1. Data on SSA external debt are weak. In most cases they are from somewhat to grossly incomplete. The pre-crisis estimate for Nigeria was about $8,000 million; the present one is over $20,000 million. For Tanzania initial international estimates for 31-XII-83 were about $2,000 million. Detailed data collection by the Central Bank and two external cooperating banks produced an end 1984 estimate of the order of $4,500 million.

2. There are four main reasons for the undercount:

   a. incomplete recording by SSA countries and/or failure to keep corrections for currency valuation changes up to date;

   b. World Bank coverage which does not include arrears of interest nor trade credit arrears;

   c. general difficulty of estimating short term commercial credit accurately except when it is in arrear leading to a sudden explosive rise as and when regular payment is interrupted;

   d. the historic fact (as demonstrated in Latin America in 1981-84) that pre-crisis external debt estimates tend to be at least 20% under the total a more detailed, crisis context calculation reveals.

3. Main types of External Debt:

   A. Short (up to 1 year initial duration or no stated duration)

   1. Non Bank Foreign Enterprise

      a. unconfirmed letters of credit
      b. trade bills
      c. non-financial firm quasi-supplier credits
      d. open book credit (e.g. UAC or Fiat to UAC-Ghana or Fiat-Tanzania)
      e. arrears thereon
These are normally to enterprises in SSA. They are rarely estimated until they go into arrear but in normal pre-1980 trade context often were up to 3 months total imports revolving on average twice a year.

ii. Commercial Bank Short

a. confirmed letters of credit (confirmed by domestic bank or more generally external bank CLC)
b. revolving trade or (to Central Bank) swing credit
c. lines of credit (usually to banks, e.g. Barclays-Botswana or to Central Banks)
d. arrears thereon

iii. Government (foreign)

Defaulted guaranteed trade credit (unless defaulted it appears or should appear in categories i and ii depending on type of enterprise initially extending it. When defaulted it is paid to issuer by export credit agency and becomes a bilateral government to government claim which can be/is included in Paris Club negotiations/reschedulings).

iv. Arrears of Principle/Interest on Medium/Long term debt. As the arrears do not arise until after payment is due they are short term even though they relate to long or medium term debt.

v. Contract or Invisible Payment Arrears

These may be in local currency but remittable when received by the enterprise, e.g. a foreign contractor or airline. Thus the payment (whether initially in foreign or local currency) will give rise to a foreign currency obligation.
B. Medium And Long (Over 1 year initial duration - in fact 1 to 3 year items are more like short)

i. Non Bank Private

a. intra group loans
b. capital goods supplier credits (of over 1 year)

ii. Commercial Bank

a. project loans - general credit of enterprise/country
b. project loans - secured on project export earnings stream
c. general purpose

iii. Non Concessional Government/International Financial Institutions

a. guaranteed export credits (normally ii-a until defaulted, i.e., project loan advanced by bank with guarantee and interest subsidy by official export credit agency)
b. World Bank (bank window and IFC), ADB (bank window), BADEA (normal terms), CDC
c. International Monetary Fund (except Trust Fund, Structural Adjustment Facility)

iv. Concessional Official

a. some export credit (e.g. Italian 2½%, 5 + 15 year export credit to certain least developed countries)
b. bilateral government to government (e.g. USAID loans)
c. International Development Association (IDA of World Bank) ADF, IFAD, etc.
d. IMF (Trust Fund, SAF)

Note: arrears on medium and long are short term because by definition they are overdue and therefore have an "initial duration" before scheduled payment of 0 days, let alone years.
4. Certain of these categories require special comment beginning with short term trade credit. This credit is hard to quantify when turning over normally (albeit recording of nature of payment associated with orders under import licenses and/or of goods received at customs could build up much better estimates than normally exist). When arrears begin they are likely to snowball:

a. for up to 365 days bills for imports which arrived earlier will fall due (exceeding current imports if market or allocation policies have cut these);

b. at the same time arrears will cause an increasing number of suppliers to demand cash or letters of credit confirmed by external international banks who in turn will move toward demanding 100% cash cover before confirming;

c. thus raising payments due well above current import levels and causing arrears to rise until the point is reached at which all commercial imports are for cash down with no trade credit left (except for the "frozen" arrears which by then act as a blockage against securing any new trade credit).

