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Uka Ezenwe\*

## The African Debt Crisis and the Challenge of Development

*Africa's total debt outstanding, which doubled during the 1980s, represents a serious threat to the continent's prospects of economic recovery and long-term development. Professor Ezenwe examines the situation in detail and proposes policy action towards a solution.*

The first half of the 1960s, when the bulk of African countries gained political independence, was a period of great expectations. It was generally believed that political independence would lead to rapid progress in raising incomes and improving the peoples' welfare. Indeed, the first United Nations Development Decade (1960-1970) was a period of socio-economic reconstruction and consolidation. Many African countries successfully expanded their basic infrastructure and social services.

However, after this initial period of growth most African economies stagnated and then went into decline. For instance, in sub-Saharan Africa per capita income has been falling in real terms since 1973. Put differently, overall Africans are almost as poor today as they were thirty years ago. In 1950 the region's per capita income was 11% of the industrial-country average; today it is 5%.<sup>1</sup> Its collective GNP has shrunk from US\$ 200 billion in 1980 to US\$ 140 billion in 1990.

The present sombre economic situation is traceable to the "unholy bunching" of unfavourable events, including: accelerating ecological degradation, population growth with its rising demands for education, health and social services, capricious weather, desertification, sluggish growth in export demand and steady declines in terms of trade, and the adverse effects of the debt overhang. To compound the situation further, a few countries, such as Ethiopia, Somalia and Liberia have been engulfed in internal strife and famine conditions.

Although these factors have, directly or indirectly, acted as a brake on African economic growth and development, the continent's external debt now clearly constitutes such an intractable bottleneck as to overshadow most of the others. Thus, for a sustainable economic recovery to occur, the resolution of the debt problem must form part of any package of policies designed to transform the African economies. Against this backdrop the thesis of this paper is that the current debt overhang is a serious threat to Africa's economic recovery and long-term development prospects; hence the need for urgent global policy action.

### Africa's Debt Profile

Africa's external debt profile and structure underwent significant changes during the 1980s. In 1982, when the debt crisis emerged, Africa's total debt stock stood at US\$ 140 bn., but by the end of 1990 the region's debt had skyrocketed to \$ 271.9 bn. (cf. Table 1). The region's debt then amounted to roughly 19% of the total outstanding debt of all developing countries, estimated at over \$ 1400 bn.<sup>2</sup> Compared to the debt of other regions such as Latin America—\$ 428 bn. in 1990—Africa's debt may look fairly modest. But conventional debt indicators show that, relative to its current productive and payment capacity, Africa's debt and associated servicing burden have long reached unmanageable limits. As can be easily gleaned

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<sup>1</sup> Cf. World Bank: World Development Report 1991, Oxford University Press, 1991, p. 13.

<sup>2</sup> African Development Bank Group: African Debt Developments and Strategies, paper prepared for the Meeting of Chief Executives of OAU/ECA and ADB, Abuja, Nigeria, December 1991.

## DEVELOPMENT STRATEGY

**Table 1**  
**Africa's External Debt and Debt Service,**  
**1987-1990**

	1987	1988	1989	1990 <sup>a</sup>
	(in billions of dollars)			
<b>Total External Debt</b>				
Developing Africa	251.9	252.6	265.4	271.9
of which:				
North Africa	121.6	123.3	122.7	124.0
Sub-Saharan Africa	130.4	129.3	142.7	147.9
<b>Debt Service</b>				
Developing Africa	21.4	25.3	27.1	27.3
of which:				
North Africa	10.9	13.2	14.6	14.8
Sub-Saharan Africa	10.5	12.1	12.5	12.5
	(percentage)			
<b>Ratio of Debt to GDP</b>				
Developing Africa	80.2	87.3	91.1	90.9
of which:				
North Africa	64.2	76.8	75.3	74.2
Sub-Saharan Africa	104.5	100.3	112.3	112.4
<b>Ratio of Debt to Goods and Services Exports</b>				
Developing Africa	371.5	339.5	327.7	300.4
of which:				
North Africa	378.8	351.3	306.0	267.8
Sub-Saharan Africa	365.3	328.2	348.9	334.6
<b>Ratio of Debt Service to Goods and Services Exports</b>				
Developing Africa	31.6	34.0	33.5	30.2
of which:				
North Africa	32.7	37.7	36.4	32.0
Sub-Saharan Africa	30.5	30.7	30.6	28.3

<sup>a</sup> Preliminary estimates.

