Africa's Debt Burden

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It is all too clear that today, Africa's external debt burden has grown so heavy and become so intractable that, realistically, there is little hope for significant social and economic advancement on the continent unless meaningful and effective measures are urgently put in place to alleviate it. As the African Common Position correctly recognises, the problem of external indebtedness is a major manifestation of the economic distress and social retrogression that have characterised the continent in the present decade and which continues with worrisome severity. As this situation has persisted, it has become increasingly evident that only sustained measures taken to stimulate economic growth can effectively resolve the formidable problems linked to external indebtedness which confront the region. It is my sincere hope that in contributing to the continuing dialogue on this issue, this seminar will move us significantly closer to the solution to which we all aspire and which Africa demands of us.

The economic and social conditions in Africa continue to be a cause of great concern to all of us. Throughout this decade. low or declining rates of output growth, combined with high rates of population growth, have resulted in falling levels of per capita output in areas such as food production; and simultaneously, to a rapid and alarming deterioration of the environment. Declining export earnings, due mainly to unfavourable movements in the terms of trade, have led to a severe compression of imports in many countries and the curtailment or suspension of a wide range of social services, including especially health and education expenditures. Balance of payments deficits, in many cases financed through external borrowings, have widened, as export revenues have failed to rebound after what initially seemed to be a temporary shortfall. As a result, Africa's current account deficit in the present decade has, on average, been some 9% of its GDP, conspicuously higher than that of any other region. And, the strains on the region's external accounts have been exacerbated by reduced capital flows, which have fallen from as high as US$20 billion annually in the early years of the decade to about US$12 billion on average after the mid-1980s.

One critical reflection of these developments is the sharp rise in the region's total external debt to an estimated US$230 billion at the end of 1988 compared to less than half that amount in the early 1980s. While it could be argued that the current level of debt appears modest in relation to that of developing countries as a whole and even more so when only commercial debt is considered, the severity of the burden is most objectively seen in the light of the very small production base and low capacity of many African countries to meet their debt service obligations, however small in relative terms.

Over the period 1985-1987, the ratio of Africa's external debt to total GDP became the highest of all the developing regions, and the ratio of actual debt service to exports of goods and services rose from about 20% to exceed 30% over the same period. This ratio is even higher in many low-income countries. Not surprisingly, the strains of meeting heavy debt service obligations continue to have a crippling effect on the majority of African countries, 22 of which are already classified as "debt distressed". For many countries, arrears on scheduled debt service payments have accumulated so rapidly that of the approximately 50 developing countries which have so far renegotiated their external debts, about one half are from Africa.

One major consequence of this situation is that an inordinately high proportion of human and financial resources which are critically needed for investment and other productive purposes continues to be siphoned off to meet debt servicing obligations. This clearly is in conflict with the imperatives of increasing investment activity to levels necessary for generating recovery and sustainable growth. It is precisely for this reason that the African Common Position recognises that debt alleviation cannot be divorced from broader issues related to terms of trade, export earnings, resource flows and investment.

Before we examine the African Common Position more closely — and the seminar will afford us much greater opportunity to do so — let us take a historical perspective and pause briefly to review some of the major approaches to the issue of external indebtedness that have so far been either proposed or implemented in the international context. Perhaps in so doing we can better appreciate the distinct and clearly relevant features of the African Common Position.

We are all aware for example of the conventional Paris and London Club rescheduling which many of our countries have undergone. The evidence has shown that such reschedulings which are by experience a continuous annual exercise have succeeded in providing only temporary debt relief and, unfortunately have contributed to increases in the stock of outstanding debt and hence the debt service burden in most countries. This, in turn, has led to sizeable reductions in the net flows of resources for investment and other purposes. Indeed, far from generating new capital flows to finance economic recovery, Paris Club style debt rescheduling have converted some of these nations into net exporters of capital, essentially due to the fact that they have not provided a level of debt relief commensurate with the debt servicing capabilities of the rescheduling nations.

It is in recognition of this fact that the Paris Club has recently begun to extend longer maturity and grace periods for the debt-distressed low income countries. For example, Mozambique and Somalia's 20 year-terms with a 10-year grace period in 1987; the first capitalisation of interest by Zaire in 1979/80; and the first multi-year rescheduling not long after, established new precedents aimed at addressing the shortcomings of conventional arrangements. However, in spite of the Paris Club's increasing flexibility, the build-up of rescheduled debt continues. This will continue to be the case so long as reschedulings are merely restricted to postponing the market related interest payments due on outstanding debt while doing little to meaningfully reduce the existing debt stock. Moreover, the current system is time-consuming and repetitive, allowing little room to debtor countries for longer-term economic planning.

