ECONOMIC COMMISSION FOR AFRICA

REPUBLIC OF SENEGAL

Expert Group Meeting

Solving Africa's External Debt Problem to Finance Development

Recommendations and Conclusions of the Experts

17-18 November 2003
Le Méridien Président Hotel
Dakar, Senegal

Organized by the Economic Commission for Africa
and the Republic of Senegal

1. The Economic Commission for Africa together with the Republic of Senegal hosted an Expert Group Meeting on November 17-18, 2003 in Dakar to explore workable solutions to Africa's external debt problem. The meeting was convened as a result of a request made to His Excellency Abdoulaye Wade, President of the Republic of Senegal by African Heads of State in Lomé in 2000 and as a result of a request by African Ministers of Finance, Planning and Economic Development at their Annual Conference in Addis Ababa on 1 June 2003.

2. Of particular concern to African Ministers was the fact that since the 1999 G8 Summit in Cologne, at which the Jubilee 2000 Campaign won a commitment from rich nations to cancel $100 billion of debt for 42 of the world's poorest nations, only 8 African countries have reached their completion points under the enhanced Heavily Indebted Poor Countries (HIPC) initiative. In the meantime, the economic conditions on which debt relief was based have considerably worsened and many countries, including those few that received debt relief from HIPC initiative, have backtracked into further unsustainable debt. The Ministers noted with concern "that the enhanced HIPC initiative is not delivering long-term debt sustainability as expected." They emphasized the urgent need to find a lasting solution to Africa's external debt problem.

3. President Wade opened the ceremony with a statement in which he recalled the genesis of the proposal he put forward to African Heads of State in Lomé in 2000 to organize a workshop on Africa's debt. The President analysed the economic factors that have led to the current high levels of indebtedness of developing countries in general and of African countries in particular. On debt relief measures, he expressed the hope that the use of HIPC resources could be extended to cover other development sectors. He urged the Experts to be bold and creative in crafting a detailed strategy to ensure a way out of the African debt problem, bearing in mind its specificity and on the basis of a detailed diagnosis of the factors underlying Africa's indebtedness since the 1960s.

4. Taking into account the concerns raised by Ministers, the Experts examined the shortcomings of the current HIPC program, explored the need for additional financing for meeting the Millennium Development Goals (MDGs), and put forward a set of policies and instruments that can constitute the next steps to reducing Africa's debt burden. In particular they focused on ways to improve the debt sustainability analysis, clarify legal aspects of external debt management, assess financing needs for debt relief and development, and minimize the impact of exogenous shocks on Africa's debt sustainability.

5. In their deliberations, the Experts emphasized that any consideration of Africa's financing needs and prospects for debt relief needs to be put in the wider context of financing for development. This is because debt relief on its own will be woefully insufficient to allow African countries to finance the MDGs and achieve long-term debt sustainability. They noted with deep concern that at current trends, Africa will be the only region in the world where the number of poor people in 2015 will be higher than in 1990. Indeed, in many areas, Africa will not meet the MDG targets on time.

6. The Experts noted that the appropriate definition of debt sustainability—the capacity of a country to repay its debt—and how the concept is applied in practice lies at the heart of attempts to reach a long-term solution to Africa's external debt problem. The debate on how to judge whether a country's debt is sustainable revolves around: (i) the way to measure debt burdens; (ii) the types of debt to include in the measurement; (iii) the way to judge payment capacity; (iv) the identification of critical threshold values for such indicators; and (v) the design of stress tests and other tools to deal with vulnerability to stochastic shocks.

7. On the measurement of debt burdens, Experts noted that the concept of net present value (NPV) of debt that is used in debt sustainability analysis may not be an accurate measure of "debt overhang". Part of the problem is that the discount rates used in such calculations are often too high and therefore underestimate the actual burden of a particular external debt on the debtor country. Private

market actors use the nominal debt "stock" to assess debt burdens, and not the NPV. If the international community is to continue to use NPV rather than stock, creditors and investors need to be educated about its meaning and trained to track it. The Experts recommended that the benefits of simply using stock measures should be further considered and also that it would be far more equitable among countries and over time to freeze discount rates on those applying to investments by developing countries (around 2.5-3%).

