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A new strategy for the debt crisis

Dr Kalim Siddiqui

The issue of debt relief of the most grievously indebted poor countries has run into difficulties, as exhibited at recent meetings of the IMF and World Bank in Washington. I find the present debt strategy fundamentally flawed for several reasons and a radical restructuring is called for if alleviation of the debt crisis is to be achieved.

The Mexican decision to discontinue service on its external debt in 1982 heralded the current international debt crisis. Several countries followed suit and it was clear that the crisis was more widespread and deep rooted, calling for urgent attention. Key international economic organisations especially the IMF, together with creditors banks, evolved 'rescue packages' consisting of debt rescheduling in return for structural adjustment polices in the debtor countries.

However, the total external debt of all Third World countries grew from $751 billion in 1981 and is about $1950 billion. It needs to be noted that the Third World as a group are now more indebted than they were in the 1980s. In 1994, their external debts as a proportion of gross domestic product (GDP) reached 40 per cent. A closer look at the major borrowers reveal that Brazil and Mexico continue to occupy the top two positions, with India, Indonesia and China having moved up in terms of total external debt outstanding. A ranking by debt service ration reveals the Latin American countries to be the major debtors even today. Other countries that are now above the danger mark, but were so in the 1980s are India (28.4 per cent) and Philippines (25 per cent).

Thirteen years of the debt crisis (dating if from the Mexican moratorium in 1982) have wrought a tremendous devastation upon Third World countries. Compared with the GDP growth rate from 1965-80, the Third World has lost during the past decade cumulatively income as follows: Low income countries other than China and India 35 per cent, sub-Saharan Africa 40 per cent and Latin America and Caribbean 45 per cent.

What this picture reveals is that after more than a decade, the problem is just as grave, if not more so, in the aggregate, and that individual countries have only worsened their position. The failure of the official strategy in reducing indebtedness is self-evident.

The question arises why debt crisis has been allowed to go on for so long. It seems because successive debt-reduction initiatives by the Northern governments have done little more than to slow the rate at which arrears are building up, and also because of the increasing weight of multilateral debt, owed mainly to the World Bank and IMF. Repayments to multilateral creditors now account for about one-half of the total severely indebted low income countries' (SILICs) debt repayments or $3.5 billion in 1995. Maintaining these payments is beyond the export capacity of these poor countries, yet in contrast to rich governments, IMF and World Bank have refused to work for a comprehensive debt-reduction, claiming that this would jeopardise their financial integrity. Despite that, thirty-two of the poor countries face chronic problems with external creditors.

To protect creditors interests the World Bank and IMF have created short term solutions.Out of every $3 in IDA grants ostensibly directed towards poverty reduction, $2 comes back to the World Bank as repayments on past debt.

The case against multilateral debt relief could be that the World Bank asserts that there is no "free lunch" in debt relief, since any debt reduction initiative will have to be paid for by diverting aid. In fact aid is already being diverted away from long term development to multilateral creditors on a large scale about – $2 billion annually or 10 per cent of the total aid flow being used for this purpose. As aid budgets decline, debt refinancing will absorb a growing share of a diminishing amount. Others say that multilateral debt reduction would erode the standing of the World Bank in the international bond markets where it raises finance forcing to raise interest rates and raise the cost of borrowing. In the case of the World Bank it is unlikely that markets would react unfavourably to a reduction in outstanding SILIC debt which amounts to less than 3 per cent of its authorised capital. In fact it would be possible to increase additional debt relief resources as suggested by a recent OXFAM report from within the IMF and World Bank without any adverse implications for their financial stability. Cautious use of World Bank reserves and sale of IMF gold stocks could mobilise $13 billion for a debt reduction operation which, as most commercial bankers acknowledge, would barely register on international bond markets. The other argument against multilateral debt reduction is that it will lead to what bankers describe as "moral hazard"- a situation in which debtors fail to behave responsibly in managing their debt. The fact that governments that accumulated their present debts behaved irresponsibly is beyond doubt. But so also is the complicity of western creditors and of multilateral institutions in pouring funds into wasteful projects and corrupt regimes. Indeed the question is who should pay for the mistakes of the past. Morality and ethic demand that it should not be the poor.

A comprehensive solution is needed, since the burden of unpayable dead-weight debt is crippling the efforts of these countries at self improvement.

