I The Multilateral Debt Crisis of the 1990s

Introduction

Two joint International Monetary Fund/World Bank papers (IMF/WB: 1996a,b) suggest that twenty countries, seventeen of which are in sub-Saharan Africa, may be affected by a serious multilateral debt problem. Eight[1] of these countries are now classified as having an unsustainable multilateral debt burden; twelve[2] others are acknowledged to be under possible stress, while two[3] obvious civil war-affected distress cases were not analysed because of data irregularities which made scenario projections for them difficult. Despite their intimidating sophistication, these analyses by the IMF and the World Bank (international financial institutions or IFIs) raise questions about whether their shifting positions on the extent of the problem and the moving goal-posts they use for cut-off criteria suggest an analytical bias toward down-playing the number of countries affected.

Contrary to the changing IFI position, more dispassionate observers suggest that a serious multilateral debt problem affects about thirty to thirty-five low-income countries, of which twenty-four to twenty-seven are in sub-Saharan Africa.[4] For the sake of argument, taking at face value the IFIs' last count of twenty affected countries, it is clear that the multilateral debt crisis of the 1990s affects more debtors than those (fifteen to eighteen) affected by the commercial bank (London Club) debt crisis of the 1980s, but fewer than the fifty to fifty-five countries affected by too large an overhang of bilateral (Paris Club) debt. Neither of these crises has been satisfactorily dealt with as yet. While the multilateral debt crisis of the 1990s differs from the commercial debt crisis of the 1980s in that it poses no threat to the stability of the international financial system, the need for a new strategy to resolve the crisis is imperative.

1 Burundi, Guinea Bissau, Mozambique, Nicaragua, Sao Tome and Principe, Sudan, Zambia and Zaire.

2 Bolivia, Cameroon, Congo, Côte d'Ivoire, Ethiopia, Guyana, Madagascar Myanmar, Niger, Rwanda, Tanzania and Uganda.

3 Liberia and Somalia; Nigeria, while not experiencing civil war, can also be included in this category.

4 See for example Mistry (1993), Martin (1993 and 1996), UNCTAD (1993) and Non-Aligned Movement (1994).

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As Killick (1995) observes:

> 'There appears to be an overwhelming case for a new approach to the issue for low-income debtor-country governments seeking seriously to tackle their countries' basic economic weaknesses. The past (multilateral debt) refinancing strategy has not prevented the problem from growing, offers debtors no exit prospects, makes large claims on scarce bilateral resources, does not represent an even-handed distribution of burdens, results in geographical patterns of concessional aid allocation which are inefficient and inequitable, undermines the credibility of Bank and Fund attempts to induce improved policies through conditionality, and creates moral hazard dangers for the multilateral lenders themselves.'

Multilateral debt reduction and relief are now essential in order to re-ignite the process of balanced, sustainable development in sub-Saharan Africa. Multilateral debt service payments presently exceed, by a large multiple, the expenditures that African countries are able to make for human capital maintenance and development (e.g. on health, education and basic nutrition), for social safety nets or for ecological protection. They are therefore imposing significant additional human and environmental costs in countries where such costs, induced by the adjustment process itself, have already been unconscionably high (Oxfam: 1996).

It can legitimately be counter-argued that room still exists for many of these severely-indebted low-income countries to increase social and other priority expenditures by reducing unproductive expenditures; e.g. defence, internal security and foreign representation. Rapid declines in such expenditures have been occurring in any event over the last five years. They are now approaching a level where further cutbacks risk being internally destabilising and externally dangerous, given the political circumstances and border disputes which confront many African countries in their immediate neighbourhoods.

It is now widely accepted, with the support of empirical evidence, that multilateral debt service payments are having serious *crowding-out* effects on public and private investment resulting in growth and export earnings capacity being compromised (IMF/WB: 1996a; Martin: 1996) thus reinforcing the vicious cycle of adjustment failure in sub-Saharan Africa. Meeting such payment obligations is also imposing unnecessarily heavy pre-emptive burdens on the increasingly constrained bilateral aid programmes of several donor countries.