Sources: World Debt Tables 1990-1991; 1989-1990; OECD: 1989 Survey; IMF Outlook, October 1990, and various issues.

from Table 2, the ratio of debt outstanding to GNP rose sharply to 95% in 1990 from some 45% in 1982. For sub-Saharan Africa, the ratio is even higher, reaching just over 110% in 1990 (Table 3). The spectre of unacceptably high debt service payments became such a concern that the African Common Position on Africa's External Debt Crisis (1987), which was updated in 1989 and discussed at the forty-fourth session of the General Assembly, specified that each country should, on average, devote no more than 30% of its export earnings to debt servicing. Even so, the stipulated 30% of export earnings covered only about 60% of the debt service payable.<sup>3</sup> In contrast, Latin American debt service payments accounted for only 25% of export proceeds.

Rescheduling, in ways that stretched out the repayments of the obligations without reducing them, took care of the balance of unpaid African debts. Despite the fact that over thirty African countries resorted to

**Table 2**  
**The African Region's' External Debt Outstanding**  
**and Actual Debt Service, 1982-1990**

(in US \$ billions except where otherwise indicated)

	1982	1986	1990 <sup>a</sup>
<b>1. Total debt disbursed and outstanding (DOD)</b>	140.4	207.1	271.5
Total official debt outstanding (ODO)	69.4	119.7	171.8
Official bilateral	47.6	80.6	112.9
Official multilateral	21.8	39.1	58.9
Total private debt outstanding (PDO)	71.0	87.4	99.7
Private long-term guaranteed (LTG)	45.4	53.7	61.8
Private long-term unguaranteed (LTU)	4.7	6.8	8.8
Private short-term (STD)	20.9	26.9	29.1
<b>2. Total debt service (TDS)</b>	19.7 <sup>b</sup>	22.6	27.4
Bilateral service (BDS)	2.65	4.6	6.6
Multilateral (MDS)	2.0	4.6	6.3
Private (PDS)	15.2	13.4	14.5
<b>3. Key debt ratios and other indicators (in percentage)</b>			
Debt service/exports ratio	24.1 <sup>b</sup>	30.8	30.4
Debt outstanding/exports ratio	162.02	291.02	291.04
Debt service/GNP ratio	6.4	7.8	9.6
Debt outstanding/GNP ratio	45.3	71.4	94.6
Interest arrears due (in US \$ billions)	1.3	4.9	12.9

<sup>1</sup> Comprises only African countries which are members of the OAU or ADB, excluding Namibia for which no data were available.

<sup>a</sup> Estimates.

<sup>b</sup> 1983.

Source: Adapted from Percy S. Mistry: African Debt Revisited, paper prepared for the Joint Parliamentarians for Global Action/ADB North-South Roundtable on African Debt, Recovery and Democracy, 8-9 July, 1991, Abidjan.

rescheduling, external debt (largely from increased arrears, rescheduled amounts and accrued interest) increased by 35% between 1986 and 1990. The accumulation of interest arrears alone came to \$ 13 bn. in 1990, as against \$ 1 bn. in 1982. Evidently, after almost a decade of debt rescheduling and cancellations of some bilateral debt Africa's key debt indices point to a worsening trend.

### Changing Debt Structure

The changing structure of the continent's debt partly explains the worsening situation. Since the eruption of the debt crisis in 1982, commercial banks have hardly made any new lending to Africa though they continue to claim a sizeable proportion of debt service payments. The share of commercial debt in the debt stock declined appreciably from 26% in 1983 to about 15% in 1990. Conversely, the fraction of multilateral and official debts has been

<sup>3</sup> For details, cf. Marjorie R. Thorpe: Assessment of the Implementation of the United Nations Programme of Action for African Economic Recovery and Development 1986-1990, text submitted by the Chairman of Working Group 1, General Assembly, September 14, 1991.

increasing. The proportion of multilateral debt in Africa's external debt stock jumped from 17.8% in 1985 to around 22% in 1990. This increase, unquestionably, reflected lending associated with the implementation of the Structural Adjustment Programme (SAP) which is strongly supported by the World Bank, the IMF and other financiers. In one significant sense, the growing importance of multilateral debt in total debt is a mixed blessing. Since such debt cannot be rescheduled and given that any new disbursements from multilateral financial institutions require that arrears be fully paid off, the current structure raises serious problems.

