E

46579

Distr. GENERAL

E/ECA/TRADE/93/24
November 1993

Original: ENGLISH

UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL

UNITED NATIONS
ECONOMIC COMMISSION FOR AFRICA

Meeting of the Inter-Governmental Group of
Experts of the Fifth Session of the
Conference of African Ministers of Finance

Libreville, Gabon
10-12 January 1994

REPORT ON THE SEMINAR ON REVIEW OF AFRICA'S DEBT SITUATION AND THE IMPACT OF DECLINING COMMODITY PRICES ON AFRICA'S CAPACITY TO GROW AND SERVICE ITS EXTERNAL DEBT

(Addis Ababa, Ethiopia, 15-16 November 1993)

I. INTRODUCTION

1. The Seminar on Review of Africa's Debt Situation and the Impact of Declining Commodity Prices on Africa's Capacity to Service its External Debt was held in Addis Ababa, Ethiopia from 15 to 16 November 1993.

2. The Seminar 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 Central Bank of Zimbabwe chaired the Seminar.

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 Seminar. He stated that the Seminar 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

Indebtness" 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. Review of Africa's External Debt Situation and the Impact of Declining Commodity Prices on Africa's Capacity to Service its External Debt

9. Presentations for discussion under this agenda item were made by representatives of the United Nations Economic Commission for Africa, the World Bank and the United Nations Conference on Trade and Development.

10. The representative of the UNECA Secretariat highlighted the situation of Africa in international commodity markets which had been characterized by declining real prices. Furthermore, he stated that for those countries which had tried to expand their export bases, these efforts had been thwarted by the decline in commodity prices. He stated that although petroleum prices had shot up during the oil price hikes of the early 70s, they had generally been weak during the latter 1980s and early 1990s due to increased supply pressures from the major producing countries.

11. Referring to the debt situation of African countries, he stated that the debt problem of the poorest countries remained acute. The debt related liquidity problems of some African countries of the 1980s had been partially alleviated by concessional lending, successive rescheduling and forgiveness. Nonetheless, for many African countries the debt problem remains a millstone around their necks.

12. It was also the hope of the UNECA that the process of brainstorming being undertaken during the Seminar would give rise to collaboration with other regional and international organizations in formulating, devising and implementing strategies and policies needed to ameliorate the adverse impact of declining commodity prices on African countries' capacity to grow and service their debts.

13. In conclusion, the representative of ECA expressed his hope that the brainstorming seminar would lead to conclusions and recommendations on those important issues which could be considered by the Fifth Session of the Conference of African Ministers of Finance which will be held early January 1994, in Libreville, Gabon.

14. The representative of the World Bank stated that while appreciating the debt problems of African countries, these were not the primary developmental problems of African countries. He stated that civil strife, weak commodity prices, natural disasters, weak physical infrastructure, poorly trained workforces, etc. were the major developmental problems facing Africa. Nonetheless, the Bank was of the view that even though debt was not the number one problem for many African countries, solutions needed to be found to help ensure the success of economic reform. After elaboration on the historical background of the debt problem, he stated that for many countries the problem was not one of cash flow or liquidity but rather that of solvency. He went on to state that while the creditors had done quite a lot, this has not been adequate to deal with the problems of some of the most heavily indebted low-income countries. The existing terms are not sufficient to put debt on sustainable levels for a number of these countries. There was need to go beyond enhanced Toronto Terms in some cases. Furthermore, for debt reduction initiatives to be successful, they needed to differentiate individual circumstances. This was necessary to avoid providing too much debt relief to some countries and not enough relief to the more deserving countries.

15. The World Bank representative also stated that for debt reduction schemes to be effective the whole stock of debt needs to be considered. Debt reductions need to be much deeper for some countries, far beyond the terms offered by the Toronto or Enhanced Toronto terms. Debt reduction should also be done in the context of sound economic reform programmes, he added.

16. The World Bank representative also spoke about the problems of debt overhang and its implications for many heavily-indebted economies. He stated that for many African countries, the debt problem was not one of liquidity, but of a severe debt overhang. Accordingly, resolving the debt overhang problem could result in an improvement in the climate for private

investment. Furthermore, this could also improve the availability and the terms of trade financing for many of these countries which at present are not credit worthy. The World Bank representative also stated that removal of the debt overhang could release the time of policymakers now tied up in protracted negotiations and could restore the relationship between these debtor countries with creditors and create a sound dialogue with banks.

