

**DEBT, DROUGHT, DEATH and DEFERRAL**

A modest interim proposal and after for Southern Africa

By Reginald Herbold Green

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Should we starve our children  
To pay our debts?

- Mwalimu Julius Nyerere

**Introduction**

It is a decade and a half since then President Nyerere posed his - he hoped rhetorical - question but it haunts us yet. In practice debt service has constricted programmes for children and safety net support more generally. Some governments have been very explicit - paying debts to external creditors did have higher priority for them than a balanced budget or primary health and education let alone safety nets and land reform. The question not only can be but is answered "yes" and not only by creditors.

In Southern Africa, today afflicted by the most horrendous drought in a century with over 50% grain crop losses not uncommon, rivers as large as the Zambesia at one-third normal flows and ones as major as the Limpopo reduced to cracked mud flats for hundreds of miles, the question must be faced urgently and literally. Seeking to keep up existing full or, more usually partial service on external debt can and will kill both through limits on imports and constraints on budget allocations to cover calamity offset programmes.

Yes, in the cases of some debts (but not those of the IMF or the World Bank) non-servicing (or greater non-servicing) will in fact be condoned - but that is rarely clear before the event. Yes, not all of Southern Africa's ten states (Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe) are in desperate external account difficulties but there is a general problem and the need

for a general framework of guide-lines within which to assess the individual country cases.

Above all there is a need for speed. Life - more accurately death by starvation - will not wait while detailed, long term external debt reduction settlements are negotiated. Interim measures - focused on deferral to free fiscal and forex cash flow - are needed now followed by a genuinely long term oriented follow-up to end the game of repetitive reschedulings when everyone is well aware the bulk of the debt will not and cannot be serviced. The moral hazard is not 'encouraging' default by those who could pay. Rather it lies in creating conditions resulting in the death of those who could live - a proposition with which Adam Smith with his emphasis on the underlying "moral economy" would have concurred heartily.

Drought is an unpredictable - even if predictably recurring - and natural - even if human aggravatable or reducible - phenomena. Famine is made by man's inadvertence or lack of concern and death by famine in the context of large external debt service payments is morally and conceptually equivalent to negligent homicide.

### Background to Debacle

The ten SADCC (Southern African Development Coordination Conference) states have a total external debt of the order of \$32,500 million excluding (\$40,000 million including) IMF drawings, trade payment arrears and currently revolving trade credits. Their GDP (domestic production of goods and services) is of the order of \$25,000 million and their exports (including services and worker remittances) about \$8,000 million. Debt service if fully paid (which in several cases it is not) would come to \$5,250 to \$5,500 million or up to 70% of total external account earnings. One need only set out the parameters to note their non-viability. Fungibility (current aid freeing export earnings to service debt) and de facto condoned arrears (every now and again formally written forward - or off) are essential to keeping several economies afloat.

There is a spectrum. Botswana's external reserves exceed its external debt (and for that matter are equivalent to 18 months imports) and its net external interest bill is significantly negative. Mozambique is, in fact, servicing nothing much beyond IMF drawings and World Bank (IDA) credits but

even that eats up 30% (the normal severely indebted cutoff point) of recorded exports plus remittances. The others are intermediate but it is worth noting that only three - Botswana, Namibia and Zimbabwe - have been totally able to avoid going into at least temporary arrears on both debt and trade payments while Zambia and Tanzania are uncomfortably close to the Mozambican situation.

The overall external balance positions range from satisfactory but with a high vulnerability factor (Botswana) and potentially (with true peace) satisfactory (Angola) through just viable (Namibia and - until 1991 - Zimbabwe) and on past very serious (Malawi) and disastrously weak (Tanzania, Mozambique and Zambia).

Therefore it is fair to conclude that:

- a. a general regional problem does exist;
- b. with need for varying degree of debt burden reduction in nine cases; so that
- c. a guide-line framework within which to negotiate case by case resolutions could be of significant value.

