Percy S. Mistry

Multilateral Debt

An Emerging Crisis?

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Forum on Debt and Development (FONDAD)

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Tables and Boxes

The tables have been derived from two sources: (1) World Debt Tables (WDT), series from 1989-90 to 1993-94, published by the World Bank; and (2) Financing & External Debt of Developing Countries, series from 1989 tot 1992, published by the OECD. WDT does not include figures for some non-reporting developing countries. OECD figures have therefore been used to supplement WDT data. There are major discrepancies in the debt data published by the World Bank (which are based on reporting by debtors) and those of the OECD (which are based on reporting by creditors). These discrepancies are difficult to reconcile. After years of technical assistance provided by various sources to improve the quality of debt data (particularly in Africa), the recording systems remain highly imperfect. WDT and OECD figures could be off-the-mark by ± 20%.

Abbreviations

AfDB	African Development Bank
AfDF	African Development Fund
AFESD	Arab Fund for Economic and Social Development
AsDB	Asian Development Bank
AsDF	Asian Development Fund
CCFF	Compensatory and Contingency Financing Facility
DAC	Development Assistance Committee of the OECD
DDSR	Debt Stock and Debt Service Reduction
DRS	Debtor Reporting System
EBRD	European Bank for Reconstruction and Development
EC	European Community
EDF	European Development Fund
EFF	Extended Fund Facility
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facility
FSO	Fund for Special Operations
FSU	Former Soviet Union
FY	Financial Year
GCI	General Capital Increase
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IsDB	Islamic Development Bank
LDC	Less Developed Country
MDB	Multilateral Development Bank
MILIC	Moderately Indebted Low-Income Country
MIMIC	Moderately Indebted Middle-Income Country
NTMD	Net Transfers on Multilateral Debt
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
PFP	Policy Framework Paper
RAP	Rights Accumulation Programme
RDB	Regional Development Bank
SAF	Structural Adjustment Facility
SDR	Special Drawing Right
SILIC	Severely Indebted Low-Income Country
SILMIC	Severely Indebted Lower-Middle-Income Country
SIMIC	Severely Indebted Middle-Income Country
SPA	Special Programme of Assistance for Africa
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States of America

Preface

It is now more than eleven years since the debt crisis erupted. A popular view is that, because the international financial system is no longer in danger and major Latin American countries have regained access to voluntary flows from western capital markets, the crisis is over. However, for many developing countries the debt problem is far from resolved. And while most attention was and still is focused on the attempts to alleviate the burdens of both *commercial* and official *bilateral* debt of the countries affected, a new problem has emerged: the pyramiding of *multilateral* debt.

The facts are worrisome, as Percy Mistry reveals in this book. The *stock* of multilateral debt owed by developing countries has grown faster than any other type of debt. It tripled from $98 billion in 1982 to $304 billion in 1992. By 1992, it accounted for 18 per cent of the total outstanding debt stock of all developing countries. Debt *service* payments from developing countries to multilateral institutions have increased even more dramatically: from less than $7 billion in 1980 to over $36 billion in 1992 – a more than five-fold rise!

Over the past decade multilateral development banks have increased their gross lending to developing countries at an annual average rate of 13 per cent simply to ensure that burgeoning debt service obligations to them are met. As a result, multilateral institutions (including the IMF) have, since 1987, been extracting real resources from severely indebted countries instead of injecting into them. "From being the *solution* as lenders of last resort for new money between 1982-85, multilateral lenders have now become the *problem* for most severely indebted low-income and lower-middle-income countries," says Mistry.

The problem of multilateral debt, like that of bilateral debt, is one which affects mainly the severely indebted low-income and lower-middle-income debtor countries of Africa, Central America and the Caribbean. It may, however, as the 1990s progress, eventually also affect a number of countries in Eastern Europe and the former Soviet Union.

Bold and imaginative action is needed to prevent a further piling up of multilateral debt. Developing a strategy for reducing it is not an easy job. According to Mistry, the first step in designing and implementing such a strategy must be explicit acknowledgement on the part of multilaterals that, while they must remain 'preferred creditors', they cannot be 'exempt creditors'. In other words, multilateral institutions will have to consider the same range of debt stock and debt service reduction tactics in dealing with their own debt that they have been suggesting to other types of creditors.

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Multilateral Debt: An Emerging Crisis? is the first in-depth analysis of a problem which is of growing concern to world financial policymakers. It is a disconcerting story told by a gifted author who combines inside knowledge with a passionate search for the facts.

Jan Joost Teunissen,
Director
January 1994

Acknowledgement

This study is based on work initiated by the author in a paper on the multilateral debt problem for a Meeting of the Expert Advisory Group on Debt convened by the Non-Aligned Movement in Jakarta in February 1993. The theme was more fully developed by Matthew Martin, who wrote a comprehensive paper on the subject in May 1993 for the 1993 Trade and Development Report commissioned by the United Nations Conference on Trade and Development (UNCTAD).

I wish to acknowledge an immense debt (and considerable gratitude) to Mathew Martin for permitting so much of his analytical work to be used. The strengths of this paper are attributable in large part to Dr. Martin's analysis. Its weaknesses are ones for which I take full responsibility.

Percy Mistry
January 1994

I Introduction

Is There Still A Debt Crisis?

Contrary to a growing popular view that the debt crisis is over or about to end, the debt burdens of developing countries in general and of the *severely-indebted low-income countries* (SILICs) in particular remain large. They remain, as yet, inadequately attended to. Debt reduction arrangements negotiated under the rubric of the Brady Initiative for various *severely-indebted middle-income countries* (SIMICs) have begun to succeed in arresting and reversing the growth of *private* SIMIC debt. In some of these countries (e.g. Argentina, Chile, Mexico, the Philippines, Uruguay and Venezuela) private capital flows – mainly of direct and portfolio equity investment – are reviving and, in turn, contributing to improved prospects for renewed access to voluntary securitised debt and trade credit flows as well.

Special *bilateral* debt reduction arrangements agreed to by OECD creditors for Egypt and Poland in 1991 have also supported the popular belief that the debt crisis is over. But these arrangements have benefitted just two countries while leaving unresolved the problems of over fifty other debtor countries which are arguably more deserving if economic rather than political criteria were to be applied in deciding the need for relief. These two cases have induced official creditors into recently reaching a consensus on the Enhanced Toronto Terms for rescheduling the Paris Club debt of eligible SILICs whilst, upto October 1993, eschewing agreement on the more meaningful Trinidad Terms proposed earlier by the United Kingdom in 1991.

The Egypt and Polish examples implicitly suggest the use of debt strategy as an instrument of international economic diplomacy by creditor nations. Debt is not, as often claimed, an issue of ensuring that obligations under agreed financial contracts are respected. As the debt crisis has progressed, it has become instead a political weapon employed by creditors to reward friendly political rather than sound economic behaviour on the part of debtors. Egypt and Poland show how far creditors can go, providing they have the political will, in resolving the debt problems of developing countries. Though regarded as 'exceptions', these two cases demonstrate that the position still maintained by many creditor countries (and in particularly Japan) – based on exaggerated fears about a more pragmatic approach to debt reduction for all severely-indebted countries resulting in free-rider, moral hazard, and other problems which will bedevil the future conduct of international transactions and jeopardise international economic relations – is no longer credible nor tenable.

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Welcome reversals in the external debt situations of a handful (but happily growing number) of Latin American debtor countries have yet to be experienced by: (a) a large number of SILICs (most of which are in sub-Saharan Africa); (b) many severely-indebted lower-middle-income countries (SILMICs) – such as Jamaica and Côte d'Ivoire – whose economic recovery remains elusive despite a decade of adjustment effort; (c) some of the independent republics of the former Soviet Union (FSU) – in particular Russia and the Ukraine – and of former Yugoslavia whose political fracture is as yet incomplete and whose economic disruption could reinstitute a threat to global stability and security; and (d) some South and South-east Asian countries with large multilateral debt obligations whose on-going economic problems threaten to convert a once-manageable external debt burden into a full-blown external payments crisis if their present delicately balanced trajectories of adjustment, reform and export-oriented growth are, for whatever reason, blown off-course.

In short, the debt crisis is far from being over although it is no longer front-page news, nor is it as high a priority on the agenda of G-7 policy-makers as it once was when the international financial system appeared to be under threat. Nor is it a major issue for creditor banks or official creditor agencies any longer. For those involved on the creditor side – or as intermediaries between creditors and debtors – in the arcane arts of debt reduction and debt rescheduling it has become an interesting and occasionally lucrative pastime – almost a game.

But the overhang of external debt remains a problem for far too many developing countries whose limited administrative resources are over-stretched and diverted by the lingering effects of a crisis whose time to be relegated to history has long passed. The ability of their governments to shift their focus of attention from perpetual debt crisis management to establishing the foundations for sustainable growth and recovery continues to be delayed by unjustifiable procrastination on the part of creditors (official and private) who appear to be far too relaxed and sanguine about the impact of their actions on debtors, especially now that the economic and financial interests of creditors are no longer under any serious threat (except perhaps in Russia). Moreover the growing weakness of political leadership through all the major countries of the OECD world in the 1990s has led to a degree of absorption with domestic political issues which leaves little room for imaginative action on the international front, except where recurrent crises compel attention.

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The Accumulation of Debt Through A Decade of Crisis Management

The debt crisis broke in September 1982. For the next three years there was a scramble to organise involuntary financing packages under the aegis of the IMF and the US authorities (the multilateral banks were junior partners in this enterprise) to safeguard the capital base of global commercial banks which had become imprudently over-exposed to developing country risk. By and large the 1982-85 period saw some success in accomplishing that objective but at enormous cost to debtor economies and societies. The debt strategy pursued between 1982-85 enmired these countries in extreme recessionary conditions. Aiming to forestall their imminent economic implosion, which would jeopardise any further prospects for debt recovery, the Baker Plan was devised in late 1985 to provide a larger volume of multilateral resources, in combination with resuscitated private capital flows to restore growth. It did not succeed as intended and was followed by a series of separate initiatives for dealing with private (Brady-1989) and bilateral (Venice, Houston, Toronto and enhanced-Toronto terms) debt burdens.

The net effect of the various debt initiatives taken so far between 1985-92 is portrayed in the following two tables:

Table 1 Net Increases or Reductions in Outstanding Debt Stock Burdens 1985-92 (billions of US dollars)

	Bilateral	Multilateral	IMF	Private Long Term	Private Short Term	Total
All LDCs:	+ 216.0	+ 138.0	− 2.0	+ 116.0	+ 112.0	+ 580.0
SILICs:	+ 36.6	+ 20.3	+ 0.5	− 1.6	+ 2.7	+ 58.5
SIMICs:	+ 62.4	+ 31.5	+ 1.0	− 19.6	+ 40.3	+ 115.6

Table 2 Net Increases or Reductions in Outstanding Debt Service Burdens 1985-92 (billions of US dollars)

	Bilateral	Multilateral	IMF	Private Long Term	Private Short Term	Total
All LDCs:	+ 9.2	+ 19.2	− 0.6	+ 1.7	− 1.8	+ 27.7
SILICs:	+ 1.0	+ 1.7	− 0.5	− 2.7	− 0.6	− 1.1
SIMICs:	+ 4.1	+ 6.6	+ 2.3	− 4.3	− 0.5	+ 8.2

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The Particular Problem of Multilateral Debt

Between 1982-92, the external debt obligations that have ostensibly been made more tractable through rescheduling, restructuring, cancellation and conversion of private and bilateral debt have been partially offset and replaced by far less flexible multilateral bank and IMF debt. These obligations have, so far, been non-reschedulable and non-reducible. They are owed to preferred creditor institutions of which debtor countries are themselves part-owners. The penalties for default or delay in meeting scheduled obligations to multilateral banks or the IMF are much harsher than for obligations to any other type of creditor. The net result has been a pyramiding of multilateral debt as current debt service obligations are financed by new multilateral flows which are not contributing as anticipated to enhancing the generation of export earnings by debtor countries. Debtor countries now have in their liability portfolios too large a proportion of hard and rigid debt service obligations to institutions which have, since 1987, been extracting instead of injecting real resources from severely indebted countries which they are supposed to be helping.

From being the *solution* as lenders of last resort for new money between 1982-85, multilateral lenders have now become the *problem* for most severely indebted low-income and lower-middle-income countries. For several low-income debtors the multilateral debt burden has become unmanageable. The extent of the problem has been obscured by significant indirect refinancing of debt service payments on IBRD loans to SILICs with compensating IDA credit flows. But even that palliative has not been able to contain the problem.

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II How has the Multilateral Debt Problem Arisen?

The multilateral debt balloon has been inflated by a chain of sequential events which, at the risk of some over-simplification, can best be characterised as follows:

- Between 1982-85, the IMF organised a series of involuntary lending packages for debtor countries which resulted in a large amount of new IMF (and multilateral bank) debt being incurred by debtors largely to repay interest on their commercial obligations.
- Between 1986-88, the IMF began to withdraw its resources from debtor countries exacerbating the problem of net resource withdrawal by commercial banks and leaving essential resources to be financed largely by multilateral banks (principally the World Bank).
- Between 1989-92, the World Bank's net transfers to debtor countries turned negative leaving it to regional development banks to provide the last line of defence for refinancing take-outs.
- Throughout the 1982-92 period private and official bilateral creditors have withdrawn a large amount of resources from SIMICs but have let their claims on SILICs balloon exponentially by permitting unpaid interest and arrears obligations to be compounded and capitalised.

The pyramiding of multilateral debt has hurt not just the indebted developing countries. Its reciprocal but less immediately visible effect has been to erode and compromise the financial strength and asset portfolio quality of key multilateral institutions, which are central pillars of the official international financial system. Measures are needed to avert the prospect of developed and non-indebted surplus developing countries being required to meet 'callable capital' guarantees which are the keystone to the capitalisation of these institutions. If in the case of any of these institutions a call is actually made on guarantee capital the edifice which has been constructed since 1947 to sustain the financing of these multilateral institutions by international capital markets risks being jeopardised.[1]

As explained earlier, since 1982, the international financial institutions (IFIs or multilaterals as they are commonly known) – which include the IMF, the World Bank, the regional multilateral development banks in Africa, Asia,

1 In that sense callable capital is similar to a nuclear weapon – its value lies in deterrence not in application.

Latin America (and now for Eastern Europe and the former Soviet Union) and other sub-regional multilaterals – have become the lenders of last resort to indebted countries. The IMF and World Bank in particular have, over the last decade, organised a large number of debt relief and new lending packages for developing countries, which have included large new loans from themselves, regional institutions and other creditors, private as well as official. As a result, multilateral debt stock and service have grown rapidly in dollar terms and as a percentage of the overall developing country debt burden during 1982-92.

In principle, debt obligations to multilateral creditors cannot be rescheduled, refinanced or reduced. Multilaterals are preferred creditors, i.e. they are given preference in the debt service payments made by any country. In other words, before countries can pay any other type of creditor, they must pay multilaterals first. In addition, the penalties for default or delay in making debt service payments to the IFIs (and particularly to the World Bank and IMF) are severe. They can, for example, result in the suspension of debt relief agreements and the cessation of most new aid flows – not only from the multilateral institutions themselves but from bilateral agencies as well – thus resulting in cutting off the only lifeline that the poorest countries have open to them for financing critical imports. Most developing countries have therefore chosen to continue paying multilateral debt service to the extent that they are able, even when it absorbs a large portion of any new credits or grants they might receive from any source.

As a result, bilateral (and more recently even commercial) creditors have tolerated major accumulations of arrears and reductions of debt or debt service, so that debt service obligations to multilateral creditors could be met. In the context of debt relief and greater tolerance of arrears by other creditors, multilateral debt stock and service have therefore accounted for a large proportion of the actual recent debt service burden.

Multilateral debt stock and service are likely to continue to grow rapidly as a proportion of the total during the 1990s. This is particularly true for low-income countries where bilateral creditors are providing most new funds as grants and are cancelling growing portions of existing debt, and commercial creditors are reducing existing debt and not lending new money. Multilateral debt is already a significant problem for many developing countries; by the end of the 1990s it could be *the major problem* for many low-income countries.

