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The IMF's untimely call for urgent debt cancellation

Michel-Henry Bouchet-May 2022[1]

1. Here it goes again ! At their Spring 2022 meeting, both the IMF and the World Bank called for urgent and large debt reduction for developing countries through more efficient coordination among creditors. The IMF's objective is restoring debt sustainability with either time, debt cancelation, or new money, i.e., with debt re-profiling or an outright restructuring of public debt. The IMF has identified roughly 30 countries at « high risk of debt distress ». With large domestic and external deficits, developing countries have taken advantage of low interest rates, search for yield by investors, and buyoant global liquidity until 2021, to increase domestic and external indebtedeness. It is not surprising, thus, that tighter monetary policy in OECD's central banks and rising risk aversion now place severe strains on debt sustainability in many countries. According to the IMF, debt vulnerabilities are rising in both low and middle-income countries. Debt is at a 50-year high – equal to roughly 250 percent of government revenues. Around 60 percent of the world's poorest countries are now in debt distress or at high risk of it. The war in Ukraine with its negative impacts on export earnings, rising prices and lower trade volumes worsens this already somber panorama.

2. **The IMF's debt reduction toolkit : « One size fits all ».** The IMF introduced a new framework beyond COVID-related initiatives such as the G20 Debt Service Suspension Initiative. The Common Framework for debt treatments is intended to deal with insolvency and protracted liquidity problems for 73 low income countries, along with the implementation of an IMF-supported reform program. The IMF demanded that the Common Framework that offers guidance for debt restructuring be improved urgently, coupled with the enforcement of the comparability of treatment among creditors[1]. The key issue is mobilizing support from private creditors, mainly bondholders, whether they like it or not. Importantly, the IMF demands that debt service payments and penalty interest be suspended until an agreement is reached. [2] This call for generous debt cancellation faces two major obstacles.

The first pitfall is that the global financial architecture has evolved since the debt restructuring saga of the 1980s and 90s. Today, international banks have moderate exposure on developing countries while enjoying large loan-losses on risky countries in debt distress. The composition of creditors has shifted with a rising share of non-Paris Club creditors. Larger Chinese loans are a matter of concern for implementing balanced debt-reduction schemes. The lending terms are characterized by much opacity, they are often linked with tied-aid, without questions asked on governance, and the loans are secured with collateral in case of default, hence a de-facto subordination of other creditors. In addition, a growing pool of private bondholders and investment funds shows little appetite for debt restructuring. They are well equiped for fighting in courts while resisting so-called « hair cuts » and write-offs for countries that show enduring bad governance.

The second and more crucial problem is that**, f**or the vast majority of these countries, debt crises are often home-made, hence stemming from a mix of low productivity of

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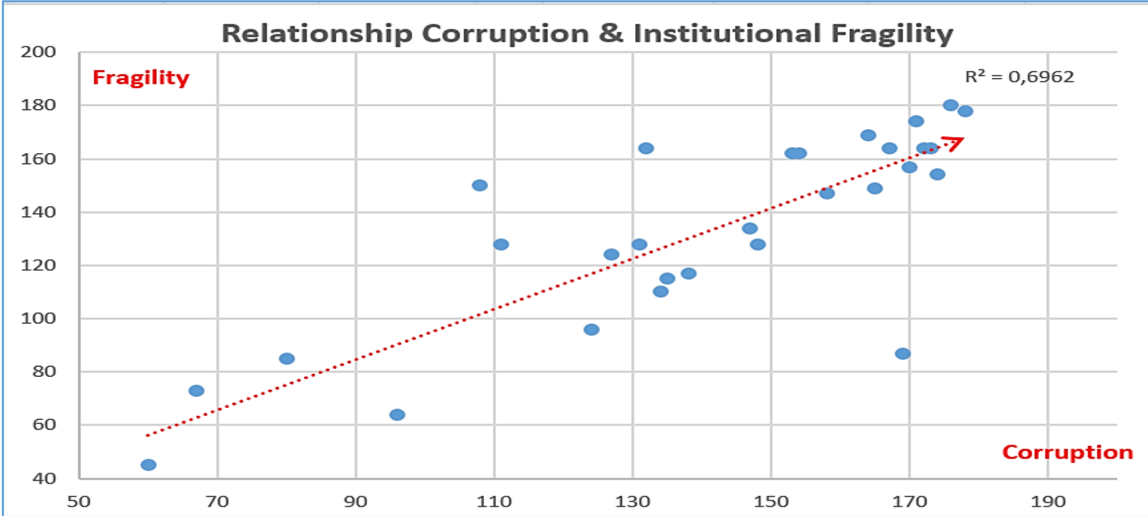
investment, bad prioritization of spending, poorly designed fiscal and monetary policies, exchange rate mismanagement, and capital flight. In addition, nearly all exemplify a combustible combination of bad governance, unabated corruption, authoritarian regimes, and institutional deficiencies. Stubborn corruption casts strong doubts on the legitimacy of these candidates for debt cancellation operations, as well on the actual benefits for the poorer of the poor. Since the late 1990s, the IMF and the World Bank have gradually opened their eyes regarding corruption and bad governance in developing countries. Today, they acknowledge that numerous countries, particularly in Sub-Saharan Africa, generate protracted socio-political turmoil, that impede buyoant investment and sustainable growth. The region has experienced an increase in the prevalence of political instability and military coups in recent years, with armed conflicts and terrorist threats[3].