### The Apocalypse Drought

Progress toward a set of viable debt stabilisation and redeployment (i.e. cutback and reduction) agreements in Southern Africa since 1985 has been piecemeal, short term, uneven and inadequate. This alone would have doomed every attempted Structural Adjustment Programme in Zambia prior to 1992. Arguably acceptance of what amounts to rolling default in Tanzania and Mozambique and a gradual broadening of scope of debt postponement/erosion explorations might have led to more adequate and durable solutions (dissolutions of crippling debt burdens) by 1995. The 1991/1993 drought (1991 rain failure until 1993, hopefully normal, main harvest) has made rapid progress much more urgent.

A sober senior UNDP official who earlier had been sceptical of drought disaster early warnings looked sadly across his desk in March 1992 and said "This is the Apocalypse drought". That is a sober fact recorded in hundreds of factual micro area reports, a dozen official and unofficial country studies and at least three major regional studies (one independent,

one SADCC, one FAO/WFP with UNICEF assistance). The grain output for South and Southern Africa is little more than 40% of normal - 1992/93 net imports will need to be 11 million tonnes vs normal 1985/91 net exports of the order of 5 million tonnes. There is no parallel case recorded since the 1890s drought/rinderpest disasters. It is symbolic that in Gaza Province of Mozambique, where the doomsday proverb is "When the great river runs dry the end of the world is at hand", the mighty Limpopo River has simply vanished for over 200 miles - an event not previously known in contemporaneously recorded history.

The Southern African 10 require at least 5,000,000 to 6,000,000 million tonnes of grain imports plus 500,000 tonnes of legumes, beans, sugar and vegetable oil to avert already grievously high average levels of malnutrition (famine borderline in most of rural Mozambique and Angola and parts of southern Malawi even in 'normal' years). Of that, commercially financeable totals can hardly exceed 1,500,000 tonnes leaving a true food aid requirement of at least 5 million tonnes grain equivalent. In fact, 5 million tonnes (\$1,000 million landed cost) is above the \$850 million of the UN appeal, much less of the probable pledges and least of all of plausible actual deliveries (the only "trigger clauses" in food aid commitments in the case of non-fulfilment point at the non-recipients not the non-deliverers). While some 1992/93 food aid had in fact been pledged earlier the additional transport distribution, camp and water supply costs of the drought far exceed the saving.

A rough estimate of food and other emergency import costs not coverable from previous aid pledges or reasonably available national import capacity is \$1,100-1,250 million plus at least \$250 million in local costs or \$1,350-1,500 million. Even were the appeal met in full the forex deficit would be of the order of \$300 million and the fiscal (allowing for some claw-back on food aid commercialised in towns) about the same.

Drought does not limit its impact to food. It hits agricultural export production too. Therefore it creates a scissors effect - more food imports needed and less agricultural export generated export proceeds available. And with the loss of grower marketed crops (food or other) comes loss of rural entitlements to buy from the urban sector and therefore of the ability to use installed urban production capacity. Lower tariffable imports, lower sales taxed manufacturing output and lower urban and

agricultural profits taxes similarly slash state revenues at the same time that drought relief costs pile more burdens on the budget.

As with debt, drought is uneven. The two northernmost SADCC states - Angola and Tanzania - have been drought afflicted only in part. Indeed Angola's north central and northern flood damage may be worse than its southeastern drought losses while Tanzania may achieve 80% of normal grain harvests. However, as a result of war (and of UNITA's land mining to prevent food production strategy) Angola has a large structural food deficit. While Tanzania does not have a structural deficit - except in wheat - neither does it have food, cash or credit margins to ride out a 15% loss of grain output especially as drought has damaged export production (especially of cotton) and 1992/93 prices for cotton and coffee are disastrously low.

The combination of drought and terms of trade declines can be anticipated to have a very serious impact on several economies. Mozambique - as a result of externally generated war - has less than no safety margin. In Tanzania, one of the longer running and more successful Structural Adjustment Programmes (1984-92 including the two years before international funding was secured) is at risk as is Malawi's rather older one. The Zimbabwe programme went badly off track in its first year reversing GDP gains, ending near balance on the current account and exploding into an expectations fuelled currency depressing/inflation raising spiral. Adding the drought pressures (including large commercial imports) could cause its early demise. Zambia's proto programme could only too easily follow its predecessors and be born mortally ill. Angola may well have a large peace dividend to come, but needs to be able to spend it on livelihood rehabilitation not debt service, while Namibia plagued by disastrous mineral markets might well be unable to continue to juggle fiscal prudence, a degree of external account balance and moderate human investment advances. The situations of Lesotho and Swaziland also gives ground for concern especially if the drought impact on South Africa leads to a demand (and remittance) collapse for scores of thousands of nominally alegal or illegal seasonal, other agricultural and small town migrant workers as appears probable.

