

# V A New Approach to the Multilateral Debt Overhang

## *Alternative Principles and Measures*

While the World Bank and the IMF have recently produced papers on the proposed framework for resolving the multilateral debt problem of the heavily-indebted poor countries, they have failed to deal with the problem in an effective manner. Those interested in a more productive resolution of the growing multilateral debt problem should argue for a different approach, with a different set of principles, on which the framework for multilateral debt reduction and relief (MDRR) should be based.

### **1. Independence and impartiality in developing an equitable approach to MDRR which would result in sustainable debt servicing outcomes.**

It is clear from what has been happening that the World Bank and the IMF (international financial institutions or IFIs) have too strong a vested interest in containing MDRR. They have demonstrated beyond any reasonable doubt that they are incapable of approaching the issue in an impartial and fair manner. They do not have either the inclination or the perspective which is needed for a solution which would be in the interests of affected heavily-indebted poor countries (HIPC).

As involved parties in what is now effectively a dispute between HIPC debtors on the one hand and multilateral creditors on the other, it is perhaps inappropriate to expect the IFIs to be independent or impartial and to suppress their vested interests in arguing the MDRR case. Their record so far has borne out the genuine difficulty they are experiencing in this respect.

Accordingly, the Development Committee, in the interests of fairness and a genuinely independent approach, should establish a Special Independent Commission on Multilateral Debt (SICOM) headed by a high-ranking and internationally credible, former senior executive of the IFIs who is a public figure (e.g. Moeen Qureshi, the former Senior Vice-President for both Finance and Operations of the World Bank, a former head of IFC and also the interim Prime Minister of Pakistan) acceptable to HIPC and IFIs. The head of SICOM should report directly to the Ministerial Development Committee through its Chairman and Executive Secretary and not to the heads of the two IFIs.

SICOM should have a time-bound life. It should be supported by a properly staffed independent secretariat comprising knowledgeable debt experts hired from outside the IFIs, along with staff seconded from the IFIs. It should:

- (a) *undertake the required analyses of debt sustainability* (with information and analysis supplied by the IFIs) on an independent and impartial basis based on appropriate and exhaustive criteria to establish: (i) the specific countries eligible for MDRR; (ii) the amount of MDRR required for a sustainable outcome to be achieved in each such country; and (iii) to suggest specific MDRR measures which should be applied by each multilateral creditor in each eligible HIPC;
- (b) *operate a properly funded global Multilateral Debt Facility* which would be financed by contributions mainly from the IFIs own resources with some supplementation by special grants from bilateral donors.

**2. Adopt a case-by-case, institution-specific approach to multilateral debt reduction by eliminating unnecessary linkages between different multilateral creditors in designing and applying MDRR.**

It is evident from what has been happening so far that forcing the IMF and World Bank to work jointly in developing an approach to MDRR has not worked satisfactorily. Of the two IFIs, the World Bank appears to be more inclined to proceed more rapidly towards an MDRR solution, albeit a sub-optimal one.

The IMF seems interested above all in securing the future of ESAF and reinforcing its role as *the* choke-holder of the short-leash for policy-reform in perpetuity. It appears much less concerned about the impact of a multilateral debt overhang in compromising the economic prospects of affected HIPCs.

Moreover, there is a strong argument for a case-by-case approach to the specific problems which the different multilateral institutions face. The nature of their facilities is different and their financial circumstances are different. It would be much easier to develop a case-by-case, institution-specific approach to MDRR, in the same way as the IFIs are proposing a case-by-case individual country approach to determining eligible HIPCs and their MDRR needs.

Those institutions which believe they face risks of an adverse market reaction to MDRR (i.e. the IBRD and AfDB) need to be treated differently to those which face no such risks. Similarly those institutions which do not borrow from markets (the IMF and the soft windows of the multilateral development banks) have more room to manoeuvre in designing their

MDRR responses. They can deploy an array of different instruments for providing debt reduction and relief.

A de-linked approach would thus enable progress on MDRR to be made more rapidly, and more sensibly, than an approach which relies on inappropriate notions of maintaining institutional solidarity within the multilateral creditor group and cross-conditional linkages which result in obstructing progress.

Moreover, a case-by-case approach in dealing with individual creditors would be symmetric with the case-by-case approach which the IFIs are arguing in favour of in dealing with the different debt problems being faced by different HIPCs.

3. **A. Eliminate unnecessary cross-linkages between action on MDRR and action for further relief on the claims of other creditors.**
  - B. Action to provide further debt reduction and relief by all creditors should be undertaken simultaneously not sequentially; with *pari passu* burden-sharing by all creditors from here on.**

Linking action on MDRR to prior action on other types of debt is a retrogressive and inequitable principle which the IFIs have proposed in April 1996. It can only obstruct and further delay action on MDRR which has already been too long-delayed.

