly those costs. That is not such a bad thing in principle. It might be very sensible to have some of those countries be indirect donors.

However, it should come under an umbrella in which they have more representation, more voice in making those decisions. It will create more complications for overall understanding and bringing in China, India, Brazil, Mexico, bringing them to the table if they feel that the G-8, the United States and its G-8 partners, and a set of other rich countries decide in their wisdom that the way to finance more debt relief for the poorest countries is in effect to impose a somewhat higher price on the middle-income countries because if those reserves are used indirectly it will increase their cost of borrowing from the World Bank.

Mrs. BIGGERT . How about you, Mr. Kapoor? Would you support using those reserves to support that relief?

Mr. KAPOOR. May I issue a point of clarification? Which is that I think the debate about the source of money is misrepresented. It goes into nuances which are not necessarily true. The reason behind that is that eventually when the IMF and the World Bank are wound up, as someday they will be, they are continuing institutions, but one hopes and one thinks that the world will not need

them at some point of time. The money that they have in reserves and otherwise will then go back to the creditor countries in the proportion of their shares now.

So the distinction between new resources from creditors, as well as existing resources from IFIs, currently is there, but it is not exactly black and white. It is shades of gray. Having said that, I think that it is entirely possible to in part finance IDA from IBRD reserves. I think Nancy does have a point. It might lead to a small increase in the cost of loans to middle-income countries.

I have in my written paper clarified that that increase would be very small and insignificant, so that is entirely possible. However, in terms of the hierarchy of funds, and again for the reasons that Nancy highlighted about middle-income countries not having a fair representation, it is perhaps not the most appropriate port of call of reserves to use. So there are other avenues that should be tapped.

However, if there is residual demand for more funds and it comes at the cost of some poor countries not getting that cancellation, then we yes very strongly favor the use of at least some of those reserves. In the past, IBRD has already cumulatively transferred $7 billion through annual income transfers to IDA, so it does have a precedent. Thank you.

Mrs. BIGGERT . Okay. So then it would appear that you support the basics that President Bush has been talking about for funding the World Bank debt relief?

Mr. KAPOOR. I would like to make a distinction here between what President Bush was saying before and what has been said yesterday. We strongly endorse what has been said yesterday, which is the additional new money which will come from the country donors to account for any loss in the lending capacity and the grant-giving capacity of IDA. What has been said before was slightly different, which was that the money that is used for cancellation would actually not be reimbursed by the United States.

So between these two options, we strongly reinforce what has been said yesterday, but the previous idea, we are not very comfortable with.

Mrs. BIGGERT . All right. So to be clear, then, that would be that they would not receive the same amount of money after the debt relief that they receive now.

Mr. KAPOOR. Yes, that was the previous proposal, but that has been addressed in the suggestion that was put forward yesterday. There was never a clear, explicit suggestion of the transfer of money from IBRD to IDA in any of the U.S. proposals that I have seen. So it was discussed, but never formally.

Mrs. BIGGERT . Okay. Thank you. My time has exceeded.

Mrs. Maloney is recognized for 5 minutes.

Mr. MALONEY. I thank all of the members for their testimony. In fact, I did read The World is Flat, literally last week, and it does present a wake-up call. I would be interested in your comments on how we should change our policies to address the new changes in the world.

I would like to begin by asking Mr. Kapoor, Jubilee was very active in introducing the Jubilee Act in 2004. Can you compare the

mechanism that that act uses to pay for debt cancellation with other proposals? In what ways is it different?

In your testimony, you also expressed your grief really that in many cases aid money, all new aid money, is used just for debt service. I would like to know, and if you do not have that, if you could give it in writing to the committee, how many countries are in that category, and if there are a lot of countries that are not already in the HIPC area.

I would also like you to address another one of your statements. You said there was tremendous ambiguity. It seemed like an arbitrary decision on how countries were selected for HIPC and that many needy ones were left off. So I would like to ask you what criteria should we use to respond, if you agree with the recommendation that Nancy put forward on per capita income.

And just all of the comments, anybody who would like to respond to the provocative questions of Mr. McNamar on how we change our new policies in the international community, given that the world has become flat.

Okay. Thank you all for your testimony.

Mr. Kapoor?

Mr. KAPOOR. Thank you very much for the questions. Please remind me if I forget to address any of those. I am a little jet-lagged.

The last question first in terms of the criteria that was used for HIPC. It is clearly known that the criteria used was politically based. It was also based on the limited resource envelope that the countries which were at the negotiating table thought they had available, and, hence, large countries, especially the example of Nigeria comes to mind, was left off simply because it was considered to be too big a case. There were not enough resources available.

The criteria used was arbitrary. There had been a lot of analysis on that. A late report from UNDP highlights clearly why the criteria was arbitrary. It had to do with debt servicing to exports ratios. If you look at most of the numbers that the Fund and the Bank use in defining such criteria, they are always very round numbers which highlights the lack of rigor behind them. So most of these numbers are like 150 percent or 200 percent or 100 percent. Amazingly, they always add up to multiples of 50 percent. So that is something about that.

The second question, I believe, was around the leakage of resources of aid money coming out as debt servicing. There are several countries, especially many of the poorer middle-income countries, the example of the Philippines come to mind, wherein the debt servicing paid is far in excess of the new aid flows that go in. As to the specific numbers, I am happy to submit the answer as a written testimony.

Mr. MALONEY. But what criteria would you suggest we use if the other was arbitrary? What criteria would you suggest we use?

Mr. KAPOOR. We have done some work in collaboration with a number of other civil society organizations. We have developed what we call the human development approach to debt sustainability. The idea behind that is as long as any country has resources that fall short of trying to meet the Millennium Development Goals, goals that many OECD countries, all OECD countries including the United States have signed up to, as long as the re-

sources available fall short of sustaining the basic needs of its citizens such as health and education, no debt should be serviced. That is the criteria we would like to use.

Based on that criteria, the number of countries which qualify, and this relates with Nancy's criteria of having a purely low per capita income basis. In fact, if you look at the country list that comes out from both these criteria, there is a very large degree of overlap. We very strongly feel that creditor rights are important, but they should not come at the cost of human lives, and that is the basic criteria we want the Bank and the Fund to go forward with.

Mr. MALONEY. Do you see a possibility, and I know the aid going into many of these countries in South America and all over the place, Africa and Asia, it is not just Government money. It is from private investments also. Would you have the same criteria with the private investments, too, that their debt service not be carried if the human suffering is too great?

Mr. KAPOOR. There have been interesting suggestions around the treatment of sovereign debt. One came up from the Fund. There has been another suggestion called the Fair and Transparent Arbitration Process put forward by the Civil Society. The idea is that enough resources should be provided by the international community, including the United States, to help meet these basic needs so that the need to borrow at exorbitant rates does not arise and the problem of the debt forgiveness cycle again is not repeated.

So as long as there are enough resources available in these countries to meet the basic human needs of their citizens, they should not be borrowing, especially at exorbitant rates in the international markets. However, there are cases where in a number of cases it is either desperation which has forced them to borrow or there are a number of cases, as you also pointed out, of odious debt where odious regimes, including that of Iraq and before that the Democratic Republic of Congo and Nigeria, have borrowed for nefarious purposes.

There should be, we very strongly feel, some sort of lending guidelines in place the first of January, 2006 going forward which ensures that private as well as public lending to odious regimes used to suppress populations and used for nefarious purposes and military expenditures should not be enforceable in the court of law. So regimes or lending to such regimes should be declared odious ab initio so that the problem does not arise and citizens do not have to pay for money that they never benefited from.

Mr. MALONEY. My time is up. Thank you for your leadership on helping so many countries. Thank you.

Mrs. BIGGERT . The gentleman from Massachusetts, the ranking member, is recognized.

Mr. FRANK . Thank you, Madam Chair.

Let me ask first about the IMF and gold your reservations, Ms. Birdsall, about the potential effect of reserves being used. I have to say, I am obviously not in the business of lending money to the Bank and the IMF, but my own sense is that the security of that investment has more to do with the inherent advantages and the international backing than the actual amount of reserves. I think

that there is a very clear commitment on the part of the donor countries not to let them go bust.

Leaving that aside, does trying to get some of the monetary value out of the IMF gold, would that have any similar problems?

Mr. BIRDSALL. No, it actually does not because—it is sort of a complicated financial system.

Mr. FRANK . We are the Financial Services Committee. We are supposed to pretend we can understand all of it, so it is okay.

[Laughter.]

Mr. BIRDSALL. Right. My apologies. You are the ones who would understand. The IMF books its gold at an old price that reflects the price that it paid or the market value when it acquired the gold. So it is booked at about $45 billion, but it is actually worth closer to 10 times that amount. So when it sells the gold, it is actually releasing resources and generating cash, which is much greater than the current book value.

So it could sell gold and actually enhance its ability in the future.

Mr. FRANK . So you are in favor of using the gold to pay for IMF debt relief?

Mr. BIRDSALL. Absolutely. I think that that holds the IMF accountable for what turned out to be expensive loans to countries.

Mr. FRANK . I agree. I gather we are getting to the point of agreeing on IMF debt relief, because there is certainly no logical reason to not also do that, and there has been the question of how you pay for it.

Mr. BIRDSALL. I think if I could say that I think there is a legitimate concern on the part of gold-producing countries and gold-producing States about sales from an official institution not creating price volatility.

Mr. FRANK . I understand. But I think those people know how to put a cartel to work. The principles of a cartel could be employed to not have any impact on the price. They know how to do that.

Mr. BIRDSALL. Yes, well, whatever. I am not sure whether I want to agree with any use of those words. But I think the point is that the price of gold is currently quite high, that there is an arrangement that has been proposed by the technical staff at the IMF under which IMF gold could be sold under the rubric of a current agreement among central banks.

Mr. FRANK . I understand the World Gold Council has indicated that it could be done right in a way that they could support.

Mr. BIRDSALL. I think here what we need is some leadership from the administration and from both parties in Congress to make a kind of deal that would ensure that this could move forward.

Mr. FRANK . Okay. I appreciate that.

Mr. Kapoor, you look like you want to address that.

Mr. KAPOOR. First may I just correct something that Nancy said, which is the amount of gold which would be the amount of money that would be raised would be $45 billion. Its current value is closer to about $8 billion. I think you said $45 billion and 10 times 45. So we do not have $450 billion in gold. I wish we did, but we do not.

I would just like to add to your first question that the IMF acknowledges that the sale of gold would actually result in a small

increase in the Fund's liquidity and that it need not erode the Fund.

Mr. FRANK . All right. That was obvious. So none of the reservations, whatever they were about the use of reserves, are there.

Mr. KAPOOR. Right.

Mr. FRANK . My next question has to do with, and I do think we are making some progress, the Poverty Reduction and Growth Fund at the IMF, which to my mind is a lot better than the structural adjustment program which preceded it, and which I think we helped get rid of. That was one of the conditions that I think this committee helped put into the previous set of agreements.

What should we do with the Poverty Reduction and Growth Fund? There have been a variety of proposals with regards to the IMF. Should the IMF stay in that business? Should it go to the World Bank? If the function goes to the World Bank, should resources go with it? I would be interested, all of you, in what recommendations you would make about that.

Mr. BIRDSALL. Maybe I could start. This is not something in my current testimony.

Mr. FRANK . I know. That is why I asked you.

Mr. BIRDSALL. I do believe that the PRGB facility, all its assets and all its liabilities, should be transferred to the World Bank.

Mr. FRANK . So you would transfer the function and the assets and liabilities.

Mr. BIRDSALL. I would transfer not the functions that are the core functions of the IMF.

Mr. FRANK . No, the PRGF. We are not talking about the core functions of the IMF.

Mr. BIRDSALL. And when the IMF would then do a program in a very poor country, it would do all the normal arrangements, with one exception, so that that very poor country does not need to borrow from the relatively high-cost IMF. It would do an IMF program with a loan subsidized from the resources at the PRGF. This would have the tremendous advantage of making the World Bank clearly accountable for the long-run structural issues. The IMF, sticking to its core issues—

Mr. FRANK . And getting them to work together, which I would appreciate.

Mr. BIRDSALL. —and getting them to work together. Exactly. And that would also subsume a little bit the distinction now which says macro first, micro second.

Mr. FRANK . Let me ask Mr. Kapoor and Mr. McNamar to comment on this. My time is up. Go ahead.

Mr. KAPOOR. I agree that the PRGF should be wound up and the resources, not the function, should be transferred to the Bank. One possible suggestion for the use of that money could be setting up a compensatory finance facility for commodity price crashes.

Mr. FRANK . A what facility?

Mr. KAPOOR. A compensatory commodity facility to compensate for sharp falls in commodity prices, which is one of the serious problems.

Mr. FRANK . Administered at the Bank?

Mr. KAPOOR. At the Bank, administered at the Bank, or it could go into the general IDA pool. So the current functions of the PRGF need to stop.

The second point, I would just like to go back to the previous question, if I have a second.

Mr. FRANK . Not for very long because we only have 5 minutes. Mr. Kapoor, I know you are jet-lagged, but 5 minutes is still 5 minutes.

Mr. KAPOOR. Okay.

Mr. FRANK . Mr. McNamar?

Mr. MCNAMAR. I looked at this question of gold sales and revaluing gold sales. I am trying to figure out how the world would be better off after we do the right thing, whatever that is. I do not know.

Mr. FRANK . Okay.

Mr. MCNAMAR. Gold is great for jewelry.

Mr. FRANK . Mr. Kapoor and Mr. McNamar, again.

Mr. BIRDSALL. Could I intervene here?

Mr. FRANK . Then Mr. Kapoor, let me go back to you again on gold for 30 seconds.

Mr. KAPOOR. This is the President of Ghana, one of the largest exporters of gold in terms of relative proportion of exports, making a statement yesterday. ″As an exporter of gold, Ghana is confident that the properly managed sale of gold will not negatively impact the gold price. Instead, it will enable countries such as ours to redouble efforts to pursue pro-growth, pro-jobs development to the benefit of our people.″ And today we have statements from the President of Tanzania, another major gold-producing HIPC country.

Mr. FRANK . I want you to submit those for the record.

Mr. MCNAMAR. May I ask how that helps poverty in Africa?

Mr. KAPOOR. It puts resources there.

Mr. FRANK . Mr. McNamar, you do not talk to each other. I do not mean to be rude, but we have only a limited amount of time. Afterwards, you have all day to talk to each other. But the answer to your question is that we are talking about it specifically to finance debt reduction at the IMF. That is how it would be helpful, debt cancellation.

Dr. Birdsall, your last statement?

Mr. BIRDSALL. This Administration and this Congress want debt relief. This is one way to help finance that debt relief. The cost is basically that some of the richest countries' central bankers will sleep slightly less well at night because there will be slightly less gold not being used that they could use in the event of a global financial crisis.

Mr. FRANK . Thank you.

Thank you, Madam Chair.

Mrs. BIGGERT . Thank you.

The gentlewoman from Florida is recognized for 5 minutes.

Ms. WASSERMAN SCHULTZ. Thank you.

My question is to Mr. Kapoor. I would really like you to share your thoughts about the effects of the overwhelming debt of these nations on their political stability.

Given the Administration's interest in burgeoning democratic governments, and you touched on it a little bit in your testimony, but what that would mean in terms of global security, given our concern with terrorism, how that potentially could breed the next generation of terrorists without us dealing with it.

Mr. KAPOOR. For starters, the current situation as it works is that even countries which are getting significant aid flows are servicing a lot of the debt. So what happens is that the accountability that these countries' governments have is to the external donor agencies, not the people, because the tax revenues that are raised from the people go to service debt, and instead they get compensated by new aid flows. So the accountability, instead of being to the people, likes more with external aid groups.

So canceling debt would first and foremost encourage accountability to local parliaments and the local population, the way it happened in the United States where the Federal Government is responsible on about how it spends the taxes that it raises from the population. It is responsible to the Congress. It is answerable to the Congress. It is scrutinized by the Congress. It is scrutinized by the people. So that is one thing in terms of long-term institutional change. It would encourage a more active participation, a more active stake from the people.

The second is that the poverty and the desperation and the fact that we now live in a world where images of great prosperity are being beamed across the continents. When I was visiting some slums in India, people who had absolutely no access to any of the things that we take for granted, they still saw the same images of extreme prosperity and, in fact, opulence that we see on our television screens. The more inequality there is, the more injustice that is felt in the countries, the more incentive there is for people to be angry. And when one is angry, irrational things happen, as we have seen.

The next point there is that in the cases of countries, for example such as South Africa and the Philippines and Indonesia and Nigeria, where past lending has been odious and questionable primarily because of Cold War dynamics, wherein for example the regime in the Democratic Republic of Congo was given the largest loan ever given to an African country by the Fund on the insistence of OECD countries just the year after the Fund's representatives said that there is no hope of any money ever being repaid, and the money, which was about $1 billion, went straight into the account of Mobutu, who was the dictator. It never reached the people of Congo.

The more these injustices add up, again, the more anger there is. And one way of redressing this would be to wipe the slate clean and come up with a practice wherein no more lending goes to support dictators. No more lending goes to prop up regimes which are oppressing their own people, and any money that goes in, goes towards development effort.

Ms. WASSERMAN SCHULTZ. Shouldn't there be a little bit more accountability in terms of following the money once it is lent? With the money that has gone to dictators and non-democratic governments that have mostly benefited leaders of nations instead of the

people of those nations, what reforms do you think Mr. Wolfowitz should make when it comes to future lending decisions?

Mr. KAPOOR. I have made a suggestion earlier, which is the adoption or discussion of future lending practices, because currently even as we speak, civil society organizations have been campaigning for addressing the issue of historical odious or illegitimate dictators. But even in those 5 years that this campaign has gone on, new lending has happened to regimes which are run by dictators which are being supported for other political objectives, similar to what happened in the Cold War except the political objectives are different.

So what one needs to do under the leadership of Mr. Wolfowitz is, given his credentials as a champion of freedom and democracy, to then have clear guidelines in place that the Bank and the Fund will not lend to regimes which are not acceptable, which violate human rights, to get this approved and to get broad approval on this issue from international creditors, so that we will not experience these problems in the future as we did in the past, so that people will not be suppressed with the money that we give to Governments ostensibly for development purposes. So that is one way forward.

As to the question of historical debt, there are loads of skeletons in the cupboard of all these OECD countries. As to whether a realistic political compromise can be reached is questionable, which is why an easy solution which circumvents all this problem of digging the dirt out would be to cancel debt and then move on with a cleaner regime.

Mrs. BIGGERT . The gentlelady yields back.

The gentlelady from Wisconsin, Ms. Moore, is recognized for 5 minutes.

Mr. MOORE. Thank you, Madam Chairperson.

A really distinguished panel, thank you for coming.

I guess my first question is I would like to address it to Ms. Birdsall. It is really related to comments that you have made in your written testimony that may be a little bit off the beaten track and also sort of dovetails with the question that Mr. Frank talked about earlier.

We are talking about debt relief here, and there seems to be a consensus, I think you agree, that debt cancellation is just not enough to really relinquish this unsustainable debt that some of these countries have. And so aid, really we are looking at what Tony Blair has been doing with trying to get the European Union together to come up with this millennial program. It is embarrassing how little the United States has contributed to that. I refer, Madam Chair, and would like to enter into the record an article from today's New York Times, Crumbs for Africa.

Mrs. BIGGERT . Without objection.

Mr. MOORE. It really talks about how only one-quarter of 1 percent of money in foreign assistance goes to Africa from the United States. So even if we were to provide debt relief and again we would not be this lend-borrow-lend-borrow cycle, places like Africa would be in a tremendous amount of trouble.

So I guess my question to you first of all would be really to affirm that that is the case and to really describe what other sorts

of programs besides debt relief that you would want to encourage us to look at. I thought I heard you say that canceling debt service was also an important element of debt relief. Did I hear you correctly?

Mr. BIRDSALL. The proposals that I support include a write-down at 100 percent of the debt owed by the poorest countries to the multilateral creditors. Most of those countries have already had their bilateral debt largely forgiven. So once all of that existing debt is written down, they would not really have the same problem of debt service going forward. That would mean that as long as the current level of aid flows continued, they would be much better off. So first, yes, write off the debt of these poorest countries.

Second, it is absolutely the case that the U.S. gives less for foreign aid overall than virtually all of our allies, with the possible exception of Japan. You take a dime out of your pocket and add three pennies every day, and that is how much we spend through our public budget on foreign aid, and another nickel through private giving. The Bush administration has justifiably emphasized the importance of using existing resources as well as possible.

At the same time, there is certainly room if we are to be the leader of the free world to move forward and find ways to provide additional resources, always attending to the reality that those resources need to be used as effectively as possible. That is why I emphasized the importance of evaluation, the importance of signaling to places like the World Bank and the Inter-American Development Bank what a positive thing it could be for us to learn from what is working and to create the evidence base that would justify larger increases in the future.

Mr. MOORE. Well, given that, Ms. Birdsall, here we are on the horns of a dilemma. If in fact we would agree with the Bush administration's assertions that we ought to do more effective work with our current resources, if we forgive debt and presumably the funds that would be returning into a revolving loan fund, and I am sorry I do not know which one of the funds operates like a revolving loan fund, so that those other countries like China, for example, who are now doing better and are repaying their loans, if we forgive debt and we do not have these funds revolve back in and be available for reinvestment, then how are we justifying not upping our contributions and grants when we know for a fact that there will not be efficient and effective ways, that the current resources will shrink with debt relief? We have all agreed that debt relief is important, but then that is a smaller pot to do good.

Mr. BIRDSALL. Yes, we are hoping that the outcome of the ongoing discussions between Prime Minister Blair and President Bush will be an agreement that the U.S., among the other advanced economies, will make up the difference going forward by increasing U.S. contributions to the IDA funds at the World Bank. It would apply also to the soft money window at the African Development Bank.

This would have the additional advantage, as I emphasized in my written testimony, of moving more of the U.S. foreign aid money through multilateral channels. I believe that is important because we are no longer living with a donor system that can be unilateral. Leadership from the U.S. has to be done in a multilat-

eral context because the U.S. now, although it is still a very important donor, is a much smaller part of the picture certainly than it was when we invented the Marshall Plan.

Mr. MOORE. Thank you. My time has expired.

Mrs. BIGGERT . Thank you.

The gentleman from California, Mr. Sherman?

Mr.SHERMAN. Thank you.

I would like to use my 5 minutes mostly to make comments. The first is that debt relief is money for the countries to which it is granted. Countries could stop making debt payments. They do not because by getting debt relief, they are in a position to borrow more.

Now, I believe we should do more in foreign aid. I believe we should give more, and debt relief is one way to do it. But we should provide debt relief only to those countries that we would give cash to. It is just like our domestic policy. You see people advocating tax credits for programs they would not advocate writing a Government check. There are two ways to provide U.S. Treasury funds or dispensation to a particular cause, and we ought to do so when the cause warrants it.

The second point I would make is that the folks before us have testified and are experts in many things, but you are not experts at what it takes to get the average American to take money out of their pocket, money away from their own family, money that means they cannot send their kids to a higher-priced college, and give it for foreign aid. I have some expertise in that, and I have advocated higher foreign aid throughout my career.

The one piece of advice I would give you is please do not disparage America in order to encourage generosity. And do not say that all we do for the world is contained in the foreign aid budget, while ignoring the hundreds of billions of dollars we spend to provide stability for the world, which I might add is more important than anything aid does. If you look around the world as to where people are dying, it is places where there is instability, places where there is conflict.

You can doubt very much the effectiveness and intelligence of our foreign policy and military efforts designed to provide stability and promote democracy around the world, but you cannot doubt that money spent promoting democracy, defending democracy, and promoting order does as much as money spent on any other aspect of foreign aid. To count what Japan does and compare it to the United States while ignoring the vast bulk of our military budget is not to defend the United States, but is to defend a world order and is an unfair disparagement to those very taxpayers I represent.