Certain African countries, such as the Sudan, Somalia, Liberia, Zambia and Sierra Leone have, in recent years, accumulated large arrears in their payments to the IMF and have had, in consequence, their drawing rights suspended, with little or no further access to external resources, bilateral or multilateral. Although a new mechanism known as the "rights approach" was created in 1990 to break the impasse between the Fund and such countries, it has the serious disadvantage of postponing rather than really addressing the thorny issue of interest service charges on large arrears balances which these indebted countries can ill afford.<sup>4</sup> It is paradoxical that heavily indebted poor countries should borrow more merely to pay debt service to the Fund when what they badly need is an increase in net resource inflows. Surely, what Africa needs from the multilateral institutions is not the negative flows – between 1986 and 1990 the IMF extracted over \$ 3 bn. by way of debt service collections from low-income countries in sub-Saharan Africa<sup>5</sup> – that have been typical of the operations of the IMF in Africa in recent years, but strong net positive flows.

### Growing Internal Indebtedness

The external debt crisis is further accentuated by the growing internal indebtedness. In Africa, the average fiscal deficit grew from 4.7% of GDP in 1980 to 8% in 1987. For the developing world as a whole, the indicators grew from 1.5% to 6% of GDP over the same period. The sharp deterioration in terms of trade, higher interest rate charges on non-concessional loans and fiscal deficits of public enterprises are often mentioned as some of the major causes of the rapid growth of internal debts in the continent. Among the policy tools often employed by governments to finance domestic budget deficits are: money creation, regulation of banking reserve

requirements, the sale of government securities to the public and the banking system and external borrowing. Deficit (or inflationary) financing is easy to achieve but it creates severe distortions in the economy. Among other things, it discourages saving, distorts the investment pattern and widens the income distribution gap. Similarly, the use of such conventional monetary tools, like reserve ratio and open market operations, in regulating the tempo of economic activities in the disarticulate economies of African countries has limited effectiveness. Needless to say, the recourse to external borrowing to pay domestic debt in the present circumstances is not a viable option.

As a last resort, a good number of African countries have often resorted to the unconventional method of domestic deficit financing by delaying or failing to pay their outstanding obligations either to suppliers or to employees. Although this crude and, for the involuntary lender, painful method could help to check the growth of demand and, *ipso facto*, inflation, it has a double negative effect on the economy. First, the institutionalisation of the practice will lead to a general loss of respect for the law of contract and even the credibility of government itself. Second, it can reduce total tax receipts since the "forced lenders" are themselves taxpayers. Thus, it follows from the foregoing that the contraction of internal debts cannot be a substitute for external support nor can one safely rely on external assistance to finance domestic deficits. This largely explains why the IMF, the grandmaster of SAP in Africa, imposes a definite ratio of government expenditure to GDP on all the countries undergoing its orchestrated structural adjustment process.

### Origins of the Debt Crisis

The aetiology of the current debt crisis is a complex one. Its genesis is traceable to certain developments in the 1970s which were compounded by the adverse developments of the early 1980s. In other terms, a confluence of trends and developments, which are discussed below, set the stage for the present debt impasse.

In the wake of the first oil price shock (i. e. 1972-1974), most of Africa's major primary exports experienced an international commodity boom, followed by a short bust. The governments of the affected countries generally responded to the price increases by sharply increasing public expenditures, complementing the revenue

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<sup>4</sup> United Nations Economic Commission for Africa: Economic Report on Africa, 1991, Addis Ababa, April 1991, p. 34.

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<sup>5</sup> North-South Roundtable on African Debt Relief, Recovery and Democracy: The Abidjan Declaration on Debt Relief, Recovery and Democracy in Africa, Abidjan 1991, p. 5.

increases accompanying the export boom with external borrowing.<sup>6</sup> The international banking system had evolved after the first oil shock to play a larger role in "recycling" the OPEC surpluses. The Eurodollar market became an important source of financing for a number of African governments which hitherto had never borrowed in it.

During this period, international banks, suppliers and official export promotion agencies increasingly put together coordinated packages for major public

investment projects. A high propensity to borrow by developing countries, buoyed by negative real interest rates during the latter part of the 1970s, as well as by the enthusiasm of commercial lenders, was clearly observable. Unfortunately, many of the aid-funded projects were unproductive, ill-conceived or mismatched with the financing maturity structure.

Consequently, when the second oil price shock of 1970-1980 hit, most African countries were poorly positioned to absorb it, given their higher level of debt, its non-concessional structure and the inflexibility of public expenditure. External debt had started to accumulate also in several oil-producing countries during the mid-1970s, though for Nigeria, the recourse to external debt was minimal until 1978, when a shortfall in oil export receipts forced her to contract a jumbo \$ 2 bn. (Eurodollar) loan in that year.

