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- Throughout the 1982-92 period private and official bilateral creditors have withdrawn a large amount of resources from SIMICs but have let their claims on SILICs balloon exponentially by permitting unpaid interest and arrears obligations to be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 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

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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

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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 .