5. This form of forced external borrowing (i.e. trade arrears) is very expensive. The fact that interest may not be paid (usually is not) does not detract from that.

a. with the loss of commercial credit more forex is needed to pay for imports in advance;

b. therefore, it is much harder to avoid fitting import levels to export swings (seasonally and in respect to shortfalls) as there is no credit left to buffer or even-out even normal seasonal swings in external cash flow;

c. with dead assets (arrears) and doubts as to payment on new shipments suppliers will (not unreasonably from their point of view) raise prices. 20 to 30% on particular goods and 10 to 15% on total commercial import bill is probably not uncommon for states with very
large arrears, e.g. Zambia, Tanzania. That cost alone can be 20 to 30% of export earnings;

d. clearing up arrears of trade credit (except officially guaranteed items) has to date proven nearly impossible when they had become really large, e.g. in the cases of Zambia and Tanzania they equal or exceed one year's exports. Assuming 6% interest, 2 years grace, 6 years repayment (generous from the point of view of the creditors) servicing them in the 3rd year (first repayment) would cost over 22% of exports.

Contract and invisible arrears (3 - A - v) are broadly analogous to trade credits in these respects.

6. IMF drawings at 7 to 8% interest, 3 years grace and 3 years repayment are quite unsuitable as a basic source of external finance for structural adjustment programmes. Recovery of external balance even in the sense that exports plus grants and concessional loans equal requisite imports plus interest plus repayments on concessional loans cannot reasonably be expected for the most severely affected SSA economies until 7 to 10 years after structural adjustment starts. Net repayment of large IMF drawings in years 4 through 7 is simply not compatible with structural adjustment with growth.

7. In practice IMF drawings can, in a sense, be rolled-over through back to back standbys so from year 4 on new drawings are made to finance repurchases of earlier ones. Given the interest rates, this is expensive financially and given the time to negotiate and the limitations imposed by higher credit tranche standbys it is likely to have high scarce personnel and not inconsiderable policy costs. Further, it is risky - in SSA few IMF agreements (let alone series' of agreements) have worked smoothly without delays in, or suspension of, drawings. The risk of forced default (because the new drawing has not been achieved) is ever present.

8. The Structural Adjustment Facility is at one level more suitable for SA use. 1% interest, 6 years grace and 4 to repay begins to fit a possible external balance recovery time frame and is certainly concessional.
However, unless the present finance is raised (President Conable and Managing Director Camdessus have proposed trebling) there are very limited resources. Further, to date the Fund has in fact, at least sometimes, applied stricter, shorter term performance targets to SAF credits than to standby drawings. This appears inconsistent as the purpose of SAF is presumably to allow a longer period before repayment to make practicable a more gradual structural adjustment.

9. **Devaluation, rescheduling, external debt service and domestic budget deficits (recurrent) and financing requirements (development or capital budget plus/minus recurrent deficit/surplus** have complex interactions:

   a. **devaluation does not** affect the real resource cost of external debt service. External debt is usually (in SSA always except for a few intra SSA debts) denominated in the lender's currency. Thus devaluation does not affect the forex cost (e.g. amount of exports, $ or £ or Yen or DM amount of foreign 'aid') needed to service external debt;

   b. **devaluation does** raise the domestic cost of external debt service. The constant forex obligation costs more units of local currency;

   c. thus there may be a fiscal problem. Domestic revenue is unlikely to rise as rapidly as the price of foreign exchange unless domestic inflation wipes out the nominal devaluation (and undesirable result) - so devaluation, through higher local currency cost of constant forex obligations is likely to widen domestic deficit/financing requirements;

   d. **rescheduling reduces** forex obligations during the grace period (i.e. it rolls them forward). Whether it reduces actual outflow depends on how much was being paid (as opposed to falling due) before rescheduling;

   e. **rescheduling - without an IMF agreement - may reduce** the local currency budgetary cost of external debt service. It does so if the external payments paid times the new exchange rate exceed the external debt service payment made abroad or into a blocked arrears
account with the Central Bank times the old exchange rate before rescheduling. (It is assumed that Paris Club rescheduling usually is part of a set of measures including devaluation.);