8. With respect to which debt to include, the Experts argued that all debt sustainability analyses and PRGF documents should examine both domestic and external debt to establish a sound and comprehensive picture of the challenges facing the debtor country. Domestic debt problems are undermining the private sector, growth prospects and the sustainability of external debt. The debtor countries should take full responsibility for developing the necessary measures to enhance monitoring and analysis of private sector debts in order to ensure that they will not produce their own foreign exchange crises.

9. The Experts underscored that judging payment capacity of African governments needs to be carefully rethought. In this respect, they recognised that the key burden for African governments is fiscal liquidity and therefore top priority should be given to reducing the ratio of debt service to revenue. Therefore, in assessing payment capacity, budget revenue should be the key denominator for government debt, and export earnings for total national external debt (other denominators can be used as extra checks if required).

10. The Experts proposed that multiple indicators should be used in the analysis of debt sustainability to enrich and deepen the insight into the country-specific circumstances of the debt crisis. This should include indicators of debt stock and debt servicing costs, relative to export earnings and total revenue.

11. Experts recommended that the growth projections, which are at the basis of stress tests, must be jointly conducted by the IMF and indebted countries. To deal appropriately with shocks, countries should develop necessary contingency plans. However, further and

urgent attention should also be given to the need of African countries to make significant progress in diversifying their economies.

12. Experts suggested that achieving African countries development goals, including the MDGs, without running into future debt servicing problems—or a debt burden that constrains growth will require a prudent strategy for future borrowing tailored to country specific circumstances, especially the quality of its priorities and institutions, and its vulnerability to shocks. Experts emphasised that resource transfers beyond countries' sustainable debt-serving capacity should be in the form of grants, not debt flows that could lead to future debt servicing problems.

13. The Experts noted that a forward financing strategy is critical that takes into account the impact that the grant-versus-loan composition of external finance has on debt sustainability.

14. The Experts further noted that debt of non-HIPC countries needs to be considered. These include "semi-HIPCS" like Angola and Kenya, non-IDA countries like Nigeria, and severely indebted middle-income countries like Gabon.

15. Experts emphasized that a lasting solution to Africa's debt problems will require good economic governance and management on the part of African countries. Experts underscored the responsibility of each African country to enhance and consolidate progress in that regard.

16. The Experts recognized that the legal aspects of external debt are an important factor in understanding the causes of the current debt burdens of African countries. The Experts recommended that proper attention be paid to the legal details involved in entering into debt contract, such as the appropriate contracting party for government debt, the equitable division of losses from state guaranteed private commercial debt, the invalidation of contracts following corrupt practices, the invalidation of contracts due to misrepresentation and the effectiveness of arbitration procedures. They felt that these steps

could play an important role in encouraging greater transparency and accountability by both contracting parties, and ultimately a lower debt burden.

17. The Experts echoed the President of Senegal's concern about odious debt. The discussion focused on the relevance of the legal doctrine of odious debt today, and what mechanisms can be put in place to prevent odious debt from being incurred in the future. It was recognized that the legal doctrine of odious debt, originated in 1898 after the Spanish-American War, holds that successor governments should not be liable for debts and is still relevant.

18. The Experts proposed the establishment of an Ad-hoc Task Force to review the modalities required for the establishment of an institution that would identify odious regimes in Africa. Such an institution would provide public information ex-ante on the character of a regime, which would reduce information asymmetry such that the country would not be legally bound to repay such debts and creditors would know the rules of the game in advance and could only lend at their own risk.

19. The Experts agreed that achieving the MDGs would require a substantial increase in financing of development assistance. Therefore any consideration of Africa's financing needs and prospects for debt relief needs to be put in this wider context.

20. The Experts put forward several suggestions on how to make financing for development consistent with MDGs. In particular, the Experts underscored the need to assess the current aid levels, their composition and quality, and the balance between grants and loans.

21. While applauding the heightened priority under the HIPC initiative to invest in social sectors, the Experts cautioned the African governments not to neglect investments in productive sectors such as infrastructure, agriculture and manufacturing. They noted with concern that there has been a sharp reduction in the share of aid going to productive sectors. There is clearly a necessity to direct HIPC

savings beyond the social sectors, and if not, they warn, countries may not be able to achieve sustained economic growth that would bring about long-term debt sustainability.