Finally, we have heard testimony about multinationalism in our aid. Imagine going to my district and saying you want to increase foreign aid, and oh by the way, $1 billion is going from the World Bank to the people who run and mis-run the Government in Iran, the very people trying to develop a nuclear weapon, smuggle it into the United States, and threaten to blow up or actually blow up an American city, and that is what your foreign aid dollars are being used for.

I will tell you now, if you want us to continue to participate in multilateral organizations, you must remove the malignancy from

those organizations. A little inefficiency? Hey, we are used to that. But when you take money from my district to spend to help keep in power the people who are trying to literally destroy my district or some other town, whichever town they happen to choose, then you can only hope for the ignorance of the American people and that ignorance of the fact that their foreign dollars are going to Teheran through these multilateral organizations.

I look forward to an Administration which after 5 years will have the guts to do something about the World Bank disbursements to the Government in Iran. I have talked to the President many times. He has a worldwide image of aggressiveness which he has gained only through his dealings with one particular country. When it comes to dealing with the World Bank, it is rather frustrating.

So I thank you for your time. I do not know if I have any time to allow a response from our witnesses, and I do not know if any of them are itching to make such a response.

Mrs. BIGGERT . Thank you. The gentleman yields back.

I do appreciate the gentleman's comments.

I would like to just ask Dr. Birdsall, what country provides the largest amount of money right now for development?

Mr. BIRDSALL. In absolute terms, I believe the U.S. still contributes the largest single amount. If you compare the U.S. to all of our European allies, we are about 50 percent of what they together provide.

Mrs. BIGGERT . And what country comes in second to the U.S. in terms of development assistance in dollar terms?

Mr. BIRDSALL. I am afraid I am not sure. It is probably Japan. Right. So Japan and the U.S. are the smallest relative to the size of their economies in their giving on public aid and the largest in absolute terms.

Mrs. BIGGERT . So you are just going from percentage, rather than dollars.

Mr. BIRDSALL. Well, I am answering your question in terms of absolute amount of dollars. So the U.S. currently provides I think an estimated $15 billion or $16 billion a year.

Mrs. BIGGERT . Nineteen billion?

Mr. BIRDSALL. It depends on the definition, how much is included for our efforts in Iraq, for example, and Japan would be behind that.

Mrs. BIGGERT . Eight or 9 billion.

Mr. BIRDSALL. Thank you very much.

Mrs. BIGGERT . Yes. Thank you.

I would like just to say that I think that the American people are the most generous in the world, and we have always been willing to open our hearts and our pocketbooks for others. I think we have to keep that in mind.

Mr. BIRDSALL. Absolutely. May I make a comment on Representative Sherman's points? To endorse the general view that it is important to look not only at our aid budget, but at the many different ways we affect developing countries. At the Center, we have an index that ranks rich countries in terms of a set of policies, including trade, migration, environment and so on, and the U.S. is

first generally on trade. It is the least-worst, you might say, among all the countries.

Mrs. BIGGERT . Let me just note that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

With that, I would like to thank the witnesses. You have been outstanding. We have had a spirited debate and thank you for coming from all the distances that you have come. We really appreciate it.

With that, this hearing is adjourned.

[Whereupon, at 4:00 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 8, 2005

Chairman Deborah Pryce

June 8, 2005
Hearing on "Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries?"

Debt relief in highly indebted poor countries is not only humanitarian, but also essential to the continued development of those countries. This timely hearing signals the initial engagement of this subcommittee on debt and development issues this Congress.

Just Yesterday, President Bush met with British Prime Minister Tony Blair to discuss debt relief for struggling African countries. President Bush, who had last year called for a new program of grants that will lead to 100% debt relief, joined the Prime Minister in saying the two countries are working on a plan to eliminate debt for countries that are showing reform.

I am proud that the United States has risen to this challenge and put forward a bold set of proposals to eliminate the debilitating cycle of lend-and-forgive that has undermined economic development for decades. We all know that the end of the Cold War and the East Asian financial crisis created major new opportunities to revisit the processes for extending development assistance. It has taken longer to find ways to eliminate the debt overhang from those days, but we have an opportunity to do something now.

All countries would benefit from a more efficient and productive developing world. Increased ability to export and innovate helps all economies. It also increases the ability of individuals to make their own decisions and participate in government. More responsive government means more participatory democracy. All of these things are beneficial to global systemic stability as well as individual well-being and merit support.

Just as everyone would benefit from elimination of the crippling debt overhang and greater economic development, so we must all shoulder the responsibility of making changes and thinking innovatively in order to make change happen. I am pleased to have the witnesses here today to discuss new and innovative ideas for debt relief. Many members of this committee have strong feelings regarding debt relief and additionally, how the relief is distributed. It is my hope that today's hearing will begin a thoughtful dialogue—one that we can share with the leaders who will take part in the G-8 summit next month in Scotland.

The Administration has also proposed funding World Bank debt relief using existing World Bank resources and by re-balancing the structure of how development assistance is provided through its concessional lending window. Our witnesses today will add further thoughts on how the World Bank's resources could be used more productively, using modern risk management tools. They will also suggest

how private sector knowledge and participation could be used to leverage existing development initiatives and limit the amount of crowding out effects that occur whenever the World Bank is involved in lending to countries. I look forward to hearing those ideas.

Regarding IMF debt, the U.K. government and a number of our witnesses have proposed selling IMF gold and using the proceeds of the 1999 IMF gold revaluation to fund debt relief. Because of gold's role in the economic system, instability in the gold market could have significant knock-on effects throughout the international financial system. Legitimate concerns have been raised about the potentially destabilizing effects that broad-based gold sales could have on global markets.

It is my understanding that a number of European governments join the United States, Canada, and Japan in opposing gold sales to fund IMF debt relief. We have testimony today indicating that the IMF has proposed a way to sell IMF gold without creating market instability. However, this solution would require European central banks to adjust their own gold sales programs for a period of time. Since there seems to be no interest in Europe to fund debt relief in this manner, it seems premature and irresponsible to continue discussing IMF gold sales.

The President and Prime Minister have proposed debt relief for the poorest countries on the planet. I support this proposal, and I support our President's stand for continuing reform in those countries. In a press conference following their meeting, *The World News* reported Bush as saying "Nobody wants to give money to a country that's corrupt, where leaders take money and put it in their pocket." I share the President's concern about the structure of the development debate this year and know Chairman Oxley feels that same.

Most discussions focus only on the funding side of development without discussing how to make development assistance more effective by assessing project performance and institutionalizing anti-corruption programs within the development banks. They seem to assume that more money will solve all of the problems in the development world. I do not share this sentiment. If we do not stop the misdirection of funds due to mismanagement, misunderstanding, bribery, or kickbacks in the procurement and administration of development assistance, then we will be here again discussing missed opportunities and lack of progress.

We have a chance right now to make a difference and help hard-working people around the world get the seed money they need to get an education, start a business, and live disease-free with clean water. Let's not blow it by focusing on the money and shirking our responsibility to make important changes.

Opening Statement
Congresswoman Judy Biggert
Committee on Financial Services
Subcommittee on Domestic and International
Monetary Policy, Trade and Technology
"Debt and Development: How to Provide Efficient,
Effective Assistance to the World's Poorest Countries"
June 8, 2005, 2128 RHOB

The Subcommittee on Domestic and International Monetary Policy will come to order. Without objection, all members' opening statements will be made part of the record. Good afternoon. It is my pleasure to welcome you today to today's hearing on Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries. We are here today to receive testimony from three witnesses regarding current thinking on how our international financial institutions can provide more effective relief to impoverished nations.
I will begin with my opening statement.

You may have noticed that I am not Chairman Deborah Pryce. I am Vice Chairman Judy Biggert. Chairman Pryce will have an opening statement for the record. She very much regrets missing this hearing today. She asked me to share with you her commitment to finding innovative ways to eliminate debt for countries that are showing reform.

Today is not the first time that this committee has focused on debt and development issues, and I am sure that it will not be the last. The issues are broad-ranging and global and elicit the interest of many persons and parties, including in my congressional district just outside of Chicago.

In April of last year, I chaired a hearing of this subcommittee to receive a report issued by the General Accounting Office concerning the projected cost of the enhanced highly indebted poor country, HIPC, program. This report produced staggering, yet somewhat questionable numbers. It became clear from that report and from the testimony we received at the hearing that simply providing billions of dollars in aid and debt relief to developing countries is not enough. Money alone is not the answer, and it clearly has not worked in the past.

We must find ways to provide more effective and efficient assistance to developing countries, and we must find ways to support developing countries' efforts to one day graduate from dependency on development assistance.

The Bush administration is taking quite a bold step in this area. It has called on the international community to provide up to 100 percent of debt relief for highly indebted poor countries and to provide more performance-based grants to them. In return, those countries would be asked to increase transparency in their decision-making, promote private sector development, and take other key steps toward self-sufficiency.

We meet this afternoon amidst a spirited global discussion about new strategies to help aid the poorest countries of the world. Our colleagues on the Joint Economic Committee have just released a new study on this topic, and President Bush continues his discussions today with U.K. Prime Minister Tony Blair on this and other issues. The

Group of Eight summit in July includes as major agenda items debt and development issues.

As we move forward, it is clear that there is no one-size-fits-all solution to alleviating the debt burden of all poor countries in the world. Each poverty-stricken country is faced with unique economic and social challenges. Under the current system, countries must continue to undergo rigorous processes to qualify for debt forgiveness or no-or low-interest loans, technical assistance and other forms of aid.

Many believe this process should be improved. It is unfortunate when a country cannot qualify for aid due to its Government's unwillingness to set policies that will help to provide them with greater economic and social certainty. It is even more unfortunate for their citizens who are poor, uneducated, or dying of disease or malnutrition.

Regardless of which approach is ultimately taken, we must continue to work with our international partners to encourage HIPC countries to implement anticorruption measures, legal systems, and other important reforms. If the U.S. and her international partners provide debt relief to countries that are without sound Governments, infrastructure or legal systems, it is the equivalent of putting water in a sieve -- it will not carry. At the same time, we do not want to withhold funding if a country is on the road to reform. We need to find ways to strike this
delicate balance.

I understand that making these kinds of reforms is not easy, but these reforms are not luxuries. Encouraging impoverished countries to form democratic societies and free-market economies can have material human benefits as they alleviate the exposure to disease and poverty that too often accompany corruption and mismanagement. These reforms also can undermine the opportunity for terrorism-based ideologies to take hold in poor countries where it can be so easy to find a scapegoat.

I look forward to hearing from our witnesses on new proposals to finance debt relief and update the delivery of development assistance. We will hear from a range of views on how funds can
be mobilized to promote economic development. I look forward to hearing from our witnesses about their proposals to facilitate responsible and sustainable debt relief and development in impoverished countries.

With that, I will recognize the ranking member of the whole committee, my friend and colleague, Mr. Frank from Massachusetts, for an opening statement.

Remarks
Rep. Carolyn Maloney
DIMP Hearing: "Debt and Development"
June 8, 2005

Thank you, Representative Biggert
and welcome to our witnesses.
I would also like to thank Chairman Deborah Pryce
for holding this hearing
on this extremely timely and important issue.

Even as we hold this hearing
the financial ministers of the G-8 countries
are preparing for the July meeting at
Gleneagles, Scotland
at which the topic of debt relief
to the 35 Heavily Indebted Poor Countries
in Africa and Central America
will be at the top of the agenda.

Only yesterday it was reported that
the United States, Britain and Canada
have agreed on a proposal for

100 percent debt forgiveness of the debts of the HIPC countries
to the World Bank and the African Development Bank.
I understand that the three countries are negotiating
to include IMF debt stock as well,
and I believe Congress should urge the Administration
to include IMF debt, since it represents 30 percent
of the debt service of the HIPC countries
over the next decade.

I also hope that the proposal is only the first step
in a renewed effort towards debt relief
for all countries requiring this assistance.
As an original cosponsor of the Jubilee Act
which would achieve debt relief for 50 nations
I will continue to work towards this goal.

The list of countries needing relief is not limited

to
the poorest countries.
When I introduced legislation to forgive Iraqi debt
we discussed the concept of "odious" debt –
for example, debt incurred by Saddam Hussein to buy arms –
and the need for countries emerging from oppression
not to bear the crushing burden of such debt.
I am encouraged that the United States
recognized the imperative to repay Iraq's odious debt,
and I hope we can apply that same realization to achieve debt relief
for South Africa, Haiti, or the Phillippines.

Today, we have before us an exciting beginning.
The US- UK - Canada proposal represents a very serious effort on both sides
to achieve real debt relief for the most impoverished nations

and give them a chance to move forward.

We stand at the threshold of a new era in global
poverty reduction
and I hope there is the political
leadership, strength and will
to achieve the promise of this moment.

The details of the proposal, as I understand
them,
demonstrate just how far each side has come
in their mutual efforts to get to a workable
solution
and both sides are to be commended.

I understand that Mr. Kapoor
is prepared to outline the proposal
but in brief, it adopts the United States policy
approach
of 100 percent debt forgiveness
for the current HIPC countries
but incorporates the British principle

that the concessional facility
(the International Development Association, or
IDA) be replenished.

As I understand it the United States
has now made a significant commitment to
replenish the IDA
in the amount needed to cover
the reduction in reflows to the IDA
that will result from debt relief.
Secretary Snow indicated Treasury would do so
when we asked him at his last appearance,
and I am delighted to hear that the
Administration
has made good on that promise.

These developments are new, they are exciting,
and I welcome them.
I look forward to hearing the testimony.

Hearing on Debt and Development
Subcommittee on Domestic and International Monetary Policy
Rep. Maxine Waters
Statement for the Record
June 8, 2005

I would like to thank Chairman Michael Oxley and Chairman Deborah Pryce for organizing this hearing on "Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries."

I am encouraged by reports that this week's discussions between President George Bush and the United Kingdom's Prime Minister Tony Blair focused on the doubling of aid to Africa and debt cancellation for the world's poorest countries. However, I was disappointed to learn that the emerging US-UK proposal for debt cancellation does not appear to cancel debts owed to the IMF and would only apply to about 18 poor countries. I was especially disappointed to learn that the only commitment the Bush Administration made was to spend an additional $674 million on famine relief. The people of the world's poorest countries need more than famine relief. They need complete debt cancellation and sustainable development programs that will enable them to diversify their economies and avoid famines in the future.

The limited debt relief available through the Heavily Indebted Poor Countries (HIPC) Initiative of the IMF and the World Bank has proven that debt relief is an efficient and effective way to assist the world's poorest countries. Uganda used the savings from debt relief to double school enrollment and significantly reduce the HIV infection rate. Mozambique vaccinated half-a-million children, and Tanzania eliminated school fees and built over 31,000 new classrooms. An analysis of the HIPC Initiative by the IMF and the World Bank shows that since 1999, the 27 countries that received debt relief nearly doubled their poverty-reduction expenditures. Clearly, debt relief has made a difference in the lives of millions of impoverished people.

Unfortunately, the HIPC Initiative has failed to provide a lasting solution to the poor country debt crisis. Debt service payments for HIPC countries have been reduced by less than one-third, and the 27 countries that have received debt relief under HIPC still spent over $2.7 billion on debt service payments last year. Other poor countries, like South Africa and the Philippines, were completely excluded from the HIPC Initiative and received no debt relief at all.

On March 3, I reintroduced ***the JUBILEE Act***, now H.R. 1130, a bipartisan bill to cancel completely the multilateral debts of fifty of the world's poorest countries. The ***JUBILEE Act*** would free poor countries from the debt burden and allow them to invest their resources in health care, education, poverty reduction and other programs that meet human needs. The JUBILEE Act would cancel the debts of all of the countries included in the HIPC Initiative, as well as other poor countries like South Africa and the Philippines. Congressional support for the ***JUBILEE Act*** has continued to grow over the past three months. Two additional Members of Congress agreed to cosponsor the bill over the Memorial Day recess, bringing the total number of cosponsors to seventy.

This coming weekend, the G-7 Finance Ministers will have another opportunity to discuss aid to Africa and debt cancellation. I encourage the G-7 Finance Ministers to use this opportunity to negotiate a deal to cancel all of the debts of all of the world's poorest countries. I sincerely hope that there will be a historic breakthrough this summer at the upcoming G-7 Finance Ministers' meeting or the subsequent G-8 Summit in Gleneagles, Scotland, on July 6-8, that will provide 100% debt cancellation to all of the world's poorest countries.

I look forward to hearing the testimony of the witnesses on this week's negotiations, ways to finance debt cancellation, and the potential for a historic breakthrough this summer that will cancel poor countries' debts once and for all.

"Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries"

Testimony for the House Committee on Financial Services, Subcommittee on Domestic and International Monetary Policy, Trade and Technology

Nancy Birdsall, President, Center for Global Development

June 8, 2005

Introduction

Chairman Pryce, Vice Chairman Biggert, Ranking Member Maloney and Members of the Subcommittee: thank you for this opportunity to appear before the Subcommittee today to talk about U.S. development policy vis-à-vis the poorest countries in the world. I would like to ask that my full testimony be entered as part of the record, and I will then briefly summarize my major points.

In 2001, I helped found the Center for Global Development, an independent, non-partisan think tank based in Washington, D.C. that is dedicated to improving the policies of the rich countries as they relate to the poorest countries. Our core mission is to work with the developed countries, first and foremost the United States, and the major multilateral institutions to develop more effective international development policies that will ultimately reduce global poverty and inequality.

As many of you know, 2005 is turning out to be a key year in creating momentum at the global level for progress in the fight against global poverty. In January, the United Nations Millennium Project led by Jeffrey Sachs issued a 14-volume report on what actions are needed if we are to meet a series of international goals to reduce poverty, curb disease, and tackle underdevelopment called the Millennium Development Goals (MDGs). In March, under the leadership of Tony Blair, the UK Commission for Africa released its blueprint for how rich countries can form a new partnership for Africa that is geared toward improving the quality of daily life in the world's poorest continent.

Just last week, Paul Wolfowitz began his tenure as the new president of the World Bank, signaling renewed support from the Bush Administration for that institution's development mission. (New presidents have also been or will be appointed this year at the Asian, African and Inter-American Development Banks.) Next month, in July, the United Kingdom will host the annual G-8 Summit in Gleneagles, Scotland—an event which will focus on development first and foremost.

Moving to September, heads of state from 191 countries will convene in New York on the floor of the General Assembly to assess international progress on development, security, and human rights and chart a way forward on the difficult issues of UN reform. Finally in December, the next round of WTO ministerial-level trade talks will take place in Hong Kong, where hopefully the world will take concrete steps toward a multilateral trading system that is more friendly to developing countries.

This unusual confluence of events and increased global attention to development reflects the deepening recognition—among national officials, international organizations, and throughout civil society—that the changes wrought by the new wave of globalization make reducing poverty and global inequality more possible, more compelling and more necessary than ever. As the world's only superpower and a leading "shareholder" in the international financial institutions and the United Nations, the United States has a particular responsibility and its own key security and other interests in ensuring progress on this global development agenda.[1]

The question before us is what specific steps in addressing this agenda the U.S. should take. Will the United States, as has historically been the case, be a leading supporter of an emerging global development agenda? What should the U.S. propose and endorse at Gleneagles in July, in New York in September, in Hong Kong in December, and beyond?

In my remaining time, I want to discuss five development initiatives on which the world needs the U.S. to step forward – in more active support of its allies' development efforts, and in some cases with its own forceful leadership. These are initiatives where the support of Congress, working with the Administration and with our allies, is critical if the United States is to sustain its traditional leadership of international efforts to bring prosperity and security to the world's poorest countries.

A common thread running through these proposed steps on the part of the United States is the need for the U.S. to not only lead by example in a unilateral way, but to take leadership in what is an increasingly *multilateral* system. In summary form they are:

- *Aid Effectiveness and Aid Accountability.* Commit this year to increased levels and an increasing proportion of the U.S. aid budget going through multilateral channels; and to the pooling of some MCA and PEPFAR resources with other donors' funds in selected eligible recipient countries; take leadership in creation of a consortium of donors and recipient governments to institute independent evaluation of the impact of selected development programs in poor countries;

[1] One of the most challenging, emerging security threats derives from weak state capacity in the developing world. These so-called "weak" and "failing" states pose a direct security threat to U.S. national security (not to mention regional and international security) because of the interconnectedness between state incapacity (lack of development) and a diverse array of transnational threats, ranging from terrorism to drug trafficking and health epidemics. See Commission on Weak States and U.S. National Security, On the Brink: Weak States and U.S. National Security (Washington, D.C.: Center for Global Development, 2004), available at: http://www.cgdev.org/weakstates.

- *Debt Relief.* Compromise with the Europeans on a common approach to reaching 100 percent debt reduction for the poorest indebted countries—agreeing to additional contributions from the U.S. to the IDA window in return for European agreement to the creation of a special grants-only sub-window of IDA for the poorest countries;

- *Making Markets for Vaccines.* Take leadership at the international level in the setting up of an "advance market" for the guaranteed purchase of malaria and AIDS vaccines, to create incentives for private research and development;

- *Trade and Market Access.* Strengthen the African Growth and Opportunity Act (AGOA), including by extending its duration; and take leadership on a WTO-based system to help countries losing trade preferences finance the needed economic adjustments;

- *U.S. Leadership at the World Bank.* Encourage and support actively the new President of the World Bank, particularly in efforts to ensure that the developing countries, including the poorest, are better represented in the Bank's own governance.

Aid Effectiveness and Aid Accountability

The key issues of aid for the poorest countries are to increase the quantity provided and the "quality" and thus effectiveness of the resources. In the report of the Commission on Africa led by Prime Minister Tony Blair, there is a call for as much as a tripling of aid to Africa between now and 2015 from the current figure of about $25 billion, adding $25 billion annually between now and 2010, and then assuming reasonable progress, adding another $25 billion until the year 2015. Several countries of the European Union have meanwhile agreed to increase the proportion of Gross Domestic Product (GDP) they spend on aid to 0.7 percent within the next ten years. Japan has also committed to a major increase in its foreign aid budget over the next several years.

The proposal of the UK for financing aid by borrowing on private capital markets against future public aid allocations (called the International Finance Facility) is meant to increase the amount of aid in the short run, and at the same time to make aid flows much more predictable from the point of view of recipient countries. In the poorest countries, a responsible finance minister cannot easily commit to a major expansion of health systems or of schools without some assurance that aid will continue to flow to fund the ongoing annual costs of managing and staffing expanded systems. The Europeans have also called for aid to be better coordinated among the many donors operating at the recipient country level, to reduce the administrative and management burden on small and poor countries associated with dealing with dozens of donors and thousands of separate projects.

The proposed increases in aid are trivial in terms of the rich world's wealth, and are well below amounts other countries received at critical moments in their

development. South Korea received nearly $100 per person (in today's dollars) in annual aid between 1955 and1972. Botswana, the world's single fastest growing country between 1965 and 1995, received annual aid flows averaging $127 per person. (It did so by combining rapid expansion of diamond exports with exceptionally good governance.) By contrast, annual assistance to sub-Saharan Africa today averages about $28 per person—not nearly enough to build a foundation for sustained growth and development.

At the same time, there is room for concern about ensuring that any aid increases are used effectively. In the best-performing countries aid as a proportion of GDP is currently more than 20 percent of gross national income in Malawi, Mozambique and Ethiopia, and more than 15 percent in Uganda, Tanzania, and Rwanda (in both cases, among others). It is about 12 percent of GNI in Ghana. In these countries with reasonably good performance, where aid is already financing virtually all new public investment, there are risks in rapid infusions of new aid. These risks include reducing the receiving country's ability to compete in export markets (if aid puts upward pressure on exchange rates or induces people to leave productive private businesses to work in government and aid-financed public programs), overwhelming fragile preventive health efforts and road maintenance programs as attention shifts to new investments, and in the worst case, creating new pressures for corruption and patronage as procurement and expenditure management break down. In countries whose governments are less willing or able to absorb aid increases, there are even greater risks that conventional aid programs will not be effective.