Attempts to arrest and reverse the growth of this problem, must inevitably cope with a circularity – i.e. new multilateral disbursements made to prevent the problem from becoming a serious threat in the short and medium term lead to an even larger problem emerging in the longer term. As a matter of stated policy, most multilateral institutions refuse to consider official rescheduling, cancelling or converting their claims into local currency. They

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do so on the grounds that unlike other types of creditors, their own funding is raised on international capital markets and is underwritten by the implicit guarantee of all their member countries. The penalties to them, and their member-owners, of rescheduling payments on their own bond obligations (to match the delay in incoming cash-flow if they were to reschedule their own claims) would be so severe as to make it virtually impossible for IFIs to consider permitting their borrowers to reschedule payments to them, regardless of the economic capacity of their borrowers to repay multilateral debts on time. The IFIs have taken this position despite arguing strongly to persuade other creditors to be much more accommodating in light of the debtors' circumstances.

It is not that IFI managements and boards do not recognise the asymmetry and self-serving bias involved in these two quite different postures. But they excuse or explain it away on the grounds that, as the 'last line of defence' in averting economic disaster, they are different to every other type of creditor and must therefore be treated differently. They must be repaid regardless of borrower capacity to oblige and even regardless of whether their claims accumulated as a result of their own misjudgments or failures as creditors in assessing and taking lending risks. Consequently, the IFIs have instead tried to refinance some or all of the debt service due to them by making large new disbursements to the same troubled debtors – in part refinancing debt service flows to commercial banks in many instances, and in part refinancing their own debt service but in a way which has caused the multilateral debt burden to spiral upwards.

As a consequence of the various debt management initiatives taken, multilateral debt stocks and debt service obligations have grown more rapidly than any other type of debt in proportionate terms. For all developing countries, the **stock of debt** owed to multilateral institutions (including the IMF) has tripled from $98 billion in 1982 to $304 billion in 1992; growing at an annual average rate of 13% over the decade. By 1992, debt owed to multilaterals accounted for 18% of the total outstanding debt stock of all developing countries. Of this, over $43 billion was owed by SILICs, four times the amount owed in 1982 and almost 25% of all debt owed by SILICs. Nearly $73 billion was owed by SIMICs, three times the amount that these countries owed multilaterals in 1982 but yet accounting for only 14% of total SIMIC debt. Thus, more than one-third of the total multilateral debt stock outstanding is owed by countries which are severely strained by their external debt burdens. In the case of some multilaterals that proportion is considerably higher. For instance, nearly 70% of the total debt stock owed to the African Development Bank Group is owed by severely-indebted countries. Of the outstanding stock of multilateral debt, the concessional proportion has stagnated for all developing countries. In SIMICs that proportion has collapsed from 12% to 5% between 1982-92, while rising sharply from 44% to 58% for SILICs, due to the refinancing of nonconcessional with concessional debt. However, this proportion of concessionality is still way below historical levels; it compares with 83% for SILICs in 1970.

Table 3 Multilateral Debt Stocks* 1982-92 (billions of US dollars / percentage)

	1982	1985	1988	1992 (p)**
All Developing Countries				
Total Debt Stock	846.0	1,123.0	1,393.0	1,703.0
Multilateral Debt Stock	98.0	154.0	246.0	304.0
Multilateral as Percentage of Total	11.6	13.7	17.7	17.9
Severely Indebted Low-Income Countries (SILICs)				
Total Debt Stock	51.4	122.3	169.0	180.9
Multilateral Debt Stock	11.1	22.7	33.1	43.4
Multilateral as Percentage of Total	21.6	18.6	19.6	24.0
Severely Indebted Middle-Income Countries (SIMICs)				
Total Debt Stock	382.1	391.7	464.8	507.3
Multilateral Debt Stock	24.1	40.0	59.5	72.5
Multilateral as Percentage of Total	6.3	10.2	12.8	14.3
Memo Item: Concessional Multilateral Debt as Percentage of Total Multilateral Debt				
SILICs	44	48	51	58
SIMICs	12	7	6	5
All LDCs	28	26	24	26

* Including IMF Debt
** Projected

Debt service obligations to multilateral institutions have more than quadrupled over the same decade from less than $8.5 billion in 1982 to over $36 billion in 1992; growing at a rate of over 17% annually. Accounting for less than 12% of total debt service payments in 1982, multilateral obligations now represent nearly 18% of total debt service payments made by developing countries and the trend is for them to continue growing. Over 30% of the actual debt service payments made by SILICs were to multilateral creditors in 1992 ($3 billion) compared to 19% in 1982. Only 24% ($14 billion) of the actual debt service payments made by SIMICs went to multilaterals in 1992, but this was seven times the amount in 1982 (under $2 billion), and six times the proportion of total debt service in that year.

Table 4 Multilateral Debt Service, 1982-92 (billions of US dollars / percentage)

	1982	1985	1988	1992 (p)	1982-92
All Developing Countries					
Total Debt Service	117.6	134.2	167.2	161.9	1,592.3
Multilateral Debt Service	8.4	17.4	34.6	36.0	190.7
Multilateral as Percentage of Total	7.1	13.0	20.7	22.2	12.0
Severely Indebted Low-Income Countries (SILICs)					
Total Debt Service	4.7	10.9	9.1	9.7	91.3
Multilateral Debt Service	0.9	1.7	2.8	2.9	25.3
Multilateral as Percentage of Total	19.1	15.6	30.8	29.9	27.7
Severely Indebted Middle-Income Countries (SIMICs)					
Total Debt Service	65.0	49.4	57.2	57.4	591.9
Multilateral Debt Service	2.7	5.1	10.9	13.9	98.3
Multilateral as Percentage of Total	4.2	10.3	19.1	24.2	16.6
Memo Item: Concessional Multilateral Debt Service as Percentage of Total Multilateral Debt Service					
SILICs	10.8	11.6	11.9	21.2	13.5
SIMICs	8.9	4.1	2.0	2.4	2.8
All LDCs	9.4	6.4	4.9	10.2	9.6

Trends in the concessional proportion of debt service matched trends in the changing nature of multilateral debt stock: by 1992, almost 80% of SILIC and 100% of SIMIC debt service to multilaterals was non-concessional .

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III Countries most Troubled by Multilateral Debt

The Low-Income Countries: The multilateral debt problem affects the SILICs more severely than other debtor groups. The stock of multilateral debt owed by SILICs has quadrupled over the decade from $11 billion in 1982 to well over $43 billion in 1992; it now accounts for a quarter of total SILIC debt. Although a substantial proportion of it (about 58%) is concessional that has not prevented a tripling of multilateral debt service by SILICs; from $1 billion to nearly $3 billion between 1982-92. About a third of total debt service payments made by SILICs are now to multilateral creditors and the proportion will continue increasing. In several African countries, debt service to multilaterals now pre-empts virtually all debt service capacity leaving no room for servicing bilateral or private debt obligations. The problems of these SILICs is discussed in further detail below.

Middle-Income Countries: For the SIMICs as a group multilateral debt poses a less daunting problem although for individual countries (such as Jamaica) the burden is as acute as for many SILICs. Multilateral debt owed by SIMICs has trebled from $24 billion to nearly $73 billion between 1982-92 with corresponding debt service payments increasing much faster and nearly quintupling from under $3 billion to over $14 billion over the same period. As noted above, annual principal and interest payments to multilaterals by SIMICs now account for 24% of their total debt service compared to 4% in 1982, indicating the dramatic increase in the dependence of this group of countries on multilateral creditors in the 1980s.

Yet, despite these rapid increases in multilateral obligations (both of debt stock and of debt service) of SIMICs the improvement in economic circumstances of a number of the larger SIMICs suggests that the debt to multilaterals can be serviced more affordably by this group of debtors than is the case for SILICs as a group. As observed earlier, however, there are important individual exceptions to this generalisation which do not permit any measure of sanguinity.

Box 1 shows the individual countries most severely affected by multilateral debt problems. It measures the severity of 'affliction' in two ways: those countries paying more than 40% of their actual debt service to multilaterals, and those countries whose scheduled debt service to multilaterals exceeds 10% or even 20% of their export earnings. The first of these indicators is less

Box 1 Countries Seriously Affected by Multilateral Debt Problems

1991 Multilateral Debt Service as % of Total 1991 Debt Service

SILICs	
Liberia	100.0
Sudan	100.0
Tanzani	92.4
Equatorial Guine	90.0
Nicaragua	89.0
Zambia	88.1
Mali	84.6
Sierra Leone	78.6
Zaire	73.0
Mauritania	69.0
Honduras	65.6
Ghana	62.7
Lao PDR	62.5
Guyana	60.5
Uganda	57.6
Burundi	55.0
Sao Tome e Principe	52.6
Madagascar	51.2
Guinea-Bissau	44.8
Kenya	40.6
Mozambique	40.0
SIMICs	
Panama	91.2
Bolivia	85.3
Peru	61.4
Jamaica	47.4
Ecuador	40.3
MILICs	
Comoros	89.5
CAR	86.7
Benin	71.0
Haiti	66.7
Togo	62.3
Gambia	49.8
Bangladesh	48.2
Malawi	48.1
Nepal	44.6
Yemen Republic	42.9
Rwanda	40.8
MIMICs	
Dominican Republic	60.9
Guatemala	60.2
Senegal	47.8
Costa Rica	46.0
Gabon	44.2
Cameroon	43.9

1992-94 Average Annual Multilateral Debt Service > 20% of 1991 Exports

Bolivia
Burundi
Guinea-Bissau
Guyana
Honduras
Nicaragua
Sao Tome e Principe
Somalia
Tanzania
Uganda

1992-94 Average Annual Multilateral Debt Service > 10% of 1991 Exports

Argentina
Bangladesh
Cape Verde
Central African Republic
Colombia
Comoros
Costa Rica
Côte d'Ivoire
Dominican Republic
Ecuador
Ethiopia
Gambia
Ghana
Guatemala
India
Jamaica
Kenya
Liberia
Madagascar
Malawi
Mali
Mauritania
Morocco
Mozambique
Niger
Pakistan
Peru
Philippines
Rwanda
Senegal
Sudan
Tunisia
Zaire
Zambia

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reliable, as it fluctuates according to different dates of rescheduling and accumulation of arrears to other creditors, and of reduction in arrears to multilaterals.[2] However, it gives some idea of the degree to which multilateral creditors receive preferred treatment from debtors. According to this indicator, 43 countries have a multilateral debt problem, including 21 of the 27 SILICs, and 5 of the 17 SIMICs.

The second is a more stable measure of the debt service burden. Although 10% may not at first glance seem such a high ratio for scheduled multilateral debt service, the picture is different when countries are incapable of generating the foreign exchange cash flow streams required to meet debt service obligations. In those situations the presence of inflexible multilateral debt plays a much more severe role in exacerbating the overall debt service difficulties faced by low-income developing countries. According to this second indicator, 44 countries, including 21 of 27 SILICs and 7 of 17 SIMICs have a multilateral debt problem. The worst problem is faced by 21 countries which fulfil both measures, and 10 severely-indebted countries whose annual multilateral debt service payments for 1992-94 exceed 20% of their 1991 export earnings.

2 For example, Zambia's 1991 figure is distorted by clearance of its arrears to multilaterals.

From: Multilateral Debt: An Emerging Crisis?
FONDAD, The Hague, 1994, www.fondad.org

IV Effects of the Pyramiding of Multilateral Debt Service

A Build-Up of Arrears to Other Creditors

To a large degree, debt service payments to multilaterals by all severely-indebted countries are being financed increasingly by a rapidly growing level of *arrears* in payments to other creditors (mainly bilateral and private) as shown in table 5.

Table 5 Growth in Developing Country Debt Service Arrears (billions of US dollars)

	1987			1992		
	Interest	Principal	Total	Interest	Principal	Total
All LDCs:	20.8	37.0	57.8	43.2	65.0	108.2
SILICs:	6.9	15.0	21.9	11.7	20.4	32.1
SIMICs:	12.6	17.3	29.9	26.9	34.6	61.5

Arrears to all categories of creditors have increased between 1987-92 although arrears to bilateral creditors and private creditors have increased the most rapidly while arrears to multilaterals have grown at a slower pace indicating that pre-emptive debt service to multilaterals is occurring at the expense of arrears exacerbation especially to bilateral official creditors. Overdue payments (of interest and principal) owed to *private* creditors by SILICs grew from \$4.9 billion to \$8.2 billion in between 1987-92 while in the case of SIMICs they grew from \$17.4 billion to \$47.7billion over those five years. Arrears to *official* creditors over the same period grew from \$17.1 billion to \$23.9 billion in the case of SILICs and from \$ 12.5 billion to \$13.8 billion in the case of SIMICs with bilateral creditors accounting for around 85-90% of these amounts.

Arrears to the IMF: As shown in Table 6, protracted arrears to the IMF barely existed at the beginning of the 1980s and were confined to one country. During the second half of the 1980s they rose rapidly, to reach a peak of SDR 3.6 billion at the end of 1991 (of which over 90% were more than 1 year overdue). Since then, they have fallen slightly, to SDR 3 billion at the end of March 1993.[3] Since 1989, rises in arrears for other countries more than offset the clearance of arrears by Guyana, Honduras and Panama, and only Peru's clearance in 1993 enabled a net reduction in arrears.

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Table 6 Arrears to IMF as at year-end

	SDR millions			Number of Countries	
	Total	< 1 Year	> 1 Year	< 1 Year	> 1 Year
1981	34.4	11.9	22.5	19	1
1982	29.3	6.1	23.3	15	1
1983	60.3	36.4	24.0	13	1
1984	178.2	144.8	33.5	21	3
1985	621.1	502.6	118.6	21	4
1986	1035.6	678.4	357.2	15	6
1987	1752.4	781.1	971.3	19	7
1988	2611.9	888.6	1723.3	7	10
1989	3099.4	640.2	2459.1	3	11
1990	3420.8	467.1	2953.7	6	9
1991	3624.5	356.8	3267.5	4	9
1992	3595.6	203.3	3392.3	10	10
Mar 1993	3010.2	176.8 [a]	2868.6 [a]	6 [a]	9 [a]

[a] end-February 1993: estimated
Source: IMF documents

Arrears to the World Bank: Aggregate data on arrears to the World Bank are available only for payments more than three months overdue while data disaggregated by country are available only for those more than six months overdue (i.e. in 'non-accrual status'). Table 7 shows arrears rising consistently from FY 1988 (with $790 million in non-accrual status), peaking in FY 1991 ($ 1,783 million in non-accrual). However, in FY 1992 they fell to $1,607 million. Arrears first began to fall in FY 1992, when Nicaragua, Panama and Sierra Leone became current. In March 1993, Peru cleared its arrears, but the former Yugoslav Republics of Macedonia and Bosnia-Herzegovina have since fallen into protracted arrears. As of June 30, 1993 a total of nearly $1.3 billion was overdue for more than six months from six countries (Congo, Iraq, Liberia and Syria in addition to the two already mentioned). Protracted arrears to IDA remain negligible. On June 30, 1993, they totalled $39 million and were owed by Afghanistan, Congo, Haiti, Liberia, Somalia and Syria. This was more than double the amount of $18 million in arrears in FY1988.

3 Almost all of the overdue amounts are owed on non-concessional facilities: only SDR 8.5 million was overdue on SAF loans in March 1993, though this has risen from under SDR 1 million in mid-1992 and could be expected to rise faster in future years as more repayments become due.

Table 7 Arrears to IBRD and IDA, 1987-92 (end of fiscal year, June, millions of US dollars)

	1988	1989	1990	1991	1992
Afghanistan	–	–	–	–	1
Congo	–	–	–	–	39
Guatemala	–	–	27 *	69	67
Guyana	24	34	–	–	–
Haiti	–	–	–	–	3
Honduras	–	69	–	–	–
Iraq	–	–	–	14	25
Liberia	33	55	93	114	150
Nicaragua	137	166	195	226	–
Panama	63	141	203	201	–
Peru	317	496	760	856	923
Sierra Leone	5	7	10	12	–
Socialist FR Yugoslavia**	–	–	–	–	16 ***
Somalia	–	–	–	–	8
Syria	105	162	257	309	399
Zambia	106	174	263	–	–
Total Overdues					
> 6 Months	790	1304	1780	1795	1615
> 3 Months	792	1311	1808	1801	1632

Notes: – less than $1 million
* in non-accrual from July 2, 1990. Total overdue here as at June 30, 1990
** arrears owed by Bosnia-Herzegovina, Macedonia, Montenegro, Serbia
*** overdue by between 3 and 6 months.
Sources: World Bank Annual Reports, 1988-92.

