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Highlights

Highlights of GAO-09-162, a report to congressional requesters

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DEVELOPING COUNTRIES

The United States Has Not Fully Funded Its Share of Debt Relief, and the Impact of Debt Relief on Countries' Poverty-Reducing Spending Is Unknown

Why GAO Did This Study

In 1996, the Heavily Indebted Poor Countries (HIPC) Initiative was created to provide debt relief to poor countries that had reached unsustainable levels of debt. In 2005, the Multilateral Debt Relief Initiative (MDRI) expanded upon the HIPC Initiative by eliminating additional debt owed to four international financial institutions (IFI): the International Monetary Fund (IMF), World Bank's International Development Association (IDA), African Development Fund (ADF), and Inter-American Development Bank (IaDB). These four IFIs are projected to provide $58 billion in total debt relief to 41 countries. GAO (1) analyzed the U.S. financing approach for debt relief efforts; (2) reviewed the extent to which MDRI might affect resources available to countries for poverty-reducing activities; and (3) assessed revisions to the analyses conducted by the World Bank and IMF to review and promote future debt sustainability. GAO analyzed Treasury, IFI, and country documents and data, and interviewed officials at Treasury and the four IFIs.

What GAO Recommends

To address limitations in the U.S. approach for financing MDRI, GAO recommends that the Secretary of the Treasury consider the use of different funding options, such as requesting separate appropriations from Congress. Treasury responded that it is open to considering alternative MDRI funding approaches in the future.

To view the full product, including the scope and methodology, click on GAO-09-162. For more information, contact Thomas Melito at (202) 512-9601 or MelitoT@gao.gov.

What GAO Found

Treasury's approach to financing MDRI, known as early encashment, does not fully fund current and future U.S. commitments. The approach does not fully fund the current U.S. MDRI commitment because the United States is in arrears on its IDA replenishment. These arrears are due to requirements under U.S. law for withholdings and across-the-board rescissions. Under early encashment, the World Bank requires that the U.S. commitment to the IDA replenishment be paid in full before early encashment income can be used to fund MDRI. The World Bank deducts the U.S. arrears to IDA from any early encashment income before applying this income toward the U.S. MDRI commitment, resulting in a current MDRI shortfall of $149 million. Treasury officials said that if the United States ultimately pays its arrears to the IDA replenishment, early encashment income will then fully fund the U.S. MDRI commitment. However, to fully fund the U.S. MDRI commitment, (1) Treasury will need to release a withholding of $94 million by reporting to Congress that the World Bank has accomplished transparency reforms required under U.S. law, and (2) Congress will need to appropriate approximately $49 million to compensate for the rescissions. Moreover, GAO estimates that the early encashment approach will be insufficient to fully finance future U.S. MDRI commitments even if U.S. payments are made on time and in full because these commitments exceed projected early encashment income.

GAO estimates that the HIPC Initiative and MDRI debt relief from the four IFIs combined may provide countries for which data are available with nearly $44 billion in additional resources over the next 50 years, but the extent to which countries spend these resources on activities to reduce poverty is unknown. In addition to providing debt relief, the MDRI program for IDA and ADF provides for a reallocation of assistance, based in part on a consideration of the strength of country policies and institutions. The estimated amount of this MDRI assistance individual countries receive will vary. Although IFIs and the U.S. government encourage recipient countries to spend resources generated from debt relief on efforts to reduce poverty, the extent to which such spending occurs is unknown for two reasons. First, debt relief resources are difficult to track, because these resources cannot easily be separated from other types of financial flows such as international assistance and fiscal revenues. Second, country data on poverty-reducing expenditures are not comparable across countries and also may not be reliable.

The World Bank and IMF have improved their country debt sustainability analyses (DSA) since 2005, including by addressing weaknesses GAO previously reported. DSAs now consider the strength of a country's policies and institutions in determining sustainable debt loads and assess future debt sustainability under multiple scenarios that adjust economic assumptions. Furthermore, IDA and ADF now structure their assistance based on a country's risk of debt distress. While the new DSAs have identified numerous ambitious actions countries should take to avoid eroding their debt sustainability, implementing these actions could prove difficult.