INSTITUTE FOR INTERNATIONAL ECONOMICS

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AFRICAN DEBT AND FINANCING

Edited by
Carol Lancaster and John Williamson

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INSTITUTE FOR INTERNATIONAL ECONOMICS
Washington, DC
May 1986

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Comments, Chapter 2

Delphin G. Rwegasira

Brau provides a very good factual account of sub-Saharan Africa's external debt situation. Both he and Agarwala sufficiently describe the gravity of the problem facing the African continent.

As can be seen from both authors, the sharp decline in net external resources in the first half of the 1980s occurred at a time when the African continent was facing serious exogenous shocks. That pattern of events raises issues well beyond the debt problem, involving broader systemic questions related to development cooperation (specifically, aid flows) and the adequacy of the international monetary system. These often-raised issues in the North–South debate, though critical for global prosperity and sustained development of the Third World, could inadvertently be overlooked in the present crisis atmosphere.

A framework that goes beyond the debt problem to total financial requirements for growth—as does Agarwala—is logical and indeed overdue. Fortunately, it has received political blessing (being consistent with the Baker initiative). That this framework is overdue can be seen in events since the early 1970s. Recent history reveals that a problem of resource availability in nonoil sub-Saharan African countries has been present since that time and that Agarwala's argument, suggesting the contrary by stressing the efficiency of resource use, is oversimplified. Following the various shocks of the 1970s, current import capacity (non-tied foreign exchange) to service existing productive capacity was progressively reduced, so that high investment rates could not generate comparable growth. The total available import capacity was not in optimal form, but strongly biased in favor of project financing. There was a lag in perception between the requirements of the moment and the traditional forms of financing (favored then by both donors and recipient governments). Thus, in recommending higher levels of resource flows to restore 1980–82 per capita import capacity, it is important to correct explicitly that bias and lay greater emphasis on nonproject lending. That may also make debt-servicing relatively easier.

When estimating external resource requirements for the 1986–90 period, it

would be useful to go beyond the objective of restoring import capacity to the 1980–82 level. There is no methodology to indicate whether or not that level was satisfactory. Sub-Saharan Africa has been experiencing retrogression (per capita income decline) for many years, and we know relatively little as a profession about the forces at work. Thus, the task of reversing per capita output decline could be quite challenging and may require larger resources than Agarwala suggests.

With respect to export performance, the problem of sub-Saharan Africa is serious indeed. As Brau mentions, despite a concessional average interest rate of between 3 percent and 4 percent for low-income countries, the ratio of scheduled interest payments to expected export earnings, by itself, reaches 20 percent in 1987. What can be done about Africa's exports, given the generally poor market prospects? This question needs serious attention.

Current rescheduling practices, it is easily argued, leave a lot to be desired—in the context of the need adequately to plan ahead the financial resources for growth. Although debt service may be manageable through rescheduling, the relatively high scheduled obligations introduce too much uncertainty in planning for growth. Could mechanisms such as multiyear rescheduling be generalized to Africa so as to reduce these uncertainties? In calling upon the donor community to step up financial transfers, could not a related call also be made to remove these uncertainties?

Lastly, a comment on payments to multilateral financial institutions. As Brau mentions, these payment obligations will be heavy in 1986–87 and beyond. Since multilateral loans are not easily rescheduled, bilateral donors should make it easier (e.g., through multiyear rescheduling, debt cancellation) so that debtor countries can restore their lines of credit to the multilaterals. Otherwise, the call for increased net financial resources will not be translated into action. Over and above this consideration, disappointment must be expressed over the trend in what John Williamson terms "net use of IMF finance." That figure turned negative in 1985. Clearly, the IMF should be more helpful in this crisis.

Reginald Herbold Green

The broad features of the evolution of the external debt of sub-Saharan Africa presented by Brau and Agarwala represent a dramatic change of perception, and indeed of available facts, compared with three or four years ago. Then it was still the common view both that external debt was a minor problem for sub-Saharan Africa and that the region's external debt was of little significance to the international financial system. The second half of the argument may well be valid—under $20 billion of the debt represents commercial bank lending, although the total of over $100 billion is comparable to that of Mexico and

Brazil. The first is simply wrong. A series of studies[1] have now demonstrated that, for sub-Saharan Africa as a whole, external debt is a heavy burden and, for a subset of states, a potentially crushing one.

ON BRAU

Brau sets out succinctly and convincingly the broad structural elements of African external debt and its evolution since 1970. He would probably agree that it may underestimate present levels of debt. Furthermore, it does not fully illuminate the difficulties confronting both traditional debt management and unilateral partial moratoria.