In these countries, corruption is closely associated with a large economic cost of violence. Measured as a ratio of GDP, that cost for 20 countries reaches more than 5% and up to 50%. The reason for that substantial violence cost is multifaceted, including authoritarian and repressive regimes, low economic and political freedom, and large institutional deficiencies. The following chart illustrates the strong relationship Corruption/Institutional Fragility for 26 developing countries elegible for debt reduction.



Overall, in countries with very weak institutions, the lack of transmission channels to express social demands for inclusive growth and human rights leads to a vicious circle of violence and repression. This is particulary true in Cameroon, Mozambique, Zimbabwe, Haiti, Zambia, Angola, Mauritania, Sudan, Ethiopia, Kenya, Nicaragua, Lao, Chad, Congo, Somalia, Burundi, and Malawi, among others. Many of these countries are close to state failure, and poverty is growing while life expectancy is shrinking. In these countries with low development score and high corruption ranking, a good deal of past borrowing has been recycled in offshore banking accounts, without benefiting domestic investment, nor economic growth, nor reduced poverty! The ratio to GDP of expatriated private savings that are deposited in international banks is above 5% for ten countries that are eligible for debt reduction, and stands in a 2-4% range for another 16 countries.

3. **Conclusion** : **Toward discouraging institutionalized kleptocracy** ? Overall, it makes little sense to reduce external indebtedness of countries that show little improvement in their governance trajectories. They are all in the worse rankings of human development, democracy, political freedom, and institutional stability. Poverty in nominal GDP terms should

never be a necessary nor sufficient criteria for debt reduction eligibility. Most of these countries are rich though with poor people. Often, mining and hydrocarbon-driven growth has been fertile soil for a two-fold power concentration, namely, economic and political. They have enjoyed robust economic growth without paving the way for sustainable and inclusive development. The latter means GDP growth coupled with those inputs that make it lasting, that is, governance, education, health, shrinking wealth gaps, robust institutions, and property rights, *inter alii*.[4]

Debt reduction as called for by the IMF is a perfect exemple of moral hazard. Without a strict governance enforcement framework, Paris Club and IFIs-supported external debt cancellation will only keep encouraging institutionalized kleptocracy. With or without debt reduction, the local governments are so corrupt that their unabated commitment is toward maintaining power monopoly. The international civil servants working at the IMF, the World Bank, and the numerous regional development banks should shift their priorities toward funding closely monitored development projects, together with on the field NGOs, to make sure that fertilizers, seed-system development, irrigation, education and health programs, directly contribute to improving local populations' well-being.

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[1] IMF, April 19, 2022 : « Transcript of April 2022 World Economic Outlook Press Briefing »

[2] Remarks by World Bank Group President D. Malpass to G20 Finance Ministers and Central Bank Governors at the 2022 Spring Meetings, April 20, 2022.

[3] IMF, April 2022 : « Regional Economic Outlook : Sub-Saharan Africa. A New Shock and Little Room to Maneuver ».

[4] www.developingfinance.org Globak Risk Management and Governance seminars May 2022.