Arrears to other Multilaterals:[4] Arrears to most other multilaterals have risen sharply since the mid-1980s: in 1985, apart from Egyptian arrears, they were virtually zero. They peaked at over $3 billion in 1989, and are still above $2.5 billion. Total arrears to the AfDB rose from under $100 million in 1988 to over $400 million in 1992. Arrears to the IDB rose to over $500 million by 1990, before falling sharply with the clearance of Peru's arrears. There have been no significant arrears to the AsDB. Arrears to EC institutions now exceed $250 million, and those to the OPEC Fund are almost $200 million. But the worst affected have been Arab institutions, due to arrears from Egypt,

4 The following data on arrears to other multilaterals should be treated with extreme caution. With the exception of the African Development Bank, they are taken from the World Bank DRS system. They may therefore represent underestimates, since some debtor countries do not report their multilateral arrears fully to the World Bank.

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Somalia and Sudan; arrears to them peaked at more than $2 billion in 1989, before falling to just over $500 million in 1991 after Egypt cleared most of its arrears.

The Reduction of Net Transfers to Developing Countries

The impact of multilateral financial transactions with indebted developing countries on net transfers of real resources[5] is portrayed below. The net effect of multilateral lending operations to the developing world in the recent past has resulted in a desultory level of net transfers at a time when the multilateral system should perhaps have been compensating for negative net transfers on other creditor accounts. Table 8 shows that net debt-related transfers from multilaterals to the developing world as a whole collapsed between 1982-92 from $13.9 billion to $2.4 billion. Over the last three years net transfers to SILICs on all debt accounts have totalled a negative $4.6 billion, while to SIMICs the equivalent negative net transfer has been $45 billion, with over a third of that real resource outflow being accounted for by the multilateral system.

Multilateral net transfers to SIMICs have been negative since 1987 with multilaterals having extracted a total of nearly $16 billion from these countries between 1987-92 (see table 9). Even in SILICs where the external resource situation has been regarded as desperate, the net transfer impact of the multilateral system has been to deliver an insignificant amount annually in the last 5-6 years. But, although multilateral net transfers to SILICs fell sharply in the mid-1980s, they have never been negative. From their nadir in 1991 (when total net transfers from multilaterals to all SILICs fell sharply to a mere $253 million) they had recovered by 1992 to $1,744 million which was 45% higher than in 1982. SILICs received $7.1 billion of cumulative net transfers from multilaterals in 1987-92 – or less than $1.2 billion a year.[6]

5 It is often argued by multilateral institution managements that it is a fallacy to focus on net transfers but to focus instead on the net resource flows (i.e. on the principal account excluding interest payments). That self-serving argument needs to be debunked decisively. What matters for severely-indebted countries are not the finer points of a theoretical debate on the difference between current and capital account transactions but the loss of real resources at a time when their need to retain such resources has rarely been more critical. To debt-distressed developing countries money is money – whether it is paid back for principal (capital account) or interest (current account).

6 However, this is not the complete picture. It excludes the growing amounts of multilateral grants from the EC, the UN and the World Bank's "fifth window". Estimated total net transfers (based on OECD's data for DAC transfers and World Bank debt data) including grants from multilateral institutions to all developing countries fell from a peak of $18 bn in 1983 to a negative $3 bn in 1987, before rising again to $5 bn in 1992. Since the bulk of grants went to low-income countries, the picture for SILICs is probably about $1.5 bn a year more positive than for debt-related transfers.

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Table 8 Net Transfers on Multilateral Debt Account* (billions of US dollars)

	1982	1985	1988	1992	1982-92
All Developing Countries					
Net Transfers on All Debt Accounts	6.44	– 26.74	– 34.69	– 3.57	– 213.67
Net Transfers on Multilateral Bank Debts	8.76	6.76	1.47	4.65	53.97
Net Transfers on Non-Concessional MBD	*5.44*	*2.58*	*– 3.19*	*– 1.45*	*5.74*
Net Transfers on Concessional MBD	*3.32*	*3.48*	*4.66*	*6.10*	*48.23*
Net Transfers on IMF Debt	5.18	– 3.08	– 7.84	– 2.24	– 18.1
Sub-Total (NTMD)	13.94	3.68	– 6.37	2.41	35.87
Net Transfers on Other-Debt Accounts	– 7.50	– 30.42	– 28.32	– 5.98	– 249.5
Severely Indebted Low-Income Countries (SILICs)					
Net Transfers on All Debt Accounts	4.27	1.21	2.23	– 2.28	11.90
Net Transfers on Multilateral Bank Debts	1.03	1.22	1.13	1.74	13.84
Net Transfers on Non- Concessional MBD	*0.19*	*0.31*	*– 0.53*	*– 0.21*	*– 1.65*
Net Transfers on Concessional MBD	*0.84*	*0.91*	*1.66*	*1.95*	*15.49*
Net Transfers on IMF Debt	0.19	– 0.32	– 0.45	0.00	– 2.00
Sub-Total (NTMD)	1.22	0.90	0.68	1.74	11.84
Net Transfers on Other-Debt Accounts	3.05	0.31	1.55	– 4.02	0.06
Severely Indebted Middle-Income Countries (SIMICs)					
Net Transfers on All Debt Accounts	– 6.34	– 24.80	– 19.47	– 17.37	– 187.31
Net Transfers on Multilateral Bank Debts	2.10	1.07	– 0.61	– 1.54	3.18
Net Transfers on Non-Concessional MBD	*1.94*	*1.00*	*– 0.72*	*– 1.56*	*2.26*
Net Transfers on Concessional MBD	*0.16*	*0.07*	*0.11*	*0.02*	*0.92*
Net Transfers on IMF Debt	1.72	0.34	– 1.93	– 2.01	– 0.66
Sub-Total (NTMD)	3.82	1.41	– 2.54	– 3.55	2.52
Net Transfers on Other-Debt Accounts	– 10.16	– 26.21	– 16.93	– 13.82	– 189.83

* This table reflects Net Transfers only on External Debt Accounts. It does not factor in net transfers from other resource flows such as those emanating from grant aid or foreign direct or portfolio investments in equities. It is therefore a partial reflection of the overall net transfer situation. Nevertheless the table reflects how serious a drain on scarce real resources the debt crisis has resulted in.

Table 9 The Cumulative Impact of Multilateral Creditors on Net Transfers of Real Resources between 1987-92 (billions of US dollars)

	Non-Concessional Accounts				Concessional Accounts			
	IBRD	Other	Total	IMF	IDA	Other	Total	TOTAL
All LDCs	–20.2	+3.7	–16.5	–14.4	+21.9	+9.3	+31.2	+ 0.3
SILICs	– 5.5	+3.7	– 1.8	– 1.9	+ 8.3	+2.5	+10.8	+ 7.1
SIMICs	– 4.9	–1.1	– 6.0	–10.3	+ 0.3	+0.1	+ 0.4	–15.9

These figures emphasise a critical point which is often obscured when multilateral institutions trumpet the amount of new lending they have done each year. The reality is that in 1992, the multilateral development banks (excluding the IMF) as a whole made lending commitments of nearly $50 billion to all developing countries, to achieve disbursements of about $34 billion but net transfers of only $4.6 billion.

The multilateral development banking system thus has to lend more than 10 times the amount of net transfers it effects to the developing world because of the high and mounting debt-service obligations that developing countries have to make to these banks to keep the system functioning.

The amount of SDRs purchased by all developing countries from the IMF increased by about $4.4 billion equivalent in 1992 (after averaging about $9 billion in the previous two years) but debt service payments to the IMF (in the form of repurchases and charges) amounted to over $6.6 billion resulting in the IMF withdrawing over $2.2 billion from the developing world.

In 1992 all developing countries together paid-back to multilaterals (the development banks and the IMF) in the form of debt service a total of about $36 billion. In the case of SILICs the net transfer situation relative to total lending is better than for other developing countries because of the high proportion of concessionality in multilateral lending (though for many SILICs even that is not sufficient). Total multilateral lending (including that of the IMF) to SILICs in 1992 amounted to over $5.4 billion with disbursements of $4.7 billion but net transfers of only $1.3 billion (after taking IMF repayments into account). By contrast, while multilaterals made commitments of nearly $32 billion to SIMICs and disbursed over $10 billion, they withdrew nearly $14 billion by way of debt service (including debt service to the IMF) resulting in a substantial flow of real resources from these countries to the multilateral development banks and the IMF.

The pattern of multilateral debt accretion which has occurred over the last decade of debt crisis management raises fundamental questions about the impact and implications of fast-disbursing multilateral lending operations –

especially for structural and sectoral adjustment. The economic outcomes of these loans and the programmes they financed have not yet generated the levels of sustainable growth required, nor sufficiently enhanced export earnings, to cover the additional debt service burdens imposed, as quickly as had been anticipated when these loans were made. The following numbers illustrate that point crudely. Between 1980-87 the outstanding stock of multilateral (including IMF) debt to sub-Saharan Africa increased by some $25 billion, most of it applied to lending for structural or sectoral adjustment. Between 1987-92, the debt stock increased by roughly a further $16 billion. Yet by 1992 the total GNP of that region was $24 billion *lower* than in 1980, and total export earnings from that region were $2.8 billion *lower* than in 1980, while total debt service obligations to multilateral institutions (including the IMF) were about $2.4 billion *higher*; having increased from under $1 billion in 1980 to nearly $3.4 billion in 1992.

Put differently, the trajectory of fast-disbursing multilateral lending to severely-indebted developing countries was forced onto a higher plane in the 1980s in the name of adjustment but actually used for continued debt-servicing to other creditors. That lending did not yield the economic pay-offs which were anticipated in terms of an economic turnaround in sufficient time. As a consequence debtors who borrowed heavily from multilateral institutions in the 1980s now find themselves squeezed in a classic 'timing trap' – i.e. their debt service payments on earlier borrowings now have to be met before the gains from economic reform have been fully captured. The refinancing provided by the multilateral system for this transitional period has simply compounded the problem, enlarged it and deferred it.

Clearly the burdens are not as onerous for debtor countries in the midst of a turnaround which are now enjoying a resurgence of capital and trade credit inflows. That is now the case for most of the major debtor countries of Latin America. They are exceptionally onerous for some of the SILMICs (like Jamaica) and even more so for SILICs in Africa whose response to adjustment ministrations (which were based on neoclassical paradigms unsuited to their structural constraints) has been either absent or excruciatingly slow. For these countries, refinancing of multilateral obligations is already being done with soft credits now refinancing hard loans; but the extent to which such refinancing can be engaged in is severely constrained by the absolute shortage of concessional multilateral resources.

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Trends in The Accumulation of Multilateral Debt – Disaggregated by Institution

The International Monetary Fund (IMF): Debt owed by developing countries to the IMF rose by 60% between 1982-92. After almost doubling between 1982-86, it fell back sharply between 1987-88 before rising again after 1989. SIMIC debt to the IMF has quadrupled between 1982-92 to represent 21% of total multilateral debt in 1992. However, SILIC obligations to the IMF rose by only 41%, falling as a proportion of their total outstanding debt stock from 38% to only 14% by 1992. As a result, the burden of IMF debt service for SILICs peaked in 1986, and had fallen by 30% in nominal dollar terms by 1992, to account for only 13% of their multilateral debt service. In contrast, SIMIC debt service to the IMF in 1992 was eleven times the amount in 1982, and accounted for a much higher proportion (27%) of their total multilateral debt service. Nevertheless, seven of the nine countries currently most affected by service to the IMF are low-income countries. How they will fare in the future is difficult to say because projected debt service figures for the next five years were not made available to the author. The country with the highest burden of debt service to the IMF in 1991 was Uganda, whose repayments to the IMF exceeded 20% of its total export earnings in 1991. In the case of Argentina, Bangladesh, Bolivia, Ghana, Madagascar, Malawi, Tanzania and Zambia, debt service to the IMF exceeded 5% of their total earnings from exports in 1991.

The World Bank Group (IBRD and IDA): Debt owed by developing countries to the IBRD more than trebled (an average rise of 12.5% annually) between 1982-92. The peak period of growth was 1985-87, i.e. during the years that the Baker Plan was in operation before it became defunct. Since then it has risen by only 5% a year. Much of the change in outstanding stock levels (expressed in terms of US dollars) was due to movements in exchange rates rather than increased lending by the IBRD. Net flows of resources from IBRD have fallen by an average of $2.5 billion a year since 1988. The stock of debt owed by SIMICs to the IBRD almost quadrupled during the decade, while that of SILICs rose by 120%. Again, however, trends have changed sharply since 1987 with the debt obligations of SIMICs to the IBRD growing much more slowly than between 1982-86 and the debt obligations of SILICs actually falling by 13%. As a result, at the end of 1992, IBRD debt accounted for only 16% of SILIC multilateral debt, compared to 48% of SIMIC multilateral debt. One explanation for the declining trend in IBRD debt for SILICs is the relative decline in income and creditworthiness of many developing countries, particularly those in Sub-Saharan Africa, many of which have become ineligible to borrow from the IBRD in the course of the

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decade. In the early 1970s, 24 sub-Saharan countries were eligible to borrow from IBRD. By 1992, this number had shrunk to six.[7]

In 1992, debt service payments made by SIMICs to the IBRD were five times higher than in 1982, accounting for 46% of their total debt service to multilateral institutions while in the case of the SILICs debt service payments to the IBRD were four times higher in 1992 than a decade before and pre-empted 49% of their debt service to multilaterals, reflecting the greater concessionality of other SILIC debt on which repayment burdens are less onerous. The individual countries seriously affected by their debt obligations to the IBRD in 1992-94 are Bolivia, Cameroon, Colombia, Côte d'Ivoire, Guyana, Honduras, Jamaica, Kenya, Morocco, Nicaragua and Tanzania, for all of whom debt service to IBRD exceeds 5% of their 1991 export earnings.

IDA lending also grew rapidly (by almost 3.5 times) after 1982, particularly for the SILICs (in whose case outstanding debt to IDA increased by 3.8 times). Though debt owed to IDA now accounts for 19% of total multilateral debt of all developing countries and 39% of the multilateral debt of SILICs at the end of 1992, its concessionality prevents it from being a part of the multilateral debt problem.

In 1992 debt service payments to IDA accounted for less than 2% of all multilateral debt service payments made by developing countries, and 7% of the multilateral debt service payments made by SILICs. Very few individual countries face problems servicing IDA debt although, as noted earlier, six countries are in arrears for more than six months (at least three of these countries could afford to clear their arrears immediately but are not doing so for political rather than economic reasons). The annual debt service due to IDA between 1992-94 exceeded 5% of the 1991 level of export earnings only for Burundi, Guinea-Bissau and Uganda.

The African Development Bank Group (AfDB and AfDF): The African Development Bank Group has expanded its lending faster than any other major multilateral institution since 1982. Outstanding amounts of debt owed to both the hard-window African Development Bank (AfDB) and the soft-window African Development Fund (AfDF) were almost twelve times higher in 1992 than a decade ago. Of this rapidly increased total, more than $3 billion was owed to the hard window by SILICs. The resulting debt service payments to the AfDB have also risen much too fast, outstripping the capacity of African

7 Part of the problem with comparisons between 1982 and 1992 is that some debtor countries have moved from the SIMIC to the SILIC category (e.g. Nigeria) in the course of the decade while others have graduated out of the severely indebted category (e.g. Chile) while yet others have entered these categories during the decade. Nonetheless, the broad trends indicated by the aggregate numbers still tell a valid story despite these technical complications which need to be recognised and appreciated.

borrowers to meet their repayment obligations on schedule and resulting in a rising level of arrears to the institution. If that trend continued, it would threaten the financial standing of that institution. Though outstanding debt owed to the AfDB Group is an insignificant 2% of the total amount owed to multilateral institutions, it accounts nevertheless for 15% of the multilateral debt service of all SILICs (most of which are African) and for 17% of the multilateral debt service of African debtors. But the present numbers represent only the thin end of a larger wedge. Scheduled debt service obligations to the AfDB will virtually double by the mid-1990s. The problem is already acute for four African SILICs with debt service payments to the African Development Bank and Fund already exceeding 10% of export earnings in Burundi and Guinea-Bissau, and 5% in Sao Tome & Principe, and Uganda. In all cases except Sao Tome, it is the payments due to the hard-window of the AfDB debt that are mainly responsible for the problem which borrowers now face.

