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Multilateral Debt

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Multilateral debt is that portion of a country's external debt burden owed to international financial institutions (IFIs) such as the International Monetary Fund (IMF) and the World Bank. For most of the world's poorest countries, multilateral debt looms larger than other debts because of the IFIs' status as "preferred creditors," as providers of core development and balance-of-payment loans. This status means that payments to them must be given the highest priority, over private and bilateral (government-to-government) debt. These institutions also maintain that their bylaws prohibit them from granting debt relief or writing off debts, as governmental and private creditors often do. Governments have special incentive to stay current with their multilateral debts, since IFIs determine the creditworthiness of countries: until the IMF gives its stamp of approval, which usually requires adherence to the economic policies it recommends, poor countries generally cannot get credit or capital from other sources. And until a country has signed onto an IMF program, it cannot apply for bilateral debt relief from the "Paris Club" of creditor countries.

Key Points

- In 1996, sub-Saharan Africa paid $2.5 billion more in debt servicing than it received in new long-term loans and credits.
- The IMF and the World Bank are "preferred creditors" who gain power over poor countries as the amounts owed to them increase.
- Structural adjustment programs, which reorient economies to benefit corporate interests while reducing spending on social programs and locally oriented production, are imposed by IFIs on severely indebted countries.

Significant growth of multilateral debt began with the Latin American debt crisis of the early 1980s. Mexico, Argentina, and Brazil all came to the brink of defaulting on loans that large private banks had freely offered during the 1970s to developing country governments in Latin America and elsewhere. The IMF and the World Bank responded with massive loan packages conditioned on implementation of structural adjustment programs (SAPs), packages of neoliberal economic reforms designed to restore economic health to indebted countries. With this move, both institutions were changing course: the IMF was shifting from short-term, balance-of-payment loans mainly for industrialized countries to medium-term loans for developing nations, and the World Bank was adding policy-linked loans to its infrastructure development projects. Private debts were converted into multilateral debt as countries used the funds acquired from the IFIs to pay off the banks that would no longer loan to them.

Multilateral debt is a problem for the entire developing world, but it's particularly acute for the poorest countries. For low-income countries (defined by the World Bank as those with per capita GNP below $785), multilateral debt increased by some 544% between 1980 and 1997, from $24.1 billion to $155.3 billion, and currently constitutes 32.75% of their total long-term debt burden (versus about 25% in 1980). For the most severely indebted of those low-income countries, multilateral debt increased by 459%, from $10.6 billion to $59.3 billion, with a corresponding percentage increase in their long-term debt from 22.3% to 30%. During this same period, the debt burden of middle-income countries—those with per capita GNP between $785 and $9600—increased by 481%, amounting to a comparatively modest 15% of their total long-term obligations (up from 9.4% in 1980). In 1996, sub-Saharan Africa paid $2.5 billion more in debt servicing than it received in new long-term loans and credits.

The impact of debt is felt in two ways—through the diversion of national resources to debt servicing and through the effects of SAPs which are designed to transform economies from production for the local market to a "globalized" model of production and export of whatever garners the most hard currency. SAP-linked IFI loans are meant to finance the redesign of governmental, industrial, and commercial systems, to enable countries to continue to pay debt servicing. However, SAPs have almost invariably caused increased poverty, unemployment, and environmental destruction and have usually led to an increase in the overall size of a country's multilateral debt. The universal failure of the standard SAP recipe has meant that debt and structural adjustment simply end up fueling each other.

A global movement called Jubilee 2000, which calls for the cancellation of poor countries' unpayable debts by the beginning of the new millennium, has gained surprising momentum. With national campaigns in some 40 countries (about half of them in the South) and the support of many major religious figures and celebrities, the movement may even be putting a scare into the IFIs. A recent flurry of new proposals from G-7 countries to improve debt relief mechanisms has been widely attributed, by the Financial Times and the Wall Street Journal among others, to the pressure mounted by Jubilee 2000.