Yet because the IFIs have managed to persuade bilaterals to provide exceptional levels of grant aid for multilateral debt servicing between 1990-94, the *extraordinary* is now being taken for granted by the IFIs as being *ordinary* (IMF/WB: 1995a, 1995b, 1996b; Mistry: 1994). Expanded bilateral grant aid flows are being treated as normal external financing (i.e. the same as export earnings) which debt-distressed countries can rely on annually for meeting debt service payments in the sustainability calculations which the IFIs make (IMF/WB: 1995a, 1995b, 1996b). Such treatment of aid flows is illogical. It defeats the notion of *debt sustainability* (Martin: 1996; IMF/WB: 1996b). Reason would suggest that if aid flows are seen as normal external financing for severely-indebted low-income countries, the notion of debt sustainability, i.e. being able to meet debt service obligations *without* recourse to extraordinary financing, becomes an irrational circularity.

The IMF/World Bank Response

At the urging of leaders from the South, especially from the Non-Aligned Movement, and of influential European NGOs in the North, the last four G-7 Summits from Tokyo to Lyon have called for action to relieve the multilateral debt burdens of several heavily-indebted poor countries. Little progress was made by the International Monetary Fund and the World Bank in responding to these calls. While the need for effective multilateral debt reduction and relief (MDRR) is beyond dispute, over the last three years the IFIs have focused their efforts on opposing a systematic approach to MDRR. The U-turn attempted by World Bank staff in mid-1995, in proposing a Multilateral Debt Facility, represented a courageous shift in acknowledging (implicitly) that more needed to be done and in conceptualising a way forward. Since then, events have been accelerated by calls from the Development Committee in October 1995 for the IMF and the World Bank to put forward workable proposals for dealing with the multilateral debt crisis in a more effective manner. Nevertheless, the initial strategy of these two institutions was to minimise the extent and dimensions of the problem in an effort to convince major shareholding countries that there was no widespread multilateral debt problem as such. Their general line of reasoning comprised the following arguments:

(a) only eight heavily-indebted poor countries had a multilateral debt overhang;

(b) for these countries remedial action was already being taken by the IFIs;

(c) no further action was necessary;

(d) if such action was pressed on them it would result in:
- disincentives to provide further concessional resources,
- policy-reform retrogression,

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– severe moral hazard problems, and
– dire consequences for their financial integrity;

(e) as a consequence, creditworthy borrowing countries would suffer because of damage to the market credit rating of the IFIs.

These arguments were demonstrated to be false. In April 1995, there was a specific call from the Development Committee for the IMF/WB to come up with practical proposals for implementing multilateral debt reduction and relief. That call reflected growing official impatience in many OECD governments with what were seen as attempts on the part of the IFIs to obfuscate, procrastinate and, to the extent possible, impede progress on an urgent international initiative.

In July 1995, the World Bank produced an internal draft document proposing a Multilateral Debt Facility (MDF) which was leaked by members of the management and staff to NGOs and the international press. While the architecture of the MDF was ill-conceived and seriously flawed, the document did acknowledge that the multilateral debt problem was far larger, and affected more countries (at least 24), than was previously portrayed by the IFIs.

Subsequent embarrassment led the Development Committee in September 1995 to require the IMF/WB to present firm proposals for multilateral debt reduction and relief at its next meeting in April 1996. Both IFIs presented analytical papers to their Boards in March 1996, followed by a short paper to the Development Committee in April 1996 entitled, 'A Framework for Action to Resolve the Debt Problems of the Heavily Indebted Poor Countries' (for a summary of the initiative, see Annex 1).

In these papers, the IFIs have resiled from the World Bank's July 1995 analysis on the number of countries with a multilateral debt overhang and the extent of MDRR needed. Instead they proposed an MDRR framework based on six principles:

(1) targeting overall debt sustainability on a case-by-case basis focusing on the totality of a country's debt;

(2) establishing demonstrable policy performance on the part of debtors to achieve a sustainable outcome;

(3) designing new measures which build on existing mechanisms;

(4) requiring that any further action on the part of multilateral creditors should involve further actions by all creditors on the basis of broad and equitable participation;

(5) preserving the financial integrity and preferred creditor status of the IFIs in order to protect their other borrowers;

(6) requiring bilateral aid donors to provide new external finance on appropriately concessional terms to enable pursuit of policy reform by heavily-indebted poor countries in order to establish an acceptable policy performance track record.