22. With regard to financing debt relief, the Experts were of the opinion that it has many advantages. Debt relief is more predictable than bilateral aid, has a long–term horizon; reduces the transactions costs of managing aid; and acts like direct budget support, therefore increasing recipient ownership. They strongly encouraged the international community to finance further debt relief as an important way of financing the MDGs in Africa.

23. The Experts were of the opinion that IMF resources could be used for funding further debt relief. One recommendation was to make use of IMF gold reinvestment or sales, as has been done before. For example, it was estimated that selling half of its gold reserves could more than fund all the additional relief needed for topping up existing HIPC countries with the remainder being used for new HIPC countries. Another option is to use Special Drawing Rights (SDR) allocations to create additional global reserves for reallocation to debt relief.

24. Although some Experts suggested the utilization of IBRD net income and IDA resources to support the financing needs of low-income African countries, it was also recognized that important issues of equity need to be carefully considered before such a proposal could be put forward.

25. The Experts noted that the share of commodities in the total merchandise export earnings of HIPC countries averages about 84%; as a result, these countries are extremely vulnerable to short-run volatility and secular downwards trends in world prices. Unstable export earnings caused in part by export price volatility and deteriorating terms of trade, in turn, lead to instability of government revenues and debt sustainability. It was recognised that such export price fluctuations are at the heart of many African countries' failure to exit the debt trap.

26. The Experts underscored that the problems facing African HIPCs include not only the severity of commodity shocks but also the high frequency of other multiple exogenous shocks related to climate, conflicts, budget revenues and aid. Not only do these countries have a higher incidence of shocks compared to other developing countries, they also tend to suffer larger costs when they occur. The Experts noted that quantity shocks are often as or more important than price variability as a cause of variability of export revenues.

27. The Experts observed that forward markets can offer a useful method for commodity risk management, but they remarked that forward prices are often almost as variable as cash prices. Further, lack of contract enforcement and full information between traders and producers in low-income countries make these arrangements non-viable. The Experts considered the establishment of a central institution, such as a marketing board which could enforce contracts and provide transparent information to market participants, as a way for avoiding above mentioned market failures. They emphasized that further consideration should be given to the benefits of the possible re-establishment of these kinds of organizations.

28. The Experts were of the opinion that market-based mechanisms for commodity risk management will need to be supplemented with official financing to support countries suffering from terms of trade shocks. It was noted with concern that HIPC countries currently have minimal access to this kind of finance. Such financing needs to be set aside up front so that disbursement can take place quickly for countries suffering from shocks.

29. The Experts considered possible mechanisms for aligning debt service payments on concessional debt more closely with commodity export revenues by conditioning payments on the world prices of export and import commodities. They noted that although such schemes appear feasible, they would, in practice, make at most a moderate contribution with uneven impact over countries. They judged that, to the extent that the problem is perceived as one of adverse shocks to export revenues, new compensatory finance schemes may provide a more promising approach.

The Way Forward

30. In charting the way forward, the Experts agreed that the meeting has identified important technical issues that need further and urgent attention. The Experts underscored the fact that the lack of a consolidated African position and an effective and collective voice to engage in constructive dialogue with Africa's partner countries and institutions with regard to debt relief was at the heart of the problem. A sense of urgency was expressed to put an end to African countries' reacting too late to global policy proposals that have vast economic implications for Africa.

31. The Experts recommended that an Ad-hoc Technical Committee should be established by ECA to facilitate timely and competent African responses to emerging global policy proposals on debt relief. The committee should be composed of experts from NEPAD, African Union, African Development Bank, some member states and sub-regional organizations under the leadership of the Economic Commission for Africa.

32. The recommendations of the Technical Committee should be presented to the African Ministers of Finance, Planning and Economic Development at their next meeting in May 2004 and thereafter to the African Union Heads of State Meeting in July 2004.

33. Finally, the Experts thanked the Economic Commission for Africa and the Republic of Senegal for bringing them together for this important meeting. They extended their special appreciation to His Excellency President Abdoulaye Wade for his exceptional leadership and outstanding contributions to the deliberations and to the warm hospitality afforded to them in Dakar.