New developments in the 1980-1983 period aggravated an already unhealthy situation. An unfavourable bunching of events in 1982, such as over-lending by banks until 1981 and sudden withdrawal of bank credit thereafter, an extremely hostile international environment characterized by sluggishness of world trade, an unprecedented fall in commodity prices and abnormally high rates of interest in the international capital markets, and defective economic policies in some debtor countries, blew the debt crisis into the open.

### Failure to Adjust

Regarding the last point, the failure of many sub-Saharan African countries to adapt their policies to the changed external environment tended to exacerbate the debt servicing problem. Besides expansionary fiscal policies and borrowing against exports to maintain consumption levels, many of these countries pursued other policies that weakened their external positions. Growing fiscal deficits and surging private credit demand led to massive monetary expansion and higher inflation in many countries. Given that most of these countries did not depreciate their currencies to offset the rise in inflation, their currencies became overvalued, inhibiting exports and, along with exchange controls, encouraging the formation of parallel exchange markets. Similarly, overvalued exchange rates and government subsidies on imported food, fertilizer and petroleum products, which in certain situations may be justifiable, promoted imports. Meanwhile, the imposition of high tariff rates or quantitative restrictions on imports of finished goods, and

**Table 3**  
**Disaggregated African External Debt Outstanding and Actual Debt Service, 1982-1990**  
(in US \$ billions except where otherwise indicated)

	1982	1986	1990 <sup>a</sup>
<b>I. North Africa</b>			
1. Total debt disbursed and outstanding (DOD)	67.8	91.7	107.2
Total official debt outstanding (ODO)	33.6	49.7	62.4
Official bilateral	27.2	39.1	48.4
Official multilateral	6.4	10.6	14.0
Total private debt outstanding (PDO)	34.3	41.8	44.9
Private long-term guaranteed (LTG)	22.3	27.5	29.6
Private long-term unguaranteed (LTU)	0.9	1.4	1.5
Private short-term (STD)	11.1	12.9	13.8
2. Total debt service (TDS)	11.2 <sup>b</sup>	12.1	15.7
Bilateral (BDS)	1.5	3.0	3.5
Multilateral (MDS)	0.5	1.5	2.3
Private (PDS)	9.2	7.7	9.9
3. Key debt ratios and other indicators (in percentage)			
Debt service/exports ratio	23.4 <sup>b</sup>	34.5	34.4
Debt outstanding/exports ratio	141.4	261.6	235.1
Debt service/GNP ratio	55.6	67.6	11.4
Debt outstanding/GNP ratio	0.5	2.2	4.9
<b>II. Sub-Saharan Africa</b>			
1. Total debt disbursed and outstanding (DOD)	72.5	115.4	162.9
Total official debt outstanding (ODO)	35.9	70.0	107.5
Official bilateral	20.4	41.5	64.6
Official multilateral	15.5	28.5	42.9
Total official debt outstanding (PDO)	36.7	45.5	54.8
Private long-term guaranteed (LTD)	23.1	26.2	32.2
Private long-term unguaranteed (LTU)	3.9	5.4	7.3
Private short-term (STD)	9.7	13.9	15.3
2. Total debt service (TDS)	8.6 <sup>b</sup>	10.5	11.8
Bilateral (BDS)	1.1	1.6	3.1
Multilateral (MDS)	1.5	3.2	4.1
Private (PDS)	6.0	5.7	4.6
3. Key debt ratios and other indicators (in percentage)			
Debt service/exports ratio	22.3 <sup>b</sup>	29.9	25.0
Debt outstanding/exports ratio	187.6	328.5	345.1
Debt service/GNP ratio	4.6	6.8	8.0
Debt outstanding/GNP ratio	38.6	74.8	110.3
Interest arrears due (in US \$ billions)	0.8	2.8	8.0

<sup>a</sup> Estimates. <sup>b</sup> 1983.

Source: See Table 2.

<sup>6</sup> For a further discussion, cf. Kathie L. Krum: The External Debt of Sub-Saharan Africa: Origins, Magnitude and Implications for Action, World Bank Staff Working Paper No. 471, 1985.

minimal tariffs on imported raw materials and intermediate goods encouraged the growth of inefficient import-intensive manufacturing enterprises. Furthermore, the failure to adjust domestic interest rates in line with rising inflation encouraged capital flight, discouraged domestic saving and promoted private borrowing, thereby adding to monetary expansion and further inflation.

The combination of these factors – external and domestic – made it difficult for a good number of African countries, by 1980, to meet debt service obligations while maintaining existing trends in the growth of imported goods and services. Many countries responded with the IMF-inspired structural adjustment programmes aimed at curbing domestic expenditure, reducing inflation and boosting exports. Although significant support for the programmes came from the IMF, the World Bank and bilateral donors (by agreeing to reschedule debts), the net flow of credit to sub-Saharan Africa declined steadily until it turned negative by 1986.