Reacting to the European proposals for increasing the level of aid, especially to Africa, the Bush Administration has emphasized the need to ensure that whatever aid is provided is used effectively. The Millennium Challenge Account (MCA) reflects that emphasis. It promises ample aid to those countries most likely to use aid well, and makes explicit the logic of allocating different amounts of aid for different countries, depending on country governance.[2] The Administration has also noted that U.S. aid to Africa has already tripled. If the MCA appropriations rise, as they should, and are combined with the continuing and ideally increasing appropriations for U.S. financing to fight the AIDS pandemic, U.S. foreign aid spending will increase still more, especially to Africa.

However, it is still the case that overall U.S. aid levels are the lowest among its G-8 allies, with the possible exception of Japan. Even with recent increases, U.S. aid represents amounts to just $.16 for every $100 of our GDP. The trend, in short, is good—but from an embarrassingly low base for the leader of the free world.

Still, differences in the point of view of the United States and the Europeans on aid issues should not be exaggerated. There is common ground on the need to raise aid levels and to improve the coordination, predictability and effectiveness of the multilateral aid system. If I had to advise Congress and the Administration on what "aid initiatives"

[2] I and colleagues are concerned about the levels of Congressional appropriations to the Millennium Challenge Corporation and the speed with which those appropriations are being disbursed to MCA-eligible countries.

the United States should be pushing for at the upcoming G-8 Summit in Gleneagles, I would offer three suggestions.

First, the United States should lead the G-8 in agreeing to maximize new donor contributions through multilateral channels, which are less subject to political and other sources of volatility, thus ensuring that aid flows are more predictable from the point of view of recipient countries, and less burdensome on recipient countries than the multiplicity of programs, rules, protocols and negotiations implied by many different bilateral programs. The United States at the moment is the most "bilateral" of all donors; the proportion of its aid that goes through its own government channels vs. multilateral channels is, at about 15 percent, the lowest. It should take the lead in committing to having an increasing proportion of its aid going through multilateral channels over the next five years. For example, the Congress could indicate support for the Administration's announcing this year that in the next round of replenishments of the IDA and the other soft windows of the regional development banks it will ask for increases in the U.S. contributions of at least 10 percent overall (across all the banks). Multilateral agencies also include the Global Fund to Fight Aids, TB and Malaria—where the U.S. should continue to take a leading financial role.

In the same spirit, the United States could also commit to serious efforts to have some proportion of MCA funds go into programs that provide pooled funding from several major donors for the best performing poor countries—for example to support sector-wide programs in education and health. This would make particular sense in the case of education. Four countries, including Mozambique and Ghana in Africa, are both eligible for the MCA and have been "qualified" by a consortium of bilateral and other donors as eligible for major support to their primary education programs under what is called the Fast Track Initiative for Education. The MCA could invite those countries to request that the MCA cover some of the costs of those agreed programs—making the MCA at least in this area in effect part of a multilateral effort. The same is true with regard to PEPFAR, the President's emergency program to combat AIDS. Wherever possible, PEPFAR resources should be pooled with other donors' funds to maximize recipient countries' ability to deploy overall external resources as efficiently and effectively as possible against their own priorities.

Second, as the champion of aid effectiveness and results-based aid, the United States should begin discussion with its G-8 partners on the creation of a completely independent system for evaluating the impact of selected development programs—funded by all sources, including recipient countries themselves. Independent evaluation of aid-financed programs has been a constant recommendation of various independent and congressionally mandated commissions over the last decade.[3] Becoming serious and systematic about such evaluation is particularly critical if the case is to be made for

[3] These include the International Financial Institution Advisory Commission (also known as the "Meltzer Commission"), the Overseas Development Council Task Force on the Future of the IMF, the Commission on the Role of the MDBs in Emerging Markets (known as the "Gurría-Volcker Commission"), and a recent World Bank working group of the Center for Global Development.

sustaining the major increases in transfers beyond the next several years which may well be warranted. I return to this point below in discussing next steps at the World Bank.

Third, the United States could take initiatives in four other areas: debt relief, trade, a vaccine initiative, and reform of the World Bank, which I discuss below. In each of these areas, there is great potential to exploit possibilities for making aid for the poorest countries more effective.

Debt Relief [4]

Debt relief is an extraordinarily efficient use of aid resources. For countries with adequate policies and anti-corruption efforts, it automatically and predictably increases their ability to fund their own programs without separate projects, reports, missions, contracts, or negotiations with individual donors. For many countries the prospect of debt relief, like the MCA, creates an incentive for governments to act responsibly, particularly in the way they manage their economies, in order to become eligible.

The United States is in a good position to seal a deal, hopefully at the Gleneagles Summit, on debt reduction for the world's poorest countries. First, it should commit a limited amount of additional aid money to finance 100 percent elimination of the debt owed by the poorest countries to the World Bank and other multilateral banks. The Administration has informally proposed eliminating the debt, but by using existing resources of the World Bank rather than committing additional resources. Congress would ideally indicate to the Administration that it would be prepared to appropriate the modest additional funds needed, including for example by increasing the contribution of the U.S. to the IDA window at the Bank as I said above.[5] In return the U.S. should secure from the Europeans their agreement on its proposal that going forward countries that are very poor (for example with annual per capita income below $500) should receive only grants from the World Bank, not loans, to ensure that they do not again accumulate unsustainable debt.

Second, to finance the write-off of debt owed by these same countries to the IMF, the United States should agree the sale of a limited amount of IMF gold, under special arrangements that would protect gold price stability in the global gold market.[6]

In 2002, John Williamson (of the Institute for International Economics) and I proposed that the International Monetary Fund sell or revalue some of its gold reserves to

---

[4] For a detailed summary of this section, see Nancy Birdsall and John Williamson, "Gold for Debt: What's New and What Next?" (Washington, DC: Center for Global Development, 2005), available at http://www.cgdev.org/docs/CGD%20Note_IMF%20Gold.pdf.

[5] The U.S. could offer to finance 20-25 percent of the costs of the write-off, or to finance that proportion of the debt service of these countries for the next ten years. My colleague Steven Radelet at the Center for Global Development has estimated very roughly that the cost under the latter proposal would be about $200 million a year—just over 1 percent of the current total aid budget.

[6] A gold sale at the IMF requires approval of 85 percent of the members' votes. The United States holds 17 percent of the votes, so its consent is necessary.

help address the debt problem of the world's poorest, most heavily indebted countries.[7] Even then the idea of using the IMF gold to provide help to those countries was not a new one. During the period 1976-1980 sales of IMF gold provided $3.3 billion to help finance highly concessional loans—well below the cost to recipients of conventional IMF loans—to low income countries. And in 1999, the Board of the IMF authorized off-market transactions in gold to help finance IMF participation in the internationally agreed HIPC (Heavily Indebted Poor Country) initiative.[8]

Since 1999, the price of gold has risen (by about 50 percent), easing the fears of gold producing countries, and the evidence has hardened that many countries, despite benefiting from debt relief, still have unsustainable debt burdens. The IMF could raise about $7 billion by selling around 16 million ounces—about 15 percent—of its current gold. Were the United States to agree to sales up to that amount, the resources could be used to write off 100 percent of the debt to the IMF owed by selected with incomes below, say $500 per capita. In addition, there would be a small reserve to be tapped to "insure" eligible poor countries for some period (e.g. 10 years) against the financial and fiscal risks of drought, floods, a collapse in the price of a key export (coffee or peanuts) or an increase in the price of a key import (oil). That would help well-run poor countries manage future shocks, giving them time to diversify their economies and creating the conditions for private sector-led investment.

The sale of gold could be managed under the existing agreement among central banks which limits the amounts that go to the market in any period, to ensure gold markets are not disrupted. Agreement to limited sales of IMF gold would have no budgetary cost to the United States, and would almost surely help lock in the long-sought compromise with the UK and other European allies on the mutually shared objective of major debt relief.

Making Markets for Vaccines

In recent weeks, there have been calls from diverse quarters for a "Marshall Plan for Africa." The idea behind such a plan is that the rich world (including the United States) should dedicate substantial new resources toward helping raise millions of Africans out of poverty. But as a noted development economist wrote recently, one could think of expanding this concept so that instead of only considering aid to Africa in the narrow sense of financing development projects on the ground, we include aid that could best be spent outside Africa, where absorption constraints will not bind, but that will ultimately benefit Africa.[9]

---

[7] See Nancy Birdsall and John Williamson, Delivering on Debt Relief: From IMF Gold to a New Aid Architecture (Washington, DC: Center for Global Development, 2002), available at www.cgdev.org/Publications/index.cfm?PubID=42. See also Nancy Birdsall and Brian Deese, "Delivering on Debt Relief" (Washington, DC: Center for Global Development, 2002), available at www.cgdev.org/Publications/index.cfm?PubID=31.

[8] The off-market transaction kept the gold off the open market, avoiding resistance in such gold-producing countries, rich and poor, as Canada, Ghana, South Africa, Uganda and the United States who feared that putting IMF gold on the market would lower gold prices.

[9] See also Jagdish Bhagwati, "A Chance to Lift the 'Aid Curse,'" The Wall Street Journal, March 22, 2005.

Let me give you one example of what I am talking about. Africa and other poor regions constitute poor markets, and because of their poverty, private companies, including in the United States, have little incentive to create the technologies that are relevant specifically to them. African countries are poor because of limited technological opportunities (for rain-fed agriculture in Africa's soil conditions, for example), but in turn these opportunities are difficult to create because of the region's low income. The research that led to the Green Revolution in Asia was almost wholly publicly funded. It yielded among the highest economic returns of any development investment.

In health, the problem is particularly acute, as lives are literally at stake. An estimated 90 percent of all research undertaken by rich country pharmaceutical firms is on diseases prevalent in the rich world—that affect less than 10 percent of the world's population. Pharmaceutical companies have much less incentive to invest in vaccines for diseases that are prevalent in low-income countries but not rich countries (such as malaria) because poor people have less capacity to pay the prices necessary to recoup R&D costs. Rich country governments can address this problem in a simple yet powerful way. They can make a legally binding promise to reward the creation of new technologies, be it via "prizes" or via agreements to purchase a fixed amount of the resulting product or process. With such a promise, the rich world would guarantee a minimum financial return to research undertaken by private firms for the benefit of developing countries.

Under this plan, first proposed by Harvard Professor Michael Kremer, the United States and other rich countries would promise in advance to buy millions of doses of vaccine, thereby creating an incentive for private companies to invest in research and development, and producing the vaccines when they have been developed. This differs from most programs that fund medical research that finance research costs as they are incurred; it provides incentives much closer to those created in privet R&D markets. Rich countries would pay for the vaccines only when and if they are proven to be effective.

The financial and legal outline of this kind of advance market mechanism, at an estimated cost of $3 billion, has recently been developed for the case of a malaria vaccine.[10] It is entirely feasible within current budgetary and legal systems, and would provide an adequate incentive to both biotech firms and large pharmaceutical manufacturers. This approach of providing an incentive for pharmaceutical innovation is not unknown. In fact, the United States (with Congress in the lead) has successfully used it in the case of the Orphan Drug Act. Bioshield I and Bioshield II (now under discussion) also recognizes the importance of public sector action to "create a market" if none exists for essential public health products.

The proposal is fully in tune with U.S. values—based on creating incentives for the private market to act, while meeting people's needs, in this case potentially saving

[10] The proposal and its legal, financial and budget implications are set out in Ruth Levine, Michael Kremer, and Alice Albright, Making Markets for Vaccines: Ideas to Action (Washington D.C., Center for Global Development, 2005), available at: http://www.cgdev.org/publications/vaccine/.

millions of lives. The Government of the United Kingdom has strongly stated its support for such an advance market commitment—and this is one area where an agreement between the UK and the US on a development priority could be achieved. The Bush Administration could signal its support at the G-8 Summit by indicating its willingness to work with Congress to make such an advance purchase commitment, and by urging that the details be worked out with other G-8 countries, and relevant stakeholders, by the time of the Millennium Review in September.

Trade and Market Access

"Trade, not aid" has become a common refrain in Washington and in other donor capitals in recent years. I would hope that the Congress will work with the U.S. Trade Representative (USTR) and the Administration to ensure a sensible agreement on the reduction of agricultural subsidies and other forms of trade-distorting price supports that undermine trading opportunities for developing countries. My colleague William Cline has estimated that liberalization of trade could help up to 500 million people escape poverty in the developing world. The opening of rich country markets to developing countries in and of itself would bring benefits to developing countries valued at $200 billion a year—far more than even a tripling of aid flows.[11]

Beyond urging the Administration to seek a favorable outcome this December, there are three additional items on which Congress can exercise leadership: the African Growth and Opportunity Act (AGOA), on which this body has been supportive of in the past; the management of "trade preference erosion"; and the need for support for "trade facilitation" so that the poorest countries can better exploit the benefits of trade liberalization.

At the Center, we applaud the support Congress has provided AGOA, particularly with last year's passage of the "AGOA III" legislation which extends the third country fabric provision, originally set to expire in 2004, until 2008, and also extends overall AGOA benefits until 2015. In addition to extending AGOA's lifetime, we hope that Congress will act to eliminate the complicated and burdensome rules of origin treatment that are currently in force.[12] AGOA has contributed to increases in apparel and other exports (and in jobs, for example from 10,000 to almost 40,000 in Kenya in apparel) from some African countries (though with recent worrying signs of a leveling off with the end of the quota protection under the Multi Fibre Agreement). Its effectiveness, however, is limited since it is perceived as easily revocable for any one country on the part of the U.S., and because of its complexity. (The proposed "Trade Act of 2005" introduced by Senators Baucus, Feinstein, Santorum, and Smith would address these points in part.)

---

[11] William R. Cline, Trade Policy and Global Poverty (Washington, D.C.: Center for Global Development, 2004), available at: http://www.cgdev.org/Publications/index.cfm?PubID=39.

[12] William R. Cline, "Trading Up: Strengthening AGOA's Development Potential," CGD Policy Brief (Washington, DC: Center for Global Development, 2003), available at: http://www.cgdev.org/Publications/index.cfm?PubID=88.

Second, there is the issue of "trade preference erosion." The United States, as a longtime leader in trade liberalization and trade capacity-building and adjustment help, could propose at the G-8 Summit that simple guidelines be developed, under the rubric of the WTO, for assistance to developing countries tied to reduced fiscal income as tariffs decline, and to temporary adjustment problems with job declines in sectors affected by preference erosion.

Finally, the United States could commit to special resources to enable Africa in particular to better exploit the opening of markets which the Doha round promises – urging greater attention to regional infrastructure investments in particular by the African Development Bank. Of particular relevance would be support for cross-border roads, airport hubs, and shared power arrangements that would reduce the costs of getting agricultural and other products to external markets while at the same time helping ensure greater integration of markets *within* Africa. Since the economic size of sub-Saharan Africa is astonishingly small (smaller than the economy of Chicago), integration of its own markets is key to its increasing its own economic efficiency through economies of scale and greater diversification.

U.S. Leadership at the World Bank

Let me end on an issue that is near and dear to my heart. For almost 15 years, I was an employee at the World Bank. So I have firsthand knowledge of the tremendous good the Bank can do when Bank management, recipient governments, and the Bank's shareholders (including the United States) join forces and work in partnership to reduce poverty in poor countries. At the same time, I understand the frustrations that many Americans have with the Bank as an institution (several of which I share). Those on the left accuse the Bank of protecting privileged insider financial and corporate interests—and perpetuating the influence of the United States and other G-7 members rather than the world's poor people and their civil society supporters. Those on the right accuse it of misusing public resources in emerging markets where private markets could operate better—and creating aid dependency in the poorest countries where its loans have contributed to unsustainable debt.

It would seem to me then that now is an opportune moment, since we are experiencing a change of leadership at the World Bank, to contemplate how to reform the Bank to make it a more effective partner in the fight against global poverty. Paul Wolfowitz, who is in his second week in office, faces at least five crucial tasks—and on each will require substantial support from the United States, the Bank's largest single shareholder.

On June 1, the Center for Global Development released the report of an independent expert working group that was charged with developing an agenda for the next Bank president.[13] If acceptable to the Chair, I would like to have entered into the

[13] Center for Global Development, The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank, Report of a CGD Working Group (Washington, D.C.: Center for Global Development, 2005), available at: http://www.cgdev.org/Publications/index.cfm?PubID=222.

record the full text of this report. The group's report sets out the five tasks. I recount them here, as they have great relevance for Congress, especially this Committee which authorizes funding for the Bank's IDA window, as well as for the Administration.

Middle-income and emerging market countries. Borrowing from this group of countries has declined dramatically, because of the high "hassle" costs of dealing with the Bank and because of their increasing (though at times uncertain and costly) access to private capital markets. Their reduced borrowing puts at risk the Bank's maintenance of its global expertise, its ability to leverage equitable and sustainable policies, and its net income over the long run. To remain relevant for these countries, whose participation in the global club matters for global progress, the Bank must transform the way it does business.

Congress could request that the U.S. Treasury develop proposals for innovative policies, products and mechanisms that would make the Bank again relevant for these countries. These could include expanding the range of financial products and instruments now available to borrowers, such as products and instruments to hedge against commodity and other risks and better use of the guarantee function. The Bank could also develop a special window for quicker and less complicated access to loans for high-performing borrowers. There is no reason why the Bank could not create a new loan product that would visibly reduce hassle costs for creditworthy countries with reasonably good performance in economic management and an adequate record of enforcing environmental and other safeguards.

Low-income countries. There is nearly universal support for an expanded Bank role in low-income countries. Yet at the same time there are widespread doubts about its past effectiveness in these countries, many of which have weak governments and limited absorptive capacity, and failing to grow much in the past, acquired unsustainable debt burdens. Against this backdrop, how can we be confident that future Bank assistance will be more effective? First, the Bank should implement a much more differentiated approach depending on each country's governance, in terms of the size and types of transfers, with longer-term commitment periods for the best-performing countries and much more flexibility in reducing transfers ("exit") when progress stalls. At the same time, the Bank should maintain high levels of administrative spending to sustain policy dialogue and engagement and technical assistance in all countries independent of the size of transfer programs. This approach would broadly be in line with the MCA vision—rewarding countries with good governance and sound economic management—while at the same time ensuring that there are resources available to help countries improve their governance to the degree where large aid transfers in the form of budget support are appropriate.

Second, to end the disagreement between the United States and Europe on how much of IDA resources to devote to grants (as opposed to loans), Congress should urge the Treasury to propose and push a third, fully grant-based window for countries with very low per capita incomes, for example, below $500; most of these are countries whose poor record of growth implies little capacity to take on debt.

Independent evaluation. Although the Bank has improved its level of transparency through its research and the increasingly frank and systematic work of its internal evaluation department, neither fills the need for credible, truly independent assessment of the impact of development investments. Echoing calls from the Meltzer Commission, the Overseas Development Council Task Force on the Future of the IMF, and the Gurría-Volcker Commission for independent evaluation across donors, we recommend that President Wolfowitz take leadership in working with the board to support the creation of an independent evaluation entity financed and governed by a consortium of public and private donors and recipient country, to complement current internal audit and evaluation activities.

This independent evaluation entity could be financed and governed by a consortium of donors and multinational creditors, including the United States. No one member would have control over the entity's operations, but its members would jointly set priorities about evaluation focus areas. The reason behind creating a consortium is that a collective decision, once agreed, would help lock in good behavior of more and better evaluation—insulating specific programs from political pressures associated with negative evaluations. The consortium could be financed by contributions from its individual members, ideally linked to each member's own annual aid disbursements. This entity would not focus exclusively on the Bank's activities, but would evaluate across donors. The Bank's leadership in creating such an entity would thus make at least this aspect of its governance more representative. In any event decision making for Bank programs would continue to rest with the board.

Global public goods. Global public goods are those goods (or "bads") that no single nation has a sufficient incentive to produce (or limit) in optimal (from a global standpoint) amounts, but which have benefits (or costs) for all nations. The United States depends on the Bank playing an active role in providing these global public goods because it fills a gap that few other institutions have an incentive to fill. Examples include technological advances in agriculture and health, and global public "bads" such as global warming. Past investments in global public goods relevant to developing countries have had impressive rates of return: as high as 40 percent for agricultural research.

Over the years, the Bank has been drawn into the financing and provision of a multitude of global programs ranging from the environment to public health. The result is a situation in which the Bank has a set of ad hoc global programs without a clear mandate and without the grant instrument needed for its more effective engagement in provision and financing of high-priority global public goods. To this end, the United States could help lead a discussion with other shareholders that would develop a clear mandate for the Bank's role in the financing and provision of global public goods. As part of this discussion, the Bank should initiate and maintain an ongoing dialogue with the regional development banks, the United Nations, and other relevant agencies to develop the proper division of labor for respective work on global and regional public goods.

But it is not enough to enter into more "discussion." This discussion must lead to a defined objective. One objective the discussion could work toward is the creation of a Global Public Goods Trust Fund that would finance the Bank's work on global public goods, based on agreed annual transfers from the Bank's net income and on contributions from non-borrowers. The Trust Fund would consolidate and help set priorities for current spending from the Bank's resources, and contribute to the financing of such new and promising initiatives as the aforementioned advance market commitment for vaccines.

Governance structure. The Bank's own governance fails to adequately represent the contribution and the interests of its borrowing members. The lack of adequate representation is undermining its legitimacy and puts its effectiveness at risk. Yet there is no issue that has been as impervious to change. It may be difficult to convince some in the United States why updating the Bank's governance structure is in America's interest. Let me suggest that the Bank's governance structure—the imbalance in shareholder votes, the inadequate representation of borrowing countries on the Bank's board, the opaque presidential selection process, and the lack of a "strategic" Board—place real limits on the transformation of the Bank from a traditional development agency to a "club" where both donors and borrowers have equal ownership and responsibility. In turn, this restricts the ownership it can engender among borrowing and non-borrowing countries, both of which are essential ingredients for successful projects and policies.

Conclusion

I would like to conclude by reiterating that the United States has a special opportunity this year to improve the development prospects of those worst off in the society. The confluence of several major development milestones—in addition to this July's development-oriented G-8, the commencement of Paul Wolfowitz's tenure at the World Bank, the impending change of leadership at several multilateral institutions (at the Inter-American Development Bank, the African Development Bank, and the World Trade Organization) and December's year-ending WTO ministerial meeting—creates an opening for the United States to resume leadership on development issues.

Since taking office in 2001, the Bush Administration has initiated the Millennium Challenge Account (MCA), the President's Emergency Plan for AIDS Relief (PEPFAR), and a host of smaller presidential initiatives geared toward development. These are singular achievements. Many development "experts" do not like to admit this, but since coming into office, the Bush Administration and Congress have more than doubled ODA spending on Africa. But these bilateral programs are not sufficient—in ideas, leadership, or financing. It is time for the United States to exercise leadership on multilateral initiatives and in multilateral fora. In an increasingly interdependent world, acting unilaterally—even on welcome new initiatives like the MCA—does not foster the kind of international cooperation that is necessary in the end to forge a collective response to the scourge of poverty and underdevelopment.

Debt and Development: How to Provide Efficient, Effective Assistance to the World's Poorest Countries?

Testimony to the House Subcommittee on Domestic and International Monetary Policy, Trade and Technology

June 8, 2005

Sony Kapoor, Senior Advisor, Jubilee USA Network

Members of the Committee, thank you for this opportunity to appear before the committee today to discuss debt and development issues. I would like to request that my full testimony be entered as part of the record.

Debt, Development, and the Importance of US Leadership in a Critical Year

Despite advances in science and technology and growing global prosperity, billions of people live in abject poverty across Asia, Africa, and Latin America. Each year, six million children die from malnutrition before their fifth birthday. The HIV/AIDS pandemic kills more than 2 million people every year and adds to the league of millions of orphans in Africa.

The United States has made commitments to address these crises. US development policies and its efforts to address the crisis of debt, which exacerbate these crises, are the subject of today's hearing.