### Deferral Now

Food aid may plug most of the import requirements gap albeit for Zimbabwe, Swaziland and Lesotho there will need to be substantial additions to commercial imports (as well as for Botswana which can afford them). On the past record it is most unlikely to cover full distribution costs or the bills related to displacement into camps or peri-urban margins. Certainly it cannot offset export earning losses. Quick disbursing, untied balance of payments support which nominally could take so long to negotiate it can hardly be expected to do much to mitigate mid-1992 to mid-1993 import capacity compression (or in the worst cases strangulation). Additional IMF drawings (beyond those already programmed pre-drought) are unlikely to be available and because most of the countries are using higher credit tranche or equally high conditionality SAF/ESAF facilities, the IMF is literally unable to fulfil its basic purpose of providing short term bridging finance fast to give time to sort out more permanent financing or rebalancing measures.

Therefore, the least unlikely route to reducing import capacity - fiscal and production compression may be reduction of debt service actually paid. It is unrealistic to expect this to be achieved by overall long term agreements on total write-downs and reschedulings completed during the next few months. It is hardly desirable that it should be achieved by non-agreed increases in accrual of arrears. For Tanzania, Zambia and Mozambique that would, in effect, mean arrears to the Fund and Bank since even before the drought they were unable to pay much to anyone else. For Angola it would threaten its reviving ability to secure new quasi-commercial project finance. For Malawi it would be the first default on rescheduled debt and for others - notably Zimbabwe and Namibia the first breach in basically arrears free records they have paid a high price to sustain in the hope of continuing to secure 90-180 day trade credit (direct or via financial institutions now) now and a rising volume of medium term loans plus investments in the foreseeable future.

### ... a Modest Proposal

Therefore, a more modest proposal - Deferral Now - deserves attention. If it is to be achieved in time six principles need to be agreed:

- a. the period of deferral is 1 July 1992 - 30 June 1993 (partly retrospective);
- b. all external government and defaulted government guaranteed debts are to be covered including those already rescheduled;
- c. creditor governments will in cases in which it would appear prudent, and Southern African governments request it, use their moral suasion to secure analogous deferral by commercial lenders in respect to medium and long term items;
- d. special arrangements in respect to service due to the IMF, World Bank and African Development Bank will be explored in cases in which these exceed 33% of the debt service actually paid over 1989/90 and 1990/91;
- e. the deferral will be reviewed in March/May 1993 and if 1992/93 crops are also seriously low (as seems likely if the 1980/84 and 1985/89 five year bad and good harvest cycles are being followed by a 1990/94 phase of poor to disastrous harvests) will be renewed for 1993/94;
- f. a general framework as to eligibility for deferral will be agreed between major debtors and the Southern African 10 but case by case application and formal agreements will then be negotiated within that framework.

The principles for reassessing need could include:

- a. severity of external imbalance based on new food import requirements (less those covered by grant aid) and projected (lowered) export levels;
- b. present levels of debt service actually paid;
- c. fiscal stringency resulting from revenue losses flowing from drought plus emergency programmes necessary to mitigate its impact.

On this basis, while the need would vary widely absolutely and relative both to present debt service payments and to imports, only Botswana would be likely to fail to qualify for substantial deferral.

Official loan/defaulted guaranteed credit service deferral would be central for Malawi, Swaziland, Lesotho and Angola. The simplest form of deferral



would be full rolling forward of 1992/93 payments to 1993/4 - 1997/8 (preferably with waiver of 1992/93 interest). The same is true of Namibia if one treats the paper issued by the Administrator General under what was, at international (and Namibian) law, a period of illegal occupation and fully guaranteed by the South African Treasury as official. It would be significant for Zimbabwe (albeit there commercial debt service is a heavier burden) and, perhaps, Zambia but not for Tanzania and Mozambique because they have a de facto, unagreed, unstable moratorium on the bulk of such debt.

