



Frequent arguments against the participation of multilateral development banks in debt relief

An analysis and response

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Frequent arguments against the participation of multilateral development banks in debt relief – an analysis and response

by Jürgen Kaiser

1. Introduction

Since April 2020, the members of the G20 and the Paris Club have granted up to 73 of the poorest countries a debt moratorium aimed at creating fiscal scope to facilitate combating the COVID-19 pandemic. Since November 2020, a debate has been ongoing over whether to grant real debt relief under the Common Framework for Debt Treatments beyond the DSSI - extending over and above the moratorium provided under the Debt Service Suspension Initiative (DSSI). One of the decisive questions over the future of such debt relief is whether all creditors, and not just the few that are willing, will join in such a move.

In this context, one vital group alongside the private creditors who, to date, have not been compelled to participate, consists of the multilateral financial institutions. In debt relief workout mechanisms so far, these institutions have claimed so-called 'Preferred Creditor Status'. On this basis, they are demanding preferential servicing of their claims and thus exclusion from debt restructuring arrangements. However, civil society in both creditor and debtor countries argues that, with any debt restructuring arrangement, not just a few but indeed all creditors must be included.

This is being met with objections from the multilateral development banks primarily on the grounds that their financial integrity is ultimately in the interests of potential sovereign recipients of debt relief, since the latter are dependent on secure financing at favourable interest rates for as long as they are not able to obtain finance at acceptable terms on the private capital markets. The following analysis initially considers in more detail the particular characteristics of multilateral creditors as a whole. We shall then look into the question of how cogent the argumentation in favour of excluding this group from debt relief actually is.

2. Who are the 'multilateral creditors'?

With cross-border lending, a distinction is made between bilateral and multilateral donors/creditors. The former include firstly public institutions consisting principally of governments, and secondly private lenders, among which are banks and investment funds, or individual investors in government bonds. In multilateral institutions, a number of exclusively public donors/creditors work together.

However, when it comes to determining the extent of entitlement to exceptional status in a crisis, the definition of a multilateral financial institution is astonishingly vague. Under international law, there exists no binding definition at all. In addition to the International Monetary Fund (IMF), Wikipedia adds twelve multilateral development banks, including the Asian Development Bank (ADB), the Corporación Andina de Fomento (CAF) and the African Development Bank (AfDB). Seven further institutions consist of sub-regional development banks, such as the Caribbean Development Bank (CDB), the Central American Bank for Economic Integration (CABEI) and the East African Development Bank (EADB). Finally, nine additional regional or global institutions claim the same status; these include the International Fund for Agricultural Development (IFAD), Nordic Investment Bank (NIB) and the International Investment Bank (IIB).¹

¹ For an overview, see Wikipedia: 'International financial institutions', https://en.wikipedia.org/wiki/International_financial_institutions (most recently referenced on 14.06.2021).

The International Monetary Fund is not included in this analysis. Its mandate as a provider of bailout finance to countries with balance-of-payments difficulties differs from that of the development banks, and there are varying views on whether its credit instruments are to be understood at all as ordinary loans. This does not mean that the special creditor status which it too claims is necessarily unproblematical. However, discussion on the IMF's entitlement is fundamentally different from the discussion surrounding the development banks, which will be explored in detail below.

The various development banks have differing origins. Whereas the best-known – the World Bank Group with its total of five organizations, as well as the IMF – date back to the Bretton Woods Conference, aimed at creating a new order for the global economy at the end of the Second World War, the other development banks mostly arose during the course of the decolonization process from the late 1950s onwards, in the context of which the question also arose of development financing and thus the business model of the banks funded by development aid and capital market funds.

The formation of new institutions has continued until the very recent past, frequently with a specific political objective, as in the case of Bank of the South ('*Banco del Sur*'). This institution was established in the mid 2000s by a number of progressive Latin-American governments with the aim of enabling greater independence from the traditional development banks, which are typically characterized by powerful influence on the part of their northern members.

Specifically in view of the particular status of the multilateral financial institutions in the HIPC and MDRI Initiatives² in around 2000, the World Bank and the IMF attempted to counter claims by an excessive number of such creditors by creating a further category, namely the 'plurilaterals'. Washington's express wish is to avoid granting the elevated status of a traditional multilateral to such institutions which, in Washington's view, also include the Bank of the South as well as those which, in formal terms, have only have two or three members and that should therefore be characterized more as bilateral than multilateral.