Unlike the World Bank and IDA, the AfDB was a relative late-comer in financing structural adjustment with most of its lending during the decade being for projects in countries which were already evidently uncreditworthy when much of this lending took place. On the face of it, this would suggest that this particular multilateral institution (i.e. its management, Board and shareholders) had learnt very little from the lessons of the debt crisis even when it was at its most intense. But, to an extent, the increase in AfDB lending was implicitly encouraged by OECD creditor countries, the World Bank and IMF. Despite the fact that its non-regional donors were unwilling (or unable) to provide the level of concessional resources which that institution needed to support the financing needs of its particular clientele, its participation was nevertheless actively sought in the 'financial programming packages' that were being put together by the IMF and World Bank between 1985-90 to support programmes of structural and sectoral adjustment throughout low-income Africa.

As noted earlier, these programmes have not worked in achieving a turnaround in debtor economies within the time-span originally anticipated. This was partly because they were inherently flawed in design and misconceived in intent, and partly because the debtor countries concerned were both reluctant and unable to implement these programmes as intended. The unfortunate result is that African SILICs are now saddled with much larger multilateral debts (owed to both the AfDB, World Bank and IMF) than their still fragile economies can possibly service; and yet they have little choice. The outcome poses a challenge both for the AfDB's debtors who have borrowed much more than they can reasonably hope to repay (given their obligations to other multilaterals as well as bilateral and private creditors), and for the institution in coping with the consequences of too large a proportion of non-performing assets on its balance-sheet.

The Asian Development Bank & Fund (AsDB and AsDF): The AsDB is not a significant part of the multilateral debt problem. Though the stock of debt owed to it by its Asian borrowers is now six times the level of 1982, it accounts for only 7% of total multilateral debt owed by all developing countries and less than 2% of the multilateral debt owed by SILICs. The Philippines was its largest debt-distressed borrower upto 1990 and the AsDB had nearly 13% of its total portfolio exposed in that country. But, the Philippines is no longer classified as a SIMIC. None of the countries which remain seriously affected by multilateral debt service problems owe large amounts to the AsDB, nor are debt service payments due to that institution likely to exceed 5% of the export earnings of any of its borrowing countries during 1992-94. However, the AsDB has large portfolio exposures in two large Asian countries (India and Indonesia) which are 'sailing close to the wind' in terms of their total debt exposures although the response of these economies to structural reforms has been encouraging so far. Providing the present trajectories in the revival and growth of these economies hold, they should avoid falling into a debt trap during the 1990s. If these reform efforts falter or fail, however, then the likelihood of these countries becoming severely-indebted will increase exponentially.

The Inter-American Development Bank (IDB and FSO): Unlike the AfDB, the IDB was fortunate (though for perverse reasons) to have avoided the problem of a massive increase in its loan portfolio during a decade when most of its borrowers were severely afflicted by the debt crisis. The stock of outstanding debt owed by Latin American and Caribbean borrowers to the IDB has grown relatively slowly in 1982-92, by only 2.4 times, although the IDB is the fourth largest multilateral creditor of developing countries. Moreover, 1992 debt service payments to the IDB exceeded $3.6 billion, more than five times the level of 1982 and over 10% of total multilateral debt service, making IDB debt service the third largest drain on developing country foreign exchange. Obligations to the IDB pose particularly onerous burdens for many SIMICs, accounting for 15% of their total obligations compared to only 4% for SILICs. Almost all of this is accounted for by the IDB hard loan window. The soft-loan window of the IDB, the Fund for Special Operations (FSO), is much smaller than in other multilateral institutions. It accounts for less than 10% of the outstanding stock of debt owed to IDB and 2% of the debt service payments due with both proportions falling. Problems in meeting their IDB debt obligations are confined to only five of its lower-income, smaller severely-indebted members. Scheduled 1992-94 debt service payments to the IDB were more than 10% of 1991 export earnings for Bolivia and Guyana, and more than 5% for Ecuador, Honduras and Nicaragua.

V The Scope for Multilateral Debt Relief

Issues Raised by the Multilateral Debt Problem

The problem of multilateral debt, like that of bilateral debt, is one which affects mainly the severely indebted low-income and lower-middle-income debtor countries of Africa, Central America and the Caribbean. It may, as the 1990s wear on, eventually also affect a number of countries in Eastern European and the former Soviet Union (FSU) unless prophylactic action is taken in time. The problem concerns mainly debt owed by certain countries to the IMF, and the hard windows of the World Bank and African Development Bank. In the case of the World Bank certain steps have already been taken to ameliorate the distress caused by debt servicing obligations to a reasonable extent. Debt owed to other multilateral institutions (especially the Asian Development Bank) does not pose as much of a problem. In the case of the Arab multilaterals, however, fairly large take-outs and negative transfers have, at the margin, added to the problems of a few African SILICs.

For countries whose external debt burdens are already severe any additional debt service obligations to any creditor (but especially to all preferred creditors) compromises their recovery and development prospects. In the case of some African countries, arrears to the African Development Bank and other multilaterals are rising as they attempt to keep current with the World Bank and IMF. These developments do not augur well for these countries in terms of damaging their financial relationships with some key institutions while becoming increasingly vulnerable to the conditionalities, strictures (and occasional management whims) of the Bretton Woods twins. The disconcerting inadequacy in the performance of some multilateral creditors since 1987 has thus added to rather than subtracted from the debt burdens of countries which need to be dealt with more sensibly. Doing so would raise several questions about relations between these institutions as creditors and their debtor-members which need to be addressed much more systematically by the international community. These include the following:

- Should the unwillingness of multilateral lending agency managements and their developed country members to contemplate rescheduling, refinancing, cancelling or converting multilateral claims – on the same basis as private and bilateral claims – now be reconsidered?
- If multilateral claims were to be treated on a basis similar to other creditor claims what would be the impact on the financial standing, capital structure and international market access of the multilateral institutions?
- Are bilateral and private creditors prepared to further subordinate their

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claims to those of multilateral agencies to enable a greater proportion of debt servicing be diverted to multilateral creditors through the 1990s – i.e. will bilateral and private creditors consider a much larger volume of cancellations and conversion of their claims than has hitherto occurred?

- Given the urgency of restoring positive multilateral net transfers to a wider group of SILICs and SIMICs what needs to be done by way of: (i) reducing multilateral debt service burdens through the 1990s; (ii) increasing multilateral disbursements; and (iii) increasing the concessionality of the multilateral lending mix for both SILICs and SIMICs?
- How should multilateral institutions and their managements be made more accountable for the consequences of their own actions?
  [At present any default on the part of the management or staff of these agencies – in, for example, misdesigning investment projects and adjustment programmes, misconstruing and misunderstanding the nature of debtor economies, engaging in imprudent over-lending or under-lending etc. – is paid for either by the debtor countries through enforced even if unaffordable debt service or by other creditors who have to tolerate higher levels of defaults, cancellations and arrears in order for multilateral debt service to be pre-emptively financed. No mechanisms are in place for multilateral lenders who err in their credit judgements to bear directly the costs of those errors.[8] That omission has, in part, led to the problem of multilateral over-lending which multilateral agency managements are understandably reluctant to have dealt with in the same way, and with the same sanctions and penalties, as they often advocate for other creditors].

These issues and questions need to be systematically and thoroughly addressed as a matter of the international public interest. In raising them for consideration as part of an international agenda for reform of multilateral institutions in the 1990s this paper eschews further detailed discussion of these questions and issues at this juncture – although the time for such discussion is perhaps overdue! Instead attention is turned to what might be done in the immediate future to ameliorate the growing burden of multilateral debt and to reverse some of the trends that would make its

8 Multilateral agency managements are becoming increasingly defensive about this issue. They have, through their lives created mechanisms and bureaucracies for insulating themselves, almost perfectly, from bearing any of the costs of mismanagement. Unlike their counterparts in private banks who are occasionally subject to the discipline of the marketplace, or in bilateral agencies who are often subject to the cruder discipline of politics, senior managers in multilateral agencies have effectively become answerable to no clear or singular authority. When discipline is attempted to be imposed on them the usual reaction is a playing of one lobby against another within the institution. The issue of accountability in the management of multilateral financial institutions is one which demands urgent political attention on the part of the leadership of the international community.

servicing increasingly untenable for many developing countries over the rest of this decade.

Arguments against Multilateral Debt Reduction: Opposition to transparent and systematic multilateral debt relief is based mainly on two arguments. The first is that providing such relief would incur the *moral hazard* of rewarding countries that were unwilling to accept conditionality and exert maximum efforts to adjust. These moral hazard arguments are echoes of arguments that were repeated *ad nauseam* between 1983-89 when they were applied to the servicing of debt due to commercial banks. As experience with subsequent commercial debt relief clearly demonstrated these arguments were hollow then and are no more meaningful now. The real moral hazard may be a different one – i.e. permitting multilaterals as creditors to be insulated completely from the consequences of their own often poorly judged actions and lending decisions which have unarguably played a role in creating and exacerbating the problem.

The second argument concerns the *preferred creditor status* of multilaterals which, though legitimate as a principle in its own right, may become dangerous if abused as an all-purpose cloak to shield multilaterals from full and proper accountability for their (occasionally unsound) lending decisions. The following arguments are generally used to support the multilaterals' preferred creditor status:

- The hard-window lending of multilateral institutions (other than the IMF) is financed by sales of their bonds to investors in international financial markets.[9] The multilaterals thus depend on uninterrupted debt service from their developing country debtors in order to maintain their own debt service obligations on time; full and timely repayment is therefore crucial to market confidence in these bonds which enables multilaterals to raise resources at extremely fine interest rates. This argument is sustainable in the sense that public announcement of a formal policy of rescheduling or debt reduction would worry the capital markets and increase borrowing costs for all developing countries. Such a reaction might occur not because of the absolute cost (e.g. writing down the debt of all SILICs and SILMICs, except Nigeria and Côte d'Ivoire, would have little impact on the IBRD, IDB or AfDB balance sheets) but because of the perceived risk that this might set a precedent for larger debtors. This risk might arise even if a write-down phased over several years were combined with partial conversion of debt into equity investments by the private sector arms of

9 Governments support these bond issues by pledging capital replenishments, most of which are not paid in, but are "callable" in the event that the institution concerned risks a default on meeting its own debt service obligations to bondholders.

multilateral institutions (for example, an IBRD-IFC debt swap) to support programmes of privatisation, the indigenous private sector and the mobilisation of foreign investment in low and lower-middle-income countries.

- The hard window (upper tranche) lending of the IMF is financed by quota increases which then begin to count as part of the official international reserves of member countries. As such, the argument against formal debt relief of debt service obligations to the IMF is that quotas must be risk-free with the reserve tranche being freely available for use on demand. In the absence of a new SDR emission, designed specifically for the limited purpose of extinguishing the debts of eligible SILICs, any rescheduling or reduction of debt owed to the IMF would require member countries to agree to reduce the value of their reserves.
- The capital component of SAF was funded by sales of gold held by the IMF (which belonged to member countries) while that of ESAF is funded by loans or other contributions from member governments which would be affected if rescheduling or reduction were to be permitted.
- The concessional windows of the multilateral development banks, the IMF (the SAF and ESAF interest subsidies) and the EC are funded by grants from donor countries. There is therefore no particular reason why such loans could not be rescheduled, refinanced, cancelled or converted into local currency. The main argument against this course of action, of course, is that concessional funding from donor countries is becoming increasingly limited as OECD governments come under acute budget-cutting pressures. Any relief would therefore reduce the availability of concessional resources available for recycling in the 1990s.[10]

If these arguments are taken at face value, the scope for multilateral debt relief may seem limited. However, they cannot be taken at face value. The merit of these points should be viewed against the current negative effects of multilateral debt in compromising the development prospects of a large number of low-income developing countries and the potentially positive effects that relief might have. The inflexibility of multilateral debt service now requires bilateral creditors to cancel large stocks of *bilateral* debt, accept growing arrears on the residual debt, and to provide financing for servicing debts to multilaterals. It is thus already diverting too large a proportion of bilateral concessional resource flows to low-income Africa from financing poverty alleviation and growth to financing debt service to multilateral

10 But that argument applies with equal force to the rescheduling and reduction of bilateral debt which has the same unfortunate effect. Nonetheless, bilateral debt reduction has now become commonplace although it is not yet as extensive as it should be. Moreover, if multilateral debts were to be reduced significantly the same quantum of concessional resources would not be needed to service them.

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institutions. The current approach also increases the total debt overhang in these countries as other creditors capitalise their arrears and multilateral institutions refinance informally with new loans. Accumulation of excess debt then discourages investment and growth in developing countries. Up-front multilateral relief in cases where it is clearly justified could free more concessional resources to finance growth and could play a major part in assisting afflicted debtor countries to exit from the debt trap with improved prospects for sustaining growth.

Approaches and Solutions to the Multilateral Debt Problem

Reluctance to address multilateral debt problems openly and squarely and to rely instead on traditional approaches (which sometimes appear to be bordering on the opaque and surreptitious) puts pressure on inelastic donor budgets and threatens the efficacy of the development assistance system. There are other options open to consideration which would avoid any significant risk to: the capital market standing of multilateral institutions; the value of IMF members' reserves; or to the threat of even more sharply constrained concessional resources available for application to development instead of debt service. These have been raised in a number of publications and fora, and have been discussed frequently (though privately) within the multilateral institutions themselves, only to be dropped for lack of political consensus among OECD countries rather than for sound technical or financial reasons. These options now need to be discussed by wider international publics with political pressure being built up to seek other ways of refinancing or reducing multilateral debt, and clearing multilateral arrears, than simply diverting bilateral aid away from priority purposes to meeting multilateral debt service.

There is a clear danger that the continued diversion of bilateral grant aid for this purpose will erode (and perhaps permanently damage) the public constituency for maintaining continued levels of development assistance from OECD countries which are suffering from acute and seemingly domestic problems (such as unemployment). After the EBRD debacle[11] and news about the World Bank and other multilateral institutions indulging in their 'edifice complexes' and other forms of egregious waste, publics in donor

11 This concerned the public outcry against the excesses of the EBRD President in wasting administrative resources on hiring charter jets and expending lavishly on dining rooms and marble entrances resulting in the EBRD spending far more on itself in 1992-93 than disbursing to its borrowers. This paper does not deal much with the portfolio of the EBRD simply because that institution has not yet built up a disbursed and outstanding loan portfolio of any significant size.

countries are becoming increasingly intolerant of having their tax funds deployed to support multilateral institutions which are perceived as profligate and ineffectual, excessively generous in expenditure on themselves (while being draconian in imposing harsh belt-tightening discipline on their borrowers), and subject to no clear authority or control. Multilateral institutions (excluding the UN) now cost a total of about $3.5 billion annually to run (the World Bank alone accounting for over a third of this amount) and there are serious questions to be raised about whether the international system is deriving sufficient value for this expenditure.

Of the options which have been tabled to tackle the problem of multilateral debt, the following appear to deserve the most serious and urgent attention:

• **A Special SDR Emission** has been proposed by various sources in recent years for providing multilateral debt relief. The major reason for opposing this source of funding is the theoretically inflationary effect that increasing global liquidity through an SDR issue deployed for this purpose might have. These fears (most strongly expressed by Germany) have been excessively overplayed with a number of authoritative analyses concluding that such a danger is minimal and the prospects of a tailored SDR issue being inflationary are infinitesimally small. The current low-inflation environment reduces even more this insignificant risk of exacerbating inflation; in fact a case could be made in the present global climate for offsetting the negative consequences of deflationary forces. There is a compelling argument for a one-time issue of SDRs to be issued and voluntarily redistributed by the Fund's OECD members (and others with a strong reserves position) to a limited number of specific eligible countries (on a case-by-case basis) which would use these SDRs to extinguish their multilateral debt.