### The Centrality of Aid to Development

In theory, there is no conclusive evidence that external aid is a *sine qua non* for economic development. For as Peter Bauer succinctly put it, “Foreign aid is plainly not indispensable to economic progress and is indeed likely to obstruct it.”<sup>7</sup> Economic history is replete with examples of countries that developed with little or no external assistance whilst others have received large amounts of international aid without much apparent benefit. The repercussions of aid arising out of its conditionality may be so adverse as to outweigh the benefits. Thus, there is no necessary statistical correlation between the amount of external assistance to, and the level of development of, a country. What is more important is the effectiveness of aid-funded investments which, in turn, is a function of a conducive macroeconomic environment.

Corrupt regimes are known to have often diverted aid funds to other uses while such funds have, in some instances, financed ill-conceived, unproductive investments. Surely, such projects cannot contribute to any meaningful development. The resolution of the debt crisis in Africa therefore presumes absolute efficiency in resource use. In other words, the demand for increased external aid flows and the cancellation of existing debts can only make sense in the context of efficient use of such resources. Hence, foreign aid is a necessary, but not a sufficient, condition for economic growth and development.

It is reasonable of course to argue that in the absence of reparations from Africa’s former colonialists for centuries of systematic underdevelopment, the West should give massive aid to Africa. But this has not been the case. It has been estimated that for low-income Africa alone, about \$ 29 bn. per year of gross external flows would be needed to achieve a growth rate of 5% per year – just sufficient to recapture, by the year 2000, the loss per capita registered over the past decade.<sup>8</sup> This figure clearly exceeds the \$ 20 bn. per year that is on average available at present. And, going by existing indicators, it looks improbable that the advanced countries will massively step up their aid to Africa in the very near future. The corollary is that Africa must resolve to pull itself up by its own bootstraps and face the challenge of development.

This necessarily would involve structural reforms aimed at: improving the overall macroeconomic environment; strengthening the supply responses to enhance demand and supply management, and boosting income growth and domestic savings, to mention a few. Donors on their part must endeavour to improve the coordination, quality and effectiveness of aid resources as well as to relax the conditionality usually imposed on aid and technical assistance in order to increase their multiplier effects on the recipient countries. The centrality of aid in the development process lies in its effectiveness, not in its volume.

### Current Debt Relief Initiatives

After almost a decade of debt crisis management, no systematic framework for debt reduction and relief has yet emerged. Even so, a good number of external debt relief initiatives have been proposed since the mid-1980s. The more important ones are: the Baker Plan (1985); the Toronto Plan (1988); the Brady Plan (1989); the Netherlands Plan (1990); the Trinidad and Tobago Plan (1990); and the Bangkok Plan (1991). These initiatives, while differing in design, share one central objective: the reduction, if not elimination, of the debts of the distressed low- and middle-income countries and the resumption of economic growth. The key features of the above initiatives are summarily discussed below to shed some light on what is required beyond the current debt alleviation options.

The Baker and the Brady initiatives were intended to provide some form of debt relief to heavily indebted middle-income countries. Both plans were designed mainly to handle commercial debt and thus, by implication,

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<sup>7</sup> Cf. Peter Bauer: *Dissent on Development*, Cambridge, Mass. 1972, for a detailed thought-provoking analysis.

<sup>8</sup> African Development Bank Group, op. cit., p. 12.

## DEVELOPMENT STRATEGY

**Table 4**  
**African Countries' Shares of Multilateral Debt**

Share of Multilateral Debt > 30%		Share of Multilateral Debt > 50%		Share of Multilateral Debt > 66%	
1980	1989	1980	1989	1980	1989
Benin	Benin	Botswana	Botswana	Lesotho	Botswana
Botswana	Botswana	Burkina Faso	Burkina Faso		Burkina Faso
Burkina Faso	Burkina Faso	Lesotho	Burundi		Burundi
Burundi	Burundi	Rwanda	Cape Verde		Chad
C.A.R.	Cameroon		C.A.R.		Comoros
Chad	Cape Verde		Chad		Ghana
Comoros	C.A.R.		Comoros		Lesotho
Ethiopia	Chad		Djibouti		Malawi
Gambia	Comoros		Gambia		Rwanda
Kenya	Djibouti		Ghana		Zimbabwe
Lesotho	Ethiopia		Kenya		
Malawi	Gambia		Lesotho		
Niger	Ghana		Malawi		
Rwanda	Guinea Bissau		Niger		
Sao Tome & Prin	Kenya		Rwanda		
Swaziland	Lesotho		Sao Tome & Prin		
	Liberia		Swaziland		
	Madagascar		Togo		
	Malawi		Uganda		
	Mali		Zimbabwe		
	Mauritania				
	Mauritius				
	Niger				
	Rwanda				
	Sao Tome & Prin				
	Senegal				
	Seychelles				
	Sierra Leone				
	Somalia				
	Swaziland				
	Tanzania				
	Togo				
	Tunisia				
	Uganda				
	Zambia				