However, such a distinction is difficult to maintain in logical terms. Ultimately, all institutions rely on public funds, either from the reserves of states in the South or from the development aid budgets of richer countries, and they supplement these through funds which they are able to raise at relatively favourable terms on the capital markets. The only truly exceptional institution is the IMF, which works exclusively with reserves from the central banks, though supplemented by donations to its special funds.

3. What quantitative significance do multilateral development banks have as creditors?

At the end of 2019, just under USD 700 billion in external debt of all developing countries and emerging economies listed in the World Bank's statistical records was owed to multilateral development banks. This represents only a comparably small proportion of total external debt, which amounts to c. USD 8.1 trillion. Moreover, the multilateral proportion is growing less rapidly than bilateral debt, i.e. multilateral debt is tending to decline in significance.

However, the importance of multilateral creditors differs substantially as between different groups of countries. While the claims of multilateral creditors against all developing countries and emerging economies make up only around 8.5% of all debt, in the case of low-income countries, this figure is a massive 34.7%. The multilateral claims on all countries participating in the DSSI are on a similar scale; however, in the case of a few countries, such as Cape Verde, the total may be up to 50%. If, from the outset, these debts are excluded from instruments such as the DSSI and the Common Framework, this substantially impairs their efficacy and accordingly imposes

² Re: the Heavily Indebted Poor Countries Initiative (HIPC) Multilateral Debt Relief Initiative (MDRI), see also [erlassjahr.de: Debt Relief Initiatives, https://erlassjahr.de/themen/entschuldungsinitiativen-hipcmdri/](https://erlassjahr.de/themen/entschuldungsinitiativen-hipcmdri/).

higher burdens on other creditors whose willingness to provide relief to a sufficient degree is in fact essential for the success of the operation.

4. Have the multilaterals actually ever granted 'true' debt relief?

Real debt relief for overindebted countries, negotiated between a debtor and its creditors, is a relatively new phenomenon. In relation to bilateral creditors, it has only existed since 1989. Until 1996, despite the ever more acute debt crisis in many countries, multilateral creditors refused to participate in debt relief, arguing on virtually the same grounds as those seeking to justify their refusal today to participate in debt relief aimed at combating the consequences of COVID-19. Since they were supported in this argumentation by their most important members from the richest countries (G7/G8), they succeeded in having their way. This situation did not change until 1996, when it became ever more apparent that multilateral debt was becoming more and more of a burden on poorer countries, with bilateral debt being increasingly cancelled, and private and public bilateral creditors scarcely providing any more new loans. It was in this year that the Heavily Indebted Poor Countries Initiative (HIPC) was launched. Initially only on a very limited basis but subsequently through various extensions and additions - most recently the Multilateral Debt Relief Initiative (MDRI) in 2005 – this Initiative enabled cancellation of almost all legacy debts owed by the participating countries, ultimately numbering 39.

However, by setting up trust funds nurtured from the development aid budgets of their wealthy members, the multilateral development banks succeeded in avoiding real losses to some extent, with the result that the poorer countries ultimately had to pay part of their debts themselves. It must be said, however, that the corresponding trust funds were also partially endowed with profits of the World Bank, and in so far as this occurred, it could be described as true multilateral relief. Yet the trust funds endowed with development aid funds only supported the major development banks of the World Bank Group, the Inter-American Development Bank and the African Development Bank. All the smaller multilateral institutions had to bear their own losses arising from unavoidable debt relief. One of the longer-term effects of this is that eight (less prominent) multilateral institutions have to date still not joined in the debt relief granted under the HIPC, which was actually intended to be borne by all.³

Since the onset of the coronavirus crisis, of all the multilateral institutions, only the IMF has already organized its own debt relief for a very limited sphere of countries, namely within the framework of its Catastrophe Containment and Relief Trust (CCRT).⁴ The multilateral development banks, which are the subject of this paper, have so far consistently refused to participate.

5. What particular qualitative features characterize the multilateral creditors?

Unlike private banks, multilateral development banks do not exist in order to make profits, or at least not to make profits for their members. Rather, they exist to provide development finance, and the aim is for their funds to be invested as widely as possible in key areas of public infrastructure and growth generation.