While there is a strong case for a sufficiently large SDR emission to enable the extinguishing of debt owed by this group of countries to the IMF, World Bank, AfDB and (to a much more limited extent) the IDB, even a smaller emission which focussed only on extinguishing debt owed to the IMF would still be worthwhile. The mechanics and issues involved in this option are arcane and complex and are not discussed in detail in this paper. But the issue is not that complicated in principle or practice. Several papers have recently been circulated within the IMF on this option (and many members of its staff and management are in favour of implementing it). These internal papers now need to be made public and debated widely. Following such discussion, international pressure needs to be brought to bear on reluctant governments to reach a positive consensus on this option or, alternatively, to find ways of proceeding without one or two governments holding the system hostage to their overplayed concerns and fears – none of which are likely to materialise.

• **IMF Gold Sales:** The original concessional facility of the IMF – the Trust Fund – was financed by the sale of SDR 3 billion of IMF gold reserves in 1976.[12] Similar sales of SDR 3-6 billion were suggested by the US Congress and Scandinavian countries as funding sources for the SAF and ESAF. Instead, the IMF chose to set aside 3 million ounces of gold (with a value of approximately SDR 1 billion) as a reserve to guard against possible non-repayment of ESAF loans. The major current objection to gold sales is that the world market price of gold (despite recent volatile movements) is near its lowest real level since 1978. In this light the sale of gold might seem to be untimely and possibly wasteful of valuable international reserve resources. However, opinion is divided on future trends in the price of gold. Many expert market analysts believe that (following restructuring of the Russian economy and the need to increase export earnings in post-apartheid South Africa), gold production will grow faster than demand during the rest of the 1990s, possibly exerting further downward pressure on prices in the long run. Uncertainty about the gold price in the medium term is even more acute. Given rates of return on financial assets, most governments around the world have been gradually reducing (in absolute and proportionate terms) their stocks of gold reserves and investing in stable currencies or income-earning government bonds. Whether the IMF as global financier of last resort should also follow this trend is a matter of open debate on which member governments have widely differing opinions. In any event, to put matters in perspective, the amount of gold that would need to be sold at current market prices to finance a total write down of the debt of low-income Africa owed to the IMF would amount to about 10-12% of the IMF's total holdings of gold.[13]

• **Retained Earnings, Provisions and Reserves:** Following the dictates of prudence demanded by the quality of their stressed asset portfolios most multilaterals have already set aside substantial provisions and/or reserves (specific and general) to guard against possible non-payment of debt service due to them. The exception to this rule is the AfDB whose 1992 Annual Report suggests that reserves and provisions are proportionately not yet as large as those of other MDBs, especially when taking into account the higher risk it appears to be carrying in its asset portfolio. But allowing for that exception, the multilateral banks generally have substantial amounts of retained earnings accumulated as a result of generating high profits (paid for

12 This was only one-sixth of a much larger programme of gold sales between 1976 and 1980, establishing a clear precedent for gold sales now.

13 This measure has already been suggested many times: for example by Goreux, Kenen and Polak in Gwin, Feinberg et al.

by developing countries) and not paying out dividends to their shareholders. These earnings, provisions and reserves are currently not being deployed in any way other than to bolster the balance sheets of the MDBs.

For example, the extent to which they have been built up in the World Bank and IDB (where retained earnings, reserves and provisions taken together now amount to over $17 billion and $5 billion respectively) permit somewhat greater room for manoeuvre in providing debt relief to deserving countries than either institution has chosen to admit or exercise, choosing instead to transfer most of the burden for such relief on already overstressed donor aid budgets. The balance sheets of these multilateral institutions already have several levels of safety built into them. Their present reserves and provisioning policies raise a question as to whether these policies have now become a convenient back-door way of accumulating cash capital on MDB balance sheets rather than being used (even to a small extent) for the purpose which they were originally created for. The possibility of redeploying a small proportion of such provisions and reserves should therefore be carefully reexamined to establish whether these institutions could not afford (without any serious damage to their balance sheets) to: (a) write-down the stock of their hard-window debt which remains outstanding in several severely debt-distressed low-income countries; or (b) to refinance it on IDA equivalent terms; or (c) finance an up-front clearance of arrears.

• **Cancelling Undisbursed Balances of Loans and Credits Made for Projects which have Proven Unviable:** Most multilaterals now have a growing proportion of loans outstanding, as well as undisbursed, for projects which have either been suspended or have not been functioning effectively for several years. As has recently been proposed by the Wapenhans Report on the quality of the World Bank's portfolio, the undisbursed balances for such projects in all developing countries should be quickly cancelled. In the case of hard-window loans this measure would prevent the further build-up of bad debt. Action along these lines is already advanced in the World Bank and needs to be emulated by the other MDBs, especially the AfDB. In the case of soft-window credits to non-debt distressed countries which had been earmarked for such projects, scarce concessional resources might actually be released and could be used to supplement both debt reduction and new lending in SILICs.

These measures would be helpful at the margin. But they would not necessarily address the problem of outstanding multilateral loan balances already disbursed for unviable and non-functioning projects. Borrowing countries are saddled with repaying those unproductive multilateral debts even though the projects financed are not generating any returns. There is a strong moral case for appointing qualified *independent tribunals* of experts to:

(a) examine the decision-making process behind these project loans to SILICs carefully;[14] (b) determine the extent to which the multilateral banks were themselves responsible for project failure; and (c) assess what proportion of the cost they should therefore bear by reducing or relieving the ensuing unproductive debt burden. Apart from the obvious morality of such action, and the confidence it would instil in the publics of donor countries who are becoming increasingly disillusioned with the multilaterals, this measure would also provide a mechanism to deter MDBs from expanding their lending simply to meet annual targets. It may also help to restore a sense of quality-consciousness in their approach which the Wapenhans Report (and its equivalents in the other MDBs) suggest has been diminishing. There is an even more compelling case for employing the same approach in the case of IMF-World Bank designed and imposed adjustment programmes in the affected SILICs which have subsequently failed, but which have left in their wake a debt burden which is unsustainable (the case of Zambia is a particularly egregious one). But the sheer complexity and impracticality of apportioning blame in the case of such lending makes this approach unviable and inapplicable.

The danger of implementing the measure suggested above, of course, is that MDBs would threaten to become so conservative and cautious in their operations that new lending and disbursements would fall sharply, resulting in large negative net transfers materialising in the coming years. While that threat is real and should be taken seriously, it should not be overplayed. Very large negative net transfers would affect the middle-income borrowers of the MDBs (where they have every incentive to lend and these borrowers are much more capable of looking after their own interests) and not the SILICs. Moreover, negative net transfers would bear the seeds of self-regulation because they would result in growing arrears to the multilaterals – a risk they can ill-afford to incur.

On the whole, perhaps the time for implementing such a measure is

14 The MDBs argue forcefully and correctly that they do not compel their borrowers to assume loans. Thus when the borrowing country agrees to the loan it accepts full responsibility thereafter with the MDBs being absolved. This was the same argument that commercial banks made in justifying some extremely dubious (in some cases even plainly corrupt) lending to developing countries in the 1970s and early 1980s. While that argument has some superficial logic to it, it belies the reality of the multilateral lending process as it occurs in most African SILICs. In these countries, the MDBs – and the World Bank in particular – dominate the entire lending process from beginning to end, ostensibly to compensate for lack of capacity on the part of the borrower but with the effect in practice of virtually cutting the borrower out of responsibility for its own decisions. The MDBs identify the project, prepare it, pre-appraise it, design it, appraise it, lend for it and supervise it. Under these circumstances borrowers might be forgiven for feeling that, having depended on the MDBs for expert advice, they were misled when it did not work out and that therefore they should not bear the entire cost of servicing the useless debt that was thus accrued.

overdue in reinforcing a system of internal checks and balances which appears to have broken down in the MDBs. The nature of relationships between their managements and Boards is counterproductive and ineffectual. Moreover, the quality of MDB management has been steadily diminishing, fostered as it is by an incestuous system of internal selection and promotion which does not permit MDB managers to build up any significant experience in the real world, making them poor assessors of substantive project or programme issues, and providing them little opportunity for exercising sound judgement in assessing credit quality and risk. The only real expertise that such systems inculcate is in the arts of report-writing, rationalisation, bureaucratic in-fighting and in honing presentational skills.

- **Multilateral Debt-for-Equity Swaps:** One technique which has met with considerable success in reducing the stock of private commercial debt and has more recently been proposed in dealing with the overhang of bilateral debt[15] is that of debt-equity swaps. In theory and principle, there is no reason why the same technique could not be attempted (even if for a small amount of debt) between the lending and investment arms of the MDBs (e.g. between the World Bank and IFC) in instances where it made sense and where such conversions might help to kick-start programmes of privatisation and public enterprise divestiture. Working out details like the pricing of such swaps would entail complex and tricky issues but none of these would be beyond the wit of these institutions to resolve if the will existed to undertake such operations and make them a success. Their shareholder governments should require that prospects for such conversions be carefully examined by each MDB with a view to reducing debt obligations of eligible SILICs to their hard-loan windows to the maximum extent possible.

Redistributing Donor Resources Among Multilaterals

Given the obvious limitations that are now pressing on securing additional resources from donor countries, the five options discussed above need to be explored more intensively in arresting the growth of the multilateral debt problem. But, although donor funds may be constrained, their current pattern of distribution among multilateral institutions is sub-optimal and reflects many of the same flaws that characterise the distribution of bilateral OECD-DAC aid. Several of the measures discussed below involve rethinking

15 See Mistry, P.S. & Griffith-Jones, S. "Conversion of Official Bilateral Debt", UNCTAD, Geneva, May 1992

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the current distribution of resources among institutions, or among the different lending windows of each institution, in order to ensure that they: (a) make the maximum contribution to restoring prospects for sustainable development in the most debt-distressed SILICs; (b) catch up with changes in developing country income levels; and (c) avoid measures which might damage multilateral credit ratings or donor budgets.

In particular, despite the 'leverage' effect of capital subscriptions to hard windows, donors now need to concentrate resources on the soft windows of the multilateral development banks, and shift emphasis from IDA to the AfDF for two main reasons:

- Many severely indebted countries in Africa have recently fallen from middle-income to low-income status, and several more will follow them, increasing demand for soft window funds, particularly from the AfDF; without a much larger AfDF-7 replenishment which enables the AfDB to refinance some of its hard-window debts with concessional financing in the same fashion as the IBRD, the AfDB's role in Africa is likely to become marginal.
- Most remaining middle-income debtors are demonstrating their ability to attract private foreign capital or promote domestic investment, thus reducing the demand for hard-window multilateral funds.

VI Prospects for Multilateral Debt Relief

As the foregoing sections have suggested, several sensible options do exist for addressing the issue of multilateral debt and the inextricably related question of new multilateral lending. But, experience and unfortunate political realities suggest the need for caution in attempting to seek any sort of global solution to the multilateral debt problem. Given the excessively bureaucratic way in which governments and multilaterals work there appears, at present, to be little likelihood of establishing a single debt reduction facility or even a single forum for coordinated reduction of multilateral debt funded by an SDR issue or by IMF gold sales.

The derivation of a common standard – or a set of common criteria – for providing such relief, to ensure burdensharing among all multilaterals or with other creditors, is also improbable, even though it would not be too difficult to design standards such as positive net transfers, or restricting multilateral debt service to agreed proportionate maxima as a percentage of either total debt service or of export earnings.

Relief is more likely to continue to be provided piecemeal by each institution separately, using its own funds, and on the basis it thinks suitable in its own circumstances.[16]

The International Monetary Fund (IMF)

Expanding Access Case-by-Case in Middle-Income Countries: SIMICs (whose debt servicing problems and concerns have not been fully addressed in this paper) have been particularly hard hit by large negative net transfers to the Fund since 1986. The IMF has done little to reverse this, because the IMF Board has recently reduced the permissible maximum multiple of quota that it lends to individual countries (this is known as *access* to Fund resources), particularly for countries regarded as poor credit risks. Publicly the Fund's position remains that where countries have strong adjustment programmes in place, the Fund will increase its exposure. There is some evidence that on a

16 Inevitably that will lead to inconsistent and inequitable treatment of debtors and will create anomalies in the system which could, with better co-ordination, be avoided. For example, it has made little sense for the World Bank to extend partial debt service relief to eligible SILICs in Africa only for the AFDB to attempt to extract full debt service from them on its own hard-window debt. To the extent that it has been successful the AfDB has been a 'free rider'; to the extent that it has been unsuccessful it has simply accumulated arrears while the debt of the World Bank has been serviced.

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net flow basis it managed to do this in the mid-1980s for countries without prolonged use of Fund resources.[17]

However, Board decisions linked to the Ninth General Review of Fund quotas in 1990 reduced access to prevent any increase in lending as a result of the quota increase. Maximum access under the credit tranches and extended facilities were reduced to an annual 68% and a cumulative 300%. Maximum access under the Compensatory and Contingency Financing Facility (CCFF) fell from 122% to 95%. This ran contrary to the arguments and projections used by Fund staff in proposing the Ninth General Review, which assumed the maintenance of 1990 access levels, or even an increase in these levels, in order to ensure continued positive net transfers to developing countries.[18] Had access been maintained at earlier levels, the quota increase in 1990 would have permitted annual lending of $12 billion in 1990-94, and positive net disbursements of $6 billion. These compare with annual lending averaging only $7.5 billion in 1990-92, and negative net disbursements of an average $1.3 billion a year.

Neither IMF staff nor independent analysts believe that restoring access to the earlier limits would pose any serious risk to the IMF portfolio as its liquidity would remain more than ample. As a result of the large negative net transfers in the 1980s, obligations to the IMF are not a large burden for most middle-income countries – with perhaps the exception of Argentina. There may be little need now for a *global* restoration of access to 1990 levels, because several heavily-indebted middle-income countries are now availing of recourse to voluntary lending from international capital markets and are the beneficiaries of unprecedentedly large inflows of direct and portfolio foreign investment. But in this group of countries there are exceptions, like Jamaica, which deserve special treatment. However, in the case of the lower-middle-income countries which do still have a debt crisis, the IMF's Board might consider applying more discretionary scope in permitting access upto pre-1990 access levels, and preferably for even higher annual credit tranches combined with the Extended Fund Facility (EFF) and CCFF limits, on a case-by-case basis.

Going Beyond ESAF for the Low-Income Countries: In 1986 and 1988, the IMF established the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF) for concessional lending to low-income countries. These followed the tradition of the Trust Fund. These two facilities have served to secure the IMF's role as a development finance

17 See Killick et al 1991 and Overseas Development Institute 1993.
18 See Gwin, Feinberg et al 1989.

institution (a role which it was never intended to play) by enabling it to lend for longer periods (10 years with 5.5 years of grace) at concessional interest rates (0.5%). However, funds from both SAF and ESAF have been disbursed extremely slowly partly vitiating the urgency and purpose for which they were set up. The slowness of disbursement exacerbated the debt service problems that the intended beneficiaries had with the Fund. By February 28, 1993, ESAF had disbursed only SDR 2.1 billion out of its total funding of SDR 6 billion. Apart from the general reduction of access limits and the policy of reducing lending to 'over-exposed' countries, very low limits were established for SAF. More generous limits for ESAF were reduced with the Ninth General Review of Quotas. Maximum exceptional access fell from 350% of quota to 255%; maximum normal access from 250% to 190%; average access from 150% to 110%; and access for newly ESAF-eligible countries from 80% to 60%. In the context of the current general shortage of donor concessional resources it seems almost absurd that the IMF should be persuading bilateral donors to help SILICs meet their debt service to the IMF when it could use ESAF resources which are more readily available to the Fund with no risk to its liquidity position. In addition to resorting to faster use of ESAF for SILICs the IMF should restore previous access levels at the earliest opportunity.

Two other specific factors explaining the slow disbursement of SAF and ESAF [19] have been:

(a) *Excessive Conditionality:* All countries granted ESAF facilities are being expected to implement dramatically tighter conditions in the first year of ESAF programmes, and uniformly tight conditions in later years, whether or not they began or completed SAF programmes before the expiry date of the SAF facility (March 1992). The concept of gradual progress through SAF to ESAF conditions – synchronised with gradual structural reforms under World Bank programmes and PFPs – has been discarded in favour of an emphasis on immediate and recessionary fiscal and monetary deflation. This tightening has delayed agreement for many countries, and has reduced growth and savings and increased current account deficits in ESAF programme countries compared to SAF programmes.