Until 1970, sub-Saharan Africa had relatively limited and largely concessional external debt. In the 1970s, debt grew at a very rapid rate, both absolutely and relative to GDP and export earnings, and it became, on average, substantially less concessional. Much of this increase occurred over the period 1976–79, when growth averaged nearly 6 percent, its best historic four-year run and about equal to the developing-country average. Most African economies were enjoying an export boom (terms of trade rather than quantity), so that this borrowing was cyclical rather than counter cyclical.

From 1980 to 1983, the external debt continued to rise absolutely and, even more, relative to exports and GDP, but for quite different reasons. Export earnings and, in some years, GDP fell. Borrowing occurred to sustain import capacity, particularly for investment. As the assumption—not unique to sub-Saharan Africa—proved false that 1979–80 would be followed by a global recovery (as the 1974–75 recession was), the region ended with external debt levels that were very high relative to GDP and exports.

The situation is worst—both in terms of ratios and of ability to meet debt-service burdens—for low-income sub-Saharan Africa. The import capacity provided by export earnings is some 30 percent to 40 percent below the peak of the late 1970s and GDP per capita is back to 1960s levels (a decline of over 25 percent).

These debt levels are objectively unmanageable with existing terms, conditions and export prospects. In 1985, over 65 percent of African economies with 85 percent of the debt could not service as scheduled. Arrears, rather than—or in addition to—rescheduling seem to have been the most general "solution." The ex ante debt-service ratio would have been 45 percent to 50 percent; even with arrears and rescheduling it was 32 percent (not all of it paid). By 1987—even on rather optimistic export projections—interest on low-

[1] For example, Reginald Herbold Green and Stephany Griffith-Jones, *African External Debt and Development* (Sussex, England: Institute for Development Studies, 1984) and Gerald K. Helleiner, "Aid and Liquidity," in *Sub-Saharan Africa: Towards Oblivion or Reconstruction*, Special Issue, *Journal of Development Planning*, no. 15 (1985).

income sub-Saharan Africa's external debt will account for at least 20 percent of export earnings.

In fact, even this stark picture is an understatement. Debt is higher, servicing harder, and rescheduling more difficult.

First, while Brau's debt total for the end of 1985—including IMF credit and arrears—is $92 billion, I believe that a more realistic estimate would be about $125 billion (table 2.14). Experience in Latin America, Nigeria, Tanzania and Zambia[2] has shown that total external debt tends to be seriously underestimated, especially for short term and arrears, prior to a crisis. Arrears are hard to estimate, and in a crisis (*vide* Nigeria) revolving short-term credits and non-bank commercial paper can go into arrears very rapidly, on a scale that is large relative to total external debt. Furthermore, unpaid bills to contractors and transporters, which would lead to remittance requirements if paid, do not show up as external arrears so long as they are unpaid domestically (this is significant, inter alia, in Nigeria, Zambia and francophone West Africa).

The case of Tanzania may be instructive. Until 1984 its external debt was estimated at under $2 billion. On the basis of detailed studies the present figure (from Tanzanian sources) is around $4 billion,[3] composed as follows (in million dollars):

Long- and medium-term	2,500
Arrears thereon (interest and principal)	500
Short-term	500
Arrears on short-term debt, commercial payments, and invisibles	500
Total	4,000

While the current IMF–World Bank–Bank for International Settlements estimate is closer to reality than before at $3.4 billion, this is still substantially below the best estimate of the true level.

Second, the nature of the debt often raises very serious rescheduling problems. For many sub-Saharan African economies, up to 50 percent of the debt is owed to the IMF, World Bank, African Development Bank, and other traditionally non-reschedulable multilaterals. Up to another 20 percent is arrears whose rescheduling on "normal" terms (say LIBOR plus 2 percent) would be likely to precipitate new defaults. This is illustrated by the fact that sub-Saharan Africa has been the main user of the Paris Club, but that most reschedulings have not stuck. Indeed, the projections associated with them suggest that the authors were building sandcastles near the low-water mark, not doing serious economic analysis, because the latter would have proved that no solution was possible in the interlocking context of actual debt, likely exports and existing Paris Club parameters.

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[2] In the case of Nigeria, pre-crisis external debt estimates were only 50 percent of actual; in that of Tanzania, detailed studies doubled identified debt over 1983–85.

[3] Bank of Tanzania estimates as of December 1984, aggregated by present author.

Third, for the more heavily indebted low-income economies, any debt restructuring yielding a plausible debt-service ratio would take one far outside approved guidelines. Again, Tanzania can serve as an example. Even with a 7-to-10 year moratorium on all principal that can legally be rescheduled and a complete failure to tackle arrears, the debt-service ratio would be 25 percent to 30 percent, given probable 1986–88 exports. This is probably unsustainable, given the general import strangulation of the economy.