Even though a small number, such as the World Bank's member organization, the International Development Association (IDA), operate as cooperatives, even these function de facto as public limited companies. This means that voting rights are based on paid up quotas. In the case of the smaller institutions, their members have considerable freedom when deciding how much to pay into the institution in question, and how many voting

³ See IMF (2019): Policy Paper 'Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) - Statistical Update', p. 32, Table AIII5, <https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/08/06/Heavily-Indebted-Poor-Countries-HIPC-Initiative-and-Multilateral-Debt-Relief-Initiative-MDRI-48566>, most recently referenced on 14.06.2021.

⁴ Re: the CCRT, see also IMF Factsheet: <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/49/Catastrophe-Containment-and-Relief-Trust> (most recently updated on 9 April 2021, referenced on 14.06.2021).

rights to take up in return. On the other hand, with the World Bank and the IMF, quotas are fixed according to a complicated formula.⁵

In principle, collective sponsorship by several states makes even smaller institutions more crisis-resistant than they would be if they were backed by just a single government. In the case of the major institutions, an added factor is that they are able to take advantage of the top ratings of their wealthier members and, as a result, can accordingly obtain loans at favourable interest rates on the capital markets.

Originally, only the IMF was conceived as having the role of 'lender of last resort', i.e. an institution that would be ready to support countries in crisis with loans at favourable terms even under circumstances where no one else would any longer do so, given that the outlook for the country in question was already too negative. However, during the so-called 'Third World Debt Crisis' in the 1980s and 1990s, even the World Bank and major regional development banks increasingly evolved from being development banks to becoming de facto bailout providers. Over the course of the crisis, the greater volume of funds at their disposal as compared with the IMF increasingly served to allow overindebted countries to keep their heads above water in terms of fiscal capacity, until ultimately even multilateral debts could no longer be serviced.

It was particularly based on this role that the Washington institutions of the World Bank and the IMF derived their claim to the status they themselves refer to as 'Preferred Creditor Status'. This means they claim entitlement to receive interest and loan repayments from a state even if it has already been obliged to suspend payments to all other creditors. 'Preferred Status' therefore in reality means 'exempt' status, i.e. the World Bank and the International Monetary Fund view themselves – at least in their role as creditors – as being situated outside any debt restructuring negotiations.

This principle was set aside for the first time in the HIPC/MDRI Initiative, which began in 1996 and is still operational today in a small number of countries. Despite the fact that, with the HIPC/MDRI, participation in debt restructuring was both imperative and feasible, today, however, the institutions are again insisting on being accorded pre-HIPC status, i.e. basic immunity from all types of debt relief. We will examine below the arguments put forward aimed at justifying this status.⁶

⁵ Here, not only is current economic output used as a basis, but also a more complex valuation applying the respectively most recent quota reform (2020). For this reason, China, for instance, at 6.6%, still has a share of voting rights far below its share in global economic output.

⁶ See, for example, World Bank (2021): Factsheet 'Debt Service Suspension and COVID-19', <https://www.worldbank.org/en/news/factsheet/2020/05/11/debt-relief-and-covid-19-coronavirus>, most recently referenced on 14.06.2021.

6. Arguments in favour of multilateral creditors not participating in debt relief – and analysis by erlassjahr.de

Argument 1: *The heads of the World Bank and IMF have repeatedly spoken out in favour of debt relief, so what is the problem?*

This is indeed the case. Recently, World Bank President David Malpass has repeatedly spoken out in favour of debt relief⁷ – to be granted by other parties, but not his own institution. Other multilateral institutions are simply holding back with their views, preferring to take cover behind the World Bank in the expectation that the biggest institution will defend the exceptional status of them all.

The World Bank primarily argues on the basis of the high dependency of a number of countries on the IDA. If IDA funds were curtailed, there would also be less funding available for those countries dependent on them. Viewed overall, however, this is a zero-sum game, if keeping money in the Global South purportedly leads to less money being available for the Global South. Why a new loan from the IDA or other institution should automatically lead to a better allocation of scarce resources than debt relief granted to countries in very real payment difficulties, is something which no one from the institutions has yet been able to explain.

This analysis of financing flows moreover overlooks the fact that, in countries where the volume of multilateral debt is particularly substantial, disregarding this substantial debt portion may render a debt restructuring arrangement negotiated with bilateral creditors completely ineffective, either because even the biggest concession by the remaining creditors within the process could not suffice to achieve a sustainable level of debt, or because those creditors willing to grant debt relief are expected to grant such an extensive waiver that they too are no longer willing to participate. In 1996 and thereafter, it was precisely this development that led to the creation and continued expansion of the HIPC Initiative.