17. The representative of the United Nations Conference on Trade and Development (UNCTAD) recalled that, as the majority of African countries have a high degree of dependency on 1 or 2 primary commodity exports, there was need to reduce this dependency by way of diversification. She stated that countries that had been able to diversify their production and export bases had been able to ameliorate the adverse impact of declining commodity prices on their economies and on their capacity to service external debt. She further elaborated that some Asian countries had successfully entered production and export of products which had traditionally been exported by Africa, mainly because of using modern cost efficient methods. She stated that diversification should not be taken to mean substituting one crop by another, but in many cases it meant producing additional types of crops. She gave the example of Colombia where decorative flowers have been planted in addition to traditional crops such as coffee in the process of diversification, using financial resources from the coffee sector. In emphasizing the importance of improving productivity, the UNCTAD representative stated that although commodity prices of primary products have declined, some countries have been able to break even in their exports by using efficient means of production and marketing. In conclusion, she stated that commodity agreements could not provide the long-term solution to problems of falling commodity prices. The issue of diversification was fundamental to solving Africa's problems related to declining commodity prices.

18. Following the presentation, the main points raised related to priority setting in economic formulation in Africa, and general problems of diversification of production and export bases of African economies. The discussion also centered on problems of debt servicing by African countries, problems relating to rates of return on investment in Africa in the context of high interest rates prevailing in many of these countries and associated high rates of inflation.

19. In discussing the African debt problem, it was noted that although Africa was plagued by other developmental problems, nonetheless the debt problem was recognized as a major constraint to Africa's development process. For many African countries, the debt problem has to be perceived in the context of financing development in Africa. The discussion on net resource transfers centered on the importance of maintaining adequate net resource transfers. In this respect, it was also clear that African countries needed to put in place appropriate macro-economic policies that will attract foreign direct investment. Reference was also made to the Tokyo Conference on Africa's Development, whose general consensus was the need for greater debt relief to be provided to the heavily-indebted African countries, including substantial cancellation of their debts.

B. Risk Management in Commodity Exports and Available Techniques

20. Presentations for discussion under this agenda item were made by the representatives of the World Bank, the United Nations Conference on Trade and Development and the United Nations Economic Commission for Africa.

21. The representative of the World Bank began by stating that "risk management" is the management of assets and liabilities to minimize adverse changes from external shocks in future cash flows. He stated that traditional risk management techniques such as contingent finance, compensatory financing and international commodity agreements had proved unsuccessful in shielding exporters from commodity price fluctuations. On the other hand, market-based instruments had been found to be more effective and cheaper. Risk management affords a country better economic management planning and budgeting and, accordingly, can enhance a country's credit worthiness. He added that a country's institutional structure was also an important element in the successful utilization of risk management techniques.

22. He then went on to discuss some of the modern techniques and tools used in risk management such as forward and futures contracts, options, and swaps. He gave examples of countries which had recently moved to adopt risk management techniques in managing their commodity exports such as Costa Rica for its coffee and Mexico for its oil exports. The World

Bank representative also drew to the attention of the meeting the existence of commodity swaps in risk management.

23. The under-developed nature of capital markets in African countries, coupled with lack of knowledge of new techniques has been an impediment to successful use of risk management as a tool for smoothing out commodity price fluctuations. The World Bank representative stated that through training, knowledge of these instruments can be disseminated. However, it was recognized that it takes time to master the techniques. Statistical evidence was presented showing that there has been extreme volatility in commodity prices over time accompanied by declining trends in prices. It was also pointed out that Africa's dependency on exports of primary commodities had increased in recent years.

24. The representative of United Nations Conference on Trade and Development drew attention to developments that had taken place in major international commodity markets. She also pointed to the fact that there had been increased use of sophisticated market-based instruments, such as forward and future contracts, swaps and options which were designed to protect firms against adverse price developments in commodity markets.

25. The UNCTAD representative stated that risk management was not designed to increase earnings from commodity exports but rather a way to manage exposure to and reduce a company's risk from price fluctuations. A key element in any hedging strategy was to determine the desired level in the trade-off between risk and rate of return.

26. It was mentioned that risk management instruments were traded in two distinct markets: the commodity exchanges and the over-the counter market. The former is a financial market where different groups of participants (hedgers and various types of speculators) trade commodity-linked contracts with the main objective of transferring exposure to commodity price risks. For example, the New York Mercantile Exchange; the Coffee, Sugar and Cocoa Exchanges; the London Metal Exchange and other markets were mentioned. The over-the-market risk management instruments such as forward contracts, swaps and options are traded directly between two parties and are usually linked to physical trade transactions.