It is both in the interest of the United States as a compassionate nation as well as in its economic interest to have trading partners that are strong economies. Trade is an important part of the US economy and the US share of world trade is more than a third. The US is dependent on many developing countries for imports of oil, other commodities and increasingly other manufactured goods and information technology-related services. Equally, almost half our exports now go to developing countries.

In terms of financial flows, our interdependence with developing countries is on the rise. For many of these countries the US is the largest single source of investment related capital flows. In turn, developing nations hold more than one trillion dollars of US government bonds and thus are responsible for recycling capital back into the United States.

By supporting impoverished country debt cancellation and other development initiatives, the United States can help to alleviate poverty, eliminate hunger, defeat the scourge of HIV/AIDS and malaria and improve the lives of billions of people around the world. Debt cancellation and development can bring resources and hope where there is little or none.

Debt cancellation and other development initiatives help to eliminate suffering and to foster conditions for sustainable growth and economic development in developing nations. Former Secretary of State Colin Powell has argued that development is a 'core national security

issue' and that "the US cannot win the war on terrorism unless we confront the social and political roots of poverty."

Development is an important tool for increasing global security and achieving global prosperity. First, if the United States increased its contributions to the development effort, it is likely that other OECD countries will follow suit and so in terms of the resources being put into development every additional dollar of contribution by the US is likely to bring in as much as two additional dollars from other OECD countries. Second, the impoverished populations that we need to help with the development effort are currently so poor that even a very small sum of money can make a vast difference in their lives. So the marginal returns to investing in development are much higher. Third, in addition to earning the goodwill of people that we help, we are also securing our long-term security and economic interests. Our actions on this front will also earn the US much goodwill in the rest of the developing and developed world.

The US 'Marshall Plan' after the world war was crucial to the rebuilding and development of post war Europe and has won the US long-term strategic and economic allies and partners.

A broad-based and effective global development policy delivers more in terms of US long-term strategic interests than almost any other policy. Debt cancellation is critical element of such a policy, as it is the most efficient form of resource delivery to developing countries.

2005 is a critical year for development and impoverished country debt cancellation. Two major new reports, one from the United Nations[1] and another from the UK's Africa Commission, have contributed to the growing global debate over what steps are needed for effective global development. The focus of the G-8 summit in July in Scotland will be development. In September, heads of state will convene at the United Nations in New York to assess international progress on development, security, and human rights. Finally in December, the next round of WTO ministerial-level trade talks will take place in Hong Kong.

Never before has the issue of development received so much attention from world leaders. There is a deeply felt need to use some of the fruits of globalization to help those who have been left out; the Millennium Development Goals are a commitment to that. Unprecedented global prosperity and knowledge of some clear steps that can be taken to alleviate poverty has created a unique opportunity for action.

The United States, as a superpower, a leading shareholder in the international financial institutions, and prominent member of the United Nations, has a particular responsibility and an interest to help move the development project forward in this critical year. This is a unique opportunity for the US to assume a natural position of leadership by advancing a bold agenda on debt cancellation, aid, trade and other development issues.

The Development Context and Issues

> *We have the opportunity in the coming decade to cut world poverty by half. Billions more people could enjoy the fruits of the global economy. Tens of*

[1] "In Larger Freedom: Towards Development, Security and Human Rights For All," Report of the UN Secretary General Kofi Annan, 2005.

millions of lives can be saved. The practical solutions exist. The political framework is established. And for the first time, the cost is utterly affordable. Whatever one's motivation for attacking the crisis of extreme poverty—human rights, religious values, security, fiscal prudence, ideology—the solutions are the same. All that is needed is action.

– *Investing in Development*, the Millennium Project Report, January 2005

In the year 2000, the world's leaders met in the United Nations General Assembly to set out a new global vision for humanity. They agreed to goals, subsequently known as the Millennium Development Goals - to halve world poverty and hunger by the year 2015; to achieve universal primary education; to promote gender equality and empower women; to reduce child mortality; improve maternal health; to combat HIV/AIDS and other diseases; and to ensure environmental sustainability.

Since then, these goals have been adopted by most major donor agencies as guiding principles for their strategies for poverty eradication. Unfortunately, reality has not kept pace with the rhetoric. Rich countries are still far from meeting the target of 0.7 % of GDP as ODA agreed to in 1970. Trade and financial liberalization of the kind being pushed in recent years has failed to deliver the desired results. High levels of rich country subsidies and continually worsening terms of trade mean that the current imbalance between the rich and poor countries is being reinforced. Worse, even resources that rightfully belong to developing countries are flowing out of the countries in the form of 'dirty money' of hundreds of billion dollars every year. This takes the form of transfer mis-pricing, tax evasion, tax avoidance and capital flight.

Worst of all, crushing levels of debt burdens remain and developing countries collectively pay more in debt service than they receive in aid flows. Even in some of the most impoverished countries debt service exceeds spending for health care and education. Debt cancellation would mean that the money that currently flows out of the poorest countries in the form of debt servicing right now could instead be diverted to development expenditure within the country.

There are three main issues in financing development today: 1) how to enable developing countries maximize the resources they can mobilize domestically; 2) what mechanisms and source of external funds can be used to supplement these domestic resources effectively; and 3) how to ensure that these resources both domestic and external stay within the developing country and are used to finance development in an effective and efficient way.

Since the focus of the hearing is on what the United States can do to assist the world's poorest countries to develop, I will focus mostly on the latter two points as action the former falls mostly within the purview of the developing countries themselves. There is however an urgent need in the international development community to recognize that much more can and should be done on domestic resource mobilization and to help developing countries fulfill that potential to minimize dependence on external financing and to achieve sustainable development.

External Funds

In the current context of discussions on development which focus on the achievement of the Millennium Development Goals (MDGs), it is appropriate to use them as a benchmark for

funding needs. It was the Monterrey Conference on Financing for Development which first drew attention to the dramatic shortfalls in resources required to achieve the internationally agreed development goals.

In the Technical section of the conference's Zedillo Report, it is suggested that "the cost of achieving the 2015 goals would probably be on the order of an extra $50 billion a year".[2] Using two different approaches the World Bank figures range between $54 and 62 billion a year, and from $35 to 76 billion per year. The recent Millennium Project report has estimated the additional ODA flows needed to meet the MDGs at between $48 and $76 billion every year from 2006-2015.

While the Monterrey Conference concluded that the first port of call for financing the MDGs should be domestic resource mobilization, it is widely agreed that large chunks of resources needed to meet the MDGs would need to be external especially for the least developed countries. So while we need to maximize the development potential of domestically available resources, external sources of finance need also to be mobilized at levels far in excess of their current levels.

The discussion on working towards the MDGs has focused mostly on three issues – Aid, Debt and Trade -- as possible mechanisms to raise enough resources to meet the MDGs. A fourth mechanism – plugging the leakage of resources from developing countries is ignored but I will address it briefly.

Because of space and time constraints, I start by focusing my analysis today on the debt crisis and the need for debt cancellation as a critical tool for development. I will then address the other broader issues.

Debt Cancellation for Global Development

The Crisis of Debt

Every day, the world's most impoverished countries pay their creditors more than $100 million in debt service. Meanwhile 30,000 children die every day because of preventable poverty[3] - that is, from hunger, lack of clean water, and diseases which could be prevented or treated if the money were available.

In 2003 Senegal and Malawi each spent about one third of their government revenues on debt service.[4] A quarter of the domestic resources available for development spending in poor countries such as Zambia, Mozambique, and Uganda are currently being diverted to servicing debt.[5]These are some of the many African countries which pay more debt service every year than they spend on health.[6]

Meanwhile, the continent is in the midst of a health crisis, being ravaged by HIV / AIDS, malaria and other treatable diseases. In Zambia, Mozambique and Malawi, for example, life

[2] United Nations "Report of the High Level Panel on Financing for Development" (Zedillo Report) (2001). Technical Report, p.16. http://www.un.org/reports/financing/
[3] 80 Million Lives 2003; Bread for the World, UNICEF; World Health Organization
[4] HIPC Status of Implementation Report, August 2004, IDA / IMF
[5] Resource Rich BWIs, 100% Debt Cancellation and the MDGs, June 2004, Sony Kapoor for the Dutch Foreign Ministry
[6] In 2002 / 2003 also true of Cameroon, Ethiopia, Gambia, Guinea, Madagascar, Mauritania, Uganda and Zambia. See 'Do the Deal', ActionAid, CAFOD, Oxfam, February 2005.

expectancy is just 37 years, and in sub-Saharan Africa as a whole, nearly one in five children dies before reaching the age of five. 2.2 million Children die each year in developing countries just because they are not immunized.[7]

For every $1 developing nations receive in grant aid, they pay back more than $3 in debt service[8]. These examples highlight the contradiction of trying to deliver large amounts of overseas development aid to impoverished countries just to see it flow out in the form of debt servicing. If they did not have to repay this debt, these countries would have substantially more resources available for development related expenditure.

Sub Saharan Africa, between 1970 and 2002 received $294 billion of money in the form of debts, paid $268 in debt service yet remains with an outstanding debt stock of about $210 billion. Canceling this debt would free up significant additional resources for use in development. Clearly efforts to deliver more aid make much more sense once debt cancellation ensures that this massive outflow of scarce resources stops. That is why debt cancellation is a critical first step for the purpose of helping meet the MDGs.

This point is elegantly summarized by an excerpt from *Investing in Development* – the report of the Millennium Project which says "... dozens of heavily indebted poor and middle-income countries are forced by creditor governments to spend large proportions of their limited tax receipts on debt service, undermining their ability to finance vital investments in human capital and infrastructure. **In a pointless and debilitating churning of resources, the creditors provide development assistance with one hand and then withdraw it in debt servicing with the other.**"

As a solution, the same report recommends "Deepening and extending debt relief and providing grants rather than loans". Furthermore it suggests that "Debt sustainability should be redefined as the level of debt consistent with achieving the Millennium Development Goals, arriving in 2015 without a new debt overhang. **For many heavily indebted poor countries, this will require 100 percent debt cancellation. For many heavily indebted middle-income countries, this will require more debt relief than has been on offer. For some poor countries left off the heavily indebted poor countries (HIPC) list, such as Nigeria, meeting the Goals will require significant debt cancellation.** A corollary for low-income countries is that current and future ODA should be grants rather than loans."

What is needed is an effective delivery of the financial resources needed to meet development aims and objectives. Debt cancellation and increased aid provide necessary and complementary financial flows. **In fact, both 100% debt cancellation and a doubling of aid will be needed if the Millennium Development Goals are to be met, especially in sub-Saharan Africa.**[9]

Debt Cancellation: An Effective Tool to Release Resources for Development

Debt cancellation is a highly effective means to deliver new resources for development because:

[7] State of the World's Children, UNICEF 2005
[8] All figures from Global Development Finance 2004. 'Grant aid' excludes technical assistance.
[9] "Resource Rich BWIs, 100% Debt Cancellation and the MDGs," Sony Kapoor, June 2004 for the (IOB) Dutch Foreign Ministry and "Unbreakable Link", Romilly Greenhill, 2003 for Jubilee Research UK.

- **Debt cancellation provides direct budgetary support to debtor countries.** It largely bypasses the considerable administrative overheads that attend the application for, granting and monitoring of overseas aid.

- **Debt cancellation is a durable and predictable source of income**: By contrast, aid delivery is often highly variable, being subject to the ebb and flow of political will in donor countries. In fact, debt relief can actually be counter-cyclical.

- **Debt cancellation engenders a deeper sense of country ownership**. It is widely recognized that attempts to buy reform from unwilling governments have been a failure. Debt cancellation also increases the incentives for citizens and civil society to hold their governments to account for how their tax revenues are spent.

- **High levels of debt (debt overhang) deter future private investment**. There is ample evidence to suggest that poor/indebted countries, with their low credit ratings, are actively avoided by private investors (unless there are large official inducements).

- **Debt cancellation is anti-inflationary**. Recent research by the IMF points to a correlation between higher levels of indebtedness and increased inflationary pressures.

- **Debt cancellation helps keep domestic interest rates low**. Poor countries are currently being driven to increasing levels of internal borrowing to service their external debts. This also leads to higher interest rates, making loans unaffordable for local businesses.

Some critics say that debt cancellation will create a moral hazard – an expectation of further debt cancellation. But Jubilee USA Network and the global advocates of debt cancellation call for a **one-time gesture which wipes the slate clean, allows countries to make a fresh start and remove the development-inhibiting debt overhang**. Couple with grants rather than loans for the most impoverished nations moving forward, future debt crises can be avoided.

Another argument used by opponents of debt cancellation is that the resources released will be diverted away from development expenditure. It is clear that this has not happened. The World Bank/IMF's existing debt relief program, the Heavily Indebted Poor Country (HIPC) Initiative, though a failure on many fronts, has successfully demonstrated that debt cancellation can be a very efficient way of delivering resources to priority sectors. Though the cancellation offered was very limited, even the small amounts on offer had substantial development impacts.

The UK's Africa Commission reports that for example:

- In Benin, 54% of the money saved through debt relief has been spent on health including rural primary health care and HIV programs.
- In Tanzania, debt relief enabled the government to abolish primary school fees, leading to a 66% increase in attendance.
- After Mozambique was granted debt relief, it was able to offer all children free immunization.
- In Uganda, debt relief led to 2.2 million people gaining access to clean water.

Countries that received limited debt relief under the IMF/World Bank's Heavily Indebted Poor County Initiative (HIPC) doubled poverty-reducing expenditures from 1999-2004, and saw no net increase in military spending.[10]

In fact, a recent paper by the IMF which was discussed by the institution's board on March 30, 2005 clearly states that "further debt relief holds out the promise of easing concerns about debt sustainability while attracting additional financing needed to reach the MDGs."

Full debt cancellation is a fundamental component of the package of measures needed to finance development; it can be delivered early, and should ideally be additional to agreed targets for increasing aid as a proportion of national income. Moreover where the loans have clearly been badly made, the creditor must also share the responsibility for the financial consequences.

There is hence, a very strong case for the cancellation of multilateral, bilateral and commercial debts of all poor countries that are struggling with trying to meet the MDGs. This debt cancellation, being the most efficient form of aid delivery, should be the first step in a bigger package of increased resource flows to resource constrained poor countries. But debt cancellation must be scaled up significantly from the limited relief on offer now through the HIPC Initiative.

The Shortcomings of the HIPC Initiative

The current debt relief scheme for the IMF/World Bank, the Heavily Indebted Poor Countries (HIPC) initiative, though it has delivered billions of dollars in debt relief since its inception, has, after 8 years, failed to deliver the 'sustainable exit from debt' which the G8 claimed it would provide. First, many of the poorest and most indebted countries such as Nigeria and Bangladesh are not included in the initiative. Of the 42 countries which qualified initially for the program, HIPC has so far provided actual, irrevocable debt stock cancellation for only 18 countries.[11] Even in the case of this limited group of countries, the burden of debt on remains vast and crushing.

The Initiative to date has reduced less than a third of the total debt stock owed by HIPC countries, and already signs are that new borrowing is likely to bring debt levels back to the levels before the HIPC program was introduced.

Without going into the detailed shortcomings of the HIPC Initiative, it is still possible to see why it has not delivered its promised outcome. The countries in question are amongst the poorest in the world and it is clear that in order to meet the basic needs of their citizens – even to meet the MDGs – they require huge injections of resources that have not been forthcoming. These resources dwarf the amount of debt that HIPC countries hold. Rather than the partial relief that has characterized the HIPC Initiative to date, full or 100% cancellation of debt is a critical step that needs to be taken in order to free up scare resources for development.

There are three main types of debt owed by impoverished nations – bilateral debt, multilateral debt, and private sector debt. While bilateral and private debts have in many cases been

[10] HIPC Status of Implementation Report, August 2004, IDA / IMF
[11] As of May 2005

written off or are in arrears, the preferred creditor status of the multilateral institutions has ensured that almost all debt owed to them has been serviced regularly. Cancellation of bilateral and private sector debt may sometimes be just a paper transaction involving cancellation of debt that was not being repaid. Such a transaction while effective in reducing debt overhang may not free up any resources. In fact most HIPC debt stock reduction to date has come in the form of writing off debt in arrears – canceling debt that was not being repaid. More than 80% of the debt stock reduction to date for HIPCs has been eroded by a reduction in arrears.

HIPC debt cancellation to date has primarily been bilateral, e.g. the US has cancelled 100% of the bilateral debt owed to it by many HIPC countries. Multilateral debt remains the most significant burden for impoverished nations today.

The Growing Problem of Multilateral Debt

For all low-income countries[12] – 61 countries with a Gross National Income (GNI) less than $765 per capita – external debt outstanding has gone up 430% since 1980 and now amounts to $523 billion[13]. Debt owed to multilateral institutions has increased faster - 793% since 1980 to $154 billion, which is 30% of the total current debt stock. Multilateral creditors such as the World Bank, IMF, African Development Bank are now the largest creditors for most poor countries - especially the HIPC countries.

For the Heavily Indebted Poor Countries, external debt has gone up 320% since 1980 to $189 billion. Debt owed to multilateral institutions has increased 800% to $70 billion so it now constitutes a full 37% of the total debt up from 14% in 1980.

However, these figures understate the true share of multilateral debt as it includes countries that are not expected to reach the initiative's completion point. Multilateral debt will be by far the largest component of residual debt for most countries that will reach HIPC completion point i.e. successfully pass through the HIPC process. The International Development Association (IDA) arm of the World Bank is now by far the single largest creditor for most completion point countries.

In fact for the first 27 countries that reached decision or completion point the share of multilateral debt is expected to be all of 61% after the completion of the HIPC initiative up from 38% before the HIPC initiative.

Multilateral Debt Cancellation Frees Up Resources for Development

Multilateral creditors such as the IMF and World Bank are treated as preferred creditors, which means that their debts are serviced first. Even countries in financial trouble repay these debts as otherwise the international community might cut them off from external source of financing. Multilateral debt thus has the effect of diverting more resources away from development expenditure than other forms of debt, which may not be repaid if the country does not have resources.

[12] For a full list see http://www.worldbank.org/data/countryclass/classgroups.htm#Low_income
[13] Data from World Bank Global Development Finance 2004 CD ROM.

The cancellation of this multilateral debt would free up significant resources for development as the money that is currently going towards servicing this debt can instead be channeled into development expenditure towards meeting the MDGs.

Multilateral loans and debt come with strings attached – harmful policy conditionalities such as reducing subsidies for the poor, charging user fees for primary health care and education, privatizing public utilities and financial liberalization. These conditionalities leave limited policy space available to governments to pursue development strategies best suited to their own unique circumstances.

Multilateral debt gives the international financial institutions a large degree of leverage in driving policy in the poorest countries. A large part of the multilateral debt is rolled over – new debt is given by the multilaterals to repay the old debt owed to them – and a failure to meet conditionalities by the national governments can result in a refusal to roll over debt leading to a default that cuts the country off from external financial markets.

Canceling multilateral debt will reduce the amount of policy leverage that the international financial institutions have over the poorest countries and hence reduce the damaging conditionalities imposed on poor borrowing countries.

The doctrine of equal burden sharing for creditors – that all creditors would contribute resources for debt cancellation in the proportion of the debts owed to them - was one of the central principles of the HIPC initiative. However, this has not been borne out in implementation as bilateral creditors have contributed far more than the multilateral institutions.

In fact most multilateral debt cancellation to date has actually been financed by additional bilateral contributions. This has the effect of turning grants into loans[14] – as the money contributed by the donor countries is then recycled as additional loans by the institutions.

Multilateral debt cancellation through the use of the multilaterals' own resources is a way of redressing this imbalance. Asking the IFIs pay for multilateral debt cancellation through the use of their own resources would mean that they would be more likely to face the consequences of any bad or irresponsible lending decisions in the future and hence they would lend more carefully thus reducing the moral hazard.

Financing Multilateral Debt Cancellation

If it is increasingly clear that impoverished nations need debt cancellation to meet the Millennium Development Goals, then the question surely must be answered: How much would debt cancellation cost creditors? And how should it be financed?

The amount of resources needed to cancel 100% of the multilateral debt depends on which group of countries one looks at. For all of the 42 HIPCs about $45 billion[15] will allow the

[14] See *Results of International Debt Relief*, http://www.euforic.org/iob/detail_page phtml?&username=guest@euforic.org&password=9999&groups=IOB&&lang=en&page=publ_nlSV

[15] In NPV or Net Present Value terms. All debt is not the same and it varies in terms of the interest rates, the period of repayment and other terms. To ensure comparability between debts owed at different terms, finance professionals use the concept of the Net Present Value which uses some assumptions to define how much the debt issued under various terms would be worth today.

cancellation of 100% of the multilateral debt. For HIPCs that have reached decision point, the amount needed is about $30 billion.

For a larger group of countries that includes all low income countries, for instance, the amount needed can be as high as $100 billion in today's money. However, low-income countries include those such as India that are expected to be on target to meet the MDGs without a need for additional debt cancellation.

Depending on which countries are included, 100% multilateral debt cancellation for the poorest countries will cost between $30 billion and $80 billion.

Some of the most contentious debates among the G-8 nations on debt cancellation center on how resources could be mobilized to finance debt cancellation. I will examine here four potential sources, including IMF gold, IBRD reserves and net income, IDA reflows, and additional creditor contributions.

IMF Gold

The IMF owns 103.4 million ounces of gold which is valued in its books at about $8.5 billion mostly because most of the gold is still held at the historical price of SDR[16] 34 or $51.5 / ounce. However the market price of the gold is much higher and as of the 28th of November 2004 it stands at $450 / ounce. If the IMF sold some of its gold, it could raise billions to finance cancellation of debts owed by impoverished nations to the IMF.

But one of the greatest concerns about the possible sale of IMF gold raised by the gold industry and others is the potential impact on gold price.

In order to completely eliminate market price impact – IMF gold could be sold under the existing Central Bank Gold Agreement under which (mostly) European Central Banks[17] plan to sell 80 million ounces of gold over the next 5 years. These banks could take a quota cut to accommodate IMF sales so that the total amount of gold sold does not exceed the 80 million ounces already announced.

Just as some central banks are selling gold others are buying it. Developing country central bank foreign exchange reserves have grown by 200% since 1997 to $1.5 trillion in 2004. However, most of this increase has been in the form of currencies – some of these banks are now seeking to have a more balanced portfolio by buying up large quantities of gold. So the IMF could sell gold directly to these central banks at a price indexed to the market price. Since the gold would not be sold outright and would not enter the open market, its impact on the market price would be minimal.

A combination of the above two mechanisms would perhaps be the most appropriate and efficient way of selling IMF gold without any significant impact on the market price. These robust arguments have helped convince previously skeptical countries and institutions that it

[16] Special Drawing Rights; A basket of currencies comprising the US dollar, the Euro, the British Pound and the Japanese yen weighted roughly in proportion of the size of the respective economies. The IMF uses the SDR as the currency unit for accounting purposes.

[17] In most European countries, the central banks are under direct government control or under indirect control through being wholly owed by the respective finance ministries. So the decision to sell or not to sell gold can be influenced by the government. This means that if there is any political agreement on debt cancellation it can be translated into quota cuts by central banks.

is possible to sell IMF gold for debt cancellation without any adverse price impact. Based on this a growing consensus is developing on the use of IMF gold, including from a number of gold producing developing nations. HIPC Finance Ministers embraced the use of gold in a March 2005 statement.

In reply to a question from the South African Parliament, Trevor Manuel, the South African Finance Minister said he favored including 5 year quotas for gold sales allocated to central banks in 2004 for the process. "The (South African) National Treasury supports the use of IMF gold sales to finance debt relief for poor countries. The sale of IMF gold when done in a managed manner that is transparent, clearly communicated to the market and ideally along the central bank gold agreement, will mean that the market can price in the IMF gold sales and thus cause no disruptions to the price of gold."

