The Search for Solutions to Africa's Debt Problems: a Progress Report

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Introduction

I am very pleased to be here to take part in this timely discussion of this important subject – a subject to which the World Bank has given a great deal of attention in recent years. I appreciate in particular being asked to speak on "the search for solutions" and to comment upon various ongoing and proposed debt relief measures. This seminar itself represents a commendable effort to advance this search in which we all have a role to play.

In my remarks, I will first make a few general observations about the *context* in which I think the African debt crisis should be seen. I will then review briefly the progress made – or not made, as the case may be – in the search for, and more importantly, in the actual implementation of solutions to the debt problems of Africa. I will next consider the next steps that most need to be taken to deal with the debt crisis per se, and then conclude with a few thoughts under the heading "beyond the debt crisis".

Context of the African Debt Crisis

My initial general observation is that Africa's debt crisis is really more a symptom than a root cause of the African development crisis. The debt crisis is but one facet of a more general crisis. Consequently, solutions to the debt crisis must be found on several fronts. Measures are needed not just to reduce debt *per se*, but most importantly to restore growth, alleviate poverty, and eventually restore the capacity of African countries to pursue normalized relationships with official and commercial creditors in a context of strengthened country creditworthiness. We must therefore be mindful of the links between structural adjustment, growth, and the eligibility of African countries for new money and debt reduction. I will return to this point later.

We should also bear in mind the diverse character and multiple dimensions of these dual debt and development crises. Although there are many common denominators among African countries with regard to the size and nature of their debt constraints, there is at the same time considerable diversity. Some African countries neither need nor want debt relief; indeed, for some it would be counter-productive, and harm rather than help their creditworthiness and growth prospects. For some countries, their debt burden is mainly a "stock" problem, as measured by large arrears or large debt overhangs relative to GDP or exports. For others, it is mainly a "cash flow" problem, where the issue is more one of liquidity than of solvency. For others, their problems comprise both elements, in varying degrees of severity.

Thus, while it may be useful to define (or redefine) a "common position" on Africa's debt crisis insofar as the problems across countries are indeed common to all, the diversity of situations calls for a differentiated, case-by-case application of the various instruments available to relieve the debt constraint. Just as no single, "orthodox" formula for structural adjustment to accelerate economic growth and restore social progress is universally applicable to all countries, so too no single formula for solving the debt crisis is universally applicable across Africa. Africa's debt problems require a varied "menu" of solutions.

A Caveat About Country Coverage

I appreciate that this seminar deals with the debt of the African continent as a whole. Since my own purview is that of only Sub-Saharan Africa, however, I should state clearly that all of my numbers and country citations pertain only to Sub-Saharan Africa. Some of my remarks on the situation of the highly-indebted middle-income countries may however pertain as well to one or more of the North African countries.

Recent Progress

The magnitude of Africa' debt problem, and the urgency of dealing with it, have been well established, including in the documents prepared for this seminar. The past two years or so have witnessed a growing recognition among donor and creditor governments and institutions that Africa's debt situation must be addressed with exceptional measures. Much more needs to be done, of course. But not everyone realizes, perhaps, just how far we have come in terms of actions actually being taken and/or being planned. Let me touch on some of these measures, distinguishing between those directed at benefiting mainly the low-income vis-a-vis the middle-income countries.

At a meeting in Paris in December 1987, the World Bank in cooperation with other donors launched a Special Program of Assistance (SPA) aimed at easing the debt constraint and increasing growth in the debt-distressed low-income African countries during the years 1988-90. On this front, in particular considerable progress has been made.

As many of you know, to be eligible for the SPA, countries must be in the low-income category (eligible for IDA credits but not for IBRD rescheduling debt service ratio of 30% or more), and be implementing an economic reform program supported by the World Bank and IMF. By mid-1989, 22 countries (with 1987 debt totalling $46 billion) had been declared eligible. More countries may be added. The program has five main elements now in place, namely:

(a) *Increased IDA Lending:* About 50 percent of the $12.4 billion available under IDA's eighth replenishment (1988-90) is going to Sub-Saharan Africa. During fiscal year 1988, 81 percent of IDA commitments in the region went to the SPA countries, up from about 71 percent in 1985-87. About half of IDA lending provides fast-disbursing import financing that debt-distressed countries need to relieve the import compression that has constrained their economic growth.

