A new strategy for the debt crisis

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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 policies in the debtor countries.

However, the total external debt of all Third World countries grew from $751 billion in 1981 and is about $1150 billion. It needs to be noted that the Third World as a group are now more indebted than they were in the 1960s. In 1994, their external debts as a proportion of gross domestic product (GDP) reached 40 per cent. A closer look at the major borrowers reveals 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 ratio 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 1960s 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 30 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 that 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’ (SILICOs) debt repayments or $3.5 billion in 1995. Maintaining these payments is beyond the capability of poor countries. 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 the fact 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 essentially directed towards poverty reduction, $2 comes in the form of non-concessional 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 $5 billion annually or 10 per cent of the total aid flow being used for this purpose. As aid budgets deflate, 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 SILICO 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. Caution about 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 “more hazard” - a situation in which debtors fail to behave responsibly in managing their debt. The fact that governments that accumulated their present debt during the 1970s and early 1980s should pay the faults 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 un sustainable external debt as a result of Liberia war, the end of oil and also the complicity of western creditors and of multilateral institutions in pouring funds into wasteful projects and corrupt regimes. The least that they should do is pay the mistakes of the past. Morality and ethic demand that it should not be the poor.

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 war 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 that any debtors who want to participate in the debt reduction initiative, the World Bank is divided with senior figures endorsing the Fund’s view, that Northern creditors are心目 the principal beneficiaries. Northern creditors 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 (SILICOs), of which 26 of them are in Africa. Together these countries owe their external creditors $121 billion, or some four times more than the debt they owe to the World Bank. The SILICOs account for 20 per cent of the change of the world total, representing less than 10 per cent of all Third World countries’ debt. Measured in terms of ability to pay, these debts represent a much heavier burden. The aggregate ratio of debt to national income in the SILICOs 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 already fragile economies. Governments in the sub-Saharan region have been transferring in excess of $12 billion annually to western creditors. The sum represents about 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 health services capable of eradicating preventable diseases like malaria, measles and respiratory infections, the main killers. The government spends only $2 per head on health, which is considerably less than the $12 each Ugandan pays to external creditors. Similarly Zambia spent over $1.3 billion in debt repayments between 1990 and 1992 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.

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 past 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. In many cases, as successfully as being backed by member governments particularly the G7, the Bank enjoys a sanctity which makes it even more powerful and powerful as it sets itself above the rules which it supposedly 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 and external contradiction for the Bank as the principles of the free market are blatantly not designed to alleviate poverty and external debt 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 heroic 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 exactly the same problem. The social and economic costs of failure will be very high.

The substantial write offs are inevitable, as the first steps towards the solution of the debt crisis. However, in so doing, the vast majority of the underwriting structural imbalances in the debtor economies, reforms are essential as a second step. Most debtor countries urgently need to move out of poverty. Efforts to reduce poverty and external debt made worse by lower 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, falling which poverty, hunger and indebtedness will persist through the 1990s.


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