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REPORT ON THE WORKSHOP ON REVIEW OF PRAGMATIC WAYS AND MEANS OF ALLEVIATING AFRICA'S EXTERNAL DEBT BURDEN

(Addis Ababa, Ethiopia, 17-18 November 1993)

I. INTRODUCTION

1. The Workshop on Review of Pragmatic Ways and Means for Alleviating Africa's External Debt Burden was held in Addis Ababa, Ethiopia from 17 to 18 November 1993.

2. The Workshop was opened by Mr. A. Bahri, on behalf of Mr. Layashi Yaker, United Nations Under-Secretary General and Executive Secretary of the Economic Commission for Africa.

II. ATTENDANCE

3. The Seminar was attended by representatives of the following countries: Cameroon, Egypt, Ethiopia, Malawi, Namibia, Sierra Leone, Tanzania, Tunisia, Zambia and Zimbabwe. The following organizations participated and/or provided resource persons to the meeting: the International Bank for Reconstruction and Development (IBRD); the International Monetary Fund (IMF); the Organization of African Unity (OAU); the Preferential Trade Area for Eastern and Southern African Countries (PTA); the United Nations Conference on Trade and Development (UNCTAD); Banque des Etats de l'Afrique Centrale (BEAC) and the PTA Trade and Development Bank (ESATDB). The representative of the Eastern and Southern African Trade and Development Bank (PTA Bank) chaired the Workshop.

III. ACCOUNT OF PROCEEDINGS

4. The Officer-in-Charge of the Commission, Mr. Bahri, speaking on behalf of Mr. Layashi Yaker, United Nations Under-Secretary General and Executive Secretary of the UNECA, welcomed the participants to the Headquarters of UNECA and expressed his special appreciation to the World Bank, IMF and UNCTAD for accepting to make available some of their experts to serve as resource persons at the Workshop. He stated that the Workshop was being held at a time when Africa was continuing to experience serious debt problems. The situation had not changed significantly since the adoption of the "African Common Position on Africa's External Indebtedness" by the Third Extra-Ordinary Assembly of the Heads of State and Government of the Organization of African Unity in 1987.

5. He regretted the fact that the economic crisis of Africa had persisted for a decade and a half, marked by a steady decline of per capita incomes, incidence of poverty and deteriorating social conditions. Among the obstacles to Africa's socio-economic recovery, he mentioned the unsustainable levels of Africa's external debt service payments. He further stated that despite the various initiatives which had been presented by creditor countries starting from 1987, Africa's debt problems continue to persist. Following the easing of the global debt crisis, the representative pointed out that the time had come to consider applying the principles of substantial write-off and/or conversion of loans originally contracted on hard terms by African countries.

6. In connection with the debt owed to private creditors, the representative supported the World Bank's IDA Debt Reduction Facility to assist African countries to retire commercial debt at highly discounted rates. However, he remarked that the facility alone was not a robust solution, as activity in the secondary market financed by the World Bank funds had the effect of driving up the price of the debt instruments. Likewise, he duly recognized the positive contribution of UNCTAD's recommendation to write off three quarters of severely debt distressed low-income countries debt was duly recognized.

7. The representative highlighted the need to increase African countries' access to compensatory financing to provide them with a measure of protection against unforseen fluctuations in commodity prices. More generally, he stressed the need for African countries to diversify their productive base to reduce their over dependency on commodity exports.

8. He concluded by noting that Africa's external debt problem was fundamentally due to lack of economic growth and development. That critically revolves around the lack of a diversified production and export base. It was, therefore not surprising that while Africa's poor economic performance had been marked by a deepening external debt crisis, the "Tigers" of East Asia had witnessed robust growth and were able to repay their debts and also attract new foreign direct investment. The contrasting experiences of Africa and Asia had a clear message: If Africa was to avoid the vicious circle of external debt crisis, it must implement policies that could keep it onto a path of sustainable growth.

A. Assessment and Evaluation of the Impact of Various Debt Relief Initiatives in Alleviating Africa's External Debt Burden

9. Presentations for this agenda item were made by representatives of the United Nations Economic Commission for Africa, the World Bank, and the International Monetary Fund. The UNECA representative started his presentation by mentioning the persistence of Africa's debt problems notwithstanding the various debt relief initiatives that had been announced by donor countries and multilateral institutions. The African debt profile had been characterized by limited additional disbursements, repeated servicing, rescheduling and accumulation arrears.