Commercial debt service deferral - say back to back transactions amounting to rolling forward at least all capital repayments - are crucial for Zimbabwe. So long as interest was paid (or net paid in part with full gross payment but partial redrawing) in what is demonstrably an emergency, the effect on post-drought credit ratings should be fairly low.

The conceptual problem cases are perhaps Malawi, probably Zambia and certainly Mozambique and Tanzania. The last two will need to have relief from at least a portion of IMF, World Bank and ADB debt service as, in all probability, will the first two. Whatever the merits or demerits of Fund/Bank rescheduling or write-off no agreement can possibly be reached in the time available. Deferral on other debt service in the context of a demonstrable catastrophe of quite abnormal magnitude raises no real issue of precedent; formal Fund/Bank arrears or reschedulings would. However, a series of ad hoc arrangements would appear less contentious:

- a. allowing higher SAF/ESAF limits above levels now programmed to enable redrawing back to back with repayments of, and interest in respect of, older drawings;
- b. current or partly retrospective conversion of old World Bank loans to Southern African states now in the "mixed" and "IDA" eligible categories to IDA status;
- c. where "b" yields little or no result because already at least partly done (Tanzania) or there are no non-IDA outstandings (Mozambique) secure additional bilateral finance to cover a portion of IDA service.

Each of these approaches has one or more precedents so no inherent problem of principle need prevent rapid agreement.

The rapid negotiation of a framework between major creditors and the region should be practicable. All are SADCC member States and have experience working/negotiating jointly. Further, SADCC is actively involved already in several other aspects of coordinating actions to mitigate human, social and economic impact of the drought. Further in fact, it did much of the homework for a Region/Creditor conference two years ago before deciding that the time was not then propitious for such an initiative.

Deferral is exactly what it says - rolling forward (albeit with some marginal alleviation elements suggested above) not resolving. However, it would in the context of the drought buy time to negotiate a more detailed and sustainable settlement (which would have been needed drought or no drought). Also it would create a useful precedent or game plan, both for Southern Africa in 1993/94 if there is a continued drought cycle and more generally for quick response to major exogenous calamities hitting severely indebted countries or sub-regions. In the present Southern African context buying time (realistically at a low cost to debtors and creditors alike) through deferral is ransoming lives.

#### And After

Clearly the end result of the drought will be a reduced ability - other things held equal - to service external debt. Equally clearly the effect of the deferral by itself would be to increase post drought debt service burden. In any case, as already noted, for a majority of the countries the pre drought debt service burden was too high to be consistent on reasonable projections with achieving sustainably high rates of output and of investment growth consistent with a manageable degree of overall external account balance.

Therefore, agreement on deferral should be followed by a long term oriented set of negotiations to reduce debt service on existing plus reasonably projected future obligations to levels consistent with prudent economic growth and development objectives (e.g. these set out in the World Bank's Long Term Perspective Study). Again a two stage approach would be desirable:

- a. Creditor/SADCC 10 Guide-lines Agreement; providing a frame for
- b. Case by case country/creditor agreements.

The Guide-lines Agreement would presumably spell out:

- a. broad criteria for estimation of debt servicing capacity and the amount to be allowed for servicing future loans (especially for countries like Zimbabwe and Angola which have realistic medium term prospects of securing such credit on a significant scale;
- b. types of debt relief instruments/approaches to be used in respect to official, commercial and - where necessary - international financial institution outstandings the service on which exceeds the ceilings estimated from the earlier Guide-lines.

Again it appears that the only non-qualifier would be Botswana. With its external reserves in excess of external debt and the healthiest economy in the region (indeed in continental SSA) Botswana is hardly a priority case for debt service relief.