Voting power at the World Bank and the IMF is apportioned according to the size of each country's monetary contribution. The U.S. has by far the largest share (18% of all votes) and can veto policy decisions, since they require an 85% vote. The IFIs may not be totally controlled by the U.S., but it's close: the New York Times recently described the IMF as a "proxy" of the U.S. government. Any analysis of IFI policies is thus also a critique of U.S. policies.

The response of the World Bank and the IMF to the crisis of unpayable debt has been the Heavily Indebted Poor Countries (HIPC) Initiative of 1996. The ostensible aim of the program is to determine which countries have unsustainable debt burdens, then to caucus with each country's creditors to reduce that burden across the board until it is sustainable. The program seeks to ensure that countries do not run up unsustainable debts again by insisting that beneficiaries demonstrate a proven commitment to "sound economic policies"—the IFIs' usual euphemism for SAPs.

To qualify for HIPC, a country must complete three years under an IMF-designed SAP. Even after that hurdle, the country must fulfill a further three years bound by another SAP before relief on multilateral debt is granted. At that time, all creditors will give matching relief to reduce the country's debt to a "sustainable" level. The June 1999 G-7 summit proposed moving up the granting of relief to the point after completion of the first SAP, though the debt could be reinstated if the second SAP was not fulfilled to the IMF's satisfaction. The cruel paradox here is that countries in desperate need of debt relief so they can begin to direct resources to social sectors are required to first demonstrate their willingness to make things worse by starving their people of health care, food subsidies, and education.

There are other problems with HIPC's complex formulas. "Debt sustainability" basically means how much a country can repay without going broke. In many cases, countries are not paying all their debt servicing bills because they simply haven't got the money. But the definition of "sustainability" is a harsh one: a debt-to-export ratio of 200 to 250%, meaning a debtor country must pay between 20 and 25% of its income from exports just to service (pay the interest on) its debt. The June 1999 G-7 summit proposed lowering debt servicing to 15%.

Since the HIPC Initiative was adopted in 1996, only five countries—Uganda, Bolivia, Guyana, Mozambique, and Mali—have received or are in a position to receive any relief before 2000. And these countries have found HIPC relief to be worth relatively little. Uganda began to receive debt relief worth $350 million in April 1998, but as a consequence lost access to other debt relief funding mechanisms. With a drop in the international price of coffee, its chief export, Uganda found itself by April 1999 once again saddled with an officially "unsustainable" debt burden. An internal World Bank/IMF report indicates that Mali and Burkina Faso (slated for HIPC relief in early 2000) will actually pay more on their debt after graduating from HIPC.

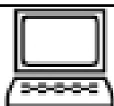
The meager results of the HIPC program suggest that its promises are hollow ones, made solely to ensure that countries remain on the debt-and-structural-adjustment treadmill when they might be tempted to default and opt out of the global financial system despite the prospect of losing access to markets and capital. The IFIs and the U.S. government also have incentives to avert defaults: any gaps in the globalized economy represent a loss of control and potential markets and may even end up offering an alternative model for economic development independent of U.S. influence.

Outright debt cancellation—the only humane solution to the poorest countries' debt crises—would result in the same loss of leverage for the IFIs as default, since the absence of debt burdens would make countries more creditworthy and thus less dependent on the IFIs' conditioned loans. In the wake of Hurricane Mitch's devastation in Central America, Treasury Department officials gave "loss of leverage" as their reason for refusing to consider debt cancellation for Nicaragua and Honduras.

The revisions in the HIPC initiative proposed at the 1999 G-7 summit rely on sales of part of the IMF's gold stocks to finance additional relief. However, Treasury Department figures suggest that only about 40% of the proceeds of gold sales would go to the HIPC Trust Funds, with the majority, some 60%, actually going to the IMF's long-term, low-interest loan fund, the Enhanced Structural Adjustment Facility (ESAF). This would, of course, not be a productive way to pursue debt relief, and it would also have the effect of making ESAF, which expects a rush of repayments on old loans starting in 2004, forever self-financing: a perpetual structural adjustment machine that need never again apply to Congress or anyone else for funds.

