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Debt Strategy

The African Point of View

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Most of the world's developing countries have used external indebtedness to finance their development. Today, this indebtedness is the main obstacle to the economic growth of these countries as a whole, and of sub-Saharan Africa, in particular.

According to the most recent World Bank report on international debt, published in January 1994, the stock of debt of developing countries totaled $1,945 billion in 1994, representing more than 40 percent of their GNP and more than 180 percent of their export receipts. At the same time, the stock of debt of sub-Saharan Africa totaled $211 billion, or 83 percent of the GNP of the region and 255 percent of its export receipts. Currently, sub-Saharan Africa's debt service stands at more than 50 percent of its export earnings, and for several individual countries of the region, it stands at more than 100 percent—a contrast to the tolerable level of 25 percent.

Based on the stock of debt, sub-Saharan Africa's indebtedness seems lighter than that of Eastern Asia and the Pacific, Europe and Central Asia, or Latin America, since it totals "only" $211 billion, compared with $367 billion for Eastern Asia and the Pacific, $351 billion for Europe and Central Asia, and $513 billion for Latin America. Even the combined debt of Mexico and Brazil considerably exceeds that of sub-Saharan African countries. As a ratio of GNP, however, sub-Saharan Africa's debt is twice that of Latin America.

The principal debt indicators—external debt/export ratio, debt/GNP ratio, and debt service ratio—have seriously deteriorated over the past ten years, reflecting the limited ability of developing countries to service the debt they have contracted. As a result, these countries have accumulated payments arrears and have had limited access to international capital markets. This situation can be blamed on the international recession and the stagnation of the world economy, which led to a drastic decline in world prices for some agricultural commodities. It is the export receipts from these very products that constitute the main source of income of many developing countries.

External debt is a serious obstacle to the growth of developing countries, in that the weight of the debt service in government finance prevents these countries from responding to more urgent needs, such as growing poverty and economic decline. In addition, this same debt blocks these countries' access to the international capital market.

The question of indebtedness is ongoing, and various solutions have been applied over the years without eradicating the problem. These solutions were based on a unanimously shared hypothesis that many developing countries, and in particular, sub-Saharan African countries, despite the best will, are unable to repay their debts. Therefore, solutions that would take account of this and at the same time protect the interests of the creditors had to be found. A wide variety of solutions have been put forward since 1982, ranging from debt restructuring without debt reduction in the 1982–85 period, to debt restructuring with debt reduction after 1989.

Recent Solutions to the Debt Crisis

For more than a decade, the following solutions have been implemented in response to the debt problem.

Classic rescheduling. As a debt strategy that came out of the 1982 crisis, rescheduling was aimed at lowering the weight of debt service while protecting the financial interests of creditors, that is, the Paris Club (public creditors) and the London Club (private creditors). The Clubs negotiated an adjustment in the principal repayment schedule with debtors. In exchange, the beneficiary country undertook to apply an economic recovery plan (structural adjustment) supported by international financial institutions. This strategy was strengthened by the Baker Plan in 1985.

The 1985 Baker Plan: rescheduling and new money. To avoid a catastrophe in the international banking system, which was weakened by the debt crisis, the international financial community, under the sponsorship of the United States, adopted the Baker Plan in Seoul in 1985. Under this plan, creditors would show more solidarity with the debtor countries by granting them more time through rescheduling as well as new money, on the condition that countries first concluded an adjustment program with the Bretton Woods institutions. The Baker Plan was aimed at allowing adequate repayment of the external debt and at the same time laid the ground for the development of an interconnection between economic growth, structural adjustment, and external debt.

From January 1980 to September 1993, there were 205 Paris Club renegotiations with 70 developing countries, and 140 London Club renegotiations with 46 countries.

The 1989 Brady Plan: restructuring with debt reduction. In 1989, the Brady Plan was instituted, directly targeting commercial bank debt. It confirmed the relationship between external debt and economic development and recognized that indebtedness was an international problem. The Brady Plan recommended that official concessional aid be granted to debtor countries to enable them to finance the restructuring of their debt to commercial banks, based on programs involving a menu of options for debt conversion and debt service. Many Latin American countries, particularly Argentina, Bolivia, Chile, Costa Rica, Ecuador, Mexico, and Peru have benefited from this plan, as have some African countries, such as Morocco and Nigeria.

Toronto terms. When successive reschedulings proved unable to resolve the debt crisis, new solutions were found to deal with bilateral debt, that is, the Toronto terms (June 1988) and the enhanced Toronto or London terms (July 1991) applied to the less developed countries (LDCs). These new initiatives of the Paris Club include cancellation of claims for up to one-third of consolidated maturities and suggest the extension of rescheduling to 25 years and application of concessional interest rates.

Some bilateral initiatives. Some of Africa's European creditors, particularly France, Germany, Great Britain, and Switzerland, have individually implemented debt forgiveness initiatives.