10. According to ECA, the debt overhang of African countries has remained an overwhelming obstacle to both private capital inflows, increased domestic savings and investment and therefore to sustainable development. Ten years after the emergence of the debt crisis, Africa's indebtedness remained an important obstacle to Africa's socio-economic recovery and development. The international community had come to acknowledge the need to establish strategies for reducing Africa's external indebtedness and lightening the debt burden. But lasting solutions to the problem were still proving illusive.

11. Between 1988 and 1990, a number of debt-reduction initiatives had emerged which included, the Brady Plan, the Toronto Plan, the Trinidad and Tobago Initiative and the Netherlands Proposal. The World Bank, the African Development Bank and the International Monetary Fund, which are among Africa's major multilateral creditors, had also adopted new instruments in order to play a more active role in the process of alleviating the debt burden. Furthermore, some countries such as France, had taken the unilateral decision to cancel a portion of the public debt of certain African countries South of the Sahara. A clear assessment of the impact of reduction initiatives on bilateral, multilateral and private debts had shown that to respond to long-term growth and development needs in numerous African countries, it would be necessary for those initiatives not only to strengthen and implement current debt relief measures but also to go beyond in order to remove the impediment which debt represents to economic growth and development.

12. In his presentation, the representative of the World Bank dwelt on the nature and scope of Africa's debt and the various restructuring mechanisms that had been available to African countries during the last ten years. For the purpose of the discussion, he concentrated his presentation on the 21 severely indebted low income countries of Africa whose debt stock had tripled from US$60 billion to US$180 billion in a single decade. He indicated that the rate of growth of debt of these (SILIC) countries was significantly faster than for any group of developing countries.

13. While much of the increase in debt was due to new, largely consessional lending, he also indicated that a substantial portion of the increase in Africa's debt stock was mainly due to exchange rate adjustments, triggered by the depreciation of the US dollar. In connection with debt rescheduling operations, he highlighted the impact of debt forgiveness which had reached an aggregate level of US$20 billion in recent years. However, he mentioned that this amount was offset by the capitalization of interest charges and arrears due to repeated reschedulings. In addition to debt forgiveness, he pointed out that other options such as debt swaps and buy backs, should also be seriously considered as viable mechanisms for restructuring debt. Nevertheless, he indicated that there was ample margin to increase the scope for debt forgiveness for severely indebted low income countries of Africa.

14. Under debt conversion programmes, the World Bank representative paid particular emphasis to debt-for-equity swaps. Under this programme, the investor buys the foreign debt of a country at a discount in the secondary market. Then, the debt is usually redeemed by the central bank of the host country at its face value in exchange for ownership of local equity, alternatively in debt-for-debt swaps for local currency instruments. This programme was by far the most significantly utilized, while debt for development swaps were the least utilized.

15. During his presentation, the IMF representative outlined the recent evolution of debt restructuring operations under the auspices of the Paris Club. In recognition that short-term cash flow relief was not enough, all reschedulings for low-income countries since December 1991 had been made on "enhanced concessional terms", providing for a 50 percent reduction (in net present value terms) of the debt service consolidated and for the prospect of a debt stock reduction 3-4 years hence. These terms, it was felt, should enable most debt-distressed low-

income countries to achieve medium-term viability. It was increasingly recognized, however, that for several countries, substantially deeper reductions of their obligations eligible for restructuring would be called for. The Managing Director of the IMF had drawn attention to this need at the recent Tokyo International Conference on African Development, while also stressing the central importance of sound macro-economic policies and courageous structural reforms on the part of African governments and the need for continuing support from the international community, through market access and technical assistance as well as financial aid and debt relief. In closing, the IMF representative expressed the belief that policies supporting rapid diversification and growth of exports offered the soundest and most lasting solution to the problems being addressed by the meeting.

16. In the ensuing discussion, participants weighed the efficiency of case-by-case approach of creditors versus the holistic approach which is preferred by African debtor countries. The case-by-case approach was fundamentally based on the premise that the debt problem of African countries should be perceived within the context of individual reform programmes. The holistic approach argues that African debtor countries should be considered as having common developmental problems which have been compounded by a number of adverse developments, including the decline in commodity prices of primary products.

17. The historical linkage between development and debt was also examined, particularly in relation to the complementarity of official credits and private capital flows and the need for African countries to provide the enabling environment to promote investment as well as the reversal of capital flight.

B. Evaluation of the Scope for Application of Various Debt Relief Techniques and Swaps to Africa

18. Presentations under this agenda item were made by representatives of the United Nations Economic Commission for Africa and the World Bank. The representative of UNECA, in introducing this subject, stated that a number of instruments and techniques for dealing with the debt problem had emerged over the years since the problem surfaced. He referred to the various debt reduction initiatives that had been put forward to deal with the problem as well as various

debt swaps and conversion techniques. Debt conversions and swaps have included debt-for-equity, debt-for-nature, debt-for-environment and even debt-for-education swaps. He indicated that these instruments have enabled other regions, particularly Latin America, to tap substantial private sector capital inflows. Africa, on the other hand, has not been a significant beneficiary of these new developments; although some African countries have availed themselves of these instruments.