Source: An African Development Perspective on the Multilateral Debt Issue, paper prepared for the joint ADB/PGA North-South Roundtable on African Debt, Recovery and Democracy, 8-9 July, 1991, Abidjan.

of less relevance to Africa whose debt is primarily owed to official bilateral and multilateral creditors (cf. Table 4).

Specifically, the main features of the Brady Plan are:

□ debtor countries to maintain growth-oriented adjustment programmes and take measures to encourage the repatriation of flight capital;

□ IMF and IBRD to provide funding in the range of \$ 20-25 bn., earmarked from their normal adjustment lending quota over a three-year period, and Japan an additional \$ 10 bn. for debt and debt service reduction through debt buy-backs at a discount for new (partly) collateralized bonds or exchanges of old debt for new bonds at par value with reduced interest rates;

- commercial banks to provide both debt reduction and new money;
- creditor governments to reschedule debt in the Paris Club and to maintain export credit cover for countries with sound reform programmes;
- tax, accounting and other regulatory impediments to debt reduction to be eliminated.<sup>9</sup>

Morocco, one of the five African countries eligible under the Brady Plan, whose external debt was valued at \$ 20.9 bn. in 1989 with a debt service ratio of 32%, signed a very favourable rescheduling agreement in 1990, under which \$ 1.2 bn. of its debt has been rescheduled for 15-20 years. The Morocco rescheduling agreement, which included a debt conversion element, was indeed the first under the Brady Plan in Africa. Congo, an equally heavily indebted country, also secured a favourable rescheduling agreement on its public and guaranteed debt with the Paris Club in mid-September 1990. The specific amount rescheduled is yet unknown but the agreement is known to contain an innovative measure to convert part of the debt into local currency projects. Within the Brady Plan framework too, Cote d'Ivoire has made considerable progress in reaching a debt rescheduling agreement. Similarly, Nigeria signed a debt rescheduling agreement on its official debt of \$ 15 bn. in January 1991. The accord covered the debt falling due before March 1991 and provided a repayment period of over 20 years with a ten year grace period for development aid, and eight years for other credits. The agreement also included provisions for limited debt swaps, and set the stage for an agreement with the London Club on the \$ 5.6 bn. owed by Nigeria to the commercial banks with whom it negotiated for a buy-back scheme,<sup>10</sup> an agreement on which was signed with the London Club in December 1991.

### Toronto Package

The Toronto Debt Relief Package established in 1988, for the first time in practice, the principle of reducing the stock of official non-concessional bilateral debt. The Toronto Menu Options – as they are usually called – involve:

- partial write-off or cancellation of one-third of debt service due during the consolidation period, and rescheduling of the remainder at market interest rates with a 14-year maturity;
- rescheduling of debt at concessional or below market

interest rates with a 14-year maturity, including a grace period of eight years;

- rescheduling of debt service due during the consolidation period at market interest rates with a 25-year maturity, including a grace period.<sup>11</sup>

By mid-1991, some 18 African countries had benefitted from the application of the Toronto terms at the Paris Club. The total amount of debt consolidated under this arrangement amounts to approximately \$ 6 bn. or about 2% of Africa's debt outstanding. Some of the beneficiary countries, including Central African Republic, Madagascar, Mali, Niger, Senegal, Tanzania and Togo have had to return a second and even a third time for the same Toronto terms. The grant element in the Toronto terms stands at about 20% which is below the 25% threshold for concessionality agreed upon by the Development Assistance Committee (DAC) countries. Evidently, the Toronto debt relief package, albeit a welcome move, has had only a very modest impact on alleviating the debt burden of its African beneficiaries.

### Further Proposals

At the Second United Nations Conference on the Least Developed Countries, held in Paris in September 1990, a Dutch proposal was presented by the Minister for Development Cooperation, Mr. Jan Pronk, calling for the writing off and full forgiveness of all debt of the poorest and most-indebted countries to governments of developed countries. Earlier on at the Commonwealth Conference in Trinidad, a less radical proposal known as the "Trinidad Terms", had been made by the then British Chancellor of the Exchequer (and now British Prime Minister), Mr. John Major. The proposal called essentially for the writing off of two-thirds of the outstanding bilateral debt balance of the poorest developing countries, rescheduling the rest at market prices over a 25-year period, including a five-year grace period, and capitalizing all or part of the interest on over-due payments during the grace period.