#### Some Building Blocks

Two and a half existing approaches would, with minor modifications, appear to offer ways to meet the debt service reduction needs of Southern Africa (and its future trading and investment partners):

1. The Trinidad Terms-Major-Pronk cluster of proposals for low income countries;
- 1.5 The Poland/Egypt agreements which are in fact Trinidad terms applying to lower middle income countries and covering commercial as well as official debt;
2. The Brady Initiative as applied/negotiated in the cases of Costa Rica and Nicaragua which de facto reduced present value of future external debt service by from 65% to 75%.

The first cluster treated broadly provides 60% and in special cases 90% official debt reduction plus moral suasion on commercial lenders to agree to similar cuts (relatively easy with secondary market prices except for Zimbabwe and Botswana unlikely to exceed 25% and probably little above decorative paper prices for most Mozambican and Tanzanian paper and with large provisioning and tax credits already made and taken).

As such these proposals relate to low income economies (roughly the IDA eligible category) and therefore would not apply to Angola (probably), Namibia, Zimbabwe or Swaziland (as well as excluding Botswana). This appears mildly illogical as the two actual agreements (for official and most commercial debt) which appear to be the model for the Trinidad proposals are Poland and Egypt, both lower middle income countries. However, this may be a quibble not requiring pursuit if the Costa Rica and Nicaragua, Brady umbrella settlements (providing well over 60% total official/commercial debt burden reduction) are viewed as precedents for economically small, debt distressed lower middle income countries.

In fact Zimbabwe, Angola and Namibia all have special debt characteristics which would need to be faced at the case level:

- a. Zimbabwe would welcome a reduction in a regional framework, donor/IFI backed context so long as it did not prejudice subsequent new commercial borrowing. On the Mexican precedent a settlement of write-down on historic debt service need not do that - but a level of 50% to 60% effective payment is likely to be needed;
- b. Angola may need deferral plus a write-down (however constructed) of somewhat less than 60% if rapid restoration of peace can be envisaged to be paralleled by buoyant real earnings from hydrocarbon exports and access to commercial project loans;
- c. Namibia's external debt is in fact South African, 'inherited' from an administration which was internationally viewed as unlawful and constitutionally is not the predecessor to the present state. The international community might well view 100% write-off of this debt as setting no precedent and, therefore, use moral suasion against South Africa (which issued and guaranteed it and whose financial institutions hold almost all of the \$225 million odd outstanding) to renounce all claims on Namibia in respect to it and service it like any other domestic South African State obligation.

#### Trade Arrears Revisited

A very special and problematic case arises in respect to non-financial institution unpaid trade arrears (whether by confirmed letter of credit or otherwise) which are over 24 to 30 months in arrears i.e. not in any

meaningful sense in a pipeline. On the one hand their payment in the foreseeable future by the three countries (Zambia, Tanzania, Mozambique) with large amounts outstanding is totally inconceivable. (Indeed in two cases at least recent IMF negotiations tacitly accept this by not including them in forward projections and targets.) Furthermore, much - probably most - of their value has been clawed back by the same firms marking up the prices on subsequent cash in advance sales to recoup their lost principle and opportunity cost interest and by bad debt write-downs for company tax purposes. On the other hand, clearing the books is psychologically important to regaining access to normal 90-180 day trade credit and, at least as crucial, in eroding the 25% to 50% above normal world prices fragmentary studies (including by the World Bank) suggest many SSA economies now pay for cash in advance imports.

One practicable solution might be offers based on secondary market value (if any!) with an upper limit of 20% and a bottom one of 5%. As the three countries principally involved cannot pay and, since they are not paying anything now or in the foreseeable future, would not welcome switching of present untied aid to this use, the evident way forward would be for a consortium of donors (preferably including the main homes of defaulted paper) to buy them up. The total outstanding is perhaps \$1,500-2,000 million face or at 5% to 20% \$75 to \$400 million. If paid by 8 to 10 countries over 3 to 4 years that would not appear totally unmanageable (i.e. \$1.75 million to \$15 million per financing country per year for the region).

### ... and the IFI's

IMF, World Bank and African Development Bank drawings - loans - credits pose special problems for permanent debt service adjustment to fit capacity just as much as they do for deferral.