Argument 2: *A reduction in the debts of multilateral creditors would, in the absence of full compensation by their bilateral members, lead to lower ratings. As a result, they would no longer be in a position to lend to developing countries at favourable rates.*

No empirical evidence of such an assertion has ever been provided. On the contrary, it is merely observable that the only partially compensated participation in debt relief by the World Bank and other major development banks under the HIPC/MDRI Initiative had no impact whatsoever on their triple-A ratings. Only once, in 1995, did the African Development Bank lose its AAA rating for several years, but this was on grounds of internal mismanagement.

Indeed, on the contrary, there is much evidence to suggest that any repayment defaults, particularly on the part of smaller and poorer members such as the HIPC states, have no impact whatsoever on ratings and hence an institution's capital costs. When deciding whether to invest cash with a multilateral institution, investors surely focus more on whether they have confidence in the guarantee provided by its wealthy AAA-rated constituent members in being able to maintain the institution's solvency under all circumstances. And, in turn, such solvency cannot be impaired if the institution participates in debt relief initiated by precisely those same wealthy members in the form of the G7/G8 or G20.

⁷ See, for example, ZDF (05.10.2020): 'Weltbank-Chef fordert Schuldenerlass' ['World Bank chief calls for debt relief'], <https://www.zdf.de/nachrichten/wirtschaft/weltbank-malpass-schuldenerlass-corona-100.html> or Reuters (13.01.2021): 'World Bank's Malpass hammers private sector to back debt reduction push', <https://www.reuters.com/article/us-worldbank-economy-idUSKBN29I2CF>, most recently referenced on 14.06.2021.

Argument 3: *Calls for debt relief to be granted by the IDA, part of the World Bank Group, ignore the fact that the IDA is already reducing the debt burden of critically-indebted developing countries through its favourable credit facilities and is thereby providing greater fiscal relief than other creditors.*

This is factually wrong. The question of whether the IDA, an institution like the World Bank, a very favourable credit provider, should participate in debt relief, is not impacted at all by the question of interest rates, grace years and repayment deadlines, i.e. everything which makes IDA loans so favourable. When it comes to the question of how much relief the IDA should grant, for example, compared with other creditors, the concessions which it grants are already taken into account. This was observable, for example, when HIPC relief was calculated and apportioned across the different creditors. Indeed, it operates in accordance with the present value principle; it is not the absolute debts owed by a debtor that are used as a basis, but all outstanding payments on the outstanding loan, discounted to the date debt relief is granted. This means that a claim by the IDA totalling USD 1 million at 0.5% interest, repayable over a 40-year outstanding term with a five-year outstanding grace period, is included in relief calculations at a far lower value than a commercial bank claim also totalling USD 1 million at 8%, repayable in full over the next three years. Accordingly, the commercial bank's million will be far more significantly reduced than the IDA's million.

Argument 4: *An IDA loan is significantly more beneficial to development than expensive commercial borrowing on which countries are otherwise dependent. The concessions which the multilaterals grant when lending must be honoured, otherwise the wrong incentives are created.*

Calculation of the debt relief required of each individual creditor using the present value method (see above) does indeed enable recognition of the particularly low-interest financing provided by the IDA and others. As regards the qualitative aspect of development-friendliness, it is likely to be difficult to categorize private or public financing in general terms as consistently more or less favourable to development.

However, over and above the present value method, it is entirely possible to envisage honouring the provision of fresh cash on the part of individual creditors within an ongoing debt restructuring process with the aim of maintaining a debtor's solvency in a critical phase. This could be achieved, for instance, through markdowns on the so-called haircut⁸ - similar to the facility already provided by the Paris Club enabling those creditors to be included that are prevented from granting straightforward debt waivers due to legal issues.⁹

Argument 5: *Unlike other public creditors, the multilateral development banks do not collect any taxes that could be used to finance their debt waivers.*

This is factually wrong. It is simply the case that they do not themselves collect taxes, but instead, they do so via their wealthy members. The funds they receive, for instance, from the German and other governments, are taxpayer funds. For debt restructuring, this means that, provided there exists the political will on the part of the wealthy members, in theory the multilateral institutions can declare unlimited debt waivers if required in order to restore the economic viability of a debtor country, without their own economic agency being impaired in the process.