27. For risk management instruments to be used by developing countries, especially in Africa, the representative of UNCTAD underlined the need to arrange for specialized training courses. She stated that UNCTAD has already been organizing training seminars in Africa to acquaint participants with these techniques. The representative indicated that certain benefits can emerge from proper application of risk management techniques, including helping in stabilization of Government budgets, improving marketing strategies, increasing access to finance at better rates, and allowing governments and companies to plan ahead. She described the various constraints and preconditions facing those wishing to use these instruments, at both the company and country levels. It was pointed out that often the policy of a government needs to be adjusted to allow for use of risk management instruments within limits which avoid their abuse.

28. With a view to sharing experience of African countries on price stabilization mechanisms, the Eastern and Southern African Trade and Development Bank (PTA Bank) representative highlighted the Price Guarantee Contract (PGC) which the Bank has created as an instrument to assist African exporters to hedge against short-term price fluctuations. The PGC was described as a financial instrument which insures an exporter, upon payment of a premium, against any negative fluctuations below a contractual price on one of the world terminal markets. The PGC can hedge both soft as well as hard commodities. The PTA Bank expects to launch the product during the first quarter of 1994.

29. During the discussion, the problems related to the utilization of some of these instruments were considered. In reviewing the underlying shortcomings of the instruments, participants mentioned the short-term nature of the instruments, while the structural problems of African countries required long term solutions at macro-economic level. The need to educate the various operators and government executives involved in the trade of commodities about risk management concepts and instruments before their application in African countries was highlighted.

30. The Seminar, nonetheless, welcomed the potential that risk management techniques offered in smoothening commodity price fluctuations. Participants outlined the fundamental mechanisms needed to institutionalize risk management. These are: analysis, training and policy

measures. The analysis should mainly focus on research on the type and distribution of risks existing in African countries, and the legal and institutional impediments to risk management. Training is needed in order to acquire the practical technical skills of risk management and it should be directed to the private and public sectors. In connection with policy measures to be developed, the need to set-up risk management units within the Ministries of Finance and/or African Central Banks to serve as focal points for any activity in risk management was emphasized. In addition to establishment of these units, policy measures should take into account the need to make private sector and government officials aware of the benefits of risk management. African countries should also be made aware of the rapid developments that have taken place in risk management as a way of reducing exposure to price fluctuations.

31. Participants also discussed extensively the problems of credit worthiness as an important element for exporters to enable them to have access to some of the instruments used in risk management. In this respect, attention was drawn to the participants of the Seminar as regards to the economic reform programmes currently being implemented by many African countries, most of which contain liberalization of marketing arrangements for commodity purchases and exports. The promotion of small-scale traders, while economically sound, has resulted in proliferation of private traders, many of which have no credit record abroad. Accordingly, suggestions were made for creation of cooperatives among private traders and exporters as a way of increasing credit worthiness and thereby enabling them to use risk management instruments.

C. Conclusions and Recommendations

32. The Seminar took note of the adverse impact declining commodity prices have had on Africa's economic prospects and on its capacity to service its external debts. While appreciating that Africa faces a number of developmental issues, nonetheless, the debt problem was recognized as a major constraint to Africa's development. In the long-term, Africa should make concerted efforts to diversify its production and export bases. Furthermore, Africa should try to regain market shares in its traditional exports by improving productivity in production of some of its exports.

33. The Seminar considered risk management in commodity exports as part and parcel of the process needed to ameliorate the adverse impact of declining commodity prices on Africa's capacity to service debt. The Seminar agreed to submit the following recommendations for consideration by the Conference of African Ministers of Finance:

1. That there should be research undertaken at a country level for the types and distribution of commodity price risks existing in African countries. This research should also include an analysis of the methods (including domestic stabilization funds, marketing boards) used to handle exposure to these price risks, as well as problems and solutions that have been tried or are envisaged. It is suggested that the UNECA play a fundamental role in undertaking such research, in collaboration with the World Bank and UNCTAD.

2. That seminars and workshops should be organized to make Governments aware of the availability of market-based risk management techniques so that they create a policy framework conducive to their implementation.

3. That the public and private sector operators be trained in the use of these new risk management techniques. The training should be practical and emphasize the use of these techniques for hedging purposes.

4. That Governments of African countries should be encouraged to establish risk management units in the Ministry of Finance or the Central Bank to serve as a focal point for any activity in the risk management area.