This new approach is, in substance, unprincipled. It represents another attempt on the part of the IFIs to continue side-tracking the more meaningful MDRR initiatives which have been proposed by various experts and organisations over the past few years.

In June 1996, the World Bank and IMF produced two more papers. The first reports on the status of World Bank participation in a new debt initiative. The second is a joint IMF/WB paper which attempts to establish the possible costs of the new debt initiative under different assumptions and their distribution among various categories of creditors.

The first paper suggests how a Multilateral Trust Fund (MTF) to provide relief on multilateral debt might be financed. It (a) reiterates the six self-serving principles for IMF/WB action presented to the April 1996 Meeting of the Development Committee; and (b) uses arguments to justify deflecting attention from the multilateral debt problem to a more generalised debt problem. These arguments are similar to ones which were used when the World Bank attempted to argue that there was no multilateral debt problem of significance to worry about.

The paper emphasises actions to be taken by other creditors instead of concentrating on what the multilaterals should do to ameliorate a problem which is, in part, of their own creation. It reiterates that the World Bank does not forgive or write-off debt. This is done to lay the foundation for creating a separate fund to pay the World Bank for what is going to be, inescapably, a write-off in the only sense that counts – i.e. the debtor simply cannot pay it back.

Arguing that instruments deployed by the World Bank for the new debt initiative should be effective, flexible and predictable and build on existing instruments for multilateral debt relief, the paper suggests augmenting present measures with: (i) supplemental IDA allocations to poor countries; (ii) using IDA grants instead of credits in exceptional instances; (iii) special allocations of IBRD net income to the Multilateral Trust Fund.

The second paper is the first serious attempt by the IMF/WB at quantifying what the costs of the new debt initiative are likely to be (see Annex 2). As with all the previous IMF/WB papers, it argues on the one hand for careful country-by-country analysis and treatment of affected heavily-indebted poor countries (HIPCs). But, on the other, it rests its case on meeting just one mechanical test for determining post-relief debt sustainability for all of the HIPCs. This paper leaves the same uncomfortable feeling as previous papers from these two organisations that the object of the exercise for the IMF/WB remains one of minimising the costs of providing MDRR and to delay for as long as possible the application of MDRR.

Both papers appear to be motivated by three reasons: (i) to reduce to an absolute minimum the number of countries to which MDRR has to be applied; (ii) to give both institutions a prolonged period of time to exert a short-leash policy-reform chokehold over the HIPCs and prove that their adjustment prescriptions will work if they are given sufficient time; and (iii) to provide a sufficiently long lead time for their own contributions to any future trust fund to be financed from allocations of their net income thus deflecting pressure to reduce immediately their reserves.

These concerns of the World Bank and the IMF might be acceptable if they did not result in doing more damage to the HIPCs whose recovery prospects remain severely compromised by their debt overhang and particularly their multilateral debt overhang. The longer remedies are postponed, the more expensive they will be for everyone to apply. Moreover, further delays in the application of MDRR will result in doing more damage to HIPC economies and delaying their eventual recovery.

The Need for an Alternative Approach

The IMF/WB calculations do not reveal other critical variables and assumptions which have been called for by dispassionate observers, such as for example: (i) assumptions about levels of aid flows during the interim period and thereafter; (ii) the connection between such flows and post-relief debt sustainability; and (iii) analysis of fiscal indicators of debt-service sustainability based on internal resource generation rather than aid flows.

Instead of adhering to a seriously flawed and unduly protracted six-year, two-stage qualification period before remedies under the envisaged new debt initiative can be triggered, the IFIs (or, better still, more dispassionate and independent analysts) should be asked to look at the relative merits and costs of providing front-loaded debt reduction and relief to HIPCs so that they can achieve post-relief debt sustainability within a time frame of three years or at most four. The political objective should be to provide a complete exit to HIPCs from the debt trap by the year 2000 at the latest. That would be more realistic and based less on guesswork and projections about outcomes too far into the future to be made with any degree of confidence.

