



Multilateral Debt: The Unbearable Burden

By Soren Ambrose, 50 Years Is Enough Network

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 impoverished countries, multilateral debt looms larger than other debts because of the status of IFIs as "preferred creditors" assigned them by the Group of 7 (G-7) industrialized countries. These same countries control the most votes at the IFIs and use the resulting leverage to insist on orthodox austerity and "free trade" policies. Because of the preferred creditor status of the IFIs, payments of multilateral debt takes priority over private and bilateral (government-to-government) debt.

Governments and private creditors often write off debts. But the IFIs contend that their bylaws prohibit them

from granting debt relief or canceling debts. Borrowing governments have special incentive to stay current with their multilateral debts because IFIs determine the creditworthiness of borrowing countries. Until the IMF gives its stamp of approval that a country is adhering to the economic policies it recommends, impoverished countries generally cannot get credit or capital from other sources. Until a country has signed onto an IMF program, it cannot apply for bilateral debt relief from the "Paris Club" of creditor countries.

The significant growth of multilateral debt came to public attention with the Latin American debt crisis of the early

1980s. Mexico, Argentina, and Brazil all came to the brink of defaulting on loans that foreign banking corporations had freely offered to developing country governments during the 1970s. The IMF and the World Bank responded with massive loan packages conditioned on implementation of structural adjustment programs (SAPs), which are packages of neoliberal economic policy reforms ostensibly designed to restore economic health to indebted countries. This promotion of SAPs marked a changing course at both IFIs. The IMF shifted from short-term, balance-of-payment loans, mainly to industrialized countries, to medium-term loans for developing nations. The World Bank added policy-linked loans to its infrastructure development pro-

jects. Private debts were converted into multilateral debt as countries used the funds acquired from the IFIs to pay off the private banks that refused to issue new loans.

Multilateral debt is a problem for the entire Global South, but it's particularly acute for the most impoverished 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. Multilateral debt constitutes 32.75% of the long-term debt burden of the most impoverished countries. For middle-income countries, the corresponding percentage is 15%. World Bank figures for 1999 show that on average \$128 million is transferred every day from the 62 most impoverished countries to wealthy countries, and that for every dollar these countries receive in grant aid, they repay \$13 on old debts.

The debilitating impact of debt is felt in two main ways: 1) through the diversion of national resources to debt servicing, and 2) through the negative social and economic consequences of the SAPs that indebted countries are obligated to adopt. These SAPs are designed to transform economies from a focus on production for the local market to one that adopts a "globalized" model of production and export of products that earn the most hard currency. SAP-linked IFI loans are meant to finance the redesign of governmental, industrial, and commercial systems that will enable countries to service debts and become more integrated into the global economy. However, SAPs have almost invariably caused increased poverty, unemployment, and environmental destruction, while also leading 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.

The global Jubilee 2000 debt-cancellation movement, which acquired great momentum in some 50 countries in the late 1990s, has continued under different names since 2000. The latest version of the IMF/World Bank debt management program, sometimes called the Cologne initiative (after the site of the 1999 summit of the G-7 countries), was a response, however inadequate, to the Jubilee movement. As part of the Cologne terms, the U.S. and other G-7 governments agreed to cancel 100% of the bilateral debts owed them by the most impoverished countries—as long as they are obeying structural adjustment programs. Despite the high hopes of many debt-cancellation campaigners, the G-7 Summit in Genoa in 2001 yielded no new decisions or initiatives on debt.

Key Points

- World Bank figures for 1999 show that \$128 million is transferred daily from the 62 most impoverished countries to wealthy countries, and that for every dollar countries receive in grant aid, they repay \$13 on old debts.
- The IMF and the World Bank are "preferred creditors" who gain power over impoverished 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.

Problems with Current U.S. Policy

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 *New York Times* has gone so far as to describe 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 value of the leverage associated with multilateral debt and the extent to which the G-7 controls the IFIs are evident at times of international crisis. Just as Egyptian and Kenyan debts were cancelled during the Gulf War, so in the wake of the September 11 attacks Pakistan was induced to assist the fight against al-Qaeda and the Taliban with promises of debt cancellation and new loans from the IMF. Should the crisis persist, Indonesia, with one of the largest debt burdens as well as the largest Muslim population, will likely benefit as well.