Although the Trinidad terms are less generous than the Dutch proposals especially as they insist on the traditional precondition of beneficiary countries adhering to SAPs and provide for less than full write-offs of outstanding debts, they represent, nonetheless, considerable progress and improvement over the Toronto terms which offer the write-off of only one-third of debt by only part of the creditors. Furthermore, the Trinidad terms are meant to apply immediately to all debt rather than to successive tranches as is the case under the Toronto terms.

<sup>9</sup> Ibid., p. 8.

<sup>10</sup> UNECA, op. cit., p. 33. The Federal Government of Nigeria in its 1992 Annual Budget announced that it has rescheduled over \$ 19 bn. of its debts under these initiatives.

<sup>11</sup> Cf. ADB Group, op. cit., p. 7.



Conceivably, it is safe to argue that it was the recognition of the inadequacy and limited effects of the Toronto measures that gave birth to these two proposals.

Building on the Trinidad terms, at the Annual Meetings of the IMF and IBRD in Bangkok the United Kingdom and France put forward a new proposal, which calls for the cancellation of up to 80% of the bilateral debt outstanding of both low- and middle-income African countries. The prospects of dealing with the entire bilateral debt stock in a single operation render this initiative a welcome advance. The significant advantages of it over previous debt relief options are that it would

- avoid the repetitiveness of the present Toronto-type arrangements;
- considerably reduce the debt burden through substantial debt write-offs;
- offer built-in performance incentives for the debtor countries.

An early general acceptance and implementation of this initiative by the creditor countries would surely demonstrate a clear appreciation of the seriousness of the current debt crisis. Meanwhile, the French Government has already written off the debts of a number of African countries, including Senegal; and the United States recently extended generous bilateral debt relief to Egypt and Poland. It is hoped that other creditors will follow suit and cancel the debts owed to them, especially by the debt-distressed African countries.

### Need for New Approaches

However, even with the full implementation of the above proposals the African external debt crisis will still persist for a number of other reasons. Firstly, multilateral debt, which currently accounts for about 40% of the continent's debt-servicing obligations, was not addressed by any of the plans. Secondly, debt rescheduling does not remove the debt-overhang; it merely defers the payments and, through interest capitalization and rescheduling charges, increases the future debt. Thirdly, short of radical and substantial debt relief, it will be extremely difficult, if not impossible, for most African countries to extricate themselves from the debt crisis; to improve their credit-rating; to re-establish their much eroded capacity to meet current and future debt-service obligations; and to resume reasonable growth.

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<sup>12</sup> South Commission: Statement on External Debt, Kuala Lumpur, March 3, 1988. This pamphlet from which this section has drawn provides a very vivid summary of the South's position on the current debt crisis in developing countries.

Thus, since the debt crisis is deepening despite the current initiatives and debt relief, new strategies and approaches are required to tackle the debt overhang and reverse the economic decline of the past decade. For the African debtor countries, the social, economic and political costs of devoting 30-40% of their export earnings year after year in order to service their external debt have now passed the limits of endurance. Austerity – even severe austerity – can be justified as a response to a short-term crisis. But at the levels of poverty now prevailing in African countries, it cannot be sustained, or even justified, especially where there is no reasonable expectation of the revival of growth in the near future.

### Danger of Unilateral Action

Historical experience suggests that unless creditors show serious concern about the situation and respond appropriately, debtors will be forced into unilateral action. In the third decade of the 19th century, as a consequence of a financial panic in London, the supply of credit to the newly independent countries in Latin America dried up. All debtors but one were forced to stop payments of interest. It took thirty years to get back to normal. Similarly, in the early 1840s a recession in Great Britain put an end to financial flows to the United States. Nine states of the USA stopped paying interest and two of them, Mississippi and Florida, repudiated their debts altogether, while that of Michigan was partially repudiated. Again in the mid-1870s a new recession in the financial centres paralyzed external financing. Eleven states of the United States went into default.