19. The UNECA representative concluded by stating that it was in this context that the Commission had organized this Workshop to share with member States their experiences in utilizing debt relief techniques and swaps. Likewise, he called on regional and international organizations present to illustrate the experiences of other regions.

20. Debt relief techniques discussed by the World Bank representative included debt buybacks and a variety of debt conversion programmes. Debt buybacks essentially allow the debtor country to repurchase its debt at a discount from the secondary market. Debt conversion programmes with potential applicability to Africa included debt-for-equity swaps, debt-for-development swaps, debt-for-nature swaps and debt-for-export swaps.

21. The advantages and disadvantages of debt-for-equity swaps were discussed during the Workshop. Among the principal advantages mentioned were the reduction of the stock of debt, the consequent savings on debt servicing obligations and the general reduction of the debt overhang. Additionally, it was mentioned that debt for equity swaps promote a new source of non-recourse financing and encourage foreign direct investment, with the accompanying spill-over effects on the economy (i.e. technology transfer, employment creation etc.). Furthermore, debt-equity swaps could facilitate and support government efforts towards privatization and stimulate capital markets. These advantages convey a strong message to international capital markets that the country is pursuing market economic reforms. Some of the disadvantages raised by critics of debt-for-equity swaps have included the observation that they have the potential for aggravating inflationary pressures by increasing domestic money supply. Likewise, it has also been argued that debt-for-equity swaps subsidize foreign investors.

22. The discussion on this subject centered on the applicability of Debt Swaps to the African situation. It was observed that debt conversion programmes instituted in the 1990s included limited use of debt swaps and had become an integral part of debt management and negotiation strategies.

23. It was argued that debt swaps could serve as an instrument to reduce debt. However, it was also indicated that these mechanisms also carry some costs and risks. Among the widely used instruments, debt-for-equity swaps were by and large, the most important type of debt conversions with totals between 1985 and 1986 reaching US$3 billion, roughly 36% of the total debt conversions globally. This was followed by Debt buyback/exchange which comprised nearly 25%. For debt-for-equity swaps to work, a creditor country was expected to undertake a serious and sustained privatization programme. The question was raised as to whether Africa is ready to undertake the necessary reforms needed to foster the utilization of these techniques.

24. Country experiences, particularly in the BEAC region, indicated that member States had not used debt swaps extensively. In recent months, the situation had been compounded by speculation about the possible devaluation of the CFA Franc which had given rise to substantial capital flight from the region. Nonetheless, it was recognized that these were only temporary developments which may not be a serious impediment to future use of these instruments in the zone.

25. The representative of the PTA Trade and Development Bank suggested that perhaps a deliberate default in the service of maturing debt obligations could trigger a significant reduction of secondary market prices of African sovereign debt. African countries could then engage, with the assistance of reputable merchant banks, in buying back the discounted debt from the market. He felt this would result in rational use of scarce foreign exchange with little or no adverse effect on the credit worthiness of the countries concerned. The meeting took note of the proposal but also of the dangers default would imply in terms of private sector capital flows as well as foreign aid.

C. Conclusions and Recommendations

26. The workshop took note of the worsening situation of Africa's debt situation since the adoption of the African Common Position on Africa's External Indebtedness by the Third Extra-Ordinary General Assembly of the Heads of State and Government of the Organization of African Unity and the ensuing steady decline of per capita income, incidence of poverty and deteriorating social conditions. It further noted with appreciation the potential offered by the various instruments and options for partially dealing with Africa's external indebtedness.

27. Accordingly, the workshop concurred to submit the following recommendations for consideration by the Conference of African Ministers of Finance:

1. ECA in collaboration with the OAU, ADB, UNCTAD, IBRD, and IMF should provide training to African policy makers, monetary authorities of African Central Banks, and foster exchange of experience, on the potential and applicability of the various swap instruments and rescheduling options used to alleviate the debt burden.

2. African countries should appeal to bilateral creditors and donors to offer increased ODA to help African countries make progress in the use of risk management techniques.

3. African countries on their part should move beyond an appeal for cancellation of debt and initiate measures needed to attract foreign direct investment through: (a) improving political and macro-economic stability; (b) undertaking appropriate privatization programmes, coupled with the restructuring of the private sector; (c) creating an enabling environment in support of economic reform.