However, any debt write-off naturally weakens the standing of the institution itself in relation to its important wealthy members, since it raises the question of whether the institution's management possibly granted

⁸ The somewhat metaphorical term 'haircut' refers in international debt management to the (enforced) waiver by a creditor of part of their claims.

⁹ For instance, the Paris Club created the opportunity for the Japanese government, which for a long time was prohibited by the country's constitution from cancelling debts, to provide equivalent benefits in the form of new grant funding.

financing which might better have been withheld. Were loans perhaps given because one of the institution's key members had particularly friendly ties with the unreliable government of a debtor country? Did financing of a project serve to secure a good private-sector business deal for one of the institution's key members? Did those in charge at the development bank rubber-stamp a financing arrangement despite the borrower's debt sustainability status already being critical, all because maximizing the bank's lending portfolio would lead to both material and immaterial recognition?

Argument 6: *Among the members of the G20, inclusion of the multilateral institutions is not being advocated at all, other than by China – based on a transparent interest arising from the fact that, as the largest bilateral creditor, it would itself have to waive fewer debts if other major creditors also made their contribution.*

It is not the first time that deliberations on issues of fundamental principle and those of everyday policymaking coincide. This is not a circumstance invented by China, which incidentally bears more than half of the foreseeable debt relief under the DSSI (an unprecedented share not matched by a single individual creditor globally under the HIPC initiative). One example, specifically related to multilateral debt relief, is for instance modification of the initial HIPC access criteria in 1996, after France had complained that, based on the initial criteria and thresholds under the Initiative, far more Anglophone than Francophone African countries were granted relief. The question of which creditor is currently pursuing which political interests should not form an argument against doing and demanding what is basically right.

Argument 7: *If debt relief is granted, the danger is that such funds will retrospectively be squandered by regimes, some of which are very questionable. If instead, as planned, repayments were made to the IDA, the IDA could then subsequently provide loans at favourable interest rates to development-friendly governments.*

Interestingly, anyone who argues on this basis assumes that debt relief – additionally, and indeed specifically - potentially benefits questionable regimes, whereas after completed repayment to the IDA, the IDA will provide the same funds - always and exclusively - in the form of finance to development-friendly governments. This raises the question of how indeed questionable governments obtain IDA loans if the IDA in principle only provides finance on a development-friendly basis?

In reality, both debt relief and new financing by the multilateral financial institutions may reward the 'wrong' recipients. Only, the fact is that the abuse of development funds to restore debt sustainability has far more frequently created the wrong incentives than the few frameworks for debt resolution implemented more recently could have done. Both lending decisions and the granting of debt relief demand an extreme careful analysis of a debtor's circumstances and, as appropriate, the imposition of conditions such as the creation of transparency and participation by civil society. It is categorically incorrect to assert that a fresh dollar handed out by the IDA is automatically more supportive of development than a dollar saved by the same country in debt service payments.

Argument 8: *If the IDA and the other institutions function in the same manner as a credit cooperative under universal ownership, then everyone should have the utmost interest in their loan repayments not being curtailed. Indeed, for the same reason, the multilateral development banks also have the utmost interest in the most prudent possible lending.*

In fact, the World Bank advocates ever better and ever more sophisticated processes in order to prevent inappropriate lending. Certainly, there can be no objection to this. Yet the best processes and controls cannot prevent a country from ending up in a payment crisis nonetheless. However sensible it is for multilateral loans to be minutely scrutinized before being allowed to increase a country's debt mountain, such controls still do not eliminate the possibility of sovereign default, not least as a result of external shocks such as the coronavirus

pandemic or climate disasters. On the other hand, the link between lending decisions and risk assumption is broken by 'exempt status', since a vital incentive to engage in responsible lending is absent if a lender can rely, without scrutiny, on their claims always being serviced, if necessary through the withdrawal of other creditors or at the cost of the population of the debtor country.

7. Conclusion

The arguments used to justify the non-participation of multilateral creditors in debt relief are not convincing. Not only can they be refuted, but they also reveal how much the question of participation or non-participation quite simply depends on the political will of the actors involved. In view of the significance of multilateral debt particularly for low-income countries, from the perspective of the debt-relief movement, in any event the wholesale negative response from the multilaterals cannot be accepted. In order to reduce the debt levels of critically-indebted states to a sustainable level, and so as not to condemn initiatives such as the G20's Common Framework to failure so soon after launch, for this reason political action should be taken not only to compel the inclusion of the private sector in debt relief, but also to secure the participation of multilateral creditors.