In all cases of generalized difficulties as in Africa today, either *de facto* or by agreement with the creditors, the burden of debt on the debtors was reduced by lowering capital, interest or both. During the 1930s, South American countries bought back their bonds at an average of 14 cents to the dollar. In the case of Germany after the First World War, when reparation payments plus interest on its foreign debt reached 24% of its exports, a special commission of the BIS determined that Germany was right in declaring that it was impossible to comply with its external payment obligations. Reparation payments stopped completely in 1932.<sup>12</sup>

Whereas the debt problem is a global problem, and given that its severity is due mainly to the underlying malfunctioning of the international economic system, a more comprehensive and mutually satisfactory solution to the problem is urgently needed.<sup>13</sup> This is particularly so in

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<sup>13</sup> Cf. North-South Roundtable on African Debt Relief, Recovery and Democracy, *op. cit.*

Africa, otherwise its debtor countries would be left with no other alternative than a unilateral action aimed at unloading the debt burden. It is plainly illogical and naive, for example, to expect a country like Nigeria to spend \$ 5.565 bn. (about 62%) of its projected total export receipts of \$ 8.998 bn. in 1992 merely to service its current foreign debts estimated at \$ 33.36 bn. Unquestionably, the solution to the African debt impasse lies in some form of radical action.<sup>14</sup>

### Policy Recommendations

It is the thesis of this paper that Africa's debt burden constitutes a critical bottleneck constraining the recovery and development of the continent. The disturbing magnitude and implications of these debts have been examined in relation to their origins. Although external aid is a necessary but not a sufficient condition for economic growth, Africa needs all the external assistance (including multilateral, bilateral, commercial) it can get now to reverse the deteriorating economic situation. As discussed above, several debt relief initiatives have been put in place but their half-hearted implementation to date has not significantly altered the picture. The implementation of some of the relief initiatives will necessarily require some structural reforms, which – unlike the orthodox SAP of the IMF/World Bank variety – must be country specific and free of ideological bias. The situation therefore calls for innovative and courageous measures to stem the tide and restore growth and development. Accordingly, the following policy recommendations appear to us to be inescapable:

- The African debt crisis is real and the socio-politico-economic costs of the present level of debt-servicing have reached unacceptable limits. Since almost a decade of debt crisis management has yielded very limited results, all the parties concerned must now work together to achieve a comprehensive debt-relief package which will ensure a drastic reduction of all forms of debt (bilateral, multilateral and private) with a view to restoring growth and development in Africa.
- African debtor countries should not continue to spend the bulk of their export earnings on debt-servicing to the point of inflicting undue hardships on their peoples and starving their industries of badly needed capital goods, raw materials and spare parts. Indeed, it is considered unhealthy for any African country to spend more than 15% of its export earnings on debt-servicing alone at this stage of the continent's development.
- The existing debt-relief initiatives, such as the Trinidad Terms and the Bangkok Plan proposed by France and the United Kingdom, which appear to hold good prospects, at

least in the short term, should be fully explored, extended to all African countries and expeditiously implemented. Indeed, outright cancellation is the logical solution to debts that are irrecoverable.

- The IMF and IBRD member governments should adopt a policy of "positive" or at worst "zero net transfer" to the African countries up to the year 2000. It is disturbingly paradoxical that African countries should be making positive net transfers to these multilateral institutions when the continent's economies are in disarray.
- The private debt problem of African countries requires the special attention of banks and governments around the world. Although long-term commercial debt accounts for less than 16% of the stock of sub-Saharan debt (excluding Nigeria) it absorbs nearly 30% of total debt service. Besides, arrears on commercial banks' loans impair the access of African countries to trade finance. Therefore commercial banks should be more cooperative and agree to debt reduction similar to that granted by governments.
- The time has come for all industrialized nations to set specific time-targets to provide at least 0.7% of their GNP by way of official development assistance to the Third World countries. Similarly, the return of flight capital and renewed private investment are essential requirements for African economic recovery and the emergence of true democracies.
- When making decisions on exchange rates and interest rates the G-7 should take into serious consideration the interests of the developing countries. Given the current environment of low commodity prices and high interest rates a significant reduction of interest rates would contribute to resolving the debt problem of Africa.
- As far as possible, future external loans should be sought for the financing of bankable or self-liquidating projects, especially in the case of debt-distressed countries.
- The mere existence of creditor organisations, like the London and Paris Clubs, is an indisputable justification for the formation of an African debtors' union. It is incumbent on Africa to press for the formation of such a body as a first step towards the resolution of its thorny debt problem.
- Finally, heavily indebted African countries should reserve the right to defer debt repayments or go into default in the overall interest of their peoples, economies, political stability and future development. History is on the side of economic justice.

<sup>14</sup> Uka Ezenwe: External Debt: The West African Experience, in: Development: Journal of the Society for International Development, No. 4, 1985, pp. 45-48.