Opinion **beyondbrics**

Multilateral development banks are part of the problem

The lending supplied by the bankers of the poor is in conflict with their mission

The leone's devaluation over the past three years has doubled the local value of Sierra Leone's dollar debt © ISSOUF SANOGO/AFP/Getty Images

Ruurd Brouwer 5 HOURS AGO

The number of poor countries in risk of debt default is increasing rapidly. In sub-Saharan Africa alone, nearly half of all countries are either in debt distress or at high risk of falling into it, according to the World Bank.

In response, the World Bank and IMF developed a debt sustainability framework for low-income countries, to support borrowers and lenders and minimise the risk of debt distress. It was first launched in April 2005; its latest iteration has been in operation since July 2018.

The framework shows that the Bretton Woods institutions are indispensable as advisers to the poorest countries. But as lenders, they and the other multilateral financial institutions, such as the African and Asian Development Banks, are part of the problem. They should improve debt sustainability by lending in local currencies rather than in US dollars.

A prerequisite for debt sustainability is debt predictability. The multilateral institutions offer primarily hard-currency loans. This makes debt service unpredictable in the borrower's home currency, the currency in which they raise the taxes needed to repay their debt. For example, the 50 per cent depreciation of Sierra Leone's leone over the past three years has doubled the local currency value of the country's dollar debt stock — 76 per cent of which is owed to multilateral creditors, according to the finance ministry.

A switch to local currencies would have other advantages for debt sustainability. At present, multilateral lenders apply a “one size fits all” dollar product to low-income countries, typically 30-year soft loans with low or zero per cent fixed interest rates. Such a loan is stripped of the economic incentives that reward doing the right thing, so that after the government of Rwanda implemented painful measures to curb inflation and get a grip on government finances, the terms of its borrowing from the multilateral institutions remained unchanged. Lending in local currency using local interest rates would reinstate the relationship between sound economic policies and a lower cost of borrowing, improving long-term debt sustainability.

The multilateral institutions pursue stability in the international financial system and the end of poverty. Economic stability in the poorest countries is a prerequisite for this. Yet the loans provided by multilateral lenders conflict with their mission, as long-term hard currency loans push currency risk to the poorest countries that are least able to manage it. The poorest countries are especially vulnerable to external shocks, as they lack financial reserves and are often dependent on exports of a single commodity. The resulting and frequent currency depreciations force these countries into crisis management mode, distracting from much-needed long-term planning and undermining government finances.

With an increasingly unpredictable global environment, trade tensions and significant swings in commodity prices, there is a need to support low income countries in bolstering their economic resilience. An important first step would be to give them a choice between hard currency and local currency loans, using their own interest rates. Local currency loans should not be cheaper, but they would allow borrowers to engage in longer-term financial planning, making the soundness of government finances less a function of international currency volatility.

The new World Bank IMF debt sustainability framework contributes to this. It includes a stress test to measure the harmful effects of currency depreciations on the debt burden of the poorest countries. It does not include an analysis of the source of such stress, as this would point to the main bankers of the poorest countries, the multilateral development banks.

As the World Bank and the IMF gather in Washington next week for their annual meetings, they must show a strong willingness to improve lending practices. After all, the majority owners of the multilateral institutions, western governments, are represented by their ministers of finance and central bank governors. These are the officials charged with protecting their home economies from currency risk. They would never fund their own national deficit in a currency other than the one in which they receive taxes. The risk to economic stability would be unmanageable and unacceptable to them. Who is better positioned to apply the same, sound macroeconomic principles to lending to the poorest countries?

Ruurd Brouwer is chief executive of the Currency Exchange Fund.

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