The main response of the World Bank and the IMF to the impoverished countries' debt crisis has been the Heavily Indebted Poor Countries (HIPC) Initiative of 1996. The ostensible aim of the program is to make the debt burden of the poorest and most indebted countries "sustainable." Once a country is deemed eligible, it must demonstrate a commitment to "sound economic policies"—the IFIs' usual euphemism for SAPs—to receive debt relief.

Under the original HIPC program, a country could not obtain benefits until it completed a second 3-year SAP. In contrast, the 1999 Cologne terms allow for some debt servicing to be suspended upon completion of the first SAP, though the original servicing terms apparently can be reinstated if the second SAP is not implemented to the IMF's satisfaction. For countries in desperate need of debt relief so they can begin to direct resources to social sectors, this type of provisional debt relief is a cruel paradox. To obtain relief, debtor nations are first required to demonstrate their willingness to make socioeconomic—and perhaps political—conditions worse by adopting programs that starve people of health care, food subsidies, and education.

HIPC's curious goal of "debt sustainability" basically refers to an assessment of the debt servicing a country can afford without going completely broke. The indicator—a debt-to-export ratio of 150%—was, as the IFIs admit, chosen arbitrarily. The unsustainability of the IFIs' approach to debt reduction was amply illustrated by the case of Uganda, the first country to go through the HIPC process. Less than a year after being accorded its debt relief, Uganda's economic indicators had slipped, due to a fall in the price of coffee, to the point where it qualified for HIPC again. (It has, in fact, received a second set of benefits under the Cologne initiative.) Seven additional countries are projected to lapse into debt-servicing unsustainability after HIPC. Two countries, Zambia and Niger, face the prospect of higher debt service costs after HIPC,

thanks to the program's complex and counterproductive formulas of sustainability.

The first 22 countries to qualify for HIPC are still spending more on debt servicing than on health care. For those that have begun to get relief as of the end of 2000, the average overall reduction amounts to 27%—not a trivial decrease but hardly the kind of sweeping cancellation needed to transform economies and to make them sustainable. These qualifying debtor countries continue to spend \$1.3 billion a year on debt service.

The new version of HIPC seeks to ensure that debt relief will effectively reduce poverty through the Poverty Reduction Strategy Paper (PRSP), through which governments and civil society ostensibly design their budget and economic program together. But in the first countries to formulate PRSPs, macroeconomic policy emerged from discussions between governments and the IFIs without any meaningful civil society participation. Restricting civil society input to narrow budgeting discussions and to efforts to gauge poverty levels ensures that the PRSP will continue to be an instrument of the standard policies of structural adjustment: high interest rates, trade and investment liberalization, privatization, elimination of subsidies, cuts in public sector jobs and social programs. Now, limited participation of civil society risks giving the SAPs the appearance of enjoying popular approval.

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. Otherwise, these countries might be tempted to default or opt out of the global financial system altogether, 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 reduced control and loss of potential markets. A delinking through debt default may even present an attractive alternative model for economic development independent of U.S. influence.

Preservation of that influence and control is a far more important factor in the U.S. approach to debt policy than recovery of the funds loaned. Illustrating this point was U.S. policy in the wake of Hurricane Mitch's devastation in Central America in 1998. Treasury Department officials privately gave "loss of leverage" as their reason for refusing to consider comprehensive debt cancellation for Nicaragua and Honduras.

Key Problems

- A voting structure determined by financial contributions means that developing countries have little voice in the IFIs, while the U.S. government holds nearly decisive power there.
 - The revised IMF/World Bank debt plan of 1999 is designed less to provide meaningful relief than to ensure that countries continue to implement neoliberal economic policies.
 - Maintaining leverage over other nations' economic policies is the central goal of debt policy of the U.S. Treasury and of the IFIs.
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Toward a New Foreign Policy

For countries that have endured decades of severe indebtedness, poverty, and subordination to the IFIs' economic policies, comprehensive cancellation of their outstanding debt, without externally imposed conditions, is necessary if their people are ever to gain democratic control of their economic destiny. As part of that cancellation, there should be a reckoning with the question of the legitimacy of much of the current debt.

Key Recommendations

- Immediate and comprehensive debt cancellation is necessary for impoverished countries to participate in the global economy as anything but a permanent underclass.
- 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 determine the legitimacy of debts and adjudicate their cancellation and reduction.
- Debts incurred for failed economic programs and nonperforming infrastructure projects should be annulled.