The Baker Plan, the focus of much attention in recent years, partly in recognition of the shortcomings of the existing rescheduling process, emphasised the need to link economic reforms to new external finance. While the plan envisioned that external financing would come from private sources for the Latin middle-income debtor countries to which it was primarily addressed, for African debtors it assumed that official and multilateral creditors would be primary sources of new finance. The underlying philosophy of the Baker Plan, restricted to fifteen heavily indebted middle-income countries (including about 4 African countries), was that these debtors would be able to grow out of their debt burdens without debt relief *per se*. One of the major shortcomings of the Plan was its failure to attract the support of the commercial banks who were expected to provide significant resource flows. The US$20 billion which was projected to be provided by commercial banks over a period of three years did not materialise.

Much has also been made of the potential for adapting financial instruments available in the international capital markets to the debt situation of individual countries. Schemes involving the conversion of outstanding debts into tradeable securities with longer repayment terms or into equity investments have been explored. These market-based solutions, again applied mainly in Latin America, have met with varying degrees of success. However, given critical differences between the structure of Latin American and African debt and especially the fact that domestic capital markets are not well developed, such solutions are unlikely to make significant inroads into Africa's debt problem. Two other characteristics of Africa's debt lead us directly to this conclusion; first, the predominance of official and multilateral creditors' debt in Africa, and second, the serious foreign exchange shortages and payments difficulties which plague many African countries and deter market-related initiatives. For example, the Mexican bond exchange offer that was made in December, 1987, and involved a special issue of zero coupon US treasury notes, which were to be purchased for cash at discount, required a substantial foreign exchange outlay in order to purchase the security. While some operations involving commodity-related financings, debt buy-backs, debt-equity, debt for nature and debt for development conversions may hold some promise, the current situation of many African countries is such that, the foreign exchange outlays needed to capitalize on those debt-conversion opportunities are simply not available, effectively limiting the prospects of their having a major impact.

Partly in recognition of these difficulties and the need for more far-reaching solutions to the problems of the poorest debtors, the Toronto debt relief package, was put forward by the G7 countries in June 1988. Under this package, creditor countries were given three options, namely: writing off one-third of annual debt service on non-concessional debt and spreading the remainder of the debt service over 14 years; consolidating obligations at market interest rates over 25 years; and consolidating obligations at reduced interest rates of over 14.

While the Toronto declaration marked a major change of attitude and an improvement over the traditional approaches of the Paris and London Clubs, it falls short of providing a lasting solution. Indeed, the amounts to which the options have been applied are such that the relief provided in terms of future debt service is not significant. It is estimated to reduce debt service for the debt distressed African countries by a little less than 5% over the next two years. Moreover, the Toronto options deal only with a single consolidation period and hence avoid neither repetitions of the process nor increases in the stock of the debt overtime payments. Indeed, in the case of a number of African countries, the debt service payments which would be required under which would be required under the Toronto options is two to three times higher than the amounts which those countries have been able to make in recent years.

The most recent initiative was unveiled by the US Treasury Secretary, The Honourable Nicholas Brady, in March of this year. It is interesting in that it marked a significant departure from previous US policy, and focused new attention on voluntary debt reduction and lower debt service payments. The plan recognises the vital importance of stronger growth, policy and structural reforms, increased external financial support, and a case-by-case approach. It also stresses the need for multilateral institutions to commit greater financial resources to supporting debt reduction or restructuring operations. Significantly, this initiative underscores the need for reducing both debt service and the stock of debt, as opposed to the present process of accumulating new debt to service old debts. It reflects a clear recognition that certain, if not all, highly indebted middle-income countries for which it is intended, may never be able to repay the full face value of their debts, a recognition which is reflected in the secondary market valuations of developing country commercial debt.

However, the Brady Plan, which again is more applicable to the large Latin American commercial debtors, addresses the African debt problem only marginally. In fact, since the major part of Africa's debt is owed to official and multilateral creditors, except for Nigeria, Côte d'Ivoire, Morocco, Egypt, Gabon and Senegal, which have a sizeable proportion of commercial bank debt, Africa as a whole is unlikely to benefit significantly from this initiative.

In spite of all these initiatives, the debt service crisis in Africa continues unabated, and after years of hope not realised, now calls for bold and decisive action. As was made abundantly clear at the industrial countries' Summit in Venice in June 1987, Africa deserves special treatment. While, for instance, the Toronto Declaration should be recognised as an important step forward, it does not meet the essential conditions for a lasting solution to Africa's problem; nor does the Brady Plan, unfortunately. We must therefore continue to search for new and more appropriate approaches.

The recent very laudable actions of the French and the US governments, following earlier moves by other creditor governments, such as Britain, Canada and some Nordic countries, etc., to cancel concessional debt owed to them are most welcome. We cannot but note, however, that these cancellations will apply only to an estimated US$3,6 billion of debt which, through a step in the right direction, clearly shows that much more is still needed beyond the Toronto debt relief package and beyond the Brady Plan. In fact, unless greater concessions are applied by the creditor community to address the specific and broader concerns of the debt-distressed countries of Africa, one should expect the African debt service crisis to remain with us for a long time to come. We can only reiterate here the Venice economic summit recommendation that serious consideration should be given to the possibility of applying lower interest rates, longer repayment and grace periods to Africa's existing debt to ease the region's debt service burden.