President Benjamin Mkapa of Tanzania, another major gold producing developing country agrees: "IMF Gold; I'm in favor of (using) it (for debt cancellation). I was worried it might reduce revenues for Tanzania, but I have been assured that selling gold would not drastically affect the price of gold in the world market. So I am in favor of it."[18]

In March 2005, the International Monetary Fund staff, in a paper discussed at the board level embraced the suggestions about selling IMF gold under the Central Bank Gold Agreement and directly to emerging market central banks.[19]

The IMF paper points out: "The direct sale of gold to one or several central banks would involve only a redistribution of existing official gold holdings and therefore should have little effect on the gold market." The sale of gold under the CBGA would ... "offer the best prospects of limiting any potential adverse effects on the gold market, since the agreed overall sales volume is already in the public domain and has been fully discounted."[20]

Some have also raised the concern that the sale of IMF gold may impact the IMF's ability to lend. Gold, as it is currently held by the IMF, constitutes only about 2% of the resources that the IMF has available to lend. In fact, the IMF's articles forbid it from lending the gold – so the Fund can not use it for normal lending operations and this means that this gold is of no practical use to the IMF for its lending operations.

The sale of gold, would actually increase, not decrease the IMF's capacity to lend by replacing gold that cannot be used for lending with its cash equivalent (of SDR 34 per ounce), which of course can be used for lending.

The limited and responsible sale of IMF gold is a viable option to finance IMF debt cancellation for impoverished nations that need debt cancellation to meet the MDGs.

IBRD Reserves and Net Income

IBRD reserves and IBRD income allocation is another source of multilateral funds that can be used to finance multilateral debt cancellation. The IBRD could transfer up to $10 billion to the HIPC trust from its general reserve, which currently stand at $21.5 billion (total equity

[18] Remarks by President Benjamin Mkapa to the Jubilee Debt Campaign National Conference, February 26, 2005, UK.
[19] IMF, "Financing Further Debt Relief for Low-Income Countries – Preliminary Considerations," March 11, 2005, Paper for discussion by the Board.
[20] Ibid.

$37 billion). Such a transfer would merely take the IBRD's reserves to the level they were at in 1997 at which point the Bank was active and successful (and rated AAA) as it is now. Such a transfer would be worth $10 billion in NPV terms.

Additionally the IBRD could transfer up to $600 million annually from its net income to the HIPC trust over the next few years. The IBRD's net income (profit) has been more than $1 billion annually for more than 15 years in a row and has averaged $1.6 billion over the past 10 years. Such an annual transfer of $600 million up to the year 2020 can generate[21] $7.5 billion in NPV terms. It would be most prudent for the IBRD to use a combination of transfers from the reserves and income allocations.

The IBRD could mobilize up to $17.5 billion in NPV terms which should be used to part fund the cancellation of poor country debt owed to IDA. In the past, the IBRD has already transferred more than $7.5 billion to IDA from its annual earnings.

It is clear from this that an allocation of $10 billion of its reserves to IDA for debt cancellation would in no way threaten its AAA rating. In fact, according to analysis by Fitch, the IBRD would still have 465% the capital that it requires in order to hold on to a AAA rating.

IDA reflows

Another option is to draw on reflows to the International Development Association (IDA). In this scenario, debts owed to IDA are simply written off. Currently, IDA has two sources of funds for disbursing loans. One is the new donor allocations that IDA gets every three years through its replenishment cycle and the second was through the loan repayments (IDA reflows). Currently, these loan repayments constitute a small fraction of IDA's sources of finds but the share of these reflows has been growing and is set to grow more as the forty year loans that IDA disbursed in the 60s and 70s become due.

So, there is a danger, especially if no allowances are made for the drying up of these reflows that IDA disbursement volumes would be lower than they would have been otherwise. This would then tantamount to the use of debtor country own resources for the canceling of debt which though structurally still beneficial would defeat one of the key motivations of debt cancellation – the delivery of new resources to developing countries. This would happen because though a country would stop paying debt servicing, it could be accompanied by a proportionate decrease in new IDA inflows – hence no net gain in resources.

However, under a regime where donors agree to increase their future IDA allocations, to compensate for a decrease in IDA reflows, it would be the donors and not the debtors who would bear the true cost. In fact, the financing is likely to be somewhere in between with neither the donors nor the creditors bearing the full cost. This would the have the advantage of removing the debt overhang and having at least some new money for development.

Donor contributions

Donor contributions are in many ways the simplest source of money that could be used for multilateral debt cancellation. It simply involves the donors paying the debt service due on

[21] Using a discount rate of 3%

multilateral debt on behalf of the debtors. However, this is deceptively simple as though it seems that the cost if straightforward borne by the donor, it may not be the case.

This is so as money in the donor budgets is fungible and this payment for debt servicing may come at the cost of additional ODA flows. In the absence of a counterfactual, there is no real way to tell what part, if any, of the donor ODA budget has been cannibalized. Thus, though donor contributions on surface seem to be unambiguously about increased resource flows to the debtors, it may not be the case.

The Current Debate on Debt and the Urgency of Action

2005 represents a unique opportunity for progress towards the eradication of poverty. The challenge and crisis of global poverty will be addressed by world leaders in just weeks at the G-8 summit, and then again in the fall at the UN Summit in September and the World Trade Organization Ministerial meeting in December.

We must seize the opportunity to advance an agenda of development and justice. The US can begin by supporting 100% multilateral debt cancellation for all impoverished nations, without harmful economic conditions. There is a unique opportunity to advance this agenda in 2005.

Jubilee USA Network, its member organizations, and debt campaigners across the globe have been encouraged proposals from the Bush Administration, the UK government, and other G-8 nations on multilateral debt cancellation in recent months. We are encouraged that the official debate within the G-8 has moved from limited debt relief to embrace our long-time call for 100% debt cancellation.

But discussions within the G-8 have stalled and become more limited in recent months, and there is a growing danger that whatever deal is agreed to by the G-8 this summer at the July summit will be partial or inadequate. Thus there are several critical markers to be included in any deal on debt:

- **Full (100%) debt cancellation must be provided for all nations that need it to meet the Millennium Development Goals.** At least 50 nations need immediate and full multilateral debt cancellation. The Jubilee Act (HR 1130), a bi-partisan bill current under consideration by the House of Representatives, calls for full multilateral debt cancellation for 50 nations. But recent reports indicate that US and UK proposals for debt cancellation may limit countries eligible for 100% cancellation to 18 or less. The country list must be expanded.

- **Debt owed to the IMF must be cancelled as part of any G-8 agreement on debt.** There is a danger that IMF debt will not be cancelled as part of a G-8 agreement on debt cancellation. This would be intolerable, as IMF debt repayments represent 30% of debt payments by the poorest nations over the next 5 years. Moreover, other regional development banks such as the Inter-American Development Bank (IDB) have been exempt from debt cancellation proposals by the G-8 – an unacceptable oversight given the fact that the IDB is a very large source of debt for poor nations in the Americas.

- **Debt cancellation must come without harmful economic conditions.** So-called "structural adjustment" policies must not be a requirement for countries to qualify for or receive debt cancellation. Such policies have negatively impacted per capita income growth across Asia, Africa, and Latin America.

Even with the progress that has been made on debt and development, the largest source of disagreement within the G-8 over how to achieve a deal on debt remains how to pay for it. I have presented in this testimony a range of feasible options. **It is now a question of political will. At this critical moment I hope that we can work together to achieve a bold new deal on debt and a stronger, more prosperous world.**

Overseas Development Assistance (ODA)

Despite having signed up to a commitment to give 0.7% of their GDP as Overseas Development Aid (ODA) in 1970 under a UN General Assembly Resolution rich countries have been allocating progressively smaller proportions of their GDP as ODA. Through the actual amounts have fluctuated, the trend towards lower levels has been clear with ODA having decreased from 0.51% of GDP in 1960 to 0.25% in 2005. There have been increasing calls for the rich countries to meet their commitments – in the past couple of years this has resulted in six countries Belgium, Finland, France, Ireland, Spain and the UK specifying timetables to meet the 0.7% target before 2015. Five countries – Denmark, Luxembourg, Netherlands, Norway and Sweden already give more than 0.7% of GDP as ODA.

Now the United States needs to increase its ODA contribution to 0.7% GDP from the current level of 0.15% of GDP which puts it last amongst the major donor countries. This could easily be easily done. Surveys of Americans show that most think the federal government devotes 15% - 20% of its budget to ODA whereas the real figure is smaller than 1%. The same surveys also show that Americans would like to decrease this contribution to about 10%. This gives ample scope for increasing ODA to 0.7% of GDP – this figure will lie well within the 10% of expenditure cap that the public wants[22].

While the administration deserves credit for the innovative Millennium Challenge Accounts (MCAs) and increased spending on HIV/AIDS but this is nowhere near enough of what is needed. The MCA focus on a few well performing countries is not enough and **the US needs to find practical ways to engage with the other countries that do not qualify for the MCA.**

Equally important as the amount of aid is the quality of aid and aid effectiveness. The largest chunk of US development assistance goes to its strategic allies – such as Israel, Egypt and Russia and now Iraq and Pakistan. Less than half of US aid flows to the world's poorest countries such as those in Sub Saharan Africa which need most assistance. **A much greater share of US aid needs to flow to the poorest nations.**

As much as 70% of US aid is 'tied' to the use of US goods and services. This severely inhibits competition and is inimical to the development of local private sector suppliers and contractor skills in recipient countries. This 'tying' of aid forces recipient countries to buy more expensive US goods and services rather than competitively tender for the most cost effective providers. This diminishes the value of US aid by as much as 25% but more

[22] www.cgdev.org

important goes against the principles of local private sector and entrepreneurial development that are so critical to our professed philosophy of a market economy. It encourages aid dependency and reduces sustainability and self sufficiency. **This tying of aid is inconsistent with our professed belief in poverty reduction, free markets, competitive bidding and should be abolished. Other countries have already taken the lead and the US should follow suit.**

US aid needs to be more flexible – too many laws and directives currently specify exactly where and how ODA should be used. This in conjunction with the severe administrative burden that the management of multiple donors with different priorities and dozens of projects imposes on limited local bureaucracy further erodes the effectiveness of aid. **There is a worldwide trend towards donor co-ordination and multilateral giving which the US should increasingly subscribe to and it should let recipient countries choose their own development priorities for using aid money.**

Migrant Remittances

One of the most significant developments in the field of external resource delivery to developing countries has been a large growth in migrant remittances. Remittances can help supplement savings in recipient countries, finance consumption, education and investment and act as seed capital for small scale entrepreneurial ventures. Perhaps the biggest attraction of remittances is that they are very stable over time and can in fact be countercyclical and provide social security for the recipient community.

However, remittances are not aid; nor can they substitute for aid. While, it is true that they can play a role in poverty alleviation this role should not be overestimated as remittances are very unevenly distributed both within and across countries. Low income countries account for less than a third of total remittances to developing counties and here too just four countries – India, Bangladesh, Pakistan and Vietnam account for over two thirds of the total remittance flows to the group of sixty one low income countries. **Sub Saharan Africa receives a tiny fraction of remittance flows even though its needs are perhaps the greatest.**

Even for countries that are large recipients of remittances, certain areas within a country account for the largest proportion of emigrants and hence receive a disproportionate share of inward remittances. **So remittances can complement aid to the poorest countries but cannot substitute it.**

It is well known that remittances especially from low income workers in developed countries to poor rural communities in their countries of origin carry the highest transaction costs which can sometimes reach as much as 30% of the face value of the transactions. It is these transfers not the transfers from the professional emigrants to their urban households, which have the most development potential.

There is thus an urgent need for both developing and developed countries to act to reduce some of the punitive costs associated with remittances. **The US needs to take urgent policy action to help facilitate a lower transaction costs for remittances especially to the poorest countries. Perhaps it would be a worthwhile idea to explore making remittances fully or partially tax deductible to help stimulate higher levels of remittance flows.**

Foreign Direct Investment

Foreign direct investment is widely regarded as an important source of financing for developing countries. It can help facilitate the transfer of technology, build up local skills and help stimulate local private sector development.

However, in reality the development impact of FDI is questionable. Empirical work on this has been inconclusive. Also, the magnitude of FDI that flows into the poorest countries is not very significant. In fact, only about 13 billion of net FDI went to the whole group of low income countries and of this about two thirds was concentrated in just five countries – India, Nigeria, Vietnam, Angola and Azerbaijan and the total FDI flowing to Sub Saharan Africa (besides Nigeria) was negligible.

Also, over the past five years for which data is available, for about $100 billion dollars of total FDI that flowed into low income countries more than $45 billion flowed out in the form of profit remittances. This highlights one of the biggest problems with FDI. Since it is for profit investment, it means that as profits are taken out, countries need to attract higher and higher flows of FDI to keep net inflows.

FDI is also concentrated in the extractive sector and it has been shown that while such FDI can help poor countries exploit natural resources, it contribute little to the development of a vibrant domestic private sector. It can also lead to environmental damage and has been known to play a part in conflict.

Increasingly, FDI is taking the shape of acquisitions of local firms by MNCs which has less overall development impact than green-field investments.

Most of all, developing countries are falling over themselves to try and attract the limited amount of FDI that is available and in order to do this are offering incentives such as lower or zero income tax rates, or tax holidays or offering to help construct the infrastructure that the MNC needs or help relax labor laws. As a study by McKinsey, the consulting firm has found out, such incentives serve no purpose except to pitch one country against another and to encourage a race to the bottom. In aggregate, such incentives had little influence on the decision of investors. However, as a result of such incentives, the effective rates of taxation in some of the poorest countries in the world have turned negative thus further eroding the already limited development impact of FDI.

Portfolio flows

Portfolio flows to developing countries are even more concentrated in the middle income countries and apart from a few countries such as India play a negligible role in low income country resource flows.

Their development impact is even more questionable than that of FDI as they are usually invested for a very short term with a pure profit motive and involve no form of technology or skill transfer whatsoever. Instead, they have been known to play and important role in the boom bust cycle often observed in immature poor country financial markets such as stocks or real estates. Sometimes, as in SE Asia, these flows can also help trigger a financial crisis which can have a very damaging effect on the economy.

Plugging the leaks

Taxation is at the heart of the 'social contract' between a modern sovereign state and its citizens. In return for fulfilling duties such as 'paying a fair share of taxes' citizens are provided with security, infrastructure and essential services such as education and basic health services.

Taxation is the primary source of revenue for governments and provides them with the funds that they need to provide infrastructure, security and other amenities to their citizens. The role of governments is especially important in the most impoverished countries where the income level of average citizens is so low that they cannot afford to purchase even the most basic services through private means even in the few cases where such a choice exists.

It is widely acknowledged that without active state intervention and participation in basic health, education and infrastructure services the development of the least developed countries could not be envisaged. It is a very serious matter then that the resources available to them to fund development expenditure are diminishing.

There are three relevant themes here with implications that go far beyond just the effect on government revenues. The three are 'Tax Avoidance', 'Tax Evasion' and 'Tax Competition'. Related themes include 'Tax Havens', 'Transfer Mis-pricing' and 'Capital Flight'.

One major route by which Foreign Direct Investment (FDI) is expected to contribute to development in a country is through the Tax Revenue that is generated on the profits on the FDI which then can be used by the government to finance development expenditure. However, faced with an ever increasing negotiating power wielded by MNCs, desperation for scarce foreign exchange which is needed to pay off huge outstanding debt burdens and severe competition amongst themselves – developing countries are offering increasing sops to MNCs to invest in their country.

A typical example could look like – MNC XYZ wants to put a $100 million bottling plant in East Africa to cater to regional demand. It goes to country A and negotiates a 20% concessional tax rate instead of the standard 30%. It then goes to country B and gets them to offer a 10% tax rate using country A's offer as a bargaining chip. With these deals in hand it finally convinces country C to charge only a 5% tax rate and offer the company free land and infrastructure facilities where the costs of these is greater than any tax revenue that would be generated on company XYZ's profits. Thus country C ends up with a negative effective rate of taxation and countries A and B having lost the investment would offer even steeper tax discounts next time there is an expression of interest from a foreign firm. This example is not academic but reflects the reality on the ground in several impoverished countries where effective tax rates are now turning negative.

Trade is supposed to contribute in a major way to development primarily through revenues generated for the governments as well as through private profit that accrues to the country. More than 60% of international trade is actually intra – company trade – transactions between subsidiaries of the same firm. More than 55% of international trade (in fact most of the intra – company trade) passes through offshore tax havens providing perfect opportunities for transfer mis-pricing and profits laundering. Ball point pens (not made from gold) priced at $800 per piece, a liter of apple juice priced at $1,012, a plastic bucket priced at $725 – these are some extreme but real examples of transactions that are used to transfer profits out of

countries (both developing and developed) to zero tax fiscal paradises (tax havens). The effect on developing countries is more severe as their tax authorities lack the resources or the sophistication that tax authorities in developed countries have and hence MNCs find it easier to get away with mis-priced transactions.

Tax Evasion, Avoidance for both companies and rich individuals in developing countries is also widespread with Tax Havens playing a very major role in facilitating capital flight and money laundering which depletes the governments and countries of scarce resources needed for development. It has been estimated that developing countries collectively lose as much as $500 billion of money every year to dirty money flows.

This is an order of magnitude higher than current ODA levels and if even a fraction of these resources can be tapped for development, the level of funding for the MDGs would receive a big boost. These monies are also ideally suited for development as a large fraction of this is money owed to governments in developing countries – i.e. money that can then be directly used to fund development expenditure. It is also better quality money because unlike ODA – which carries with it the weight associated with a donor-recipient unequal relationship – capturing dirty money flows for development empowers developing countries as they get a larger share of what is rightfully theirs – so it is a form a domestic resources – which the Monterrey Consensus highlighted were ideally suited for development.

The actions needed to tackle these issues would benefit both developing and developed economies tremendously. The only real losers might be the small island tax havens which would then need to explore other avenues for raising resources. It is extremely important to note that the gain that tax havens derive from haven related activities are a very small fraction (much less than 1%) of the losses that these actions inflict on other non haven nation states. That is why a strong case can be made for the creation of a fund that will help facilitate the transition from a haven economy to a more sustainable and diversified one. This fund could easily be financed out of the proceeds of the gains accruing to developed economies from the abolition of tax haven related activity. This suggestion for a generous fund for tax havens that renounce haven activity would go a long way in reducing the opposition from these countries to moves to crack down on tax haven activity.

Amongst the steps that need to be taken are:

- Establishing a forum for international tax co-operation (not just between the OECD) countries that would facilitate an automatic exchange of information between tax authorities so that tax evasion cannot happen through the exploitation of the gaps between various tax jurisdictions. It would lower the incentives and opportunities for tax evasion, tax avoidance and transfer mispricing.

- Having an agreement on a minimum rate of corporation taxation would be very helpful to put limits to tax competition. The rate does not need to be very high as even a low rate could prevent tax rates from becoming negative.

- Legislation of a general anti avoidance principle would help clamp down on tax avoidance activity by making it illegal to indulge in activities aimed primarily at reducing tax liabilities.

- Eliminating bank secrecy would go a long way in catching perpetrators that are currently able to hide behind this secrecy and be safe from being prosecuted for laws they have broken. This would also be a very significant step in tackling the problems associated with terrorist financing, money laundering, smuggling and capital flight.

- Having an international agreement on company accounts that give a detailed breakdown of economic activity, profits and tax paid in each jurisdiction would make it much harder to avoid and evade taxes and engage in transfer mis-pricing at a large scale.

Some of these measures such as the legislation of a general anti avoidance principal can be unilateral but most others need to have at least a degree of international co-operation. This is where the USA and OECD countries can take a lead and support these issues not just from a development perspective but also as issues that would simultaneously have significant advantages for their own citizens.

Also, politically it is much more realistic to expect an agreement or consensus on the need and mechanisms for 'international tax co-operation' than for 'international taxation'. The magnitude of monetary flows that can be mobilized for example by concerted and co-coordinated action against tax havens, are also an order of magnitude higher than the revenue estimates from many of the proposed international taxes such as the 'Tobin Tax'. For example, a combination of measures suggested in the above section could easily result in as much as $100 - $200 billion of resources becoming available to developing countries in the medium run.

Unlike most other sources of development funding which imply a zero sum game – both ODA and Debt Cancellation for example imply a transfer of resources from citizens in the OECD countries to citizens in the developing world – money accruing from international tax co-operation is a win-win game. The same issues which are inhibiting development in countries as diverse as Brazil and Kenya are the factors which are leading to an erosion of the welfare sate in OECD countries. The interests of a majority of citizens in both the developing and developed world are then aligned pitting them against the interests of the super rich elite who number a few million at most.

It is also easy to get diverse constituencies such as labour unions and religious groups mobilized on the issue and parties from both the right and left end of the spectrum have much to gain. The left can use the additional monetary flows to increase welfare and infrastructure spending without unpopular tax rate hikes and the right can cut tax rates without unpopular cuts in the welfare state. Additionally security issues such as closing down channels which can be used for terrorist financing and money laundering would play well with the right of the electorate.

In fact, tax avoidance and tax evasion cost OECD governments hundreds of billions dollars every year. Co-coordinated action on international co-operation on tax matters could easily net these governments at least half of this money in new income every year. For example, the unpaid income tax on income of the more than $11.5 trillion dollars of assets held offshore alone is estimated to be about $255 billion every year. Using even $50 billion or 10% of these new tax revenues for increasing ODA flows can easily help finance the MDGs. Of course, this action will also help release tens of billions of dollars of developing countries' own money too.

The issue of tackling tax avoidance and tax evasion is thus something that has a lot of latent public support as well as support from both developing and developed country governments. **The sheer size of the problem and the positive impacts on both developing and developed countries mean that this is an issue that is likely to be politically feasible in the medium run. Policy makers and campaigners should push for the tax justice to be included as a financing for development theme because it is so central to the development debate and because the issue has not yet got the kind of attention that it deserves. So short term action can lead to some easy wins (such as the enactment of legislation enshrining the general anti avoidance principle in law by developing countries) and create the momentum and profile needed to co-coordinated action on the medium term with the potential to generate hundreds of billions of dollars for both developing and developed nations.**

Trade Liberalization

Trade liberalization and private sector involvement can play a significant role in fostering growth and development. They can help through capacity building, increasing income levels, a diversification of the economy, infrastructure development and faster growth levels. However, there is a need for caution.

The great benefits being promised by the theoretical models are, to begin with, based on questionable assumptions. Even worse, the real life implementation of trade liberalization as has been observed over the past few decades is very different from what we see on paper. Worst of all, this liberalization in its current form has not brought about most of the benefits promised though the costs imposed have been real.

Trade liberalization should be used as one amongst many policy instruments in the context of a national strategy for achieving growth and development. Trade liberalization without the external and internal supporting set of conditions has led countries to slow and erratic growth, rising poverty and unemployment, de-industrialization, a very dangerous erosion of fiscal revenues and environmental degradation

Empirical evidence from countries that have been able to use trade liberalization as an instrument for increasing growth and development (ranging from China and India, less recently the East Asian tigers, and, during this century and the last one, today developed countries such as United States and Netherlands) shows that they:

1) implemented it on a selective basis, giving priority to sectors that had achieved a certain level of economies of scale and were ready for international competition,
2) had secured a certain market and access conditions that would allow them to further develop sectors
3) had the flexibility to pace and sequence the trade liberalization process, as well as roll-it back when reforms did not work or outlived their usefulness
4) had been able to previously use trade protections as an instrument to build strong and competitive national industries
5) The state facilitated –through different policy instruments-- the provision of access to credit on affordable terms for the national industry.