(b) *Balance of Payments Viability and Capacity to Repay the Fund:* Countries are informally obliged to make major progress towards balance of payments viability during the programme period and to show that they will be able to repay the Fund loan. In theory, this should mean progress towards

19 On these, see also Feinberg in Husain and Underwood 1991; Green 1993; Martin 1991, Chapter 7; and Overseas Development Institute 1993.

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ending reliance on debt relief and IMF purchases.[20] In practice, it means demonstrating that comprehensive debt relief and huge aid flows will be available to finance the programme. Because Paris Club reschedulings and some balance of payments support normally follow the making of IMF loans, several countries have been deprived of Fund lending and of exceptional financing. This vicious circle could be broken if the IMF and creditor governments agreed to provide debt relief and balance of payments support on the basis of a Fund-monitored programme without an accompanying IMF loan (as they are doing with Rights Accumulation Programmes and post-ESAF shadow programmes).

SAF and ESAF have refinanced only 40% of low-income countries' repayments of non-concessional debt to the IMF. But they have perhaps fulfilled another more invidious and questionable role: i.e. they have enabled the IMF to continue lending to low-income countries even as these countries have been compelled to meet debt service on non-concessional IMF loans. The good aspect of this development is that non-concessional IMF debt of low-income countries has fallen dramatically since 1987. At the end of February 1993 it totalled only $6.2 billion, of which $3.4 billion was owed by India. The SILICs owed the IMF $2.1 billion in upper tranche obligations; but once arrears are excluded, they will owe less than $400 million. For that reason, consideration might be given to establishing an equivalent of the World Bank's 'fifth dimension' facility, for refinancing non-concessional IMF debt of IDA-only countries, using a special SDR emission or gold sales for funding it.

The preferable approach would have been for SAF and ESAF not to have been created in the first place but to have had the resources of IDA expanded instead to fulfil the roles of SAF and ESAF. IDA would have provided a more appropriate vehicle for the IMF to withdraw from a development financing role in the low-income countries and being obliged instead to confine its activities to advice and surveillance. IDA facilities (with a maturity of 40 years and a grace period of ten years) are also far better suited to the multilateral debt refinancing needs of SILICs rather than ESAF facilities whose maturities and grace periods are much too short, resulting in the debt servicing problem caused by IMF loans being deferred for a short period and renewed rather than decisively resolved.

The funds of the current ESAF will be exhausted during 1993-94. There is, unfortunately, a broad consensus among developed and developing country governments in favour of a successor concessional facility within the IMF modelled after its predecessor. The optimal solution would be

20 See Goreux in Gwin, Feinberg et al 1989

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expanding IDA rather than financing ESAF-II. However, once an institutional dynamic takes over, and vested interests in support of one institution over another become entrenched, it is very difficult to achieve sensible rationalisation in the multilateral system. Accepting a new ESAF as a sub-optimal reality, it could however be improved by giving the facility the following features:

(a) *Less Rigid Conditionality:* based on the length of prior adjustment and degree of prior stabilisation rather than some uniform standard for ESAF successor programmes. For countries progressing from third or fourth year ESAF programmes to its successor, there should be no requirement to accelerate progress towards balance of payments viability: they should only have to maintain it at the current pace.
(b) *Larger Loan Size* with increased access limits.
(c) *More Concessionality in Terms:* at least 67% grant element to match the Paris Club's Trinidad terms (IDA terms would be preferable for SILICs), achieved by lengthening the grace and maturity periods to 8 and 15 years and maintaining the current 0.5% interest rate.
(d) *A Longer Period* allowed for achieving balance of payments viability, thereby easing disbursement restrictions for some countries.
(e) *A Larger Replenishment:* of at least SDR 8 billion over three years, considerably larger than the original ESAF, because eligibility has now been widened from low-income debt-distressed to all 72 IDA-eligible countries and because several newly-eligible countries may follow Zimbabwe in abandoning their earlier decision not to use ESAF resources.[21] Eligibility may need to be further expanded to include 7 more Caribbean and Pacific states.
(f) *Capital Funding for ESAF from normal General Resources Account* funds rather than from loans by donors. This is vital because it avoids the need for a specific reserve to ensure the repayment of donor loans.[22] The SDR 1 billion of gold pledged to back this reserve, and the net earnings from investment of donor contributions to the ESAF could then be freed to cofinance an interest subsidy on the larger total funds, along with additional gold sales of approximately SDR 3.3 billion.

Beyond ESAF-II, consideration must be given to removing the development financing function altogether from the Fund before it becomes an embedded perversion of the Fund's role. The Fund could still fulfil its role of gatekeeper

21 Countries added in 1992 are Albania, Angola, Côte d'Ivoire, Dominican Republic, Egypt, Honduras, Mongolia, Nicaragua, Nigeria, Philippines and Zimbabwe.

22 It would also reduce the current complexity of proliferating multiple accounts and facilities in the Fund.

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to rescheduling and new aid, by approving and monitoring the monetary, fiscal and external sector policies and targets of an adjustment programme as it currently does. Creditors would accept a role of monitoring with negative net transfers (as they have during the 1980s) whereas they would be unlikely to accept a complete transfer of programme design to the World Bank. This role would also ensure that staff time and attention were not diverted away from low-income countries to other borrowing countries, and might reduce political pressure to lend, allowing staff to focus still more on the viability and consistency of adjustment programmes; as has recently been shown by post-ESAF Fund-monitored programmes in Ghana and Gambia.

As noted above, the development financing function should be more appropriately fulfilled by IDA, with bilateral donor grants being used to augment IDA rather than ESAF. The SDR 3 billion provided for ESAF would have increased IDA-10 by 23%. In order to begin moving in this direction, the interest subsidies inherent in ESAF-II should be financed not by donor grants but by sales of IMF gold instead. The Fund's financing role in low-income countries should revert to its earlier role in the 1970s: i.e. that of providing quick, ready access first line liquidity and longer-term contingency finance to offset sudden, unprojected external shocks.[23] The quantum of recyclable concessional funds already built up in the Fund appear adequate to meet that requirement for the foreseeable future.

The World Bank

The World Bank has been at the vanguard in taking several creative and helpful steps in recent years to help SILICs cope with the problems created by debt service obligations to the IBRD, and to maintain positive net flows and transfers to borrowing countries.[24] It has focussed particularly on former IBRD borrowers whose creditworthiness has deteriorated sufficiently for them to now be classified as IDA-only countries, many having fallen from middle-income to low-income status. Since 1988, IDA has earmarked a portion of repayments on earlier credits (IDA reflows) to assist eligible SILICs in meeting part of their interest payments on IBRD loans borrowed when they were middle-income countries.[25] Initially this was established as

23 For more discussion of this issue, see Green 1993.

24 Sadly, the Bank has taken full credit for doing so unilaterally when the real impulse for these initiatives (especially the fifth dimension facility) have come from concerned donors; in particular, the Nordic donors.

25 Until 1987, reflows were used largely to cover exchange rate losses on IDA contributions.

the 'fifth dimension' of the Special Programme Assistance (SPA) for Africa; it has since been expanded to cover all IDA-only borrowers.[26]

Disbursements are made as supplements to adjustment credits, and therefore have sometimes been delayed by failure to agree or implement programmes. In 1988, the funds available were a maximum of 10% of IDA reflows or approximately $400 million, which financed only 60% of interest payments due from eligible countries. However, due to favourable exchange rate changes, improvements in IDA's financial position,[27] and because not all eligible countries agreed to implement acceptably tough adjustment programmes, the Bank was able to refinance 90% (and in 1992-93 almost 100%) of interest due on IBRD loans for the remainder. The total amount allocated under the programme during 1988-92 has been more than $520 million In addition, Finland, Norway and Sweden have provided additional donor support to refinance IBRD interest *and principal* payments.

Under IDA-10 the 'fifth dimension' will continue, but there seems currently little prospect of expanding it to refinance principal payments on IBRD loans by IDA-only borrowers (as proposed by several donor governments since 1987). One objection in principle is that refinancing all IBRD principal would make the terms of IBRD loans softer than IDA loans. However, a formula could easily be devised to refinance a proportion of principal payments which equalised the net present value of IBRD and IDA loans. The greater barrier is that all but 10-15% of IDA reflows are needed to enhance IDA-10 commitment authority (see below). Any extra amount allocated to the fifth dimension will be a 'safety margin' to cover interest subsidy financing requirements for additional countries which may soon become eligible.[28] For that reason the case is strong for using exceptional financing sources to refinance the principal of IBRD loans owed by IDA-only countries, through a one-off, up-front formal refinancing using some of the Bank's reserves.

Few would argue that similar measures should be taken to maintain a positive net transfer from the IBRD to middle-income developing countries,

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26 Countries currently eligible are Bangladesh, Bolivia, Ghana, Guinea, Guyana, Honduras, Kenya, Madagascar, Malawi, Mauretania, Nicaragua, Senegal, Sierra Leone, Tanzania, Uganda and Zambia. Honduras and Nicaragua have recently become IDA-only countries.

27 These improvements in IDA's financial position are caused by larger earnings on investment of donor contributions, because donors contribute more than is scheduled to be disbursed or because disbursements are delayed. In addition, the proportion of IDA funding which comes from transfers of IBRD net income is now able to be "called" simultaneously with donor contributions (whereas before it was called only after donor contributions).

28 For example, when the CFA franc is eventually devalued (as it must be to restore a semblance of equilibrium in the franc zone economies) Côte d'Ivoire will become a low-income debt distressed country and might alone absorb 6% of total reflows if it becomes eligible.

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given that many are now receiving large private capital inflows. However, there may be a case for considering the extension of IDA loans on an exceptional basis to severely-indebted lower-middle-income countries with a heavy IBRD service burden (particularly Bolivia, Côte d'Ivoire, Jamaica and Morocco). IDA credits could be used to refinance a proportion of the existing hard-window IBRD debt and to restructure debt service on intermediate terms.

Debt owed to IDA is not an issue which requires any urgent solutions. Instead, the issue is whether IDA *should* or *can* continue to bail out other multilateral creditors. To a large extent during the late 1980s, IDA has acted as the international financial system's 'lender of last resort' for SILICs by attempting to provide positive net flows to low-income countries. The most recent IDA replenishment (IDA-10) agreed in 1992, for commitment between 1994-96, totals SDR 13 billion (or approximately $18 billion). Viewed in the context of severe donor budget constraints the replenishment amount was generous. Viewed in the context of SILIC and other low-income country financing needs, it was insufficient, for the two reasons noted earlier: (a) more middle-income countries are continuing to fall into low-income status, increasing eligibility and demand for IDA loans; and (b) many IDA countries are reaching their existing commitment ceilings and require more credits for gap-filling in growth-oriented adjustment programmes.

As a result, IDA contributions from donors have traditionally been supplemented by using transfers from the investment income of IBRD and, more recently, by IDA reflows from credits made in the 1960s and 1970s which are now being repaid.[29] IDA reflows will grow sharply in the mid-1990s. But, in the current IDA commitment period 90% of IDA reflows will still be needed to meet planned commitments for IDA-10 recipients. There is therefore little room for IDA to do more than it is already doing to overcome multilateral debt problems unless present allocations to much better-off countries such as China – whose continued access to IDA might be questioned in view of its highly favourable economic circumstances – are deployed for higher priority purposes. If the political problems associated with such perfectly sensible reallocations could be satisfactorily dealt with, there may be more room for manoeuvre than meets the eye.

29 IBRD profits from investment income have also been used to finance buybacks of commercial debt owed by low-income countries - the so-called "sixth dimension" of the SPA. As of mid-1993, these funds had been used for only 5 countries (Bolivia, Guyana, Mozambique, Niger and Uganda), but several operations were close to conclusion and the Bank is asking its Board for more funds to replenish the account.

The Regional Development Banks

The African Development Bank: As discussed earlier, debt service payments to the African Development Bank are now becoming a significant burden for most African countries as grace periods on loans made in the mid-1980s expire and disbursements on commitments made between 1987-92 rise dramatically. The bulk of AfDB's portfolio remains of generally high quality but is beginning to show signs of structural deterioration. Time is running out for finding remedies which will arrest and reverse the future growth of what might become a serious problem. The most important measure that needs to be taken is to rectify the imbalance between the concessionality of funds available for lending and the income level (and creditworthiness) of most of its borrowers. A debt servicing problem has arisen because the substantial expansion of AfDB's lending between 1987-93 was financed by the wrong kind of resources, using hard-window (IBRD-type) AfDB loans instead of softer (IDA-type) AfDF credits. Surprisingly, during those years when the debt crisis was at its peak, the AfDB was making relatively large amounts of AfDB loans to patently uncreditworthy African countries which were already severely debt-distressed and which had, even then, been downgraded by the World Bank from 'IBRD-eligible' to 'IDA-only' status. As observed earlier, this lending was not simply the fault of AfDB management alone – though it must bear the main burden of responsibility. Such lending was approved by its Board (indeed actively promoted by regional members of the Board) and endorsed by all its shareholders (including OECD donors). Implicitly it was also encouraged by the IMF and World Bank when AfDB funding was sought to close financing gaps for Bank-Fund designed adjustment programmes in low-income African countries.

Thirty-four of the AfDB's forty-eight borrowing members are now low-income, and this number will almost certainly grow during the 1990s. The AfDB's major concessional window, the African Development Fund (AfDF) provides credits on the most concessional terms available to developing countries – they are interest-free with a service charge of 0.75%, a 50-year maturity and a 10-year grace period. For the fifth (1988-90) and sixth (1991-93) replenishments of the African Development Fund, donors pledged unexpectedly large amounts ($2.7 billion and $3.4 billion equivalent respectively).[30] The sixth replenishment represented a 14% increase in real

30 For additional analysis of African Development Bank funding, see Jerlstrom, B., "Banking on Africa: An Evaluation of the African Development Bank", Swedish Ministry for Foreign Affairs, Stockholm, 1990; the African Development Bank 1990; Larrecq in Husain and Underwood 1991, and the AfDB Annual Reports.

terms, exceeding the increases for any other soft window multilateral. Yet these amounts remain insufficient to address the financing requirements of African countries and to avoid a marginalisation of the AfDB's role as a significant regional multilateral institution. Moreover, the trebling of the AfDB's capital in 1986 permitted a much higher level of AfDB lending than was warranted or justifiable, so that AfDB disbursements in 1990-92 continued to be twice those of the AfDF – exactly the reverse of what was needed given the low and declining income levels and creditworthiness of most African borrowers.

In view of the overhang of AfDB hard window debt for low-income countries, several donors have been discussing establishing an interest subsidy facility for AfDB loans to IDA-only countries, similar to the World Bank's fifth dimension. However, there have been two constraints:

(a) *Inadequacy of Own Resources:* AfDB's levels of net profit after provisioning are very low (averaging around $160 million between 1989-92) as are AfDF reflows ($31 million in 1991). These internally-generated funds are therefore inadequate in permitting AfDB to take the kind of action which the World Bank has done. Therefore any substantial contribution to a fifth-dimension type facility will require diverting a much larger proportion of financing provided by donors under AfDF-7 to support the current commitment authority of AfDF.

(b) *Donor Conditionality limiting AfDB Lending:* Most donors have specified the precondition that there should be no more AfDB disbursements to IDA-only countries. This would considerably reduce the AfDB's ability to operate in many of its borrowing member countries, and make it difficult for the AfDB to sustain continued positive net flows and transfers towards 2000. However, the latter difficulty must be resolved by expanded AfDF lending (and therefore by a much larger AfDF-7 replenishment) and not by continued AfDB lending which would only enlarge and worsen the problem.