(b) *Increased Co-financing:* Bilateral donors pledged $6.4 billion in concessional assistance to go with the IDA aid, about half of it estimated to be in addition to disbursements they had previously planned. By the end of 1988, donors had officially allocated nearly $3 billion of the amount to specific projects or programs in eligible countries, and a billion has been disbursed.

(c) *IDA Supplement:* Supplemental IDA adjustment credits, drawn from the repayment of earlier IDA credits and IDA's investment income, were added to the package in September 1988. This is the so-called "5th Dimension" of the SPA to partially offset debt service to IBRD by countries now eligible only for IDA credits. Eight credits totalling more than $150 million have been or are being processed for fiscal 1989-90.

(d) *Fund Programs:* Since 1986, the IMF has created two new facilities for low-income countries — the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF). By the end of calendar 1988, $2.2 billion had been committed on concessional terms to Sub-Saharan African countries under these programs ($1.3 billion under the SAF and $0.9 billion under the ESAF). This represented 64 percent of total commitments under these facilities.

(e) *Debt Relief:* The final pillar of the SPA is debt relief, involving both concessional and nonconcessional debt. The World Bank has vigorously lobbied on many fronts not only to encourage donors and creditor institutions to increase the; flows of new money, but also to encourage various forms of debt service relief and debt reduction.

Concessional Debt Relief

Bilateral donors converted about $1.8 billion of Sub-Saharan African concessional debt to grants (in other words, forgave it) during 1978-86. The SPA calls for more such debt-forgiveness. In 1988, Canada, Germany and Japan converted more of their ODA loans to grants. In May 1989, French President Francois Mitterand announced plans to cancel, beginning in 1990, debt service on about $2.5 billion worth of official debts owed to France by 35 of the poorest African countries. The United States also recently announced a program to forgive about $1 billion of concessional debts owed by 23 Sub-Saharan African countries. I might mention too that the USSR has indicated its intent to grant a 100 year debt moratorium.

The scope for further relief by the donor community in this direction is however fairly small. Even before these latest relief measures, bilateral concessional debt represented only 25 percent of the long term debt and only 10 percent of the debt service payments of low-income African countries. On the other hand, many donors continue to be *more* concessional, given the very limited debt servicing capacity of some borrowers.

Nonconcessional Debt

At their economic summit in Toronto in June 1988, the heads of seven leading industrial countries agreed to a menu of options to reduce the burden of official nonconcessional debt owed to them by low-income African countries. These options, among which each creditor agreed to choose "within the framework of comparability," consist of partial debt forgiveness and reschedulings with longer maturities or lower interest rates. The agreement was made final at the annual meeting of the Bank and Fund in Berlin in September 1988. By mid-1989, the Paris Club had applied the Toronto terms to 12 African countries, namely Benin, The Central African Republic, Guinea, Madagascar, Mali, Mauritania, Niger, Senegal, Tanzania, Togo, Uganda, and Zaire.

The additional impact of the Toronto agreement will be relatively small in the next few years. But the potential savings could become much larger as more debt service is rescheduled on these terms in the future. According to a World Bank analysis, if these options were applied to all 22 SPA countries through the year 2000, their total stock of bilateral, official, nonconcessional debt at the end of that period would be about 7 percent lower than if past Paris Club rescheduling terms were continued. The additional saving in debt service for the 22 countries combined would average only about $100 million a year in the early 1990s, but would rise to some $400 million a year early in the next century. The relief would be greater, and come faster, if the debt service were consolidated under these Toronto agreements. Implementation would also be more predictable and manageable if carried out in a multi-year framework.

Meanwhile, the World Bank is launching a facility to help IDA only countries reduce the burden of their commercial debt that is not guaranteed by creditor governments. Financed by $100 million form IBRD 1989 net income, the program will provide grants to help countries that recognize that this a relatively modest commitment, but we will endeavour to get other donors to supplement these funds.

Middle-Income Countries

There is so far no special program solely for Africa's middle-income countries whose economic circumstances vary widely. Some export oil and some import it. Some appear able to service their debts comfortably whereas others have amassed significant debt arrears or are having great difficulty in keeping current, notwithstanding debt reschedulings.