At the Dakar summit in May 1989, France wrote off the official development assistance debt of 35 African countries, in the amount of F 16 billion, and stated its intention to limit the applicable interest rate to 5 percent on official loans extended to middle-income countries, such as Cameroon, the Congo, Côte d'Ivoire, and Gabon. In October 1992, under the management of the French Development Fund (CFD), a development loan conversion fund of F 4 billion was set up for these four countries.

Later, in 1994, after the devaluation of the CFA franc, France decided to write off 50 percent of the debt of the franc zone African countries to neutralize the effect of the devaluation on the local currency amount of their outstanding debts.

Limitations of the Various Debt Plans

Despite all these measures, the crisis continues. Indeed, successive reschedulings and the Baker and Brady Plans have clearly not met expectations. While they have brought some relief, they have contributed to the countries' further indebtedness without significantly improving their repayment capacity.

The Baker Plan, in particular, has the following limitations:

- High financing costs for restructuring;
- Access limited to middle-income countries, to the exclusion of the less developed countries (LDCs). Of course, there is the IDA debt reduction facility, which is exclusively for LDC use, but, in many cases, the amount allocated to each country ($10 million) is insufficient; and
- Transformation of a large portion of commercial debt into multilateral debt, which is not eligible for rescheduling.

Unsuccessful Results of the Various Debt Plans

The principal ratios and data on the evolution of debt clearly show that the various treatments have had little or no effect on the debt situation.

Between 1980 and 1994, the total debt rose from $84 billion in 1980 to about $211 in 1994, and debt service rose from $6 billion to $8 billion. During this period, the debt/GNP ratio moved from 30.7 percent in 1980 to 82.8 percent in 1994, while the debt/export ratio increased from 91.5 percent to 254.5 percent.

These aggregates show that the debt burden persisted despite the treatments applied, and that bilateral and multilateral debt strategies did not yield the desired results. Outstanding principal and debt service continued to increase, at least for sub-Saharan African countries. In general, the relief expected was not forthcoming, and more specifically, the ratios of debt and debt service to exports worsened considerably. Radical measures, therefore, are necessary to end the debt crisis.

New Solutions

It is worth noting that the G-7 (and Russia) recently agreed to a 65 percent reduction in the debt of the less developed countries. There is a need, however, to take these commendable but inadequate solutions further. It would be useful to consider solutions that would be both realistic and compatible with debtor countries' financial resources.

Indexation of debt payments to export receipts. A recent report by the IMF Research Department pointed out that in sub-Saharan Africa, from 1980 to 1990, debt service payments increased by almost 50 percent, while export receipts fell by over 40 percent. Despite reschedulings and write-offs of these countries' debts, the situation continues to deteriorate.

In view of the size of the debt burden and the inability of a number of countries, in particular African countries, to regularly service their debt, it seems essential for the Paris and London Clubs to place emphasis on indexation of debt payments to debtors' revenue or debt forgiveness. The proposal to index debt payments to export receipts should be further explored as a lasting solution to end the penalization of African countries, whose development is closely tied to the performance of the world commodities market.

The Paris Club. Ideally, Paris Club creditors should agree to write off interest payments and to consolidate the principal on IDA terms (that is, over 40 years with a 10-year grace period at a concessional rate of 0.5 percent). This proposal is similar to that made in Trinidad in September 1990 by British Prime Minister John Major.

The London Club. Two solutions could be envisaged for the London Club: either the cancellation of almost all interest payments or their refinancing by developed countries.

Cancellation of interest on private debt and consolidation of the remainder on IDA terms. The first solution for eliminating (alleviating) private debt would consist of requiring that banks cancel two-thirds or three-fourths of the interest on all generations of debt, incorporating the remainder in the principal, with a view to its restructuring over 25–30 years at concessional rates.

Repurchase of private debt by developed countries and consolidation on IDA terms. The second solution for alleviating private debt would be for host countries of creditor banks to refinance commercial debt. These countries would repurchase the bank debt either individually or collectively through the establishment of a common fund, and then these, now official, debts (Paris Club) would be reconsolidated on concessional IDA terms (over 40 years with a 10-year grace period at an interest rate of 0.5 percent). This second alternative has the advantage of maintaining, or even strengthening, the financial position of the international banking system.

Conclusion

More thought should be given to an integrated debt/development strategy in which debt relief would be a catalyst for sustainable development. Despite the large amounts of financing and new concessional financing that some African countries obtained as debt relief, these countries have failed to end the debt crisis for a decade. This failure is the result of the absence of links between the debt strategy and economic and financial reforms. For example, debt relief strategies have often been implemented without regard to the real performance of debtor countries' economies or of their structural adjustment programs, and vice versa. This trend must now be broken. Debt strategy should be viewed as an important link in the long-term development program. Debt relief should lead to a recovery of economic growth that, in turn, will allow debtor countries to generate surplus resources that can be allocated to debt repayment.

This is the price to be paid if developing countries as a whole, and particularly those in Africa, are to develop the capacity to repay their debts without simultaneously jeopardizing their long-term development.