The U.S. government should ideally take the lead in such a program of cancellation, first by canceling the bilateral debt of the most impoverished countries without creditor-imposed conditions, and then strongly urging similar cancellation of multilateral debt. It should also advocate for and participate in a "truth commission" on the accumulation and abuse of debt over the years, as a way of establishing the legitimacy or illegitimacy of debts that national populations have been asked to pay. That process could be linked to a new system in which an international arbitration court arbitrates debt disputes and arrears independent of the

IFIs. Such a system would address both countries on the "debt treadmill" and countries with currency crises. Instead of a drawn-out drama like the one Argentina has endured since 1998, culminating in a virtual default in late 2001 despite three IMF "bailout" packages, a country in crisis could submit to the insolvency procedures of an independent court and begin to re-establish its productivity with a minimum of damage to the more vulnerable parts of the population.

University of Vienna economist Kunibert Raffer has suggested a process for recognizing partial insolvency of 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, while guaranteeing that essential services provided by the municipality are not affected. His recommendation is echoed by a November 2001 report issued by an "emerging markets eminent persons group" of widely respected former finance ministers of South Korea, India, and Ghana, and the former head of Chile's central bank. 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 World Court establish a body with authority over the IFIs and both creditor and debtor governments.

Once constituted, the new international court of arbitration 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 re-enter the global economy on fair terms. This new court would not have the power to insist on particular economic programs as a condition for debt reduction.

The IFIs and some powerful governments would likely object to such a debt arbitration system on the grounds that the IFIs' 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 that the IFIs must take some responsibility for the effects of the policies they have imposed around the world. In a similar vein, the World Bank should be pressured to annul debts owed to it for projects its own analyses show to be economic failures. (A 1992 World Bank report, *Effective Implementation*, estimated 37.5% of World Bank projects should be so classified.) The proposed court should perform an assessment of which IFI claims are legitimate in light of their poor policy advice and failed projects.

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. The current HIPC program does not mandate that the IFIs write off debt; instead they simply agree to accept full payment of the debts from a fund created by donations from wealthier governments.

Activists in Jubilee South, which brings together debt cancellation campaigns from across Latin America, the Caribbean, Asia-Pacific, and Africa, emphasize the imperative of assessing "who owes whom:" after the exploitation of slavery, colonialism, and the current economic system, their insistence that Southern governments should repudiate their debts, and that Northern governments and institutions should pay reparations and restitution cannot be lightly dismissed as too radical or too unrealistic. At this point, realizing economic and moral justice would require a deeper accounting of past practices than most governments and institutions are prepared to make.

Soren Ambrose <soren@50years.org> is a policy analyst with 50 Years is Enough: U.S. Network for Global Economic Justice.

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Editors
Tom Barry (IRC)
Martha Honey (IPS)

Communications Director
Erik Leaver (IPS)
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Orders and subscription information:

Mail: PO Box 4506
Albuquerque, New Mexico 87196-4506
Fax: (505) 246-1601
Email: infocus@irc-online.org

Editorial inquiries and information:

IRC Editor
Voice: (505) 388-0208
Fax: (505) 388-0619
Email: tom@irc-online.org

IPS Editor
Voice: (202) 234-9382/3 ext. 232
Fax: (202) 387-7915
Email: ipsps@igc.org

Sources for More Information

Organizations

50 Years Is Enough: U.S. Network for Global

Economic Justice

3628 12th Street, NE

Washington, DC 20017

Voice: (202) 463-2265

Fax: (202) 636-4238

Email: 50years@50years.org

Website: <http://www.50years.org/>

Contact: Njoki Njehu; Soren Ambrose

European Network on Debt and Development (EURODAD)

BELGIUM

Voice: +32-2-543-9060

Fax: +32-2-544-0559

Email: eurodad@agoranet.be

Website: <http://www.oneworld.org/eurodad/>

Jubilee Plus

c/o New Economics Foundation

UK

Voice: (44) 207 089 2810

Fax (44) 207 407 6473

Email: info.jubilee@neweconomics.org

Website: <http://www.jubilee2000uk.org/>

Jubilee USA Network

222 E. Capitol St. NE

Washington, DC 20003

Voice: (202) 783-3566

Fax: (202) 546-4468

Email: coord@j2000usa.org

Website: <http://www.j2000usa.org/>

Contact: Marie Clarke

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<http://www.jubileesouth.net/>

International Monetary Fund

<http://www.imf.org/>

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

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