Three African countries (Côte d'Ivoire, Nigeria and Morocco), were among the 17 "highly indebted" Baker Plan countries on which the international community's debt strategy of recent years was focused. Given the limited coverage and limited success of the Baker Plan, various new approached have been proposed over the past year or so to help deal more effectively with this problem of commercial debt.

Now coming into effect is a plan formulated by U.S. Treasury Secretary Brady in March 1989. This plan calls for continued economic reforms by debtor countries, reduction in debt and debt service by commercial banks, support for debt reduction by the Bretton Woods institutions and regulatory changes by creditor nations.

Following up on this latest initiative, on June 1 the World Bank announced guidelines for IBRD loans which eligible countries can use to reduce their commercial debt and debt service or for credit-enhancement programs. This is called the Debt and Debt Service Reduction Program. The IBRD funds are to be accompanied by parallel assistance from the IMF. Countries eligible for this Bank support will be those that have large external debt burdens and which have adopted adjustment programs acceptable to the Bank. Amounts "set aside" for debt reduction will be determined on a case by case basis, but can be up to 25 percent of a country's adjustment lending program over a three year period, or up to 10 percent of its overall lending program where the World bank is concentrating its support on investment operations and where the country has an acceptable medium-term economic policy framework. Where justified, additional resources of up to 15 percent of the Bank's overall three year lending programs for individual countries may also be made available for debt and debt service reduction.

The middle-income countries in Africa face long-term development problems *not* significantly different from the low-income countries. Indeed, when the correction of over-valued currencies — as in Nigeria for example — places some of these countries in the low-income category, they should be considered eligible for the same debt relief measures as those granted to low-income African countries, provided they are willing to implement adjustment programs. This is the position the World Bank is advocating. Whether it will be adopted remains to be seen. But as I have indicated, we are pushing on all fronts.

Other Proposals

Beyond these initiatives, other proposals have been made to provide long-term relief on debt from official as well as commercial sources. Among these is a proposal from the African Development Bank (jointly with S.G. Warburg of London) which suggest a securitization plan whereby claims are exchanged for longer-term bonds of the same face value, payable only at maturity and carrying a lower interest rate.

Over the past two years, proposals have been made to relieve the pressure on foreign exchange resources by swapping local assets — physical or financial — for debts. Nigeria has already converted close to $100 million (as of May 1989) of its promissory notes into Nigerian naira and has received applications for conversion of close to $1.6 billion.

The simplest form of swap — debt for equity — has limited application in Africa because of the lack of perceived investment opportunities and of developed markets for financial instruments. The possibility of swapping debt for the assets of state enterprises is being studied in the Congo and Togo, but so far no arrangements have been concluded.

Other new and innovative forms of debt conversions are however being explored. For example, several debt-for nature swaps have taken place, and others are being proposed. Usually, debt is exchanged for local currency or local bonds to be held by a local environmental organization, with the proceeds invested in environmental projects. Alternatively, official debt relief is tied to support for environmental actions. The first debt-nature swap took place in July 1987 in Bolivia with an arrangement aimed at protecting Bolivia's rain forest. This approach can be broadened to cover any form of debt-for-development arrangement. For example, in December 1988 the Midland Bank donated to UNICEF its holding of Sudanese debt ($800,000) which the Sudanese government redeemed in local currency to be applied to a water, reforestation and health program for the Kordofan region. The advantage for the bank is that this donation can be treated as a tax-deductible expense.

Another variation is for a donor to purchase debt (at a discount) and then pass the loans to a non-governmental organization (NGO) on the understanding that the debtor government will redeem the loans in local currency or bonds. The NGO can subsequently exchange or swap the debt, and then use the proceeds for development purposes.

These are just some of the ideas emerging on how to deal with Africa's debt crisis. More creative thinking is needed and further innovative actions are required. Each debtor country has its specific debt profile and special circumstances, and the solution to its debt problem must be decided upon a case-by-case basis. As a general principle, however, debt relief should be given only to the most debt-distressed countries that are also willing to implement policy reforms to improve their capacities for growth and future debt service. On the donor side, in order to ensure that debtor countries truly benefit, special finance for debt relief or concessional debt rescheduling should be genuinely "additional", and not be taken out of the aid budgets already allocated to beneficiary countries. In some cases, bridge financing may be needed before countries can make use of debt relief facilities. Debt relief is a two-way process; both creditors and debtors must play their part.