To surmount these two problems, the African Development Bank needs a fundamental restructuring of its resource base to reflect the changed income level of its borrowing members. The current negotiations for the seventh replenishment of the AfDF need to aim for an amount of at least $5 billion. Almost all of the increase ($1.6 billion) should be set aside for refinancing AfDB loans to IDA-only countries on AfDF terms, in conjunction with donor cofinancing if necessary.[31] To facilitate this major shift away from non-concessional to concessional lending for the remainder of the 1990s, the next

31 On this issue, see also Mistry 1991.

AfDB Capital Increase should be deferred for as long as possible towards the end of the decade.[32]

The Asian Development Bank: Given the small stock of AsDB debt, its negligible impact on the debt service ratios of its borrowers, and the fact that only two of them are SILICs, there is currently no need for special mechanisms to restructure its portfolio or to refinance its hard-window debt onto soft terms. If a refinancing facility were felt necessary for reasons of keeping up with other development banks, the amounts would be tiny and could easily be funded out of the AsDB's profits. In the longer-term, as it continues to expand its lending programme, the AsDB will need to monitor closely developments in some of its major borrowers, particularly Bangladesh, India, Indonesia, Pakistan, the Philippines and Sri Lanka, which are already classified as 'moderately-indebted' though they all have particularly heavy multilateral debt burdens. As has been observed earlier, if the present processes of economic reform which all these countries have embarked on take hold and bear fruit, none are likely to pose a problem. But if these reforms falter or fail then the burdens of debt incurred to finance these reforms may become too onerous for countries to meet without some form of relief. Moreover, the AsDB confronts new challenges in the low-income countries of Indo-China, Afghanistan and Myanmar (assuming that political developments in these two countries will make them eligible for borrowing during this decade). In these countries the resources provided will need to be mainly concessional in nature to avert, at the outset, any debt problem from emerging in these fragile economies.

The Inter-American Development Bank: The major problem posed by outstanding obligations to the IDB is the drain on scarce convertible resources caused by the need to meet IDB hard-window debt service obligations for a handful of its smaller, severely-indebted members: three SILICs (Guyana, Honduras and Nicaragua) and two SILMICs (Bolivia and Ecuador). Yet, because of an inadequacy of soft-window resources the IDB has been shrinking the proportion of its FSO lending to low-income countries. The Seventh General Increase of IDB capital saw a rise of $26.5 billion, a 45% increase in real terms over the Sixth GCI, which enabled a 50% rise in commitments (40% in disbursements) during 1990-93, compared to the previous four-year period. In contrast, FSO resources were boosted by

32 The current proportion of overall paid-in capital is 12.5%, and a zero increase in real terms with 6.25% paid in would keep it well above 10%. This compares with much lower paid-in ratios for the other MDBs (2.5%), and should easily preserve its international credit rating.

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only $200 million when a more appropriate amount would have been around $1 billion.

The IDB has been very creative during 1990-93 in augmenting the lending capacity of FSO by using resources generated internally. It funded the interest rate subsidy for its intermediate facility (the IFF) from FSO reserves until the year 2010, and financed additional FSO commitments by using FSO reflows expected during 1994-97. This has enabled soft-window lending to be maintained at nine times the donor-funded level. Because of these measures, the IDB has been able to maintain a marginally positive net transfer to its low-income members. Nevertheless, the proportion of FSO funds in total disbursements has fallen from 12.9% in 1987 to 8.7% in 1991. All low-income members except Haiti are still receiving hard-window disbursements. In the lower-middle-income countries of Central America and the Caribbean that is causing problems. For these latter countries what is needed is a 'blend' of IDB and FSO resources on what are then effectively intermediate terms – not quite as concessional as FSO but not quite as onerous as IDB either.

With reflows having been fully committed, the financing base of the FSO needs to be made more secure, by formal replenishments to increase its lending capacity to levels which enable the IDB to curtail hard window lending to low-income members. In addition, the IDB needs to look actively at using part of its profits to extinguish the hard window debt of the low-income countries through informal refinancing, preferably of the entire stock.

Other Multilateral Institutions

The European Community Multilaterals: Of themselves, debt service obligations to the EC are not a serious problem for any developing debtor country. This is because European Development Fund (EDF) aid is provided almost entirely on grant terms. In addition, EC capacity to disburse has expanded dramatically in the early 1990s, particularly as a result of the 25% real increase in funding for the Fourth Lome Convention (Lome-4) for 1991-95. This has more than refinanced debt service payments due to the EC, and has made the EC a crucial source of net transfers for low-income ACP countries. In addition, the EC has recently taken a further step to reduce the burden of its debt. Under Lome-4 it has agreed to cancel the STABEX/SYSMIN debt of low-income countries, and to make future transfers to these countries on grant terms.

However, the **European Investment Bank,** continues to lend non-concessional resources to low-income countries, even for feasibility studies rather than bankable investment projects. EIB loans carry an interest rate subsidy which reduces the rate by up to 4% (to a rate of between 2-6%) and

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have relatively short grace and maturity periods – as low as 2 and 5 years on some loans from the mid-1980s, and even now only 5 and 11 years. These terms, though intermediate, are still too 'hard' for low-income countries. Like the other multilaterals the EIB raises most of its loanable resources by borrowing on international capital markets, and therefore resists rescheduling. However, it would be possible to refinance EIB service using a Trust Fund equivalent to the 'fifth window' of the World Bank, and preferably on EDF-equivalent (i.e. grant) terms. Up-front refinancing of such debt for the SILICs would cost a total of $835 million, and would reduce total debt service to the EIB from SILICs by $125 million a year during the 1990s.

EIB also lends 'risk capital' as a managing agent for EDF funds; and EDF makes 'Special Loans'. Both these types of debt could be rescheduled on Paris Club-comparable terms without any discernible impact on EIB's credit rating. Alternatively, reflows from previous loans under these facilities could continue to be treated as an additional source of financing for EDF above the amount agreed in the Lome Convention; or, they could contribute to refinancing EIB debt.

Arab-OPEC & Islamic Multilateral Institutions: These institutions receive most of their loanable funds from various Arab and OPEC governments. Until recently, other multilateral creditors have tended to refinance current debt service due to them with equivalent amounts of new loans for fast-disbursing balance of payments support, often on concessional terms (especially for the SILICs). However, most Arab and OPEC governments suffered a collapse in revenues when the real price of oil collapsed in 1986 and their capacity to keep funding these institutions was dramatically curtailed as a result. In addition, these institutions have always been reluctant to disburse aid for quick-disbursing adjustment support, (believing that function not to be the business of development banks) and have preferred to concentrate on financing slower-disbursing projects. For these reasons, it is unrealistic to expect that these institutions will be able to refinance debt service in the same way that other multilaterals have (as the recent negative net transfers confirm). This group of multilaterals cannot expect new capital or concessional funding to enable them to continue net new lending to developing countries; nor do they play any sort of role as gatekeepers for debt rescheduling and new aid to guarantee their preferred creditor status. Given these limitations, they face a particularly difficult challenge in coming up with creative ways of reducing the burdens of debt which their developing country borrowers owe them in the 1990s.

The simplest method would be cancellation of part of their claims or rescheduling of their service on Paris Club-comparable terms. There have

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already been some steps taken in this direction, with the rescheduling of arrears for selected countries by BADEA. However, these reschedulings have generally been on terms considerably harder than 'Enhanced Toronto' terms. The next step could be for these institutions to ensure 'uniformity of treatment' among debtors, and 'comparability' with other rescheduling bilateral creditors, by rescheduling on 'Enhanced Toronto' terms for all SILICs. Another option would be to consider debt-equity conversions on their project portfolios, especially if such conversions could be designed to have other collateral benefits.

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VII The Urgent Problem of Clearing Existing Multilateral Arrears

Improving the Rights Approach in the IMF

Until 1988, countries cleared arrears to the Fund using their own foreign exchange reserves, supplemented as necessary by bridging loans from OECD central banks or (more expensively) commercial banks. In April 1988, the IMF Board agreed that countries which became ineligible for IMF loans because of accumulated arrears should follow 'shadow adjustment programmes' for a year, while they cleared arrears. At the same time, donors established Support Groups to provide additional balance of payments support to clear arrears to the Fund – or to stabilise them until a bridging loan was arranged. The first such arrangement was for Guyana in 1989, where donors placed funds in an account administered by the IMF (and the Bank for International Settlements – BIS – provided a bridging loan) to clear IMF, World Bank and Caribbean Development Bank arrears, while the Fund and Bank monitored a shadow programme for a year without any accompanying lending. Though Guyana successfully cleared its arrears in June 1990, a new programme was financed by the IMF having to grant 170% access to ESAF and standby resources, with tranches from both being heavily front-loaded. The procedure was seen as: (a) an unsustainable expansion of IMF exposure to a risky country (though subsequent improvements in Guyana's balance of payments enabled it to repay); (b) a breach of the Fund principle of uniformity of treatment for access by all countries; and (c) an excessively heavy burden on donor funds.[33]

For these reasons, in May 1990, the IMF adopted a new approach for countries with large protracted arrears, known as the *Rights Accumulation Programme* (RAP). Under this approach, all accumulated arrears of interest and principal upto the starting date of the RAP would be frozen for a period of 3-4 years during which countries could accumulate 'rights' to future IMF disbursements. These were to be triggered only when sufficient rights were accumulated to repay a bridging loan contracted to clear all the arrears. However, these countries still needed to remain current on all interest service payments which were due to the Fund during the period of the shadow programme being implemented.

33 For details of the pre-1988 approach, see Martin 1991; for details of support groups, see the IMF's World Economic Survey for 1991.

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Eligibility for RAP was limited to countries with protracted arrears at the end of 1989.[34] The RAP was funded out of the General Resources Account of the IMF. The IMF has since eliminated special charges on protracted arrears – initially only for nations which were current on special charges, and then retroactively for arrears on those charges. This was agreed because countries could not afford to have arrears increasing indefinitely due to charges, and because beyond a certain level of arrears, charges had no deterrent effect. However, it means that countries which have made no progress in reducing protracted arrears (Liberia, Somalia, Sudan) pay no charges, while those accumulating small brief arrears do.

As of March 1993, three countries had 'benefited' from RAPs: Peru, Sierra Leone and Zambia. The experiences of Peru and Zambia are detailed in Annex 1. The RAP approach has generally been regarded as a success by the IMF and its Executive Board has extended it until April 1994. However, the design of the IMF's RAPs could be improved in three specific ways:

(a) *Removal of the Interest Payment Requirement during the RAP period:* Interest charges have accounted for 25-35% of total arrears under the three RAPs. Though special charges have been eliminated and penalty charges have not been introduced, ordinary interest has continued to accrue on all arrears (including interest at the upper tranche level of 6-7% on overdue SAF and ESAF credits). As noted above, countries undergoing RAPs have been expected to pay this during the RAP in order to maintain arrears at the pre-RAP level. This requirement imposes an unnecessarily onerous burden on the beneficiary of a RAP and has required resort to external donor funding to repay the Fund. All interest accruing during the RAP could either be waived during each quarter in which RAP conditions are implemented or, alternatively, interest could be capitalised and refinanced on ESAF terms. Such measures could be backdated to the start of existing RAPs, or of RAP-equivalent shadow programmes before the RAP approach was agreed.

(b) *Suspending Current Debt Service during the RAP:* Under existing RAP rules, the country has to keep current on its debt service obligations to the Fund, while receiving no new disbursements – resulting in large negative net transfers to the Fund which have to be financed by other multilaterals or by bilateral donors. In 1991-92 Zambia was unable to keep current on these payments (when its RAP was suspended) although Peru and Sierra Leone (and Zambia since 1992) have paid on schedule. However, bilateral donors should not be expected to compensate for this negative net

34 Cambodia, Guyana, Honduras, Liberia, Panama, Peru, Sierra Leone, Somalia, Sudan, Vietnam and Zambia.

transfer to the IMF during the RAP by diverting more concessional resources to meet debt service obligations to the Fund. Ways of dealing more realistically with current debt service obligations could easily be found. For example, when the RAP was being established, Fund management proposed using:

- SDR 600 million of leftover SAF funds;
- SDR 725 million from widening the spread between charges to borrowers of SDRs and remuneration to lenders of SDRs; and,
- using funds that the IMF has accumulated in a 'burden-sharing mechanism' to offset income deferred as a result of arrears. By the end of 1992 this amount exceeded SDR 2 billion; as arrears are cleared and income received, it could be recycled.

These suggestions could be revived and used for current and future RAPs, without any damage to the Fund's balance sheet and would relieve excessive demands being made on donor aid funds at a difficult time.

The publicity for the RAP has obscured the fact that since 1990, only one country (Peru) has cleared arrears using a RAP, while three (Cambodia, Guyana, Honduras) have had to resort to organising donor support groups and another two (Panama, Vietnam) have had to use their own reserves or organise bridging loans to reduce or clear arrears. Sudan has made little progress on reducing arrears, despite intensive discussions with the Fund. Liberia and Somalia have had few discussions on how to reduce arrears, given their internal security problems.

Five new cases of protracted arrears to the IMF have emerged since 1991: Bosnia-Herzegovina, the Federal Republic of Yugoslavia (Serbia/Montenegro), Haiti, Iraq, and Zaire. These new countries are not eligible for the RAP. For the vast majority of countries in arrears, Fund procedures are no more flexible, and the RAP remains a last resort for use only when new Fund disbursements are too small to repay bridging loans.

However, the Fund has been more flexible for the limited number of countries with protracted arrears which have made no attempt to adopt essential adjustment programmes (Liberia, Sudan and Zaire). In these cases the Fund has issued 'declarations of non-cooperation'. It has consistently postponed suspension of voting rights and ultimately of membership for these countries, because such a step is regarded by many Board members as a negative move which could only be counter-productive and because they have at various stages made apparent moves to reduce arrears or suffered from major internal security breakdowns. However, in late 1993 the suspension of Sudan has become a live issue and may be acted upon.

Given the success of the rights approach in Peru and the resulting recent fall in total arrears to the Fund, there is no consensus among Fund Board or management as to whether further steps need to be taken to alleviate the

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arrears problem of other countries' obligations to the IMF. However, the Zambia RAP is again in trouble and it is doubtful whether other RAPs will be as successful as that of Peru. More drastic measures may well be needed for Liberia, Somalia and Sudan should they agree to Fund programmes and try to clear arrears, because their arrears range between 400% and 700% of their present quotas. Thus, under existing rules, there is no way that the Fund could, in the foreseeable future, provide them with sufficient resources to clear these arrears.

Hidden Rescheduling and Refinancing by the World Bank

The amounts of arrears owed to the World Bank have hitherto been small enough to be cleared using donor aid, or overnight commercial bank bridging loans which are immediately repaid by new Bank disbursements. During 1990-91, Nicaragua, Panama, Sierra Leone and Zambia cleared their arrears using these methods.

In May 1991, the Bank introduced a programme of 'Additional Support for Workout Programs in Countries with Protracted Arrears'. As with the IMF's RAP, under the Bank's programme the eligible country accumulates rights to disbursements during a 'performance period'. Actual disbursements are only made upon clearance of arrears to the Bank. The only substantive difference between the two approaches is that the Bank's Executive Board is able to approve commitments of loans to the country during the 'performance period', before arrears are cleared. Countries do not necessarily have to clear their arrears in 'parallel' (i.e. simultaneously) to the IMF and World Bank. But in those cases where parallel clearance is agreed (as it was in Peru), the Bank's 'performance period' is of the same length as the RAP. However, in the cases of Sierra Leone and Zambia, arrears to the Bank were much smaller than those to the IMF and were cleared first, using donor funds and bridging loans.

The Bank has so far applied this policy only to Peru, in July 1991. In a recent review, it was judged to be broadly successful. The Bank's approach has some major advantages over the RAP:

(a) because non-accrual status is applied only to principal which is six months overdue, additional interest charges do not accrue on the total original principal and interest arrears.
(b) the announcement of up-front loan approvals by the Bank's Board helps to mobilise funds from other donors and restore confidence for private sector flows.
(c) approval of Bank loans allows funds from other donors (which are cofinancing these loans) to be disbursed before Bank arrears are cleared.

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Therefore the only remaining major problem is the burden of current debt service during the 'performance period', which results in negative net transfers to the Bank. While Peru managed to pay all of this current service, it is again questionable whether bilateral donors should (or can) be expected to compensate by increasing concessional flows. Current service for future programmes could instead be funded (at least partly) by the large amounts IBRD has set aside for loan loss provisions against the possibility that arrears will not be paid. At the end of June 1993, these provisions totalled $3.15 billion, more than 250% of arrears on loans in non-accrual status. The proportion of provisions which was related to Peruvian arrears (which have now been cleared) should now be made partly available for recycling to help other debtors pay current service without any negative effect on the IBRD balance sheet. The amount actually needed are negligible, as only in Liberia and Syria are current arrears likely to require Peru-style 'performance periods'.[35]

Like the IMF, the World Bank has been reluctant to apply harsh punitive measures against countries with protracted arrears. On the other hand, it has been inventive in finding a way to discourage temporary arrears. In July 1991 the Bank took a positive step to encourage countries to pay IBRD within one month of the due date: a one-year waiver of 25 basis points on interest. In FY 1992, this cost the Bank $132 million out of an estimated $160 million which was set aside as a reduction of income. This measure is seen as highly successful and was extended through FY 1992/93.