There is an urgent need to rescue 32 countries with unsustainable debt over a-fifth of which is due to international financial institutions. There are two fundamental concerns, however: first how to fund the IMF's share of the debt relief operation and second how to provide the burden between bilateral donors and international financial institutions. Germany and Japan in particular believe that sales of the IMF's gold would set an undesirable precedent. The more fundamental point is that gold no longer serves a useful monetary purpose and should be used for something more valuable such as proposed debt relief.

The international creditors namely World Bank and IMF have been subjecting the world's poorest countries to a debt strategy moulded solely around the interests of creditors. The result has been destroying the lives of vulnerable communities on a scale that could be only similar to the figures from civil wars and natural calamities. International efforts are needed to end this destruction. Last year, the Halifax summit of the Group of Seven countries called for a comprehensive solution to the debt problems of these countries, and the World Bank task force report acknowledged, for the first time, the need for Northern creditors to reduce their claims. Since then, normal service has resumed. The IMF has ruled out participation in a debt reduction initiative, the World Bank is divided with senior figures endorsing the Fund's view, and Northern governments are indifferent and silent.

The social and economic costs of failure will be very high. There are thirty-two nations classified by the World Bank as severely indebted low-income countries (SILICs), of which 25 of them are in Africa. Together these countries owe their external creditors $210 billion, or some four times more than they did in 1980. Viewed globally, the SILICs debt is the small change of the world total, representing less than 10 per cent of all Third World countries' debt. Measured in terms of ability to pay, however, it presents a massive burden. The average ratio of debt to national income in the SILICs is in excess of 110 per cent. In countries such as Sudan, Zambia, Uganda and Nicaragua, every inhabitant including children owe the equivalent of more than six times their entire annual income.

The external creditors are imposing a huge strain on the most fragile economies. Governments in the sub Saharan region have been transferring in excess of $12 billion annually to western creditors. The sum represents around one quarter of their export earnings. Furthermore, actual repayments represent less than one half of the scheduled payments so that arrears have quadrupled since 1990 to $56 billion.

An international debt reduction strategy could alter this picture. For instance Uganda has one of the world's highest maternal and infant mortality rates. According to the World Bank it costs about $12 per capita to provide the country with a health service capable of eradicating preventable diseases like malaria, measles and respiratory infections, the main killers. The government spends only $3 per head on health, which is considerably less than the $15 each Ugandan pays to external creditors. Similarly Zambia spent over $1.3 billion in debt repayments between 1990 and 1993 or 35 times what was spent on primary education. Repayments to the IMF alone amounted to more than the combined spending of the government on health and primary education. And also child mortality has risen by 20 per cent in the last decade.

It is true that the debt relief would not automatically reach the people and improve their living conditions. Most governments in poor countries would be more likely to spend the resulting benefits in weapons imports or Swiss bank accounts. But a pact in which governments promise that debt reduction would be linked to increased spending on human resource development could help. Debt reduction would also improve the prospects for an investment led recovery and a reduction in aid dependence.

The World Bank is the most influential and powerful institution in the Third World, controlling billions of dollars, state economic and social policies and ultimately millions of lives. Its influence extends well beyond an ordinary bank's financial and economic concern due to its size and influence and considerable political and social leverage. The bank operates as an omnipotent economic institution which practices a creed of faith in the free market. And it is this belief in the free market which is unremittingly imposed on Third World countries. Due to its unique institutional arrangements as backed by member governments particularly the G7, the Bank enjoys a sanctity which makes it even more powerful particularly as it sets itself above the rules which it so rigorously imposes on its creditors. The Bank claims to lend money not so much to make profit but in order to fight poverty and to promote development and environmental protection. However it stands as a central contradiction for the Bank as the principles of the free market are blatantly not designed to alleviate poverty and external debts nor protect the environment. If the bank is really interested in solving these issues it would employ quite different economic and political policies than those of the free market.

In the real world of course the fact is that with all the hectic efforts of devising new instruments of debt relief with the Baker and Brady plans coming and going and with all the negotiations, we are back today with increased amounts of debt. The chief beneficiaries seem to be commercial banks and the world financial system which has been protected and safeguarded rather than SILIC countries.

The substantial write offs may be inevitable as the first step towards the solution of the debt crisis. However in so far as the debt crisis is a reflection of the underlying structural imbalances in the debtor economies, reforms are essential as a second step. Most debtor countries urgently need to move out of poverty, illiteracy and preventable diseases made worse by low economic growth and rising debts. What needs to be stressed here is that this is possible only through the effective reversal of the current strategy, failing which poverty, hunger and indebtedness will persist through the 1990s.

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