f. rescheduling - with an IMF agreement may sharply increase the local currency cost of external debt service. This occurs if the IMF agreement provides that payments by the government will be on the old schedule and that until paid abroad on the new schedule the Central Bank will hold them in a blocked account;

g. The real resource cost of transfers to a blocked account is nil. The implications in respect to performance ("trigger") clauses can be major. If the blocked account does not count as a Treasury deposit to offset against borrowing from the Central Bank then such transfers count as part of the government bank borrowing ceiling;

h. the result of f/g is that for any given real level of domestic spending more revenue must be raised to avoid breaking a debt ceiling and that the blocked amount is sterilised (i.e. it is an increase in money supply which is not allowed to feed through to domestic credit formation and, therefore, demand for/upward pressure on prices of domestic goods and services).

10. For SSA economies the bottom line is:

\[(G + L) - (I + A + AR) = NRI (NRO)\]

\[G = \text{Grants}\]
\[L = \text{New Loans}\]
\[I = \text{Interest}\]
\[A = \text{Amortisation (Principal Repayment)}\]
\[AR = \text{Arrears Reduction}\]
\[NRI = \text{Net Resource Inflow (if } G + L \text{ is larger)}\]
\[NRO = \text{Net Resource Outflow (} I + A + AR \text{ is larger)}\]

a. For virtually all SSA economies it is essential to have - and to seek to maximise - GRI. (Strong external balance and/or reserve economies like Botswana can afford short run low GRI's or even passing small GRO's. Others cannot.)
b. However, two ways of raising GRI are as noted earlier - unsound:

i. AA, i.e. Arrears Accumulation which leads to an overhang of short term obligations, higher import costs and reduction of G + L;

ii. fully commercial L unless for projects which will not only be profitable but also will generate a foreign exchange flow from exports at levels and with a time profile adequate to pay the interest and amortisation on that loan;

c. It is necessary to include G because otherwise the true external balance position and the overall NRI cannot be known:

\[(G + L) + X + AA = (I + A + AR) + M \pm \text{Reserves Change.}\]
\[(G + L) - (I + A + AR) + AA \pm \text{Reserves Change} = X - M.\]

11. There are potential implications from the above:

a. the Latin American external debt model may not be appropriate as in the large LA states G is negligible;

b. similarly for these states L costs are more uniform because concessionary loans are negligible too;

c. therefore it is crucial to maximise grants and concessional loans in SSA (whereas in LA this is often either a trivial or an impossible goal);

d. substituting grants or soft loans for hard loans increases net inflow (including G) but can reduce gross Loan inflow (excluding G). The bottom line matters, not the components taken out of context, e.g. when the UK switched to grant terms for most SSA countries, L - (I + R) on UK official went negative but (L + G) - (I + R) rose. Similarly for the IBRD Bank Window LB - (I + R) has gone negative because the loans have been replaced by rising volumes of IDA credits so LB + LIDA - (I + R) has risen.
e. The Alan Garcia (Peru) gross debt service (as a % of exports) ceiling may not be a good rule in SSA even though it probably is (would) be for most larger LA economies. That formula assumes G (grants) to be nil or trivial; new loans at most equal to (rolling-over) amortisation, and I (interest) if fully paid to exceed the ceiling % set.

f. In SSA G is not necessarily trivial and concessional. L can (and often do exceed A (amortisation). Therefore a NRI (net resource inflow) is attainable. If a ceiling % prejudices flows of G + concessional L it can lower the Net Resource Inflow, i.e. be counter-productive.

12. The OAU's internal debate on external debt has not always grasped clearly that NRI is the bottom line and that - unless one assumes G + concessional L are independent of unilateral 'deferral' of payments - setting a % ceiling may not be consistent with maximising NRI. The warning that SSA debt is unmanageable, that no state can reduce its economy to a halt and its people to starvation and that there is a real danger of won't pay because can't pay situations is another matter. But its likely value is to push the laggard states (notably USA, Japan, Federal Germany and USSR) to accept movement in the directions proposed by the UK, France, Italy, the Nordic States and (except for its own claims) the World Bank:

a. longer periods to pay;
b. lower interest rates;
c. retrospective conversion of government to government loans to poor SSA countries into grants.