It is important to mention several features and trends of current trade agreements that might hinder the ability of countries to implement a pro-development trade policy

Trade in services: current FTAs tend to incorporate trade in services, especially requiring countries to eliminate regulations that might act as barriers to foreign service providers. In many trade agreements the trend is towards "negative list" approach and require countries to slash regulations that are not the "least trade-restrictive." Countries signing onto these agreements are deprived from instruments to ensure that services needed to support the development of the productive economy are provided on affordable terms (such as financial services, transport, tele-communications)

Intellectual property rights: current FTAs tend to incorporate strong patent protection, in some cases (TRIPs-Plus mode pursued by United States) stronger than the conditions existing under the WTO Agreement. Since these protections enforce a monopoly by the owners of the patents, TRIPs-type protections had been criticized as not being really about competition, leading to even strong supporters of trade liberalization to call for taking intellectual property rights out of trade agreements. Access to technology in affordable terms is another condition required for the productive sector to be able to compete successfully.

Foreign investment: current FTAs also incorporate rules that protect rights of foreign investors, grant them National Treatment, Most Favored Nation, ban performance requirements by the host state. FDI comprises capital, know-how, technology, managerial skills and access to markets, all assets that can enhance the competitiveness of a country in international markets. However, FDI can only make this contribution when its different factors are incorporated into the local productive economy, which requires unpacking them. Investment agreements prevent countries from using policy instruments suitable to this purpose, especially performance requirements.

Cross-border capital flows: current FTAs tend to also incorporate (either under investment or financial services) rules that strip the state away from its power to establish capital controls or otherwise manage foreign capital inflows and outflows. These capital flows have been successfully used by states to ensure a stable exchange rate policy suitable to enhance export performance. Also to prevent the build up of unsustainable public and private sector debt profiles that trigger damaging financial crises.

Trade liberalization can be used to help development but must be pursued in a controlled manner. Poor countries can benefit from a reduction in import tariffs but this benefit is maximized when the abolition of tariffs is selective – on goods and services that facilitate development such as capital goods. An across the board slashing of tariffs has been shown to increase import penetration to excessive levels, discourage the development of local industries, worsen both the current account and the fiscal balance and result in a massive increase in import of luxury goods for the elite classes.

Technology transfer is a very important source of long term development under the trade regime but is not being seen in actual implementation. The liberalization of financial services too, instead of removing credit constraints has been seen to decrease access to credit for the poorest and serve as a channel for the flight of capital.

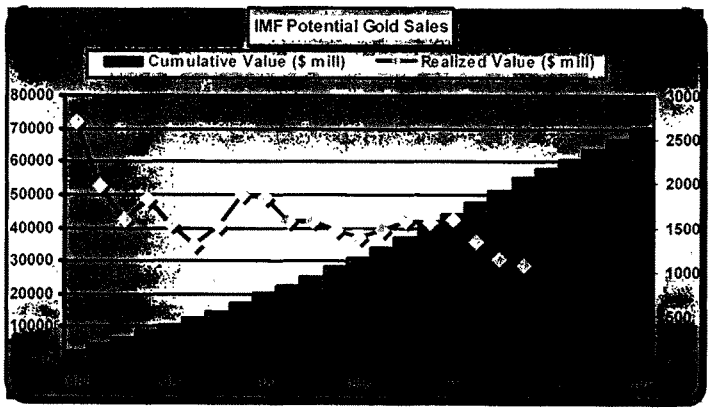
Other major issues and positive steps that can be taken

Some of the other major steps that the US can take to help maximize development for the poorest countries involve the role of the International Financial Institutions.

Maximizing the efficiency of resources available to the IFI's

The opportunity cost of holding gold

The IMF claims that the benefits of gold holdings are being passed on to members. However, this is misleading as these stated benefits are intangible and insignificant compared to the significant opportunity cost of holding undervalued gold reserves. According to our calculations[23], if the IMF had sold its gold holdings into the market gradually over a period of say twenty years from 1980 and invested the proceeds, it would have had current reserves of more than $78 billion[24]; almost twice the current market value of its gold holdings of $42 billion.



It is important to recollect, that Fund staff in 1979-1980 wanted to sell the gold and invest proceeds in income generating assets but were thwarted by lack of political will. **Had the fund sold gold gradually and invested in income generating assets, it would have had current reserves worth as much as twice the current market value of gold. So the IMF should sell some of its gold and thus use resources available more efficiently.**

---

[23] We assume that the IMF sold 5 million ounces of gold in the market every year from 1980-1999 at the market price and the proceeds from such sales in excess of SDR 35 per ounce were invested in securities yielding 5% per annum. A simple calculation shows that the IMF would now have more than $70 billion. If we add the current book value of IMF gold of about $8 billion this gives a potential current market value of $78 billion. This compares with the actual current market value of $42 billion..

[24] In Can the IMF and the World Bank cancel 100% of HIPC debt – by Sony Kapoor September 2003 at Jubilee Research for Debt and Development Coalition Ireland, we have used slightly different assumptions. In that paper, we performed conservative calculations that used a 10% discount to the market price of gold. Also, instead of using the actual value of SDR 35 we used $43 throughout as an approximation. This gave a current potential market value of $71 billion as compared to the present calculation that gives a value of $78 billion.

The IMF should transfer PRGF resources to IDA

The PRGF has been attacked by many development professionals as not being conducive to development, as severely limiting policy space, as not being concessional enough and for general ineffectiveness.

In the PRGF, the Fund has overstepped its mandate and it should immediately transfer the money available in the PRGF to IDA where it may be used to create a compensatory financing facility for commodity price shocks or just go into the general IDA pool. It is likely that this money would be more efficiently used then.

The IBRD needs to use its resources more effectively

In recent times IBRD's capacity utilization for its lending has been hovering around 50-55%. This not only means that IBRD resources may not be being used effectively but also imposes a higher interest cost on the limited borrowers currently borrowing from the IBRD.

Moreover there is clear evidence that the IBRD has excessive reserves which can be used better either through an allocation to IDA or through other means.

Modernizing the delivery of development assistance

The institutions need to go back to the spirit of their original mandate. The IMF needs to go back to being the guardian of financial stability in the international economy, lender of last resort, macroeconomic data and surveillance and institutional capacity building around systems of account, data collection and reporting and perhaps being a platform for discussion around the role that the BIS currently plays. It needs to play a merely advisory role not a hands-on policeman role in designing macro policy.

The IBRD needs to go back to being a bank and not a policy making institution. While it is important to have development oriented research and advice this should be consultative and advisory rather than binding. It needs to behave more like a private sector bank in terms of lending for projects with a more hands off approach.

IDA needs to become primarily a grant making facility. Poor countries have had problems repaying even the deeply discounted loans they have taken on. This is partly because of the exchange rate risk. Once the fall in the exchange rates of the local currencies is accounted for IDA loans are no longer very concessional. Since we have not addressed the problem of exchange rate risk yet, it is best to perhaps mostly disburse grants.

MIGA does not belong to the World Bank group. It should be either spun off or shut down altogether. Most countries have EXIM banks that serve the same function.

IFC can be much better if it is seen more as a standard setter for banks and private sector.

IBRD and IDA should be split separated.

The macro-governance structure of these institutions needs to be changed – we need to hold ourselves to the same levels of democratic decision making that we expect of other institutions and bodies. Developing countries need more representation and the overall

structure needs to be democracy based. The US uses a one person one vote system not one where the biggest taxpayers get more of a voice. We need to do the same for these institutions. Perhaps a combination of population and economy based voting is feasible in the medium term.

At the same time, the incentive structure within these institutions needs to be changed. Lessons can be learned here from the private sector and incentives for staff should be aligned with the stated macro goal of the institution. So staff performance should be measured not on how much loans they disbursed but on how much their action have facilitated development – this system would work better if feedback from developing countries is incorporated into staff evaluation.

On managing budgets basic common sense should apply. The IMF needs to help develop technical and educational capacity on managing budgets – develop robust systems. CSO can help replicate this at a local level.

The IFIs need to stress on full transparency both with the public and with the parliament. That is why budget based support is good for the development of **accountability** as each dollar is allocated and spend with parliamentary oversight. **The IFIs should discourage off budget financing which seems to be a growing trend.** It stretches the limited resources of the domestic authorities and at the same time can reduce accountability and transparency.

The IFIs need to help developing countries mobilize and retain their own resources – this can be done with the help of debt relief which immediately frees up domestic resources for domestic use. Even if debt relief comes at the cost of some aid – i.e. debt relief is financed by decreased aid flows it is very positive for institutional building and for better budgetary practices.

Citizens have more of a sense of ownership of money released from debt relief and this creates the incentives for increased democratic scrutiny and accountability – critical for long term institutional building. Citizens will participate more actively in governance and this will also help weed out corruption in the long run. The United States' own experience with regards to democratic accountability of the Federal government to the congress and citizens who scrutinize how their taxes are spent is very encouraging.

Countries need more income, therefore, they should be encouraged to tax corporations-- domestic and international and avoid harmful tax competition. International co-operation on tax policies of taxing where wealth is created and helping countries cark down on intra-firm transfer mis-pricing and tracking and reversing capital flight will all help develop more domestic revenue practices, better budgetary policy and encourage democratic participation and local institutional building. If governments can tax their own and earn local revenue, they will need less ODA/WB loans and there will be a greater sense of ownership and this in fact is the only route to sustainable development and decreasing aid dependence.

Aid and external assistance are volatile. Moreover they are more often than not accountable to external donor based structures and do not encourage the development of domestic systems.

The IFIs need to encourage country ownership, institutional development and sustainability, participation, transparency and accountability and confirm with international standards on the environment, indigenous people and governance etc.

The IFIs need to give countries policy space by moving away from Economic Policy Conditionality – DfiD has set a good precedent which should be followed.

Managing commodity price shocks

For managing commodity price shocks – there are four broad options available.

Building developing country reserves – This can be done when the commodity prices are high. The Norwegian oil fund and the Nigerian oil pool are good examples. However, this can prove tricky when commodity prices instead of just fluctuating are in a long term decline. This can also be done thorough fiscal austerity which is extremely difficult for countries with populations decimated by hunger, poverty and disease.

Compensatory Financing Facility – The development of such a facility should be encouraged and this needs to be able to disburse substantial sums of grant funds in the medium term as commodity prices are in secular decline. Such a facility can be established under the auspices of IDA with contributions coming in from both bilateral and multilateral donors. Seed capital for this could be provided by the PRGF and/or the sale of IMF gold. Some income can be generated by using income proceeds from the sale of IMF gold.

Diversification – We see ourselves in some form of a neo-colonial paradigm where poor countries are stuck in an international system as provides of primary commodities. Moreover, in the past they have been tacitly encouraged by the IFIs as well as donors to move towards cash crops and other primary commodity generation so as to maximize foreign exchange earnings. While, for a small group of countries this may have been a good idea we have now ended up in a situation where there is a systemic oversupply of most primary commodities and hence prices have been in long term secular decline.

The only way out of this is to, with an immediate emphasis, encourage and finance the diversification of developing countries productive sector – both within the primary commodity sector and away from it. Standardized – one size fits all models – need to stop being peddled.

Systemic reform - Countries need to be able to resume practice of commodity boards to buy from small farmers at guaranteed price and sell on market when prices are higher. There is a need to explore the use of derivatives to assist with short-term price volatility.

Developed countries need to a) open their markets, and b) cut out the subsidies that create surplus on international market at below production costs; allow countries to have import barriers--also source of revenue; need to support research on how to tame commodity shocks. Perhaps we need to revisit the original idea of international commodity agreements which failed in its original incarnation.

Increasing absorptive capacity

Much recent research has focused on absorptive capacity and capacity building in poor countries. It is clear from this that capacity issues are closely linked with poor infrastructure and poor institutions. Many measures can help increase absorptive capacity for the poorest countries. Some of these are

Improving transparency, improving procurement systems, reducing leakage, reducing time between allocation of external funds and disbursement and the democratization of institutions all help towards increasing capacity building for the poorest countries.

There is a string case for the development of infrastructure development to remove infrastructural bottlenecks. But it is important to be sure about who such development is targeted at. If it caters to the elite few in a country rather than the general populace, it is likely that it will fail in the long term. It is also important to ensure that there are no white elephant projects which erode credibility in the donor institutions and waste precious resources.

It is important to ensure that financing is adequate and that growth and revenue projections realistic. Else, the project may run into trouble mid-life or there may not be enough revenue generation for the purpose of the maintenance of the infrastructure.

The choices made need to be participatory and aligned with the priorities of the local government and population.

Capacity building should not automatically translate into huge flows of technical assistance. Excessive dependence on external contractors and consultant and equipment reduces trust in local talent. Instead, capacity building needs to be synergistic – feed on itself to generate even more capacity. This is entirely feasible – a big infrastructure development project for example, **offers great opportunities for maximizing the involvement of local firms, contractors, consultants and individuals and leaves them more experienced, confident and dependable**. So it generates even more long term capacity while building infrastructure.

This is the only route to sustainable capacity building. However, current practice falls far short of this ideal **with a very strong emphasis on 'tied aid' external contractors and the general use of expatriate talent and resources. This practice severely constraints local capacity building and needs to be stopped instantly.**

Development needs to emphasize longer term needs such as educational infrastructure. The collapse of higher education in Africa is very alarming.

The US green card system is a good place to start the discussion on the movement of natural persons. There needs to be an expansion on the temporary movement to of natural persons and a check on the alarming loss of professionals especially from the poorest countries in Africa. Sensible steps need to be taken to help the development of an experienced

In summary

Broadly the main issues involved in tackling the problem of development are

1) **Freeing up more policy space for poor countries. This would help them have domestically owned development strategies, give flexibility to adapt to local**

conditions and allow them to foster a better and more accountable democratic regime.

2) **Being wary of pushing standardized one size fits all policy approaches including indiscriminate trade liberalization. Such standardized policies have partly been responsible for the race to the bottom that has been observed in taxation issues as well as in commodity prices.**
3) **Increasing the quality and quantity of resources available to developing countries. There needs to be an increase in the quantity of ODA in the short to medium term. Moreover, in order to increase the effectiveness of aid, there needs to be higher donor co-ordination, reduced economic policy conditionality and an immediate 'untying' of aid.**
4) **Stopping the leakage of resources from developing countries. Billions of dollars flow out of the poor countries in the world in the form of debt servicing as well as dirty capital flows. Debt should be immediately cancelled and action should be taken to minimize the outflow of money through tax avoidance, tax evasion, transfer mis-pricing and illegal capital flight.**

I would like to sincerely thank members of the congress for this opportunity. I will be available for follow up questions at any time and am happy to make supporting documentation available.

Sony Kapoor - Biography

Sony Kapoor works on issues relating to international finance, development and governance both with Non Governmental Organisations and various Governments. He is the senior policy advisor to Jubilee USA Network, Christian Aid UK and the International Tax Justice Network, which advocates regulation of tax havens. Sony is also a member of the New Rules for Global Finance Coalition.

For the past two years, Sony has played a leading role in the international policy and advocacy effort around multilateral debt cancellation and other development issues. Sony has written extensively on debt, financial stability, taxation, and development financing.

Mr. Kapoor has a background in the financial services industry having worked both as a banker and a derivatives trader. He has a Masters degree in international finance from the London School of Economics and an MBA in Finance. Sony also holds an engineering degree from the prestigious Indian Institute of Technology.

STATEMENT OF

R.T. MCNAMAR

ON BEHALF OF

THE BRETTON WOODS COMMITTEE

ON

DEBT AND DEVELOPMENT: HOW TO PROVIDE EFFICIENT, EFFECTIVE ASSISTANCE TO THE WORLD'S POOREST COUNTRIES?

BEFORE

THE DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE AND TECHNOLOGY SUBCOMMITTEE OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

JUNE 8, 2005

INTRODUCTION

Madam Chairman, Ranking Member Maloney, and members of the Subcommittee, it is an honor and pleasure to appear before the Subcommittee today. My name is Tim McNamar.[1] I am a Senior Advisor to PricewaterhouseCoopers on advanced information technology for accounting. In earlier days, I served in the Reagan administration as Deputy Secretary of Treasury. Since then, I founded two Internet startups and served in senior management positions in a number of leading U.S. financial institutions.

I am here today as a witness for The Bretton Woods Committee of which I am a founding member.[2] The Bretton Woods Committee is a bipartisan, public education organization dedicated to increasing understanding of the benefits to the United States of global economic growth, development, and liberalized trade. The group reminds the public and their elected officials about the key role played by the multilateral institutions in helping meet these goals. This includes the World Bank, the International Monetary Fund, and the World Trade Organization, along with the regional development institutions. The Committee also participates in the policy development process by

[1] In compliance with Congressional rules, a brief biographical statement appears at the end of this statement.

[2] The views I offer today are my individual views and are not necessarily reflective of views held by other members of the Bretton Woods Committee. They also do not represent views of PricewaterhouseCoopers LLP.

reviewing current issues and sharing its conclusions with the public, government officials, and leaders of the multilateral institutions.

The Bretton Woods Committee is comprised of about 700 members from across the country. Typically, they are opinion leaders: heads of businesses, universities, labor groups and NGOs along with former government officials. We are proud of the fact that all the former secretaries of Treasury and State are members, as are a good number of former members of Congress. Our co-chairmen are former Congressman Bill Frenzel and Gerald Corrigan, the one-time president of the New York Federal Reserve. Jim Orr, who as some members of the Subcommittee will remember, served as the international counsel to the Financial Services Committee in the late 1970s and early 80s, provides day to day leadership of the Committee.[3]

I am delighted to discuss with you some thoughts on how to increase the effectiveness of development assistance to the world's poorest countries. My testimony will cover some of my own perspectives and those of The Bretton Woods Committee on improving the quality and quantity of development assistance over the immediate, medium, and long-term. I will begin urging continuing support for assistance efforts offered through the International Development Association (IDA) and the regional development banks, and will then share ideas on some creative initiatives I believe could make development resources go further.

[3] Truths in Testimony rules require a statement about the receipt of any federal grants or contracts. As a matter of policy, The Bretton Woods Committee accepts no government support of any kind. Nor does it accept funding from the any multilateral financial institution. It is supported solely by voluntary contributions from its members along with occasional foundation grants.

IMMEDIATE ACTION: IDA REPLENISHMENT

While the subject of today's hearing does not specifically deal with the World Bank's assistance program aimed at the poorest countries – the International Development Association, or IDA – replenishment legislation for this important program will soon come before you. No development program has proven more effective in helping the world's poorest countries emerge from absolute poverty. IDA has enjoyed a tradition of bipartisan support from every U.S. administration and Congress since the Eisenhower era. It is an interesting historical fact that a member of Congress first suggested the creation of IDA, and American support and ideas have helped the agency evolve and become more effective over the years. Today, the United States remains a linchpin to IDA's success, leading the way in institutional modernization and increasing IDA's effectiveness in eradicating poverty throughout the developing world.

IDA policy reflects U.S. values in many ways. IDA and the World Bank share the U.S. belief in the importance of open economies and free market discipline for promoting growth and stability. The World Bank pioneered the push for the "democratization" of aid decision-making, insisting that borrowing countries reach a broad domestic consensus on development priorities and strategies. The World Bank also promotes transparency, demands accountability, and helps recipients fight corruption. IDA has also embraced the U.S. initiative to shift toward "results-oriented" development strategies.

IDA reflects the United States' strong humanitarian values and demonstrates a serious commitment to social development. Sound economic and political institutions cannot work unless people are healthy and educated enough to take advantage of them. IDA's commitment to fight hunger and malnutrition and to encourage the poorest nations to invest in their own people's health and education reflects the Unites States' commitment to human dignity and self-sufficiency.

IDA has helped advance U.S. security interests. IDA projects address the scourge of poverty – the number one cause of unrest in the world – and other global security threats, including migration and the spread of HIV/AIDS. Massive migration due to conflicts, for instance, create major social and economic dislocations. IDA makes it possible for people to confront problems within their own borders without fleeing to other countries to escape their desperate situations. Similarly, through support for a systematic attack on HIV/AIDS in countries that lack the basic resources to fight the pandemic on their own, IDA helps slow the spread of the disease from one country to the next.

In an indirect way, IDA lending has also advanced U.S. trade and economic policy goals. IDA's main focus is to increase productivity by improving access to basic education, training, health care, clean drinking water, and other basic necessities. This helps promote economic stability in the short run and ultimately helps countries grow to the point that they can become active participants in the world economy and valued trading partners.

IDA's work in developing countries has created new markets for some U.S. goods like food grains, capital equipment, and technology. IDA requires that foreign suppliers to projects it finances be chosen by international competitive bidding. This fair bidding structure has helped U.S. firms sell equipment to World Bank and IDA-financed projects. Over the years, such sales have nearly matched total direct U.S. contributions made to the World Bank and IDA.

It is our belief that enactment of the IDA replenishment legislation, along with similar replenishments for the African and Asian Development Banks, will allow these institutions to continue channeling vital assistance and enable the United States to keep faith with its commitments and obligations as the world's leading economy.

CREATIVE WAYS TO MAXIMIZE DEVELOPMENT RESOURCES

More resources are needed to help bring countries out of poverty. The world's leaders recognized this five years ago when they met and agree to make a dramatic increase in development resources by the year 2015. Yet, these Millennium Development Goals remain well beyond our current reach. Government officials and leaders of development institutions are actively searching for new resources or new mechanisms to bridge the gap. This will be a central focus of the G-8 economic summit in Scotland in a few weeks.

I believe the timing is right to explore innovative means of maximizing both the resources available to developing countries as well as the delivery of sustainable changes. There is considerable worldwide support for expanded debt relief for a limited number of world's poorest countries who lack the ability to repay past loans. The U.S. Congress has been a stalwart in providing funds in the past for debt relief. Of course, debt relief must be done carefully to ensure that long lasting gains are made. And funding for debt relief should not come at the expense of IDA's resources. We must bear in mind that IDA and other programs for the poor rely on repayments of past loans to supplement annual donor contributed funds. This means that to maintain current levels of support donor countries either to increase their financial commitment to IDA or to pursue new and creative mechanisms that will maximize available resources. Several donor countries have expressed hesitation at the idea of increasing their commitment, which provides further impetus for "thinking outside the box."

The Bretton Woods Committee recently shared a set of recommendations with the new president of the World Bank. A number of these suggestions would have the effect of stretching resources further. I will outline of few of the most relevant. The full list of recommendations is appended to this statement, along with a proposal of my own to use oil-backed bonds for development.

Employing Modern Financing Techniques

The World Bank is well behind the curve of financial innovation. Instead, it should be on the forefront, leveraging its financial position and that of its donors to

maximize development assistance flows. It should be much more open to the adoption of modern financial market techniques that could permit expansion of its resource base and the creation of new products to spur new investment in development.

The Bank can do this with minimal risk. Among the ideas it should consider are: expanded use of guarantee instruments; the creation of special purpose financing subsidiaries, perhaps backed by callable capital; securitization of some Bank or IDA loans, perhaps with Bank provided credit enhancements; and other mechanisms to "leverage" the Bank's balance sheet for development.

Modernizing the Bank's Investment Portfolio

The Bank should consider diversifying its portfolio to raise current and longer-term yields, and should consider contracting out portions of the portfolio to established money managers on a global basis. The Bank should invite proposals as to how it should invest its capital and pick the best balance among the proposals. An easily achieved 1 percent improvement in the Bank's yield on its $35 billion portfolio would mean a $350 million annual increase in Bank profits – a sum greater than all the profits derived from the IBRD's market-based lending. Increased Bank profits can be used to help finance the important shift to grant assistance and other new initiatives.

Increasing Performance-Based Assistance

The World Bank and other multilateral development banks should provide a greater proportion of their assistance to the good performing countries. However, IDA and other soft loan windows should continue to provide poverty reduction assistance to

all poor countries, even the poor performers. Where governments lack the capacity or are themselves the obstacle, the soft loan lenders should work through non-governmental organizations (NGOs) or businesses.