Fourth, apparent falls in the debt-service ratio after the late 1980s are unreal. They assume no new (gross) borrowing after 1985, which is clearly not an actual or operational projection.

Fifth, however, a 10 percent ceiling on the debt-service ratio (a la Alan Garcia) would not work in most sub-Saharan countries. Unlike Peru, sub-Saharan Africa receives substantial grant and concessional loan flows, which would presumably be jeopardized by any type of moratorium.[4] For sub-Saharan Africa, the bottom line is the net inflow of funds, i.e., gross loans and grants *minus* interest and principal repayments.

ON AGARWALA

Agarwala succinctly summarizes the resource position of sub-Saharan Africa. For the 1980s, it is clearly correct: without a restoration of the capacity to import, there will be no recovery—or at least not soon, not generally, and not along the lines sought by the Bank. For the 1970s, his argument that there was no severe scarcity of external resources is less convincing. The 1970s were by no means a homogeneous period for sub-Saharan Africa's growth rates and external balances. The 1971–73 record was poor. Over 1974–75, growth was negligible or negative, and external resource constraints were severe. As a whole, both regional growth and external balance performance over 1976–79 were the best in over two decades. Admittedly, this was not uniformly true, especially for sugar and mineral exporters.

In the 1980s, sub-Saharan Africa has been characterized by low and falling GDP per capita, rising debt-service requirements, declining import capacity (with both exports and net financial flows declining in real terms), and current account deficits. They were reduced from their peaks in the early 1980s only by Draconian import cuts leading to what can be described only as import strangulation in perhaps half the countries, cutting the use and maintenance of existing capacity as well as investment and debottlenecking.

The direct causes of the external constraints are fairly easy to identify. The terms of trade worsened (here Brau's estimate of about 25 percent for the period seems more reasonable than Agarwala's 10 percent). The volume of exports also fell, partly as a normal market reaction to falling world prices and

[4] Nigeria may be an exception because of its modest concessional finance. In any case, its 30 percent ceiling is well above interest payable and would allow an agreed rollover of principal.

partly because import cuts eroded the infrastructure and the capacity to produce exports.

For Southern Africa, a special economic factor was South African aggression and economic destabilization. Over 1980–84, this cost $10 billion by a conservative estimate[5] and, by 1985, it was running at $3 billion to $4 billion a year.

On export volume, there is a paradox Brau does not raise. Most of Africa's exports are the production analogue to "Giffen" or "inferior" goods. Price elasticities are such that more exports reduce foreign exchange earnings. As this category accounts for 60 percent to 70 percent of agricultural exports,[6] plus copper and perhaps oil, it is none too clear that sub-Saharan Africa would be better off today had it sustained market shares. Had Nigeria and Ghana produced that much more cocoa, the additional 500,000 tons a year would have pushed prices below $500 a ton, with candy crunchers and dentists the only winners.

Partial national economic integration has worsened the impact of import cuts. In a pure "plantation economy," the loss of domestic income from reduced export earnings is multiplied only by lost export-import collection and distribution services. When—as in Tanzania and Zimbabwe—the import to GDP ratio (excluding fixed investment) is about 20 percent and virtually all imports are food, capital goods, or intermediate goods, import cuts result in massive reductions in GDP in nonexport sectors.[7]

The decline in growth since 1979, given the relatively high fixed capital formation of the 1970s (and especially 1976–79) does, as the paper argues, reveal inefficiency in investment. One should ask whether this was primarily microeconomic and project, as some certainly was, or macro and sectoral inefficiency. As the overriding constraint has been import capacity, the dominant inefficiencies seem to have been macro and sectoral, involving the failure to develop a larger and more diversified export base and a failure to reduce basic food, intermediate good and energy import requirements by import substitution. Export promotion and import substitution should not be regarded as alternatives, for they are logically and historically more analogous to the two sides of one coin (although of course one or the other may be temporarily dominant in any one country at a particular time).

Sub-Saharan Africa's export record has been poor. Few states have had coordinated medium-term export development strategies keyed to projected

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[5] *Overview* (to Harare SADCC Annual Consultative Conference), Annex B, Southern African Development Coordination Conference, Gaborone, 1986.

[6] See for example, M. Godfrey, "Trade and Exchange Rate Policy," in *Crisis and Recovery in Sub-Saharan Africa*, edited by T. Rose (Paris: OECD, 1985).

[7] For a fuller discussion in Zimbabwe context, see X. Kardhani and Reginald Herbold Green, "Parameters as Warnings and Guide-Posts: The Case of Zimbabwe," *Journal of Development Planning*, no. 15 (1985).

medium-term import requirements. Fewer still aimed at a substantial broadening of their export base (other than into their neighbors' low price elasticity exports!)