In the case of the IMF the conversion of all present drawings to SAF/ESAF - (and their subsequent rolling over until the country achieved a structural external surplus) would arguably reduce the problem to manageable proportions. However it could usefully be accompanied by two additional steps:

- a. making SAF/ESAF 'extra quota' in the specific sense that "Gold Tranche", "First Credit Tranche" and Compensatory Facility drawings

would be available on low conditionality as bridging finance to allow time to face sudden calamitous shocks irrespective of whether SAF/ESAF had been used. Bridging finance not long term development loans are the statutory lending purpose of the Fund and permanent exclusion from access to such funding for any category of members seems undesirable;

- b. reconsidering whether the IMF should be in the long term development lending business. SAF/ESAF were created to bail the Fund and structurally adjusting drawers out of the disaster that always overhung them when large amounts of 7% to 9% 3+3 year credit were outstanding. They were not a result of any general belief the Fund should set up a new window as a parallel to, or competitor with IDA and the Regional Development Banks' analogues to IDA. The answer may very well be no - the Fund should not enter into the long term development finance business. Specialisation and division of labour have something to be said for them. In that case SAF/ESAF should be frozen once conversion is complete and new resources channelled via IDA or the African Development Fund, not the IMF.

The World Bank and ADB have no equally handy solution to parallel SAF/ESAF. If their funders agree (to putting up new capital or allocation of profits) present or partially retrospective conversion to IDA of old Bank loans to newly IDA or mixed eligibility countries could be useful. So - if real IDA/ADF resource provision can be raised - would be to push up IDA eligibility to say the \$750 (1991 prices) GDP per capita. However, the basic solutions would appear to need to be along two lines:

- a. avoidance of Bank group or ADB net cash collection (interest plus repayments in excess of new loans drawn) from Southern African countries except with their agreement (e.g. Botswana after the mid 1980s did not seek new Bank loans until about 1991);
- b. bilateral donor cash transfers to reduce the burden of meeting World Bank and ADB obligations where these were a significant portion of an external debt service burden exceeding the level posited as a ceiling by the Guide-lines.

### Looking To The Bottom Line

The bottom line is the combined profile of nominal debt service and proportion reduction of present value of total future debt service. How this is achieved is logically, at most secondary, for lenders and tertiary, or less, for borrowers.

In the case of commercial institutions particular home country tax provisions could lead to preferences for present principal write-downs rather than future interest rate reductions (or visa versa). Similarly political preferences could have the same impact on official lenders. Indeed a few (e.g. Japan) may prefer to convert virtually all future transfers to grants and to add a past debt contract servicing allowance to basic development transfers rather than reduce principal or interest. Whether this appears logical to other creditors or to debtors is rather beside the point. So long as the Southern African states secure reduction of the service burden on past external debt obligations to levels consistent with sustainably high levels of growth, human investment, physical infrastructure improvement together with sustainably low levels of profit taxation and manageable external balances and so long as creditors make roughly equivalent reductions, how the attainment of these goals is packaged is of no great importance. To insist that each commercial lender or government use the same approach is not only not necessary but probably counterproductive.

### In Summary

The external debt service burden of most Southern African states was unmanageable before the 1991/93 drought debacle. It is even more so now.

While explorations and initial partial moves toward significant debt service burden reduction had begun in several cases these were both sketchy and far from reaching a permanent sustainable debt service write-down outcome. None had reached a point at which speeding up dialogue could reach a conclusion in time to cope with the present drought impact scissors on external and fiscal accounts.

Therefore a deferral of most or in some cases all non Fund/Bank/ADB external debt service for the period 1 July 1992 through 30 June 1993 deserves immediate attention. In some cases - especially Mozambique,

Zambia, Tanzania - it might need to be complemented by steps to reduce effective burden on the debtor of meeting IMF, World Bank, African Development Bank obligations.

The most satisfactory approach to speedy results would probably be a regional working conference (major donors/Southern African 10) to set Guide-lines followed by use by case agreements within that framework. That two stage method could then be applied to reaching a package of more permanent external debt service burden reductions based in the Trinidad-Major-Pronk proposals, the actual Poland/Egypt agreements and the Brady Initiative as applied in the cases of Costa Rica and Nicaragua.