Other creditors did not link their earlier debt-reduction initiatives on what the IFIs did. As a matter of fairness, IFIs cannot require, simply on the basis of preferred creditor status, that other creditors should go even further before they are required to act. That principle defies both logic and propriety.

As other creditors have already provided debt reduction – albeit to an inadequate extent – the preferred position of the multilaterals has been preserved. The IFIs' status as creditors would continue to be preferred if, from here on, further debt reduction were provided by all categories of creditors on a *pari passu* basis; although the evidence suggests that multilateral creditors need to do proportionately more than other creditors in terms of debt stock reduction simply because they have not undertaken any such reduction so far.

Bilateral creditors have not only reduced debt stocks and tolerated a very large volume of arrears – thus providing *de facto* debt reduction which is much larger than that negotiated *de jure* – they have gone even further in providing grant financing to cover the multilateral debt service of many HIPCs with unsustainable multilateral obligations. It is therefore not up to the IFIs to dictate that bilateral creditors ought to be doing even more and to refuse to act before other creditors have done more.

Clearly, the further debt reduction actions proposed by the IFIs for the

Paris Club and other bilateral creditors, are desirable and should be implemented. But there is no case – financial, legal or on any other basis – to make MDRR conditional on *prior* action being taken by other creditors for further reduction of their claims. Such conditionality is simply unacceptable.

Thus, while the Paris Club and private creditors should be encouraged through other fora to do as much as they can in providing further debt relief and in eliminating arrears – which have now risen to absurd proportions – they should not be required by the IFIs to act before MDRR can be applied.

4. **A. Focus MDRR initially on debt stock reduction and not just on rescheduling or debt-service relief as proposed by the IFIs.**
- B. Use bilateral funds only to finance the MDRR efforts of the African Development Bank**
- C. Require MDRR provided by other multilaterals and the IFIs to be financed from their own resources.**

For all the wrong reasons, what the IFIs seem to be ruling out altogether in their April and June 1996 proposals is any debt stock reduction on the grounds that this would compromise their financial integrity, hurt their credit ratings, increase their borrowing costs and thus damage the interests of other borrowing countries.

Thus they are concentrating only on refinancing, rescheduling and debt-service relief in their approach to providing MDRR. These are all sub-optimal ways of alleviating a debt overhang problem – as the IFIs have themselves argued on several occasions when urging bilateral and private creditors to undertake significant debt stock reductions.

None of the hypothetical arguments the IFIs make against reducing their own debt stocks through write-offs and partial write-downs are valid, as has been pointed out in a number of papers from credible independent sources.

Up to \$10-12 billion of multilateral debt stock reduction can be financed by resources already available within the multilateral system (income, provisions, reserves, gold sales, soft-window funds) without any damage to the financial integrity of the IFIs or regional development banks.

Only in the case of the African Development Bank would the resources for MDRR need to come from outside that institution. They could be provided as part of the next two soft-loan window (AfDF) replenishments if donors so wished with special allocations to AfDF from their existing aid budgets for financing debt relief.

After multilateral debt stocks have been reduced sufficiently to eliminate the multilateral debt overhang, residual balances can be rescheduled with

maturity and grace periods which would result in debt-service sustainability – without further reliance on external grant funding for this purpose. But rescheduling should only be resorted to after debt stocks have been reduced.

**5. Arresting immediately the further growth of the multilateral debt overhang in affected HIPC's by putting interest on outstanding multilateral loans into non-accrual status immediately.**

When it is acknowledged that up to 20 countries (and possibly 4-12 others) have a serious multilateral debt problem, it is odd that all of the analyses and projections of future debt-service obligations done by the IMF and the World Bank show these IFIs as collecting principal and future interest from countries which are obviously distressed by excess multilateral debt.

Under these circumstances it would be more appropriate for the IFIs to cease accruing interest on outstanding balances in affected HIPC's with immediate effect. That would certainly stop the multilateral debt problem from growing worse than it now is.

A policy of income non-accrual would be a useful start in applying partial MDRR immediately. Foregoing income on loans to over-indebted HIPC's would represent a significant immediate contribution by IFIs to MDRR and would reduce the total amount which may have to be written-off in the future. Such a measure would also release immediately a significant portion of bilateral grant resources which are being diverted for multilateral debt-service relief. These savings could then be applied to the reduction of principal balances owed to the African Development Bank.