Lack of Action on Clearing Arrears by Other Multilaterals

No other major regional multilateral institution has followed the IMF and World Bank in developing special approaches to clearing protracted arrears. On the one hand, the regional development banks (RDBs) have stayed with their conventional policy of insisting on clearance of arrears. To this end, increasing numbers of countries have been contracting bridging loans to pay off RDB arrears. Among recent examples were a loan to Peru from the Latin American Reserve Fund for clearing IDB arrears, and a bridge finance arrangement for Sierra Leone to clear its arrears to the AfDB. On the other hand, Arab multilateral institutions have gone further than the World Bank or IMF, with BADEA formally rescheduling arrears for some countries, in part because they have only received 'secondary preferred creditor' status – in other words, other creditors have been prepared to informally accept the

35 In addition to these provisions, the IBRD also has a General Reserve of $11.14 billion and a Special Reserve of $293 million.

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accumulation of arrears to them unless they are maintaining a positive net transfer to the debtor country.

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Conclusions

The foregoing pages have attempted to establish why there is already a serious multilateral debt problem affecting several countries, especially African SILICs. That problem will grow larger as the 1990s unfold and the volume of commitments made between 1989-93 to finance adjustment and investment are translated into disbursements and outstanding loans on which debt service payments must be made. In all probability the multilateral debt crisis will widen beyond the countries that are presently affected in Africa, Central America and the Caribbean to engulf some countries in Eastern Europe and the Former Soviet Union and, if present reform efforts do not succeed, possibly some countries in Asia as well.

The following facts are disconcerting enough in telling the story:

- Debt service payments from all developing countries to multilaterals have increased more than five-fold over twelve years from less than $7 billion in 1980 to over $36 billion in 1992. They will probably exceed $42 billion by the mid-1990s and $50 billion by 1999.
- Debt service payments to multilaterals by all severely-indebted countries (SILICs and SIMICs) which were just about $3 billion in 1980 had climbed to nearly $17 billion in 1992.
- Arrears to the multilateral system which were negligible in 1980 grew to over $9 billion in 1991 before dropping to around $7.3 billion in 1992 with the clearance of large arrears by Guyana, Peru and Zambia to the IMF and other multilateral creditors during that year.
- At the beginning of 1993, eleven countries were overdue by more than 6 months on debt service payments to the IMF for an amount of over $4.6 billion.
- In mid-1993, six countries were in arrears by more than six months to the World Bank for an amount of $1.3 billion.
- At the end of 1992, twelve countries were in arrears by more than six months to the African Development Bank for an amount of over $300 million.
- In the case of ten countries, scheduled multilateral debt service for 1992-94 exceeds 20% of their actual 1991 export earnings although eight of these countries were current on their debt service to multilaterals. In thirty-four other countries it exceeded 10% of export earnings.
- Net transfers from multilaterals to all developing countries were negative between 1987-89 and averaged about zero between 1987-92. Multilateral

net transfers were mildly positive for SILICs but highly negative for SIMICs.

The problem of multilateral debt has risen for a variety of reasons explained in this paper some of which have to do with default on the part of the multilaterals themselves. In African SILICs multilateral institutions – and in particular the Bretton Woods twins – through the 1980s have played an overwhelmingly dominant role, not merely as lenders of last resort but virtually as instruments of neo-colonial governance (on behalf of their OECD shareholders) in sub-Saharan Africa with unchallenged sway over determining the direction and thrust of economic policy and of public investment in most of the countries of that region.[36]

Contrary to experience elsewhere, much multilateral lending during the 1980s for adjustment as well as for investment in Africa has not worked as well or as quickly as had originally been anticipated. A number of explanations have been provided for that outcome by the multilaterals – most of which unfortunately attempt to lay the blame elsewhere, but mainly on their borrowers. Some of the arguments are true while others are reminiscent of false arguments made by the global commercial banks to explain their disastrous bout of lending to the developing world in the 1970s. In the process their hapless borrowers have accumulated large multilateral debts which have proven unproductive but which must be repaid by them nevertheless.

Commercial banks and many bilateral creditors have already paid a price (for too large an amount of misguided lending) through rescheduling, refinancing, reduction and discounting of their claims on developing countries. Bilateral creditors will keep doing so for some time to come. Whether that price has been large enough or fair enough in comparison to the price that their borrowers have had to pay in terms of their development being reversed for over a decade will remain a matter of argument for a long time.

But the multilateral institutions are now attempting to draw the cloak of preferred creditor status around themselves for protection against paying any price whatsoever. Their main argument is that debts due to them cannot be reduced or relieved to any significant degree but must be repaid on time. To do otherwise would simply impose more difficult burdens on both their

36 In other regions their roles have not been quite as overwhelming and pervasive, with the more advanced Asian countries choosing to borrow less and less from the multilateral system. In economies in transition (i.e. in Eastern Europe and FSU) it is clear that the multilaterals are being pressed by their OECD shareholders to play a role that they are ill-equipped for with the probability increasing that multilateral involvement there may create unmanageable and unserviceable multilateral debt burdens within the foreseeable future.

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borrowing members as well as their donor-members since ultimately they must bear the cost of whatever actions multilaterals have taken. The penalties for not doing so are heavy for their borrowers. Moreover the multilaterals argue that, since their members, through their representatives on multilateral boards, have been aware of the actions taken, and indeed have often instigated them, the issue of holding the multilaterals themselves (i.e. their managements and staff) responsible or accountable for outcomes does not arise.

Given the myriad ways in which multilateral managements and staff have become adept at sedating and concealing essential information from their Boards, that argument does not have much merit.[37] To the extent possible, multilaterals have attempted to deal with the growing difficulties that SILIC borrowers face in meeting debt service obligations to them by making extraordinary demands on bilateral donors to cover them despite the other demands they continue to make on bilateral resources for co-financing, replenishing their soft-loan windows, augmenting the capital bases of their hard windows, and providing technical assistance funds connected with multilateral lending operations.

Nevertheless the multilaterals have realised in private what they remain reluctant to acknowledge or to have discussed openly in public – that a serious multilateral problem does exist (which they must bear a large part of the responsibility for creating) and it is growing. The actions taken by some multilaterals (in particular the IMF and World Bank) to deal with the problem of arrears to them, and of large negative net transfers for a prolonged period, is testimony to that implicit acknowledgement. But, as this paper makes clear these actions do not go far enough.

There is no clear strategy apparent within each institution, nor across the multilateral system as a whole, for arresting and reversing present trends which indicate that the problem may worsen considerably if the rosy scenarios for borrowers' economic and export performance (on which most such lending has been justified) fail to materialise. Clearly there are no soft options. But the cancerous growth of the problem does suggest that perhaps the time is now overdue to re-examine the financial and developmental role of multilateral institutions more thoroughly, rather than have each of these institutions take on a multitude of disparate tasks each time a new crisis breaks. Opportunistic responses to exigencies – which have become the modus operandi of most of these institutions – result in unnecessary

37 The strategy that multilateral managements have employed in dealing with their Boards is known in the vernacular as the "mushroom theory of management" i.e. to keep their Executive Directors in the dark and bury them in horse manure (an evocative and accurate allusion to the sheer weight of useless documentation that Executive Directors' offices are inundated with).

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competition and duplication of multilateral efforts (along with unhealthy squabbles such as those that arise frequently between the IMF and World Bank as well as between the World Bank and regional development banks) which are rendering them unmanageable and ineffectual.

The multilateral system is on a treadmill where all the multilateral development banks must run faster to increase their lending and disbursement levels not to promote development through real resource transfers but simply to ensure that burgeoning debt service obligations to them are met. Had multilateral lending been as successful and productive as it was expected to be when appraisal reports were presented to multilateral Boards, the problem would not have arisen. But, sadly, multilateral institutions have proven to be as fallible (and perhaps in some cases even more fallible) than their commercial counterparts. The prospective pyramiding of multilateral debt needs to be moderated and reversed before more damage is done. In turn, such reversal may mean reducing and confining the financing role of multilaterals to only those areas and activities which commercial institutions and capital markets are, for whatever reason, unwilling to lend or provide equity for.

A strategy to contain the growth of the multilateral debt problem must obviously meet several conflicting demands not all of which can be easily accommodated. It must, for example:

- achieve a reduction in multilateral debt stocks and debt service payments (especially from SILICs and SILMICs) without compromising the financial standing of multilateral institutions – particularly those that rely on borrowings from international capital markets for the bulk of their loanable resources;
- reduce extraordinary demands on donor budgets to levels which are affordable and sustainable;
- achieve a higher level of concessionality in the mix of outstanding multilateral debt obligations owed by all low-income and lower-middle-income countries and not just those which are debt distressed;
- compel both borrowing member country governments and multilateral managements to become more responsible and accountable for their actions and to bear directly the costs of their own misjudgments and errors; [At present the cost of errors and misjudgements on the part of multilateral managements and staff are borne almost entirely by their borrowers, and now to an increasing extent, by donors whose bilateral aid budgets are being raided and pre-empted for meeting multilateral debt service.]
- avoid compromising the legitimate interests of other types of creditors through absolute pre-emption;
- avoid encouraging 'moral hazard' and 'free rider' problems;

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- involve closer cooperation and coordination of multilateral exposure monitoring and control in all developing countries and especially in those which are severely debt-distressed or likely to become so; [This is something that multilaterals have lamented did not occur in the case of commercial bank and export credit agency lending to the developing world but they themselves have been remiss in not doing it either.]
- avoid relying on endless and counterproductive repetition of the sanctity of preferred creditor status in determining the choice of strategy and tactics and acknowledge that the preferred creditor status of multilaterals must be respected in a *relative* rather than an absolute sense. [To a degree the tedious reliance of multilaterals on repetition of the preferred creditor *mantra* is quaintly reminiscent of earlier times when commercial banks were basing their case for repayment on the same repetitive arguments about the sanctity of contracts regardless of the circumstances].

Clearly when these demands are listed, they reveal that a strategy for reducing multilateral debt which attempts to strike a reasonable balance among conflicting constraints is not going to be easy to derive and implement. But, as this paper suggests, it is not impossible. The first step in designing and implementing such a strategy must, however, be explicit acknowledgement on the part of multilaterals that while they must remain 'preferred creditors' they cannot be 'exempt creditors'. In other words, multilateral institutions must now be as willing to consider the same range of debt stock and debt service reduction (DDSR) tactics in dealing with their own debt as they have been in suggesting the adoption of these tactics by other types of creditors. Clearly the design and implementation of these tactics, as well as the degree to which they can be taken in the case of multilateral institutions, will be quite different from either private commercial creditors, or bilateral creditors. But multilaterals cannot any longer keep stonewalling against consideration of all of these options – the five main ones of which have been dealt with at length in this paper.

In addition, the set of measures which some of these institutions have already taken, can and must be: (a) extended to other institutions where they are necessary (in particular the African Development Bank); and (b) further developed and expanded within the institutions where they were invented in the first place. How this might be done has also been suggested – on an institution-by-institution basis in this paper.

Finally, it needs to be said that the aim of this paper is not to present any final or global solutions to the multilateral debt problem. Finding holy grails cannot be the aim of pragmatic analysts living in the real world even if it is an attractive quest to the imaginative mind. Instead, the paper attempts to suggest that there are a wider range of options and possible solutions for making the multilateral debt problem more tractable – all of which will need to be further examined in greater detail and developed in a tailor-made fashion to suit the circumstances of individual multilateral institutions and their borrowers.

If the paper serves to make multilateral managements less defensive, less complacent, more open-minded and more concerned about finding a way out of the present situation with its attendant dangers – and less prone to tediously repeating self-serving justifications and rationalisations for why multilaterals cannot compromise their positions and do more by way of providing relief to debt-distressed borrowers than they already have – it will have more than served its purpose.

Over the past five years, multilaterals have made major contributions towards getting other creditors – private and bilateral – to acknowledge the dead-ends which some of their strategies have been leading to and to take bolder and more imaginative action.

To the multilaterals one can now only say: *'Physicians it is now time to heal thine selves!'*

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Annex 1

Clearing Multilateral Arrears: the Experiences of Peru and Zambia

Zambia was the first country to benefit from the IMF's new arrears clearance procedure, with a "Rights Accumulation Programme" of SDR 837 million in April 1991, though it had to repay $125 million of IMF arrears using aid to make RAP feasible. It cleared World Bank arrears up-front with conventional methods: donor aid ($120 million) and a Bank of England bridging loan ($200 million) in March 1991. Peru used new procedures with both the World Bank and the IMF. From July 1991, the World Bank applied its new arrears strategy to Peru: during February-June 1992, the Bank approved three adjustment loans totalling $1 billion. In September, the IMF Board approved a RAP of SDR 610 million.

The two countries have had very different experiences of these approaches. Peru made rapid progress in implementing the conditions in the Fund and Bank programmes. By December 1992, Peru successfully completed the RAP and the Bank's adjustment conditions, and in March 1993 it became the first country to clear multilateral arrears using the "Strengthened Cooperative Strategy". For this, it used funds from the US Treasury and Japan's Eximbank (and a Peruvian contribution of $10 million) to clear Fund arrears. The Fund then disbursed its RAP funds and the first tranche of an Extended Facility loan, most of which were used to clear World Bank arrears. Disbursements from the World Bank programme loans were then used to repay the US and Japan. Zambia's experience has been less positive. Its RAP had to be formally revised in 1992 after the 1991 programme collapsed; at the same time, it went back into non-accrual status with the World Bank and had to use a commercial bank loan ($51 million) to clear the new arrears in January 1992. Under the new programme, accumulation has been waived for two quarters out of five. At the current rate of accumulation, its RAP will last 4 years. The explanations lie in the design of the RAPs, the implementation of adjustment policies, and exogenous factors (notably flows of external finance).

The design of the two RAPs were very different. First, the Peru programme was considerably shorter than the Zambian (18 months compared to 36 months for the RAP; 27 months compared to 45 months including the pre-RAP Fund-monitored programme). In turn this reflected a lower amount

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of arrears compared to quota (200% compared to 300%), and Peru's better adjustment record during the 9-months pre-RAP period. Second, Zambia's programme was less growth-oriented in design and outcome. Though both programmes foresaw 3% annual GDP growth, the Peruvian programme envisaged steep increases in external financing and imports (compared to the previous non-adjustment period); while Zambia's envisaged falling imports and net external finance.

The Peruvian government showed incredible commitment to the programme, implementing all of the IMF targets, and World Bank structural measures 3 months ahead of schedule. The Zambian government failed to implement many of its IMF targets and World Bank structural adjustment conditions in 1991: this partly reflected the holding of multiparty elections. The new government has been strongly committed to adjustment and made major progress on adjustment, but with limited results on stabilisation.

The external financing of the programmes demanded of donors differed dramatically in size. For Peru, a Support Group in 1991 provided $422 million for 1991 and $500 million for 1992, compared to imports of $3.5 billion and $3.8 billion. Japan provided almost all of these funds, followed by the US, the Netherlands, Switzerland, Sweden and France. Zambia's programme was much more dependent on donor aid: $750 million a year for 1991 and 1992. Both countries suffered shortfalls in donor disbursements. However, due largely to unexpected factors, the Peruvian programme turned out overfinanced. Reserves rose by $1 billion during 1990-93 and GDP grew by 3% in 1992, largely due to somewhat unexpected inflows of private transfers (returning flight capital and investment in privatisation) totalled of $2.7 billion in 1991-92. These offset small shortfalls in donor flows in 1992. Though donors (including the World Bank) made an exceptional effort to disburse, particularly in the first quarter of 1991, Zambia's aid disbursements subsequently fell more than $50 million short in each year, and there have been no offsetting private sector inflows.

This vulnerability of the Zambian programme to shortfalls in donor flows – which were themselves partly due to uncertainty about the implementation and results of adjustment – indicates that methods of clearing multilateral arrears which rely on donor flows to offset negative transfers to the Fund are inappropriate for low-income countries where adjustment policies have less catalytic effect on private sector flows. Additional measures to reduce interest charges and refinance current service to the IMF may be especially necessary in low-income countries.

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