The West Needs a More Nuanced Approach with Lending

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Tridivesh Singh Maini

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World Bank headquarters in DC.

As a result of increased proximity between developing countries with China in recent years, there has been increasing distrust of the International Monetary Fund and the World Bank.

While it is true that the International Monetary Fund and the World Bank are in dire need of reform, it is important to bear in mind that China's economic ties with developing countries involved in the Belt and Road Initiative could best be described as one-sided. In turning to China, many developing countries take on unsustainable economic debt. This is often referred to as 'debt-trap diplomacy.' This debt eventually leads to China indirectly arm-twisting many countries.

While Western institutions are often criticized for linking assistance to stringent loan conditionalities, China's attempts to use its economic leverage for increasing political and strategic clout can best be seen in some countries severing ties with Taiwan. As far as infrastructure projects are concerned, a good example is the Hambantota Project which was handed over to China in 2017 because Sri Lanka was unable to pay back the Chinese loans it had taken out.

While the IMF and the World Bank justifiably draw criticism for the nature of their assistance programs, the Chinese model of engagement is often given a free pass.

One of the outcomes of this anti-Western sentiment is that some countries will shun institutions like the IMF despite dire economic conditions. As Sri Lanka's economy was worsening, it refused to seek assistance from the IMF. In April, former President Gotabaya Rajapaksa admitted that not seeking assistance from the IMF was a mistake. "It was a mistake not to go."

Nandalal Weerasinghe, the head of Sri Lanka's central bank, while commenting on Sri Lanka's delay in seeking IMF assistance said: "If we had taken the decision to go to the IMF earlier, if we started the debt resettlement process one year before, we could have managed the situation without this kind of suffering."

In June, an IMF team visited Sri Lanka and issued a statement that it had constructive discussions with the government and that it would provide a comprehensive package.

While addressing parliament, President Ranil Wickremesinghe said that Sri Lanka was left with no option but to go to the IMF and that the country needed to make tough decisions. He urged lawmakers to join hands towards forming an all-party government, to deal with the current economic crisis.

Pakistan, whose economy is also in the doldrums, signed an agreement with the IMF in 2019, under the Extended Fund Facility (EFF) program. While talks had broken down due to political instability in April, the government resumed talks with the IMF in May, and it has been compelled to take some tough measures – including the removal of subsidies on fuel, and higher rates of taxations for businesses and individuals. Pakistan has limited options, and countries like China and Saudi Arabia had also made assistance subject to Pakistan re-entering talks with the IMF.

Miftah Ismail, Pakistan's finance minister, has repeatedly stated that tough decisions were needed to put the economy back on track, while opposition leaders, as well as members of the coalition, have not been particularly happy with what they feel is kowtowing to the IMF. Some members of the ruling coalition even admitted that there was no option but to go for an IMF-dictated budget given the state of the economy. It would be pertinent to point out that the ruling party fared poorly in elections in Punjab Province due to economic decisions taken by the government.

In contrast to Sri Lanka, Bangladesh was quick to go to the IMF after seeing a dip in its Foreign Exchange Reserves. Bangladesh has been one of the most important growth engines for South Asia. It would be pertinent to point out that the decision to raise fuel prices by over 50% last week came in for criticism not just from opposition parties, but also led to protests. Removal of energy subsidies and the introduction of a fuel pricing mechanism in sync with global markets had been recommended by the IMF.

It is important for developing countries to not get swayed by either Chinese propaganda or be coerced by the IMF or the World Bank. It is also important for the U.S. and Western institutions to provide feasible alternatives to developing countries rather than just criticizing China's economic model.