13. A checklist of what SSA states in severely strained external positions could usefully seek includes:

a. Paris Club rescheduling of arrears plus 5 to 10 years forward payments (e.g. arrears plus 1987/88 – 1992/93 or 1997/98 payments) at one time;
b. no interest on rescheduled amounts during grace periods;
c. 10 years grace (e.g. 1987/88 and arrears would begin to be paid in 1997/98);

d. 10 years repayment of rescheduled amounts (e.g. 1987/88 and arrears over 1997/98 - 2007/08);

e. interest during repayment at initial interest rate or 4% a year whichever is less (a 50% reduction on most export credits);

f. for present low income SSA countries retrospective conversion of past concessional loans (and optimally export credits in arrear) into grants;

g. for the same states conversion of past World Bank bank window loans into IDA credits.

14. Rather less sweeping rescheduling should be sought (can be won) by less debt embarrassed states. Any state whose debt service ratio exceeds 25 to 30% is likely to have good reason to seek rescheduling and any with over 50% is virtually certain to find it imperative. The proposals above break some new ground - 10 years future payments moved forward at one go is well beyond any current case and Bank to IDA conversions are unknown. However, the package is not miles beyond the recent Mozambique and Uganda Paris Club reschedulings - indeed it is less far from them than they are from the standard 1980/84 rescheduling format.

15. However, it must be remembered what rescheduling (including write-off) is about: raising NFI by reducing outflow consistent with raising inflows to meet minimum (or above) import targets consistent with economic rehabilitation, basic service restoration and growth. For countries with a Consultative Group/Roundtable this implies:

a. calculating operating, rehabilitation, new capacity import requirements by sector on a consistent basis with stated assumptions;

b. subtracting projected exports less debt service (before rescheduling);
c. leaving gross new funds plus savings on rescheduling required;

d. negotiating with external financing sources a funding and rescheduling package meeting c, preferably on a disbursement schedule not merely a commitment basis;

e. implying that the Paris Club meeting once a CG/R agreement is reached should (as is not always now the case) act to implement the rescheduling savings the CG/R provided for in agreed projections, not to carry out a parallel, free standing set of negotiations.

16. Regaining access to external credit should be a goal of SSA states. It is not an unattainable one. The key questions relate to what credit for what uses.

17. One key access recovery needed is for trade credit (from confirmed letters of credit through open book credit) to reduce the levels of forex needed as working capital and to iron out seasonal imbalances. To pay cash forex in advance (literally or via 100% deposits to secure CLC's) can raise forex requirements by up to 25% of annual commercial imports (excluding externally financed projects, food aid and similar items). That is not a burden a forex short SSA economy can afford to take lightly. One sub-component in regaining such access (especially from exporters) is restoration of at least limited official export insurance on 90 and 180 day commercial trade billings.

18. To achieve this access requires:

a. an agreed rescheduling which reduces external debt service obligations to levels which are credibly payable;

b. at least 6 months (perhaps up to 18 months) paying external obligations on time (including not running up new commercial arrears);

c. either clearing or rescheduling arrears on revolving trade credits with commercial banks;
d. and on that record discussing with export credit agencies.

Nigeria, for example, has achieved partial restoration of short term commercial cover by ECGD within a year of reaching agreement with the World Bank and Fund even though it has not yet achieved a fully adequate set of arrangements for agreeing the amount or repayment schedule of non-guaranteed commercial arrears.

19. Export credit access for projects with high forex generating (or, in principle, saving as well) potential may also be important. Here as well as meeting the conditions set out for trade credit either a longer period of performance, a watertight prior claim on project export earnings or a case by case negotiation with official export credit agencies will be needed.

20. Access to non-trade voluntary commercial bank loans is (except for Botswana, Cameroon and perhaps 1 or 2 more) unlikely to be regainable before 2000. Perhaps luckily it is also undesirable - 8 to 10% (or above), 3 to 7 year money is a luxury few SSA economies (and none engaged in SA programmes requiring Fund/Bank backing) can afford.

21. However, in the short term the access which can (and for survival of SA must) be maximised is that to grants, concessional loans (including SAF but not normal IMF drawings) and sweeping reschedulings.

- R. H. Green
Falmer
August 1987