Key Problems

- A voting structure determined by financial contributions means that poor countries have little voice in the IFIs, while the U.S. government holds nearly decisive power there.
- The IMF/World Bank debt plan is calculated less to provide meaningful relief than to ensure that countries continue to implement neoliberal economic policies.
- In determining their policy on debt, U.S. Treasury officials have sought to maintain leverage over other nations' economic policies.



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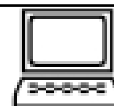

For countries that have endured decades of severe indebtedness, poverty, and subordination to the IFIs' economic policies, cancellation of substantial portions, if not all, of their outstanding debt, as urged by Jubilee 2000, is necessary if their resources are ever to become available for development and if their people are ever to gain a sense of ownership of their economic destiny.

The U.S. government should ideally take the lead in such a program of cancellation, first by canceling its bilateral debt with the poorest countries, and then by using its position at the IFIs to urge cancellation of multilateral debt. Even if that were to occur, a system for treating national debts independent of the IFIs is still necessary. With such cancellation not forthcoming, such a mechanism is all the more necessary.

Key Recommendations

- Immediate and comprehensive debt cancellation is necessary for poor countries to reenter the global economy on equitable terms.
- An international body—with strict requirements of fair representation, with an orientation to sustainable and equitable development, and with authority over the IMF and the World Bank—should be created for the adjudication of debt cancellation and reduction.
- Debts incurred for failed economic programs and nonperforming infrastructure projects should be annulled.

University of Vienna economist Kunibert Raffer has suggested a process for according partial insolvency to national governments. Raffer cites provisions in U.S. law permitting debts of local governments to be treated like those of a company or an individual who has gone bankrupt, but essential services provided by the municipality are not affected. Although Raffer maintains that this process could occur without the creation of a new international agency—he suggests a panel of arbitrators with equal creditor/debtor representation—it is hard to imagine that the World Bank and the IMF would have adequate incentive to participate without the creation of some new regimen. This would require that the United Nations or the G-7 establish a body with authority over both the IFIs and debtor governments.

Once constituted, the new international bankruptcy body would function much like courts in the U.S. adjudicating cases of insolvency or bankruptcy. It would be empowered to instruct creditors to accept a portion of their claims and demand no more, and it would establish a process for cleansing a country's credit record, so that nation could reenter the global economy on its own terms. This new entity would not have the power to insist on particular economic programs as a condition for debt reduction.

Objections to such a body are easy to imagine: the IFIs would fret that their status as preferred creditors would be threatened if decisions on debt relief were removed from their control. Such concerns should be met with the insistence—more easily imaginable, now, in the wake of the criticism IFI policies have received since the East Asian financial meltdown—that the IFIs must take some responsibility for the effects of the policies they have imposed around the world. If the lower interest rates charged by the IFIs have entitled them to special status, the harm done by the policies imposed with those rates must also be considered. In a similar vein, the World Bank should be pressured to annul debts owed to it for projects its own analyses show to be failures. (A 1992 World Bank report, Effective Implementation, estimated 37.5% of World Bank projects should be so classified.)

The IFIs should also be forced to accept—through a change in their bylaws, if necessary—the option of writing off debts. Private banks do this routinely with loans they can never expect to be repaid, and many took some losses in resolving the Latin American debt crisis in the early 1980s.

If IMF gold is sold for debt relief, it should go directly to a fund to buy out the debt owed to the IFIs by the most indebted and poorest countries. Such a move would not obviate the need for the insolvency process described above; indeed, the proposed bankruptcy body should perform an assessment of which IFI claims are legitimate in light of their poor policy advice and failed projects. The bottom line is that the world's poorest countries need debt cancellation if they are to function as sovereign components of a globalized economy.

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(Their website now includes a new proposal for debt arbitration "concordats" by Ann Pettifor, building on the work of Kunibert Raffer.)

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Oxfam
http://www.oxfamamerica.org/INFO.HTML

Kunibert Raffer (personal web page of this expert on insolvency and governmental debt)
http://mailbox.univie.ac.at/~a4411maj/

U.S. Treasury Department
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