It is in recognition of the fact that the debt servicing difficulties of African countries cannot be alleviated through short-term and partial solutions such as those proposed in the Toronto and Brady initiatives that the African Common Position was put forward as early as November, 1987.

The Common Position, as we all know, takes as its starting point the assertion that the debt question cannot be divorced from broader issues bearing on economic recovery and sustained growth in Africa. It further stresses that debt service payments must be made compatible with what each debtor country can reasonably be expected to pay; that the continued increase of the debt stock through the capitalisation of interest in the absence of significant inflows of funds must be arrested; and that debt not cancelled should eventually be repaid. The Common Position also calls for the conversion of part or all outstanding concessional loans into grants for the poorest African countries as was advocated in the UNCTAD resolution of March 1978 which demanded the conversion of all ODA loans of the poorest developing countries in outright grants.

Furthermore, the Common Position ties the resolution of Africa's debt service crisis not just to debt-relief but also to broader issues such as primary commodity prices, the flow of resources to the region and the adoption of growth-supportive measures by African governments to strengthen domestic savings, encourage foreign investment and make more efficient use of available resources. Within this context, the Common Position, of which the AFDB Debt Refinancing Proposal is, in essence, a technical manifestation, calls for, among other things, the conversion of the outstanding stock of debt into tradeable securities with long maturities, the reduction of interest rates to below market levels or into outright grants. It also suggests the possibility of past lebts being exchanged for local currencies. It thus provides a comprehensive framework that can and should be developed into a practical solution through a constructive discussion between creditors and debtors. Through consultations, such as the one we will be having in the coming few days, the Common Position could evolve into a viable yet flexible framework adaptable to the particular circumstances and conditions of individual African countries.

It is in this context, and in view of the limitations of the other initiatives referred to earlier where Africa is concerned, that we would like to appeal to the international community to give the African Common Position the full consideration it deserves and to explore its potential as an effective approach to the challenges before us. We, at the African Development Bank, have always argued that it is only through such a comprehensive approach that the debt strategy can lead to a technically durable solution, equitable to creditors and debtors alike, and a significant alleviation of the debt crisis, which not only threatens the survival of African countries, but poses even greater risks for the world economy at large.

The central development problem in Africa revolves around ways of increasing the level and productivity of investments to generate economic growth at rates in excess of population growth. To fall short of this would be to continue on the path of economic decline which has been the unfortunate lot of many African countries in the recent past. While Africans have the primary responsibility of working for a more reassuring future, the international community also has an important role to play, by increasing resource flows, by alleviating the external debt burden and by fostering the evolution of an international trade environment supportive of Africa's exports.

The progress made so far in all these areas has not been satisfactory. And while one can point to many reasons for this, a major factor is undoubtedly the lack of general agreement and a framework on the kind of specific actions that need to be taken by those concerned with Africa's development. It would, therefore, be no small achievement if this seminar, inspired by the African Common Position, can help to sharpen our perspectives on the problems of Africa's indebtedness, and contribute to the evolution of a consensus on the kind of actions that will ensure a speedy and equitable resolution to the current crisis.

Any effort to tackle the African debt crisis will have to be comprehensive and meet the basic requirements that growth must be revived; debt service payments must be made compatible with debtor countries' debt service capacity; the continued accumulation of debts through interest capitalisation must be stopped; and debt not cancelled should be eventually repaid.

Many African countries are making strenuous efforts to restructure their economies and to push ahead with policy reforms. The International community has also responded in a number of positive ways cancelling part of their debts and pledging additional concessional resources for IDA, the ADF and the IMF's special facilities, as well as authorising significant increases in the capital of the World Bank and ADB. Similarly, the Paris Club has modified some of its procedures and practices to become more flexible. Unfortunately, however, these efforts have not been sufficient to reverse Africa's economic decline and to bring the debt service crisis to an end. Our discussions should therefore be seen in the broader context of the recovery of the African economies. And we hope that this seminar will come up with practical and feasible proposals to permit us to move forward with the Common Position. The African Development Bank, of course, stands ready to provide whatever support we can to this effort.

I would like, in conclusion, to invite you all to reflect on some of the outstanding technical issues that are necessary for the advancement of the Common Position into a practical action plan. Among others, we look forward to hearing ideas on the practical approach that African countries should adopt to ensure that future discussions on debt relief are directly linked to broader issues such as the volatility of primary commodity prices and the need to stabilise export revenues. Secondly, we should look to reconcile the Common Position's call for conversion of official loans into outright grants with the need to secure additional resource flows from donors. Lastly, I hope that we can come up with suggestions on how to promote a greater understanding of the objectives of the Common Position on the part of various creditor groups.