To: Rep. Jim Saxton
Vice Chairman
Joint Economic Committee

From: Adam Lerrick

Date: September 18, 2000

RE: Temporary Funding and Review of the HIPC Initiative

The Administration is requesting a total of $600 million for the US contribution to the Heavily Indebted Poor Country (HIPC) Trust for multilateral debt relief. This sum is to be spread over three years. It is being presented to Congress as all that is needed. In fact, it is only a down payment that will require far greater calls on taxpayer funds. There will be a $5-9 billion gap between multilateral debt relief promised and resources available for the task. The total cost to the US of multilateral relief will then reach $2.5-3.6 billion. The IFIs are fully capable of financing their share of the program. The present multilateral forgiveness measures less than 2% of effective capital and 17% of loss provisions and reserves for the four largest agencies. In addition to the question of funding the program, serious doubts have been raised by the GAO as to the likelihood of the initiative achieving the announced goal of providing an exit from unsustainable debt for the HIPC nations.

In light of the questions regarding both the program's probability of success and its financing, it would seem that the appropriate policy would be to provide the funds necessary for the current year's operations (less than $100 million) and review the entire initiative next year.

I. HIPC Initiative Financing Gap

From industrialized nation taxpayers, the international financial institutions (IFIs) are now seeking $2.5 billion (US share $600 million) which is being presented as all that is needed. This is, in fact, only an initial down payment, for the IFIs already know that funds will be exhausted by 2005. As old loans come due, $700–1,200 million more will be required annually for two decades to fulfill projected relief commitments to 32-36 nations.

Total official HIPC debt amounts to an effective $125 billion divided into $80 billion in obligations owed to individual nations and $45 billion to 27 multilateral agencies. As a prerequisite to any IFI participation, the industrialized nations must forgive 67% of their bilateral debt. Only then does the HIPC initiative commence. The program's present total for 32 nations of $27.3 billion divides into $13.2 billion coming directly from the bilaterals and $14.1 billion assumed by the IFIs. Of this $14.1 billion, a contribution of $3.6 billion has been committed by industrialized taxpayers, $5.5 billion will be coming from multilateral internal resources, while $5 billion presently remains in limbo. This last may be disguised as "replenishments" for the International Development Association (IDA) and its regional counterparts, and soon be demanded of G7 legislatures.

For donor nations, this appears to mean paying for 60% of the multilateral losses, 80% of the HIPC initiative, and 90% of all debt relief. If the program expands to embrace four additional countries that are expected to qualify, the HIPC initiative will grow to $35.1 billion, segmented into $17 billion direct bilateral and $18.1 billion multilateral, while a $9 billion gap in IFI funding will result from the difference between debt forgiveness promised and resources committed to the task. Then, the final cost for the donor governments will mount to 70% of multilateral losses, 84% of the HIPC initiative, and 94% of total forgiveness.

The true cost of multilateral debt relief to the US would then reach $2.5-3.6 billion in 1999 dollars (see Appendix).

II. IFIs Fully Capable of Financing their Share of Relief

The IFIs are owed a total of $45 billion, of which the four largest (IMF, World Bank, Inter-American and Asian Development Banks) hold 70%. Under the current plan, a minimal $14 billion, or less than one-third, will be forgiven and even this with substantial recourse to the taxpayers of the industrialized world. Total debt relief would require of the four principal agencies only 5% of their $609 billion in effective capital or 54% of the $58 billion in loss provisions and reserves held for times when bad lending decisions must be addressed. The present program demands less than 2% of effective capital and 17% of loss provisions and reserves. Only the African Development Bank faces a significant drain on its resources.

III. Unlikely Success of HIPC Program

A new study by the GAO warns of impending failure (NSIAD-00-161). Should the present limited debt relief plan be executed, it predicts that in 15-20 years time, debt levels for HIPC nations will be as high and unsustainable as they are now. Next time, since the bilateral donors will have cancelled out all past debt and plan to rely on outright aid in the future, all the defaults will accrue to the IFIs.

To imagine otherwise is to endorse a new and untenable assumption, for the success of the initiative is premised upon average annual growth rates for HIPC economies of 7-12% in nominal dollar terms in exports, in GDP and in government revenue for the next 20 years. Is this a realistic expectation for 42 impoverished nations with a long term record that falls far short of these targets, now plagued by tropical disease and AIDS of epidemic proportions, bloodied by civil strife, victimized by corrupt politics, constrained by a difficult climate to subsistence agriculture, wanting in industry, subject to volatile commodity export prices, and facing a tidal wave of population growth? If the initiative's ambitious forecasts fall just 2-3% short of the mark, the GAO cautions that debt burdens will return to levels that these poor countries cannot support.

IV. Review of HIPC Financing and Expected Results

There has been a series of failed rounds of debt relief. After already writing off $7 billion in bilateral debt and granting $440 million to assist the IMF in meeting its relief goal, Congress must take a critical look at the initiative's true funding demands and the likelihood of the program's success to ensure that public monies are responsibly employed.

Donor inflows now more than offset HIPC debt payments, eliminating any net drain on national resources. Debt relief is not as straightforward as it sounds. Forgiveness of past obligations is tightly linked to a commitment by donors to keep on giving and to provide the same flow of new funds which in years past has been wasted and stolen.

The US contribution to multilateral debt relief required for this year's operations is less than $100 million. In light of the questions regarding both the program's likelihood of success and its financing, it would seem that the appropriate policy would be to provide the funds necessary for the current year and review the entire initiative next year to identify the requisite resources and to establish a program that will achieve the stated goal of providing a clear exit from unsustainable debt burdens.

Appendix

US Contribution to Multilateral HIPC Debt Relief

$2.5-3.6 billion in 1999 dollars is the estimated US contribution to financing multilateral HIPC debt relief. It does not include any bilateral relief.

It is determined in the following manner:

US contribution to IMF HIPC relief: $440 million
US proposed contribution to HIPC Trust: $600 million

Total donor contributions to IMF HIPC relief: $1,100 million
Total donor contributions to HIPC Trust: $2,500 million

US share of existing donor contributions to multilateral relief: $1.04 out of $3.6 or 28.9%

Financing gap in 1999 dollars for multilateral HIPC relief :
32 countries: $5 billion
36 countries: $9 billion

US share (28.9%):
32 countries: $1.44 billion
36 countries: $2.6 billion

Adding existing IMF contribution ($440 million) and
proposed HIPC Trust contribution ($600 million):
32 countries: $2.5 billion
36 countries: $3.6 billion

This will be the US contribution in 1999 dollars to multilateral HIPC relief.

The 36 countries excludes: Nigeria, Eq. Guinea, Vietnam,
Yemen, Kenya and Angola.