Looking Ahead: Beyond the Debt Crisis

Once conclusion to be drawn from this review of actions is that encouraging progress has been made during the past two years, in terms of concrete actions taken by donor/creditor country policy-makers. These positive steps may be seen as an appropriate – albeit not yet a sufficient – response to the courageous actions being taken by a growing number of African policy-makers in pursuit of economic reform. Especially for the low-income, debt-distressed African countries pursuing adjustment programmes, the combination of additional new, quick-disbursing concessional aid and debt relief measures has greatly alleviated the foreign exchange constraint to their economic development. And in a number of these countries we are now seeing some resultant supply responses. *That is the bottom line.*

This is *not* to say, however, that the debt problem is *not* still very serious — indeed of crisis proportions for may countries. There is still a very long way to go to achieve lasting solutions across the continent in terms of broadening, deepening and *sustaining* the adjustment-with-equity process underway in Africa, and ensuring that these reform programs are adequately financed. The combination of new monies and debt relief measures now in hand is sufficient for only a sub-set of low-income countries. And especially as additional countries adopt or re-adopt adjustment programs that will render them eligible for the various forms of financial assistance, the financing gap for Africa in the near-term will grow. Projections of this gap, and of how we envisage that it can — and must — be filled, will be laid out in more detail in a Long-Term perspective Study that will be published by the World Bank before the end of the year — a study which many of you have seen in earlier drafts.

I cannot assure you that sufficient resources will be raised. But I *can* promise you that the World Bank will be pressing hard as an advocate of the adjusting countries of Africa to ensure adequate new official flows and to find new ways and means both to encourage increased private capital flows and to effect debt relief. In this regard, our near-term agenda includes the replenishment of IDA; the extension of the SPA program; further internal analytic work and technical assistance to African governments on the design of workout scenarios, debt buybacks, and other "financial engineering" measures; and the advocacy of more options and better terms for Africa's middle-income countries in the Paris and London clubs and in other relevant forums.

I should not, however, conclude without re-emphasizing that our agenda is geared mainly to addressing more effectively the *root causes* of Africa's slow growth and development. For whereas debt relief deals with symptoms, comprehensive development programs — or structural transformation as some might call it — deal with the root causes. This means that highest priority should be given to making ongoing and future adjustment programs more effective, as we have sought to do in recent years by adapting longer -term time frames, building in social, poverty-alleviation and environmental objectives and dimensions, and trying to ensure that governments have a maximum role in program design — and hence maximum ownership of the program. *We all agree that Africa must adjust.*

As these reform programs are deepened and yield their benefits, both on the balance of payments and more fundamentally on productivity and output, Africa's debt problem will diminish to secondary or lesser significance. *Looking backwards* we can see that if Sub-Saharan African countries had simply *maintained* their 1970 share of non-oil primary exports from developing countries, their export earnings would have been \$9-10 billion a year higher in 1986-87. This shortfall is similar in magnitude to Sub-Saharan Africa's current annual debt service payments. This fact serves to emphasize that without a policy framework conducive to long-term development, the removal of Africa's debt burden today would do no more than provide temporary relief. *Looking ahead*, we can see that the right combination of new debt relief measures and appropriate policies will serve to ensure that new borrowings – and the consequent new debts – are development-enhancing rather than development-constraining.

Thus, one of the principal items on the World Bank's agenda this fall is the completion and issuance of the Long-Term perspective Study that I just mentioned. The horizon of this study extends far beyond the immediate distractions of the debt crisis. Among the principle foci of the report are the needs for African governments and donors to enter into a new global coalition to ensure food security; to slow the rate of population growth that is threatening to swamp all other development progress; to protect and sustain Africa's natural resources and reverse the environmental degradation that is taking place at an alarming rate; to promote increased regional integration in Africa, allowing the expansion of internal markets and trade; to strengthen access to and the quality of education; and in general to build the human and institutional capacities, in every sector and at every level, that Africa will need to become more productive, more self-reliant, and more competitive in the 1990's and into the 21st century. Debt relief and debt reduction will truly serve to enhance Africa's long-term developmental prospects only if and when real progress is made on these fronts.

In conclusion, let me again express my appreciation for this opportunity to exchange views with you towards the objective of finding better solutions to the African debt problem, and by extension, the broader developmental challenge.