Judging from the recent IMF/WB papers, the response of the IFIs remains obstructionist and disappointing. There seems to be a basic unwillingness on the part of these two institutions to take much bolder steps towards resolving an urgent problem. In the case of the IMF, it is particularly unfortunate that the debate on MDRR is being used, entirely inappropriately, as an opportunity to advance its own case for an expanded, self-funding Enhanced Structural Adjustment Facility (ESAF). This would not solve the multilateral debt problem, in fact, it may even add to the multilateral debt problem if ESAF's terms are not equivalent to those of IDA.

Based on the above mentioned six principles and supported by their own analysis, the IFIs offer no details as to how MDRR might be provided or how the funds required for MDRR would be mobilised, organised or applied in the case of each eligible country. Their behaviour so far suggests that the IFIs intend to employ the strategy and tactics of the Paris Club – which has procrastinated and delayed resolution of the bilateral debt problem for over twelve years with partial and ineffectual adjustments to reduction/rescheduling terms. The Paris Club's annual changes have resulted in much lower amounts of debt stock reduction than are essential for sustainable outcomes, as has been argued repeatedly by the IFIs themselves over the last four years. They have not resulted in improving the sustainability of debt servicing by the heavily-indebted poor countries nor have they had any effect on improving their prospects for economic recovery. The only countries in which such effects have been achieved are those in which substantial up-front debt stock reduction was resorted to – i.e. Poland and Egypt.

For the heavily-indebted poor countries (particularly those in Africa), the Paris Club has tolerated a *de facto* build-up of large arrears to levels which make substantial bilateral debt stock reduction inevitable. Thus the Paris Club has achieved *de facto*, what it has been reluctant to acknowledge *de jure* – effectively resulting in debtor countries viewing Paris Club debt as dead debt which does not need to be paid. Bilateral creditors have thus effectively made themselves *subordinated creditors* seemingly (but not entirely) by default. But the Paris Club has achieved this outcome in the least attractive way – i.e. by encouraging, through the wrong actions on its part, a breakdown of credibility and discipline in debtor-creditor relationships. In doing so it has seriously damaged the long-term integrity of debtor-creditor relations in the bilateral context and has cast a permanent pall on the future servicing of official bilateral debt obligations by poor developing countries.

With regard to multilateral debt, arrears have also been built-up in the case of the IMF and the African Development Bank although not yet to the same degree as arrears on bilateral debt. High arrears have been prevented in the case of the World Bank by refinancing through IDA, the fifth-dimension facility, and extraordinary grant support provided by bilateral donors to maintain debt service to the IFIs. For obvious reasons, multilateral creditors cannot afford to be as tolerant of arrears as bilateral creditors can; which would argue even more strongly in favour of properly structured and systematic MDRR as a matter of considerable urgency.

Given the likelihood that the IMF and World Bank will continue to act in ways which delay the right MDRR remedies from emerging, a different approach is needed. If real progress is to be achieved on MDRR, it should by now be clear to all shareholder governments that the IFIs cannot be expected to act against what they perceive to be their own vested institutional interests. Therefore, one crucial ingredient of a new approach would be that responsibility for coming up with an appropriate solution to MDRR is transferred from the IFIs to an independent, objective forum with no vested interest in the outcome. One other important element of a new approach should be that measures are taken to substantially reduce debt *stocks* rather than engage in repeated rescheduling of debt-service obligations. This point has been argued eloquently by the World Bank itself when it observed:

> 'The debt problem of the 1980s ... is by no means over for many severely-indebted low-income countries, most of them in Sub-Saharan Africa. ... many SILICs face an unsustainably large debt overhang, despite [various debt reduction initiatives]. ... The problem is not cash flow; most receive transfers far in excess of their actual debt service payments. Instead, the problem is their persistently large, and sometimes, growing debt stocks. For many SILICs, ... there is no viable alternative to debt stock reduction.'[5]

The following chapters will explore the dimensions of Africa's multilateral debt problem and suggest what might be done to alleviate this burden by outlining a new multilateral debt strategy.

5 World Bank, World Debt Tables 1994-1995.