The multilateral development banks already have non-accrual policies in place for loans to countries which are in arrears for more than six months. That policy could be extended easily to cover non-accrual on loans to countries which have been determined to have a serious multilateral debt overhang and whose arrears are being prevented simply by recourse to extraordinary grant funding.

**6. Applying a time-limit to cleaning up the multilateral debt overhang.**

From a political and practical perspective it would be useful for the G-7 states and for the IFIs to announce a politically evocative time bound limit (say the year 2000) for clearing up the multilateral debt overhang.

With a more serious approach on the part of the IFIs to MDRR and greater political will on the part of their major shareholders, such a deadline is feasible, practicable and desirable from the viewpoint of debtors and creditors.

It will help to concentrate minds, provide a major disincentive to the IFIs to persist with continued obfuscation and procrastination and provide an incentive for potentially eligible debtor countries to embrace and pursue policy-reform programmes with greater vigour and enthusiasm.

## **7. Ensuring that the preferred creditor status of IFIs is not used as an excuse by IFIs to assume exempt creditor status.**

The IFIs have argued repeatedly that applying MDRR, and especially writing down debt, would affect their preferred creditor status. As long as the multilateral institutions write down less debt than other creditors and provide less overall debt relief, they will still remain preferred creditors.

Thus they are using the preferred status argument as an excuse to exempt themselves altogether from debt stock reduction. Also the IFIs stress their preferred status as if it were holy writ enshrined in their constitutions. Preferred creditor status is a matter of convention rather than constitution and conventions can be changed depending on circumstances.

There is, of course, no valid argument for compromising the preferred status of the IFIs which convention and market preference has endowed to them over several years. That status has been useful in bolstering their resource-mobilisation efforts. To the extent that they borrow from markets (and only the hard-windows of the multilateral development banks do that) the importance of such a convention cannot be underplayed.

But there is no basis for the IFIs to misconstrue, misrepresent or hide behind preferred creditor status to avert or forestall MDRR of the kind that is needed (i.e. up-front debt stock reduction) when that can be done without incurring any of the problems or risks which the IFIs exaggeratedly allege.

## **8. Combining a Global Multilateral Debt Facility with country-specific MDRR funds.**

In addition to espousing the seven alternative principles outlined above – and pressing G-7 leaders as well as the Ministers who make up the Development Committee to accept them as the basis for building an MDRR framework – one should also press for the establishment of a global Multilateral Debt Facility (MDF) combined with country-specific MDRR funds (à la Uganda).

A global MDF, first conceptualised by the World Bank in July 1995, should be established and operated, but along lines quite different than those suggested by the World Bank itself (see Mistry: 1995). In addition, country-specific funds for HIPCs which are eligible for MDRR should also be established and should operate in tandem with the global MDF along the lines

proposed by Martin (1996). The MDF should be funded mainly from the resources of the IFIs themselves. Top-up bilateral resources should be provided only to cover debt reduction offered by the African Development Bank.

Most importantly, the MDF should not be administered by the World Bank but by the Special Independent Commission on Multilateral Debt suggested above.

### ***Conclusion***

These eight alternative principles offer a more practicable and reasonable basis than the six principles suggested by the IFIs on which to build the framework for MDRR. They take more account of the real MDRR needs of debtors instead of viewing the problem exclusively from the perspective of the IFI creditors.

They also serve to redress the balance in what has so far been an asymmetric approach to MDRR dominated entirely by the views, preferences and vested interests of the IFIs with little account being taken of the legitimate needs and imperatives of the HIPC. Although the indications are that the World Bank is prepared to move more expeditiously towards providing MDRR, it is being held back by the IMF. That institution seems to be running interference on all MDRR proposals until it has achieved its own self-serving objective of financing an expanded, self-sustaining ESAF.

It is clear from their most recent proposals that the IFIs are not moving the MDRR initiative forward and are still procrastinating in an attempt to protect their own positions. That is unacceptable. Responsibility for finding and implementing an appropriate solution to the multilateral debt problem which deals equitably with the legitimate interests of affected debtors and creditors alike – but which does not confuse the issue with unnecessary extraneous linkages – should therefore be shifted away from the IFIs and transferred to a more responsible and responsive independent body with the authority to devise and implement a solution which is fair and workable.

The above mentioned package of principles and measures represents the minimum set of requirements which a new approach to resolving the multilateral debt crisis must embody if the debt-development impasse facing sub-Saharan low-income economies is to be resolved. Absent these measures and absent a new multilateral debt strategy, it is difficult to imagine how African economies, blighted for over two decades by their own failures of economic management and those visited upon them by the failure of internationally imposed adjustment, can emerge from the shadows of recession, stagnation and retrogression onto the more illuminated pathways of sustainable recovery and growth, and to resume the momentum of long-term development.