This glaring gap remains. While the blind enthusiasm for undifferentiated primary product export expansion[8] has waned, neither strategic reformulation nor a coherent body of product and country-specific research has taken its place. Only for Zimbabwe may macroeconomic policy plus revolving funds to cover the import cost of exports come close to being sufficient as well as necessary conditions for export revival. Processing of present raw exports, new natural resource based exports, some temperate agricultural products, perhaps some resource-linked manufactures, with selective rehabilitation of debilitated existing primary export capacity, all offer specific possibilities. But thinking, studies, and external funding to date have been in notably short supply.[9]

If the short- and medium-term export prospects are as poor as Agarwala indicates, there will be no recovery no matter what is done in regard to debt relief. Even if there were, recovery would be sustainable only at rapidly rising levels of concessional program aid—which are most unlikely to be available on that scale for that purpose with no end in sight.

Agarwala's paper notes the fall in gross fixed capital formation as a priority problem in sub-Saharan Africa. This may be the inverse of reality. Investment may still be too high, eating up import capacity desperately needed to restore maintenance and operating levels of the existing capital stock.[10]

Except where gross investment is clearly below wear and tear so that net investment is negative (Uganda, perhaps Ghana), the most effective use of external resources is on intermediate goods, and spares to restore production, including export production.[11] This is now half-accepted conventional wisdom—as it was not in 1979, when several sub-Saharan African states and the present author began to argue the thesis—but apparently still has not markedly affected bilateral official development assistance (ODA) allocations.[12]

However, maintenance and restoration—while vital to recovery, and in many cases to holding the fabric of society and polity together—are not enough. Investment in debottlenecking, selective import substitution, export production

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[8] See, for example, World Bank *Accelerated Development in Sub-Saharan Africa: An Agenda for Action* (Washington, 1981).

[9] In the case of Tanzania, this appears to be the one area—apart from $300 million private risk capital in the quest for oil—in which no substantial finance has been secured despite many requests.

[10] For a fuller discussion in the Zimbabwe context see Kardhani and Green, "Parameters as Warnings."

[11] This implies that an auction—as opposed to allocation—system of rationing foreign currency would be highly production-inefficient.

[12] See T. Rose, "Aid Modalities—Sector Aid as an Instrument in Sub-Saharan Africa" in *Crisis and Recovery*, edited by T. Rose.

and improvement in basic services (the sick and illiterate are very poor producers) are essential. Even now, at least half of gross investment in sub-Saharan Africa does not seem to meet these tests but raises the stock of unusable capacity. In most cases, reorienting investment is more urgent than raising the rate of investment.

Most additional external resource flows should go to road repairs, not new roads; to fuel and fertilizer, not new agroindustrial complexes; to drugs and vaccines, not new hospitals; to dyes and spares, not new textile mills. Stagnation or decline is not a context in which structural adjustment of production patterns (necessarily a medium-term operation) can be sustained. Recovery is such a context.

By the same token, raising savings to GDP ratios may not now be an appropriate, across-the-board, priority.[13] When exports will not even cover essential operating import needs, savings can, at most, equal the domestic content of gross investment. In sub-Saharan Africa, that is rarely over 30 percent to 40 percent (counting indirect as well as direct imports). Thus, an investment rate of 20 percent will support a savings ratio of only 6 percent to 8 percent. Trying to raise savings will usually fail to free actually exportable goods, so that it can raise investment only if it drives down production and incomes and thus intermediate or (consumer) goods imports. As the production loss is likely to be substantial and use of the new capacity import-strangled, this is not a desirable approach.

As an old Treasury hand, I should indicate that the above is not a case against action on the revenue side to reduce (indeed, in the long to medium term, eliminate) recurrent government budget deficits. These raise severe macroeconomic management problems and are inflationary. However, cutting the deficits is likely to reduce government dissaving and private saving by roughly the same amounts, leaving total saving little changed.

I draw the following implications from these two papers regarding external debt management and relief. First, sub-Saharan Africa cannot service its existing external debt on present terms and conditions. Second, present Paris and London Club formats for rescheduling are inadequate as to term and forgiveness components. Third, for heavily indebted countries with poor short-run export growth prospects to 1990, money with three years' grace plus three-to-five years' repayment (IMF or export credits) is likely to defer and exacerbate, not solve debt problems. Fourth, for several countries, open or concealed debt relief is inevitable (involving, for example, conversion to long, concessional terms with an extended grace period). Fifth, the bottom line for most sub-Saharan African states is not the gross ratio of debt service to exports (as in Latin America), but the net inflow of new loans and grants minus interest and repayments.

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[13] For fuller argument and projections in the context of Zimbabwe, see Kardhani and Green, "Parameters as Warnings."

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