Graduating Middle-Income Borrowers

The Bank has not been sufficiently rigorous in enforcing its graduation policy for countries that can access the private capital markets. In one sense it is tying up capital that could be better used for higher priority development needs, e.g. Africa. However, the Bank relies on the income from these loans to cover approximately one-half of its annual operating budget. More creative thinking should be given to levels or forms of graduation, phase outs, and knowledge management for fees that the Bank can perform that would be substitute income from the most credit worthy borrowers. There may be a variety of securitizations, bank credit enhanced refinancing, etc. that will move the bank toward more rigorous enforcement of its graduation policy while preserving some of the Bank's income from this group of borrowers.

Enhancing Donor Coordination

More effective donor coordination is critical to avoid duplicative efforts and waste. This must be accorded a higher priority. The World Bank must also continue to measure its skills against other institutions, especially the regional development banks. It should develop metrics to test its lending efficiency, project implementation, staff size, etc., against the regional institutions.

Creative resource management should be accompanied by a thoughtful review of Bank priorities, focus, and delivery. I will review some policy areas key to sustainability and growth to which the Bretton Woods Committee has the new World Bank management to pay particular attention.

Decisive Help for the Private Sector

It is imperative that the Bank offer decisive help to develop the private sector in developing countries. No country has ever broken out of the ranks of the "poorest" to achieve the status of an "emerging market" without first creating a well functioning private sector able to permit capital formation and the building of local businesses, which employ workers and pay taxes to support other governmental services. Aid to the private sector, as the Bank's Operations Evaluation Department recently suggested, is the best way of reducing poverty.

To this end, the Bank should focus on two things. First, it is crucial to increase the skill set of the Bank's in-country staff relating to the private sector, through training, business internships, and other innovative programs. The Bank should also encourage developing countries to actively promote foreign direct and portfolio investment.

The International Finance Corporation (IFC), which is the Bank's main instrument to help the private sector, should do two things. One is to provide aid directly to private sector companies in the developing world. The other is to work closely with private companies in other countries that wish to make investments in the developing world. The IFC will need increased capital to address these issues. The Bank should,

therefore, consider the transfer of some of its capital to the IFC, as it has done in the past. The Foreign Investment Advisory Service (FIAS) and the Multilateral Investment Guarantee Agency (MIGA) should also be expanded.

Lending to Sub-Sovereigns

As a further step to strengthen the Bank's private sector role, the Bank's articles should be changed if necessary to allow greater lending flexibility. For example, both the World Bank and IDA should be able to lend directly to sub-sovereign entities. Since the London-based EBRD, which lends directly to the private sector, enjoys an AAA rating, changing the Bank's articles to permit a broader range of lending should not undermine its own AAA credit rating.

Using New Thinking and New Modalities

The Bank needs to redouble efforts to deliver basic infrastructure to borrowers, particularly to disadvantaged areas, where private sector finance will not be available. This means radically more efficient and effective ways must be found to secure infrastructure development and to increase the role for private investment where possible. Similarly, creative new ways must be found to assist the humanitarian, housing, health, and education needs of the world's poorest people. In some instances, this will require bypassing public authorities and greatly expanding direct work with NGOs with proven effectiveness.

The shockingly low disbursement of funds targeting AIDS in recipient countries provides a poignant example of this dire need. In 2004, only 40% of the funds committed

to fight AIDS were disbursed due to inadequate human and other infrastructure in the recipient countries.

Stepping Up the Fight Against Corruption

Anti-corruption must be at the vanguard of all multilateral development efforts, and much more remains to be done. The Bank should maintain pressure on governments to confront corruption within their borders. Its agencies should provide increased funding and technical assistance to support anti-corruption efforts and to help empower an active civil society that can help reinforce this.

DEBT RELIEF

The Bretton Woods Committee was and early and steady advocate of carefully structured debt relief. At critical junctures, we played a behind the scenes role in helping persuade other government representatives that multilateral debt relief could work.

More must be done to end the vicious lend-and forgive cycle. Several creative solutions have been proffered, however it is apparent, even at this stage that building an international consensus will be the biggest impediment to moving beyond initial discussions.

U.S. Treasury Department's Plan

Secretary Snow's proposed 100% debt relief for the Heavily Indebted Poor Countries (HIPCs). All repayment obligations would be removed and new assistance flows would be reduced by the amount that is forgiven. Importantly, net transfers would not decline for any country undergoing debt forgiveness. Maintaining constant net flows across countries ensures that no country receives more favorable treatment than others because of debt relief and that no country benefits from having excessively borrowed in the past.

Counseling Caution

We advise caution against the adoption of dramatic changes that could impair the World Bank Group's ability in the future to provide the highest level of service to its client countries. It is important to ensure that any solution maximizes the effectiveness of the savings from repayments forgiven.

Grants and loans extended through IDA or IBRD are accompanied by assistance from Bank experts in program selection and implementation according to the country assistance strategy as determined by the client country and Bank staff. The process ensures that resources are channeled to meet each country's individual development objectives, assistance is provided where needed, and transparency measures ensure that assistance safely reaches its destination, unimpeded by officials seeking to divert funds for other purposes.

Relieved repayments would not be subject to this kind of arrangement. Recipient countries would freely determine their use, which could prove problematic in countries struggling to establish a culture of institutional integrity. Economic problems in the poorest countries are largely rooted in domestic issues such as governance, corruption, lack of policy coherence, corporate and public governance, and internal political strife.

The Committee therefore urges policymakers to require that any new substantial debt relief be accompanied by ample assurances that the money is used wisely and solely to further the country's development agenda. All of want to help ensure that debt forgiveness has long lasting benefits for the recipients, and we owe it to taxpayers providing the resources to ensure strict oversight.

The international community is entertaining several other proposals that offer varying degrees of feasibility and deserve mention. These ideas will be discussed further at the upcoming G-8 summit in Gleneagle.

The International Finance Facility

The British proposed International Finance Facility (IFF) would constitute a financing mechanism that could provide an additional $50 billion in development assistance in the years up to 2015. The IFF would leverage long-term donor commitments made to produce additional money now from the international capital markets. Bondholders would be repaid using future donor payment streams.

For the United States, the IFF is a non-starter for several reasons. By pledging future steady aid streams, it would effectively require one Congress to limit the actions of future Congresses, which presents problems. It is also seems unlikely that Congress would be willing to vote any sizable increases in international development resources, given the current tight budget situation and the limited constituency for such increases. Finally, there is concern about borrowing countries' capacity to use additional aid effectively. Too much money chasing too few good opportunities could undermine public support for development assistance within donor countries.

Selling off the IMF's gold reserves for debt relief

Gordon Brown has also thrown Britain's lobbying efforts behind the idea of selling a share of the IMF's gold reserves in order to fund debt relief. The IMF holds 103.4 million ounces of gold at a book value of $9 billion and a market value of $45 billion. The selling of 16 million ounces of IMF gold would raise an estimated $7 billion for the debt relief cause. Proponents say that this amount would not only cover the short term goal of 100% debt cancellation for approved countries, but would also insure these countries for 10 years against unforeseen fiscal risks and would help the IMF with plans to issue grants rather than loans to some of its poorest members.

Those opposed to IMF gold sales say doing so could flood the market, drastically lowering gold prices, causing a market shake up that could be damaging to many countries around the world including some of the most severely indebted countries in Africa that depend on gold as a primary export. The United States, France and Germany

have ruled out the IMF gold sales plan, and Canada strongly opposes it. Japan has expressed concern that complete debt write-off could provide too much relief, however did support the IMF gold sales plan.

Global Taxes

A Franco-German proposal to raise revenue through the introduction of global tax instruments has also been making the rounds. Global tax proponents point to the idea of an international airline fuel tax, which, if levied globally at a rate of $0.20 per gallon, could raise about $9 billion annually. A global tax on arms sales could also raise significant sums.

Reactions vary to proposed global tax mechanisms to help finance development. The U.S. administration has expressed concern that the global tax could be destabilizing to world markets and does not support the proposal. If it is to move beyond the idea phase, the first hurdle will be to win more support for the idea. Given the difficulty of raising taxes here in the United States, even for programs highly valued by constituents, it would seem a difficult task to muster the necessary political support.

CONCLUSION

In conclusion I would like to reiterate that while the challenges to development are great, so are the opportunities. We urge the Congress to provide support for the authorization measures and appropriations for IDA, the African Development Bank and

the Asian Development Bank. Members of The Bretton Woods Committee stand ready to lend support to you in this. Thank you for your attention.

Attachments:

- Biographical Statement of R. T. McNamar
- Bretton Woods Committee Recommendations to New World Bank Management
- "Oil for Development" Proposal
- Signed "Truth in Testimony" Disclosure Form

Hon. Judy Biggert

Dr. Birdsall, your testimony and your recommendations to World Bank President Wolfowitz both advocate the elimination or reduction of "hassle costs" in borrower dealings with the World Bank.

a. What exactly do you mean by "hassle costs"?

b. Do you include within this term the full range of anti-corruption and procurement policies in place within the World Bank that seek to ensure that development assistance reaches the people that most need it?

c. I cannot believe that you would recommend reducing anti-corruption protections so that the World Bank could gain more clients. Could you clarify your position?

The New York Times

Editorial

June 3, 2005

The Price of Gold

If you could improve the lives of hundreds of millions of the world's most destitute people with a program that might - just might - temporarily reduce the profits of the global gold industry, most people would probably think it is worth doing. Even most members of Congress. That's why it has been so disturbing to see gold producers strong-arm Congress and the White House into blocking just such a desperately needed measure.

Poor countries need debt relief. Some African governments spend three times as much on debt service as they do on health care. They could be using the money to train nurses, eliminate school fees and fight AIDS. More debt relief is needed, and a deal needs to be sealed at the summit of the Group of 8 industrial countries in July.

A real solution has been postponed because the wealthy countries can't agree on how to finance it. But Britain offered a good answer: have the International Monetary Fund sell about $12 billion of its gold reserves, which have a total market value of about $43 billion. That would cover debt owed the fund, which accounts for 30 percent of the interest payments owed over the next 5 to 10 years by the affected countries. The fund could sell more gold to cancel debts owed the World Bank and other banks.

This is the simplest and least painful solution. It would not require new contributions or hurt lending to middle-income countries, and it is the only one that has any hope of support from rich countries. But the United States has veto power over gold decisions in the monetary fund, so this idea needs approval from Congress - and the mining industry has blocked a vote. In January, a letter opposing the sale of I.M.F. gold was signed by 12 senators from Western states, including the Democratic leader, Senator Harry Reid of Nevada. The letter argued that the sale could drive down the price of gold. A similar letter was signed in March by 30 members of the House.

Because few lawmakers spend much time thinking about the I.M.F., the letters -sparked by lobbyists from the National Mining Association and gold mining companies - persuaded the leadership that the gold proposal would not pass, even before it came up for discussion. The Bush administration, apparently unwilling to take on a Congressional fight, began in April to oppose gold sales outright.

The gold industry is worried about a pricing hit that probably would never happen. In March, the monetary fund concluded that gold prices would not be affected, as it could sell the gold over several years while at the same time asking central banks to sell less. Gold-producing poor countries endorse I.M.F. gold sales. The president of the World Gold Council said recently that he would give them conditional support. Congress needs to debate the issue, not allow a special interest to deny help to hundreds of millions of poor people. President Bush should spend the political capital to push this good idea through the Republican-controlled Congress before the July summit.

The New York Times
Editorial

June 8, 2005

Crumbs for Africa

President Bush kept a remarkably straight face yesterday when he strode to the microphones with Britain's prime minister, Tony Blair, and told the world that the United States would now get around to spending $674 million in emergency aid that Congress had already approved for needy countries. That's it. Not a penny more to buy treated mosquito nets to help save the thousands of children in Sierra Leone who die every year of preventable malaria. Nothing more to train and pay teachers so 11-year-old girls in Kenya may go to school. And not a cent more to help Ghana develop the programs it needs to get legions of young boys off the streets.

Mr. Blair, who will be the host when the G-8, the club of eight leading economic powers, holds its annual meeting next month, is trying to line up pledges to double overall aid for Africa over the next 10 years. That extra $25 billion a year would do all those things, and much more, to raise the continent from dire poverty. Before getting to Washington, Mr. Blair had done very well, securing pledges of large increases from European Union members.

According to a poll, most Americans believe that the United States spends 24 percent of its budget on aid to poor countries; it actually spends well under a quarter of 1 percent. As Jeffrey Sachs, the Columbia University economist in charge of the United Nations' Millennium Project, put it so well, the notion that there is a flood of American aid going to Africa "is one of our great national myths."

The United States currently gives just 0.16 percent of its national income to help poor countries, despite signing a United Nations declaration three years ago in which rich countries agreed to increase their aid to 0.7 percent by 2015. Since then, Britain, France and Germany have all announced plans for how to get to 0.7 percent; America has not. The piddling amount Mr. Bush announced yesterday is not even 0.007 percent.

What is 0.7 percent of the American economy? About $80 billion. That is about the amount the Senate just approved for additional military spending, mostly in Iraq. It's not remotely close to the $140 billion corporate tax cut last year.

This should not be the image Mr. Bush wants to project around a world that is intently watching American actions on this issue. At a time when rich countries are mounting a noble and worthy effort to make poverty history, the Bush administration is showing itself to be completely out of touch by offering such a miserly drop in the bucket. It's no surprise that Mr. Bush's offer was greeted with scorn in television broadcasts and newspaper headlines around the world. "Bush Opposes U.K. Africa Debt Plan," blared the headline on the AllAfrica news service, based in Johannesburg. "Blair's Gambit: Shame Bush Into Paying," chimed in The Sydney Morning Herald in Australia.

The American people have a great heart. President Bush needs to stop concealing it.

Center for Global Development

• Edward W. Scott
Chairman
• Nancy Birdsall
President

Board Members
Bernard W. Aronson
• C. Fred Bergsten
Kwesi Botchway
Jessica P. Einhorn
Timothy F. Geithner
C. Boyden Gray
• Bruce Grayson
José Angel Gurría Treviño
James A. Harmon
Rima Khalaf Hunaidi
Carol J. Lancaster
• Susan B. Levine
Nora C. Lustig
Paul O'Neill
Peter McPherson
• John T. Reid
•• Dani Rodrik
William D. Ruckelshaus
• Richard H. Sabot
Jeffrey D. Sachs
Ernest Stern
Belinda Stronach
Lawrence H. Summers
• Adam Waldman
Kevin Watkins

• Member of Executive Committee

•• Ex officio, Chair of Advisory Group

Honorary Members
John L. Hennessy
Colin Lucas
Amartya Sen
Joseph Stiglitz

Response of Dr. Nancy Birdsall
to Questions from Representative Judy Biggert

July 2005

1. In my view, "hassle costs" are a combination of 3 different kinds of costs: 1) legitimate environmental, social and anti-corruption safeguards; 2) other fiduciary and procurement, compliance safeguards; 3) internal bureaucratic costs, including the long periods of time between stages in the project preparation phase.

2. The effect of the profusion of project safeguards and program conditionalities on quality may be driving away some middle-income borrowers from the World Bank, particularly from interest in large infrastructure projects. When I refer to minimizing the "hassle costs," I am primarily speaking about categories 2) and 3). I think that the Bank, working with the shareholders, can minimize these costs in a way that is satisfactory to all parties.

3. For the high-performing borrowers, let me offer one possible solution to deal with reducing some of these costs. To be clear, I am absolutely not recommending the abolishment of any project safeguards, including anti-corruption protections and procurement policies. What I am advocating, however, is that the Bank devise a system whereby each client country is rated according to the full range of its internal capacity on procurement, transparency, audit, anti-corruption, etc. Once the Bank develops these ratings, it can make a sound determination based on the evidence concerning the countries that the Bank can rely on to implement the necessary range of safeguards themselves. This reliance on "country systems" should only occur if and when the Bank has devised some kind of adequate rating system. There will undoubtedly be some countries whose internal country systems will be wholly adequate—reducing the "hassle" costs vis-à-vis the World Bank And there will be others whose country systems are less developed, and in those countries the Bank will retain its role on safeguards, etc.

4. So, when I referred to a "hassle-free" lending instrument in my testimony, what I was referring to was the ability for high-performing developing countries with adequate country systems to borrow from the Bank, relying on their own internal safeguard measures, rather than the Bank's. This would surely reduce hassle costs and improve countries' borrowing relationship with the Bank.

1776 Massachusetts Avenue, NW, Third Floor
Washington, DC 20036
T: 202.416.0700
F: 202.416.0750
www.cgdev.org

February 7, 2006

Jubilee USA Network Response to Rep. Barney Frank's Inquiry Regarding Sony Kapoor's House Financial Services Testimony on June 8, 2005

South African and Tanzanian government statements in favor of IMF gold sales to fund impoverished country debt relief and cancellation

"We would probably want to ask that if we could speed up debt relief and ensure that there is deeper debt relief for African countries, that the IMF sales get precedence over some of the other countries sales."

Trevor Manuel, South Africa Finance Minister, speaking on the sidelines of a two-day meeting of Britain's Commission for Africa, March 2005

"I have been assured that selling [IMF] gold would not drastically affect the price of gold in the world market. So I'm in favour of it. Not as an alternative but as an addition to what Gordon Brown has suggested in terms of the IFF funding for development in our countries."

President Benjamin Mkapa of Tanzania in response to a question about use of IMF gold at Jubilee Debt Campaign conference, 26 February 2005

222 East Capitol St, NE
Washington, DC 20003

202.783.3566 tel
202.546.4468 fax

www.jubileeusa.org

Joining hands to break the chains of debt

February 13, 2006

Jubilee USA Network Response to Rep. Carolyn Maloney's Inquiry Regarding Negative Aggregate Debt and Aid flows from the developing world – Supplement to US Congress Testimony by Sony Kapoor on Debt and Development, 2005

The tables 1 and 2 presented in this section is derived from Global Development Finance, 2005 statistics published by the World Bank.

Table 1

Table Comparing Interest, Debt Service and Grants 1970-2004		
	Region	*In US$ million*
Interest	All developing countries	2,063,753
Debt Service	All developing countries	5,543,180
Grants	All developing countries	663,013
Interest	East Asia & Pacific	387,135
Debt Service	East Asia & Pacific	1,126,526
Grants	East Asia & Pacific	59,037
Interest	Europe & Central Asia	367,947
Debt Service	Europe & Central Asia	1,134,570
Grants	Europe & Central Asia	112,387
Interest	Latin America & Caribbean	915,573
Debt Service	Latin America & Caribbean	2,252,370
Grants	Latin America & Caribbean	59,836
Interest	Low income	218,350
Debt Service	Low income	544,144
Grants	Low income	324,483
Interest	Lower middle income	1,076,812
Debt Service	Lower middle income	2,893,067
Grants	Lower middle income	171,150
Interest	Middle East & North Africa	156,135
Debt Service	Middle East & North Africa	427,887
Grants	Middle East & North Africa	102,997
Interest	Middle income	1,742,263
Debt Service	Middle income	4,625,241
Grants	Middle income	198,403
Interest	South Asia	121,001
Debt Service	South Asia	305,508
Grants	South Asia	33,023
Interest	Sub-Saharan Africa	115,962
Debt Service	Sub-Saharan Africa	296,319
Grants	Sub-Saharan Africa	116,868
Interest	Upper middle income	665,451
Debt Service	Upper middle income	1,732,174
Grants	Upper middle income	21,125

222 East Capitol St, NE
Washington, DC 20003

202.783.3566 tel
202.546.4468 fax

www.jubileeusa.org

As we can see, for all categories of countries, the total debt serviced between 1970 and 2004, significantly exceeds the total amount of aid inflows. What is even more surprising is that for all these groups, the total interest paid in this period also exceeds the total amount of aid inflows. This turns on its head the commonly held view that significant sums of money flow from the rich developed world into the poor developing world every year. Instead what we see is a net outflow of resources even when we look just at debt and overseas development aid (ODA).

The current picture, though slightly better is also alarming. The following table shows how the outflows on debt service still significantly exceed aid inflows for all groups of developing countries.

Table 2

Table Comparing Interest, Debt Service and Grants in 2003		
Interest	All developing countries	101,180
Debt Service	All developing countries	419,774
Grants	All developing countries	43,358
Interest	Low income	9,849
Debt Service	Low income	34,543
Grants	Low income	27,120
Interest	Lower middle income	61,350
Debt Service	Lower middle income	239,746
Grants	Lower middle income	8,133
Interest	Middle income	91,332
Debt Service	Middle income	385,231
Grants	Middle income	16,238

However, there are two more factors which make the situation for developing countries even worse than it may appear at first glance.

1) A significant proportion of the debt being serviced was not legitimately incurred

A significant part of the money contracted as debt, especially during the cold war, was money that never made it into the country but instead ended up in secret foreign bank accounts of corrupt dictators who were given the money for geo-strategic reasons not related to development or poverty reduction. The money given to Mobutu, which included the largest IMF loan (at that point in time) was an example of such a loan that ended up in offshore accounts. The following table[1] documents some examples of this.

[1] *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* by Raymond Baker, Wiley, 2005

Table 3

Dictator	Country	Period Active	Conservative Estimate
Mohamed Suharto	Indonesia	(1967-1998)	$15 - $35 billion
Ferdinand Marcos	Philippines	(1972-1986)	$5 - $10 billion
Mobutu Sese Seko	Zaire	(1965-1997)	$5 billion
Sani Abacha	Nigeria	(1993-1998)	$2 - $5 billion
Slobodan Milosevic	Yugoslavia	(1989-2000)	$1 billion
Jean Claude Duvalier	Haiti	(1971-1986)	$300-$800 million
Alberto Fujimori	Peru	(1990-2000)	$600 million
Pavlo Lazarenko	Ukraine	(1996-1997)	$114 - $200 million
Arnoldo Aleman	Nicaragua	(1997 – 2002)	$100 million
Joseph Estrada	Philippines	(1998 – 2001)	$78 - $80 million.

Part of the money given as debt helped illegitimate regimes such as the apartheid regime in South Africa stay in power longer than they otherwise would have. The population of these countries has suffered twice – first when this money helped the illegitimate regimes suppress them and now when they have to pay this back.

Significant amounts of loans were also given irresponsibly such as the loan given to finance the construction of the Bataan nuclear plant in the Philippines that was built on an earthquake fault line because of insufficient due diligence and cutting corners. Though it never has and never will generate any electricity the citizens of the Philippines are still servicing millions of dollars a day from this loan diverting the money away from essential social expenditure.

So not only are the amount of interest and debt service paid by developing countries greater than the aid inflows but what make the situation worse is that they are having to service this debt despite a significant proportion of it never having benefited them in the first place.

2) A significant amount of capital is fleeing developing countries every year

In addition to the outflows thorough debt servicing, a significant amount of money is illegally leaking out of developing countries. The following tables - 4[2] and 5 [3] give some estimates of how large this amount is. A large proportion of this leakage happens through transfer mis-pricing by large trans-national corporations operating out of developing countries and is handled by western banks operating through tax havens.

---

[2] Boyce, James, and Leonce Ndikumana, 2001, "Is Africa a Net Creditor? New Estimates of Capital Flight from Severely Indebted Sub-Saharan African Countries, 1970–96," *Journal of Development Studies*, Vol. 38, No. 2, pp. 27–56

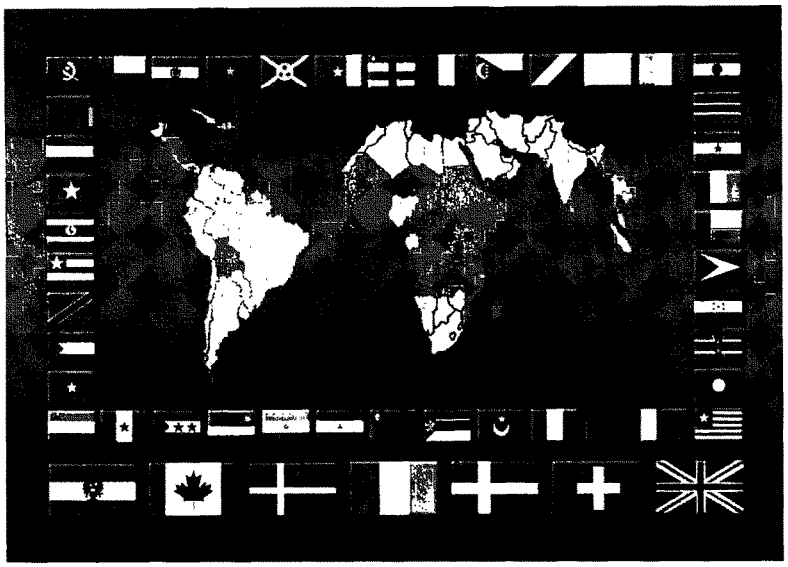
[3] *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* by Raymond Baker, Wiley, 2005

Table 4

Capital Flight from some African countries between 1970 and 1996	
Country	$ million
Angola	17,033
Côte d'Ivoire	23,371
Mozambique	5,311
Nigeria	86,762
Zambia	10,624

Table 5

Annual Capital Flight from Developing Countries through Commercial Transactions		
	High Estimate ($ billion)	Low Estimate ($ billion)
Mispricing	150	100
Abusive transfer Pricing	200	100
Fake Transactions	200	150
Total	**550**	**350**



DEBT RELIEF AND FINANCING THE MDGs

Communiqué of the 11th Meeting of HIPC Finance Ministers

Maputo, 16 March 2005

The 11th meeting of Finance Ministers of Heavily Indebted Poor Countries (HIPCs) was held in Maputo on 16th March 2005, under the joint chairmanship of H.E. Manuel CHANG, Minister of Finance of Mozambique, and H.E. Adelino Castelo DAVID, Minister of Finance of Sao Tome & Principe. Representatives of 20 HIPCs took part, and made important recommendations for measures to improve debt relief delivery, assure long-term debt sustainability, and finance the attainment of the Millennium Development Goals (MDGs).

1) – Improving Debt Relief Mechanisms

Ministers strongly support the initiative of the UK government in favour of cancelling the debt service due to multilateral institutions through until 2015. In particular, they encourage:

- other donor countries to finance their share of the service due to multilateral institutions (IDA, AfDB/AfDF, IADB), where possible also drawing on financial contributions from the resources of the multilateral institutions themselves;

- the use of the IMF's gold reserves as a means to ensure the additionality of funding for debt relief. Ministers would also like to see the IMF's gold reserves being used to finance debt relief by other multilateral organisations ;

- a guarantee of equitable treatment for all HIPCs. Ministers recommend that all HIPCs – in particular those between decision and completion points, and post-conflict countries – should benefit from greater reduction of their multilateral debt service in order to accelerate their anti-poverty and pro-MDG spending programmes. This arrangement could also cover countries which are not yet eligible for HIPC. For this last category of countries, the savings on debt service could be invested in a « trust fund » which they could access once they reach HIPC decision point.

- equitable treatment of severely indebted low-income countries which are not eligible for the HIPC Initiative, achieved by providing large amounts of assistance through debt reduction or budget support aid.

Ministers strongly repeated their demand to the international community for help to ward off lawsuits which they are facing from a growing number of external and domestic creditors. Eighteen (18) countries are currently facing lawsuits, and are having to pay large amounts to settle them. As a result, Ministers :

- request the very rapid establishment inside the Commonwealth Secretariat of a « rapid response » assistance mechanism for debtor countries which are subject to lawsuits. They would also like this important initiative to be extended to HIPCs which are not members of either of these two institutions (possibly in cooperation with the Agence Internationale de la Francophonie and the HIPC CBP) ;

- call on the international community to put in place immediately a fund destined to resolve the debts owed between severely indebted and low-income countries.

2) – Long-Term Debt Sustainability

Ministers note the new long-term debt sustainability analysis framework for low-income countries designed by the Bretton Woods Institutions, and welcome the improvements made in its design in recent months. Nevertheless, they recommend :

- greater ownership of the framework by debtor countries, by conducting analysis for themselves and defining their own sustainability indicators. This should be done in a participatory process by collaboration between governments and civil societies, in the same spirit as the construction of national Poverty Reduction Strategies ;

- recognition that the ratio of debt service to budget revenue is the most important in analysing debt sustainability. Ministers underlined that their countries have reliable data on their budget revenue, and that they will continue (with IMF help) to ensure maximum efforts to increase these revenues ;

- acceleration and additional funding of efforts of independent (non-BWI) organisations which reinforce debtor capacities to undertake debt sustainability analyses ;

- taking the problem of domestic debt fully into account in the new framework, to improve public finance management, monetary policy and financial market development. Ministers underline that reliable data and methods for analysing domestic debt sustainability are already available and being used by HIPCs under the HIPC CBP ;

- increased flexibility in IMF programmes, as regards conditionalities on budget deficits and on indicative limits on the present value of new borrowing, to ensure that they are entirely coherent with national MDG financing needs.

3) – Financing the Millennium Development Goals (MDGs)

Ministers deplore once again the slow progress being made in reinforcing their capacity to analyse the sources of pro-poor growth ; the costs of meeting the Millennium Development Goals ; and the best practices in increasing absorption of additional external aid flows. They urge donors to accelerate independent (non-BWI) efforts to support them in such analysis.

Ministers congratulate those donors which have fixed specific target dates to reach the level of aid (0,7% of GNP) set at the Monterrey Summit. They support the recommendations of the Millennium Project and the Commission for Africa to double aid flows to HIPCs. More particularly :

- they welcome the progress made in putting into place a pilot phase of the International Financing Facility (IFF) by the government of the United Kingdom and other countries, and urge other donors to support the IFF ;

- they also support the proposals made by a group of countries (Brazil, Chile, France, Germany and Spain) on 11 February 2005, with the aim of mobilising new financing sources, including through taxation of airline tickets ;

- they also support the proposals of the Commission for Africa regarding the establishment of a new grant-based facility to offset the effects of exogenous shocks.

They recommend that this facility should be disbursed much more rapidly and flexibly than funding from existing anti-shocks mechanisms.

Finally, Ministers welcome the joint efforts of the donor community and developing countries to improve the efficiency of aid, which were reinforced during the High Level Forum meeting from 28 February to 2 March 2005 in Paris. They support the concrete commitments made on that occasion by the member states of the European Union, Norway and Switzerland. For their part, they undertake to meet all targets assigned to them, in order to convince the international community to use HIPCs' own procedures for disbursing their aid. In addition, they encourage donor countries to:

- reach a final consensus agreement among all donors and developing countries, on precise indicators and targets, well before the post-Monterrey meeting due in New York in September 2005 ;

- include in the indicators :

  - a reduction of conditionality, especially on political issues and by bilateral donors,
  - a transformation of technical assistance into capacity-building support,
  - an increase in budget and sector support aid,
  - the allocation of all aid to priority sectors of PRSPs,
  - commitment of a maximum amount of aid through multiannual agreements,
  - disbursement of a maximum amount of aid in the 1st quarter of HIPCs' budget years,
  - the design by HIPCs' themselves of aid management strategies with precise aid effectiveness indicators, and action plans to reach annual targets,
  - the reduction of requests by donors for counterpart funds for projects,
  - the alignment of reporting, accounting and auditing procedures with those of HIPCs,
  - the simplification of procurement procedures.

- Establish an objective system for joint evaluation of progress, by donors and developing countries (if necessary with independent support), at the national, regional and international levels.

Ministers agreed to meet once again at the time of the Annual Meetings of the Bretton Woods Institutions, in Washington in September 2005.

THE BRETTON WOODS COMMITTEE
1990 M STREET, N.W., SUITE 450
WASHINGTON, D.C. 20036

TELEPHONE (202) 331-1616
FAX (202) 785-9423
EMAIL info@brettonwoods.org

HONORARY CO-CHAIRMEN
PRESIDENT GEORGE BUSH
PRESIDENT JIMMY CARTER
PRESIDENT GERALD R. FORD

PAST CO-CHAIRMEN
HENRY H. FOWLER
HENRY OWEN
PAUL A. VOLCKER
CHARLS E. WALKER

CO-CHAIRMEN
E. GERALD CORRIGAN
BILL FRENZEL

EXECUTIVE COMMITTEE CHAIRMAN
RICHARD A. DEBS

EXECUTIVE DIRECTOR
JAMES C. ORR

Recommendations to

New World Bank Management

June 1, 2005

Introduction

The Bretton Woods Committee is a bipartisan, public education group dedicated to increasing understanding of the benefits of economic growth, development, and liberalized trade to the United States. The group reminds the public and their elected officials about the key role played by the multilateral institutions in ensuring attainment of these goals. The Committee also participates in the policy development process by reviewing current issues and sharing its conclusions with management and governments. Committee members are drawn from the ranks of senior American business leaders, heads of academic institutions, civil society organizations, and former U.S. government officials and legislators. The Committee's mostly American persona enables it to share its views with Congress from time to time.

In March 2005 the Committee launched an initiative to develop a series of policy recommendations for the World Bank to be considered during the leadership transition. Committee members and other outside experts were consulted, and the resulting list has been reviewed and endorsed by an informal working group of Bretton Woods Committee members.

The recommendations come with some caveats. Recommendations for policy change are invariably cloaked in language critical of institutions, and coupled with long lists of things that need to be fixed. This document is no different. From a broader perspective, however, there is undiminished support by the Bretton Woods Committee for the important work of the World Bank and for the skill and integrity of its dedicated staff. Improvements are always possible, however, and hence these recommendations.

The second caveat is that not all members of the informal working group support every recommendation or their importance in relation to others. Finally, the recommendations are not designed to be final proposals, but should be considered more as "thought starters" that point the direction for more World Bank staff work. Members of the Bretton Woods Committee would be eager to offer any assistance in this effort.

These Bretton Woods Committee members' ideas and efforts helped shape the recommendations:

Ms. Carole Brookins, former U.S. Executive Director, the World Bank
Mr. Michael E. Curtin, Executive Consultant, Bechtel Enterprises/ International Water
Mr. Warren E. Emblidge, Jr., President, McCullagh International, Inc.
Mr. David Hale, Chairman, Hale Advisors LLC
Mr. Gary Kleiman, President, Kleiman International Consultants
Mr. R. T. McNamar
Dr. Theodore Moran, Georgetown University
Mr. James C. Orr, Executive Director, The Bretton Woods Committee
Amb. Henry Owen, former Co-Chairman, The Bretton Woods Committee
Mr. Rutherford Poats, former President, International Investment Services, Inc.
Mr. Robert F. Riordan, Vice President, Black & Veatch
Dr. T.N. Srinivasan, Yale University
Mr. Frank Vogl, President, Vogl Communications, Inc.
Mr. Derish M. Wolff, Chairman, The Berger Group, Inc

Recommendations

I. HIV/AIDS ASSISTANCE

Combating HIV/AIDS and Other Diseases

(1) On behalf of the international community, the World Bank is playing a unique and effective leadership role in providing HIV/AIDS assistance. This should continue to be a top World Bank priority; otherwise the result could be a human crisis without equal since the Black Plague devastated Europe nine centuries ago. To this end, the Bank needs to continue to increase the volume and disbursement rate of AIDS assistance. In 2004, only 40% of the funds committed to fight AIDS were disbursed due to inadequate human and other infrastructure in the recipient countries. The World Bank should provide more money to meet these infrastructure needs.

II. THE PRIVATE SECTOR

Decisive Help for the Private Sector

(2) In all but the poorest countries, the main purpose of the Bank today should be to increase private sector development. Aid to the private sector, as the Bank's Operations Evaluation Department recently suggested, is the best way of reducing poverty. To this end, the Bank should:

(a) Increase the skill set of the Bank's in-country staff relating to the private sector, through training, business internships, and other innovative programs.

(b) Encourage developing countries to actively promote foreign direct and portfolio investment. The International Finance Corporation (IFC), which is the Bank's main instrument to help the private sector, should do two things. One is to provide aid directly to private sector companies in the developing world; and the other is to work closely with private companies in other countries that wish to make investments in the developing world. The IFC will need increased capital to address these issues. The Bank should, therefore, consider the transfer of some of its capital to the IFC, as it has done in the past. The Foreign Investment Advisory Service (FIAS) and the Multilateral Investment Guarantee Agency (MIGA) should also be expanded.

(c) Devise ways of providing all of its financial participation in private sector projects without demanding host government guarantees of private investors.

(3) In new developing country markets, the absence of legal sanctity of contracts and violations of property law hinder capital formation and foreign private investment. The explosion of filings for dispute resolution at the International Centre for the Settlement of Investment Disputes (ICSID) of the World Bank is testament to this. Further, ICSID tribunals need to be supervised more so that decisions are not unnecessarily delayed. As the statement goes, "Justice delayed is justice denied."

Lending to Sub-Sovereigns

(4) As a further step to strengthen the Bank's private sector role, the Bank's articles should be changed if necessary to allow greater lending flexibility. For example, both the World Bank and IDA should be able to lend directly to sub-sovereign entities. Since the London-based EBRD, which lends directly to the private sector, enjoys an AAA rating, changing the Bank's articles to permit a broader range of lending should not undermine its own AAA credit rating.

Employing Modern Financing Techniques

(5) The World Bank is well behind the curve of financial innovation. Instead, it should be on the forefront, leveraging its financial position and that of its donors to maximize development assistance flows. It should be much more open to the adoption of modern financial market techniques that could permit expansion of its resource base and the creation of new products to spur new investment in development. The Bank can do this with minimal risk. Among the ideas it should consider are:

- Expanded use of guarantee instruments.
- Creation of special purpose financing subsidiaries, perhaps backed by callable capital.
- Securitization of some Bank or IDA loans, perhaps with Bank provided credit enhancements.
- Other mechanisms to "leverage" the Bank's balance sheet for development.

Modernizing the Bank's Investment Portfolio

(6) The Bank should consider diversifying its portfolio to raise current and longer-term yields, and should consider contracting out portions of the portfolio to established money managers on a global basis. The Bank should invite proposals as to how it should invest its capital and pick the best balance among the proposals.

III. IMPROVE EFFECTIVENESS

Improving the Bank's Development Effectiveness

(7) The World Bank should reexamine the way in which it evaluates its own work and consider using outside evaluators to make independent judgments. A peer review system might be adopted. A third-party might be retained to evaluate projects or the evaluations prepared by the Bank's Operations Evaluation Department.

(8) The World Bank should also conduct an objective review of its IDA lending practices. While some countries have graduated from IDA over the years, many appear tied to a vicious cycle of poorly implemented and sometimes uneconomic projects, supported by new rounds of concessional lending. The Bank and its staff should establish clearly defined goals and metrics for measuring IDA loans and programs, followed by objective reviews of their performance. If many of the IDA borrowers fail to

show progress, the lending procedures should be further refined, administrative costs significantly reduced, and the conditionality requirements carefully tested before they are applied.

Using New Thinking and New Modalities

(9) The Bank needs to redouble efforts to deliver basic infrastructure to borrowers, particularly to disadvantaged areas, where private sector finance will not be available. This means radically more efficient and effective ways must be found to secure infrastructure development and to increase the role for private investment where possible. Similarly creative new ways must be found to assist the humanitarian, housing, health, and education needs of the world's poorest people. In some instances, this will require bypassing public authorities and greatly expanding direct work with NGOs with proven effectiveness.

Stepping Up the Fight Against Corruption

(10) Anti-corruption must be at the vanguard of all multilateral development efforts, and much more remains to be done. The Bank should maintain pressure on governments to confront corruption within their borders. Its agencies should provide increased funding and technical assistance to support anti-corruption efforts and to help empower an active civil society that can help reinforce this.

(11) The World Bank must closely police the international bidding process to ensure that procurement for its projects is completely transparent and everyone's actions are above reproach. Where bidding irregularities are uncovered, they must be quickly brought to public light, vigorously uprooted, and severe punishment meted out. Multilateral institutions that depend on public confidence and support must be ever vigilant on this score.

Increasing Performance-Based Assistance

(12) The World Bank and other multilateral development banks should provide a greater proportion of their assistance to the good performing countries. However, IDA and other soft loan windows should continue to provide poverty reduction assistance to all poor countries, even the poor performers. Where governments lack the capacity or are themselves the obstacle, the soft loan lenders should work through non-governmental organizations (NGOs) or businesses.

Graduating Middle-Income Borrowers

(13) The Bank has not been rigorous in enforcing its graduation policy for countries that can access the private capital markets. In one sense it is tying up capital that could be better used for higher priority development needs, e.g. Africa. However, the Bank relies on the income from these loans to cover approximately one-half of its annual operating budget. More creative thinking should be given to levels or forms of graduation, phase outs, and knowledge management for fees that the Bank can perform that would be substitute income from the most credit worthy borrowers. There may be a variety of securitizations, bank credit enhanced refinancing, etc. that will move the bank toward more rigorous enforcement of its graduation policy while preserving some of the Bank's income from this group of borrowers.

IV. ORGANIZATIONAL CHANGES

Limiting Priorities

(14) The often-heard comment about the Bank is, "the World Bank has a strategy for every problem and each strategy is one of the Bank's top priorities!" Together with Bank staff and member governments, the new management must decide what should be the true top priorities in coming years. For its part, the Bank staff must avoid attempting to be all things to all people in the developing world and try to focus on areas where the institution has a clear comparative advantage. Similarly, the G-7 and other donor countries must be careful not to diminish the Bank's development effectiveness by assigning it ever more things to do.

Improving Bank Focus and Follow-Through

(15) The Bank needs a clear vision, articulated mission, specific goals, and agreed upon strategies or programs to achieve them. Assuming the Millennium Development Goals (MDGs) represent the Bank's current objectives in reducing poverty, top management must ensure the institution has the information systems, tracking capabilities, and personnel performance evaluation systems in place to achieve the MDGs.

Enhancing Donor Coordination

(16) More effective donor coordination is critical to avoid duplicative efforts and waste. This must be accorded a higher priority. The World Bank must also continue to measure its skills against other institutions, especially the regional development banks. It should develop metrics to test its lending efficiency, project implementation, staff size, etc., against the regional institutions.

Reducing and Empowering Staff

(17) The Bank can and should reduce the number of staff and should increase the empowerment of the remaining staff. Some current controls designed to avoid risks are leading to extended project cycles. One former senior Bank manager believes up to 40% of the tasks could be outsourced and savings could be used to enhance anti-poverty programs. At the same time, ways should also be found to decrease time from loan preparation and design to the implementation phase.

Reforming Personnel Policies

(18) The Bank's mandatory retirement at age 62 rule deserves review. Many of the Bank's best employees have retired or are retiring because of this rule, which does not correspond to general practice in the private business community. For example, the effective and highly regarded head of the IFC was recently forced into retirement against his will and against the best interests of the organization. It is sometimes said within the Bank that the talented people leave, the good people are retired, and that the mediocre people stay until retirement to remain in Washington, DC.

(19) Facilitating more early retirements could help reduce staff size and clear out dead wood. However, because of visa issues, many non-Americans who want to remain in the United States can only do so by continuing to work at the World Bank. Hence they are not motivated to take early retirement and resist being fired or seeing their positions abolished because they will have to leave the United States. One possibility would be seeking U.S. legislation granting foreign executives of the World Bank, IMF, and IADB who have lived and worked in Washington for a certain period the right to remain in the United States.

WOLFOWITZ AND OIL: FACTS AND OPPORTUNITY

In the last twelve months oil prices have risen 67% to historic highs. Relatively recent and ever-growing Chinese demand is a new factor in the world oil markets and suggests that oil prices will remain at relatively high levels for the foreseeable future. A new Goldman Sachs study cautions that oil markets may have entered a prolonged period of a "super spike" with prices reaching $105 per barrel before industrialized countries institute meaningful conservation measures and world prices begin to decline.

Against this background, the new President of the World Bank, Paul Wolfowitz, will undoubtedly receive proposals to use oil revenues for poverty reduction, economic development, and policy reform. For good reasons these proposals may be largely directed toward Africa and the Middle East. When they become public, it is highly probable that the press will repeat their mantra that Mr. Wolfowitz is following Robert McNamara from the Defense Department to the World Bank to explicate his personal guilt over a war with which he is closely identified. Their assertion that Mr. Wolfowitz always intended to use Iraq's oil to rebuild it is simply a statement of an obvious policy option.

To introduce some historical facts, the two most promising "oil for development" proposals predate Paul Wolfowitz's nomination to be the World Bank President by years. One is thirty-one years old and the other was publicly proposed almost a decade ago.

In the older approach, during 1974, the International Monetary Fund marshaled excess petro-dollars for an IMF Oil Facility that made temporary balance of payment loans to countries. A parallel opportunity exists today if the World Bank applies its leadership and technical skills to establish a development fund from today's available petro-dollars.

With such a fund, the World Bank's opportunities are unprecedented to promote improved educational and economic policies in Africa while simultaneously physically rebuilding Iraq, Afghanistan, and when there is a recognized government, Palestine. This three decades old idea should be reevaluated in the light of today's challenges and the World Bank's opportunity to play its unique catalytic role in reducing global poverty.

The second more recent oil-for-development concept makes use of oil-backed bonds. This was publicly recommended after the financial collapse of Russia that began April 1, 1998. More than three years ago, two prestigious Wall Street investment banking firms considered trying to obtain a patent on a business method of designing oil-backed bonds given the possibility of a war in Iraq. Today, oil-backed bonds still deserve careful consideration by the World Bank to accelerate the rebuilding and economic development of Iraq. (Consider how much economically better off Russia would be today if Russia had used oil-backed bonds to refinance its public debt given that oil from the Urals was $11-12 dollars a barrel at the time.)

In recent years Iraq's oil exporting capabilities were reduced due to mis-management and its lack of investment for on-going maintenance and expansion initiatives. More recently,

war damage and sabotage by terrorists further restricted production, transportation, and exportation of oil.

While Iraq's export of oil, measured in barrels, temporarily declined, the revenue per exported barrel has increased significantly. As a result, Iraq's existing and anticipated oil export revenue can finance the needed rebuilding and development of the oil industry to further expand exports. Simultaneously, infrastructure construction, rebuilding, educational, and other development programs can be funded years sooner using the proceeds from oil-backed bonds rather than sales on the market.

In this oil-backed bonds approach, the World Bank's technical leadership can help Iraq structure and sell 10 to 15 year maturity oil-backed bonds. A first offering might quickly provide $10 to $20 billion in funds for Iraq's rebuilding and economic development. These dollar-dominated bonds could have two classes. The Class A bonds would pay a current market yield in cash with the principal being paid from future sales of oil beginning in five years. The Class B bonds would be zero coupon bonds where the interest and principal are both paid from oil sales at maturity.

Bond holders would have the right to take payment of principle in physical oil rather than dollars and for the Class B holders the interest could also be paid by physical delivery of oil. The bonds are expected to be attractive to potential investors who are concerned about both the availability and price of oil in the future and want to hedge future purchases, e.g., the airline industry and China. A secondary market for the bonds and their oil deliveries is highly likely to develop.

To broaden the market demand for the bonds further, the World Bank could consider enhancing the credit of the Iraq oil-backed bonds to investment grade so that they would be qualified investments for pension funds. Given a well-designed Iraq-World Bank back up plan for additional Iraqi oil sales in the event the World Bank guarantee were utilized, the guarantee would present no threat to the Bank's existing credit rating. This credit enhancement would markedly increase the billions of dollars that can be financed for Iraq's accelerated reconstruction and development.

Goldman Sachs may or may not be right about the future of oil prices. However, for the foreseeable future, increases in Chinese oil demand will exert continuous upward pressure on world crude oil prices. Now that it has a government, Iraq can avoid Russia's mistake in not issuing oil-backed bonds in the late 1990s. Iraqi oil-backed bonds are an obvious World Bank policy option. Inaccurate and misleading press characterizations impugning Mr. Wolfowitz's motives should not limit World Bank creativity. Rare development opportunities must prevail over predictable Beltway rhetoric.

R.T. McNamar
Financial Consultant
Former Deputy Secretary
US Treasury
Washington DC

○